The Market Meltdown

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From March 10th, 2009 to February 19th, 2020 the North American equity markets went, more or less, straight up. There were corrections and some volatility along the way, but as many noted, it was the longest period without a recession in United States economic history. Many market watchers predicted that, sooner or later, we would experience a significant market pullback, and this is precisely what has happened.

We aren't aware of anyone who anticipated a market meltdown so significant as a result of the global novel coronavirus pandemic, which was also exacerbated in Canada by an oil price war between Saudi Arabia and Russia. It was certainly reasonable to assume that at some point there would be a normal market correction. But it is important to remember that, before the health crisis, the U.S. economy was steadily growing, with record low unemployment, strong consumer spending, accelerating housing sales and low interest rate levels which made fixed income alternatives quite unattractive in comparison to stocks. Under those conditions it was, in our view, the right thing to have our clients invested in high quality, dividend paying stocks to the extent that they are comfortable from an asset allocation and risk perspective.

The capital markets reaction to the current situation has been abrupt, brutal and across the board. As we saw in 2008 and 2009, good companies were punished along with the bad. The large names such as the big banks, pipelines and technology stocks have been sold off simply because they are liquid and can provide readily available cash. At times, the bond market has been extremely illiquid and overly dysfunctional and; therefore, prohibitively expensive as a place to raise cash. We are now at market levels where high-quality companies are trading anywhere from 30% to 50% down in one month, and dividend yields have climbed commensurately in-line. We can now get cash-on-cash yields in the 5% to 8% on stocks where we believe the dividend to be safe. In a world where the 10-year bond is trading at well under 1%, those yields are very, very high and very, very attractive.

We do not know what will happen next. We do know that markets will not go to zero, will not go down indefinitely, and when we view what our clients own as a business rather than a stock trading vehicle, we see a lot of great businesses on sale, discounted below their true value. We are also seeing unprecedented monetary support from the U.S. Federal Reserve system as well as huge fiscal support for the unemployed and struggling businesses from governments all over the world. These measures may not restore the economy to its prior state, but they will certainly be very helpful.

Most of our clients know that we emphasize the difference between price and value. Warren Buffett reminds us that the market in the short run is a voting machine. Right now, it is voting against stocks. But in the long run it is a weighing machine, carefully assessing and measuring value. Buffett became one of the richest businessmen in the world by understanding this concept. We believe that it is quite likely that his company, Berkshire Hathaway, is taking advantage and significant positions in some value depressed stocks.

In the previous financial crisis nearly all our clients remained invested. While they put up with nearly two years of pain, in the end it was the correct decision. Those that sold near the bottom of the market did not benefit from the major surge we saw starting on March 10th, 2009. From its low point, the S&P 500 doubled in 14 months. Almost everyone who sold out in panic or despair during the downturn, missed those upward gains.

We don't know how this global health crisis will play out. The circumstances are to a great extent, unprecedented. However, we know that life will return to the economy and that well financed, soundly managed businesses will return to profitability.

We urge you to stay the course, but we recognize every client has his or her own unique capital needs, income requirements and tolerance for risk. Your BCV portfolio manager and your referring financial advisor are always available to discuss asset allocation, capital needs and portfolio income requirements with you.

Bonds Are Not Supposed to Be This Exciting

Chris Richard

Head of Fixed Income Investing & Portfolio Manager

Over the past few months, the world has been gripped by the novel coronavirus (Covid-19). As a result, a significant portion of the global economy has been suspended, as countries attempt to bend or flatten the curve, thereby reducing the number of people infected by this virus. The speed and ferocity of the virus spread caused economic activity to effectively freeze up. This has taken a toll on the global equity markets and as the panic intensified the bond market has participated in the hysteria.

When we speak to clients about our bond strategy, we highlight the importance of risk reduction to client portfolios. The bonds that we purchase for client accounts act as a ballast for investors, offsetting the higher volatility of equities.

We balance the need for safety with the reality that most people rely on their portfolio as their primary source of income in retirement. Since the Great Recession of 2008/2009, government bonds have not been able to supply the required income due to the persistently low interest rates we have seen and will likely see in the future.

As government bonds have not been a suitable option for most clients, BCV invests primarily in investment grade corporate bonds issued by Canadian companies. We focus on generating a return on your capital as well as a return of your capital when the bond matures, and high-quality corporate bonds allow us to align for that.

Two factors that impact corporate bond prices are the credit risk of the company, and the relative ease which the bond can be bought or sold in the market (know as 'liquidity'). Higher perceived credit risk and/or bonds that are more difficult to buy or sell will result in lower prices.

To discuss the depths of the research done to determine the credit worthiness of the bond issuer would be too lengthy of this venue. This is a significant undertaking before we purchase a bond for client investment accounts. We focus on bonds from well-run companies, domiciled in Canada, who have a history of strong and consistent cashflow.

Over the past month corporate bond prices have reacted, albeit with less severity, in concert with the equity markets. The bond market is an 'over-the-counter' market, meaning that bond dealers hold inventories of bonds and act as both buyer and seller to those who wish to trade with them. Large bond funds have been selling significant quantities of bonds to these dealers as they attempt to raise cash necessary for redemption requests. The bond dealers, for their part, only want to buy the most liquid securities, and will pay a premium to do so. Bonds that are not as liquid, or with higher perceived credit risk, will correspondingly be priced at much lower levels than normal, making it unattractive to sell certain bonds in the current environment. The measures undertaken by central banks around the world are helping and we have seen liquidity return over the past few weeks and prices have partially recovered.

The focus has now shifted to the credit worthiness of the borrower. The companies whose debt we invest in have a significant amount of real assets, much the same way as a mortgage is backed by a home. The real estate that is backing these bonds are still standing. Oil is still flowing on pipelines. The banks will still make money. Power will still be generated and used. Once the overhang of the pandemic has lifted and we get back to our new normal, corporate bond prices are expected to drift higher as the market starts to recover.

We want to reassure readers that what has occurred over the past month isn't normal. If you had asked us at the beginning of the year what would push North America into a bear market, a virus originating in a food market in Wuhan, China would have been low on the list. While a crisis can result in dramatic moves in financial markets, clients should rest easy knowing that the companies in their portfolio are of high quality, both in equities and fixed income securities.