Manulife Securities

ROYDS REPORT

2nd for July 2020

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Most Recent Statements

Most portfolios were actually a few dollars higher at the end of May than at the end of June, but compared to the end of March, June statements are beautiful. **Markets have had their best 3 months of growth since 1999** (per BNN Bloomberg on July 2, 2020). **The slight drop in value from May to June is not because of COVID. On the afternoon of June 13, the market became fearful of the escalating trade tensions between China and the USA**. This caused the market to drop about 7% in hours. The market slowly started rising after that drop but then took a small step back again in the last week of June because of COVID's resurgence in much of the USA. Although most portfolios around June 12 had re-attained their Dec 31, 2019 values already, they didn't finish the month quite so high. This should not be a surprise. The market doesn't just go straight up. At least the market is recovering faster than expected and most of our portfolio managers are getting even more upside than the market in general.

There are some trends we noticed that are different from what we see in a normal economic and market downturn. Usually we see the most aggressive investors, who are not only purely in equity but also in some volatile equity funds, do the worst in a downturn, but eventually recover and go on to have the best long-term returns. **This time, it was the most aggressive investors who went down the least and have recovered first and best.** And those who were in less volatile equity funds and perhaps in balanced funds, to protect their current or impending income stream from savings, have not recovered quite as much, because the bonds, dividend paying stocks and utility stocks in balanced funds were greatly impacted by COVID-19 (both the shut down and lowered interest rates) and balanced funds typically lack high tech exposure (more on that below). As usual, those with high percentages of cash or GICs got the lowest growth. It was really noticeable who added money at the bottom of the market (they did really well) and who had an overconcentration in a single stock (most did extremely poorly). And as usual, it was noticeable by the returns alone, without looking at the names associated with them, to see who has not been meeting with us to keep their portfolio up to date as fund managers leave or as return prospects for different parts of the world change.

As we check individual portfolio reviews, before mailing them out, **we will continue to look for weak holdings that are not participating in as much "up" as they should for their category and style. We will also look for over-concentrations in slower growth parts of the world**.

We are getting to the end of what we can do to position portfolios to prosper as the market rebounds. So, we would really **like to get back to planning. We can update projections as to when the savings needed to retire should be reached, or what income should be attainable in retirement. We are available to have meetings on this with you, by phone, by video and soon face to face**. We have our PPE in place, including acrylic sneeze shields in the boardroom. We would just like the virus to be a little more under control to invite people back into the office.

In the US recently, there have been big increases in purchases in two diametrically opposed areas – firearms and life insurance. We're glad Canadians are not following the same path. However, this may not be a bad time to check whether you are properly insured. Situations change. Do you still need your insurance? Do you have more than you need or not enough? Is your term insurance about to rollover for another 10 years at a much higher cost? Also, insurance companies have relaxed their rules a bit for getting under $2 Million in insurance during this COVID period, which makes it a good time to get insurance if you need it. So if you have any spare time, give us a call and we can review your insurance coverage situation with you.

By the way, most portfolio reviews of 4 pages or less have been stapled in a more environmentally friendly way. Every little bit helps. (Sorry, the first few were a bit messy.)

Second Wave

There has been so much talk of a second wave that might cause many businesses and entertainment venues to have to re-close. Recently there has been a **shift to expecting multiple little waves instead of a major second wave**. We are already **seeing an upturn in cases in 37 or more US states and some states starting to re-close-up non-essential businesses and locations**. When this happened in the last week of June, the market did indeed drop a little to reflect the impact of some of the economy re-closing. (Contrast that to Hamilton with over 500,000 population, which at the time of writing had 3 consecutive days of 0 new COVID cases and has 0 COVID patients in hospitals. Yeah!)

National Bank's Deputy Chief Economist, Matthieu Arseneau, offered some reasons on BNN Bloomberg on July 2, 2020 as to why the impact of a second wave, or little resurgences, should not cause markets to re-test their lows. He expects **focused shutdowns** as opposed to general ones. So, places where social distancing is not possible (like some restaurants) or where it isn't being observed (like beaches) could be shutdown, leaving most non-essential businesses free to stay open. He also pointed out that lockdowns only contribute 30% to the reduction of cases. The other important factors globally in the number of cases a country gets are the GDP per Capita, the percentage of the population who are seniors in nursing homes, tourism and a country's health care resources. We were surprised that he didn't mention the density of population (think Toronto versus Tuktoyaktuk or Elmira), nor the willingness of certain societies to follow public health recommendations or edicts (like the adoption of mask wearing in South Korea versus Texas and Florida where many people have disregarded all social distancing guidelines and directives).

Luckily there are also a few improvements in treatment (like Remdesivir) which reduces the likelihood of death and shortens the time to recover from COVID-19, as well as trials in the use of plasma from those who have antibodies to share after having recovered, which should lessen the impact of any future resurgences and may reduce the measures that have to be taken in the future to keep the virus under control. And **there are 17 drugs/vaccines in human trials already, with 4 vaccines by Moderna, CanSino Biologics, Inovio Pharmaceuticals and BioNTech with Pfizer, showing real promise**. (Source: Globe and Mail, July 2, 2020) A return to normal could take a couple of years, and in some areas there will be a new normal and no return to the old ways. The market sees this progress back to normal and seems focused on that path rather than on the bumps along the way.

FAANG Stocks Cloud the Picture

Remember **FAANG companies – Facebook, Apple, Amazon, Netflix and Google? If you add a sixth company to that, Microsoft, you have the answer to why the US market has gone up as fast and as strongly as it has. (In Canada, the equivalent is Shopify.)** These companies have done great business during the COVID-19 shutdown and are expected to retain extra business for the long-term after COVID-19 passes. It should be no surprise that most or all of these companies have record high stock prices. **At the time of writing this, the US' S&P 500 total return index (which includes dividend income) is down only about 5%. If you exclude the FAANG stocks and Microsoft, the index is down 23%!!!** (Source: BNN Bloomberg July 2, 2020) People are always asking why has the stock market done so well, while the economy is still suffering so much. The answer is that these few companies, which are doing well financially during COVID-19 are a huge weighting of the stock market and have taken the index up, even as most of the other stocks on the index are suffering. The market, and especially the index, cannot be used as a proxy for the economy.

The recovery our funds have had is even more impressive, given that most of them don't have big exposure to the FAANG stocks (which some people think are at pretty rich prices right now). And our small cap funds certainly don't hold these large companies' shares, so their recovery, that has almost kept up with the large cap index, is even more astounding.

While we all love to see our own portfolios up, it seems to really be bothering people that the market has rebounded so quickly (a V recovery so far), while the economy is far, far behind in recovering. The June 15, 2020 Bloomberg Businessweek magazine listed 6 reasons why this bull market is so unloved and why we have such conflicted emotions about it. Maybe looking at them will help us understand any ambivalence we feel. The reasons listed were:

- It's hard to rejoice when market recovery is happening at the same time as thousands are still dying
- The market doesn't reflect the economic pain that people and countries are experiencing
- Government aid, especially the US Fed, gave markets and companies a lot of help so gains aren't from normal economic activity
- Stock bargains disappeared so quickly that we didn't all get the opportunity to take advantage of them
- Big market rallies help the top savers and earners most and don't help the most disadvantaged
- The gains coincided with mass protests and increased focus on social injustices

How is the Economy Doing?

The Canadian economy is tightly linked to the US economy and most of our investments are in the US market. So let's look at how the US economy is doing.

Because so many unemployed people are making more money on government assistance during COVID-19 than they were earning in March 2020, **average income in the US has increased during COVID**. This gives people more money to spend and helps keep personal bankruptcies at bay. **Unemployment in the US dropped to 11.1%** (still double the rate of 2008 during the Great Recession) with 4.8 Million jobs being added in the month of June (after 2.7 Million jobs were added in May). This was better than expected by about 20%. However, a lower percentage of jobs in the areas of government, finance and education came back. It is **expected that office workers will experience the greatest permanent loss of jobs**. It is also expected that unemployment could rise again in July due to re-closures. (Source: Andrew Husby, BNN Bloomberg Economist on July 2, 2020) The US is getting back to work faster than expected, but not nearly fast enough for those who are unemployed. And just because people are getting back to work, it doesn't mean that GDP and the economy are growing in the same proportions. **Productivity is negatively impacted by the extra measures that businesses have to take to keep people safe**. And, in the US, there have been and could be again future re-closures of some of businesses where COVID cases rise.

We do know people who couldn't wait to get back into stores and go eat at restaurants. And we have all heard about how busy hairdressers and golf courses are. But there are lots of people who are still going to wait till the pandemic is easing, before going out to such businesses as much as before, let alone get on a plane or cruise ship. The economy is recovering, but certainly not in an instantaneous fashion and it will be a long haul.

And what will happen to consumption and spending that fuels the economy at the end of June when most of the US financial supports for individuals end? The US purchasing mangers index (the PMI which shows whether purchasing managers expect to be doing more or less buying for their companies in the next 2 years) for June was 57. Anything above 50 is positive and means buying will be increased. 52 or 53 are considered very strong numbers. In contrast, the Bank of Canada reports that half of all firms in Canada expect lower sales next year. Luckily in Canada, financial supports have been extended a little longer, but presumably our PMI will also be above 50. And there has been **a rebound in the price of oil – more than 2/3 of the way to what is necessary for oil producers to break even**. So, the news seems to be trending toward recovery. Investors can see a full recovery coming sometime in the future, just the future won't necessarily look like the pre-COVID world. Source: BNN Bloomberg Jul 6/20

Some people ask why we would concentrate our investments in the US when that country is still suffering badly from COVID and may open up its businesses much later than in other parts of the world. As you have heard us say before, **Americans are very innovative and entrepreneurial** (even if that often means buying up Canada's innovations before they have been fully monetized in Canada) and that the government regulations and taxes promote business. And **over half of the 500 largest companies in the US get over half of their income from other parts of the world so they aren't just a barometer of business within the US**. We still believe that, but here is another perspective on what fuels the US stock markets above all others, from the president of Vassar University as quoted in Bloomberg Businessweek on Jun 15/20. A World Values Survey was done on public attitudes. Scandinavians thought the top functions of government were to reduce inequality, promote literacy and protect the population's health. **Americans however believe that the government's priorities are providing "protection from**

foreign enemies, keeping neighbourhoods safe, and spurring economic growth." It didn't say what Canadians believe the role of government is**.** Something in between perhaps?

India

Looking well beyond the COVID recovery, we still need to keep our eyes open for sources of strong long-term growth. One place we shouldn't ignore is India. **India's economy is expected to grow 1000% (at an annual rate of 7.7%) between 2016 and 2050 to become the third largest economy in the world, after China and then the USA**. Indonesia may be a close 4th. It's growing its economy at 6.2% annually. China is only growing at 4.4% annually, but it has a big head start over India and Indonesia. The USA's growth pales in comparison at 1.8% annual growth rate, which is why it might not be too many more years before India and Indonesia both surpass the US and perhaps even China. (Source: Price Waterhouse Cooper report courtesy of Sun Life) It will help that India should have about 926 million people in their prime working years (aged 20-59) by 2050, whereas China might have 610 million, Europe 315 million and the US only 188 million. It would be hard for the US to have a stronger GDP than India, when India will have 5 times more workers, the level of education in India is increasing, and government reforms are making the country friendlier to investors and businesses. (Source: United Nations courtesy of Sun Life) In the last 5 yrs, India has gone from being the 143rd easiest country out of 190 to being the 60th easiest. Great strides! (Source: World Economic Forum) India is already the 4th largest auto market in the world, has the fastest growing domestic air traffic in the world, has the largest motorcycle market, and has the 2nd largest smartphone market. (Source: a Mar 2017 BCG Report courtesy of Sun Life) This is a country with a bright future. And even better, according to a 5 yr study by Bloomberg (courtesy of Sun Life), the correlation between India's stock market and Canada's is extremely low, at **.**17. The lower the number, the less the stock markets move in unison. A correlation of 1 would mean the 2 markets move exactly in sync. It's hard to find good funds with lower correlation than .75. So, a .17 correlation could provide real diversification, such that if one fund fell hard, the other might not necessarily move in the same direction, or at least not very strongly.

Emerging markets, even the Indian market, have struggled with currency issues, trade tariffs etc. That doesn't negate the potential of the country and its market.

Off Topic - Americans In Canada

The former US Ambassador to Canada was on BNN Bloomberg on July 2, 2020 advising Americans living in Canada to take advantage of their rights to vote, and he went so far as to recommend for whom to vote (he had served under the Obama administration, so you can guess whom he recommended). He said there were more Americans living in Canada than live abroad in any other country, and that the Americans in Canada could make a difference in the outcome of the next election. He advised going to **votefromabroad.com to exercise your legal right to vote as Americans living abroad**. This could be a really important year for the US, for Canada and for the world in which to cast your ballot for president.

Off Topic – Relatives in Long-Term Care

Ross & McBride is one of Hamilton's largest law firms. One of their partners, Anandi Naipaul, wrote about obligations of Long-Term Care facilities. Within 6 weeks of someone's admittance, the facility must have a full, written care plan and they must review it at least twice a year. "You can request a copy of the plan and observe whether the home and staff are complying. You should also request that you be made aware of any changes to the plan". If you think the facility in not in compliance with the plan, the place to lodge a complaint is the Ministry of Health and Long-Term Care. (Source: Hamilton Spectator, Jun 29, 2020)

Gamification of Stock Trading - On-Line Stock Trading Apps

Wealthsimple Trade in Canada and Robinhood in the US are stock trading apps. Wealthsimple makes money on its currency-conversion fees, when users buy or sell US-listed securities. Rob Carrick on Jun 25, 2020 wrote about stock trading apps in the Globe and Mail. He said these **apps are near-gamification of stock trading and they are attracting people who don't know about investing**. Here are excepts from his article:

"Wealthsimple Trade has gone from 25,000 users last July to about 180,000, while Robinhood has about 13 million users. … **The stock market … has been invaded by hordes of non-wealthy Gen-Z and millennial investors. …Wealthsimple Trade reports an average of three trades daily by users**. Some of Wealthsimple Trade's most heavily traded stocks in late June were Air Canada, Tesla Inc., Toronto-Dominion Bank, Apple Inc., Suncor Energy Inc. and Cineplex Inc., which is to say a mix of blue-chip and speculative. Robinhood clients have been criticized most recently for going big on Hertz Global Holdings Inc., the bankrupt car-rental company. [After the company announced its bankruptcy, its stock price went from $0.85 to $5.53 and at the time no one could figure out who was bidding so much for it. It then settled down to about $1.50 while the bankruptcy plays out.] Trading apps have teamed up with conventional online brokers to give new life to day trading, an investing fad that boomed and went bust in the dot-com era…A lot of young day traders are going to have their butts handed to them. Why don't they know better? One reason is **the hothouse atmosphere created by the pandemic – people stuck in their homes, feeling stressed about money, looking for amusement and financial gratification. In a rising market, day trading through an app is escapist entertainment**. … Stock-market rallies and investing fads all end, and they often end ugly. Can trading apps redirect their obviously clever technology to help clients become investors instead of traders? "

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