

The Great Rotation

Raj Bansal, CFA, CFP
Vice President & Senior Investment Counsellor

2020 Returns: Leaders and Laggards

- Mega cap (very large) technology companies were the clear leaders and had the lion share of gains in 2020. Meanwhile cyclical stocks like financials and industrials lagged as large parts of the world economies were shut down due to the COVID pandemic.

- A good example would be to look at 2 of your largest holdings: Apple and Royal Bank.

- Both Apple and Royal Bank are excellent companies, leaders in their industries and terrific at compounding their growth.

- In 2020, Apple was a darling “COVID” company as people ordered iPads and MAC notebooks to work and study from home. This resulted in Apple stock gaining 78% in 2020.

- In contrast, Royal Bank, which was hitting record highs right before the pandemic, struggled with uncertainty of loan losses. In addition, interest rate spreads between short term and long term bonds tightened to record lows. This hurt bank loan profitability. The tremendous amount of government stimulus and prudent management skills of the senior team allowed the Canadian banks to recover their earnings but banks remained out of favour for most of 2020. Royal Bank gained 7.75% in 2020.

Late 2020 and 2021 - The Great Rotation

- On November 9, 2020, Pfizer released the results of their COVID-19 vaccine trials and they were beyond expectations. This allowed the market to see through the pandemic and started to value the “post pandemic portfolios” that included cyclicals and financials.

- With vaccines rolling out, indications of a \$1.9 Trillion U.S. fiscal stimulus and the federal reserve still on hold keeping interest rates low, the cyclicals have come roaring back while the mega cap technology stocks have lagged.

- The optimism of a strong economy re-opening and major pent up demand has caused long term rates like the U.S. 10 year bond to quickly move higher. Although, the rates are still below 1.5%, they are coming from much lower levels.

- This “steepening of the yield curve” has made cyclicals and financials more attractive. On the other hand, as interest rates have risen, it’s made higher valuation growth companies less attractive.

- In the case of Apple vs. Royal Bank, the result YTD has been Royal Bank gaining 6.9% while Apple has lost 6.4%.

- We expect financials and cyclicals to carry their strong momentum through 2021 as technology stocks take a breather.

The Importance of Diversification

- As managers of your investments, one of the key ways we preserve your capital and take advantage of market opportunities is to build diversified portfolios with exposure to both cyclicals and secular growth companies
- Having exposure to best of class growth companies in the U.S. helped us last year. Having exposure to best of class cyclicals and financials in Canada and internationally will help returns in 2021.



Please contact your BMO financial professional if you have any questions or would like to discuss your investments.



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