GUARDIAN CAPITAL

GUARDIAN MANAGED INCOME PORTFOLIO Q4 2023 COMMENTARY

Market Overview

After a soft start to Q4, global financial markets rallied aggressively through the final nine weeks of 2023 as indications of moderating underlying inflationary pressures suggested the desired rebalancing of supply and demand was taking place, allowing central banks to move to the sidelines and stoking expectations that policy would begin to move back toward “neutral” sooner than previously assumed. November and December marked the best two-month stretch for performance in stock markets in three years, while the domestic bond market turned in its best two months since 1982
For the quarter as a whole, the MSCI World Index was up 8.7% in Canadian dollar terms against very broad-based gains across segments of global equity markets. In terms of industry sectors, only Energy registered a decline in Q4 as crude oil prices slumped in the period while the more interest rate and growth sensitive groups were the top performers. With respect to geographic regions, the US (S&P 500 Index +8.9%), Canada (S&P/TSX Composite Index +8.1%) and Europe, Australasia & the Far East (MSCI EAFE Index +7.7%) and posted uniformly strong returns in Q4, while Emerging Markets underperformed (MSCI EM Index +5.2%).

Likewise, fixed income markets turned in broadly robust gains as market interest rates fell sharply from their earlier decade-plus highs. The FTSE Canada Universe Bond Index rose 8.3% in Q4 (its best quarter since 1985) with long-term bonds (FTSE Canada Long Term Bond Index +14.8%) notably outperforming short- and mid-term bonds (the FTSE Canada Short Term Bond Index and FTSE Canada Mid Term Bond Index were up +4.1% and +8.3%, respectively). Generally shorter-duration corporate bonds (FTSE Canada All Corporate Bond Index +7.6%) lagged government bonds (FTSE Canada All Government Bond Index +8.5%) and High Yield bonds underperformed their higher quality counterparts (FTSE Canada High Yield Overall Bond Index +6.1%).

Performance Attribution

The Guardian Managed Income Portfolio (the “Fund”) was overweight Global Equity (and underweight Fixed Income, and to a lesser extent, Canadian Equity) relative to the Manager’s Strategic Asset Allocation, which proved accretive to relative performance in Q4 as it was the top performing asset class of the market over the three months ended December. The impact of security selection, however, was negative as the strategic bias toward laggard income-focused Equity strategies and the tactical tilt toward underperforming credit in Fixed Income weighed on relative performance. The net result was that the Fund’s tactical multi-asset portfolio finished the quarter modestly behind its blended benchmark.

Portfolio Transactions

The stark improvement in the market backdrop in Q4 prompted the decision to spend some cash held in the Fund’s portfolio to add exposure to equities, specifically increasing the allocations to US-focused equity strategies within Global Equity. As well, the decision was made to reallocate some funds from an income-oriented Global Equity strategy toward more quality growth focused mandates that stand to benefit from improving market breadth that is anticipated to come against a more sanguine economic outlook of low but positive growth, moderating inflation and lower interest rates. The allocations to Canadian Equity and Fixed Income were unchanged.

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Portfolio Outlook & Positioning

The market backdrop improved fairly notably in Q4, with the dataflow continuing to indicate that a material downturn in economic momentum is not imminent while inflationary pressures have continued to abate.
Indeed, while inflation remains above central bank targets, the degree of moderation and trajectory has removed the impetus for policymakers to keep hiking interest rates. Global central banks have increasingly moved to the sidelines, but, more notably, the recent communications from the US Federal Reserve indicated that not only are no more hikes anticipated but discussions have shifted to the potential timing of rate cuts.

This development has driven a material shift away from the views that rates would stay higher for longer, with markets pricing in more rate cuts sooner — underpinning the rally in bond markets through the quarter. The broad and significant decline in market interest rates has, in turn, fueled a notable rally in global equity markets from their October lows.

That said, the magnitude of the recent cross-asset rally suggests that markets may well have gotten ahead of themselves, and this is particularly the case for bonds. Ordinarily, the end of a tightening cycle (and the beginning of easing) would favour adding duration to Fixed Income allocations, but the move in the final weeks of 2023 creates a more balanced outlook than otherwise would be expected. As such, there has been no preference to make changes to Fixed Income allocations that are tilted in favour of credit and modestly below benchmark duration.

For Equities, the easing of risks to growth, particularly with respect to interest rates, is supportive of the expansion of valuation multiples — and even with the recent increases, underlying market valuations are not viewed as particularly expensive, in large part due to the fact that the majority of overall gains last year can be attributed to a very narrow subset of the stocks. Looking forward, while there is potential that current earnings forecasts prove to be too optimistic — setting up for some possible fundamental disappointment — any material changes to expectations are unlikely in the near- term (barring some sort of shock), while the more constructive backdrop could support an expansion of market breadth that could sustain upward market momentum for the coming months.

The year ahead will also likely see more emphasis on the impact of the developments related to what is viewed as a secular theme of artificial intelligence — and the US is viewed as the leader in this area, suggesting it will reap more productivity and profitability benefits sooner than its peers.

Overall, the Fund’s portfolio asset mix remains overweight Equity with a bias toward Global Equity and a focus on quality growth strategies that stand to benefit from a market environment in which general growth moderates to lower rates and profitability faces greater constraints. In Fixed Income, there remains a skew in favour of high-quality corporate credit, for which carry and spreads are attractive, and duration remains below that of the broad bond market index. The small position in cash represents dry powder should an attractive opportunity present itself while collecting a high yield in the meantime.

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