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Commentary: NCM Pension Portfolios

On March 25, 2024, Portfolio Manager John Poulter, CFA shared his latest views on equity and fixed income markets and how he is currently positioning the NCM Pension Portfolios.

TRANSCRIPT:

My name is John Poulter. Today is March 25th, 2024, and I'm going to be reviewing the NCM pension funds today. My review is going to focus on equity and the fixed income components of these funds individually, as each of the three funds have very similar positions in these asset categories. And they only differ from fund to fund in the percent allocation to the two different asset classes.

And I'm going to start with the equity allocations in the fund today. My equity outlook is pretty supportive today. This slide lists a number of factors and the reasons that equity markets have been very strong. And it's why they're likely to hold their value and maybe even move a little higher through this year. And I borrowed these topics from a strategist that I follow named Ed Yardeni.

He wrote a piece a little while ago that was 12 reasons why equity markets should support higher levels or why these factors should support higher levels in equity markets. And, his forecast back when he wrote that report was the S&P to be at 5400. And today if you look it's trading around 5227. So, so far so good on on that prediction. But I picked off some of what I think are the more important reasons that the market should see some support.

I'll start off with the top on this this particular slide, the purchasing power in the US has been very strong. And, you know, a lot of that has to do with the second point. The high labor market demand. But the fact is that consumer spending today has been calculated out to be about 70% of GDP. So a stronger consumer leads to a higher, you know, positive macro event in, GDP production. And as I just noted a moment ago, the high labor market demand today is been, very, very strong, stronger than many had expected.

And it's one of the reasons that the Fed has been dragging its feet on policy reversal with their higher interest rate regime, which gets me to the next slide, normalization in interest rates. So even with the higher labor demand, I think the idea is that we can have a fairly robust economy and still leave room for the Fed to change its policies. And we're still expecting two cuts to come in 2024. And there is a dichotomy in various strategies' outlook, but we're still in the camp that, we'll see some easing this year.

Another very strong supporter, and an indicator for a robust economy, is the housing market upturn in the USA. And also now we're noticing that mortgage expenses are coming in lower. And, you know, a source of information here comes from the St. Louis Federal Reserve where they've calculated out 1,521 thousand units in February of this year, up from 1,374 thousand in January. So pretty good strong growth. This has been a trend for a while. And it's being pointed out as something that's definitely showing that, people are more confident.

Also noted is strong corporate cash flows. These are in billions of dollars, but, you know, $3,246 in Q3 of 2023. I'm still waiting for the 2024 number to come out. $3,154 in the third quarter of 2022. And that's up from $2,716 in the third quarter of 2021. So very, strong trajectory there. And again, this is sourced from the St. Louis Federal Reserve.

And then, something that we spoke about over the last couple meetings, or the last couple recordings, and that's the expectation that inflation is going to be transitory. And that's because a lot of it came from some unique situations coming out of Covid, which clearly is now behind us, and also some supply disruptions. That took a while for the economics of supply and widget production to catch up on. We're seeing that now clear. And also just the fact that year over year comps means that we're going to be looking at price levels that are being compared to higher price levels from a year ago. So there's just a simple mechanic that should see inflation continue to ease and ultimately leading the Fed to reverse policy and the Bank of Canada and other central banks. So, we think that there's pretty good support for equity markets in general.

And the main negatives that investors worry about are high valuations relative to history, the risk of a recession, which is something that I don't think is in the cards. And the fact that a significant amount of the recent performance is only in a handful of companies. And I've often argued in the past that if the market is hostage to a few names and the indices reflect this in their pricing, then it's it's possible that stock pickers can still do okay, even if the headline index numbers get some bounce.

And I'm seeing some very constructive stock selection in the NCM Core Global Fund these days. And this is the reason that I'm incrementally adding to this particular fund in the pension funds themselves. For example, I think I you know, my view is obviously a very robust consumer and, I think that's going to be a good support factor for a couple recent adds in NCM Core Global, like Walmart and Amazon and Mastercard. I think these are going to be solid investments if the consumer stays strong.

You may also recall, if you've been watching these webcasts that I had exited my position in the QQQs and the Nasdaq index, and that was at the beginning of the quarter. And now I'm trimming Canada, to increase my overall global exposure.

And, I've also been trimming some of the positions in the new economy segment of the portfolio, specifically cybersecurity, because of price appreciation, which is a good result. And I've also got electric vehicles under the microscope right now, and I've trimmed a little bit there, and that's due to the sector having some bumps, and I'm reviewing the constituents of that ETF right now.

But, my next slide shows what the portfolio looks like today. And I'm also showing with my arrows some of the recent trades that I've been making.

So I'm going to move to fixed income now, and I'll start off by saying that our fixed income strategy has not changed. It's remained the same that it's been for quite a while. And that is short term investment grade bonds mixed with a balance of long and short high yield ETFs. And recently, the strategy's been paying off. Definitely so far this year. And we're well ahead of our benchmarks, which closed out with historically high returns at the end of 2023.

And we're seeing a lot of that reverse now. And this is occurring due to softness in the longer end of the yield curve or longer dated bonds. Our fixed income returns indicate our concentration in short term investment grade is hanging in quite well. The yield curve is still very much inverted, and that means that we have a discounted price to bonds, which gives us a capital appreciation potential in the portfolio, and return support, and also higher stability because of their shorter maturities.

And we've also done some sensitivity analysis to the portfolio and determined that we hold a capital appreciation potential in excess of 3%. And that's in the absence of defaults, which we believe are going to be very unlikely in the pedigree of bonds that we're holding. And we should receive this capital appreciation as interest rates normalize.

So maybe in the near term, we'll see this price appreciation in these bonds. And in the very worst cases, when these bonds mature, and they call that the pull to par. We also weight our mix between corporate and investment grade and high yield ETFs, meaning we have an average income creation in our fixed income portfolio of 4.6%, which is a pretty decent income while we wait for the rate policy to play out.

So right now, our fixed income in the pension funds has this allocation associated with it. It's a higher mix in investment grade than it's been for some time. And, that's been at the expense of taking some of the exposure out of the long term high yield.

And our high yield component of the portfolio is also allocated mostly towards the shorter end of the yield curve. So showing our report of our fixed income returns, which is just the fixed income component of the funds, is around 1.6% so far year to date versus our benchmark, which has given up significant value and is down 1.4%.

We believe that our outperformance in this portion of the portfolio should continue because, until rate policy changes, we are going to see volatility in the long end of the curve. So we're quite happy to stay safe in short term and with the stability.

So that concludes my review of the pension funds overall and both the equity and the fixed income. And thank you for watching.

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