Monthly Market Monitor

March 2020

HIGHLIGHTS

Coronavirus fears spread

Global equity markets plunged nearly 10% in the last week of February as investors recalibrated their (negative) expectations about the potential impact of the coronavirus, which is now seeing a surge in cases outside China. Interestingly, Canadian equities fared best amid the global market turmoil.

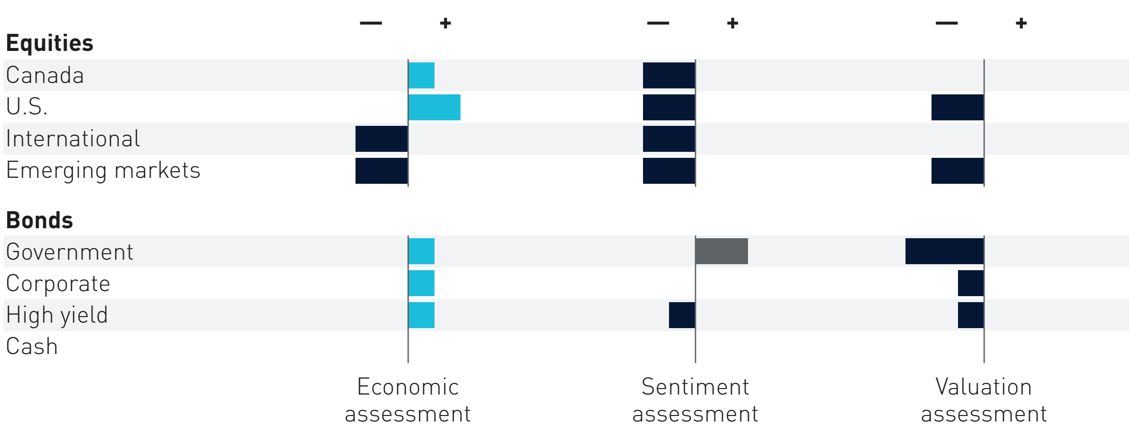
Flight to safety

Yields on U.S. Treasury bonds fell to their lowest levels on record as panicked investors flocked to safe-haven securities. Gold and the U.S. dollar also rallied.

Central bank response

Market participants have started pricing in an increased likelihood of central bank rate cuts as a way to offset economic weakness stemming from the virus.

OUTLOOK SUMMARY



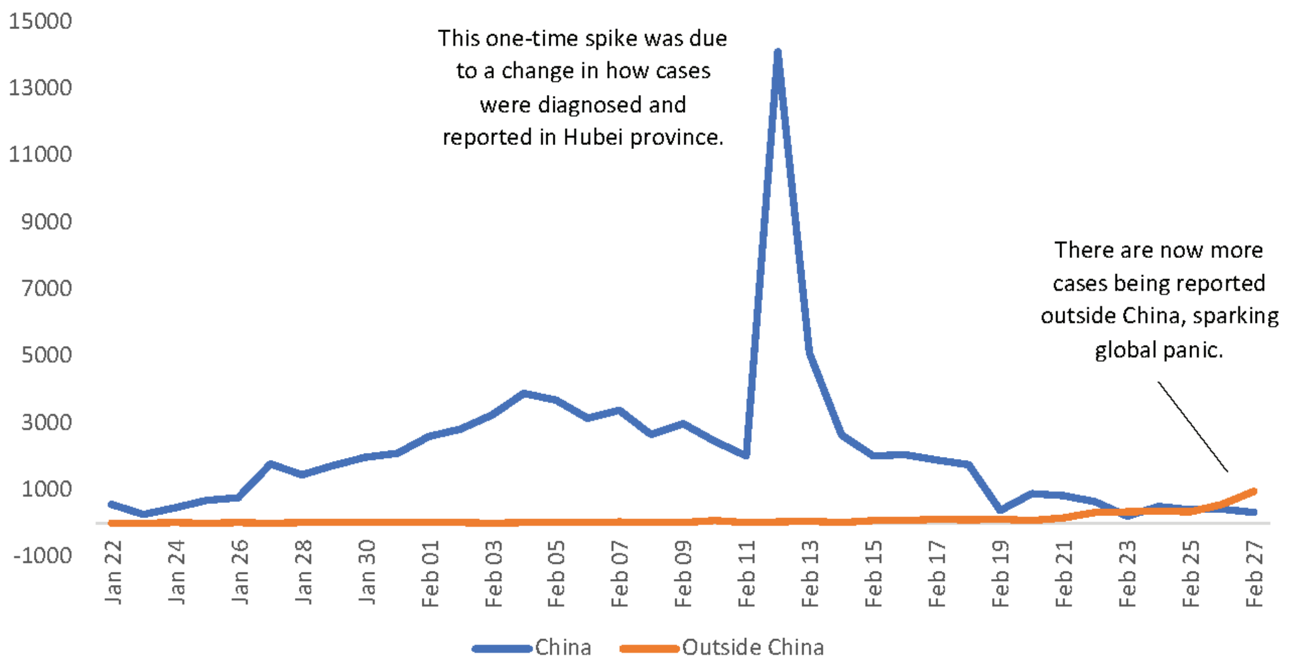
Source: NEI Investments. Data as of February 29, 2020.

ALLOCATION INDICATOR

OVERVIEW

The COVID-19 (coronavirus) outbreak continued to rattle markets last month. Just when it seemed like China was getting a handle on the situation, cases started to spring up in Iran, Italy, Japan, and South Korea. The U.S. Centers for Disease Control and Prevention warned Americans to prepare for a coronavirus outbreak in that country.

Daily change in number of reported COVID-19 cases



Source: https://www.worldometers.info/coronavirus. Data as of February 29, 2020.

So far China is feeling the brunt of the economic impact as many small and medium-sized businesses have been forced to remain closed even after the Lunar holiday ended. Chinese authorities have taken measures including cutting interest rates and boosting bank lending, but market reaction indicates it's not enough. According to Bloomberg, as many as two-thirds of Chinese private businesses will run out of cash within two months. Industries most affected include airlines and travel, shopping malls and theatres, as well as hotels and restaurants. China's February manufacturing and service PMIs came in at all-time lows, 35.7 and 29.6, respectively.

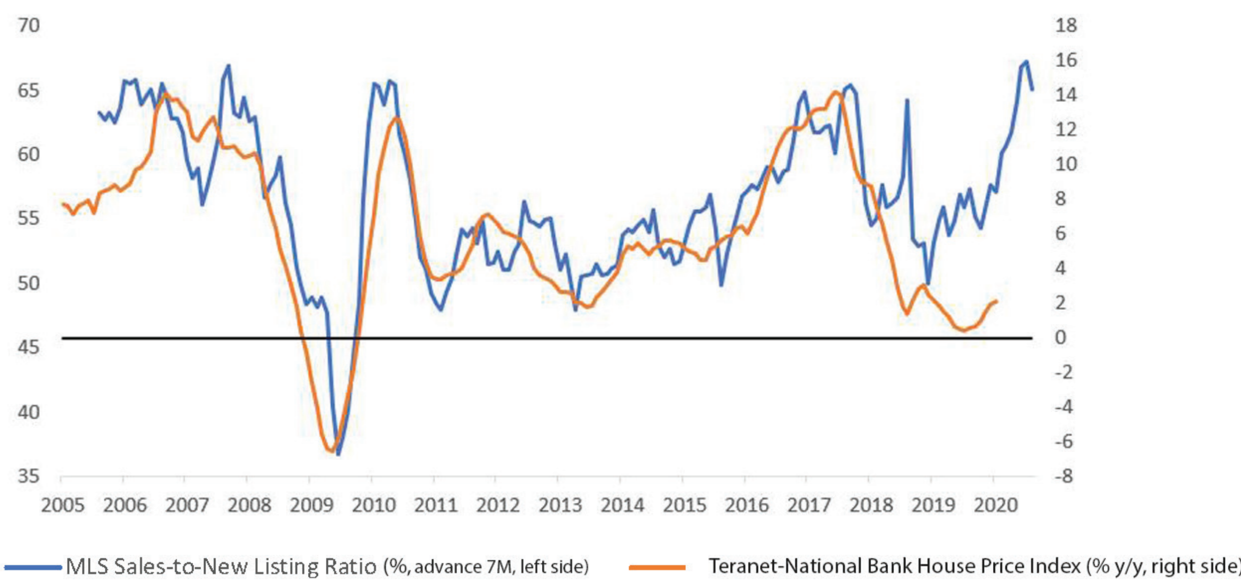
On a global scale, many multi-national companies now face a serious risk of disruptions in their supply chains. Widespread adoption of just-in-time manufacturing over recent years only amplifies the downside effect. Apple, the world's second largest company by market cap, issued a revenue warning last month citing the coronavirus outbreak. Microsoft and United Airlines both issued lower guidance. Auto manufacturers also face an increasing risk of a parts shortage.

As we noted in last month's Market Monitor, we continue to believe there is unlikely to be any long-term economic and market impact. Truth be told, no one can predict the magnitude of the global outbreak. There is growing consensus that we'll see flat growth in Q1, and possibly Q2, and asset prices are already reflecting this scenario. Things will likely get worse before they get better.

CANADA

The Canadian housing market is seeing a strong start to the year. The Teranet-National Bank House Price Index has rebounded from its mid-2019 lows. The sales-to-new listings ratio, a good leading indicator of future prices, remains at a level higher than where it was in mid-2017 at the peak of price inflation. As mortgage stress tests are set to become less stringent in April (with a lowering qualifying rate), we will likely see continued upward pressure on housing prices going into the spring.

Canada house prices versus Sales-to-New Listing Ratio



Source: Capital Economics, CREA, Teranet. Data as of February 29, 2020.

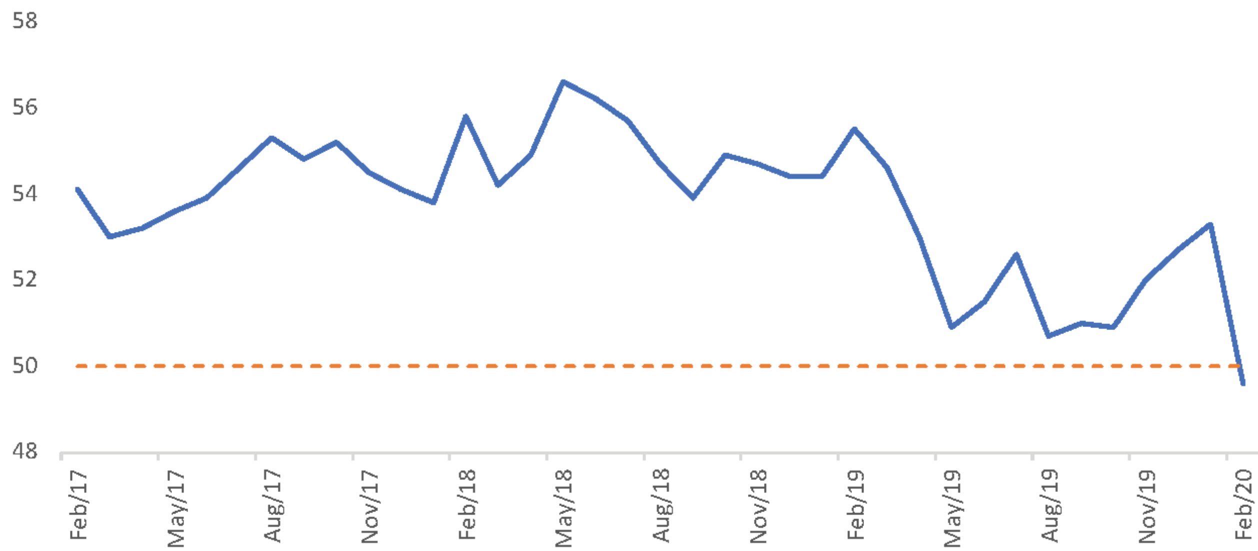
Canada's GDP growth of 0.3% annualized in the fourth quarter was weak but stronger than expected. While it doesn't capture the impact of the coronavirus, it does highlight the fundamentals underpinning the economy. Transitory factors including pipeline shutdowns, labour disruptions, and bad weather weighed down on the reading. The weaker economic data combined with coronavirus fears have increased the odds of the Bank of Canada cutting rates this year. While we agree a stronger case can be made for easing, markets should probably temper their enthusiasm, given that inflation is running above 2% and a continued home price rally may risk bringing "frothiness" back to the housing market.

U.S.

Coronavirus concerns drove U.S. 10- and 30-year Treasury yields to new all-time lows last month, reaching 1.148% and 1.675% respectively. Markets are also pricing in four more 25 basis point rate cuts from the U.S. Federal Reserve by January 2021. Our asset allocation solutions were already positioned somewhat defensively as of early January on concerns over faltering economic growth, which afforded us some cushion when markets turned over. And, we had increased the duration of our fixed income allocations, which increases the portfolios' sensitivity to changes in bond yields. As bond yields fell to new lows, the move helped deflect some of the equity market selloff. That said, at current levels, we don't expect to increase duration any further, as bonds show signs of being extremely overbought. Between February 19 and 24, the move in the 30-year U.S. Treasury yield was in line with moves seen during the financial crisis, as well as in 2011 when the U.S. faced its first credit rating downgrade.

Market volatility aside, our concerns have also grown with the preliminary U.S. Composite PMI dropping into contraction territory, falling from 53.3 to 49.6.

Markit U.S. Composite PMI



Source: Bloomberg consensus estimates. Data as of January 31, 2020.

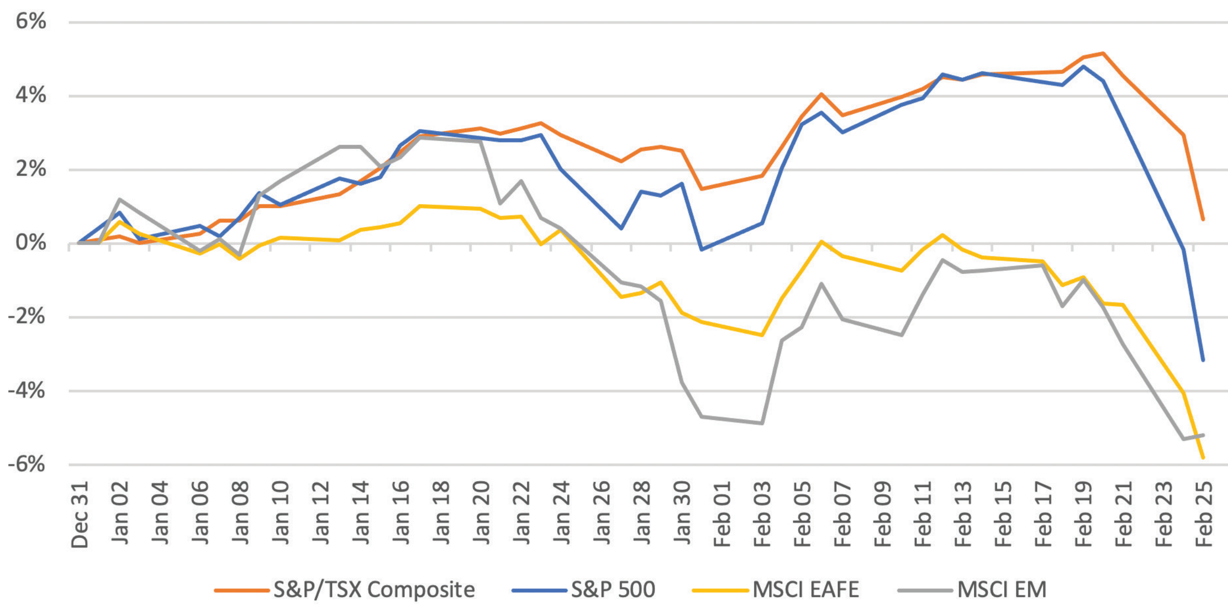
Excluding the 2013 government shutdown, the recent dip below 50 signals the first contraction of U.S. business activity since the financial crisis. According to IHS Markit, which produces the index, the deterioration was partly linked to the coronavirus outbreak, and partly linked to concerns of a wider economic slowdown ahead of the U.S. election.

Consumer confidence, on the other hand, remains near its all-time highs, and paints a very different picture from the business sentiment indicators. Consumer spending drives 70% of total U.S. GDP, and strong consumer confidence allows us to take some amount of comfort in the near-term. We will need to see more data points to have a firmer picture, but all-in-all, despite high consumer confidence, we would say the risks have tilted further to the downside.

INTERNATIONAL AND EMERGING MARKETS

International and emerging markets have seen the largest year-to-date declines on coronavirus concerns, and understandably so. Most of the cases are in China (the epicenter of the outbreak), nearby Asian countries, and Europe, and these regions have a larger manufacturing sector and are therefore more vulnerable to labour force and supply chain disruptions.

Global equity market returns YTD



Source: Bloomberg. Returns in local currency. Data as of February 29, 2020.

In Europe, Italy has by far the most reported cases. The concern is that affected regions in northern Italy, which include Milan and Venice, are not only manufacturing centres but also popular tourist destinations. Europe just can't seem to catch a break. Compared to the U.S., manufacturing and trade make up a much larger share of euro area aggregate GDP. Even if the coronavirus were to be eradicated tomorrow, there remain challenges with the underlying economy. For twelve consecutive months now, the region's manufacturing PMI has shown contraction. For the time being, within equities, we remain overweight North America versus the rest of the world.

MARKET PERFORMANCE

Percent return in Canadian dollars

	1 Mo	3 Mo	6 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Fixed Income								
Bloomberg Barclays Canada Aggregate	0.73	2.52	1.87	3.63	9.11	4.52	2.92	4.44
Bloomberg Barclays Global Aggregate (CAD Hdg)	1.25	2.85	1.98	3.09	9.65	4.56	3.57	4.48
Bloomberg Barclays US High Yield 2% Issuer Cap (CAD Hdg)	-1.43	0.47	1.33	-1.43	5.33	4.03	4.58	7.14
Equities								
MSCI World (Developed Markets)	-7.08	-5.29	1.91	-5.81	6.65	7.72	7.43	11.38
MSCI World Growth	-5.97	-1.98	4.92	-2.48	14.49	12.54	10.19	13.41
MSCI World Value	-8.26	-8.63	-1.14	-9.17	-0.96	2.94	4.61	9.29
MSCI Canada	-5.91	-4.29	0.00	-4.45	3.26	3.94	3.42	5.48
MSCI USA	-6.84	-4.41	2.96	-4.83	9.77	9.81	10.09	14.69
MSCI EAFE	-7.68	-7.07	0.10	-7.81	1.34	4.39	3.44	7.37
MSCI Europe	-7.92	-7.13	-0.11	-8.45	1.28	4.70	2.74	7.26
MSCI Japan	-7.78	-7.54	1.39	-7.23	3.01	3.82	5.17	7.65
MSCI Pacific Ex Japan	-6.31	-5.98	-1.70	-6.03	-1.55	4.12	4.26	7.75
MSCI EM (Emerging Markets)	-3.86	-1.92	3.98	-6.51	0.01	5.36	4.23	5.68
World currencies (relative to CAD)								
US Dollar	1.50	1.06	1.02	3.52	1.92	0.45	1.46	2.42
Euro	0.60	0.68	0.76	1.30	-1.68	1.57	1.03	0.22
Pound Sterling	-1.65	-0.20	5.95	-0.19	-2.12	1.33	-2.34	0.64
Yen	1.99	2.60	-0.59	4.29	5.19	1.68	3.57	0.45

Source: Morningstar. Data as of February 29, 2020.