

Looking Back

A Strong End to an Unprecedented Year

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Global equity markets ended the year on a strong note. While the second wave of coronavirus infections resulted in increased restrictions and lockdowns around the world, markets interpreted the U.S. election results and the approval of vaccines positively and the ongoing monetary and fiscal stimulus measures around the world provided broad support for equities.

In the fourth quarter, the S&P 500 rose 12.2%, the TSX rose 9.0%, the MSCI AC World Index rose 14.7% and the MSCI Emerging Market Index rose 19.7%. From the lows in late March, equity markets around the world have staged an incredible rally, with the TSX up almost 60%, and the U.S. and World markets up over 70%. While most markets outside the U.S. were still in negative territory at the end of September, the strength in Q4 resulted in almost all markets ending the year with very strong 2020 full year returns. For the year, the S&P was up 17.8%, the MSCI AC World was up 16.3%, the TSX rose 5.6% and the MSCI Emerging Market Index was up 18.3%.

While Q4 saw strong equity markets, as did the 2nd and 3rd quarters, there were some important differences in the underlying performance drivers. The first 9 months of the year were largely driven by a handful of large cap technology names, which resulted in U.S. markets leading all others. The final quarter, however, experienced a reversal in that theme, with non-U.S. markets outperforming U.S. markets and with technology stocks and growth stocks underperforming value stocks. In the fourth quarter, the MSCI AC World Value Index was up 16.6% vs. the comparable growth index which was up 13.1%. The logic behind this reversal was that although a small segment of companies disproportionately benefited from COVID effects such as work from home and lockdowns, now that the vaccines have begun to roll out, those companies which were hurt from COVID effects (the vast majority of

companies, to some degree) will start to see normalization over the next several quarters. While this past quarter saw an outperformance in value vs. growth stocks, the full year performance differential remained massively in favour of growth as a result of the first 9 months. To illustrate, the MSCI AC World Growth Index was up 33.6% while the comparable value index was down 0.3%. Consequently, the relative valuation level between value and growth stocks remains close to historic extremes with value stocks trading near their lowest levels in history relative to growth stocks.

Interest rates began to trend up during Q4. In the U.S., the 10 year government bond yield ended December at 0.91%, up from 0.68% at the end of September. Similarly, the Canadian 10 year government bond yield rate ended the year at 0.68%, up from 0.56% at the end of September. While monetary policy remains accommodative, expectations around ongoing stimulus and eventual renormalization of economies has pushed inflation expectations higher. From a return standpoint, investment grade bonds were up modestly over the period. For the quarter, the FTSE Canada Universe Bond Index was up 0.6%, bringing year-to-date returns to 8.7%. In the U.S., the Barclays Aggregate Bond Index was up 0.7% in the quarter and 7.5% for the year. High yield bonds performed strongly as credit spreads tightened with increased risk appetite, returning 5.9% for the quarter and up 4.7% for the year.

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In commodities, oil prices trended higher during the quarter, moving from around \$40 to over \$48 by the end of the year. Gold was fairly volatile in the quarter but ended the year close to where it was in September at around \$1,900. In currencies the general theme was one of the U.S. dollar weakening, which has been fairly consistent through an environment of increasing risk appetite. The Canadian dollar ended the year at 1.27, stronger than its 1.33 level at the end of September and significantly stronger than the weakest levels in March when it hit 1.45.

Investors enter the New Year with various conflicting messages on a daily basis. On one hand, infections, hospitalizations and deaths are increasing and lockdown measures are becoming more stringent in many places around the world. It can be difficult to remain positive in a situation where this news is objectively bad. On the other hand, markets are reaching new highs on a daily basis and the vaccine roll-out has begun. This is, once again, a case of the short versus medium/long-term and what's most important with respect to markets. While only a very small number of people have been vaccinated thus far, many of us will have been in the next six months, and even more so nine months from now. With respect to markets, the economic impact of the lockdowns in the next few quarters has been completely discounted as investors are looking through to the light at the end of the tunnel and an eventual renormalization. Given the huge magnitude of the market rally and with bullishness at extreme levels, our current positioning is to be relatively neutral on equities. We continue to follow our proven investment philosophy and apply ongoing strategic reviews and expert management.

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