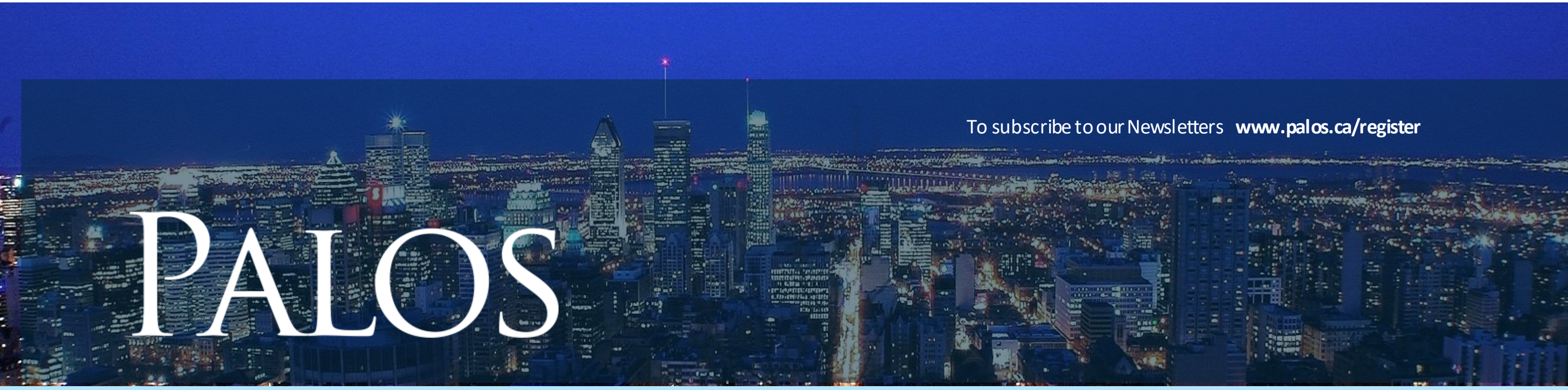

The Mitchell Report

July 6, 2020

By William Mitchell, CIM ®
Portfolio Manager

Accomplished investors have long understood that successful investing is about having the discipline to look forward rather than backward.

Wall Street vs. Main Street

Since the March lows we have seen an impressive bounce in financial markets, and this is great news for investors. However, if we take a step back and observe the ‘state of affairs’ from around the globe it’s difficult to find a logical reason why.

As Covid-19 continues to shutter wide swaths of the economy, unemployment has seen an unprecedented spike to depression like levels. Consumer spending on discretionary items like restaurant and retail has cratered. While some jurisdictions have made progress in mitigating the spread of the virus, others have hurried to reopen economies with the predictable outcome of a spike in cases and rising hospitalizations.

As if the health crisis is not enough to discourage investors, social unrest and a growing discord in the U.S. are at their highest levels in decades. The oil industry is in crisis mode, interest rates are at historic lows, and the relationship between China and the west is deteriorating. With a presidential election less than five months away, the White House is in turmoil and the political divide is bigger than ever. Despite the pessimism and uncertainty, ‘Wall Street’ has performed remarkably well while many on ‘Main Street’ wonder, how is this possible?

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Why the "smart money" is Bullish?

Without a doubt, we are living in uncertain times. The economic impact of the pandemic has been severe, and this is borne out in economic numbers. Challenging investors emotions is a daily bombardment of bad news from around the globe that makes it difficult to process why markets continue to climb higher, in the face of rampant negativity. This begs the following question; why is the market so bullish?

1. Unprecedented stimulus

In reaction to the severe economic fallout from Covid-19, governments around the world have implemented unprecedented economic stimulus. In the U.S. alone, Secretary Mnuchin and Federal Reserve Chairman Powell have made it clear that the government will take whatever steps necessary to stabilize the economy. The initial $2 trillion package that was passed by Congress in March dwarfs the package from the 2009 financial crisis and there is more to come. With governments declaring a willingness to make open market purchases of securities, investors feel assured by the knowledge that authorities and central banks are committed to supporting both financial markets and the economy. In other words, the government has your back. Ultimately, the massive amount of money that has been injected into the global economy will trickle down to "Main Street." The Wall Street adage of ***"Don't fight the Fed"*** has never been more relevant.

2. TINA (there is no alternative)

Central banks have ushered in an era of historically low interest rates. In fact, the return on government bonds actually went negative in Germany and Japan; truly hard to fathom! This leaves conservative investors who rely on interest income, and pension fund managers who require a defined rate of return, asking themselves, how will I reach my objectives? With fewer long-term, lower risk, income generating investment options available, where will income seeking investors find an acceptable return? In fact, the rate of return on conservative fixed-income portfolios may not even cover the rate of inflation. This leaves income seeking investors in a position that necessitates the assumption of greater risk. The most likely outcome? Investment dollars will flow from safer assets like cash, short term treasuries, and government bonds to riskier assets like equities, high yield bonds and commodities. The "search for yield" should be supportive of equities for the long term as practically speaking, ***there is no alternative***.

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3. Interest rates will be “lower for longer?”

Further to the interest rate/fixed income conundrum, many believe an ultra-low interest rate policy is with us for the foreseeable future. While there are no guarantees, this makes sense. Central banks have little choice but to maintain low rates until the economy begins to heal, and these intentions have been made clear.

Given the damage done, the economic impact may be felt for a decade. A low rate environment circles us back to a bullish scenario for equities, higher yielding corporate bonds, and commodities. These asset classes are where the yield will be found. In fact, some pundits argue that high quality, dividend paying stocks pose less risk than high yield bonds.

4. FOMO (fear of missing out)

The Covid-related flight to safety has exacerbated the amount of cash on the sidelines. This is a normal byproduct of emotionally charged markets as elevated investor fear diverts investment dollars away from equities and into safe haven assets which include cash, short-term fixed-income securities, and treasuries. Eventually, the low returns offered by safe haven assets will cause the pendulum to swing the other way as investors regain confidence and develop an appetite for risk. Over time, the “risk-off” trade (cash) will be supplanted by the “risk-on” trade (stocks) as investors typically develop a case of FOMO (fear of missing out). The FOMO inspired shift into riskier asset classes usually equates to adding fuel to the fire. ***Eventually, the money flows towards risk-on assets.***

5. Hope: Yes, this crisis will come to an end

While the optimal solution is a vaccine, there is no doubt that government mandated social distancing practices, improved preparedness with regards to health services, and greater reliability in health care supply chains will lead us towards normalcy. Scientists and researchers make daily progress on potential therapies or hopefully, a vaccine. While predicting when a vaccine will be widely available is merely guesswork, the “smart money” is of the mindset that dollars put to work today is done so with conviction that better times lie ahead. While there is no foolproof method for timing, the rule of thumb is that markets are forward looking mechanisms with the uncanny ability to discount future values. Based on this thesis, the markets appear to be telling investors that the bad news has been discounted and the future looks bright.

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William Mitchell, CIM ®

I am a discretionary portfolio manager at Palos Wealth Management based in Montreal, Quebec, Canada, and portfolio manager of the Palos-Mitchell Alpha Fund.

My experience in the investment industry is extensive, having spent more than thirty years analyzing, trading and investing in global financial markets.

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If you have any questions about investing, our services, or becoming a client of Palos Wealth Management, please contact me:

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