PRIVATE WEALTH
MANAGEMENT

CIBC WOOD GUNDY
HINES INVESTMENTS

HINESIGHT INTERIM REPORT

A FED SAFTEY NET, A NEW BULL MARKET OR JUST A BEAR RALLY

The major declines since Feb 23, 2020 have witnessed the S&P 500 drop from a high of 3385 to a low of 2250, now standing May 11, 2020 at 2929 (Bloomberg). This volatility and rebound for many investors are a comfort that the “hold your stocks, don’t sell” theory will continue to serve them well thru this bear market. Some even believe we have entered a new bull market and the “V” shaped recovery will occur.

At CIBC Hines Investments, we believe the current recovery back to 2929, is part of a normal action in a bear market. Our philosophy is not to “hold and wait for the stocks to recover”. Economies change thru a bear market and leadership of economic sectors also changes. When we begin a new Bull market, new sector leadership will emerge. We prefer to be well equipped to take advantage of opportunities via a disciplined process vs a “hold and hope”.

Our current thesis as follows:

- The Federal reserve injection of capital placed a safety net under the March lows. The swift action was taken from the 2009 financial crisis playbook. Part of this injection was used to buy corporate bonds, placing a short-term support underneath what could be, in our view at CIBC Hines Investments, a coming credit crisis (see our Q2 Hinesight).
- A normal bear market has 3 legs. We believe we are completing the second leg, a bear market rally. This leg typically recovers 50-66% (2817-2950) of the first leg down. For example, from Nov 20, 2008 to Jan 6, 2009 the S&P500 was up 26.3% before sinking by 27.3% to its March 9, 2009 bottom (Moodys).
- Market bottoms are a process, not a “V” turn. The next 6-8 months could be, in the best case, a sideways market. Our belief is that we will see a retest of the March lows, and probably exceed them to a new low of 2000 on the S&P500.
- Fundamentally, many S&P earnings estimates are coming in for 2020 in the $125-135 range from $155 in 2019. Is a 17% decline in earnings appropriate for the current global problem and GDP decline? We believe it is a start.
- To put this in perspective, normal valuations would have the S&P500 trade in the range of 16-20x the earnings estimate. If we use 18x $130 EPS, we get a S&P level of 2,340. At the peak (3385) in Feb 2020, the S&P was trading at 22x the 2019 EPS of $155. Stretching us to 22x $130 is 2,860 on the S&P500. The past 3 US recessions, the EPS low was 10.1x, 13.8x and 10.2x respectively (JP Morgan). As you can see, it gets very hard to validate a conservative valuation for the current market levels using an earnings theory.
- Global Pandemic: The world has not experienced a problem such as this since WW II. As the reader is aware, the world was unprepared on how to act. It is even hard to believe there are still leaders in denial and not heeding the advice of global epidemiologists. Without going into a long narrative, it is fair to say the probability of the global economies returning to normal in a three-month time frame is not a risk we, at CIBC Hines Investments, are willing to take.

- Corporations are preserving cash, stock buybacks are on hold, dividends have been cut or eliminated. These buybacks and dividends had been part of the market support the past.
- The past few years has seen consumer demand as the driving force behind the economic expansion (60% according to CIBC economics). Lower incomes via limited return to work and government support along with the uncertain economic outlook will not have consumers lead us out of this recession in the near future.

Overall, we do not know for certain what will happen in the future. We have our views. We are also confident that, as in any bear market, we need time to repair the market and economic damage.

At CIBC Hines Investments we have been:

- Raising cash in this bear market rally
- Targeting 2000-2250 on the S&P500
- Target the Loonie to work its way to the CAD/USD $0.65 ($1.54 USD/CAD) in the next 12 months
- Bond yields to remain under 1% (10-year US Treasury) for the foreseeable future
- Investments to remain in the large blue-chip companies
- Remain cautious of a coming credit crisis and what that will do to small and mid-cap companies
- Remain cautious of high yield credit, and the impact that will have on the market in a credit crisis

We would rather be out of the market wishing we were in than in the market wishing we were out! If we protect the capital, there will always be another opportunity!

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