CIBC Asset Management

# MARKET SPOTLIGHT - MAY 2020

## Where do we stand now? A COVID-19 update


As the COVID-19 pandemic spread over the past six months, global economies came to a standstill and financial markets collapsed. Approaching mid-year 2020, we've witnessed some flattening of the virus transmission curve along with a bounce off the bottom for many global equity markets. Unemployment has climbed to record numbers in many countries, economic data looks dismal and bankruptcies accumulate, but we're also seeing some early signs of greater stability. As the world contemplates reopening, all eyes are on those economies that have taken their first tentative steps in that direction.

In this edition, we update some of the main themes surrounding COVID-19 and its financial fallout.

## What's next for investors?

**Luc de la Durantaye**
*Chief Investment Strategist*

There seems to be an increasing divergence between equity markets that continue their breath-taking march to recovery and dismal economic data. From the lows, this has been the strongest rally ever out of a world equity bear market. At the same time, the U.S. labour market recorded its steepest increase in unemployment on record. This is a perfect example of the forward-looking nature of financial markets. As the economy looks for a bottom, equity markets anticipate the reopening of the world economy. As reopening is under way, beginning with Asia, it will be difficult to go back and lock down the entire world again, given the dramatic economic consequences that are now obvious in the daily stream of economic data. The world has also learned about effective social-distancing measures, and the need for better-prepared hospitals and healthcare facilities and increasing testing and tracking. Meanwhile, scientists are working at unprecedented speed towards producing a vaccine and are researching anti-viral drugs to further reduce the health and economic impact of this virus.

As the world economy reopens, it will be difficult to predict what sectors will reopen first, at what pace and whether we'll encounter surprises along the way. There are risks remaining and there will likely be some setbacks. For example, certain areas around the emerging world and some U.S. states are reopening without having recorded the sort of sustained decline in new infections that reduces the risk of second-wave infections; some rise in cases should be expected as lockdowns are eased. But the unprecedented size and breadth of monetary and fiscal stimulus measures so far adopted, with potentially more in the coming months, should curtail the more negative outcome for the global economy.

We expect higher risk assets, such as equity and corporate credit, to continue to recover in the coming months, though we expect a moderation in the pace of gains. Economic and healthcare-driven market setbacks in riskier assets should be assessed and can provide opportunities for the long-term investor within the context of our recently updated long-term expected returns.

# Restarting the economy

**Vincent Lépine**
*Director, Economic and Market Research*

The path of virus transmission following reopening carries some major risks. On one hand, it may be possible to restart significant amounts of business activity while keeping public health risks manageable. On the other hand, we may find out that transmission rates pick up after restarting activity, beginning with the more straightforward sectors like manufacturing and construction. We should learn much more about these issues over the next few weeks. If the reopening of the economy is a success, the number of active cases should continue to decline in line with current projections.

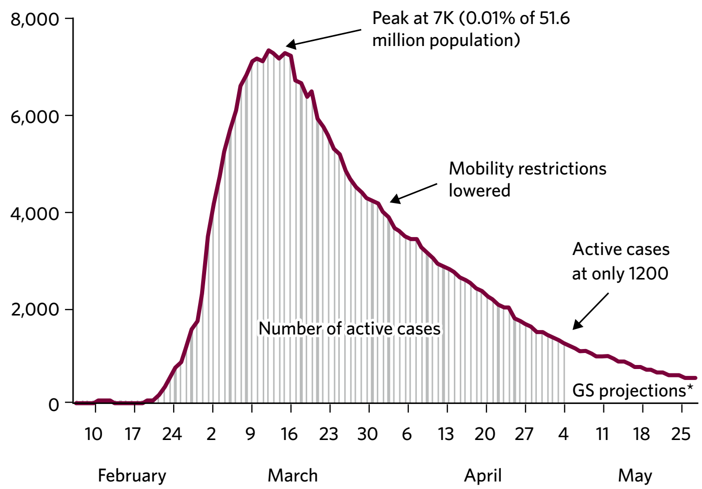
In terms of how to manage the pandemic, South Korea undeniably qualifies as a success story (top chart). With relatively lower mobility restrictions, South Korean authorities have kept the number of active cases very low (a peak at only 7,000). They also significantly flattened the curve, with active cases now at only 1,200 for a population of 52 million. South Korea is not the only success story. Across Asia, the number of active cases has substantially declined, representing less than 0.01% of the total population in China, Hong Kong, Taiwan, Malaysia, the Philippines, New Zealand, Australia and India.

To figure out if it's still too early to reopen economies, it's worth paying attention to developments in Germany. German authorities have so far been quite successful in limiting the propagation of the coronavirus (bottom chart).

The number of active cases in Germany peaked in early April in the context of a minor partial shutdown of the economy. It's worth noting that the German economy reopened further on April 22, with no negative impact on the flattening of the curve over the following three weeks. With only 23,000 cases still active in a population of 83 million, mobility restrictions were further eased last week.

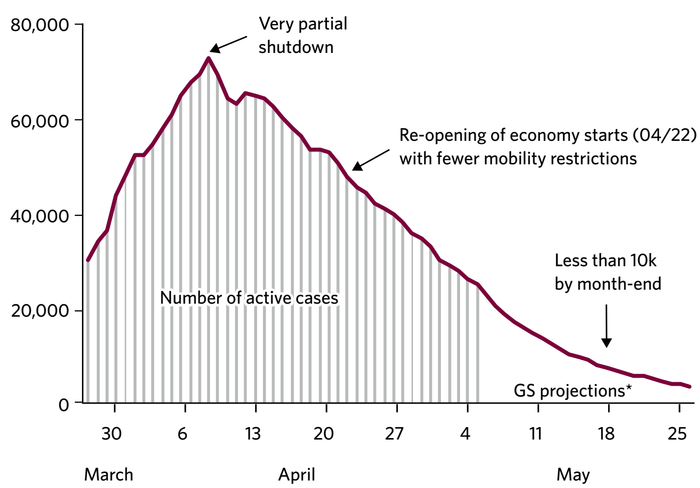
**Bottom line:** The big question is whether the same thing can be accomplished in the rest of the developed world. If everything works as planned, we should see a plateau followed by a deceleration for countries like Canada, France, the UK and the United States. If an immediate reacceleration occurs, we should see a widening gap—this wouldn't qualify as a second wave, but an intensifying first wave.

### South Korean success story




*Sources: Johns Hopkins, Bloomberg, CIBC Asset Management Calculations and *Goldman Sachs (GS) projections, as at May, 2020*

### Germany: so far, so good




*Sources: Johns Hopkins, Bloomberg, CIBC Asset Management Calculations and *Goldman Sachs (GS) projections, as at May, 2020*

## Corporate bond buying opportunity?

**Patrick O'Toole**
*Vice-President, Global Fixed Income*

When the pandemic took hold, investors shunned riskier assets like equities and corporate bonds in favour of government-guaranteed debt. The result was a seizure in the corporate bond market, as investment dealers quickly moved to limit their purchase of that debt. The consumer saw that reflected in an increase in mortgage rates, as financial institutions saw their funding costs rise.

Given the danger that companies could find themselves in the position of not being able to easily refinance upcoming maturities, the U.S. Federal Reserve (Fed) took action. Its launch of a Primary and Secondary Market Corporate Credit Facility was incredibly successful. The new-issue window opened immediately for corporate America, with corporate Canada riding on the Fed's coattails, resulting in record new issuance volume in the U.S. in the first week following the Fed's announcement.

However, the efforts of the Fed and the Bank of Canada (given the latter also announced that it would purchase investment grade corporate bonds), haven't fully repaired all the damage to the sector since the pandemic took hold.

Credit spreads remain double what they were prior to the selling of riskier assets and bid/offer spreads in the secondary market reflect a higher price that investors are willing to pay to execute. That means liquidity, while improved, has not fully healed. It also reflects the anxiety that investors currently feel about the unknown impact from the pandemic on companies' abilities to survive and continue to make coupon and principal payments.

Despite those concerns, we continue to expect that corporate bonds will handily outperform government bonds over the coming year. That view is predicated on the re-opening of global economies that, while not returning to pre-pandemic levels over the period, will show a marked improvement over activity levels experienced in the current quarter. That should also allow for some modest drift higher in longer-term government bond yields as investors' risk appetites continue to improve.

The result would be a material outperformance of both investment grade and high yield corporate debt versus government debt. These episodes of sharply wider credit spreads have generally proven to be opportunities for investors to reset portfolios for solid returns over the next couple of years.

## Initial signs of pent-up energy demand

**Brian See**
*Portfolio Manager, Resources*

We've seen signs that the oil market is stabilizing in the past week or two, as supply and demand find an equilibrium. The quick, voluntary curtailment of production by North American oil producers as the COVID-19 lockdown continues has helped. Where supply had been building and overwhelming the available storage capacity, we're starting to see oil inventory builds flattening out—in much the same way the COVID curve is also flattening. An additional factor: pent-up demand and people anxious to return to work are creating some demand for energy products. Last week, there was a decline in gasoline inventory rather than the build-up that has characterized previous weeks.

In China, where the course of the pandemic is several months ahead of Europe and North America, refining utilization has returned to normal levels. Surrounding Asian countries also seem to be trending towards normal. And, we're hearing some positive comments from North American refiners about an uptick in demand.

It's premature to say the worst is over. However, since many forecasters had considered 2020 a complete write-off, we're encouraged to see some signs that early recovery could be starting to take hold.

# Changes brewing in the technology sector

**Jonathan Mzengeza**
*Portfolio Manager, Technology*

The technology sector peaked at +10.5% on February 19, fell -31% to a trough on March 23 and recovered +20% since then. This compares to the broader market, which only peaked up +3.1%, fell even further (down -34%) and has also recovered +20%. The tech sector has been resilient because there seems to be an inherent benefit from the work-from-home trend for some of the larger tech companies. For example, Amazon benefits, as it provides e-commerce services and grocery delivery as well as having the number one position in cloud computing. Microsoft benefits because of its cloud computing platform, collaborative apps like Skype as well as its Xbox video game service. Netflix has benefited, reporting their Q1 results, where they added over 15 million paid subscribers globally in the period—a number far higher than they've ever achieved before.

I've been thinking about what will change as a result of this pandemic. If you look at the global supply chain, many of the goods we purchase—almost all our electronics, medical equipment, clothes and many more items—are made in China. Manufacturing there permits a benefit from low cost as well as proximity to other parts of the supply chain, particularly for tech. I believe cost-benefit calculations are happening as a result of the current crisis that will have a profound impact on manufacturing outsourcing companies, especially those with large Asian footprints.

> "The current crisis will have a profound impact on manufacturing outsourcing companies, especially those with large Asian footprints."

In my view, we'll see new manufacturing hotspots emerge in places like Canada and South America. While Apple seems to be staying in Asia for the time being, it's already moved some of its manufacturing out of China and into Malaysia and Indonesia. India is also being heavily explored as an option by many companies. In some of these regions, I think we'll also see more and more robotics and automation in manufacturing to combat the higher labour costs.