NCM PENSION PORTFOLIOS MONTHLY UPDATE

Pension Style Investing for ALL CANADIANS

June, 2022

John Poulter, CFA
Portfolio Manager

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

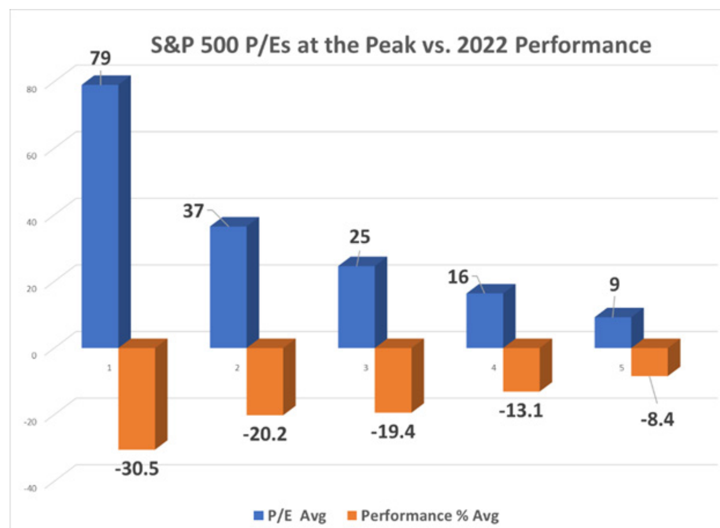
Are We There Yet?

What is it about kids that makes them ask the question, "Are We There Yet?" while clearly, if the car is moving, we are not there. Investors and portfolio managers are starting to behave similarly. Capital markets are still moving in response to several known irritants that need to play out, so we are not "there yet." With S&P 500 and TSX equities down approximately 19% and 11% respectively, I suppose it is a reasonable question: Are we at a bottom? Our expectation is that the road to clarity still has a few twists and turns ahead before we confidently declare we are there.

Investors still need to digest a few more challenges before elevated price risks have subsided. It may be true that COVID risks, valuation excesses and central bank rate shocks are behind us but the impact of QT activities, the ongoing war and inflation still need to be resolved. Even with a murky future there are some signs we see that has us reviewing our allocations with changes in mind. Our last market commentary was named "Holding Pattern" but that idea might be changing. Tactical positioning is usually best executed in advance of the events they are associated with. Although we need to work through several risks, this doesn't mean that we shouldn't start considering what our tactical positioning should be in the anticipation of risks subsiding. Preparations to take advantage of new opportunities that are developing need to be considered. At NCM, we are busy making plans and examining where we can take advantage of a challenging and changing investment landscape.

In our view, the two most significant dynamics in capital markets are the changes in equity market valuations and the likely normalization of the term structure of interest rates. This commentary will focus on equities.

Let's consider valuation and the S&P 500 today. The polarization between value and growth of this market over the past few years has given me a lot to write and worry about. While I may have been early in my doubts and concerns, the melt down in the first half of this year has me feeling a little vindicated. My concerns about the S&P 500 had less to do about stocks in general and more to do about this index's top-heavy concentration in growth stocks that were significantly overvalued. When we dissect the market to investigate what this polarization has meant in price pain, my worries are exemplified. The bar chart below shows how stocks, when split by valuation levels (quintiles of P/E rankings), have performed. The market peaked sometime in late December 20211. The returns in this chart span December 29th, 2021 to June 17th of this year. The orange bars show the average performance of the S&P 500 stocks, ranked according to P/E's in late December 2021.



Source: S&P Capital IQ

The performance differential between the most expensive quintile (100 companies) and the best valued 100 companies is over 20%. The most expensive companies had P/E's averaging 79X earnings and represented twice the market capitalization than the low P/E companies, with an average P/E of 9X earnings. The high P/E stocks are down over 30% and the low P/E stocks are lower by 8.4%. It appears that actual earnings have trumped earnings prospects and, as usual, actual earnings cushioned the price erosion in this recent sell off. This of course has ramifications for our actions going forward. We now see the market valuation gap narrowing as the valuation spread between growth and value companies has come in a lot. The related opportunity is that we can finally see companies with good growth prospects at attractive valuations. This adds stability to the overall index.

To surface the opportunities that represent that dual characteristic of both growth and value, we ranked our own large company universe of stocks using our own composite modeling that combines value, growth in earnings and dividend yield. This composite modeling has duplicated the rank ordering that is discussed above but now using post market meltdown prices and current P/E's. Naturally, it is indicating that a lot of price risk has been wrung out of the market.

The table below shows the characteristics of the companies that we have surfaced and perhaps the most interesting comparison is the 24% forecasted earning growth and the P/E average of 9.2X earnings. Those two numbers indicate that it is possible to buy a lot of higher growing earnings for attractive prices. It also might be indicating the severe market weakness might be coming to an end. Bargain hunting investors don't have to work too hard to uncover some compelling ideas. Will this turn the total market? That's hard to tell but it will support some specific companies and further, specific price damage might be mitigated.

Composite Model

Focus: Growth Valuation and Yield

	P/E 12M Frwd	Price/CFL	Price/ Book	Price/ Sales	Dividend Yield	5 Year Forecast Earning Growth
Opportunity Set*	9.2	7.3	3.01	1.3	3.50%	24%
Universe**	17.2	14.1	4.7	3.0	2.10%	10%

* 100 Companies Ranking Highest in PIQ Composite Modeling — Data Source Capital IQ
**Universe is 700 Large Profitable North American Companies — Data Source Capital IQ

It is quite possible that the companies surfaced in the ranking will be the leaders as equity markets bottom and start to recover. So, to get back to my opening statement, "Are We There Yet?" I'd say we don't know. On the other hand, our inspection and dissection of stock markets seems to point out that there are new opportunities emerging. While it's hard to invest in markets with negative momentum, some fundamentals are too compelling to ignore. The tactical move that results from the foregoing analysis is a significant departure from our longer-term stance. We've been wary of the major markets in the USA for years but now they are looking better. This outlook has us investigating the potential to increase our weight in this region. We might not pick off the bottom but lots of good value can be bought while we wait and see when the bottom is reached.

And, more realistically, we will only be able to say we were there, as the bottom will be known in hindsight only.

1. Fundamental Data and performance source: S&P Capital IQ

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