Quarterly Report
SUMMER 2020

HEWARD
INVESTMENT MANAGEMENT INC.

COVID-19: Managing for Global Stimulus, Re-openings & Geopolitics

OVERVIEW

COVID 19 has exposed the frailty of both the global financial system and its geopolitical structure. It has created a world where GDP will decline, one in which one-third of its population was in one form of lockdown or another, and in which geopolitical tensions have risen. Credit or debt has displaced savings, money was printed out of thin air and markets no longer determine the level of interest rates: that has become a function of central banks. Central banks and governments have been/are prepared to do whatever is necessary to stabilize and allow growth to resume, even if the measures just kick the can down the road.

The COVID crisis has had a dramatic effect on the fiscal outlook of both developed (DM) and emerging (EM) economies. In addition to causing a collapse in output and a cyclical widening of budget balances, government across the world have introduced extraordinary measures to support incomes and limit lasting damage from the pandemic. Although the crisis is a call to all, most DM are in a stronger position than EM to absorb its fiscal implications.

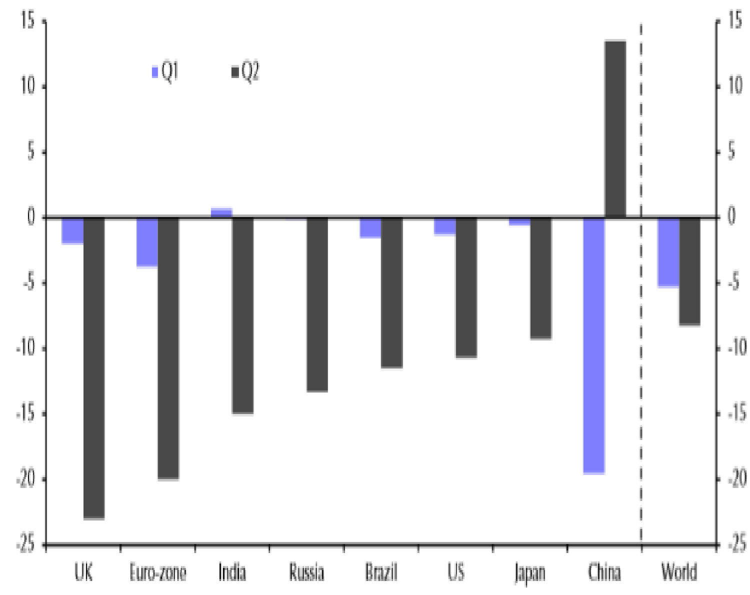
It is no means inevitable that the coronavirus crisis puts a big permanent hole in the supply capacity of economies. With the right government policies, many economies should be able to revert to the path of output they were on before the crisis. Nonetheless, with demand likely to recover slowly, this will take time and there could be several exceptions to this generally optimistic picture. Having caused a sharp decline in supply capacity of economies, largely because lockdowns forced work places to close, there are three potential ways in which the coronavirus could cause permanent damage. These are: destruction of capital stock, a reduction in human capital and an adverse impact on efficiencies in which economies operate.

The most significant legacy of COVID-19 may be a reshaping of the world order in sourcing, manufacturing, trade, tariffs, sanctions and technology, driven by geopolitics. Like other trends, the pandemic is likely to accelerate companies' shift from thinking globally to thinking locally. This will create a range of implications for investors in the coming years, even if supply chain changes aren't as dramatic or as swift as some expect. It will however, be more likely to drive a much faster than expected shift in manufacturing away from China, especially as the trade war between the U.S. and China is kept on track by hardliners on both sides trading jabs. Producing in other countries unfortunately has proven to be less efficient, with Bank of America strategists citing an estimate that it can take twice as long for goods to hit the shelves in the U.S. from Thailand as China. Plus, U.S. companies are unlikely to rip out supply chains from China completely, in large part because they are producing for China's large market as well.

Speaking to Bloomberg news, the International Energy Agency (IEA) said that eventually oil consumption would return to pre-crisis levels, and even surpass previous demand peaks.

The assessment of oil demand trends for after COVID-19 pandemic and recession should sound reassuring to oil producing nations that depend on oil revenues for their budgets. The IEA believes that a new trend will develop which will see more people shun public transit in favor of using their own vehicles. Some producers have recently expressed concern as to whether or not oil demand would ever return to peak levels seen in 2019. Scepticism like this is a common fault amongst commodity experts and producers, usually seen at the bottom of a demand cycle.

GDP (%Q/Q, SEASONALLY ADJUSTED)



Source: Refinitiv, CIBC, Capital Economics

UNITED STATES

Fed Chair Powell and his colleagues on the policy setting Federal Open Market Committee have taken dramatic measures to shelter the economy from the coronavirus pandemic. They have cut their benchmark interest rate to nearly zero, but while other central banks have taken their rates into negative territory, Powell admitted that such a move was not being considered at this time. While the economic response has been both timely and appropriately large, it quite likely is not the final chapter. Furthermore, Mr. Powell in his testimony to the House Financial Services Committee, said that Congress ending its authorization of ambitious stimulus programs too soon could jeopardize economic improvements made thus far. While a broad range of companies had been getting support from the Fed as it had started to purchase exchange traded funds that own corporate bonds, in June the Fed followed up with a program to purchase $250 billion of investment grade bonds directly from companies and banks that own them. The efforts and measures put in place now seem to be baring fruit as growth rates are clearly picking up. With the re-openings, previously housebound Americans are out in force doing what they do best – spend! Industrial production is improving, capacity utilization is up and there has been a solid bounce in housing. Also, the Credit Managers Index (credit professionals) rebounded sharply in May, signaling that credit managers are seeing brighter days ahead for the manufacturing and services sectors. The bottom line is that the U.S. is improving but does not appear to be a standout. This fits with recent US$ weakness.

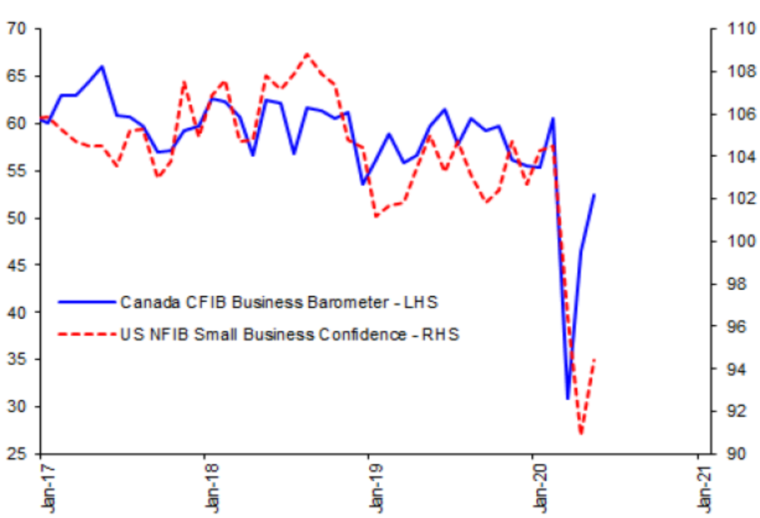
CANADA

The worst may be over for the Canadian economy, but the nation's more cautious approach to reopening could mean a slower rebound than in the U.S. Real time data such as online job postings, restaurant bookings and mobility tracking show economic green shoots are evident after more than three months of COVID 19 restrictions. However, the data also suggests the economy is about two-four weeks behind its largest trading partner. Meanwhile, the Bank of Canada (BOC) has been buying provincial debt, helping to keep borrowing costs low. New BOC governor Tiff Macklem also said that they have no intentions of raising interest rates, instead focusing on keeping them low to support the recovery. That will help to lower the cost to service debt that households and businesses have taken out to bridge to better times. With the government extending emergency programs to help buffer the impact of the virus, Canada's net debt as a portion of its economy has reached a twenty year high. This has caught the eyes of rating agencies, with one (Fitch Ratings) downgrading our rating from AAA to AA+. Triggered by Saudi Arabia's supply increase and the exacerbated by the pandemic that sapped global demand for crude, declining oil prices will have a negative effect on the Canadian economy as it is inextricably linked to the energy sector. While the U.S. and Canada often feel oil price shocks in succession, Canada bears the brunt as its economy is more reliant on the health of its oil industry. This is especially true in Alberta, where major oil sands producers have ramped down oil sands production wells and mines in the face collapsing demand and growing inventories.

EUROPE

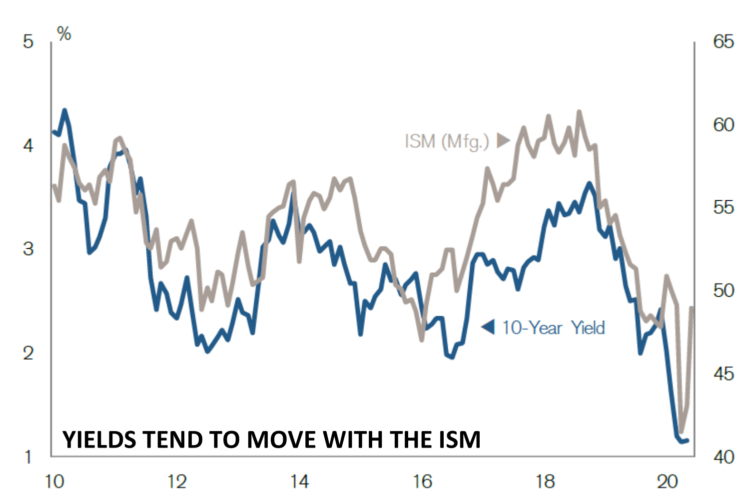
The European Central Bank (ECB) has massively stepped up its government bond purchases under various programs. This should sustain the positive sentiment towards the euro zone and reinforcing the sense that, for now, European policymakers have got their act together. Also, June data showed huge demand for the ECB's targeted lending to commercial banks. These operations and government loan guarantees have been successful in raising bank lending to the private sector, and there is scope for the ECB to make its funding for banks even more generous. Meanwhile, the historic downturn in the euro zone economy continues to ease as vast swathes of businesses reopen. By the end of

US VERSES CANADA BUSINESS CONFIDENCE



Source: Scotiabank GBM Portfolio Strategy, Bloomberg

US INSTITUTE OF SUPPLY MANAGEMENT (ISM) MANUFACTURING PMI VERSUS TEN-YEAR TREASURY YIELDS



Source: Credit-Suisse

June, the first official reports for May confirmed the message from high frequency data and surveys that economic activity is recovering fairly strongly. The latest business surveys suggest that it continued to do so into June. But, disruptions to supply chains and depressed demand mean that euro zone goods exports will slump this year. Also, the U.S. announced a list of 30 products that could be subject to new tariffs as part of the U.S./European dispute over aircraft subsidies. In mid-June, the EC President and UK Prime Minister injected fresh momentum into stalled Brexit talks. While the next stage of negotiations will not be easy sailing, odds are that they will strike a "thin" free trade agreement by the end of the transition period. Britain's private sector shrank less than expected last month as more businesses restarted work putting the economy on a course to return to growth. As in the euro zone, the PMI's showed healthy improvements, easily beating expectations.

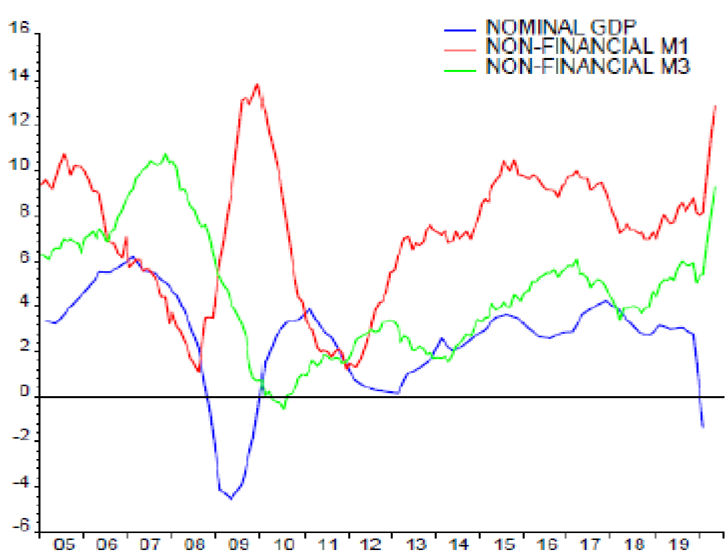
EMERGING & DEVELOPING MARKETS

Recent data for China is indicating that the economy looks to be well on its way to recovering as COVID-19 is largely under control. While manufacturing and investment appear to be bouncing back, a return to normal may not happen until next year as it has been difficult to entice the consumer to spend. To further a pickup in the recovery rate, it is going to be important that global demand revives so exports see some recovery and confidence in the recovery spreads to the retail sector. Two recently released reports profiling the continued economic reforms and development for the Western regions indicate that stronger growth for China lies ahead. One sets out how the government intends to deepen reforms, open up the economy further by accelerating the development of the pilot free trade zones and free trade ports, by more focus on the construction of The Belt & Road system and lifting most restrictions on foreign investment. Whilst these have been platitudes in the past, given the current political and economic strains, there is likely to be more teeth to them now. Japan pursued a less strict approach to contain the virus within its borders, but the domestic economy still suffered. Green shoots however, are now appearing as the state of emergency has been lifted and the services PMI has rebounded nicely. However, the latest Reuters Tankan print remained unclear as to a bottom for manufacturing, leaving concerns about a divided recovery in the third quarter.

COMMODITIES

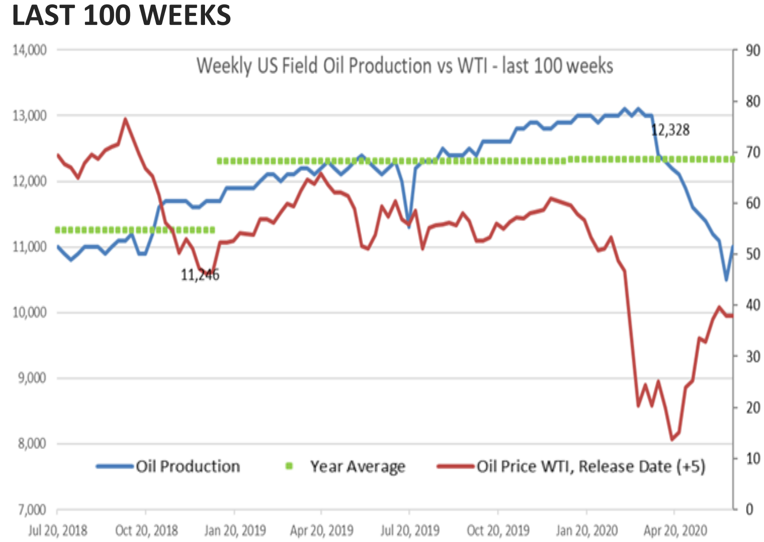
Since the oil market's inflection in mid-April it may seem ironic that commodities, spot assets devoid of expectations, have mirrored the strength of the rally in financial markets, which are anticipatory assets entirely driven by expectations. The oil market only moved into deficit late May and still faces the daunting task of normalizing excess inventories. Yet, the oil relief rally remains unfazed, with prices doubling and exceeding our year-end target just weeks after the likely cycle lows. Fueled by a macro risk-on backdrop and a policy induced Chinese import binge, demand expectations are running ahead of a more gradual and still highly uncertain recovery. For the metals this rally should not be as surprising, given tight metal markets. Their rally has been driven by several factors. Chinese metals demand from construction and infrastructure projects has exceeded even the most optimistic projections. COVID-19 related supply disruptions and a lack of scrap availability, have left metal markets with little inventory. Also driving the commodity complex has been the normalization in dollar demand as COVID-19 related fears subside with the lifting of lockdowns in major developed markets. However, the rally across most commodities seems to have gotten ahead of the fundamentals. With oil surpassing $40 WTI, production that had been cut by market conditions in North America may be incentivized to return. Like oil, the agricultural complex may be set up for a sharp reminder that they are a physical asset. Notably, corn and sugar are set for historically large levels of production even as COVID-19 related disruptions have dampened the demand outlook.

EUROLAND NOMINAL GDP & MONEY (% YOY)



Source: Thomson Reuters Datastream, Simon Ward, Money Moves Markets

WEEKLY US FIELD OIL PRODUCTION VERSUS WTI LAST 100 WEEKS



Source: Bloomberg

RECOMMENDATIONS

The most important part of investing is keeping one's eye on the ball. True investors, not short- term traders, must not let short term bumps in the road, even huge ones, knock them off course. Recent doses of heavy selling days and those that may be coming, also should not be enough to shake a true investor's resolve, as global economic activity has clearly bottomed out. While there are many variations on how the recovery will play out, to us it looks like a small "V" then developing into a "square root" shaped comeback. In spite of infections having picked up pace in parts of the U.S. and rising in several EM economies, output and activity have begun to recover in all major economies. Monetary indicators have shown the positive effects of generous central bank and government support, and labor market consequences have been limited by extensive government programs. The recovery however, will be gradual, in spite of what the market recovery may be signaling, and stock/ sector selection will be key. Having returned our portfolios to a more neutral stance, we have concentrated on Technology, Healthcare and stocks that will benefit from the work/shop at home "new world" that has and will continue to develop. Our focus has been on quality (multi-national outside of Canada) companies that have both rising earnings and a clearer predictability of those earnings. Furthermore, all of our recent purchases carry good dividends as well as the ability to grow those dividends. If the recovery unfolds as we project, and using market pull-backs, we anticipate adding to equities, all the while watching polls and trends that will be developing leading up to the U.S. elections. After massive cuts in rates by the Federal Reserve and the BOC, bond yields have collapsed to new historic lows (long Canadas under 1%). While this has resulted in substantial gains (especially long bonds) the overall fixed income returns were limited as widening credit spreads, because of economic uncertainty caused by the virus, held back the performance of corporate bonds. Given the current low yield environment, it is hard to imagine bonds providing similar returns as we have seen over the past few years. While we expect central banks to keep their rates low, we do not see negative rates coming as they have done in Europe and Japan. As such, we will continue to underweight duration in our fixed income portfolios and aim to add value by investing in higher yield solid corporate bonds, convertible debentures and preferred shares. Although potentially more volatile, in the long run this strategy is expected to benefit fixed income returns.

FORECAST 2020	**CURRENT 30-JUNE-2020**	**2020 RANGE**	**2020 YEAR-END**
INTEREST RATES			
Bank of Canada Overnight	0.25%	0.25%- 1.75%	0.25%
Federal Funds Rate	0.80%	0.25%- 2.00%	0.25%
10-year Canadian Treasury	0.53%	0.25%- 2.10%	0.75%
10-year US Treasury	0.66%	0.35%- 2.25%	0.85%
COMMODITIES			
Gold (US$/oz.)	$1,770	$1,400- $1,850	$1,835
Copper (US$/lb)	$2.47	$2.09- $3.15	$2.85
Oil WTI (US$/bbl)	$39.77	$21.00- $62.00	$43.00
MARKETS			
S&P/TSX Composite Index	15,515	11,228- 17,940	16,600
S&P 500 Index	3,120	2,237– 3,380	3,250
CANADA DOLLAR/US DOLLAR	$0.736	$0.69- $0.77	$0.75

2115 rue de la Montagne, Montreal, QC H3G 1Z8
Telephone: (514) 985-5757
Toll Free: 1-800-567-5257
Email: info@heward.com
www.heward.com

HEWARD
INVESTMENT MANAGEMENT INC.