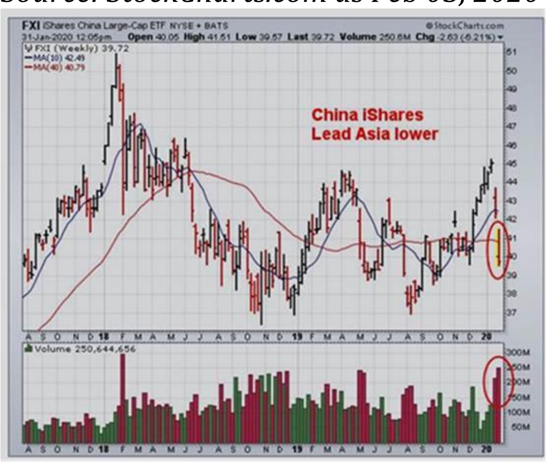
Portfolio Management
Monthly update

January 2020

Corona Virus Trigger for Pullback

FXI (iShares China Large-Cap ETF)
Source: StockCharts.com as Feb 03, 2020



Highlights

- Corona Virus taking a toll on economic growth forecasts.
- North American earnings still look good & monetary easing to increase.
- Buy on a further dip in the next few weeks.

With over 17,000 cases & 361 deaths in China, the Corona Virus has not peaked yet- The WTO feels that it will become a pandemic as it appears to spread easily like the flu, more so than SARS and MERS. The good news is that the mortality rate is similar to the flu near 2%. Because of the large numbers of people who will be infected, the numbers of deaths will be high, although much less than the global flu deaths of hundreds of thousands annually. Based on some case histories from Germany it appears that people are infectious without displaying overt symptoms & are also infectious beyond that usual recovery periods that one finds with the flu. Again there is some good news as it appears that people in the west have been exposed to the virus and not become seriously ill. As is typical with the flu it is the elderly and those with compromised immune systems who are most at risk.
With media hysteria & social media the public response will likely be overblown as will the stock markets.

Technical Comments-a minor pullback is the call- After the roughly 17% run up in the S&P 500 since the lows of September a pullback was due. The Corona Virus has provided the trigger. We are now off about 2% from the highs on the TSX & 3.4% on the S&P 500. Our technical analyst Rush Visch thinks the pullback has not done yet. He expects the TSX break its 50 day moving average back to the trend line at 16,950 down another 2.1%. The S&P is already near its 50 day moving average & he looks for 3,125 a further 3.1% drop. Despite the ugly headlines he expects the pullback to be fairly mild.

Fundamental Comments-buying opportunity soon! Strong earnings from market leaders Amazon & Apple certainly help. Brian Belski's theory that Q4 may have been the trough in earnings appears to be bearing out so far. The Corona Virus is going to hurt global growth, especially since China is such a large part of the global economy & has an outsized impact on the supply chain for many companies.

Easy Monetary Conditions- Many had been expecting a ¼% drop in the US Fed Funds rate in Q2. It may come sooner depending on global economic numbers. China is already easing with a cut in the 7-day lending rate to investment dealers to 10 bps to 2.40%, with more likely coming. And, 1.2 trillion yen was injected into the markets using reverse lending rate on Monday. Factories have been ordered to remain closed until February 10. And now, the leadership is reconsidering its 2020 growth target (which hasn't been released yet but was speculated to be around 6% after the 6%-to-6.5% range in 2019) given the damaging effects from the virus. BMO had already sliced China's Q1 GDP growth to 4.5% y/y last week, but the situation is clearly fluid.

Buy Candidates- For those with the risk tolerance there will be some excellent buys in the cyclical stocks, hit by falling economic growth forecasts. In the consumer area, airlines, hotels & Chinese focused gaming stocks are being hit hard. Air Canada is a company we will consider, as well as Disney, Royal Caribbean Cruise Lines & Wynn Casinos.

Great Chinese companies such as Alibaba & Tencent lagged US stocks in 2019. They started to move up when the trade war simmered down, but are getting hit again & look very cheap vs US comparables.

Technology stocks, especially those with Cloud exposure have been on a tear & may give us a buying opportunity. Some clients own Amazon, but we would add on weakness. Amazon lagged the other FANG stocks last year & is breaking out of a 1 ½ year base. Some of the mid-size technology issues with very high growth, such as Workday, Square & Shopify are very volatile & funds such as Fidelity Special Situations & Dynamic Power Growth are good ways to get exposure.

Health Care stocks don't have a reason to fall, except with the general market.

We still like the spending power of the **U.S. consumer and stocks**, such as Costco, Ulta Beauty & Walmart may come off with the market. Starbucks has direct Chinese exposure but could fall enough to be interesting.

Regards,

Scott Barnum, CFA
V.P. and Portfolio Manager

Don Behan, CFA
V.P. and Portfolio Manager