Smart Investor



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Tax Return for 2019:

Due to COVID-19, the deadline for filing has been extended to June 1, 2020.

Contact

Shiuman Ho, M.Sc., MBA, CIM®
Vice President
Portfolio Manager & Investment
Advisor
Shiuman Ho Wealth Advisory Group
TD Wealth
Private Investment Advice
shiuman.ho@td.com
604-482-8409



A Novel Coronavirus Infects the Markets

Review of Markets

Economy hits the brakes

After chalking up impressive gains in 2019, financial markets continued their run into the middle of February. At that time, the spread of the novel coronavirus had not hit North America in a big way. When it became clear that we were not going to be immune from this serious illness markets started to assume the worst.



Source: Thomson Financial as at Mar 31, 2020

The chart above shows how the Canadian and U.S. stock market indices plunged after February 19 and hit a bottom on March 23, 2020. Both the S&P 500 Index (S&P 500) in the U.S. and S&P/TSX Composite Index (TSX) in Canada subsequently rebounded, but still finished the first quarter down 20% and 21% respectively from the end of 2019. The drop was not the deepest in history, but occurred in a far shorter time than the correction of 2008 which took six months to reach its low point.

All developed and emerging market indices declined in a similar fashion. The MSCI World Index was down 21%

in the first quarter of 2020. Bond markets held up for the most part, with the FTSE TMX Canada Universe Bond Index returning 1.6%, demonstrating the benefits of a diversified portfolio that includes the stability offered by bonds.

Crude oil and the Loonie slid, too

The oil market was hit by a sharp drop of demand as air travel and commuting all but came to a standstill as stav-athome orders were instituted. At the same time, a dispute between two major oil producers - Saudi Arabia and Russia - caused supply to increase, which led to a glut in oil just as demand disappeared. Oil inventory built up to such a level that on April 20 oil futures pricing turned negative. The Canadian dollar has been known as a "petro currency" because its value is closely tied to that of oil. As the price of a barrel of crude slid, the value of the Loonie slid with it, which for a few days dipped below 70 cents U.S. to a dollar.

Questions You May Have

Why did the markets drop?

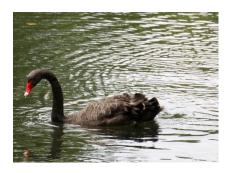
By the middle of March most businesses were ordered to close or send their employees home. Retail stores and restaurants switched to offering online and takeout while essential services such as pharmacies and grocery stores remained open. Businesses large and small felt the immediate effects of significant fall off in sales while much of the costs remained. Share prices are closely linked to present and future earnings; with earnings likely to shrink in the coming months stock prices dropped sharply, assuming the worst. Unemployment claims spiked, not due to a lack of jobs, but because workers are not allowed to work. Paul Krugman, a economist, likened this to be a "medically induced coma" for the economy.



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Why didn't anyone foresee this?

Some events, such as the sun rising in the morning are predictable, whereas rain, even in Vancouver, is not a certainty. Meterologists use sophisticated models to make forecasts based on probability. On rare occasions they may fail to forecast a once in a hundred year snowstorm. That's a black swan event – high impact, but very low probability. The financial crisis that led to the Great Recession of 2008 could also be termed a black swan event.



By nature such rare events are hard to predict. The current bear market was unique in that it was brought about by a global pandemic not the usual economic cycle.

What has the government done?

The Canadian government has announced a series of measures to alleviate the hardship caused to workers and businesses. It's the government's way to pay to keep businesses closed in order to limit the spread of the coronavirus. The Bank of Canada as well as the Federal Reserve in the U.S. have each lowered interest rates, and enacted programs to stabilize the bond and mortgage markets.

When will markets improve?

The simple answer is when the pandemic is under control and economic activity returns to normal. However it is not a simple matter of flipping on a switch; more likely we will

see a phased approach to re-open businesses. Some industries such as those related to travel may take longer to recover. Until a vaccine is available, which medical experts estimate would take at least 18 months or longer to develop, some form of physical distancing will likely remain in the way business is done. TD Economics is expecting the economy to start to show positive growth in the second half of 2020, but won't return to previous levels until late 2021.

Strategy in a Downturn

You may recall an analogy I have used before, that we need to dress appropriately and carry an umbrella if we are expecting rain. We may need to keep our rain boots on for now, but look to the horizon for signs of blue skies.

Stay invested

The old adage about "time in the market" rather than "timing the market" is never truer than it is now. The S&P 500 has rebounded strongly since the end of March; anyone who sold in a panic in March would have missed out on the gains since.

Make tactical adjustments

A sailor does not simply set the course and sit back, but is constantly trimming sails or direction depending on the winds and current. We may need to adjust the type of bonds or sectors we invest in.

Ensure resilience

Some sectors have been more resilient than others in this bear market. For example, technology companies that enable distant learning or work-fromhome are proof that some businesses can prosper in this environment. As mentioned on page one, bonds can be a good diversifier when stocks drop.

Trust your long-term plan

If you have a written financial plan, it was likely developed to ensure you

withstand financial dislocations such as what the pandemic is causing.

Shiuman's Corner What to do in a lockdown



Signs of life (photo: Shiuman Ho)

After a month of sheltering at home, many of us have settled into a new routine. The first priority to make sure the technology of connecting to work systems was up and running. The short commute was easy to get used to. As the days became weeks the novelty wore off and became the norm. although there's nothing normal about this. I feel fortunate to be able to work during this time, and appreciate my clients' patience that we cannot meet face-to-face. However, the use of video conferencing has spiked. All of us have had to adapt to the conditions that have been thrusted upon us. The media is full of stories of heroic feats by frontline workers, to whom all of us owe a great debt. The rest of us have taken up baking, or binging on streaming shows. My wife decided it was time to start a vegetable garden, not least because it cuts down the number of trips to the grocery store. For me I have been out on my road bicycle to stay active and spending more time learning Goldberg Variations on the piano. I'm only on the fourth of 30 variations so they will keep me going for a little longer.



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