



Di Iorio Family Wealth of RBC Dominion Securities

Think bigger. Act bolder. Invest better.

Back in Black

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Every so often, we like to post a blog focusing on positivity. About why from an investing perspective, we feel the glass is half full, rather than half empty, and why we feel that investors who share this belief will do extremely well over the next 5 to 10 years. Last time we did this was in a post called “Changing the Negative Narrative”, back in early 2019, where we addressed the seemingly never-ending narrative we see pushed to investors that the market is constantly on the verge of the next collapse. Here we are over a year later, and despite the fact that the world has gone through nearly unprecedented economic turmoil due to an ongoing pandemic, the market sits 20% higher than it did on the date we published that blog (March 29th, 2019). We feel that we are seeing a very similar situation today, as we have again been hearing many of our clients and partners expressing concerns over the outlook for the market – often based on alarmist narratives being pushed to them by the media. This is likely being fueled by the recent return to positive territory by the S&P 500 (ie. back in the black), and in this post, we will once again focus on the bright side of things and examine why we believe there is plenty of room for continued upside over the years to come.

One of our favourite fund managers, Noah Blackstein, recently shared some comments about investing for growth – using the example of investing in Walmart in the 1970s. An investment of \$5,000 in this extremely young growth company at the time left untouched would be worth over \$82 million today. Looking at their annual report from 1972, the company had just posted revenue and earnings growth of over 76%, and the runway for future growth was long and wide. However, at the time, it may have felt like it would make more sense to rotate away from this “Generational” company, and into a more blue chip value stock like GE. Doing so would have turned your \$5,000 into a mere \$26,750 48 years later. Trading Walmart for another conservative name like General Motors would have turned your \$5,000 into zero – as they went bankrupt during the global financial crisis. The takeaway here is quite simple: most people don’t remember what the economic situation was like in 1972, what the slope of the yield curve was, or what was happening with unemployment, and no one should care. Opportunities from innovation and disruption can be found everywhere, and today is no different.

Last month, we blogged about some of the most frequently asked questions we receive, and lately, there is one question everyone is dying to know the answer to: Is the market getting ahead of itself, and are we due for a major correction or even a new bear market? We will seek to address a few of the main reasons people seem to feel this will be the case below:

On the length of the bull market:

Our often discussed view based on long-term technical trends that history tends to repeat itself leads us to believe that this is the furthest thing from the truth. “Secular bull markets” are observable going back close to 100 years, tend to last 16-18 years, and are driven by technological advancement. We believe we are currently living through one of these periods, and that it started somewhere between 2013 and 2016, meaning there is plenty of runway left for innovation to propel us higher for years to come.

On speculation and millennials:

One headline that seems to be getting pushed a lot is that the current market rally is being fueled by day trading, speculators, and the so-called “Robinhooders” of the world. This is fueling concerns that the market may be getting ready to “top” and reverse course back lower again. The belief seems to be that the source of these phenomena are millennials, and that they are somehow not a sustainable source of capital long-term. However, we think this couldn’t be further from the truth. The slide below, taken from one of our favourite sources of technical research, Fundstrat, actually shows that the millennial generation will actually be the largest ever cohort of US population, projected to peak at 95.8 million in 2038 (30 million more than Gen X, the current peak income earners). In our view, millennials continuing to build wealth and getting more involved with stocks and investing will actually prove to be a major tailwind for markets, particularly with respect to the industries and sectors they are most interested in.

In addition, we believe that the downside from any near-term “frothiness” caused by speculative money at this point will be limited, as there remains an estimated \$5 trillion in cash on the sidelines waiting to buy into any ensuing weakness.

On valuation and economic conditions:

Once again drawing on some insight from Fundstrat, there are quite a few reasons to be optimistic from an economic perspective, and from a valuation perspective on stocks and the market:

The US economy has likely bottomed, as indicated by falling jobless claims and growth in employment. Many people point to the fact that the market has fully recovered, but the economy appears to still be in the earlier stages of recovery, but this actually has plenty of historical precedent. People often forget that markets are forward-looking, and are already trading based on the outlook for the months and years ahead. Many of the “epicenter” areas of the market are in fact still well below their peaks, and an eventual return to the highs for these stocks would continue to

provide upside for the indices in general. Combining this with a Federal Reserve that has clearly committed to remaining accommodative, and doing whatever is necessary to stimulate the economic recovery, we think that the economic outlook is much better than many people anticipate.

On the valuation side, one thing that makes us very confident in the outlook for the core of our portfolios is that their valuations appear not only reasonable, but extremely attractive. In our opinion, stocks like Facebook, Amazon, Apple, Netflix, and Google (often referred to as FAANG) have incredibly strong business models – enough so that we would suggest that the sustainability of the future earnings streams of these businesses are comparable to the cash flows from an average investment-grade bond. These businesses have not only been able to weather the current economic turmoil, but have clearly emerged stronger and look like they are of even higher quality than previously believed. Bearing this in mind, at the current average yields you can earn on investment-grade credit, it would take you 50+ years to earn back the price paid for these bonds from the income they provide. This compares to something more like 25-30 years of the current earnings on these aforementioned stocks to “earn back” the price paid for them today.

On the upcoming election:

Looking back at the performance of the S&P 500 index since 1928, the Schwab Center for Financial Research found that the market ended on a positive note in 17 of the 23 presidential election years – or 74% of the time – with an average annual return of 7.1%. Additionally, when a new party comes into power, analysts at US Bancorp found that stock market gains averaged 5%, and when the same president is re-elected (or if the same party retains control of the White House), returns were slightly higher, averaging 6.5%. We believe that trying to read through into the effects that all the different election scenarios will have on markets is simply time wasted not identifying opportunities to invest in companies that will continue to drive growth, regardless of the outcome of the election.

Bottom line:

What is really clear to us is that this time is not different. Successful investing has always been achieved by finding growth, investing for a better future, and benefiting from the power of compound interest along the way. We believe that the most innovative, and fastest growing companies on the planet are the ones that will continue to shape our future, and that those need to be at the core of investors' portfolios for the next decade. Innovation is making the quality of our lives better, making us more productive, less polluting, more conscious about our decisions, and better off as a society in general. Growth will only accelerate further after this pandemic has come and gone, and we believe those who share in these beliefs with us will be well compensated. Stay tuned for details on an upcoming webcast in which we will explore some of the trends and technologies we see shaping the future, and how our portfolios are invested to benefit from these.

For those about to rock... and invest, we salute you!

Sincerely,
Di Iorio Family Wealth

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