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Third Quarter Investment Commentary 2020

The third quarter ended on a sour note, as September lived up to its reputation of being a difficult month, slipping 3.5% to give up some gains made in the prior months. Nonetheless, the quarter finished in the black, building on the strong second quarter. Throughout the period, headlines were dominated by uncertainties about the timing of economic reopening, rising COVID-19 case counts, flaring tensions between the US and China, US social unrest and inequalities, and policy uncertainty surrounding the extension of pandemic relief benefits. However, markets managed to look past these concerns and were driven by the usual suspects: monetary and fiscal stimulus, vaccine progress/hopes, better-than-expected corporate quarterly results and economic data that surprised to the upside.

The Bank of Canada, like its US counterpart, pledged to maintain interest rates near current levels for the foreseeable future. On the fiscal side, the minority Liberal government delivered a throne speech promising to do “whatever it takes” to support Canadians through the pandemic. While much of the speech was focused on the current crisis, many of the Liberals’ policy initiatives that were announced during the 2019 election were also mentioned. The full cost of the fiscal spending will not be known until the budget, but regardless we know it’ll be a big number that will be tacked onto Canada’s already swelling debt. Credit rating Fitch already downgraded our nation’s credit rating from AAA to AA+ stable in June and reiterated that Canada's current debt-to-GDP ratios are higher than AA+ rated peers. Recognizing the ballooning deficits, the throne speech did pledge the government to fiscal sustainability once we exit the crisis. Finance Minister Christina Freeland also vowed to preserve Canada's reputation of sound fiscal management as the government considers the next steps to drive the economic recovery. If there is a silver lining here it’s that interest rates are extremely low and many spending measures are temporary; unlike the 1990s when Canada’s deficits were structural and interest payments were a significant drag on spending.

With a few concessions, the NDP supported the Liberals during the confidence vote, thus Canadians did not return to the polling stations. This may change due to the current liberal investigation. The same cannot be said for the US as November’s general election is quickly approaching. National polling data has VP Biden slightly in the lead, but the race for the White House will be closer than initially expected as Trump has picked up some ground in recent weeks. In our view, the best outcome for the market is a decisive win by either candidate, while a close election result on November 3 will create further uncertainty as ballots are recounted. If there is one thing markets dislike it is uncertainty.

The last US election that was too close to call, and ultimately was decided by the Supreme Court, was in 2000. Florida was the battle ground, a state where George W. Bush won by a slim margin over Al Gore. Given the margin, state law required a recount and resulted in a month-long legal battle which ended in a 5-4 Supreme Court ruling in favour of Bush.

There was not much variation in the measures of the “big three” (B3) (financials, energy and materials), and the “everything else” index (EE) until late in the quarter. Weakness in energy and gold stocks in September weighed on B3, giving back significant rallies in both groups from the prior months. Financials were the bright spot following the banks’ quarterly results which alleviated near-term concerns about non-performing loans and helped the sector gain 2.8%. Nonetheless, Canadian financials will need to contend with the headwind of interest rates staying lower for longer and the credit deterioration as generous government relief measures become less supportive. Within the EE index, industrials and information technology were the main drivers of return with honorable mentions going to consumer staples and utilities.

Looking at the breadth of the market it suggests continued strength can be found in the materials, technology, industrials and consumer staples as these sector have more than 50% of issues trading above their 200-day MA. While both materials and technology have experienced some near-term consolidation, the long-term drivers remain. For the materials sector, base metals and forestry stocks will continue to benefit from the reflation trade, while precious metals benefit from an environment of negative real rates. As for technology, which had become extremely overextended and was due for some profit taking, the greater adoption of technology during the pandemic has accelerated to present day many trends that were three to five years in the future. Even as we move past the pandemic, the accelerated adoption of technologies in our daily lives will support those companies.

From a historical perspective, we’re entered the strongest seasonal trend for the market, as Q4 and Q1 show the greatest number of positive quarterly returns as well as the best combined average return. This year has produced many records and Q3 was no different. History suggests Q3 should have given back some of the gains from Q2, but that clearly did not occur. As for the next quarter, the history books suggest the S&P/TSX will finish the year on a high note but, as this is a US election year, the pattern may deviate. Historically, markets tend to weaken heading into the presidential election and once a clear winner is identified, they begin to rally. This cycle will likely be prolonged due to the significant number of mail-in ballots that will need to be counted (in some states, mail-in ballots cannot even be opened prior to

election night) and the potential for a contested election. Without a decisive win by either candidate on November 3, the likelihood of a delayed election result is a high probability and will cause prolonged uncertainty for the markets. History does demonstrate however that no matter which party wins over the medium to long term positive performance ensues.

The Canadian dividend model underperformed the market due to its REIT and pipeline exposure. These securities while off their lows provide excellent cash flow. The model is currently comprised of good quality dividend stocks including industrials with some exposure to gold. Detractors to performance for the quarter were; Pembina, Enbridge, Brookfield

Asset Management , Nutrien and Royal Bank while the contributors were ; Alimentation Couche -Tard, Wheaton Precious Metals, Waste connections, Franco Nevada and Jamieson wellness.

The performance for our Canadian dividend model was -6.5% YTD versus -5.5% for the benchmark (S&P/TSX) and -5% YOY versus -3% for the benchmark. The performance for our 30/70 asset mix model was 1.4% YTD versus -0.88% for the benchmark and 5.5% YOY versus 3% for the benchmark.   This outperformance was due to its global exposure some of which is invested in technology and due to a recovery that was experienced in the fixed income allocation.

We expect the dividend stocks, which have generally underperformed the broad market will eventually move up due to the very low interest rates which will most likely be the case for some time.

We can expect the headlines to be dominated by the election outcome and the virus. We will be monitoring the markets for opportunities which may result from the volatility and uncertainty as we expect the markets to recover from a correction if one is experienced.

We are always here to discuss any concerns or questions you may have please do not hesitate to contact any one of us. Keep safe and keep well.

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