Gold Investment Portfolio Manager

Investment Letter

Q2-21 Investment Letter (No. 56)
July 23, 2021

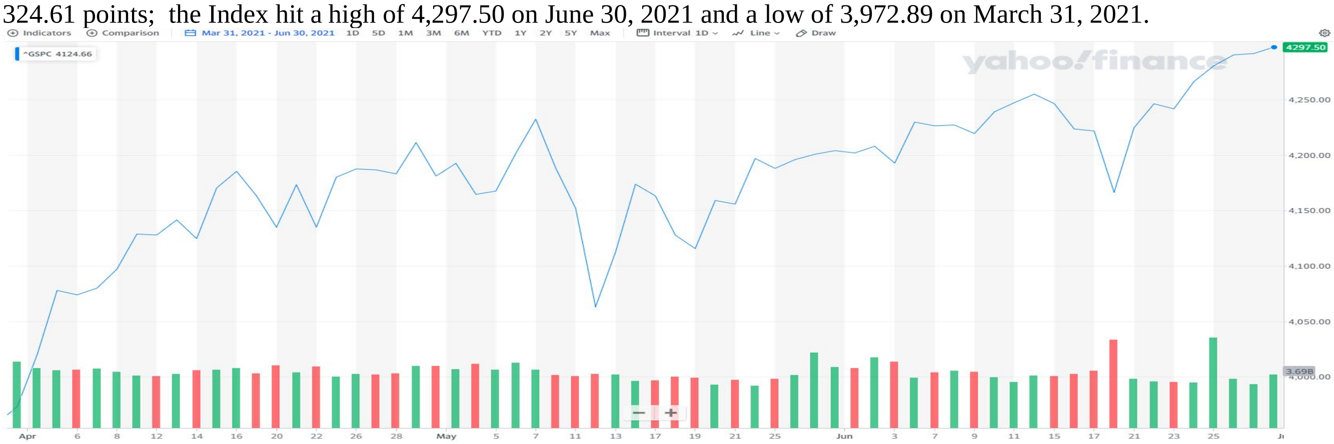
OVERVIEW

Dear Clients and Friends,

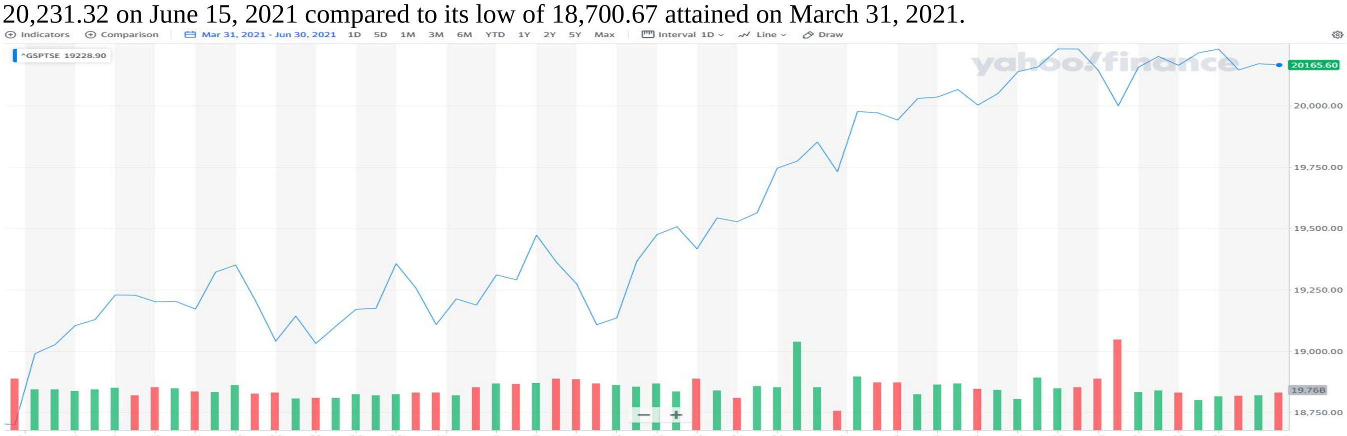
We are pleased to provide this quarterly report for the period ended June 30, 2021. The letter will be divided into three sections: (1) Market Recap, (2) What's New and (3) Commentary.

MARKET RECAP

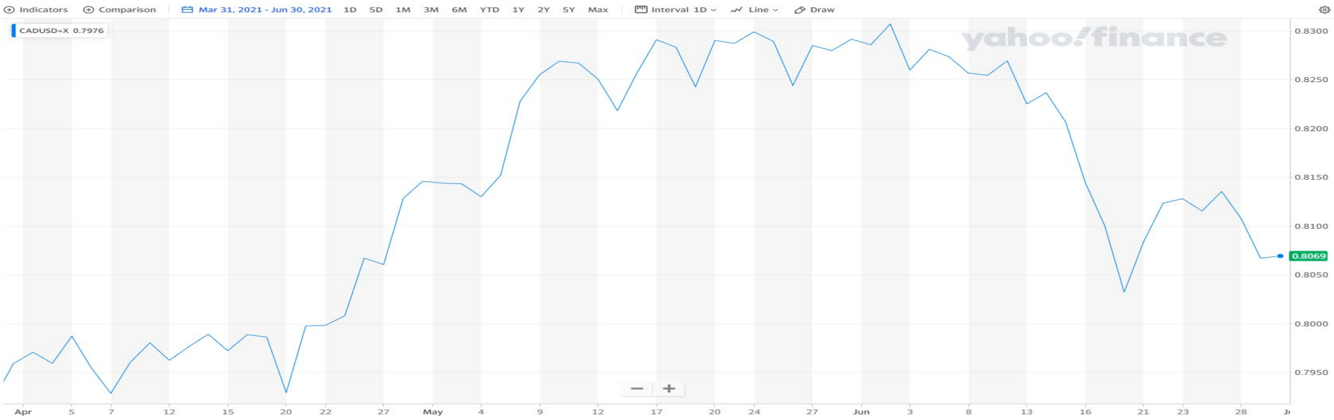
The S&P 500 Index (in USD) advanced 8.17% for the three month period ended June 30, 2021. The net increase over the quarter was 324.61 points; the Index hit a high of 4,297.50 on June 30, 2021 and a low of 3,972.89 on March 31, 2021.



The S&P/TSX Composite Index rose 7.83% in the second quarter of 2021, an increase of 1,464.91 points. The Index reached a high of 20,231.32 on June 15, 2021 compared to its low of 18,700.67 attained on March 31, 2021.



The Canadian Dollar quoted in USD (CADUSD) gained 1.32% during the quarter ended June 30, 2021. CAD/USD closed at 0.8066 on June 30, 2021 versus a close of 0.7961 on March 31, 2021



WHAT'S NEW

REGULATORY UPDATE - ENHANCED CONFLICTS OF INTEREST DISCLOSURE

As you may be aware, the Canadian Securities Administrators are implementing "client- focused" reform amendments to certain of the obligations that firms and their registered representatives owe to clients. As of June 30, 2021 this will include an enhanced conflict of interest standard. Under this standard, we will be required to address and manage existing, as well as reasonably foreseeable, material conflicts in the best interest of our clients.

A conflict of interest can include any circumstance where: (a) the interests of different parties, such as the interests of the firm and those of a client, are inconsistent or divergent, (b) the firm or one of its registered representatives may be influenced to put their interests ahead of a client's interests, or (c) monetary or non-monetary benefits available to the firm or a registered representative, or potential detriments to which they may be subject, may compromise the trust that a reasonable client has in the firm or the individual. Whether a conflict is "material" or not depends on the circumstances. In determining whether a conflict is material, the firm will typically consider whether the conflict may be reasonably expected to affect the decisions of the client in the circumstances, and/or the recommendations or decisions of the firm or its registered representatives in the circumstances.

In addition to other measures that will be taken to address existing and reasonably foreseeable material conflicts of interest, the firm will typically provide clients with disclosure in respect to the potential conflict. It is important that clients read this disclosure to help inform their decision when evaluating our business practices, conflicts management and overall performance on an ongoing basis. The Canadian Securities Administrators note that conflict disclosure is critical to a client's ability to make an informed decision about how to manage and evaluate its relationship with a firm. If you have any questions in regard to our conflicts of interest disclosure or, more generally, in respect to conflicts, please contact us by telephone at 1.888.436.9955 or email: invest@gold-im.com and a portfolio manager will gladly assist.

The firm's enhanced conflicts of interest disclosure is contained in our current Relationship Disclosure Information document and is now available for viewing. We are sending you this e-mail letting you know the disclosure has been posted to the website. Additionally, a reminder will also be contained in the materials you receive from the firm following the June 30th end of quarter, including how you can instruct us to make this information available to you by paper copy at your request.

COMMUNICATION

If you desire more interaction with a Portfolio Manager or your individual circumstances have changed, please contact our office.

COMMENTARY

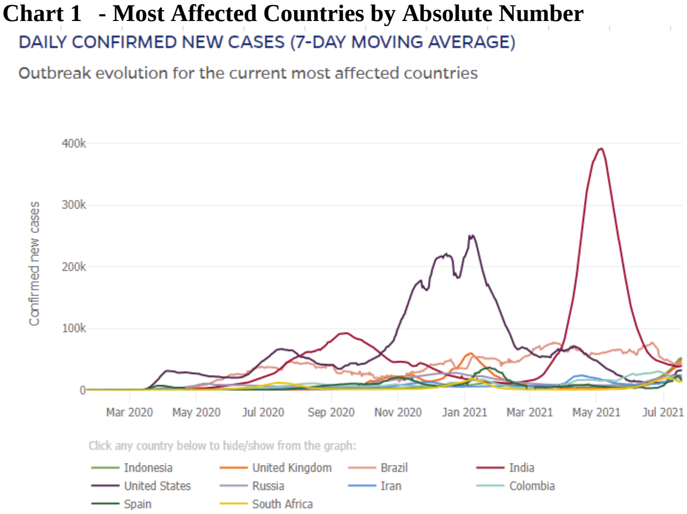
Happy summertime everyone. For our clients in B.C. and Alberta, July has been nice considering the provinces have entered Phase 3 of reopening at the end of June, meaning gyms, restaurants and indoor social gatherings (within limits) are now permitted. Ontario has started its Phase 3 reopening on July 16.[1]

PART 1: COVID News

This is not really investment related but we think this is good news to be shared. Despite the intense media scrutiny on COVID variants, the world is beating this virus. Here are the countries most affected by absolute numbers.[2] Likewise, mortality is also declining as seen in the most affected countries.[3]

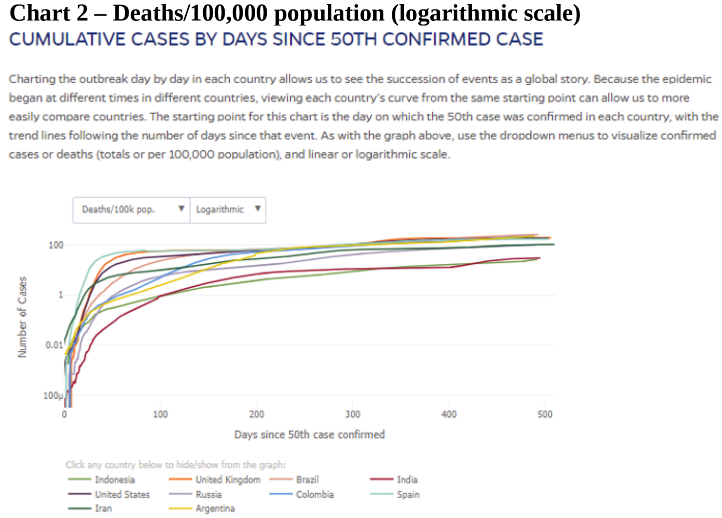
Chart 1 & 2 – Flattening the Curve and Falling Lethality

Chart 1 - Most Affected Countries by Absolute Number



Source: John Hopkins University of Medicine, Corona Resource Center

Chart 2 – Deaths/100,000 population (logarithmic scale)



Summary: COVID is acting like a "normal" coronavirus. It is mutating to become more contagious but is becoming less lethal. Having said this, the virus can still make you very sick and even if immunized you can pass it on to someone who has not been fully immunized. So please continue to be careful.

PART 2: Inflation & Markets

We have been writing about inflation for years and inflation worries are finally being reported in the mainstream media. We have always maintained the actual cost of living is higher than the official rate of inflation. Food, energy and shelter are what we need to spend money on every day, and they are not discretionary. As we spend a disproportionate amount of our paycheque on what we need to live on, a small uptick in the inflation rate is going to have a much bigger impact on us as individual consumers. Simply put, we can not afford significant price increases in food and essentials and one of the primary jobs of a central bank is to manage inflation risk.

In the U.S., June inflation, as measured by the Consumer Price Index (CPI), came in at 5.4% year-over-year. June import prices in the U.S. rose 11.2% Y/Y, reflecting a gigantic double digit rise. When removing volatile data (like food and shelter costs) the "core" CPI was 4.5%. Moreover, the components of inflation are flashing warnings, as written by the economics team at BMO (emphasis ours).

> *"It's not just the recent speed of the increase that's raising eyebrows (at least ours), it's the breadth. More CPI items are flashing some real heat, beyond the services that are rebounding after pandemic plunges or the vehicles that were affected by chip shortages. Floor coverings, video and audio services, and lesson fees all jumped the most on record in June, while furniture, appliances, sporting goods and domestic services are up more than 5% in the past year."* [4]

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[1] https://www.cp24.com/news/a-look-at-covid-19-reopening-plans-across-the-country-1.5513698
[2] https://coronavirus.jhu.edu/data/new-cases
[3] https://coronavirus.jhu.edu/data/cumulative-cases
[4] BMO focus, July 16, 2021

We wrote in our last quarter's newsletter we thought there was a real risk of higher producer expenses, starting from transportation costs, being passed on to the end-consumer. This has taken hold at a speed that surprises us. In Canada, CPI is following lockstep with U.S. inflation, Canada's inflation statistics came in earlier on June 16, showing May inflation up 3.6%[5] year-over-year.

Table 1 – Economic data

CANADA	Q1 21	Q2 21E	Q3 21E	Q4 21E	2020	2021E	2022E	Comment
Real GDP %	5.6	2.5	6.0	6.0	-5.3	6.0	4.5	2021 GDP reflects COVID rebound
CPI %	1.4	3.3	3.7	3.8	0.7	3.1	2.9	
BoC Overnight	0.25	0.25	0.25	0.25	0.50	0.25	0.31	Annual BoC rate is average for the year
U.S.	**Q1 21**	**Q2 21E**	**Q3 21E**	**Q4 21E**	**2020**	**2021E**	**2022E**	**Comment**
Real GDP %	6.4	9.5	8.3	6.0	-3.5	6.8	4.3	2021 GDP reflects COVID rebound
CPI %	1.9	4.8	5.5	5.0	1.2	4.5	4.0	
Fed Fund rate	0.13	0.13	0.13	0.13	0.38	0.13	0.13	Annual Fed Funds rate is average for the year

Source: BMO focus, July 16, 2021

The question about inflation is whether it is temporary or is it going to be sticky and last longer? Central banks have been reluctant to raise interest rates to fight inflation. In Canada, on July 14, 2021, the Bank of Canada (BoC) kept its policy rate of 0.25% and said it will keep the rate at near zero until the Canadian economy improves enough to handle an increase - sometime in the second half of 2022. The BoC's scenario is that inflation will be high for 2021-2022 and will drop in 2023, by which time the economy will be strong and interest rates can be raised.[6]

Our perspective: The Bank of Canada is trying to thread a very fine needle. If anything goes offside we are looking at higher than expected inflation and/or interest rates. The things that have to go right are no upward wage pressure, continued economic growth and productivity to offset rising producer costs, and/or modest government regulation/taxation. In the meantime, the BoC is asking us to ignore the things we need to live on, like food, transportation and shelter costs, because groceries and gasoline prices are volatile and not part of "core inflation".

Summary: The BoC is trying to keep interest rates low and talk down the risk of inflation. Cash and fixed income (bonds) do not give inflation protection. The interest rates for a bank savings account is about 0.25% and the yield on 10-year Government of Canada bond is 1.14%.[7] If inflation is running at 3% and you are getting 1% or less in a GIC or bond, it will erode your buying power by over 2%. Inflation is insidious that way. Investors who wish to do better than the rate of inflation are being forced to take on some type of investment risk; for our clients this means exposure to the stock markets.

PART 3: Summer stock markets

This brings up our third topic for this newsletter, the stock market and what happens in summer. If cash and fixed income cannot protect against inflation this leaves the stock market. There are other assets that protect against inflation, like real estate, commodities / resources and private investments. But owning real estate is illiquid; commodities are typically played through the futures markets, which can be even riskier than the stock market; and private investments also suffer from being illiquid.

The stock markets have had a good runup in the first 6 months of 2021. For example, year-to-date the S&P500 and S&P/TSX Composite are both up over 14% from January 1 to July 20.

Chart 3 – S&P500 YTD + 15%

Chart 4 – S&P/TSX Composite YTD + 14%

Source: Yahoo Finance, July 20, 2021

[5] https://www150.statcan.gc.ca/n1/daily-quotidien/210616/dq210616a-eng.htm
[6] https://globalnews.ca/news/8026277/bank-of-canada-economic-outlook-interest-rate/
[7] Source Scotiabank quote July 20, 2021

So far, so good. The 2021 trendline continues the bull market from the second half of 2020. But here is a scary looking chart (Chart 6) and one that has been seized on by some bearish investors. It is the Nasdaq, which is technology heavy. Technology has rallied tremendously in the past few years even taking the drop of early 2020 into consideration. If we go back to January 1, 1995, even the year 2000 dot com bubble looks like a tiny bump compared to where the index is now.

Chart 5 – Nasdaq Composite YTD + 13%

Source: Yahoo Finance, July 20, 2021

Chart 6 – Nasdaq Jan 1, 1995-July 20, 2021 + 1,830%

Dot com bubble

Nasdaq YTD choppy but still up ~13%

Nasdaq +1,830% since Jan 1, 1995.
Are we in another tech bubble?

Does the long-term chart of the Nasdaq mean the various stock markets are going to collapse? We do not believe this is true and we have 4 reasons.

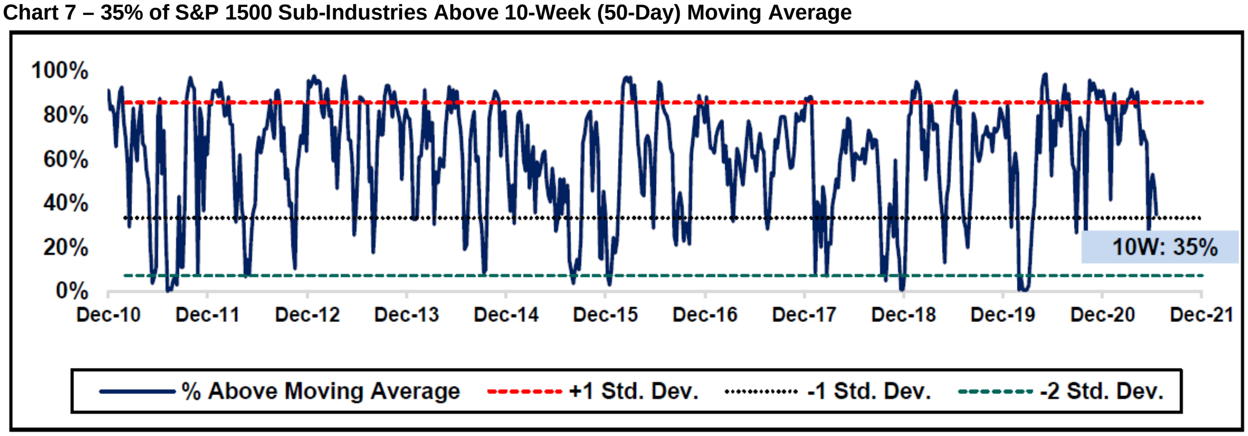
1. The Nasdaq is considered a technology market and the broader indexes like the S&P/TSX and S&P500 have technology as only a piece of their composition. Because the broader markets are more diversified they are less risky than having all of one's securities in just a technology basket.

2. To be part of an index, companies must perform and have positive earnings. Otherwise, their share prices will collapse and they are removed from the index. So it is not just as simple as looking at a price chart. The Nasdaq is currently trading at a price/earnings (P/E) ratio of 25x 2021 earnings and pays a forward dividend of 2.14%.[8] This valuation is somewhat expensive in our opinion, but in the context of a 10 year U.S. Treasury Bond yielding 1.18%[9], a 2.14% dividend is not too bad. It means if Nasdaq just treads water for the next year you are still doing better than a risk-free government bond.

3. Currently 35% of the S&P1500 sub-sectors are trading above their 50 day moving average prices, a sign of bad breadth, meaning that fewer names are propelling the markets higher. But this looks like a normal seasonal pattern as can be seen in Chart 7.

   Summertime is usually a period of light volume on the stock exchanges so share prices movements can be magnified. Traders and portfolio managers take vacations. Clients are likewise enjoying summer so any portfolio action must wait until they are contacted as well. There is therefore commonly a seasonality effect where industry sectors are choppy in summer.

Chart 7 – 35% of S&P 1500 Sub-Industries Above 10-Week (50-Day) Moving Average



Source: CFRA Sector Watch, July 19, 2021

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[8] https://finance.yahoo.com/quote/ndaq/key-statistics/
[9] Source Scotiabank quote July 20, 2021

4. Finally, the stock market is one of the few legitimate asset classes left where expected returns exceed inflation. Recall we have said cash and fixed income (bond) markets don't give inflation protection. Private investments and real estate are illiquid, so an investor can not easily liquidate in an emergency. Commodities and resources carry their own risks. But over the long term equity markets have delivered returns through wars, economic shocks, and pandemics. We are in the midst of second quarter earnings reports and of the 60 S&P500 companies that have reported so far, 85% have beaten earnings expectations. [10] It is this fundamental driver which propels the stock market upward and the index has responded accordingly. The charts below show over the long term it is fundamentals that overwhelm the bubbles and pandemics. The dot com bubble in late 1999/2000 and housing bubble of 2006/2007 are mere blips over this time period.

Chart 8 – TSX since Jan 1, 1995 + 375%

Chart 9 – S&P500 since Jan 1, 1995 + 840%

Source: Yahoo Finance, Jan 1, 1995 to July 20, 2021

Markets up over the long term regardless of bubbles, wars, pandemics or economic shocks

Summary: It is fundamentals, like earnings, that drive stock markets. Be wary that a single piece of information or a single chart only tells part of the story. There is often a seasonal choppiness of stock markets in the summer, but it does not suggest anything bad. *Staying out of the market is actually the biggest risk.* If investors had sold out at the recent market bottom in March 2020 they would have left a lot of money on the table as the equity markets rebounded very quickly.

PART 4: Conclusion

Interest rates are near zero and cash and fixed income asset classes do not provide sufficient yield to cover the cost of rising prices from inflation. Inflation is insidious as it eats away at your savings and the only way to deal with this is to take on assets with some type of risk. The good news is that forward equity valuations are not outrageously expensive nor are they expensive relative to interest rates.

We have written about inflation concerns for a number of years now because we believed there was a deafening silence from the rest of the investment community about what we believed was a risk. This is exactly the sort of thing that Paul Simon and Art Garfunkel sang about in *The Sound of Silence*. We are particularly impressed with the U.K.'s Royal Marines orchestra who performed a fantastic cover of the song **here**. It is a 5-minute clip that will make your day even better – guaranteed! [11]

However we are not about to engage in a pity party. If you have made it this far into our newsletter we thank you and leave you with a unique twist to the theme song from *Gilligan's Island* (we are dating ourselves) found **here**. It's summer and we will end on a light note. Thank you Puddles the Clown! [12]

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Thank you for entrusting us with your investments. As always, we welcome your questions and comments. You can contact GIM by telephone: 1.888.436.9955, fax: 1.866.541.7947 or email: invest@gold-im.com.

Yours truly,

GOLD INVESTMENT MANAGEMENT LTD.

[10] DJ Newsplus, July 21, 2021
[11] For clients with paper statements the Youtube link: https://www.youtube.com/watch?v=o05f8yLaaKM
[12] For clients with paper statements the Youtube link: https://www.youtube.com/watch?v=K4MKQMTHplI

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