AGAINST THE FLOW

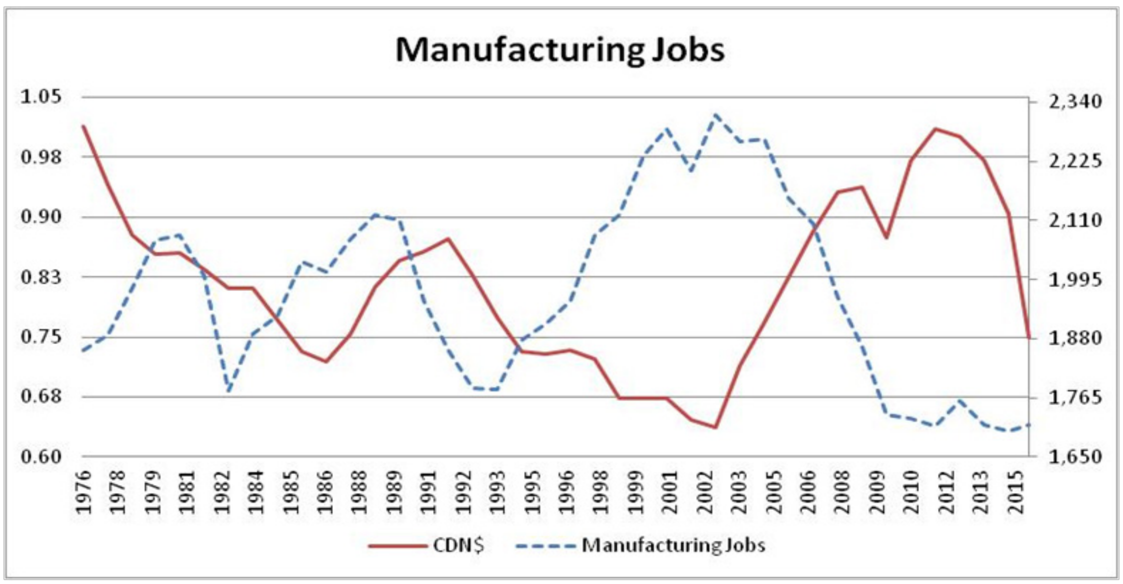
The Vestcap Point Of View

November 2015

One of the prevailing investment mantras is that a low currency is good for manufacturing job creation. In Canada we have generally welcomed a low currency on the belief that entrepreneurs will create capacity (and related jobs) to supply the world with our comparatively cheaply produced goods. As contrarians, we have tested that mantra and find it to be false.

In the past, a lower Canadian dollar may have, over short periods of time, have an inverse relationship to Canadian manufacturing job creation. In the chart below, we compare total manufacturing jobs (blue - dashed line) to the level of the Canadian currency (red-solid line) over the past 40 years. While there exists some correlation (dollar down, jobs up), except for certain periods (1984-86, 1994-2002) it is pretty hard to see, even if one figures in a bit of a lag. Since 2007 – one year before the onslaught of the Great Recession – the Canadian dollar has dropped by 19% while manufacturing jobs have also contracted in the double digits. On an absolute basis, there are only 1.7 million manufacturing jobs in Canada today compared to over 2.3 million prior to the recession. Manufacturing jobs have fallen and they can't get up. We do not think they are coming back, even if the loonie trades lower.

Dating back to 1976, about 20% of Canadian jobs belonged to the manufacturing sector. Today, that figure has dropped in half to below 10%. While total employment has increased by 85% over the past forty years, our manufacturing jobs have actually contracted on an absolute basis by 8%. We expect that trend to continue for two key reasons.



First, globalization has opened borders. Now, companies look overseas for inexpensive labour. While the average Canadian manufacturing worker makes $52,000 here at home, his Chinese counterpart earns a mere $10,700 abroad. The cheap cost of labour overseas will continue to pull jobs out of Canada.

Second, machines can do today what humans once did before. The more expensive labour becomes, the more easy it is to replace with a machine. The 6 percent annual growth in global automation has outpaced industrial production by twice as much over the past ten years.

Over the past few decades, Canada not only lost manufacturing jobs, but we lost manufacturing companies in which we could invest. While the US manufacturing sector has shed jobs in a manner not dissimilar to Canada, the US has a plethora of global oriented manufacturing companies in which we can invest. At Vestcap, we focus our investment thought there. After all, Wayne Gretzky once famously said, "Skate to where the puck is going, not where it has been."

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