The Market in Review

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This week's articles and insights

1. *Markets This Week*
2. *The Shape of Things to Come*
3. *Tax Filings*
4. *Building a Bridge*
5. *Raymond James Steps Up*

"There is nothing more permanent than a temporary emergency government program."

- **Milton Friedman**

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	23,538	- 0.77%	- 17.52%
S&P 500	2,800	+ 0.35%	- 13.35%
TSX	13,899	- 1.89%	- 18.54%

Markets This Week

The recent stock market crash was the fastest in history. The “relief rally” since March 26th has been equally fierce, resulting in a 25% rally from the bottom to today.

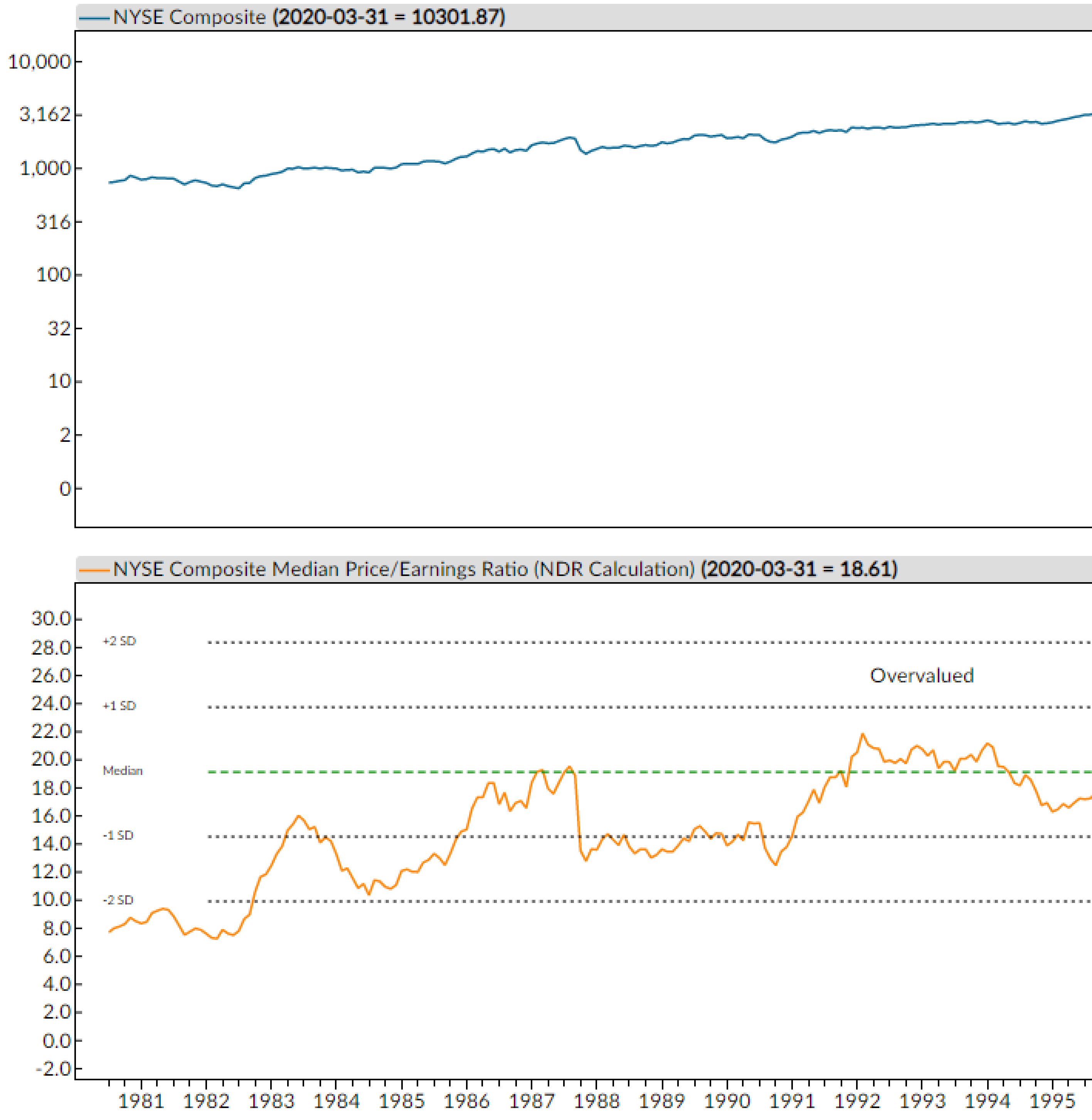
That’s a full bear market and bull market in the space of a month. If it feels like your head is spinning, it probably is.

What is also difficult to comprehend is how stocks have risen 25% in the face of the economy at a full standstill and unemployment soaring. How can stocks be positive when the data is so bad?

For starters, many professional investors had raised cash in January and February due to high valuations. The March decline brought us all the way back to 2012 levels based on price/earnings ratios (see chart below). This helped to bring these investors back into the market.

NYSE Composite vs. NYSE Composite Median Price/Earnings Ratio (NDR Calculati

(Customized client version of DAVIS107)



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Stocks look 6-9 months ahead. Capital Group, one of the largest mutual fund managers in the world, describes the three phases we have to pass through:

1. Health Phase – The curve is flattening around the world and countries are starting to open up. North America was the last region to be hit, so will be the last to emerge. We hope to see Canada and the US start to re-open in May, which means we are nearing the end of this phase.

2. Economic Phase – This is the aftermath of the shutdown – the unemployment, the terrible earnings, and all the misery that goes with it. Companies began reporting earnings this week for the January-to-March quarter and they aren't pretty. They won't be for several quarters yet. We are starting to see the winners separating from the losers, though. Some companies are thriving.

3. Normalization Phase – This begins when the economy re-opens. We will see how fast customers return to stores and what events are allowed to go ahead. What will be the "New Normal"?

Because we are just entering the Economic Phase, expect markets to churn. We have said this for a few weeks now, and this could last several months. For existing investors, it will require patience. For new investors, it should be a chance to average money in at lower prices.

The portfolio managers at Capital Group have been adding money back to markets through the lows of March, yet still hold triple the amount of cash they did on January 1st. Even a company managing over a trillion dollars is somewhat tentative.

What are they waiting for?

"We are not looking for good news to invest more money. We are looking for less bad news."

In an "ordinary" recession (as if any recessions are ordinary), portfolio managers load up on utilities, consumer staples (grocery and drug stores), and health care stocks. This is no ordinary recession caused by a slowing economy, like a decelerating car. This is a Ferrari hitting the wall at 90 mph.

Capital Group's largest funds hold low amounts of consumer staples stocks, almost no utilities, and big positions in health care and technology. Health care is sort of obvious – there is a tremendous amount of research happening on Covid-19 vaccines and treatments, and health care will be a favoured sector for years to come as a result.

Technology, however, has not historically been a recession-proof sector. Capital's portfolio holds Amazon (**NASDAQ AMZN**), Microsoft (**NASDAQ MSFT**), Advanced Micro Devices (**NYSE AMD**), Taiwan Semiconductor (**NYSE TSM**) and Alibaba (**NASDAQ BABA**) in its top 15 holdings. These have made it a top-quartile fund this year, as it has been for many years.

Technology companies have allowed us to connect on a vast scale, to work from home, and are helping us track the spread of the virus. Perhaps they are the world's new utilities.

The Shape of Things to Come

It is an alphabet soup of projections for the world's future. Economists love letters and symbols, and several lend themselves well to the current environment.

For example, many strategists projected a **V-shaped** recovery early into the crisis. The slowdown would be short and sharp for a few months, followed by a big bounce-back by late spring.

Economic numbers no longer support the V. Over a million Canadians have lost their jobs and the US is close to 17 million, putting both countries on track to exceed every ugly record since the 1930s. Oil prices have hit their lowest levels in decades as the stuff is close to overflowing storage containers. A recent survey stated that just 15% of economists now expect a V-shaped recovery. Note that any medical breakthrough would lead to a V-shaped recovery, and a big one.

The consensus is now for a **U-shaped** recovery. This scenario incorporates a huge drop in Q2 (April through June) numbers, followed by a gradual rise as economies open up in the summer. The US is planning on partial reopening for some businesses starting in May and Canada is likely to follow. This all depends on the trajectory of hospital admissions, of course. New York City is seeing fewer new admissions this week, which offers a ray of hope.

In Europe, Austria allowed smaller stores, as well as all hardware and gardening stores, to open this week. Face mask wearing is mandatory when shopping, as well as on public transportation. On May 1st, shopping centers and bigger stores will open, and this will include hair salons. Restaurants and hotels will start opening in mid-May. Spain reopened some construction and manufacturing facilities and Denmark will open some schools this week. 52% of respondents in the survey believe the recovery will follow the U-shaped pattern.

A **W-shaped** pattern may appear if a secondary wave of infections appears later in the year. This could lead to closures again, albeit on a more limited scale. Until a vaccine is available, it is inevitable that we will see the virus reappear once we are back to some semblance of normalcy. This means the recovery will take longer than expected. Personal savings will have taken a big hit from the closures and many jobs lost will never reappear in their current form. 22% of respondents to the survey expect a W-shaped economic recovery.

What governments have been working hard to prevent is the **L-shaped** depression, where we fall and take years to recover. Few expect this to happen, thanks to the speed of government programs. Most governments can be faulted for not preparing for a pandemic, but central bankers should not be included. They were the first to react, and they did so in bold fashion. The Bank of Canada cut interest rates three times in three weeks in March to 0.25% and began buying bonds of provinces as well as corporations – something Canada has never done before.

To put this into perspective, the Congressional Research Service compared the costs of today’s US coronavirus measures with previous wars (thanks to Andrew Adams of Saut Strategy):

- Iraq and Syria cost the US around $1.5 Trillion
- World War II cost the United States $4.1 Trillion in today’s dollars
- Coronavirus programs currently at $3 Trillion

Actions like these help to ensure that no provinces, states, cities, and as few major corporations as possible lose access to money. Central banks today learned a great deal from past crises. Consider the speed with which they have worked:

- After the stock market crash of 1929 and the subsequent contraction, it took **4 years** until 1933 before the US government devalued the dollar and initiated deposit insurance. By then, over 25% of US banks had failed, taking people’s life savings with them.

- In 2008, it took two months for quantitative easing to start and five months before bank rules regarding how they valued their bond reserves (mark-to-market) were relaxed.
- Today, interest rate cuts began before the pandemic was even officially declared on March 11th. Central banks began buying government, state, and provincial bonds within days, and corporate bonds within a few weeks.

What does this mean in real terms? Consider Ford (**NYSE F**), a huge employer. Its bonds were recently downgraded to junk status (below BBB). You can buy insurance against a default on bonds like these, and this downgrade caused Ford's default insurance rates to spike higher. However, as soon as the US Federal Reserve stepped in and began buying bonds of companies like Ford, the insurance rates were cut in half immediately.

The Depression was caused mainly by bank failures and the loss of people's savings. By taking swift actions to keep money flowing and bankruptcies to a minimum, it is highly unlikely we will see a depression today.

That said, this will be the deepest recession since the 1930s. The opening of our economies will be cautious, complicated, and careful. We can only hope the end is already in sight.

Tax Filings

Both the US IRS and Canada's CRA tax agencies are cutting us some slack on filing taxes.

In Canada, the normal filing date of April 30th has been extended to June 1, 2020 and if you owe money, you don't have to pay until September 1, 2020.

In the US, the normal filing and payment date of April 15th has been extended until July 15, 2020.

Of course, if you are expecting a refund, file now, No reason to wait.

Building a Bridge

In the 2000 recession, the average Baby Boomer was 45.
In the 2009 recession, the average Baby Boomer was 54.
In the 2020 recession, the average Baby Boomer is 65.

No one is questioning the need to bail out the savings and investments of the aging Boomers. What <u>will</u> be questioned will be the cost to the next generation. And, how are <u>they</u> going to pay for it?

This may explain why a recent survey showed that 25% of Millennials are drinking more than normal in this recession, compared to only 8% of Baby Boomers.

Drinking at home alone 2019 = sad loser.
Drinking at home alone 2020 = hero citizen.

Governments are printing trillions of dollars to cushion the blow of no income and no job for millions of people. All this stimulus is to buy time until we can recover – they are trying building a bridge over a deep recession.

A very similar spending spree happened in WW2. We won, of course, but there was a huge bill to pay at the end.

To fund the ~$4 trillion (in today's dollars) cost of WW2, the government borrowed the equivalent of 12% of GDP. It was a staggering number. From April 1942 to July 1947, the Federal Reserve fixed T-bill yields at 0.375%. Long-term yields were capped at 2.50% until March 1951. After the long deflation of the 1930s (like we have seen since 2009), inflation roared back – it averaged 6.3% per year through 1945.

You were paid 0.375% interest on your savings while inflation eroded your money by 6.3% per year.

As a result, $1.00 in 1942 was worth just $0.74 by 1947 due to inflation. This was terrible for savers, but great for the borrower – the US government. Inflation and artificially low rates cut their debt substantially by the 1950s.

Today, US T-Bills yield about 0.125% for a year and Canadian T-Bills yield 0.25%. Don't expect these to change for years, as we may now be following the WW2 playbook.

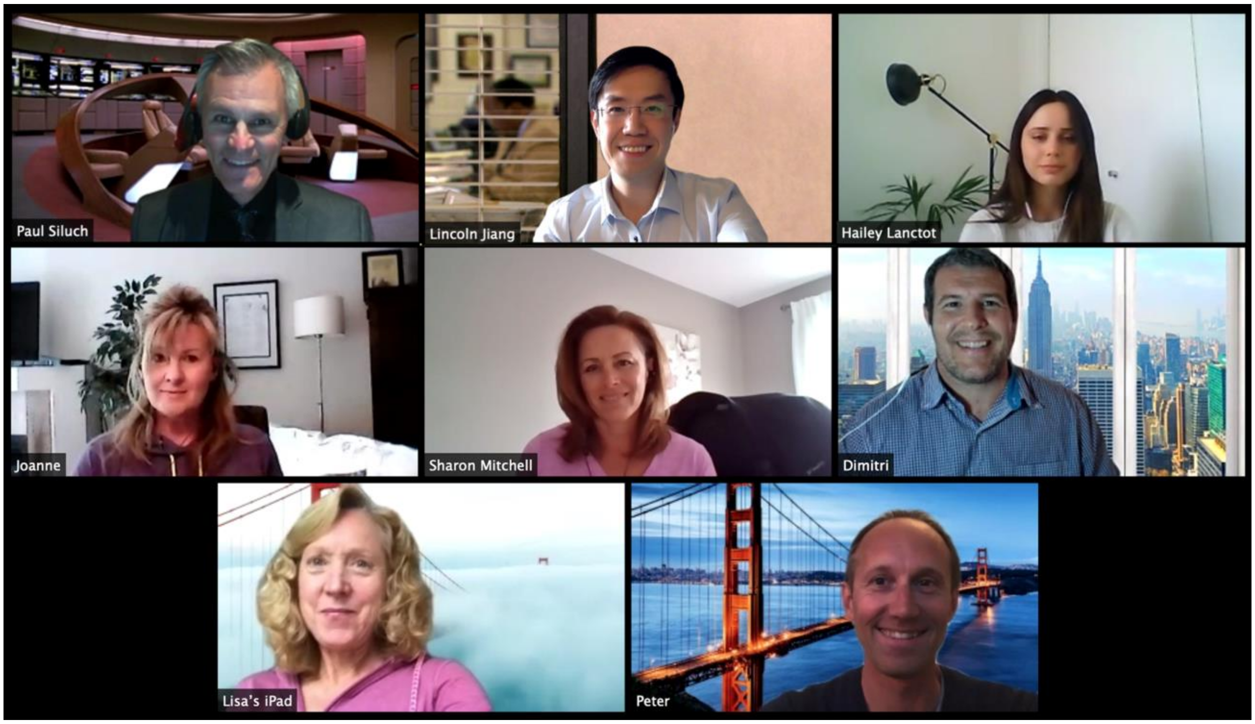
Deflation this year, followed by inflation next year? It could happen.

Raymond James Steps Up

Around March 25th, Raymond James Canada announced a program called the RJ Cares 4 Community Campaign. The goal was to raise $100,000 from employees which the company would then match. We reached this goal inside of three weeks, and will now be distributing $200,000 to shelters and food banks across the country. Here in Victoria, the Mustard Seed Church and Victoria Cool Aid Society will be recipients. In total, 42 agencies across Canada will receive cheques from Raymond James.

Following the Canadian lead, our US parent Raymond James Financial announced a US$1.5 million commitment to support charitable organizations delivering essential services to communities affected by COVID-19.

A big hello from the team on our daily Zoom meeting!



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Prices shown as of April 16th, 2020

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