L-R: Bogue Clark, Juliana Weese, Blair Mott, Tony Liokossis, Stephanie Lindsay

NATIONAL BANK FINANCIAL WEALTH MANAGEMENT

MOTT LIOKOSSIS WEALTH MANAGEMENT GROUP

December 2021 Commentary

We were up 0.60% in our hypothetical equity model in November, bringing our year to date total to 9.37%. It's a decent number but we are lagging our main benchmarks this year. It happens, so yes – we are making money – but it has been an utterly unremarkable year for us on a relative basis. When this happens from time to time it's important to pay attention. Here's why.

Market Update

When we lag a major market index in performance it's usually because there is a lot of turnover amongst leading investments, rather than sustained trends we can ride. Fewer, bigger names deliver the majority of the performance as opposed to a broader participation of stocks. Equal weight indexes – where each stock is given equal representation – *underperform* capitalization (cap) weight indexes, where the leading stocks grow faster than the rest and become a bigger percentage of the index. The most extreme example of this close to home is when Nortel grew so quickly during the Dotcom boom that it became 35% of the Canadian TSX Composite Index. No portfolio could keep up to the index unless it had an imprudent allocation to that one stock. Of course, we all know how that ended. This 'narrowing of the market' has reasserted itself lately. It is sometimes a late-stages phenomenon before we get a crash.

In addition, commodities are starting to weaken over after posting some breathtaking returns this year, tempering the advance of the Canadian stock market in the process. These and other of our risk indicators are starting to twitch. As a result we have not yet deployed the almost 20% cash position we've been holding in our model.

That is a broad technical picture. But technical analysis is just a reflection of the underlying narrative. Sometimes we don't know what is making stocks behave a certain way until later. Here's our stab at what could be happening now.

Politics, Again

Right now our southern neighbour is awash in spending. The U.S. central bank has decided that the S&P500 is not going to go down. Because the house, senate and executive were all in Democrat control, they could do whatever they wanted – and what they wanted was a buoyant market. At least this was the state of affairs up to the recent bell weather election in early November for Governor of Virginia, a Democrat strong hold. It was a shocker because it was a decisive victory for the Republican candidate. Why is this important? The market likes stability, especially if it is with a government pursuing accommodative monetary policy. It keeps the party going. The Virginia election could be the portent of change. If the surprise result turns out to be a preview of the 2022 mid-terms in the U.S., it will mean a division of power leading to stalemate.

This would threaten the totally open monetary policy spigots currently supporting stock prices and lead to a good decline in stocks. How bad? Our guess is worse than a garden variety 15% correction but not a true bear market that declines 50%+ and takes 5+ years to recover. Let's call it a nice round 30% down. In short, it would be bad if you stick around for the whole ride. Our model is designed to get us out without taking the full decline and get us beck in at lower prices. In short, it would be a great opportunity.

That's our working theory and remember, we've successfully predicted 13 of the last 3 corrections. Kidding aside, what we are seeing is that the Republican victory in Virginia started to weaken our risk indicators which had been improving until that point. That's why we still hold some cash. Eventually our broken clock will be correct; it's been over a year and a half since the last crash over Covid in March 2020.

Central Bank Influence Waning?

This is a stretch, but it may be possible that the pendulum of central bank influence may be swinging back the other way. It is not only a question of political factors (discussed above) but also a question of how many bullets they have left in their gun. In the long run, no central bank can bend a market to its will forever. If and as their influence wanes, it will be a huge benefit for us and your portfolio. Here's why.

For clients who've been with us that long, we've done extremely well in the last five years. The vast majority of our clients are up roughly 50-75% net of fees, depending on their asset mix. It has been great, but we consider this to be a sub-par result and it does not really showcase what we can do. Why? Starting with the surprise devaluation of the U.S. Dollar in 2016, central banks really cranked up their market interventions. They distorted outcomes. They threw increasingly more money at every crisis. They used new tools that they had never tried in the past, such as directly purchasing stocks in the open market. Critically for us they also didn't provide guidance of their intentions, so their moves were often a destabilizing surprise to investors.

Our approach relies on unfolding trends. The most fruitful ones form over time by the slow dissemination of information that works it's way into the open market. The reality is that much of it is from people who are extremely close to the situation and who will trade on that information. This happens at the individual stock level but also at the central bank macro-policy level. When the bank uses surprise as its MO, there is no trend, just an abrupt change in direction. Two times since 2016 we completed exited a risky stock market. Both times the market should have plunged much lower, giving us a superb entry point and setting the stage for super-sized returns. Both times central banks intervened robustly. Time will tell if we're right about this potentially changing.

60,000 Foot View Part 2 (continued from last months letter)

Last month we laid out the problem. To summarize, government spending and deficits are out of control, obligations for social programs and pensions will not be met, and politicians know they going to be held to account. The economic condition of particularly Europe (but Canada is rapidly following suit), has dramatically deteriorated post-2008 sub-prime crisis. The response to that crisis was poorly handled in Europe. Central banks intervened by pushing interest rates *negative* in an attempt to generate inflation and growth that has actually yielded the opposite. The correct solution would have been to *raise* interest rates to normalize economic functioning and get pensions back in the black. This solution was there for the taking in the immediate aftermath of '08 but it is now long gone. Conditions have worsened profoundly since then. They cannot raise rates because of the destruction that would be unleashed upon a super-leveraged continent. The Covid response has only worsened things and made debt defaults more likely.

One Theory for How This is Going to be Handled

Of course we are not privy to the discussions being had at the highest levels. It's not something they advertise. There are many possibilities as to how things will be go. Having said that, here's what seems to make the most sense when we connect the dots. A debt default would be devastating for state and private pensions that hold those bonds. If that were to happen, the response and unrest would be swift. How do the leaders of these nations escape the seemingly inescapable? We have touched upon the Great Reset and the World Economic Forum in the past. We believe the architects of that plan have promoted a solution. Around the world we've seen governments implement benefits to provide income to those who lost their employment due to the pandemic. In Canada we have CERB. We think these benefits will be transitioned into a permanent Universal Basic Income (UBI).

This will basically be paid for with money printed by governments as needed and they will stop borrowing. (It's based upon a new idea called Modern Monetary Theory (MMT) where they can just print whatever they need. It's not for this month but we may touch upon it in a future letter). This UBI will replace pensions and placate people who have or would have lost their incomes due to failing pensions or displacement during the pandemic. Selling this utopian solution to people desperate for income will provide cover for governments to default and reorganize themselves. It's a crazy plan but that is our best guess as to how things will unfold. If we're right, we'll finally get the answer to how much debt is too much.

Conclusion

We don't think the plan has a chance but that doesn't mean they aren't going to try. So, what are the practical conclusions? Generally speaking, we want to avoid government bonds but especially those of European nations who are riskiest. Though asset prices will be volatile as always, it's probably best to own private assets like stocks and anything tangible that will still have value on the other side of a messy re-organization of the economic landscape. Governments can do what they want with their debt. If you own a house, shares in solid companies, precious metals, collectibles, land – these will have value going forward. That value should be enhanced as money pours out of government bonds and into these private assets.

We will also rely heavily on our tactical approach. Literally every day we monitor conditions to determine which assets are best so that we can be there and avoid the trouble spots.

This is essentially the same prescription we've been proposing for a few years now. The difference is that after the last two years of accelerating deterioration in government finances, we are closer than ever.

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In the meantime, Merry Christmas!!! We sincerely hope you can have a wonderful holiday and are able to enjoy it with family and friends and maybe even some champagne.

Team News

Hopefully you noticed a new face in our banner photo, top. Earlier this year we acquired the practice of a retiring colleague in St. Catharines, Robin Lewis. Robin will remain in St. Catharines until the end of 2022 to help transition his clients before retiring fully. A happy result is that Robin's long time associate Bogue Clark will be joining the team. She'll be working out of the St. Catharines office and helping us a lot on the admin side. She is great and we couldn't have asked for a better addition to our team!

Robin Lewis, Investment Advisor
NBF St. Catharines

December 2021 Portfolio Review

Mott Liokossis Hypothetical Model sector breakdown at the end of November 2021:

Cash	12.39%
Diversified Global Equity Portfolio	38.05%
Diversified Canadian Equity Portfolio	11.87%
Electronics & Semi-Conductors	8.30%
Energy	6.62%
Conglomerates	6.06%
Computer Software	5.81%
Financial Services	5.59%
Banking	5.30%

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Hypothetical Model Growth Portfolio Holdings at the end of November 2021:

% Held	Security	Symbol	Sector	Price	Yield
12.73%	Cash				
8.51%	ASML Holding NV	ASML	Electronics & Semi-Conductors	$ 1,011.31	0.39%
5.63%	Barclays PLC	BCS	Banking	$ 12.65	1.32%
5.65%	Infosys	INFY	Computer Software	$ 28.85	1.38%
6.79%	Cheniere Energy Inc.	LNG	Energy	$ 133.70	0.25%
5.31%	Oracle Corp.	ORCL	Computer Software	$ 115.94	1.04%
38.16%	SIA ML Global Tactical Pool	SWI220	Global Equity Portfolio	$ 27.15	5.80%
5.77%	Textron Inc.	TXT	Conglomerates	$ 90.46	0.09%
11.72%	BMO SIA Focused CDN EQ ETF	ZFC	Canadian Equity Portfolio	$ 39.83	1.59%

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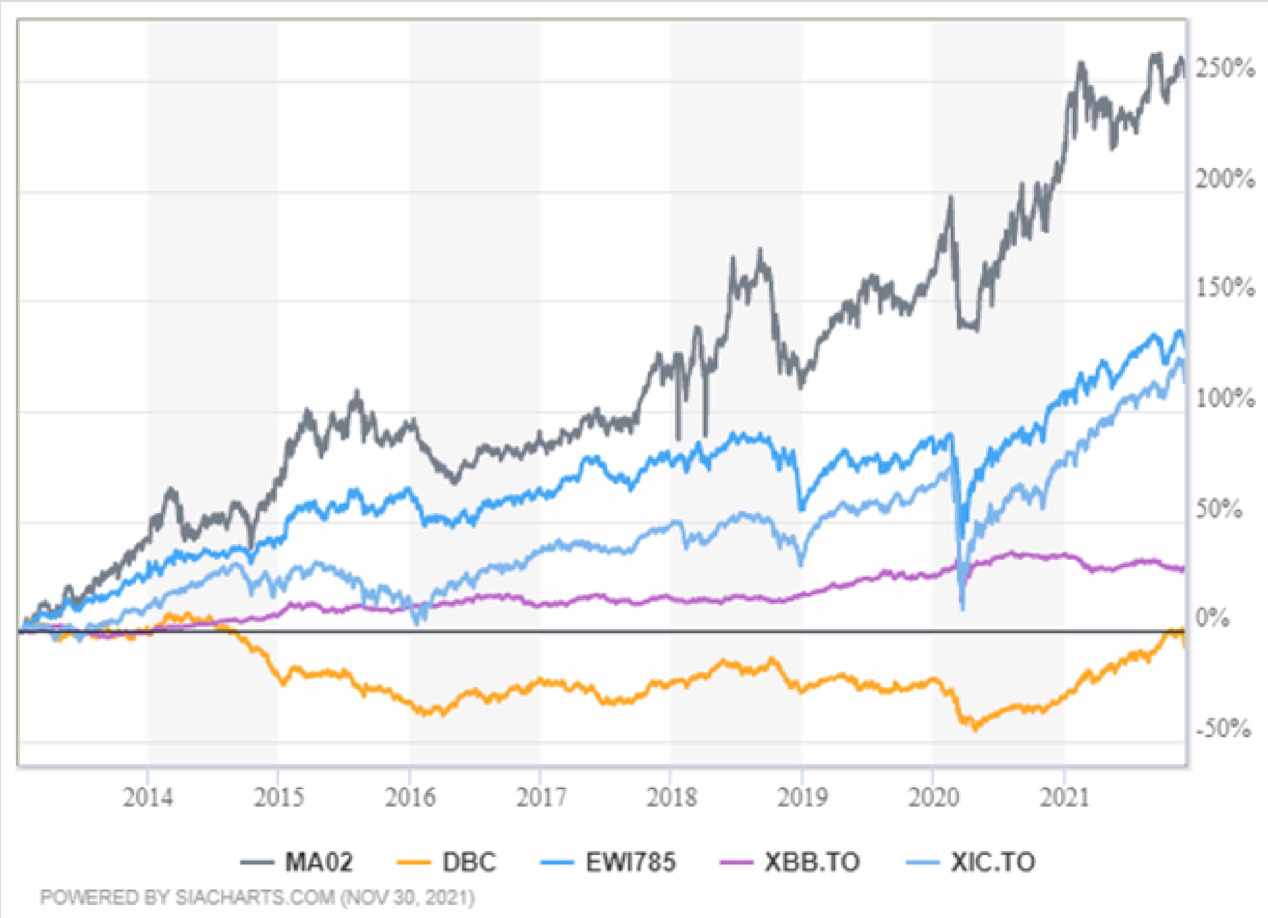
Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yearly Returns	
2021	1.62%	5.68%	-3.36%	0.16%	-0.85%	0.93%	0.28%	7.23%	-4.67%	1.70%	0.60%		**9.37%**	**YTD**
2020	4.33%	-3.90%	-8.54%	-0.42%	9.70%	2.13%	5.75%	4.27%	-2.33%	-1.79%	7.32%	6.07%	**22.93%**	
2019	1.36%	5.01%	3.75%	3.46%	-1.58%	2.58%	0.97%	1.13%	-3.33%	-0.78%	3.76%	2.09%	**19.73%**	
2018	2.84%	0.81%	-0.31%	-0.79%	5.53%	8.19%	-0.60%	8.18%	-2.65%	-14.70%	-0.14%	-2.73%	**1.60%**	
2017	-1.26%	3.11%	0.49%	3.26%	1.45%	-3.95%	0.50%	2.31%	3.43%	7.33%	2.38%	-3.57%	**16.08%**	
2016	-3.29%	-2.97%	-3.70%	-3.30%	5.04%	1.01%	3.03%	-0.56%	1.02%	-1.70%	1.56%	0.82%	**-3.36%**	
2015	9.73%	2.78%	3.71%	-8.98%	10.69%	-4.34%	7.93%	-5.39%	-3.05%	0.23%	-0.08%	1.84%	**13.89%**	
2014	6.39%	6.38%	-5.18%	-4.67%	1.52%	1.94%	-1.25%	5.18%	-2.40%	0.44%	5.70%	3.57%	**18.08%**	
2013	6.00%	4.20%	3.95%	-2.83%	9.64%	-3.67%	4.06%	3.65%	3.29%	3.42%	4.68%	2.66%	**45.96%**	

Monthly & Annual Returns for the Mott Liokossis Hypothetical Model Growth Portfolio.
Performance reflects actual trades executed in our maximum growth model and does not include fees or expenses.
We use this hypothetical model as the basis for our clients' portfolios.



Growth of $10,000	Jan. 04, 2013 - November 30, 2021
Mott Liokossis Model (MA02)	$35,161
World Stock Equal Weight Index (EWI785)	$22,904
Canadian Stocks (XIC.TO)	$21,307
Canadian Bonds (XBB.TO)	$12,929
Commodities (DBC)	$9,305

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