

QUARTERLY REPORT

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Ginny Arnott-Wood
BA, CFP, CIM

Wealth Advisor &
Associate Portfolio Manager

905-333-1920

ginny.arnott-wood@raymondjames.ca



Laurie Smuk, B.Sc
Administrative Assistant

905-333-1955

laurie.smuk@raymondjames.ca

Arnott-Wood
Wealth Advisory of
Raymond James Ltd.

1455 Lakeshore Rd., Suite 204S,
Burlington, Ont. L7S 2J1

www.raymondjames.ca/ginnyarnottwood/

A Perspective on Risk and Uncertainty

When I wrote my last report in early April, the world was only beginning to come to terms with the enormity of the global pandemic. We were all in lockdown - schools and businesses abruptly shuttered, planes grounded, and hospitals across North America were preparing for, or contending with, unprecedented numbers of seriously ill patients suffering from a virus we had never experienced.

As we all reeled from this sudden assault on our lives, investors ran for the hills. The stock markets' reaction was a global convulsion that reached its nadir on March 23, 2020. As Covid-19 overwhelmed many cities, the subsequent decimation to businesses, at least temporarily, resulted in a double-dose of fear for many: am I going to catch this awful virus, *and* will I be able to pay the rent? Investors' appetite for risk disappeared like so much toilet paper from Costco.

Three months later, the virus rages on, causing destruction to lives and businesses across the globe. However, we have learned a few things about the virus' behaviour, along with some ways to navigate life around it. While the US, Brazil, and India report record daily new infections, other countries (blessedly including Canada) are taking to heart what the scientists and health professionals are discovering. As a result, our infection rates are starting to recede as we cautiously open our economies to a compromised version of pre-pandemic normal.

And investors are back - for example, the S&P/TSX Composite, down as much as 38% in March from its high watermark in February, is now down only about 10% as of mid July. The tech-heavy NASDAQ is currently trading above its February high. There are many investment gurus having difficulty reconciling how equity markets could rebound so dramatically, while the pandemic continues to ravage, and humans, and our economies, struggle to get a foothold back to normal functioning.

This discrepancy got me thinking about the nature of risk vs. uncertainty. I found an article on the subject, which is interestingly from July 2002, another period where an unprecedented event (9/11) had spooked investors out of the market, only to see it come roaring back less than a year later. In his article, *Beyond Risk Lies Uncertainty*, Frank A. Schmid wrote:

“Risk and uncertainty are two concepts that emanate from randomness. Neither concept is fully understood. Although risk is quantifiable, uncertainty is not. Rather, uncertainty arises from imperfect knowledge about the way the world behaves. Most importantly, uncertainty relates to the questions of how to deal with the unprecedented, and whether the world will behave tomorrow the way it behaved in the past.”

These ideas resonate for me when I look at what has happened over the last few months. The extreme selloffs in the market at the end of February and March had everything to do with uncertainty – everyone trying to grapple with the unbelievable suddenness of our lives being shut down. Absent more information, the “risk-off” reaction is understandable, because no one knows how to price it, and they just want out.

Now that we’ve learned more about the virus, and how we may be able to work around it, we’re figuring out ways to emerge from complete shut-down and try to keep the economy moving, albeit with a limp. It’s all about understanding the risk and managing it accordingly. The stock markets do that too – managing risk, and putting a price on it, however imperfectly, is something done everyday.

It’s also worth noting that the stock market is a “leading Indicator “. Seasoned investors know that in the short term anything can happen (no kidding!) but two, three, five years out, with or without a vaccine, what will be the great companies? And where might the bargains be today given that the world is still unclear about the future of the pandemic?

Uncertainty and risk – we deal with them everyday in every sphere of our lives. Most of the time the stakes aren’t that high. But lately it feels like there is so much riding on even simple things like going to the store for groceries or sending our kids to school. We’re in the middle of a giant, worldwide experiment, which will require leaps of faith, and calculated risks to get through our days till a reliable and widely available vaccine is found.

Meanwhile, intrepid investors are likewise putting a price on risk – and will be the ones to reap the rewards when (and if) the all-clear is sounded.



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