# Highlights from our Investment Specialists

## HIGHLIGHTS FROM OUR INVESTMENT SPECIALISTS

January 19, 2023

After a challenging 2022, we kicked off the year at a due diligence conference in Toronto with a cross section of global equity and fixed income investment specialists. They shared their views on the current markets, their portfolio positioning, the risk factors they are watching, and why they are optimistic about the markets in 2023. The following are some of the key highlights:

### It's All About Inflation

Our investment specialists are entering 2023 with both concern and cautious optimism. Central bank efforts to curb inflation are beginning to take hold. We see signs of this throughout the economy, including within the Purchasing Managers Index (PMI) which measures the prevailing direction of economic trends in the manufacturing and service sectors. As Sam Baldwin mentioned in his discussion, currently, 83% of countries are reporting downturns in economic activity. Additional evidence is seen in the commodities, real estate, and automobile markets where prices have come off recent highs.

> "The markets are moving past inflation, but the Fed is not."
>
> – David Picton

It appears that the U.S. Federal Reserve (Fed) wants higher unemployment to stop pressuring growth in wages and to ensure that purchasing power continues to be reduced by inflation. The main concern for many at this point in the rate cycle is whether the Fed will make a policy error by hiking rates too far for too long. The prospect of a moderate economic recovery beginning in the second half and the Bank of Canada and the Fed cutting rates by the end of the year means there's light at the end of the tunnel, though the tunnel may still seem long.

## VIEWS FROM OUR INVESTMENT SPECIALISTS

EQUITIES

**Sam Baldwin**
**Guardian Capital LP**
**Mandate: Canadian Equity**

While the short-term outlook is negative, Guardian invests in quality companies that are resilient and whose valuations can surge during a recovery. Valuations are currently low in Canada relative to other markets, suggesting future outperformance for Canadian equities. Guardian is currently underweight in the energy sector and sees future opportunities in consumer and technology stocks.

**Pat Palozzi**
**Beutel Goodman**
**Mandate: North American Value Equity**

Increased volatility in 2022 provided opportunities for Beutel Goodman to actively invest in strong companies that have been on their radar for a while. Beutel has a very disciplined approach to finding securities that are trading at a significant discount to their intrinsic value, which helped provide downside protection in 2022. They are currently underweight energy and are seeking out opportunities in stable businesses and cyclical companies with strong cash positions.

## EQUITIES

**David Picton**
**Picton Mahoney**
**Mandate: Canadian Growth Equity**

While less concerned about inflation, Picton Mahoney believes the Fed will raise rates too high causing markets to retest the lows of 2022. When the Fed pivots to lower rates, the markets will surge making the pain of 2022 worthwhile. This shift will likely mark the beginning of a new commodities cycle. Going forward, David believes inflation will emerge faster making future business cycles shorter in duration and will require better portfolio construction.

**Dave Aspell**
**Mount Lucas**
**Mandate: U.S. Value Equity**

Mount Lucas runs a quantitative fundamental model based 70% on value factors and 30% on momentum factors, as both are important for picking stocks they believe will outperform. U.S. markets are important in portfolios since they represent a significant share of global wealth, business interest, and innovation. Dave says industrials, energy, and financials continue to look cheap while tech remains expensive. Dave noted that inflation continues to fall as evidenced by several data points including declining used car prices and slowing rent growth in key U.S. cities.

**Brandon Harrell**
**TSW**
**Mandate: International Value Equity**

Brandon believes the last three years have provided insight into what changes a company can handle in this era of economic and market turmoil. TSW's fundamental, bottom-up approach focuses on value and finding great companies at a good entry point. They are currently optimistic about high dividend-paying European banks featuring strong balance sheets trading at half of their book value.

**Ken Applegate**
**Wasatch**
**Mandate: Global Small Cap Equity**

Wasatch added to their favourite companies in 2022, trimming their portfolio to focus on their best ideas. They currently feel there is a significant gap between earnings and portfolio growth and expects this dispersion to revert to the mean. Wasatch is optimistic on Japanese small caps where shareholder reform and improvements in corporate governance will help buttress future mergers and acquisitions and will look for opportunities to add high-quality names in 2023.

## FIXED INCOME

**Konstantin Boehmer**
**Mackenzie**
**Mandate: Canadian Fixed Income**

Last year was bad for all classes of fixed income. Mackenzie continues to believe inflation will ultimately prove transitory, albeit not as much as originally thought given its persistence. The current focus is on the U.S. labour markets that must weaken for a recession to happen. Mackenzie likes Canadian fixed-income markets for 2023 due to their interest rate sensitivity and aggressive central bank policies, although some pain is expected. The Mackenzie fixed income team currently favours shorter-term bonds for their favourable yields and low volatility.

**Elsa Goldberg**
**Franklin Templeton**
**Mandate: Global Fixed Income**

Templeton's Global Macro Team is looking for countries where they can benefit from policy and interest rate divergence. Accordingly, they are expecting the USD to fall and Asian currencies to rise in 2023. Fundamentals throughout Asia all point to a better picture, with Japan predicted to grow faster than other G7 economies and this has the potential to help provide additional sources of diversification and returns to the portfolio in 2023.

**Corrado Russo**
Hazelview
Mandate: Global Real Estate

It was a perfect storm for real estate in 2022. Recovery for equities was far more pronounced than for REITs (real estate investment trusts) which have yet to recover. Public real estate remains well below pre-covid levels and entry at these levels has historically led to outsized gains for REITs suggesting that investors should continue to consider REITs a long-term hold. Going forward, markets will focus on value and wait for that value to be realized. Hazelview favours the industrial and multi-unit residential sectors and noted that investors will need to be very selective in the office and retail spaces.

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## OUTLOOK FOR 2023

Overall, our investment specialists believe the economy is slowing and that there is a risk that the economy will slip into a mild and short-lived recession in 2023. Markets will likely retest 2022 lows before entering a recovery phase in the second half of the year. The downturn since the emergence of inflation has made valuations more attractive but there is an additional risk to corporate earnings that may further pressure equity markets. This underscores the focus on quality businesses such as This underscores the focus on quality businesses such as investment specialist Pat Palozzi's focus on companies like TD Bank, CGI and Alimentation Couche-Tard that have managed through recessionary cycles before.

Regardless of what is happening in the broader economy, we remain focused on the long term. At times like this, it is important to maintain a disciplined approach and maintain a long-term perspective rather than letting quick decisions or feelings guide your outlook. Economic shocks are still rippling through the global economy meaning any forecasts for 2023 remain uncertain. Accordingly, we are maintaining an underweight position in equities and an overweight in fixed income to provide protection on the downside. We are also lowering our short-term bond exposure to add duration to the portfolios as we see most of the rate increases priced into fixed-income markets – meaning there is still likely more downside risk in equities currently.

Market volatility is normal and our portfolios along with our investment specialists continue to implement several proven strategies to help protect and grow your clients' wealth. The one thing we can be reasonably sure about is that the economic backdrop is likely to look and feel very different in a year's time.

**When markets are volatile, we know its tough to keep your emotions at bay.**
**If you have any concerns, please give us a call.**

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