PRIVATE WEALTH
MANAGEMENT

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HINESIGHT

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WELCOME TO THE BEAR MARKET OF 2020

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Reviewing our thoughts from our first quarter of 2020 newsletter (written just before Christmas in 2019), we were optimistic. Our disciplined principles indicated a path that the market would continue its trend to higher valuations. This essentially proved correct for the first month of the year. Then, as you know, the COVID-19 began.

As the market rose in January and during the beginning of a correction in February, we moved to a very large cash position between 25% & 40% in our portfolios. This was not luck but rather a simple practice of following our discipline. Our principles began highlighting higher risk in the market and we took action to protect capital.

A simple example to highlight our discipline is Boeing airlines. In December 2019, in our first quarter (Q1) 2020 newsletter, we highlighted the downside risk in Boeing. At that time our portfolios did not own Boeing. As you can reference our Q1 2020 Hinesight Newsletter, we targeted $240 for Boeing (falling from a price of $320). Today Boeing is approximately $100, with a debt rating downgrade.

Our philosophy “to preserve capital” continues to guide our decisions. There are two kinds of losses:

1) Loss of Capital
2) Loss of Opportunity

We preserve capital, knowing there is always an opportunity

Highlights in Hinesight:

- 2020 has ushered in the start of a Bear Market
- Overcoming Investor Fear
- Corporate Debt Crisis
- Top 3 Trends in Technology

DO WHAT IS HARD, LIFE WILL BE EASY

Our philosophy is to always have a strategic plan of action. This plan encompasses targets to buy and targets to sell. Capitalizing on a loss when one sells can be emotionally difficult. Adhering to a disciplined investment style enables decisions and action to be taken. This discipline easily avoids the fear of risk and loss, or the phrase “hold, don’t sell as markets will return in the future”.

As we approach the Q2 of 2020 (March 21, 2020), we need to be mindful of the future direction of the markets. It's important for each of us to understand that the markets discount the future. Our role as Portfolio Managers is to take advantage of this opportunity, acting in the face of fear. No doubt over the last month our readers have been inundated by the media and by numerous newsletters on what has happened. Many of these stories are inundated with fear. Fear is the emotion that allows our minds to avoid stepping up and making calculated logical investment decisions.

Our strategy, based on the factual information we know today, combined with our knowledge of how markets react historically in downturns is as follows:

- Today, the S&P 500, at 2300, is down 30% (March 23, 2020) from its peak (3,386) in Feb 2020; the first wave down in our view. We expect (absence of worse events at this time) for an oversold Bear market to contain an up leg, retracing 50% of the prior down leg. This would target 2800-2950 area.
- Upon reaching our target area above, we will then raise cash again. A “V” shaped recovery back to old highs, in our opinion, is not in the cards.
- In the final down leg of the Bear market, we are targeting approximately 1950 on the S&P 500. We believe this final leg down will be caused by an upcoming corporate credit crisis.
- Hines Investments has gone to a fully invested format this past week. If we are wrong, we will exit. This follows our first principle: to protect capital.

THE NEXT BULL MARKET

On a happier note, we know each Bear Market leads to a new Bull Market. In Jan 2019 we wrote about the 20- and 40-year market cycles that bottomed together in 1942 and 1982. They are due to bottom again in 2022 (see chart below). This is a concept based on past reality.

It is interesting that each of the past Bull market was led by a new wave of demographic cycles. Men coming home from the War in 1942, greeted by a population of lovely ladies. This began the “Baby Boomer” generation.

The Baby Boomers began having their children in 1982. There were approximately 71M Millennials born from 1981 to 1996 (in comparison, not far behind 74M Baby Boomers).

Peak spending years are usually between age 35 – 50. In 2022, the average age of a Millennial will be 33 years old.

Each Bull market has a new demand cycle. Today we can only predict. Hines Investments has been investigating discoveries in artificial intelligence and 3D Printing for possible investment opportunities.

Our discipline only allows us to invest in companies with strong financials. Thus, we may be constrained in this area, but will maintain our following to take advantage when the time comes. A new wave of demand will arise, albeit in different sectors, just like past Bulls.

Preserving capital today allows us opportunity to invest in the future.

INVESTOR FEAR

Since COVID-19 went viral, investor ”fear of risk” has sky-rocketed. Rightly so, within three weeks the stock indexes have dropped 30% (Mar 22, 2020). This rise in fear is a classic human response not only to a stock market drop, but in many other facets of life.

Investor fear of risk and loss is the largest inhibitor to the “critical thinking” side of our brain. Many investors will remember the most recent Bear Market of 2008-2009. This period of time was very emotional in many ways for both investors and society in general. This period has programmed many to hang onto fear vs making educated decisions in order to achieve success. I often remind investors, of how our body`s control center flows:

“The Mind Controls the Brain, the Brain controls the Body, the Body operates Muscle Functions. If you Control the Mind, You have Control”

During times of Fear in the markets, controlling the emotions must be continuously practiced by every investor. Negative “Group Think” can be devastating, emotionally & physically if we allow it. Our critical thinking goes to sleep when someone else is telling us what to do. Take a moment to think about how you listen to cable TV news, readings that promote fear or end of the world syndrome. All of this allows the mind to function in a negative or destructive way. Please review the above referenced quote and see if your body’s mind is listening to that fear. Are you able to feel the chain reaction? This is simple science called Behavioral Science.

If we “take the emotion out” we change our focus. If we practice this each day, you will start to change the way you make decisions. We can do this by:

1) Meditation: in a quiet setting, release all of our thoughts and breath slowly, listen to yourself breath and listen to your body. This clears your mind of “all the noise”.
2) RAIN:
   <u>Recognition:</u> Stop and realize an emotional response is overwhelming you
   <u>Acceptance:</u> Acknowledge the current situation or thought. Do not push your thought away.
   <u>Investigation:</u> Ask yourself Questions; Why do I feel this way? Are these thoughts logical? Are they real?
   <u>Non-Identification:</u> You are the awareness that is underneath every thought or emotion. Who you are is not defined by your thoughts or emotions.

At Hines Investments, we develop a “Goals” based Wealth Plan with our clients. This process defines “Why” we invest. This allows each goal to be invested within a defined risk parameter. In short, this process takes the emotion out of investing. This brings a natural sense of freedom and ease, an inner peace during an economic storm.

We have been investing our clients` wealth for over 35 years and have been through many market ups and downs. Markets do not stay down forever. We can`t control what the market will do and how it will react under various conditions. However, we can always control the risk we take in the market and that is reflective of the way our portfolios have been handling the current volatility. By controlling our emotions, we can take advantage of the opportunity that will reward our clients long-term.

Consider the advantage our team of professionals can bring to your overall wealth plan.

CORPORATE CREDIT CRISIS

Sheldon Hines, Portfolio Manager, Hines Investments, CIBC Private Wealth Management

While the focus of late has been the plunge in US Treasury yields and the Federal Funds Rate, corporate fixed income has been experiencing its own turmoil. This is a topic that has not received a lot of media attention, but in our opinion, is a problem bubbling underneath the surface. This could be the caveat that will lead to a deeper recession later this year.

To our new readers, Hines Investments exclusively invests in high quality corporate investment grade fixed income and investment grade government debt. We do not invest in high yield or low-quality investment grade debt. We believe the risk is not worth the reward.

Nominal rates like US Treasury Yields capture the headlines, we focus on the spreads. For example, the difference between the yield on the 10yr US Treasury vs a corporate bond with the same duration. The credit spread captures the payoff for assuming a higher credit (default) risk for investing in the corporate bond.

As markets decline, investors sell their higher risk bonds in favor of more secure government bonds, such as US Treasuries, pushing up the yield on the corporate bond. While this is not an issue if yields spike for a short period of time, this can cause issues if this persists over a long period of time as this forces companies to refinance their debt at a higher interest rate.

As interest rates have remained low over the past 10 years, investors have been forced to “move down the curve” to attain an attractive yield. This has lead borrowers in the BBB category to issue debt at very attractive rates. The risk is that some of these BBB rated corporations have their debt downgraded to non-investment grade debt (termed a fallen angel) as the economy enters a recession. If this happens, pension funds and other institutional investors restricted to investing in investment grade debt will be forced to sell the bonds of the fallen angel, thus, dramatically increasing the cost of borrowing for that company. Ford Motor Company became a fallen angel in the fall of 2019.

The total size of the US corporate debt market covered by Standard & Poors is $9.3 Trillion. Of this, 43% of corporations issuing debt are considered investment grade (rated BBB or higher) and make up 72% of the $9.3T issued. Some of this corporate debt is from the big issuers like Apple and Microsoft who can support large debt levels. However, with higher number of corporate debt issuers in recent years, there is concern in the market that we will see more fallen angels in coming months.

In the United States, there is $165B in speculative grade debt issued by oil and gas companies according to Standard & Poors. According to CIBC Economics, US shale oil producers are profitable around $50-60/bbl. With the current oil price war playing out for the foreseeable future, there is a real possibility that these small and mid-sized oil producers will not be able to service their debt.

There is also an additional $249B in investment grade debt in the US oil and gas industry. As companies exit the coronavirus lockdown, many will do a post assessment of the productivity of their workforce and if it is possible to continue to work from home. On top of the demand from millennials to eat fresh and local, governments are now putting money into local agriculture industries to help boost local production to ensure the food supply chains continue through the virus lockdown. Thus, we believe we will see a decrease in the demand for oil consumption as we move into the post COVID-19 era. These pressures may cause some fallen angels in this sector, putting additional debt servicing at risk.

The High Tech and Media and Entertainment industries have $308B and $420B in speculative grade debt respectively. Considering the rise in these companies has largely been over the past 10-year expansion, there are many of these companies who have not gone through a recession or bear market. The inexperience to prepare or understand the dynamics of the capital markets through a downturn such as this may cause some of these companies to fold.

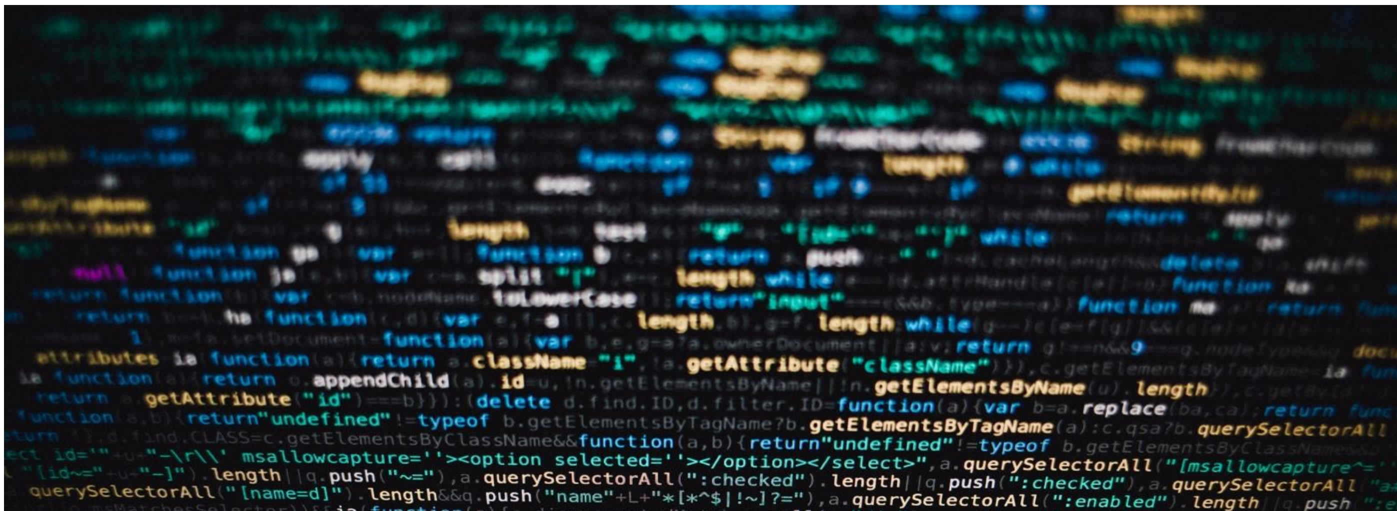
With the increase in work from home, we would anticipate pressures on the commercial real estate landscape. Bloomberg has published recent articles indicating the commercial real estate mortgages are under stress. This is a highly leveraged sector of the economy, and higher vacancy rates could have widespread economic issues. Unfortunately, there are also a lot of individual investors and institutional investors who have been sold Real Estate funds as “a great way to diversify” without understanding the types of commercial real estate buildings they are investing in.

If you`re thinking that these companies can just refinance and someone will buy their debt, that may be more difficult than you think. A sinking equity market increases the cost of corporate debt by making it must costlier, if not impossible to replace debt capital with equity capital. Moreover, equity weakness reduces the amount of cash that can be raised via the sale of business assets. Tesla is a great example of a company who has refinanced debt with equity in the past.

This is also important as the bulk of corporate debt was issued from 2017-2019 according to Standard & Poors. Speculative companies often refinance this debt every 3-4 years. With a significant tightening of the credit markets as we are witnessing, this may be impossible for these companies to refinance their debt.

The government and federal reserve may help them out in the short term through the funding packages announced and to be announced. However, the Federal Reserves announcement as we go to press, clearly states they are only willing to assist institutional grade debt. As we witnessed the weekend of March 21st, it would be a hard-political sell to rescue a number of these companies who had issued debt over the past 5 years to be rescued by the government. Democrats are specifically (and correctly I may add) pointing out companies who have issued cheap debt to finance share buybacks and dividend increases to boost equity share prices. Democrats would have a hard time selling corporate bailouts to their political base, and free market Republicans would have a hard time giving loans to corporations who have overextended themselves during good times. So, assistance with the $900B in speculative debt that we have outlined here is not in the plans to be saved come a downturn. Any fallen angel would find themselves without any help!

If you are unsure what your exposure is to the types of companies discussed above, please reach out to us at Hines Investments for a no obligation review of the debt risks in your portfolio.



TOP 3 TECHNOLOGY TRENDS

Contributed by our partners at CIBC Private Wealth US

Innovation in technology is moving forward at a remarkable speed. Just a few short years ago, the average person simply couldn’t conceive of 3-D printed houses, zero-carbon natural gas, brain-computer interface or swallowable medical devices.

“The tech sector is more dynamic today than it’s been in the past 20+ years I’ve been covering it,” says Phil Lorenz, CFA, equities analyst for CIBC Private Wealth. “You hear the word ‘disruptive’ used regarding every technology there is—and it’s true. Technology is *inherently* disruptive. That term is not overused. Certainly, artificial intelligence has the potential to be very disruptive in ways we haven’t yet seen. On the other hand, the ubiquitous and now 35-year-old Excel spreadsheet was mightily disruptive, and it’s easy to forget that.”

Not all tech investment opportunities are as amazing as a 3-D printed house. Some are as ordinary looking as a metal box on a light pole, but with the promise of bringing about one of the biggest communication transformations we’ve seen. Here are three top trends in technology and the potential they offer.

ARTIFICAL INTELLIGENCE (AI)

Can AI interpret human emotions? The ability to decode facial expressions, analyze voice patterns and measure neurological immersion levels is just one example of what AI scientists are tackling.[1]

AI uses algorithms that identify and act on repeatable, persistent patterns in observed data. Its key premise is the ability to take insights from personal or business data and create predictive models that result in better, faster, and more accurate and consistent decision-making. AI, says Jigar Patel, CFA, managing director and manager of the hedge fund platform for CIBC Private Wealth, is being called the next industrial revolution. “People may be familiar with the use of AI by big companies such as Google, Apple and Microsoft—Siri and Alexa use AI for speech recognition and natural language processing—but the biggest potential for AI’s use is happening elsewhere, in healthcare, agriculture and utilities, for example. It has the potential to be one of the most disruptive forces of this century.”

Deep sense AI, a consulting firm focused on AI-powered solutions, says that the top AI trends are its use in chatbots and virtual assistants (advanced use of natural language processing), development of augmented training models, wider adoption of autonomous vehicles, and greater transparency on the growing social and legal impact of the use of AI (unintentional bias within datasets, such as resumes, and “decisions” by AI-powered

autonomous vehicles about choices when faced with a potential accident).[2]

There are very few "pure play" investments in AI in public equities, according to Patel. "But enabling technologies, such as some chip makers, can be considered an investment in AI as well as in the Internet of Things (IOT)," he says. "In addition, you could make an entirely plausible argument that Google itself is a pure play company because a search algorithm is a predictive algorithm. So, many of what you could call 'AI companies' are essentially hiding in plain sight—banks, for example, are building AI capabilities into their software, as are cybersecurity companies. AI is deeply embedded in what many companies are doing."

Much of the potential for investment is being provided by private equity firms, who are funding some of the most exciting new enterprises in the AI space, according to Lester Duke, CFA, Senior Vice-President and Head of due diligence and selection for alternative investments at CIBC Private Wealth. "Many of the AI companies being funded are on the vanguard of what is being called the 'Fourth Industrial Revolution,'" says Duke. "The enabling technologies being developed and implemented by many companies are transforming large swaths of the economy—driving widescale innovation though the use of technologies and applications, ranging from neural networks, reinforcement learning, transfer learning and open source software. AI today is augmenting or replacing highly specialized and repetitive work at scale, which has led to the growth of many venture-backed companies that have been swallowed by larger-cap companies. These larger companies are eager to capitalize on the efficiencies and innovations these acquisitions can add to their portfolio of service offerings. One example is a company that developed an AI assistant that listens, takes notes and captures critical information in meetings as a productivity enhancement tool in the corporate world."

5G: NEXT-GENERATION WIRELESS

Financial Times calls the fifth generation of wireless technology "a game changer for humanity."[3] While that description is certainly eye-catching, 5G may, indeed, dramatically change the wireless world in which we live.

Today's wireless system is being overwhelmed by the need for more data to go through cellular networks. The new 5G architecture will offer much faster speed (theoretically up to 100x faster than current 4G technology), a lower cost per gigabyte of data and lower latency, which is the delay between when your device "asks" for something and when it receives it. One of its key features will be the ability for more devices to be connected at once, further fueling the rise of the IOT.

For consumers, a movie from a streaming service might download in seconds. Augmented reality, virtual reality and mixed reality will offer new experiences in entertainment, gaming and education, and for such critical interests as emergency management and search-and-rescue. For businesses, 5G promises relief from the logjam on the current spectrum so that the IOT can reach maximum potential and avoid breakdowns in service—and breakdowns in service can be catastrophic when autonomous vehicles are on the road or when delivery of healthcare is on the line.

"The benefit to autonomous transportation could be critically important," says Fred Weiss, CFA, managing director and co-manager of CIBC Private Wealth's Mid-Cap Growth Equity Strategy. "When a self-driving vehicle needs to know the vehicle in front is stopping quickly or changing lanes, it can't wait four seconds to find that out. That's where low latency comes in."
Adds Lawrence Li, Senior Vice-President and Senior Investment Analyst for CIBC Private Wealth, "The combination of low latency and technology to support the interconnection of many more devices could unlock so many advancements. Think of wearable healthcare devices to monitor patients' health without blind spots or low connectivity to the network. The expansion of the 'surveillance state' is another example. Already, in many parts of China a network of cameras with built-in facial recognition can identify crimes and tag them to people."

"The promise of 5G is currently a chicken-or-egg situation," says Weiss. "There's no point in buying a 5G phone if the 5G network is not available. Conversely, if you want to take advantage of a 5G network, you will have to purchase a new phone.

That is just one of the investment opportunities with 5G—we see estimates of 10% of the total cell phone market being 5G phones in 2020."[4] Apple is expected to roll out 5G phones in late 2020, with an estimated 208 million projected to ship in 2021.[5]

Global infrastructure, specifically new radio antennas on towers and links to cloud computing, also represents an investment opportunity. 5G stand-alone towers are about the size of a mini-fridge—in urban areas, that might mean 5G towers will be on every lamppost.[6] Existing towers will have new 5G antennas hung on them, resulting in ongoing revenue for the tower companies without significant new cost to them. Companies that manufacture semiconductor chip testing equipment also are a part of the broad 5G investment opportunity.

BATTERY INOVATION FOR CLEAN ENERGY

In 2018, global new investment in clean energy was $288.9 billion, far exceeding the financial backing for new fossil fuel power. Solar energy was the largest share at $139.7 billion with wind power investment close behind at $134.1 billion.[7] The maturing of clean energy has come with the maturing of the environmental, social and governance (ESG) space, an investing theme with significant appeal to many investors and in which clean energy squarely fits. Clean energy's continued growth is largely due to remarkable advances in energy storage, specifically batteries.

"The next five years will see the emergence of batteries as an integral tool used by electricity providers to balance generation and load and supply and demand," says Sam Jaffe, CEO of Cairn Energy Research Advisors, an energy storage global research and consulting firm. "We expect this market to grow from a global revenue total of $6.7 billion in 2015 to $13.2 billion in 2020. This is a tremendous change for the electricity industry: The electricity grid has existed for more than 150 years and has never used batteries as an important tool for grid management. Batteries are entering the electricity grid in a very big way and will become a foundational tool for grid management, making the grid cheaper, cleaner, more efficient and more resilient."

Lance Marr, CFA, Senior Vice-President and Team Lead on the CIBC Private Wealth clean energy strategy, agrees. "Battery innovation is going to be the key enabler of the future of energy transformation. New storage technology will dramatically impact the penetration of renewables by addressing the intermittency issue and the growth of the 'smart grid.' In addition, new batteries will be a key enabler of electric vehicles. Advances are being made in solid state and zinc-air batteries, but the one that's driving all of this is the lithium ion battery. Today's lithium ion battery is not yesterday's lithium ion battery—immense advances in chemistry have greatly improved energy density and safety."

As with wind and solar power, battery storage has seen a large drop in cost and a major increase in efficiency—the technology is being deployed today at scale because the cost makes sense. According to the National Renewable Energy Laboratory, storage costs are projected to decline from 2018 to 2030 in a range of between 21% to 67%.[8]

"For electric vehicles, the cost trajectory goes only one way, and that's down," says Marr. "And the further down it goes, the faster the adoption rates. For renewable energy such as wind and solar power, the big knock on it has always been: When the wind isn't blowing or the sun isn't shining, how do you have enough energy? New battery technology for energy storage eliminates that problem." The entire supply chain is the investment opportunity, according to Marr—the lithium miners, battery manufacturers, auto manufacturers, battery recycling companies and the utilities that are deploying storage to make new installations of wind and power even more valuable. And although it's in the early innings, enabling the transport of renewable energy will also be an important by-product of new storage. "An excess of storage at massive solar and wind farms in one location could represent huge investments globally as renewable energies become a bigger part of the energy grid in less-developed areas," says Marr.

Jerimiah Booream, CFA, Vice-President and Investment Analyst for CIBC Private Wealth, points out that the electric grid currently is vulnerable

to fires, natural disasters and sabotage. "Reliability and resilience are critical. Think of the recent fires in California and the 'preventive' blackouts. Distributed storage of renewable energy has the potential to greatly improve the grid's resilience. It also will help bring emerging countries into the 21st century."

1 *The Risks of Using AI to Interpret Human Emotions, Harvard Business Review, 11.18.2019.* 2 *Five top artificial intelligence (AI) trends for 2019, deepsense.ai/ai-trends-2019/, 01.09.2019.* 3 *5G Stocks: How to Invest in the Technology That Is Going to Change Everything, investorplace.com, 09.12.2019. 4 Strategy Analytics: 5G Phone Sales Will Soar in 2020, businesswire.com, 10.02.2019.* 5 *5G: Next- Generation Wireless, 5G Technology Primer, Oppenheimer Equity Research, 10.02.2019.* 6 *What is 5G Technology and How Must Businesses Prepare For It? Forbes.com, 10.25.2019.* 7 *United Nations Environment Programme, unenvironment.org, 06.18.2019.* 8 *The Potential for Battery Energy Storage to Provide Peaking Capacity in the United States, nrel.gov. June 2019.*

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