



SUMMER NEWSLETTER 2020

To all of our clients and friends

UP, UP AND AWAY!

I am sure all of you will agree, so far 2020 has been a year without precedent! Who would have thought as we were thinking of New Year's Resolutions, travel plans would be dashed, going outside would be restricted or even that there would be zero in the way of sports to help pass the time in lockdown. We have all become familiar with new terms such as coronavirus, "new normal", social distancing and pandemic. Now, as more and more people are wearing masks, we have to learn how to interpret what folks are saying without being able to use the usual visual keys we are accustomed to from facial expressions.

When I wrote the last commentary in mid-March, we were at the height of the lockdown. The stock markets were nearing its panic lows and we had no idea when things would start to thaw again or what the new economy would look like. The financial markets were righted by a double whammy of massive injections of liquidity by the global central banks and support programs from governments of all levels. People were able to defer their rents or mortgages, employees were paid to stay home with aid packages that appeared limitless. We are now going to be left with a huge debt burden on society that will take years to pay down. Since mid-March, the capital markets have been moving higher led by a few technology names and slowly the global economies have begun to reopen, although in fits and starts depending on whether or not new infections occur. Some industries such as those that help people who work from home have flourished while others such as travel and hospitality have been limping along trying to find a way to reinvent themselves.

As I mentioned in March, the main problem global economies are facing is behavioral because personal habits have changed so dramatically. While many are going about their lives as far as local travel, trips to the store or visiting in small groups goes, it will be a long time before there are packed bars, crowded live sporting events or even full places of worship. Fortunately, unlike in the past, we have very robust communication systems which serve to allow loved ones to visit virtually and sports nuts to be able to start watching their sports again soon. Nonetheless, as I have commented many times over the years, I never want to make investment decisions in front of government policy announcements or court rulings and now I can add another one - beware of pandemics!

With respect to the stock markets, we were concerned late last year the economy was nearing a recession and the markets had become significantly overvalued. As I discussed in the winter newsletter, it would not take much to knock the markets for a big decline. Over the preceding decade, the S&P had rallied 370% while earnings / share had increased by 93% and sales / share by 50%.

With that in mind, I thought it would be a good time to discuss the current valuations and what some potential outcomes could be. On one side we have the massive injections of funds by both the global central banks and governments. While there have been several times in the last 12 years the US Federal Reserve has injected liquidity into the markets the effects are diminishing over time. For example, in 2009 it took \$1.49 to generate a dollar of growth and today it takes \$2.96 for the same growth.



On the other hand, we have a stock market that has been led higher by a relatively few technology companies. The six largest US tech companies now comprise over 24% of the value of the S&P 500 index. Some have become so volatile that TESLA, for example, in one two hour period recently, had its market capitalization swing a greater amount than the total market capitalization of CIBC! A vast majority of the market metrics I follow are in the 90th percentile which is great if you are a student, but not so much as an investor. How many investors are aware that when they invest \$100 in the S&P500 \$6.15 goes to buy Microsoft or Amazon and only \$.02 goes towards Xerox, Alaska Air or Harley Davidson?

Possibly, the most expensive stock in North America is Ottawa based SHOPIFY. It is trading at 2,000 (yes that's right - 2,000) times earnings, 60 times current sales and has been 20% larger in market cap than Royal Bank! By the way, US based, Walgreens, Target and Kroger have a lesser TOTAL market capitalization and have 175 times the sales of SHOP and all pay a nice dividend. That is not the half of it since investors are clamoring for many other companies that have stratospheric valuations. Another example of the "casino mentality" that has overtaken the stock markets with early 2000's zeal is the way companies that are bankrupt are seen their shares trade. HERTZ, for example, a bankrupt company with zero value to its shares saw the shares run on hundreds of millions of shares from about \$US .50 to \$US 6. When the company said they would issue shares at that price they were stopped by the SEC who said it would be fraud.

Meanwhile, some of our favorites such as BCE, the Canadian Banks or pipelines garner little if any interest. They are trading in the middle of their ranges with real earnings and dividends. Warren Buffett, who is possibly the most successful investor of all time, is not taking positions at this time other than buying pipelines which he considers cheap.

As the economies around the world start to reopen, I wonder what the longer term effects of the pandemic and related lockdowns will be. For sure it will be a long time before the general public will be comfortable in crowded situations, but what about what was once normal such as Black Friday? What about sitting next to somebody cheering on your kids as they play a sport? Financially, will the average person be more inclined to save more for an unexpected rainy day? What effect will that have on consumption? Certainly travel using any method that is crowded such as public transit, airplanes or cruise ships will be different in the future. Will there be other knock on effects such as younger adults realizing they can work effectively from home and so decide to move to more rural areas? That reversal of generations moving towards the cities may end up causing a seismic shift in city based real estate and population profiles. The list of potential outcomes is limitless and, as an investor, our job is to try to be one step ahead of the crowd in determining the most likely events.

Of the four "Iliffe Investment Team" portfolios we manage, two were number one at Wood Gundy in Canada at the end of March, April and May for one year and second in Canada for three year returns. Our other two portfolios were top quartile over the same time periods. For our managed portfolios, we were fortunate in having taken a defensive posture when the first signs of trouble occurred. As the market run continues, we see many similarities to other manias over the years and are now slowly moving to similar positions as we had in February. I would call our view "very cautious bulls" with our hand on the sell switch. If you have any questions on our current market view or would like to put some money to work in our portfolios, let us know.

Our team has managed to stay to course, mostly working from remote locations, but regrettably response times have become a little slower and we have had to learn to communicate efficiently via Skype, text, email and voice instead of just hollering from an adjacent office. Jasmine, who started on our team in May, has done a great job of getting up to speed considering she could not be in the office every day. Now, as things are starting to open up a little, our office is being used more and we are all exploring the "new normal". We wish to thank you for being patient during the first few weeks of the shutdown!



We have been trying to keep you informed with some email updates and we hope they have been helpful. Please note our email addresses to contact any of our team members: Arthur - arthur.iliffe@cibc.ca Matt - matthew.macewan@cibc.com Sandra - Sandra.leah@cibc.ca Jasmine - jasmine.sandhu@cibc.ca. While the telephones are working, please email us with a telephone number rather than leaving a voice mail so we are sure to get your message. We will call you back.

For more information on the Federal plan to reduce your RRIF payment, give Sandra a call. For those of you who have not made your TFSA contributions for 2020, the contribution amount for this year is \$6,000. As always, we are here to answer any question so please do not hesitate to reach out.

All the best and STAY HEALTHY!

Sincerely,

W. Arthur C. Iliffe, CIM, FCSI
Vice-President, Portfolio Manager

Matthew MacEwan, CIM
Portfolio Manager

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