Market Update

Q1 2023

RICHARDSON Wealth
PARTINGTON WEALTH MANAGEMENT

Market Returns March 31st, 2023 (YTD)

- 4.6% S&P TSX TR (Toronto)
- 7.5% S&P 500 TR (US)
- 16.8% Nasdaq (US Tech)
- 6.7% FTSE All-World
- 3.22% DEX (CDN Bonds)
- 0.28% USD to CDN

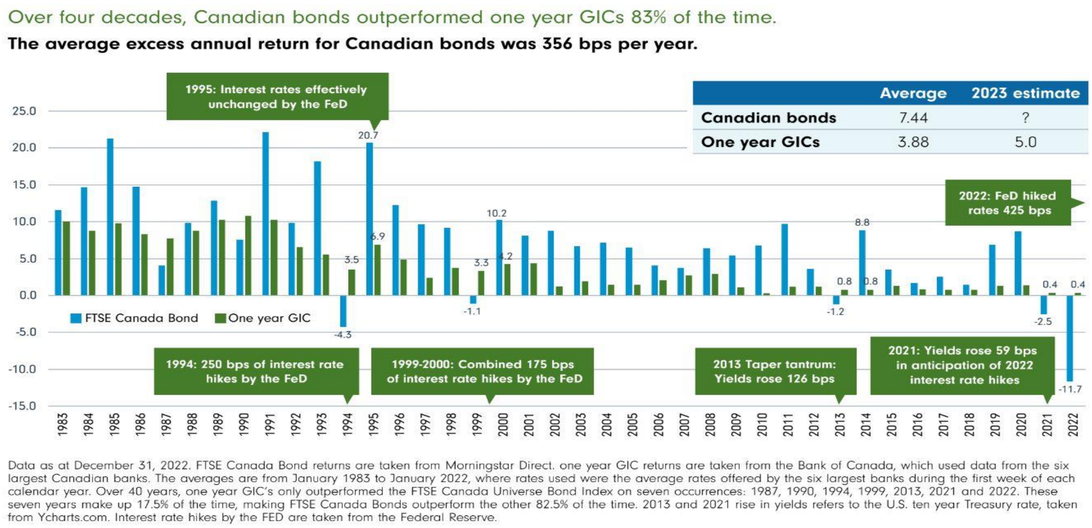
Hard Landing, Soft Landing, it's still getting expensive!

Over the first quarter of 2023 we have experienced a lot of volatility. January started with a bang and looked like a great bounce back from a tough 2022. However, the next two months gave a lot more to be desired with several banks going bankrupt in the US and globally, or at least being bought out by another bank, as UBS was by Credit Suisse. This brought up questions about another 2008 banking crisis and what could have been a contagion issue. In no way is this like the 2008 financial crisis. This is a liquidity issue in which the government came to the rescue yet again to bail out depositors and keep the markets from falling even further. This was needed as companies and individuals were going to be penalized for placing money with a bank that took on too much risk. I want to clarify that this was vastly different than 2008. In 2008, no one really knew who owned what debt and clever investment bankers wrapped up risky mortgages and said that if you have a lot of risky mortgages, it can't be as risky, not all of them will default – clearly wrong in hindsight!

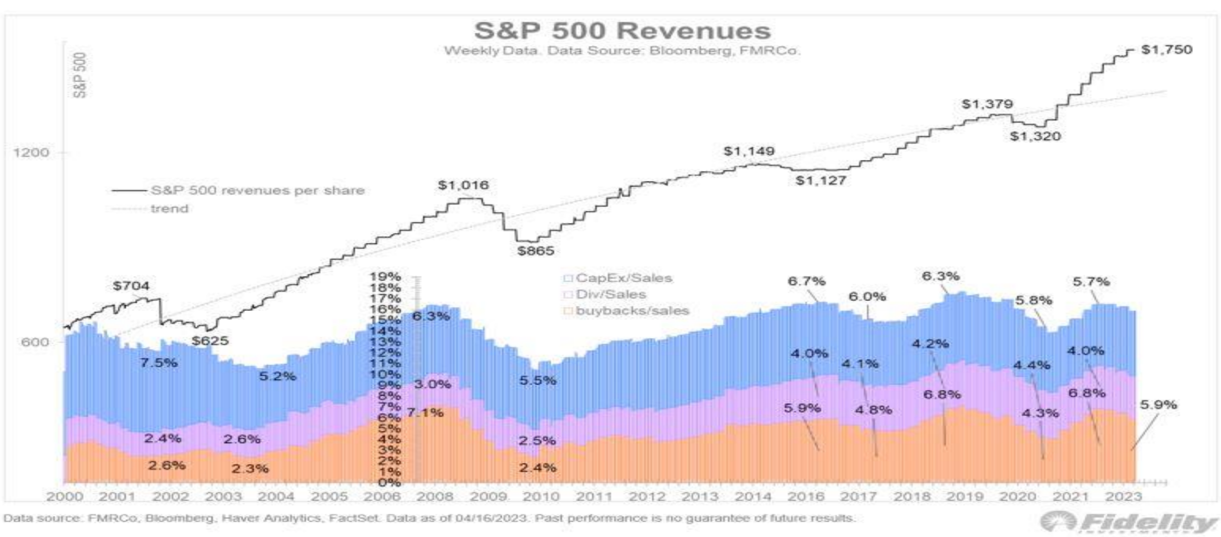
What happened with Silicon Valley Bank (SVB) was a Fed induced issue. I know it is easy to be a commentator from the stands however, I will repeatedly argue that Jerome Powell has gone way too far with interest rates. He should have started rising much earlier and he should stop or should have stopped a few hikes ago. Each rate hike takes time to work through the economic system for the desired impact they are looking to achieve. SVB invested their client's cash into one of the safest investments, US Treasuries. Their problem was that they, along with many others, didn't think interest rates would appreciate to the level they did. As interest rates move higher, bond prices move lower. Furthermore, they also didn't anticipate that there would be a run on the bank, which happens when many depositors decide to pull their money out all at once. Most banks don't pay interest while holding cash in their accounts and with interest rates moving higher you are now earning over 4% to buy money market funds. Hence the run-on bank deposits. This created a problem, SVB had to give clients back their money and the only way to do that was to sell the safe Treasuries they had bought with client's deposits. These investments are guaranteed and hence safe unless you think the US is going bankrupt. They will get back 100% of their money only at maturity so in 5 or 10 years. Similar to what our clients experienced last year; bonds saw their worst year in history. This created a mismatch in timing for liquidity as these banks sold their Treasuries for massive losses. The losses were what bankrupted these large financial institutions.

So, should I hold GICs which won't go down?

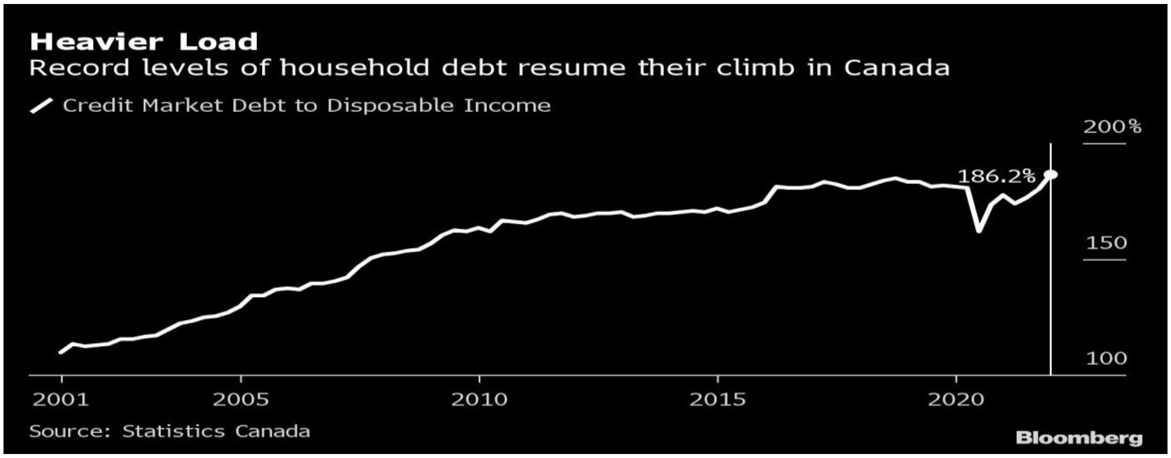
The chart below shows the value of looking past GICs. GICs provide the allure of safety as they don't go down on your investment statement. History shows that bonds are a much better investment over time which is why we are adjusting clients' allocation to bonds. We have been underweighting bonds for the last 8 years and now they are paying enough to be attractive again. Not to mention, if the Federal reserve does cut rates, we could see the opposite of last year where we earn higher interest income and a capital gain.



Earnings are slowing down but revenues for companies have not. The part about inflation people forget is that over time it will increase revenue, as the price of goods appreciate, sales will slowly move higher. Also, with the unemployment rate as low as it is in the US and their consumers having locked in mortgage rates for 30 years, I see more of a softer landing vs a deep and hard recession. Below shows revenue per share growing, also the blue, purple and orange sections show where companies are spending as a percentage of sales: Capital Expenditures, Dividends and Share Buybacks.

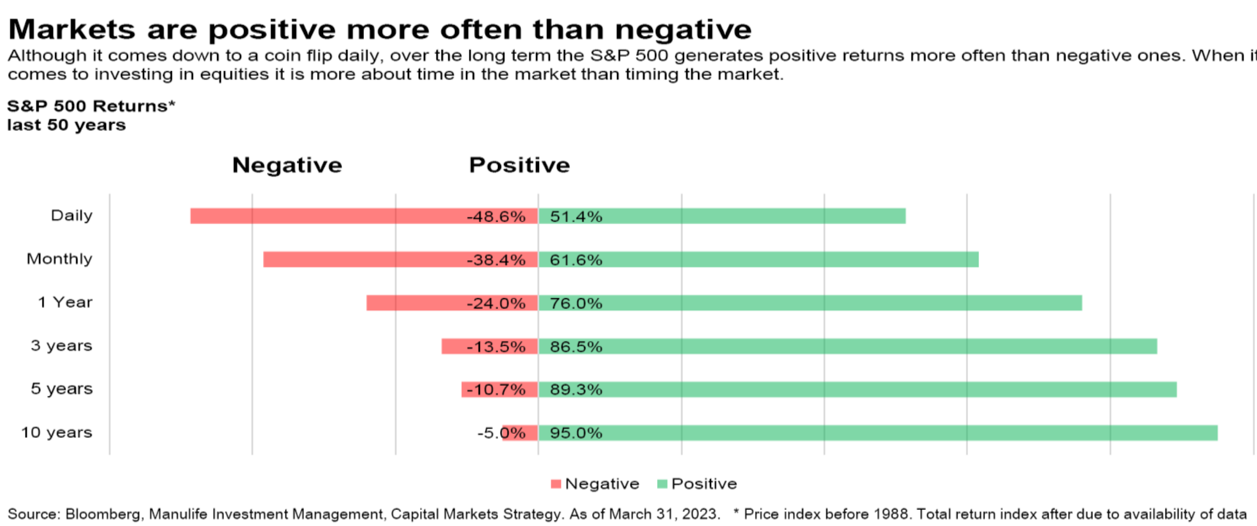


For the average Canadian, we have continued to leverage debt as if it were our second job. Canadians don't have enough money from income, so their line of credit has been how they afford their lifestyle.



On a positive note, I have seen mortgage rates come down over the last three months, which is a good indication that we might see rate cuts over the next year. This is needed as we are all struggling with the cost of everything moving higher. The issue remains, inflation rates may be coming down, but they are not going negative. This means groceries and gas likely won't come down, but they might not be going up as much as we have seen recently. More importantly, if we do get rate cuts, that could help with the lines of credit and variable mortgage increases we have experienced over the last year. CIBC reported over 20% of all their mortgages were underwater. So, people are paying mortgage payments where the interest that had accrued is more than the principal and interest payment combined. Therefore, their principal balance was increasing. Crazy!

With all the uncertainty, this is the most anticipated recession we have ever had, and companies are preparing for it. Layoffs are occurring in the tech sector and earnings have been strong so far this quarter. We continue to find opportunities to buy great companies that have long track records of managing through recessions and coming out stronger on the other side. We expect 2024 to be a strong year, so let's manage through 2023 and look for clearer skies ahead. Unexpected, good, or bad events can change our outlook, but I will leave you with a positive chart, knowing 2022 was a negative year we should be in great shape for positive markets over the next two to three years.



Investment Highlights in the 1st Quarter 2023

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 03/31/2023	Standout based on Q1 - 2023 returns	Stocks Under Pressure – Q1 2023 returns
US Stocks (in USD)	Nvidia Corp (NVDA): +85.10% Apple Inc (APPL): +26.73%	Pfizer Inc (PFE): -19.64% Devon Energy (DVN): -18.63%
Canadian Stocks (in CDN)	Canadian Tire (CTC.A): +25.23% ATS Corporation (ATS): +34.45%	GoEasy Corp (GSY): -9.74% Slate Grocery REIT (SGR.UN): -9.20%
Mutual Funds	Fidelity Global Innovators: +17.05% BMO Concentrated Global Equity Fund: +10.90%	Lynwood Opportunities Fund: -2.27% Waratah Alternative ESG Fund: -1.43%

US Stocks

In Q1 2023, the US Asset Growth and Income Model was up 6.2% relative to the S&P 500 Total Return Index which was up 7.5% resulting in an underperformance of -1.3%. Over the quarter, we remained relatively defensive in the US strategy given the macro uncertainty and market volatility. A common theme we noticed over the quarter was that the positions that had the most downside in 2022 were the same positions that bounced the most in Q1 2023. Moreover, our positions that positively contributed to the model's outperformance in 2022, resulted in our underperformance in Q1 2023.

Over the past quarter, we finally sold out of CF Industries (CF) after trimming the position several times in 2022 and have purchased United Airlines Holdings (UAL). Our decision to sell CF was due to our concerns about the company's ability to generate earnings growth while the underlying commodities in which they sell continue to trade lower. This coupled with the relatively sticky inflationary pressures producers face (wage growth, increased CAPEX costs, etc.) resulted in a sell decision. We view UAL as a reopening story. We believe that the consumer is still stronger than the market anticipates (and therefore, pricing in) and that the pent-up travel demand resulting from COVID will provide a positive tailwind for earnings growth, leading to a rerate on the stock. Other notable rebalancing trades we did over the quarter were the following: trimmed back O'Reilly Automotive, Merck, and Nvidia and topped up Apple, Devon Energy, Albemarle, and Pfizer.

Canadian Stocks

The Canadian Dividend Growth Strategy was up 4% over the quarter relative to the S&P/TSX Total Return Index which was up 4.6% resulting in an underperformance of -0.60%. One of the reasons that our YTD underperformance lagged the benchmark is due to the portfolio being underweight materials (currently 3.8% vs the benchmark 12.5%), which is comprised of precious metals that are up approximately 14% as of March 31st. As you may recall, we have recently incorporated a growth sleeve of 5 positions into the Canadian strategy and this component of the model was up approximately 13% over the quarter.

Recent changes to the model include the sale of Cogeco Communications (CCA) and the purchase of Fairfax Financial (FFH). We've been debating on selling CCA for a while as the company made several poor capital allocation decisions that has destroyed shareholder capital. We were hoping that CCA was a "turnaround" story but there was no evidence this was going in the right direction, so we decided to move on. Fairfax Financial Holdings Limited is a unique financial services company who are primarily engaged in property and casualty insurance and reinsurance, and associated investment management services. At the time of our purchase, we viewed FFH as "cheap" after speaking with several analysts, and soon after the company reported a very strong quarter and the stock traded up – since then, analysts have all revised their target prices much higher. Other notable rebalancing trades over the quarter were: trimming back Loblaws, Constellation Software, and Manulife Financial to top up our positions in Scotiabank, Toronto Dominion Bank, GoEasy and TC Energy. All of these companies have pulled back significantly and we believe they're close to bottoming with significant yield support (these companies have a dividend yield of 4%-7%).

Mutual Funds

In Q1, our top performing mutual funds were the Fidelity Global Innovators Fund and the BMO Concentrated Global Equity Fund which were up 17.05% and 10.90% respectively. We were pleased to see both funds do well over the quarter seeing as they struggled in 2022, with Fidelity Global Innovators being down -29.65% and BMO Concentrated Global Equity Fund down just over -12.35%. The only good thing about when the markets pullback, it gives top fund managers the opportunity to redeploy capital into better companies with better risk/reward metrics (or at least that's always the goal). Fidelity Global Innovators Fund and the BMO Concentrated Global Equity Fund 3-year annualized return numbers are 19.5% and 13.3% respectively. One area of client portfolios that struggled over the quarter were the hedge funds, primarily: the Lynwood Opportunities Fund and the Waratah Alternative ESG Fund. These funds were down -2.27% and -1.43% respectively and have both been "whipsawed" several times due to the increased market volatility in February/March. Lynwood struggled throughout 2022 and now into Q1 (like similar hedge funds) as the investor demand for Canadian Small Cap companies has dried up and it has largely been a risk off market. Furthermore, not many of these companies are going to market (i.e., raising equity) so there has been no New Issues which is where Lynwood typically has an informational advantage due to strong connections with brokers, bankers, and other industry connections. We're hoping Lynwood's fund manager can turn around the underperformance as we are keeping a close eye out for other opportunities. The Waratah Alternative ESG Fund is a market neutral hedge fund which we expect to lag other long only funds in a market rally given they always have hedges and short positions. So, their underperformance doesn't necessarily surprise us although we'd love to have seen a better return for the quarter. The main role of this position in client's portfolios is to provide downside protection when the market has a sustained downturn (e.g. in 2022 the fund performed well and was up 2.1% when most equity and fixed income funds were negative). We're being cautiously optimistic for now and are happy with holding the fund but will likely trim the position and redeploy into opportunities with more upside potential when we believe the time is right.

Warm regards,

Simon and Team

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