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PIMG Portfolio Management Report

First Quarter Commentary 2020

Unhindered by Moral Hazard

Similar to 9/11, March 2020 will be a distinct moment in human history that demarks a before and after. There's no doubt as we move forward we will be keeping greater distances, washing our hands more and adopting different greeting routines. The global economy has effectively been shut down and the markets have reacted accordingly. Fortunately, governments across the board have taken the economic impact just as seriously as the virus itself. We are seeing broad measures announced to support individuals and business which are helping to buy some time as the economy remains in an induced coma. There's no doubt we will be faced with a global recession of some magnitude, however, this doesn't spell the end of times. With almost unlimited government support being promised, it is as important as ever to ignore the scary short term noise and rationally consider the potential for a robust long term recovery.

We entered the first quarter with the global economy operating near full capacity as the trends that had pushed markets to new highs were still very much intact. Things were by no means perfect but a decent environment had persisted since the financial crises underpinned by low interest rates, modest inflation and a moderately growing economy. What started as a virus observed from afar, quickly fell closer to home and suddenly our leaders were closing businesses and shutting in borders. A suddenly shuttered economy collided with a market that was trading on the expensive side of valuations as we noted throughout late 2019 and early 2020. Regardless of where valuations may have been, it's hard to imagine the stock market calmly digesting recent COVID-19 related events. How does one value a business that has effectively been stripped of their license to operate for an indeterminate length of time? The market always hates uncertainty and the events that unfolded in March created about as much uncertainty as we have seen throughout our careers. Indeed panic spread as unemployment claims spiked to unprecedented levels. When it was all said and done, global markets had fallen around 30% from their early February highs to their March 23rd lows.

Governments across the globe have been swift to step in offering their support in various ways. Much of this support has come via improved unemployment benefits and loan programs directly to businesses. Each country seems to be taking slightly different approaches but the general message is there is money available and much of it will be forgiven if certain conditions are met. In Canada, this has amounted to $400/week in direct payouts to anyone who has lost income due to the virus. So far in both Canada and the US, this initial wave of direct support should amount to around 10% of GDP ($105B CAD & $2T USD). If the virus lasts longer than expected, more support is expected to follow. In addition to this, central banks have stepped in to stabilize markets through direct intervention and open market activities. So far this has done a good job ensuring the system continued to operate properly through a period of unprecedented stress. Whether this will be enough to offset a spike in unemployment rates and what the long term impact this has on inflation, remains to be seen.

Most of the programs being implemented by governments are striving to keep employees on the payroll. This should enable firms to start back up more quickly once restrictions ease and demand returns. Of course the swiftness of the recovery won't be evenly distributed across industries and businesses of varying health will respond differently. However, this does create an environment where things can get back up and running more quickly than a typical recession where we tend to see people on government benefits for extended periods of time as they fall behind on skills and stop looking for work. In addition to the government support, banks are in much better health than they were heading into the financial crisis of 2008. Banks are providing the opportunity to defer mortgage payments and even utilities are offering bill forgiveness for those affected. Credit card companies are also starting to announce a reduction in interest rates to help things along. Industry is stepping in to help produce the equipment we need to support those afflicted in addition to those people on the front lines. This is what capitalism is supposed to look like.

Early in this quarter we started to feel a little uncomfortable with certain company valuations. We trimmed a number of companies from higher weightings and reduced exposure in some cases by several percent. While the trimming of holdings when they are expensive and buying companies when they are cheap will add value over time, you can never have enough cash when you experience a sharp sell-off as we did throughout March. Fortunately, it did provide us with elevated cash levels relative to the past few years which we have put to work as most stocks have become attractively valued. With the global economy likely already in recession, we have focused our attention on companies whose revenues are likely to hold up best and those that have manageable balance sheets. Within portfolios and P.I.M.G. accounts more specifically, we did take advantage of price dislocations by adding to a number of existing portfolio names such as Gibson Energy, Bank of Montreal and Sunlife while adding to a few new positions that we felt represented compelling opportunities including

McDonald's and Google. We also repositioned some of our fixed income weightings, adding to a diversified high credit quality corporate bond strategy that offers an attractive yield north of 3%. We are also encouraged with the performance of many of our core portfolio holdings as they have shown strong leadership over the course of this recovery rally. This is testament to the strength and underlying value of these names and further demonstrates that high quality companies remain well sought after when demand returns.

When it comes to market developments, we believe that the U.S. Federal Reserve's recent action represents a pivotal moment in this crisis. Jerome Powell's statement included that "we will continue to use these powers forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery" and probably the most important, historic statement, "We should make them whole. They did not cause this." This crisis is different from any other in recent history in that it was not caused in any way by businesses or investors. Unhindered by moral hazard, the response of fiscal and monetary authorities is and will continue to be unprecedented, with the goal of essentially making everyone 'whole.' We believe the significance of this development is underestimated by markets, and this reinforces our view of a full asset price recovery, and equity markets reaching all-time highs next year, likely by the first half. Investors who focus on negative upcoming earnings and economic developments are effectively 'fighting the Fed,' which was historically a losing proposition. Bold statements indeed but in this business you have to form a decision and make an ensuing "call." That is our current call and we continue to believe that most of the surprises will come to the upside. We are investing accordingly.

Thank you for your trust and confidence in allowing us to manage your financial affairs.

Sincerely,

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