STONE ASSET MANAGEMENT LIMITED

Sleep well.

MARKET COMMENTARY & FORECAST

MAY 31, 2020

Superman is alive and well in the United States. Faster than a speeding bullet, he can trade around the globe, and print money to save everyone. More powerful than a locomotive, his vision sees the recovery stage of global pandemics, and he leaps tall bank towers in a single bound. The Man of Steel under the mask is Jay Powell, head of the Federal Reserve, and unfortunately, reality will eventually prevail.

You can call this a euphoric rally of a late-stage bull market or a bear market rally trap, it really doesn't matter; the data points tell us this is a very expensive market. Prudence, seeking the preservation of capital, should be foremost in investors' minds. Investors (perhaps really casino gamblers) have bid up America's Bombardier – Boeing – as if it had no business problems at all. Airline, cruise, and bank stocks are fearlessly bid up by investors, yet the fundamentals may struggle to support these prices into the future. We sit in our investment meetings day to day, focusing on preserving our clients' money and providing them growth on their capital at a risk level that a prudent person would accept. Truthfully, we're not bewildered or confused by what's going on. We may not have perfect clarity on the catalysts that are causing this dramatic run in the market, but what we know for sure is that the market is expensive.

North American and global stock markets continued their remarkable rallies in May in the face of dismal economic numbers and growing grief and rage over social unrest in the US. Hopes for a potential opening of economies, coupled with select corporate earnings that were not as bad as originally feared, were cause for investors to continue buying these markets. North American stock markets, oil prices and the loonie all rallied to three-month highs.

MARKET RETURNS (as at 05/31/20, in native currencies)

MSCI World Index	**+4.63%**
S&P 500 Index	**+4.53%**
DOW Jones Industrial Average	**+4.26%**
Nasdaq Composite	**+6.75%**
TSX Composite Index	**+2.79%**

The biggest gainers were information technology up 14.6% (led by Shopify which temporarily became the largest capitalization company on the TSX), consumer discretionary up 8.1% and health care +5.48%. The interest sensitive sectors performed the weakest with real estate down 0.39%, utilities up 0.04% and the heavily weighted financials up 0.44%.

Given the collapse in earnings estimates, coupled with the current rally in equity prices, the price earnings estimate is at an eye-popping 21.6x forward earnings. This high a level of PE has not been seen since the dot-com bubble days of 2001-02. However, the PE ratio is a bit deceptive as it reflects earnings expectations during a time of severe turmoil with the closing of global economies due to the pandemic. Putting things in perspective, the S&P is back to the same level as October 2019 when earnings expectations for the forward 12 months were 25% higher than the estimates today. At that time, the forward PE level was 17.4x – a level also thought to be expensive. It is as if the market is priced for perfection and Superman can manage any speedbump in the global economy reopening and/or virus data, which normally could be a setback for the markets.

Earnings expectations and economic outlook are not the only driver for stocks. The US budget agency came out and said that the US economy is not expected to recover from the pandemic and related shutdowns for the better part of a decade! Thank goodness we have Superman and a fiscal policy of spend, spend, spend. So, investors are clearly not banking solely on this metric. The collapse in interest rates since the crisis began has left many investors with no other alternative than equities. Massive monetary and fiscal policies have convinced investors that if stocks fall again, the central banks and authorities will come to the rescue. The Federal Reserve has cut rates to the zero lower bound and announced quantitative easing of at least $700B. These quick and aggressive actions show the seriousness of the Fed's policies. Exiting the telephone booth, the Man of Steel announced the Fed's willingness to do "whatever it takes", which was met with equal vigour by the EU's "all in" policies – not sure the EU has a Superman. The market dropped 35% with such speed from the February 19 highs to bear market lows on March 23. The central bank and government stimulus policies since March 23 have created a significant tailwind for stocks. The result is that markets bounced back at lightening speed, jumping 36% since the lows.

The markets are climbing a wall of worry as many are looking at the headlines and trying to figure out why they are going higher. The news is not getting any better and the market's ability to shrug it off just adds to the disconnect between Main Street and Wall Street. COVID-19 deaths have surpassed 100,000 in the US while over 40 million people have filed for unemployment. The news is both overwhelming and devastating. The growth rate in money supply has skyrocketed, while the velocity of money declines. Declining velocity prevents inflation from being a threat. Another result of the lack of velocity of money is that the personal savings rate has jumped to very high levels as households are saving their money hopefully for another rainy day. Our fear is with stores, restaurants and bars closed, it's a forced behaviour change and not a new long-term trend.

The above market analysis and reaction is like what Sir John Templeton proclaimed: "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." There has been plenty of optimism in the past few months, especially in relation to finding a vaccine for the virus. In fact, some of the best-performing market days recently came on days where a big announcement was made with the virus. Liz Ann Sonders of Charles Schwab noted that on four days alone, a total of 2679 Dow points were tallied from the below headlines related to the virus:

- April 17: Remdesivir shows effectiveness in treating COVID-19 (DJ + 705)
- April 29: more positive data on Remdesivir trials (DJ + 532)
- May 18: Moderna announces early-stage human trials for COVID-19 (DJ + 912)
- May 26: Merck announces plans to work on a vaccine and Novavax announces phase one clinical trials.

All the SAM-managed Stone portfolios have been structured with a bias to preservation of capital. We believe the best way to invest in these markets is to have a total return focus. Investors should be rewarded by buying companies with strong balance sheets, the ability to sustain a reasonable level of growth during difficult times, and sufficient free cash flow to sustain dividend payments.

We use our proprietary investment process daily and in volatile market conditions such as these, we seek to ensure that we can manage downside risk and adjust the portfolio accordingly while seeking to achieve our long-term investment goals for our clients.

We remain invested and are committed to companies that provide revenue growth, improving free cash flow and higher earnings per share. We are active portfolio managers with a disciplined investment process including the implementation of various risk management tools to benefit our investors.

Kindest Regards,

Stone Asset Management Limited

Richard G. Stone
Chief Investment Officer

FUNd PERFORMANCE - Series F/FF @ May 31, 2020	1 mo	3 mo	6 mo	YTD	1 yr	3 yr	5 yr	10 yr	Since Inception	Inception Date
Stone Dividend Growth Class Series F	1.9	(1.8)	(5.0)	(4.3)	4.9	5.8	4.7	7.9	9.1	07/31/2003
80% Morningstar® Canada Index, 20% Morningstar® US Large Cap Index	3.3	(2.7)	(6.5)	(7.1)	1.9	4.7	5.3	7.9	7.9	
Stone Global Sustainability Fund (Formerly Stone EuroPlus Fund) Series F	6.2	8.4	0.0	(1.1)	5.6	(1.6)	1.8	8.2	3.7	05/31/2008
Morningstar® Global Markets	4.2	2.7	(1.2)	(1.2)	7.2	2.2	4.0	9.1	3.9	
Stone Global Balanced Fund Series FF	3.0	4.1	3.0	3.2	7.5	4.3	4.9	7.6	8.2	12/31/2008
15% Morningstar® Canada Index, 15% Morningstar® US Large Cap Index, 30% Morningstar® Developed Markets Large-mid Cap Index and 40% Morningstar® Canada Liquid Bond Index	2.6	2.0	0.4	0.4	8.0	6.5	6.1	7.9	8.5	
Stone Growth Fund Series F	4.6	9.6	6.1	5.6	15.1	11.1	5.4	9.3	7.0	09/30/2001
50% Morningstar® Canada Index and 50% Morningstar® US Large Cap Index	3.6	1.3	(2.5)	(3.1)	8.0	8.0	7.3	8.9	7.9	
Stone Global Growth Fund Series F	8.1	12.3	12.1	11.6	19.1	12.3	12.3	15.2	9.5	07/31/2003
Morningstar® Developed Markets Large-mid Cap Index	4.5	4.0	(1.5)	(2.0)	9.7	6.9	8.2	12.4	7.4	
Stone American Dividend Growth Fund Series F	2.9	2.4	(4.6)	(4.7)	7.7	0.1	3.2	n/a	5.6	07/17/2014
Morningstar® US Large Cap Index	4.2	8.1	4.2	3.5	18.7	12.1	12.8	n/a	15.4	
Stone Dividend Yield Hog Fund Series F	1.7	(14.5)	(19.1)	(18.8)	(11.7)	(6.7)	(6.1)	1.0	0.6	02/07/2006
Morningstar® Canada Index	3.1	(5.4)	(9.1)	(9.7)	(2.1)	2.8	3.4	5.7	4.7	
Stone Global ESG Strategy Fund (Formerly Stone Global Strategy Fund) Series F	4.0	6.5	2.6	2.6	7.7	3.6	3.8	8.2	4.4	09/22/2006
Morningstar® Global Markets	4.2	2.9	(1.2)	(2.3)	6.1	5.8	5.8	7.7	6.3	
Stone Covered Call Canadian Banks Plus Fund Series F	0.8	(15.8)	(20.3)	(19.9)	(10.4)	(1.0)	1.9	n/a	1.5	07/17/2014
S&P/TSX Financial Services Index	0.4	(17.4)	(23.0)	(20.9)	(15.4)	(3.5)	0.1	n/a	0.5	
Stone GaleForce Dividend Growth Pool	(1.2)	(2.3)	(7.3)	(6.4)	(0.3)	3.6	3.2	n/a	5.3	05/17/2012

The returns set out above are historical annualized compounded returns net of all fund fees and expenses. The returns assume a re-investment of all distributions. Historic returns are provided for general information purposes only and may not be indicative of future returns or fund performance. Performance data of other Series of the Funds may differ from those shown above due to differences in fees. Please visit our website at www.stoneco.com for performance data of all Series.

CANADIAN FACTS – THE FIRST HERO

Superheroes are so common these days – on television and at the movies; in comics, books, and apps; alone and in teams – you would be forgiven for thinking they had always been around. Joe Shuster would tell a different tale. In 1933, the Toronto artist and his writing partner, Jerry Siegel, were the first to create a comic book superhero – a mysterious figure who uses extraordinary physical powers to uphold good and fight evil. Yet they had to push their creation to publishers for nearly six years – suffering rejection after rejection – before Superman finally stepped out of the telephone booth in Action Comics No. 1 in June 1938, cover price ten cents. The next year, their Man of Steel earned his own series and took off like a speeding locomotive, selling more than half a million copies per month. The golden age of comic-book superheroes was underway – a welcome tonic to a world on the brink of the most destructive conflict in human history. Today, these heroes and heroines are just as popular. In 2014, a single copy of Action Comics No. 1 sold at auction for $3.2 million – an approving nod to Canadian Joe Shuster's first hero.

Adapted from *Ingenious - How Canadian Innovators Made the World Smarter, Smaller, Kinder, Safer, Healthier, Wealthier, and Happier*
By David Johnston & Tom Jenkins

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Knowing you'll have the financial resources to live well.

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