DZWMG Update – May 22, 2020

This week was marked by an early dose of optimism. More specifically, a promising update on a potential coronavirus vaccine and more progress on the easing of restrictions and reopening of economies. Offsetting this to some degree was the ongoing struggle to slow the spread of the virus globally, particularly in the emerging markets. Unfortunately, the week is ending on a sour note on renewed tension between China and Hong Kong, which may have global ramifications. In the week ahead, the spotlight turns to the Canadian banks who are expected to report results. We provide our thoughts below.

Coronavirus update
At a high level, the trends of the past few weeks have remained in place. Europe continues to broadly improve. As a result, countries in the region are gradually loosening an increasing number of restrictions and reopening more parts of their economies. In Canada, a similar story continues to unfold though new daily cases in Ontario and Quebec simply refuse to meaningfully decelerate. Nevertheless, both have moved forward with their reopening plans. In the U.S., the story remains as mixed as it has been of late, with new daily virus cases that have not changed much. To be clear, in some states, the levels have meaningfully improved but in others, they have risen, essentially offsetting one another. Encouragingly, despite the loosening of restrictions and gradual reopening across Asia, Europe, Canada, and the United States, there have not been signs yet of any acceleration in case counts.

The epicenter of the health crisis is now in the emerging markets where new daily case counts are elevated and some countries are seeing an acceleration. Russia and Brazil now have the unfortunate label of being the second and third countries with the highest number of infections globally. It is hard to anticipate a change in this trend, particularly in Brazil where the approach to containment appears disorderly.

Vaccine hope
We recently highlighted the remote possibility for a vaccine to emerge over time given the unprecedented global efforts by the scientific community. We did not expect an update to come so soon. Earlier this week, a U.S. company provided encouraging results from a Phase I trial. In a nutshell, the vaccine showed the potential to induce the immune system to produce antibodies that could help protect people in a safe and tolerable way. The results spurred an impressive and understandable rally in markets as they priced in an increase in the odds of a best case scenario – immunity from the virus. But, as with most early stage clinical development, there are some important caveats to consider. These include the small sample size of 45 individuals, the lack of disclosure and data for analysis, and the durability of the antibodies among other things. While it remains very early and much more work is left to be done, it was an encouraging update. This is one of nearly 10 human trials and more than 100 pre-clinical trials (stage of research that does not include humans beings) underway globally.

Spotlight on the Canadian banks
The Canadian banks are set to report second quarter results over the next week. This is a particularly important update. First, the banks tend to be a good gage of the health of our overall economy. The results for the period of February through April, and management commentary on the outlook, will offer clues about the extent and trajectory of economic damage in this country. Secondly, the banks represent a meaningful portion of most Canadian investor portfolios. If the U.S. banks, who reported their own results weeks ago, are any indication, the results are not likely to be very good. But, that may already be expected by the market to some degree. Bank stocks trade at valuations that were last seen

during the great financial crisis of more than a decade ago. This signals to us that investors already expect the companies to face higher risks in the form of future loan defaults and customer bankruptcies. While these loan issues may not arise immediately, the banks have to effectively budget for them in advance and it is widely expected they will begin to do so with the release of their results. We take some comfort in the strong capital positions they have accumulated in recent years that can help provide some cushion against the credit losses that may come. While earnings may be volatile and balance sheets will be tested, we believe the banks will continue to offer sustainable dividend income for investors.

There has been enough to worry about in recent months. We view China's announcement of new national laws being imposed on Hong Kong as being yet another potential source of stress in the relationship between China and the U.S. It is a risk we will continue to watch closely.

Should you have any questions or concerns, please feel free to reach out.