February 8, 2021

Portfolio update

Global equity markets ended January in slightly negative territory as speculative trading by retail investors caused volatility to spike near month end. Our portfolios continued their uptrend, outperforming benchmark indexes.

We continue to expect the world economy to return to its trend rate of growth in 2021. Although the rising number of COVID-19 cases and mobility restrictions may taper activity early in the year, vaccine rollouts and the development of more effective therapies should allow most sectors of the economy to normalize by year end.

A new cyclical expansion has begun

According to the International Monetary Fund (IMF), the size of the world economy should exceed $91 trillion in 2021, 4.0% above its 2019 pre-pandemic level. At the end of 2020, the US unemployment rate was 6.7%, well above its 2019 level of 3.5% but a significant improvement from its April 2020 peak of 14.8%. US retail sales also hit record levels in September, and total 2020 sales of existing homes in the US were 5.6% higher than in 2019. We are particularly encouraged by the high US savings rate which, at 13.7%, almost twice its 2019 level, will strongly support consumer spending.

This new cyclical expansion was made possible by the record fiscal and monetary stimulus injected into the world economy. In 2020, these measures totalled a staggering one-third of world GDP, and there are signs that more is to come in 2021. President Biden's proposed US$1.9 trillion economic rescue plan, which includes direct payments to taxpayers and enhanced unemployment benefits, is aimed at further boosting US economic activity. Top EU and Japanese officials have also indicated that fiscal stimulus will continue well into the recovery. Along with supportive financial conditions, the overall policy mix should help lift activity in 2021.

TABLE 1

	Potential monetary stimulus		Potential fiscal stimulus		Potential monetary and fiscal stimulus	
	$trillion	% of GDP	$trillion	% of GDP	$trillion	% of GDP
US	$6.21	29.0%	$4.19	19.6%	$10.40	48.6%
Eurozone	$2.38	17.9%	$4.27	32.0%	$6.65	49.9%
Japan	$1.03	20.0%	$2.79	54.1%	$3.82	74.1%
UK	$0.57	20.7%	$0.59	21.6%	$1.16	42.3%
Canada	$0.43	20.0%	$0.34	16.2%	$0.77	36.2%
China	$1.43	10.0%	$1.22	8.4%	$2.65	18.4%
Other	$0.51	n/a	$2.51	n/a	$3.02	n/a
Total	**$12.56**	**14.5%**	**$15.91**	**18.4%**	**$28.47**	**32.9%** of world GDP!

Note: The table shows stimulus measures announced and enacted between February and December 2020.
Sources: Cornerstone Macro, IMF, World Bank, Bank of Canada and Letko Brosseau

Stimulus spending, combined with strong progress on the healthcare front, was a key ingredient in restoring confidence in the recovery. This translated into strong demand for housing and manufactured goods and hence rising consumption of raw materials. As shown in Table 2 below, many commodity prices, including natural gas, copper, steel, lumber and oriented strand board (OSB), are well above their pre-pandemic levels. Moreover, the price of oil has risen to US$52.20 in January 2021 from a record low of negative US$36.98 in April 2020 (with oil storage tanks overwhelmed, traders were briefly willing to pay buyers to assume delivery of physical barrels). Improvements in freight rates, both land and ocean, are also indicative of pent-up demand developing as the economy normalizes.

TABLE 2

Business Condition Indicators

	End of 2019	2020 low point	Most recent
US retail sales (US$ billions)	525.66	412.77 (Apr)	540.92 (Dec)
US auto sales (millions)	17.0	8.6 (Apr)	16.3 (Dec)
Oil price – WTI (US$/bbl)	61.20	-36.98 (Apr)	52.20 (Jan)
Gas price – AECO (Can$/GJ)	2.22	1.25 (Oct)	2.92 (Jan)
Copper price (US$/lb)	2.79	2.09 (Mar)	3.54 (Jan)
Steel price (US$/ton)	588	461 (Apr)	1,149 (Jan)
Lumber price (US$/mbf)	395	280 (Apr)	925 (Jan)
OSB price (US$/msf)	220	220 (Apr)	775 (Jan)
Flatbed rate (US$/mile)	2.10	1.62 (Apr)	2.52 (Jan)
Container freight rate, China-US West Coast (US$ per 40' container)	1,368	1,300 (Mar)	4,286 (Jan)
US passenger air traffic (millions)	70.2	3.3 (Apr)	26.4 (Dec)

Sources: US Census Bureau, Autodata Corporation, Energy Information Agency, Natural Gas Exchange, FactSet financial data and analytics, Random Lengths, Bloomberg, Transportation Security Administration

Mining stocks have been significant beneficiaries of this strength in commodity prices. For example, the share price of Freeport-McMoRan, one of the world's largest copper producers, increased by 83% since the beginning of October last year. Canadian copper producers Hudbay and Lundin saw their share prices rise by 40% and 68% respectively over the same period. Copper is used in a wide variety of industrial end markets, such as construction and transportation as well as electricity generation, transmission and distribution. The metal also benefits from secular growth in renewable energy and electric vehicles (EVs) due to their high level of copper content. An estimated rise in EV's share of new cars sold globally, from 4% in 2020 to 35% over the next decade, will have

TABLE 3

Projected key metrics of companies in LBA equity portfolios and their benchmark indexes

		2-year forward growth		P/E ratio*		Dividend Yield	
		Sales	EPS	2021	2022	2021	2022
Canadian equities	S&P/TSX	13.5%	57.4%	17.2	15.2	2.9%	2.9%
	LBA	**18.3%**	**77.0%**	**13.2**	**11.7**	**3.0%**	**3.0%**
Non-Canadian equities	MSCI World	12.4%	43.3%	21.8	18.7	1.9%	2.1%
	LBA	**14.8%**	**92.1%**	**13.9**	**11.9**	**2.9%**	**3.1%**

*Based on equity prices as of January 29, 2021
Sources: Bloomberg consensus estimates and LBA calculations, Letko Brosseau Canadian Equity Fund, Letko Brosseau International Equity Fund

major implications for copper consumption. As an EV uses on average 60 kg more copper than a regular car, such a rise could increase copper demand by almost two million tons in 10 years, the equivalent of 8.5% of current demand. Continuing growth in renewable energy, specifically solar and wind, could add another 4% to today's demand. The good news is that our exposure to copper stocks is well-positioned to capture the long-term upward trend in eco-friendly products.

As the world is recovering from the pandemic, we believe that the combination of vaccine rollouts and massive stimulus will lead to robust economic activity over the next two years and our portfolio should continue to benefit from these positive tailwinds. We estimate that, over the next two years, revenues for our Canadian portfolio companies will grow by 18.3% and 14.8% for our non-Canadian equity investments (Table 3). This strong uptrend in revenues should result in earnings growth of 77% (Canadian equities) and 92% (non-Canadian equities) over the same period.

Despite expectations of a faster rise in revenue and earnings than the indexes, our equity portfolios continue to trade at substantial discounts to the benchmarks. Long-term investors should reap the rewards for their patience.