Wealth Management
Dominion Securities

2021 Q2 Commentary

Jon Mitchell
Portfolio Manager &
Investment Advisor
jon.mitchell@rbc.com
Phone: 780-944-8851
Fax: 780-424-7153

Jon Mitchell, Portfolio Manager

Are The Good Times Really Over

I wish a buck was still silver
It was back when the country was strong
Back before Elvis
Before the Vietnam war came along

Before The Beatles and 'Yesterday'
When a man could still work, still would
The best of the free life behind us now
And are the good times really over
for good?

Are we rolling down hill
Like a snowball headed for Hell?
With no kind of chance
For the Flag or the Liberty Bell

Wish a Ford and a Chevy
Could still last ten years, like they should
Is the best of the free life behind us now?
Are the good times really over for good?

I wish Coke was still Cola
And a joint was a bad place to be
It was back before Nixon lied to us all
on TV

Are we rolling down hill
Like a snowball headed for Hell?
With no kind of chance
For the Flag or the Liberty Bell

Wish a Ford and a Chevy
Could still last ten years, like they should
Is the best of the free life behind us now?
Are the good times really over for good?

Stop rolling down hill
Like a snowball headed for Hell
Stand up for the Flag
And let's all ring the Liberty Bell

Let's make a Ford and a Chevy
Still last ten years like they should
The best of the free life is still yet to
come
The good times ain't over for good

— Merle Haggard, from the
Motorcycle Cowboy Album (2000)

Continued on page 2

2021 Q2 Commentary

Continued from page 1

I "discovered" Merle Haggard a few years ago while out walking my dog, Marley. This is my favourite song of Haggard's, as it describes the simpler times of days gone by, while questioning whether we have lost the foundational forces of hard work, freedom and community.

I write this just as Ontario, Canada's largest province, moves to Step 3 of its COVID-19 re-opening plan.[1] For more than seven months, gym owners, hair salons, theatres, clubs and bars have been closed to any indoor activities, forcing some owners into significant debt and many employees into a 16-month furlough with federal worker's benefits.

The Canada–U.S. border remains closed to land travel, although air travel is gradually re-opening. Instinctively, my inner "Spidey sense" is tingling, as the possibility of a severe fall and winter flu season coupled with variant risk means another looming round of restrictions on our ability to move around and congregate with our family and friends. I hope I am wrong on this prediction.

To date, it appears that only Manitoba has introduced some version of a vaccination passport,[2] which conveys certain options to those fully vaccinated residents. Quebec's system is pending and would likely only be implemented if a fourth wave of the virus arose. Any proof-of-vaccine documentation would also likely be limited to venues such as gyms, bars and festivals.

British Columbia, Alberta and Saskatchewan have ruled out any sort of vaccine passport,[3] although it remains to be seen whether individual businesses may require them. Large venues such as concert halls or sports arenas would be the obvious starting point. I noted in my last commentary that Israel, which has one of the highest vaccination rates, had implemented a "green passport" earlier this year, but has already terminated it, as there was no evidence it was making any difference. The best way to describe the situation is fluid.

Medical update

As western nations continue with their vaccine rollout, the focus of the COVID-19 narrative appears to be on new variants and the slower distribution of vaccines to poorer countries. Recently, the World Health Organization (WHO) opted to change the identification of the variants from a regional name, such as the UK,

Brazilian or Indian variant, to one using a letter of the Greek alphabet, such as the Delta.[4] The most recent official variant is the Lambda variant, which was declared by the WHO on June 14, 2021, as a "global variant of concern."[5]

The most pressing issue with the variants is the effectiveness of the vaccines against them, similar to the issue of the effectiveness of antibiotics against various strains of infectious bacteria such as C. difficile.[6] What is noticeable in countries such as the UK, is that although the number of infections is rising, the number of hospitalizations and severe outcomes is still low and modest.[7] It seems possible that some countries will opt for a third dose before the onset of the fall flu season. Pharmaceutical firms are modifying their vaccines to combat the latest variants.

Vaccine distribution will require major support by the wealthier nations. The U.S. is leading the COVAX program, which supports poorer nations, by pledging 500 million doses of the Pfizer vaccine. We are looking at 2022 for most of the COVAX distribution to likely be completed. In an interesting development, the small but populous city-state of Singapore announced on May 31, 2021 that COVID-19 will be treated like other endemic diseases such as the flu.[8] There will not be a goal of zero transmission, cases will not be counted, and quarantining for close contacts of cases won't be required. I am not expecting other G20 nations to adopt this approach but some other nations are studying Singapore closely.

We are seeing some resistance to the proposed plans to vaccinate both young people and children, given their strong immune response to the virus and low rates of transmission. As well, there is debate on whether young people and college students who have recovered from the virus will now have a natural immunity to it as a result, or whether they will benefit from being vaccinated.[9] We are seeing some court challenges in the U.S. with respect to colleges who have mandated vaccinations for in-person learning this fall.

Finally, on June 25, 2021, the Federal Drug Administration (FDA) issued an update requiring both Pfizer and Moderna to include a warning in their literature regarding the risks of heart inflammation (myocarditis and pericarditis), particularly after the second dose.[10] This was issued after an emergency meeting of the FDA took place that week in reaction to over 1,200 reported cases of these adverse events, with the majority occurring in young men.

Social behaviour

As the provinces begin to open up, one by one, on their own terms and schedule, our lives are slowing starting to return to our pre-COVID-19 days. Here in Alberta, masks are optional in most businesses and public venues. Some employers still require their staff to wear masks indoors, while for others, employees have a choice.

Businesses like movie theatres continue to allow for empty seats to provide physical distancing. Summer camps are resuming this year, colleges and universities are slated to resume classes in September, and many sports teams are back practicing and playing games again. Churches are re-opening with limited or no restrictions and even hand-shaking is starting to come back in some settings.

Continued on page 3

2021 Q2 Commentary

Continued from page 2

There is, of course, still caution in the air as we have understandably been conditioned to maintain distance and be aware of others. This is a healthy situation, as showing respect to others is one way we will gradually gain confidence in the re-opening. It is truly amazing to see the changes in the level of restrictions in the past 90 days here in Canada, where we were dealing with border closures, school closures, limited mobility beyond your region, and a large number of businesses closed for in-person activities.

One thing that has changed is employers' attitudes to staff health. For years, it was considered a "badge of honour" for employees to drag themselves to work and soldier on at their desks or station despite fighting a cold or flu. No more. The questions that employees need to answer each day to enter their office or workspace are designed to minimize the spread of any disease. Also, for many who have the flexibility to work from home, any sign of illness can be the only factor needed for remaining home and working from there.

The next few months will mark whether the re-opening has legs or not. Major employers such as governments, cities, large corporations, and sports and arts venues will be facing the arduous process of bringing employees and patrons back from their homes to the office or venue.

Investment observations

Inflation: Transitory or intransigent?

If I were to have provided a prediction in January – when the U.S. Consumer Price Index (CPI) for December was released at 1.4% – that, in six months, the CPI for June would be 5.4%, a lot of you would have thought I was crazy. Yet that is exactly the figure that was released on July 13. The 5.4% CPI rate is the highest since August 2008 (which was pretty much the peak of the housing bubble before the ensuing Great Financial Crisis). Here are excerpts of U.S. Federal Reserve Committee (Fed) Chairman Jerome Powell's July 14 testimony before the U.S. Committee of Financial Services (with my comments in brackets, and my added emphasis):

"Conditions in the labor market have continued to improve, but there is still a long way to go. Labor demand appears to be very strong; job openings are at a record high, hiring is robust, and many workers are leaving their current jobs to search for better ones." (See comment below on JOLTS data.)

"To avoid sustained periods of unusually low or high inflation, the Federal Open Market Committee's (FOMC) monetary policy framework seeks longer-term inflation expectations that are well anchored at 2%, the Committee's longer-run inflation objective. Measures of longer-term inflation expectations have moved up from their pandemic lows and are in a range that is broadly consistent with the FOMC's longer-run inflation goal. (Really? Current inflation is already at 5.4%, more than double long-term target.)

"As always, in assessing the appropriate stance of monetary policy, we will continue to monitor the implications of incoming information for the economic outlook and **would be prepared to adjust the stance of monetary policy** as appropriate if we saw signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with our goal." (Neither the terms "materially" or "persistently" were defined by Chair Powell.)

So the real issue becomes, how long can or will the Federal Reserve wait before increasing interest rates in light of rapidly increasing inflation?

The Fed is still positioning that today's inflation is "transitory" and that it will soon start to decline again as supply chains resume and consumers catch up on their spending plans. Meanwhile, the Fed is content to keep the overnight interest rates pinned at 0.25%, presumably for at least two more years. I wonder if this policy will be updated if the CPI rates continue tracking to 6%, 7% or higher.

In a recent piece, John Hathaway, a lead precious metals manager with Sprott Inc., shared his position that inflation is not transitory, but rather it is intransigent or unyielding. Here are a few of his comments.

"*In our view, inflation will likely prove to be intransigent. Rising wage rates are a key reason. Based on Bureau of Labor (BLS) data, the pace of wage inflation is 4.8%. Labor, which accounts for roughly 67% of U.S. GDP (gross domestic product), is ubiquitous. It is embedded in the cost structure of everything. Worker pay is sticky and will not decline because of small increases in interest rates. Even though the rate of change in labor costs may vary year to year, it has never declined absent an economic crisis. Producers and manufacturers must find a way to pass increased labor costs along in order to maintain profit margins and thus inflation spreads.*"[11]

Reinforcing this position are the recent U.S. Job Openings and Labor Turnover Survey (JOLTS) numbers, which are at an all-time record high. In a recent note from Purpose Investments, they provided this comment and graph.[12] "*An interesting statistic is job openings almost equaling the unemployed, which is a good thing but why aren't people jumping at these opportunities. As of June 2021, 9.5 MM people were unemployed (the chart below shows Job openings of 9.2 MM). With all the job openings, employees are confidently leaving their current positions to find new jobs. If employers have to start increasing wages to keep and attract employees, this will cause wage inflation and wage growth is seldom transitory.*"

I would add that in Canada and the U.S., programs to pay furloughed employees to stay home were extended to September 30, nearly six months since the Toronto Blue Jays played as the visiting team to the Texas Rangers in their sold-out stadium.

Figure 1: U.S. job openings

Source: U.S. Department of Labor, July 13, 2021.[12]

Rising food prices, energy prices and real estate

Some of the largest components in everyone's budget are food, fuel and housing. We are seeing significant increases in all of these components in the past year. Looming this fall is a significant deficit in Western Canada's grain production, which is being severely stunted by record temperatures and drought conditions. Many farmers are expecting only 30% to 50% of the hoped-for yields at this time in the season.

Without continued stimulus in the midst of rising food and energy costs, consumer spending could come under pressure. According to a June 2021 article from MacroMavens: "In the past 40 years, there have been nine such instances (when food and energy outlays outpaced wages) — only one of which failed to

Continued on page 4

2021 Q2 Commentary

Continued from page 3

deliver an economic or financial downturn of real magnitude." Here is a graphical portrayal of these factors. As you can see, whenever the red line (food and energy) outlays crosses the dotted blue line of wages, a recession is nearly always the result. The 2004 data point only delayed the recession by a few years due to the amount of equity homeowners cashed out of their homes through refinancing.

Valuations matter

Real interest rates (nominal rates less inflation) remain negative along the yield curve which is not only very accommodative but leaves investors with no long term alternative to risk assets. Traditional fixed income is guaranteeing a loss to investors in all but the most deflationary scenario.

So where do we go from here? Valuations for all kinds of assets (houses, paintings, non-fungible tokens such as digital art, sports cards, land, and so on) have been bid to prices never seen in history (and we have not even touched on cryptocurrencies – which will be an item for a future commentary). Hathaway goes on to state, "Finally, the highly evident inflation in financial assets, tangible assets and collectibles are unmeasured by the CPI. The Buffet indicator[8] is 45% higher than the market peak in 2000 and 90% higher than the 2007 market peak, as shown in Figure 3."[11]

Are you positioned for inflation, whether it is transitory or intransigent? One final chart from Hathaway's piece is on the relationship between the price of gold bullion and real interest rates (the nominal posted interest rate minus the inflation rate). Back in April 2020, while the markets were imploding, gold recovered all of the pandemic crisis' losses in less than one month, before setting a record nominal high of U$2,080 in August. In real terms though, gold would need to reach U$2,800 to achieve its inflation-adjusted high.

Whether it is gold, commodities, real estate, equities, inflation-adjusted government bonds or floating rate corporate bonds or preferred shares – there are many ways we can build in an element of inflation-protection for your portfolio.

Figure 2: Wages versus food/energy outlays (1969-2021)

Source: MacroMavens.

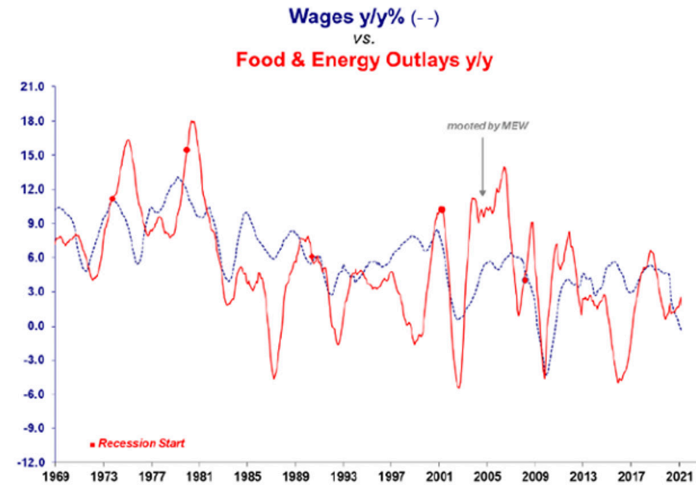
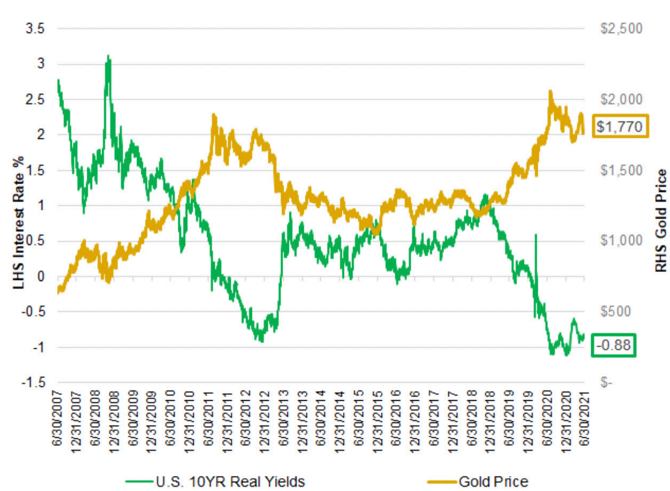


Figure 3. The Buffett indicator is at an all-time high
Total Stock Market Capitalization to GDP (2003-2021)

Source: Bloomberg. Data as of July 12, 2021. Total Stock Market Capitalization is measured by the FT Wilshire 5000 Index.

Figure 4. Negative real interest rates drive gold higher

Source: Bloomberg. Data as of 06/30/2021. Real yields are measured by USGGT10Y Index, representing U.S. 10-year TIPs (Treasury Inflation Protected) yields. You cannot invest directly in an index. Past performance is not indicative of future results.



Notable quotes

" A society that puts equality before freedom will get neither. A society that puts freedom before equality will get a high degree of both."

– Milton Freedman

"The urge to save humanity is almost always a false-front for the urge to rule."

– H.L. Mencken

"It is a sobering fact that the prominence of central banks in this century has coincided with a general tendency towards more inflation, not less. If the overriding objective is price stability, we did better with the nineteenth-century gold standard and passive central banks, with currency boards, or even with 'free banking.' The truly unique power of a central bank, after all, is the power to create money, and ultimately the power to create is the power to destroy."

– Paul Volcker (Chair of the Federal Reserve, 1979-1987)

"Even the luxury suites on the Titanic end up at the bottom of the ocean when she sinks."

– Unknown

Books I've read recently

Brave New World, by Aldous Huxley

The Education of a Value Investor, by Guy Spier

Team updates

- With the July 1, 2021, Alberta re-opening, we are gradually returning to the office. All of the staff will be back at the south side office either full-time or on a rotating basis starting August 3.
- We continue to use Webex for our client meetings, although we can now meet for lunches with our clients or in our lobby. More to follow on in-branch meetings in our next commentary.
- Tina retires at the end of July and our new team member is James B. Lee. James has been working with Tina and Pauline since June 1, so some of you have already had connections with him. We are really pleased with his energy and attention to detail and look forward to blending his unique skills into our team.
- Jon continues his weekend trips to Unity, Saskatchewan, to visit farmers and friends in the area. He and his family will be away in Ottawa, Ontario and Gracefield, PQ, from August 6 to 23 visiting his wife's family and relaxing a bit at the family cottage.
- As always, we are open to speaking to any of your friends that may benefit from a second opinion on their investments or current wealth plan.
- Finally, we would like to recommend that you circle back to our website from time to time, as we are using our site as one of our primary points of contact to post salient articles on our firm's views, along with details on relevant government programs and announcements. You can access it here: ca.rbcwealthmanagement.com/jon.mitchell/

Again, stay safe and take care. We have a lot to be thankful for, living in Canada. Do your best to enjoy the positive moments each day, and please support your local businesses whenever you can.

Below is a table of the performance of various sectors of the market in the second quarter of 2021, and for the 2021 results / three-year rolling periods.

Investment index	Q2 2021 return	2021 YTD return	3-year compound return
S&P/ TSX composite index	8.5%	17.3 %	10.8 %
S&P 500 (C$)	7.2 %	16.1 %	16.4 %
NASDAQ comp (C$)	8.1 %	9.6 %	22.2 %
Short-term comp bond index	0.1 %	-0.5 %	3.1 %
iShares U.S. High Yield Bond Index ETF (XHY, C$ Hedged)	2.2 %	2.5 %	5.1 %
US$ / C$	-1.3 %	-2.6 %	-1.9 %
Gold bullion (C$)	3.5 %	-7.1 %	10.8 %
Global gold mining index (XGD – C$)	2.9 %	-6.4 %	15.5 %

[1] CP-24, “Ontario moving to Step 3 of summer COVID-19 reopening plan on July 16,” July 9, 2021. https://www.cp24.com/news/ontario-moving-to-step-3-of-summer-covid-19-reopening-plan-on-july-16-1.5503079

[2] CBC News, “Here's what Quebec can learn from other regions with vaccination passport systems,” July 12, 2021. https://www.cbc.ca/news/canada/montreal/quebec-vaccination-passports-regions-1.6098362

[3] The Globe and Mail, “Provinces diverge on COVID-19 vaccine passports as some sectors begin requiring proof of immunization,” July 14, 2021. https://www.theglobeandmail.com/canada/article-provinces-diverge-on-vaccine-passports-as-some-sectors-begin-requiring/

[4] New Scientist, “Coronavirus: WHO announces Greek alphabet naming scheme for variants,” June 1, 2021. https://www.newscientist.com/article/2279063-coronavirus-who-announces-greek-alphabet-naming-scheme-for-variants/#:~:text=Alpha%2C%20beta%2C%20gamma%20and%20delta,are%20rising%20in%20the%20UK.

[5] The Conversation, “The Margin of Error Explained,” June 25, 2021. https://theconversation.com/covid-lambda-variant-is-now-in-29-countries-but-what-evidence-do-we-have-that-its-more-dangerous-163936

[6] BBC News, “Covax: How many Covid vaccines have the US and the other G7 countries pledged?,” June 11, 2021. https://www.bbc.com/news/world-55795297

[7] U.K. Coronavirus Dashboard. https://coronavirus.data.gov.uk/details/deaths

[8] NZ Herald, “Covid 19 coronavirus: Singapore's surprising new plan to 'live with' virus,” June 25, 2021. https://www.nzherald.co.nz/world/covid-19-coronavirus-singapores-surprising-new-plan-to-live-with-virus/EKXDOTWZYMUGFRRMF553CH2T5U/

[9] NPR, “Lawsuit Challenges Indiana University's Mandate Requiring COVID-19 Vaccination,” June 28, 2021. https://www.npr.org/2021/06/28/1011043728/lawsuit-challenges-indiana-universitys-mandate-requiring-covid-19-vaccination

[10] Reuters, “FDA adds warning about rare heart inflammation to Pfizer, Moderna COVID shots,” June 25, 2021. https://www.reuters.com/business/healthcare-pharmaceuticals/us-fda-adds-warning-about-rare-heart-inflammation-pfizer-moderna-covid-vaccines-2021-06-26/

[11] Sprott Gold Report, “You Gotta Have Faith,” July 12, 2021. https://sprott.com/insights/sprott-gold-report-you-gotta-have-faith/?utm_source=insights&utm_medium=email&utm_campaign=sprott-gold-report-you-gotta-have-faith&_cldee=am9uLm1pdGNoZWxsQHJiYy5jb20%3d&recipientid=lead-0a3563980dc6ea11a812000d3a0c94a6-5b2503d174d041ffb25609685aa89e68&esid=98b44774-ade4-eb11-bacb-000d3ae992e8&utm_source=insights&utm_medium=email&utm_campaign=sprott-gold-report-you-gotta-have-faith&_cldee=am9uLm1pdGNoZWxsQHJiYy5jb20%3d&recipientid=lead-0a3563980dc6ea11a812000d3a0c94a6-5b2503d174d041ffb25609685aa89e68&esid=98b44774-ade4-eb11-bacb-000d3ae992e8

[12] U.S. Department of Labor: https://www.bls.gov/news.release/pdf/cpi.pdf

Wealth Management
Dominion Securities

21_90731_PZF_003