Investment Notes

March 31, 2020

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

COVID-19 is the Black Swan event that abruptly ended the 11 year bull market, with all the major indices around the world down double-digit year-to-date (see statistical summary table). The unexpected crude oil price war initiated by Saudi Arabia against Russia on March 8 accentuated the free fall in stock markets driving the crude oil price down 66% since the start of the year.

A government-imposed shutdown on all businesses and activities on a global scale has never occurred. Pandemics, however, have occurred many times in history and “humanity will endure, overcome and come out the other side”, according to Margaret Atwood in a recent Globe & Mail opinion piece.

The path out of this recession will be largely dictated by the speed by which the COVID-19 outbreak can be contained and the ability for society to learn to live with the virus. Economic and earnings forecasts at this juncture appear to be relatively futile although directionally there will continue to be downward revisions the longer the current health situation prevails.

Commentary

The official start of the bear market was March 12th when the S&P 500 Index (SPX) pullback exceeded 20% from its February 20th high. North American indices hit a low on March 23, with the S&P/TSX Composite Index down 37% and the SPX down 34% from their respective highs. Whether this marks the low remains to be seen. Technically, evidence does suggest selling pressure reached an extreme level on March 23 and a bottoming process is underway – there could be several rally-retest phases before a final bottom is in place.

The velocity of the sell-off was unprecedented, propelled by numerous factors including automated computer driven trading programs, the need for liquidity to fund redemptions, margin calls and a general flight to safety. Volatility (as measured by the Volatility Index or “VIX”) remains very elevated (Figure 1) and typically has an inverse relationship with stock markets. The fear of the unknown, which in this case is the prognosis of the coronavirus outbreak as well as the depth and duration of the recession, is resulting in a high level of anxiety.

Global central banks and governments took major policy actions to limit financial market stress and cushion household and business income losses. Below is a list of fiscal stimulus packages announced so far (compiled by CIBC):

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Major Announced Fiscal Stimulus in Current Period Relative to 2008/2009 (US$ billions)

Country	COVID-19 Stimulus (US$)	Financial Crisis Stimulus (US$)	Increase/ Decrease %
United States	2,112	939	125%
Japan	502	441	14%
Germany	836	94	789%
France	50	30	68%
Italy	28	10	170%
UK	82	40	106%
Spain	223	103	116%
Canada	77	34	122%
China*	395	575	- 31%
	4,303	2,267	90%

*China stimulus of a possible CNY 2.8 trillion (US$395 billion) is yet to be confirmed

Central banks have lowered interest rates to near zero and announced quantitative easing programs. The U.S. Federal Reserve Bank has taken a series of steps designed to support the flow of credit in the U.S. economy, essentially becoming a buyer of numerous fixed income products. Specifically, the Fed is providing much needed liquidity to markets in corporate bonds and asset-backed securities and it will soon announce details about a facility that is designed to support lending to small and medium sized businesses.

In Canada, OSFI, Canada's banking regulator, is giving financial institutions more flexibility on requirements such as capital buffers - lowering them to free up an estimated $300 billion of lending capacity. To assist banks that are allowing customers to delay mortgage payments by up to six months, it will treat these deferred mortgages as performing loans in the calculation of risk-weighted assets on the bank's balance sheet which will alleviate some of the pressure on rising loan loss provisions. The major Canadian banks are well-regulated, highly profitable, well-capitalized and capable of riding out economic cycles.

This health crisis is similar to a natural disaster such as an earthquake or hurricane that generates a sharp disruption, halting daily activities. The normal rebound from these type of events tend to be rapid and include a period of escalated growth to make up for lost production. Importantly, businesses and employees typically treat a natural disaster as transitory and pick up afterward where they left off. The severity of the event and the pace of rebuilding influence the extent of lasting economic scars. Using that analogy, the magnitude of the pandemic's disruptive power and global reach suggests a prolonged period of time before the global economy recovers to pre-crisis levels.

A global synchronized recession is now underway with global GDP in the first half of the year to be down double-digit. The outlook for the back half of the year will largely be dependent on the timing of relaxation in containment measures and the pace at which activity begins to normalize.

Most forecasts assume the virus in North America will be brought under control within three months, referencing the countries that contracted the virus the earliest, e.g. China, South Korea, Italy and Germany.

Using Apple's experience in China as a proxy to when containment measures may start to be loosened: the company started closing its retail stores in China in early February and by March 13, all 42 stores were re-opened although some stores had special business hours. Therefore, its stores in China were closed for about five weeks. Apple announced the closure of all its retail stores outside of Greater China on March 13. Trump has extended federal social distancing guidelines to April 30. Perhaps some sort of staggered lifting of containment measures and reopening of businesses in May is feasible. This timing may coincide with the arrival of summer and potentially positive seasonal effects. Living with the virus also requires widespread availability of personal protection equipment and tests.

The significant collapse in the price of oil due to a confluence of a price war between Saudi Arabia and Russia and reduced consumption from curtailed activity will have serious ramifications. Not only are energy producers suffering but also industries that provide products and services to them. The current price of crude oil is below the $40 level required by Russia to balance its budget and $80 level required by Saudi Arabia. The global oil supply/demand balance will remain under significant pressure if an emergency OPEC+ cut is not made and the price war continues. A coordinated output cut on a global scale may be required.

Corporations will start to report first quarter earnings in a few weeks. Pre-announcements of shortfalls and withdrawal of guidance previously provided for the year have already started to happen. While it may be premature to forecast how much corporate profits will decline, a sharp decrease is expected this year. The severe pullback in stock markets reflect this negative trend but until there is more clarity when containment measures are lifted, it will be difficult to make an accurate forecast. Damage done to consumer and business psyche will also influence the degree of rebound in corporate profits when the health crisis passes.

Numerous initiatives are underway by healthcare companies to combat COVID-19 in the areas of testing, therapeutics to treat the virus and vaccine development. Some examples include: (1) Abbott Labs' testing system that can deliver positive results within five minutes and negative results in 13 minutes (2) potential therapeutics include remdesivir (Gilead's antiviral drug), chloroquine (used to treat malaria) and hydroxychloroquine (used to treat autoimmune diseases) (3) scientists at the University of Pittsburgh School of Medicine believe they have found a potential vaccine and hope to start human clinical trials in a few months and (4) Johnson & Johnson expects to initiate human clinical studies of its lead vaccine candidate at the latest by September and anticipates the first batches of a COVID-19 vaccine could be available for emergency use authorization in early 2021. Last Thursday, Bill Gates announced that his philanthropic organization, the Gates Foundation, was picking the top seven vaccine candidates and will spend billions of dollars to fund the construction of manufacturing capacity for them. Even though not all may be successful, he wants mass production to begin immediately when the vaccine(s) are identified.

The companies you own are financially sound with strong balance sheets and well-positioned in their respective industries. While their share prices may be volatile over the near term, we expect them to continue providing income through dividends and over the longer term, prosper and appreciate in value. We are experiencing an unprecedented situation and extreme volatility in markets, however, history shows maintaining a long-term focus will ultimately be rewarding for investors.

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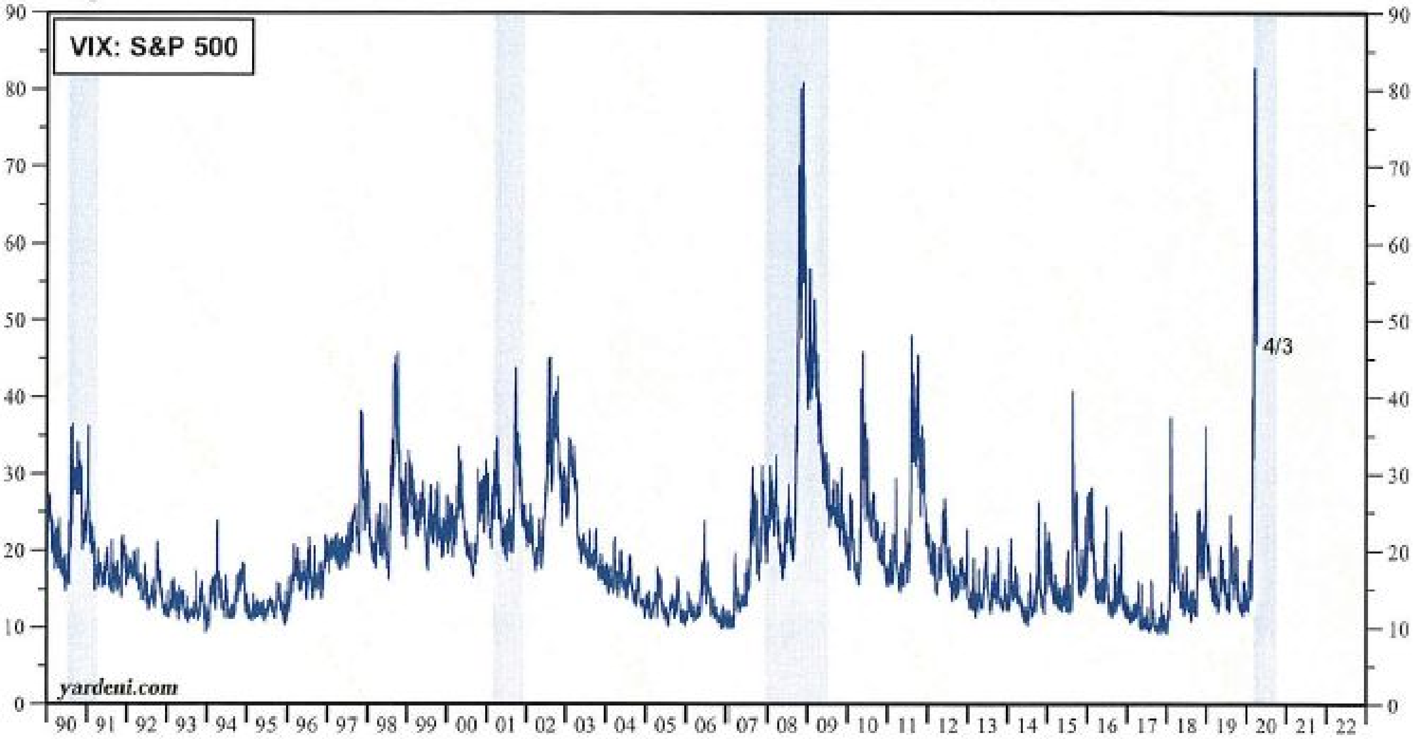
Upcoming 2020 BNN Dates

Christine: April 15 @ 6:00pm
Christopher: April 30 @ 6:00pm
Christine: May 13 @ 12:00pm
Christine: June 11 @ 6:00pm
Christine: July 8 @ 6:00pm
Christine: August 11 @ 12:00pm
Christine: September 14 @ 6:00pm
Christine: October 14 @ 2:00pm
Christine: November 9 @ 6:00pm
Christine: December 14 @ 12:00pm

Figure 1.



Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Chicago Board Options Exchange.

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March 31, 2020 Statistical Summary

STOCK MARKETS	**QTD**	**1 Year**
S&P TSX Composite Total Return (CAD)	-20.9%	-14.2%
S&P 500 Total Return (CAD)	-13.0%	-2.0%
S&P 500 Total Return (USD)	-19.6%	-7.0%
DJIA Total Return (USD)	-22.7%	-13.4%
NASDAQ Composite Price Return (USD)	-14.2%	-0.4%
MSCI World Index Price Return (USD)	-15.0%	-7.4%
CANADIAN UNIVERSE BOND INDEX	1.6%	4.5%
COMMODITIES		
GOLD	5.4%	24.3%
SILVER	-20.5%	-6.1%
COPPER	-19.7%	-23.9%
NATURAL GAS	-25.1%	-38.4%
WTI	-66.5%	-66.0%
BRENT	-60.4%	-61.9%

TREASURY BONDS	**03/31/20**	**03/29/19**
2 Year (CAD)	0.42%	1.55%
(US)	0.23%	2.27%
5 Year (CAD)	0.60%	1.52%
(US)	0.37%	2.23%
10 Year (CAD)	0.71%	1.62%
(US)	0.70%	2.41%
30 Year (CAD)	1.32%	1.90%
(US)	1.35%	2.81%
Inflation		
CPI (CAD)	2.2%	2.1%
(US)	2.3%	2.1%

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