# WATERMARK PRIVATE PORTFOLIOS JULY 2023 COMMENTARY

**Market Highlights**

Global equity markets saw another positive month despite a coordinated effort by major central banks (Bank of Canada, US Federal Reserve, and European Central Bank) to increase short-term interest rates by 0.25%, resulting in the highest level of interest rates in developed countries in the last 20 years:

- Strong oil prices and continued strong employment numbers for the month of July likely means that core inflation persists:
    - Medium- to long-term interest rates rose in Canada, causing bond prices to fall.
    - With the increase in short-term interest rates, floating rate notes and private credit should benefit from higher yields.
    - Canadian equities, with a large portion of oil-producing companies, had a strong month.

- Canada remains a strong destination for immigration, which continues to support the rental apartment market in Canada benefitting private real estate.

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| | July 31st Value | Monthly % Change | YTD % Change |
|---|---|---|---|
| Canadian Short-term Lending Rate | 7.20% | 0.25% | 0.75% |
| Canadian Bonds (FTSE Canada Universe Bond Index) | 1,065.60 | -1.11% | 1.37% |
| Canadian Equities (TSX Composite) | 20,626.64 | 2.58% | 8.43% |
| US Equities (S&P 500, in C$) | 4,674.28 | 2.67% | 17.20% |
| Gold | 2,009.20 | 2.58% | 8.09% |
| Oil (West Texas Intermediate Crude) | 81.8 | 15.80% | -12.88% |
| Canadian dollar | 0.7595 | 0.42% | 2.75% |

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**S&P 500 Equity Valuations & MegaCap-8 Companies Dominate Headlines**

The double-digit move in the S&P 500 year-to-date is largely due to the significant increase in valuations and resulting higher stock prices of the MegaCap-8, comprised of technology companies Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, NVIDIA, and Tesla.

The price paid for earnings of the MegaCap-8 (indicated by the red line in the chart below) has increased by nearly 50% this year, heading towards its 2020 and 2021 highs—at that point, the valuations of these companies became too high, and the stock price sold off. On the current trajectory towards historically high valuations, we should expect to see the prices of these companies fall back towards lower levels unless these companies can materially grow their earnings.

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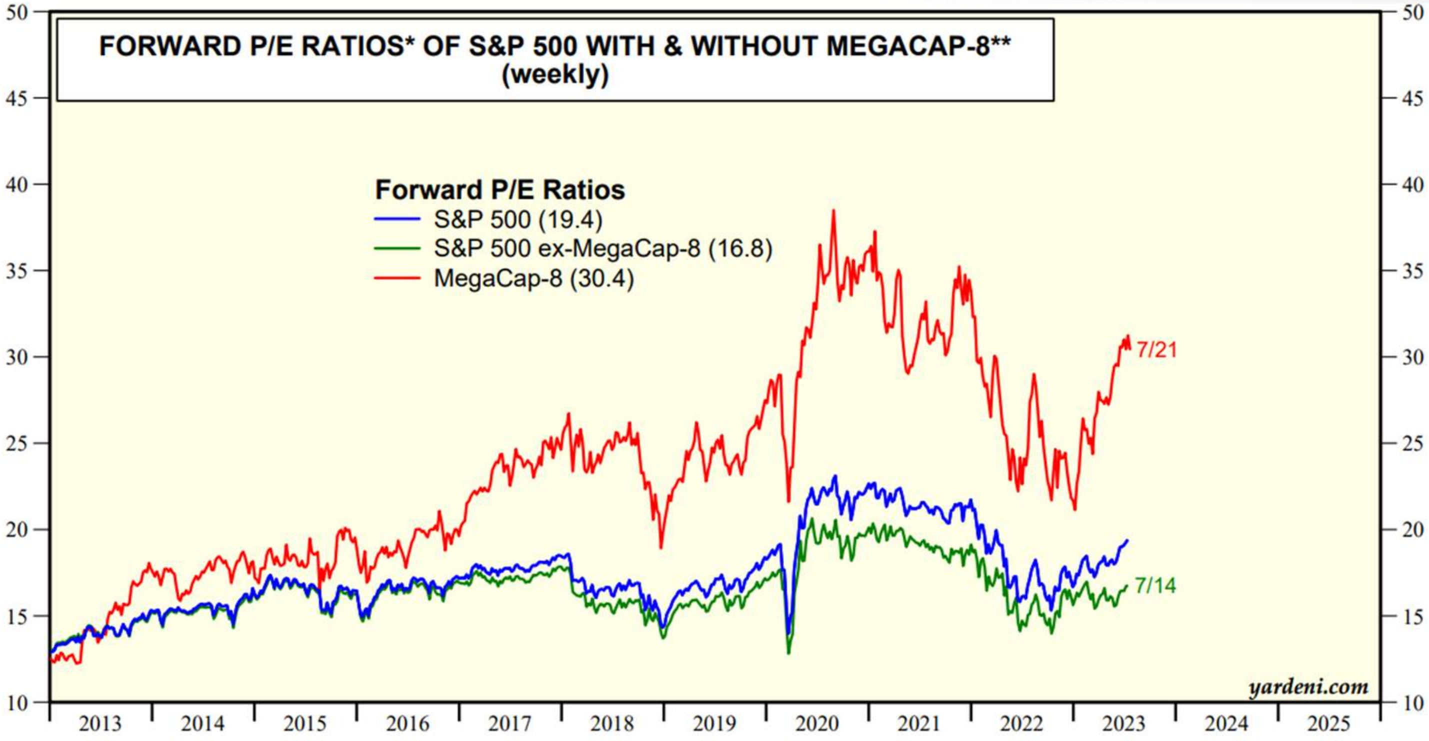


* Price divided by consensus forward earnings forecast.
** MegaCap-8 stocks include Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, NVIDIA, and Tesla. Both classes of Alphabet are included.
Source: I/B/E/S data by Refinitiv.

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We're currently in the Q2 earnings season and keeping an eye on the performance of these market leaders. So far, we've seen a mixture of earnings and reactions:

- Netflix, Tesla, and Microsoft ended lower after announcing earnings.
- Both Alphabet (Google's parent company) and Meta surpassed analyst expectations for revenue growth, and both moved higher.

Excluding the MegaCap-8 stocks from the S&P 500, most other companies are trading around 16.8 forward P/E (indicated by the green line in the chart above), meaning other companies/sectors in the S&P 500 are trading at more reasonable valuations.

In addition, US Mid and Small Cap companies are still trading at attractive valuations of around 14 times future earnings. These present a better opportunity as they have not experienced the same valuation run-up as the S&P 500 Large Cap companies. We continue monitoring these companies to see how higher interest rates are impacting their businesses to see if we should be adding them to the portfolios.

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**Commodities**

The US dollar (USD) dominates global currencies because most trade and debt are settled and denominated in USD. Furthermore, commodities such as oil, gas, gold, and copper are priced in USD, so when the USD moves, it affects commodity prices.

USD fell this month with the market anticipating the US Federal Reserve is nearing the end of its interest hiking cycle. We're closely monitoring the USD and its strong relationship with commodities:

- When USD falls, commodities become cheaper and rally.
- When USD rises, commodities become more expensive and fall.

After careful review of the commodities market, we bought Nutrien Ltd., one of the largest global fertilizer companies, for larger accounts this month. Nutrien should benefit from a higher demand for food, particularly in countries with large population growth. Furthermore, the war in Ukraine continues to impact food supply chains and should benefit Nutrien. Lastly, should the USD pull back, it should also provide a tailwind for this commodity producer.

# WATERMARK PRIVATE PORTFOLIOS JULY 2023 COMMENTARY

**Outlook and Positioning**

| Asset Class Positioning | Underweight | On Target | Overweight |
|---|---|---|---|
| Fixed Income | | | X (Floating Rate) |
| Equities | X | | |
| Private Credit | | X | |
| Private Real Estate | | X | |

- Our current portfolio positioning remains in line/neutral to long-term strategic weights, with a slight overweight to fixed income via a floating rate security.

- We continue to maintain, where permitted, a long-term allocation to private credit and private real estate. Private credit, as a floating rate asset class, benefits from the current rising rate environment, while strong immigration in Canada and the significant gap between housing supply and demand continues to benefit our private real estate holding.

- We remain underweight in equities despite this month’s market rally. We continue to believe the floating rate bonds, yielding over 5%, are a better risk-adjusted return asset compared to equities currently.

# WATERMARK PRIVATE PORTFOLIOS JULY 2023 COMMENTARY

**Outlook and Positioning (Continued)**

- Employment numbers remain strong, so we believe interest rates will remain higher for longer.

- We have refrained from buying into the US equity market, which would chase the high valuations of the MegaCap-8.

- We continue analysing opportunities for longer-term investments at reasonable valuations and bought Nutrien Ltd., which should benefit from escalating actions in Ukraine, disruptions in the food chain, and a lower USD.

With the sharp move higher in stocks since the US regional banking crisis in March, it wouldn't surprise us to see a pull back within the next couple of months. This will allow us to assess how the economy is performing, so we can evaluate if we should put cash to work in quality companies with strong balance sheets, free cash flow, and attractive growth prospects.

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