Market Matters

Summary for January 2020

Highlights

Global virus outbreak weakened stock markets around the world.	In prior epidemics, capital markets followed a pattern where markets bottom only to rally and recover.
Flight-to-safety investing cycled cashflows out of cyclical stocks and into defensive sectors or bonds.	Market corrections are a normal, healthy part of bull markets and provide an opportunity for risk-adjusted growth.

The Coronavirus – a (viral) strain on markets in January

Despite the initial trading days of 2020 signaling a strong start to the decade, investor concerns quickly grew as a global health outbreak emerged – causing stock markets to weaken around the world.

The growing spread of the Novel Coronavirus, which originated in the Wuhan region of China, unfortunately coincided with Lunar New Year celebrations (a period of immense travelling throughout Asia) working to amplify global health concerns. Investors responded with flight-to-safety trades:

- Out of stocks and into bonds;
- Out of cyclical sectors and into defensive sectors;
- Out of commodities, like copper and oil, and into safe-haven assets like gold.

All about defense

North American defensive sectors, such as Utilities and Real Estate, were strongly positive in January, while the Energy and Materials sectors waned on both sides of the border – punished for their more cyclical nature, and that tie to Chinese economic growth. Investors also continued to crowd into Information Technology sector stocks, which are viewed by many as having a secular growth story that's more resilient to slowdowns in global growth. Results were mixed within the Industrials sector, but the search for quality holdings in times of uncertainty helped major Canadian holdings like Thomson Reuters Corp, Waste Connections, Canadian Pacific Railway Ltd. and Canadian National Railway Co. to significantly outperform. This extra boost from Canada's Industrial sector returns, along with a better showing from Canadian banks versus their global peers, helped the S&P/TSX Composite manage one of the few positive starts to the year compared to most major global equity markets. Ultimately, it was Canadian fixed income investors who had more to smile about as investors

Market Summary

Canadian Fixed Income[1]	Month	YTD
FTSE Canada Universe Bond Index	2.9%	2.9%
FTSE Canada All Corporate Bond Index	2.7%	2.7%

Canadian Equities[2]	Month	YTD
S&P/TSX Composite	1.5%	1.5%

	Month		YTD	
Global Equities[2]	**Local**	**CAD**	**Local**	**CAD**
S&P 500	-0.2%	1.8%	-0.2%	1.8%
MSCI EAFE	-1.3%	-0.2%	-1.3%	-0.2%
MSCI Emerging Markets	-3.3%	-2.8%	-3.3%	-2.8%

Currencies and Commodities (in USD)	Level	Month	YTD
CDN $	$0.756	-1.9%	-1.9%
Oil (West Texas)	$51.56	-15.6%	-15.6%
Gold	$1,583.62	4.0%	4.0%
Reuters/Jeffries CRB Index	$170.31	-8.3%	-8.3%

Canadian Sector Performance[2]	Month	YTD
Energy	-2.4%	-2.4%
Materials	-2.4%	-2.4%
Industrials	4.5%	4.5%
Cons. Disc.	-2.5%	-2.5%
Info Tech	9.4%	9.4%
Health Care	-2.6%	-2.6%
Financials	1.4%	1.4%
Cons. Staples	4.4%	4.4%
Comm. Services	2.8%	2.8%
Utilities	7.6%	7.6%
Real Estate	4.4%	4.4%

Local currency unless otherwise stated.
[1]Total return [2]Price only return
Source: Bloomberg

sought out the safety of bonds. The FTSE Canada Universe Bond Index offered up a hefty monthly return of 2.9%.

Putting the market impact of the Coronavirus outbreak into context

The world has faced 12 epidemics within the past 40 years and six Public Health Emergency of International Concern (PHEIC) declarations by the World Health Organization since the designation was adopted following the 2003 SARS epidemic. After each episode subsided, corporate and economic fundamentals returned as the main driver of stock prices. At the half-way mark of the Q4 2019 company reporting period, the biggest fundamental factor of them all – corporate earnings – have thus far surprised to the upside. In fact, research by GLC's Investment Strategy team shows that capital markets have historically followed a pattern: markets bottom at the height of fear and hysteria as new case counts peak, followed by a relief rally where the most beaten-down assets (i.e., emerging market equities, airlines, oil and copper to name a few) see the most significant recovery.

When China coughs, the global economy catches a cold

It's clear this health outbreak will have some negative impacts on the economy, especially for China, and not all of these may pass quickly. When compared to SARS in 2003, the immediate impact to global growth is more material now than it was back then. Consider that China's share of global GDP has nearly quadrupled from 4.3% in 2003 to 16.3% in 2018, with domestic consumption a much larger factor in their economy. Fortunately, and to further contrast the two epidemics, today's global response to the outbreak is much swifter, larger and more coordinated, and the disease appears to be less deadly. Overall, from where we are today, we believe capital markets will tolerate some economic disruption, with most industries (save for perhaps tourism) seeing a post-crisis catchup to offset lost output. However, the longer the disruption remains, the harder it will be for equity markets to pass-off the damage as transitory or limited.

A stock market setback waiting to happen

Imagine for a moment you set sail in 2015 for a deserted island with no contact with the outside world, and you've just returned to be told:

- The U.S. and China have been in the throes of a complicated trade war, albeit with a recent détente
- We were experiencing a multi-quarter corporate earnings slump, but signs of improvement were materializing
- The U.S. yield curve had inverted only a few months ago
- Many European and Japanese government bonds were offering negative yields
- An escalation of Middle Eastern tensions had become increasingly tenuous
- The World Health Organization had declared a global emergency due to a spreading virus
- Corporations were broadly awash in all-time high levels of debt

…and then you learned that – despite the above – equity markets were flirting with all-time highs.

One can be forgiven for finding that puzzling. The fact is, as we enter 2020, markets are experiencing overbought conditions and stretched valuations. In other words, the environment is conducive for a near-term correction in equity markets. The mild negative reaction thus far in equities has not alleviated our near-term concerns over these conditions.

Market corrections are a normal, healthy, natural part of bull markets. They actually work to extend the advance. Without them, risk becomes mispriced and misallocated. Sell-offs in equities return discipline to investors and purge the system of complacency. It is for this reason that, given the shallow and short-lived equity market pullback, GLC's 2020 Capital Market Outlook continues to reflect our current investment views – opportunity for growth, with a nod to defensive, risk-adjusted positioning.

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VP Marketing and Communications, has more than 15 years of investment industry experience and has been writing the monthly Market Matters for over 10 years.