PRIVATE WEALTH MANAGEMENT

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WAY DOWN THEN HALFWAY BACK UP-DO MARKET PRICES HAVE IT RIGHT?

Please find enclosed our firm's latest 'Market Spotlight'.

In addition, here are some comments from us regarding where we see markets going from here. As numerous factors are driving this market, we will look at the positives and negatives and what we believe are the key challenges and opportunities going forward:

Negatives:

1. We have never seen a bear market perform in this manner. The initial drop over about a four-week period (to March 23rd) was about 2/3rds as bad as the entire (six-month) worst-ever bear market we have seen in our careers to date, namely the "2008/09 financial crisis". As was the case in 08/09, the decline experienced to March 23rd was a broad market decline that affected all areas of the stock and corporate bond market; but the 08/09 bear market occurred over six months - while this one occurred in a mere four weeks. Given the magnitude of economic damage from Covid-19 and given the strong market rebound in prices since the lows of March 23rd, many in our industry question whether markets have rebounded too fast?

2. We are experiencing the greatest short-term decline in GDP and the fastest increase in unemployment - in modern history.

3. Government spending has increased by record levels resulting in a large increase in debt levels.

4. Until a vaccine is discovered and mass produced, there will continue to be economic damage, particularly in industries related to travel, entertainment and restaurants.

5. Consumers always respond to situations like this by decreasing discretionary type purchases, which negatively affects many industries such as auto's and higher cost retailers.

6. No one can accurately predict how the virus will behave from here.

7. The risks of the virus resurging as economies open and/or during the fall when flu season begins.

8. The small risk of not being able to create a vaccine, resulting in a long-drawn-out process, as we wait for 'herd immunity' to take its course.

9. The U.S. is suffering more than it must due to its uncoordinated response - given some view a vacuum of leadership at the federal level (we are keeping a close eye for our neighbors to the South.)

10. Many experienced market participants have been bearish or at least cautious all through this market. Warren Buffet, for example, has sold a small percentage of stock and has yet to add materially to equities.

Positives:

1. The speed and magnitude of monetary and fiscal response to deal with this crisis is by far the greatest the world has ever experienced. As a result, there is a well-functioning banking and corporate bond system; and many people and businesses have been able to access needed government financial support.

2. There is much less concern about hospital systems being overwhelmed, as was the case a short while back; and less concern regarding lack of ventilators or personal protective gear.

3. We are hearing some positive announcements in terms of potential vaccines and therapeutics.

4. As you will read in the accompanying report from our firm 'so far so good' - in terms of the re-opening of economies in Asia and in some other countries, such as Germany.

5. While global government debt levels have increased considerably, actual debt servicing cost is quite low (due to low or even negative interest rates.) Canada, for example, is still experiencing close to record low debt servicing costs as a percentage of government spending. Interest on Canada's federal government debt is a very manageable eight percent of total government spending. That number was way higher (and way scarier) in the 1980's.

6. Many investors feel 'bearish' about markets. Historically, that has been a 'positive indicator', as markets more often get into trouble when most investors feel 'bullish'. A good example of how markets can surprise in the short-term is how well markets have done since March 23rd. At that point, most investors were bearish and many market pundits on CNBC, etc. suggested selling equities and raising cash. By March 23rd, the TSX index had dropped to 11,100 (from its 18,000 previous high in mid-February). From there as you know, markets have moved up nicely (the TSX is currently over 15,000). I don't know anyone (including us) who saw that fast a market recovery coming.

7. This last positive is what we believe is by far the most important point – and something that we think investors need to really focus on and consider. We almost surely are going to be in very low interest-rate environment for a long period of time. Central banks are clearly indicating the same, as is the bond market - where ten year Canadian and U.S government bonds pay close to just .6% per year - while in Europe, countries such as Germany can issue ten-year bonds at negative .5% per year! Thus, the German government makes money by issuing debt (strange times). Germany therefore pays 5% less than principal value – over the ten years - while investors also lose further money to inflation. In this super low interest-rate environment, we believe our higher yielding quality stocks and corporate fixed income will do well over the medium to longer-term.

Challenges and Opportunities in financial markets:

Regarding where markets may trade in the short-term, we are fully cognizant about economic challenges from here and that we face a high degree of unpredictability in terms of the short-term. As a result, markets have greater than normal downside risk. To compensate investors for taking this above average risk, the 'risk premium' on stocks has increased (namely they are lower in price) which in turn increases long-term expected equity returns.

With respect to mitigating downside risk, we are quite comfortable with client investment portfolios in that they were built having factored in the high likelihood that we would have to deal with some degree of economic recession, as we had gone a long eleven years without one.

We have thoroughly reviewed all our investments in terms of how they are likely to perform given the ramifications of Covid-19, and while there is some degree of effect on most businesses, our high quality, good yielding and defensive nature of industry exposure - gives us a good degree of comfort in terms of how portfolio's will perform over the longer-term.

Comments on Real Estate Investment Trusts (REITs):

Regarding North American "commercial real estate" (which we own through REITs), some clients have been asking about the risks associated with an acceleration in the trends 'working from home' and 'online shopping'. Office buildings and retail properties will indeed have these challenges to deal with. On the positive side though, REITs also gives exposure to industrial and apartment buildings, which by and large are still doing fine.

With respect to 'working from home risk', less than ten percent of Canadians were working from home pre-Covid-19: Right now, that number is forty percent. How many will not totally return to the office? Our guess is perhaps one out of four (post-Covid); and many of those will choose a hybrid method of 'some home and some office'. Creativity and good

communication are key elements of successful companies-and working together in an office environment promotes same.

Regarding office buildings, keep in mind that company leases are longer-term contractual obligations so businesses cannot simply walk away from them. There is also lot of discussion on how companies on average will need 20-30% more space in order to achieve proper spacing to deal with Covid-19 and any possible future pandemic (e.g. our branch in Richmond!). In addition, should demand for office space decrease in future, developers will respond by building less which will eventually fix any overage in supply. Also, in all areas of commercial real estate in Canada, vacancy rates pre-Covid were very low (except for office space in Calgary).

Regarding retail properties, just fourteen percent of retail sales were 'online' pre-Covid, while 'brick and mortar' retail sales were still able to increase sales by about 1.5% per year over the past ten years. A positive surprise is how many retailers are maintaining a good degree of sales by adopting 'curb-side pickup'. Big retailers such as Target and Best Buy just announced surprising strong sales results in the past month.

Canadian REITs who own retail properties typically own quality properties in densely populated areas (near public transit lines) that have high land value, which in turn has been benefiting them in terms of developing multi-use buildings/condos on their high value land - at zero-land cost. In addition, only about fifteen percent of retail rental income typically comes from smaller businesses (who are eligible for government support) with eighty-five percent of rent comes from larger more well-known retailers such as Walmart.

Normally REITS perform well when interest rates drop as they are typically leveraged forty-five to fifty percent. Due to the decline in interest rates, future financing costs will now be lower than was assumed just two months back, which is a big positive to future cash-flow. As was the case back in 2008/09, REITs have dropped as bad or worse than stocks, thus we can now buy REITs that are down an average of 30% in trading price and trade at a significant discount to appraised value (of between 30% to 50%). Average yield is a healthy eight percent.

Overall, factoring in all the positives and negatives, we believe REITs are undervalued at current trading prices. As one CEO of a larger REIT said recently on a conference call we tuned into said, "REITs are sometimes not suited to public market trading, which of late has treated them like risky stocks rather than the longer-term income producing investments they are."

What have we done with portfolios?

1. In our discretionary accounts (about 85% of our clientele), shortly before the downturn, we established two (mostly) privately valued pooled investments for about 5% of portfolios in order to minimize public market risk.

2. As we can trade quickly without client permission in our discretionary accounts, we added about 2% to equity exposure on March 24th, by using an investment that will go up 235% of the TSX 60 index (on a 5-year basis). We sold fixed income to fund same. The TSX 60 Index gives clients ownership in Canada's largest 60 publicly traded companies. Thus far, timing of that trade looks very good. As Winston Churchill said, "never let a good crisis go to waste."

3. With cash coming into all clients' accounts that is available for re-investment, we have largely been adding to REIT's and good yielding corporate fixed-income exposure.

4. For those clients with new money to invest, we have been focusing mostly on higher yielding Canadian dollar investments like defensive high dividend paying equities and REITs; plus, we are buying dividend paying preferred shares (yielding a high 7%).

5. We continue to have conversations with some clients who are understandably concerned about short-term risk. Some have asked if we should sell part or all equity exposure in order to more comfortably ride out this very challenging economic situation. As said in this letter, we share those concerns. We go on to say though that with cash paying so little, we will need to come back into long-term investments that pay better at some point, and we are concerned that for this trade to work we must accurately predict two things. Firstly, that the market will drop a fair amount from here (perhaps), but more difficult than getting that prediction right is

timing when to get back in before markets rebound. While it's theoretically possible for this market timing strategy to work, history has proven how on average this type of trading has led to lower long-term returns. Missing just the best ten days of positive returns in the past ten years would have resulted in a 30% lower return. Having said this, it's very important that clients feel comfortable with their portfolios and as we have said thousands of times in the past, we have no ability to predict stock market direction in the short-term; thus we are always here to discuss your comfort level regarding risk/return and will action changes if need be to address. For portfolio's in general right now though, instead of selling stocks, our preferred strategy is to mitigate short-term risk by keeping the remaining portion of client fixed income intact. As said, we have not added materially to markets since our March 24th buy in thus should markets indeed drop by a reasonable amount from here, we still have 'dry powder' to take advantage of it.

Secure messaging

Sending personal client information by email poses a risk of being accessed by another party, potentially exposing clients to fraud and identity theft. For this reason, our firm no longer allows certain type of information to be sent via regular email. To address this risk, the firm has rolled out a mandatory *Secure Messaging* system for electronically sending out any client information. This means that any statements, reports, or forms can only be sent electronically using this new system.

There is a one-time registration process for clients to follow to be set up to receive secure messages from CIBC e-mail addresses, going forward. The registration involves setting up a password and security questions.

Password requirements:

- 8-20 characters long
- At least one uppercase letter
- At least one lowercase letter
- At least one digit (0-9) is required
- At least one symbol (non-alphanumeric) character is required. e.g., !@#...

You only have to do the registration process once, then you can use the same password to retrieve all Secure Messaging from any CIBC email address. The next time you ask for any of the information (mentioned above) to be sent via email, you will be prompted to set up your password. Please call us if you have any issues with this password set up.

Sincerely,

CIBC Wood Gundy

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