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QUARTERLY COMMENTARY

Richard Liss, CFP, CIM®, FCSI®
Portfolio Manager &
Vice President, PCG
richard.liss@raymondjames.ca

Amy Ong
Financial Advisor Assistant
(416) 777-7076
amy.ong@raymondjames.ca

Raymond James Ltd.
Scotia Plaza - Suite 5300, 40 King Street West, Toronto, ON M5H 3Y2
Phone: (416) 777-7041
Fax: (416) 777-7020
www.raymondjames.ca/richardliss

More Ups and Downs

Last quarter I mentioned how hopeful I was that we were entering a more normal environment with regard to the pandemic and we're finally seeing that come to fruition. However, in China, it's a whole other story – the city of Shanghai (which has a population of 26 million and is a city of global transport, manufacturing, finance and trade) is currently in full lockdown. It's home to the world's busiest port and third largest cargo airport. Many other cities in China have had partial lockdowns imposed on them as well. The reason I am raising this issue is because should this continue for much longer, it will exacerbate the current logistical backlogs the world is experiencing and that is going to continue putting pressure on prices for products for some time. The Chinese are on the wrong side of this, I think – perhaps they think they can continue this zero Covid policy since despite a slowdown in March their first quarter GDP came in better than expected. Inflation will continue to be problematic everywhere until the production of goods and the ability to ship them normalizes and China is key to that happening.

Last quarter, U.S. stocks lost ground finishing down 5.3%, European stocks were lower by over 9%, but the TSX was more resilient than most, gaining 3.1%. That is primarily because the Canadian market has more exposure to energy and the mining sector that benefit from higher prices and inflation. I believe the TSX will be one of the higher performing indexes this

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year, so continued exposure to Canada will be important for investors. The one caveat I would say is this – should energy prices deflate from here, the energy sector will drop somewhat, although I think some continued exposure is warranted. And why would energy prices come down? There is a chance that even though the Arab countries are mostly supporting Russia, the U.S. may be able to put enough pressure on OPEC that they increase their daily production significantly. That will lower the price of oil and give us all some relief. Higher energy prices have had a huge impact on the price of many goods, and of course the war in Ukraine has been especially difficult for the entire European community. Not only will it reduce inflation but it will lessen the daily financing of Russia's war machine since they are one of the world's largest energy producers. I cannot adequately express how upsetting it is to see the daily atrocities that are taking place due to Putin's disgusting and devastating war.

The West's drive to wean itself off of Russian energy added to an existing energy crunch. The result: Rising energy prices today are contributing 4 percentage points more to Euro area inflation than in the five years before COVID. In addition, reduced food and fertilizer exports from Russia and Ukraine have created food insecurity around the world. These new supply disruptions add to existing pressures: Farmers already faced sharply higher fertilizer and diesel costs so food inflation could become a larger driver of inflation in developed markets as a result. World food prices jumped 13% in March to a new high, Food and Agriculture Organization data show.

Amid all the uncertainty, we believe capital will flow to the "cleanest dirty shirts in the laundry" over the near-term, which from a Canadian investor's perspective means Canada and the US markets. Both economies are set to grow by +3.8% and +3.1%, respectively, in 2022, above the 20-year trend of ~1.8%. Similar to 2021, we expect the recovery, which is only in year three of the business cycle (since 1960, historical expansion for Canada has lasted ~10.9 years), will remain uneven in 2022 and likely also in 2023. The latest forecast for global GDP growth puts real GDP growth at +3.0% year-over year (YoY) for 2022. This compares to the 20-year average of (2000-2020) of ~3.2% YoY.

Regarding the stock markets, there is something really interesting going on. The defensive sectors (consumer staples, utilities, health care and REITs) have been performing well, despite the headwinds of rising interest rates and being outside of their strong seasonal period. This doesn't normally happen. So, what is going on? Investors want to stay invested in the stock market and not miss out on large potential gains. They are concerned and worried about market valuations, a slowing economy, rising interest rates, the Russia-Ukraine war and other factors but, rather than leave the stock market, investors have been moving into the more defensive sectors. They are still invested and rationalize that they can always rotate into more aggressive areas if the stock market starts to rally. It is always easier to rotate in between sectors than make the much more difficult decision whether to get out altogether.

I still prefer equities over bonds because the inflationary environment favours stocks. I prefer the Canadian and U.S. markets over Europe within developed markets because the impact of energy and food shocks are greatest there. So far, many developed market companies have been able to pass on rising costs and have kept their profit margins high. First quarter results starting this week will provide a reality check.

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There weren't many implications for investors in Budget 2022. While I think the housing affordability measures were long overdue, more needs to be done to address affordability across the country, including the addition of meaningful housing stock. A main concern for investors were impending tax hikes for companies in the financial sector (31% of the S&P/TSX Index) but while they are a negative, they weren't as bad as feared. There was a one-time, 15-per-cent charge on taxable income above $1 billion for the 2021 tax year for the country's big financial institutions (raising over $4B!) and a plan to permanently increase the corporate income tax rate for banking and life insurance groups by 1.5 percent for taxable income above $100 million. As a result, there really wasn't much of an effect on the sector, which is a good thing considering it is the most widely held of all.

Thank you for your continued trust and confidence. Should you have any questions or concerns at any time or if you would like to have a detailed discussion of your personal portfolio, please do not hesitate to let me know.

Sincerely,

Richard