THOUGHTS FROM HOME

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The Intelligent Investor in Volatile Markets

"The intelligent investor is a realist who sells to optimists and buys from pessimists."
- Benjamin Graham, Father of Value Investing

Benjamin Graham wrote the book "The Intelligent Investor: The Definitive Book on Value Investing," but his comment on the necessary mindset to be a successful investor is perhaps one of his greatest insights. Market related

numbers are the same for all participants but it is your viewpoint which can dictate success or failure. This month, we will review current market conditions through Graham's value investing perspective to help determine where we stand at the moment, the path to success going forward and review the portfolio changes we have taken to help achieve our goals.

October brought some welcome relief to the markets with the S&P 500 gaining 8.8%, the Nasdaq 5% and the TSX up 5.24%. The U.S. Federal Reserve (Fed) raised interest rates 75 basis points as expected, as did the European Central Bank (ECB). However, for the first time in many months, Governors of the Fed's board suggested that it might be time to consider slowing the pace of their historic rate increases to better determine the effects on the global economy. The Bank of Canada and the Reserve Bank of Australia took this more cautious view a step further by only increasing rates by 50 basis points. It does seem strange that the market would react so positively to another rate increase but it is actually the market's belief that we might be closer to the end of this trend which has led to this rally. Any negative comments from Fed Chairman Powell at the November 2nd meeting could hurt short term trading but remember the value investor is always trying to buy at more attractive price and that often means buying before a negative cycle has fully ended.

Inflation remained stubbornly high for September at 8.2% and we don't expect the situation to have improved much in October as food and housing remain elevated. Unfortunately, the Fed uses a housing cost model which compares the past month's cost data versus what is currently happening in the economy. As a result, inflation figures appear higher than they may actually be at the present moment.

Slowing demand for goods is leading to a decline in some prices. One of our favourite indicators, the World Container Index which is basically the cost of shipping a container from China, is now $3,145 U.S. per 40 ft container, down $869 from last month and over 70% below the March high. Prices will fall eventually as supply and demand come back into balance but this may take longer than expected, particularly as U.S. GDP was up 2.5% in the latest quarter. Emotionally, the market is still looking for the green light from the Fed but value investors are increasingly finding encouraging signs in the corporate earnings and lower market price-to-earnings (P/E) multiples.

For example, third quarter U.S. corporate earnings reported well in October, with strength in banking, industrials and energy. Microsoft and Apple beat sales and net profit expectations, yet their stocks sold off due to worries about future growth which we feel to be unfounded, representing a compelling buying opportunity. One of the strongest signals came from JP Morgan, one of our core bank holdings, as their shares rose over 20% this month. If the market truly believed we were in for a recession, JP Morgan would be trading lower as

banking is considered a leading indicator of market direction and often points to a positive change.

The relentless increase in interest rates has continued to make this a tough environment for fixed income investments. At the time of writing, the 2 yr U.S. Treasury currently yields 4.7% while the 10 yr is at 4.15%. The steepening inversion of the yield curve over the last couple of months is commonly regarded as a precursor to a recession. In past periods, unemployment rose under such conditions, however, that is not how the present situation is currently unfolding. The fact that the 10 and 30 year bond yields have remained well below short-term rates during this period of consistent rate increases suggests the market believes yields will come back down once the Fed is finished. We fully expect the fixed income market to benefit with the stock market once this upward cycle ends.

The U.S. consumer continues to spend as layoffs have not truly impacted the unemployment rate, which rose slightly to 3.7%. The number of unfilled jobs increased by 491,000 this month likely due to a demand for short-term workers over the holiday season. One of the real measures of the U.S. economy will be Christmas spending over the next two months. Disappointing holiday sales may signal greater recessionary fears but hopefully retailers will offer attractive sale prices to help clear excess inventory.

In Canada, oil stocks have benefited from recent OPEC production cuts. Base metal stocks such as iron ore and copper also rallied as there was news that China may lighten their restrictive Covid rules which would increase demand for these raw materials. Banking stocks also made a significant recovery from their October 12th lows.

Faced with stubbornly high inflation and a determined Fed, we are focusing the portfolio on dividend paying companies with lower P/E multiples and below-average volatility. This month, we added Sun Life Financial to the portfolio. It pays a 4.9% dividend and has proven to be more resilient to interest rate increases than our Brookfield holding, which we have now sold. We also sold out of Magna due to slowing car sales and persistent supply chain issues. In its place, we made the timely purchase of Unum, a growing U.S. life insurance and benefits company, to capture their quarterly dividend of 2.9%. Where possible, we have also been actively writing calls to capitalize on market volatility and generate additional cash flow. As we look to rebalance portfolios into year end, we will endeavour to keep you apprised of any realized capital losses. Capital losses can be carried back 3 years to reclaim taxes paid and carried forward indefinitely to offset future taxable gains.

Now that earnings season is largely behind us, we expect the U.S. midterm elections, the Russian invasion of Ukraine and analyst earnings downgrades to be the major sources of news flow. The Republicans are poised to take control of possibly both the House and the Senate.

The resulting gridlock should be a positive for markets as it would limit the Biden Administration on implementing increases in spending or increasing the corporate tax rate. This does raise some concern about how much support the U.S. would continue to provide the Ukraine.

While there still exists a variety of geopolitical and economic issues, encouraging signs are definitely beginning to emerge. Costs of goods and labour remain high but they are not materially increasing and significant deflationary pressures continue to build, such as shipping costs. P/E multiples for stocks stand at their best levels in the last 5 years. As we continue to add defensive growth to the portfolio and complete tax-loss selling, we continue to follow Graham's discipline of intelligent investing. In the meantime, our focus will remain on generating cash flow and reducing volatility. Until next month, stay positive.

As always, questions, comments, thoughts, feedback and concerns are always welcome.

Yours truly,

Trevor, Walter and the Cooper Wealth Management team

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