2020 First Quarter Review

“What’s Going On?” - Marvin Gaye

Last quarter, the COVID-19 pandemic caused a kind of turmoil and chaos in financial markets that is not simple to summarize. Suffice to say it was truly unprecedented and provided some foreshadowing to what most people are now experiencing in their daily lives. The **rapid market downturn and volatility** of Q1 signaled the beginning of a global “storm” that threatened to get worse before it would get better. Many equity markets dropped as much as 35% from lofty mid-February highs with huge daily swings, up and down, before recovering somewhat yet remaining unstable and volatile as Q1 ended.

Meanwhile, and in response to the sudden health emergency putting untold lives at risk globally, **governments mandated business closures and lockdowns**. Simultaneously, in an early effort to alleviate the resulting financial hardship, they initiated aggressive stimulus through **lower interest rates and massive spending**. Interest rates in major countries were lowered to near zero and central banks supplied massive capital through debt purchases. Quickly, governments launched programs of tax deferral, wage subsidies and unemployment income, among others.

Canadian stocks, as measured by the S&P/TSX Composite, fell 20.9%, partly because **oil prices plummeted** when Saudi Arabia and Russia decided it was a good time to start a price war. The Bank of Canada lowered rates to 0.25% - a level not seen since the 2008/2009 financial crisis. With all but essential businesses closed in March, leaving millions out of work, the economy stalled. GDP growth for Q1 was certainly negative and a **recession was to be expected**.

The US market fared relatively better, but the broad S&P 500 fell 12.4% (CAD), partly boosted by a lower CAD/USD exchange rate. Like other policymakers, **Congress passed an enormous fiscal package** in March and the Federal Reserve cut rates to 0-0.25%. However, even with trillions in aid underway, it was viewed as merely a first step in what might be required.

Internationally, developed and emerging markets stocks returned -15.9% and -16.8%, respectively. China, where the novel coronavirus first appeared in late 2019, began the tricky task of “reopening” their economy; the **reboot seemed more tentative than hoped**. In Europe, there were early signs that hard-hit Italy and Spain might soon be past their worst as well, reminding investors that this horrible pandemic, however devastating, is a **temporary ordeal**.

With global interest rates falling and governments buying debt, **bond prices rose as yields declined** significantly. At March 31st, Canadian 5- and 10-year government bonds yielded 0.6% to 0.8%; US 5- and 10-year Treasuries yielded 0.5 to 0.8%. A basket of short-term Canadian bonds, as measured by the Canadian FTSE Short-Term Bond Index, returned 1.9%.

Following are the returns for major indices for the period ended March 31st, 2020:

	1st quarter actual	YTD actual	1 year actual	3 year annualized	5 year annualized	10 year annualized
Canadian Short Term (FTSE 30-Day T Bill)	0.5	0.5	1.8	1.3	1.0	0.9
Canadian Bonds (FTSE Short Term Bond)	1.9	1.9	3.2	2.1	1.7	2.5
Canadian Stocks (S&P/TSX Comp.)	-20.9	-20.9	-14.2	-1.9	0.9	4.1
U.S. Stocks (S&P 500)	-12.4	-12.4	-1.7	7.2	9.1	14.2
Non-North American Dev. Stocks (EAFE)	-15.9	-15.9	-9.5	0.1	1.6	6.2
Emerging Markets Stocks (FTSE / MSCI Emerging)*	-16.8	-16.8	-12.6	-0.4	1.2	4.1

* 1st quarter, YTD, 1-year, 3-year, and 5-year returns are FTSE Emerging. 10-year returns are MSCI Emerging. All returns in Canadian dollars. Source: SS&C Technologies and Vanguard

Outlook

"Coming Out of the Dark" - Gloria Estefan

It is not possible to chart a proper path forward in the midst of a turbulent storm; the best initial strategy is to batten down the hatches. That is, rightly, what policymakers have done so far (some more successfully than others) to deal with this global emergency. Now, as the skies clear a bit, concrete steps for economic recovery and renewal are under discussion. Clearly, everyone wants to get back to work as soon as possible.

However, the pandemic is not over. Confounding questions remain about the obvious **risks of relaxing the economic shutdown** too much or too soon or both. At the same time, it is untenable for people to "stay at home" indefinitely. With no historical roadmap to follow, we must find a new path forward - governments, policymakers, market participants and everyday people are all resolved to do that. Perseverance in the face of difficulty is human nature.

As we try to gauge how markets may behave through this transition and beyond, we think there are three distinct, but connected, areas of concern investors should watch: **healthcare outcomes, financial stresses and the global economic recovery**.

Healthcare Outcomes

First, the novel COVID-19 is causing this current calamity and, ultimately, until a vaccine for it is widely available, other measures to "stop the spread" are only partly effective. Yet a game-changing vaccine may be months away. In the meantime, most experts say, in order to relax physical distancing rules without causing a resurgence of the virus, **nationwide testing and contact control** is needed. Every effort is underway to develop and deliver rapid testing so small outbreaks might be quickly identified and isolated, allowing most economic activity to resume. Alongside this effort to ramp up testing, including immunity testing, other innovators have been mobilized to alleviate the sudden shortage of medical equipment straining healthcare systems. Drug trials are underway for new treatments. Truly, all available effort is being made.

For most of us though, the short-term remedies have short-circuited our normal life and livelihoods. It's a bizarre adjustment to realize that, by staying home, we are actually changing the trajectory of this deadly pandemic. The evidence is clear on that, so we must do our part.

Medical experts say the virus, and how we handle it, will determine the timeline for everything else. In the shock of the last few weeks, the health news has been very grim. But **health outcomes will improve** going forward and probably faster than we think. Along with inevitable setbacks, there will also be unexpected advancements and breakthroughs - perhaps even an early vaccine. Until then, we must accept the science and hold the line.

Financial Stress

There is no doubt that many families and businesses of all sizes are currently being stretched to their financial limits and beyond. That said, we should note that, by historical standards, the swift responses by governments and central banks to provide assistance are unparalleled. For example, the initial **$2.3 trillion US package accounts for a staggering 11% of US GDP**. By comparison, less than 7% of GDP was pumped into their economy during the devastating 2008/2009 financial crisis. Similar stimulus has been put in place in Canada, where the federal government has assured Canadians that "**nothing is off the table**" in providing families and businesses the financial help they will need to weather this storm.

So far, **financial markets have taken some comfort in these reassurances**. As so-called "leading economic indicators", stock markets are **forward-looking**, seeing past the current distressing news and anticipating what an economy will look like farther down the road.

Economy

As mentioned, markets already reflect the fact that the economic data for Q1 and Q2 will be terrible, with job losses being reported at levels not seen in our lifetime. As the first country to shut down, China has also been first to release dismal figures, so the West knows what lies ahead. **Global recession is inevitable** but, unlike typical cyclical recessions where there's economic excess or instability that builds up over time and eventually boils over, this time, **it *is* different**. We've had a sudden, mandated stoppage. Depending on how quickly and effectively we clamp down on COVID-19, some economists view a **quick "V-shaped" recession as possible** but, even if the bounce-back takes longer, the "new normal" will reflect all the innovation and ingenuity undertaken to achieve it - and that alone will boost future economic growth.

Outlook

We look to Asia for guidance, where the virus first emerged and strict mitigation efforts show early signs of success. **Economic activity there is picking** up as businesses reopen and activity resumes somewhat. That said, as a global supplier, their immediate growth prospects will be tempered by slowdowns everywhere else. The path for North America and Europe depends first on the efficacy of **fiscal and monetary support**, then on successfully implementing our own containment strategies and, ultimately, on advances in health science.

The "problem-identification" stage of this crisis is over - do not underestimate the resilience and determination of people to find work-arounds to overcome our new challenges, even while the world waits for a vaccine. This pandemic ***will not last forever*** and we will prevail. Every day brings us closer to that time when these strange events will be in the rear-view mirror.

Portfolio Strategy

Navigating any market shock can be difficult because it is human nature to be too optimistic when things are going well and too pessimistic when they are not. Importantly, this time around, investors have every assurance that central banks and governments will continue doing what's required to provide financial assistance - at least in the "first world" - until the pandemic is finally contained.

We know **economic numbers will be depressing** in coming months: the **stock market is already discounting** that reality. What matters now is what the global economy will look like later, once activity is on its track of recovery and renewal. Stock markets "lead" the economy: **they typically hit bottom well before the economy does**. For example, typically, US stock prices start to rise an average of four months before a recession ends, meaning that, by the time the economy starts to look better, stocks prices have already had a significant rebound.

At Milestone, each client has a tailored portfolio reflecting their specific circumstances and risk tolerance level, with an appropriate amount of fixed income investments to help weather market storms - even one that might last a long time. While stocks are riskier than bonds and regularly go through periods of substantial weakness, for that exact reason, over time, they also provide higher expected rates of return. These may be needed either to meet retirement goals or to ensure the longevity of the portfolio throughout retirement. Fixed income assets, by themselves, typically would not generate the returns required, particularly when interest rates are so low.

Where it is warranted, we are **selectively rebalancing portfolios by gradually adding to stocks** during this period of weakness. Typically, we consider rebalancing when three conditions have been met: the equity weighting is 3%-5% below its target range, the client is supportive of an increase and the portfolio has ample fixed income assets (interest and principal) to provide cash-flow needs for many years to come. Given their relative weakness compared to other equity markets, this may mean adding to Canadian stocks, particularly those which offer attractive and secure **dividends** and which would enhance future cash flow to the portfolio. In fixed income, we are **focused on**

preserving capital using high-quality issues during these uncertain times. Proceeds from maturities are usually reinvested in one- to two-year GICs, which are currently providing better rates relative to bonds.

To close, we repeat our familiar refrain: **staying disciplined is the path to successful investing**. Consider this analogy: there are two "stores" - Walmart and Stockmart. When things are overpriced, Walmart is empty, yet the Stockmart is full of shoppers willing to pay full price and more. But when everything goes on sale, we know which store is full and which one is not.