The Stan Clark Financial Team's

PERSPECTIVES

COVID-19 Special Edition

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With the recent onset of the COVID-19 pandemic, the longest bull market in history abruptly ended. In this special edition of Perspectives, we look at the economic effects of this pandemic, previous bear markets, and what we're doing. We also offer our insights for braving the short term while being optimistic about the long term. We believe that sticking to your financial plan, having patience, giving things time and investing wisely is still the best approach. In the meantime, please stay safe and stay healthy!

Stan

CIBC Wood Gundy

Take the long-term view – and take heart

By Stan Clark - Senior Investment Advisor and Michael Chu - Investment Advisor

The emergence of the COVID-19 pandemic has resulted in an extraordinary worldwide effort to contain the outbreak. While these initiatives are the highest priority in containing the virus, they have also resulted in significant economic cost.

Governments and central banks around the world have acted quickly to support the economy through unprecedented monetary and fiscal stimulus. Meanwhile, investors have been whipsawed between the positive impact of the stimulus and the continued suppression of the economy. Add the oil price conflict between Russia and Saudi Arabia, and we get even more uncertainty and volatility.

Given the nature of our economy and its heavy weighting towards commodities, Canadian equities have been hard hit. Other markets around the world were down by a similar magnitude, but U.S. dollar investments held up better in Canadian dollars because of the strength of their currency.

Quick end to the longest bull market

After almost 11 years, the longest bull market in history ended mid-February 2020. What followed was the fastest bear market in history, with the markets falling about 34% from their high point in just over a month. Then, a few weeks later, the market rallied back almost half the losses. Most investors welcome this partial recovery. But they also find it very confusing, for these reasons:

1. The economy is still shut down.
2. Unemployment continues to worsen.
3. Although social distancing appears to work, the virus will be with us for some time.
4. No one knows what will happen when the economy reopens.

On the other hand, as noted, governments around the world have introduced much financial aid. In the U.S., short-term interest rates were reduced to 0%, and a $2 trillion fiscal plan approved, with more likely on the way. Other relief included loans and support for small- and medium-sized businesses, as well as corporate, municipal and state bonds. Governments in Canada and around the world have launched similar programs.

Fearing the virus or fearing socialism?

According to economist Ed Yardeni, the stock market might have feared the emergence of self-described democratic socialist Bernie Sanders as much as it feared the virus. Yardeni notes that the rout in the stock market coincided with Bernie gaining momentum in the primaries. Investors feared Bernie would undercut capitalism by raising taxes, increasing regulation and other socialist initiatives. Then, as former Vice-President Joe Biden scored major victories, the stock market rallied. Perhaps there was more going on in the

	1st Quarter 2020	Trailing P/E	Trailing Earnings Yield	Dividend Yield
Canada	-22.9%	12.6	7.9%	4.1%
U.S.	-11.6%	18.0	5.6%	2.3%
EAFE (Europe, Australasia, Far East)	-16.5%	12.9	7.8%	4.1%
Emerging Markets	-17.3%	12.5	8.0%	3.2%
World	-14.5%	15.7	6.4%	3.0%

Source: Bloomberg

market than just the virus.

What have we been doing?

With the drop in stock prices, portfolio equities percentages are obviously down as well. Where clients had more than enough fixed income to meet their needs for the next few years, we have used the market drop as an opportunity to add to equities at lower prices. We believe markets will eventually recover, and we have resisted the temptation at timing the markets as this is hard if not impossible. We are following the same approach we used in the Financial Crisis of 2008/09 – an approach that had good results.

We have also done some work on the survivability of the stocks we own. We reviewed the debt and cash flows of each holding. The result of this analysis indicated no red flags. While not every company is perfect, risk/reward trade-offs were justifiable.

In terms of managing specific stocks, little has changed in our approach compared to pre-virus. We're still looking for companies that have strong characteristics of reasonable value and improving prospects. Now, as always, it's good to remind ourselves that emotions, corrections and volatility are natural parts of investing. The key is to remain calm, carry on and focus on the long term.

Looking to the past

When confronted with a bear market, the first thing we all want to know is how it will play out. How big will the decline be, when will it end and how will the recovery go? The simple solution would be to look for historical comparisons. The problem: There aren't that many cases to consider. In the last 90 years, there have been 25 bear markets. That is not a large sample, so it's hard to draw a firm conclusion. Looking at the data, we can only say two things. First, bear markets are all different in terms of length, severity and recovery. Second, they have all been good buying opportunities, as stocks have always come back.

We're not saying don't study the past. There's a lot to learn about what caused previous bear markets – and which responses worked. History may not exactly repeat itself, but it may often rhyme. Perhaps the greatest lesson is that staying the course has consistently been a good decision. By contrast, trying to predict exactly how things will play out in the short term is likely a losing game.

It's true we're in unprecedented times. Studying history will also provide a range of outcomes. Every market crash is different, except for one thing – they all end. Stocks recover, economies grow and people always want to improve their position in life.

How did the world survive World War I, the Spanish Flu, the Great Depression and World War II, all within about 30 years? People have many flaws, granted. But our ability to adapt and push forward is not something to be taken lightly.

Today vs. the Great Depression

Searches on the Internet for "Great Depression" have spiked recently. People are worried, so it's natural to look at the worst economic calamity of modern times. But seeking parallels is probably misguided. At the peak of the Great Depression, unemployment was 25%; it stayed in double digits for a decade. Also, U.S. President Herbert Hoover would not offer the help of the federal government. Instead, Hoover's priority was to balance the budget. The central bank back then also made significant monetary policy mistakes (they actually raised interest rates!).

Sure, we too will have a big spike in unemployment. But it should be short-lived. A Great Depression today would make the Financial Crisis and dot-com collapse look like walks in the park. Stocks in the Great Depression fell 89%, leaving investors with permanent scars. Government actions today are far different, e.g., pumping trillions of dollars into the economy. Banks are also much healthier now than back then.

So, yes, things are scary today. We may react emotionally by thinking we're heading to another Great Depression – but in reality making comparisons is not fair.

The roaring '20s

Now let's look back at the years leading up to the Great Depression. Any similarities to be found there?

In *Only Yesterday: An Informal History of the 1920s*, published in 1931, Frederick Lewis Allen discussed one of the most transformational decades in modern history. World War I, starting in 1914, remains one of the largest wars fought, with over 70 million soldiers involved. The war also played a major role in the spread of the Spanish Flu as soldiers deployed around the world. Epidemiologists estimate that 50-100 million people may have died from one of the worst pandemics in history. Half of those were in their prime ages. The flu lasted two years; however, two-thirds of deaths occurred in the first six months. 1918 saw a post-war recession, with the economy shrinking by 25%. Then, in 1920, another depression not only shrank the economy but was accompanied by the most deflationary year on record in the U.S.

Those eight years must have been hell to live through. Yet, look what happened after! Few if any could have predicted during the war/pandemic/recession/depression that the 1920s would be one of the most innovative and prosperous times the U.S. has ever seen.

What does this have to do with today? We're not saying things are as bad as the 1910s. But it's encouraging to see what conditions people have historically battled back from. The fact that people shrugged off such a debilitating period and turned it into one of the most optimistic times speaks volumes of our ability to move forward.

Of course, what followed the Roaring '20s was the greatest economic crash in U.S. history. Let's hope that, if we are fortunate enough to experience another roaring '20s, we will take heed of how the last one ended – and avert the same fate.

Valuations at the bottom

It's usually better to buy things when valuations are cheap. But valuations aren't always low at market bottoms. Valuations require context. They don't always tell you everything you need to know about the relative attractiveness of stocks. While sometimes things are ridiculously cheap at market bottoms, at other times the signals do not cooperate.

Here's a look at market bottoms, along with their valuations, using price-to-earnings (P/E) ratios and interest rates.

Valuations at the bottom

Bottom	Drawdown	CAPE	P/E Ratio	10 Yr Yield
Jun 1932	-86.2%	5.6	9.4	3.5%
Feb 1933	-40.6%	7.8	15.0	3.3%
Oct 1933	-29.8%	11.7	22.0	3.2%
Mar 1935	-31.8%	10.4	11.5	2.8%
Mar 1938	-54.5%	11.8	10.9	2.5%
Apr 1939	-26.2%	13.9	14.9	2.3%
Jun 1940	-31.9%	12.8	9.3	2.1%
Apr 1942	-34.5%	8.5	7.7	2.5%
Oct 1946	-26.6%	11.4	15.6	2.2%
Jun 1949	-20.6%	9.1	5.8	2.3%
Oct 1957	-20.7%	14.2	12.0	4.0%
Jun 1962	-28.0%	16.8	16.0	3.9%
Oct 1966	-22.2%	18.8	14.0	5.0%
May 1970	-36.1%	14.0	13.7	7.9%
Oct 1974	-48.2%	8.8	7.7	7.9%
Mar 1978	-19.4%	9.0	8.1	8.5%
Aug 1982	-27.1%	6.6	8.0	13.1%
Dec 1987	-33.5%	13.4	13.8	9.0%
Oct 1990	-19.9%	14.8	14.2	8.4%
Aug 1998	-19.3%	35.4	28.0	5.3%
Oct 2002	-49.1%	22.0	29.2	3.9%
Mar 2009	-56.8%	13.3	110.0	2.9%
Oct 2011	-19.4%	20.1	13.9	3.5%
Dec 2018	-19.8%	28.3	19.4	2.8%
	Median	13.1	13.9	3.5%
	Average	14.1	17.9	4.7%

Source: Robert Schiller

Notice the pattern? No? That's because there is no pattern. Some bottoms occurred with low valuations, but as you can see, many times markets bottomed with high valuations. The profile of a market bottom is just as murky as a market top. Investing would be a lot easier if there were set valuations signalling when to sell or buy. But the real world doesn't work that way.

Stocks for the long run

Wharton Professor Jeremy Siegel, author of Stocks for the Long Run, recently said that a recession is his worst-case scenario. It would be a unique recession from a historical standpoint, as recessions are usually caused by tremendous excesses built up in the economy. Excesses we didn't have this time.

Siegel says there are four steps to an economic recovery. First is monetary and fiscal support – which we have. The second factor is flattening the curve. This isn't a slam dunk, but social distancing does seem to help. Third, vaccines and therapeutics. These are being worked on, with best estimates that they're at least a year away. The market has likely priced in a three- to six-month shutdown. The fourth step is better health measures and procedures. This might include a surveillance system (e.g., via smart phones), rapid and reliable testing, and serology tests to discover who is immune and can go back to work first.

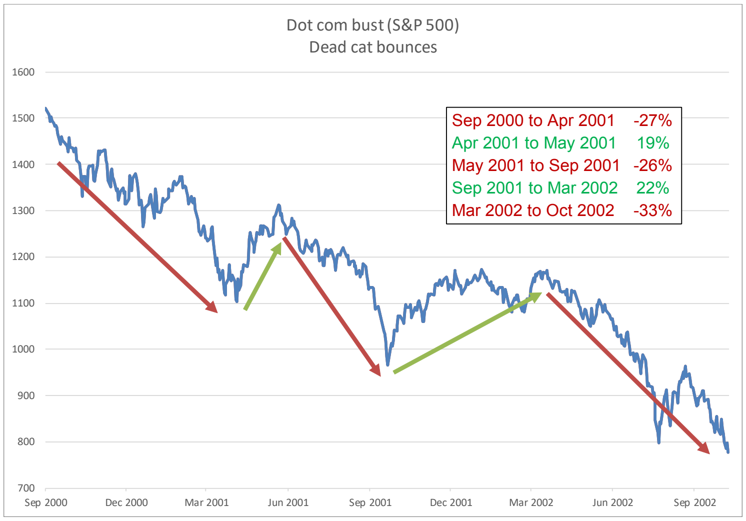
Dead-cat bounces

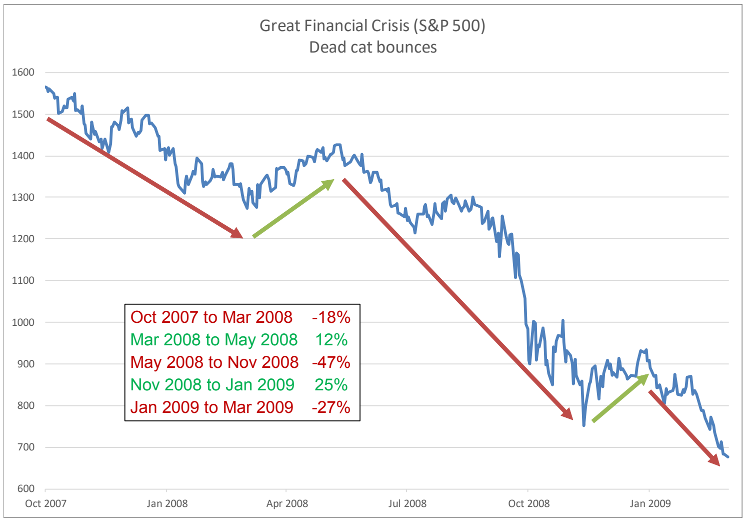
Things were looking pretty bleak for the market after the third week of March. But then something happened. The market started to go up – and in a hurry. There were a number of fundamental reasons for the quick turnaround, the most obvious of which were the temporary support programs rapidly agreed to by governments and central banks. There were also perhaps some technical causes: quarter-end "window-dressing," short covering, algorithms or rebalancing. No one knows exactly why the market rose. It's possible this is just temporary relief within a broader bear market that isn't over yet.

Many of history's greatest crashes have included head-fake rallies that gave investors a false sense of hope. Such temporary recoveries are called dead-cat bounces. During the Great Depression, stocks initially fell by 45%. They dead-cat bounced, or rallied, by about 50% – only to then fall by 80%. This also happened, to a less extent, in some other bear markets. When glancing back at history, it often looks like crashes occur in a straight line, but usually that's not the case.

According to Gavekal Research, "markets rarely clear after one massive decline. In 15 bear markets since 1950, only one did not see the initial major low retested within three months… In all other cases the bottom has been tested once or twice." Since the news flow in today's crisis will likely worsen, perhaps by a rebound in COVID-19 cases after the lockdown is relaxed, a retest seems likely.

Oaktree Capital's Howard Marks has presented some data about S&P 500's movements around the last two big crises. The first and second declines were followed by substantial rallies, which then gave way to even bigger declines:





This tells us that markets rarely move in a straight line. Rather, their movements are a continuous tug-of-war between bulls and bears, and the result rarely goes in just one direction. Marks concluded that: 1) markets may well be considerably lower sometime in the coming months; and 2) in the meantime, we're still buying today when we find good value.

But sometimes it's not a dead-cat bounce

It's difficult to tell when it's a dead-cat bounce or an actual bottom. When stocks do eventually bottom, they tend to have strong gains out of the gate. Here are the three- and six-month returns from past bear markets.

Short term returns after bottoms

Bottom	Drawdown	3 months	6 months
Jun 1932	-86.2%	92.5%	53.0%
Feb 1933	-40.6%	88.2%	96.2%
Oct 1933	-29.8%	29.2%	27.8%
Mar 1935	-31.8%	26.8%	46.2%
Mar 1938	-54.5%	40.9%	40.0%
Apr 1939	-26.2%	11.7%	22.2%
Jun 1940	-31.9%	16.2%	18.0%
Apr 1942	-34.5%	15.4%	26.2%
Oct 1946	-26.6%	4.6%	0.1%
Jun 1949	-20.6%	16.1%	23.0%
Oct 1957	-20.7%	6.7%	9.8%
Jun 1962	-28.0%	6.6%	20.5%
Oct 1966	-22.2%	14.6%	21.4%
May 1970	-36.1%	17.2%	20.8%
Oct 1974	-48.2%	14.0%	29.9%
Mar 1978	-19.4%	15.2%	19.3%
Aug 1982	-27.1%	36.2%	41.6%
Dec 1987	-33.5%	20.2%	19.3%
Oct 1990	-19.9%	6.2%	28.7%
Aug 1998	-19.3%	22.4%	28.2%
Oct 2002	-49.1%	19.2%	12.2%
Mar 2009	-56.8%	38.8%	50.2%
Oct 2011	-19.4%	16.5%	28.6%
Dec 2018	-19.8%	20.6%	23.9%
	Average	24.8%	29.5%

Source: Ben Carlson

We will never know when we're at the bottom, as the bottom can only be recognized in retrospect. So, we can't wait for the bottom.

Granted, every recovery could have been called a dead-cat bounce – but some turned out to be a real bottom. The problem is, only in hindsight can you tell.

Looking for the bottom

Oaktree's Marks was asked, "Since you expect more bad news… shouldn't you wait for the bottom?" He answered with a clear "No." We will never know when we're at the bottom, as the bottom can only be recognized in retrospect. So, we can't wait for the bottom.

Now, investors can wait until the bottom has passed and buy on the way up. In this scenario, they're willing to miss the bottom and then also face buying pressure on the way up. Instead, investors willing to buy should buy on the way *down*. That's when sellers are feeling the most urgency and other buyers won't stop the downward movement of prices. The goal of the investor should be to make a large number of good purchases, not just a few perfect ones. It's enough to buy a good asset at an attractive price, and you need not do it all at the bottom.

It's natural to feel uneasy about buying when prices are going down. As one wise observer quipped, "When the time comes to buy, you won't want to."

After the bottom

U.S. stocks just experienced the fastest bear market in history, falling close to 30% in just 18 trading sessions. According to Ben Carlson of Ritholtz Wealth Management, there have been just 11 bear markets with losses greater than 30%.

Worst bear markets in history (S&P 500 since 1928)

Peak	Trough	Drawdown
Sep 1929	Jun 1932	-86.2%
Sep 1932	Feb 1933	-40.6%
Jul 1933	Oct 1933	-29.8%
Feb 1934	Mar 1935	-31.8%
Mar 1937	Mar 1938	-54.5%
Oct 1939	Jun 1940	-31.9%
Nov 1940	Apr 1942	-34.5%
Nov 1968	May 1970	-36.1%
Jan 1973	Oct 1974	-48.2%
Aug 1987	Dec 1987	-33.5%
Mar 2000	Oct 2002	-49.1%
Oct 2007	Mar 2009	-56.8%

Source: Ben Carlson

Stocks can always go down further. Considering that the current quarantine is basically a live experiment, no one knows how bad things will get economically. Though it might not feel this way right now, things will eventually recover. The following table shows the one-, three- and five-year returns after a bear market. Average returns have averaged 52%, 89% and 132%, respectively.

No one knows when stocks will bottom. Six of the 11 bear markets had stocks go down over 40%. Three of the 11 had stocks go down over 50%.

In mid-2008, investment magnate Warren Buffett wrote an article for the *New York Times* entitled "Buy American, I am." At that point the stock market was down 40% and in the worse financial crisis since the Great Depression. In his article Buffett said, "The financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary. So… I've been buying American stocks."

Returns following worst bear markets in history (S&P 500 since 1928)

Peak	Trough	Drawdown	1 year after	3 years after	5 years after
Sep 1929	Jun 1932	-86.2%	162.9%	170.5%	344.8%
Sep 1932	Feb 1933	-40.6%	98.7%	194.6%	154.6%
Jul 1933	Oct 1933	-29.8%	2.9%	120.1%	87.3%
Feb 1934	Mar 1935	-31.8%	83.8%	16.3%	84.9%
Mar 1937	Mar 1938	-54.5%	35.2%	38.2%	84.5%
Oct 1939	Jun 1940	-31.9%	8.0%	59.7%	118.8%
Nov 1940	Apr 1942	-34.5%	61.2%	128.6%	144.9%
Nov 1968	May 1970	-36.1%	34.8%	50.6%	42.2%
Jan 1973	Oct 1974	-48.2%	38.1%	72.7%	117.5%
Aug 1987	Dec 1987	-33.5%	23.2%	55.5%	121.7%
Mar 2000	Oct 2002	-49.1%	24.4%	59.0%	105.1%
Oct 2007	Mar 2009	-56.8%	53.6%	98.0%	181.6%

Source: Ben Carlson

Stocks would fall another 30% from the day Buffett said he was buying – proving that even the world's greatest investor can't nail the bottom. But looking back, he's still glad he did buy, even after factoring in today's events.

Buying too early means you could experience some pain if stocks go down further. Buying too late means you could experience some pain if stocks have already bounced. But this only matters for short-term thinkers. It would be nice to buy at the bottom, certainly. But it won't matter that much when we look back on this years from now. Remember, we're long-term investors investing long-term capital.

Upcoming earnings

In the Chartered Financial Analyst (CFA) program, they taught us that *the value of a company is the present value of future earnings*. In theory, if a company lost a year's worth of earnings, the value would drop, say, 5-10%. But the relationship between huge drops in earnings doesn't mean a huge drop in stock prices. Stock prices did worse than earnings in the Great Depression, while earnings fell much more than stock prices in the Great Financial Crisis. One explanation is that investors can over- or underreact on their expectations of the future, meaning the pendulum can swing far above or below fundamental values.

By the time you read this we should be in earnings season, i.e., when companies announce their quarterly earnings. As the lockdown didn't start in the U.S. until about March, the first-quarter earnings might not be affected that much, but they still won't be pretty. Second-quarter earnings will likely look much worse.

How long is this going to take?

The stock market tends to look forward and anticipate the future. As far as the virus goes, the pandemic won't likely be over until a good vaccine is developed and widely distributed. According to Michael Osterholm, Director of the Center for Infectious Disease Research and Policy at the University of Minnesota, a vaccine is anticipated to be 12-18 months away. Apparently, the hardest part isn't to develop something effective, but to ensure that it is safe. Vaccines are the highest bar there is in terms of testing, because they involve immunizing healthy individuals.

Another issue involves the supply chain. You might have a vaccine, but then you need to make enough of it to treat hundreds of millions of people. While this time horizon seems long, at least it provides a likely fixed endpoint to the problem. This is a big advantage over many other bear markets, where the problem causing the bear had no set ending at all.

Looking ahead

The coming recession will likely differ from anything we've seen before. In the hope of containing the virus, authorities are deliberately shutting down the economy. The good news is that the drop in economic demand is not permanent. Once the virus is under control, economic activity will return. The big questions are: When and by how much?

We are in a global state of fear and uncertainty. Can we survive the drought and re-emerge on the other side? We believe so. We're optimistic. We believe that people have the resilience and resourcefulness to help curtail the worst-case scenarios. They have before and they will now.

It's okay to be worried about the short term, yet optimistic about the long term. We believe that sticking to your financial plan, having patience, giving things time and investing wisely is still the best approach. In the meantime, please stay safe and stay healthy! ■

Stan Clark is First Vice-President, Portfolio Manager and Senior Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

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Teaming up for Team Talk

This month, we decided to team up for Team Talk to show you how we're all doing while working from home. Below, a picture from one of our regular team video conference calls. Starting from top left, here we are: Johnny Lyall, Stan Clark, Michael Chu, Heather Guzak, Elaine Loo, Martha Rodriguez, Sylvia Ellis, Meghan Jones and Jocelyn Johansson.

Johnny

The kitchen table is our office, the living room is our gym and the bedroom is for conference calls. Definitely an adjustment. But Erin and I are getting used to this new way of life for the next while. We make sure to get out of the house every day: Important to get some fresh air!

Stan

I usually work from home on Fridays, so now every day seems like Friday. We're doing lots of walking and biking, while trying to get enough sleep. It's easy to work nonstop plus try to keep up with the news, so my biggest challenge is maintaining a healthy balance.

Mike

I don't mind working at home, but you have to be careful with all those snacks! Fortunately the weather has been good so I am regularly biking – social-distance style, of course.

Heather

We are surviving our isolation day to day by trying to stick to a schedule that allows my husband and me to work, teach our children and get stuff around the house completed. We look forward to our one outing of the week – putting the garbage out!

Elaine

Self-isolation started out rough but I think we finally have a routine down. My husband is making sure we have enough food for a month, while I am making sure I have enough wine for a month! I have discovered a very useful quarantine trick, though: Keeping a glass of wine in each hand keeps me from accidentally touching my face.

Martha

I just got back after a shortened trip visiting family in Peru. With a strict national lockdown, complete with curfew, police and army patrolling the streets, we knew we had to get back to Canada asap. Getting repatriation flights home was harder than getting tickets to the hottest concert, but we were finally successful. What a story. It's good to be home, even with our mandatory quarantine where we are not allowed out at all. Can't wait to go for a walk!

Sylvia

All is well with me, my husband Craig and our dog Kobe as we all work from home. A bright spot is having to go out at least twice a day to take Kobe for a walk. With the sun coming out, it gets even better. Lessons learned? I forgot how easy it was to do my own hair. Fun with colour! And to also be more conscientious with things like—well, Ziploc freezer bags, for one. Built to withstand more, they can be reused with a good wash and then air-dried on a pasta rack.

Meghan

The past four weeks have been challenging, at best. Especially navigating a four-person dining table with my partner, Adam, as our shared home-office space ;). Living so close to work does put me at an advantage, however, and I am able to pop into the office if need be in order to make sure our clients' needs are met.

Jocelyn

Working from home with a young toddler and a kindergartener is certainly keeping us on our toes. To keep them busy and learning, we have become full-time teachers and sports directors! We have had family dinner every night, which is a lovely change. Prior to COVID-19, it was rare for us all to be able get together for dinner during the week. The challenging thing is that my office is our dining room table, which is also the art station and my kindergartener's classroom. Meanwhile, my husband is relegated to a chair in the family room with his computer on his knees. Really wish we had put in a home office!

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