



With the holiday season upon us and a new year shortly forthcoming, many investors will be eager to start fresh in 2023. To say the past year was a tumultuous one would be doing somewhat of a disservice to tumult. However, instead of slamming the door on 2022 and trying our best to forget it, we reflect on the year and identify numerous structural changes afoot.

Heading into 2021, Forstrong were predicting an inflationary surge, as unprecedented pandemic stimulus, pent-up consumer demand and still tangled (albeit improving) supply chains would contribute to cost pressures. However, we did not expect it to play as rapidly as it did. Russia's incursion into Ukraine caused a significant dislocation in commodity markets (particularly energy) and threw the burgeoning inflationary pressure into hyper-drive.

What had been previously viewed as "manageable" or perhaps even "transitory" inflationary devolved into a more sinister self-reinforcing variety. Central banks were caught flat-footed and were forced to scramble into a hawkish stance in order to prevent inflation expectations from becoming unanchored.

The ultra-accommodative monetary conditions financial markets had grown accustomed to over the past decade were swiftly reversed. This led to steep losses for asset classes such as US growth stocks, long-term bonds and cryptocurrencies

which had thrived during the former regime. Now, with inflationary pressure ebbing from high levels and most central banks nearing the end of their respective tightening cycles, what are the key takeaways looking forward?

We believe the shift in market leadership away from last decade's winners is firmly entrenched. For starters, bear markets almost always bring about a change in leadership. But more importantly, given the pivot towards fiscal spending initiated during COVID, the 2020s were always going to have a higher inflationary impulse. This means that inflation should continue to cool from eye-watering levels; but will likely settle in a range notably higher than the post-Global Financial Crisis era. Furthermore, a return to near-zero interest rates is highly unlikely for the foreseeable future.

The transition away from fossil fuel-derived energy was already firmly entrenched prior to 2022. However, the immensely costly latticework of infrastructure projects underpinning it are likely to face a notable acceleration following the European energy supply crisis. Countries in Europe and around the world will be putting renewed focus on the diversity of their energy mix as well as their import dependencies. Viewed in this context, security has become an increasingly important facet of the transition, in addition to addressing climate change concerns.

Putting it all together, there are tangible implications for client portfolios. Yesteryear's winners are unlikely to regain their dominance. In an era of higher interest rates and inflation, more value-oriented "real economy" equity sectors such as materials, industrials and financials are primed to outperform. Fixed income duration should remain structurally short. An accelerated timeline for green energy infrastructure bodes well for industrial metals such

as copper and steel, while battery metals including lithium and cobalt will continue to be in high demand.

We would like to wish all of our clients and partners a happy holiday season and a prosperous new year. Thank you for your continued patronage!

CASH AND CURRENCIES

Keeping neutral cash position

- Changes to broad asset mix were muted this quarter, as the Investment Management team elected to stay the course.
- With rising money market yields and peaking inflation, cash looks appealing as an offset to equity and fixed income risk.
- However, macro conditions are also becoming more favourable for equities and fixed income. Accordingly, cash and equivalents have been maintained near neutral levels

US dollar underweight

- Widening interest rate differentials versus most major economies has propelled the trade-weighted US dollar to even loftier levels of overvaluation this year.
- As financial markets become increasingly convinced of a forthcoming pivot from the US Federal Reserve, the dollar is vulnerable to a reversal.
- US dollar exposure remains materially underweight in client portfolios.

GLOBAL EQUITIES

Equity overweight maintained

- Economic momentum continues to decelerate in much of the world as tighter financial conditions and falling real incomes bite into demand.
- Historically, equity bear markets tend to bottom well before the economy does, and in our view, the downturn in global GDP has already been discounted in stock prices.
- Equity positioning has been maintained at overweight levels this quarter.

Increasing emerging markets exposure

- Emerging markets (EM) equities had a challenging year, as global risk appetite contracted, most EM central banks battled inflationary pressure and China languished through lockdowns and property sector turmoil.
- Now, these factors have all peaked or are in the process of peaking in our view, making the asset class primed for re-rating.
- Overweight EM equity exposure has been increased in client portfolios.

GLOBAL FIXED INCOME

Short duration and underweight fixed income exposure

- A combination of fading growth and inflation would generally be considered a fertile environment for high quality government bond returns.
- Unfortunately, with an inverted yield curve in key markets such as Germany and the US, bonds have effectively discounted the macro tailwind and do not offer adequate compensation to extend duration.
- Fixed income positioning remains short duration and underweight this quarter.

Liquidating leveraged loans

- Short duration and overweight corporate exposure remains our preferred US fixed income positioning, as in addition to the yield curve comments above, corporate spreads have widened materially to compensate for elevated default risk.
- However, the risk-reward trade-off of our position in US senior leveraged loans has skewed negative, as their floating rate structure means that issuers will face cash flow stress much earlier than fixed rate issuers.
- Leveraged loan exposure has been liquidated and moved into fixed rate US corporate bonds this quarter.

OPPORTUNITY INVESTMENT HIGHLIGHTS

Initiating US high yield bonds

- US sub-investment grade bonds may seem like a counterintuitive asset class selection amidst an economic slowdown which will put upwards pressure on default rates.
- The combination of strong fundamentals, wide option-adjusted spreads and our view that the US economy will be more resilient than the consensus expects provides for a favourable outlook for returns.
- A position in US high yield bonds has been initiated in income-oriented strategies this quarter.

Chinese equities a top pick

- The storm clouds are clearing over Chinese equities, as property sector woes are being managed with macroprudential policies, COVID lockdowns are ebbing and policymakers maintain an accommodative stance.
- Despite the recent recovery in share prices, Chinese shares are still attractively valued relative to historical levels.
- Chinese equities are a key opportunity holding in balanced and growth-oriented strategies this quarter.

INVESTMENT STANCE	Versus Benchmark			Changes from previous quarter
	Under	Neutral	Over	
NET GLOBAL ASSET MIX				
Cash		⬇️		➖ Unchanged
Total Equity			⬇️	⬆️ Increased
Total Fixed Income	⬇️			⬇️ Decreased
Opportunity		⬇️		➖ Unchanged
CANADA INVESTMENTS				
Bonds	⬇️			➖ Unchanged
Stocks			⬇️	⬆️ Increased
U.S. INVESTMENTS				
Bonds		⬇️		⬇️ Decreased
Stocks	⬇️			⬆️ Increased
INTERNATIONAL INVESTMENTS				
Bonds	⬇️			➖ Unchanged
Stocks			⬇️	⬇️ Decreased