CUMBERLAND

Private Wealth

First Quarter 2021 Review

GLOBAL EQUITY AND INTERNATIONAL STRATEGIES

Despite a bout of volatility that emerged towards the end of the quarter, global equity markets finished the first quarter with positive gains. The advance in the stock market was driven by improving economic conditions and progress with COVID vaccinations. During the quarter, the United States generated some of the strongest gains on the back of two overriding themes – greater than expected stimulus and an accelerated vaccine rollout. During the quarter, the S&P 500 generated a total return of 6.2%. This compares with a total return of 4.9% for the MSCI World Index.

Economic data has been strong and is providing further evidence that the global economy continues to recover from the COVID-induced recession of 2020. In the United States, the ISM manufacturing index surged to 64.7 in March, far above expectations for 61.5. This manufacturing reading was the strongest since 1983 and the level of new orders was the strongest since 2004. Economic data is also encouraging on a global basis with the J.P. Morgan Global Manufacturing PMI reaching 55.0 during the month of March. This represents a 10-year high and marked the best reading since February 2011.

In addition to strong economic data, the largest vaccine rollout in history is underway. It has been estimated that more than 700 million doses have been administered globally including more than 170 million doses in the United States. Over the last week, an average of more than 3 million doses per day were administered in the United States. Approximately 32% of the U.S. population has received 1 dose and nearly 20% are considered fully vaccinated. The U.S. government has also stated its intentions to have enough supplies available to vaccinate all adults in the U.S. by the end of May. While this is great news for the United States, it is also good news for the rest of the world because once the U.S. has been fully vaccinated, vaccines will be re-directed to the rest of the world. While global cases have been on the rise in recent weeks, the average rate of inoculation is outpacing the rise in new cases.

Outlook for 2021:

As we think about the remainder of 2021, we are cautiously optimistic about the prospects for global equities. There are several reasons for our positive stance but there are also some risks to consider.

Starting with the positives, we expect a strong global economic recovery to unfold as the year progresses. The swift actions taken by central banks and governments in the early stages of the pandemic and the global vaccine rollout are key factors that will drive the recovery. There are also several other factors that come into play including the type of recession we just had. The recession of 2020 was a different kind of recession given that it emerged out of left field in the form of a global pandemic. Looking back in history, most recessions are caused by imbalances in the economy or overheating which forces the hand of central banks to raise rates to choke off inflation. But the recession of 2020 was not caused by the typical factors that lead to recessions. This is very important because the consumer was in good shape prior to COVID and the financial system was in excellent shape. Global Corporations also went into the recession from a position of strength. The reason this is important is that most economic recoveries begin in a very gradual manner. In a typical recovery, personal households need time to rebuild their income and their savings before they feel comfortable spending. Corporations also typically need time as they wait for demand to recover and as they repair their balance sheets. And governments also need time to recover lost tax revenue. But in this COVID front-loaded economic recovery…households, corporations, and governments are flush with record amounts of cash. As a result of this, they can simultaneously contribute to the global economic recovery. That is what makes this recovery different from the typical economic rebound. In addition, there is huge pent-up demand from consumers given that most people have been trapped inside their home for over 1 year now. As we exit the pandemic, there will be substantial demand for dining out, travel, sporting events, and concerts. There is also a US $2 trillion infrastructure proposal in the United States courtesy of the Joe Biden administration. Putting all of these variables together, we see a path to a strong global economic recovery. The level of growth is likely to be the strongest we have seen in decades.

Now let us consider some of the risks. There are new variants of the virus, valuations are elevated, and there are concerns about the potential for inflation. In terms of the new variants, they are a concern but thus far we have not seen anything to suggest that the vaccines are not effective against the new variants. In fact, Pfizer recently stated that its vaccine is 100% effective against the variant from South Africa. Furthermore, Pfizer said their studies have found no serious safety concerns related to the vaccine and that the vaccine efficacy was generally consistent across age, gender, race, and ethnicity. With respect to valuations, while it is true that some traditional valuation metrics such as the PE (Price to Earnings) ratio are at elevated levels, not all metrics are at extremes. In addition, stocks appear more attractive than bonds given the prospects for a global economic recovery. Furthermore, when it comes to stocks we don't think of it as a stock market, but rather a market of stocks. Not every stock in the market is expensive and some areas of the market are still providing attractively valued opportunities. Finally, there is the risk of inflation, a concern that has begun to surface more recently. We view this as a valid concern given the vast amounts of stimulus that have been deployed since the beginning of the pandemic. However, taking a step back, investors were fearful of inflation in the aftermath of the Great Financial Crisis in 2008-09. Money printing was rampant in the years that followed the Financial Crisis yet inflation did not materialize. In fact, central banks have spent more time worrying about deflation than inflation over the last decade. At this point, there is still a significant amount of slack in the economy due to job losses associated with the pandemic, so inflation is not a major concern of ours.

Although each of these risks is significant, we believe they are all manageable. And speaking of managing risks, this is where portfolio construction plays a very important part in what we do at Cumberland. The companies that we own are profitable across the business cycle and they generate strong free cash flow even during economic downturns. The companies we own are highly resilient and in many cases, our companies emerged from the COVID pandemic in an even stronger position than they were in previously. Furthermore, our companies hold leadership positions in attractive industries which gives them strong pricing power. This will protect them if the global economy transitions into a higher inflationary environment. We are confident that our companies can handle the setbacks that will eventually materialize down the road.

In summary, we are expecting a strong economic recovery that will become increasingly obvious as the year progresses. Within this construct, we view equities as the preferred asset class to benefit from the recovery. Within equities, we are particularly excited about our global mandates. The U.S. economy has performed well over the last decade and we expect this to continue. However, we believe there is catching up to do in both Europe and the Emerging Markets, which have gone through several years of lacklustre growth. Our global mandates have exposure to these economic regions and are well positioned to benefit as the recovery unfolds.

Phil D'Iorio
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*Cumberland refers to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). CIC acts as sub-advisor to certain CPWM investment mandates including the CPWM Global and International mandates with Phil D'Iorio as its lead Portfolio Manager. Phil D'Iorio is a Portfolio Manager at CIC.