Cidel Asset Management

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Humans are Poor Prognosticators

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If you are feeling uneasy or anxious about the current state of the markets, you're not alone. We often forget that markets, particularly in the short term, can be subject to what is not always rational human emotions.

For example, most of the public think that the stock market will be lower a year from now. According to a survey conducted by the New York Federal Reserve, when asked for the percentage chance that, 12 months from now, stock prices will be higher then they are now, on average respondents predicted just a 36% chance.

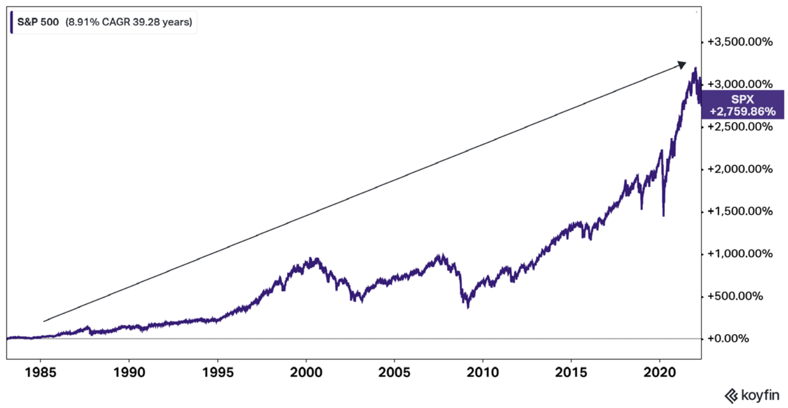
Expectations of higher stock prices

Mean probability that stock prices will be higher one year from now

Source: New York Fed Survey of Consumer Expectations, May 2022

Its easy to see why people are pessimistic: inflation stories dominate our business news, the market is down 20% year-to-date, the Ukraine invasion, interest rates rising, COVID continues, and so on.

So far, this year, they have the right to be bearish given the current market environment. **However, their attitudes aren't far off from the historical survey response average of 39% chance of an increase in equity markets.** We find that fascinating. While the market has returned, on average, about 10% per year over the past 50 years, more than 50% of people surveyed think that stocks will be lower year in and year out. **It is worth remembering, the reality is that stocks *usually* go up in the long run.**



Consider this: For the most part, we all want the world to be a better place. We want a higher standard of living for ourselves and the ones we care about, which incentivizes things like hard work and ingenuity. This inevitably comes with the demand for better goods and services that companies work to create and deliver for their customers. Investing in shares of these companies makes you an owner and is a proven way to be rewarded accordingly.

Stocks represent ownership in companies

You might think that stocks go up and down randomly. In the short term, that may be true. However, **stocks have long tracked the upward trajectory of earnings, which is a main driver for stocks.** The following chart proves the point:

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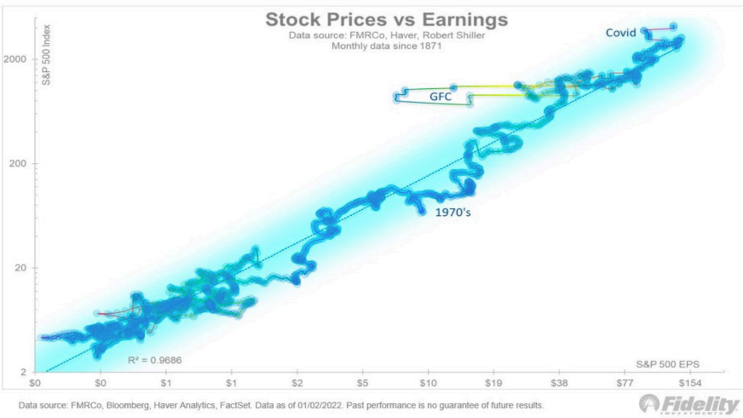
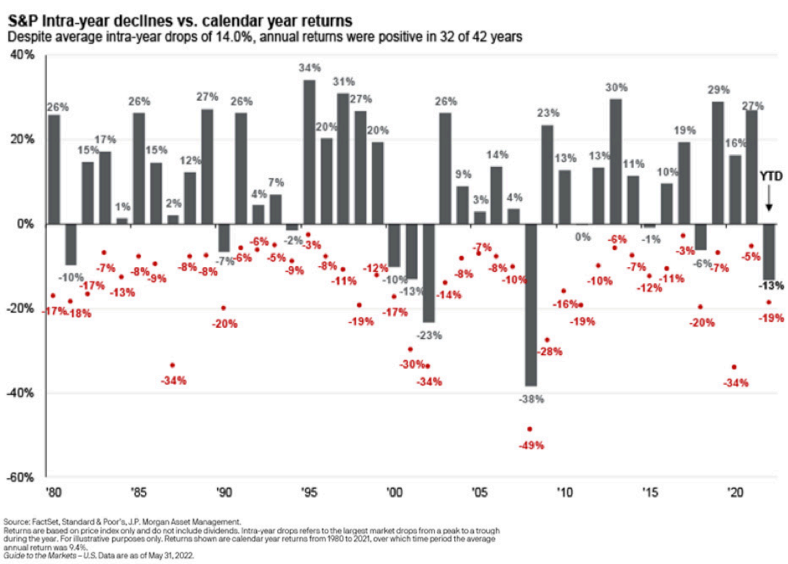


The data goes back to the 1800s. The chart plots earnings of companies on the x-axis, and share prices on the y-axis. The R2 of the charts linear regression is 97%. Here's a much more simple way of putting it: earnings do an exceptionally good job of predicting how stock prices will behave. This chart is a reminder that, over the long-term, stock prices have been supported by an upward move in earnings.

There will be volatility in the short term

Of course, the pessimists don't always lose. There has been a lot of volatility. And the first six months of 2022 has been painful for equities – and for bonds. Mild corrections - and even huge sells offs are not uncommon. In fact, on average, stocks experience a 14% drawdown, at some point, within a given year.



In this diagram, the red dots represent the largest drawdown each year and the black bar is where the market closed. As indicated, the market has ended positively in 32 of the past 42 years, despite these sell-offs. This means that if you sold during one of these sell-off periods, you risked missing out on the recovery. And the recovery can be quick and sharp.

Cidel's Approach

Cidel aims to construct portfolios that can weather the storm and deliver for our clients' stated needs. We manage risk through asset mix. That means allocating to different types of assets. Equities for longer term growth. Bonds for liquidity, to provide a hedge in crisis times, and for some income. Alternatives are used for different roles – sometimes for accessing higher potential growth in private markets that cannot be accessed other ways – or, for example, to provide uncorrelated and more consistent returns irrespective of the direction equity or bond markets take.

Our process for selecting securities is based around that same goal of reducing risk and providing protection in the long term. That is why, in our equity portfolios, we seek companies with high cash flows that are positioned to grow them even through tougher business conditions.

In summary

There is no shortage of bad news and there is cause for worry. You can't rule out the potential of the market continuing to generate negative returns over the balance of the year.

With that said, there is always bad news and there is always something to be worried about. If we look back at more recent history, there are plenty of worrying headline topics. EU sovereign debt issues, a hard landing in China, a presidential election crisis, and the pandemic. If you believe

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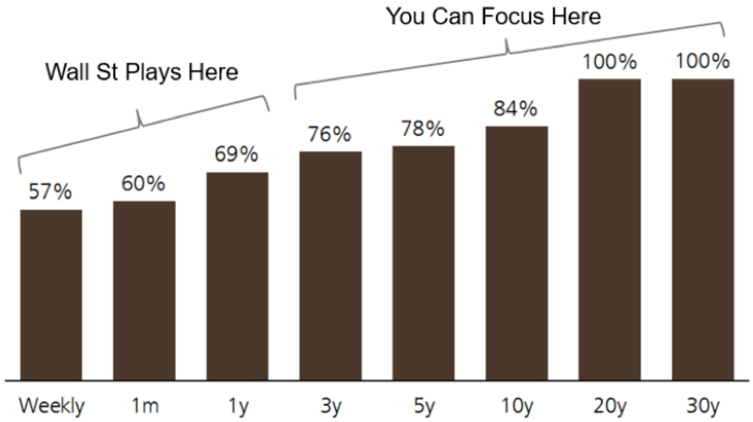
in human nature and our progress, you will believe that, in the longer term, we will better our lives and good companies will succeed. Focus on your personal time horizon, remember that diversifying your asset mix may take away some of the pain of the market dropping - and try and block out any of the short term “noise”. Contact us if you have any questions or want to review your personal situation.

Remember, you are playing a different game than Wall Street.

How often the S&P 500 has outperformed 3-month Treasury bills, based on various holding periods since 1928



Source: Shiller, Federal Bank of St. Louis, UBS, May 2021