The Blue Chip Report – April 2021

The Roaring 20's – Version 2.0

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March 23, 2021 was the one-year anniversary of the Coronavirus stock market crash (and my second pandemic birthday). Although it has *only* been twelve cruel months of unprecedented change, chaos, and closures, it feels like it has been a lifetime. Reflecting on the year that simultaneously was and was not, we are all changed because of it. So, is it impossible to know what the world will be like after the pandemic? With history as our guide, is our future in our past?

Over a hundred years ago, after the devastation of World War I and the Spanish Flu pandemic, the World was emerging, societies were challenging social and political norms, and new technologies were transforming where and how people worked – sound familiar? People felt they were overdue to enjoy life to its fullest, boom psychology set in and the 'Roaring 20s' were born. That was then and this is now. As variations of the vaccine roll out, economies cautiously reopen, and people begin to emerge, are we poised for a sequel to one of history's merriest decades?
The stage is set for a boom.

Pent up Demand – The pandemic has paused much of life as we know it, thus triggering a significant halt in discretionary spending upon most. Closures, CERB (the Canadian Emergency Response Benefit), and clarity on financial well-being have contributed to a surge in the overall level of household savings in 2020, which was estimated by the Bank of Canada to be about $180 billion, or roughly $5,800 per person. After being deprived of certain activities and when the constraints are lifted, individuals may ravenously consume what was previously out of reach. The best thing Governments can do is get out of the way and allow consumers to spend.

Rising Consumer Confidence – Consumer Confidence in the United States (a value based on consumers' assessment of current business and labor market conditions) surged in March to its highest reading in a year. According to FactSet, March provided a reading of 109.7, blowing past consensus of 96.0 and outpacing February's high of 90.4. Consumer spending comprises over 70% of economic activity and given the strength of renewed optimism, should pave the way for solid economic growth in the second half of the year.

Human Desire to Socialize – Socialization is an essential human need. After a prolonged period of physical distancing, many people will be eager to participate in greetings, gatherings, and parties once again. A recent survey by the Harris Poll found that 71% of Americans say they miss socializing in restaurants and bars, 61% say they miss shopping in stores and 52% say they miss movie theaters. As vaccine inoculations enable reopenings, the "new normal" will inevitably be replaced with the "old normal".

All good things must come to an end. The perpetual party of the late 1920s ended abruptly when an inexperienced Federal Reserve struggled to cope with the low inflation and surging stock prices. The stock market crashed, and depression (and recession) ensued. History generally does not repeat itself exactly, instead it rhymes. Today, the Fed is expected to face inflationary concerns instead of deflationary catalysts. Other growth themes that existed then, like urbanization and labor productivity, have played out in today's economy.

The path of this decade's recovery remains to be seen. Will the V-shaped recovery continue, and will we party like the Gatsby's? Or will we RSVP "no", as the W emerges like many initially predicated? 2020 reminded us that *un*certainty is the only certainty in life. So, while we should all prepare for the inevitable party of our lifetime (hopefully later this year), be sure to enjoy responsibly.

The Inflation Debate

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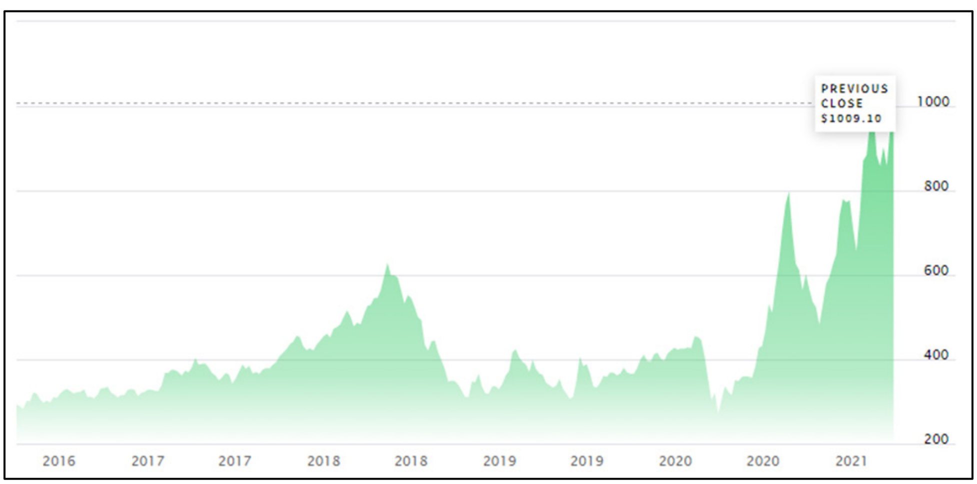
In the middle of the economic crisis caused by the global COVID-19 pandemic and the early stages of the ensuing recovery; the decline and phoenix like recovery of the North American equity market was shocking. What was as equally shocking, were interest rates and the belief that those rates were going to stay at those historically low levels.

In August of 2020, the 30-year Government of Canada bond interest rate reached an absurd level with a yield to maturity of – drum roll please - 0.888%. An investor who bought these bonds at the time made a difficult decision because at the end of March 2021, the same bond now has a yield to maturity of 1.948%. This is still quite low by any historical measure; however, it resulted in a loss of over 22% during that time period. This is a good time to remind readers that as interest rates rise, the price of bonds decreases.

These historically low yields can be attributed to the significant monetary stimulus from global central banks, and the uncertainty around the impact the COVID-19 pandemic would have on the global economy. In addition, the fear that deflation would take hold, also existed.

Fast-forward eight months and inflation is the new concern. As vaccines rollout and citizens become inoculated, we can begin to see the other side of the pandemic and feel the excitement surrounding the reopening of the global economy, whenever that may come. Both Canada and the United States are poised for very strong GDP growth in the second half of 2021 and into 2022. With this type of economic activity, inflation is generally a natural byproduct. Inflation is the rate of which the prices for goods and services increase. Anyone who buys groceries for their household knows that the price of meat seems to be increasing at an alarming rate; however, it's starting to show up in other items as well. Lumber prices are at an all-time high (as seen in the chart below), and it is these increases in input cost that then flow into the increasing cost of finished goods, such as housing.



www.nasdaq.com/market-activity/commodities/lbs

While the demand for raw materials is high, the demand for consumer experiences is anticipated to be just as strong as the economy begins to fully reopen. Who among us isn't excited to take that next vacation or go to their favorite restaurant with friends once we are able to do so? Consumers competing for the same types of products and services will cause the prices of those items to increase.

Central banks around the world are aware of these facts and are walking a very fine line of allowing inflation to return while concurrently allowing the economy to recover. Most historians blame austerity measures for increasing the length and depth of the great depression and central banks would rather not make the same self-inflicted mistake twice. This has caused some central banks to rethink their approach to interest rate policy coming out of this recession. Canada has recently started to message that it will take its foot off the quantitative easing pedal and the United States has also shifted their dual mandate to full employment and an *average* inflation of 2% over the medium time horizon. This small change will have huge implications for markets as the Federal Reserve is willing to allow inflation to rise over 2% and remain there before they raise short term interest rates.

All this points to inflation coming back and interest rates rising as a result. So why the debate? Some market pundits feel that inflation will prove to be a blip on the radar and won't be sustained over the long term. They point to pre-pandemic times when the unemployment rate was at generational lows and inflation was effectively benign. Consider this, over the past year and a half, you have likely not taken your regular annual vacation(s). Once the economy opens again, are you going to take your normal vacation, or will you perhaps add one more? Will you make a point to eat out more often or will the experience wear off after a few visits to your favorite dining establishments?

The wild card is government spending. The United States seems to unveil new trillion-dollar packages every other month and that extra gas on the economic fire will have an impact, but how much is yet to be seen. For BCV and our investment strategy, focusing on bonds with a short term to maturity and focusing on quality has paid off. Until we begin to see the precursors of inflation and rising interest rates, we don't foresee a meaningful change to our investment philosophy.

BCV encourages all readers to follow all local, provincial, and Health Canada guidelines as it relates to the global COVID-19 pandemic for the health and safety of all. For more information about COVID-19, please refer to the following link - https://www.canada.ca/en/public-health/services/diseases/coronavirus-disease-covid-19.html

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