WATERMARK PRIVATE PORTFOLIOS JANUARY 2022 COMMENTARY

Stock markets had a poor start to 2022 with the S&P500 having one of its worst January's ever falling 4.8% (in CAD). At home, the TSX Composite fell 0.4%, performing better than the S&P500 as returns on Canadian banks and oil companies were much stronger than US technology companies. The Canadian Universe Bond Index also had a poor month falling 3.5%, thereby making matters worse for traditional portfolios consisting of bonds and equities. We continue to use private real estate and private debt as the core safety portion of your portfolios, and both asset classes held up well in January, giving you better downside protection than bonds, resulting in more diversified and less volatile portfolios.

Markets

Markets dropped as the US Central bank, the Federal Reserve (FED), announced it will be tightening economic conditions to fight inflation. With that, markets sold off very quickly, pricing in higher interest rates and money coming out of the system. The FED's importance to the market is paramount, with its actions since the financial crisis in 2008 driving the overall direction of the S&P500:

1. When they provide easy economic policy (lower interest rates and inject capital via bond purchases) the stock market inflates, which we saw in 2009, January 2019 and March 2020.

2. When they tighten economic conditions (raise interest rates, and/or stop bond purchases and sell bonds) the market falls, as we saw in 2011, 2018 and 2020.

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The chart below of the S&P500, courtesy of well known technical analyst Sven Henrich, who goes by the name Northman Trader, illustrates the FED's impact, with his notes in blue, tying the S&P500 to FED actions of buying bonds (also known as Quantitative Easing or QE). You see green bars (S&P500 is rising) when QE is in place and then when it is stopped and/or they raise rates you see large red bars, signaling the market selling off:

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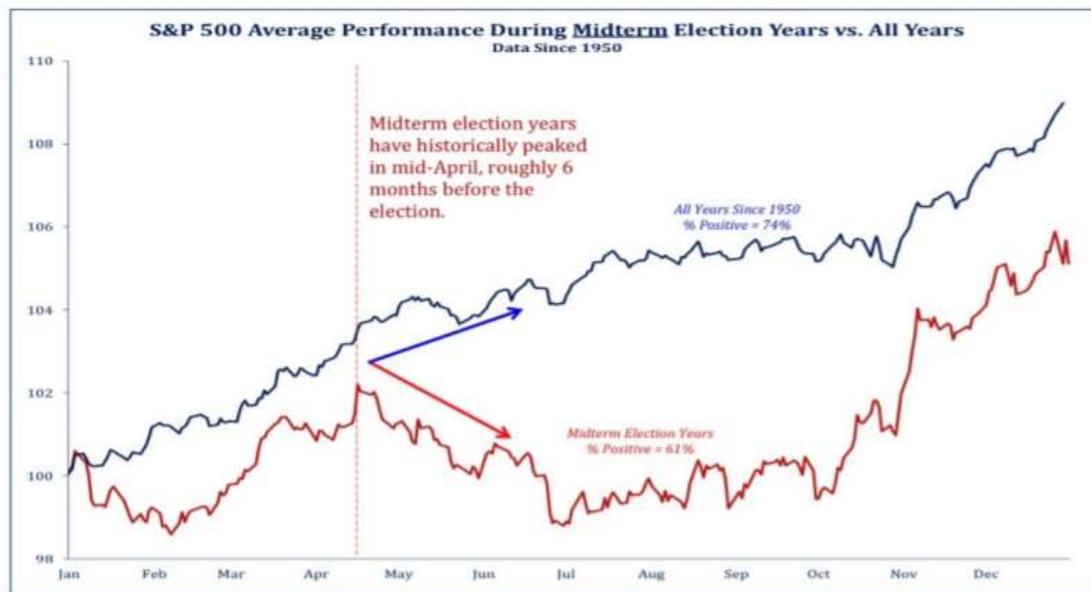
Based on the history of the FED tightening and stocks selling off we are likely looking at a more volatile year, where markets can still end the year higher but will likely move both up and down quickly depending on the FED's actions and messaging. Should they sound like they won't tighten as quickly then the market should rally, and if they sound like they will tighten quicker then the market probably falls. At this point in time, the FED has not committed to anything, other than ending its bond buying program so we could easily see a relief rally in February based on oversold sentiment indicators. Furthermore, the S&P500 is following the typical mid-term election year with a poor January, as we can see from the red line below:

1/21/2022

COMPARED TO REGULAR YEARS, MIDTERM SOFT PATCH ARRIVES EARLIER



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In addition to the oversold sentiment and seasonality on the mid-term election year, the buy-back window for large S&P500 companies to start buying back their shares opened last week, and 2022 is scheduled to be the largest year of buybacks on record at $1.23 trillion USD of shares to be bought (roughly 2.5% of the current value of the S&P500), which puts a large buyer back in the market.

While it's been a volatile month this is always part of investing, unfortunately equities do not go up in a linear fashion. Some months and years see oversized returns, which then come back to historical averages. We therefore complement our investments in companies/stocks with private debt and private real estate (namely apartment buildings), as these investments provide more predictable returns because they are focused on producing income, which is easily forecasted. These investments held up well in January giving us the protection needed when stocks sold-off.

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