APRIL 4, 2021 MONTHLY

Global Investment Letter

Notable Inside This Issue:

- ***"Irrational Exuberance" and Virus Strains Remain Troubling***
- ***Continue to Hold Our Positions in S&P and Russell 2000***
- ***Maintaining Our Long Volatility Trade***
- ***Continue Long Exposure to Health Care Sector***
- ***Established New Long Position in DAX***
- ***Still Long the Nikkei***
- ***Long U.S. Dollar Position Working Well***
- ***Oil Prices Expected to Weaken***
- ***Gold Price Searching for a Bottom***

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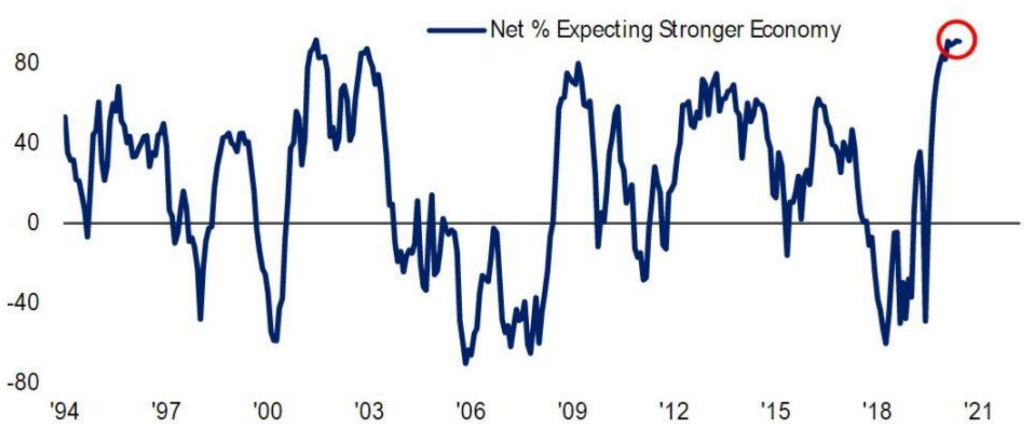
REASONS FOR OPTIMISM….AND CONTINUED CONCERN

The first quarter of 2021 is at an end, and while this year started much as 2020 ended, there is reason for optimism. Winter is over, and the weather is improving (for subscribers in the northern hemisphere), while the distribution of vaccines in most countries is (finally) well underway. Stock markets generally performed well in the first quarter.

While we acknowledge these positive developments, we cannot help but continue to be concerned about a raft of potential catalysts that could upend the very optimistic consensus expectations that are reflected by stock markets.

Exhibit 3: Record amount of FMS investors expect a stronger economy

Net % Expecting Stronger Economy



Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

A fundamental concern is that so many expect the same outcome, in this case, a strong economic recovery, as depicted by the chart above.

If a record number of investors are expecting a result, it is presumably already priced into the market, leaving little upside even if the hoped-for result occurs. Danger lies in what is not priced into the market, in this case, a softer recovery than anticipated.

We commented at length in the last issue as to why we believe that consensus opinion is overestimating the economic rebound ahead.

Beyond our reservations about the economic practicality of engineering the unprecedented "V" shaped recovery expected by markets are our lingering concerns about the pandemic.

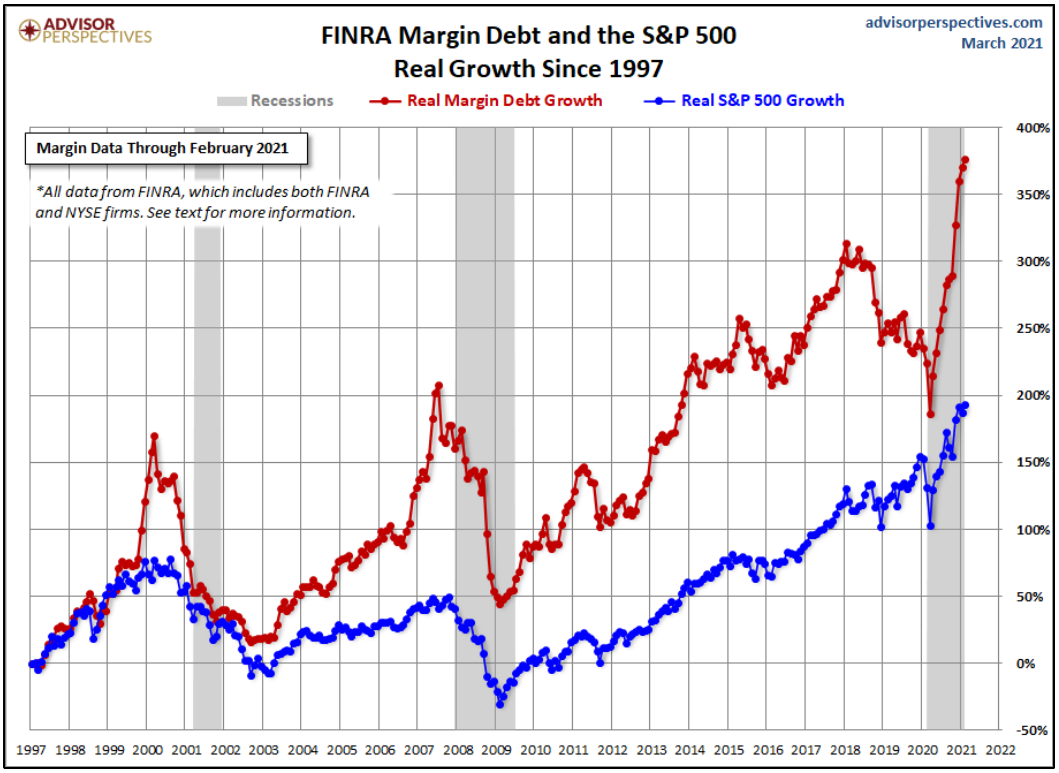
Our discussions with medical professionals in the past month confirmed our thoughts in terms of threats posed by the emerging variants of the Coronavirus. The fact that we have already seen a variety of more virulent strains emerge is disconcerting. More troubling still is the possibility that new, more vaccine-resistant strains will emerge before global "herd immunity" is achieved.

I also learned, during the past month, that fundamental questions remain in the medical community about the assorted vaccines. Questions such as how long the immunity achieved by the vaccine lasts? Will the longer than designed interval between doses compromise the ultimate effectiveness of the respective vaccines? There are also questions about whether new vaccines will need to be developed, and how soon, to deal with the emergence of strains that evolution theory suggests may prove vaccine-resistant.

This host of questions, and more, suggests that a quick transition to a post-pandemic world cannot be taken for granted. The renewed lockdowns in Europe and Canada attest to how stubborn a problem the Coronavirus is and may continue to be.

The "Goldilocks" scenario currently embraced by consensus opinion makes markets vulnerable to a recognition that the Coronavirus may exact an economic and human toll greater than is currently imagined.

We certainly hope consensus opinion is correct in this matter, but the probability that pandemic-related issues could still have significant investment implications is high enough that it must be considered.



Our concern about the extreme bullish sentiment extant in markets has been remarked on in these pages ad nauseam! Current levels even eclipse those we saw during the internet bubble era.

We leave readers to consider the chart above, which illustrates the trend in the growth of margin debt over the past 25 years.

Most noteworthy to us is the unnerving tendency of the steepest increases in margin debt to precede significant stock market declines.

We continue to believe the current risk/reward proposition offered by equity markets is unattractive.

We are prepared to lock in profits on our long positions should markets decline to pre-determined levels and continue to be positioned for a spike in volatility associated with a market pullback, as discussed in this issue.

An old sports maxim is, “Defence wins championships.” The saying applies to investing, and we are at a market juncture where defence is called for.

EQUITIES COMMENT

S&P 500 (WEEKLY)

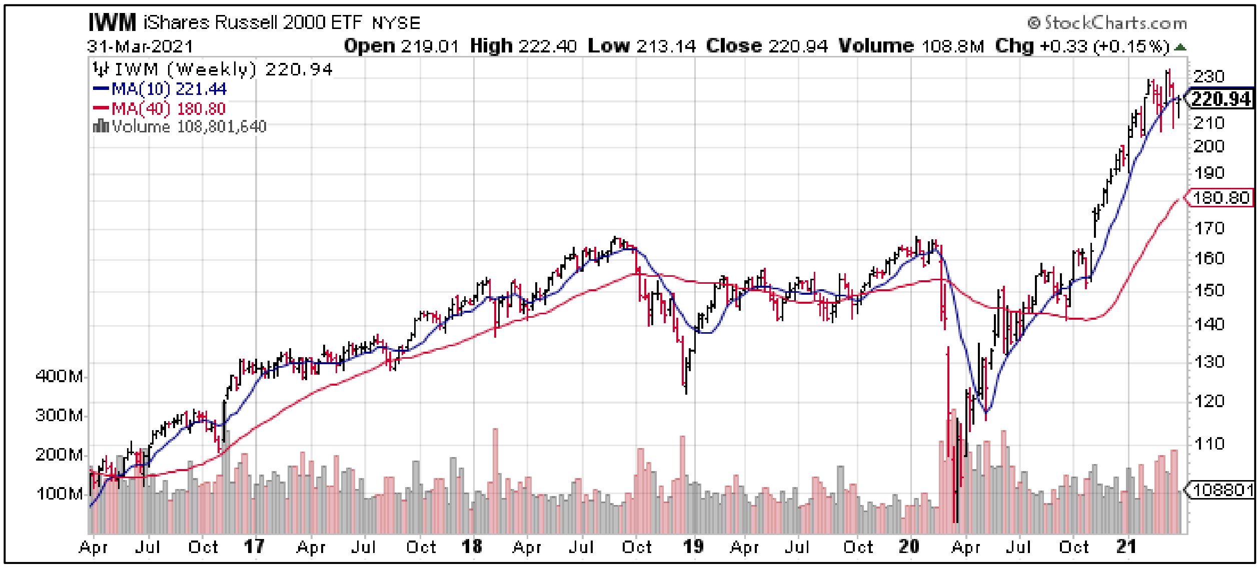
The S&P 500 rebounded smartly in March after displaying sufficient weakness in February to suggest that equities could have a difficult month of March. Such was not the case, as investor optimism of a strong economic recovery and end to the pandemic remained intact.

We have written at length of our concerns about the risk/reward offered by stock markets given their extended valuation and what we consider widespread investor complacency. Our concerns were significant enough to warrant our adoption of a long volatility position to guard against a market correction (see Volatility Trade comment in this issue).

Nonetheless, the S&P 500 continues to behave in a bullish fashion, which causes us to maintain the solidly profitable long position we initiated on its breakout last November.

However, our view that equity markets offer a poor risk/reward proposition currently prompts us to raise our sell price target to 3750 from 3650 as a means of preserving profits in what we see as a high-risk investing environment.

iSHARES RUSSELL 2000 INDEX ETF (IWM) (WEEKLY)



The Russell 2000 small cap index (represented above by the IWM ETF) underperformed the large-cap S&P 500 and is exhibiting signs of a potential change of trend.

Our long position initiated on the breakout above 170 in November has been very successful, generating a gain at month end of almost 30% in five months.

We will continue to hold our long exposure to the Russell 2000 but will raise our sell price target to 210 from 190 to preserve our hard-won gains in what we see as an increasingly risky market environment.

VOLATILITY TRADE

S&P 500 VOLATILITY INDEX (VIX) (DAILY)

We continue to hold a long position in the Volatility Index (VIX) both as a hedge against our existing long positions and as a means to profit from what we believe will be a sharp rise in volatility in response to a correction by equity markets.

Investor optimism, which produces investor complacency, remains at very high levels. Almost every measure of sentiment we use, both publicly available and proprietary, remains at extreme levels.

Forecasting market behaviour, because it involves human psychology, can never be done with precision. However, market history and our personal experience have provided convincing evidence that adopting a position opposite to extremes of investor sentiment yields strong results.

Our long volatility position is currently showing a loss as the VIX declined in March. Patience is required to await what is an inevitable spike in volatility. The question is when, not if, such a rise will occur for volatility is endemic to the human condition, as history demonstrates.

We will continue to hold our long volatility position in expectation of a price spike.

HEALTH CARE TRADE

HEALTH CARE SPDR ETF (XLV) (WEEKLY)

Health care is a core investment theme of the Global Investment Letter, given the powerful tailwinds provided by the ageing populations of developed economies and the acceleration of new treatment introductions.

We maintain our long position in the XLV ETF as a proxy for diversified exposure to this sector.

Our bullish view would only change should the XLV trade below its 40-week moving average, which would suggest a bearish change of trend.

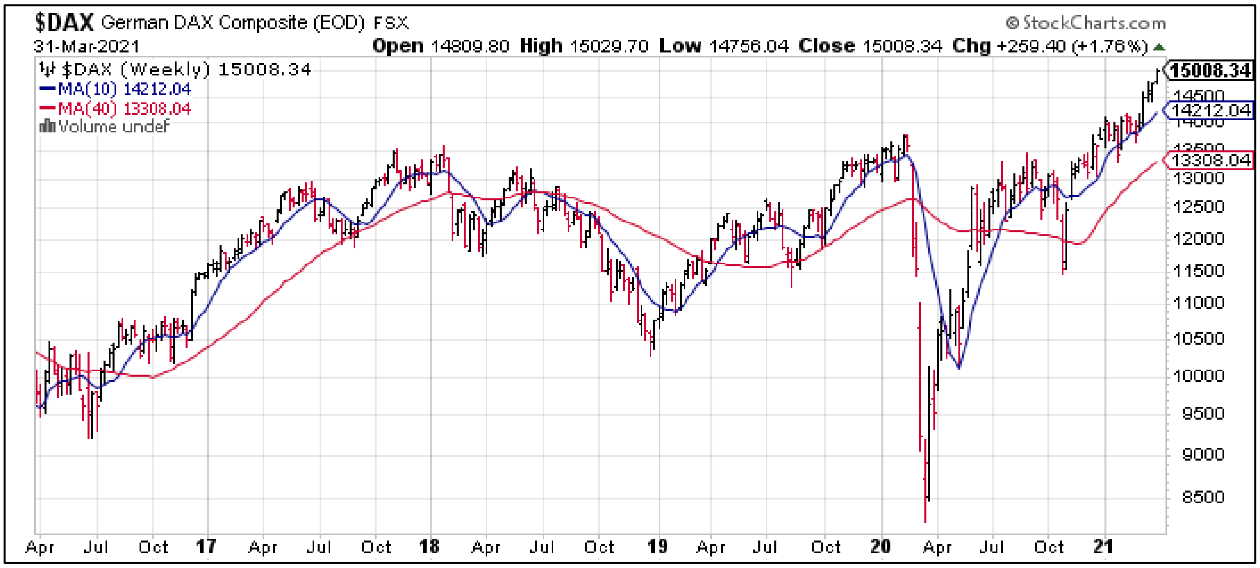
FTSE 100 (DAILY)

Our long-held cautious view of the FTSE remains, as we continue to believe that Brexit will have negative economic implications for the U.K. that have yet to be priced into the market. The recent strength of the pound is presenting another challenge for the post-Brexit British economy, though we do expect a weaker pound over time (see comment on the pound in this issue).

Our reservations about the FTSE are bolstered by our general wariness of the prospects of global equities in general and the current sideways trading pattern of the FTSE. The best risk/reward opportunities are presented by markets exhibiting clear trends, which the FTSE is not.

We will continue to stand aside from this market until an opportunity presents itself.

DAX INDEX (WEEKLY)



The prospect of a breakout to new highs by the DAX, as a requirement for us to change our view to bullish, has been discussed for many months in these pages.

The breakout finally occurred, and thus, we established a long position in the DAX at 14250.

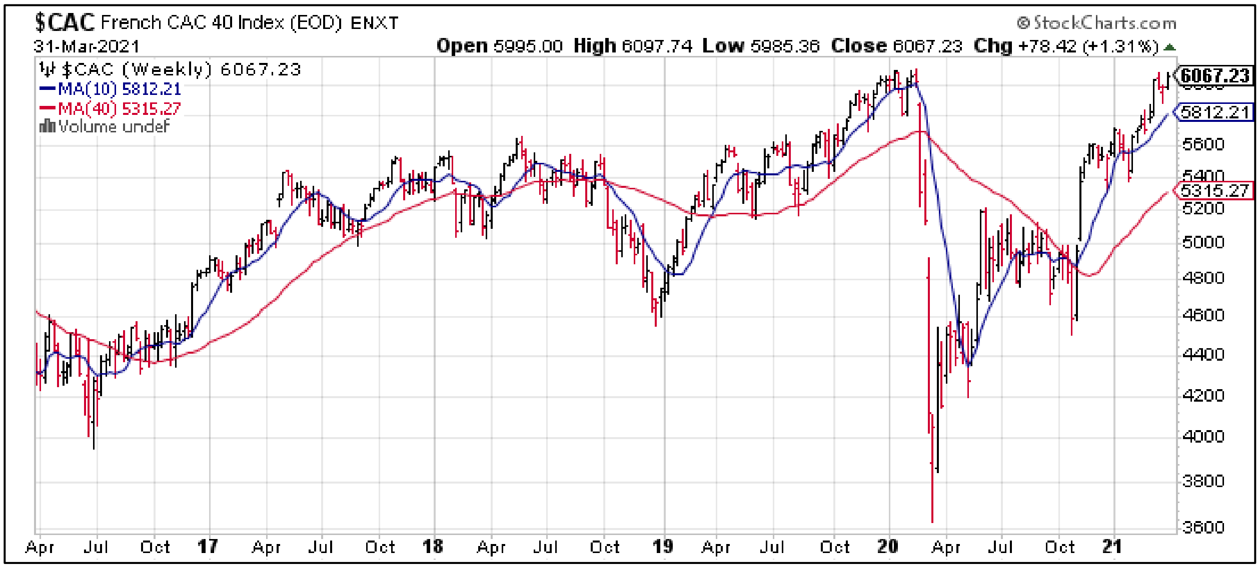
While we remain cautious of equity markets, experience has taught that breakouts through “triple-top” resistance levels should be taken advantage of as they offer compelling risk/reward opportunities. Our recent similar experiences with the Nikkei and Russell 2000 indices have proven to be solidly profitable.

The bullish move by the DAX is likely a consequence of the sharp drop in the value of the euro against the U.S. dollar, which will serve to benefit the export-dependent German economy. The strong moves by the German automakers support this notion.

The behaviour of the euro is likely to continue to offer clues to the performance of the DAX.

We will maintain our long position to participate in further upside. However, we would sell our long position on a price retracement below 14200 as that would imply a failed breakout and be very bearish indeed.

CAC 40 (WEEKLY)



The CAC 40 rose strongly in March for what we believe is the same reason for the rise in the DAX, a weaker euro.

Unlike the Dax, however, the CAC has yet to establish a new pre-Coronavirus high. Thus, we remain on the sidelines.

We would establish an initial position in the CAC on a move through the 2020 high but would be quick to exit the position should the market trade back below that level. Our cautious view of equity markets and the somewhat extended nature of the CAC would cause us to be quick to cut losses should the trade fail.

NIKKEI INDEX (WEEKLY)

The Nikkei continued to consolidate in March, following the sharp rise that has produced an almost 25% gain on our long position established in October on the breakout above 24000.

The weakening yen is providing a boost to the Nikkei, while at the same time reducing returns for non-yen denominated investors.

The Nikkei remains one of the more constructive looking global equity markets, and we continue to hold our long position.

We will, however, raise our sell level from 26400 to 28000 to preserve profits if the current consolidation pattern resolves into a change of trend.

SENSEX (WEEKLY)

We took profits in February on our latest position in the Bombay Sensex index, and we remain on the sidelines with this market until another attractive buying opportunity emerges.

EMERGING MARKETS ETF (EEM) (WEEKLY)

As with the Sensex, we took profits on our position in the emerging markets ETF (EEM) in February.

The EEM continued to decline in March as emerging markets came under pressure from renewed strength in the U.S. dollar.

We await an opportunity to re-establish a position in the EEM with a better risk/reward than is currently offered.

FIXED INCOME COMMENT

10-YEAR US TREASURY NOTE (WEEKLY)

We alerted readers, in our October issue, to the potential of a significant decline by the 10-year Treasuries if the 10-year broke below the 137 level. However, we did not expect such a dramatic drop.

The sharp increase in interest rates that produced this decline is the result of a growing consensus that inflationary pressures will emerge from the massive global fiscal/monetary stimulus used to counter the effects of the pandemic.

We continue to be less than convinced that inflation will be a concern in the near term. The concerns we harboured about the inflationary effects of the stimulus measures used to combat the 2008 Financial Crisis proved to be groundless. The fragile global economy could not muster sufficient demand to push prices higher, and consumer psychology did not adopt the inflationary mindset that would have spurred buying and created a self-fulfilling prophecy.

Our reservations about inflationary pressures are tied to our more modest expectations for the economic recovery of the global economy than consensus opinion. As we detailed in the last issue, consumer spending on durable goods has been very strong through the pandemic, suggesting that further spending increases may be less than robust. There is certainly room for a rebound from the service sector as travel and restaurant dining recover, but that seems unlikely to propel significant economic growth.

As well, the sharp pandemic-induced recession has negative economic implications that will linger for some time. The unemployment rate is not expected to return to pre-pandemic levels for years. The economic damage inflicted by the failure of many businesses will be felt for some time.

A recovery sufficiently strong to cause meaningful inflation will require a swift and uncomplicated transition to a post-pandemic economy. The presence of Coronavirus variants and questions about the ultimate efficacy and length of protection offered by vaccines against the variants make it impossible to assume a seamless transition to a post-pandemic world with complete confidence.

Treasuries appear oversold following their very sharp recent decline, and a short-term counter-trend rally would not be surprising.

However, even if our premise that inflationary pressures are less than currently envisioned proves correct, there is another factor that may maintain upward pressure on interest rates in 2021.

We remind readers of our discussion in the last issue of some $2 trillion (likely a low estimate) of government debt that will be coming to market this year. The Fed can be counted on to continue being the major buyer of government debt in 2021, but unless it is prepared to escalate its already considerable purchases, it may be difficult for all the issued debt to find a home without pushing interest rates higher.

There is already evidence from Treasury debt auctions earlier this year that it may be difficult to generate sufficient buyer interest to constrain upward pressure on rates.

Therefore, while we may see a short-term bounce in Treasuries, there is reason to believe that upward pressure on interest rates will remain through 2021 even if inflation anxieties are reduced.

A factor that would likely produce stronger Treasury prices would be a significant stock market decline. Such a decline would send capital from equities into Treasury markets.

In conclusion, the current risk/reward for Treasuries is not sufficiently attractive to adopt a position, and thus, we will continue to stand aside from this market.

Upon evidence of a significant correction in equity markets, we would look to assume a long position in Treasuries if an attractive opportunity is presented.

CURRENCY COMMENT

US DOLLAR INDEX (DXY)(WEEKLY)

Our somewhat controversial view at year-end 2020 that the decline of the U.S. dollar was at an end was confirmed by the strong move higher in March that took the price above the important 40-week moving average.

A pullback after such a strong move would not be unusual, with the 40-week moving average being a likely support level.

The positive interest rate differential of the U.S. dollar compared to other major currencies and the diminished possibility that the Fed will adopt negative interest rates given the steepening of the yield curve argue for continued strength in the dollar.

The relative strength of the U.S. economy and the dollar's role as the world's reserve currency also serve to provide demand for dollars. We remind readers that some $12 trillion of U.S. denominated bonds issued by foreign governments and institutions represents a considerable short position in dollars.

In the absence of compelling alternatives, demand for dollars will remain firm.

CAD/USD (WEEKLY)

The Canadian dollar rose slightly higher versus its U.S. counterpart in March, displaying conspicuous strength against the dollar compared to most other currencies.

The strength of the Canadian dollar over the past year is largely due to the strength of oil prices, for the dollar has long been highly correlated to the oil market.

Our expectation of lower oil prices (see oil comment further on in this issue) suggests that the bullish trend of the Canadian currency is at, or near, an end.

If our premise on oil proves correct, then a lower Canadian dollar is almost certain.

As well, we believe that the Bank of Canada does not wish to see continued dollar strength as a lower Canadian currency would serve to make exports to the important U.S. market more competitive.

In conclusion, we expect a weaker Canadian dollar. The main risk to our bearish view would be renewed strength in oil prices.

EUR/USD (WEEKLY)

Our bearish view of the euro was certainly vindicated in March, as the euro fell to $1.17 from $1.22 the month previous.

We continue to expect lower prices over time, but we would not be surprised, after such a sharp price decline, to see a short-term retracement to the vicinity of the 40-week moving average before the euro continues lower.

Our belief that the U.S. dollar remains the "least-flawed" of the major currencies, combined with the economic and political challenges facing the European Union, causes us to be long-term bears on the euro.

POUND/USD (WEEKLY)

Our short position in the pound initiated in the last issue at 1.393 was solidly profitable at the end of March, with the pound closing at 1.379.

We continue to believe that the post-Brexit rise in the pound was unjustified, as a weaker pound is clearly in British interests to help offset the negative economic effects of Brexit.

While we have been bearish on the pound for some time, non-commercial futures traders remain solidly bullish. Such bullish consensus gives us more confidence in our continued bearish view.

Our next downside price target is circa 1.35.

YEN/USD (WEEKLY)

Our bearish view of the yen continued to reap rewards in March, as the Japanese currency declined about 4% versus the U.S. dollar.

We expect more weakness by the yen, with circa 112 continuing to be our near-term target.

Non-commercial futures traders of the yen are positioned very bullishly, while commercial traders maintain large short positions. We'll become more bullish on the yen when the non-commercial traders adopt a less optimistic view.

YUAN/USD (DAILY)

Our expectation of a weakening yuan finally began to be realized in mid-February and continued last month.

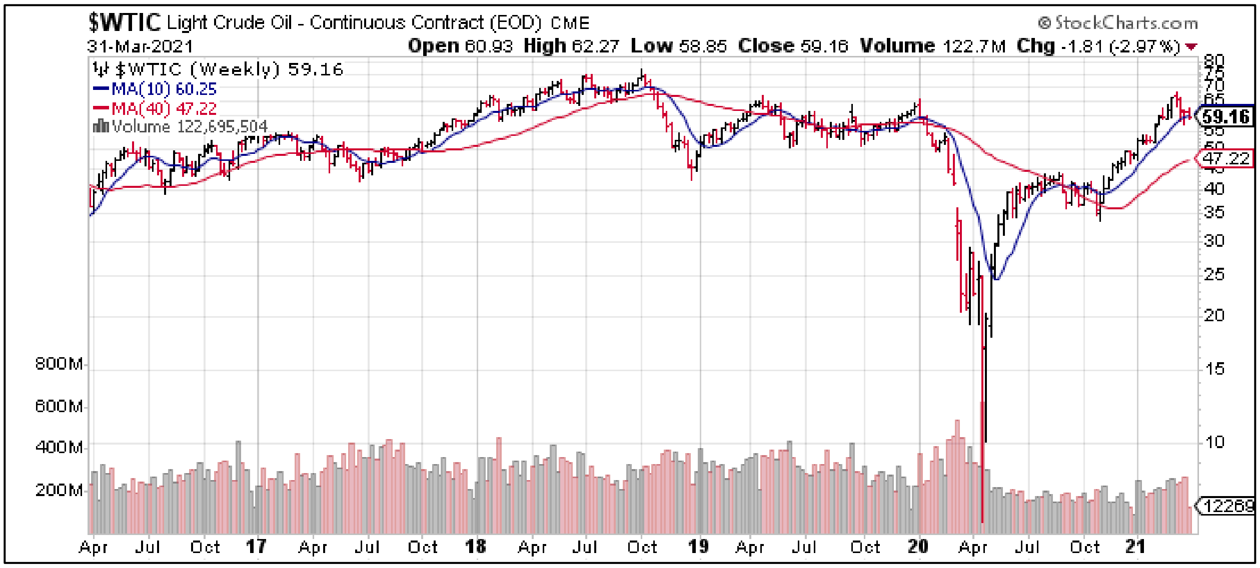
We confess to being surprised by the strength of the yuan given the sharp deterioration of China/U.S. relations, which has long been a barometer for the yuan/dollar exchange rate.

There does appear to have been a trend change, certainly aided by the recent general strength of the dollar.

We expect the yuan to continue to weaken, with an initial target of circa 7 yuan to the dollar.

OIL COMMENT

CRUDE OIL (WTI) (WEEKLY)



We suggested in the last issue that the $65 price level would be a formidable obstacle for oil to overcome. That proved to be the case last month, as the price of oil again tested that price level before ending the month at $59.16. The appreciation potential for oil appears limited at current levels, with the price obstacle at $65 followed by another at circa $70.

We remain bearish on oil because we believe the oil market is reflecting a more optimistic view of the supply/demand balance than is warranted.

In late March, OPEC+ announced their intention to add back some 2 million barrels per day (bpd) of oil production between May and July 2021. OPEC+ will add back 350,000 bpd in May, 350,000 bpd in June and 400,000 bpd in July. As well, Saudi Arabia will add back 1 million bpd of its production that it had cut.

Also, the supply of oil will benefit from an expected recovery in U.S. production in the second quarter. The U.S. Energy Information Agency stated that production was 11.1 million bpd in January, which was essentially unchanged from December but 1.7 million bpd below the level of a year previous. The unusually cold weather in Texas in the first quarter likely impacted production, which is why we do not expect a sustained recovery in U.S. production until the second quarter. We expect U.S. production to challenge its pre-COVID peak of 13 million bpd in 2022.

Meanwhile, our less than consensus expectation for global economic growth suggests that oil demand may be less than generally anticipated. This combination of increased supply and soft demand suggests lower oil prices ahead.

Lastly, the sentiment of non-commercial futures traders remains very bullish, while their commercial counterparts retain large short positions. Given our tendency to trade against extremes of sentiment, we consider the bullishness of the non-commercial traders to be yet another bearish indication for future oil prices.

DEFENCE SECTOR COMMENT

US AEROSPACE & DEFENCE ETF (ITA)(WEEKLY)

The global defence sector remains one of our core long-term investment themes. The deterioration of the geopolitical climate and rapidly evolving military technology suggests that defence spending will be robust in the decades ahead.

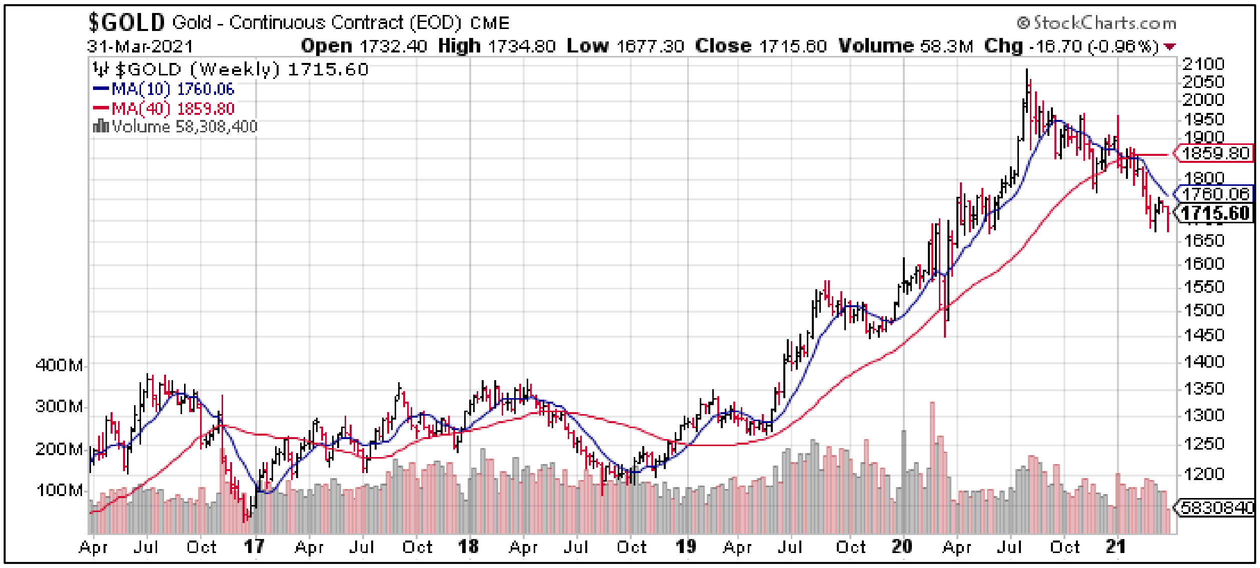
However, while we have made strong profits with our defence proxy, the ITA ETF, we currently remain on the sidelines in the absence of an attractive risk/reward buying opportunity.

The relative underperformance of the defence sector since the March 2020 lows has been a concern.

We will practice patience until an attractive purchase opportunity is presented. We continue to believe the best-performing stocks will be those producing products of the highest technology, such as aircraft and missile systems.

GOLD & SILVER COMMENTARY

GOLD (WEEKLY)



The bearish stance on gold we initiated when it broke below the $1800 level continued to be rewarded in March as the price fell an additional 1%.

As we have discussed in previous issues, the behaviour of gold is surprising (at least to us) given the enormous increase in the global money supply and the rising inflationary expectations being reflected by bond markets. These conditions have historically produced strong gold prices; that they have not is noteworthy.

In the absence of evidence to the contrary, we remain of the view that the primary force driving gold prices is risk perception. The strength by stock markets, Bitcoin et al. over the past year suggests that investor perception of risk is very low, which has certainly been supported by a host of measures of investor sentiment.

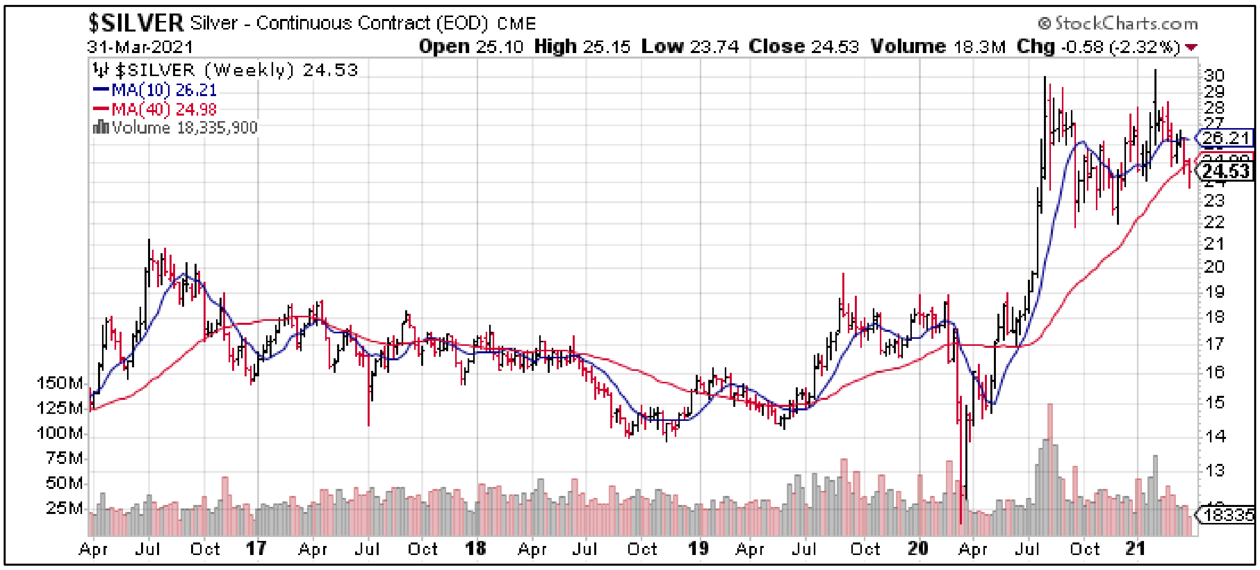
Therefore, the resumption of higher gold prices would seem to be tied to rising risk concerns, which will likely coincide with falling stock prices. Given our view that equities offer a poor risk/reward, a rebound in gold prices seems more likely sooner rather than later.

The slowing of the decline in March, and the attempt at price consolidation, offer some hope that the worst may be over for gold. However, a good deal of technical damage has been done, and the investing public remains largely indifferent to risk, so we must maintain our bearish short-term view.

We would become bullish should gold trade over $1760, which would increase the probability that March represented the end of the sell-off, thereby creating a favourable risk/reward buy point.

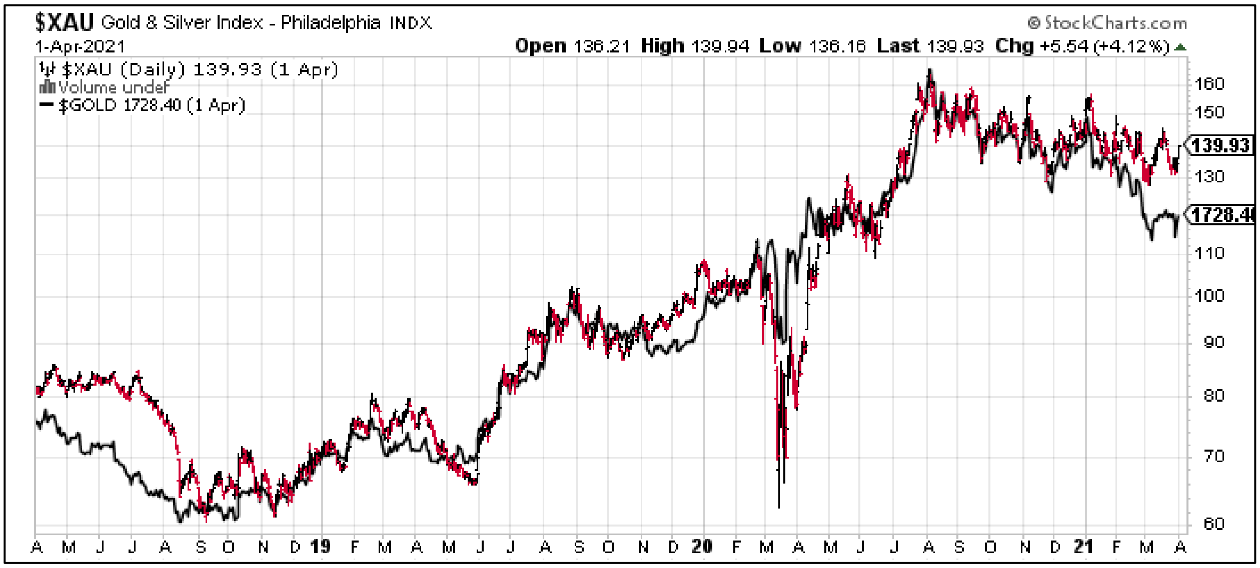
We remain bullish on gold long term, especially if we are correct that risk perception will be the major price driver, for we anticipate a good deal of volatility in the years ahead.

SILVER (WEEKLY)



As per our comments of last month, we continue to believe that silver likely offers better long-term price appreciation potential than gold. However, we will remain on the sidelines until silver trades higher than $30, which would be very bullish and suggestive of much higher prices.

GOLD & SILVER INDEX (XAU) vs. GOLD (DAILY)



Gold and silver equities, as represented by the XAU index, have not declined as sharply as gold in 2021.

A bottoming of the underlying metals is often accompanied by sharp declines in the XAU. In that respect, it would be desirable to see greater weakness in the XAU to confirm that a low in the metals has been made. The relative strength of the XAU creates the risk of a sharp pullback by the index should we see further weakness in the price of gold.

Gold and silver stocks offer the best leverage to bull markets in their respective metals. We continue to favour restricting purchases to producers operating in politically stable jurisdictions such as Australia, Canada, the United States, etc. Our concerns of rising geopolitical risk for gold producers in politically unstable nations will rise with the price of gold/silver.

We would only contemplate purchasing precious metal equities if the decision was confirmed by the price action of the underlying metal.

ABOUT THE EDITOR

The Editor and Publisher of the Global Investment Letter is Jonathan Baird CFA. Prior to founding the Global Investment Letter, Jonathan spent more than 25 years as an award winning money manager in Canada, most recently winning a Lipper Award in 2010 for managing the #1 Global Equity Fund in Canada. Jonathan managed several #1 ranked funds over the course of his career as a money manager, investing in all major industries, asset classes and markets. Along with his interest in the world of investment, Jonathan has been a lifelong student of history and uses the lessons of history to help interpret and provide context to current events. Jonathan no longer invests money for others, managing only his own account. The Global Investment Letter represents his personal thoughts and opinions.

Jonathan well understands the difficulty of the investment process, and the essential role that quality information and opinion play in successful investing. Each monthly issue will contain comments on major markets, economics, geopolitics as well as investment ideas. There may also be discussion of investment philosophy or practices and reviews of books deemed of potential interest to readers.