Patrick O'Brien's

August 2020 Client Note: Update

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Dear Clients and Friends,

I hope that this note finds you well and enjoying some warm summer weather. I am watching the small birds–chickadees, gold finches, and others loading up on the seeds of the sunflowers I plant for them each year. I am happy to provide them with the extra fat for the winter or their trip south.

Executive Summary (all you really need to read):

Markets continue to make progress based on the expectation of a licensed vaccine before Christmas and the eventual end to the pandemic. The US elections are expected to be acrimonious, but historically have had little effect on market trends. While I expect dividend increases to slow temporarily, two companies in most portfolios have increased their dividends in the last month.

Be careful of the media. Remember that downturns are inevitable, unpredictable, but **temporary** when you hold quality companies. That doesn't make them fun or enjoyable; just a fact of life for which we are well compensated. Please contact me to discuss your portfolio/financial planning as you see fit. I enjoy the conversations and look forward to speaking with you. Celine and Brooklyn (Celine's new assistant) are back in the office. Tanner and I will return at an as yet unspecified date.

The Long Version (only for those who want more...)

Market Update:

Markets continue to recover and the "chickens" (i.e. stocks) continue to lay their eggs (dividends). "Chickens" that have increased egg production recently include Capital Power Corp (electricity) and CP Rail. A company needs to be doubly certain that it can afford to increase its dividend during the worst economic downturn since 1929.

Question: Why is it that the market and the economic situation are not in sync?

The short answer is that they usually aren't anyway, yet people continue to be perplexed by their disparate paths. You would think that measuring business and other types of economic activity would be useful in predicting the direction of stock markets. It isn't, counter intuitive, but true. As Warren Buffett has famously said, "Any company with an economist on staff has one too many employees." I don't mean that pejoratively as economic theory has it uses in policy design, but it is hopeless as a predictor of stock market direction. The market is generally forward looking and economic data is backward looking so the economic information is always behind the times. The current market is looking past the pandemic and the US election. Governments around the world are supporting their citizens and corporations (which includes the stock market) with stimulus to replace the regular income that has been curtailed by the virus induced lockdowns.

The Continuing Pandemic:

I expect that portfolios will continue their gradual "two steps forward one step back" with many now in positive territory year to date. I don't have a crystal ball, but I believe that an effective vaccine may not be far off with multiple vaccine producers in the final phase 3 trials required for licensing. The COVID-19 vaccine trial results to date (published in multiple recognized journals) appear to be uniformly positive. Further, they are already in vaccine production anticipating licensure and striking supply agreements with government agencies including Canada. Please call me to discuss this further as you see fit.

The US Presidential Election:

The US presidential election is likely to be more acrimonious than usual. The good news is that historically, elections do not have any lasting effects on the markets. Democratic regimes (should that be the outcome) also tend to have better stock market performance as well. Not that surprising really since both parties would be considered pro-business if they were located here in Canada. But what if the election is too close to call and is disputed? In the 2004 election, the vote was very close prompting Mr. Gore to challenge the results causing a few months of uncertainty. I will allow that the mercurial nature of the incumbent may intensify that uncertainty if the election is close. However, I also believe that the democratic institutions of the US will prevail and the loser will have to acquiesce, if not necessarily quietly.

Where to Now?

I am very pleased that a number of clients have called me recently to discuss their market concerns. Their emotions ("gut feeling") are telling them to sell now at the "top" and then buy back in at the "bottom". Sounds like a great idea and there are many professional and lay people who follow market timing models. Unfortunately, it doesn't work and can create significant tax bills as well. I recently did reviews with three friends with similar portfolios. Two follow my suggestions and we have experienced the downturns and the upturns through the years. We know that downturns are inevitable, unpredictable but temporary when you own companies that produce a necessity. The results have been pleasing. The third person has on two occasions sold out his portfolio attempting to side step a downturn and buy back at lower prices. The result has been a 37% underperformance relative to his peers since 2012 and serious anxiety around the re-entry into the market. The most recent lost opportunity cost was about $115,000 and a tax bill of around $40,000.

Managing the Media Hype:

The hysteria over the pandemic and the US presidential election has proved to be an advertising bonanza for media companies of all stripes. Humans still behave like a prey species, given to believing that the worst is the most likely outcome of any negative surprise. The media is largely responsible for the "gut" feeling that is often conveyed to me by concerned clients. They have the feeling that terrible things are about to happen, i.e. the equivalent of a tiger is chasing them. I am not immune to those feelings, but over the last 25 years of market experience, I have learned to control my thoughts. That part of the brain that creates the "fight or flight" response is critical to our survival in the jungles of the Indian subcontinent, but counterproductive when applied to the investment process. Since the media is the major source of the emotional response, limiting its power is a helpful exercise.

This is how I manage my media inputs to my brain:

I recognize that I need information to be an active participant for our democracy to be maintained and to be an effective investment advisor. However, I must be wary of the sources, content, and the amount of time spent consuming it. Therefore, I do not watch any television news. It is too powerful an influencer and beholden to the need to keep eyeballs to facilitate advertising sales. Radio has likewise become so infused with trepidation that it has become unhelpful. I have for many years read widely from media with a variety of perspectives to get the information I need both for effective investment and the promulgation of the Canadian democracy. Some stories are germane and well written, others are poor in content or importance and only worthy of a glance at the headline.

Bottom Line:

Stay the course, limit your media consumption, and we will be fine because we hold quality companies that provide necessities from valuable assets (like a hydro dam). The elections will be over and so will the pandemic. Remember that downturns are **inevitable, unpredictable, but temporary** when you hold quality companies. That doesn't make market declines fun or enjoyable; just a fact of life for which we are well compensated by much higher returns than holding a strict GIC portfolio only.

Please do call me if you need, or even just want, to talk about your portfolio or any aspect of your financial planning. I am not tempted to sell my holdings (except for possible tax reasons only to rebuy after 30 days). My discussions with you are part of my job. In the end, this is your money and I give advice, but take orders from you. If, after speaking with me, you want to change the portfolio safety level, we can easily do so.

On another note, my staff and I will be gradually returning to the office with Celine and Brooklyn already present as of Monday August 17th, albeit with significant restrictions. Tanner and I likely won't be able to return for a while yet, but I can make arrangements to meet with you either by WebEx video conference, phone, facetime, or at a location other than the office where I am able to keep a social distance.

I wish you a pleasant end to the summer season.

Regards,

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