Manulife Securities

ROYDS REPORT

Late July 2022

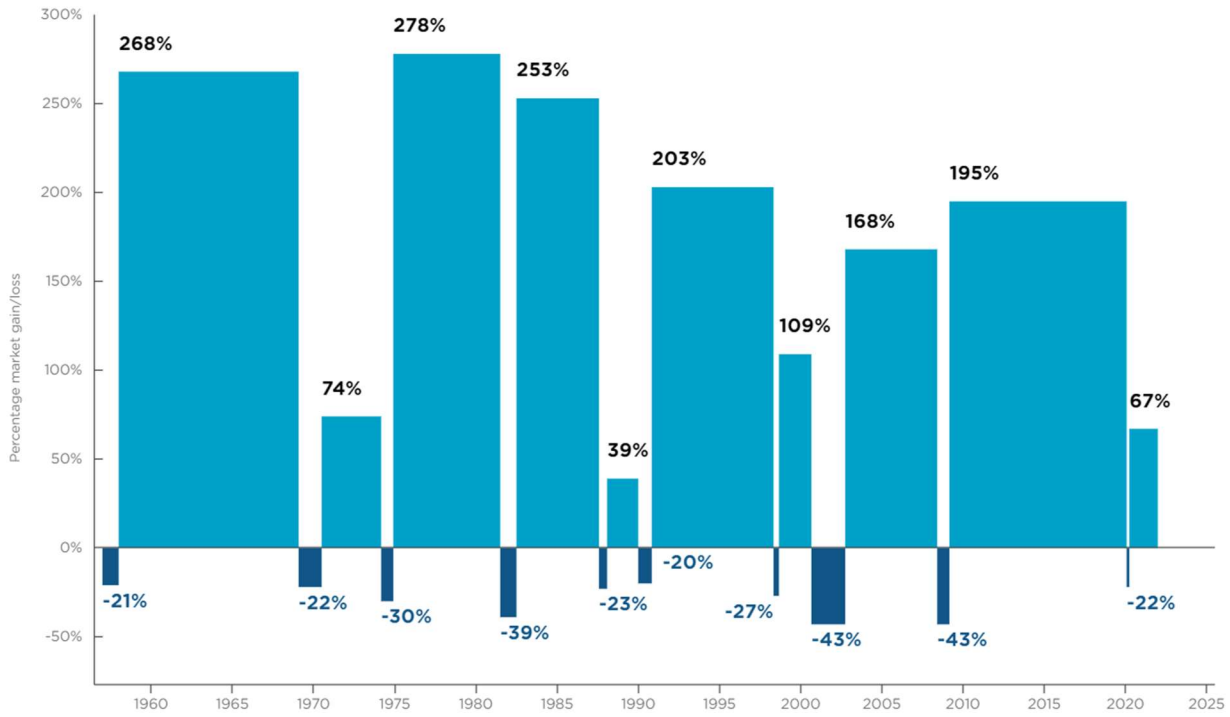
We know we said there might not be any new newsletters till September, because of vacations, but we're squeezing this newsletter in anyway. A lot of it summarizes things we've written about before. Here's our interpretation of markets and the world today!

It may be the first time in history that inflation is rising as the economy is slowing down. Since inflation usually happens when demand for goods and services is high, because the economy is firing on all cylinders, it's unusual for inflation to be rising as the economy weakens. The supply chain issues caused by Covid related shutdowns in China, the disruption to wheat, potash, oil and gas supply caused by Russia's invasion into Ukraine, and the pent-up demand for things not used much during Covid had sent inflation soaring to levels not seen since the early 1980s. Because central banks in the western world are fearful of long-term inflation much above 2%, central banks, like the Bank of Canada and the US Federal Reserve, have increased interest rates. This makes loans by corporations and individuals more expensive and should reduce borrowing which in theory should reduce spending and demand, and thereby cause inflation to ease. Almost immediately after interest rates were raised, we saw the housing market be impacted by falling house prices. More interest rate increases are expected. When homeowners have to renew their mortgages at higher interest rates over the next months, some people may be forced to sell their homes, because they can no longer afford to pay their mortgage. The other big impact on higher interest rates was that bonds were hurt and fell more in a 6 month period that we have seen in 100 years (according to what Guardian fund manager, Dino Bourdos said in a webinar on July 21 2022). Since bonds are usually put into conservative balanced funds as ballast to increase the stability of fund valuations as stock prices gyrate, the big drop in bond prices actually worsened balanced fund valuation drops. Many times in the past you may have heard us say that your portfolio dropped less than the market by a substantial amount. That wasn't true with this recent market drop, because most things (stocks, bonds, real estate, gold, copper etc) fell, with oil and gas being the notable exceptions.

In the previous bear market in Feb-Mar 2020 (as Covid spread into our consciousness), the market drop was far worse than this one, but virtually no one called or wrote us with any concerns. This time, with just over half as much market drop, more people are calling for reassurance. We think this is because:

- It's been so long that we've had a drop lasting over a few months, that people forgot how normal this is
- With house values down, people feel less rich on two fronts. The Globe and Mail on July 14 2022 reported that between the stock, bond and real estate market drops, more than $50 Trillions USD of wealth was destroyed, which more than the wealth destruction of the global financial crisis of 2009-2009
- With inflation, people are worried about their cash flow and money in general more
- Even conservative investments fell, so that caused more worry than usual, and
- People are exhausted from living in a world with Covid and don't have the same patience.

We wanted to share with you this diagram from Bloomberg that Dynamic Funds shared with us. It shows how much the market has gone up between bear market drops (of 20% or more) and how little the market drops have been in comparison to bull or up markets, and for how short a time down markets usually last relative to the up markets. This chart is for US markets in US dollars terms. The light blue bars show how much the market rose before having a 20% or more drop and the width of the dark blud bars show how long the downturn lasted, with the scale in years on the x axis. If you ever wondered why you risk being in the stock market when it can fall like it just did, this chart and the next one are why. The stock market rises more than it falls and over the long-term the market has always grown. And the second chart shows you how much inflation erodes your buying power, unless your savings are growing faster than inflation, which they haven't been able to do in GICs for a long time.



Bulls and Bears

Between 1957 and 2021, there were ten bull markets and bear markets for Canadian stocks. Historically, bull markets have lasted longer than bear markets. The average bull market increase was 165% over an average duration of 67 months. Conversely, the average bear market decline was 29% over an average duration of 11 months.

Bull Markets

Bull Markets are usually defined by periods where the economy is strengthening or already strong. During this period, stock prices are generally rising and investor sentiment is positive. These periods can last for months, or even years.

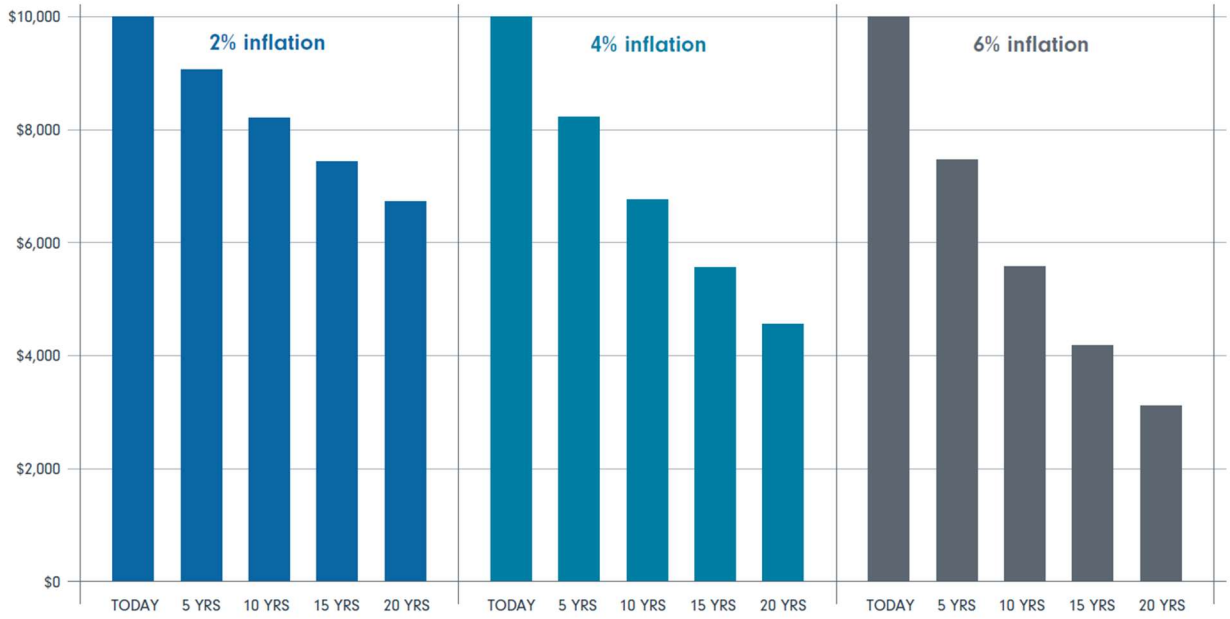
Bear Markets

Bear Markets are defined by periods where stocks are declining in value. In the above illustration, the generally accepted measure of a market decline of 20% or more over any given period has been used. These periods tend to be shorter compared to Bull Markets.

Source: Bloomberg. Percentage market gain/loss based on monthly compounded returns from the S&P/TSX Composite Total Return Index from December 31, 1956 to December 31, 2021. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. The terms bull market and bear market describe upward and downward market trends, respectively. Bull markets are movements in the stock market in which prices are rising and the consensus is that prices will continue moving upward. Bear markets are the opposite - stock prices are falling. In the above illustration, the generally accepted measure of a price increase or decline of 20% or more, respectively, over any given period, has been adopted.

This second chart shows the buying power that $10,000 has today versus what it will have in 5-20 yrs, depending on the rate of inflation.

The chart illustrates the effect of inflation on $10,000. Even at the relatively low rate of 2%, $10,000 shrinks to $6,729 of purchasing power in 20 years.



Source: Fidelity Investments Canada ULC.

You can see that if we have 6% inflation for 20 years, $10,000 kept in cash all that time would only be able to buy as much as a little over $3,000 today could buy. That's why central banks are trying to calm inflation and why we need to invest in things that are growing faster than inflation over the long-term.

What is the bottom line?

- We need to be patient when markets are down to give our investments time to recover, which as you can see in the first chart, they regularly do.
- Markets drop dramatically pretty often, and it's never signalled that everything was soon going to be worthless before. So, as long as your funds are holding diversified baskets of profitable, necessary companies, this market drop is not an indication that you are going to lose all your savings.
- This market drop is painful, but that's the price we pay to invest in the market, and you need to be in the market to maintain and improve your savings' buying power. The alternative is to put your money in a savings account or under the mattress and have it buy less in the future than it's worth today. "After periods as bad as or worse than the second quarter was, when the S&P 500 lost 16 per cent, returns over the following year averaged18.1 per cent." (Source: The Globe and Mail, July 14, 2022).

If it helps you, just don't look at your portfolio for the next few months. If you would feel more confident knowing what kind of vital, essential companies you are invested in through your funds, give us a call. If you have extra money, now is a better time to invest it than last fall was, or than it will be after the market recovers.

We'll end with a piece of good news. Your statements were printed as of June 30. Every account we have looked at since then (as of Jul 22 when this is being written), is up. This is probably because a lot of companies have issued some good second quarter earnings reports. There's a chance this is the start of a market recovery (because markets typically recover months before the economy does), but it might not be. If it's not, we'll do best by just staying patient and standing pat with our investments.

Either Jordan or Elaine are around all summer, so call us if you want to chat or have a regular review meeting. Have a good rest of the summer.

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