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Investor Strategy

The latest market insights from
Richardson Wealth

Craig Basinger, CFA
Chief Market Strategist,
Purpose Investments
CraigB@purposeinvest.com

James Price, CFA
Head of Market Strategy
Richardson Wealth
James.Price@RichardsonWealth.com

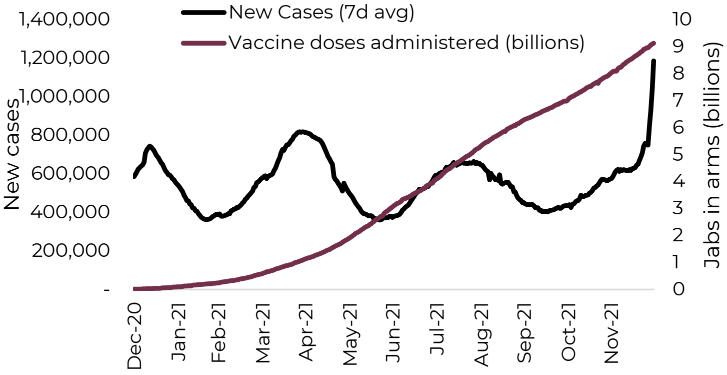
Reminiscing about 2021, and looking to 2022: Not your typical year, not your typical market

The holiday season offers a good opportunity to pause, take a step back from the daily market gyrations and reflect. While 2021 certainly had a lot of twists and turns — from a pandemic that won't go away, to inflation, to meme stocks — it ended up being a rather pleasant year for investors with many equity indices advancing over 20%. We will save a deeper dive into market performance till later, but for now let's hit a few of the highlights of 2021:

Persistent pandemic

As 2021 began, the race to develop, gain approval and roll out vaccines was really starting to get going. Thanks to advances in science and global effort by government and health care companies, vaccines, which historically have taken a decade to develop, were completed in less than a year. Mass production has resulted in over 9 billion jabs administered during the year. Truly impressive.

Pandemic remains persistent



Source: Bloomberg

Now if you had told anyone a year ago that 9 billion vaccines would be distributed, most would have expected the daily case counts to be lower today. Combined with much broader testing, the Omicron variant is now driving new records for cases. So far, the evidence does support vaccines limit the spread and even more importantly, dramatically reduce hospitalization rates. Nonetheless, the world thought we would be in a better place by now. This pandemic has truly proven to be more persistent, with some starting to use the word 'endemic'.

Society has adapted and continues to learn how to live with the disease. While approaches vary considerably from region to region, it is a testament to people's resilience and adaptability.

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Digital domination

Very often the words ‘new normal’ are bandied about in an attempt to describe what life will be like, even after the pandemic fades. However, the pandemic may be more akin to hitting the fast forward button on several pre-existing trends. Remote work, diminishing bricks & mortar retail, the cloud, AI … the list goes on. 2021 saw a dramatic increase in the speed of these trends, in many cases out of necessity.

These trends drove demand for hardware, connectivity, nicer home office chairs and of course an improved background for those abundant zoom calls. Conferences, education and meetings all moved to a virtual world. Documents are now signed digitally. And of course, shopping moved even further online.

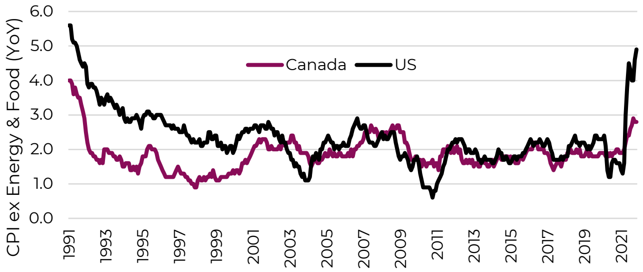
While there were many losers, or companies that suffered from the acceleration of these key trends, there were some big winners too. The good news for the equity markets is that the winners tended to have a much bigger weight compared to the losers — advantage market cap weighted indices.

Supply chains and inflation

Netflix was able to meet the rising demand of changing consumer habits caused by the pandemic: the more subscribers the merrier. The same cannot be said for producers of goods. As spending habits changed from vacations to home improvements, supply chains simply couldn’t adjust quickly enough. Adding to the complexity of supply chain logistics were pockets of disruptions caused by Covid outbreaks and a previous mantra of ‘just in time logistics’.

The interconnectivity and dependence of supply chains become very apparent. While grossly simplified, here’s a good example: Less wind in Europe led to higher gas demand as weather cooled. Supply couldn’t respond quickly enough, leading to higher prices. This resulted in fertilizer production being taken offline (natural gas being a key input), driving all fertilizer prices higher globally, which in turn is driving higher agriculture prices. Yes, your Cheerios may now cost more because of calm winds in Europe.

Core Consumer Prices are running the hottest since early 90s



Source: Statistics Canada, Bureau of Labor Statistics

Changing spending habits, bottlenecks, disruptions and high energy prices have driven consumer prices higher. While this will ease as the supply side re-adjusts to meet demand, and CPI data will come back down, the question is whether the longer-term seeds of inflation are planted and starting to grow? We believe periods of elevated inflation are likely to be a recurring theme in the years ahead, but likely much lower than CPI data is printing today.

Sustainability

Weather deserves mention in any look back on 2021. Wildfires, floods, heat domes, atmospheric rivers … one would have to assume a polar vortex is next. There is no denying that sustainability gained a lot of attention and traction in 2021, highlighted even more by the COP26 gathering.

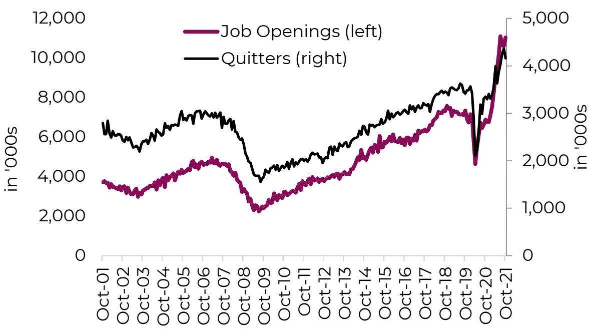
This has led to an increased focus on sustainability from the investment world. Key funds have increasingly announced the desire to stop investing in fossil fuel-related companies. Meanwhile, most companies continue to improve their respective carbon footprints, even companies in the extraction world. Energy demand has not slowed down, however, and lack of investment into traditional energy makes our outlook bullish for the sector in 2022. Sustainability also looks to be a trend that will continue, attracting investment especially in the venture capital space.

Labour mobility

2021 may go down as the 'great resignation' year. On the surface, one would assume that with many people working remotely, switching employers would be a more challenging endeavor. It is not easy to make new friends and connections via zoom compared to sitting in the office, within the corporate ether. Still, lifestyle choices, increased demand for labour, inflated stock and home prices, and perhaps even just working from home pondering 'what is next', has led to a record pace of quitting.

It may actually be more labour freedom from geography. While anecdotal, in conversation with an advisor team in our Partnership Program, they highlighted that this year has seen a much higher proportion of new clients from cities outside their home turf. Geography isn't the barrier it used to be as meetings are now virtual and documents are signed digitally. In a very cool chart from McKinsey & Company, a survey of people who started a new job in a different city indicated that only 13% were required to move to the new city.

2021: The Great Resignation



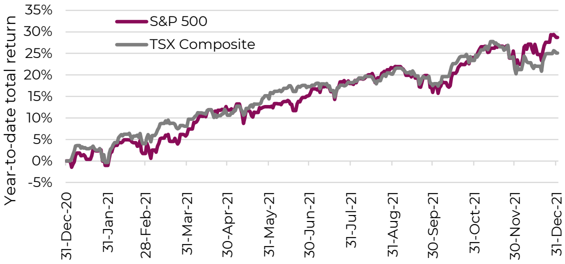
Source: U.S. Bureau of Labor Statistics

2021 does appear to be a year in which labour has enjoyed more flexibility and negotiating power. This has led to substantial changes in how, where and when people are working. The question is, will it begin showing up more and more in wages? **We think the outlook for 2022 is that it will.**

So, how about those markets?

A well-diversified investor in 2021 has probably left the year with a great return but feels like it should have been more. The pain of the bear market of Q1 2020 appears to have left most investors' memories and has been replaced by the barrage of headlines highlighting record highs for the S&P 500 and the TSX. The S&P 500 has now reached a brand new all-time high in 14 consecutive months, rising 28.7% in 2021. TSX doesn't have the same string of records, but +25.1% for any calendar year is impressive.

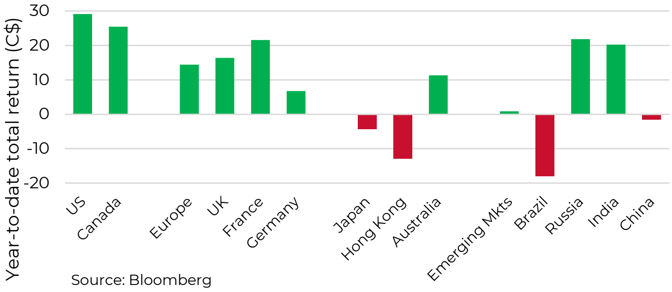
S&P & TSX had little to complain about in 2021



Source: Bloomberg

There is no denying the TSX and S&P 500 have had great years. The news keeps getting better as it wasn't just the mega caps. Microsoft, Apple., Shopify and Royal Bank, given their weights and solid performance did some heavy index lifting. But the gains were broad based with the median index member returns relatively close to the overall market. This can also be seen in the level performance of the S&P 500 and S&P 500 equal weight index. Plus, very few companies lost money. Only about 14% of the S&P 500 members declined on the year, while 26% of TSX members fell (skewed a bit higher by more gold and marijuana companies which comprised about ½ of all the companies that declined).

Outside N. America, equity returns were softer



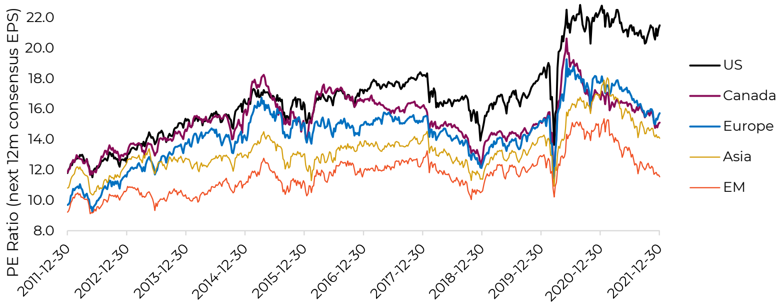
Source: Bloomberg

Geographic equity diversification hurt performance in 2021

If you only owned Canadian and U.S. equities, you are likely feeling especially good about 2021. However, most of us have diversified portfolios because not all years are like 2021. Regardless, **diversification, either by geography or by asset class, detracted from performance this past year.**

Other major equity indices did not keep pace with North American markets, especially once converted back into Canadian dollars. Europe managed a bit over 10%, Asia much worse and emerging markets were all over the place. Still, equity returns were

Stronger earnings growth more than offset price appreciation to bring valuations in many regions back to neutral levels



Source: Bloomberg

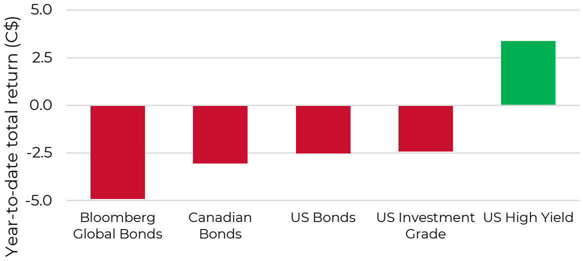
largely positive and, in many cases, positive in a material fashion.

You know what grew even faster than equity markets in 2021? Earnings!! Companies pivoted and adjusted very quickly to pandemic-induced changes in behaviour. Combined with unprecedented monetary and fiscal stimulus, driving the global economy first to recover, then to start reaching new highs, earnings growth spiked higher. Even when 'P' rises, if 'E' rises faster, you get better valuations. This was the case in most equity markets.

Asset allocation diversification muted returns

On the fixed income side, returns were even harder to come by. With global yields rising during the year, bonds had a tougher go and, in most cases, lost value during the year. Truth be told, these results would have been worse had Omicron not surfaced to push global yields back down late in the year. Credit performed well, although this performance was front-end loaded as the economy gained traction and fear of bankruptcies faded.

Bonds largely detracted from equity performance in 2021



Source: Bloomberg

Put it all together

2021 was a very eventful year, lots of news, great economic growth and thankfully markets that reacted well. A generalized balanced portfolio likely came through the year ranging between 8-12%, depending on investment mixes. Yes, the defensive positions likely dragged down performance, but that is literally what they are designed to do — act as a ballast for the overall portfolio in good times, not just bad times. Overall, it's hard to complain about 2021 from a portfolio perspective.

Human nature may have investors wanting to tilt portfolios to take on more risk. While we do remain bullish for 2022, as we noted in our December 2021 Investor Strategy [Richardson Wealth Outlook 2022], it would appear some of the future performance may have already been enjoyed by the markets. And this coming year will likely prove more challenging given central bank pivots, continued inflation issues and the slowing pace of growth. We believe the monetary cycle of tightening has already started, and would suggest expelling defensive components of your portfolio to chase upside may prove inopportune as we head into 2022.

Portfolio construction

Not much has changed from the views we expressed in last month's Investor Strategy. Although December had a big rally in bonds, we remain positioned for a rate-rising cycle which keeps us short of benchmark duration. Similarly, inflation expectations continue to be front weighted — meaning the market expects inflation to die down over the longer term and today's 6.8% CPI rate is not expected to last. However, we still feel the longer run rate of inflation will remain elevated compared to what we have grown accustomed to.

We have already seen some of the extreme valuation names falter in 2021, while more reasonably valued companies are holding up. This is a product of those higher rates, and we expect that to continue, so we will remain defensive in that camp favouring cyclical yield and value sectors. Is 2022 the year that the US dominance in markets ends? Who knows, but over a decade of outperformance has the comparative valuations in Europe and Canada looking pretty good vs. the USA broadly.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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This report is authored by Craig Basinger, Chief Market Strategist, Purpose Investments Inc. and James Price, SVP Investment Strategies, Richardson Wealth Ltd. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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