SUMMER 2021

Info SIGMA

Beware the FOMO

COVID-19 has been felt like a huge shockwave throughout the financial markets in several ways. Unfortunately, one casualty in some cases has been investor discipline. The past 16 months have made it hard for some investors to keep their eyes on long term goals. The investor that is most at risk is the one who did not have a well-established discipline from the start.

Uncertainty caused by the pandemic, the huge sums of liquidity sloshing around from injections into the system by central banks financial support programs offered by governments, a population confined to their homes, and the use of social platforms by financial promoters have all created a potentially explosive cocktail. Speculative bubbles have multiplied in certain segments of the stock market. Social networks are playing an increasingly important role in spreading speculative waves. Similar to videos and news stories that go viral, certain stocks and themes are heavily promoted on networks, creating a wave of intense interest in an attempt to drive up the price. It looks a bit like the Old West. There are none, if not any regulations on the information that is conveyed on the networks. It is always astonishing that it is permissible for holders of certain securities or asset classes to promote them in order to increase the value of their positions. The aim is to create the fear of missing out on "the big payoff", commonly referred to as the FOMO, or the Fear Of Missing Out.

The important differences in returns between different segments of the financial markets have not made things any easier. Isn't it tempting to ditch the least performing parts of one's portfolio and only bet on the rising stars that are currently outperforming? Why should I keep holding my dividend stocks and other quality stocks, or REITs while the big growth stocks keep going up?

Our objective for Sigma remains the same, which is to maximize the reliability and persistence of performance of our portfolios over the long term. There is a cost to this reliability; We do of course hold a healthy allocation to the growth segment of the marketplace, as their growth potential is undeniable. But also keep those other asset classes and segments that may underperform one particular year because if there is one constant in the markets, it is that any asset class that outperforms will underperform sooner or late, and those asset classes that may have underperformed will eventually outperform. We call this the return to the mean. The Sigma Balanced and Sigma Income portfolios take advantage of these averages by selling in strength and buying in weakness. This rebalancing discipline allows us to take profits in the outperforming asset classes during their ascent, and to reduce our average cost in the asset classes during their period of underperformance, ensuring that we are well positioned during their return to the mean.

Sometimes a divergence in performance lasts long enough to become a trend. These trends can sometimes last for a very long time. The outperformance of the US stock market over these last years is a good example. But there is a difference between chasing the flavors of the month and benefiting from sustained trends that are supported by a solid macroeconomic background or industry themes playing out. This difference is having an established discipline, and never forgetting that risk management should always be the first consideration.

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Market review

The COVID pandemic is on the decline thanks to vaccination. On the other hand, the arrival of new variants and a hesitation with regards to vaccination pose real challenges. The health crisis is easing, but not uniformly. Some regions of the world have ended their sanitary measures while others are grappling with a new wave of contamination. It's two steps forward, one step back. On the one hand, economic activity is picking up and consumer confidence is returning, but supply chains are not in their best shape as the pandemic remains present in several regions. We have witnessed several shortages. We have all heard of the soaring price of lumber, although it has recently returned to more usual levels. The cost of shipping has also exploded over the past 18 months, affecting the profits of many businesses. This strong recovery in demand combined with supply difficulties are leading to higher inflation. The question on everyone's mid is whether this inflation is transitory or is bound to stay with us. Most economists are leaning towards the transitory inflation scenario as its causes are mostly linked to the particular circumstances we have been experiencing since the start of 2020.

Stock indexes have obviously risen sharply since the announcement of Pfizer's vaccine in at least November, and even more so from their low in March. But behind the general advance are large hidden divergences and deep rotations among the different segments of the stock market Since the trough of March 2020, we can count three distinct phases to the stock market recovery.

The first phase covers the period from the low of March to November 9, the "COVID stocks" period. During this time, tech and e-commerce stocks dominated, along with residential construction, renovation and obviously some pharmaceutical stocks. Aside from the indices holding these sectors to a certain extent, stock market indices had been treading water. This first phase also gave rise to an impressive bull market in high quality bonds, such as government bonds, caused by the drop in interest rates due to fears of a deep recession. Paradoxically, investors during this period took refuge in very safe bonds on one hand, and in the technology sector, one of the most volatile on the stock market on the other. The US dollar and gold also played their traditional roles as safe havens during this turbulent. Meanwhile, dividend-paying stocks and mature, high-quality stocks were largely shunned by investors. Massive injections of liquidity from central banks and governments, along with a homebound population, led to a frenzy of day-trading and speculation that resulted in a succession of bubbles as well as an overvaluation of tech stocks on a scale comparable to the bubble of 1999-2000. On November 9, Pfizer announced its vaccine, and markets do a 180 beginning the second phase. COVID stocks had a substantial pullback, having become expensive compared to even the most optimistic of scenarios. At the same time, stocks that had been shunned to date started their impressive rally. Interest rates had a sharp rise and quality bonds plunged while preferred stocks (mostly pro-cyclical to interest rates) rise. The prevailing scenario went from a world living in a pandemic where everything is done online from home to a scenario of a possible return to normalcy, even if one is not too sure of its timeline. This reversion to the was quite strong, resulting in a catching up of dividend stocks and sectors of a more cyclical nature. The current phase started in mid-June. At this point, dividend-paying stocks, so-called cyclical stocks have caught up much of their lag. After leveling off in the first quarter, growth stocks are attempting another bullish run, despite still posting historically high valuation ratios. It's a race between different market segments, the markets being divided between two scenarios with very different consequences. This tension between the two dominant scenarios will probably continue for some time.

Rebalancing

We often describe the different asset classes as being interconnected. Depending on the economic situation and the circumstances, capital moves from one asset class to another, all part of the same system. It is during periods of uncertainty that our rebalancing discipline shows its full value because no matter which scenario prevails, our Sigma Balanced and Sigma Income portfolios hold the asset classes and market segments where capital eventually goes. In addition, rebalancing opportunities are plentiful during these times of volatility, providing several opportunities to sell high and buy low across different asset classes.

The majority of rebalancing in the first half of the year were to take profits in stock and real estate indices and rebalance upward the bond and gold indices. As an example, the rebalancing for the month of March was to sell US real estate, the S & P500, the Canadian index of dividend stocks, TSX and Canadian real estate, and buy Canadian bonds, real return bonds and emerging market bonds. The rebalancing at the end of June was to take profits in the US real estate index, Canadian real estate, and the S & P500 and rebalance gold, Canadian bonds and high yield bonds.

The asset class rotation basket

The asset class rotation basket's focus on capturing established trends gave it a defensive stance until the November announcement of Pfizer's vaccine. Before November 9, only the S & P500 earned a place in the portfolio, given its fairly large weighting in technology stocks. On December 1st the basket adopts a growth positioning. However, it's not the S & P500 and technology leading the charge in 2021, but rather dividend stocks, real estate and preferred shares.

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We are pleased to announce that Sigma porfolios have been recognized by the ***Foundation of Greater Montreal.*** Please visit fgmtl.org for more information on the organization.

Do you know of anyone that could benefit from our services?
Don't hesitate to contact a member of our team!

YOUR TEAM

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