COOPER WEALTH MANAGEMENT
RBC Dominion Securities

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THOUGHTS FROM HOME

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Exploring the Markets

"Exploration is the engine that drives innovation. Innovation drives economic growth. So let's all go exploring."
- Edith Widder, Oceanographer

Edith Widder explored the depths of the ocean and found the giant squid, a feat previously thought impossible, which fostered innovation and new opportunities in the world of oceanography. The market is our ocean and this month we will explore the issues of today and look for opportunities to innovate.

The biggest problem on the horizon is the new Omicron strain of Covid. It is initially thought to be less virulent than Delta but may be more transmissible. Ironically, this comes at a time when the original Covid virus has all but disappeared and only represents 2.5% of new cases versus 97.5% for Delta. The market's initial reaction was a sharp sell off on US Black Friday but markets appear poised for a recovery immediately. Fear is the usual reaction to the unknown but the market has gone through this twice before with Covid and the Delta variant. There will likely be some days of market weakness if the Omicron news gets worse and leads to another wave. However, the world is much better prepared with both vaccines and treatments. Also, most investors will remember that the panic selling of February and March 2020 was a mistake, as it always is. Our lesson in innovation from the initial Covid crisis was that the traditional safe haven equity investments such as banks and utilities were not as effective and growth stocks, particularly large capitalization technology were the right direction. What seemed like taking more risk was actually the lower risk trade. The coming days will require patience but our Covid playbook remains in place, focusing on a balance between strong growth and dividend income.

Inflation is also much in the news and must be looked into. The good news is that some of the main short term causes seem to be easing. Shipping bottlenecks appear to be clearing. As a result, the cost of shipping containers has dropped dramatically and the Baltic Dry Index, which measures the cost of shipping new materials by sea is down by 50% from its high. We have also seen the cost of commodities such as lumber and iron ore normalize as supply and demand find their proper levels. Demand is still strong globally and that will keep some inflation pressure in the economic pipeline but we continue to view this current higher inflation level as transitory. The ironic part of all this is when demand does slow back to normal, the market will start to worry about recession while we will be looking for opportunities to innovate again.

The next area to explore is monetary policy. As soon as inflation enters the discussion, the market immediately expects the US Federal Reserve to begin increasing interest rates to slow down economic growth. In the past, this had been a very effective monetary policy tool as major companies were heavily reliant on short term borrowing to fund their operations. This is simply no longer the case. Most S&P 500 companies have used the low interest rate environment of the last few years to refinance their operations at low cost, long term levels. Except for financial companies, interest rate increases will have little effect. There is also the compound effect of negative interest rates in large portions of the world, particularly the European Union and Japan. As long as foreign investors can buy US Treasury bonds and make a positive return net of currency exposure, there will continue to be downward pressure on US yields, regardless of what the US Federal Reserve does. For interest rates to move higher globally, all governments would have to stop their quantitative easing/bond buying programs and everyone would have to raise interest rates together. An action this drastic would be a disaster for global bond markets and would definitely cause more problems than it would solve. Our overall view remains that interest rates will remain near current levels.

Next, let's take a look at the consumer. Demand for consumer goods remains elevated but services are still below pre-Covid levels. This is particularly true in the hospitality and travel sectors. Covid has canceled many travel plans in the last two years but that demand has not gone away. It has merely been deferred. Omicron may delay these plans further, depending on how the coming weeks play out. What will be tough for policy makers to adjust to will be how long this economic cycle will continue to run in a post Covid world. Further to the interest rate discussion, how can the US Federal Reserve even consider raising rates at this point when significant parts of the economy are literally borrowing monthly to just survive? The good news is that on average, US consumers are spending at normal levels, plan to spend more when travel is easier and safer, and still managing to save. These are all positive indicators for the stock market as it appears the economy will be solid for the year ahead, despite still being below full capacity.

Unemployment remains a key economic driver and must be considered. As soon as it starts to rise, nervous investors exit the market as they anticipate an economic slowdown. Fortunately, as people have been vaccinated and the US economy has largely reopened, this number has steadily improved. In fact, millions of job postings are going unfilled due to both a mismatch of jobs and available candidates, a high level of Baby Boomer retirements and overly generous Covid related benefits. This has, and will likely continue too, put inflationary pressure on wages. This is definitely something to watch going forward but so far has had a minimal impact on most corporate profits.

Innovation has been a key theme during the Covid crisis. As people, we had to come up with new routines for daily life. Working from home was no longer an option but a necessity. Governments rethought monetary policy and provided massive stimulus to keep economies afloat. As investors, innovation came through a change in thinking about how to approach portfolio construction and stock selections. We have taken these lessons to heart and will continue to focus on technology and companies that have proven they can navigate through crisis. The investment ocean may be choppy for a while but calmer days lie ahead.

All of us here with Cooper Wealth Management wish you and your families all the best for the holidays and a happy, healthy and prosperous New Year.

As always, questions, comments, concerns and opinions are always welcome.

Yours truly,

Trevor, Walter and the Cooper Wealth Management team