Insights on recent market events

Market Update: A quarter for the record books

The first quarter of 2020 is now in the record books. It is an understatement to say that the year has gotten off to a rocky start. The health crisis has led to sudden stops in economic activity, significant dislocations in credit and funding markets, falling asset values, compressed valuations and an historically large and coordinated global policy response.

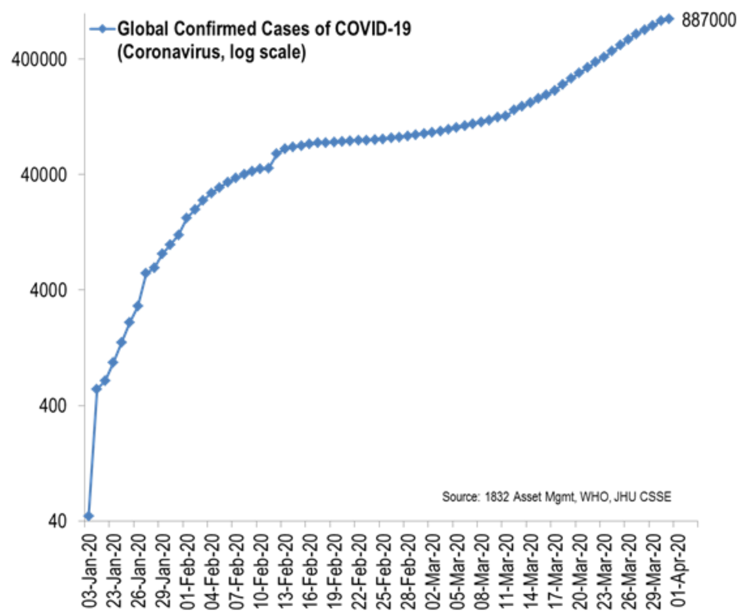
Tracking the Virus

This novel coronavirus which began as a problem for a couple of hundred Chinese in early January quickly spread across the Mainland and into the rest of the world. The speed of contagion was augmented by a complex interplay of policy missteps (e.g., “It’s just the flu”) and of people via road, rail, water, and air. However, it wasn’t until March 11 that the World Health Organization officially declared the COVID-19 outbreak as a global pandemic. At the time of the announcement, there were 118,000 cases and 4,000 deaths worldwide, with the virus having found a foothold on every continent except for Antarctica.

The quarter ended with some stories of success. China and Korea, with their vast efforts to social distance and contact trace, were among the first countries to successfully slow the viral spread to a crawl. Italy, which was one of the harder hit countries later in the quarter, also showed progress in flattening the caseload curve. Spain looked to be trailing Italy’s progress by a week or two.

Yet, most countries remained in full battle mode throughout the quarter. The doubling time for case infections remained uncomfortably high in many countries including the U.K., U.S., and Germany. Momentum also picked up in many other countries including Russia, Brazil, Chile, Pakistan, Columbia, Mexico and South Africa.

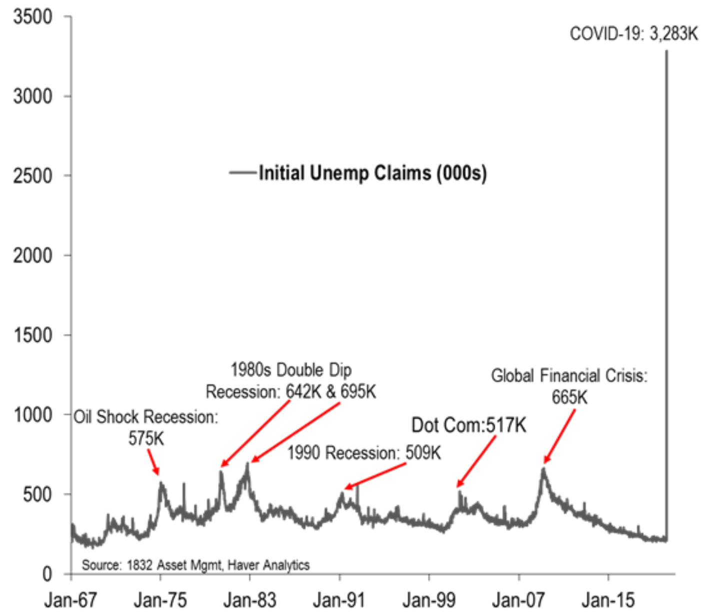
As the quarter came to a close, there were 858,000 confirmed cases and 42,309 deaths for COVID-19 (at the time of writing, 887K cases & 44K deaths). By the time you read this, those totals are likely to have approached, or even surpassed, 1 million and 50,000, respectively.



Early Economic Impacts

Countries have shut down pretty much all non-essential economic activity. Schools and universities were closed, sporting events were cancelled, travel came to a standstill and leisure activities disappeared. In most parts of the world, it was as if a light switch had been turned off. Early indicators of economic activity, such as those for restaurants, airlines, hotels and autos were down anywhere from 75-95% on a year over year basis. U.S. domestic box office sales for the week ending March 26 totalled $5,179. Yes, you read that right. That is down from the $202 million in sales recorded during the same week a year earlier. This has been an unprecedented stoppage in economic activity.

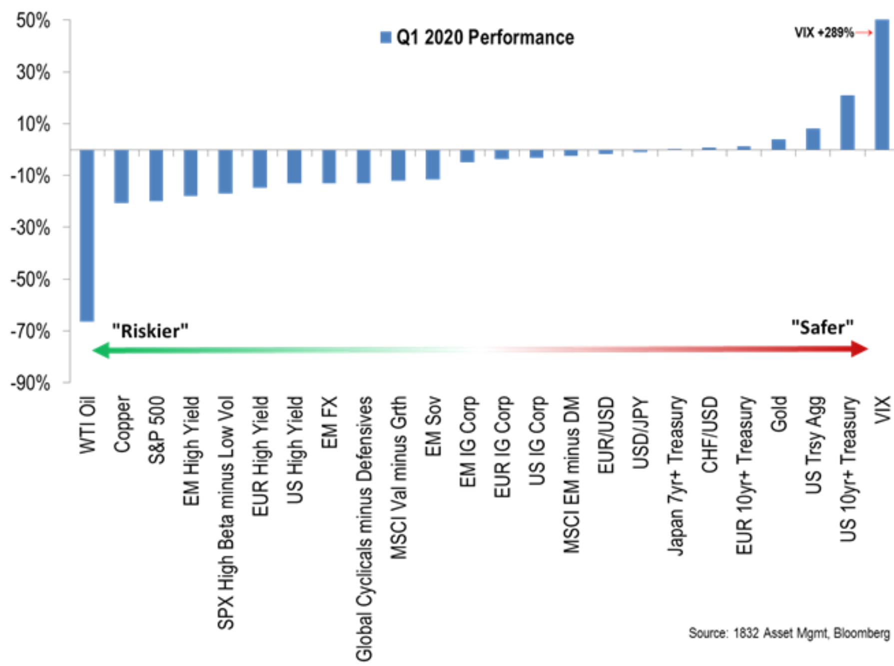
The early toll on the labor market is striking. The weekly data tracking U.S. unemployment insurance claims surged to 3.3 million for the week ended on March 21st. That is the highest number of official jobless claims since the Department of Labor started tracking the data in 1967. The next weekly update will be released later this morning, for the week ending on March 28. Similar stress was evident in a number of other labor reports around the world, including Canada's.



But, there are some glimmers of hope shining through. China's activity indicators bounced back as the country gained control over the spread. In fact, official reports estimate that 97.8% of activity had returned to Hubei, China's hardest hit province, by the end of the first quarter. Hopefully this is what will be in store for much of the rest of the world over the next one to two quarters.

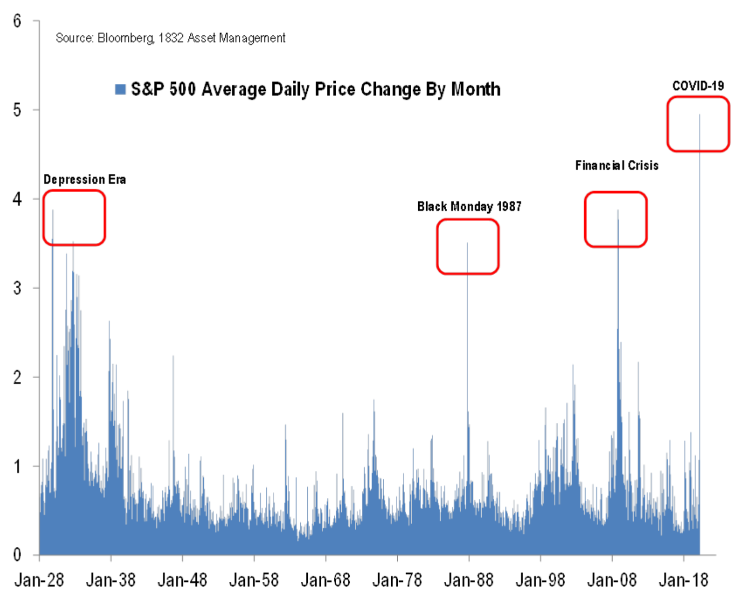
Financial Market Mayhem

The viral spread struck fear into financial markets during the first quarter. There were scant places for investors to hide. Treasuries, gold, bunds and U.S. dollars represent pretty much the entire list within a group of asset classes we examined that were able to deliver a positive return during the year's first three months. This is still quite an achievement considering that the Treasury market was plagued by liquidity concerns, gold volatility surged to levels not seen since the last financial crisis, and clouds hung over government bond markets as policymakers mulled further stimulus to soften the impact of the virus.



Most other asset classes were not treated as kindly with global bourses down by 35% at their worst. Equity volatility finished at heightened levels and the magnitude of average daily fluctuations spiked to never before seen levels with March 2020 surpassing even the Depression Era., Both high yield and investment grade credit were weighed down by concerns about market illiquidity and corporate insolvency. The biggest loser, and by a wide margin, has been oil. The world's largest producers began a price war at the same time that demand cratered as a result of the pandemic. The commodity, down by 67%, was dealt its worst quarter in history.

While the prices for many of the riskier asset classes surged higher in the final few days of March, it was not by nearly enough to save the quarter.

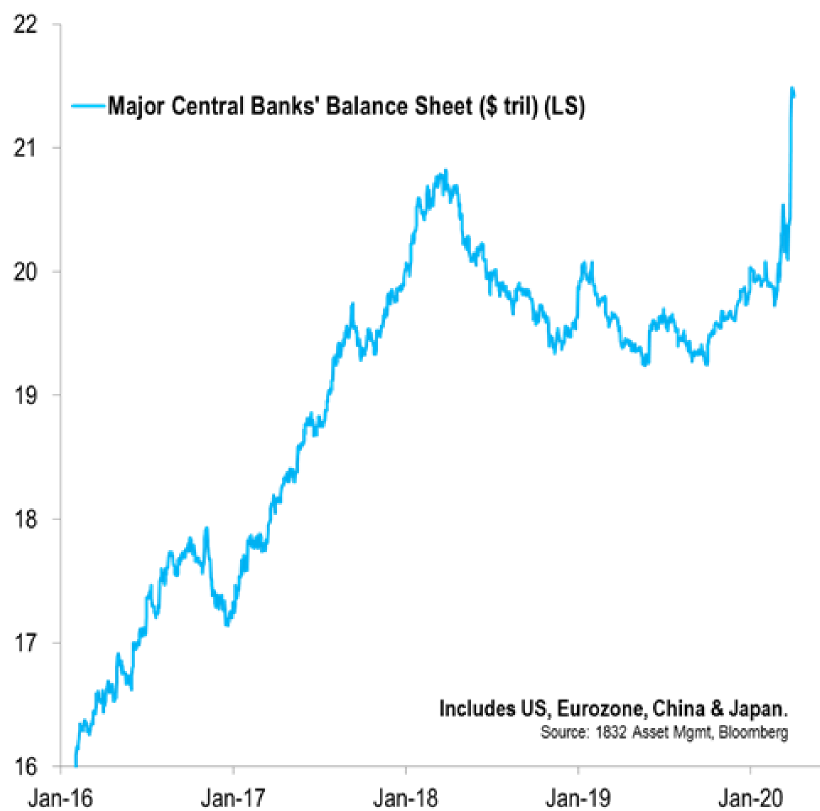


Policy Response

Global policymakers went into emergency response mode. The steep loss in income and dislocation in financial markets had the authorities throw everything but the kitchen sink at the situation. Emergency spending measures went into effect, with the American government leading the way by offering more than $2.2 trillion in aid to the national economy under the CARES Act. Even the fiscally tight laced German government had opened its purse strings, announcing an $US825 billion package on March 23. The G20 said, in an official statement released on March 26, that it would inject more than $5 trillion into the global economy and still do "whatever it takes" to tackle the pandemic.

By the end of the quarter, even before the ink had time to dry from signing the CARES Act, President Trump was lobbying congressional leaders for another monster spending effort. His eyes were on another $2 trillion, and I quote, "…focused solely on jobs and rebuilding the once great infrastructure of our Country!". Japan and others are also seriously considering upsized fiscal packages. In coming weeks, and months, the extent of further spending efforts will be undoubtedly tied to the severity and duration of the pandemic's spread.

Meanwhile, central bankers were doing what they could to backstop the economy and financial markets. They had rapidly lowered interest rates, with the U.S. and Canada both joining Europe and Japan in the 0% interest rate club by the last month of the quarter. Large scale asset purchases (quantitative easing) were restarted or accelerated across a number of domains. Trillions of dollars of liquidity were injected into repo and swap markets. And various facilities had been established in order to help the functioning of credit and short-term fixed income markets. Central bank balance sheets were growing rapidly, once again.



Parting Thoughts

An incredibly challenging first quarter has drawn to a close. It is not all that obvious which direction the equity market will be heading next. Two powerful narratives seem equally plausible at this stage of the pandemic.

Despite the tough times that define the here and now, some investors are starting to see across the valley. A positive storyline can be constructed on the ideas that (1) social distancing has been successful in a number of countries, so it's only a matter of a couple more months before those benefits take hold in many more corners of the world; (2) the economy has already collapsed, meaning that there is only one direction future activity is likely to travel; And, (3) the trillions of dollars' worth of policy stimulus already in place should allow activity to find a steeper pathway than otherwise would be the case once economic behaviour starts to normalize.

Then there is a more concerning storyline, which is as follows: (1) We have no innate immunity to COVID-19, meaning that even if social distancing proves effective now, there are likely to be future waves of re-infection absent a vaccine; (2) The longer the economy remains offline, the more likely we are to see delinquencies and insolvencies which can then feedback negatively into the economy and financial markets; and (3) The lack of economic visibility, given the possibility of sporadic disruption, will weigh materially on business hiring and capital spending plans.

Both points of view make some sense to us. This is why we believe it remains so important to have an investment plan and portfolio structure in place which can generate a satisfactory outcome for an investor regardless of whether the next major market move is +10% or -10%.

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