Kleinburg PRIVATE WEALTH

Carte WEALTH MANAGEMENT INC.

KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 11, ISSUE 11 NOV 2022

"There is no reason that we can identify, to suggest a shift in fundamentals and as such fear should be taken advantage of." **- Eric Nuttall**

Sergio Simone
EDITORIAL COMMENT

Kristina De Souza, CFP
FASHION AND FINANCE

Ryan Simone, CFP, CLU, CHS
THE FALL OF STOCK VALUATIONS

EDITORIAL COMMENT

Sergio Simone

"Even if you know the Future, You don't know the Future".

I wish I could recall where I read this line, but it has stuck with me and has become quite appropriate recently.

I tend to focus my research on macroeconomic and geopolitical issues but there are periods of time where these issues need to take a back seat to more dominant micro-economic situations. I noticed this playing out recently when the markets were rallying despite earnings misses by some of the giant mega cap tech stocks.

FASHION AND FINANCE

Kristina De Souza, CFP

I recently came across a phenomenon that sparked my interest. Upon further research I learned that this is no spring chicken, it has been around formally for nearly a century, demonstrating once again that what's old is new again.

To shed light on this fascinating concept I am going to step slightly out of my realm of advice here and provide some insight on a different but seemingly related topic- fashion. I have learned that just like the economy, fashion is cyclical in nature. When it comes to new fashion trends, it is typically not the premiere of a certain trend but rather a revival of a previously existing one that takes place.

THE FALL OF STOCK VALUATIONS

Ryan Simone,
CFP, CLU, CHS

The big buzz word these days is inflation. Taking out a line of credit to feed a family of 4 ... inflation. Monthly gas budget equivalent to launching a space rocket in 1990 … inflation. Stock portfolio in the dumps … inflation.

It's no secret that investors are feeling like they're already deep into a market recession. Most of the major indexes are in negative double-digit territory with wild swings happening daily. Sure, the economy hasn't quite caught up yet but even the government is talking about the likelihood for a 2023 economic recession.

When the feds started raising interest rates in an attempt to lower inflation, stock valuations began their steep decline. Alternatively, the impact of rate hikes on the economy remains to be seen (although that should be happening within the next few months).

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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

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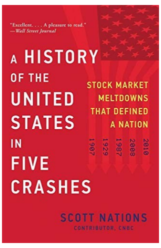
BOOK OF THE MONTH



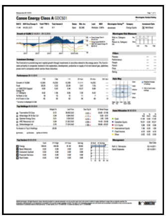
A HISTORY OF THE UNITED STATES IN FIVE CRASHES

- by Scott Nations

In this absorbing, smart, and accessible blend of economic and cultural history, Scott Nations, a longtime trader, financial engineer, and CNBC contributor, takes us on a journey through the five significant stock market crashes in the past century to reveal how they defined the United States today

The stories behind the great crashes are filled with drama, human foibles, and heroic rescues. Taken together they tell the larger story of a nation reaching enormous heights of financial power while experiencing precipitous dips that alter and reset a market where millions of Americans invest their savings.

FUND OF THE MONTH



DYNAMIC CREDIT ABSOLUTE RETURN II FUND

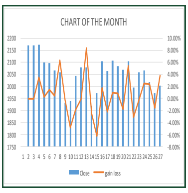
Access to an alternative portfolio strategy that invests in diversified long and short positions of North American credit securities. The fund has the flexibility to use leverage to potentially enhance total returns while maintaining an investment grade credit rating.

There is low exposure to interest rate risk and a low correlation to traditional asset classes. The fund also has the ability to generate returns throughout a complete credit cycle.

Political Calculations

DIVIDENDS BY THE NUMBERS IN OCTOBER 2022 SEND RECESSIONARY SIGNAL

CHART OF THE MONTH



The number of U.S. firms either increasing or decreasing their dividends in any given month can tell us about the developing state of the U.S. economy. In October 2022, the number of announced dividend reductions sent a clear signal the U.S. economy is experiencing recessionary conditions.

TECH PARKAS

BLOG OF THE MONTH

CURRENT CONSUMER SPENDING IS UNSUSTAINABLE

The strength of the consumer balance sheet is commonly cited as a reason to expect continued strong corporate earnings and persistently high inflation. While consumer savings remain high, they are falling rapidly, as is debt rising. Consumers are spending beyond their means and at some point in the near future spending will fall significantly. When this occurs, a negative feedback loop between consumer spending and employment is likely to occur. This situation is likely to be exacerbated by the rapid rise in interest rates that has brought asset prices down.

The post-pandemic economy has created an unusual situation where consumer confidence is at extremely low levels despite a strong economy. People are also becoming more pessimistic about conditions, with inflation a key concern, although younger generations are less worried about inflation. Consumer confidence is generally highly correlated with inflation, but even after adjusting for current levels of inflation, consumer sentiment is at levels typically associated with recessions.

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

NATIONAL BANK

WHAT ARE THE BENEFITS OF A FAMILY TRUST?

Setting up a family trust could help you reduce your tax burden, plan how to transfer your wealth, protect your assets, and provide for the next generation. This is particularly true for business owners. Read on to find out if a family trust is a good option for you.

breeze.

INSURANCE FOR HIGH-NET-WORTH– INDIVIDUALS (HNWIs), EXPLAINED

Conservative estimates put the number of high-net-worth individuals (HNWIs) — people with financial assets worth at least $1 million — in the United States at over 6 million. In addition to staying on top of the tax laws and preserving as much of their wealth as possible, HNWIs have another area of their financial world that is unique to them — insurance. The average American family buys insurance to protect their assets, such as their home and auto. But an HNWI, in addition to also needing to protect these, has some exclusive personal property that they need to insure correctly. That said, let's take a closer look at the various types of insurance high-net-worth individuals need to have:

Morgan Stanley

FALL PLANNING FOR YOUR FINANCES

The end of the year is a good time to revisit your investment strategy and asset allocation to help ensure your portfolio is still apportioned among stocks, fixed income, cash and other asset classes in a way that fits your goals and risk tolerance. In periods of uncertainty, active management strategies, where portfolio managers aim to identify potential outperformers and manage risk, may outperform passive investment strategies that track an index. (An investment cannot be made directly in a market index.)

Investopedia

PROBLEMS ULTRA-HIGH-NET-WORTH INDIVIDUALS FACE

In a climate of growing income inequality, where the rich are amassing wealth at unprecedented levels while record numbers of everyday citizens live paycheck to paycheck, it may not seem like ultra-high-net-worth individuals (UHNWIs) have much to worry about. While it takes a special kind of financial irresponsibility for a person with that kind of wealth to develop the kinds of money troubles that plague the rest of society—think bankruptcy, foreclosure, or garnishment of wages—the ultra-wealthy deal with their own unique brand of financial problems.

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CORPORATE CULTURE

Kiplinger

HOW BUSINESS OWNERS SHOULD INVEST DIFFERENTLY

As a business owner, you often face a very different set of financial risks than your non-business-owning counterparts. When it comes to investing, there are two major considerations you'll need to remember. First, keep your powder dry. This is an old seaman's term that I like to use when describing the need to keep enough cash in your personal and business finances to weather life's storms.

The other consideration is that you likely have heavy concentration risk. In other words, most of your net worth is tied up in your business. For the purposes of this article, let's assume that you have enough dry powder. Let's also assume you're like the majority of business owners and you're dealing with concentration risk.

THE GLOBE AND MAIL

WHY YOU NEED TO ATTRACT A MULTIGENERATIONAL WORKFORCE—AND HOW TO DO IT

Many Canadian workplaces now span four or even five generations, making it one of the most multigenerational workforces on record, and cementing age as a key component of diversity in the workplace. "The share of workers over age 55 doubled over the last 20 years; that's a major shift," says Indeed senior economist Brendon Bernard. "Part of the story of the rising share of older workers in the labour force is purely demographics, but we also see rising employment rates among older workers, and there are a few reasons for that."

CFIB
CANADIAN FEDERATION OF INDEPENDENT BUSINESS
In business for your business.

EXIT OPTIONS: PASSING TO FAMILY, MANAGEMENT BUY-OUT, AND SELLING TO A THIRD PARTY

Every business situation is unique, which means there is no cookie-cutter way to exit your business. You need to consider both the future of the business, and your own future as you move into retirement or onto new challenges.

One of the most important considerations is retaining legal and financial advisors who have the experience and wisdom not only to present the company to the market, but to lead it to a successful sale. Your legal advisor is particularly valuable in protecting your interests within the intricate language usually found on the purchase and sale agreement.

CEOWORLD Magazine

WHY IT PAYS TO LISTEN TO B2B CUSTOMERS

Listen to your B2B customers and you'll hear something amazing: the keys to your true competitive advantages. That's the power that comes from a type of deep qualitative research called Voice of Customer (VOC).

Often used to undercover early warning signs of customer dissatisfaction, we find VOC research can be used beyond risk mitigation to guide meaningful change such as improved positioning and brand strategy, product enhancements, and even surprising new market opportunities.

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FUND MANAGER COMMENTARY

PHIL TALLER
MACKENZIE GROWTH TEAM

SEBASTIEN MC MAHON
IIA CLARINGTON

KEVIN McCREADIE
AGF INVESTMENTS INC

TOBY GIBB
FIDELITY INTERNATIONAL

Phil Taller, Sr. V.P., Portfolio Manager, Head of Growth Team

Mawer Investment Management

Portfolio Manager Monthly Insights

The future is uncertain, but there may be increased investments in communications, Cloud and public infrastructure, security, data analytics, regional supply chains in many industries, pharmaceutical and medical technology research, the Internet of Things, automation and robotics, and online services and commerce.

Sebastien Mc Mahon, Chief Strategist and Senior Economist

IA Clarington Financial Group

Stock Market Rally: Mirage or Reality?

It's always before dawn that night is the darkest. Investors have been experiencing dark times since the beginning of the year. The stock and bonds markets are currently failing. Why are we in this situation?

Kevin McCreadie, CEO and Chief Investment Officer

AGF Investments Inc.

Are Investors Through the Worst of it Yet?

Equity markets are rallying again, but more time and more positive data may still be needed to put this year's bear market behind us for good, says AGF's CEO and Chief Investment Officer.

Toby Gibb, Global Head, Investment Directing

Fidelity International

No Major Frights This Halloween

Overall, global equity markets performed well last month, with sentiment among some central banks becoming less hawkish, with many hopeful that policymakers would start to loosen monetary policy. The European Central Bank (ECB) raised interest rates to 2% (up 75bps) but announced that it was removing forward guidance, whilst declaring that the Governing Council had made "substantial progress" towards withdrawing policy accommodation.

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LINKS

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FED MAKES ANOTHER BIG RATE INCREASE, KEEPS OPTIONS OPEN FOR NEXT MOVES	5 SURVIVAL TIPS FOR THE BEAR MARKET	UNEMPLOYMENT SURGES ABOVE EXPECTATIONS AS THE NUMBER OF JOBLESS AMERICANS RISES
THE FUTURE OF CRYPTOCURRENCY: 8 EXPERTS SHARE PREDICTIONS FOR THE SECOND HALF OF 2022	OCTOBER INFLATION REPORT. PRICE PRESSURES SHOW SIGNS OF COOLING	NEW TAXATION FORMULA FOR ETFs TO TAKE EFFECT THIS YEAR
NAVIGATING THE ECONOMIC STORM	Q4 2022 GLOBAL MARKET OUTLOOK	ASSET CLASS PREFERENCES

Goldman Sachs | Asset Management

RATES ARE A'CHANGIN'

Last week, the Fed approved a 75 bps hike, driving interest rates to their highest level since 2008. Though rates have risen sharply, G10 hiking cycles lasted just over 15 months on average. When they do end, relatively large cuts tend to arrive

FRANKLIN TEMPLETON INVESTMENTS

EMERGING MARKETS IN NOVEMBER—LATIN AMERICA CONTINUES TO SHINE

Markets in Latin America have been the best performer in emerging markets (EMs) year-to-date, driven by the rise in the energy sector, which has posted double-digit returns. Looking ahead, Luiz Inácio Lula da Silva's successful run for a third term as president of Brazil, in combination with his party's lack of control of either House of Congress, imply that there are checks and balances in place to act as fiscal constraint. Additionally, recent reforms imply the risk of a repeat of past interference in the management of government-controlled companies has diminished. We remain positive on the outlook for equity markets in Brazil and Latin America.

VIDEO AND PODCAST LINKS

HOW WE GOT THE HIGHEST INFLATION IN 40 YEARS	THIS MIDTERM ELECTION OUTCOME IS 'TYPICALLY GOOD FOR MARKETS': WHAT INVESTORS CAN EXPECT	GOLDMAN SACHS EXPECTS "SIGNIFICANT" DECLINE IN U.S. INFLATION IN 2023

FINANCIAL CALCULATORS

INVESTMENT GROWTH CALCULATOR	FIDELITY myPLAN SNAPSHOT	RRSP SAVINGS CALCULATOR
Find out how much your savings will grow over time by making regular investments	The Fidelity **myPlan** Snapshot enables you to get a glimpse into your retirement finances in seconds.	Estimate how much your registered retirement savings plan will be worth at retirement

EDITORIAL COMMENT - CONTINUED

It wasn't that long ago that these tech corporations operated in comfort knowing that the Fed had their back. They even coined a term for this, "The Fed Put". This is a play on the option term "put" and is the market belief that the Fed would step in and implement policies to limit the stock market's decline beyond a certain threshold. For years this seemed to be the case, leaving investors with a serious sense of misplaced comfort.

This was the panacea that gave investors the motivation to keep investing, especially when the market fell back, and prices became cheaper.

As I write this, the World Series is tied at two games and I thought it would be appropriate to commemorate this by quoting immortal Yankees catcher, Yogi Berra**, "if the world were perfect, it wouldn't be",** and just when we thought the investment world was perfect, it wasn't.

Inflation became an issue, and the Fed decided it could no longer support the markets with their Fed Put. With the Put removed, and the Fed on the warpath to control inflation with a rate hiking spree, many of the high-flying tech stocks have fallen ungraciously back to earth.

Recently, almost every conversation I have had with investors or potential investors inevitably leads to questions about my thoughts on where the markets are going. To shamelessly use another Yogi Berra quote, **"It's tough to make predictions, especially about the future."**

I do not have a crystal ball, and any forecast I have ever made is based on research, guestimates and experience and still they are only my opinions. What I can state with certainty is that I have no fear of bear markets or recessions. For me, they are a necessary evil. In fact, I am convinced that they serve a very valuable purpose, which is to "take the trash out", so to speak.

During periods of time where there seems to be an endless supply of free money and zero interest rates, many businesses that normally would have no right to be operating, find themselves in a situation were investors are begging these businesses to take their investment dollars. But eventually, sanity and common-sense re-enter the marketplace and these risky ventures find themselves floating without a paddle, or as the inimitable Warren Buffett said, **"it's only when the tide goes out that you learn who has been swimming naked."** Well, today, the tide has gone way out and there are a lot of businesses that have been caught swimming naked, and this, in a nutshell is why the markets are down year-to-date.

It wasn't that long ago that investors believed the stratospheric valuations attached to certain companies was quite appropriate. This reminds me of a term used by former Fed Chair Alan Greenspan in 1996. He called it **"irrational exuberance".** The result of irrational exuberance is that markets tend to overcorrect when they turn negative and ultimately fall far below their intrinsic value. I refer to this as the "Elastic Band" theory. You stretch that elastic band so far one way, that when it is released, it goes too far the other way, but eventually it settles at its mean.

Another term I frequently use with my clients is that ***"we do not attempt to be the first at the party but will eventually arrive."*** So, when we experience these extremely volatile times it is often better to wait until after the news is out and the dust has settled. The bottom line is that there is plenty of time to get to that party. Remember, investing is a marathon, not a sprint.

So, back to my original quote: "Even if you know the future, you don't know the future". As convoluted as this saying sounds, it does make a lot of sense. For example, it is no secret that forecasters and pundits have been predicting that interest rates were going to rise since early this year. A general rule of thumb is that Fed rate cuts tend to cause the market to rise and Fed rate hikes cause the markets to fall but, there is no guarantee as to how the market will react to any given cut or hike.

According to Dow Jones Market Data, the first four rate hikes in 2022 resulted in the following index returns: March 16, +2.2%; May 4, +3%; June 15, +1.5% and July 27, +2.6%.

The bottom line is that even if you are fortunate enough to know what is going to happen, you cannot know how the market will react to what is going to happen. For this reason alone there are two rules I follow. Rule #1, If you are currently in the market, stay in the market. Rule #2, If you want to get into the market during volatile times, do it slowly by dollar cost averaging. Don't try and time the market based on certain upcoming events.

If you know my investment philosophy, you know that I am an optimistic contrarian at heart. With the market down as much as it has been, I have been slowly increasing my exposure to equities. We are in a time of high uncertainty and volatility, so my response is to take my time building positions slowly. .

EDITORIAL COMMENT - CONTINUED

I always have my eye on the long-term, but it does not mean that I shouldn't take advantage of short-term anomalies.

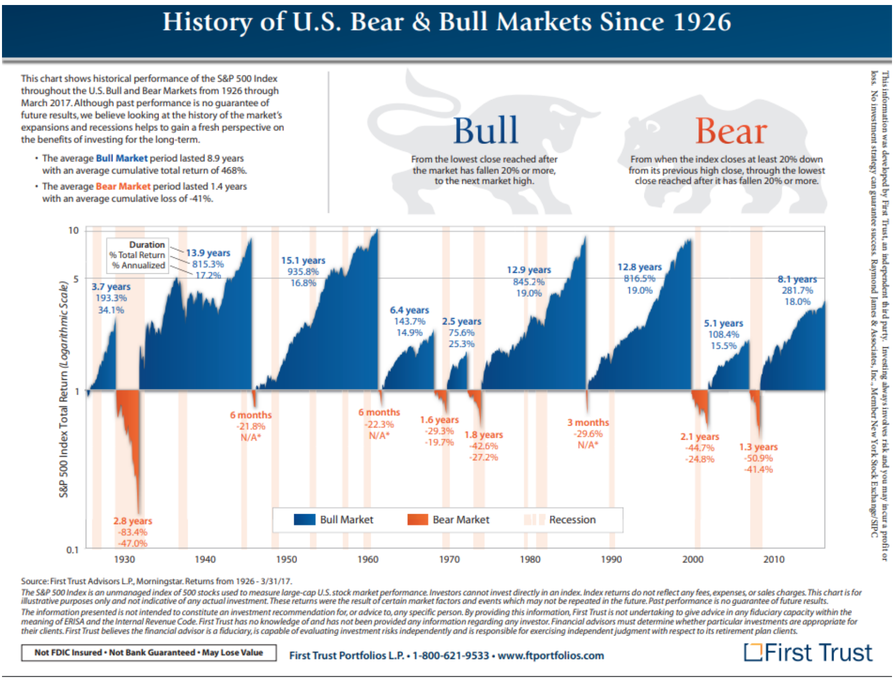
Since an understanding of probabilities is important in the investment industry, I'd like to share one that has proved successful since the beginning of time. **"The odds ALWAYS favour the Bulls".**

The reason this adage holds true is that it has been historically more advantageous to be a bull for long-term investors. By being a bull, I do not have to endure the risk of getting the market wrong.

According to Steven Check, president of Check Capital Management in Costa Mesa, California, the Number One mistake that investors make is sell when the market drops. It is easy to understand why some investors panic sell when assets decline, but many regret the move once the market recovers, and it always recovers. Check states **"the biggest mistake is thinking you're going to get out low and buy in lower."** He continues to say, "Money is an emotional thing, but you have to remember the stock market has done well over time."

Another mistake investors tend to make in volatile markets is to curtail their investing. A recent survey from Allianz Life concluded that 65% of investors are keeping "more money than they should" out of the stock market because they are afraid of losses. Unfortunately these investors are more focused on what they could **potentially** lose on paper than the opportunities they pass by that were never capitalized on.

The following chart is the primary reason I am an optimistic bull.



It is important to note that since 1926 the average Bull Market lasted 8.9 years with an average cumulative total return of 468% while the average Bear Market lasted only 1.4 years with an average cumulative loss of –41%.

The only conclusion I can arrive at is that the probability of being a successful investor is greater by staying invested than by not.

I'd like to conclude with a couple more Yogisms:

"If you don't know where you're going you might not get there".

I believe this is Yogi's way of saying that having a plan and sticking to it is essential in achieving it.

And finally, I do not believe the last quote requires any explanation.

"There are some people who, if they don't already know, you can't tell 'em".

Fashion And Finance —Continued

There are many factors at play that cause fashion to cycle, such as politics, celebrity influence, and cultural trends. But the influential factor that naturally stands out the most to me is the state of the global economy. Practically speaking, when money is tight, it makes perfect sense that fashion would be high on the list of indulgences consumers sacrifice to save money. Trendiness becomes less of a concern than thriftiness.

Although you, like me, may only be hearing about this for the first time, I assure you this line of thinking is nothing new. Back in the 1920's, economist George Taylor was the first to note the correlation between fashion and the economy; and developed the "Hemline Theory" accordingly. When things were good, he noticed hemlines became shorter as a way for women to showcase their silk stockings. Alternatively, once the financial market crashed, longer skirts became the norm. It's been suggested that this came to be because women could no longer afford the silk stockings.

Economists argue that the cost and availability of fabrics have historically affected the hemline of skirts, supporting this premise. In boom times, when producers typically charge more for their yarn or textiles, designers would make skirts shorter to cut costs. However, skirt lengths do not act alone, and are seemingly not the only indicator. There also exists the idea that the height of heels provides hints as to the state of the economy. An interesting argument is that during an economic downturn, the height of heels increases, as consumers turn to more extravagant fashion as a means of fantasy and escape. As such, in 2009 during the peak of the recession, the median height of heels reached 7 inches, the highest on record.

Then there is the concept that caught my attention recently and is the premise for this article. Within the category of beauty, allegedly it is lipstick that is the leading indicator, and is referred to as the Lipstick Effect or the Lipstick Index. It was first conceived by economics and sociology Professor Juliet Schor in her 1998 book **The Overspent American.** She found when money is tight, women would splurge on luxury brand lipsticks that are used in public and forego higher-priced beauty products that are applied in the privacy of home, such as facial cleansers and eye makeup. Her argument was that women ***"are looking for affordable luxury, the thrill of buying in an expensive department store, indulging in a fantasy of beauty and sexiness, buying 'hope in a bottle.' Cosmetics are an escape from an otherwise drab everyday existence".***

It was the chairman of Estee Lauder, Leonard Lauder, who stood behind this theory that the sale of **"cheap thrills"** are indicative of the state of the economy. He argued that during economic downturns you'd see minor splurges, such as lipstick, increase in sales as more expensive indulgences become unattainable. The basis of this argument is that in times of a recession and other economic pressures, women will indulge in discretionary purchases that provide an emotional uplift without breaking the budget. Lipstick fits the bill based on its ability to provide a relatively affordable, immediate, and profound beauty transformation. In 2001, he supplied anecdotal evidence of the lipstick effect when he reported his company saw a spike in lipstick sales after the 9/11 terrorist attacks, and again after the recession of 2008.

Since its inception, several research studies have lent further credence to the lipstick effect theory. With that said, it has not come without its critics; who suggest it has lost steam over time and no longer holds as much sway in the current economy.

In one academic study led by Texas Christian University professors, the researchers adopted the broadest definition of the lipstick effect to include all beauty products, as opposed to focusing exclusively on lipstick. Beauty products were defined as cosmetic products that enhance a woman's physical appearance. Through a series of experiments, the findings were consistent, and it was concluded that: Economists have established that recessions are reliably associated with increased spending on two types of products: traditional inferior goods (because of budgetary constraints) and morale boosters.

Although the lipstick effect has garnered some circumstantial validity, their research suggests that women's spending on beauty products may be the third indicator of economic recessions, one that may be rooted in psychology. Critics also argue that fashion used to be much more of an indicator of economic trends. That's because these days, there are so many different types of clothing that any particular trend in fashion doesn't necessarily point to a direction for the economy. The wide availability of different fabrics and inexpensive manufacturing techniques enable designers to offer something to suit shopper's unique tastes. Consumers today have more fashion choices than ever before and can express their individuality regardless of what the trends are.

Although some argue that fashion as it relates to finance is a thing of the past, the stats beg to differ, and certain theories hold strong. During the pandemic, when everyone was hidden behind their face masks, makeup sales plunged but fragrances experienced unprecedented growth. In the absence of being able to wear lipstick, it appears consumers instead flocked to fragrances. Now as things are returning to normal, women are once again indulging in the power of lipstick.

Fashion And Finance —Continued

As 2022 has (un)welcomed a record 40-year high for inflation, the phenomenon is in full swing. As of June, it was reported that lipstick and other lip makeup grew nearly 50% year-over year in the first quarter, which is reportedly twice as fast as other beauty categories. Lipstick sales continue to grow week-by-week with prestigious brands taking a bigger share of sales than the mass-market brands, and brighter, more dramatic colors being the more popular look this year.

Time and time again the data backs up lipstick's recession-proof quality. Further to this, the online monthly lipstick items that have completely sold out has consistently outpaced last year. Lipstick sell outs in 2022 are up 7% year over year and prices haven't budged, with an average cost of $24 in the USA (same as 2021). However, while the price of lipstick hasn't moved, it's important to note that the beauty industry isn't immune from inflation. Higher production and shipping costs have led several big-name cosmetic companies to announce price hikes. The beauty categories that have been affected the most include, haircare and toiletries, while bath & body and makeup products have experienced the lowest year over year change.

It's been suggested that despite the last few years of chaos, the cost-of-living crisis shouldn't eliminate consumers' desire to treat themselves. However, as inflation persists, it will be up to beauty retailers to develop sound strategies to remain competitive and protect their bottom line.

We've learned that the economic indicator, also known as the Lipstick Index, describes the behavior pattern of consumers purchasing small indulgences during times of financial stress to uplift their mood. Thus, if we consider all this information in combination with the most recent fashion trends, we may gain some insight into the current state and projected future of the economy. It has been suggested that 2021's "ugly sandal" trend (i.e., Birkenstocks and slides) is still going strong and, according to this theory, suggests we're pulling further out of the financial crisis. The rationale is that the flat sole and general unattractiveness of these shoes indicate we; have a sufficiently expansive footwear collection that allows us to include an ugly pair, and we are willing to spend money on riskier fashions.

The 2022 Winter Fashion Week further supported this positive economic projection, as leading trends included fur, leather, sequins and glitter, which are a sign the consumer is not only willing to binge on luxury but is also looking to stand out. The prominence of sequins and glitter is particularly significant: during periods of economic growth, flashy styles dominate as consumers want to show off their wealth, whereas during periods of recession, it's an indiscretion to advertise extravagant spending.

The less practical the trends are, the higher the probability money is flowing freely. It's important to remember fashion is still an industry, and therefore, is heavily influenced by our economy. So, take it with a grain of salt, or leave it, but I'll be slipping on my sequined boots heading into this winter as we stroll towards better economic times ahead.

Although some argue that fashion as it relates to finance is a thing of the past, the stats beg to differ, and certain theories hold strong. During the pandemic, when everyone was hidden behind their face masks, makeup sales plunged but fragrances experienced unprecedented growth. In the absence of being able to wear lipstick, it appears consumers instead flocked to fragrances. Now as things are returning to normal, women are once again indulging in the power of lipstick.

The Fall Of Stock Valuations—Continued

This is because it takes about 6 months to see the effect a rate hike will have on economic activity and it has only been about 5 months since the first rate hikes took place. In any case, the stock markets are forward-looking and different than the economy, and thus reacted more swiftly to higher interest rates.

So why do stock valuations decrease as interest rates increase? The 10-year US Treasury yield (aka interest rates) jumped from 1.51% to 4.05% this year. Over the same period, the forward price/earnings ratio of S&P 500 stocks fell from 22.3x to 16.7x – a 25% decline!

If you're confused about what the heck a P/E ratio is, here's a technical definition:

The P/E ratio is a way to put measurable value on a company by comparing the company's current share price relative to its earnings per share. In other words, how much are you paying for a share and how much money will that share pay you back?

In the most simple terms, a P/E ratio helps stock pickers determine if a company is overvalued, undervalued or fairly valued. Higher interest rates can reduce a company's profitability so a company that is considered fairly valued before rising rates, may start to appear overvalued in a rising rate environment. In other words, that 22x valuation would drop to 16.7x since each share is less profitable. The result would be lower valuations, which is what we've been seeing this year in the stock market. Growth stocks have been hit particularly hard since these are companies with larger cash flows projected to occur further out in the future. Tech companies are a good example. In fact, as a category, growth stocks are at a 70-year valuation low right now. This should be considered a generational occurrence, meaning most of us probably won't see a decline like this again in our lifetimes. For an investor with an investing time horizon of 5 or more years, this could be a huge money-making opportunity.

Stock valuations are down, but how much further will they go? It's a difficult question to answer, so let's look at both sides. First, it could go lower because a company's P/E ratio is determined by both its share price and earnings per share. One could argue that earnings forecasts haven't come down enough to reflect the challenges businesses will face in 2023 in an economic recession. Moreover, there is still a lot of uncertainty around inflation, interest rates and growth. This uncertainty makes for the additional risk that share price declines and current valuations don't yet reflect a worsening situation.

However, a second scenario suggests that valuations won't fall much further from here. Going back to 1978 and looking at the relationship between interest rates and equity valuations, a clear pattern emerges: in most periods, when yields were between 4%-6% (they are at 4.05% right now), P/E ratios didn't fall much below 15x (they are at 16.7x right now). The only time P/E ratios fell significantly below 15x was when rates exceeded 8%. The one exception was the Global Financial Crisis in 2008 when a deep recession prompted both low rates and low P/Es – a very different situation than we are experiencing right now.

If the past can offer some glimpse into the future, it appears that we want two key things to happen to keep valuations from plummeting further. First, we want interest rates to stay below 8% (they are at 4.05% right now). And for interest rates to stay low, we need inflation to come down again, so look for that to happen in the next few months. Second, we want a shallow economic downturn in 2023 with modest damage to corporate earnings; for example, a 14%-15% decline in corporate profits versus what was experienced in 2008 and the late 90s (57% decline in '08 and 32% decline in the 90s tech crash). If you believe that these two things will happen, then you are in the camp that believes declining stock valuations have hit near bottom.

Although inflation has been the big buzz word of late, no doubt the buzz word around money managers and active traders is stock price valuation. Managers that have been sitting on cash will be analyzing profitability of companies and deciding when will be the right time to buy. In fact, we've been seeing many of those managers adding positions to their portfolios of late. The point is, we don't know how cheap things will get, we just know that there is a sale on right now across multiple asset classes – that most asset classes are cheaper than they were two years ago. And if you are of the belief that growth will still occur over the long term, then you can probably recognize that we're heading into some interesting money making opportunities.

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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).

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Andrew McCreath—Continued

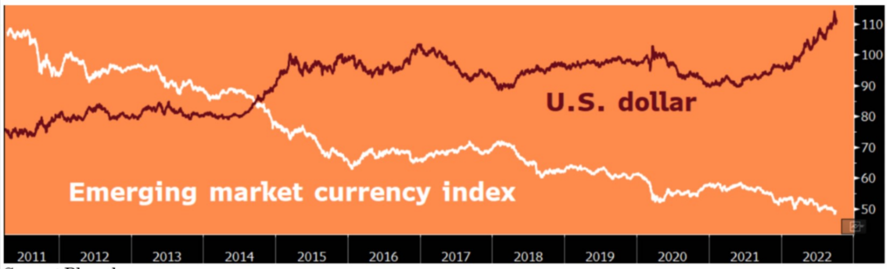
Perhaps even more startling, the Nasdaq-100 and long-term US Treasuries are both down by roughly 30% since the start of January and yields on U.S. 10-year bonds hit 4% for the first time since 2010.

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.

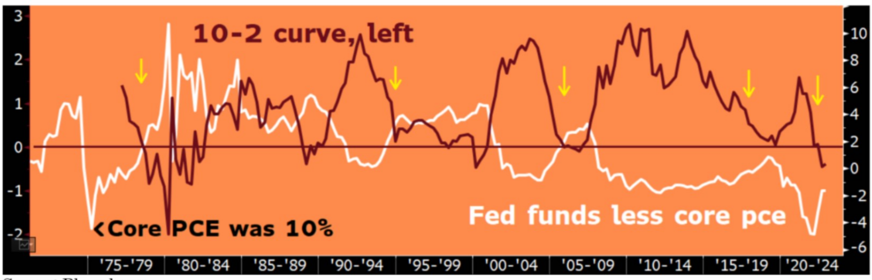
Beyond commodity-specific fundamentals, it strikes us that the recent intervention in currency markets is the start of another source of turbulence in markets. As a recent commentary illustrated the strength of the U.S. dollar against other G7 currencies, the white line on the 11-year graph below opts 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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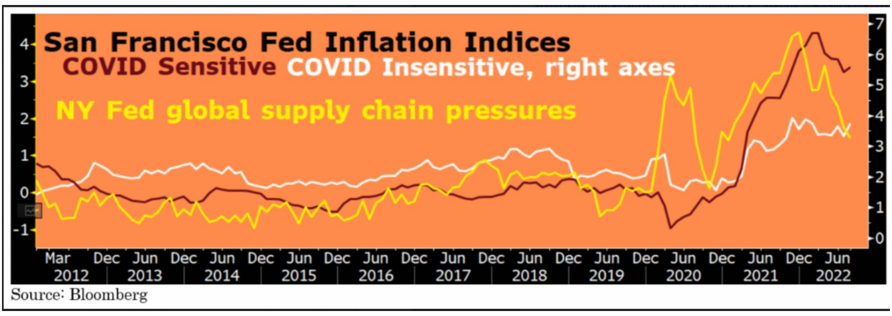
Andrew McCreath—Continued

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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