**The Path Forward**
**Post COVID-19**

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Over the last century, humanity has made **immeasurable progress** in almost all facets of life. This is particularly true for developed countries where longevity has increased, infant mortality rates have declined, and the standard of living has improved significantly. Our hospitals have the best equipment, and our surgeons routinely perform complex surgeries that would have been impossible a century ago. We live in a world with smartphones, smart cars, and consistently rely on cutting-edge technology. Still, surprisingly, we were ill-prepared for a pandemic despite repeated warnings about the pending threat.

To make matters worse, we made the mistake of offshoring the manufacturing of personal protective equipment (PPE) in a futile attempt to economize. We maintained a critically low inventory, thereby unintentionally jeopardizing the lives of healthcare professionals and other front-line workers.

Our lack of preparedness has resulted in countries worldwide **closing their economies** to prevent the spread of COVID-19, costing the global economy billions in lost output. At this stage, a recession (possibly global) is inevitable, and further deterioration is possible if government interventions fail to cushion the expected rise in bankruptcies and unemployment. We expect significant economic challenges throughout 2020.

**How can we be so short-sighted?**

Despite our ability to be progressive in most facets of life, we are occasionally burdened by poor choices because we fail to accurately assess the situation and place too much emphasis on the immediate cost or benefit to the detriment of what is best for the long-term. Climate change is another example of our inability to address a lingering problem adequately.

We see parallels to this **penny wise, pound foolish** approach to managing investment programs. Organizations will occasionally seek to hire low-cost service providers such as investment consultants and portfolio managers, sometimes **saving thousands of dollars, only to lose millions to underperformance**. It is no secret that investment management is a business where the price that appears on the invoice fails to reflect the service's actual cost.

## Lessons Learned

The world is going through a difficult period with COVID-19. We believe that this is a **wake-up call**, and everyone is being put on notice that the **environment is fragile**. People are beginning to realize that our collective wellbeing is inextricably linked. What someone does on one side of the planet has an impact on everyone.

Before the market correction this past March, there was a consensus in the investment community that with frothy valuations, it was just a matter of time before an external factor would burst the bubble and precipitate a **market correction.** This is a familiar scenario that has occurred on numerous occasions in the past. We are saddened, however, that in this case, COVID-19 will result in a significant number of deaths before it runs its course. The **human toll** is far more unsettling than the market correction. The markets always recover, but the same can not be said about the fatalities resulting from the virus.

Over the years, we have had the privilege of managing through a variety of **significant market corrections**, including the market crash of 1987, the dotcom crash 2000-2002, the global credit crisis of 2008, and now the 2020 correction attributable primarily to COVID-19. Through these difficult periods, we learned that, no matter how bleak the circumstances, **the markets always recover**.

What differs from one period to another, however, is the amount of time that it takes to recover. And the level to which the portfolio must climb to restore what was lost. For example, the 20.9% decline recorded by the S&P/TSX in the first quarter will require that the market increase by 26.4% to just break-even. The math of percentages shows that as losses get larger, the return necessary to recover to break-even increases at a much faster rate. This asymmetric relationship between losses and gains is why downside protection is beneficial (more on downside below).

## <u>The Importance of Good Governance</u>

Our experience suggests that **governance** is the foundation for building a successful investment program. But what is governance?

**"governance is the process of making and implementing decisions. Ultimately, it is about accountability, transparency, and allocating resources to meet policy objectives."**

The knowledge we have gained over time confirms the overriding need for a **robust investment process** designed to meet policy objectives. The recent market correction is an excellent time to review your governance framework and strengthen the areas that require attention.

Our clients are taking this opportunity to **review their investment policies** and **assess their investment managers**. We are encouraging them to take a pragmatic approach recognizing that challenging market conditions are an excellent opportunity to evaluate a manager's ability to provide **downside protection**. Downside protection is essential because it insulates a portfolio from market shocks and can add significant value to performance. Not all market corrections are alike, and market dislocations require careful analysis.

The major credit rating agencies have already **issued warnings** through negative rating outlook changes and rating downgrades in several sectors. As the recession worsens, we expect that there will be additional **rating downgrades** that may impact the eligibility of certain investments based on investment policy guidelines.

We have no way of knowing how long the current downturn will last, but if history is a guide, we should expect favorable performance over the next few years after the markets stabilize. Investors will require patience, and it will take time, but it is comforting to know that rising markets have followed past corrections.

"The most difficult thing is the decision to act, the rest is merely tenacity." – *Amelia Earhart*