FIRST CAPITAL FINANCIAL

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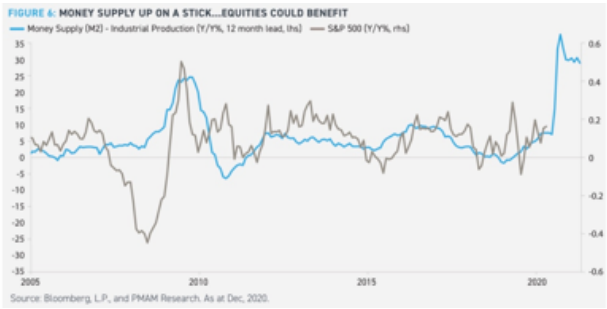
Sponsoring Mutual Fund Dealer

The stock market backdrop at the start of 2021 has been very positive. Central banks continue to support major economies with extreme levels of monetary policy and liquidity that has -and we believe will continue to- buoy Markets, while contributing to both a manufacturing and corporate profit recovery. Programs including President Biden's $1.9T US stimulus package should add to growth. This coupled with a successful rollout of vaccine programs will likely be a tremendous driver of pent-up demand in a number of industries that have been most negatively affected by Covid-19 related shutdowns.

The amount of excess liquidity in the system (beyond what the economy can productively use for real growth) is likely to contribute to further gains in risk-assets (stocks and high yield bonds). More, as the economy accelerates, ultra-low real bond yields can also compel investment flows out of fixed-income instruments and into stock markets. Given the probabilities of this outcome, there is a distinct possibility that stock prices have took to move higher this year. The Bloomberg graph shows the correlation between Money Supply and the S&P 500, the broadest measure of US stocks. Where money supply leads, Markets follow behind.



Our positive Market outlook is complicated by a few shorter-term risks. Among them are higher (by historical standards) than average valuations for stocks currently, delays in the roll out of vaccinations -Canada is stuck in the low single digits- and new variants that might require a re-tooling of vaccines already approved for use. The rally in stocks has left Markets vulnerable to the outcome that is less than the one that we all hope for: a return to relative normalcy in daily life. Looking at the Manufacturing sector (which has held up remarkably well), is showing some signs of sensitivity to reckoning effects. The new orders component of the Philadelphia Federal Reserve Business Outlook -the most forward-looking component of Manufacturing, has fallen in recent weeks. A negative surprise from US employment data is becoming increasingly likely, which could cause more Market volatility in the near term.

Bottom line is that Market optimism combined with weakening economic data is a mix that seems destined to cause a spike in stock market volatility. Our expectation though is that any pull-back will be brief and shallow. By the end of Q3 we expect the virus to be largely contained, at least to a point that further large outbreaks are unlikely -the kind that would require a move to shutdown as was the case this year. This will allow all industries including the beleaguered leisure sectors (travel -ah travel!) to resume normal activity. Through what lies ahead between now and then, we have confidence in our institutional wealth management partners at **Dimensional**, **EdgePoint**, **Guardian** and **Mackenzie Investments** to navigate their way through, positioning your hard-earned savings for solid, risk-adjusted returns.

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