SEAMARK

THE LATEST

INSIDE

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Robert McKim CFA
CEO & Chief Investment Officer
30 Years at SEAMARK
42 Years in Industry

Donald Wishart CPA, CMA, CFA
President
15 Years at SEAMARK
24 Years in Industry

George Loughery CPA, CGA, CFA
Chief Portfolio Manager
20 Years at SEAMARK
28 Years in Industry

Beste Alpargun MBA, CFA
VP Fixed Income, CCO & Portfolio Manager
11 Years at SEAMARK
30 Years in Industry

CIO Commentary

September 30, 2020

The third quarter economy demonstrated some come-back from the depths of despair following the Covid-19 forced shut down in March-April. Thankfully, the world economic engine was able to respond to trillions of dollars of stimulus thrown at it by the world's Central Banks and political leaders. The U.S. and Europe committed stimulus that measured approximately 12% of the GDP of their economies. Canada reached even deeper into its coffers, introducing monetary and fiscal stimulus programs approaching 20% of GDP.

Notwithstanding the obvious lack of economic activity in many sectors of the economy, the flood of liquidity orchestrated by Central Banks shored-up financial assets in Q3. Stocks and bonds both provided positive returns for the period against that backdrop. The third quarter snapshot captured a moment in time during the pandemic where unprecedented infusions of liquidity were looking for a home, bolstering the prices of financial assets. Equities rose in July and August, before retrenching in the month of September. Bonds prices moved higher initially, before giving up the gains, and then flat lining in August and September. Even though equities moved higher in concert with an improving economy, bond yields failed to rise more than a couple of basis points, in a sense failing to confirm that the economy is truly on a sustainably stronger footing. Government of Canada 10-year bond yields rose from 0.53% at June 30 to 0.56% at Sept 30. U.S. 10-year Treasury yields rose from 0.66% to 0.68% during the quarter.

The S&P TSX Composite stock index rose 3.9% in the third quarter, while the S&P 500 Index, driven mostly by a few of the largest companies added 8.5%. The stock indexes in both markets were unduly influenced by the performance of just a few mega companies. A deeper look into the U.S. market shows the lop-sided nature of the performance of equities. The S&P 500 Equal Weighted Index (each company has an equal weight, rather than a capitalization weight), rose a more modest 6.2% in the quarter, 250 basis points less than the S&P 500 Index, which is cap weighted. Year-to-date the Equal Weight Index has declined by 6.3% (versus the cap weighted rise of 4.1%), thereby providing a more realistic view of stock prices in the face of a flagging economy. The S&P TSX has more closely mirrored the experience of the S&P 500 Equal Weighted Index, falling by 5.5% for the nine months ending September 30. I encourage you to read the articles entitled "*Behind the Numbers – Capitalization vs Equal Weight Indexes*" and "*Revisiting Value vs Growth Behind the Numbers*," for an in depth look at the unusual dichotomy of equity markets during this pandemic (Quarterly Publication: The Latest).

What of the balance of 2020? So many questions remain. The economy (and corporate earnings) continue to beat lowered expectations but are no where near the aggregate levels of 2019. The impact of the overhang of COVID-19 is the biggest question mark – will the approval of therapeutics, or a vaccine that can tame the virus arrive before the second wave? Unfortunately, probably not. Cases are already picking up as the weather cools, and more children are at school. The flu season is nearly upon us. Even with the pace of vaccine development set at warp speed, it will be too late for the fall and winter seasons that health authorities have worried about from the start. That is not to say that the economy needs to be shut down in its entirety as it was in the spring. We know more about the virus and how to limit its spread. But we can't deny the fact that the virus has a much wider footprint than it did early in the year, from which it could easily springboard to the second wave. Even if there is no government mandated closure, most individuals are more likely to err on the side of caution when the level of known cases pick up. Staying home puts a cap on economic activity.

Stock markets though, have a long history of looking 6-9 months ahead. So, presumably we'll be in a much healthier place by then. We all hope so. If we could just traverse from here to there, the economy and markets will probably be sustainably better. But the world waits with bated breath now as the U.S. election looms, on November 3…and beyond. The logistics of handling an unprecedented level of mail-in ballots, is a new phenomenon that threatens to delay the election result beyond the night of Nov 3. And the spectre of a contested election looms, as delays in ballot counting threaten potential legal action in a hyper-partisan political environment.

SEAMARK portfolios are defensively positioned given the magnitude of the uncertainties that lie ahead. The market has already witnessed a possible blow off for the mega cap companies that have been the backbone of index performance this year. The advance of tech stock prices in the month of August is reminiscent of prior market tops in the sector. And once we get to a healthier place, it is very likely that it will be the rest of the market that catches up, as year-over-year earnings comparisons will be much easier and more dramatic in the recovery sectors. This should return investor focus to many sectors of the market that have been underperformers this year. We believe that SEAMARK portfolios are properly positioned, both for the uncertainty that lies directly ahead, and for the attractive opportunities that will come out the other side, in 2021.

Sincerely,

Robert G. McKim, CFA
Chief Investment Officer

Behind the Numbers – Capitalization vs Equal Weight Indexes

From time to time it can be instructive to look behind the numbers, to gain insight and context into investment markets. It might be timely to do so again, given the upcoming U.S. election, and President Trump's proclivity to trumpet how well the U.S. stock market is performing.

Another reason to take a deeper look is the huge dichotomy this year between Wall Street and Main Street. Stocks have recovered in price a lot faster than the economy has. There are still millions of people out of work, with many wondering how to meet their next mortgage or rent payment, or even how to put food on the table.

On the surface it looks as though stocks have managed to make new highs, despite the worst health pandemic in 100 years. That's rather incredible and, understandably, has a lot of folks scratching their heads. The NASDAQ, powered by technology stocks, is indeed higher, reflecting the attractive *no-touch* aspects of e-commerce. But the S&P 500 Index is more of a mixed bag. Much has been written about the top 5 mega stocks that comprise more than 20% of that index, and how they have been the principal drivers of performance. Canadian investors will recall the Nortel days, while both Canadians and Americans will recollect the tech bubble of 2000. It took the NASDAQ 16 years to return to the lofty heights it originally recorded in 2000. The hard lesson learned? Nothing lasts forever.

One would assume that an index like the S&P 500 is truly a broad measure of the largest and most successful companies in the U.S. As such, it might be expected to represent a logical benchmark for how the economy and stocks are faring. But when the largest companies get so top heavy in an index, investors would be right to question the validity of the result. The S&P 500 is a capitalization weighted index, which allows the biggest companies to dominate the performance of the index. However, S&P also produces an Equal Weighted Index, *for the same 500 companies*. An equal weighted index is arguably an even broader measure of the economy and stock market. Instead of comprising some 22% of an index of 500 companies, the 5 largest companies when equal weighted, make up only 1% of the index, the same as any five companies that comprise part of the index.

Is this relevant to anyone? Yes, it should be, to the investor and to money managers too. Perhaps, even U.S. voters would have more than just a passing interest, for it has been the Equal Weighted S&P 500 Index that has performed more in line with the economy this year. Its performance reflects some meaningful recovery in stock prices, but it is certainly short of reaching new highs. The Equal Weighted Index exposes the false impression given by the Cap Weighted Index, that the economy is back. At September 30, the YTD returns of the two S&P 500 Indexes can be seen below.

S&P 500 Value Index (Orange)
S&P 500 Index – Equal Weighted (Purple)
S&P 500 Index – Capitalization Weighted (Broken Line)
S&P 500 Growth Index (Blue)
Source: TD Web Broker

Many lay observers would agree that the performance of the Equal Weighted index is much more indicative of the real economy, the Main Street economy, that pays the bills for most folks.

Those money managers that count themselves as 'risk managers' are also interested in the dichotomy of returns between the two indexes. This raises an interesting question: does the money manager view risk as a variance in return from the Cap Weighted Index (a Benchmark manager), or does the manager see risk in more absolute terms, i.e., an aversion to the loss of capital? The answer may depend on the manager's end client, and that client's ability to replace capital that might be 'lost' in the market. If capital can easily be replaced, risk management may come second to the quest for returns. That could result in a portfolio strategy having position weights anchored to the cap weighted index. But if capital preservation is important, then position size would be normalized, and used as a mitigation strategy to reduce the potential of actual loss for the investor.

The year to date differential between the S&P 500 Cap Weighted and Equal Weighted Returns is significant…exceeding 1000 basis points (over 10%!). The top-heavy Cap Weighted Index has performed of late, like a momentum investment style which, incidentally, is the style least tied to valuation metrics, and potentially subject to the deepest correction in price.

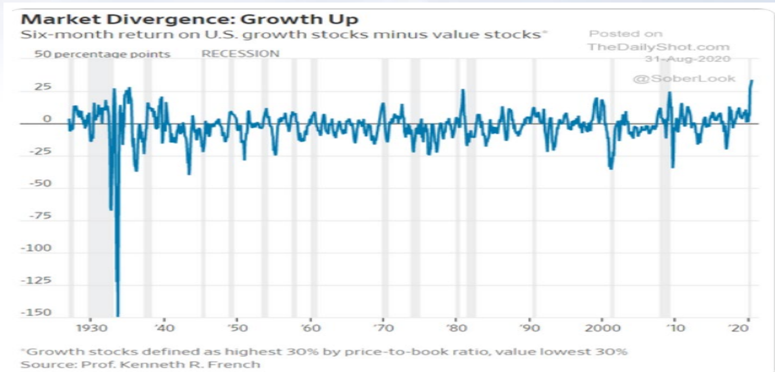
Investors should always be aware of the risks of investing, and know which risks are important to their investing comfort!

--- Robert G. McKim, CFA

Revisiting Value vs Growth Behind the Numbers

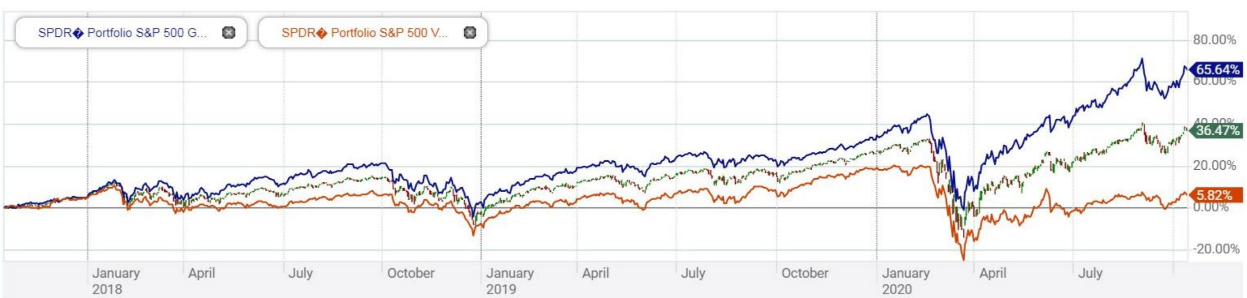
In *'Behind the Numbers'*, we spoke of the S&P 500 Index taking on the style characteristics of a momentum manager. It should always be a warning signal, whenever investors are in a mood to chase stocks. Money manager Cole Smead wrote an interesting piece recently entitled "Value's Lifeblood is Performance Chasers" in which he uses the phrase "dogs chase cars and humans chase stocks." Both are accidents waiting to happen.

We have suggested that one way to mitigate investment risk (from chasing stocks) is to construct portfolios that look more equal weighted than capitalization weighted. That construct better insures investors against large capital drawdowns when momentum plays inevitably return to earth and get marked down to more reasonable valuation levels.



When market performance is dominated by either growth picks or value picks, investors will be well served to take a step back to review how history has treated value investors and growth investors. A brief glance at the following chart would suggest a more or less equal number of observations above and below the mid-line. A closer look defines each of the observations to be *the return of growth stocks minus the return of value stocks.* So, observations above the horizontal line indicate outperformance by growth, and observations below the line reflect underperformance of growth, a few of which, over the years, have been quite dramatic. In fact, rather routinely, growth underperforms value by as much as 25%. Rarely does growth *outperform* by as much as 25%, but we are living a relatively long and robust period of growth outperforming value right now. Interestingly, growth has quite often outperformed value, going into recessions. But value delivered stronger performance, coincident with economic recoveries.

We can take a closer look at what the market has been doing over the last three years. Clearly, growth selections have been winning the day for an extended period.



S&P 500 Growth Index (Blue)
S&P 500 Index (Broken Line)
S&P 500 Value Index (Orange)
Source: TD Web Broker

No investor should be afraid of growth, but occasionally, (when humans chase stocks), the share price performance of growth stocks far exceeds the underlying growth rate of those companies' earnings. This momentum driven phenomenon in turn drives an expansion of valuation multiples. We have been living this in spades this year. Investors have been willing to pay more for a dollar of earnings for growth stocks than at any time since the tech bubble burst in 2000. That willingness is based on a view that a higher sustainable growth rate is upon us. But maybe that presumed higher growth rate only reflects a pull forward of future growth, accelerated by COVID-19.

How does it happen that investors are suddenly willing to forego time-tested valuation disciplines? One explanation can be gleaned from a note from CNBC. It speaks of the new investor phenomenon that has happened this year, even in the height of the Coronavirus Pandemic:

Retail trading has taken off in 2020 amid the coronavirus downturn that many young traders saw as an entry point into the world of investing. Major brokerage firms saw record new accounts in the first quarter. Fidelity, for example, saw a record 1.2 million accounts open in the first few months of the year.

"New investors who sense a generational-buying moment but do not have much background in the equity space," Citi chief U.S. equity strategist Tobias Levkovich said in a note to clients in May. "We have heard anecdotally about younger individuals with less market experience viewing the March plunge as a unique time to start portfolios and often crowding into the tech arena, purchasing the stocks whose services or products they know and use."

The influx of young, inexperienced traders is benefiting Robinhood. In March the start-up said it saw three times its average customer trading volume compared to 2019. That uptick continued through April and into May, Bhatt said.

Robinhood users recently told CNBC they were using COVID-19 stimulus checks to invest.
Source: CNBC Disruptor 50, Published June 17, 2020.

Is this liquidity driven phenomenon a wake-up call for investors? With everything having gone in growth's favour, one should question if the table is being set now for value to do better as the economy emerges from the COVID slowdown. That would make sense. When the economy fully recovers, the best year-over-year earnings comparisons will likely come from the traditional economic sectors that have seen their earnings fall the most during the Coronavirus pandemic.

--- Robert G. McKim, CFA

2019 Pooled Fund Capital Gains Tax Deferrals

	Tax Loss Carry Forwards*
SEAMARK Pooled U.S. Equity Fund	$ 21,670,194
SEAMARK Pooled Total Equity Fund	$ 17,800,236
SEAMARK Pooled Low Volatility Equity Fund	$ 4,625,983
SEAMARK Pooled Canadian Equity Fund	$ 4,967,080

*Audited Financial Statements, as at December 31, 2019

Some of these tax loss deferrals are significant compared to the assets in the respective Pools.

Please contact Ann-Marie Slawter for more information:
902-423-9367 aslawter@seamark.ca

Composite Performance Update

Calendar Year Performance

	Q3 2020	2019	2018	2017	2016	2015	2014	Since Inception	Inception Date
SEAMARK Balanced Composite (%)	**2.9**	**14.6**	**-5.2**	**4.9**	**8.8**	**6.0**	**12.8**	**6.7**	12/31/2009
Balanced Benchmark* (%)	3.1	15.3	-1.4	7.4	7.8	3.9	10.7	7.0	
SEAMARK Low Volatility Equity Composite (%)	**2.9**	**15.5**	**-2.4**	**6.7**	**12.4**	**7.0**	**15.1**	**8.4**	12/31/2010
S&P/TSX Composite Index (%)	4.7	22.9	-8.9	9.1	21.1	-8.3	10.6	4.6	
SEAMARK Canadian Equity Composite (%)	**6.7**	**19.5**	**-12.7**	**5.2**	**19.8**	**-6.3**	**13.8**	**4.6**	01/31/2011
S&P/TSX Composite Index (%)	4.7	22.9	-8.9	9.1	21.1	-8.3	10.6	4.5	
SEAMARK Total Equity Composite (%)	**4.1**	**19.1**	**-6.0**	**5.9**	**12.2**	**6.7**	**16.0**	**9.6**	09/30/2011
Total Equity Benchmark** (%)	5.3	22.8	-4.0	12.1	13.2	5.3	14.2	11.1	
SEAMARK Fixed Income Composite (%)	**0.9**	**5.6**	**1.6**	**2.6**	**1.8**	**3.8**	**8.4**	**3.8**	04/30/2012
FTSE Canada Universe Bond Index (%)	0.4	6.9	1.4	2.5	1.7	3.5	8.8	4.2	
SEAMARK U.S. Equity Composite (%)	**2.7**	**17.5**	**2.4**	**3.4**	**13.9**	**14.1**	**18.5**	**12.7**	04/30/2012
S&P 500 Index (CAD) (%)	6.6	25.2	4.0	13.8	8.6	21.0	24.0	17.1	

*Effective 30 Sep 2018, the SEAMARK Balanced Composite Benchmark is 5% FTSE Canada 91 Day TBill Index, 40% FTSE Canada Universe Bond Index, 27% S&P/TSX Composite Index, 20% S&P 500 Index, 8% Morningstar Developed Markets ex North America GR Index
**50% S&P/TSX Composite Index, 35% S&P 500 Index, 15% Morningstar Developed Markets ex North America GR Index

Links to Q3 2020 Pooled Fund Profiles

Balanced   Canadian Equity   Low Volatility Equity   Canadian Bond   U.S. Equity   Total Equity

Stay in Touch!

Phone: 1 902 423 9367
Toll free: 1 888 303 5055
Email: information@seamark.ca
Visit: www.SEAMARK.ca

SEAMARK Asset Management Ltd.
400-1718 Argyle St
Halifax, NS B3J 3N6

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