Ryan Chook

From: Ermes Monaco
Sent: Wednesday, September 29, 2021 2:10 PM
To: Ryan Chook
Subject: FW: VALUED CLIENT MAIL LIST: Economic Outlook - Spring 2021

Importance: High

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From: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Sent: May 24, 2021 9:31 AM
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Source: Google Images

LANDING IN THE FOG

I had an intriguing conversation recently with a commercial airline pilot who asked me a series of questions about the financial markets. He asked several questions in a manner which indicated to me he was approaching the topic as he might when having to land an aircraft in the fog. In this situation I expect the pilot would need to gather and distill a wide range of information into a single assessment whether to "go or no go". In the process, a Plan B would also emerge.

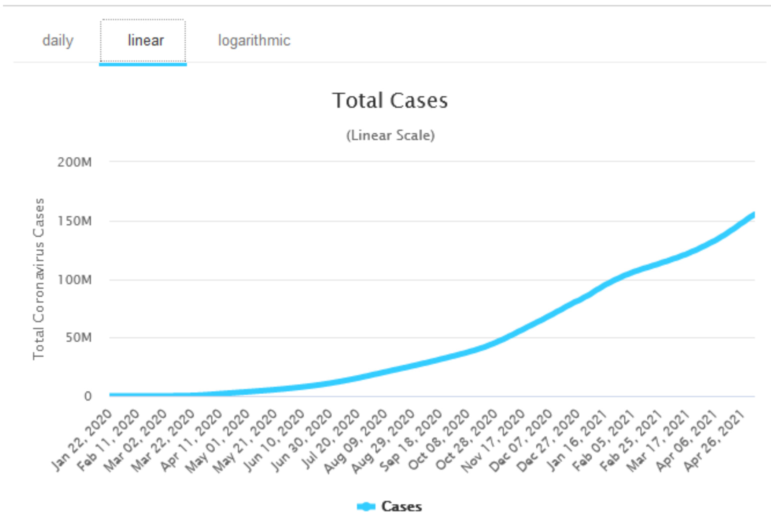
The same occurs with active financial management particularly during periods when entering or exiting major market cycles and events. A wide range of economic, fiscal, political and human considerations need to be correlated in order to ensure future returns and investment objectives can be achieved. The operative word is future. I'm a believer that capital, like water, always finds its course although the route it takes is not always obvious.

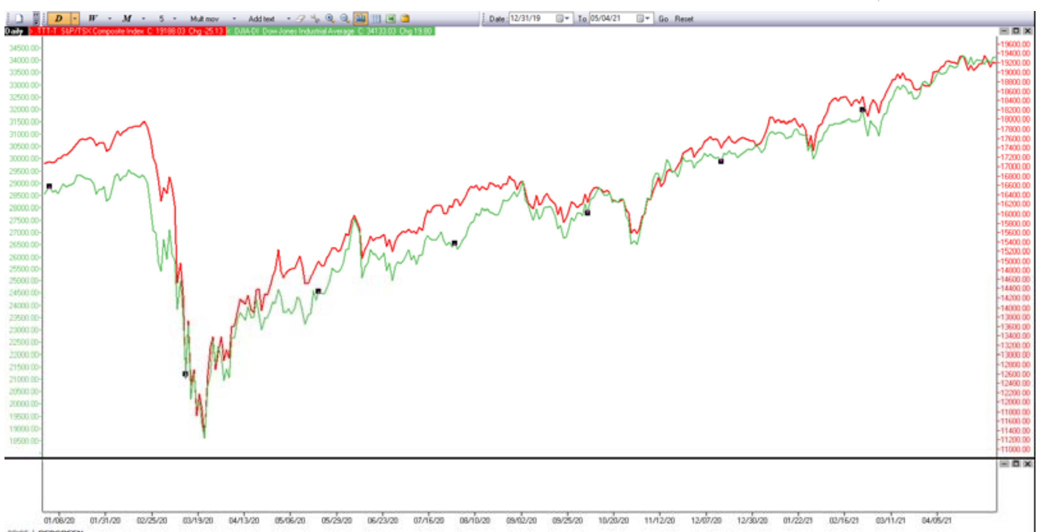
The current financial market conditions have created a range of mixed signals and it might be useful to take the pilot's approach through a series of questions to better understand conditions and identify an optimal path to take.

1. Why have the financial markets continued to increase during the pandemic?

The financial markets invest today for tomorrow based on future expectations. The current market consensus is that the pandemic is an event which will eventually diminish followed by strong economic recovery.

Trend in Total Cases of Covid **TSX and Dow Jones Indexes (Jan 2020 to present)**





Source: Worldometers.Info

Source: Thomson Reuters

2. What will happen to the Canadian dollar due to all the debt federal and provincial governments have spent to support the country through the pandemic?

All major governments around the world have also been incurring debt for the same reason so that the value of the Canadian dollar is relative. The key to the direction of the loonie will depend on how successful we will be in recovery.

3. Then why is the Canadian dollar so strong relative to the U.S.?

Although considerable cash remains idle around the world pending post-Covid recovery, speculative money has been seeking alternatives to the "stock market" because of its continued highs. At the outset of the pandemic, gold (including I.T. and digital currencies, ie. Bitcoin, as pseudo commodities) attracted hot money followed by oil and most recently base materials (ie. copper, silver, nickel, aluminum). Canada is rich in hard commodities and although the amount of speculative funds flowing into these alternatives is not as great as it would appear from the business media, the movement into Canadian hard assets has buoyed the Canadian dollar at this time.

Canadian dollar vs Energy Index (Jan 2020 to present)

Source: Thomson Reuters

4. What is the probability of rising interest rates?

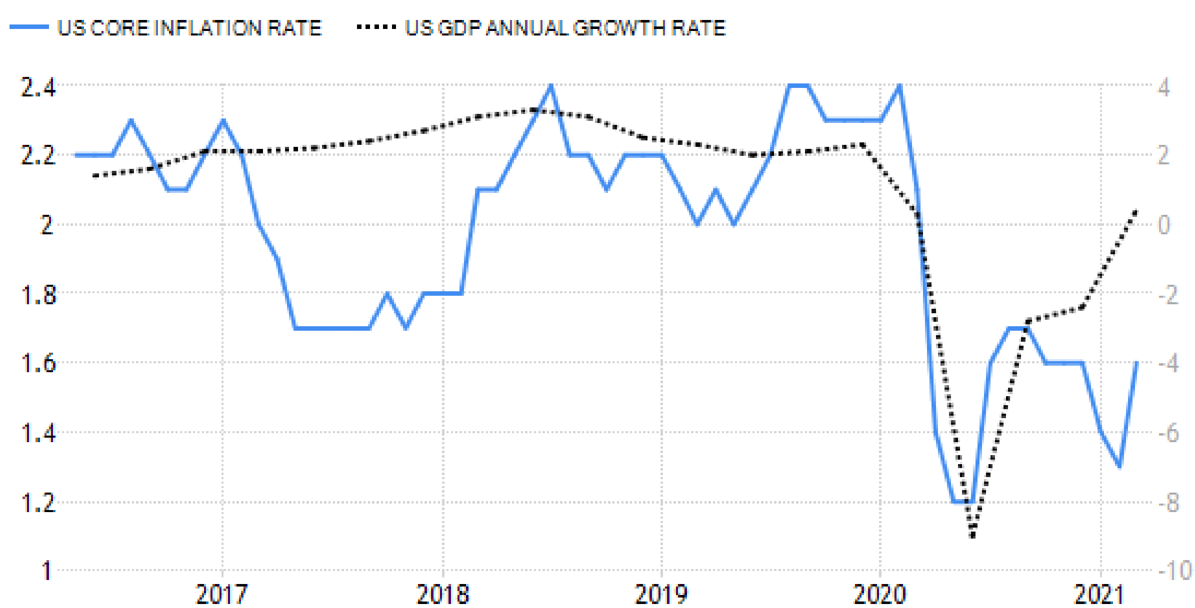
The risk of increasing government debt triggering higher interest rates is being offset by the relative value of currencies and governments would prefer to see lower interest rates to help carry the debt. Instead, it is consumption that will attract the attention of the central banks and the risk of higher rates if consumers increase borrowing for personal spending on recovery. The Bank of Canada has indicated it does not expect to see the need for interest rate increases until the second half of 2022 because of the current level of inflation and that

it doesn't want to discourage a resumption of consumer spending once the pandemic is controlled.

In the meantime, as much as e-commerce spending has increased, consumer spending has still not reached pre-covid spending levels. About 10-15% of the country's GDP comprised of travel, hospitality and leisure is receiving little consumption spending.

5. Why haven't interest rates increased because of inflation?

The central banks continue to see core inflation running below the targeted 2 % threshold which is cautioning them from increasing interest rates *(tradingeconomics.com)*. However, individual items such as gas, food, real estate and automobiles have undeniably risen in cost without signs of softening. <u>The real issue here is not demand as much as supply</u> which has been interrupted because of the pandemic and a tighter supply chain. Factory production for goods has been interrupted, less fuel is being refined because of less travel and generous mortgage rates are allowing higher price carrying costs and <u>encouraging sellers to hold off</u>. As a result, whatever is currently available is commanding a premium.



Source: TradingEconomics.com

6. Then what is the best investment strategy at this time?

Active and measured portfolio management is the key in controlling a safe "landing":

1. EXPECT THAT THE POST-COVID ECONOMY WILL DIFFER AS SOME BUT NOT ALL OF THE COVID FRIENDLY BUSINESS SECTORS WILL CONTINUE TO PROSPER AT PREVIOUS LEVELS. IT WILL LIKELY BE A HYBRID AS:

- **E-commerce will remain popular but consumers will inevitably also return to in-store shopping, reducing e-commerce momentum.**
- **Speculative alternatives will weaken as economic fundamentals and corporate earnings drive values again.**
- **Recovery will eventually fuel consumer inflation and higher interest rates.**
- **The fallen sectors of travel, hospitality and recreational will experience an initial surge but require some time to ramp up to pre-covid levels.**
- **Volatility will heighten as pent-up demand triggers a surge in consumer spending on recovery; this will likely subsequently pull back before finding a more stable trend.**

2. **SECTORS WHICH HAVE BEEN CRITICAL DURING THE PANDEMIC WILL CONTINUE TO MAINTAIN IMPORTANCE AND POTENTIAL FOR CONTINUED PERFORMANCE. THESE INCLUDE:**

- **Renewable energy generation to support continued power demand.**
- **Healthcare and medical services to help guard against further widespread illnesses.**
- **Areas of I. T. technology supporting increasing cloud and artificial intelligence capability; this differs from social media and other consumer digital applications.**
- **Transportation services supporting and enhancing the supply chain.**
- **Higher technology industrial goods such as computer chips will continue to increase in demand versus commodities as consumer products continue to become more sophisticated.**
- **The defensive component should be actively managed and incrementally re-invested as stable business trends become apparent.**

These factors will not be the only components driving recovery and further important items will likely emerge as the pandemic winds down.

However, ensuring these factors have been considered in the post-pandemic portfolio strategy will greatly increase the chance of a "safe landing"!

Regards

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