The Fortnighter

Wealth Management
Dominion Securities

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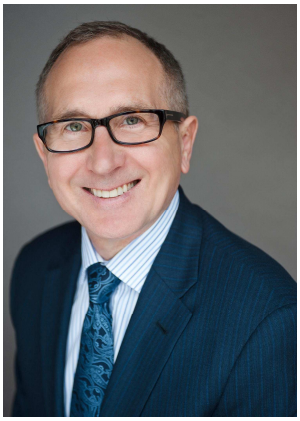

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The stock markets are many things, but as shown by their solid performance over the past two months, they are NOT the economy.

Yes, over the long-term, markets tend to move in tandem with economic conditions - but in the short-term they often move in widely disparate directions. So why are markets behaving the way they are currently? Here are my top 3 thoughts:

1) Fundamentally, the value of the market represents a series of discounted cash-flows on its underlying constituents, i.e. - how much money companies are expected to earn in the future. Cash flow is king because those earnings can be returned to shareholders in the form of dividends, re-invested in the business, used to buy back shares, etc., etc.

But note the word "discounted". If inflation is 5%, a dollar of earnings **next year** is only worth 95 cents. The further out we project, the less those earnings are worth. But if inflation is at or near 0%, as it is today, those future earnings are little-diminished and stock prices can **move higher** without a change in profitability**.** This is part of the reason equities have strengthened here.

2) What are the Alternatives? One of the consequences of the unprecedented amount of central-bank stimulus we're seeing is historically low interest rates. In addition to cheap loans and outright cash, governments are also buying up actual securities in the marketplace – which has been driving yields significantly lower.

Investors always have a choice as to what they can do with their money. Currently, I can buy a 5-year Royal Bank bond and it will pay about 1.5%. Or, I can buy Royal Bank common shares and get a dividend of 4.7%. Note: This isn't a recommendation and (of course) the common shares inherently have more risk – but that's a pretty compelling "yield pick-up". This, again, helps drive investment dollars towards stocks.

3) Statistics and Probabilities. Despite the prevalence of grim news, statistical trends for the COVID-19 pandemic are, for much of the developed world, improving. Markets are always forward looking – yes, the world will be a different place post-pandemic, but new businesses will be created and most existing ones will survive, adapt and become profitable again. Another plus for stocks.

So why the continued caution? In a word, probabilities – and most importantly, the probability that there will be a resurgence in COVID-19 cases later this year. If we have no good data on this, isn't that probability 50%? It's certainly not zero. I just don't see the current market stats factoring this in adequately.

So for now, I recommend portfolios maintain a "more" cautious stance – that means more quality, more "alternatives" and more cash. For an update on specific strategies – and your own portfolio, please give me a call.