Kleinburg PRIVATE WEALTH

Carte WEALTH MANAGEMENT INC.

KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 11, ISSUE 10 OCT 2022

***"Inflation is taxation without legislation"* - Milton Friedman**

**Sergio Simone**
**EDITORIAL COMMENT**

**Kristina De Souza, CFP**
**INSURED RETIREMENT STRATEGY**

**Ryan Simone, CFP, CLU, CHS**
**THE EXECUTOR'S YEAR: IT'S NOT EASY**

## EDITORIAL COMMENT

Sergio Simone

We have now reached a critical point in the current market pullback. Do we throw in the towel or take stalk of where we are in this cycle and figure out a way to take advantage of what the future may hold for us?

2022 began with a U.S. stock market that was generally considered to be overvalued, which is one of several reasons the market corrected. Not only did the market correct, but it has "over-corrected" to the downside and is now trading in very undervalued territory.

If 1.0 is considered fair market value, the broad U.S. stock market is trading at a price to fair market value of 0.79. (Morningstar Equity Research, Sept. 26, 2022).

## INSURED RETIREMENT STRATEGY

Kristina De Souza, CFP

I recently came across an insurance-based concept that may prove highly advantageous for some of our most valued clients. The insured retirement strategy (IRS) combines the benefits of permanent life insurance with a surrender value with the potential of having the necessary liquidity to generate a flexible retirement income.

Essentially, the policy owner whose life is insured, invests in a permanent life insurance policy, and benefits not only from the revenues generated by the investments made in the policy but also from the surrender value which accumulates tax sheltered during this period.

## THE EXECUTOR'S YEAR: IT'S NOT EASY

Ryan Simone,
CFP, CLU, CHS

The "executor's year" is the term used to describe the time for which an executor gathers the deceased's assets and administers the estate before distributions are made to beneficiaries. The year begins from the date of death, and once completed, beneficiaries can compel executors to begin paying out estate assets.

Basically, the executor's year is meant to provide some breathing room to get the estate organized and ready for distribution. However, it's also a reminder to the executor that they have a duty to "get a move on". During the executor's year, an executor will identify and gather assets, pay estate expenses and debts, and file tax returns. Beneficiaries will have to take a backseat to debts and taxes, however, they can become contentious when they see the executor as acting slowly or if there is an undue delay in distributions.

**Kleinburg Private Wealth**
**91 Anglewood Ct.,**
**Kleinburg, ON, L0J 1C0**

www.kpwfinancial.com

**905.893.2540**
**info@kleinburgprivatewealth.com**

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"Over the last few years, the landscape of financial advice has proven increasingly challenging to navigate. But for Wealth Professional's 5-Star Advisory Teams for 2022, those challenges have been opportunities to evolve and grow.

In selecting this year's crop of 5-Star Advisory Teams, Wealth Professional sought nominations of teams from across Canada. The process looked for teams that meaningfully contributed to their clients through differentiated service offerings and enhanced value propositions.

Among the hallmarks that set this year's teams apart is a focus on personalization. Rather than trying to be everything to everyone, they offer dedicated services and shape their business models to address the needs of their own specific book of clients.

We are honored to receive this award and look forward to providing continued excellence in service and value for our clients."

**Meet Your Award Winning KPW Team**

Sergio Simone

Kristina de Souza

Ryan Simone

Rosy Ragno

Roberta Di Petta

Katrina Van Rhee

Kleinburg Private Wealth
91 Anglewood Ct.,
Kleinburg, ON, L0J 1C0

www.kpwfinancial.com

905.893.2540
info@kleinburgprivatewealth.com

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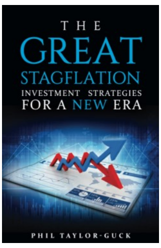
**BOOK OF THE MONTH**



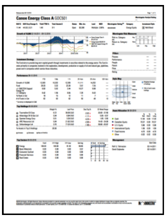

## THE GREAT STAGFLATION

- by Phil Taylor-Guck

The Covid-19 pandemic presented the biggest world crisis for generations, upending our daily lives and routines. Even as we have started looking forward to a better future once more, the worst may yet be to come.

While few politicians and economists like to admit it, all signs point towards an unprecedented financial crisis, the most dangerous economic phenomenon of them all: stagflation. Caused by the worst possible macro-economic combo – rising unemployment and high inflation – it's a scenario that, until recently, experts insisted cannot happen.

**FUND OF THE MONTH**



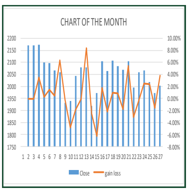
## FORGE FIRST CONSERVATIVE ALTERNATIVE FUND

To generate consistent risk-adjusted net returns over the long-term with low correlation to North American equity and credit markets. The Fund uses alternative investment strategies, such as equity long/short, pairs trading, arbitrage trading, thematic trading, the use of derivatives for leverage and/or borrowing for investment purposes, and seeks to achieve its objectives by investing primarily in equities, ETFs, fixed income and listed options in North American markets. During normal market conditions, the Fund's expected range of aggregate gross exposure is 100% to 175% times its net asset value.

Manulife

## THE BIGGEST HURDLE TO MAKING MONEY IN THE MARKETS IS THE ABILITY TO STOMACH THE ROLLERCOASTER RIDE

**CHART OF THE MONTH**




In recent history, the absolute worst time to buy U.S. equities would have been at the peak of the Global Financial Crisis on October 9th, 2007. However, if you stayed the course, return on your investment would be up as of the end of April 30, 2022 by ~ 255% or 9% annually when factoring in dividends

RSM

# BLOG OF THE MONTH

## FALLING GAS PRICES IMPLY FURTHER INFLATION RELIEF

Retail gasoline prices in the United States are poised to continue their recent decline as the summer driving season ends and households fall back into more traditional schedules.

The average retail gasoline price has declined to $3.78 per gallon from a peak of $5.01 on June 13—a 21.2% drop—and wholesale futures point to sustained declines ahead.

Disclaimer

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# PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

## EXECUTOR'S GUIDE (CANADA)

When a parent or someone close to you passes away, it can be a trying experience. In addition to dealing with natural feelings of grief, there are a number of practical matters that need attention: funeral arrangements, obtaining death certificates, reading the will, probate, distributing assets, and so forth.

This Guide explains key responsibilities and tasks associated with the death of a loved one, with an emphasis on the duties of the estate executor (also known in some provinces as the personal representative, administrator, estate trustee, or liquidator).

## SPLIT DOLLAR COVERAGE

Permanent life insurance policies have tax-deferral advantages that make them very attractive to high income executives. However, they may not personally feel the need for insurance. Businesses, on the other hand, often want key person coverage on these individuals but do not want the expense of paying for a cash value life insurance policy.

Split dollar life insurance can be an ideal solution. The business and the executive jointly purchase a life insurance policy on the executive. The business is the owner and beneficiary of a level amount of death benefit coverage and the executive is the owner and beneficiary of the cash value of the policy.

## WHY HIGH NET WORTH INDIVIDUALS SHOULD CONSIDER ALTERNATIVE INVESTMENTS

When most people think about investing, they think of stocks, bonds, and mutual funds. But most people aren't high-net worth individuals! While traditional investments can be a great way to grow your money, in uncertain times, it's important to have a well-diversified investment portfolio. While stocks and bonds are traditionally seen as the mainstays of a diversified portfolio, there are many other types of investments that can help you achieve your financial goals. One such category of investments is alternative investments.

## 6 TRUSTS FOR HIGH-NET-WORTH ESTATE PLANNING

If you have a high net worth, one of the most powerful tools available to you is a trust. They can help you pass your wealth to your heirs and may be able to shield your money from creditors. However, there are many types of trusts available. Selecting the right trust(s) will help ensure your money goes to the people you want rather than being drained from your accounts.

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# CORPORATE CULTURE

Harvard Business Review

## SUCCESSFUL LEADERS ARE GREAT COACHES

Leadership is going through massive changes as the Baby Boomers transfer power to emerging leaders in the Gen X, Millennial, and Gen Z generations. That generational change is bringing with it a shift in leadership style, from leaders as capable managers to leaders as great coaches of people.

While in recent years many leaders have hired external coaches, some have gone further, conceptualizing their jobs as executives as fundamentally about coaching. An example of a great coach is Bill Campbell, who started his career as coach of Columbia University's football team and later became known as the "Coach of Silicon Valley."

FINANCIAL POST

## BUSINESSES NEED TO REIGNITE DEI CONVERSATION THAT INCLUDES DISABILITY NOW

Disability inclusion is reshaping the nature of work and business success more than ever — but with progress on conversation and action stalled for two years by the global COVID-19 pandemic, it's vital for businesses to now refocus on their diversity, equity and inclusion (DEI) conversation, goals and actions this National Disability Employment Awareness Month (NDEAM) — and make disability part of that dialogue.

Government of Canada Gouvernement du Canada

Canada

## EMPLOYER-SPONSORED PENSION PLANS

An employer pension plan is a registered plan that provides you with a source of income during your retirement. Under these plans, you and your employer (or just your employer) regularly contribute money to the plan. When you retire, you'll receive an income from the plan.

There are two main types of employer pension plans:

Defined contribution plans and defined benefit plans

mccarthy tetrault

## MAKING THE DECISION TO GO PUBLIC: KEY FACTORS TO CONSIDER

Going public is among the most critical decisions a corporation can make. It is an intensive and complex process that affects virtually every facet of the corporation's operations. Before proceeding with an initial public offering, a corporation must reflect upon whether it is in a position to make a successful public issue of securities, and it must consider very seriously the implications and realities of being a public corporation.

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## FUND MANAGER COMMENTARY

CHRISTIAN DECKERT
MAWER INVESTMENT MANAGEMENT

SEBASTIEN MC MAHON
IIA CLARINGTON

PHIL D'IORIO
CUMBERLAND INVEST-MENT COUNSEL INC

ANDREW McCREATH
FORGE FIRST ASSET MANAGEMENT

### Jeff Moore, Portfolio Manager

**Mawer Investment Management**

**September Portfolio Commentary**

The key driver of equity returns and returns across all asset classes this year continues to be rising interest rates. We've seen our companies generally pass-through inflation very well, really flexing the pricing power that they have, which is a testament to the strength of their business and the value they provide to their customers.

### Sebastien Mc Mahon, Chief Strategist and Senior Economist

**IA Clarington Financial Group**

**Canada: Could Housing Push The Economy Into A Recession By Itself?**

Sebastien summarizes the current market situation with a focus on the effect the housing market could have on accelerating a Canadian Recession.

### Phil D'Iorio, Portfolio Manager, Global Equities

**Cumberland Investment Counsel Inc.**

**Global And International Outlook**

As we look ahead to 2023, we have a cautiously optimistic view for our portfolios and there are several reasons for this. First and foremost, the valuations for our portfolio holdings are much more attractive given the significant share price declines experienced thus far in 2022.

### Andrew McCreath, Chief Investment Officer

**Forge First Asset Management Inc.**

**September Manager Update**

In light of the growing stagflationary environment, investors experienced the full brunt of the renewed downside correlation between stocks and bonds during September, historically the worst month of the year. For the first time since 1938, the S&P 500 closed the quarter with a negative return (-5.28%) after earlier rising more than 10% (+14% July through mid-August gain) as breadth turned strongly negative during the last month of the quarter. In fact, to highlight what has become a year-to-date trend, 56.4% of all trading days during 2022 have shown declines for the SPX, including 26.1% of those days featuring declines of at least 1%.

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# LINKS

REVERSE MORTGAGES CAN OFFER SENIOR HOMEOWNERS A FINANCIAL LIFELINE WITH BOTH STOCKS AND BONDS SINKING

CRA PRESCRIBED RATE INCREASES FOR Q4 2022

CONSUMER DEBT INDEX HIGHLIGHTS IMPACT OF AFFORDABILITY CRISIS

OSC CHIEF MAKES THE CASE FOR CRYPTO REGULATION

HIGHER INTEREST RATES NEEDED, SIGNS OF ECONOMIC SLOWDOWN NOT ENOUGH, SAYS MACKLEM

IMF WARNS OF HIGHER RECESSION RISK AND DARKER GLOBAL OUTLOOK

THE AMOUNT STOLEN IN CRYPTO HEISTS IS UP 60% THIS YEAR TO $1.9 BILLION

CHOOSING TECH STOCKS AS INTEREST RATES RISE

BUSINESS BANKRUPTCIES ARE ON THE RISE, BUT ACCOUNT FOR ONLY 10% OF LOOMING BUSINESS CLOSURES

HUMBLEDOLLAR

## BACK TO FUNDAMENTALS

WHAT DO ALL BEAR markets have in common? By definition, stock prices must fall at least 20%. But often, that's pretty much where the similarity ends.

TD

## PROVINCIAL HOUSING MARKET OUTLOOK

As we've raised our forecast for the Bank of Canada policy rate, we've also downgraded our projections for Canadian home sales and average prices compared to June. We now see an additional 75 bps of tightening, bringing the policy rate to 4.00% by the end of the year. However, given still-elevated inflation, the risk to this call is tilted the upside.

The higher borrowing costs will further erode affordability and weigh on overall economic growth, which in turn will exert another drag on housing demand. Ultimately, we think sales will bottom out at about 20% below their pre-pandemic levels in the early part 2023, while remaining very subdued for the rest the year.

## VIDEO AND PODCAST LINKS

OPEC AND RUSSIA SLASH OIL PRODUCTION IN BID TO BOOST PRICES

FED'S BOSTIC-DALY DOUBLE TEAM FAILS TO QUASH 2023 RATE CUT BETS

RESTORING PRICE STABILITY FOR ALL CANADIANS

## FINANCIAL CALCULATORS

**INVESTMENT GROWTH CALCULATOR**

Find out how much your savings will grow over time by making regular investments

**FIDELITY myPLAN SNAPSHOT**

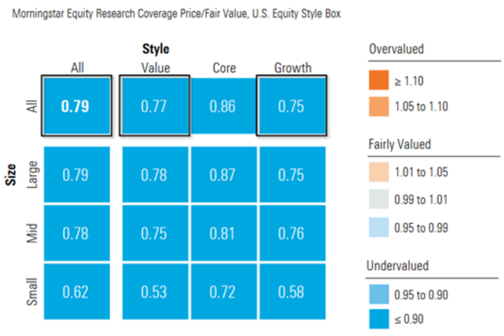
The Fidelity **myPlan** Snapshot enables you to get a glimpse into your retirement finances in seconds.

**RRSP SAVINGS CALCULATOR**

Estimate how much your registered retirement savings plan will be worth at retirement

**EDITORIAL COMMENT -** CONTINUED

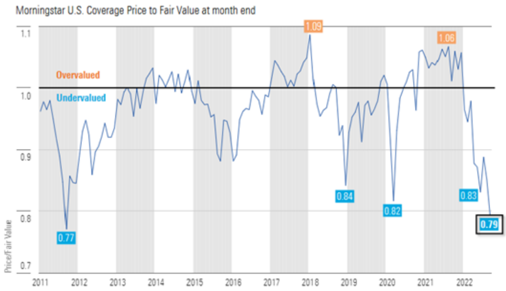
The following chart shows that Small Cap Growth stocks are the most undervalued at 0.58.




The current level of undervaluation is the greatest level we have seen since the start of the pandemic in March 2020 when it bottomed out at 0.77.

This area of undervaluation is significant as there have only been a handful of times when we have experienced this level. It happened in the fall of 2011 over concerns that Greece would default on its debt and that the fallout would spread across other European countries. It occurred once again in December 2018 as the Fed was in the midst of tightening and markets were pricing in a global growth scare.

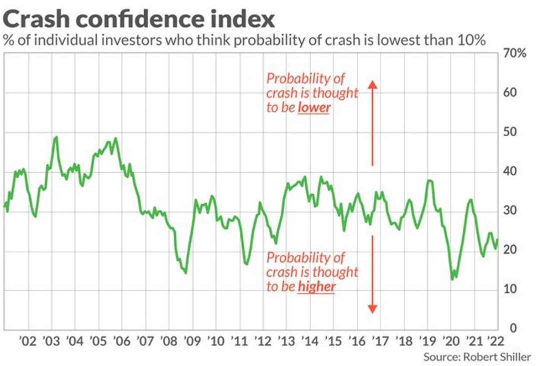
In my opinion, the market is being overly pessimistic regarding the long-term prospects for equity valuations. Markets often act like a pendulum and swing too far one way or the other. In 2021 they had swung too far to the overvaluation side and now they have compensated by overreacting to short-term pressures by swinging too far to the undervaluation side.




This swing is also responsible for a majority of investors' increasing negative views of the markets and a belief that a stock market crash is inevitable. Many of us believe this is a bullish sign. The reason we believe this is that crash anxiety is a great contrarian indicator. I would be more concerned if investors were investing like a crash would not occur.

Robert Shiller is a respected finance professor at Yale University. Since 2001, Shiller has been conducting a monthly survey of investors. One of the questions on the survey is: **"What do you think is the probability of a catastrophic stock market crash in the U.S., like that of October 28, 1929, or October 19, 1987, in the next six months?"**

Shiller takes the responses and categorizes them as a percentage of the respondents who are convinced the probability is less than 10%. The following chart shows that approximately 23% of individual investors believe this probability is low. There were two other times since 2001 that the probability reached lower numbers. One was at the bottom of the 2007-2009 and 2011 market collapses.




To clarify, the chart does not show the percentage of investors who think a crash is probable. It shows the percentage of investors who believe that this probability is low. Therefore, lower values indicate that crash anxiety is more widespread, and higher values indicate that crash anxiety is low. The current reading of approximately 23% indicates that approximately 77% of investors believe there is a greater-than-10% probability of a crash occurring. To really get a grasp on how powerful this contrarian indicator is, consider the data in the following table.

| Crash confidence index readings: | Fear of crash is... | Average S&P 500 total real return over subsequent 12 months | Average S&P 500 total real return over subsequent 2 years (annualized) | Average S&P 500 total real return over subsequent 5 years (annualized) |
|---|---|---|---|---|
| Lowest 10% of historical readings | *Highest* | 25.6% | 19.5% | 15.3% |
| Highest 10% of historical readings | *Lowest* | 5.6% | 6.6% | 6.1% |

It measures the contrast between the average S&P 500 total real-return in the wake of either the 10% of months when crash anxiety was highest or the decile when that anxiety was lowest.

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**EDITORIAL COMMENT -** CONTINUED

The returns following low anxiety periods is significantly less than those following high anxiety periods, ranging from 4.5 times higher after twelve months to 2.5 times after five years.

The total average return of the index twelve months out from the high anxiety level was 25.6%. The average return over the subsequent two and five-year annualized returns was 19.5% and 15.3% respectively. Compare these returns to the 1, 3 and 5-year returns when crash anxiety was at its lowest points.

I take solace from the fact that the subjective probabilities reported in Shiller's survey are basically a reflection of investor sentiment rather than objective reality. That is why I am not worried about the current state of the markets.

Another factor that eases my worry is something I have stated over and over again, "Me and most of us in this industry think of the long run; we believe, based on precedent, that markets are resilient. The short term, however, is a different story.

The most common question I hear lately relates to outlook. Clients want to know how long it will take for the markets to bounce back from a recessive state. Even though we, as Advisors, are armed with reams of data and expert commentary, opinions on this particular matter may differ significantly. Our objective during these recessionary times is to offer a well-reasoned, emotionally neutral opinion. Fortunately, we are committed to our long-term outlook so, navigating the many possible outcomes, although challenging, comes with a pre-determined result.

Understanding market resilience is key to a successful investment portfolio. Although the current economic environment may be unfamiliar stomping grounds for many investors, it is by no means unprecedented. When markets become this volatile, most investors are prone to overreaction, which causes them to make regrettable decisions like selling at the wrong time and accepting the substantial losses that come with the sell orders. As I said, markets are resilient and investors who stay invested will recover their losses and grow their wealth.

## CHART OF THE MONTH - CONTINUED

### The biggest hurdle to making money in the markets is the ability to stomach the rollercoaster ride

S&P 500 Total Return (10/31/2006 – current)


Manulife Investment Management

Source: Bloomberg, Capital Markets Strategy. As of April 30, 2022

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Disclaimer

**Insured Retirement Strategy —**Continued

Upon retirement, the insurance contract may be assigned as collateral to a financial institution in exchange for providing a source of liquid retirement income, in the form of a loan. It has been recommended to utilize participating life insurance for this strategy, one that would ensure the long-term growth of the death benefit and surrender value due to annual dividends.

This particular strategy may not be suitable for all, but is designed for high net worth, high income individuals, or business owners. For example, individuals who have maxed out their TFSA and RRSP contributions, those who are looking for tax efficient sources of asset diversification, and those anticipating a significant growth in their estate. On the other hand, it is suited to business owners who are looking for access to liquidity and long-term financial stability, access to financial leverage in order to generate retirement income and an alternative source of tax efficient retirement income.

The benefits of this strategy are numerous, as the basis for it is providing a flexible retirement income that adapts to the policy owners' unique needs. The policyowner is able to select the timing and the amount of the loan based on their retirement income needs. They are not required to request any loans or pay any interest, because the interest is permitted to be capitalized annually.

The owner also has access to the surrender value of the life insurance policy, by either requesting it or through a policy loan. It is this accumulated policy surrender value that is the asset that may be assigned as collateral to a financial institution to obtain credit or loans, which can be reimbursed any time.

Another benefit is the reduction in income taxes owed, since the revenues generated in a life insurance policy and the growth of the surrender value are non-taxable. This tax savings leads to a faster annual growth rate of the life insurance policy as opposed to other investment vehicles. Ultimately, the loans constitute a non-taxable liquidity source. Finally, because the death benefit is paid tax free to the estate, the estate will benefit from an increase in value. Again, the loans will be reimbursed from the death benefit.

The phases of this strategy are as follows: during the life of the policy owner, they purchase a permanent life insurance policy with a surrender value. During the accumulation phase, the surrender value and death benefit of the life insurance policy accumulate in a tax shelter. During retirement, a loan and guarantee agreement is established between a financial institution and the policyowner, where the life insurance policy serves as collateral and the insurer is not a stakeholder in the agreement.

Based on their unique needs, the policy owner selects the timing and amount of the loans, which are not taxable. In terms of the interest terms and conditions, the interest is generally capitalized. The policyowner, however, has the option to pay the interest or request reimbursement of the loans at any time in part or in full.

Upon the death of the policy owner, the agreement establishes that the loan is to be reimbursed by the estate, directly from the death benefit, with the remainder of the benefit going to the estate.

Like all good things, we must be aware of all the variables to consider with this strategy. We need to be mindful of the Income Tax Act and its interpretation by the tax authorities as it evolves and must be monitored on a regular basis. It's also important to note that interest paid or payable on amounts dedicated to personal expenses is not deductible. Also, the terms and conditions of a loan aren't determined when the strategy is initiated.

The policy owner must be eligible financially based on the criteria set out by the financial institution when the loan is issued. Further, the loan interest as well as the amount of preauthorized loan amounts can vary over time as set out by the institution.

One should also be aware that when compared to other investment strategies, opting for the surrender value may not be the best course of action. It's critical that the strategy matches both the policy owners' needs as well as their long term financial capacity.

There is also longevity risk with this strategy, in the event that the loan/surrender value ratio surpasses the long-term forecasts, the strategy will need to be reviewed. In such cases, the risk can be mitigated by paying interest to limit the loan growth, mortgaging additional benefits, reimbursing a portion of the loan, or making additional deposits to the life insurance policy.

As I mentioned, this strategy is not suitable for everyone, but it certainly would appeal to and benefit certain individuals and businesses. Please let me know if you wish to discuss further.

**The Executor's Year. It's Not Easy—**Continued

If a beneficiary brings a court application, a judge would consider how effectively and diligently the executor had administered the estate under the presumption that estate assets should be gathered, and legacies paid during the executors year. So it is important for an executor to act timely and understand that there is some personal liability to this role.

In many cases, executors are able to collect assets and pay debtors and beneficiaries in the first year without issue. This will probably be the case when a spouse is still alive to inherit the estate or, if there is no spouse, a proper estate plan has been created (I would argue that even with a spouse, a proper estate plan is a must!) However, on occasion, executor's run into delays which can frustrate beneficiaries and create potential legal problems.

Delay's typically occur within the estate administration which, according to Tom Junkin – senior VP of personal trusts services with Fiduciary Trust Canada, tends to take longer these days. There are a few reasons for this, for example, there can be a backlog of several months when trying to obtain a certificate of probate from the province.

An executor may also need to seek several probate certificates if the deceased owned property in more than one jurisdiction such as in Ontario and Florida. Executors also need to wait for clearance from the CRA stating that all tax liabilities have been paid before distributing assets. Executor's will certainly want to wait for this clearance since it removes all personal liability from the executor in the event that other liabilities arise and money has already been paid to the beneficiaries.

Other factors like new privacy legislation, having to wait for parties to make claim against the estate, and challenges against the will also slow the entire process down. In B.C. for example, executors are prohibited from making distributions until 210 days after the granting of probate, unless authorized by the court and agreed upon by the beneficiaries. So, you can see, that the entire process is peppered with speed bumps!

Delays in the distribution of the estate means some beneficiaries are entitled to interest, paid for by the estate, on the amount starting one year after death until they receive the gift. Even if the delay occurred outside of the control of the executor, interest is still paid. This rule only applies to individuals who were meant to receive a fixed amount from the will. A beneficiary who receives a share of the estate does not have access to this entitlement since residual beneficiaries would automatically receive any growth made in the estate during the executor's year. Beneficiaries receiving non-cash bequests such as land or publicly traded shares are not entitled to interest on their gifts, even if there is a delay.

There is a great deal of responsibility being named an executor of an estate. There can also be some personal liability, so it is always a good idea to plan ahead for such a role. Be mindful that most people are not professional estate trustees and they may need some professional guidance to successfully navigate an executor's year.

**Phil D'Iorio—**Continued

We have also repositioned the portfolios to be more resilient with an increased weighting in sectors that have higher earnings stability such as Consumer Staples and Healthcare. Furthermore, investor sentiment measures are very depressed and have reached levels seen at the height of the Great Financial Crisis in 2008-09 and the COVID pandemic in 2020.

Another reason that we are cautiously optimistic is related to stock market history. Based on historical data, once the S&P 500 has a 20% drawdown there is a strong likelihood of strong returns over the next 1, 3, and 5 years. As seen in the chart below, the S&P 500 has gained 16% on average over the next year and 13% annually over the next 3 and 5 years following a 20% drawdown.

| Start Date | End Date | Duration (Mo.) | Drawdown (Peak to Trough) |
|---|---|---|---|
| 10/25/1939 | 6/10/1940 | 8 Months | -32% |
| 11/7/1940 | 4/28/1942 | 18 Months | -34% |
| 5/29/1946 | 5/19/1947 | 12 Months | -28% |
| 6/15/1948 | 6/13/1949 | 12 Months | -21% |
| 8/2/1956 | 10/22/1957 | 15 Months | -22% |
| 12/12/1961 | 6/26/1962 | 7 Months | -28% |
| 2/9/1966 | 10/7/1966 | 8 Months | -22% |
| 11/29/1968 | 5/26/1970 | 18 Months | -36% |
| 1/11/1973 | 10/3/1974 | 21 Months | -48% |
| 11/28/1980 | 8/12/1982 | 21 Months | -27% |
| 8/25/1987 | 12/4/1987 | 3 Months | -34% |
| 7/16/1990 | 10/11/1990 | 3 Months | -20% |
| 3/24/2000 | 10/9/2002 | 31 Months | -49% |
| 10/9/2007 | 3/9/2009 | 17 Months | -57% |
| 2/19/2020 | 3/23/2020 | 1 Months | -34% |
| Average | | 13 Months | -33% |
| **Median** | | **12 Months** | **-32%** |

The 3-year and 5-year returns noted above are annualized returns. The rows shaded in grey are periods when the economy went into a recession.

But there is a caveat. Based on history there could be more downside in the short term. During the time under consideration, once the market dropped 20%, there was an average additional downside in the mid-teens percentage range. While another 10-15% downside in the market wouldn't feel very good, it must be viewed in the context of the cumulative 3-year and 5-year returns of 42% and 68% respectively for the S&P 500 following a 20% decline. At its low point on September 30th, the S&P 500 was down nearly 25% on a year-to-date basis. This is not too far off the average bear market decline of 33% noted in the table above. This leads us to believe that we are getting closer to a bottom. While 2022 has been a challenging year and our portfolio returns have not met our expectations, we believe that a significant amount of bad news has been priced into stocks. More importantly, we are very encouraged by how well our companies have performed in terms of growing their business with many of them gaining market share from competitors during a very challenging period. We believe this bodes well for future share price performance.

**Christian Deckert—**Continued

And we expected that they'd have good pricing power, but it has been even better than we expected because they haven't really been tested in the last 10 or 20 years and periods of lower inflation.

We don't simply aggressively add to the names that have sold off the most. As a rule of thumb, we don't typically double down because it's always a balance for us between having conviction in our investments and all of the analysis and research we've done, the conviction that these are good long-term investments, but balancing that with the humility and acknowledging that we could always be wrong. And that's a big part of our culture at Mawer—having that humility and recognizing that no matter how good your analysis is, the future's uncertain. You could have gotten something wrong, or a low probability risk could play out. And we need to acknowledge that. That said, we are looking for opportunities. Some of them are becoming too attractive to ignore, and we will be adding to some of them selectively.

**Navigating Inflation—Portfolio & Company Level:**

**Portfolio Level:** We insulate from inflation through equity duration. We conduct a discounted cash flow analysis on every company we own and thus can calculate an implied equity duration. If you look at some of our trading history—especially near the beginning of the year—we were looking to change the equity duration of the portfolio downward. Beyond that we've always had a philosophy of staying diversified. And not only does that mean being diversified across different economically sensitive variables, but it also means being diversified across the spectrum of duration. We think our portfolio was well structured for this environment. By and large, we've been relatively happy with the fundamental performance of the portfolio, perhaps slightly less happy with the equity value performance. But when we look at the fundamentals, overall they are very strong.

**Company Level:** inflation can be a positive for wealth-creating companies. As a wealth-creating company with a sustainable competitive advantage, when economic turmoil comes, these are the companies that tend to gain market share and perform better. Why? People have their preferred brands for products. However, sometimes when demand is high, that brand isn't available, but because that item is still needed a consumer might buy a company with weaker competitive advantages. When times are challenging, people tend to no longer need to buy from the more marginal producers. They would focus back on the core producers. And the companies we own tend to be core producers of products and services in their industries. Able to succeed in both environments.

These defensive holdings still benefit from sustainable competitive advantages thanks to their strong market positions, and yet trade at discounts to their intrinsic values. Novo Nordis for example – a Danish pharmaceutical company that specializes in diabetes treatments that has the ability to pass on higher costs to their customers. Other businesses like Essity, a Swedish hygiene and health company also have this ability.

**Our Forward Looking Mindset**

Whereas the risks may appear heavily one-sided, we have been focused on ensuring that our emotions stay balanced. Our philosophy and process orient us toward businesses that are enduring, that have the ability to exercise pricing power through the value propositions they provide to their customers, and that are run by able and honest managers. We have been revisiting our discounted cash flow models to ensure that they reflect the economic scenarios that many of these businesses may face (e.g., the potential for higher and more sustained labour costs or inventory levels).

**Andrew McCreath—**Continued

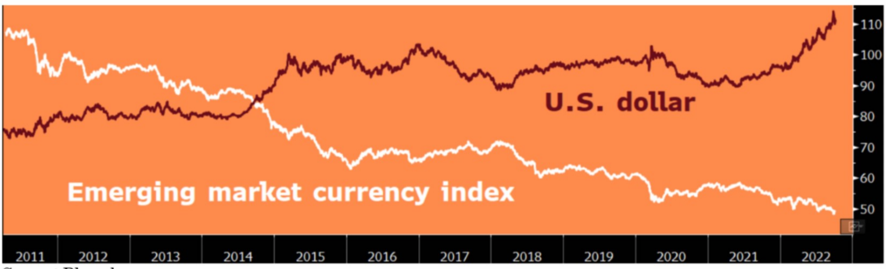
Perhaps even more startling, the Nasdaq-100 and long-term US Treasuries are both down by roughly 30% since the start of January and yields on U.S. 10-year bonds hit 4% for the first time since 2010.

In fact, the disorder we've seen year to date in markets, catalyzed by the regime change in monetary policy last fall, has now entered the arena of the absurd, given the Bank of England's recent moves to hike rates, boost their inflation forecast, yet pivot from QT to QE in an attempt to save the plummeting Pound.

The apparent intent of the European Union (EU) to follow through with both its physical embargo as well as its price cap on Russian oil will undoubtedly have a negative impact (we've seen a range of 0.6-1.5M/day) on global oil supplies. Last week, OPEC announced a 2M barrel reduction in daily quotas, which we surmise likely represents 1.2M barrels off the market as of the start of November. As for America's Strategic Petroleum Reserve ("SPR"), the current 180M barrel release (165M released so far as of last week) expires near the end of October.

As fiscal 2023 begins, it's true President Biden will have access to a further 70M barrels of future budgetary planned sales. Typically distributed over a two-year period, Biden does have flexibility on the timing of these releases plus the ability to release additional oil from the SPR as deemed "appropriate". Regardless, the bottom line is that despite pervasive and justified fears of a recession, the price of oil remains in steep backwardation; a telltale sign of a physical imbalance between supply and demand. We maintain the belief expressed in a commentary several months ago that during 2023, oil prices will average US$95 versus the current strip of US$80 for next year.

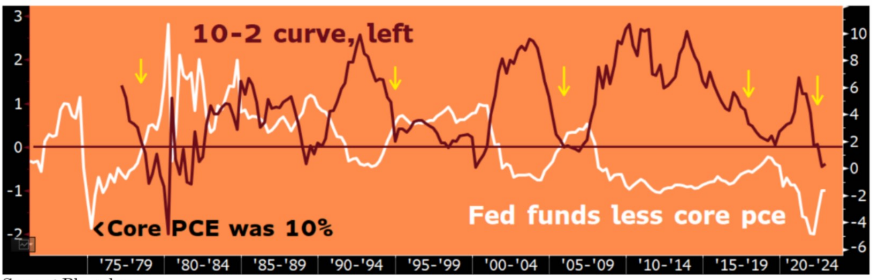
Beyond commodity-specific fundamentals, it strikes us that the recent intervention in currency markets is the start of another source of turbulence in markets. As a recent commentary illustrated the strength of the U.S. dollar against other G7 currencies, the white line on the 11-year graph below opts to highlight the J.P. Morgan Emerging Markets currency index, straight down to the right!




Source: Bloomberg

Unless the Fed backs off its most hawkish ever stance in a timely fashion, we anticipate a broadening in central bank intrusion in FX markets, actions that could ultimately represent a means to justify a higher tolerance towards inflation. Obviously, if our expectation that inflation will prove to be stickier is wrong, the perception that a Fed pivot is inevitable could prevent monetary authorities from repeating the same policy mistakes they've made during past cycles. Further, if by stroke of luck, China fully re-opened its economy and/or the war in Ukraine resolved itself in a timely fashion, it's possible financial markets could experience a gentler outcome. For now, we don't foresee either happening, hence the Long Short Alternative Fund has tactically adjusted its positioning to capture further upside from a market set-up that appears similar to the experience of the first several months of 2022.

Our view is that the Fed will proceed with the remainder of the rate hikes that have been communicated for 2022. These moves would lift the Fed Funds Rate to 4.25% by Christmas. Once we move into 2023, there's no question in our minds that the Wall Street-friendly Chairman of the Fed would love to stop hiking rates. It's true and logical that the Fed should consider taking a pause to see whether the historical 6 to12-month lag of monetary policy's impact on the economy will serve as the standard once again this cycle. Whether a pause is justified or not will depend on what's happening with inflation. In fact, it's your call on inflation that should dictate the positioning of your investment portfolio.




Source: Bloomberg

The 50-year graph above compares the Fed Funds Rate less the Core Personal Consumption Expenditures Price Index ("PCE") (white line, right axis) against the 10-2 Year Treasury Yield Curve (red line, left axis).

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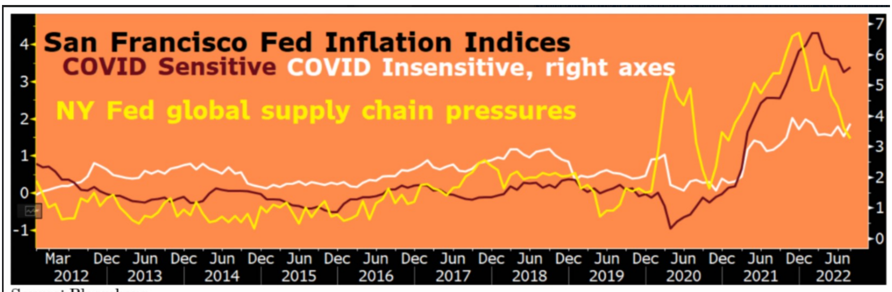
**Andrew McCreath—**Continued

The yellow arrow highlights periods when the curve is flattening or inverting and the Fed Funds Rate less the Core PCE is rising. Unless inflation recedes markedly in a timely fashion, this historical relationship is supportive of additional rate hikes by the Fed.

Is inflation going to march back down to the low 2s by late Spring of 2023? There's little question the law of large numbers will shortly begin to kick in, enabling inflation to march lower. We're not economists, but for several reasons our instinct remains that nine to 12 months from now, it will still be in the mid to high 3s. First, we believe energy prices will move higher from current levels. Assuming we're correct, the pricing trajectory of utilities is unlikely to abate plus, post a three to six-month lag, given the pervasive use of energy commodities, higher energy prices should catalyze a renewed push higher in economy-wide pricing.

Rents and food prices are likely to remain sticky into the second half of next year. Remember, rising rates hurts housing affordability, in turn increasing the demand for rental properties. Further, meetings our team has held with the senior management of grocery and restaurant chains have us thinking food prices will continue to climb by the high single digits into the back half of next year. It's true that labour markets are showing modest signs of loosening up, but at 5.0% in the U.S. and 5.6% in Canada, there's yet to be any slowdown in wage hikes.



Source: Bloomberg

Finally, the above graph helps us to understand the inflationary impact of the current state of supply chains. August is the last data point in the above 10-year graph, so perhaps September will have shown further improvement. The yellow line on the left axis is the NY Fed's Global Supply Chain Pressure Index (GSCPI), while the red and white lines on the right axis are the San Francisco (SF) Fed's price indices for COVID-Sensitive and Insensitive Contributions (products and services) to Inflation, respectively. Note how the COVID-insensitive index has flatlined at higher-than-historical levels for all of 2022. Further, the decline in the COVID-sensitive price index has markedly lagged the improvement seen in the supply chain index. Collectively, these factors explain why nine to 12 months from now, our hunch is that inflation will stay in the 3s vs. the targeted 2s, making it tougher for central bankers, especially since neither the Chinese, European, or North American consumers (U.S. savings rate now sits at just 3.5%) will fuel a resurgence in the economy during 2023.

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