One for the Books

QPW Perspectives – May 2020

The first quarter of 2020 was one for the history books, but not in a positive way.

The world was turned upside down as the Coronavirus (COVID-19) pandemic spread rapidly, forcing countries to implement lockdown measures that restricted travel, non-essential business, and social gatherings in an effort to slow the spread and prevent overloaded healthcare systems (also known as “flattening the curve”). The current pandemic has been compared to the 1918 Spanish Flu in terms of transmission and mortality rates, which ultimately infected about 1/3rd of the world’s population at the time and resulted in millions of deaths. This grim comparison makes it clear why unprecedented containment measures were taken around the world, even at great economic cost.

Economic activity was effectively halted in many industries and millions of people around the world were abruptly laid off in what is intended to be a temporary short-term lockdown situation. The global economy has, in all likelihood, entered a significant recession as a result.

Global equity markets declined sharply during March and marked the end of the 11-year bull market that began in March 2009. Market volatility was comparable to historical crises such as the Great Financial Crisis (2008-09) and the Great Depression (1930s). Additionally, a 66% collapse in the price of oil due to lower demand and a glut of supply added to the market volatility.

Central banks around the world acted quickly by lowering interest rates and enacting quantitative easing measures designed to support liquidity in the capital markets. Both Canada and the U.S. cut their respective short-term rates by 1.50% to near zero and are expected to hold there for the foreseeable future. Governments also introduced massive fiscal spending programs designed to support shuttered businesses and the unemployed. It remains to be seen how long the current lockdown measures will be in place and what the lasting impacts to business (especially small business) will be.

The beginning of 2020 was also eventful – it is easy to forget what happened pre-COVID-19. As a reminder, here are some of the other noteworthy events that also happened during the first quarter:

- Australia experienced its worst bushfire season on record.
- The U.S. killed Iranian general Qasem Soleimani via drone strike and Iran responded by launching missile attacks against U.S. military bases in Iraq.
    - A Ukrainian passenger plane was then mistakenly shot down by Iran, killing all 176 people on board, including 63 Canadian citizens.
- The U.S. Senate voted to acquit Donald Trump on both articles of impeachment, marking an end to only the third presidential impeachment trial in American history.

It bears repeating that the previous quarter was one for the history books.

Q1 2020 Financial Market Breakdown

Returns As of March 31, 2020	Q1	1YR
Canadian equities (S&P/TSX Index) CAD$	-20.9%	-14.2%
U.S. equities (S&P 500 Index) USD$	-19.6%	-7.0%
International equities (MSCI EAFE Index) USD$	-22.8%	-14.4%
Canadian Fixed Income (FTSE Canada Universe Bond Index) CAD$	+1.6%	+4.5%

Source: Bloomberg

All equity markets declined during the quarter, experiencing price declines in excess of 30% before regaining some of the losses in the last week of March. From a sector perspective, the story was much the same around the world. All sectors posted negative performance, led by the Energy sector, which mirrored the oil price collapse. The Information Technology sector proved to be the most resilient as these companies are generally less susceptible to the impacts of physical lockdown measures. Performance of foreign equities looks better in Canadian dollars as the loonie declined against most other major currencies.

Fixed income markets benefitted from lower interest rates induced by central bank actions but were negatively impacted by rapidly rising credit spreads. As a result, government bonds posted positive performance while essentially everything else was negative, including investment grade corporate bonds, high yield bonds, and preferred shares.

Current State of Markets

Returns As of April 30, 2020	Since March 23	YTD
Canadian equities (S&P/TSX Index) CAD$	+32.3%	-12.4%
U.S. equities (S&P 500 Index) USD$	+30.4%	-9.3%
International equities (MSCI EAFE Index) USD$	+23.2%	-17.6%

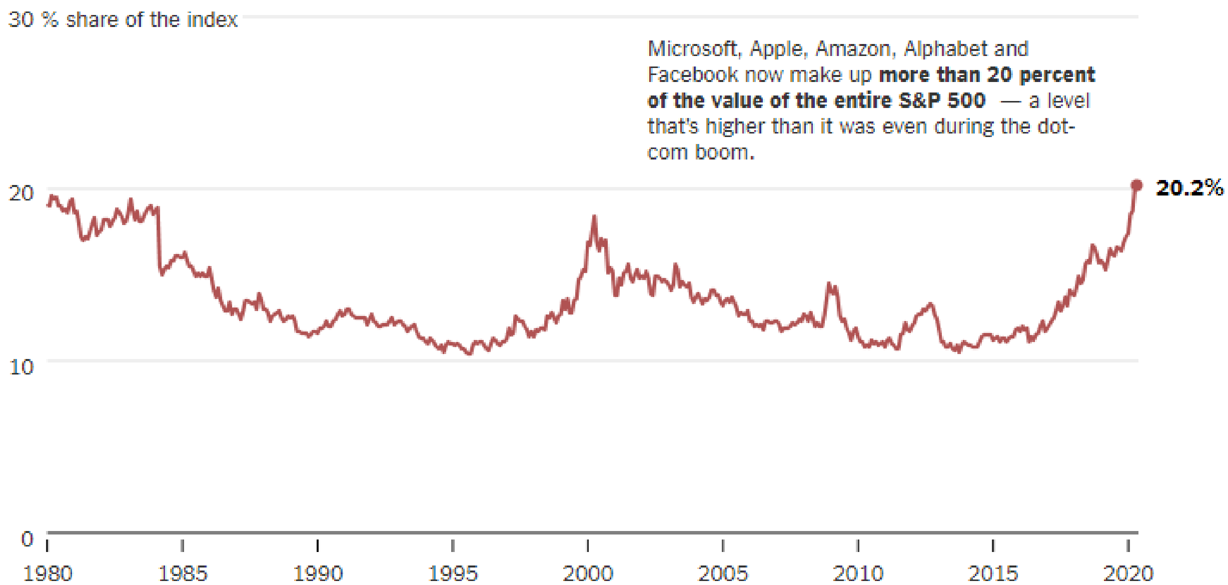
Source: Bloomberg

Global equity markets have bounced back considerably from the lows seen in late March. Central bank policy is likely a main driver of this rebound as interest rates are again at rock bottom levels and investors seek higher returns in the equity markets. Given the unprecedented shutdowns, and that much of the economic and corporate earnings data is yet to be released, it is possible that equity markets have rebounded too quickly. From a valuation perspective, markets may be as expensive or more expensive than they were pre-COVID-19 after allowing for the decline in earnings most companies expect.

Another thing to keep an eye on is that market indices seem to be growing more concentrated. For example, 20% of the S&P 500 index on a market capitalization weighted basis is now concentrated in five companies (Microsoft, Apple, Amazon, Alphabet, Facebook) – a historically high percentage.

This is not necessarily a good thing or a bad thing, it is just what the current composition of the index looks like. Investors should be mindful of this if invested in a market index fund or if benchmarking against the index as these five companies will have an outsized impact on performance.

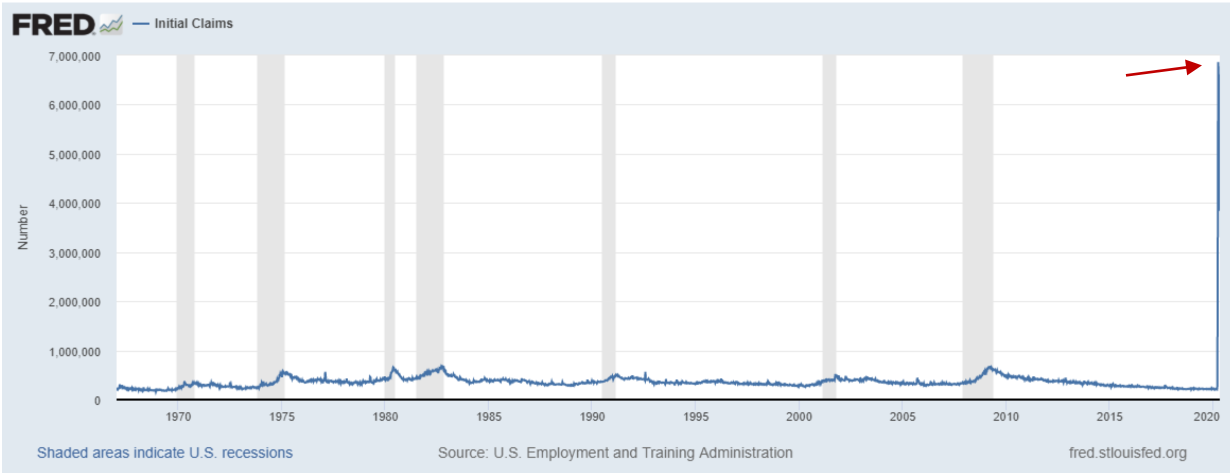
Market capitalization of five largest S&P 500 companies



By The New York Times | Source: Goldman Sachs

Going forward, economies and capital markets will be highly dependent on how long the current lockdown measures are in place and how quickly things can return to normal or near normal. How long the lockdown measures are in place is highly dependent on how successful we are at containing the virus, preventing any resurgent waves of infection, and developing an effective treatment or a vaccine.

How quickly things can return to normal (whatever that may be), also depends on how efficiently the unemployed can return to the workforce. The chart below shows the number of weekly jobless claims in the U.S. up to the end of April 2020 – a staggering number that dwarfs any recorded period before it. It is expected that most people will be rehired but there is a possibility that some companies will either learn to operate leaner going forward (i.e. fewer employees required) or will have been so negatively impacted that they are not able to reopen at all.



All of these factors represent significant uncertainty at this time and are subject to both positive and negative surprises relative to expectations.

It is impossible to predict how financial markets will behave in the short term as there are countless variables at play, not the least of which is unpredictable human behavior. Given this reality, it remains important to structure your portfolio in a globally diversified manner and focus on risk management.

At Quadrant, we diligently manage asset mix and investment manager selection in order to provide overall diversification and asset class expertise. We look to our asset class investment managers as experts in their respective niches to manage risk at the individual security level – something which we believe is particularly important in this rapidly changing environment. Actions our investment managers are taking during this time include:

- Specialized and concentrated financial analysis of portfolio companies regarding balance sheet strength, impact on earnings, liquidity, quality, and overall resiliency specific to the current environment.
- Selling or reducing positions in investments that are no longer attractive from a risk/reward standpoint.
- Initiating new positions or adding to current positions where opportunity exists.
- Managing portfolio cash levels as appropriate.
- Increased direct communication with companies within each portfolio.

In addition, actions Quadrant is taking during this time include:

- Increased communication and dialogue with clients.
- Updating client wealth plans.
- Staying abreast of and conveying information on various government programs related to COVID-19.
- Exploring tax loss selling opportunities where appropriate without compromising portfolio design.
- Increased communication with our asset class investment managers.
- Ongoing portfolio oversight and mindful rebalance decisions.

We sincerely hope you and your families are staying well during these challenging times. We are ready and available to assist you in any way possible.

About Us

Disciplined. Compassionate. Effective.

Quadrant Private Wealth is an independent, comprehensive, integrated wealth management firm committed to your financial well-being and peace of mind. We take the time to understand your complete financial picture. We tie all of your information together, including tax planning, to paint a picture of what your financial future could look like. And we aim to earn your complete confidence in the process.

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