Canadian money managers weigh in on the latest market mayhem- and what they're buying and selling

BRENDA BOUW

PUBLISHED JANUARY 29, 2021
THE GLOBE AND MAIL

Record-setting markets and the social-media-driven investor protest against short sellers that has sent stocks such as GameStop Corp.GME-N soaring has investors worried about a market bubble that could soon burst. The Globe and Mail asked several Canadian-based portfolio managers to give their take on the market run-up amid the pandemic and the David-versus-Goliath battle over unloved stocks that could be putting everyone at risk:

CRAIG JERUSALIM, SENIOR PORTFOLIO MANAGER FOR CANADIAN EQUITIES AT CIBC ASSET MANAGEMENT INC. IN TORONTO

"There is no doubt we are experiencing some very peculiar equity distortions," Mr. Jerusalim says, "but the pockets of irrationality are too narrow to say we are in the midst of a full-fledged bubble." Instead, he sees more "microbubbles, or the gamification and exploitation of targeted loopholes," citing the recent trading frenzy around stocks such as GameStop Corp. and BlackBerry Ltd.BB-T

"Groups of investors with varying levels of sophistication have recognized that, with enough pooling of capital against thinly-traded and highly-shorted securities, they can trigger these short squeezes once the market is cornered, or effectively controlled," he says. That sends the securities "into an irrational spiral higher, completely devoid of any fundamental rationale."

Adds Mr. Jerusalim: "This certainly is one time that I am glad our firm is a long-only shop, with no short positions in any of our funds."

He says the lofty valuations in the broader markets are "appropriately incorporating" the massive monetary and fiscal stimulus offered by governments and central banks to help combat the economic fallout from COVID-19.

"There are lots of reasons to be optimistic about future equity returns, especially relative to cash or bonds, but just don't expect the pace and consistency of growth we've experienced since March to continue," he adds.

CHRISTINE POOLE, CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR AT TORONTO-BASED GLOBEINVEST CAPITAL MANAGEMENT INC.

Investors have ignored the political chaos in Washington and focused on the positive implications of a Democratic-controlled Congress, Ms. Poole says, including more fiscal stimulus and investment in initiatives to combat climate change. She notes that swift and "unprecedented" monetary and fiscal actions globally "have cushioned the normal effect of a recession," while the vaccine rollout has created a "visible path to a normalization of economic activity."

Ultralow interest rates are supporting equity valuations, Ms. Poole says, but says excessive liquidity is incentivizing some investors to take more risks.

"Speculative activity and a widening disconnect between business fundamentals and valuations in some sectors suggest nascent signs of a bubble are emerging," she says, pointing to historical bubble indicators such as easy access to capital in a low-interest- rate environment, the growth of first-time investors and what Ms. Poole calls "investing in a promise." The clear sign of that is "the resurgence of special purpose acquisition companies (SPACs) which favour targeted companies in sectors including electric vehicles and online gambling."

While she doesn't think the overall markets are in a bubble, she says "speculative activity is pronounced in certain sectors" such as electric vehicles with Nikola Corp. and Fisker Inc., "which have no revenues and market capitalization in the billions of dollars."

Ms. Poole has stayed away from these and other speculative names in the headlines recently, sticking to a "value-based disciplined investment process of investing in financially sound, well-run companies at reasonable prices."

She has a positive outlook for equity markets in general, which will be driven by monetary and fiscal policy support until economies can fully reopen and become more self-sustaining in the aftermath of the pandemic.

"Corporate profit growth will continue to improve as the year unfolds, providing a catalyst for stocks to climb higher," she says. "Market pullbacks are inevitable, and we view pullbacks as buying opportunities."

For instance, in the past week, Ms. Poole says her firm bought more shares in companies such as Fortis Inc. and Algonquin Power & Utilities Corp. "for their attractive and growing dividends and defensive attributes," as well as Royal Bank and JPMorgan, which are expected to improve alongside the economy. She also bought "quality industrial companies," including Canadian National Railway Co. and Otis Worldwide Corp.

JASON DEL VICARIO, PORTFOLIO MANAGER IN VANCOUVER, AT HILLSIDE WEALTH, IA PRIVATE WEALTH

Mr. Del Vicario doesn't believe the recent market run-up represents a bubble if interest rates stay low, which he believes they will for the foreseeable future. "Since no one knows where inflation or rates are headed, I believe no one can make a bubble call with any certainty."

An exception is tech stocks, in particular those with no earnings, which are "in a massive bubble," he says. "This area of the market feels a lot like [the tech bubble in] 1999-2000. When it ends, I have no idea, but I am confident it won't end well."

He prefers to hold money-making tech giants with double-digit revenue growth, such as Microsoft Corp. "One does not need to take unnecessary risk to attain one's objectives," he says.

Mr. Del Vicario also believes heavily-shorted stocks with "horrendous fundamentals," such as bricks-and-mortar video-game retailer GameStop, "are also in a massive bubble perhaps unlike we've ever seen."

He believes a broader market drop could be a buying opportunity for long-term investors buying stocks with strong fundamentals. "Ignore the noise and focus on one's long term financial goals."

KATHRIN FORREST, PORTFOLIO MANAGER WITH SUN LIFE GLOBAL INVESTMENTS (SLGI) ASSET MANAGEMENT INC.

Ms. Forrest says the "tremendous run in equity markets," was supported initially by strong central bank liquidity last spring and summer, followed by anticipation of an economic recovery amid the COVID-19 vaccine rollout.

She sees underlying fundamentals – corporate earnings in particular – becoming more of a focus in the weeks and months ahead. “Our sense is that, for the market overall, a lot of optimism around reopening and a cyclical recovery has been priced in, and the path forward may not be as smooth as currently expected.”

Ms. Forrest says there has been a “remarkable divergence in performance across geographies, sectors, factors and individual stocks” in the markets, and says “certain areas of the market look much more stretched than others.”For instance, she sees an exponential run-up in valuations for a small number of stocks that have made headlines in recent days.

“These are generally stocks that have seen a strong increase in daily volume, options activity and strong price appreciation without a meaningful change in underlying fundamentals,” she says. “One important metric to be mindful of here is liquidity. It’s intoxicating to see how easily valuations can run up on a crowded trade into a relatively small stock. But it’s important to consider how this plays out as the party moves to another venue and the crowd heads for the exits.”

More broadly, she says “volatility, momentum and growth stand out as key market drivers,” in the United States, but believes the market “has really not rewarded dividends, value or profitability.”

Her team has started to reduce its holdings in U.S. growth stocks and moved into smaller-cap names, value stocks and non-U.S. markets. “We believe we need to be selective within these though, anticipating that earnings and profitability are likely to become much more critical,” she says.

One area they still like is renewables in water, agriculture and energy, “but more indirectly across broader supply chains, given the recent run-up in valuations.”

Adds Ms. Forrest: “There are still gems out there, but we have to look much harder, and more carefully, to find them.”

STEPHEN TAKACSY, PORTFOLIO MANAGER AND CHIEF INVESTMENT OFFICER AT MONTREAL BASED LESTER ASSET MANAGEMENT INC.

Mr. Takacsy agrees ultralow interest rates and government stimulus to fight the economic fallout from the pandemic have been driving markets higher, and have been largely responsible for increasing investors’ appetite for risk.

“Some of the multiple expansion in stocks is justified because of low rates. However, many people are being paid to stay home and are saving money, and have turned into speculators,” he says. “There is so much cash sloshing around that parts of the market have become virtual gambling casinos.”

Markets over all aren’t in a bubble he says, “because there are still many companies trading at reasonable valuations.” Nevertheless, it’s very much a “stock-pickers” market in which the difference between winners and losers is large.

However, he believes many speculative sectors, such as bitcoin, are in a bubble as well as “concept” stocks, such as electric vehicle maker Tesla Inc., and stocks under the influence of social media, such as GameStop and BlackBerry.

Mr. Takacsy sold BlackBerry earlier this week at $25 because, he says, it “far exceeded our fundamental valuation.” He also says insiders sold, “so it was obvious the company was not in blackout and there was no material undisclosed news.”

He would buy back BlackBerry if it falls back to around $12 “because there is value there,” he says. “Otherwise you are overpaying for a company that still needs to prove it can grow profitably.”

DAVID BARR, PRESIDENT AND A PORTFOLIO MANAGER AT VANCOUVER-BASED PENDERFUND CAPITAL MANAGEMENT LTD.

Mr. Barr notes that stock indexes are market-cap-weighted, which means the run-up in recent months is driven by some of the largest companies, which today happen to be the large tech stocks.

“We look at markets from the bottom up, and today we are seeing companies that have really high valuations but lots where the valuation is attractive to the underlying fundamentals,” he says.

His firm is very active in the tech sector and believes that, while some companies in it may be overvalued today, “a lot of other companies in the space, particularly in the Canadian world that are still attractive.”

Adds Mr. Barr: “Just because a stock has gone up a lot doesn’t mean it’s expensive. The long-term fundamentals of the business will tell us whether it should be in the portfolio or not.”

JOHN DE GOEY, PORTFOLIO MANAGER, WELLINGTON-ALTUS PRIVATE WEALTH INC.

Mr. De Goey says the recent run-up in equities is a “serious source of concern, especially for the U.S. market.”

He adds that the Shiller CAPE (cyclically adjusted price-to-earnings ratio), a traditional metric for the S&P 500, is now around 35 – not far from its all-time high of 47, reached in 2000, and double its historical average of about 16.7.

“The only time it was higher was during the tech bubble,” he says. “I’m not predicting a sell-off, necessarily (although I do think it is likely), but I am astounded by the lack of concern some fellow advisors are showing.”

While Mr. De Goey believes nobody can really predict a bubble, he believes some “adviser humility” is needed in the current market. “Most of what I see is adviser hubris – i.e. we got out of 1974 and 2001 and 2009 alright, so how bad can it be?” he says.

Meantime, he says that Japan’s Nikkei 225 stock index hit an all-time high in 1989, then crashed and “it still hasn’t recovered.”