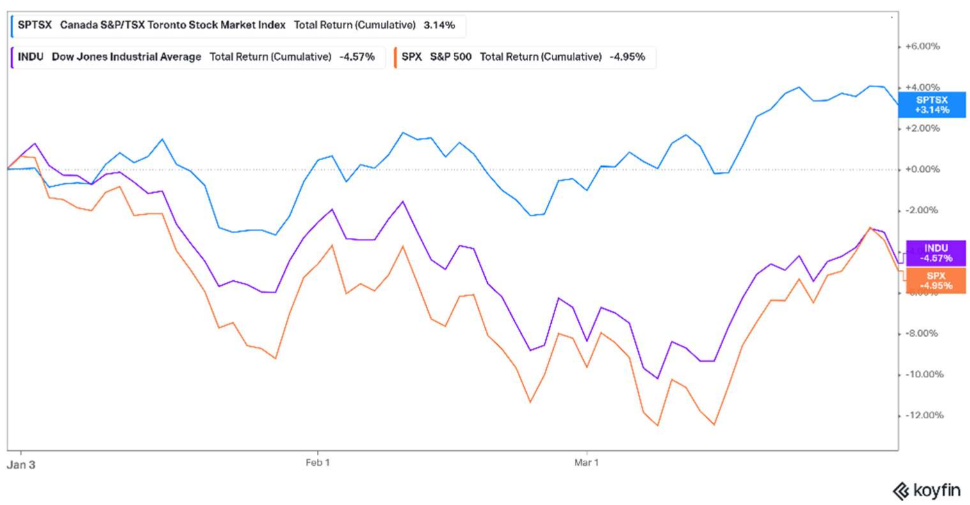
Lee Turner

Investment Quarterly
April 2022

Review

We've come to know the tale of David & Goliath as a situation where an underdog, David, takes on an opponent that is perceived to be in a much more advantageous position, Goliath. In the first quarter this year, the world saw this narrative unfold across several areas of life. Geopolitically, we saw Ukraine defend itself from invasion by Russia. Closer to home, we saw 'Freedom Convoy' protesters demonstrate their angst towards law makers and pandemic restrictions. Economically, we saw consumers battle Goliath increases in prices for goods and services.

While the strength in spending translated to Canada's GDP increasing (now back above its pre-pandemic level) and all-time-high employment figures despite the Omicron wave, central bankers finally had enough of the inflation driven by the widening gap between pent-up demand and the lack of supply. Even with the uncertainty created by the Russian invasion of Ukraine, the Bank of Canada and US Federal Reserve increased their overnight rate target by 25bps to 0.50% in March, their first attempt to quell the highest rates of inflation in three decades.



Perhaps this was only a modest increase in investors' eyes, as the timing of rate hikes coincided with some optimism in broad markets. Despite being down through February, the S&P/TSX Composite Index managed to climb 3.1% by the end of the quarter led by the Energy and Materials sectors. The Dow Jones Industrial Average was down 8.4% through February, before gaining some ground in March, closing the quarter down 4.6%.

Forecast

Inflation has certainly been soaring the last few quarters. While a little bit of inflation is healthy for the economy, triple the rate of the central bank's target is much too high. There are signs this rate could be slowing down, and as welcomed as this is, we do not anticipate inflation to fully dissipate in the near term for a few reasons.

NATO allies swiftly sanctioned Russia in participating in the global economy in almost everything except energy (Russia supplies 40% of Europe's gas needs). With economic powerhouses like the US and EU effectively no longer doing business with them for most things, it is reasonable to forecast further disruption to global supply chains and increased demand for non-Russian-produced goods. While we have no lens as to when the physical war will end, we expect these economic sanctions and its related ripple effects to be prolonged for years beyond the last bullet being fired.

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Adding further fuel to the inflation fire, or in this case, the lack of fuel, you've likely noticed that prices at the gas pump have skyrocketed around the world. This has not caught us off guard, and we see multiple factors that have caused the price of oil to soar. The recent Russia/Ukraine conflict contributes to the global supply shortage/volatility. We are also witnessing the continuation of the global re-opening, with several countries around the world now fully open to travelers, thereby requiring the gas to fuel up the jets. Over the longer term though, we have seen policymakers attempt to reduce/eliminate consumption of anything carbon through their rule of law. This of course includes oil and all its byproducts. Due to these unfavorable investing conditions, it is unlikely we will see oil & gas operators increasing capacity.

As we noted in a prior newsletter, the global supply chain is in rough shape. Different pieces of the supply chain are run by different operators, and they all have their issues causing a bottleneck that has yet to resolve itself. And as demand for goods has not declined, we still have a severe imbalance that is disparate and complicated. Resolution will likely come from a shift of discretionary spending from buying tangible goods to experiential services like travel and entertainment.

Finally, there is currently a lot of money circulating in the Canadian economy. The rate to borrow money has been near zero for years. This begun to change this quarter but its impact will not be immediate. Interest rates will still be relatively low for some time. This, coupled with very loose fiscal policy from the current federal regime indicates that policymakers have a strong intention to keep the money flowing.

Altogether, inflation, as we had anticipated, is not so transitory. It will drive consistent interest rate hikes for the remainder of the year. But with interest rates going up, do we foresee this tightening of monetary policy to tighten economic growth? Not yet. As noted, GDP and macroeconomic performance is demonstrating its resilience, and we believe that key indicators point to sustained growth propped up by Canada's exposure to commodities sectors, though the indebtedness of the Canadian consumer may be an issue. Despite our optimism, we know that as quickly as rates can rise, so too can economic performance decline; stagflation remains on our radar. We will be eyeing key indicators with heightened awareness moving forward.

Strategy

The current macroeconomic backdrop is giving us plenty to consider in our investment strategy. War, a pandemic, inflation, interest rates, consumer sentiment, federal budgets and the like are all factors that will be influencing the direction of your portfolios. For now, our asset allocation and sector allocation are set up to benefit as these major storylines of the quarter play out over time. Equities will remain the main asset class for your portfolios. They give us indirect ownership of commodities like energy and materials and provide us with exposure to potential tailwinds from the factors listed above. Further, several high quality companies you own are continually reporting positive results and demonstrating strong fundamentals. Fixed income remains an unattractive asset class at this time. The low interest rate environment is not a strong incentive for us to be bullish on bonds. However, as rates and yields become more attractive as the economic cycle winds along, we will be certain to evaluate their role in your portfolios.

Our communication with you

If you would like to opt for emailed quarterly packages and discontinue mailed quarterly packages, please email trevor@lee-turner.com and let us know. Thank you.

Suite #790 - 999 West Hastings Street
Vancouver, BC V6C 2W2
Telephone: 604-689-3289