Wealth Management
PH&N Investment Counsel

Counsel Views

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Key takeaways: the 2022 RBC PH&N Investment Counsel Conference

Global markets are forever dynamic and economic conditions are constantly in flux. While our investment philosophy focuses on the long term, it is important to always assess the risks and opportunities over various timeframes. With that in mind, we recently hosted our spring 2022 RBC PH&N Investment Counsel Conference – the third virtual investment conference for employees since 2020. It was an opportunity for Investment Counsellors to hear directly from an array of investment industry experts, and ask portfolio managers questions directly.

Guest list: Tapping into global expertise

An important component to our investment decision-making process is considering different and often competing forecasts. The virtual investment conference allowed us to efficiently hear forecasts from both internal and external experts at different organizations around the world:

- RBC Wealth Management
- RBC Global Asset Management
- RBC Economics
- Evercore ISI Research
- Ironside Macroeconomics
- Credit Suisse Global Research
- The Carlyle Group
- Hamilton Lane
- Apogem Capital (formerly GoldPoint Partners)
- Blackrock Canada
- BCA Research

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Key takeaways from each conference topic

Week One

- ✓ **Global markets:** A wide range of potential outcomes keeps us neutral to our strategic targets.
- ✓ **U.S. dollar as reserve currency:** Long-term potential to see the greenback lose its role as a reserve currency, favouring commodities and gold.
- ✓ **Inflation:** Inflation will have a positive productivity shock for capital investment, labour and technology.
- ✓ **China vs. the West:** Relations continue to be mutually beneficial to both China and the U.S.
- ✓ **U.S. politics:** Stage appears set for Republican Congress and Senate after mid-terms and a Biden-Trump rematch in 2024.
- ✓ **Transition to renewables:** Medium to long-term positive to provide the U.S./allies with cleaner energy sources.
- ✓ **Credit and rate markets:** So far this year, it's been a difficult market for fixed income, but credit showing attractive opportunities.
- ✓ **Gold:** Offers a store of value in geopolitical risk period, but its price is influenced by the direction of real rates.

Week Two

- ✓ **Canadian equities:** Well positioned to benefit from strength in energy and financials, and attractive valuations vs. U.S. equities.
- ✓ **Low volatility investing:** Does not always mean lower returns.
- ✓ **Emerging markets:** Currently experiencing less inflation than developed markets, and balance sheets healthier vs. previous periods.
- ✓ **European equities:** Focusing less on macro-economic themes, and more on owning solid businesses with a flexible capital base.
- ✓ **Real estate private markets:** Canadian core real estate is well positioned for 2022-23, with net revenue growth expected to insulate asset values from rising rates.
- ✓ **Equity private markets (Carlyle):** Remains positive on the pipeline across all regions.
- ✓ **Equity private markets (Apogem):** Meeting for Investment Counsellors with the former GoldPoint Partners team.

Week Three

- ✓ **Long-term portfolio themes:** Despite short-term uncertainty, we remain positive on the longer-term outlook for growth and equities.
- ✓ **Our evolving investment offering:** We're focused on value-added fixed-income investment solutions, alternative investments and building strong partnerships.
- ✓ **Alternative investments:** We're exploring new opportunities within RBC Global Asset Management and externally as well.
- ✓ **Environmental, Social & Governance (ESG):** How portfolio managers can integrate an ESG framework into the investment process.
- ✓ **Corporate governance and Responsible Investing:** Active stewardship, reporting on responsible investing progress and industry trends.
- ✓ **Canadian housing market:** Correcting as rates move higher. Supply/demand imbalance will persist, and balance sheets are in good shape, so no financial crisis in sight.
- ✓ **The family office in Canada:** As wealth grows, family offices are seeking new investment opportunities and help with risk management.

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Conference insights

Over the next 6-12 months...

- **Inflation remains the wild card across most scenarios.** While there are signs that inflation may peak in 2022, there is limited conviction in the short-term outcomes for global markets today. The wide range of potential outcomes for bonds and stocks over the next 6-12 months based on the pace of central bank rate hikes and monetary policy tightening to combat inflation suggests that we should remain close to our strategic asset allocation targets.
- **It's possible that inflation may peak this year.** There are signs that financial market conditions have already tightened, essentially doing some of the work of central banks which have been stepping up the pace of monetary policy tightening (i.e., raising interest rates to slow economic growth and fight inflation). Real consumer spending is showing signs of slowing as prices rise. China's zero-COVID policy has been putting the brakes on global demand for oil and other commodities which is slowing the pace of inflation somewhat. Finally, some of the drivers of rising inflation, such as used vehicle prices, have started to show signs of peaking in the March data. While inflation in consumer durables may be peaking, there are some concerns about future inflation via services. The wage inflation data today doesn't suggest this is a near-term threat, but it does bear close watch over the rest of 2022.
- **Holding more portfolio assets like commercial real estate, infrastructure, commodities and precious metals has been positive during periods of rising inflation.** High levels of correlation to inflation historically has meant the value of real assets in portfolios has held up quite well during periods of rising inflation. While we are not expecting inflation to be a long-term threat, we believe that including exposure to real assets as part of a diversified portfolio is a good strategy.
- **Expect more volatility ahead especially as central banks begin to reduce the size of their balance sheet holdings in bonds/other instruments.** This is the process known as quantitative tightening. As such, we are holding shorter duration positions in fixed income, being selective in credit exposure, while also diversifying with global bonds. Low volatility investment solutions and higher quality core equities should also do well in a higher volatility period in the markets.
- **Geopolitical risk is important to watch, but it's rarely had any lasting impact on market performance.** The long-term ramifications of weaponizing money cannot be ignored as it has consequences across different asset classes so we continue to be mindful.
- **Gold has proven to be a winner so far in 2022, outperforming both bonds and stocks.** Geopolitical risks and higher inflation have been the drivers behind much of the movement in gold prices so far in 2022. Some of the conference presenters believe that global central banks will be looking to increase gold reserves potentially as a response to how Russia's central bank holdings were frozen by other central banks. While this could represent potential demand for gold, we note that the price of gold tends to be negatively correlated with the movement in real interest rates, i.e. nominal rates less inflation, which have been increasing lately. As real interest rates rise, we expect the price of gold to be challenged.
- **Over the next 6-12 months we'll continue to watch a mix of leading and coincident indicators to assess the risk/reward scenarios ahead.** In general these include Purchasing Manager Indices (PMIs), housing indicators like permits, starts and mortgage applications, market liquidity indicators, trends in corporate earnings, credit spreads and inflation expectations.

Beyond the next 12 months...

- **Post-pandemic world:** With elevated levels of debt, aging demographics, and now a period of what is expected to be tightening of financial conditions, investors should be incorporating lower secular growth expectations for both fixed income and equities. The choice amongst investors going forward in order to meet their objectives will be to: a) increase capital/savings into investment portfolios; b) adjust goals/objectives; c) take on additional risks to potentially earn a higher return; d) lengthen time horizons; or e) some combination of all four of these. Our portfolio strategy continues to emphasize diversification across a number of building blocks including asset classes, regions, currencies, strategies and investment managers.
- **Increasing allocations to alternative investments:** We discussed this in our recently published special report, "The role of alternative investments in your portfolio," where we highlighted the evolution and growth in popularity amongst institutional investors and private investors into alternative investments over the last decade. Increasing allocations to alternative investments like real estate, private debt, private equity and hedge funds may be one way to enhance potential returns, expand the investable universe

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into a much larger market compared to public markets, and to diversify risk from public market investments. Several surveys of institutional and high-net-worth investors highlighted at the conference indicate allocations to alternative investments over the next 3-5 years will be increasing. Please reach out to your Investment Counsellor for a copy of our special report or if you wish to discuss specific alternative investments.

- **Canadian equities remain well positioned in a new environment where a greater importance is placed on energy security.** Canada exports what is scarce in the current environment, and it is the fourth largest exporter of crude oil (mostly to the U.S.), and is the fifth largest agriculture exporter (third for wheat). Canada also produces gold, potash, aluminum, uranium, coal, lead, and zinc, which are all mostly in shortage. In addition to favourable commodity exposure, the Canadian financial services industry is the largest sector in the S&P/TSX Composite Index, approximately one-third of the index today, and is poised to benefit from the rising interest rate environment. Along with strong tailwinds for energy, materials and financials, Canadian stocks currently trade at the steepest relative discount to the S&P 500 Index since the Technology Bubble in 2002, on a forward price-to-earnings basis. Historically, when there has been such a discount, Canadian equities tend to outperform U.S. equities over the following 12-month period. Of course, past performance is never a guarantee of future performance, however this discount to U.S. equities seems quite overdone considering expected earnings growth for Canada is higher than the U.S. over the next 12 months. Beyond the next year, it is Canada's ability to offer both commodity exposure and political stability in a world of geopolitical tension that keeps us invested in Canadian equities.
- **Environmental, Social, Governance (ESG) and Responsible Investing as a core part of the investment portfolio.** RBC Global Asset Management (RBC GAM) has been at the forefront of integrating ESG tools into the investment decision-making process for many years now. Given the post-pandemic outlook for lower secular growth, increasing exposure to alternative sources of value creation such as ESG is one way for investors to potentially earn higher returns over an investment cycle. One of the presentations from RBC GAM at our conference highlighted that financial capital is not the only capital source in a company. Alternative capital comes from customers, suppliers, community, etc. But these are largely ignored by traditional financial reporting and by some investors. Strong ESG attributes at a company level creates heathier overall capital, leads to more sustainable businesses and ultimately delivers superior financial results. In addition to uncovering these potential sources of additional return for investors, RBC GAM is an active steward through thoughtful proxy voting, engagement with issuers and regulatory bodies, and collaboration with other like-minded investors.
- **Despite lower expectation for growth ahead, there is still good reason to be optimistic about the long term.** Investors are often caught in the trap of "short-termism" – and looking for answers in any place that seems to fit their current thinking (i.e. slowing growth, higher interest rates and inflation). Yet the speed in which change occurs for the betterment of society as a whole may be at a slower pace than people may realize. Some long-term trends happen slowly and incrementally. For instance, each family lifted out of poverty, each classroom that gets built, and each village gaining access to basic vaccinations may not seem significant on a scale of billions of people – but over decades, these gains add up to create a more secure, better educated, and healthier world. These long-term trends are unfortunately not visible in our daily lives as they don't make the evening headlines. However, they are all trending in the right direction and all are positive for growth, the environment and for investors. The declining cost of technology hardware and software has served to break down barriers for entrepreneurs who use capital efficiently to fuel future growth and productivity. Finally, we highlighted several long-term themes in the public and private markets that various investment solutions may be exposed to including the following:
  - Climate change (renewable energy, green mobility, energy storage)
  - Resource Management (food security, waste/water management)
  - Safety & Security (data & cyber security)
  - Industry 4.0 (robotics, artificial intelligence)
  - Digital disruption (cloud, blockchain, 5G/6G)

Lifelong learning, as well as being curious and humble

Global markets are forever dynamic and economic conditions are constantly in flux. While our long-term investment philosophy keeps us grounded by focusing on "time in the market" versus "timing the market," it is important to always assess the risks and opportunities ahead while of course recognizing that we cannot predict the future with certainty, hence always being well diversified.

Investment conferences are one medium of learning that we use at RBC PH&N Investment Counsel. We also have an extensive training and education program that helps to ensure consistency in our approach and acclimatize new team members into our culture. To help ensure Investment

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Counsellors are aware of the risks and opportunities ahead, we provide weekly market summary notes, hold regular regional conference calls to update teams on investment performance and market updates, in addition to quarterly updates provided by RBC Global Asset Management. All of these opportunities to learn are in addition to the commitment to lifelong learning many of our team members have through the CFA Institute, and other professional accreditation programs.

There are many benefits to our approach of lifelong learning including developing a mindset of growth and agility. Continuous learning encourages individuals to be curious and to be humble, which are two essential components to successful long-term investing. Studies have also shown that continuous learning can lessen the impact of confirmation bias which is the tendency to search for, interpret, favor, and recall information in a way that confirms or supports one's prior beliefs or values.

Over time, by focusing on training and education, our Investment Counselling teams are better able to learn, adapt, unlearn, and relearn to keep up with changing market conditions and meet the needs of clients. And by coming together as a community to learn together and engage in dialogues with other professionals, we can enhance consistency through our firm-wide investment approach.

Please reach out to your Investment Counsellor with any questions you may have on this article, or with any questions about your portfolio.

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