2022 – The Year of The Curve Ball

It's usually at this time of year when many of us begin to reflect on the past year and start to put together a list of new goals/desired behaviours for the upcoming one. This reflection process is not only a great opportunity to look back on the many successes or achievements from the past year, but it's also an opportunity to hit the reset/recalibrate button on some of the goals that may not have been achieved during the year. In most cases, either the list of goals was doomed from the very start (e.g., not specific enough) while in other cases, the unexpected happened (e.g., new job, a new addition to the family, etc.), hindering one's ability to achieve their newly set goals.

But as we all know, when it comes to setting any type of goals, especially ambitious ones at the start of the year, there is always the possibility that life can throw a few curve balls and derail one's plans. However, unlike in the game of baseball, where balls are thrown one at a time from a pitcher directly in front of a batter, life can often feel like several curve balls are being thrown at us simultaneously from all directions. This was especially true in 2022, as global equity, bond and commodity markets all struggled to find a clear direction throughout much of the year, only to end the year mostly in the red. The Russian invasion of Ukraine and the continuation of zero-COVID policies in China added to the flurry of unexpected events in 2022.

Unfortunately, we continue to expect another challenging year ahead for investors in 2023. But rather than trying to anticipate and/or avoid all the curve balls, we suggest investors position portfolios to withstand the unexpected – more on this below.

2022 Curve Balls: 40-year High Inflation, the Russian Invasion of Ukraine, Zero-COVID in China, a Hawkish BoC, etc.

To state the obvious, the upbeat narrative at the beginning of 2022 for the Canadian economy changed quite meaningfully as the year progressed to a more cautious one. Economic and market fundamentals all continued to weaken into year-end, as the many

Canada Economic & Market Indicators Weakened In 2022

Indicator Name	Q1 2022	Q2 2022	Q3 2022	Q4 2022 E
S&P/TSX Index 2022 Price Target (Consensus)	21890.16	18861.36	18444.22	19485.89
GDP growth (% y/y)	3.20	4.70	3.90	2.20
Consumer spending growth (% y/y)	5.20	8.20	2.90	2.40
Investment growth (% y/y)	0.20	-1.70	0.50	-1.80
Government consumption growth (% y/y)	2.20	0.90	1.60	1.30
Exports of goods and services growth (% y/y)	-2.60	4.70	6.00	3.60
Imports of goods and services growth (% y/y)	4.10	10.90	11.40	4.70
Unemployment rate (%)	5.80	5.10	5.20	5.30
Employment growth (% y/y)	4.70	5.00	3.00	1.70
Headline Inflation (% y/y)	5.80	7.50	7.20	6.50
Policy interest rate (%)	0.50	1.50	3.25	4.25
PMI*	74.20	62.20	59.50	51.40
CAD/USD (CAD per USD)*	1.25	1.29	1.37	1.36
WTI Oil Price ($/bbl)*	100.53	107.76	79.91	80.48

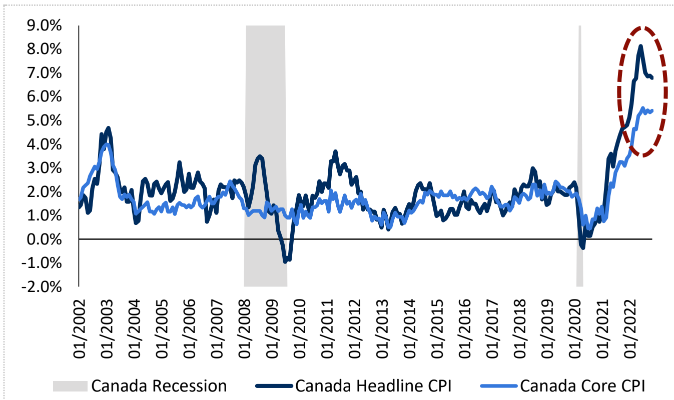
Source: Capital Economics; Raymond James Ltd.; Q4 Estimates are as of December 20, 2022; *PMI, CAD/USD and WTI Oil Price are actual data as of December 20, 2022.

unexpected curve balls became unavoidable and weighed on the Canadian economy/markets and consumers.

Inflation was initially viewed as transitory or temporary, largely a function of the reopening process and something that would not require much by way of intervention by policymakers. However, the sheer magnitude of stimulus, the uneven access to vaccines and the reopening policies globally sent inflation here in Canada soaring to levels not seen in 40+ years. This was further complicated by the Russian invasion of Ukraine and the global sanctions that followed, along with the continuation of zero-COVID policies in China.

Together, these factors exacerbated existing inflationary impulses and sent Canadian headline and core consumer price indices (CPI) soaring to record highs and rising by 8.1 per cent and 5.5 per cent YoY in June and July, respectively.

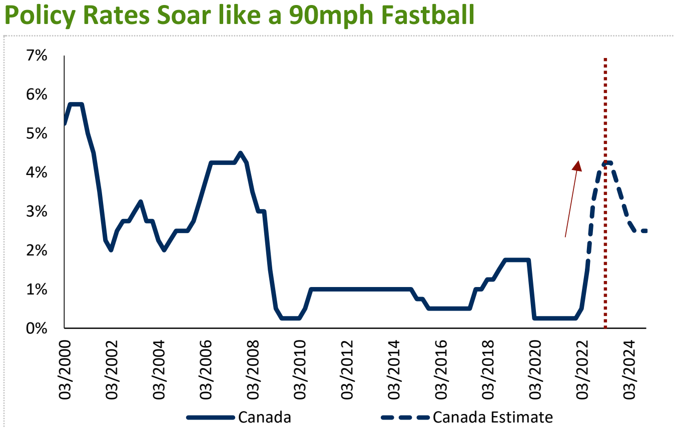
Inflation Pressures Appear to Have Peaked in 2022



Source: FactSet; Raymond James Ltd.; Data as of November 30, 2022.

What started off as expectations for gradual increases in policy rates by the Bank of Canada (BoC) quickly evolved into abrupt and rapid increases in rates as inflation broadened out across the CPI basket and soared to new highs.

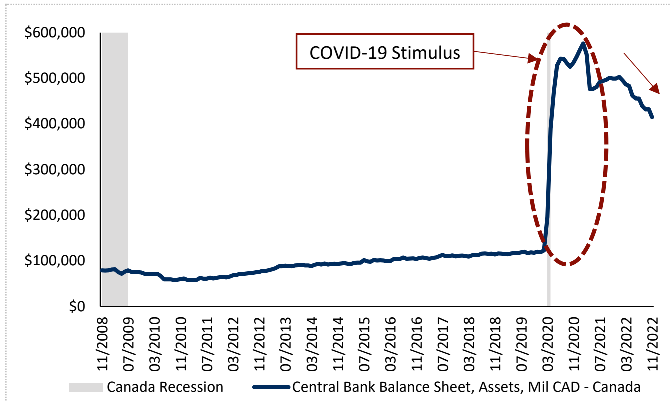
Policy Rates Soar like a 90mph Fastball



Source: Capital Economics; Raymond James Ltd.; Data as of December 23, 2022.

Additionally, in 2022, investors saw overnight interest rates rise at the fastest pace on record from 0.25 per cent to 4.25 per cent in a matter of only 10 months. Moreover, pandemic-related assistance programs quickly came to a close, while the BoC began unwinding its balance sheet of bonds and simultaneously raising rates – something not done at any time in the past 20+ years.

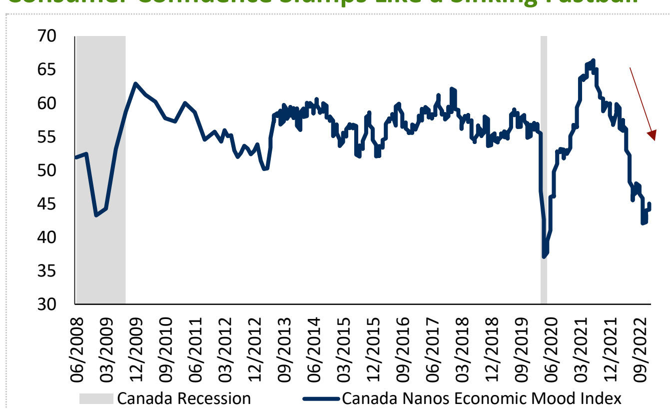
BoC Gets A Double Play



Source: FactSet; Raymond James Ltd.; Data as of December 16, 2022.

The many uncertainties and curve balls of 2022 created a tremendous level of worry for investors and wreaked havoc on Canadian consumer sentiment. The Bloomberg Nanos Canadian Confidence Index – a weekly measure of Canadians' economic mood on the strength of the economy, job security, real estate and one's personal financial situation – has since collapsed to recession lows after hitting an all-time high in 2021.

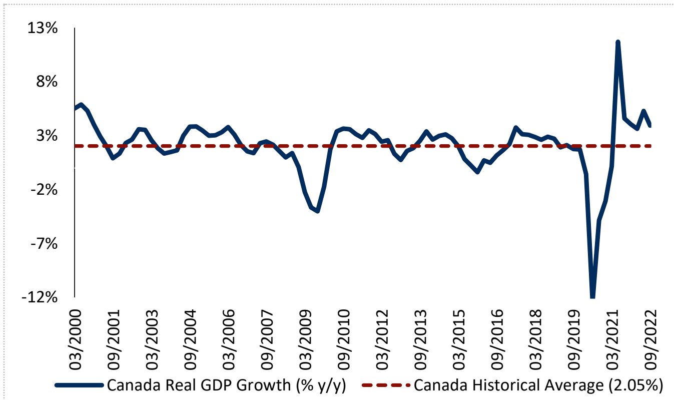
Consumer Confidence Slumps Like a Sinking Fastball



Source: FactSet; Bloomberg; Raymond James Ltd.; Data as of December 16, 2022.

While a measure of consumer sentiment is a helpful gauge of Canadians' feelings about several issues, the reality of all this was that the deteriorating sentiment was a rather accurate reflection of the many curve balls impacting the real economy and causing it to slow aggressively. The most material contributor to the economic slowdown was the sheer pace and magnitude of policy tightening that took place in 2022. Real GDP growth in 2021 soared to an unsustainable and highly inflationary level of growth of 5.0 per cent YoY, however, it is now expected to grow at a much slower pace in 2022 by 3.5 per cent and show no growth in 2023. This is a dramatic fall from peak levels as the pendulum swings aggressively from one extreme to another. Not surprisingly though, with all that has transpired in 2022, investors are now expecting a recession in 2023, the probability of which has risen to 65 per cent for a potential recession over the next 12 months.

A Slow Pitch for Canadian Real GDP Growth

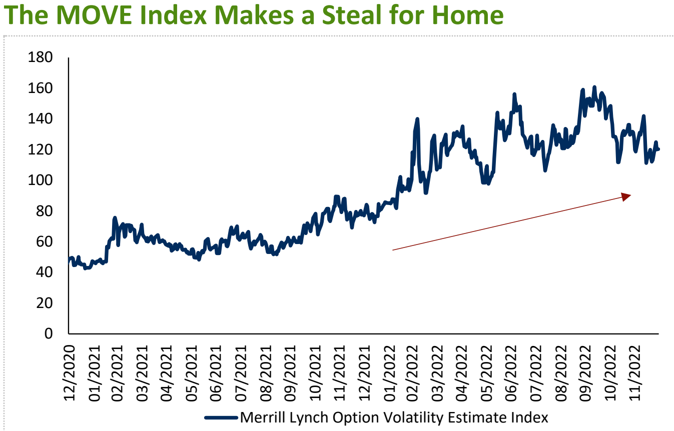


Source: FactSet; Raymond James Ltd.; Data as of September 30, 2022.

These rather abrupt changes in the economic/market climate have equated to a much more difficult investing backdrop, which was plagued by higher levels of uncertainty. The commonly watched volatility gauge (e.g., the MOVE Index) seesawed quite violently throughout much of the year.

Complicating matters further for investors in 2022 was the fact that both Canadian equities as well as bonds and even commodities offered lower diversification benefits than in times past.

The MOVE Index Makes a Steal for Home



Source: FactSet; Bloomberg; Raymond James Ltd.; Data as of December 29 2022.

Raising Your Batting Average for 2023

As we have noted since the beginning of the year, investing is less of an art and more of a science. It takes a high degree of due diligence to identify good quality businesses and even more rigour to determine a fair value to pay for these businesses – the easy gains as we have said are so 2021 – i.e., behind us.

Additionally, we suggest investors try to focus on "places to invest" – i.e. owning securities that can help investors reach their investment goals and are fairly/attractively priced rather than following the fear gauge in one's gut, only to invest in securities that won't go down over the short-term no matter the price - we regard these investments as "places to hide". In our view, searching for "places to hide" is highly inconsistent with the main premise of investing and generating long-term wealth, so avoid this practice at all costs, where possible.

For the S&P/TSX Composite index, we see good value for the index as the broad market is trading at 12.3x next 12 months earnings versus the 20-year median of 14.6x. More specifically, at the sector level, we see good relative value/lower risks for the Energy, Materials (e.g., golds), Real Estate, and Consumer Staples sectors, however, we see further downside risks either from valuation compression or from earning revisions for the Information Technology, Industrials, and Utilities sectors.

S&P/TSX Composite Sector Valuations – It's a Full Count (3 balls, 2 strikes, & 2 outs)

Index/Sector	Current PE NTM	Historical PE (Since 2000)	Premium (Red) / Discount (Green)	YTD Return
S&P/TSX Composite	12.3	14.6	-2.3	-5.1%
Energy	8.8	15.0	-6.2	29.9%
Materials	14.1	17.2	-3.1	3.2%
Financials	9.4	11.5	-2.0	-8.9%
Health Care	15.1	16.4	-1.3	-59.8%
Consumer Discretionary	14.0	14.3	-0.3	-4.7%
Real Estate	14.7	14.7	0.1	-21.6%
Consumer Staples	16.2	15.8	0.4	12.7%
Utilities	18.9	17.9	1.0	-9.1%
Communication Services	17.0	15.7	1.3	-3.3%
Industrials	22.4	15.6	6.8	2.8%
Information Technology	32.1	21.4	10.7	-50.9%

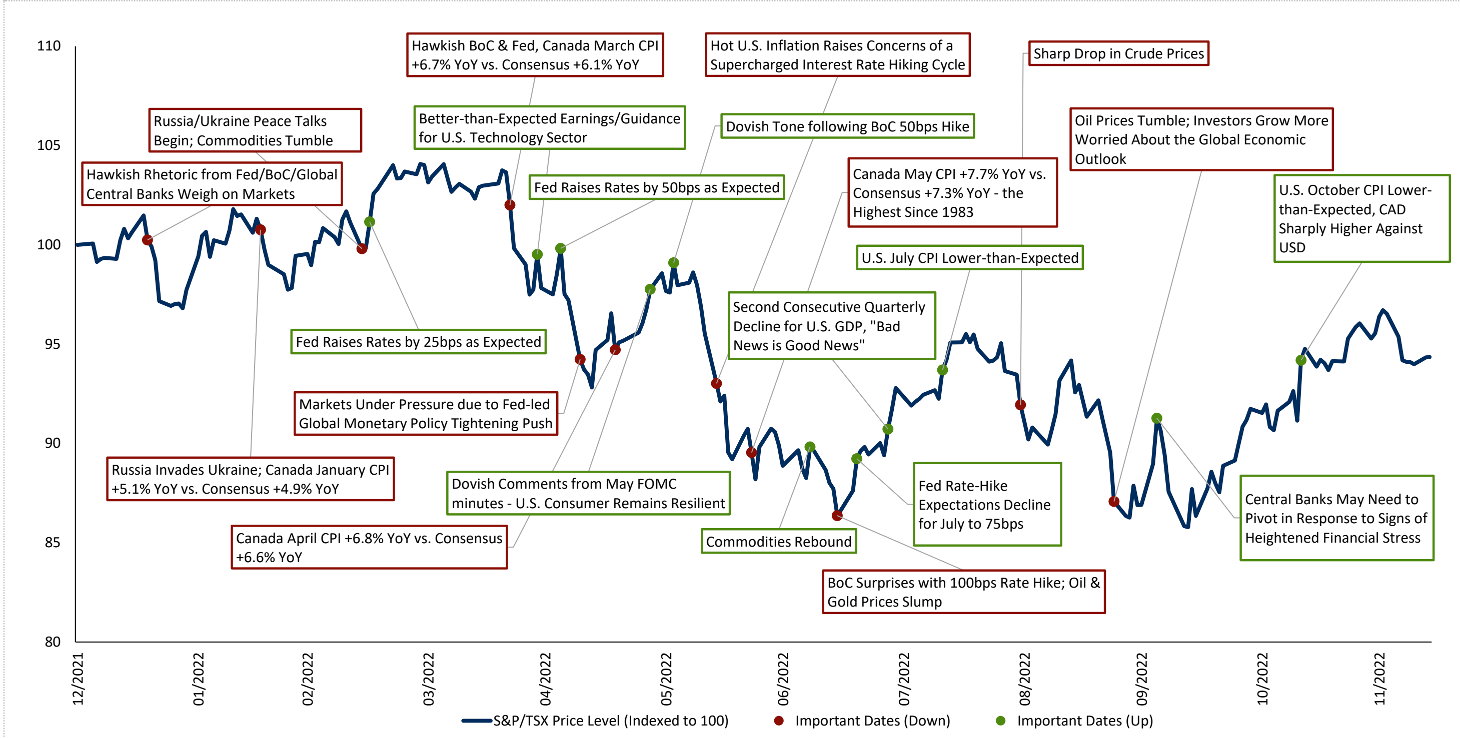
Source: FactSet; Raymond James Ltd.; Data as of December 22, 2022.

Final Thoughts for Investors

For long-term oriented investors, we suggest to: **1)** Stay invested and well diversified across/within asset classes including equities and bonds; **2)** Ignore the headlines; **3)** Stick to your investment plan; **4)** Capitalize on mis-pricing/bargains in the marketplace across asset classes; and **5)** Remain selective and focus on allocating capital to securities that offer compelling risk/reward profiles with a high margin of safety.

Click here for our outlook report: **2023 Outlook – It's Complicated…**

A Look Back at the S&P/TSX Composite Index Performance in 2022



Source: FactSet; Raymond James Ltd.; Data as of December 13, 2022.

Despite a Volatile Backdrop, the S&P/TSX Composite Outshines Major U.S. & Asian Market Peers

Equities	3Mo (in USD)	3 Mo (in CAD)	YTD (in USD)	YTD (in CAD)	Current PE NTM	Historical PE Median (Since 2000)	Premium (RED) / Discount (GREEN)
Canada							
MSCI Canada Value (Canada)	-0.3	1.3	-5.2	2.2	9.5	12.3	-2.9
S&P/TSX Composite (Canada)	1.2	2.9	-11.9	-5.1	12.3	14.6	-2.3
S&P/TSX 60 (Canada)	1.1	2.7	-12.2	-5.4	12.1	14.4	-2.3
S&P/TSX Small Cap (Canada)	3.2	4.9	-16.2	-9.7	11.8	16.9	-5.1
MSCI Canada Growth (Canada)	3.5	5.2	-19.3	-13.1	17.9	18.0	0.0
U.S.							
S&P Composite 1500 Value (U.S.)	7.6	8.7	-5.3	-0.2	15.1	13.9	1.3
S&P Mid Cap 400 (U.S.)	5.0	6.8	-12.6	-5.8	12.9	13.7	-0.8
S&P Small Cap 600 (U.S.)	3.9	5.6	-15.5	-8.9	12.4	15.8	-3.5
S&P Composite 1500 (U.S.)	3.0	4.6	-17.0	-10.5	16.4	15.7	0.7
S&P 500 (U.S.)	2.8	4.5	-17.3	-10.9	16.9	15.9	1.0
S&P Composite 1500 Growth (U.S.)	-2.0	-0.6	-27.5	-22.6	18.0	18.5	-0.5
NASDAQ Composite (U.S.)	-4.3	-2.8	-31.0	-25.6	22.8	22.2	0.7
Europe							
FTSE 100 (U.K.)	10.7	12.5	-9.2	-2.2	9.8	12.5	-2.7
CAC 40 (France)	17.5	19.4	-11.5	-4.6	12.3	13.3	-1.0
Euro STOXX 50 (Europe)	19.2	21.1	-15.9	-9.4	12.3	13.3	-1.1
DAX (Germany)	18.6	20.6	-16.9	-11.5	11.5	12.8	-1.3
Asia Pacific							
Hang Seng (Hong Kong)	4.8	6.5	-15.2	-8.7	9.3	12.1	-2.7
Nikkei 225 (Japan)	6.4	8.2	-18.4	-13.1	15.0	16.4	-1.5
MSCI China (China)	4.5	6.2	-23.8	-17.8	10.7	10.9	-0.2
Major Aggregates							
MSCI EAFE (Developed Markets ex U.S. & Canada)	12.0	13.8	-13.5	-6.7	12.1	13.6	-1.4
MSCI World (Global)	4.9	6.6	-17.0	-10.6	14.9	15.6	-0.7
MSCI EM (Emerging Markets)	2.7	4.4	-20.2	-14.0	11.6	11.5	0.1

Source: Bloomberg; FactSet; Raymond James Ltd.; Data as of December 22, 2022.

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