GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

DECEMBER 2021

UPCOMING 2022 BNN SHOWS

Christine: January 18 @ 12 pm

Christine: February 15 @ 12 pm

Christine: March 15 @ 12 pm

Santa arrived just in time to reward equity investors, propelling the broad equity indices to new highs in the last days of the year. Robust corporate profits were the catalyst behind higher stock prices, overcoming concerns of rising inflation, tightening monetary policy, and the highly contagious Omicron COVID-19 variant.

Earnings growth of the companies in the S&P/TSX Composite Index and S&P 500 Index are coming in better than expected in 2021 with current consensus expectations at 56% and 50%, respectively, compared to 31% and 23%, respectively, at the beginning of the 2021. Unlike most “bull” market years, multiple expansion played a minimal role in price returns as the price to earnings ratio on 2021 consensus earnings for both indices remained relatively unchanged throughout the year.

The Pandemic

The global economy continues to be at the mercy of the pandemic. Its initial collapse was followed by a sharp rebound amid unprecedented policy support and economies reopening. The mutation of variants has resulted in a very uneven recovery between countries due to differing vaccination rates and lockdown restrictions. The Delta variant caused unexpected hiccups in the global supply chain and inflationary pressures. The reaction from financial markets on the Omicron variant suggests this latest wave will subside relatively quickly.

Within Canada, some provinces have recently taken a significant step back in their reopening plans due to the emergence of the Omicron variant. Despite new fiscal support plans that have been announced, these shutdowns will hamper economic growth over the near-term.

While Omicron is highly contagious, studies so far indicate the virus causes relatively mild symptoms compared to prior variants. Fully vaccinated people are susceptible to infection, however, the vaccines still prevent serious disease. Preliminary studies suggest that Omicron can invade the upper respiratory tract more easily than Delta, but is far less effective at infecting the lungs, which would explain its higher contagiousness and lower mortality.

In the U.S., cases counts have spiked to a new high (significantly above the Delta surge in late August), but patient hospitalizations are *only* near the level back then (Chart 1). Encouragingly, it appears that even among people who need hospital care, symptoms are milder and requiring less acute treatment. In the U.K., the number of patients on ventilators has remained roughly constant, even as the number of cases has soared. Data from mid-December shows that around 60% of those in intensive-care units are unvaccinated despite accounting for only 9% of the adult population last month and the remainder tend to be people who have been vaccinated but suffer from serious underlying conditions that are aggravated by COVID-19. In South Africa where Omicron was first identified on November 24, there has been a noticeable drop in cases since the peak with the government officially announcing on December 30 that the Omicron wave had passed (Chart 2).

High vaccination rates supplemented by boosters, effective therapeutics and herd immunity provide hope that the COVID-19 virus will transition from a pandemic to an endemic sooner rather than later.

Persistent Inflation

The high rates of inflation experienced in many developed countries was the result of a surge in demand for goods coupled with a depleted global supply chain, exacerbated by base year effects. The ongoing health impact from new COVID-19 variants has also obstructed workflow fluidity leading to a more persistent inflationary outlook.

Central bankers have acknowledged that inflation will persist longer than initially expected, exemplified by the “Powell Pivot” in December when the U.S. Fed Chairman adopted a decidedly more hawkish tone by announcing a faster taper of its bond purchases, putting the FOMC on track to conclude those purchases by March. Interest rate increases were also pushed forward from potentially one hike to projections of three hikes equal to 75 basis points (bps) in 2022. A faster than expected improvement in the employment situation was also cited as a reason behind a faster taper.

So, once again, the focal point is the level of inflation a year from now and specifically, when the supply and demand imbalances will be resolved. Two key factors to consider include the ongoing impact of the pandemic and consumer demand.

Assuming the pandemic evolves into an endemic, supply chain bottlenecks should start to abate. Supply chain pressures are already easing as evidenced by declining container shipping rates from peak levels, progress in clearing congestion at major U.S. ports and a sharp decline in the Supplier Deliveries Index reported in the December ISM

Manufacturing Index (Chart 3). Many shipping and retail executives say they expect the U.S. port backlogs to clear in early 2022, after the holiday season and when the Lunar New Year shuts many Chinese factories for a week in February, slowing output. While it may still take some time for the global transport system to normalize, sustainable progress will allow production in overseas markets to move toward meeting demand and lower logistics costs.

Soaring consumer demand for goods also contributed to the imbalances. Through October 2021, the level of U.S. retail sales (which mostly measures goods spending) had risen 21.4% above its pre-pandemic February 2020 peak. In the prior cycle, retail sales peaked in November 2007, and it took until September 2016 before retail sales rose 21.4% above its pre-recession peak. Thus, in comparison, it took almost nine years in the prior cycle to achieve the spending increase that occurred over 20 months in this cycle (Chart 4).

Reasons behind the surge in consumer spending on goods include limited expenditures on services due to pandemic-induced restrictions and household income supplemented by three rounds of fiscal stimulus payments. Going forward, the composition of consumer spending is expected to shift back towards more services than goods. Wages and salaries income will again resume its role as the primary income source. This should moderate the demand for goods and when combined with a more fluid supply chain, help alleviate the upward pressure on inflation. The core Personal Consumption Expenditures (PCE) Price Index was up of 4.7% in November and should start to trend downwards as the year unfolds.

Inflation over the near term will be elevated. That is what happens when economies catapult rapidly out of a pandemic-induced recession resulting in too much demand chasing too little supply. As previously discussed, several factors point to progressively lower inflation over time. While the process is taking longer than expected, the high inflation we are experiencing now should not be labelled “permanent.” Admittedly, the longer it persists the greater the risk that the current price environment starts to influence future expectations.

Glass is half full

Along with consumers, businesses have been investing in their businesses. Business fixed investment spending, particularly on equipment, has seen a spike. One widely followed proxy for future capital expenditure spending is core capital goods orders (Chart 5). Past periods of major capital spending have been associated with stellar productivity growth which helps to mitigate higher costs and wages.

We have already witnessed the positive impact of productivity growth this past year with the S&P 500’s profit margin posting a record high of 13.1% (Chart 6). Corporate profits are expected to continue to grow this year with consensus forecast for the S&P500 companies up 8.4% and S&P/TSX companies up 9.7%. Also supportive of earnings per share growth is buyback activity which is at a record high for the S&P 500 companies. We reiterate that corporate profits continue to be the primary driver of higher stock prices.

The Powell Pivot was initially greeted positively by the markets. My interpretation of the pivot is that the FOMC was signaling that it is not willing to let inflation expectations get out of hand. The 10 Year Breakeven Inflation Rate is 2.48% as of January 7th, marginally higher than last quarter and remains at a reasonable level (Chart 7). The Fed's dual mandate is to seek maximum employment and price stability. The employment situation has recovered more quickly than expected and arguably is approaching maximum employment albeit the labour participation rate remains below pre-pandemic levels at 61.9% versus 63.3%. The U.S. unemployment rate is now at 3.9% compared to 3.5% in February 2020 while core PCE inflation is 4.7%, more than double the longer-term FOMC target. That was the catalyst for the pivot. As well, higher wages are starting to broaden beyond the leisure and hospitality sector. History has shown, however, that the FOMC path is never entrenched and as markets have observed, data dependent.

In Canada, the job market has recovered above pre-pandemic levels. The unemployment rate is 5.9% and the labour participation rate is 65.3% compared to 5.6% and 65.5%, respectively, in February 2020. Canadians have been more willing to return to the workforce than their southern neighbours. Perhaps this can be attributed to a significantly higher vaccination rate and comfort level to returning to work. Omicron is expected to temporarily pause the recovery in January due to the re-imposed containment measures announced in Ontario and Quebec.

The positive takeaway from the employment data is that there is a healthy job market and employers are looking to hire. That means the discontinuation of fiscal support payments are being offset with wages, keeping household incomes relatively intact.

We are better equipped to cope with the pandemic. According to various sources that track vaccination rates, the global vaccination rate is approximately 50% (two doses), with higher vaccination rates skewed to developed countries. Vaccination rates including booster shots will continue to improve as time passes.

For your interest, here are links that track global COVID vaccinations:
https://www.nytimes.com/interactive/2021/world/covid-vaccinations-tracker.html
https://ourworldindata.org/covid-vaccinations

Build Back Better

The $1.9 trillion Build Back Better (BBB) Act, President Joe Biden's social spending plan, hit a roadblock on December 19 when Democratic Senator Joe Manchin stated he will not support the BBB in its current form. The legislation includes funds for childcare, free universal pre-kindergarten, monthly child tax credits, expanded health care benefits and measures to fight the climate crisis. Without Manchin's vote, the 50/50 split in the Senate means the budget bill cannot go forward using the budget reconciliation process. The Biden administration and Democrats in Congress may still agree on a slimmed down revised package, but time is of the essence as politicians will be focusing on the midterm elections in the second half of the year.

RUSSIA

Talks are commencing with the West and Russia regarding the build-up of Russian troops along the border of Ukraine. Russia wants NATO to pull its forces out of former Soviet countries, end any eastern expansion and rule out Ukraine joining the alliance. The demands are viewed as unrealistic, however, U.S. officials have said they are open to discussions on curtailing possible future deployments of offensive missiles in Ukraine and putting limits on American and NATO military exercises in Eastern Europe if Russia is willing to back off on Ukraine. The U.S. and Europe reiterated Russia will be hit hard with massive economic sanctions should it intervene in Ukraine. The wide divergence in their opposing stances suggests there will no quick resolution. A more likely positive outcome would be an agreement to de-escalate tensions in the short-term and a return to talks at a future date. A game of chicken is underway.

CONCLUSION

The world economy is still recovering and has yet to achieve a synchronized reopening. Growth expectations for first quarter of 2022 are being revised downwards due to the impact of the Omicron variant, but the damage should be offset in subsequent quarters. In the U.S., retail inventories have collapsed to a historical low (Chart 8). Restocking will be a tailwind to manufacturing activity and trade flow for some time. The eventual return of international travel is another source of incremental business activity. As the year progresses, a more balanced global recovery should take hold.

The economic backdrop remains constructive for equities and is supportive for further price appreciation. Growth rates will moderate from the sharp rebound witnessed last year to a more normalized pace. As the imbalances are resolved, the long-term deflationary trends of demographics, globalization and technology should reassert themselves.

While monetary policy has turned less accommodative, at near zero, interest rates had only one way to go – up as economic conditions improved. History shows that stock returns remain positive in the months leading up to and following the first rate increase which has now been penciled in as earliest as March. The negative impact from higher interest rates tends to happen later in the economic cycle when a tight monetary policy flattens or inverts the yield curve. The spread between the 10 Year and 2 Year US Treasury Yield Curve is 90 bps - we are not there yet.

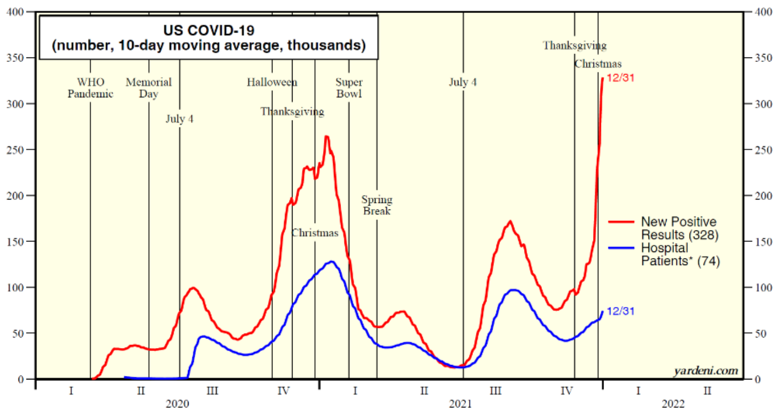
ANNOUNCEMENT

As many of you know, eight years ago Peter Brieger, the founder of GlobeInvest Capital, stepped away from the day-to day operations of the firm and took on the role of (Honorary) Chairman. As planned, effective this year, Peter has relinquished that position. We wish him all the best as he continues to keep busy with various activities, both business and personal, as well as watching his grandson grow up.

Wishing you all a happy, healthy, and prosperous 2022!

Christine Poole, MBA, CFA

CHART 1: US COVID-19 (number, 10-day moving average, thousands)
-Department of Health & Human Services, Centers for Disease Control & Prevention, COVID Tracking Project and Oxford University, Yardeni



Note: Data for hospital patients from July 2020 to the present is from Oxford University, prior to that data is from COVID Tracking Project.

CHART 2: COVID-19 cases and deaths in South Africa
- J.P. Morgan

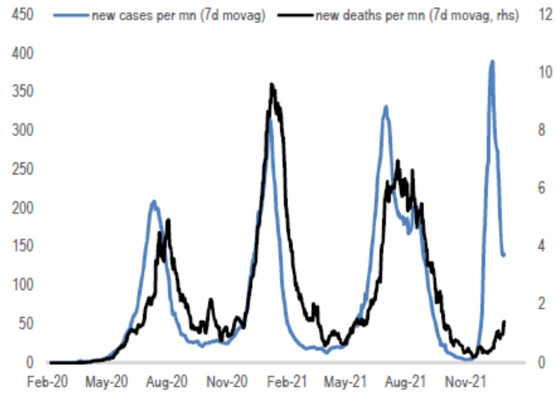


CHART 3: Supplier Deliveries Index (United States: ISM Manufacturing PMI) (Index; >50 denotes slower)
-Haver Analytics, Rosenberg Research

Note: Shading indicate recession

CHART 4: Total Retail Sales (Billions of Dollars, Seasonally Adjusted)
-U.S. Department of Commerce and Wells Fargo Securities

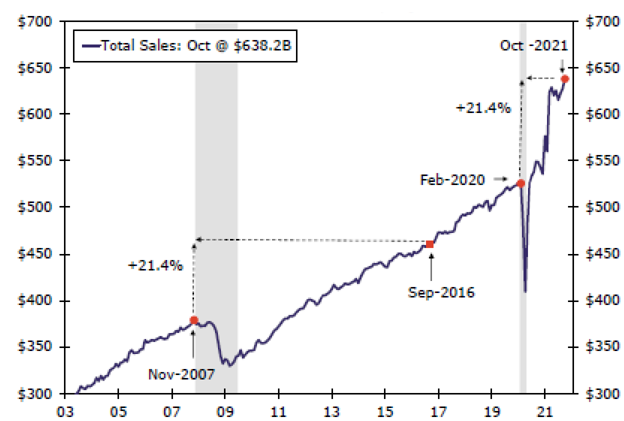


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CHART 5: Manufacturing Production vs. Core Capital Spending
(Index, 2017=100;Billions of Dollars)
– Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

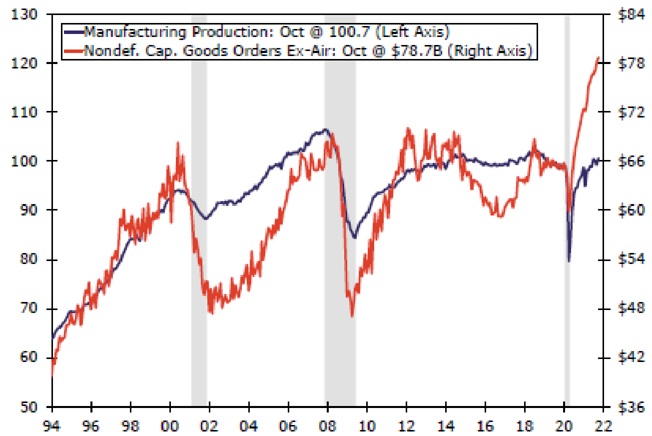


CHART 6: S&P 500 Profit Margin
– Standard & Poor's Corporation (revenues) and I/B/E/S data by Refinitiv (operating EPS)

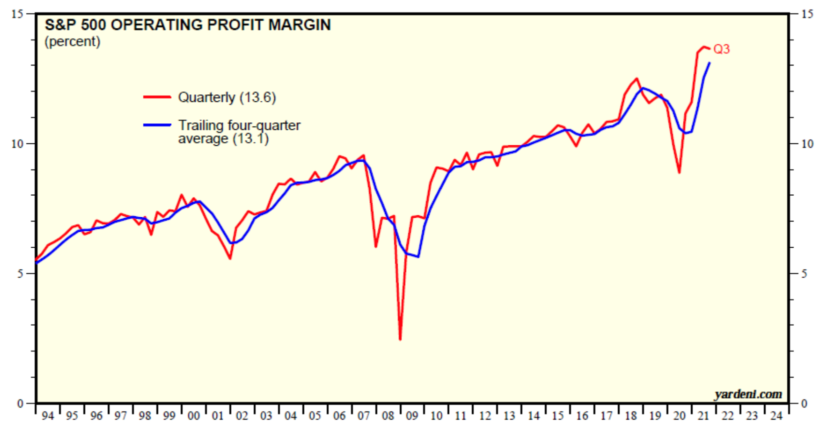
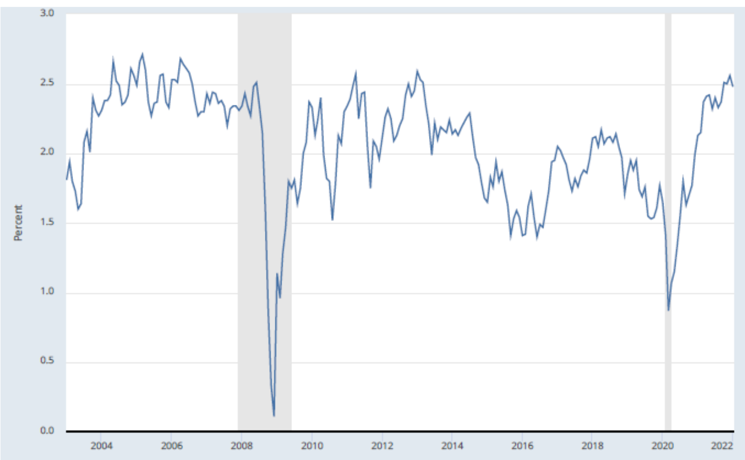
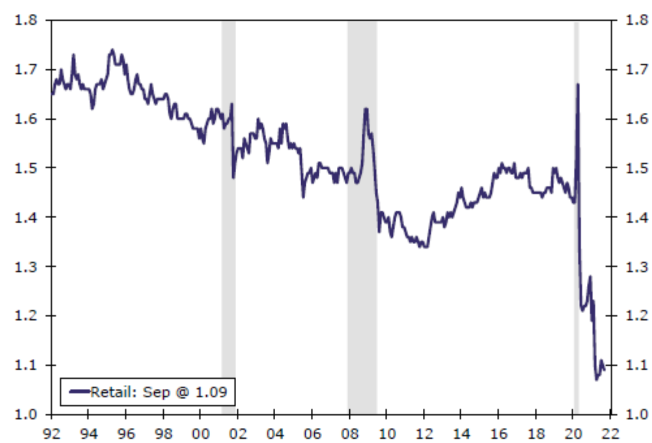


CHART 7: 10-Year Breakeven Inflation Rate
– Federal Reserve Bank of St. Louis, FRED



Note: Shaded areas indicate U.S. recessions

CHART 8: Retail Inventory-to-Sales Ratio
– U.S. Department of Commerce and Wells Fargo Securities



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RECENT BNN SHOWS

Christine: December 14, 2021

Christine: November 16, 2021

Christine: October 13, 2021

Christine: September 14, 2021

Christine: August 12,2021

Christine: July 13, 2021

Christine: June 16, 2021

DECEMBER 31, 2021 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	3 YEARS*
S&P TSX COMPOSITE TOTAL RETURN (CAD)	6.5 %	25.1 %	17.5 %
S&P 500 TOTAL RETURN (CAD)	10.6 %	27.7 %	22.9 %
S&P 500 TOTAL RETURN (USD)	11.0 %	28.7 %	26.1 %
DJIA TOTAL RETURN (USD)	7.9 %	20.9 %	18.5 %
NASDAQ COMPOSITE PRICE RETURN (USD)	8.3 %	21.4 %	33.1 %
MSCI WORLD INDEX PRICE RETURN (CAD)	7.5 %	20.1 %	19.7 %
CANADIAN UNIVERSE BOND INDEX	1.5 %	-2.5 %	4.2 %

COMMODITIES	QTD	YTD
GOLD	5.2 %	-3.8 %
SILVER	5.4 %	-11.8 %
COPPER	8.9 %	25.7 %
NATURAL GAS (NYMEX)	-36.4 %	54.0 %
WTI	0.2 %	55.0 %
BRENT	0.2 %	50.1 %

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TREASURY BONDS	12/31/21	09/30/21	12/31/20
2 YEAR (CAD)	0.98 %	0.53 %	0.20 %
2 YEAR (US)	0.73 %	0.28 %	0.13 %
5 YEAR (CAD)	1.28 %	1.11 %	0.41 %
5 YEAR (US)	1.26 %	0.98 %	0.36 %
10 YEAR (CAD)	1.45 %	1.51 %	0.70 %
10 YEAR (US)	1.52 %	1.52 %	0.93 %
30 YEAR (CAD)	1.72 %	1.98 %	1.24 %
30 YEAR (US)	1.90 %	2.08 %	1.65 %
CPI (CAD)	4.70 %	4.40 %	0.70 %
CORE CPI (CAD)	3.60 %	3.50 %	1.00 %
CPI (US)	6.80 %	5.40 %	1.40 %
CORE CPI (US)	4.90 %	4.00 %	1.60 %

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