

## May Monthly Market Comments

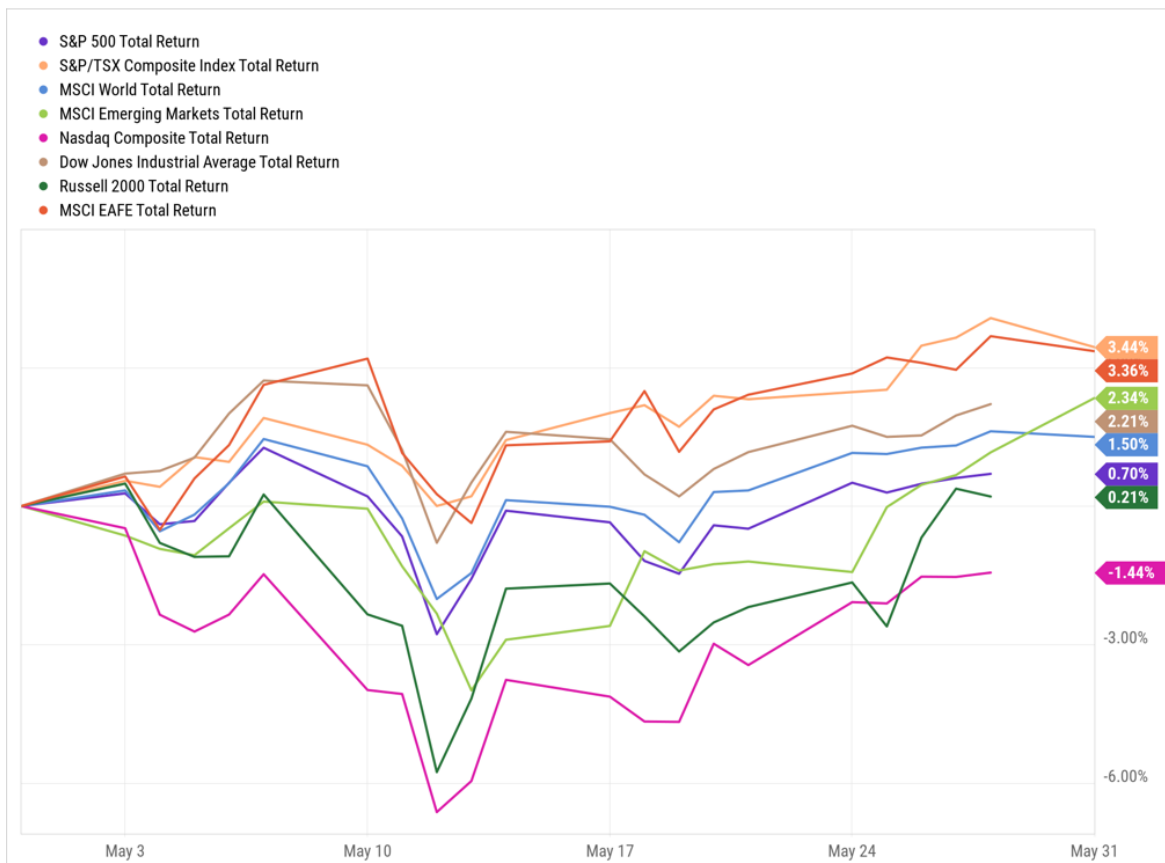
June 7, 2021

Have you ever heard of this investment adage? The phrase "sell in May and go away" is thought to originate from an old English saying, "Sell in May and go away, and come on back on St. Leger's Day." This phrase refers to a custom of aristocrats, merchants, and bankers who would leave the city of London and escape to the country during the hot summer months. St. Leger's Day refers to the St. Leger's Stakes, a thoroughbred horse race held in mid-September and the last leg of the British Triple Crown.

North American traders and investors who are likely to spend more time on vacation between Victoria Day/Memorial Day and Labor Day mimic this trend and have adopted the phrase as an investing adage. And indeed, for over half a century stock market patterns have supported the theory behind the strategy in comparison to the other 6 months (typically colder months) of the year.

In saying that, it fails to mention that although these summer months typically don't produce as attractive returns as the months from November through April it has historically still been a positive experience. In fact, the S&P 500 has returned only 1 negative monthly return over the past 10 years [2015 (-0.3%).]

So how did markets fare in May this year? Canadian and International Equities led the way, but short answer is pretty positive. The tech and high growth style companies sell off (i.e. Nasdaq) continued to some extent with fears of inflation, and very little change in the US 10-Year Treasury.



## ***Thoughts on Long Bonds and Yields?***

Investing 101: Bond markets are different than equity markets. Equities fluctuate daily; companies and sectors will fall in and out of favour given the backdrop. With bonds it's a different story. In the bond market to recoup your losses, you can:

1. Hold and collect your coupons
2. Wait for a change in the environment for the worse (i.e. the economy starts to weaken)

Given the current economic backdrop, both are highly unlikely. Yields will continue to steepen putting long bonds in further losses so consider cutting your losses and reallocate to something else that can provide you better returns. Since January 1<sup>st</sup> of this year the 10 Year Treasury Rate has increased from 0.93% to 1.63% - that's a 75% increase. So where do they go from here?

I believe it's likely inflation and yields move higher. Below is the 10 Year Treasury Rate since January 2000. Given the economic backdrop and historic yields I believe it's a reasonable expectation that we hit 2.5% by the end of the year.

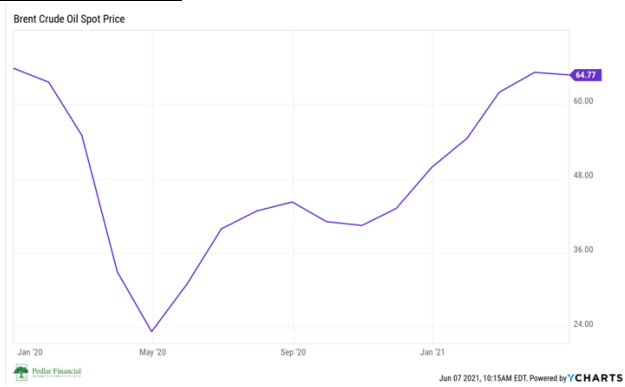


So, what do fixed income investors do? Do we negate bonds? Absolutely not. Bonds play a critical role in portfolios - especially for conservative clients. Rather, protection in this environment means reducing your duration (less than 5 years), embrace more credit (A, BBB) and perhaps hold high yield credit. I would favour dividend growers in equities as a source of income. An area to avoid is the very speculative tech names if you believe rates are going to increase.

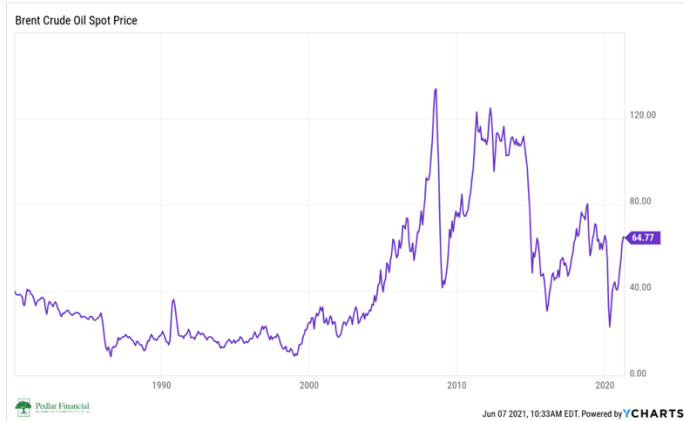
## ***Energy Sector and the Canadian Dollar – Highly Correlated***

I don't think this should shock anyone. The CAD has been labelled as a "Petro Dollar" for a reason. Today, energy is hovering around \$65/barrel and as you can see from the graph below it is valued at pre-pandemic levels. Gasoline demand in the US is already at pre-pandemic levels. Although energy has had a good run it remains as one of those sectors that over the long term has not proved to be a very viable asset class. Hence, we typically have very little to no exposure in energy in our portfolios. With the surge in energy prices, the Canadian dollar has been quite strong relative to most other major currencies in 2021. For investors, being invested in companies held outside of Canada, the (CAD) dollar's strength acts as a drag on performance. In the long term, currency works itself out in the wash. The dollar fluctuates and in times like this the only benefit is you can buy USD for travel (not that we can go anywhere today) at a discount.

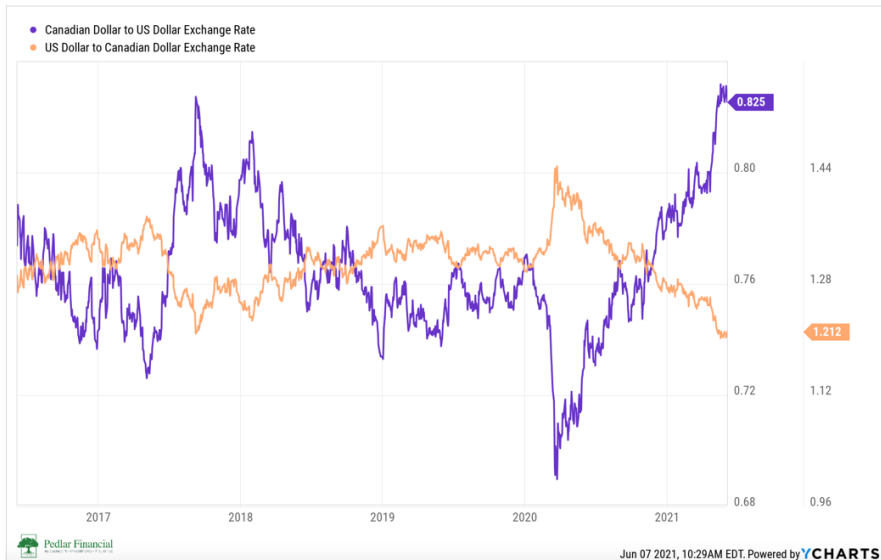
Brent Crude Oil Spot Price (since Jan.1.2020): Back to Pre-Pandemic Levels



Brent Crude Oil Spot Price: Long Term Oil Is Not a Great Buy/Hold Strategy



CAD vs USD: The strength of the CAD has been steadily increasing since April 2020 and has continued its strength into 2021 as Oil Prices have rallied. Today it would cost you just over \$120 CAD to receive \$100 USD.

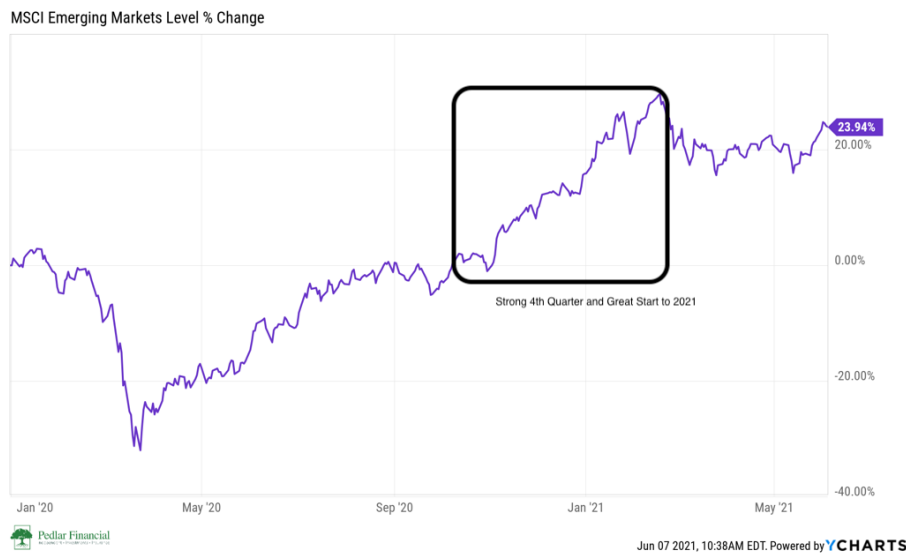


## Emerging Markets - What's the Outlook?

Back in September we started to see great opportunities in the Emerging Markets space. In fact, our model portfolio introduced a 5% weighting and by the end of the fourth quarter it was increased to 10%. Emerging Markets had a strong 4<sup>th</sup> quarter 2020 and had great start to 2021 before hitting a correction. See graph below. So, is Emerging Markets still in favour for 2021 with their underperformance in comparison to developed markets year to date?

Short answer is YES. Factors such as human capital, financial capital, and the growth of the middle class has not changed in the last 3 months. Oppose to years past, Emerging Markets has changed - 80% of it today has exposure to Greater Asia. This is a strategic play, and the fundamentals haven't changed. This weakness is short term in nature and investors should take advantage of it.

Typically, a correction outside of a recession the 1 year forward look is positive 90% of the time. The buying the dip mentality has allowed the US to avoid this same correction. There is nothing fundamentally that would change my mindset that "Emerging Markets will do well" based on our growth matrix the belief we are in an "accelerating growth/accelerating inflation" environment. Short term hiccups happen, and you don't manage money with a short-term view. You want to own Emerging Markets long term because there is a lot of opportunity and structural changes happening over the next 5-10+ years.



### Capital Markets Strategy Team - Growth/Inflation Momentum Matrix

Average annual return by asset class in each environment

Decelerating Growth / Accelerating Inflation		Accelerating Growth / Accelerating Inflation	
SPX	1.4%	SPX	12.1%
R2000	3.6%	R2000	13.9%
TSX	5.5%	TSX	12.8%
MSCI EM	8.2%	MSCI EM	21.0%
Commodities	5.9%	Commodities	7.2%
Gold	23.2%	Gold	11.8%
High Yield	3.9%	High Yield	11.1%
DXY	-2.3%	DXY	-2.3%
US 10-Year Yield (BPS)	0.40	US 10-Year Yield (BPS)	0.50

Decelerating Growth / Decelerating Inflation		Accelerating Growth / Decelerating Inflation	
SPX	5.2%	SPX	15.7%
R2000	4.5%	R2000	20.2%
TSX	-0.6%	TSX	11.5%
MSCI EM	-2.3%	MSCI EM	17.4%
Commodities	-4.5%	Commodities	1.4%
Gold	0.5%	Gold	5.5%
High Yield	6.0%	High Yield	13.0%
DXY	3.5%	DXY	0.6%
US 10-Year Yield (BPS)	(0.67)	US 10-Year Yield (BPS)	(0.38)

- The CMS Growth/Inflation Momentum Matrix examines multiple growth metrics (GDP, OECD US LEI, ISM PMI etc.) against the inflationary backdrop to determine individual asset class performance (on an average 4-quarter basis).
- Through our macro-research we then determine the growth/inflation environment that we believe we are moving into over the next 12 months.
- We can then identify the asset classes that are likely to perform well in such an environment using our matrix.

### ***Closing Thoughts:***

We have continued to see a rotation from a style standpoint of growth to value in equity names. Growth names have benefited investors the past few years but once a vaccine was created and a foreseeable timeline came into view the market started to see past this pandemic and value and cyclicals typically perform well in a re-opening trade or post recessionary markets.

The broad indexes have performed well, and I think investors are always a bit cautious in these situations thinking “there has to be a pullback” or “markets are up big on a rolling 12 months, so we are due for a correction.” Reality is if we look at momentum going all the way back to 1927 our Capital Markets Strategy Team concluded that actually momentum gets momentum.

When looking at both a 6- and 12-month period – if the markets are up 20% - did we have a greater probability of them going up or down in the next 12 months? The answer is UP.

When you are up 20% over a 12-month period the probability of it going up by 10% in the coming 12 months are greater than any other period. In fact, 70% of the time. Hence, momentum gets momentum.

Another interesting fact is when we look at the S&P 500 for example. The average return is 12% but its wild to note that it rarely produces average returns. Since 1970, 20% of the time markets returns are negative, 20% of the time returns are between 0-10%, 60% of the time they’re greater than 10% and 35% of the time its greater than 20%.

Given the economic background there doesn’t appear any glaring signs that we should we be taking money off the table. If you think earnings are going to continue to grow, we must understand it’s an attractive market, but valuations are high in some particular areas so don’t go chasing home runs. We should continue to exercise rebalancing portfolios and implementing a dollar cost averaging (DCA) strategy when putting new money into the markets.

Thanks for taking the time to read my latest market commentary. I know it was super long winded, but I love helping my investors become well-informed. I hope you find this insightful, and it provides you some further clarity as we continue to navigate the ever-changing financial markets. Although markets change one thing that doesn’t is my commitment to provide valued clients sound advice based on fundamentals.

Warmly,



**Aaron Pedlar**, HBA, CHS

Financial Advisor

*“Helping Clients Achieve Financial Independence & Security”*



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