Elaine's News and Views

2nd for April 2020

Someone in New Zealand has maintained their sense of humour through this pandemic. They have declared the Easter Bunny and the Tooth Fairy as "essential workers". Someone working on that official list must have young kids at home. (Source: Bloomberg Opinion email of Apr 8, 2020)

Subjects in this Newsletter

Light at the End of the Tunnel Re COVID-19

There is starting to be good news on the health side. Wuhan has lifted all restrictions, 82 days after their shutdown began. Some European countries are seeing their number of new cases decline. New York is seeing a decreasing rate of new infections. The peak in North American cases may come this month. There are now 10 prominent companies working on vaccines, some even in the animal testing stage. Canada is part of a multi-country trial for a treatment based on harvesting antibodies from the plasma of recovered patients. Several companies are now producing equipment for COVID-19 quick tests so more testing can be done. Plans are being made in some areas to test people for antibodies to determine for whom it is safe to go back to work first. Critical supplies for our front-line workers and respirators are starting to be made in Canada by many companies, and supplies are coming in from other countries (ironically many from Huawei!). So relatively soon the medical supply shortages may be over. Social isolating is working to flatten the curve. The light at the other end of the tunnel is still a long way off, but it is visible. There is lots of talk of people going back to work (and in some regions school) in mid May and of most people being back to work by the end of July.

Financial Aid for Those Affected

We've also seen a tremendous amount of government financial aid being made available for workers, students, and employers of all sizes. Aid for vulnerable seniors and the oil patch has been promised. There have been deferrals on the payment of 2019 taxes owing and property taxes to help people with their cash flow. Banks are also willing to negotiate deferral of mortgage payments and possibly credit card interest rates on outstanding balances. Some utilities are also receptive to deferred payments. Some auto insurance companies are even offering rebates or other accommodations to lower insurance costs for those working from home or who have lost their employment (you have to call to discuss this with them). (Here's the federal government's website, where you can check out the latest assistance programs. https://www.canada.ca/en/department-finance/economic-response-plan.html)

Globally the aid announced is estimated to exceed $10 Trillion, which is about 5 times as much stimulus as governments paid out in the 08/09 Great Recession. It's an unprecedented amount of money to keep individuals and companies solvent, so they can come out the other side of this pandemic healthy enough to carry on. It won't make up for all the lost income for either individuals or companies. All these programs are certainly not perfectly conceived, and they won't be perfectly executed, but all this financial assistance is coming faster than I've ever seen government aid come. And for cash flow needs, speed is essential. Not all businesses will survive the pandemic and many people and businesses who were previously "just managing" will have huge financial problems. Many individuals' finances and many companies balance sheets weren't all that healthy before COVID-19 struck, and many companies and individuals didn't have enough emergency reserves to survive even a slight hiccup. So, there will be lots of pain for many and financial disaster for some, but way less than there could have been. Most analysts I have heard are predicting the economy to be essentially back to normal in 2021.

I don't think anyone thinks our 3 levels of government shouldn't be helping those whose paycheques have been affected by COIVID-19 or helping the million plus small businesses who provide 70% of the employment in Canada, and the large companies who provide much of the rest of the employment. The price of not helping them would be enormous. Some may be asking though, what pain we'll see later from all this spending. The good news is that the federal government was in pretty good shape financially before the pandemic started. This $100 Billion of so of announced funding due to the pandemic will bring our cumulative debt to GDP ratio up to 23%. In the 1990s before Paul Martin, the Finance Minister under the first Trudeau, raised taxes and started paying down debt, our cumulative debt was 60% of GDP. We survived that and got ourselves to one of the healthiest financial conditions of all G20 countries afterward. At the end of WWII, our cumulative debt was 109% of GDP. So, we have certainly seen Canada be in way worse shape before. The record low interest rates will help keep the burden of servicing the debt down. Taxes are very likely to go up though, as they did in the 1990s. Governments will be in a bind wanting to keep interest rates down to help businesses rebound and help citizens and the government to be able to afford their debt payments, but also wanting to raise interest rates so that companies and people aren't tempted to take on more debt. (The financial crisis of 08/09 didn't scare people away from debt, but maybe this pandemic will get people to think about living within their means and keeping an emergency reserve.)

Winners and Losers in the Economy

As I've said before, there will be winners as well as losers coming out of the pandemic. More medical manufacturing may ramp up or continue on in Canada, since no country wants to be dependent on foreign supplies for the next health crisis. And some companies have already tooled up to produce medical supplies, which they might need as a side business as their normal business production declines, like in the automotive industry. On-line video game and entertainment companies, cloud computing, home delivery services may retain much of their increased business. Pet store are all offering curbside pick up or even home delivery. People who don't like lugging those 37 pound bags of dogfood around may not be willing to go back to instore shopping! Costco memberships are up hugely. Teachers and professors may not all want to give up video conference learning options. Or there could be a whole move to revolutionize our education system after this, and imbed more on-line medical consultation. On-line shopping may continue on with those who barely or never used it before. Walmart and Amazon were hiring 250,000 people for that during the pandemic. More people may work from home on a regular basis after this is over. Wouldn't it be nice, if roads remained so uncrowded and car pollution was reduced on a sustained basis. Of course, that means less business for tire makers, gas stations, mechanics etc. The whole issue of foreign supply chains for all businesses may be revisited, although any repatriated manufacturing may be so robotized that not a lot of jobs return as production is brought back to Canada. There's talk of less frequent mail delivery being better accepted in the future. Apparently virtual "clubbing" has been really popular and may not go away entirely, like on-line art and exercise classes. High speed internet for more rural areas could become a higher priority in this country, and around the world. Emerging markets could be big losers if production, especially of medicines, is repatriated to first world countries. Overseas travel might not rebound for years, because of fear. Cruising may never regain its popularity. Maybe medical companies and entrepreneurs will decide to see what other tests they can speed up after their advancement with this coronavirus and al the medical ingenuity we have seen might continue.

There are some surprising products that have turned into bestsellers during this crisis. We all know about toilet paper. Amazon sold 186% as much as normal between Feb 20 and Mar 23. And understandably, hand wash product sales are up 506%. Would it surprise you to know that stuffed animals/plush toys sales are up 435%? Kitchen and home product sales are up almost 1200%. I guess now that people are cooking more and spending their days indoors, they're outfitting their homes better. U.S. gun stores are an unfortunate winner. They're considered an essential service in much of the U.S., and gun stores are still open in 41 states. 3.7 Million background checks were done in March alone regarding gun purchasers. The big winner though is allergy, sinus and asthma medication. Sales through Amazon (so excluding hospital orders presumably) are up almost 20,000%. So, there will be winners and outsized profits in some areas, just as there will be lost profits in many other areas. (Source: CommerceIQ analysis courtesy of Dynamic Funds and Globe & Mail Apr 4/20)

Our Portfolios and the Market

Our portfolios, even the pure equity ones (all stock funds), fell less than the market. You may wonder why they didn't rise in value as much as the market, when the market rebounded 20% off the bottom (leaving it down only about 24%). This is a very funny market. Some days its oil companies and airlines that climb enough to lift the whole market (of course they dropped about 80-90% in the first place). Some days it's high tech or small companies. It's often not the majority of the market that makes big moves. Recently we have been seeing value companies (solid companies selling at a discount to intrinsic value) outperforming growth companies (that's a change from the last few years) and seeing small companies having a bigger rebound than larger companies (of course, they fell more in the first place). The main thing is that our managers have been upgrading, that is they're buying companies they think are better than what they already own, because those companies are now trading at even better prices. Our managers have also been spending their cash to get fully invested at these prices. They are looking for companies with little or no debt, so they can withstand the economic slowdown/pause, companies with competitive advantages in must-have-non-cyclical products and companies that are selling for unbelievable prices. I've listened to managers tell of finding a few companies selling for less than the net cash the company had, or selling for only 3 or 6 times regular earnings. These are once in a decade finds. Some people say that price to earnings ratios aren't valid anymore, because profits will be different this year because of COVID-19. Fair enough. But if those earnings are likely to recover next year, then it's not a useless measure of value. Our fund managers however don't use anything that simple. They usually value a company based on the present value of the next 20 years of a company's earnings. So the reduction in profits in 2020 does affect valuations, but not as much as one might think. When clients ask if there is any chance of their portfolios ending up being worth nothing, I ask them if they think Nestles, Walmart, Costco, the big pharma companies, Microsoft, Visa etc are going to be worthless coming out of this pandemic. Those are some of the companies in our portfolios. Others are companies whose names we don't recognize, like the second largest lens maker in the world, the nail and fastener company with the biggest market share in the world, or the world's leading developer of antibodies. The reason we pay these managers to invest for us is because they do research we can't hope to do and find us solid value with companies whose profits we can share. So, Jordan and I are not concerned about any of the funds we use. (One fund did get hurt more than all the others. It owned part of 6 of the busiest airports in the world, part of toll roads, commercial real estate, part of ports and pipelines. The world can't manage without these businesses, but with the kind of pandemic the world is going through now, these businesses were all hurt beyond imagining. However, the company also owned water desalination plants, water purification plants, solar farms, wind farms, cell towers and other infrastructure. So that fund was hurt, not killed, and will undoubtedly recover a ton when the world normalizes.) We did not hold cyclical businesses, travel industry companies, pot stocks, utilities or casinos or many banks, all of which fell terribly. We also didn't own a lot of companies just for their dividends, which is good because so many have cut their dividends and fallen in price. We chose your funds carefully before the pandemic to get the best managers and investment styles we could find, and now the funds are doing what we expected them to. We can sleep at night knowing our funds own quality companies that should survive this pandemic well. We hope you can all sleep at night too.

The market dropped from its high well over 35% at its worst this year. Then when there seemed to be some good news about vaccines for COVID-19, the market bounced around the bottom until it found a slightly higher level. The market could fall again, retest the bottom, if there is worse news than investors are already expecting. Investors seem to be prepared for terrible first and second quarter earnings reports, 10-15% unemployment temporarily and people working from home for at least another 2 months, 3 if you have an underlying medical problem or are older. If something worse comes, I expect the market to fall again. When good news come, like the expected strong third quarter profit reports, then the market will start up. No one knows how fast that will happen, but most expect a much higher market by next year. Almost no one, now that governments are finally addressing the seriousness of COVID-19, is talking about a recession that lasts years. No matter what though, the economy will recover, and markets will recover at some point too. We've been through this many times. Each cause of the market crash is different, but the end result of a market that recovers and solid companies thriving doesn't change. The only prudent thing to do is to hold on till then. If you pull out before the recovery, you'll miss the rebound, let alone the long-term growth that markets have always provided.

Mental Impact Now and Later

The Great Depression of the 1930s affected people so much that even in the 1990s, I would hear clients refer to is as a reason not to invest a certain way. The children of those raised in the Great Depression were taught that wasted food was a sin and re-using in general or re-purposing was a virtue. Debt was hugely hated by those whose families got burned by it in the 1930s. After this crisis passes, people are expected to be traumatized for some time. Maybe more people will keep up the good handwashing habit. Maybe more people will be a little more afraid of debt going forward and try to build up an emergency reserve. Maybe young families will continue to spend more time together. If China is any indicator, we can expect more divorces coming out of this pandemic. Maybe there will be more attention paid to the problem of domestic abuse which has become more apparent during this time of WFH (Working From Home). Some people will struggle for at least a year to get re-employed. Some people may struggle with fear and anxiety for a long time after the pandemic ends.

If you are feeling stressed, there are temporarily free online resources to help you. Shoppers Drug Mart is offering a stress program on-line free till mid-July at https://shoppers.silvercloudhealth.com/onboard/shoppers/stress/?email=ZWxhaW5lcy5leWVwaG9uZUBnbWFpbC5jb20=&utm_campaign=2020_04_07_Healthcare&utm_medium=email&utm_source=sfmc&utm_content=SE%20-%20A%20Badge%20-%20SilverCloud with passcode Shoppers. Morneau Shepell, Sun Life, Canada Life and BCI and a few public sector partners, including the Mental Health Commission of Canada are making a program called WellCan available to all Canadians online and through an app to support mental health during the COVID-19 epidemic. https://www.morneaushepell.com/ca-en/welcome-wellcan

Impact on Us as Investors

We're all human and we're hard-wired with instinctual reactions to fear and things we perceive negatively. These instincts helped our ancestors keep from being eaten by wild animals, being burned alive, killed in battles etc. We can't change these instincts, but we are facing something scary but non-life-threatening, like public speaking, going for a job interview, or looking at our investments in a down market, we can take the time understand our reactions and take a minute to assess whether the reactions are rational. Here are some points about the impact of fear on us that may help us understand why we can feel so bad when markets are down and makes us forget that this is a normal part of economic and investing cycles.

When someone is suffering from negative emotions (like during this pandemic?), time pressure, exhaustion or other stressors, you suffer from cognitive rigidity where you can't take in new information or see a different point of view from your gut reaction.

In the face of fear, we all have one of three responses:

Flight which for an investor is risk aversion (let's head to cash)

Fight which is risk seeking (willing to take a gamble you wouldn't otherwise considered)

Freezing which is decision paralysis.

It's good to know which of these responses you have when you see your portfolio drop in value, so you can evaluate how your gut is telling you to react.

When some people see their portfolio drop in value, they imagine the worst. They "catastrophize" and go through "what iffing", imagining the worst. They ruminate and get stuck on negative thoughts, and never get to move on to the problem solving stage or to the "so what" stage that leads to the answer about whether they'll be okay in the end.

When stress hits, our body releases cortisol. This can lead us to a "present bias". This is where you think whatever is happening now is going to keep happening. If the market is dropping, you think it will keep going down to zero. You stop being able to weigh the future accurately. It can also intensify a person's natural loss aversion. This rarely leads to better decisions.

Here are a few truths about investing that it's easy to lose track of:

Investing is different than speculating. It's not trying to outguess the madness of the crowds.

1/3 of the time a well-constructed portfolio will go down in value. The other 2/3 of the time, history shows us it goes up. We have no control over the market, only over our reactions to the market

Source: Morningstar and Bridgestone Conference Call Apr 8, 2020

Tax Opportunity If You're Working from Home

If your employer is requiring you to work from home now, did they give you a T2200 form, or will they before your tax return is due next year for 2020? That form asserts that your employer requires you to work from home. With that form, you may be able to claim part of your rent, heat, hydro, maintenance costs, and phone expenses. Commissioned sales people can claim some of their property taxes, mortgage and home insurance costs too. For more information about what sort of expenses might be able to deduct, try the Mar 30 and Apr 2, 2020 articles from a prominent accountant/author who writes for the Globe & Mail at https://www.theglobeandmail.com/authors/tim-cestnick/ . The following government website link will take you to a lot more detailed information.
https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/line-229-other-employment-expenses/salaried-employees/work-space-home-expenses.html

Other Tax Opportunities Resulting from COVID-19

Many retirees are withdrawing from their investments every month, even though they have sufficient cash on hand to live on for an extended period of time. Portfolios of retired people were set up in advance to allow for withdrawals from less volatile holdings or even near-cash to guard against serious portfolio damage. However, if you do have extra cash reserves on hand and don't need your monthly withdrawals right now, why not defer taking those withdrawals for a while, till the market has recovered more. The less you sell while markets are down in price, the faster your portfolio can recover. To suspend monthly withdrawals for a few months, you just need to call our office, no signature required.

On the other hand, there are two kinds **opportunities for "in kind" transfers that can help reduce taxes** in the future. First, people with RRIFs and LIFs have to take money out of those accounts every year and those withdrawals constitute taxable income. Let's say that you had to withdraw $10,000 in 2020. If you withdraw it now, that could be 10% of your RRIF or LIF. If you wait till November to withdraw that same $10,000, it might only be 7% of your portfolio because of market recovery. You pay the same tax on that $10,000 regardless of what month you withdrew it in. So, if you can get 10% of your account out for the same tax cost you would later pay for only 7% later, why not take it out now. If you can transfer $10,000 of your funds from a LIF or RRIF to a TFSA, so much the better. The whole recovery can get tax sheltered. If you don't have TFSA room and have to move $10,000 of funds into an unregistered account, at least future growth is only half taxable, as opposed to eventually being fully taxable when it's withdrawn from the RRIF or LIF.

I should point out that the government is allowing people to withdraw 25% less from their RRIFs than the normal minimum should be, because of the COVID-19 impact on the market. This isn't something you should automatically take advantage of. Often we try to deplete a RRIF on purpose by withdrawing more than the minimum to reduce the future tax liability for a person's estate. If you don't need all the normal minimum income from your RRIF, let's discuss if it makes sense to take the new reduced minimum amount.

If you have an unregistered account, you could transfer funds from it into a TFSA now, if you have TFSA contribution room. That would allow all future rebound to be fully tax sheltered. If it triggers capital gains to transfer those funds from your unregistered account, it's triggering way lower capital gains than it would have triggered if you had done the same thing in early Feb. Even if you just wanted to re-position from one fund or stock to another but you were hesitating because of the capital gains tax liability, why not reposition now? The tax liability will be less. It's important not to forget the old adage not to let the tail wag the dog. That means don't let tax implications prevent you from shifting to better investment opportunities. I knew one man in 2000 who had $1 Million of Nortel stock, but wouldn't sell because of the huge tax hit. Those Nortel shares ended up being worthless later.

Even if you "only" have cash to top up your TFSA. Now is a good time, not only because prices are down, but also because there is a potential for more gains to be tax sheltered now, than there will be after the market recovers.

Protect Yourself from COVID Scam Artists

During this pandemic, cyber criminals have been sending out emails with supposed free offers and helpful information about COVID-19 or pretending to be a financial institution reminding you to pay them. Don't be fooled. If you don't recognize the e-mail address, don't open it. If it's from a friend, but you think it looks suspicious, call the person to see if they really sent it. And don't forget the trick of hovering your mouse over the sender's name or email address to see the whole thing, so you can judge if it's legitimate. Union Gas for example does not send out emails that end in "x5mpf.ne". And unless you are 100% sure of the legitimacy of the sender, never click on a link in an email or call back the number they claim is a company's number. Go to the company's website to reach them or to find their number.

Phone scammers are pretending to be bill collectors now that so many people are failing to pay all their bills on time. If you get a call from a number you don't recognize, just let it got to voicemail and then you have time to figure out if it is legitimate. Protect yourself.

On Apr 12, 1959, John F. Kennedy pointed out that, "The Chinese use two brush strokes to write the word "crisis". One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger – but recognize the opportunity." While this applies to us as investors, it also applies to our society as we adapt to doing things in new ways, some of which may be better than the old ways, for our own health, for the environment etc. Let's all be aware of avoiding the dangers and keep our eyes open for the opportunities and silver linings.

Stay safe; keep connected with family and friends at a distance; be grateful for all those doing essential jobs now; stay confident that we will get through this. And remember that the economy and markets will recover, as they always have, even though we don't know when. So, be patient and don't lose sleep over your savings. And hopefully soon this endless stream of newsletters from me to you will stop too. I just want to keep you updated while you may feel uneasy about current markets. The markets seem to be getting used to the bad news or the world's current situation, so hopefully you are feeling calmer about it too and know that "This too shall pass".

Financial Services is considered an essential service. You always need to have access to your money. Our office is still open. Call Sarah or Amber if you have questions about tax slips or password resets. Call Jordan or me, if you want to talk about your portfolio or the market or anything financial.

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