MONTHLY COMMENTARY | AUGUST 2020

"The problem with experts is that they do not know what they do not know"

- Nassim Nicholas Taleb, The Black Swan: The Impact of the Highly Improbable

In the first half of 2020, the COVID pandemic gripped the global economy with the speed and unpredictability of the scariest of "black swans". While governments all the world over had a pretty good idea what to expect in a case of a global pandemic, very few were truly prepared or qualified to make the difficult decisions that it required.

What was particularly hard to foresee was the extent and economic effect of strict lockdowns that had to be put in place in all major markets to counter the little known but deadly infection. Roughly a decade after the global financial crisis, central banks and governments unleashed unprecedented economic stimulus measures as wealth creation had to take a second place after concerns for the future health and wellbeing of the human race.

As a result, equity markets have raced back to pre-pandemic levels.

We do not believe that we will see another black swan this year. Equally, given the various epidemiological uncertainties ahead, we do not think that the markets will behave predictably (do they ever?). In June we saw a strong rebound of economic activity as Asian and European nations started to cautiously to emerge from their lockdowns. As we navigate the shades of grey around the market, tactically we are aiming to stay alert, flexible, and ready to respond to any sudden volatility when it comes.

The performance of equity assets outside the US continue to lag their US peers though a bit misleading given the weight of large tech stocks in the US. We believe Canada and Europe benefits from a number of advantages that could enable the region to deliver better relative performances in the second half. Although this preference for Europe remains tactical, over the longer term, we are finally seeing more structural reasons that would encourage us to favour businesses in the Old Continent.

Like Canada, European indices have a stronger cyclical component which enables them to outperform when the economy rebounds. After weighing on European countries, the strict lockdowns implemented in March in Continental Europe should now be beneficial: management of the virus appears to have been more effective than in the US and the economic rebound is likely to be stronger.

Uncertainty seems stronger in the US today than in Europe. These risks are mostly associated with two factors: on the one hand, management of the pandemic and of its economic impact, and, on the other, the potential of a "blue wave" after the Presidential election this November, bringing forth changes to tax and other policies that might be negative to market prices.

As to the latter, while the Covid-19 epidemic has continued to spread significantly in the United States, it appears under control in China, Europe, Japan and Canada. The "poor" management of the epidemic has altered electoral forecasts that had pointed to the re-election of Trump in November now sees the likelihood of a full Democrat victory significantly increased. The blue wave would have a number of negative sector impacts (particularly for healthcare and energy).

The higher valuations of US stocks in general mean there is less margin for potential disappointment than in other parts of the world. The US market is more expensive than the European market, even excluding technology and communication stocks.

Through the trough and subsequent escalation of market prices, and despite the pressures exerted on market prices by valuation and economic policy as well as the potential havoc caused by the November election, we remain steadfast in our conviction that client portfolios be exposed to stable, profitable businesses which are positioned to thrive in any environment.