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CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Market Comment

Most economies around the world expanded in 2021, with worldwide GDP now surpassing its pre-pandemic levels. Overall, this was generally a favorable environment for assets like equities and commodities. Now that the economy has recovered, governments have begun announcing plans to taper the stimulus that was put in place in response to the pandemic. Debate remains high whether this unprecedented level of stimulus will lead to a longer period of elevated inflation. Markets are currently pricing in an expectation that 2022 will see governments move beyond tapering stimulus and begin raising interest rates. Rising rates and inflation are both challenging for traditional fixed income investors, which may be contributing to the above-average equity valuations we have today. On the topic of valuation, it is important to note that not all markets or companies are valued the same, and these valuation differences offer opportunities for investors to consider. Some of the trendiest names saw significant losses towards the end of 2021 as profitability mattered to investors once again.

Looking forward, several positive conditions remain in place: GDP is expected to rise, interest rates remain low, and profits are forecast for moderate growth. But some challenging factors have also emerged: fading government support, persistent inflation, and a greater pressure on stocks to deliver earnings growth to support higher valuations. As we enter 2022, we remain optimistic, but this might be the year to move from bullish to balanced.

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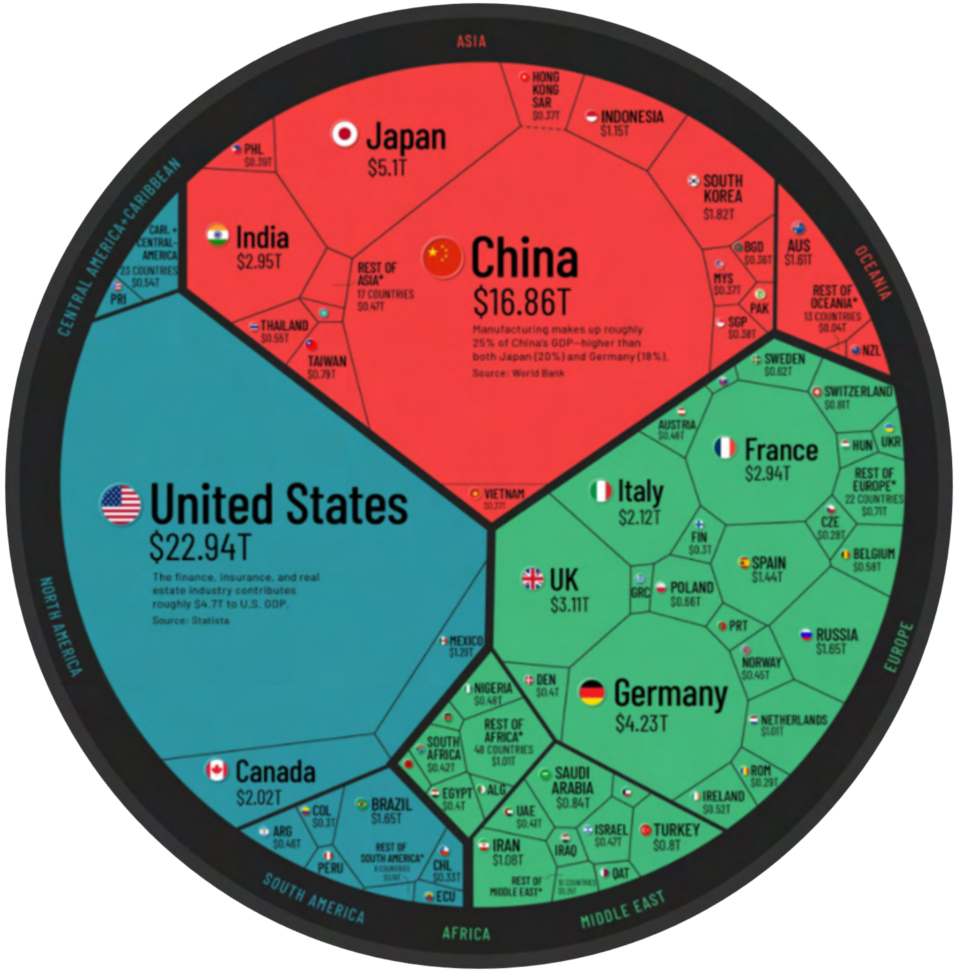
Global GDP 2021



Gross Domestic Profit (GDP) serves as a barometer for a country's economic health. This is a measure of the total market value of the final goods and services produced in a country during a given year.

According to the IMF, World GDP grew by 5.9% in 2021 and is over 8% higher than the pre-Covid level towards the end of 2019.

Together, the US and China account for approximately 42% of global GDP.

 | Source: IMF (2021), VISUALCAPITALIST.COM

Most equity markets outperformed fixed income in 2021. Commodities, which had been lagging for the better part of the past 15 years, saw strong relative performance.

The ‘Asset Allocation’ is a balanced portfolio of equity, fixed income, commodities, and real estate. It illustrates the consistency typical of pursuing a diversified investment strategy versus investing in only one asset class.

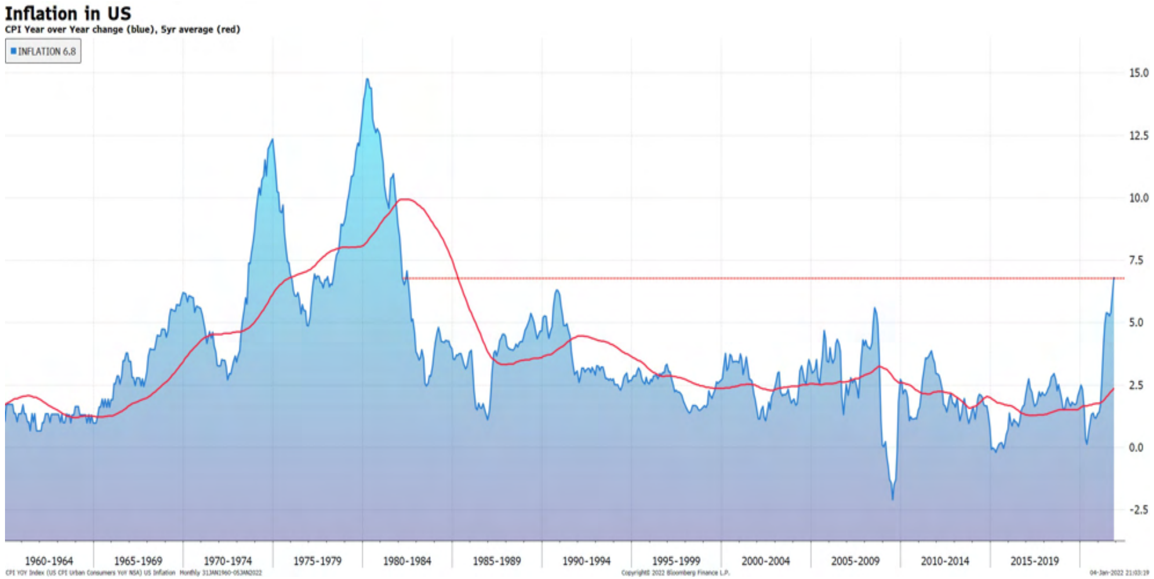
Asset Class Returns

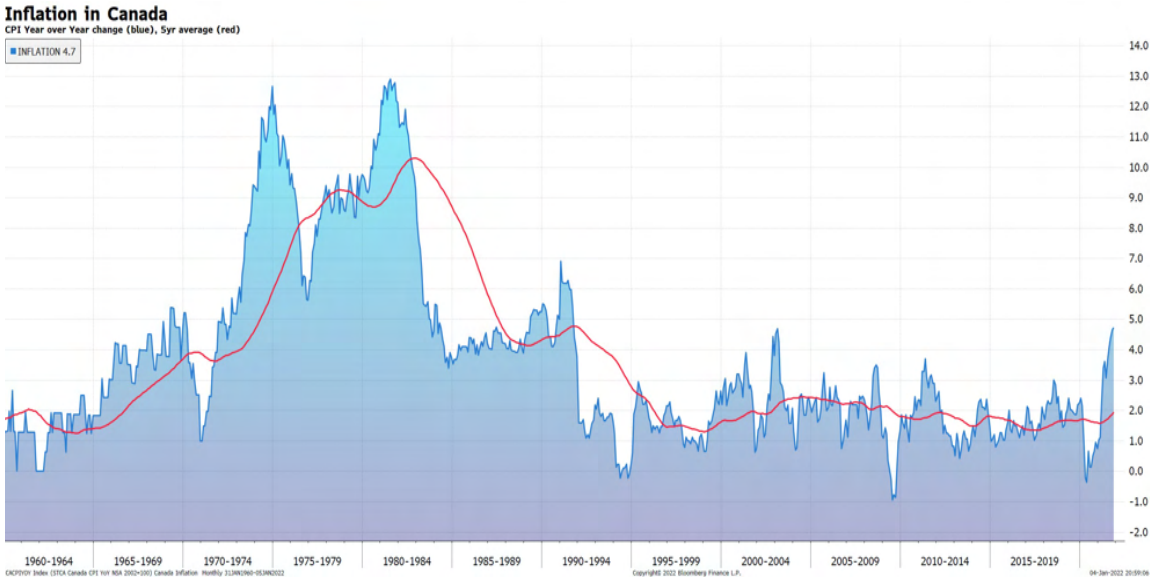
2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%
Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%
DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%
Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%
Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.4%
Large Cap 5.5%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%
Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%
High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%
Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%
REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%

The “Asset Allocation” portfolio assumes the following weights: 25% S&P500, 10% Russell 2000, 15% MSCI EAFE, 5% MSCI EM, 25% Bloomberg US Bond Agg, 5% High Yield, 5% Cash, 5% Commodity, 5% REIT.

 Source: J.P. Morgan Asset Management, OceanFront Investment Counsel Inc.

Inflation





Inflation in both the US and Canada, has surged year over year. The last time inflation was this high in the US was in 1982. Back then, the interest rate on a US 10-year Treasury Bond was nearly 15%. At the end of 2021, it was 1.5%.

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Inflation Expectations

Market indicators for inflation expectations remain elevated.

While the market isn't pricing in inflation to remain as high as the current rate of increase, it does imply inflation to be above average for at least the next five-year period.

 Source: Bloomberg Professional, OceanFront Investment Counsel Inc.

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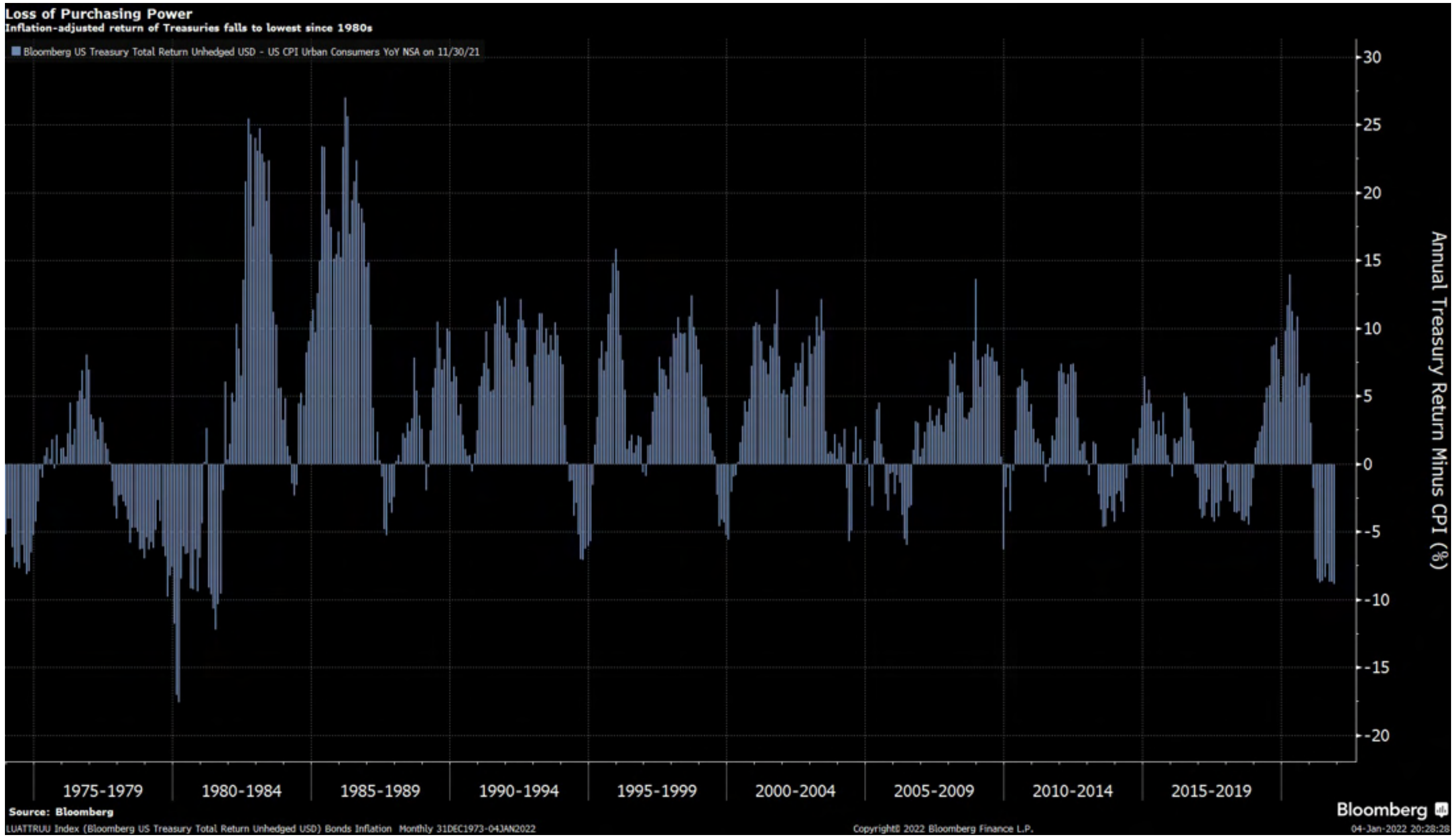
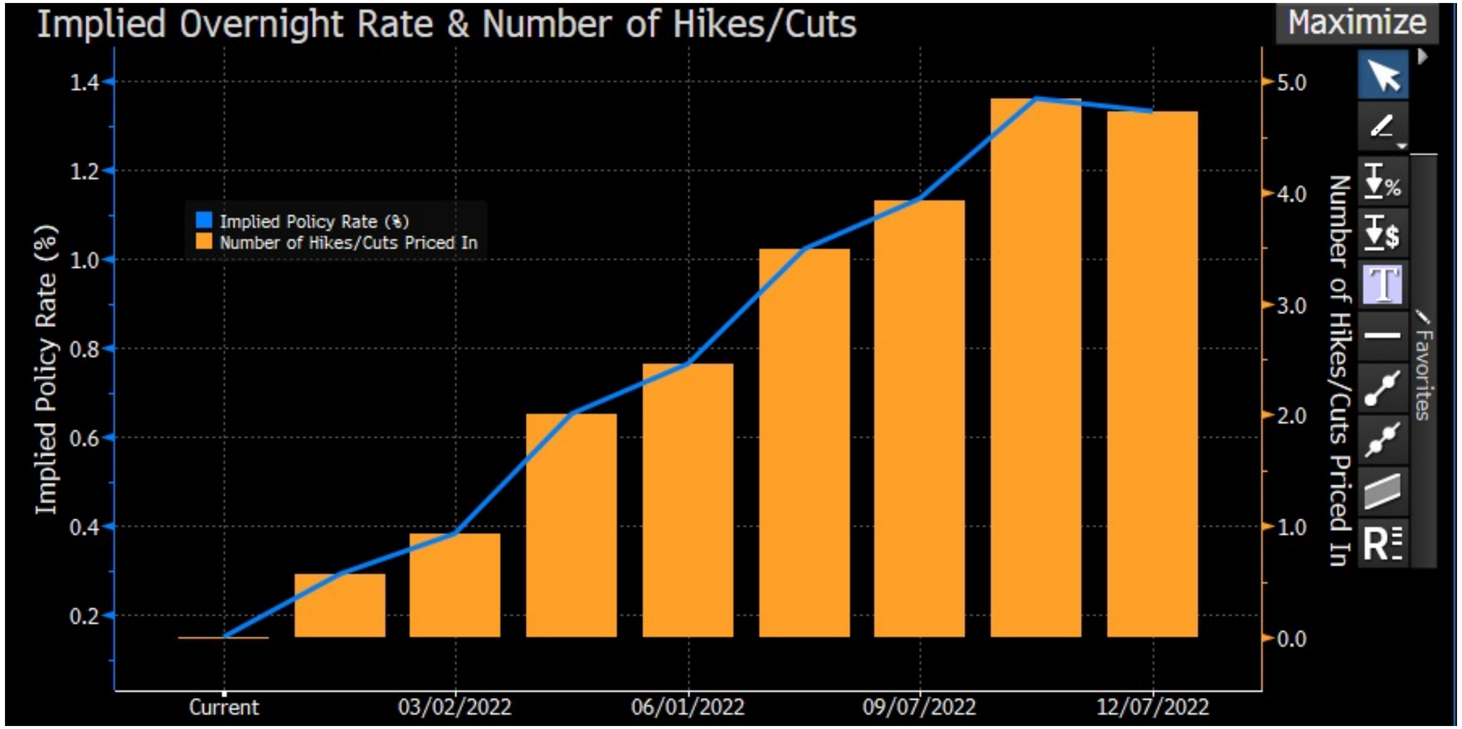
Sub Zero Rates

Treasury investors are losing more money than they have in four decades after inflation is accounted for.

What's more, the bond market is projecting that 10 Year Treasury yields will hold below the inflation rate for the next decade.



Rates Expected to Rise



The Bank of Canada is scheduled to meet eight times in 2022.

Investors are betting the Bank of Canada will begin a cycle of raising rates in the first quarter of 2022, that will be the most aggressive among advanced economies. Markets are pricing in five increases, which would bring the benchmark rate to 1.5%.

Meeting	#Hikes/Cuts	Implied Rate
01/26/2022	0.6	0.29
03/02/2022	0.9	0.38
04/13/2022	2.0	0.65
06/01/2022	2.5	0.76
07/13/2022	3.5	1.02
09/07/2022	3.9	1.13
10/26/2022	4.8	1.36
12/07/2022	4.7	1.33

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US Valuation Measures

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	21.18x	16.83x	1.30
CAPE	Shiller's P/E	40.9	27.86	2.05
Div. Yield	Dividend yield	1.35%	2.00%	1.97
P/B	Price to book	4.41	3.08	1.66
P/CF	Price to cash flow	16.17	11.11	2.30
EY Spread	EY minus Baa yield	1.35%	0.16%	-0.60

The S&P500, the main proxy for the US Equity market, appears elevated on several valuation measures relative to the past 25 years.

However, considering the main alternative to equity is typically bonds, it is worth noting the Earnings Yield (EY) Spread (the difference between Earnings Yield on stocks and the yield on a Baa rated bond) is below its 25-year average.

By this measure, stock investors are perhaps accepting higher equity market valuations considering the alternative of ultra-low bond yields is even less attractive.

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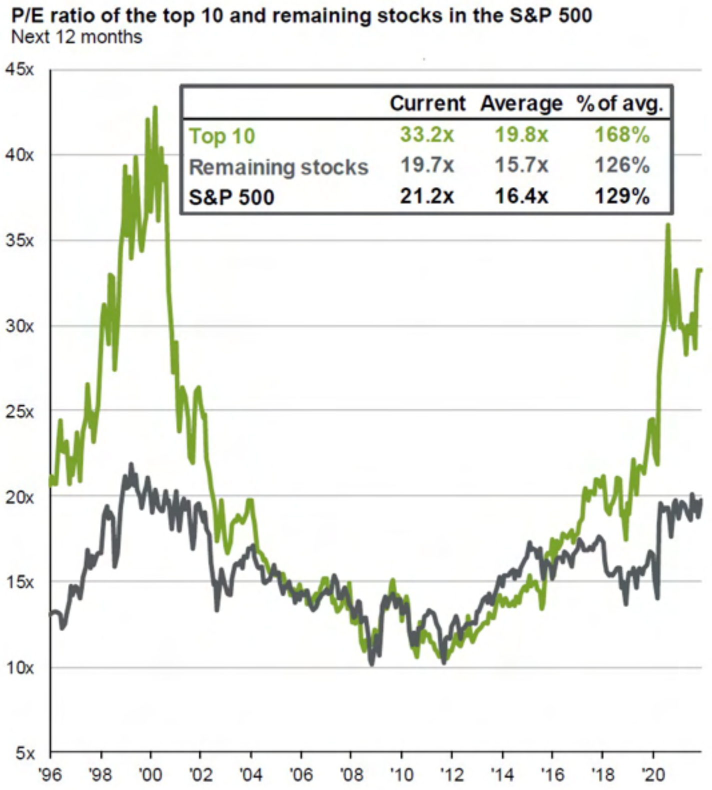
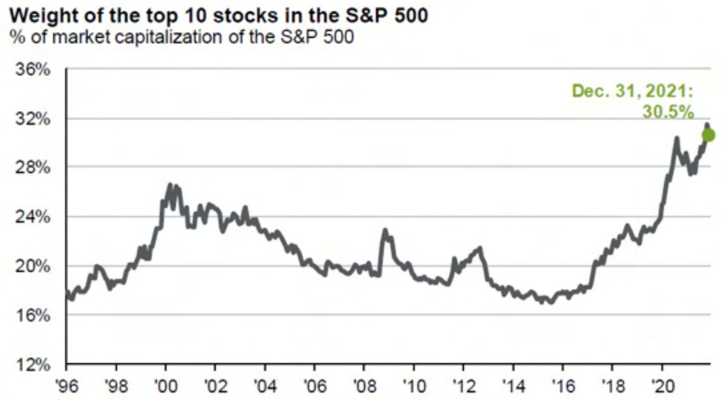
S&P500: Index Concentration, Valuations & Earnings





The 10 largest companies comprise a higher weight in the index than any other time in the last 25 years…

…but profit contribution is starting to accelerate elsewhere in the market.

The top 10 companies in the S&P500 index have considerably higher valuation multiples than the rest of the companies in the index. This, coupled with how big these companies are in the index, is skewing the index's overall valuation. If profit contribution continues to accelerate elsewhere in the index, this valuation gap may be challenged as the smaller companies become more attractive to investors.

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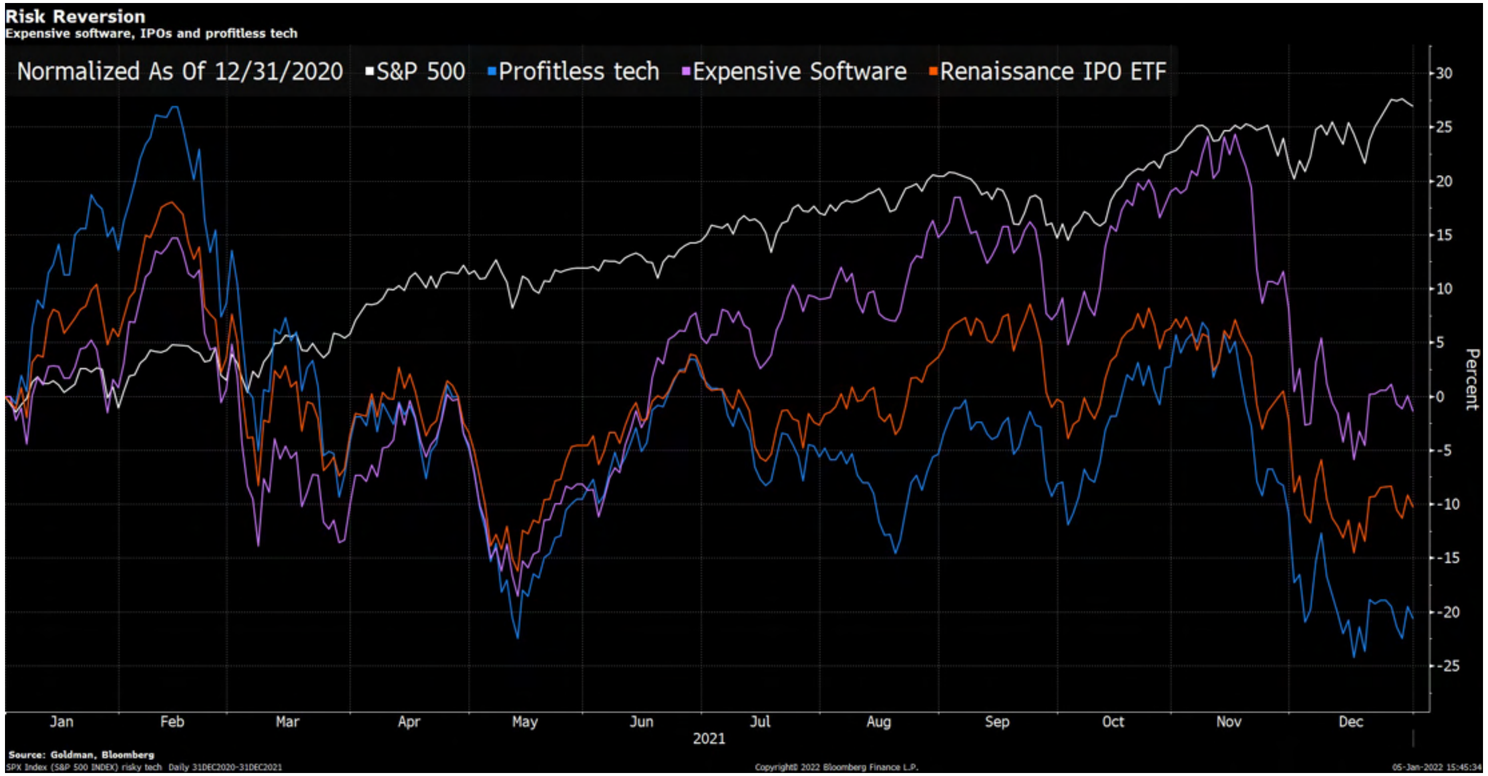
Expensive, Profitless and Hot

At the beginning of 2021, US companies that fell into a category of either profitless technology, expensive software, or newly issued IPOs were beating the market.

By the of the year, all three categories lost money despite the overall index being up over 25%.

This might be related to retail traders' hot and cold nature, as these names often appeared in "meme" stock chats. But perhaps more fundamentally, this illustrates the greater sensitivity to rising interest rates for companies with profits far off in the future.

And profits matter… eventually.



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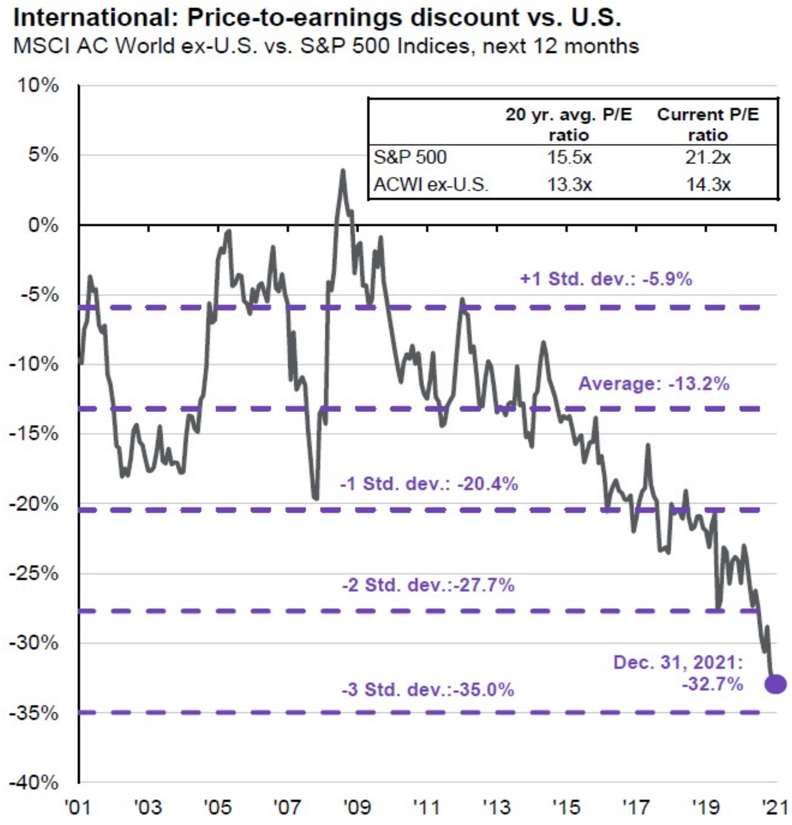
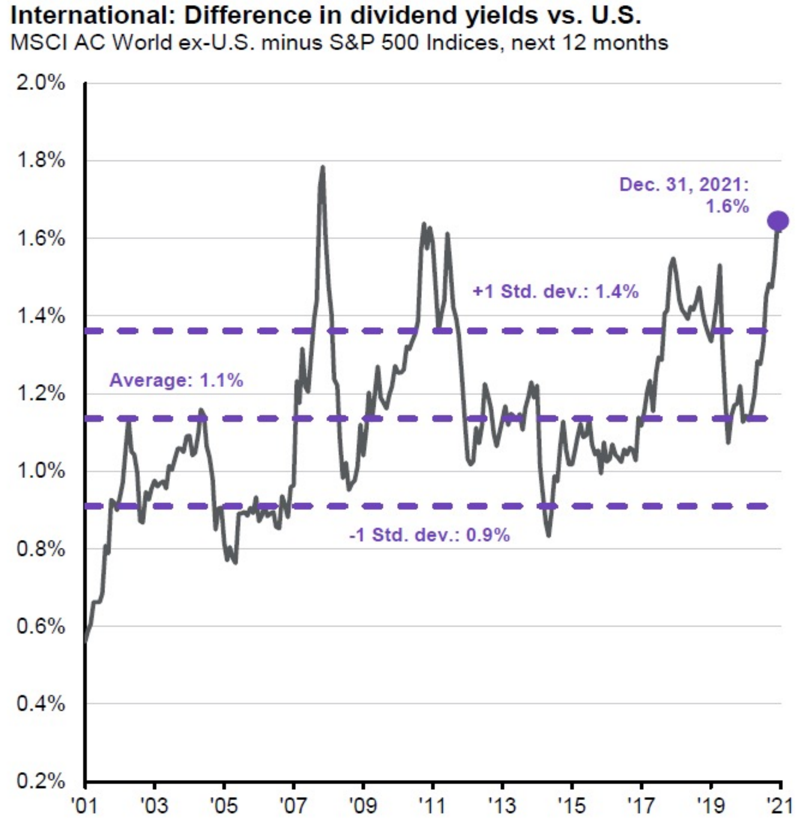
International Valuations & Dividend Yields



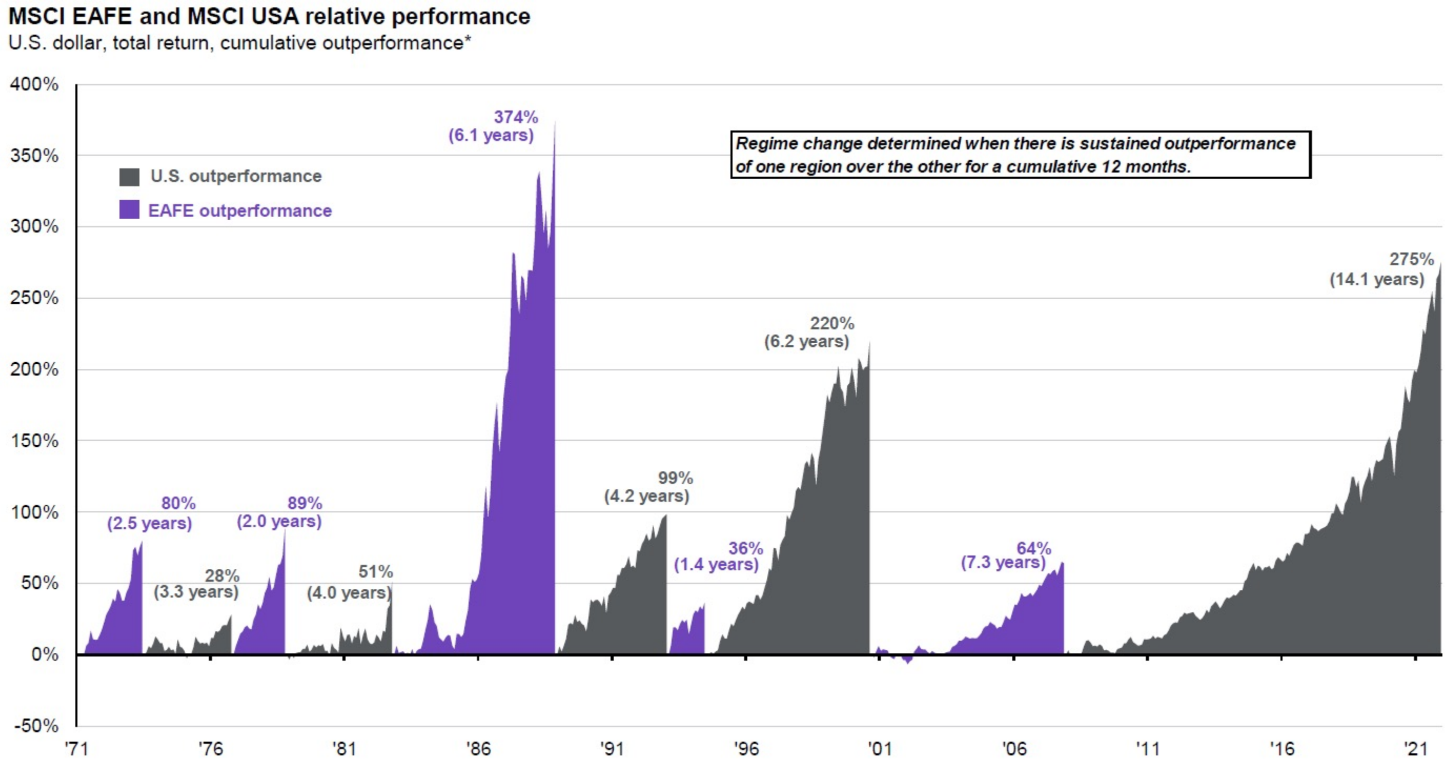


Valuations and dividend yields outside the US appear to offer better value.

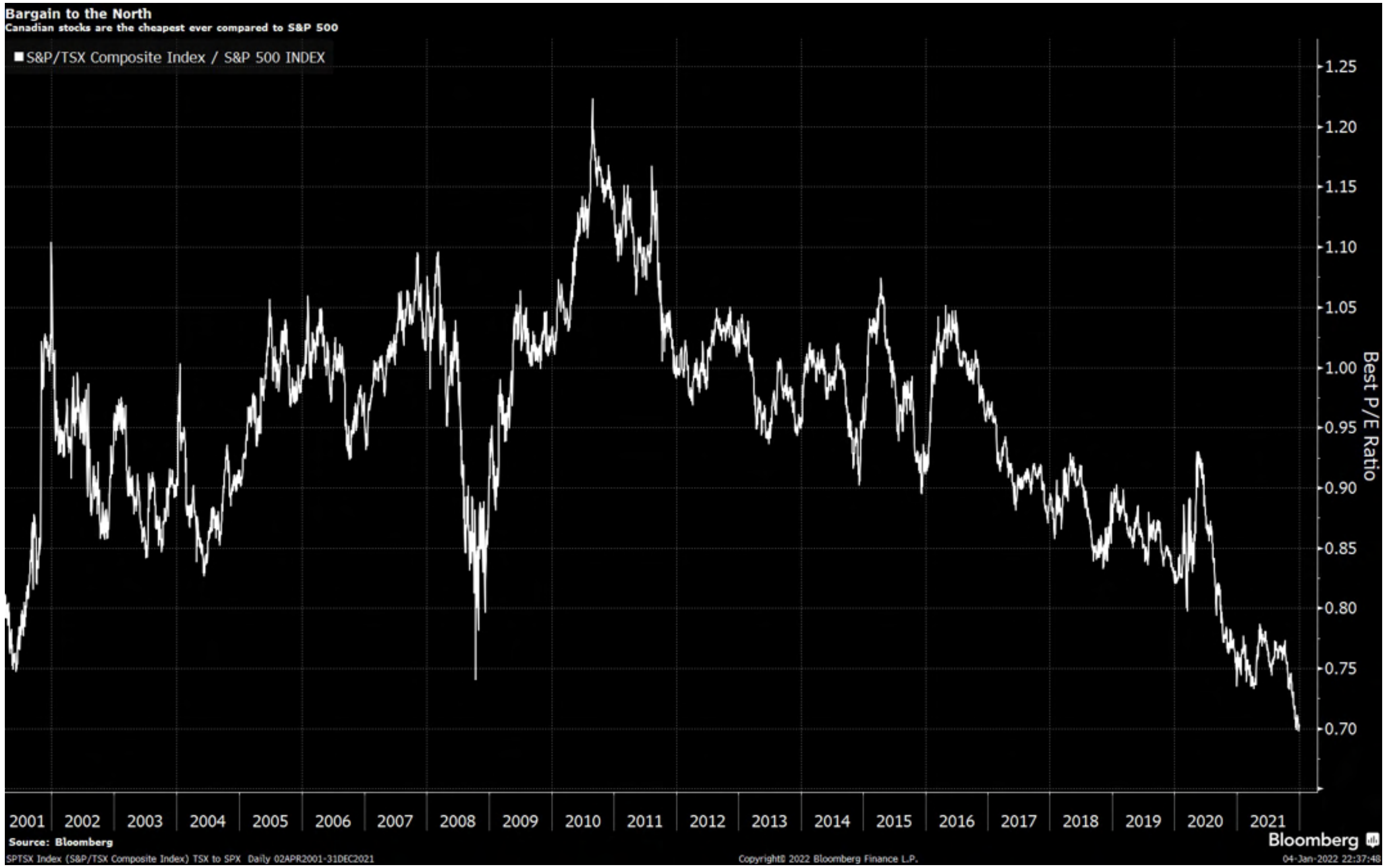
Cycles of US Equity Outperformance

In the past 50 years, the leadership between the US and the rest of the world (EAFE) has oscillated ten times, with the most recent period being the longest in length.

The material valuation gap highlighted on the previous slide between the US and EAFE offers an interesting set up for investors who think this time isn't different.



Bargains At Home Too!



The Canadian stock market is at its greatest discount in over 20 years relative to the US when comparing valuations (P/E Ratio) between their major indexes.

 Source: Bloomberg Professional, OceanFront Investment Counsel Inc.

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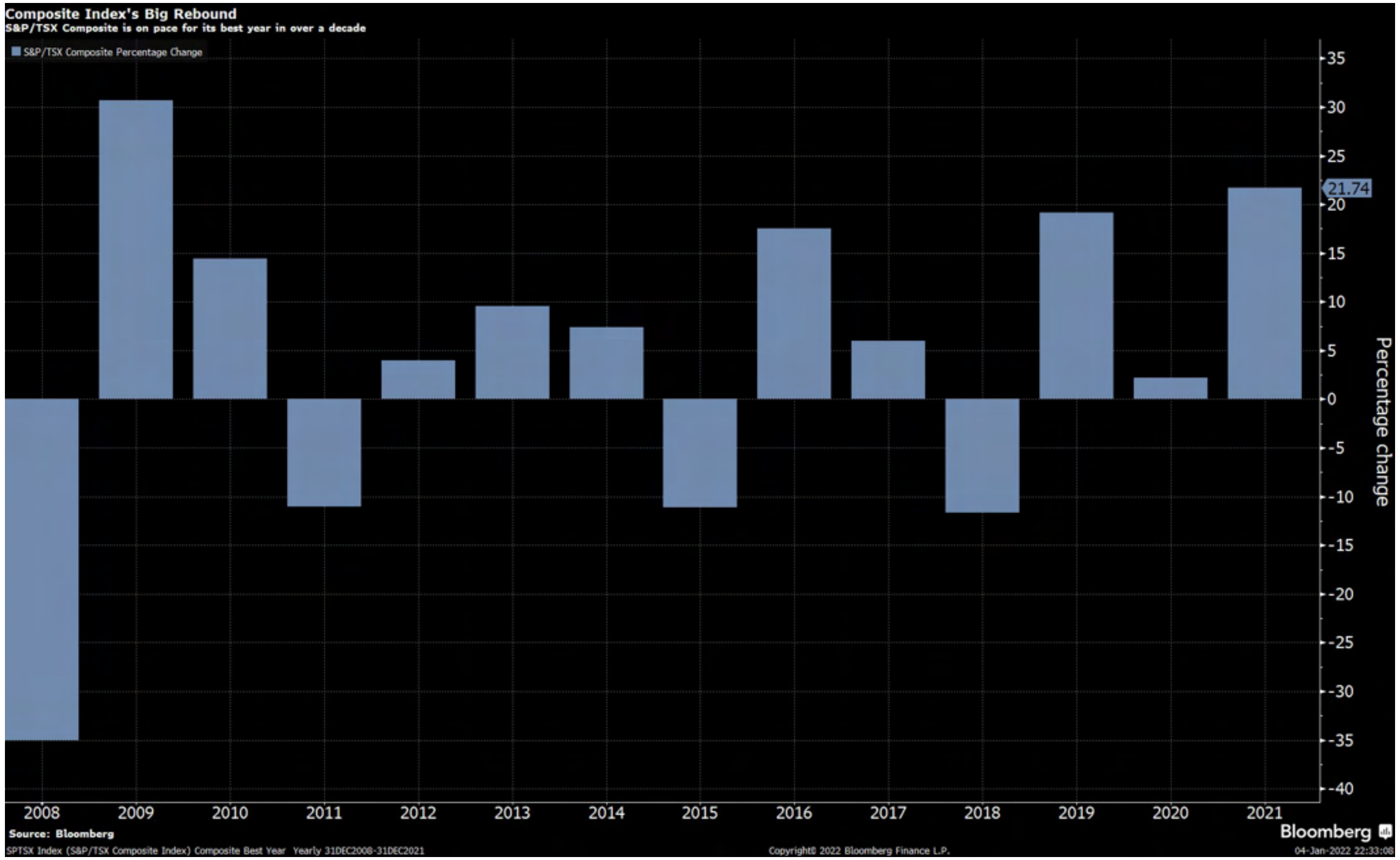
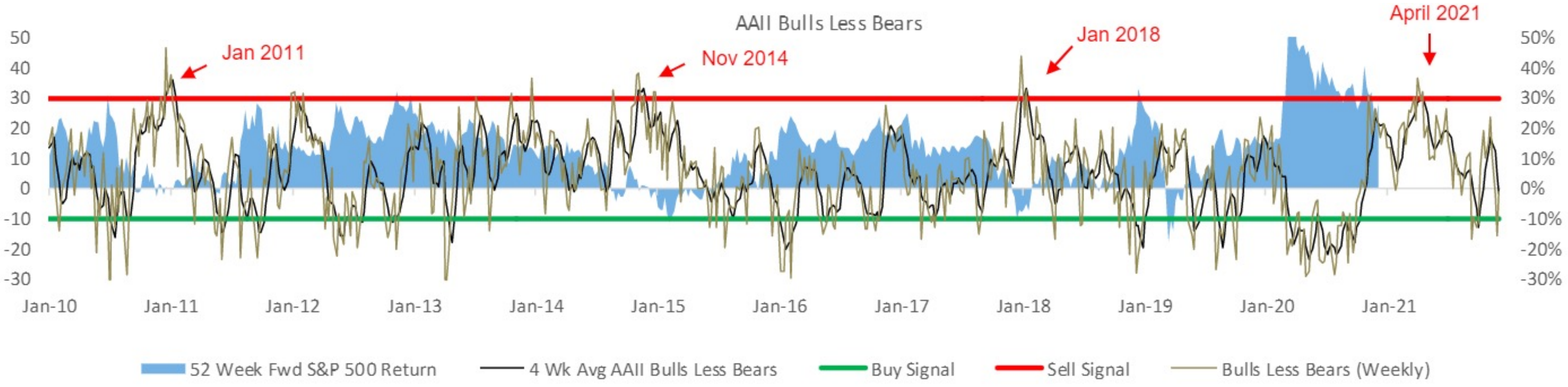
TSX Best In A Decade

Canada's stock market recorded its best year in over a decade amid the rebound in oil prices and strength in the banking sector.

Energy companies dominated the top-performing list, occupying 8 of the top 10 spots.



Investor Sentiment and Timing



Peaks in investor sentiment are often associated with lower returns in the subsequent 52-week period. The opposite is true, with strong returns following a low in sentiment. The last major peak in investor sentiment was in April 2021, as expectations around Covid-19 vaccine effectiveness and reopening were strong. More recently, sentiment has weakened, likely due to the emergence of Omicron. This level of lower investor sentiment is close to registering as a contrarian buy signal.

DISCLAIMER

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E&OE

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