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Wealth Management
Dominion Securities

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Quarterly Update

It seems like any time we've turned on the TV or gone online in the past year, there's been something about COVID-19. If we were to only watch media outlets and not look at any other news, we might believe we're in an apocalypse. But while the war against COVID-19 is still being fought, the rest of the economy and markets seem to be looking past it, slowly progressing back to pre-pandemic levels and breaking to new highs.

It can be hard to see the light at the end of the tunnel, but we need to trust that things are continuing to move forward. Global growth, unemployment, retail sales and corporate earnings are all coming back faster and better than expected—this on top of unprecedented government support that far surpasses support during the financial crisis of 2008/09. Fears of inflation may cause apprehension, as may equities that appear to be expensive. But the data points to further expansion and growth as we continue in this recovery.

U.S. economy strengthens with upbeat economic data

With vaccine rollout expanding in the U.S., the easing of lockdowns has helped spark an increase in American consumer spending and the lowest number of new unemployment claims since the start of the pandemic. U.S. retail sales grew a seasonally adjusted 9.8% in March compared to the previous month, as spending was bolstered by the arrival of a fresh round of federal stimulus cheques. Meanwhile the number of Americans filing for new unemployment benefits fell by 193,000 to 576,000 in the week ending April 10.

According to an article from the Wall Street Journal on April 6th by Yuka Hayashi, the IMF increased its 2021 growth projection from 5.5% in January to 6%—the highest projected growth rate on record going back to 1980. Manufacturing data added to the optimism, as the Federal Reserve's industrial production report showed factory output grew the most in eight months. Two regional manufacturing surveys from the New York and Philadelphia Feds also topped expectations, according to a March 18 Bloomberg article by Vince Golle, with the latter hitting its highest level since 1973. This is all in accordance with the U.S.'s recent $1.9-trillion COVID-19 relief bill—the latest in a long list of massive government fiscal-support measures enacted around the world.

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The strong growth of corporate earnings (figure 1), already rising faster than expected, is also driving a capital-spending rebound that is likely to improve productivity and help keep inflation in check. We expect the momentum provided by the reopening, the delayed impact of fiscal and monetary stimulus and the initiation of infrastructure spending will all provide further solid gross-domestic-product (GDP) and earnings gains in 2022. Share prices should advance further over the course of this year, in anticipation.

Fear of inflation

The normally sleepy world of fixed income continued to keep investors on their toes through the first quarter of 2021. After opening the year below 1%, the benchmark U.S. 10-year treasury yield jumped to 1.75%, amongst the biggest three-month moves of the past 20 years. After a decade-long stretch of low inflation, concerns of inflation are now dominating the narrative, given what has been known to take place on the back of other periods of historic stimulus.

Not surprisingly, major moves such as these have the tendency to spook markets, but we continue to believe this move in treasury yields is happening for all of the right reasons—and that it's simply reflective of a robust economic outlook, as economists and the Federal Reserve revise growth estimates. For all the large numbers associated with this recovery and the unprecedented nature of the global pandemic, the developments in fixed-income markets in recent months are largely in line with the normal cadence we've seen in the aftermath of past recessions. This suggests good times may be just getting started.

What are we doing?

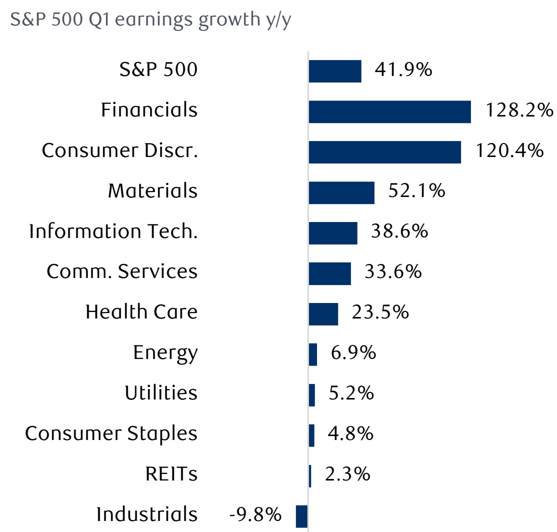
Our thesis on the economic landscape continues to remain intact; we see continued economic growth and recovery as we continue to get back to pre-pandemic levels. Even though we remain in a third wave and COVID-19 is still at large, our investment stance has not wavered from overweight equities and underweight fixed income. Our long-term investment stance remains: if there is no U.S. recession in sight, give global equities the benefit of the doubt.

There are powerful tailwinds moving the economy forward. These include the continuing impact of fiscal stimulus, much of which sits unspent in bank accounts, the ongoing effort by businesses to replenish severely depleted inventories and the potential for large infrastructure spending starting in 2022.

And within our evolving equity bucket, we have recently added a new position that aims to benefit from a transition to green and renewable energy from oil and the use of fossil fuels. With several nations around the world looking to reduce the use of fossil fuels and oil consumption over the next 10 years, this has led us to look for an investment solution that does more than just check the ESG (environmental, social and governance) boxes. This equity fund aims to find companies with solid balance sheets and growing earnings that are either developing products that produce green energy or will benefit from the transition to renewable energy. Even though this green transition is still many years from mainstream use, we want to be early on the side of change.

As we spoke about earlier in this piece, the rising of yield curves and inflation is expected for an economy that is recovering. While we don't believe rising rates will happen in the short term, we do believe we'll see rates continue to move back toward long-term averages in the coming years. This presents a major risk with fixed income, which is why we continue to hold high-quality, short-duration fixed income.

The earnings recovery is underway



Source: FactSet, RBC Wealth Management; data through 4/29/21

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