GLOBE INVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

MARCH 2021

UPCOMING 2021 BNN SHOWS

Christine: April 15 @12pm

Christine: May 18 @12pm

Christine: June 16 @ 12pm

Christine: July 13 @ 12pm

Christine: August 12 @ 12pm

Christine: September 14 @ 12pm

Christine: October 13 @ 12pm

Christine: November 16 @ 12pm

Christine: December 14 @12pm

Concerns facing markets presently compared to a year ago could not be more different. A year ago, the global economy was falling into a deep recession, economic and earnings forecasts were on a downward spiral and human clinical trials for COVID-19 vaccines had yet begun. Fast forward to present day when the overriding concern for markets is inflationary pressures due to strong demand for goods and services, driving up Treasury bond yields. A steeper trajectory on the economic recovery is also leading to positive revisions to GDP and corporate earnings growth.

While the actions taken by central banks and governments following the pandemic have often been referenced as “unprecedented”, this term can also be applied to describe the pace of development of several approved COVID-19 vaccines. Both have significantly contributed to the stronger than expected economic rebound that is unfolding this year.

The rollout of vaccines to the general population will determine how quickly economies can reopen. According to the Bloomberg Vaccine Tracker (% of population given at least one dose), Israel is the highest with a vaccination rate of 58.1% and amongst the major developed regions, the United Kingdom is leading with 47.2%, followed by the United States at 32.0%. U.S. President Joe Biden has recently doubled his initial goal of administering 100 million doses to 200 million doses by the end of his first 100 days in office. For reference, the population of the U.S. is approximately 331 million. Canada and the European Union are lagging at 14.0% and 12.3%, respectively. The wide disparity amongst countries on vaccination rates means the global economic recovery maybe somewhat uneven initially albeit vaccine availability and logistics will eventually be resolved leading to a more synchronized recovery.

Since taking office, President Biden has swiftly put his words into action. The $1.9 trillion American Rescue Plan (ARP) effective March 11, 2021 is the third COVID-19 stimulus package passed by the U.S. government and the first for President Biden using budget reconciliation made possible by the Democratic control in the House and Senate. The ARP is comprised mainly of government transfer payments such as direct cheques and expanded unemployment benefits and will meaningfully alleviate economic suffering from the pandemic keeping households, businesses, and state & local governments solvent. Th ARP has also raised inflationary concerns because it was deficit-financed and will potentially boost consumption over a relatively short-term period. Nonetheless, the ARP is viewed as a significant near-term stimulus to the U.S. economy.

The Biden administration quickly followed up with the American Jobs Plan (AJP), a sweeping $2.25 trillion infrastructure plan spanning over the next eight years and the first of a two-part economic plan. Unlike the ARP, the AJP includes proposed tax hikes to pay for the new spending. The tax increases are concentrated on businesses, raising the corporate income tax to 28% from 21% and setting a 21% minimum tax on global corporate earnings. The AJP is facing Republican opposition notwithstanding the timeline is to move the AJP through Congress before the August monthlong recess.

President Biden is expected to announce the second plan, focused on childcare, healthcare, and education sometime in April. The second plan will likely include higher taxes on top earners' personal income, capital gains and estate. Combined, the two economic proposals are expected to cost between $3 trillion and $4 trillion over the decade. "Sleepy Joe" has awoken since taking office!

The yield on the benchmark 10-year U.S. Treasury note has risen to 1.7% from 1.0% at the beginning of this year on expectations that strong economic growth fueled by stimulus measures combined with the economy reopening due to higher vaccinations could push inflation higher. While the speed of the recovery back to its pre-pandemic level was unexpected, the 10-year US Treasury bond yield remains extraordinarily low in a historical context (Chart 1).

U.S. Fed Chairman Powell continues to reassure markets that he does not expect the $1.9 trillion stimulus package will lead to a sustainably higher inflation rate above the Fed's targeted range. He states that if spending rebounds quickly as the economy continues to reopen, supply bottlenecks could limit how quickly production can respond in the near-term and may lead to price increases. However, supply chains will eventually re-balance and these one-time increases are likely to have transient effects on inflation.

For now, the Federal Reserve is projecting inflation to accelerate to 2.4% by the end of this year and recede back to 2.0% in 2022. With the unemployment rate presently at 6.0%, it remains well above its pre-pandemic level of 3.5% (Chart 2) so monetary policy is expected to remain highly accommodative.

Over the past 60 years, the U.S. economy has experienced three episodes in which inflation has moved meaningfully higher over a period of a few years (Chart 3). A review of these episodes suggests the catalysts in place then are not necessarily as relevant today:

1. From late 1965 to 1969, CPI rose from less than 2% to more than 6%. This period coincided with a significant increase in government spending to fund the Vietnam war, resulting in strong real GDP growth, a lower unemployment rate which declined to 3.4% from 5.0%, and a marked acceleration in unit labour costs. Today, unemployment remains high at 6.0% and the labour participation rate of 61.4% remains below the pre-pandemic level of 63.4%. The combination of a higher unemployment rate and an expanding workforce should moderate upward wage pressures.

2. The oil price shocks of the 1970s saw the CPI rise from 3% in 1972 to nearly 15% in early 1980. The OPEC oil embargo (1973-1974) and the Iranian revolution (1979) were the causes behind higher oil prices. The oil price hikes that occurred over that decade reverberated throughout the economy. Petroleum was the primary source of energy, pushing up production costs which were passed onto consumers through higher prices. Spending on goods represented about one-half of overall personal consumption expenditures (PCE) back then compared to one-third today (Chart 4). A higher unionized labour force with cost-of-living (COLA) clauses in their contracts also led to automatic increases in wages. In 1983, unionized workers represented 17% of the private sector compared to 6% today. Moreover, the use of COLA clauses in collective bargaining contracts has fallen from 60% in the late 1970s to 22% by 1995.

3. The Fed tightened monetary policy sharply to wring out inflation in 1980 and the Fed funds rate shot up close to 20% in 1981, which sent the economy into a deep recession in 1981-82. Consequently, the CPI receded to 1% in 1986. The combination of monetary easing and expansionary fiscal policy that cut taxes and saw sharp increases in defense spending led to an economic boom and the CPI climb back to nearly 5% by 1990. In present time, while the three COVID-stimulus plans were deficit-financed, the recently introduced infrastructure program and any additional programs will be accompanied with tax increases to help pay for the new spending. The U.S. economy should lead in this recovery following such substantial policy support and timely vaccine rollout, but growth among other economies will likely lag. Slower growth in many of its trading partners should keep consumer goods prices from rising significantly.

Other factors that influence the rate of inflation is demographics, automation & technology, and globalization. An ageing population is considered a contraction in the labour supply, however, there are two key countertrends to consider:

1. many people are working beyond what is considered “retirement” age and
2. the adoption of automation and technology is accelerating, inherently offsetting upward wage pressures from a declining labour supply.

On the demand side, ageing demographics favour savings over consumption, especially considering two "once in a lifetime" shocks in the span of a dozen years. As well, as observed by David Rosenberg, domestic inflation has become increasingly influenced by globalization, which despite hiccups in the form of increased tariffs and subsidies, will continue to grow and likely continue to keep inflation in developed countries contained.

Positive conditions and indicators for continued upside to stock markets include:

- Strong economic indicators from the U.S. ISM Manufacturing and Services Indices, indicating robust expansion in both parts of the economy (Charts 5 & 6).
- According to Refinitiv, a surge in mergers and acquisitions activity globally in the first quarter of 2021, up to 93% from a year ago to $1.3 trillion, the second-biggest quarter on record and reflective of optimism amongst corporations.
- Household net worth in both Canada and the U.S. are at record highs, positioning consumers to deploy spending as economies and service industries reopen.
- Stable credit conditions with the spread between high yield less 10-year U.S. Treasury bond remaining subdued (Chart 7 & 8).
- Receding volatility in the S&P 500 Index as reflected by the CBOE Volatility Index (VIX), which measures the level of risk, fear, or stress in the market over the coming 30 days, to a "normal" level of below 20 (Chart 9)
- Positive revisions with consensus 2021 earnings per share (EPS) for the S&P500 and S&P/TSX companies now forecast to exceed reported 2019 EPS.

Given the rebound in stock markets, an economic recovery is the base case. We remain constructive on equities as corporate profit growth is accelerating and broadening across industry sectors. Inevitably there will be pullbacks on any news that dampens growth expectations, however, substantial policy support remains steadfast. Inflation will firm as economic growth strengthens but it needs to rise meaningfully on an ongoing basis before the U.S. Fed will deviate from its current path. We will continue to monitor core inflation indicators that may cause an adoption of a less accommodative policy by the Canadian and U.S. central banks.

Christine Poole, MBA, CFA

CHART 1

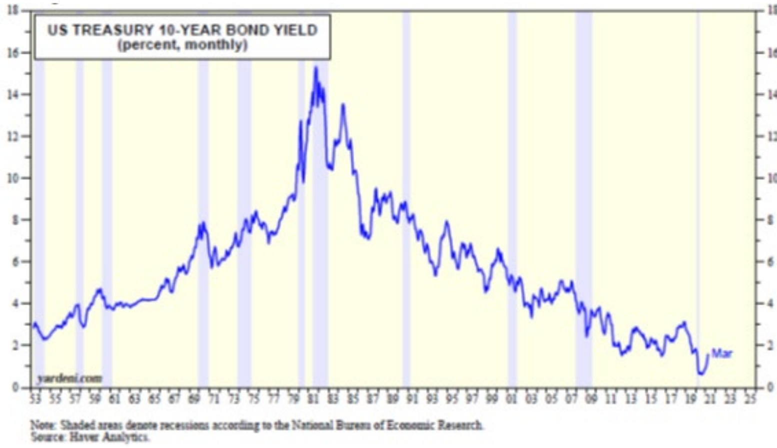

CHART 4

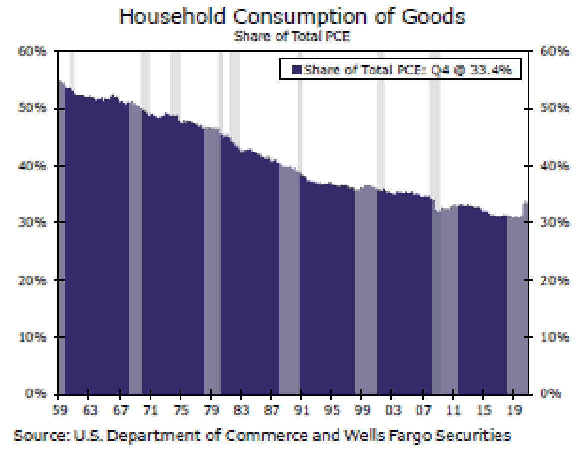

CHART 2

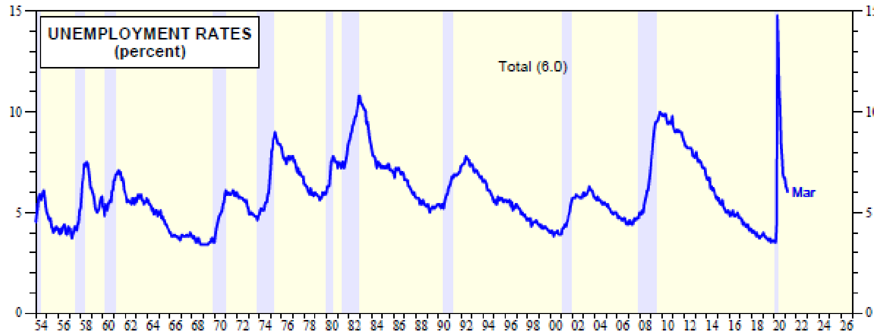

CHART 5

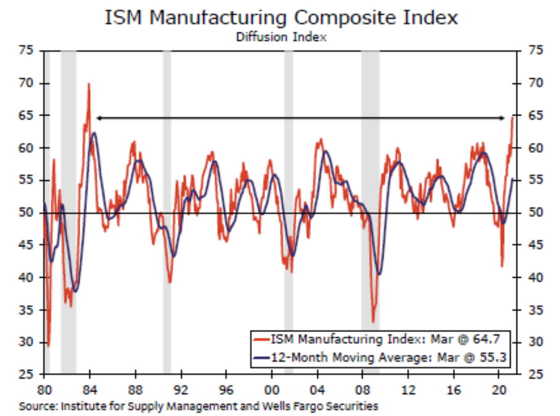

CHART 3

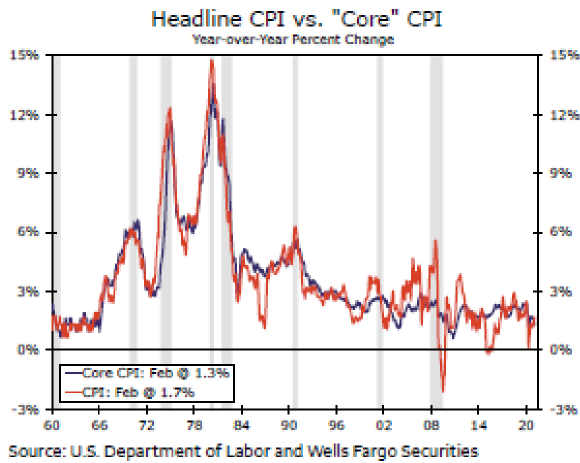

CHART 6

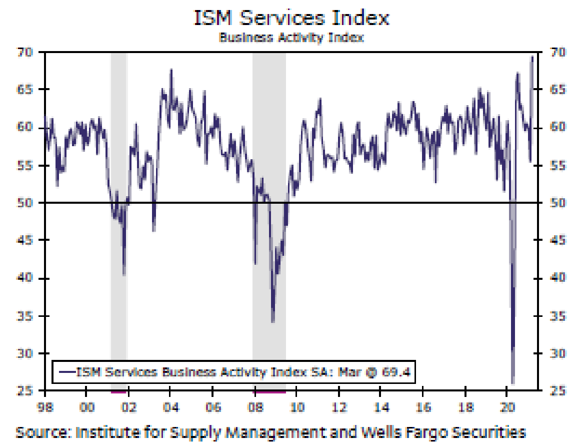

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CHART 7

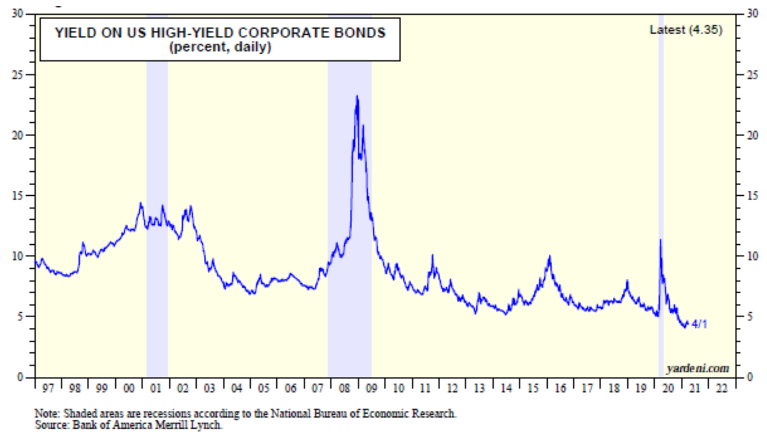


CHART 8

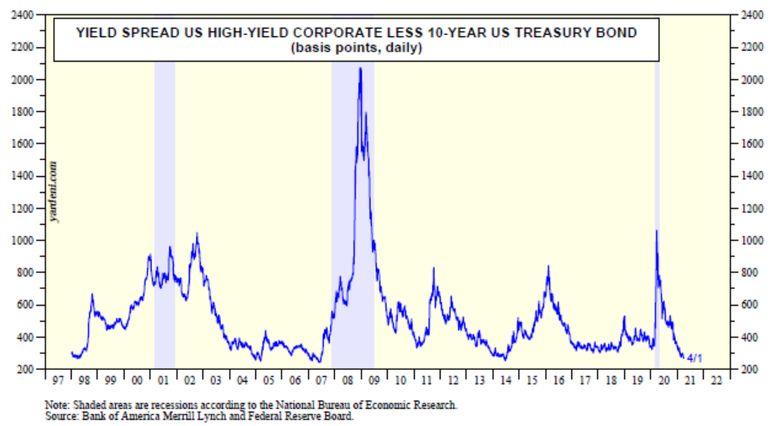
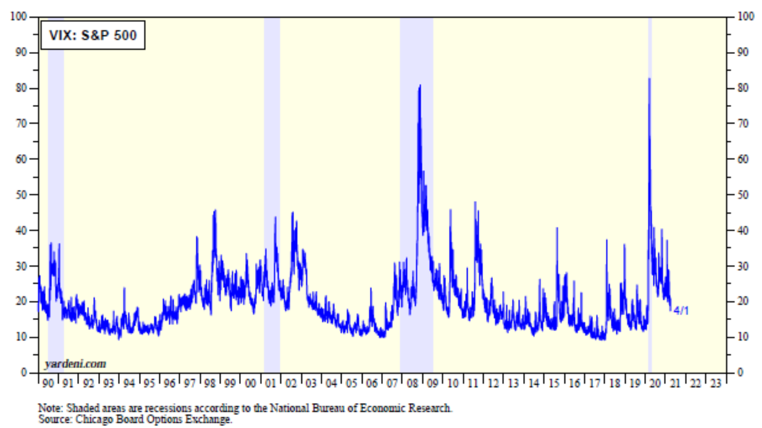


CHART 9



RECENT BNN SHOWS

Christine: March 16, 2021

Christine: February 19, 2021

Christine: January 18, 2021

Christine: December 14, 2020

Christine: November 12,2020

Christine: October 14, 2020

Christine: September 15, 2020

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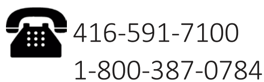
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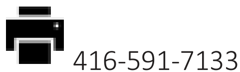
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MARCH 31, 2021 STATISTICAL SUMMARY

STOCK MARKETS	QTD	1 YEAR	3 YEARS*
S&P TSX COMPOSITE TOTAL RETURN (CAD)	8.1 %	44.3 %	10.2 %
S&P 500 TOTAL RETURN (CAD)	4.7 %	38.1 %	15.8%
S&P 500 TOTAL RETURN (USD)	6.2 %	56.4 %	16.8 %
DJIA TOTAL RETURN (USD)	8.3 %	53.8 %	13.6 %
NASDAQ COMPOSITE PRICE RETURN (USD)	2.8 %	72.0 %	23.3 %
MSCI WORLD INDEX PRICE RETURN (CAD)	3.3 %	37.1 %	11.7 %
CANADIAN UNIVERSE BOND INDEX	-5.0 %	1.6 %	3.8 %

* ANNUALIZED

COMMODITIES	QTD	1 YEAR
GOLD	-10.9 %	5.0 %
SILVER	-7.7 %	70.9 %
COPPER	13.4 %	77.9 %
NATURAL GAS (NYMEX)	9.3 %	50.9 %
WTI	21.9 %	188.9 %
BRENT	22.3 %	144.6 %

TREASURY BONDS	3/31/21	12/31/20	3/31/20
2 YEAR (CAD)	0.22 %	0.20 %	0.42 %
2 YEAR (US)	0.16 %	0.13 %	0.23 %
5 YEAR (CAD)	0.99 %	0.41 %	0.60 %
5 YEAR (US)	0.97 %	0.36 %	0.37 %
10 YEAR (CAD)	1.55 %	0.70 %	0.71 %
10 YEAR (US)	1.72 %	0.93 %	0.70 %
30 YEAR (CAD)	1.97 %	1.24 %	1.32 %
30 YEAR (US)	2.35 %	1.65 %	1.35 %
CPI (CAD)	1.10 %	1.00 %	2.20 %
CPI (US)	1.70 %	1.20 %	2.30 %

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