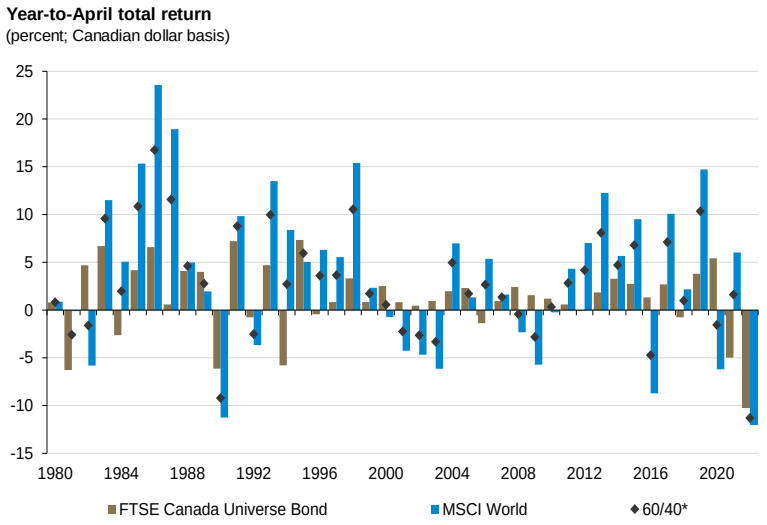
Things are never as bad as they seem

The last few years have seen a seemingly unending string of adverse shocks hit the world, disrupting the normal course of economic activity and, more generally, everyday life. And while the New Year began with hopes of much-needed calm on the horizon, the last four months have seen the emergence of new downside risks that have weighed on the outlook and reverberated through global financial markets. These risks include continued pandemic waves (particularly those in China, where the nation is feeling increasing stress due to its adherence to a strict "COVID zero" policy) and the resultant ongoing supply chain constraints. In addition, global central banks have taken an aggressive turn from focusing patiently on supporting fragile growth to the ardent need to fight inflation (underpinning the jump in market interest rates) and the spikes in geopolitical risks and commodity prices that arose from Russia's invasion of Ukraine. These have all conspired to dim the near-term expectations for economic growth, and boost inflationary pressures that crimp purchasing power and create the potential for more severe headwinds for growth ahead.

This has spurred investors to weigh the prospect of a global economy mired in a prolonged 1970s-style 'stagflation' environment (stagnant growth and high inflation) and, increasingly, the possibility of an imminent recession. Gauges of consumer confidence have plunged to post-pandemic lows in response, while measures of investor sentiment have fallen to highly depressed levels. The American Association of Individual Investors' survey[1], for example, indicates that investors are the least bullish on the outlook now than at any point in the last three decades — lower than amid the bursting of the 'tech bubble' at the turn of the millennium, the financial crisis a decade ago, or the onset of the pandemic.

This general lack of optimism is very evident in (and likely compounded by) the performance of the broad spectrum of financial assets this year. Global equities have turned in their worst start to a calendar year since 1990 (MSCI World Index -12% net CAD to the end of April). The broad domestic bond market benchmark is having its worst year in four decades by a wide margin (FTSE Canada Universe Bond Index -10%); and a classic 60/40 balanced portfolio of these two assets has set a record for futility to this point as well (-11%).



**60/40=portfolio that is 60% MSCI World, 40% FTSE Canada Universe Bond;*
source: Guardian Capital Advisors based on data from Bloomberg as at April 30, 2022.

[1] American Association of Individual Investors, AAII Investor Sentiment Survey, What Direction Do AAII Members Feel The Stock Market Will Be In The Next 6 Months? , website accessed on May 5, 2022. https://www.aaii.com/sentimentsurvey

However, it is interesting that while it may well be that the outlook now is not as upbeat as it was a few months ago, things are still far from dour and certainly do not support the degree of pessimism that is typically reserved for significant downswings. The economic data flow has proven to be resilient to this point, with solid momentum still entrenched. Unemployment is at or near record lows across the globe. Household balance sheets are in good shape and businesses' order books are flush, prompting productivity-enhancing investments. Even with recent downgrades, the base case expectation remains that global growth will be sustained at rates still notably above pre-crisis trends, with the pace of expansion likely to perk up in the coming months as pandemic-related restrictions are further scaled back and activity returns to pre-crisis levels.

While price pressures may remain elevated relative to previous trends, it is likely that the peak in year-over-year price increases will recede over the near term (if not already occurring). Additionally, inflation is likely to moderate throughout the remainder of the year as base effects fade, supply chains thaw further, spending shifts away from goods back toward previously inaccessible services, and commodity prices ebb from crisis peaks. Even nascent evidence of such a moderation in the coming months could ease the impetus for policymakers to raise interest rates — and markets have priced in a highly aggressive path that has driven the surge in yields and weighed on fixed income returns.

There are undoubtedly risks and uncertainties clouding the outlook. Still, the most likely outcome at this point remains something that should be constructive, which seemingly stands in contrast to the prevailing mood in the marketplace. This makes for a challenging backdrop for investors; however, history suggests that while sentiment can dominate in the short term, fundamentals ultimately take charge of financial market performance.

So, while the current weakness and volatility in markets can lead to the emotional impulse to run for cover, allow us to repeat that allowing emotion to drive the investment decision-making process has generally been bad for investors' wealth. Why? Because short-sighted and undisciplined reactions to short-term events can carry significant negative implications for long-term portfolio performance.