Insights & Strategies

PRIVATE CLIENT SOLUTIONS

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Contents

What's in Style for U.S. Equities?

Fashion styles can often be described as an expression of one's true personality and creativity. And with the evolution of time, fashion has also evolved typically over the span of decades to keep up with changes in the environment. However, given the rapid pace of change in the environment that we have all observed over the past year, it feels as though we have transitioned from the simpler times of the 1920s to the fast fashion days of the early 1990s in a matter of only nine months.

Soaring inflation, rapid increases in interest rates/yields, a war brewing in Europe, and lockdowns in China have resulted in a material increase in market volatility globally and the deceleration in global economic growth prospects. At the onset of the year, we were expecting a change from the simpler days of 2021 – most asset classes including stocks, commodities, crypto, etc., ended the year in the green – the current backdrop has been anything but that. **That said, one consistent theme we have been reiterating since the beginning of year was for investors to focus on quality stocks. So what does this specifically mean?**

The definition of quality is quite subjective and will vary quite extensively from one person to the next. However, given the growth in factor investing over the past +10 years, which to put it simply is an investment approach that involves targeting specific drivers of returns for various asset classes, there has been a lot more consistency in how factors such as quality are defined.

In the world of factor investing, there are six major style factors: growth, value, quality, low volatility, high dividend, and momentum. For each of these factors, there are common metrics used to group stocks into each of these style factor buckets. For example, for the quality style factor, this would include companies that have durable business models, a sustainable competitive advantage, and high profitability. Given the uncertainty of the economic backdrop and our expectation that a recession is on the horizon, companies that meet this definition represent our preference since these companies have historically outperformed during periods of economic contraction.

Style Factor Definitions

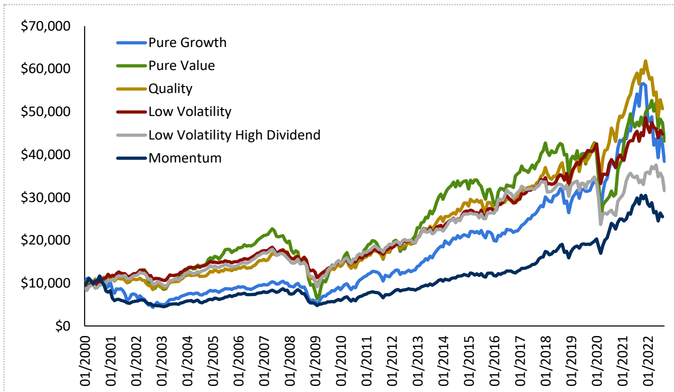
Style Factor	What it is?	Commonly Used Metrics to Identify Stocks	Index
Growth	Capture excess returns to stocks that are expected to grow at an above average rate compared to their peers	Sales growth, the ratio of earnings change to price, momentum	The S&P 500® Pure Growth index
Value	Captures excess returns to stocks that have low prices relative to their fundamental value	Book to price, earnings to price, book value, sales, earnings, cash earnings, net profit, dividends, cash flow	The S&P 500® Pure Value index
Quality	Captures excess returns to stocks that are characterized by companies whch have durable business models, a sustainable competitive advantage, and high profitability	ROE, earnings stability, dividend growth stability, total assets, free cash flows, accruals, financial leverage, gross margin	The S&P 500® Quality Index
Low Volatility	Captures excess returns to stocks with lower than average volatility, beta, and/or idiosyncratic risk	Standard deviation (1-yr, 2-yrs, 3-yrs), downside standard deviation, standard deviation of idiosyncratic returns, beta	The S&P 500® Low Volatility Index
High Dividend	Captures excess returns to stocks that have higher-than-average dividend yields	Dividend yield	The S&P 500 Low Volatility High Dividend index
Momentum	Reflects excess returns to stocks with stronger past performance	Relative returns (3-mth, 6-mth, 12-mth, sometimes with last 1 mth excluded), historical alpha	The S&P 500® Momentum

Source: MSCI Inc.; S&P Global; Raymond James Ltd.

Fast Fashion or Sticking with the Classic Look?

Over the long term, including over the past 20 years, quality as a style has outperformed all other factors. That said, there have been many periods and even extended periods when quality as a factor has not outperformed. The worst-performing factor has been the fast fashion style or in this case momentum.

Growth of 10,000 by Style Factor



Source: FactSet; Raymond James Ltd.; Data range from January 1, 2000 to September 26, 2022. Each style factor is represented by its corresponding S&P Dow Jones Index.

Quality Definitely in Vogue Today

Our expectations for the remainder of this year and heading into 2023 remains consistent with a disinflationary theme – best defined as an environment in which the rate of change of inflation slows down. Recent developments suggest to us that we are now past the peak in inflation, with year-over-year change in CPI moderating from +9.1 per cent in June to +8.3 per cent in August. Moreover, given our expectation for a further weakening in the economic backdrop including our forecast of a recession in 2023, quality appears best positioned to outperform in this environment followed by momentum.

Style Factor Performance: Four Inflation Regimes

	Inflation	Flat	Disinflation	Deflation
Definition	Goods and services prices rising at a increasing pace	Goods and services prices rising at a relatively steady pace	Goods and services prices rising at a decreasing pace	Goods and services prices falling (CPI YoY % Chg. < 0)
# of months since 1997	136	94	67	15
Growth	15.4%	0.6%	13.0%	27.4%
Value	7.5%	14.2%	8.6%	26.4%
Quality	11.9%	3.4%	17.1%	14.4%
Low Volatility	10.6%	11.0%	11.4%	4.1%
High Dividend	13.7%	11.7%	12.4%	16.8%
Momentum	14.3%	-5.6%	16.9%	4.1%

Source: FactSet; Raymond James Ltd.; Data as of August 31, 2022.

What Styles Are Pricey vs. Cheap?

The low volatility style is trading closest to its long-term average, which makes sense given the elevated level of uncertainty observed this year. In our view, that will likely continue, while momentum is trading at the largest discount/spread relative to its historical trading range.

Style Factor P/E NTM Current vs. Historical

Median PE NTM	Current	Historical	(+) Premium/ (-) Discount
Growth	15.7	20.3	-4.6
Value	9.3	11.7	-2.4
Quality	14.9	18.2	-3.3
Low Volatility	17.8	18.9	-1.1
High Dividend	11.6	13.3	-1.7
Momentum	14.0	21.1	-7.1

Source: FactSet; Raymond James Ltd.; P/E NTM data range from January 1, 2016 to August 31, 2022. Each style factor is represented by its corresponding Invesco S&P 500 style factor ETF.

Style Factor Performance: Recessions/Non-Recessions

Performance	Avg. Annualized Return During Recessions	Avg. Annualized Return Not in A Recession	3-Month Return	YTD Return
Growth	-21.6%	13.4%	-2.8%	-30.7%
Value	-34.7%	16.0%	-7.9%	-11.7%
Quality	-12.6%	13.5%	-5.1%	-23.5%
Low Volatility	-22.5%	11.5%	-3.8%	-12.4%
High Dividend	-24.1%	13.2%	-9.5%	-9.6%
Momentum	-20.4%	12.9%	-4.6%	-21.4%

Source: FactSet; Raymond James Ltd.; Performance data range from December 31, 1996 to September 26, 2022. Each style factor is represented by its corresponding S&P Dow Jones Index.

Final Thoughts

As the market/economy moves closer to the end of this cycle and into an eventual recession, we believe the quality style is where equity investors should be focused on allocating capital to. As history shows, the quality style factor – and in particular companies that have durable business models, a sustainable competitive advantage, and high profitability have performed the best during recessionary periods.

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Eve Zhou, Multi-Asset Analyst

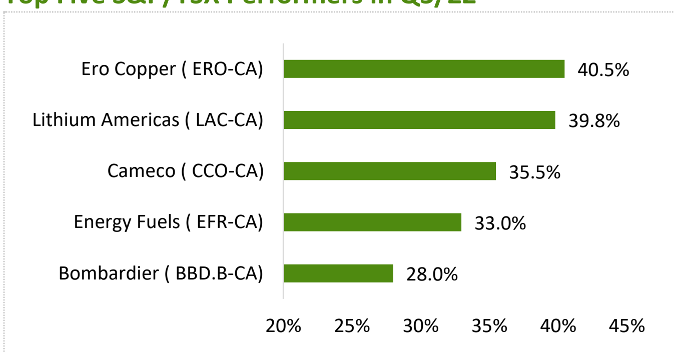
Q3/22: Leaders and Laggards

This month we look at the top and bottom performers within the S&P/TSX Composite Index for Q3/22, highlighting the stock- and industry-specific drivers behind the leaders and laggards for the quarter.

Base Metals Dominate the Leaderboard

Two materials companies led performance in the quarter with **Ero Copper (ERO-CA)** and **Lithium Americas (LAC-CA)** increasing 40.5 per cent and 39.8 per cent, respectively. Copper miner Ero Copper came in pole position despite missing its quarterly earnings results and increasing cost guidance because of inflationary pressures. However, underlying operations remained strong, with management reiterating the company's 2022 production guidance. The miner also announced a nickel sulphide system discovery in the Curaçá Valley to end the quarter, benefitting the stock. As for Lithium Americas, the lithium miner increased on no particular stock-specific news. Lithium Americas, which owns a ~45 per cent of the Cauchari-Olaroz Argentinian lithium brine that remains in pre-production, increased on the back of the announced U.S. Inflation Reduction Act (IRA). The IRA includes EV incentives, which are supportive of the EV-battery supply chain, and other incentives for lithium miners expanding in the U.S.

Top Five S&P/TSX Performers in Q3/22



Source: FactSet; Data as of September 30, 2022.

Within the energy sector, uranium producers **Cameco (CCO-CA)** and **Energy Fuels (EFR-CA)** led gains, up 35.5 per cent and 33.0 per cent, respectively, on the back of Japan's plans to restart additional nuclear plants, some of which had been idled since the 2011 Fukushima disaster, and build new nuclear plants.

Aerospace product and parts manufacturer **Bombardier (BBD.B-CA)** rounded out the top five, increasing 28.0 per cent after reporting Q2/22 financial results that came in well ahead of analyst estimates with free cash flow (FCF) coming in at $341 million while analysts on the Street were expecting the company to burn cash, as the company had increased its 2022 FCF guidance to $515 million from $50 million.

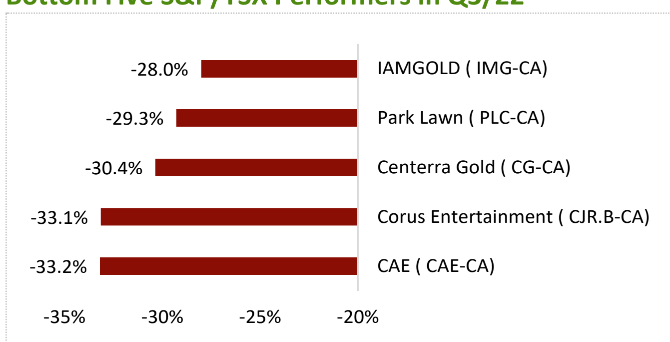
Weakest Links

The S&P/TSX's bottom performer was digital immersion and training services provider **CAE (CAE-CA)**. The company declined 33.2 per cent with the release of quarterly results that saw the bottom-line come in lower than expected because of a weaker defence segment, with the company reducing its 2023 adjusted operating income growth guidance (from mid-30 per cent to mid-20 per cent).

Broadcasting company **Corus Entertainment (CJR.B-CA)** was the second worst performer in the quarter down 33.1 per cent after providing a grim near-term outlook amid the macro backdrop and ongoing COVID-related impacts, citing meaningful pressure on TV advertising revenues. Various analysts on the Street downgraded the stock following the update.

Gold producers **Centerra Gold (CG-CA)** and **IAMGOLD (IMG-CA)** took up the third and fifth positions, declining 30.4 per cent and 28.0 per cent, respectively, on the back of operational setbacks. Centerra Gold unexpectedly suspended gold sales from its Oksut mine in Turkey for the rest of the year, withdrew its 2023 guidance, and revised its 2022 production/FCF guidance lower. As for IAMGOLD, the company updated investors on its Cote Gold development project in northern Ontario, noting higher capital expenditures and a longer timeline to production than previously indicated.

Bottom Five S&P/TSX Performers in Q3/22



Source: FactSet; Data as of September 30, 2022.

Finally, **Park Lawn (PLC-CA)** ended down 29.3 per cent in Q3/22 after the death care company's release of weak quarterly financial results, with revenue and EPS coming in well below analysts' estimates, as a decline in the national mortality rate led to decelerating cemetery sales activity.

Larbi Moumni, CFA
Portfolio Manager and Senior Equity Specialist

High Interest Savings ETFs Are in the Spotlight!

In August 2022, fixed income ETFs experienced a $258 million inflow according to a recent report published by the National Bank of Canada. What is interesting about this figure is that this net positive number was largely driven by high interest savings exchange traded funds (HISA ETFs), which saw the creation of **$589 million in inflows** for the month – the highest inflow of any subcategory within the fixed income ETF universe.

What Are HISA ETFs?

These products are cash alternative strategies whose assets comprise of deposits in high interest savings accounts placed with Schedule 1 Canadian banks. The ETF provider places investor capital in savings accounts across select banks and will periodically pay out interest payments as its distribution yield. HISA ETFs can be compared to other low-risk strategies such as money market mutual funds, T-Bills, GICs, and traditional high interest savings accounts. However, unlike traditional savings accounts and GICs, HISA ETFs are not insured by CDIC.

Which ETF Providers Offer HISA ETFs?

In Canada, there is a handful of HISA ETFs. Below is a list of some popular options available in the Canadian marketplace from Horizons, Evolve, CI, and Purpose along with some key figures. Given the fact that these ETFs are all investing in high interest savings accounts across Schedule 1 Canadian banks, they are all highly correlated to one another.

Canadian HISA ETFs

ETF Name:	Ticker	AUM	Current Net Yield	Management Fee:
Horizons High Interest Savings ETF	CASH	$507M	3.69%	0.10%
Evolve High Interest Savings ETF	HISA	$817M	3.69%	0.05%*
CI High Interest Savings ETF	CSAV	$3540M	3.56%	0.14%
Purpose High Interest Savings ETF	PSA	$2730M	3.59%	0.15%

*Evolve is offering a reduced management fee promotion on HISA from May 10, 2022 - Dec 31, 2022. On Jan 1, 2023, the management fee is expected to increase to 0.15%

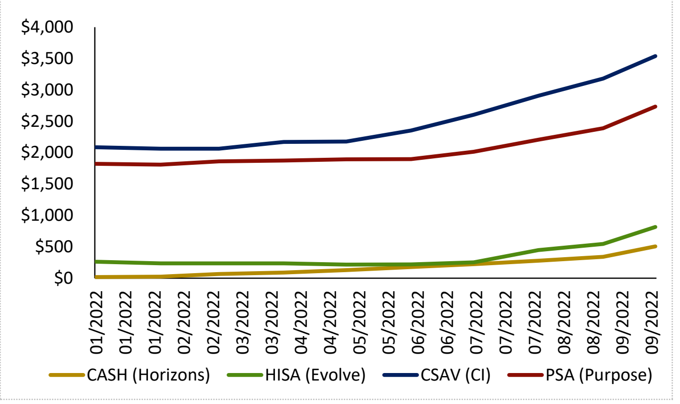
Source: FactSet; Data as of September 27. Yield figures sourced directly from ETF providers, as of September 26, 2022.

Why Are HISA ETFs Gaining Popularity?

HISA ETFs have gained interest as the Bank of Canada continues to increase their policy interest rate, thereby increasing HISA ETF product yields. Since the beginning of 2022, we have seen the Bank of Canada make an aggressive series of five rate hikes in six months in order to control inflation. As such, we have also seen a rise in assets under management (AUM) in HISA ETFs YTD as the yield on these products increases with the Bank of Canada's overnight rate. To summarize, if interest rates continue to rise, the yield of these ETFs will rise, and one would expect investor interest in HISA ETFs to continue to rise as well.

The following chart illustrates the rapid YTD AUM growth in the four HISA ETFs previously mentioned.

YTD AUM Growth of HISA ETFs (CAD Mil.)



Source: FactSet; Data as of September 27, 2022.

When Do HISA ETF Strategies Make Sense?

The main appeal for HISA ETFs is the safety they offer investors. A HISA ETF can be used as a complementary position for ultra-risk-averse investors looking for some short-term inflation protection. HISA ETFs can also be great strategy to consider for individuals who need cash readily available in the short term and are interested in earning modest interest in the interim. While an investor would likely get a better return by locking in a GIC, the HISA ETF offers a liquid structure that provides investors the flexibility to sell at any time. Lastly, a HISA ETF can act as a convenient cash allocation sleeve alongside equities and fixed income in an overall portfolio.

The net return is equal to the annual yield of the ETF less the management expense ratio (MER). For these strategies, given how highly correlated they are to one another, using an ETF that keeps the cost down is a key differentiator. In addition, while opening a separate high interest savings account effectively produces the same strategy, an ETF structure offers convenience.

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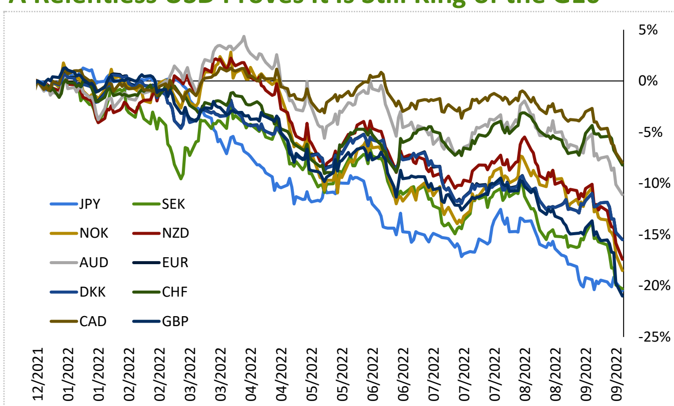
It's Every Currency for Itself!

The Federal Reserve (Fed) delivered its third straight 75bps hike and an accompanying dot plot that elevated terminal rate projections above consensus into 2023. This, coupled with an uneasy risk-off environment, pushed the DXY U.S. Dollar Index to its highest levels since 2002 and the Bloomberg U.S. Dollar Index to its highest level on record. Looking at the USD's performance against some of its major peers at the time of writing, the GBP is trading at its lowest ranges since 1985, while the EUR is trading at its lowest ranges since 2002 as it remains pinned below par. The JPY has also been trading at its lowest levels against the U.S. dollar since 1998, which prompted the Japanese Ministry of Finance to intervene in the FX markets for the first time since that year in order to prop up the yen. Given the deteriorating global economic outlook as central banks continue to ramp up rate hikes in order to tame heightened inflationary pressures, we have seen material risk-off shocks to global markets and heightened volatility across asset classes. As a result, we continue to hold a constructive outlook for the broader USD.

A Relentless USD Proves It Is Still King of the G10



Source: FactSet; Raymond James Ltd.; Data as of September 26, 2022.

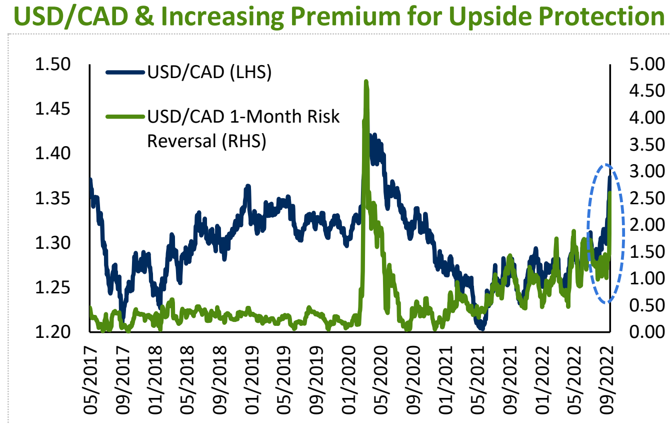
GBP Not Looking So Sterling

Newly minted British Prime Minister Liz Truss pushed forward with a radical budget package of unfunded personal/corporate tax cuts and plans for large-scale government borrowing. Loose fiscal policy during a period in which the U.K. has the highest inflation in the G10, coupled with a ballooning current account deficit, sent the GBP spiraling to an all-time low of 1.0350 against the U.S. dollar and caused the yield on 10-year British Gilts to soar, breaching 4.50 per cent for the first time since 2008. All eyes are now on the Bank of England (BoE) to take aggressive action in order to plug the Sterling's collapse in an environment where a majority of the major currencies have fallen victim to the U.S. dollar's strength. The BoE has stated that they will gauge the implications of the PM's new budget at their next meeting in November; however, that did not stop them from making a surprise intermeeting policy announcement to address the slump in British Gilt prices by unleashing a temporary QE program to target long-dated Gilts in order to restore orderly market conditions. While the GBP did find some temporary reprieve, the pressure is still on, and the most logical path towards GBP stabilization may in fact be through aggressive monetary policy tightening. At the time of writing, the market is pricing in +150bps of tightening at the BoE's November meeting and a terminal rate of nearly six per cent. This makes sense given the U.K.'s gaping trade deficit and, in order to attract foreign investment flows, this may very well require higher rates.

CAD Crushed by Its Southern Neighbour

The Fed is expected to have a higher terminal rate this cycle than a majority of its major peers. The Bank of Canada (BoC), on the other hand, has a relatively highly leveraged household sector to contend with, which supports the market's expectation that it will end its tightening cycle with a lower terminal policy rate than that of our neighbours to the south. We anticipated a re-pricing at the beginning of the year when this relationship was flipped in the BoC's favour, which supported our bullish outlook for USD/CAD. This, along with a strong USD that will garner additional support from the safe-haven channel as the backdrop for risk assets is expected to remain compromised, underpins our constructive outlook for the broader USD and USD/CAD, and we recommend buying into any material dips to the 1.34-1.35 range. We anticipate dip-buying interest on pullbacks as the market continues to look for a test of the 1.40 handle in the short- to medium-term. USD/CAD option markets are also showing a jump in the premium for topside protection (i.e., more demand for calls).

USD/CAD & Increasing Premium for Upside Protection



Source: FactSet; Raymond James Ltd.; Data as of September 26, 2022.

Ajay Virk, CFA, CMT
Head Trader, Currencies

Seasons Change

As we move from summer into the autumn season, the air is cooler, the sun sets earlier, and for every person embracing "sweater weather", another is unhappy that the hottest days of the year are behind us. When it comes to the perfect environment, the response runs the gamut – each person has a preference to the ideal temperature, humidity, and feelings toward rain or snow. Just like how some people get the most joy out of a particular season, different investments perform better or worse based on environmental factors. Here, we review how changes in key drivers can affect bonds differently based on the type of bond and predict how their value and yields may change in the coming months.

All else equal, as interest rates rise, the yields on fixed income products increase as well. For a newly issued security, the change is simply a higher coupon when the bond (or GIC) comes to market. However, for bonds that were outstanding prior with a fixed coupon rate, something else needs to adjust to increase the bond's yield: bond prices decrease to allow for a higher yield to maturity (YTM).

Many Factors at Play

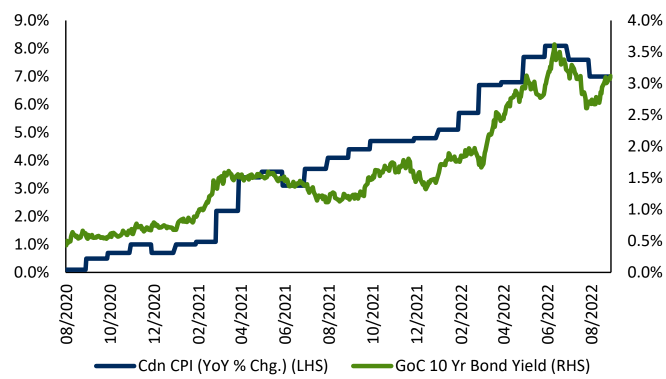
Although this result is consistent across the majority of fixed income securities, the amount of change can vary based on numerous factors:

- **Sub-asset Class:** Sub-categories of fixed income securities include federal bonds, provincials, corporates, high yield, money market, etc. Each type may experience changes to the investment environment differently due to differences in credit quality, perceived safety, and ability to raise funds through taxation (a unique characteristic of government issuers).
- **Term to Maturity:** In general, bonds with longer terms to maturity have higher YTMs as your capital is held for a longer period of time. They also tend to be more sensitive to changes in interest rates.
- **Credit Quality:** Lower credit quality securities often carry higher yields to compensate investors for the perceived increase in risk. If investors are concerned about upcoming events, a flight to safety would more negatively affect bonds with lower credit quality.

More Uncertainty Ahead

Today's environment is full of uncertainty. Since a key driver of rising interest rates has been inflation, it is an important thing for us to consider. Most recently, headline CPI prints have been moving lower, though we are nowhere near the end of the bumpy road. If inflation does continue on a path to the downside, we should expect a moderation in rate hikes and perhaps a period of stabilization or even rate cuts as the Bank of Canada narrows in on the "right" amount of support for the economy. This would, in turn, influence bond yields.

Bond Yields Rise as Interest Rates Move Higher



Source: Raymond James Ltd.; Data as of August 31, 2022.

With broad strokes, high quality bonds with shorter terms to maturity should see less of a price impact than those with lower credit ratings, longer terms to maturity, or generally perceived to be more risky (such as high yield securities). Economic conditions experience cycles just like the seasons do. Investors just need to remember to be prepared with the right investments for the environment they will face.

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Vice President, Fixed Income and Currencies

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