RBC Dominion Securities Inc.

The Sandler Quarterly

Wealth Management
Dominion Securities

Volume 18 | April 2020

Scott Sandler
VP & Portfolio Manager
scott.sandler@rbc.com
416-842-6684

Ronan Clohissey, CIM
VP & Portfolio Manager
ronan.clohissey@rbc.com
416-842-6683

Michelle Noel-Smith
Associate Advisor
michelle.noelsmith@rbc.com
416-842-8675

Brendan Hollis, CFA
Associate Investment Advisor
brendan.hollis@rbc.com
416-842-8673

Steve James
Associate
steve.james@rbc.com
416-842-8674

Gary Tsang, MBA, CFA
Associate Advisor
gary.h.tsang@rbc.com
416-842-8672

Joshua Orr
Associate
joshua.orr@rbc.com
416-842-8676

Tiffany Kee
Associate
tiffany.kee@rbc.com
416-842-6677

Volatility Spikes as Virus Infects the Economy

KEY INSIGHTS

- Equity markets rebound from March lows despite worsening economic developments and an impending recession
- Markets have stabilized, for now; volatility has decreased but remains elevated
- Governments and central bankers fire a bazooka of money in the hopes of bridging individuals and business
- Interest rates find never-imagined new lows while unemployment rises to previously unthinkable levels

The coronavirus pandemic continues to take a tragic human toll while wreaking havoc on health care systems and economies across the globe. The response from government authorities has been unprecedented in its size and speed. Central banks have stepped up to the plate with a variety of liquidity and lending programs to alleviate stress and improve the flow of credit to businesses. Governments have pledged billions in direct support for businesses and households and even more in loan guarantees. Total support programs already amount to trillions on a global basis, and this is before stimulus packages that will seek to reignite the economy once the immediate crisis subsides.

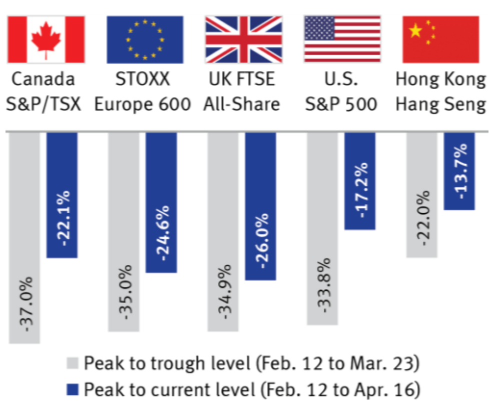

Figure 1*: Index performance since the MSCI All-Country World Index peaked on Feb. 12, 2020 (Source: RBC GAM, Bloomberg)*

Policy support of this magnitude should prevent a worst case scenario and underpin an eventual recovery. Already, in fact, it has inspired a rebound in equity markets. However, the near term economic hit will still be dictated by the scale, duration and effectiveness of virus containment measures. After what will likely be record declines in the second quarter, RBC Economics is projecting a sizeable rebound in GDP over the second half of the year.

It seems like everyone has become an armchair epidemiologist recently. Unfortunately, projecting case growth curves and mortality rates has replaced playoff banter around the virtual Zoom water cooler. We do not claim to have an edge in this regard and prefer to leave projections to those qualified to give them. In fact, it can be difficult these days to separate fact from fiction and well-reasoned opinion from pure speculation.

Quarterly Review
Q1 2020

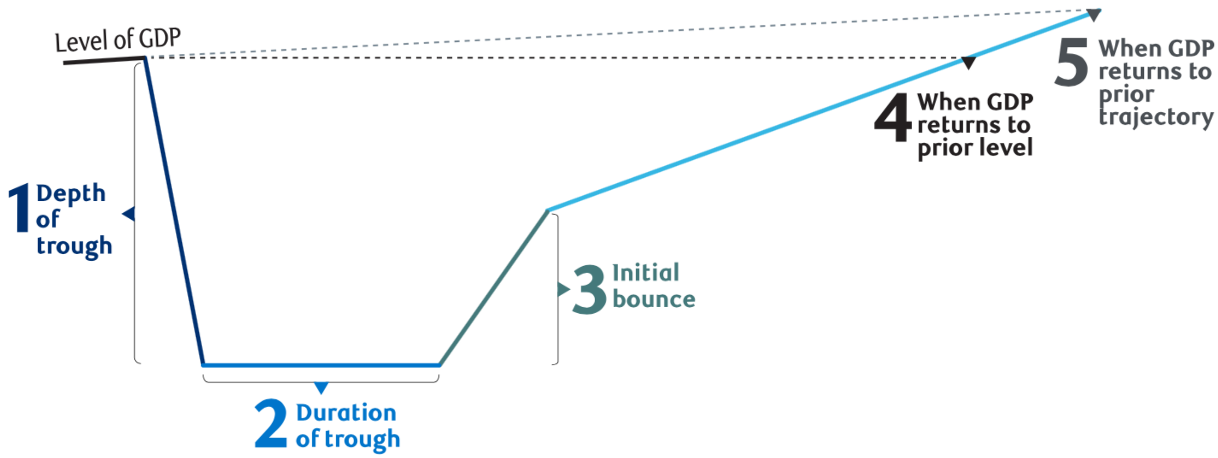

***Figure 2**: Five key economic questions during a crisis*

We urge you to rely on trusted news sources and try to limit your news intake to a reasonable level. Checking the latest developments just a couple of times a day should keep you abreast of the situation. Watching CNN on a loop is counterproductive in our opinion.

For reliable data and opinion we are fortunate to have the RBC Economics team available to us. Through this period we have come to rely on their guidance as we form our opinion. Chief Economist, Eric Lascelles, detailed what he sees as some of the key positive and negative developments in his most recent #MacroMemo report.

Positive developments:

- *Evidence is mounting that quarantines are working as the new daily cases of COVID-19 diminish in a wide range of countries.*
- *Exit strategies are being discussed more and more, with Spain even lifting restrictions on certain sectors. Whether significant easing will prove realistic any time soon is an open question, but it is heartening that we can now ponder the timing of the economic upswing.*
- *The recent OPEC+ agreement is certainly good news for the oil market, though prices should remain very low.*

Negative developments:

- *The handful of countries that are now enjoying a falling number of new daily cases have not managed as rapid a decline as did China and South Korea.*
- *Testing numbers have increased massively – the U.S. is now conducting roughly 140K tests per day and Canada is managing around 27K. But that is still wildly shy of the ideal of being able to test nearly everyone every week to ensure a confident restart of economic activity.*
- *We are becoming more nervous about the speed of the economic recovery once quarantines are lifted. It is far from certain that this occurs quickly or smoothly.*

On that final point, Eric goes on to discuss in detail his forecast for the North American economy. From a range of potential outcomes he settles on a 7.7% decline in GDP for calendar year 2020 as being the most likely for the US economy and slightly worse for Canada. This forecast is arrived at assuming a rapid 20% peak to trough decline in output for a period of 12 weeks before a lengthy recovery period.

Other scenarios in his model range from highly optimistic to extremely pessimistic. See *Table 1* on the following page. While there are a number of factors that go into making these projections, the most meaningful, in our opinion, is the duration of the trough (see *Figure 2* above).

Projecting just how long the global economy will remain on lockdown is anyone's guess. We are highly optimistic that this period will pass and ultimately be remembered as a time of opportunity for investors. That said, we are also realistic about the high degree of uncertainty surrounding Covid-19 and the ensuing recession we have surely entered. We are also wary of the strength of the recent rally

Quarterly Review

Q1 2020

that markets have staged from the lows of March 23rd. For these reasons, we have chosen to move cautiously and methodically as we manage portfolios through this period.

As we seek to manage risk over the coming weeks, we also want to use this time wisely to identify longer term opportunities. Times like this come about rarely and can present us with the chance to buy "wish list" businesses at compelling valuations; companies that we have always wanted to own but for which we were never willing to pay the price. Companies like MasterCard (we have already purchased some), Google, and CN Rail (to name a few) are businesses that we have followed for many years and always hoped to own. By the end of the year we hope to add some more of these to your portfolio.

We are also using this time, where appropriate, to harvest tax losses. Selling an investment at a loss is never something we plan to do, yet it can make sense in certain circumstances. For example, selling one Canadian bank while simultaneously buying another might allow us to realize a tax loss while maintaining our exposure and dividend income. Tax losses can be carried backwards or forwards to offset capital gains taxes payable in other years. When making these switches we also seek to buy a replacement investment of similar or, ideally, better quality.

Equity markets typically steal the spotlight and make headlines, yet fixed income markets have arguably been

Current forecast highlighted: Medium depth and medium duration contraction would result in a 7.7% decline in 2020 GDP growth

2020 GDP growth scenarios

Depth		Duration: Short 6-week trough	Duration: Medium 12-week trough	Duration: Long 39-week trough
Shallow	-10% trough	-2.0%	-2.8%	-5.9%
Medium	-20% trough	-6.1%	-7.7%	-13.9%
Deep	-40% trough	-14.4%	-17.7%	-30.0%

Source - RBC Global Asset Management; forecasts as of 4/6/20. Data show annual average percentage change. Assumes a rapid decline into the trough versus a much lengthier recovery period.

Figure 3*: RBC US GDP growth scenarios*

the bigger story as of late. Central banks have slashed interest rates to effectively zero while corporate bond rates skyrocketed, for a period, as investors sought the safety of cash. Through the middle of March, corporate bond markets came perilously close to seizing up only to be lubricated with government intervention. This market is now functioning in a more rational manner to the relief of all.

Preferred shares have come under pressure recently as they, for the most part, pay dividends benchmarked against the Government of Canada 5 year bond rate. As

Figure 3*: Gold price in USD (January 1st, 2015 – April 16th, 2020)*

Quarterly Review
Q1 2020

government bond yields have fallen, so too has the outlook for preferred share yields. That said, these shares pay highly attractive dividend income relative to corporate bonds and can rise in value when investors begin to anticipate even small increases in interest rates.

A recent bright spot of note has been gold (see *Figure 3* on page 3). A combination of falling interest rates and global turmoil has caused gold to rise to its highest level in 8 years. At current price it sits not far from its all-time high. Interest rates at or near zero are a positive for gold. When making the decision to hold gold, a consideration is the return one must forgo on holding cash. At the moment, there is little or no opportunity cost to owning gold. For this reason we continue to view gold favourably.

We remain confident and optimistic that the world will return to normal in time, albeit a new form of normal. As humans, we are social, ambitious and determined beings. We will find innovative ways to solve this and future crises. This report gives a brief overview of some of the many treatments and vaccines currently under development. While the Covid-19 death toll is tragic, we must remember that global population grows by approximately 83 million people every year; so too will the economy return to growth.

Please stay safe and positive through this difficult time. Where possible, take pleasure in the simple things that often get over looked in "better times". Keep in touch with family, friends…….and us!! We are all working from home but are fully connected. We are available at any time to discuss your portfolio, the markets, or even just how to bake a better loaf of bread (Ronan could use some tips).

Sincerely,

Scott Sandler
VP & Portfolio Manager

Ronan Clohissey, CIM
VP & Portfolio Manager

	Q1 2020	1 Year*
Indices		
S&P/TSX	-21.59%	-16.91%
Dow Jones	-23.20%	-15.47%
S&P 500	-20.00%	-8.81%
Nasdaq	-14.18%	-0.38%
Euro Stoxx	-25.59%	-16.85%
Japan Nikkei	-20.04%	-10.79%
India Sensex	-28.57%	-23.80%
VIX (Volatility)	288.53%	290.52%
Commodities		
Gold	3.95%	22.04%
Silver	-21.72%	-7.57%
Copper	-19.68%	-23.86%
Oil	-66.46%	-65.95%
Natural Gas	-18.18%	-37.36%
Currency		
CAD	-7.65%	-5.10%
EUR	-1.62%	-1.67%
JPY	1.02%	3.08%
AUD	-12.68%	-13.60%
GBP	-6.31%	-4.72%

*As of March 31st, 2020

Wealth Management
Dominion Securities