The Miatello Quarterly

April 2020

Let's connect

Miatello Investment Management
BMO Nesbitt Burns

Brian Miatello, CFA
Portfolio Manager

1 First Canadian Place,
39th Floor
Toronto, Ontario
M5X 1H3

Tel: 416-359-5793
brian.miatello@nbpcd.com

www.miatello.ca

Pandemic Most Foul

Aficionados of troubadour Bob Dylan will recognize the above headline riff on the artist's latest oeuvre. While Dylan focuses on the 1963 Kennedy death and resultant cultural aftermath, we will face the same but far more dire consequences with respect to COVID-19. The future changes will be substantial. Foundational will be the conception of the nation state as the protector of its citizenry. Historically, protection was meant to be against foreign enemies, but now it is also against disease. If the state is eventually judged to have failed, repercussions will be severe to the political order and to the world. Future governments, based on being the economic saviors of 08-09 and 20, will become more prevalent and important in world economies. This macro change will decrease productivity.

There are a few corporate changes that seem inevitable. Companies will need to be more resilient by diversifying supply chains, reducing leverage and short funding, and adding online services. De-globalization will accelerate. Larger companies will be better able to bear the increased costs versus smaller competitors thus reducing competition. Profit margins will increase.

It is interesting to note that the great intellectual fabrication that promoted the necessity of balanced government budgets has proven itself to be one of the biggest lies ever told. Within a few short weeks, governments, with all party support, have decided to spend massive amounts of money. If now, why not before, while our children were housed in hundred-year old schools as governments squeezed educational resources, while our long-term care for seniors was shockingly deficient, and while Canadian hospitals have the lowest per capita presence amongst developed countries? The ideology was so effective that it was promoted naively by mainstream politicians who most probably were unaware of its falsehood. You must wonder who was behind this deception.

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As a virus doesn't recognize borders, it seems obvious that global cooperation is required to address the challenges. However, the world's leading economies are moving away from global responses to any issue, and some have caused great division both internally and externally to no rational discernable national advantage. To my mind, a judgement of current failure attributed to many governmental, societal, and corporate structures would be appropriate and necessary to put the world in a better position to move forward.

In the Spotlight: Travel Stocks

Market reaction to the government fiat economic shutdown was severe. From the US market high of 3,386 on February 19th, the market declined by 33% to March 23rd. There was no place to hide in the equity markets. Everything was hit. But travel related stocks were affected most of all. In this category are hotels, casinos, travel facilitators, cruise ships and airlines. Declines in this area started at 40% and went to as much as 85% for cruise lines. At a low point, the top three cruise firms were priced in the market at $13 billion against a replacement value of their ships at $128 billion. The message was that this industry would collapse, and the ships were priced at perhaps scrap value or less.

During the debacle it was reported that Saga, a UK listed cruise company, was experiencing something quite different. When the UK government closed the company in March, the ships were 86% full. Sixty percent of the passengers immediately rebooked cruises instead of asking for refunds. They said, "Right, when can I book again?" Saga's ships are 80 percent full for this fall and early 21. Last week Saudi Arabia's Public Investment Fund revealed a new 8.2% holding in Carnival. Carnival also floated $4 billion of bonds secured against mortgages on most of the vessels at a 12% yield with 3-year maturity. The offering was at least four times oversubscribed.

I would say cruising will remain a business, but I won't be buying anything here.

Major airlines were also priced as if they were going out of business. Two major US airlines and Air Canada have solid balance sheets and great ability to reduce variable expenses. These airlines dramatically improved their operations and profitability in recent years. The US government recently announced an aid package to US carriers that, in its sophistication, shocked the street in its hardline approach. The US government will retain an option to acquire some equity in the carriers although it will be small, United at ~2.1% and Delta at ~1%, in exchange for the loan portion of the bridging financing.

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The casinos of Macau and Vegas are shuttered. At the lows, the market priced these securities as if it would be years before they ever opened again, if ever. Yes, the market believed that ten thousand years of human wagering had suddenly and permanently ceased. I would bet against that, even at long odds.

The big picture in this area is that there is tremendous uncertainty as to the closure length and subsequent reduced demand period on various companies. We acknowledge those risks. In the end, it comes down to price. If we can buy at cheap prices, and bankruptcy is a very low probability event, then we are indifferent to the time.

I'll close with this quote:

***"The gladdest moment in human life, methinks, is a departure into unknown lands."* – Sir Richard Burton**

Ask Brian

Hey Brian:

I've taken quite the hit in my portfolio. When am I going to get back my losses?

John

Dear John:

I don't know. I understand the question, but I would suggest that it is perhaps not the most useful question at this time. I think the question stems from picking the high-water mark for the portfolio and thinking that number is a solid amount in the bank account. Obviously, that was not true and in fact, never was true.

I would ask you to go back in time to when you first decided to put money into the stock market. Why did you decide to take the plunge? If it was a short-term bet in a concentrated theme, i.e., cannabis, then you have lost the bet my friend. Think tax loss selling.

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If it was excess funds to your everyday needs or funds for retirement, then in essence you have decided to commit for a multi-year period. If you are not currently withdrawing funds, then in theory you should be indifferent to the path that the portfolio takes between the starting point and the terminal date. The variability and wild swings we have been experiencing are not unusual in market history. There have been periods in the last few years where there has been utter calm. That was odd and it did lead to some complacency and forgetfulness. It is notable that Warren Buffett, one of the most successful investors over the last 50 years, has experienced short term losses of 37% in 1987 and in 1989-1990, 49% in 1998-2000, and 51% in 2007-2009. Despite these drawdowns, he achieved a compound return of 21% from 1980 to 2018. You might bear in mind that Buffet has allowed his cash to build to $128 billion, representing 20% of his portfolio. He recently stated that he doesn't like to hold the cash but has steadfastly refused to pay dividends or to substantially buy back his stock. I would not be surprised if he made significant moves in this period.

If you are currently drawing funds from your portfolio, you are presumably in a balanced account of some sort. There would be many questions around this scenario including whether the target equity weight was appropriate, the withdrawal rate and other factors. These are best addressed with an investment advisor.

I hope that helps.

Regards,
Brian

Sources: Financial Times, BMO Capital Markets, RBC Capital Markets, J.P. Morgan, Barron's, Wall Street Journal, The Globe & Mail, National Post, H. Kissinger, Stephanie Kelton

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