

**In this issue:**

- **Backed by the economy's rebound, the stock markets continue to rise**
- **The Canadian market is back with a vengeance**
- **Are inflation and new variants a serious threat?**

Dear friends,

We are slowly coming back toward normality. Optimism on vaccination speed and the reopening of businesses propelled the Canadian market to new heights. For once, the economic rebound is favouring Bay Street, who outpaced Wall Street so far for the year, rising 15.7 % compared to 11.4 %. Thanks to a strong second quarter, Oil is now up 52.5 % for the year. The Oil sector was a big contributor to the success of the S&P/TSX. Common metals' producers were also part of the party; all the while we witnessed lower stock volatility and a weakening of the US\$. However, we must notice that in June, the US\$ index – called the DXY – managed to rebound with the strongest one-month performance since March 2020. Is the rebound party about to end? The inflation strengthening and the emergence of new COVID variants are factors to consider.

However, we don't think it's time to worry. Risk factors are indeed present, but it is not the time to throw ourselves in the US\$ or other safe havens. By looking back, we can see that the world economy continued to rebound strongly during Q2-2021. However, the peak in the rate of growth is behind us. As the COVID rebound came stronger and much faster than anticipated, we are now entering a period of slower growth. Despite this deceleration, the economy is still healthy and strong, and we believe that for the rest of the year, growth will stay above average rates.

Regarding interest rates, the Federal Reserve has been very accommodating and adopted a letting-go-of-the-reins attitude toward inflation. The Fed admitted it would tolerate a stronger than usual inflation until the economic recovery was complete and long lasting. However, if inflation was to become persistent or higher than anticipated, the Fed could be forced to adjust its current stance. The inflation in wages is to watch. We are currently forecasting a first increase in rates in 2023, maybe in late 2022 according to some. In all cases, if the job market and wages continue to improve, the Fed might have to speed up its plans and proceed to an earlier tapering<sup>1</sup> of the quantitative easing.

|                                 | Closing<br>30-Jun-21 | Change** |       |
|---------------------------------|----------------------|----------|-------|
|                                 |                      | Quarter  | 2021  |
| <b>Stock Indices (% in C\$)</b> |                      |          |       |
| S&P/TSX                         | 20,166               | 7.8%     | 15.7% |
| S&P 500                         | 4,298                | 6.8%     | 11.4% |
| MSCI EAFE*                      | 2,305                | 3.0%     | 4.5%  |
| <b>Currencies</b>               |                      |          |       |
| CAN\$ (US\$/C\$)                | 0.8067               | 1.3%     | 2.7%  |
| Euro (US\$/EUR)                 | 1.1857               | 1.1%     | -2.9% |
| <b>Commodities (US\$)</b>       |                      |          |       |
| Oil (WTI)                       | \$ 73.62             | 24.4%    | 52.5% |
| Gold                            | \$ 1,765             | 3.6%     | -7.0% |
| <b>Volatility Index</b>         |                      |          |       |
| VIX                             | 15.83                | -3.57    | -6.92 |

\* MSCI Europe, Australasia and Far East (US\$)

\*\* Changes are expressed in C\$ for Stock Indices.

<sup>1</sup> Tapering involve the slowing of asset purchases, which leads to the reversal of quantitative easing (QE) policies implemented by a central bank.

**Strong Canadian market**

*Backed by a strong rise in earnings, the markets really took off during the quarter. What can we expect now? We must first notice that Q2 strong growth rates were*

*made on the back of the 2020 depression. Nonetheless, this earnings season is starting well with several upward revisions. After the impressive rebound of the first half of the year, growth rates should come back to a more reasonable and normal level. For the whole year, the consensus for the growth rate stands strong at 46.6 % for the S&P/TSX and at 37.4 % for the S&P500. While the rebound in S&P500 and S&P/TSX earnings for Q1 and Q2 was faster than what was predicted a year ago, growth rates for 2022 were revised downward for the S&P 500. They remain strong nonetheless. On the Canadian side, the strong results of the first half seem to be spreading forward until 2022, a result of the advantageous positioning of our companies. With a Forward P/E ratio of about 15.9, the relative 12-month forward P/E ratio of Canadian stocks compared to US ones is at historical lows. We therefore continue to favour TSX equities but would consider appropriately priced American names providing diversification.*

|   | Year<br>2020* | Q2<br>2021 | Q3<br>2021 | Q4<br>2021 | Year<br>2021 | Q1<br>2022 | Year<br>2022 | Forward<br>P/E |
|---|---------------|------------|------------|------------|--------------|------------|--------------|----------------|
| <b>Forecasted Earnings Growth (Year over Year) and Forward Price-Earnings Ratio</b> |               |            |            |            |              |            |              |                |
| S&P/TSX   | -35.1%        | 98.0%      | 22.4%      | 20.2%      | 46.6%        | 41.3%      | 11.0%        | 15.9           |
| S&P 500   | -16.3%        | 65.8%      | 24.8%      | 17.6%      | 37.4%        | 16.7%      | 11.6%        | 21.6           |

\* Realized Earnings

Source: I/B/E/S data from Refinitiv (Thomson)

**Should we be afraid of variants?**

*Fears regarding new COVID variants, like the Delta variant, had some impact on the markets in June. The Delta variant is supposedly three times more contagious and a new wave of infections could affect the economy. We currently observe a rise in new cases in Korea, Japan and Europe, particularly in the UK. In order to get rid of this pandemic, vaccination is fundamental and it is the priority of governments around the world. As an example, France just made vaccination mandatory for health sector employees and set up a “vaccination pass” to incite people to get vaccinated. The good news is that we are now aware of what we are against and that the death numbers stay relatively low. We shall surely see a fourth wave too, but we believe that the impact on our economy will be mitigated if appropriate measures are kept in place. Fortunately, our leaders, Mr. Biden and Trudeau, are well aware of it.*

**Conclusions and Forecast**

*Our base scenario is that the economic recovery will continue in 2021 and 2022, fuelled by the vaccination effort. With the help of accommodating central banks, growth will be above average and inflation will be kept within a reasonable range. On the short term, however, we can expect some bouts of volatility in the stock markets due to slowing growth rates, rising COVID cases or changing interpretations of the Fed’s intentions. While some experts see an interest rate increase before the end of 2022 – at this time – nothing indicates that the Fed will follow those inflation hawks unless inflation pressures are really increasing and we have evidence it is persistent. In this case, central banks would have to withdraw the monetary easing faster than what’s currently planned. This would undoubtedly impact negatively the stock markets. However, as we do not think serious long term inflation is on the radar, we favour investing in undervalued securities that are well positioned to profit from the reflation recovery. We particularly like Cyclical stocks, Value stocks, ideally combined with an interesting dividend. We stay cautious and vigilant.*