iA Investment Management

INVESTMENT FUNDS

Market and Funds Update

Funds names: Diversified Funds
Global Asset Allocation Funds (iAIM)

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Positioning for Recovery

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Why is your investment approach suitable for the current market environment?

– Markets in almost all asset classes have reached historically high levels of volatility. For example, daily changes (up and down) on the S&P 500 Index reached an average of 4.8% in March, the highest level ever seen for a single month over the last century. Looking ahead, with all the uncertainties surrounding the length of the lockdown and what the new normal will look like post-crisis, volatility is expected to remain higher than usual.

– Active management plays a crucial role in this kind of environment, where it's more challenging to find the best risk/reward return opportunities and protect capital.

– Correlations increase drastically during periods of high volatility, diminishing diversification within asset classes. Allocation decisions between asset classes become the main driver of portfolio returns, so a macroeconomic approach to investing is valuable.

– Our deep expertise in economics and extensive experience in federal and provincial politics enable us to understand the real impact of monetary and fiscal measures taken by the authorities in this highly uncertain and historically unique environment.

– Our ability to make use of ETFs and derivatives allows for broad flexibility within our mandates.

What type of recovery do you envision?

– We think Q2 economic numbers will be catastrophic, with the unemployment rate soaring to historic levels and company earnings plummeting.

– We anticipate a lot of consolidation across sectors, as many companies with weak balance sheets could have difficulty finding financing – or financing at a reasonable rate of interest – for expansion.

– However, we expect the economy to start recovering in the second half of 2020, driven by massive fiscal and monetary measures. Major central banks added liquidity to the financial system, launched new quantitative easing programs (including corporate bonds) and lowered short-term rates to near 0%, while governments implemented big stimulus packages, representing in some cases more than 10% of GDP – an historical rarity.

– The pace of the recovery is very difficult to gauge, as it will depend on the duration of the current economic lockdown. Based on information from medical experts, our base case is to see global activity restarting gradually in late Q2. We should see positive economic growth in the second half of the year and a bigger recovery in 2021 (a U-shaped recovery).

– However, we expect Wall Street to recover before Main Street. We do not discount the possibility of a V-shaped recovery if COVID-19 cases and deaths start to peak across the globe and a treatment/vaccine is found. Investors will see the light at the end of the tunnel. Stock markets are leading indicators and historically, equities have always rebounded many months before the trough of a recession (see table below).

Economic recessions vs. market lows

Recession start	Recession end	Duration	Market low	Recovery (market low to recession end)	S&P % perf. from low to recession end
Jul. '53	May '54	10 months	Sep. '53	8 months prior	28.5%
Aug. '57	Apr. '58	7 months	Oct. '57	6 months prior	11.4%
Apr. '60	Feb. '61	9 months	Oct. '60	4 months prior	21.3%
Dec. '69	Nov. '70	10 months	May '70	6 months prior	25.8%
Nov. '73	Mar. '75	16 months	Oct. '74	5 months prior	33.8%
Jan. '80	Jul. '80	6 months	Mar. '80	4 months prior	23.9%
Jul. '81	Nov. '82	15 months	Aug. '82	3 months prior	35.3%
Jul. '90	Mar. '91	8 months	Oct. '90	5 months prior	27.0%
Mar. '01	Nov. '01	7 months	Oct. '02	11 months prior	-
Dec. '07	Jun. '09	17 months	Mar. '09	3 months prior	35.9%
			Average	**4 months prior**	**24.9%**

Source: Strategas. "S&P" refers to S&P 500 Index.

How are you positioning for the recovery?

- We were slightly overweight equities before the first leg of the stock market downturn in late February, but we had an overall neutral exposure to equity risk, taking into account our hedges (put options, gold miners, and CAD/USD currency management). These hedges helped significantly reduce the drawdown of our portfolios in March.
- We resumed our deployment of capital into equities mid-March following the announcements of monetary and fiscal stimulus worldwide, which was more than needed to reduce the severity of the economic slowdown caused by the pandemic. However, we think it is too soon to be strongly overweight equities, as volatility remains very high and there is still uncertainty around when the lockdown will end. We thus continue to have some hedges in place to manage our equity risk overall.
- We think now is a good time to be underweight government bonds, as yields have been depressed and the term premium is extremely low. We think the yield curve could steepen in the coming months, given the unprecedented fiscal stimulus implemented by G20 governments.
- We recently began increasing our currency hedging on CAD/USD. We think oil may reprice higher as production cuts could be coordinated by several G20 countries to help mitigate the impact of the anticipated demand collapse (over the Easter long weekend, OPEC+ agreed to cut

9.7 million barrels a day, with the deal taking effect on May 1).

Where do you see opportunities in the market?

- We focus on regions and sectors that we believe offer the best risk/reward opportunities over the medium term.
- U.S. banks (KRE ETF)
  - We see value in the banking sector. We feel the risk premium priced in by the markets is too high, in our view, considering that the banks are better capitalized today than in the past. Furthermore, we think the yield curve could steepen in the coming months.
- U.S. equities (SPY ETF)
  - We expect the U.S. stock market should do well in this environment, as the index composition is tilted toward sectors that should be less affected by the cyclical downturn (i.e., information technology and health care). We think it is too soon at this stage to invest heavily into cyclical regions such as emerging markets.
- We increased our exposure to U.S. investment grade corporate bonds following the U.S. Federal Reserve's announcement that it will "backstop" this asset class in the new quantitative easing plan. We believe this should put a ceiling on investment grade credit spreads.

Are there any areas to avoid?

- The pandemic that is hitting the global economy illustrates the limits of our globalization-based economic model. The crisis will most likely push world leaders to put the benefits of globalization into perspective, as it is clear that the specialization of production has made the world economy interdependent and vulnerable to a sudden cessation of activity in key countries in the supply chain.
- We think emerging market countries could experience headwinds for some time post-crisis, as there could be an unwinding of globalization in the coming years.
- We recently removed our overweight positions in emerging market equities and bonds.