The Year of the Rat.

2020 Heralds in the Year of the Rat in the Chinese calendar and we wish all of our Asian clients a Happy New Year. People born in the year of the Rat are believed to be very industrious, thrifty, diligent and positive individuals.

2020 has started off much like 2019 with a fair amount of volatility in the markets, stemming largely by extraneous events. We started the year with conflict in the Middle East, the assassination of an Iranian and Iraqi military commander, the downing of an airline and then last week the outbreak of Coronavirus in China. As the old Chinese proverb says, "May you live in interesting times". Personally, I think I would settle for a couple of quarters of stability and give up the 'interesting times bit'. Just saying….

The Middle East conflict and the brief period of instability that followed ended very quickly for the markets as they seemed to shrug off the impacts and get back to economic and market fundamentals very quickly. Some of this, I believe, has a lot to do with the lessening impact and reliance on oil that the US and other countries now have on Middle Eastern oil. The US is now a net exporter of oil and the fact that there is clearly no shortage of oil in the world led to the financial markets shrugging off this incident in short order.

Now this week we are dealing with the outbreak of the Coronavirus. This virus is thought to have originated in a market that was illegally selling live wildlife in Wuhan city. This outbreak now has the markets a little riled up the last couple of days, with most global markets selling off in fear of the virus spreading and curtailing economic activity in Asia. Our Economics Department released a playbook of previous health scares like the SARS virus: Past health scares tend to follow a standard playbook for markets and the economy. The spread of the disease and rising death toll inject a sense of alarm among investors, and equity markets sell off (China's market slid 3% on Thursday). Share prices of airlines, restaurants, and hotels got notably slammed. Safe-haven buying lifts the Yen and Swiss Franc at the expense of resource-based currencies, such as the Loonie which plunged to a four-week low. Government bonds strengthen—the 10-year U.S. Treasury rate slid 10 basis points this week. Commodity prices fell in anticipation of weaker global demand. Oil prices plunged 6% this week to six-week lows on fears the virus will hammer travel in China, the world's largest energy consumer, while copper prices rode a six-day losing streak in anticipation of weaker global demand. People shop less, delay travel and stay home. Companies turn cautious and delay investments. While some of the adverse economic impact is offset by increased demand for health care services and government measures to control the crisis, the economy slows nonetheless. The Bank of Canada estimates that the SARS crisis, which hit Canada particularly hard with 44 deaths, carved 0.6 pts from (annualized) growth in the second quarter of 2003.

However, as health care authorities work to contain the outbreak and the number of new cases falls, financial markets subsequently rally and the economy rebounds. After the three earlier viral outbreaks this century, U.S. equities quickly recovered. The Bank of Canada estimates the SARS crisis reduced full-year 2003 GDP by only about 0.1%, with more than half of the initial decline regained within two quarters. The Conference Board estimates only a slightly larger 0.15% impact. Other studies have found

a similar small impact on the global economy, though some Asian countries were temporarily hit quite hard. China's real GDP growth dove from 12.2% (annualized) in 2003 Q1 to 3.4% in Q2, before snapping back to 15.7% in Q3. That rebound allowed the annual growth rate to actually strengthen by almost one percentage point to 10% in 2003. China will face the brunt of the current crisis, but, assuming it arrests the outbreak soon, the economic impact should be similarly short-lived.

It is interesting to see how in the past the markets shrugged off conflict in pretty short order and I believe the same will apply this time around to this latest outbreak. A lot of our fears are driven and fanned by the media and the media can only keep people's attention for so long before moving on to the next story. The case in point would be the Australian Bushfires, where I found myself recently asking if they were all out now? Unfortunately the sad answer is No, but since we are no longer getting the daily influx of incredible images in our inbox, we are so quick to forget and so are the markets. This too shall pass.

Here's how the S&P 500 performed after several potential Middle East flashpoints in recent decades:

Event	**Date**	**Three Months Later**	**Six Months**	
Suez Canal Crisis	10/31/1956	-3.8%	-0.1%	-11.5%
Arab Oil Embargo	10/17/1973	-13.2%	-14.4%	-36.2%
Iranian Hostage Crisis	11/3/1979	+11.6%	+3.8%	+24.3%
U.S.S.R. Invasion of Afghanistan	12/25/1979	-7.9%%	+6.9%%	+25.7%
Iraq Invades Kuwait	8/3/1990	-13.5%	-2.1%	+10.1%
Persian Gulf War	1/17/1991	+23.5%	+20.6%	+33.1%
World Trade Center Bombing	2/26/1993	+2.5%	+4.0%	+6.4%
9/11	9/11/2001	+2.5%	+6.7%	-18.4%
Iraq War	3/20/2003	+15.6%	+17.4%	+28.4%

Outlook for 2020

Ok so now that we have dealt with the scary stuff let's talk about the coming year. It seems like 2020 will follow in 2019's footsteps, in that I expect it to be somewhat volatile and yet can only hope that it is not as volatile as 2019, as it will likely be affected by different factors than the previous years. 2019 was characterised by large swings in the market, as the world economy starred down the face of a global recession, which was heightened by the bruising trade war between the US and China. That in turn forced the Central Banks to cut interest rate and US Fed to do a 180 degree turn and cut interest rate, three times to provide support to a weakening global economy.

As we have come to see over the years, Central Banks have become increasingly powerful in moving the markets and their policies are closely scrutinized and hugely impactful to the daily movement of the stock and bond markets. So now that the Trade War is somewhat settled, 'at least for now', and the global economy has breathed a much needed sigh of relief, it should take the pressure off of the Global Central Banks for the next little while. The problem though is that Central Banks have become increasingly powerless to fight deflation and get inflation back into their 2% target range. We are 10 years in from the 2008 Great Recession and still interest rates hover at zero in large parts of the world.

In North America we have positive interest rates but still at very low levels. Given the strength of the US economy how is this possible? You have record low unemployment in the US, a consumer that is doing well, stable and strong housing prices and yet no inflation and record low interest rates?

We have spoken of this phenomena before and argued that it truly is 'different this time', as we rewrite the economic text books. We were told that when Central Banks, 'print money' it leads to inflation and yet here we are with record low interest rates. The culprit for such low inflation is largely based in technology, which makes everything we do easier and cheaper to accomplish from manufacturing to using your phone. The difficulty the Central Banks face is that the world is awash with debt and cheap credit and yet with no signs of inflation they cannot raise interest rates without risking blowing up the whole system.

There is also the double problem that 10 years after 2008 we are still dealing with low global economic growth, which is especially evident in Europe. One of the few weapons that the Central Banks have to increase growth is lower interest rates. But now what? Take for example the Coronavirus outbreak and the impact that it is likely to have on China's growth this quarter, which in turn is likely to affect the US economy. What if Canada's growth also drops, will the Bank of Canada be forced to cut interest rates? Probably and so here we go again as Central Banks struggle to find the means to raise interest rates.

With even a slight increase in rates, an already overstretched consumer is at risk of defaulting on their debt. When default rates rise, the banks get very nervous and the contagion affect is very real as we found out in 2008. Yet today we have a lot more debt in the system than we did in 2008. This is a long way of saying that the Central Banks hands are tied, as they are trapped in a Negative Feedback Loop. Raise rates and they cause a recession, don't raise rates and the world gorges on more credit and debt. When the next recession does come, then the Central Banks have less ammunition to fight it as they cannot lower rates below zero. As much as they would like to raise rates to give themselves a cushion, they cannot do so.

Ok so how does this tie into the market and what do we do with your investments in 2020?

What we have started to see in the last couple of months is that the market has begun to realize that there is the real chance that Central Bank interest rates get closer to zero in North America over the coming years. Global investors are suddenly starting to look at US and CDN Bonds and their positive yield of around 2.7% and realize that this is a pretty juicy relative yield, especially if interest rates continue to go lower.

As this realization gathers steam, investors are starting to look at other long term assets with stable cash flows that pay dividends with greater and greater interest. Think utilities, real estate investment trusts, infrastructure projects, pipelines and waste services. Investors look at these sectors and stocks with their 3% or more dividend yield and they want a piece of it. If interest rates go lower and/or we go into a recession, that positive cash flow is going to be key, especially if the companies can continue to pay those dividends and are not overextended with debt.

In the market this has been evident in that we see investors chasing the above mentioned sectors and pushing multiples and share prices ever higher in search of that positive dividend yield. We have also seen bonds rallying even on days when the stock market is up strongly. We recently tried to purchase a small amount of bond for a client and was unable to get a fill price, as demand was so strong and we could find no sellers at even a half reasonable price and this was to try and get a yield of 3% over 4

years. So investors are willing to lock in 3% return for 4 years as they believe interest rates go lower, as do we. We have positioned our portfolios accordingly a number of months ago with good bond allocations and good dividend yields in the vast majority of our stocks. We are looking to play the long game and think we are likely to see interest rates lower this coming year and increasing demand for those stable cash generating assets. We also feel that these investments are likely to be less volatile, as investor demand is so strong for these assets. This is definitely not the 'sexy' side of the market… for example, owning two waste removal companies is definitely not like owning some 'Hot Tech Stocks'. It all comes back to our Philosophy and our Investment Mandate, which is to protect your capital and produce steady consistent returns, without chasing this market up and down.

Technology

It's one of our favorite subjects and have said many times any business that does not embrace technology will not be in business in the coming decade. So as per our comment above we believe Technology is a major disrupter of everything we do and will lead to a new economic reality as it rewrites the text books. As much as investors are looking at bonds and dividend yields, they are also putting more and more emphasis on certain technology companies that are driving developments in every sector of the economy.

These companies pay little to no dividends and yet represent the future of our economy. They are the great railroad companies of yester-year that helped North America develop. Think infrastructure yet over the web. The demand for ever increasing tech solutions, chips, processors, software and every other aspect of technology will continue unabated for decades to come. The problem for us is that investing in this sector comes with some volatility. Case in point we own a lot of Amazon and have done for years. The stock reported earnings on Friday 31st of January and on a truly ugly day in the markets with Coronavirus taking centre stage and the DOW down 600 pts, Amazon stock soared 9%. Yet last year Amazon was down -13% from its high and did not much of anything for us as the market ripped higher. So Tech investing will remain a cornerstone for us in portfolios this year and in the years to come, though we will tend to be a little more conservative in our application in order to try and minimize the associated volatility that comes with this sector. There is also the small issue that the Tech Titans like Microsoft, Amazon, Google, Facebook now make up close to 20% of the S&P500 index and so their performance is more and more likely to impact the whole market in any given cycle, hence the need to tread carefully as we invest in this sector this coming year.

Currency

Currency trading is a zero sum game and something that is impossible to predict. Last year the CDN $ appreciated by over 5% against the US $ as the Bank of Canada failed to cut interest rates while most other Central Banks cut rates to boost growth. This month, as Canada's growth slows and oil prices fall further it looks increasingly likely that the Bank of Canada may be forced to cut interest rates to boost growth and so the CDN $ starts to fall back again and now trades back below $0.76.

If this Coronavirus takes another bite out of global growth and a further hit to demand for Canada's commodities, then we could see the Bank of Canada cut rates further and consequently we could see the CDN $ back below $0.74 to the US $. Trying to time these movements is very difficult and so we remind our clients that once we change CDN $ into US $ to invest in the US market we keep it in US $. We are intent on investing in the US market in order to gain access to global leaders like Microsoft and Amazon to name just a few. We believe that over time these investments will pay off handsomely and the returns will far outweigh the currency fluctuations between the US and CAD $.

The difficulty of course is that when the CAD $ is stronger it devalues our US $ holding and vice versa, which of course skews portfolio value and performance numbers when all the holding are converted back into CAD $ on your statements.

Environment

I have often described myself as a pragmatic environmentalist when people have asked. I drive a car, need gas and require many of the products to live my life that the petro-chemical complex spits out. Having said this, I think there is a sea of change underway as finally the globe and the politicians awaken to risks and the long term impacts that climate change has brought about. Unfortunately it might just be the Australian fires that are the catalyst needed to implement change. Australia has often been called the 'Canary in the Coal Mine,' as economic events that occurred there were often felt months before the rest of the world.

With these fires, we see the devastating effects on all aspects of their economy and lives. The events there are also likely to lead to political change and more willingness to change the way that all Australians lead their lives. Alongside this we are seeing increasing awareness and pressure in the investment community around climate change. As we all know, money is a major motivating factor and finally the money is starting to talk. Much like technology, companies that fail to invest, address and or plan for the growing awareness around climate change are unlikely to stay in business in the coming decade. Just because things have been done a certain way does not mean that they should continue to be done that way. The same applies to investing, do we need to own energy company shares or plastics companies that fail to change the way they do business? These changes are going to change the way capital flows and the access to capital that companies require. I found the letter below very interesting as it comes from one of the largest Asset Management companies in the world that controls billions of dollars and was sent out to every client and employee and posted on the web. We endorse very much what Larry Fink lays out below and those same sentiments will be increasingly driving the decisions that we make, when investing in companies in your portfolios.

The letter below is from Larry Fink, CEO of Blackrock Asset Management: Jan 2020.

Dear CEO,

As an asset manager, BlackRock invests on behalf of others, and I am writing to you as an advisor and fiduciary to these clients. The money we manage is not our own. It belongs to people in dozens of countries trying to finance long-term goals like retirement. And we have a deep responsibility to these institutions and individuals – who are shareholders in your company and thousands of others – to promote long-term value. Climate change has become a defining factor in companies' long-term prospects.

Last September, when millions of people took to the streets to demand action on climate change, many of them emphasized the significant and lasting impact that it will have on economic growth and prosperity – a risk that markets to date have been slower to reflect. But awareness is rapidly changing, and I believe we are on the edge of a fundamental reshaping of finance. The evidence on climate risk is compelling investors to reassess core assumptions about modern finance. Research from a wide range of organizations – including the UN's Intergovernmental Panel on Climate Change, the BlackRock Investment Institute, and many others, including new studies from McKinsey on the socioeconomic

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implications of physical climate risk – is deepening our understanding of how climate risk will impact both our physical world and the global system that finances economic growth.

Will cities, for example, be able to afford their infrastructure needs as climate risk reshapes the market for municipal bonds? What will happen to the 30-year mortgage – a key building block of finance – if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas? What happens to inflation, and in turn interest rates, if the cost of food climbs from drought and flooding? How can we model economic growth if emerging markets see their productivity decline due to extreme heat and other climate impacts?

Investors are increasingly reckoning with these questions and recognizing that climate risk is investment risk.

These questions are driving a profound reassessment of risk and asset values. And because capital markets pull future risk forward, we will see changes in capital allocation more quickly than we see changes to the climate itself. In the near future – and sooner than most anticipate – there will be a significant reallocation of capital.

Climate Risk Is Investment Risk
Over time, companies and countries that do not respond to stakeholders and address sustainability risks will encounter growing skepticism from the markets, and in turn, a higher cost of capital. Companies and countries that champion transparency and demonstrate their responsiveness to stakeholders, by contrast, will attract investment more effectively, including higher-quality, more patient capital.

Accountable and Transparent Capitalism
Over the 40 years of my career in finance, I have witnessed a number of financial crises and challenges – the inflation spikes of the 1970s and early 1980s, the Asian currency crisis in 1997, the dot-com bubble, and the global financial crisis. Even when these episodes lasted for many years, they were all, in the broad scheme of things, short-term in nature. Climate change is different. Even if only a fraction of the projected impacts is realized, this is a much more structural, long-term crisis. Companies, investors, and governments must prepare for a significant reallocation of capital. In the discussions BlackRock has with clients around the world, more and more of them are looking to reallocate their capital into sustainable strategies. If ten percent of global investors do so – or even five percent – we will witness massive capital shifts. And this dynamic will accelerate as the next generation takes the helm of government and business. Young people have been at the forefront of calling on institutions – including BlackRock – to address the new challenges associated with climate change. They are asking more of companies and of governments, in both transparency and in action. And as trillions of dollars shift to millennials over the next few decades, as they become CEOs and CIOs, as they become the policymakers and heads of state, they will further reshape the world's approach to sustainability.

As we approach a period of significant capital reallocation, companies have a responsibility – and an economic imperative – to give shareholders a clear picture of their preparedness. And in the future, greater transparency on questions of sustainability will be a persistently important component of every company's ability to attract capital. It will help investors assess which companies are serving their stakeholders effectively, reshaping the flow of capital accordingly. But the goal cannot be transparency for transparency's sake. Disclosure should be a means to achieving a more sustainable and inclusive capitalism. Companies must be deliberate and committed to embracing purpose and serving all

stakeholders – your shareholders, customers, employees, and the communities where you operate. In doing so, your company will enjoy greater long-term prosperity, as will investors, workers, and society as a whole.

Conclusion

As always, we hope that you enjoy our newsletter and hope that it puts what we do into perspective in relation to the markets and the decisions that we make when investing your hard earned capital. Please be reminded as always that as we approach tax season we will be mailing out your tax packages in the coming months. Many of the tax slips can be accessed online through the Gateway access. If you need assistance please reach out to Samantha or Kenzy for help.

As always please **DO NOT FILE** before April as the last tax slips are not issued until the end of March. In keeping with our greater concern on the impact to our fragile environment we will not be mailing out Portfolio Reports for your holdings as of Dec 31st. Please reach out to any one of us and we can send you a softcopy via encrypted email that is protected.

All the best from all of our team members.

Greg, Jed, David, Marion, Lili, Kenzy & Samantha

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