REVIEW AND COMMENTARY
2nd QUARTER – 2021

While Canada had a rather slow start in the race to vaccinate it certainly has outpaced most other G7 Countries recently. As measured by those fully vaccinated, Canada has drawn even with Italy and remains ahead of Japan and France. If we were to include Canadians inoculated south of the border, Canada would probably be closer to Germany. Canadians appear to be comfortable embracing vaccinations which, if this persists, should get us closer to 'herd immunity'. Once this is achieved, Provincial and Federal restrictions will lessen, allowing our economy to open fully and return to pre-COVID levels. Vaccinations are worthwhile- Dr. Fauci, America's top infectious disease expert, recently stated that of recent COVID related deaths, over 99% of the deceased were not vaccinated.

While the Canadian equity markets have been hitting new highs, economic conditions have been far from optimal due to COVID. While there have been certain industries that have suffered, such as those travel and entertainment related, a significant number of the larger publicly traded companies are not under the same financial strain. While there are significant amounts of debt and borrowing, it is important to note that it is our governments, from local to Federal, whose finances are under substantial duress. Mounting global governments' debts can increase currency risk to Canadians investing internationally however for those investing primarily at home, equites remain attractive compared to more traditional alternatives such as fixed income and cash equivalents. A recent CIBC report estimates that over $230 billion dollars are on the sidelines in Canada. Moreover, the Canadian Banks (which presently represent over 30% of the SP/TSX index) will likely have announced dividend increases and share buy backs by the end of this year. With increased dividends, stock buybacks and significant money on the sidelines, any weakness in the markets, barring a cataclysmic event, will likely be short lived.

Over the last quarter equity concerns over inflation unsettled some investors. Resources, real estate, and many basic services have seen prices increase, some significantly, which stoked selling after comments from the US Federal Reserve Chairman. While fears subsided as the quarter closed, the question remains whether the recent uptick in inflation will be temporary or a long-term concern?

Inflation is most frequently reported on an annual basis. For example, inflation numbers in May 2021 are compared to prices in May 2020. A year ago, lockdowns in most countries were prevalent and demand for most products had dropped significantly. A year ago, crude oil prices were trading below $40 USD per barrel (in April 2020 they were negative for several days) compared to more than $74 USD on July 1st, 2021. While this was a significant jump year over year, crude prices two years ago were trading in the high $50's; three years ago, they were approximately the same as they are now.

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The Canadian Consumer Price Index (CPI) does not measure home prices specifically, instead, CPI measures the cost of 'shelter' such as rent and mortgage costs, insurance and repairs, taxes, and utilities. Thus, the cost of maintaining a home has been relatively steady compared to buying one. Home prices have been rising steadily over the past several years in major Canadian cities, and there has been some spillover into smaller jurisdictions as the work at home crowd looked outside the city to find larger homes. Leisure properties have seen significant demand and with COVID travel restriction there has been a significant increase in prices. However, as businesses decide whether to require employees to spend more time in the office and travel restrictions are lifted, we may see these price trends ease.

There is a growing chorus among Central Bankers to remain accommodative (keep interest rates low) until COVID is well behind us and economies return closer to pre- pandemic levels. This would mean that they have little concern about inflation presently. Low interest rates can be inflationary particularly when economies are reaching maximum output. Most major economies are nowhere near capacity so low interest rates should be here for a while.

Exactly when rates will start to increase is difficult to determine but Central banks will likely first start by reducing the liquidity in their economies through the reversal of Quantitative Easing (QE). The Bank of Canada has started this process and J.P. Morgan estimates the US Federal Reserve will not start until 2022. The European Central Bank (ECB) is increasing their purchase program so the threat of higher rates overseas appears insignificant well into 2022.

Governments and Central Banks worldwide will eventually need to deal with their mounting deficits. As economies rebound so should tax revenues. However, revenues may not, depending on the Administrations in power, be able to restore balance sheets quickly enough to satisfy their spending programs. This may result in some Governments imposing additional taxes or changes to the tax code on their constituents, however, if they do, let's hope they will not impose significant changes before their economies regain solid financial footing. Given the damage COVID has inflicted, it will likely take even longer for economies to fully recover. If that holds true, then rates will stay low longer allowing equities to remain attractive for the foreseeable future.

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