Portfolio Strategy Update at March 24, 2020

Since our last communication last week, the markets have remained quite volatile with daily swings of + or – 4% on average. They did reach their year low last evening (Monday March 23rd) with the MSCI World down 32% in US$ terms or down 30.5% in local currencies. The Canadian stock market (TSX) with a higher component and dependence on the oil and gas sector is down 34% in Cdn $ terms. In the meantime, the drop of the Canadian dollar largely as a result of much lower oil and gas prices has fallen near 69 cents US from its previous 75-76 range.

This devaluation of the Canadian dollar in effect has meant that Canadian investors benefit by nearly 10% in terms of their US equity investments (S&P500) being down 22% in Cdn $ term rather than 31% in US $ term. As a result, one might be tempted to increase exposure to Canadian equities though this would really depend on seeing a rebound in oil prices, which seems unlikely in the short term. Russia and Saudi Arabia are holding to their strategy of flooding the market during what is also turning out to be a period of severely curtailed global demand. It is aimed at forcing more expensive oil producers including US shale oil producers to cut production drastically. Canadian producers who now have an average Western Canadian crude price at around $11 will certainly not be spared.

The Covid-19 news flow is now starting to gravitate between grave in Europe and the USA to more hopeful in China, Taiwan, Korea and Japan where infection and death rates are improving and where governments are looking to gradually reopen their domestic economies. These signs of hope along with strong government and central bank support across the globe for both the unemployed and for business seem to be calming markets with overnight and this morning increases of 5 to 6% across the board. All eyes are on the US senate for a large bailout package to top the massive $2 trillion pledge by the Federal Reserve to be an active buyer of government and, for the first time, corporate debt.

With prices not much different than a week ago when we initiate the first tranche of repurchase, we are holding still. Gold prices have rebounded to US$1,600 per ounce this morning. This will help bolster the value of clients' defensive holdings in this sector.

An unexpected decision by Canada Life not to allow any further withdrawals from its real estate funds (so as not to cause a forced fire sale liquidation of some of its properties) will mean we will need to adjust our plan in terms of where the liquidity will come from in our next round(s) of equity repurchases. We will source from the cash (and in some cases bond) balances, from a portion of the gold protective position and from the more defensive equity funds that have held up better over the past few months. In the meantime, the Real Estate Fund is maintaining its value showing a +1% net real return since the start of the year. All indications are that it will be able to sustain this rate of return through this down period.

We are now well into the thick of the storm without a doubt. Lockdowns in Canada are certainly being enforced and to a very large extent respected. We should be able to find our way to a slow recovery over the summer as well as benefit from the learnings in Asia. The US is likely to be on a slower path as it is seen mismanaging its lock-down, the result of disjointed leadership, complicated state structure and extremely polarized political partisanship.

In terms of the global economy, there is no longer any doubt that the Q1 and Q2 2020 GDP numbers will show the most dramatic quarter to quarter drops in the history of the modern world. Unlike 1929 depression, there is enormous capital being injected to bridge this gap of global inactivity until restart likely over the summer.

For those who wonder more on the longer-term effects of Covid-19, we invite you to read Gwynne Dwyer's latest column below. It reflects well our thinking.

As usual, please do not hesitate to contact me on any matter or concern.

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Dyer: COVID-19 won't change world forever, but it will change a lot for a long time

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GWYNNE DYER, SPECIAL TO POSTMEDIA NEWS

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They teach you in journalism school never to use the phrase, “X has changed the world forever.” Or at least they should. COVID-19 is certainly not going to change the world forever, but it is going to change quite a few things, in some cases for a long time. Here’s nine of them, in no particular order.

1. The clean air over China’s cities in the last month, thanks to an almost total shutdown of big sources of pollution, has saved 20 times as many Chinese lives as COVID-19 has taken. (Air pollution kills about 1.1 million people a year in China.) People will remember this when the filthy air comes back, and want something done about it. India, too.

2. Online shopping already was slowly killing retail shops. Lockdowns will force tens of millions who rarely or never shop online to do it all the time. (Yes, all the websites are crashed or booked until mid-April now, but there will be lots of time to scale them up to meet demand.) Once customers get used to shopping online, most won’t go back, so retail jobs will disappear twice as fast.

3. Not so radical a change with restaurants, but basically the same story: more takeouts and home deliveries, fewer bums in seats. Habits will change, and a lot of people won’t come back afterward. Food sold out the door generates much less cash flow than food served at the table, and half of servers’ jobs are gone. There will be a severe cull of restaurants.

4. Once it becomes clear that “remote working” actually works for most jobs, it will start to seem normal for people not to go in to work most days. So a steep drop in commuting, lower greenhouse-gas emissions and eventually a lot of empty office space in city centres.

5. There will be a recession, of course, but it probably won’t be as bad or as long as the one after the financial crash of 2008. It isn’t a market collapse costing people their jobs this time — a virus made them stop working, and governments are doing far more than ever before to sustain working people through what probably will be a long siege.

When the virus is tamed and they can return to work, the work (in most cases) still will be there. There also will be a few trillion dollars of extra debt.

6. Don't worry about the debt. Banks always have created as much money as the government requires. Put too much money into the economy and you'll cause inflation, which is bad, but just replacing what people ordinarily would be earning so the economy doesn't seize up is good.

So President Macron can tell the French that no business, however small, will be allowed to go bankrupt. Prime Minister Johnson can tell Britons the government will pay them 80 per cent of their normal income, up to the equivalent of $3,000 a month, if their work has vanished. And President Trump can talk about sprinkling "helicopter money" on the grateful masses.

7. What is being revealed here is a deeper truth: "Austerity" — cutting back on the welfare state to "balance the budget" — is a political and ideological choice, not an economic necessity. What governments are moving into, willy-nilly, is a basic income guaranteed by the state.

Just for the duration of the crisis, they say, and it's not quite a Universal Basic Income, but that idea is now firmly on the table.

8. Collective action and government protection for the old and the poor no longer will be viewed as dangerous radicalism, even in the U.S. Welfare states were built all over the developed world after the Second World War. They will be expanded after the Plague ends.

Indeed, if Joe Biden were to drop out of the presidential race tomorrow for health reasons, Bernie Sanders would stand a fair chance of beating Trump in November.

9. Decisive action on the climate crisis will become possible (though not guaranteed), because we will have learned "business as usual" is not sacred. If we have to change the way we do business, we can.

So it's an ill wind that blows no good (a saying that was already old when John Heywood first catalogued it in 1546). Some of the anticipated changes are definitely good, but we are going to pay an enormous price in lives and in loss for these benefits. It could have been dealt with a lot better.

And the West should learn a little humility. Taiwan, South Korea and China (after the early fumble) have handled this crisis far better than Europe and North America. These are already more dead in Italy than in China, and America, Britain, France and Germany certainly will follow suit.

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