ROYDS REPORT

Early June 2020

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Less Bad News – Yeah!

The next best thing to good news is less bad than expected or less bad than previous news. That's what we're seeing now. The May jobs report for the US just came out. It was expected that there would be an additional 7,500,000 jobs lost. Instead there were 2,500,000 jobs created. That's 10 Million more jobs than expected. Similarly, in Canada we expected another 500,000 jobs to have been lost in May, but actually 290,000 more jobs were created than were lost (most of the job creation came in Quebec). Economists didn't expect to see these kind of numbers for another month, but it appears that the economy is getting back to work earlier than expected. The Canadian unemployment rate is still a terrible 13.9%, and that number doesn't even include the laid off people who aren't looking for work, but just awaiting a recall.

China's economy restarted faster than anyone expected as well. We heard how much air traffic they were getting, even though international travel hasn't reopened. Now North American airlines are adding more flights earlier than expected. Full recovery could still be many years away, but the path to it is further along than expected by now.

Alberta oil production is down 25% but oil prices have been much more stable and higher (over $30/barrel for Western Canadian Select) than we would have believed possible a month ago. Oil inventory in North American fell more than expected in May, which is positive for future prices and price stability.

The Bank of Canada announced the worst-case scenario for our economy had been avoided. On the COVID front there had been a similar pronouncement, that the worst case scenario didn't happen.

The stock markets of North America have responded to all this less bad news by rising significantly. Technology companies have generally led the pack and many companies are a long way from former values (resources, retail, airlines, hotels). Despite all the uncertainty and difficulties still facing the economy, especially with respect to a second wave for COVID, the market is seeing through to longer term performance and profits. Many people think the market moved too high too fast. So there could be some price corrections, but fewer and fewer people seem to be expecting the market to retest the lows of Mar 2020.

(All of the above has been printed in the Globe and Mail and reported on BNN Bloomberg News)

How Did Your Investments Fare?

Almost everyone's portfolio fell less than the market and many are still down only a little from Dec 31 levels. Some are even back to the highs of Feb, especially if they added to their investments during the downturn. Surprisingly, the more conservative the investor, the less fully their portfolios have rebounded. Perhaps that's because the bonds in their balanced funds have held back the recovery.

Our Growth At a Reasonable Price stockpicking managers did not disappoint! Many of them are up 3-12% for the year and the rest are mostly within 1% of their Dec 31 values. Funds that invest in small to mid size companies, which fell more in the first place, haven't finished recovering, but are generally down less than the general stock market, and they generally come out of downturns with some of the largest growth. That could still be the case this time. We continue to see 2 global managers lagging, but we have no reason to expect that they won't prosper again this time, just on a delayed basis, as they have many times before.

We continue to reposition people out of the most protective funds into funds that are still protective, but which have been participating strongly in the rebound. We also continue to leave the bank issued low volatility funds which did not really handle this downturn as well as expected. And for those who are prepared to take a little more risk with a small portion of their portfolio, we have a couple of spicy stockpicker fund managers who've managed to make huge gains (25-35%) for the year already. These managers thrive with big volatility in the stock market, but one needs to remember that they can also fall more than their conservative peers.

We continue to overweight US investments and keep a minimum amount invested in Canada.

Tougher Rules for House Buyers

COVID has exposed just how precarious some people's financial situations were/are and this has caused Canada Mortgage and Housing Corporation to reassess the criteria for mortgages they will insure. It will be considerably harder for first time, or low down payment, buyers to qualify for a house and in general with the same income level, buyers will qualify for a 12% less valuable house than they would have before the change in rules (per Patty Lovett Reid on BNN). Total debt service ratios can no longer be as high as 44%, but only 42%. Credit scores of 600 will no longer qualify you for a loan. Homebuyers will need 680 scores to get mortgages with less than 20% down payment. And CMHC is still calling for house prices to fall 9-18% over the next 12 months. So, there will probably be fewer homebuyers in the future and it may therefore be harder to sell your home.

Interest Rates

The Global Chief Economist for Manulife Investment Management said on a Jun 10, 2020 conference call that she projects no interest rate rises until 2025!. She sees 25% of all debt instruments world-wide still yielding negative returns and deflation continuing for another month, then going flat and finally ending with inflation reappearing in Apr 2021, but not exceeding 2.5%. This is all good for debtors, because it will be easier to repay loans with low interest rates. It's not good for GIC type investors who will continue to earn next to nothing on their savings for years to come and will have to "move up the risk curve" to be able to make any money.

Elaine *Jordan*

L. Elaine Royds, MBA, CFP®

Senior Financial Advisor, Manulife Securities Incorporated
Financial Planner, Manulife Securities Insurance Inc.

Jordan Royds

Financial Advisor, Manulife Securities Incorporated
Life Insurance Agent, Manulife Securities Insurance Inc.

Suite 303 - 1685 Main St W, Hamilton, ON L8S 1G5
Office 905-393-0787 Toll Free 1-855-640-1857 Fax 905-393-0788
Website www.roydsfinancial.com
Assistant Investment Representative: Sarah Breimer sarah.breimer@manulifesecurities.ca
Administrative Assistant: Amber MacDonald amber.macdonald@manulifesecurities.ca