The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

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"Do not take yearly results too seriously. Instead, focus on four or five-year averages."

- ***Warren Buffett***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	31,041	+ 1.42%	+ 1.42%
S&P 500	3,804	+ 1.27%	+ 1.27%
TSX	18,028	+ 3.41%	+ 3.41%

The Buffett Dilemma

Starting in the 1950s, Warren Buffett grew a small stake of $10,000 in personal savings into $84 billion today. He beat the S&P 500 in many of those years and, in 2008, became the richest man on Earth when he hit the level of $62 billion. Bill

Gates passed him just months later. Bill had held the title before for several years and seized it back when Microsoft began to climb out its post-dotcom bust malaise.

Don't fret for Mr. Buffett. He is still worth $84 billion, even after giving away $37 billion to charity. From the #1 spot in 2008, he has slid to #7 on the billionaire list, having been passed by more technology titans, including Jeff Bezos (#1) and newcomer Elon Musk (#2). As of Thursday, Musk is now the world's richest person.

Mr. Buffett is one of the few truly diversified billionaires. Those richer than him tend to have all their eggs in single baskets. His company, Berkshire Hathaway (**NYSE BRK.A**), invests in a myriad of companies from railways to beverages to banks. Warren Buffett has always been a "value guy" in the sense that he rarely overpays for anything. He is picky about positive cash flows, the value of a company's assets, and the width of a corporation's economic moat. Traditionally, he has owned very few technology shares in his portfolio, claiming he just doesn't understand their valuations. In recent years, he has accumulated a large position in Apple (**NASDAQ AAPL**), which has helped his performance.

2020 was a mediocre year for Mr. Buffett's portfolios, as it was for most people - Berkshire Hathaway returned just over 2% for the year compared to 18% for the S&P 500. The company holds a record $150 billion in cash, or 38% of its entire portfolio.

On the surface, U.S. stocks were the stars this year. Looking more closely, it was the handful of technology companies that most benefited from the stay-at-home edicts. These are not the companies Berkshire Hathaway traditionally buys.

In fact, in 2020, the more extreme the valuation of companies and the worse their earnings were, the better the shares seemed to do. Tried-and-true dividend-paying companies performed poorly, as some were forced to cut their dividends. The Dividend Aristocrats – those companies which have raised their dividends for 25-50 years, and where Mr. Buffett typically shops, returned just 3% in the U.S. and -3% in Canada.

Most world markets do not have the same high weighting of technology companies in their indexes. As a result, Canadian stocks had a lackluster year with a return of about +5%. Global markets were the same.

So how did Mr. Buffett's year go? He was caught off guard, as were most investors.

Berkshire Hathaway came into the year expecting the economy to pick up. He owned $4 billion in four airline stocks (Warren dislikes airline stocks and he vowed not to own them just a few years earlier) and then plunked down $20 billion for Occidental Petroleum shares on March 6th. Ouch. He dumped the airline stocks for a big loss in May, saying their future had become far too uncertain, and then sold a portion of his Occidental Petroleum near the lows in June. His bank stocks limped along all year until the vaccine was announced in November.

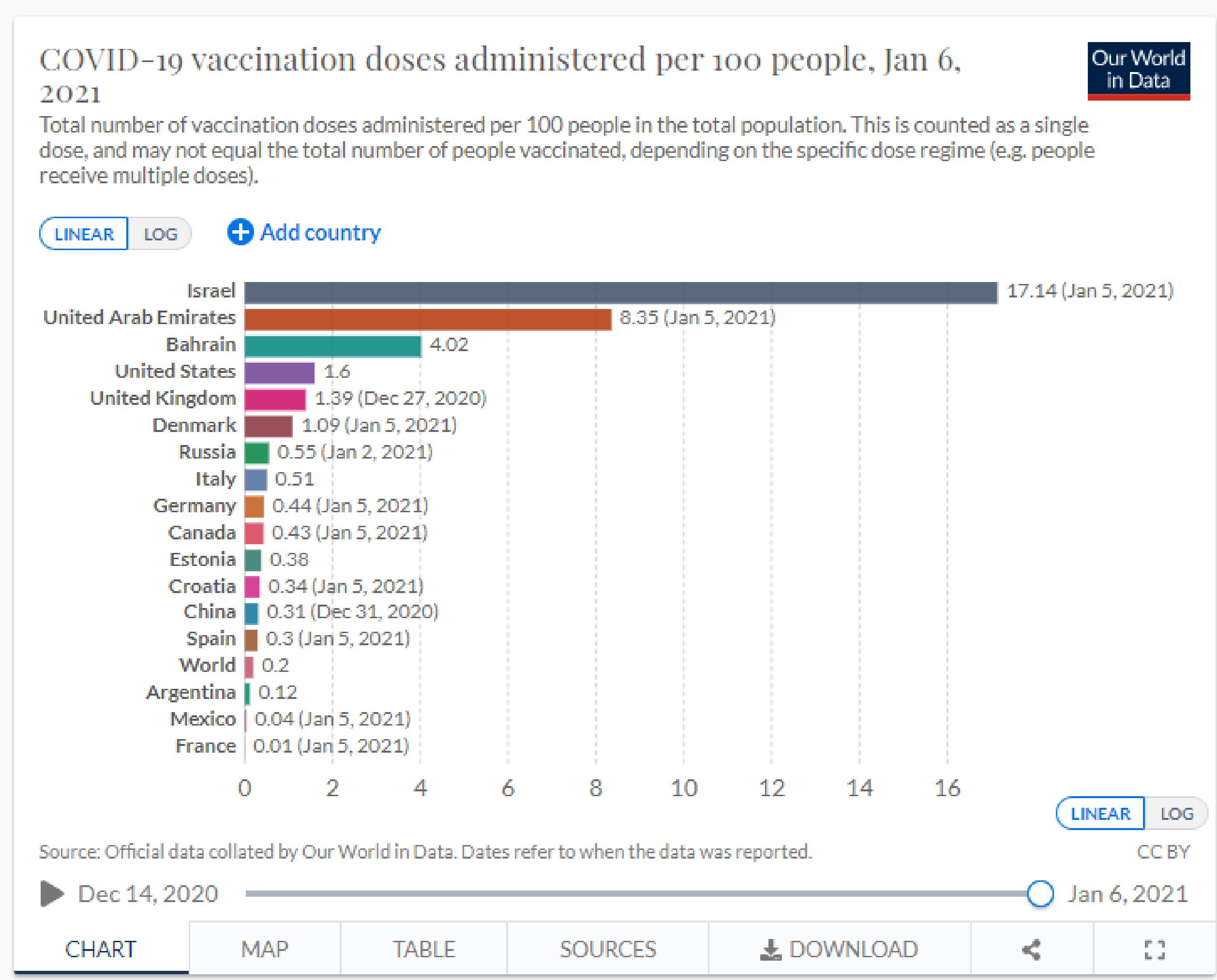
Did he buy anything? Being a value guy, he struggled to find bargains this year. He added to his Bank of America (**NYSE BAC**), convinced that U.S. banks are truly cheap (they are), waded into the hated energy sector with a purchase of some natural gas pipelines for $4 billion, bought shares in Barrick Gold (**NYSE GOLD**) - his first foray into gold - and finished up by buying into four Japanese conglomerates. Many think Japan is finally turning the corner, and Mr. Buffett obviously agrees.

So banks, oil, gold, and foreign stocks. Except for gold, these were not the favourites for 2020. However, they may be for 2021.

Warren Buffett faltered this year, just as most value managers did. Don’t count on it continuing in 2021.

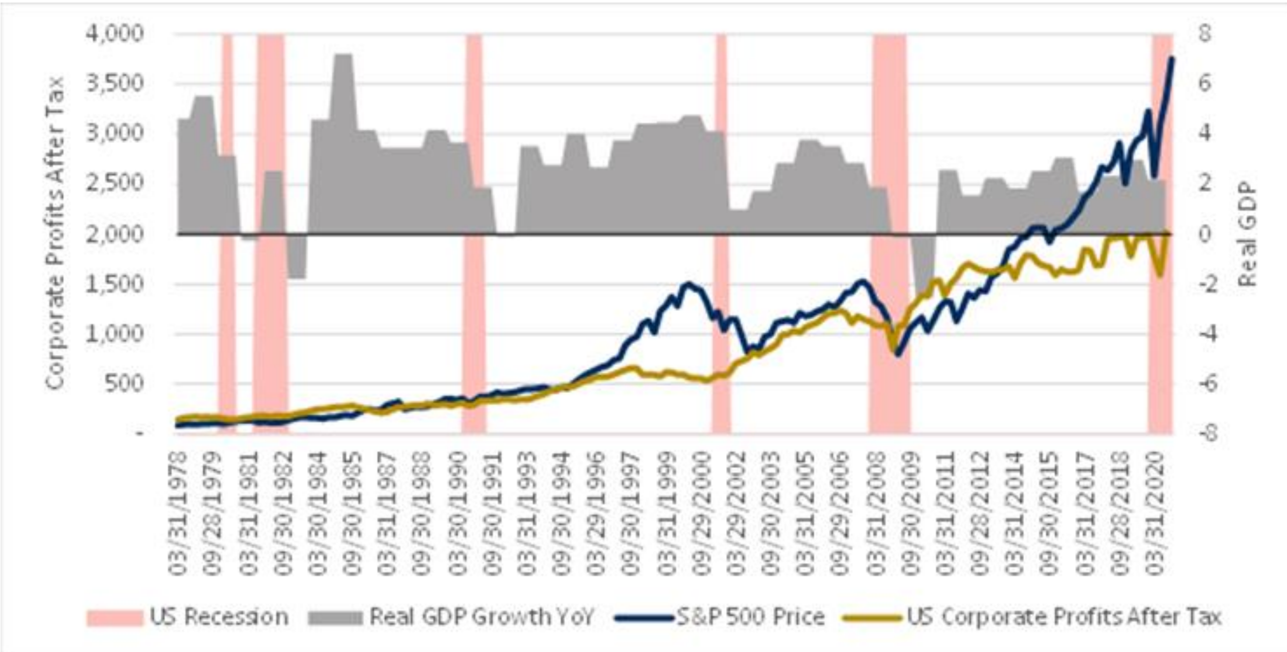
2021 – The Long and Winding Road

Welcome to 2021, the New Year that looks suspiciously like the old year. At least we have a vaccine to look forward to, although the rollout is slower than expected. Israel has vaccinated 17% of its population, the US about 1.6%, while Canada has completed just 0.4% of our population. Expect the pace to accelerate everywhere in the weeks ahead.



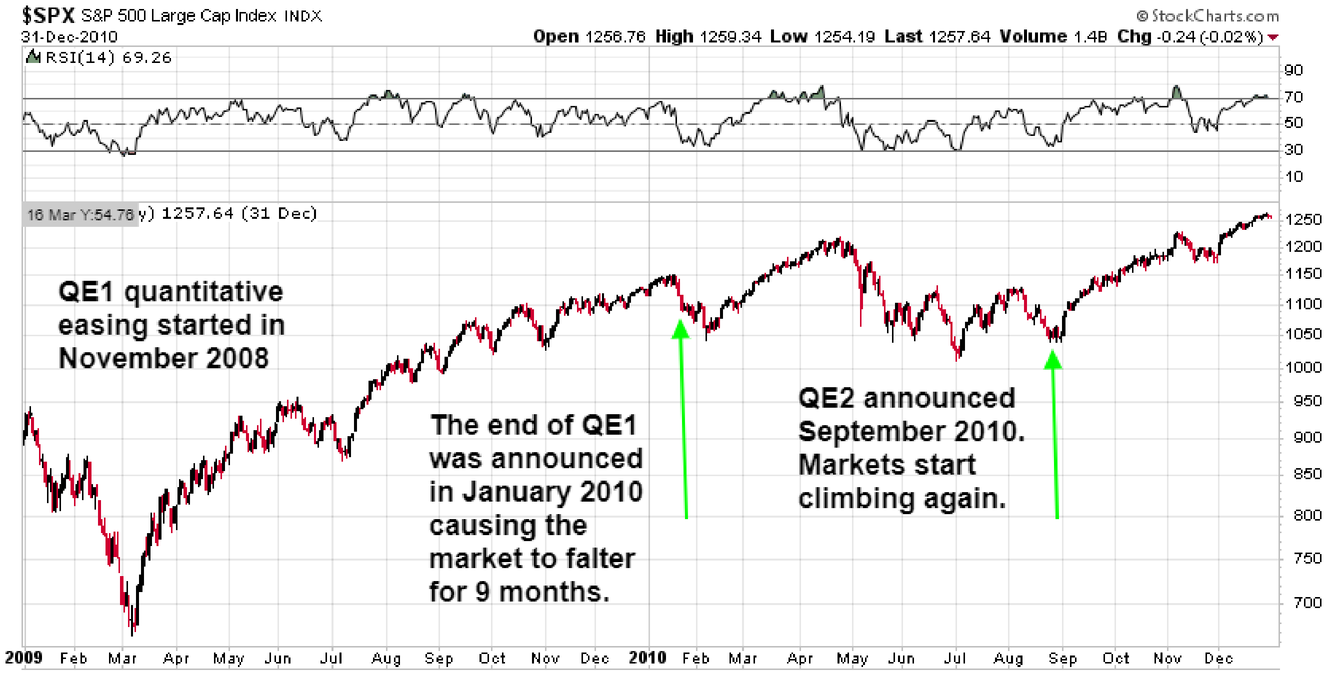
New lockdowns are delaying a global recovery. However, increased vaccinations and ongoing support programs will mitigate this.

Last year, the stock market outperformed the economy. This year, the two may be reversed, with the reopening economy outperforming the stock market. The graph below shows how much the stock market has outperformed corporate profits. Note that in past cycles, they usually meet back in the middle in due course.



As we recover, our spending will shift away from buying things like new laptop computers, toilet paper, and renovating our homes, to travel and entertainment.

One thing to note is how important the flow of newly-printed money – stimulus – is to the direction of the stock and bond markets. *It is very important*. Markets began their recovery when the giant interest rate-lowering and money-printing programs began in March of this year. This is the same pattern we saw in 2009 after the Great Financial Crisis. When the money was flowing in with QE1, stocks rose. When this stopped, stocks faltered.



There was a QE3 program after QE2 starting in late 2012 because the economy continued to be weak. If we call the most recent stimulus program QE4, we can see that the U.S. has done as much stimulus in 9 months in 2020 as they did in six years from 2008 through 2014.

And they aren't even close to being finished.

Balance sheet expansion under rounds of quantitative easing (QE), USD billions

	Announced	Terminated	Length (m)	Treasuries	MBS	Loans**	Balance sheet
QE1	11/25/2008	3/31/2010	16	$300	$1,074	$0	**$1,403**
QE2	11/3/2010	6/29/2012	19	$829	-$196	$0	**$568**
QE3	9/13/2012	10/29/2014	25	$822	$874	$0	**$1,674**
QE4* **	3/23/2020	Ongoing	9	$2,209	$715	$197	**$3,245**

Source: JPMorgan

In the U.S., the Democratic party completed its sweep by taking two seats in the Senate in Georgia. The Democratic agenda has been to spend more than the current Republican administration, and this removes an impediment to that.

Therefore, the risk of the stimulus being turned off has been averted. Expect to see more stimulus cheques, spending increases to assist states, and possibly student loan relief. There is likely to be a large tax increase, but the spending will likely outweigh any tax hikes for now. Marijuana is likely to be legalized across the U.S. in this next presidential term, and we expect a big increase in on-line sports gambling. Both would provide needed sources of new revenue.

We can also expect a large infrastructure program in the next year, as well as improved overseas relations. This means global stocks should have better performance going forward.

Also, inflation is coming, which means gold and commodities should continue to shine. A shift from “new economy” technology stocks to “old economy” value stocks is occurring, as well. This should help Mr. Buffett and the other value investors out there.

Supply and Demand

The pandemic has been brutal on department stores, especially those in malls. Canada’s Hudson’s Bay has deferred its rent payments in several mall locations and its former parent, Lord & Taylor, has since closed its doors. Sears, once the nation’s biggest retailer, is down to just 100 stores. Consumption has increased nationwide, but not from department stores. Demand has shifted to the digital on-line world.

And speaking of that, one of the biggest questions we are asked recently concerns bitcoin. This is the digital currency that few understand, but that keeps going up by the day.

Bitcoin was designed as a currency and payment platform to circumvent the banks and traditional payment systems, such as credit cards. It is created by computers doing enough complex calculations (“mining”) until a new bitcoin is earned. These digital coins can then be spent at the touch of a button. There can only be so many bitcoins mined, which makes them somewhat scarce.

And that is pretty much all you need to know. Bitcoins are scarce, while dollars are being created by the billions every minute. Some say bitcoins will replace gold one day as the new store of value, but many are not so sure. Gold is tangible and has 5,000 years of history; whereas, bitcoin could be rendered illegal overnight by a central bank.

Financial bubbles often occur in new technologies getting ahead of themselves. We saw this in the internet from 1995-2000 when we wrapped the world in fibre optic cable four times over, and most were empty. The stocks of these companies collapsed. Along came the i-phone and these cables were overflowing with data by 2010.

Similarly, there was a mania in railway construction in England starting around 1830. There was so much interest in railway stocks, 48% of all quoted stocks were railway shares and 15 new stock exchanges had been created to trade them by the mid-1840s. From 1845 to 1848, the value of the railway index was cut in half as the bubble popped. England was left with a first-class rail system, but most investors lost money.

For the moment, the scarcity (and mystery) of bitcoins prevails, meaning they could rise even further. However, they display all the hallmarks of a classic bubble: exponential rise in price, devoted investors, and few understanding what is going on.

Monday Webinar

Raymond James will be broadcasting a webinar entitled TEN THEMES FOR 2021 on Monday at 1:15.

Please join Raymond James Chief Investment Officer, Larry Adam, as he presents his 10 Themes for 2021 – Seeking the Thrill of Victory.

The Olympic Games are a fitting metaphor for the current times, as the events were cancelled in the midst of the pandemic last summer and are now rescheduled to begin on July 23, 2021 – a date that should coincide with the sustainable reopening of many parts of the world. The Olympics will be utilized as a framework for our 10 Themes, as each theme will be tied to an Olympic sport. From the US economic recovery taking on a triathlon, to keeping portfolios en garde despite low yields, to earnings doing the heavy lifting to help the S&P 500 break records, to riding the ESG wave, we aim for our views on the economy and various asset classes to become a reliable, integral part of your investment game plan.

We have sent out an invitation with the link. If you don’t have it and would like to listen in, send us a reply and we will forward it.

Thank you for your referrals this month! They are always handled with great care and discretion.

http://www.dividendvaluepartners.com

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca
sharonmitchell@raymondjames.ca

(250) 405-2417

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