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LUFT FINANCIAL
MODEL PORTFOLIOS

SEMI-ANNUAL REVIEW: FIRST HALF OF 2022

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FEW PLACES TO HIDE AS MARKETS PLUNGE

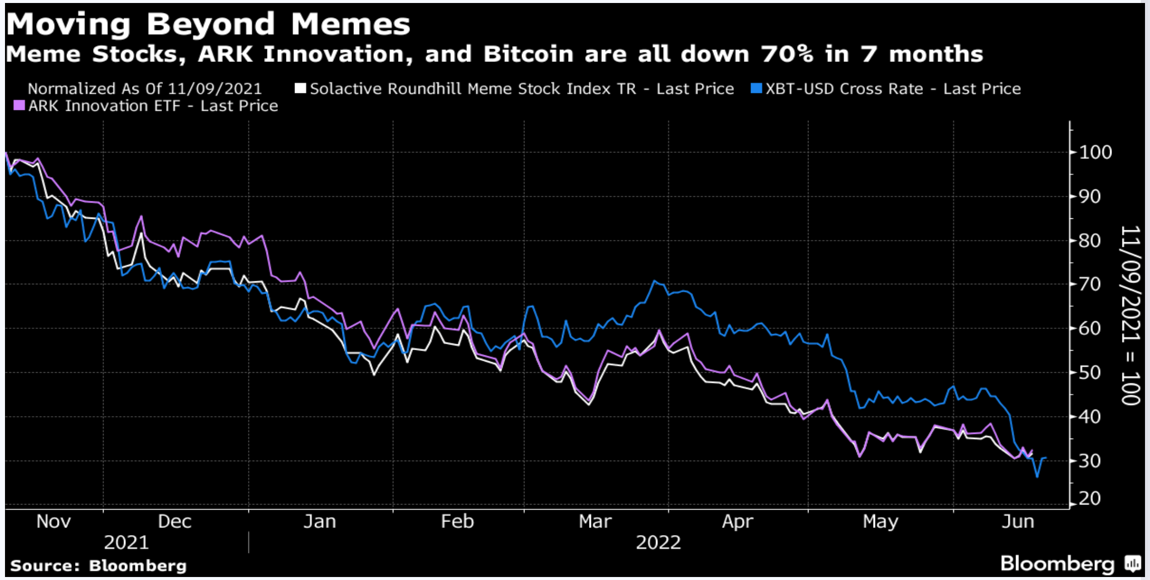
There were few places to hide in the first half of 2022 as prices of most assets plunged in the face of surging inflation, which was exacerbated by the steep rise in energy and commodity prices following Russia's invasion of Ukraine in February. Investor sentiment was also affected by multiple interest-rate hikes – and the prospect of more to come – from the U.S. Federal Reserve and Bank of Canada, as they moved belatedly to counter inflationary pressures.

The S&P 500 tumbled 20.6% in the first half, its worst performance over this period since 1970. The Nasdaq Composite fared even worse with a 29.5% freefall; the Dow Jones Industrial Average outperformed on a relative basis with a 15.3% decline.

While most major equity indices around the world endured similar double-digit declines, the TSX Composite outperformed its U.S. counterparts thanks to its 18% weight in energy. The TSX fell 11.1% in the first half, outperforming the S&P 500 by 9.5 percentage points during this period (top chart). The TSX's margin of outperformance had reached a 17-year high of almost 13 percentage points as of end-May.

Technology stocks have borne the brunt of the selloff, as investors were quick to recalibrate and lower their unrealistic growth expectations. Even the tech titans (formerly known as FAANG) that drove much of the market's advance from the March 2020 lows have not been spared, with an average decline of 40% YTD, led by Netflix (-70%) and Meta Platforms (previously Facebook, -51%). But the most damage has been inflicted on the speculative fringe (bottom chart), including "meme" stocks, Special Purpose Acquisition Companies (SPACs), and cryptocurrencies. Bitcoin's 58% plunge in Q2 was its worst performance in a decade, while the cryptocurrency sector overall has lost 70% of its value since November 2021.

(Data Source: FactSet; Charts: Bloomberg)



ENERGY SECTOR SURGES, SHOPIFY SWOONS

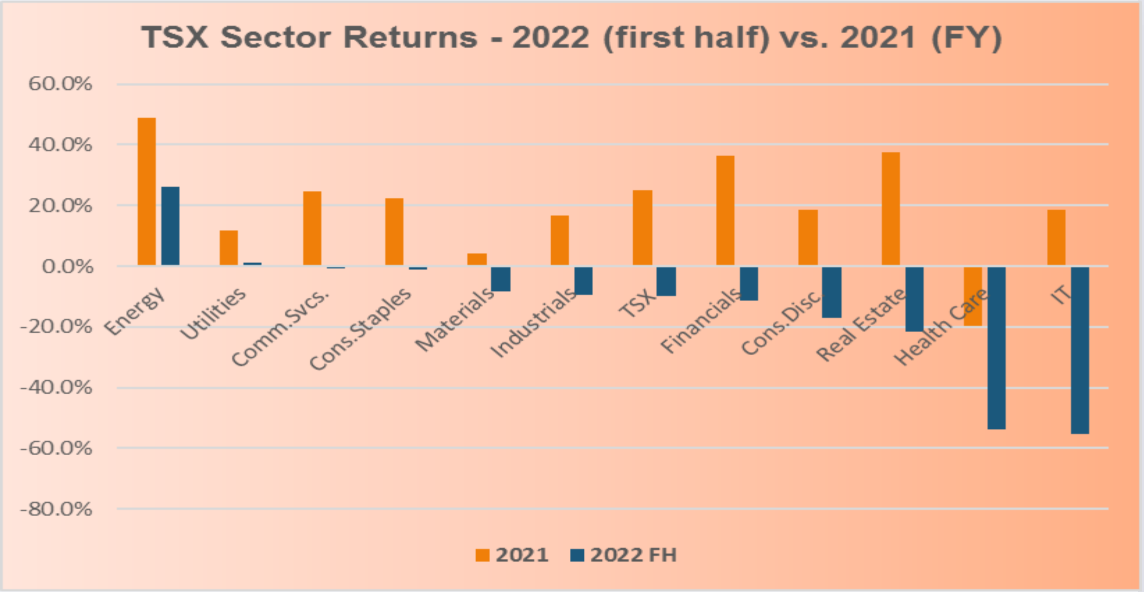
The TSX had a total return (price change plus dividends) of -9.9% in the first six months of 2022, with energy and utilities the only two groups to generate positive returns (top chart).

The TSX energy sector, which had returned 49% in 2021, followed up with a 26% return in the first half. Energy producers dominated the list of the best TSX performers as crude oil gained 40% and natural gas surged 45% in the first half. Crude oil traded over US$120 before paring gains on recession concerns, while natural gas more than doubled in price by end-May on global supply fears triggered by Russia's invasion of Ukraine but plunged 33% in June. Utilities, communication services and consumer staples – all of which are considered defensive sectors – handily outperformed the TSX in the first half.

Among the laggards, the materials sector returned -8.3% as base metal miners slumped in line with commodity prices, and a handful of gold producers were among the only ones with positive returns. The financials sector – which constitutes almost one-third of the TSX – returned -11%, as the Big Five banks fell from record highs earlier this year into bear market territory (declines of at least 20%) due to recession fears. The health care sector lost more than half its value, with two of its constituents – Aurora Cannabis and Bausch Health – among the three worst TSX performers.

But the wooden spoon for underperformance surely goes to Shopify, whose 77% plunge in the first half made it the worst TSX performer over this period and contributed to a 55% decline for the IT group. Shopify was the biggest Canadian company by market capitalization last year but has plummeted over 80% from its November 2021 peak, erasing more than $150 billion in market value. In the process, Shopify has become the latest manifestation of what we call the "Icarus Syndrome," where high-flying companies that were among the biggest in Canada had a swift fall from grace, previous examples being Valeant Pharma (renamed Bausch Health), BlackBerry and Nortel Networks.

(Data Source: FactSet; Charts: FactSet, Bloomberg)



PORTFOLIO REVIEW: CONTRIBUTORS AND DETRACTORS – PENSION MODEL PORTFOLIO

	Rescaled Weight	Return	Contribution
Pembina Pipeline Corp	3.09	22.16	0.67
Nutrien Ltd	3.07	8.95	0.44
Loblaw Companies Ltd	3.35	12.62	0.43
Hydro One Ltd	3.12	7.51	0.24
Johnson & Johnson	3.09	5.25	0.17
Verizon Communications Inc	2.51	0.34	0.02
Barrick Gold Corp	3.37	-3.78	-0.01
Manulife Financial Corp	3.50	-5.67	-0.16
Canadian National Railway Co	3.44	-5.80	-0.18
Berkshire Hathaway Inc Class B	3.40	-8.19	-0.23

	Rescaled Weight	Return	Contribution
Invesco S&P 500® Top 50 ETF	13.02	-21.61	-3.02
Qualcomm Inc	4.97	-28.82	-1.59
CI Canadian REIT ETF	7.53	-18.85	-1.45
Magna International Inc	3.55	-29.99	-1.14
The Walt Disney Co	2.46	-38.93	-1.12
Invesco S&P 500 Equal Weight ETF USD	6.06	-16.15	-1.02
Invesco WilderHill Clean Energy ETF	2.25	-35.00	-0.83
Financial Select Sector SPDR® ETF	3.78	-18.11	-0.71
CI Mstar Canada Mom ETF Comm	10.52	-5.16	-0.45
Restaurant Brands International Inc	2.94	-14.47	-0.42

Source: Morningstar, Luft Financial

- **Our Pension (Balanced Growth) model returned -12.47% to June 30, outperforming similar balanced ETFs like Vanguard's VBAL (-14.41%) and BMO's ZBAL (-14.69%) by about 200 basis points**.
- Our Canadian stock picks were the biggest contributors to outperformance. The best performers in the first half were a diverse bunch – pipeline company Pembina, grocery chain Loblaw, fertilizer producer Nutrien, and utility Hydro One. Barrick Gold, Manulife and CN Railway also outperformed the TSX on a relative basis.
- The Platinum Growth Fund (-21.6%YTD) was the biggest detractor to first-half performance with a contribution of -4.31%, arising from its 20% weight in the Pension model. The Invesco S&P 500 Top 50 ETF (XLG), the top contributor for the previous two years, was another notable detractor.
- **Overall, our 18 top stocks – with a combined 24% weight in the Pension model – are outperforming the TSX and S&P 500 by about 8 percentage points on average YTD**. We remain very confident in the long-term outlook for these blue-chips – especially the ones that have been disproportionately sold off, like Disney, Magna and TD Bank – on account of their improved valuations, leadership position and sustainable competitive advantage.

PORTFOLIO REVIEW: CONTRIBUTORS AND DETRACTORS – DIVIDEND MODEL PORTFOLIO

	Rescaled Weight	Return	Contribution
Pembina Pipeline Corp	3.89	22.16	0.84
Nutrien Ltd	4.88	8.95	0.68
Enbridge Inc	3.82	13.86	0.53
Loblaw Companies Ltd	3.51	12.62	0.46
BMO Covered Call Utilities ETF	17.89	1.60	0.33
Hydro One Ltd	4.14	7.51	0.32
Canadian National Railway Co	3.61	-5.80	-0.19
Manulife Financial Corp	4.77	-5.67	-0.23
The Toronto-Dominion Bank	4.91	-11.61	-0.54
Restaurant Brands International Inc	3.75	-14.47	-0.55

	Rescaled Weight	Return	Contribution
CI WisdomTree Intl Qual DivGrETF Non-Hdg	21.04	-23.73	-5.48
CI Canadian REIT ETF	17.54	-18.85	-3.48
Magna International Inc	6.24	-29.99	-2.03
Restaurant Brands International Inc	3.75	-14.47	-0.55
The Toronto-Dominion Bank	4.91	-11.61	-0.54
Manulife Financial Corp	4.77	-5.67	-0.23
Canadian National Railway Co	3.61	-5.80	-0.19
Hydro One Ltd	4.14	7.51	0.32
BMO Covered Call Utilities ETF	17.89	1.60	0.33
Loblaw Companies Ltd	3.51	12.62	0.46

Source: Morningstar, Luft Financial

- The Canadian Dividend model – our second-biggest by assets after Pension – returned -9.96% to June 30. This model also has a balanced growth profile with a mandate to generate significant tax-efficient income; it currently has a distribution yield above 4%.
- As with the Pension model, our Canadian stock picks were the biggest contributors to outperformance in the Dividend model. In addition, the BMO Covered Call Utilities ETF (ZWU) made a positive contribution to performance. This ETF uses a covered call strategy to earn option premium income on an equal-weighted portfolio of utilities, telecoms and pipelines; it pays a monthly distribution of 8 cents for a distribution yield of 7.5%.
- The Dividend model does not hold U.S. stocks, but instead holds dividend ETFs and has a higher allocation to the NBI Preferred Equity Income Fund, because of the favourable tax treatment accorded to dividends from Canadian companies.
- The CI WisdomTree International Quality ETF was the biggest detractor to first-half performance, followed by Platinum. With REITs under pressure from surging yields in the first half, the CI Canadian REIT ETF – the second-best contributor to 2021 performance – was another notable detractor.

REBALANCES SUMMARY AND POTENTIAL PORTFOLIO CHANGES

- We use a disciplined rules-based process to rebalance client portfolios in order to exclude our emotions and biases, and rebalance in the most efficient way. One of our rules is to rebalance all portfolios if either the TSX or S&P 500 deviates at least 7.5% away from the prevailing index levels at our previous rebalance. **Based on this rule, we have already rebalanced client portfolios three times in the first half of the year**.

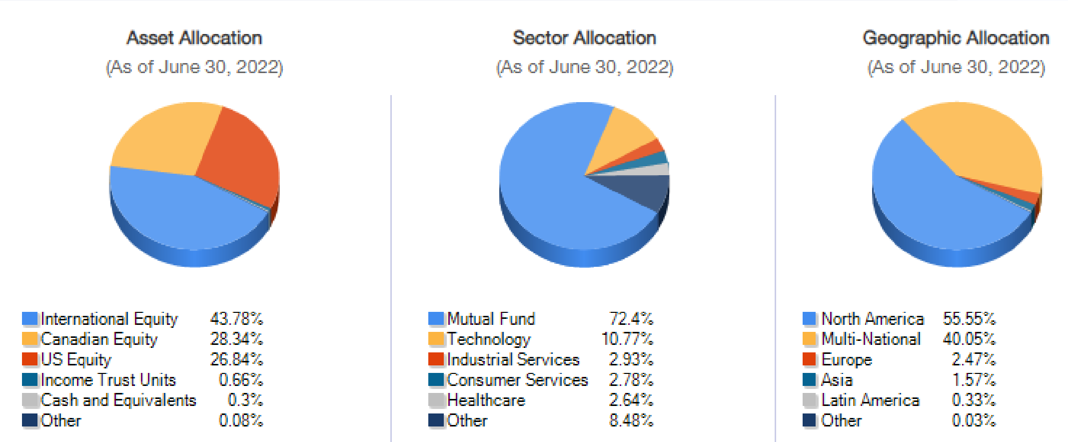
- In January 2022, based on our assumption of continued global economic growth, we boosted portfolio exposure to the energy and financial sectors by adding the Invesco Canadian Dividend ETF (PDC), increasing allocation to US banks through the Financial Select Sector ETF (XLF), and boosting target weights for TD Bank and Manulife. In March, we rebalanced portfolios to take advantage of the S&P 500's 9% dip and deploy client contributions to registered accounts. As markets declined, we rebalanced portfolios in mid-May, selling stocks that had outperformed – such as Nutrien, Pembina Pipeline, Loblaw, and Barrick Gold – and buying securities including Disney, Qualcomm and Platinum Growth Fund.

- Our rebalance strategy for the rest of the year will be dictated by whether or not a recession actually materializes by 2023. While markets seem to be factoring in the possibility of a recession by next year in North America, an economic contraction could be a short and shallow one. Last week, economists with the Royal Bank of Canada forecast that the nation will head into a moderate and short recession in 2023, as inflation, labour shortages and higher interest rates take a toll on the economy.

- If recession concerns escalate, we intend increasing the defensive tilt in client portfolios by trimming the allocation to growth-oriented securities, and using the proceeds to increase the weighting in fixed income and defensive equity sectors like health care, consumer staples and utilities. Central banks are likely to follow their established playbook and slash interest rates aggressively if a recession does take hold. Our assumption in such a scenario is that inflation would be under control by then, given that at least part of the inflation problem has been worsened by a number of temporary (and hence reversible) factors, including the Russia-Ukraine conflict and the after-effects of the pandemic on supply chains and labour. Fixed income and defensive companies with stable dividend yields typically outperform in recessionary conditions. In the event that recession concerns recede – unlikely though that may seem at present – we intend using proceeds from trimming our alternatives allocation (fixed income and hedge funds) and topping up our allocation to growth securities, as these have been among the biggest decliners in the ongoing market correction.

PLATINUM GROWTH FUND – Net Asset Value

PLATINUM GROWTH FUND – Allocations

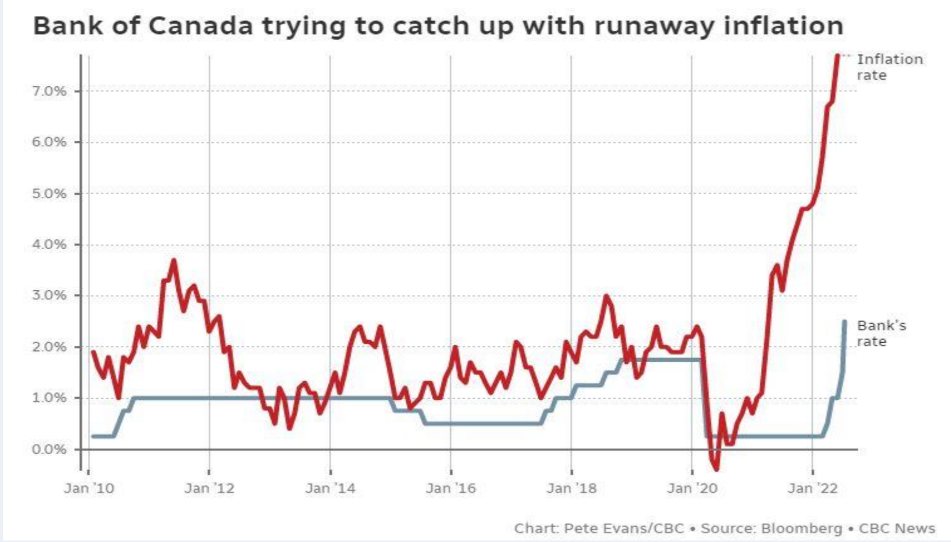


PLATINUM GROWTH FUND & STEADFAST INCOME FUND

- Platinum Growth Fund consists largely of our previous core, long-term mutual fund positions. Although the Fund fell 21.6% in the first half (top chart), we remain very confident in its long-term outlook and continue to add to positions in client portfolios on market dips. The Fund is very diversified (bottom chart) across geographies and sectors, and we are confident that the managers of its constituent funds will make the right calls in this challenging investment environment.
- While the fund managers in its constituent funds focus primarily on large-cap stocks, Platinum is not particularly concentrated. Its top 10 holdings (as of July 15) – Amazon, Microsoft, Alphabet, Apple, Meta, Nvidia, Dollarama, UnitedHealth Group, and Visa – made up 16% of the fund. Platinum's primary growth mandate perfectly complements our value-oriented stock picks, but if recession concerns intensify, we may boost its minimal value exposure by adding to the Russell Infrastructure Pool at the expense of one of the more volatile growth funds.
- Steadfast Income Fund, which is actively managed by some of the best fixed income managers in Canada and globally, returned -8.9% YTD, significantly outperforming a passive ETF like the BMO Aggregate Bond Index ETF (ZAG), which returned -12.3%. The Steadfast Fund has a yield above 4% and effective duration of 5.3 years.

***Disclosures**: 1. Robert Luft, Elvis Picardo and Aaron Arnold are Investment Committee Members for the Platinum Growth Fund, which is managed by Majestic Asset Management as the Portfolio Manager. Majestic is a portfolio manager of pooled funds and is not related to iA Private Wealth.
2. Elvis Picardo is an Investment Committee Member for the Steadfast Income Fund, which is managed by Majestic Asset Management as the Portfolio Manager. Majestic is a portfolio manager of pooled funds and is not related to iA Private Wealth.

Sources: Fundata, Majestic Asset Management, Luft Financial



RAPID DETERIORATION IN ECONOMIC OUTLOOK

- The global growth outlook has deteriorated so rapidly over the past few months that it has made recent economic forecasts redundant. For instance, the IMF estimated in April that the global economy would grow at a 3.6% pace in 2022 and 2023, but with North America and Europe potentially on the verge of a recession, those forecasts may be subject to substantial downward revision.

- We had noted the following in the July 2021 edition of this publication: “The Bank of Canada and U.S. Federal Reserve, however, have consistently maintained that current inflation pressures are transitory. The Bank of Canada does not expect to raise interest rates before the second half of 2022, while Federal Reserve policymakers expect to raise interest rates twice by end-2023.” That benign view of measured interest rate hikes has been totally upended by recent data that shows inflation running at a four-decade high of about 8% in Canada and the U.S.

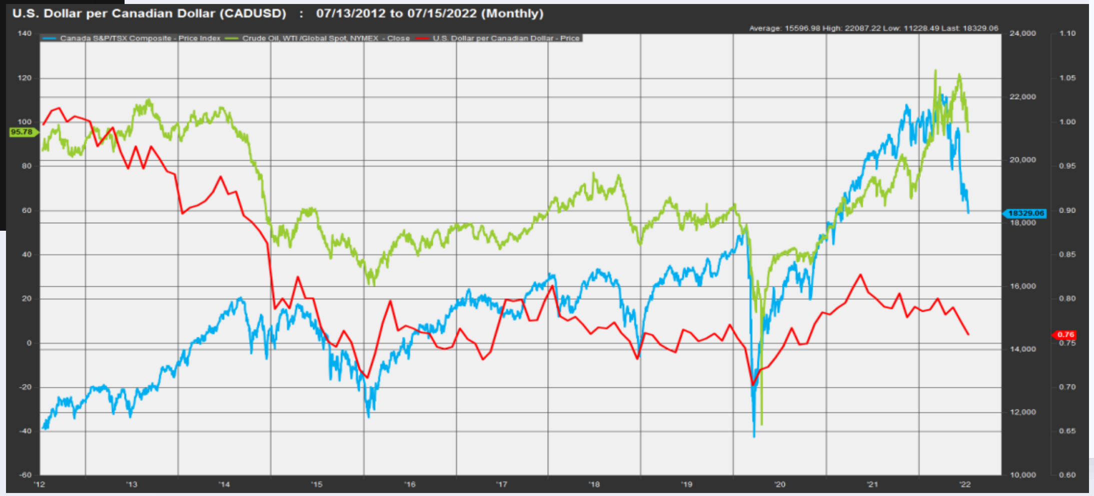
- On July 13, the Bank of Canada raised its benchmark interest rate by a full percentage point, the biggest increase since 1998. Coming on the heels of two 50 basis-point increases in the second quarter, the latest hike took the benchmark rate to 2.5% (top chart). The Bank said that it decided to “front-load” the path to higher interest rates because of factors including excess demand in the economy, high and broadening inflation, and expectations for high inflation to persist for longer.

- The Federal Reserve raised the federal funds rate by 75 basis points on June 15 – the biggest increase since 1994 – and investors expect a rate hike of 75 to 100 basis points later this month. However, with economic data softening and the yield curve signaling recession (bottom chart), traders have already begun looking past the rate hike cycle and are factoring in interest-rate cuts in the middle of 2023.

Sources: Bloomberg / CBC News (top chart), FactSet (bottom chart)

Americas 10-Year Government Bond Yields

COUNTRY	YIELD	1 DAY	1 MONTH	1 YEAR
United States »	2.93%	-4	-36	+163
Canada	3.14%	+0	-31	+188

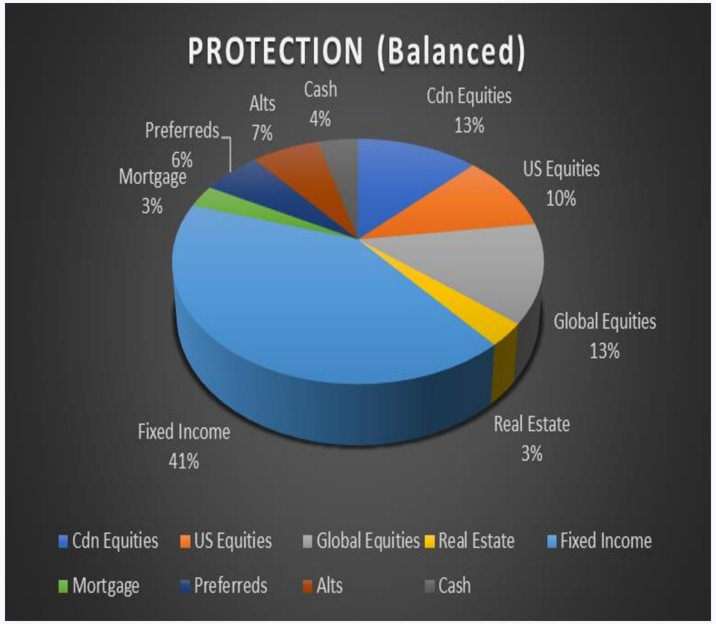


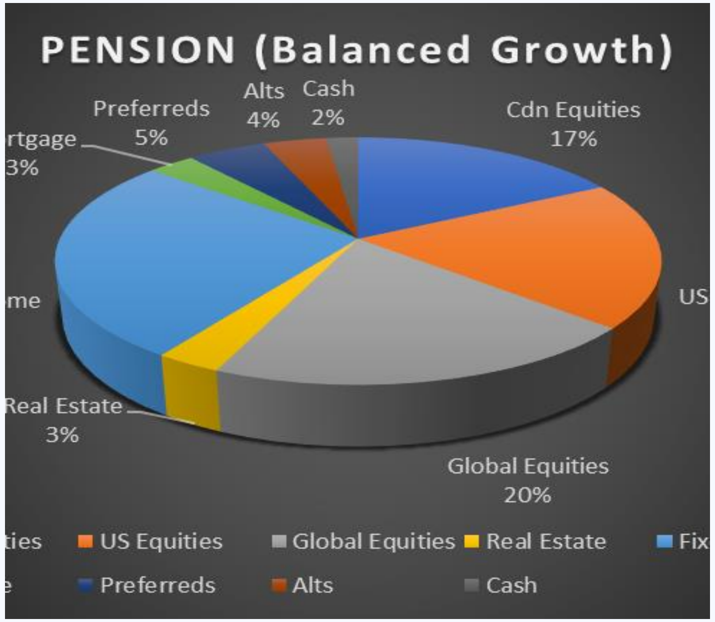
BANKING ON THE BALANCED APPROACH

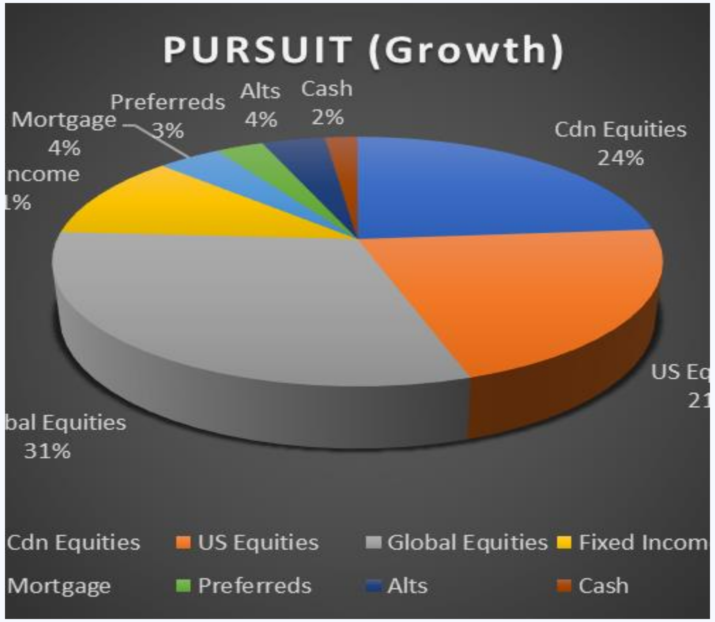
- In our opinion, while the possibility of recession poses a real and potent threat to the economic outlook, the existence of mitigating factors suggests that the prudent course of action may be to adopt a middle-of-the-road investment approach rather than one that is tilted too defensively or aggressively. These mitigating factors include the possibility of a resolution to the Russia-Ukraine conflict within the remainder of 2022, and an easing of supply chain issues and labour shortages as the Covid pandemic becomes less of a risk to the global economy. Should these occur, inflation could peak and necessitate less aggressive monetary tightening by central banks, which would in turn spur a relief rally in equities led by oversold growth stocks.
- This may sound like wishful thinking, especially as the decline in bond yields over the past month (top panel) has many market participants convinced that economic weakness lies ahead. However, given that the average market decline in a recession is about 40%, and the S&P 500 and Nasdaq have already tumbled 25% (on average) from their peaks, we believe the risk-reward ratio for U.S. equities has improved significantly since the beginning of this year. The S&P 500's valuation has compressed in record time as a result of its 20% decline. The index currently trades at a forward P/E (based on forecast 2022 EPS) of 16.7x, which is close to its average multiple over the last 20+ years, and well below the 24x multiple it traded at last year.
- That said, index earnings estimates and forecasts continue to reflect excessive optimism, in our opinion. Estimates for the S&P 500 have been virtually unchanged despite the market slump (middle panel), with index earnings projected to grow 10% to $227 this year and 9% to $247 in 2023. We believe those estimates will be revised downward as companies struggle with higher input costs and a US dollar that is at a two-decade high. TSX index earnings are forecast to surge 21% to $1629 in 2022 and moderate to a 4% growth pace next year for EPS of 1695. The median target for the S&P 500 is 4,868, representing 28% upside from current levels, while the median target of 24,331 for the TSX implies even greater upside of 33%. Not likely, in our view.
- The Canadian dollar has been unable to capitalize on the triple-digit price of crude oil, declining 2% against the USD in the first half, but that is a function of the greenback's overwhelming strength rather than any inherent weakness in the loonie. In any case, a weaker Canadian dollar (currently trading at 76.3 US cents) has a net positive impact on our client portfolios, since USD-denominated securities typically make up 20% of these portfolios.
- The TSX and S&P 500 are currently a little away from our rebalance targets of 18,222 and 3,635 respectively (based on their July 14 closing levels of 18,329 and 3,790). We see little reason to deviate from the balanced approach in our portfolios, with growth-oriented securities offset by our value-based blue chips, as well as fixed income and alternative investments.
- As noted earlier, if recession concerns escalate, we intend increasing the defensive tilt in client portfolios, but if they recede, the gameplan is to trim our alternatives allocation and top up our allocation to growth securities that have been among the biggest decliners in this market correction.

Sources: Bloomberg (top and middle chart), FactSet (bottom chart)

MAIN MODELS ASSET ALLOCATION







PROTECTION

PENSION

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