ISSUE
23
MAY
2020

CROFT
FINANCIAL GROUP

May 2020 Commentary & Outlook

Two Extremes

The record-breaking rally in stocks continued through the month of April with both the Canadian and U.S. markets recovering half of the losses incurred during the sell-off over February and March.

Since the market top halfway through the first quarter, the narrative for stocks in 2020 has really been of two extremes.

The first part being the fastest market correction in history, driven by panic as investors ran for the exits motivated by the barrage of negative headlines surrounding the global pandemic and the resulting economic uncertainty.

The second part being the record-breaking relief rally in which the markets recovered in just over a month the equivalent of what usually takes more than a year to achieve. The motivation for this second act seems to have been inspired by monetary and fiscal stimulus and the expectation that central bankers would do whatever it takes to support the markets as the pandemic runs its course.

Where to From Here?

With stock prices having rebounded sharply, while earnings expectations in many hard-hit sectors continue to plummet, price-to-earnings ratios are elevated to levels that have not been seen since the Dot Com boom over 20 years ago.

While the low interest rates and seemingly limitless quantitative easing orchestrated by central banks support this re-inflation of investment values to a certain extent, the near-term economic outlook is dismal, the longer-term outlook very uncertain, and many companies have refused to provide forward-looking guidance.

At this point, three significant uncertainties remain:

1. While we remain optimistic, we can't rule out the risk of multiple waves of COVID-19 infection as countries begin to loosen restrictions.

2. How long will the severe lockdown-induced recession last, and then how long will it really take to get back to something that resembles normal economic activity?

3. Can the various national fiscal and monetary policy responses support where it really counts, which is in the pockets of the millions of newly unemployed?

With stocks having recovered so much, so quickly, and current valuations being questionable based on the underlying economic uncertainties, upside potential for both U.S. and Canadian markets would appear to be very limited for the near term. While the technology sector has outperformed, the major indices, including the tech-heavy NASDAQ, now seem to be consolidating within price ranges below their respective short-term highs.

"W" Shaped Recovery

As outlined in our CIO Richard Croft's most recent article, entitled *The Shape of the Recovery*, we expect a W-shaped pattern to be the most likely scenario for the stock market. This suggests that we could have another pull back as COVID-19 continues to run

May 2020 Commentary & Outlook

its course and the true impact to the global economy becomes clearer.

Portfolio Positioning

For those of you invested in our Enhanced Mandates, we have remained defensive in our pooled funds through the month of April with an allocation to bearish and market neutral strategies on what we believe to be overvalued companies as well as hedges in place and a higher allocation to cash. This portfolio positioning has resulted in a recent underperformance compared to the benchmarks over the short term. However, given our expectation of a more drawn out bottoming process and the possibility of a pull back, we believe this investment strategy is most likely to benefit our clients over the rest of this year.

Moving forward, we will continue to invest actively and adjust our approach as needed to navigate changing market conditions. We will continue to establish positions in companies on our watch list as opportunities present themselves and will use option strategies to help offset some of the broader market risk and enhance cash flow while managing through the uncertainty.

Stay Safe and Healthy

Finally, we would like to encourage everyone to stay safe and healthy as social restrictions ease and we take initial steps towards re-opening the economy.

R N Croft Financial Group
1.877.249.2884
www.croftgroup.com

Investment Committee

Jason Ayres, DMS	CEO
Richard Croft	CIO
Kenneth Mulders, CFA	PM
Christopher Croft, CFA	PM
Alex Brandolini, CFA	PM
Mark McAdam, CFA	PM
Jack Morris, CIM	PM
Paul Fettes, CFA	PM
Christopher Heaman, CIM	PM
Bo Chew, CIM	PM
Robyn Thompson, CFP, CIM, FCSI	APM
Rod Burylo, CIM, FCSI	APM
Kevin Gebert, CIM, CFP	APM
Kelly Morris	Analyst