GUARDIAN CAPITAL

Economic Outlook

SUMMARY

- The COVID-19 pandemic has dealt a historic shock to the world economy, with Q1's decline alone comparable to the peak-to-trough decline in the worst recession before the 2008/09 financial crisis. At the same time, the anticipated cumulative 12% drop for the G7 in the first half of this year more than doubles the hit from that historic downturn a little more than a decade ago.
- The heightened concern and pessimism over the current situation permeated into expectations for growth; however, these downbeat views largely neglected to take into account what actually happened to the global economy.
- The fact that the downturn, sharp as it is, is the result of an exogenous shock to the supply-side of the economy rather than structural issues impacting demand, making it very different from previous experiences. Typically, in scenarios of this kind, activity can normalize fairly quickly once those external forces subside, resulting in a rapid 'V'-shaped rebound in momentum.
- Indeed, data covering everything from housing to consumer spending to construction to industrial production across the globe are exhibiting a conspicuously sharp inflection from the lows registered amid widespread shutdowns in April.
- There is still plenty of ground to make up before we can consider things are 'good' in an absolute sense. How the recovery progresses from here depends on whether or not the rolling back of emergency measures to stem to the spread of infection can continue unabated — a process that is being complicated by the accelerating spread of infection in the US and major EM economies.
- To the extent that the non-zero odds of a renewed large-scale lockdown can be diminished — for example, by indications that the contagion is coming under control, or there is progress on the development of therapeutics — that would present upside risks to the outlook. It still appears that the balance of risks is tilted in this direction.
- As such, risk assets appear primed to continue on their road to recovery from their crisis lows, as investors continue to pare the undue weight assigned to the worst-case scenario outcomes.

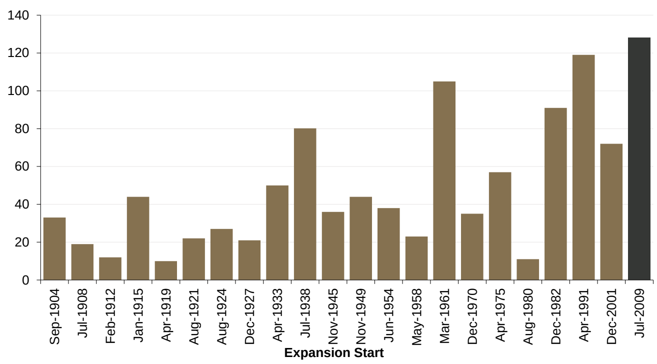
To 'V' or not to 'V', that is the question

While it was broadly assumed to be the case when the global economy went into lockdown on June 8, the National Bureau for Economic Research's Business Cycle Dating Committee (the arbiters of the economic cycle) officially declared that the economy entered recession in March.

That declaration formally ended the expansion that began in July 2009 and closed the books on the longest stretch of continuous growth on record.

CHART 1: IT WAS GOOD WHILE IT LASTED

Duration of US Economic Expansions
(months)



Source: National Bureau of Economic Research, Guardian Capital

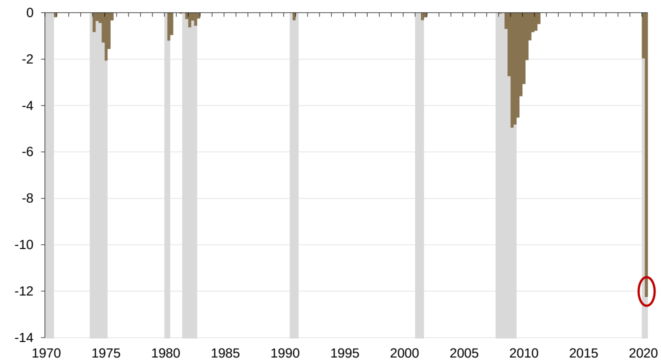
One record clearly deserves another. All indications suggest that the decline in activity that resulted from the shuttering of large swaths of the global economy (in an effort to mitigate the spread of COVID-19 and reduce its human cost) is of a magnitude never before seen.

The aggregate real output from the G7 economies (Canada, France, Germany, Italy, Japan, the UK and US) is estimated to have contracted 2% over the first three months of 2020; and is forecast to have plunged by a record 10% in Q2 (which will make headlines as a nearly 40% annualized quarterly decline).

For some context, Q1's decline alone is comparable to the peak-to-trough decline in the worst recession for the group before the 2008/09 financial crisis. At the same time, the anticipated cumulative 12% drop in the first half of this year more than doubles the impact from that historic downturn just over a decade ago.

CHART 2: A RECORD-BREAKING DIVE

G7 Real GDP Drawdown from Peak
(percent)

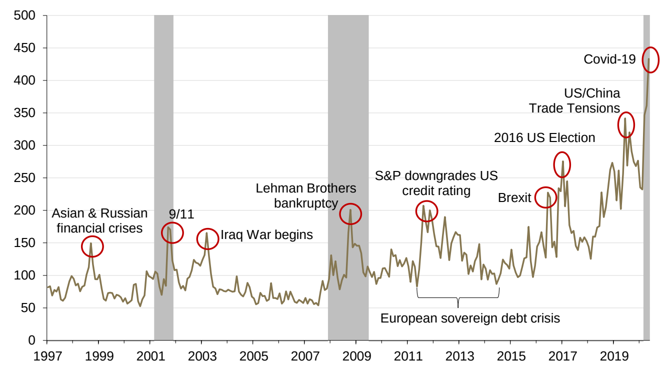


Shaded regions represent periods of US recession
Source: OECD, IMF, Bloomberg, Guardian Capital

The unprecedented hit to the global economy, and the associated historically elevated levels of uncertainty, led fear to become the dominant emotion. This fear triggered a spike in financial market volatility that coincided with the quick and sharp sell-off in risk assets stopping the 11-year equity bull market, dead in its tracks.

CHART 3: WE LIVE IN UNCERTAIN TIMES

Global Economic Policy Uncertainty Index
(index)



Shaded regions represent periods of US recession
Source: PolicyUncertainty.com, Bloomberg, Guardian Capital

The heightened concern and pessimism permeated into expectations for growth: would the future trajectory be "\"-shaped, where activity continues to plunge toward zero; 'L'-shaped with the recession morphing into a long period of stagnation; or 'U'-shaped, where that stagnation eventually gives way to a rebound once a cure for the coronavirus was developed down the road?

These downbeat views, however, largely neglected to take into account what actually happened to the global economy.

First of all, not all economic contractions are cut from the same cloth. The duration of a recession and how long it takes for a recovery to take hold are entirely dependent on what caused the downturn.

Driving the last two global recessions were significant imbalances in the marketplace: the tech bubble around the turn of the millennium and the housing and credit bubble in 2007/08, both of which were popped by the tightening of monetary policy.

The speed of the rebound from these types of slumps depends on how long it takes imbalances to get back into balance — and that can mean a long and drawn out period for demand to recover. Such was the case in the aftermath of the housing market crash that left most banks (the grease in the economic cogs) in need of serious healing, and many households in rough financial shape.

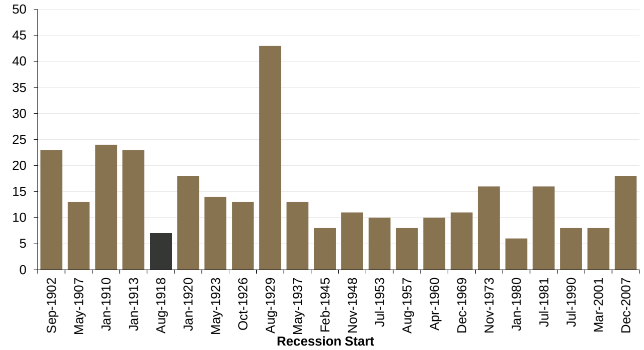
In contrast, a downturn that results from an unforeseen event like a natural disaster or public health crisis results in a supply-side shock. In these circumstances, demand has not necessarily been eroded but there are sudden outside factors inhibiting the ability of business to return to normal.

As such, activity is able to normalize fairly quickly once those external forces subside, resulting in a rapid 'V'-shaped rebound in momentum. The bulk of displaced labour has been effectively furloughed instead of fired and is able to step back into their old jobs as soon as the "all clear" has been signaled.

This is the typical experience for economies hit by hurricanes, tornados and earthquakes. It also echoes what played out in perhaps the most comparable situation to the current: the Spanish flu pandemic that infected nearly a third of the world's population, killing 40 million people globally, and inducing a downturn in 1918/19, which stands among the shortest recessions on record.

CHART 4: DOWN BUT NOT FOR LONG

Duration of US Recessions
(months)



Source: National Bureau of Economic Research, Guardian Capital

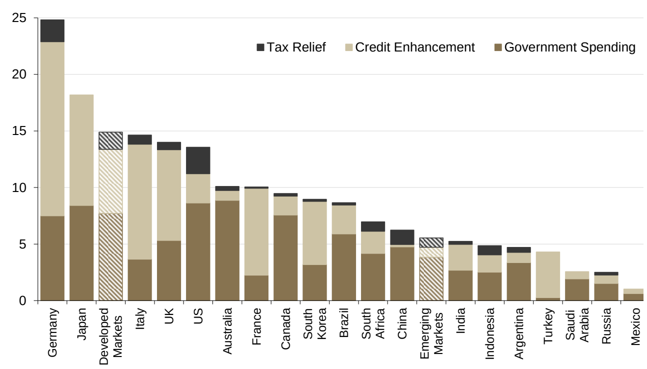
Secondly, the expectation that conditions would only continuously deteriorate ignored the role of policy.

In times of economic crisis, policymakers on both the fiscal and monetary side typically step in to try to blunt the impact of the collapse of private demand and provide a general backstop for the economy. This time was no different — though it was quite different in terms of the speed and magnitude with which these official bodies acted.

Since March, governments across the G20 economies have pledged nearly $8 trillion (11% of G20 GDP) in fiscal support from programs, including direct payments for individuals, to loans for businesses and infrastructure investments. There is considerable variation across countries though, with the major Developed Market (DM) committing nearly 10 percentage points more of their GDP in support than their EM counterparts.

CHART 5: LET'S GET FISCAL

Announced COVID-19 Fiscal Response, G20
(percent of gross domestic product)

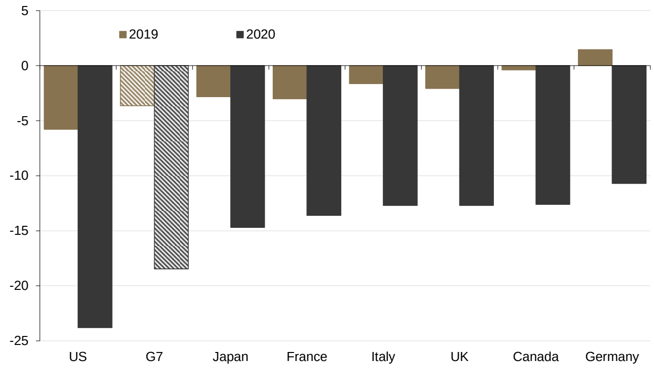


Source: Center for Strategic & International Studies, IMF, Guardian Capital

While emergency measures are warranted to help keep economies afloat through the forced sidelining of activity, the associated substantial deterioration of fiscal balances, and resultant surge in public debt, will undoubtedly prove to be a burden that will need to be addressed down the road. That means either reduced public spending, increased taxes or both — policies that will provide an unambiguous drag on future overall economic growth.

CHART 6: IMBALANCED BUDGETS

Gross General Government Fiscal Balance
(percent of gross domestic product)



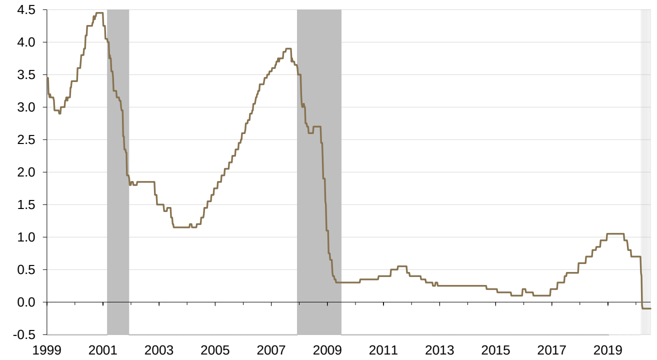
** 2020 forecasts from IMF's June 2020 World Economic Outlook*
Source: Bloomberg, International Monetary Fund, Guardian Capital

For now (and the foreseeable future), however, the cost of carrying that growing debt burden is far from onerous thanks to central banks worldwide slashing interest rates to never-before-seen levels.

The US Federal Reserve (the Fed), Bank of England (BOE), Bank of Canada (BOC), Reserve Banks of Australia (RBA) and New Zealand (RBNZ), and Norway's Norges Bank have all cut their policy rates to their effective lower bounds. The net result has been that the weighted-average short-term interest rate for the group has fallen by nearly 100 basis points from February's levels and into previously uncharted negative territory.

CHART 7: LESS THAN ZERO

Aggregate Central Bank Short-Term Policy Rate*
(percent)



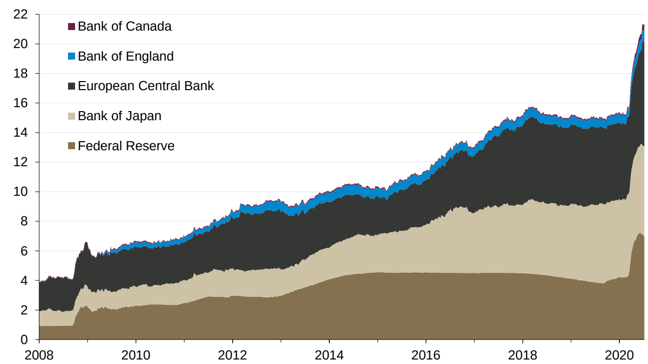
**GDP-weighted average policy rate of 11 Developed Market central banks*
Shaded regions represent periods of US recession
Source: Bloomberg, International Monetary Fund, Guardian Capital

Monetary authorities have also re-opened their unconventional policy toolkits, implementing numerous lending facilities and restarting (or introducing for the first time) asset purchase programs (they also broadened the scope of those programs). These programs pumped liquidity into the financial system, and eased dislocations in funding and credit markets; helping prevent the public health crisis from turning into a financial crisis.

As a result, central bank balance sheets have expanded by nearly $6 trillion since February — for some context, it took more than five years for balance sheets to expand by this magnitude during the financial crisis.

CHART 8: HERE WE GROW AGAIN

Central Bank Balance Sheets
(trillions of US dollars)



Source: Bloomberg, Guardian Capital

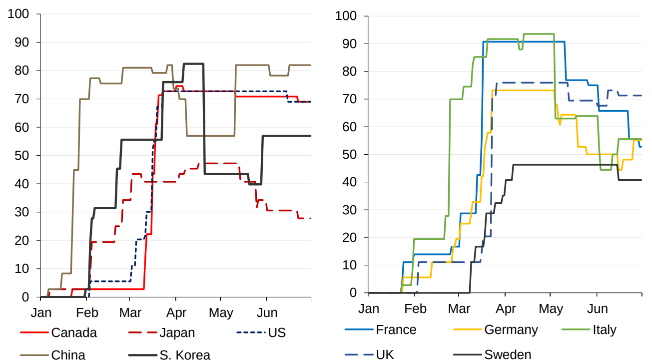
Taken together, this represents an unprecedented degree of policy stimulus that has so far created an unambiguously positive effect on economic activity.

A funny thing happened on the way to the economic apocalypse

While the pandemic is still far from over, many countries' success in slowing the spread of infection and mitigating the strain on their healthcare systems has permitted policymakers to scale back the stringent measures put in place and start to reopen their economies. Though the bulk of social distancing initiatives remain in place, broad reductions have occurred from their peak levels.

CHART 9: EXTREME MEASURES

Government Response Stringency Index*
(index)

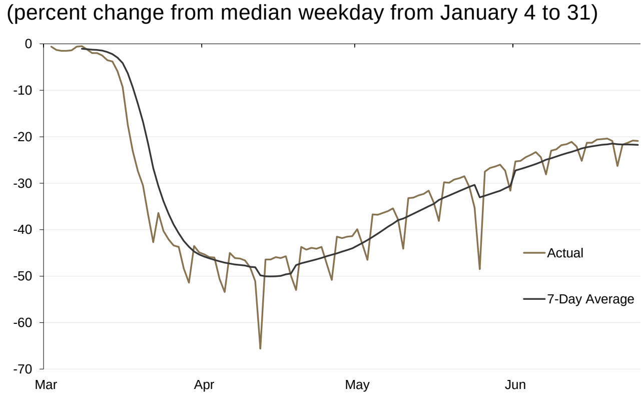


*The Stringency Index is a composite measure calculated as the simple additive score of seven indicators measured on an ordinal scale, rescaled to vary from 0 to 100; the indicators are school closings, workplace closings, public event cancellations, public transport closures, public info campaigns, restrictions on internal movement, and international travel controls
Source: Oxford COVID-19 Government Response Tracker; Guardian Capital

As restrictions on activity have eased, many businesses have been able to re-open over the last two months. For example, it is estimated about 60% of shuttered small businesses in the US have reopened by the end of June.

CHART 10: BACK IN BUSINESS

US Local Businesses Open
(percent change from median weekday from January 4 to 31)

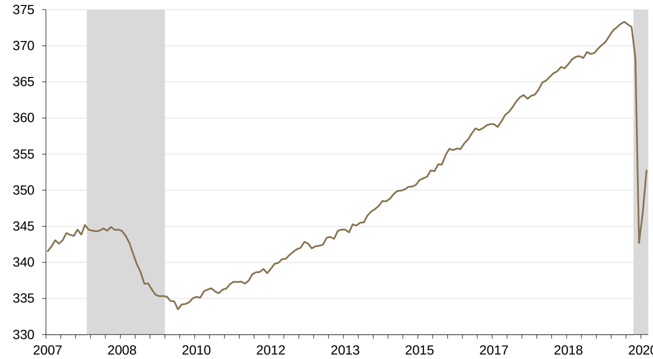


Source: Homebase, Bloomberg, Guardian Capital

With this, workers have been able to return to their places of employment. The official job market data available through June indicate that the G7 economies have already recovered one-third of the jobs lost in March and April.

CHART 11: BACK TO WORK

G7 Total Employment
(millions)



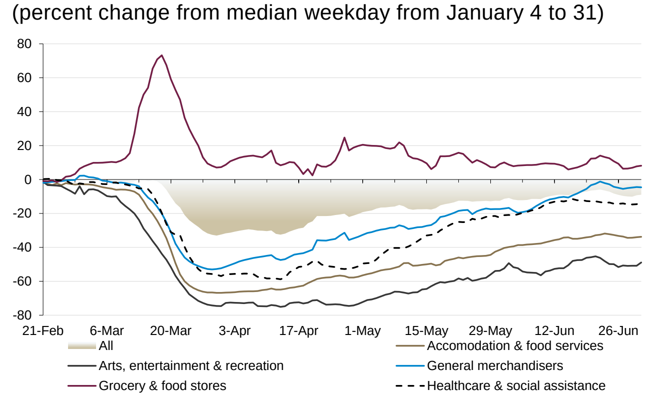
Source: Bloomberg, Guardian Capital

Of course, the ebbing of supply-side constraints does not matter all that much if customers are either unable or hesitant to return. On that score, however, the high frequency data have been almost uniformly encouraging.

At the end of June, consumer spending in the US was just 9% below its pre-crisis levels. However, there is understandably, considerable variation across categories, with those areas still under tight restrictions (arts & entertainment and food services & accommodation) lagging while other segments (namely grocers and general merchandisers) are effectively already back to normal.

CHART 12: CONSUMERS CONSUMING

US Consumer Spending
(percent change from median weekday from January 4 to 31)

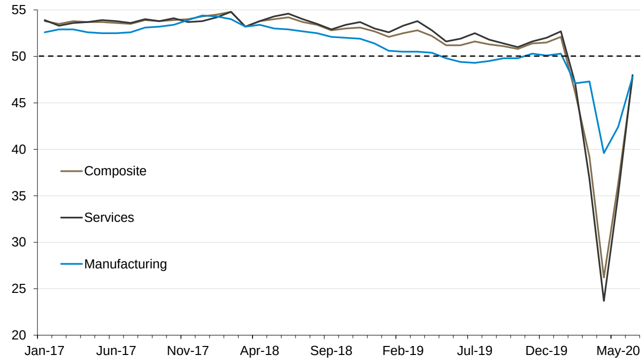


Source: Affinity Solutions, TrackTheRecovery.org, Guardian Capital

More broadly, activity in both the goods-producing and service-providing sectors of the world economy has perked up sharply over the last two months as evidenced by the rebound in the bellwether global purchasing managers' indexes. Every component country that makes up the aggregate gauge of economic momentum has registered an improvement in the last few months, so this is a story of synchronous improvement rather than a few countries skewing the measures.

CHART 13: 'V'ERY QUICK TURNAROUND

Global Purchasing Managers' Indexes
(index; >50 denotes expansion)



Source: Bloomberg, Guardian Capital

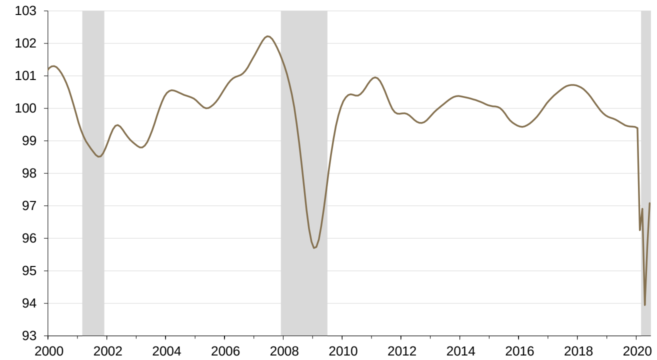
Note the distinctive 'V'-shape evident in the line chart of these indicators.

In fact, data covering everything from housing to consumer spending to construction to industrial production across the globe are exhibiting a conspicuously sharp inflection from the lows registered amid widespread shutdowns in April.

The aggregated, composite leading economic indicator for the 36 industrialized economies of the Organisation for Economic Cooperation and Development (OECD) and six other major emerging economies, has posted its biggest jump on record in the two-months to June.

CHART 14: LEADING THE WAY FORWARD

OECD+ Composite Leading Economic Indicator
(index; >100 denotes above trend growth)



Shaded regions represent periods of US recession
Source: OECD, Guardian Capital

How is the outlook looking?

The gap between economic output and its previous peaks has narrowed; however, there is still plenty of lost ground to make up. Things are getting better for sure, but still not in a place, we can consider 'good' in an absolute sense.

Should the resumption of activity continue on its current trajectory, there is upside risk to growth as hopes of a 'V'-shaped recovery are realized.

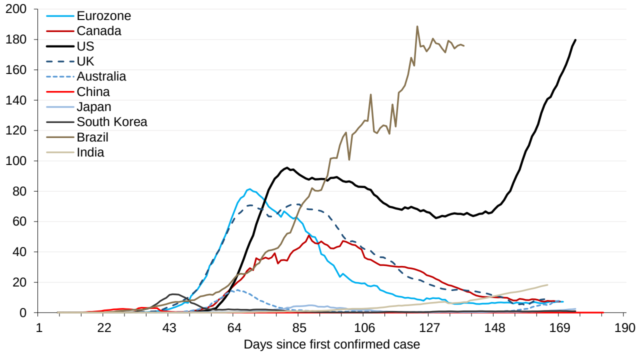
For such a scenario to play out, however, the stringent measures put in place by governments around the world need to continue to be rolled back and permit consumers and businesses to return to something akin to 'business as usual'.

That is becoming increasingly difficult amid signs that the spread of COVID-19 is escalating aggressively in not only several major EM economies (most notably Brazil), but also the more economically important US.

CHART 15: TWO ROADS DIVERGED…

New Confirmed Cases of COVID-19

(case per million people, seven-day moving average)



Data to July 11, 2020

Source: Bloomberg, Johns Hopkins University, Guardian Capital

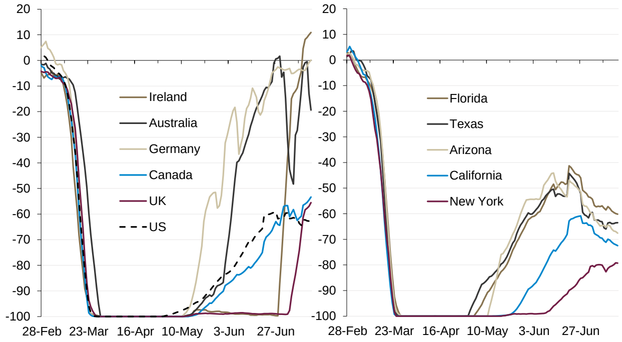
There is limited, if any, appetite for renewed lockdowns, should such measures be necessary to once again arrest the contagion in the absence of vaccines or therapeutics (which are on the horizon, but not ready yet). A renewed lockdown could stop the recovery in its tracks and increase the likelihood that the growth outlook is more 'W'-shaped.

There are already signs of economic momentum rolling over in those regions of the US that are experiencing the most severe outbreaks, such as the recent slump in restaurant reservations — no doubt in part a reflection of some areas again tightening restrictions on public gatherings.

CHART 16: HAVING SOME RESERVATIONS

Seated Diners at Restaurants on the OpenTable Network

(year-over-year percent change, seven-day moving average)



Source: OpenTable Data Centre, Guardian Capital

Such a path is not the base-case, but it is also a non-zero probability given the deterioration in conditions stateside. The potential for a repeat of what played out through March is dampening expectations and tempering enthusiasm over the growing signs that the global economy is amid a 'V'-shaped rebound.

With that said, should indications emerge that the contagion is coming under control (and there are some nascent signs of a slowing in new cases stateside), that would diminish the odds of this worst-case scenario materializing and present upside risks to the global outlook.

Managing expectations

The underlying balance of risks to the outlook clearly carries substantial importance to financial markets.

Indeed, the simplest explanation for the rapid rebound in financial markets since the end of March is that things have been playing out much better than expected. This unexpected improvement is, in part, a function of the extremely pessimistic expectations priced into the marketplace during the early and highly uncertain days of this public health crisis.

Asset valuations in financial markets (in theory) reflect consensus expectations. If everything turns out as expected, there should be no reason for a revaluation — any price changes therefore should be the result of new and unexpected information.

The onset of the pandemic was clearly an unexpected event that carried wide-ranging implications. The initial shock and uncertainty caused many investors to reprice their expectations, but entirely too much weight was put on the worst-case scenario and markets cratered accordingly.

As policymakers introduced the massive slate of stimulus measures and provided a backstop to key structural elements of the economy (namely, funding and credit markets), the anticipation of the most negative potential outcomes diminished materially. The distribution of potential outcomes shifted to the positive side as investors realized the first sharp leg lower represented an overshoot to the downside.

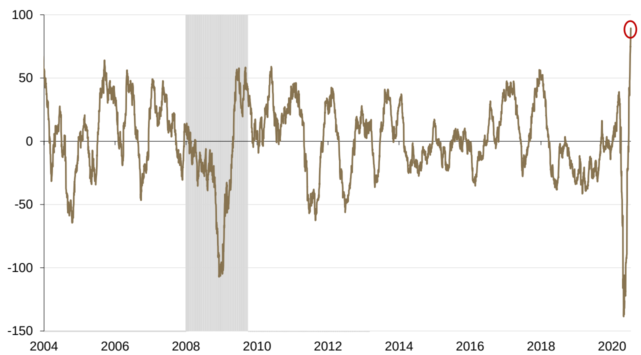
Even still, market sentiment remained overwhelmingly pessimistic. While the absolute worst was viewed as less likely, there was a complete lack of optimism over the outlook as uncertainty about both the current situation and the near future remained shrouded in fog.

These low expectations left the balance of risk still tilted to the upside and provided the scope for a bounce if developments provided a positive surprise.

Positive data surprises have become plentiful. The dataflow has so far shown that activity was actually snapping back much faster than anticipated and suggested that the worst may well be in the rearview mirror. For example, the Citi Economic Surprise Index for the G10 swung sharply and touched a record high, in a sign that economic data beat expectations by a previously unheard of degree.

CHART 17: I'VE NEVER BEEN MORE SURPRISED!

Citi Economic Surprise Index, G10
(diffusion index; >0 denotes reports exceeding expectations)

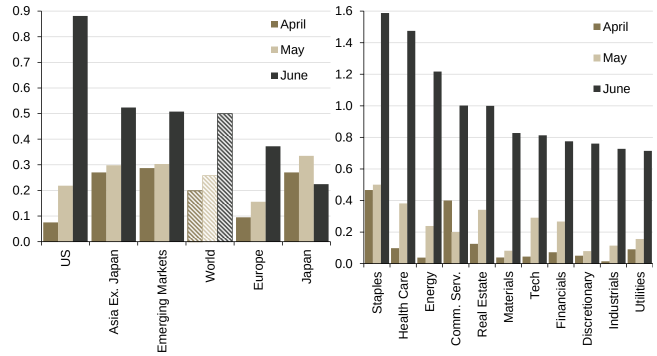


Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Accordingly, equity analysts, who initially rushed to slash their earnings forecasts, have started to backtrack and revise expectations higher. Consensus earnings per share (EPS) projections have moved off their lows, and earnings revision ratios (a measure of EPS upgrades-to-downgrades) actually improved across geographic regions and industry sectors at the closing of the first half.

CHART 18: RATIOS REVISED

One-Month Earnings Per Share Revision Ratio
(ratio of upgrades-to-downgrades)



Source: Bank of America Merrill Lynch, Guardian Capital

Against this backdrop of shifting expectations, risk assets rallied off their lows and seemingly have positive momentum entering the second half.

Born to run

The MSCI World Index finished Q2 down just 6% on the year and 10% from its all-time high, despite the broad global equity benchmark plunging 34% from its peak on February 12 — the market is up nearly 40% from its March 23 low.

CHART 19: A WILD RIDE

MSCI World Index
(index)

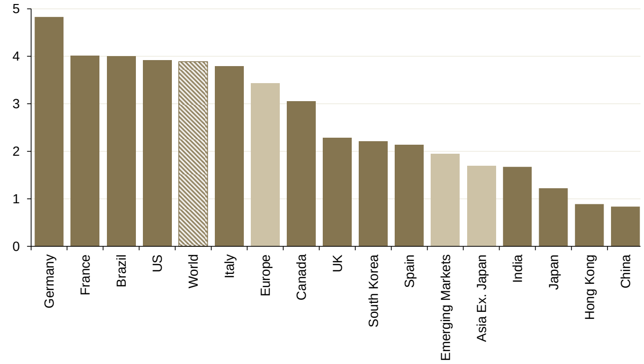
Source: Bloomberg, Guardian Capital

On the surface, this magnitude of rebound coming in the midst of a historic economic crisis could reasonably raise concern that the market has gotten ahead of itself with respect to the outlook. That would suggest there might not be much room left to run over the coming months — even if there is still 10% to go before retaking the previous peak.

Further to this, many 'traditional' valuation metrics are looking historically stretched currently. For example, the forward price-to-earnings ratio for the MSCI World Index is 23x, which is nearly *four standard deviations* above the 15-year average.

CHART 20: A LITTLE RICH FOR MY TASTE

MSCI Country Index Forward Price-to-Earnings Ratio
(standard deviations from 15-year average)



As at June 30, 2020
Source: Bloomberg, Guardian Capital

Still, that said, given the heightened uncertainty over the near-term and significantly, wider than typical confidence intervals of forecasts, these are not necessarily the useful gauges of fundamental value, as they are in 'normal' times.

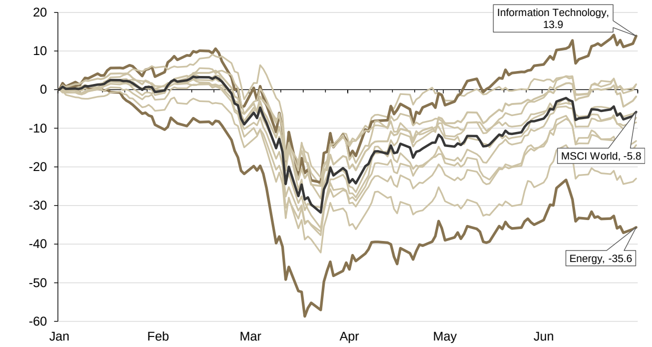
Moreover, it is important to recognize that while broad market benchmarks serves as a good enough representation of how the market is performing on average, they definitely do not tell the entire story of what is going on under the hood. The strong overall rebound has not been felt in all areas of the market.

The MSCI World Index is a market capitalization weighted average composite of the more than 1,600 stocks from 23 DM economies. It may be down just 6% for the year, but the average (and median) stock in the index is still down nearly 10% — and as of the end of Q2, one-third of the component stocks in the index are still down 20% or more year-to-date.

In other words, there has been substantial performance dispersion within the marketplace, as evidenced by the spread of year-to-date performance of the index's 11 industry sectors (and just 4 have outperformed the overall benchmark).

CHART 21: NOT EXACTLY SHARING THE WEALTH

MSCI World Sector Performance, Year-to-Date*
(percent)



**To June 30, 2020*
Source: Bloomberg, Guardian Capital

What that narrow leadership would suggest is that the market is not exactly pricing in the type of growth that will cause all segments of the economy to come roaring back. Instead, the perception is more of a mixed outlook that will result in winners and losers across sectors.

Against this backdrop, any positive developments that accelerate the return to normal for the broader global economy (such as rapid progress on developing a vaccine and therapeutics for COVID-19) could result in consensus expectations for economic growth (and earnings) finding that higher is the path of least resistance. Shifting expectations higher, in turn, would provide a fundamental basis for stocks having plenty of room still left to run.

The going rate

Even if growth does not offer an upside surprise (and absent a new shock to the system), there is a significant support for risk assets that is going to remain for the foreseeable future.

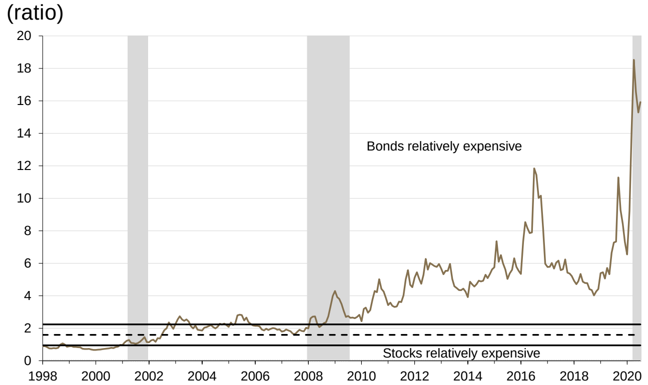
At their most basic level, asset prices equal the present values of their future cash flows. These future payments to investors (such as dividends, coupon payments and buybacks) are discounted into a present value using their expected rate of return, which is the market's risk-free rate and a premium to compensate investors for taking on some risk by holding that asset.

All else the same, a lower interest rate raises that calculated present value and therefore means higher asset prices and higher valuations.

So, while equity prices may look expensive in the context of the deterioration in expected earnings and continued uncertainty over the outlook, relative to where yields on government bonds (traditionally viewed as risk-free assets) currently sit, equities actually look quite inexpensive.

CHART 22: IT'S ALL RELATIVE

MSCI World Earnings Yield-to-Global Government Bond Yield
(ratio)



Dashed line is pre-financial crisis average; bars +/-1 standard deviation
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Accordingly, from the perspective of a balanced portfolio and with a cautious optimism over the near-term outlook, a continued tilt in allocations toward equity over bonds appears to be supported.

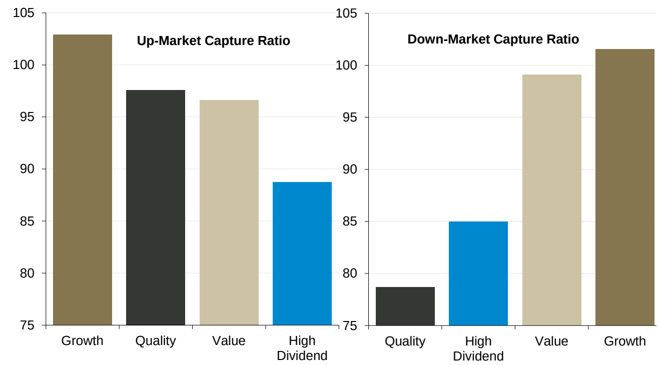
With that said, however, the uncertainty over the outlook suggests that it remains prudent to try to manage risk exposures. For example, while the balance of macroeconomic risks arguably is tilted to the upside and therefore could clearly benefit assets and sectors that are most levered to the economic cycle, those segments would also be more vulnerable should a renewed downturn materialize.

As such, the limited visibility is not necessarily supportive of chasing growth for the sake of growth as much as it is about putting an emphasis on 'quality' growth. That is, looking at those companies that are able to consistently generate solid earnings growth with low leverage thanks to sustained advantages over competitors, and focus on secular trends rather than cyclical ones.

Historically, companies that score highly in terms of profitability, earnings growth stability and leverage tend to keep pace with the overall benchmark in up-markets, but more importantly, are better suited to weather market turbulence and thus outperform when markets decline.

CHART 23: RIDE THE WAVE AND DON'T SINK

MSCI World Style Index Up- and Down-Market Capture*
(percent)



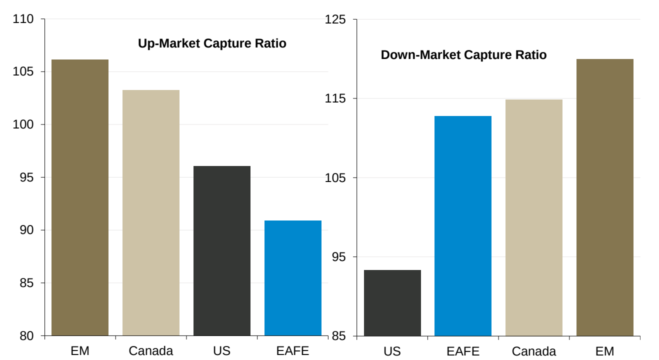
**Based on monthly data for the 30-year period ended June 30, 2020 versus the MSCI World Index*
Source: Bloomberg, Guardian Capital

These characteristics, as well as the premium placed on stable fundamental growth in an environment of limited opportunities and heightened uncertainty about growth, suggest that equities that meet these criteria could continue to warrant relatively high valuations no matter the developments.

Similarly, the US would appear to be the best region in terms of the trade-off between risks and rewards given the current uncertain market backdrop.

CHART 24: REGIONAL RISKS & REWARDS

MSCI World Country Index Up- and Down-Market Capture*
(percent)



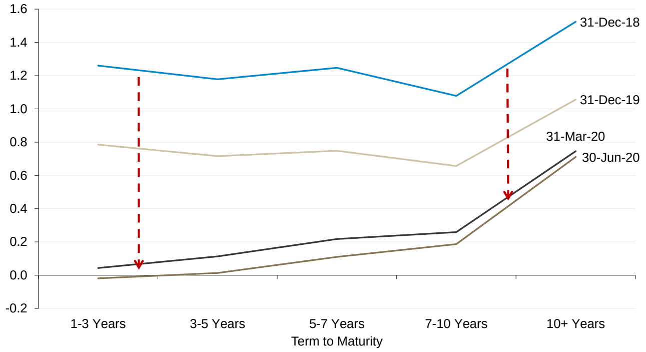
**Based on monthly data for the 30-year period ended June 30, 2020 versus the MSCI World Index; US dollar basis*
Source: Bloomberg, Guardian Capital

On a fixed income

Central bank intervention in bond markets has had an unambiguously positive impact on the performance of fixed income securities in the first half of 2020. The combination of aggressive rate cuts and large-scale asset purchase programs have pushed government bond yields across the curve to historically low levels.

CHART 25: LOWERING THE BAR

ICE Bank of America Global Bond Yield Curves
(percent)

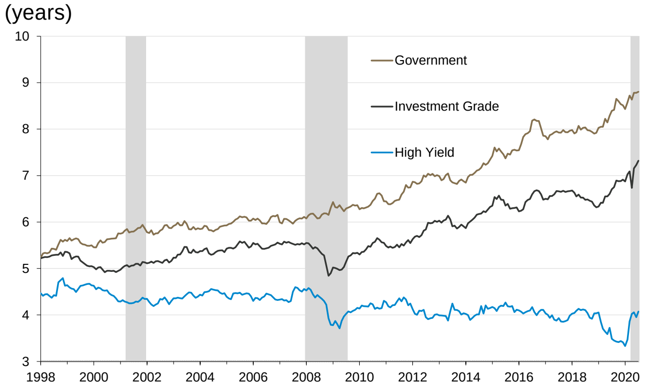


Source: Bloomberg, Guardian Capital

Clearly, the lower rate environment is beneficial to borrowers like governments and businesses as it not only has lowered their cost of capital but also allowed them to lock in low rates for extended terms. This resulted in the average duration of debt in the bond market hitting all-time highs.

CHART 26: GETTING LONGER

ICE Bank of America Global Bond Index Duration
(years)



Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

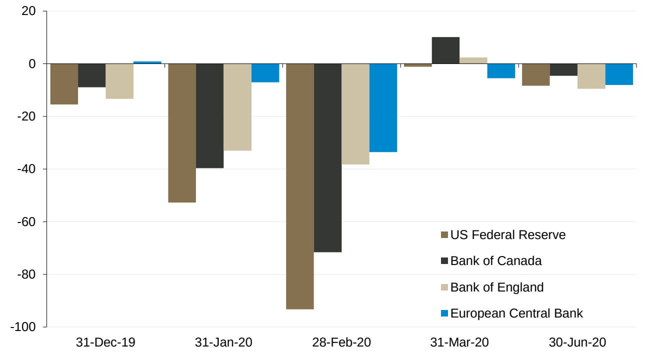
The situation, however, is less appealing for the investors given they are the ones doing the lending.

The increase in duration, by definition, means that fixed income securities are more sensitive to movements in market interest rates. As yields have declined, that has meant that bond investors have been able to receive strong returns over the last six months. Going forward, however, there is little expectation that those gains will be sustained.

Central banks globally are now at their effective lower bounds for policy rates and have expressed limited appetite for any further cuts. Consequently, markets are effectively pricing in no further actions for the next year.

CHART 27: STEADY AS SHE GOES

OIS-Implied* Change in Policy Rates Over Next 12 Months
(basis points)

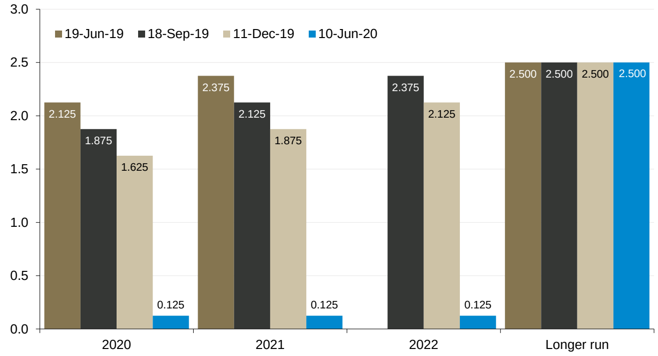


**Difference between 12-month overnight index swap rate and policy rate*
Source: Bloomberg, Guardian Capital

Of course, there is little expectation for policy rates to rise any time soon as inflationary pressures remain nowhere to be seen. Forward guidance from the Fed and BOC, for instance, indicates that the current low level of short-term interest rates will remain through at least 2022.

CHART 28: HERE FOR A LONG TIME, NOT A GOOD TIME

FOMC Median Projected Year-End Fed Funds Rate Target
(percent)



Source: Federal Reserve Board, Guardian Capital

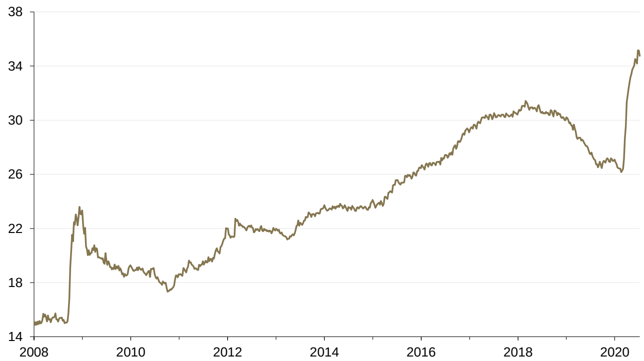
With that said, the need for governments to tap credit markets to finance their gaping deficits means that a substantial supply of government bonds is destined to be issued, which could put some upward pressure on yields and negatively impact investors' performance.

Any upside, though, is likely to be somewhat contained, thanks to the ongoing presence of the large, price-indiscriminate buyers that are global central banks. Major DM monetary authorities now hold the equivalent of more than one-third of the market value of the global bond market on their balance sheets and, with asset purchase programs continuing for the foreseeable future, that share is likely to continue to get larger.

CHART 29: BIG FISH IN THE POND

Central Bank* Assets as Share of Global Bond Market

(percent)



**Fed, ECB, BOJ, BOE and BOC*
Source: Bloomberg, Guardian Capital

Given the magnitude of their role and the market's seeming dependence on central bank liquidity, central bankers are going to face significant hurdles should they ever want to extricate themselves from public markets. However, much like how governments will be forced to deal with the ramifications of their fiscal policy decisions, that is a bridge to be crossed later.

For the here and now, it means that government bonds will likely be stuck in a range with limited upside in the coming months — performance is likely to be in line with the coupon on offer, which is paltry at best and provides negligible cushion for even modest rate increases.

Credit where credit is due

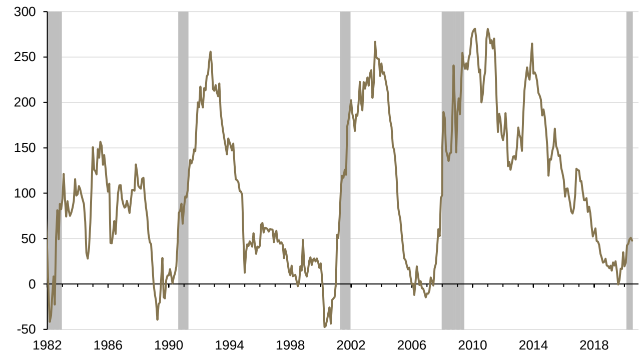
Higher yields are available on debt with either a longer maturity or lower credit quality — but that added carry comes with a commensurate increase in risk, either from rising interest rates or default, respectively.

Yield curves have steepened in recent months, but that spread is still on the narrow side of history. Further, the absolute yield provides no protection to rising rates — a 10-Year US Treasury note yield of 0.65% means that a 6½ basis point rise would be sufficient to wipe out the 12-month carry.

CHART 30: YIELDING TO THE CURVE

Spread Between 10-Year and 2-Year US Treasury Note Yields

(basis points)



Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Corporate credit, however, looks more appealing.

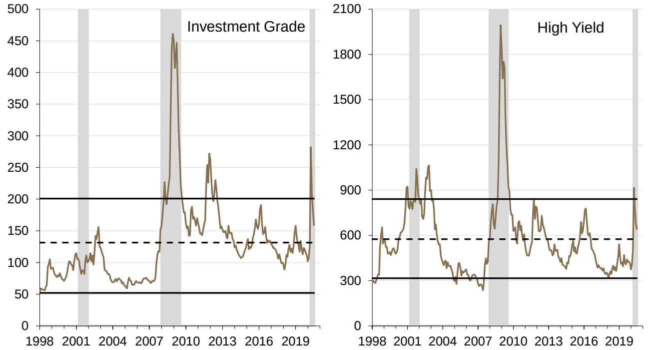
Yields on both Investment Grade and High Yield corporate debt (which have comparably lower durations on average than government bonds) have fallen sharply from the crisis highs thanks to the rally in risk assets, and more notably, the fact that several central banks expanded the scope of their bond buying programs to include these issues (including some speculative grade bonds).

Still, even with the declines and resultant narrowing of credit spreads, the yield premia over government debt still remain above their historical averages, in a sign that corporate credit is an asset class that appears to be relatively inexpensive.

CHART 31: SPREAD ‘EM

ICE Bank of America Global Option-Adjusted Yield Spreads

(basis points)



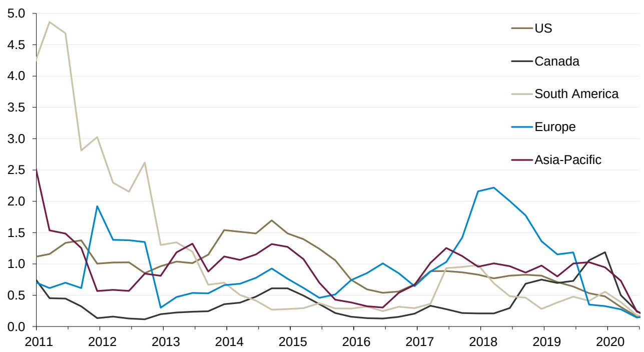
Dashed line represents series average; solid bars +/-1 standard deviation
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

However, issuers across the globe have been on the receiving end of significantly more downgrades than upgrades by rating agencies as the sharp economic downturn weighs on credit quality.

CHART 32: GETTING NO CREDIT FOR THE OUTLOOK

Ratio of S&P Credit Ratings Upgrade-to-Downgrades

(ratio)



Source: Bloomberg, Guardian Capital

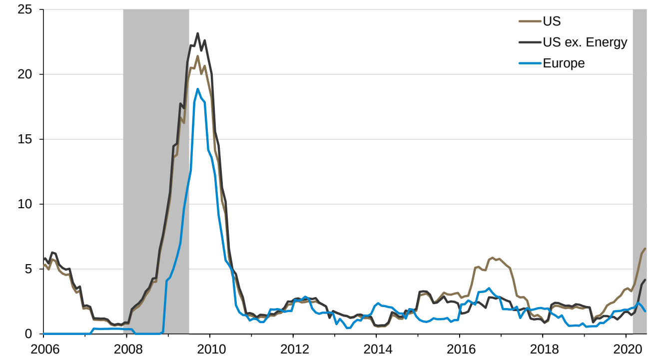
Defaults have already started to drift higher, and troughs in the credit cycle typically come 6-to-12 months after credit spreads have peaked, suggesting that the full fallout from the recession in terms of business failures is still yet to come.

Notably, though, more than half of the issuers that have defaulted are in the Energy sector (which accounts for 14% of the ICE Bank of America Global High Yield index, the index’s highest weight; for comparison, Energy accounts for 3% of the MSCI World Index, and oil and gas make up approximately that amount of global output).

CHART 33: DEFAULT SETTING

High Yield Bond Par-Weighted Default Rate

(percent)



Shaded region represents period of US recession
Source: Bank of America Merrill Lynch, Guardian Capital

While the sharp economic downturn did the sector no favours, idiosyncratic supply-side issues also sideswiped Energy. That could suggest that the overall trend in defaults is more reflective of the sector-specific hit of 2015 than the broad-based wave of defaults globally recorded in 2009.

Furthermore, the plethora of low-cost lending facilities and credit enhancement programs established by policymakers worldwide to help businesses stay afloat through this crisis — in addition to the central bank bond buying — could mitigate pressures by reducing the likelihood of firms running short of cash, and limit a sustained broad upswing in corporate defaults.

Finally, as with equities, the view that the balance of risks to the outlook is tilted to the upside, is positive for corporate credit fundamentals. That would drive a further narrowing in spreads, which could supplement the returns recorded from the relatively higher absolute yield on the securities.

Also echoing the view on equities, the persistent uncertainty over the economic outlook would suggest a continued preference toward quality in credit remains prudent with a bias in allocations toward higher credit quality issues.

Complex commodities

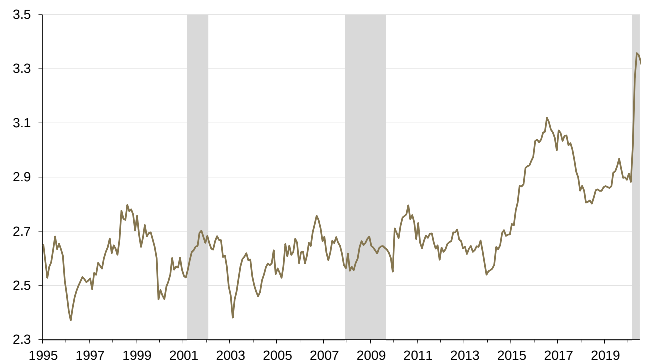
As if the collapse of economic activity on its own was not enough, the Energy sector has also had to endure a crisis of its own making.

The (brief) dispute between the Organization of Petroleum Exporting Countries (OPEC), led by Saudi Arabia, and non-member Russia roiled markets. The rise in crude oil output, at a time when demand was slumping thanks to the stay-at-home orders and forced shutdowns of industrial activity, sent inventories skyward.

CHART 34: PIPELINE PRESSURES

World Stockpiles of Crude Oil & Other Liquid Fuels

(billions of barrels)



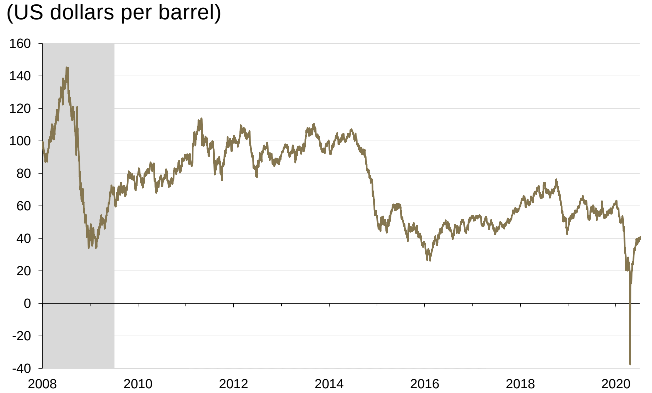
Shaded region represents period of US recession
Source: Energy Information Administration, Bloomberg, Guardian Capital

The sizable supply and demand imbalance put a strain on pipeline capacity and resulted in elevated storage costs. These combined with some of the crude futures market operational quirks to send front-month West Texas Intermediate (WTI) oil prices diving deeply in negative territory in late April.

CHART 35: BELOW ZERO

West Texas Intermediate Crude Oil Price

(US dollars per barrel)



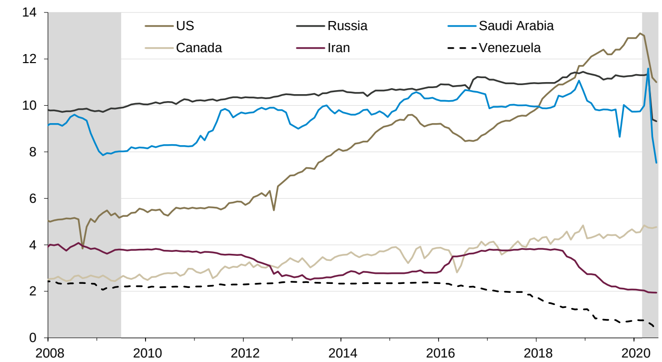
Shaded region represents period of US recession
Source: Bloomberg, Guardian Capital

The market has generally stabilized since. The stronger-than-anticipated recovery of economic activity so far has provided support via improved demand. As well, an agreed upon record large production cut by OPEC and Russia, and sharp reductions in output by US producers, has helped ease supply-side strains.

CHART 36: THIS IS NOT A DRILL

Crude Oil Production

(millions of barrels per day)



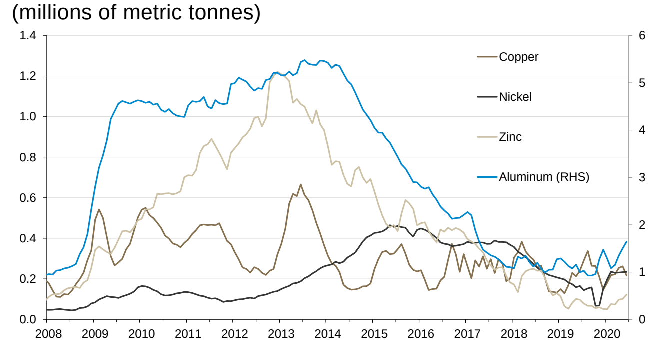
Shaded region represents period of US recession
Source: Bloomberg, Guardian Capital

The world remains awash with oil, however, and plans for OPEC and Russia to scale back their curtailments starting in August will slow the speed of the needed rebalancing. This provides little reason to anticipate that oil prices will break out of their new, lower trading ranges in the foreseeable future.

Base metals, in contrast, already underwent the protracted market rebalancing that left stockpiles at more than decade lows. The commodities are now in a much better position to weather the unexpected drop in industrial demand — as well as ride the subsequent rebound that has left the Bloomberg Base Metals Index retesting the highs of the year.

CHART 37: METALS FIND THEIR BASE

London Metal Exchange Warehouse Stocks
(millions of metric tonnes)



Source: Bloomberg, Guardian Capital

Gold has fared even better, as the backdrop of elevated volatility, low interest rates, central bank balance sheet expansion and deteriorating fiscal positions plays right into the traditional safe haven asset's wheelhouse.

Prices for the yellow precious metal have been bid up to their highest levels since the 2013 sovereign debt crisis — and all-time highs will likely get consideration as the confluence of constructive market forces for gold remain in place for the foreseeable future.

CHART 38: GOLD MEDAL PERFORMANCE

Spot Gold Price

(US dollars per troy ounce)

Shaded region represents period of US recession
Source: Bloomberg, Guardian Capital

The road to recovery

The world has been dealt a historic shock from the COVID-19 pandemic, and while the crisis remains ongoing, there is reason to think that the worst is now in the rearview mirror.

To date, growth momentum has recovered much faster than anticipated, and the economy is in a much better place than it was three months ago. Still, there is plenty of ground to make up before we can consider things as 'good' in an absolute sense.

How the recovery progresses from here depends on whether or not the rolling back of emergency measures to stem to the spread of infection can continue unabated — a process that is being complicated by the accelerating spread of infection in the US and major EM economies.

That said, there is virtually no appetite (politically or economically) for renewed large-scale lockdowns and the base-case assumes that stringent policies continue to be cautiously reversed, permitting consumers and businesses to gradually return to something akin to 'business as usual'.

To the extent that the non-zero odds of a return to March-like conditions can be diminished — for example, by indications that the contagion is coming under control or progress is made on the development of therapeutics — that would present upside risks to the outlook, and it still appears that the balance of risks is tilted in this direction.

Undoubtedly, plenty of risks linger over the horizon. Beyond the pandemic, there is a laundry list of concerns such as persistent tensions in US-China relations, the upcoming US election, and ongoing civil unrest simmering on the backburner. However, it appears that the global economy is on the road to recovery; and the path of least resistance for the coming months will be toward improvement underpinned by a continued abundance of fiscal and monetary stimulus.

As such, risk assets appear primed to continue on their road to recovery from their crisis lows as investors continue to pare the undue weight assigned to the worst-case scenario outcomes.

Equities	+	Fixed Income	—
Canadian Equity	+	Government Bonds	—
US Equity	+	Investment-Grade Credit	+
EAFE Equity	+	High-Yield Credit	+
Emerging Markets	+		

Market Returns at June 30, 2020 All returns in Cdn $.

CANADIAN EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P/TSX Composite	2.5	17.0	-7.5	-2.2	4.5	6.3
S&P/TSX 60	2.2	15.0	-6.3	-1.4	5.2	6.7
S&P/TSX Completion	3.5	25.5	-11.8	-5.1	2.0	5.3
S&P/TSX SmallCap	5.6	38.5	-14.3	-10.1	-0.2	1.5
BMO Small Cap Blended (Weighted)	4.6	36.7	-12.8	-7.9	0.9	3.2
S&P/TSX Composite High Dividend	0.1	8.5	-21.3	-14.4	1.4	5.6
S&P/TSX Composite Dividend	1.0	11.8	-11.3	-6.4	4.6	N/A

S&P/TSX SECTOR RETURNS (%)

Communication Services	-2.5	-1.0	-9.0	-6.3	6.3	10.9
Consumer Discretionary	1.9	32.8	-10.8	-10.5	1.4	9.9
Consumer Staples	-0.4	11.7	1.3	3.0	8.3	16.2
Energy	-4.6	10.9	-30.4	-24.6	-6.6	-2.3
Financials	3.7	6.2	-16.2	-11.0	5.0	8.8
Health Care	-3.5	9.9	-30.9	-54.5	-39.7	-3.8
Industrials	1.5	13.2	-3.8	-0.3	10.9	13.8
Information Technology	13.5	68.3	62.0	85.6	33.3	15.1
Materials	4.5	42.0	15.4	24.9	9.1	0.8
Real Estate	3.2	11.7	-20.0	-15.3	3.8	10.2
Utilities	-0.7	3.8	-1.7	10.4	10.2	8.7

U.S. EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P 500	0.5	15.3	1.8	12.0	12.7	16.9
Dow Jones Industrial Average	0.3	13.4	-3.8	3.7	12.6	15.8
NASDAQ	4.4	25.0	17.7	30.9	17.1	19.9
Russell 1000	0.7	16.6	2.1	12.0	12.4	16.9
Russell 2000	2.0	20.0	-8.6	-2.7	6.1	13.3
Russell 3000	0.8	16.8	1.4	11.0	12.0	16.6
Russell 1000 Growth	2.8	22.3	15.3	28.5	17.9	20.2
Russell 1000 Value	-2.1	9.4	-12.0	-5.0	6.5	13.2

S&P 500 SECTOR RETURNS (%)

Communication Services	-2.0	14.9	4.7	15.8	9.1	13.4
Consumer Discretionary	3.5	27.1	12.6	17.4	15.2	21.2
Consumer Staples	-1.8	3.5	-0.9	8.0	9.1	14.6
Energy	-2.7	24.9	-32.1	-33.4	-7.6	2.7
Financials	-1.8	7.4	-19.8	-10.3	7.3	12.5
Health Care	-3.8	8.7	4.2	15.6	10.1	18.7
Industrials	0.5	12.0	-10.3	-5.2	8.6	14.6
Information Technology	5.6	24.9	20.7	41.6	25.6	23.5
Materials	0.7	20.6	-2.2	3.1	7.3	12.6
Real Estate	0.0	8.3	-3.9	2.1	N/A	N/A
Utilities	-6.1	-1.7	-6.7	2.0	12.1	14.1

INTERNATIONAL EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
MSCI World Index (Net, C$)	1.1	14.2	-1.0	7.2	8.8	12.7
MSCI EAFE Index (Net, C$)	1.9	9.9	-6.9	-1.1	3.9	8.4
MSCI ACWI (C$)	1.7	14.1	-1.5	6.4	8.3	11.9
MSCI France (C$)	4.5	11.1	-11.6	-6.5	5.3	8.5
MSCI Germany (C$)	4.6	21.1	-3.0	1.5	3.6	8.8
MSCI Japan (C$)	-1.5	6.8	-2.4	7.5	5.3	8.8
MSCI U.K. (C$)	0.0	3.1	-19.4	-14.3	-0.7	6.5
S&P/IFC Investable (Emerging Markets)	5.9	13.7	-5.7	0.0	5.0	6.6
MSCI EAFE Growth (Gross, C$)	1.7	12.1	1.6	8.9	7.8	10.9
MSCI EAFE Value (Gross, C$)	2.1	7.8	-14.9	-10.4	0.7	6.8

Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

INTERNATIONAL EQUITIES

MSCI EAFE SECTOR RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	3.3	8.6	-2.3	0.6	0.3	7.9
Consumer Discretionary	0.6	12.7	-9.4	-1.5	2.7	10.0
Consumer Staples	0.4	4.7	-0.6	2.4	6.5	10.8
Energy	-0.6	-4.3	-33.0	-35.5	-2.1	2.4
Financials	5.3	8.5	-18.5	-14.6	-1.7	5.4
Health Care	-1.2	9.3	9.3	24.9	7.9	13.6
Industrials	1.8	12.9	-8.9	-2.5	5.7	9.2
Information Technology	4.0	18.1	6.7	18.6	12.9	11.9
Materials	3.5	18.4	-4.9	-1.3	6.3	6.3
Real Estate	0.5	4.1	-17.3	-15.5	N/A	N/A
Utilities	3.0	7.6	2.5	9.7	7.2	6.2

Market Returns at June 30, 2020 All returns in Cdn $.

CANADIAN FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada 91 Day TBill	0.0	0.1	0.8	1.6	1.0	1.0
FTSE Canada Short Term Overall Bond	0.5	2.1	4.0	4.5	2.1	2.6
FTSE Canada Mid Term Overall Bond	1.0	4.8	8.3	8.1	4.0	5.0
FTSE Canada Long Term Overall Bond	3.5	11.2	11.4	12.0	7.0	7.4
FTSE Canada Universe Bond	1.7	5.9	7.5	7.9	4.2	4.6
FTSE Canada High Yield Overall Bond	3.4	7.6	-2.1	1.3	5.2	5.7
FTSE Canada Real Return Bond Overall	2.4	6.2	6.3	5.5	3.4	4.6
SECTOR RETURNS (%)						
FTSE Canada Federal Bond	0.5	2.3	7.5	7.2	3.0	3.4
FTSE Canada Provincial Bond	2.1	7.7	9.1	9.4	5.2	5.8
FTSE Canada All Corporate Bond	2.6	8.1	5.4	6.6	4.4	5.0

GLOBAL FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE World Government Bond	-0.8	-2.4	9.3	9.0	5.5	5.0

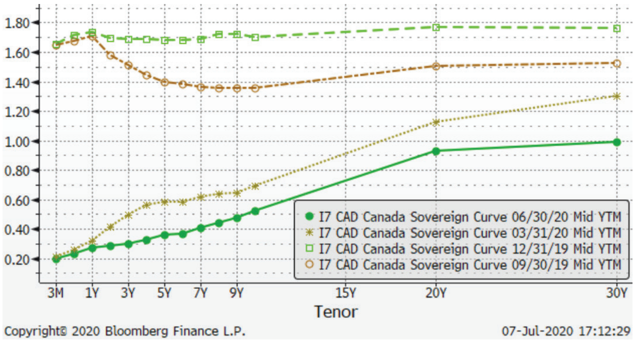
COMMODITY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Bloomberg WTI Cushing Crude Oil Spot Price	9.0	83.5	-32.5	-30.0	-6.3	-4.0
Bloomberg European Dated Brent BFOE Price	10.0	82.2	-35.3	-33.9	-6.2	-3.4
Edmonton Crude Oil Syncrude Sweet Blend FOB Spot	0.0	243.5	-39.6	-38.4	-8.6	-5.0
S&P GSCI Nat Gas Index Spot	-6.7	2.2	-16.0	-20.9	-7.6	-6.9
S&P GSCI Copper Index Spot	10.4	16.3	2.4	4.6	2.7	1.7
S&P GSCI Gold Index Spot	1.3	7.9	24.2	32.7	10.9	6.4

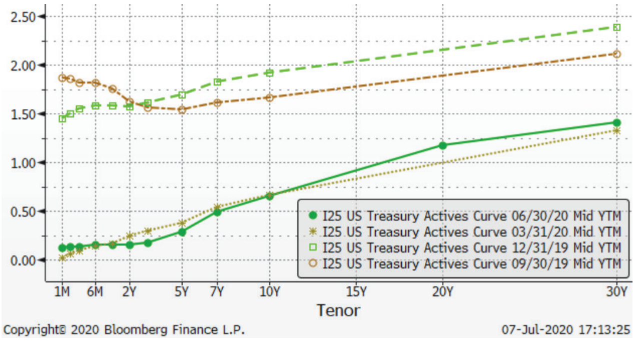
CURRENCY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Canadian $/U.S. $ (% chg)	-1.5	-4.3	5.0	4.2	1.8	2.5
Canadian $/Yen (% chg)	-1.6	-4.2	5.8	4.1	4.4	0.5
Canadian $/GBP (% chg)	-1.5	-4.6	-2.0	1.2	-3.0	0.6
Canadian $/Euro (% chg)	-0.5	-2.1	5.1	2.8	1.9	1.6

GOVERNMENT OF CANADA YIELD CURVE



U.S. TREASURY YIELD CURVE



Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial