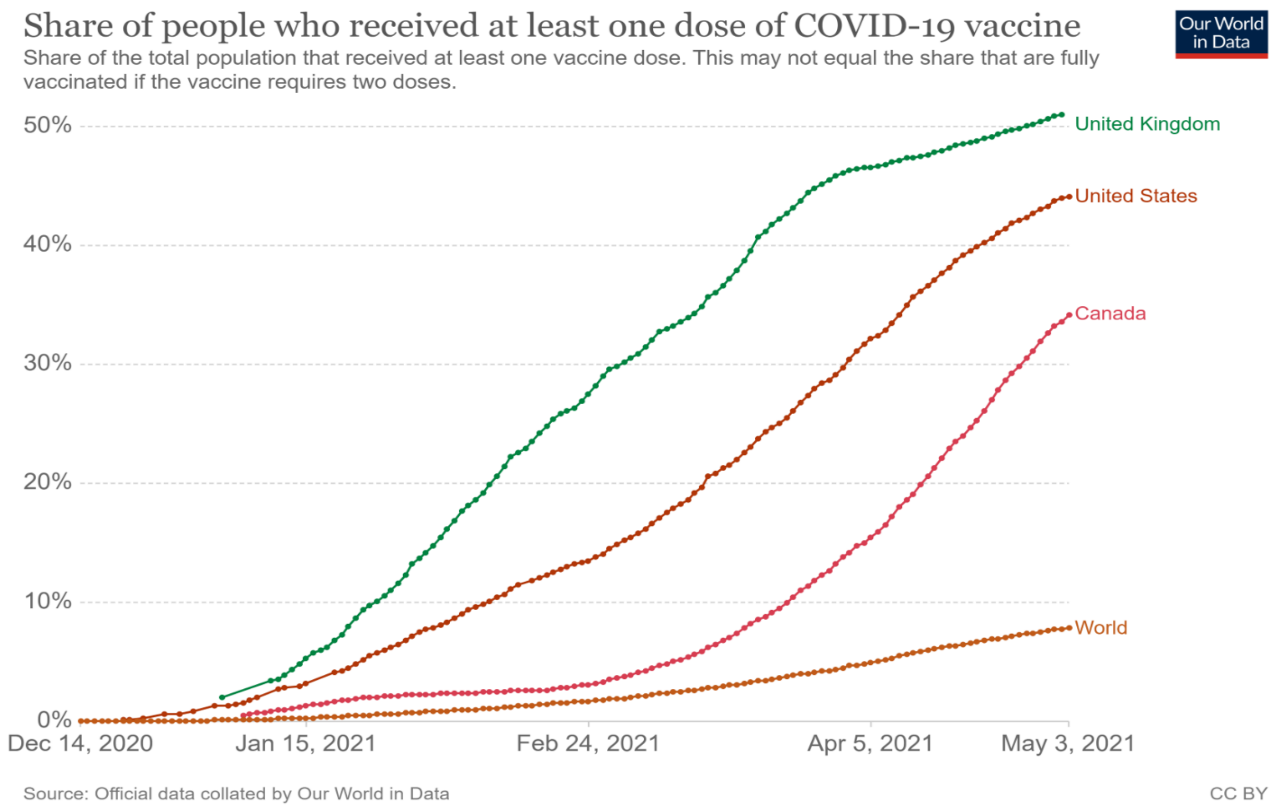
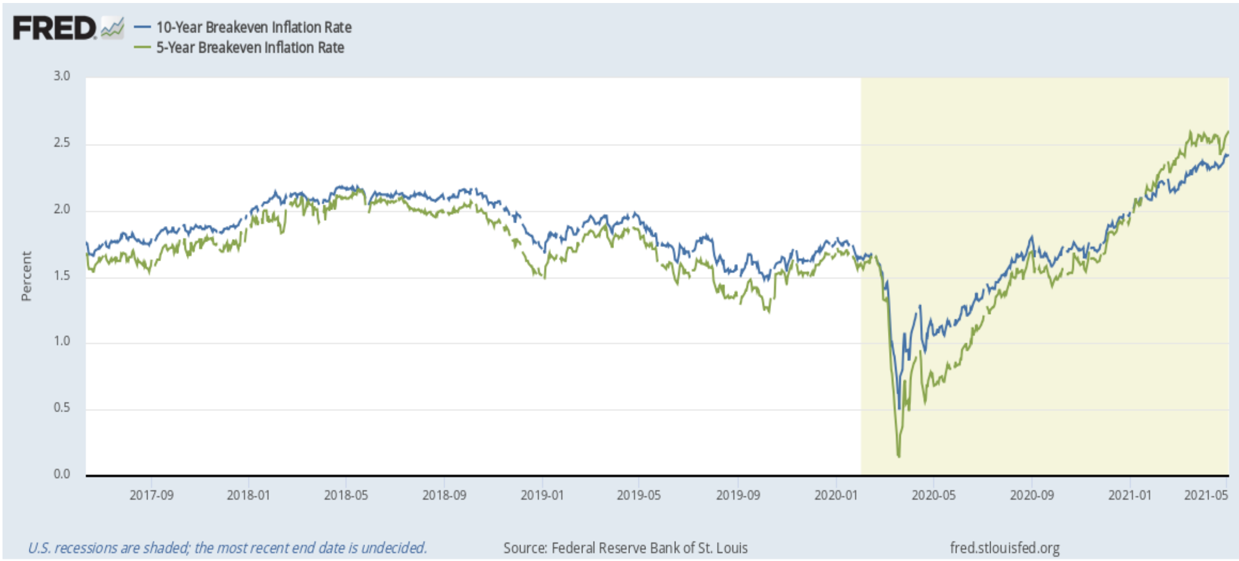
THE GREAT REOPENING – Spring 2021

Wow, what a difference a year makes! At this time last year, fear was rampant and the stock market had lost a third of its value in just 33 days amidst the deep uncertainty brought on by the spread of COVID-19 and the government mandated lockdowns. Most governments were quick to act with unprecedented and extraordinary measures which in turn gave investors renewed confidence that the economy would eventually recover. We have gone from panic and turmoil to a systematic rollout of the COVID-19 vaccine. Some sense of normalcy is creeping back into our daily lives which is a much-needed relief. Although the vaccine roll out in Canada has been slow relative to the United States and the United Kingdom, the pace is now accelerating thereby putting a time limit on how long social distancing will be constrained.



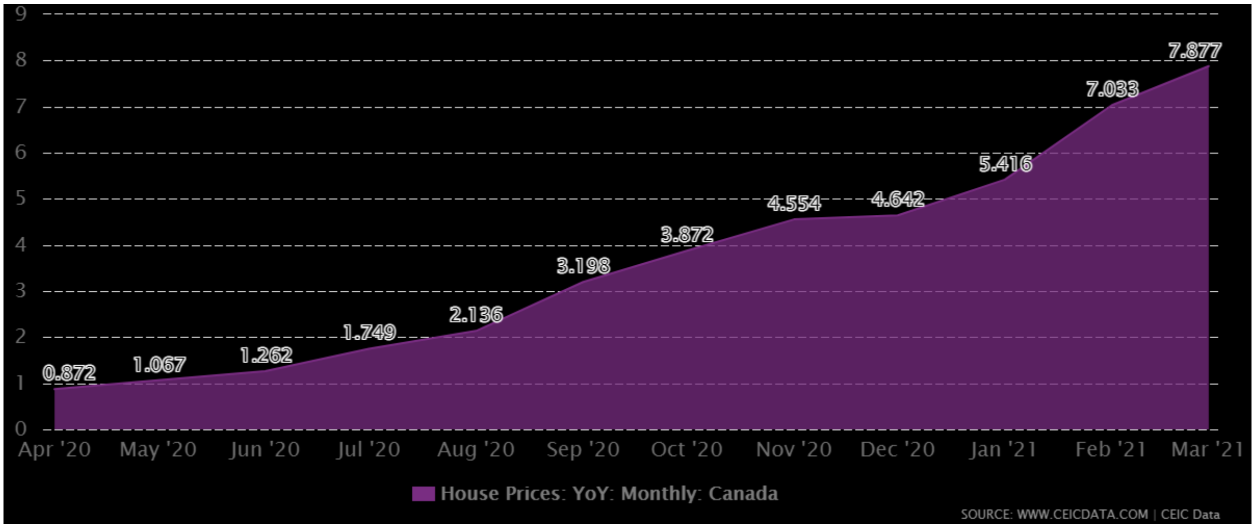
Pent up demand, massive government spending and easing monetary policy are key ingredients driving GDP growth past pre-pandemic levels. A strong global recovery is widely expected for the markets in 2021 and spilling over into 2022. In contrast to stocks, bonds posted a negative return during the first quarter of 2021 as investors responded to increased inflation concerns by demanding higher yields for longer term bonds. In fact, this fear has caused bond prices to fall dramatically. The yield on the 10-year US Treasury bond rose by .83% to end the quarter at 1.74%. As interest rates increase, bond prices decrease and as a result, the Bloomberg Barclays US Aggregate Bond Index had its first quarterly loss in 3 years declining -5.97% during the quarter in Canadian dollars, its largest loss since 1981. *Bloomberg*. As implied by the graph below, market participants expect inflation to be much higher on average over the next 5 to 10 years.



With economic activity expected to pick up sharply in the second half of the year and more deficit spending by governments, it's reasonable to expect that inflation will be higher then in the recent past. As restrictions or lockdowns reduce demand, they in turn push down prices of many goods, services and commodities. The average inflation rate in the US was 1.2% in 2020. Simply by way of looking at year over year comparisons, it's virtually certain that we will see higher prices in the coming months to years. The rise in inflation forecasts is also normal given the stronger economic activity. When you understand that pent up demand is getting a limited supply from manufacturers and service providers, who are either pausing or shutting down operations, we just might see prices adjust higher until increased capacity comes back.

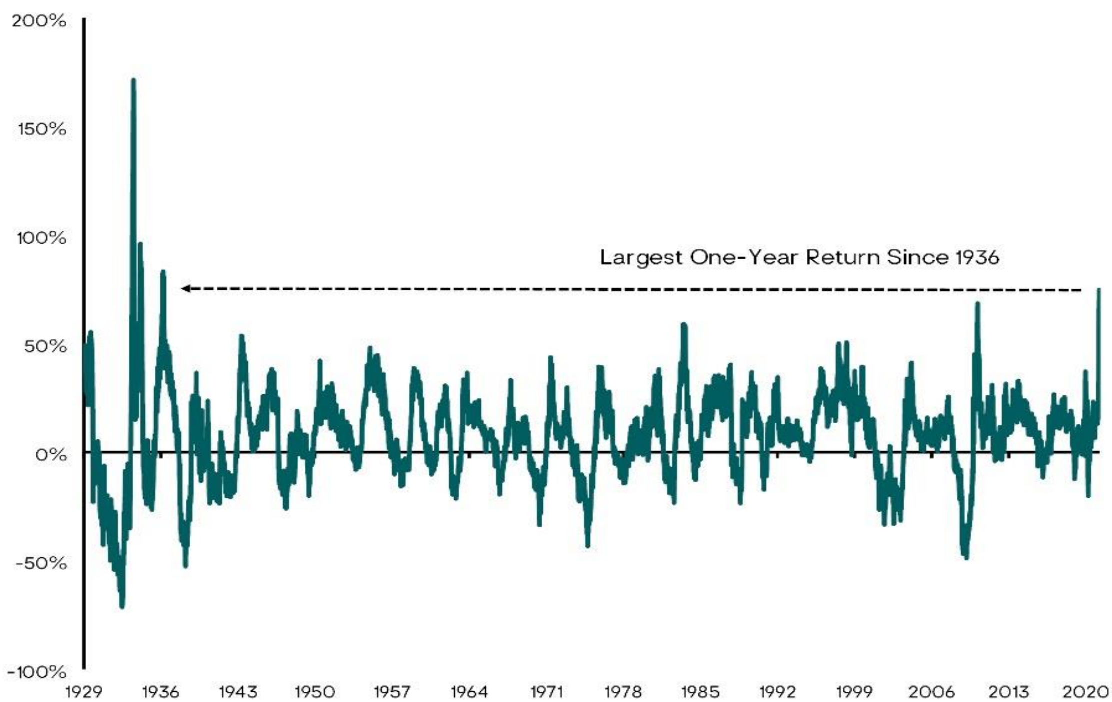
With bonds having a rough start to the year, we know bonds still serve a purpose in a balanced portfolio. Every asset class, every sector, every investment has its time to shine. We also understand there is no way in predicting how markets will react to current conditions. That is why diversification is crucial to an investment strategy. Not only do we use asset classes to diversify a portfolio, we also diversify by using investment fund managers who diversify what types of stocks and bonds they use during different phases of the market cycle. Fixed income will always play a key part in a balanced portfolio.

Speaking of inflation, it must be noted that property prices in Canada are skyrocketing. Much of this can be explained by low interest rates, fiscal stimulus, and strong levels of employment among homeowners versus low-income renters. Immigration, demographics, and short-term supply issues remain in play as drivers over the long term. While we need to keep our eye on mortgage defaults and the likelihood of an economic crisis spreading from one marketplace to another because of sharp pullbacks in property prices - interest rates remain low, fiscal support continues, and strong employment numbers increasing, these should underpin the property market partially. With the average growth rate of 1.8% from January 1982 to March 2021, the graph below shows house prices grew in Canada 7.9% year over year in March 2021, following an increase of 7.0% year over year in the previous month. "Canadian Housing Boom Raises Concerns, With Homes selling Far above Ask Price" *Wall Street Journal*, March 24, 2021.



In the first quarter of 2021, the S&P 500 index gained 8.0% (CDN), the MSCI EAFE index returned 3.13% (CDN), and the MSCI Emerging Markets gained 1.30% (CDN). From the low on March 23, 2020, these benchmarks are up an astonishing 80%, 75% and 75%. In fact, the S&P 500's one year return from the low was its best since 1936!

The S&P 500 Just Had Its Best One-Year Return Since the 1930s!



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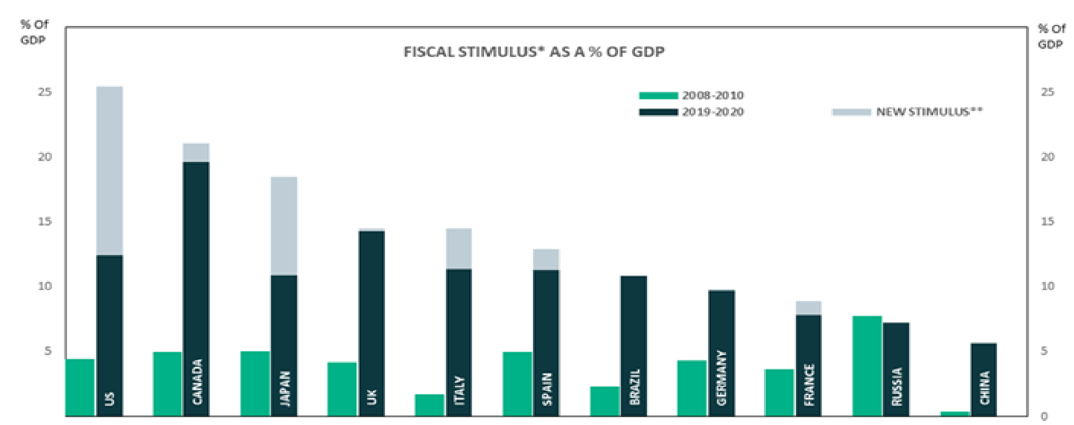
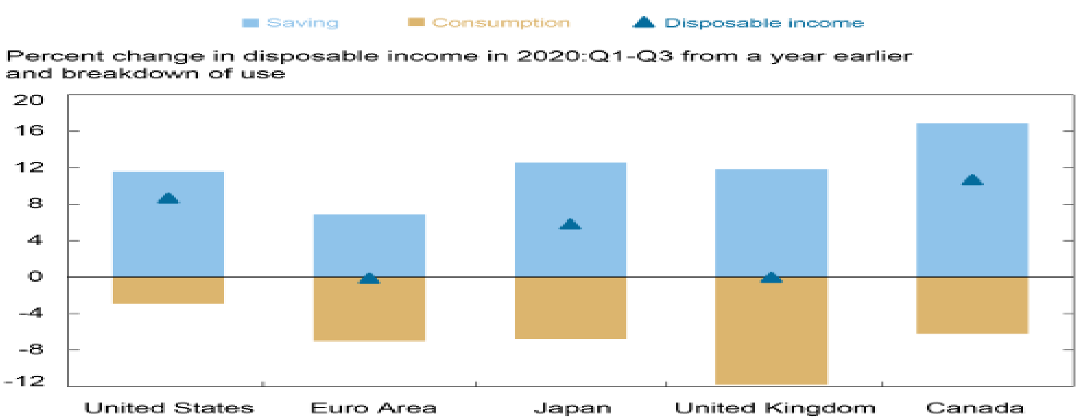
The big news over the first quarter was the passage of the $1.9 trillion American Rescue Plan Act (ARP) which is the equivalent of roughly 9% of U.S. GDP. While most expected the Biden administration to enact a large fiscal package, many were surprised by Congress passing the full amount initially proposed. Adding to the prior two pandemic relief fiscal packages passed during the Trump administration in March and December 2020, the total fiscal stimulus equates to more than 25% of GDP. This is a huge number and is roughly five times the fiscal response during the 2008 Great Financial Crisis.



* CALCULATED AS THE ABSOLUTE VALUE OF THE CHANGE IN OVERALL BALANCE (NET LENDING/BORROWING AS % OF GDP). EXCLUDED LOAN GUARANTEES AND QUASI-FISCAL STIMULUS.
** NEW STIMULUS PLANS REVEALED AFTER OCTOBER 2020, INCLUDING: THE US' $2800 BN OMNIBUS BILL & BIDEN RESCUE PLAN, JAPAN'S THIRD RELIEF PACKAGE WITH $385 BN IN DIRECT FISCAL SPENDING, CANADA'S PROPOSED $78 BN STIMULUS PLAN OVER THE NEXT THREE YEARS (ASSUMING SPEND EVENLY), UK'S $6.2 BN NEW LOCKDOWN STIMULUS, ITALY'S $53.9 BN BUSINESS AID & STIMULUS, SPAIN'S $13 BN SMALL BUISNESSES AID, BRAZIL'S $ 8 BN EXTENDED FEDERAL CASH TRANSFER PROGRAM, AND FRANCE'S $24.3 BN BUSINESS AID PLAN. ADDITIONALLY, ITALY, SPAIN, GERMANY AND FRANCE'S NEW STIMULUS ALSO INCLUDE COMMITMENTS FROM THE EU RECOVERY GRANTS (EXCLUDING LOANS).
SOURCE: IMF FISCAL MONITOR (OCTOBER 2020) AND BCA CALCULATIONS.

The COVID-19 stimulus packages last year created the largest federal budget deficit since World War II at 15% of GDP. The 2021 budget deficit is projected to be the second largest at 10% of GDP. Of the $1.9 trillion stimulus package, not all will be immediately spent. A good portion of it will go into household savings and to pay down debt according to Oxford Economics. Americans have accumulated $1.8 trillion in excess savings since the start of the pandemic. Oxford estimates this could rise to $2.5 trillion by this summer. Not only are consumers in the US increasing their savings rate but this has been a trend seen around the world as depicted in the graph below.

Saving Surged while Consumption Plummeted



Sources: Bureau of Economic Analysis; Eurostat; Japanese Cabinet Office; Statistics Canada; U.S. data are from the Integrated Macroeconomic Accounts.

Notes: Disposable income and saving are net of depreciation. Data for the United Kingdom exclude a reported pension valuation adjustment. The bars show changes in nominal saving and consumption for 2020:Q1–Q3 versus 2019:Q1-Q3, measured as a percentage of disposable income in the earlier period. These changes add up to the percentage increase in nominal disposable income.

On the upside, strong pent-up demand could spur an even faster drop in household savings than anticipated. On the downside, new virus variants could significantly derail the recovery. The increased risk from the spread of new, more infectious variants is happening in several European countries leading to renewed lockdowns and fears of something similar playing out all over again. The US could reopen local economies (which they are currently doing) and relax social distancing and public health restrictions too quickly leading to another virus surge. Overall, the light at the end of the pandemic tunnel certainly appears to be getting brighter.

In the first quarter of 2021, the S&P/TSX Composite index returned 10.64% while the S&P/TSX Small Cap index gained 14.32%. Since March 23, 2020, the S&P/TSX Composite index is up around 76%. The Canadian economy has shown remarkable resiliency despite more prohibitive lockdowns than in the U.S. Most estimates have been revised higher and suggest gross domestic product (GDP) growth of about 5.5% for 2021, a considerable margin above the Bank of Canada's estimate of 4.0%. The contributing factors to this development have been two-fold: the housing market's resolute strength supporting the construction industry and a stimulus-primed U.S. economy boosting Canadian exports. These higher estimates seem appropriate and suggest the Canadian economy may converge toward its pre-pandemic level by the third quarter of 2021.

Going forward we expect a strong global recovery during the remainder of 2021 amid significant fiscal support, accommodative monetary policy, diminishing lockdowns, and accelerating vaccinations. Despite an expected bump in inflation in the coming months, we feel inflation generally will remain below central bank targets over the next one to two years. Although, markets may remain focused on inflation risks in the near term contributing to elevated volatility in the markets. We remain optimistic about where we are headed, while anticipating this period of significant market fluctuations will continue as investors respond to developments in the fight against COVID-19 and the promising economic recovery.