

### Performance in Canadian dollars (%)

	9 months	3 years (Annualized)	5 years (Annualized)
Bonds	7.7	6.0	4.1
Canadian equities	-3.1	4.2	7.6
U.S. equities	8.3	14.7	14.0
Euro-Pacific equities	-4.7	2.8	5.1
Emerging markets equities	1.6	5.0	9.2
Real estate investment trusts	-22.4	2.3	4.9
Canadian/U.S. dollar	-2.5	-2.2	0.0

*Source: Bloomberg, September 30, 2020*

Under the impetus of unprecedented fiscal and monetary stimulus, the global economy began to recover in the third quarter even as the pandemic continued to spread. Interest rates stayed unusually low and the stock markets rose by about 5%. All portfolio managers have the same problem right now: how to structure their portfolios in an environment where, on the one hand, interest rates are close to zero and, on the other hand, equities are trading near their previous peak. The solution lies in diversification.

### Economic activity

The global economy is without a doubt recovering. Most of the leading indicators are up sharply in the developed countries and even more so in China. The pace of the recovery will slow in the coming quarters, but there is every reason to think economic activity and corporate earnings will return to prepandemic levels by the end of 2021.

### The pandemic

Most people think we will be coping with the COVID-19 virus until a vaccine is deployed, probably in the summer of next year. In fact, it is more likely that we will make gradual progress in containing the virus by applying, with increasing effectiveness, the approach taken by countries that have managed to contain it, such as South Korea, Taiwan and Vietnam: mask wearing, social distancing and extensive testing and

tracing. One of the intermediate steps will be reached when quick and inexpensive tests become available, possibly in the near future. It is also important to note that the rate of deaths per capita has dropped dramatically.

In those countries where the authorities have taken adequate measures, there may not even be a second major wave if the population complies with the guidelines.

### Inflation

A pandemic is a decidedly deflationary event. Central banks have been fighting deflationary forces for the past decade, and the virus is complicating their task. In Europe, for example, the consumer price index fell in comparison with the previous year, and the core index, which excludes the most volatile items, stands at 0.2%.

A number of analysts are predicting that the inflation rate will spiral upward over the next few years because of the unprecedented expansion of the money supply, but nothing could be less certain. So far, increases in the money supply have created inflation in the financial markets, but not in the real economy.

### Interest rates

Interest rates have fallen around the world, to the point where a quarter of the bonds on the global market have a negative yield. In North America, 10-year Government of Canada bonds and U.S. Treasuries are yielding less than 1%. The markets have been flooded with liquidity, and the central banks have promised not to raise interest rates for several years, even if inflation accelerates. The U.S. Federal Reserve has said it is prepared to tolerate an inflation rate above 2% and the European Central Bank is considering doing so too. The Bank of England, for its part, has not ruled out the possibility of a negative rate.

Long-term interest rates are expected to rise in the coming months, but the increase will be moderate as long as short-term rates remain low, a situation that could last several years.

### U.S. stock market

The U.S. stock market has a double personality at the moment. On the one hand, the FAANG stocks and Microsoft have risen so much that they now

account for 25% of the S&P 500 Index, an all-time high. Five years ago, these securities accounted for less than 10% of the index. To justify their current valuations, these companies will need strong growth over the next five years with profit margins approaching 20%. The same concentration occurred in 1999-2000 with Internet infrastructure stocks, and it was a story with an unhappy ending.

On the other hand we have all the other companies, which are trading at about 18 times forward earnings. At current interest rates, this valuation is not excessive. The most likely scenario is that the FAANGs and Microsoft will underperform as the pandemic abates and economic activity picks up.

### House prices

CMHC forecasted that house prices would fall because of rising unemployment, but the opposite has happened because lower interest rates have significantly reduced monthly mortgage payments. In addition, many people plan to work more from home and are therefore looking for larger houses. This phenomenon has occurred around the world, and housing starts are very strong. As long as short-term interest rates stay low, house prices will remain firm, especially as the unemployment rate will fall in the coming months.

### REITs

REITs were by far the most profitable asset class over the past 10 years, that is until the virus arrived. They have fallen 30% from their last peak earlier this year, and for good reasons. First, they suffered a significant drop in income; but what is even more important is that the most indebted REITs run the risk of a liquidity shortage. Finally, there is the possibility that shopping centres and office towers will never regain their value because of significant changes in work and consumption habits.

There will undoubtedly be an evolution, but no drastic change. It will be recalled that, after the events of September 2001, the most oft-repeated phrase was: "The world will never be the same again." There were forecasts of a fall in world trade and international tourism because of the terrorist threat, but precisely the opposite happened. Trade and travel grew strongly.

The majority of REITs will most likely cut their distributions, which will reduce their current yields; but such securities still offer solid long-term value in an environment where interest rates will remain lower for longer.

### Preferred shares

Preferred shares are still the most attractive investment for Canadians in need of income. They are yielding about 6.5% versus about 1.9% for corporate bonds. This market has remained depressed as the other markets have recovered, because financial institutions were prepared to issue new preferred shares as soon as the market rate fell below 5%. That is no longer the case. In fact, the opposite will happen as a result of a regulatory change that now allows financial institutions to issue, on the institutional market, a new type of bond that strengthens their capital. Since interest is tax-deductible for the issuer, but dividends are not, financial institutions will no longer issue preferred shares. In fact, TD Bank has just announced it will redeem one of its preferred share issues.

### The asset allocation model

Our model selects the assets that have performed best over the past nine to twelve months. The model suggested selling the stocks following their decline last spring. We did not sell any stocks in the actual portfolio that follows this pattern because, as we mentioned in the Market Review at that time, you should never sell in a market characterized by fear. As a result, the performance of the actual portfolio has been 9.7% so far this year.

Currently, the model suggests holding mostly US stocks, bonds and gold.

### Dashboard as at September 30, 2020

Canada	
Canadian dollar versus U.S. dollar	=
Corporate bonds	=
Long-term government bonds	-
TSX 60	+
REITs	+
United States	
U.S. dollar versus euro	=
Long-term Treasury bonds	-



LANDRY

## Market Review Third Quarter 2020

S&P 500	+
NASDAQ	-
<b>Europe</b>	
Euro versus U.S. dollar	=
MSCI Europe	+
<b>Asia</b>	
Yen versus U.S. dollar	=
MSCI Japan	=
<b>Emerging markets</b>	
MSCI Emerging Markets	+

= : neutral    + : overweight    - : underweight