2020 Q2 commentary

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Living in a COVID-19 world: Reality sets in

Jon Mitchell, Portfolio Manager

Despite the arrival of summer and favourable weather, we are gradually moving to acceptance that life is going to be different for the next year, or possibly for considerably longer. We are also witnessing a major divide from those whose financial stability is still reasonable, and those who are in a very precarious situation that has been temporarily rescued by government aid and loans. It is evident now that we are battling a war on many fronts: medical, social behaviour and on the financial side (personally, and as a society, reflected through our governments). Let's take a look at these in a bit of detail and then touch on some of the investment trends.

Medical: COVID-19

According to The New York Times, most medical experts are placing the projection of a working vaccine sometime in 2021. The ability to scale the production to meet the demand will be a major challenge, although the amount of support from major nations is also unprecedented. Therapies to treat COVID-19 are also advancing. Gilead, a U.S.-based pharmaceutical firm, has been advancing trials for its drug to treat the Ebola virus, Remdesivir, as a possible treatment for patients infected with COVID-19. In late June, the U.S. government secured 500,000 doses of the drug (most of Gilead's production for the next several months) in an exclusive arrangement.

Many countries have been making great strides in reducing the infection rate, including Canada, which is now running at approximately less than 500 new cases a day on average, according to Worldometer. Meanwhile, large nations like the U.S., Brazil and Russia have seen their infections soar recently. For example, the U.S. is seeing more than 60,000 new cases every day. This is having a marked effect on the recovery of the economy, as many states have had to slow their economic re-start measures.

As time has passed, medical researchers have discovered new ways to treat infected patients, with various treatments explored, including the use of steroids, new treatments such as Remdesivir, along with therapeutic use of oxygen and ventilators, according to the World Health Organization.

Social behaviour

After months of isolation, our day-to-day activities are starting to begin again. Restaurants, stores, offices, courts, airports and so many aspects of our lives are re-opening, but with many new protocols in place. Public use of face masks is gradually becoming the norm and has become mandatory in some communities across Canada. Still, most people are reluctant to get on a plane to travel, most international borders are still closed for travel and we are less-inclined to visit a shopping mall or a sit-down restaurant than a store that we can walk in and out of. The routine of millions of Canadians in travelling to the U.S. or other warmer climes in the winter is certainly up in the air for 2020–2021. Without a vaccine or proven therapy, most snowbirds just do not feel safe in leaving the security of their Canadian homes this year.

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Large gatherings such as sporting and concert events are a 2021 dream at the moment. Some professional sports like the NFL and NBA will fare better due to lucrative broadcast deals, but many sports will struggle to survive if this goes on for more than a season. Certainly, many arts and cultural organizations are already in peril given the closure since March.

For parents with school-age children, there is still a lot of uncertainty as to how schools will deal with the return to classes this fall, after a six-month absence. Will it be a combination of in-class and online teaching? How will that impact parents who are being called back to their places of work? Most post-secondary universities and colleges have already opted to continue online learning until at least January 2021.

Now that so many professionals have been working remotely from home for four months, will it be possible to have them return to their workplaces in a safe manner, or will many strive to continue to work remotely? Large centres with high-rise offices will have major challenges just moving people up and down the elevators. Trains and buses, normally packed for rush hour commuting, will have to have modifications for capacity.

The shift from in-person shopping to online shopping has taken a quantum leap in the last four months, as evidenced by the enormous moves by e-retail companies like Amazon and Shopify. The amount of delivery trucks in our communities has gone up exponentially, as well as delivery or pick-up of groceries and restaurant meals.

With the curtailment of air travel, many people have focused on camping (according to Business Insider, recreational vehicle sales are burgeoning), home improvements and furnishings and “staycations” or vacations within a short driving distance. Pastimes such as baking and sewing have also seen a growth spurt, as people spend more times in their homes. According to the Washington Post, bicycle sales in the U.S. have skyrocketed since April as a means of getting around, and for physical exercise, as many gyms and recreational centres remain closed. Used car sales have recovered dramatically, as people weigh the risks of public transit against travelling in their own car.

Financial – personal and societal (government)

For most of our clients who are retired or who are nearing retirement, with a reasonable amount of savings and pension income, the past quarter has seen an impressive rebound to their investments (see table at end of this commentary). As we speak to clients, many have naturally reduced their spending, given the fact that they have minimized their interactions and have stayed home for their own safety.

The consequences of the COVID-19 crisis on financial investments has been significant, though: short-term interests are now near 0%, GIC rates are at all-time record lows at 1.5% for five-year terms, and government bonds are yielding 0.55% for 10-year terms. Earnings for most sectors of the market have plummeted, with nearly half of the 500 companies in the S&P 500 suspending their earnings guidance. There have been some notable dividend cuts or suspensions due to the uncertainty of future earnings, and finally, there have also been some significant winners and losers, due to the resulting stay-at-home / work-from-home reality.

There is little doubt that the key factor that staved off a global depression and which underpinned the market recovery was the action of central banks, which injected trillions of dollars through bond and mortgage purchases and by governments through fiscal measures such as extended unemployment benefits such as Canadian Emergency Response Benefit (CERB), or forgivable loans to employers, in order to maintain employee payrolls. This week, Canadians got a glimpse into the size of the spending with the federal government pinning the expected deficit at over $340 billion for the current year. The U.S. deficit is on track to be close to $4 trillion USD by year’s end ($2.7 trillion USD after nine months). Meanwhile, corporations have issued record levels of new debt in recent months, with some issues for survival of the business (airlines, hospitality firms) and some to simply take advantage of the incredibly low interest rate environment.

There are many unknowns facing society as government programs start to wind down, and the enormity of the newly minted debt starts to sink in for all levels of government. I would say that Canadians have demonstrated extraordinary resilience in this pandemic, and made creative strides in keeping in touch with their loved ones and friends.

Investment observations

With the lockdown in place, there has been an explosion in do-it-yourself online trading, with some brokerage firms reporting year-over-year growth rates for new accounts at as much as 170%, according to CNBC. With professional sports shut down since mid-March, the lack of sports betting has shifted into stock trading, in many cases.

Another notable trend, which is much more established in nature, has been the concentration of winning stocks into a few very-large groups of technology stocks. Facebook, Amazon, Apple, Google and Microsoft recently made up 23.7% of the market capitalization of the S&P 500 ($6.75 trillion), while the bottom 350 companies in the index comprised only 20.3% ($5.78 trillion). Three of these companies have a market capitalization of more than $1.5 trillion (Amazon, Apple and Microsoft). All of these technology companies have benefitted from the stay-at-home / work-at-home circumstances that we have experienced since the onset of COVID-19. My only comment here is that valuations do matter, perhaps not in the short-term, but for sure in the longer-term.

Finally, as a short follow-up to the last letter, we are seeing both gold bullion and the related gold mining stocks show continued strength in the second quarter. In speaking to clients, I try to pose a question to them such as “Do you think that the injection of $3 trillion USD by the Federal Reserve makes the value of all existing U.S. dollars more valuable or less valuable?” Additionally, given the size of government deficits expected for the next few years, there will be ever greater supplies of U.S. dollars in the banking system. Due to the known amount of gold, and its historical store of value, it is viewed as a more stable from of money, which is contributing to its steady growth. RBC Capital Markets recently noted on July 9, that “when it comes to rates however, they not only have played a central role in getting gold to where it is now (ultra-easy monetary policy, low and negative nominal and real rates across much of the world, etc.), low and negative yields represent the key to keeping gold elevated.”[1] RBC CM is assigning a 45% probability that gold will average U$2,014 by Q1 2021.

[1]RBC Capital Markets, "Gold Strategy: Crossing the Threshold," July 9, 2020.

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Notable quotes:

"How did you go bankrupt? Two ways. Gradually, then suddenly."

– Ernest Hemingway, The Sun Also Rises

"Markets can stay irrational longer than you can stay solvent."

– John Maynard Keynes, 1930s

"Say it with me ... Stocks only go up. Only losers take profits. [June 4, 2020]

"I'm sure Warren Buffett is a great guy, but when it comes to stocks he's washed up. I'm the captain now. [June 9 2020]"

– Dave Portnoy, aka Davey Day Trader Global, founder of Barstool Sports

(Note: Buffet's Berkshire Hathaway did announce a $10 billion purchase of natural gas assets and pipelines on July 5, 2020)

"In the short-run, the market is a voting machine but in the long run, it is a weighing machine."

– Benjamin Graham, 1934 publication entitled Security Analysis

Team updates

- We are hoping to return to our office sometime in August, as phase 1 of our "return to premises" protocol. More details will be updated as part of our weekly notes on our website.
- We have also started doing online meetings using WebEx, which is a secure system run by Cisco. If you are interested in meeting with Jon over WebEx, please let one of us know.
- Pauline is now tentatively scheduled for knee surgery in mid-September (as her March date was cancelled due to COVID-19).
- Tina participated in two online choirs that were nationally broadcast on Canada Day.
- Jon continues to travel most weekends out to Unity, SK, where he splits his time between a small privately-owned campground in town and his rustic campsite in the nearby Round Valley.
- As always, we are open to speaking to any of your friends that are looking for a second opinion on their investments.
- Finally, we would recommend that you circle back to our website from time to time, as we are using that as one of our points of contact to post salient articles on our firm's views, along with details of the government programs and announcements. You can access it here: www.rbcds.com/jon.mitchell/

Again, stay safe and take care. Enjoy the Alberta weather and your safely distanced meetings with family and friends.

Set out below is a table of the performance of various sectors of the market in the second quarter of 2020 and for the 2020 results / 3-year rolling periods. I have added lines for the NASDAQ and the global gold mining indices.

Investment index	Q2 2020 return	2020 return	3-year compound return
S&P/ TSX composite index	17.0 %	-7.5 %	3.9 %
S&P 500 (C$)	16.4 %	1.3 %	12.4 %
NASDAQ comp (C$)	26.1 %	17.2 %	19.7 %
Short-term comp bond index	2.2 %	4.0 %	3.0 %
iShares U.S. High Yield Bond Index ETF (XHY, C$ Hedged)	7.2 %	-5.9 %	1.3 %
US$ / C$	-1.4 %	4.5 %	1.5 %
Gold bullion (C$)	8.8 %	23.6 %	14.9 %
Global gold mining index (XGD – C$)	47.4 %	32.4 %	21.1 %

Wealth Management
Dominion Securities