January 2023 Newsletter

We would like to wish you and your family a healthy and prosperous 2023. Last year was an eventful year including the Ukraine invasion, the return of inflation with higher interest rates, and challenging stock markets globally to name just a few. And as challenging as 2022 was, we are also grateful that for most globally, the worst of the pandemic is now behind us.

In this newsletter we provide a review of our investment process results and what our team expects in 2023.

Investment Process and Portfolio Review

Our investment process for our Multi Asset Portfolios is designed to capture most of the market's upside, while seeking to avoid most of the market's downside volatility. The process utilizes a multi asset approach which may include Canadian equities, U.S. equities, developed international equities, emerging international equities, currencies, commodities, gold, oil, infrastructure, Real Estate Investment Trusts (REITs), bonds, preferred shares and cash. We actively measure the supply and demand for each asset class and allocate our investments to the strongest prevailing asset classes.

Each of the Multi Asset Portfolios has two positions – a "Core" position and a "Tactical" position. The core position is always designed to hold specific assets, while the tactical positions change based on the universal law of supply and demand.

Core Position

The core position contains our North American (N.A.) stock portfolio and our fixed income portfolio.

The N.A. stock portfolio consists of 20 individual stocks, equally weighted, and rebalanced annually. The N.A. stock portfolio underperformed on relative basis during 2022. We utilize an investment process better known as "momentum" investing. The strength of this process is to capture well defined trends amongst sectors and individual stocks. The process's weakness is when there is significant rotation from one sector to another or a general lack of sustained leadership, the portfolios tend to underperform. In 2022, the NA stock portfolio experienced both.

To better explain sector rotation and how it impacts the portfolio, lets imagine a dress shop owner. The goal of the shop owner is to stock the store with inventory that will sell with a reasonable profit margin. During the last six months, red dresses have been flying off the shelves. To keep up with demand the shop owner continues to order red dresses. However, for whatever reason, demand shifts and now dress buyers want yellow dresses, not red dresses. As a result, the shop owner begins to order yellow dresses, but currently has a store full of red dresses. To make room for more yellow dresses, she discounts the red dresses, perhaps even at a loss.

In the first quarter of 2022, the NA stock portfolio had a significant exposure to technology companies in Canada and the U.S. As inflation and interest rates started to rise quickly, technology stocks began to sell off quickly. And while technology stocks were replaced with much more defensive stocks in the energy and financial sectors, the technology stocks suffered greater declines than other sectors during this rotation which was a drag on the returns for the NA stock portfolio.

The NA stock portfolio has experienced this underperformance ~~a number of times~~ in the past and most often occurs as the stock market transition from a “bull” market to a “bear” market, as it did in 2022.

Fixed Income Component

Traditionally the fixed income component invests in Canadian, U.S., and global bonds as well as preferred shares. In the past, we have used these investments as a substitute for owning risk assets such as stocks. 2022 was a very non-traditional year.

For anyone born after 1982, they have generally only experienced a decline in interest rates. However, in 2020 governments globally flooded their economies with money to prevent a global economic collapse due to COVID. In 2022 it became apparent in the form of inflation that they “stimulated” too much. One tool to cool inflation is to raise interest, and many governments globally including Canada increased interest rates at an unprecedented rate.

Rising rates have the inverse effect on bond prices and as a result, the U.S. and Canadian bond indices experienced one of the worst price declines in history declining by 15% and 13% respectively (excluding interest payments). Fortunately, our process reduced our exposure to bonds in favour of cash or very short-term bonds in the first half of the year. We also added a few bonds and a GIC to the portfolio to reduce bond risk, increase income and provide additional stability to the income component. The bond component produced negative returns for 2022 but did outperform its relative benchmark.

The tactical position can have up to four positions of the various asset classes and may from time to time be invested only in cash as a defensive measure. As with the core stock portfolio, the constituents in the tactical portfolio are also determined by supply and demand. Exchange Traded Funds (ETFs) are used in this component to provide liquidity to the portfolio.

Tactical Component

The tactical component began the year with exposure to risk assets including Canadian and U.S. stock. As the stock markets began to see demand wane and supply increase and transition from a bull to bear market, these assets were sold and replaced with agriculture, oil and cash. Each of these assets provided exceptional stability through the first six months and allowed this tactical component to perform very well. The second half of the year experienced two six weeks rallies in the stock markets globally– the first from the end of June to mid August and another from mid October to the beginning of December. In both cases our process waits to see a shift in demand before buying, and a shift in supply before selling. Unfortunately, both rallies were very short lived. This resulted in the tactical component increasing exposure to equities only to see the stock markets reverse shortly thereafter. This resulted in losses that caused the tactical component of the portfolio to underperform its benchmark in the last half off the year, and for the year overall.

The tactical component is the largest component of all the Global Multi Asset Portfolios. As such, its performance was largely responsible for our portfolios underperforming their relative benchmarks in 2022. You can view all the portfolio results **here.** In addition, you can see the portfolio construction of all the portfolios **here.**

Looking Ahead

The question we are most often asked at this time of year is where do we see the markets going this year? We have no idea, and nor does anyone else with any degree of certainty. While the past does not predict the future, we are optimistic for 2023 for a variety of reasons.

Currently, the number of professional investment advisors and portfolio managers that are ‘bullish” about investment prospects currently is near the lows seen during the 2008 financial crisis and the COVID bottom in 2022. Both marked significant lows. As well, the numbers of investors using put options to protect portfolios reached near historic highs in December 2022. This also has been a reliable contrary indicator. In addition, 2022 was a “mid term” cycle year in the U.S. 2023 is a “Pre- Election” cycle year. According to Oppenheimer, since 1928, the S&P 500 averaged 18% return during “pre-election” years when the “mid term” year was negative, as 2022 was. And it was accurate 80% of the time. Finally, the S&P has posted back-to-back losses only 8 times since 1928, and seven of those eight times occurred when the last quarter of the previous year was negative. The last quarter of 2022 was positive. So, while the media, individual investors, and professional investors alike are pessimistic we believe the odds of favourable market returns this year are very good.

If you have any questions about this summary or your investment portfolio, please call us.

Sincerely,

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