// Insights & Strategies

PRIVATE CLIENT SOLUTIONS

March 1, 2022

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Beating the Drum - Bang, Bang, Bang…

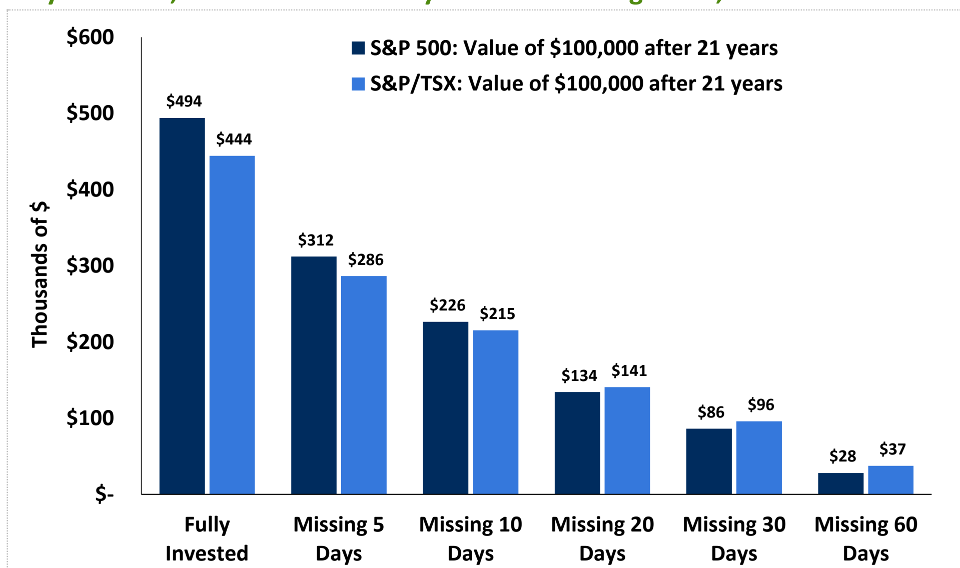
When my daughter Ella turned one last year, my wife thought it would be a good idea to fully immerse her in music. COVID-19 made in-person music classes a non-starter, so bringing music classes home was the next best thing–i.e., buying her a full suite of instruments, including a toy drum set. While I agreed with the decision, not that I really had a choice in the matter to be honest, this past year working from my home office has been challenging to say the least. My Zoom/phone calls have been frequently interrupted with my daughter in the background beating her drum set to the latest and greatest hits from Cocomelon nursery rhymes. I love my daughter, but I must say that the constant beating of that drum, especially the offbeat thumps with the tempo of the nursery rhymes is quite annoying, and it makes working from home an unproductive endeavour when Ella is around and awake.

However, given the surge in volatility this year and the spike in uncertainty due to the Russian invasion of Ukraine over this past week, the constant banging and nursery rhymes blaring in the background has been more calming than usual especially when staring at all the red on my computer screen.

First off, our thoughts and prayers are with the people of Ukraine. Secondly, in terms of the markets, more volatility should be expected in the weeks and months ahead. However, that said, there are a few things we can say with a high-level of certainty:

1) **It pays to stay invested - avoid the temptations to time the market, it's a losing proposition for even the smartest minds (e.g., Long-Term Capital Management).**

Stay Invested, Markets Have Always Rewarded Long-Term, Patient Investors



Source: FactSet; Raymond James Ltd; Data as of December 31, 2021. Illustration is based on S&P 500 Total Return Index and S&P/TSX Composite Total Return Index from January 1, 2000 to December 31, 2021. Does not take into account income taxes payable by the investor that would have reduced returns.

Please read domestic and foreign disclosure/risk information beginning on page 6.

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2) Ignore the noise, and remember to be "fearful when others are greedy, and greedy when others are fearful".

While it may be difficult to avoid all the "sharp corners" (periods of volatility/sharp sell-offs) in the market cycle, we remind investors that markets have continued to rally higher over the past 21 years despite all the headlines/dire outlooks.

For example, the S&P 500 and the S&P/TSX indices have generated total returns of ~8.0% and ~7.5%, respectively, on an annualized basis over this period. We remind investors that this 21-year period was not all "sunshine and rainbows". Rather, it consisted of the Dot-com bubble, 9/11 Terrorist Attacks, the 2007-2008 Financial Crisis, the Annexation of Crimea in 2014, and more recently, the COVID-19 pandemic and the Russian invasion of Ukraine.

While the outlook remains unclear today, we continue to suggest investors ignore the noise and utilize periods of volatility, including periods of grave uncertainty, to add to their portfolios. Maintaining diversified portfolios can help to minimize the drawdowns in portfolios during periods of elevated volatility.

Ignore the Noise - They Come & Go Like the Wind..

Year	S&P 500	S&P/TSX	Headline
2000	$1,320.28	$8,933.68	Y2K aftermath | Tech bubble
2001	$1,148.08	$7,688.41	Recession, 9/11
2002	$879.82	$6,614.54	Corporate Accounting Scandals
2003	$1,111.92	$8,220.89	Bush Jr. declares War in Iraq
2004	$1,211.92	$9,246.65	U.S. has massive trade & budget deficit
2005	$1,248.29	$11,272.26	Record oil & gas prices
2006	$1,418.30	$12,908.39	Housing bubble bursts
2007	$1,468.36	$13,833.06	Sub-prime loan crisis
2008	$903.25	$8,987.70	Banking and credit crisis
2009	$1,115.10	$11,746.11	Jobs Recession
2010	$1,257.64	$13,443.22	Sovereign debt crisis
2011	$1,257.60	$11,955.09	Eurozone crisis
2012	$1,426.19	$12,433.53	U.S. fiscal cliff
2013	$1,848.36	$13,621.55	Federal Reserve begins to taper
2014	$2,058.90	$14,632.44	Ebola outbreak I **Annexation by Russia**
2015	$2,043.94	$13,009.95	Commodity sell off
2016	$2,238.83	$15,287.59	Brexit
2017	$2,673.61	$16,209.13	Oil Price Decline
2018	$2,506.85	$14,322.86	Equity Markets Sell Off
2019	$3,230.78	$17,063.43	U.S.-China Trade War
2020	$3,756.07	$17,433.36	COVID-19 Pandemic
2021	$4,766.18	$21,222.84	Record Inflation

Source: FactSet; Priced as of February 22, 2022

3) Stay rational when others/markets appear to be behaving irrationally.

Since the beginning of the year, we have stated that, while a repeat of 2021 was unlikely moving forward, the US and Canadian economies were in relatively good shape with economic growth still expected to rise above trend in 2022. As well, strong employment conditions have recovered to pre-pandemic levels in record time. And while we expect policy normalization efforts to continue in 2022 by the Federal Reserve (Fed) and Bank of Canada (BoC), conditions still remain fairly accommodative historically speaking with households in much better conditions than they were pre-pandemic. Broadly speaking, corporations on both sides of the border remain in good financial positions.

For the S&P 500 and the S&P/TSX index, we are expecting above trend earnings growth in 2022 and 2023, which is in line with or slightly above consensus expectations. And following the recent sell-off, equity valuations also appear way more attractive than at the start of 2022 and are supportive of our constructive view for the US and Canadian economies and markets in 2022.

Real GDP & EPS Growth Still Above-Trend in 2022…

	Average 2000-2017	2018	2019	2020	Forecasts 2021E	2022E	2023E
GDP Growth (% YoY)							
US	2.00	2.90	2.30	-3.40	**5.70**	**2.70**	**2.00**
Canada	2.10	2.80	1.90	-5.20	**4.60**	**3.60**	**2.30**
	Average 2008-2017	**2018**	**2019**	**2020**	**2021**	**Forecasts 2022E**	**2023E**
Earnings Growth (% YoY)							
US - S&P 500	5.09	21.19	0.95	-14.09	50.15	**8.39**	**10.31**
Canada - S&P/TSX Comp	2.12	10.85	1.50	-29.68	84.27	**9.95**	**5.31**

Source: Capital Economics; Data as of February 16, 2022. FactSet; Street consensus as of February 25, 2022

Investor Recommendations

Against this uncertain backdrop, consistent with our expectations for the remainder of 2022, we suggest investors stay the course, remain invested, buy low/sell high, and ignore the noise!

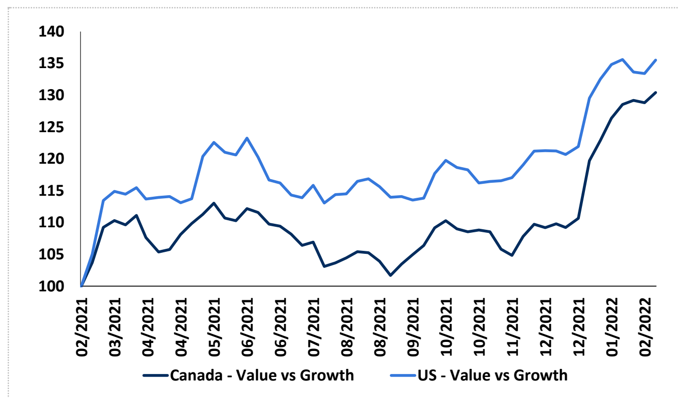
And finally, for those of you with young children at home, consider buying them a drum set; the louder the better in my opinion - it helps drown out all the market noise!

Nadeem Kassam, MBA, CFA, Head of Investment Strategy
Eve Zhou, Multi-Asset Analyst

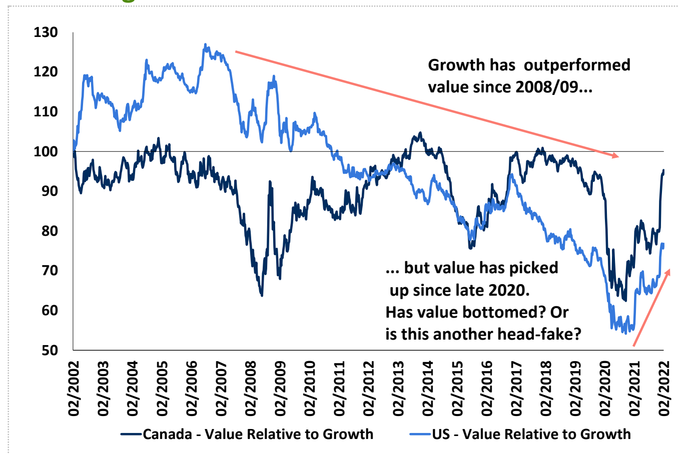
Value Striking Back

Our preferred investment style heading into 2022 has leaned towards value over growth, and growth at a reasonable price rather than growth any cost. Growth stocks are those companies that have shown above-market levels of top- and bottom-line growth, while value stocks trade at a valuation discount compared to the overall market/peers. So far in 2022, value has been a strong performer right out of the gate with the MSCI Canada Value index outperforming its growth counterpart by ~16% while the US Russell 2000 Value index has outperformed its growth counterpart by ~9% as of February 28, 2022. Given our positive outlook for the economy and markets in 2022, we suggest investors maintain some exposure to value related sectors/stocks within a diversified portfolio.

Value Has Been the Clear Winner over the Past Year…



…But Longer Term Performance Has Favoured Growth



Source: FactSet; Raymond James Ltd.; US Growth = Russell 2000 Growth; US Value = Russell 2000 Value; Canada Growth = MSCI Canada Growth; Canada Value = MSCI Canada Value. Indexed at 100 on February 15, 2002

While recent performance has clearly favoured value stocks, the past two decades tell a different story, with growth stocks having done much better than value over the period in both Canada and the US. Between both markets, we believe the performance divergence has been more pronounced south of the border given the US market's higher overall exposure to growth sectors such as information technology and consumer discretionary versus Canada's higher overall exposure to value sectors such as financials and energy. The outperformance of growth stocks has also been more noticeable since 2008/09 as investors searched for growth in the low growth and interest rate environment that followed the Global Financial Crisis (GFC). We believe this makes sense since, when there is an absence of growth, market participants flock to companies that can show growth regardless of conditions on the ground.

Value Idea Screen

Only time will tell whether the recently observed outperformance of value over growth will continue in the foreseeable future for longer than we have observed in the past. In the meantime, for clients interested in allocating capital towards value stocks, we screen for stocks on the S&P/TSX Composite and S&P 500 indices for Strong Buy-rated companies by Raymond James that also trade at a discount to their historical average price-to-earnings (P/E) multiples and at a discount to the market multiple. Of note from the screen below, our team's preferred names include: **Tourmaline Oil (TOU-CA)**, **Canadian Apartment Properties REIT (CAR.UT-CA)**, **Target (TGT-US)**, and **Qualcomm (QCOM-US)**.

Strong Buy Value Ideas

Name	Ticker	GICS Sector	Last Price	Market Cap (bln)	P/E (NTM)	5-Yr Average P/E (NTM)
Canada S&P/TSX Composite			***21,106***		***14.3x***	***15.6x***
BRP, Inc.	DOO-CA	Cons. Disc.	$90.98	$3.6	8.7x	15.0x
Tourmaline Oil Corp.	TOU-CA	Energy	$48.22	$15.9	7.1x	15.1x
Interfor Corporation	IFP-CA	Materials	$38.90	$2.4	3.9x	14.4x
Canadian Apartment Pro	CAR.UT-CA	Real Estate	$53.63	$9.3	8.8x	13.6x
S&P 500			***4,385***		***19.3x***	***18.9x***
DISH Network Corporatic	DISH-US	Comm. Services	$32.80	$9.53	11.8x	16.1x
PulteGroup, Inc.	PHM-US	Cons. Disc.	$48.66	$12.32	4.7x	8.6x
Mohawk Industries, Inc.	MHK-US	Cons. Disc.	$144.27	$9.39	9.3x	13.8x
Target Corporation	TGT-US	Cons. Disc.	$199.22	$95.45	15.0x	16.5x
Advance Auto Parts, Inc.	AAP-US	Cons. Disc.	$205.57	$12.56	14.9x	17.7x
D.R. Horton, Inc.	DHI-US	Cons. Disc.	$86.02	$30.48	5.3x	10.0x
Diamondback Energy, Inc	FANG-US	Energy	$133.27	$23.66	7.3x	12.8x
Willis Towers Watson Pu	WTW-US	Financials	$223.63	$27.87	16.1x	16.2x
Huntington Bancshares I	HBAN-US	Financials	$15.57	$22.39	11.6x	11.7x
Cigna Corporation	CI-US	Health Care	$232.84	$74.73	10.2x	11.8x
PACCAR Inc	PCAR-US	Industrials	$91.71	$31.88	12.9x	14.2x
United Parcel Service, Inc	UPS-US	Industrials	$209.95	$153.09	16.3x	16.4x
Delta Air Lines, Inc.	DAL-US	Industrials	$41.54	$26.58	16.4x	18.1x
Qualcomm Inc	QCOM-US	Info. Tech.	$170.93	$192.64	14.2x	16.3x
Microchip Technology In	MCHP-US	Info. Tech.	$72.15	$40.11	14.1x	15.8x
Micron Technology, Inc.	MU-US	Info. Tech.	$90.10	$100.89	8.4x	9.0x

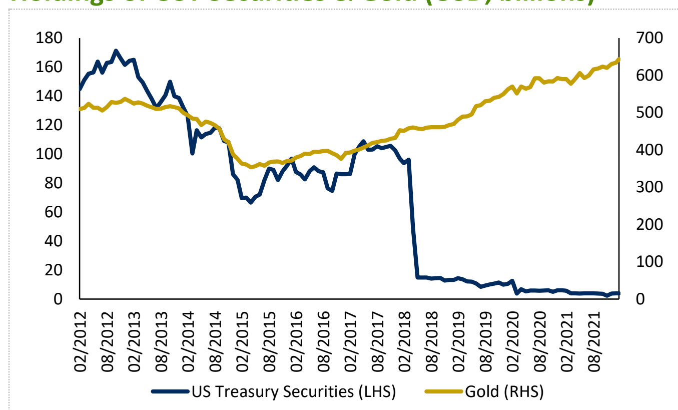
Source: FactSet; Priced as at February 28, 2022

Larbi Moumni, CFA
Portfolio Manager & Senior Equity Specialist

A Russian Drawdown & Wobbly Ruble

After recognizing the sovereignty of Donetsk and Lugansk People's Republics (DLPR), Russian President Putin dropped the pretenses and proceeded to launch a full-scale invasion of Ukraine. Market reaction was swift to say the least; global equity markets sold off, both commodities and US Treasuries caught a material bid, and the rug was pulled out from under most of the major emerging markets and G10 currencies. While the greenback received a decent influx of safe-haven flows following the news, we do expect some of this premium to be inevitably given back once the situation cools. However, as is with any major geopolitical event, headline risk will continue to dominate market sentiment and price action for the short term. This situation is still quite fluid and far from over, with the United States, Europe and other big players continuing to ramp up their scale and scope of punitive sanctions. In his first-wave of sanctions, US President Biden cut off the Russian government's ability to raise money from the West and trade debt on US and/or European markets. This appeared to be nothing more than a subtle "slap on the wrist," especially knowing that Russia has been scaling back its investment in US Treasury securities since 2018. While Russia now holds only USD$3.9bln in US Treasury securities, compared to over USD$100M at the end of 2017, it has actually been steadily shifting more of its reserves into gold.

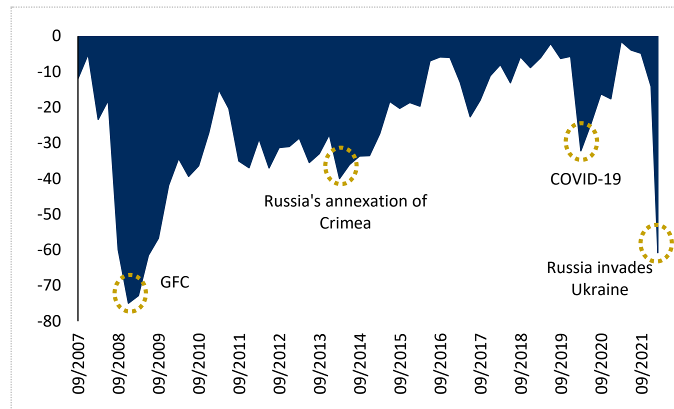
Holdings of UST Securities & Gold (USD, billions)



Source: FactSet; Raymond James Ltd.; Data as of February 24, 2022

It is evident that this escalation of events has spilled into nearly every crevice of the financial markets. The Russian ruble hit an all-time low against the USD (112.21 per dollar on February 28, 2022) before Russia's central bank intervened in the FX markets to stem the bleeding. There is also fear brewing in the sovereign risk market after Russia's 5-year credit default swaps (CDS) spiked to nearly 920bps, its highest levels since 2001. Despite the Bank of Russia's war chest of more than USD$600 billion in liquid reserves, it is clearly not helping ease concerns in the sovereign risk market. The MOEX Russia Index witnessed its largest drawdown since the 2008 GFC (nearly 60% at the time of writing), eclipsing the nearly 30% drawdown from the 2020 COVID-19 pandemic as well as the 40% drawdown following Russia's annexation of Crimea back in 2014.

Russian Stock Market Drawdowns



Source: FactSet; Raymond James Ltd. Data as of February 24, 2022

Meanwhile, in Ukraine, its central bank also took emergency measures to plug the outflow of capital; it suspended its FX market, imposed limits on cash withdrawals and prohibited the issuance of foreign currencies. Prior to suspending its foreign exchange market, the Ukrainian hryvnia hit its lowest level against the USD since 2015 (30.87 per dollar at the time of writing). Glancing at CDS swap curves for both Russia and Ukraine show that the cost of short-term default protection, or insurance, has risen above longer-term protection, further exemplifying the degree of uncertainty in markets at this time. Oil prices also spiked higher over fears about disruptions to the global energy supply; both Brent and WTI rose above $105/bbl and $100/bbl respectively, for the first time since 2014. Russia is the third-largest oil producer and the second-largest oil exporter and, seeing that the global oil supply remains largely tight as demand continues to recover from pandemic lows, the broader oil market will be very susceptible to these large-scale supply disruptions. Higher energy costs will also feed into inflationary pressures, especially for import-heavy regions like Asia. CAD, and particularly CAD crosses, should receive a tailwind from elevated oil prices in the short run, despite a cloudy long-term outlook. Lastly, given the fact that geopolitical tensions have clearly escalated, posing a negative growth shock to Europe, we will remain cautious of European currencies like the EUR, GBP and Scandies (SEK and NOK) for the time being.

Ajay Virk, CFA, CMT
Foreign Exchange

Split Preferred Shares

The total size of the Canadian preferred shares market has been shrinking due to frequent redemptions of outstanding issues, combined with the light issuance of new preferred shares (prefs). Investors might need to consider alternatives to the traditional preferred share if they wish to maintain positions in the asset class. One option could be split share corporation preferred shares (split preferreds). We believe that this area of the market is not as widely known and is underutilized. In this article, we look to explain the structure of split preferreds, their pros and cons, and note additional considerations before including these products in an investment portfolio.

What is a Split Preferred Share?

A company looking to create this type of structure would select a basket of companies to invest in and hold the common shares in their fund. Securities chosen are usually high quality names, with the most popular being Canadian banks, life insurance companies, and dividend growth equities. When the company goes to raise capital, they would create two separate issues–Class A shares and preferred shares, hence the name split corporation (split corp) as the fund is “split” into two share types.

The preferred shares of a split corp are, like preferred shares in general, designed for investors that seek recurring income at the expense of participation in any capital appreciation (the Class A would be the benefactor here). At the launch of the fund, the Class A and preferred share would each get an initial net asset value (NAV). A NAV is in essence a fund’s assets minus its liabilities, often displayed in a per-share format. By adding up these two separate NAVs, you would get the total NAV for the split corp. The dividends and capital appreciation in the underlying securities would be allocated between the two split share types. When it comes to paying out dividends to the shareholders of either class, the preferred share side would receive their payment first, with any remaining dividend/share appreciation and monies generated from covered call writing going to the Class A side.

The Case for Preferred Shares

Split preferreds tend to offer an attractive dividend yield for investors compared to more traditional preferred share types like perpetuals or fixed resets. However, if you compare the yield on the underlying common shares in a split share corporation to the yield of the preferred, you may discover that, in fact, the yield on the underlying is lower. If that is the case, how sustainable is the dividend on the preferred share?

As mentioned above, the preferred shares side of the split corp are paid first before Class A holders, which provides a buffer to the preferred investors. If the combined NAV of the split corp is below a pre-determined threshold, the fund would be prohibited from making any more distributions to the Class A investors until it exceeds that threshold again, protecting the future cash flow of the preferred share.

Drawbacks

A downside to split preferreds is the complexity of the fund structure, making it more challenging to fully understand all the risks involved with investing in the product. In addition, the flexibility to write call options to generate additional income may be a benefit or disadvantage depending on the market conditions and skill of the investment manager. Writing call options would generate income, but it could also limit capital gains growth on the underlying common shares. Although not a drawback per se, it should be noted that these preferred shares tend to carry lower credit ratings (if any), have a low market cap, and generally are even more thinly traded.

Portfolio Positioning

Split prefs can be very attractive due to the higher yield that they offer relative to other options in the market. However, it is important to consider the track record of the issuing company, the quality of the underlying securities, and the sustainability of the dividend. Some issues have been outstanding for decades, giving a lot of history to refer to in different market conditions. One factor to look at would be the NAV of the total split share corporation (preferred share plus Class A share). This total current NAV gives a glimpse into how well managed the split corp is and how it has performed. A higher NAV would have better protection to keep the dividend payments coming, so although investors may look at the relative attractiveness of yields before investing in preferred shares, we suggest investor also consider past NAV performance before investing in split preferred shares. Below are a few split preferreds that could be considered given their healthy current yield and comfortable NAV buffer.

Highlighted Split Preferred Shares:

Issuer	Symbol	IPO Date	RJ Rating	NAV	Buffer	Current Yield
CANADIAN BANC CORP	BK.PR.A	28-Jun-2005	MEDIUM	$25.45	$15.45	4.81%
FINANCIAL 15 SPLIT CORP	FTN.PR.A	29-Oct-2003	MEDIUM	$22.68	$12.68	5.21%
LIFE & BANC SPLIT CORP	LBS.PR.A	28-Sep-2006	MEDIUM	$21.29	$11.29	5.25%
PREMIUM INCOME CORP	PIC.PR.A	30-Oct-1996	MEDIUM	$24.33	$ 9.33	5.64%

Source: FactSet; Raymond James Ltd. February 23, 2022

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