



CI Multi-Asset Management: June 2022 Market Commentary and Portfolio Positioning

Market performance

	Last five days (6/7/2022)	2022 high (1/3/2022)	Year-to-date (12/31/2021)	COVID Low (3/23/2020)	Pre-COVID High (2/19/2020)
S&P 500 Index	-10.2%	-22.1%	-21.6%	67.0%	10.3%

Source: Bloomberg Finance LP, as of June 14, 2022

The S&P 500 Index moved aggressively following the 8.6% inflation print announced on June 10.

On a year-to-date basis, the index is 21.6% lower, even though corporate earnings have reached new highs. On forecast earnings of \$225 for 2022, it is trading at a 16.6x price-to-earnings (P/E) multiple. This level is fair valuation from historical standards but low from recent memory.

The index is 67.0% higher from the COVID lows on March 23, 2020. However, it is only 10.3% higher from the pre-COVID high. Since then, corporate earnings of the S&P 500 Index constituents have grown significantly (from \$157 in 2019 to \$208 in 2021).

Also note markets had bottomed very quickly. While it was painful to go through, the S&P 500 Index bottomed in 33 calendar days in 2020 following a drawdown of 34%.

What caused the volatility?

It is now obvious the U.S. Federal Reserve (the Fed) has been behind the curve on hiking rates as inflation keeps rising. To be fair, inflation got complicated as the war in Ukraine and global sanctions on Russia created price pressures as both countries are major suppliers of wheat, fertilizer, oil, natural gas, metals. This incident alone probably added 2% to inflation.

So far, the Fed has only hiked 75 basis points. It is not surprising higher rates has not had a meaningful impact in cooling inflation. It is widely expected the Fed will hike another 200 to 250 basis points within the next 12 months. This will mean a gradual slowdown in consumption, employment, the economy and inflation.

However, the concern is this will not be enough and that the Fed would have to trigger a recession to bring down inflation. Instead of the Fed Funds rate topping at 325 basis points, the markets are now calling for 400 basis points.

This has already triggered a sell-off in fixed income. The 10-year U.S. Treasury yield rose 21 basis points on Monday June 13 (yield and price have inverse relationship, 21 basis points translates into 2% price drop).

Repricing central bank policy has led to lower equity and fixed income markets this year, with both recording double-digit declines.

What's our take?

Unlike COVID, Fed policy change is a “controllable” event. We would not imagine the Fed to fight inflation alone while not paying attention to its implications to economies and job markets. With only a quarter of the intended hikes being implemented, it is too early to call “not enough”.

External factors aside, consumption is topping, and inventory is climbing in the U.S. as the world operates at full capacity.

Nominal corporate earnings are unlikely to fall given inflation. Valuations are attractive. You need to look past the hiking cycle, which will remain noisy.

Inflation should cool beginning in the fourth quarter; however, investors are very impatient. Going to cash now will buy you some comfort, but you will likely miss the bottom and end up re-purchasing at a higher price. I have seen many people who got out “correctly” but never got in again (as it is a high emotional hurdle to pay more) and obviously missed the returns equity provides over the long term.

The risk is that oil remains elevated or spikes further, making it harder for inflation to come down.

What are we doing and how are the portfolios positioned?

Over the long term, we typically see numerous recessions. However, excessive volatility rarely leaves a dent to long-term returns as valuations eventually return to mean levels and earnings grow. Our portfolios are diversified in terms of asset class, geography, and investment style.

At a tactical level, we have made some changes this year. These changes are expected to enhance our returns without getting ourselves into binary outcomes:

- Increasing our energy exposure to overweight following the Russia/Ukraine incident. This also helps to hedge higher inflation risk due to rising oil prices.
- We have reduced equity across all portfolios. In the balanced funds, equity weight was reduced from over 70% to just over 60%, which was completed in May.
- We have trimmed Europe and U.S. exposures broadly and turned more positive on Canada.
- We have bought fixed income gradually.
- We will be using market weakness to increase equity exposure to take advantage of “the sale”

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