

# Assessing the Opportunities of Choppy Markets Requires Active Decisions

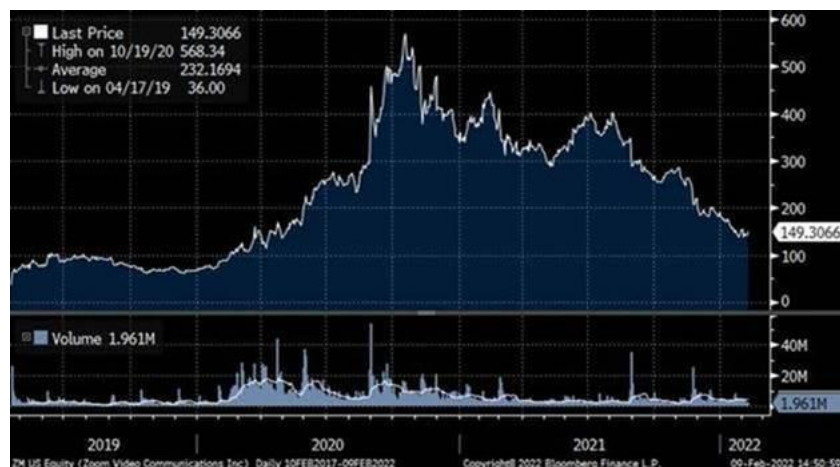
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As we entered 2022, capital markets have gotten a lot choppier. The core bond markets, as measured by the FTSE Canada Universe Bond Index, lost 3.4% in January. While the global stock markets, as represented by the MSCI World Index C\$ declined 4.9% for the same period. Canada fared better due to rising oil prices and strong performance of the financial sector. There are two main reasons that caused volatility: the burst of a speculative bubble and the beginning of tighter monetary policies.

The by-product of easy money policy was speculation. We saw growing number of trading accounts in the US and growing interest of companies that sound good but not enough earnings to support their prices. The pressure from not wanting to miss out had caused many people to invest in companies that they know very little about, especially the financials. As you probably know, good company is not always good investment as valuations makes a difference. Take Zoom Video as an example. As the pandemic started in 2020, the demand for virtual meeting solutions increased. This directly benefited providers such as Zoom Video Communications Inc. While their revenue grew, the price growth was even more aggressive. Share of Zoom was priced below \$100 before the pandemic and traded as high as \$568 in October of 2020. The sell-off got aggressive since the middle of last year and has declined to \$154 (Jan 31, 2022), a drop of 73%! Another good example would be Moderna Inc, one of the COVID-19 vaccine makers. Its share has lost 65% from the peak. There are plenty of other examples but we will not go through. What caused? Greed caused investors to get in at any prices (in behavioral finance, it is called “crowding”) which created the bubble. The bubble lasted as long as new investors and money joined the crowd. Most people enjoyed very brief moment of rich and eventually lost all the gains and majority of capital. For institutional investors like us, it was painful to go through a period of under-performance against speculators. It takes experience and conviction to stay out of trouble. Compared to the losses on speculative stocks, the overall equity markets are much healthier. Companies are reporting strong earnings growth with 79% of the companies in the S&P 500 Index beating the earnings estimates in Q3. (92% for the TSX) Their valuations are richer than normal but not anywhere close to the speculative segment.

Price chart for Zoom Video Communications Inc.



Moderna Inc.



Source: Bloomberg Finance, LP

Another reason for volatility was change in central bank tone. Investors were concerned that tighter monetary conditions will cause recession. US inflation, as measured by Consumer Price Index, gained 7.0% in 2021. (4.8% for Canada) Inflation reduces the purchasing power of our income and decreases the real return of our investments. It is generally central banks' mandate to keep inflation low. With economies performing strongly, unemployment rates returning to pre-pandemic levels, it is about time for monetary policy to change. Both the US Federal Reserve and the Bank of Canada have hinted hikes to start in March. The timing has been moved up versus the consensus just a few months ago. At this time, we anticipate 4-5 hikes for both US and Canada. This will take policy rates from 0.25% to 1.25% to 1.50% in Canada, and in the U.S. from 0.10% to 1.10% to 1.35%. These rates are higher, but still substantially lower compared to normal. This means accommodating policy will continue in 2022. What investors scared the most is will hikes go too far that they eventually trigger recession, like some of the previous cycles. Central banks have said their path is data dependent. Data include inflation, economic growth and employment. We expect the first couple of hikes to have very little impact to all of the above. However, annual inflation rate should moderate as we enter the second half of this year. Why are we so confident? This is because some of the data points -the monthly inflation for April, May, June, and July, were substantially higher than trend due to supply shocks that are continuing to ease. The bad news is anything labour-driven are getting more expensive as wages are rising to attract workers to return and oil prices are rising. With all considered, this year inflation for US and Canada will probably be close to 4%. It is still a relief. We expect economies to reach equilibrium at 3% inflation and 2% central

bank rates. To get to lower than 3% inflation, bank rates have to rise and increases the likelihood of recession. We will probably get to the equilibrium sometime in 2023.

Aside from collapse in the speculative segment of the markets, (which we do not play) and change in central bank tone reacting to very strong economic conditions, not much is different this year. There is chance our life will be returning to normal as pandemic turns into endemic. People are getting hired, paid growing wages and spending. Investors are seeking opportunities to invest; even if we do not care about growth, we need to grow our assets to preserve purchasing power. Our portfolios have held up very well during this correction as we underweight bonds and avoided speculative investments. We will continue to actively manage the portfolios to navigate change in policies and also investor sentiments. We are finding opportunities outside of US and have been trimming US equity and adding to emerging markets and Japan, both would be considered laggards that offer better value. In addition, many countries in emerging markets are either at the middle or end of tightening monetary cycle. Japan, which suffered decades of disinflation, is unlikely to see rate hikes. These countries offer better value and also shelter from North American hike cycle. We recognize there is growing trend of Artificial Intelligence, Virtual Reality and Electric Vehicle. The common denominators of all of them is demand for high performance semiconductor chips. Even though some of the semiconductor manufacturers may be domiciled in US, which is subject to higher interest rates, their growth is unlikely to change regardless of the timing and size of hikes. It is also important that they are not new kids in the block, they have been around for years with solid balance sheets and cash flows. Their products have been enhanced and use have been changed allowing their revenue and margins to grow significantly. We are expecting the sector to benefit and have established a significant position to capture the growth.

Combined top 15 equity holdings as of January 31, 2022 of the Assante Private Portfolios 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft Corporation	6. Meta Platforms Inc. (Class A)	11. Constellation Software Inc.
2. Royal Bank of Canada	7. Mastercard Incorporated (Class A)	12. Humana Inc.
3. Alphabet Inc. (Class A)	8. Taiwan Semiconductor Manufacturing Co., Ltd. (Sponsored ADR)	13. Suncor Energy Inc.
4. Amazon.com Inc.	9. Toronto-Dominion Bank	14. Open Text Corporation
5. Brookfield Asset Management Inc. (Class A)	10. Intact Financial Corporation	15. Analog Devices, Inc.

Source: Bloomberg Finance L.P. and CI Global Asset Management as at January 31, 2022.



For more information, we encourage you to speak to your advisor or visit us at [assante.com](https://www.assante.com)

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