Monthly Market Matters

Summary for January 2021

Brent Joyce, CFA
Investment Strategist

Justin Truong, CFA
Manager, Investment Strategy

Highlights

- COVID-19 cases decline sharply amidst vaccine rollouts; virus mutations remain a concern
- Under heavy security post the US Capitol riot, US President Biden takes office: Signs 42 executive orders and proposes a $1.9 trillion fiscal stimulus bill
- Heavily shorted stocks: GameStop, AMC and Blackberry exhibit extreme volatility garnering headlines as retail investors pile in
- US Q4 Corporate earnings are coming in better than expected thus far

Market Summary

The much anticipated 'fresh slate' 2021 was expected to deliver has opened with a bombardment of the same kinds of eye-catching headlines that have become all too familiar. Whether it be a handful of new variants of the coronavirus, protestors storming the US Capital, reported delays in vaccine distributions or one of the most fascinating short-squeezes of all time playing out, investors are left wondering *what could possibly be next?*

These sensationalized headlines are seemingly par for the course in today's world, and we believe investors should ignore the noise and focus on long-term fundamentals. We caution that the first half of 2021 is fraught with pitfalls and short term volatility is to be expected. However, we believe there are reasons for optimism: chief among them is the rollout of vaccines that will flatten the COVID-19 infection curve.

The S&P/TSX Composite Index bested many of its developed market peers. A 35% jump for the Health Care sector (mainly cannabis stocks) helped mitigate what would have been a steeper loss. US and international indices fared slightly worse, with the S&P 500 and MSCI EAFE Index (USD) falling over 1%. Emerging markets strung together their second consecutive month of outperformance relative to their developed counterparts. The MSCI Emerging Market Index (USD) marched 3% higher amid China's robust economic recovery remaining largely intact, despite a recent spike in cases.

The Democrats swept both Georgia Senate runoffs, handing them control of a now 50-50 split Senate (short of the 60 seats required to avoid a filibuster and the reconciliation process). Newly inaugurated President Biden wasted no time, signing 42 executive orders while proposing an additional $1.9 trillion fiscal relief bill. Finally, global central banks have reiterated their dovish stance, which should continue to bode well for risk assets.

Canadian Fixed Income	Level	Month	1 Year
FTSE Canada Universe Bond Index	1,208	-1.1%	4.6%
FTSE Canada All Corporate Bond Index	1,389	-0.5%	5.5%
Global Equities	**Level**	**Month**	**1 Year**
S&P/TSX Composite	17,337	-0.6%	-1.0%
S&P/TSX Small Cap	657	0.4%	12.3%
S&P 500	3,714	-1.1%	13.5%
NASDAQ	13,071	1.4%	40.9%
Russell 2000	2,074	5.0%	25.7%
UK FTSE 100	6,407	-0.8%	-14.4%
Euro Stoxx 50	3,481	-2.0%	-6.8%
Nikkei 225	27,663	0.8%	18.3%
MSCI China (USD)	116	7.4%	39.3%
MSCI EM Index (USD)	1,330	3.0%	21.1%
Currencies and Commodities	**Level**	**Month**	**1 Year**
CDN $	$0.783	-0.3%	3.3%
US Dollar Index	90.58	0.7%	-7.6%
Oil (West Texas)	$52.20	7.6%	-2.1%
Natural Gas	$2.56	1.5%	5.3%
Gold	$1,848	-2.7%	17.2%
Copper	$3.56	1.1%	37.2%
Canadian Interest Rates	**Level**	**Month**	**1 Year**
3-month T-bill	0.07	1	-157
GOC bonds 2 yr	0.15	-5	-131
GOC bonds 10 yr	0.89	21	-42
GOC bonds 30 yr	1.47	26	3
Canadian Sector Performance		**Month**	**1 Year**
Energy		2.7%	-28.4%
Materials		-3.5%	18.0%
Industrials		-2.9%	6.4%
Cons. Disc.		-2.6%	11.4%
Info Tech		-0.7%	61.6%
Health Care		35.3%	2.0%
Financials		-0.8%	-6.3%
Cons. Staples		-5.3%	-7.2%
Comm. Services		0.5%	-11.0%
Utilities		2.6%	5.6%
Real Estate		1.3%	-16.5%

President Biden wastes little time

The 46th president moved swiftly upon his arrival to the White House, inking 42 executive actions. The focus was on dismantling many of President Trump's regulations, boosting funds for COVID-19 relief and implementing environmental protection policies. He also intends to adopt his predecessor's "Buy American" provisions. President Biden revoked the Keystone XL pipeline permit, which is in line with his green-energy mandate and will undoubtedly lead to further job losses in Canada's already beaten-down energy sector. Overall, the executive actions boosted key names in the tech and health care heavy NASDAQ Index as well as the Russell 2000 US small-cap benchmark sending the two indices toward the top of the performance tables.

The proposed $1.9 trillion "American Rescue Plan" package would primarily bolster COVID-19 relief efforts in the form of stimulus payments ($1,400/person) and boost unemployment aid to $400/week (up from $300/week). The widely expected proposal would be on top of the recently signed ~$900 billion aid package. Needing 60 Senate votes or the use of the reconciliation process, the question is whether the bill will pass as outlined. If history is a guide, it may be a while before Americans begin receiving any additional help.

Q4 Earnings: So far, so good

At the time of writing, 185 S&P 500 companies have reported their Q4 2020 earnings. Of that total, 151 (82%) have topped their earnings estimates for the quarter. Punctuating the solid results, the average company beat their estimate by a 13.6% margin versus the five-year average of 6.3%. Despite the strong showing, earnings are still down 2.3% y/y due to the pandemic's widespread economic damage.

Retail investors take on Wall Street

A fierce tug-of-war broke out between retail investors (spearheaded by the Reddit group "WallStreetBets") and a few large players in the hedge fund space leading to a violent short squeeze playing out in a handful of stocks with significant short interest (most notably the brick and mortar video game retailer, GameStop). The news gained steam on social media, with GameStop shares, at their peak, skyrocketing an eyepopping 1,745% YTD. This, in turn, led to massive losses for a few hedge funds that held large short positions and forced brokerage firms to limit trading in these names, alongside increasing investor margin requirements. The media frenzy raised concerns over excessive speculative behaviour in the markets. We see the activity as a sideshow to be observed from afar and not a risk to capital markets' proper functioning. As eye-catching as the headlines may be, our focus remains on the long-term stewardship of your assets.

However, it does raise an eyebrow regarding risk appetite and sentiment. It has now been more than ten months since the steep decline in March, and we have yet to witness a 10% or greater correction. The S&P 500 and S&P/TSX have risen over 66% and 54%, respectively. One must ask: How pumped-up is equity market sentiment given this run? Especially considering ample liquidity, fiscal stimulus, elevated saving rates, and historically low interest rates provide an extremely accommodative environment for risk assets. Current sentiment leans much more toward the side of greed than fear – extreme bullish sentiment abounds.

Stay the course

Among many narratives surrounding the short squeeze is the notion that equity markets are casinos. While participation in both comes with the risk of losing money, unlike casinos, capital markets provide a valuable contribution to society – they facilitate capitalism. Capitalism delivers innovation. Innovation improves our lives – indeed, it can save lives (thank you Pfizer, Moderna et al.)! Capital markets connect those with excess savings to those in need of money to fund good ideas. But what makes a good idea is often difficult to identify in advance. Hence the need for risks and rewards to discipline the allocation of capital so that the cream rises to the top. In capitalism, good ideas and strong companies thrive. While bad ideas or no longer useful companies are removed, freeing up resources that are best deployed elsewhere. Options and short selling are tools of the trade. They help capital markets fulfill their essential role of price discovery. This is not to say that these are perfect tools or aren't hazardous. A knife is an indispensable kitchen utensil, but it can cause harm if not used properly. No system is perfect, and the best systems should grow and learn from their mistakes. Capital markets price risk; one needs to be careful if you remove risks from a system where the risk of loss disciplines the participants.