CUMBERLAND
Private Wealth

March 31, 2021

First Quarter

NORTH AMERICAN EQUITY STRATEGY

During the first quarter of 2021, the S&P500 total return index was up +6.2% in US dollars. Adjusting for currency, the S&P500 returned +4.9% in Canadian dollars, as the Canadian dollar appreciated about 1.0 cent, closing the quarter at US$0.795. The TSX total return in the first quarter was +8.1%. As in the fourth quarter of 2020, the market was influenced by the prospect for a vaccine induced reopening of the economy and better than expected earnings. Supporting this were the recent March economic projections from the Federal Reserve (Fed) members shown in **Exhibit 1**, which show further strength in real GDP growth for 2021 and 2022, with the 2021 rate revised up by 2.3% to 6.5% from 4.2% in December representing the strongest growth in GDP since 1983! Interestingly, the unemployment rate was also revised down for each year through 2023 once again approaching the pre-COVID low of 3.5% in February 2020, which already represented a 50 year low! Meanwhile, Core Personal Consumption Expenditure (PCE), the Fed's preferred measure of inflation, is barely expected to rise above 2%, which gives the Fed plenty of cover to keep rates low. And notwithstanding these sharply ramped up forecasts for growth, somewhat higher inflation and lower unemployment, the Fed is still projecting no interest hikes in the forecast period through 2023. Some transitory inflation through the second quarter of 2021 is built into the Fed forecast as we lap lower prices last year due to COVID-19; however, it is not enough to cause a change in their 2021-2023 view.

Exhibit 1
FOMC Forecasts

FOMC Forecasts	Median		
	2021	2022	2023
Real Change in GDP	6.5	3.3	2.2
December Projection	4.2	3.2	2.4
Unemployment Rate	4.5	3.9	3.5
December Projection	5.0	4.2	3.7
PCE Inflation	2.4	2.0	2.1
December Projection	1.8	1.9	2.0
Core PCE Inflation	2.2	2.0	2.1
December Projection	1.8	1.9	2.0
Projected Policy Path			
Fed Funds Rate	0.1	0.1	0.1
December Projection	0.1	0.1	0.1

Source: Renmac, Federal Reserve

However, the bond market may be signaling a different view regarding inflation as US 10 Year Treasury yields rose from 0.93% on December 31st and a low of 0.54% in August 2020, closing at 1.74% on March 31st. Perhaps the interpretation we heard from one strategist sums it up best as to where markets might be today: the stock market is at a point when 'good news is bad news' because bond yields continue to rise on the prospects for further anticipated growth and 'bad news is bad news' because stocks are pricing in good news given the positive forecast for growth. What it comes down to is how much are bond yields competing with stock earnings yields (which is the inverse of the forward price/earnings multiple)? As bond yields rise, bonds become more attractive relative to stocks.

In the table shown in **Exhibit 2** below, we try to answer that question by comparing three recent points in time: October 2020, January 2021 and March 2021 to put the current environment into context. While many strategists try to solve for the equity risk premium discounted in the market (the premium you need to justify owning equities over risk free assets), our approach is to try to understand the implied forward earnings discounted in the market compared to the consensus12 month forward earnings (F12m). As indicated in the table below, in October when the US 10 Year Treasury was trading at 0.74%, the implied forward earnings discounted in the market were just under US $140 as compared to the then consensus F12m earnings of US $157.36. This implied that the market was relatively cheap at least compared to consensus F12m forward earnings forecasts at that time. If we fast forward to today, the opposite is true due to a combination of rising bond yields and the higher level of the market. Today, the implied forward earnings discounted in the market are just north of US $200, which compares to F12m earnings of $180.82. In fact, the consensus earnings according to FactSet for 2021 and 2022 are currently $175.21 and $201.70 based on 9.6% revenue growth in 2021 and 6.8% in 2022, respectively. Now this analysis is not an exact science, but it does suggest that right now directionally, the market is pretty much pricing in year end 2021 or 2022 consensus earnings and could be vulnerable to a pullback or perhaps at least a correction in time until we get closer to year end.

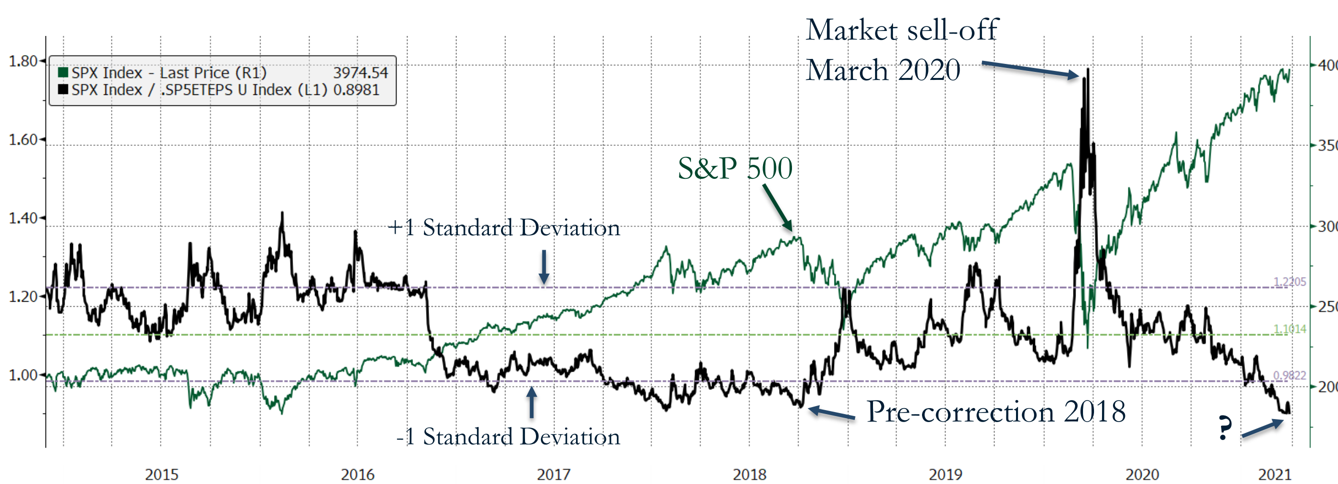
Exhibit 2:
Ratio Consensus Earnings/Implied Earnings vs S&P 500

	Date		
	Oct 6/20	Jan 5/21	Mar 26/21
10-year Treasury Yield	0.74%	0.95%	1.68%
10-year Average Equity Risk Premium	3.42%	3.41%	3.39%
Implied Earnings Yield	4.16%	4.36%	5.07%
Market (close)	3,360.95	3,726.86	3,974.54
Implied Earnings Estimate (per share)	139.82	162.49	201.51
Consensus Earnings Estimate (per share)	157.36	166.55	180.82
Ratio (Consensus/Implied EPS)	1.13	1.02	0.90

Source:Bloomberg (BEst EPS BF12m), Cumberland (Asset Mix Review Dates)

Exhibit 3 shows the ratio of consensus earnings to the implied earnings based on the implied earnings yield and compares this to the S&P500. As you can see in the chart, we highlight the correction we had in 2018 as well as the initial COVID-19 crisis last year. Clearly, the low ratio today is closer to the pre-correction territory of 2018. The difference now versus 2018 is that back then the Fed had increased interest rates four times and was signaling further rate hikes, whereas today it is the exact opposite with the Fed on hold while the GDP growth outlook today is also arguably stronger.

Exhibit 3:
Ratio: Consensus Earnings/Implied Earnings vs S&P 500



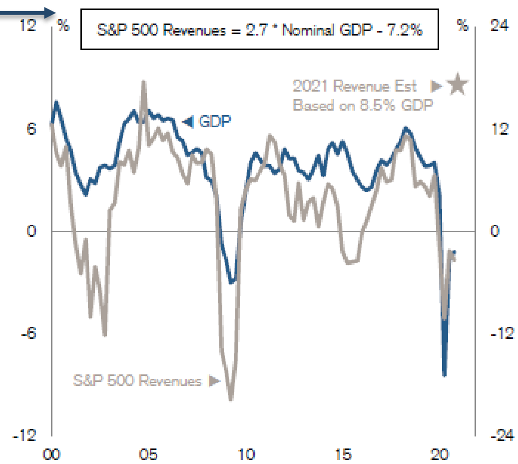
Source: : Bloomberg (BEst EPS BF12m), Cumberland (Asset Mix Review Dates)

In addition, some of the more bullish strategists such as Credit Suisse are moving 2021 and 2022 S&P500 earnings estimates considerably higher to $185 and $210, respectively, based on the almost unprecedented GDP growth forecasts. This could propel overall consensus earnings estimates higher. While consensus Nominal GDP growth for 2021 is currently +7.2% (**Exhibit 4 - right**), the large and presumably more sophisticated banks are estimating +8.6% nominal growth. And these forecasts were confirmed by the recent Fed forecast in March for real GDP growth of +6.5% versus the big banks at real GDP estimates of +6.1%. Applying Credit Suisse's multiplier formula of GDP growth that it uses to estimate revenue growth (**Exhibit 4 - left**), it implies a revenue growth rate for 2021 closer to +16%, not the consensus +9.6% noted above. If their predictions are directionally correct, then consensus revenue and earnings estimates for 2021 and 2022 are likely too low.

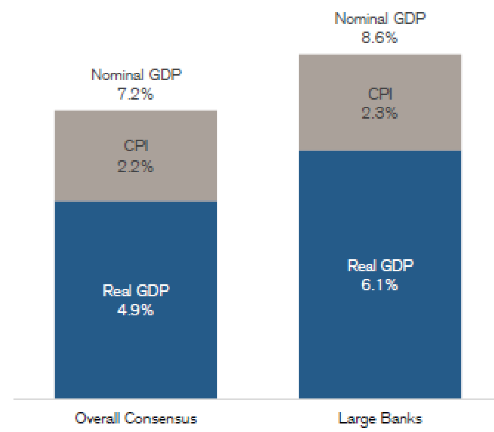
Exhibit 4:
US GDP Multiplier Effect

Multiplier Formula:
Revenue Growth as
Function of
Nominal GDP
Growth

Revenues vs. Nominal GDP



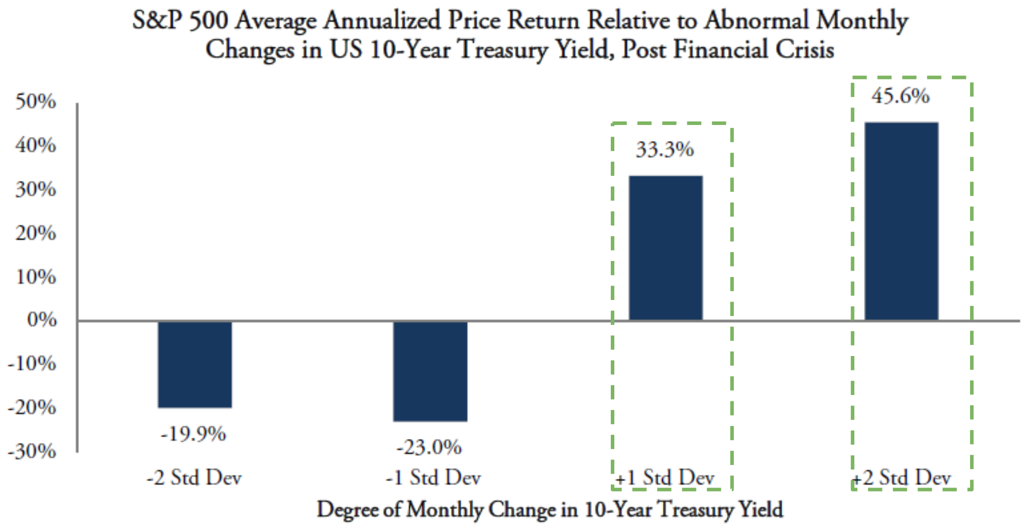
GDP Consensus Estimates-2021



Source: Credit Suisse

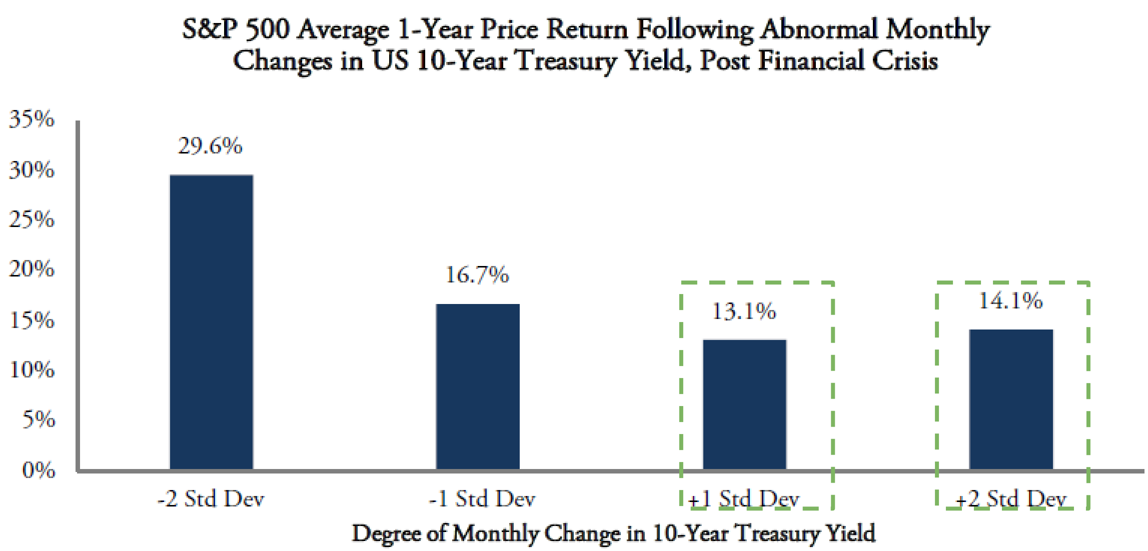
And of course, there is the argument that interest rates should go up because the outlook is getting better! **Exhibits 5 and 6** look at periods of rapid interest rate changes, both positive and negative in the post-financial crisis world as measured in terms of standard deviations and compares them to the performance of the S&P500 both during **(Exhibit 5)** and after **(Exhibit 6)** these outsized changes. The analysis showed that periods of extreme drops in interest rates, similar to what we saw during the COVID-19 crisis **(Exhibit 5)** coincided with substantial losses in the S&P500, while extreme upward moves similar to what we are seeing today coincided with strong gains. Also, in the year after the +1 and +2 standard deviations moves upward in interest rates **(Exhibit 6)**, the average return for the S&P500 was +13.1% and +14.1%, respectively. Intuitively, this makes sense to us as periods of rising rates are usually associated with stronger economic growth and positive earnings surprises.

Exhibit 5:
S&P 500 Performance During Extreme Fluctuations in 10-Year Treasury Yield



Source: BMO Capital Markets

Exhibit 6:
S&P 500 Performance After Extreme Fluctuations in 10-Year Treasury Yield



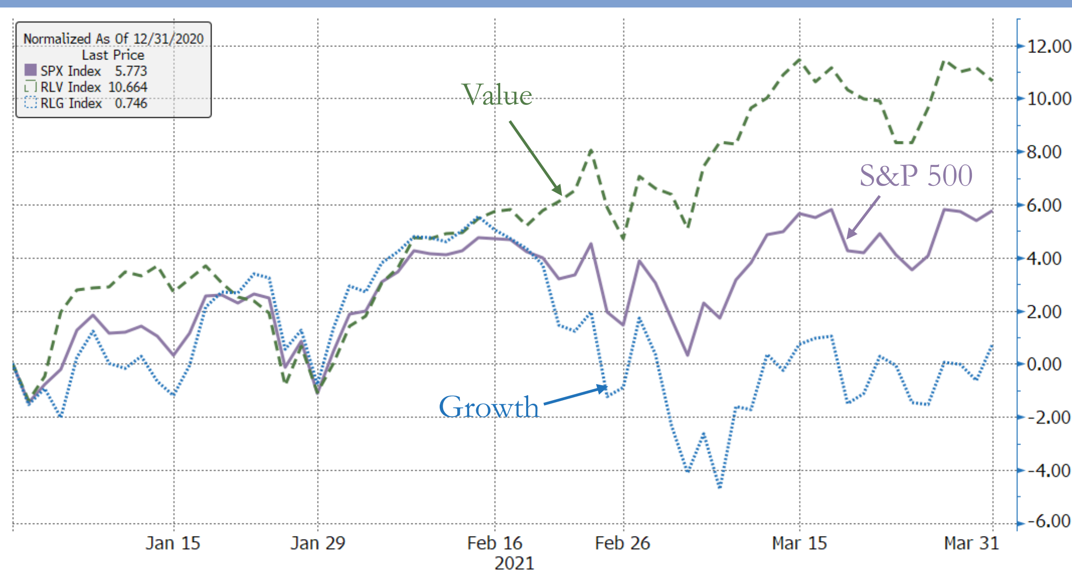
Source: BMO Capital Markets

Asset Allocation for our North American Equity Strategy As at March 31, 2021	
Equities	94%
Fixed Income	0%
Cash	6%

During the quarter, our overall equity exposure decreased by 3% from 97% to 94% at March 31st. Our US equity exposure decreased from 52% to 48% while our Canadian equity weight increased from 45% to 46%. Cash increased from 3% to 6%. It is important to note that many of our clients follow our North American plus International equity strategy within the equity component of their portfolio, given the approximately 20% allocation to international equities, the actual weights of US and Canada will be lower than this.

In the current environment, we have continued to position the portfolio toward the value end of the spectrum to benefit from economic recovery while maintaining about a third of the portfolio in growth stocks. Our current split between growth stocks, which typically rely on trends independent of an improving economy, is about 33% (down from 40% at December 31st) versus value stocks, which are more dependent on and should benefit from an economic recovery, at about 56% (up from 51% at December 31st). Staples, which we don't classify as either growth or value in terms of investing style, make up the balance of our equity exposure. Recent performance in the first quarter continued to benefit from the shift into value stocks as shown in **Exhibit 7**.

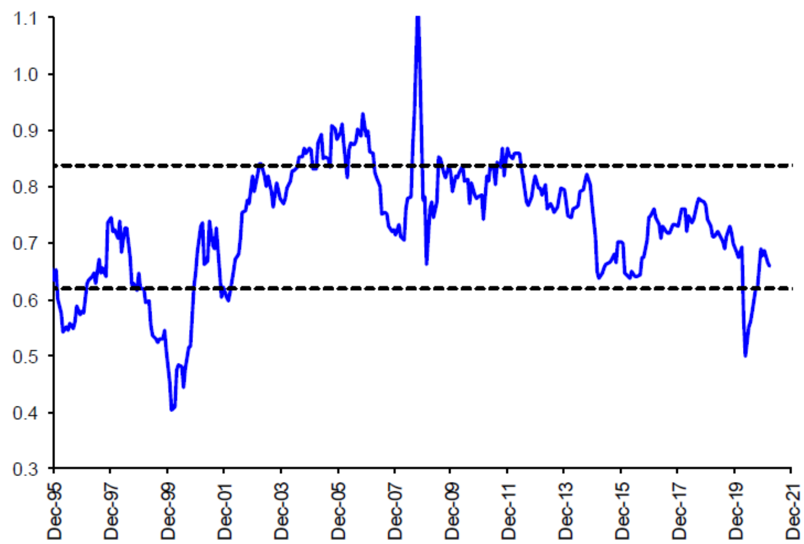
Exhibit 7:
Growth vs. Value Year-to-Date



Source: Bloomberg, price returns in USD from Dec 31/20 – Mar 31/21

Our biggest sector increase and largest sector exposure right now is Financial Services, which should continue to benefit from a steepening yield curve due to rising, long term interest rates. In late March, we learned that the Fed will lift US banks' restrictions on dividends and share repurchases after completion of the June 30th US bank stress test review. We expect a similar response from the OSFI regulators in Canada sometime thereafter, which should bode well for future stock buybacks and catch-up dividend increases for both Canadian banks and insurance companies. **Exhibit 8** shows the relative forward P/E ratio for Canadian banks (the larger portion of our exposure) versus the TSX going back to 1995. Currently, it is trading near the historically lower band of 0.62x the TSX forward P/E multiple, or at about 11x forward earnings. US banks are also expected to report strong first quarter earnings growth, second only to the Consumer Discretionary sector, which we are also overweight in our portfolio.

Exhibit 8:
Canadian Banks: Relative P/E Ratio

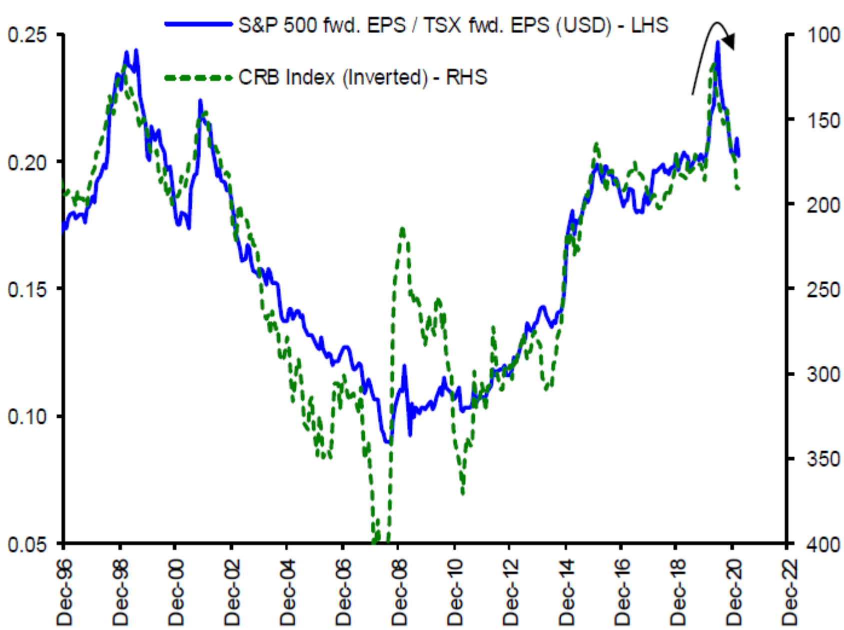


Source: Scotiabank GBM

On the growth side of the portfolio, the decrease in weighting in Q1 was mostly in Communication Services and Healthcare, as we maintained our exposure to Information Technology. During the quarter, the IT sector suffered its own mini-correction as we saw the NASDAQ fall over 10% from mid-February through mid-March again as a result of the rotation towards value stocks. However, heading into the quarter, earnings for 2021 Information Technology are still expected to report year-over-year growth in excess of 22%, about double the expectations on December 31st and about in line with the S&P500 consensus growth rate of about 23%. We remain constructive and may add to this sector on further weakness.

We continue to partially hedge our US dollar exposure; however, our hedge was reduced in March as we believe any short-term pullback in the S&P500 would likely result in US dollar strength. **Exhibit 9** compares the ratio of the S&P500 forward earnings momentum to the TSX forward earnings momentum and the CRB index. The CRB index is a representative price indicator of the current global commodities markets. For the past ten years, outperformance of US stocks was likely driven by strong US earnings momentum as indicated by the upward sloping blue line from 2010 through 2020. However, more recently we have seen a reversal of that trend such that the TSX earnings are now rising faster than the S&P500 driven by the acceleration in commodity prices. We think this should continue to provide relative support for the TSX and the Canadian dollar.

Exhibit 9:
CRB Index vs S&P 500/TSX EPS Ratio



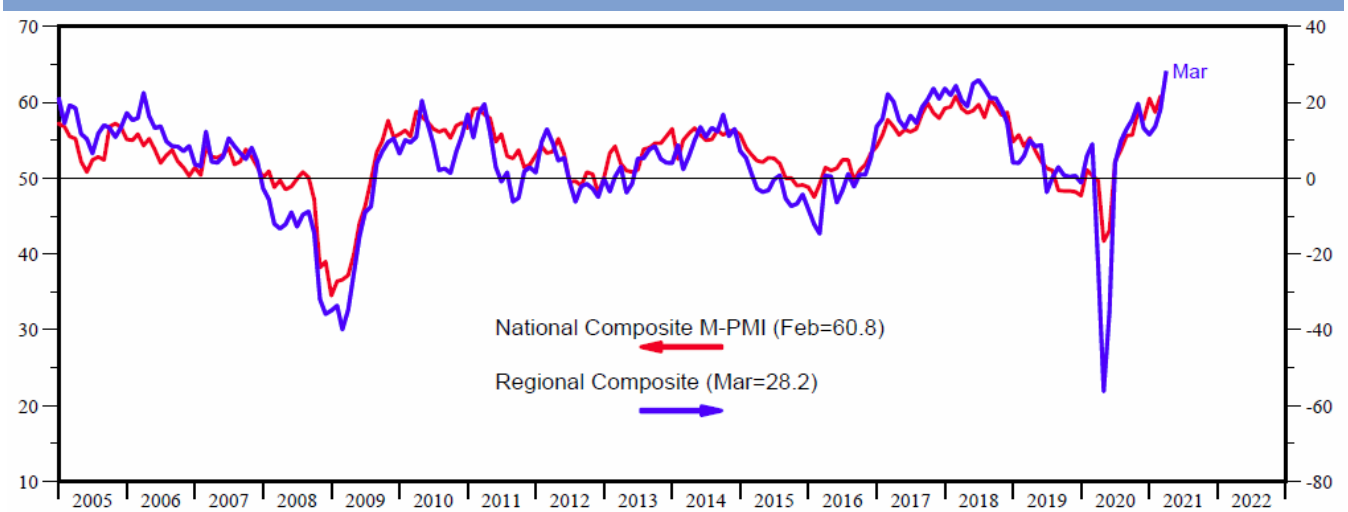
Source: Scotiabank GBM

During the quarter, we added three new positions to the portfolio including U.S. Bancorp, Intact Financial Corp and Dollarama Inc. A complete review of the business and fundamental outlook for each of these companies can be found in **Appendix 1**.

Outlook

Probably the best way to describe the US economy today is "smoking hot". Recent March regional PMI data from the five Fed districts show that the manufacturing sector continues to accelerate. Overall, the composite index for the five districts (**Exhibit 10**) expanded at the fastest pace since tracking the data back to 2004. This suggests the ISM (National) data for March due later this week could also set a record high, leaving the stock market somewhat stuck in the middle between the very strong economic growth and the resulting inflationary pressures that will likely drive bond yields higher, and the potential for this to lead to lower stock valuations. Between the US Treasury's US $1,400 stimulus cheques issued to 250 million Americans in March (adding even more fuel to the fire) and the Fed sitting tight on interest rates, the bond market is open to interpret its own outlook for inflation while the stock market attempts to balance this against the future earnings outlook. The bottom line is that the risks have increased and the market now appears to be pricing in some of that future upside in earnings. Whether that results in a short-term pullback, a correction in time or a complete reassessment of the positive earnings outlook, time will tell. As a result, we have raised a little cash. We are still positive on the economic outlook; however, we will pause for the moment to see how this sorts itself out in the second quarter.

Exhibit 10:
National & Regional Composite Manufacturing PMIs



Source: Yardeni Research

Peter Jackson
Chief Investment Officer
March 31, 2021

APPENDIX 1

NEW EQUITY INVESTMENTS:

NORTH AMERICAN EQUITY MANDATE

CANADA

Intact Financial

Intact Financial (IFC) is a property and casualty insurer (i.e. it primarily insures homes and autos). Its management team has a stellar tack record both in operating its business (IFC's return on equity averages over 5% above the industry's) and in making accretive acquisitions. IFC is in the midst of making a material acquisition of RSA Group of the UK, which we believe will prove to be a real winner. Most (75%) of the value creation will come from the synergies of combining RSA's Canadian operations with IFC's, but the remaining UK and international operations are being acquired at an extraordinarily low implicit valuation whether they are kept or sold off.

Dollarama Inc.

Founded in 1992, Dollarama is the largest and only national dollar store chain in Canada, selling an assortment of general merchandise, consumables and seasonal products. It has expanded its store network to over 1,300 company-operated stores across the country and recently launched an e-commerce platform that allows customers to buy in bulk. Over the years, the company has consecutively demonstrated industry-leading operations and growth that has outperformed its peers. The company expects to continue its Canadian growth trajectory by opening 60-70 net new stores per year towards its long-term target of 1,700 stores by 2027.

In addition to its established Canadian business, the company has expanded into Latin America by acquiring a 50.1% majority stake in Latin-American operated dollar store chain, Dollar City, with over 240 stores already in operation. It will serve as a compelling second growth platform for Dollarama to expand in nine Latin American countries, representing a total addressable market about 4x larger than Canada and characterized by favourable consumer demographics. The combined efforts of its Canadian and Latin American business position the company incredibly well for long-term growth with added torque in the short-term from a favourable Canadian dollar.

UNITED STATES

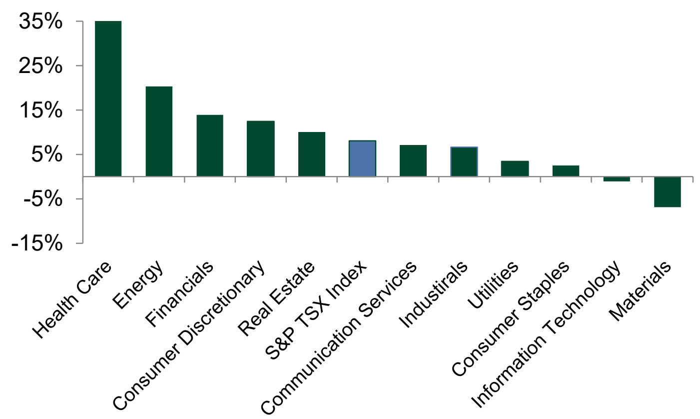
U.S. Bancorp

U.S. Bancorp provides a full range of financial services including lending & depository services, cash management, capital markets, and trust & investment management services. It also provides credit card services, merchant and ATM processing, mortgage banking, insurance, brokerage and leasing. With more than $500 billion in assets, U.S. Bancorp is the 5th largest commercial bank in the United States measured by asset size. Over the last 20 years U.S. Bancorp has been one of the premier banks in the United States and has also been one of the most profitable banks based on its return on equity. Similar to other banks, U.S. Bancorp was hit hard by the pandemic, which negatively impacted one of its distinguishing characteristics, its annuity-like fee revenue stream. As the US economy recovers from COVID, we believe the company will experience a rebound in its fee based businesses and it will also benefit from an improved credit outlook in 2021.

APPENDIX 2

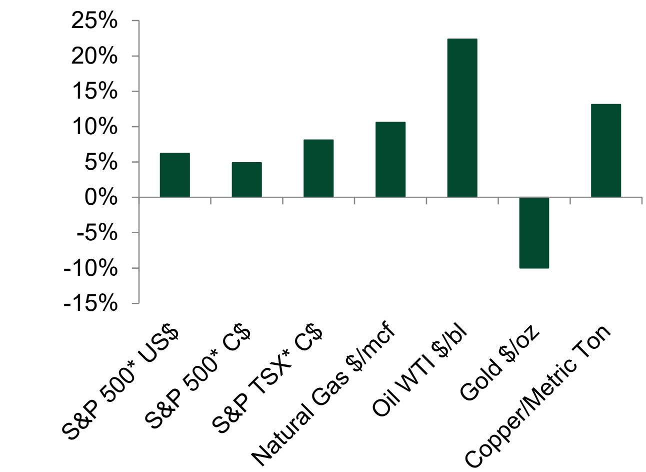
PERFORMANCE CHARTS

S&P TSX (C$ Total Returns)
Quarter Ending March 31, 2021



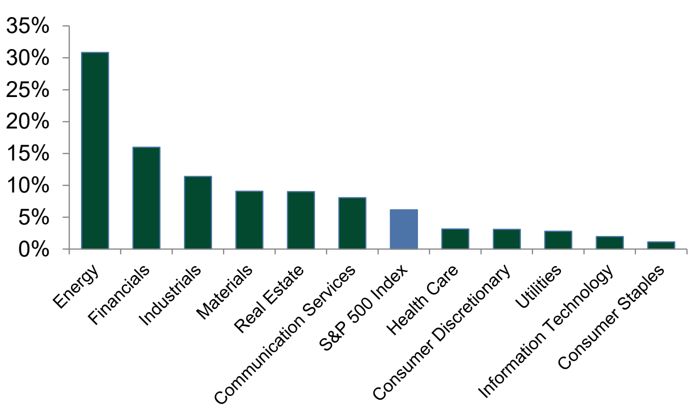
Source: TD Securities

Quarter % Change
Quarter Ending March 31, 2021



Source:Bloomberg *Total Returns

S&P 500 (US$ Total Returns)
Quarter Ending March 31, 2021



Source: TD Securities

*Cumberland and Cumberland Private Wealth refer to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). CIC acts as sub-advisor to certain CPWM investment mandates.