WATERMARK PRIVATE PORTFOLIOS JUNE 2022 COMMENTARY

Stock markets had another weak month in June, with the S&P500 (in CAD) dropping roughly 10.3% over the six trading days after the US Consumer Price Index was released on June 10th, and then rebounding for a decent rally for a few days, before selling off again into month end. For the full month, the TSX Composite was down 9.4%, while the S&P500 (in CAD) fell 7.4% (as the USD rallied 1.7%). Bonds continued their poor year, as the Canadian Universe Bond Index fell another 2.2% and is now down 12.2% year to date, with persistently strong inflation and subsequently, higher interest rates.

Markets

Inflation continues to be the biggest driver of markets (bonds, stocks, and currencies) forcing central banks to remain aggressive; bonds and stocks were hurt and money flowed out of countries/currencies that won't raise interest rates as fast as others. Stocks and bonds were holding up to start June, and once the high CPI print came in, they both dropped like rocks over the next few trading sessions. Unfortunately, global central banks have likely made a large error by providing incredibly easy monetary policy for too long, thereby not allowing markets to freely price in the true cost of money.

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The loose monetary policy has resulted in bonds and stocks being overvalued for a longer period, and now that the global central banks are tightening, we are seeing valuations fall on both stocks and bonds. While it is much healthier in the long run if stocks and bonds trade at more reasonable valuations as cash flows can be priced with more certainty, it is currently proving to be one of the most difficult investments times in history as this current tightening environment is likely occurring:

1. While we are in a recession, thereby hurting the future earnings of stocks.
2. After interest rates were artificially driven to all-time lows (interest rates are still negative in Japan, which make zero sense to us), thereby:
   a. Hurting returns of bonds as interest rates rise and resulting in a high correlation to stocks.
   b. Hurting valuations of stocks as companies can no longer borrow at low interest rates.

The result is the worst period for a 60/40 portfolio (consisting of 60% equities and 40% bonds) in the last 30 years, which we can see below, courtesy of Bloomberg:

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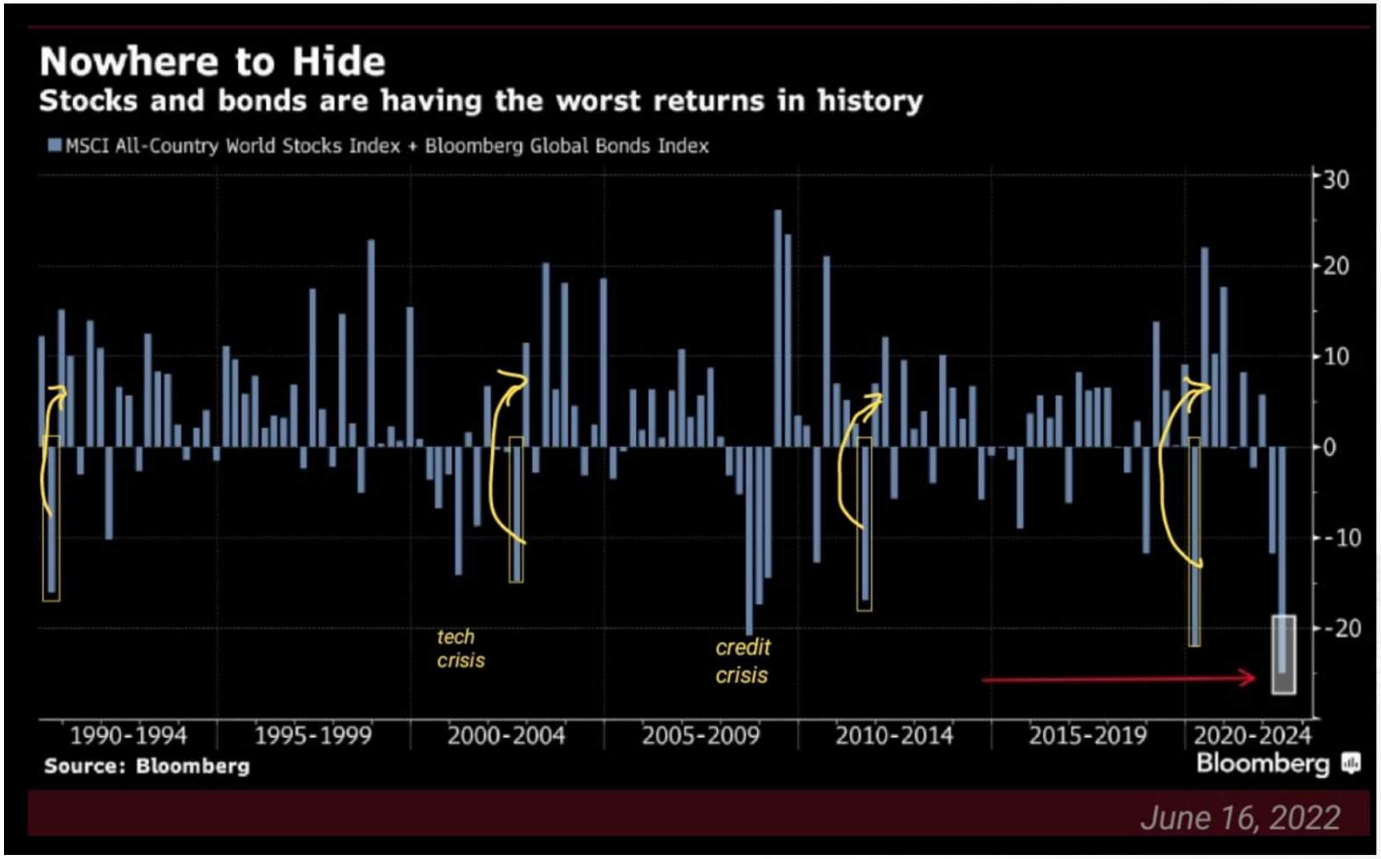

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This once again leaves us positioned defensively, with higher amounts of cash than we've ever held, combined with holdings in private debt and private real estate. As mentioned before, our private debt and private real estate pools both benefit from inflation; on the debt side, the loans are floating and rise when interest rates rise, and on the real estate side, higher inflation results in higher rents. We would like to reiterate that while your portfolios are down, they have held up very well year-to-date and should continue to do so, no matter how public equity and bond markets perform. Furthermore, we believe we are getting closer to levels in public stock markets where valuations appear more reasonable and we can allocate the cash back into stocks, likely as we get later into summer and likely as equity indices fall a bit more.

DISCLAIMER

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