

WOOD GUNDY

A SEASON OF FAITH'S PERFECTION

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By Brahm Satov

The title is not my own, some may recognize it from one of my favorite movies, "Finding Forester". It is true that seasons come, and seasons go. And I am hoping that this season, that of the pandemic is nearing its end. We have been living through a time in history, where wearing a mask is not just widely accepted, but in most places, required. In my opinion, seasons are also changing for the stock markets, sort to speak. Perhaps as a metaphor, we have been enjoying a really long summer season in equity (stock) markets, where investing has been relatively easy, and now I think we are heading into the Fall. In 2021 we witnessed a year where North American stock markets rose to all-time highs again and again, and it seemed as if everyone was becoming an investor. Many "adopted" the belief that stock markets always eventually trend higher. Hence the mantra, buy on weakness. I am all for adoption, but this notion of stock markets always trending higher, in my opinion depends on the underlying fundamentals and on your timeline. I believe this year will be one whereby having a strategy and selecting great businesses will make a meaningful impact on performance.

For those who have flown, we know that a tailwind is always nice as it gets us to our destination faster. Similarly, in the financial markets, tailwinds act as a catalyst to help the economy and/or stock markets. As long as central banks continued with their dovish bias, (or to pour liquidity at unprecedented levels into the system), the stock markets had a tailwind, a big one, but recently that changed. Many central banks have pivoted to a more hawkish bias, and consequently I believe it will be a more challenging environment for stocks so long as this bias remains. (Hawkish and dovish- Central bankers are described as "hawkish" when they are supportive of the raising of interest rates to fight inflation, (higher rates puts downward pressure on the economy as rates rise usually means higher costs including mortgages), conversely dovish is when they lean towards lowering interest rates or stimulating the economy).

Inflation has become a concern of late. We are now in an environment whereby individuals on fixed incomes, which includes retirees, are seeing costs rise, and this has been difficult for many, especially for the less affluent. Why do I say, "especially for the less affluent", that is because those that are more affluent usually have investments in the stock market or real estate and in inflationary times, they usually do well. Given that many in the former group are voters, politicians have felt the pressure to combat this rising inflation, and as a result, many central banks have shifted from a dovish stance to a more hawkish tone. Just to be clear, this bout of inflation in my opinion was due primarily to massive stimulative policies including but not limited to QE and to a smaller degree a culmination of prolonged low interest rates exacerbated by supply chain disruptions as a result of Covid. My belief is that the economy will slow if central banks continue to maintain their more hawkish bias, and as the aftereffects of existing stimuli diminishes, so shall we see inflation dissipate. However, it is possible for central banks to stay hawkish for longer than they should, as inflation is a lagging indicator, and this could make stock markets even more choppy.

In general, when we see rising rates, growth tends to underperform value, in other words for those invested in riskier assets, (like Bitcoin or stocks trading at better than 50x earnings, or no earnings at all, like some technology companies), so long as central banks continue this hawkish path, these types of investments should underperform. I realize that the last time I wrote about Bitcoin, when I believe it was trading at about \$55,000USD (now under \$40,000 USD or down well over 25%), my opinion that it was worthless, was unpopular, so this time, I will avoid saying that.

Unlike North America, some major indexes are not trading at or near all-time highs and have not been for quite some time. In other words, buy and hold or buy on weakness has not always worked even for extended periods of time. China's Shanghai index has not made a new high in 8 years, and in Japan, the Nikkei has not made a new high since 1989 or over 30 years. Look, corrections are a normal part of the investing cycle, and the best part is, often stocks go from expensive to undervalued, and for those with a strategy, this could turn out to be a very opportune period.

My grandmother, I called her Granny, loved the Fall and the changing colors of the leaves. I was fortunate to spend so much time with her, and together we often went for drives and enjoyed this part of the changing of the seasons. When the seasons change, it makes sense to prepare for it, as we approach Fall, most put away the swimming trunks, mower, and lawn chairs and ready the shovels, hats, gloves, and boots. Similarly, as we go through a transition in the stock markets, a changing of the seasons if you will, investors may want to consider repositioning their portfolios.

Sincerely,

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