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We have had a very good move in the stock market. This rise has caused some investors to get their finger hovering over the sell button. To assuage some of this foreboding it may be a good time to update my thoughts on where we are and the structural underpinnings of equities.

Before we start trying to peek into the murky future remember my last note How to Get Rich(er)?. In this I traced the history of the immense wealth that has been created in the last two hundred years. So, if you are a long-term investor which you should be, and don't worry about short term volatility you can stop reading now. This is aimed at those that have an interest in markets and are a bit jittery because of the recent rise.

There is an expression about generals fighting the last war since that is the one they experienced while young. They fail to take into consideration new strategies, technology, attitudes etc. I think this is happening in the investment world today. The big money managers are in their 50s, 60s and 70s. They grew up in a world of high inflation and the corresponding high interest rates. The world has changed on them. Low rates started in Japan a generation ago, then swept through Europe after the Great Recession and are now here. If low interest rates are here to stay, then equity markets still have more upside. Low interest rates make the cash flow from companies more valuable. A lot of large money managers are still running money as though interest rates are going to go back to where they were when they were young. This means there are still a lot of assets to be deployed into stocks that are currently in cash or other alternative investments.

Another factor is that in the past equity analysts have been slow in readjusting their earnings upwards as we come out of a recession. And it is no different this time. In this most recent reporting season 87% of companies beat earnings expectations. And with the economy still recovering these earning surprises should continue. The more earnings companies make the more valuable they are. This is supportive of continuing good markets.

Let us not forget recency bias. This is when a rare event occurs it makes us readjust our calculation of the probability of it happening once again. We then expect it to reoccur much more often than it actually will. We remember the crash that happened in the spring of 2020 and have an unreasonable assumption that the next one is upon us with every negative news article we read. This recency bias lingered for several years after the dramatic fall in 2008. And if anyone had sold in 2009, they would have missed a decade of spectacular wealth creation.

There will be market corrections. These are healthy and normal. And we have had a phenomenal recovery so it will be no surprise if there isn't a significant pullback. There is still lots to worry about. Government debt, supply chain disruptions, continued pandemic concerns etc. But the point to remember is that the underpinnings for a strong market are in place. Low interest rates, cash on the sidelines and improving earnings are supportive of this. So those of us that are feeling jittery try to turn off the shrill, clickbait news and get outside and enjoy the rest of the summer.

Have a great week.

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