RBC Wealth Management
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Year End 2021

Happy New Year. At a time when hospitalizations are rising, writing about investments seems almost trivial but, perhaps this letter can be some distraction from the news of the day. I will let others opine about the trajectory of this or that variant, which of course is vitally important to the investment landscape. In this quarter's letter I will retreat from a discussion of macro-economic variables, of which the pandemic could be said to be one, and instead focus on micro-economics, namely the individual securities in our portfolios. Firstly, I should at least set some context.

In 2021 the S&P/TSX had its best year since 2009, up 25.1%. Incidentally, I used to complain that the Toronto stock market index was the least diversified among major stock markets. As described in The Globe and Mail (December 17, 2021), a few years ago, Financials, Energy and Materials were two-thirds of the TSX Composite Index. The Financials sector still accounts for about a third, but Energy is now down to a 12.7% weighting and Materials to 11.3%. Industrials (12.3%) and Information Technology (11%) have each grown in share. As a result, the TSX is now more diversified, like other major indices. In the USA, the S&P 500 had the third straight year of double-digit gains. It returned almost 30% in USD, beating the technology heavy NASDAQ (up 21.4%) for the first time since 2016. The Dow Jones Industrial Average returned a not too shabby 20.9%.

Given the negative bond market returns (the Canadian bond market returned minus 2.5% in 2021) and the frightful pandemic, I must admit that these spectacular stock market returns were not what I would have expected. I should leave off forecasting.

Let's talk stocks:

Every year the stock market is made up of relative winners and losers. When I talk about my favorite stocks, I naturally focus on winners, but clients tend to want to talk about losers (which they usually define as stocks that have a current market price below their own cost). So, to begin here are some of the detractors from the performance of our portfolios this year (percentages are approximate and ignore dividends, which can be important, and are in local currency. This is not an exhaustive list):

Boralex was about our worst performer in 2021, down 26.5%. To be fair BLX was up a smashing 93% in 2020, when clean energy companies were all the rage. In 2021 the group had a dramatic reset. Algonquin Power & Utilities Corp. was also among our worst, down 12.8%.

Another example of a stock that was way up in 2020 only to be way down in 2021 was Walt Disney (down 14.5% in 2021). In 2020 there was excitement about Disney's new movie streaming service, Disney Plus. This year that was replaced by concerns about theatrical releases, theme parks and cruise ships and the profitability of streaming.

Verizon's 11.5% decline was partially offset by its 4.5% dividend yield. Fierce competition for cellular subscribers led to aggressive discounts on new phones and plans.

Colgate was about even which in 2021 made for a relatively poor performance. Brand name consumer products don't seem to have the same hold on consumers nowadays. Shoppers can easily inform themselves about alternative products and don't have to trust in a brand.

Rounding out this selection of poor performers is 3M, which gained 1.6%. Like many other industrial companies 3M faced supply chain challenges. What is hard to quantify and therefore worrisome is its liability for PFAS, so-called forever chemicals, that were used in fire retardant and stain prevention, and which have infiltrated the water supply.

Among the biggest gainers in 2021 was Interfor which was up 70.4%. There were shortages of many things in 2021, including lumber. I've always liked trees you know because they grow. Beyond the temporary shortages brought on by COVID and remodeling, millennials it seems are now starting families and building houses. Mass timber may also start to increase demand as taller structures made of wood become approved.

Mega capitalization technology stocks were also winners. Alphabet (GOOGL) was up 65.2% and Microsoft was right behind at 51.2%. They are both indisputably successful companies; my concern is that they have become such popular stocks. As we know great companies are not always good investments. However, when I look back at the years since the financial crisis in 2009, I have way underestimated how rapidly these companies could keep on growing.

Loblaws, up 65%, which is owned by George Weston, up 54%, is an example of a stock that really surprised to the upside. Grocers stand to benefit from inflation because their low profit margin is applied to a bigger number but, wow, I didn't look to a grocer to be a standout performer.

It is perhaps not such a surprise that Pfizer was up 60%, given its well-known success with a vaccine and potentially with a new treatment for COVID.

Park Lawn was a relatively new selection in 2021 and so it was heartening to see that it gained 48%. Last year funerals were constrained but it is not a dying business.

Killam Apartment Properties REIT was up 37.8%. I had a feeling we could count on those tenants in the Maritimes to keep paying their rents, even in a pandemic.

International Flavors and Fragrances gained 38%, after a topsy turvy 2020 following the merger with Dupont's nutrition business.

Banks were great in 2021. They can benefit from higher interest rates with wider interest spreads between their loans and deposits. For example, Toronto Dominion was up 34.8%.

An honourable mention for good performers in 2021 must be our rate-reset preferred shares. They benefit from higher interest rates as in many cases their dividend rate resets every 5 years based on the 5-year government bond yield. After several years of dodgy performance many have rallied up close to their $25 dollar redemption price beyond which no further capital appreciation should be expected. Rate-reset preferreds provided a nice counterpoint to the weakness in the bond market in 2021.

In sum, I wish I had had more of the winners in 2021 and, none of the losers. But sometimes last year's winners can become this year's losers, or not. Sometimes last year's winners become this year's winners. How a stock did last year does not predict how it will do this year. A diversified portfolio with ballast provided by predictable dividend payers remains my investing comfort zone. I will continue to avoid companies that are not making profits and will try to invest where the puck is going, so to speak.

Associates Margarita Martinez Elizondo, back from maternity leave, Elena Venneri, now a full-fledged member of our team and, also, Kristin Middleton the sometimes not so silent but the longest running partner of Team Stedman, join me in wishing you all the best for 2022. Thank you for reading.

Sincerely,
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