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Well! How did we get here?
As we enter the Fall and month 6 of living and working with COVID, one of the questions we're asked the most is: I don't understand why the market is up when things are so bad? What we are seeing is a disconnect between the reaction of Main St. and Wall St. to the COVID pandemic. So here is our best explanation of where things currently stand, how we got here and what to expect going forward.

A short Recap.
When COVID first hit Europe and North America in March the global markets went into literal freefall crashing over 36% in a matter of weeks. Factories, businesses and everything else grounded to a very rapid halt and in so doing caused one of the sharpest and shortest recessions ever recorded in the history of the markets. The DOW Jones Index bottomed around the 23rd of March and from there the index started to stage a sharp recovery in the days and months ahead. Many investors were bewildered as to how this could occur and continue to occur as news surrounding COVID continued to get worse. The answer to all of this is the Central Banks. The global Central Banks (Bank of Canada, US Federal Reserve, European Central Bank, etc) all stepped in and basically became the lender of last resort. They collectively did this by buying both Government and Corporate bonds, and so provided much needed liquidity instantly to the system. They continued the stimulus further by lowering interest rates to effectively zero; more on this later. The speed at which they came to the rescue was impressive indeed and the scope and breadth of their actions was such, that the stock markets of this world suddenly realised that the Central Banks would do 'whatever it takes' to stabilize the system. Basically what they said is: we are going to re-inflate all asset prices, stocks, bonds and real estate. Good credit, bad credit, no credit….no problem, we have your back.

Shortly thereafter the Federal Government relief programs kicked in and so took additional burdens off of the consumer. Delay your mortgage payment? No problem. Lost your job? Here have some money to tie you over. The market looked at this and said 'wait a moment, we have seen this scenario before back in 2008'. The recession and market meltdown of 2008 were real as the real estate market collapsed, which is the biggest store of wealth for individuals in the world. Back in 2008 -2009 the Central Banks of the world were slow to react and they did not have the tools or the expertise to implement these programs which, back then were called 'Quantitative Easing'. Central Banks eventually came to the rescue and pumped massive amounts of stimulus into the market and what ensued was one of the longest bull markets in history, until COVID hit in March of 2020.

So fast forward a couple of months. The market realizes that the Central Banks are willing to provide unlimited liquidity and the Federal Governments are going to help out the consumer and that at some time we are all going to have to go back to work in order to survive. And so the rally back begins! To put this in perspective: the US has pumped in roughly 40% of their GDP in stimulus and Canada roughly 29% of their GDP in just a few short months. These are massive amounts of money that flow back into the system and in turn boost the economy long-term.

People often forget that the market is a forward looking mechanism and is more concerned with what *will* occur in the coming months and year, than what *has* occurred, or even what *is* occurring in the present day. Throw into the mix a possible vaccine some time in 2021 and the stock markets view becomes even rosier for the post-COVID period. The market is saying corporate earnings of course will be bad in 2020 but who cares when corporate earnings are going to be even stronger in 2021! Another part of the whole paradigm is how the Central Banks lowered interest rates during this whole episode. Essentially interest rates are almost zero in North America and will most probably be actually zero in the coming years, much like the rest of this world. By lowering interest rates they provided a massive level of support for the real estate market. When you can go into the bank and get a mortgage at less than 2% why wouldn't you leverage your assets? In so doing they just created the next bull market for the real estate that is likely to run for many years to come. Bottom line is that interest rates are not going up for many years to come and I personally think they will not go up for a decade. Think about what that could do to real estate in the coming years.

In lowering interest rates they have also discouraged cash savings. So you go to your local bank branch and want to buy a GIC and they offer an interest rate of 0.6% for 1 year and 0.7% for 2 years (yup, no typo there!) In disbelief you think well maybe you can buy a Govt of Canada Bond. Well, that will pay you 1.25% for 10 years. The reality is that no retired individual can live on a return of 1% per annum as they need cash flow. Think about every pension fund in the world, every Baby Boomer coming into retirement and or in retirement, they have to have a positive return on their capital in order to live. So what occurs is that once again, the stock market is the only place that they can generate any positive or meaningful return on their investments; that and real estate and so…..back the money has to come into the stock market, back into dividend stocks, back into the stocks that have growth potential. It becomes a self-fulfilling prophecy with the money flows continuing to fuel the economy and the stock markets. And so the market rallies continue and it is my humble belief, that what you have just witnessed is the start of the next Bull Market in stocks and real estate. How long it lasts is anybody's guess but the US Federal Reserve has your back and has basically admitted that they have given up on beating inflation (because there isn't any). What they have just told you is they are not going to raise interest rates for years to come and possibly decades: Go forth and invest, go forth and leverage, borrow money, invest in your business. Woe betide the person that saves and stashes their money in the bank, as they are likely to get left behind, as their capital dwindles away unable to generate any return and after tax that return is even lower. Strange days are these in so many ways.

It is Different This Time.

We have so often been told that these are some of the most dangerous words in our industry but trust me it is different this time and so let me explain. COVID comes along and is a once in a 100 year phenomena, the last one being the Spanish Flu circa 1918 or so. Think of how different the response is today vs back then. The expertise, the funding and the technology that is being applied to finding a vaccine is unprecedented. The time to develop a marketable vaccine will be a fraction of what it normally takes and from this experience, will develop a host of new research, knowledge and technology. The differentiating factor being exactly that: **Technology**. We were all told to go home and work and guess what, we did. Business thrived and companies continued to operate and what occurred was the forced change of how we do things on a daily basis. Generally speaking, humans are highly resistant to change unless it is forced upon them or is needed to survive. COVID was the catalyst for major changes in every individual's life and in many instances there are some very positive changes that occurred. People realized what was important to them and what made them happy and going forward how they were going to pursue a new way of life and work-life balance.

Change creates innovation and with that comes great opportunity. The exact same phenomena occurred in the corporate world, as companies scrambled to figure out how to operate in a whole new paradigm. They needed to be creative, innovative and the one common theme was to invest heavily in technology in order to run their business.

Technology is something that I have spoken endlessly about in previous newsletters and COVID has once again revealed how it has become a necessity in order to operate both on a personal and a corporate basis. Those companies that had great technology in place made fairly seamless transitions when COVID hit and those that had failed to invest in technology, modernize, or innovate, failed. The list of failed retailers is long and sad however many of those companies had been failing for years, COVID just accelerated the whole process. Retailers like Wal-Mart, Amazon, Target and others prospered greatly as the massive amount that they had spent building out their e-platforms paid off in spades. Other companies that suddenly needed more help with online services, processes, software and hardware spent heavily to stay in the game. The stock markets of this world saw this process unfolding and realized that the Tech companies were growing market share and earnings and so rewarded them through moving their share prices rapidly higher. Tech has been a very clear winner through COVID and once again will emerge even stronger in the months and years to come. Those that failed in the Tech-race, will fail even further in the years to come. From this disruption will emerge new companies that are faster, more nimble, more innovative and a whole new generation of Tech savvy entrepreneurs that will lead these companies forward. It is very different this time as Tech truly is the differentiator.

Other positive aspects that have come out of the Covid pandemic, is the continued and accelerated push towards renewable energy. The CEO of British Petroleum openly speaks about 'Peak Oil' demand occurring in 2020 and has pushed BP to reduce oil and gas production by over 40% in the next 5 years as they invest heavily in building renewable energy resources. Coal fired power plants have been closing at record levels. Investment in renewable energy is booming and the Carbon Energy Industry retreats massively. Innovate or die, as they say.

One thing that COVID has taught us is that there are winners and losers in the recovery and that this recovery is not occurring in all sectors of the economy. Not every person is fortunate enough to still have a job and not every company is going to survive this disruption. This is where the 'disconnect between Main St. and Wall St.' occurs. There is still a lot of pain out there and you see it on 'Main St.' the most. The small retail stores and restaurants that will never open again are a stark reminder. A recent report from Yelp, the online booking app, predicted that 63% of restaurants would close their doors for good. Unemployment is likely to stay elevated for quite some time to come and is highly unlikely to get back to pre-COVID levels for many, many years. This is a whole other story, however Technology is a major disrupter and once again has shown that jobs can get rapidly displaced when technology innovations are applied. It is also an important reminder that unemployment is a lagging indicator and unemployment is likely to still be high long after the economy is already back to full strength, as companies continue to learn to do more with less.

The Economy vs Main St.

The difficulty with current situation is that our day to day point of reference is 'Main St' and not Macro Economics. The media reports on human interest stories and not Manufacturing Index numbers and reports, which is where we spend a large portion of our time. What we are seeing is that the global economic numbers are improving rapidly, manufacturing is back up and running at full steam and consumers are back buying.

Anecdotally go and try buy just about anything right now and you will get the same answer; 'Sorry it is on back order'. Try and go buy a car, a truck a camper, a bicycle, clothing, household goods, everything is in short supply. What this tells you is that inventory has been completely depleted and now there is the mad scramble to fire up production to meet demand and rebuild inventory. So when you look globally every factory is running hard and this is what the stock market sees. This is why when things look bleak on Main St. the stock market continues to rally as they are looking forward and seeing this massive rebound globally in manufacturing and demand.

Of course there are industries that are not in great shape: airlines, cruise ships, tourism and travel, fitness and gyms and so the list goes. Recessions are always painful and this one will be no different, however the big difference is the speed of the recovery and the continuing strength of real estate and the average consumer globally, which bodes very well for the coming year and well beyond. 'Here's some perspective on how incredibly quick the recovery in equities has been from the lows of this economic shock. Note that the deflating of the tech bubble during the early-2000s took more than seven years to earn back. The financial crisis took more than five years. And, even the 1987 crash, while similar in depth to COVID, took about two years to recover. This time, the S&P 500 undid the damage in a cool six months. Unprecedented monetary stimulus, fiscal stimulus and thriving tech have all helped.' (BMO Capital Markets Early Edition: Daily Client Note, Sept 17th, 2020.)

What we Don't Know.

The question that nobody can answer is: What about the debt?
Once again we are in a whole new paradigm of economics, where previous economic theory has been thrown out the window. We were told that when the Central Banks 'print money' we will be faced with massive inflation and a currency that is devalued. Well, that didn't happen. Central Banks said they will try and target inflation at 2%, no matter how hard they tried they could not get it any close to 2%. We were told that debt would burden the economy and future generations and yet that does not seem to be case.

Global Debt continues to climb and what the final outcome is, is anybody's guess. Putting it in perspective, debt levels have been this high before, which was post World War 2 and the period that followed was one of the most prosperous, generating massive wealth creation that resulted in the entire Baby Boom generation!

The sad reality is that if you were a saver and did not take on debt over the last 2 decades, you have been left behind and seen your net worth stagnate at best. The individuals and companies that used leverage have come out of this much further ahead sort of defies logic, but that is what declining interest rates have accomplished over the last 36 years. Yet here we are with interest rates effectively at ZERO, so it is unlikely that lower rates can provide much more stimulus in the years to come. It is also concerning that each new round of stimulus fails to generate as much GDP growth as the last one.

When and how this debt is paid back is the head scratcher and one that I have not seen any real answers for. What I do know, is that the Central Banks are going to have an impossible task of ever raising interest rates, as that would just increase the cost of servicing all that debt. Raising interest rates would be like shooting yourself in the foot. I think the basic premise is that as long as you have a stable and minimally growing GDP, then the debt load remains serviceable. What happens when states or countries GDP starts to shrink and debt loads become unsustainable, is where problems occur.

The end result is that disparity between rich and poor both as individuals and countries, is likely to widen even further in the years ahead as the availability and access to credit becomes all that more important. The disparity grows even greater between rich and poor.

It is also going to be a little tougher on retirees, as the access to vehicles that provide steady low risk income have evaporated and the stock market becomes the only way to generate retirement income. That and of course real estate, but in retirement the ability to use leverage and service debt is greatly reduced and preservation of capital becomes of far greater concern.

Some other consequences of high Government debt are likely to be higher taxation. Governments around the world are already talking about how to implement higher taxes in a whole host of different areas and some of the things that are being contemplated in Canada, are higher capital gains taxes, higher personal and corporate income taxes, a wealth tax, increasing GST and possibly changing the exemption of the Principal Residence from capital gains. At this point many of these discussions are pure speculation and we are unlikely to know more until sometime next year when the budget in Canada is released. Having said that, the reality is that Governments will be looking to recoup as much as they can in the coming years to pay for COVID measures, and taxation seems the most obvious course of action.

Bottom Line.

Recessions have a way of resetting the bar and this one has been no different though it may the shortest one in history. Coming out of recessions there is always massive disruptions, uncertainty and yet at the same time massive opportunity. The stock markets of this world have focused very squarely on the opportunity that lies ahead and captured that in higher stock prices. Not all sectors and industries though have captured the initial recovery and the 2nd leg of this will be as that rally widens out to include an ever greater group of companies as more and more of the economy recovers. This is the time factor that needs to occur and will take many months more, though the outlook for 2021 is looking increasingly positive.

Along the way we will encounter times of euphoria and fear as COVID is very far from over and something that we are likely to live with for many years to come. The stock market will react to these periods with rallies and pullbacks along the way, which is to be expected. Longer term though I believe we are in the beginnings of the next Bull Market and one that will be increasingly driven by companies that have a Technology focus as we enter into a very different decade.

In the near term we are also getting closer to the US Presidential election which is likely to generate an unprecedented amount of attention globally. I am not sure that the US has been this fractured and divided since the Civil War, sad as that may be. How the market reacts is unknown, being a forward looking vehicle it seems more concerned at present with the recovery in earnings and economies next year than elections for now. The Trump Presidential term has been characterised as being very erratic and one of great uncertainty and disruptions, all of which is generally not good for the markets, as markets do not like uncertainty. If Joe Biden comes into this election with a wide lead it is highly likely that the market will already have 'baked in' a Biden win. If however it is a close race, with an undecided result and legal challenges to the results, it is likely to lead to some market volatility in the short term. Remember however that the US Fed and every Central Bank in the world has your back and I cannot emphasize enough how much that will power the economy and markets in their recovery in the coming years, short term politics aside.

All the best from our team members.

Greg, Jed, Marion, David, Lili, Kenzy, Samantha and Tracy.

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