WATERMARK PRIVATE PORTFOLIOS AUGUST 2022 COMMENTARY

After being up almost 5% into mid-August, stock markets rolled over later in the month as inflationary pressures persist (primarily in Europe and notably Germany) leading to a continuation of restrictive monetary policy. At the recent central bank conference in Jackson Hole, the communication coming out was that central banks will be taking away the punch bowl and continue with their aggressive stance to curb higher inflation. Subsequently, markets responded with the S&P500 falling quickly and ending the month down 1.3% (in CAD), while the TSX Composite ended August with a drop of 0.8%.

The bond market continues to respond to inflation before stocks, as interest rates drifted higher all month and bond prices moving lower before stocks. The result was another poor month for the Canadian Universe Bond Index as it fell 2.4% during the month. Once again, the traditional 60/40 balanced portfolio was hurt on both the growth side (equities) and the defensive side (bonds). Therefore, we continue to diversify into other asset classes, such as private real estate, private debt, and private equity, that large endowments have used for decades to achieve better risk-adjusted returns.

Markets

Stock markets started the month well, moving higher until the S&P500 closed right below the closely watched 200-day moving average, which is the average price the S&P500 has traded at over the last 200 days. The S&P500 broke below the 200-day moving average in April, and now that it re-tested the average and failed to move back above it, the market will likely continue to move lower from here. Furthermore, the slope of the S&P500's 200-day moving average has turned down, which typically signals more pain ahead, see the blue line below:

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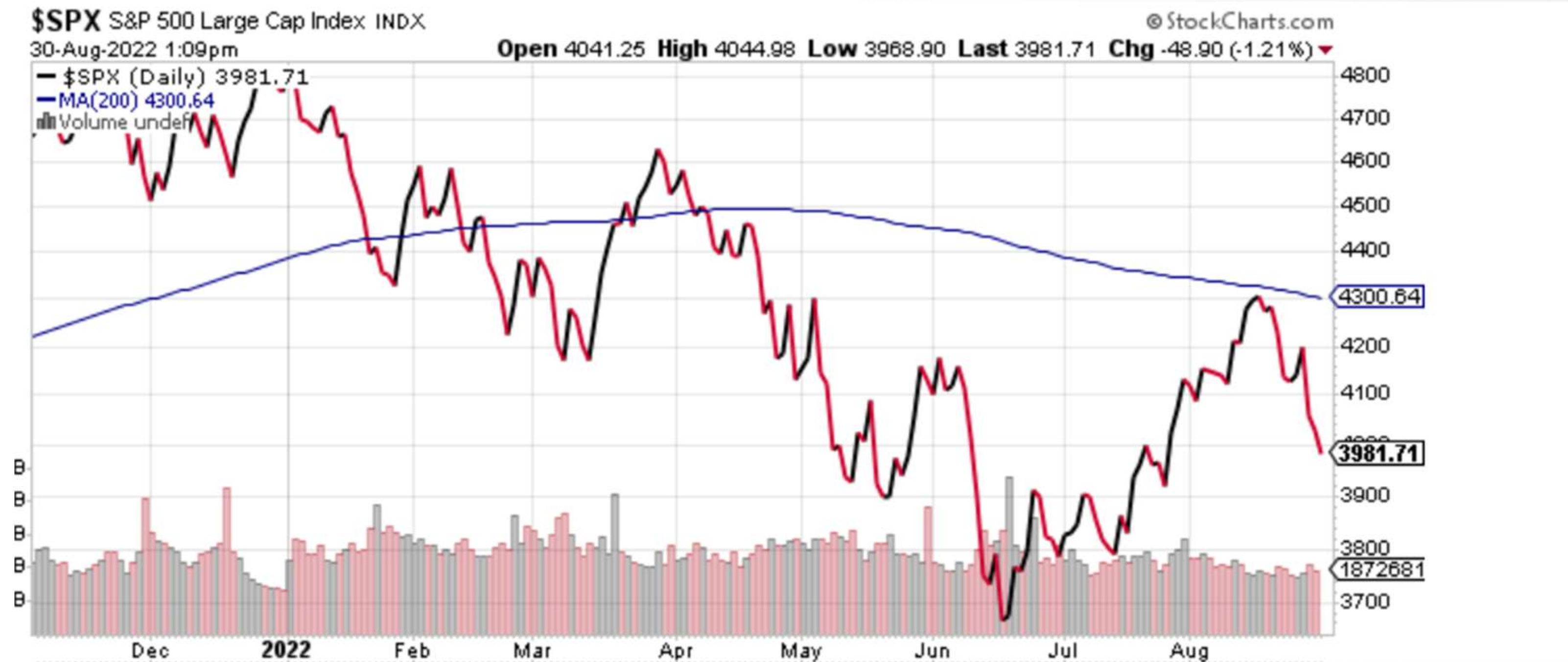

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Further providing head winds to markets is a US Dollar (USD) that continues to appreciate, which hurts foreign countries as a large portion of global debt is denominated in USD. With the US Federal Reserve communicating that they will continue to be tough on inflation while increasing the reduction of their bond holdings in September, the USD continues to move higher against its two main counterparties, the Euro and the Japanese Yen:

1. The European Central bank is trapped because if it raises rates too aggressively then high debtor nations of Greece, Italy, and Portugal could default but with Russia limiting gas exports, energy inflation is through the roof and hurting German industry.
2. The Bank of Japan, suffering from years of deflation, has capped its interest rates, not allowing interest rates to rise above 0.5%, causing money to flow out of Japan as investors seek higher rates.

This leaves us with two large headwinds: the US Federal Reserve providing restrictive monetary policy to reduce inflation and the subsequent rise in the USD that the restrictive policy is fueling. With both economic headwinds and a poor technical trading set-up, we continue to position the portfolios defensively. In our larger portfolios, we sold both equity ETFs that we bought in July for small gains, putting those proceeds into a short position on the S&P500, a liquid alternative that attempts to provide positive returns, and increased our cash position. We continue to watch the actions of the central banks, movements in the US dollar, and longer-term US interest rates for guidance on where stocks are going.

Once again, rest assured that if markets continue to fall, we have measures in place to protect the portfolios. In addition, the private real estate pool, which focuses on income-producing assets such as apartments, student housing, storage units, and senior housing, continues to see increased rents in this inflationary environment, partially offsetting losses from stocks.

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