

The Fortnighter



Wealth Management
Dominion Securities

Winter 2022 – Issue #75



Gair Wealth Management
RBC Dominion Securities Inc.

Al Gair, MBA, CIM

Senior Portfolio Manager &
Investment Advisor

al.gair@rbc.com

604-665-5526

Bonnie Walmsley

Associate

bonnie.walmsley@rbc.com

604.665.5527

745 Thurlow Street, 20th Floor

Vancouver, BC V6E 0C5

www.gairwealthmanagement.com

1-800-427-7766

The stock markets got off to a bit of a rough start in the New Year – although a solid rally in the last few days of January dulled the pain somewhat. Things were especially difficult for many of the high flying growth companies – like Shopify, Tesla and Netflix. At one point the tech-heavy NASDAQ Index was down over 15% - clear “correction territory” in market parlance.

The worry, of course, continues to be inflation and what the big central banks are going to do about it. Both the Bank of Canada and the U.S. Federal Reserve have yet to actually increase rates – but it’s pretty clear they’re on their way.

Inflation and rising interest rates are generally “problematic” for most businesses – but they are particularly bad for “growth” stocks like those in the technology sector. To understand this, it helps to look at our old friend earnings.

Profits are everything in the market place and (naturally) growing those profits over time is important. It stands to reason that growth stocks will (or should!) generate most of their earnings in the future. A company like Shopify doesn’t currently make a lot of net profit (in 2020 it was a little over \$300MM). The reason Shopify was briefly valued at more than Royal Bank (which made \$11 billion in 2020) is that the market expects Shopify’s future earnings to grow dramatically over time.

If inflation is close to 0, like it has

been for the past few decades, all those (potential!) future earnings for Shopify grow and compound massively. However, if inflation rises dramatically, those future earnings are worth far, far less and the company is repriced lower. Hence a market rout for tech stocks in January.

At the other end of the earnings spectrum are “Value” stocks (like the aforementioned Royal Bank). Value stocks are earning a larger share of their earnings NOW. In an inflationary environment, they look a lot more attractive. “Value” is currently clobbering “Growth” in the marketplace.

So, load up on “Value” if inflation is going up, right? Well, not so fast. Aside from banks, another value sector on fire right now is Energy. Yes, major energy players like Suncor and Canadian Natural Resources are generating boatloads of cash, but in the future?? There’s a reason these companies are called “cyclical”.

So, two questions investors might ask themselves here: 1) Am I investing for now or the future? and 2) What’s my outlook for inflation?

As to question 1, for me it’s “Both!”, so I want both earnings “growers” in my portfolio as well as companies generating a lot of cash. As to inflation, I’m still in the camp that believes prices will moderate over the coming year or so. That gives me a little bit of a bias towards “growth” vs “value”. Not sure I’d buy Shopify, but there are plenty of other great companies to own in the space.