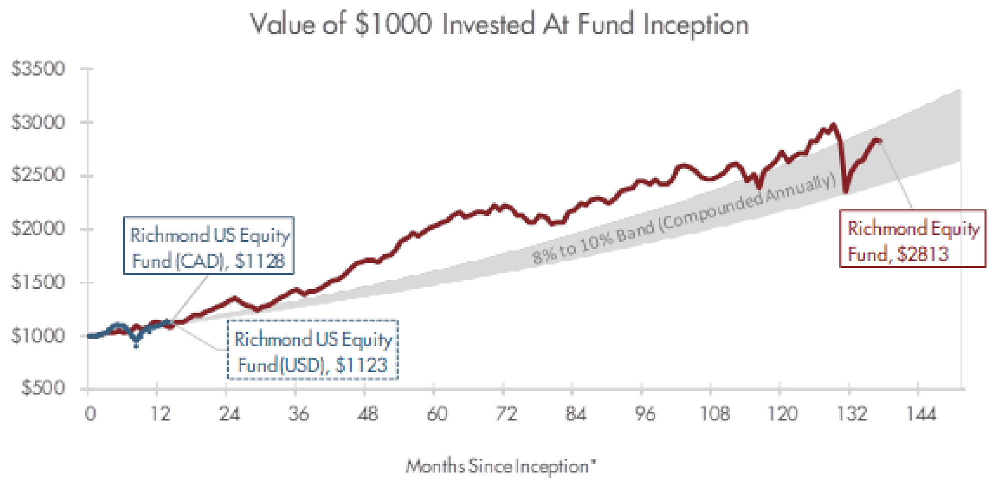
Richmond Equity – 3rd Quarter Review 2020

October 14th, 2020

The Richmond Equity Fund ("REF") generated a return of 6.6% in the quarter, closing with a unit value of $18.96 after a dividend distribution of $0.12 and a capital gain distribution of $0.20. This brings the year to date return to - 3.0%. The Richmond US Equity Fund ("RUSF") returned 4.7% in CAD dollar terms in the quarter, closing with a unit value of $11.20 after a distribution of 2.0 cents. The year to date CAD return is 4.0%. Performance since inception for both funds is shown below.



Richmond Equity Fund date of inception is May 12th, 2009 and the Richmond US Equity Fund date of inception is August 28th, 2019. The 8% to 10% band is indexed to the first day of the month each fund was launched. Performance is shown net of fees and expenses and includes changes in security values and reinvestment of distributions. Income taxes payable would have reduced returns. The funds are not guaranteed. Performance and Net Asset Value of the funds will fluctuate, and past performance may not be repeated.

The Canadian economy has officially entered recession territory with two consecutive quarters of GDP contraction. Without a doubt, this recession feels different than those prior. Several housing markets across the country are booming, consumer spending is approaching pre-COVID levels, nearly two out of every three jobs lost since the beginning of March have been recovered, and widely followed North American equity indices have (so far) formed the too good to be true V-shape recovery. Aggressive monetary policies and fiscal aid to date has addressed short-term economic concerns: sending cheques to displaced workers, cutting interest rates to zero, lending money to businesses, and implementing nationwide social programs. What all investors are asking now is how long will the recovery last and if (or rather when) the spending runs out are we set for another systemic correction?

We are in no position to predict the long-term economic implications of the pandemic nor what, when, and how a new normal will take shape but instead we must continue assessing the new reality we are in and how equities will respond. There are a few points we would like to address in support of equities in the near and medium term. First, there still seems to be value beneath the surface as not all sectors within the S&P/TSX Composite Index (Canada) and the S&P 500 Index (US) have returned to pre-COVID levels. Secondly, the flow of capital is pointing towards equities as actions taken by central banks should continue to be supportive of equity prices and real asset values.

For the first two months of the quarter the spotlight was on anything with a glint of gold or the multinational e-commerce company, Shopify Inc. (SHOP-T). Preference shifted in September as Shopify and the mining industry cooled down and some of the more supressed sectors (Industrials and Consumer Discretionary) started to see a slight rebound. Still, as shown in the chart below, year to date returns would be decidedly negative (-12.8% in Canada and -3.3% in the US) were it not for contributions from a small number of market darlings. Financials continue to face a challenging environment with the large Canadian banks now trading at the lowest multiples relative to the TSX in the last 20 years.

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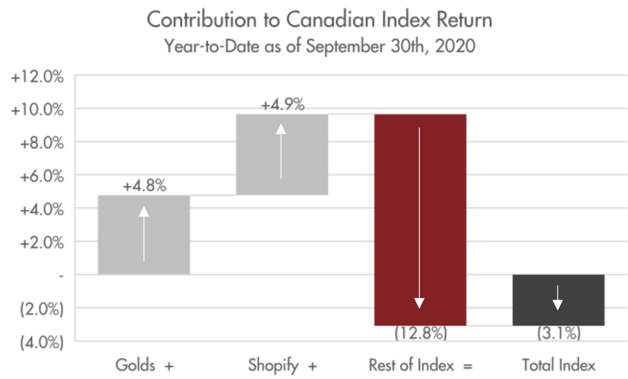
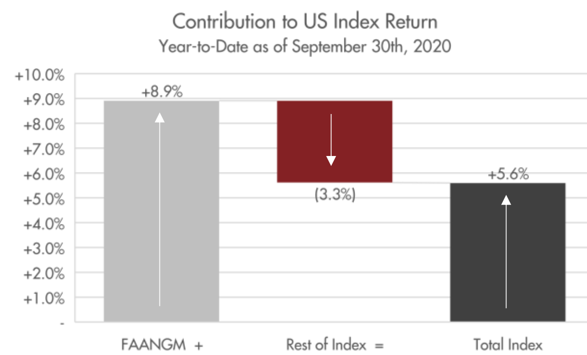
However, the sector seems primed to do some catch up as four out of the five Canadian banks beat analysts' expectations in the third quarter owing to provisions for credit losses reverting lower and capital markets revenue continuing to soar higher.





Note: Index returns approximated using the iShares Core S&P/TSX Capped Composite Index ETF and the iShares Core S&P 500 ETF to represent the Canadian Index and the US Index, respectively. FAANGM stocks include: Facebook, Inc. (FB-Q), Amazon.com, Inc. (AMZN-Q), Apple Inc. (AAPL-Q), Netflix, Inc. (NFLX-Q), Alphabet Inc. (GOOG-Q/GOOGL-Q, formerly Google), and Microsoft Corporation (MSFT-Q).

Even if all constituents within these indices had returned to pre-COVID levels, actions taken by governments and central banks should be supportive of equity prices. Fiscal stimulus plans totaling trillions of dollars across the global economy have been created to support businesses forced into lockdown and the increasing ranks of unemployed workers. Central Banks slashed interest rates to record lows and either restarted or launched asset purchases aiming to stabilize the economy and head off a financial crisis. Of the major G7 countries, the US has enacted one of the most aggressive monetary policies aimed at capital markets. A major monetary policy shift in the US is 'average inflation targeting', meaning the central bank will allow inflation to run higher than the standard 2% target before hiking interest rates. Lower for longer interest rates typically support the equity markets as lower rates directly impact share prices due to higher net present value of cash flow.

Lower rates typically benefit the equity market but are a detriment to the bond market. The spread at the end of September was 3.21% between the S&P/TSX Composite dividend yield and the government 10-year bond yield. Although the spread has compressed slightly since the end of March it, is still nearing the highest level since March of 2009. At the current bond yield, investors are seeking alternative strategies to stay ahead of inflation and achieve a consistent income stream. Superior dividend yields, growing dividends per share, and opportunity for capital appreciation makes income and growth biased equities a compelling option. Investors are being forced to consider their willingness and ability to take on risk and accept that volatility is the price you pay to receive higher returns offered by the equity market.

Looking ahead, volatility will remain a factor with the uncertainty of the US Election results, the severity of a second wave of COVID-19 cases, and the impact tax loss selling may have in the fourth quarter. During times of uncertainty it is imperative for investors to take a long-term perspective towards equity investing. As bottom-up money managers we will focus on purchasing and holding companies that have a strong foundation to weather the bumpy road ahead.

If you have any questions regarding Richmond Equity, please call us directly at 403.538.7330.

The Richmond Equity Team