# Market Outlook

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**Reflecting on the First Half of 2021**

Markets performed well in the first half of the year, with the TSX Composite having its best start since 2008 and the broader American S&P 500 posting the largest gain in 23 years.

The optimism has been driven by the reopening of the economy as coronavirus lockdowns come to an end across North America. In Ontario, the last jurisdiction on the continent still under lockdown, we look forward to the reopening later this month as 53% of eligible people are now fully vaccinated and 78% have had at least one jab.

Reflection is a great way to stay disciplined so let us revisit the question we asked in January: what is the biggest risk going forward? For several months, the economic data has been showing a spike in inflation. The central banks have assured us that inflation is only “transitory” and will not stick around; as a result, interest rates are to remain low for some time.

Economic data does reflect that a good amount of the inflation observed was because prices fell when the pandemic first hit. Think of a rental car company cutting its prices last year as the pandemic emerged but only now are beginning to normalize rental rates; that jump in rates will be considered “inflation” even if it is only temporary. The same phenomenon can be observed in gasoline, used car prices, hotel lodging and other areas decimated by the pandemic.

With the massive fiscal stimulus coming out of the United States, there was fear that central banks would be forced to raise interest rates sooner than expected. However, as the months go by and “base effects” wear off (which is what we call the inflation caused by situations like our rental car example above), we expect to see interest rates staying low, in line with the trajectory outlined by the central banks.

**Staying Focused with a Rules-based Approach**

Regardless of what happens in the market, we like to stay focused by using a rules-based approach. This approach, which consists of a set of systematic rules that we add on top of our analysis, allows us to manage risk without letting emotions get involved.

Here is a sample of some of our rules:

- No more than 3-4% in any one individual company
- No more than 25% in any one sector
- 30-35 positions across the portfolio, optimizing diversification
- Cut losses on individual stocks if they hit 20%; “the first loss is the best loss”

This rules-based approach provides a consistent discipline and as a result, consistent performance.

**Yearly Rate of Return (%), 2016 to June 30, 2021:**

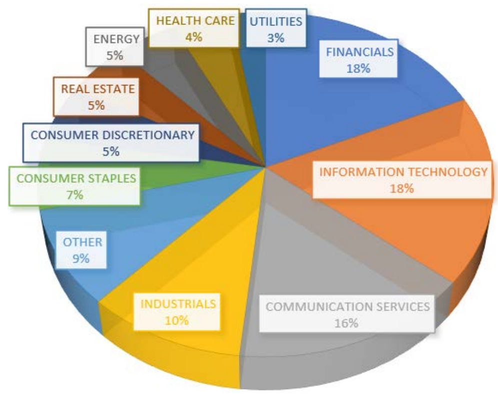
| | 2016* | 2017 | 2018 | 2019 | 2020 | 2021 YTD |
|---|---|---|---|---|---|---|
| Growth & Income (100% Equity) | 10.9 | 9.7 | -2.8 | 18.2 | 13.5 | 14.9 |
| Balanced (80% Equity /20% Fixed Income) | 8.9 | 8.1 | -3.0 | 15.4 | 10.8 | 13.4 |

*Starts January 16, 2016

**Positioning for the Future**

Looking ahead to the back half of the year, we anticipate that the Canadian market will continue to outperform the US. Since Canada lags the US in reopening after the pandemic, we expect pent up demand to drive Canada's economy forward. Having said that, growth in the US market is by no means over and our portfolio remains 40% invested in US markets.

For our equity portfolio, here is our current sector positioning:




Recent sentiment around inflation has cooled and the fear that interest rates will be increased before the 2023 date declared by the Feds has dissipated (US 10-year yields have gone from 1.7% to 1.25%). Since pressure to raise rates is alleviating, we think momentum growth stocks, like technology, should perform well going forward. With the return of growth stocks, we are anticipating potentially increasing our US exposure later this year.

With respect to inflation, the biggest risk remains upward wage pressures, which tend to be a lot harder to reverse once they begin. Many companies in Canada and the US are reporting difficulty in hiring staff and are raising wages as a result; some employers are even paying job candidates just to show up for an interview. With extended unemployment benefits in the US expiring in September, more people should be getting back to work, which means wage pressures should alleviate.

We also expect the second half of the year to be choppy since corporate earnings will be facing more challenging year-over-year comparisons going forward as the impact of the coronavirus dissipates from balance sheets.

Regardless of what happens, you can count on SVWM's rules-based approach to stay focused and help you meet your financial goals. We wish you a wonderful summer full of cheer and sunshine!