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June 2020 Commentary & Outlook

Are Stocks Ahead of the Economic Realities?

Both Canadian and U.S. Stock markets spent most of May range bound before pushing higher into the end of the month. Notably, the NASDAQ erased all its pandemic related losses marking an all-time high for the tech-heavy U.S. Index. Meanwhile, labor reports continue to reflect job losses and employment at lows not seen in over 20 years.

While the stock market is known to be forward looking, it is hard not to wonder if stock prices have gotten a little ahead of the economic realities or should I say uncertainties. After all, the headwinds cited in last month's commentary remain in place, namely:

1. Consideration for, and potential severity of, a second wave.
2. Likelihood of an effective vaccine this year and how long will it take to restore the economy.
3. Whether fiscal and monetary stimulus can continue to support the millions of unemployed as main street struggles to get back to work.

FED Committed to Stimulus

Since the 2008 recession, monetary stimulus in concert with a low interest rate environment have always been prime contributors to asset prices moving higher. And once again this year, the U.S. Federal Reserve has reaffirmed its support for this policy until at least 2022.

This commitment in and of itself seems to have been sufficient to prop share prices up and encourage the participation of retail traders in record numbers. All of which helping to drive the recent upward momentum.

Yields on Stocks Are Attractive

Add to that the relevant attractiveness of the yield on the S&P comparative to the bond market as outlined in our latest CIO research update, entitled *Walls of Worry*, and one can see the case for owning stocks.

However, even with company valuations adjusting higher to a lower interest rate environment, attractive dividend yields, and many companies now better equipped to face the crisis, the previously mentioned headwinds remain in place, and in the first two weeks of June, we saw the first significant pause in the recent relief rally.

And, as referenced in last month's *Portfolio Managers Brief*, with stocks having recovered so much so quickly and valuations on the high side for many companies, even considering the low interest rates, a pull back on renewed concerns of a second wave and the associated profit taking on the part of investors is not all that surprising.

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That said, given the amount of liquidity in the market and the support for stocks by both investors and the Feds, a W-shaped pattern may not necessarily be in the cards. However, the risk of a retracement of the current up-trend would not be unrealistic as investors react to pandemic related headlines and the related economic data.

Staying Defensive

Based on the significant possibility of a pull back, we continued to remain defensive through the month of May. While our defensive stance has resulted in a lag in performance of our Enhanced Mandates compared to the benchmarks in the short term, with U.S. markets testing new highs so soon after the crash, we determined last month was not the time to be aggressive.

June has so far proved to be a bumpy month, and we plan to use any market weakness to continue to build positions in companies on our watchlist while maintaining a level of defensiveness. Our approach also includes active profit taking and continuing to use a variety of option strategies to help offset some downside risk and take advantage of any increased market volatility.

Stay Safe and Healthy

As always, we would like to encourage everyone to stay safe and healthy as social restrictions ease and we take initial steps towards re-opening the economy.

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