In the Eye of the Coronavirus and Oil Storm

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March brought stock markets no reprieve and the blame rests squarely with Coronavirus fears (now officially a Global Pandemic as per the World Health Organization) and the oil market share war between Russia and Saudi Arabia which started this week. Given the Canadian market's high commodity and energy sensitivity, this was a particularly unpleasant development for the Great White North.

The odds of a short recession have clearly risen in the last few weeks as Italy has practically shut down the entire country and several other countries and companies are taking preventive steps to slow the rate of infection. In particular, BMO's economics team reduced growth estimates in the last few weeks. For Canada, GDP growth in 2020 was cut to 0.5% from 1.7% (with more downside risk if oil prices stay depressed). In the U.S., the biggest cut is to their Q2 GDP call, which is now minus 2.0%. This takes the 2020 annual rate down to 1.0% (vs 1.8% pre-virus). However, the silver lining is that they expect a relatively strong rebound in 2021. As we noted a few weeks back, lower interest rates – and by extension mortgage rates – are highly supportive for the huge real estate market and consumers. A number of governments are also discussing adding fiscal stimulus to try to offset the negative impact of the Coronavirus. This means that the recovery will be all the stronger assuming COVID-19 infections begin to level off by the summer (and encouragingly, new Chinese cases have come down very sharply in the last few weeks).

So our objective with this note is not to recommend buying very economically sensitive equities immediately but rather to strongly advise against selling high quality defensive stocks in a panic. Despite the volume of bad news to which investors have been subjected recently, and the sharp reduction in growth forecasts that led to lower interest rates, we continue to think that high quality diversified portfolios are investors' best defense against these high volatility environments. Like previous shocks, the declining bond yields have provided a cushion to weaker equity markets mitigating the impact on portfolio value and performance and reinforcing the importance of diversification.

In our view, the sharp market pullback already discounts a large part of this year's anticipated economic and profit slowdown. Even more important, history has proven that the market tends to rally strongly following exogenous shocks. Since a picture is worth a thousand words, we turn our readers' attention to the "market map" on the next page which encompasses one hundred years of data and captures every war, epidemic and political upheaval that has happened in that period. Despite all these events -many of which were far more destructive than the Coronavirus has been to date- the market has ALWAYS managed to make significant new highs over time. This time will be no different.

While the environment will remain volatile for some time and more downside is certainly possible, the key is to maintain a well diversified portfolio including bonds, cash and high quality stocks. Please contact your BMO financial professional if you would like to discuss your investment portfolio.

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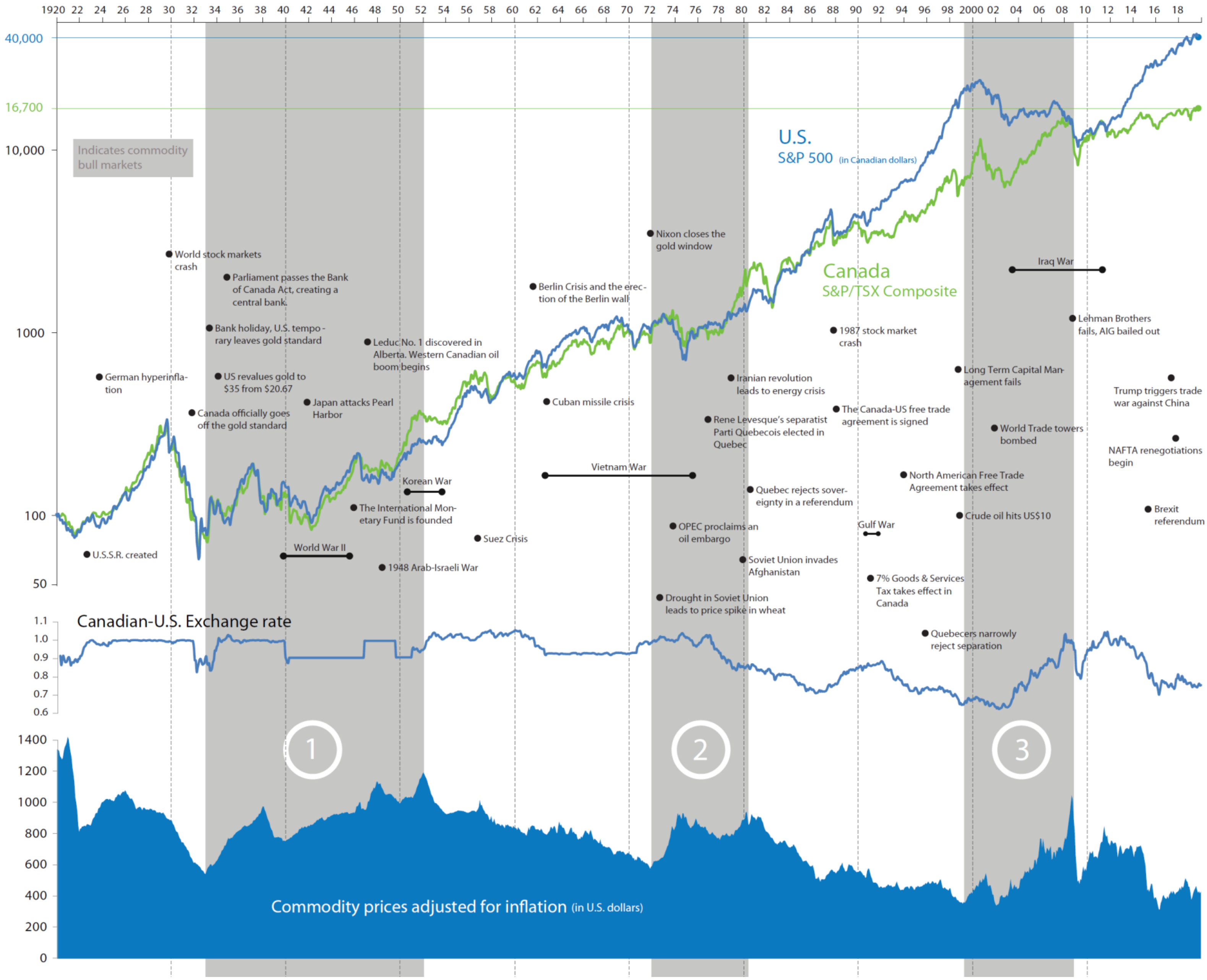
The Canadian and U.S. Stock Markets From 1920 to the End of 2019



Source: BMO Nesbitt Burns Portfolio Advisory Team

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