The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

1. *Punctuated Evolution*
2. *Markets are Forward-Looking*
3. *The Good, The Bad and The Ugly*

"Debt is an increase in current spending in exchange for a decline in future spending."

- ***Lacy Hunt, Hoisington & Associates, on the impact of today's government borrowing***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	23,625	- 1.05%	- 17.22%
S&P 500	2,853	- 1.00%	- 11.71%
TSX	14,510	- 2.18%	- 14.97%

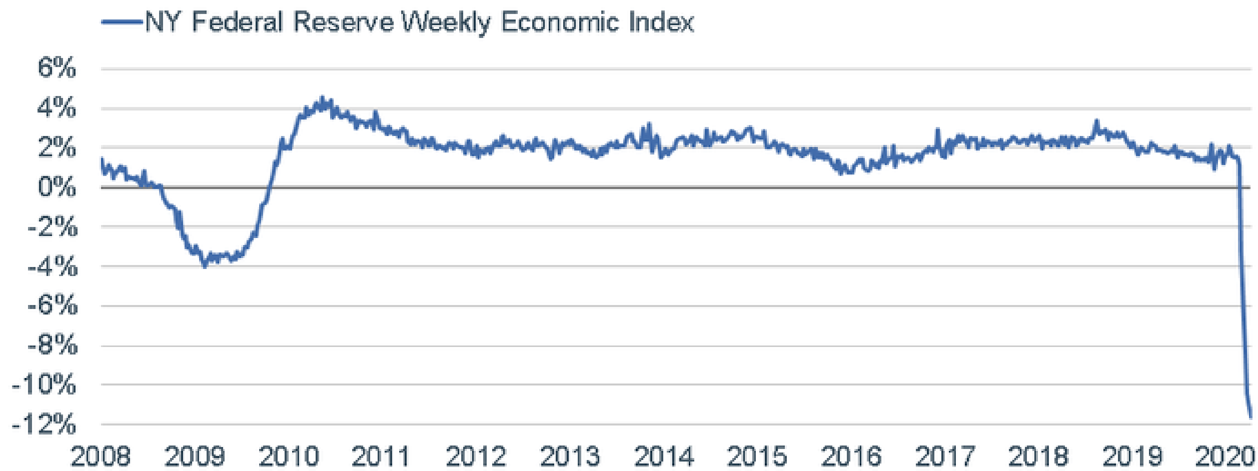
Punctuated Evolution

Around 65 million years ago, a huge meteor slammed into what is now the Yucatan Pensinsula in Mexico, leaving a 93-mile wide crater. This unleashed a shock wave of debris and heat that circled the globe and wiped out three-quarters of all life on Earth. Anything big, lumbering, and hungry died out.

As direct descendants of one of the surviving groups, we know the qualities that helped avoid extinction. Mammals – us - were warm-blooded, small, and liked to burrow. Perfect for a cooling world. Birds, part of the dinosaur family, were probably the quickest to flee and managed to find a new niche up in the air. Small reptiles, amphibions, fish, and insects also lived through the nuclear winter that followed.

When evolution was first proposed as a theory, it assumed a gradual change over the millennia. Most paleontologists today subscribe to “punctuated evolution” where things stumble along unchanged for long periods, then mutate rapidly when disaster happens.

The Covid-19 pandemic is like an economic meteor slamming into what was a stable economic system:



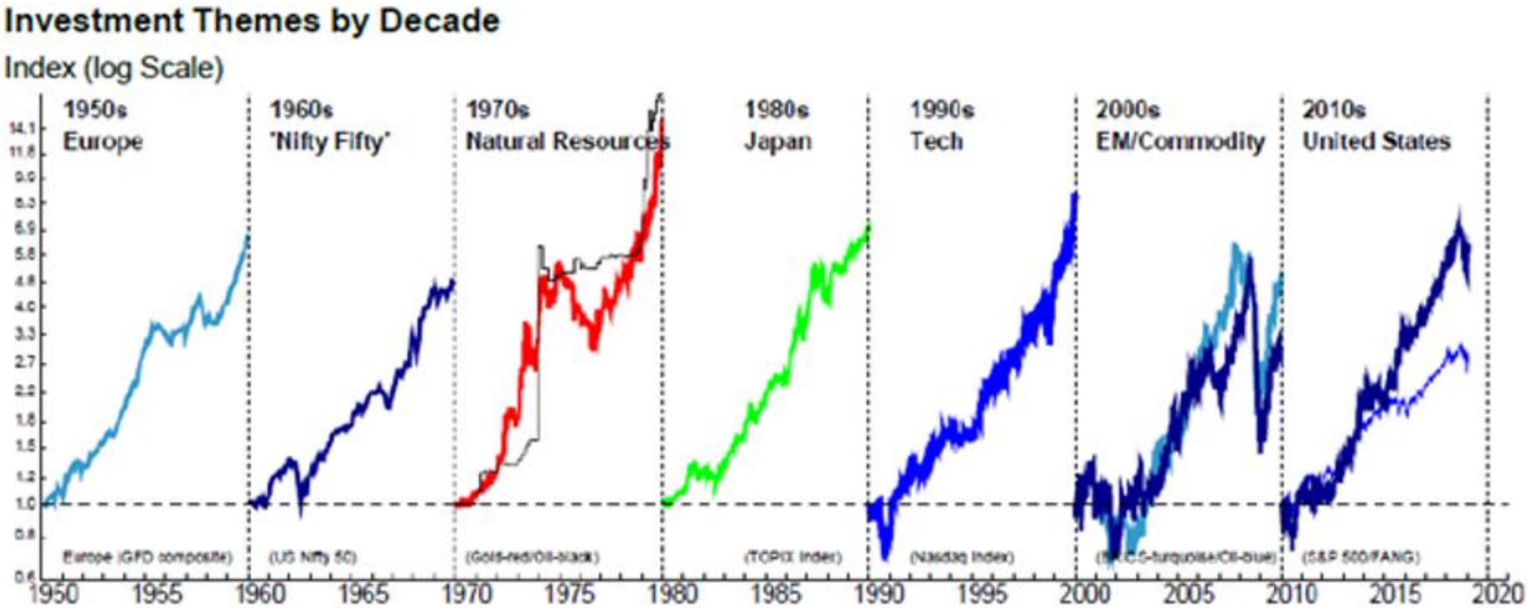
My wife asked me the other day which companies will prosper at the end of this epic pandemic and I replied with my meteor and dinosaur story.

“It is too early to tell,” I said, “which companies are T-Rex’s and which are birds”. The dust is still flying and the survivors are struggling to adapt.

Once the sky clears, and it will, new companies will dominate. Some are obvious today, like Costco (**NASDAQ COST**) and Amazon (**NASDAQ AMZN**) but others will pop up that we haven’t even heard of yet. The company we know as Google - Alphabet (**NASDAQ GOOGL**) – was virtually unknown in the dot.com crash and did not become a public company until 2004. Now it is one of the largest companies on Earth.

Earth’s eras were dominated in turn by bacteria, invertebrates, reptiles, dinosaurs, and finally mammals. Just as these eras were marked by a dominant life theme, each decade in recent financial history has been marked by a dominant asset class. The most recent has been the rise of the internet giants, the so-called FAANG (Facebook, Apple, Amazon, Netflix, Google) stocks. Some strategists today speculate that the 2020’s dominant sector will be health care. Biotechnology is still in its infancy, is growing rapidly, and has just received an enormous push from all the research done into Covid-19. We may be on the cusp of dramatic improvements to everything from cancer treatments to even life extension.

Couple biotechnology with a renewed focus on hospitals, infections, and a glaring need for better care of our seniors and you might have the recipe for a decade-long boom.



Source: https://affinitypw.com/news-and-views/article/10-year-itch and https://www.bissan.es/donde-esta-el-minimo-del-mercado/)

Markets are Forward-Looking

Markets rallied in April because of government stimulus and optimism that pandemic deaths had peaked. It was a highly confusing month for investors because it was still full of bad news. New York, for example, kept seeing higher death counts even as stocks screamed higher. Stock markets bottom 5 months before recessions end, on average, leading some to think an economic recovery is on the horizon.

Economic data is getting better by the day, but the hard slog is ahead of us. Restaurants will open with half-capacity, as will airlines and movie theatres. Concerts and sporting events remain closed with no dates set for re-opening.

Signs of thawing are becoming more apparent, however. RBC published data from cell-phone and credit card purchasers to show the economy bottomed around April 1st.

Chart 5: Apple Mobility Report: Driving (Index, 24th February = 100)

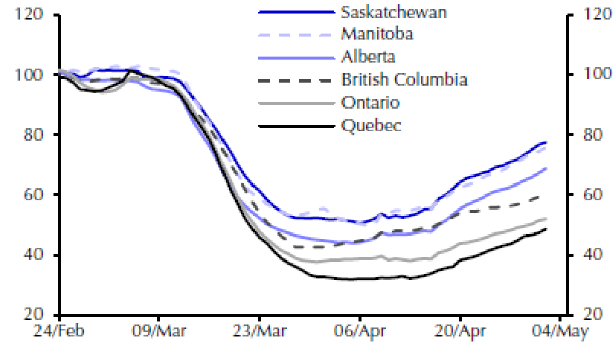
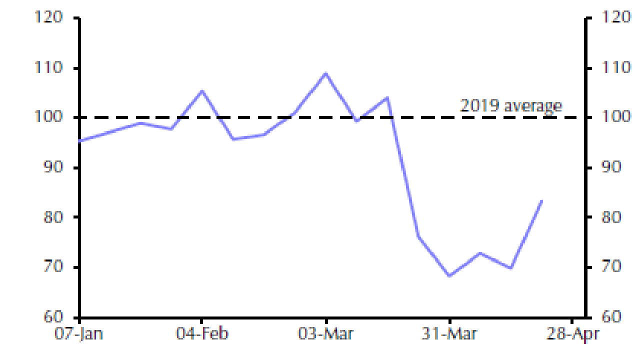


Chart 6: RBC Debt & Credit Card Spending (2019 average = 100)



Sources: Johns Hopkins CSSE, StatsCan, Refinitiv, RBC, Capital Economics

As the economy opens, we will see unemployment rapidly decrease. Most unemployed Americans were temporarily laid off from their jobs, with nearly 80% classified as *furloughed* (which means leave of absence). There will be permanent layoffs, we know, but most jobs will return. One example is home applications, which were up 11% last week over the month before. Perhaps the shelter-at-home lockdown is the calalyst for millennials to finally move out of the basement.

However, as the data gets better, markets may decline. Many stocks have risen too far on hopes for a vaccine and bigger and bigger government bailouts. What happens when the bailouts stop? What we need never comes as fast as we want it to (just ask any kid at Christmas), so any stutters in the openings will be a disappointment.

There is also an internal battle between growth investors and value investors. The growth investors, riding the coattails of Apple (**NASDAQ AAPL**) and Microsoft (**NASDAQ MSFT**), have carried the year so far. Companies like these are crushing their competitors, so it is no surprise.

The value camp sees tempting bargains in the losers in this pandemic. Banks and insurance companies trade below book value and many industrial stocks are at their lowest levels in a decade. Value investors see this as a generational opportunity to pick up true bargains.

The result? Lots of emotion, but little locomotion until the winners sort themselves out. Expect this to be the theme for markets for the next while.

The Good, The Bad and The Ugly

A blogger we read called this the ***Clint Eastwood Market*** because stocks today are either Good, Bad, or Ugly. And none of them are easy investments right now.

Both the Good and Ugly categories are holds. In other words, “hold ‘em if you got ‘em” because the Good stocks are too late to buy more and the Ugly stocks are too early to touch.

Where we are doing most of our research is in the Bad category. These are stocks that have been hurt by the pandemic but have potential catalysts to turn around sooner.

The Good

Technology and health care comprise most of this list. The Work-From-Home movement has seen Netflix log record downloads while Amazon had to hire 170,000 more workers to keep up. Apple has now surpassed 500 million users for its Music and other monthly services, and Facebook now serves 40% of the world’s population. Great companies, but hard to chase them up here.

Over in health care, there are close to 90 vaccines and anti-viral drugs in the research pipeline. Governments are throwing billions at anything to do with Covid-19: test kits, masks, gowns, and face shields are all on back order. Telemedicine is now a normal way to see your doctor.

Gold is another clear beneficiary. Not so much because of the problem (the virus), but because of the solution (0% interest rates and money printing). Some of us on the Dividend Value team think gold will go much higher while others think it is grandpa’s folly. We argue about gold every week in our shop!

The Bad

These are companies and industries that have been hurt but have a catalyst to turn around sooner:

- Packaged food – We used to hate canned soup. Now we stockpile it.
- Elective surgery and medical devices – Our aging population hasn’t gone away. They will need new hips and pacemakers more than ever.

- Plastics makers – Disposable plastic shopping bags are back, and more and more food is being pre-wrapped (a setback for the environment).
- Building cleaning and retrofitting – Expect to see office cleaners in the daytime now cleanng every surface. Air ducts need better filters and buildings need to be opened to let in fresh air.
- Defense companies – Governments are spending more on masks than on missiles right now, but not forever. The divide between the US and China is only getting wider.
- Refiners – We will drive and fly again. The companies that refine gasoline and jet fuel will profit mightily from all this cheap oil.
- Industrial construction – India has reached out to more than 1,000 U.S. companies to offer incentives to relocate from China to India. Japan has budgeted $2.2 billion to help shift factories home from China, and Europe and the US are contemplating doing exactly the same thing. Expect to see a boom in local factory construction in the years ahead.

The Ugly

These are the companies most affected by the coronavirus. All of the recent bankruptcies - J. Crew, Neiman Marcus, JC Penney, Aldo, Pier One, True Religion, Cirque du Soleil– come from these industries. It will likely be years before we see revenues from these sectors return to 2019 levels. There are likely wonderful trades here because of the deeply depressed prices. There will also be more dividend cuts and bankruptcies, so we tread extra cautiously with these groups:

- Cruise lines
- Banks
- Airlines
- Oil
- REITs
- Insurance
- Hotels
- Entertainment

Our offer for hand-made masks is still open. We just received a fresh shipment!

Thank you for your referrals this month! They are always handled with great care and discretion.

http://www.dividendvaluepartners.com

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca
sharonmitchell@raymondjames.ca

(250) 405-2417

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Prices shown as of May 14th, 2020

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