Can This Be Real

Fatigue is perhaps the easiest way to describe one's feelings/mode about Covid-19 and the various stages of lock-down we have absorbed. The massive fiscal war waged by governments around the globe against the virus will undoubtedly be reviewed once we are thru it. Was it better for governments to pay citizens and take on mountains of debt versus the normal fiscal process used in the past? We shall see. This fiscal experiment is expensive, no matter how approached. The one particular aspect, the government debt process entertained is beyond massive and even when compared to World Wars makes those look small in relation.

Let's delve into what is your number one question from our conversations these past months.

"Can this recovery in Equity markets be real, and when does it collapse?"

Quick Answer: I cannot believe I am saying this...It is real.

Government Debt

Unprecedented is the best description when talking about the amount of debt taken on by Global governments, and especially here in Canada. The benchmark of debt to GDP (Gross Domestic Production) has avalanched from 31% to 51% today, and some suggest closing in on 60% by 2024. In the US, it is approaching 108%. Some may feel solace in seeing Canada's ratio lower than our Southern neighbours. However, the opportunity to increase GDP itself is dramatically higher in the US than here in Canada. No matter what, it is a ton of debt that my grandchildren will never see paid off in their lifetime.

If one focuses on government debt, one thinks this recovery cannot be real, for the financial disaster must be near?

Personal Debt

Added to the government debt is people's willingness to, what appears to be, overpay for houses and take on more mortgage debt at these unprecedented low-interest rates. A person of sound fiscal perspective will state that it does not make sense to rack up more of it because debt costs are low. Like many of you, Jennifer and I had mortgage debt in the '80s in the 14%+ range. Like you, we know what high borrowing costs are and the impact upon one's life.

If one focuses on housing costs and mortgage debt, one thinks the price of houses needs to correct as well?

Super Low-Interest Rates

As clients know, we park cash in HISA's (High-Interest Saving Account) when not deploying cash. Umm...does 0.50% qualify as high interest? These HISA's need to be renamed to LISA's...Low-Interest Saving Account, for 0.50%, is not high in any realm. Low rates facilitate purchasing by reducing the value of saving money. People buying goods help equity markets remain buoyed.

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Unprecedented...Everything

My anticipation with these low-interest rates is that governments will convert this debt into 50+ year bonds to push all this "unprecedented" debt down the road and lock in these low rates. This conversion enables governments to find a stabilization cost to this high debt. A sort of "stabilization" to the cost of this debt today and tomorrow. This does not mean the debt gets paid off, but the cost to carry it gets stabilized. Since the general population is willing to ignore both this debt and its cost, it is good for equity markets.

Valuing Equities

These "unprecedented" low-interest rates have provided a new view on evaluating companies. Usually, a P/E ratio (Price to Earnings) of 16 would be deemed fair, and if it reached 23 would suggest the overvalue of a company's stock. Today, many companies we like have P/E ratios in the 23+ range, and I still like them. Why? Low-interest rates re-values money, and this re-evaluation appears to have entered into the pricing of the company's stock and debt. Is this the "New-Norm" (another term I hate) in valuing companies? The value was always an excellent way to buy these names for a guy who likes companies with momentum and dividend growth as their stock prices moved lower. I have to be pragmatic and accept that this new P/E ratio valuation may be the norm from now on.

I said in the depth of the crisis that the company's that meet my screening process and meet our criteria as "Dividend Growers" will not cut their dividends. As of December, only CAE has cut dividends. And if you held this position, we sold out of it as it no longer fit the ownership criteria. Dividend growth is still happening amongst positions we hold, as some company's have already announced increases.

Inflation is Coming

We have entered a climate of too much money chasing too few goods, a natural recipe for inflation. Increased taxation on goods will also produce inflation. I don't anticipate governments moving interest rates higher in 2021 to resolve this. However, this will be an issue in 2022 and beyond. The starting of inflation typically supports a rising equity market.

Perhaps governments have realized that the average person does not understand the debt they hold, so adding it does not matter. Maybe they are correct that this malaise does exist, so pile it on. I agree the current debt loads of Federal/Provincial/State/Municipal governments and agencies is beyond repayment. Those of us who can look at these times and take advantage of them prudently should do so. Buy good companies and take advantage of how well they are managed.

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