LEE, TURNER & ASSOCIATES INC.
INVESTMENT QUARTERLY

REVIEW April 2021

An epic battle between the ages was waged in the stock market over the past months, and it was one for the ages. Young amateur investors, those in their early to mid-twenties, were looking to squeeze profits out of old veteran professional investors by trading stocks against them. The premise of the young set was to unite an army of traders to take on and profit from the old guys. That army's strategy was to pool their knowledge, through social media and online forums, and then pool their capital to buy, en masse, the shares of financially distressed companies with the view of forcing the old guys to buy those same shares off them later, but at higher prices. Sounds like a plan. For a while, that plan seemed to have worked as incredible volatility and trading volumes were recorded in the stock markets. Take for instance the share price of one of the more favoured companies amongst the young set, at one point it jumped 890% in 5 days and then slumped 74% over the next 5. Such trading volatility continues to today and seemingly without end in sight. We do not know how this stock market skirmish will end, but for now we find it nothing more than an amusing side show. Meanwhile in the real world of investing, financial markets have more than fully recovered from the coronavirus pandemic. North American stock market indices are all either at or near their new all-time highs. The Dow Jones Industrials Average ended the quarter with a 5.8% gain. The S&P/TSX Composite Index climbed a touch more, 8.1%. Bond yields have also surpassed their pre-pandemic levels and the yield curve steepened considerably. Because bond prices fall when investors demand higher bond yields, the total return on bonds over the quarter netted out to a loss of 5.0%. Bonds with long maturity dates (between 20 to 30 years) lost 10.7% while the short-term maturities (between 1 to 5 years) showed a smaller loss of 0.6%.

FORECAST

We, along with every person we know, are looking forward to our vaccination appointments and an end to the year-long pandemic lockdown. Barring any major unforeseen glitches with the vaccine roll-out, we are forecasting a healthy economic rebound in the coming months. We see a high probability of economic growth surprising us on the upside. We believe that great many consumers will soon succumb to spring fever, after having endured cabin fever for what seemed an eternity. We think these folks will be eager to loosen their purse strings and undergo some much-needed retail therapy where they would heartily unleash their forced savings and pent-up demand on goods and services. If the supply of goods and services cannot ramp up quickly enough to meet the surge in demand, then price inflation should be expected. To our south, the first cheques of a US $1.9 trillion COVID relief fund went out in the middle of March. We believe the economic power of such a large quantity of money fed into the economy over a short time frame will show up in the statistical data before long. In our view, those statistics will point to a very vibrant economy over the short term. At that time, the Central Banks will be very challenged to fine tune their policies as they must delicately balance short term growth with long term inflationary expectations.

INCOME STRATEGY

Bonds

While a battle between the ages waged in the stock market, a battle between the sages was breaking out in the bond market. Smart and well moneyed private institutional investors, such as bond funds and pension funds, pitted themselves against the wise and extremely well moneyed public policymakers, the Central Banks. The two groups, each holding to firm but divergent outlooks for the North American economies, asserted their pointed views through the bond market – money's ultimate battleground. Private investors are quite convinced that the economies will soon break free from the grips of the COVID-19 virus and rebound in sustainable growth. Once the foundation for growth is established, they reason, a build up of inflationary forces will be inevitable. And so, private investors sold down bonds, pushed yields up, much to the chagrin of the Central Banks. Their message to the policymakers seems: if you are going to just sit on your hands instead of doing your job with regards inflation, then we will do your job for you, move interest rates up. The Central Banks, meanwhile, are indeed happy to just sit on their hands. They appear bent on maintaining near zero interest rates as they stayed on pace with their bond purchasing programs. They seem wanton in disregard for the positive economic implications stemming from the proven success of the many vaccines, as well as the stimulative effects of a $1.9 trillion relief package that just got underway in the US. When put to task, the Banks made it clear that they would not consider raising interest rates until they see a substantial improvement in the general level of employment. For the time being, the edge in this interest rate tug-of-war goes to the private investors as evidenced by the fast clip at which the bond market's yield curve steepened. When yields at the long maturity end of the curve rises, pressure is on for the yields at the short maturity end of the curve to rise as well, making it more difficult for the policymakers to maintain their targeted interest rates. This clash of the titans has commanded our full attention and its resolution will no doubt have longer term implications for all financial markets. For the time being, we are quite content to just sit on the bond market's sidelines and observe.

Preferred Shares

This past spring brought a renaissance to the rate-resets segment of the preferred shares market. Two significant developments in these shares' landscape sent investors rushing into the space. First, as noted above, investors are expecting interest rates to climb and thus in turn for these shares' dividend rates to reset at progressively higher levels from now on. Second, this segment of the market has been physically shrinking. There was a grand total of just one new issue of rate-resets since June of 2019. Corporations are now reluctant to issue new rate-resets given that more cost-effective means of raising capital have recently been made available to them. Additionally, many past issuers (5 in the last 3 months) have started to redeem their outstanding issues, because those can now be refinanced at significantly lower costs. Put together, the supply of rate-reset preferred shares has been falling while the demand for them continues to climb. Now, one of the most elementary laws of economics says that if the supply for a product falls while its demand rises, then its price will rise. And that is exactly what we are observing in the preferred shares market today, sharply climbing prices for the rate-resets. Higher expected dividend rates and a declining supply add up to an excellent risk/return proposition for these shares. We recently added to our existing positions and may continue to do so in the near term.