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Chris provides financial planning, investment planning and full implementation services to about 100 families.

We are pleased to welcome new clients. New clients should have $1 million or more of investable assets.

Covid Holidays

The virus is still with us and although it is proving to be much less virulent than first feared, it is also proving persistent, and thus driving policy responses constraining economic and personal activity by various degrees. Economic activity snapped back very strongly over the summer, which gives us reason to be optimistic about the eventual recovery.

Now with the development of vaccines the end is in sight. I look forward to watching the US and European pharmaceutical machinery demonstrate its power for the benefit of humanity by churning out hundreds of millions of doses.

Big Picture

As the saying goes, 'May you live in interesting times'. The global financial and political picture is as interesting as ever in the almost four decades that I have been studying it, while at the same time the more micro picture of individual markets and the securities within those markets also harbor several very interesting and important stories.

So I set myself the slightly overambitious task of skimming through some of the more salient of these topics in one newsletter essay.

The virus

I wish I didn't have to comment on the virus. But at the present moment it is completely dominating our lives on a scale of breadth, depth, and time like nothing since WWII, so it is quite reasonable to ask what the impact on your investment strategy might be.

The big-picture answer is that outside of the many individual tragedies and the serious increase in the national debt, the virus will have little long-term structural effect on the economy or investment markets. The virus is like so many other things we've experienced; while they have great importance on a personal, political, or humanitarian level, they aren't major economic developments.

Over the next few months as the vaccines are rolled out, the importance of the virus will begin to dissipate, and general economic activity will begin to normalize. As soon as the front-line workers and elderly are immunized, the terrible tradeoff between balancing the Covid impact on the elderly against the unsustainable costs of lockdowns will evaporate. We can only hope that Canada, with only a generic pharmaceutical industry, isn't left too far behind in the vaccine rollout.

I will resist the temptation to comment further on the virus, except to say the cost of the lockdowns in terms of mental health, children's education, financial damage to business owners, and the national debt, will be debated for many years.

Policy Response: Fiscal Policy

The deflationary impulse from the financial crisis of over a decade ago is dovetailing with ageing demographics and now the global pandemic-induced shutdowns to constrain economic growth in the major Western economies. A time of policy-induced shutdown with inflation hovering just over zero is not the time for government austerity, it is the time for generous government spending.

But the Canadian government deficit is truly staggering. Fitch, a credit rating agency, estimates the Canadian federal deficit for this year at C$380 billion, or 17% of total GDP, while others estimate it at over $400 billion. That would be almost 20 times last year's deficit of C$20 billion.

To put this in perspective, a deficit of $400 billion will increase the total outstanding Canadian government debt from about $800 billion to $1.2 trillion, an increase of 50% in one fell swoop. In terms of annual GDP, which is how you gauge the sustainability, total federal debt will increase from 36% to over 54% of GDP. It is a fantastic number to contemplate. Part of the debate is that you could fund a lot of hospital beds for $400 billion.

This untethered fiscal policy is backed by the central banks who are still having nightmares over the deflationary impact of the financial crisis and are printing all the money the politicians are asking for. Printing money saves the government from having to raise the money in the bond market, which would risk driving interest rates higher. We are walking a tightrope…

Policy Response: Debt

Yes, deficits do matter, because if interest rates are higher than the GDP growth rate, as they usually are, the debt grows faster than the economy and you are eventually swamped.

The good news is that a debt crisis isn't exactly imminent: with 10-year interest rates at 0.5%, a government can borrow a lot of money before interest costs become a problem. Nevertheless, political courage will be required soon…

Policy Response: Monetary Policy

The US Federal Reserve at its annual August policy meeting in Jackson Hole Colorado closed the door on 40 years on inflation-fighting. Monetary policy in all major Western economies is now all-in on zero interest rates for the next several years, and printing money to support government fiscal deficits.

Canada's central bank printed about C$430 billion between January and September according to Trading Economics, mostly to buy government bonds, which is how central banks increase the money supply. Normally such increases in money supply as we're seeing today, in concert with interest rates at zero, would cause a spike in inflation expectations. An increase in money supply of $430 billion is roughly 25% of Canada's GDP of $2.2 trillion. It's an alarming number.

Fortunately for now, inflation seems nowhere in sight. We aren't sure why, but the 30-year US Treasury bond, normally very sensitive to long term inflation expectations, is yielding about 1.6%, the 30-year inflation protected Treasury bond (TIP) is yielding about zero, and negative interest rates prevalent in Europe all tell us that holders of these securities aren't worried about inflation…yet.

Conclusion: Interest rates were low before Covid, but now they're zero. Inflation may be out on the horizon, but it isn't visible yet. Stay tuned…

Financial Repression

The salient feature of investment markets today is not Covid, or a new US president, low oil prices or anything else that you see in your newsfeed. History will look back on these days and see that this was the time when traditionally safe investments ceased to exist.

With nominal short-term interest rates artificially suppressed to zero, and real (after-inflation) rates negative, investors cannot use low-risk interest-producing investments such as bank GICs or government bonds for retirement income. If you wanted a risk-free retirement income of say $40,000 by investing in 10-year government bonds you would need $8 million.

Investors are being forced to take on more risk to earn retirement income without consuming their capital. This is what we call financial repression.

Just as financial repression punishes savers, it rewards governments and other borrowers by giving them lower interest costs. It thereby produces a transfer of wealth from savers who would have earned the interest income, to borrowers who benefit directly from lower rates.

Conclusion: Governments have a strong incentive to keep rates low, punishing savers and rewarding borrowers like themselves. Investors have no choice but to adapt.

Investment Perspectives, Looking Forward

Income

The good news here is if you need income there are many investment alternatives: corporate bonds, real estate, infrastructure such as privately owned roads and airports, traditional income-producing instruments such as high-dividend electrical or water utilities, pipelines, and so on all produce high-quality dividends in the 3% to 7% range.

Yet the downside (pun intended, sorry) is that these income investments have more short-term volatility than government bonds. Portfolio design and financial planning needs to incorporate and plan for this volatility. This is what we do.

The approach is to use a balance or mix of these various income-producing instruments. Active management is crucial here for two reasons: first, because the individual income securities are very different from each other, even within the same asset class, and require detailed analysis to determine which ones you want and which you don't. A preferred share yielding 6% dividend looks great but if it's callable at 6 months, or resettable at issuers option, it isn't going to do you much good.

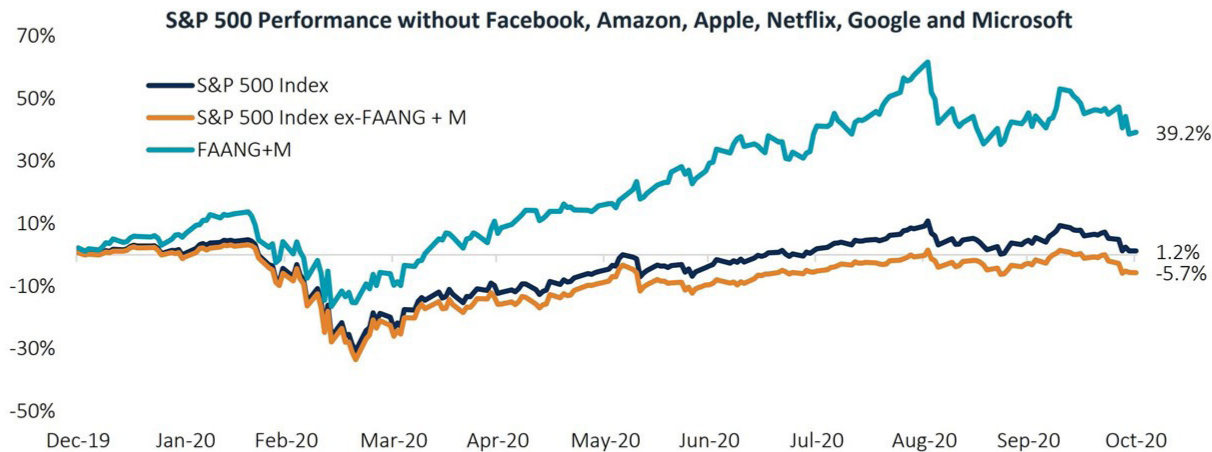
Secondly, active management is important to manage the transition of these different types of income securities through the evolution of the pandemic and the return to economic normalcy. Investment grade corporate bonds are going to transition very differently depending on the industry, while corporate bonds as an asset class will behave very differently from real estate investment trusts which will be very different from shares in infrastructure such as highways and airports. This is because the credit quality of the various instruments will be affected differently by different economic conditions, and it requires detailed analysis to understand, so that your portfolio is appropriately balanced.

And if inflation shows up on the horizon, significant adjustments will be required. We are on alert…

Conclusion: Active management of the income segment of the portfolio is crucial to balance the more volatile risk/return equation across the range of income investments required in today's environment. Retired investors will need to live with more volatility in their portfolio than they would normally have.

Equities

The equity markets, although looking superficially benign near all-time highs in the US as I write in late November, have some dangerous currents running beneath the surface. Six technology stocks, Apple, Amazon, Alphabet/Google, Microsoft and Facebook have soared this year on the back of the pandemic-induced shift to digital commerce. These six stocks[1] have driven almost all of the market recovery and now account for about 25% of the US$30 trillion market capitalization of the entire S&P500. If you include Tesla the weight is 26%. Fully one quarter of the total market value of the 500 largest, best capitalized, best run companies in the largest economy in the world is accounted for by six stocks.



Source: CI Global Asset Management, Bloomberg Finance L.P. As at October 31, 2020. Return calculations do not include dividends.

The price gains of these and other growth stocks has powered growth-style managers to the greatest level of performance over value managers since the tech bubble of 1999. In the 12 months to September, Barclays US Momentum stock index was up almost 27% while US Value index was down 4%.[2]

If you think that's reason to pause for thought, you're right. Value-style managers, who tend to prefer stocks with high intrinsic value and low prices such as banks, oil producers, agriculture and other out-of-favor economic cyclicals, have been frustrated by poor returns. As the FAANGs go to the moon. If this seems like déjà vu all over again, to quote the famous investment advisor Yogi Berra, you are partly right.

But yes, this time is different. This time is not like 1999. Today the tech monsters are profitable. Some are wildly profitable. Some of the Big Techs meet your managers' criteria for investment and are included in your portfolio – a far cry from 1999 when none of your managers would touch Big Tech with a barge pole. Just to make it interesting, some also have a whiff of anticompetitive behavior about them which is attracting the attention of Congress.

We won't see the instantaneous vaporization of the techs like in 2000 – that was last time. Instead, look for a 'stealth bull market' in the value stocks as the general economy recovers, while the high-growth stocks pause to catch their breath after the Covid boost to online commerce.

Chances are we'll see a stealth or rolling bull market as the different sectors gain traction coming out of the Covid Recession. This seems to be getting under way now: the Big Six Techs appear to have peaked in August, while the value stocks are rumbling along: Bank of America is up more than 20% in November to date, Boeing is up 55% too as light appears at the end of the Covid/737 Max tunnel, General Motors is up 35%, and Imperial Oil is up almost 60% in the same time, according to my Bloomberg service. The spot price of coal has more than doubled from its March lows to the end of November, as has iron ore. Both are driven by demand from China and India.

Conclusion: The world economy was firing on all cylinders in January 2020, and there is no reason why it shouldn't be doing so again as the Covid alarm dissipates. Share prices are reasonably valued – even cheap if rates stay low. The recovery of the value stocks appears to be under way, while the more modestly priced growth stocks continue to have a great future. The FAANGs as investments should be treated with extreme caution. Your portfolio has been positioned with regard to all these things. We are patiently and prudently biding our time as the virus runs its course. To misquote another old proverb: 'The big wheel continues to turn, exceedingly slowly...'

Happy New Year

Finally, I would like to wish you all the best in this very difficult winter season. I look forward to being able to see you all in person again soon. Zoom might be good for some types of calls but another lesson from the lockdowns is that person-to-person, face-to-face interaction is so much more rewarding. I have known many of you for 15 and 20 years (some of you for almost 30 but I don't want to admit to being that old!!) and I miss our opportunities to be across the table from each other.

Surely one of the best lessons from the lockdowns is we have had the opportunity to see clearly what is most important to us. With the daily tempo of activities having been shut off for so long, we will now more deeply appreciate those special moments that enrich our lives: seeing your grandchild's face for the first time in 6 months; watching your children play with friends in the schoolyard; laughing with friends at a cocktail party on the cottage dock; or greeting work colleagues at a business function for the first time in a year; all these things and many more will be that much more deeply appreciated because we have been starved of them for so long.

It is a privilege to help you with your financial affairs, and I am deeply grateful for the opportunity and the responsibility. It is a pleasure and an honour to work with you all.

Endnotes

1 Alphabet is Google's parent. Google has 2 classes of shares, each of which occupies its own spot in the top six.

2 Barclay's indexes, 12 months to September 2020.

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