Wealth Management
PH&N Investment Counsel

Stu's View

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Finding a way forward

Our investment strategy during the COVID-19 crisis

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Having learned from the lessons of 2008, central banks have committed to doing whatever it takes to support financial market liquidity.

All of us have had to quickly adjust to a new reality. We are also facing the possibility that our new daily routine may not be as temporary as we first thought. It has not been easy to adjust. Adding to the anxiety that we all feel from the spread of COVID-19 across the globe, there are serious concerns about the fallout from COVID-19 on the economy and investors. The declines in the stock and bond markets have been swift, and harsh. The fastest correction in history quickly turned into a bear market. What will next week bring us? We are in new territory, with wild market swings, and investors are asking how long this period of uncertainty might last.

In this weekly update, we try to provide some answers to these important questions. To be certain, there are reasons to be optimistic, if we can look past the dark days. We discuss our sense of cautious optimism, with an expectation that markets may continue to decline further, but that over time this crisis will end. Throughout history, humanity has overcome two world wars, numerous famines and many pandemics, inflation, policy errors, and housing and financial market crises. We have every confidence we will get through this too. Patient investors have been rewarded over time.

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Bear markets tend to occur every seven years

Since the 1930s, there have been 13 bear markets, defined as an equity market where prices decline at least 20% from their prior highs. Over this 90-year period, investors would have seen a bear market about every seven years or so. Each of these 13 bear markets have similarities and differences, and we know history is only a guide. Investing in a bear market is not easy, but as we will discuss, timing the market, or waiting out periods of time in the market, can be quite costly. Bear markets are not the only period where markets decline. In fact, during non-bear market environments, about 70% of years experience drawdowns of 10% or more.

Historically, equity bear market pullbacks from prior highs have taken between one to 33 months to reach a bottom, averaging about 16 months in duration. For the S&P 500, the average price decline in those bear markets was -34% (a range of -32% to -86%). This time around, the S&P 500 reached a bear market in just 16 days, which was the fastest time period on record.

What typically happens to stocks after they reach a bottom? Looking at the chart, the average one-year return from the market's bottom has been 50%, and even the worst one-year return has been about 5%. Nobody can consistently predict the market top, or the market bottom. Our investment philosophy is not predicated on timing the market, but rather time in the market. What is most interesting from the chart is that stocks tend to perform well in the year following a large decline, and over a reasonable investment time horizon of 1-5 years, have done really well after such declines.

					Forward returns (from Trough date)		
Peak Date	Trough Date	Peak S&P500 Index Price	Trough S&P500 Index Price	Peak to Trough Drawdown (return)	1 Year Return from Trough	3 Year Return from Trough	5 Year Return from Trough
September 16, 1929	January 6, 1932	31.86	4.4	-86.2%	121.4%	119.8%	262.7%
October 9, 2007	March 9, 2009	1565	677	-56.8%	68.6%	102.6%	177.5%
March 6, 1937	March 31, 1938	18.7	8.5	-54.5%	29.2%	17.2%	36.2%
March 24, 2000	October 9, 2002	1527.5	776.8	-49.1%	33.7%	55.4%	80.6%
January 11, 1973	October 3, 1974	120.2	62.3	-48.2%	38.0%	55.3%	76.0%
September 7, 1932	February 27, 1933	9.3	5.5	-40.6%	95.5%	165.6%	105.1%
November 29, 1968	May 26, 1970	108.4	69.3	-36.1%	43.7%	55.8%	30.7%
November 7, 1940	April 28, 1942	11.4	7.5	-34.4%	53.7%	150.6%	108.4%
August 25, 1987	December 4, 1987	336.8	223.9	-33.5%	22.8%	45.7%	93.0%
October 25, 1939	June 10, 1940	13.2	9.0	-31.9%	9.2%	36.5%	65.6%
February 6, 1934	March 14, 1935	11.8	8.1	-31.8%	80.8%	33.7%	51.6%
July 18, 1933	October 21, 1933	12.2	8.6	-29.4%	4.9%	99.0%	51.1%
February 19, 2020	March 23, 2020	**3386.1**	**2237.4**	**-33.9%**	**???**	**???**	**???**
	Averages				**50.1%**	**78.1%**	**94.9%**

Source: Bloomberg LLP, RBC PH&N IC. Drawdown: period of time when prices are in decline. Peak: the last price before a series of lower prices. Trough: a point in the market cycle where prices are bottoming and heading higher. 3 Year Returns and 5 Year Returns not annualized.

Lessons learned from the great financial crisis of 2008

From a monetary policy perspective, central banks have now cut policy rates to zero, if not beyond. Having learned from the lessons of 2008, central banks have committed to doing whatever it takes to support financial market liquidity. This is being done with the goal of limiting any damage that a protracted and deep bear market could have on the global economy, beyond the possible impact from COVID-19.

The U.S. Federal Reserve announced the biggest "bazooka" of all in its promise of unlimited quantitative easing going forward. It will buy a colossal US$625 billion in Treasury securities and mortgage securities over just the coming week, and presumably continue as needed into the future. Taken together, the Federal Reserve programs are considerably more aggressive and have been done in quicker fashion than what happened during the 2008-09 financial crisis.

Canada's federal government has resumed a mortgage-buying operation it undertook during the global financial crisis. From a timing perspective, it took central banks more than a year into the global financial crisis before implementing quantitative easing, so they deserve full marks for the nimble response this time.

We presume central bank balance sheet expansion, monetary stimulus and fiscal policy responses will be at least as large in response to COVID-19 as to the financial crisis, perhaps even larger. At the time of writing, the U.S. Senate has passed a $2-trillion fiscal stimulus package, which is expected to be approved by the House and signed by President Trump. It would be the biggest package in modern history, totaling 9% of GDP, with provisions to benefit: 1) households (including direct payments and extended unemployment benefits), 2) businesses (including loans/grants to small businesses and those in impacted industries) and 3) other

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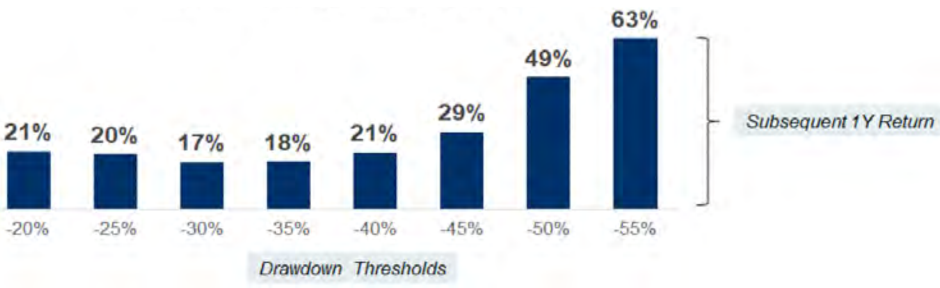
Return following volatility – S&P 500



The above chart shows 1-year median returns for the S&P 500 Index following the date on which the above-indicated drawdown occurred. Source: RBC GAM, Bloomberg. As of March 16, 2020. An investment cannot be made directly into an index. The graph does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

support (for hospitals/health care, farmers, state/local governments, etc.).

Remaining invested, adding to existing positions

We believe that investors with a reasonable time horizon should consider selectively adding some exposure to equity markets. The market decline has broadly depressed equity prices, and some equities have very attractive values. However, we are always mindful of large-scale changes to portfolios in volatile environments. Historically speaking, timing the market has been extremely difficult to say the least, and as such would advise a systematic approach to rebalancing portfolios between equities, fixed income, alternatives and cash weights.

Adding to equities here after a decline is not an easy pill to swallow of course. However, forward return prospects improve as the market falls, and dollar cost averaging in this environment counters both a fear of getting in too early and a fear of missing the rally.

Now, this is not to say remaining invested is analogous to taking a walk in the park. Indeed, there will continue to be more unfortunate headlines related to COVID-19. It's also possible that until there is a viable vaccine found, we could be in this period of uncertainty. We just don't know at this stage. Many experts suggest it take another 1-2 years for the development and distribution of a viable vaccine.

What we are watching

First of all, we remain focused on providing you, our clients, with the highest level of service. Together with RBC Global Asset Management, RBC PH&N Investment Counsel is monitoring several potential developments which could impact financial markets. The list starts with developments that could theoretically arrive fairly soon, and finishes with items that will likely take longer to achieve:

- Further significant enhancements to containment, border control and disease testing efforts
- Further major government stimulus announcements
- A decline in the number of new daily cases in Italy
- A decline in the number of new daily cases in the U.S.
- A decline in the daily global fatality rate
- A decline in the total number of people actively sick
- Development of an important therapeutic treatment for COVID-19
- End of quarantining
- A return to economic growth
- Development of a vaccine

We fully recognize that this is a period in time that is highly stressful for you, and your family. Your portfolio is likely down and you have questions and concerns. Your Investment Counselling team is here for you. We welcome any, and all, of your questions related to financial markets and the impact COVID-19 may have on your investment portfolio, at any time. As we move through this period of uncertainty, we promise to consistently provide you with relevant market and portfolio updates, and wish you and your family all the best.

Be well,

Stu

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