CIBC

CIBC PRIVATE WEALTH

Year Ahead Outlook

January 2022

Happy New Year! As we enter 2022, here is our year ahead outlook. Many thanks to Graeme, our newest team member, for doing the "heavy lifting" to compile this year's report.

Looking back at 2021, we're pleased with our overall returns, but a particularly interesting asset class outperformed the Pope Team Model Portfolio. It was *Champagne!*

Key regional indices

Index 30/11/2021 (monthly close)	Level	MOM	YTD	1yr	5yr
Liv-ex Fine Wine 1000	415.31	2.44%	16.51%	17.42%	40.02%
Liv-ex Bordeaux 500	350.40	0.92%	9.24%	9.44%	20.76%
Bordeaux Legends 40	426.79	2.25%	10.57%	11.11%	22.60%
Burgundy 150	686.80	3.86%	27.18%	28.17%	89.76%
Champagne 50	567.92	8.09%	33.78%	34.31%	74.18%
Rhone 100	224.43	0.37%	12.49%	13.34%	31.48%
Italy 100	359.67	1.46%	11.52%	14.19%	47.02%
Rest of the World 60	339.47	3.21%	19.02%	20.85%	30.59%

The Champagne 50 index was the top-performing sub-index in the Liv-ex Fine Wine 1000 (up 33.8% in 2021).

Much has been made in the way of "bubbles" as of late, so it seems fitting to tie this in. Historically, the science of fermentation was not well understood. "Popping bubbly" could be a 'hit,' but more often it was a 'miss'. Bottles would often explode! Thus, most patrons chose to pop their much-valued Champagne in their kitchen sink.

Are there lessons to be learned here? Read on to learn more about how we view the markets currently, changes we're making in your portfolio, and how we're planning for the future.

Where are we now?

We feel that we have perhaps two years left in the current positive economic cycle. Central banks continue to print money aggressively, although some tapering has begun. Unemployment is almost back to normal (6% in Canada and just 3.9% in the U.S). Interest rates are still historically low and there's a lot of money chasing assets. Equities are still the place to be for

the time being given low rates on bonds and the inflation protection one gains by owning good quality businesses.

We continue to avoid frothy areas of the market and will always have a value or "growth at a reasonable price" tilt to our portfolio, in order to minimize risk.

Determining which areas are frothy is obvious in some sectors, but not in others. The FAANGM (Facebook (Meta), Apple, Amazon, Netflix, Google, Microsoft) companies may have accurate pricing. However, we are not currently investing in most of these names as they are a bit too expensive - and based on past history, have not done well in an increasing interest rate environment. Apple on the other hand, offers good growth prospects at a reasonable price and was a new addition to client portfolios in 2021.

We can still buy companies for reasonable valuations in Canada, Europe, Asia, Emerging Markets and some areas of the U.S. market. We will continue to take advantage of this.

Are Price to Earnings Ratios "Bubbly"?

A price to earnings ratio is the 'number of years based on current earnings' for you to regain your principal investment. If you buy CIBC stock at a price to earnings ratio of 11, and earnings remain the same, you could expect to receive your principal investment back in 11 years. The higher the P/E ratio you pay for a company, the more growth you need to expect (in earnings) to justify the valuation.

A new electric vehicle company Rivian just IPO'd at a very expensive valuation of 100 times sales. Think about that one for a moment. One hundred times sales. What does this mean?

If you bought a company with a 100 P/E multiple, you would need 100 years based on current earnings to regain your principal. Almost everything would have to go right with this business to justify paying such a rich valuation. However, 100-times sales? This is way more expensive than an already expensive 100-times earnings, and means you are paying 100 times business revenues while not accounting for any expenses (no cost of goods, administration, taxes, or research and development). Wow!

We won't really know if Rivian's stock is a bubble until we "pop the cork". Eventually we'll find that either Rivian has no bubbles (bad company), contains just the right amount of fermentation (great business) or explodes everywhere (massive bubble).

Paying just ten times revenues in the investment world is considered inordinately expensive. Very few companies can deliver on these expectations. Many will point to the FAANGM stocks, but they are the exception, not the rule. Historically, many expensive stocks have suffered long periods of stagnation or decline after reaching a valuation of ten times sales. Finding the next trillion-dollar company is harder than it may seem.

We had some consternation the other day at this graph showing the total market cap of businesses currently priced at over 10 times sales. Richly valued stocks are the most expensive we have seen in our careers to date. They are even more expensive than was the case prior to the technology stock crash of 2000/2001 . The picture below speaks for itself.

Fig. 1: Stocks Priced for the Improbable (Stocks >10 P/S) vs. The Cheapest Stocks in the Market

Source: Kailash Capital, LLC; Data from 4/30/1989-8/31/2021

Are we in a new paradigm? It's possible, but not probable. As long-term investors, we will stick to fundamentals. Investing fundamentals are there for a reason and will guide us through both the good and bad times, no matter what the future may bring.

Are we Missing out on the latest Tech?

Generally, when it comes to investing in new technology you don't want to be too early, and you don't want to be too late. At one point in time, there were 2,525 search engines before market leader (Google) emerged. It's often easy to see in broad terms what industry trends are, however selecting which new companies will be industry leaders (or maintain their leadership) is very challenging. At one point in time, the cell phone industry was dominated by Nokia, Blackberry and Motorola. Well-liked by most stock analysts, these three companies combined had almost all the market share of what proved to be a fast-growing emerging industry. They were all eventually beaten out by Apple and Samsung – as both these companies proved to be more innovative than the competition.

We feel the next major innovative wave will be in human biology (genomics, bioinformatics, to 3D printing of artificial organs/limbs.) The speed at which our COVID vaccines were developed are a pre-cursor to what's coming. If we decide to invest in these areas however, it will only be when we see reasonable valuations that give us a proper margin of safety.

In our previous 2020 year ahead letter, we commented on over-valuation in crypto, unprofitable technology and green energy. These asset classes are now down over 50% from their 2021 highs. Although we feel that downside pressure has a ways to go (particularly in unprofitable technology), we will be looking more closely at green energy investments and assessing where we can find value in this space.

Inflation and Interest Rates

High inflation at present is likely - in our view - “transitory” and is expected to move lower towards the end of 2022. As vaccination rates increase across the world, we expect supply chain issues to resolve - causing inflation to settle back close to previous levels. High inflation of late has put central banks in a tight spot. Increasing interest rates too early, or too much (to combat inflation) will dampen the economic recovery we’ve been experiencing. It will be a tightrope walk for central banks over the next couple of years as they consider how to take away the massive monetary stimulus they have been providing without derailing the economic recovery that is underway.

Privately owned Fixed Income/Commercial Real Estate

Privately owned fixed income and privately owned commercial real estate continues to demonstrate very good risk adjusted returns. As interest rates will likely continue to be a lot lower than what we’ve seen historically, we’ve had to pivot in terms of how we minimize downside risk - while at the same time maintaining a reasonable rate of return.

Historically we’ve invested between 40% and 45% of client assets in bonds and bond-related investments. If we continue to do this at today’s low interest rates, overall portfolio returns will suffer. We believe privately valued fixed income and real estate can assist us in our goal of keeping portfolio risk at reasonable levels, while at the same time continuing to meet our return expectations.

We will look to increase our investment in privately valued fixed income/commercial real-estate (to close to 20% of client’s portfolios) if public stock and fixed income markets continue to provide good returns - and reach a high point where we feel portfolio risk should be decreased. Large pension funds (such as the CPP) have been successfully utilizing privately valued investments for the past decade.

Many publicly traded Real Estate Investment Trusts (REITs), which were trading at significant discounts to ‘Net Asset Value’ when the pandemic derailed financial markets, are now beginning to trade closer to fair value. We monitor the REITs in our portfolio closely and still like where they stand, both from a discount to Net Asset Value and cashflow generating basis. We are regularly seeing new lease renewals coming in between 7% to 9% above current rent and there continues to be good occupancy levels and solid land value. Should our REITs (as we expect) move up to trade closer to Net Asset Value, we will begin moving some of these publicly traded REITs into privately valued commercial real estate. Privately valued properties are valued by appraisals, and therefore not subject to public market selling pressure - as is the case with publicly traded REITs.

In addition, privately valued fixed income allows us to move some money out of publicly traded fixed income and decrease risk that comes with this asset class, especially when public markets experience large downturns.

As these privately valued investments (in commercial real-estate and fixed income) tend to be ‘non-correlated’ to our publicly traded holdings, this helps to reduce portfolio volatility and enhances diversification.

To sum up, good returns combined with better portfolio diversification is why pension funds have been moving significantly into this asset class. We feel fortunate to have these investments at our disposal. Otherwise, the only way to maintain returns going forward (that meet our expectations) would be for us to increase stock exposure (and therefore risk) to levels far higher than what we historically have employed.

Preferred Shares

The huge comeback we have seen in preferred share prices has been welcome news. In 2022, we will continue to see many issuers redeem their preferred shares at $25 par value. We expect that preferred shares (that are trading below $25) will continue to increase in price, given good investor demand (and shrinking supply). Any increase in interest rates favors this asset class (as future preferred share dividends on our 'rate reset preferreds' increase - when interest rates increase). When we feel preferreds are trading high enough in price, we plan on selling most of our exposure here as in recent years, preferreds have provided poor downside protection during any major market sell off.

Cryptocurrency

The crypto market in our view remains largely speculative and we believe most buyers are investing here for price appreciation rather than for actual currency usage. There's a big difference between "investing or speculating" when it comes to allocating capital in the financial markets.

An investor is buying ownership in an asset or business that they feel has good long-term prospects - based on current and expected future cash earnings. It's this expectation of future cashflow that allows investors to have some sense of the value of their business. Speculation on the either hand involves buying something in the hope that someone in the future will buy it from you at a higher price.

Cryptocurrency does hold a lot of intellectual appeal. The origin story is fascinating and the underlying 'blockchain technology' has a lot of utility.

For those who wish to read the still unknown inventor of Bitcoin's (who goes by the pseudonym Satoshi Nakamoto) original paper, here it is: https://bitcoin.org/bitcoin.pdf

As we view buying cryptocurrency or related investments as speculation, we don't plan on investing in this space.

Defensive Measures

If markets continue to climb higher over the next two or three years, we plan to take additional measures (in addition to investing in privately valued fixed income and real estate) to offset risk. This could involve investing in gold, long term U.S. treasury bonds, and/or option writing strategies. Ticker symbol ZPAY is a BMO option writing ETF that we may consider using (to generate a good yield with bit of capital appreciation - while taking on about 50% of the market's overall volatility.)

Omicron

The rise of this new variant creates headwinds for the upcoming year as its transmissibility rates are much higher than the previous variants we've encountered. The latest data seems to indicate however that the severity of symptoms following infection is milder - compared to former strains we've encountered.

Based on the data at hand, most GDP estimates for the U.S. and Canada have been lowered very slightly for early 2022 because of this latest variant. Overall, 2022 GDP estimates for the U.S. and Canada are still a healthy 4.2% and 4.0%, respectively.

Potential Risks (and Opportunities)

Aside from valuations being stretched in several 'in favor' industries (which we are largely avoiding) we remain watchful of the effects of today's artificially low interest rates and significant 'quantitative easing' (which started as a central bank experiment back in 2008 and has become the go-to method of fixing any economic downturn).

Corporate borrowing has been largely incentivized by low interest rates; however a lot of newly raised debt capital has gone into buying back the company's stock - rather than research and development or capital investment.

Although central banks have had good success in their goal of smoothing out the economy's booms and busts, we are not seeing a normal healthy cleansing through bankruptcies, (of inefficient companies) which in the longer-term is needed to enhance corporate efficiency.

Add in record amount of fiscal stimulus (that has produced huge government deficits) and we see an overall 'sugar rush' that is benefiting the economy in the short run but leads us to be ever aware of longer-term risks of "asset bubbles" . Eventually, we will have to 'pay the piper' regarding record amounts of government debt.

On the positive side, as we begin 2022, we have a reasonably strong economy and lots of pent-up demand that should eventually benefit the struggling travel and hospitality sectors. Analysts are projecting 2022 to be a decent year for overall corporate earnings growth. Consumer confidence is also strong due to heathy growth in individuals 'net worth.'

Given the poor alternatives in the bond market, 2022 may see a reasonably good return year for equities, particularly in areas of the market that are still trading at reasonable valuation levels.

Bits and Bites

This year's TFSA limit remains at $6,000. For most client situations, we will be investing in auto-parts manufacturer, 'Magna International' – a good value and earnings play on the increase in electric vehicle production in the coming years.

Magna is well positioned to take advantage of vehicle electrification and autonomous driving. It has invested in a massive re-tooling of its production factories to accommodate these trends. Instead of paying 100 times sales for Rivian, we're able to buy Magna at under 14 times earnings with good prospects and a large margin of safety. Less concern about champagne bottles exploding here!

The 2021 RRSP maximum is $27,830 (deadline end of February). The 2022 maximum RRSP is $29,210. Please check your CRA notice of assessment for your RRSP limit.

As we head towards tax season, please look out for your investment management fee report which will be mailed to you. The fee (in non-registered accounts) is tax-deductible.

BC resident children (ages 6 to 9) are eligible for $1,200 grant (fully BC government funded) towards a 'Registered Educational Savings Plan.' In RESPs we manage here, we track the children's age – and help clients apply for the funds when the child turns six. Please talk with Cheryl (or any other team member) regarding how to take advantage of this program.

We've been very fortunate to have a number of new clients join our practice this past year. We would like to wish a warm welcome to everyone who has joined us! And thank you all for mentioning our practice to your family, friends, and colleagues. Our minimum for new clients continues to be $500,000, but as we have always said, any of your children or parents are welcome as clients and we are more than happy to provide general advice over the phone to people you care about - regardless of how much money they have to invest.

Each year, via our firms' 'Children's Miracle Day', we give a portion of client revenues from the past year to charity. The Scientists in Residence program which we supported for many years, is now fully funded for when it resumes.

We've donated to two new charities this past year, Athletics for Kids and Kids Up Front. Athletics for Kids pairs underprivileged children wanting to participate in sports with high school athletes for support and friendship. They also assist financially with sign-up and equipment costs. Kids Up Front provides access to arts, culture, sports, and recreation for children who otherwise would not have the opportunity.

We also continue to support Richmond's excellent charity, Pathways Clubhouse which supports individuals with mental health challenges by helping them in a variety of ways - including seeking employment.

In conclusion, we take our responsibilities to you very seriously and prefer to toast with our (reasonably priced) Champagne rather than speculate that the current high price for renowned vintages represents a bigger 'bubble' than it contents. Besides, the wealthiest people we know got that way by NOT drinking 10k bottles of wine; or as is the case with Warren Buffet, on days the markets are down at opening, he skips his usual McDonald's breakfast for a lower cost option… true story!)

The Pope Team also has a new secret weapon should we need a pep talk in another market downturn: https://twitter.com/CBCTheNational/status/1466021765822386178 Click for joy!

CBC News: The National
@CBCTheNational

···

The 6-year-old who became coach for a day and gave an inspiring pep talk to the Peterborough Petes.
#TheMoment

Please don't hesitate to reach out if you would like to discuss any of these items with us further. All the best in 2022!

Sincerely,
The Pope Team

Neil Pope, MBA, CIM
Portfolio Manager,
Investment Advisor
Tel: 604 207-8578

CIBC Wood Gundy
The Pope Team
www.thepopeteam.ca
606-5811 Cooney Rd, Richmond, BC V6X3M1

Rick Aulik, CFP, CIM, FCSI
Investment Advisor
604 207-8585
rick.aulik@cibc.ca

Susan Christie, CFP, BA, CIM
Associate Portfolio Manager
604 207-8570
susan.christie@cibc.ca

Graeme Schuss, CFP, BSc
Associate Investment Advisor
604 207-8582
graeme.schuss@cibc.ca

Cheryl Sy, BSc	Melanie Burns	Phoebe Tagaca
Client Associate	Client Associate	Administrative Assistant
604 207-8581	604 207-8583	604 270-6457
cheryl.sy@cibc.ca	melanie.burns@cibc.ca	phoebe.tagaca@cibc.ca

CIBC Private Wealth consists of services provided by CIBC and certain of its subsidiaries: CIBC Private Banking; CIBC Private Investment Counsel, a division of CIBC Asset Management Inc. (“CAM”); CIBC Trust Corporation; and CIBC Wood Gundy, a division of CIBC World Markets Inc. (“WMI”). CIBC Private Banking provides solutions from CIBC Investor Services Inc.(“ISI”), CAM and credit products.

CIBC Private Wealth services are available to qualified individuals. The CIBC logo and “CIBC Private Wealth” are trademarks of CIBC, used under license.

This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. CIBC and CIBC World Markets Inc., their affiliates, directors, officers and employees may buy, sell, or hold a position in securities of a company mentioned herein, its affiliates or subsidiaries, and may also perform financial advisory services, investment banking or other services for, or have lending or other credit relationships with the same. CIBC World Markets Inc. and its representatives will receive sales commissions and/or a spread between bid and ask prices if you purchase, sell or hold the securities referred to above. © CIBC World Markets Inc. 2022.

There are ongoing fees and expenses associated with owning units/shares of an Exchange-Traded Fund (ETF). An ETF must prepare disclosure documents that contain key information about the fund. You can find more detailed information about the fund in these documents. ETFs are not guaranteed, their values change frequently and past performance may not be repeated. You will usually pay brokerage fees to your dealer if you purchase or sell units/shares of the Exchange-Traded Fund (ETF) on TSX/NYSE. If the units/shares are purchased or sold on TSX/NYSE, investors may pay more than the current net asset value when buying units/shares of the ETF and may receive less than the current net asset value when selling them.

Please click the applicable link(s) below to view important disclosures that relate to this email and the investment recommendations and/or products mentioned in it. https://cibc.digitalagent.com/cibc-disclaimer-viewer/security-view.jsp?viewId=38167

Clients are advised to seek advice regarding their circumstances from their personal tax and legal advisors.

Yields/rates are as of December 30, 2021 and are subject to availability and change without notification. Minimum investment amounts may apply.