Smart Investor

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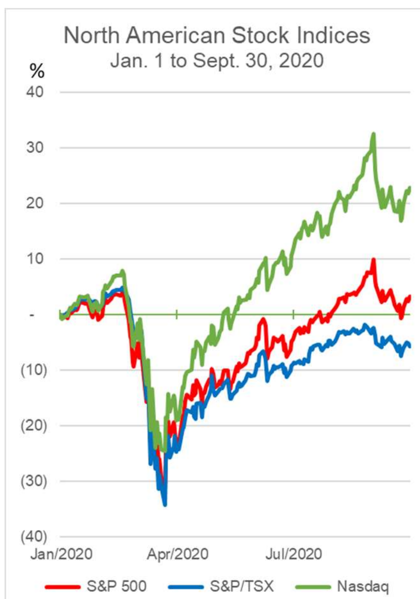
Continued Recovery in Q3

Review of Markets

Markets set new highs

If ever there was a time to learn why we should not try to time the market, the first nine months of 2020 would be a perfect example. After setting what was then a low point on March 23rd in the major indices in Canada and the U.S. both markets rebounded strongly in the second quarter. Since July, the S&P 500 Index (S&P 500) in the U.S. have set multiple new highs before taking a breather after Labour Day.



Source: Thomson Financial as of Sept. 30, 2020

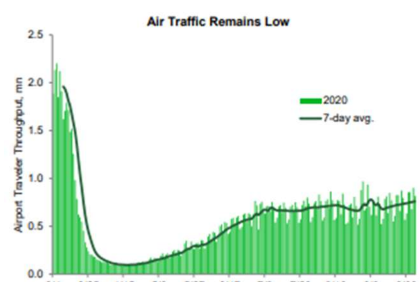
The chart above shows the S&P 500 in the U.S. and S&P/TSX Composite Index (TSX) in Canada since January 1st this year. The S&P 500 is up about 4% while the TSX is down 5.5% as of September 30th. The Nasdaq Composite Index (Nasdaq) was up 24.5% during the same period. The fact that the S&P 500 and Nasdaq outperformed the TSX was mainly due to the leadership of large technology companies. The technology sector accounts for 20% of the S&P 500 and almost 50% of the Nasdaq. The TSX was driven by precious metals and its technology sector – albeit a much smaller one than in the U.S. – but dragged down by its energy sector.

Economy vs. Stock Market

With the shutdown of many sectors of the economy to varying degrees since March, we are technically in a recession. Unemployment levels are still elevated. Yet stock markets have been doing well. Why?

K-shaped recovery

There has been talk of an alphabet soup of recovery shapes, ranging from "V" to "U" or "L". But now there's a new one – "K". While the other ones are reasonably intuitive, this one needs some explanation. Essentially we are seeing a recovery that is unevenly distributed. Some sectors—namely technology, professional services and grocers— are doing better than others such as travel, hospitality and most retail sectors. There is also disparity in terms of workers. In general, university-educated white collar employees who are home owners have fared better than those with a high school education and work in frontline service positions.



Source: TSA, TD Securities

The S&P technology index was up 29% for the first three quarters in 2020 compared with the S&P airlines index which was down 47% for that same period. U.S. air passenger volume (above chart) is a good proxy measure of what we may consider "normal" life because air travel for most people is a discretionary activity. The contrast between the upper and lower leg of the letter "K" is understandable, but nonetheless, jarring.

The stock market is forward-looking

The value of a company is the sum of all future cash flows into its coffers adjusted for inflation and risk, also known as net present value. The key word is "future". One could argue that market participants already expect poor earnings for 2020 and possibly for 2021. But at some point in and around 2022 or 2023 we may see a return to previous levels. It is that anticipation that is propelling stock markets.

Entering the Last Quarter

Life amidst COVID-19

As we enter fall and winter there is much talk of a potential second wave of viral infection. We are learning in real time how to re-open schools and businesses in order to revive the economy, but without causing coronavirus cases to spike. The risk is a rise in cases may lead to another shutdown thus hampering any recovery.

Low rates for (much) longer

In a speech to the National Association of Business Economics, Federal Reserve Chair Jerome Powell explained that the FOMC (Federal Open Market Committee) would maintain its present target rate just above zero until the unemployment rated dropped to 4% and inflation was consistently above 2%. His projection was that it would not happen until the end of 2023, but cautioned that should COVID-19 cases rise economic activities would feel the impact.

Every recession is different, but the recovery from the Great Recession that was sparked by the financial crisis in 2008 was characterized by long periods of very low interest rates. This supported the consumer and business community alike, thus aiding the recovery. The Bank of Canada (BoC) chair Tiff Macklem said in a speech to the Global Risk Institute on October 8th that the BoC was committed to maintaining low interest rates. However, given an already hot housing market in some parts of Canada, there is a risk that may be exacerbated by sustained low interest rates.

Technology is here to stay

Many of us who are working from home, or having switched from attending school to a virtual classroom will one day return to our offices and school. However, it is unlikely that our use of technology will return to the previous level. I may continue to use video-conferencing with my clients, not as a substitute, but supplemental to face-to-face meetings. Companies may find that virtual meetings can replace at least some business travel, which will be good for corporate budgets, and the environment. In retail if you have tried online shopping for the first time since the lockdown, you may well continue to take advantage of its convenience. Therefore, it is likely that our adoption of technology is a long-term trend, not just a passing fad.

Who will occupy the White House?

As I write this some three weeks from the U.S. election, polls show the Democratic candidate with a sizeable lead over the incumbent. It is not my place to predict an outcome, or the reaction in financial markets following the election. Four years ago the vote for the UK to leave the European Union ("Brexit") and the last U.S. election taught us a lesson in the futility of guessing the result of a free vote. In its *Outlook* for 2020, Capital Group noted that in the year following a presidential election, markets tend to rise irrespective of the party that won the White House (see footnote). While there may be winners and losers in terms of sectors and industries, one over-riding factor will be sustained low interest rates that will drive the economy and financial markets. For investors this means sticking to your long-term goals, strategic asset allocation and being well diversified. By all means watch the election news, but don't let that affect how you think about your investment portfolio or retirement plans.

Shiuman's Corner

Fund raising in a pandemic

Reach for the top (photo: Shiuman Ho)

Almost a year ago I committed to join the Ride to Conquer Cancer, a 200km ride over a weekend at the end of this August to raise money for BC Cancer Foundation. A few dozen colleagues formed a team. It was a blow when we heard the event was cancelled due to COVID-19, although it was totally understandable. Cancer treatment and research do not stop just because there is a pandemic, so I decided to do my own Personal Ride.

Over the course of a week, I had two long rides in which I was joined by a small group of riding friends, plus a few shorter solo rides covering a total distance of 330km. The week started with a 100km — "century" in cycling parlance — scenic trip around Stanley Park, Spanish Banks, UBC, Steveston and Richmond. I capped off the week by climbing Mount Seymour with an average gradient of 7% and 1,000m of elevation gain. It was physically taxing to do the Ride especially the Seymour route, but it was a fitting reminder of the challenges cancer patients and healthcare professionals face. I am happy to play a small part in the fight. The above photo shows a "thumbs up" which was a salute to all those who supported my efforts through donations, and to the good work done by BC Cancer Agency. It's hard to tell whether it was a smile or a grimace on my face though. You can read more about my campaign (https://bit.ly/37xbxRO). Stay safe and well.

Capital Group: "Outlook. Long-term perspective on markets and economies. January 2020.