QUARTERLY COMMENTARY

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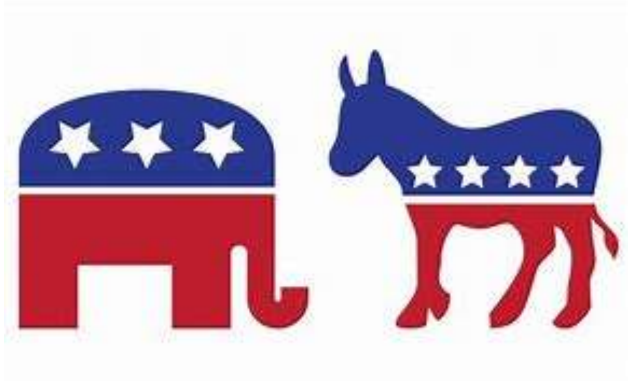
Happy New Year?

"May you live in interesting times" is an English expression that is claimed to be a translation of a traditional Chinese curse. No matter what it's origination it aptly describes what we've all experienced in 2020 and the first few weeks of 2021. I simply do not have the words to express my shock and consternation for the events that occurred on January 6th in the U.S. Capitol. A building that is a beacon of democracy and a wonderful attraction for tourists and history buffs has now turned into a fortress. It as well as many other US state capitol buildings are now surrounded by an army of soldiers sent in to protect them from any possible additional riots during Biden's inauguration. This is truly an historic moment – one which I hope we'll never have to live through again, although there are those who say that this is only the beginning of something that our neighbour to the south will have to endure. I believe the only way to fight such a populist movement is major political reform in the U.S. as well as changes in how social apps generate information. The schism in American society, magnified by a manipulative social media is not a rift that will be mended any time soon. I do believe though that better times lay ahead but it's not going to happen overnight. That being said, how will this affect our investing and equity markets?

Historically, wartime has actually been a boon for equity markets – and we have been on a wartime footing for some time – against a virus and now a populist movement in the U.S. and elsewhere. What it comes down to is the fantastic amount of liquidity and fiscal stimulus that governments around the world have pumped out to protect society and keep economies functioning. With mass vaccinations now rolling out, it's expected that life will return to be more (although not totally) normal and major economies will rebound strongly in the second half of 2021. Leading economic indicators which show where things are going are forecasting an end to the recession – and since markets look through current economic data (which is rather poor) to what lies ahead, the markets continue to rebound nicely. Investors are shocked that the US equity markets were up 15% in 2020 and even that the Canadian markets were up 2% on the year. Markets can be



irrational in the short term but in the long term it's the fundamentals like earnings growth and dividend growth that share prices follow. The Canadian market is only just now recovering to a level that reflects a more normal valuation. It compares quite favourably to other markets like the NASDAQ which is arguably very expensive. I must say though when you compare today's high tech stock prices to those during the "tech wreck" of 2000, it's a completely different story. Back then, practically all of the new tech companies had little in the way of earnings or even revenue growth – they were just starting out and the excitement about their potential was palpable. Buying into markets that are experiencing the highest valuations when the fundamentals just aren't there results in a long term expected return of only 1%. That was experienced by investors who bought in 2000 – ten years later they were barely breaking even.

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Today's high tech companies though are very strong in that most of them generate very high cash flows as well as strong earnings. This may be one of those times when earnings grow into these companies' elevated valuations. It's always important to be aware of valuations when investing in anything. If we get a full recovery back to where we were in 2019, and the recent earnings recovery of around 35% sticks, equities are not that overvalued. Overall, Canadian equities offer very reasonable valuations and an attractive yield.

Our more cyclical stock market should continue to perform quite well with an earnings recovery. High yield corporate bonds, emerging markets and commodities should also remain strong while long duration bonds and the US dollar will most likely underperform. The reason I think that longer maturing bonds will not do well is because there is some indication that inflation is actually starting to show itself again. Interest rates have been up and down in the U.S. in the longer end of the yield curve. With Biden pushing for a higher minimum wage and employment potentially picking up later in the year we could see a return of higher long term rates both in the U.S. and here in Canada.

So why did Canadian equities underperform in 2020 when compared to the US? We don't have anything close to the number of large growth companies such as the technology stocks that are a big component of the US markets. We have more cyclical and value type equities. The current period of underperformance of value stocks (any company trading at below their intrinsic value that typically pays a solid dividend) is the longest in history and buying low always increases the chances of good returns. Over time the value style of investing outperforms growth, and 95% of the time when there is this much of a discrepancy, it outperforms by a wide margin in the subsequent 12 months. Since its very challenging to time markets though,





it makes sense to invest in some great growth companies for the long term as well.

As you know, I'm no Pollyanna and I recognize what a mess things are right now – but I think that there is light at the end of the tunnel. Thank you for your continued trust and confidence. Should you have any questions or concerns at any time or if you would like to have a detailed discussion of your personal portfolio please do not hesitate to let me know.

Sincerely,

Richard