Canada Outlook

April 2020

Adapting to a volatile environment

Key takeaways

- The Bank of Canada lowered its target for the overnight rate by 50 basis points to 0.25%. This unscheduled rate decision was the third rate cut in March.
- We do not expect the Bank of Canada to cut its overnight rate into negative territory.
- The Bank also announced a minimum $5-billion-per-week in market purchases of Government of Canada bonds. This marks the first time the Bank has engaged in quantitative easing.
- The Bank of Canada's aggressive action, along with its commitment to do more if conditions worsen, is a constructive sign for the market.
- On the fiscal policy side, the government of Canada has committed to a range of economic supports as part of a $107-billion COVID-19 economic response plan.

HSBC Global Asset Management

Q1 review and outlook

The markets have faced an indiscriminate sell-off as COVID-19 has spread globally. Economic indicators in the next few months are going to be extremely negative and reflect the temporary reality we are in. But it's critical to remember that economic indicators are always a rear-view picture and that markets have a tendency to lead the economy by six to nine months.

There are three primary indicators to watch for: the number of new COVID-19 cases around the world, economic data, and policy action from governments and central bankers. Although all the headlines speak of rapid growth in the number of new cases in Europe and North America, it's important to highlight that in Asia the number of new cases in China, Korea, Japan, Singapore and Hong Kong have all come down.

Policymakers in Canada and around the world are taking extraordinary measures

Toward the end of the quarter, Canada and other G20 countries pledged US$5 trillion in economic stimulus to combat the COVID-19 crisis. The G20 is also committed to supporting vulnerable countries with weak healthcare systems.

On the fiscal policy side, the government of Canada has committed to a range of economic supports as part of a $107-billion COVID-19 economic response plan. This support represents roughly 10% of Canada's GDP. The plan will provide up to $52 billion in direct support to Canadian workers and businesses, plus $55 billion to meet liquidity needs of Canadian businesses and households through tax deferrals to help stabilize the economy.

In late March, the US Congress approved a US$2.2-trillion economic aid package. This unprecedented funding represents close to 10% of US GDP.

Central bankers are cutting interest rates and flooding markets with liquidity to support financial systems

Following an unscheduled meeting on March 15, the US Federal Reserve cut the target range for the federal funds rate by 100 basis points to 0–0.25%. The Fed also committed to at least US$700 billion in asset purchases to support markets.

On March 27, the Bank of Canada lowered its target for the overnight rate by 50 basis points to 0.25%. This unscheduled rate decision was the third rate cut in March. This level represents the Bank's idea of the "effective lower bound."

We do not expect the Bank of Canada to cut its overnight rate into negative territory. Financial institutions deposit their excess cash at central banks for safekeeping, where they earn a small return on those funds. But in a negative rate environment, the banks get charged by the central bank for storing dollars.

Bank of Canada announces programs to support liquidity

The Bank of Canada also announced two new programs, including a minimum $5-billion-per-week in market purchases of Government of Canada bonds, "to address strains in the Government of Canada debt market and to enhance the effectiveness of all other actions taken so far."

This marks the first time the Bank has engaged in quantitative easing, which involves a central bank purchasing longer-term securities on the open market to boost the money supply and encourage lending and investment.

Canadian market and economic highlights

Markets have been extremely volatile, and we have cautiously rebalanced our portfolios on several occasions.

Based on current valuations, riskier asset classes are offering compelling values for patient long-term investors.

Investment strategy highlights

Markets have been extremely volatile, and we have cautiously rebalanced our portfolios on several occasions. We've upgraded the quality of our fixed income holdings in our portfolios for the near term. We have also made targeted investments in equities that now represent good long-term value.

Based on current valuations, riskier asset classes are offering compelling values for patient long-term investors. Risk assets are any assets that are not risk-free. Risk assets include equities, commodities, high-yield bonds and other financial products that fluctuate in price.

We still believe the disruption to global economic activity is likely to be shorter term in nature, with policy support helping to cushion the blow. But despite this, at this point, we think it is important to build up portfolio resilience against the potential for a more significant and protracted global economic slowdown. We will continue to be more selective in the risk assets we hold.

Markets forced lower by pandemic

Canadian equities, as measured by the S&P/TSX Composite Index, were down 20.9% in the first quarter. Canadian bonds, as measured by the FTSE Canada Universe Bond Index, finished the first quarter up 1.56%.

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S&P/TSX Composite Index and Sector Performance

(period ended March 31, 2020)

	3-Month	1-Year	2-Year*	5-Year*	10-Year*
S&P/TSX Composite Index	-20.90%	-14.21%	-3.69%	0.89%	4.10%
Energy	-37.18%	-33.88%	-16.94%	-9.30%	-3.79%
Materials	-18.78%	-7.31%	-2.36%	1.17%	-2.64%
Industrials	-15.05%	-7.47%	3.35%	6.02%	11.65%
Consumer Discretionary	-32.83%	-29.48%	-18.17%	-3.88%	6.95%
Consumer Staples	-9.33%	-6.22%	6.03%	5.90%	13.84%
Healthcare	-37.15%	-62.45%	-26.22%	-39.78%	-3.68%
Financials	-21.10%	-13.28%	-5.15%	3.76%	7.03%
Information Technology	-3.74%	26.05%	27.58%	18.58%	6.17%
Telecom Services	-8.11%	-5.61%	5.05%	6.98%	11.45%
Utilities	-5.28%	12.15%	12.23%	7.59%	7.74%
Real Estate	-28.44%	-25.33%	-5.62%	0.64%	8.77%

*Compound annual growth rate

Source: Bloomberg as at March 31, 2020. Performance stated in Canadian dollar total returns.

In the near term, crude oil prices will likely remain under pressure.

Oil prices spike but remain depressed

Crude oil prices gained ground in early April after US President Donald Trump said he expected Saudi Arabia and Russia to make major output cuts, of about 10 million barrels or more, though his comments triggered scepticism over the volume of curbs and whether reductions would actually be made. A Kremlin spokesperson said Russia had not agreed to a production cut with Saudi Arabia. Saudi Arabia also did not confirm the cuts but called for an urgent meeting of OPEC and its alliance to reach a "fair deal" that would restore balance in oil markets. In the near term, crude oil prices will likely remain under pressure. The International Energy Agency said global demand could drop by as much as 20% due to coronavirus lockdowns.

Q1 in review: Investor confidence in the age of uncertainty

The price of West Texas Intermediate (WTI) oil traded around $25 per barrel in early April, down from almost $50 per barrel in early March. The Government of Canada is working on a rescue package for struggling oil companies. Finance Minister Bill Morneau has also suggested providing support for banks that lend to the sector

Unemployment numbers hit record levels

US initial jobless claims surged to an all-time high of 3,283,000 at the end of March, well above an expected 1,700,000. Weekly jobless claims have never before breached 700,000, even during the depth of the financial crisis or the recession in the early 1980s.

The number suggests that at least 2% of the US workforce applied for unemployment insurance last week alone. Many non-essential businesses have been forced to shut their doors and lay off staff amid the COVID-19 outbreak and social distancing policy response.

More than one million Canadians have already applied for unemployment benefits. An Angus Reid survey at the end of March found that 44% of Canadian households have suffered job losses or reduced work hours.

Diversification and focusing long term are key to getting through this crisis

"Timing the market" is notoriously difficult, the right strategy is, in fact, to focus on "time in the market."

Whereas "timing the market" is notoriously difficult, the right strategy is, in fact, to focus on "time in the market." Staying invested and diversified is key. According to data from 2010 to 2019, portfolios that missed out on the top 20 performing days during this period would have been significantly harmed.

Sources: HSBC Global Asset Management, Bloomberg, S&P/TSX Composite Total Return Index, as at December 31, 2019. Period range is from January 1, 2010 to December 31, 2019. Past performance is not an indication of future returns. The performance may go down as well as up.

Our portfolios are diversified in bonds and currencies that are mitigating the impact of the correction. History suggests that panicked sellers will likely lose out, because they end up selling low and buying high. Selling and parking cash on the sidelines might seem like a good plan, but timing re-entry into market is extremely difficult.

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We expect a U-shaped recovery

Eventually, a huge amount of pent-up demand should lead to a recovery in consumer spending. We expect a U-shaped economic recovery, not a V-shaped recovery. This suggests things will get better gradually. Bonds will provide the first signs of stability in financial markets, with liquidity improving and yields firming up. Based on past crises, stocks will then likely recover ahead of the economy by six to nine months. It's important to remember that a once-in-a-generation economic crisis usually creates a once-in-a-generation investment opportunity for the patient and disciplined long-term investor.

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Important Information:

All quoted returns are total returns as at March 31, 2020 in Canadian dollars. Sources include HSBC Global Research, Bloomberg, RIMES, Statistics Canada and the Bank of Canada.

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Expiry Date: June 30, 2020

DK2000183A