The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | July 2020 www.krygierwealthmanagement.ca

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Second Wave?

November 16, 2002 in Foshan, Guangdong, China marked the first time the SARS virus was identified. It was the first deadly epidemic caused by a coronavirus (which prior to 2003 was known only to cause common colds), and it took eight months to run its course, after spanning almost 30 countries. It caused mass isolations, hoarding of face masks, and the cancellation of trips to Asia. How did it end? Some say a combination of traditional medical practices such as testing, isolation of those testing positive, and screening of people in places where they might spread the disease, and luck, to the extent that it never reached less-developed countries that often lack sophisticated health care systems. Covid-19, which apparently shares 70% of the genetic material of SARS but is clearly more transmittable, has spread far beyond the reach of SARS and has killed many more people, despite the prior experience the medical system had with SARS. The measures taken to counter Covid-19 have been unprecedented, both in their magnitude and scope, but were likely necessary to slowdown the spread of the disease. As governments continue to struggle with the "reopening" of the economy, the fear of a "second wave" of the disease continues to fill the media headlines. What if this time we cannot contain it? What if a vaccine cannot be found? Interestingly, even as sections of the economies are reopening, and correspondingly in such places instances of the disease are in fact rising, sometimes dramatically, the number of those dying and those severely affected by it are at the same time declining, prompting some to suggest that the disease is weakening and may end, like SARS, without a vaccine being found.

Even without a second wave, there are real concerns about the longer-term impact on the economy after the forced closures. Many industries were clearly negatively impacted, such as airlines, restaurants, hotels and live entertainment. Others were clearly impacted positively, such as basic food suppliers, and anything to do with "stay at home" such as on-line shopping and entertainment, but for both types of businesses the question remains for how long? The surge of buying food and other basics has long-subsided. The waning demand for PPE (Personal Protective Equipment) including hand sanitizers and face masks has left huge piles of inventories in many warehouses and store shelves by those who were hoping to cash in on the short-term panic demand. The challenge for investors is to figure out which of these companies' stocks are worth buying, holding or selling. Companies providing basics will likely not see more than normal demand going forward. In contrast, hotels, restaurants and airlines may not see normalized demand for months or even years. Consider that while professionals like Warren Buffett were selling the stocks in airlines and banks, retail clients were buying these "bargain" stocks. Retail clients also bid up the prices of obvious winners from the closed economy, like Zoom, Amazon and Netflix, to extreme valuations not seen since the tech bubble of 2000. Worse, some very strange happenings have been occurring in the markets. For instance, Hertz, the car rental company, in the midst of going bankrupt, was only prevented at the last minute from issuing US$1 billion worth of shares, proving again the P.T. Barnum maxim that "a sucker is born every minute". Investors beware!

Recently I listened to a conference call from David Fingold, an experienced institutional global portfolio manager with a lengthy track record of investing success. Mr. Fingold strongly believes that the economic shutdown simply cemented the themes that were already in place for several years and brought them forward in a more rapid way. He suggested commercial real estate prices will be negatively impacted for years, as many small entrepreneurs go out of business, and as commercial tenants cut back on space that they lease with more "at home" workers. In contrast, he believes that cloud computing, which has pushed the earnings and the stock prices of companies such as Microsoft and Amazon much, much higher, has now become fully entrenched and he felt it still has more room to run, as many businesses and governments have yet to adopt it into their systems. Furthermore, he suggested that many "bargain" stocks will undoubtedly return to the "bargain bin" as their broken models of doing business was only exacerbated by the economic closures. Think about the airlines that Mr. Buffett sold (to which Mr. Fingold heartedly agreed was the right decision). They will almost definitely be flying less passengers while at the same time they will be suffering higher costs of cleaning thoroughly between flights. Less revenue and higher costs… Similar comments can be said about hotels and the entire leisure market. While cruise ships became the "go to" choice for globe-trotting baby boomers, how many will be willing to chance catching a deadly virus amongst 3-5,000 strangers in tight quarters? Sports arenas? Movie theaters? A turning point may have been reached for many businesses and industries and the challenge is to sift through them for the ones that will succeed.

Is it a good time to invest? Certainly, the question is only in what to invest. It's crucial to do one's homework, not to believe everything one reads or hears, and to recognize that just because something "sounds" like it is growth oriented, does not mean it is in fact. Recent investors in a Chinese property company, named Fangdd Network, found this lesson the hard way after they pushed the value of this company's stock from US$800 million to US$10 billion in a mere four hours of trading, after social media hysteria spread the message that its name suggested it was a cheap ETF holding the famed "FAANG" technology giants (Facebook, Apple, Amazon, Netflix and Google). How should one invest? In such volatile times it is more important than ever to be disciplined about investing, including diversifying properly, holding only quality companies with low debt levels, paying attention to valuations, having a long-term approach, and finally, remembering the lessons of history, or as the poet George Santayana said, "we are condemned to repeat it."

Bottom line

The impact of Covid-19 will be felt long-after the virus ends. Investors certainly have reasons to be wary, but they also have many reasons for optimism, both with regards to the virus itself, as well as with the investing opportunities that are continuing to present themselves. The time for panic is behind us, the time for planning is now!

Global benchmarks
As at June 30, 2020 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	-7.5%	-2.2%	3.9%
S&P 500 TR - US$	-3.1%	7.5%	10.7%
NASDAQ Composite - US$	12.1%	25.6%	17.9%
MSCI Europe Index Price Return	-10.1%	-5.5%	-1.2%
MSCI Emerging Markets	-6.7%	-2.2%	1.0%
China S.E Shanghai A Price Return	0.8%	1.0%	-2.0%
MSCI World Index Price Return	-2.4%	4.8%	6.3%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	25.5%	30.3%	13.6%
10-year U.S. T-Bond - US$	13.0%	14.9%	7.5%
Long GOC Bond (2048)	19.5%	18.5%	10.9%
10-year GOC Bond	11.8%	10.4%	5.7%
5-year GOC Bond	7.1%	6.5%	3.6%
3-month CDN T-bill	0.7%	1.5%	1.3%
US$/CDN$ (1.3573)	4.5%	3.7%	1.5%

Source: RBC Capital Markets Quantitative Research

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