

2022 begins with much to consider

During what's normally one of the quieter parts of the calendar for market news, the closing weeks of 2021 introduced at least three significant developments for investors to contemplate, each adding nuance to the inflation story that had already come to dominate financial headlines. First came the detection of the "omicron" covid variant in South Africa and its subsequent sprint around the globe; next was the press conference held by US Federal Reserve Chairman, Jay Powell, during which he left little doubt that the days of ultra-easy money in the world's most important economy will soon be past; and, finally, there was the decision by a swing-vote US Senator to reject the administration's multi-trillion dollar "Build-Back-Better" stimulus package.

The first and third of these items will undoubtedly have a dampening effect on US and global growth and, under ordinary circumstances, would exert similar downward pressure on consumer and producer prices. These are not normal times, however, and the significant liquidity still present on household balance sheets could allow consumer activity to look past economic speedbumps, just as it did over the past 18 months. The vastness of this excess capital across major economies is illustrated by the accompanying chart, which puts the US and Canada at the head of the pack (as an aside, Canadian families aren't at the top of the list because we're

the thriftiest or because our economy has experienced the strongest rebound - *neither is true*; rather, it's more a reflection of transfer payments and government indebtedness which, relative to GDP, has expanded more here than in any other country; Australia, for example, which is a fairly close economic peer to Canada, has borrowed about half as much as we have since the beginning of the pandemic).

Regardless of how it came to be, consumers continue to have significantly more means at their disposal than would ordinarily be the case. How this accumulation of capital and the building inflationary backdrop interact with the evolving stance of central banks, the virulence of the omicron variant, and the fiscal plans of major governments will likely explain much of the behaviour of interest rates and economies in 2022. Anyone using macroeconomic forecasting as the primary input to

equity decisions will surely be watching these variables and their interplay closely in the weeks and months to come.

As bottom-up equity managers whose analytical work focuses primarily on company-level attributes, macro considerations mostly show up in our decision-making process with respect to position weights or in an opportunistic sense, if we

believe that investor reaction to transitory conditions has overshot a stock's enduring intrinsic value. The latter of these circumstances occurred on several occasions in our equity mandates in 2021,



with a Canadian and US example highlighted below.

Boyd Group Services Inc. – Boyd is a leading consolidator in the highly fragmented autobody repair industry. Through its disciplined approach, the company has been able to acquire hundreds of “mom-and-pop” outlets across North America and quickly boost their profitability through synergies and management efficiency. We first bought the stock in 2015 in the low \$50’s and this fall it reached an all-time high of more than \$265. In the fourth quarter, however, Boyd shares fell sharply on concerns that revenues would be hurt by delays in parts deliveries related to the supply chain problems that are plaguing many industries. From our perspective, though, this is a near term nuisance that’s dwarfed by the long runway of growth opportunities that lie ahead of Boyd and the demonstrated excellence of its management team. Because of this, we capitalized on the myopic reaction of others by adding to our position in the final weeks of 2021.

Visa Inc. – Visa is both one of the longest-held positions in our portfolios and amongst the most prodigious contributors to DM client returns. Like Boyd, however, the stock retrenched in the fourth quarter, in part due to worries about what a new covid strain would mean for travel and spending activity in the first part of the new year. The decline not only made Visa shares attractive relative to their historic valuation, in our view it also misrepresented the company’s unique position in the economy, its powerful network economics, and its history of shareholder-focused capital deployment. The company must have felt similarly, as shortly after we decided to up our position, management added a massive \$12bn to Visa’s existing share repurchase program. The market seemed also to have had second thoughts on stock’s outlook, pushing it up by

13% from where we added to our position in early December.

With multiple cross-currents running through markets, 2022 seems destined to bring bouts of volatility similar to those that buffeted our positions in Boyd and Visa last year. The key as always, though, will be to gauge which ones are just typical equity fluctuations and which could inflict lasting damage to a position’s price. Though challenges like supply chain snags are troublesome in the near term, we tend to believe that hurdles such as these are eventually overcome by human ingenuity, economic readjustment, and especially the resourcefulness of skilled management teams.

The inevitable shift in central bank policy, on the other hand, could have much deeper – *and in some cases, existential* – implications for certain vehicles that have gained wild popularity in recent months. It’s no secret that one of the spillover effects of the massive monetary and fiscal accommodation necessitated by the pandemic has been asset price inflation; in fact, capital has flowed so freely and landed so broadly that the term “asset” might be a generous characterization for some of the things that have attracted much of it over the past year. If policy makers begin to drain the same liquidity from the system that has powered stratospheric gains at the most speculative ends of the financial spectrum, it could be difficult for these areas to maintain their present heights – as the oft-quoted Warren Buffett once said, “*when the tide goes out, you discover who’s been swimming naked.*” Should we experience such a revealing ebb at the hands of monetary authorities, the established earnings streams and sound balance sheets of the companies comprising your Dixon Mitchell portfolio will stand out in even sharper relief.

Happy new year from the DM team!