THE KWAMMENTARY

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ODLUM BROWN
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Saint Valentine's Portfolio

My lovely wife and I had a discussion a few weeks ago about our (meaning *my*) plans for our (meaning *her*) Valentine's Day. In my typical fashion, I decided to discuss, at length, the historical context in which Saint Valentine existed and why I thought the holiday made no sense. I thought I had made a compelling case, but as any discerning individual could gather, this has ended up costing me dearly. I have been making apology dinners ever since.

The story of Saint Valentine is disputed, but the general idea is that Valentine (a holy man) was big on promoting his faith at a time when it was lethal to do so, and the Roman Emperor at the time (Claudius) was having none of it. His non-consensus view got him executed, and we have been buying flowers and chocolate shaped hearts from Costco ever since.

The beginning of 2022 has been unnaturally volatile, with significant moves in indices like the NASDAQ Composite Index (-11%), S&P 500 Index (-6%) and Dow Jones Industrial Average (-3.5%), all year-to-date as of February 4, 2022. Confusion and uncertainty around interest rates, inflation, COVID-19 and geopolitics seem to have all collided at once, creating a general sense of pessimism in the market. The way we construct our investment portfolios are an argument for an optimistic (albeit, tempered with caution) outlook on the next couple of years. I still believe the case for optimism is compelling, but in the immediate term, it looks like the market is not in love with the idea (i.e., non-consensus). Unlike the case with my wife, or Emperor Claudius, I believe our viewpoint will not get us in as much trouble.

Interest Rates: What is the situation?

Around mid-January, the U.S. had signaled that interest rate increases were on track to begin in March, a full two years since they were set at near zero to combat economic fears at the beginning of the COVID-19 pandemic. Across the globe, other central banks have been mulling the same action as inflation fears have started to take root, both in the actual numbers, as well as in the public's consciousness. The expectation is that rates will increase this year, but to what extent and at what magnitude remains unclear. The decision is contingent on whether the economy continues to operate on a restricted basis, whether inflation pressures continue to mount and what the labour market response looks like over the course of the year.

Inflation: What is the situation?

I have discussed the factors that create inflation in previous notes, so I will not belabour the point again. In the U.S., there was a 7% increase in prices in December on a year-over-year basis, and similar themes played out across most major economies (4.8% in Canada, 5.4% in the U.K., 10.08% in Brazil and 5.0% across the Euro region). While this is immediately disconcerting, I believe a portion of that inflation calculation should alleviate itself over the course of this year as things start to reopen and supply chains get back to actually supplying. This is not to say inflation will not be a factor going forward, but barring another restriction related shock, it is difficult to envision it getting significantly worse.

COVID-19: What is the situation?

The Omicron variant spike seems to be rolling over, globally. According to *The New York Times*, daily new cases worldwide have peaked at approximately 3.7 million and are on a downward trajectory (at 3.2 million as of this writing). As evidenced by the numbers, this wave has been milder than previous variant waves from a mortality perspective. The seven-day average mortality rate has only recently breached the 10,000 range on a basis of approximately 3 million cases (same time average). Compared to an average rate of almost 13,000 on a basis of approximately 824,000 at the peak of the Delta wave, it is clear to see that the landscape has changed. This development, ironically, has created its own challenges, as governments begin the process of determining how to effectively exit the pandemic period. I expect to see this dynamic create some volatility.

Geopolitics: What is the situation?

Let me begin by saying two things:

1. I am not a geopolitical analyst or expert. At most, I'm an enthusiast.
2. There is a lot going on here, and one paragraph will not do justice to this complex topic.

Having said that, here are the things that have been eating up some of my mental RAM.

Russia versus Ukraine (and the U.S., EU and U.K.) – In the interest of not putting my foot in my mouth, I will not comment on whether this escalates into an armed conflict. The truth of the matter is anyone who says they have an idea with confidence should be regarded with some skepticism. Interestingly, the tensions have highlighted some of the dysfunction within NATO (North Atlantic Treaty Organization) countries. On one hand, the members have varying levels of interest in establishing a unified hardline stance against an incursion on nations neighbouring their border. There seems to be an (unofficial) positive correlation between avoiding a hardline approach and how much gas Russia supplies their respective countries. On the other hand, Russian aggression is changing the calculus for other countries outside of NATO and providing an incentive to consider joining the alliance. We will have to just wait and see on this one.

Chinese Financial Expansion – China launched an initiative back in 2013 under the moniker of "One Belt, One Road," which was designed to function as an updated version of the ancient Silk Road. Like its predecessor, its success relies on relationships with countries along trade routes, as well as investments in infrastructure, to be able to keep products moving. Although the success of the initiative is debatable, it is still early days. More importantly, the attempt highlights a substantial strategic shift from the country as it jockeys for global influence. I suspect that efforts under this initiative will intensify as the world exits the COVID pandemic, because developing these relationships and routes would be beneficial to China's slowing economy. Expect to see more flexing.

U.S. Midterm Elections – If President Biden's approval ratings are any indication of the Democratic party's chances of success in the midterms this year, things are looking grim. Should the Democrats lose control of Congress, it is safe to assume that no major legislation would be passed for the duration of Biden's presidency. This would be a less than ideal scenario for policies around infrastructure, climate change and social programming, but there is a certainty that comes with knowing that no major legislative changes are on the horizon, which markets typically enjoy.

Putting it all Together

In previous notes, I have discussed the positive aspects of our current situation (e.g. labour/unemployment, consumer demand and years of stimulus). All of these factors are still in play as we begin 2022, and I believe their impact will become more visible once we allow "normalcy" to return. The abovementioned issues present unique challenges, and they will create bouts of volatility like what we have seen over the first five weeks of the year. They will likely continue to create volatility for the duration of the year, until they are either fully realized or fully addressed. However, the environment we are in is drastically different from where we were two years ago. With that new environment comes new opportunities, driven by volatility, which I will take advantage of for my clients' portfolios.

Sincerely,

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