COOPER WEALTH MANAGEMENT
RBC Dominion Securities

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THOUGHTS FROM HOME

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The Half Full Glass

"A pessimist is somebody who complains about the noise when opportunity knocks."
- Oscar Wilde

The last 18 months have been remarkable, both in our personal lives and in the equity markets. From the March 2020 low, the S&P 500 has doubled, with over 50 daily new record highs. All this success in so short a time has lead to a widening divide of opinion among market traders between optimism and pessimism on the future direction of the market. The glass half full optimists point to strong corporate earnings, low interest rates, a recovering economy and record liquidity. The pessimists see inflation, global supply constraints, the overly long market rally and inflated price/earnings ratios. This month, we will examine both sides of this debate.

First, a few thoughts about Covid. Almost half the daily new cases globally are coming from the U.S. but in total, recoveries are matching new cases so at least the total number of people with Covid is not increasing. We are cautiously optimistic the Delta wave is close to peaking, but the battle is not over. The market has weathered the crisis well and barring a further significant shutdown, should continue to do so.

The Glass Half Empty Argument

The current level of inflation has largely been accepted by the market but it is the fear of future inflation, particularly in base metals and currency, that has the market on edge. We expect commodity inflation to remain in place for the next couple of years until the excess global demand for goods has worked its way through the economy. As to monetary inflation, we will only become concerned when we begin to see loan demand exceed money supply growth. Given the continued quantitative easing going on globally, we do not see this happening for the foreseeable future. For our further thoughts on inflation, please refer our July newsletter, "The Inflation Situation".

Global supply constraints will continue until the excess demand for goods caused by Covid restrictions returns to normal. This will likely take another 1-3 years, as many parts of the economy such as small businesses and travel are still operating at reduced levels. When these businesses return to normal, their renewed demand will extend the economic recovery.

The market has rallied for seven months in a row, setting new records along the way. It is undeniable that a sell off will occur at some point, whether caused by simple profit taking or some other event. However, the depth and breadth of any future sell off is impossible to predict. Given the data at hand, it is our belief that any weakness in the near term would represent a buying opportunity.

Finally, with the S&P 500 trading at an average of 22 times forward earnings, stock valuations in the U.S. could be considered on the high side at the moment. We would note that many components of the S&P, particularly the technology names, are experiencing 10-20% growth in earnings, making these valuations much more reasonable. Overall, we will continue to be very selective in picking stocks with both strong current earnings but also potential growth.

The Glass Half Full Argument

Last quarter, U.S. corporate earnings did not disappoint with over 90% of companies beating estimates. This factors in a global economy below pre-Covid levels, supply constraints and higher unemployment. No doubt expectations will be higher for next quarter but there still remains significant opportunities for corporate earnings growth.

Low interest rates have long been a strong catalyst for the equity markets. The U.S. Federal Reserve has started to hint that they are looking to begin raising interest rates sometime in 2022 or 2023. This is similar to the tactic they tried in the last quarter of 2018 which completely failed. The amount of total cash in the global economy, as well as the amount of foreign debt carrying negative interest rates, is even higher than it was in 2018. Unless economic conditions change dramatically between now and then, we do not believe that any U.S. rate increase would be sustainable.

The recovering global economy will also continue to support the market. The economic recovery has been delayed by the Covid Delta variant but that simply means it will continue to improve over a longer period of time, which provides a longer runway for market improvement. Travel will be a particularly key element, as tourism is a major source of revenue for many countries.

The record level of liquidity means investors will have to continue to look at the stock market for returns, as fixed income investments mostly have a negative real rate of return now, once you factor in inflation. We continue to generate positive returns for our fixed income investors through the use of preferred shares, which offer the added benefits of the dividend tax credit and much higher yields, while maintaining investment grade quality.

In summary, referring back to Oscar Wilde, very few pessimists are successful long term investors. On balance, all the available evidence seems to be pointing in a positive direction. We will continue to rebalance your investment glass so that it's neither half empty or full but just right.

As always, comments, criticism, questions or concerns are always welcome. Until next time, stay healthy.

Yours truly,

Trevor, Walter and the Cooper Wealth Management team