

We Stand on Guard for Thee

Equity Markets

Developed equity markets were quite sanguine over the third quarter of 2021, exhibiting low volatility and rising slightly, adding to the strength of recent quarters. Domestic investors were helped a bit further by mild weakness in the Canadian dollar over the quarter, boosting returns from international markets. The MSCI EAFE Index rose 1.9% and the S&P 500 gained 2.9% in the quarter, both in Canadian dollar terms, reflecting a mix of longer-term optimism about economic reopening balanced against immediate worries surrounding the Delta variant of the virus. The S&P/TSX Composite Index was slightly positive, rising 0.2% over the quarter, bringing domestic market returns to 17.5% thus far in 2021. Gains within global markets were generally tightly dispersed around this average, with most sectors either gaining or losing ground minimally. The positive exception to this was the Information Technology sector, rising 4.2% in the United States (US) and 7.2% in the EAFE region as investors circled back to this longstanding winning group. The returns of this sector going back over the past decade are impressive, rising at a 14.1% annual pace in the EAFE region, 25.7% in the US and 24.2% in Canada, all in Canadian dollar terms. The main negative outlier, in comparison, was the Health Care sector in Canada, falling 19.4% this quarter as cannabis producers reversed course from earlier optimism about federal legislation in the US. To finish the comparison, the small Health Care sector in Canada has declined at a 7.8% annual pace over the past decade, ranking it last among domestic sectors.

Having bottomed in March 2020, equity markets have continued a steady ascent ever since, with many stocks back to all-time-high prices in advance of a commensurate operational improvement, reflecting the view that better times are still to come. For now, investors collectively remain relatively unconcerned about inflation, with the current spike in costs stemming from transportation congestion, insufficient raw material supply, upward pressure on wages and curtailed production capacity viewed as transient. The coming months, as employment support programs sunset and businesses continue to reopen, could provide a better sense of how enduring these pricing pressures will be. This remains a key point to monitor, as the ultimate trajectory of inflation will have direct bearing on the path of interest rates and, in turn, stock market valuations.

Fixed Income Markets

Canadian Fixed Income markets traded largely sideways for most of the third quarter of 2021, before turning negative in the final week of September. While most economic news remained broadly constructive despite the fourth COVID-19 wave, the potential for outsized inflation to take root led to negative performance on government and investment grade fixed income.

Canadian government bonds and investment grade bonds returned (0.6)%¹ and (0.1)%², respectively, in the third quarter, while high-yield bonds returned 1.3%³. While Canadian bonds broadly were down, the

¹ FTSE Canada All Government Bond Index.

² FTSE Canada All Corporate Bond Index.

³ FTSE Canada High Yield Overall Bond Index.

shorter duration FTSE Short Term Bond Index was essentially flat, returning 0.1% in the quarter, while the FTSE Canada Universe Bond Index was down (0.5)%.

Both the Bank of Canada and the US Federal Reserve expressed interest around the growth of inflation, with new concerns arising that inflation could be structural rather than transitory. The Bank of Canada noted on September 8 that “These factors pushing up inflation are expected to be transitory, but their persistence and magnitude are uncertain and will be monitored closely.” The US Federal Reserve expects inflation to trend above their 2% target in the near-term, balancing a long trend of below 2% inflation to achieve their targeted rate in the longer run.

While underlying economic numbers showed reasonable strength, the Delta variant of COVID-19 continued to tax healthcare systems and limited the ability of jurisdictions to fully re-open to 2019 levels of activity. Vaccination efforts continue globally and, as a greater percentage of the planet receives their inoculation, there is likely to be a modest amount of inflation in the supply chain. Governments everywhere will grapple with their incremental COVID-19 debts and almost certainly increase taxation rates, a disinflationary force that must be balanced and measured so as to not disrupt the broader recovery.

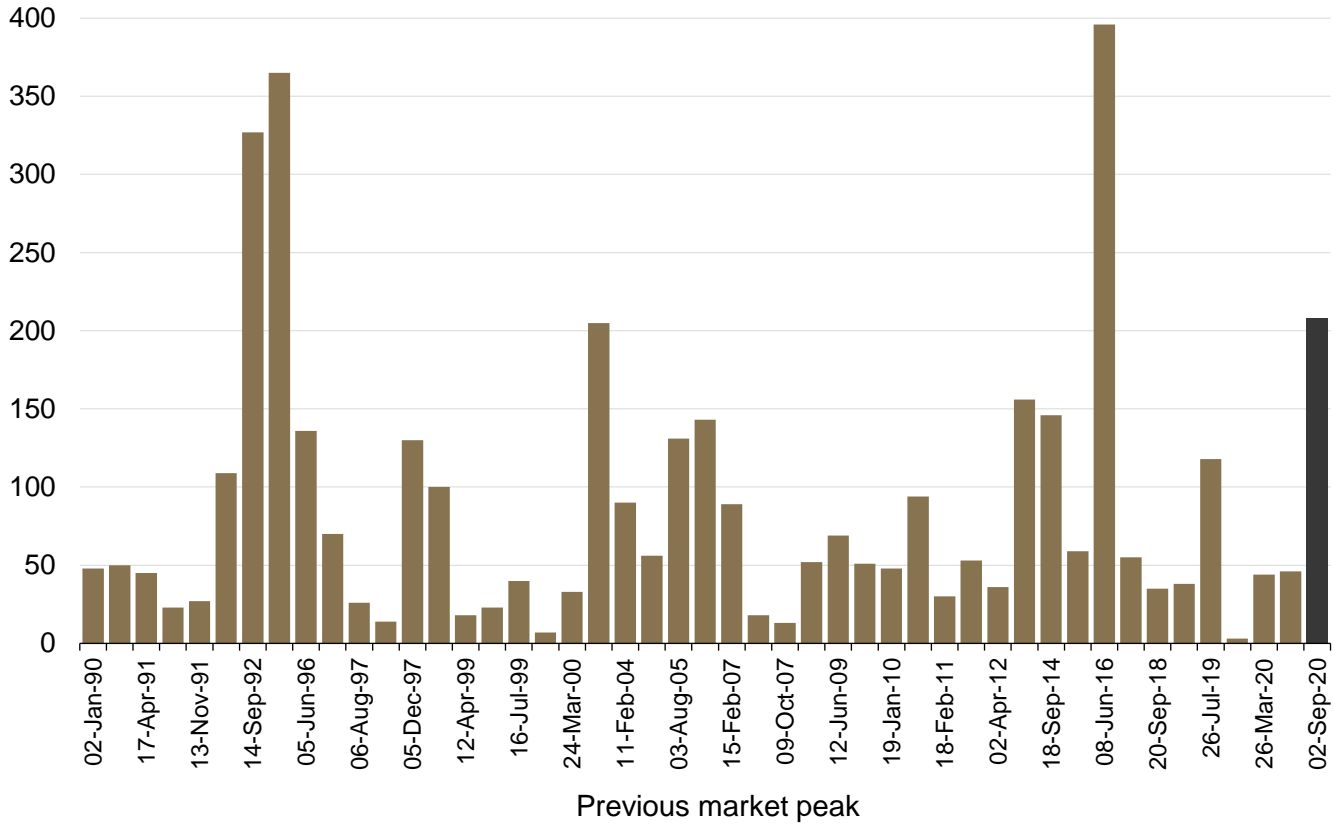
Commentary

Despite the general turmoil of the past year, in which multiple waves of COVID-19 have crested and ebbed, financial markets have kept their eyes on a post-pandemic future where all lost ground has been fully recovered and a more sustainably-paced economic expansion has become fully entrenched.

The hope for better days combined with persistently surprising resiliency of the global economy in the face of a pandemic has buoyed equities to not only establish new all-time highs, but has seen the road to these new heights be free of any significant bumps or detours. At the time of writing, global equities are up roughly 30%⁴ over the past 12 months and it has been more than 200 trading days since the last peak-to-trough decline of at least 5% in the S&P 500 Index — good enough for the fourth-longest uninterrupted stretch over the last 30 years.

⁴ MSCI World Index.

Trading days between bull market corrections of at least 5% in the S&P 500 Index
(trading days)

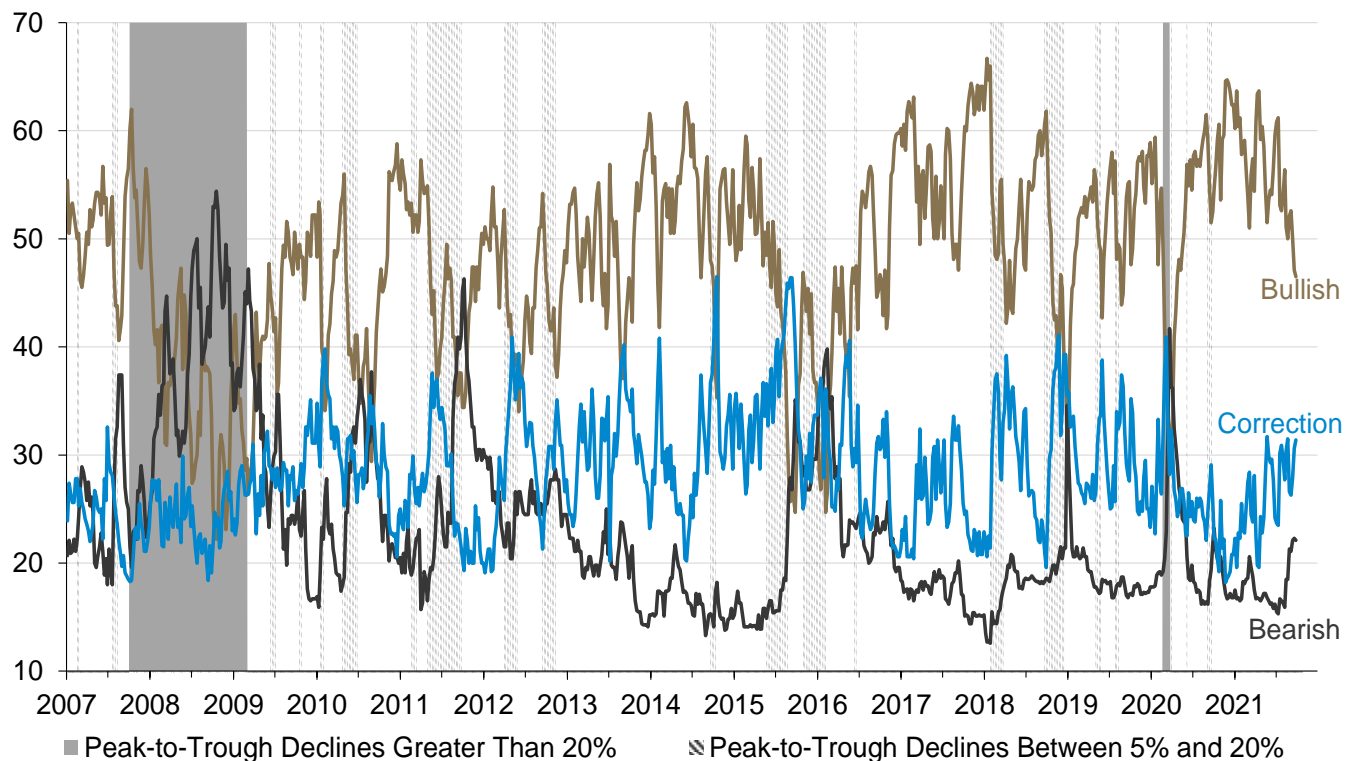


Data to September 28, 2021
Source: Bloomberg, Guardian Capital

Investors could be forgiven for being swept up by the euphoria of the thought that equities can only go up, given the absence of market shocks. An increasing number of investors are beginning to think that the quiet, is perhaps...too quiet. The flow of data continues to indicate solid global growth, even with ongoing stringent public health measures in place. Global infection rates are falling and vaccination rates are rising, however, investor sentiment has notably eroded over the last month.

Investors Intelligence Advisor Sentiment Survey

(share of survey respondents, percent)



Data to September 28, 2021

Source: Ned Davis Research, Wall Street Journal, Bloomberg, Guardian Capital

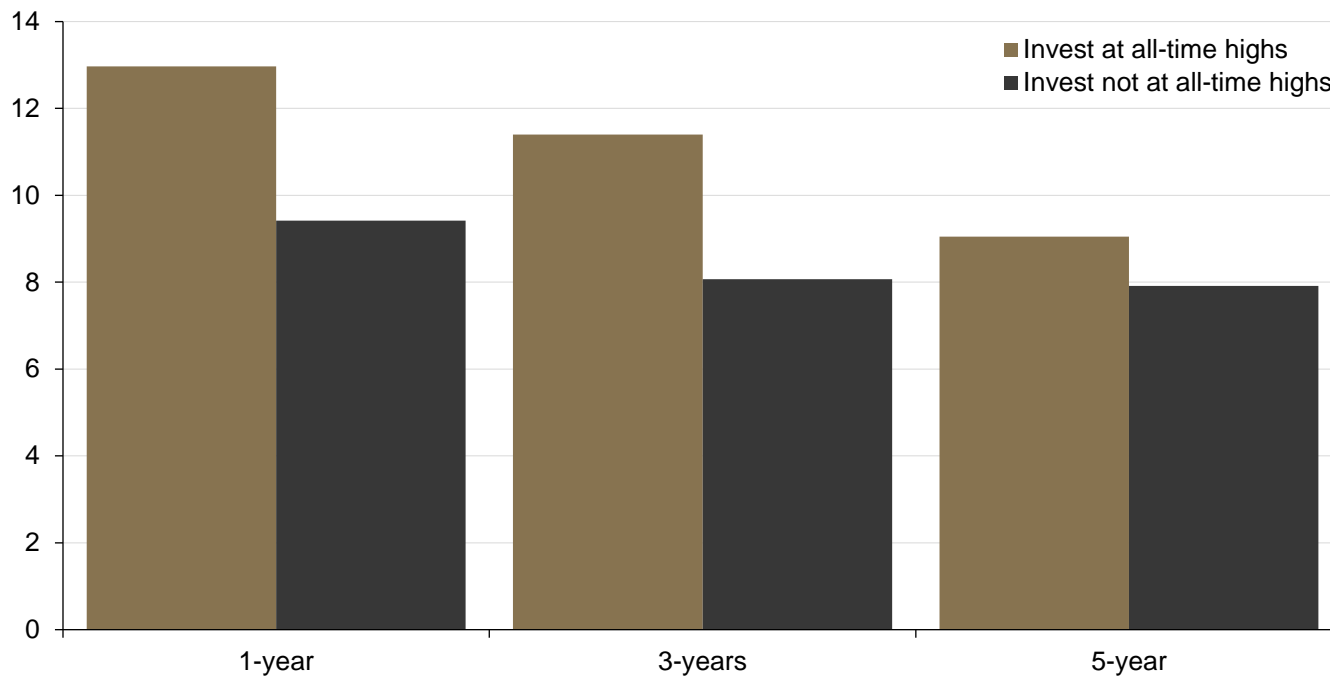
The trending investor psychology serves to actually mitigate the risks of something wicked coming this way — if everybody is anticipating something bad is going to happen imminently, the balance of risk actually shifts to the upside as the bar for expectations gets lowered.

Of course, that is not to say that a market shock cannot materialize some time soon — exogenous shocks are always possible, with a litany of known risks that litter the outlook at the moment (the pandemic, China, central bank policy, US politics and global supply chain issues, to name a few), that could flare up and bring the party to an end.

Guessing not just if, but when, these risks will fully materialize, however, is inherently difficult — and overreacting to headlines (as appears to be the case with the concerns of contagion from the Evergrande situation at the moment), can lead to missed opportunities that will ultimately leave investors worse off. The reality is that the risks we know are not the ones to fear.

Anxiety can be high when things seem too good to be true, but history shows that markets tend to go up more often than down, and while it may be surprising, buying into the market at an all-time high actually has proved to be a profitable strategy in the past.

S&P 500 Index price return
(annualized percent change)



*Data covers period from January 2, 1990 to September 28, 2021
Source: Bloomberg, Guardian Capital*

These periods of relative calm are often a good a time to ensure a plan of action is in place for when the next risk event inevitably materializes and market conditions become more tumultuous. All this really means is to be aware that market dynamics have not pushed your portfolio positioning too far from your risk and strategic allocations. Your Investment Policy Statement is your North Star during these times, and your Investment Counsellor stands on guard ensuring you stay on your journey.

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