March Madness

Equity Markets

It was a tumultuous quarter for equity markets globally in early 2020. The first seven weeks of the year saw a continuation of 2019's strength, with many developed markets hitting all-time highs as the end of February approached. However, from then onwards the tone changed dramatically, as the rapid onset of the coronavirus triggered a rapid market decline, as all major economies ground to a halt. The domestic S&P/TSX Composite Index fell 37% over a mere four-week span, ending the quarter with a decline of 21% overall. In the United States, the S&P 500 performed in similar fashion, falling 12% over the quarter in Canadian dollar terms, as did the MSCI EAFE benchmark internationally, losing 15% in price. Weakness in the Canadian dollar offered a partial consolation for domestic investors, buffering losses by approximately 9%.

In Canada and around the world, the Energy sector was under heavy pressure, impacted by the dual hit of a sudden contraction in natural gas, jet fuel and gasoline demand, alongside a supply war declaration by both Saudi Arabia and Russia. In comparison, domestic companies in the Consumer Staples and Communication Services sectors held in better, supported by stable business attributes and steady dividend payouts. Outside of Canadian borders, classically defensive sectors such as Utilities, Consumer Staples, Communication Services and Health Care outperformed in both the US and EAFE regions. Regionally, Japan performed notably better than other constituent nations in the MSCI EAFE benchmark, in part reflecting highly conservative balance sheets and perhaps also a reflection of the nation's excellent management thus far of their domestic COVID-19 outbreak. There were also a couple of notable divergences from expectations during such a sharp downturn. The typically staid REIT sector was unhelpful to investors in both Canada and EAFE, as the exposure to retail and restaurant chains common for many of these companies was suddenly a point of concern, making normally dependable dividends seem at risk. In contrast, Information Technology stocks, historically quite cyclical, were the best part of markets in every region, perhaps reflecting the maturation of this sector that offers better profitability, more durable balance sheets and more proactive capital management than in the past.

Fixed Income Markets

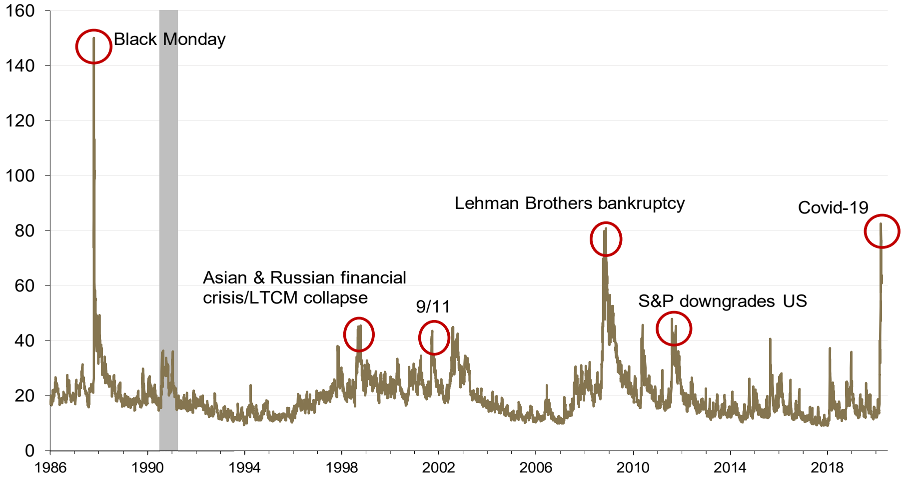
Fixed income returns varied widely in the first quarter of 2020, as uncertainly surrounded the scale of economic slowing associated with the coronavirus shutdown. Government bonds were well bid, returning 3% in the quarter, while concerns regarding future earnings and funding caused investment grade corporate bonds to weaken, leading to a decline of 2% in the first quarter. As expected, high yield bonds languished under the combined pressure of oil's dramatic plunge in price, spreads on lower-grade bonds widening substantially, and a number of 'fallen angels' – investment grade bonds being downgraded, all contributing to a decline of 9% in the period.

Economic data to begin the quarter was neither hot nor cold, supportive of the low policy rates held by both the Bank of Canada and the US Federal Reserve (Fed). To mid-February all data pointed to continuing on-trend and low inflation growth, both central banks had taken their policy rates down substantially, with the Bank of Canada's overnight rate at an all-time low of 0.25% and the Fed taking rates down to lows seen during the depths of the financial crisis.

Commentary

Despite the absence of the annual US college basketball championship tournament, March was not without madness this year – the seemingly year-long last month was momentous to say the absolute least.

CBOE Equity Market Volatility Index
(annualized percent)

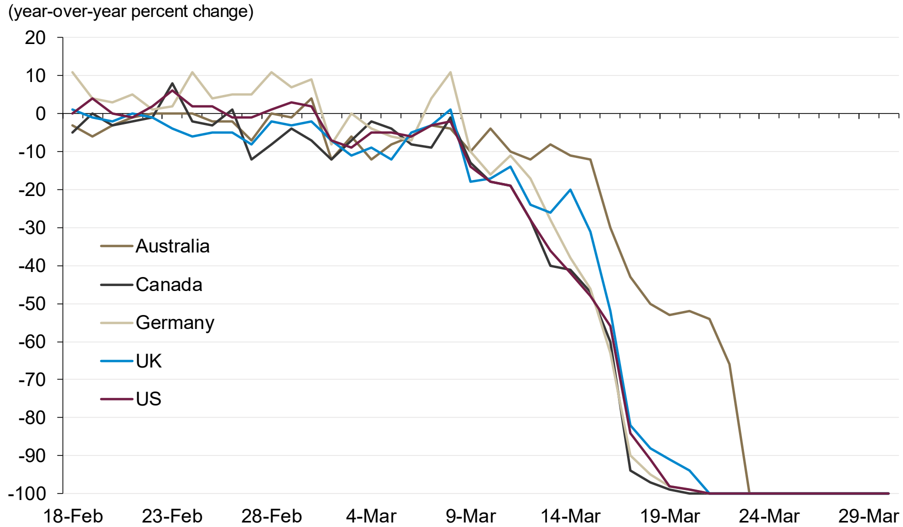


Shaded regions represent periods of U.S. recession; prior to 1990, VXO used
Source: Bloomberg, Guardian Capital

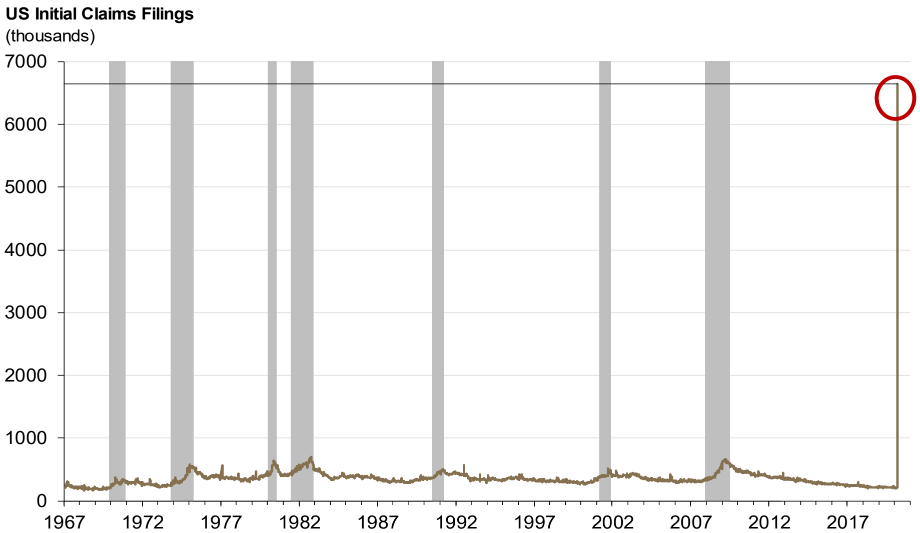
As investors are undoubtedly aware, the 11-year bull market was stopped dead in its tracks, with global equity prices swinging from all-time highs into bear market territory with an alacrity never before seen. Along the way there have been some of the worst days and weeks in the history of organized capital markets – with a sprinkling of a few of the best days ever in there among the general waterfall of declines. Gauges of market volatility surged to levels only ever before seen in Financial Crisis in 2008 and on “Black Monday” in October 1987 (hardly the best company to keep from a markets perspective).

The catalyst for this has obviously been the rapid spread of COVID-19. It has led to the effective closure of most economies across the world, and that all but assures that the decade of continuous economic expansion has also come to a screeching halt. Perhaps the best example of the unprecedented impact is the complete shutdown of in-restaurant dining. Data from online reservation service provider OpenTable shows that the volume of activity on their network has plunged to zero across the globe.

Seated Diners at Restaurants on the OpenTable Network
(year-over-year percent change)



Source: OpenTable Data Center, Guardian Capital



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

The official government-produced activity figures are likely to echo these negative superlatives as the reference periods begin to capture the impact of the shutdowns – for example, the data on initial filings for unemployment insurance in the US in the last week of March. It showed an unprecedented spike in layoffs that was nearly five times the previous record high (and anecdotal reports suggest the Canadian data, that is released with a lag will be of a similar magnitude).

In other words, it looks as though things will get worse before they start to get better. But as much as human nature tends to put most of the focus on the first part of that comment, it is worth emphasizing the second part: things will start to get better. The timing is up in the air at the moment, but whether it is a matter of weeks or months, we will eventually finish crawling through this metaphorical 500 yards of [excrement] a la Andy Dufresne in the 1994 film *The Shawshank Redemption*, to come out clean on the other end. The signs of success of societal shutdowns in Asia in arresting the spread of the coronavirus provide optimism that the extreme measures we are now taking in this part of the world can result in a return to normal sooner rather than later.

A focus on the better days ahead is not only better for your mental state but for your investments as well. History has shown time and time again that allowing emotion to drive the investment decision-making process is bad for investors' wealth, as short-sighted and undisciplined reactions to short-term events can carry significant negative implications for long-term portfolio performance. Instead, trust the long-term risk profile laid out in your Investment Policy Statement: if your investment objectives, time horizon and true appetite for risk didn't change in February, then there is no need to deviate from the baselines that were created during more sanguine times.