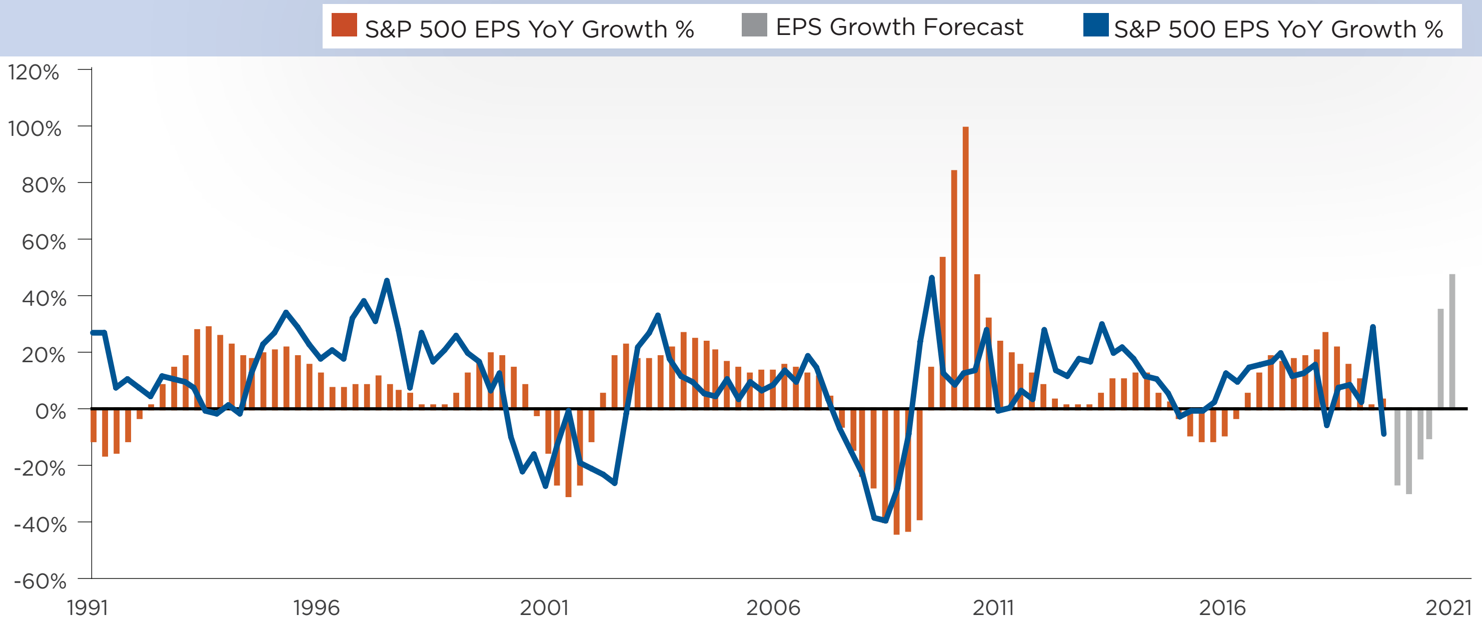
S&P 500 Return vs. EPS Growth



Source: Dow Jones S&P Indices, S&P 500 Index. The S&P 500 Index is unmanaged and is not available for direct investment. Past performance is not a guarantee of future results.

QUARTERLY MARKET OUTLOOK: **THIRD QUARTER 2020**

Equity Outlook

Because much of the domestic and global economy was under a lockdown in April with business activity stopped or curtailed, we expect the brunt of COVID-19's impact on corporate earnings to hit in the second quarter. Though the earnings slump is likely to improve in the second half of the year, a full earnings recovery back to pre-pandemic levels may take two to three years.

- **Canadian stocks to continue a wobbly grind higher in the second half of the year -** The strong rally in stocks from the March-lows was driven primarily by 1) aggressive and early fiscal and monetary stimulus and 2) market optimism about a quicker-than-average earnings recovery, starting in 2021. We expect equities to continue to rise in the second half of the year guided by a sustainable, albeit uneven, economic expansion, low interest rates and a gradual rebound in corporate profits. Though directionally the path of prices is upward, occasional downward swings are likely as market sentiment adjusts to the uncertain effect of the pandemic, and a possible second wave of new COVID-19 cases, on the timeline to full economic recovery. The market rally has occurred in the presence of an earnings decline, pushing valuations above historical levels but still reasonable in our view due to low interest rates and the outlook for a quicker-than-average start to the recovery. However, November election uncertainty in the U.S. and geopolitical concerns tied to trade, are likely to keep volatility elevated for the remainder of 2020.

- **Earnings recovery will take time -** Corporate earnings, which drive stock prices over the longer term, are expected to decline this year due to restrictions placed on the economy to contain the spread of COVID-19 in March and April, with the brunt of COVID-19's impact on corporate profits likely to occur the second quarter of this year. The estimated consensus earnings decline for S&P 500 companies is nearly 44% from a year ago, which would be the largest decline since 2008, and expect similar decline in Canadian equities. As shown in the chart, we expect the earnings slump to continue to improve in 2020, and for earnings growth to increase solidly in 2021. In past recessions, from 1948 to 2009, it has taken almost three years for earnings to return to levels reached before the downturn. Despite a promising growth path in subsequent quarters, history shows a full recovery to pre-pandemic levels of corporate profits is unlikely to happen within the next year. Additionally, we expect companies to face higher costs and supply chain disruptions tied to the global pandemic, which is likely to dampen market optimism for a quick rebound and prompt occasional market pullbacks.

▶ *Action for Investors*

Long-term investors can benefit from occasional market swings by using periods of volatility to trim overweight allocations and fill in gaps in underrepresented asset classes and sectors. Maintaining diversification across defensive and cyclical sectors will help minimize the risk of loss during the economic downturn and position portfolios to take advantage of the economic recovery we expect to take shape later this year.

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