Seymour Investment Management

April 15, 2020

We are spending many hours at Seymour working to understand how this virus now known as COVID-19 is impacting global markets, and the portfolios that we manage on your behalf. We continue to have meetings with companies that we own, and also with analysts from various firms. While our meetings are no longer "face-to-face", video conferencing is proving very useful, and we are fortunate to be in a business where we can conduct our analysis in a similar environment to what existed before the crisis. Some members of our team continue to work in the office, using social distancing, while others are able to work remotely from home. This working arrangement may continue for some time, but we feel fortunate in that it in no way impedes our ability to conduct our business and manage your portfolios.

In times of economic and market turmoil, our primary focus is ensuring the companies in our portfolio have sufficient cash reserves, balance sheet capacity, and liquidity to survive the downturn. We have stress-tested the business models and balance sheets for our holdings, and although we expect revenue and earnings declines in the short term, we are confident in the sustainability of the companies in our portfolio, even if the downturn is more protracted than we might hope.

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Every crisis has a different origin, perhaps none so much as what has been created by COVID-19. Not only has the virus caused a global recession, it has also resulted in the complete shut down of much of our economy. Among the many consequences of Covid-19 has been the fastest occurrence of a bear market in history. In a span of weeks, most major equity markets experienced declines of over 30%.

In Canada, the TSX index was down 20.9% in the first quarter. In the U.S., the S&P 500 was down 19.6% for the quarter. Smaller companies have been particularly vulnerable, with the small cap index in Canada down 38.1%, and in the U.S. down 32.6%.

Fortunately, governments and central banks are acting quickly and decisively to maintain the stability of the financial system and to stave off mass bankruptcies with sizeable aid packages, interest rate cuts, and asset purchases. We will examine this later in the letter.

While we have no historical reference points to use as a guide in understanding how COVID-19 may impact our economy, we do know that it has a caused a global recession and a Bear market for stocks. Any roadmap for gaining insight as to what we may expect in the future can better be drawn from examining our past experience with recessions and bear markets.

Recessions, Bear Markets, and COVID-19

The definition of a recession is two consecutive quarters of negative GDP growth. **In the last forty years, we have experienced four recessions, or roughly a recession every decade.** Unlike COVID-19, past recessions have all been characterized by some structural deficiency in the economy or a failure in the banking system.

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In 1981, the recession was caused by inflation concerns and record high interest rates. In 1991, the recession was characterized by excessive debt brought on by the Savings and Loans crisis, as well as an oil price shock due to Iraq's invasion of Kuwait. In 2001, the recession was caused by the Tech Bubble and the events of 9/11. Our most recent recession was the Great Recession, in 2008-2009, which at that time was the worst financial crisis since the Great Depression.

COVID-19 has caused a very different type of recession. While the economic data today does not support the traditional definition of a recession (two consecutive quarters of negative GDP), it is evident that the unprecedented economic dislocation will result in a very sudden and deep recession, with uncertainty surrounding its duration.

The significance of the expected decline in GDP is reflected in the amount of financial stimulus that governments and Central Banks around the world are injecting into the financial system. The following chart indicates the amount of stimulus relative to the Great Recession in 2008-09.

Exhibit 1: Major Announced Fiscal Stimulus Relative to 2008/2009 as at March 29, 2020

Country	Coronavirus Stimulus (US$)	Financial Crisis Stimulus (US$)	Increase/ Decrease %
United States	2,112	939	125%
Japan	502	441	14%
Germany	836	94	789%
France	50	30	68%
Italy	28	10	170%
UK	82	40	106%
Spain	223	103	116%
Canada	77	34	122%
China*	395	575	-31%
Total Stimulus	**4,303**	**2,267**	**90%**

Source: CIBC World Markets Inc., Reuters. *Yet to be confirmed

The COVID-19 crisis stimulus is significantly larger than comparable stimulus in 2008-09

These numbers are preliminary and could be subject to significant changes. Since this chart was published at the end of March, Japan has subsequently increased their stimulus to US $1 trillion, and Italy has increased by 400 billion euros. Most governments acknowledge that the amount of stimulus will have to increase the longer their economies remain dormant.

It is likely difficult for many of us to conceive of the enormity of these numbers. The financial crisis of 2008-09 was the worst since the Great Depression and most countries in the world deployed fiscal stimulus equivalent to 3.6% - 5.5% of their GDP (RBCGAM). **The COVID-19 crisis stimulus is significantly larger.** In the U.S., the stimulus package is approximately **10% of GDP**, and if Japan proceeds with their recently announced stimulus package, it will be **20% of GDP**.

Remarkably, this stimulus package may only be sufficient for the short term, and it is imperative for governments to reopen their economies as soon as can be safely done from a health perspective.

Unfortunately, there will continue to be a massive cost to dealing with COVID, both human and economic. The sheer scale of the monetary stimulus will stretch government balance sheets, many of which were not in great condition going into the crisis. The story on this part of the COVID crisis has yet to be written and will likely be a topic of future letters.

The impact of COVID-19 and the dramatic reduction of GDP has also caused significant weakness in equity markets. At their lowest point in March, most stock markets were down more than 30% from their record highs near the end of February. A Bear market is defined as a decline of 20% or more. This recent decline certainly qualifies, ending what has been the longest Bull market in history beginning over 11 years ago. **The following chart indicates that this has been the fastest drop into Bear market territory in history.**

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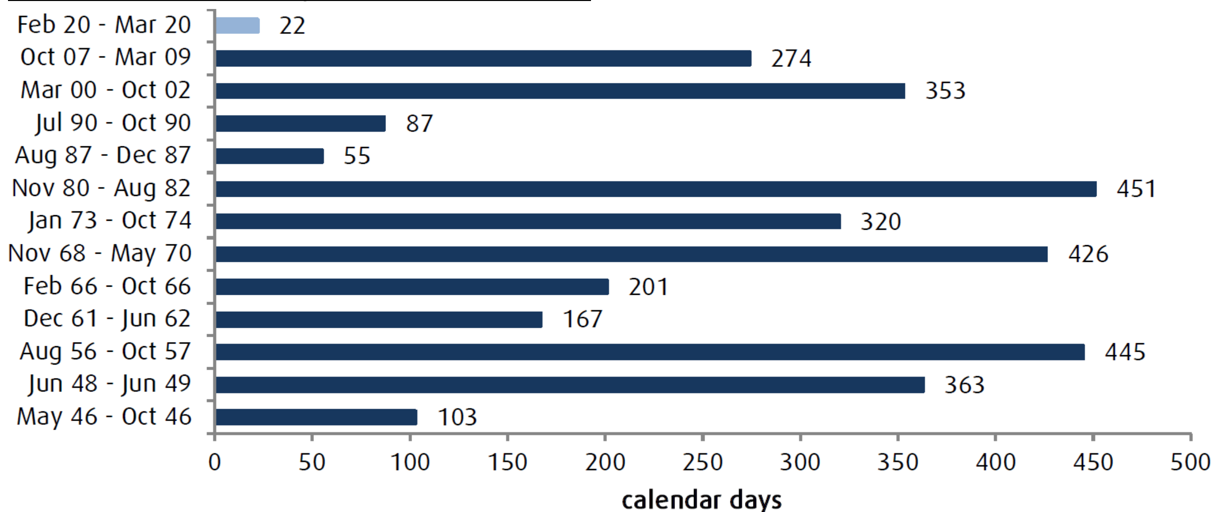
Exhibit 2: Number of Days to fall in Bear Market



Source: BMO Investment Strategy Group, FactSet

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Volatility associated with Bear markets can be extreme and this Bear market has recorded the most volatility of any Bear market since the Great Depression. Post Depression, **March 2020 experienced three of the six biggest daily percentage gains and losses ever in the history of the S&P 500**. Interpreting the volatility is difficult as it has been created by the success or failure of initiatives that have no past reference to financial markets: flattening of curves, new cases of infections, social distancing, self isolation, viral tests, etc.

We have written in the past about the perils of trying to time the market and how important it is to stay invested. Since 1980, missing just the 10 best days halves the return to investors. More recently, in the last 15 years up to December 31, 2019, the S&P 500 has an annualized return of 9%. Missing the ten best days in this period more than halves the return to 4.1%. **The value of owning equities is best**

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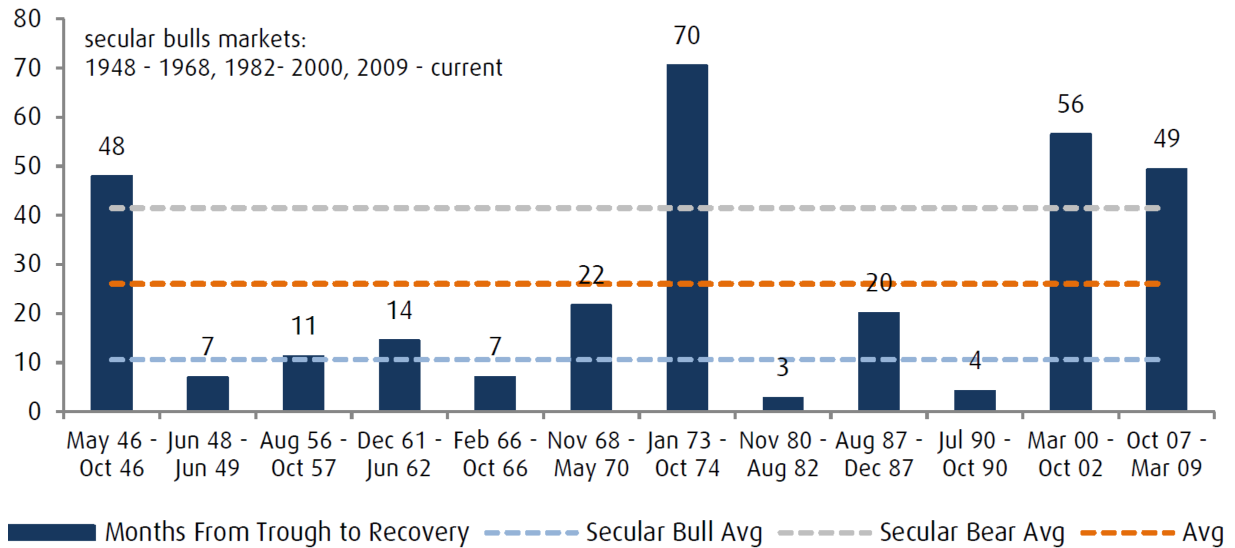
If recessions have an end, so must Bear markets. The following chart analyzes past Bear markets and indicates the number of months from the bottom of the market to a new all-time high.

Exhibit 3: Number of Months from Trough to Recovery



Source: BMO Investment Strategy Group, FactSet

There is a great deal of disparity in the recovery time, with each of the last two Bear markets taking just over four years to recover to new highs. However, there is reason to be optimistic that the recovery time for this Bear market may be of the shorter variety. The data from the chart suggests that there is a significant difference in recovery time depending upon whether we are in a secular (long-term) Bull market or a Bear market. If we are in a secular Bear market, the recovery time could be similar to the last two recessions, perhaps over three years. However, **if we are in a secular Bull market, the recovery time could be much shorter**, as little as twelve months.

Another factor that may argue for a shorter recovery period relates to the fact that corporations often use recessions as a time to cut costs and get “lean and mean”. Some companies will emerge from the recession with more earnings power than they had entering the recession. Investors may underestimate the speed of the earnings recovery, and thus the speed at which the market recovers.

While there remains a very high level of uncertainty as to how this crisis will unfold, we continue to believe the secular bull market thesis, driven primarily by historically low interest rates.

Of course the above analysis compares the current bear market with previous ones, even though the cause and effect of this bear market is so much different than previous markets. The analysis does nothing to factor in the almost complete cessation of much of the global economy and the lingering concerns about the global health crisis. However, our optimism in the secular bull thesis is rooted in our belief that the current economic shutdown is not sustainable, we will find a way to operate our economy with COVID-19, and there will eventually be relief through the development of a vaccine, improvement of treatments, massive testing and potential herd immunity.

Investment Strategy

We continue to focus on well managed companies, operating good businesses that trade at reasonable valuations

We are examining the positions we hold in every company and analyzing how they will be able to manage their way through this crisis. Importantly, we are focusing on company balance sheets, as in most recessions, it is the companies with too much debt that are the most vulnerable. We continue to focus on well managed companies, operating good businesses that trade at reasonable valuations. This company analysis is no different from what we do on a regular basis, however the economic environment today is much different than in a regular business slowdown.

For clients with new money to invest, this recession will be like any other and present a “once in a decade” opportunity to earn significant gains. It is difficult to pinpoint a bottom for the stock market while in a recession. It may be useful to think of recessions as offering “windows of opportunity” where there may be multiple times to invest, some better than others. Investors who can take advantage of these “windows” might invest incrementally when the market is down 20%, 30% or even 40% from their highs. All purchases will yield generous returns if the stock market recovers to its former highs in the next 2-3 years. With the Bear market having such an impact on stocks, it is **likely that stocks offer far superior returns compared to real estate and bonds over the next few years.**

“Once in a decade” opportunity

Final Thoughts

It can certainly be argued that this time it really is different. A pandemic has caused much of the world to shut down economically and conform to mitigating practices such as social distancing, self-isolation, and virus testing. Undoubtedly the pandemic will continue to cause pain and suffering. Besides the obvious health concerns, freedoms that we have taken for granted are no longer available, business owners are struggling to survive, household finances are at risk, and the social contact that is so important for our society has largely been taken away.

However, as with any crisis, there is a beginning and there will also be an end. Science is on our side, and perhaps unprecedented is the unified goal of the world to find a solution to COVID-19. As with any crisis, people will step up to help each other and the crisis will serve to bring people and communities together. We may find we pay more attention to the scientific community in the future, and will certainly be better prepared in the future for another COVID type virus.

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As we go to print on this letter, it is encouraging to see that the mitigating actions society is taking are yielding some positive results. As they relate to the stock market, most major markets are up 5-10% since the end of March, and are up 20-30% from the lows of March.

In the meantime, all of us at Seymour wish the best for you and your families during this uncertain time. We will touch base with you to discuss your quarterly report, and please feel free to call and discuss your portfolio at any time with us.

Warm regards,

The Seymour Team