

INVESTMENT STRATEGY COMMITTEE

QUARTERLY PORTFOLIO STRATEGY REPORT

U.S. CORE EQUITY MODEL PORTFOLIO

October 2022



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Unless otherwise noted, all prices quoted in this report are as of the close of markets on September 30, 2022.

Market Review: Q3/2022

After a strong summer rally in July off the mid-June lows, equity markets sold off in August and September as the central banks reaffirmed their commitment to tighten monetary policy to combat persistently high inflation, which was driven by high energy prices along with a spike in food prices. This was also exacerbated by the ongoing Russia-Ukraine conflict. Record-high inflation and a weak economic growth outlook weighed on market sentiment, driving stock prices into negative territory. In Q3, Canada's S&P/TSX Composite Index returned -1.4% on a total return basis as rising interest rates and elevated levels of macro uncertainty fueled volatility in the market, resulting in a drawdown across the broader market. The industrials and consumer discretionary sectors were the best-performing sectors but the gains were more than offset by high-single-digit declines from the communication services and real estate sectors as rising bond yields presented a relatively attractive alternative to stocks in these historically higher-dividend yielding sectors.

The S&P 500 Index rallied nearly 14% from the end of June to the middle of August before ending the quarter down 4.9% on a total return basis as renewed fears of a hard landing for the economy as a result of the U.S. Federal Reserve's (Fed) monetary policy actions pushed stocks to new lows. Consumer discretionary was the top-performing sector, led by Tesla, Amazon, and Starbucks. Energy was the only other sector to finish the quarter in positive territory, despite the price of West Texas Intermediate (WTI) crude oil dropping by nearly 25% since the start of the quarter. Communication services, which posted a double-digit decline, was the worst-performing sector, dragged lower by losses in index heavyweights, Alphabet, Meta Platforms, and Verizon Communications. The real estate sector, which has been pressured by rising bond yields along with a weakening housing market outlook, was the second-worst performing sector. The technology-heavy Nasdaq Composite Index and the Dow Jones Industrial Average fell 4.1% and 6.7%, respectively.

Global markets also declined amid slowing global growth and soaring inflation, with the strong U.S. dollar adding pressure on international and emerging market equities. European stocks lost ground with the UK's FTSE 100 Index, France's CAC 40 Index and Germany's DAX Index posting negative returns of 3.8%, 2.7%, and 5.2% respectively in the quarter. Looking at the Asian markets, Japan's Nikkei Index fell 1.7%, with the yen trading 6% lower versus the U.S. dollar, reaching a multi-year low against the greenback during Q3. The Shanghai Composite Index recorded a sharp drawdown of 11% in the quarter as China's Covid-19 lockdowns in major manufacturing and technology hubs and lingering weakness in the housing market pressured its economy. However, the economic data coming from China improved throughout the quarter as Chinese authorities adopted incremental policy measures to support the economy, including lowering the policy rate, cutting taxes and supplying economic assistance to the infrastructure and property sectors.

The Bank of Canada (BoC) raised the benchmark overnight interest rate by 75 basis points (bps) to 3.25% on September 7, as was widely expected by the markets, and stated that it will continue with quantitative tightening. While the BoC acknowledged that Q2 GDP growth in Canada missed its forecast, it highlighted the strength of domestic demand, including strong growth in consumption and business investments. It maintained the view that "the policy interest rate will need to rise further", signaling that further rate hikes will be required in the coming months to dial down inflationary pressures. In August, inflation slowed down modestly in Canada, with the headline CPI declining by 0.3% month-over-month and the annual rate dropping to 7.0% from 7.6% recorded in July, and lower than economist expectations of a 7.3% year-over-year (Y/Y) gain. Lower gasoline prices contributed the most to the monthly CPI decline but food prices continued to climb higher, with prices up 10.8% Y/Y, which is the fastest pace since 1981.

In the U.S., the Fed raised the target range for the federal funds rate by another 75 bps to 3.00%-3.25% on September 21, marking the first time ever that the Fed has hiked rates by 75 bps in three consecutive moves. The Fed officials raised their projections for the rate path, with the median projection increased to 4.4% at the end of this year and 4.6% at the end of 2023, before starting to be cut closer to the 2.5% longer-run projection through 2025. This suggests that the Fed would continue their rate-hiking cycle to bring interest rates in line with the median dot plot by the end of the year. Inflation continued to rise in August with the annual core inflation rate hitting 8.3% versus 8.1% expected, despite falling gasoline prices.

In fixed income markets, bonds continued to decline as yields rose across the Treasury curve, with the yields on the short end of the curve rising the most. The Canadian 10-year bond yield ended the quarter at 3.17% while the U.S. 10-year yield ended the quarter at 3.83% after reaching a high of 3.95% earlier that week.

Portfolio Performance

ISC U.S. Core Equity Model Portfolio

The CIBC Private Wealth U.S. Equity Portfolio strategy outperformed the benchmark during the third quarter of 2022. Allocation contributed to the outperformance of the portfolio relative to its benchmark while selection detracted. Regarding allocation, overweight positions in utilities, energy, industrials and consumer discretionary as well as underweight positions in materials, consumer staples, real estate and information technology contributed to the outperformance. Overweight positions in healthcare and communications services as well as an underweight position in financials detracted. Regarding selection, materials, healthcare, consumer staples, utilities and technology contributed to the portfolio's outperformance while energy, industrials, financials, communications services and consumer discretionary detracted.

The materials, healthcare and consumer staples sectors were some of the biggest contributors to our performance. Our position in Ingersoll Rand performed well as the share price recovered partially from its recent low after it delivered good quarterly results and raised its guidance. The share price of Walmart rose during the quarter as rate hikes boosted investor concerns, prompting them to seek refuge in defensive names. Shares of CVS Health performed well following the release of the company's quarterly results which beat expectations and increased guidance from the company for the remainder of 2022.

The consumer discretionary, communications services and financials sectors were some of the biggest detractors of performance. Shares of Nike declined during the quarter due to concerns for the remainder of 2022 from weakness in China's COVID lockdowns, margin compression and mixed quarterly results that included lowered guidance and the company noting that it would take a cautious approach when forecasting its revenue. McDonald's shares were weak during the quarter as a strong U.S. dollar and growing concerns about lower-income consumers' ability to continue spending during times of rising inflation weighed on shareholder sentiment. Shares of Blackrock declined as fears of a recession and weaker financial markets for the coming 12 months continued to be incorporated into the share price. Over the longer term, we continue to believe there is an opportunity within the U.S. financials and given the weakness in many of the companies in the sector so far this year, we have seen valuations come back down to more attractive levels.

Overall, since we expected that the U.S. Federal Reserve's actions to curb inflation could result in slower economic growth, in Q3, we reduced our exposure to holdings for which we expected limited upside potential and we increased exposure to our initiated positions in names which we believed would outperform in conditions of economic and market uncertainty. An example of this was our switch from General Electric, which had been underperforming due to the negative impact on growth and margins from the ongoing supply chain issues, inflationary pressures and the Russia-Ukraine conflict, to a position in Caterpillar Inc. which is expected to boost its margins and the demand for its products as it continues to expand its total addressable market.

We also reduced the position in Union Pacific due to cost pressures and staffing shortages, which led to reduced operational efficiencies and we reduced exposure to Meta Platforms after a weak quarterly print and a poor outlook for advertising caused the company to reduce guidance. We increased the position in Texas Instruments after it delivered strong quarterly results and because it had been outperforming the broader semiconductor index. The position in Merck & Co. was increased, given its low valuation and its quarterly results that beat expectations and we raised exposure to Alphabet after the company posted strong revenue growth in its quarterly earnings release, despite the macroeconomic situation becoming more unpredictable. While the upcoming Q3 reporting season will likely bring current earnings expectations lower (driven by themes such as continued supply chain pressures, Covid impacts in China and inflation), we are starting to see some interesting pockets of opportunity across several different sectors.

The team here at CIBC will continue to deploy a multi-disciplined investment approach that utilizes fundamental, quantitative, and technical research methodologies to construct a portfolio of mid and large-cap U.S. equities that aims to achieve long-term growth of capital and income for our clients.

Results as of the end of September 2022

Portfolio Performance	3 month	YTD	1 year	3 year	Since Inception¹
U.S. Core Equity	-4.67%	-20.11%	-11.13%	10.05%	13.21%
Benchmark ²	-4.88%	-23.86%	-15.46%	8.17%	11.91%
Relative	0.21%	3.75%	4.33%	1.88%	1.30%

¹ February 16, 2016

² Benchmark: 100% S&P 500 Index (USD)

Current Environment

Although there has been some easing in overall inflation readings from the earlier peaks, core inflation measures remain troublingly-high in both the U.S. and Canada. That includes pressure on service prices from demand that has surged ahead in Canada as Covid-19 restraints were relaxed, as well as from wages that are escalating in the face of a tight jobs market. Central banks are therefore aiming at opening up more slack in the labour market, and reducing goods and services demand growth, in their efforts to bring inflation back to target.

The U.S. Federal Reserve (Fed) and the Bank of Canada have ratcheted up their thinking on how high rates will have to get to in order to generate the cooling they are looking for. Part of this seems likely to be on the mark, as the improvements that we have been hoping to see in global supply have been less forthcoming, impacted by events like the war in Ukraine and China's Covid-related shutdowns.

Even so, given the lags between rate hikes already engineered and those coming in October, central banks might be overstating the need for additional increases, or are simply erring on the side of talking tough on rates to help cool inflation expectations. Both the U.S. and Canada have seen some easing in job gains, and a turn towards lower job vacancies that, if continued, should begin to moderate wage inflation. Housing's contribution to growth is easing with slowing home sales, and that will cut into construction activity in upcoming quarters as the timing for new projects gets pushed back. In Canada, the upcoming year will see more households renewing existing mortgages at sharply higher rates than those they replace, squeezing discretionary spending power.

As a result, we don't see the need for the Canadian overnight rate to eclipse 3.75% or perhaps 4.0%, and similarly, the Fed should be able to pause once its target rate ceiling is at 4.25% or possibly 4.5%. In the very near term, however, markets might continue to fear a higher endpoint, with a more dovish outcome not being clear until the turn of the year.

Even that degree of tightening looks sufficient to entail at least a close brush with recessions in the U.S. and Canada in the next few quarters, with our forecast essentially calling for a stall in growth through the first half of 2023. A flat period for economic activity will put pressure on corporate profits by cutting into any volume gains. Margins are likely to be squeezed by diminished pricing power, a lag before wage inflation eases, and as higher interest costs are absorbed.

Outlook

In the third quarter of 2022, North American equity markets continued to be plagued with the concerns of investors as the market continued to try and navigate the many overhangs it continues to be presented with this year. Despite a modest mid-summer rally, the equity markets have resumed their bearish tone and continue to exhibit high volatility. The S&P/TSX Composite Index (TSX) finished the quarter down 1.4% on a total return basis in the third quarter leaving its year-to-date total return at -11.1% while its U.S. counterpart, the S&P 500 Index (S&P) lost 4.9% on a total return basis as it pushed deeper into the red with it now sitting at -23.9% on a total return basis for the year thus far. Safety within sectors was fleeting as most ended the quarter down on the TSX with the only exception being the modestly positive returns on the materials, consumer staples, and consumer discretionary sectors. The many apprehensions and uncertainties such as supply-chain disruptions, high inflation, rising interest rates, geo-political tensions, slowing economic growth, etc. that were present in the early part of the year have yet to be resolved and these concerns are likely to remain in place for the foreseeable future and will likely continue to weigh on market sentiment as we move into the tail-end of 2022 and into the new year.

At this point in the year, the market has priced a significant amount of rate hikes into the U.S. and Canadian yield curves. The committee continues to believe that we are in a rising 10-year rate environment for the time being and that the possibility of fewer rate hikes in Canada remains on the table as signs of slowing growth are beginning to be visible. With the expectations of a slower economy, the committee prefers to take a defensive stance and increase its exposure to fixed income by adding to the middle part of the Sovereign bond curve. This is an area that has lagged relative to the other parts of the curve in terms of priced-in rate hikes. This positioning kept the overall duration of the fixed-income component more or less unchanged as it remains below that of the benchmark. As such, the portfolio is less sensitive to the yield curve than its benchmark.

Heading into the final quarter of the year, the committee has a preference for fixed-income over equities at the asset class level. While equity valuations have come down quite a bit, the economic environment is still expected to slow and the committee believes that earnings estimates need to be revised lower to accommodate this view. The committee views the current risk-reward dynamic between Canadian equities and U.S. equities as fairly even. While the year began with a significant valuation gap between the two geographic regions the outperformance that Canadian equities have experienced this year relative to the U.S. has narrowed that gap quite a bit.

Appendix A: Investment Strategy Committee Members

**Wincy Wong, CFA, FSA credential holder**

Executive Director, Investment Strategy Group, CIBC Private Wealth

Wincy Wong joined CIBC in 2021 and has over 20 years of investment experience. Previously, she held lead portfolio management responsibilities for a number of large cap dividend mandates at Mackenzie Investments. Wincy is the chair of the Investment Strategy Committee's (ISC) Stock Selection sub-committee. She is also a member of the CIBC Asset Allocation Committee. Wincy is a CFA charterholder and a holder of the Fundamentals of Sustainability Accounting (FSA) credential awarded by SASB.

**Ian de Verteuil, MBA**

Head of Portfolio Strategy, Quantitative and Technical Research, CIBC World Markets Inc.

Prior to joining CIBC in 2014, Ian was the Global Head of Research at another major financial institution and led that firm's 70+ fundamental analysts, its quantitative team and its Economics department. During his tenure in the investment industry, Ian was also a top-rated analyst in the consumer products and banking sectors. He has a B.Sc. in Chemistry from McGill University and an MBA from the University of Western Ontario.

**Sid Mokhtari, CMT**

Chartered Market Technician & Research Analyst, CIBC World Markets Inc.

Sid Mokhtari is a chartered market technician (CMT) and a research analyst with CIBC World Markets Inc., with a mandate in technical-model trading aspects of the Canadian stock universe. Sid assesses the internals of the broader indices for a top-down analysis, while his TrendSpotting Matrix provides bottom-up analysis from technical perspective. Sid plays an important role in educating CIBC's clients through technical disciplines and models. Sid has been selected as the first Canadian technician to hold a seat on the Market Technicians Association's Journal Review Board. He is a regular guest speaker on the Business News Network (BNN), at Canadian conferences, and is often quoted by the Canadian financial press.

**Michael O'Callaghan, MBA, CFA**

Director, Investment Strategy Group, CIBC Private Wealth

Michael O'Callaghan joined CIBC in 2011 and is responsible for providing market commentary, portfolio strategies and investment recommendations to CIBC Wood Gundy Investment Advisors and their clients. Prior to joining CIBC, Michael was in a similar position at another Canadian investment dealer. A graduate of the Richard Ivey School of Business's MBA program and a CFA charterholder, Michael has more than 15 years of experience in the financial industry.

**Brad Brown, MBA, CFA**

Director, Investment Strategy Group, CIBC Private Wealth

Brad Brown joined the Investment Strategy Group in 2014 and is responsible for developing equity and portfolio strategies as well as providing market commentary to CIBC Wood Gundy investment advisors on both U.S. and Canadian equities. Prior to joining CIBC, Brad was Head of U.S. Equity for a European independent research firm where he developed trading strategies and investment ideas for U.S. dealers, institutional asset managers and hedge funds. In addition, Brad spent several years trading interest rate and equity index futures. He graduated with distinction from the John Molson School of Business at Concordia University and is a Calvin Potter Fellow. He also holds an MBA from the Rotman School of Business at the University of Toronto and is a CFA charterholder.

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 Allied Properties Real Estate Investment Trust (1b, 2g) (AP.UN-TSX, C\$27.43)
 Bank of Nova Scotia (2a, 2c, 2e, 2g, 3a, 3c, 7) (BNS-TSX, C\$65.87)
 BCE Inc. (2g, 7) (BCE-TSX, C\$58.86)
 Cameco Corporation (2a, 2e, 2g) (CCO-TSX, C\$30.77)
 Canadian Natural Resources Ltd. (2g, 7) (CNQ-TSX, C\$75.16)
 Fortis Inc. (2a, 2c, 2e, 2g, 7) (FTS-TSX, C\$50.92)
 Franco-Nevada Corporation (2g, 7) (FNV-TSX, C\$163.61)
 Loblaw Companies Limited (1b, 2a, 2c, 2e, 2g) (L-TSX, C\$109.21)
 Maple Leaf Foods Inc. (1b, 2g) (MFI-TSX, C\$20.91)
 Nutrien Ltd. (2g, 7) (NTR-NYSE, US\$86.58)
 Restaurant Brands International Inc. (1b, 2g, 7) (QSR-NYSE, US\$53.95)
 RioCan REIT (2a, 2e, 2g, 7) (REI.UN-TSX, C\$18.73)
 Rogers Communications Inc. (2a, 2e, 2g, 7, 13) (RCI.B-TSX, C\$52.12)
 Shaw Communications Inc. (1b, 2g, 13) (SJR.B-TSX, C\$33.87)
 Suncor Energy Inc. (2g, 3a, 3c, 7) (SU-TSX, C\$44.39)
 TC Energy Corporation (2a, 2c, 2e, 2g, 7) (TRP-TSX, C\$56.98)
 Teck Resources Limited (1b, 2g, 7, 12) (TECK.B-TSX, C\$45.97)
 TELUS Corporation (1b, 2a, 2c, 2e, 2g, 7, 9, 13) (T-TSX, C\$27.42)
 TFI International Inc. (2g) (TFII-NYSE, US\$96.98)
 Tourmaline Oil Corp. (2g) (TOU-TSX, C\$79.01)
 Waste Connections Inc. (2a, 2c, 2g, 4a, 4b, 7) (WCN-NYSE, US\$128.79)
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