

# LEE, TURNER & ASSOCIATES INC.

## INVESTMENT QUARTERLY

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### REVIEW

October 2020

Our world is getting better at managing the current COVID-19 pandemic. While the spread of the coronavirus is still ongoing, promising developments on its vaccine and treatment fronts give hope to its eventual end. The panic that was evident at the early days of the virus' discovery has now subsided. Today, people are less fearful, and most are doing their part to contain its spread. Assuaged fears have allowed global economies to reopen and track towards sustained recoveries. In North America, we saw a remarkably swift economic recovery; it was indeed a "V" shaped recession from beginning to end. Investor sentiments in the meantime have taken on a slightly more optimistic tone, but that may well turn for the worse as fall and winter approaches, and fears of a second wave of infections rise. Stock market indexes also took on a "V" shape since late February of this year. Over the recent quarter, the Dow Jones Industrials Average charged ahead with an 8.5% rise while the S&P/TSX Composite Index climbed a more subdued 4.7%. There were substantial performance differences amongst the markets' component sectors. Technology stocks performed very well, hitting all-time highs, while the more traditional sectors lagged. Bond markets maintained their strength as the Central Banks' bond buying programs continued with no signs of letting up. The shape of North American yield curves, understandably, remained unchanged over the quarter. Canadian bonds had a 0.4% total rate of return over the quarter.

### FORECAST

On the whole, North American economies responded very well to the massive influx of fiscal and monetary policy inputs. This sharp economic recovery, on surface, appears to be broad-based and underpinned by strong consumer demand for both durables as well as discretionary items. In truth, this recovery has been anything but broad-based, in fact it has been rather uneven and disjointed. The current economic story is really a tale of two, one for the haves and another for the have-nots. Roughly speaking, large enterprises whose revenues come from remote, without inter-personal contact, delivery of services were fortunate enough to prosper during the lockdowns. These businesses and their employees have socked away their earnings and are now brimming with cash at the ready to satisfy their pent-up demand for goods and services. On the other side are those who had lost their jobs or had their businesses shuttered because of lockdowns, people who relied on close person to person contact to deliver goods or services. These unfortunate folks are still struggling to make ends meet with government handouts. Overall, while we would prefer to have an economic recovery that is truly broad-based, across all sectors of the economy, we are satisfied with what we have at hand so far. We expect politicians to continue with their largesse by providing more fiscal stimulus, and we know that monetary stimulus from the Central Banks will continue unabated. We expect North American economic growth to continue, but the pace of which will moderate somewhat. Lastly, whatever the outcome of the US election in November, it will not have any meaningful impact on the near-term prospects of the post pandemic recovery.

## **INCOME STRATEGY**

### **Bonds**

The tone in the Central Bankers' forward guidance became rather strong and explicit recently. In July, the Bank of Canada said: "we are being unusually clear that interest rates are going to be low for a long time." Similarly, the Federal Reserve stated in September that it "will likely keep interest rates at their current level through to 2023". These statements exude conviction and, to us, imply that bond yields over the next few years will remain at their current levels. Therefore, expect Government of Canada bonds to yield 0.35% annually over the next five years and 1.0% per year for the next thirty years. We believe the Central Banks had plenty of confidence in making their intentions known because they have structurally altered their approach to policy making, moving their goalposts, if you will. The Federal Reserve announced (and the Bank of Canada will likely follow soon) that from now on, it will direct their policy actions firstly towards achieving full employment and secondarily towards an inflation rate target of averaging 2%, instead of below 2% (as they have had over the past couple of decades). While we see their goal of achieving full employment as admirable, we are however alarmed by their want for more headroom in inflation before having to commit to raising interest rates. We are quite concerned by the outlook of where interest rates will be kept low for a long time, while the inflation rate will be allowed to go over 2% for an extended period of time (because it has been substantially below 2% for most of the past year). We are troubled by this investment scenario because it exposes investors to the near certain fate of negative real rates of return from bonds. By our calculation, an investor in a 5-year Government of Canada bond would likely see a negative real rate of return of 2% per year for the next 5 years. We thank the Central Banks for their candor as it gave us plenty of caution while we prepared for our income investment strategy – which is to stay clear of bonds.

### **Income Trusts**

Plenty of prognostications have been made to advance the thesis of a permanent demise in the commercial use of real estate and, thus, Real Estate Income Trusts as well. We think most of these ideas are just overly simple extrapolations of vacancy rates and other issues surrounding the current pandemic. When COVID-19 is contained (it is just a matter of time that it will) people will no doubt resume gathering in groups to eat, play, or work. So, no, we are not overly concerned with our REIT holdings. Again, we stress that the REIT's in our portfolios are owners of valuable, strategically located, and irreplaceable properties.

## **EQUITY STRATEGY**

The disparity in the economic recovery carried over into the stock markets. There was a significant performance divergence between the sectors making up the index. Amongst the under-performing sectors were banks and telecommunications. But in here we see some very compelling risk/return values. With the banks, we know they are facing heightened loan loss risks, but we feel these are more than manageable due to the provisions that have already been made. As well, all the banks have plenty of capital on reserve to buffer any liquidity shocks. With the telecommunications group, its underperformance seems counter intuitive. There is no questioning the demand for more distanced communication during the pandemic, but a downturn in new customer additions, lower demand for roaming services and fewer new devices sold have hamstrung these companies' revenues. We expect these conditions to ameliorate and the companies' profitability to return.