MARKET WATCH
A NEW BULL?

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"All knowledge resolves itself into probability." – *David Hume*

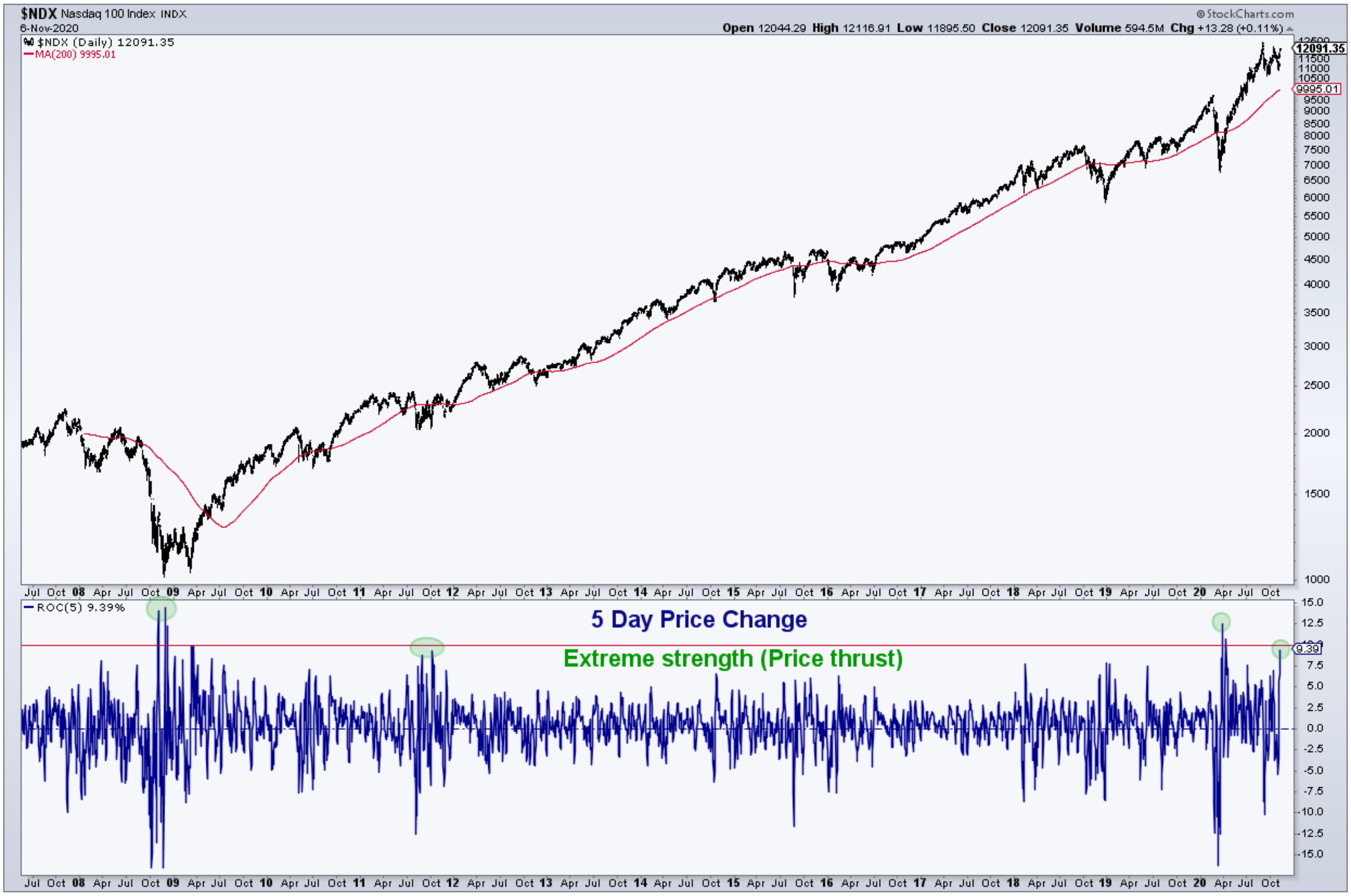
Bottom Line: All indications are that the stock market does not care who the president of the US is. While some volatility is to be expected, the weight of evidence is supportive of stocks.

In the Markets

All net stock market gains over the past three years have come when 70%+ of markets are above their 50-day moving average price. Considering the last three years in stocks, that may not be saying much but this also holds for the overwhelming majority of net gains over past 40+ years. Over the past week, the percentage of world markets trading above their 50-day averages rose from 6% to 71% (in October this peaked at 63%). It is hard to over-estimate how bullish this is.

A Major Thrust

The Nasdaq 100 Index produced a major thrust last week rising over 9%, among the top 1% weekly moves in its 35-year history. These are normally seen after major lows, but this time it occurred after the 13% correction in the NDX since the summer. The stronger the initial move, the more bullish the longer-term implications for the market.

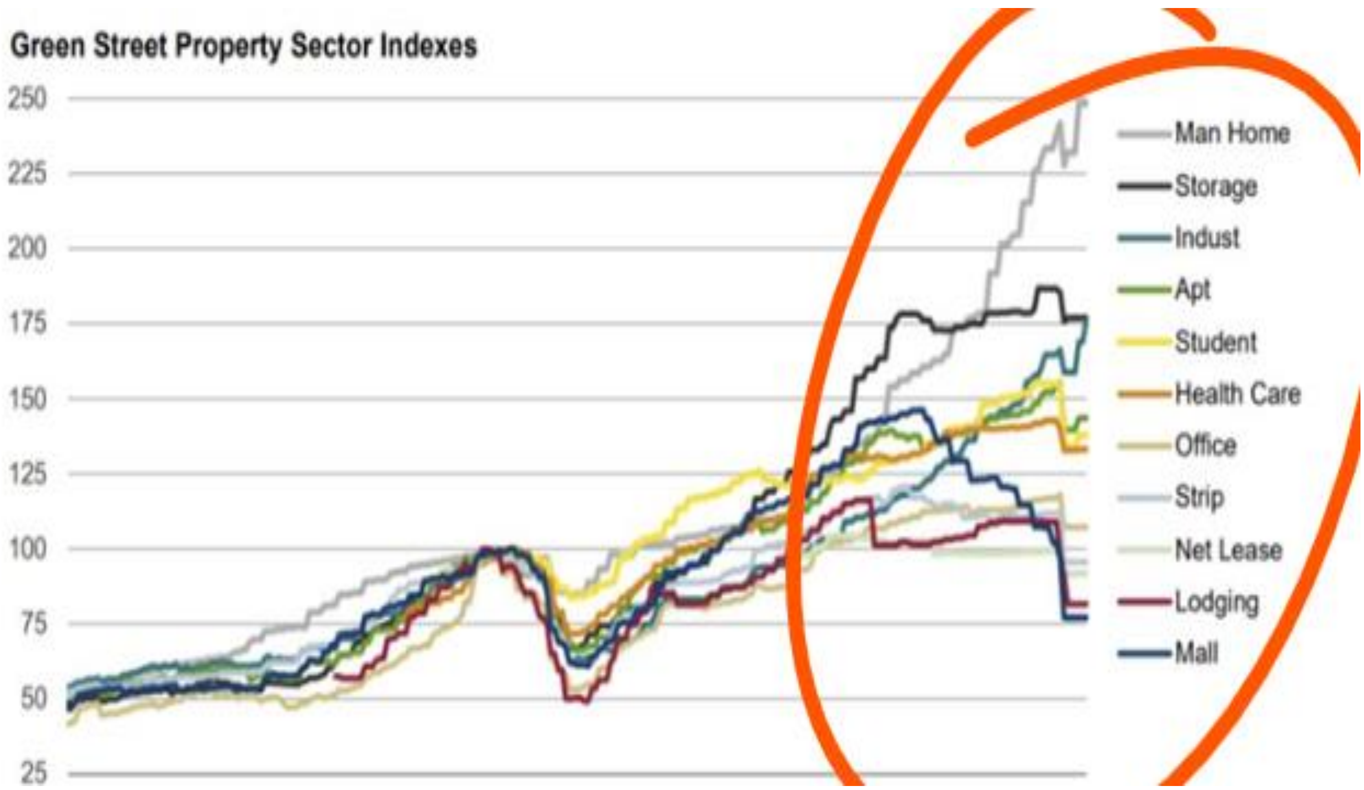


There were other ways to measure the powerful move last week. It was difficult not to notice; the S&P began the week with four consecutive one percent, or more, days, specifically 1.23, 1.78, 2.21 and 1.95%. Over the last thirty years looking for previous times this occurred only once which I would normally disregard as insufficient for meaningful inferences, but this particular data point happened to fall on April 3rd of 2009 which was followed by a 41.22% annual return and launched one the greatest Bull Markets ever. So, digging deeper, and looking at data back to 1950 there were three additional times that this happened. All four Dates returned +20% over the following year as well at +10% over the next six months.

Four occurrences is not enough to make a judgement but it's impressive that it caught the beginning of four of the major bull markets of the last 70 years. It aligns with the weight of evidence we see and will likely keep us invested through year end.

Commercial Real Estate (CRE)

Given global "Covid lockdowns" this year the disruption to business was obviously enormous. Everyone, including me, expected that CRE is subject to disruption in various ways. However, much like the stock market and the economy in general, everything is location and property specific now. There is no single answer anymore to "how is CRE performing" as it is highly dependent on which sector, and therefore which economy, the real estate is in.



US economy

While many people seem concerned about investment prospects because of economic uncertainty compounded by the US election circus, we need to realize that the US presidency has very little bearing on the primary trend of the stock market.

The S&P 500 or "Dow" Index are often cited as barometers for the U.S. economy. But these benchmarks only offer a glimpse of broader economic growth. That's why it's important to be mindful that while there's a relationship between the stock market and the economy, they're not the same. Perhaps a bigger surprise to many is that the US economy is doing rather well. In fact, manufacturing has recovered in the US, not just to pre-Covid numbers, but has actually recovered to 2019 pre-trade war levels. Employment is still lagging but Ned Davis Research has the US economy in the Early Expansion Phase. See graphic below.

Where the U.S. economy stands in Q3 2020

NDR NED DAVIS RESEARCH

OVERALL CYCLE

Early expansion

The economy rebounded at a record pace in Q3, helped by reopenings and massive monetary and fiscal stimulus. Both manufacturing and services activity strengthened. But output and employment have yet to recover to pre-COVID levels.

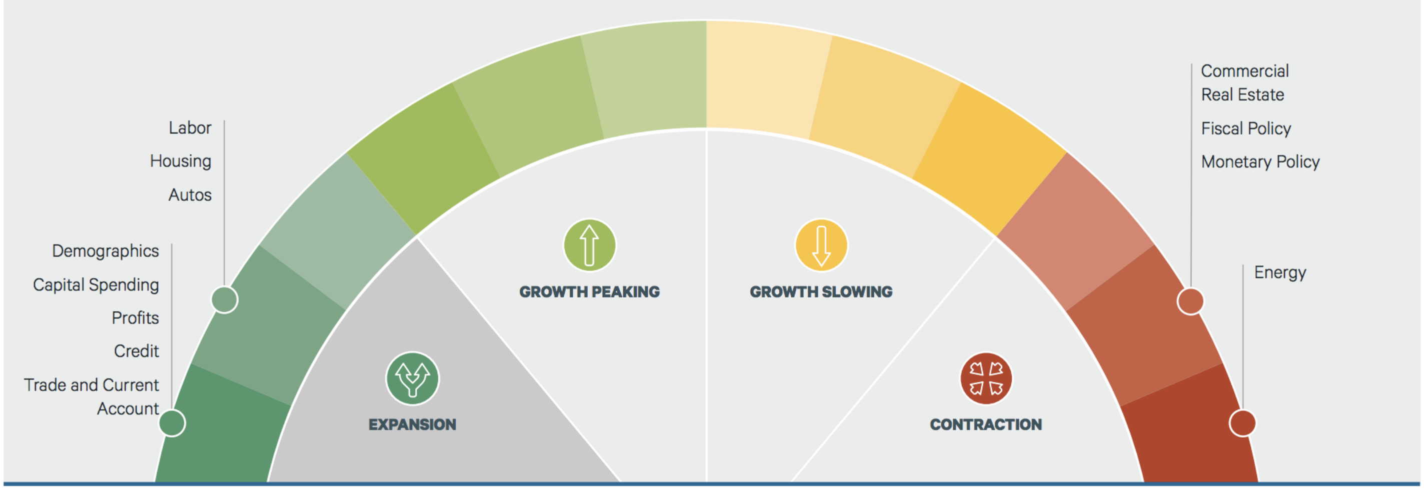
POSITIVES

- Fiscal and monetary stimulus initiated in 1H 2020 continues to support the economy.
- Employment has recovered about 1/2 of the losses.
- Record low interest rates boost demand for homes, autos, and other durables.

NEGATIVES

- COVID resurgence preventing a fuller re-engagement of economic activity.
- High economic and political uncertainty weighs on capex.
- State and local governments cut spending, as federal support wanes and budgets come under pressure.

The four phases of the economic cycle
and the current status of 12 economic sub-cycles



Buying Power, and Waiting for The Breakout

Since January 2018 (Trade War) the average stock market has gone nowhere!

The price of the Toronto stock exchange is still below the upper end of its two-year range and the ultimate question is will it join the strength we are seeing across the basic materials (chart below) ? Our Buying Power Model has us expecting a breakout to the upside but as in life, nothing is certain.

Right now the health of the breakout in Cyclical stocks we own like Freeport McMorran, Teck Inc, Arcelor Mitel and First Quantum Minerals suggests it will continue and will be in conjunction with rising yields.

If our Buying Power Model and Primary Trend Indicator turn negative, all bets are off and we will reverse this call but for now, it's rising cyclical stocks, rising interest rates and inflation.


XLB Materials Select Sector SPDR Fund NYSE
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6-Nov-2020
Open 68.22 High 68.61 Low 67.72 Close 68.00 Volume 6.1M Chg +0.17 (+0.25%)
XLB (Daily) 68.00
Basic Materials Index
$TSX 16282.83
Toronto Stock Exchange

"But the market is so expensive!"

One item on our RAPS sheet which examines the real driving forces of market cycles is market 'valuation'. We point out that the market is indeed expensive with a P/E of over 28X. We also point out that the Price to Earnings (P/E) has no bearing on market direction over the coming 6-12 months. Besides between Covid and the US Election also overshadowed has been better than anticipated third-Quarter Earnings. S&P500 are now back to an estimate of 31.23 for the third Quarter as 87.4% companies so far have beat or met third Quarter estimates. With the S&P at 3500, we need to average $35/share over the next four Quarters to trade at a 25- times earnings. Yes, that is historically high level but historically we haven't seen zero percent interest rates either. Still the 'market' will not be cheap at these levels over the next year, but again that simply does not matter.

We are not trying to justify an expensive market here but acknowledging that the market has been expensive for some time and the "proper levels" of inputs into a complex system like the stock market are just not that easy to isolate with certainty. Maybe it is possible that the market is telling us that with anticipated additional stimulus, and zero rates forever, PEs in the 25-30 range are justifiable.

Conclusion

We remain completely open to any eventuality that the markets bring. Our strategies, tactics and tools will help us to successfully navigate whatever happens as we focus on monitoring supply and demand signals that the market provides us.

I hope you had a very good weekend. If you have any questions about this update, or anything else please do not hesitate to reach out.

Peter Schenk, CMT, CIM | Portfolio Manager

Words we operate by:

"Deliver to the world what you would buy if you were on the other end. There is huge pleasure in life to be obtained from getting deserved trust. The way to get it is to deliver what you would want to see if you were on the other end."*-Charlie Munger*

"Strive not to be a success, but rather to be of value." *-Albert Einstein*