

Market Review

The S&P/TSX Capped Financials Index TM (the "Index") had a total return of 6.83% during the second quarter ended June 30, 2020 ("Q2 2020"). After the worst quarterly performance for Canadian financials since the 2008 global financial crisis in Q1 2020, financials were able to claw back some losses as market sentiment improved.

The quarter began with the Canadian economy in lockdown mode due to the COVID-19 pandemic. With many Canadians either unemployed or furloughed, the Canadian government moved quickly to provide financial help for Canadians. The CERB program was launched on April 6, 2020, at the beginning of Q2 2020, in anticipation that many would not be able to work. These and other programs, which the government has committed to in these unprecedented times, should help the Canadian banks avoid the worst situations involving persistent defaults. Fears of large loan losses and mortgage defaults were hanging over the sector throughout Q1 2020. But with the intervention of the government, these fears have been somewhat assuaged.

Option Writing Strategy

CI Financial ("CIX"), the asset management company, was the best-performing stock in our portfolio, returning 24.93% during Q2 2020. Bank of Nova Scotia ("BNS") was the only bank with negative returns in Q2 2020, and one of only two stocks that was lower during the quarter. The BNS exposure to emerging markets, which have less of an ability to help the economy financially, risks impacting earnings in the quarters to come.

While volatility levels did come down during Q2 2020 as compared to Q1 2020, they still remain at multi-year highs versus previous quarters. Higher volatility levels benefit the covered call overlay strategy used in the portfolio by increasing the amount of premium we receive for the call option sold. It would not be surprising to continue to see higher volatility levels than normal, going into the rest of the year, as there is still much uncertainty in the marketplace about the economic outlook.

Outlook and Positioning

Despite these efforts to support the economy, it may still be a long road ahead for the Canadian financial sector. Banks likely need to take losses through increased loan-loss provisions. Also, low interest rates for the foreseeable future will weigh on net interest margins. Banks will also be helping Canadians by offering to defer mortgage payments. Asset management companies could be the least impacted by the crisis. Most employees have been able to successfully transition to a work-from-home environment, and with a recovery of asset prices in the second quarter, profitability won't be as impacted as what might have been expected.

