Lynx Capital Group Ltd

Disciplined Strategic Investment Management

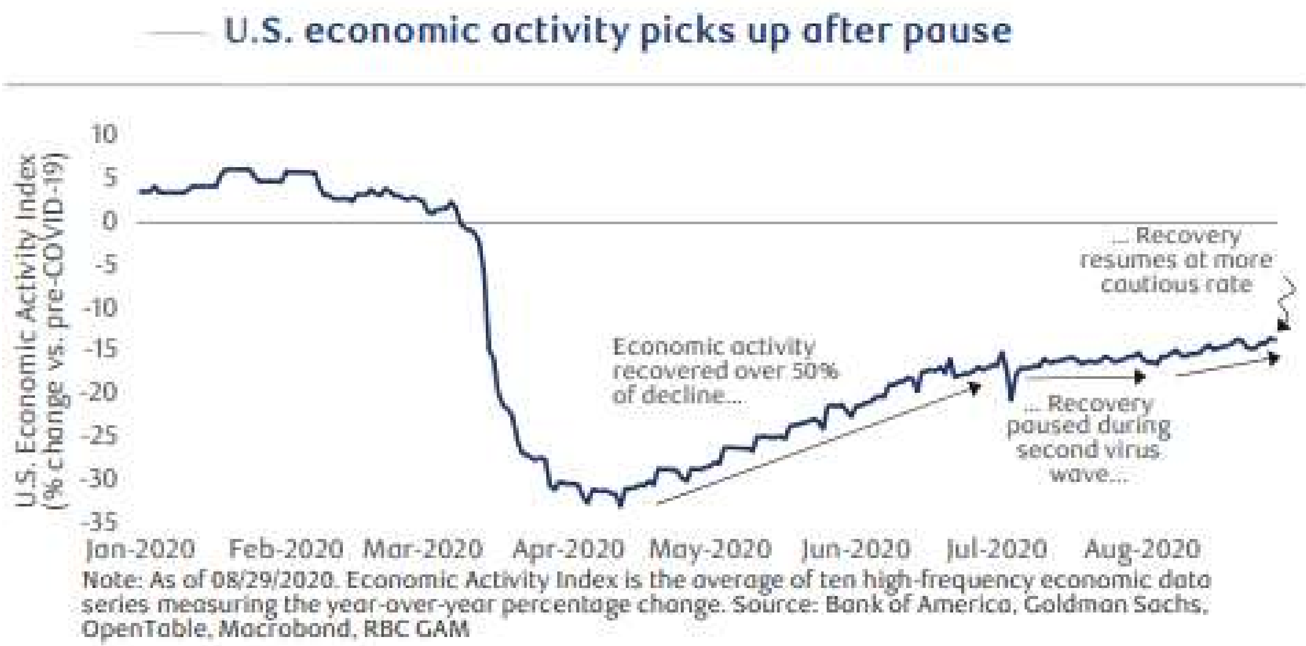
http://www.lynxcap.com

Market Outlook as of October 2020

"Successful investing is anticipating the anticipations of others."

***John Maynard Keynes -** British Economist, 1883 -1946.*

The US and world economies are on a much better track than they were at the beginning of the Coronavirus breakout. In many areas, economies have adapted extremely well to “remote workers” and “social distancing” especially through the use of technology. There has been a lot of progress towards treatments for COVID-19 and there are several promising vaccines and treatments in the final stages of development. In many areas, the global recovery has started earlier than most investors initially expected, supported by unprecedented amounts of monetary and fiscal stimulus.



Many sectors, such as entertainment and travel, are likely to remain under pressure until a vaccine becomes widely available. Unemployment remains unacceptably high, and many businesses like restaurants are closing their doors for good. Congress has already curtailed a lot of its support for the unemployed and is dragging its heels on approving another stimulus package. The absence of additional stimulus would likely put a drag on further economic growth. Monetary policy, especially from the Federal Reserve, is expected to remain highly accommodative for the foreseeable future.

Three Macro Themes are presently influencing our <u>long-term</u> investment outlook:

Valuations Matter: Most of the recent gains in the market have been attributable to six stocks that are priced to perfection. For now, "buy low sell high" is dead. It is now <u>"buy high and it will go even higher"</u>! From past experience and history (i.e. the 2000 dot.com bubble) this does not end well.

The valuation gap between growth and value stocks (reasonable P/E's and low price to book) has now reached extremes not seen since the tech bubble of the late 1990s. U.S. growth stocks (especially in the now very crowded FAAMNG (Facebook, Apple, Amazon, Microsoft, Netflix, Google) trade) are awfully expensive, while U.S. value stocks are approaching historically cheap levels. While no one can predict with exact timing, we expect to see the beginning of rotation out of these expensive growth stocks. Given their extreme valuations, the threat of government anti-trust activity and a broadening economic rebound due to the "pandemic trade" ending within the next six months or less.

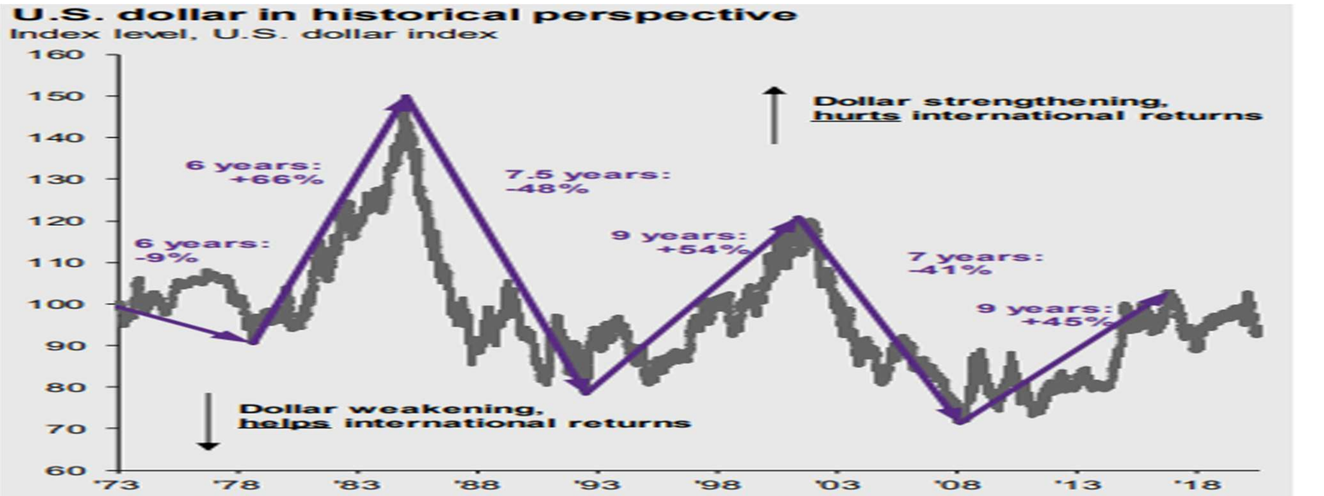
Looking over a 10-year horizon and discounting future earnings to the present, earnings of the many growth stocks would have to rise at a growth rate of around 22% plus each year on average for the next decade to reach break-even with value stocks. These stocks have achieved this in the past, but eventually the laws of gravity win out.

On a relative basis, the valuation gap between growth and value has now exceeded its tech-bubble peak (see chart below). The current backdrop of anemic economic growth and ultra-low interest rates still favors the FAANMG, but the momentum behind them is dissipating. Forces that are triggering a shift more towards value, small capitalization and foreign stocks would be due to the economic recovery broadening out globally, rising inflationary pressures (caused by a weaker dollar), and a steepening yield curve.

Exhibit 21: Growth to value relative performance
Russell 3000 Growth Index / Russell 3000 Value Index

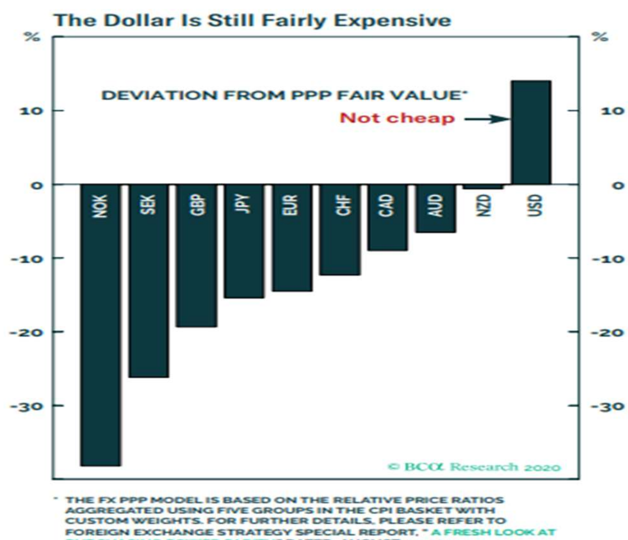
Note: As of August 31, 2020. Source: Bloomberg, RBC GAM

The US Dollar has also been in a long upwards trend that we think will change.



Source: FactSet, J.P. Morgan Asset Management; (Left) Federal Reserve, ICE; (Right) MSCI.

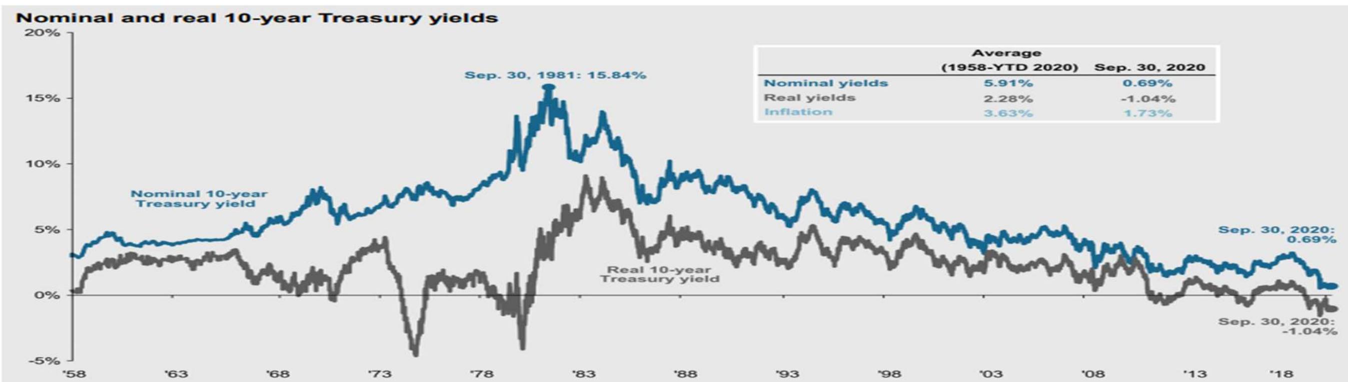
U.S.-dollar weakness expected to endure. The decline in the trade-weighted dollar since March is just the beginning of a longer-term period of U.S.-dollar weakness, supported by several structural, cyclical, and political factors. The U.S. is a safe haven during times of turmoil and as world economies get back on track, foreign funds will be repatriated to take advantage of local opportunities which are generally a lot cheaper than the U.S.



Bond yield and the increasing importance of Dividends for income

Most people do not realize that bonds and bond funds do well when interest rates are falling. In fact, interest rates have been declining since 1981 – a 40 year bull market in bonds. Today the 10-Year treasury has a nominal yield of 0.69% compared with 15.84% in 1981. (See Chart below) Longer term, we believe that interest rates have nowhere else to go but up, which will put pressure on bond prices.

On a relative basis, however, stocks look much more attractive than cash and many areas of the bond market. This is the so-called TINA (there is no alternative) argument for stocks: It's hard to make the case that stocks aren't the better option when the dividend yield of the S&P 500 is higher than the long-term government bond yields. The dividend yield on our dividend growth portfolio is over 100% higher than that (1.5% vs 3.1%).



Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for September 2020 where real yields are calculated by subtracting out August 2020 year-over-year core inflation.

The potential for higher inflation would be an unexpected likelihood to most, given the total dominance of low inflation over the past decade. Even with a fully effective vaccine, we believe the COVID crisis will still take at least the better part of 2021 for developed economies to return to their pre-COVID-19 peak. The virus is far from gone, but it is increasingly coming under control, at a minimum, policymakers have an understanding of how to limit transmission, even if not all have proven willing to accept the accompanying economic hit. A second wave however now looks increasingly likely.

The U.S. election sits at the forefront of most investors' thoughts. The possibility of a contested election will roil markets. The overall economic environment remains supportive of moderate risk-taking in financial markets. We continue to own a mix of growth but are more weighted towards value stocks. We do not see any current challenges that will permanently derail the economic recovery but think going forward it will occur at a slower pace than what we have seen so far. Economies simply do not recover overnight and there will be a back and filling process.

It is always advisable to review one's individual circumstances and tolerance for risk. If any of your financial circumstances have changed, or you want to adjust your portfolios risk profile we always encourage your input should you want to make any changes to your portfolio allocation.

As always, please feel free to contact us with any questions or concerns.

Brian Chait
President, October 16th 2020

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