Real life requires active management. November 30,2020

E.Q Trendwatch™

Warp speed

Venable Park Investment Counsel Inc.

33 Clapperton St.
Barrie ON L4M 3E6

Tel: (705) 792-3991
Toll Free: 866-792- 3991
Fax: (705) 792-3992

Cory Venable

CIM, FCSI, CMT
Market Analyst

Danielle Park

LL.B., CFP, CFA
Portfolio Manager

Venable Park Investment Counsel Inc.
www.venablepark.com

"This winter will be hard. So, we will not have a big impact on the infection numbers with our vaccine in this winter."

--Dr. Ugur Sahin, developer BioNTech Pizer vaccine Nov 2020

"If people think that by March everybody is going to be out of the woods because we're all going to get vaccinated, that doesn't work. We expect that those non-pharmacological interventions like physical distancing, mask wearing ... will likely need to still be in place for another year or so because we don't expect most ...Canadians to have been vaccinated before that time."

--Dr. Caroline Quach-Thanh, Cdn Nat'l Advisory on Immunization, Nov 24, 2020

In this edition: November brought the election of a new American President and the announcement of 'warp speed' favorable trial results for COVID-19 vaccines. Stock and commodity prices leapt, but in truth, consensus forecasts had already more than priced in the presumption of a concluded election and widely administered vaccine in 2021. In the meantime, the virus has the upper hand and realists warn that the economic fallout will take years to repair and deeply-divided-governments reduce the size of fiscal stimulus expected. The one-month market implosion February to March roared back to mania and record leverage by November. Historically, asset prices fall for 9 to 24 months during recessions. While vaccine hopes and stimulus are boosting market jubilance in the near-term, bubble-pricing, stubborn economic problems and hopes for a swift return to normal leave much room for disappointment. The cure for financial mania is a decline deep and long enough to crush speculative spirits and restore quality investment prospects. In the meantime, defensive, principal-secure assets offer the best financial strength and stability for individuals.

It was a year ago that stories first began circulating of a novel coronavirus outbreak in China. By January 10, 2020 Chinese scientists had isolated the virus and released the genetic sequence of the nCoV to global researchers. By February 15, more than two dozen companies were working on a vaccine and, just nine months later, three of them announced favourable human trial results in November. The graphic on left (courtesy of The Guardian) summarizes the 8 leading contenders to date.

Most promising vaccines in development

Organisation	Country	What type is it?	When could it be ready?
Moderna	US	mRNA vaccine	Interim data showed the vaccine has an efficacy of 95%. A limited quantity is likely to be available in the US by the end of the year and globally next year
Pfizer/ BioNTech	US/Germany	mRNA vaccine	Interim analysis showed it was 90% effective in protecting people from transmission. It will probably be available in limited quantities in the UK by the end of the year
Oxford University/ AstraZeneca	UK	Adenovirus vector vaccine (it uses the virus that causes colds in chimpanzees)	Interim results due in weeks and, if good, limited quantities could be available by the end of 2020
Novavax	US	Protein adjuvant vaccine (boosts immune system)	If phase 3 trials, which include 10,000 UK volunteers, go well, there may be doses available in the second half of next year
Janssen Pharmaceuticals (part of Johnson& Johnson)	US	Adenovirus vector vaccine	In phase 3 trials and expected to deliver in the second half of next year if all goes well
Valneva	France	Traditional approach with a whole, inactivated virus	Doses to be manufactured in Scotland and available in second half of 2021 if safety and efficacy data is good
Sinovac	China	Traditional approach with a whole, inactivated virus	In phase 3 trials in Brazil, Indonesia and Turkey. Interim data expected in November. Trials in Brazil have resumed after one participant died by suicide. Has already been offered for emergency vaccination in the Chinese city of Jiaxing
Sanofi/GSK	France	Uses the same recombinant protein-based technology as one of Sanofi's seasonal flu vaccines. GSK contributes an adjuvant, that will be mixed in with the vaccine to trigger a stronger immune reaction	Phase 3 trials due to start in December involving more than 30,000 volunteers in different countries. Approval expected by June 2021

In science fiction, a warp drive is a theoretical propulsion system that enables a spacecraft to travel many orders of magnitude faster than the speed of light.

Operation Warp Speed (OWS) was the name given to the COVID-19 response partnership among the US Department of Health and Human Services, including the Centers for Disease Control and Prevention (CDC) and the US Department of Defense. Their mission: to engage private firms and government agencies to coordinate and accelerate COVID-19 therapeutic interventions and deliver a vaccine to 300 million Americans in record time. Manufacturing of hopeful drugs began on an industrial scale before their efficacy and safety could be proven.

The graphic on right shows the number of participants in Phase-3 trials for each of the seven leading vaccines—4 of them American. Questions remain about any long-term side-effects, ability to prevent transmission, duration of immunity, and efficacy in the elderly and children.

There have been incidents of COVID-19 survivors becoming re-infected and studies show falling antibody levels within months of recovery. Experts think that booster shots will be periodically required.

A full field

Selected covid-19 vaccines in phase-three clinical trials, 2020

Developer	Type	Doses	Participants*	Study location	Phase-3 start date
Johnson & Johnson	Viral vector	1	60,000	International	Sep 7th
AstraZeneca/Oxford University	Viral vector	2	50,000	International	Aug 28th†
Novavax	Inactivated	2	45,000	Britain, US, Mexico	Sep 28th
Pfizer/BioNTech	mRNA	2	43,998	International	Jul 27th‡
Gamaleya (Sputnik V)	Viral vector	2	43,600	International	Sep 7th
Moderna	mRNA	2	30,000	United States	Jul 27th
Sinovac	Inactivated	2	27,980	International	Jul 21st

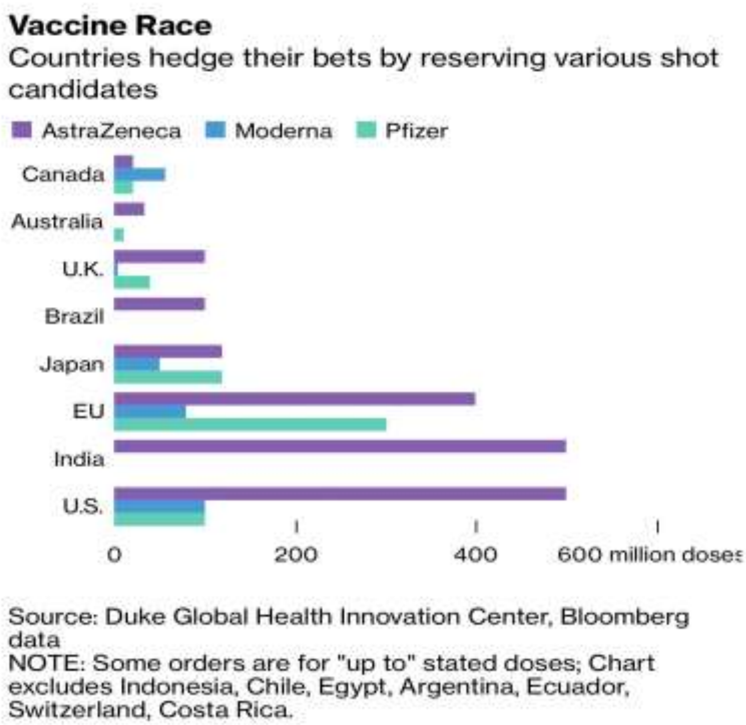
Sources: PLOS; VFA; ClinicalTrials.gov; press reports *Estimated number of enrolees in phase three †US trial ‡Announcement of phase 2/3

The Economist

Participants in Moderna and Pfizer's coronavirus vaccine trials reported high fever, chills, body aches, bad headaches, daylong exhaustion and other symptoms. Doctors worry that side-effects could deter some recipients from returning for the necessary second shot required four weeks after the first.

Initial doses to frontline workers and vulnerable people are to begin in the US if the FDA grants an Emergency Use Authorization (EUA) in the days following the FDA Advisory Panel Meeting scheduled for December 8 to 10. This is likely a done deal, although, FDA vaccine advisory board committee member, Dr. Cody Meissner noted this month: *"We all have a healthy skepticism because companies clearly want to sell their vaccines."*

National agreements defining who is vaccinated, in what order, must be defined. Pfizer suggests approval for the general population should come "several months" after the EUA. In the meantime, experts caution that so long as new case growth outpaces vaccinations, any improvement in hospitalization rates will be slow and overwhelm a vaccine with even 100% efficacy.

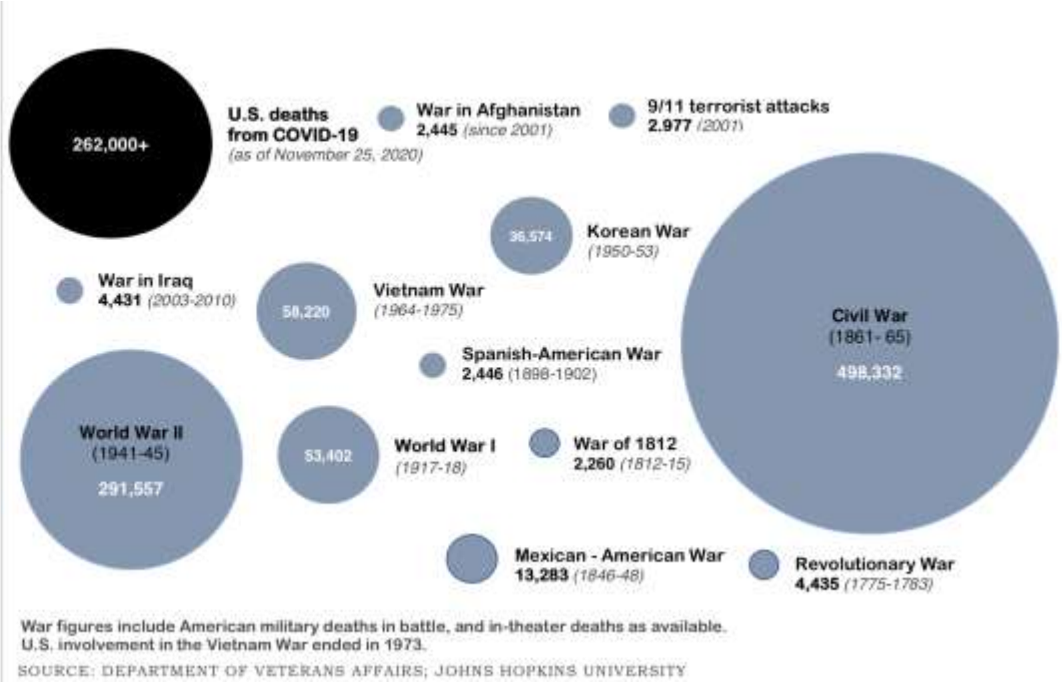


As shown on the left, nations that can afford it have been pre-ordering frontrunners. According to Citigroup analysts, the highest income countries have collectively secured 85% of total bilateral pre-orders of Covid-19 vaccines. The U.S., U.K., Japan, Canada, Australia and some in the European Union have ordered supplies that exceed their populations. In these countries, the consensus view is that most people who seek vaccination should have it by at least by the end of 2021. Uneven vaccination suggests an uneven global recovery. Some countries, like Australia, have said they are planning to proactively share any excess stock with less affluent neighbours.

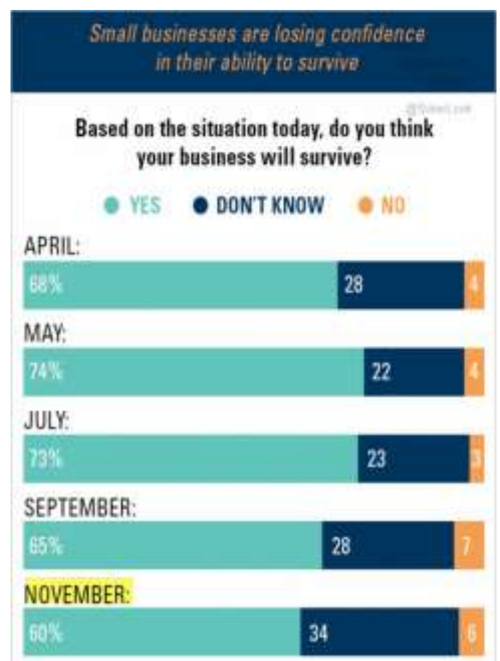
Producing the billions of doses needed, along with sub-zero storage, distribution, and the reticence of many to trust vaccines (particularly rushed ones) are all hurdles. In June, a group of researchers asked 13,000 people in 19 countries if they would take a safe and effective vaccine; more than a quarter of respondents said no. In September, a Pew survey found just 51% of American respondents said they would take a COVID vaccine.

In general, vaccine coverage of at least 70% is considered necessary to achieve herd immunity. The National Institute of Allergy and Infectious Diseases director, Dr. Anthony Fauci, noted this month that vaccine skeptics along with mutating versions of the virus mean COVID-19 may never be eradicated, "*I think we need to plan that this is something we may need to maintain control over chronically."*

Meanwhile, fatigue on distancing measures is helping a second wave spread about triple the pace of the first. Despite official recommendations to stay home, some nine million travelers passed through U.S. airports around US Thanksgiving last week and AAA estimated that some 48 million auto travelers were on the road for the holiday—a 4.3% drop from this time last year. Christmas is next. Holiday get togethers will accelerate illness and fatality numbers.



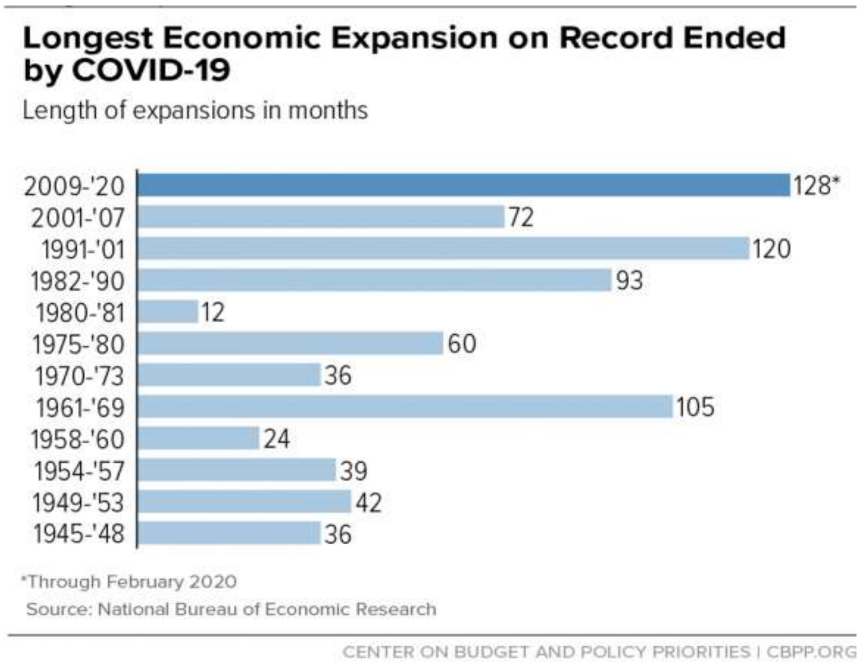
The scale of human loss to date has already been historic. In March 2020, the National Institute of Allergy and Infectious Diseases estimated that one to two hundred thousand Americans could die from COVID-19 and were denounced by some as alarmist. Eight months later, **November closed with reported US COVID deaths above 266,000—higher than the total American lives lost in World War I, Vietnam and Korea combined, and on track to surpass the 291,557 Americans lost in World War II within 2 weeks (graphic on left)**. A more recent reference: a daily average of 2000 US deaths is equivalent to a 9/11-scale-terrorist attack every 1.4 days. America, of course, is not alone in loss.



Canadian COVID-19 deaths exceeded 12,000 in November among 1.46 million recorded fatalities worldwide. At month-end, more COVID-19 patients were hospitalized in North America than at any other point since March and over 600,000 health care workers had retired or left their job.

As lockdowns and layoffs resumed in November, just 55% of US and 78% of Canadian jobs lost in March and April had been recovered. Randy Quarles, the vice chair for supervision at the US Federal Reserve, opined this month that it could be as late as 2023 before the economy returns to pre-COVID-19 levels. Historically, getting back to pre-recession employment levels has taken an average of four years from the cycle peak. The deeper than average contraction suggests that recovery this time will take longer than four years. Surveys this month found 40% of small businesses (the largest source of jobs) were doubtful they will survive (see chart on right). Just 26% were this pessimistic in July.

President Trump took office in January 2017 in the 91st month of an economic expansion that began in June 2009. Tax cuts and unprecedented accommodation from central banks helped to extend the expansion to a record 128 months (table on left) when it ended in February 2020 after the slowest GDP growth rate ever recorded.



President-elect Joe Biden takes office on January 20, but nearly a month after the election, the outgoing administration is refusing to concede its loss or share information about the pandemic and national security. According to the Wall Street Journal, advisers to President Trump say that even though he understands he won't win the fight to overturn valid election results, he remained intent on pushing the legal battle as far as it will go because "*he believes he was robbed.*" We recommend Michael Lewis's excellent book *The Fifth Risk: Undoing Democracy (2018)* on the risks-inherent in a disorderly transition of power.

Mayhem in America is negative for other closely linked economies. The Canadian-US border has been closed since March and was extended this month to at least December 21. US emergency support programs are set to lapse on December 11, 2020 and the deeply-divided-government delays and reduces the size of fiscal stimulus expected. Central banks are gearing up for even more asset buying from financial intermediaries, and partisan standoffs are rife: US Treasury Secretary Steven Mnuchin last week asked the Federal Reserve to return unused cash earmarked for virus-related emergency loans by the end of December. The Fed has said that it *"would prefer"* that the funding stay in place to support *"our still-strained and vulnerable economy*." (source: NY Times). Mnuchin was unmoved, leaving it to incoming Biden appointee, Janet Yellen, former Federal Reserve Chair, to barter new loan programs through Congress in 2021.

The extent to which new President-elect Joe Biden can deliver on his campaign promises for higher corporate taxes, green investment to offset climate change, forgiveness of some student debt and an increase in funding to pursue tax avoiders will only become clear on January 5, once two pivotal Senate seats in Georgia are filled.

In some areas, President Biden can issue executive orders to quickly reverse some of the executive orders that President Trump had issued before him. As geopolitical specialist Ian Bremmer summarized in his weekly letter this month: "*That will mean a significant reassertion of the administrative state and heavier regulatory oversight in every area of the US economy, most particularly around environment and big industry.*"

An illumination of the COVID-19 pandemic has been the extent to which individual behaviours can help and

hurt collective health. The awareness is expanding around issues of climate, water, air, health and food.

Biden has promised a clean-energy agenda, to continue putting 'America first', and to issue executive orders to cancel the revived-by-Trump-Keystone pipeline and introduce *"aggressive methane pollution limits for new and existing oil-and-gas operations"* as soon as he takes office. He has also promised new requirements for publicly traded companies to disclose climate risks and Green House Gas emissions (global initiatives led by ex-Bank of Canada head Mark Carney), and to apply a 'carbon-adjustment fee' "*against countries that are failing to meet their climate and environmental obligations."*

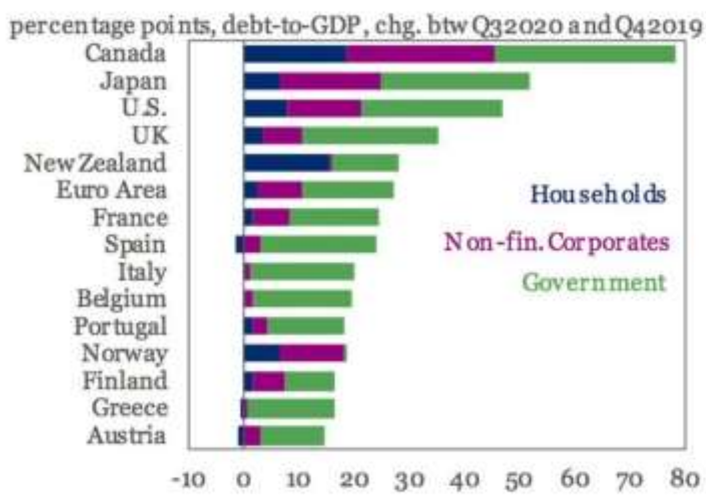
The sectors poised to benefit include solar, wind, hydro and geothermal along with materials and services that improve the energy efficiency of buildings and transportation. Canada will need to update its regulation, incentives and tax policy if we are to attract green-investment dollars and related jobs amid intense global competition in this rapidly growing area. While oil prices rallied this month on vaccine hopes, the Organization of the Petroleum Exporting Countries (OPEC) reduced its 2021 global demand forecasts citing a weaker-than-expected economic outlook and surging virus.

Analysts estimate that some 40 to 50% of business travel will not resume when the pandemic ends. Virtual meetings, work-from-home, electric vehicles and rising energy efficiency are all permanently reducing fossil fuel demand. In November, the United Kingdom became the latest country to ban the sale of new gas and diesel cars by 2030—a decade sooner than previously targeted.

While the Obama administration also came into office at a tough time in January 2009, Democrats then commanded a large majority to enact stimulus plans—something Mr. Biden won't have even if Democrats win the two remaining Senate seats in January.

Moreover, in 2009, there was no pandemic and the debt on the balance sheet of households, governments, corporations and central banks was a fraction of present levels. At $300 trillion today globally, **total debt—households, corporations and government—as a percentage of GDP has leapt for all mature economies year over year (see right).** Canada led G20 countries with a near 20% increase in total debt/GDP and a federal deficit of some $343 billion. More debt supports spending in the near-term, but cannot replace lost revenue, and ultimately reduces cash flow available for future spending and investment.

Chart 2: Sharp spike in debt ratios across mature markets

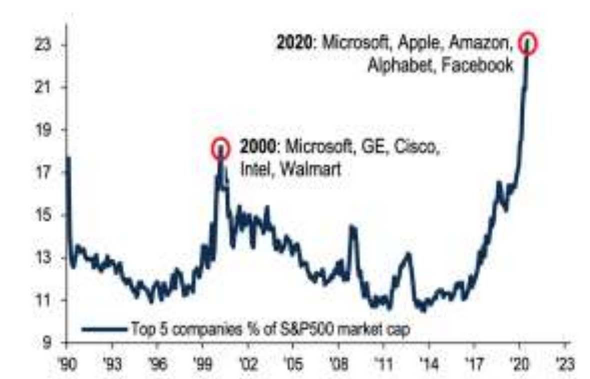


Source: IIF, BIS, IMF, National sources

In the first quarter of Obama's Presidency, stock markets ended a 15-month bear market that had lopped 50% to 80% off security prices and finally restored some attractive yield and investment prospects. The Biden administration has no such luck.

After the fastest one-month bear market in history—February to March 2020—a warp speed rebound since has returned prices to extreme bubble territory once more, with **the top five largest tech stocks—Microsoft, Apple, Amazon, Alphabet and Facebook—making up 23% of the overall S&P 500 index and even more concentrated than the top five companies at the tech bubble top in 2000 (as shown on right).**

Chart 10: Top 5 stocks % of SPX market cap at all-time highs



Source: BofA Global Investment Strategy, Bloomberg.

In November 2020, US stocks have the grotesque distinction of being priced in the 91 to 100th percentile of all historically relevant valuation metrics in the last century as shown below. This has baked in the probability of negative annualized returns from present levels for the next 10 to 12 years.

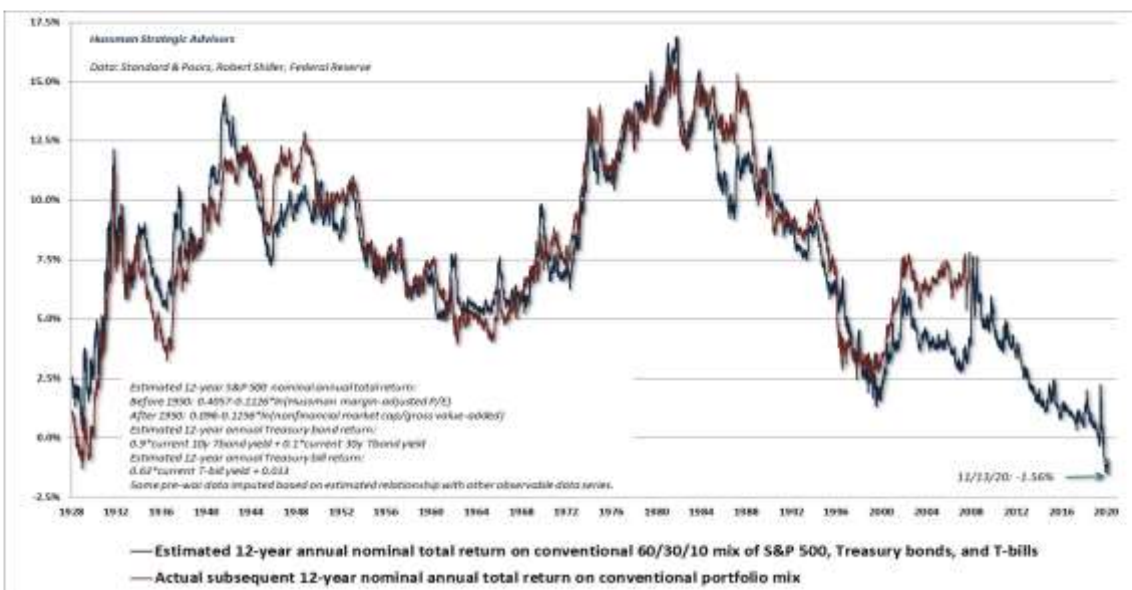
S&P 500 Valuations

Model Factors	Most Recent Value	Historical Percentile
Median EV to Sales (Ex-Financials)	4.0	100%
US Total Market Cap to GDP	170%	100%
EV to Free Cash Flow Margin-Adjusted (Ex-Financials)	48.8	100%
Median Price to Sales	2.8	100%
Median Price to Book	3.9	100%
Median EV to EBITDA (Ex-Financials)	15.0	100%
Aggregate EV To Sales	3.0	100%
Aggregate EV to Trailing 12M EBITDA	17.5	100%
Aggregate EV to 2021 EBITDA Estimate	15.9	100%
Aggregate Price to 2021 Book Value Estimate	3.8	100%
Aggregate Price to Tangible Book Value	12.8	100%
Aggregate Price to Earnings	27.9	98%
Cyclically Adjusted P/E (CAPE)	32.9	97%
Aggregate Price to 2021 Earnings Estimate	25.6	97%
Aggregate Price to Book	3.9	93%

Source: Bloomberg, Yale/Robert Shiller, John Hussman *Numbers as of November of 2020 ©2020 Crescat Capital LLC

As charted below by John Hussman, the projected 12-year nominal average annual total return from present levels for a typical passive portfolio invested 60% in stocks (the S&P 500), 30% in Treasury bonds and 10% in Treasury bills (cash) is now -1.56%--worse than at any time including the bubble tops of 1929 and 2000. <u>A higher stock-weighted portfolio is projected to fare even worse</u>. **The red line below shows how near-perfectly the actual subsequent 12-year total return on a balanced portfolio has tracked its projected return through time**.

In our time of sub 1% interest rates on principal-secure holdings, many people have moved their savings into principal-insecure holdings in the hopes of picking up yield nickels in front of oncoming trains. This has all increased downside risks and funding challenges from here.

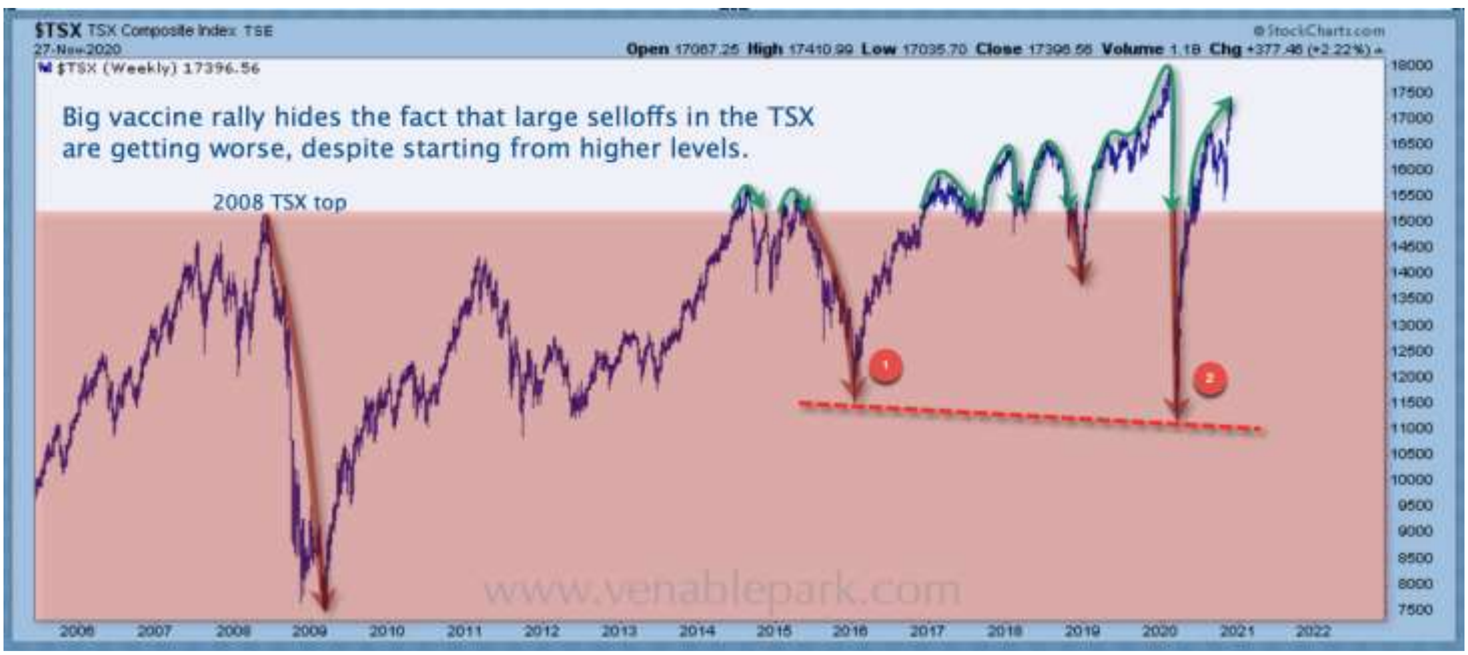


As GMO co-founder Jeremy Grantham observed this month, extremely priced assets in a speculative market can look like progress in the near-term but come with negative returns for years thereafter. There's no free lunch in extreme valuations, just a buffet of longer-term health costs:

> *"The one reality you can never change is that a higher-priced asset will always produce a lower return than a lower-priced asset. You can't have your cake and eat it. You can enjoy it now, or you can enjoy it steadily in the distant future but not both. And the price we will pay for having this market go higher and higher is a lower and lower 10-year return from the peak."*

Emerging market stocks are one of many examples that demonstrate this reality. Even after the longest economic recovery in history (2009 to 2020) and rebound over the last 8 months, emerging market stock prices (EAFE Index) are still below the all-time high they topped at in 2007. Big gains in 2012, 2016-17 and 2019 were all offset by spectacular falls in the intervening years.

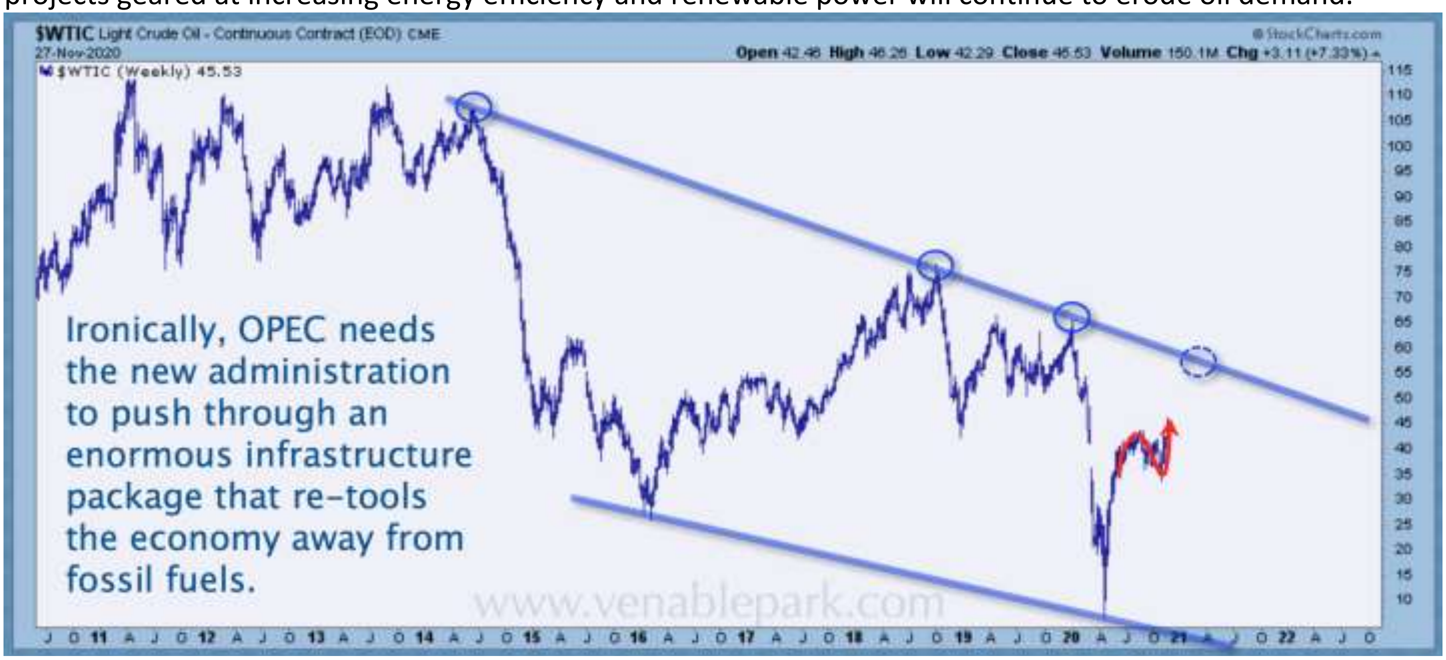
The Canadian stock market has seen a similar fate. As shown below since 2005, from its exuberant cycle high in April 2008, Canada's TSX was 26% lower 12 years later by April 2020. Even with the warp speed bounce since, the TSX closes November 2020 just 15% above its 2008 top and faces the prospect of a third lower-low (beneath 11,000) in its next downside test.



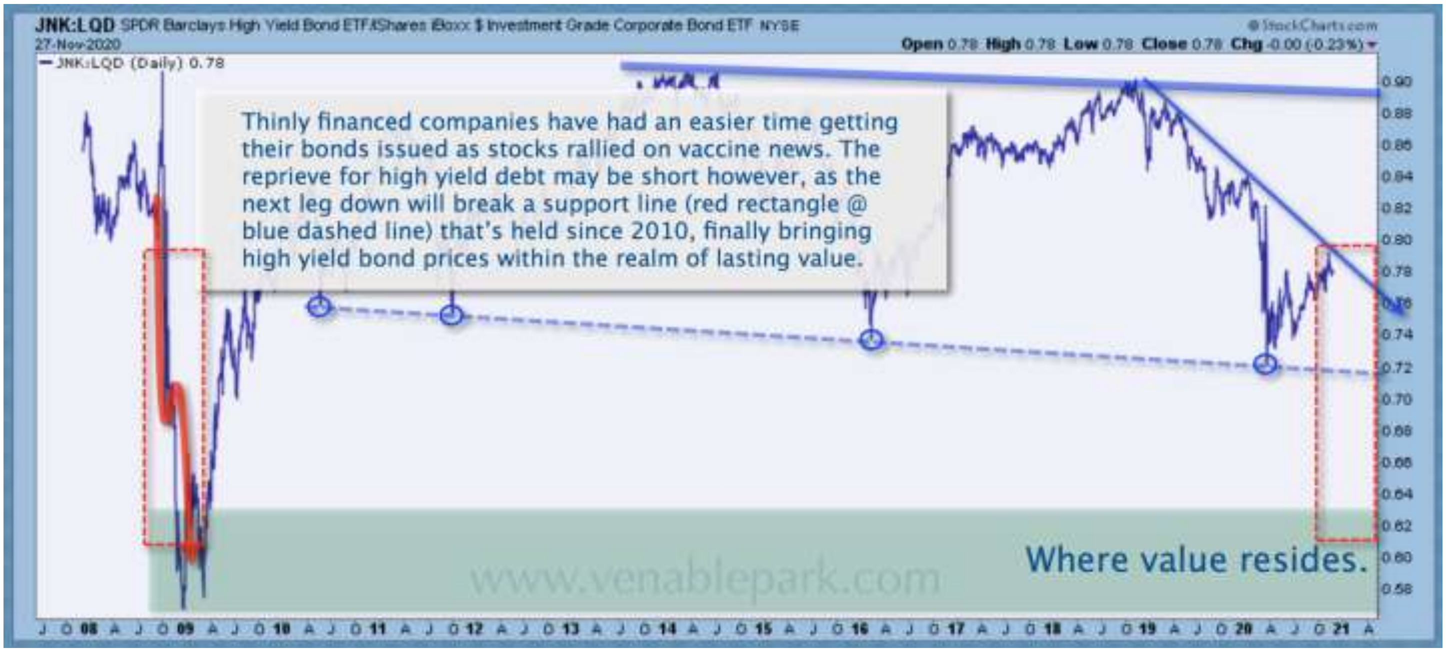
Historically, asset prices fall for 9 to 24 months during recessions and take years to recover. The higher that starting valuations are, the deeper and longer the loss cycle that follows. The one-month plunge in 2020 was a bear in depth but not duration. Financial manias do not end until losses are deep and long enough lasting that they crush speculative spirits, knock out weak players and restore investment prospects for those with cash and discipline. In the meantime, more than ever in our lifetime, defensive and liquid, principal-secure assets offer the best odds of durable financial strength and stability for individuals.

The US dollar weakened in November to retest $1.29 CAD (yellow band) as traders tried to guesstimate the size of monetary and fiscal stimulus that may come in the new year. Less stimulus from a divided government is likely to buoy the greenback and undermine the risk rally, while a break lower could extend it.

Oil (WTIC below since 2010 priced in U$) has been range bound since June as oil consumption has slumped and producers have brought more supply on stream. Oil's best hope in the near-term is that the world will undertake massive, energy intensive infrastructure upgrade projects. In the longer-term, however, these same projects geared at increasing energy efficiency and renewable power will continue to erode oil demand.



Prices for the lowest quality corporate 'junk' bonds (JNK) dropped relative to the highest-grade issues (LQD) from 2018 to March 2020 (blue line below since 2007) before bouncing into November as central banks bought "fallen angel" corporate bonds. Corporate balance sheets are now more indebted than 2008 and bankruptcies are accelerating. This process will take more time to play out, but lower prices will eventually boost yield and capital gain prospects on these bonds and make the survivors investment worthy once more.



US Treasury 10-year minus 2-year yield (in blue since 1995) has widened to positive sloping (short below long) year-to-date. Equity prices and bank shares, in particular, typically fall as this yield spread rises and do not bottom until the spread tops in the 2.6% range (vertical box at top of arrows). Not there yet.

The US 10-year treasury yield, here since 2005, has moved marginally higher since August but remains far below the lows of the 2008 recession. The ongoing bid for government bonds despite historically low yields is a non-confidence vote for the risk rally and its growth and inflation expectations for 2021.

Canada's 10-year government bond yield (here since 2011) has also ticked marginally higher since the summer, but at .68 remains moribund under the weight of Canada's record debt, unemployment and suppressed immigration over the last year. Without a clear growth catalyst interest rates will lack lift.

Vaccine hopes and the largest tech stocks dragged the S&P 500 index back to a marginal new high in November. Equity bulls at 59.2% were an eye-watering 40 points above bears (just 19.4%) in last week's Investors Intelligence Data. Some folks are comfortable driving on thin ice with big cracks; we are not. A third breakdown will test the overly confident.

The price of copper (in blue below since 1990) is considered economically reflective because it is used in the production of so many products and processes globally. Stock prices (S&P 500 in green) are also supposed to be economically reflective. As we can see here though, stocks have wildly overshot the price change in copper since 2012 as central banks and public corporations have relentlessly pumped cash into corporate debt and shares. A lesser disconnect occurred from 1996 to 2003 as the stock market boomed and then burst.

Happy December, may you have peace for the holidays.

"It's incrementally going to get tougher for Biden. He's got bad fundamentals and expensive stocks. That's a recipe for short-term disaster. The stock market is going to be walking on eggshells waiting for Biden to drop the tax bomb at some point. It's just going to be a very different type of dynamic."
—FBB Capital Partners, Nov 2020

"Implicit in holding dividend stocks is the idea that those stocks are not going to suffer capital losses, that they're not going to go down 20 or 30 per cent. And what if these companies start struggling and can't keep up their earnings and have to cut their dividends? There's a lot of risk in dividend stocks, even if we haven't seen that risk showing its teeth yet." —Fred Vettese, Actuary, Nov 14, 2020

"You own bonds in the portfolio to manage your risk, so ignore those folks who tell you to dump your bonds because yields are too low. They are low because, as a price, the bond market is telling you that we are heading into a future of ultra-low expected returns.

There is inflation risk and duration risk in Treasuries, to be sure, but they are unique in their payment safety characteristics. They are the only assets where security and certainty of payment is assured and guaranteed."
--David Rosenberg, Economist, Nov 26, 2020

"The whole of the world is going to be green…If you invest in the greening of the economy, and we get behind it and we do enough to save our bacon, you will make tons more money than betting on the rest of the economy. If we fail, you are screwed anyway."
—Jeremy Grantham, CNBC, Nov 12, 2020

"This Court has been presented with strained legal arguments without merit and speculative accusations, unpled in the operative complaint and unsupported by the evidence."

--Judge Matthew Brann, in rejecting Donald Trump's motion to block Pennsylvania's certification of millions of voters, Nov 21, 2020

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