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Navigating the Trade Winds

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Dear friends,

Without a doubt, we will remember 2020 for a very long time. When the stock markets were at the bottom last March, after a near 40% drop, who would have thought that we would close the year on such an upbeat tone? With an 8.1% performance in the fourth quarter, the S&P/TSX finishes the year in positive territory. Thanks to the GAFAM[1], the S&P 500 closes the year with a cumulative gain of 14.0% (expressed in C$). With telecommuting, the pandemic allowed the IT and Telecom stocks to outshine the rest of the market. However, in the last stretch of the year, it's the foreign markets and the commodities (oil, iron, copper, nickel, etc.) that performed the best. With the economic recovery, is it time for mining, oil & gas and emerging markets stocks to finally outperform?

		Closing	Change**	
		31-Dec-20	Quarter	2020
***Stock Indices** (% in C$)*				
S&P/TSX		17,433	8.1%	2.2%
S&P 500		3,756	6.8%	14.0%
MSCI EAFE*		2,148	10.6%	3.4%
Currencies				
CAN$ (US$/C$)		0.7853	4.6%	2.0%
Euro (US$/EUR)		1.2215	4.2%	8.9%
Commodities (US$)				
Oil (WTI)	$	48.28	20.5%	-21.0%
Gold	$	1,898	-0.1%	24.8%
Volatility Index				
VIX		22.75	-3.62	+8.97

** MSCI Europe, Australasia and Far East (US$)*
*** Changes are expressed in C$ for Stock Indices.*

While 2020 was definitely the year of the pandemic, 2021 shall be the year of vaccination and economic recovery. Even though current news is still often depressing, it is what lies ahead that matters for the stock market. If we project ourselves 6, 9 or 12 months in the future, we are optimistic. Vaccination is starting and this brings a positive sentiment for the economy and the stock markets. Investors chose to put aside the current rise in the number of COVID-19 cases and preferred to focus on a post-vaccine economy and the economic stimulus measures to come. After harsh negotiations, American Congressmen finally approved a US$ 900 billion package to support the economy. As with the rest of the G7 countries, Justin Trudeau was similarly generous here in Canada.

The Canadian economy rebounded in the third quarter as the economy south of the border held tight. Strong consumption played an important part as the job market stayed strong, buoyed by the colossal government aid measures. On a global scale, manufacturing showed great resilience and the world economic indicators are back to pre-COVID levels. China remains a pillar of the world's economy as its factories are still churning. The early containment of the virus in China allowed them to quickly come back to 2019 levels. While uncertainties remain, the stars are aligned for a much more favorable year in 2021.

Time for Canadian Equities

	Q4 2020	Year 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Year 2021	Forward P/E
Earnings Growth (Year over Year) and Forward Price-Earnings Ratio								
S&P/TSX	-4.4%	**-19.9%**	41.3%	72.7%	7.2%	14.7%	**31.3%**	**17.0**
S&P 500	-7.8%	**-15.1%**	16.7%	46.8%	14.9%	20.4%	**23.9%**	**22.5**

** Source: I/B/E/S data from Refinitiv (Thomson)*

With current valuation levels, we tend to favor the Canadian market versus its American counterpart. At 17-to-22.5, the gap between the price-earnings ratio of the two markets has never been so wide. With cyclical stocks being strongly represented in the Canadian market, the economic recovery, paired with the weakness of the US dollar, should allow the Canadian equities to outperform American equities. As the results for the fourth quarter of 2020 are gradually disclosed, we presume that quarter to be the last with decreasing earnings. Analysts are forecasting a robust 31.3% growth rate for the S&P/TSX in 2021. Don't forget however that this growth will be on the aftermath of the steep profit decline of 2020. The recovery of 2021 will bring gains for cyclical stocks (oil & gas, mining and industrial sectors) and for the Canadian market in general.

Alternative investments in a near-zero interest rate world

In the mean time, interest rates should remain at a very low level for some time. Many economists don't see any raise in rates until 2023. The yield on fixed income products will therefore continue to be a drag on the performance of balanced portfolios. We believe that central banks will tolerate some inflation in order to let the economy come back to its full potential before raising rates again. With that in mind, non-traditional income strategies become a way to overcome the weak bond returns. Funds of real assets linked to inflation are also an attractive avenue. For those reasons, we still recommend including these instruments in your portfolio. Private debt funds, private equity funds, infrastructure and real estate funds are a new normality. With regards to real estate, we would prioritize industrial and residential sectors over non-essential goods retail.

Conclusions and Perspectives

The world's economy is still governed by the evolution of the pandemic. Lately, news has not been great. Even though the economic recovery momentum might slow in the first months of 2021, we believe that vaccination and the abundance of liquidity injected by the governments will eventually prevail and allow the economy to rebound strongly. As President Biden is sworn in, combined with the Senatorial election results in Georgia, the Democrats have all the tools they need to come up with a stronger economic stimulus plan – if needed. On January 6th, in spite of the attack on the Capitol, the stock market reacted favorably to the unexpected outcomes in Georgia, indicating the focus of investors on the recovery plan and the financial stimulus package. If the Trump era rimed with "Fake News", allusions of electoral fraud, and a downright attempt to steal the presidential election, the Biden era should be less polarizing and more positive. By inciting his partisans to walk to the Capitol and stop the President-elect's confirmation, Trump managed to get himself impeached for the second time. That really takes the cake! While the stock market could be volatile in the short term, we believe that the future will be increasingly positive and less unpredictable, especially now that Trump's Twitter account is suspended!

[1] *Google, Apple, Facebook, Amazon and Microsoft.*

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