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Market Disruptions – Then and Now

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Generally, stock markets fall dramatically for two reasons: 1) new capital has run dry following excessive speculation; and 2) natural disasters. Both greed and nature are unavoidable.

Following this template, I am highlighting three incidents in recent history to demonstrate how and why markets reacted as they did, before outlining our expectations for the current COVID-19 (coronavirus) pandemic.

Japan nuclear accident in 2011 – natural disaster

On March 11, 2011, an earthquake off the coast of Japan triggered a tsunami, which destroyed the Fukushima Daiichi Nuclear Power Plant. It was the most severe nuclear accident since Chernobyl in 1986. Large amounts of water contaminated with radioactive isotopes were released into the Pacific Ocean during and following the disaster. The Japanese government evacuated 154,000 residents, some of whom are still in temporary homes today. At the time, there was a lot of uncertainty and it was speculated that the permanent damage to people's health would result in the loss of many lives and significant damage to the Japanese economy. However, the actual impact was not nearly that severe, to say the least.

Before the accident, the Nikkei 225 Index was trading at 10,857 before falling 21% to 8,605 in just 22 days. It took 682 days to repair investor confidence and return to the previous peak. If you were unlucky and bought at the peak in 2011 before the accident and did not avoid the recent market correction due to coronavirus, your return since February 21, 2011 would have been 71% as of March 12, 2020. If you did time the trough in 2011 but did not avoid the recent drop, your return would have been 116% as of the same date.

Global financial crisis – excessive speculation

Prior to the global financial crisis of 2007-08, lending standards in the U.S. were very lax, which led to a lot of speculation in the housing market. Prior to the bursting of the housing bubble, you didn't need to have a job to qualify for a mortgage to buy a house, something that seems senseless today. The system eventually ran out of capital to support itself and some of the large banks (i.e. Bear Stearns Companies, Inc. and Lehman Brothers Holdings Inc.) went bankrupt, while many others needed bailouts. It created the most severe credit crisis in history. In response, central banks globally pumped trillions of dollars into the system. Money generally went into sustainable business models instead of buying empty houses to bail out speculators. This injection of capital was ultimately successful. At the time, many people thought we would go through a depression that could last a decade, stocks wouldn't bounce back and the U.S. would lose its status as the largest economy in the world. The reality, of course, was quite different, and U.S. unemployment is at its lowest rate ever.

Before the turmoil, the primary U.S. stock market index, the S&P 500, peaked at 1,426. It then fell 53% to 677 in 294 days and took 1,277 days to return to the previous peak. Those who bought at the peak on May 19, 2008 and did not avoid the recent market correction due to the coronavirus, would have had a return of 74% as of March 12, 2020. If you timed the trough in 2009, but did not avoid the recent pullback, your return would be 267% as of the same date.

Tech bubble – excessive speculation

Similar to what happened in 2007-08, the tech bubble burst due to excessive speculation when new capital ran out. Unlike the global financial crisis, central banks did not offer bailouts. If central banks had bailed out the speculators, businesses with little to no value would have continued to trade at a premium, and speculative activity would have continued. It took the sector a long time to re-invent itself and replace companies with no assets with stronger and more profitable franchises. The Nasdaq Composite Index peaked in 2000 and it took 15 years to return to the previous level. This scenario was a true bubble.

The current situation – coronavirus

Every incident is unique. Coronavirus is a serious natural disaster because it is unknown and unfamiliar. Its severity has created supply chain disruptions and reductions in consumption around the globe. Due to the large degree of uncertainty, the stock market drawdown is unusually large and took only a few days, similar to what happened with Japan's Nikkei 225 Index in 2011. Investors should remember that 1) the value of a company is in its future earnings on a "going-concern basis," meaning it is not based on one quarter or even a year. The value should not change much due to coronavirus, but share prices have, falling mainly due to the lack of liquidity – few investors are willing to place the first bid. 2) Before coronavirus, global economies were on a solid path for growth supported by low interest rates and low unemployment rates.

What happened is that the world quickly ran out of confidence and effectively ran out of new capital. In reality, capital is abundant, but a lack of confidence has blocked commitment. Fortunately, as with previous scenarios, when investors are unwilling to commit capital, central banks and governments can step in. The U.S. Federal Reserve, European Central Bank, Bank of Japan and Bank of England are injecting hundreds of billions of dollars into the economy, with the promise of more if needed; the limit being "whatever it takes."

I am not a doctor or a scientist and cannot comment on the virus itself. I do know there are many people working towards a vaccine, every country is working to contain the virus and people are on alert to avoid infection. In the meantime, central banks are calming emotions by injecting capital into the economy. To put your money in a savings account in a zero-interest rate world will give you returns close to zero. It is very hard to imagine stock markets or our portfolios not outperforming zero and if history is any guide, outperformance could be significant. Considering how quickly markets have fallen, we would not be surprised if there is a quick recovery with a strong rebound given 1) the strong economic fundamentals entering this event; 2) there is over $3 trillion in cash funds in the U.S. alone; and 3) governments and central banks are being aggressive in their stimulus.

	Japan nuclear accident		Global financial crisis		Tech bubble	
	Date	Nikkei Index	Date	S&P 500 Index	Date	Nasdaq
Peak before the incident	21-Feb-11	10,857	19-May-08	1,426	10-Mar-00	5,049
Trough after the incident	15-Mar-11	8,605	09-Mar-09	677	08-Oct-02	1,129
Back to previous peak	25-Jan-13	10,926	06-Sep-12	1,432	20-Mar-15	5,049
March 12, 2020	12-Mar-20	18,560	12-Mar-20	2,480	12-Mar-20	7,201

Source: Bloomberg Finance L.P as at March 13, 2020.

	Japan nuclear accident	Global financial crisis	Tech bubble
	Nikkei Index	S&P 500 Index	Nasdaq
Drawdown from the incident	-21%	-53%	-78%
How long it took to bottom (days)	22	294	942
How long it took to recover (days)	682	1,277	4,546
Return from previous peak on March 12, 2020	71%	74%	43%
Return from previous trough on March 12, 2020	116%	267%	538%

Source: Bloomberg Finance L.P as at March 13, 2020.

Please look after your loved ones during this difficult time and let us look after your savings. As always, we will manage them diligently.

Combined top 15 equity holdings as of February 29, 2020 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft Corp.
2. Canadian Natural Resources Ltd.
3. Enbridge Inc.
4. AltaGas Ltd.
5. iA Financial Corporation
6. Alphabet Inc.
7. E-L Financial Corp. Ltd.
8. Toronto-Dominion Bank
9. Fortis Inc.
10. Ashtead Group PLC
11. Royal Bank of Canada
12. ATCO Ltd.
13. Prologis Inc.
14. Power Financial Corp.
15. Franco-Nevada Corp.

Source: Bloomberg Finance L.P and CI Multi-Asset Management as at March 13, 2020.