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Dear friends,

We sailed against the wind and tide in 2022. Runaway inflation and sustained rate hikes around the world blew hard against equities. Global equity markets have experienced their worst annual performance since the 2008 financial crisis. Central bankers are determined to stop inflation, and the aura of a recession, which remains present at the beginning of the year, contributed to the 13.6% decline in the S&P 500. The S&P/TSX index, on the other hand, ended the year down only 8.7%. Our decision to favour Canadian equities, high dividend yielding stocks and oil companies continues to serve us well. The energy sector was the best performer in 2022 (30%), helped by the price of oil. If the restrictive monetary conditions of the central banks have affected the stock market, bonds have also taken a hit.

	Closing 30-Dec-22	Change**	
		Quarter	2022
Stock Indices (% in C\$)			
S&P/TSX	19,385	5.1%	-8.7%
S&P 500	3,840	4.9%	-13.6%
MSCI EAFE*	1,944	14.6%	-10.8%
Currencies			
CAN\$ (US\$/C\$)	0.7380	2.1%	-6.7%
Euro (US\$/EUR)	1.0704	9.2%	-5.9%
Commodities (US\$)			
Oil (WTI)	\$ 80.23	0.4%	6.7%
Gold	\$ 1,812	8.3%	-0.6%
Volatility Index			
VIX	21.67	-9.95	+4.45

* MSCI Europe, Australasia and Far East (US\$)

** Changes are expressed in C\$ for Stock Indices.

The interest rate tide was powerful. For the eighth consecutive time, it was no surprise that the Bank of Canada raised its key rate on January 25. It is now indicating that it wants to pause to assess whether its proactive stance will slow the price surge in the coming months. The increase in the policy rate from 0.25% in March 2022 to 4.50% did not come without a hitch. Bonds fell sharply to end the year with historic losses. When interest rates rise, older bonds lose value because their interest coupons are lower than those of new bonds issued in the market. This is why bond prices have been dragged down. Bonds have experienced their biggest drop in decades, creating significant losses for investors who thought they were holding conservative investments. Fortunately, rates are stabilizing, and the appeal of bonds is finally back with attractive yields.

After 40 years of disinflation sustained by trade and demographic factors, the return of inflation will not be temporary in our opinion. While the pandemic brought the first price shock, the repatriation of production locally, labour shortage, and ethical and sustainable factors are more current examples that suggest inflation will remain high. In 2023, this could help bonds, to the detriment of equities, especially growth ones.

Traditionally, money managers were allocating assets between two categories, namely fixed income and stocks, in a proportion corresponding to the risk profile of their clients. Those two asset categories were historically moving in relative different directions, providing diversification and stability to the portfolio. Extremely low interest rates of the past decade challenged that relationship and interest in traditional fixed income products waned. Over the past few years, to maintain well diversified portfolios, we have been offering non-traditional investments to our clients. This has served us well, as traditional products were negatively impacted in 2022 by the quick succession of interest rate increases. This should continue this year.

Non-traditional investments consist of several types of assets not included in the usual bonds and stocks categories. Those categories may include absolute return strategies, private debt, private equity, real assets or infrastructure funds. Non-traditional or alternative investments can be incorporated into the portfolio of any client on a case-by-case basis and adapted to the needs and goals of everyone. By providing returns that are not correlated with stocks and bonds, a proper allocation of assets into alternative investments will reduce the volatility of the investor's portfolio all the while increasing its risk-adjusted return. By carefully selecting the type of alternative investments, it is also possible to provide a stronger hedge against inflation and more stable cash flows.

Conclusion and perspectives

Given the current economic uncertainties and the lack of visibility on the direction of monetary policies, we continue to believe that sound management must include fixed income as well as alternative investments. In 2022, the four non-traditional funds we hold all posted positive yields, while the stock market was declining. On the fixed income side, we continue to opt for short-term bonds and reinvest those that come due, aiming for an average term of two to three years. We still hope to take advantage of attractive rates by then. We also keep a portion of the fixed income for the very short term because the rates offered are respectable, and this gives us some flexibility. This could allow us to seize opportunities that arise if the stock market falls again.

The rebound in equities over the past few weeks could end quickly if earnings, economic data or inflation figures disappoint investors. In our view, the bear market is not over, and everything indicates that a recession is inevitable. The question now is whether it will be short-lived or stretch over time. If for some the current context is similar to that of the period from 1965 to 1980, let us remember that inflation was stimulated by energy prices. We continue to select our stocks carefully and maintain our overweight stance in the energy sector. We are staying the course with "value" style, quality stocks and high dividends. We avoid overvalued "growth" stocks that are affected by higher interest rates and inflation.