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Third Quarter 2020

There is no shortage of topics to write about this quarter. The virus and the election are undoubtedly important and interesting. There is a third elephant in the room – near zero interest rates.

September is on average the worst month for stocks and it lived up to its reputation. It was a poor month, but in a great quarter. The Canadian TSX was down -2.1% in September, up 4.7% in the third quarter. The S&P 500 was down -1.8% for the month but up 6.9%, measured in Canadian dollars, for the quarter. The comparison I really want to make is for the trailing 12 months. The TSX, loaded down with energy and financial stocks, has had a 12 month return of 0.0%. The technology laden NASDAQ is up 40.4% (39.6% in US dollars). The work @ home movement is accelerating the digital transformation. Last quarter I mentioned Amazon and Microsoft as beneficiaries of the school and work at home trends. Another standout is United Parcel Service which is finally reaping the benefit of rising shopping from home volumes.

There are some other, at least to me, less predictable effects of the virus. Some of these enthusiasms risk getting ahead of themselves. The pandemic seems to have sparked interest in ESG (environment, social and governance) investing, and especially in electrification. Clean electricity companies have been good performers for us. In the spring frankly I wasn't expecting working from home to lead to record high lumber prices. That is at least until I set out to rebuild stairs to the deck at our cottage. I couldn't find straight boards. The resurgence of the suburbs and rural communities, and the new availability of downtown apartments and condos, are trends that have persisted longer than I might have expected. Declines in immigration, university student populations and travel (Airbnb has shrunk) and the desire for a backyard while stuck at home, continue. Last spring, I would not have predicted that Canadian National Railway would haul record amounts of grain. Pantry stuffing can only continue for so long I should think but as the CEO of the Royal Bank, Dave McKay, was quoted as saying in The Globe and Mail (October 5), there are unusually large deposit balances "sitting in the chequing accounts of Canadians".

In the last few weeks, the stock market seemed to toggle between stocks that benefit from staying at home and those that would benefit from an economic recovery. There is so much that remains



unknown. For example I've been asked how the election might impact the markets. It is hard to know. One week the market is said to have fallen because of concerns about Biden's proposed tax increases, another week it is said to have fallen because of Trump's chaos. One day it rises because there is less uncertainty about Trump's recovery, another day because there is less uncertainty about Biden's lead in the polls. Sometimes I feel that whatever it is the markets do, pundits have an explanation for it afterwards.

The Federal Reserve and the Bank of Canada have both signaled that they have no intention of raising interest rates until perhaps 2023. When interest rates are near zero, cash and government bonds become untenable long-term investments. I should say unprofitable long-term investments because although the returns are negative after inflation and fees they still have some utility for flexibility. Barron's (October 3) quoted JPMorgan's Jan Loeys: "There could be a 'Japanization' of the bond market, with yields near zero for many years. Alternatively, the future could see rising inflation and higher yields from the Fed's massive bond purchases, which effectively 'monetize' the Treasury's multi-trillion-dollar budget deficits. It's all unknowable..."

Alternatives to government bonds can be what JPMorgan calls "equity-like bonds and bond-like equities". Examples from our portfolios might include preferred shares as equity-like fixed-income and Real Estate Investment Trusts or utilities as fixed-income like equities.

There have been interesting times in our household. We all tested negative for the virus after my son's classmate was a confirmed positive case. That took 3 days. Even after a negative test result he has had to quarantine for two weeks from the last confirmed exposure, which has now been lengthened to a total of 3 weeks. Unfortunately the day he is scheduled to be released, October 8, the rest of our Red Zone shuts down for another 3 weeks. We are missing a lot of hockey. Thank goodness for WIFI and some rainy weather.

I wish you all a Happy Thanksgiving, but not in person.

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