MARKET SPOTLIGHT

March 2020

Global Markets

Reacting to the COVID-19 outbreak

Global markets tumbled in the past several weeks after reaching multi-year highs (all-time highs for some markets) in mid-February. The severity of the COVID-19 pandemic is now a prime market mover and topic of debate. Adding to the unrest, a crude oil price war between Saudi Arabia and Russia caused a large, quick and historically unprecedented oil price decline in early March. Financial market volatility jumped as investors scramble to determine the fallout for the overall economy and various business sectors.

The question on everyone's mind: how dramatic and long-lasting will the effects of COVID-19 be? Because there are so many unknowns and changing elements, what financial markets respond to evolves daily. Will monetary or fiscal stimulus be enacted and will it work? Will the pandemic be contained? Are governments taking the right steps and providing leadership and reassurance? What is an appropriate response and what is an overreaction/ underreaction?

In this edition, we address some investing issues that we know concern our clients.

The view from our Chief Investment Strategist:

Luc de la Durantaye

Our advice during this volatile time

Financial markets are now close to pricing in a global recession, with sovereign bond yields declining sharply, credit spreads widening, and many equity markets in bear market territory (down more than 20%). These market movements have resulted in a tightening of financial conditions, leading to market concerns of a sudden halt in credit availability. Monetary policymakers led by the U.S. Federal Reserve have responded very quickly with a series of measures to lower interest rates to zero, start a new Quantitative Easing (QE) program and relax credit availability. Other major central banks around the world, the Bank of Canada included, used their respective tools to ease financial conditions as well. However, central banks have fewer available tools and it is time to pass the baton to fiscal policies, which should be more effective in providing support to the current economic impact from COVID-19. While the situation remains quite fluid, a number of countries are putting measures in places to support local businesses suffering supply chain interruptions or a sudden drop in demand. Some countries have already announced additional fiscal stimulus in the form of income support to families while they are quarantined, payroll tax cuts and other forms of income support are being contemplated or implemented as we speak. This should be more effective in supporting an eventual economic recovery. At this point, it remains difficult to assess the length of the economic slump. Monitoring the spread of the virus as well as containment measures will also be a key part of estimating a peak in the epidemic and a bottom is financial markets. As containment measures gain traction, especially in Europe and North America, and with a little help from warmer weather, these actions could help nurture an economic recovery sometime in the second half of the year.

In volatile times, it's human nature to predominantly focus on risk aversion. Yet it's in those times that opportunities are also created. While risk should always be well managed, market corrections create the seeds of the next investment opportunities. We are fully focused on navigating the current market conditions to achieve the best outcome possible for our clients by seeking this difficult balance between risk and opportunities. This means keeping our eyes on risk, but also identifying the evolving opportunities to add return created by this latest correction.

We are advising clients to keep portfolios broadly diversified by maintaining a balance between government bonds and stocks. Where possible, diversify into non-traditional strategies such as multi-asset strategies and non-traditional asset classes that can include gold, safe-haven currencies, and some cash to take advantage of unavoidable market corrections.

Sound Bites

Patrick O'Toole
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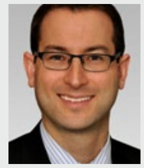
Central banks step in to help

Although it can't fully offset the impact of the spread of COVID-19 on capital markets, the U.S. Federal Reserve (Fed) is doing its job with its announcement Sunday March 15 that it is cutting its rate by another 100 basis points (bps) to 0.00%-0.25%. It's also officially restarting quantitative easing (QE) with a $700 billion bond purchase program of Treasury bonds and mortgage-backed securities. The Fed is also taking other measures that should act to ensure that liquidity is sufficient so the global financial system can continue to function. But despite being back at the lower bound, the Fed isn't out of ammunition, and could act further with forward guidance and more QE, in addition to seeking other powers that may require changes to legislation.

We also expect to see the Bank of Canada (BoC) and federal government take further steps to mitigate the damage to the economy that will occur. The BoC's 0.50% cut to its rate on Friday leaves its rate at 0.75%, and a similar cut is likely this week as it joins a slew of other central banks that are taking swift action.

The bond market's reaction to the Fed's moves on March 15 is more a response to the unknown damage that is coming for the economy as the infection rate increases. Government bond yields are falling today, although they remain above the historic lows seen last Monday morning. The fallout from the pandemic likely means interest rates will remain at extremely low levels for the foreseeable future. However, the crisis is providing an opportunity for investors to acquire higher yielding corporate bonds at credit spreads that haven't been seen in years. We are carefully assessing the opportunity and will opportunistically look to take advantage of the situation.



Craig Jerusalim
Portfolio Manager

Why staying calm is so important

An emotional reaction to market volatility can generate anxiety, prompt investors to do the wrong thing and jeopardize a well-constructed investment strategy. How does this play out? Markets go through extended periods of lower volatility when many investors infrequently check their account balances. Then, short periods of extreme volatility attract media attention and can lead to frequent account balance checking, and the desire to "do something" to alleviate anxiety.

The decision to sell stocks and get out, with the intention to get back in when the dust settles, might sound appealing and "conservative" in theory. In reality, selloffs are often swift, sharp and come without warning and bouncebacks are often the same. Getting out and getting back in at the right time is extremely difficult, while missing the bouncebacks often results in missing most of the gains the market has to offer. If you have money to invest, consider dollar cost averaging into investments. If you need to withdraw money, consider dollar-cost-average selling.

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