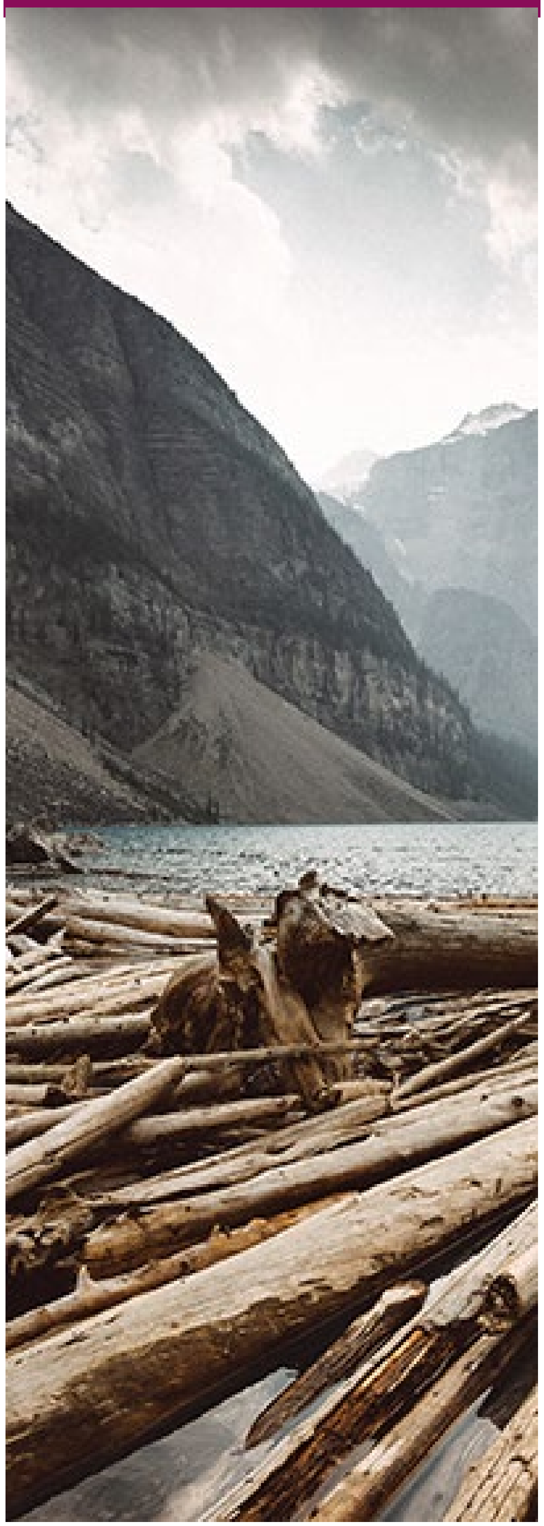
RICHARDSON Wealth

PARTINGTON WEALTH MANAGEMENT

Market Update

Year End 2022



Market Returns December 31st, 2022 (YTD)

- -5.80% **S&P TSX (Toronto)**
- -18.10% **S&P 500 (US)**
- -33.10% **Nasdaq (US Tech)**
- -17.70 % **FTSE All-World**
- -11.41% **DEX (CDN Bonds)**
- +7.26% **USD to CDN (good holding US stocks)**

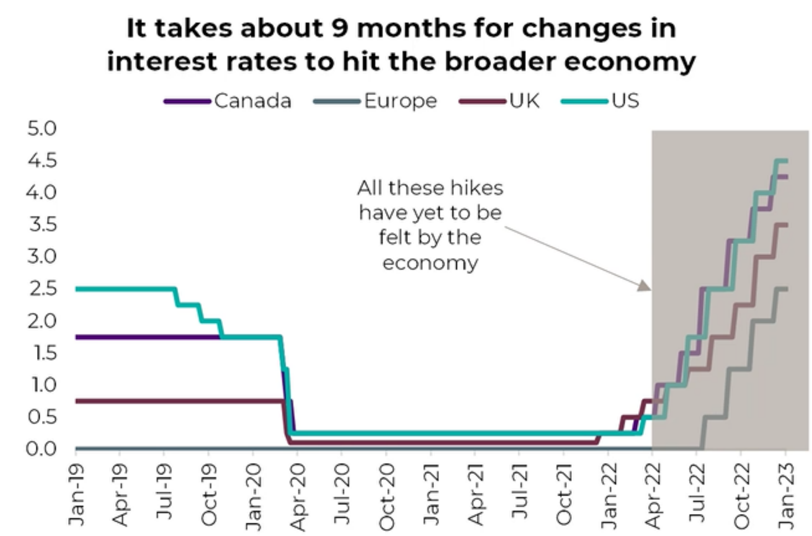
How To Navigate This Market When Buying the Dip Isn't Working

A common theme in many recent financial reports is that things have changed, and the world should be viewed through a different lens. These reports encourage changes such as moving to value vs. growth, buying GICs that are paying up to 5%, or selling equities to sit in cash. Watching the nightly news or looking at headlines has created a bearish sentiment. The headlines haven't changed as there is no resolution to the conflict in Russia, China is still navigating lock downs, central banks are continuing to raise interest rates and governments continue to pile on debt while calling it an inflation reduction act. We believe that finding quality companies that are producing earnings will equate to higher stock prices over time.

For the first time in 14 years, we have experienced a full year without a rebound. Since 2008, the investment process can be broken down to "buy the dip". Effectively this means adding to your equities when the markets drop and trimming when the markets reach new highs again. This strategy worked amazingly well until last year. The other side of the equation is bonds. The last 10 years have given such abysmal returns in bonds that you would have been better to simply hold equities through the volatility knowing that the rebound was coming.

Our strategy for investing is of a similar mindset to pensions funds; we position clients so that portfolios are always fully invested. We don't make cash calls. Instead, we rebalance by shifting allocations. Our models use alternative investments to limit the downside and provide a different return profile when comparing stocks and bonds only. These asset classes include private equity, long/short funds, and private debt. Last year, our allocation to bonds was underweight, which turned out to be a good call. We therefore had a higher equity allocation which posted negative returns over the last year but has provided better long-term performance when compared to holding more bonds over the last 5 years.

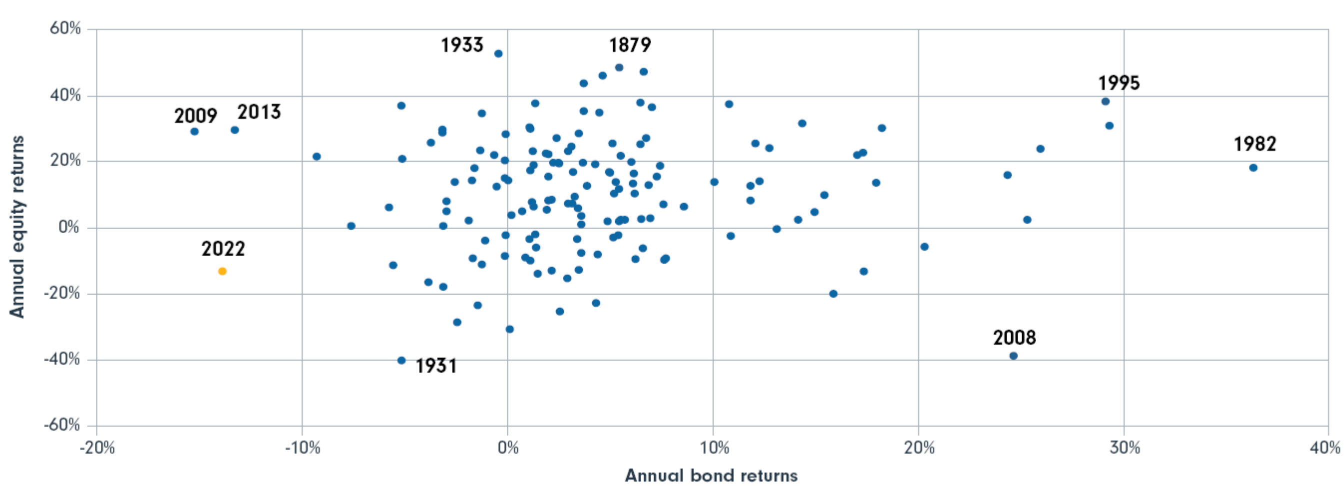
The Federal Reserve has slowly switched from "inflation is transitory" to "we need to take the US into a recession to combat inflation". At the start of 2022, GICs were earning less than 1% and there was no indication that rates would be raised as far and as fast as they were. Raising rates in a slow and structured manner would have allowed the markets time to react and slowly trend downward as opposed to the drops that we experienced. Instead, the Fed took the path of "ripping the band-aid" without realizing that band-aid was in fact duct-taped. All the stimuli that central bankers had put in place (not only from COVID) but since 2008, has made changes in policy extremely negative for the markets. Historically, rates have never increased by this magnitude. Some of you may be thinking about the 80's when people were paying 18% interest! While doubling rates from 9%-18% is meaningful, this year we have seen rates go up 16 times from where they were. Unfortunately, we all know someone who went house shopping with the mentality of "what is the maximum purchase price my income can afford me today" vs. "what can I reasonably afford". This has led to many homeowners with variable rate mortgages, needing to cut back on other expenses to cover their new monthly payments. The chart below demonstrates the enormity of the rate increases, but more importantly where I feel the Fed and other central banks have overstepped, is that we have yet to feel the effects of what has been implemented. It takes nine months for these interest rates to take full effect and they are still not done?



Source: Bloomberg, Purpose Investments

Last year was one of the toughest years on record for a 60/40 portfolio. The graph below shows the calendar returns of both the equity and bond markets. In 2022, bonds were down more than 10% and equities were down almost 20% as is shown toward the bottom left of the chart. You will notice that 1982 and 1995 were two great years for return performance for both equity and bonds investors.

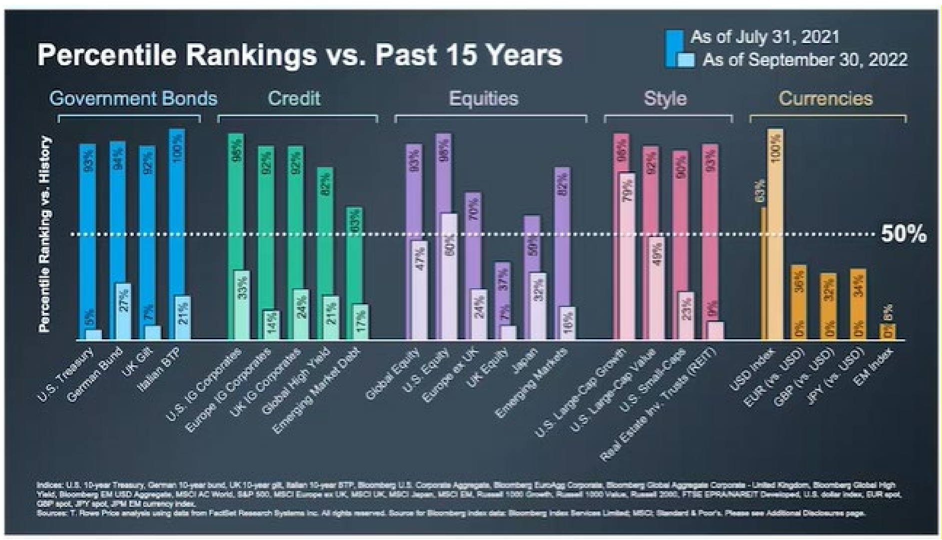
Chart 1: The year 2022 was an outlier, because both bonds and equities performed poorly.



Annual nominal returns of S&P 500 and US 10y Treasuries 1870–2022; data for 2022 are for the year to December 1, 2022. Source: Pre-2021 data from Òscar Jordà, Katharina Knoll, Dmitry Kuvshinov, Moritz Schularick, and Alan M. Taylor, "The Rate of Return on Everything, 1870–2015," *Quarterly Journal of Economics*, 134(3), 1225-1298, 2019. Post-2020 data from Refinitiv and Fidelity International, December 2022.

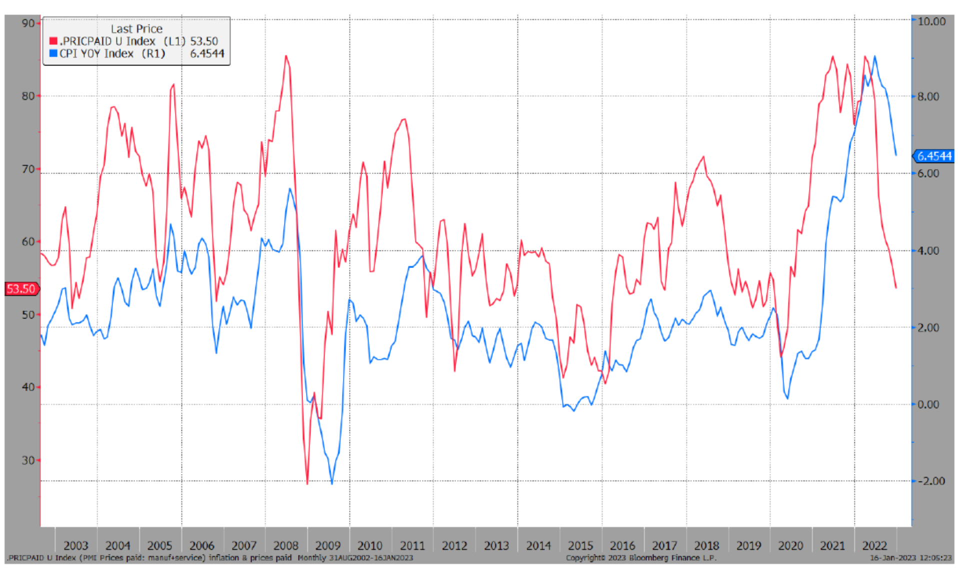
Many conservative clients performed similarly to balanced clients as the bond (safety) exposure did not protect the portfolio. We struggled with buying GICs when they were paying less than 1% and inflation was running between 6 to 9%. Purchasing a GIC would effectively lock in a sure loss to inflation.

Below, you'll see a chart from a year end update by T. Rowe Price. It shows the percentile rankings of where we were in July vs. September 2022. Keep in mind that October and December were also negative months, this would indicate that we are in a better position than even this chart shows as of the summer of 2022. The only caveat is that the US dollar remains very high when compared to global currencies. This could be an interesting area to monitor as the dollar will no doubt come down over time. Typically, both international companies and gold benefit in this scenario, and both investments are in our portfolios today. We have just recently rebalanced all balanced and growth clients to have at least a 2.5% weighting in gold, if not higher.



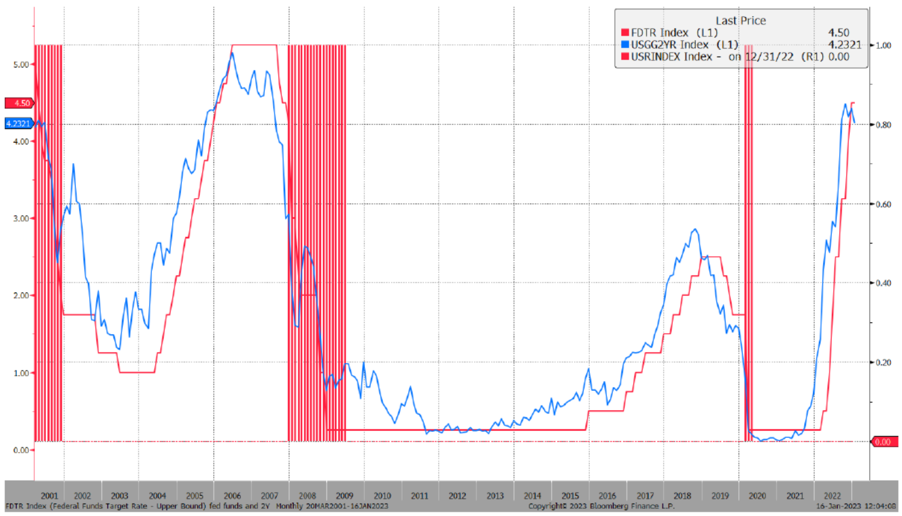
The next few charts focus on rates and our view on why we should see the Fed change course. Inflation pressures are coming down as shown by the red line. This is a combination of commodity prices plus goods and services. This is typically followed by a CPI (blue line) year over year change, which is what central bankers watch to ensure that the rate increases are effective.

Rates: Inflationary pressures easing (red, prices paid, goods + services), CPI (blue)



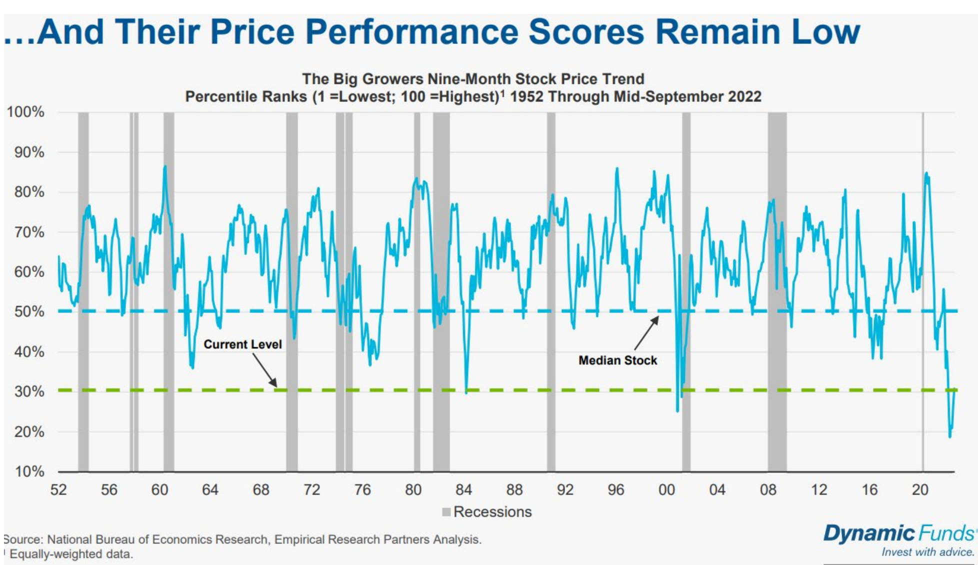
Furthermore, the chart below shows the relationship between short term treasury bonds and current interest rates. Dating back to 2001, you can see the relationship between the last few recessions (red vertical lines), two-year treasuries – (blue horizontal line) and the current interest rates – (red horizontal line). For the last 20 years the Federal Reserve has stopped increasing interest rates when the two-year treasury line crossed below the current interest rates. We have now entered this territory, giving us confidence that rates have gone far enough.

Rates: Fed Funds (red) > 2-year (blue) = pause, typically good for stocks

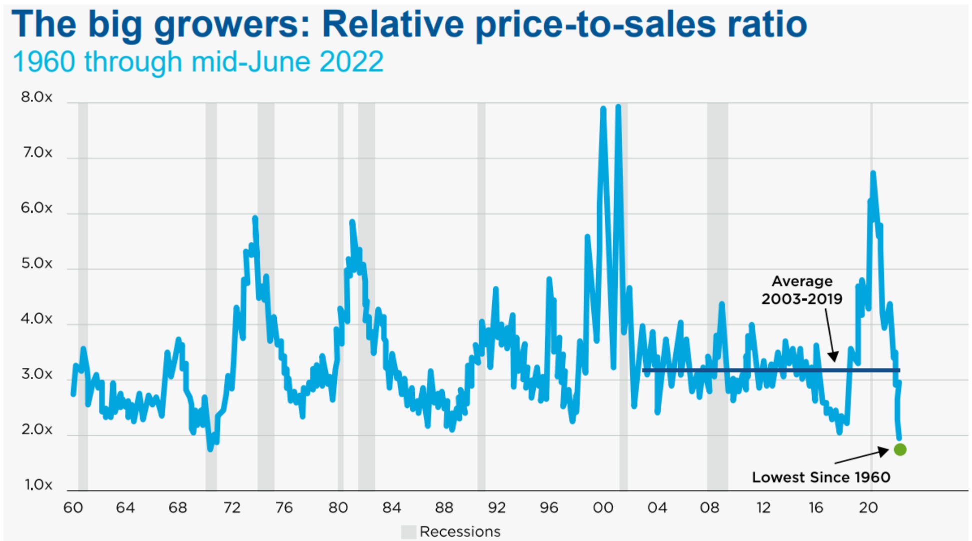


While we have been a bit more technical in this report, the main take away is to realize that in 2023 the Fed will stop raising rates which has been the biggest negative for your portfolios. Even better, when the markets perceived a change of policy such as a pause in rates going up or a rate cut, there is strong buying in the equity markets. We continue to see ample cash on the sidelines, which overtime will move into bonds as they are now providing high single digit income. This is followed by the fear of markets rebounding and investors who have been sitting on the sidelines, will begin deploying after the markets have already moved higher. We are well positioned to take advantage of this by staying invested.

The next two slides came from our growth manager Noah Blackstein, who had a tough year in 2022. The first chart shows the decline in price of large cap growth stocks which has reached the lowest point dating back 70 years. It is important to point out that even though Noah was down 50% in 2022, his 10-year returns still show over a 10% annualized return.

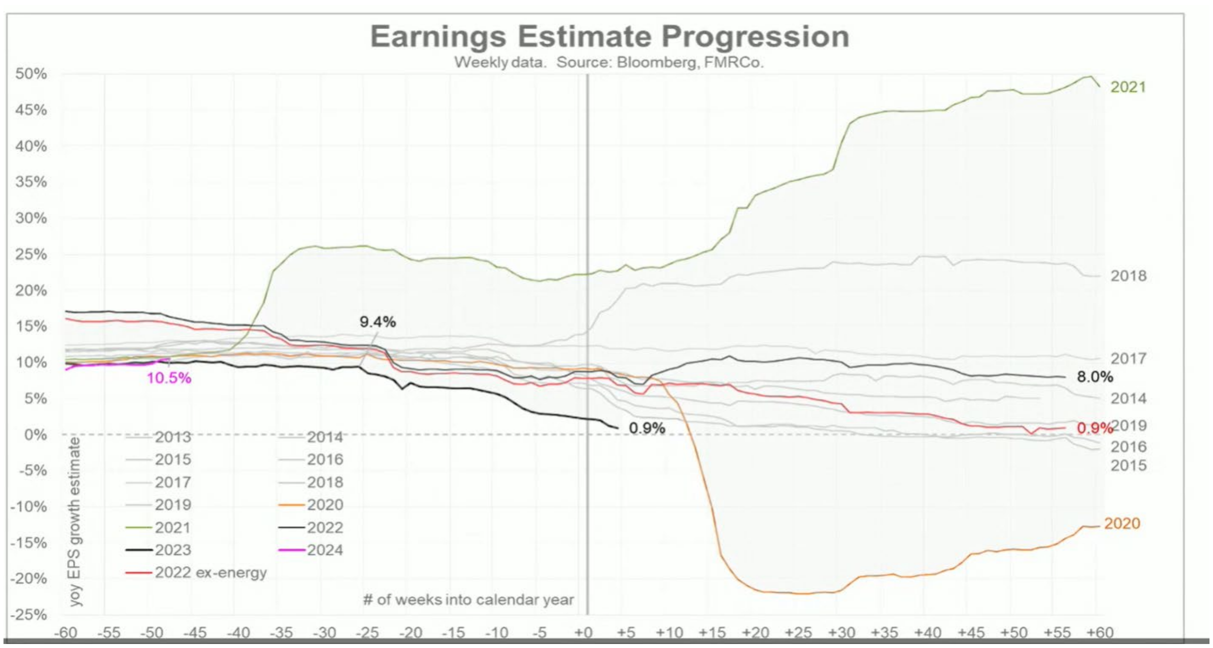


The second chart shows the price of growth stocks relative to their total sales, which was the lowest since 1960. This is meaningful as you can manipulate income statements and EBITDA numbers, but it is hard to manipulate the amount of revenue you generate. Noah Blackstein, a Portfolio Manager with Dynamic Funds, started managing money in the late 90's and is more excited about the opportunities in the growth sector today than ever before in his career.



Source: National Bureau of Economics Research, Empirical Research Partners Analysis.

The last chart shows the earnings estimates for companies in the S&P 500. In 2023, they are estimating that earnings will be flat to negative. This is in part the reason for the sell-off in the stock market. There is a lot of discussion around a recession: will the US have won and if so, will it be a soft or a hard landing? It is tough to say as we do not know what the Fed will ultimately end up doing with interest rates. However, the fourth quarter earnings are coming out now and many companies are in line with expectations, which is a positive trend. I think we can all understand that with higher expenses, earnings for 2023 are not going to be robust. However, when you look ahead to 2024, earnings are expected to rise by 10.5%. Many companies are cutting jobs now, which can only help earnings by lowering costs. Lastly, we feel that if there is a recession, it will be quite mild as you can't have much of a recession with unemployment as low as 4%.



For more information on what other investment banks are saying, you can read their year-end reports as well. You will need to sign up for the free version access to read them.

We wanted to end with a short note regarding the 2022 market conditions as well as overall investor sentiment. In times of extreme volatility, economic uncertainty and general market stress, market participants can succumb to behavioural biases which typically lead to poor decision making (groupthink, information bias, etc.). In many instances, both professional and novice investors will make long term investment decisions based on short-term movements in the share price. We've all been there at some point or another. Fortunately, our goal as stewards of investor capital is to focus on investing over the long term and follow a strict investment process which helps to negate these biases in the investment decision making process. One of the keys to investing is to see the "forest through the trees" and to focus on information that is relevant to the investment decision making process while filtering out irrelevant information. While admittedly, 2022 has been more volatile than we had expected (and most definitely more than we would have liked), we view the set-up going forward as positive compared with the year we just came from.

Investment Highlights in the Fourth Quarter

For those of you who enjoy more detail on investments, please see the below comments from myself and Brenan. This commentary provides a more detailed evaluation of our best and worst performing stocks within the models.

As of 12/31/2022	Standout based on Q4 - 2022 returns	Stocks Under Pressure – Q4
US Stocks (in USD)	Deere & Co. (DE): +28.41% Merck & Co. (MRK): +28.83%	CF Industries (CF): -11.48% Albemarle Corp (ALB): -17.99%
Canadian Stocks (in CDN)	Restaurant Brands Int. (QSR): +19.18% Slate Grocery REIT (SGR.UN): +14.90%	Nutrien Ltd. (NRT): -14.19% Canadian Tire (CTC.A): -3.77%
Mutual Funds	Dynamic Precious Metals Fund: +15.8% Turtle Creek Equity Fund: +13.40%	Dynamic Power Global Growth Fund: -12.1% Fidelity Global Innovators: -4.46%

US Stocks

In Q4 2022, our US strategy was up 11.9% compared with the S&P 500 TR Index which was up 7.6%. This resulted in an outperformance of 4.3% over the quarter. In 2022, the US strategy was down -8.9% whereas the benchmark was down -18.1% leading to an annual outperformance of 9.2%. The US dollar appreciated relative to the Canadian dollar (CAD) by 7%, so holders of the US model were benefactors of this. Thus, in CAD, the US model was down approximately 1.9% in 2022.

Over the quarter we sold Discover Financial Services (DFS) and purchased a consumer discretionary stock named Ulta Beauty, Inc (ULTA). DFS reported early in the Q3 earnings season, beating top and bottom-line estimates and traded up 10%+. We used this as an opportunity to sell DFS and buy ULTA as we believed that ULTA provided a greater opportunity going forward – ULTA later reported a very strong quarter and raised guidance. Since we made the trade, DFS is up approximately 4% whereas ULTA is up close to 27%.

Overall, we did not make many changes to the portfolio in the fourth quarter as we believe that the companies we hold are quality companies with strong earnings growth. We know that companies who have a clean balance sheet and are growing earnings will eventually lead to share price appreciation. Sometimes it just takes the market time to remember.

This proved profitable for clients as most of our portfolio holdings beat estimates, helping us outperform the S&P 500 over the quarter and on the year. We wanted to be careful not to trigger additional gains and so we took losses where possible to take advantage of tax loss selling.

Canadian Stocks

In Q4 2022, our Canadian strategy was up 3.9% compared with the S&P/TSX TR Index (which was up 6.0%), resulting in an under performance of -2.1%. In 2022, the Canadian strategy was down -9.3%, whereas the benchmark was down - 5.8% and thus, underperformed by -3.5%. Keep in mind that we have been under weight in energy, keeping a more ESG-focused approach to investing. As mentioned in the last newsletter, we have been working on a solution to tweak the Canadian strategy to generate alpha while still focusing on downside protection and dividend growth. The revised Canadian strategy was fully implemented in November and has beat the benchmark in November and December so we're comfortable with continuing to run the Canadian mandate like the US strategy, where we run 10 growth stocks and 10 income stocks. We are adding five growth names to the Canadian portfolio.

As an example of this, in Q4 we sold Emera Incorporated (EMA) and purchased Finning International Inc (FTT). FTT is a Canadian based Caterpillar equipment dealer that sells and rents parts/service for equipment to their clients. FTT has operations in Canada, South America, and Europe. They have been successful in navigating a tough economic environment and have consistently grown their earnings. FTT is currently paying a dividend yield of 2.58% and we believe investors will benefit from their dividend as well as share price appreciation as earnings continue to grow.

Mutual Funds

In Q4, the top performing mutual funds were Turtle Creek Equity Fund and the Dynamic Precious Metals Fund. Turtle Creek was up over +13% on the quarter, while Dynamic Precious Metals was up over +17%. Although Turtle Creek still ended the year down -16.9%, the fund has benefited from the market sell off by being extremely active and has been able to accumulate positions in companies that they have previously deemed to be "far too expensive". The fund also was able to average down on their highest conviction stocks, which benefitted from the Q4 rally. The Dynamic Precious Metals Fund was up 15.8% in Q4 of 2022 but was still down -15.7% on the year. The fund benefited from a late Q4 rally in the precious metals sector as investors viewed the month over month declining inflation data as a positive for the Fed to stop raising rates so aggressively. Typically, precious metals (gold) are inversely correlated (i.e. they move in the opposite direction) with interest rates, which is one of the main reasons for precious metal equities underperforming in 2022. Typically, inflation and real assets such as gold are highly correlated, but the market (including US) didn't account for interest rates rising so aggressively. As a result, the increase in interest rates trumped the inflation benefit that we were expecting the precious metals sector to have in 2022. Also, the US dollar was very strong compared to global currencies, which added to the negative price of real assets. This is something we believe is reversing and we think this trend will continue into 2023.

The worst performing funds in Q4, were the Dynamic Global Growth Fund and the Fidelity Global Innovators Fund, which were down -12.1% and -4.46% respectively over the quarter. For the year, the Dynamic Global Growth Fund was down - 50.1% and Fidelity Global Innovators was down -29.65%. Both funds entered 2022 highly exposed to growth equities which were predominantly in the technology sector. To compare, the NASDAQ was down -33.1% in 2022 and many investors flocked from growth equities to value-oriented equities. We have been averaging down on both funds seeing as we still believe in the portfolio managers' ability to generate outsized returns as rates start to ease and investors look to move back to risk-on investments. As indicated above we feel that this area of the market is undervalued and can provide great returns as shown in 2020 when both managers returned over 90% to investors in that year.

Warm regards,

Simon and Team

Simon Partington, CIM, CFP
Portfolio Manager, Investment Advisor, Wealth Advisor
Tel.: 416.969.3179

Brenan Formosa
Associate Investment Advisor
Tel.: 416.941.6740
Email: Brenan.Formosa@RichardsonWealth.com

Mikaela Carson, CIM
Associate Investment Advisor
Tel.: 416.969.3170
Email: Mikaela.Carson@RichardsonWealth.com

Irina Korolev, CFP
Associate Wealth Planner
Tel.: 416.969.3171
Email: Irina.Korolev@RichardsonWealth.com

Grace Finlayson
Associate
Tel.: 416.969.4766
Email: Grace.Finlayson@RichardsonWealth.com