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The way forward

Making sense of the Q1 economic shock
From record highs to a sudden bear market - what a difference a month makes!

On February 19, the S&P 500 Index—the benchmark for U.S. equities—reached an all-time high of 3,386, Senator Bernie Sanders was the front runner to win the 2020 Democratic nomination, and investors were evaluating the extent to which the Coronavirus would create supply chain disruptions. Fast forward a month and a bit, the S&P 500 Index sits 24% lower, Joe Biden is now the front runner, and hundreds of millions—if not billions—of global citizens are self-isolating in their homes.

The market collapse has been broad-based and not limited to any one country. In Canada, the S&P/TSX Composite Index fell from the high reached in January for a year-to-date return of -21.6%. The volatility in Canadian stocks has been amplified by the 66% percent drop in the price of oil as measured by the West Texas Intermediate (WTI) price per barrel of crude. WTI started the year at US$61.06/bbl and ended the month of March at US$20.49/bbl. In the United States, the S&P 500, Dow Jones, and Nasdaq Price indices were down by -20.0%, -23.2%, and -14.2%, in U.S. dollar terms, respectively. In overseas markets, international equities were down -23.4 percent in U.S. dollars as measured by the MSCI EAFE Price Index. It's not just the magnitude at which the sell-off has taken investors by surprise, it's the speed. It took just 22 days for the S&P 500 Index to fall -30% from its record high. The fastest drop of this magnitude in history.

Avoid a fool's errand
There are two investing activities that offer little to no hope of success:

1. **Selling high quality stocks, at these levels, based on fear.** Dalbar, a company that studies investor behavior and analyzes investor market returns, found that the average investor earned below-average returns over a period of 20 years. Investor behavior is often irrational during market selloffs as decisions are based on emotion.
2. **Trying to call a stock market bottom.** As of March 31, 2020, global equity markets as measured by the MSCI World Price Index in U.S. dollars are down -21.4% from their record highs. For context, the recession of 1973/1974 and the Great Financial Crisis of 2008/2009 saw economic output measured by Gross Domestic Product drop -3.2% and -5.1% respectively. In those periods, markets fell by -48.2% percent and -56.8%, respectively.

The impact on the broader economy over the short term will likely mirror a severe recession, and history would suggest there may be more downside to the equity markets. However, given the magnitude of the selloff, financial history also suggests we are closer to the later stages of this downturn as opposed to the early or mid-stages.

The way forward
Conditions are ripe for a material snap-back for the global economy and capital markets but volatility in the stock markets has yet to materially impact the credit markets. Dislocations of the banking system in 2008/2009 led to the worst recession since the Great Depression. This time around, central banks around the world are acting preemptively, faster, and more decisively with monetary policy tools. The U.S. Federal Reserve has essentially pledged to do whatever it takes to ensure liquidity in the financial markets, including but not limited to:

- Lowering their overnight interest rate to near zero, and
- Investing directly in investment grade corporate bonds and investment grade bond ETFs—something they have never done before.

On the fiscal side, governments have also increased their support in the face of large job losses, giving leeway in terms of loan payments in attempts to support quarantined workers. In the short-term, fiscal policy will provide a

cushion for those who are economically affected. In the long term, corporations and consumers will be shielded from extreme financial hardship, facilitating a recovery afterward.

> ***"When others are greedy, I'm fearful and when others are fearful, I get greedy."***
> -Warren Buffet

Investing during times of economic downturn is often challenging for the fearful investor. At the same time, others may look for opportunities. But now is not the time for greed. Now is the time for **calculated decision making**.

The markets have historically provided an investment golden nugget—once a decade. During the severe recession of 1973/1974, sky high oil prices from the OPEC oil embargo and the Vietnam War created fear. During the blow up in the dot.com era, it was the destruction of the new economy and 9/11. In the Great Financial Crisis of 2008/2009, it was the potential collapse of the financial system and housing market. Today, it's a virus that in a matter of a months has spread around the world.

What does it mean to be calculated?
Remove emotion from your decision making. Continue to be disciplined with your asset allocation. Don't sell quality investments at a loss. Consider dipping your toe into equities and taking advantage of the volatility.

We are given only a handful of golden nuggets during our investment lifetimes. Make sure you don't waste them.

As always, if you have questions about the markets or your investments, I'm here to talk.

Regards,

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