Gold Investment
Portfolio Manager

Investment Letter

Q1-22 Investment Letter (No. 59)

April 20, 2022

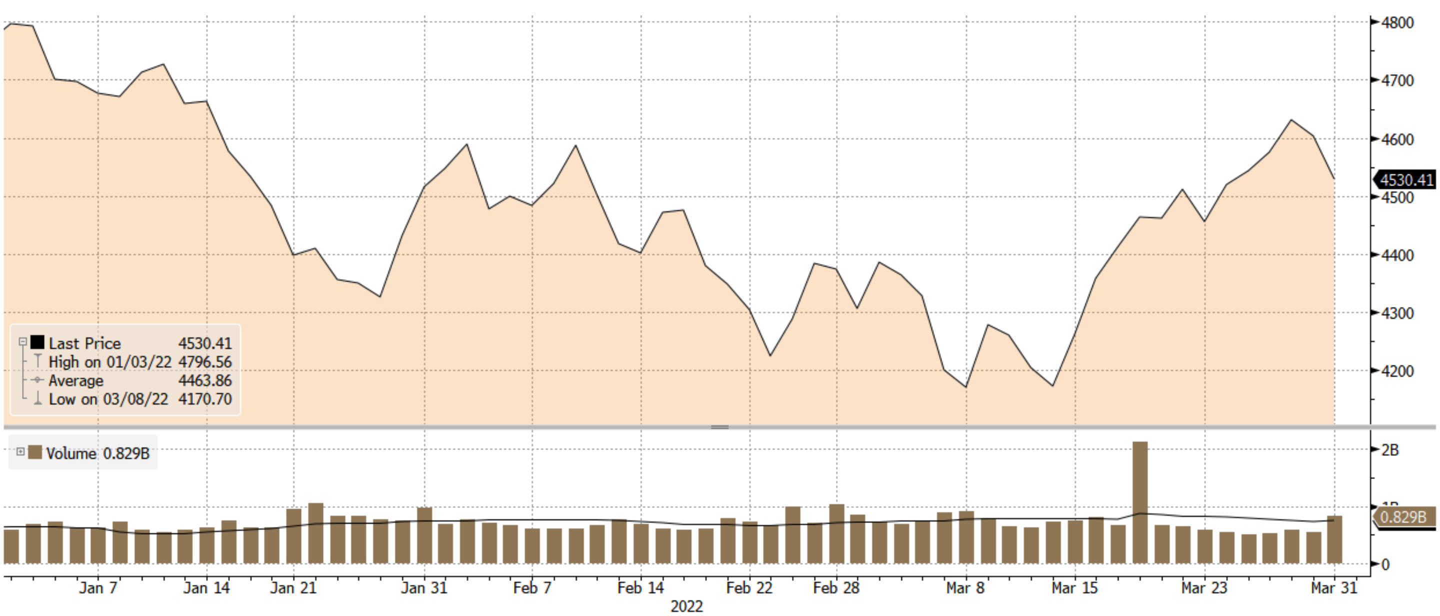
OVERVIEW

Dear Clients and Friends,

We are pleased to provide this quarterly report for the period ended March 31, 2022. This report 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) declined 4.95% for the three month period ending March 31, 2021. The Index hit a high of 4,796.56 on January 3, 2022 and a low of 4,170.70 on March 8, 2022.



The S&P/TSX Composite Index advanced 3.14% in 2022's first quarter. The Index reached a high of 22,087.22 on March 29, 2022 compared to its low of 20,544.11 on January 27, 2022.

The Canadian Dollar quoted in USD (CADUSD) rose 2.09% during the first quarter of 2022. CAD/USD closed at 0.7995 on March 31, 2022, reached a high of 0.8045 on March 30, and hit a low of 0.7752 on March 8.

WHAT'S NEW

CLIENT UPLOAD

We are pleased to advise that we have launched a secure portal for you to upload and send documents to our office. If you have items to send to our team or if we are requesting documents from you, we will provide a secure link to the portal. You may drag and drop to return items and no set up is required.

2022 "KYC" REVIEWS

As per GIM's ongoing obligations to conduct annual "Know Your Client" ("KYC") reviews, you may receive communication from our admin department to schedule a review with one of our portfolio managers. Investment reviews are a great way to keep us informed on your personal and financial circumstances so we can best serve you. If you wish to speak with someone or have a change in your circumstances, please do not hesitate to contact our office.

COMMUNICATION

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

COMMENTARY

March is finally behind us, and we welcome the start of Spring. This has been another tough year as we've completed 2 years of the pandemic. While still dangerous, it is evident that COVID is mutating to become more contagious but less lethal, and restrictions are being lifted.

This quarter's newsletter is split into 3 parts. The first will speak to the war in Ukraine, the second part will be investment related and the third part will summarize. In the first two sections we have music for you to appreciate.

Part 1 – Ukraine war

Our head office is in the Canadian Prairies and there are many Western Canadians whose families have emigrated from the Ukraine. We have a number of clients whose background is Ukrainian and to these clients we offer our heartfelt sympathies.

We sent a letter to clients March 1, 2022 regarding the conflict and we donated to the International Red Cross. *"Money raised will enable the Red Cross and Red Crescent Movement to respond to humanitarian needs generated by almost eight years of conflict, as well as preparedness and response efforts due to heightened tensions in Ukraine. The support could include preparedness, immediate and ongoing relief efforts, long-term recovery, resiliency, and other critical humanitarian activities as needs arise, both in Ukraine and surrounding countries, including supporting populations displaced."* For more information about donations please see here.[1]

We had a soliloquy written about the war but threw it away when a client sent us a song that they had composed to raise awareness of the humanitarian crisis in Ukraine. We simply can't do any better than this. Our clients constantly amaze us. You have the most incredible talents.

The video is on YouTube and is called *On the Other Side of Morning*. The producer asks that you circulate this by social media and other means. You can see the music video here.[2]

For Ukraine, their infrastructure is being destroyed and it will take decades to rebuild. The cost will be enormous. For Russia, in our view, the sanctions imposed may continue after the fighting has stopped. Western Europe will pivot away from using Russian oil & gas, one of its major exports. Both countries will emerge from this war in a weaker economic state.

Part 2 – Bad medicine is what you need

Inflation continues to be front and center in the news. Despite the war in the Ukraine, both the Bank of Canada and the U.S. Federal reserve raised interest rates. For March 2022, inflation in Canada is an unpleasant 6.7% and the U.S. is an eye-watering 8.5%. Canada's inflation rate is the highest in 31 years and food inflation is even worse at 8.7% for March 2022. When we dive into details the picture is much worse. Staples like pasta and breakfast/cereal foods jumped a ghastly 17.8% and 12.3%, respectively.[3] While we can put off buying new clothes or furniture, we simply cannot stop eating or paying for a roof over our heads.

---

[1] For those with paper newsletters: https://donate.redcross.ca/page/100227/donate/1?locale=en-CA

[2] YouTube link is **https://www.youtube.com/watch?v=0GHIbXPKM4E**

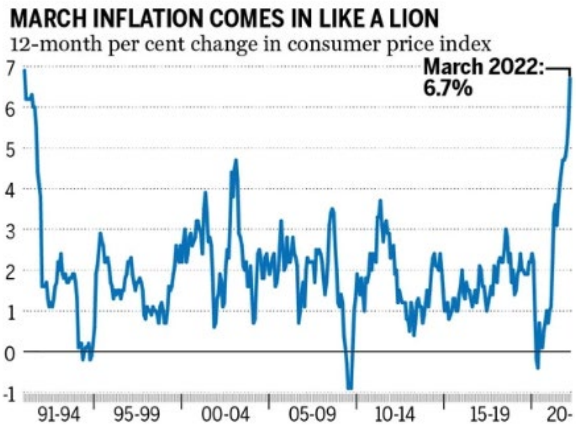
[3] https://www150.statcan.gc.ca/n1/daily-quotidien/220420/dq220420a-eng.htm
https://financialpost.com/news/economy/u-s-inflation-quickens-to-8-5-ratcheting-up-pressure-on-fed

Inflation is caused by governments printing money out of thin air.[4] It is not caused by supply chain, weather problems or the COVID pandemic. We know the treatment for inflation. It's to raise interest rates to slow down economic growth.

But here's the problem. Remember the lyrics to the Bon Jovi song, "*bad medicine is what I need*". Rising interest rates are meant to keep an economy healthy like vitamins keep your body healthy. Rate hikes, however, can become bad medicine very quickly if central banks keep raising interest rates until the economy goes into a recession – which they often do. This happened in the 1970's when Canada went through a period of stagflation, that is, high inflation and stagnant growth. We have always believed central bankers would choose above-target inflation and a strong economy rather than deal with the alternative scenario of flat or negative economic growth. Unfortunately the Bank of Canada ("BoC") spent the past 2 years insisting inflation was "temporary", "transitory", "transient", "short term"… until they couldn't ignore it anymore (they probably also ran out of synonyms). Now that inflation has gotten out of hand there is a very real risk that they must raise interest rates until the last proverbial straw breaks the camel's back – very bad medicine, indeed.

On April 13, 2022, the BoC raised their Overnight Rate an aggressive 0.50% to 1.00%, the first half-point rate hike in 22 years to reign in inflation.[5] Our central bank usually does smaller 0.25% moves in interest rates. Such a large move means someone at the Bank finally saw the smoke from the forest fire. In our opinion there are going to be further hikes. At this point, there is no "one and done".

Chart 1: Inflation running hot:



Source: Statscan, Financial Post[6]

If you don't remember *Bad Medicine*, you can see Bon Jovi singing it right here because, seriously, who doesn't like Bon Jovi?[7]

Back on topic, let's take a look at the 1970's, where we saw a great deal of volatility.

Chart 2: TSX Composite 1969-1979

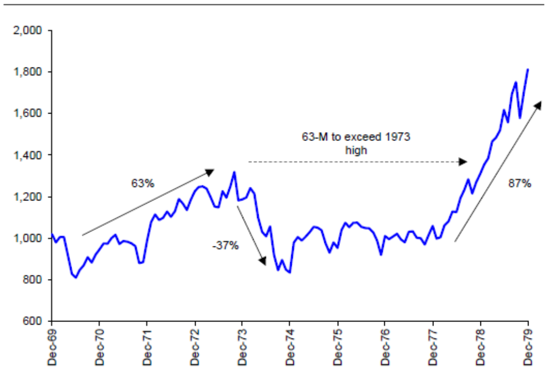
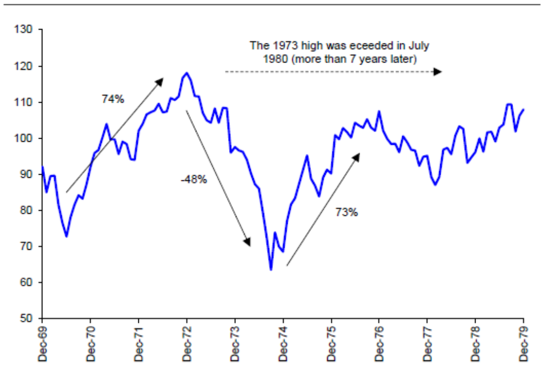


Chart 3: S&P500 1969-1979



Source: Scotiabank, Portfolio Strategy, Revisiting the 1970s in Charts, March 23, 2022

[4] https://www.hoover.org/research/inflation-true-and-false
[5] https://www.cbc.ca/news/business/bank-of-canada-rate-hike-1.6418132
https://financialpost.com/news/economy/bank-of-canada-kevin-carmichael-0413
[6] https://www150.statcan.gc.ca/n1/daily-quotidien/220420/cg-a001-eng.htm
https://financialpost.com/news/economy/canadas-inflation-comes-in-much-hotter-than-expected
[7] For clients with paper documents, the link to Bon Jovi's *Bad Medicine* is **https://www.youtube.com/watch?v=eOUtsybozjg**

While the S&P500 finally exceeded its 1973 high in July 1980, the Canadian stock market did better. But what was the secret sauce for doing better than inflation? The answer is our favorite word **DIVIDENDS**. Especially companies that *grew* their dividends.

Table 1: The 1970's

10-year Compound Change	Dec 1969 – Dec 1979	Notes
US CPI	7.4%	Figures are on per year basis
Canada CPI	7.5%	Consumer Price Index is inflation
S&P500 price return	1.6%	
S&P500 total return	5.9%	Total return includes dividends reinvested
S&P/TSX price return	5.6%	
S&P/TSX total return	10.4%	TSX total return handily beats inflation

Source: (i) Scotiabank, Portfolio Strategy, Revisiting the 1970s in Charts, March 23, 2022; (ii) Bloomberg

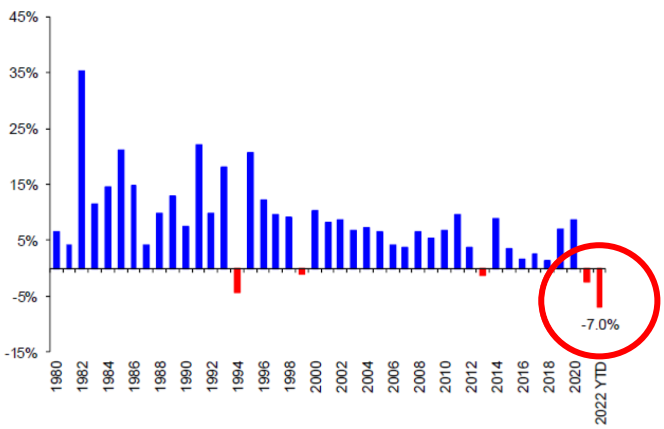
The story being told in the above table is that the stock market can help protect from inflation. If we look at just the price change of the stock markets, they did not keep up. But factoring in dividends, Canada's stock market handily outpaced inflation. The TSX's dividend per share *growth* was 8% per year in the 1970's and the average dividend yield was 4%.[8] Canada's dividend growth in the 1970's was helped by the high concentration of resources and commodities in our stock index. With the current high inflation, we expect this to happen again as the demand and price of resources, from fertilizer to oil, has gone up.

So, what are the investment markets doing right now? We see current themes of de-risking by avoiding low yielding, expensive and long-duration assets.

Equities. In the stock market we believe there is a rotation from expensive non-dividend paying equities to less expensive dividend paying equities. By less expensive, we do not mean a high share price; we refer to valuations such as P/E (price to earnings), where the higher the P/E the more expensive a stock is relative to its earnings. Another measure of value is the dividend yield (dividend to share price), the higher the dividend yield the cheaper the stock is. We believe companies that aren't too expensive and reward shareholders with regular dividends and dividend increases will do relatively better.

Fixed income. A lot of damage has been done to the bond market. Bonds have seen their worst performance in 40 years in only 3 months, and it's not getting better as further interest rate increases are expected.

Chart 4: FTSE Canada Universe Bond Index (total return) – worst in 40 years



Source: Scotiabank, The Chart Book, April 2022

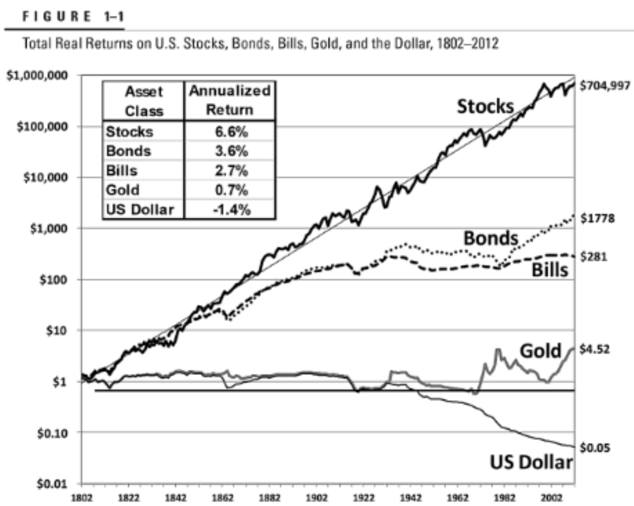
In the bond market, our strategy has been to favor bonds of shorter maturities, namely bonds that mature in less than 5 years and buying bonds with the largest interest payments. When we have rising interest rates like we do now, bonds that are long maturity and pay no coupon (a *zero* or *strip* in bond terminology) will see the largest decline in price. Bonds that mature quickly and pay the highest interest will be the least impacted.

[8] Scotiabank, Portfolio Strategy, Revisiting the 1970s in Charts, March 23, 2022

Cash. Ray Dalio was quoted in December 2021 as saying, "Cash is trash." He went on to say, "Cash is not a safe investment, is not a safe place because it will be taxed by inflation". [9] Deposits at the bank currently pay well below 1% and the 3-month T-bill yield is 0.72%[10]. With inflation at 6.7%, putting your money into something with low or nil risk means your savings will be eaten up very quickly. Cash is not a place to be during periods of high inflation. Your bank statement may not change but the cost of living will burn a large hole in your savings account.

The long run. The chart below offers a rare glimpse at asset class returns over the very long run – 210 years! Note that gold has kept slightly ahead of inflation while the U.S. Dollar has lost 95% of its value. If we extrapolate the returns from 1802 to 2022, we get a value of $2,394 for a $1 investment in bonds and $1,340,286 for a $1 investment in stocks.

Chart 5 – Long Run Returns



Source: Stocks for the Long Run, 5th Edition by Jeremy Siegel, McGraw-Hill, 1994

Individual investors don't have a two-century investment horizon. If you are saving up cash for a renovation, car purchase or other big-ticket item in the next 1-3 years then by all means keep it in the bank as we don't know what the markets will do in the short term. For investors with a low or moderate risk tolerance, short-term bonds still make sense as they protect investment portfolios against significant downturns in equities. However, if your investment horizon is 10 years or longer, equities make sense as today's cash or bond returns won't keep up with the cost of living.

No Wholesale Change. To be clear, we are not advocating for wholesale changes to client portfolios. Empirical evidence has shown that all-equity portfolios have produced inflation-beating returns over centuries. However, it has not been a smooth ride. For example, from October 1929 to the summer of 1932 the Dow lost 89% of its value. The Dow did not return to pre-crash heights until November 1954.[11] During the start of the COVID-19 pandemic, it took the S&P 500 only 22 trading days to fall 30% from its record high reached on Feb. 19, 2020, making it the fastest drop of this magnitude in history. In these cases, fixed income's role as a critical diversifier was on full display. Investors holding short-term bonds enjoyed near flat returns as equities plummeted. It's worth repeating: For investors with a low or moderate risk tolerance, short-term bonds still make sense.

Silver Lining. There is a potential silver lining for clients holding short-term bonds as well. While interest rates are expected to rise sharply there will be an opportunity to transition to longer dated bonds and these bonds have the potential to produce equity-like returns as interest rates begin to decline. Central banks have a poor track record of producing the "soft landing" and the more probable outcome in 12-18 months is recession. Interest rates are typically lowered during recessions to stimulate economic growth and in these environments long dated bonds thrive.

[9] https://financialpost.com/moneywise/ray-dalio-says-your-cash-savings-are-not-safe-and-will-be-taxed-by-inflation
[10] Scotiabank April 6, 2022
[11] https://www.federalreservehistory.org/essays/stock-market-crash-of-1929

Part 3 – Summary

According to the textbooks, cash is the safest asset class to be in and bonds are the next safest. Cash is falling woefully short after inflation and long term and/or low yielding bonds are seeing losses caused by rising interest rates. Ironically, when taking the risks of inflation and rising rates into account, the stock market may be the safest place to be. For today, investment markets have been turned upside down and we live in truly interesting times.

===

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.

DISCLAIMER

Gold Investment Management Ltd. ("GIM") is registered as a portfolio manager in the provinces of Alberta, British Columbia, Saskatchewan, Manitoba, Ontario, Quebec and Nova Scotia and as an investment adviser with the U.S. Securities and Exchange Commission. This material is provided to you for informational purposes only. For greater certainty, the information contained herein should not be construed as a recommendation of any specific model portfolios or investment actions. Any third-party information contained herein has been compiled from sources believed to be reliable, however, GIM makes no representation or warranty, express or implied, as to its accuracy or completeness. Any market prices and estimates in this report are for informational purposes only. The opinions contained herein are effective as at the date of the report and GIM does not assume any responsibility for advising the reader of any subsequent change of opinion. Any indications of past performance contained herein is not indicative of future results and any information with regard to the performance of GIM's investment portfolios is presented gross of fees which will vary from mandate to mandate. For additional information please visit our website: https://gold-im.com/legal/.