Manulife Securities

# ROYDS REPORT

**Late May 2020**



## Good News

The market may be reasonably priced even after its strong rebound. According to a portfolio manager at Fidelity, Jurrien Timmer, on May 19/20, if earnings estimates are correct for 2021 and 2022, then the forward looking P/E (Price to Earnings ratios) would be about 18 in 2021 and 16 in 2022. Those are not abnormally high valuations in these days of low interest rates. He also said that $4.8 Trillion are sitting in cash now with few options of where to invest. GICs and bonds are not paying much. If a sizable portion of that cash comes into the stock market after some fear and uncertainty is past, then that could fuel markets to higher levels. Surprisingly, investor confidence reached its lowest level, not during or after the 35% market drop, but now, after the market has rallied about 35% off the bottom. (Remember that when the market falls 35% to 65% of its previous level, when it rebounds 35%, it only goes back to about 87% of its original value.) So we've had a strong and quick rebound, but markets are still negative for the year.

The chief economist of RBC, also on May 19, 2020, had lots of good news on his webinar for the second week in a row. He pointed out that

- the estimate for how much the economy would fall in April was 22.5%, but it only fell 18%.
- According to the Federal Drug Administration (FDA), there are **400 clinical trials underway now**. Pfizer and Johnson & Johnson are so confident in their candidates for vaccine, that they have started to produce them. So that if the drug gets approved, it can be rolled out quickly.
- In the US, credit card spending was down 36% in April, but is now only down 9%. Credit card spending since Georgia opened up has already recovered 50% of the amount it dropped due to COVID.

- In China, air travel has already recovered to 64% of previous air traffic levels, even though international travel is still banned. The economy is bouncing back extremely quickly. Almost 100% of people are back at work in China.
- According to Goldman Sachs, 74% of the people laid off in the US are actually making more money from subsidies than they made while they worked. That should help consumption continue and do a lot to keep the economy going.

Dynamic Funds shared research from Bloomberg which showed that U.S. companies with a triple A credit rating (that is, with a very clean balance sheet and manageable debt) have, on average, reached new high valuations. The companies doing the worst in this recession are those who had the most debt, led by resource companies. It makes sense that quality, fiscally prudent companies would have investor confidence.

The number of mortgages in arrears, according to the Bank of Canada on May 14, 2020, is "only" .8% versus the 2% projected number. The difference is attributed to the actions taken by the government and banks.

14% of all mortgage holders applied for mortgage relief under the program concocted by the government and banks. It is not known how many of these people truly needed the deferred payments and how many just took advantage of it, because they could. Thank goodness those mortgage holders had the chance to preserve their cash flow, but how sad that about 1/7th of mortgage holders didn't have the resources to keep up with their payments. What would have happened if those people had lost their jobs in Jan for totally non-COVID related reasons?

Most bankruptcies we've seen so far have been with renters, not homeowners, even those with big mortgages. (Source: Webinar with David Arpin of Mackenzie Financial on May 14, 2020) There is fear though that many of those who deferred their payments will hit a debt wall later, that they won't be able to manage.

A major Canadian Real Estate Investment Trust, H&R Reit, reported on BNN Bloomberg, that while only 59% of retail rent is being paid, 98-99% of all office and industrial rents are being paid.

**Sale Prices Coming**

Housing prices have held up pretty well through this pandemic. Supply dried up almost as much as buyers did. Still there were 43% as many sales in Mar and Apr as there were last year at this time. Prices fell across the country by about 11% and just a little more in the GTA. (Canadian Real Estate Association as quoted in the Globe and Mail May 16, 2020) However, Canada Mortgage and Housing Corporation (CMHC) is predicting that house prices could fall as much as 18%, and CMHC may stop underwriting high percentage mortgages. The big banks are **only** forecasting housing price drops of 5-10% in Canada. (Source: BNN Bloomberg May 21, 2020)

With clothing sales being down about 80% (except for leisurewear?), and store inventory getting to be out of season, there may be massive sales coming. You may have noticed that Swiss cheese has been on sale for a fraction of its normal price. There is so much cheese in Europe that isn't being sold, that one cheesemaker speculated on BNN Bloomberg that it may have be re-purposed as animal feed, so it won't go to total waste. From $27/kg to animal feed!!

**Being Irreplaceable Has Always been Good Insurance**

Earlier this year there were 36 million routine, easily automated, jobs in the US (some estimate even 50 million). If events unfold after this recession like after the recessions between 1980 and 2012, 88% of those jobs will be automated away within 12 months. Recessions force more attention to be paid to the bottom line and fuel changes in operations and automation. Already we have heard about disinfecting being done in hospitals and warehouses by robots carrying ultraviolet lights, that wasn't happening before COVID19. (Source: Apr 13, 2020 Bloomberg Businessweek)

Jerome Powell, the US Federal Reserve Chairman, said on 60 Minutes on May 27, 2020, that 40% of all people in the US making less than $40,000 have lost their jobs, but that he sees economic growth in the third quarter this year. The Globe & Mail reported on May 14, 2020 that in Canada, over 50% of people making less than $32,000/yr had lost their jobs (laid off or terminated) and most of those employees work for smaller employers (restaurants, daycare, hair salons, dental offices, drycleaners, gyms etc). Most people who lost their jobs worked in the service sector, in contrast to past recessions when it has traditionally been those in manufacturing who lost their jobs. In this recession more young people than older and more woman than men have lost their jobs, partly because more women are home taking care of family members (because they are ill or because they are out of school).

**We're All in the Same Boat, but Some of Us Have Better Lifejackets**

We've been hearing from clients that their friends' investments have suffered pretty badly in this bear market. If they were like most Canadians, they had 90% of their portfolios in the Canadian market, which generally means having lots of exposure to resources, like oil and gas. There are much bigger losers out there. There's Trump for example. His estimated net worth is supposed to have fallen from $3 Billion to only $2 Billion this year. (You thought we meant something else about Trump, didn't you!) Is it any wonder he wanted the economy opened back up, so people could go golfing on his courses, stay overnight at his resorts and hold conferences in his hotels? Apparently on Mar 12, there were 2,231 billionaires in the world, but as of 12 days later (still 5 days before the bottom of the market so far), there were 226 fewer billionaires in the world. The remaining billionaires are worth $700 Billion less than a year ago. (Source: Forbes Magazine May 2020)

On a brighter note, some billionaires are worth less because they have given substantial money away for COVID research and relief programs. Long ago Bill Gates, the second richest man in the world and the founder of Microsoft, gave away $46.8 Billion, of which $300 Million has recently gone to COVID19 research. His main goals for the money are to eradicate polio and malaria, reduce HIV infections and to get vaccines delivered to people in poor countries.

Scientists from Cambridge and University College London are predicting a second wave of COVID19 in 4-5 months, unless we adopt serious masking protocols in all public spaces. We could be masking in public for years and can expect future periods of masking the next time there is a serious viral outbreak. After epidemics of SARS, MERS, Ebola, COVID19 etc in the last decades, we can reasonably expect there to be new pandemics in the future. (Globe & Mail May 16, 2020).

**Financial Therapists**

Money has always been one of the topics that spouses fight about most. We shouldn't have been surprised when we heard on a Morningstar webinar, that there are financial therapists (at least in the

US). Apparently, you can go to one with your spouse to try to come to a resolution about how you will handle your finances as a couple. If you're interested in that kind of help, you and your partner can try this new trial website https://bird.morningstar.com/MoneyTalk/index.html#/webMoney to help you explore your attitudes towards money. We'd be interested in any feedback you have on the site.

**43 Ways Our World May Change**

The Globe and Mail on May 16, 2020 was way thicker than normal and had 46 articles on ways COVID will change our world forever. Many of the ideas were fascinating. Some seemed less plausible. Here is a summary of 43 of them:

- The world will enter a new cold-war as Chinese/US tensions increase, like the cold war of the 50s and 60s
- As populism and protectionism rise, and in the absence of geopolitical leadership by the US, middle power countries like Canada will have to stick together, as super powers flout international agreements
- Shops will move on-line forever
- The Canadian Emergency Response Benefit may open the door to Guaranteed Universal Basic Income***
- "The future will be masked"
- More power will be centralized with the federal government
- The oil sector will be at least partially nationalized
- Office Towers will stand empty as more people work from home. [As Shopify's president said on May 22, 2020, "Office Centricity" is over and working digitally from home will be the default in the future.]
- Co-working (the sharing of desks and offices when people come into the office some days) will require more space in the future (as desks may not be easily shared for health safety reasons)
- Grocery stores will embrace online ordering
- More companies will reduce, or end, business travel
- Alberta will finally adopt a sales tax, like the rest of the provinces
- Cash will be used less and less in favour of plastic (credit and debit)
- Bank branches will become fewer as more people bank online
- Supply chains will build in redundancy and become more local
- Dividends will become variable rather than be fixed
- Vacations will likely be in-country, and by car, for at least the rest of the year
- Live theatre may be reduced to one act plays with no intermissions and the audience in masks
- Concerts will get tiny and even more expensive
- Art viewing will be by appointment, so no crowds can congrugate
- Live streamed classes may replace many gym visits
- Movie theatres will be reserved for blockbusters only
- Fashion may actually be sold in season at full price, instead of being stocked a season in advance
- Office buildings will have windows that open and reduce recirculated air
- Movie chains will sell pre-ordered snacks for pickup from boxes unlocked by your phone
- Customer service may increase as stores face decreased demand, as people eschew consumerism
- There won't be any more cheap flights
- You'll have to get to the airport even longer in advance before boarding to get disinfected

- Long-term care facilities will be overhauled
- The handshake won't return, at least not for a long-time (in China people are tapping each others' toes??)
- Mid-size cities will flourish, as people shun high-rise downtown condos, and people work remotely
- We'll accept more vulnerability in leaders (and more women, especially after seeing women holding 50% of top our provincial health officers)
- Electric bikes will proliferate as people shun public transport but can't tolerate congestion in a car
- More medical appointments will be held on-line
- Parenting styles might change
- Food delivery to homes is here to stay
- Temporary buildings will be built quickly and as needed
- The Olympics may find a permanent home
- People will socially interact with fewer people in person
- People will return to office wear, and even ties
- Digital renditions of sports games and athletes will expand
- Post-sports-game shaking of hands, kissing and beer & wine chugging from trophies will be no more
- Spitting on cricket balls and fighting in games may be considered too dangerous going forward

A post-pandemic world with better nursing homes and less commuting sounds like an improvement, but some of the other changes seem pretty regressive. We got used to having to go through airport scanners after 9/11 and I guess we'll get used to most of these other changes too.

***Guaranteed Universal Basic Income was first proposed in 1516 in Thomas More's book "Utopia". Some people tout it on the basis that poverty is immoral in a prosperous land like ours. Others argue that poverty is simply inefficient and expensive, because "an impoverished population is a drag on economic growth [and the healthcare system]….In early March researchers at McMaster University in Hamilton - one of the communities involved in the Ontario pilot – published a report based on data from the aborted Ontario experiment. … Recipients found it easier to find work and enjoyed better physical and mental health, along with greater food and housing security. Many moved to more secure and higher-paying jobs. There was little evidence that the program prompted people to quit work or quit looking for work." Source: The Globe and Mail May 16, 2020)

**<u>What We're Working on Now for Your Portfolio</u>**

First, we'd like to thank you all. You didn't panic when the market was in freefall. Not a single client liquidated or locked in losses. Everyone stayed with their equities and/or balanced funds and got a lot of recovery. Even if it was emotionally hard, you gave the market a chance to recognize the quality and value of the strong stocks held inside our Growth At a Reasonable Price funds. So many of you trusted that we hadn't steered you wrong and stuck with the strategy and style we practice. That means a lot to us (and it kept you on track financially). Thank you so much.

When the market started falling Feb 19 until the bottom Mar 23, we were busy checking that all our funds were being as protective as we expected them to be, and we started doing working longer hours each day, so we could listen to our fund managers, to the economists we trust most and read tons of reports on what was happening to the economy, in the market and with respect to COVID19. Just before the bottom of the market and during the early recovery period, we were helping people invest their extra money into funds we felt would get a good lift in the recovery period. (Even one client, who decided to put money in one morning on a day when the market rebounded 10% and wasn't as great a bargain as we hoped, ended up doing really well by putting money in during the downturn.) After the bottom, we started watching and tracking our most used funds daily to see which funds were getting good rebounds. We continued to monitor closely what the fund managers were doing to make sure they were sticking with their process and doing what we expected of them. As we said in previous newsletters, we identified a couple of funds which didn't handle the speed of this market crash well and weren't catching the upside, because it was too quick/volatile. And we identified a couple of funds which are being so conservative, that they also aren't keeping up with the market recovery, let alone besting it. They didn't fall very much, which was what we wanted and why we held them in the first place, but their future prospects didn't look good compared to other equity finds. And, now we are also concerned about CI Canadian funds. Our other Canadian funds avoided the huge drops that resources and Canadian banks suffered, and they've been finding ways to get good upside. But CI's Cambridge Canadian funds, which we have used with success for about a decade, seem to have abandoned the best GARP practices (like avoiding resources!), and we don't have confidence in their managers anymore. Lately we've been working with clients who hold the above funds, so we could move them to more strategic Growth At a Reasonable Prices (GARP) funds. If you hold any Ivy, RBC Qube Low Volatility, TD Low Volaility, Cambridge Canadian or AGF funds and haven't already called us to move out of them (per our suggestion in a previous newsletter and notes on many of last quarter's Portfolio Reviews), why not call us now, rather than waiting for us to call you. Of course, we will continue watching every fund as closely as we can to make sure that you are in the best funds we can find and that we don't need to adjust our funds or strategy in any other ways. And we will keep trying to communicate to you what we see going on in the economy and market.

As usual, we welcome your calls if you have any questions, concerns, planning needs or just want to be reassured. You don't have to wait for us to call you. Sarah is also trying to schedule people for regular planning and review meetings. (She's also the one to call, if you have an on-line viewing problem or need a password reset). We may not be in the mode of doing face to face meetings again, but we can do Zoom, Facetime, or Skype calls, or plain old phone calls. And over the next few months we will be able to accept digital signatures for more and more account paperwork to make things easier to do remotely.

## **<u>What you Can Do to Move Toward Your Goals Faster</u>**

We are doing everything we can think of to help your portfolios recover as quickly as possible, but if you are still employed, there are things you too can do to shorten the time it will take to reach your financial goals. Here are some ideas:

- If you haven't done your TFSA contribution for this year yet, and you have either cash you could invest, or you have unregistered investments that you could transfer into your TFSA now, before the market is fully recovered, it is a great time to make such a contribution to your TFSA.
- Are you optimizing what you are doing with any tax refund you get? Paying off credit cards would be a first priority. Paying off other debt or adding money to your savings are other good choices. Registered Education Savings Plans (RESPs) are also a great place to add money, if you haven't maximized the amount of matching government grant money you can get. Don't miss out on that free money!

- Most people are saving money during the pandemic. Some are saving costs on commuting, coffees and lunches, dinners out, other entertainment, vacation travel, work wardrobes etc. What are you doing with that extra cashflow? Are you working as hard as possible to lower your debt or adding the unspent cash to your retirement savings?
- And are you reassessing your spending priorities? Some people are finding that they used to spend money on things they no longer value or no longer view as essentials. This is a good time to assess where you spend your money and make plans to ensure that you always spend less than you earn, so that you have the chance to build up an emergency reserve and allocate more income to saving.
- Book a financial planning and review meeting. Let us know if you would like it to be a video call or just a conference call.

**<u>Cautionary Words about CERB</u>**

If you are collecting CERB, remember that this income will be taxable, and no tax is being withheld at source now. So, you should be putting some of it away for your future tax liability, or at least figuring out where you will be getting the money to pay tax on it next Apr.

**<u>Closing Words</u>**

Your portfolios will recover in time. Some portfolios are very close to their Dec 31, 2019 value already. We have not seen any portfolio that has been destroyed and would de-rail anyone's financial future. So, don't waste your energy worrying about markets or your portfolios. In due course, your accounts will be fine, and we are watching them closely. Most people have enough stress already with the virus and social isolation, and for some, the worry of job and income loss as well. You don't need to add to your stress by overdosing on financial news or over-monitoring of every change in your portfolio value.

Jill Heinreth wrote a book, "Into the Planet: My Life as a Cave Diver". She offered her opinion about these days of COVID19, when "we're all navigating the same uncharted waters", drawing on her experience as an explorer for the Royal Canadian Geographical Society. Here are her words from the May 16, 2020 Globe and Mail:

"Uncertainty can bring people together. We don't know what tomorrow, next month or next year will hold for us. Who would have imagined our current reality when we were making New Year's resolutions a few months ago? We are diving in the uncharted waters of the pandemic. We can acknowledge the new risks we face without surrendering. We can't wait for the world to feel normal again before we choose to act. Opportunities for growth will arise from these unexpected challenges. Although no one can accurately predict when this crisis will end, we can take small steps out of our dark caves each day and work with determination to rebuild the world we choose to create."

We hope to see you in person some month soon. In the meantime, we at least enjoy connecting with you by phone or videoconference. You are what motivates us and makes us love our work, even when markets are rough. Stay safe and keep in touch.

*Elaine*

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