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MAKING CLIENTS WEALTHY
OUR MISSION



MARKET COMMENTARY SUMMER 2022

Karen Steinmann, MFin, CFA
Investment Analyst

Mandeville Market Commentary – Summer 2022

When nothing is sure, everything is possible.

-Margaret Drabble

As we prepare for summer, many of us are ready to disconnect from a daily life that seems increasingly uncertain. The S&P 500 has entered the second bear market of the pandemic; inflation has now reached decade-long highs; interest rates continue to rise and the war in Ukraine rages on. In times like these it's important to keep in mind that when the world is at its most chaotic, disciplined long term investors have the opportunity to capture rewards. Because when everything is uncertain, great possibilities exist.

Legendary investor Warren Buffet believes in investing for the long-term and encourages others to “only buy something that [they’d] be perfectly happy to hold if the market shut down for ten years”. While this mentality may not be for the faint of heart, having a solid plan, clear long term goals and open communication with your Mandeville advisor can help you weather the storm and help get you home to your investment objectives.

Drawing inspiration from Warren Buffet’s investment philosophy, Michael Lee-Chin’s investment principles are as critical now as in a bull market:

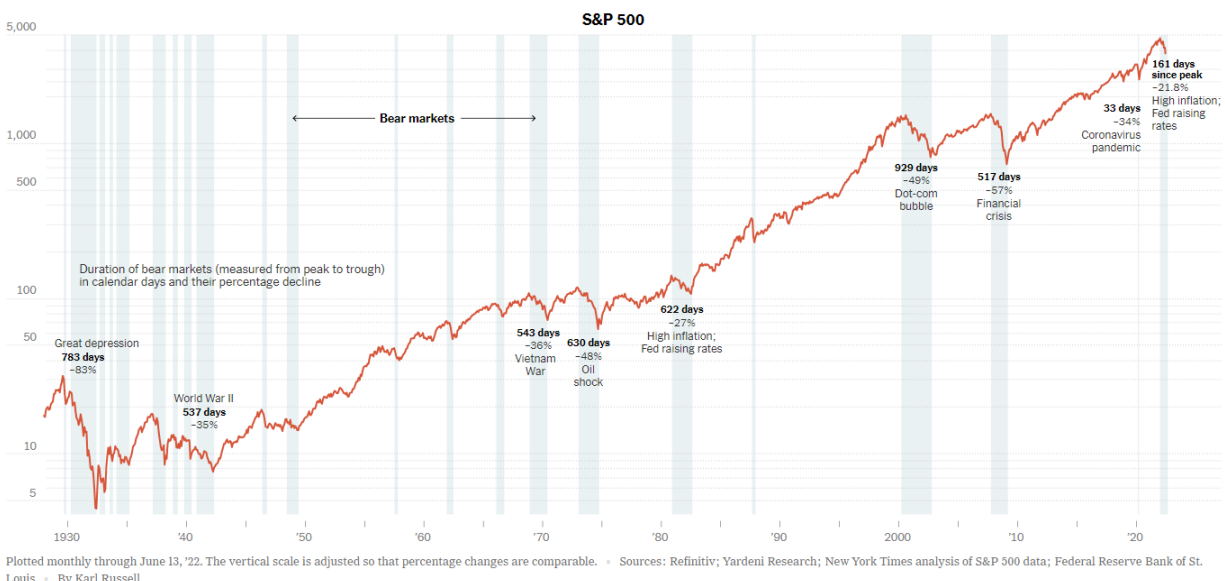
1. Own a few high quality businesses;
2. Thoroughly understand those businesses;
3. Ensure those businesses are domiciled in strong, long-term growth industries;
4. Use other people’s money prudently;
5. Hold these businesses for the long run.

To paraphrase Frost, taking the road less travelled has made all the difference. The same can be said for investing. Remembering that there are opportunities beyond the public markets and enjoying the lower volatility of alternatives is another way to leverage the Mandeville Difference.

Looking forward, two key financial themes weigh heavily on markets and our minds; (1) the lifting of COVID restrictions and their knock-on effects in most of the developed world, and (2) the broader economic consequences of Russia’s invasion of Ukraine. Given their impact, we believe investors can expect the following:

- Operating in a new regime, central banks face unfamiliar territory. The path of inflation and rates has become more uncertain.
- Despite moderating growth, opportunities in value and growth are emerging.
- Supply side shocks will complicate the path forward but will be a tailwind for commodities.
- Central banks have a deeper toolkit today than in the 1970s. The current uncertainties offer opportunity for disciplined investors – particularly as inflation begins to retreat.

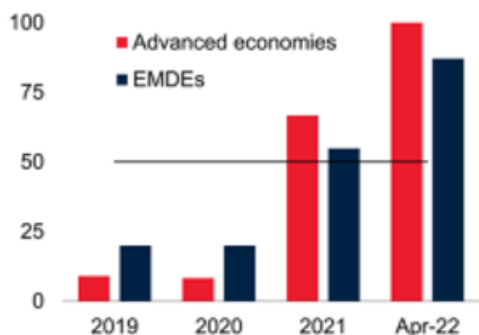
Exhibit 1: Duration of Bear markets on the S&P 500 since 1920 (measured from peak to trough) in calendar days and their percentage decline



WHAT TO EXPECT WHEN YOU'RE EXPECTING. . . RATE HIKES

When the Coronavirus pandemic initially struck, monetary growth surged nearly everywhere. Central banks worried about deflation and worked to keep it at bay. However, they underappreciated the degree to which the combined impact of ultra-easy monetary and fiscal policy would spur the rebound of the economy, including the near-record lows in unemployment. They can also not be blamed for not foreseeing the prolonged labour shortages or supply chain bottle necks. These challenges were made worse by Russia's invasion of Ukraine. The convergence of these factors now has central banks working hard to rein in inflation, as Canada and the US see levels not seen since the 1970s and 1980s.

Exhibit 2: Percentage of countries with inflation above target including emerging market and developing economies (EMDEs)



Sources: Consensus Economics; International Monetary Fund; World Bank.

Central bankers have been very vocal about their intentions to raise rates and fight inflation. The Fed recently raised rates by 75 basis points (bps), and has stated it can raise them again by 50-75 bps when they meet again. Federal Bank Chairman Jerome Powell is trying to frontload the rate increases in 2022 so that 2023 can be a smoother year.

Central banks are in a difficult position. In the case of the United

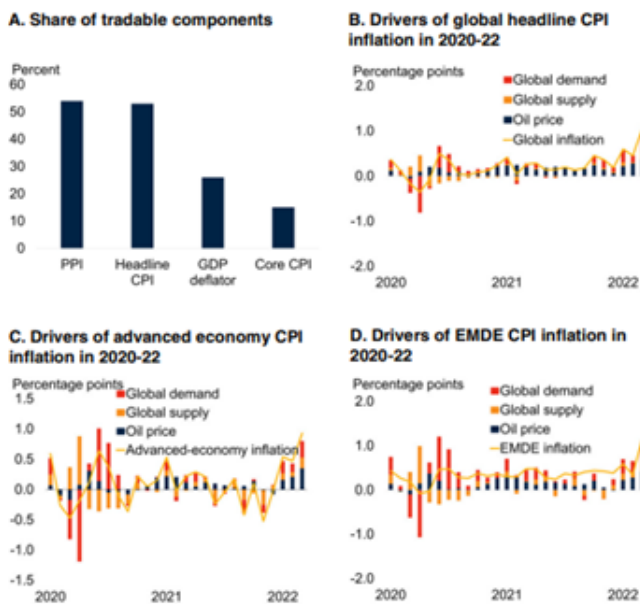
States, the Federal Reserve's dual mandate is to promote maximum employment and price stability. In Canada, the Bank's mandate is more squarely focused on inflation control, but still with an eye on maximum sustainable employment. With inflation running significantly above target in both countries, achieving both objectives will be challenging.

At its June meeting, Fed Chair Powell said he believed the central bank still has a path to achieving a 2.0% inflation target, while maintaining strong employment, but that commodity shocks were complicating the matter. Although the Federal Reserve can influence demand via its policy tools (i.e. the Fed Funds Rate, Fed balance sheet and forward guidance) it has little ability to influence markets for say gas, fertilizer, or food prices - many of which are being influenced by war in the Ukraine and global supply chain disruptions. These challenges are complicating the potential path of rates and the variability of outcomes.

As happened last summer, it is possible inflation may soften and then re-emerge more aggressively, forcing the Fed to respond with a more sporadic tightening path. It's also possible that in an effort to control inflation, the Fed overshoots, spurs a recession and undermines its employment goals.

Exhibit 3: Main drivers of inflation from 2020 to 2022

Between January and May 2020, demand factors played a major role in dampening global inflation. Since mid-2020, global supply and oil price shocks have also contributed significantly to rising inflation.



Sources: Ha, Kose, and Ohnsorge (2021a); U.S. Bureau of Labor Statistics; World Bank.
Note: CPI = consumer price index; EMDEs = emerging market and developing economies.

As Chair Powell has articulated, for many years the Fed had operated in a world dominated by the disinflationary forces of technology and globalization, where supply shocks were generally transient. Whether these supply shocks persist, or whether we see more, is difficult to say. Whatever the case, central banks globally now have to uncover price stability in this new regime. As the Fed Chair made clear, failure to achieve price stability is not an option. Taking his comments to their logical conclusion, there is a risk that the importance of this goal demands action that produces a not so soft landing and one where maximum employment is necessarily sacrificed in the short term for a healthier labour market in the longer term. What is clear is that the environment has changed, risks have risen, and central banks globally are now operating in an environment that is less familiar to them. This increases the potential for policy

mistakes and the scope of potential asset class outcomes for investors.

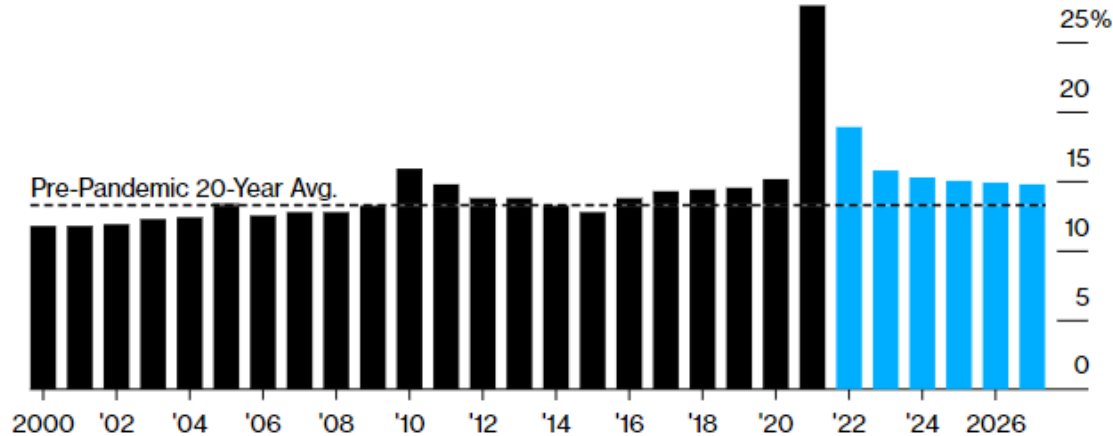
In Canada, the federal government's spending programs appear to be acting as a counterbalance to the Bank of Canada's monetary policy tightening efforts, forcing it to raise rates potentially faster and higher than would otherwise be necessary. In attempting to combat the negative effects of inflation by increasing spending, the Trudeau government is creating a feedback loop that is adding fuel to the inflationary fire. In enacting fiscal policy that conflicts with the Bank's monetary policy objectives, the Federal government may be introducing an added layer of unpredictability to economic outcomes, potential asset returns, and to highly levered Canadian consumers.

Exhibit 4: Federal spending as a percentage of GDP

Still Stimulative

Canada's program expenditures forecast to exceed historical averages

■ Program Expenses as % of GDP ■ Forecasts



Source: Department of Finance

In the European Union, continued economic growth as well as high inflation means the European Central Bank (ECB) will likely begin raising interest rates next month. In developed markets, there is now a concern of enduring stagflation – high inflation coupled with slow economic growth and joblessness.

NOT SO GREAT EXPECTATIONS

As the pandemic winds down in most of the world, we may have envisioned celebrations and new market highs but instead we are faced with a more reserved reality; the economic impact of COVID has been complicated by Russia's invasion of Ukraine in late February, setting global economic growth back even further. After the onset of the war, the World Bank lowered its global economic growth forecast from its original projections in January: gross domestic product (GDP) in the Eurozone was lowered to 2.5% from the originally projected 4.2%, for the US, the world's largest economy, their GDP growth expectations declined 1.2% to 2.5%.

Exhibit 5: Year-to-date total returns: value versus growth

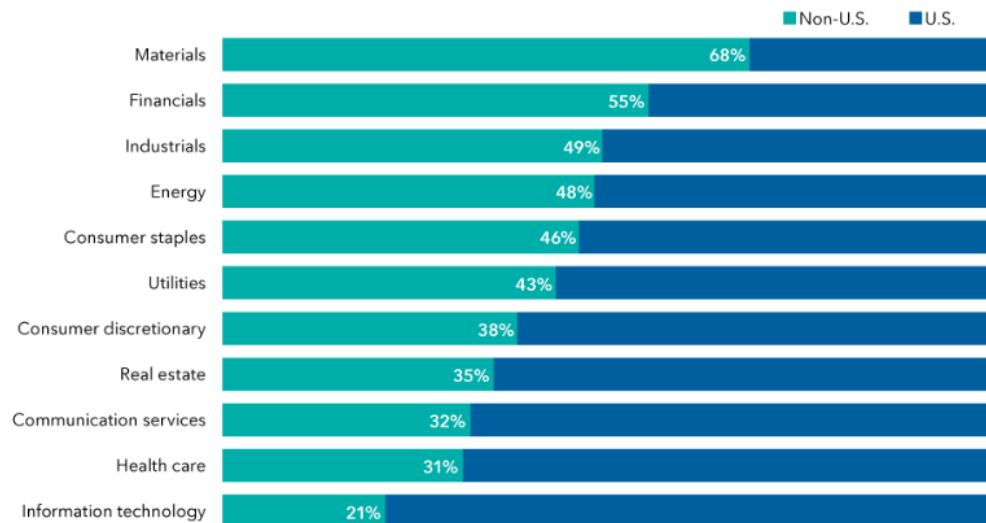


Sources: Capital Group, MSCI, Refinitive Datastream. Returns reflect cumulative total returns from December 31, 2021, through May 24, 2022. Returns are in USD.

In spite of these headwinds, there are opportunities to be found. The sharp declines in many growth and technology stocks mean value stocks are finally having their day in the sun. It is premature to say how they will both progress, as both have weakened, but value stocks are down considerably less than growth stocks.

European stocks lean heavily towards value-based industries. Despite the war in Ukraine, Europe's unified response indicates a Europe that is willing to work together to combat its collective enemies, whether they are an invading country or the possibility of stagflation.

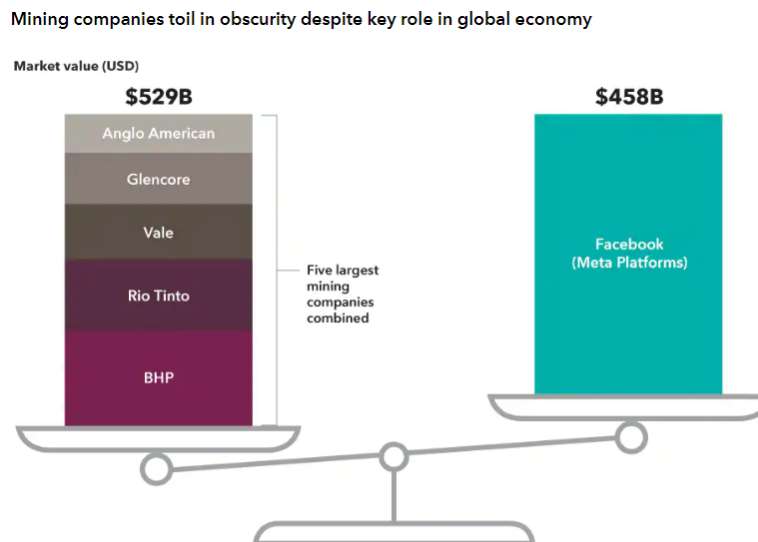
Exhibit 6: Regional exposure of each sector within MSCI ACWI



Sources: MSCI, RIMES. As of 4/30/2022.

Increased demand combined with long-term neglect means commodities are doing well. Many commodity prices will remain high thanks in part to chronic underinvestment in new mining projects but also because of the drawn-out government approval process. Despite their critical role in the global economy, the top five mining companies only just make up a larger market share than Meta Platforms (formerly Facebook).

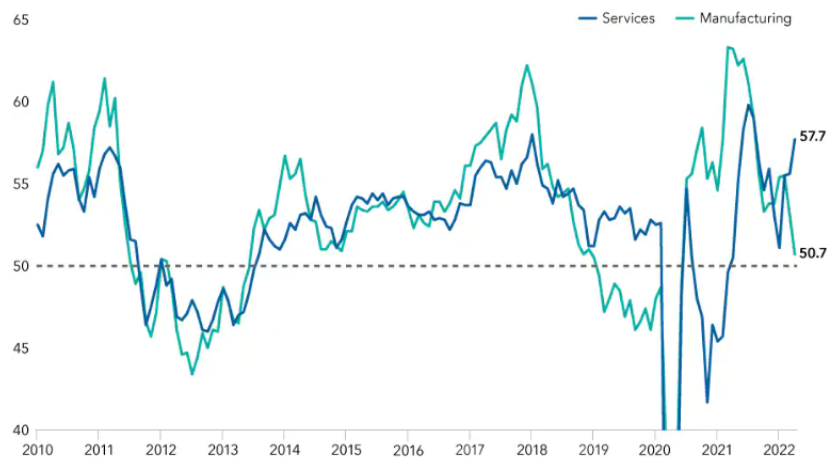
Exhibit 7: Market cap of top five mining companies compared to Meta Platforms (formerly Facebook)



Source: RIMES. As of 5/31/2022. Facebook data is the market value for the entire company, which was renamed Meta Platforms in 2021.

For many, the pandemic put most of life on hold and those fortunate enough to maintain their employment saw large increases in savings rates. That money is now being directed towards the services industry with commensurate benefits for the sector. As European manufacturing slows, the services sector -- which includes finance, retail and tourism -- is enjoying relaxing COVID restrictions and people's desire to spend money. The services sector accounts for the majority of employment and economic output in the eurozone, meaning if current trends persist, Europe could continue growing despite weakness in the manufacturing sector.

Exhibit 8: Services versus manufacturing business activity in Europe since 2010



Sources: Haver, S&P Global. As of April 2022, The Eurozone Purchasing Managers' Index (PMI) is a measure of business activity compared to the previous month, based on a survey of around 5,000 companies based in the euro area manufacturing and service sectors. PMI levels above 50 indicate growth and levels below 50 indicate contraction. In 2020, the Services PMI declined to 12.0 and the Manufacturing PMI declined to 18.1, but are not shown on the chart for scale.

A SERIES OF UNFORTUNATE EVENTS

In late February, global demand, labour shortages, extreme weather, COVID-19 disruptions, and on-going supply chain issues had already put upward pressure on food and fuel prices. Russia's invasion of Ukraine only pushed them higher.

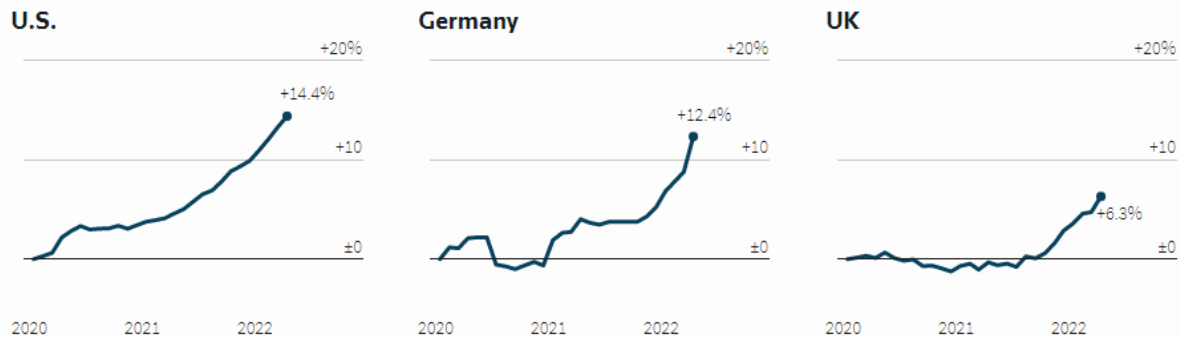
Exhibit 9: Global food price increases compared to their average prices from 2014-2016



Source: Refinitiv

With so many sanctions against Russia, the world's largest exporter of fertilizer, the scarcity of resources for future crop planting has not yet been realised. The second largest exporter, China, already imposed export limits in 2021 to safeguard its domestic farming production.

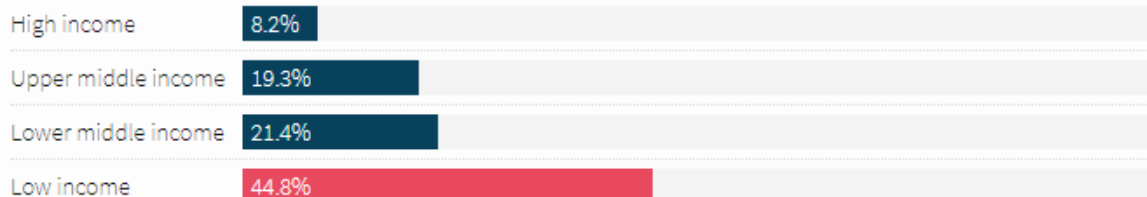
Exhibit 10: Change in the consumer price index for food



Source: Refinitiv

Unsurprisingly, those most impacted by rising costs of food are lower income earners. And as more household income is dedicated to rising fuel and food costs, less is spent on discretionary spending. In the US, Walmart and Target are already reporting increased inventory levels; an indicator for declining future sales.

Exhibit 11: Food as a share of household expenditures

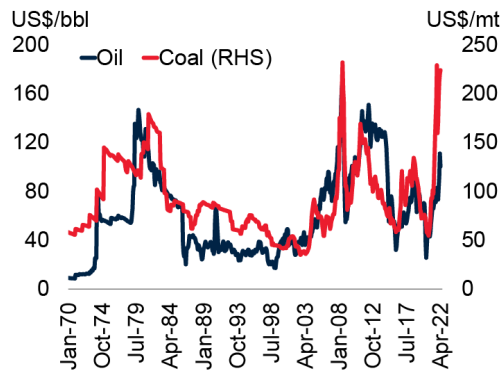


Note: 2017-2019. Calculated on per-capita GDP and excludes food consumed away from home.

Source: Organisation for Economic Co-operation Development (OECD) and the Food and Agriculture Organization (FAO) of the United Nations

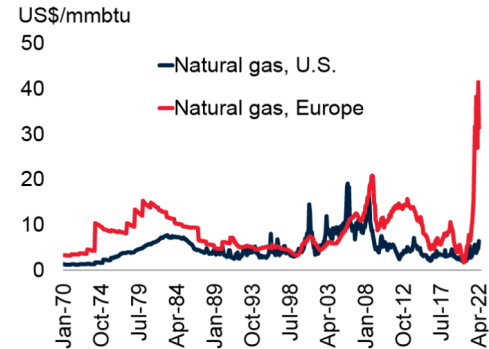
From January 2020 to December 2021, the World Bank's energy price index increased 50 percent. Between January and April of this year, it increased a further 26.3 percent. The index includes pricing on coal, natural gas, and oil. Ignoring inflation, crude oil prices have seen the largest two-year increase since the 1970s. However, once inflation is considered, it is only European natural gas prices that are at true all-time highs. Coal prices are hovering near their 2008 peak and, believe it or not, oil prices are *below* their 2008 highs. There is no reason to believe prices will come down any time soon; in fact, they're expected to go even higher with an overall average increase of 50 percent in 2022.

Exhibit 12: Oil and coal prices after accounting for inflation



Source: World Bank.

Exhibit 13: Natural gas prices after accounting for inflation



Source: World Bank.

THE SUN ALSO RISES

As central banks remove their monetary support, stock prices are falling and fixed income yields are increasing. Staying ahead of inflation is growing more challenging and for those seeking reliable income, inflation-proof income can seem like an impossible task. While daunting, it is wise to remember that we are tasked with better tools than ever before to combat inflation. Decades of monetary policy mean we have come a long way from the drawn-out inflation seen in the 1970s. Investing is a long-term strategy, and with your Mandeville advisor by your side, you can maintain your plan and take advantage of the Mandeville Difference.

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Mandeville Holdings Inc., 1375 Kerns Road, Suite 200, Burlington, Ontario L7P 4V7 Tel.:1-888-990-9155
• Fax: 1-905-331-4245 • www.mandevilleinc.com