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### **First Quarter 2021**

Financial markets have been somewhat topsy turvy in the first quarter of 2021, and in some ways opposite to 2020. Oil, which was worth less than zero a year ago, was up some 20% while gold, which was perceived as a safe haven a year ago, fell 9% in this year's first quarter. For about the first time since the 1980's real interest rates and inflation expectations rose. The yield on the 10-year U.S. Treasury bond jumped from 0.9% to 1.7%. Interest rates had started to rise gradually after news of a positive vaccine trial was announced in November but the rate of change in yields accelerated in February and March as the vaccine rolled out and stimulus checks became more likely. Although rates remain at historically low levels, the sudden rise spooked investors. Higher interest rates make financing businesses more expensive and, they make future cash flows worth less in today's dollars. This especially pressures high multiple growth stocks.

Money rotated out of popular technology stocks into the economically sensitive sectors, Financials and Energy. For the first time in a long time, value stocks outperformed growth stocks. The Dow Jones Industrial Average outperformed the technology heavy NASDAQ by about 5% in the first quarter. The S&P TSX bested the S&P 500 by better than 3% (in Canadian dollars). I can't remember the last time I observed that the U.S. dollar lost 10% against the Canadian in a year. Unlike last year, the giant tech stocks did not dominate all else. The promise of stimulus checks from the U.S. federal government combined with a Federal Reserve that seems intent on holding short-term rates near zero has raised expectations of an economic boom as vaccinations and reopening proceed in the U.S.

For 12 years suffering savers have been penalized by ultra-low interest rates. Prolonged near zero interest rates have made possible a tremendous amount of speculation. Some, like Jeremy Grantham of GMO, have described the current markets as a speculative bubble of historic proportions. But the thing about bubbles, as I learned in the late 1990's, is you never know how big they are going to get or how long they are going to last. The other thing about bubbles is they set loose expectations of high returns. It was just a year ago that I was trying to reassure that our portfolios had not declined as much as the stock market indices. Now of course the opposite is true. To paraphrase Will Rogers in reverse, we have gone from worrying about the return of our money to the return on our money, in just one year.



On April Fool's Day the Wall Street Journal Online headline asked the question "If people Aren't Bored Anymore, What Happens to the Stock Market?" They explain: "Many on Wall Street turn to the 'boredom market hypothesis' to explain the stunning rally of the past year. Bereft of travel and other pursuits, stimulus-check recipients gambled on hot stocks ranging from GameStop to electric-vehicle startups. As economies reopen, investors will need to grapple with the consequence of more people spending their checks outdoors. (...) forcing people to stay indoors turned gambling on hot stocks into a new form of entertainment."

Whether bond yields and inflation will rise, whether long neglected so called value stocks will continue to outpace growth stocks and whether the anticipated economic boom materializes soon are questions time will tell.

To me the lesson of this last year, as the markets whipped from the despair at the start of the pandemic to the euphoria of its hoped-for end, is the value of diversification. In fixed income, from a mix of preferreds, deposits and bonds with varying maturity dates which as they mature will get reinvested at the then prevailing interest rates to earn an average yield. In stocks, from economically sensitive businesses mixed with more rapidly growing companies with higher valuations.

I am writing this letter a little late as the Easter long weekend was blessed with weather too nice to sit in front of a computer screen. A couple of days of mild temperatures and blue sky has helped my mental attitude immensely. I wish the same for you.

Sincerely,

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*Please visit us at [www.georgestedman.com](http://www.georgestedman.com)*

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