

Economic Outlook

Winter 2023

Summary*

- While the outlook to start last year was one of hopeful optimism and potentially growing economic tailwinds, the macroeconomic path for the months ahead looks to be lined with challenges and lingering headwinds.
- Tighter financial conditions, elevated inflation and geopolitical uncertainty all have the potential to act as material drags on economic activity that is already decelerating and materially raise the risks of a downturn.
- Undeniably, there are there are significant risks to the outlook, but it is arguable that undue weight is put on the worst-case scenario, which lowers the bar for expectations and skews the balance of risk.
- There are mitigating factors that suggest that current consensus forecasts may prove overly pessimistic. The likelihood of a recession materializing over the coming year cannot be written off, but there are growing indications that the global economy is actually on a path right now toward a “soft landing.”
- The challenging backdrop provides little reason to anticipate a reprieve from the heightened uncertainty that has become the norm since the onset of the pandemic and, therefore, warrants caution, but the broad valuation adjustment across asset classes, and persistent emphasis on downside risks, provides a better setup to start this year than prevailed 12 months ago.
- Of course, any improvement over last year’s dismal performance is unlikely to come in a straight line, as markets (over)react to every ebb and flow in the data and the potential implications for growth, inflation and interest rates.
- History still shows longer-term returns tend to be much better when the starting points for valuations across assets classes are off their extremes and at more middle of the road levels.

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Reset & restart

A year ago, the outlook was pretty positive. The anticipated move back to “normal” levels of activity would underpin sustained economic growth rates above the past decade’s trends — and the degree of uncertainty surrounding growth forecasts was ebbing as the pandemic appeared to be coming under greater control (supporting the rollback of public health measures) and geopolitical tensions were coming off the boil.

While inflation was on the rise, it was still being viewed as “transitory”, a by-product of the onset of the pandemic that would be unwound as the broader reopening of the global economy continued.

Accordingly, while central banks were acknowledging that crisis-era levels of policy stimulus were no longer warranted, they were in no hurry to raise rates and were broadly expected to move only gradually once they did.

As a result, market yields remained near historic lows — with the persistently low costs of borrowing standing to serve as another support for the global economic cycle as it transitioned from “recovery” mode into “expansion.”

This anticipated macro backdrop would drive robust profit growth, giving a fundamental lift to risk assets.

And, though valuations for these securities were elevated, representing a potential performance headwind, they were arguably justified by the low rate environment; which not only raised the values of the output of “discounted cash flow” models but meant that there was no alternative for investors looking to generate any sort of real return. Investors were upbeat and willing to chase momentum.

Of course, inflation quickly proved to be anything but transitory. The imbalance between strong demand and constrained production was exacerbated by supply chain pressures that persisted due to renewed public health restrictions early in the year (particularly in China) and the commodity price shock driven by Russia’s invasion of Ukraine.

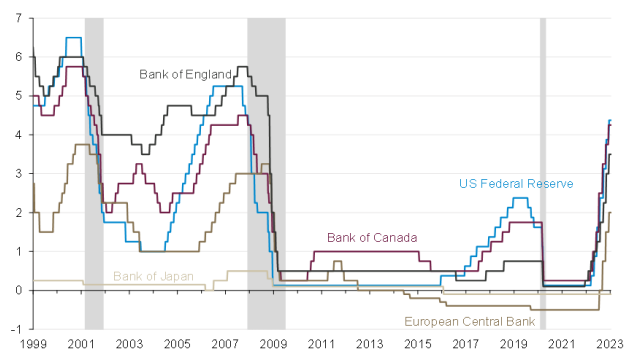
In response to the significant upward shift in inflation

and inflation expectations, monetary policymakers felt pressure to move quickly and aggressively to try to get ahead of the curve to prevent price pressures from spiraling ever-higher at a significant, longer-run cost to the global economy.

Suddenly, markets that had largely been permitted to ignore inflation and costs of capital over the last decade were forced to recalibrate — first slowly, then all at once as the breadth and the magnitude of central banks’ responses to firm readings for pricing and underlying economic activity expanded.

CHART 1: QUITE THE TURN OF EVENTS

Central bank policy interest rates (percent)



Source: Guardian Capital based on data from Bloomberg to January 13, 2023

The impact of a shift in monetary policy takes time to filter into the broad real economy (though more interest rate-sensitive areas such as real estate are already feeling the effects), however, it was quickly evident across all segments of financial markets.

The sharp upward adjustment to rates devastated bond markets as the complete lack of yield on offer meant there was no income cushion to soften the blow to total return from the plunge in bond prices.

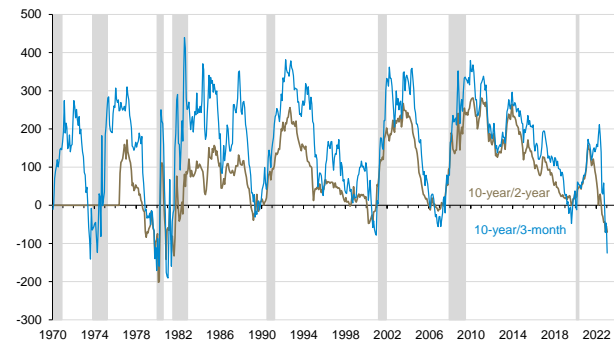
Short-term fixed income securities fared better than their longer-duration peers due to their comparably lower sensitivity to changes in rates, though, their yields recorded large increases given they are most directly impacted by central bank decision-making.

Longer-term rates, however, saw smaller increases as markets wagered the negative economic impact of aggressive tightening would compel policymakers to reverse course sooner rather than later.

The net result was an inversion of the yield curve at a magnitude not seen in four decades — an ominous indicator for the durability of the expansion.

CHART 2: GRADING ON A CURVE

US Treasury yield curve (basis points)



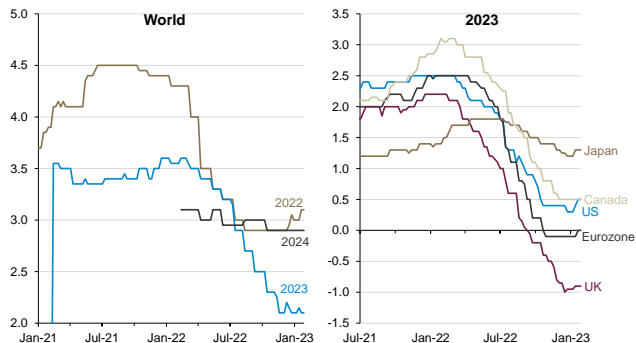
Shaded regions represent periods of US recession; source: Guardian Capital based on data from Bloomberg to January 13, 2023

Tighter financial conditions, elevated inflation and rising geopolitical uncertainty created clouds over the outlook and saw forecasters echo the bond market in raising risks of an economic downturn.

The consequent sharp downgrades to growth forecasts across the globe weighed on the prospects for earnings, serving up another body blow to equity markets that were already reeling from the impact of the rates — just as low rates boosted valuations, higher rates drove multiple compression, particularly among the high-flying growth stocks.

CHART 3: SLASH & BURN

Consensus real GDP growth forecasts (percent)



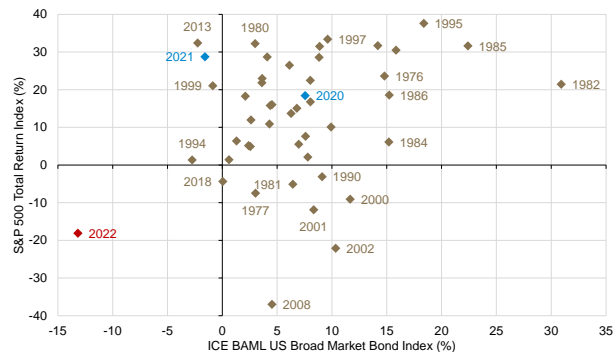
Source: Guardian Capital based on data from Bloomberg to January 13, 2023

The end result was a historical outlier of a year. While equities have posted bigger declines through

a calendar year before, bonds have not — and 2022 marked the first time in the last four-and-a-half decades that both declined at the same time. There was no cover for investors anywhere.

CHART 4: AN OUTLIER OF A YEAR

Calendar year total return

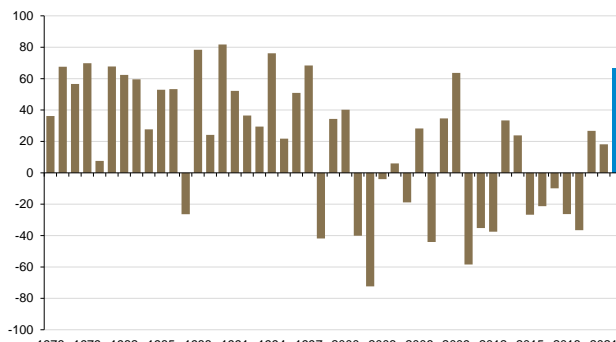


Source: Guardian Capital based on data from Bloomberg from 1976 to 2022

That stocks and bonds marched in step lower, and correlations between asset classes surged to quarter-century highs, meant the typical diversification benefits of multi-asset portfolios were nowhere to be seen. Balanced investors recorded historically terrible performance.

CHART 5: MARCHING IN STEP

Correlation of 12-month total returns for stocks & bonds* (percent)



*Stocks=S&P 500 Index¹; bonds=ICE/BAML US Broad Market Index²; source: Guardian Capital based on data from Bloomberg from 1976 to 2022

A 180° change in perspective

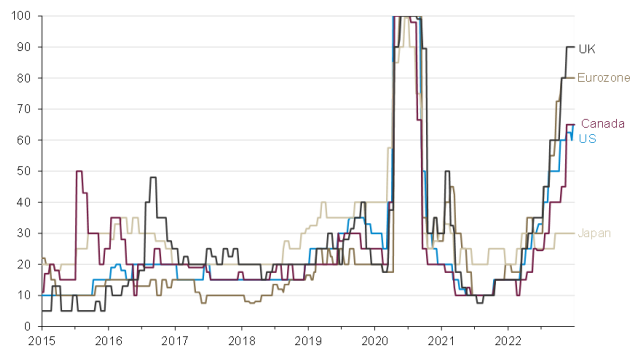
Shifting the focus to the year ahead, what stands out is that the market landscape is almost the polar opposite of what prevailed 12 months ago.

The current consensus view is that a global recession is effectively a certainty in the next 12 months, as the impact of high inflation and restrictive

monetary policy work together to restrain demand.

CHART 6: RISING RECESSION RISKS

Consensus expected probability of recession in 12 months (percent)

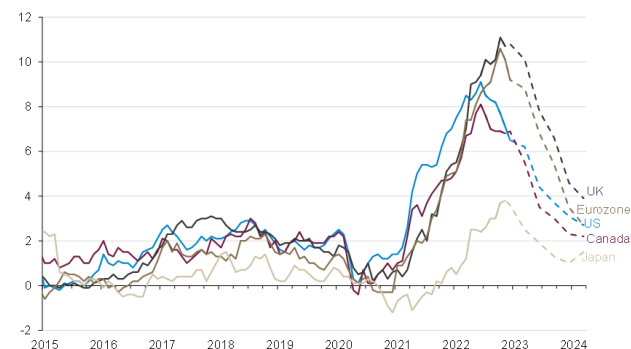


Source: Guardian Capital based on data from Bloomberg to January 13, 2023

The anticipated downshift in demand growth combined with easing supply chain constraints suggests that price pressures should continue their moderating trend — inflation, however, is expected to remain relatively elevated through the year to come, which will keep pressure on central banks to maintain their tighter policy stances barring some sort of exogenous shock to the system.

CHART 7: PAST THE PEAK

Consumer Price Index³ (year-over-year percent change)



Dashed lines represent consensus forecasts as at January 13, 2023; source: Guardian Capital based on data from Bloomberg to December 2022

Indeed, despite expectations that inflation will ease and rising recession risks, central banks appear likely to keep pushing interest rates higher through the early part of the New Year before shifting to the sidelines, with recent rhetoric suggesting policymakers are content to maintain rates on the restrictive side of neutral for the foreseeable future.

So, while the outlook to start last year was one of

optimism and potentially growing tailwinds, the macroeconomic path for the months' ahead looks to be lined with challenges and lingering headwinds.

The combination of this backdrop and 2022's broad reset in asset prices has resulted in last year's optimism and expensive assets being replaced by pervasive pessimism and more moderate valuations. This, somewhat ironically, makes for a more constructive outlook for performance, for both stocks and bonds, than prevailed a year ago.

Look out for the outlook

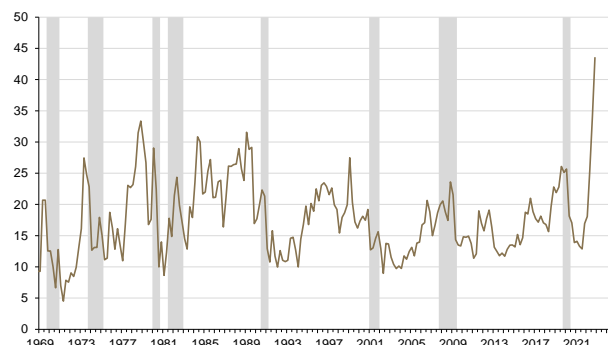
Recent history has shown that things rarely turn out as expected. The future tends to end up neither as great as hoped nor as bad as feared.

That seems to be especially the case when the expectations are skewed toward the extremes and when there is a broad consensus — or, as the old Wall Street adage goes, *“when all the experts and forecasts agree, something else will happen.”*

On that score, it is worth highlighting that the latest *Survey of Professional Forecasters* from the Federal Reserve Bank of Philadelphia⁴ showed that the experts have assigned the highest probability of a recession stateside in the next 12 months in the study's more than 50-year history.

CHART 8: EXPECTING THE WORST

Estimated probability of recession in the next year, US (percent)



Source: Guardian Capital based on data from Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters to Q4 2022

Undeniably, there are downside risks that could materialize in the months ahead and provide a material drag on economic momentum.

That said, the fact that everybody is on high alert for any signs of deteriorating conditions and proceeding with caution arguably lowers those risks — or at least the potential size of any fallout.

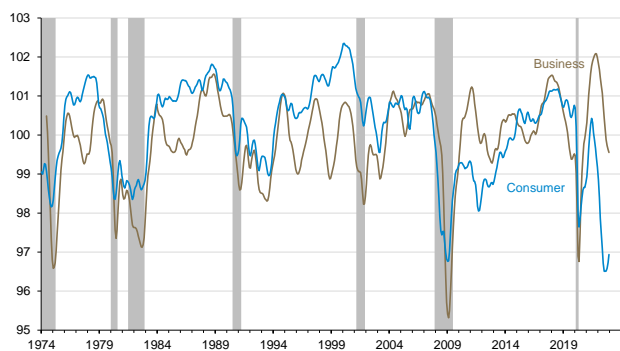
Aside from unexpected shocks (such as war, natural disasters or a pandemic), economic downturns are the product of systemic imbalances. Excesses can persist until there is a catalyst that causes the positions to be forced to unwind. Typically, it is a central-bank-induced jump in costs of capital that makes overextended financial positions untenable, with the larger the imbalance, the greater the unwind and resultant negative spillovers.

The persistent uncertainty over the economic outlook since the onset of the pandemic has, undoubtedly, factored into preventing significant financial imbalances from developing simply because the constraints on activity limited the ability and willingness of households and businesses, in aggregate, to overextend themselves.

Even as public health restrictions were rolled back in earnest last year, risk-taking was generally reined in by the increasing prevalence of discussions of looming recessions, which combined with increasing costs of living and production to depress consumer and business sentiment. The former fell to all-time lows across the 38 (industrialized) member countries that comprise the Organisation for Economic Co-operation and Development (OECD)⁵.

CHART 9: DOWN IN THE DUMPS

Business & consumer confidence, OECD
(index; long-term average = 100)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from the OECD to December 2022

Again, changes in monetary policy take time to get

fully integrated into the real economy, but the fact that there are no indications of material problems showing themselves, as yet, suggests that there is a general dearth of significant financial imbalances that stand to create a deep and long-lasting hit.

There were, absolutely, pockets of excess that have come under pressure (for example, the wide range of cryptocurrency-related entities), but nothing to this point that suggests a true “hard landing” is in the offing for the global economy.

Perhaps the best example is real estate. Property markets are highly sensitive to interest rates and the surge in mortgage costs over the last year has corresponded with a plunge in housing activity. Home sales have dropped to levels not seen since the aftermath of the housing crisis a decade ago.

CHART 10: NO WIND IN HOME SALES' SAILS

Sales of new & existing single-family homes, US
(millions of units, seasonally-adjusted at annualized rates)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from the US Census Bureau, National Association of Realtors and Bloomberg to December 2022

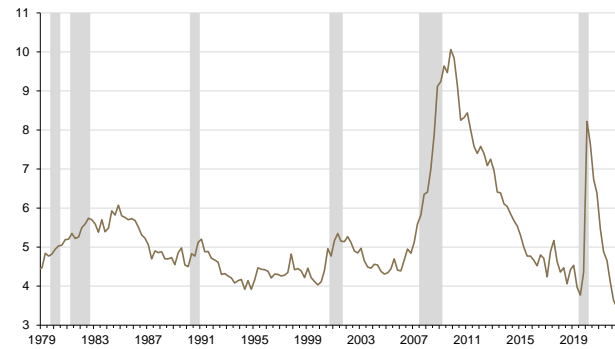
In contrast to that period, the slump, so far, has been outright orderly, reflecting a distinctly different (sounder and more balanced) market environment than in 2008.

The higher costs of borrowing have weighed on demand for housing and taken the wind out of prices (that had surged earlier through the pandemic), but they have not spurred on a wave of defaults.

In fact, the latest mortgage delinquency data for the US showed the share of borrowers that are behind on their mortgage payments hit its lowest level in the data's 44-year history.

CHART 11: NOT FALLING BEHIND ON PAYMENTS

Mortgage delinquencies as a share of total loans, US
(percent)



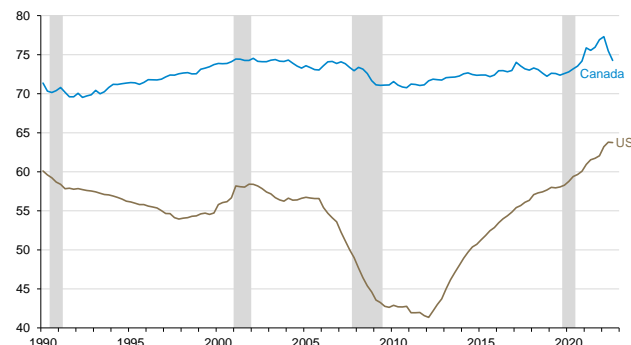
Shaded regions represent periods of US recession; source: Guardian Capital based on data from the Mortgage Bankers' Association to Q3 2022

Clearly, while higher mortgage rates negatively impact housing affordability, the fact that a 30-year fixed-rate mortgage is the standard in the US means most current owners are not impacted - and note that fixed-rate mortgages are also the norm in Canada and the UK (albeit with a shorter typical five-year term), providing some insulation as well; the higher prevalence of variable-rate loans in Europe does pose greater concerns, however, renting tends to be more common than homeownership.

Moreover, the pullback in prices comes at a time when owners' equity in real estate was historically elevated — an indication of the underlying strength of household balance sheets that have an ample wealth cushion to soften the blow from further price depreciation and mitigate the potential broader hit to the economy.

CHART 12: PLENTY OF SKIN IN GAME

Homeowners' equity in real estate assets
(percent of total)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from the US Federal Reserve Board and Statistics Canada to Q3 2022

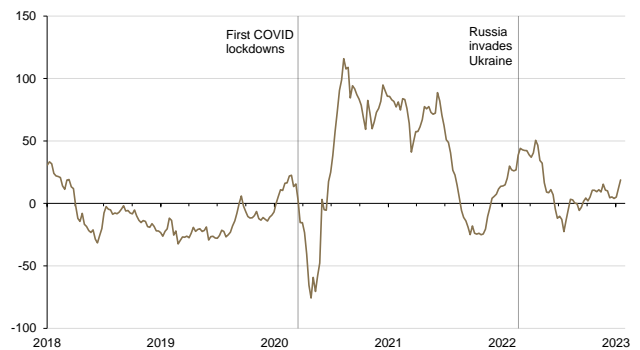
Lowering the bar

The human tendency to catastrophize, particularly in times of heightened uncertainty, means that undue weight is put on the worst-case scenario, which lowers the bar for expectations and skews the balance of risk.

In the summer, after the onset of the pandemic in 2020 and the period following Russia's invasion of Ukraine last year, economic forecasts were geared down significantly, only for the dataflow to broadly come in better than anticipated, as evidenced by the strongly positive readings in global economic surprise indexes — a trend that has, again, developed over the last three months.

CHART 13: EXCEEDING (LOW) EXPECTATIONS

Economic Surprise Index⁶, World
(diffusion index; >0 denotes "better than expected" dataflow)



Source: Guardian Capital based on data from Bloomberg to January 20, 2023

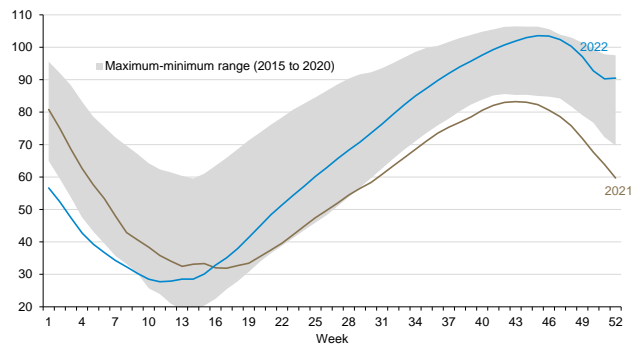
It is not to say that the data has been outright positive in an absolute sense — the data indicate that tighter financial conditions are impacting activity and growth momentum is slowing — it is just consistently better than feared.

A big source of upside surprise of late has been Europe. Heading into the winter, it was expected that the continent's dependence on energy imports, especially Russian-produced oil & gas, could see supply shortages that would further drive up prices and constrain already crimped household budgets.

In this event, however, the shortfalls have not materialized. Governments across Europe rapidly shored up their stockpiles ahead of the traditional heating season, with natural gas in storage sitting at the higher end of the of their five-year ranges.

CHART 14: STOCKED UP

Natural gas in storage, European Union (billions of cubic metres)

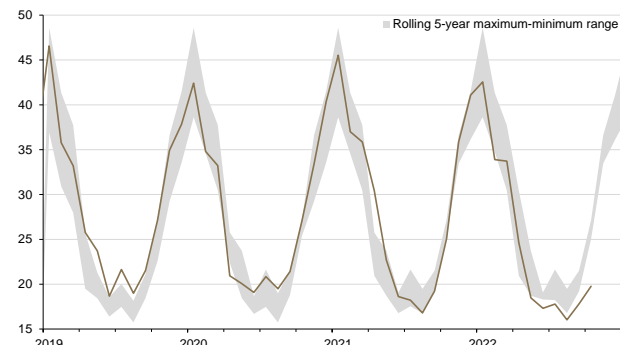


Source: Guardian Capital based on data from Bruegel to December 2022

Moreover, supplies have seen a smaller than normal drawdown, as demand for heating has been depressed by the unseasonably warm temperatures throughout Europe. Natural gas consumption is running roughly 20% below its five-year average and through the bottom end of the range since 2017.

CHART 15: NOT IN USE

Natural gas consumption, European Union (billions of cubic metres)

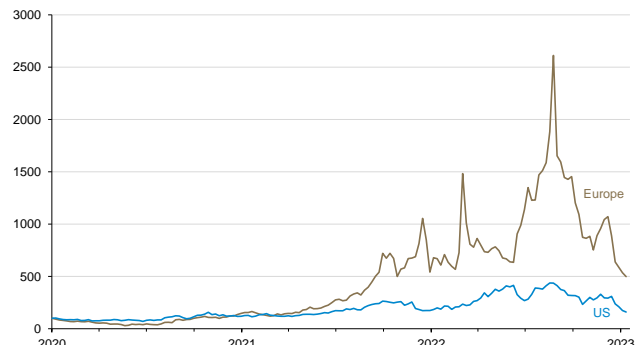


Source: Guardian Capital based on data from Eurostat to October 2022

The surprising imbalance has been a factor behind the sharp drop in natural gas costs — benchmark European prices have plunged 80% from their August peaks and are now lower than before Russia invaded Ukraine.

CHART 16: PRICING OUT OF GAS

Natural gas benchmark prices (index; January 1, 2020 = 100)



Source: Guardian Capital based on data from Bloomberg to January 13, 2023

The double-whammy of using less gas and spending less for what is being used has been a boon to households — and that has been compounded by the roughly €600 billion worth of subsidies rolled out by European governments to help offset the rising costs of living — and has helped to avoid the worst outcomes so far.

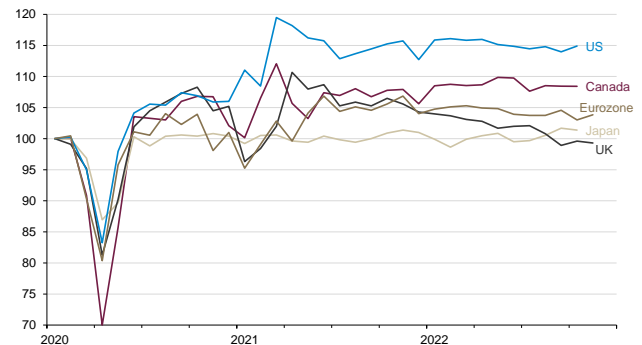
Conspicuous consumption

The upside for European consumers reinforces what has been the biggest source of shocking demand strength over the last three years.

Despite the waves of pandemic lockdowns idling a historic number of workers, sharply higher costs of living and extreme uncertainty over the outlook impinging consumer confidence, real household expenditure, particularly for goods (which make up the bulk of retail spending), has proven resilient.

CHART 17: RETAIL THERAPY

Real/inflation-adjusted retail sales (index; January 2020 = 100)

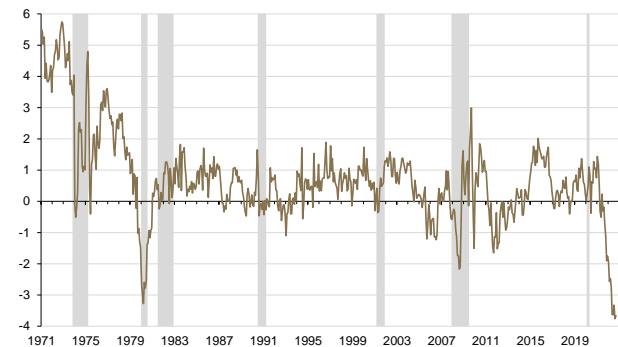


Source: Guardian Capital based on data from OECD to November 2022

The underlying strength, however, has come as inflation has taken a significant bite out of household purchasing power — inflation-adjusted average hourly wage rates across the G7 have seen their largest 12-month declines in the last 50 years.

CHART 18: INFLATION CUTTING PAY

Real/inflation-adjusted average hourly wage rate, G7
(year-over-year percent change)

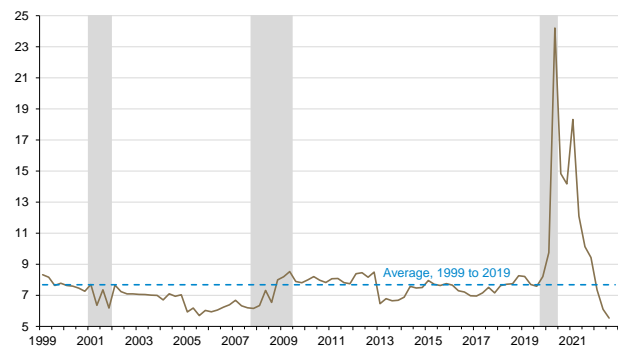


Shaded regions represent periods of US recession; source: based on data from the OECD and Bloomberg to September 2022

That has meant that spending has been supported by drawing down savings — savings rates across the G7 have declined to their lowest levels since at least the turn of the millennium.

CHART 19: DIPPING INTO THE RESERVES

Personal savings rate, G7
(savings as a percent of personal disposable income)



Shaded regions represent periods of US recession; source: based on data from the OECD, International Monetary Fund (IMF) and Bloomberg to Q3 2022

In ordinary circumstances, a generationally low savings rate at a time growth was downshifting would arguably be a cause for concern, as it could be indicative of households being stretched thin, drawing down savings and possibly relying too much on credit to fund purchases. That would create a somewhat precarious backdrop for consumer spending, especially in a high inflation and rising

interest rate environment.

Of course, circumstances are currently not ordinary. The low prevailing savings rate come after a period of historically (by magnitudes) high savings that resulted from the combination of pandemic stimulus payments and restrained spending due to public health measures.

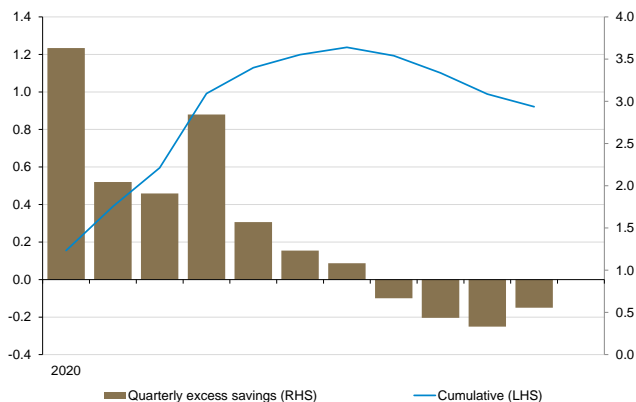
That is a huge stockpile of savings that was created and it should not be particularly surprising (or really concerning) that some of that is now being spent.

Through 2020 and 2021, households across the G7 put away nearly US\$4 trillion over and above pre-crisis savings trends — or almost 10% of the total output of these key Developed Market (DM) economies.

The drawdown in savings last year made only a minor dent in that hoard, with trillions still remaining that can serve as a cushion to offset the impact of various economic shocks — though, reducing the excess would mean less future capacity to spend.

CHART 20: QUITE THE RAINY DAY FUND

Excess* personal savings since 2020, G7
(trillions of US dollars)

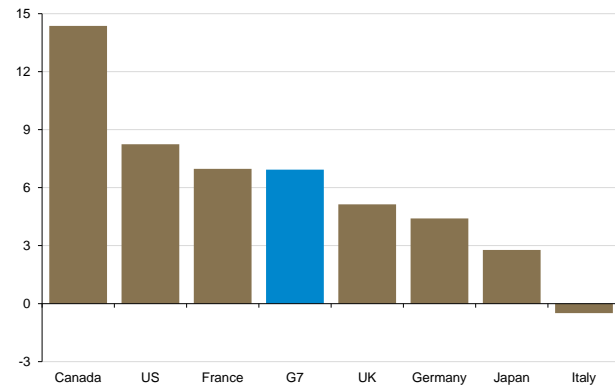


*Personal savings in excess of 1999 to 2019 trends; source: Guardian Capital based on data from the OECD, IMF and Bloomberg to Q3 2022

The accumulated savings cushions, however, are not evenly distributed across regions. There is a noticeable North American skew that, in part, reflects the comparatively generous pandemic income supports, less significant cost pressures, and generally better economic performance over the past three years, which has underpinned the relatively stronger performance of these consumers.

CHART 21: SAVING GRACE

Excess* personal savings, G7
(percent of nominal gross domestic product)



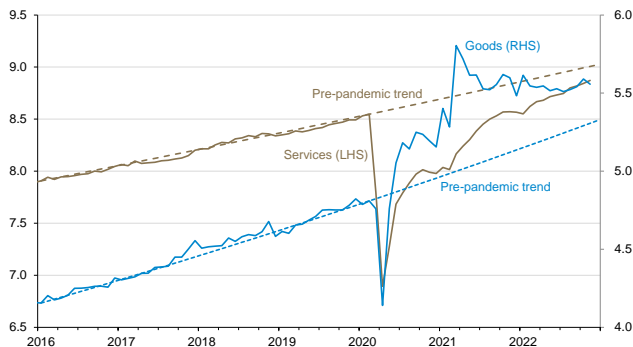
*Cumulative personal savings from Q1 2020 to Q3 2022 in excess of 1999 to 2020 trend savings rates; source: Guardian Capital based on data from Bloomberg and the OECD to Q3 2022

It's not all goods

As public health restrictions have been scaled back, consumer spending has started to transition back in favour of the previously restricted services that dominated the household budget pre-pandemic. Goods spending has held at above prior trend levels, but overall gains are now driven by services.

CHART 22: SHIFTING SPENDING HABITS

Real personal consumption expenditure, US
(trillions of chained 2012 US dollars)



Source: Guardian Capital based on data from the US Bureau of Economic Analysis to November 2022

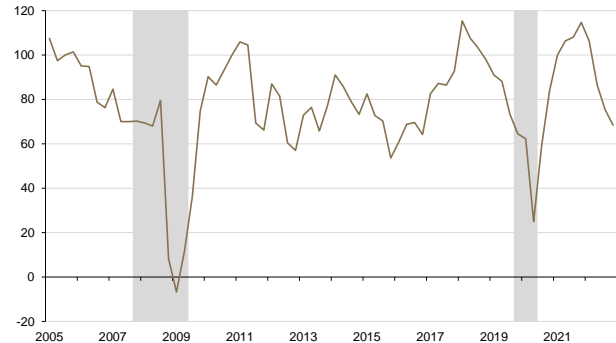
Goods producers are also facing waning demand related to the slump in real estate. Housing market activity is typically accompanied by a slew of ancillary purchases, such as furniture and electronics, not to mention the materials for new builds.

Further, higher costs of capital and economic uncertainty are leading businesses to temper

expansion plans — recent surveys of corporate leaders indicate that overall capital spending plans are being pared back.

CHART 23: SHRINKING EXPANSION PLANS

CEO economic outlook⁷ capital spending plans, US
(index)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from Business Roundtable and Bloomberg to Q4 2022

The result has been that the once-blistering pace of activity in the factory sector has cooled markedly in recent months. Manufacturing purchasing managers' indexes⁸ (PMI) globally have fallen sharply since the summer, with less than one-third of reporting countries above the "50" percent growth break-even threshold in December (a distinct turn from the 85% in expansion territory a year ago).

CHART 24: ROLLING OVER

Manufacturing purchasing managers' indexes above 50
(percent of total)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from Bloomberg to December 2022

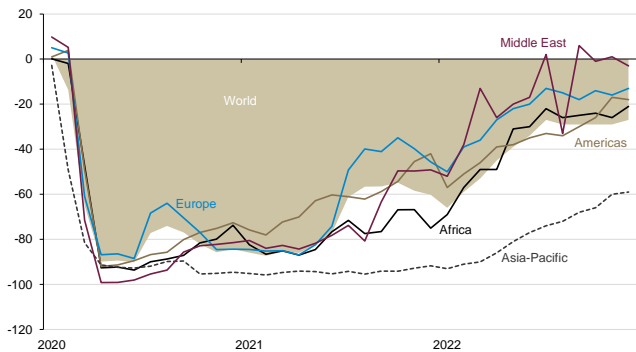
While the contraction in manufacturing has historically been a less than favourable omen for the outlook, this sector does account for less than a quarter of activity across DM.

As it stands now, there are still limited indications of spillovers to the broader economy from the pullback

in manufacturing and housing. The services sector is still experiencing tailwinds from the easing of public health restrictions and the pent-up demand for less tangible experiences like travel and tourism.

CHART 25: DETOURED

International tourist arrivals
(percent change versus 2019)

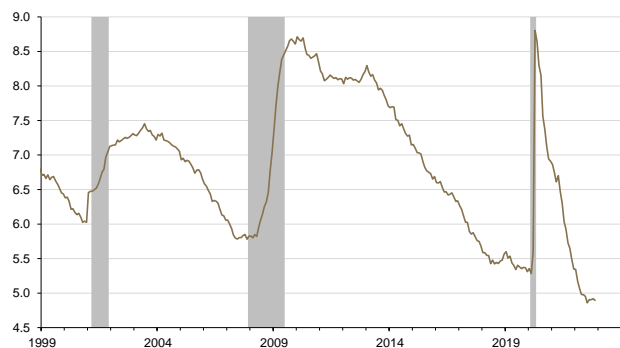


Source: Guardian Capital based on data from United Nations World Tourism Organization to December 2022

This demand for these more labour-intensive industries, combined with the still-subdued labour participation, is keeping job markets extremely firm across the world. Unemployment rates are at, or near, historical or generational lows across most DM (another support for continued consumer resiliency).

CHART 26: TIGHT AS A DRUM

Unemployment rate, OECD
(percent)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from the OECD and Bloomberg to December 2022

An ebbing wave

As well, there is reason why policymakers would view these trends in the goods sector positively.

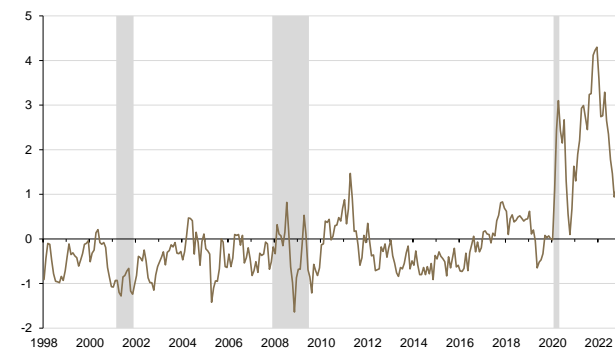
Unsustainably high pandemic levels of demand for goods put considerable strain on capacity — production was unable to keep pace, kinks

developed in supply chains, and prices rose.

The moderation in sales gives the supply-side of the economy a chance to catch up; logistical backlogs are working through and operations are flowing much more smoothly. There is still further room for improvement, but the aggregated gauge of global supply chain pressures, as compiled by the Federal Reserve Bank of New York, has moderated from its extremes and returned closer to “normal.”

CHART 27: PRESSURE RELEASE

Supply Chain Pressure Index⁹, world
(standard deviations from the average)



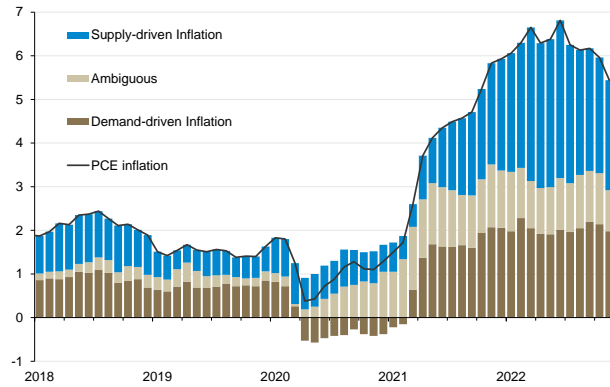
Shaded regions represent periods of US recession; source: Guardian Capital based on data from the Federal Reserve Bank of New York to December 2022

As a result, cost points throughout the production process have come down sharply from pandemic-era peaks — shipping & transportation costs have returned to pre-COVID levels, while even commodity prices have largely unwound the Russia-tied gains.

Accordingly, the Federal Reserve Bank of San Francisco estimates that the supply-side has been the main contributor to the recent ebbing in inflation.

CHART 28: DOWNSIDE SUPPLIES

Personal consumption expenditure inflation by source, US
(year-over-year percent change)

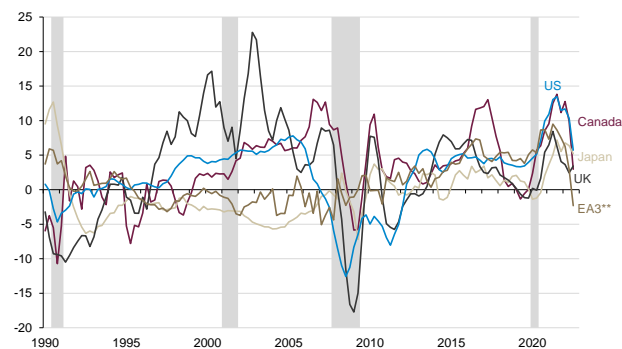


Source: Guardian Capital based on data from Federal Reserve Bank of San Francisco to November 2022

Looking ahead, the ongoing normalization of the supply-side and the impact of tighter monetary policy on the demand-side may continue to exert downward pressure on inflation. In terms of the latter, the impact of the sharp moderation in home prices enters into the estimates for shelter costs with a lag, meaning that the retrenchment in the largest component of inflation will be evident in the coming year.

CHART 29: MOVING INTO THE BASEMENT

Real* house prices
(year-over-year percent change)



*Real house price is the ratio of the nominal house price to the consumers' expenditure deflator in each country; aggregates are GDP-weighted average; **EA3=France, Germany & Italy; shaded regions represent periods of US recession source: Guardian Capital based on data from the OECD to Q3 2022

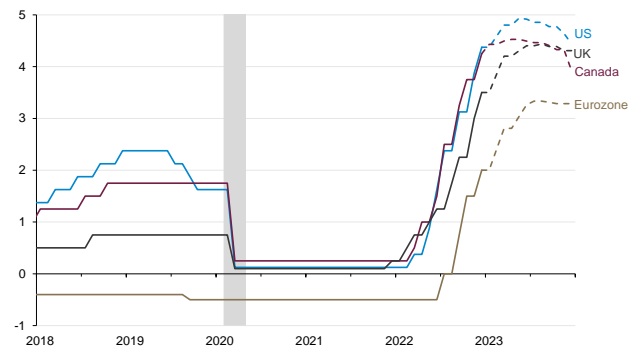
The growing evidence that inflation is on a clear downward trajectory is welcome by monetary policymakers and makes their job a little easier.

That said, with inflation still running uncomfortably high, central banks are not ready to declare “mission accomplished” quite yet. Forward guidance

suggests that further hikes are imminent.

CHART 30: A LITTLE BIT MORE

Overnight index swap-implied forward policy rates
(percent)



Shaded region represents period of US recession; source: Guardian Capital based on data from Bloomberg to January 13, 2023; dashed lines represent OIS forward data as at January 13, 2023

The cooperative inflation data, however, means that there is likely not much left in the tightening cycle.

There is potential for hawkish surprises in upcoming policy decisions, but worries of central bankers having to drive rates ever higher to rein in inflation have been largely quashed.

Again, this significantly lowers the odds of a “hard landing” scenario where the monetary screws are tightened until something breaks. In fact, the indications that there may be scope for inflation to fall even faster than currently anticipated could even open the door for policy to move from restrictive toward a more “neutral” position — though the bar for cuts in the near term is likely higher than markets are currently pricing.

Fine China?

Something significant that has gone largely unmentioned to this point is China.

The world's second-largest economy has struggled over the past year, as it dealt with a homegrown property market crisis and adhered to a strict “zero COVID” policy. The former stymied domestic investment and eroded wealth, while the latter stifled consumer spending and exacerbated global supply chains' issues.

With neither issue resolving itself, policymakers finally decided to step in and address the problems.

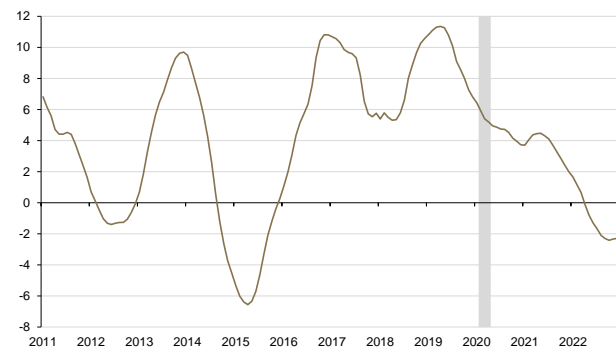
Starting with real estate, Chinese monetary policy authorities and financial regulators have introduced initiatives to stabilize the sector.

The policies focus on supporting developers in moving forward with projects and easing conditions on mortgages. The goal is to underpin confidence that contracts between homebuyers and builders will be honored and ensure a willingness to make payments (many homebuyers have been boycotting payments against concerns that homes will not actually end up being built).

While it is uncertain whether this will be sufficient to revive the beaten-down real estate sector, at a minimum, it should ease concerns and provide something of a floor under prices.

CHART 31: A SUSTAINED SLIDE

Newly built commercial/residential building price index¹⁰, China
(year-over-year percent change)



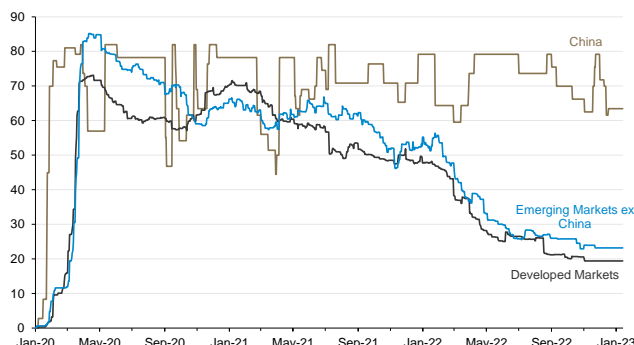
Shaded region represents period of US recession; source: Guardian Capital based on data from Bloomberg to December 2022

China's shift with respect to pandemic management is something that carries much broader implications for the global economic outlook.

Amid growing civil unrest over lockdowns and rising economic pressures (that this came alongside a slowing in demand for consumer goods that had offset the soft domestic activity data is unlikely a coincidence), the Chinese government has decided to follow the rest of the world in scaling back its more stringent public health measures.

CHART 32: LOOSENING THE RESTRAINTS

Government COVID-19 response stringency index, G20
(index; higher denotes more restrictive measures in place)



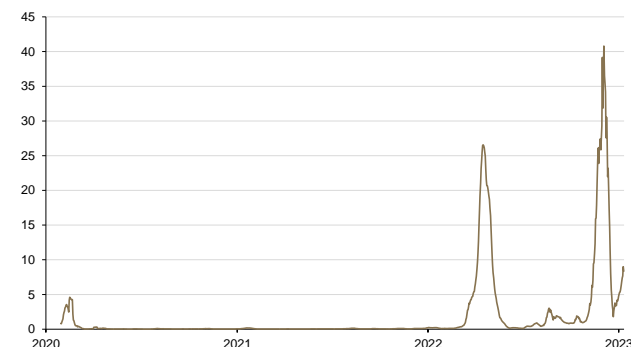
Source: Guardian Capital based on data from Oxford COVID-19 Government Response Tracker, IMF and Bloomberg to January 13, 2023

After the 20th National Congress of the Chinese Communist Party in November 2022 — which saw President Xi Jinping secure his unprecedented third five-year term as China's leader — there was a marked shift toward easing the more stringent restrictions, followed by a further scaling back of the “zero COVID” policies in December.

This laxer approach to the pandemic management has resulted in an aggressive wave of infection that China had largely avoided to this point — and this has been particularly harsh given the lack of natural immunity established by earlier infection within their populations and the dearth of full vaccination among the elder portion of the population.

CHART 33: THE DAM HAS BURST

Confirmed daily COVID-19 cases, China
(thousands, seven-day moving average)



Source: Guardian Capital based on data from Our World In Data to January 9, 2023

As has been the case elsewhere in the world over the last three years, the wave is likely to be short-lived — the infection will run its course and some semblance of herd immunity will be established,

resulting in more benign cycles going forward.

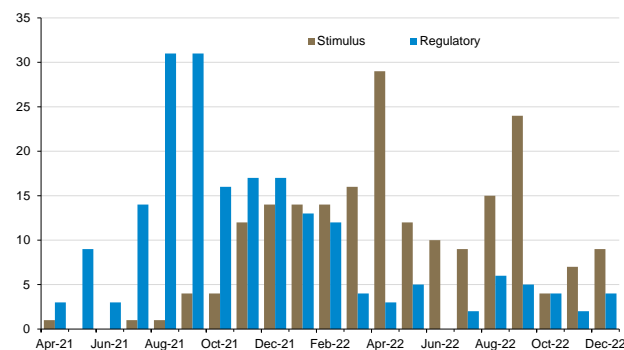
The Chinese government is trading (hopefully) short-term pain for more upbeat medium- and longer-term economic prospects. The spread of infection and the possibility of lockdowns in response may restrain activity in the near term, but the rollback of restrictions stands and broad reopening of the Chinese economy should lead to an acceleration in growth momentum in the months to come.

On top of this, Beijing has recently adopted a more conciliatory approach to managing its relationships with its domestic and international partners — and, while recent history provides plenty of reason for caution, the importance of China in the global economic machine means that these developments cannot be discounted.

Internally, regulators have softened their approach toward private enterprise after years of crackdowns, particularly in the technology space. The balance between new stimulus measures and regulatory actions is now tilted in favour of the former.

CHART 34: CRACKING CRACKDOWNS

Government regulatory actions & stimulus measures, China
(number of measures introduced)



Source: Guardian Capital based on data from Piper Sandler to January 13, 2022

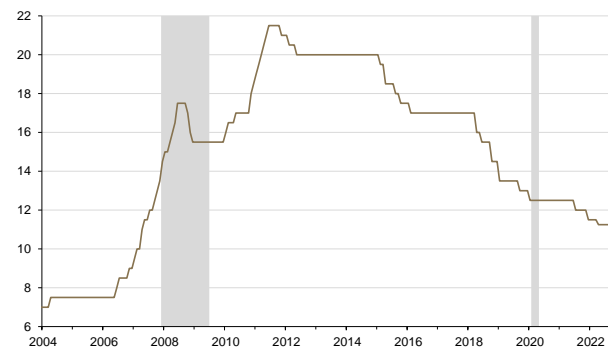
Abroad, Chinese delegations have adopted a less aggressive tone, softening diplomatic relationships in the interest of shoring up foreign investment and exports to support its economic goals.

Finally, in stark contrast to virtually every other central bank, the People's Bank of China has eased its policy stance. China's central bank cut its reserve requirement ratio (which determines how much

banks can lend relative to deposits) further in December, which stands to inject added liquidity to their financial system and economy.

CHART 35: LOOSENING THE SCREWS

Reserve requirement ratio, China
(percent)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from Bloomberg to December 31, 2022

Taken together, the shift in policies within China are unambiguously positive for the domestic and global economic outlook. Moreover, while there is the potential for an uptick in demand from China to add some verve to inflationary pressures, the potential of more rapid easing of supply chain pressures, resulting from a less constrained Chinese economy, would provide some offset.

Marrying the macro and the market

Bringing it all together, the bottom line is that, while there are significant risks to the economic outlook, there are mitigating factors that suggest that current consensus forecasts may prove overly pessimistic.

The likelihood of a recession materializing over the coming year cannot be written off, but there are growing indications that the global economy is actually on a path right now toward a “soft landing.”

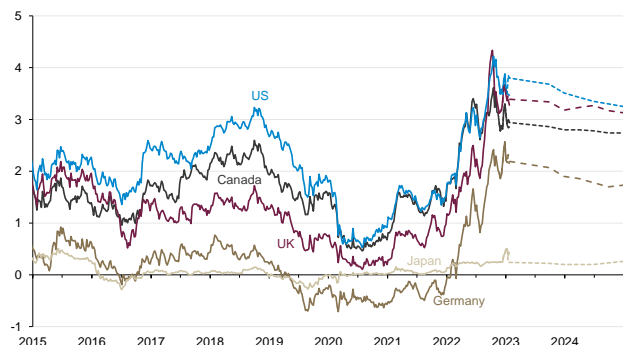
So, what does this mean for global markets?

For starters, the outlook for bonds is substantially improved relative to a year ago — the risk/reward profile for fixed income securities has actually not looked this compelling in over a decade.

The consensus is that interest rates are likely to remain rangebound around current levels, as policymakers hold fast despite slowing growth and inflation.

CHART 36: TRADING WATER

10-year sovereign bond yields & forecasts
(percent)

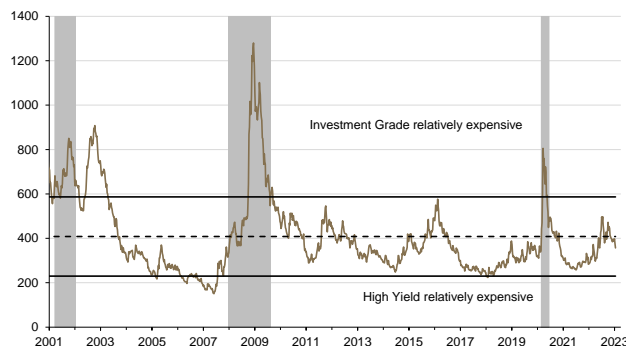


Source: Guardian Capital based on data from Bloomberg to January 13, 2023; dashed lines represent Bloomberg consensus forecasts as at January 13, 2023

As such, returns would be driven by yields on offer, with the shape of the curve and wider credit spreads supporting a continued bias toward shorter-duration securities and corporate credit — the uncertainty over the outlook and relative valuations would suggest it would likely be prudent to bias exposures in favour of issuers higher up the quality curve.

CHART 37: QUALITY OVER QUANTITY OF YIELD

Investment Grade over High Yield credit spread, Global
(basis points)



Dashed line represents series average; solid black lines are +/-1 standard deviation from the average; shaded regions represent periods of US recession; source: Guardian Capital based on data from Bloomberg to January 13, 2023

That said, the balance of risks in the bond market appear to be skewed to the upside — there appears to be more room for rates to move lower than higher (which would be positive for bond prices).

Central bank tightening cycles are approaching their conclusion and any upside surprise to inflation would likely result in only marginal further increase in rates.

In other words, the probability of a repeat last year's surge is low and the yields now available, particularly at the front end of the yield curve, provide an adequate cushion to absorb the hit without seeing returns turn negative.

In contrast, if inflation comes down faster than currently anticipated or economic activity slows more materially than forecast, not only would expectations of further rate increases be pared, but the prospect of faster moves away from the now-restrictive policy stances could increasingly be priced into the market — and a more dire outlook would also see a flight to quality serve as a tailwind for fixed income performance.

The seeming asymmetry in potential outcomes would suggest that there could be opportunities to add duration in bond exposures.

Moreover, the potential for bonds to generate positive performance, regardless of what transpires, thanks to last year's painful rate adjustment, ups their value as a diversifier in a balanced portfolio.

The outlook for equities is less clear-cut, but carries a positive skew.

Last year's harsh and broad-based sell-off was predominantly the product of what were extreme valuations adjusting to higher market interest rates. Earnings held steady for the most part, as softening sales volumes were largely offset by margin strength. Market declines were multiple-driven.

CHART 38: VALUATION ADJUSTMENT

Forward price-to-earnings ratio, MSCI All-Country World Index (ACWI)¹¹ (ratio)

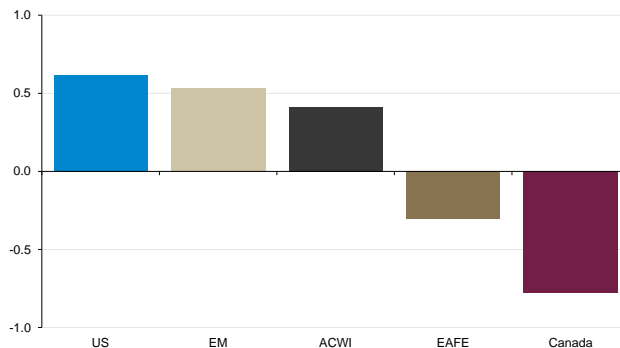


Shaded regions represent periods of US recession; dashed line represents 15-year average; solid black lines represent +/- 1 standard deviation from the average; source: Guardian Capital based on data from Bloomberg to January 13, 2023

Overall, market valuations are not necessarily “cheap”, but they are back well within the realm of “normal” — and DM outside of the US are trading at steep discounts relative to history.

CHART 39: VALUE TO BEHOLD

MSCI country index forward price-to-earnings ratio (standard deviations from long-term average)



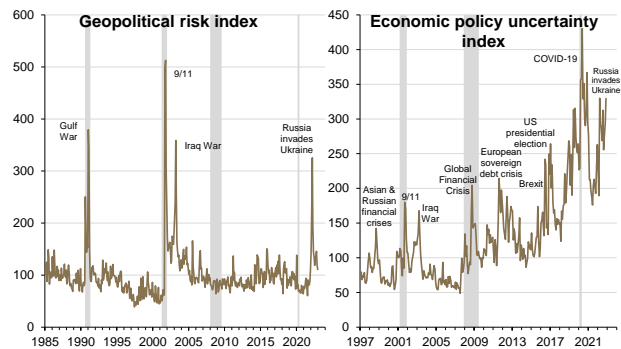
EM=Emerging Markets; ACWI=All-Country World Index; EAFE=Europe, Australasia & the Far East; source: Guardian Capital based on consensus data from Bloomberg to January 13, 2023

The lower valuations offer positive performance prospects, but at the same time, there is justification for more conservative market pricing.

While there have been positive recent developments with respect to the outlook that have reduced the potential likelihood of a “hard landing”, there is plenty of uncertainty that will continue to weigh on sentiment and keep risk premia elevated.

CHART 40: RISKY BUSINESS

Geopolitical Risk Index¹² & Policy Uncertainty Index¹³, World (index; pre-2019 average = 100) (index)



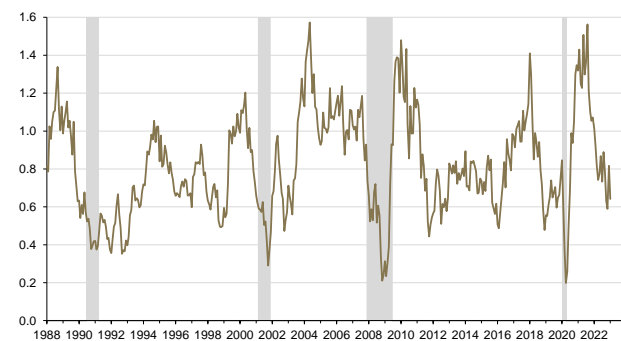
Shaded regions represent periods of US recession; source: Guardian Capital based on data from PolicyUncertainty.com to December 2022

As well, the more middling equity valuations are dependent on earnings meeting their expectations.

Echoing the downward revisions to the economic outlook, analysts have been reducing their corporate profit forecasts — and history suggests that there is scope for further downgrades to come.

CHART 41: LOSING MOMENTUM

One-month earnings per share revision ratios, World (ratio of analyst upgrades to downgrades)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from Bank of American to January 2023

Disappointment on earnings could serve as a catalyst for equity markets to take another leg lower.

As with bonds, however, it may be that the balance of risks in equities is also skewed to the upside.

Just as economic growth forecasts may be putting too much emphasis on the worst-case outcomes, so too may be expectations for earnings.

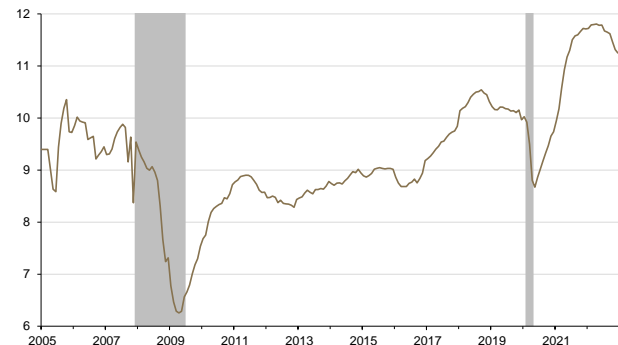
Demand has proven resilient over the last three years, despite numerous headwinds, and underlying strength in the consumer sector gives reason to

believe that this could continue. As well, an added contribution from China could keep top-line sales growth from deteriorating.

With indications that cost pressures are easing, profit margins may not compress as much as currently anticipated, providing fundamental support to equity market performance.

CHART 42: MARGIN FOR ERROR

12-month forward profit margins, MSCI ACWI (earnings as a percent of revenues)



Shaded regions represent periods of US recession; source: Guardian Capital based on data from Bloomberg to December

A better setup

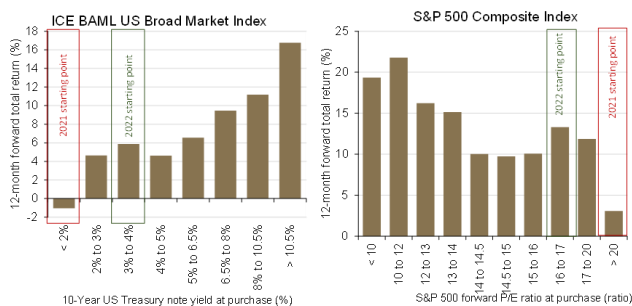
The bottom line is that, while the challenging economic outlook provides little reason to anticipate a reprieve from the heightened uncertainty that has become the norm since the onset of the pandemic and, therefore, warrants caution, the broad valuation adjustment across asset classes, and persistent emphasis on downside risks, provides a better setup to start this year than prevailed 12 months ago.

Of course, any improvement over last year’s dismal performance is unlikely to come in a straight line, as markets (over)react to every ebb and flow in the data and the potential implications for growth, inflation and interest rates.

But, history still shows longer-term returns tend to be much better when the starting points for valuations across assets classes are off their extremes and at more middle of the road levels.

CHART 43: IT’S ABOUT WHERE YOU START

12-month total return by valuation at purchase (percent; US dollar basis)



Source: Guardian Capital based on data from Bloomberg from January 1976 to December 2022

Market Returns at December 31, 2022

All returns in CAD

CANADIAN EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P/TSX Composite	-4.9	6.0	-5.8	-5.8	6.8	7.7
S&P/TSX 60	-5.4	5.6	-6.2	-6.2	7.4	8.4
S&P/TSX Completion	-2.8	7.7	-4.2	-4.2	5.1	5.8
S&P/TSX SmallCap	-1.8	8.4	-9.3	-9.3	3.1	4.2
S&P/TSX Composite High Dividend	-4.1	4.7	0.6	0.6	7.3	7.5
S&P/TSX Composite Dividend	-4.6	5.4	-0.1	-0.1	7.5	8.5

S&P/TSX SECTOR RETURNS (%)

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	-3.1	6.1	-2.6	-2.6	5.6	8.8
Consumer Discretionary	-4.3	8.8	-6.0	-6.0	4.8	12.0
Consumer Staples	-1.9	8.5	10.1	10.1	10.4	14.7
Energy	-5.6	8.9	30.3	30.3	7.2	4.1
Financials	-5.6	3.4	-9.4	-9.4	6.7	10.4
Health Care	-16.8	-10.9	-61.6	-61.6	-29.2	-20.8
Industrials	-5.7	7.3	1.4	1.4	11.1	14.0
Information Technology	-7.2	12.6	-52.0	-52.0	13.9	17.6
Materials	-1.8	8.2	1.7	1.7	7.6	1.8
Real Estate	-2.7	7.1	-21.5	-21.5	4.3	7.5
Utilities	-4.5	-7.4	-10.6	-10.6	7.6	7.3

U.S. EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P 500	-5.8	6.1	-12.2	-12.2	11.2	16.1
Dow Jones Industrial Average	-4.1	14.4	-0.1	-0.1	10.1	15.8
NASDAQ	-8.8	-2.4	-28.2	-28.2	10.4	16.8
Russell 1000	-5.9	5.8	-13.2	-13.2	10.9	15.9
Russell 2000	-6.5	4.8	-14.7	-14.7	5.8	12.4
Russell 3000	-5.9	5.7	-13.3	-13.3	10.5	15.7
Russell 1000 Growth	-7.7	0.8	-24.0	-24.0	12.7	17.7
Russell 1000 Value	-4.1	10.9	-0.8	-0.8	8.4	13.8

S&P 500 SECTOR RETURNS (%)

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	-7.9	-2.8	-35.5	-35.5	2.6	7.5
Consumer Discretionary	-11.3	-11.4	-32.5	-32.5	7.8	15.3
Consumer Staples	-2.9	11.1	6.6	6.6	10.6	14.5
Energy	-3.0	21.1	77.8	77.8	11.0	9.3
Financials	-5.3	12.0	-4.0	-4.0	8.1	15.7
Health Care	-2.0	11.2	5.2	5.2	14.3	18.7
Industrials	-3.0	17.6	1.4	1.4	9.1	15.5
Information Technology	-8.4	3.3	-23.0	-23.0	17.7	22.0
Materials	-5.6	13.4	-5.9	-5.9	9.2	13.2
Real Estate	-4.9	2.4	-20.8	-20.8	7.6	N/A
Utilities	-0.6	7.1	8.9	8.9	11.3	14.6

INTERNATIONAL EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
MSCI World Index (Net, C\$)	-4.3	8.2	-12.2	-12.2	7.8	12.3
MSCI EAFE Index (Net, C\$)	0.0	15.7	-8.2	-8.2	3.2	8.0
MSCI ACWI (C\$)	-4.0	8.2	-12.4	-12.4	6.9	11.4
MSCI France (C\$)	-0.2	20.5	-7.0	-7.0	5.1	9.5
MSCI Germany (C\$)	-0.1	22.8	-16.7	-16.7	-1.5	5.9
MSCI Japan (C\$)	0.2	11.7	-10.6	-10.6	1.8	8.9
MSCI UK (C\$)	-0.4	15.4	2.1	2.1	2.6	6.3
S&P/IFC Investable (Emerging Markets)	-1.5	7.7	-13.5	-13.5	0.9	5.6
MSCI EAFE Growth (Gross, C\$)	-1.2	13.5	-17.1	-17.1	4.5	9.3
MSCI EAFE Value (Gross, C\$)	1.3	18.1	2.0	2.0	2.4	7.4

INTERNATIONAL EQUITIES

MSCI EAFE SECTOR RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	-0.2	8.6	-10.7	-10.7	-1.1	6.1
Consumer Discretionary	-2.2	16.2	-16.8	-16.8	2.4	8.6
Consumer Staples	0.5	9.1	-6.7	-6.7	2.5	7.9
Energy	-2.3	18.1	37.0	37.0	4.2	5.9
Financials	3.3	22.2	2.4	2.4	1.7	7.0
Health Care	0.8	12.6	-4.6	-4.6	7.8	10.7
Industrials	0.0	17.4	-14.8	-14.8	2.9	8.8
Information Technology	-5.1	13.3	-27.5	-27.5	5.7	12.2
Materials	-0.2	19.0	-3.7	-3.7	5.6	7.7
Real Estate	1.0	9.5	-15.1	-15.1	-3.0	N/A
Utilities	2.2	17.8	-6.1	-6.1	5.5	7.5

Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

Market Returns at December 31, 2022

All returns in CAD

CANADIAN FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada 91 Day TBill	0.3	1.0	1.8	1.8	1.2	0.9
FTSE Canada Short Term Overall Bond	-0.2	0.7	-4.0	-4.0	1.0	1.4
FTSE Canada Mid Term Overall Bond	-1.9	0.3	-10.3	-10.3	0.7	1.9
FTSE Canada Long Term Overall Bond	-3.6	-1.0	-21.8	-21.8	-1.1	1.7
FTSE Canada Universe Bond	-1.7	0.1	-11.7	-11.7	0.3	1.6
FTSE Canada High Yield Overall Bond	0.7	2.1	-5.4	-5.4	3.5	4.7
FTSE Canada Real Return Bond Overall	-0.6	2.8	-14.3	-14.3	1.3	1.1

SECTOR RETURNS (%)

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada Federal Bond	-1.5	-0.1	-9.3	-9.3	0.1	1.0
FTSE Canada Provincial Bond	-2.3	-0.3	-15.1	-15.1	-0.2	1.8
FTSE Canada All Corporate Bond	-1.0	1.0	-9.9	-9.9	1.1	2.4

GLOBAL FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE World Government Bond	-0.2	2.4	-12.3	-12.3	-1.0	1.9

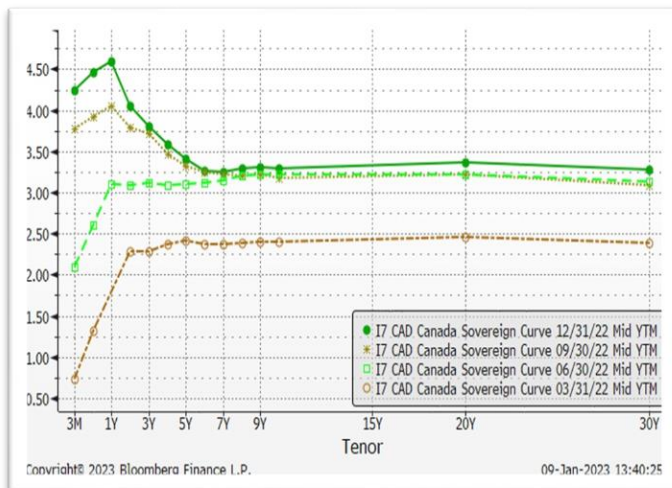
COMMODITY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Bloomberg WTI Cushing Crude Oil Spot Price	-0.4	-0.4	11.8	11.8	7.5	1.8
Bloomberg European Dated Brent BFOE Price	-1.9	-2.7	17.7	17.7	6.6	0.3
Edmonton Crude Oil Syncrude Sweet Blend FOB Spot	-1.5	-5.3	21.2	21.2	9.4	2.2
S&P GSCI Nat Gas Index Spot	-35.5	-34.8	28.7	28.7	10.4	6.2
S&P GSCI Copper Index Spot	1.6	8.2	-7.8	-7.8	4.6	3.7
S&P GSCI Gold Index Spot	3.7	7.7	7.1	7.1	8.6	4.0

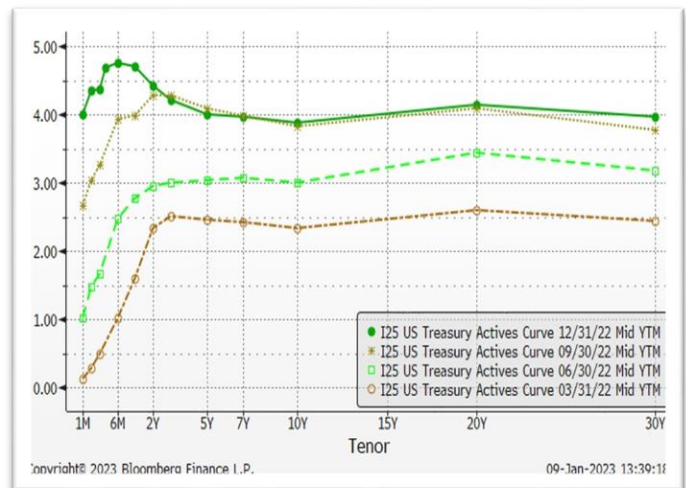
CURRENCY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
CAD/USD (% chg)	-0.1	-1.4	7.3	7.3	1.6	3.1
CAD/Yen (% chg)	5.7	8.2	-6.4	-6.4	-1.5	-1.1
CAD/GBP (% chg)	1.0	6.3	-4.7	-4.7	-0.8	0.1
CAD/Euro (% chg)	3.6	7.4	0.7	0.7	-0.8	1.0

GOVERNMENT OF CANADA YIELD CURVE



U.S. TREASURY YIELD CURVE



Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

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ENDNOTES

¹ The S&P 500 Index is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap US equity universe.

² The ICE BofA US Broad Market Index tracks the performance of investment grade debt publicly issued in the US markets, including sovereign, quasi-government, corporate, securitized and collateralized securities.

³ Inflation measured by consumer price index (CPI) is defined as the change in the prices of a basket of goods and services that are typically purchased by specific groups of households.

⁴ The Federal Reserve Bank of Philadelphia, Fourth Quarter 2022 Survey of Professional Forecasters, *Forecasters Predict Lower Growth and Higher Unemployment Rate*, 14 Nov '22, <https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q4-2022>

⁵ The OECD Business Confidence Index is a composite measure for the 38 OECD member countries that provides information on future developments, based upon opinion surveys on developments in production, orders and stocks of finished goods in the industry sector.

⁶ The Citi Economic Surprise Index measures the pace at which economic indicators are coming in ahead of or below consensus forecasts.

When the index is negative, it means that the majority of reports are coming in below expectations, while a positive reading indicates that most data is coming in ahead of expectations.

⁷ The CEO Economic Outlook Index is a composite index of CEO plans for capital spending and employment and expectations for sales over the next six months.

⁸ The Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing; a monthly survey of purchasing managers to determine whether business conditions are improving, unchanged, or deteriorating compared to the previous survey. A level above 50 represents improving conditions, while a level below 50 represents deteriorating conditions and a level of 50 represents no change from the previous survey period.

⁹ The Federal Reserve Bank of New York Global Supply Chain Pressure Index is a measure of global supply chain conditions.

¹⁰ Price Indices of Newly Constructed Residential Buildings (by Floor Space) in 70 Medium- and Large-sized Cities. This index shows the year-over-year change in new home building prices in China, and is calculated in weighted average method and the weight of each city is based on the population.

¹¹ The MSCI All-Country World Index (ACWI) is a market capitalization weighted index of equities in both Developed and Emerging Markets.

¹² The Geopolitical Risk Index, created by Dario Caldara and Matteo Iacoviello, is a measure of adverse geopolitical events and associated risks based on a tally of newspaper articles covering geopolitical tensions. The index reflects automated text-search results of the electronic archives of 10 newspapers related to adverse geopolitical events in each newspaper for each month (as a share of the total number of news articles).

¹³ The Economic Policy Uncertainty (EPU) Index is an index developed to measure economic policy uncertainty and is calculated by calculating the relative frequency of each country's newspaper articles, including terms 'economy', 'policy', and 'uncertainty.'