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GLOBAL INVESTMENT MANAGEMENT

INVESTMENT OUTLOOK Q4 2020

HIGHLIGHTS

Economic Review

- News of highly effective vaccines, further US federal fiscal support and a Brexit agreement helped to boost investors' risk appetite.
- Interest rate increases over the quarter were concentrated in longer maturities as central banks continue to anchor short rates at very low levels.
- Most developed markets posted strong returns in the quarter, despite spikes in infection rates and tightened restrictions.

Investment Outlook

- While the pace of recovery is expected to slow as a consequence of further COVID-19 outbreaks and the resulting government restriction measures, the impact on economic growth is not expected to be as extreme as it was in 2020.
- Financial markets are not showing significant signs of distress following the surge in virus infections, likely owing to the early deployment of vaccines that allows investors to look past current concerns.
- Policy makers will need to strike a delicate balance between short-term needs and the longer-term impacts of the toll the pandemic has taken on country finances.

Market Returns (as at December 31, 2020)

(%)	3 M	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	9.0	5.6	9.3	5.8	6.0
S&P 500 (C$)	7.0	16.3	13.2	16.8	10.5
S&P 500 (US$)	12.1	18.4	15.2	13.9	9.9
Russell 2000 (US$)	31.4	19.9	13.2	11.2	8.9
DJIA (C$)	5.7	5.5	10.1	13.0	7.9
DJIA (US$)	10.2	7.2	11.9	10.2	7.2
MSCI EAFE Net (C$)	10.7	5.9	5.6	8.2	5.1
MSCI EAFE Net (US$)	16.0	7.8	7.4	5.5	4.5
MSCI Emerging Mkts Net (US$)	19.7	18.4	12.8	3.6	6.6
FTSE Canada Universe Bond	0.6	8.7	4.2	4.5	4.7
FTSE Canada 91 Day T-Bills	0.0	0.9	1.0	1.0	1.5
C$/US$	4.8	1.8	1.7	-2.5	-0.6

Converted to CAD using London 4pm rates. Returns are annualized for periods greater than one year.

ECONOMIC REVIEW

The resilience of the economic recovery continues to provide a positive backdrop for financial markets. The final quarter of the year saw relatively strong gains posted by both equities and corporate bonds, capping off an extraordinary year. News of highly effective vaccines, further US federal fiscal support and a Brexit agreement helped to boost investors' risk appetite. In Canada, economic growth increased by 8.9% in the third quarter, coming off an 11.3% decline in the second quarter, but still leaving GDP 5.2% lower than it was at the end of the third quarter 2019. Globally, growth in the quarter was much the same although, broadly speaking, China and Asia are faring much better than the rest of the world. The US dollar continued its slide, which is not surprising given that it typically rises during periods of uncertainty and declines in stronger market environments.

BOND MARKETS

During the quarter, the Canadian bond market increased 0.6%, registering a more modest return for the quarter but a solid 8.7% gain for the year. Corporate and provincial bonds continued to outperform their federal counterparts. The improving economic prospects raised risk appetites, as did the negative real yields on the highest quality bonds around the world. In general, interest rates rose in the quarter although the increases were concentrated in longer maturities as central banks continue to anchor short rates at very low levels. Within the corporate sector, the strongest returns came from past laggards, as shown by the outperformance of energy and real estate companies. The more defensive names trailed the broader market, in particular corporate bonds of utility and telecommunications companies.

EQUITY MARKETS

The fourth quarter continued to see strong gains for global equity markets, with most firmly set in positive territory for the calendar year. Emerging markets led the way (+19.7% in USD), with renewed risk appetite along with better virus containment in key Asian economies, notably China. The Canadian market also posted strong returns (+9.0%) as the Financials and Energy sectors recovered strongly. This was despite a notable weakness in gold-related equities as the precious metal retreated from its highs. While US markets were positive, gains were slightly behind other developed markets in the quarter. Most other developed markets posted strong returns in the quarter as well, despite spikes in infection rates and tightened restrictions.

From a sector standpoint, major rebounds were seen in the Energy and Financial sectors around the world, two areas particularly hard hit during the early stages of the pandemic. In the case of the Financial sector, progress around the development of vaccines has provided hope in the medium term around manageable provisioning for loan losses and the resumption of dividends in some regions. Lagging sectors were those that provided most support early in the pandemic, including Consumer Staples and Healthcare. Overall, most markets staged a vigorous rally from the lows of March 2020 to end firmly in positive territory, despite the volatility brought on by the global pandemic.

OUTLOOK

While the pace of recovery is expected to slow as a consequence of further COVID-19 outbreaks and the resulting government restriction measures, the impact on economic growth is not expected to be as extreme as it was in 2020. This is due to continued strong policy support: central banks have not even hinted about raising interest rates and the US government is on the cusp of implementing its second largest fiscal stimulus program ever. Savings rates are close to 70-year highs in the US, which suggests that when businesses are fully re-opened and consumers are free to spend as they choose, there will be an extraordinary surge in demand. Supply of services, in particular, will likely be constrained so we expect to see an uptick in inflation, although it may be more of a temporary swell than persistent and repeating pressure.

Financial markets are not showing significant signs of distress as a result of the surge in virus infections, likely owing to the early deployment of vaccines that allows investors to look past the current concerns. Businesses have also seen how quickly the economy recovered from the first wave and, with the promise of vaccines in hand, are more willing to stretch past the valley of the second wave.

Undoubtedly, the prospects for the upcoming year and beyond will depend heavily on the rollout and effectiveness of the various COVID-19 vaccine options. In conjunction with this will be the willingness and ability of central banks and governments to keep monetary and fiscal conditions very easy as economies attempt to re-emerge from the pandemic. Policy makers will need to strike a delicate balance between short-term needs and the longer-term impacts of the toll the pandemic has taken on country finances. A definitive outcome around the US elections calmed another major uncertainty, but as Joe Biden is set to take the presidency, it will be important to assess his major policy platforms on such areas as global trade, regulation on big technology and healthcare.

As we look ahead, we continue to believe the market remains fertile ground for active management. Against a relatively positive economic backdrop is a market environment where valuations are elevated, leaving a modest risk premium or margin for error should, for example, the pandemic or virus take a turn for the worse. Our perspective is that, in many cases, a speedy recovery has already been priced in, while in other instances the market is extrapolating what may be temporary trends for a long period into the future. Finally, while we all hope to put the difficulties of 2020 in the rear view mirror, there are going to be some positive permanent changes in behavior, where some companies will see sustainable, long-term benefits.

All returns are expressed in Canadian dollars unless otherwise indicated.