2020 in Review

Annus Horribilis II -2020 Good Riddance

1992 was described by Queen Elizabeth as Annus Horribilis as many members of the Royal Family had well publicized personal problems and a fire ravaged one of her personal residences. She described the year as one she would not look back on with 'undiluted pleasure'. 2020 has to be one of the worst years since World War II. It will be nice to have 2020 behind us all.

COVID 19 has been indiscriminate and devastating. Infection and death rates are increasing at the time of writing despite the initiation of inoculations. Total US infections recently passed 21 million people with over 100,000 cases daily. In Canada, infections recently passed 600, and daily cases exceed 6,500. These numbers are horrific. Public health officials expect the numbers to get worse before they improve. The UK has recently initiated its third lockdown, many countries are in at least their second lockdown with potentially more restrictions to follow worldwide.

While we will review our predictions for 2020, we predict *Proximus Annus Erit Melius* (next year will be better). Last year we predicted the following:

1) Volatility in the North American equity markets will increase in 2020.
2) Interest rates will remain low.
3) Despite US equity valuations being relatively expensive they will provide a positive return, but more defensive stocks will outperform.

Major North American equity markets bottomed on March 23rd, 2020. In the latter part of February equity markets were at all time highs. Over the next three weeks, the equity markets fell faster than during the Great Depression (1929), Black Monday (1987), and the 2008 financial crisis. Both the S&P500 and the S&P TSX fell approximately 32% and 38% respectively.

Both major equity indices in Canada and the U.S. did post positive returns for 2020 however defensive stocks did not outperform over the year. Defensive or value stocks posted negative returns over the year, outperformed by growth stocks. One of our quarterlies briefly discussed this. Shopify provided a return of 178% for the year. Pipelines, Energy, Telecommunications and Real Estate sectors posted negative returns while Financials posted only marginal gains for the year.

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Interest rates did remain low and the narrative from North American Central Banks is that interest rates will remain low for the foreseeable future. This accommodative nature has aided equity returns. As mentioned in one of 2020 quarterlies, there appears to be a disconnect in the equity markets at least with the long-term perspective we have embraced for the past several decades; with interest rates at historically low levels and economies struggling to regain lost footing, high yielding defensive names should gain favour. So far, they have not.

Enbridge is a classic example. At the time of writing the yield is over 8%. In 2020 the stock was down over 20%. Detractors will list their concerns about the future of the transportation of fossil fuels, debt levels and concerns the industry is facing on future growth projects. However, the company remains confident so much so that they recently increased their dividend 3%. In times of uncertainty investors have historically embraced this kind of investment. This did not happened instead companies with promising futures but with little to no earnings and crypto currencies were favoured. Our mandate has always been to be more tortoise than the hare and we believe the more defensive, higher yielding companies presently provide exceptional long- term value.

Our predictions for 2021;

1) Defensive stocks will outperform growth stocks in 2021.

2) Equity prices in North America will provide positive returns and outperform mid to long-term fixed income.

3) Canadian equities will outperform US equities as measured by the S&P TSX index versus the S&P500 index.

While control of the U.S. senate remains uncertain at the time of writing, it would seem more than probably that the U.S. administration will attempt to provide citizens with another stimulus package, considerably larger than the one recently passed. As well, they have campaigned on increasing corporate taxes and have focused their narrative on increasing the regulation and taxes rates on the technology companies. This may pressure valuations in the tech sector and may, in turn, shed more positive light on more defensive names. For example, North American banks have weathered the most recent year very well and their capital levels are well above minimum levels which may allow them to start to raise dividends and buy back their own shares. If the new U.S. administration attempts to normalize relations with many of its allies, global trade may rebound and basic industries will, in absolute and relative terms, benefit enormously. Further, under Democratic administrations domestic economic policy favours actual investment rather than tax breaks which should favour more defensive names.

Given the past year, it is hard to imagine that there may be a more opportune time to invest in equities in the upcoming months. However, we do not consider the market overvalued particularly in the more defensive space which is consistent with our mandate. Of course, the market volatility tends to spare few participants. It is also important to remember, as we reviewed in our last quarterly, that U.S. equity markets tend to historically perform better under Democratic administrations than Republican.

Thank you for your confidence in the past. Best wishes for good health and prosperity in 2021.