The Market in Review

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This week's articles and insights

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"Voters like all this spending. No one really wants to balance the budget. There is no desire to make the sacrifices and endure the pain it would take to change the course we are on.

So, it won't change, and debt will keep piling up."

- John Mauldin

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	26,659	- 6.01%	- 6.59%
S&P 500	3,310	- 4.15%	+2.46%
TSX	15,671	- 3.74%	- 8.16%

Better Weather Ahead?

This is a picture taken from Peter Mazzoni's office this month. It is a reminder that the sun does return eventually.

According to Chinese mythology, a double rainbow - there is a faint one in the picture - is considered to be a sign of future success.

Next week starts the Seasonal Best Six Months for North American stock markets. Since 1950, the November-through-April period has been the best 6-month period to be invested, while May-through-October has been the worst.

Does it work every year? It got turned on its head in 2020, since we all know what happened last March. Historically, however, it has statistically held up that the winter months have the strongest returns. And this works even more strongly in international investing.

Markets This Week

Markets have struggled since September, culminating in a severe drop on Wednesday of this week. This occurred for a variety of reasons:

- There have been more elections than we care to count. The big one – the U.S. Presidential election – looms next week. This has caused all manner of worries about unrest and judicial disputes.
- The Covid-19 second wave has hit (3^{rd} wave in some countries). We knew it would, but many thought the restrictions and lockdowns were over. They aren't.
- The massive wave of stimulus has ebbed, with much of the money spent. The economy is begging for another infusion but politicians are either delaying or offering less.

While there may be more bumps to come, we focus on the 'better weather ahead' theme this week:

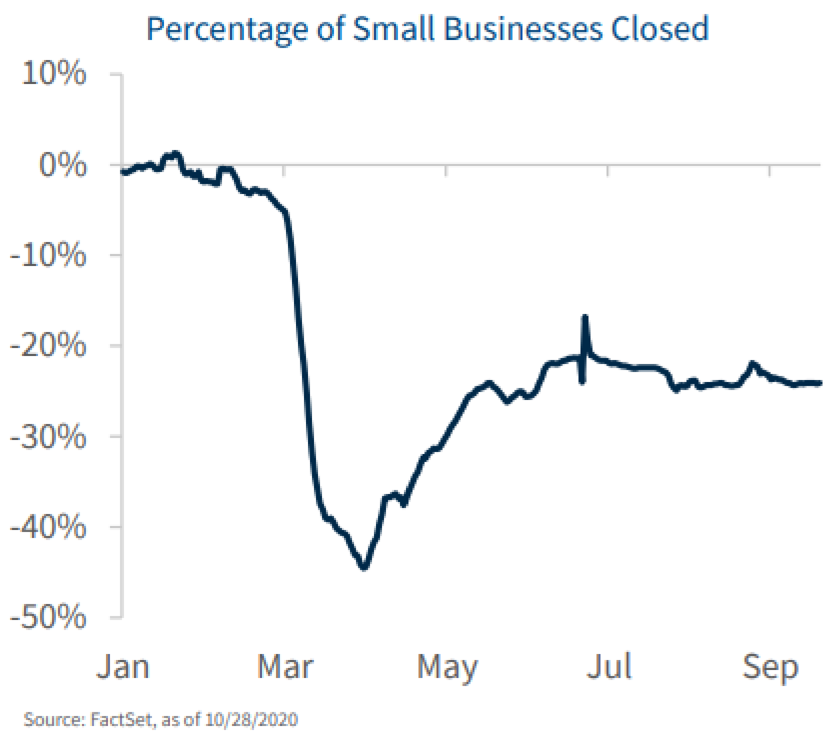
- The U.S. will have a president by this time next week. There may be some squabbles, like there were in 2000, but the election will be over.
- There will be some riots, but not nationwide. We are over-worrying this. We always do.
- There is a high probability that new vaccines will be approved in November, with at least one and perhaps as many as four. Deliveries could begin as early as December or as late as January, but they will begin. Markets are forward-looking and once they sense mass vaccination is in sight, it will be a clear signal that the economy can truly begin to open up.
- The 2nd wave of Covid-19 was always going to be more widespread, but far less deadly. We should see a peaking in numbers in the next 2-6 weeks.
- There will be another massive stimulus plan ahead. Bigger under the Democrats, but still big under Trump. Markets have tended to rise when fresh money enters the economy.

In other words, the market may have worried enough about these for now.

Another sign is how well the U.S. economy grew in the 3rd quarter – it was +33.4% on an annualized basis. This was ahead of what was expected and double the European growth rate. This sets the 4th quarter up for a strong start, as well.

Manufacturing is also up, and the unemployment rate is down. Both are hopeful signs.

It won't be a straight path higher, though. After a bounce through July, many small businesses remain closed. Regional lockdowns will also slow the recovery.



A full recovery is still at least a year off, but the signs of recovery are here.

Of course, much depends on the progress of the Covid-19 virus. The 2nd wave has reached into corners previously untouched (i.e. rural areas and those spared in the 1st wave). However, the hospitalization and death rate is far lower. This is exactly what happened with the 1918-19 Spanish Flu where the first wave was the most deadly.

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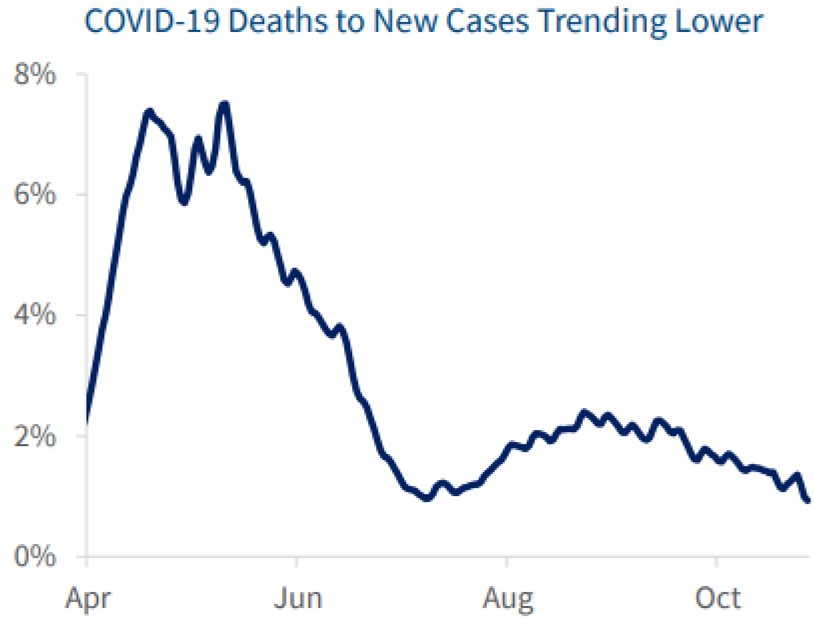

Source: FactSet, as of 10/28/2020

New lockdowns are rattling markets in Europe but shutdowns in North America are not widespread enough to stop the recovery. That could change, but so far, hospitals are managing.

Market Observations

Are there winners in all this? Pharmacies like CVS (**NYSE CVS**) in the US and Shoppers Drug Mart in Canada are setting up for a booming business in vaccinations – both for flu right now and Covid-19 in 2021. Also, UPS (**NYSE UPS**) is gearing up for massive deliveries of vaccinations worldwide next year. There will be billions of doses needed and someone has to deliver them.

It is earnings season once again. I often say to my wife that what is important in the stock market is not if a company's earnings are "good" or "bad", but if they are "better" or "worse". For example, both Amazon (**NASDAQ AMZN**) and Zoom (**NASDAQ ZM**) delivered good earnings, but because the stocks are already quite expensive, 'good' was not 'good enough'. Both stocks declined on the news.

On the flipside, energy company Suncor (**TSX SU**) delivered a surprising loss and Molson Coors (**NYSE TAP**) reported sales of beer that are down from last year. Both stocks rose after their reports. Why? Probably because both are already down, cheap, and unloved. Anyone who wanted to sell has already sold. The interesting part will be in the months ahead, as oil demand picks up and beer sales at sporting events resume. Amazon and Zoom will both do well in the years ahead, but will they do as well as they did during the pandemic?

Fires and Zombies

In 1910, several devastating forest fires in the United States prompted the U.S. Forest Service to begin a policy of strict suppression of all fires. In 1935, their official policy was to extinguish every fire by 10 a.m. the next day.

Both British Columbia and the US Forest Service followed strict suppression policies until the 1970s, when some controlled burns were allowed. However, these have been too small and too few to clear out decades of dry brush.

The policy was brilliant…for a few decades. Then the buildup of brush and stunted trees became tinder for even larger fires. Many tree species rely on fire to propagate their seeds, needing intense heat for their cones to open. These trees actually survive most fires because they don’t reach the crown of the tree. The extra accumulation of dead wood allows an intense fire to consume the entire tree, however, which destroys the natural cycle.

Couple this with increasing intrusion of homes and human activity deeper and deeper in remote forests and you have the recipe for what happened this summer in California: devastating wildfires whose smoke covered much of western Canada.

The point of bringing this up is to highlight the importance of what Schumpeter called “creative destruction” in financial markets. Without the natural thinning of weak companies, capital and human talent is held captive at “zombie” companies, which just struggle to survive. In the U.S. today, it is estimated that close to 19% of all companies make just enough money to service their debt payments, and no more. They can’t grow, yet low interest rates allow them to shamble along like undead creatures from The Walking Dead TV series.

The reaction of central banks during every crisis since the 1987 crash, when markets fell 23% in one day, has been to lower interest rates and flood the market with money. Like fire suppression, this helps in the short term because there are fewer bankruptcies and investor losses.

A prime example of this was in Japan, which became famous for its own zombie banks. Burdened by billions in impaired loans, the government propped them up instead of forcing them to take steep losses. The result was that few new loans were made, and the economy stagnated.

With low interest rates, too many companies are allowed to live on. For example, would Bombardier (**TSX BBD.B**) still exist if it were not for cheap debt (and government help)? Or would we have smaller and more nimble aerospace companies in Canada if they went away?

Aging At Home

Another major shift brought on by the Covid-19 pandemic is the desire to stay at home rather than move to a nursing home. Bugs spread better in close quarters, so why take the risk if you can afford not to? Over 75% of all Covid-19 deaths in Canada occurred in long-term care homes.

A survey conducted by the National Institute on Ageing at Toronto’s Ryerson University in late July showed that an increased number of Canadians want to continue living at home as they age. The survey of 1,517 Canadians showed 60% of respondents said the pandemic had changed their opinions on nursing or retirement homes.

The number grew to 70% for those respondents over the age of 65.

While private retirement homes can be expensive, so can in-home care. And much parental care is done by younger relatives, which may save money in salaries but can be very expensive in terms of time. Canada’s Statscan says 1 in 4 Canadians over the age of 15 already provides some sort of support to family or friends with age-related problems. This can only be expected to grow in the years ahead as the population ages.

A shift away from institutionalized care toward home care would create many disruptions, as well as opportunities, in the investment space. Another theme to watch.

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Prices shown as of October 29th, 2020
