<u>Where We Were: *We Live in Interesting Times*</u>

It has been a busy start to the year with the peak of Omicron occurring early in Q1 leading to a widespread global re-opening, Russia's invasion into the Ukraine in mid-February and the corresponding global response to the war, followed by the recent re-emergence of Covid impacts in the Asia Pacific region. At the extreme in China, Shanghai's over 28 million people have been in lock down for much of April.

The outcome of most of these geopolitical and economic scenarios has been rising inflation which is impacting virtually every commodity in the world including leading to year-to-date gains for 47 out of 55 commodities we track. We are also seeing pressures in wages and a variety of other goods and services with oil price up ~35% in 2022, which ultimately is passed onto most goods and services as transportation and utility costs increase the cost of business.

The interplay of these factors has heightened complexity in capital markets. There is growing uncertainty and markets do not deal well with uncertainty. Prices have mostly been under pressure as a result with even the aggregate of the global bond market down over 10% to begin the year.

<u>Where We Are: *Volatility Continues*</u>

Inflation has been historically high. March had the highest month over month inflation by a very wide margin dating back three decades. Rising prices acts as a consumption tax on people across the world, lowering disposable income and creating strain on the social system.

In response, Central Banks around the world have used their primary tool to fight back. The Bank of Canada has raised their short-term target rate several times already with us sitting at 1% after a loud and clear raise of 0.5% in mid-April. The U.S. Federal Reserve is on the same path, at 0.5% today after recent increases.

The market is anticipating a fairly aggressive continuation of increases through the next several years to combat the rising cost of living. Expectations are calling for Canada's target rate to exit 2023 at 2% or doubling from present and the U.S. to be even higher at 2.7%, more than a quadrupling.

<u>Where We May Be Going: *Markets are Forward Looking*</u>

Rising rates and continuing inflation can be good in moderation, and quite detrimental at sustained highs. With that said, as we've previously highlighted, since 1954 there has been 17 Fed tightening cycles with only eight or less than half bringing on a recession.

Assuming no easing of inflationary pressures, some of the anticipated impacts include falling disposable income, increasing input cost pressures to businesses that pass these through to customers and ultimately a slowing of global growth which could in turn lead to recession.

For investments, rising rates negatively impact the safe area codes of the investable universe including bonds. It isn't only the less risky assets that are impacted negatively. Higher rates lead to lower prices for stocks and when combined with slowing growth, falling profitability and increasingly negative investor sentiment, the confluence of these factors can be quite negative to stock prices.

<u>Conclusion: *Risks Exist but Valuations Look Increasingly Attractive*</u>

The market is currently pricing in a lot of bad going forward but not much in the way of the possible good.

There is still likely to be significant growth across many economies around the world in 2022 and 2023, eclipsing levels prior to the pandemic off the back of pent-up demand for services and hospitality. Furthermore, many of the inflationary and war factors hurting market performance could reverse without notice alleviating many of the pressures we face today.

For Canada, high resource prices are creating an economic boom and European and American concerns about energy and food scarcity created by the Russia conflict have not only short, but medium and long-term positive implications for many of the country's industries. Despite the positives, stocks in Canada are now trading at or below long-term levels. Today you pay less for next year's expected TSX Composite earnings than you have at all time periods save for the Great Recession all the way back to 1998 where we first have available data.

In the U.S., fears of a Dot Com style valuation burst after years of strong financial market performance seem untethered from valuations that fall well below levels around the turn of the millennium. Dating back to 1999, you would have paid more for earnings in almost exactly half of the years relative to the 20x today. Positively as we look forward, we note stock markets have historically been weak prior to mid-term elections, followed by notable strength the year thereafter.

Higher rates are also providing improving opportunities to invest in higher return bonds and there are positive impacts to a variety of fixed income asset classes including rate reset preferred shares in Canada.

The pendulum between greed and fear is swinging to the latter and opportunities are surfacing as a result.

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