Public

This Month in the Markets

Febuary 2022

Equity Commentary

War Worries

February's prominent news item was the escalating war in Ukraine following the Russian invasion. The immediate effect on markets was a surge in energy prices and a retrenchment of yields (see our fixed-income section). News agencies and commentators have morphed from playing armchair epidemiologists to geopolitical strategists. Of course, circumstances can change. Several new scenarios are developing around inflation, central bank policy, and other geopolitical hot spots. We do not profess to be experts in either, but we acknowledge the uncertainty and the volatility our current environment offers. The direct effect on our holdings has been limited, as we do not hold any Russian securities. We have taken the opportunity to slightly reposition the portfolio, given a few options to add two high-quality and large moat businesses (see below). Although the outcome of this conflict is unclear at the time of this writing, we feel our current holdings still offer attractive propositions over the medium and longer-term and their fundamentals will not be materially altered by recent events.

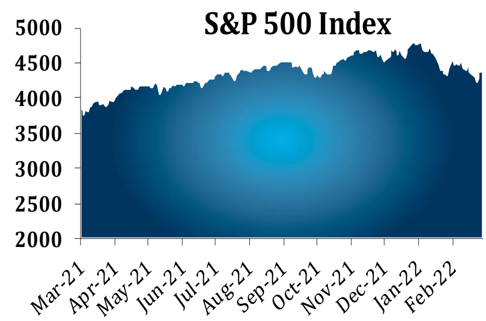
The MSCI ACWI Net Total Return Index ended lower with a -2.6% return in February. The S&P 500 fell 3.0%, while the MSCI EAFE Net Total Return Index declined 1.8%. Value held up better than growth. The MSCI World Value Index fell only 1.6% compared to a 3.5% decline in the MSCI World Growth Index. The ACWI Materials Sector index was the top performer, climbing 2.6% as the Bloomberg Commodity Index jumped 6.2%. The MSCI ACWI Communications Services Sector was the under-performer with a 5.5% loss due to the sell-off in some social media names.

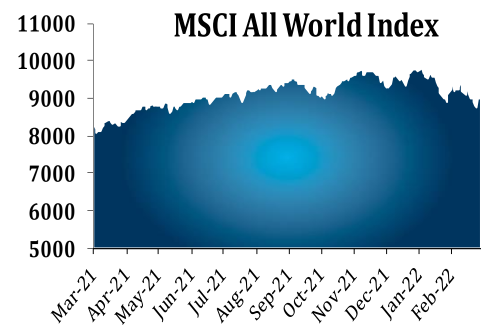
Meta Platforms Inc. was the largest detractor in the portfolio for the month, with a decrease of ~22% before our sale (see below). The top performer in the month was Freeport-McMoRan Inc. which rose 26.1% on the back of climbing copper prices.

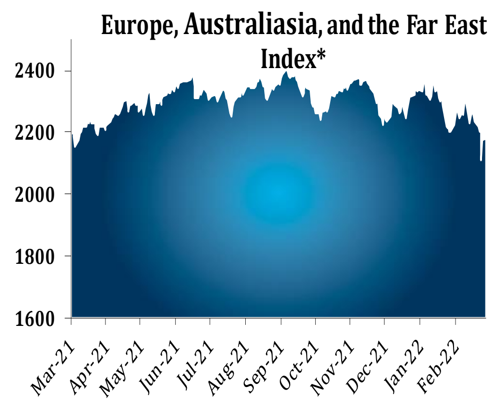
During the month, we exited Bath & Body Works Inc. ("BBWI") and Meta Platforms Inc. ("FB"). The BBWI disposal was related to our reassessment of nearer-term growth fundamentals deteriorating as the company lowered guidance. We also sold FB after it reported a quarter that indicated that the company's fundamental business model and its competitive position were eroding. We feel Tick Tok and Snap are now taking share and eroding its network strength. We believe the changes surrounding privacy for iOS and Android platforms will continue to make its targeted marketing proposition increasingly more difficult.

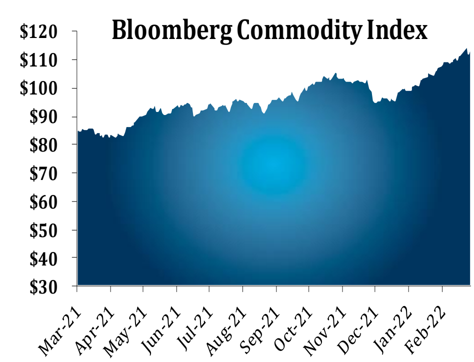
We bought two new positions in February: ASML Holdings ("ASML") and Adobe Inc. ("ADBE"). ASML is the only global supplier of extreme ultraviolet ("EUV") equipment used in producing semiconductor chips. EUV is the next iteration of lithography and uses lower-wavelength light to make smaller circuit patterns. As chip features continue to become more and more complex, ASML's lithography equipment will continue to be required. We see a multi-year period of onshoring and expanding the semiconductor manufacturing sector. This has driven and will likely continue to drive more capital investment, especially with ASML's suite of products and services.

Adobe dominates the digital content creation marketplace with its products like Photoshop and Illustrator. Although commonly known for its PDF file format, ADBE is a high-quality software as a service (SAAS) company that plays into the continual evolution of digital content. We believe its product suite offers the most comprehensive portfolio of tools for creators, and it maintains a formidable moat with high switching costs and network effects. Adobe Creative Cloud is so prevalent in the creative professional world it has essentially become the required software. ADBE's recent acquisitions have helped expand its total addressable market, and we see ample scope for continued growth.









*MSCI EAFE Index

Fixed Income Commentary

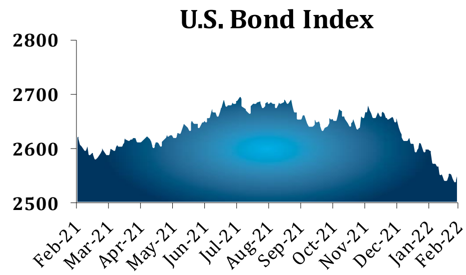
Pockets of Volatility

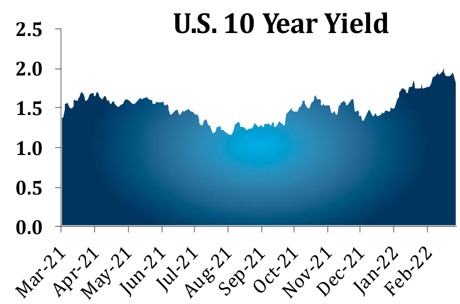
Volatility rose markedly in February, driven by 'Russia's (despicable) invasion of Ukraine. While this volatility was evident in equity markets, it was also notable in both short- and longer-term maturities in treasury rates. The Move Index, a proxy for treasury rate volatility, rose 18% to the highest level since April 2020. At the beginning of February fed funds futures were pricing in almost five 0.25% rate hikes. By mid-February, this had risen to six 0.25% rate hikes (including a 0.50% hike in March) before ending the month at five hikes (and a 0.25% hike in March). The 10-year treasury followed a similar path directionally throughout the month, peaking at 2.05% in mid-February before ending the month at 1.83%. Taking it all in, the treasury curve continued to flatten, maintaining the trend 'we have seen since the second half of 2021. The yield differential between the 2-year and 10-year treasury ended February at only 0.39% compared to 0.60% on January 31, 2022. This curve flattening suggests the bond market is wary of an economic slow-down ahead. Indeed, with inflation still very elevated (latest consumer price index = 7.5% year-on-year), consumers are feeling the pinch. The University of Michigan consumer sentiment surveys are lower than they were during March 2020.

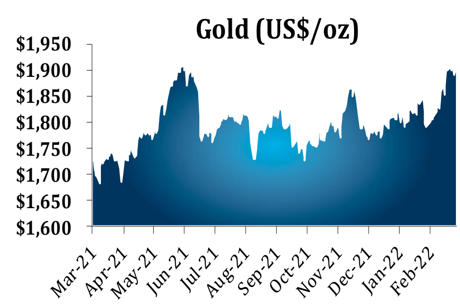
The Federal Open Market Committee (FOMC) will meet in mid-March with a 0.25% rate hike, a virtual certainty. The FOMC will also update their individual projections on growth, inflation, and the unemployment rate, as well as their projection on the fed funds rate over the next few years. Note, these are individual members' projections and not a consensus but are nonetheless closely followed by investors. The last time these projections were updated was December 2021. Since then, interest rates have moved higher, inflation has remained significantly elevated, the yield curve has flattened more, and a war has broken out. We will be paying particular attention to forecasts of the terminal rate – the rate consistent with full employment and stable prices. The 'FOMC's median estimate is currently 2.5%. We will also be looking out for their thoughts/plans concerning the balance sheet and quantitative tightening. Both elements will give us a sense of how much monetary tightening the Fed believes the market can take.

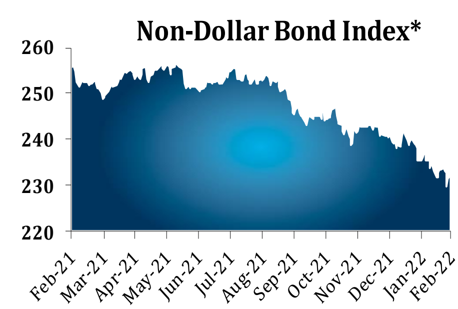
US corporate credit spreads widened only slightly despite the volatility seen in equities and treasuries in February. The spread-to-worst of the ICE BofA US High Yield Index rose +0.16% to 3.98%, while the spread-to-worst of the ICE BofA US Investment Grade Index rose +0.21% to 1.28%. Credit spreads of both indices remain well below their long-term averages. The muted credit spread move is quite surprising given high yield corporate bond issuance slowed dramatically in February, with only $9 billion of primary market issuance – the lowest February since 2016. Alarmingly, there was no high yield issuance between the 10th and 23rd of February. In the past, when we have seen primary issuance dry up, it has been accompanied by notably wider credit spreads (4Q18 and March/April 2020). Jim Bianco, of Bianco Research L.L.C., posited that fund managers 'haven't been rushing to sell corporate bonds, but rather hedging the credit risk with credit default swaps. It should also be noted that only 4% of the ICE BofA US High Yield Index matures in 2022, highlighting how issuers were able to take advantage of the reach for yield environment in 2020 and 2021.

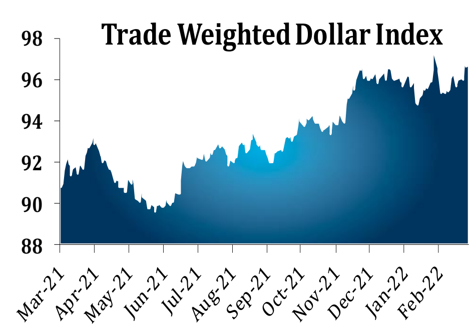
Nonetheless, we continue to maintain a cautious view on corporate credit given the stretched risk/reward profile and a hawkish fed determined to wrangle elevated inflation (and outright war between Russia/Ukraine). As such, we have an underweight high yield credit positioning versus our neutral allocation. All our high yield exposures are comprised of high conviction upgrade to investment grade candidates and/or are very short maturity.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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