December 7, 2020

Portfolio update

The recovery is gaining momentum. Announcements by Pfizer-BioNTech and Moderna on the outstanding effectiveness of their COVID-19 vaccines suggest an end to the pandemic is within sight. This positive news, together with stronger global economic data and clarity on the U.S. election outcome, has led to double-digit stock market returns in the month of November alone. Our portfolios have seen an even larger rebound, recovering much lost ground from earlier this year.

COVID-19 vaccine is a gamechanger

Pfizer and Moderna's phase 3 clinical trials indicate efficacy rates of 95%, ranking them among the best vaccines ever developed. Both companies are expected to obtain emergency use authorization from the FDA in mid-December. This will pave the way to start vaccinating key high-risk populations, such as healthcare workers and the elderly, before the end of the year. The AztraZeneca-Oxford University vaccine has also been shown to be effective, but at a level which is still unclear. However, its key advantages include lower costs, easier storage and transportation conditions, and much a higher supply potential in the short- and medium-term. Based on the manufacturing capacity of the three pharma companies, there should be enough supply to vaccinate developed countries' populations in the second half of 2021.

An additional positive development is the emergency use authorization of a self-administered COVID-19 test. Lucira Health's home-test kit provides results in 30 minutes, continuing a trend to decentralize testing and improve turnaround times. We expect it will become more widely available in the spring of 2021. Moreover, a recent report from the La Jolla Institute for Immunology showed that natural immunity may last years, perhaps even decades, and involves multiple arms of the immune system. This bodes well for the durability of vaccines and our ability to strive for herd immunity. Improvements on the treatment front and behavioural changes are also helping countries cope with the pandemic as we navigate the challenging months ahead.

The pandemic is progressing along our base case scenario outlined earlier in the year. We expect a gradual return to a more normal life beginning in mid-2021.

Markets see light at the end of the tunnel

The global economy is recovering in a synchronized fashion. Business conditions are improving and corporate earnings are generally exceeding consensus expectations. Retail sales at Walmart increased 6.2% year-on-year, with e-commerce revenues up by 79%. The Shanghai Container Freight Index, covering the export container market from China, rose 150% year-on-year and is up 114% year-to-date, driven by historically low retail inventories and a shortage of empty container capacity. United Parcel Service, a bellwether of global economic activity, saw a 14% volume increase across its network year-on-year. Estimates for Q1 2021 S&P 500 earnings from S&P Dow Jones Indices show operating earnings rising by 92% from Q1 2020.

Recent economic data are similarly encouraging. The Global Purchasing Managers Index, a key leading indicator of economic activity, is in expansion territory for the fourth consecutive month. U.S. October housing starts were running at a seasonally adjusted annual rate of 1.53 million, up 4.9% from September and 14.2% compared with October 2019. Unemployment rates around the world are broadly trending downwards. Record levels of fiscal and monetary stimulus are having an effect, and the full benefits are likely to kick-in next year.

Stock markets surged in reaction to positive vaccine news and the potential for a strong economic recovery. The S&P 500 increased 8% (total return in Canadian dollars) in November, while the S&P/TSX was up 10.6% and the MSCI World rose 9.6%. Our portfolios performed even better, with the Letko Brosseau Canadian Equity Fund up 19.4% and the Letko Brosseau Equity Fund up 15.3%, recovering much of the ground lost earlier in the year. We may be at the beginning of a rotation from high-multiple stocks into low-multiple value stocks, a development we discussed in detail in our October 2020 report The illustrious history of growth through value investing.

Biden/Harris administration likely to pursue pro-growth policies

With the uncertainty of the U.S. election behind us, attention has turned to the policy initiatives likely to be pursued by a Biden/Harris administration. We expect a pro-growth bias to be maintained, as the U.S. economic recovery is still vulnerable. While it has been generally observed that stock markets tend to do well coming out of a recession, the table below shows that there is no clear pattern between political party and stock market performance.

TABLE 1

President	Political Party	Term	Annualized S&P 500 Return
Bill Clinton	Democratic	1993-2001	15%
Barack Obama	Democratic	2009-2017	14%
Donald J. Trump	Republican	2017-2021*	13%
Dwight D. Eisenhower	Republican	1953-1961	11%
George H.W. Bush	Republican	1989-1993	11%
Gerald R. Ford	Republican	1974-1977	10%
Ronald Reagan	Republican	1981-1989	10%
Harry S. Truman	Democratic	1945-1953	8%
Lyndon B. Johnson	Democratic	1963-1969	8%
Franklin D. Roosevelt	Democratic	1933-1945	8%
Jimmy Carter	Democratic	1977-1981	6%
John F. Kennedy	Democratic	1961-1963	5%
Richard Nixon	Republican	1969-1974	-4%
George W. Bush	Republican	2001-2009	-6%
Herbert Hoover	Republican	1929-1933	-31%

*as at November 30, 2020
Source: Bloomberg, all data shown as annualized stock market price returns

Portfolios positioned for post-pandemic recovery

A vaccine rollout will pave the way for a gradual re-opening of economies in 2021. With less uncertainty about the path of the pandemic and U.S. domestic politics, and with massive fiscal and monetary stimulus in the pipeline, we expect a dynamic year for economic growth. Our balanced portfolios favour equities over fixed income investments, and our equity holdings are tilted to the real economy. We believe that our portfolios remain attractively valued and well positioned for the recovery.