



Memorandum

DATE: March 2, 2020

TO: Our valued clients

FROM: Michael Pallett, CFA & Jonathan Bloom PFP

RE: This too shall pass

In January this year, investors faced an interesting dilemma: how should thoughtful investors approach their portfolios in the face of the aging bull market and stocks reaching, or approaching full valuation?

Last week, a solution to this dilemma was delivered with a swift decline in North American stock indices. The TSX fell by 9% while the more expensive S&P 500 fell by approximately 11%. Last week's sell-off took the market back to where it was in late 2019. It was unpleasant, but a reminder of what can be described as investing's "rich pageantry". So, as February ended, January's problem was solved... while another serious issue newly emerged – COVID-19.

The new test for investors is to understand the unfolding challenges (and opportunities) that will result from the widening pandemic of COVID-19, and the resulting deceleration in global economic growth. While the global economy has faced similar challenges before, the current situation is novel in many respects and understanding how policy makers and Mother Nature will resolve the current situation is unknowable. So, accepting this fundamental truth, what should investors do now?

Wading vs. Waiting

For most investors the default strategy should be "do nothing". Portfolios built with a diversified mix of quality dividend paying common shares, ETFs and mutual funds have nothing to fear. A market decline of 10% or more is inevitable, and is part of the normal "ups and downs" of markets as new information and economic news is discounted in share prices.

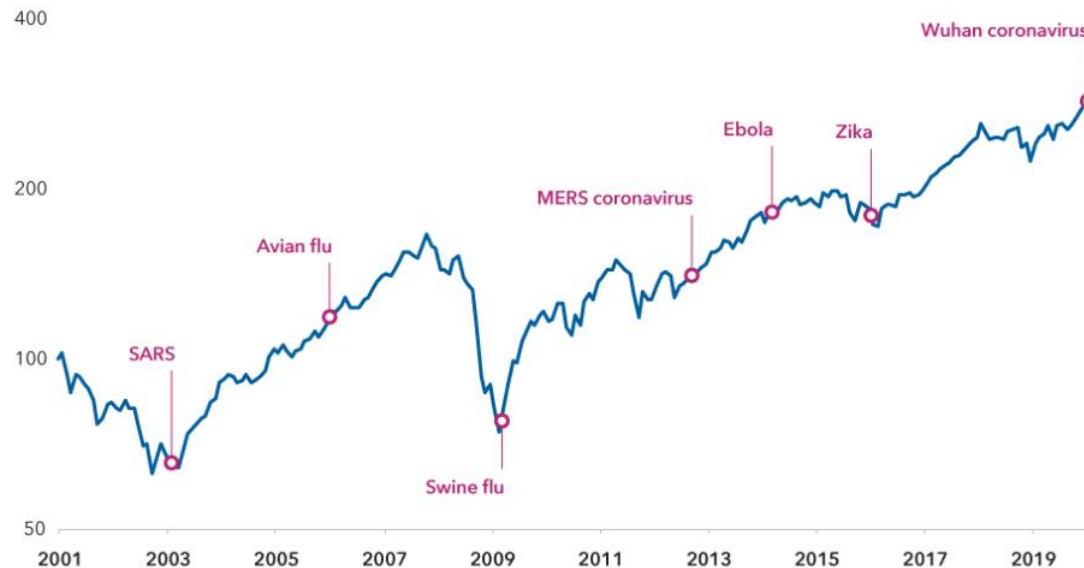
Some investors will want to dive in to the uncertainty in the hopes of a quick rebound. While a V-shaped rebound is possible, the old adage about diving into unknown waters is probably sage advice. When the depth of the water is unknown, wading in gradually is a much safer strategy.

Conversely, some investors may be tempted to sell into the market weakness. While this approach appears attractive in stemming short-term losses, it has the significant disadvantage of solving only half the problem, as most investors fail to reposition their portfolios to benefit from the eventual rebound in prices. If you are an investor with long-term income and retirement goals, try to mirror those objectives by making sensible long-term investment decisions with your savings.

Behavioural finance teaches us the best strategy for investment success is to be aware of your investment “blind spots”. One such bias is “anchoring”, or the behavioural bias in which the use of a psychological benchmark carries a disproportionately high weight in the investor’s decision-making process. For example, seeing gains from last month (or last year) in your portfolio recede is difficult, but comparing your portfolio’s current value with where you started (vs. last week’s high water mark) will help your investment plan stay on track.

Global equity markets have powered through past viral outbreaks

MSCI ACWI index levels



Sources: Centers for Disease Control and Prevention, RIMES, MSCI. As of 1/29/20. Chart shown on a logarithmic scale. Total return index levels in USD, indexed to 100 on 12/31/2000. Disease labels are estimates of when the outbreak was first reported.

Finally, market pundits and scientific experts are busy looking for historical precedent for the COVID-19 pandemic and the associated market fall-out. The 1918 Spanish flu epidemic killed tens of millions and resulted in a bear market drop of more than 20 percent. Other epidemics, like the Asian flu of 1957 and

Hong Kong flu of 1968, were barely noticed in financial markets. (Both flu pandemics resulted in millions of deaths worldwide.) The health concerns regarding COVID-19 are significant and serious, especially for vulnerable populations here and abroad. While the rational and efficient pricing of new information into our financial markets is swift and dramatic – we know from past macro-economic shocks – this too shall pass.

Thank you for the trust you have placed in our team and RBC to help you navigate these uncertain waters.

Best regards,

Mike, Jon, Mark & Meredith

Btw, if you ever wondered...

The phrase “this too shall pass” can be traced to ancient Persia (ironic given the locus of COVID-19 in modern day Iran). It is found in the writings of the medieval poets Sufi and Rumi. The phrase entered the western lexicon through the retelling of a Persian fable in the poetry of the 19th century English writer Edward Fitzgerald and was most famously invoked by Abraham Lincoln at an agricultural fair as he prepared for his run for the presidency in 1860¹. Lincoln stated,

It is said an Eastern monarch once charged his wise men to invent him a sentence, to be ever in view, and which should be true and appropriate in all times and situations. They presented him the words: "And this, too, shall pass away." How much it expresses! How chastening in the hour of pride! How consoling in the depths of affliction!

During his speech, Lincoln spoke about the potential American innovation to lead to a more prosperous and equitable future. He marveled at the potential for the steam-plough to revolutionize agriculture. And Lincoln argued against the mudsill theory of labour, foreshadowing the start of the Civil War and his views on the abolition of slavery.

Lincoln’s speech framed **this too shall pass**, not simply as the potential (or inevitability) for the tables to turn where the “victor becomes the vanquished”. Rather Lincoln believed that science, innovation, sound policy and hard work

¹ Address before the Wisconsin State Agricultural Society. Abraham Lincoln Online. Milwaukee, Wisconsin. September 30, 1859. <http://www.abrahamlincolnonline.org/lincoln/speeches/fair.htm>

could overcome any obstacle. He concluded by saying, “And yet let us hope it is not quite true. Let us hope, rather, that by the best cultivation of the physical world, beneath and around us; and the intellectual and moral world within us, we shall secure an individual, social, and political prosperity and happiness, whose course shall be onward and upward, and which, while the earth endures, shall not pass away.”

As science and policy makers confront the challenges of COVID-19, let’s share his optimism for the future and remember the inevitable trajectory of “onward and upward” that Lincoln set as our course.