SECOND QUARTER REPORT – JUNE 30TH, 2020

One third of all investors over the age of 65 sold all their stock holdings from February to May.[1]

MONEY FOR NOTHING

We are in middle of the worst economic contraction and pandemic of the last 100 years. Record job losses. A tsunami of corporate bankruptcies. Half of our work force on government support. Yet, you wouldn't know that by looking at the stock market. After a record sell-off, it's close to where it started the year.

Clients are telling me that it doesn't make sense. And they're right. How can the stock market be close to all-time highs in the middle of a worldwide pandemic? In order to understand the stock market, there are other factors that determine the behavior of investors and the prices of investments.

Lehman Brothers was one of the largest investment banks in the world. On September 15th, 2008 the firm filed for bankruptcy. This is the largest bankruptcy in the history of the United States. Over the following seven months, a credit crisis proceeded, throwing the world into chaos. Credit markets seized up, stock markets fell by 50%, and unemployment soared.

As credit markets froze, companies feared lending to each another. A depression was becoming a real possibility. Central banks had to move fast. They provided a massive amount of liquidity to provide stability and unfreeze credit markets. Any well-functioning economy needs to have stable credit markets. You wouldn't do business with a company that you are uncertain will be around next week. Businesses deal with each other when they aren't worried about the failure of the other.

To help provide liquidity to the markets, central banks expanded their balance sheets. Also known as printing money. They also drove interest rates to zero to encouraged borrowing. Just like the Dire Straits said in their 1985 hit, 'Money for Nothing'. These coordinated actions by central banks worked and brought calmness to the markets. Credit markets stabilized, lending picked up, confidence returned, and companies began hiring again. With low interest rates and plenty of liquidity, the result was an incredible boost to the economy and the markets.

What followed over the next 11 years was a 400% return for the S&P500 and the longest bull market ever.[2] During the panic and market selloff in 2009, investors sold stocks. They were sitting on record cash balances.[3]

With interest rates at close to zero, cash was not an attractive investment option. Inflation would eat away at any cash savings. Investors needed to put their cash balances back to work. Funds flowed into the stock market over the next decade, fueling a tremendous bull market.

Fast forward to 2020. In mid-March, markets and lending seized up again, like in 2009. However, this time it happened tremendously faster. Investors had limited information on COVID-19, how you contracted it, how deadly it was, and how long an economic shut-down would last. Credit markets seized up and central banks had to step in to provide support again. They acted like they had in financial crisis. However, the scale of support was much different. Imagine the 22-story building of the

[1] Fidelity Investments
[2] https://www.ft.com/content/0815dfa2-3927-11ea-a6d3-9a26f8c3cba4
[3] https://www.ccmmarketmodel.com/short-takes/cash-balances-could-push-stock-market-higher

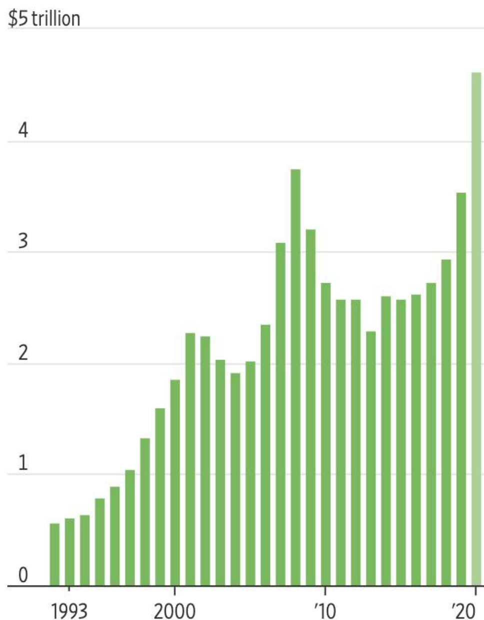
US Federal Reserve (FED) in New York City. Each floor has a machine to print money. In 2008, they used 2 floors to print money. In 2020, they used all 22. In 2008, after Lehman Brothers collapsed, the US FED expanded their balance sheet over a trillion dollars in 15 months by "printing money". In the past three and half months, the FED increased their balance sheet by close to three trillion.[4] *They have increased the money supply by three times, in less than a quarter of the time than in 2008-09. Last time they acted with much less firepower, it helped fuel the longest ever market rally in the history of the S&P500.*

Now that the markets have appeared to have stabilized, are they done? No. On May 17th, CBS interviewed the chair of the US Federal Reserve Chairman, Jerome Powell. He stated that the FED is just printing money right now and that they will worry about the consequences later.[5] He also said, "the FED will act forcefully, proactively, and aggressively until we are confident we are solidly on the road to recovery."[6] We can expect any economic weakness to be met with more action by central banks.

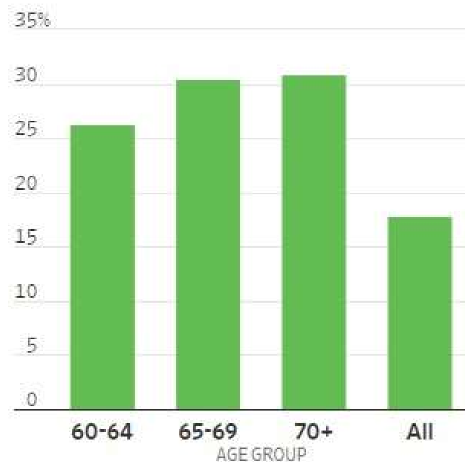
As we have stayed home and cut back on our spending, there has been a record collapse in economic activity. This has left a huge gap in our economy. Governments have responded quickly to fill it. They have spent record amounts of money to ensure citizens have cash in their pockets. They have also provided funds to companies that need them. In Canada, many people are receiving more money to stay at home, than what they earn at work. This has caused unexpected consequences. Surprisingly, some businesses have reported labor shortages. They have been unable to find people to fill jobs. As governments have kept funds flowing to those who need it, the economic gap has been bridged.

How Did Investors Do in 2020?

Not well. Many panicked and sold. Close to a third of individual investors over the age of 65 sold all their equities from February to May. Investors are sitting on records amounts of cash, and don't know what to do. In Canada, cash in ETF's and mutual funds increased 43% from a year ago.[7] Sitting on cash right now provides no protection against inflation. The younger you are, the higher the risk. Since World War II, inflation has averaged 3.76% per year. Considering that average, cash will be worth 50% of its value in 20 years. In 40 years, it will be worth less than 25%.



Note: Figures for 2020 are through June 10.
Source: Refinitiv Lipper



Note: Data was collected from Feb. 20 to May 15.
Source: Fidelity Investments

[4] https://fred.stlouisfed.org/series/M2
[5] https://www.cbsnews.com/news/full-transcript-fed-chair-jerome-powell-60-minutes-interview-economic-recovery-from-coronavirus-pandemic/
[6] https://ca.finance.yahoo.com/news/powell-federal-reserve-will-act-forcefully-proactively-and-aggressively-to-support-the-us-economy-140009400.html
[7] https://business.financialpost.com/personal-finance/managing-wealth/holding-cash-is-a-sign-of-fear-and-fear-is-the-worst-investment-of-all

With record cash balances, investors need to get it back to work. Market selloffs will be met with buying. With low interest rates and fewer options, cash will flow back into the markets.

How Have the Markets Done After Strong Market Rallies and Accommodative Central Banks?

The S&P500 had its strongest 50-day market rally ever on June 3rd, and its best quarter since 1998. Strong market rallies have historically led to additional returns. *In the past, the average one-year return was 17.3% after 50-day market rallies that had initial gains of over 20%.*

Largest 50-Day Gains Ever (Greater Than 20%)

This Was The Greatest 50-Day Rally Ever, Past Big Rallies Lead To Continued Strength

		S&P 500 Index Return			
Date	50 Day % Change	1 Month	3 Month	6 Month	12 Month
3/6/1975	26.9%	-4.0%	10.8%	3.0%	18.2%
10/22/1982	35.6%	-3.3%	3.6%	15.6%	20.3%
3/26/1991	20.8%	0.8%	-1.5%	3.0%	8.7%
6/24/1997	20.5%	4.9%	6.2%	6.4%	26.4%
12/18/1998	23.8%	4.0%	6.2%	12.4%	19.4%
5/19/2009	34.2%	1.1%	9.0%	22.2%	22.8%
9/16/2009	21.3%	2.6%	3.7%	9.1%	5.2%
6/3/2020	37.7%	?	?	?	?
	Average	0.9%	5.4%	10.2%	17.3%
	Median	1.1%	6.2%	9.1%	19.4%
	% Positive	71.4%	85.7%	100.0%	100.0%

Source: LPL Research, FactSet 06/03/2020 (1950 - Current)
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

Don't Fight the FED. I've highlighted this in my past newsletters. If central banks are pushing interest rates down, printing money, and making bonds and cash less attractive, then you want to be invested. Being invested when central banks are accommodative has produced much stronger returns to investors than when the FED has raised rates.

Since 1982, from the when the FED cut interest rates, to when they finally raised rates, the average annualized return for the S&P500 has been 20%.

How Are We Navigating these Markets?

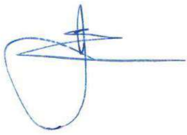
During the market sell-off in mid-March, portfolios were rebalanced. Extra cash balances were deployed. High-grade fixed income was reduced. With positive returns in 2020 for our Canadian Bonds, we found better value elsewhere. Some companies were trading at half the price they had been a month before.

Prices of companies have been affected very differently since COVID-19. Investors have gotten very excited by companies that have been positively affected during the lock-down. These include companies in sectors such as e-commerce, digital service providers, and other internet companies. Stock prices are very high, valuations are expensive, and fundamentals don't matter. We are finding much better value elsewhere. Sectors such as Industrials, Consumer Discretionary, and Insurance. We are also under weight Canadian banks. Canadian consumers have record debt levels and have deferred 20% of all current mortgages. It is very difficult to see the Canadian consumer continue to borrow while unemployment at 13%. Borrowing is one of the main revenue sources for banks and with it under pressure, growth will be difficult.

More recently, we have found attractive opportunities in Global Bonds. With our Canadian Bond exposure up 6% this year, we've been reducing it and adding the proceeds into Global Bonds. These have much more attractive yields (4-5%), and better upside.

We hope you and your families are keeping safe and healthy. We are here for you. Please don't hesitate to reach out to me if you have any questions.

-Kind regards,



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