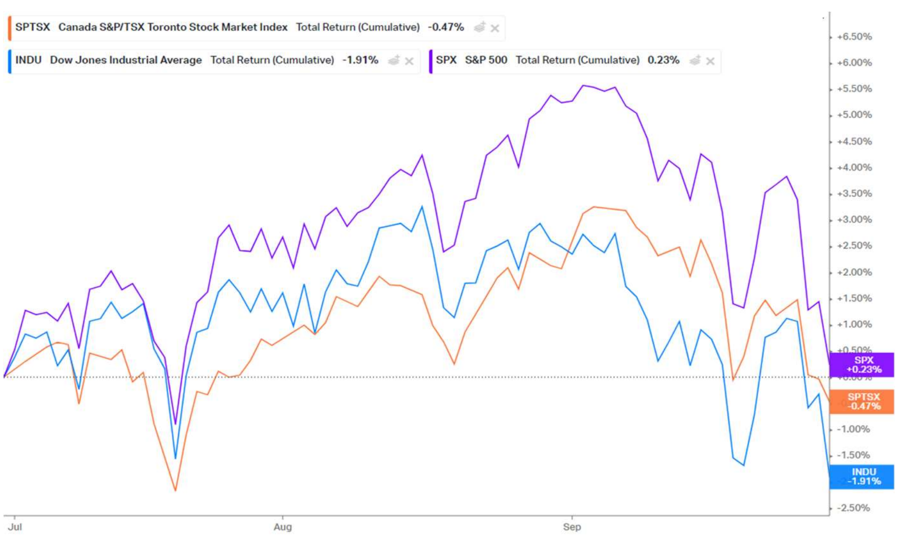
Lee Turner

Review

The world largely seems to be moving towards accepting life with COVID, understanding that full eradication of the virus seems unlikely in the near future. The vast majority have come to understand both the risks of the virus(es) and the benefits of vaccinations. In addition, people have adapted to the ongoing measures intended to curb rates of infection, which is likely to be the norm going forward.

Drawing parallels between COVID and financial markets may seem unlikely, but in both cases, we see them drawing inspiration from the new James Bond film: *'No Time To Die'*. Demonstrating strength and persistence, the virus and its variants' have mutated, and stuck around despite high vaccination rates in Canada – alas, its time to die will soon come. Albeit in a positive light, financial markets channeled the *'No Time To Die'* energy with the strength to mutate from a deep bear 18 months ago, into a raging bull. As for its persistence, markets have grown significantly despite polarizing economic data since the beginning of the year. The last 3 months, however, we've seen a bit less upward movement. Mixed economic news and adverse global events appear to have investors cautious of the current recovery's strength and persistence. For now, we'll be very satisfied if markets *'Die Another Day'*.



Koyfin data; October 1, 2021

The S&P TSX Composite stubbornly crossed the volatile quarter's finish line down -0.47%. Dow Jones finished slightly softer at -1.91%, while its US counterpart S&P500 came in positive at +0.23%.

Canadian federal leadership also felt that 2021 was *'No Time To Die'*. The Liberals decided to call a snap election in August which resulted in near identical results from only two years ago, with a reported taxpayer bill of $610mm. Despite not having a comprehensive reason for sending Canadians to the polls during a pandemic – aside from the Prime Minister's persistence for a majority government – the results demonstrated voter strength for the status quo.

Forecast

You'll forgive us if we think about monetary policy – along with fiscal policy, we think about it quite a bit. The current loose monetary and fiscal policies have created an environment ripe for high rates of inflation, a story that has gone from whispers earlier in the year, to screaming

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headlines in recent months. From a fiscal perspective, we do not expect much major change as the Liberals failed to gain their desired majority. From a monetary perspective, central bankers are maintaining their belief this intended inflation is ‘transitory’, and that rates of inflation will normalize once this period of supply and demand imbalance works itself out. This juggling act does not seem like it will be balanced any time soon. Labour shortages, supply chain bottlenecks, factory shutdowns and other variables, coupled with increases in household savings, pent up consumer demand, and near-zero interest rates will likely drag out this higher-than-normal inflationary period for a while longer. Although this is not an ideal situation, as capital allocators, we much prefer a supply shortage than a demand shortage.

If this imbalance continues, is there a potential for stagflation, where inflation continues to run hot, but the economy does not? Yes, and we are keenly aware that this scenario might play out. In the short run, there are several signals telling us that it is mildly here. Slowing GDP growth but accelerating inflation rates over the summer months surely announced its arrival. With shortages and shutdowns still playing out around the world while households crave normalcy through strong consumer spending, we will be keeping close watch on how quickly stagflation indicators accelerate or decelerate. In the long run we don’t believe stagflation will be a significant concern. Government wage programs are set to end soon, and in the US, where unemployment benefits have already begun winding down, companies are seeing a strengthening labour market. Surely, this is a positive sign. What is even more positive (yes, positive) is that interest rates must inevitably rise from their near-zero level. Central bankers have been quite transparent in telegraphing they will be increasing rates to cool the economy sometime in the next year or two with some smaller economies already beginning to raise rates. This comes as no surprise to institutional investors, contrary to the markets’ response we saw throughout the quarter. This volatility may continue in the near term, with headline risks of continued inflation, tapering, rate hikes, seasonality and global adverse events continuing to present itself to investors over the coming months.

Aside from this noise, we remain cautiously optimistic that we will soon resume normality in the business cycle, and we are certainly looking forward to a period of consistency and predictability.

Strategy

Although we have a high conviction that interest rates will be rising in the short to medium term, we know that markets may get shaken and stirred as investors determine valuations. In our eyes, there is little reason to spend too much time and energy in trying to nail down the central bank’s timing. The fact is, interest rates, despite a hike or two, will still be relatively low enough to enable continued economic growth. The global supply shortage puts our portfolios in a beneficial position when it comes to our sector exposure in Energy and Materials. Banks have generated strong excess cash that is now waiting to be deployed as soon as allowed. This outlook makes bond yields unattractive and equities the asset class of choice. If the markets exhibit more volatility over the coming quarter, we will be laser focused on finding high quality businesses for our portfolios. We will be adding to our current positions or starting new positions that meet our criteria for a quality holding. We know that stock markets tend to go up over the long term, so in addition to preparing for buying opportunities, we will be focused, patient and letting the markets run its course.