Financial Market Update - February 15, 2021

Good Morning!

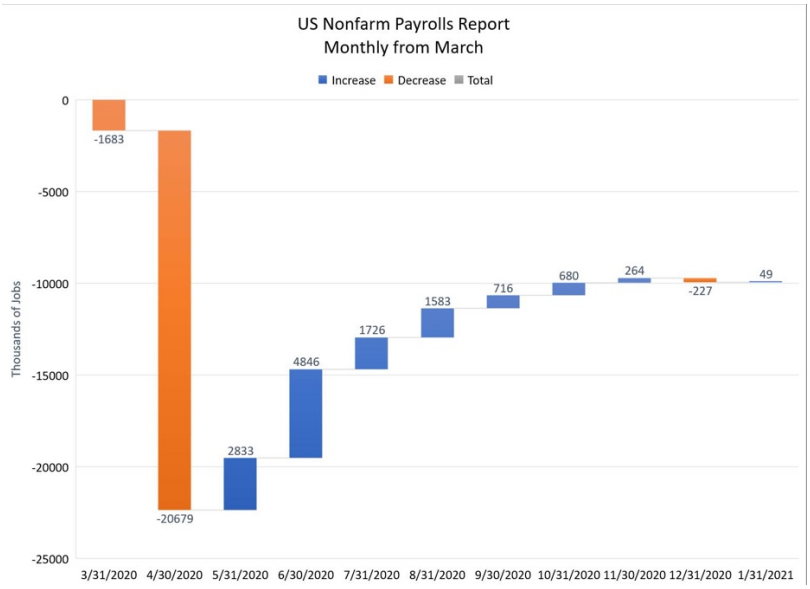
With today being a day where we celebrate family, I figured this might be an ideal time to send out a market update as you may find yourself looking for some reading material to accompany your morning coffee.

It has been a very busy past couple of weeks of activity in the markets and with economic data (and let's not forget Gamestop!) I wanted to provide you a quick assessment of the environment.

Any weaker economic data reported over the next few weeks won't really matter to our 12-month investment outlook.

Some were concerned with last week's US Nonfarm Payrolls report that showed a modest and below consensus net gain of 49,000 jobs for the month of January. Additionally, the Canadian Labour Force Employment report that showed 212,000 jobs were lost in January may dampen the optimism by some market participants. However, I would argue that little can be gleaned from either of these releases that we didn't already know. And that is the crux of the challenge with economic data that is backward looking. It is only common sense to understand that with renewed lockdowns come renewed weakness in some of the economic data. What we need to do to ensure proper reasoning is ask **whether this is a trend or a temporary anomaly?** As we saw after the spring lockdowns in 2020, COVID cases are once again falling in Canada and the United States, and as such we expect what will follow will be a similar rebound in the labour market and other data in the coming months.

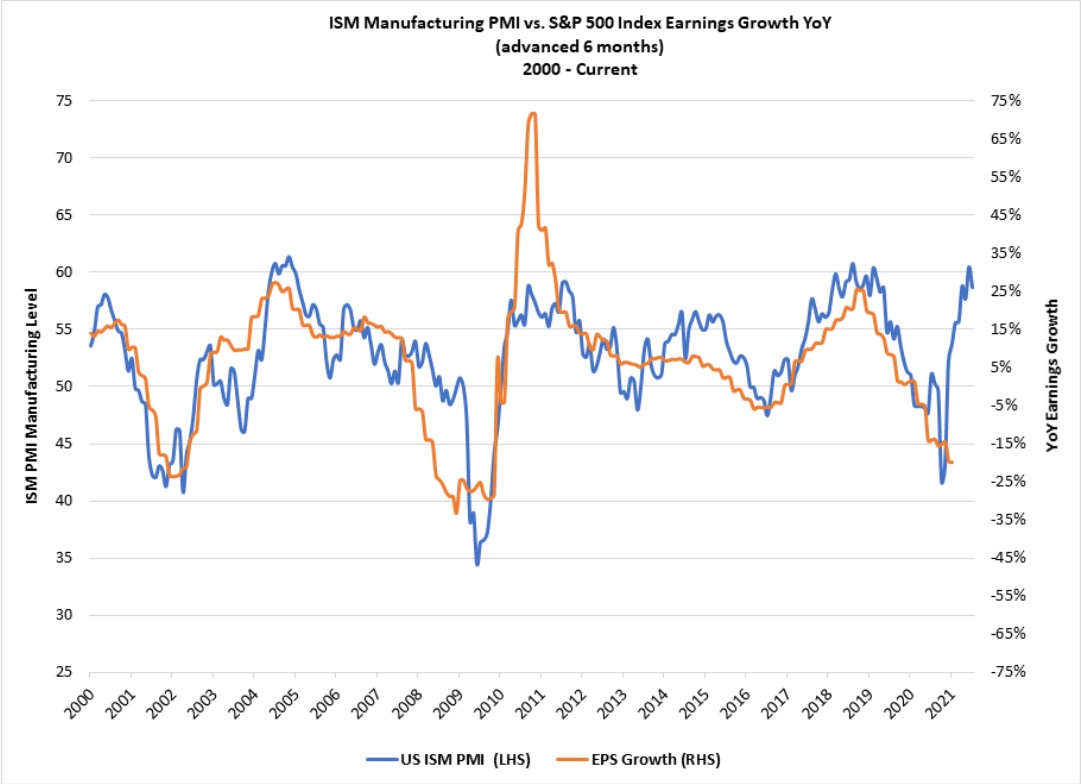
*While the job gains have flattened out over the past few months in the United States, we expect a second wave to the labour market recovery to take place in the back half of the year in our **Rapid Reopen** thesis.*



After three quarters of negative year-over-year earnings per share (EPS) growth, the earnings recovery has begun

Last week was also met with continued strength in the US manufacturing economy with the Institute for Supply Management Manufacturing Purchasing Managers Index (ISM PMI) that showed a reading of 58.7. It was a tick lower from the recovery high of 60.5 for December, yet still at a very encouraging level for forward earnings growth. This is a very pertinent indicator as the ISM PMI has the ability to forecast trends in S&P 500 earnings growth. The recent data confirms the belief of a very strong earnings recovery for 2021. .

As of today, we are approximately 74% of the way through the fourth quarter earnings releases for S&P 500 companies and the results are showing promise. 80% of the reported companies have reported a positive EPS surprise and 78% have reported positive revenue surprise. If this number holds it will mark the third highest percentage of S&P 500 companies reporting a positive EPS surprise since this matrix began being tracked in 2008. On my latest call with the capital markets team, they believe 2021 earnings may not only reach 2019 levels but exceed them. In turn, this supports a favourable view towards equity markets in 2021 on what looks to become a very strong earnings recovery.



Source: Bloomberg

This is an attractive environment for the Emerging Markets

I came across this insightful piece of information introduced as the Growth/Inflation Momentum Matrix. It is a culmination of the "Capital Markets Team" work on varying growth and inflation environments for the US economy with data going back to the 1950's. The team believes 2021 will be characterized by an "***accelerating growth and accelerating inflation"*** environment. Certain asset classes are at their best in this environment. In particular, emerging market equities tend to outperform when growth and inflation are accelerating. I continue to hold a favourable view towards China, and the broader emerging markets as a whole.

Growth/Inflation Momentum Matrix

Decelerating Growth / Accelerating Inflation	
SPX	1.4%
R2000	3.6%
TSX	5.5%
MSCI EM	8.2%
Commodities	5.9%
Gold	23.2%
High Yield	3.9%
DXY	-2.3%
US 10-Year Yield (BPS)	0.40

Accelerating Growth / Accelerating Inflation	
SPX	12.1%
R2000	13.9%
TSX	12.8%
MSCI EM	21.0%
Commodities	7.2%
Gold	11.8%
High Yield	11.1%
DXY	-2.3%
US 10-Year Yield (BPS)	0.50

Accelerating Inflation Momentum ↑

Decelerating Growth Momentum ← → Accelerating Growth Momentum

↓ Decelerating Inflation Momentum

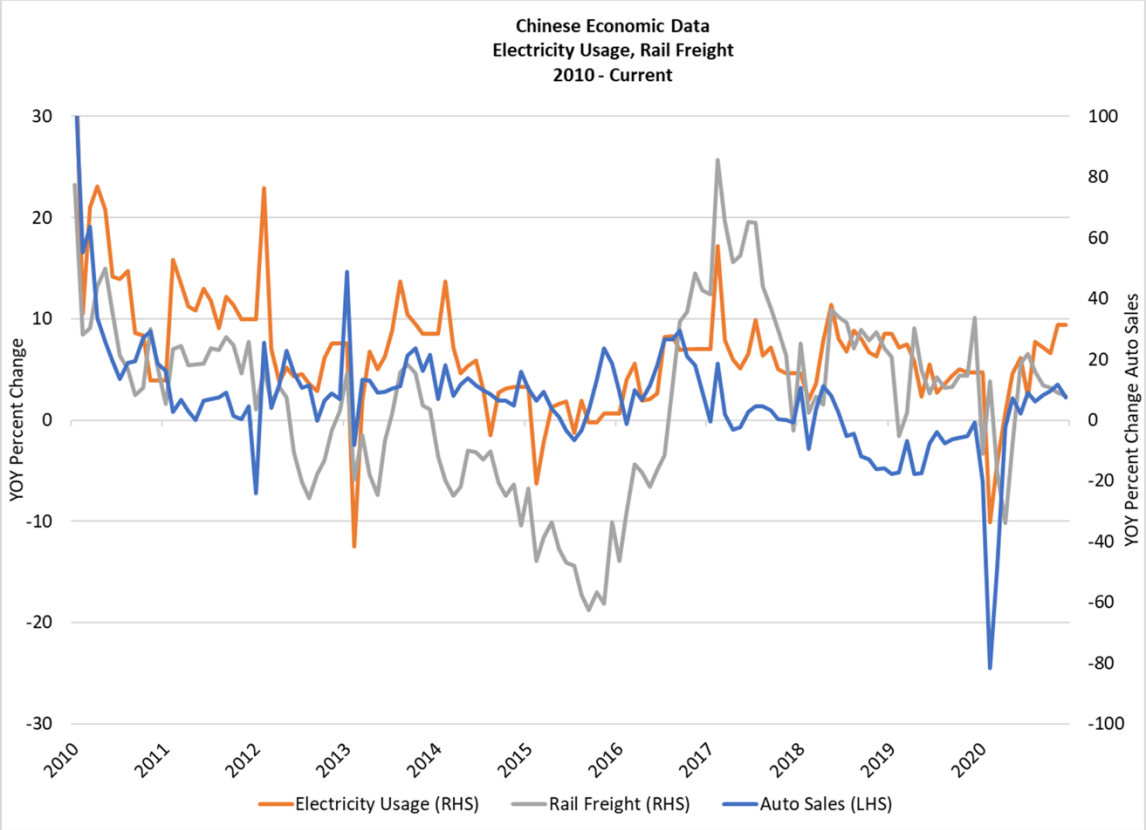
Decelerating Growth / Decelerating Inflation	
SPX	5.2%
R2000	4.5%
TSX	-0.6%
MSCI EM	-2.3%
Commodities	-4.5%
Gold	0.5%
High Yield	6.0%
DXY	3.5%
US 10-Year Yield (BPS)	(0.67)

Accelerating Growth / Decelerating Inflation	
SPX	15.7%
R2000	20.2%
TSX	11.5%
MSCI EM	17.4%
Commodities	1.4%
Gold	5.5%
High Yield	13.0%
DXY	0.6%
US 10-Year Yield (BPS)	(0.38)

Source: Bloomberg

The Chinese New Year was this past Friday and 2021 is the Year of the Ox in the Chinese zodiac. A quick search on the year of the ox reveals, "Having an honest nature, they are known for diligence, dependability, strength and determination." – which is an appropriate theme for 2021 as we advance

through the global pandemic. We should also remember that the Chinese New Year brings a lull in economic activity at the beginning of the year while the country engages in New Year celebrations. **As is typical, the January China PMI data came in modestly weaker on a month-over-month basis while remaining in expansion territory at 51.9. We would expect to see additional softening of the PMI in February as well. We do not see this as a sign that Chinese economic growth is in jeopardy of exhaustion but rather seasonal and temporary.** As with the labour market data noted above, investors would be well served to take any near-term weakness in Chinese economic data as typical for this time of year. We would point to recent rail freight, electricity usage and auto sales data that as of December would argue the positive growth trend remains intact.



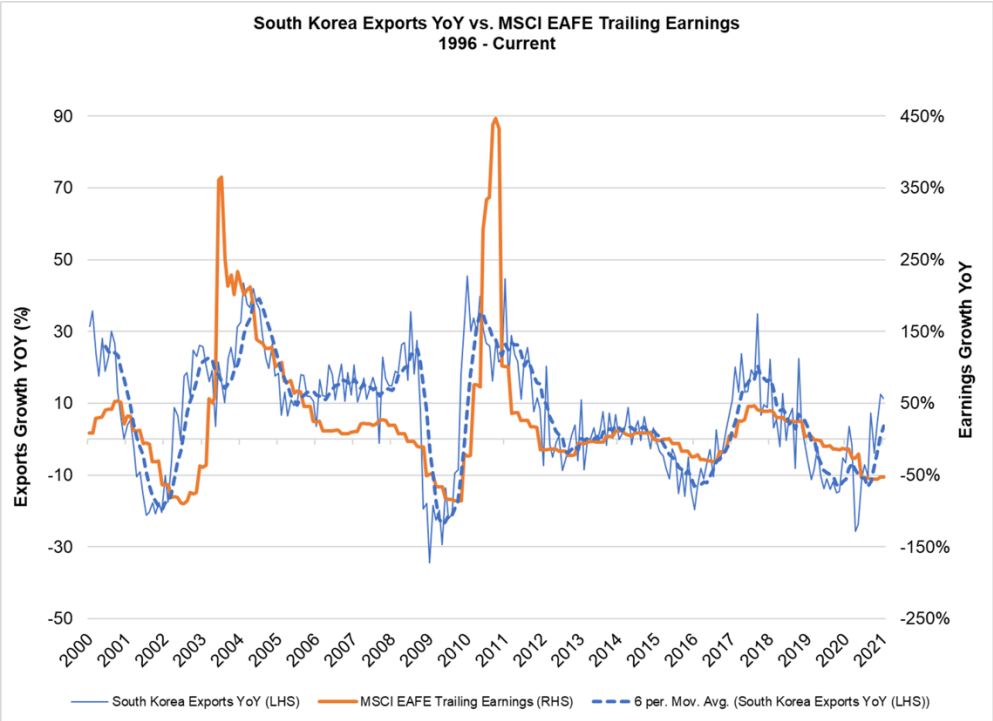
Source: Bloomberg

Lastly, as it pertains to the earnings outlook for 2021, the work of the Capital Markets Team would suggest that the earnings recovery will be broad and include the emerging markets. They have long-held South Korean trade data as a bell-weather for the global economy. In saying that, we have seen a strong relationship between South Korean exports measured on a year-over-year basis and earnings growth for many indices but in particular, for the MSCI Emerging Markets Index (as we would expect given South Korea has representation in the index).

I bet you didn't know this - South Korea is the fifth largest exporter in the world, and its exports include a diverse array of products. Which is why it is a good indicator for global growth. As you can see from

the chart below, I believe EM earnings growth is set to shoot higher as indicated by South Korean export growth that is up 11% year over year. The current data suggest EPS growth expectations of 25%-plus for EM with risk to the upside. As EM is also exhibiting much better valuation than the S&P 500 Index currently, I would expect more of the earnings growth to be priced into EM – combined with the matrix output that would suggest significant outperformance potential relative to US or EAFE stocks.

While I believe 2021 will be a good year for global equities overall, the data suggests there is good reason to believe there exists the potential for emerging market equities to enhance portfolio returns over the course of the next few years.



Source: Bloomberg

Financial Markets continue to be an interesting and evolving topic that are most often unpredictable. Common sentiment across investors is the "Main Street vs. Wall Street" unbelievable disconnect. Understanding we cannot see the unforeseen, it remains prudent investors stick to a calculated strategy and not variate based on emotion, short-term volatility or phenomenon's (i.e. Gamestop). This can be difficult as it feels more comfortable to follow the herd mentality at times. That is why I am here, and this is where the value of independent, sound advice plays it role.

Thank you for the continued opportunity to provide you timely, pertinent insights as it pertains to financial markets.

Warmest Regards,

Aaron Pedlar