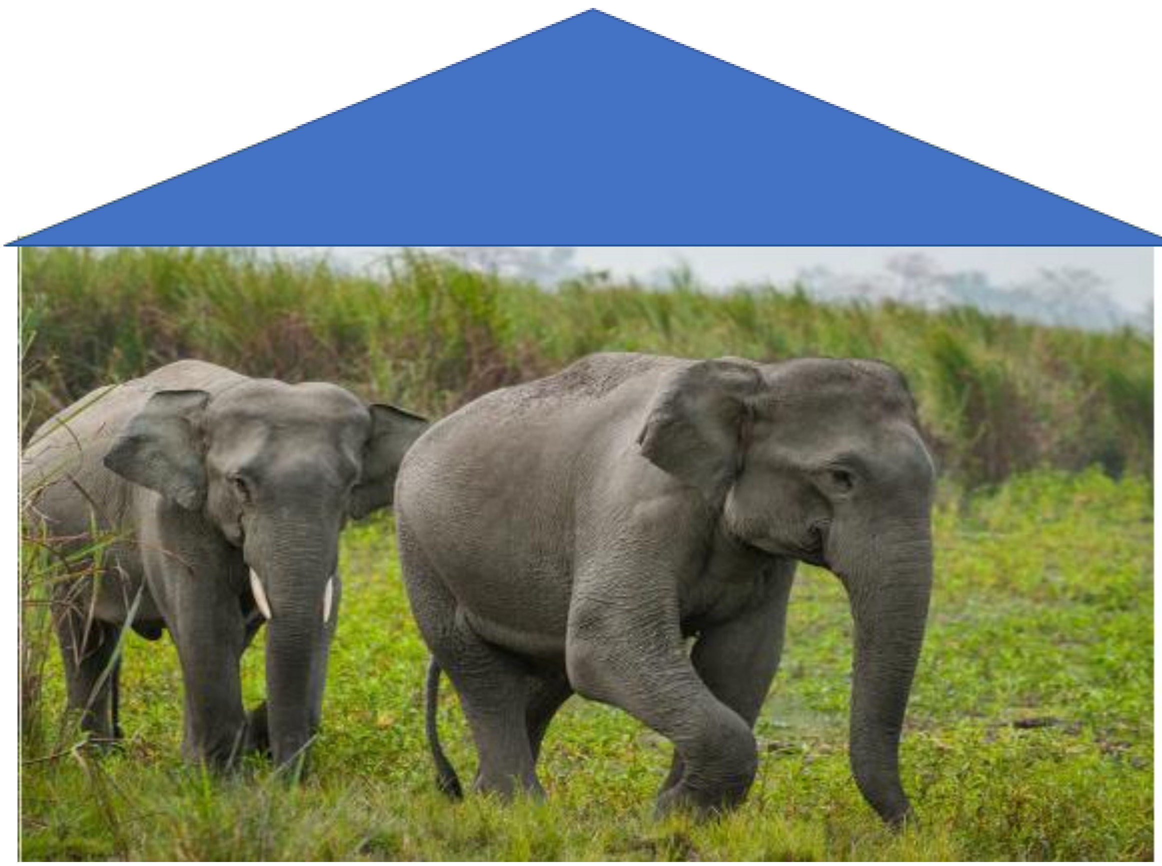
# THE ELEPHANTS IN THE ROOM

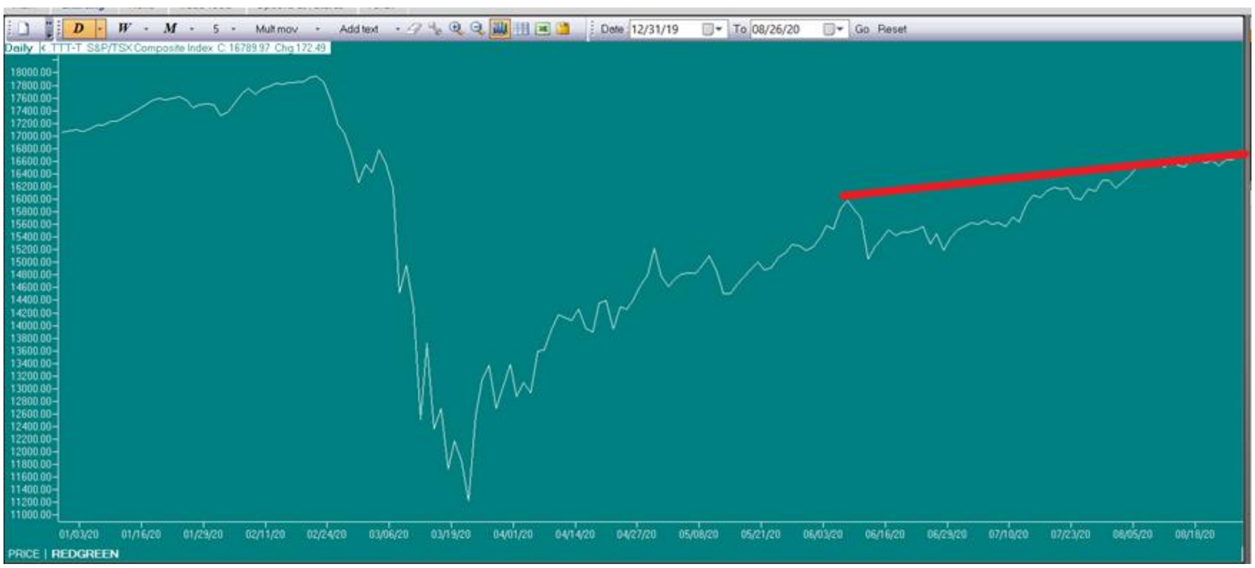


*Original*

*Source: Google Images*

**We have been taking comfort over the summer watching the financial markets recover from the pandemic driven March decline during which the TSX experienced a -39.2% drop** ***(Thomson Reuters)*****. This, together with a slower new normal life style and nice summer weather, has relaxed anxieties and fostered an impression the financial risk is over. However, in reality, the market remains guarded about prevailing conditions and has, in fact, been largely moving "sideways" over the summer, with incremental improvements created by smaller volumes of activity, indicating the absence of a robust upward trend.**

**TSX Dec 31/19 – Aug 26/20**




***Source: Thomson Reuters***

**We've talked in recent newsletters about why the markets returned some of the lost value post March based on expectation of future economic improvement. The market always looks forward and pays for future potential returns. That is what defines stock price-earnings multiples.**

**However, two outstanding issues continue to represent a significant risk to fuller recovery between now and the future sometime in 2021:**

- **The development and introduction of a safe vaccine for the Covid-19 virus is still considered several months away. Thereafter, a factor in the reduction of the virus risk will be acceptance by the public in taking the vaccine. Until then, normal economic activity remains interrupted.**

- The outcome of the US Presidential election in November will be a factor in terms of how quickly and how widespread economic recovery will occur. There are concerns about the possibility of the outcome being challenged as well as policies emerging from the next Administration which could affect global trade and geo-political stability.

They are the elephants in the room which the average investor has largely become acclimatized to but which the market practitioner is monitoring closely for resolution and timing. There a numerous signs recovery is not on track for a straight up "V" shaped performance:

➢ US dollar vs Gold

The US dollar remains the global currency and is typically held as a safe haven during periods of geo-political risk. However, as indicated by the green line below, the US dollar has been declining in value since the outset of the pandemic. This is indicative of market concerns about the ability of the country to deal with prevailing issues effectively at this time.

By comparison demand has grown for Gold as a safe haven in place of the US dollar.

However, it is important to expect that, as Gold is acting as a hedge against current circumstances and, as economic conditions eventually improve, this relationship will reverse itself.

*Source: Thomson Reuters*

- **Low Trading Volumes and Cash Reserves**

  **While some reduction in trading activity post-March can be attributed to summer seasonality, the trend has been toward "risk-off" which is maintaining substantial cash and near cash reserves at this time, pending the resolution of the "elephant" issues.**


*Source: Thomson Reuters*

- **Select Areas of Recovery**

  **The persistent sense of unresolved issues continues to favour those business sectors perceived to be pandemic-resistant which have driven much of the recovery through the summer. These are services we've already identified in recent newsletters which are either "essential" or are aiding the consumer's ability to cope with the new normal conditions. These include e-commerce, transportation, select I.T., power generation, healthcare or Gold as a hedge. Otherwise, other mainstream business sectors continue to show measured improvement fuelled in part by historically low interest rates although they continue to be muted by higher unemployment levels.**

***The following takeaways from the previous newsletter continue to be valid:***

## WHAT'S THE TAKEAWAY FOR NOW?

- **It has become apparent that an eventual vaccine or treatment is not around the corner. There is a sufficient medical consensus that we will have to live with the virus as a recurrent social condition best checked by vigorous social practices in the meantime.**
- **The financial markets are not waiting for the "magic pill" and are rewarding areas of growth least impacted by the pandemic while penalizing those industries most likely to continue to be affected.**
- **We should expect the drag on economies to maintain a recessionary environment for the near term. The contraction in GDP has slowed but the pace of recovery may result in further declines in quarterly GDP through 2020.**
- **A consequence of the weakness in the affected industries will be persistent higher unemployment.**
- **A characteristic of the market recovery will be on-going volatility.**
- **Market activity should include a focus on more pandemic resistant sectors including power generation, healthcare and commercial transportation. Within all sectors seek out best in class survivors even amongst challenged sectors.**
- **Maintain selective diversification and including alternative forms of returns.**
- **Become accustomed to maintaining a continuous and active defensive reserve.**
- **Anticipate a change in the financial environment starting 2021 post vaccine and U.S. Presidential elections.**

***BUT . . . . . . .***

***ONCE THE ELEPHANTS LEAVE THE ROOM:***

- **WE SHOULD ANTICIPATE A BROADER RECOVERY IN 2021 PARTICULARLY IN AREAS CURRENTLY OVERSOLD AND UNDERVALUED. THIS INCLUDES U.S. ASSETS AND CONSIDERATION SHOULD BE GIVEN TO PURCHASING $U.S. DURING THE CURRENT WEAK CURRENCY CYCLE.**

- **WE SHOULD CONSIDER SYSTEMATICALLY CONSOLIDATING SOME OF THE WEAKER SECTORS WHICH HAVE BEEN VICTIMS OF PANDEMIC ANXIETY BUT WHICH CONTINUE TO SUSTAIN ACTIVE BUSINESS OPERATIONS.**

***Regards***

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