I would like to share with you my current outlook on the markets, provide some commentary on recent market events, and hopefully provide a few words of advice that can provide some useful perspective.

MY ONE YEAR OUTLOOK

I have a **positive outlook for the markets when looking one year out from today, while humbly not believing I can time the next pullbacks and corrections.**

What makes me optimistic about the year ahead?
- Many corporations used the extraordinary events in 2020 as an opportunity to reduce their costs and refinance their lending at lower rates. This should all bode well for the stock market for calendar 2021.
- There is plenty of pent up demand from consumers that have been forced to save money.
- Greater predictability and relative professionalism has returned to Washington - both on domestic and foreign policy.
- COVID-19 has forced technological adoption by necessity.
- The pharmaceutical industry delivered a wonderful 'vaccine' gift to the world with staggering speed. This bodes well for future medical advances - with many positive repercussions.
- Strong continued monetary and fiscal stimulus from the government is a positive for the markets

What keeps me up at night?
- Taxes will need to go up at some point - but hopefully this will have been offset by government stimulus.
- Money may be taken out of the markets as the economy recovers, e.g. less investing on behalf of individuals using the stock market as a past time during COVID + money to be used to spend on travel, entertainment, etc.
  This being said, many companies will benefit from this added spending.
- I am slightly worried by the high bullish sentiment as witnessed with a big increase in options' trading amongst retail clients. This points to some speculative excess in certain segments of the market.
- I am also worried by 'the bus you can't see coming!' There is the 'known'. There is the 'known unknown' (i.e. the things for which we don't know the end result yet - but we are aware of their existence). It is the unknown that only a few know exists and are essentially ignored by the markets that often prove to be more damaging. For instance, back in 2019, how many market experts built in a pandemic scenario in their forecasts? Almost nobody, I would guess. So could 2021 could also reserve another big surprise? Maybe it will be a military conflict? Maybe a liquidity crisis in the financial markets? Maybe some other health crisis?

Regardless of what happens to the high risk segments of the markets (see commentary below) , and consistent with my positive outlook for the stock market, certain segments of the stock market will do better in relative terms than other sectors - and those sectors may not the same sectors that outperformed in 2020. In looking at the second half of 2021, I cannot see the entire world population spending as much time indoors and on their computers once lockdowns come to an end, vaccines are widely distributed, travel becomes easier, restaurants open, we are able to go to concerts, etc. This may take some of the speculative froth out of some of the riskiest market bets we have seen lately and also out of some of the more pure 'stay-at-home stocks'. Consequently, I recommend above-average exposure to 'value/economically sensitive/ cyclical/ older economy' stocks for 2021. Many Canadian investors already have above-average exposure to these sectors through investments in financial, commodity, and emerging market stocks. Interestingly, since so-called 'Pfizer Monday' (Nov. 9th, when

Pfizer officially announced its favorable vaccine results), cyclical stocks have actually been outperforming 'growth' stocks. Still, for the average investor, exposure to both 'growth' stocks and 'cyclical' stocks is probably wiser since that would not involve special timing skills + would smooth out one's returns. I therefore continue to advocate broad diversification for equities.

I believe broad diversification makes sense for fixed income also. On any given day, some economists/financial experts proclaim that excessive government spending will lead to inflation and higher rates while other economists/ financial experts say that the central banks have to keep rates low for the next two-to-three years so as to not interfere with the expected economic recovery. It is therefore difficult to make a short-or-medium term prediction on interest rates. Consequently, fixed income diversification is a good way to go, in my opinion.

On a different but not totally unrelated matter: Many of us probably wish we could go back in time and be much more aggressive with our investments back in March 2020 - i.e. during the market lows. Since that is impossible, I sometimes simplify my search for value in the stock market by looking at a company's stock price at the end of 2019. I then search for that company's earnings forecast for 2022, and compare it to that company's actual earnings in 2019. If that company's earnings are expected to be higher in 2022 than in 2019, it is reasonable to believe (not a guarantee, of course) that its stock price will end up higher than it was in 2019. By comparing 2022 expected earnings to actual 2019 earnings, it is much easier to find many stocks that might still be quite undervalued, in my opinion. And for the stocks that are already much higher than their 2019 price (think big 'growth' stocks, e.g. Microsoft, Costco, etc.…), that is typically because their 2020 (let alone their 2022) profits were higher than their 2019 profits.

MARKET COMMENTARY + VIEWS ON A POSSIBLE CORRECTION

Back on October 30th, the title of my newsletter was '*Is this the point of Maximum Uncertainty?*'. Well we now seem to have moved from a time of high uncertainty back on October 30th to a time when many (but never 'all') of the questions we had then have now been answered. For example, (1) the final outcome of the US elections is known, and (2) the vaccine testing results are out and the vaccination process has begun.

So does this decreased level of uncertainty now mean it is 'safe' to invest', or does it mean the exact opposite, i.e. we need to be on guard for what could go wrong now? Time will tell but it would be very natural to openly wonder if we are now due for a correction.

<u>A market correction would be natural, normal, welcome by some (who want to buy at lower prices!), and probably even healthy in the long-run</u>. According to Chris Hyzy, Chief Investment Officer of Merrill and Bank of America Private Bank, "*on average, we have two to three pullbacks in the 5% range per year, and one 10%+ correction per year"* (CNBC, Jan22). <u>The problem is that nobody can consistently and reliably predict exactly when we will experience these pullbacks and corrections</u>. I would also argue that even if you had all the publicly available information in the world and hired the top ranked market analysts to analyze this data, you would still not be to accurately forecast the timing of the next pullbacks or corrections. You may make a few good market calls, but you will not be able to consistently and reliably make accurate short-term market forecasts.

Thankfully, being able to make consistent, reliable, and accurate short-term market forecasts is <u>not</u> a requirement to be successful in the markets over the long run. In my opinion, it is more important to (1) generally have a positive view of the stock market since history shows that the broad markets do well over the long-term, (2) keep your emotions in check - which essentially translates to not getting overly pessimistic during market downturns and not getting overly optimistic when markets are at their highs, and (3) if circumstances allow, consider adding risk to a portfolio during market downturns and reducing risk after strong market advances. These three important suggestions do not require any forecasting ability. I would even argue that overconfidence in one's ability to accurately time short-term market moves could be dangerous to your financial health.

COMMENTARY ON SOME WILD MOVES IN CERTAIN SEGMENTS OF THE MARKET

2021 is already off to quite an interesting start. We have witnessed (1) a so-called Reddit revolution as exemplified by significant up and down moves in higher risk investments such as of GameStop - which many say is propelled by a new generation of retail investors using social media,(2) the strong rise in the value of bitcoin, (3) a strong interest in SPACs (i.e. special purpose acquisition company, sometimes even referred to as "blank check companies"), which are formed strictly to raise capital or the purpose of acquiring an existing company. I would add that many stocks in the electric vehicles and renewable energy industries have also garnered a tremendous amount of attention over the past two years and may have gotten ahead of themselves.

I certainly find it a bit disconcerting that the recent sharp rise in GameStop shares was discussed on the front page of the Globe and Mail both on January 28th and January 29th. This, in my opinion, might be a warning sign in and of itself. In fact, as of this writing (11:20am, Feb 2) GameStop is down 40 percent on the day! But I do believe that the rapid increases we are witnessing in the market values of many of these riskier types of investments are probably partly a reflection of what is currently going on in our society and in our economy. For instance, think of (1) the increased use - some would say- misuse of social media, (2) the possible 'gamification' of the markets - meaning that some investors may treat investments almost like a video game, and have zero interest in the actual fundamental value of what they are buying, and (3) due to COVID and the government stimulus, many people have more money and more time on their hands, and have fewer outlets for gambling activities - so the markets can present an attractive outlet.

Will all of this end badly? If the bubble was to burst in these riskier segments of the market, would this affect the overall market? One could even legitimately ask whether the overall stock market is in a bubble territory that is ready to burst?
I certainly do believe that some pockets of the market are in bubble territory, and should come with a strong '*investment in this product can be hazardous to your financial health'* warning. But markets do not behave homogenously, i.e. if GameStop went back to $20 a share, I am not convinced that would have a major impact on the rest of the markets. Bursting the current speculative bubble in high risk investments should not lead to a general major contagion to less risky investments, in my personal opinion.

As always, we will remain vigilant in regards to the markets, events and trends that might impact your investments, and we greatly appreciate your support.

Should you have any questions or concerns, please feel free to reach out.

Wade Brown, MA, MBA
Portfolio Manager and Wealth Advisor

February 2nd, 2021

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In this section, as I often do, I would now like to offer a few very recent quotes/insights/observations from respected market experts that hopefully provide useful perspective during these special times.

" Parts of the market are in bubbles, but they are unlikely to take the overall market down with them when they pop, according to Goldman Sachs.
The Wall Street firm said exuberance around special purpose acquisition companies, as well as around investor interest in companies with negative earnings are cause for concern. It added that these speculative areas don't pose a risk to the S&P 500.
'Pockets of the market have recently demonstrated investor behavior consistent with bubble-like sentiment,' Goldman chief U.S. equity strategist David Kostin told clients. 'But these excesses present low systemic risk to the broader market given their modest share of market cap.' "
Source: Maggie Fitzgerald, CNBC, January 25

"Risk of a major correction is 'really low,' economic forecaster Lakshman Achuthan says
The stock market may avoid a major near-term correction, according to economic forecaster Lakshman Achuthan.
Achuthan, co-founder of the Economic Cycle Research Institute, told CNBC's 'Trading Nation' on Thursday that the risk a pullback of at least 10% is 'really low' because the U.S. is in expansion mode.
The cycle is on the side of the bulls for the time being,' he said. 'At some point, our forward-looking indicators, which have nailed this upturn, will peak and turn down. Today, they haven't done that. They are still heading to the upside.'
The S&P 500 and tech heavy Nasdaq closed at all-time highs on Thursday. Bears have been sounding the alarm on the rapid pace of the gains — citing frothy investor sentiment and stretched valuations. They've been warning investors that the backdrop makes the market vulnerable to an adjustment.
However, Achuthan is optimistic.'You could have a 3% or 5% kind of correction any time. But a really big one? Unlikely, according to cycle history,' he said.
Achuthan brought a chart going back to 2009 to support his case. He finds large corrections are linked to economic cycles, specifically to downturns in growth rate."
Source: Stephanie Landsman, January 22

" Yikes! I've grown too old or have been listening to Cramer too long. I thought IBM was a bargain six months ago with its 10 P/E and 5% plus yield. Guess not – Robinhood and momentum rule. Value and dividends are so pre-Covid.
Anyway – I want to reemphasize what I futilely wrote in my last outlook of a few months ago. This market is driven – yes – by intense speculation, but also by fiscally pumped, central bank-primed corporate earnings, which when discounted to present value by near zero nominal and in many cases negative real interest rates, produce record stock prices. A lot of these record breaking index days are justified, so don't put me down as a perma bear just yet…. low interest rates, especially low real interest

rates, are a fundamental factor (Robinhood groupies skip this part) in the discounting of expected forward earnings, which when inserted in a dividend discount model produce higher and higher stock prices the lower they go. ….My point though is that the 200-basis point decline in real 10 year treasury yields since January 2019, has been instrumental in the 50% price increase in the S&P 500 over the same period.….a lot of the market's appreciation over the past two years, especially for growth stocks, has been due to lower real interest rates…. Growth stocks, SPACs, and the Teslas of 2020 may struggle to please day trading Robinhoods. My favorite market sector is the natural gas pipeline group, with yields between 9% and 12% for investment grade stocks with certain tax advantages."
Source: Bill Gross, legendary bond-fund manager, once referred to admiringly on Wall Street as the 'Bond King', his newsletter January 5, 2021

" *You want to own stocks where the price needs to catch up to the fundamentals, as opposed to stocks that need the fundamentals to catch up to the price"*
Source: Steve Weiss, Chief Investment Officer and Managing Partner of Short Hills Capital Partners LLC, CNBC , December 28

"Lindsay Lohan Records Video Predicting $100,000 Bitcoin And $10,000 Ethereum—Is 2017's Celebrity Crypto Mania Back?
…. actress Lindsay Lohan has recorded a paid video via the personalized celebrity video website Cameo predicting bitcoin and ethereum, the world's second-largest cryptocurrency, will continue to climb—and signalling a return to the high-octane crypto mania of 2017. The return of celebrity cryptocurrency endorsements could be a sign that retail investors, who have so far remained largely on the sidelines of this bitcoin bull run, are about to pile into the market.
'Don't stress. [Lindsay Lohan] just wants you to know that bitcoin is going to $100,000 and ethereum is going to $10,000,' said a London-based computer scientist who posted the video to Twitter. Speaking via Twitter DM he said a friend commissioned the video for their private group called Crypto Buzz. Lohan, who can be hired to make a personalized video for $350 on Cameo, told viewers the bitcoin price 'is going to $100,000' and ethereum 'to $10,000,' wishing everyone 'a prosperous 2021 and hoping you all get to drive your lambos to the moon'—a popular cryptocurrency meme. Lindsay Lohan was commissioned by a bitcoin and cryptocurrency news outlet to record a message …
Signs that retail investors are returning to the bitcoin and cryptocurrency market after being scorched in 2018's bear market have emerged elsewhere….
San Francisco-based Coinbase, one of the largest bitcoin and cryptocurrency exchanges with almost 40 million users around the world, recorded a record daily volume of almost $10 billion this week—more than double its 2017 highs….
Growing retail interest in bitcoin and cryptocurrencies caused the U.K. financial watchdog to issue a stark warning to people considering jumping onto the crypto bandwagon this week—they 'should be prepared to lose all their money.'
While most in the bitcoin and cryptocurrency community are feeling bullish going into 2021, even crypto veterans are cautious about making bitcoin price predictions.
'Price predictions are fraught with risk,' William Quigley, cryptocurrency fund manager at Magnetic and cofounder of the stablecoin tether, said via email.
'No one knows what will happen in crypto land. All we can do is look at historical patterns and track demand changes for cryptocurrency.' "
Source: Billy Bambrough, Forbes, January 13