Extra-ordinary Measures for Extra-ordinary Times

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Background

Over the numerous decades that we have managed our clients' wealth, we have experienced several periods that have tested our resolve on the basic principles of investing. While each correction or bear market is accompanied by its own narrative, in all cases there is one common thread – a degree of uncertainty around how bad this can get and when will it end.

It's only natural to think that the period we are in is the worst one yet, because how exactly it will play out has not yet been defined. In other historical cases, we know how they ended and how long it took to recover from the respective market event. This allowed us to become comfortable with something that was very uncomfortable at the time – the true benefit of hindsight.

Once again, we are faced with a new uncertainty. The onset of COVID-19 has evolved into a global pandemic that none of us have seen before. But frankly, when events like 9/11 or the Global Financial Crisis occurred most of us had never experienced anything like that before either. I remember after the 9/11 attacks returning to work, and staring out to neighbouring towers in the downtown core with a lingering thought that another plane might fly into a building. In 2008, fears surrounding the survival of big-name financial institutions gripped the market with distress that was also unprecedented to us at the time.

Today, the onset of COVID-19, and the extra-ordinary measures already announced to help manage the health care requirements of this global pandemic have fuelled a continuation in market volatility and a global bear market in stocks. What started out as a health crisis has quickly moved to an economic crisis and a decimation of expectations in earnings growth. As credit markets have responded with escalating yields, fears are quickly moving towards the financial ramifications of this crisis.

While global policy-makers cannot prevent a sharp economic slowdown, they are fully committed to preventing a financial crisis from the global pandemic by supporting markets through monetary and fiscal stimulus. Examples that are already in place are the intra-meeting cuts by the major central banks, including the U.S. Federal Reserve and the Bank of Canada. A number of fiscal stimulus measures have also been announced. This is critical, since it is necessary to keep businesses afloat and provide income to the millions of impacted workers. Economists have begun to move quickly to adjust economic growth expectations despite the inability to forecast the end of the extreme social distancing measures.

The Canadian Government announced an $82 billion fiscal stimulus package which includes $27 billion in direct support for individuals and companies, and $55 billion in tax deferrals for both households and businesses. BMO's Chief Economist, Doug Porter notes that, "This is a significant set of steps which, at just over 1% of GDP in direct support, should begin to help in relatively rapid fashion. We doubt that this will be the last word, and the Prime Minister suggested that the federal government stands ready to do more as needed." Canada's Minister of Finance also stated that they would do "whatever it takes to ease the situation."

The U.S. is currently considering stimulus of over US $1.8 trillion, including the possibility of direct cheques to all adults below a qualifying income threshold. The rescue package is currently in limbo as Senate negotiations continue between Democrats and Republicans. In further support, the Federal Reserve also announced a major expansion in market intervention to support the liquidity and functioning of credit markets with commitments to purchase an unlimited amount of Treasury and mortgage securities.

During this volatility, our investment teams remain focused on their investment discipline, adjusting portfolios where they see opportunity. In the early days of a swift market sell-off, securities sell off indiscriminately where there is the most liquidity and, thus, valuations become temporarily disconnected from the fundamental value of the underlying business. For those investors that have a proven process for choosing great investments, with the benefit of time and patience, superior returns can be realized.

Looking at over one hundred years of market history, some facts are undeniable. First, the stock market typically leads the real economy by approximately six months, so stocks will begin to recover before official economic data has bottomed. Second, the market is inherently "mean reverting." This means that excesses to the upside or downside typically lead to a powerful opposite reaction. The market has weathered countless wars, epidemics and other major shocks and has always managed to make significant new highs over time.

While it is likely that the environment will remain volatile for some time and more downside is certainly possible, the key to achieving your investment goals is to maintain a well-diversified portfolio across asset classes and geographies that aligns with your time horizon, risk tolerance and wealth requirements.

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