RBC Dominion Securities Inc.

The Sandler Quarterly

Wealth Management
Dominion Securities

Volume 19 | July 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

Please visit us at:
www.SandlerWealth.ca

Resilient market looks beyond pandemic

KEY INSIGHTS

- Investors regain poise as policymakers deliver record stimulus and virus trends improve in many countries
- Equity markets rebound sharply from March lows, though questions remain
- Government bond yields fall to new all-time lows as investors and central banks step up buying
- Technology and healthcare sectors lead, while travel, entertainment, consumer discretionary and REITs lag

Our last quarterly newsletter was written at the end of March, a time of confusion for markets and fear for society at large. Much has happened since then and thankfully the outright panic experienced by many has subsided. While some semblance of calm has returned, there remain many unanswered questions and unresolved issues with which to contend.

The COVID-19 shock altered the course of the global economy and ravaged financial markets, prompting policymakers to step in quickly and with scale. Unprecedented monetary and fiscal stimulus, combined with more recent signs of an economic recovery as lockdowns ease, have triggered a rapid rebound in markets. (See *Figure 1 below*)

Legendary investor Ben Graham (Warren Buffet credits him with shaping his investment philosophy) famously said "In the short run, the market is a voting machine but in the long run, it is a weighing machine". Investors are currently busy voting on the outcome of the COVID-19 pandemic. Will it pass relatively quickly and allow the economy to return to its growth trajectory? Or will it (and the resulting recession) linger and cause a longer and more severe global slowdown? Only time will reveal the true answer.

***Figure 1**: S&P500, Jan 2018 – Jun 2020 (Source: Thomson Reuters)*

Quarterly Review
Q2 2020

At the moment, equity markets seem to be voting with optimism and looking beyond the current crisis to better times and a return to growth. Markets have experienced a remarkable recovery, albeit sector specific, since the lows of late March. While we are optimistic that this too shall pass, we are not blind to the many risks that remain on the horizon. COVID-19 aside (what more can we add that you haven't already read elsewhere), the economy must still contend with a recession, massive unemployment and surging debt at all levels of government (See *Figure 2* below). Again, for the record, we are optimistic that these issues can and will be overcome – but we are clearly not out of the woods yet.

I think we can all agree that nobody knows with certainty what the future holds – particularly in the short run. As portfolio managers, our goal is to walk the fine line between remaining invested while also managing risk and volatility. In this regard, we have opportunistically added some new holdings to our portfolio while maintaining a slightly underweight equity position overall. This stance should reward us if markets continue to rise as we have plenty of exposure to best in class companies. Conversely, a return to weakness and volatility will provide opportunities to add to our equity holdings. Essentially we are heading out for a walk, but bringing an umbrella just in case.

As countries ease lockdown measures, the most prominent risk is that the virus regains traction and forces economies into a second closure as we are now seeing in California. The pandemic's longer-term repercussions include elevated debt levels that could hinder growth and lifestyle changes that could lower productivity. While the virus has dominated our thinking, there are other risks that are worth keeping in mind. The U.S. election in November and the deterioration of U.S.-China relations could both serve as sources of volatility for economies and financial markets.

Inflation

Inflation could also emerge as a concern once economies eventually recover. Inflation is most commonly measured as the aggregate price of a basket of goods (groceries, clothes, gas, etc) known as the consumer price index (CPI). In the short term, it is unlikely that we will see increased inflation. Recessions are almost always deflationary, and the temporary loss of nearly 20% of economic demand is far more likely to reduce inflation than to spur it on. Additionally, this particular recession has been paired with a collapse in oil prices – a major influence on CPI. However, the balance of evidence points to higher inflation over the medium and long run. Many of the initial depressants are already fading; economies are opening up and the oil shock is already starting to abate.

Meanwhile, the arguments for higher inflation are potentially more long-lasting. The money printed by central banks is unlikely to be unwound quickly. Elevated public-debt levels will almost certainly endure, and with them the temptation to run inflation slightly hotter in an effort to reduce their real burden. Efforts by developed economies to bring some manufacturing back within their borders are also likely to lead to higher prices as countries seek to reduce their dependence on others.

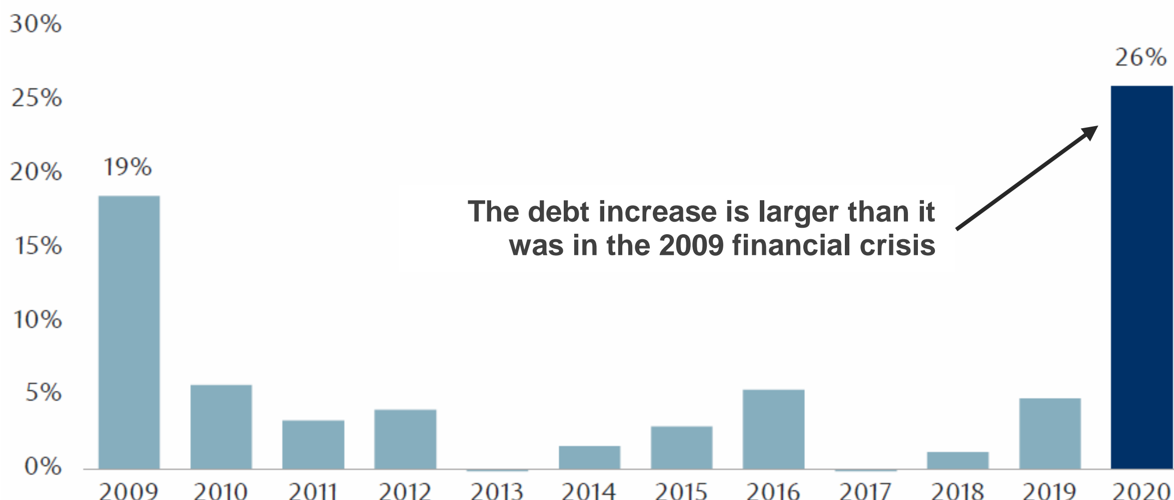

***Figure 2**: Annual increase in government debt, as a percentage of GDP (Source: IMF)*

Quarterly Review
Q2 2020

Inflation is a key consideration when planning and investing for the long term. Higher prices in the future necessitate an investment return to maintain one's purchasing power, creating yet another investment challenge. Ultra-low interest rates have been a reality for many years now; or so we thought! Since the onset of the current crisis, interest rates have fallen to previously unimaginable levels. (See *Figure 3* below) Put mildly, generating reasonable returns in the bond market has become difficult. The traditional 60:40 portfolio made up of 60% stocks and 40% bonds is being revisited by investors around the globe. With bonds now yielding such meagre returns, do investors accept lower overall returns, or seek to shift some of their fixed income allocation to other asset classes?

Figure 3*:* U.S. 10-year bond yields *(Source: Bloomberg)*

Close to home, just one example of this is occurring at RBC Global Asset Management. They recently altered their strategic asset allocation by shifting 5% out of bonds and into stocks. In their latest Global Investment Outlook report they made the following comments:

> *Our view that stocks will provide superior returns, that results for sovereign bonds will be unappealing for an extended period and that sovereign bonds will not provide the income or risk-diversifying properties of the past 40 years have led us to adjust the strategic neutral weights in our multi-asset and balanced portfolios.*

Replicated around the globe, this trend will be a powerful driving force. This conundrum is faced by all investors - individuals, pension funds, insurance companies, etc. The amount of money potentially looking for a new home is counted in the tens of trillions of dollars. This shift is very likely what is driving recent strength in the stock market and fund-flows into equities. T.I.N.A is a term commonly used in the market to describe this phenomenon – There Is No Alternative! (See *Figure 4*) We do not subscribe to this concept entirely but we are aware that it is, to some extent, already happening and should continue to do so.

Figure 4*:* Percentage of S&P500 companies paying dividend greater than the 10-year Treasury yield *(Source: BoA Research Investment Committee, Bloomberg)*

Assuming that rates remain low for the foreseeable future it is likely that vast amounts of money will seek returns outside the bond market. Not all of it needs to be redirected to the equity market. Gold (and other precious metals), infrastructure, real estate, private equity and debt, and a host of other alternative asset classes are potential beneficiaries of this trend.

These investment vehicles, in our opinion, will experience a net inflow of new investment dollars and will lead to asset price inflation. Asset price inflation is different from the more common CPI measure of inflation described above. It benefits owners of assets (investors), while CPI inflation disadvantages spenders. This will be a key focus for us over the coming years as we make investment and asset allocation decisions.

As mentioned in previous newsletters, we have taken a position in a basket of the world's largest gold mining companies to benefit from what we see as a rising price environment for precious metals (See *Figure 5 below*). This investment was initially made last year and was performing well even before the current crisis. Now, with interest rates

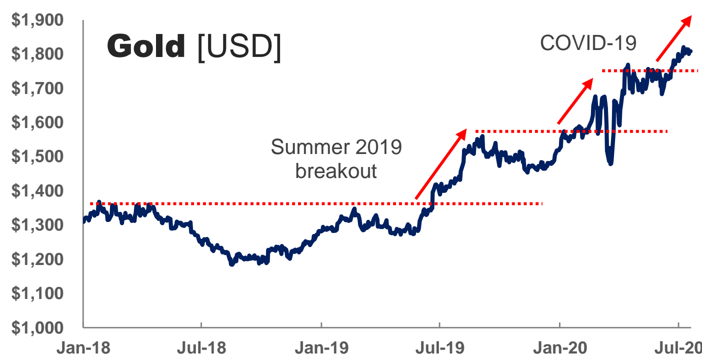

Figure 5*:* Gold price in $USD *(Source: Thomson Reuters)*

Quarterly Review
Q2 2020

plumbing new lows, the world awash in stimulus dollars and a global pandemic, gold continues to climb and recently reached its highest level in over 10 years.

The Bottom Line

The bottom line is that COVID-19 has totally upended the economy, casting confusion over the markets. The global economy has now suffered the deepest recession in modern history for a reason that was impossible to foresee. If nothing else, this reminds us of just how difficult it is to forecast the market and why a diversified portfolio is essential.

Nevertheless, the situation is improving. We have now gained a tentative handle on the event, a better understanding of the characteristics of the disease and the magnitude of the economic damage. We are even beginning to accumulate evidence of an economic rebound. Much remains unknown, including the pace at which the recovery will proceed and the probability of a recurrence of the virus. But the moment of maximum chaos has arguably come and gone and this has understandably been a great motivator for the financial-market rebound visible thus far.

Everyone will have their own opinion on how the world will have changed when we finally emerge from COVID-19. Our take is that while there will obviously be some lasting changes, our world in 18 months from now will look remarkably like it did 6 months ago. We look forward to seeing all of you again in person and being able to spend time together in the office as a team. After all, our business is as much about people as it is about money.

Thank you for your continued support through such an unusual period,

Scott Sandler
VP & Portfolio Manager

Ronan Clohissey, CIM
VP & Portfolio Manager

	Q2 2020	1 Year*
Indices		
S&P/TSX	15.97%	-5.29%
Dow Jones	17.77%	-2.96%
S&P 500	19.95%	5.39%
Nasdaq	30.63%	25.64%
Euro Stoxx	16.05%	-6.90%
Japan Nikkei	17.82%	4.76%
India Sensex	18.49%	-11.37%
VIX (Volatility)	-43.16%	101.79%
Commodities		
Gold	12.92%	26.35%
Silver	30.29%	18.88%
Copper	21.58%	0.38%
Oil	91.75%	-32.84%
Natural Gas	0.12%	-29.26%
Currency		
CAD	3.62%	-3.55%
EUR	1.84%	-1.22%
JPY	-0.37%	-0.04%
AUD	12.59%	-1.67%
GBP	-0.15%	-2.32%

*As of June 30th, 2020

Wealth Management
Dominion Securities

The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc.* nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. RBC Dominion Securities Inc. and Royal Bank of Canada are separate corporate entities which are affiliated. *Member CIPF. ®Registered trademark of Royal Bank of Canada. Used under licence. ©Copyright 2004. All rights reserved.