

INVESTMENT STRATEGY COMMITTEE

QUARTERLY PORTFOLIO STRATEGY REPORT

U.S. CORE EQUITY MODEL PORTFOLIO

January 2022



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Unless otherwise noted, all prices quoted in this report are as of the close of markets on December 31, 2021.

Market Review: Q4/2021

Developed market equities continued to climb higher in the fourth quarter of 2021 (Q4) as investors focused on strong corporate earnings amid a resilient macroeconomic backdrop, which outweighed concerns around the highly contagious Omicron Covid-19 variant and the hawkish stance taken by the central banks globally to calm the spike in inflation. Canada's S&P/TSX Composite Index (TSX) rallied by 6.5% in Q4, posting a full-year total return of 25.1% and closing out its best year since 2009. The materials sector was the best performer in the quarter, driven by higher commodity prices, followed by a strong performance from the real estate sector and the financials sector. U.S. equities performed exceptionally well with the S&P 500 (S&P) realizing broad-based sector performance and reaching a new all-time high in late December. The S&P closed the quarter up 11.0% led by the real estate, information technology, and materials sectors while the energy, financials, and communication services sectors lagged. All U.S. sectors had positive returns with the exception of the communication services sector, which was flat for the quarter. The Dow Jones Industrial Average and the NASDAQ Composite rallied 7.4% and 8.3%, respectively.

In the U.K., the FTSE 100 index climbed higher by 4.8% in the quarter. In Europe, France's CAC 40 index recorded a solid gain of 9.9% while Germany's DAX index advanced by 4.1%. The European Central Bank announced a cautious tapering approach amid uncertainty on the impact of the Omicron variant on GDP growth. In December, the Bank of England became the first major central bank to raise interest rates since the onset of the pandemic as inflationary pressures mounted. China's push to tighten regulations on the technology sector and worries of a potential spillover of its property market problems to the rest of the economy pressured Chinese stocks. The Shanghai Composite Index posted a modest gain of 2.1% while the Japanese equities slid lower with the Nikkei index posting a decline of 2.1%. Emerging markets posted negative returns given currency headwinds from a stronger U.S. dollar and concerns regarding the Omicron variant weighing on global economic growth estimates.

The Bank of Canada held the benchmark overnight interest rate at 0.25% at its latest meeting. It expects the economic slack to get absorbed in the middle two quarters of 2022, signaling that the first rate hike could occur in the second or third quarter of 2022. The Canadian 10-year bond yield ended the quarter at 1.42% and the loonie strengthened against the greenback, finishing Q4 at US\$0.7912, up slightly from US\$0.7885. In the U.S., the Fed noted at its December Federal Open Market Committee (FOMC) meeting that it would look to accelerate the end of its quantitative easing program (by early 2022 from mid-2022 previously) and signaled a faster pace of raising interest rates to combat rapidly rising inflation, which the Fed no longer views as "transitory". The infamous Fed 'dot plot', which charts each of the Fed officials' estimates of the federal funds rate over time, revealed a median of three rate hikes expected in 2022. The U.S. 10-year yield closed Q4 at 151 basis points (bps), down 2 bps, while the 2-year yield rose 44 bps to 73 bps.

The Canada Consumer Price Index (CPI) rose 0.2% month-over-month (M/M) in November, keeping the annualized rate steady at 4.7% for the second month in a row, in line with consensus expectations. Gasoline prices, which have been a key driver of the surge in CPI inflation, climbed higher by 43.6% year-over-year (Y/Y). Price increases in food and furniture were also major contributors to the rise in CPI. In the U.S., inflation remained top-of-mind for investors as CPI continued to accelerate, reaching 6.8% Y/Y in November, the highest level in 40 years, driven by persistent supply chain challenges and elevated commodity prices. Energy prices rallied in October as the energy crisis unfolded in Europe and Asia, before reversing in November on demand concerns due to the outbreak of the Covid-19 Omicron variant.

Canada's economy advanced at 0.8% month-over-month in October, in line with the consensus expectations, driven by broad-based gains across most sub-sectors. The manufacturing sector posted an impressive 1.8% gain, primarily due to a strong increase in auto production. Construction, real estate activity, and the mining, oil & gas sectors also contributed to GDP growth. Statistics Canada's advance estimate for November showed a modest 0.3% increase in GDP, however, the flooding in BC and a pullback in economic activity due to renewed restrictions are expected to be a drag on Q4 GDP growth. The unemployment rate in Canada fell to 5.9% in December, reflecting the lowest level seen since February 2020. The economy added 54,700 jobs in December, which was more than double the consensus expectations. In Q4, the U.S. economy is expected to have accelerated from the seasonally adjusted annual rate (SAAR) of 2.0% in Q3 to a consensus estimate of 5.6%. The labour market continued to tighten with unemployment reaching 3.9% in December, from 4.7% in September, and underscores the difficulty employers are facing in securing workers despite further wage increases (+4.7% Y/Y in December).

Portfolio Performance

ISC U.S. Core Equity Model Portfolio

The CIBC Private Wealth Management ISC U.S. Equity Portfolio strategy outperformed the benchmark during the fourth quarter of 2021. Stock selection was the primary contributor to alpha while allocation detracted. From an allocation perspective, overweight positions in healthcare, consumer discretionary, and utilities contributed. Overweight positions in industrials, communications services, energy, and financials detracted as well as underweight positions in materials, real estate consumer staples and information technology.

Selection in a variety of sectors including industrials, communications services, healthcare, energy, utilities, and materials contributed to alpha. Selection in communications services and industrials were the biggest contributors. Alphabet performed well as search engine traffic remained high and demand for online advertising continued to experience robust demand. Despite this, the shares trade at the mid-point of the 5-year range of their 1-year forward price-to-earnings ratio, suggesting some reasonable upside from here. Sentiment on volumes hauled on Union Pacific's network remained positive, despite supply chain disruptions caused at the ports on the U.S. west coast. Following a quarterly release that beat the consensus expectations, Ingersoll-Rand continued to benefit from the strong demand for pneumatic and hydraulic equipment, systems, and applications as economic growth continued as the global economic reopening proceeded.

Partially offsetting this was selection financials, consumer staples, and information technology. Texas Instruments shares lagged, despite strong demand for its semiconductors, as the company's quarterly guidance was below expectations due to supply constraints. Shares of IBM lagged during the quarter following the company's disappointing earnings release. The company had reported revenue contraction in its Global Technology and Services businesses, which account for approximately 40% of IBM's total revenue. However, the subsequent spinoff of Kyndryl, IBM's low-margin IT infrastructure management business, resulted in the shares moving up during December. Visa, a position we eliminated from the portfolio during the quarter, saw its shares lag after delivering disappointing guidance amid concerns over reduced pricing power, increased competition from new entrants in the payment processing sector, and doubts regarding the recovery of the travel industry. Within the consumer staples sector, Walmart weighed on performance as the retailing giant saw a decline in its gross margin due to rising supply chain costs and increases in employee wages. Investors traded down the shares of money-centre bank JP Morgan as its perceived high valuation and a possible decline in loan volumes due to expected higher interest rates outweighed its anticipated upward revenue sensitivity once interest rates begin to increase.

Results as of the end of December 2021

Portfolio Performance	3 month	YTD	1 year	3 year	Since Inception ¹
U.S. Core Equity	11.24%	28.58%	28.58%	26.66%	19.54%
Benchmark ²	11.03%	28.72%	28.72%	26.08%	18.97%
Relative	0.20%	-0.14%	-0.14%	0.58%	0.57%

¹ February 16, 2016

² Benchmark: 100% S&P 500 Index (USD)

Current Environment

Looking Past Our Latest Woes

We all hoped that vaccinations would let the economy wave good-bye to the pandemic in 2021, but the Omicron variant, and its ability to evade those vaccines, has had much to say about that. Omicron might still entail fewer fatalities than prior waves in countries with high vaccination rates or partial immunity from prior infections. But it will still be disruptive to services demand, staffing levels at workplaces, and supply chains, thereby dampening growth early in the year but keeping upward pressure on inflation.

Still, markets enter the year looking past these current woes, and if anything, seeing Omicron as a painful way of attaining greater population immunity against severe cases in subsequent waves. Equities are priced for solid earnings growth to resume after what could prove to be only a first quarter disruption, while the bond market continues to hold to expectations for both the Fed and the Bank of Canada to hike rates as early as the second quarter of the year. Both of these hopes seem reasonable, given that we've already seen that services demand can be swift to bounce back after periods in which its held back by Covid fears, and households still have ample spending power from prior stimulus funds and last year's solid job gains. The extremely rapid run up in case counts, and a ramping up of vaccinations and boosters, will have the Omicron variant running out of potential victims in a month or two.

There's plenty of time for both central banks to cool growth sufficiently by 2023 to prevent a sustained period of elevated inflation. That's not really the danger to the bond market at this point. Instead, it is that the yield curve is only pricing in a short burst of rate hikes stateside, with the fed funds rate assumed to plateau at well under 2%. History suggests that a tightening cycle sufficient to contain inflation will require short rates in both the U.S. and Canada to top 2% towards mid-decade. The bond market not only has to price in that further climb in short rates, but also the impacts on supply from the end of quantitative easing purchases by North American central banks, and the risk that the Fed and the Bank of Canada will turn from adding to their balance sheets towards letting bonds roll off and having those added to the supply in the hands of the public.

While higher rates are, on their own, a negative for equities, particularly those seen as yield substitutes, central banks will only be carrying through on their tightening message if economic growth holds up well, and the economy continues to move towards full employment. There will be some pressure on margins from higher wage rates, but there's an offsetting impact on unit labour costs as firms improve capacity use and spread out those costs over more volume.

Reducing Duration in Government Bonds

Long rate bonds had rallied somewhat as Omicron fears built late in 2021. The committee saw this as an opportunity to further lighten on holdings of long government bonds, ahead of a likely sell-off as markets started to look past what could be only a one-quarter drag on economic growth, and using those sales to add weight to equities. Within the bond portfolio, we're retaining an overweight in corporate bonds, which should benefit from higher running yields and an improvement in the outlook for corporate profits further out.

Outlook

2021 was a strong year for equities as the TSX Composite Index, the S&P 500 Index and the NASDAQ Composite Index rose 25.1%, 28.7% and 22.2%, respectively, but our expectations for returns in 2022 are positive, although more modest. Returns will likely be driven by the continued demand recovery and adjustment to a Covid world, offset by challenges related to variant outbreaks and impacts from higher inflation and interest rates.

The new and more infectious Omicron variant of the Covid-19 virus has spread faster than national governments anticipated but it appears much less potent versus Alpha or the Delta variant. The biggest challenge appears to be the large number of infected individuals and its impact on the already strained healthcare systems and the labour force. So in 2022, the Covid factor will probably continue to weigh on investor sentiment and influence the markets.

Global supply chains, which had been impacted by the lockdowns and restrictions on cross-border travel, seem to be holding up. Whether this is sustainable and supply chains continue to function adequately remains to be seen. Not helping matters is the number of workers, many of whom had been sidelined due to lockdowns, who are leaving their jobs. Dubbed the Great Resignation, the tightness in labour supply resulting from this mass exodus could be inflationary and it occurs when additional workers are severely needed to support the economy.

With central banks now willing to admit that the higher inflation seen in the back half of last year is no longer transitory, investors who have never known inflation as a major risk will now have to learn how to invest in a higher-inflation environment in the coming quarters. The tough economic conditions and disappointing performance of the financial markets in the late 1970s and early 1980s, a period of high inflation and stagnant economic growth, reminds one that if left unaddressed, inflation can wreak havoc even with carefully laid investment plans. This may cause equity investors to wonder which sectors of the economy to favour and which to avoid. With inflation rising faster than central banks expect and no longer being seen as transitory, the Bank of Canada (BoC) and the U.S. Federal Reserve (Fed) are winding down more than a decade of quantitative easing. The release of the minutes of the Fed governors' December meeting now has investors expecting quantitative easing to end sooner than previously expected with the possibility of rate hikes in 2022. In Canada, expectations are for six rate hikes in 2022. Hopefully the BoC and the Fed will not repeat the mistakes of 1994, when multiple rate hikes caused a recession. With the Fed holding almost US\$9 trillion of fixed-income assets, a key question is if the Fed will reduce its fixed-income holdings by selling them or letting them mature once quantitative easing ends. Either solution will only serve to push bond prices lower, yields higher and present a headwind for equities in 2022.

Despite these challenges, corporate earnings should continue to rise. These factors could cause higher market volatility but market returns should be positive in 2022.

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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Bank of Nova Scotia (2a, 2c, 2e, 2g, 3a, 3c, 7) (BNS-TSX, C\$84.41)

Canadian Natural Resources Ltd. (2g, 7) (CNQ-TSX, C\$52.44)

Intact Financial Corp. (2a, 2e, 2g, 7) (IFC-TSX, C\$164.42)

Kirkland Lake Gold Ltd. (2a, 2e, 2g, 7) (KL-TSX, C\$52.57)

Loblaw Companies Limited (1b, 2g) (L-TSX, C\$97.61)

Nutrien Ltd. (2g, 7) (NTR-NYSE, US\$68.81)

Restaurant Brands International Inc. (1b, 2g, 7) (QSR-NYSE, US\$56.3)

Toronto-Dominion Bank (2a, 2c, 2e, 2g, 3a, 3c, 7) (TD-TSX, C\$95.86)

WSP Global Inc. (2a, 2e, 2g) (WSP-TSX, C\$179.53)

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