

Portfolio Management Monthly update

December 2020

Looking Forward to Better 2021

Economic Forecast (#s according to BMO Economic Forecast summary December 18, 2020)

2020 GDP will come in about -3.5% for the U.S., -5.7% for Canada & -7% for the Eurozone. China posted a real V shaped recovery to 2% positive growth and 8% is forecast for 2021. Chinese growth has been the driver for strong base metals and agriculture prices.

With all the lockdowns, 2021 GDP growth is going to start very slow at ½ & 1% for Q1 in Canada & the US respectively. The forecast is for growth to pick up dramatically in Q2 (10 & 7%) & Q3 (7.5 & 5%) as lockdowns ease & the vaccines are administered. 2021 GDP growth for Canada is forecast at 5%, 4.5% for the U.S. and 5.5% for Europe. The 13% rise in the Canadian dollar since the lows of March is surprising to many, given our massive deficit spending, now about 20% of GDP. What is helping Canada is our relatively strong growth rate vs other countries & rising commodity prices. However 25% of Canada's growth has come from the housing sector with homes sales up 25% and transaction prices up 13%. Hopefully growth will broaden out to become more sustainable in 2021.

The main reason for the rising Loonie has been weakness in the US dollar, which is down 9% this year vs all global currencies on a trade weighted basis. According to currency traders U.S. \$ weakness stems from the combination of high valuation after a number of strong years, poor response to the pandemic & political turmoil. **We expect short term interest rates to remain low for some time**, but longer term rates should creep up as the economy improves. BMO expects 10 year US treasuries yields to move from .9% to 1.1%. We don't expect a dramatic rate increase since even a small rise slows economic growth due to the massive debt levels accumulated during the pandemic.

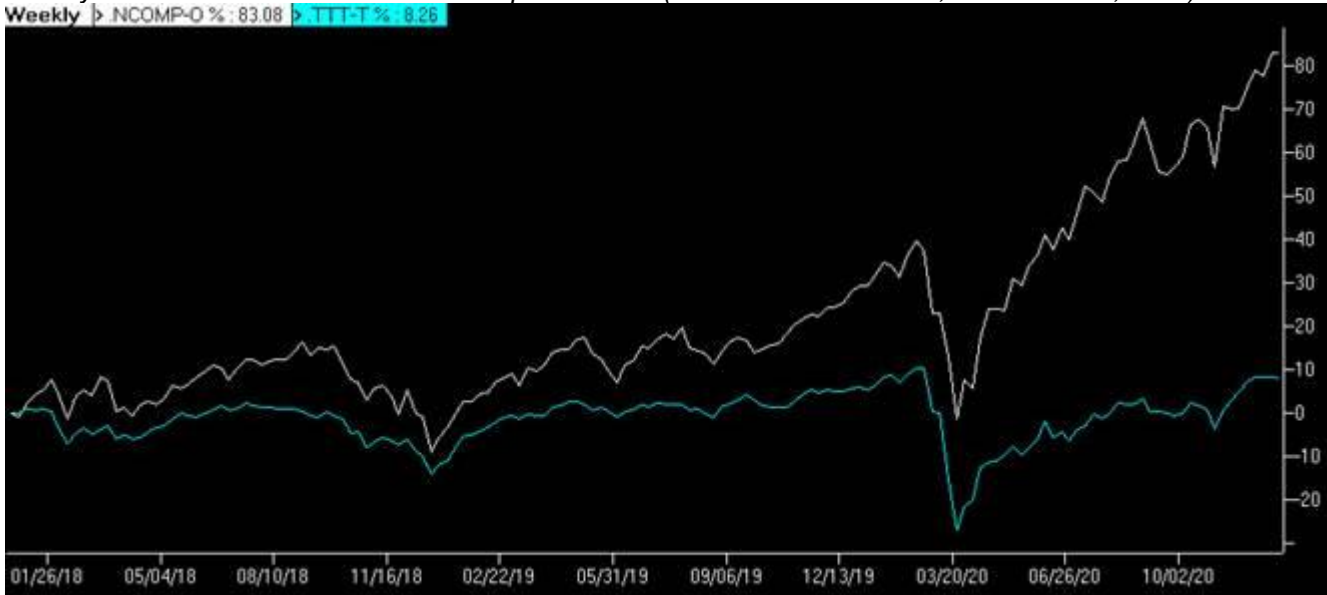
Stock Markets & Investing - Why is the stock market rising while the economy is still struggling?

Low interest rates, ample money supply and optimism about vaccines are driving the market. Current valuations are historically high, but not when the current low level of interest rates is taken into account, according to JP Morgan's 2021 outlook. 2021 is likely to see more modest stock market growth in the US, with its heavy technology exposure and better growth elsewhere as non-tech earnings recover. Economic activity has been recovering fairly quickly and some of the most visible casualties of the lockdowns small shops, health clubs & restaurants do not trade on the stock market. Most recessions are caused by money supply contracting, since that isn't currently the case, the recovery should be dramatic. The massive concentration of capital in the big cap tech/social media stocks: Amazon, Apple, Alphabet, Facebook & Microsoft is worrisome since any big pullback in these has a huge effect on stock market indices which increase volatility & fear....

In fact they have overstated market strength and a pullback in them would understate the strength of all other stocks. The oligopoly "winner take all" power of these companies allows them to generate excellent profits and growth, but has drawn very negative attention from the regulators. Moves to split some of them up might create buying opportunities both in the parts which would still be huge, great growth stocks and in other unrelated stocks which might go down in sympathy, not for fundamental reasons.

The big stock market story in 2020 was the most dramatic sector rotation we have ever seen. Most value stocks are still down on the year, while many technology stocks have tripled. Even amongst the commodities dispersion is dramatic, with gold up 20% & oil still down.

Weekly Chart NASDAQ vs. TSX S&P Composite Index (Source: Thomson One, December 22, 2020)



Covid “stay at home” beneficiaries had massive upside while shut down & cyclical sectors, such as energy, restaurants & travel were decimated.

Why technology in 2020 & what for the sector in 2021?

Technology stocks benefitted from the stay at home tailwind and the scarcity of growth in other areas. Low interest rates also helped since future earnings are discounted back at lower rates, giving higher present values. We are believers in the long term outperformance of technology since it has become a massive sector embedded & improving every facet of the economy. High valuations however, require tremendous sales & eventually earnings growth to justify. Small misses vs expectations will likely be treated more harshly since a better economy enables other alternatives for growth. This volatility will provide some excellent buying opportunities as well as testing the conviction of longer term holders.

Sectors which look good in 2021

Our chief strategist, Brian Belski favours Consumer Discretionary, Financials, Healthcare & Industrials. This is generally in agreement with the equity managers highlighted in the Dec 19 issue of Barrons. We agree with this view & add Emerging markets to the buy list. Emerging markets should benefit from a falling U.S. \$, low rates, better earnings for cyclicals and the largest discount vs U.S. stocks in years. We favour Fidelity’s Emerging markets fund which has the best track record we have found, and good sector diversification. Many emerging markets ETFs & funds are overloaded with technology stocks.

Consumer Discretionary stocks are poised to benefit from reasonable valuations, pent up demand post lockdowns & relatively low consumer debt. According to Barons (Dec 19/20) Americans have paid off \$150B of revolving debt & added \$2 Trillion to bank deposits. This coupled with rising home & stock market prices have meaningfully improved household net worth. Sadly those at the bottom rung of the economy without equities or homes [ownership](#) haven’t benefited from asset inflation brought on by low interest rates & are more likely to be out of work. Government stimulus has helped this group & more is required in Q1.

Although **U.S. housing starts** have slowed somewhat, we still like that sector.

For clients with higher risk tolerance, the travel sector airlines, hotels & cruise lines are coming back. Recent big jumps here encourage us to wait for pullbacks. Cannabis stocks also look interesting now that the purge has happened & proper management is being put in place. Biden's victory improves the odds of favourable U.S. regulation.

Industrial & transportation stocks have been surging in the recent value & cyclical rotation. We like these very much, but investors need to be selective given the recent rise.

Financial stocks are beneficiaries of a steepening yield curve, have low valuations and good dividends. After a few years of lagging, bank dividend growth should resume when regulators realize loan loss reserves are more than adequate. Digital payment companies such as PayPal & Visa are expensive but with strong growth, any pullbacks are buying opportunities.

Health care stocks are not as cheap as the other sectors highlighted but benefit from tremendous medical & technological advances. Now comprising over 17% of the S&P 500 market, this huge sector of traditional pharma, biotech, devices & orthopedics, health insurance & hospitals offers many choices. TD Health Sciences fund with a number of PHDs on staff has been a consistent out performer. Remote access companies allowing on line & home diagnostics such as glucose & heart monitors continue to be a long term growth area since they improve patient health and reduce costs. JP Morgan particularly likes these stocks, highlighting Teledoc as a top pick.

Sectors to Avoid in 2021

- Utility stocks are popular with older clients looking for income & stability. They have lagged the indices, so are generally not expensive. We believe they continue to lag given that interest rates are likely to rise somewhat next year.
- Real Estate stocks also face the head wind of somewhat higher rates, but some areas, such as Canadian Apartments have been hit hard and should rise back to historical cap rates.
- Bonds look particularly challenging next year, both in the high quality area due to rising rates and corporate bonds given historically low spreads. We have been impressed with our favourite bond managers ability to navigate these issues, but would be keeping bond allocations to a minimum.

Have a Happy Holiday season!

Best Regards,

Scott Barnum, CFA
V.P. and Portfolio Manager

Don Behan, CFA
V.P. and Portfolio Manager



BMO Wealth Management is the brand name for a business group consisting of Bank of Montreal and certain of its affiliates, including BMO Nesbitt Burns Inc., in providing wealth management products and services. © "BMO (M-bar Roundel symbol)" is a registered trade-mark of Bank of Montreal, used under licence. © "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Inc. BMO Nesbitt Burns Inc. is a wholly-owned subsidiary of Bank of Montreal. If you are already a client of BMO Nesbitt Burns, please contact your Investment Advisor for more information. The opinions, estimates and projections contained herein are those of the author as of the date hereof and are subject to change without notice and may not reflect those of BMO Nesbitt Burns Inc. ("BMO NBI"). Every effort has been made to ensure that the contents have been compiled or derived from sources believed to be reliable and contain information and opinions that are accurate and complete. Information may be available to BMO Nesbitt Burns or its affiliates that is not reflected herein. However, neither the author nor BMO NBI makes any representation or warranty, express or implied, in respect thereof, takes any responsibility for any errors or omissions which may be contained herein or accepts any liability whatsoever for any loss arising from any use of or reliance on this report or its contents. This report is not to be construed as an offer to sell or a solicitation for or an 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 will buy from or sell to customers securities of issuers mentioned herein on a principal basis. BMO NBI, its affiliates, officers, directors or employees may have a long or short position in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. BMO NBI or its affiliates may act as financial advisor and/or underwriter for the issuers mentioned herein and may receive remuneration for same. A significant lending relationship may exist between Bank of Montreal, or its affiliates, and certain of the issuers mentioned herein. BMO NBI is a wholly owned subsidiary of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Nesbitt Burns Corp.

BMO Nesbitt Burns Inc. is a Member - Canadian Investor Protection Fund. Member of the Investment Industry Regulatory Organization of Canada.