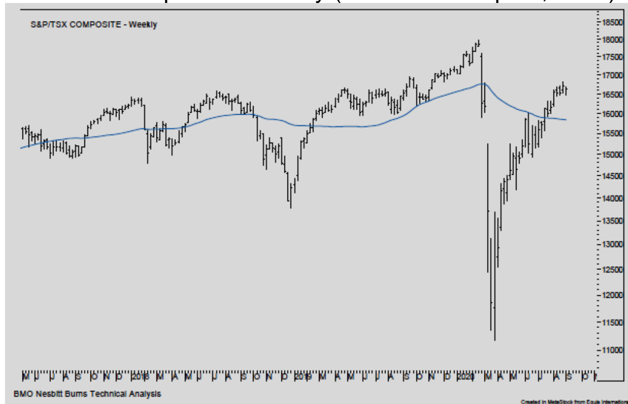
Portfolio Management
Monthly update

August 2020

Market Rally Broadening Out

S&P/TSX Composite –Weekly (Chart as of Sep 02, 2020)



Highlights

- Technology stocks are expensive (some extremely so), but not nearly as high as the 1990s tech bubble.
- Easy money still driving the markets
- Value & cyclical stocks are not expensive and some companies are delivering stronger than expected EPS (think the Canadian banks).
- COVID has altered many investors' retirement plans. Do not hesitate to reach out for Financial Planning assistance.

Why is the market so good given everything that is going on? (Wall Street vs Main Street) The answer is that most companies, especially in the TSX, are not doing particularly well. The TSX is up about 1% year to date, however Shopify and gold stocks combined are about 16% of the TSX index (by weight) and they have contributed a 9% increase to index returns. Therefore, the **other 200 stocks in the TSX are down about 8% this year.**

Growth vs Value: Extremely low interest rates help growth stock valuations since the growth rates are discounted back at low rates with a higher impact on faster growing companies. In addition, with growth hard to find, those that have it, are receiving outsized attention. Look no further than the recent earnings from our bank, BMO and the move it had post-earnings. Expectations were low, yet the earnings were pretty decent = strong equity move.

Dramatic, but short recession & earnings drop Well known portfolio manager Veronika Hirsch in her July earnings summary noted that: "Despite dire predictions of a disastrous second quarter earnings season, North American equity indexes continued their ascent in July. Even though the second quarter GDP report revealed the worst U.S. economic contraction on record, **earnings as a whole proved resilient, with 60 % of companies beating top line estimates and 83% of companies surpassing consensus earnings** (U.S. numbers as of August 7, with earnings season not concluded). There is no question that analysts lowered their expectations as business ground to a halt during the spring pandemic lockdown, but **cost cutting and implementation of some innovative measures allowed enterprises to navigate the difficult environment better than analysts and investors had feared**."

As we have noted in our morning comments, technology is not the only area doing well. Companies facilitating the new 'work from home' & 'play at home' environment, whether food delivery or home improvement products such as home office furniture & gym equipment, all the way to big ticket items **such as boats & RVs are replacing foreign** travel. That of course left travel-related businesses as the main underachievers, many missing even the

most dismal expectations as the top line of the poorest performers spiraled down by 90%.

There are 3 things that tend to drive markets: fundamentals, sentiment & money supply: a) **Fundamentals** such as earnings and long term prospects are mainly what people talk about as we did above. b) **Sentiment** is improving as we have covered regularly in our AM Notes. Sir John Templeton's quote is still the best: "**Bull markets are born on pessimism, grown on skepticism, mature on optimism & die on euphoria".** We believe we are now in the optimism stage with some signs of excess, such as Tesla. **Generally, the overall market is not displaying the typical euphoria associated with tops in markets**. c) The other driver is **money supply**, which is currently very bullish and certainly appears set to stay that way a while (years likely). Governments will likely continue to print money until a vaccine is readily available. We could have a situation when, after an initial bounce on a vaccine, the market sells off on rising interest rates & falling money supply, however, we have learned that trying to "time the markets" is not a successful, long term strategy. We stick to our knitting and try to identify leading companies at valuations that appear to us as undervalued and great fund managers that complement our firm's strengths.

<u>What are we buying/selling?</u> We are **keeping most of our technology** holdings even though they have had a good run. Recently we have selectively added some industrials and financials. The US Federal reserve's recent comments that they are going to let inflation run helped longer term interest rates go up somewhat, which helped interest sensitive banks & insurance companies. We don't expect much of an uptick in rates however, given the drag of massive debt subdued, demand and an aging population. Given the checkered history of September/October returns, we have kept some cash back to take advantage of market dips or select opportunities. A 10% pullback could happen anytime and having some dry powder is nice.

We continue to be **impressed with Fidelity Global Innovators fund**. The manager, Mark Schmehl's barbell approach of growth at one end & value the other is working well. **His value buys in home builders, airlines & hotels have surprised nicely**. He has an active trading style which is working particularly well in this volatile environment. We have also been slowly adding to **global funds such as Capital International & Canoe, as improving international equity markets give more confidence that the US isn't the only game in town.** The falling US dollar and cheaper relative valuations, is helping this trend.

As Brian Belski our chief strategist says, "**This is another hated bull market" and this is good news.**

Regards,

Scott Barnum, CFA	Don Behan, CFA
V.P. and Portfolio Manager	V.P. and Portfolio Manager

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