

“Kingwest's success can be attributed to three principles that the firm has abided by for over 35 years: put the client first, think sensibly, be patient.”
- Richard Fogler, CIO

Investment Manager Profile

Kingwest has been investing capital in Canadian and US securities markets through 7 market cycles with one consistent investment process and we have been earning returns well above what the market indices have delivered over a comparable time frame.

We manage \$1.7 billion on behalf of institutional and high net worth clients.

Kingwest has grown under stable employee ownership since 1982. Long-term thinking drives our approach to investing, building client relationships and growing our business.

Investment Philosophy

We believe an actively managed, value based approach, using clearly defined and consistently applied thinking offers investors the best opportunity for long-term outperformance.

Contact Information

Alexandria Horvat
Manager of Sales and Client Relationships
ahorvat@kingwest.com

86 Avenue Rd.
Toronto, Ontario M5R 2H2
Tel: 416-927-7740
Fax: 416-927-9264

2022 Investment Outlook: What we know and what we don't

2021 was a very good year for equity markets. Will 2022 be as good? No one knows, but here are some of the things that we know, and those that we don't, going into 2022.

The knowns:

The economy in Canada, the US and the rest of the developed world, is strong. The speed of the economic bounce-back from the serious dislocations of 2020 has taken many economic forecasters by surprise. The Canadian economy is just 1.4% below its pre-pandemic level while the US economy is 1.4% above. The big European countries, Britain, Germany and Italy have fared similarly to Canada, so there is still some snap back potential left in these economies. Because of population growth and productivity improvements the potential for the economy should be at least 4% larger than in 2019 in both North American countries.

Canada is enjoying a solid recovery. Output will likely surpass pre-pandemic levels at the end of 2021 or early in 2022, and the economy should grow faster than trend in 2022 (+3.9%) and again in 2023 (+2.8%). The US is experiencing even more strength; it was 1.4% above the 2019 level at the end of September. Consensus forecasts are that growth will likely be around 6% in 2022 followed by around 3% next year.

We are clearly past the strongest pace of growth in this cycle. This probably occurred around the second quarter of last year. However, the global economy should still be quite strong next year with 4.5% growth and most economies expanding well above their longer-term trend.

Consumer confidence is very high. Credit card spending is around 17% higher across all items except airlines. The financial condition of consumers is very strong. They have accumulated substantial savings during the pandemic, although the sales and interest rates in the economy are moving towards normal levels. The strong savings rate of consumers is still there, but it will probably be expended over time. It is a positive that consumers have de-levered quite a lot.

The unknowns:

The spread of the Omicron variant is likely to curtail growth in early 2022, but the economic recovery should continue throughout the remainder of the year. While cases are way up, hospitalisations are rising at a much slower pace. Omicron is much less serious threat than previous Covid variants. The great majority of the vaccinated, and a lot of the unvaccinated, suffer mild symptoms. The new Covid pill from Pfizer should improve the odds of recovery for those who do get very sick.

We could come out the other side of this with less serious consequences from the virus and with a big majority of the country either triple vaccinated or with resistance from having been infected (and in many cases both). This should take the handcuffs off the service economy and the job market at last — and continue to give asset prices a leg up.

The biggest imponderable at the moment is inflation. Inflation is high but the Central Banks expect it to moderate into the second half of the year to around 2.5%. Inflation is an important ingredient to interest rates.

The reasons why inflation is up are pretty straightforward: people are gradually coming back into the workforce, but at a much slower pace than businesses would like to hire. The demand for jobs and people to do those jobs is very high. The labour participation rate is correcting but is very likely to remain below pandemic levels. The labour shortage will probably take the unemployment rate towards 3.5% by the end of next year and a bit lower at the end of 2023.

That leads right into the question of interest rates. At the moment, interest rates are not in line with that inflation picture. Interest rates most likely will have to go up and the markets most likely will have to price in more inflation than they are pricing in today.

Market prices signal investor confidence that inflation will stay low. Measuring the spread between inflation-linked and normal five-year bonds shows the market is pricing expected inflation over the next five years under 3%, as you can see in this chart.



Source: Federal Reserve Board of Governors

Some supply constraints are easing, but most are not. The consumption of goods in the US was up around 25% from pre-pandemic to the peak and now it stands at 16%. When you have that kind of demand, there will obviously cause some pressure on transport, containers, and other related industries. However, the supply chains are starting to improve. We have seen indications like EMI delivery times are lower and the price of containers is coming down. Overall, the hope is that the supply situation will normalize slowly over the next year. It remains to be seen.

For the raise of inflation to become a real problem, the Fed, will have to ignore the inflation signals. A scenario where long-term inflations expectations are changing, in which the Fed does not react will result in a big change in real rates in the long term. Most economists do not put a high probability on that scenario.

Can China contain its real estate crisis? Economic growth in China is slowing as it shifts away from its investment driven growth model. But the massive debt and overbuilding that are the result of that model remain. Can the authorities let the air out of the property bubble without a financial crisis? So far it looks like they have. But the game is still being played out and the final score is anyone's guess. It could be the biggest story of 2022, or nothing at all.

Will Democrats enact more stimulus? Some are clutching on to hopes that Joe Biden's marquee social policy bill, Build Back Better, can eventually pass, despite pivotal senator Joe Manchin's protestations to the contrary. 2022 will be the Democrats last chance to pass big stimulative legislation before an expected mid-term change in at least one of the houses of Congress no longer gives them control of the legislature. If Build Back Better fails, pressure could build for Democrats to enact policy by executive decree, such as mass student debt forgiveness — giving household balance sheets a boost on the liability side. Forgiveness by decree would surely be challenged in court, but the many question marks around US policy could have ramifications for the markets.

And lastly, There Is No Alternative (TINA). This is the big one. Why shouldn't stocks at all-time highs, in price and valuation, worry us? Because There Is No Alternative: the earnings yield on stocks are still well higher than fixed income yields. So, you could even say they are cheap.

On balance, the environment still is very favourable and pending any unforeseen calamity, companies should continue to post excellent results.

We continue optimistic and look forward to an excellent 2022.