# Tradex

## QUARTERLY

**First quarter 2020**

## President's Report to Tradex Members

Equity markets experienced one of their fastest declines into a bear market with the US S&P 500 falling 21% from February 19th to March 12th and the S&P TSX falling 30%. Thus ends the longest bull market for the S&P 500 which saw it rise from March 9th, 2009 a total of 364%. The cause of this bear market is the anticipated deep economic impact of government mandated closures and distancing activities in response to the COVID-19 pandemic combined with the impact of the Saudi Arabia and Russia oil price war. From the lows reached March 23rd the S&P/TSX Composite Index increased by 19.2% but ended the quarter down 21.6%. Meanwhile, in the US the S&P 500 Index was up 15.4% from the low however down 20% for the past 3 months. The decline in terms of Canadian dollars was lower for the quarter as the Canadian currency decreased from 76.99 cents to 70.49 cents, a decrease of 8.4% for the period. As of March 31, the dividend yield of the S&P/TSX was 4.0% and S&P500 2.3%, which indicates significant relative value in stocks as the 10-year government bond yields were 0.7% in Canada and for US Treasuries.

The Bank of Canada and the US Federal Open Markets Committee both completed emergency rate cuts of 1.5% in March to the effective lower bound for interest rates, in order to provide support to the financial system and the economy during the pandemic. Globally central banks and governments have delivered coordinated unprecedented stimulus to offset the economic impacts of the pandemic and ensure properly functioning financial markets. Furthermore, they have enacted numerous targeted responses and continue to indicate they will do whatever is necessary to offset the economic impact and to lay the foundation for the economy's return to normalcy.

### Management Reports of Fund Performance and Financial Statements

For members who did not elect to receive a mailed copy, the 2019 reports are available anytime on our website for downloading. If you wish to receive a printed copy, please contact us.

### Tradex 60th Anniversary Meeting

As our annual presentations have been postponed due to COVID-19, our three portfolio managers usual updates will appear on our website at www.tradex.ca by mid-May in the section entitled "Members' News".

Blair Cooper
April 17, 2020

### Bear Markets

The following are excerpts from an article written in December 2008 providing Phillips, Hager & North's perspective on bear markets and how investors should react (originally reprinted in its entirety in our First quarter 2009 newsletter) adapted for today's circumstances.

Looking back through history, an observer can see that bear markets generally share similar attributes that take shape as investor psychology shifts from greed to extreme fear over a relatively short period of time. Common characteristics include: some form of crisis (war, runaway inflation, real estate collapse), economic recession, corporate profit declines, job losses, increasing loan defaults, and excessively expensive equity markets revaluing downward quickly. Sound familiar?

Despite what seem like obvious warning signs, in hindsight, bear markets tend to catch most everyone off guard – including professional investors. Not only is the timing of a bear market nearly impossible to predict, but so, too is its severity. Bear markets are usually more violent than expected and generally there are no safe harbours.

Given how difficult bear markets are to predict, it should be no surprise that trying to peg a market bottom is equally difficult. More importantly, this type of guesswork – fodder for countless market pundits, talk show panelists, and armchair investment managers – is actually counterproductive, since it ratchets up the hype and distracts investors from their long-term focus. The key to successful long-term investing,

*(continued on back page)*

## Tradex Equity Fund Limited – Quarterly Review – March 31, 2020

| | Total return (%) | | | Average annual compound return (%) | | | | |
|---|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 4 years | 5 years | 10 years | Since inception* |
| Tradex Equity Fund Limited | -18.9 | -14.2 | -11.5 | 0.7 | 4.4 | 2.5 | 5.5 | 8.9 |
| S&P/TSX Total Return Index (TRI)** | -20.9 | -18.4 | -14.2 | -1.9 | 2.9 | 0.9 | 4.1 | — |
| Average Canadian Focused Equity Fund** | -18.5 | -15.4 | -12.2 | -2.6 | 1.0 | -0.3 | 3.8 | — |

*April 1960 **Source: Morningstar

During the fourth quarter an investment in Tradex Equity Fund Limited decreased in value by 18.9%, outperforming the Fund's benchmark, the S&P/TSX Total Return Index, by 200 basis points. It declined 11.5% for the past year, outperforming the Canadian index after all expenses.

Phillips, Hager & North (PH&N) as portfolio managers are responsible to ensure the portfolio is underpinned by exceptional companies that can withstand even the most challenging phases of the business cycle. They deem the holdings to have sufficient access to liquidity to get to the other side of this global pandemic and emerge without impairment to their long-term value and growth opportunities. Their stress-testing on the global portion reaffirmed that all retained companies should weather the storm and remain comparatively resilient.

They have also identified those companies among our holdings for whom the unique circumstances have the effect of reinforcing their strengths. Amazon, for example, continues to move from strength to strength. Similarly, Microsoft's cloud offering is integral to the accelerated shift online. Leading private equity firm Blackstone had the foresight to patiently build cash holdings in anticipation of the heightened potential for a global recession. Finally, MarketAxcess has benefitted from the push to online trading for ease of price discovery, volume, fulfillment, and communication. Adyen, a Netherlands-based payments platform business, was a new addition to the portfolio.

The S&P/TSX Composite Index began the quarter where it left off in 2019, as diminishing uncertainty and rising valuations nudged the index to an all-time high in mid-February. However, the spread of COVID-19 across the globe in the first quarter of 2020 sent equity markets and oil prices down sharply on concern about slowing economic growth and its negative impact on corporate earnings.

Over the quarter, the fund's relative performance was primarily aided by security selection within the Health Care and Financials sectors. Newmont Corp was the largest single contributor to performance, as the metals & mining company benefitted from a flight to safety during the market sell-off. Additionally, an overweight in Thomson Reuters boosted fund performance as the company benefited from ongoing organic growth and strong bottom line results in their legacy businesses.

The Fund's exposure to the Energy sector had a negative impact on returns. The industry has been under immense pressure as the drastic decline in oil prices has hurt Canadian producers. Overweight positions in Suncor and Canadian Natural Resources were a drag on relative performance.

As at March 31, 2020 the Fund's 10 largest holdings were as follows:

| | | | |
|---|---|---|---|
| Royal Bank of Canada | 4.0% | United Healthgroup | 2.3% |
| TD Bank | 3.6% | Danaher Corporation | 2.3% |
| Roche Holding AG Genusschein | 2.7% | Microsoft Corp. | 2.2% |
| Enbridge | 2.4% | Bank of Nova Scotia | 2.2% |
| Canadian National Railway | 2.3% | Brookfield Asset Management | 2.0% |

PH&N indicates the number of COVID-19 cases is likely to continue to climb, and equity markets may remain volatile until investors can gain more clarity regarding the severity and duration of the outbreak. Many businesses are resourceful in managing their profitability in light of changing environments, and economic downturns often serve as incubators for new products and business lines. As a result, they view the current equity declines as an opportunity for long-term investors. They are fully committed to stewarding investors' capital through these challenging and unprecedented circumstances. Importantly, the portfolio is comprised of businesses that are able to weather the current storm and are positioned to prosper when an economic recovery begins to take shape. They place a great deal of emphasis on monitoring the positioning to maintain resiliency as market environments evolve.

## Tradex Bond Fund – Quarterly Review – March 31, 2020

| | Total return (%) | | | Average annual compound return (%) | | | | |
|---|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 4 years | 5 years | 10 years | Since inception* |
| Tradex Bond Fund | -6.8 | -6.3 | -5.1 | -0.9 | 1.3 | 1.1 | 3.2 | 5.4 |
| FTSE TMX Canada Universe Bond | 1.6 | 0.7 | 4.5 | 3.7 | 3.1 | 2.7 | 4.3 | — |
| Average Canadian Bond Fund** | -0.8 | -1.5 | 1.7 | 2.0 | 1.8 | 1.3 | 3.0 | — |

*September 1989 **Source: Morningstar

An investment in the Tradex Bond Fund decreased in value by 6.8% during the fourth quarter (as equity and preferred share markets entered a bear market with declines over 20%), while it has decreased by 5.1% over the past year. Most risk assets began the year on a positive tone. However, as the quarter progressed the tone reversed as worry about COVID-19 seeped into investor sentiment before turning into full blown market panic in March. The negative sentiment lead to global equity markets falling by record levels. The preferred share market continued its recent trend of falling in lock-step with equity declines. Given yields across most of the Canadian yield curve declined during the quarter, the below-benchmark duration positioning detracted from relative performance.

Given the deteriorating economic outlook and rapidly expanding negative sentiment, the Bank of Canada, along with other global central banks, were quick to react by cutting their policy interest rate by 50 basis points on three separate occasions to reach their self-described lower bound of 0.25%.

These actions had a dramatic impact on bond yields at the front end of the Canadian yield curve. After a dramatic kneejerk move downward at the end of February, the 30-year yield retraced higher. Government of Canada bond yields decreased during the quarter as seen in the following table:

| Term to Maturity | Yield Dec. 31/06 | Yield Dec. 31/18 | Yield Dec. 31/19 | Record Lows | Yield Mar. 31/20 |
|---|---|---|---|---|---|
| 2 year | 4.02% | 1.86% | 1.69% | 0.28%* | 0.42% |
| 3 year | 3.99% | 1.86% | 1.69% | 0.30%** | 0.50% |
| 5 year | 3.99% | 1.88% | 1.68% | 0.48%*** | 0.60% |
| 10 year | 4.08% | 1.96% | 1.70% | **0.53%****** | 0.71% |
| 30 year | 4.14% | 2.18% | 1.76% | **0.71%******* | 1.32% |

*Source: Bank of Canada.* ***Record (50 years or more) low rates***
**January 15/16, **Jan. 19/16, ***Feb. 11/16, ****Mar. 9/20, *****Mar. 9/20*

The Fund continued to be diversified across income-generating asset classes. At quarter-end, 49% of the Fund's portfolio value was in government bonds, 27% in corporate bonds, 12% in preferred shares, and 10% in common shares, REITs and Income Trusts. In March, Foyston, Gordon & Payne (FGP) initiated four new equity positions when market volatility presented opportunities to purchase at significant discounts to their assessment of intrinsic value. The yield on the Fund's overall portfolio was 3.2% as at March 31st, as shown in the following table, while the yield on the FTSE TMX Canada Universe index was 1.9%.

| | *Government Bonds* | *Corporate Bonds* | *Preferred Shares* | *Common Shares, Trusts, REITs* | *Weighted average total* |
|---|---|---|---|---|---|
| *Yield** | *1.6%* | *3.3%* | *7.6%* | *6.8%* | *3.2%* |

*The gross estimated annual yield for 1 year is calculated before fees & taxes

The monumental reaction in monetary, fiscal, and regulatory policy did eventually provide much needed stability to equity and fixed income markets to finish off the quarter. This reaction to government and central bank policy is positive as it demonstrated that the tools developed during the Great Financial Crisis to ensure proper functioning of the banking system are highly effective and able to be redeployed in a timely manner. That being said, the actual economic impact of the current pandemic will play out over a much longer timeframe and will likely lead to persistence in the heightened volatility.

## Tradex Global Equity Fund – Quarterly Review – March 31, 2020

| | Total return (%) | | | Average annual compound return (%) | | | | |
|---|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 4 years | 5 years | 10 years | Since inception* |
| Tradex Global Equity Fund | -24.4 | -16.6 | -16.9 | -0.4 | 4.6 | 2.6 | 8.6 | 5.2 |
| Average Canadian Global Equity Fund** | -16.3 | -11.4 | -9.5 | 0.0 | 2.9 | 2.0 | 6.5 | — |

*May 1999 **Source: Morningstar

During the first quarter of 2020, the value of each unit in the Tradex Global Equity Fund decreased by 24.4%. This compares to a decrease of 14.4% in the Fund's benchmark.

A quiet and positive start to the year for global equity markets was completely upended by quarter end as the COVID-19 coronavirus outbreak spread globally throughout the human population, halting economic activity in its wake. As if another competing crisis were needed, Russia and Saudi Arabia failed to agree to a reduction in oil production and, coupled with collapsing demand, the WTI oil price sank from US$61.06 a barrel at the start of the year to US$20.48 a barrel at quarter end. Equity markets reached a peak in mid-February only to decline 18.5% from there by quarter end after a bounce from the bottom when equity markets were almost 30% lower. Bond yields have similarly collapsed as central banks have slashed interest rates while the US dollar strengthened sharply versus most currencies. Meanwhile governments everywhere have opened the taps for fiscal stimulus as they seek to alleviate what they hope will be temporary pain from increased unemployment and/ or reduced incomes. The ramifications of these policy decisions are hard to predict but the effects will probably be felt for years to come.

While the initial outbreak of the virus came from China, the first in, first out concept seems to have applied to equity markets as Chinese-related markets were among the best performers over the period as draconian measures halted the virus spread. The Shanghai Shenzhen CSI 300 Index fell only 3.3% (Cdn $) over the period while Hong Kong's Hang Seng Index declined 7.6%. Equally, countries regarded as "safe havens" benefited from a flight to quality with currency appreciation mitigating some of the local weakness in share prices. In particular, in Japan the Topix Index fell 9.5% as the yen strengthened 9.3% while the Swiss market fell only 3.1% as the Swiss Franc appreciated 9.0%. The US dollar also benefited and limited the decline in the S&P 500 Index to just 12.4% over the quarter. In contrast, resource-oriented markets were among the worst performers with the Australian and Canadian markets falling 26.7% and 20.9% respectively while emerging markets fared even worse as Russia's market lost 28.7% and Brazil's fell 47.0%. European markets were also weak as the virus spread quickly in Italy, Spain, France and the UK. The UK's FTSE 100 index slid 22.4%, Germany's DAX Index lost 20.3% while France, Italy and Spain's markets declined 21.1%, 22.6% and 23.8% respectively.

The Fund's performance suffered from being underweight to the US market although it benefited from overweight exposure to Japan and China. Even more impactful was a widening in discounts on many of the closed-end funds in which the Fund invests. This is very common in times of market panic but is almost certainly temporary. In the meantime, it presents many opportunities to buy assets cheaply and City of London Investment Management (CLIM) have taken advantage of the market dislocation to sell relatively expensive securities and buy those whose prices have fallen sharply and appear to offer great value and the potential for outsized returns.

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## Bear Markets *(continued from p.1)*

after all, is to remain fully invested during the market lows because equities have historically outperformed other forms of investments over the long term, even when you include the effects of bear markets.

Sadly, for many investors, the emotional and financial hardship of a bear market is too much to take. Too many investors succumb to the pressure, sell at the bottom, and sit on the sidelines during the market recovery – thus missing out on the upside after having suffered through much of the downside. In fact, the largest gains in equity prices have come, more often than not, after significant declines.

Historically, when the S&P 500 has experienced price declines of 30% or more, it has then gone on to return over 40% the following two years as measured from the low.

A crisis like today's has the dual catastrophic consequence of eroding an investor's nest egg and also shortening an investor's time horizon (represented by a capitulation from his or her long-term plan). Now, more than ever, we urge investors to seek advice and establish a long term plan that will help ensure financial wellbeing beyond the time horizon of this bear market.

Of course, even for investors who have the discipline to stick to their strategies it is normal to wonder when some light will appear at the end of the tunnel.

Admittedly, it is very difficult to look past the negative headlines such as rising pandemic cases and deaths, rising unemployment and significant short term economic contraction. It is quite possible that things may get a whole lot worse before we see signs of a recovery. Fortunately, central banks and governments have learned fiscal and monetary policy lessons by studying the Great Depression and Japan's so-called "lost decade." More recently they learned that speed and massive scale – shock and awe – were critical to stemming the tide of the financial crisis. Unprecedented monetary and fiscal policy responses continue to be rolled out around the world to counteract the contagion.

Although Canada will see significant declines in corporate profits and employment in the near term, the declines will become less pronounced over time and the headlines will be less sensational. Investor and consumer sentiment are as negative as we have witnessed in many years. Historically, such negative sentiment has consistently been a reliable contrarian indicator. Recently, interest rates have again reached all time lows. While it may be hard to believe right now, in the months ahead, this will help kick-start consumer and corporate spending and drive a rebound in corporate profitability. The inexpensive valuations we are currently witnessing in equities are at levels not seen in decade (the same can be said of corporate bonds). Today, our fund managers are seeing opportunities in the market unlike any that have been available in a long time. In our portfolios, we are favouring securities issued by those companies best suited to not only survive the current environment, but also thrive as the economy moves into a recovery and beyond.

Investors who have discipline and a long-term focus have the two most important things needed to get through the current bear market. The last piece of the puzzle is time.