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First Quarter 2022

Does anybody else feel like there is an awful lot of news lately? Between CEGEP and university, I worked as a newspaper reporter at the Sherbrooke Record. My Editor liked to say that "the thing about news is, there is always more of it, almost all of it bad". The last two years have been especially newsworthy. From the start of the global pandemic in March of 2020 to the war in Europe in March of 2022, sometimes I feel it gets to be a bit much. In March of 2020 my son had COVID symptoms, which was scary. In March of 2022 I had COVID, which was boring. Much has changed in the last two years.

In the first quarter the S&P 500 bottomed in early March, down about 13%, just after Russia invaded Ukraine. It finished the quarter down 4.6%, including dividends (-5.6% in Canadian dollars), which was the worst quarter since March 2020. Commodities had their best quarter in years. The war has disrupted traffic. The price of oil, which was negative $25 US a barrel two years ago, is now over $100 a barrel. The S&P TSX Composite Index had a total return of 3.8% in the first quarter. It was the resource heavy Canadian stock market's best showing relative to the technology heavy US stock market since 2016.

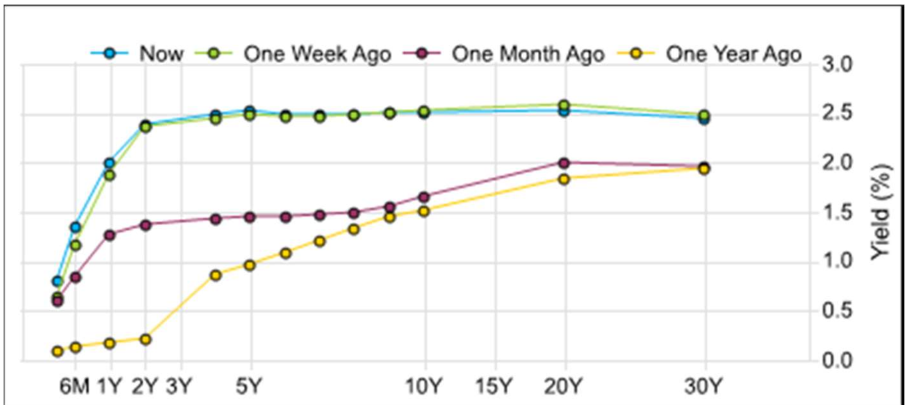
It can be difficult to stick with stocks among headlines of pandemic and war. The Chairman's Message to Shareholders of Berkshire Hathaway was released on February 26. Warren Buffett wrote that he bought his first stock 80 years ago (during World War ll). He wrote: "After my initial plunge I always kept at least 80% of my net worth in equities. My favored status throughout that period was 100% - and still is."

Bond yields have skyrocketed this year as both the Federal Reserve and the Bank of Canada have signaled their intention to repeatedly raise short-term interest rates in response to the highest inflation readings in decades. For two years central banks had held short-term bond yields at artificially low levels, below the rate of inflation, in response to the pandemic. Now they are expected to 'normalize' them. In Canada the yield on the two-year Government of Canada bond has risen from 0.97% at the start of the year to 2.29% at the end of the first quarter. The 10-year Canada yield has risen from 1.43% to 2.41%. Similarly in the US the two-year Treasury yield has increased from 0.73% at year end to 2.34% at quarter end and the 10-year from 1.51% to, coincidentally, 2.34%.

The chart below shows that the Canada 2-year bonds now (blue line) yield almost the same as 10-year bonds and much more than a month ago (red line).

Fixed Income - Government Yields - CANADA

Canada bond yield curve - now, one week ago, one month ago and one year ago.



Sources: FactSet April 5, 2022

The explosive rise in bond yields has hurt bond prices. The Canadian Bond Broad Composite Index returned negative 7% in the first quarter. 'Safe' bonds did worse than 'risky' stocks. Higher bond yields, although painful in the short-term because bond prices are lower, are not all bad news for savers as in time they will translate into greater income, at least in the medium term. The bonds we own generally have terms of 5 years or less and most will run off in the next 2 or 3 years.

For the first time in some years there is now a broad selection of investment grade bonds trading at a deep discount to their par value. Time will pull these bonds up to their par values at maturity. Capital gains can be very favorable in taxable accounts because, as it stands now, only half of a capital gain is taxable.

Another aspect of our fixed-income investments has been rate reset preferred shares. Their yield resets every 5 years, based on the Government bond yields. They had fallen below their $25 par value a few years ago when interest rates hadn't gone up as was then expected. If interest rates now rise, their dividends I expect will be reset higher, providing an offset to rising bond yields.

One of the things I like about the investment business is that every day is new with a different context of news and events. That is also one of the things I don't like. The first quarter of 2022 was treacherous. I am glad it is now history.

Sincerely,
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Senior Portfolio Manager
Please visit us at www.georgestedman.com