Caldwell Securities Ltd.

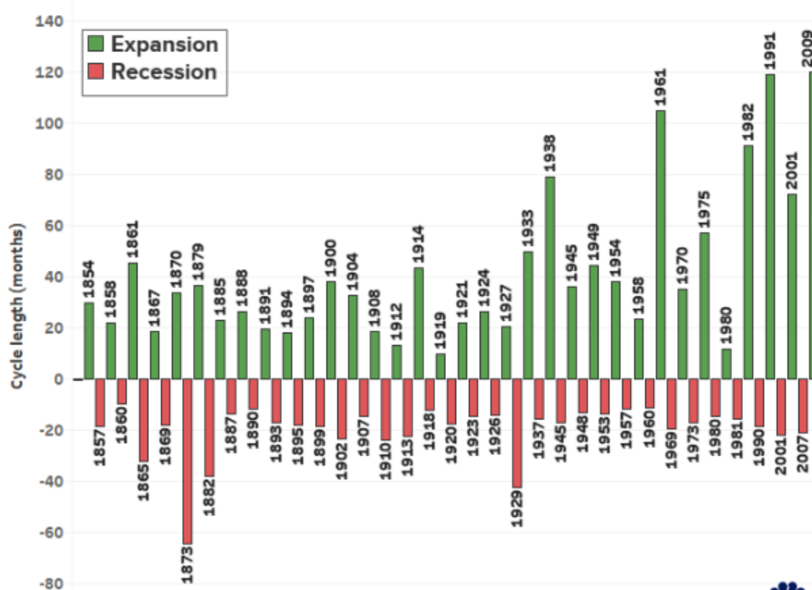
Independent Investment Advisors

Markets during coronavirus vs. historical corrections

Summary outline — March 24, 2020

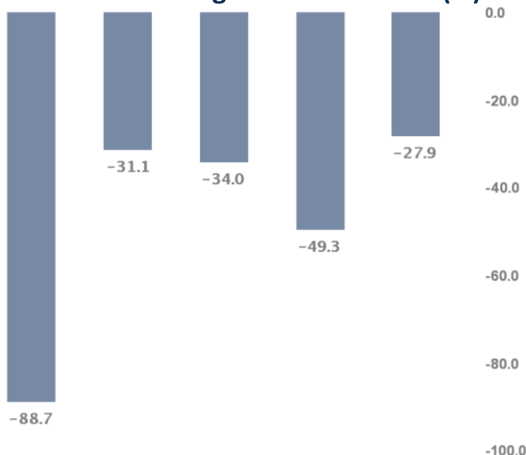
- The S&P 500 Index has fallen 33.9% between February 19 and March 23, 2020 as a result of the COVID-19 pandemic and current crude oil market.
- The current market selloff is on par with past downturns, notably that of the 2000's Dot-Com bubble (-34%) & Black Monday of 1987 (-31%).
- The most recent economic expansion has been the longest in history with 127 months (10.5 years) without contraction.
- Market corrections tend to be short-lived compared to the recovery period afterwards. Following the 2008 Financial Crisis the market took about 5.5 years to regain its previous highs while the Dot-Com bubble took 4.5 years.
- During a correction, all sectors tend to fall together, regardless of the earnings strength of the respective underlying industries.
- S&P 500 grew 23.67% through the 12-months preceding the January 23, 2020 COVID-19 lockdown in Wuhan, compared to 33% the year leading up-to the 2007 crisis.

The U.S. economy experienced a total of 11 business cycles between 1945 and 2009, with the average length of a cycle lasting a little less than 6 years. The average expansion during this period lasted nearly 5 years, while the average contraction lasted under one year[1]. When economies start improving, they tend to keep getting better for a while.



Source: CNBC; [1] Fidelity Investment Research

Peak-to-Trough Market Decline (%)



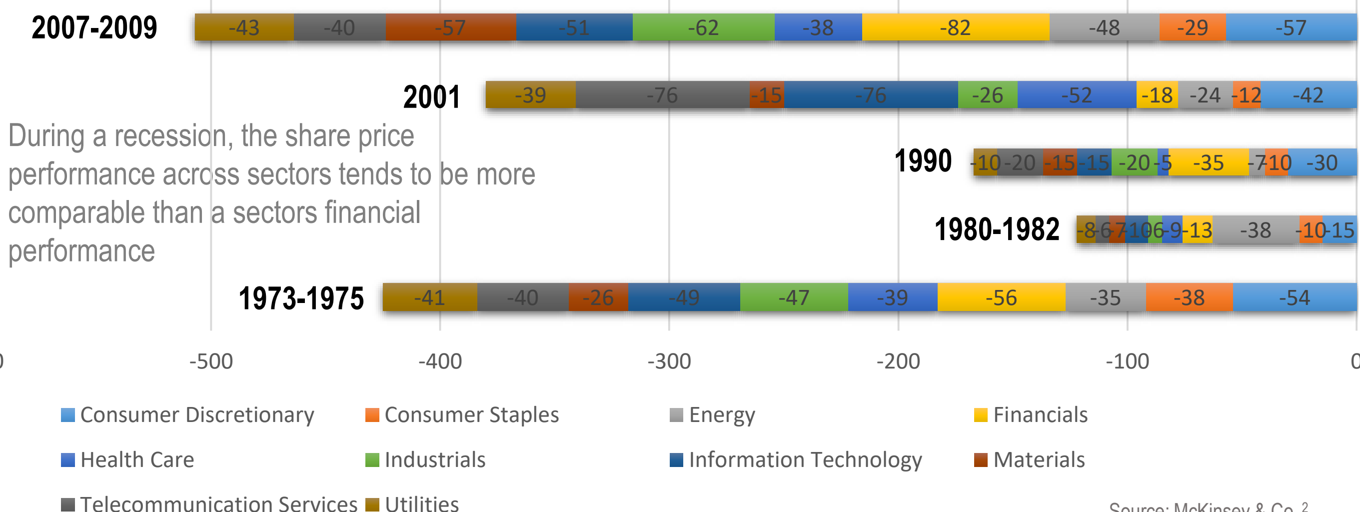
Source: Forbes; Trefis Team, March 16, 2020

*March 16, 2020 figures

Past Pre-Crisis Market Peak & Market Trough

Crisis	Pre-Crisis Peak	Crisis Trough	Time between Peak & Trough
Great Depression	August 1929	June 1932	34 Months
Black Monday	August 1987	November 1987	3 Months
Dot-Com Bubble	December 1999	September 2002	33 Months
Financial Crisis	October 2007	February 2009	16 Months
Coronavirus	*February 2020*	*Ongoing*	*N/A*

S&P 500 Performance by Sector (%)



Sector performance over the past 5 recessions was highly dependent on a *core underlying shock* that initiated the contractionary period (e.g. sub-prime mortgage defaults in the 2008 financial crisis, the 2000 tech wreck). Often, the consumer discretionary sector is the first sector hit, but there is no consistent pattern among the others. COVID-19 could be the shock that tips the global economy into the next recession, however the current volatility in crude oil prices as a result of the failed OPEC deal between Saudi Arabia and Russia has added additional pressures to the energy sector. When economies contract, earnings take an average of 18 months to two years to reach their true bottom[2]. Stock markets, in anticipation of a recovery, can turn around faster, but not all sectors recover equally.

1990 recession	SPX	Consumer Discretionary	Consumer Staples	Energy	Financials	Healthcare	Industrials	Tech	Materials	Telecomm.	Utilities	Real Estate
Peak to trough	94	94	45	45	112	45	94	99	99	45	46	**
Trough back to peak	123	99	111	111	148	103	231	120	118	502	54	**

***Data not available*

Tech Wreck: 2001	SPX	COND	CONS	ERGY	FINL	HLTH	INDU	INFT	MATR	TELS	UTIL	RLST
Peak to trough	772	927	924	882	772	694	925	772	772	763	772	**
Trough back to peak	1701	N/A	78	554	1128	1732	1436	N/A	289	N/A	1883	**

** N/A = sector did not fully recover to previous peak*

***Data not available*

GFC: 2007-2009	SPX	COND	CONS	ERGY	FINL	HLTH	INDU	INFT	MATR	TELS	UTIL	RLST
Peak to trough	518	385	518	514	515	514	518	518	511	518	518	515
Trough back to peak	1995	917	710	N/A	N/A	1295	1915	1288	3213	N/A	2110	N/A

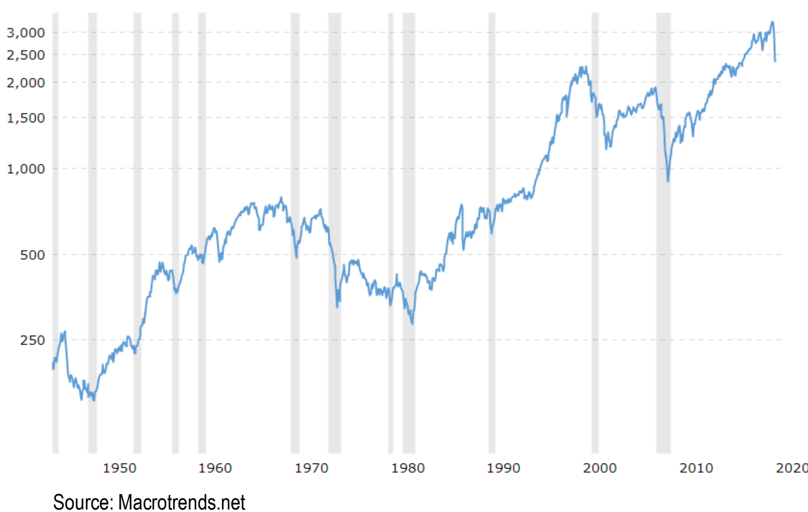
** N/A = sector did not fully recover to previous peak*

The table above captures this variability over the past 3 recessions. It shows the number of days from peak-to-trough for the S&P 500 on a sector-by-sector basis, as well as the recovery time from trough-to-previous-peak levels, representing the break even point in time for lost gains. The 1990 recession was relatively short-lived, with nearly all sectors recovering within a year. The last two recessions—the 2000's tech-bubble burst and the 2008 mortgage crisis—were much more severe. Given the relatively higher levels of the S&P 500 index versus 1990 levels, it took much longer for a complete recovery to occur. This is something to keep in mind as the Price-to-Earnings (P/E) ratio of the S&P 500 was approximately 45% above its long-term average before the COVID-19 selloff (see next page). Of note, Energy, Financials, Telecommunications and Real Estate never fully recovered from their 2007 highs. Excluding Consumer Discretionary and Consumer Staples, most other sectors took over 3 years to reach their previous 2007 peaks.

[2] McKinsey & Co. Jiang, B., Koller, T. M., & Williams, Z. D. (2009, November 30). Mapping decline and recovery across sectors . Retrieved March 18, 2020, from https://www.mckinsey.com/~/media/McKinsey/Business Functions/Strategy and Corporate Finance/Our Insights/Mapping decline and recovery across sectors/Mapping decline and recovery across sectors.ashx

S&P 500 Price / Last twelve months earnings per share

The S&P 500 Index Performance

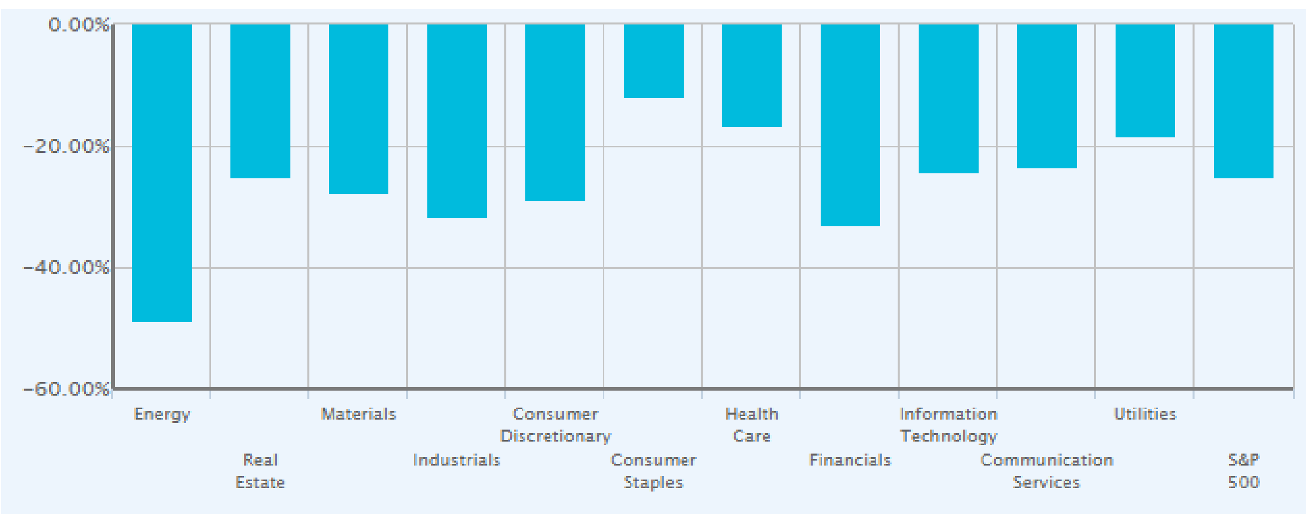


Source: Macrotrends.net

The above chart shows that when the stock market corrects, P/E multiples rise, even as share prices are falling, because earnings are falling even faster. The fastest sectors to recover tend to be those that are able to show a recovery in earnings. Good 2020 question: What sectors can find their earnings most quickly? It is very early, but the Consumer sectors, Healthcare, Technology and Financials would seem the best bets. Energy and Transportation may take much longer.

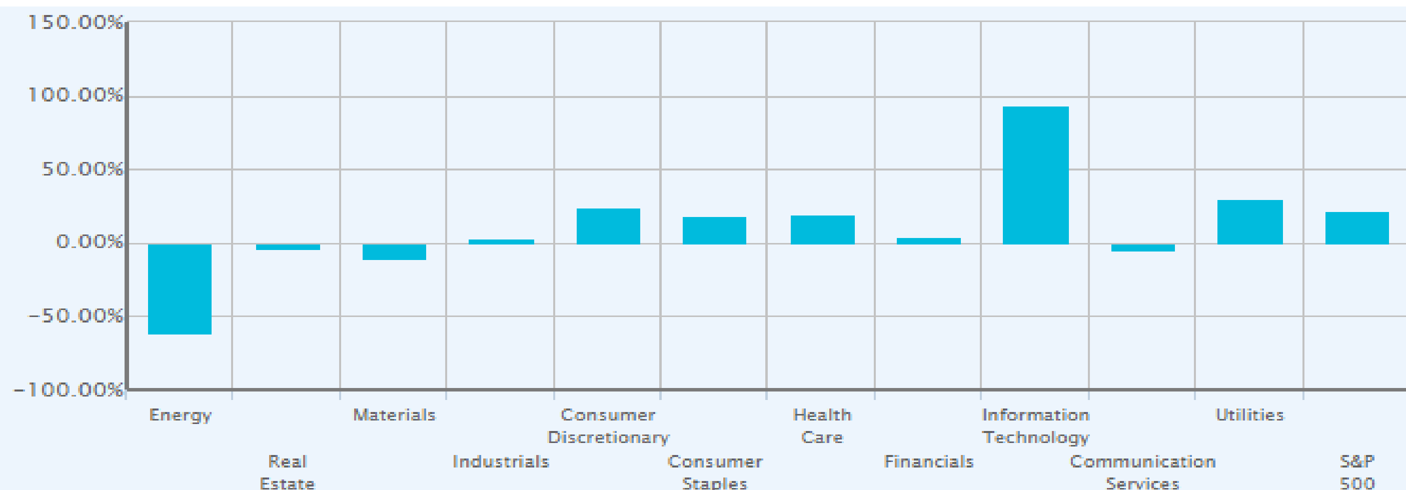
In most instances, recessions have a snowball effect as a result of negative investor confidence, volatility, slowdown in manufacturing, and fear of the unknown all adversely impacting market performance. While the stock market can "anticipate" the end of an economic contraction, investor confidence takes time to lift markets to their previous highs.

Past 30-Day S&P 500 Index Performance by Sector



Source: S&P Capital IQ; March 18, 2020

Past 5-Year S&P 500 Index Performance by Sector



Source: S&P Capital IQ; March 18, 2020

It is important to note that no two recessions have been the same, particularly in their sector-specific performance. However, the magnitude of a recession or contraction in the market can be somewhat mitigated by government and corporate fiscal stimulus. In the case of the 2008 mortgage crisis, there was a US$700 billion 'Emergency Economic Stabilization Act' passed by the U.S. government that provided a lifeline to financial institutions and auto-manufacturers alike. The total economic bailout of 2020 is expected to dwarf even that.

Global macroeconomic factors are at play now. Traditional defensive equity sectors such as Financials and Real Estate are no longer a protective hedge against market volatility. As of 2020, corporations across industry groups have increasingly accumulated large debts as a means to fuel growth. Debt is a significant risk if liquidity dries up and a corporation's cash flows cannot service its obligations. **Investors should look for companies with strong balance sheets as these should be far more capable of utilizing opportunities, regardless of their sector.**

From 1945 to 2001, the average market recession was 11 months, while the average expansion lasted 57 months. Each sector has varied outcomes, but Industrials, Materials, and Utilities sectors historically take the longest to recover from a recession—averaging 345 weeks or 79 months during the 2008 mortgage crisis. While Consumer Discretionary and Consumer Staples rebounded much quicker, averaging 116 weeks or 27 months.

Unlike the 2008 sub-prime mortgage crisis, COVID-19 market correction is not the result of a fundamental flaw within a particular sector, but rather an external factor impacting the market as a whole. The COVID-19 pandemic may have long-lasting economic effects due to the slowdown of manufacturing and production, but the market could rebound much faster than past recessions should there be a vaccine developed or a global decline in new cases or hospitalizations.

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Telephone: (416)-862-7755
1-800-387-0859
E-Mail: info@caldwellsecurities.com
Online: www.caldwellsecurities.com
Address: 150 King St. W., Suite 1710, P.O Box, 47
Toronto, ON M5H 1J9

Caldwell Securities Ltd.
Independent Investment Advisors

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