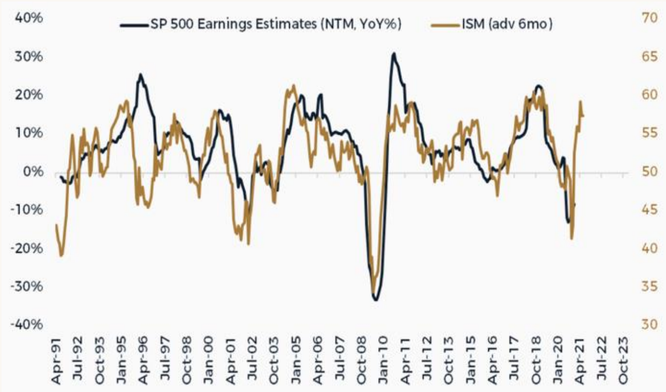
“There are no road maps where no one has been before.”

We all see the news and it is almost universally negative: the global pandemic is reaching new levels of infections and deaths; the impact of the virus is being felt in the economy; and the riots and political discord which are taking place in Washington D.C. In spite of it all equity markets remain strong with the Dow Jones and S&P 500 indices at all time highs. The dichotomy can be explained by two major factors impacting stock markets; a consensus outlook that there will be a strong economic recovery in the second half of this year and the continuing large injections of liquidity and stimulus by global governments, particularly in the U.S.

However we need to be concerned at least in the near term by a stretched valuation and a perceived sense of euphoria amongst market players that seems to suggest losing money is not a worry. The current price to earnings multiple (P/E) is north of 20 which is historically high and has usually advised caution. There are two ways that the P/E can come down to a more reasonable level. The Index can correct and lower the price, which is the most common outlook by bearish forecasters, or conversely the earnings component can rise to compensate which is obviously the bullish view. If a strong economy in the second half becomes a reality and with it a surge in corporate earnings that would go a long way to rectifying the overvaluation. Presently the consensus estimate for S&P 500 earnings growth in 2021 stands at 24%, which if accurate would accomplish the task. As for the euphoria, examples are everywhere. Tesla is a real company (I've seen the cars) but rising from a 52 week low of $70 to a high of $884 seems excessively optimistic. (As you probably guessed I didn't own Tesla LOL) My favorite though is the stock of Signal Advance a one man company in Texas that traded up from $0.60 to over $7.00 in two days after it was confused with an app Musk recommended, an encrypted messaging service called Signal. A pullback of 5%-10% in the overall market would in my mind cool some of the overenthusiasm and be better for the longer term outlook.

Given the huge drop in the economy in the 2nd quarter of 2020 due to the pandemic and the equally remarkable recovery in the 3rd quarter it is very difficult to precisely evaluate current releases since context and comparison are so difficult. Still direction can be assessed and the impact of the COVID resurgence is being felt; retail sales and unemployment claims are two examples of weaker than expected reports. The market though is more concerned about the future and the Purchasing Managers Index, which is a leading indicator, remains strong providing solace to those like myself expecting better things in the second half. The chart above shows that the ISM Manufacturing Index advanced 6 month has done a good job of predicting earnings. Of course the global economy is totally dependent on defeating the pandemic and finding a successful strategy to inoculate large populations with an effective vaccine within the next 6-9 months. My confidence has been boosted by recent studies showing that given the large proportion of deaths and hospitalizations occurring in those over the age of 60, getting the vaccine in those arms may well shorten the timeline to control of the virus.



Say what you want about the madness taking place in the U.S. it still remains the dog that wags everyone else’s tail. I don't envy President Biden and the job in front of him. He is definitely an uptick in personality to his predecessor but that won't necessarily make problem solving any less difficult. One significant advantage he does have is that after the traditionally Republican Senate seats in Georgia fell to his Democratic party, Biden has control of both houses of Congress and an easier path to bring his policies to fruition. Easier, but not necessarily happening. While I'm far from intimate with U.S. legislative laws and processes many major bills require 60 votes to pass not just a simple majority. For instance the current $1.9 trillion stimulus bill proposed by the Democrats provides a $1,400 cheque and extended unemployment benefits to certain citizens and those parts can pass in the Senate by a simple majority. However for immediate passage without debate 60 votes are required, and so does the increase in the minimum wage to $15 per hour. Whatever negotiations and compromises are needed you can take it as gospel that more government spending is coming and the Fed will continue to inject massive amounts of liquidity. Modern Monetary Theory may not yet be official policy but you might not notice the difference. The theory tells us that running up deficits and debt is not an issue until inflation becomes a problem which leaves wide possibilities for additional spending. Good for markets but the Lord giveth and the Lord taketh away so be prepared for increased taxes, both personal and corporate, and increased regulations.

Given the increase in money supply, the commitment by the Fed to keep interest rates low, the potential for inflation and a general sense that the U.S. isn't the bastion of democracy and safe haven it used to be we have seen weakness in the dollar and a good argument that this weakness is likely to continue. With a recovery in the global economy, the lower U.S. dollar and a resulting rise in commodity prices I can see the Toronto Stock Exchange Index outperforming the S&P 500 this year.

As I mulled over what I would write this month it struck me how the investment industry is rife with quotes and adages that can be trotted out in any and all situations to explain where we are in the market and more importantly where we are headed. Unfortunately this can lead to a lack of deep analysis and a tendency to fall back on easy and often incorrect reasoning. Frequently there are two diametrically opposite maxims that each will fit current conditions. Imagine that you were evaluating your portfolio at the end of October last year and were faced with two choices both of which are backed by long held beliefs and credible historic examples that make sense. If you chose “bull markets climb a wall of worry” you would have owned stocks and be up nearly 18% in an S&P 500 fund. On the other hand if you embraced the notion that “the market abhors uncertainty” you sold stocks and are grumbling about the less than 1% you are earning in a short term piece of paper. I guess if there is a point to be made it is that just because someone quotes the likes of Keynes or Buffet or delivers an axiom that has become received wisdom through repetition it isn't necessarily so. Pause and reflect and make your own decision. It is particularly required in these unprecedented times. There are no road maps where no one has been before.

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