PORTFOLIO CONSTRUCTION

CI ASSANTE WEALTH MANAGEMENT

Are Stocks Overvalued?

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Cases of COVID-19 are declining and economies are re-opening. It won't be long before the only thing that isn't normal is interest rates. It's widely expected that the first interest rate hike will be in late 2022 or early 2023, and it will probably take another two to three years for rates to rise back to pre-COVID-19 levels. Until then, economies will be in a growing phase with central banks holding your hands. Sounds pretty good, doesn't it?

Time for a market correction?

We have read concerns that stock markets, the U.S. in particular, are due for a correction. The main reasons being above normal valuations and recent strong performance. We respect the opinions, but we are more constructive.

Strong past performance has come from improving economies and asset inflation driven by money supply growth. Unlike other recessions, aggregate household savings and wealth have grown during this pandemic. Consumers are eager to spend, which will support corporate earnings growth. In fact, corporate earnings for the first quarter of this year have already surpassed the quarter prior to the COVID-19 outbreak.

S&P 500 Index earnings:

Q4 2019	$35.53
Q1 2021	$45.95

Source: S&P Global

We are confident the global economy will continue to perform exceptionally well in 2021 and 2022. The recent market rally is simply a reflection of expected earnings growth.

When valuations are overvalued

The real question is – are markets ahead of the fundamentals? In other words, are they overvalued? Looking at price versus current earnings, the S&P 500 Index does look expensive – its price-to-earnings ratio is currently 24x compared to a historical average of 16-18x.

So, how do we bring market valuations that are above average… back to average? Will it be a sharp market correction as others have called for? Probably not. With a large pool of excess capital due to money printing and a lack of alternatives (as bonds offer little yield), investors will continue to favour equity.

In addition, due to a scarcity of assets that deliver growth (compared to the 10-year U.S. Treasury yield at 1.3%), fair value is probably at the top of its historical range. Therefore, we expect earnings growth (not a dramatic price drop) will gradually drive valuations down from 24x to 18x over the next three to five years. As we said at the beginning, central banks are holding investors' hands by lending support whenever they need it.

What does this mean for your portfolios?

In our portfolios, we remain overweight equity and underweight bonds. We believe global economies are in the early innings of multi-year economic growth. The returns from equity through dividends and earnings growth will surpass bond yields even with some valuation compression. We've also allocated our assets globally, as valuations are much friendlier outside of the U.S. From time-to-time the markets will be bumpy, but it doesn't mean they're unsafe.

Combined top 15 equity holdings as of June 30, 2021 of the Assante Private Portfolios 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft Corp. 2. Alphabet Inc. 3. Amazon.com Inc. 4. Brookfield Asset Management Inc. 5. Royal Bank of Canada	6. Mastercard Incorporated 7. Facebook Inc. (Class A) 8. Intact Financial Corp. 9. Taiwan Semiconductor Manufact. Co Ltd. 10. Adobe Inc.	11. Apple Inc. 12. Booking Holdings Inc. 13. Prologis Inc. 14. Nvidia Corp. 15. Canadian Tire Corporation Ltd.

Source: Bloomberg Finance L.P. and CI Global Asset Management as at June 30, 2021.

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For more information, we encourage you to speak to your advisor or visit us at assante.com