



A YEAR INTO THE PANDEMIC

It has now been a year since the beginning of the COVID-19 pandemic. After strong returns in the first quarter of 2021, client portfolio valuations are now higher than pre-pandemic levels. Although financial assets have nicely recovered, everyday life remains constrained as we patiently await a return to “normalcy”.

Leading major countries in the world in per capita vaccinations, consensus forecasts for economic growth in the U.S. are upwards of 7% for 2021. Inhibited by a dearth of domestic vaccine production, Canada’s economic recovery will significantly lag the U.S. Canadians should be very thankful to the European Union. So far over 80% of the COVID-19 vaccines administered in Canada have come from European-based manufacturing facilities. Less than 15% of our COVID-19 vaccines have come from the U.S. with the remaining 5% from India.

In 2020, long-term bond yields reached modern day lows during the earlier months of the pandemic. These low yields were supported by an unprecedented amount of government economic stimulus and direct government bond buying programs (quantitative easing). These initiatives have had the desired effect of positioning North American economies for strong 2021 economic growth.

Unfortunately, strong 2021 economic growth

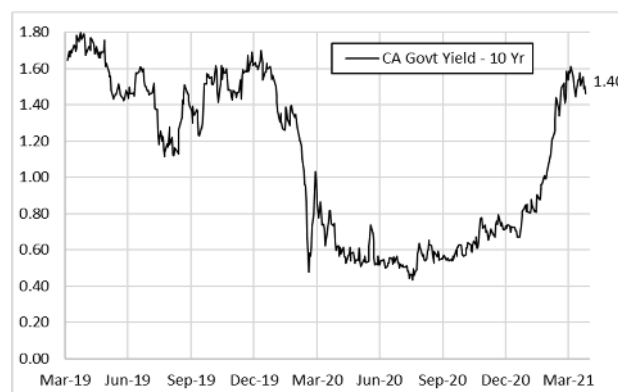


Figure 1: 10-Year Government of Canada Yield

has greatly heightened inflation concerns for investors. Long-term interest rates in North America have already experienced a sharp rise year-to-date. After finishing 2020 at a lowly 0.70%, yields on 10-year Government of Canada bonds have quickly doubled to 1.40% (see chart). With central banks in North America continuing to keep short-term interest rates near zero, yield curves are extremely steep in both Canada and the U.S.

Anecdotal signs of consumer inflation are evident in the rising price of groceries, gasoline, home improvement goods (lumber), etc. In March, the U.S. Consumer Price Index (CPI) rose by 0.6% on a month-over-month basis. This is the highest monthly CPI increase in over a decade. It is very evident that a combination of rising consumer demand and pandemic-driven supply chain bottlenecks have led to delivery delays and rising input (commodity) costs. Finally, consumer prices tend to lag increases in input costs so further

inflationary prices are a given.

2020 saw strong share price performance in the large, dominant U.S. technology companies (Amazon, Apple, Google, Facebook, Microsoft, etc.). High valuation metrics for these companies are very dependent on low interest rates. As interest rates rose in early 2021, the stock price of these technology companies underperformed while valuations of more traditional industrial, commodity, health care and financial companies; those that we tend to own, improved substantially.

We expect headline inflation pressure to continue to push long-term interest rates higher over the next year or so. Rising interest rates push down bond prices thus greatly increasing the challenge of generating modest, but reliable, returns from fixed income investments. Internally, we are focusing sizeable resources on this challenge. As long as interest rates rise in a gradual fashion, the North American economic recovery will continue and, in the process, support higher corporate earnings and stock prices. Any dramatic shocks to long-term interest rates (in either direction) will change this outlook. Ultimately, as always, we continue to position client portfolios to weather different future inflation and interest rate environments.