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Capital Markets & Portfolio Update

Markets Continued to Look at the Positives in June

Global equity markets posted another positive month in June as countries around the world began to reopen their economies. Adding to investor confidence was continued monetary and fiscal support from central banks and governments. Although COVID-19 case counts continued to rise in a number of countries, the massive stimulus programs and economic pickup were enough to keep investors focused on a future beyond the pandemic and led share prices higher. Our Balanced Growth Model Portfolio, even though we're maintaining a fairly defensive posture, participated nicely in the recovery and had another positive month, gaining 1.24% (slightly better than its peer group).

The gains in June were a little different then the last few months, however, as Canadian and European equites posted stronger returns than the U.S. The S&P/TSX gained 2.5% for the month; while the EAFE Index (Japan and Europe) climbed 2.0%. The Canadian market was helped by rising gold prices, which pushed past $1,800/oz for the first time since 2011.

The U.S. market, which was likely ahead of itself, and has suffered from a resurgence in positive virus cases, was still able to record a modest 0.6% gain for the month.

Going against conventional wisdom, bonds had another positive return in June even though investors were embracing risk assets as well. The Canadian Bond Universe returned 1.7% for the month, increasing the index's year-to-date return to 7.5%. Corporate bonds had an even more impressive month, gaining 2.1% (U.S. investment grade corporate bond index) for the month on the back of the U.S. Fed's program to provide liquidity to the corporate bond market.

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Although gold prices did well in June, energy didn't fare quite as well, with the Canadian energy index dropping -5.3% for the month and pipelines losing -6.3%. Helping our Model Portfolio, however, insurance companies and real estate both had a respectable month returning 6.6% and 2.8% respectively.

As mentioned earlier, our Balanced Growth Model had a good month also, and is doing well year-to-date, but it is still slightly behind the benchmark so far for the year. That's simply due to us holding extra cash and other defensive investments as we feel there are still substantial risks; and thus we are favouring downside protection currently over chasing the recovery. We do, however, also have a basket of undervalued assets that we think could provide very strong market-beating returns going forward when economies open up more fully.

Here's how the key indexes performed for the month:

Bellwether Indices	Source: CIBC Wood Gundy				
As at June 30th, 2020	Price Performance % Change				
	1 mo	**3 mo**	**6 mo**	**12 mo**	**YTD**
S&P/TSX Composite Index	2.5	17.0	-7.5	-2.2	-7.5
S&P 500 US Index	0.6	15.7	1.7	11.8	1.7
MSCI EAFE (Europe & Japan)	2.0	10.5	-6.7	-0.9	-6.7
TMX Canada Bond Universe Index	1.7	5.9	7.5	7.9	7.5
Canadian vs. U.S. Dollar	1.5	3.6	-4.3	-3.7	-4.3
Morningstar CDN Neutral Balanced[1]	1.2	9.3	-2.9	0.1	-2.9
GP&A Balanced Growth Model	**1.2**	**8.9**	**-4.0**	**0.3**	**-3.8**

Investment Strategy & Portfolio Positioning

In the best of times, let alone during a pandemic, there's a lot of misinformation, sensationalism, and outright bad advice when it comes to investing. So much so that I

[1] The Morningstar Canadian Neutral Balanced benchmark is an industry regulated benchmark that reflects the performance of all Funds in Canada that invest at least 70% of total assets in a combination of equity securities domiciled in Canada and Canadian dollar-denominated fixed income securities. In addition, they must invest greater than or equal to 40% but less than or equal to 60% of their total assets in equity securities.

would suggest the majority of individual “investors” have little idea what they are investing in, or even why they’re investing. To them, it’s gambling, “playing the market”, rather than investing into attractive companies or lending money to sound businesses and governments (i.e. bonds and private loans). That mentality, and lack of understanding in how to value investments, causes a lot of the volatility we see day to day. Certainly there are professional traders as well “playing the market”, but they are mostly trading off the volatility created by the inexperienced individuals.

As professional portfolio managers for our clients, and ourselves, we try to ignore the noise created by the media and the markets and focus on proven investment principles that have stood the test of time. These principles include asset allocation (asset class diversification), investment-style (direct, passive, active, and hedge), and investment selection (opportunistic and diversification). If we do these three tasks well, we should earn attractive long-term returns, with greatly minimized volatility and virtually no risk of losing capital over our time horizon, regardless of what markets do along the way.

We have been reminded recently of the importance, and the value, in managing one’s money with sound principles and techniques. Although we have had record volatility in the markets, with significant moves both down and up, our Balanced Growth Model Portfolio has been able to keep the portfolio’s volatility within our acceptable, and expected, tolerance levels for a recession and thus bear market.

Given these unprecedented times, and the extreme level of noise in the markets, and uncertainty, I thought I would take a moment this month to discuss how we’re applying the above principles in your portfolio so that we can continue to weather this storm, gain from the eventually recovery, and ultimately have this challenging period simply be another blip on a long-term positive return chart.

Asset Allocation

Studies have suggested that asset allocation has more impact on long-term returns than any other single factor. In other words, which investment market/sector we’re invested in has far more influence on long-term returns that what stock or bond we own. Sure we may get lucky on occasion and own some hot stock at precisely the right time, but odds are we’ll own a few less-than-hot ones along the way as well and our return will simply end up being in line with the overall market. Thus, it’s more important to be in the right market than the right investment per se. Like pension funds and other large

professionally managed pools of money, we investment in a large number of asset classes in order to find opportunities as well lower portfolio volatility. Currently, we have investments in the following assets and sub-sectors (parentheses indicates whether we are overweight or underweight from our "base", or normal, allocation):

- Domestic government bonds (underweight)
- Domestic corporate bonds (overweight)
- Perpetual Preferred shares (neutral)
- Fixed-Rate Preferred shares: inflation protection and upside potential (overweight)
- Global fixed-income: government and corporate bonds, mortgages, emerging market debt and high-yield bonds (overweight)
- Gold (overweight bullion)
- Risk-Minimizing Hedge Funds (neutral)
- Real Estate (overweight multi-family residential and underweight commercial)
- Domestic Equity (underweight)
- U.S. Equity (overweight)
- EAFE Equity: Japan and Europe (underweight, but increasing)
- Emerging Markets (underweight)
- Cash (overweight for extra portfolio protection and future buying opportunities)

Investment Style & Security Selection

As you likely know, we have the ability to invest in mostly any asset, investment style, or geography; and I invest the vast majority of my personal money (over 90%) in our Balanced Growth Model Portfolio. Also, we don't earn any fees, etc. from the investments we make for clients. As such, we are as independent and aligned with our clients as possible. I say that simply to be clear that when we make investment decisions, the only criteria we consider is risk/return/cost. Because of that, we focus on academic research, facts, and history in selecting the investments and not sales pitches or incentive fees.

With the above said, the academic work is extensive and quite conclusive that low-cost broad-market passive investing outperforms stock picking in efficient markets. As such,

once we determine the asset classes, and areas, we want to invest, we tend to favour index ETFs over mutual funds or individual stocks, REITs, bonds, etc.

There are, however, less efficient markets, and times during the market cycle, where sector-specialists, and very sophisticated investment styles (i.e. certain hedge fund strategies), can be used to increase returns and reduce risk. As such, we do a lot of work to determine when, where, and how to use these active strategies for better returns (pension funds have done this for many years).

Our current investment posture, therefore, is based on the above philosophy and the following current investment thesis:

1. We are overweight active managers vs passive indexes due to a strong bifurcation in the markets due to the pandemic between have and have-not companies; which we feel could persist for some time. In addition, we like technology based growth companies for the foreseeable future, however, we believe strong expertise in the area is needed to determine which companies will lead and which will be the also-rans.

2. We are slightly overweight growth vs value, although we still have a strong tilt toward value, as investors favour growth companies in low interest rate and low GDP growth environments (like today).

3. We are overweight active managers vs passive indexes in our fixed-income allocation as well due to near zero interest rates and the need for specialized balance sheet analysis when investing in corporate bonds, loans, mortgages, and emerging market bonds.

In a nutshell, the above asset allocation and investment positioning has our Balanced Growth Model Portfolio well positioned for this current environment and with a clear barbell approach, both in equity and fixed income investments. On one end, we have high-quality defensive investments like blue-chip dividend paying companies, government bonds, defensive hedge fund, gold, and cash. On the other, growth companies, real estate, inflation-linked preferred shares, high-yield bonds and emerging markets equity. The balance has been working well to smooth out volatility, provide good protection from a subsequent sell-off, but also make strong gains as markets have been recovering.

Contrary to what the media and the investment industry like to go on about, investing is not about playing the market. It's about building a diversified portfolio of quality investments that can withstand the occasional shock but also grow over time and enhance your wealth so you can live the lifestyle you desire and accomplish stated goals. That's what we're here to help you with and what we focus on everyday.

Let me close by quoting our favourite homespun billionaire, Warren Buffett: "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight, or inside information. What's needed is a sound intellectual framework for decisions and the ability to keep emotions from corroding that framework."

Have a great summer and stay safe.

Daniel E. Girard

Data Sources: CIBC World Markets, Thomson ONE.

Daniel Girard is a Portfolio Manager and Investment Advisor with CIBC Wood Gundy in Waterloo. The views of Daniel do not necessarily reflect those of CIBC World Markets Inc. This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change.

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