A LIGHT AT THE END OF THE TUNNEL

Since March 22nd, global stock markets have had a powerful rally with Canadian and U.S. stock markets, up 36% and 34%, respectively as of April 29th. Year to date these markets are now down by 11% and 9% respectively. Despite continued negative COVID-19 headlines in terms of growing global cases and deaths, the markets have rallied as investors discount bad news and have begun looking out over the next 12 months. As a result, many media commenters are now speculating on the shape of an economic recovery. Whether it will be a ‘V’, ‘U’, ‘L’ or ‘W’ recovery, no one really knows for sure. Predicting the shape of the recovery is like guessing the weather in Calgary – wait a few minutes and it will change again. Rather than speculating on the shape of the recovery, let’s focus on the facts that we know.

First, this is the first global recession that is self-induced in order to save millions of lives. Although the economic hardships faced by millions of individuals and businesses is real, saving lives is the priority. Governments and central banks will continue to inject money into the economy and provide assistance for consumers to dampen the negative economic impact. Governments seem to have an unlimited printing press in terms of continuing to expand the size and depth of the social security net the longer the economies remain partially closed. We know that the economy will recover with time as businesses reopen through a phased-in approach.

Second, although many comparisons to the Great Depression are being made, that period was significantly different than today’s. Back then, central banks and policy makers made a series of mistakes, as they had less experience dealing with serious recessions. In addition, there was no social security net in place for businesses and individuals. Since then, policy makers and central banks have learned from past recessions and have fine tuned their response mechanism. The lesson of the Great Financial Recession of 2008/09 was the need for quick and massive monetary and fiscal response by central banks and governments to calm credit and equity markets. In the last six weeks we have seen global central banks and governments quickly move to a ‘whatever it takes’ attitude in response to the Great Lockdown.

According to the International Monetary Fund (IMF), the global economic contraction from 1929 to 1932 was approximately 10 percent, while advanced economies shrank by 16% during that period. In the IMF’s recent World Economic Outlook, it projects that the global economy will contract by 3% in 2020, with advanced economies contracting by 6.1%. This year’s reduction of output will be far more severe than the last recession, when the world economy contracted by less than 1 percent between 2008 and 2009: however, it may not be as large as in 1929-1932. Looking out to 2021, the IMF predicts a significant 5.8% rebound in global economic growth (see table below).

Latest World Economic Outlook Growth Projections

The COVID-19 pandemic will severely impact growth across all regions.

(real GDP, annual percent change)	2019	PROJECTIONS 2020	PROJECTIONS 2021
World Output	**2.9**	**-3.0**	**5.8**
Advanced Economies	**1.7**	**-6.1**	**4.5**
United States	2.3	-5.9	4.7
Euro Area	1.2	-7.5	4.7
Germany	0.6	-7.0	5.2
France	1.3	-7.2	4.5
Italy	0.3	-9.1	4.8
Spain	2.0	-8.0	4.3
Japan	0.7	-5.2	3.0
United Kingdom	1.4	-6.5	4.0
Canada	1.6	-6.2	4.2
Other Advanced Economies	1.7	-4.6	4.5
Emerging Markets and Developing Economies	**3.7**	**-1.0**	**6.6**

Source: IMF, World Economic Outlook April 2020: The Great Lockdown

Third, stock markets are forward looking and as result they usually bottom before the trough of a recession. On average the U.S. stock market bottoms five months before the trough (see table below). Using that average, and assuming the market low was in late March, we would anticipate the recession may trough in the late August/September timeframe. Stock markets have been rallying for the last five weeks as investors continue to discount the deterioration of economic data, negative earnings growth and limited earnings visibility for 2020, while focusing more so on the potential economic rebound that may follow in 2021 and beyond.

S&P 500 Bear Markets and US Recessions since 1929

Bear Markets		Economic Cycles		# of months: Market Lows
Peak	Trough	Peak	Trough	to Recession Troughs
Sep-29	Jun-32	Aug-29	Mar-33	9
Jul-33	Mar-35			
Mar-37	Apr-42	May-37	Jun-38	n/a
May-46	Jun-49	Nov-48	Oct-49	4
Aug-56	Oct-57	Aug-57	Apr-58	6
Dec-61	Jun-62			
Feb-66	Oct-66			
Nov-68	May-70	Dec-69	Nov-70	6
Jan-73	Oct-74	Nov-73	Mar-75	5
Sep-76	Mar-78			
Nov-80	Aug-82	Jul-81	Nov-82	3
Aug-87	Dec-87			
Jul-90	Oct-90	Jul-90	Mar-91	5
Mar-00	Oct-02	Mar-01	Nov-01	n/a
Oct-07	Mar-09	Dec-07	Jun-09	3
Feb-20	Mar-20			
Average # of Months				5
# of Bear Markets				16
# of Bear Markets Extending after a Recession				2
# of Bear Markets Leading to a Recession				10

Source: Scotiabank GBM Portfolio Strategy, Bloomberg, NBER.

The Bottom Line

Over the last five weeks, the Matco funds have participated in the strong rally and remain close to fully invested. We continue to focus on companies with dividend sustainability, low debt ratios and have limited exposure to commodities. Following our strict investment process, we replaced a few companies in our equity portfolio with some that provide a better reward/risk ratio and increased the corporate bond exposure in our fixed income fund to take advantage of attractive yields. On an asset mix level, we increased the equity weight in our balanced fund mandates and took profits on the fixed income weight. We believe that the Matco funds are well positioned despite the continued economic and COVID uncertainty. If you would like more information about Matco funds please contact us by email.

Stay Safe. Stay Healthy.

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