

Pearlstein's Corner





Wealth Management
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We are Living in “Interesting Times”

“The pandemic has shaken up our world. Millions have been infected (and most recovered) but, as of the end of September, over one million people have died. In countries such as New Zealand, which seemed to have had Covid-19 under control, it’s re-appeared. Europe and Canada are playing whack-a-mole with it – one day good news, the next day bad news. In the U.S., it’s virtually out of control with no cohesive national plan in sight.

Trillions of Dollars in Government Money

Governments have injected trillions into their economies to keep populations and businesses afloat. Using “quantitative easing”, a central bank’s balance sheet expands when newly created electronic cash is used to buy bonds on the open market. Some of that cash finds its way into the hands of individuals and businesses. The Bank of Canada’s balance sheet expansion is up to \$543 billion as of early August. The U.S. Federal Reserve’s has exploded by seven times that amount and should have traditional economists shouting dire warnings from the rooftops.

Despite the cash injections, many small businesses have shut their doors for good. There is grave concern over people not being able to afford basic food, and being evicted from their homes.

All of this, while a highly contentious election is underway in the U.S.

The Stock Market Says “Party on Wall Street”

And yet... until very recently, the stock market has been breaking records. It’s as if the market doesn’t care about the headlines. How can that be?

Well, a closer look shows that some of the world’s biggest companies, the “Fab Five” (Amazon, Apple, Microsoft, Google and Facebook) account for more than 50% of the gain in the total market cap of the S&P 500 since June 2014.

So, assuming you’ve had a healthy percentage of tech in your portfolios, you’ve participated in this growth. The fact that they now have a composite price earnings multiple of 41X compared to 21X six years ago doesn’t seem to matter – these companies continue to dominate.

Even big retailers are showing gains with strong earnings reports from Walmart and Home Depot. While smaller stores suffer, these retail giants continue to perfect their online shopping and home delivery services to grow their market share.

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How Long Can This Go On?

So, the dark shadowy questions in the back of many minds is, “Will this all come crashing down? Are we living in fantasyland?” Surely all of this new unexpected government debt must be repaid, and result in higher interest rates and inflation. Governments that just months ago portrayed themselves as conservative money managers seem to be handing out millions on a daily basis. (BTW, does anyone actually remember January?)

How long can the world live with Covid-19? When will a proven and safe vaccine become available?

What about the U.S. election? Will it happen peacefully, or descend into chaos? And whatever the outcome, how will the markets react? These are confusing times indeed. So much seems to be up in the air at once.

Does Modern Monetary Theory Make Sense?

Let’s look at government debt, since it would logically have the biggest impact on the markets. Traditionally, people thought of government debt in the same way we think of household debt. Debts must be repaid. Either we repay it, or leave it there for our children and grandchildren to repay.

But “Modern Monetary Theory” (MMT) suggests otherwise. MMT says that any government that prints its own currency – such as Canada, the U.S., Japan and the U.K. – can’t be forced into default. It can simply print money as long as there is a demand for it. If the money is put to good use, for example to drive employment and create infrastructure, it will stimulate the economy and keep inflation down. People will have faith in the currency and support it.

A prime example of this is Japan. In 2019, Japan recorded a government debt equivalent to 236.6% of the country's GDP. Yet their inflation was just 0.79% and, on the whole, the country seems to be doing fine.

By comparison, in the U.S. the 2019 debt to GDP was 106.9%, with inflation at 2.3%. For Canada, the numbers are 53% (excluding substantial provincial debt) and 1.95%.

Yes, these numbers will look quite different at the end of 2020. But keep in mind that many economists have been giving warning signals for years and yet the economies keep rolling along. Many people are betting that the economies can withstand all of the stimulus payments.

If you're not familiar with the tenets of "Modern Monetary Theory" (MMT), I'd suggest you Google it to see how you feel. Look for videos by Stephanie Kelton, a professor of economics and public policy at Stony Brook University. She explains MMT quite clearly.

Your Investments

So, with all this anxiety in the air, what should you do about your investments?

I would suggest you do as you've always done. Maintain a well-balanced portfolio that meets your needs in terms of return. Review it on a periodic basis and make any necessary adjustments.

You might consider adding gold to your portfolio if it's not already there. It's a very traditional hedge against uncertainties. Think of it as insurance.

I've been buying gold bullion exchange traded funds (ETFs) for a number of months in my clients' portfolios. Gold itself is up 20% this year. Individual gold stocks tend to be more volatile and have done even better.

Gold recently made headlines when Berkshire Hathaway built a position in Barrick Gold of over \$500 million U.S. Warren Buffett has famously been averse to gold, but he seems to have changed his mind.

Many of my clients have a 3% weighting in gold. In the old days Swiss bankers would allocate 5 – 10% of a portfolio to gold. So, it's certainly a consideration if you're adding to or making changes within your portfolio.

Time for a Portfolio Review?

If you're currently a client and would like a portfolio review, please get in touch at [416-733-5257](tel:416-733-5257) or email mark.pearlstein@rbc.com

If you're not yet a client, but would like to discuss your portfolio and your investment goals, please contact me and start a conversation.

A Brief Message from Mark

Just a quick note to our loyal readers that after 20 years of writing hard copy newsletters, I have decided to discontinue this format in favour of video. Over the years, I have enjoyed creating this quarterly content very much. As we continue to move forward into the 21st century, it just seems appropriate for me to deliver interesting and timely topics in a more personal way. If you have any suggestions or areas of interest that you would like me to cover, we would be love to hear from you and do our best to include them in future videos.

Some of my clients have mentioned that they've found my newsletters and videos very useful and have shared them with other family members, friends or colleagues. If you know someone who might benefit from this, pass it on!



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