WATERMARK PRIVATE PORTFOLIOS MAY 2022 COMMENTARY

Stock markets had another poor start to the month, with the S&P500 dropping 4.8% over the first nine trading days before rebounding and putting in what may be a bottom, at least in the short run. For the full month, the TSX Composite was flat, while the S&P500 (in CAD) fell 1.1%. It's likely no coincidence that stocks bottomed just after bonds, as the Canadian Universe Bond Index hit its low for the year a few days before stocks. However, the Index was still flat on the month, but for now it appears the aggressive move higher in interest rates has stopped, thereby, reducing interest rate volatility and allowing stocks, at least in the short run, to put in a floor, while also reducing stock market volatility.

Markets

Markets started the month poorly, with the weak sentiment from April continuing to drive global stock markets lower. In addition, earnings from large cap defensive companies came in weaker than expected with inflationary pressures eating into margins as costs went up and sales slowing. As a result, the stocks of companies that are considered defensive sold off mid-month, as we see below (table courtesy of Noah Blackstein, of Dynamic Funds):

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		Beta	% Change
Clorox (CLX)	"Bleach"	0.37	-7.0%
Hormel Foods (HRL)	"Spam"	0.42	-8.8%
Campbell Soup (CPB)	"Soup"	0.47	-8.1%
General Mills (GIS)	"Cereal"	0.49	-7.3%
J M Smucker (SJM)	"Jelly"	0.52	-10.5%
McCormick (MKC)	"Spices"	0.58	-9.3%
Church & Dwight (CHD)	"Baking Soda"	0.58	-6.9%
Conagra (CAG)	"Packaged Foods"	0.62	-8.4%
Kraft Heinz (KHC)	"Ketchup"	0.65	-9.6%
Tyson Foods (TSN)	"Chicken"	0.66	-7.7%
Hershey (HSY)	"Chocolate"	0.67	-7.9%
Mondelez (MDLZ)	"Oreos"	0.69	-7.3%

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It appears that inflation is reducing demand for goods as consumer purchasing is lower with the persistent inflation in food, rent, and gasoline. With demand for goods falling, some companies are announcing layoffs. With negative GDP growth in Q1, we may already be in a recession, for all we need is Q2 GDP to be lower than Q1. The good news is that if this is the case, it’s currently a very shallow recession as the job market is still showing signs of strength.

Also on the positive side is that it appears that the S&P500 has, at least for now, put in a short-term bottom after moving down exactly 20% from the December 2021 high, which is identical to what happened in 2018, the last time the US Federal Reserve started a tightening cycle. Further assisting the technical bounce on the S&P500 was the fact that the Core Personal Expenditures Index, a measure of prices that consumers pay for goods and services in the US, came in lower than expected in April (reported one month later in May) and lower than the previous few months, as we can see below:

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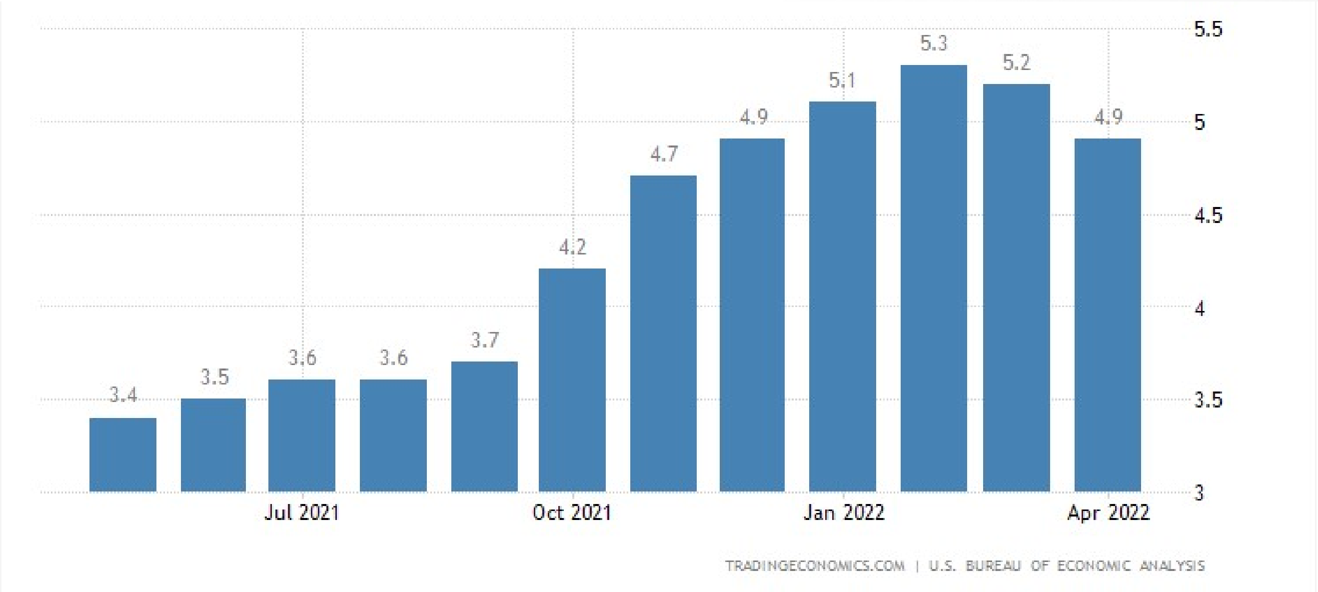

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This gave investors confidence that inflation may have now peaked, with investors hopeful that central banks will therefore not tighten as much as expected, resulting in a strong rally in stocks and bonds. Adding fuel to this theory was one of the US Federal Reserve Governors, Raphael Bostic, stating that a pause of interest rate moves higher could happen in September and that he was optimistic that inflation would be lower by then.

As such the macroeconomic environment continues to be incredibly tough:

1. Demand destruction appearing (ie. Consumers reducing their purchasing as they have lower real wealth due to inflation) – resulting in slowing equity growth and inflation.
2. Companies announcing layoffs – potential for growth to slow further.
3. War persisting in Ukraine – oil and certain commodities and goods remaining scarce and thus keeping prices high.
4. US Federal Reserve continuing to tighten economic conditions into slowing growth but indications that they may stop after August.

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This means we continue to take a cautious approach on public equities and trade opportunistically for your portfolios, locking in gains when we feel that rallies may taper out. This pairs well with your private debt and private real estate holdings, which are both expected to have strong years with returns uncorrelated to public stock markets. We'll continue to listen to central banks and watch how the market interprets their actions and messages, staying nimble and ready to pivot as necessary, which could result in larger cash positions in your portfolios at times. Your portfolios have held up well year-to-date and should continue to do so, no matter how public equity and bonds markets perform.

DISCLAIMER

I have prepared this commentary to give you my thoughts on various investment alternatives and considerations which may be relevant to your portfolio. This commentary reflects my opinions alone and may not reflect the views of Harbourfront Wealth Management. In expressing these opinions, I bring my best judgment and professional experience from the perspective of someone who surveys a broad range of investments. Therefore, this report should be viewed as a reflection of my informed opinions rather than analyses produced by Harbourfront Wealth Management Inc."