



Pension Portfolios Monthly Update

Pension Style Investing for All Canadians



John Poulter, CFA

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

Volatility Prevails But a Strong Start For The Year

The year started with the promise of a stock market recovery. The S&P 500 came out of the blocks with over 6% in capital appreciation, and the TSX 60 was higher by almost 5%. Of course, momentum like that is unsustainable and February has seen some of those January

gains erode, but it's hard not to feel like investors are looking for bargains.

While the mood seemed to support a bull market, it was tempered with a discerning eye. Investors want growth, particularly in the current higher inflation environment, but they don't seem to be interested in buying growth at any cost. This was the theme of our last monthly commentary. The message then was that 2023 will be a stock pickers market. Growth stocks that got over sold would see relatively higher recoveries. Growth stocks and the risk of volatility often go hand in hand. The following tables show that investors have been buying risk but, in my opinion, not at any cost.

Table 1 shows the performance of the S&P 500, partitioned by growth. Table 2 shows the S&P 500 partitioned by sectors that define growth categorizations. Both of the tables show investors are seeking earnings growth, but it appears they are buying it with an eye to the valuations. This is a classic stock picker's modus operandi.

Table 1: S&P 500 Performance by Growth and Value

	Avg. P/E	Avg. PEG	Avg. Returns
High Growth	24.1	1.3	5.7%
High Growth Value	10.9	0.7	4.2%
Medium Growth	22.7	2.6	2.5%
Low Growth	19.7	3.9	4.1%

Source: Capital IQ

Table 1 shows the performance of the S&P 500 split into three segments based on forecasted 5-year forward earnings growth across all sectors. For further context, I have separated value stocks as a subset of high growth stocks. The average returns reflect the total performance year-to-date from the end of December to February 25, 2023.

A few observations from this table:

- High growth companies have been getting the most buying support.
- High growth is by far the most attractive attribute.
- This subset of the market trades at a very attractive 1.3 PEG ratio.

The PEG ratio stands for price to earnings to growth. It indicates the amount of earnings growth investors are buying given the current earning level of each company. Lower values indicate better value.

The High Growth Value companies in green are forecast to have higher future earning growth, but they currently trade at very attractive investment valuation levels. While they have not yet been the best performers, as a group, they have seen a decent start to the year. With lower valuations such as P/Es but higher growth forecast, they may represent a solid low risk way to buy growth with a possible floor for prices.

Table 2 supports the observations and conclusion drawn above, however, this table partitions the market by sectors. For example, the high growth sector includes Communications, Consumer Discretionary and Technology. In contrast, the low growth group includes sectors such as Utilities, Materials and Energy.

The table shows that investors are looking for growth and investment values in the sectors that got hardest hit last year. They are in search of the "rebound" but, as noted above, with an eye to value.

New money should be rewarded by higher future growth but those that have suffered the P/E contraction might be facing permanent losses. It is possible that investors that were hit hardest by last year's P/E contraction may have capitulated toward the end of the year and fueled deeper price reductions through tax loss selling. If you expect P/E expansion won't bring you on side, then a healthy tax loss benefit might be your only salvation. This is presenting opportunity in many sold-out companies for new investors rotating in new cash.

Table 2

S&P 500 Performance by Sector	Wgt% S&P 500	Average Performance	
High Growth Sectors	56.3%	4.7%	Communication, Consumer Discretionary, Technology
Medium Growth Sectors	22.6%	1.2%	Financials, Industrials, Materials, Real Estate
Low Growth Sectors	21.7%	-0.3%	Consumer Staples, Energy, Health Care, Utilities

Source: Capital IQ

The sectors dominated by growth also indicate where investors have been concentrating their interests. The defensive groups that held up relatively well last year (i.e. Health Care and Staples) are seriously falling behind as we begin the year.

While it may look like equity investors began the year with a “risk-on” attitude, I believe the buying is more rational than that. With inflation stubbornly high and potentially staying higher than it has been in years, and 2023 earnings at risk due to a soft economy, it makes sense to look to longer term growth as the best characteristic for investments today. After the price damage many growth stocks experienced last year, it makes sense to look to this group for both growth and value. The high growth PEG ratio at 1.3 suggests there is value to be found.

Fixed Income

We are seeing a similar “risk-on” trade happening in fixed income, however this action might have a simpler catalyst.

Both long-term and short-term higher yield (and higher risk) fixed income investments have been outperforming the comparable termed higher-grade indices. Table 3 makes this point. The table compares a series of high yield corporate bonds and structured fixed income ETFs to the Core Canadian Bond Index. The Core Canadian Index holds Government Bonds and AAA credits, meaning the lowest risk bonds.

As a group, the higher yield ETFs are higher so far this year by almost 3% and well ahead of the benchmarks across all the periods shown. Numbers in green are ahead of the index. The reason for this is that the higher yielding ETFs have provided higher cash returns and defaults have been reasonably low. The higher yield bonds have seen lower prices, but the lower prices appear no worse than the price damage done to the highest investment grade.

It’s my belief that this outperformance will be maintained through the year and perhaps longer. I expect that the discounted bond prices imbedded in these ETFs will recover and the higher coupons they pay will remain in place.

Table 3

	2/27/2023	YTD	3 Mos	12 Mos	24 Mos
High Yield Pubcos		3.15	2.86	-4.93	-4.91
Invesco Exchange-Traded Fund Trust II - Invesco Senior Loan ETF		2.9	3.1	1.3	2.5
TCW Strategic Income Fund, Inc.		7.6	8.6	2.0	0.7
BlackRock Income Trust, Inc.		3.1	2.4	-10.8	-19.9
iShares Trust - iShares J.P. Morgan USD Emerging Markets Bond ETF		1.0	0.8	-10.8	-15.6
BMO High Yield US Corporate Bond Hedged to CAD Index ETF		1.4	1.5	-7.5	-8.0
iShares Trust - iShares 0-5 Year High Yield Corporate Bond ETF		1.3	1.3	-1.7	0.5
SPDR Series Trust - SPDR Bloomberg Short Term High Yield Bond ETF		1.9	1.9	-1.7	0.3
iShares US High Yield Bond Index ETF (CAD-Hedged)		1.0	0.4	-7.1	-7.2
iShares S&P/TSX Canadian Preferred Share Index ETF		7.0	4.8	-11.5	-3.6
Mackenzie Floating Rate Income ETF		4.2	3.8	-1.5	1.2
iShares Core Canadian Universe Bond Index ETF		0.17	-1.14	-7.10	-10.41

Source: Capital IQ

Each of the three NCM Pension Portfolios have this trade represented in their bond holdings. The NCM Pension Portfolios primarily hold shorter term BB and BBB investment grade bonds as this is where we believe the sweet spot is for this discount price opportunity.

Generally speaking, the trade remains: focus on shorter term and buy discounted credit. The natural pull-to-par in the 1-5 year maturities in the NCM Pension Portfolios is almost 7%. Pull-to-par is a term used to describe the price movement from discount to principle pay back when the bond comes due. This means that the bonds currently held should increase in value by close to 7% simply with the passage of time. This capital appreciation is in addition to a coupon yield that is measurably higher than the market benchmark.

Current Allocations

Charts 1 and 2 present the equity and fixed income allocations in our NCM Pension Portfolios.

Seeking growth in equity has seen the movement of funds from low beta Canada (NCM Core Canadian) to higher beta mid-cap Canada (NCM Income Growth Class) and a shift from the Non-North America Global ETF to NCM Core Global, which includes a significant amount of S&P 500-style investments. My argument above to capture higher growth in the USA is the reasoning for this new repositioning.

Chart 1: Equity Holdings Detail

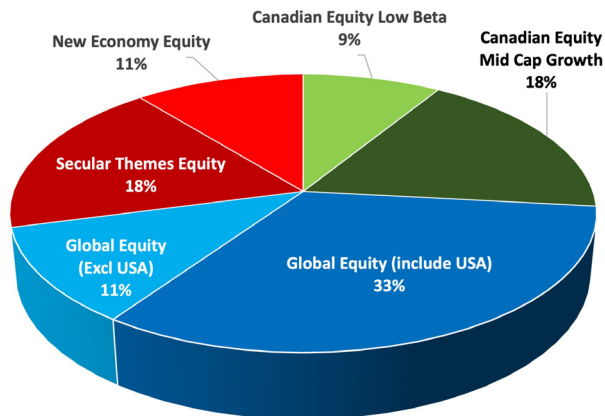
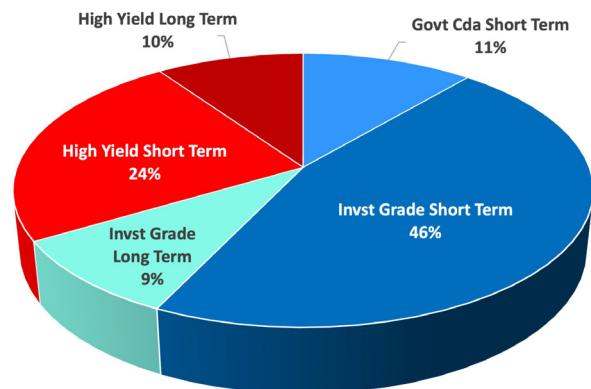


Chart 2: Fixed Income Detail Investment Grade 66% : High Yield 34%



We are currently investigating new investments that will capture more of the equity characteristics described above. The Portfolios' new Economy Themes (i.e Cyber Securities and Electric Vehicles) have remained in place as these industries are expected to be significant growth engines that are independent of macroeconomic bumps.

The bond allocations represent the themes described above. We are predominantly in corporate bonds with shorter maturities and we have maintained a healthy allocation to high yield in both short term and longer-term allocations. We also maintain a modest allocation to short term government risk-free ETFs.

Recent market action has seen a significant amount of the returns enjoyed through January evaporate, but I don't think this a new trend lower. January's pace was unsustainable, and the world is not without the same unknowns that plagued us over the last year. The central bank cycle is still with us. While we believe its closer to its end, data point news continues to produce mixed signals from the Fed and the Bank of Canada. A new "Soft Landing, Hard Landing, No Landing" news story comes out every day. And now China is potentially ramping up its support to Russia and providing weapons for its illegal war in the Ukraine.

Investors are nervous and sell on any news that has a negative taint. In our opinion, that will simply create volatility and not necessarily change this year's trend to higher equity markets. We also believe it will be a year where good equity and sector selection will be rewarded with handsome payoffs. Buying growth at bargain prices should be a solid theme.

Finally, we are happy to stay out of the way of the volatility in the long end of the government yield curve. This means we will remain short term and follow our strategy to pick up discount price bonds and hopefully ride that opportunity to its capital gain payoff.



NCM Asset Management Ltd.

Head Office 1850-333 7th Avenue S.W., Calgary, AB T2P 2Z1 | 310-99 Yorkville Avenue, Toronto, ON M5R 3K5
client services: (877) 531-9355 | toll-free: (877) 431-1407 | info@ncminvestments.com | ncminvestments.com

John Poulter is a Portfolio Manager, with Cumberland Investment Counsel Inc. (CIC). CIC is the sub-advisor to its affiliate, NCM Asset Management Ltd. The information in this document is current as of February 27, 2023 but is subject to change. The contents of this document (including facts, opinions, descriptions of or references to, products or securities) are for informational purposes only and are not intended to provide financial, legal, accounting or tax advice and should not be relied upon in that regard. The communication may contain forward-looking statements which are not guarantees of future performance. Forward-looking statements involved inherent risk and uncertainties, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. All opinions in forward-looking statements are subject to change without notice and are provided in good faith. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.