MARKET COMMENTARY

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"Challenging times call for challenging decisions, but moments of crisis challenge us to think and innovate in ways we never thought of before."

-Eric Willey, American Reserve Restaurant, Kansas City

As portfolio managers we spend a significant amount of our time identifying directional shifts in the economic cycle, forward thinking about shifts in business and business practises and as we've said many times predicting the future. All of those tasks can be extremely humbling, and at times even humiliating; however for the most part the predictions are logical. The timing is where most of us get it wrong, and generally we invest early, fail to select the ultimate leader in the space and tire of the investment before it matures as we lose conviction.

The closest example of this in my career was the dot com period in the late 1990s to early 2000. We could see the endless possibilities of micro-processing, the internet, digitization and cellular communication to name just a few world and life changing technologies and we rushed into invest only to learn we were too early to identify the success stories from the "stories".

We all know of the amazing wealth we could have created if we only purchased the eventual winners (Microsoft, Dell, Intel, Apple, Cisco, Oracle, etc.) and as importantly had the conviction to hold those assets as they fluctuated in value from their many successes and failures. What an explosion of value creators as our society changed forever and for the better.

Now, here we are at what I consider another turning point in our development as the pandemic has caused a shift in the need for efficiencies in healthcare, drug development, supply chain management, entertainment, education, workplace innovation and communication to name just a few areas that require change to provide greater efficiencies and better outcomes. Necessity is the mother of innovation.

The pandemic has simply been a catalyst to make us aware of the complacency that has crept into our lives. We were accepting mediocrity not realizing how it affected things; eldercare and education for two examples.

Why is it that children can totally engage in gaming apps but find it boring to do online education? Online education is 1990s technology, gaming apps understand what motivates and attracts children. With similar understanding and investment, education apps can do the same thing. Wouldn't it be great when you ask your grandson what he's so obsessed with on his laptop that he answers mathematics?

There has long been a recognition that eldercare facilities are underfunded, understaffed and in general mediocre places to finish up our lives. Can innovative management practices improve their quality? We know it can simply by redeploying assets in a more efficient respectful way.

The development of drugs has become a very expensive lengthy bureaucratic process. I have been fascinated by the development of autoimmune stimulating drugs for at least a decade.

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Their development has moved at a glacial pace until the need for a vaccine to combat COVID19. Within months we have numerous candidates of various potential vaccines that required investment and innovation to make a difference.

Now that I've teased you to think about all the potential opportunities the pandemic is shining the light of day on, don't forget the risk of attempting to select the right company at the right prices at the right time while maintaining conviction as setbacks befall your choices.

I think we are in a secular bull market in stocks and I think the disruptions we've seen in globalization (Trump administration) and the pandemic have provided the pause and reflection to allow market consolidation before moving higher. We are currently seeing capital rotate from expensive growth stocks to lesser valuation "*value*" and "*dividend*" stocks. Interest rates will remain low as long as inflation stays in check. This back drop bodes well for a broadening out of market returns before growth and innovation once again take over leadership in the markets.

All the best,
Graham Burns

Andrew's Planning Corner

There has been a great deal of talk about the "shape of the recovery" since the March lows on the markets. These shapes are an informal way to discuss economic progress and recovery, with each shape representing a different course and endpoint.

There was initial fear that it would be an "L" (essentially, there would be no recovery on the markets or broader economy – think new Great Depression). Due to a significant amount of action by central banks around the world, and the US Federal Reserve's monetary policy in particular, we thankfully saw economic activity pick up as soon as the most severe lockdown restrictions were made.

Next came the debate over "V", "U" and "W", differentiated mostly by how long the trough at the bottom is, and how quickly and smoothly everything recovered. Early June saw rapid market growth, with the stock market deviating substantially from underlying economic recovery, and the V path of down and straight back up, while seemingly optimal, proved to be overly optimistic, especially as coronavirus case numbers in the US began to rise rapidly, with some jurisdictions returning to more strict restrictions on activity.

Increasingly, though, the shape of the recovery is looking different than is commonly thought about. Peter Atwater, an adjunct lecturer in the economics department at William & Mary (one of the oldest Universities in North America), coined the idea of a "K-shaped" recovery. A K-shaped recovery is one in which there is a universal steep drop-off in the markets and economy (as we saw in an unprecedented fashion in March of this year), followed by a split recovery where some sectors and segments do extraordinarily well, and others continue to decline and struggle. The ongoing economic impact of the virus is not hurting every individual and company evenly, rather a disproportionate divergence emergences.

We have seen companies and industries that are well situated to take advantage of the work-from-home trend; online shopping, logistics/shipping and tech companies grew faster than ever, with expansion in revenues and share prices. Conversely, retailers, the service industry, small business, companies carrying low levels of cash and large amounts of debt and tourism sectors have struggled mightily. There has already been a wave of closures and bankruptcies In the case of some large companies who were struggling even prior to the pandemic, such as Hertz, Brooks Brothers, J. Crew and a local Kelowna favourite, Pier 1.

This differentiation in business recovery and growth is likely to continue into the future. There are a number of long-term economic and political trends that, combined with this pandemic environment, are culminating in a new business cycle that will be very different that the last 20 years, including:

- The US becoming a net exporter of oil and gas for the first time since the 1940s, which has dramatically changed the global energy picture (highlighted by the Saudi-Russian oil price war earlier this year);
- Reducing globalization in manufacturing and economic ties, exemplified by Brexit, Trump's Chinese trade tariffs, ongoing tourism/ travel restrictions;
- The baby boomer generation reaching retirement en masse;
- Extremely low interest rates for the foreseeable future;
- Rise in online shopping, and the corresponding strain on commercial retail,;
- Central banks becoming actively involved in ensuring liquidity on the markets;
- Ongoing social distancing, gathering restrictions and management of the spread of the coronavirus;
- And many other factors.

Moving forward, successful investing and portfolio construction will require taking advantage of these changing economic conditions. With the upcoming US election this fall, there will be opportunities and volatility. A prudent and disciplined approach to investing, while looking for growth potential and risks, and avoiding speculative fads, will yield the best opportunities.

As always, if you have any questions, or if there is any additional information or insight that we can provide, please do not hesitate to let us know – we are here to help!

Enjoy the last bits of summer, and stay safe.

Sincerely,
Andrew Gilchrist, CFP®, BA
Financial Advisor

Due to the impact of COVID-19, we are taking temporary measures to ensure business continues while we practice social distancing and work remotely from home. Client service is number one and so we want to make sure that we stay connected for all our client needs. We would like to re-confirm our contact information.

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