

How Long Will the Bifurcated Market Last?

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The theme we are seeing right now is that the market has increasingly become bifurcated. Indices have gone up significantly this year in both US and Canada, with the S&P 500 up 24% and the S&P/TSX Composite Index up 22%^[1]. As a result, there has been a huge amount of capital gains realized and a lot of tax planning is underway.

What does this mean? To crystalize tax losses, investors start selling stocks on the way down which puts more pressure on stocks that have not done well. On the other hand, investors are unwilling to sell stocks that have outperformed which triggers additional capital gains, so it has created a bimodal market where winners keep on winning and losers keep losing.

If tax planning is the main reason behind this bifurcation, we expect to see a major reversal and renewed flows in the New Year, whereby companies that have been out of favour for an extended period of time start to attract investor interest again.

We have talked about the “risk off” status and relative underperformance of small and microcap companies in previous commentaries. Increased volatility in the small and microcap space has created selling pressure on a wide range of names in this universe. The additional tax planning measures have further exacerbated the downward pressure on these names.

We believe that having more sellers than buyers of these businesses today creates a wonderful opportunity for these names over the longer run. We await for things to unfold.

^[1] Year to date until November 30th, 2019; source - PenderFund, Bloomberg