CIBC PRIVATE WEALTH MANAGEMENT

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HINES INVESTMENTS

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THE BEAR MARKET OF 2020

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The US Federal Reserve seems to have shown its hand and it is *all* in!

Over the past few months the markets have rebounded, particularly in the US with major indices at or exceeding their February 2020 highs. Admittedly the extent of the rebound has surpassed our expectations at Hines Investments. Is this a bad thing? Are we too conservative and missing out?

Perhaps, but our own research combined with one of our guiding principles maintains our faith:

We would rather be out of the markets wishing we were in, vs in the market wishing we were out.

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:

- Our current views on the markets and outlook for later half of the year
- The ABCs of Fixed Income investments
- Debt and Deficits

Higher Returns with Lower Volatility and Lower Risk

Disciplined, Conservative, Blue Chip Investing

Mandate	1 YR		3 YR		5 YR		10 YR	
	Return	Quartile	Return	Quartile	Return	Quartile	Return	Quartile
Hines Global Dividend	9.55%	1st	7.19%	1st	8.51%	1st	9.01%	3rd
Hines Global Growth	11.28%	1st	11.01%	1st				
Hines Global Balanced	9.92%	1st	7.37%	1st	7.86%	1st	7.74%	1st

Hines Investments Composite Annualized Performance Returns (as at May 31, 2020)

THE MARKETS, GLOBAL ECONOMY & HOODINI

Gerald Hines, Senior Portfolio Manager, First Vice-President, Hines Investments, CIBC Private Wealth Management

The Federal Reserve in June gave their GDP growth for the USA for the next three years. GDP, Gross Domestic Product, the monetary value of all finished goods and services made within a country during a specific period. It is an economic snapshot to estimate the size of an economy and the growth rate. Fed Chair Powell gave the expectations for growth in 2020 (6.5%), 2021 a bounce of 5%, 2022 increase of 3.5%. (Federal Reserve, June 10, 2020). This translates into zero GDP growth from 2020 till the beginning of 2023. To put this into perspective the average annual GDP growth in the USA is 3.18% from 1948 until 2020. (Trading Economics, US Bureau of Economic Analysis). The Chair also noted longer term risks of destruction capacity and worker skills.

Their solution, in our view at Hines Investments, the Feds become "Houdini". The Reserve is committed to funding liquidity, in record amounts in the system to back market functioning. This translates into purchasing not only treasury bonds but corporates also. The goal is to establish investor confidence in the markets and economy. Keep in mind our past reports on a "Coming Corporate Credit Crisis". Do the Feds know something about this crisis, thus why they are supporting the Corporate market?

This action has led to bond spreads (difference between a corporate or provincial bond yield and the similar government bond) narrowing to near record narrow spreads.

Additionally, the Feds have indicated they expect to keep interest rates at very low levels for some time. This would coordinate with the GDP expectations.

Thus, we will summarize what we see as the economic facts and projections over the next few years, as we see it today:

- Unemployment at record levels, expectations for a slow move towards norm, not reaching norm for years to come
- Interest rates "controlled" to stay at near zero for next three years (see GDP above)
- Inflation by the Fed screen staying well below 2% threshold. (Federal Reserve, June 10, 2020). Our take on inflation for you the consumer is more in the 4-5% area. Outside of gas, review the items you buy everyday as well your operating bills such as electricity. Combined with the above unemployment could curtail consumer spending.
- US Dollar is strong today. However, all this injection of capital by the Feds, could lead to a weaker dollar in the near future. Normally that would translate into US exports becoming attractive to consumers in other countries. We must then assume the global consumer, outside the USA is financially better off. We disagree.
- The S&P 500 earnings estimates have been falling since the start of the year. Today they are in the $130 area. For 2021 they are in the $170 area, information by Factset. Today with the S&P 500 at 3150 (mid June), that is a 24X multiple for 2020 and 18.5X for 2021. A fair price to earnings multiple is between 16-20X.

From the above we will outline our strategy below going forward, based on our principals at Hines Investments.

- We, at Hines Investments continue to believe we are in a Bear Market. Yes, the market has risen well beyond our prior targeted bounce off the bottom. However, risk has only risen, not abetted in our view.
- Given the high risk of a second wave of the Virus, the second "shutdown" will be longer and more constraining. Today Florida, Texas, Arizona and California are experiencing rising cases.
- The markets are fully valuing in any future growth now until the end of 2021
- The risks of expected growth in Q4 2020 and 2021, being pushed out to late 2021 and into 2022 are very real, in our view.
- Risk appetite has returned due to the "FOMO". Fear of Missing Out emotion. An emotion that can attack retail and institutional investors. Many Fund managers are paid to beat the index. This irrational human behavior is ideal for the Bear to come to life!
- Our portfolios are at near max cash holdings as per their IPS.
- Our equity holdings are defensive in nature.

FIXED INCOME INVESTMENTS – THE ABC'S OF BONDS

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

The world of fixed income investments can seem complicated and confusing. Terms such as "investment grade" and "junk" are often spoken and attached to a letter grading system reminiscent of elementary school days. In order to alleviate the confusion, this article will breakdown the rating world, the characteristics of investment grade and high-yield bond issuers and our thoughts on the risks and rewards of the various grades of debt.

THE ABC'S OF BONDS

Most government and corporate bonds are rated by third-party bond rating agencies, such as Standard & Poor's, Moody's, Finch or DBRS Morningstar. These ratings are intended to be used as a broad measure of credit risk. Simply put, it is a credit score for corporations like your personal credit score that allows you to get mortgage or loan. In both cases, the credit score tells the lender your probability of paying back your debt.

While various agencies may differ in their approach to assign a rating, they all use a similar scale, which ranks credit from strongest to weakest. As you can see in the chart, AAA is the highest credit rating, followed by AA then A. The sequence is the same for B and C and ends at D or Default. To

Credit Quality	Rating
High Grade/ Investment Grade	AAA
	AA+
	AA
	AA-
	A+
	A
	A-
	BBB+
	BBB
	BBB-
High Yield/ Spectulative/ Junk	BB+
	BB
	BB-
	B+
	B
	B-
	CCC+
	CCC
	CCC-
	CC
	C
Default -	D

complicate matters, each category has + and – modifiers. So, BBB+ is a higher credit rating then BBB which is higher than BBB-. The highest ratings are often, although not always, reserved for governments and the largest corporations. Some rating agencies may assign a different rating to the same bond based on their own published methodologies. However, all rating agencies attempt to predict the probability of default, expressed by the rating, by combining several quantitative and qualitative measures.

INVESTMENT GRADE & HIGH YIELD – WHAT'S THE DIFFERENCE?

Investment Grade issuers are often the companies with the most recognizable names or brands. Despite being in various industries, these companies all share several characteristics. They are relatively stable industries and do not generally experience large fluctuations in profitability. They all operate globally with large portions of their revenue being generated outside of North America. Their brands are recognized for quality, pricing, and competitive positioning within their industry. They do not generally employ excessive amounts of debt and they have ample cash on hand to meet short term obligations. From a credit rating perspective, these bonds are rated BBB- or higher.

High Yield debt, sometimes referred to as speculative or junk, is issued by large and small corporations. They tend to derive more of their revenue from concentrated geographies, often operating in more fragmented and competitive industries. Since these industries are inherently more cyclical, these companies see more volatility in profitability. They also tend to have higher debt burdens (relative to earnings and cash flow) and less cash on hand relative to short-term obligations. From a credit rating perspective, these bonds are rated BB+ or lower.

An Investment Grade rating is often important to companies as it is not just for prestige. Investment Grade companies can have their debt purchased by institutional investors such as pension funds, foundations and regulated institutions. With the larger investors willing to purchase your debt, this makes it easier and cheaper for corporations to finance their business activities. The higher the credit rating, the lower the interest rate charged on the corporation's debt.

INVESTMENT GRADE & HIGH YIELD EXAMPLES

To provide some examples, let's look at a few of the largest corporate debt issuers in the world. Among these are recognizable names from many various industries such as AT&T, Apple, Ford, Microsoft, Anheuser-Bush InBev (Global Finance Magazine).

Microsoft and Apple are two of the largest companies in the world and are two of the largest borrowers (in dollars) in the world. For the reasons noted above, they are Investment Grade issuers with Microsoft a AAA and Apple a AA+ credit rating by both Standard & Poor's and Moody's.

AT&T and Anheuser-Bush InBev are rated BBB and BBB+ respectively by both Moody's and Standard & Poor's. Both companies took on large amounts of debt after recent acquisitions. However, due to the stable businesses of each company, they are still rated Investment Grade.
Ford has been anointed a unique title called "Fallen Angel." This term is reserved for those companies who used to be rated Investment Grade but have since been downgraded to High Yield or Junk status by both Moody's and Standard & Poor's with a rating of BB+. This downgrade will lead to Ford finding it more difficult to obtain future financing as pension and investment funds can no longer hold their debt. As well, in order to attract buyers of their debt, they will be forced to pay higher interest rates.

DOES HIGHER RISK = HIGHER RETURN?

Since high-yield rated have an increased risk of default relative to investment-grade-rated bonds, they should generate higher returns. However, over the past 10 years, high-yield bonds in the US have performed relatively in line with investment-grade corporate bonds and outperformed government bonds (see chart 1).

What is most important to note is that high-yield bonds may exhibit significant volatility and negative returns during shorter time periods. When compared to higher quality bond returns, these negative returns are closely correlated with equity returns (S&P 500).

HIGH-YIELD – WORTH THE RISK?

At Hines Investments, our short answer is no. The risk/reward trade off does not make sense.
If we are to expect that high-yield bonds will perform like equities on the downside, we would also expect them to perform similarly on the upside. As you can see from chart 1, the Liquid High Yield return YTD and return from January 1, 2020 to March 31, 2020 is very close to the S&P500. However, longer term, you can see the outperformance of the S&P500. Why would you invest in something that captures all the downside risk with no upside? This is lost opportunity.

When comparing to Investment Grade corporate bonds, the long-term return is almost identical and there is little incentive to take the risk with high-yield debt. Why would you take on more risk if you're not going to be paid for it over the long term?

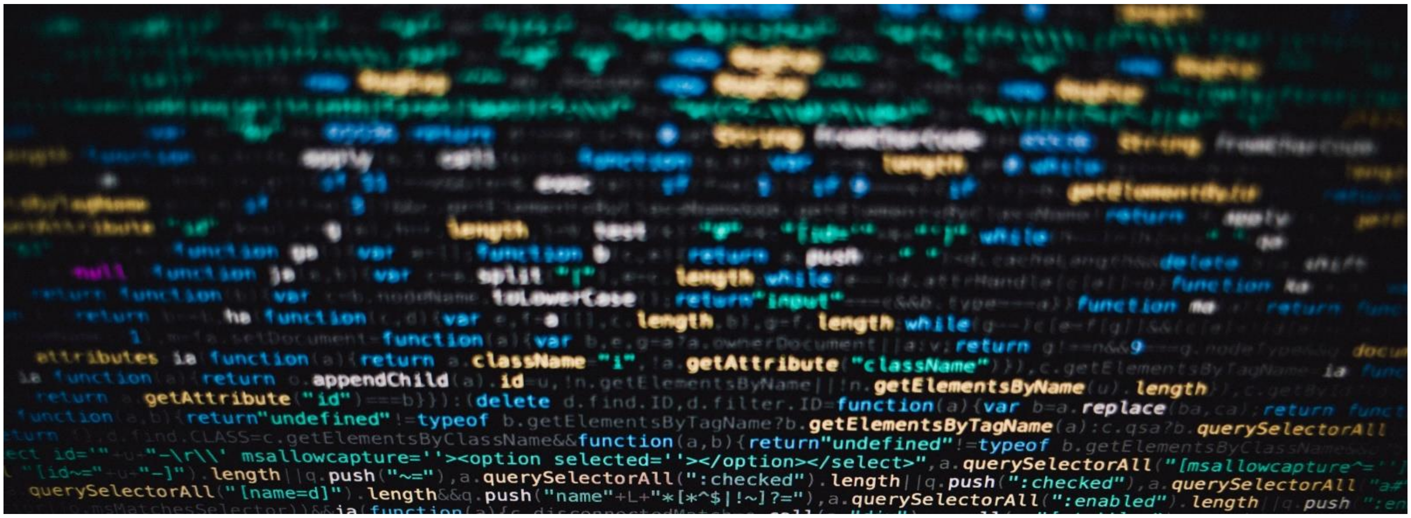
The past 5 years the investor appetite for high yield has been insatiable in the search for higher returns on fixed income securities in a low interest rate environment. With high yield comes higher risk. If you are holding fixed income securities to balance your portfolio and provide protection in the case of a downturn, why would you want to hold a product that acts like an equity during the downturn?

If you have any questions about the types of debt that we hold in our portfolio or want a second opinion on your current investments, please reach out to us at 844-887-4995 or via email at hinesinvestments@cibc.ca

Chart 1

Index	Jan 1 2020 - March 31, 2020	YTD	1 Year	3 Year	5 Year	10 Year
Markit iBoxx USD Liquid High Yeild Index	-11.99	-5.03	1.41	3.01	3.85	6.17
Markit iBoxx USD Liquid Investment Grade Index	-3.24	3.93	12.37	6.62	5.71	6.19
S&P U.S. Treasury Bond Index	6.97	7.6	10.05	5.03	3.5	3.06
S&P500 Total Return	-13.12	-4.97	12.84	10.23	9.86	13.15

*All returns as of May 30, 2020 unless otherwise noted



DEBT AND DEFICITS

Contributed by our partners at CIBC Private Wealth US

The magnitude of both human and economic costs of COVID-19 is still being counted. The average forecast for gross domestic product (GDP) losses in 2020 is nearly 6% and would be the largest contraction in the U.S. economy in the post-World War II era.[1] The size and speed of policy response has been equally massive. Resources deployed to fight the virus in the U.S. total over $3 trillion, or 14% of GDP. Political leaders have appropriately adopted wartime analogies to describe the fight against the virus. Government deficits have also taken on a wartime appearance, given the accumulation of bills associated with various economic stability programs. As Federal Reserve Chairman Jerome Powell noted when addressing the questions from those reluctant to add debt, "This is not the time to act on those concerns. This is the time to use the great fiscal power of the U.S." Regardless of the Chairman's warning, we are going to take a look forward to consider the potential outcomes of wartime-sized deficits in the post-COVID-19 environment.

The Congressional Budget Office recently estimated deficits of $3.7 trillion in fiscal year 2020 and $2.1 trillion in fiscal year 2021. As a percent of diminished GDP, the fiscal 2020 deficit will reach nearly 18% before counting any outlays from future legislation currently under debate in Congress. As evident from the chart below, an 18% deficit would be the largest since the post-war debts of the 1940s, and roughly double the fiscal deficit created in the aftermath of the Great Recession.

FUND IT TODAY, DEAL WITH THE CONSEQUENCES LATER

Chairman Powell's plea has resonated with markets, so far. The greater concern now is deploying of resources – not the financing. Issuance of U.S. Treasuries has ramped up to match the stimulus. The cost to the U.S. Treasury is currently very low as demand for safe assets has far outweighed the concern of expanding supply of those assets. The most recent 10-year Treasury auction was completed for $32 billion at a coupon of 0.625%. The Treasury received over $86 billion in bids for that auction. Lower interest rates currently outweigh higher debt balances when it comes to annual debt service for the Treasury. Last year, a similar 10-year note was auctioned for an amount of $27 billion at a coupon of 2.375%. Last year's smaller note auction will result in an annual cash outflow from the Treasury that is over three times the amount of this year's larger auction.

Who is buying long-term fixed rate debt at 0.625%? For now, the largest buyer of U.S. Treasuries has been the Federal Reserve (Fed). The Fed added more than $2.5 trillion in Treasury debt to its balance sheet since mid-March, covering the majority of outlays created by lawmakers in the first four COVID-19 related stimulus packages.

FINDING A WAY OUT

Policymakers can't rely on this level of demand or yield as the health crisis abates, and pressures will emerge to allocate resources towards areas other than servicing the country's debt. The pathway out for highly-indebted sovereigns could head in one (or more) of the few broad directions: default, growth, austerity/taxation and inflation.

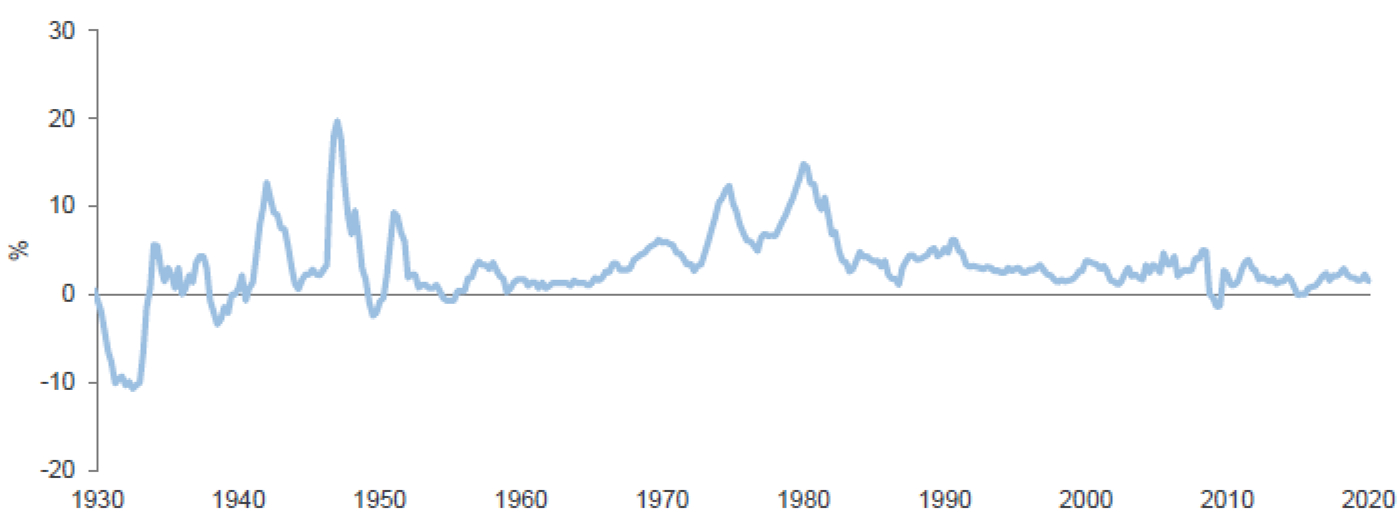
We would place a near-zero probability on the worse-case default or restructuring. Policymakers and politicians of both parties understand the importance of access to capital markets and the risk to the political structure that could result from the U.S. abrogating its role in the global financial markets. Debt monetization, where the central bank prints money to finance excessive central government spending, has been a common denominator in volatile periods of hyperinflation and eventual sovereign defaults. What the U.S. does not share with those extreme outcomes is that it borrows in its own currency and stands as a global reserve asset.

The best outcome would include faster growth without inflationary pressure. An increase in real growth and the associated tax revenues could be used to gradually reduce leverage, while low inflation keeps the cost of carrying debt under control. This may be how the early stages of a COVID-19 recovery play out as the economy comes back online, while slack in the labor and resource markets is reduced. Pro-growth policies will be harder to implement for a longer timeframe given the current lack of fiscal flexibility. There is still a great deal of uncertainty over how business and consumer behaviors adapt to a post-virus economy. Without a vaccine, this could be a very protracted period of slow growth, making this outcome less effective.

Markets and economist had higher expectations for inflation coming out of the Great Recession of 2008/2009, but politics intervened, and deficits were reduced through fiscal austerity. Of course, political pressures always exist, and large deficits will intensify those pressures in the years ahead. The party in power at that point will determine whether the fiscal tilt will be toward higher taxes or reduced spending. Agreements along this pathway are extremely rare as we have seen over the last few decades.

The other way out of this fiscal deficit is to let the economy run hot with a period of higher inflation, rather than hyperinflation. Today's fixed-rate debts become less onerous for the borrower in tomorrow's inflated dollars. What may be different in the post-COVID-19 environment when compared to the Great Recession, is a greater willingness to tolerate inflationary policies at the Federal Reserve. The Fed was struggling to raise inflation to its desired target range prior to the

Consumer price index, year-over-year



Source: Bureau of Labor Statistics, April 2020.

virus and was exploring ways to achieve its goal, including targeting or capping Treasury yields. This is very similar to a policy the Fed used during and after WWII. During the war, the Fed capped T-bill yields at 0.375%, and the Fed's charter was rewritten to assist in the funding effort. Post-war deficits were large enough for the Fed/Treasury relationship to persist into the start of the following decade. This long period of low-rate policy occurred alongside a period of growth and inflation that contributed to deficit reduction. The approach is not without risk. As evident in the chart on the next page, post-WWII inflation levels became uncomfortably high and led to a dissolution of the Fed/Treasury agreement. Market reaction to an explicit coordination between the Fed and Treasury would likely lead to a higher risk premium due to a perceived loss of central bank independence. For the moment, the fiscal and monetary policy makers have their interests informally aligned.

A government strategy to inflate its way out of the high fiscal deficits may have to wait, simply because inflation may be a long way from emerging. The immediate economic impact of the virus is that of a demand shock. The gap between supply and demand will have to narrow in order for pricing pressure to emerge. At that point, we may find that the Fed is more reluctant to pull back from expansionary policies than it was in the last cycle.

Given the size of projected deficits and risks of the various options, the way out probably involves multiple routes. We expect the most likely solution to include changes in fiscal management and monetary policy. A combination of tax increases and spending cuts will depend on the November election results and the will of the public to shift priorities toward budget discipline. While it may be difficult to see that shift occurring today, economic recovery and/or the discovery of a vaccine, could accelerate the process. Shifts at the Fed toward more lenient policies were already underway and will likely continue well into an economic recovery. The Fed has no shortage of variables to focus on as it rolls out more accommodative policies, but it will likely pay very close attention to employment and the degree to which its new liquidity is absorbed into the economy and financial markets.

PRIVATE WEALTH MANAGEMENT