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PIMG Portfolio Management Report

Second Quarter 2020

"Off The Grid – a 20/20 Look Back On The Second Quarter"

Anyone "off the grid" for the first half of the year, could easily review their June statement and think that the first half of 2020 was a relatively moderate setback for markets. This fortunate person likely saved themselves a whole bunch of stress, as the rest of us endured one of the wildest six-month periods in market history. While the first quarter of the year registered one of the worst quarterly performances ever, the second quarter was one of the best. The sharp recovery pushed markets broadly higher while technology stocks, particularly those perceived to benefit from the pandemic, saw valuations soar. With the global pandemic and related shutdown rendering economic data and quarterly results temporarily meaningless, it has taken great conviction to allocate capital under the assumed return of a new normal that looks a lot like the old normal.

It seems like a lot more than three months ago when governments around the world told everyone to stay home. As our offices emptied and home work stations were established, central bankers were busy putting together massive economic stimulus packages. The market was quick to respond to what was effectively a firehose of cash that was unleashed on the economy. According to the IMF, global stimulus measures have amounted to more than 12% of GDP. In the US, this number is closer to 20% or more than $6 trillion dollars. So far the announced measures will dwarf those taken during the financial crises of 2008/2009. These numbers will undoubtedly grow as any vaccine is still many months if not many quarters away.

Typical recessionary playbooks were of little use to investors who looked to analogous periods of history for clues as to how this might play out. Typically after a market crash we see spooked investors gradually take on risk again with the most predictable and stable, blue chip companies regaining investors trust first, followed by the riskier parts of the market recovering as the economic recovery broadens. The most expensive stocks getting a lot more expensive was certainly not a feature of any previous recessions we had studied. While many features of this current situation are highly unique, one thing that is remarkably familiar is the "V" shape to the recovery. Similar to 2008 and most every significant correction before that, the sharpest part of the downturn was matched with a similar shaped recovery. While it may take many years for the economy to fully recover, the markets will almost surely price in the total recovery much sooner.

Technology stocks, which had been market leaders for the last few years, not only recovered through the last quarter but broke out to new all-time highs. The technology focused Nasdaq index was up over 30% in the quarter. While many of these companies, such as Zoom, quickly became required work from home tools, and will benefit in the near term with big increases in revenue. Most technology companies have surged in price through nothing other than multiple expansion (multiple expansion is what happens when a stock price goes up but the revenue or sales of the company don't). One needs a powerful imagination to fathom how a global recession makes Apple's business more valuable. Perhaps the best example of this "investor euphoria" is Canada's own Shopify. This Ottawa based company promises to bring every small business online, which was exactly what every business needed the most last quarter. Investors rushed in to buy the stock and it's value more than doubled and eclipsed Royal Bank as Canada's most valuable company. Shopify still loses money every year and now trades at over 100x revenue. For comparison sake, Royal bank trades at just over 2x revenue…even Amazon trades at a more reasonable 5x revenue. We hope that Shopify can grow into this valuation over the coming years but this type of investment doesn't much appeal to us, particularly knowing the unfortunate outcomes of the last three companies to take over the top spot of Canadian business; Nortel, Valeant, and Blackberry. So while many investors were taking their government stimulus cheques and replacing their lost sports gambling with gambles in the stock market, we were busy buying companies we feel were attractively valued. In Canada, we added Montreal based CGI Inc. which is one of the world's top IT consulting firms. Similar to a Shopify, CGI Inc helps businesses adopt technology and run their businesses more efficiently. They have a crystal clean balance sheet and have been rewarding long term shareholders with consistent dividend increases and stock buy backs. We also took the merger, and subsequent breakup, of United Technologies and Raytheon as an opportunity to buy shares in Otis Elevators. Otis is one of two global providers of elevators and services. We like investing in duopolies with high barriers to entry, and also appreciate the more than 60% of revenues that come from servicing existing elevators. In our U.S. focused portfolio we purchased shares of Marriot hotels as we felt the

50% discount more than adequately priced in the cost of near term travel disruptions. In Canadian portfolios we said good bye to Chartwell Retirement Residences this quarter. While this company may ultimately make its way back into portfolios, we feel the pandemic has fundamentally reduced the medium term value of the business.

While we remain hopeful of finding a vaccine soon and our lives as we knew them can return, we submit that the market's performance over the balance of the year will be largely in the hands of central bankers and government leaders. This may be an unnerving situation given the ineptitude shown by many "leaders" so far, yet with a US election just months away, we can all but guarantee that the spending spigots will remain open. It's not an easy time to have confidence in the options we have in front of us. There are lots of big question marks that remain and the unintended consequences of so much government intervention remain to be seen. However, holding cash or GICs is not without risk as the potential for inflation has never been higher. As always, we continue to promote a diversified approach and a commitment to the long term. This playbook has worked well through every major market event and recession in history and we have no reason to doubt its efficacy this time around.

Sincerely,

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