GENUS CAPITAL MANAGEMENT

In Focus
March 2020

Another shock to the system: Oil price war breaks out; COVID-19 cases expected to rise

Highlights

- We still expect the US economy to narrowly avoid a recession and rebound in the second half of the year.
- However, we are concerned about the recent oil price war and its impact on Canada so we have reduced our Canadian weighting.
- China's virus cycle was roughly two months and we expect to see a similar timeline for the rest of the world
- Typically, when the WHO declares a virus a global pandemic, it has been a time to buy equites
- The Fed has released a large amount of liquidity as QE4 is underway. We expect the balance sheet to rise from the September lows of 3.8 trillion to roughly 6 trillion, well ahead of the 4.5 trillion we saw during the 2008 financial crisis
- We have started to use some of our cash we built up during the beginning of the COVID-19 virus breakout and are adjusting our asset mix to switch from bonds to our dividend fund.
- We still believe the 11-year bull market cycle is intact after this drop and believe equity markets will recover.

Over the weekend, talks broke down between Saudi Arabia and Russia as doubts clouded the future of the OPEC+ pact. Saudi Arabia began to offer discounts on its oil to European customers, sparking an almost 25% plunge in oil prices on Monday, with prices closing at $30.94 after dipping as low as $27.40. Lower oil prices are not great for producers, but they are good for consumers. Because of this, we believe the net economic effect of depressed oil prices will be neutral: the positives from consumers' increased disposable income are likely to cancel out the negatives in the North American energy sector.

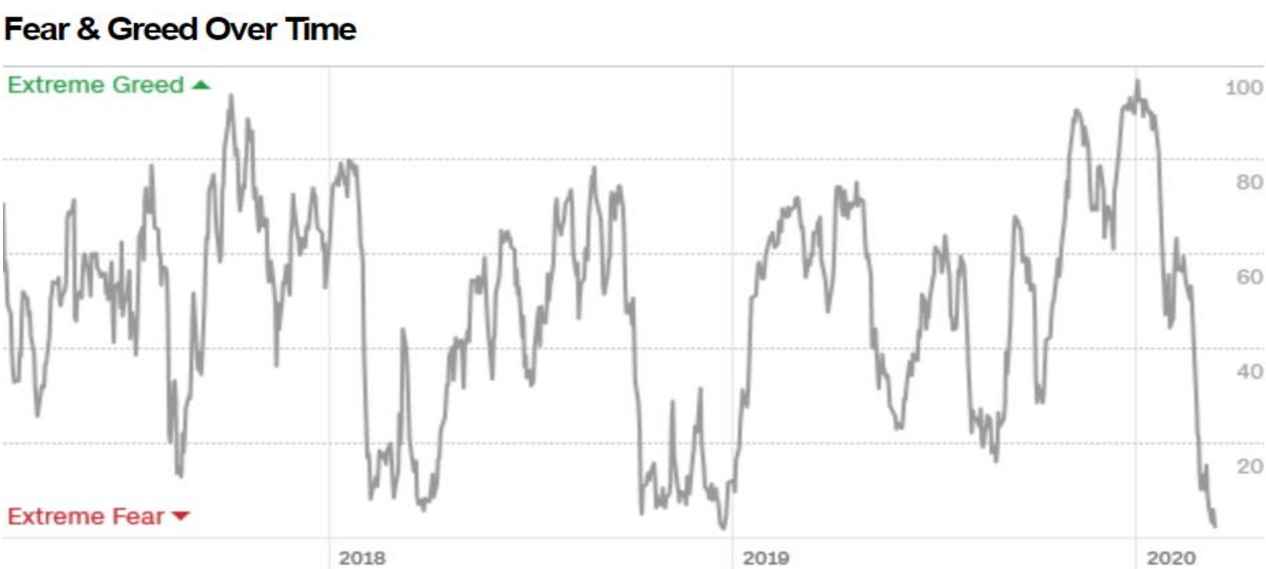
Global equity markets continued to be volatile this week, with the S&P 500 falling roughly 16.5% in the first four trading days of the week—the fastest fall since the 2008 financial crisis. The key twin catalysts were the intensifying oil price war and continuing fears of the economic impact of COVID-19 as more and more events are cancelled. From its highs in late February, the S&P 500 is now down just under 19% in what may turn out to be the swiftest 20% correction in history. Valuations continue to fall even as earnings forecasts plummet, with the S&P 500 Forward price-to-earnings ratio dropping to around 15x.

The bond market responded by falling to record lows on the US 10 Year bonds. Given this reaction, we believe the market is pricing in both further escalation in the COVID-19 virus and action by the US Federal Reserve. The market sees the Fed cutting 50 to 75 basis points in March followed by another 50 points in April, bringing rates back down to 0%. The Fed has also announced more liquidity measures to help prop up the markets. So far, these measures include the emergency rate cuts seen last week plus an increase in repo operations (a policy tool used by the Fed to keep financial markets liquid). On Thursday, we also saw the Fed announce another $1.5 trillion liquidity injection into the financial markets by the end of April. This would bring their balance sheets from the $3.8 trillion lows seen in September, to a record $6 trillion dollars, which well ahead of the $4.5 trillion we saw during the 2008 financial crisis.

The question remains: Will the COVID-19 virus coupled with an all-out oil price war cause a recession? We are inclined to think we are not headed there just yet in the US, but the chances of a recession in Canada are increasing as oil continues to plummet and businesses begin to default, exposing Canadian banks to greater risks. Canadian corporate to government bond yield spreads—a measure of corporate risk—remain at relatively low levels, hovering around 1.0%. That is similar to the levels we saw during the December 2018 pullback.

In terms of our portfolios, we have made some adjustments in response to these events. We have lowered our exposure to Canada, mainly in the energy and financial sectors, as well as to emerging markets. We have begun to spend the cash we raised during the past two weeks as the market approached the bottom of the ten-year trading channel. We will also consider asset mix switches moving from overbought bonds into our dividend fund. We will continue to monitor the situation and act accordingly.

Figure 1: CNN Fear and Greed Index



Source: CNN (https://money.cnn.com/data/fear-and-greed/) – at March 12, 2020

Please feel free to contact your Portfolio Manager if you have any questions.

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