



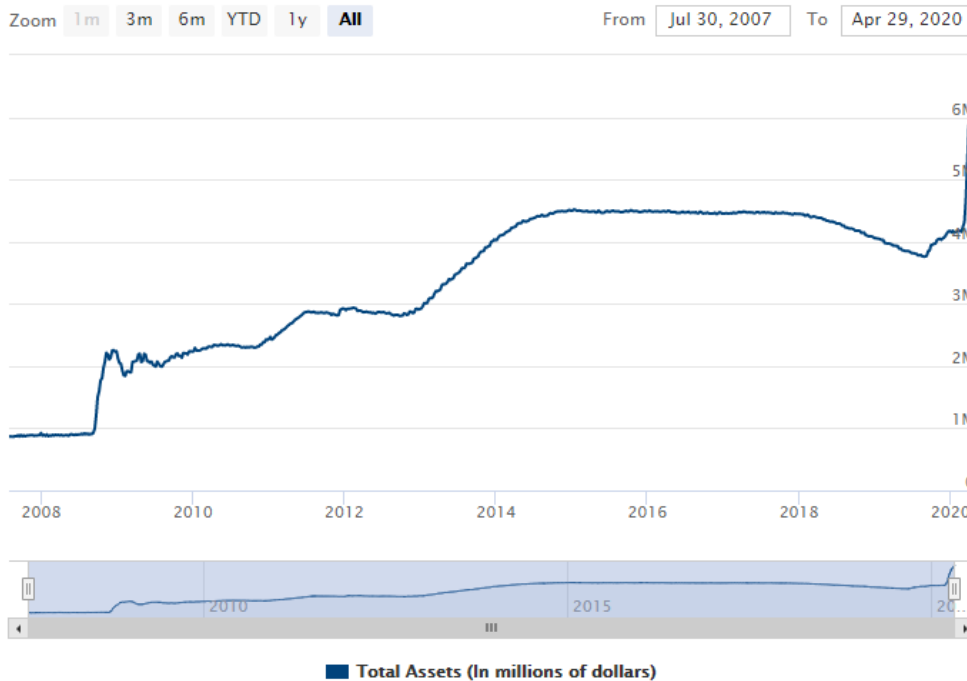
May 2020

Navigating the New World

MMT – Magical Money Tree

In first-year university economics, you learn supply and demand, equilibrium and host of other terms like elasticity of price. That was 30 years ago, wow how time flies! More recently there has been a developing new school of thought emerging on a new economic take: Modern Monetary Theory (MMT). It has its own wiki site (so it must be real – not fake) and in simple terms basically means that central banks can issue paper money to pay for pretty much anything to help the economy. We have taken a bit of a tongue in cheek approach to this view because we see it in simple terms that whenever some economic incident happens the US FED and other central banks around the world suddenly have more money that can fix the problem. Hence the Magical Money Tree reference. I checked at the local garden store for the seeds to buy one of these trees, but I was notified that they were beside the unicorns in the rainbow aisle just under the pot of gold.

However, the reality is there is a magical money tree and it lives with central bankers. We first saw green shoots of this back in 2008. The chart below provides some context of how much money this tree has given out over the last number of years. The closest term that we hear in mainstream media to define this is QE or Quantitative Easing.



Source: Federal Reserve

The chart above illustrates how much money the FED has pumped into the economy over the past 12 years. The balance sheet has grown from \$1 trillion to \$6.6 trillion. That's a lot of hamburgers where we come from.

Where Does the Money Go?

In 2008 we had a credit and mortgage crisis. The FEDs response was to purchase Treasuries (US Government Bonds) to keep rates low, debt and mortgage-backed securities to increase the availability of credit for those who wanted to purchase homes and support the economy. These actions were called QE or quantitative easing.

Fast forward to current times 2020 and the FED in their recent statements are open to buying pretty much any assets, bonds, exchange traded funds, mortgage-backed securities and they hinted that they could even purchase stocks? The greater part of their recent statement suggest that they have an unlimited chequebook for those purchases. History and the chart on page one would suggest this is true. Need more money? Just get it from the money tree.

COVID-19 aside, this is what is happening in the world economically speaking. The downside of not having a money tree is a global recession which would be great for movie audiences but terrible for all of us. I guess we should be thankful for the MMT.

MMT – Cannot Save Everyone

As we have seen in the last couple of months the world is a different place. Companies have gone bankrupt from energy (Witting Petroleum) to retail stores (J Crew) in recent announcements. This results in economic destruction that is not soon replaced. Our best guess is that there are likely more on the horizon. In reviewing Warren Buffett's remarks recently from his recent first quarter, it is clear that he is no fan of the airline industry. Couple this with the recent Air Canada guidance and they are not expecting the industry to recover until 2022 or later. This is damage that is only undone with time. MMT will help but it does not help everyone.

Where are we Now?

April was one of the best months in modern history and most are calling it the bear market bounce. Others believe in hope for a vaccine and that the MMT keeps on buying up assets and that the new bull market has started. This is the beauty of the market, there is always a buyer on one side and a seller on the other side. We have planted roots in the rationality of price and believe there may still be some dark days ahead of us. The root of this thinking is that a value purchase is more protective of one's assets versus playing momentum musical chairs. The past month may be considered musical chairs because the only positive data points we could find was that the money tree was in full bloom and the COVID-19 global curves seemed to be flattening. Ultimately any good news on COVID is great news for our world and the human condition.

Going Forward

There is no doubt that some industries have been rattled. In April, we saw a negative \$37 print on a barrel of oil. The technical aspects of how this happens are multiple pages in length so we can walk you through this another time should you want the murky details. However, imagine having to pay someone \$37 dollars to take your barrel of oil off your hands. This was simply unthinkable 6 months ago. Today it stands as fact and will be written in the history books.

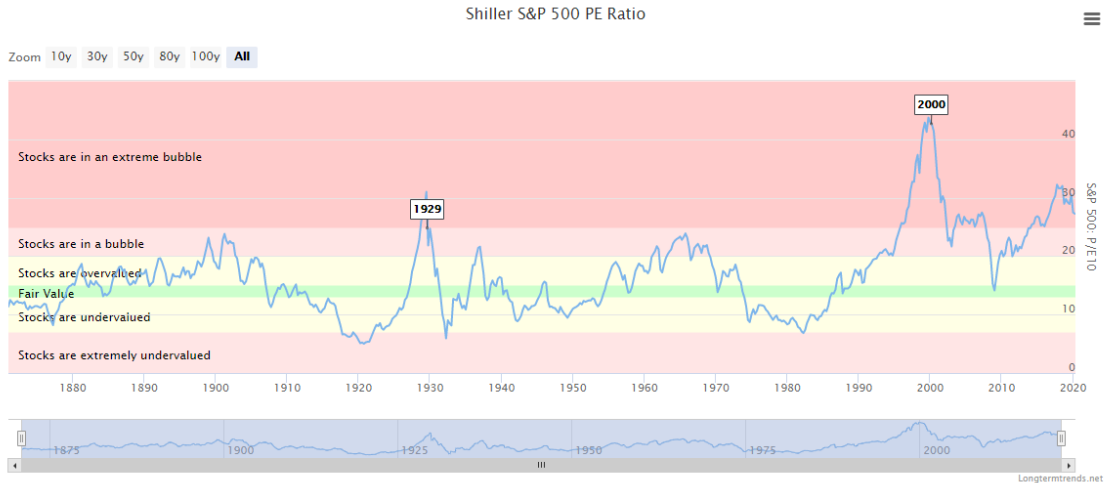
Range of Possibilities

The scope and range of possibilities have, in the last week or two, become wider. The markets abrupt about-face has a large part to do with the scope broadening as it has pushed valuations generally back into the 20 times price-earnings range. The jury on the market has suggested all kinds of different letters to explain how the economy recovers from a V-shaped recovery to W, to L, to U, and I even heard a recent Y in a conversation.

The Market is Expensive

In the last couple of quarters, we have been tracking valuations in search of rationality with which to allocate capital. Our concerns have been rooted in excessive valuation; COVID-19 was an X-Factor scenario we had not modelled. The chart below provides an interesting view of the historical valuation in the market. The S&P 500 is currently in what is described as an extreme valuation bubble. It should be noted that valuations can remain in bubble territory for extended periods of time. The march of valuations up to 2000 and down was a multiyear event. Some of the commentaries around the current state of our economy suggest things are just getting started.

The Shiller PE Ratio



Source: Longtermtrends.net

Final Thought

As we deal with the first world problems of the granular decisions of placement of capital and wealth management, we remain constantly reminded that our world has changed. The playbook on managing this change is being built brick by brick daily. Our efforts remain exhaustive but fall from the efforts of first-line responders and their daily decisions on life and death. The world has now changed, and we will find a way through this, but the timeline remains fuzzy. Our greatest hope for everyone is that all are coping well through managing the change at home and in your workplaces.

When I looked out in the backyard this morning, I was reminded that there is no magical money tree growing out there, just the grass. Ah, the smell of freshly cut grass...

Thank you for reading and we will keep you posted as we grind forward.

John Wiman
Portfolio Manager
Investment Advisor
T: 416-869-7125
John.Wiman@nbc.ca

Jason Wong
Portfolio Manager
Investment Advisor
T: 416-869-7142
Jason.Wong@nbc.ca

Darlene Lanigan
Investment Associate
T: 416-869-7445
Darlene.Lanigan@nbc.ca



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