INVESTMENT OUTLOOK Q1 2020

HIGHLIGHTS

Economic Review

- In light of the human and global tragedy that is the COVID-19 pandemic, economic activity has virtually ground to a halt.
- Central banks, such as the Bank of Canada and the U.S. Federal Reserve, have cut interest rates outside of regularly scheduled meetings in order to provide liquidity.
- Massive stimulus and bailout packages from governments led markets to finish March with overall losses that were perhaps less than many had expected.

Investment Outlook

- The overall ramifications that COVID-19 will have on the economy much depends on the effectiveness of policy actions taken to offset the impact of the government response to containing the spread of the virus.
- For Canada, we need to further discount the outlook for our increased sensitivity to the declining energy sector and higher levels of household indebtedness.
- As an asset manager and steward of our clients' capital, we will continue to stress test our holdings and focus on the fundamentals of the businesses we follow.

ECONOMIC REVIEW

"There are decades where nothing happens; and there are weeks where decades happen" is a most appropriate quote to summarize the first quarter of the new decade. The COVID-19 pandemic contributed to a multitude of economic, financial, political, and social unknowns. Simultaneous supply and demand shocks in the oil market only added fuel to the fire. One thing financial markets do not like is uncertainty, and when investors have to price in a new set of unknowns, it usually leads to major price adjustments and increased volatility.

The year started out with some optimism. Brexit had finally run its course, and while details remained to be ironed out, the path to clarity was beginning to emerge. Trade disputes, which had dominated headlines for much of 2019, were expected to diminish as the U.S. and China had come to a tentative phase 1 deal. The outbreak of COVID-19, initially believed to be a regional challenge, has clearly changed the previous trajectory and rendered previous forecasts worthless. In light of this human and global tragedy, economic activity has virtually ground to a halt. The fallout has thus far been particularly acute in Italy and Spain, which have had severe outbreaks and higher death rates than other global averages. As we approached the end of the quarter, there were glimmers of hope as growth in infections appeared to plateau after aggressive social distancing measures.

Given the scale of the disruption, global monetary policy coordination has been swift and significant. Central banks, such as the Bank of Canada and the U.S. Federal Reserve, have cut interest rates outside of regularly scheduled meetings and initiated significant fixed income purchase programs in order to provide liquidity. Massive stimulus and bailout packages from governments led markets to finish March with overall losses that were perhaps less than many had expected. There was also a "flight to safety" in the currency markets, with the U.S. dollar rallying, which benefitted Canadian investors as it helped to improve returns converted to Canadian dollars.

BOND MARKETS

During March, global bond markets experienced record low interest rates for federal government bonds, unprecedented fiscal and monetary policy responses, a broad based breakdown of liquidity, and the fastest ever adjustment in valuations, from expensive to cheap, for corporate credit. The longer the "unknowns" remain outstanding the greater the difficulty in pricing them in and the more of a discount to fair value that markets will demand. By late March markets seemed to have priced in a recessionary scenario with investment grade corporate bond spreads (the difference in yield between a corporate bond and the equivalent maturity federal government bond) reaching 2.7% while spreads for high yield issues reached above 10%.

Central bankers, particularly the US Federal Reserve, took a "kitchen sink" approach to stabilize market liquidity and catalyze a quarter-end rebound. The US Federal Reserve's announcement of unlimited purchases of high-quality debt was unprecedented. By including investment grade corporate bonds, they have essentially put a floor under valuations.

EQUITY MARKETS

The story on the equity side was similar, with global equity markets posting significant and rapid declines as a result of the spread of COVID-19 across the globe. No major markets were spared negative results, as investors indiscriminately sold any and all risk assets in light of the virtual shut down of most major economies. Coupled with this dynamic were deteriorating fundamentals in the global oil markets, as Saudi and Russian representatives failed to agree on a course of action to stem the oversupply. Subsequently, each decided to maintain or increase production in spite of significantly reduced demand.

Against this backdrop, volatility reached peak levels and performance disparities were significant. Currencies played a significant role in returns for domestic investors in foreign markets, as safe havens such as the US dollar, Japanese yen and Swiss franc showed increased stability when compared to those more affected by oil prices or the COVID-19 outbreak.

From a regional standpoint, the U.S. and other technology-heavy markets were amongst the leading performers globally. Information Technology, as a sector, held up relatively well on a global basis, likely due to higher quality recurring revenue streams, strong financial positions and increased use as a result of a progressively more mobile work environment. Other defensive sectors showing resilience included Consumer Staples and Health Care, with lower economic sensitivity and robust balance sheets. Lagging sectors included Energy and Financials, the latter due to increasing loan loss provisions, slower growth and anticipated margin contraction as a result of interest rates approaching historically low levels. Relative corporate financial strength, as measured in terms of both debt and liquidity, has become a key driver in relative stock performance.

With the downdraft in energy alongside a heavy financials component, the Canadian market was amongst the weakest performers of the world's developed markets. Emerging markets showed a wide range of variability, with China posting much higher returns than many others such as India, Brazil and South Africa. Other developed markets were also generally weaker, with strength in both the Swiss and Japanese markets being offset by most other developed European indices.

Market Returns (as at March 31, 2020)

(%)	3M	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	-20.9	-14.2	0.9	4.1	5.2
S&P 500 (C$)	-11.8	-0.9	9.2	14.3	8.8
S&P 500 (US$)	-19.6	-7.0	6.7	10.5	7.6
Russell 2000 (US$)	-30.6	-24.0	-0.3	6.9	5.7
DJIA (C$)	-15.7	-9.9	6.7	11.0	6.2
DJIA (US$)	-23.2	-15.5	4.3	7.3	5.0
MSCI EAFE Net (C$)	-15.3	-8.8	1.7	6.3	4.2
MSCI EAFE Net (US$)	-22.8	-14.4	-0.6	2.7	3.1
MSCI Emerging Mkts Net (US$	-23.6	-17.7	-0.4	0.7	5.4
FTSE Canada Universe Bond	1.6	4.5	2.7	4.3	4.6
FTSE Canada 91 Day T-Bills	0.7	1.9	1.0	1.0	1.6
C$/US$	-8.9	-6.1	-2.3	-3.3	-1.1

Converted to CAD using London 4pm rates. Returns are annualized for periods greater than one year.

OUTLOOK

Making predictions about the future is difficult at the best of times but is especially so when most of the world's countries are essentially on a war footing against an unpredictable enemy. Best estimates for the economic recession that will result from the lockdown policies put in place to combat the virus are around -4% GDP for the year, which is about the same decline as during the Global Financial Crisis in 2008. A wider confidence interval around this episode seems obligatory due to the record amount of corporate debt, the already low levels of interest rates, and the record policy stimulus.

As to the duration of the recession, the historical record shows a range of one to six quarters; as a reference, the 2008 financial crisis was at the longer end. Judging by other countries' experience with the virus and previous economic shocks due to influenzas, best estimates are at the shorter end of the range, around two quarters. We do not consider it as economic capacity having been destroyed, but rather as being sidelined for future use. For Canada, we need to further discount the outlook for our increased sensitivity to the declining energy sector and higher levels of household indebtedness.

While we are not tremendously focused on the exactness of the numbers, what we can say is that the virus' effect on the economy will be serious but, with some caveats, we believe it will be relatively short-lived. Much depends on the effectiveness of policy actions in offsetting the impact of the government response to containing the spread of the virus. As to the longer term impacts, the marrying of monetary policy with fiscal policy will ultimately result in higher inflation risk premiums. The one thing that will be even more difficult to predict is the effect on human behavior.

So what comes next? Since this situation is unprecedented, making substantial bets is likely to be perilous. Some areas, such as travel and tourism, are being hit especially hard and will take a long time to recover. There may even be some sectors that will come out of this crisis looking completely different in the future. As an asset manager and steward of our clients' capital, we will continue to stress test our holdings and focus on the longer-term fundamentals of the businesses we follow. We may sell some positions that we feel have poor prospects of recovery, and we will buy, hopefully at discounted prices, some companies we feel are more resilient or will come out the other side even stronger.

All returns are expressed in Canadian dollars unless otherwise indicated.

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