MANDEVILLE
PRIVATE CLIENT INC.®

Market Commentary
Q2 2020

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ECONOMIC AND MARKET SUMMARY

Global financial markets which where ravaged through the later half of the first quarter of 2020 as the COVID-19 pandemic spread virulently across the globe, have rebounded nearly as quickly on the relief of unprecedented monetary and fiscal stimulus and signs of economic turnaround as business shutdowns have eased and economic activity began to return for many sectors of the global economy. The initial shock from the COVID-19 crisis was the largest and most abrupt halt to economic activity in modern history, giving rise to a sudden and violent drop in values for risk-based assets. The efficacy of the equally unprecedented turnaround for financial markets, a so called "v-shaped" recovery, has been driven by the speed and scale of the policy response. Massive fiscal and social spending programs have been implemented by governments around the globe to support individuals and businesses affected by lockdowns and business closures. Central banks around the world, including the Bank of Canada and the U.S. Federal Reserve, moved expediently to lower short-term lending rates to near zero levels, providing both stimulus and liquidity for financial markets. The effects of these actions, combined with a decisive public policy response in most jurisdictions to flatten COVID-19 transmissions have resulted in a rapid rebound in risk-based asset prices. Most major equity market indices have substantially or even fully recovered to pre-pandemic levels, and several including the technology heavy NASDAQ and even the broader S&P 500 have established new highs. Year-to-date to mid August, the S&P/TSX composite index is down by less than 3% (after having dropped by over 30% in the first quarter), while in the U.S., the S&P500 is up over 4% and the NASDAQ has provided impressive gains of over 24%. Index returns however paint a picture of bifurcation between new economy, ecommerce, technology and healthcare driven industries which have done well or even flourished in the COVID-19 environment, versus more traditional industries including retail, travel/tourism, industrials and consumer discretionary sectors, which have been hard hit by business closures and changes in consumer behaviour through the pandemic.

The narrative on the general economic side has been more unidirectional challenged. With global COVID-19 infection rates currently remaining elevated and certain hot spots not managing to curb the spread as effectively as other jurisdictions, major countries like the United States (which today remains the global epicentre of the COVID-19 pandemic) and other hot spots including Brazil, India, Russia, Mexico, have pushed transmissions levels higher. The virus has now infected over 21 million people globally and resulted in over three-quarters of a million deaths world-wide according to the World Health Organization. Although deaths and illness are certainly a tragedy, the specific impacts resulting from government mandated lockdowns and business closures have curtailed consumer activity and negatively impacted global economic growth. While the worst of the economic fallout appears to be already behind us, peaking in the April to May period, ongoing and protracted impact from lower than normal business activity and lower spending levels will likely negatively affect global economic output through the balance of 2020. If a second wave of virus spread should emerge in the fall or early winter leading to renewed lockdowns and tighter business closures, the extent and timeframe for economic adversity could be greater. The consensus economic outlook for the U.S. economy generally expects an annualized contraction in GDP by over 7% in 2020, with the outlook for Canada being marginally worse. Relative growth expectations between global regions vary based on the severity of lockdown measures in place, the sector makeup of their economies, and country-specific vulnerabilities such as older populations.

The pandemic's longer-term repercussions include elevated debt levels that could hinder growth and lifestyle changes and lower productivity levels. Inflation could also emerge as a concern once economies eventually recover, however this does not appear to be a concern in the immediate future and both interest rates and inflation are expected to remain low. For the economy, while COVID-19 has been the focus of attention, other events and risks are worthy of mentioning. The U.S. Presidential election in November, the ultimate path and timing for Brexit, and the deterioration of U.S.-China relations (and U.S. foreign relations more generally), all could serve as sources of volatility for economies and financial markets. Valuations in many sectors are once again high, and headline risk for equities and financial assets more generally give credence to investor caution and a focus on quality and safety in the portfolio selection processes.

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ANALYZING THE DISPARITY BETWEEN EQUITY MARKETS AND ECONOMIC FUNDAMENTALS

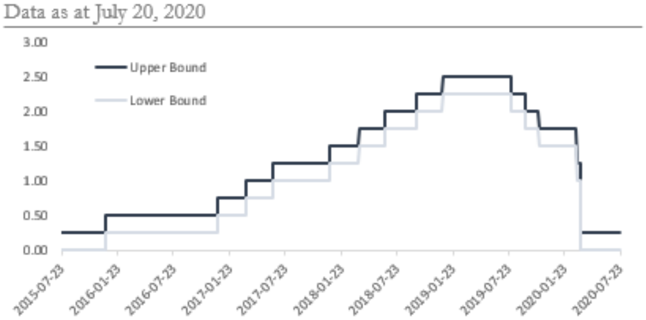
During the second quarter, major North American equity indices experienced a v-shaped recovery despite an economic backdrop that continues to be lined with uncertainty. We believe there are several forces driving this disparity:

1. Liquidity

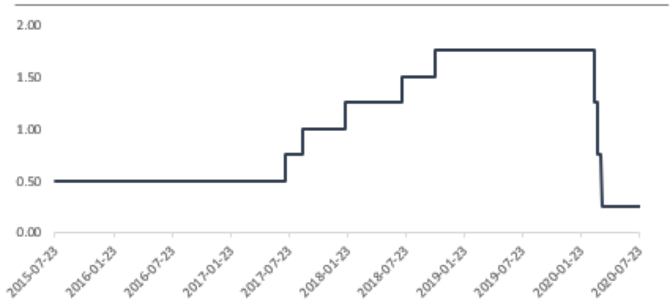
Perhaps the most powerful driver of the recent asset price recovery has been central bank and government liquidity. The U.S. Federal Reserve's balance sheet has grown substantially since the beginning of the crisis, reaching the $7 trillion mark thanks to asset purchases of unprecedented scale. Fed Chair Jerome Powell has demonstrated a relentless commitment to stabilizing the financial markets by providing (essentially unlimited) liquidity. In a recent speech, Powell provided investors with forward guidance on central bank policy using a tool honed during the Great Financial crisis and indicating that rates will remain low "until the central bank is confident that the economy has weathered recent events and is back on track to achieving its maximum employment and price stability goals". In other words, the central bank has committed to keeping interest rates lower for longer. Through numerous mechanisms, the Fed has also; 1) provided direct lending to major corporate employers and small businesses, 2) supported state and municipal borrowing programs, and 3) provided direct lending to banks to encourage loan origination and borrowing, among other things. The Bank of Canada has largely followed suit, lowering rates to the effective lower bound and rolling out their own set of stimulus programs. At the March lows, we believe the equity markets were pricing a draconian scenario whereby the COVID-induced demand shock would lead to mass corporate insolvencies; fortunately, ample liquidity has provided investors with the confidence that the Fed will use any means necessary to shore up asset prices.

Central Banks are Providing Unprecedented Levels Monetary Accommodation

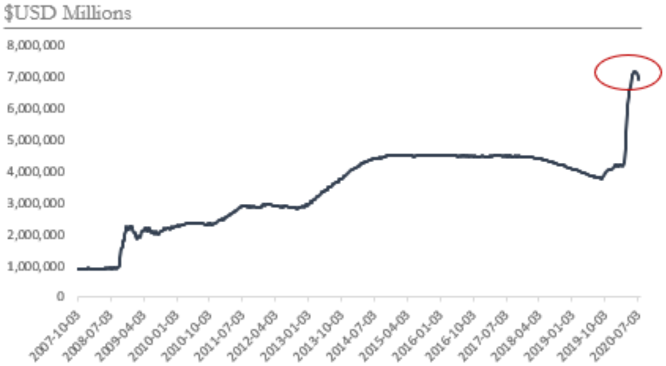
US Federal Reserve Target Policy Rate
Data as at July 20, 2020



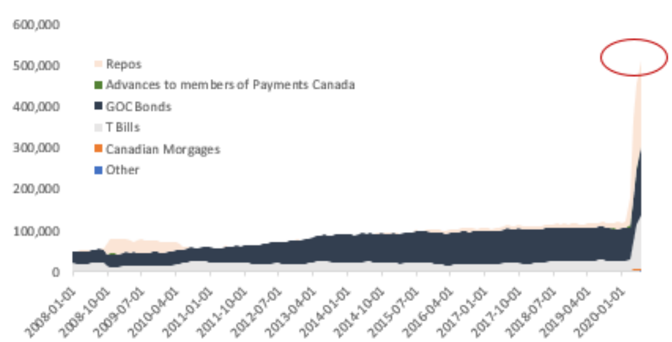
Bank of Canada Benchmark Policy Rate
Data as at July 20, 2020



US Federal Reserve Total Assets
$USD Millions



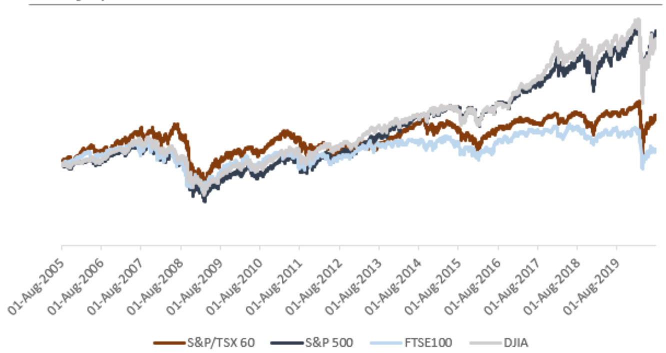
Bank of Canada Total Assets
$CAD Millions



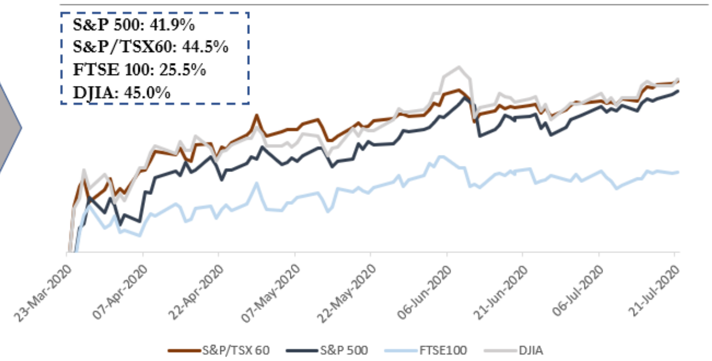
Source: Eikon

Equity Markets Have Rebounded Dramatically from March Lows

Global Equity Indices Historical Performance
As at July 2020



Global Equity Indices Performance From March 23, 2020
As at July 2020



Stimulus from the fiscal side has also played a significant role in the asset recovery. In Canada, large government support programs including the Canadian Emergency Response Benefit (CERB), Canada Energy Wage Subsidy, Canada Emergency Student Benefit and Canada Emergency Commercial Rent Assistance programmes, are cushioning the financial burden for those most affected by the pandemic. Banks and governments across North America have also been working together to accommodate loan deferrals from renters, businesses and households in an effort to ensure both corporate and household solvency.

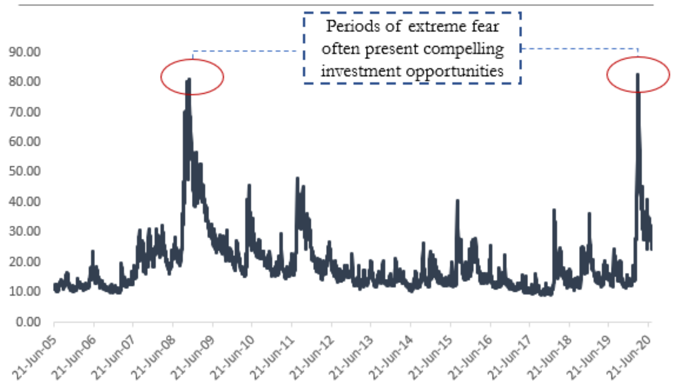
We believe that the v-shaped recovery in equity markets is less about the state of our real economy, and more about the unprecedented liquidity backstops put in place by fiscal and monetary policymakers.

2. Looking Beyond 2020

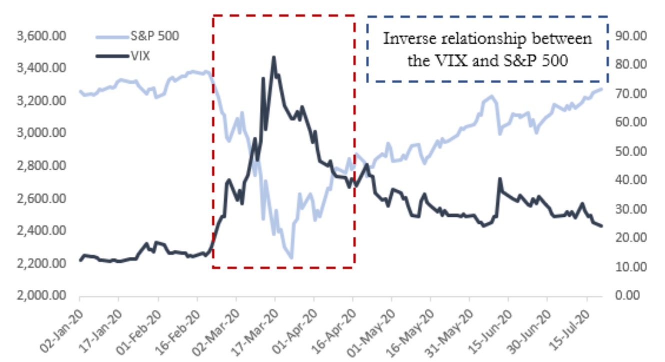
The market is a discounting mechanism that continually strives to estimate the present value of all future cash flows that businesses will generate from now into perpetuity. Given the sharp decline in business activity as a result of COVID-19, investors with a longer-term time horizon are likely to disregard 2020 corporate earnings and instead focus on "normalized" corporate earnings power (i.e. what companies "should" be earning under normal market conditions) to arrive at a valuation.

Periods of Extreme Volatility Can Lead to Compelling Investment Opportunities

Historical Volatility Index
VIX



Volatility in Relation to the S&P 500
VIX vs. S&P 500



Source: Eikon

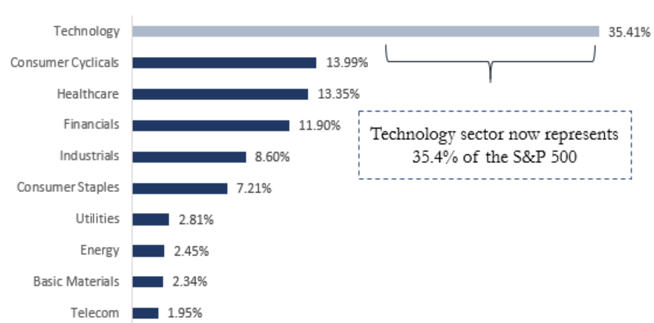
This has caused traditional valuation metrics such as price to earnings (P/E) ratios to be less relevant in today's environment, as depressed 2020 earnings cause this ratio to become temporarily inflated. Long-term investors have historically benefited from such earnings dislocations and periods of extreme market volatility. For those who have the discipline to obey Warren Buffet's mantra of "being greedy when others are fearful", record market volatility (such as that experienced in March) tends to present outstanding opportunities for investors to add to their equity allocation.

3. The Economic Recovery is Not Broad-Based

In our opinion, large blue-chip equity indices are a misleading gauge of true economic health. Looking at the Dow or even S&P 500 for example, the later is a stock market index that tracks the performance of the 500 largest companies in America. Two sectors, technology and healthcare, now represent about 49% of this index. Businesses in these sectors are less affected by COVID-19, and in many cases have even benefited from the pandemic. Technology in particular is playing an outsize role in the "new" economy, with more people working from home, shopping online and using web-based services to communicate with friends & family – all of which are growth drivers for companies that provide the necessary technology and services to do so. This has caused a large divergence between the performance of companies who serve the "new" economy, and those that are more exposed to the "traditional" economy. This disparity is highlighted by the ~58% relative outperformance of the U.S. Technology index against the U.S. Bank index from January 1st to July 20th. We feel that the significant outperformance of technology stocks, coupled with the tech sector's outsize representation in the S&P 500 index creates the illusion that all stocks have made a full recovery back to pre-COVID levels. However, the recovery rally in equities has been far from broad-based, despite the appearance otherwise.

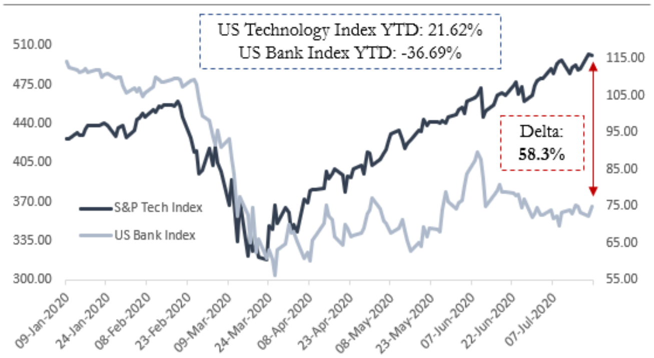
"Real" Economy vs. "New" Economy

Sector Composition of the S&P 500 Index
Data as at July 20, 2020



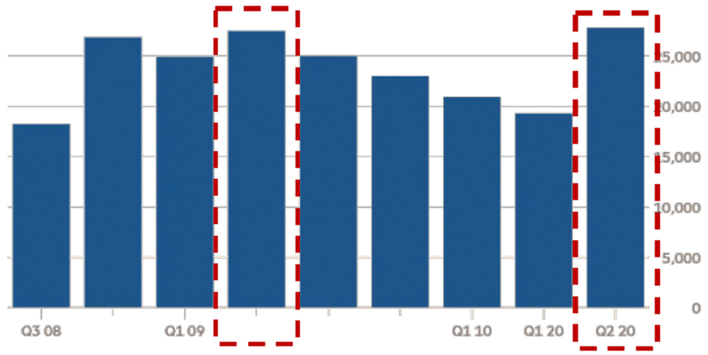
Source: Eikon

Relative Performance of Technology vs. Financials
Data as at July 20, 2020



In our opinion, sectors like financials may offer better insight into the underlying economic health of the "traditional" economy. Given the fact that growth in credit is inextricably linked to growth in GDP, earnings releases from large financial institutions are good indicators of the overall economic picture. In the second quarter alone, three of the largest U.S. banks set aside a record $28bn to cover bad loans, levels that exceeded those during the 2008-2009 Great Financial Crisis. Banks must report the total amount of credit losses they expect to incur in future periods; it would appear then that these institutions are forecasting a recovery that looks far from "v-shaped".

Loan loss charges across Citigroup, JPMorgan Chase and Wells Fargo ($m)



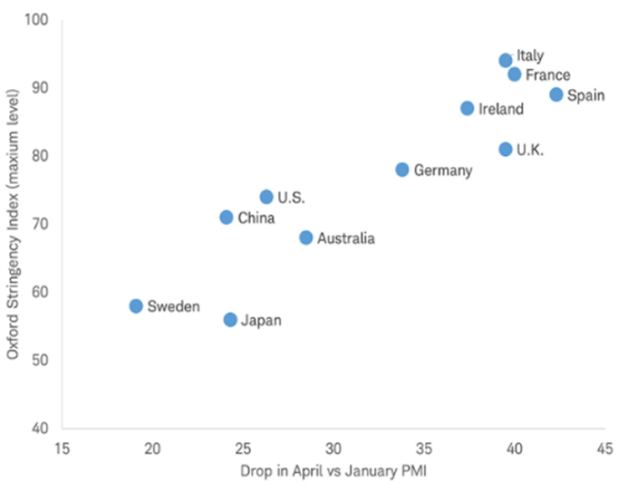
Source: Company reports, FT calculations

THE ECONOMIC IMPLICATIONS OF COVID-19

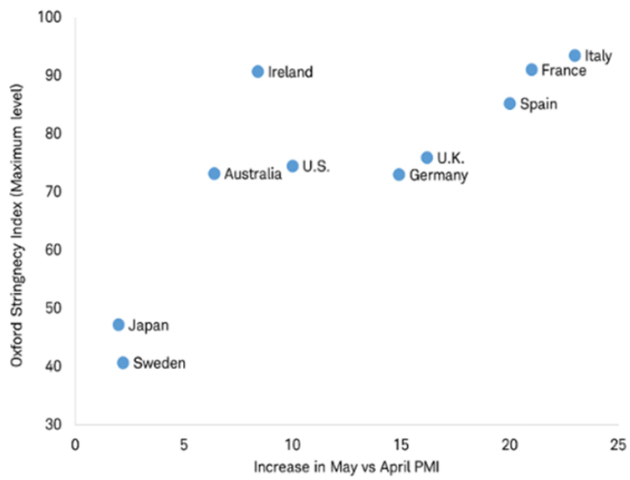
Governments were quick to lock down cities and implement social distancing policies in the early days the pandemic. As one would assume, the countries who imposed the strictest lockdown measures are the ones who suffered the greatest economic impact. Oxford University tracks the stringency of various government COVID-19 responses – a clear relationship exists between the level of government COVID response severity and economic deterioration.

Countries with Stricter Lockdown Measures Experienced Largest PMI Deterioration

Severity of economic lockdowns and downturns from January to April
Data as at July 6, 2020



Severity of economic lockdowns and rebounds from April to May
Data as at July 6, 2020

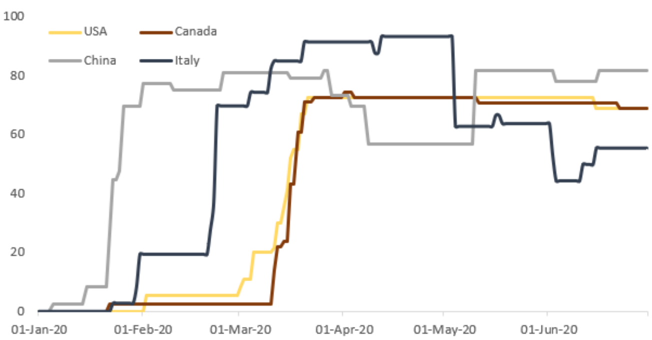


Source: Oxford University, Bloomberg, Charles Schwab

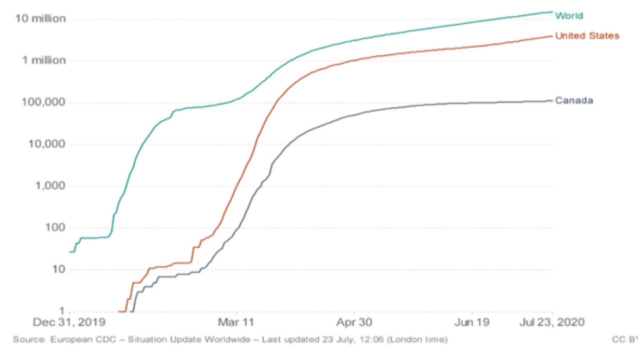
Policymakers have found themselves in a precarious position with respect to re-opening their economies. On one hand, the most obvious way to contain the spread of the virus is to force people to shelter in place; on the other hand, governments are seeking to limit the permanent economic damage that these types of drastic measures entail. The most severe government lockdown measures reached peak levels in April, and since then, cities have gradually re-opened despite the number of global COVID-19 cases rising.

Government Responses to COVID-19 Have Relaxed

Oxford Government Response Stringency Index
Data as at July 20, 2020



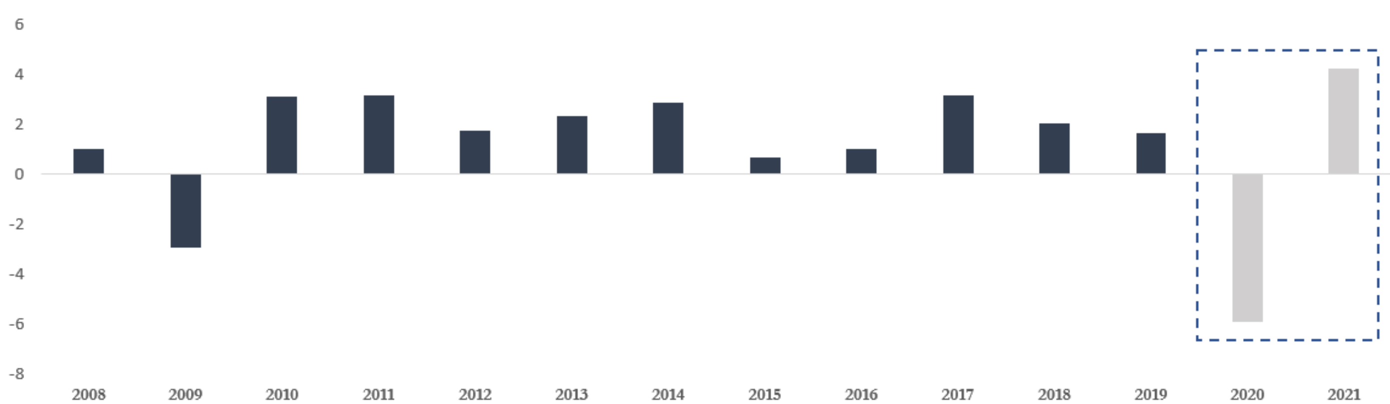
Number of Confirmed COVID-19 Cases
Data as at July 20, 2020



In Canada, the government has opted to re-open the economy in provincially regulated stages. For Ontarians, Stage 1 saw businesses re-opening that could efficiently modify operations to meet public health advice guidelines and workplace safety measures. Stage 2 allowed the government to take a regional approach as they opened more businesses and services across the province with city governments regulating this process. Stage 3, which began on July 17th for much of Ontario outside of Toronto, Peel region and Windsor saw nearly all businesses and public spaces re-opening, capping indoor gatherings at a maximum of 50 people and outdoor gatherings at 100.

Canada's labour market added a record-setting 952,900 jobs in June as lockdown restriction eased across the country, reversing some of the economic damage inflicted by pandemic induced closures. Consumer spending, business sentiment and home resales have all edged higher from the March/April lows. We continue to believe that the pace of economic recovery will largely depend on combatting the rate of infections, and as of now, we are cautiously optimistic about a 2021 GDP recovery.

GDP Forecast for 2020 & 2021



Source: RBC Economics

A cautious growth outlook for the remainder of 2020 is predicated on the assumption that there may still be economic trickle-down affects from lockdown measures, and that job cuts may not be completely over yet. Additionally, households may experience challenges in the coming quarters as consumer payments that were granted deferral (i.e. home mortgages, auto loans/leases, etc.), begin to resume or come due.

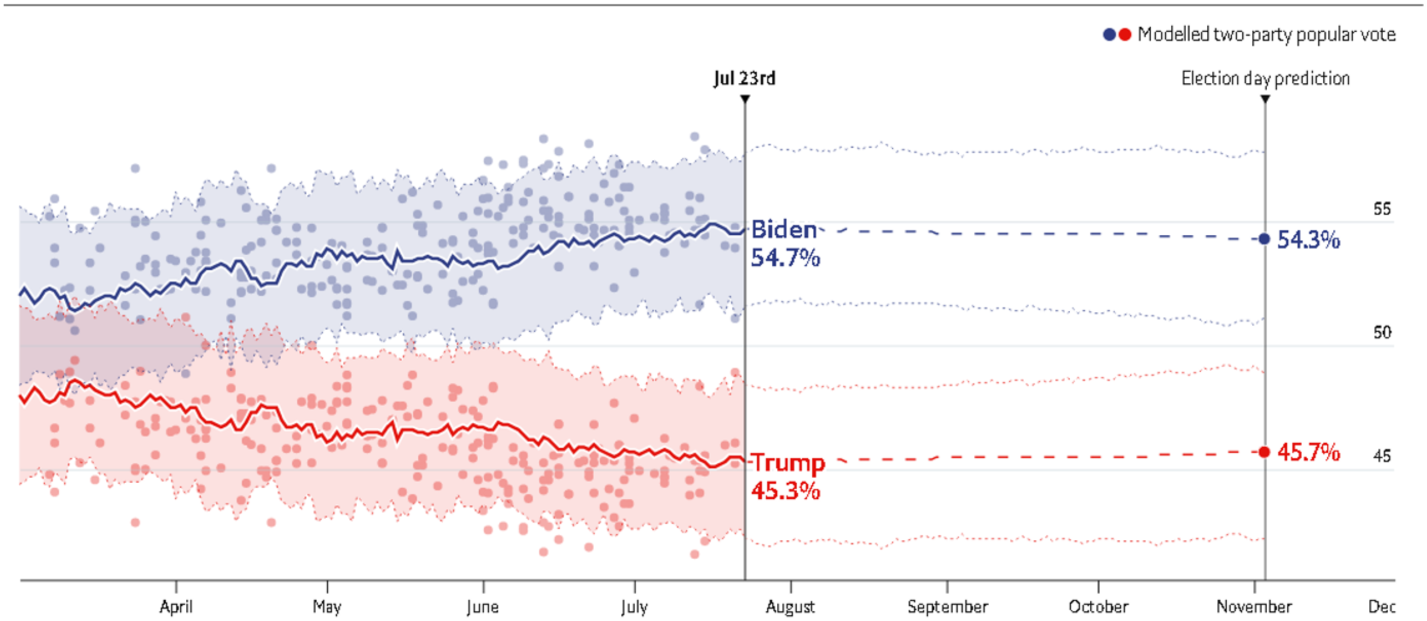
Weakness for the U.S. dollar following initial pandemic driven demand surge

The flight to quality and safety of the U.S. dollar and U.S. denominated assets that accompanied the initial phase of the pandemic we believe was the ninth inning stretch of a protracted bull market run for the U.S. dollar. Dollar weakness through late May and early June signaled that investors have begun to factor in its overvaluation as well as the country's fiscal and monetary excesses. Shorter-term considerations, such as lower U.S. interest rates and election uncertainty, may also be weighing on the currency. The euro may be most likely to benefit during this initial phase of the U.S.-dollar decline but the Canadian dollar is more likely to lag.

US FEDERAL ELECTION

With COVID-19 news dominating headlines, the upcoming U.S. Federal Election on November 4 may be less front of mind for many individuals, but its impact on future economic (and social) direction is certainly important. The latest polls suggest that former Vice Present and democratic nominee Joe Biden has built an early lead over incumbent President Donald Trump. As of late June and through July, election forecasting models have been predicting a marginal but increasing election-day victory for Biden, driven by growing frustration over President Trump's poor handing of the pandemic and the negative economic impact that the U.S. has suffered therefrom. With Biden formally being affirmed as the democratic nominee and selecting California senator Kamala Harris (a woman of black and south Asian decent) to the ticket as his vice presidential running mate, Democrats hope to appeal to voters seeking a more empathetic and culturally diverse executive branch to steer

U.S. Election Forecast Models Predict a Biden Victory



the United States back on course, economically and socially, and focus on unity as opposed to the divisiveness experienced under the Trump administration.

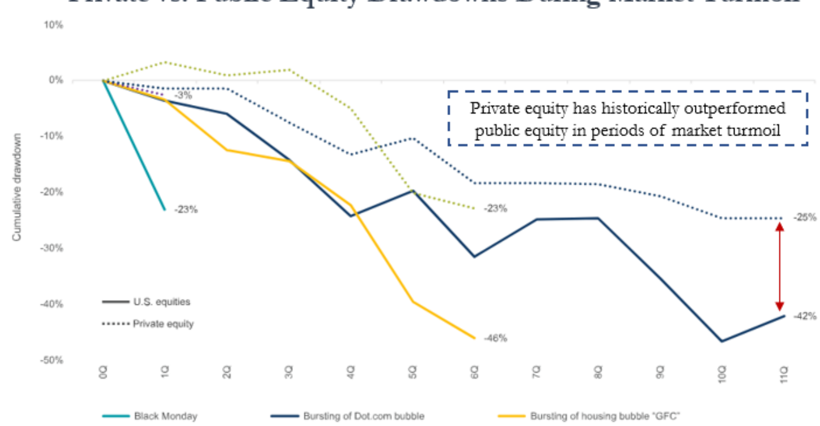
What does this mean for the equity markets?

We believe it is highly likely that equities will experience heightened levels of volatility through late November. Wall Street analysts who provide research to hedge funds, asset managers and other large institutional investors, say that clients are increasingly seeking their advice on the impact of a Biden presidency. Chief equity strategist Jonathan Golub of Credit Suisse says investor concerns are almost entirely related to the issue of corporate taxes. In June, Biden announced his plans to roll-back most of Trump's $2 trillion in tax cuts – the original tax cut was widely regarded as one of the main drivers of the market's impressive rally since Trump took office in 2016. Investors worry that such a roll-back in tax cuts will put pressure on corporate earnings growth, and in turn, reduce the amount of excess cash that companies can return to shareholders through dividends and share repurchases. Biden has floated the idea of raising the U.S. federal corporate tax rate from 21% to 28%, a move which Goldman Sachs estimates could reduce the earnings per share of S&P 500 companies by as much as 12%. Biden's proposal to increase the federal tax rate to 28% would take the combined average federal and state tax rate to about 33%, the highest amongst G-7 countries, including Canada. Wall Street widely regards a Trump second term as the most favorable outcome for equities, however a re-escalation in trade disputes with China would likely add to the market's volatility, and poor ongoing management of the COVID-19 pandemic could have even more dire and longer-term consequences for the U.S. economy.

THE CASE FOR PRIVATE INVESTMENTS

At Mandeville, we have always firmly believed that volatility is an unavoidable reality of investing in the public markets, and we have certainly seen this thesis hold true in recent months. If volatility remains elevated, what can investors do to reduce their overall portfolio risk? One answer is the inclusion of private investments.

Private vs. Public Equity Drawdowns During Market Turmoil



Volatile market conditions highlight the importance of strategic asset allocation: building an allocation that aligns with the goals, objectives and risk tolerances of the investor and maintaining that framework as market conditions evolve. Private investments can play a crucial role in that discipline, as they often have structural characteristics that provide important diversification and behavioral advantages over public equities. Analyzing performance data of U.S. private equity vs. U.S. public equity during periods of market turmoil, we note that private equity has historically experienced about half of the total drawdown compared to public equity markets. Aside from private equity, intuitional investors have been increasing allocations to private debt strategies in recent years. Private debt as an asset class encompasses corporate debt, real estate debt and infrastructure debt as well as various opportunistic credit strategies. With interest rates on government bonds near zero, certain private debt strategies can offer investors an attractive yield profile while also helping reduce overall portfolio volatility and risk.

PORTFOLIO ALLOCATION AND POSITIONING

Underscoring several trends that were already in place before the emergence of the COVID-19 pandemic, such as unsustainable high equity valuations and a global economy mired in an ongoing period of lacklustre economic growth, low interest rates and highly accommodative monetary policy, the current environment supporting price expansion among financial assets appears limited. Assuming other variables remain relatively constant, a sustained low real interest rate environment will create the conditions for financial assets to trend below long-term average rates of return. Despite these financial headwinds, equities should still expect to provide opportunity for outperformance relative to fixed income investments and cash assets. As a result, our tactical overweight to equities recommended over the past several quarters remains, however, the degree of conviction and degree of overweighting is narrower now than previously, reflecting more modest return assumptions and below normal economic growth expectations. Focusing on higher quality, larger capitalization companies whose business models are more specifically focused on new economy sectors and sales methods will likely provide greater opportunity for outperformance and portfolio risk mitigation than the market at large.

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