Quadrant
Private Wealth

# Expectations to Reality

## QPW Perspectives – February 2022

Beginning last year and continuing into 2022, inflation remains front of mind for many. Inflationary conditions are impacting both consumers and investors. Consumers are paying higher prices for products and services. Investment portfolios are experiencing the effects of rising interest rates in response to increasing inflation - which can negatively impact both fixed income and, in the short term, equity returns. As inflationary conditions continue to transition from expectations to reality and interest rate increases by central banks loom closer, it is understandable to feel a degree of concern regarding investment portfolios. As such, this is a good time to pause and reflect on capital market movements and portfolio management within the context of the current economic environment.

| Returns expressed in CAD | Q4 2021 | January 1-31, 2022 |
|---|---|---|
| **Canadian equities (S&P/TSX Index)** | +6.5% | -0.4% |
| **U.S. equities (S&P 500 Index)** | +10.7% | -4.8% |
| **International equities (MSCI EAFE Index)** | +2.4% | -4.7% |
| **Canadian fixed income (FTSE Canada Bond Universe Index)** | 1.5% | -3.4% |

Source: Bloomberg and FTSE Russell.

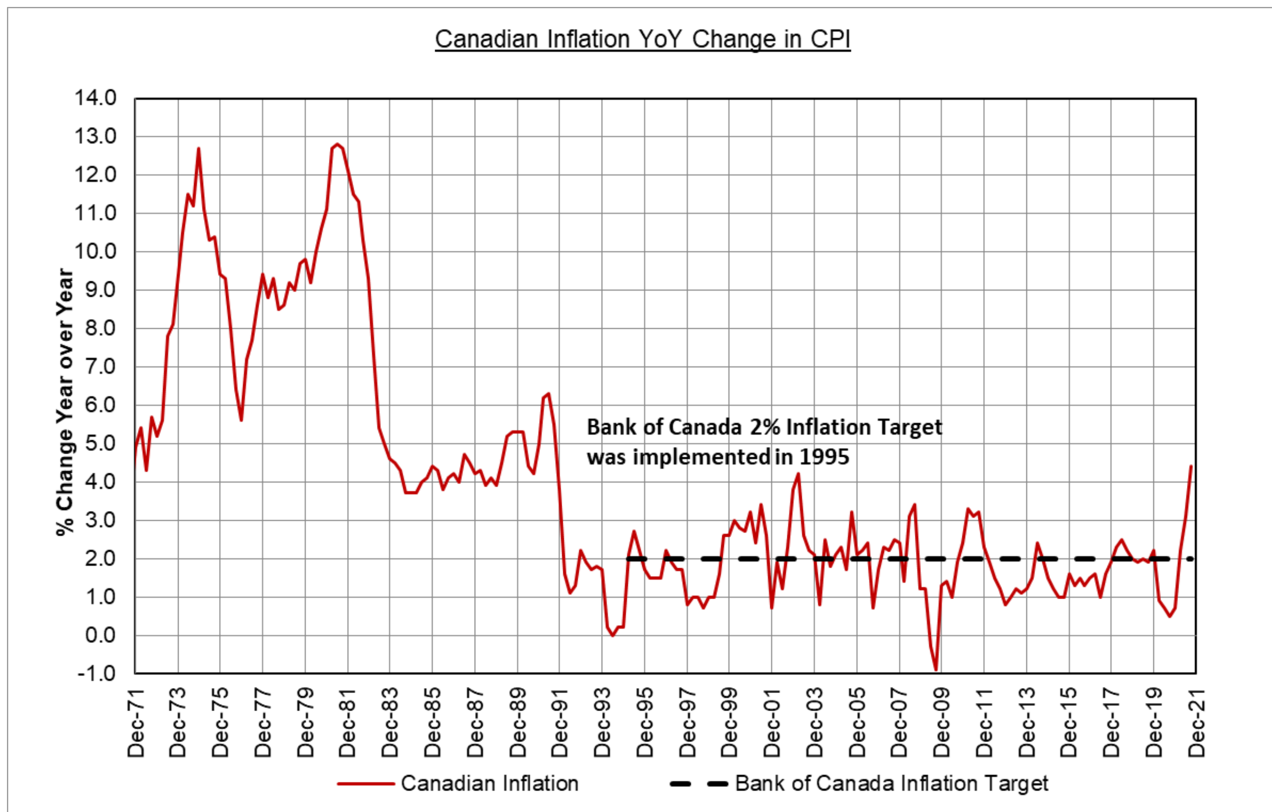
Recent Canadian economic reports continued to show increasing inflationary indicators, which, in turn, was reflected in capital market performance for the first month of the new year. Canadian fixed income returns were negative given the expectation of an interest rate increase from the Bank of Canada as early as next month. Current market expectations are for five to six policy rate increases of 0.25% each for a total of 1.25% to 1.50% in 2022.

Equity markets' returns were also negative for the first month of the new year. Despite the positive performance of the fourth quarter, which was largely supported by solid corporate earnings results, challenges are still present. Supply chain disruptions still persist due to the pandemic and company profitability is being affected by elevated inflation from a cost of goods and wages standpoint.

In looking at the change in market tone from 2021 to 2022 so far, it's important to bear in mind that these are not new developments. Inflation, whether transitory or not, has been anticipated for 2022 since mid 2021. Supply chain disruptions, which put upward pressure on prices for goods, continue to exist. Unlike mid 2021, however, the effects of inflation are now being seen in reporting data, with year over year inflation data at levels not seen since the early 1990s in Canada. Inflation is transitioning from expectations to reality.

### Inflationary Conditions are a Normal Part of the Business Cycle

Inflationary conditions are a normal part of the business cycle but it's been a long time since the current levels of inflation were experienced first hand. As of December 31, 2021, Canadian inflation, as measured by year over year change in the Consumer Price Index, was at 4.7%, a level not seen since late 1991.




Source: Bloomberg

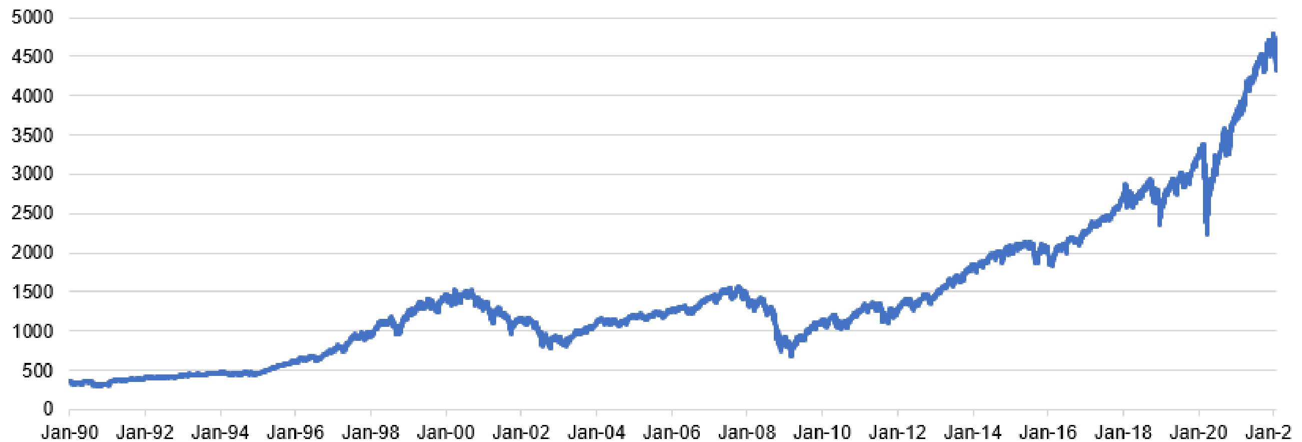
As we discussed in Inflated Inflation Worries, the double-digit inflation levels of earlier decades are not anticipated. The Bank of Canada manages inflation more prescriptively than it did during past time periods of high inflation, which is something investors and consumers should take some comfort in. That was a lesson learned from the inflationary conditions of the 1990s. And unlike prior time periods, the Bank of Canada is also openly preparing the economy by widely signalling their intent to dampen inflation increases through increasing interest rates.

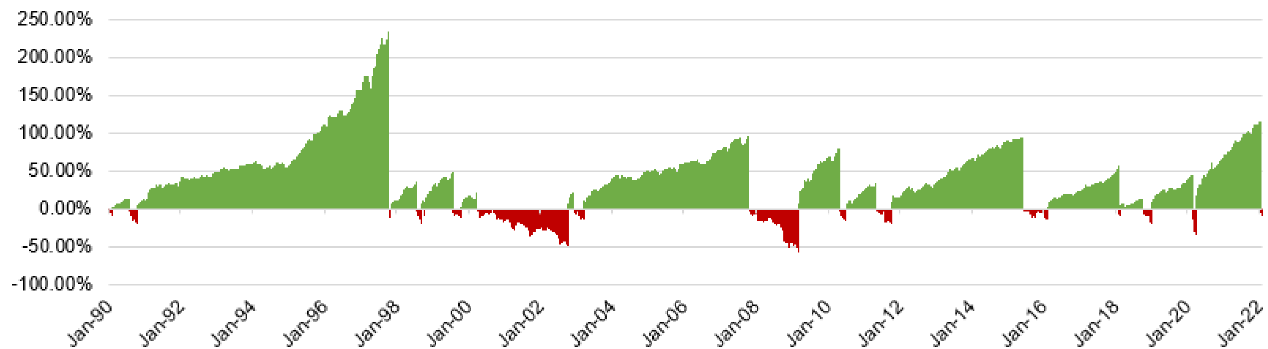
Even if the Bank of Canada does not get the timing of interest rate decisions completely right (highly likely), the bank will increase interest rates as it deems necessary to stave off an extended time period of inflation beyond policy targets in an effort to avoid inflationary experiences of the past.

**Financial Markets go Up and Down in Response to the Business Cycle**

Financial markets go up and down. Sounds simple, but the down part, or anticipation thereof, can create anxiety; especially considering that we have experienced unprecedented growth in equity markets over an extended period of time. Looking beyond the short-lived negative returns experienced in the early days of the pandemic, there are many investors who began investing during the past decade who haven't experienced a time period of negative returns over more than a quarter in the capital markets. And for more experienced investors, it's been a long time. This doesn't necessarily mean that a prolonged time period of negative equity market returns is upon us. However, the absence of a material correction can heighten anxiety that it may occur.

This is where perspective helps. The following, based on the S&P 500 Index, illustrates the growth of U.S. equities over the past thirty years and highlights time periods where there were corrections (price declines) of 10% or more. As can be seen, the last time period of a prolonged market correction dates back to 2007 to 2009, otherwise known as The Great Financial Crisis. U.S. equity markets recovered from this historic (in terms of magnitude) correction within two years and have continued to provide material positive returns beyond that point.




Source: Bloomberg

Part of the journey in choosing to invest in equities, or any asset class, entails volatility and experiencing time periods of negative returns. Acceptance of the volatility and exposure to negative returns is the very nature of choosing to invest in the capital markets. The magnitude of volatility and negative returns is relative to each asset class. As an example, an equity investment has greater volatility than a bank savings account investment but an investor can expect to receive a higher return over the long term in exchange. Historical returns have supported this expectation. As can be seen above, despite historical market corrections, the overall trend is positive over the long term.

**Perspective is Key**

When it comes to investing, the current economic environment can create pressure to “do something” in response and make dramatic portfolio changes. Portfolio changes should not be made in reaction to anxiety and discomfort. This can be easier said than done. Long term focus is key. Assuming a portfolio has been constructed appropriately, based on an investor’s time horizon, risk tolerance and long-term financial goals, as well as taking price growth and inflation expectations into account, entering an inflationary time period should not necessitate wholesale portfolio changes.

At Quadrant we continue to remain disciplined and dedicated in our long-term perspective regarding portfolio management and asset allocation with the goal of helping our clients remain on the path towards reaching and maintaining their financial goals. Our asset class managers are selected and monitored with a view to minimizing downside risk exposure and protecting capital in their respective strategies.

Having a well thought out and constructed long term investment and wealth plan, disciplined investment advice with purposeful asset allocations and best-in-class investment managers positions a portfolio to weather all stages of the economic business cycle, including inflationary ones.

**About Us**

Disciplined. Compassionate. Effective.

Quadrant Private Wealth is an independent, comprehensive, integrated wealth management firm committed to your financial well-being and peace of mind. We take the time to understand your complete financial picture. We tie all of your information together, including tax planning, to paint a picture of what your financial future could look like. And we aim to earn your complete confidence in the process.

**Quadrant Private Wealth**
Suite 720, One Lombard Pl
Winnipeg, MB
Ph: (204) 944-8124
email: inquiries@quadrantprivate.com
web: www.quadrantprivate.com

If you or someone you know could benefit from our services, please have them contact our offices at 204-944-8124 or email us at inquiries@quadrantprivate.com.

Sources: Bloomberg, as may be applicable. This report may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Quadrant Private Wealth (“Quadrant”). Any unauthorized use or disclosure is prohibited. The information herein was obtained from various sources believed to be reliable but Quadrant does not guarantee its accuracy. Neither Quadrant nor any director, officer or employee of Quadrant accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its content. The opinions, estimates and projections contained in this report are as of the date indicated and are subject to change without notice. Certain of the statements may contain forward-looking statements which involve known and unknown risk, uncertainties and other factors which may cause the results, performance or achievements of the company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Past performance is not indicative of future performance.