RBC Dominion Securities Inc.

The Sandler Quarterly

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Dominion Securities

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There's more where that came from

KEY INSIGHTS

- Global equity markets make new highs as investors look beyond Covid
- Governments and central bankers keep the money flowing with continued stimulus
- Increased inflation outlook takes centre stage
- Short term interest rates remain at rock bottom levels while longer rates head higher
- Global vaccine rollout is spotty at best, but gives hope for better times ahead

2021 has begun with a bang!……from an investing perspective at least. Yes, we know that many parts of the world continue to battle in the Covid trenches (Canada and Ontario not least among them), but investors have clearly chosen to overlook Covid when making capital allocation decisions.

Market watchers and analysts credit this market strength to investors looking beyond the pandemic. This thesis is based on better times ahead, economic growth, and a return to normal. We subscribe to this way of thinking, but do not believe it to be the only driver behind markets reaching all-time highs.

For those of you who regularly read our quarterly newsletters, you will recall that the topic of asset price inflation has been our core theme since last summer. A brief refresher goes like this: Governments and Central Banks print trillions of dollars to support and stimulate the economy. (*See Figure 1 - US money Supply*) At the same time, they also reduce interest rates to virtually nothing and pledge to keep them there for the foreseeable future. This wave of money makes its way through the economy and quickly comes to rest in strong hands (wealthy individuals and companies). Leaving this cash pile in the bank with interest rates at zero is not a palatable option. (*See Figure 2 - cash*

Figure 1: U.S. money-supply growth *(Source: Havery Analytics, RBC GAM)*

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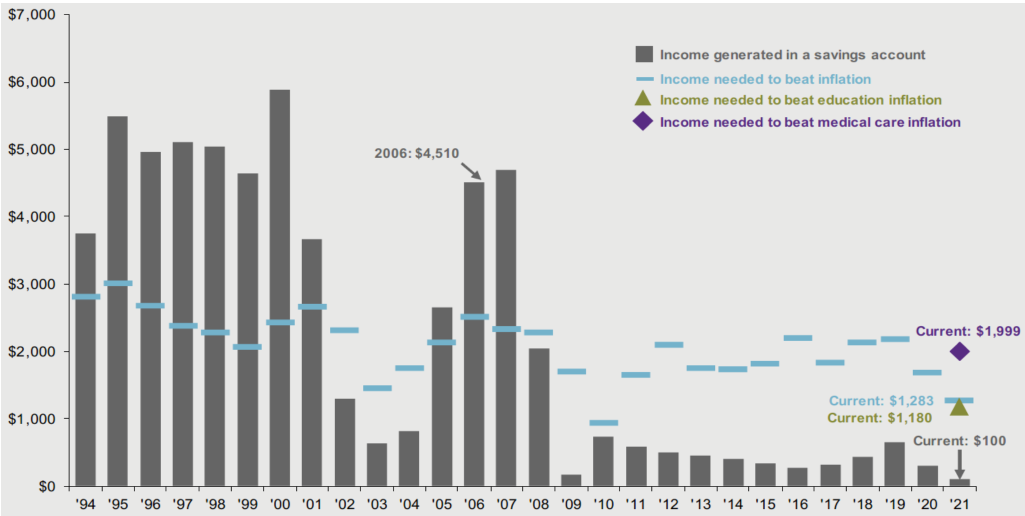

***Figure 2**:* Income earned on $100,000 in a savings account *(Source: JPMorgan)*

account returns) And so the money pours into the market, real estate, precious metals, crypto-currencies, art, etc.

Globally, consumers have stockpiled an extra $5.4 trillion of savings since the pandemic began according to the Financial Times of London. This hoard will either be spent in the economy (who isn't dying to take a trip?) or put to use in investments. Spending on goods and services will boost earnings, making companies more profitable and attractive. (*See Figure 3 - S&P500 earnings*) This will, in turn, support the case for the wave of dollars continuing to flow into the market.

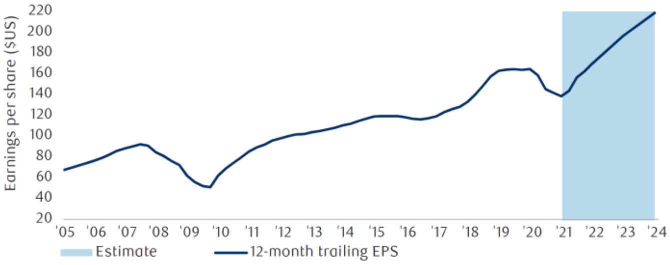

***Figure 3**:* S&P 500 Index 12-month trailing EPS *(Source: RBC)*

Money flows into assets for two main reasons: to generate a return on capital or to protect capital (or sometimes both). An investment in a business (the stock market) seeks to generate a return in the form of dividends and/or growth of the underlying business. An investment in precious metals, fine art or classic cars is seen as a store of value and inflation protection. Real estate can provide both a return on capital (in the form of rental income or utility) and also act as a store of value and inflation protection. In a world where more dollars are printed on a daily basis, all of these options seem attractive depending on your objectives.

We recognize that we have restated these concepts in recent newsletters but we do so because we view this as the main driver behind the remarkable strength in the equity and real estate markets. Also, when we first started highlighting the inflation theme, most economists were downplaying the issue. Fast forward to today and it's almost all one reads about in the financial pages. Since it has become widely topical recently we thought it worthy of a refresher.

We also revisit the idea of asset price inflation because we see it continuing to play out over the coming months and years. The money printing-presses show no signs of slowing down. The US recently gave the go-ahead on yet another $2 Trillion stimulus package and are currently debating an infrastructure spending package that would see trillions more spent over the coming years. And this is just one, admittedly large, country. Canada's latest budget (just announced) is unsurprisingly focused on spending programs. See page 5 for a review of the key highlights.

It won't be smooth sailing (there's always a correction around the corner), but equity markets and other assets should continue higher in our estimation. Remaining invested seems imperative.

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The real world manifestation of these concepts can be seen in global markets and portfolios trading at all-time highs. The TSX, Dow and S&P500 are all achieving record levels at time of writing with the tech-heavy NASDAQ not far off it's high. Additionally important for our clients is the remarkable strength seen year to date in the preferred share market. We have traditionally owned preferred shares for the predictable income they provide but recently they have also delivered capital gains.

For the most part, Canadian preferred shares are linked to the Government of Canada 5 year bond yield. Higher bond yields translate into higher dividend yields on rate-reset preferreds. This in turn makes them more attractive and pushes up share prices. In recent months, longer dated bond yields have risen as investors refuse to accept the paltry yields offered late last year. This again comes down to inflation; if inflation is expected at 2.5% for example, why would one want to lock in a 5 year commitment to a bond paying half a percent? Preferred shares have likely seen the lion's share of their price increases for the time being but still offer great income in the form of dividends.

Investing Styles - Value, Growth……or a little of both!

There are an infinite number of ways to invest one's money. Broadly speaking however, equity investing styles can typically be categorized as either "Growth" or "Value". Growth investors buy businesses that they believe will be able to rapidly increase earnings in the future. They are willing to overpay today in the belief that paying a premium will be justified by higher earnings in the coming years. Value investors seek to buy established businesses at a fair price based on a tangible understanding of the assets, earnings and dividends.

Growth investors take a leap of faith and, on balance, are rewarded for it. Value investors prefer the predictability of knowing what they are getting for the price they pay. Value investors are rewarded for their discipline and for buying a business at, or below, its intrinsic value. Both styles of investing work. However, the ride from point A to point B can feel quite different.

Consider a drive from Toronto to Montreal. The growth investor is in a sports car and the value investor is in a comfortable sedan. The growth investor jumps from lane to lane, speeds up, slams on the breaks, etc. When things are moving freely it's fun and exciting, but there is also a fair share of scary moments as speed and weaving present unexpected risks. The value investor settles into the centre lane and sets the cruise control at 100kph. Both investors reach their destination but have had quite a different experience.

We are value investors. We like to know what we are buying and what we are paying for it. This does not mean that we do not seek growth in our investments, but we want to understand the trajectory and see a clear path to increasing earnings. Growth investors are required to take a leap of faith that is often rewarded……but sometimes not.

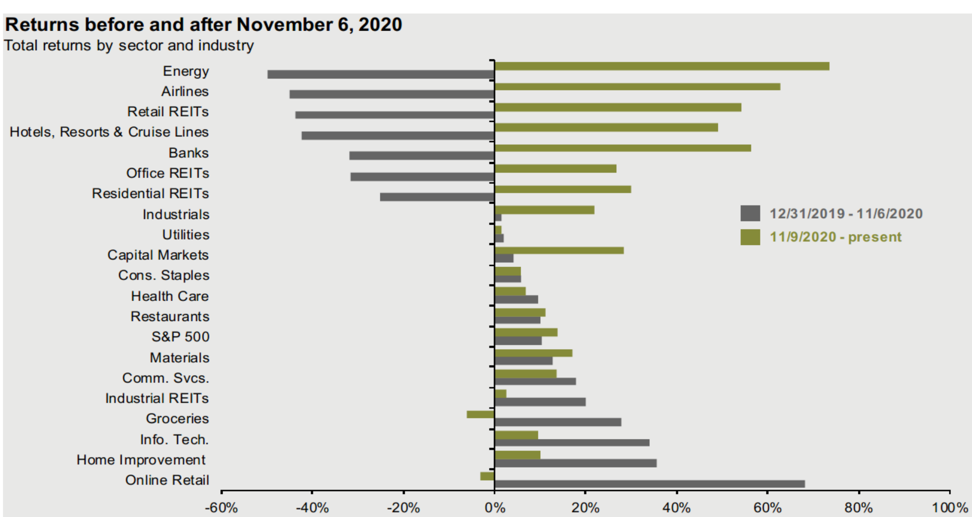

***Figure 4**: Sector leadership through the pandemic, returns before and after Nov 6th, 2020 (Source: JPMorgan)*

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Over time, both styles of investing come in and out of favour. In 2020, growth companies like Netflix, Zoom and DocuSign caught the attention of investors willing to pay huge prices for a share of their bright futures. 2021 has seen market participants focus their attention back on the old guard of banks, insurance companies, industrials and real estate. *Figure 4* chooses November 6th as a turning point and shows performance of individual sectors before and after that point. As of March 31st, Russell large cap value style index had gained 11.3% while large cap growth had only advanced by 0.9% YTD. *Figure 5* shows the year to date outperformance of value investing.

	Value	Blend	Growth
Large	11.3%	6.2%	0.9%
Mid	13.1%	8.1%	-0.6%
Small	21.2%	12.7%	4.9%

Figure 5: *YTD returns by investment style (Source: JPMorgan)*

As you can imagine, the delineation between growth and value companies is not crystal clear. Some can fall into both camps. GARP (growth at a reasonable price) is an investment strategy that combines the merits of the two styles. A company like Apple may have a higher valuation than Royal Bank, but the expected and quantifiable growth in Apple's business can make paying that premium acceptable. It is important to note that GARP investments like Apple, Google, Amazon and MasterCard all possess a visible pathway to grow into their valuation in the foreseeable future. This is very different from the leap of faith required to justify the lofty valuation of Tesla or Shopify.

Another Asset Class - Insurance

We regularly talk about asset classes like equities and fixed income. We are constantly reviewing your asset allocation to ensure that your stated targets are adhered to. While equities and fixed income have a place in everyone's portfolio, there is another alternative asset class to be considered in certain situations. Life Insurance is typically viewed as a risk management tool to protect family members from adverse financial conditions. That said, in many circumstances it can also be used as a highly effective tax-exempt investment vehicle.

While not for everyone, individuals with excess capital and ample cash flow should at least understand the concept of insurance as an investment. If it is apparent that you will leave an inheritance to your children, an insurance policy can achieve the following benefits:

- All deposits into a life insurance policy grow tax-free, similar to a portfolio within a RSP
- The death benefit is paid to your heirs tax-free and can avoid probate tax
- The policy can be structured so that you have access to the value of the policy during your lifetime on a tax-effective basis

In addition to these attractive features, life insurance owned through a corporation magnifies these benefits and allows for corporate dollars to be liberated in a highly tax-efficient manner.

Please find a link below to a brief overview of the concept. Speak to us directly to explore if life insurance may form an appropriate part of your overall investment strategy.

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We continue to live in interesting and uncertain times. Now, and always, we seek to manage uncertainty with an informed outlook and a logical plan. As things change (and they will) we will shift our outlook accordingly. Always, however, against the backdrop of a well-reasoned asset allocation target and a focus on owning the best quality businesses in the world.

We thank you for your continued support and loyalty through the past year. Ours is a business built on longstanding relationships - never before has this been more apparent and gratifying.

Enjoy the spring and all of the wonderful and positive things that it brings,

Scott Sandler
VP & Portfolio Manager

Ronan Clohissey, CIM
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A Post-Budget Analysis with Eric Lascelles

	TTM	YTD
Indices		
S&P/TSX	39.78%	7.27%
Dow Jones	50.48%	7.76%
S&P 500	53.71%	5.77%
Nasdaq	72.04%	2.78%
Euro Stoxx	40.63%	10.32%
Japan Nikkei	45.08%	16.01%
India Sensex	68.01%	3.68%
VIX (Volatility)	-63.77%	-14.73%
Commodities		
Gold	8.28%	-10.04%
Silver	74.73%	-7.52%
Copper	77.93%	13.40%
Oil	188.87%	21.93%
Natural Gas	47.00%	4.96%
Currency		
CAD	11.98%	1.38%
EUR	6.34%	-3.98%
JPY	-2.87%	-6.68%
AUD	23.93%	-1.25%
GBP	10.97%	0.83%

Values as of March 31st, 2021

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