Market Perspectives

June 15.2022

I would love nothing more than to write you today to comment and discuss how beautiful the weather is outside, but the reality is we find ourselves in a period of persistent negative headlines and narratives that understandably scare investors. This has undoubtably been the worst start of a calendar year for both stocks and bonds in over 50 years and investors are looking for answers. The most difficult conversations have been with conservative and balanced investors as equity markets in general are down 20% YTD, but the bond market has not been the standard gatekeeper and ballast in the portfolio it has been in the past, down 12% YTD. As you can see from the chart below, the 60/40 (equity/income) has not provided any relief.

What is remarkable is that two seldom-correlated asset classes – stocks and bonds – are simultaneously underperforming. Since 1977, the gold standard 60/40 portfolio has only produced a negative calendar year return 8 occasions (chart on the left). If we dig deeper into those 8 negative calendar years on the S&P 500, chart on the right, you will notice that in every single circumstance the portfolio was negative solely because of poor equity/stock performance while the bond aspect provided positive returns to help offset and minimize the negative impact to the overall return, outside of 2002 & 2008, of less than -4.0%.

60/40 Portfolio: US Stocks (S&P 500) and Bonds (Barclays Aggregate) Total Returns (1977 - 2022)

Year	Return	Year	Return	Year	Return
1977	-3.0%	1993	9.9%	2009	18.2%
1978	4.5%	1994	-0.4%	2010	11.7%
1979	11.9%	1995	29.9%	2011	4.4%
1980	20.1%	1996	15.2%	2012	11.3%
1981	-0.3%	1997	23.9%	2013	18.6%
1982	25.3%	1998	20.6%	2014	10.6%
1983	16.7%	1999	12.3%	2015	1.1%
1984	9.7%	2000	-0.8%	2016	8.2%
1985	27.6%	2001	-3.8%	2017	14.5%
1986	17.2%	2002	-9.2%	2018	-2.6%
1987	4.6%	2003	18.8%	2019	22.4%
1988	13.1%	2004	8.3%	2020	14.0%
1989	24.8%	2005	3.9%	2021	13.8%
1990	1.7%	2006	11.2%	2022 YTD	-17.3%
1991	24.7%	2007	6.1%		
1992	7.5%	2008	-20.1%		

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S&P 500 Down Years (1976 - 2022)

Year	S&P 500 Total Return (Stocks)	Bloomberg Barclays US Agg Index TR (Bonds)	60/40 Portfolio (S&P 500/Barclays Agg)
1977	-7.2%	3.0%	-3.1%
1981	-4.9%	6.2%	-0.5%
1990	-3.2%	9.0%	1.7%
2000	-9.1%	11.6%	-0.8%
2001	-11.9%	8.4%	-3.7%
2002	-22.1%	10.3%	-9.2%
2008	-37.0%	5.2%	-20.1%
2018	-4.4%	0.0%	-2.6%
2022 YTD	**-20.8%**	**-12.1%**	**-17.3%**

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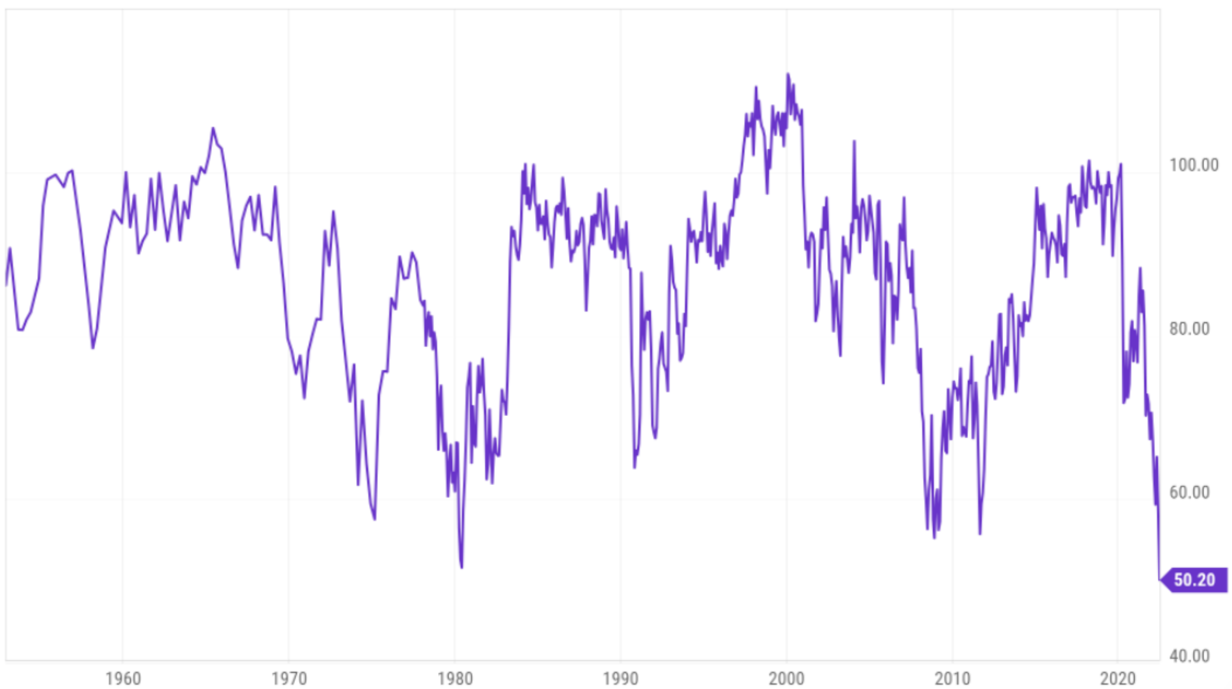
Through this turmoil, trust you are not alone as the general mood for investors is a state of paralysis. We know that when markets are weak and showing deep discounts, as we are currently experiencing, history has shown us time and time again that this is a buying opportunity. But in the heat of the fire, we become paralyzed with fear. Market sentiment is at a historically low point. We rely on "The US Index of Consumer Sentiment" (ICS), as provided by University of Michigan, which tracks consumer sentiment in the US, based on surveys on random samples of US households. The index aids in measuring consumer sentiments in personal finances, business conditions, among other topics. Historically, the index displays pessimism in consumers' confidence during recessionary periods, and increased consumer confidence in expansionary periods. Since this index has been tracked, November 1952, it is currently the lowest it has ever been at a current level of 50.20, down from 58.40 last month and down from 85.50 one year ago. It's simply a matter of time before sentiment turns around.

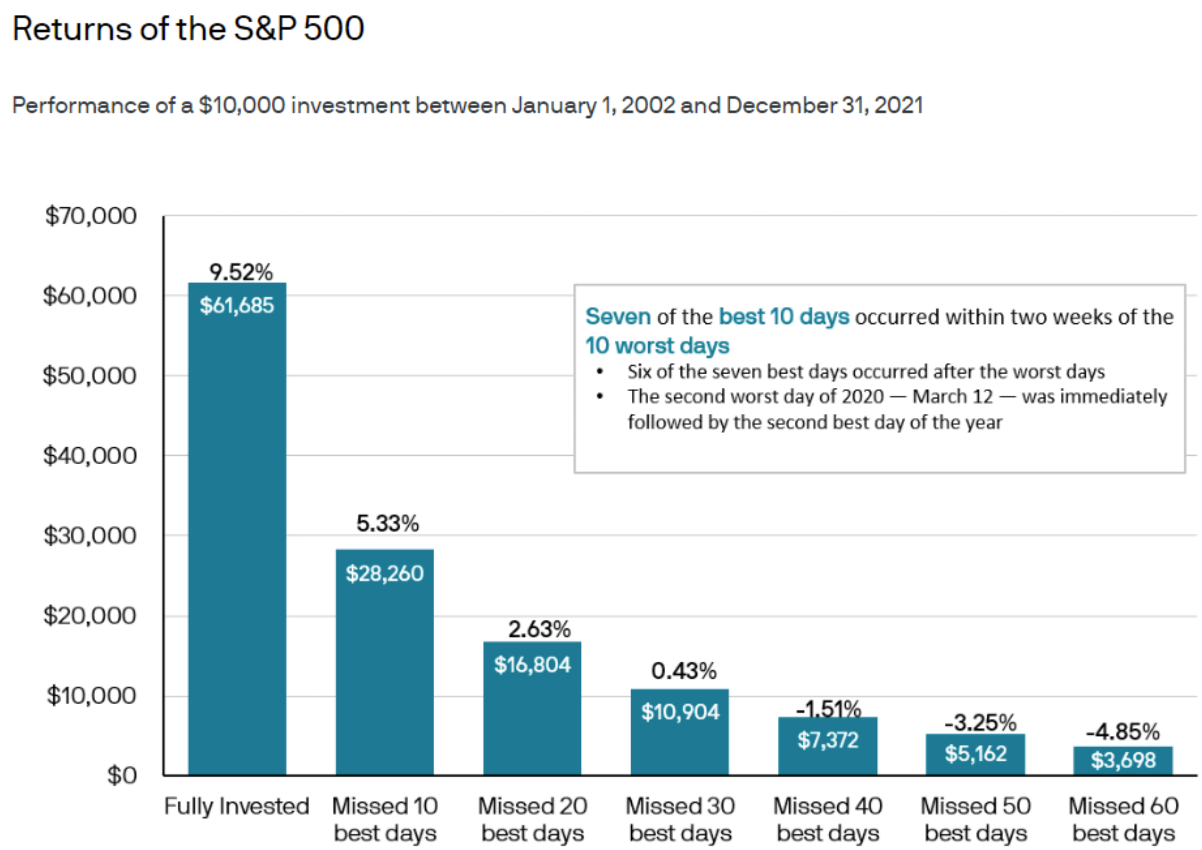
US Index of Consumer Sentiment



According to retail brokers Charles Schwab and Interactive Brokers, U.S. retail investors cash as a percentage of assets under management reached nearly 12% in the month of April. Extreme market volatility can put investors on an emotional roller coaster, and it is normal to trigger impulses to get out of the market altogether. It is completely normal to want to remove things in our life that are causing discomfort or pain – I get it.

I have outlined this in previous communications but the first challenge with attempting to time the market is that bottoms and peaks are only evident with plenty of hindsight, and there is not much evidence to suggest that market timing is an effective strategy. The second challenge history has shown us is that making the **emotional** decision to go to cash in your investment portfolio is that it involves two decisions, not one. It also requires the decision to get back in the markets to get back on the path to your goal.

The damage to your return as a result of missing key days for the market has been catastrophic. In fact, since 2002 if you remove the best 40 days from the performance of the index, it's return would be negative. In the past 20 years, there have been about 5,000 trading days. Those 40 trading days represent 0.8% of the 5,000 total, so damaging long-term returns does not require one to be out of the market for very long.



When challenges flare up, and we have been here before and the long term investor will experience again, it is key to remember your longer-term plan and knowing the harm that can come with missing big days for the market can work to underscore that approach. Investors are looking and waiting for some clarity from the Federal Reserve as it pertains to inflation and interest rate challenges. As a forward-looking mechanism, stock markets will have likely rallied, leaving investors behind trying to "time the market". Think back to several weeks ago, while it was too early to call the rally a pivot in sentiment, it does highlight how quickly markets can move. The S&P 500 Index was up nearly 9% over a six-day period.

Last week's United States Consumer Price Index read of 8.6% vs. 8.3% estimate will no doubt add to the paralysis. In response, this afternoon the Federal Reserve announced a 75-basis-point increase that up until Friday's Consumer Price Index read was not really on the table, all in an effort to tackle persistent inflation.

Although inflation has remained stubbornly persistent in the near term, the view from our Capital Markets Strategy team hasn't changed over the medium term. In their inflation model, when they input oil at $115/bbl, wage growth at 5% per annum, owner's equivalent rent at 4.5%, and the US Dollar Index (DXY) at 95, the inflation model indicates that inflation will trend towards 4% as we end the year and fall below 3% next year. After today's increase the market expects a 50-basis-point increase by the U.S. Federal Reserve in its next meeting. In the end, it is widely believed that these short-term large hikes will be enough to take some steam out of the economy and in turn we continue to believe they won't be as aggressive as the year progresses to see the effects of rate increases. While recession risks have increased since the start of the year, we believe a "real recession," where unemployment skyrockets, remains unlikely in 2022.

Everyone is Focused on the 2 R's and Neglecting the 2 E's

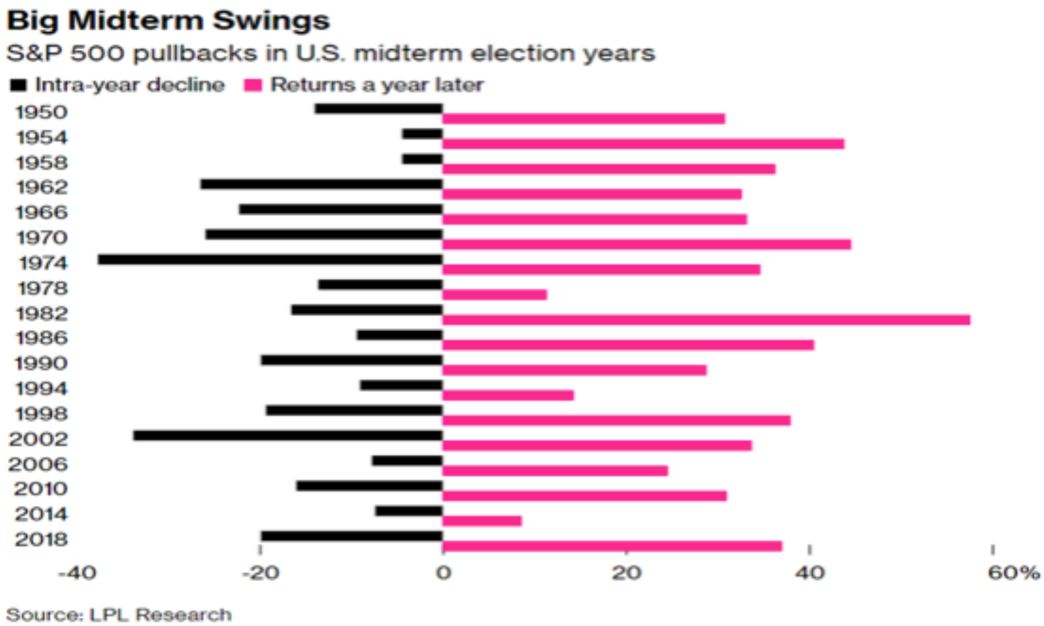
You open the paper, internet, BNN, you name it and all they want to talk about is **Rates and Recession.** Do remember we are coming from an ultra-accommodative credit environment and we have been here for a long time. The health of the overall economy would quickly support that the federal reserve is behind the curve and in hindsight they should have started hiking rates late 2020/early 2021.

In terms of the phrase "recession," investors and the media have this notion that it's a game over environment. As educated investors we know that bear markets with or without a recession are not a terminal event rather they are normal and history has shown they don't last all that long. Since World War II there have been a dozen recessions so doing the math that works out every 6/7 years. Furthermore, they are a normal part of the economic cycle and come in all shapes and sizes. They aren't all like 2008, some can be very shallow and mild but most importantly to repeat myself - they are **not terminal**. Some view them as the end of something but the eternal optimist views them as the beginning of something. They clear the air, get rid of excess inventory, and finally they present many great opportunities that we are already starting to see develop.

What you don't see in the media is any headlines highlighting how robust **Earnings and Employment** continue to be. On Friday, June 3rd the US Jobs Data was reported, and 381,000 jobs were added versus the 319,000 estimates. Great news for jobs and one would think this would be positive right? The market responded by viewing this as inflationary and leaving the door open for further interest rate hikes. In terms of earnings, companies in large part reported surprisingly strong results in Q1 numbers – yet the market didn't reward these companies. Personally, I am looking forward to the day we get out of this crazy cycle where good news is bad and vice-versa.

Mid Term Elections

An important event that is quickly approaching that hasn't received much attention is that this is a mid-term election year in the United States. Mid-term elections call for the entire House of Representatives and one-third of the Senate to stand for re-election. Mid-term cycles normally lead to the Fed taking to the sidelines so not to be seen as influencing voters, interesting in a year of such dramatic change to the monetary setting. Mid-term election years also follow a rhyme that we see taking shape in 2022. The chart below illustrates the action of the S&P 500 Index in mid-term election years back to 1950. **In every single circumstance (ALL 18) early corrections are always followed by strong market performance.**



Investing is a probability-based decision, and the odds are overwhelmingly in investor's favour in bear markets. As highlighted before, we believe:

- market expectations of the Federal Reserve's rate path are too aggressive in a slowing economy and they'll need to soften their hawkish tone
- although China's closing of major cities will likely extend supply chain disruptions, the recent opening of Shanghai and Beijing, in addition to new stimulus, should be a positive for global growth in the second half of the year
- inflation is likely plateauing—as evidenced by April's Personal Consumption Expenditures Price Index inflation data, which grew at its slowest pace in a year and a half.

I believe these factors will be supportive of stronger equity and fixed-income markets for the second half of the year. Furthermore, once investor sentiment shifts, the "cash on the sidelines" is likely to act as a tailwind.

Final Thoughts

- We are not “market timers” rather we understand long term success involves “time in the market”. As thoughtful long-term investors it’s important in these moments we take a breath and put these issues into perspective.
- As a forward-looking mechanism, I believe equity markets have priced in the bulk of bad news when it comes to interest rate hikes. From a valuation standpoint, equities are trading at much more reasonable multiples (valuation) today than they were 12-18 months ago.
- In terms of monetary policy and interest rates - this transitory period where rates are moving up should be put into context that we are coming off the floor (essentially 0). We are moving from an ultra-accommodative monetary policy to a less accommodative monetary policy - still “Accommodative”.
- This too shall pass. We have been through periods of geopolitical issues, increasing interest rates, inflation, trade wars… Historically, markets have continued to advance higher in every single scenario. Good, quality businesses will never go out of favour.

‘We’ll get to our destination but there will be pit stops along the way’

Market corrections are inevitable, economic cycles move in patterns, this we know. While uncertainty creates market volatility, we need to remain mindful to take these pit stops in stride and focus on the road ahead to make sure we arrive at our destination.

What we do know for certain is that markets are resilient, downturns don’t last forever and the longer we extend the time horizon out - the higher the probability a dollar invested today is worth more in the future. If we stay focused on our long-term goals, process, and fundamentals - together we will go far.

Thanks for the continued trust to help you navigate the complexity of financial markets. Although the summer months are a blur for everyone, I am never too busy to arrange a in person meeting or phone call to address any additional concerns you have. My only goal remains providing you sound advice to help you achieve your end destination.

Warmly,

Aaron Pedlar