Third Quarter 2020

We hope that you are keeping well and have watched the leaves turn such vibrant colours as we ease into fall.

Markets around the world continue to recover from the initial shock of Covid-19. This has been fueled by historically low interest rates and government stimulus. Capital markets remain healthy and credit continues to flow in spite of the ongoing pandemic. It is likely that any future stimulus measures are priced into the markets, either before or after the U.S. elections.

The trend of low interest rates should continue for the foreseeable future and this will be essential as we move toward the second wave of the virus. This is becoming a reality, especially in the United States, as the lack of a concrete plan is becoming apparent, with the individual States and the Federal Government appearing at odds with each other. The inconsistent response to the virus in the United States means much higher infection rates and viral loads than countries like Canada which closed down more aggressively and reopened more cautiously. Added to these concerns is the ongoing stalemate on new stimulus measures. Negotiations this close to the election have become politically motivated as every calculation is measured against re-election metrics. This is causing short-term volatility which will likely continue for the rest of the calendar year. As we move beyond the elections and move towards a vaccine we need to see corporate profits and investing fundamentals catch up with stimulus spending. There are signs, during the current earnings season, that this is beginning to occur. Economic numbers on both sides of the border have been trending positive and vaccine and anti-viral news is positive making a full shutdown unlikely.

The Equity Markets continue to trend upward, however, the rally remains narrowly based. 10% of the S&P 500 index is taken up by three stocks (Microsoft, Apple and Amazon) all which have outperformed the general market by a wide margin. This masks the reality that the majority of stocks on the index are trading below their 50 day moving average. We did see a recent correction on the Nasdaq index, however, the recovery from the lows has been impressive. Growth stocks will likely trend higher over time, however, they are priced for perfection and will likely be volatile over the short term. There are signs that the rally is spreading to more cyclical stocks like industrials and financials and this will be essential as we move forward.

The Canadian markets have also performed positively, although more modestly than the U.S. indices. The more disciplined approach to mitigating Covid-19 in Canada has led to a more gradual reopening of the economy than seen in the United States. Government stimulus spending has been more consistent on this side of the border, however, it has also been more constrained than spending south of the border. The TSX has reflected this however, it is important to note that the action of a few stocks such as Shopify distorted the broader index performance similar to the S&P 500.

The U.S. election is the largest over-hang to the current investing climate. The initial thought that a Biden win would be negative for markets due to increased taxation seem to be changing as the Democrats are gaining momentum. The possibility of a "Blue Wave" with the Democrats holding the House, Senate and the White House may become a reality. Even though the Democrats appear committed to a redistribution of wealth through taxation, the potential stimulus measures that they would propose seems to be giving markets some promise. It may be that the sense of certainty provided by a Biden presidency is more favourable to the chaos of tariffs and isolationism that the Trump presidency provided even though his taxation policies were ultimately business friendly.

Going forward we are seeing signs that financials and other dividend paying equities are beginning to look attractive. Interest rates are at record low levels and do not appear to be going higher in the near future. People dependent upon investment income face a difficult choice. They can roll over GICs at 1.2% for 5 years or look to historically proven equities that maintain and grow dividends. The TSX offers many solid opportunities to gain dividend income of north of 4%. For example our banks should not have to cut dividends in even a worst case scenario and yield between 4.43% (TD) and 6.41% (BNS). The concern over loan losses appears to be subsiding as defaults appear to be at lower levels than predicted and consumers appear to have used government stimulus to pay down debt, especially credit cards. There are definite head winds for the banks as low interest rates compress margins, but trading desks and wealth management fee income offsets this to a large degree.

Many Canadian pipelines, utilities and industrials benefit from stable and growing cash flows, strong regulatory environments and dividends that should be secure. We are also seeing strength in Renewable energy producers as the world pivots to more environmentally friendly options and in many cases payout ratios in these companies are sustainable as they continue to grow. The move away from fossil fuels to green energy appears to be a real trend as renewable power is now competitive even without government subsidies. In addition, the recent announcements by several major oil companies to either de-emphasize oil production or go "carbon neutral" means that they could become significant players in the green energy space by partnering with or potentially taking over existing companies in an effort to gain scale.

Although markets have recovered from the lows we have a long way to go to get back to "normal". Sovereign nations have accumulated massive debt loads that ultimately will need to be paid. It is important to remember that markets look to the future and price in long-term trends. There will be corrections as we move forward, however, at this point we are seeing the market projections as ultimately constructive.

As always if you have any questions or just want to catch up, we are an e-mail or phone call away.

Be well,

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