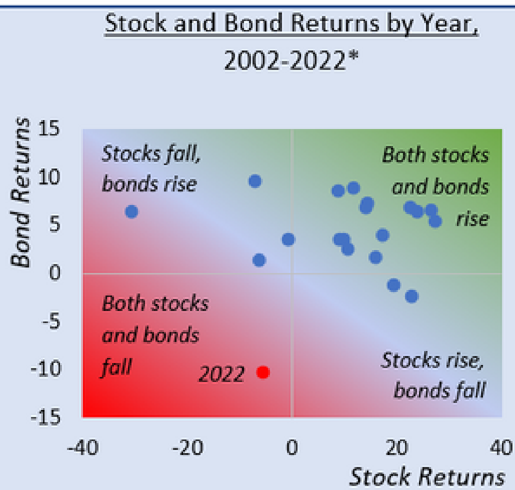
2022 In Review

2022 delivered painful surprises to everyone at the grocery checkout, the gas pump, and in our investments. Stocks and bonds both declined as inflation and interest rates rose, and it was hard to escape negative headlines about global events and local politics. At Encasa, we felt the same pain, but we believe there are good reasons to consider 2022 an outlier, and to be optimistic about 2023 and beyond.

LOOKING BACK AT 2022

2022 was unusual in that both stock and bond prices fell at the same time. This is the first time we have seen this in over 20 years, and one of only a handful of times this has happened since the 1970s. The chart below shows how much of an outlier this is.

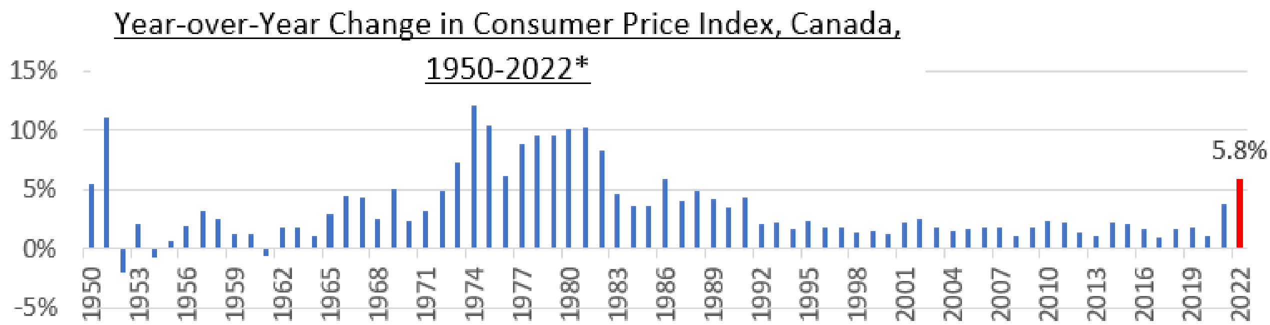


This chart shows, year by year, how both stocks and bonds did in each year from 2002 to 2022. Returns for stocks (using Encasa's equity benchmark of 35% Canada, 65% World stocks) are shown on the horizontal axis, and bond returns (using the FTSE TMX Canada Universe Bond Index) are shown on the vertical axis. 2022 is the only year in recent history in which both stocks and bonds have both fallen for the year overall

**2022 results are as at Nov. 30, 2022*

Data Source: eVestment Alliance

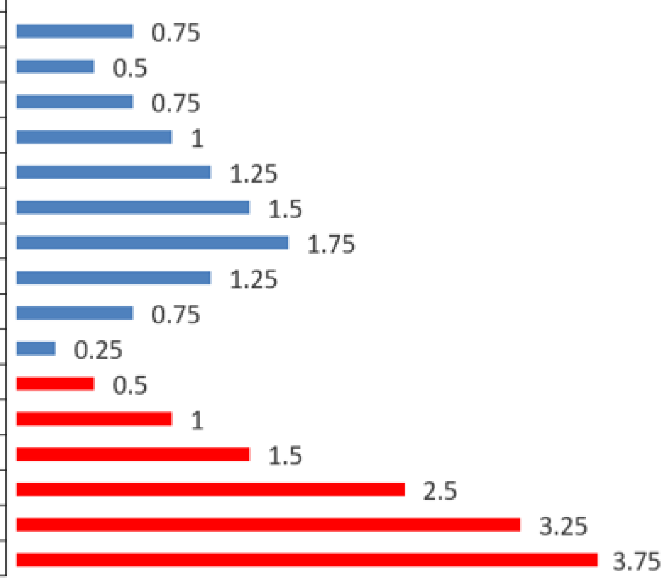
The cause of this year's twin decline was an unexpected surge in inflation and a rise in interest rates. Supply chain issues and pandemic-related government spending contributed to 2022's inflation surge. Transportation networks that were already running a bit rough after 2021's pandemic measures were backlogged further in 2022 as ports became jammed. One-off events like the grounding of a container ship in the Suez Canal disrupted trade further. Russia's invasion of Ukraine shook energy and grain markets, as transportation of Ukrainian grain to market became more complicated, and as Russian exports of oil and gas were affected first by economic sanctions, and then by damage to pipelines. The result was inflation at levels not seen since the 1980s:



**November to November year-over-year change, excluding eight most volatile items*
Source: Statistics Canada table 18-10-0256-01

Central banks responded to higher inflation by raising interest rates and taking other measures to make it more expensive for consumers (and governments) to borrow. We can see the change in the Bank of Canada's overnight lending rate in the table below:

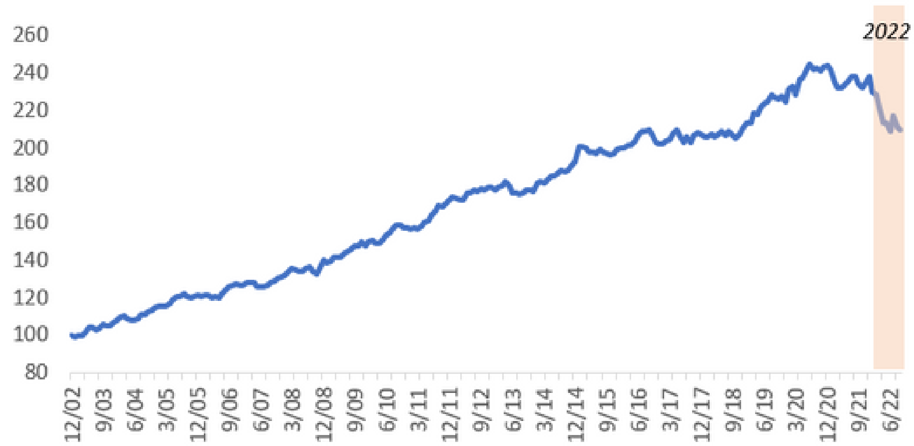
Date	Change from Previous	Target for the overnight rate
January 21, 2015	-0.25	0.75
July 15, 2015	-0.25	0.5
July 12, 2017	0.25	0.75
September 6, 2017	0.25	1
January 17, 2018	0.25	1.25
July 11, 2018	0.25	1.5
October 24, 2018	0.25	1.75
March 4, 2020	-0.50	1.25
March 16, 2020	-0.50	0.75
March 27, 2020	-0.50	0.25
March 3, 2022	0.25	0.5
April 14, 2022	0.50	1
June 2, 2022	0.50	1.5
July 14, 2022	1.00	2.5
September 8, 2022	0.75	3.25
October 27, 2022	0.50	3.75



Source: Bank of Canada

This is the most aggressive series of rate increases since the late 1970s and early 1980s. The most direct impact was on bond prices. When interest rates rise, bond prices fall. We can see this in the following chart, which shows the growth of $100 invested in a major Canadian bond index over the last 10 years:

Growth of $100 Invested in FTSE TMX Canada Universe Bond Index, 2002-2022



Source: eVestment Alliance. Data are for 10 years ending Nov. 30, 2022.

Stock prices were also hit, as the value of future dividends and earnings seemed less exciting to investors when higher interest rates made bonds, or even cash in the bank, suddenly more appealing. Market commentators began expressing concerns about declining corporate profits or even a recession.

Growth of $100 Invested in Stocks (35% S&P/TSX Composite, 65% MSCI World), 2002-2022

Source: eVestment Alliance. Data are for 10 years ending Nov. 30, 2022.

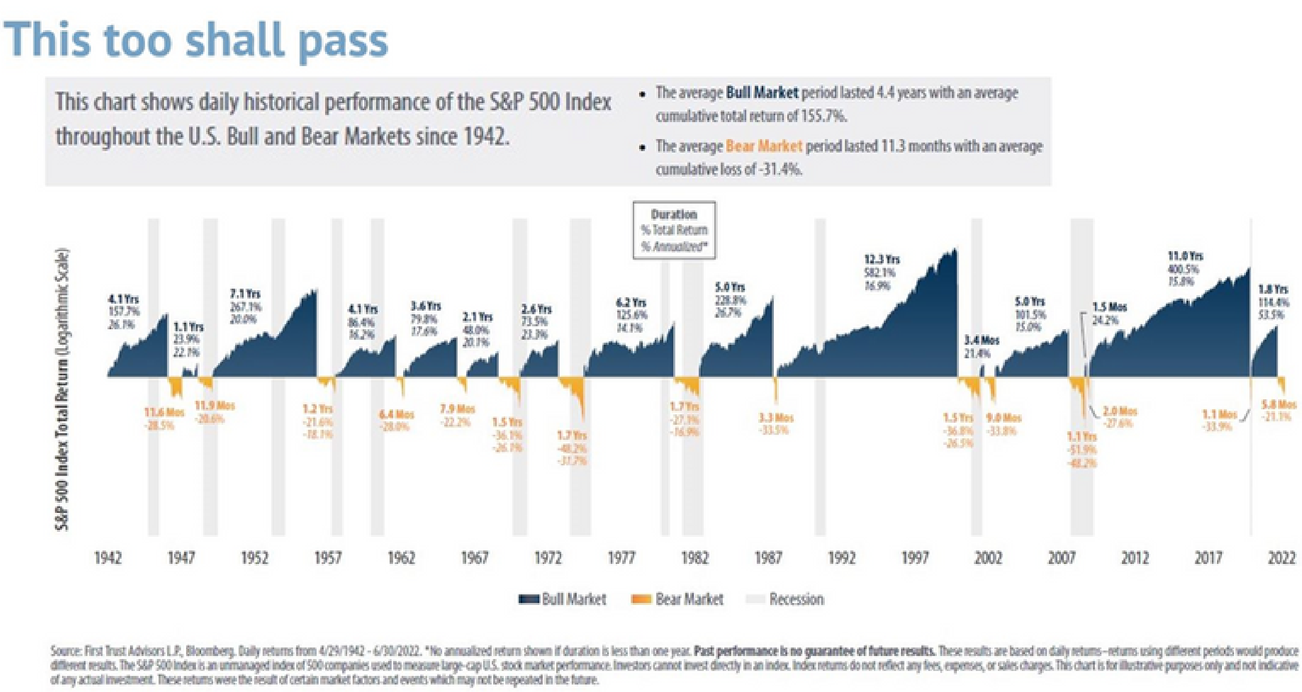
In summary, 2022 brought higher inflation, which led to higher interest rates, which hurt both stocks and bonds.

LOOKING AHEAD TO 2023

In the fourth quarter of 2022, markets have stabilized and mostly gone sideways as inflation has stopped accelerating, at least in North America. Whether central banks will be able to engineer a "soft landing" in which growth slows just enough to bring inflation down, without causing a recession, remains to be seen. The Bank of Canada may face a particularly challenging balancing act as Canadian households' high debt levels and the widespread use of variable-rate mortgages mean that interest rate increases may squeeze consumer spending and hurt economic growth more than it would like.
As always, it's impossible to know exactly what the news will bring or how markets will take it. However, there are some general principles that can guide our approach to investing in 2023.

BEARS EVENTUALLY HIBERNATE

Financial commentators often refer to "bull" and "bear" markets. As a rule of thumb, commentators talk about "bear markets" when prices have declined by 20% or more from their peaks. Based on these definitions, 2022 has seen a bear market in stocks in most major markets, and bonds have not been that far behind in some cases.
Historically, bear markets have tended not to last long. The chart below shows this: the average bull market period in the U.S. since 1942 has lasted 4.4 years with an average cumulative return of 155.7% while the average bear market has lasted 11.3 months with an average cumulative loss of 31.4%.



Source: John Authers, Bloomberg Opinion

DIVERSIFICATION

A second principle to note is that diversification continues to make sense. 2022 was unusual in the degree to which stock and bond prices fell at the same time. Most years, they move in unrelated or even opposite directions, stabilizing the portfolio's overall returns.
It seems unlikely that both stocks and bonds will fall again in 2023. At this point, major central banks, including the Bank of Canada and the US Federal Reserve, have suggested that interest rate increases going forward will be less aggressive and more tailored to the specifics of inflation in their local economies.

BONDS: A MATTER OF PRINCIPAL

Unlike stocks, bonds have a set maturity date. This is important because, although bonds can fall below their face value temporarily, they will return to face value at a set date. Many bonds are trading below their face value after the sudden interest rate increases of 2022, but over the next few years, many of them are likely to rise in price as their maturity dates get closer.
As noted above, bonds could also benefit from a stabilization or even a decline in inflation rates. If inflation eases and interest rates come down, bonds could do well, offering price appreciation as well as higher yields than we have seen in the last decade.

BONDS: A MATTER OF PRINCIPAL

This brings us to the final point. Your organization invested for growth over the long term, not over a single year. 2022 has been a tough year for all investors, but the most important thing is to focus on the future, and to ensure that the organization's portfolio is set up to deliver on the organization's investment objectives and tailored to its time horizon and ability to bear risk. Your advisor is available to review your organization's portfolio with you to ensure that it is properly set up to meet your organization's needs. Please don't hesitate to contact us with any questions or if you'd be interested in meeting with us for a review.

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