Cows in Control

Special Report – Macro Update March 2020

Ryan Copithorne 2/29/20 Special Report

Special Report – Macro Update

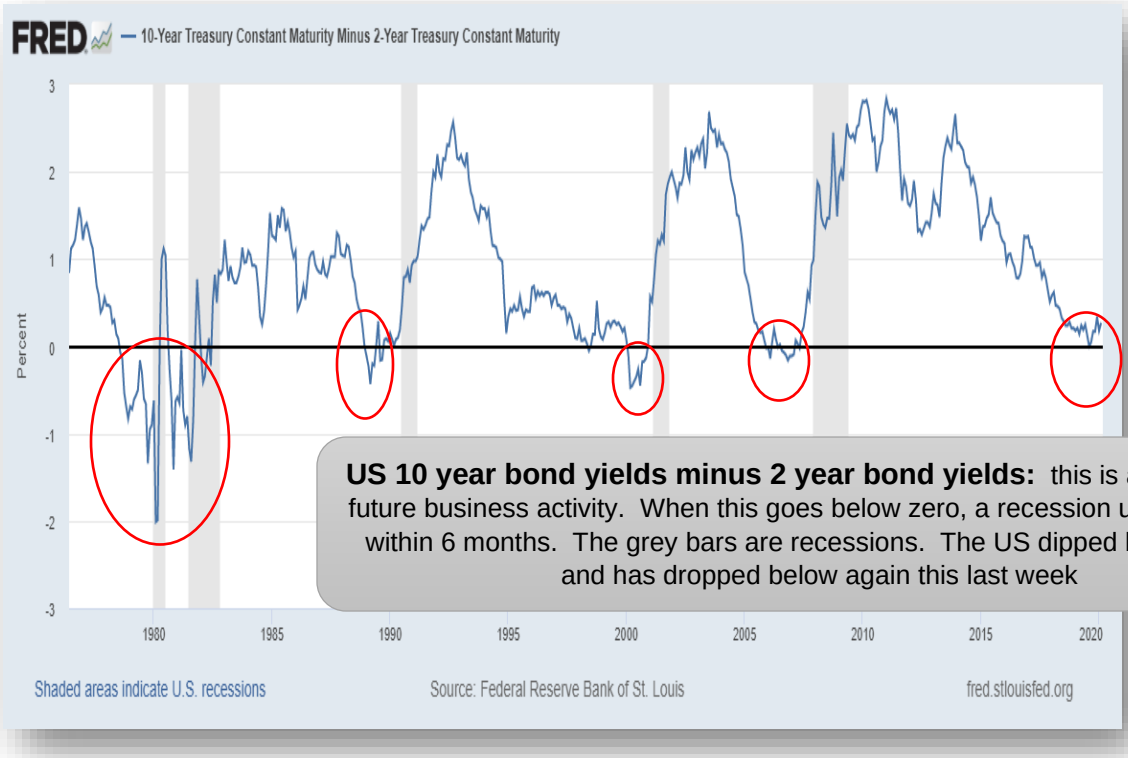
- *Warnings in the economy*
- *Concern of bond collapse and interest rates rising*
- *Debt*
- *A bear market coming (underway) in stocks*
- *The future of agriculture and recommendations*

March 1, 2020

This is a special report and will not be for everyone. I want to use a bit of macroeconomics to describe what I see happening with the markets, the global economy and how excessive global debt is going to lead to tougher times we haven't seen for some while. Interest rates may rise. Agriculture will come out the winner in the end but be ready to batten the hatches.

Recession indicators

The first thing to be conscious of is that Canada and much of the rest of the world are looking to tip into recession. Recessions generally mean a slowdown of business activity and dropping of spending which is a threat to beef prices that are a high value discretionary food item. Let's have a look at the indicators…



US 10 year bond yields minus 2 year bond yields: this is an indicator of future business activity. When this goes below zero, a recession usually follows within 6 months. The grey bars are recessions. The US dipped briefly below and has dropped below again this last week

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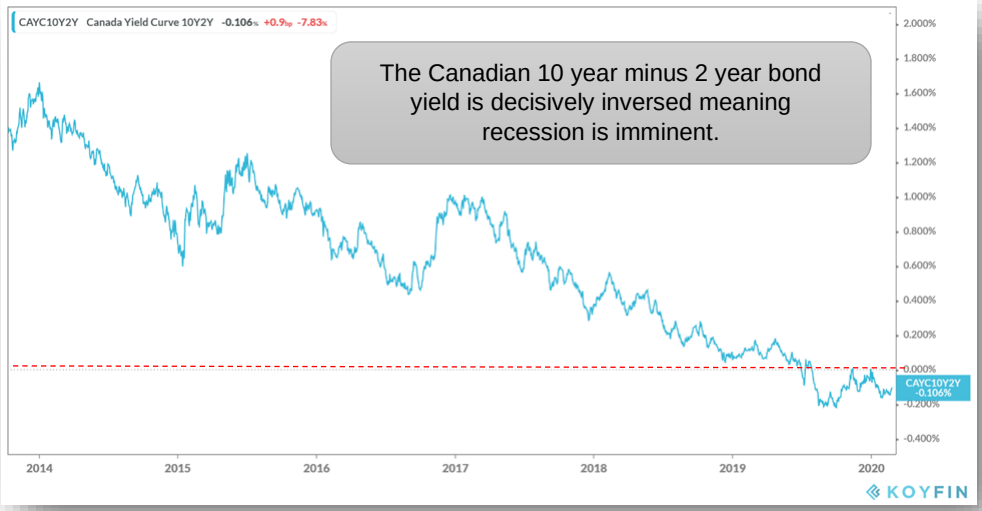
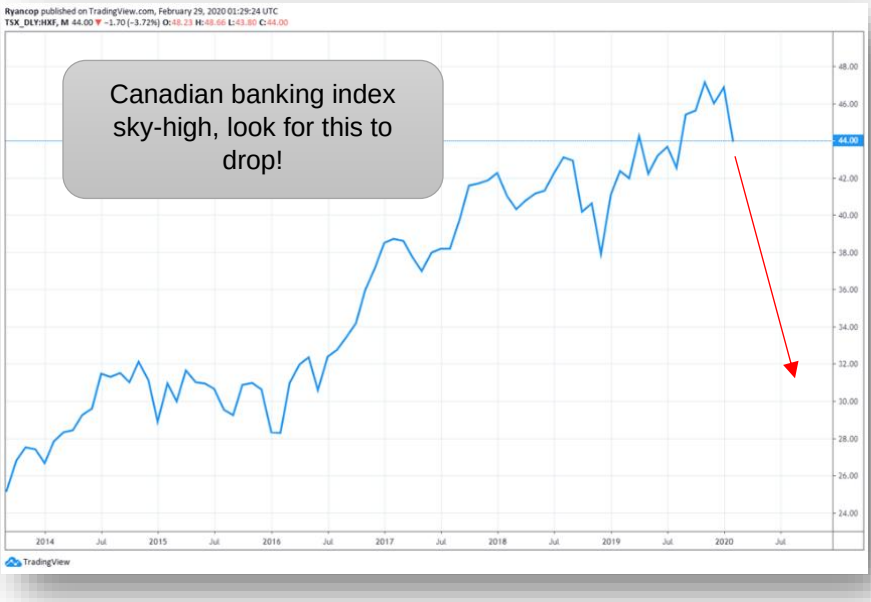


The Canadian banking index has been on a tear. Banks borrow money short term and loan it out to all of us on longer term arrangements. When interest rates are lower on 10 year money than 2 year money, banks lose money. Therefore, they pull in their lending which creates recessions, and ultimately banks start making less money. Expect our precious bank stocks to start losing value…



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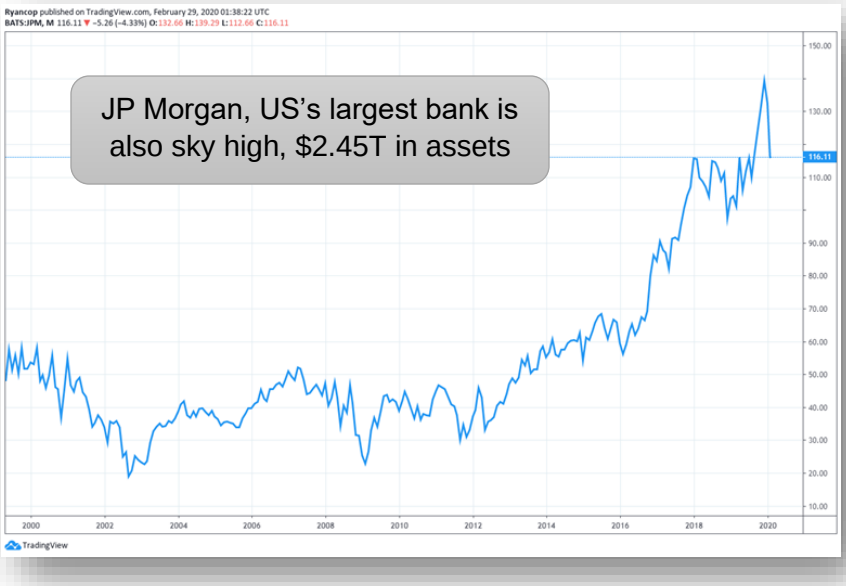
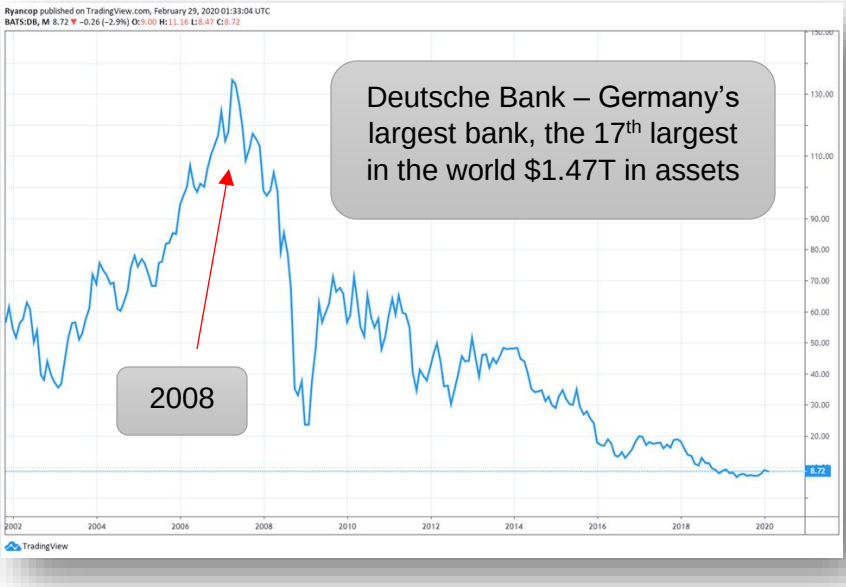
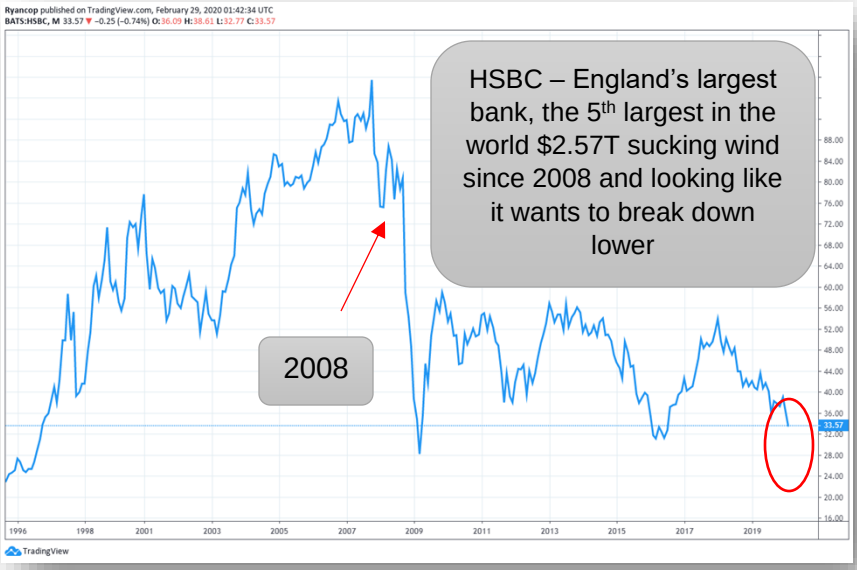


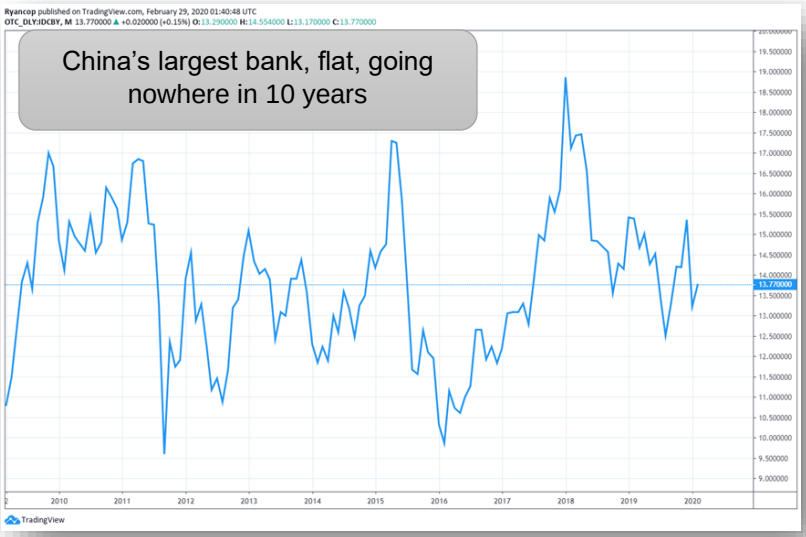
Europe and especially Germany has been battling recession since the great recession. They moved to negative interest rates where banks actually pay investors to borrow from them, and investors still don't want to borrow! Look what happened to Germany's biggest bank since 2008..



Same with England's largest bank…



China has the top 4 largest banks in the world in terms of assets under management. Did you know that? That is why when China goes to sleep like it has with Coronavirus, things start to slow down. Industrial and Commercial Bank of China is the largest bank in the world with $3.62T in assets, the top 4 China banks combined have over $12T in assets!!



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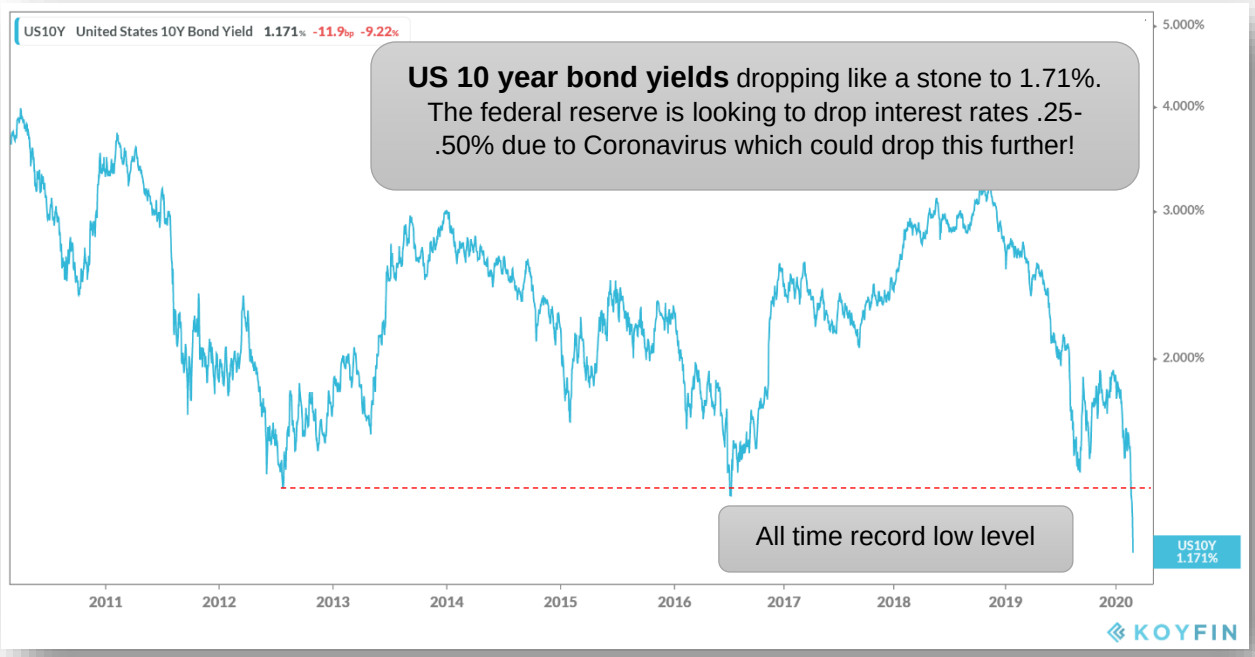
US bonds and the coming bond collapse

Interest rates in most of the world right now are below zero percent except the US, Canada and a few commonwealth countries. There is $17T worth of bonds in the world with interest rates less than zero percent.

The easiest trade in the world right now is to borrow money at less than zero percent in Japan or Europe, and buy US bonds that are trading 1-2%, leverage that 10 or 20 times, and you make a risk free return of 10-20%! Easiest game in town, eh? Every bank is playing it, hugely.

Here is a chart of US 10 year bond yields, dropping like a stone…



The world because of this "carry" trade is loaded up on US bonds. What happens when the US drops interest rates to zero or even below zero like the rest of the world in order to prop up its stock market and keep interest costs down on its $1T government fiscal annual deficit? There is no longer a competitive advantage to buy US bonds over the rest of the world's bonds. China and Japan who hold some $2T in US bonds may start cashing them in and investing in their own economies instead and ….WHOOSH….there goes the US bond market.

Bond prices trade inversely to interest rates. When rates rise, bonds fall, when rates fall, bonds rise. In this scenario, if people sell bonds, bond prices will fall, and interest rates will suddenly rise in the US and ultimately Canada. BE READY. This affects our borrowing rates!

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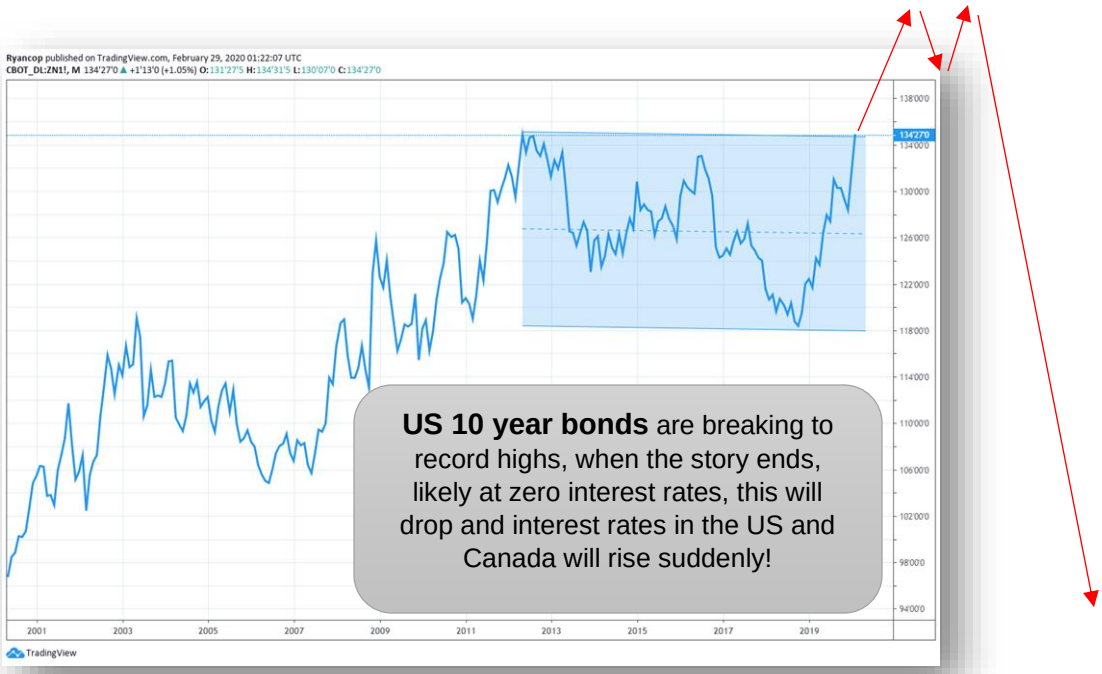
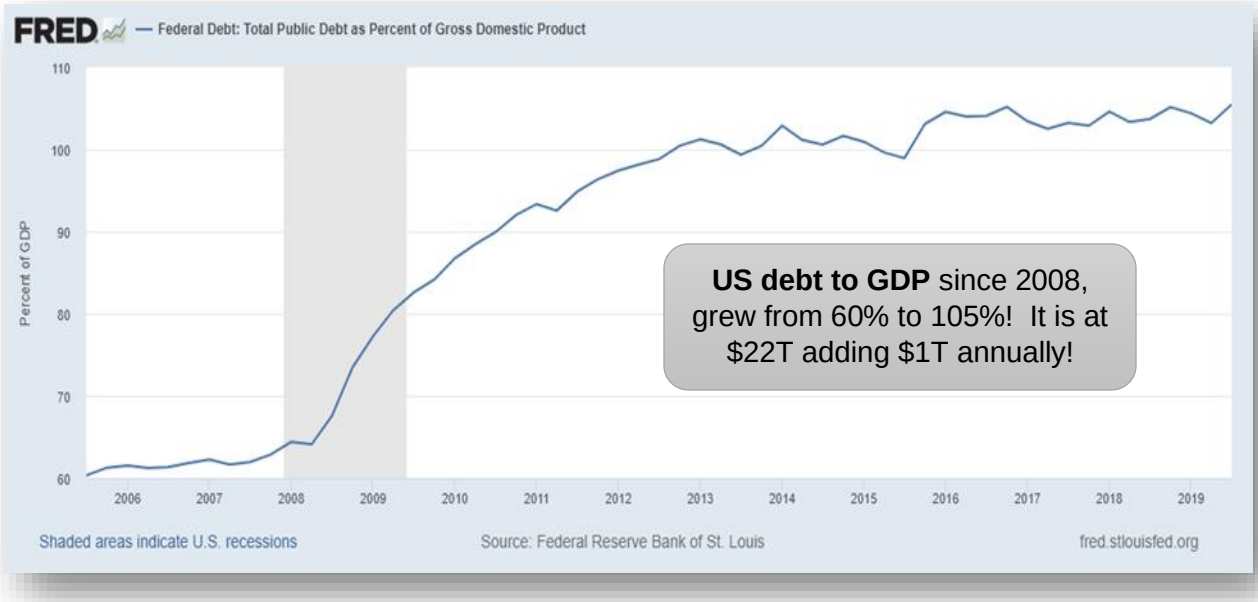


Debt

Global record low interest rates are creating the greatest debt bubble of all time…



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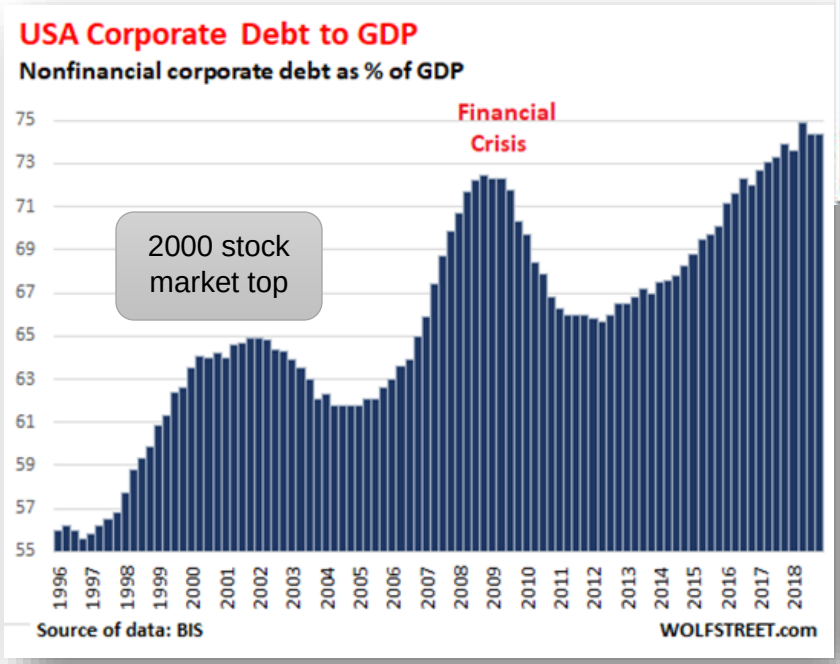
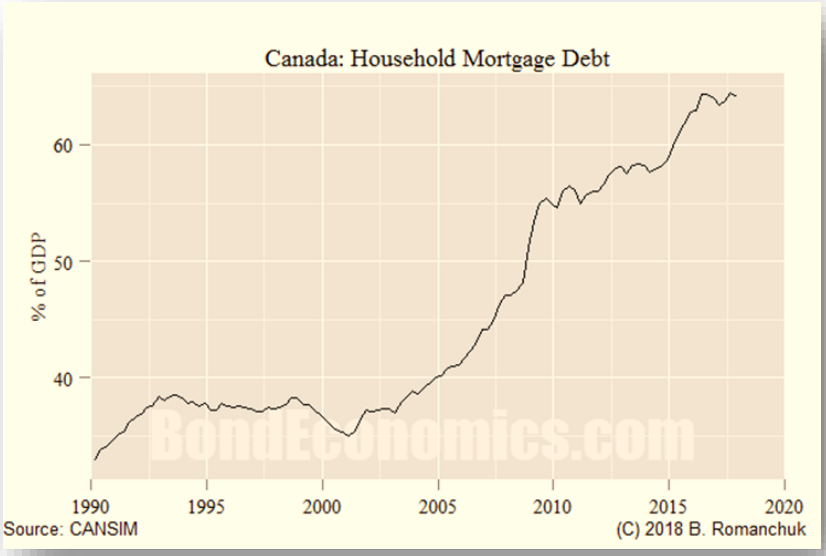
Farmers in the US are also getting very indebted…

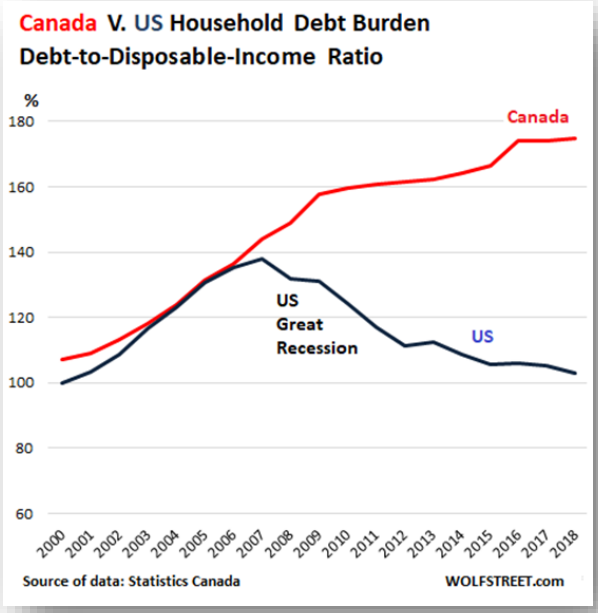
As are corporations, borrowing at near zero rates and buying their own stock to bid up their share prices in the biggest stock rally in history!



We are not exempt from this in Canada…



…in fact we may be worse off than the US because we never had the housing collapse that they had in 2008, our house prices kept right on going!



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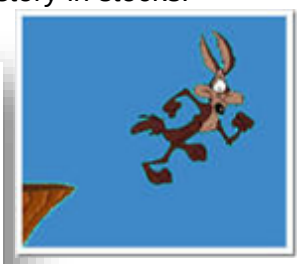
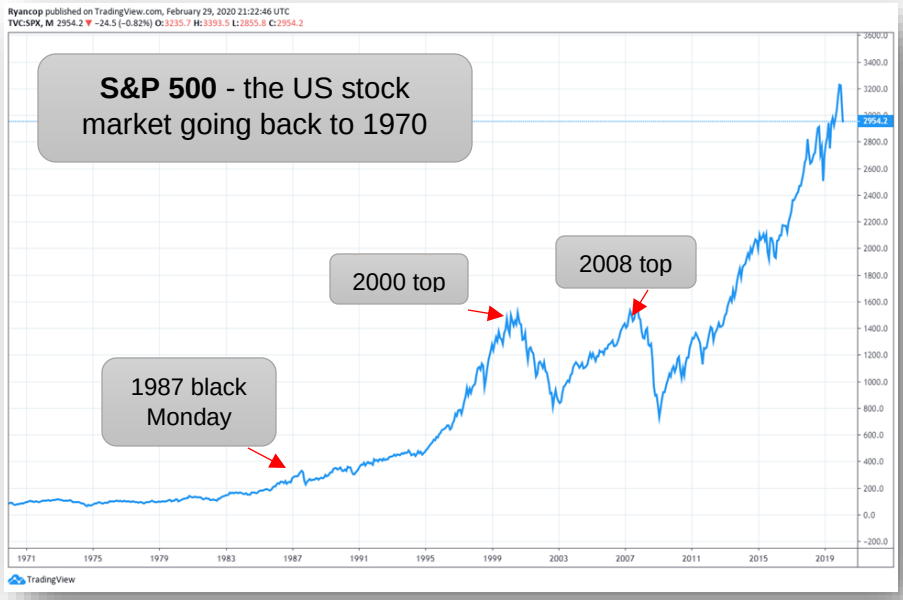
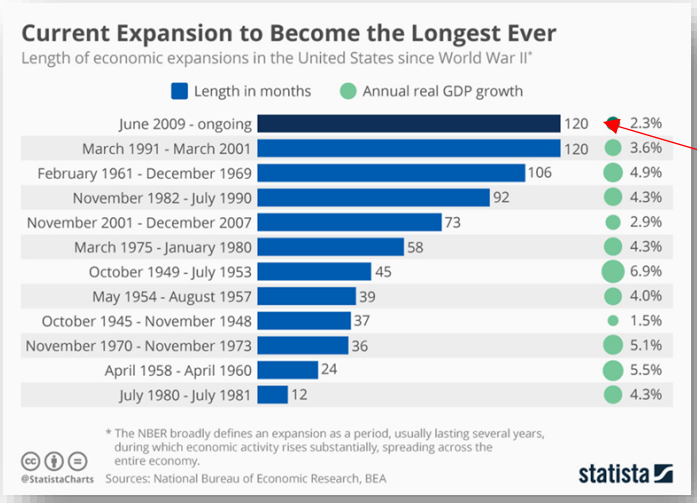
Stock Market Correction (or bear market?)

With low interest rates, people can borrow a lot of money. As we said earlier, banks and investors are borrowing at below zero rates elsewhere in the world and investing in the US and Canada where rates are above zero with a ton of leverage. Corporations are doing this as well, borrowing to buy their own stocks. This has created the biggest bull market in history in stocks.







The run from 2009 has been the longest bull market since WW2 (this chart was made in June 2019, it is 8 months longer now)

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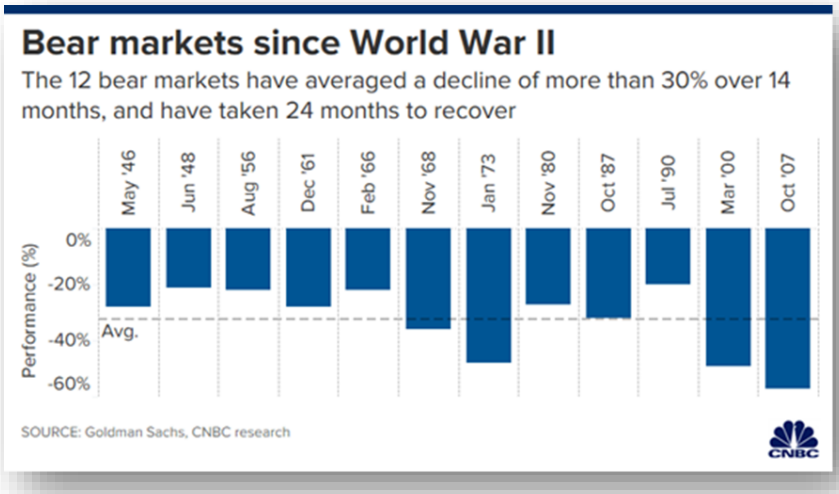
Here are all the bear markets since WW2, you can see they range from 20-60% drops in the market, averaging 30% and generally take over 2 years to recover from…



I want to show you what happens when over valued markets collapse. The chart above I believe are just corrections in a bull market. Let's look at what happens when markets really correct in a true bear market…

Here is the Asian bear market correction in 1990, look how much of its gains it gave back!

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Nasdaq 2000 bear market

Remember the dot com bust in the tech heavy Nasdaq in the US in 2000? Here is what that market did, it gave everything back and didn't regain its old highs until 14 years later!…

…and of course 1929. It took 25 years to regain its old highs…

Looks a lot like the 2000 and 2008 tops and the big run that we are in now except this is 100 years ago

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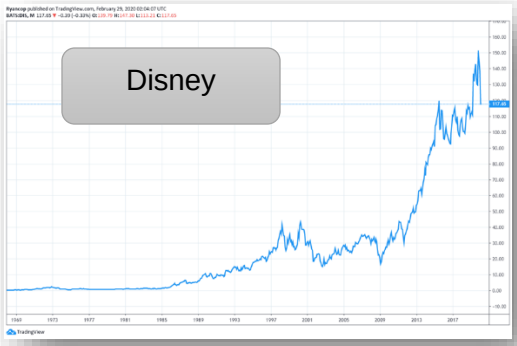
Now lets look at some particular stocks to get a feel of how crazy this has got of late…



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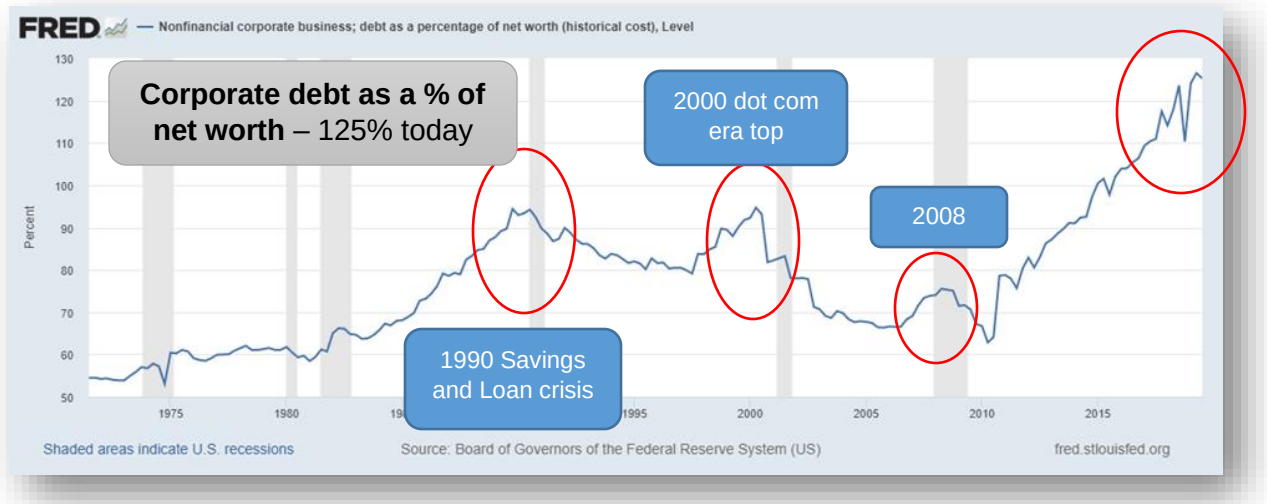
Let's have a look at the current Nasdaq market. At the left of the chart you see the 2000 top, it took until 2014 to regain those highs. I have drawn retracement levels of where a common bear market could take the Nasdaq if it doesn't collapse all the way down like it did in 2000 (red arrows)…

You can see that when corporations get overleveraged, it coincides with market tops. This is one mother of an overleveraged position…



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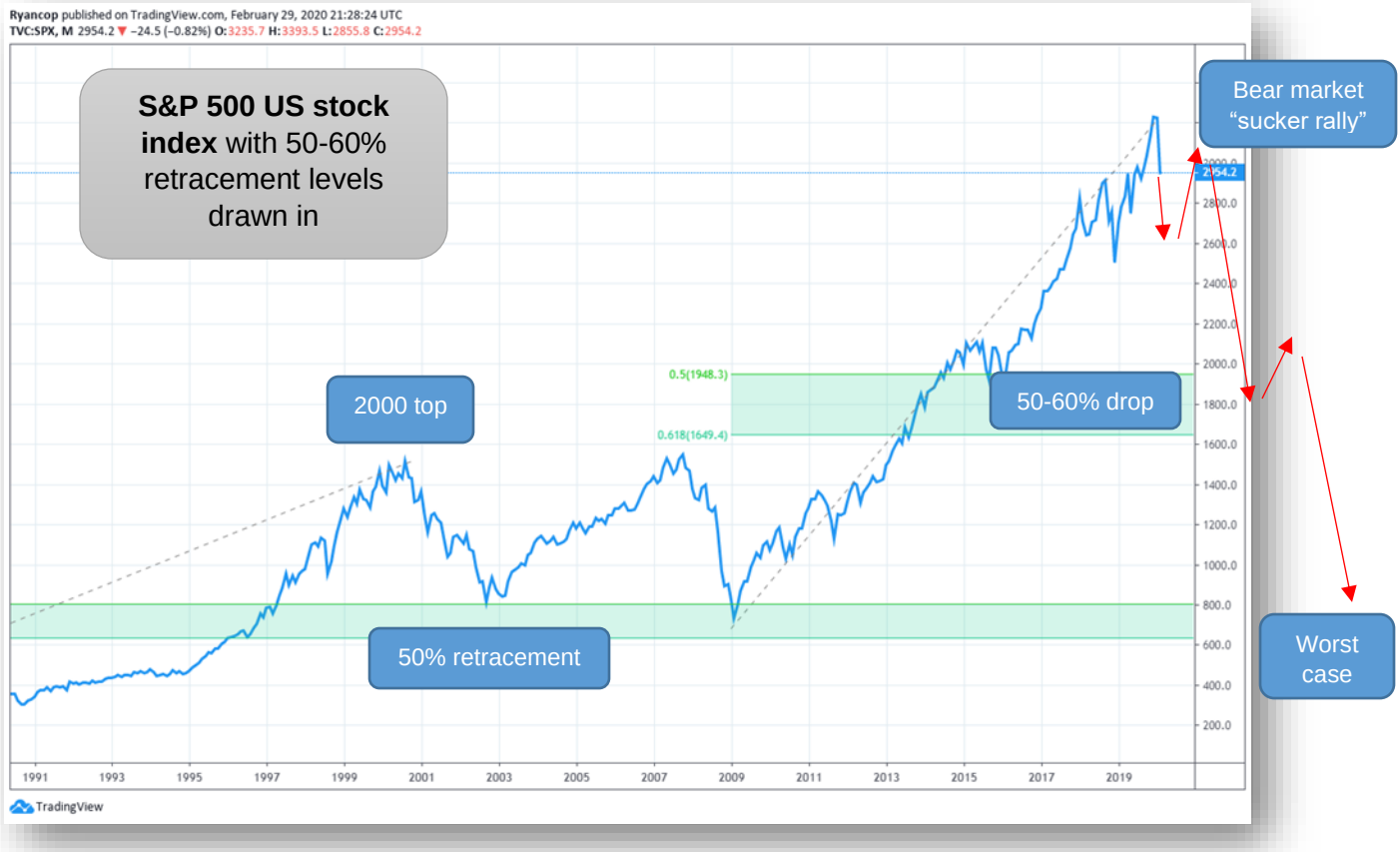
Here is the S&P 500 Stock Index with 50-60% retracement levels drawn in. We topped at 3300, a 50% drop takes us to under 2000. You can see how the year 2000 bear market took us right to the 50% retracement level which it retested in 2008. I think we will see a drop like this again.

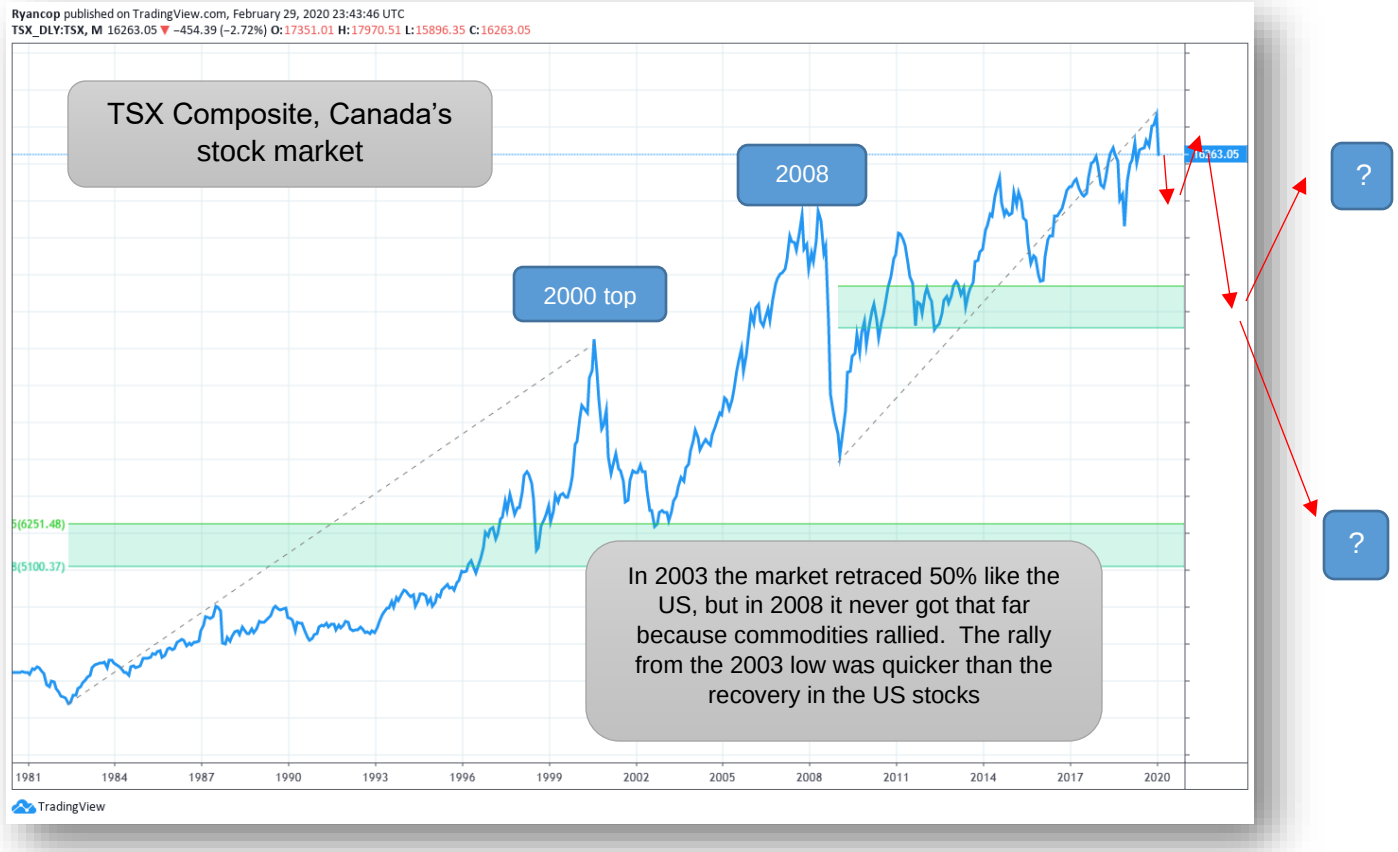


I am not trying to scare you or be a doomsday spokesman. I am trying to show you that ***these types of bear market corrections are common, typical, and we are very overdue for one***. If Coronavirus is the trigger, so be it. I think Coronavirus is an excuse for a very overleveraged society fueled by cheap interest rates needing to normalize.

Now let me show you the Canadian market because I think there may be a slightly different scenario there, slightly more optimistic.

You will notice on the chart next page that we are sky-high just like the US market, but not quite as "parabolic" (parabolic means when markets rapidly accelerate to where their charts go literally vertical).

The 50-60% retracement level is not nearly as severe as the US stocks. You can see how we tested the 50% level in the 2000-2003 break and it only took 6 years to regain those highs due to the commodity rally that ensued at the bottom of the bear market in stocks. Canada is a commodity country despite Trudeau's views. Our bear markets will be supported by commodity rallies that occur at the bottom of bear markets…



When markets drop, excessive valuations disappear, leverage is unwound. Investors and banks leveraged 20:1 all of a sudden deleverage, and look for real investments that have been undervalued, are real, and are tangible, not paper fluff. Farmland, commodities, small businesses and other "hard asset" investments fall in this category.

The next chart is commodity prices relative to stock prices. You can see the massive underinvestment in commodities of late relative to stock prices. People will rotate into commodities ***after*** the market collapses (***special note:*** commodities will fall with stocks as they fall but will be the first thing to rebound, and will rebound harder and faster than stocks. That is why Canada will fare better than the US in this next drop).

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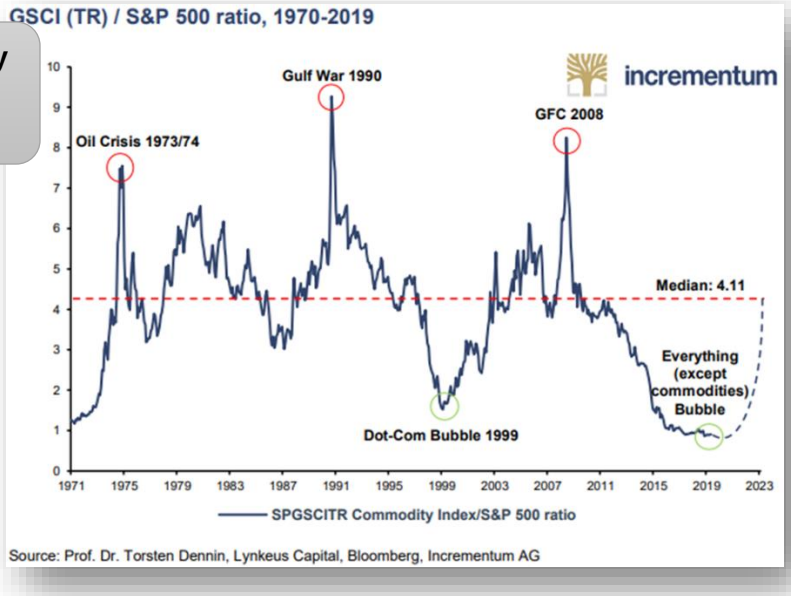
A famous newsletter writer Dennis Gartman says *"when the house of ill repute is raided, even the piano player gets shot"*. This is what will happen to commodities as margin calls force people to sell "everything", but they will rally back quicker and more severely than stocks.

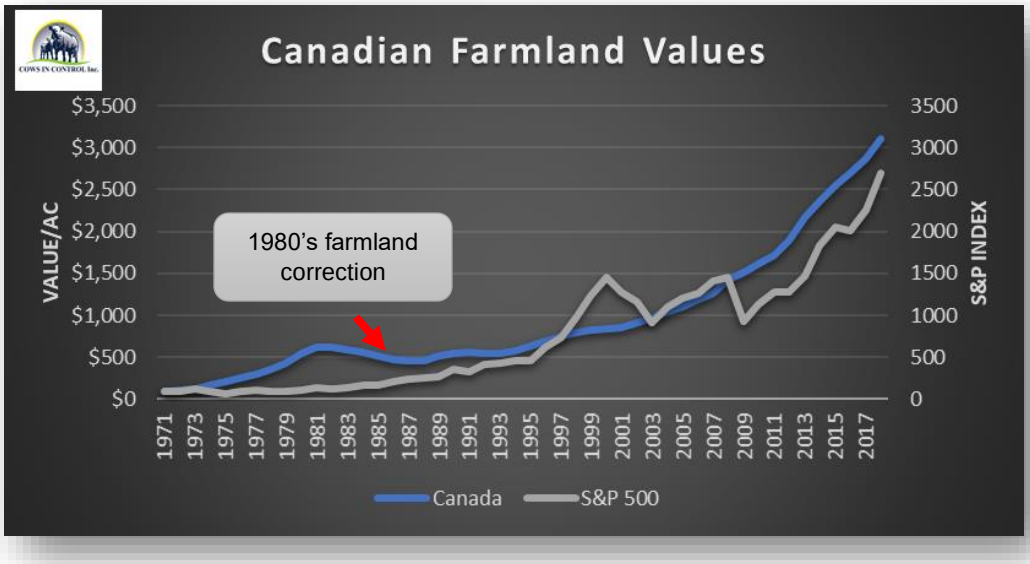
Here is a chart of commodity to stock prices…

Commodity to stock price ratio



Commodities expensive, stocks cheap

Commodities cheap/ stocks expensive – **WE ARE HERE**



Farmland may drop as interest rates rise but notice how less volatile farmland is than stock prices and the smooth appreciation of it!

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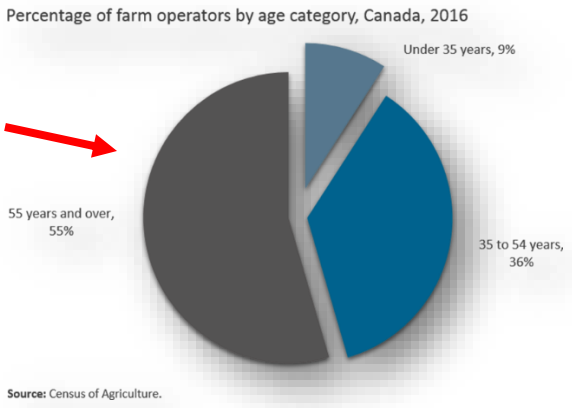
Now back to agriculture and cattle

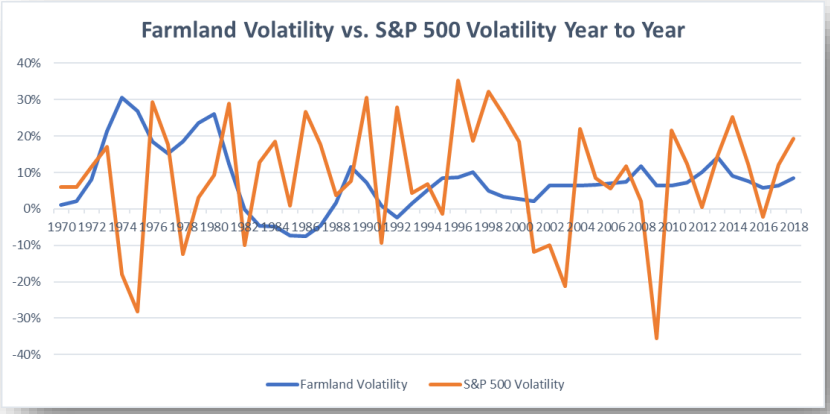
If anything will shake farmland prices, it will be this next chart. 55% of farm operators are over 55. If they decide to sell out or deleverage themselves when things get tough, we may see a rough patch in land prices…

55% of farmers are over 55 years of age



That is why succession planning and new models that help new producers get started is so critical right now. We need the energy of the youth, willing to "dig in" when prices back off a bit. Older generation farmers will likely back off as economics toughen, where new producers if properly capitalized will invest and grow as prices back off.

Our team of advisors is working on this problem, finding investors to buy the land and partner with farm operators, especially when the bloom comes out of the stock market. Let's work on solutions to allow a retirement exit for aged farmers, investment opportunities for land investors, and opportunities for next generation farmers looking for capital to get started or expand.



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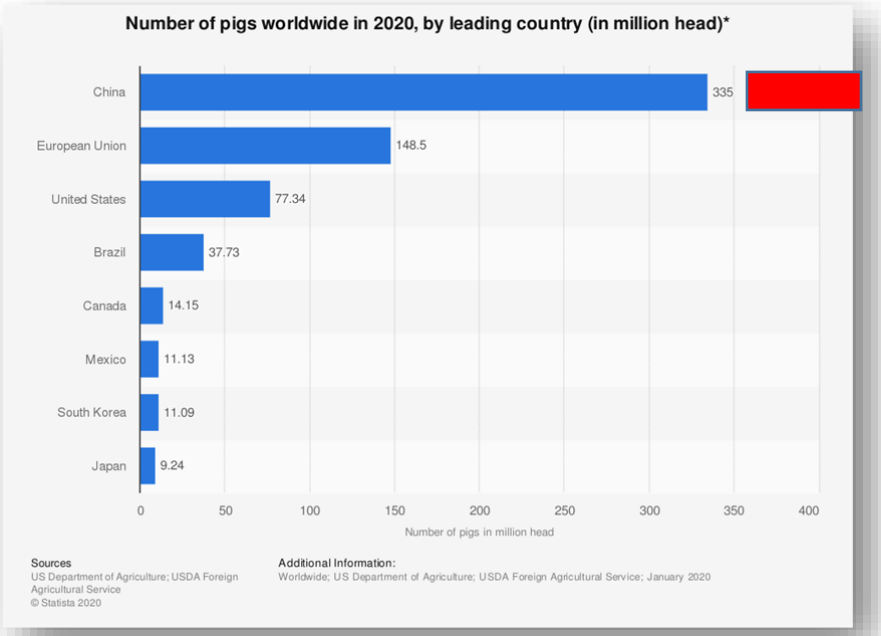
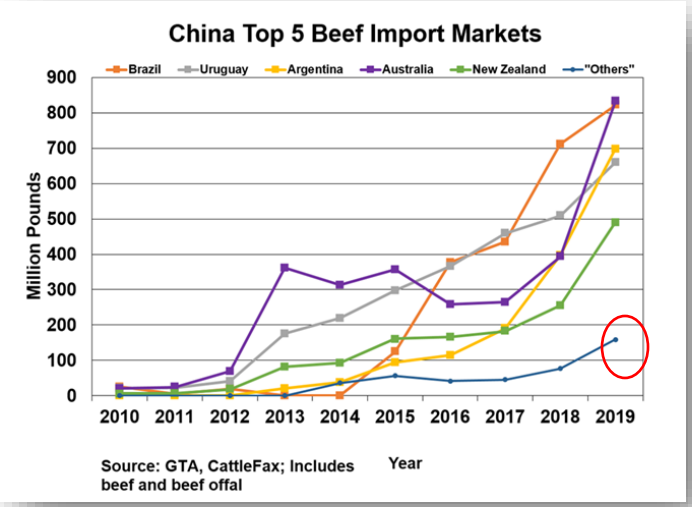
The Upside in Cattle due to China and ASF

The African Swine Flu in China has been devastating. The red bar I have drawn in shows the drop in pig numbers in China and how many hogs China actually produces. Pork is 56% of their diet and they produce over half the world's hogs…



440 million hogs last year vs. 335M this year (officially) unofficial rumours are that this red bar should be about 50%



China has been filling the gap with meat from Australia, NZ, Uruguay, Argentina and Brazil but they are liquidating their inventories to fill this market. US and Canada have hardly participated! Those 5 countries have supplied 20X what North America combined has contributed!

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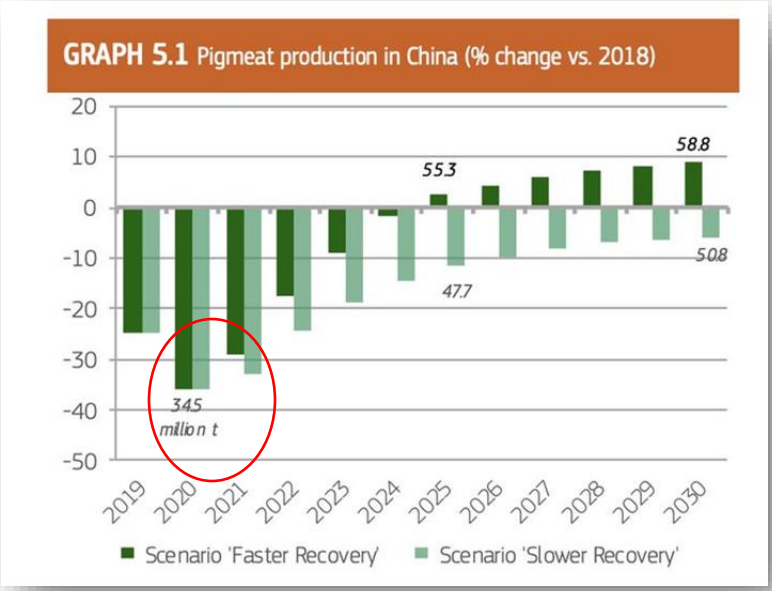
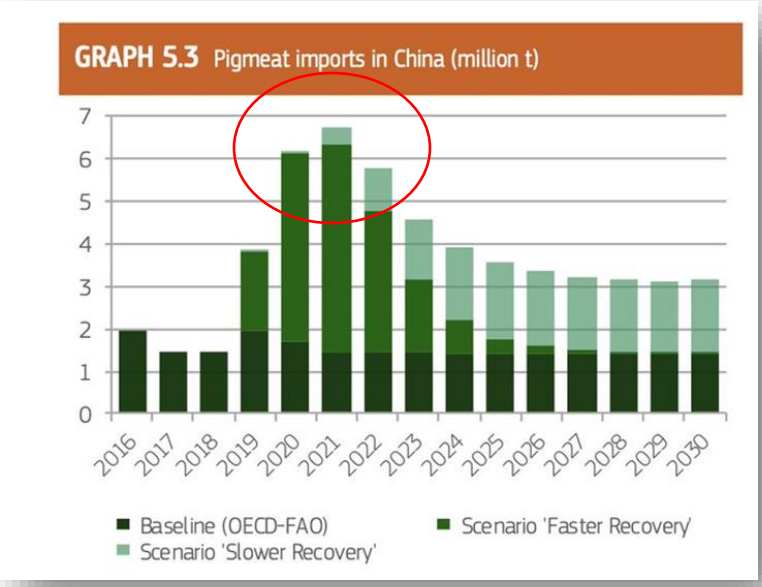
These next two charts show how much China's pork production will and has dropped, and the elevated level of imports required to fill that market. It will be filled with pork, poultry and beef imports.





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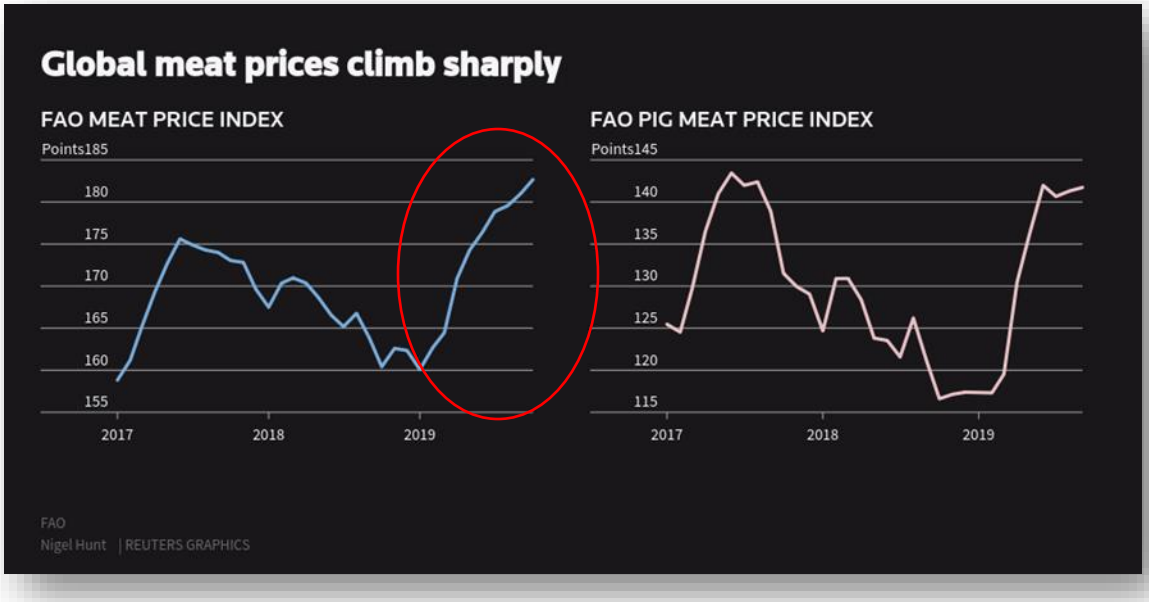
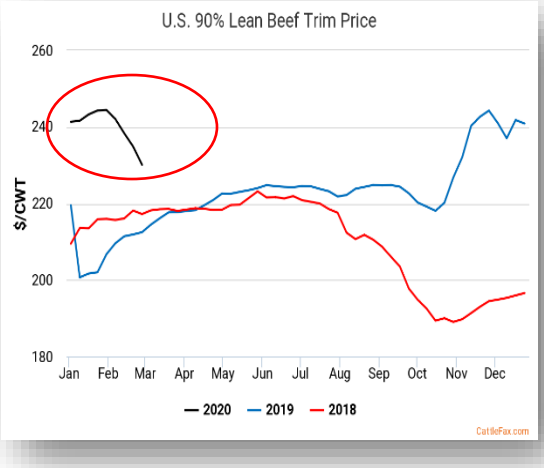
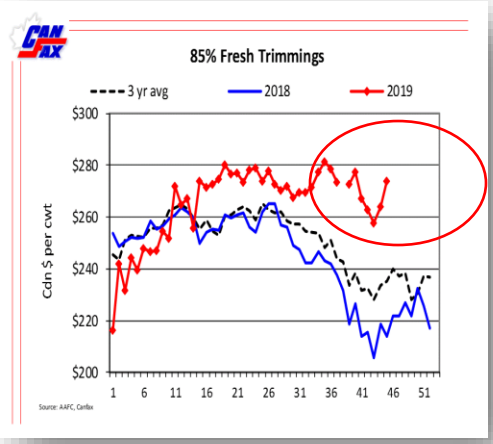
This is all causing global meat prices to rise…



Our best indicator of global meat prices is lean beef prices in North America (cull cow, bull and non-fed beef prices) that directly compete with global meat prices. You can see it is rising in both the US and Canada. Cull cows are going to lead the charge to higher prices!





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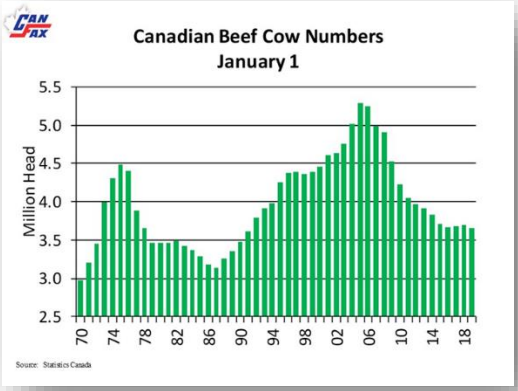
Why we are looking at forage finished beef

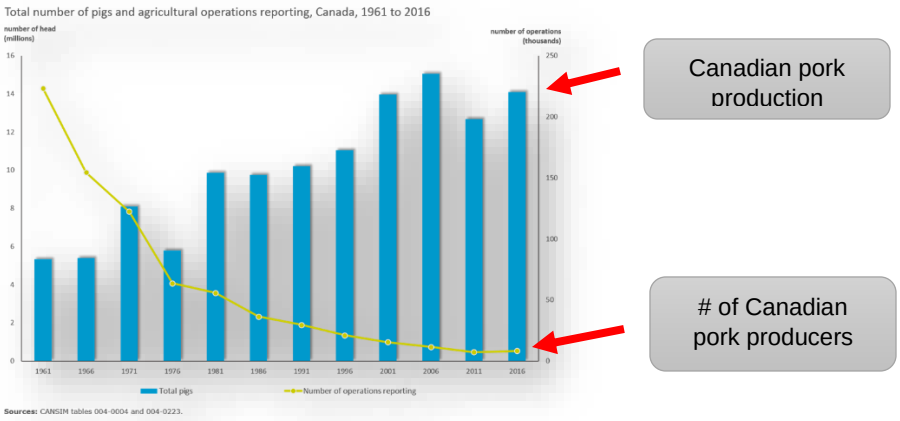
With a 9 billion population coming in the next few decades, we need to produce as much food as we can. Grain is not going to leave the beef diet anytime soon, and likely not hormones, beta agonists and all the other performance enhancing techniques of raising cattle.

However, confined feeding is not looked at favourably by the consumer from an animal rights perspective. "Factory farming" is not seen positively in light of the African Swine Flu and Avian flu in poultry that has decimated herds due to excessive confinement (and some poor habits for sure!). Believe me, I know the need for feedlots, but expect a continuing push for "Range fed", "humanely raised" or "forage only fed" beef.

The other reason we are looking at this is the shrinking volume of producers globally and in our country. All you have to do is look at our Canadian inventory numbers…



Or look at this chart of the pork production in Canada relative to the number of producers…



This is becoming a famous chart showing how much of the income in agriculture is going to input suppliers rather than farmers…

Producers need to look at ways of scaling back inputs and owning the product longer. Go back to nature. Do we need the feedlots, hormones, auction marts, beta agonists, vaccines, tractors, shredders, balers, grain bins, infrastructure and the like to the extent we are using them? What about cows on grass with a little fencing, a cow horse and a dog? What about the person that raises the calf selling beef at retail prices rather than selling calves to an auction mart at wholesale prices?

Let's not run down our necessary auction marts, feedlots, vets, etc. We are encouraging ranchers to look at what they can do on the farms without added inputs, infrastructure, equipment, equipment financing, hauling calves all around the country multiple times before their end state, and the like. Can we cut freight costs, shrink, sickness and vaccines resulting from excessive movement of livestock out of their natural environments by keeping them on the farm longer?

Consumers can be oblivious to reality sometimes, but aren't totally stupid. They are calling for naturally raised beef the way God intended them before we discovered that if we filled ruminants with grain, they will get fat more quickly. 90 million buffalo in North America were eradicated, we need to replace those ruminants for the sake of our soil regeneration and nutrient recycling. As cattle producers we know this story, and it is a great story for cattle, and a reason to start looking at kicking cattle out of pens and back into the fields.

So let's not throw the baby out with the bath water, we need commodity grain fed beef to feed the world and stay competitive, but I think we should explore trying to let cattle graze on ranches

as long as possible whether it is on cocktail crops, swaths, banked forages, bale grazing, stubble, fodder or grass without machinery and other inputs that require debt financing to feed them.

Summary

Lets add all this up into some summary recommendations:

1. **Interest rates will likely rise if the bond market collapses. Get your debt levels in line and fix your interest rates where possible. Interest rates are at ALL TIME LOWS!**
2. **Reduce exposure to bonds and stocks**
3. **Expect a drop in farmland prices if interest rates rise or if older farmers begin to sell when the economy turns**
4. **Find ways to lower your cost of production by eliminating equipment and overhead financing as higher interest rates will be a drain on finances**
5. **Commodities will likely drop in this upcoming bear market but will be the first to recover and will rally the quickest. Be ready for that bottom in the market to go hard at expansion, keep some powder dry!**
6. **Explore ways to keep cattle on the ranch longer under nature's methods of growing livestock. Eliminate middlemen and excessive freight and inputs in the lifecycle of an animal.**
7. **Find ways to get your income more directly related to retail prices, not wholesale prices.**
8. **Explore new methods of farm ownership and financing that don't include debt. Find investors willing to invest equity to partner or joint invest with you**
9. **Most of all, don't worry. Ecclesiastes says "nothing is new under the sun". Bear markets and downturns will occur the same way they have repeatedly in history. There is no such thing as "it is different this time". Only the variables change, the principles remain. Remember, the timing of all this is uncertain but the eventuality of it is certain.**
10. **Hang on to the cow's tail. Good times are coming beyond the storm!**

Take care out there, we are here to assist you.

--Ryan Copithorne, and The Cows in Control team and Partners

(403) 775-7534 Cows in Control Main Office
(403) 669-3451 Ryan Cell
(403) 543-2825 Western Futures Group for assistance with futures/options trades
(403) 277-2605 Fred Mertz & Associates for tax planning, estate, land, accounting
(587) 707-9553 Peters Wealth Management for personal wealth strategy assistance
(403) 782-5488 Insight Ag Marketing, Greg Petersen for grain marketing/risk advice