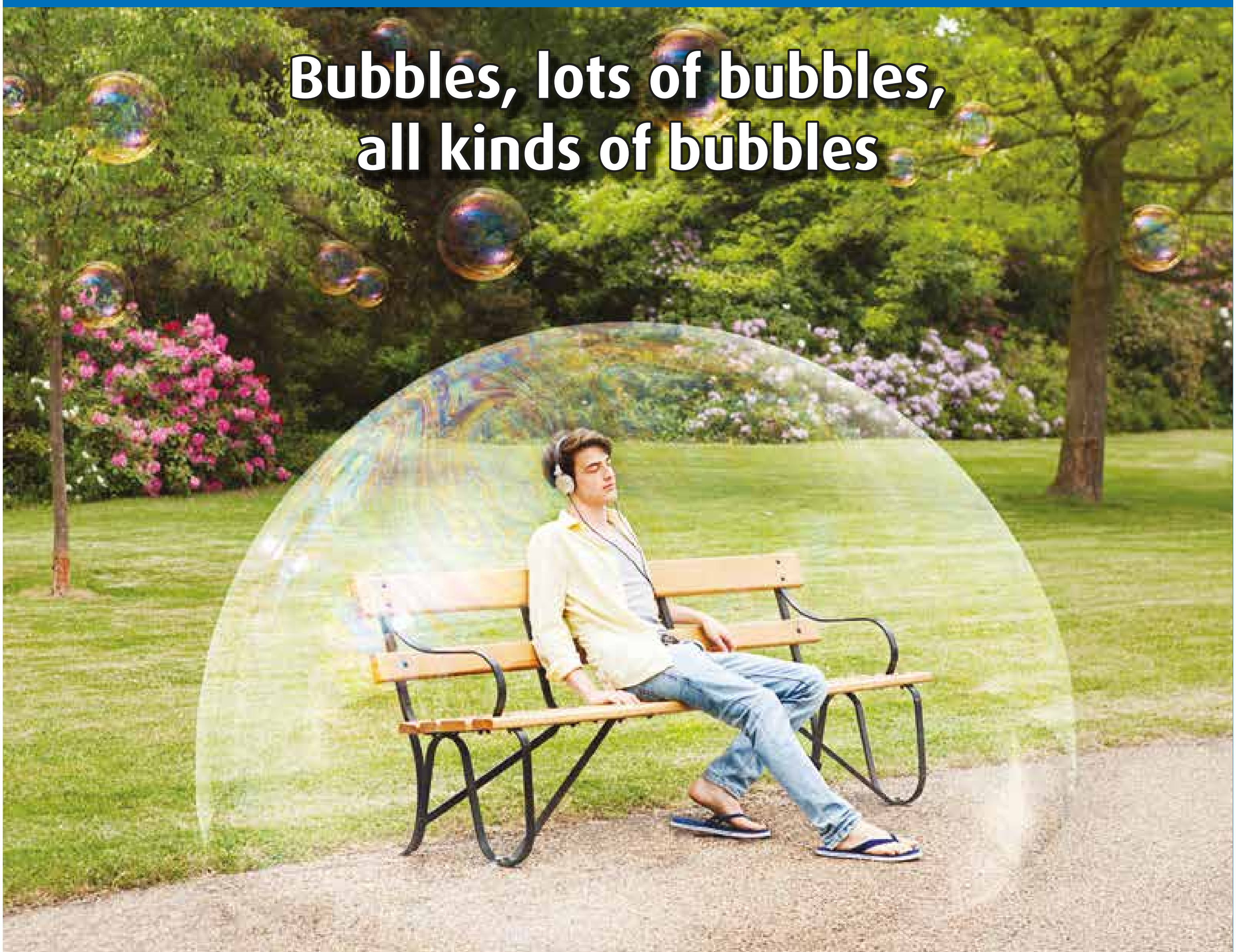
Morin Dupont Lessard & Associates
BMO Nesbitt Burns

Sound advice with outstanding service

October 2020 – Excerpt # 64

Bubbles, lots of bubbles, all kinds of bubbles



BMO Private Wealth
BMO Nesbitt Burns

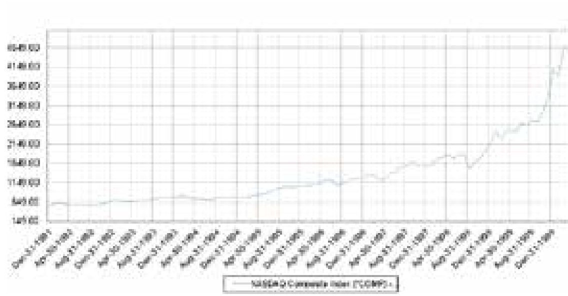
Morin Dupont Lessard & Associates

Pierre's Comments

Bubbles, lots of Bubbles, all kinds of bubbles

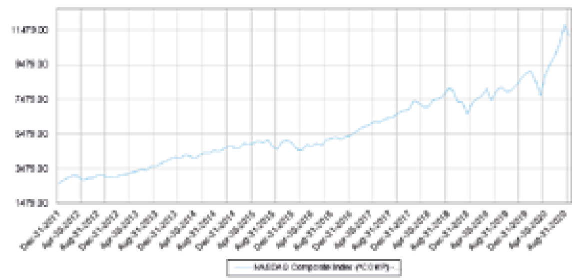
Can you say déjà vu?! This market picture seems quite familiar... Chart 1A-1B

Chart 1A: NASDAQ 1992-2000



Sources : capital IQ

Chart 1B: NASDAQ 2012-2020



Sources : capital IQ

1. What can we learn from the past?
2. Is this euphoria?
3. Is it different this time?
4. What is the smart money doing?
5. What are my options?

So many questions in such very turbulent times... With the COVID-19 pandemic's second wave, social unrest and the upcoming U.S. elections, the fear factor is certainly present, yet the stubborn stock market continues to "bully" everything on its path. This newsletter will neither eliminate nor induce fear, but should help provide clarity for your thoughts and enable your mind to trust your common sense. History certainly can help, but given that market timing is nearly impossible, patience, balance and common sense will prevail.

1. What can we learn from the past?

Thirty-eight (yes, 38) years ago, when I started as an investment advisor, there were no personal computers or any other technology that we use or enjoy today. On Thursdays, we used to gather around the "ticker tape" to get the money supply figures and the result of the Treasury bill auction that determines the T-bill yield. While an expansion of money supply (back then M1, M2, M3, represented by M4 today) stimulates inflation, a contraction could signal a slowing inflation (chart 2) rate which, in turn, could put downward pressure on interest rates.

Chart 2: Money supply

Sources : center for financial stability, macrobond

This chart would suggest significant inflation could be expected, as we are at record levels of money supply resulting from massive money printing also known as quantitative easing (QE), combined with interest rates at nearly 0%!

Back in early 80’s, Chairman Paul Volcker was trying to defeat inflation by driving interest rates higher, forcing consumers to save rather than spend, thus stifling inflationary pressures. It also created one of the worst recessions on record in 1981-82, with interest rates reaching 20% and inflation at nearly 11%. Eventually, money supply finally trended lower, signaling the end of the recession in late 1982. Although high interest rates contributed to slowing inflationary pressures, it was the first free trade agreement between Brian Mulroney and Ronald Reagan in 1984 that was the final nail in inflation’s expansion. Free trade initiated a globalization movement which turned out to be the beginning of a 36+ year disinflationary era. As costs of production came down, so did inflation. In the following three decades, we benefited from the two longest economic cycles ever, 1990-2000 and 2010-2020, with a dead decade in between for U.S. markets unlike the Canadian market.

The first one, 1990-2000, ended following a boom and bust in technology stocks which were to lead the “new economy.” Although they eventually did so, at the end of that economic expansion they were unbelievably overpriced and perhaps were the main cause of the resulting collapse of investors confidence.

In 1999, names such as Sun Microsystems, Cisco, Nokia and Microsoft were up between 65% and 262% and were part of the top five positions of all best-performing funds. They were trading at prices that reflected a price-to-sales multiple of say 10 times rather than a price-to-earnings multiple of 10 times. In fact, many of these companies did not have earnings to show. Does that seem familiar?

Valuations were off the wall and made no common sense using any basic, fundamental metrics. In the following two years, all tech stocks got punished and the NASDAQ dropped an astounding 83%.

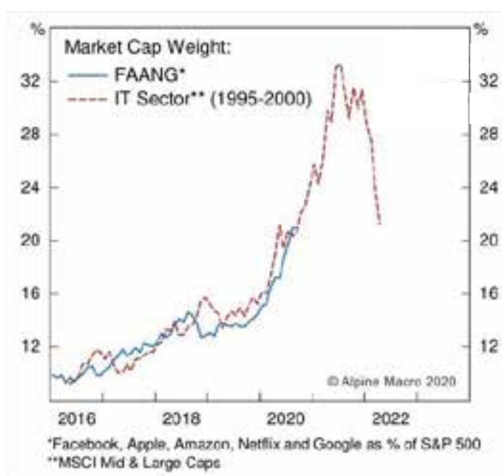
Microsoft was the best performer losing only 62%!

In the 1920s, the tech stock equivalent to today was RCA (Radio Corporate of America) which plunged 98% from its high of 1929.

And let’s not forget Kodak and Polaroid, part of the “nifty fifty” of the 1973-74 market collapse, or, more recently Nortel, WorldCom and BCE Emergis among others.

Growth stocks provide investors with great opportunities, with explosive returns along with huge volatility. Moderation and discipline will result in lower performances in great market rallies but will outperform in bad markets. The “FAANG” stocks of today, namely Facebook, Apple, Amazon, Netflix and Alphabet (Google), are found in most outperforming funds today and are trading at huge valuations...just like in 1999. Chart 3

Chart 3: FAANG stock valuation by market cap vs IT Sector 1995-2000



Sources: posted on thedailyshot.com 10-sep-2020, Alpine macro 2020

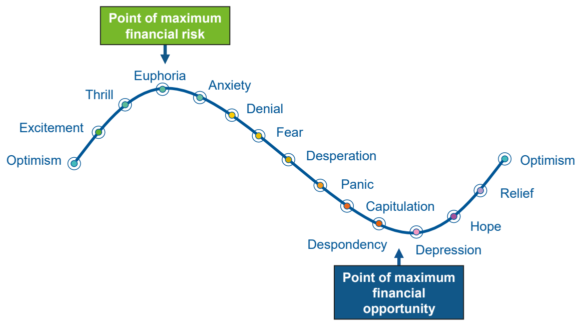
There may be more room for tech stocks to go up, but a smart investor should worry about those over-owned companies that represent a huge portion of the sector’s exchange traded funds (ETF). About 45% of investors today uses ETFs to participate in a sector and as such, the significant weighting of FAANG stocks as a percentage of the ETFs (QQQ) makes them more vulnerable. Apple alone represents roughly 13.5% of the index but combine with other FAANG stocks as well as Microsoft the weighting exceeds 45%.

As a consumer, you may be cost-conscious, seeking to get a specific product or service at the best possible price. There should be no difference in our behaviors as investors or "consumers of stocks." Why should I pay a multiple of a properly valued stock? The answer is in discounting forward earnings. If growth is exponential, so will the stock price, and so will the risk. But discounting future earnings using 0% interest rates translates in unlimited valuations…? We all know that unexpected events could derail the momentum, like COVID-19 or unexpected inflation or social unrest or…??? Perhaps, a more appropriate strategy would be to take advantage of such irrational growth to rebalance your exposure to equities in line with your investment profile, and use some of your profits to hedge your remaining risk and potentially increase your investment income.

2. Is this euphoria?

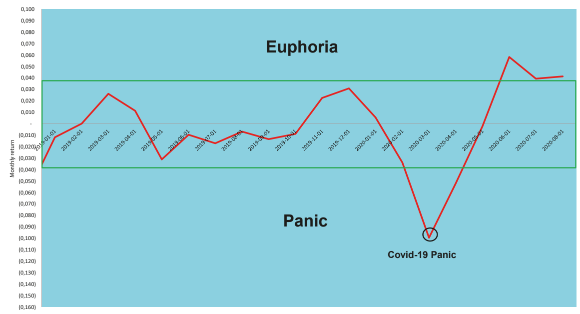
Another historic indicator is market volume. Typically, institutional volumes represent 70% to 80% of the total. Recently, although total volumes have slowed, showing signs of caution, retail volumes (small investors) have increased. This contrarian indicator is a sign of euphoria i.e. when the taxi driver tells you what to buy in the market as he has become an expert. Chart 4A- 4B

Chart 4A: Emotional cycle



Sources : Westcore Funds / Denver Investment Advisers LLc, 1998

Chart 4B: Current emotional state



Sources : BMO capital market and citigroup

Historically, this is a sign that all the money is in the market as it has reached even the smallest investors who turn out to be the last ones holding the bag! Where are we on that chart? Some will argue we are only at the beginning of the cycle as we just came out of recession. The fact that there is over 1 trillion dollars in cash on the sidelines, where we find all the non-believers in this brand-new bull market, might justify that there is much more room to go…

Also, if there is a lot of liquidity on standby, there is also an economy that is not growing at the rate of last February, unemployment level is triple what it was, and the stock market is at nearly all-time highs? Something will have to give unless a catalyst changes the perspective..

If it feels like euphoria and it looks like euphoria and it smells like euphoria, then it is probably euphoria! We just don't know when this will end! What is your contingency plan? What is your hedge strategy? What is your downside protection?

3. Is it different this time?

Although there are immense similarities with the last tech bubble, there is a very important difference. On the back of the pandemic, central bankers are desperate to provide unprecedented monetary stimulus to ensure a very strong recovery, as it will be needed to pay back debt. The Fed and all other central banks are basically handcuffed trying to maintain low interest rates and maintain quantitative easing (QE) or printing money as long as it takes. The U.S. and others will need a 4% GDP growth for a few years in order to generate the significant tax revenues needed to offset the deficit and pay down the debt. This explains why the Fed committee unanimously opted to change the 2% "target" inflation rate to a 2% "average" inflation rate over time. Given that we have fallen short of 2% for the last 12 years, the Fed is signaling that it is bound to let inflation run to 3% or so without intervening or raising rates and allow economic expansion to overheat.

It should also be noted that interest rates were raised in the year *prior* to the 1929 market crash and the year prior to the tech bubble bursting in 2000. So, given that the Fed indicated that it was unlikely to raise rates for several years and will allow for inflation to expand, there are many that believe that this bull market will continue. That is the obvious difference.

As globalization is becoming less popular and trade wars between the two biggest economies continues, manufacturing costs are bound to increase, and our purchasing power could diminish over time. In addition, a lower U.S. dollar, which has dropped against international currencies by roughly 10% since last March, puts additional inflationary pressures as the cost of importing goods increases. Chart 5

Chart 5 $US Index (DXY)

https://www.marketwatch.com/investing/index/dxy/charts

Real estate, equities and gold have been the best performers against inflation over time. But when central bankers fall too far behind the inflation curve, interest rates can move sharply higher, as they did in the late 1970s, when Paul Volcker was in charge of the Fed. At that point in time, those who had high levels of debt were in real trouble.

The debate is now about how many bubbles will the Fed create with its accommodative monetary policy? A treatment and a vaccine against the COVID-19 virus would allow economies to fully reopen, adding fuel to the market. Value stocks such as banks, industrials and materials, would surely benefit, as they have fallen behind in the market rebound, perhaps to the detriment of growth stocks (technology) now largely overpriced. We have witnessed some realignment favoring value and inflation-sensitive stocks lately, perhaps as a precursor of what is to come.

Given that the Fed's monetary policy remains accommodative and that history shows the market rarely collapses under such a policy, believers will buy on dips and will continue to do so until the Fed tightens. But I would caution to stay away from the "nifty fifty" of the 1970s, the "new economy" stocks of 2000 and the FAANG+ of today.

4. What is the smart money doing?

When we think smart money, the first name that comes to mind for many is Warren Buffett, although there are many others, such as Leon Cooperman and Stanley Druckenmiller. All three have communicated a bleak picture on the horizon. Druckenmiller has suggested that "the action of the Federal Reserve has raised the chances for inflation and deflation. The Fed's willingness to let inflation run hot posed a risk to price stability and therefore justifies caution and hedges..."

As for Leon Cooperman, he is astonished that market valuations of Tesla as well as Apple jumped more than 50% after the stocks split. But the action of splitting only entices small investors as it makes the stock price more accessible!

If you ask for change for a $20 bill, would you expect to get six $5 bills? But if you do, take the surplus and spend it or better yet, invest it in something else. In the case of Tesla, he noted that its market capitalization was almost the same as Toyota, Volkswagen, GM, Daimler, BMW, Ford, Fiat, Chrysler, Honda and Nissan combined!

The only problem is that these automakers sold 50 million cars compared to 367,000 cars for Tesla last year! The other funny thing is that when the stock was trading at about $400 last year pre-split or $80 equivalent today, Tesla was the most shorted stock on the exchange. Perhaps short coverage was a big part of the rally. Nevertheless Mr. Cooperman remains leery of those highflying stocks and maintains that stock market returns may be "unimpressive for a long time."

As for Warren Buffett, he is acting on his own saying "Be fearful when others are greedy and greedy when others are fearful" by taken a US$565 million stake in Barrick Gold in the second quarter.

First, he did not enter the market heavily at the peak of the crisis unlike other similar times. Second, he never was a gold advocate. He buys what he understands and that is cash flow and profits.

In the past two years, the top four gold producers of the world merged to become two, making the third producer very small in comparison. These two, namely Barrick Gold and Newmont, represent 25% of the $18 billion VanEck Vectors Gold Miners ETF and nearly 35% of the Global Gold Producers Index ETF (XGD). Without speculating on the potential of rising gold prices in an inflationary environment combined with geopolitical instability as well as out of control indebtedness and the habit of printing money out of thin air, there are huge cash flows being generated at *current* gold prices. The dilutive effect of printing money without any barriers can be worrisome. The simple fact that the biggest buyers of gold are those who are printing fiat currencies with no restriction reflects what an investor should do. Central banks purchased 646 tons net of sales in 2019 and 293 tons this year to date (Kitco.com). Regardless of how high gold prices may go, the average cost to produce 1 ounce of gold is roughly US$1,000. At US$2,000 an ounce, this represents a 100% margin. I would say it represents a pretty good downside protection in any portfolio, especially when we know that the yellow metal tends to increase during inflation or deflation.

In the late 1990s, many said that Mr. Buffett had lost his touch, but what he missed was the bubble burst. Recently, he was again questioned of his lackluster performance not taking advantage of the recent run up. He might be right, again!

5. What are my options?

Investment strategy

As complicated as the situation may be, as difficult as it is to predict the right outcome, as simple becomes the strategy if we want to protect the obvious downside risks without weakening our future purchasing power.

First in importance is income. With interest rates so low, stocks that provide a secure source of income in the form of dividends should be at the forefront of investment priorities at this point. Mature companies that have the capacity to grow their dividend payments, without a debt-burdened balance sheet, would be preferable. Their growth may be less attractive, but so is the downside risk. **In 1999, a year before the tech bubble burst, our portfolio had very little exposure to tech stocks. Although it caused us to underperform that year, we largely outperformed in the three following years thanks to our overweight in utility income trusts at the time (See performance table at the end)**

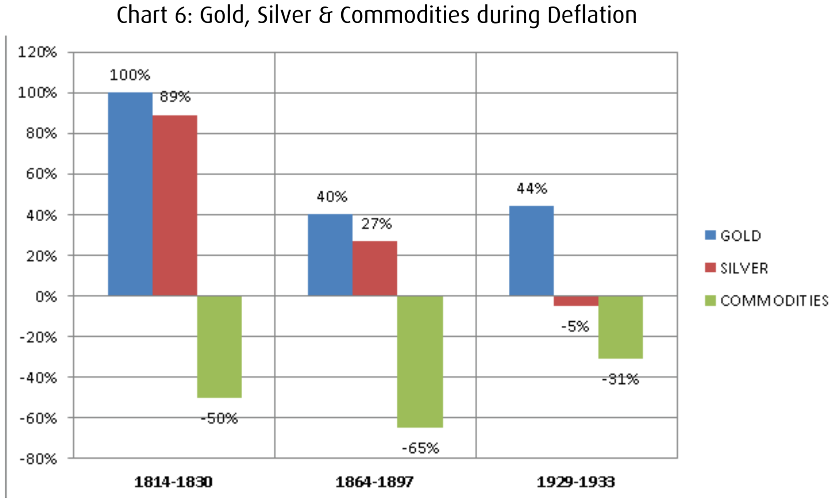
In that cycle, the Fed raised interest rates in June of 1999 and cut back those rates as the bubble burst in 2000. That triggered an increase in demand for yield, driving up income trust valuations. Today rates are low and will remain low for some time. Although we may not get the pop in valuations this time around, we can still benefit from very attractive yields. The pop should be related to inflation-sensitive stocks rather interest-sensitive ones given the Fed's intention to allow inflation to expand.

Inflation sensitive stocks are related to the cyclical nature of the economy. Energy, base metals, lumber and forest products, precious metals and industrial stocks.

However, we need a robust recovery, worldwide, so that demand outstrips supply and commodity prices firm up. At this point we recommend limited exposure to these sectors by concentrating in sector market leaders and gold. The case for gold is solid and is not a function of rising gold prices.

At current levels, some of the gold producers enjoy sustainable cash flows and are bound to increase their dividend distributions if, as and when gold rises further. Bank of America has recently predicted gold prices to reach $2,500 US per ounce next year and that comes on the heels of both Goldman Sacks and JP Morgan who are calling for $3,000 US per ounce by the end of 2021. We recommend a 4% to 5% exposure to gold for both inflation and deflation risks. Chart 6

Chart 6: Gold, Silver & Commodities during Deflation



Over the past 200 years, our economies suffered three depressions (deflations), two of which took place in the 19th century. Gold increased an average of 42% during the last two depressions. The Gold Rush of 1848 as well as that of 1930s were the results of high unemployment and major family sacrifices trying to put food on the table. Gold provides a good insurance policy but, more important is the world's underweight in that sector. There is a lot of room to catch up and a lot of cash on the sidelines that pays no interest. An increase of 1.5% in income over cash (dividends on many gold stocks) in addition to a downside protection, arguably for free, and significant upside with improving margins and cash flows is a sweet proposition.

Finally, the financial sector has historically been the sector leading us out of recession. This has not been the case this time given that interest rates fell so low; there is very little room for profit on loans. Furthermore, provisions for bad loans have gone through the roof given a complete stop in the economy since last March. Controlling the spread of COVID-19 is the key for a lasting economic recovery well needed to pay back debt. Financial institution stocks will reflect the spread and contraction of the virus. We believe that most Canadian banks have the backbone to make it through this rough patch, and assuming a return to normal economic activity in the next year, they could well be among the top performing sectors once again.

CONCLUSION

At the time of writing, there are 53% of economists that believe we are past the recession. This slight majority supports continued equity exposure at your target equity weighting. Overweighted positions should be cut back to the benefit of under-weighted sectors. The temptation of overweighting equities justified by low interest rates will further expose you to wild volatility. The questionable or undisciplined actions of central bankers and governments (i.e. printing money and raising debt) should not drive investors to become undisciplined themselves. Balance and moderation will be your best strategy while bubbles come and go... We may well be at the dawn of a new «golden» decade!

Recommended sector weighting October 2020			
Sectors	**Rec'd weighting**	**Trend**	**Rational**
Communication Services	4.00%	⬆	Our favourite yield play given secular dividend growth, recent underperformance provides timely opportunity.
Consumer Discretionary	2.00%		Consumer is clearly stretched; debt servicing under pressure, focus on names with US growth exposure.
Consumer Staples	5.50%		Expensive, but still very stable in terms of earnings growth, stay focused on names with U.S. growth exposure.
Energy	3.00%	⬇	Focus on yield and cash flow only; languishing underlying commodity likely to persist.
Financials	14.00%		Steadfastly maintaining holdings within the broader sector; however, we prefer those companies with stronger U.S. platforms – especially within the banks.
Healthcare	5.00%		For new money, we prefer using a currency hedged ETF to gain exposure to large cap names in the sector and therefore reduce our exposure to currency risk. If you already own the big names in the sector in USD (such as PFZ and JNJ, they are a hold as they provide stable and predictable dividend income and good growth potential.
Industrials	6.00%	⬆	Will benefit from a cyclical recovery but stick with high quality.
Information Technology	7.50%	⬇	Still prefer the U.S.; Online shopping has become a necessity; wireless and broadband budgets to explode.
Materials	3.50%	⬆	Stonger precious metals prices should improve fundamentals, however commodities remain volatile. Stay defensive and focused on cash flow.
Real Estate	5.00%	⬇	Yield and cash flow; interest rates lower for longer should provide support.
Utilities	7.50%	⬆	Yield and stability of dividend; interest rates lower for longer should provide support.
International Equities	2.00%		Be aware of exchange rates. We favor North American Equities.
Total actions	**65.00%**		Average equity weighting.

• The suggested weightings are appropriate for a 65/35 equity/fixed income portfolio and should be adjusted based on your investor profile.

RECOMMENDED ASSET MIX				
INCOME PORTFOLIO			**BALANCED PORTFOLIO**	
Apr 2020	Oct 2020		Apr 2020	Oct 2020
10%	10%	CASH (maturities ≤ 12 months)	10%	7.5%
50%	47.5%	Fixed income (Bonds & GICs)	35%	35%
10%	10%	Convertible Debs. And, Income, Generating, Securities	10%	10%
22.5%	25%	Equities	35%	37.5%
7.5%	7.5%	Foreign	10%	10%

Disclaimer: Subject to an evaluation of the risk profile of individual clients

Sources:

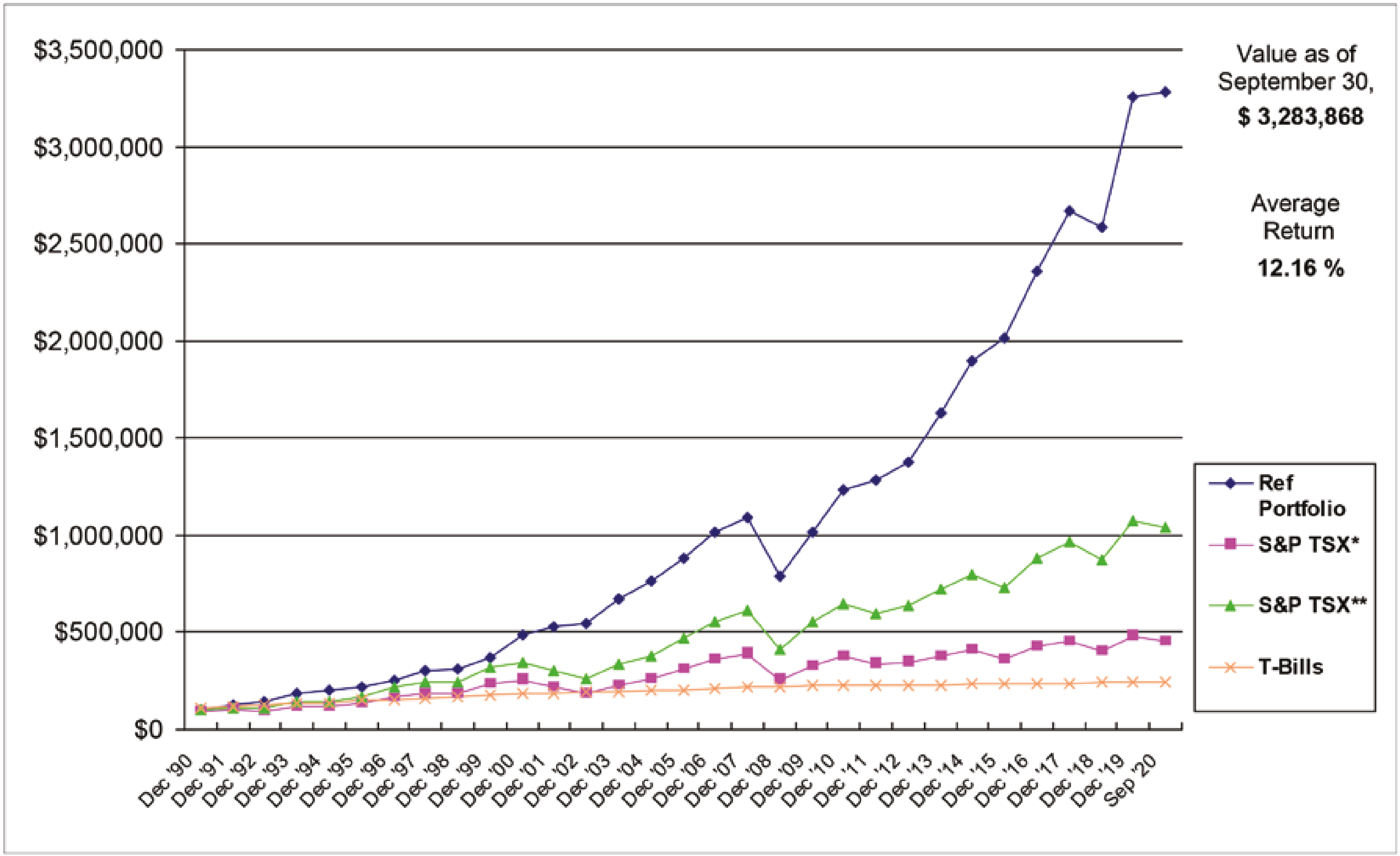
- Bloomberg
- BMO Capital Markets Equity Research Reports
- BMO Capital Markets North American outlook
- BMO Financial Group Economic Outlook
- BMO Nesbit Burns
- BMO Nesbit Burns Part Team, portfolio advisory team
- BMO NB Canadian Equities Guided Portfolio – September 2020
- BMO NB US Equities Guided Portfolio – September 2020
- BMO NB North American Equities Guided Portfolio – September 2020
- BNN
- CNBC
- Dow Jones Newswires
- Globe and Mai
- Incrementum
- Morgan Stanley
- Phases and Cycles
- Standard & Poor's Capital IQ Equity Research
- The Barons
- Thedailyshot.com
- The high-tech Strategist
- The Wall Street Journal

The calculation of performance data set forth herein has been prepared by the author as of the date hereof and is subject to change without notice. The author makes every effort to ensure that the contents have been compiled or derived from sources believed to be reliable and contain information and opinions, which are accurate and complete. However, BMO Nesbitt Burns Inc. ("BMO NBI") makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions which may be contained herein and accepts no liability whatsoever for any loss arising from any use of or reliance on this report or its contents. Information may be available to BMO NBI or its affiliates that is not reflected herein. This report is prepared solely for information purposes.

Please note that past performance is not necessarily an indicator of future performance. The indicated rates of return are gross of fees or commissions. Individual results of clients' portfolios may differ from that of the model portfolio as fees may differ, and performance of specific accounts is based on specific account investiture. The noted model portfolio may not be appropriate for all investors.

This report is not to be construed as an offer to sell or a solicitation or offer to buy any securities. BMO NBI, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities mentioned herein as principal or agent. BMO NBI may act as financial advisor and/or underwriter for certain corporations mentioned herein and may receive remuneration for same.

Reference Portfolio Return Graph



$100,000 invested on June 1st 1990

**Does not include income or div*

***Includes income and div*

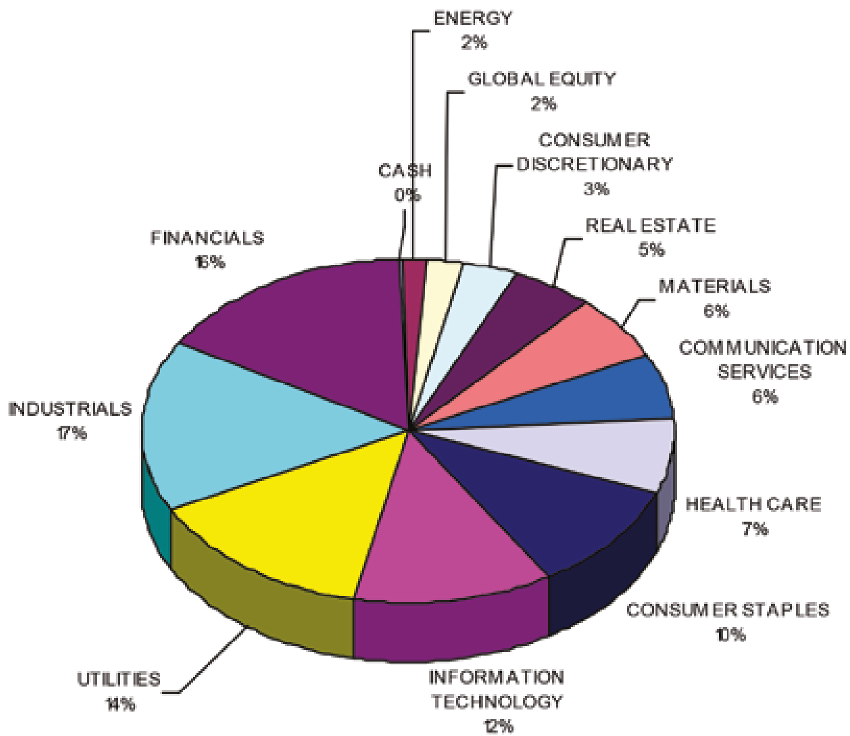
The returns are compounded monthly and revenues are reinvested.

BMO Private Wealth
BMO Nesbitt Burns

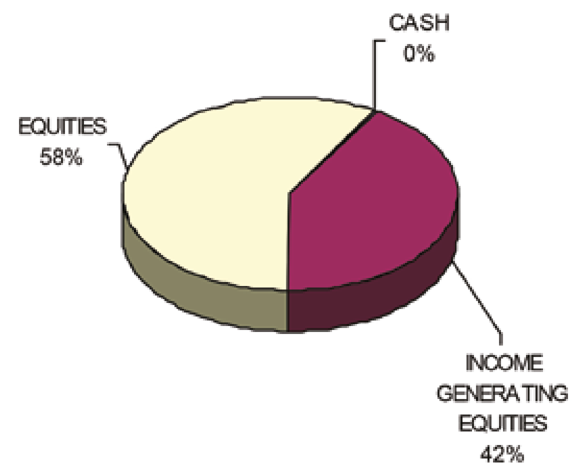
Morin Dupont Lessard & Associates

September 2020

REFERENCE PORTFOLIO HOLDINGS AND ASSET MIX



By Sub-Index %



By Category %

Performance - T-Bills vs SP TSX vs Reference Portfolio				
Year	T-Bills (return)	SP TSX[1]	SP TSX[2]	Portfolio(return)
1990	13.20%	-17.96%	-14.80%	**5.94%**
1991	9.35%	7.85%	12.02%	**22.14%**
1992	6.67%	-4.61%	-1.43%	**10.50%**
1993	4.68%	28.98%	32.55%	**34.91%**
1994	5.19%	-2.50%	-0.18%	**6.09%**
1995	6.42%	11.86%	14.53%	**8.09%**
1996	3.93%	25.74%	28.35%	**16.21%**
1997	2.85%	13.03%	14.98%	**21.05%**
1998	4.56%	-3.19%	-1.58%	**1.87%**
1999	4.67%	29.72%	31.71%	**19.96%**
2000	5.23%	6.18%	7.41%	**30.40%**
2001	3.73%	-13.94%	-12.57%	**9.54%**
2002	1.75%	-13.97%	-12.44%	**3.61%**
2003	2.22%	24.29%	26.72%	**22.23%**
2004	1.84%	12.48%	14.48%	**13.87%**
2005	2.53%	21.91%	24.13%	**15.73%**
2006	3.52%	14.51%	17.26%	**14.30%**
2007	3.59%	7.16%	9.83%	**8.06%**
2008	1.50%	-35.03%	-33.00%	**-28.07%**
2009	0.29%	30.69%	35.05%	**29.37%**
2010	0.60%	14.45%	17.61%	**21.05%**
2011	0.92%	-11.07%	-8.71%	**4.18%**
2012	0.97%	4.00%	7.19%	**7.38%**
2013	0.97%	9.55%	12.99%	**18.14%**
2014	0.92%	7.42%	10.55%	**16.43%**
2015	0.50%	-11.09%	-8.32%	**6.36%**
2016	0.50%	17.51%	21.08%	**16.75%**
2017	0.71%	6.03%	9.10%	**13.26%**
2018	1.40%	-11.64%	-8.89%	**-3.26%**
2019	1.67%	19.13%	22.88%	**26.19%**
*2020	0.37%	-5.52%	-3.09%	**0.79%**
Return Compounded as of December 31, 2019				
3 years	1.26%	3.73%	6.89%	11.41%
5 years	0.96%	3.12%	6.28%	11.42%
10 years	0.92%	3.80%	6.90%	12.33%
Average return since inception (YTD) …………………………………..				**12.16%**

* (YTD): Year To Date (September 30, 2020)

$100,00 invested on June 1st 1990

The returns are compounded monthly and revenues are reinvested.

1: Does not include income or dividend

2: Includes income and dividend

Our Team

Pierre Morin
Senior Vice President and
Associate Portfolio Manager
514-282-5828
pierre.morin@nbpcd.com

Josée Dupont
Vice President and
Associate Portfolio Manager
514-282-5707
josee.dupont@nbpcd.com

Hugo Lessard
Associate Investment Advisor
Financial Planner
514- 282-5861
hugo.lessard@nbpcd.com

Brenda Walls
Investment Representative
514- 282-5887
brenda.walls@nbpcd.com

Patrick Delaney
Investment Representative
514-282-5847
patrick.delaney@nbpcd.com

Neela Patel
Investment Representative
514-282-5840
neela.patel@nbpcd.com

Nancy Landry
Administrative Assistant
514-282-5801
nancy.landry@nbpcd.com

Janie Morin
Associate Investment Advisor
Financial Planner
514-282-5816
janie.morin@nbpcd.com

Louis Morin
Associate Investment Advisor
Financial Planner
514 282-5955
louis2.morin@nbpcd.com

Katia Harb
Investment Representative
514-282-5833
katia.harb@nbpcd.com

For more information, please contact us:

Morin Dupont Lessard & Associates
BMO Nesbitt Burns

Investment Advisors

1501 McGill College, suite 3000,
Montreal, Quebec, H3A 3M8

Tel: 514-282-5828
Toll free: 1-800-363-6732
Fax: 514-282-5838

www.morindupont.com