TD Wealth

Investor Newsletter

Winter 2022

With the support of very strong third quarter earnings, equity markets were generally able to extend on what was already strong 2021 performance in the fourth quarter. A sharp rally during earnings season was sandwiched between volatility induced by inflation and thereby interest rate concerns in early October and the rise of the Omicron variant in early December. The result was that, while broadly higher, there was an increase in regional dispersion as 2021 came to a close: S&P/TSX Composite Index 25.09%, S&P 500 27.89%, U.K. London FTSE 16.94%, German DAX 7.24%, MSCI Japan 1.6%, China Shanghai Comp 6.89%, MSCI EAFE 11.29%, MSCI Emerging Markets -2.64%, and MSCI World Index ex-USA 7.83% (2021 returns adjusted to Canadian dollar).[1] With the CAD/USD exchange relatively flat over the full calendar year, it was the Euro that required the most adjusting after a relative loss to the Canadian dollar of more than 8.5%. The strong breadth experienced in the first nine months of 2021 expanded further in the fourth quarter with all but one S&P/TSX sector in Canada, healthcare, posting a negative return for the year. The U.S. did one better by having all 11 S&P 500 sectors post double digit gains for the year. The top three sectors on both sides of the border, and in order were, energy, real estate, and financials.[2]

Rising prices were not limited to stocks, as increases in day-to-day goods has inflation, as measured by Consumer Price Index (CPI), at its highest level in Canada since 1991.[3] That the most recent data, Q4 CPI at 4.73%, is roughly in line with the Bank of Canada's October Monetary Policy Report comes with little relief. Bank of Canada (BoC) projections have CPI waning to a still robust 4.2% in 2022, above their targeted range of 1-3%. With forecasts generally split on whether rate lift-off would occur following their January meeting, the BoC kept the overnight rate at 0.25%. Their view that economic slack has been absorbed is being interpreted as a strong indication that they will start moving rates higher at the next meeting in March, with a chance that they'll halt the reinvestment of the bonds accumulated during their quantitative easing program. TD Securities is currently forecasting four hikes of 0.25% in 2022, taking the overnight rate to 1.25%.

Soon to be confirmed for a second term, Federal Reserve Chairman Jay Powell is facing similar inflation concerns in the U.S. During his recent confirmation hearing, he acknowledged that issues with the supply chain have turned out to be "more persistent and more substantial" than he and the U.S. Federal Reserve's Open Market Committee (FOMC) expected and the much-debated use of the descriptor "transitory" is gone. This acknowledgement and their own taper announcement in November of 2021 has brought forward expectations of rate hikes in the U.S. While also leaving rates unchanged, the FOMC shifted to a more hawkish tone during their recent January meeting with the market currently pricing "lift-off" for March. While the market is currently pricing a relatively short rate hiking cycle, both the BoC and FOMC have expressed a willingness to move aggressively to combat the embedding of higher inflation expectations if needed.

After a short-lived rally following the discovery of Omicron, bonds faded into year-end as the markets adjusted for the changing rate hike expectations. The iShares Core Canadian Bond Universe ETF's total 2021 return, interest payments included, was -2.80%, its first negative return since 2013. Further increases in interest rates in early January have that ETF down another 3.51%, as of January 26, creating a hurdle rate for which we don't expect interest payments to be able to make up.[4] As the moves have been in reaction to expectations related to central bank rate hikes, shorter term bonds yields have felt impact more significantly. The Canadian 2-year Treasury yield has increased by 75 basis points to 1.27% since the end of September, while the 10-year Treasury yield gained 37 basis points to 1.78%.[5] Though the central banks are tasked with fighting inflation, higher rates mean higher interest expenses on much larger piles of debt and we expect real rates on Canadian and U.S. Treasury bonds to remain negative beyond 2022.

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The 2021 performance of the Canadian dollar was a tale of two halves with the CAD gaining 6.24% at its best in early June before fading to end the year near unchanged relative to the U.S. dollar.[6] The combination of higher energy prices in early 2022 and adjustment of short-term interest rate expectations resulted in the Loonie getting some of the gains back in January. With the FOMC and the BoC seemingly on very similar schedules, we expect there is limited further upside relative to the U.S. dollar. Though higher rates are coming from other G10 central banks as well, the BoC and FOMC look to be out ahead of the group and we expect the CAD and USD to see some strength globally as a result.

Historically speaking, years following 20%+ gains for the S&P 500 have seen above average performance. While that may yet be the case, it's been a weak start to 2022. Higher interest rates meaning that future earnings have lower present values and a shaky start to earnings season have resulted in weakened sentiment. In an environment where there is a shift in monetary policy and economic growth is slowing, volatility is to be expected. But that doesn't shake us from our preference to maintain full equity exposure. We expect the markets will adjust to these changes with an internal sector rotation that sets up favorably for the Canadian market.

Registered Account & Tax Reporting Information

The Tax Free Savings Account (TFSA) annual contribution limit remains at $6,000 for 2022. The annual contribution limits for Retirement Savings Plans (RSPs) are $27,830 and $29,210 for 2021 and 2022, respectively.

Please note that we are expecting the 2021 TD Wealth Tax Packages to be delivered in mid-March. Third-party slips will be delivered separately and have the following mandatory mailing dates, to the degree that they apply:

T5 February 28, 2022
T-5008 February 28, 2022
T3 March 31, 2022

Sources:
1. Bloomberg Finance L.P. as at December 31, 2021. Total Index returns. Index returns calculated in C$.
2. Bloomberg Finance L.P., as of December 31, 2021. Index Total Returns.
3. TD Securities - Global, FX & Commodities Strategy
4. https://www.morningstar.ca/ca/report/etf/performance.aspx?t=0P000080T1&lang=en-CA
5. Refinitv powered by financial.com
6. Refinitv powered by financial.com

Interest Rates as of January 27, 2022

Fixed Income Securities	1 year	2 years	3 years	5 years	10 years	20 Years	30 Years
GICs**	0.60%	0.80%	0.85%	1.15%			
Canadian Treasury Bonds*	0.12%	0.16%	0.20%	0.45%	0.89%	1.15%	1.47%
U.S. Treasury Bonds*	0.09%	0.12%	0.18%	0.44%	1.08%	1.65%	1.85%

* Rates provided by TD Securities
** Rates provided by TD Wealth

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