January 14, 2021 - Market Overview & Portfolio Discussion

BMO Nesbitt Burns

Week in **Review**

BMO Wealth Management
BMO Nesbitt Burns

Economic Overview:

Looking ahead we note four major factors as influencing our outlook for 2021:

1. Central banks globally and in particular in the US and Canada have signaled no interest rate increases until 2023. This strategy approach is designed to stimulate the economy, although we note if inflation takes off this directive could change.

2. The Democrats control the US government (although by very narrow margins) and we expect the Biden administration to be expansive in their economic approach. Also we will see them focusing on renewable energy growth, infrastructure spending, healthcare reform and more generally policies that will stimulate employment.

3. The vaccines roll out should be well under way by mid to late 2021, with spending recovering in the depressed sectors including retail, travel, hospitality and commercial real estate.

4. Equity markets are reflecting full valuations (to be discussed in greater detail below) and further gains in 2021 may be modest even with a strong recovery from the Covid depressed 2020 economy.

Markets Overview

Canadian Equity markets, up a modest 2.2% in price in 2020 (total return of 4.9% with dividends), started the New Year in a positive mood, gaining 3.3% so far in 2021. With the US elections and Brexit in the rear-view mirror and the vaccines rolling out, markets are hoping that by the second half of 2021 we will begin seeing a return to normal. The US markets are up a more modest 1.5% so far in 2021, coming off a banner year in 2020 gaining 15% in C$ terms, and now carrying a fairly high valuation, particularly in the all-important tech sector. Canadian markets, more harshly affected by Covid, while trading with a reasonable amount of optimism are more fairly valued compared to historical norms. The Chinese Market was up ~6% in C$ in 2020 and we added exposure in late 2020 to support our need to broadly diversify portfolios as the US market climbed to record levels. Chinese GDP growth is forecast at ~9% in 2021 while the US is ~3.7% and though headwinds including a tougher stance from China's regulators and poor relations with the US are likely to persist, the lower valuation and high growth continue to be appealing.

The Canadian $ is trading at the high end of its 5-year range at US$0.79 which continues to make new US$ exposure attractive.

Our outlook for the fixed income markets points to much more modest gains in 2021, if any, compared to 2020 where declining interest rates resulted in 7-8% returns for the investment grade bond markets in 2020. With 5 & 10-year bond yields beginning to rise in both the US and Canada, gains in the bond markets may be hard to come by. Keeping maturities short will dampen any price declines due to rising yields; however short-term bonds do not provide the same hedging offset of long-term bonds if the economy were to weaken and interest rates declined. Conversely, we expect the preferred share market to continue its rebound which began in mid 2020 as interest rates started to stabilize. We will comment in greater detail on the pref market in subsequent commentary but note that rising bond yields are positive for the pref market, particularly the rate reset market which have been the hardest hit market in 2020. We recommend maintaining an allocation to bonds but keeping the average maturities short and supplementing it with an allocation to high quality preferred shares.

Gold performed strongly in the first half of 2020 and hovered around the $1,800 level since, though up 23% in C$ in 2020. We continue to hold gold and gold equities as an uncorrelated asset class, one that proved out in 2020 and may continue to get a lift with the massive government stimulus programs propping up the economy. With central banks vowing to keep interest rates low, government debt rising to record levels globally and the US dollar weakening in the back half of 2020 we see continued strong rationale for holding gold and gold equities.

Canadian Equity Markets

The Canadian market was hit hard during the pandemic with the Energy sector down 31%, Telecoms down 8% the Financial sector down 3% in 2020. Valuations in the Canadian markets looking ahead to 2021 and 2022 are in the normal range with an estimated p/e of 17x's based on 2021 earnings estimates. This includes the fact that Shopify which is now the most influential weighting at 8.3% of the index, is trading at a 250x's 2021 p/e multiple. As can be seen in the below schedule most major Canadian names reflect reasonable valuations based on 2021 and 2022 earnings estimates**.** Considering a full recovery in earnings will not appear until 2022, we do not see the Canadian market as overvalued.

We recommend a full allocation to Canadian equities, although we have not invested in Shopify, opting for the large US Techs, as our Tech names to be included in our models. Note that the high dividend paying Canadian Banks, Life Insurance, Pipeline and Utility names are showing reasonable p/e's on a forward basis and should be able to recover their earnings growth as the pandemic subsides. While some short term gains could be achieved in Oil & Gas names for investors looking for a trade, in our model Portfolio we only include energy names; TC Energy (NA's largest gas pipeline network) and Brookfield Renewable comprising of hydro, wind and solar power operations.

US Equity Markets:

Much has and continues to been written on the concern of the high valuations seen in the US equity markets. The forward p/e (i.e. the current market price/2021 earnings estimates) is 23x's which is near an all time record and well above the 16 – 17x's average levels seen historically. While we share the concern of high valuations we note that the Tech sector (including the Tech like names of Google, Tesla and Amazon) which now account for over 40% of the S&P 500 index are skewing the average multiple given their high weighting and lofty 2021 p/e's of 26x's for Facebook to 381x's for Tesla. Looking at 2021 p/e's for JNJ of 17x's , JPMorgan at 14x's and Home Depot at 21x's, we note that valuations while still at the high end of the range are not overly elevated and we are able to continue to justify investment there. Given 2021 is viewed as a recovery year, assuming vaccinations arrest the spread of Covid, we would also look to 2022 estimates and see valuations of these non Tech names as in the average range.

We have held the weightings of Tech and Tech like names in our Portfolios to about 20% as we do view these high valuations as a concern but also note that the dominant names of Apple, Microsoft, Amazon and Alphabet continue to have fortress like balance sheets, some utility like characteristics, high growth outlooks and high moat market positions (difficult barriers of entry). As for the non tech names we would remain fully invested viewing the valuations as reasonable, especially looking at 2022 p/e's based on a continuing recovery into 2022.

We would continue to be invested to our target allocations in the US equity markets but with underweight positions in the Tech and Tech related dominant names and avoiding such valuation excesses as Tesla.

Portfolio Names Canada	Price	Yield	Mkt Cap	Conc. Target	EPS 2021E	EPS 2022E	EPS Growth Est.	PE 2021E	PE 2022E
BROOKFIELD ASSET MANAGEMENT INC CL A	$48.51	1.3%	73.23	66.15	1.80	2.12	8.5%	27.0	22.9
CANADIAN NATIONAL RAILWAY	$144.40	1.6%	102.70	130.52	6.33	7.10	5.9%	22.8	20.3
TC ENERGY CORP	$54.90	5.9%	51.61	69.68	2.83	3.01	3.1%	19.4	18.2
BROOKFIELD RENEWABLE PARTNERS LP	$47.20	4.6%	12.97	39.21	0.14	0.18	13.4%	*337.1*	*262.2*
FRANCO-NEVADA CORP	$159.24	0.8%	30.39	212.21	3.25	3.41	2.4%	*49.0*	*46.7*
FORTIS INC	$51.43	3.9%	23.90	59.29	2.83	3.01	3.1%	18.2	17.1
MANULIFE FINANCIAL CORP	$24.34	0.7%	47.22	24.23	3.12	3.33	3.3%	7.8	7.3
ROGERS COMMUNICATIONS INC CL B	$60.91	3.3%	23.99	67.92	3.33	3.91	8.4%	18.3	15.6
ROYAL BANK OF CANADA	$108.56	4.0%	154.44	112.53	8.73	9.41	3.8%	12.4	11.5
TORONTO DOMINION BANK	$74.61	4.2%	134.58	76.10	5.84	6.50	5.5%	12.8	11.5
Portfolio Names US and Intl	**Price**	**Yield**	**Mkt Cap**	**Conc. Target**	**2021E**	**2022E**	**EPS Growth Est.**	**2021E**	**2022E**
ALPHABET INC. (C)	$1,754.40	0.0%	578.72	1,893.33	68.29	80.94	8.9%	25.7	21.7
AMAZON.COM INC	$3,165.89	0.0%	1,588.49	3,819.30	59.17	79.96	16.2%	53.5	39.6
JOHNSON AND JOHNSON	$157.91	2.6%	415.71	167.41	8.99	9.77	4.2%	17.6	16.2
JPMORGAN CHASE & CO	$140.36	2.6%	427.85	139.29	9.61	11.01	7.0%	14.6	12.7
MASTERCARD INCORPORATED	$346.23	0.5%	342.24	370.43	8.23	10.40	12.4%	42.1	33.3
MEDTRONIC PLC	$118.74	2.0%	159.83	129.29	4.20	5.83	17.8%	28.3	20.4
NEWMONT CORPORATION	$62.05	2.6%	49.85	80.89	4.22	4.35	1.5%	14.7	14.3
UNILEVER PLC NEW ADR	$59.18	3.9%	155.52	70.00	2.55	2.69	2.7%	23.2	22.0
RAYTHEON TECHNOLOGIES CORPORATION	$70.48	2.7%	107.04	82.13	4.45	6.20	18.0%	15.8	11.4
VANGUARD INFO TECH ETF	$355.56	0.8%	41.77						
TELADOC HEALTH INC	$231.68	0.0%	33.59	245.18	- 0.50	0.57		*-463.4*	*406.5*
ISHARES MSCI CHINA ETF	$85.31	1.0%	6.88						
WALT DISNEY CO (THE)	$176.13	0.0%	318.88	180.54	2.28	6.11	63.7%	77.3	28.8

Cecil Hayhoe
Investment Advisor &
Portfolio Manager

(416) 359-5361
cecil.hayhoe@nbpcd.com

Gwyneth Pryse-Phillips
Investment Advisor &
Portfolio Manager

(416) 359-5384
gwyneth.pryse-phillips@nbpcd.com

Adeel Yusoof
Investment Representative

(416) 359-8296
adeel.yusoof@nbpcd.com

Sources: Bloomberg, JP Morgan, Thomson & BMO Nesbitt Burns research. We deliver a full complement of thoughtful, customized wealth solutions for private clients and institutions, drawing upon global resources, top ranked research and the collective wisdom of BMO Nesbitt Burns and our internal and external partners. For more information on our team we invite you to contact us.

BMO Nesbitt Burns | 2 St. Clair Ave. West | 19th Floor | Toronto, ON M4V 1L5