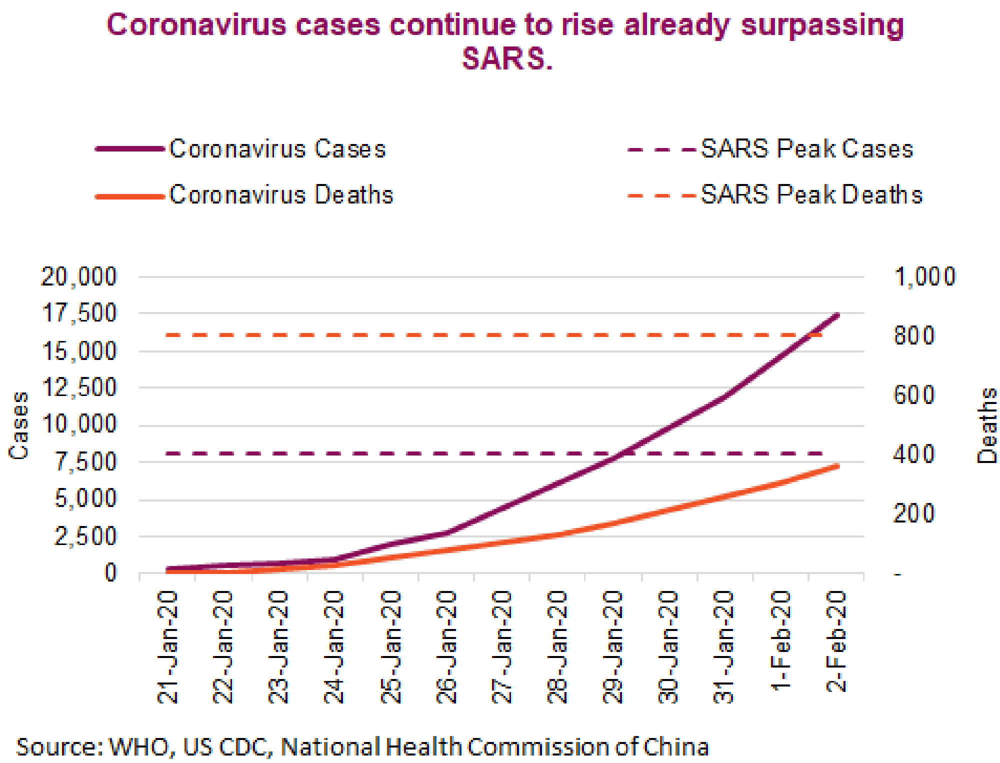
February 2020

We Haven't Been This CONFIDENT Since the Turn of the Century!

There was not a lot to cheer about to finish off the month! The Coronavirus is front and center and is almost eclipsing the SARS epidemic. The graph below compares the two outbreaks as it currently stands.



Source: Connected Wealth

Much of the chatter has suggested that these types of events typically do not have profound effects on capital markets. However, we have found ourselves in interesting times both fundamentally and technically as the market goes. Currently, complacency is at almost an all-time high and consumer confidence running in the same category. The chart below shows long-term consumer confidence over the past 50 years. The last time we were at this type of level was coming into the end of the century. Arguably a bit more to celebrate!?

Source: Thomson One

How the market (S&P 500) reacts to consumer confidence adds a bit of perspective to the graph above. More recently, the market has extended itself well beyond the level of confidence. If we went deep into mathematics, it would be obvious that the correlation to markets and confidence would track pretty close:

Source: Thomson One

One could easily surmise that if confidence begins to fail that the market might too. The big question is, does the Coronavirus have the legs to undermine global confidence? If this was pop culture, we would simply ask Zoltar the fortune teller for a ticket and the answer would become obvious.

How easily we digress!

Easier Mortgages

In January, the Bank of Canada left its key interest rate unchanged at 1.75% and marked down its estimates for near-term growth, opening the door for a future rate cut if the domestic outlook worsens. Meaning lower mortgage rates!

In a statement that accompanied the rate decision, the central bank said growth will be slower than previously anticipated after exports, business investment and job creation all weakened toward the end of 2019. While residential investment has continued at a solid pace, the central bank said, consumer confidence and spending have been unexpectedly soft. Confidence is strong in the US but soft in Canada.

Canada's central bank has kept interest rates on hold since October 2018, bucking a trend that saw many of its developed country peers introduce easier monetary policy last year. Bank of Canada Governor Stephen Poloz previously said the economy was demonstrating enough resilience for policymakers to keep interest rates steady, despite a weaker global backdrop.

This could be the backdrop for central banks around the world if things start to slow. In a very simple analogy, it's like giving your kids more money at the amusement park so they can keep having fun. In a rational world, at some point, the parents just run out of money. In our central bank world, we just keep the printing press running and keep confidence high.

Maybe all these components have a high correlation…

Final Thought

In some of the reading over the past month, it became apparent from game theory insights that a good process does not always produce the desired outcome. The reason for undesirable outcomes in the presence of a strong process tends to relate to random variables. The Coronavirus could be considered a random variable. Some may argue that these types of events are ever-present, which is true, but the timing of these types of events is considerably more random. Our process has evolved nicely, and we find ourselves less correlated to random variables as we go forward.

John Wiman **Portfolio Manager** **Investment Advisor** **T: 416-869-7125** John.Wiman@nbc.ca	**Jason Wong** **Portfolio Manager** **Investment Advisor** **T: 416-869-7142** Jason.Wong@nbc.ca	**Darlene Lanigan** **Investment Associate** **T: 416-869-7445** Darlene.Lanigan@nbc.ca

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