NCM PENSION PORTFOLIOS
MONTHLY UPDATE

April, 2022

Pension Style Investing for
ALL CANADIANS

John Poulter, CFA
Portfolio Manager

Cumberland Investment Counsel Inc.,
affiliate of NCM Asset Management Ltd.

Diversifying For an Unpredictable World

This month's commentary is longer than usual, but so is the list of issues facing investors today!

While we were prepared for a number of the recent headlines, the current combination of market gyrations and geo-political news is, in my opinion, unprecedented.

When it comes to investments and investing, there is always *something* that gives investors and portfolio managers cause to worry. As Portfolio Managers, it's basically our job to worry. Even the most robust bull markets have that certain *little* concern that might become a *big* concern.

The fact is, there is always something that can derail even the strongest markets. Since the risks that are associated with unknowns are exactly that - unknown - we must take steps to diversify our holdings and be prepared for surprises.

Sometimes positioning for risk has its own costs and seems to be a wasted effort. Sometimes those costs pale in comparison to the benefits of having diversification in place to cushion our portfolios when all hell breaks loose.

In the first three months of 2022, all hell broke loose, and we are witnessing our positioning and diversification efforts cushion us, in a market environment no one could have imagined 12 months ago.

Today's events do not reflect the niggling little concerns alluded to above, but rather a multitude of massive, market-shaking negatives. Individually, the problems we face would be measurably disruptive. As a package, they are truly daunting.

In my opinion, there is no single policy or decision, let alone direct government effort, that can solve the various spites that have left the box.

How's this for a list?

1) A US market with valuations and returns at unusual highs
2) Inflation at decades-long highs
3) Major central bank tightening around the world
4) Fears of World War III
5) A continuing global pandemic

It's difficult to imagine what would have been a perfect portfolio positioning for the environment we are currently experiencing. We have written extensively on our opinions and positioning concerning the list above. For example, take central bank tightening; it seems like ages ago we positioned in shorted-dated fixed income and, given the economy was still pretty strong, we bought credit, meaning higher yielding bonds. This has worked out well.

We have also written quite a bit about Canada's relative value versus other regions and specifically the U.S. Our NCM Pension Portfolios have been significantly tilted to Canada to reflect this thinking.

We have argued that liquidity-driven inflation could potentially be an issue. We have suggested a strategy where the growth and secular nature of our Real and Renewable and New Economy investments would provide a decent hedge against an inflationary flair up.

My point is that we adjusted for the potential impacts of economic events that seemed somewhat forecastable. But who could have foreseen the outbreak of a war that has NATO fretting about a third world war? Who saw double-digit inflation coming? And, looking back two years, who predicted a global pandemic?

I would offer that no one saw these things. We are now experiencing the exact purpose of portfolio diversification: being prepared for the unknowns.

How We Are Navigating

Valuation risks

Over the past three years, S&P 500 returns have ballooned beyond many investors' expectations. In addition, these returns are, historically, as rare as unicorns. Since 1926, the S&P 500 doubling in three years has only happened seven times. The returns after these unusual three-year periods are dependably poor. We wrote about this a few months ago and adjusted our portfolios accordingly. Our trades away from the U.S. and toward Canada and Non-North American investments were elevated and are significant.

Valuation has also been one of our concerns. The top-weighted Nasdaq 100 and S&P 500 companies have been something we've noted not long ago. These are the companies that make up an inordinate amount of the market capitalization but also have (or had) ridiculously high valuations. Not only have we tilted away from the U.S., but our NCM individual funds also reflect this thinking and tilt away from the high tech and social media bets that are leading/dragging the U.S. market lower today. The damage to these companies is exemplified by the performance of the Nasdaq 100. At the end of March, this index (measured by the ETF QQQ) was lower by 8.8%, almost double the S&P 500's loss, which was lower by 4.7%. Additionally, the volatility in the QQQ ETF has been off the charts, bottoming on March 14 with losses measuring over 20%.

We continue to watch valuation risks sort themselves out with lower prices. At some point in this cycle, some of the companies trading lower will become interesting, but with all the turmoil in the market today, it doesn't feel safe to try to pick a bottom. Our current policies toward the U.S. and growth remains static, meaning: proceed with extreme caution.

Tightening and Inflation

Globally, central banks have been preparing investors for a capital tightening cycle for over a year. Tightening to reverse pandemic "rail greasing" seemed easy enough to digest. When you throw in the fact that post pandemic employment rates are much higher and perhaps historically high, the case is solidified. And then, you overlay inflation at levels not seen for 40 years and you have a slam-dunk for rates to be cranked and cranked fast. Of course, that is if you don't have a war happening on the threshold of western Europe.

Central bankers' hands are likely tied at least until a Russia/Ukraine resolution is in sight. Rates will edge higher, and inflation might now be the biggest factor to be addressed. Unfortunately, the inflation we are experiencing today might not respond to tighter monetary and fiscal policies. We wrote about "cost-push" inflation in a previous comment. With that said, the momentum towards tightening is not new, and we responded to this some time ago by significantly shorting our maturities to avoid a steeper yield curve. This policy has not changed, and the NCM Pension Portfolios continue to bar-bell its fixed income between short- and medium-term fixed income. While this is not a change, remaining in this positioning is an active decision.

War Trades

We did not diversify our portfolios to benefit from the suffering of others. The fact is, we diversify to cover off the risk of extraordinary occurrences. Crowing about profiting from the misfortune of others would be particularity distasteful, so I find this portion of my comments difficult, even though I am simply relaying facts.

Conflicts leading to global instability are typically a non-event for major North American markets. They often result in a measurable drawdown at the onset, but the market recovers in about two months. There is no doubt that some industries get a boost, but generally there is little enduring effect, and the current Russian invasion seems to be following that path.

Our portfolios have experienced war-related volatility, but have also been cushioned by some specific holdings. We have pointed out our relative overweight in Canadian investments. Canadian stocks enjoyed a decent first quarter as investors appear to be focusing on this country's resource sectors and perhaps Canada's relative value profile. The TSX 60 (ETF: XIU) and Canadian Dividend Payers (ETF: CDZ) total returns are higher by over 3.6% and 5.4%, respectively. Clearly, they buck the trend, as most major indices are lower, some significantly, since year end.

Beyond the regional cushion Canada provided, we have also experienced a significant move higher in the prices for some of the specific themes in the NCM Pension Portfolios. Real and Renewable investments and specific ETFs in our New Economy holdings are reacting with higher prices given the current events. Global Agriculture, Global Infrastructure, Clean Energy and Cyber Security have all seen higher prices. The reasons for the higher prices should be obvious and can be directly linked to the conflict.

Our recent portfolio adjustments has reflected three goals. The first is to reduce volatility and the second is to remain in Canada. We expect to reduce volatility by shifting a significant amount of our Canadian holdings from the NCM Income Growth Class to NCM Core Canadian. The NCM Income Growth Class has exposure to smaller companies which can exhibit higher price fluctuations while the NCM Core Canadian has, as per its mandate, a low volatility profile. The expectation is that the NCM Core Canadian fund will provide the value characteristic we find attractive with lower price fluctuations overall.

The third goal is to crystalize gains. We have reduced our weight and taken profits in the Global Agriculture ETF (ETF: COW). This ETF has responded to the grains supply disruption caused by the conflict in Europe. Russia and Ukraine are major global producers of wheat and corn. The war has caused grain prices, vegetable oils and fertilizers, among other commodities, to skyrocket. The COW ETF has seen its price skyrocket in turn. The COW's price increase over the quarter is over 23%, and most of this (+21%) since the invasion began. The proceeds of this sale were directed both to NCM Core Canadian and the Global Infrastructure ETF. It is our belief that infrastructure spending will be an enduring result of this conflict whereas the end of hostilities might see the COW retreat.

Macro Asset Allocations

Our allocations between stocks and bonds have remained unchanged and reflect a neutral balance. Our reasoning here is that even with higher interest rates, the cost of capital remains low and manageable. Lower cost of capital favours equity markets. Our approach, as usual, is to be selective in our equity themes and regions and in our bond credits and terms to maturity.

Specifically defensive stocks (eg. Value Stocks, Staples and Health Care) will backstop the unknowns concerning the extent and duration of the Russian aggression. Even as the criminal campaign in Europe continues, people will still need to eat and will demand health services.

Our NCM funds hold many companies with very strong brands that enjoy pricing power, and we believe these companies can maintain margins even with escalating input costs. The takeaway here is that not only should investors be regionally focused but also company and industry selective as well.

Our comments this quarter are longer than usual and this is because the number of extraordinary events unfolding around us is unusually large as well. Extraordinary times lead to extraordinary measures, and we have been active as we adjusted to these events. Above all, this is a time to remain focused on the long-term and depend on diversification as our single best strategy.

NCM Investments

CONTACT US

www.ncminvestments.com

Calgary
Suite 1850, 333 - 7 Avenue SW
Calgary, Alberta T2P 2Z1

Toronto
310, 99 Yorkville Avenue
Toronto, Ontario M5R 3K5

FOLLOW US

403.531.2650 Phone
1.877.531.9355 Client Services
1.877.431.1407 Toll-Free
info@ncminvestments.com