Monthly Market Monitor

April 2020

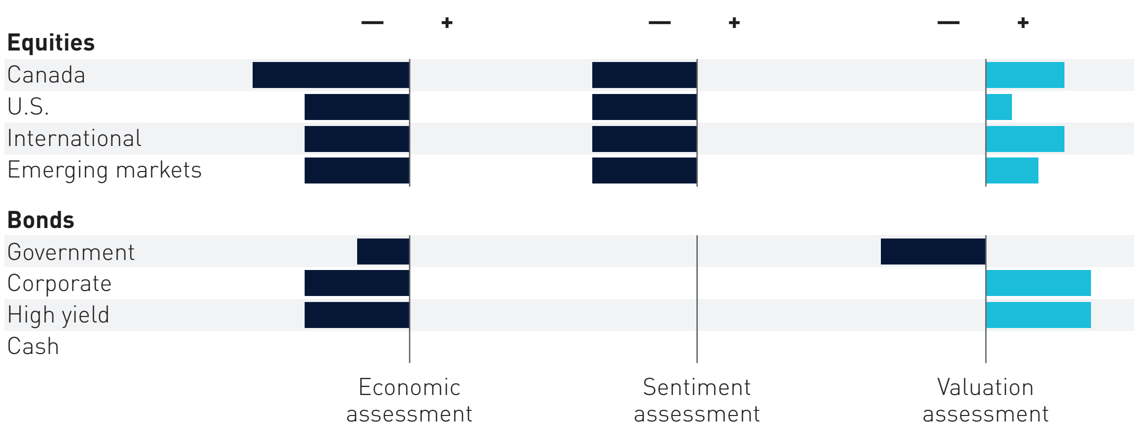
HIGHLIGHTS

COVID-19 ravages the global economy and global markets
With countries around the world in lockdown to slow the spread of the virus, economic activity is plummeting and unemployment is soaring. Stocks sold off, volatility spiked, and even bonds faced liquidity issues.

Record stimulus from U.S. and Canada
Central banks in Canada and the U.S. dropped interest rates to near zero and injected over one trillion dollars into the financial system. Their respective governments also announced fiscal stimulus packages of approximately 10% of GDP, joining other countries with aggressive packages to stabilize their economies.

Too soon to call the peak in new COVID-19 cases
We have seen a peak of new cases in China and South Korea and hopefully hard-hit Italy. No signs of a peak in Canada or the U.S., but we are seeing developments to help fight the virus such as social distancing, faster tests, more ventilator production, and potential new vaccines.

OUTLOOK SUMMARY



Source: NEI Investments. Data as of March 31, 2020.

ALLOCATION INDICATOR

OVERVIEW

The COVID-19 outbreak rages on and shows little sign of slowing. In an effort to "flatten the curve," significant portions of the global economy have effectively come to a halt as people stay home and businesses shut their doors. In the March NEI Market Monitor we suggested that 2020 Q1 and Q2 growth will be impacted, with a potential rebound in activity in the second half. At this point, flat global growth for the year is likely the best-case scenario.

As investors attempt to digest the rapid news developments, there have been record-breaking market movements over the last month. From its all-time high on February 19, the S&P 500 dropped 26.7% by March 12, the quickest ever descent to a bear market, ending the record 11-year bull run in U.S. equities. Stocks bottomed on March 23, only to be followed by an incredible three-day rally. Depending on which equity index we look at, we could technically already be into the next bull market (the Dow Jones Industrial Average gained 21.3% over those three days). While it's certainly a relief from the sea of red, we wouldn't recommend getting too excited here. Things aren't over yet.

On one of our COVID-19 update calls two weeks ago, we put forth three conditions that would need to apply before markets can truly bottom out: 1) global monetary response, 2) global fiscal response, and 3) plateauing of new cases.

Over the past weeks policymakers around the world have announced unprecedented waves of both monetary and fiscal stimulus, a clear signal that they are willing to do whatever it takes to cushion the virus's economic impact. This checks off the first and second points.

Now the entirety of the economic impact depends on how long people remain in social isolation, which in turn depends on how quickly the virus can be contained. Until then, we need as much government stimulus as necessary to help keep businesses afloat and support displaced individuals. While all the helicopter money in the world won't stop the virus from spreading, it does create conditions for a strong eventual economic recovery.

The epicenter has now shifted to the U.S., and at their current pace of response we have little confidence that the U.S. will be able to contain the virus to the same degree as Asia or even Europe. Until then, we are staying defensively positioned and continue to overweight fixed income and cash in our asset allocation solutions. That said, valuations for risk assets such as equities and credit are looking increasingly attractive. Indiscriminate selling often creates opportunities for active managers who can purchase quality companies at cheap prices.

New daily cases since 100th case

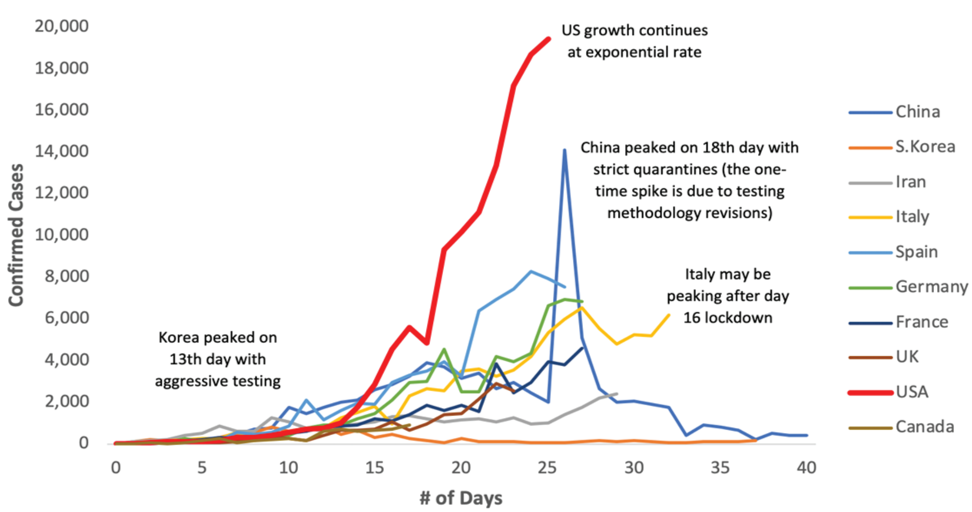


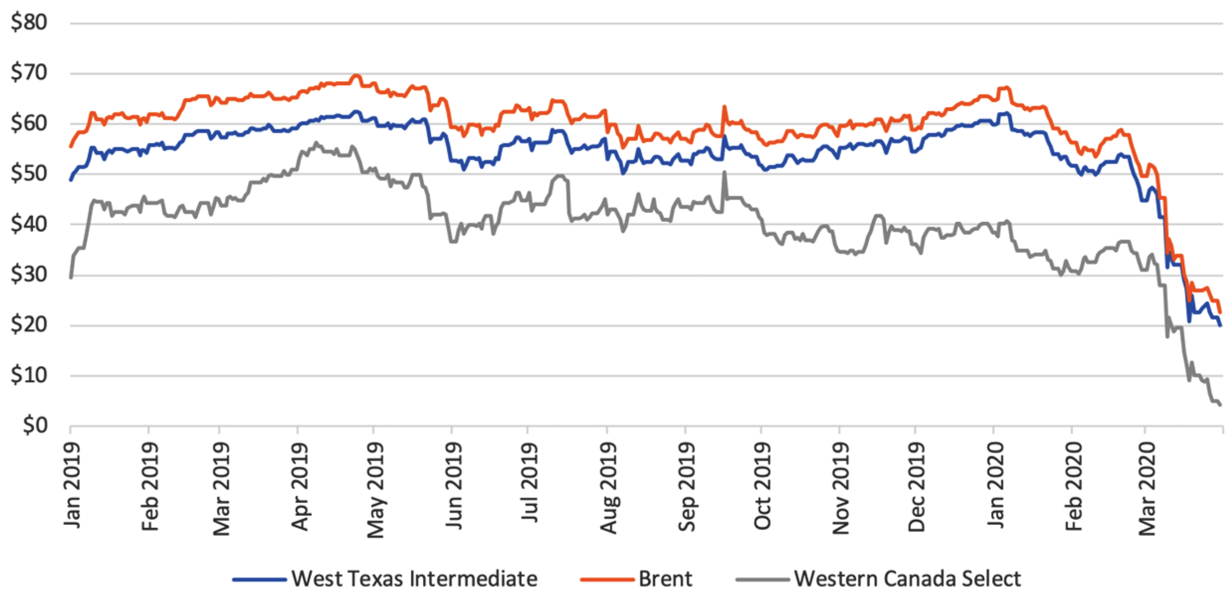
Chart: NEI Investments. Data source: https://www.worldometers.info/coronavirus/. Data as of March 28, 2020.

CANADA

As if dealing with a pandemic wasn't bad enough, Canada is also facing one of the worst oil crises in history. The collapse of OPEC+ has led to an all-out price war between Russia and Saudi Arabia. Faced with a slump in global oil demand, neither country has been willing to further cut production to support falling prices. Instead, the two nations abandoned their previous production quotas and have turned their "taps" on full. This also may be an attempt to collapse the U.S. shale industry which has been flooding global markets with supply since 2014.

Canada is caught in the crossfire, and now our energy sector faces major headwinds. Canadian oil sands have one of the highest unit production costs in the world, which means Russia and Saudi Arabia can afford to continue oversupplying the market for quite some time. With more than a US$15/barrel discount to the global benchmark West Texas Intermediate, our Western Canada Select currently sells for about US$5/barrel. It now costs more to transport our oil than the commodity itself.

Crude oil prices (US$/barrel)



Source: Bloomberg, Data as of March 31, 2020.

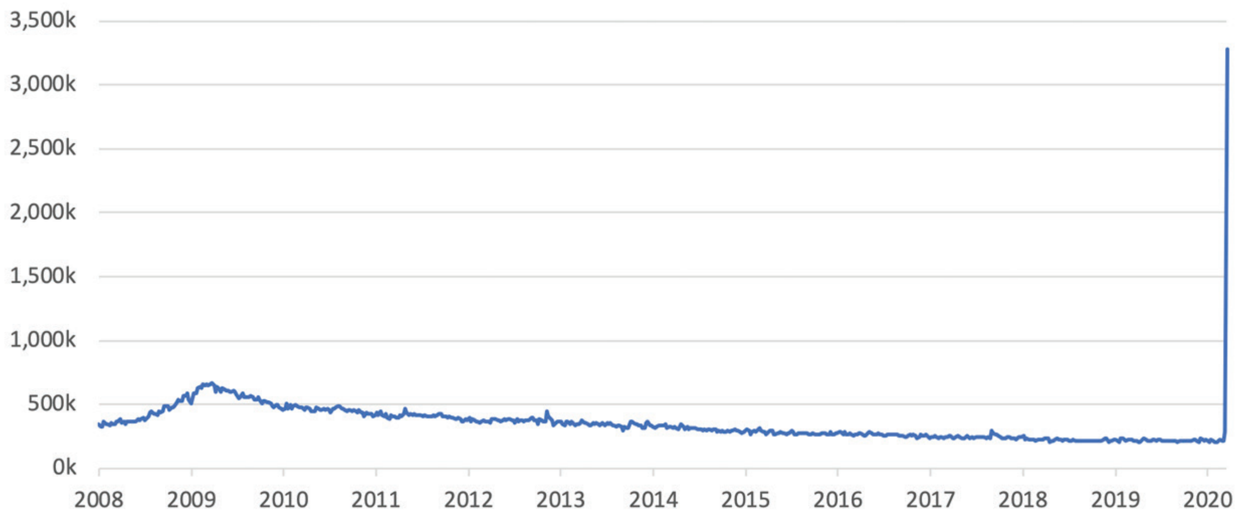
Fighting a battle on two fronts, Ottawa unveiled a wave of new policy measures, including a record fiscal package worth $202 billion (approximately 10% of GDP). The Bank of Canada cut interest rates back to the global financial crisis low of 0.25%. And for the first time in history, our central bank will begin buying at least $5 billion a week of Government of Canada bonds across the yield curve, with no specified upper limit. The BoC also announced a Commercial Paper Purchase Program which should ease short-term funding stress and provide further market stability.

During the last recession, we were one of the few major economies that did not resort to unconventional monetary policy. This time we are faced with both a supply and demand shock, which has the potential to hit the economy even harder. Last week alone we saw nearly a million Canadians file for unemployment claims, and that's only the beginning. We applaud our policymakers for taking the necessary measures. As Bank of Canada Governor Stephen Poloz put it so eloquently: "a firefighter has never been criticized for using too much water."

U.S.

Among the numerous stimulus measures announced around the world, the U.S. response was the one-two punch investors were all waiting for: zero-bound interest rates, unlimited quantitative easing (that now also includes corporate bond purchases), and a US$2 trillion fiscal stimulus package whose focus is not bailing out Wall Street, but Main Street. In fact, approximately half will go to supporting individuals and small businesses, and another quarter will go to support state/local governments and public health. On top of that, there's already talk of a fourth stimulus package. Last week saw a record 3.3 million spike in U.S. initial jobless claims, which, like in every other country ravaged by COVID-19, is only the beginning.

U.S. weekly initial jobless claims



Source: Bloomberg. Data as of March 31, 2020.

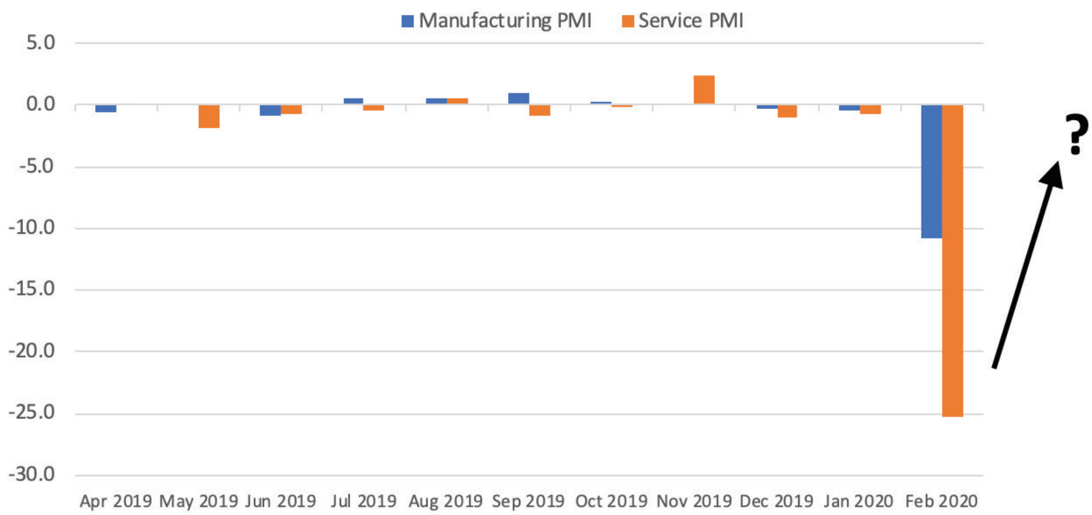
The combined U.S. fiscal and monetary response should help provide a floor for equity markets, as well as much needed liquidity and stability for bond markets. Despite the policy measures, it does not appear that the situation is anywhere near controlled. COVID-19 cases have appeared in all 50 states. Just 10 days after implementing nationwide social distancing guidelines, President Trump widely announced he wanted the country to go back to work by Easter, only to quickly backtrack and extend social distancing guidelines by another month. National Institute of Allergy and Infectious Diseases Director Anthony Fauci estimates U.S. COVID-19 deaths could reach as high as 200,000. The U.S. response is the single largest uncertainty at this point, and any sense of clarity whatsoever will likely bring back market confidence.

INTERNATIONAL AND EMERGING MARKETS

Overseas, some parts of Europe, such as Italy, may be past the pandemic peak, and we're starting to see business activity resume across some parts of Asia. The lockdown on the province of Hubei was lifted on March 25 and the lockdown on the city of Wuhan itself, where the pandemic is reported to have started, is set for April 8.

In China (based on 2013 data), small-and-medium-sized enterprises (SMEs) comprise 97% of all firms, 80% of urban employment, and 60% of GDP. Compared to large corporations, SMEs are much more vulnerable during a forced economic shutdown. Whereas manufacturing sectors were thought to be the most affected due to their cyclical nature, it turns out the service sector was hit even harder. In some ways this goes against the commonly held notion of the relative resilience of the service sector throughout economic cycles, whereas manufacturing is largely driven by the boom and bust. This kind of unprecedented impact justifies the unprecedented policy response we've seen.

China economic activity plummeted. Will it bounce back soon?



Source: Bloomberg. Data as of February 29, 2020.

Some have posited that the COVID-19 outbreak will have long-lasting effects for years to come. It may change the way we travel, the way we conduct business, and perhaps even change consumer behavior. We may even see the virus resurface as seasons change. The 1918 Spanish flu, for example, came in three waves with each more deadly than the last. While that's certainly not our base case, we can't rule out the possibility of these extreme scenarios.

To finish on a positive note, it is encouraging to see a strong spirit of collectivism in helping fight the virus. For instance, social distancing measures in B.C. are working, with the rate of increase in daily cases halving from 24% before restrictions in travel and social contact began two weeks ago, to an average daily increase of 12%. More tests are also critical. The U.S. Food and Drug Administration recently authorized a new rapid coronavirus test that could give patients results "in as little as five minutes and negative results in 13 minutes."

On the ventilator front, auto companies and even Dyson, best known for vacuums, are being enlisted to manufacture these life-saving machines that are in critically low supplies. Convention centres and hotels are being repurposed to field hospitals to help deal with the expected surge in cases. Finally, vaccines are being fast-tracked to aid in the fight. While it is too early to call victory, these are welcome developments in this war against the global pandemic.

As we watch Asia and soon Europe attempt to return to business as usual, it will provide important insights as to the path of our recovery here in North America.

MARKET PERFORMANCE

Percent return in Canadian dollars

	1 Mo	3 Mo	6 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Fixed Income								
Bloomberg Barclays Canada Aggregate	-1.90	1.67	0.77	1.67	4.53	3.70	2.60	4.31
Bloomberg Barclays Global Aggregate (CAD Hdg)	-1.66	1.38	0.80	1.38	5.99	4.00	3.10	4.29
Bloomberg Barclays US High Yield 2% Issuer Cap (CAD Hdg)	-12.18	-13.44	-11.29	-13.44	-8.30	-0.29	2.00	5.45
Equities								
MSCI World (Developed Markets)	-8.00	-13.34	-7.86	-13.34	-4.53	4.16	5.68	10.24
MSCI World Growth	-4.55	-6.92	0.06	-6.92	5.21	9.96	9.08	12.68
MSCI World Value	-11.74	-19.83	-15.74	-19.83	-14.01	-1.66	2.19	7.72
MSCI Canada	-16.76	-20.46	-18.29	-20.46	-14.68	-2.58	0.07	3.16
MSCI USA	-7.46	-11.94	-6.01	-11.94	-1.64	6.73	8.42	13.61
MSCI EAFE	-8.12	-15.29	-10.26	-15.29	-8.78	0.33	1.73	6.25
MSCI Europe	-9.28	-16.94	-11.46	-16.94	-9.97	-0.20	1.02	5.99
MSCI Japan	-1.54	-8.66	-3.71	-8.66	-0.58	3.17	4.22	7.40
MSCI Pacific Ex Japan	-15.43	-20.53	-17.67	-20.53	-18.66	-2.60	0.80	5.66
MSCI EM (Emerging Markets)	-10.30	-16.14	-8.14	-16.14	-12.30	0.54	1.99	4.15
World currencies (relative to CAD)								
US Dollar	6.03	9.76	7.50	9.76	6.54	2.19	2.36	3.44
Euro	5.92	7.29	8.20	7.29	4.11	3.07	2.80	1.30
Pound Sterling	2.93	2.74	8.17	2.74	1.38	1.91	-1.26	1.38
Yen	5.95	10.49	7.62	10.49	9.24	3.28	4.54	1.96

Source: Morningstar. Data as of March 31, 2020.