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CIBC PRIVATE WEALTH

July Update: Testing our Mettle

June was another tough month, after a pause in May. As of the end of June, the S&P 500 had the worst start of the year since 1970. With the underperformance of bonds in the first quarter, followed by equities in the second, the classic 60/40 balanced portfolio has had one of the worst half years in history.

In June, the investment narrative swung from the threat of uncontrolled inflation to whether a recession was coming, or had even arrived. As we have seen throughout 2022, there were massive swings in stock prices across a variety of sectors.

A good example of these incredible changes in sentiment that translates into stock performance is the energy sector in June. The most popular energy ETF had moved from $10.53 on Dec. 31, 2021 to $18.51 (+75%) on June 8 2022. From June 8, 2022 to July 6, 2022, the same ETF travelled back down to $13.61 (-26%). This reflected the drop of oil prices from $122.11 to $87.14 on weak consumer sentiment surveys. What happened to supply and demand?

This is a simple illustration of how quickly the investment landscape that we try to navigate can change. The conditions I outlined in my newsletter (see Black Swans) have not really changed that much and exert tremendous influence on "the markets" every day. Add in the threat of a recession, and the daily movements become even more hectic.

When you open your statement you will see another significant down month for June. These months are not fun for you, and you know that they are not fun for us.

Down, but not out!

We recognize that seeing the portfolio decline month-over-month can be tough on you emotionally. This is the reason that we are so committed to doing financial plans that give you some context to evaluate the situation, and use conservative assumptions that allow us to absorb times like these. As we said in our end-of-year newsletter, the past few years have allowed us to build up a capital reserve that will cushion these all-too-common bumps in the road, and enable us to stay on plan.

The only silver lining so far this year is that valuations have come down quite dramatically so, potential future returns have a higher probability of meeting our expectations as outlined in our plan. At the moment, we can get over three percent in a one year GIC which exceeds our long-term bond return assumption.

So between having excess capital going into 2022, and having better long term return prospects mean that we are in good shape.

Rope-a-Dope

I was trying to think of an analogy for what has been going on as a Portfolio Manager these past six months. What came to mind was the fighting strategy of the rope-a-dope.

For many of us that grew up in the 70's and 80's boxing was a big deal. The most famous boxer of the time was Muhammed Ali. What made Ali so great was his ability to not only "dance like a butterfly" and "sting like a bee", but to outthink his opponent. This was most evident in his first match against George Foreman nicknamed the "Rumble in the Jungle". At that time, George Foreman was the most fearsome fighter in the world as he not only beat opponents, but destroyed them. Many fight experts where genuinely concerned about Ali's health, if not his life.

So what did Ali do to beat this terrifying hulk of a fighter, Foreman? He came up with the "rope-a-dope" technique. Ali knew that he could not go head-to-head with Foremen at the start of the fight, so he leaned against the ropes, covered up his head and as much of his body as possible and absorbed the blows raining down. He knew that eventually Foreman would punch himself out, at which point he would go on the offensive. And it worked!

Over the past six months we have been doing a lot of "rope-a-dope". We entered 2022 in good shape and aware that things could potentially get challenging. Like Ali, as the powerful market forces began to rain down blows we covered up, raised some cash, and resisted the urge to go on the offensive. Our goal was to protect the capital as best we could, knowing that the occasional punch would get through. On balance we feel we have done a pretty good job in that regard.

We feel that the next month or so of Fed meetings and earnings announcements, and guidance will help us gauge if this Bear market is tired enough for us to go on the offense or is it best to keep covered up and roll with the punches.

We may see a number of powerful counter-trend rallies over the coming weeks, but often these rallies are part of a longer-term Bear market trend, and are sold off. We really like the companies we own but recognize that you sometimes can fight the weight of the market so will keep our powder dry until we see some sustainable upward movement.

Future Leaders

For the past 10-plus years, all eyes have been focused on technology and how it has transformed the world. Today's biggest companies are all technology companies in some form or another. History would show that after a Bear market the leadership shifts to another up and coming trend.

We believe that the pandemic has revealed a number of medium-to-long term trends that we are beginning to position in our portfolio. Here is a quick summary of what we are looking at:

Energy Security

While we all wish we could go all-renewable tomorrow, the reality is very different. There is no doubt that we will need to rely on carbon-based energy for a period of time to keep the lights on, and our homes heated as we try and reduce our consumption and generate more green power.

If we look at where the majority of this carbon-based energy is produced we see that much of it comes from jurisdictions that are not as reliable as we thought. Just look at Germany having to use coal because its source of natural gas has become a global pariah and it uses energy as a weapon.

We are beginning to add companies that can help with this energy transition and provide energy security for the most important democratic economies.

We are also looking at companies that can support the electrical grid so that people are able to charge their cars and live in 45-degree heat.

Food security

As we know, millions of people are unable to grow or buy enough food to meet their daily needs. The effects of climate change is having a profound impact on food security as formerly arable land dries up and catastrophic weather events destroy crops. The war in Ukraine has only exacerbated the situation. These droughts and food inflation have led to the largest number of people seeking refuge in history. It also leads to societal breakdown and failed Governments. We are looking for companies that can help mitigate food security by maximizing the efficiency of every acre that is planted.

Water is another area that we are looking into for investment. As water is needed to grow crops we need to manage this resource very carefully and efficiently. If you want a lesson on the effects of low water you should look into the situation around the Colorado River and Lake Mead. California gets 4.4 million square acres of water from the Colorado River each year - 90% of it goes to agriculture!

The Green Transition Supply Chain

There have been a number of studies that show that with the existing technology, it will be difficult to supply the necessary materials to meet the expected demands coming from the move to electric vehicles and other battery storage needs. While we find the mining companies difficult to invest in because of their volatility, we are investing in companies that are a key component of the mining process or have technology to improve the process to help reduce the impact.

Global Supply Chain Adaptation

The pandemic clearly demonstrated that the supply chain that has been created over the past thirty years needs a major rethink. It seems clear that companies can no longer rely on factories across the world to provide necessary and immediate components and must adapt to what we call, “almost just in time”. This will require companies to store inventory near the production facility, to diversify their supplier by region, and likely move some production closer to home.

We are looking at the distribution facilities at robotics companies and other industrial requirements like sensors, as all new factories will be automated.

Biotech Revolution

The MRNA vaccine that helped save countless lives during the pandemic may prove to be a healthcare game-changer. Combining advanced technology and science should help us develop cures for various ailments in record time.

This can be a tough space to invest because of the binary nature of the outcomes for the drugs (it works, or it doesn't) so we would look to an ETF or active manager for exposure to these developing biotechs.

Counter Punch

You will have noticed that over the past few months we have been adding small positions to these themes with the idea that we would add more as the market conditions improve. This helped the portfolio perform during the sell-off of technology but in June these companies got caught up in the energy/materials sell off.

Plan for the Summer/Fall

We have been reluctant to put any money to work over the past month, but are beginning to sense that the market may be tired of going down.

We feel that the first place to look is in the bond market as it will usually turn upwards first when market conditions improve. We are currently underweight in this asset class but are finding it much more attractive that it has been for several years. Currently, the high-yield market is yielding around eight percent, and the investment grade market is over five percent, so we may begin to nibble at these investments through our managers.

On the equity side we will see how earnings and guidance are over the next four to six weeks and begin to allocate to specific names if the momentum turns positive.

Sincerely,

Lisa Applegath	Tom Trimble
Senior Wealth Advisor	Portfolio Manager

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