Navigating volatile markets

A collection of expert perspectives and investor materials amid the COVID-19 pandemic.

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It's an unprecedented time, and now more than ever, Canadian investors are looking to you for advice, insights, and reassurance. With that in mind, we've curated some materials in our Navigating volatile markets e-book which has been developed to help you during this time and includes economic updates, articles and commentaries from our investment experts. We hope that these insights from our thought leaders, will help you navigate challenging markets, and provide support and assistance to your clients.

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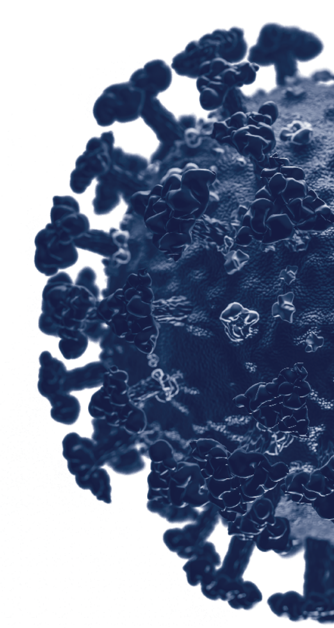
Macro economic updates through COVID-19

From **Todd Mattina**
Chief Economist, Mackenzie Investments

The economic fallout from the oil price war coupled with the coronavirus outbreak is causing stress in several areas. Todd Mattina discusses the expectations of policy makers and the future for long-term investors.

Todd Mattina
Senior Vice President,
Chief Economist

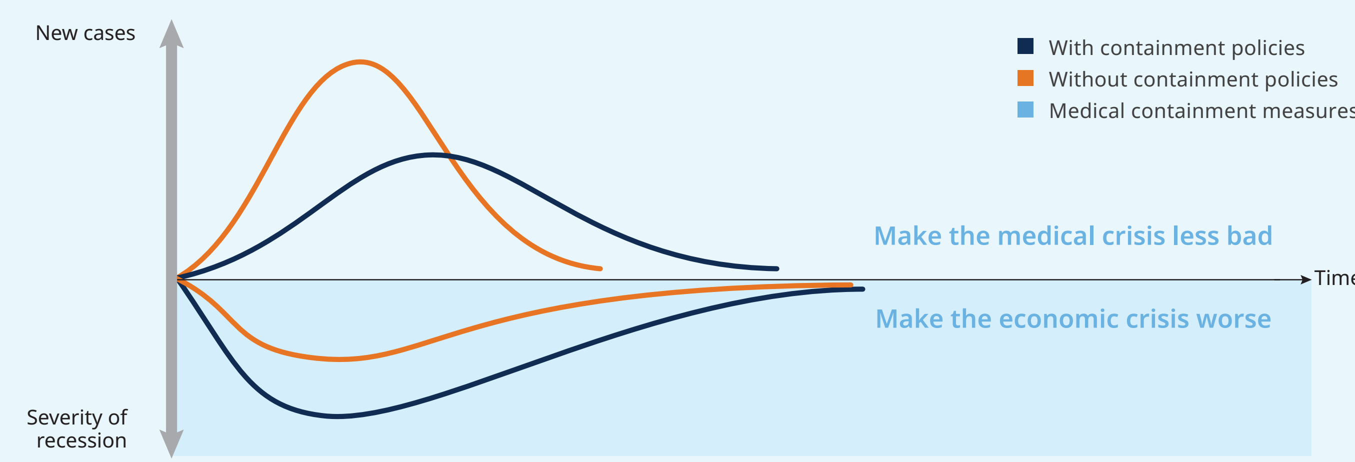
Flattening the curves and the impacts to markets



Stopping the spread of the COVID-19 epidemic will come at a steep economic cost.

Medical experts argue that “flattening the infection curve” through stringent social distancing can save lives and avoid overwhelming the healthcare system. However, these measures also steepen the recession curve with the economy in lockdown (Fig. 1). This sudden stop in economic activity is leading many US forecasters to expect a sharp contraction in GDP during April to June with estimates ranging between 12% and 25%.[1]

Fig. 1 | Flattening the infection curve steepens the recession curve
Containment policies flatten the medical curve, but steepen the recession curve

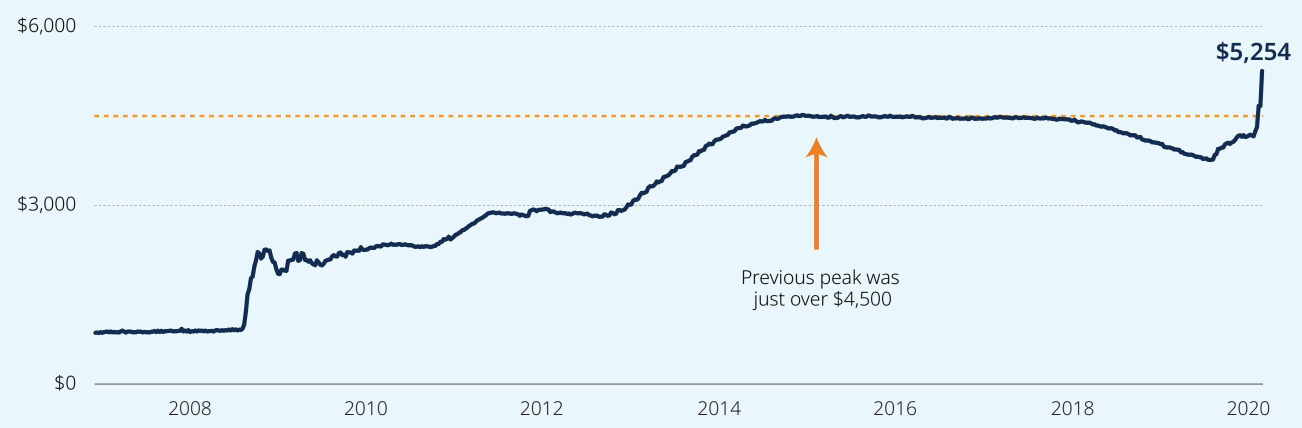


Source: https://voxeu.org/content/economics-time-covid-19-0

[1] Goldman Sachs is predicting a contraction in real GDP by 24% in 2020 Q2. Oxford, JP Morgan and other forecasters are forecasting declines of about 12% to 14%. Top Economists See Some Echoes of Depression in U.S. Sudden Stop, Bloomberg (March 22, 2020).

Macro economic updates through COVID-19

Fig. 2 | Total assets of the US federal reserve surpass previous peak
(in billions of US dollars)



Source: Total Assets of the US Federal Reserve as of March 25, 2020. Data provided via Bloomberg

Fig. 3 | Decline in market pricing of 10-year US average inflation
(breakeven US inflation rate based on 10-year TIPS)

Source: Market data provided via Bloomberg as of March 25, 2020

Policymakers have acted quickly to implement measures of unprecedented size and scope to "flatten the recession curve".

Major central banks have moved quickly with larger measures in many cases than during the Global Financial Crisis in 2008 so that the expected economic slowdown does not become a financial crisis. Central banks have eased rates, injected liquidity in money markets, launched new lending facilities to unlock credit markets and expanded Quantitative Easing (QE) to tackle illiquidity (Fig. 2). Governments have also announced fiscal packages of unprecedented size, including tax deferrals, cash transfers to households and backstops for business credit. The US stimulus package of about US $2 trillion amounts to about 10% of GDP. Germany is considering a package of a roughly similar magnitude. In Canada, the announced measures of $82 billion are more modest at just over 3% of GDP. Critically, global policymakers are striving to avoid a temporary cash squeeze leading to business insolvencies and higher unemployment. Failure to prevent insolvencies from a temporary and deliberately induced economic slowdown would likely lead to a much slower recovery when the epidemic is resolved.

The policy toolkit has been largely borrowed from measures taken during the Global Financial Crisis, but the current crisis is different in important ways.

The Great Recession in 2009 stemmed from sharp deleveraging by the private sector following a confidence crisis and financial sector failure, which led to a sharp decline in aggregate demand and a recession. The priority in that crisis was to boost aggregate demand by rebooting credit markets and providing liquidity. The current economic downturn is primarily a supply-driven shock as policymakers deliberately induced a sharp slowdown to contain the COVID-19 outbreak. The crisis also resulted in a large decline in aggregate demand, pushing expected inflation even lower (Fig. 3).

[2] Paul Krugman expressed a similar view on March 22, 2020: https://twitter.com/paulkrugman/status/1241690862448529408

Policymakers should compensate for the decline in demand but not try to over-compensate for the decline in aggregate supply.

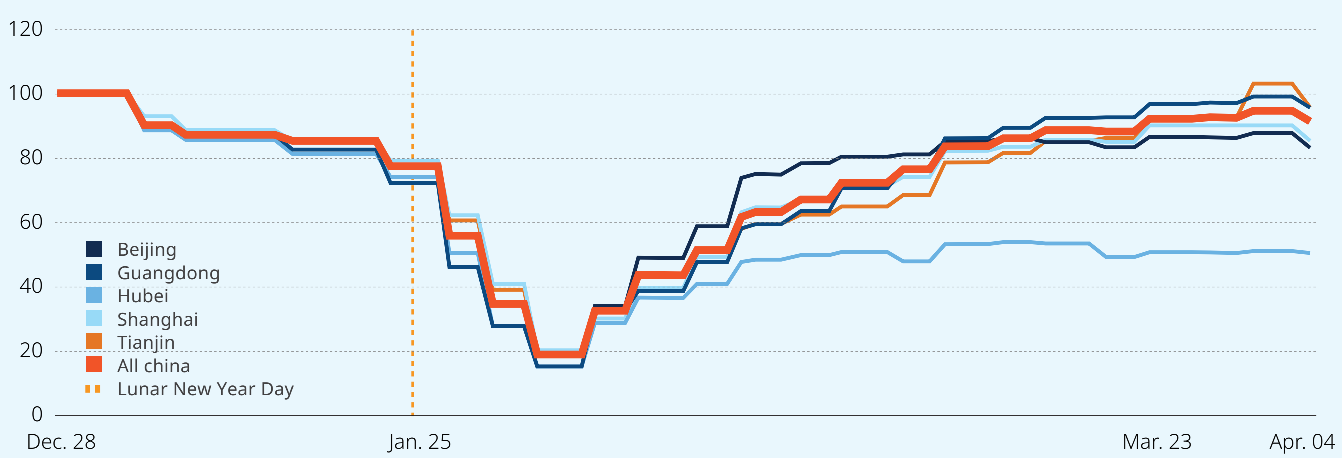
Monetary and fiscal policy can play key roles by preventing a further deterioration in demand causing higher unemployment.2 Policies can also backstop credit markets and the financial system to avoid bankruptcies simply due to the short-term liquidity crunch rather than long-term insolvency. In contrast, lower central bank rates and cash transfers from the government cannot offset the large loss in production and incomes due to business closures and quarantined workforces. However, we believe policymakers cannot restore demand to its pre-crisis level while the economy remains in lockdown as the economy would be unable to meet that higher level of demand.

Looking ahead, the macro outlook depends mainly on the duration of the economic lockdown to contain the pandemic spread.

President Trump indicated that the US economy could return to work as early as Easter. Several European countries have only partially shut down economic activity. In Canada, the federal and provincial governments appear to be preparing for a prolonged shutdown. While the duration of the lockdown is uncertain and likely to differ across countries, the global economy is expected to experience a contraction in the second quarter that extends into the third quarter. Based on the early experience of China, the recovery appears to be U- or even L-shaped after the prolonged lockdown of Hubei in early 2020 (Fig. 4). Once the

Fig. 4 | Economic activity indicators in China

Job offers: Hubei Province, other selected Provinces and China, one month prior to and after Lunar New Year Day, December 28, 2019 - March 23, 2020 (December 28, 2019 = 100, jobs data as of 8:00 Beijing time March 24, 2020)



Source: https://voxeu.org/content/economics-time-covid-19-0

Macro economic updates through COVID-19

epidemic is behind us in North America, the speed of the economic bounce will depend critically on our success in preventing business failures during the temporary liquidity squeeze so that unemployed workers can quickly return to work, allowing income and production to normalize. The next few months could include both upside and downside surprises, ranging from new medical innovations to treat the virus to potential secondary waves of infection.

For long horizon investors, cheaper equity valuations following the sell-off point to higher long-term expected returns.

Attempting to time asset mix allocations tactically based on views about the epidemic outlook is inherently difficult. However, following a disciplined investment process can help investors:

- **Investment horizon:** The intrinsic valuation of risk assets like equities is lined to long-term fundamentals, such as earnings growth and real interest rates. We believe, cheaper stock valuations today after the sell-off imply a higher long-term average expected return.
- **Portfolio rebalancing:** For investors with a long-term asset mix, periodic rebalancing to target has historically helped to reduce total fund drawdowns in periods of market stress and contributed to a faster rebound in portfolio value. Generally, rebalancing can also help to ensure the factors driving portfolio risk and return remain aligned with the target long-term asset mix.
- **Liquidity:** Maintaining sufficient allocations to liquid high-quality assets is critical to cover short-term financial commitments and avoid sales of distressed assets at inopportune times to raise cash.

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Macro economic updates through COVID-19

Market turbulence follows coronavirus and oil price war

The worsening coronavirus outbreak and oil price war have sharply increased financial market turbulence. The number of coronavirus cases is expected to rise sharply over coming weeks in North America and Europe based on the views of respected epidemiologists. Even if fatalities remain low, essential measures to contain the virus are expected to disrupt global supply chains and weaken consumer confidence. Compounding the economic shock from the coronavirus is Saudi Arabia's oil price war, which comes at an inopportune time for the global economy. Ramping up oil supply to boost market share and displace US shale producers has increased credit risk in the high yield energy sector.

The global sell-off has increased stress in several areas

Stock market volatility

Circuit breakers have curbed trading in US markets following strong selling pressure. Equity markets have now entered bear market territory after declining by more than 20%. The sell-off in US stocks on Thursday by 9.5% was the worst day for the S&P500 since 1987. The S&P TSX declined by 12.3%, the worst day since May 1940.

Treasury yields acting unusually

High-quality bonds typically move against equities in risk-off scenarios. On Thursday, US Treasury yields traded higher during the session even as equities sold off. These movements point to potentially distressed or liquidity-constrained investors closing trades or raising cash. This market action in part prompted the Federal Reserve to intervene in money markets with unprecedented liquidity operations.

Inflation market pricing-in unusually low

The rapid decline in bond yields in the last two weeks implies a breakeven or expected inflation rate below 1% in the US for the next 10 years, which has not been priced-in by markets since 2009.

Credit spreads widening sharply

High yield corporate credit spreads jumped to over 700 basis points this week compared to about 350 basis points in mid-February. In the energy sector, high yield spreads more than doubled to over 17% since mid February, a level last seen in 2016. Widening corporate spreads increase funding stress for companies.

Money markets under pressure

For the third time in four days, the US Federal Reserve announced measures to increase its lending into the critical US repo market in which investors exchange high-quality bonds for short-term cash. The Fed stands ready to inject over $5 trillion as needed in short-term loans held in weekly auctions until April 13. These short-term liquidity injections are important to ensure that short-term funding remains liquid for investors and other borrowers.

Policymakers are expected to take additional actions to help calm market turbulence by easing central bank rates further, ensuring funding liquidity and delivering fiscal stimulus that support vulnerable industries and workers.

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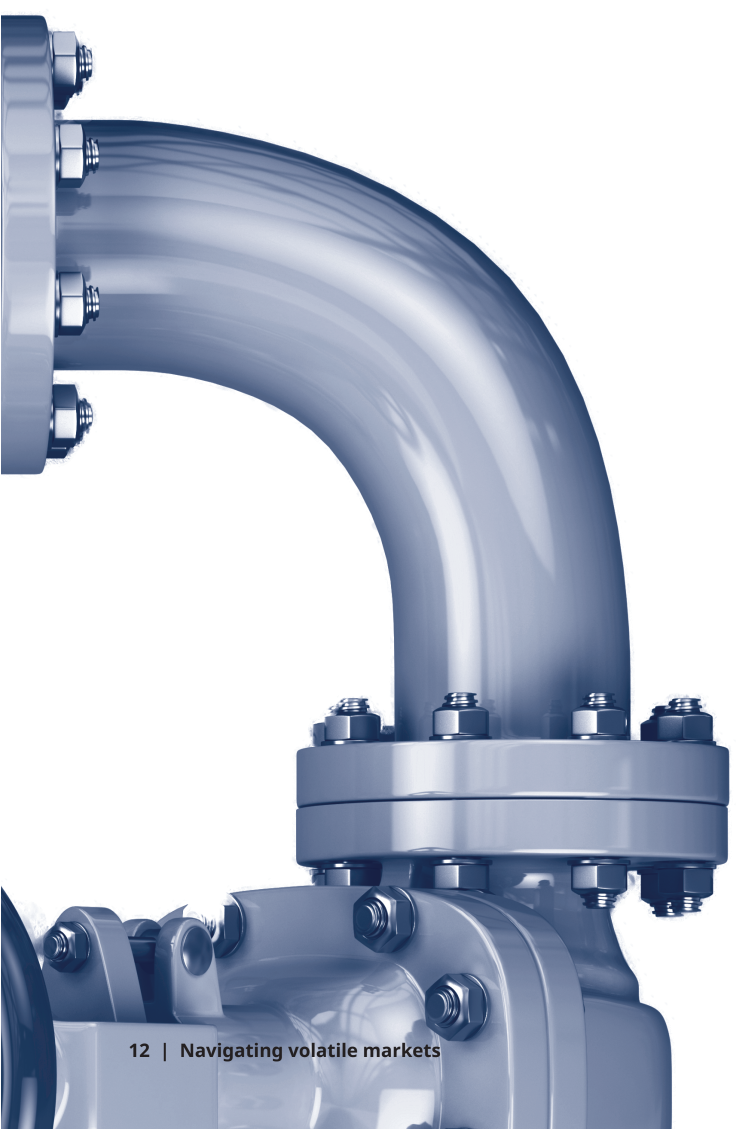
Looking ahead, long-term investors should continue rebalancing portfolios to their long-term asset mix. The coronavirus and oil price shock are unlikely to affect long-term earnings growth of the corporate sector and long-term interest rates, which largely drive the long-term fair value of equity indexes. In that context, several important factors to consider include the following:

- **Investment horizon.** Cheaper stocks after the recent sell-off result in a higher long-term expected return. For this reason, investors with long-term financial objectives should stay invested if possible. However, volatility may remain elevated in the short term.
- **Portfolio rebalancing.** For investors with a long-term asset mix, regular rebalancing can help to reduce total fund drawdown in periods of market stress and potentially contribute to a more rapid rebound. After a prolonged multi-year bull run, equity allocations in some portfolios could be higher than long-term targets. Other investors who were closer to their target asset mix in early 2020 may now be underweight in equities following the recent sell-off. Rebalancing to a neutral asset mix position can help maintain a well-balanced portfolio during volatile periods and position the portfolio for the recovery phase.
- **Fixed income and portfolio diversification.** As government bond yields reach low levels, they may eventually become less effective in diversifying multi-asset portfolios because rates will have less room to fall. However, the low yields of other high-quality government bonds suggest US and Canadian sovereign yields still have room to fall in distressed economic scenarios. Bonds still play a critical role in a well-balanced portfolio to diversify equity risk and provide liquidity.



Investment perspectives through volatile markets

From our **Global Equity and Fixed Income** Portfolio Managers

Our leading portfolio managers provide their unique perspectives on the current markets and the COVID-19 pandemic. They share everything from how their teams are navigating the volatile markets, to areas of resilience, and why quality names, and a vision for the future are so important right now.

Darren McKiernan
Senior Vice President,
Portfolio Manage

Steve Locke
Senior Vice President,
Portfolio Manager

The benefits of dividend investments during market volatility

As of Monday, March 16, 2020, global markets were down almost 30% YTD and the day of March 16, U.S. stocks plunged the most since the 1987 stock market crash. The selling has been widespread and indiscriminate (unless you happen to own Zoom Video Communications or the odd grocery retailer). The culprit, as everyone knows by now, is the novel coronavirus known as COVID-19. This was first considered an exogenous event which was causing a hit to global aggregate supply by disrupting trade from China. It has now turned into a worldwide public health crisis causing a major disruption in global demand. Almost all industries and government agencies are being affected via school closures, private and public event cancelations, travel and border restrictions, and the banning of large public gatherings, among other things. The impact could very well drag the global economy into recession.

While the hit to the portfolio has been fast and significant, we are not standing still. Over the past three weeks we have turned over 20%+ off the portfolio, selling down or eliminating 24 names and adding 16, a net reduction of 8 names and counting. We asked ourselves a simple question several weeks ago before the sell-off began in earnest: what businesses do we own that we would not be thrilled to add to if they were down 25%? If there was any question about our conviction – or we felt they might not have the balance sheet to withstand significant stress – the position was sold and/or replaced. Some of the sales have been fortunate – we significantly reduced our energy exposures before OPEC decided to flood the market. In other cases, we were too sanguine about some companies near term prospects and did not reduce our exposures enough to account for the fact that their business may be disproportionately impacted by the pandemic over the medium term. This might read as somewhat trite given the sea of red on our screens we are all looking at today, but I feel better about the portfolio now than I did three weeks ago. I am one of the largest individual unitholders and will continue to add to my holdings throughout this period of uncertainty. One year's worth of earnings and cash flows likely disappearing will impact our companies near term prospects. For the vast majority of businesses that have the balance sheet to weather this storm and offer products and services that will be in demand once the world is able to work its way out of this frightening moment in history, their long-term intrinsic values have not been impaired.

> **This might read as somewhat trite given the sea of red on our screens we are all looking at today, but I feel better about the portfolio now than I did three weeks ago.**
>
> - Darren Mckiernan

Right now, the market's volatility is reacting in real time to different potential outcomes, some not so bad (as the Friday, March 13 move would indicate) to potentially catastrophic (what March 16 felt like). It is our view that the world will get through this and adapt, as it has always done. It may take months, or it may take the rest of the year and beyond. While that feels like a lifetime from now, it is not. In the meantime, besides doing our part as a member of society to stay safe and help those in need, we will do our best to position the fund such that when the clouds part and the sun comes out, we will have the best-positioned portfolio since joining Mackenzie.

Dividend investing: tried and true, for a reason.

Dividends can be an important component of total return over the long term. They are often a more stable component of return than stock price performance and can help buoy a portfolio in years when market returns are negative. When a company can consistently increase its dividend over a long period of time, this is often a signal that the business is able to generate strong free cash flows through a myriad of market environments. Historically, companies that pay a dividend and grow it over time have delivered better returns with less volatility.

Discover the Mackenzie Global Dividend Fund, a 5 star fund managed by Darren McKiernan, team lead for the Mackenzie Global Equity & Income Team.

Learn more

Making market maneuvers across the fixed income spectrum

Mackenzie Investments podcast series with Steve Locke

Join Steve Locke, Vice President, Portfolio Manager and Head of the Mackenzie Fixed Income Team. Matt will dive into Steve's career, find out what sparked his interest in Portfolio management, and learn how Steve and his team are maneuvering through the markets during the COVID-19 pandemic.

> **"Having the integrated team and having the ability to look into different areas of the capital structure, trade in markets associated with that area of the capital structure, gives us an ability to access liquidity differently and in a more differentiated fashion."**
>
> \- Steve Locke

Listen now

Seeking higher yield in today's low rate environment often means taking on more risk

Offer your clients an income-oriented solution that can flexibly maneuver across the fixed income spectrum with a focus on downside protection.

Mackenzie Unconstrained Bond ETF takes its cues from a deep macroeconomic and credit analysis to respond to the credit cycle, in ways that conventional strategies that are subject to greater restrictions cannot.

Learn more

Helpful investor resources

Insights to help investors stay invested during volatile markets

7 healthy habits for investors in volatile markets

Commit to a plan, despite volatility

Feeling anxious when the stock market drops is a natural response to volatility. That's why it's important to stay committed to your long-term plan, and only make investment decisions when you are thinking rationally.

Seek guidance

Your advisor is there to listen and provide guidance. They will help you keep your emotions in check as you navigate the ups and downs of the market, together.

Tune out market noise

Market noise can persuade you to make changes that negatively affect your long-term plan. That's why it's important to tune out the noise and stay focused on your long-term plan.

Don't try to time the market

Try and resist the urge to time the market. Guessing what's ahead is not a sound investment strategy. Your advisor has research that illustrates this point.

Don't take daily 'stock' of investments

When you look at your investments every day, you end up focusing on the short-term. Your advisor performs regular due diligence and will alert you to any changes. That helps you remain focused on your long-term goals.

Market predictions can be inaccurate

Markets are unpredictable. That's why you shouldn't pay attention to people who try and predict the future. Take comfort in knowing that your portfolio is diversified and you own quality investments.

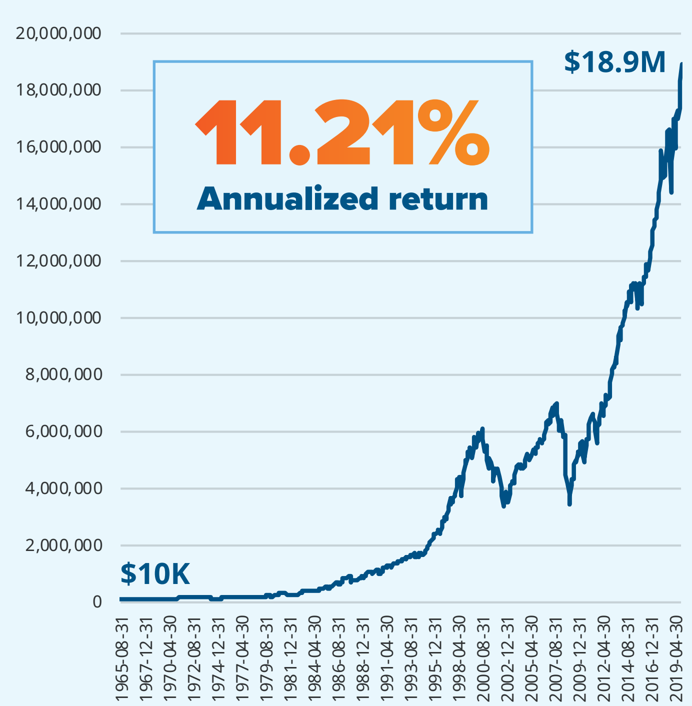
Prepare for ups and downs

When you initially met with your advisor, you discussed your tolerance for volatility. Your portfolio was built with your specific tolerance level in mind. As an investor, it's important to remember that the market fluctuates.

Building market confidence: Markets recover despite volatility

The S&P 500 has delivered an annualized return of 11.21% since 1950 and has proven to be resilient through the worst market conditions. Over the same period, there have been instances where the market experienced significant declines. Yet as seen below, each time the market recovered and achieved a higher level. Staying the course is of the utmost importance during periods of volatility as it enables investors to fully recover from these periods and achieve their long-term investment goals.

Growth of a $10,000 investment, 1950-2019



Source: Morningstar Direct / Bloomberg

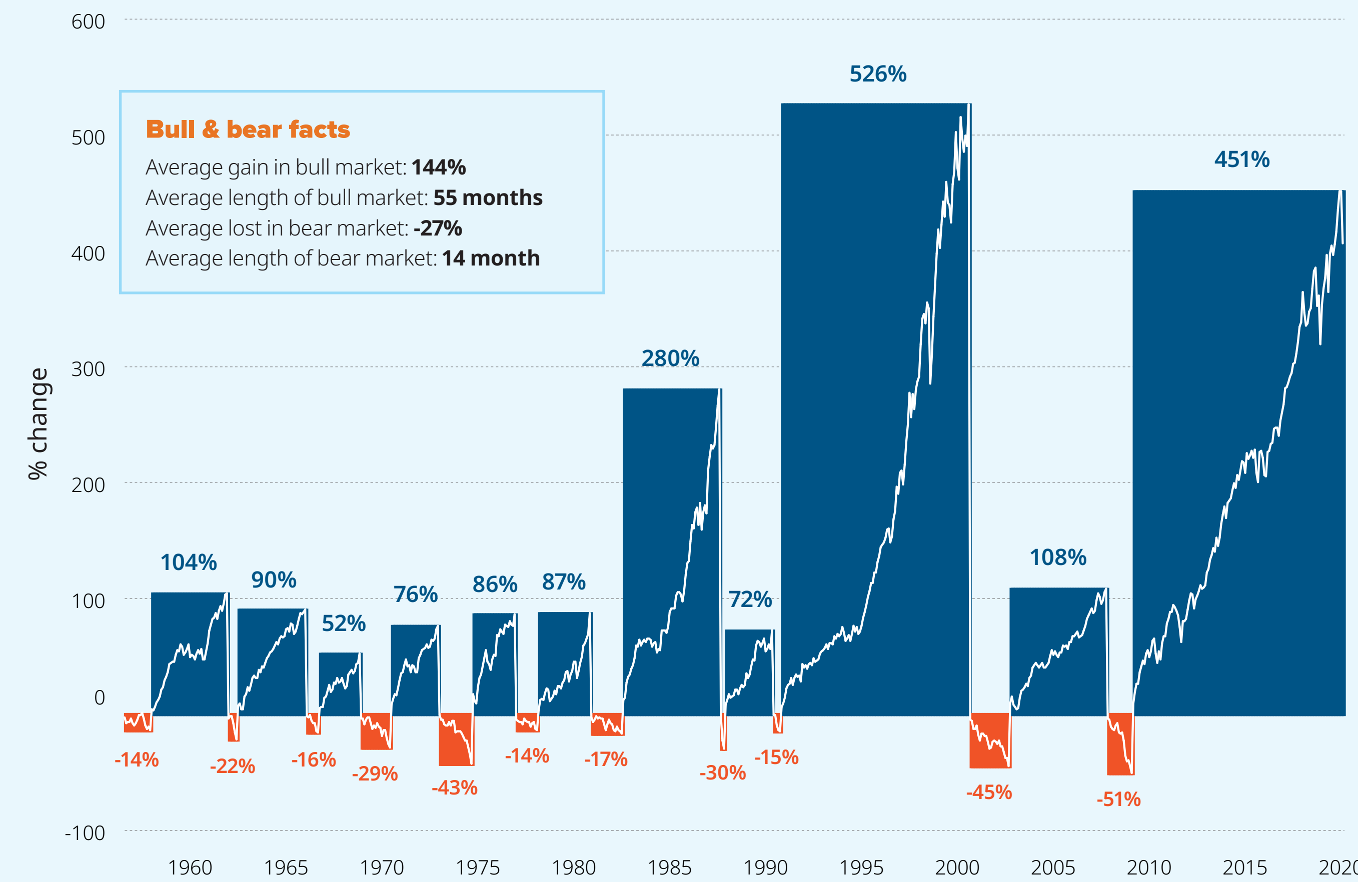
Crisis	Market low	1 yr later
Korean war	July 13, 1950	28.8%
Cuban missile crisis	September 23, 1962	33.8%
JFK assassination	November 23, 1963	25.0%
1969-70 Market break	May 26, 1970	43.6%
1973-74 Market break	June 12, 1974	42.2%
1979-80 Oil crisis	March 27, 1980	27.9%
1987 Stock market crash	October 19, 1987	22.9%
Desert storm	October 11, 1990	21.1%
Soviet coup d'état attempt	August 19, 1991	11.1%
Asian financial crisis	April 2, 1997	49.3%
Dot-com bubble crash /Sept 11 / Enron	October 9, 2002	33.7%
Invasion of Iraq	March 11, 2003	38.2%
North Korean missile test	July 17, 2006	25.5%
Subprime mortgage crisis	March 9, 2009	68.6%
Average appreciation		**33.7%**

Snapshots in time of significant negative impact international events from 1950 to March 2009, and the subsequent change in market value from the S&P 500.

Focusing on the long-term: The ride up is usually bigger than the ride down

If today's volatile markets concern you, take heart. In almost 200 years, extreme market performance has been relatively rare and performance has been moderate, with many more calendar years producing positive returns. When you invest for the long term, you can withstand occasional down periods along the way.

S&P 500 Index August 1956 – February 2020



Source: Bloomberg, February 2020

Setting realistic expectations: Markets move higher over time but expect a few bumps

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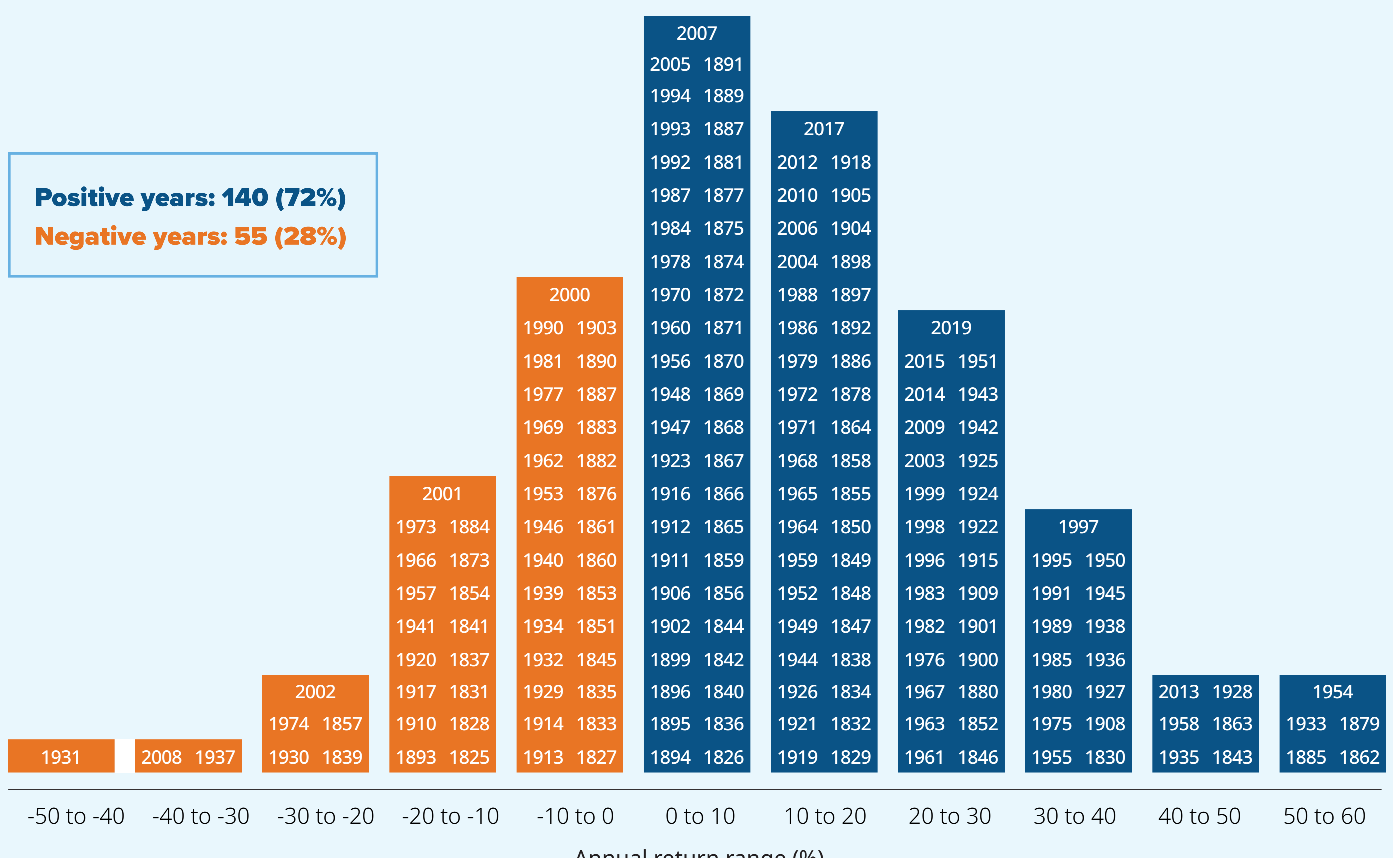
S&P 500 Index annual total return: 195-year history



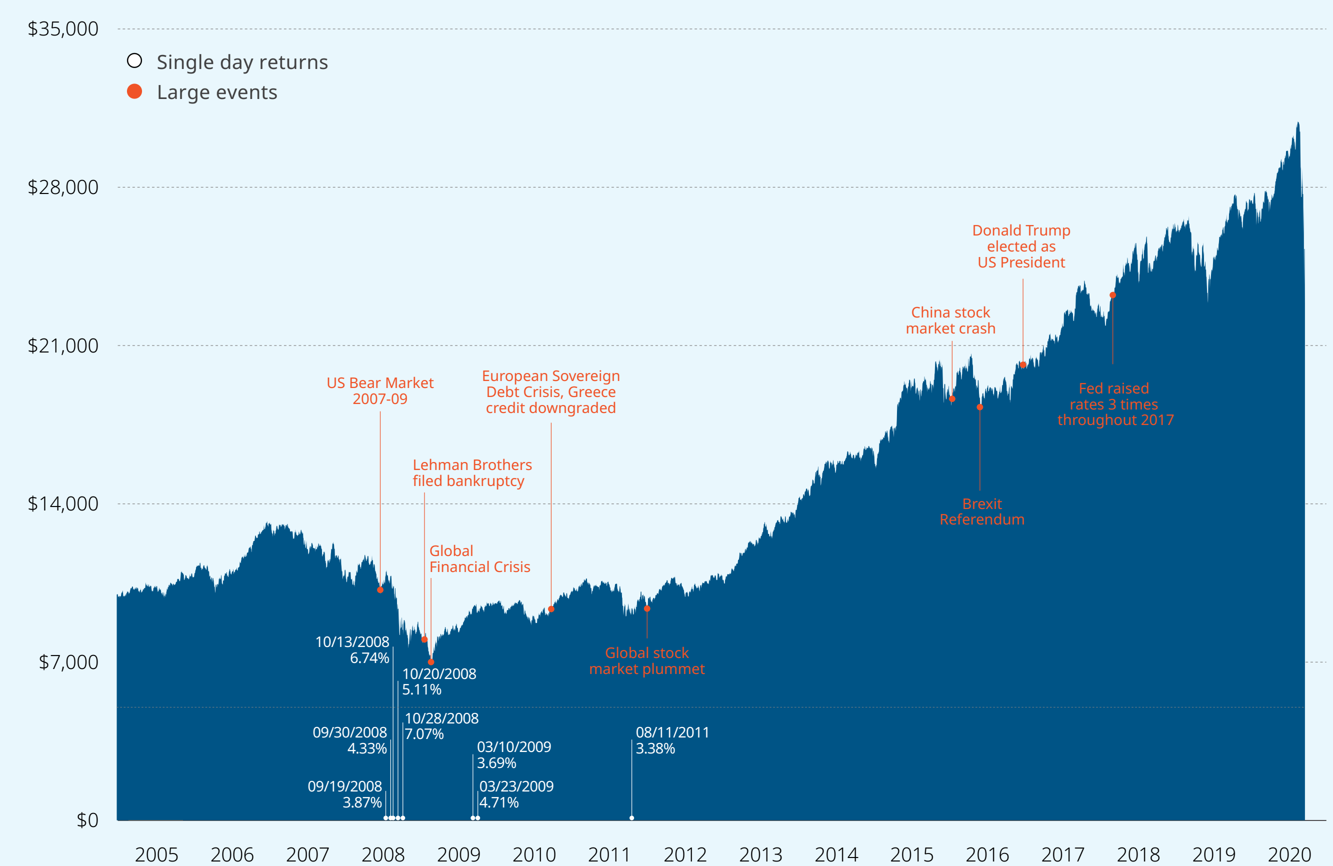
Sources: Morningstar Direct, datastream.

Sticking to a plan: Stay on track to get ahead

Many people react to the market's ups and downs by making emotional decisions about their investments, buying when the stock market is nearing a high, and selling when the market reaches low points. This type of emotional investing may lead to investors sitting on the sidelines and potentially missing out on some of the market's biggest gains.

Keeping money in the market over the long run means investors get the full benefit from all up-market movements. Over the past 15 years, investors who stayed invested even during the worst periods ensured full participation during the best recorded days.

MSCI World Index – March 18, 2005 to March 16, 2020



Source: Mackenzie Investments, Morningstar (For illustrative purposes only).

Taking advantage of government programs: Tax and estate planning infographic

On March 25, 2020, the government announced a set of economic measures - worth $82 billion - to help stabilize the economy during this challenging period.

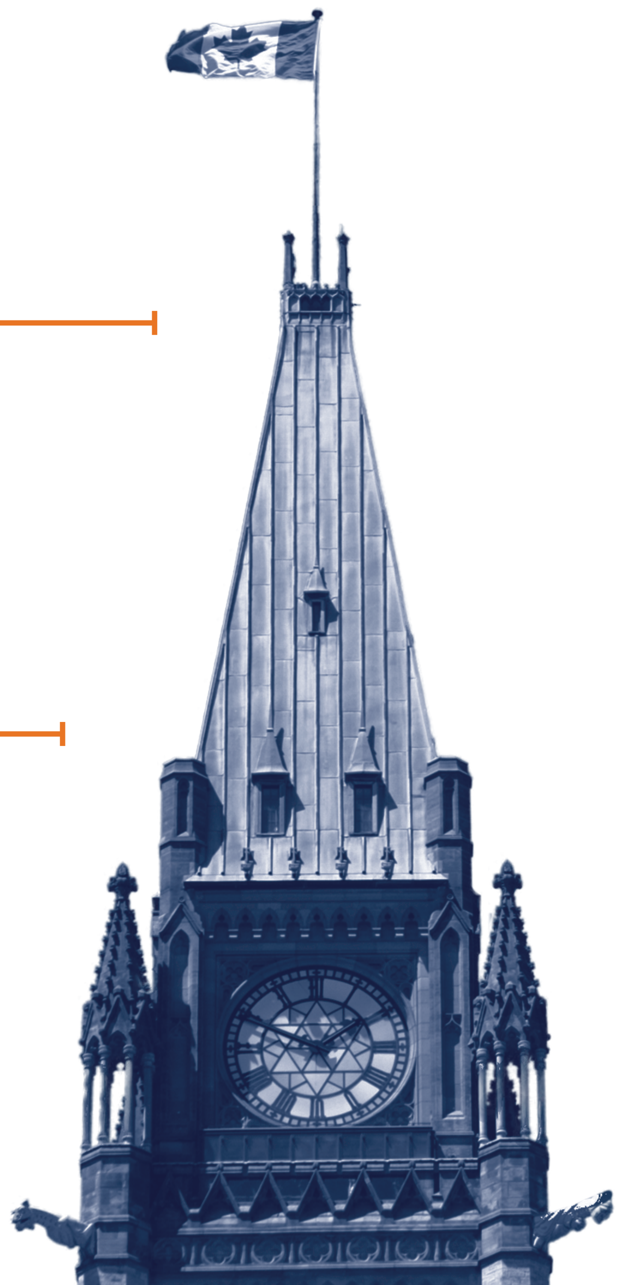
Canada Emergency Response Benefit (CERB)

The CERB is a taxable benefit replacing the previously announced Emergency Care Benefit and Emergency Support Benefit. The CERB is $2,000 per month for 4 months for workers who lose their job as a result of COVID-19. The CERB is a simpler and more accessible combination of the two above benefits. CERB covers Canadians who have lost their job, are sick, quarantined or taking care of someone who is sick with COVID-19, working parents who must stay at home with children who are sick or at home because of school/daycare closures, wage earners, contract works, self-employed individuals who would not otherwise qualify for Employment Insurance and finally to workers who are still employed but not receiving income because their work is disrupted due to COVID-19.

Up to
$2,000
per month for 4 months

$52B
Direct support for Canadian workers and business

$52B
Direct support for Canadian workers and business



Source:
https://www.canada.ca/en/department-finance/news/2020/03/canadas-covid-19-economic-response-plan-support-for-canadians-and-businesses.html

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Helpful investor resources

Working Canadians

GST credit

Maximum annual GST credit will be doubled for the 2019-20 benefit year. One-time special payment to be made by early May 2020. This will increase income by $400 for qualifying individuals and $600 for couples.

Canada child benefit

Maximum annual benefit will be increased by $300 per child for the 2019-20 benefit year. Overall increase will be approximately $550 per family.

Tax returns

Filing deadline for individuals is moved to June 1, 2020 from April 30, 2020. Payment of income tax can be deferred to September 1, 2020.

Mortgage payments

CMHC will permit lenders to allow mortgage payment deferral beginning immediately.

Student loans

Six-month interest-free moratorium on repayment of Canada Student Loans.

RRIF withdrawals

Minimum withdrawal amount will be reduced by 25% for 2020.

Canadian small businesses

Small business wage subsidy

Businesses of all sizes will receive a wage subsidy for three months equal to 75% of remuneration on the first $58,700 of income, or up to $847 per week. This measure will be backdated to March 15, 2020.

Business credit availability program (bcap)

Business Development Bank of Canada (BDC) and Export Development Canada (EDC) will provide over $10 billion of support, largely targeted to small and medium-sized businesses. BDC and EDC are working with private sector lenders to coordinate on credit solutions for individual businesses.

Business taxes

Payment of income tax can be deferred to September 1, 2020.

For more information, contact your financial advisor or visit mackenzieinvestments.com

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That's **better** together

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