CHARTBOOK

Market Comment

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Market Comment

Stock markets continue to climb higher despite a pandemic and a dismal news cycle which is leaving many investors puzzled. Although expected by many, markets have not undercut the lows made in March – at least not yet. It's always important to remember that markets are forward looking organisms which look past short-term events.

Perhaps the market is regarding the pandemic as only a relatively short-term interruption of the economy. If this is what the market is expecting, there would be a risk of a deeper correction should there be a second wave of the virus or another event that kept economies offline for an extended period. Over the past few weeks we have been doing extensive research on the possible outcomes we could experience and have been updating our action plan for each possibility.

In addition to the regular virus updates, the news of the week has centered around relief payments going out to individuals and businesses, corporate earnings reports and new releases of data showing the economic effects of the virus.

Source: Ocean Front Wealth Management, Stockcharts.com

Fiscal Stimulus: Canada

For information on the benefit programs and to see if you qualify, please visit the resource page on our website: https://oceanfrontwealthmanagement.com/covid-19/resources/

Updates on government relief programs:

- The Canada Emergency Response Benefit (CERB) has paid out $24 billion in benefits to 7.3 million applicants
- Almost 10,000 businesses applied for the Canada Emergency Wage Subsidy (CEWS) after the opening of the application process on Monday morning

Source: Yahoo Finance[1], Ocean Front Wealth Management

Fiscal Stimulus, continued:

How is the government going to pay for all this?

There are a few options to choose from:

1. Increase taxes or introduce new taxes
   - This would be the least popular option among taxpayers

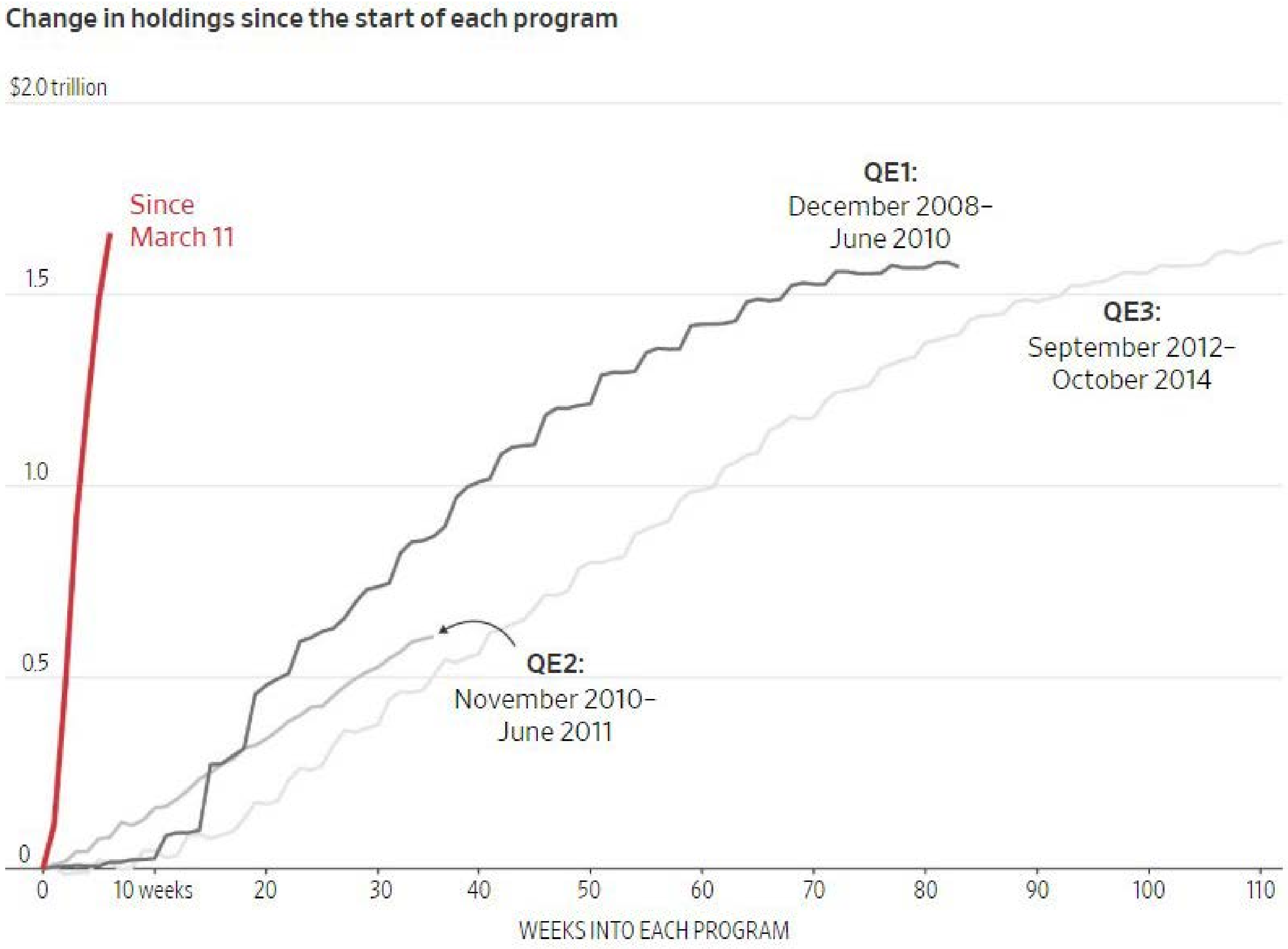
2. Increase debt
   - The government can run deficits so long as investors and foreign nations are willing to purchase their bonds

3. Print money
   - The government can create new money

4. '*Quantitative Easing':* the purchase of assets by the Bank of Canada
   - Central Banks like the Bank of Canada and the Federal Reserve can create money which they use to purchase assets, including government bonds. They are doing this already. This means that the central banks lend newly created money to the government for the government to spend as it pleases.

Source: Bank of Canada, US Federal Reserve Bank, Ocean Front Wealth Management

Monetary Stimulus - USA

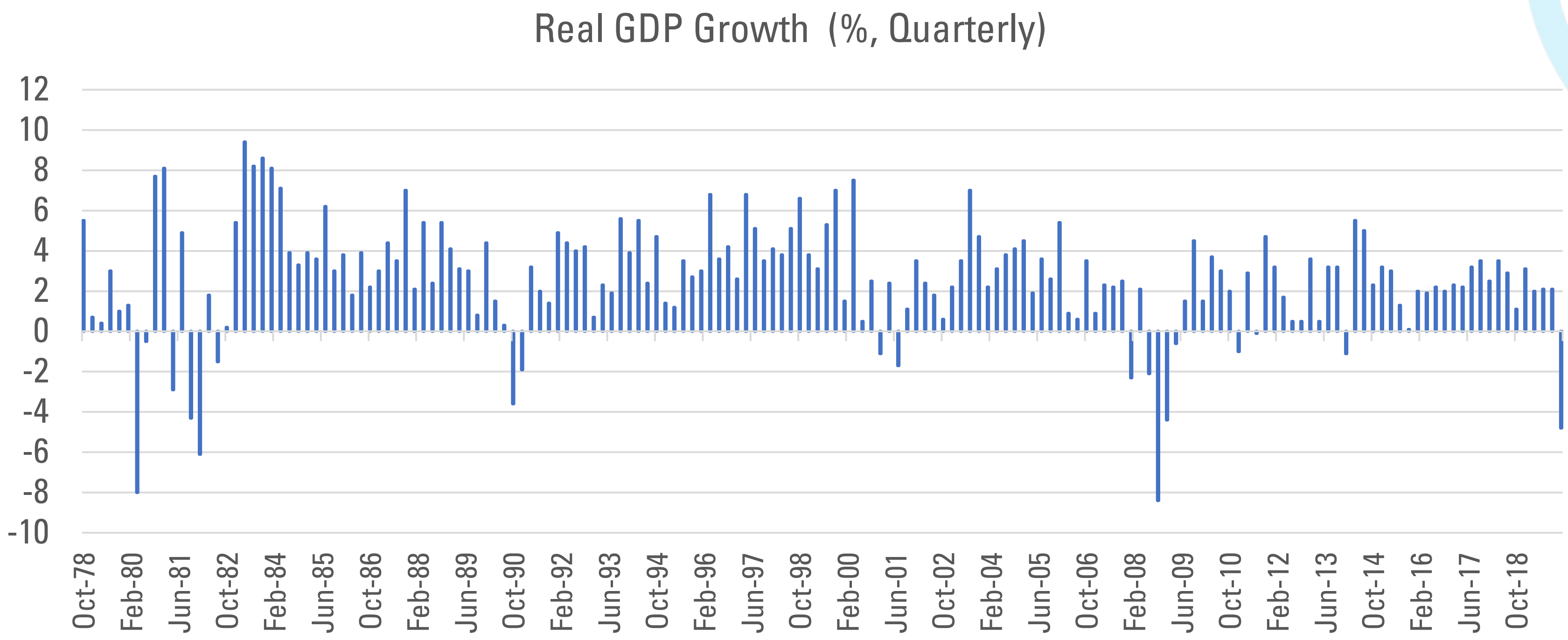


*Treasurys, mortgage-backed securities and Fannie Mae and Freddie Mac debt
Source: Federal Reserve Bank of St. Louis

This chart compares the amount of stimulus the US Federal Reserve has provided to financial markets from different *quantitative easing* programs. You can see that the amount of stimulus from the current program is both larger and faster than any of the previous examples.

Source: Wall Street Journal, Federal Reserve Bank of St. Louis, Ocean Front Wealth Management

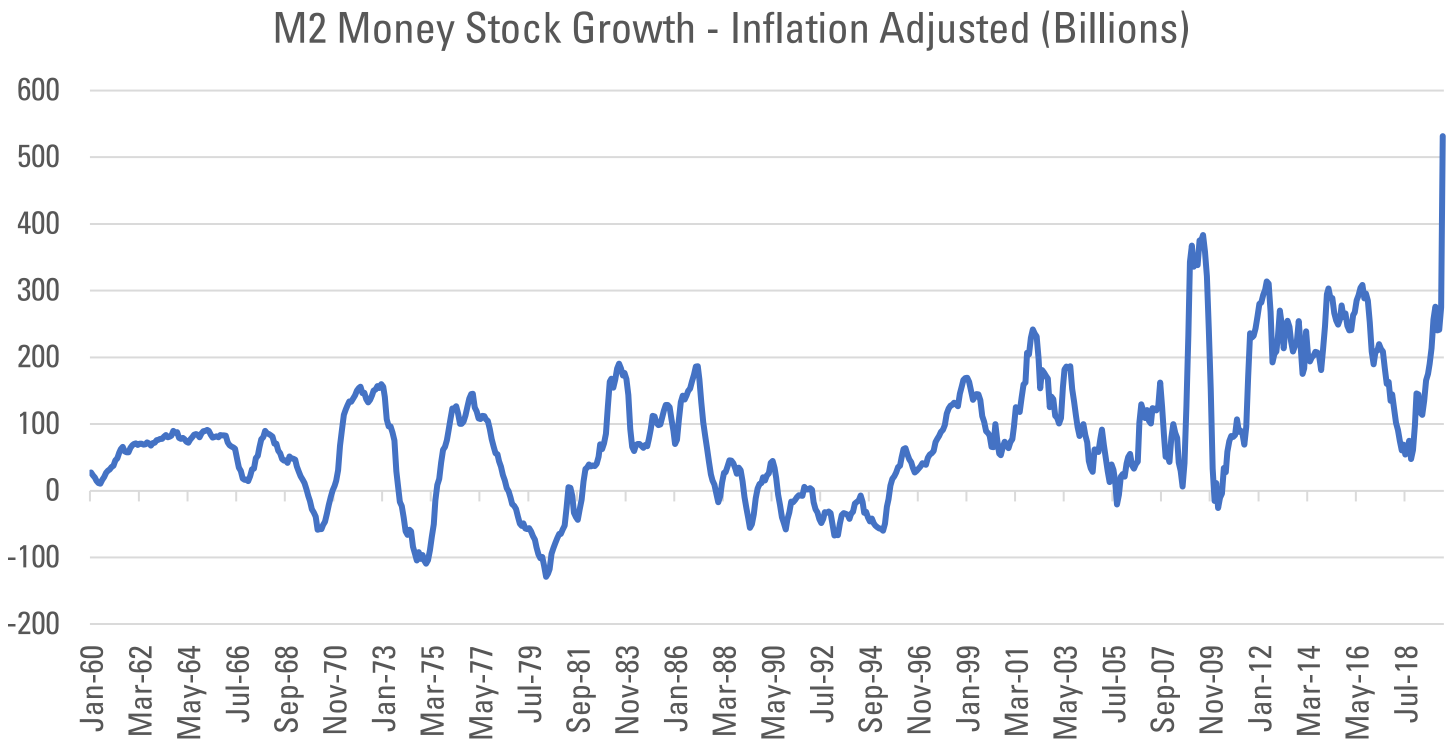
Gross Domestic Product - USA



Q1 GDP was reported in the US this week, coming in at -4.6%, the worst quarter since 2008. Note that for much of the first quarter the economy was still operating as normal. Q2 GDP is expected to be much worse, the Congressional Budget Office estimates -40% annual growth, which would dwarf every number on this chart.

Source: CBO[2], US Federal Reserve Bank of St. Louis[3], Ocean Front Wealth Management

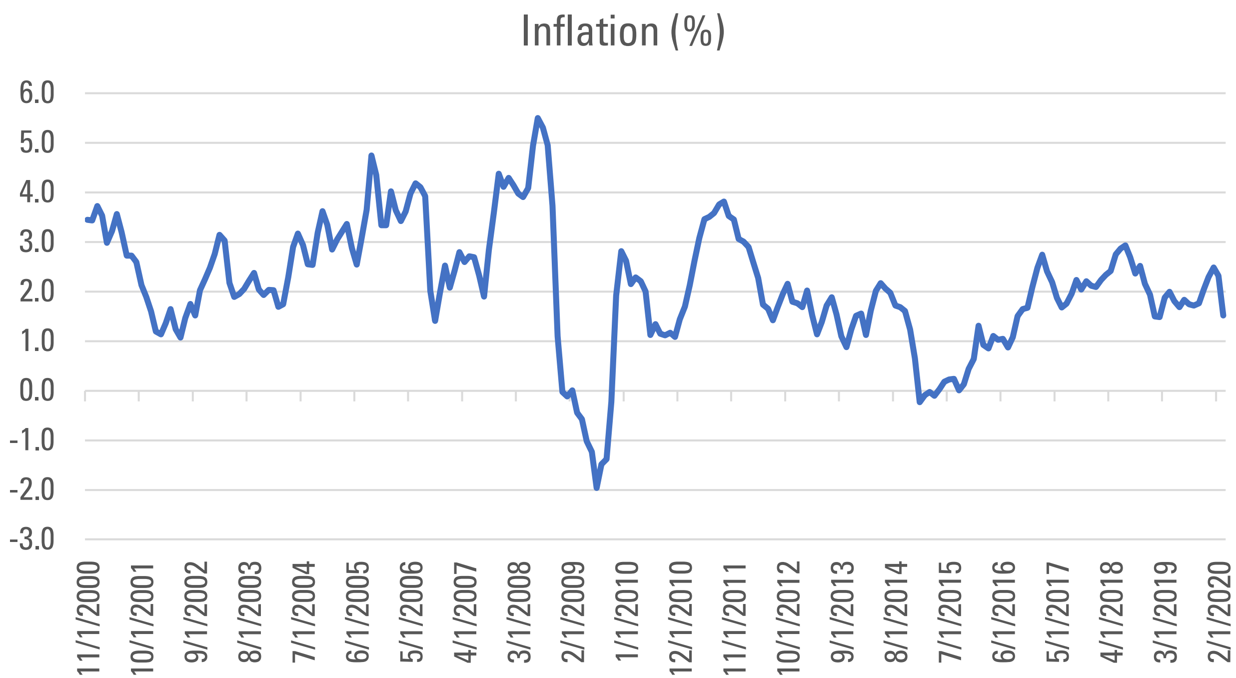
Money Supply - USA



The money supply in the US, a way to look at how much money is being printed, is growing more than any other period dating back to 1959. Whenever new money is created, it should decrease the value of the existing money. If the money supply was $100, and another $10 was printed increasing the supply to $110, the value of each pre-existing dollar would decrease from $1 to $0.9, creating inflation of 10%. If the value of goods and services (and other assets, like gold) stays the same, their new prices should increase 10% in this scenario (all else equal).

Source: US Federal Reserve Bank of St. Louis[5], Ocean Front Wealth Management

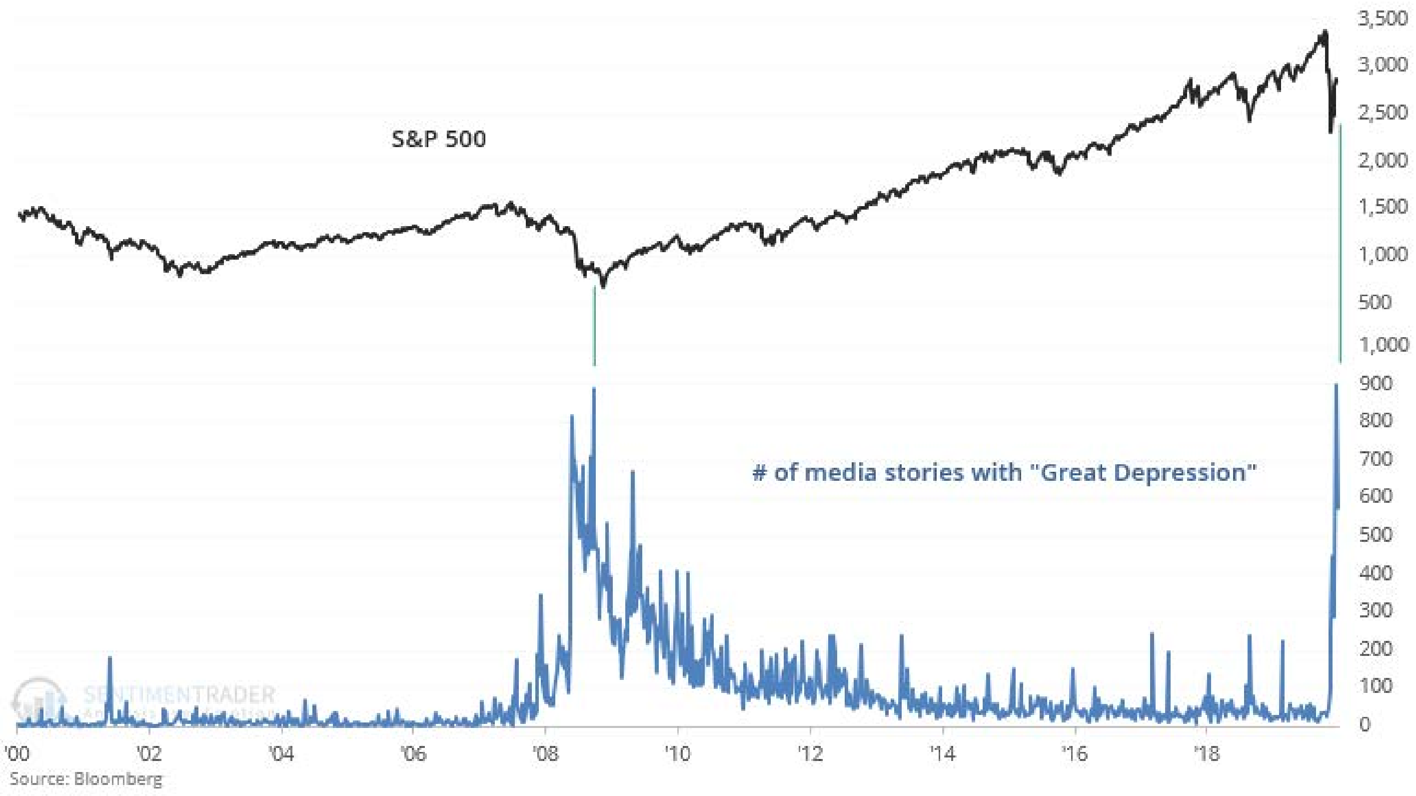
Inflation - USA



USA inflation decreased to 1.5% in March, showing the battle between the deflationary forces of the virus' impact and the inflationary policies and money printing of the government.

Source: US Federal Reserve Bank of St. Louis[6], Ocean Front Wealth Management

Investor Sentiment

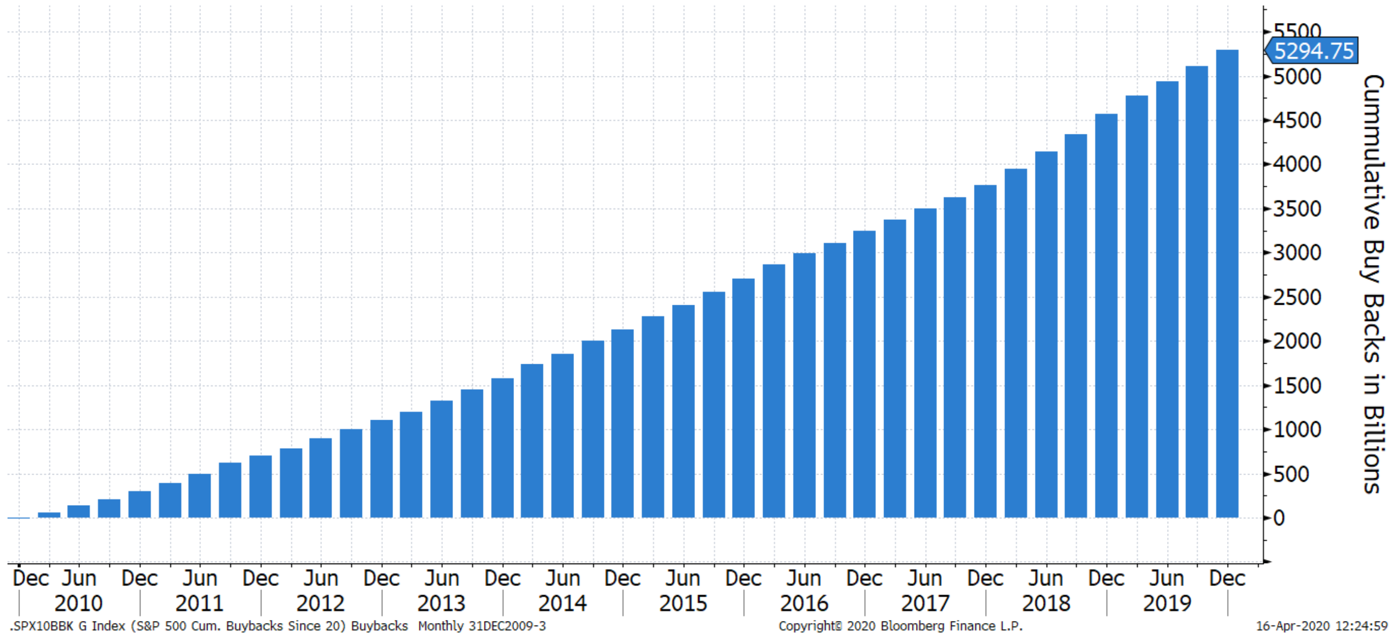


You've probably heard it several times by now that a particular event has occurred for the first time *"since the Great Depression."*

The number of media stories mentioning the Great Depression has recently reached the highest level since January 2009, which was two months before the Financial Crisis bottom in March 2009. This may signal that investor psychology is near the point of maximum fear.

Source: @sentimentrader on Twitter[7], Bloomberg, Ocean Front Wealth Management

Stock Buybacks – A Thing of the Past?

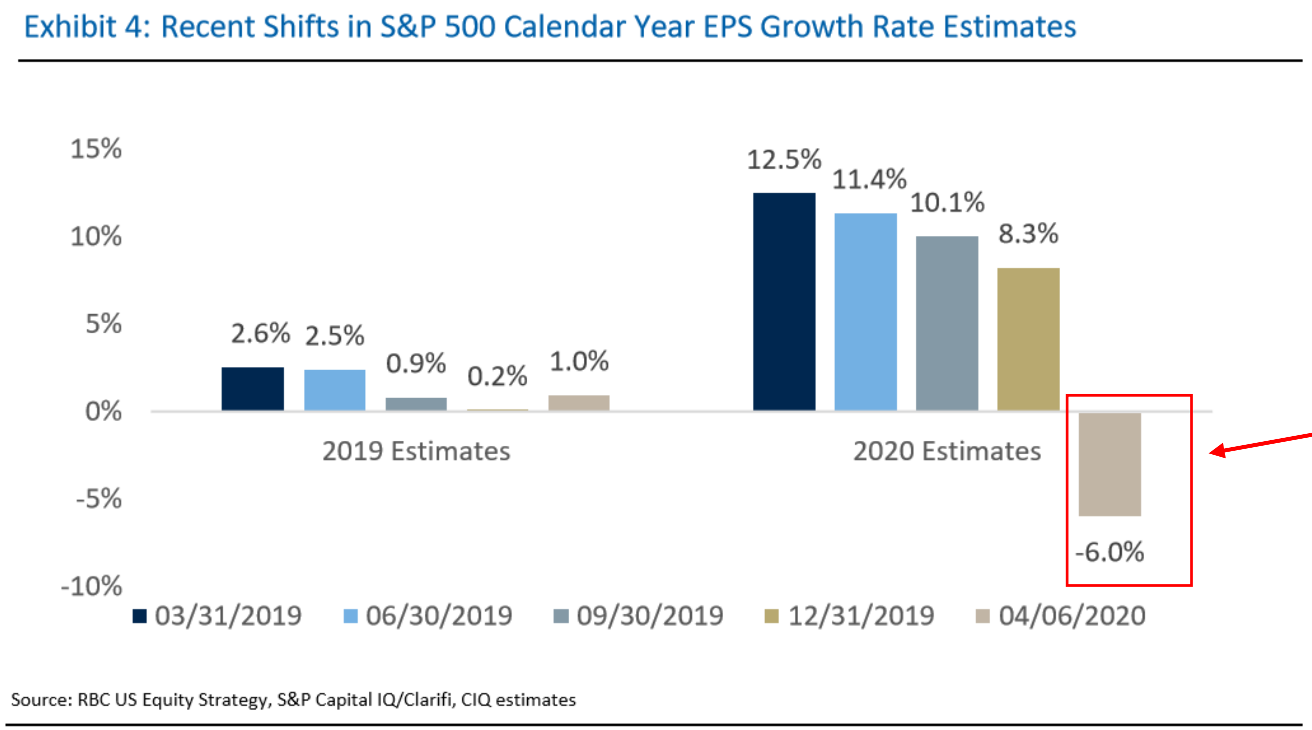


Companies have bought back $5.2 TRILLION of their own stock over the past 10 years. These buybacks have not just been a source of demand for stocks, they are also a driver of earnings per share growth. These programs now face a threat from weakened revenues, restrictions tied to government support, and the need to protect cash during the coronavirus' economic turmoil.

In addition, there is increasing debate about whether buybacks are 'socially unacceptable' which could decrease their popularity in the future.

Source: Ocean Front Wealth Management, Bloomberg Professional

Analysts Slow to React



The collective consensus of analysts' forecasted US profits has shifted from +12% to -6%. This number will likely see more cuts in the coming weeks.

Source: Ocean Front Wealth Management, RBC Capital Markets

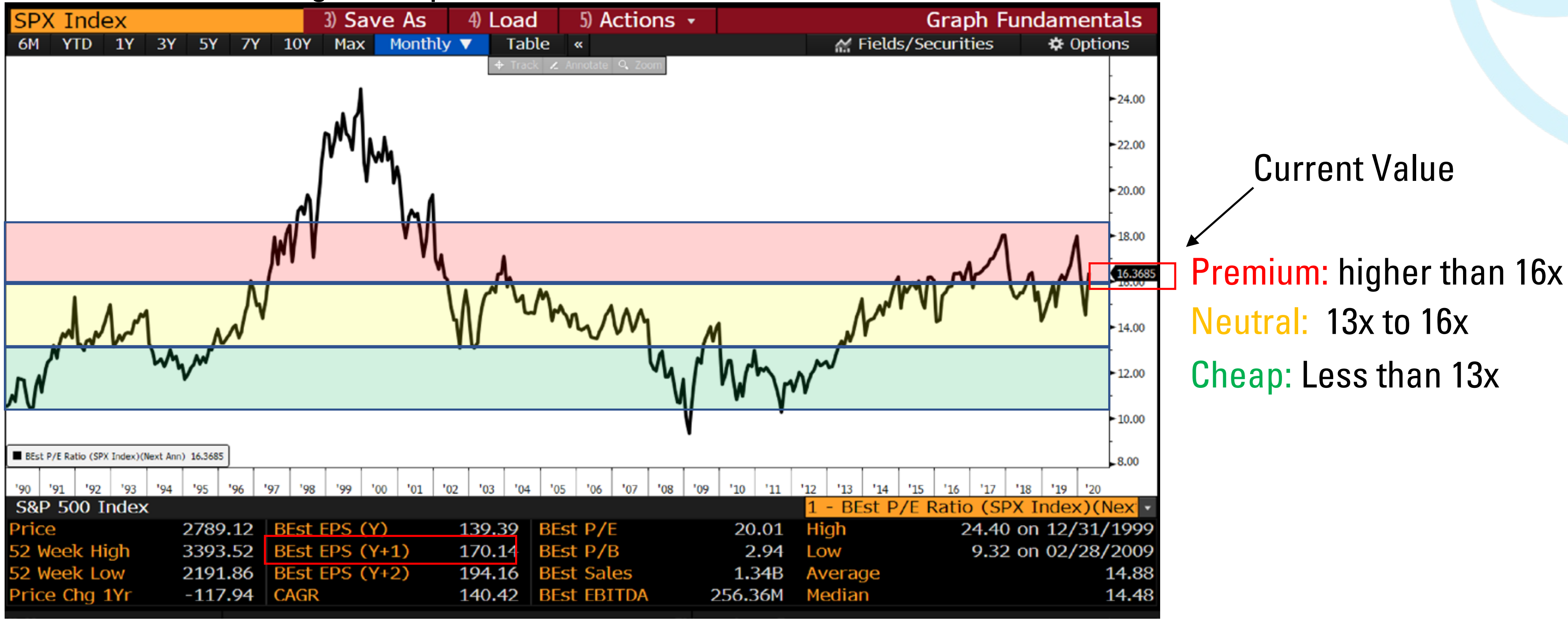
Valuation - S&P 500 Price/Earnings Multiple

As the value of a company is tied to how much income it will earn over its lifetime, we look at the Price-to-Earnings Multiple (P/E) as a measure of how much we must pay for those earnings. After the recent decline in the market, the valuation multiple is actually 10% HIGHER than six months ago because prices have fallen but earnings have fallen more. This means these stocks are not 'cheap', but are rather trading at an expensive, premium valuation. We are skeptical as to whether a premium is warranted given the economic uncertainty due to the virus.

Source: Ocean Front Wealth Management, Bloomberg Professional

History of Valuation

S&P500 Price/Earnings Multiple



On the chart, you can see the last time S&P500 stock valuations were in the "cheap" zone was in 2012. Ignoring 2020 and looking out to 2021 earnings, the forecast right now is for $170 of earnings/share which implies a 16.3x P/E multiple. This is already a premium multiple and we believe profits in 2021 are going to be much less than $170.

Source: Ocean Front Wealth Management, Bloomberg Professional

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Forward Return Outlook

Combining Valuation Multiple with Earnings Projections

The numbers in the top row show earnings multiples (P/E) we have assumed to be historically cheap, neutral or premium (from the previous slide)

Examples of different scenarios for 2021 earnings/share (EPS)

P/E Mutliple on 2021 EPS Estimate

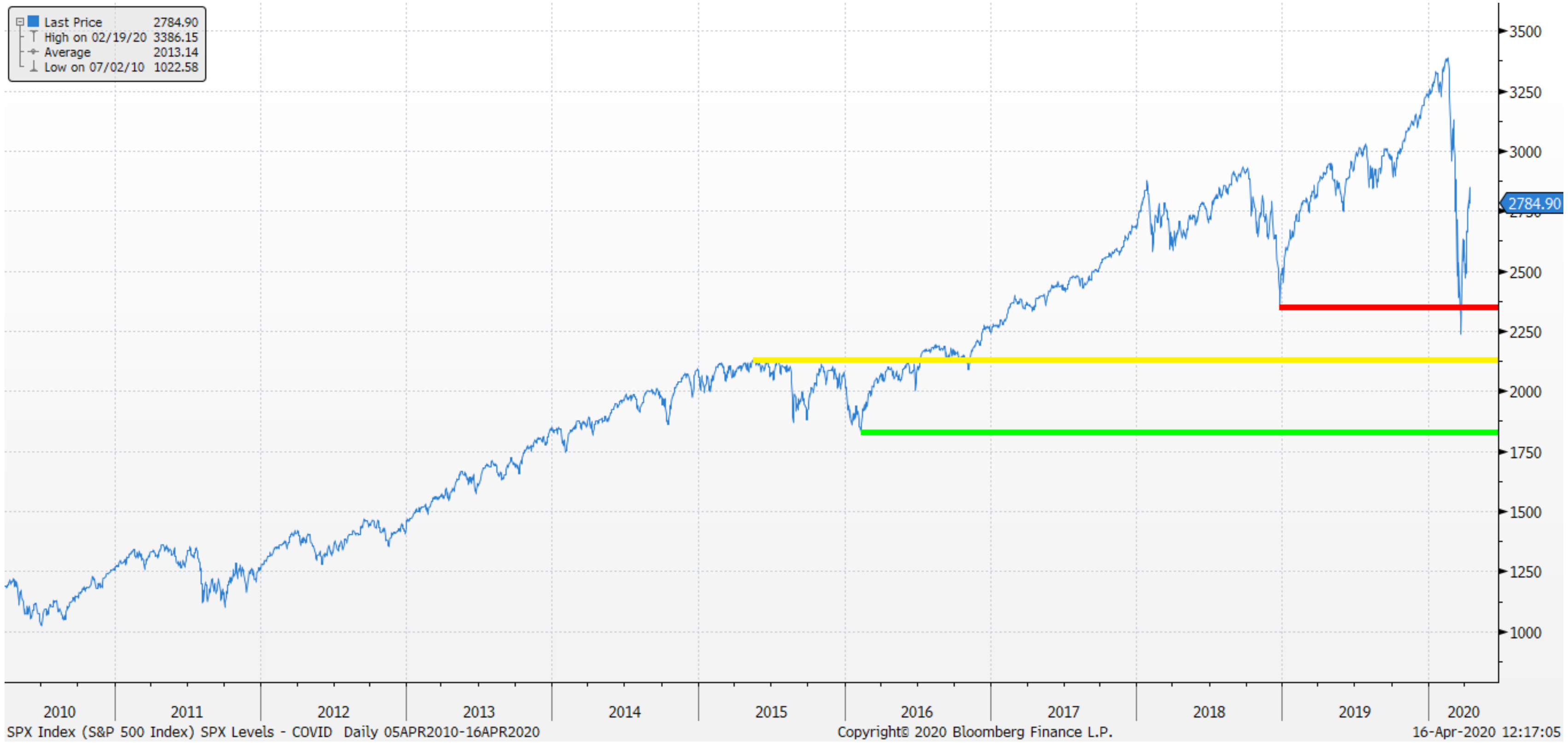
			11	12	13	14	15	16	17	18	19
	Current Consensus Estimate	$170	1870	2040	2210	2380	2550	2720	2890	3060	3230
EPS Estimate for 2021	Base Case Scenario	$150	1650	1800	1950	2100	2250	2400	2550	2700	2850
	Stress Case Scenario	$141	1551	1692	1833	1974	2115	2256	2397	2538	2679

The numbers in the table show where the S&P500 should be trading at (it's at 2942 as of this writing)

The S&P500 is at 2942 as of this writing. When we look this up in the table, we find the price of the market is at a premium valuation for even the Current Consensus Scenario, while it's off the chart for both the Base Case and Stress Case Scenarios. The market would have to be considerably lower to be considered cheap, which is the margin of safety we seek to become aggressive buyers of equities.

Source: Ocean Front Wealth Management, Bloomberg Data

Price – S&P500 Technical Study



We've identified these key technical support levels for the S&P500, which line up to the same zones as the boundaries between Premium, Neutral and Cheap in our valuation matrix.

You can see that the index recently bounced when it reached the red line.

Source: Ocean Front Wealth Management, Bloomberg Professional

Why is the market going up then?

The rally we have seen since the initial crisis decline in stocks has been both impressive and surprising. It could still be a "bear market rally" that eventually fails and we see even lower prices, it could be the beginning of a new bull market, or it may be something in between. It's impossible to know for sure what will happen, but there are several factors which support the "bull" case, which include:

1. <u>Governments & Central Banks:</u>
   - A record amount of stimulus is flowing into the markets and economy
   - The US Federal Reserve is buying all kinds of assets, including high-yield bonds, which they have never done before, and will help prevent corporate defaults
   - Trump will probably do and spend whatever it takes to get the market higher in time for the election in November
2. <u>Interest Rates:</u>
   - Rates being so low pushes valuations higher
3. <u>A lack of attractive alternatives to stocks:</u>
   - The yields on "safe" bonds like US Treasurys, are near record lows. The US 10-year Treasury yield is around 0.60%, which can easily be wiped out by inflation. In past bear markets investors had the option of buying treasuries at yields 10-20 TIMES higher than this
   - The yield on cash deposits like High Interest Savings is 0.3%-0.5% in many areas
4. <u>Optimism</u>
   - Perhaps one of the best-case scenarios turns out to be the result, and in the long run a 2-3 quarter interruption of the economy is not a major concern

Source: Ocean Front Wealth Management, Bloomberg Professional

What do we do now?

We prepare for all outcomes. We have identified prices where we would be comfortable buying equities at a relatively cheap valuation, and where technical levels with favourable supply and demand market dynamics exist. We discussed these in previous slides.

In the absence of lower prices, we are watching for progress in reversing the factors that caused this crisis. When enough of the below factors have been addressed, we would feel comfortable that the crisis is coming to an end and investing more aggressively.

- ✓ 1. Significant Containment Strategy - strong, swift and coordinated healthcare policy
- ✓ 2. Fiscal Policy – we need to see important fiscal support measures announced and cooperation amongst and within governments
- ✓ 3. Monetary Policy – coordinated and effective monetary policy to support the proper functioning of markets
- ✓ 4. A slowing in the rate of growth of new cases and improvement in first hit European countries
- 5. A deceleration of bad news – in terms of economic and corporate updates
- 6. Treatment, Eradication, Vaccination

Source: Ocean Front Wealth Management, Bloomberg Professional

Treatment, Eradication, Vaccination

As reported by Bloomberg this week:

"The Trump administration is organizing a Manhattan Project-style effort to drastically cut the time needed to develop a coronavirus vaccine, with a goal of making enough doses for most Americans by year's end."

"The project's goal is to have 300 million doses of vaccine available by January, according to one administration official. There is no precedent for such rapid development of a vaccine."

"There are at least 70 different coronavirus vaccines in development by drug-makers and research groups, according to the World Health Organization. But drug-makers have not coordinated their efforts to the extent they could through the Warp Speed project, one of the people said."

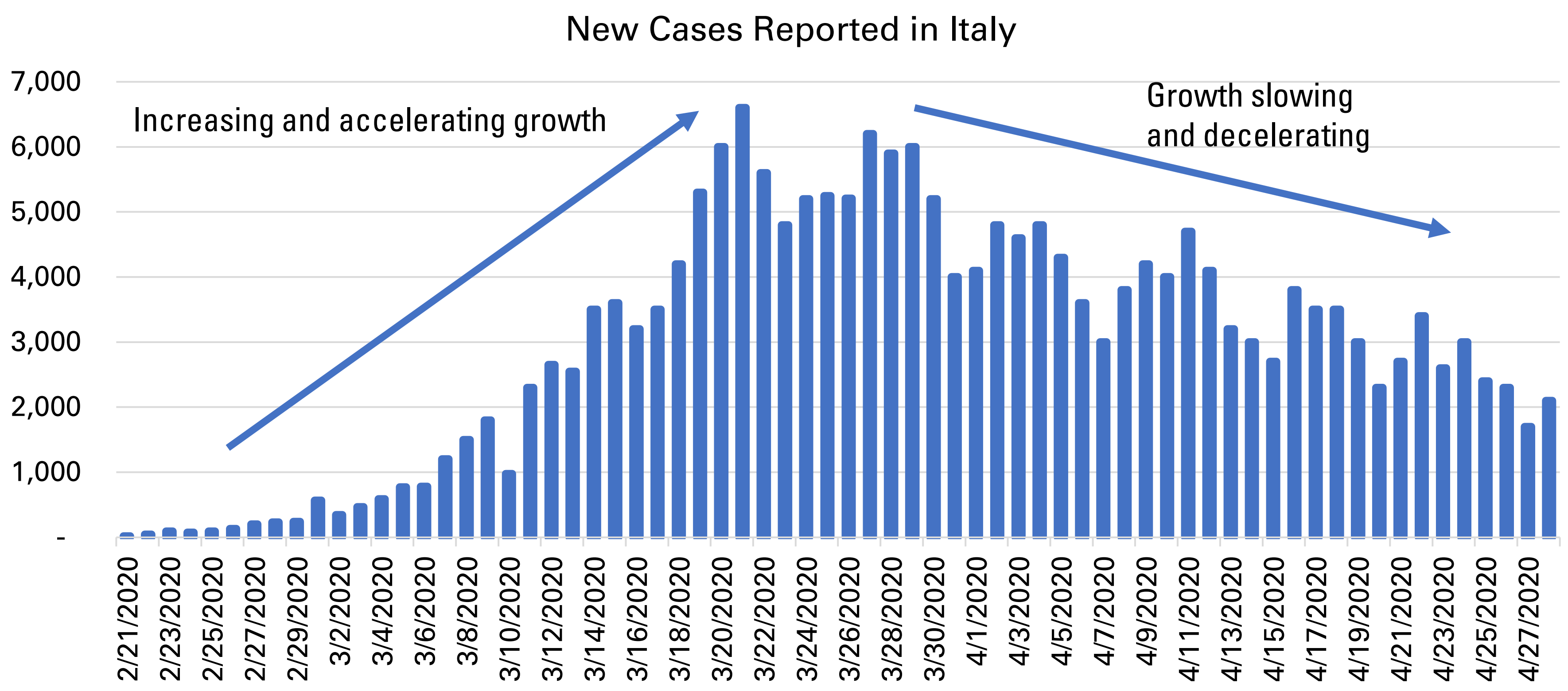
"The Trump administration isn't alone in trying to fast-track a vaccine. One of the world's most promising vaccine candidates has been developed by a team at Oxford University in London. Last month, scientists at the U.S. National Institutes of Health innoculated six rhesus macaques with the Oxford vaccine and then exposed them to the coronavirus," the New York Times reported.

"All six were healthy more than four weeks later, according to the Times. "

"Gilead Sciences Inc. announced Wednesday that in a trial conducted by [Dr. Anthony] Fauci's agency, the U.S. National Institute of Allergy and Infectious Diseases, its experimental coronavirus therapy remdesivir helped patients recover faster than under standard care."

Source: Ocean Front Wealth Management, Bloomberg[8]

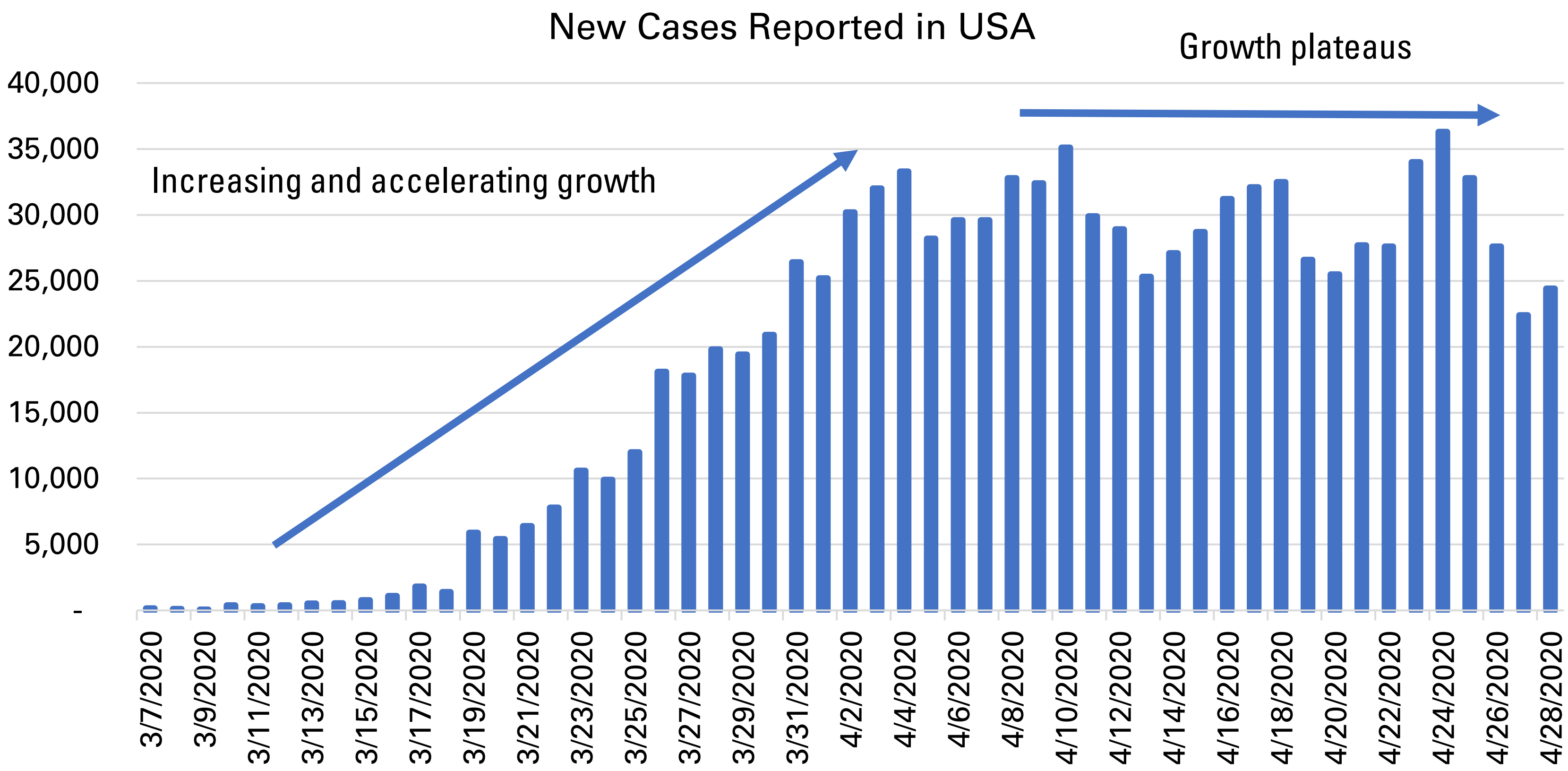
Spread of COVID-19 in Italy



Italian case growth is still in steady decline. Italy is now working on its plans for re-opening.

Source: Johns Hopkins University[9], Ocean Front Wealth Management

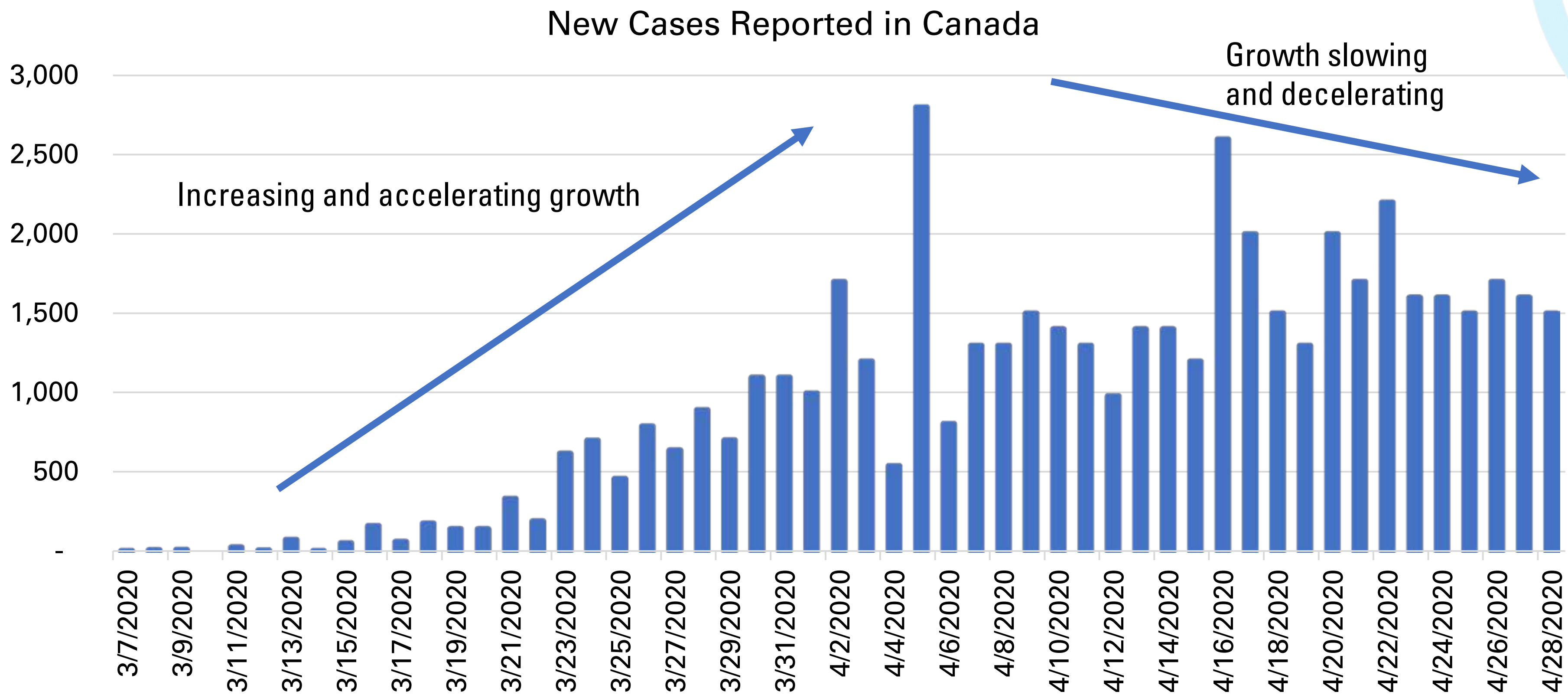
Spread of COVID-19 in USA



US case growth appeared to have peaked in early April but seems to have plateaued rather than declined at the rate Italy's did.

Source: Johns Hopkins University[9], Ocean Front Wealth Management

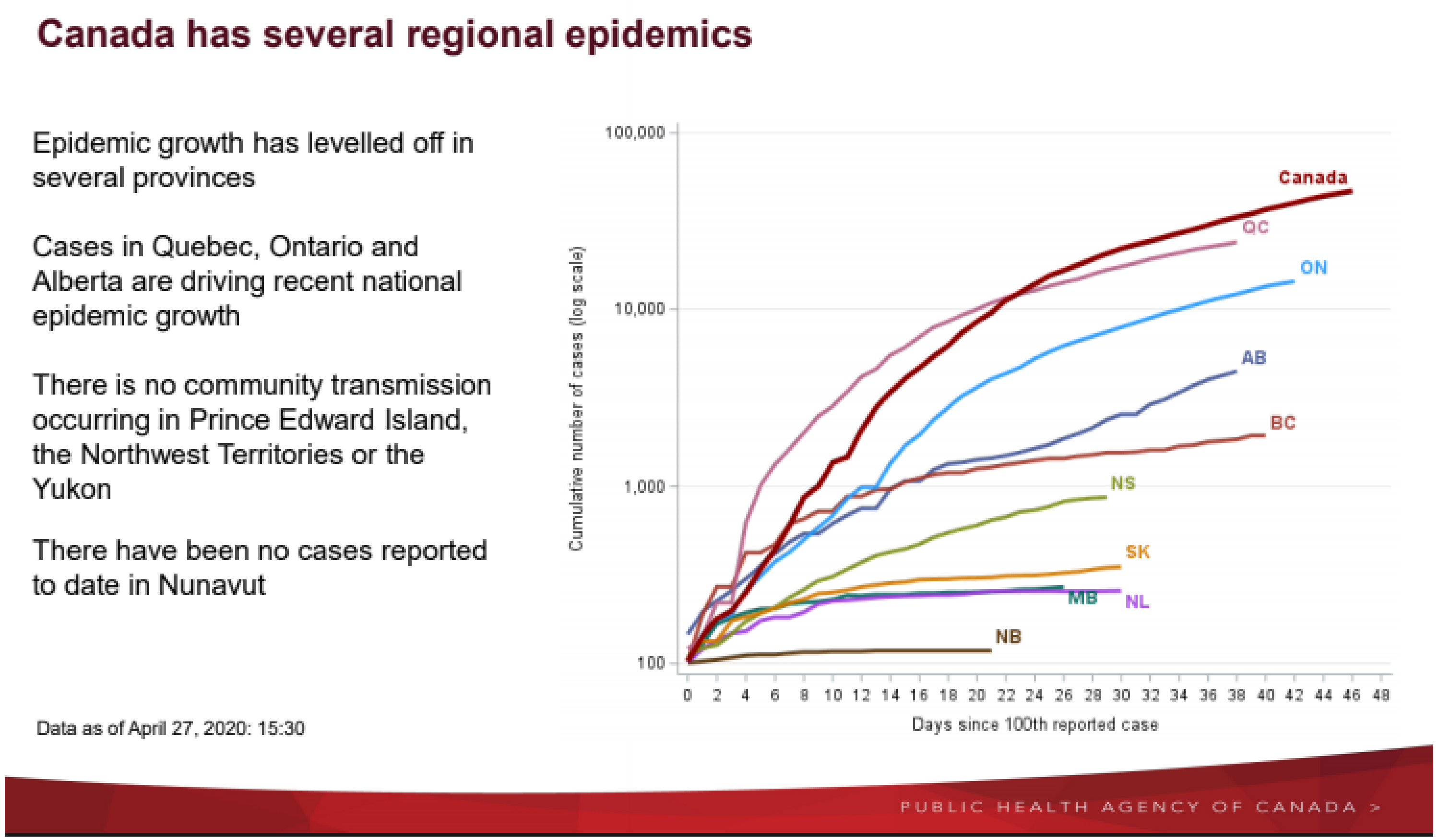
Spread of COVID-19 in Canada



The Canadian case growth trajectory appears more like the US trajectory than Italy's.

Source: Johns Hopkins University[9], Ocean Front Wealth Management

Spread of COVID-19 in Canada



Recent Canadian case growth has been mostly driven by Quebec, Ontario, and Alberta, while here in BC it has slowed significantly.

Source: CBC[10], Ocean Front Wealth Management

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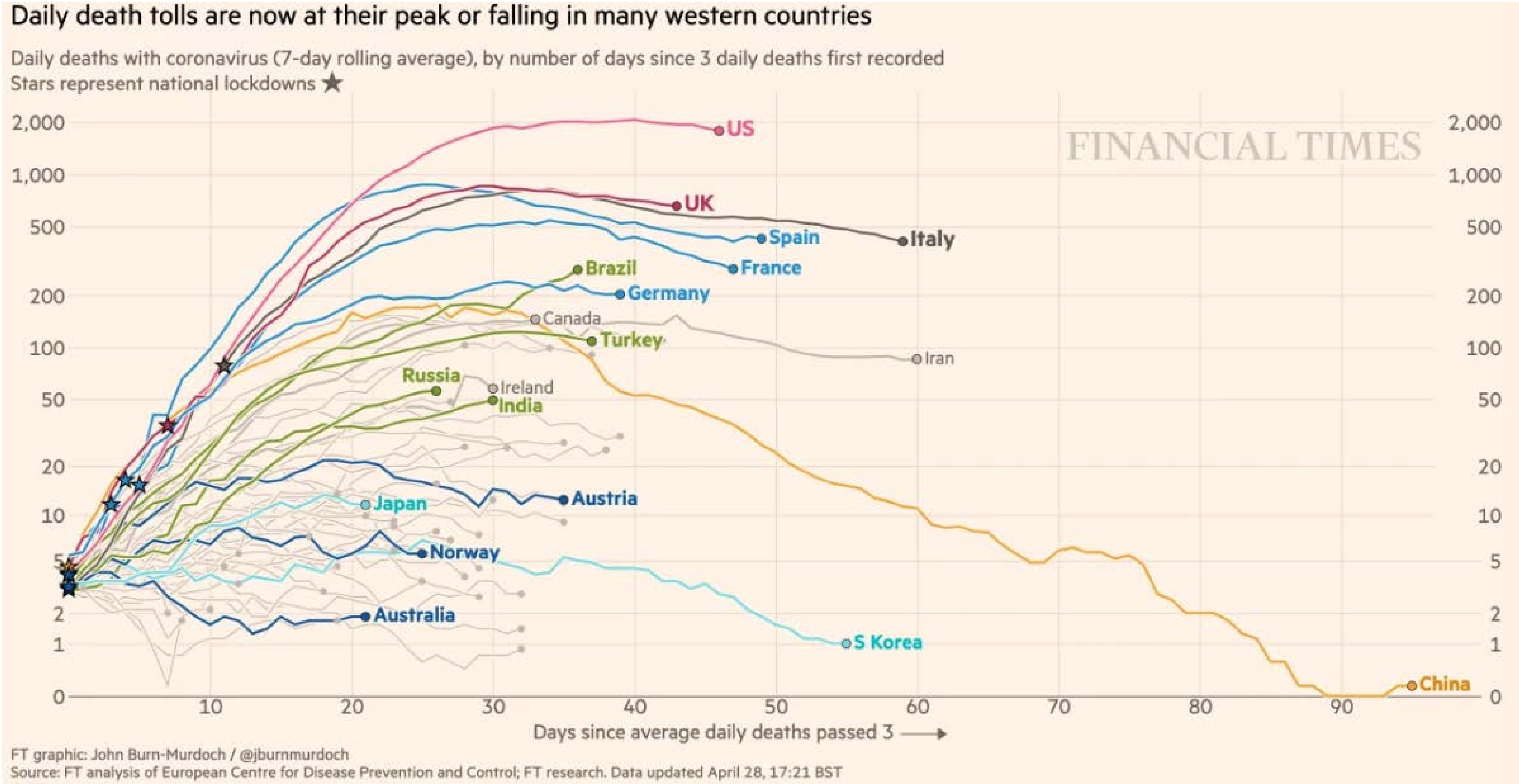
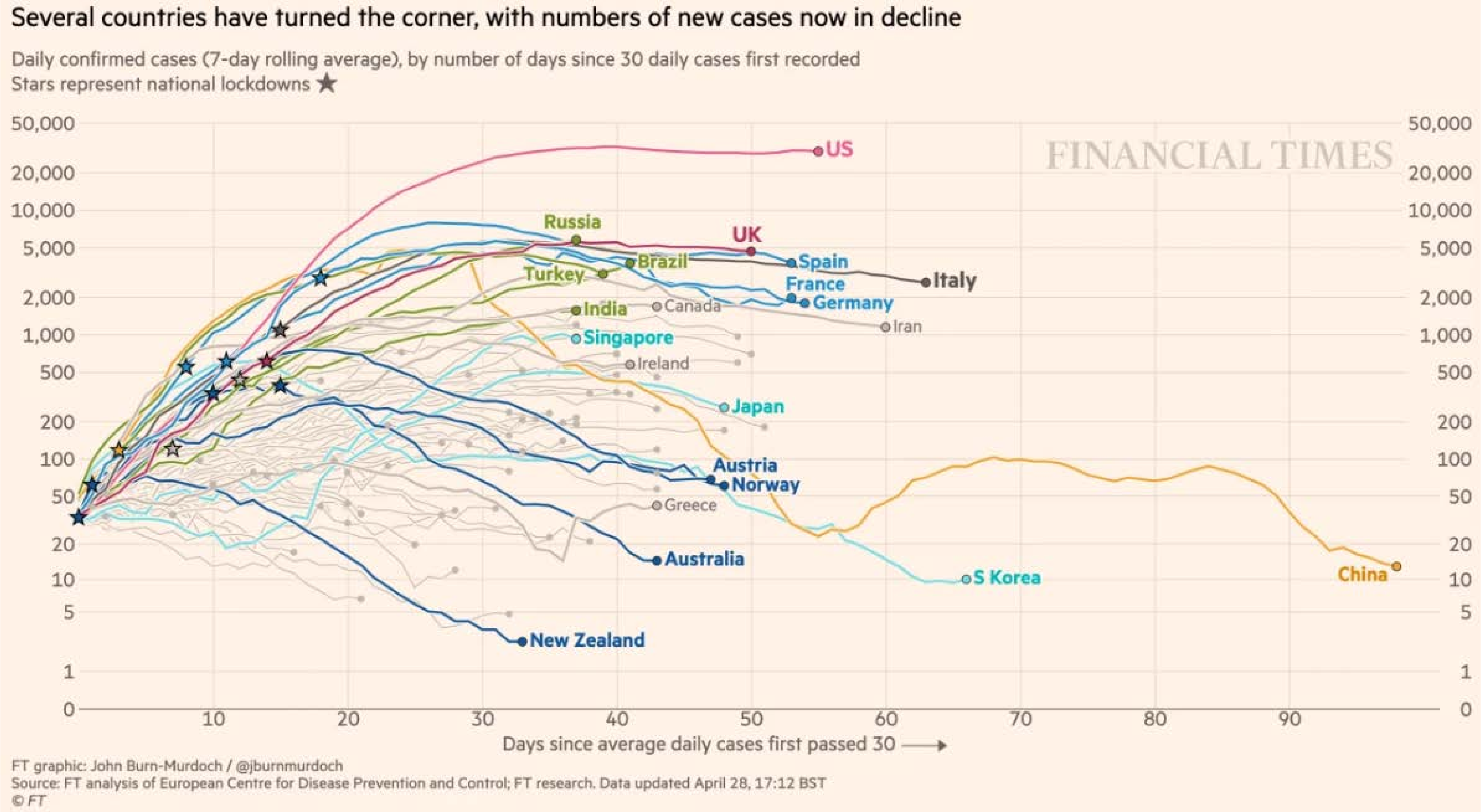
Looking for the Curve to Flatten - Deaths



Daily death tolls continue to show progress in many western countries. Numbers in Brazil, India and other countries are still growing. These numbers lag the new infection numbers, meaning they peak after infections do.

Source: Financial Times[11], Ocean Front Wealth Management

Looking for the Curve to Flatten - Infections



Daily new cases are declining or decelerating in most countries, including the major hotspots of Italy, Spain, USA and UK.

Source: Financial Times[11], Ocean Front Wealth Management

Re-opening Plans

European nations continue to announce re-opening plans and/or easing of restrictions. This week it is France, Spain and Italy announcing their intentions. Like Germany and Austria previously announced, France will begin opening shops on May 11.

From the Globe and Mail:

"On Sunday, Spanish children younger than 14 were allowed to play outside for the first time since March 14, when the country's lockdown, one of the most severe in Europe, began. They had to be accompanied by one adult and return home within an hour."

"The Italian government on Sunday revealed plans to lift the national lockdown, a slow process that will start on May 4 in the European country hit first and hardest by the rapid spread of the novel coronavirus…Italian Prime Minister Giuseppe Conte and Roberto Speranza, the Health Minister, urged caution and discipline among Italians, who will get no respite from the physical distancing and face mask rules that have been enforced since the quarantine started."

Source: The Globe and Mail[12], Yahoo Finance[13], Ocean Front Wealth Management

Concluding Thoughts

We hope that you and your friends and families are holding up well during this challenging time.

Stay safe and healthy, and don't hesitate to call if there is anything you would like to discuss.

"Nothing gives one person so much advantage over another as to remain always cool and unruffled under all circumstances."

- Thomas Jefferson

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Source: Yahoo Finance, Berkshire Hathaway, Ocean Front Wealth Management

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