Quarterly Commentary

Craig Fairborn | February 2021

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2020: Q4 Market Commentary

Happy New Year! We hope this newsletter finds you and your family safe and well. Odlum Brown's plan for returning to the office in the wake of COVID-19 will continue to be gradual and conservative to ensure the safety of our clients and our team members. We are still working from both our Chilliwack and Langley locations at a reduced capacity, as well as from our home offices.

2020 was a year for the record books on many levels, and we hope 2021 will bring prosperity and more cheer for all. As we continue the battle against COVID-19, we must be mindful that much work still needs to be done. As expected, when the normal cold and flu season arrived, we saw an increase in COVID-19 cases across much of the developed world due to people spending more time indoors. As a result, various safety measures have been put in place, ranging from new public health orders on social gatherings to strict lockdowns in some parts of the world, in an attempt to slow the spread of this virus.

The good news is that within Canada, these efforts have started to bear fruit, and cases have slowly fallen, or at least plateaued, for the past few weeks. Meanwhile, the news on the vaccine front remains encouraging, and our most vulnerable residents have already started to receive their inoculations. In the coming months, more vaccines will likely receive approval across the globe and existing stockpiles will increase, which will provide much-needed aid worldwide. Hopefully by this fall, we will start to see the tide turn definitively to our advantage. In the meantime, we must remain disciplined in our social distancing efforts, use common sense and continue to wash our hands and wear a mask as we attempt to limit the broader impact of the virus within our communities.

The historical record of pandemics provides a stark reminder that Mother Nature can bring home some heavy lessons from time to time. As we slowly put this difficult year behind us, the question remains, "What will we have learned?" This pandemic has not only had a substantial impact on the global economy, but it has also affected our politics, culture, education, healthcare, media, and science and technology, just to name just a few. Perhaps the greatest lesson, or reminder, is humanity's interdependence on each other in an ever-changing world.

2021 offers a renewed optimism that we may expect a rebound of the global economy – and of life in general. The rapid development and distribution of COVID-19 vaccines has been nothing short of extraordinary and should allow daily life and the global economy to move from hurting to healing in the year ahead.

As with most patient care, we can expect some setbacks in our economic recovery, but with the right regimen, we will continue on the right path. This will require some patience, hard work and a little good fortune along the way. 2020 created a tremendous amount of upheaval and challenged many widely held rigid assumptions (both good and bad). This brought to the forefront the importance of being flexible and balanced in one's approach in order to meet this ambiguity. This dynamic will likely stay with us for a while, as a fair amount of economic uncertainty remains while the course of the virus continues to be the main determinant of how things will progress.

Early Days of COVID-19: Dazed and Confused

While I write this newsletter, I'm reflecting on the fact that it was only a year ago when we witnessed the first confirmed cases of COVID-19 within our borders. Like any newly born pathogen, much was unknown in early 2020 about the disease in terms of how it spread, the range of symptoms or the mortality rate. The initial reports from China were limited, with a high degree of secrecy surrounding what information was released. In addition, the international panic level skyrocketed due to social media and viral videos of overrun hospitals and posts about widespread fear and panic throughout China. It wasn't until late January when the mainstream media began to warn about the possibility of this becoming a global concern and the potential implications for the global populace.

Within the U.S., the Trump administration continued to downplay the significance of the virus, while global health authorities quietly discussed strategies on how to mitigate its spread, including the use of stringent lockdowns in countries around the world. At the height of the initial panic, societal functioning began to fray as supply channels were overrun and grocery store shelves were emptied almost overnight of basic necessities; ammunition sales increased; and other harmful and anti-social behaviour took hold.

At this point, we really don't need to revisit all of the details, since we all lived through it. Fortunately, some of the most severe concerns at the initial stages of the pandemic did not come to pass and the world has slowly migrated toward a more coherent strategy to fight the disease as we learn more about it.

Within our business, 2020 proved to be one of the most intense years for investors in the last 100 years. In fact, U.S. investors witnessed the fastest and steepest drop on record when the S&P 500 Index went from an all-time high on February 19 to its low on March 23 – a 34% bear market decline. As credit markets began to seize up in March, the authorities really had to dig deep to wrestle the panic down. As of writing, the size of the U.S. and European stimulus (both monetary and fiscal stimulus) totals roughly 50% of their respective Gross Domestic Product (GDP), while Japan's equates to about 75% of their GDP. In some cases, this is over three times the size of the stimulus launched during the Great Financial Crisis of 2008.

Given all of this, it is amazing how some investors and media pundits continue to operate with a high degree of hindsight bias, as if they know how this chapter of history will ultimately play out. Social psychology has been a fascinating thing to watch over the past year.

Based on our current economic charts, the global economy is recovering, but the pace of the recovery and its durability as 2021 progresses remain big unknowns for investors. Clearly, investors are betting on an end to the earnings recession as the vaccines are deployed globally. In addition, investors seem to be discounting a better political environment following the U.S. election and hopefully an end to the political chaos that has gripped the lives of Americans for many months.

At this point, the COVID-19 pandemic continues to cause tremendous human and economic suffering across the world. While vaccines do provide a light at the end of the tunnel, the path of the global economy will still depend significantly on the course of the virus. Any unforeseen delay or other impediment to the vaccine rollout or efficacy would generate significant risks for the outlook.

Market Performance this Quarter

After a relatively modest snapback in Q3, financial markets experienced a flurry of activity in the fourth quarter of 2020 following the results of the heavily contested U.S. election and positive developments on the vaccine front. The S&P/TSX Composite Index returned 9.0% for the quarter. Cyclical stocks, like energy and mining, led the way on hopes for increased demand if the global economy begins to normalize in the latter part of 2021. A renewed interest in marijuana stocks after the Biden victory also helped the overall performance for our index. Overall, the S&P/TSX Composite Index managed to squeeze out a 5.6% total return for the year.

Meanwhile in the United States, the S&P 500 Index registered a gain of 12.1% in Canadian dollar terms for the quarter. Once the vaccine news was released, we witnessed a tremendous change in leadership within the market, as the stay-at-home stocks registered mainly flat performance, while more economically sensitive names benefited. Value stocks also saw a huge resurgence following a very difficult period of several years. It was another important reminder about the importance of diversification within the various sectors of the market. Given the weightings of the bigger tech titans in the Index, the S&P 500 managed to return 16.5% in Canadian dollar terms in 2020.

Bonds were once again essentially flat for the quarter, with the FTSE TMX Canada Bond Universe adding 0.63%. However, returns from high-quality bonds proved to be quite strong on the year, as the index returned 8.69% with interest rates cratering and investors fleeing for safety. As expected, positive vaccine news coupled with more expected fiscal stimulus from a Biden administration fueled a selloff at the longer end of the bond curve, as investors worry about some uptick in inflation due to better growth potential.

The vigorous debate about the future path of inflation also continues to intensify based on the growing state of government finances and the huge monetary stimulus that we have witnessed. Given some logistical pressures and strong demand, pockets of the economy are seeing pricing pressure, including food prices, lumber prices and the value of land, as people re-evaluate their living arrangements and their diet while stuck at home more often. While transitory inflation is a current reality, the overall disinflationary effects on an aging demographic, debt overhang and technological disruption remain structural issues that should not be ignored.

Stay Optimistic

According to the International Monetary Fund (IMF), it is estimated that the global economy contracted 3.5% in 2020. This is an improvement from its earlier predictions back in the fall of 4.4%. Nonetheless, this is the worst performance for the global economy since the Great Depression of the 1930s. On a geographical level, China was the only major country to witness positive growth (of 2.3%), while the U.S. economy contracted 3.5% for its worst performance since 1946. The worst outcome was for the U.K., where forecasts expect a total contraction of 11.3% for their economy in 2020.

However, the IMF expects global growth to recover by 5.5% this year on hopes for increasing vaccinations and additional improved therapies to combat COVID-19. While the outlook for Canada was slashed to growth of 3.6% for this year, our economy has proven more resilient than many anticipated at the start of the pandemic.

Overall, the deep scarring of the economy will eventually heal as the output gap is closed. In the meantime, we can expect the developed economies of the world to support their citizens to some extent until normal activity is realized. One of the mistakes of the Great Depression was to allow the tax base to erode further, which only resulted in a longer recovery in the economy due to the economic scarring to the tax base.

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The unemployment rate in Canada finished the year at 8.6%, down from the peak level of 13.7% in May 2020. Given new public health restrictions announced in some provinces in December, Canada witnessed its first increase in unemployment since April, with the economy shedding 63,000 jobs. Meanwhile, the U.S. unemployment rate finished the year at 6.7%, down from its peak of 14.8% back in April, but still well above the 3.5% of a year ago. Slowly, employment has continued to heal, with hopefully even better news ahead as the year progresses.

Ultimately, while some industries are currently facing existential threats to their businesses, we do expect a release of pent-up demand to take hold when public health measures are lessened, hopefully later this year and into 2022. This is somewhat reminiscent of the booms shortly after the 1918 Spanish Flu and the end of the First World War. Indeed, the power of YOLO ("You only live once") will be an interesting phenomenon to witness, as people shift how they choose to spend their time and money, given a new appreciation for life and general sense of happiness once the pandemic draws to an end.

New U.S. President

As if the world didn't have enough uncertainty in 2020, the recent U.S. election and its aftermath became one of the most contentious events in modern political history. President Biden has a tremendous amount on his plate, from the poor management of the pandemic under the Trump administration, to the recovery of the broader U.S. economy, re-establishing ties with U.S. allies on the world stage and combating a growing sense of mistrust amongst the populace towards government, science and the media – all amidst growing economic inequality.

Some of these issues have echoes from the past in American history, but economic prosperity will eventually return, and hopefully, we will witness a more bipartisan approach to solve some of them. A strong and stable United States can have a calming influence on world affairs, so we will have to wait and see what kind of policies come out of Washington in the coming months.

Planning Ahead

As mentioned, the economic outlook continues to operate with a fair amount of uncertainty; however, the timeline for recovery appears to be quickening thanks to the expected pace of vaccinations. We will continue to advocate for patience, flexibility and an adherence to a balanced outlook.

COVID-19 was a black swan event that has provided a fair number of twists and turns over the past year. This pandemic has also driven home the reality that crises do happen from time to time and the importance of having high-quality stocks and an appropriate amount of fixed income/cash to meet your risk tolerance and investment goals. While we are optimistic about getting to the other side, investors should remain disciplined, diversified and opportunistic with regard to rebalancing their portfolios.

Given our current dynamic, investors will also need to continue to balance the tradeoffs in portfolio construction from record-low interest rates. The expected returns from bonds and cash for the foreseeable future will likely be below historical averages. Some of this decision making can entail some serious thought, but investing is always about tradeoffs.

In the meantime, if you have any questions or concerns about your investments, I am always here to help. Please feel free to contact me at **(604) 858-2455** or toll-free at **1-800-663-5251**. Stay well, and remember to continue helping those most in need in our community during this difficult time.

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