IN FOCUS

IAIC Quarterly Commentary

April 2022

IAIC
Independent Accountants' Investment Counsel Inc.™

Investing in Unsettling Times

Our recent Quarterly Commentaries have focused on the market impact of inflation, interest rates and the Covid pandemic. As the economic impact of Covid recedes, a terrible new event in the first quarter of 2022 has captured the world's attention – Russia's attempted invasion of Ukraine. With financial and military supply assistance from the Western world, Ukraine has at least temporarily thwarted Russian President Putin's plans to unseat its Western-leaning government; however, military analysts expect a fierce and renewed Russian military effort to seize at least some eastern regions of the country. Expectations now are for a protracted bloody conflict and for the West's ongoing relations with Russia to be affected for years to come.

In this article we'll assess the impact of these world events on investment markets and our investing strategy.

The Impact of Russia's Actions on the Global Economy

Although it represents only about 1% of global economic output, Russia has a significant impact on three key global commodities markets:

1. Oil - Russia produces about 10% of the global oil supply, 50% of which is exported. This translates into a potential supply shortfall outside of Russia of 4 to 5 million barrels per day. To counter this, countries around the world are working to make up any shortfall and reduce further reliance on Russian energy.

2. Natural gas – Russia is the largest exporter of natural gas in the world, with three-quarters of its exports going to Europe. This dependency is significant for electricity, particularly in the wake of the shutting down by some European countries of nuclear and coal-fired plants.

3. Potash – Russia produces about 40% of the world's total potash supply, which directly affects agriculture production.

In addition, Ukrainian production of a significant portion of the world's supply of neon gas, used in making computer semi-conductor chips, has halted because of the conflict with Russia.

It is important to note that Canada is a significant producer of oil, natural gas, potash and neon gas.

The international sanctions being applied against Russia will impact supply chains, creating dislocations and the shifting of supply and demand further away from equilibrium, adding to global inflationary pressures.

Mike Williams, CFA, MBA

Advising Representative

Russia's invasion of Ukraine may have indirect consequences for relations between major global powers. China's and India's passive reactions to date to the Russian invasion may contribute to an expansion of future military action beyond Ukraine and damage international relations and global economic growth.

Inflation and Interest Rates

In January, annual inflation rates among developed countries rose to about 7%, reaching the highest levels in the last 30 years. We've discussed in past newsletters the reasons for the increase in inflation, many of which resulted from the economic impact of the pandemic.

Here in North America, after nearly two years of keeping their overnight lending rates at historic lows, both the U.S. Federal Reserve ("the Fed") and the Bank of Canada ("BOC") increased interest rates during the first quarter of 2022, a first move to reset rates to within an "acceptable range" and to address inflationary pressures. Markets are anticipating up to six additional hikes in 2022 and possibly three more in 2023. These most recent moves by the Fed and the BOC, and the tone of their communications, indicates a clear shifting away from the pandemic-induced "stimulus at any cost" mindset to one of tempering the economy and reigning in inflation. The BOC may have a little more latitude than the Fed given the economic boost provided to the Canadian economy by rising commodity prices.

The Impact of Ukraine, Inflation and Interest Rates on Financial Markets

As the financial markets absorbed information on Ukraine, inflation, interest rates, forward growth rates, and the strength of the consumer, the first quarter of 2022 saw substantial changes to valuations in the equity and fixed-income markets.

Many growth stocks, where valuations are based more on future-based earnings flows than current inflows, experienced notable declines. Corporate earnings across the board are beginning to reflect slowing top-line growth (although this is not totally unexpected due to rapid drop and then rise in earnings in the first 12 months of the pandemic). Some industries and companies are less able than others to pass on rising labour and borrowing costs.

The economic environment has also impacted the normally "boring" bond market, which suffered losses in the first quarter due mainly to rising interest rates and a rare occurrence known as the "flattening yield curve." While long-term rates are increasing, they are doing so at a slower pace than short-term rates, resulting in a flatter curve when plotted on a graph. In the past, this inversion has been an often-reliable leading indicator of economic decline or recession.

Investing in this Unsettling Environment

History has shown us that economic shocks, for the most part, are unforeseen and their duration and impact difficult to project. As a result, we invest our clients' savings in a way that we believe will best respond to such unpredictable disruptions. Nevertheless, as events unfold, we adapt to new information with tactical adjustments to our investing strategies. Here are some of the guiding principles our portfolio management team is following:

- While rising interest rates have had an impact on the bond market, we maintain a relatively short bond ladder (1-to-5-year issues, held to maturity) for our clients, which ensures a locked-in yield despite some price volatility. We do not pay large premiums for bond purchases, which helps protect our clients from large swings in the price of their bonds as they come to maturity.
- We continually monitor the shape of the yield curve. Analyzing the spreads between various fixed-income instruments, equity markets and overall economic growth rates helps to guide us in our strategic allocation of our clients' investments.
- We carefully select the companies that our clients own. We look for companies and industries that have pricing power, that can pass increased costs through to their customers. These companies can sustain earnings and dividend growth and provide a partial hedge for our clients against inflation.
- We assess the changing profile and outlook of the overall economy. To paraphrase a Wayne Gretzky quote: "Focus not on where the puck is, but where it is going." The economy is evolving faster than ever before: new technologies, consumer preferences, a renewed awareness of our vulnerabilities, social responsibilities, and future global growth and prosperity means the "economic pie" will look different in the future than it does today.

Although we employ tactical shifts to navigate the changes, challenges and opportunities the world continually presents, we do not abandon the disciplines of diversification and fundamental asset valuation. A properly diversified strategy during such turbulent global events remains paramount.

Going through the financial planning process forces us to ask ourselves a tough question: If I were to pass away today, how would my family be able to cope with the sudden loss of income? On top of grieving the loss of someone they love, you don't want your family to also be faced with potentially significant financial challenges – including immediate and longer-term cash needs.

Life insurance can provide a tax-free lump sum to your family to help replace your income and ensure all bills are covered and to provide savings for future goals. Additionally, it can provide the cash needed to cover funeral expenses and any additional costs associated with your death.

WHO SHOULD HAVE LIFE INSURANCE?

KEY INCOME EARNING SPOUSES/PARTNERS

As primary income earner, you provide financial security for your family. Life insurance is a way to help ensure there are sufficient funds to provide for household expenses and future financial needs such as your children's education, your spouse's or partner's retirement and costs related to aging parents.

HOMEOWNERS

A life insurance death benefit may be used to make monthly mortgage payments or even pay off a mortgage entirely. Life insurance can provide added reassurance that your family will be able to remain in their home without financial worry.

BUSINESS OWNERS

Life insurance can be a tax-effective way to help transfer a family business to the next generation. Life insurance may also be used to help pay off business debts and other financial obligations, helping to ensure that the business you have worked so hard to build will carry on.

THOSE WHO THINK OF OTHERS

Life insurance offers a way to give your children or grandchildren something for their future or used to leave a generous gift to a favourite charity.

WHAT ABOUT THE INSURANCE I ALREADY HAVE?

You may already have some life insurance in place through your employee benefits or attached to your mortgage. This is a good start, but here are a few things to keep in mind:

Life insurance offered through your mortgage provider is paid to your lender, not to your family. It only covers the outstanding balance of your mortgage. Nothing is left over to help your family with the other expenses they may face. Even as your mortgage decreases, the insurance cost stays the same. When the mortgage is paid off, the insurance is gone and cannot be maintained for other purposes.

Life insurance through your employee benefit program is a very affordable way to begin your life insurance program, but it is important to make sure this coverage is enough to meet your needs. You may be able to buy additional coverage, up to a maximum, through your employee plan. Remember, this insurance does not go with you if you change employers or retire and can increase in cost each year as your age increases.

Consult your accountant, financial planner, or insurance specialist to determine if you need life insurance and calculate the amount of life insurance to fit your situation.

Oliver Lee, B.Math

Vice President
IALIA

Life & Living Benefits

IALIA
Independent Accountants' Life Insurance Agency Inc.™

How The Markets Performed

Equity market returns were a mixed bag this quarter depending on which side of the border you were standing. Canada, which had lagged the US over the last few quarters, significantly outperformed the US and started the year in positive territory.

Grayson Waechter, CFA

Advising Representative

The US ended its run of seven straight quarters of positive returns in negative territory.

Internationals were the worst performers with tensions in Europe weighing on the index.

The Bank of Canada raised interest rates at their last meeting and gave indication to expect several more to come sooner than later. Despite this the preferred share index started the first 3 months of 2022 in negative territory.

Key Indicators		Mar-22
90 Day Tbill		0.61 %
CPI (Y/Y) (Feb)		5.7%
$U/$C		$0.80
Major Market Returns	**3 Month Total Return**	**12 Month Total Return**
S&P/TSX Composite	3.8%	20.2%
S&P/TSX Preferred Share	-2.5%	16.9%
S&P 500 Composite (C$)	-5.7%	14.9%
MSCI EAFE (C$)	-6.8%	1.0%
IAIC Equity Sector Benchmarks		
Consumer	-1.7%	5.7%
Financial	1.4%	18.4%
Utilities	5.9%	15.4%
Industrial	-10.4%	-0.3%
Resource	23.9%	43.1%

Source: National Bank Financial

Trusted Contact Person (TCP)

A Trusted Contact Person (TCP) is someone you choose who can help us protect your financial well-being. We are required to ask you for the name and contact information for a person that you trust to assist us in protecting your investments. This person does not have the power to make any decisions on your behalf.

We would contact this person to confirm or make inquiries about any of the following:

- Your current contact information
- Possible financial exploitation affecting you or your account
- Concerns about your mental capacity as it relates to financial decision making
- The identity of any legal guardian, executor, trustee or other personal or legal representative

You may designate multiple Trusted Contact Persons by using multiple copies of this form and ranking the order of your preference for those individuals to be contacted by IAIC. Please also note, IAIC is not required to contact your Trusted Contact Person. The designation of a Trusted Contact Person is optional, and you may withdraw the designated Trusted Contact Person at any time by notifying IAIC in writing.

If you would like to appoint a Trusted Contact Person, please click here

Conflicts of Interest - What You Need To Know

In October 2019, the Canadian Securities Administrators passed comprehensive regulatory reform, referred to as the Client Focused Reforms (CFRs). Part of the CFRs relate to how Portfolio Managers, such as IAIC, assess, manage, and monitor any existing, potential, or reasonably foreseeable conflict of interest, and how we ensure any potential conflict of interest is always addressed and managed in our client's best interest.

At IAIC, we pride ourselves in always acting in our client's best interest. We address and manage conflicts of interest in many ways – by managing conflicts through internal controls, avoiding conflicts wherever possible, and by ensuring transparency with our clients through continuous disclosure of any existing or potential conflicts of interest.

We have posted to our website a complete list of existing or potential conflicts of interest that may exist between our firm and you, our client. This can be found by visiting www.iaic.ca/COI. The listing explains how each of these conflicts is addressed and managed in your best interest. In addition to posting it on our website, we also distributed the list to you along with your June 30, 2021 IAIC Quarterly Statement.

As always, please contact us by phone at 519-291-2817 (toll free 877-291-3040) or send an email to compliance@iaic.ca with any questions you may have.

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IAIC Disclosures

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