WATERMARK PRIVATE PORTFOLIOS SEPTEMBER 2022 COMMENTARY

September was another volatile month, with central banks continuing to create volatility as a direct result of the mistakes they have made over the past 15 years, which we will explain below. The S&P500 fell 9.3% in USD but only fell 4.8% in CAD (due to a 4.5% gain in the USD vs CAD), while the TSX Composite fell 4.2%.

The bond market continues to be incredibly volatile, too volatile for the safety portion of a portfolio, falling 1.5% until September 27th, and then rallying 1.9% on September 28th. On the 28th, the Bank of England capitulated and announced that it was going into the bond market to buy British bonds until mid-October, seemingly to save British pension funds that were suffering massive losses on their exposure to bonds. This action was taken even when the Bank of England expects inflation in Britain to remain in the double digits over the next year. The result was that the Canadian Universe Bond Index finished the month down 0.7%.

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Markets

Central Banks continue to “be” the market, which they have been since the Great Financial Crisis (GFC) of 2008/2009, and arguably since 2000, when they kept rates too low coming out of the “Dot.com” crash, which led to the GFC of 2008/2009. By keeping rates too low for too long, they’ve created the following:

1. Encouraged massive amounts of borrowing that likely wouldn’t have occurred at higher rates.

2. Forced investors out of lower-risk products, such as GIC’s and government bonds, and into higher-risk investments in seeking normal returns that they could no longer get from GIC’s and bonds.

3. Increased leverage in the financial system, with a higher use of margin/borrowing for sophisticated investors.

4. Companies, instead of investing back into their company in an effort to grow, have been borrowing at low interest rates to buy back their shares and thereby driving share prices higher.

5. Until this year, when the US Federal Reserve started increasing interest rates, the USD has remained relatively low versus other currencies, allowing foreign countries to issue higher amounts of USD debt.

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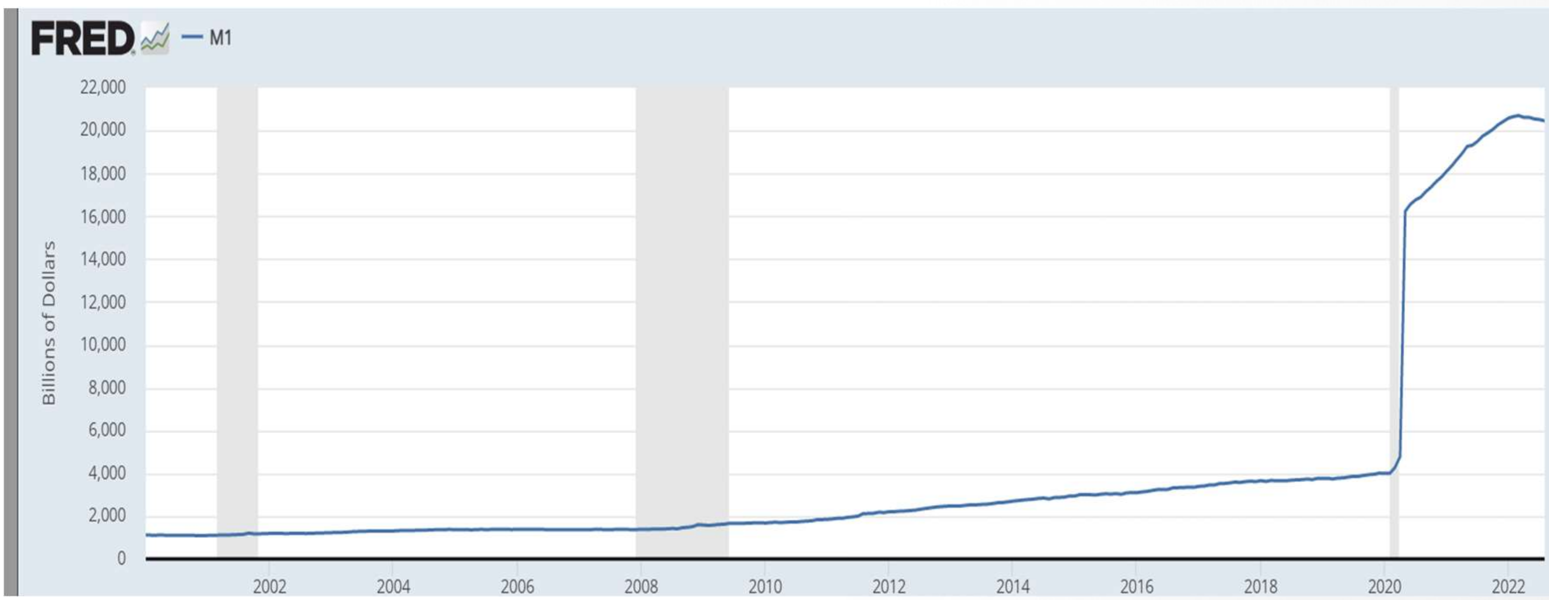
In addition to keeping short-term interest rates artificially low from 2009 to 2020, central banks also decided to try and keep longer-dated bond yields lower by buying US treasuries and mortgage bonds (to keep mortgage rates low), which was a great temporary idea to help restore normalcy after the GFC. However, instead of ending the program in a timely manner, they kept buying these bonds, resulting in further dislocations to the primary input of economies, interest rates. When COVID-19 hit, they applied the same programs, but this time on steroids, doing more in a few months than what was done in the past 300 years, as illustrated below in the US money supply chart (from the St. Louis Federal Reserve):



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These monetary and fiscal policies, along with the Russian-Ukraine war, pent-up demand from COVID-19 shutdowns, and the disrupted supply chains that occurred during the last 2 years have all contributed to the elevated inflation that we see today. Instead of acting early in 2021 to remove the stimulus that they placed in the system, central banks said that they believed inflation was “transitory” (meaning it would go away shortly on its own), so they continued to buy bonds until early 2022, thereby making a major policy mistake. This action put them behind the curve, forcing central banks to raise interest rates aggressively over the past few months, led by the US Federal Reserve (FED), driving the USD higher and further choking off global growth, with 85% of the world trade priced in USD.

Confirming what we are seeing on the macro-economic front, FedEx, a barometer of global flows, pre-announced falling revenues on weak global trade, with its stock dropping 29.2% on the month. Towards the end of the month, Apple announced that sales for its iPhone are slowing and asked suppliers to slow down the building of iPhone components, resulting in the stock falling 8.2% on the week.

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While all this news is seen as negative, we are encouraged that global central banks are trying to “get out” of markets and normalize interest rates. This should allow for a better investment environment where companies with strong earnings are rewarded, and weak companies will be forced to go bankrupt instead of easy money chasing the latest fad. Companies that can grow their dividend will once again become valuable, and bonds too may have some value going forward. We hope central banks can resist the desire to go back in and “meddle” with markets, although we’ve already seen the Bank of England capitulate this month. We, therefore, continue to watch the US Federal Reserve for a change in policy and remain cautious until they change or until stocks start to look even more compelling to buy. At that point, we will reduce our cash pile and pick away at investments on our buy list. The portfolios continue to hold up well relative to what is going on in the market. We thank you for your patience in this difficult environment created by central banks and politicians who continue to overspend with little thought of the consequences.

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