QUARTERLY COMMENTARY

Richard Liss, CFP, CIM®, FCSI®
Portfolio Manager &
Vice President, PCG
richard.liss@raymondjames.ca

Amy Ong
Financial Advisor Assistant
(416) 777-7076
amy.ong@raymondjames.ca

Raymond James Ltd.
Scotia Plaza - Suite 5300, 40 King Street West, Toronto, ON M5H 3Y2
Phone: (416) 777-7041
Fax: (416) 777-7020
www.raymondjames.ca/richardliss

Time For A Breather

Struggling with stress for long periods can drain your physical, emotional, and mental resources to the point where your body no longer has strength to fight it. That may be the condition that the stock markets are in right now. After having staged a very strong and impressive rally, they may have to take a breath and reassess. The way people respond to stress is often referred to medically as general adaptation syndrome (GAS). The theory, created by Dr. Hans Selye, typically follows a three-stage process that describes the physiological changes the body goes through when under stress – alarm, resistance and exhaustion. Alarm is the initial phase that results in a panicked, fight-or-flight response, the resistance phase is when our bodies adapt and learn to cope. This then leads to the exhaustion stage if we remain in the elevated stress level for too long.

If the market is indeed exhibiting general adaptation syndrome, then I would argue we're about to move into the third phase. And even though the market may experience 'exhaustion', I believe that this phase will involve a slow recovery of the global economy. One reason to expect a market breather is because the uncertainty is too great over the next 12 months – a potential COVID-19 second wave, renewed trade tensions between China and the United States, and the U.S. election. That's a lot for the market to focus on and we've already had quite a big lift. After massive injections of liquidity into the markets by the Federal Reserve in March, the stock market managed to stop its free-fall and rally. Expectations of a rebounding economy ensued and the economy started to show signs of improvement. The Nasdaq has rallied to all-time highs and the S&P 500 has rallied to levels not too far from the start of the year. Meanwhile, the Canadian and International markets

QUARTERLY COMMENTARY

have lagged behind. After a self-imposed lock-down the economy has been re-opening and some economic numbers are showing signs of improvement. In North America, economic improvement has been much slower than the rallying stock market performance. That is because the stock market is a forward-looking mechanism - it looks out six to nine months. As a result, a better performing stock market is a natural occurring event when the economy is bouncing off a bottom. And as previously discussed the Federal Reserve's loose monetary policy is providing funds to drive the stock market higher. At some point however, either the economy must grow at a faster rate or the stock market must slow its acceleration.

Over the past two months, indicators from consumer confidence to retail sales, business surveys and industrial orders suggest modest improvements off the bottom readings registered in April when the most stringent lockdown measures were in effect. The better economic data is most apparent in Asia, particularly in China. Yes, China's economy is growing again. The world's second largest economy grew 3.2% in the April-to-June period compared to one year ago. This was better than the 2.5% growth forecasted by analysts. The rebound is significant since China is where the outbreak originated and it was also the first major economy to reopen. Industrial output was a bright spot, growing 4.8% in June, which is its fastest pace this year. Manufacturing in high tech sectors was solid and overall investment was better than expected. A return to growth in China is welcome news and hopefully will foreshadow what lies ahead for the rest of the world. Of course Chinese stocks have performed well too as they were helped by improving confidence in China's ability to control COVID-19. This not only increases confidence in China's ability to control a second wave, but it suggests China could execute a relatively robust economic recovery.

QUARTERLY COMMENTARY

It is a totally different story regarding the contagion in the United States – we all see the troublesome statistics every day and I won't belabour them here but the US is in big trouble. There is growing concern about the Americans inability to control the spread of COVID-19. It's so sad that just as everything else is politicized there, so too has the issue of wearing masks and social distancing. The disturbing health statistics are responsible for the significant divergence we have seen recently in U.S. stock market performance, with tech stocks dramatically outpacing other parts of the market. Investors are now expecting a slow and uneven recovery in the U.S., and that continues to drive investors to larger-cap, secular growth stocks which have historically outperformed in such environments.

In terms of the economic statistics the bounce has been encouraging. Industrial production in the United States rose 5.4% in June, after a gain of 1.4% in May. Wall Street economists were expecting a gain of 4.1%, so industrial production is improving a little better than expected. Retail sales have also surprised to the upside with June retail sales rising 7.5% in the month of June. That was on top of the 18.2% jump in May and was ahead of consensus estimates which had forecasted retail sales growth of 5% in June. If any sector of the U.S. economy has made a true V-shaped recovery, home-building would receive the honour. The latest survey of the National Association of Home Builders shows that the conditions are almost back to the highs of the last few years and home buying demand was 25% above pre-pandemic levels in early June. A strong recovery in the housing sector is a welcome development for the US economy given housing's ability to spur economic growth through the multiplier effect.

Two things are necessary for this economic recovery to be able to continue in the US and thus provide stability to the markets: 1) the U.S.'s ability to control the spread of the virus (making face masks ubiquitous will be critical in achieving this) and 2) more fiscal stimulus from the government, especially for parts of the economy hard hit by the virus. Achieving this could happen this month as Congress contemplates more fiscal spending. I will be following both closely.

This pandemic continues to have paused the economy but it has accelerated the transition into the future. Trends in place before have accelerated during this time ie: digital transformation of enterprises, the shift to e-commerce, the digital transformation of health care and wearables. A lot of longer term growth trends pre-pandemic have expanded tremendously because of it - the way we shop and entertain ourselves is undergoing a permanent shift to online consumption (e-commerce and online gaming). Additionally, the new 5G networks that are being rolled out will allow for enormous benefits and impact growth rates in automation and healthcare technologies.

In any kind of market there are always opportunities to take advantage of and investors are gradually accepting that there is a new “normal” that may stay in place for longer than we anticipate.

If you have any questions about your portfolio or any changes you would like to discuss, please don’t hesitate to contact my office at any time.

Sincerely,

Richard