Quant Insights
Market Sell Off

MAR 2020

At a glance

- Indiscriminate selling occurred during February 2020 after the world wide spread of the Novel Coronavirus (COVID-19)
- With US yields reaching record lows during the month, high yielding sectors could provide a very interesting opportunity
- While Low Volatility funds generated benchmark-like returns, we believe that defensive names have largely been oversold, and that patience will reward low volatility investors

Market reaction to COVID-19

Markets began a big sell off late in February driven by fear that the COVID-19 virus would spread globally. It is still too early to assess how broadly COVID-19 will spread, how long the outbreak will last, or how impactful it will be on future economic growth. What is clear is that market volatility could well persist over the next few quarters.

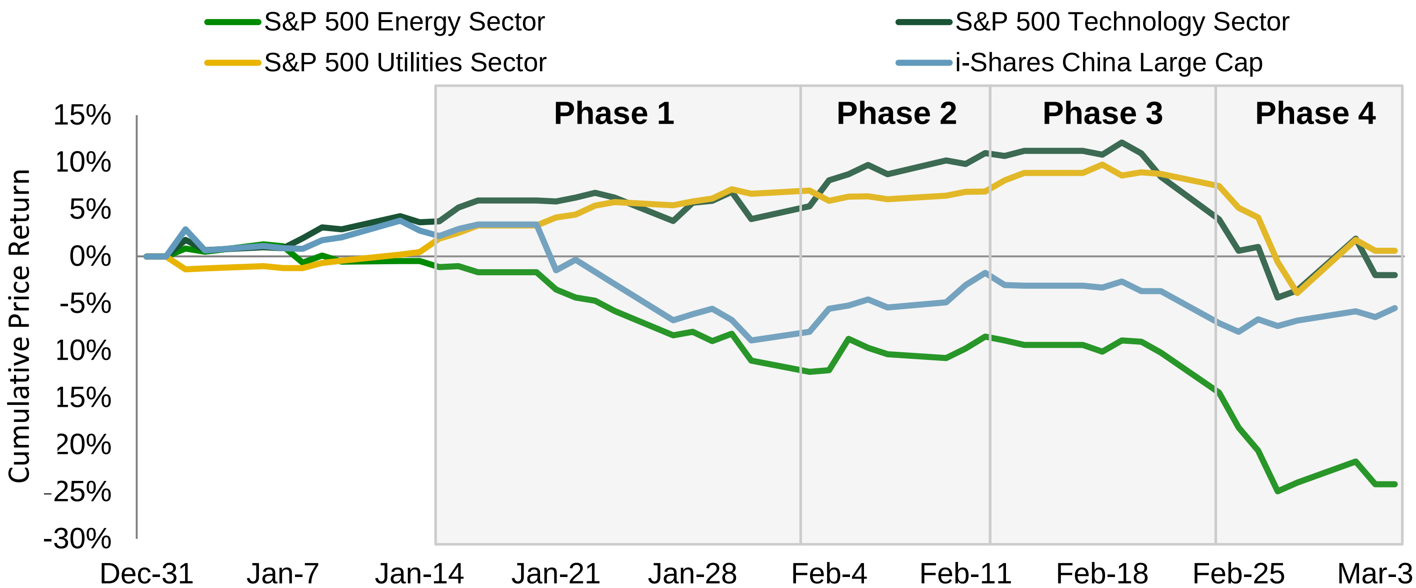
The COVID-19 virus has created 4 phases of market action since the beginning of the year. The first started in mid January with the virus impacting Chinese equity markets, causing a selloff and a knock on effect on oil demand, hurting the energy sector.

The second phase stretched over the first two weeks of February. News of virus containment in China and stimulus plans led to a rally in markets.

When the outbreak reached Japan, Europe and South Korea, risky assets fell and our Low Volatility funds performed as expected by protecting against the downside – Phase 3.

However, when the number of infected rose precipitously in South Korea and Iran and it was clear that containment would be difficult, and with no market intervention from global governments, there was widespread selling during Phase 4. In fact, even typical safe haven assets like Gold sold off. There was no where to hide and our Low Volatility funds delivered benchmark like returns.

Chart 1: Evolution of the market sell off

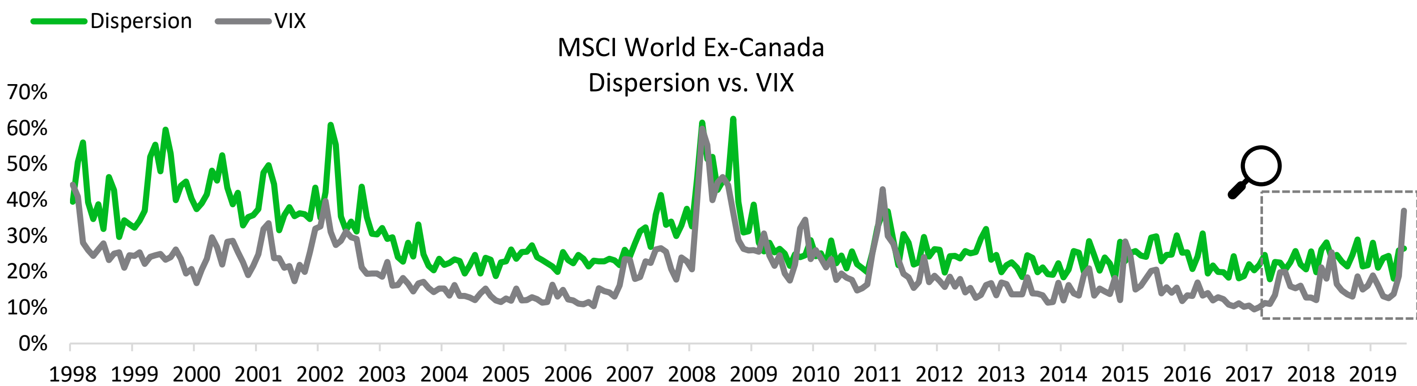


As of February 28th 2020. Sources: Bloomberg, S&P

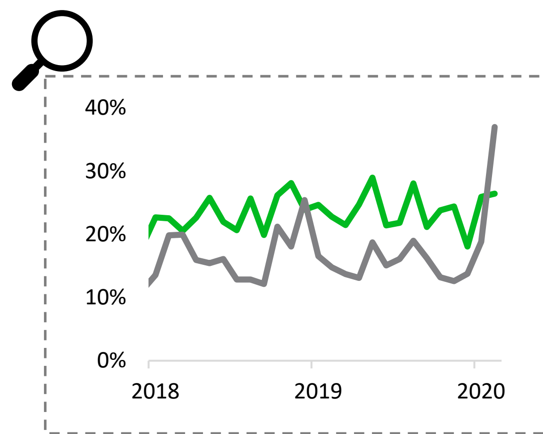
While a single month is a relatively short period to study, we can still learn by looking into why our Low Volatility funds had a difficult time in February. We saw an increase in volatility as measured by the VIX index that started off February at around 18 and jumped as high as 49 during the last few days of the month. Typically, we would expect dispersion to increase in line with the VIX during market downturns, helping our low volatility strategy to outperform the benchmark (Chart 2).

However, we did not see an increase in cross-sectional dispersion in returns despite the higher volatility. Dispersion was roughly unchanged from January levels contrary to the VIX index that almost doubled. In other words, this means most stocks, if not all, suffered equally during this market downturn and there simply was nowhere to hide in a long-only equity portfolio.

Chart 2: Stock dispersion was very low in February 2020 given the market volatility



As of February 28th 2020. Sources: Bloomberg, TDAM



Finally, in Chart 3 we show single stock returns for the Developed Markets Ex-Canada universe grouped by Sectors and volatility quintiles. The center line being the median stock returns and the box representing the interquartile range (upper quartile to lower quartile). We once again confirm the lack of dispersion by sector and volatility buckets. The least volatile sectors performed on par with the most volatile, and the most defensive also performed on par with the most cyclical with energy being the exception.

When there is indiscriminate selling of equities, all signs point to a global de-risking into cash and bonds. In such an environment, it is nearly impossible to differentiate ourselves from the benchmark in a long-only equity context.

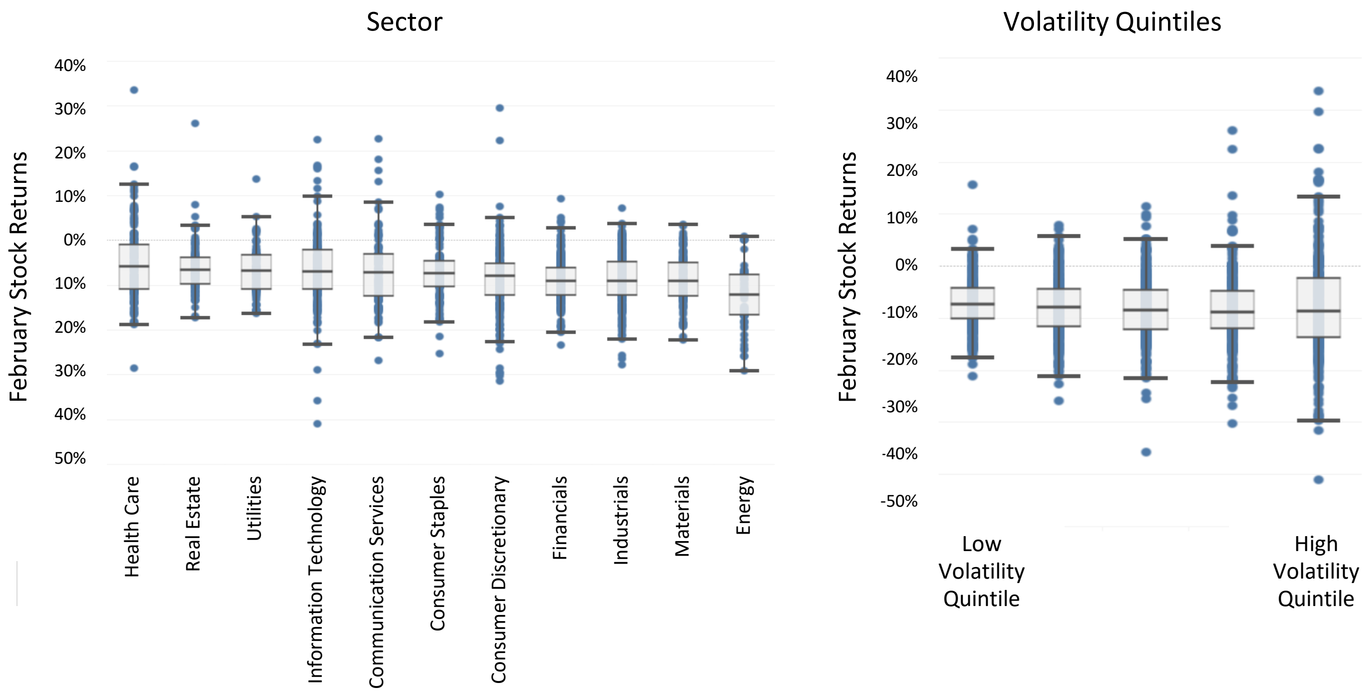
However, if the market selloff continues we should expect the dispersion of stocks to increase as was the case in the 2000's, 2008 and 2011.

Furthermore, low dispersion within equities is atypical in an environment where there is high differentiation between asset classes, most specifically between equities and bonds.

Given how far long term rates have fallen, we believe that our preferred sectors such as utilities, real estate and consumer staples have largely been oversold in the recent market sell-off, and should eventually be repriced as a result of accommodative central bank policies, or provide highly attractive yields compared to increasingly expensive bonds.

Economic conditions may deteriorate further and market volatility may persist, but we remain optimistic that patient investors will continue to be rewarded.

Chart 3: Apart from the energy sector, all sectors had a similar median and distribution of returns in February. All volatility quintile groupings has similar median returns as well.



As of February 28th 2020. Sources: Factset, TDAM

Please see your monthly performance commentary for additional information on the performance of your specific investment

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