

A Defensive Approach to Volatile Markets

with Tej Rai

Tej Rai

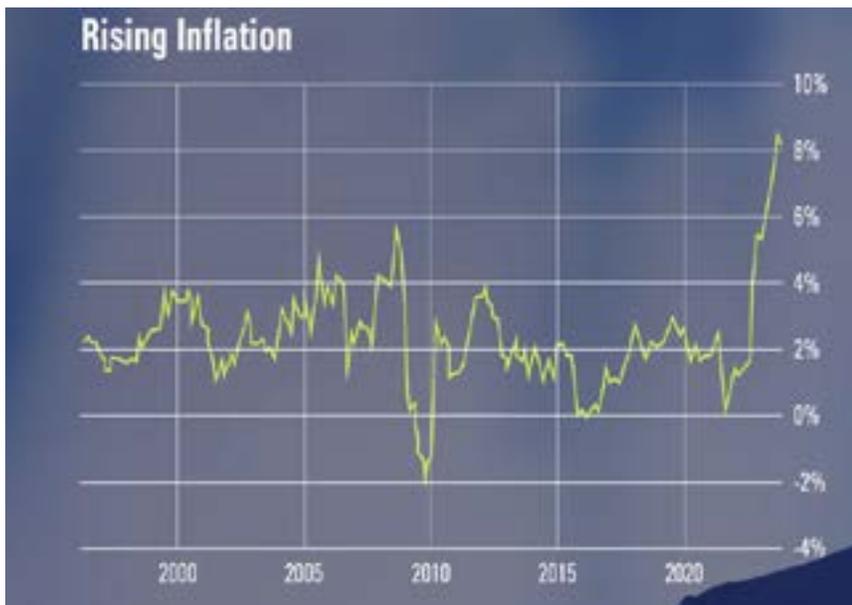
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Funds managed:

IA Clarington Global Risk-Managed Income Portfolio
IA Clarington Monthly Income Balanced Fund
IA Wealth Enhanced Bond Pool
IA Wealth Managed Portfolios
IA Clarington Inhance SRI Portfolios

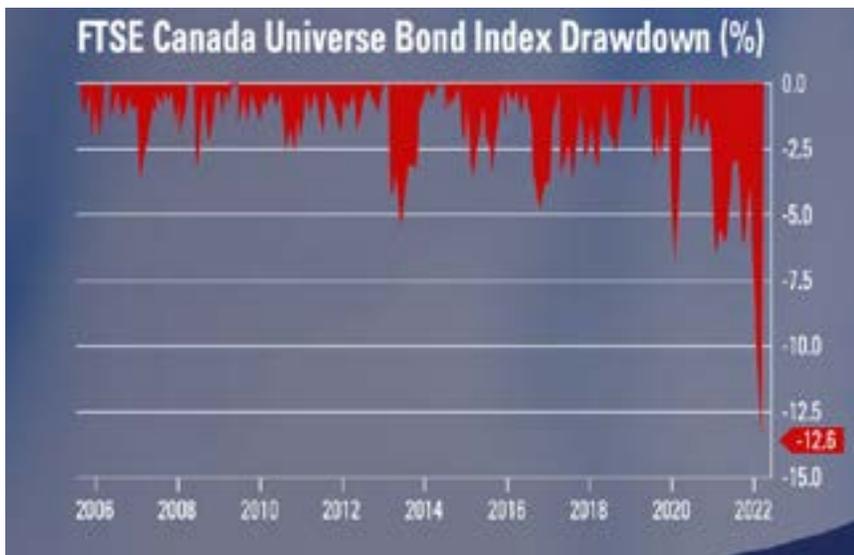
What happened in Q1 and what surprised you most?

- We started to see a level of sustained inflation that we haven't seen in 40 years.



Source: Tradingeconomics.com and U.S. Bureau of Labor Statistics.

- The central banks raised interest rates in a bid to restore price stability. This led to a rapid repricing of the bond market and significant knock-on effects for equities, particularly technology and growth names.



Source: Macrobond and iA Investment Management, as at April 27, 2022.

- The simultaneous decline of bonds and equities has continued into Q2, leaving investors – especially those with 60/40 portfolios – with nowhere to hide.
- What I think has been surprising, apart from the fact that bonds and equities have fallen in tandem, is the speed and magnitude of the decline.
- For most of the last 30 years, stocks and bonds have been inversely correlated – when stocks zig, bonds zag. But this is because the causes of weakness in the stock market – poor earnings, war, etc. – don't negatively affect the bond market at the same time.
- Inflation is the one phenomenon that negatively impacts both equities and bonds, and this is what made Q1 of this year – and potentially the rest of the year – so difficult.

	S&P 500 Index	Barclays U.S. Aggregate Bond Index
1977	-7.2%	3.0%
1981	-4.9%	6.2%
1990	-3.2%	9.0%
2000	-9.1%	11.6%
2001	-11.9%	8.4%
2002	-22.1%	10.3%
2008	-37.0%	5.2%
2018	-4.4%	0.0%
2022 YTD	-12.9%	-9.5%

Source: Compound Advisors, as at May 13, 2022. Returns in U.S. dollars.

Why would it be a mistake for investors to sell off their bond exposure?

- We have to keep in mind that the bond market has already priced in four 50 basis point interest rate hikes. This means a lot of the pain is already priced in.
- That doesn't mean bonds can't decline further, but we think this can only happen if inflation expectations come in hotter than what's already priced in for both Canada and the U.S.
- If inflation were to moderate faster than expected, we could end up seeing a relief rally in bonds as the market comes to see that things won't be as bad as anticipated.
- If you're looking at things from a long-term perspective, it makes sense to stick to the asset allocation that's appropriate for your risk tolerance and objectives rather than try to time the market.

What are you favouring in this environment?

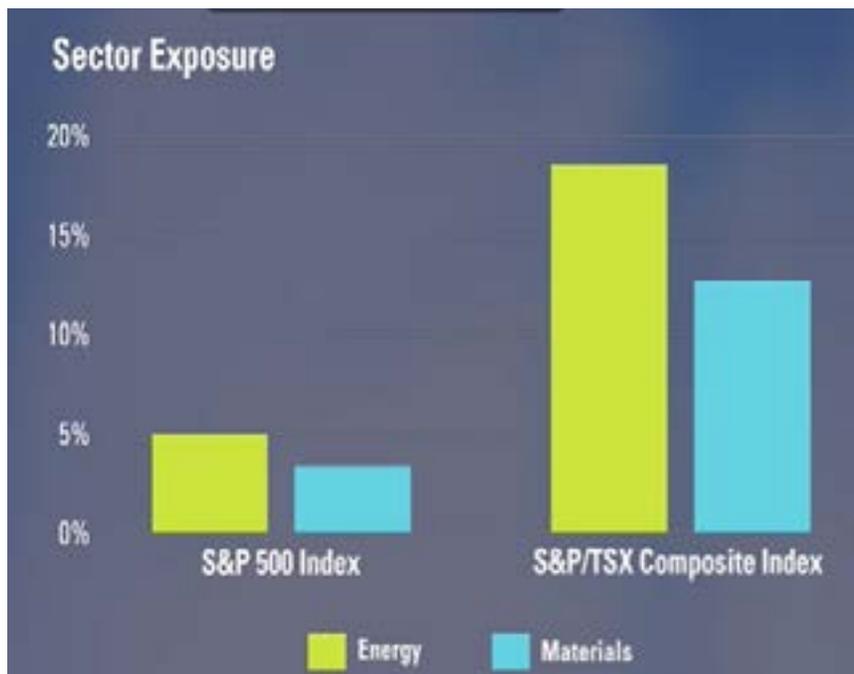
- We're favouring cash. Throughout Q1 and into Q2 we have been reducing our equity exposure, to the point where we're underweight stocks. On the fixed-income side, we've been underweight for a long time and we're staying that way.
- Within our equity underweight we're favouring Canada over the U.S.
 - Canada is heavily exposed to commodities, which generally do well during inflationary times.
 - Valuations in the U.S. have been historically high and we're starting to see economic activity fade slightly in the U.S. as a result of elevated inflation.
- We're watching the equity and bond markets for an opportunity to get back to neutral or overweight, but we're not quite there yet.

	Current Positioning				
	--	-	N	+	++
Money Market					
Bonds					
Equities					
Canadian Equities					
Foreign Equities					
U.S. equities					
International equities					
Emerging markets					
Gold					
Foreign Currencies					
CAD vs USD					
CAD vs Euro					

Source: iA Investment Management, as at April 30, 2022. Market views from very negative (- -) to very positive (++). N = Neutral view.

How can you adapt the portfolios to deal with higher inflation?

- There are a few things we can do to mitigate inflation's impact on equities and bonds.
- One is to have exposure to areas of the market that either aren't affected by inflation or that benefit from it, particularly commodities. We can gain this commodity exposure in a variety of ways, including:
 - Direct exposure to gold
 - A basket of stocks of commodity-producing companies
 - Overweighting countries with a large commodity sector (e.g., Canada, Australia, and select Latin American countries)



Source: Morningstar, as at May 11, 2022.

- Another way of dealing with inflation has to do with the machine side of our “human + machine” approach to asset allocation.
- There are a few systematic strategies that tend to do well when market and economic regimes change, as is happening now with the shift from an accommodative monetary policy to a tightening cycle.
- Trend-following and momentum models tend to be able to pick up on these shifts and ride the wave as it's happening, and these models are part of the reason we're currently underweight equities and bonds.
- We believe our combination of asset class exposures and systematic strategies positions us well in the current inflationary environment.

Visit iaclarington.com to learn more about Tej Rai and the iA Investment Management Asset Allocation team.

For definitions of technical terms, visit iaclarington.com/glossary or speak with your financial advisor

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