Seymour Investment Management

January 19th, 2020

The year 2020 closed out on a strong note, with the S&P/TSX Composite Total Return Index (TSX) up 9.0% on the quarter, finishing the year up 5.6%. The S&P 500 Total Return Index recorded 12.1% in the fourth quarter and 18.4% for the year. Similarly strong quarters occurred around the world with Europe, Japan, and Emerging Markets all posting positive, double-digit returns.

Looking back on what was a turbulent year, we are reminded of the importance of having a clear and unwavering long-term investment philosophy and approach. The 2020 annual returns, reported above, do not tell the full story of the historic volatility global markets experienced over the course of the year. Both Canadian and Global equity markets experienced not only one of the fastest bear market declines but also the shortest subsequent recovery on record. The year 2020 was an extreme example of how investing is never a straight line.

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The speed with which information, headlines and predictions are digested and reflected in equity markets contributes to the market's volatility. Volatility is further amplified by investor uncertainty and skepticism. Markets, led by the reactions of the market participants, are to a large degree influenced by sentiment and emotions. In the short term, this can exacerbate dislocations in the market as we saw exemplified in 2020. It is particularly important for investors to maintain a long-term perspective and stay the course during these periods of volatility.

Recessions and market corrections are a regular part of investing, with recessions typically occurring every decade or so. While the COVID-19 recession remains unprecedented in many ways, there will be some similar outcomes to that of past recessions. Markets can rebound strongly as they "climb a wall of worry" and many companies will use the recession as an opportunity to take steps to emerge stronger.

Cash on the Sidelines

During the height of the pandemic related uncertainty in March, many investors across Canada and the world, capitulated to the uncertainty and fear that gripped the market. The ensuing outflow was reflected in a precipitous decline in equity markets. As at October 2020, over $21 billion was pulled by investors out of Canadian equities, reflecting the largest net equity outflow (excluding M&A) on record (Brian Belski, Chief Investment Strategist, BMO Capital Markets).

This accumulation of cash that customarily occurs during recessions as households endeavor to expand their rainy day holdings was augmented by the fiscal stimulus swiftly supplied by governments around the world. The year 2020 represented only the second time a major stimulus package was introduced to combat a recession since the Great Depression. In comparison to the

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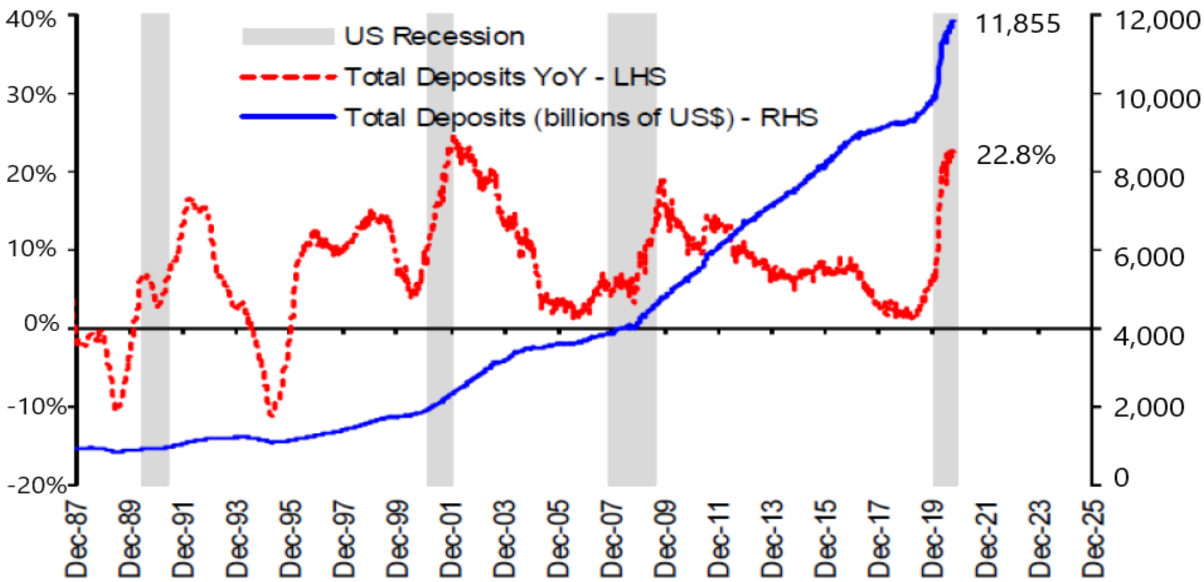
previous response that occurred during the Great Financial Crisis in 2008, the collective global lockdown-induced fiscal stimulus in 2020 was injected markedly faster, and in many cases, double or triple in size.

The sheer volume of cash on the sidelines is detailed in the graph below. Noted in blue, U.S. cash deposits increased by approximately US$2 trillion since February, up 23% from pre-Covid levels.

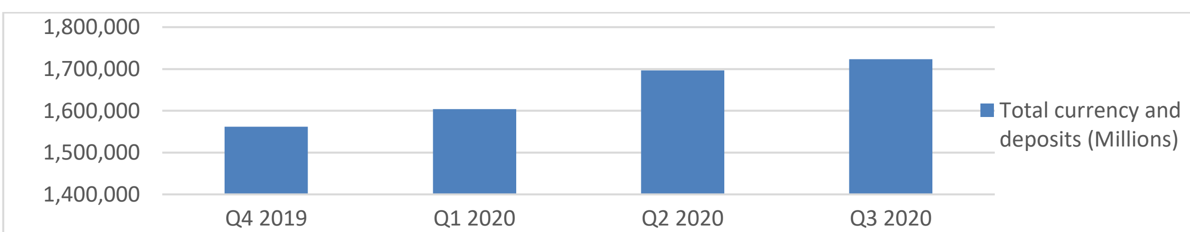
Chart 1: Total savings Deposits - U.S. Depository institutions



Source: Scotiabank GBM Portfolio Strategy, FRED

Canadian households similarly saw total currency deposits steadily increase by approximately $160 billion since the start of the year as a result of a savings rate that was eight times higher than its 10-year average, contributing to the lowest debt to disposable income rate since the beginning of the decade.

Chart 2: Total Savings Deposits – Canadian National Balance Sheet



Source: Statistics Canada National Balance Sheet Accounts

The potential deployment of the billions of dollars of cash on the sidelines may prove to be a tailwind for equity markets

As a result, quarterly consumer bankruptcies and insolvencies are at the lowest levels seen over the past 3.5 years per data from Statistics Canada. In addition, consumer loan delinquency rates have fallen relative to the same time a year prior.

Record liquidity as evidenced above and pent up consumer demand eagerly await a return to relative normalcy. When interest and confidence returns to the Canadian equity marketplace, the potential deployment of the billions of dollars of cash on the sidelines may prove to be a tailwind for equity markets.

Corporate Earnings Showing Resiliency

Corporations similarly showed resiliency in building cash reserves, aided by central bank support and available lines of credit at historically low interest rates. As a result, despite the considerable impact the global pandemic has had on many industries, there have been fewer commercial bankruptcies over the past few months than there were this same time last year. This is depicted by the red rectangle in the chart below.

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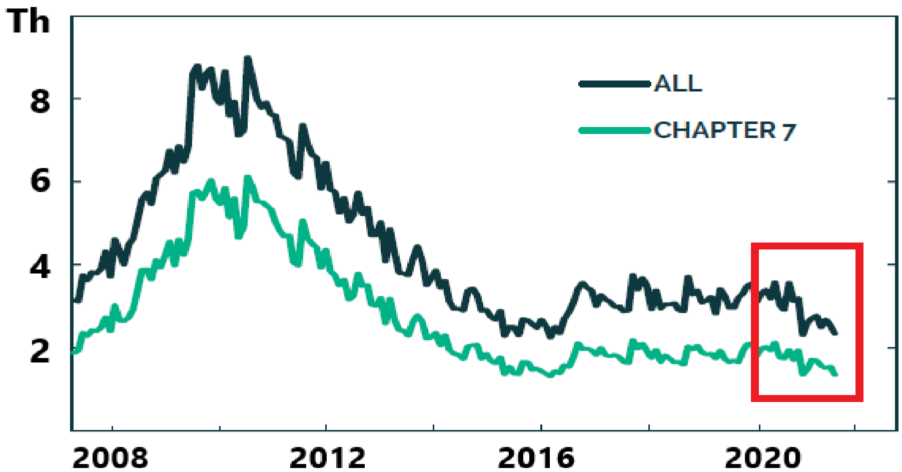
Chart 3: Fewer Commercial Bankruptcies



Source: Bank Credit Analyst, American Bankruptcy Institute

Historically, revenue growth is strong in the couple of years that follow a crisis. Nevertheless, investors generally tend to underestimate the earnings power of companies who are able to weather the storm.

There is a popular phrase, whether coined by Winston Churchill or another: "never let a good crisis go to waste". Many companies, led by strong management teams, use economic downturns as an opportunity to cut costs, become more efficient, and expedite adoption of technological and operational improvements. Merger and acquisition ("M&A") activity also resumes, as companies with strong balance sheets complete opportunistic acquisitions to emerge stronger.

Over the long-term, the biggest influence on equity prices is corporate earnings growth

Encouragingly, we have seen many Canadian companies demonstrate the resiliency of their business models and corporate profit margins. In addition, M&A activity is seeing a resurgence after a respite during the first half of 2020 leading to record high M&A activity in Q4.

We are reminded that throughout the shocks and headlines, as well as the uncertainty created by today's politics and the pandemic, the biggest influence on equity prices is corporate earnings growth. Although short-term volatility is to be expected, the outlook for earnings growth, supported by historically low interest rates, remains constructive.

We hope everyone remains safe and healthy in the year ahead.

Sincerely,
The Seymour Team