Weekly Trends

PRIVATE CLIENT SOLUTIONS

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March 13, 2020

Bear Territory

It was a good run; one of the best in fact. An eleven year US bull market, uninterrupted by a 20% drawdown, until this week. We came close a few times, like in 2011, 2015 and most recently, 2018. In each of these instances, monetary authorities were able to steer the market back on track. The Fed surely couldn't have imagined that something as small as 20 nanometers, indistinguishable by the human eye, could abruptly end the most historic bull run in American history.

- By far, one of the more difficult aspects of investment management is knowing when to sell. When prices are rising, no one wants to sell but oddly when prices are falling everyone runs for the exits at the same time.
- For example, let's look back at the financial crisis. Recall the panic in the street as each day investors speculated on which financial institution was going to fail. It was a difficult time and when you're in it, you wonder how the market will ever recover. The waterfall selloff began in October 2008 and selling pressure persisted until the March 2009 bottom. As we know a bottoming process will take time, but we can be on the outlook for technical signs to confirm the process.
- We will continue to be on the outlook for a bottoming process, but during periods of volatility, it's important to take a step back and look at the bigger picture. Equity markets are prone to corrections and can even temporarily slip into bear markets within the context of a secular bull market.

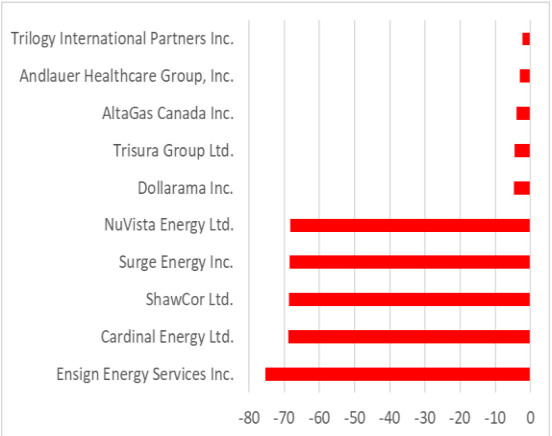
S&P/TSX 2-Yr Chart

Canadain Mkt & Sector Breadth

No. Stocks Above 50-d	11	2%
No. Stocks Above 200-d	50	9%

GICS Sector	Issues Above 50-d MA	200-d MA
Communication Services	0%	0%
Consumer Discretionary	6%	8%
Consumer Staples	0%	8%
Energy	0%	4%
Financials	4%	4%
Health Care	7%	22%
Industrials	0%	9%
Information Technology	4%	20%
Materials	1%	8%
Real Estate	2%	13%
Utilities	0%	10%

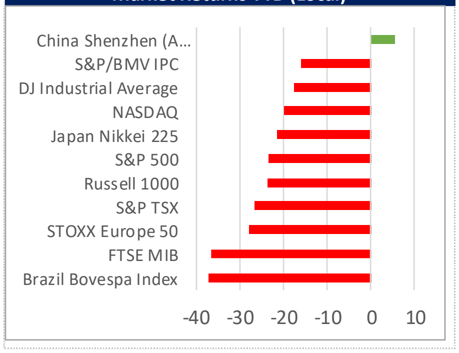
Canada Top Advancers/Laggards*



Canada Top Yielding *

Company	Yld (%)
Vermilion Energy Inc.	54.3
Ensign Energy Services Inc.	44.4
Surge Energy Inc.	33.3
Cardinal Energy Ltd.	26.5
American Hotel Income Properties REIT I	23.5
TORC Oil & Gas Ltd.	22.9
Peyto Exploration & Development Corp.	20.2
Whitecap Resources Inc.	19.5
ShawCor Ltd.	18.8
Chemtrade Logistics Income Fund	17.7

Market Returns YTD (Local)



Source: FactSet, Raymond James Ltd; * 5-day price return

Source: FactSet

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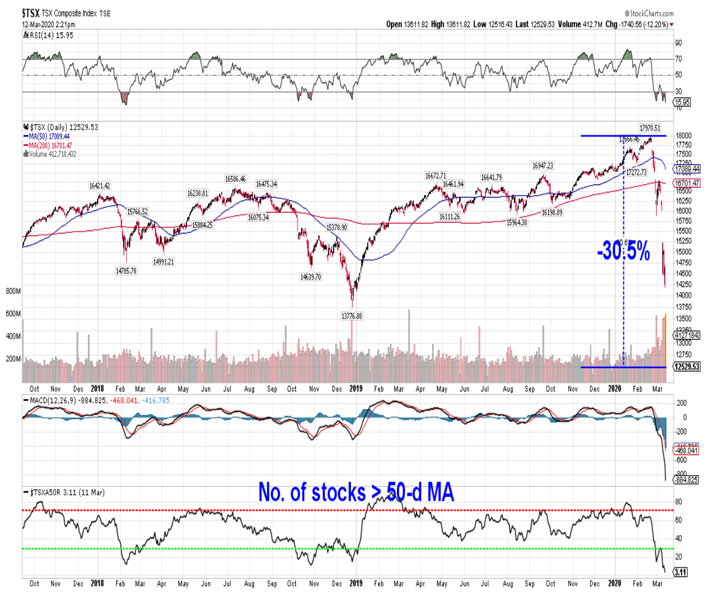
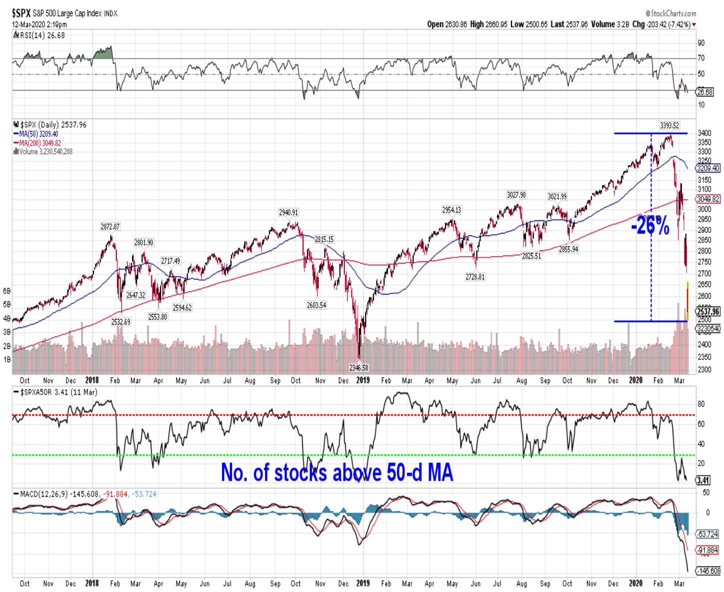
The S&P/TSX and S&P 500 have now officially entered bear market territory as of Wednesday March 10, 2020 (in an odd temporal twist, the bull market began on March 10, 2009). As I write this in my kitchen, I ask my wife what this could possibly mean. “Well, some things just happen.” she says. I’m going with it; weird coincidences happen all the time.

S&P/TSX – Down ~30 Intraday



S&P 500 – Down 26% Intraday



Source: Stockcharts.com, Raymond James Ltd, priced as of Thursday, March 12 2020.

It was a good run; one of the best in fact. An eleven year US bull market, uninterrupted by a 20% drawdown, until this week. We came close a few times, like in 2011, 2015 and most recently, 2018. In each of these instances, monetary authorities were able to steer the market back on track. The Fed surely couldn’t have imagined that something as small as 20 nanometers, indistinguishable by the human eye, could abruptly end the most historic bull run in American history. But, COVID-19, a novel coronavirus, was able to do it. However, the truth of the matter is the bull market begun to show its age as far back as 2018. Global growth was decelerating while the US Fed remained steadfast in its commitment to normalize interest rates, which exacerbated this situation. Investors that focus on chart patterns would have noticed divergences, but in the moment they’re hard to rely on when you know central banks can easily make you look foolish.

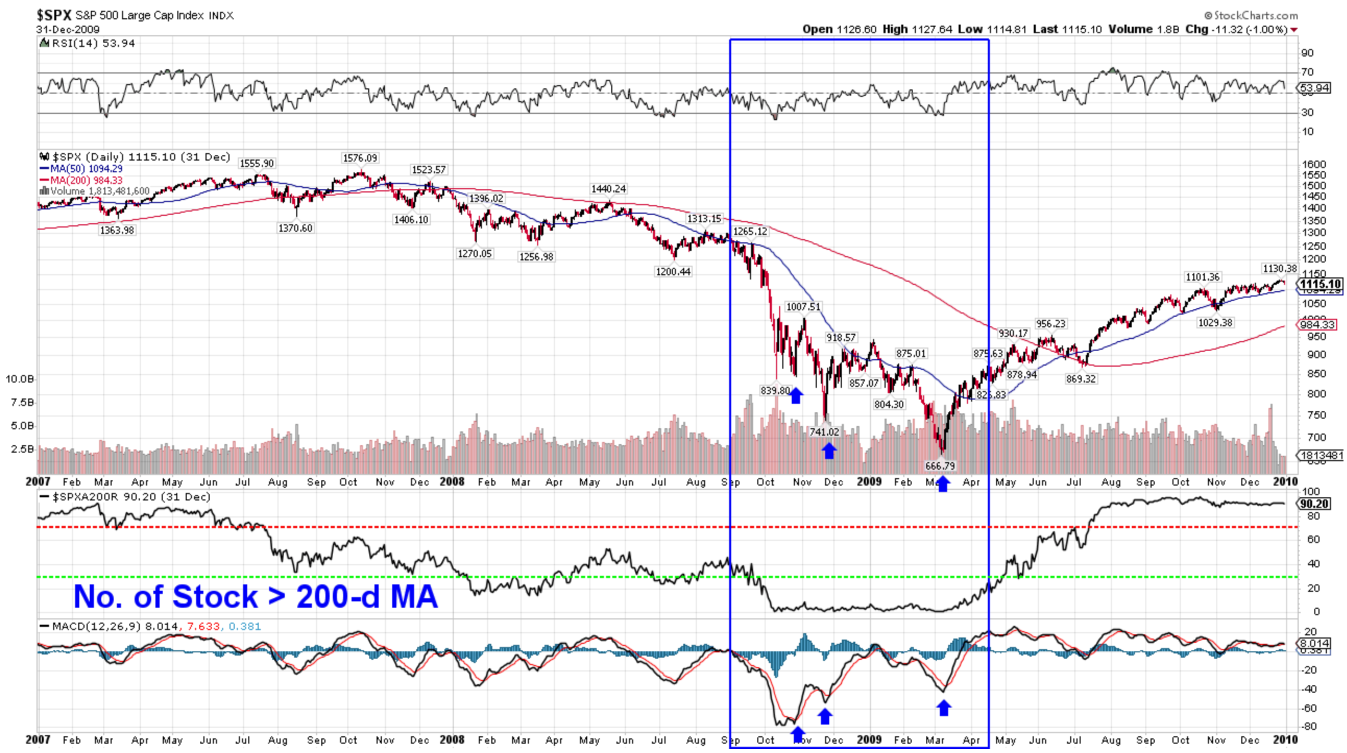
Time to Sell or Time to Buy?

By far, one of the more difficult aspects of investment management is knowing when to sell. When prices are rising, no one wants to sell but oddly when prices are falling everyone runs for the exits at the same time. If you feel the impulse to sell today, ask yourself will the securities I’m holding be worth more or less than its current value when I actually need the funds? As most investors that have significant equity exposure are likely many years away from retirement, the answer invariably is higher.

We downgraded equities to neutral in November 2018, which is looking more and more like a good decision, but the more difficult question remains. Reducing equity exposure after a decade run in equities made sense in the face of rising risks to the global economy, but the harder decision, which we all face in the coming months, is when to put capital back to work. We also must make a call on whether we have entered a secular bear or cyclical bear market. Secular markets trends have an overarching direction that lasts for five years or more; cyclical trends are like the seasons, they come and go. You can have cyclical bears within a broader bull market, which is our going assumption at this time. The median cyclical bear market associated with a US recession has declined 35.9% over 517 days (17 months) versus -23.3% over 224 days (7 months) for cyclical bear markets not associated with recessions. If the US doesn't slip into a recession, the US markets at these levels have often been good entry points. If we enter a recession there is further downside. The important point that we'd like to highlight is the duration; bottoms take time to form. Also calling the exact bottom is extremely difficult, so we like to be accumulator of good companies over time particularly when they go on sale.

For example, let's look back at the financial crisis. Recall the panic in the street as each day investors speculated on which financial institution was going to fail. It was a difficult time and when you're in it, you wonder how the market will ever recover. The waterfall selloff began in October 2008 and selling pressure persisted until the March 2009 bottom. As we know a bottoming process will take time, but we can be on the outlook for technical signs to confirm the process. Considering the chart below, as the S&P 500 continued to make lows in 2008 and early 2009 we note a divergence between the MACD, which was make successively higher lows. These classic types of divergences are rather easy to spot in hindsight. One could have made the case that a bottom was in late 2008, which would have meant you were a few months early; however if you had opportunistically accumulating good companies over that timeframe you were handsomely rewarded within two years.

S&P 500 – Financial Crisis; Real Bottoms Take Time to Form



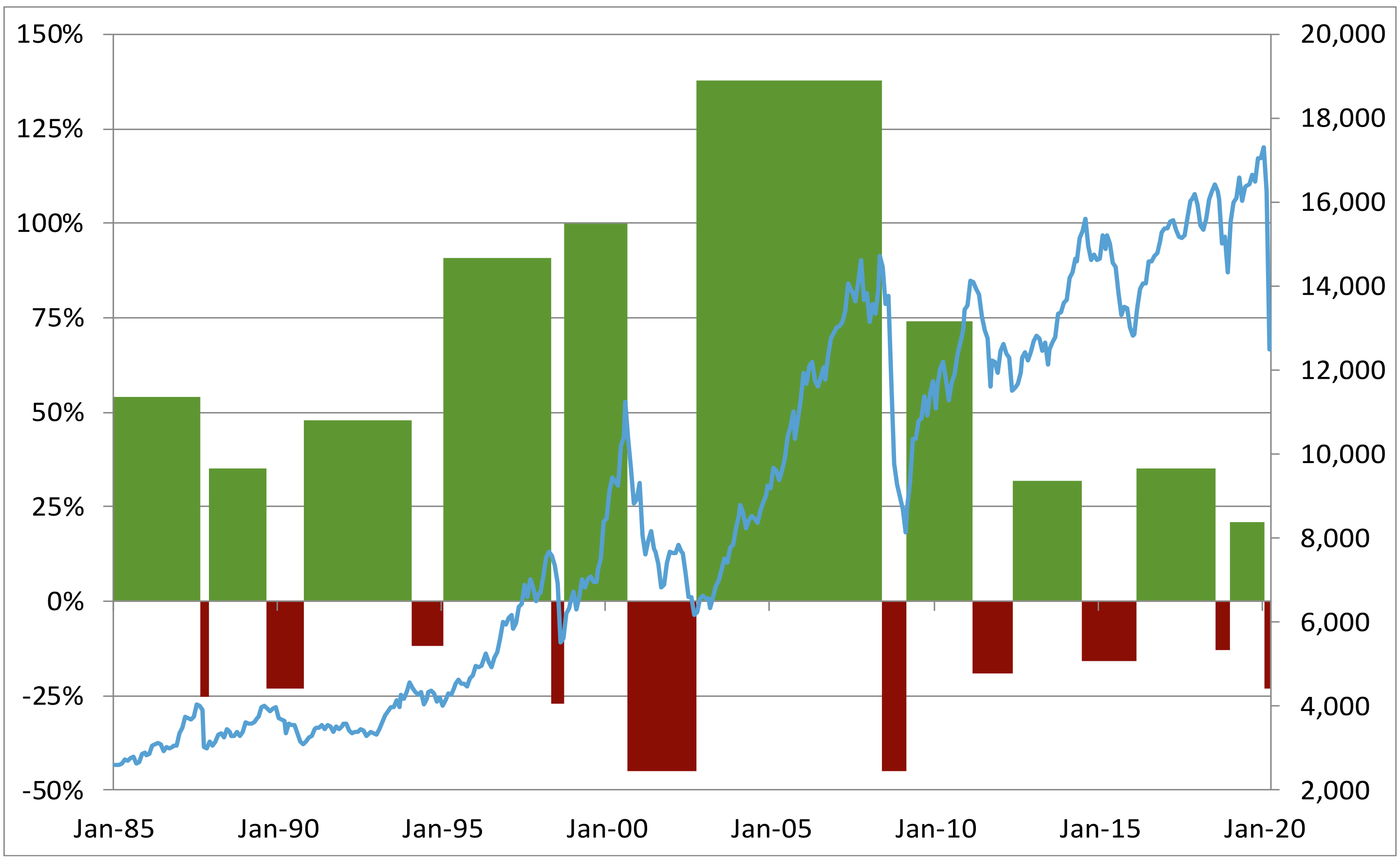
Source: Stockcharts.com, Raymond James Ltd.

We will continue to be on the outlook for a bottoming process, but during periods of volatility, it's important to take a step back and look at the bigger picture. Equity markets are prone to corrections and can even temporarily slip into bear markets within the context of a secular bull market. We like to remind investors of the historical context of market cycles:

- Bear markets tend to be shorter in duration and magnitude than bull markets;
- Bull markets always follow bear markets, with equity prices recovering from previous downturns; and
- Over the long run, equities provide investors with solid returns, enabling investors to achieve their financial goals.

These points are illustrated in the chart below. Note how the bear markets and market corrections (in red) are more shallow in duration and magnitude relative to bull markets (in green), and note the long-term upward trend of the S&P/TSX. While the S&P/TSX goes through these up and down cycles, over the long run, it has returned roughly 7.5%, including dividends, per year since the 1980s.

S&P/TSX – Bull Markets & Market Pullbacks



Source: FactSet, Raymond James Ltd.

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