From the Desk of Robert Vanderhooft

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Robert Vanderhooft, CFA, is **Chief Investment Officer (CIO)**, TD Asset Management Inc. (TDAM), and **Senior Vice President**, TD Bank Group.

Robert is also **Chair** of the **TD Wealth Asset Allocation Committee (WAAC)**, which provides broad asset allocation guidance to all of TD Wealth.

In his note below, Robert provides his latest insights on recent events affecting the markets and his strategy outlook.

TDAM View: COVID-19 Infects Markets

With a number of major market events making headlines, including the S&P500 Index declining approximately 13% from its recent highs, 10-Year US Treasury yields hitting a new record low of 1.18%, and gold set to break multi-year highs; we want to highlight a few important points.

As we currently stand the major known unknown is how COVID-19 will evolve. If the coronavirus doesn't become a worldwide epidemic, then risk assets will likely recover quickly. But in a worst-case scenario where the outbreak morphs into a pandemic, the resulting market downturn could get somewhat worse, but in our view, we have already seen a significant move to an oversold position. As market participants are faced with this increased uncertainty of binary outcomes, equities and other risk assets could face continued downward pressure should the severity of the virus accelerate.

The current known knowns; China accounts for ~19% of global Gross Domestic Product and many indicators, such as declining traffic and pollution levels in major manufacturing cities, indicate that China may be facing severe economic contraction. It's been widely estimated that COVID-19, as it stands, will curtail global growth by more than 1%. On the positive side we could see a rapid pick up in industrial economic data as the virus abates in China as early indications are implying.

We are of the view that the most probable outcome is the economic impact of the virus will likely be short lived for the following reasons:

- As economic activity is suppressed, we believe it is driving global inventory levels to fall rapidly. Low inventory levels should create pent up demand that will boost economic growth in the following quarters.
- The Peoples Republic of China will move away from financial de-risking and return to aggressive fiscal and monetary easing in order to help ensure a swift domestic economic recovery.

- It is important to remember that prior to the viral outbreak, the global financial outlook for 2020 was generally positive as market participants felt that the economic momentum had slowly turned the corner after a soft 2019.
- In addition, and unlike the global financial crisis of 2008, economic imbalances are generally smaller now than a decade ago.
- And finally, global monetary policy remains highly accommodative.

We expect these factors to support a rebound in capital markets once the virus has run its course or has been contained.

Now that equity valuations have become more attractive and credit spreads have widened, we are maintaining our modest overweight position to equities and spread products. We are also maintaining our underweight position to government bonds. We are currently taking advantage of opportunities in oversold sectors primarily in equities with modest selective buying

Strategy Overview

Low Volatility Equities

How do you protect capital within equity markets in months like February 2020? Early into this recent drawdown, traditionally defensive positions like utilities outperformed, especially as yields fell. And in fact, our low volatility portfolios performed according to expectations as the drawdown started, as we initially protected against up to 50% of the losses. With the selloff becoming more broad-based, there is only about a 4% spread between the best sector and the second worst performing sector (Energy did significantly worse than other sectors). In a very diversified, long-only equity strategy, this means that there isn't much opportunity to protect against the downside.

February was indeed unusual as even the range of stock returns (technically referred to as dispersion) is much narrower than we typically see in downturns. This points to a possible overreaction given that grocery stores and Utilities are likely to be less impacted than car makers if a full pandemic were to occur. We may be seeing an opportunity for safer stocks developing. As the COVID-19 virus spreads, markets are showing some fragility. Ironically the Chinese equity market has been a relative outperformer. All of this speaks to a somewhat indiscriminate selloff of equities that isn't specifically targeting cyclical or risky stocks.

We are well positioned against future drawdowns and are not looking to shift our portfolios significantly due to the current selloff. While we expect our final monthly returns to show close to full downside participation for February, solid, reasonably valued, defensive positioning tends to do well when market drawdowns persist.

Fixed income

The flight to safety currently unfolding in the fixed-income markets has been mostly directed to the government bond sector with 10-year Canada Bonds yielding below 1.10% resulting in a significantly inverted curve. In contrast, the corporate bond market didn't participate in this rally resulting in slightly wider credit spreads of +17 basis points (bps).

Our Credit Analyst team is monitoring how this market downturn effects individual sectors. In situations where we believe the economic impact of the COVID-19 virus will meaningfully affect company fundamentals, analysts are taking action by either adjusting their risk score or credit rating.

We remain focused on quality and are confident in the names we hold. If credit spreads widen further, we have built up dry powder to take advantage of opportunities as they arise. We will look to strategically increase our corporate allocation to benefit from the market dislocation. We will do so only if our credit research analysts determine that credit ratings and risk scores are not materially impacted by the virus driven downturn.

Fundamental Equities

We continue to manage the active fundamental public equity portfolios with the same disciplined investment process. Some of the industries and companies held in the public equity portfolios are impacted more than others by the coronavirus. At this juncture however, TD Asset Management Inc. believes the longer-term results will not be impacted by this exogenous event. Due to the disciplined investment process, TD Asset Management tends to invest in higher quality companies, market leaders with skilled management teams and robust balance sheets and has conviction that the companies will manage issues as they arise that might mitigate or reduce any impacts due to the exogenous event. We have not made any significant changes to our active portfolios but will continue to monitor the situation and review the impact on companies in the portfolio to ensure there is no permanent impairment to the underlying revenues and earnings power in the holdings.

Additional Insights

New Video: In an interview recorded on Friday February 28, Kim Parlee of BNN speaks with Rob Vanderhooft, Chief Investment Officer, TD Asset Management and Senior Vice President, TD Bank Group, about the implications of the coronavirus outbreak for global financial markets

Our investment strategies and portfolios are designed to effectively manage market risk, particularly during periods of elevated market volatility, by investing in what we believe are high-quality companies that are best positioned to deliver solid long-term results.

While recent market activity may create investor uneasiness, rest assured the TDAM's investment professionals are closely monitoring the investment landscape and responding accordingly. Should you have any questions related to your portfolio, please reach out to your Relationship Manager.

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The TD Wealth Asset Allocation Committee (WAAC) is comprised of a diverse group of TD investment professionals. The WAAC's mandate is to issue quarterly market outlooks which provide its concise view of the upcoming market situation for the next six to eighteen months. The WAAC's guidance is not a guarantee of future results and actual market events may differ materially from those set out expressly or by implication in the WAAC's quarterly market outlook. The WAAC market outlook is not a substitute for investment advice.

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