Despite rapidly escalating coronavirus case numbers around the globe the S&P500 Index continues to trade near all-time highs. As more restrictions are being reintroduced it is a certainty that economic growth will be negatively impacted in the near term. Let's not forget how fortunate we are, only eight months ago Bill Gates and the ever present health experts said a vaccine was at least two years away and 60% to 70% efficacy was the best we could hope for. The US Congress is negotiating a fiscal relief bill that would help bridge the gap until vaccinations become more available to all and it is badly needed. As I have said so many times, stock markets are forward looking, discounting the anticipated conditions we will be experiencing in six to nine months. As such it is not that surprising that markets remain strong assuming a rebounding economy and return to a more normal way of life by the summer of 2021. Nevertheless, the degree to which this consensus is so widely accepted makes me uncomfortable. There is an overabundance of enthusiasm in financial markets reflected in many areas; sentiment indicators are exceeding bullish; index and individual stock options are heavily to the buyside; IPOs like Airbnb and DoorDash skyrocketed due to huge demand; margin debt is nearing old highs. All of the above and other signs suggest to me that investors currently have little or no concern for risks and that can make for dangerous times. But as John Maynard Keynes wrote "the market can stay irrational longer than you can stay solvent". Let's not forget the "Donald" has a month to do something unbelievable and screw everything up. My hope is the market will work off these excesses in the short term and allow me to remain positive on the longer-term outlook.

There is little argument in my mind that once enough people receive the vaccine and the so-called "herd immunity" kicks in there will be a surge in the economy as the population excitedly gets out of the house and goes to restaurants and takes vacations. The question is what will the follow through look like. I think the Georgia Senate runoff elections will have a big impact. If the Republican candidates win both or split the seats, Republican control of the Senate will continue and in all likelihood, legislation will be difficult to get passed and the economy will revert to pre-pandemic levels of slow grinding growth. If on the other hand the Democratic candidates take both seats (not the expected outcome) that party would dominate policy and in my opinion fiscal spending will accelerate along with the rate of economic growth. As evidence of the difference in spending plans the Democratic proposal for the current stimulus bill started at $2.5 trillion but Republican negotiations have reduced it to less than $1 trillion.

More growth sounds great but we have to be careful what we wish for. If spending gets out of control and modern monetary theory is the policy of the day the risk of an overheating economy and inflation and Fed tightening become a real concern for financial markets. We are already seeing an uptick in the CPI and a lower U.S. dollar suggests higher commodity prices. Should that transpire, for the first time in a long while the argument for Canadian economic and market outperformance is realistic. A final thought: will the supply line problems experienced during the pandemic result in attempts to restore industrial production to North America? There are two things we don't need during the festive season; a bear market or long investment letters so…

Happy and safe Holidays to all.

Disclosures

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