Gold Investment Portfolio Manager

Investment Letter

Q4-21 Investment Letter (No. 58)

January 25, 2022

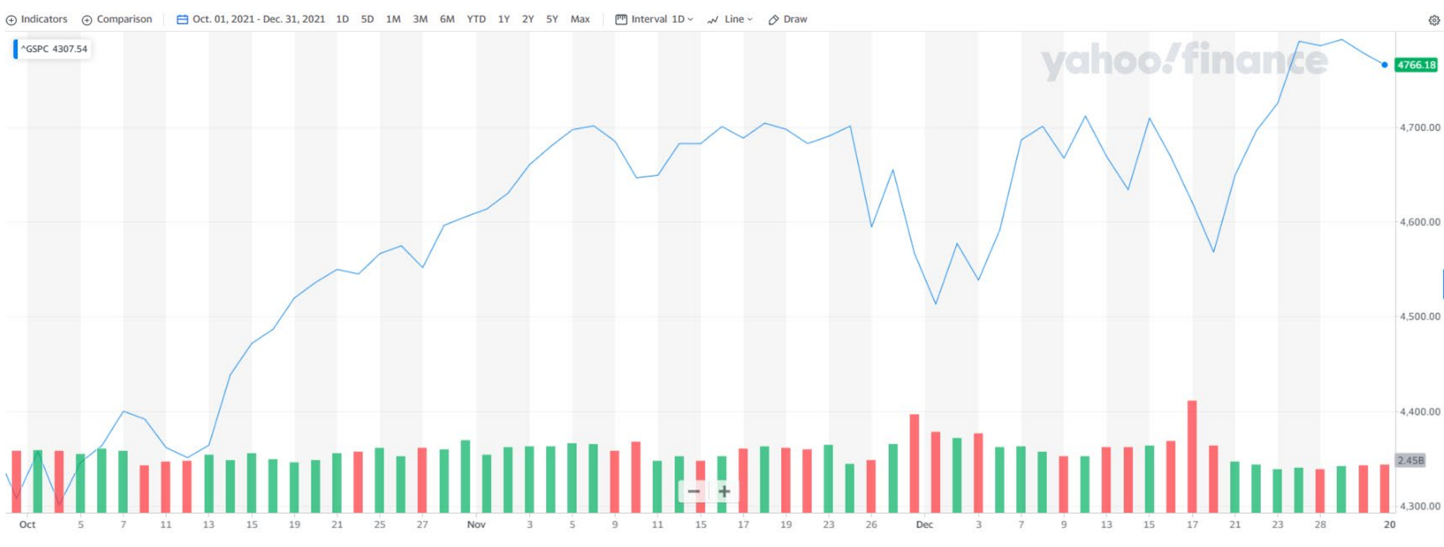
OVERVIEW

Dear Clients and Friends,

We are pleased to provide this quarterly report for the period ended December 31, 2021. The letter will be divided into three sections: (1) Market Recap, (2) What's New and (3) Commentary.

MARKET RECAP

The S&P 500 Index (in USD) advanced 10.65% for the three month period ended December 31, 2021. The net increase over the quarter was 458.64 points; the Index hit a high of 4,804.06 on December 29, 2021 and a low of 4,278.94 on October 4, 2021.



The S&P/TSX Composite Index climbed 5.74% in the fourth quarter of 2021, an incease of 1,152.50 points. The Index reached a high of 21,773.10 on November 12, 2021 compared to its low of 19,968.50 on October 4, 2021.

Despite a sharp rally at year-end, the Canadian Dollar quoted in USD (CADUSD) fell 0.47% during the quarter ended December 31, 2021. CAD/USD closed at 0.7847 on December 31, 2021 versus a close of 0.7884 on September 30, 2021

WHAT'S NEW

2022 INVESTMENT SEASON
The TFSA limit for 2022 is $6,000; you can deposit up to $81,500 ($163,000 per couple) if you have never contributed to a TFSA. RRSP limits for 2021 and 2022 are $27,830 and $29,210 respectively; You may be able to contribute up to 18% of your earned income for the prior year up to the annual limit. You are encouraged to check your contribution room with Canada Revenue Agency prior to making a contribution. The deadline for RRSP contributions for the 2021 tax year is March 1, 2022. Other great ways to invest include pre-authorized contributions (PACs), RRSPs, RESPs, RDSPs and open/taxable accounts. Please visit GIM's Investment blog for more information.

TAX DOCUMENTS
2021 tax year documents will be released by Credential Qtrade Securities Inc. over the coming weeks. We would like to provide you with some information on how to retrieve tax documents for your account(s).

For clients registered for electronic documents, please log in to Credential's online client portal. Navigate to the e-Services page where you may filter for tax documents and download items you require. Please check for any messages in your portal's inbox from

Credential that may contain updates on tax information.

For clients registered for paper documents, any tax documents will be sent by mail to the address we have on file.

For all clients making RRSP contributions, in response to demand Credential will be generating RRSP contribution receipts more frequently. Contribution receipts for March 2, 2021 to December 31, 2021 will be online and mailed on or before January 16, 2021. Receipts for contributions falling between January 2, 2022 to February 4, 2022 will be online and mailed bi-weekly. Receipts for contributions falling between February 5, 2022 to March 4, 2022 will be online and mailed weekly.

All tax documents are expected to be available by March 23, 2022. If you do not see any tax documents issued in 2022 in Credential's online portal or you have not received anything by mail, then you may not have tax documents for your account(s) for the 2021 tax year. If you have any questions regarding tax documents for your accounts, online login information, document delivery preferences or your mailing address, please do not hesitate to contact us.

COMMUNICATION

If you desire more frequent interaction with a Portfolio Manager or your individual circumstances have changed, please **contact** our office.

COMMENTARY

Part 1 – Rising cost of living

It finally happened. The cost of living has made it onto mainstream media. Inflation was a topic that was ignored until it couldn't be ignored any more. Too many people were talking about it so that means the media is now all over this.

As an example, we did a brief scan of just one media website – the CBC – and without effort saw these headlines:

Trying to make sense of inflation? So is everybody else[1]
As inflation fears send markets on a wild ride don't kick yourself if you didn't see it coming

Canada's inflation rate rises to new 30-year high of 4.8%[2]
Grocery prices increasing at fastest pace in more than a decade

U.S. [December] inflation rises to another 40-year high of 7%[3]

Inflation on P.E.I. having 'devastating' impact[4]
Soup kitchen sees big increase in demand

Canada's December 2021 inflation is at a 30 year high of 4.8%, up from 4.7% in November 2021. The U.S.'s December inflation red-hot at 7.0%.

[1] www.cbc.ca/news/business/inflation-data-column-don-pittis-1.6310801
[2] www.cbc.ca/news/business/inflation-canada-1.6320085
[3] www.cbc.ca/news/business/us-inflation-1.6312003
[4] www.cbc.ca/news/canada/prince-edward-island/pei-inflation-impact-1.6287878

Chart 1

Source: CBC.ca

There is one thesis in the first 2 CBC articles, Trying to make sense of inflation? and Canada's inflation rate rises to new 30-year high of 4.8%, which we disagree with.[1,2] These articles blame supply chain, weather, semiconductors, and ignorance of central bankers for inflation. But we think they are all specious arguments. The bylines and articles say, for example:

> *For a lot of smart people, the way inflation works is no easier to understand than COVID-19.*
>
> *If [Federal Reserve Chairman] Powell* [5] *and his highly paid experts didn't see it coming, don't kick yourself if you didn't, either.*
>
> *The price of fresh produce is being walloped by two things, [Statistics Canada] said: "Unfavourable weather conditions in growing regions, as well as supply chain disruptions."*
>
> *An ongoing lack of semiconductor microchips continues to drive up the price of just about anything with a microchip in it.*

To quote economist Milton Freedman, ***"Inflation is always and everywhere a monetary phenomenon."* In other words, at its core, inflation is caused by governments running the presses and printing money out of thin air**.[6]

Unfortunately, media articles do everything but talk about the proverbial elephant in the room – inflation is caused by governments printing money. Frankly we do not understand why CBC does not state this basic fact.

CBC does quote U.S. Senator Patrick Toomey, and we think he nailed it (emphasis ours). "There have been some comments about wage gains [offsetting higher expenses] … but wage gains that are more than wiped out by price increases do not leave a family better off." [1]

Summary. We believe central bankers knew exactly what they were doing in downplaying inflation through 2021.

1. Fighting inflation requires raising interest rates and this is what they wanted to avoid. We believe central bankers prefer to see strong employment and a robust economy before they tackle inflation. We think this is because economists know how to deal with inflation, even high or runaway inflation, as there is lots of history on this. At least inflation is the devil they know.

2. We think what central banks are even more afraid of is deflation or stagflation. Deflation is falling prices, which means no economic growth as consumers (60% of the economy) will put off spending as things can be cheaper tomorrow, which will in turn drive up unemployment. Stagflation is stagnant economic growth plus inflation, if the central bank raises interest rates too soon to combat inflation, they risk choking off economic growth.

In conclusion, Canadians are in for a rough time with rising living expenses. Our clients need to stay invested according to their level of risk, as it is your investments that will mitigate rising expenses.

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[5] Chairman Powell is the head of the U.S. Federal Reserve ("Fed"), the U.S. central bank and it is his job to combat inflation.
[6] www.hoover.org/research/inflation-true-and-false

Part 2 – Market response

Other investors see the same information as we do. So, let's look at the market's response:

Interest rates have moved upwards lockstep in anticipation of central banks' tightening. The table below shows two important things.

i. Steepening yield curves. Firstly, over just the last 30 days short term (less than 1 year) and long term (10 and 30 year) yields have moved up, but the long-term yields have moved up more. In bond-speak we say the government yield curves in Canada and the U.S. are ***steepening***, reflecting the market's expectation of higher interest rates.

ii. Negative returns. Secondly with inflation 4.8%-7% and bond yields about 2%, returns on cash deposits and bonds are negative after inflation. Bond managers will say ***real returns*** are negative.

Table 1 – Bond markets

Canada	Jan 18, 2022	30 days ago	Change	Comment
6 month T-bill	0.71%	0.28%	0.43%	4.7% inflation Nov 2021.
10 yr Gov of Canada	1.89%	1.32%	0.57%	Canadian long-term interest going up more than short term,
30 yr Gov of Canada	2.10%	1.67%	0.43%	which means the Canadian interest rate yield curve is *steepening.*
USA	**Jan 18, 2022**	**30 days ago**	**Change**	**Comment**
6 month T-bill	0.36%	0.16%	0.20%	7.0% inflation Dec 2021.
10 yr Treasury	1.88%	1.43%	0.45%	U.S. long term interest going up more than short term,
30 yr Treasury	2.19%	1.85%	0.34%	which means the U.S. interest rate yield curve is *steepening.*

Source: Scotiabank, Scotia iTrade

The bond market is already anticipating higher interest rates, with more to come throughout the year. Economists in Canada are forecasting the Bank of Canada's Overnight Rate to rise from 0.25% on January 1, 2022 to 1.50% by the end of the year, which is the equivalent of five 0.25% rate hikes.[7] In the U.S., expectations are for the Fed Funds Target Rate to rise from 0.25% in January 1, 2022 for 3-4 times in increments of 0.25% to 1.00-1.25% through 2022.[8]

Value stocks are rallying on the inflation news. "Value" is our polite term for cheap. The price of resources is going up, which benefits the sector. We are in Alberta so when we talk about resources, we refer to oil & gas. The chart below shows the Canadian energy ETF (XEG) in **red** over the past 3 months is up 22%. In actual dollars, a barrel of oil (West Texas Intermediate) closed at $86.56 on January 18, 2022.

Expensive stocks have been falling. When a portfolio manager says expensive, we mean valuations are high relative to earnings and these are also called growth stocks. Technology is a classic growth sector as investors are paying up for future growth, a high risk/high reward scenario. The chart shows the Canadian technology ETF (XIT) in blue over the last 3 months is down -20%.

Finally, Chart 2 shows that most of the rally in energy and decline in technology has occurred in the past 30 days. This is when the market finally realized our central banks had stopped their story line of inflation being temporary. Frankly, we never believed this and were of the opinion inflation is much more insidious than what was presented.

[7] www.bloomberg.com/news/articles/2022-01-06/canadians-prefer-rate-hikes-during-highest-inflation-since-2003
[8] www.fxstreet.com/news/fed-to-hike-interest-rates-each-quarter-this-year-rabobank-202201181646
nypost.com/2022/01/10/federal-reserve-projected-to-hike-rates-4-times-in-2022/
www.cnbc.com/2021/12/15/the-majority-of-fed-members-forecast-three-interest-rate-hikes-in-2022-to-fight-inflation.html

Chart 2: 3-month return ending Jan. 18, 2022: XEG + 22% (**red**) vs XIT -20% (**blue**)

Yahoo Finance, 18JAN2022

Inexpensive Oil & Gas +22%

Expensive tech sector -20%

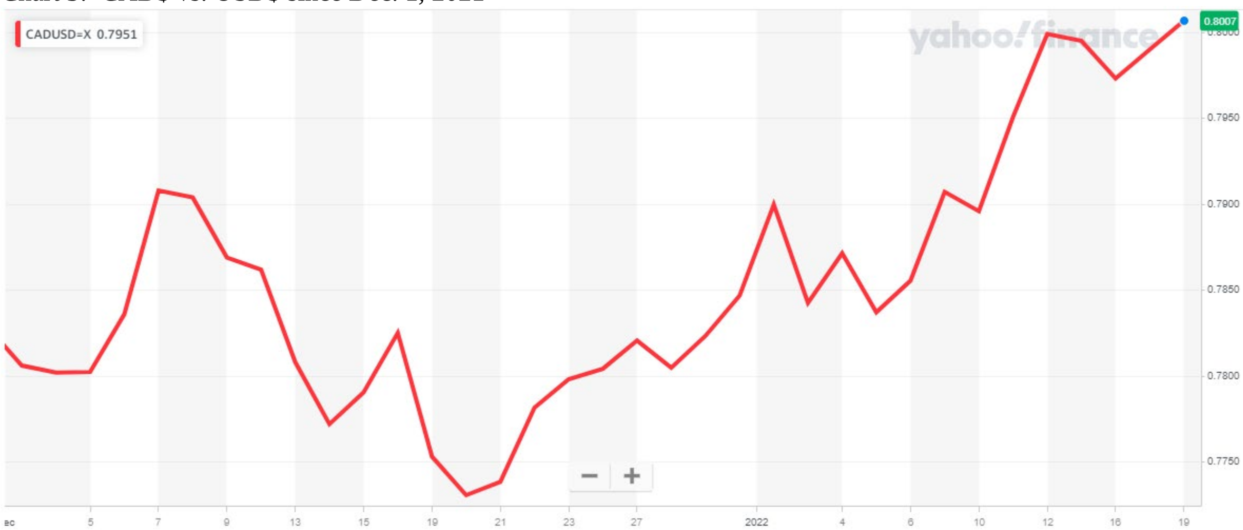
Base metals are also doing well. Copper is a primary component of all sorts of industrial products and its price is a leading indicator of economic growth. Since the March/April 2020 pandemic low, copper has been on a gigantic rally. News of inflation and rising interest rates have not caused a pullback in prices.

Chart 3: 5-year price trend Copper (US dollars/pound)

www.macrotrends.net/1476/copper-prices-historical-chart-data

The Canadian dollar rallies. The CAD$ has rallied to $0.80 per USD$, not far off the October 2021 peak of $0.81. A large portion of our economy is cyclical, namely resources. With resources expected to go up, the Canadian dollar has responded in lockstep since before Christmas. What will cause the Canadian dollar to decline will be if the U.S. increases interest rates more aggressively or if the Bank of Canada is less aggressive in raising its rates than expected.

Chart 3: CAD$ vs. USD$ since Dec. 1, 2021



Yahoo Finance, 19JAN2022

Summary. Central banks stopped talking about inflation being only temporary in late 2021 and the market immediately reacted. Bonds and expensive growth stocks immediately lost value. Value stocks, resources/base metals and the Canadian dollar all rallied.

The rotation out of growth and into value has been very fast, occurring in the last 30 days. Bonds and cash are, perversely, riskier than equities after considering inflation and interest rate risk.

It is the stock market that will mitigate our clients' portfolios against inflation risk. We are pleased to say that all GIM clients in low, moderate and high-risk portfolios have a component of equities. We believe the rest of the market also sees the same information and we believe they too will draw the same conclusions. Markets may be irrational over the short term, but over the long term they have always been rational.

Part 3 – Final Thoughts

We have written before, that historically safe assets such as cash and bonds, are riskier than the stock market after considering inflation and rising interest rates. Returns on cash and bonds are currently negative after inflation.

We believe investors will look to the equity markets to mitigate inflation[9]. Central bank authorities are effectively telling anyone saving money that to keep up with the cost of living we must take on investment risk of some type. All of our clients in low, moderate and high-risk investment portfolios already have equity market exposure as this is a message that became loud and clear to us quite a few years ago.

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Thank you for entrusting us with your investments. As always, we welcome your questions and comments. You can contact GIM by telephone: 1.888.436.9955, fax: 1.866.541.7947 or email: invest@gold-im.com.

Yours truly,

GOLD INVESTMENT MANAGEMENT LTD.

[9] When we speak of equity risk we also refer to assets with equity-like risk such as commodities, resources and real estate.

DISCLAIMER