Wealth Management
Dominion Securities

Ord Private Wealth Management

Update On Your Discretionary Portfolio

Semi-Annual Rebalance Commentary

January 25, 2023

Dear clients,

Now that we have put 2022 in the rear-view mirror (finally), we wanted to provide you with some quick thoughts on the year that was, and also update you on recent changes in your discretionary portfolio based on our semi-annual rebalancing that was completed earlier this month (January 9th – 11th). Those changes are detailed in the "Portfolio Comments" section below.

2022 was not a good year for equity investors, which seems somewhat obvious. However, when you add in how poorly the usual "safe haven" bond market performed, the story gets even more negative, as it

turned into one of the worst investment years in recent memory for those with a balanced portfolio.

Some context here: Most of you have likely heard of the classic "60/40 portfolio" (meaning: your portfolio contains 60% stocks/40% bonds). The reason this portfolio is popular is that some of the inherent risk of equity investing can be reduced by owning quality bonds at the same time. Often, when stock prices go down, bond prices will go up as investors pile into the relative safety of bonds to ride out the storm. This usual correlation did not occur in 2022 however, due to another important factor that affects bond prices – interest rates. Everyone is aware of last year's inflation story at this point, and how central banks have attempted to combat this by continuously raising interest rates. Well, in rapidly rising interest rate environments, prices for bonds that have already been issued will go down. For example: if you bought a 5-year bond in 2021 that pays you 1.5% annually (at a cost of $100), but now you can buy a similar bond paying you 5% in 2022 (for $100), the current price of that previous 1.5% bond will have to drop enough to make it attractive for an investor to buy (maybe it's now roughly $85). At that new price, the bond is now paying a similar all-in yield to the 5% bond, when you include capital gains.

That was the kind of environment that fixed income investors were in during 2022, which led to a total bond market return of -13.1% (based on the Bloomberg U.S. Aggregate Bond Index). When combined with stock market returns, an average 60/40 investor was down 16% last year. In the past 47 years (since the bond index was created), this is the second worst return for this type of investor. Only 2008 was worse for 60/40, but even then bonds provided a positive return and risk offset.

This past year was something that has rarely been seen in markets. Going into 2023, the setup is entirely different now that interest rates have somewhere to go besides up from near 0%. We've written about the renewed case for fixed income in our previous monthly newsletters, and have done some work locking in rates about 5% within the portfolio for those that have an allocation to this asset class.

Portfolio Comments

As is the case each year, January brings us the first of our semi-annual portfolio rebalances. Each company and position in the portfolio is re-evaluated, and given a weighting in our model. Decisions are also made about the weighting for each asset class (fixed income; Canadian Equities; US Equities; Global Equities; Alternatives and cash).

During this rebalance, we continued to add a little bit more to our Canadian equity sleeve. In order to fund this, we sold a bit from our Global equity positions. This has led to the following equity mix in our model:

Canadian Equity – 50% *(up 2.5% from previous)*
US Equity – 40% *(no change)*
Global Equity 10% *(down 2.5% from previous)*

You may recall from previous correspondence that we have moved our Canadian equity position substantially since 2021. What used to be a 35% allocation became 47.5% early in 2022. That shift was a positive decision as Canadian markets outperformed the U.S. in 2022 by a fair margin, even though they were also negative on the year. Going forward we still see a valuation gap between Canadian and U.S. equities that cause us to lean more toward Canada at this time.

Within the portfolio itself, we made some changes based on our continued effort to increase quality within the portfolio where we can. In Canada, the only company that was sold outright from the portfolio was CIBC (CM). We split the proceeds amongst our bank holdings in Royal Bank (RY) and TD Bank (TD), which we have more conviction in. We do also have a position in Bank of Montreal (BMO) that we added a little more to. Other companies that we increased exposure to include: Element Fleet (EFN); TC Energy (TRP); Brookfield Infrastructure (BIP.UN); Canadian Natural Resources (CNQ); Telus (T) and Canadian Apartment REIT (CAR.UN). Additionally, we increased our stake in the Mackenzie Greenchip Global Environment Fund (MFC5786).

On the US side, we sold our entire position of Walt Disney (DIS) and replaced with health-care company Merck (MRK). This was a defensive move in case there does end up being a US recession in the near term, as Disney is very exposed to consumer spending and health care is a sector that can outperform in tougher economic conditions. Some other transactions during the rebalance included picking up some more Amazon (AMZN) after recent weakness and increasing holdings in Home Depot (HD); Palo Alto Networks (PANW); Constellation Brands (STZ) and Alphabet (GOOG). We also trimmed and took profits on some companies that had outperformed in the last few months of 2022, such as Xylem (XYL); AbbVie (ABBV); Thermo Fisher (TMO); UnitedHealth (UNH) and Honeywell (HON).

For those of you that have a fixed income allocation, we added a bit more exposure and brought the asset class back to its usual weighting for clients. Since we had previously purchased GICs and bonds in the 3-5 year range (with yields over 5%) back in the fall, we bought a 1-year GIC paying 5.29% since short term rates are offering the best return at the moment. We funded this by trimming some of the Alternative asset class holdings including Atrium (AI), and also taking gains on some of the market-neutral and merger-arbitrage funds that actually provided positive returns in 2022 (Picton Mahoney funds). Having a slight overweight within the Alternatives class since 2021 has been the right move, as we had previously transitioned a good amount of our Fixed Income exposure into these assets. We also completely sold out of our preferred share holdings earlier in 2022 at a sizeable gain, which ended up being great timing. The preferred share market sold off heavily starting in April and was down over 15% on the year from that point.

We remain cautiously optimistic for 2023, as the many factors that caused market turmoil in 2022 (supply chain problems; inflation; interest rate increases) have begun to resolve in some fashion. Central banks are also likely near the end of their rate hiking cycles, though both the Bank of Canada and U.S. Federal Reserve will each likely raise the short-term rate by 25bps at their upcoming meetings. The ride may be choppy, but we have already seen a substantial bounce off of October's recent bottom in stocks.

We will remain diligent in monitoring the economy and market conditions, and will make additional changes to the portfolio if necessary.

Please feel free to contact us directly if you have any questions.

Best regards,

Ord Private Wealth Management
John, Tim, Liam & Mikail