DM PORTFOLIO COMMENTARY

1st Quarter 2022

Things didn't get any better; they just stopped getting worse

Though individuals often invest most confidently when they're feeling good about the world around them, it regularly happens that stocks rally while socio-economic and other conditions are far from ideal. We saw this on an exceptional scale when markets soared long before either the Great Financial or Covid Crises were solved and, during the past quarter, we experienced it in a more concentrated way.

Equity markets began the year under a cloud, as investors grappled with both inflation rates that hadn't been seen in decades and the expected end to ultra-loose monetary policy, concerns which were soon compounded when Russian tanks and troops crossed the Ukrainian border. While the TSX mostly kept its head above water, owing to the relatively high representation of resource industries in our economy, the S&P 500 posted its fourth worst start to a calendar year as measured by the opening month and a half of 2022.

Against expectations, however, US stocks reversed course in the final weeks of Q1 and managed to recoup much of their earlier loss. While trying to explain any short-term market move generally amounts to a fool's errand, it's safe to say that this bounce-back *didn't* happen because all the unpleasantness suddenly went away. In fact, it could be argued that each of the impediments that worried investors at the start of the year only became more entrenched as the quarter progressed: inflation spread more fully across the economy and gas prices became an even more significant drag on household budgets; the US Federal Reserve not only made its initial interest rate increase, it signalled that several more would follow; and, rather than a short-lived, violent skirmish, it quickly became clear that the Ukraine conflict was in fact a war, one which would grind on for many weeks and inflict significantly more destruction and loss of life than had initially been predicted.

Even as these issues put down roots, though, investors likely took some solace in the improved visibility that came as the quarter passed. Yes, the world's key central bank would be in hiking mode for the foreseeable future, but at least we got to hear from its chairman and get some sense of how high and how quickly policy rates might rise through the balance of the year. And while gas prices remained punishing, the price of crude oil fell by as much as 20% from its interim peak, providing hope that climbing energy costs might eventually plateau. In Ukraine, meanwhile, the scenes were (and are) brutal but the defending army and resisting civilians seemed often to get the better of their tormentors, seeding thoughts of what both a chastened Russia and newly reunited NATO might eventually mean for global security and western integration. As is often the case, recovering stocks were probably reacting less to what was immediately before them and more to faint glimpses of what might be around the corner.

When macro topics begin to dominate investor discourse as they have in recent weeks, our instinct is to redouble our company-level analysis, knowing that these attributes make a far greater contribution to long-term portfolio success than the flashy stories that light up cable news chyrons. Conveniently, earnings reports for Q4-21 came out in the midst of the market downturn, providing us with fresh figures to update our financial models and rework our expected return forecasts. Perhaps as useful, though, were the executive interviews that accompanied most releases. These frank and mostly unprepared exchanges put a human face on our holdings and provide insight into how management teams are dealing with prevailing conditions.

We conclude this note with recent quotes from a few of our core equity positions. As you'll see, the individuals leading our companies don't necessarily have all the answers, but they guide their enterprises with extraordinary levels of effort, acumen, and dedication. In challenging times, we couldn't ask for much more!

"I give a lot of credit to our merchant team and the supply chain team for working in a very collaborative fashion to make sure that, not only are we fully good about what we have from a product category, but also the quality of the inventory. The coastal holding facilities that we established on both the east and west coast have given us the ability to land imported product early and take possession of it. This will elevate inventory levels on a temporary basis, but we feel that it's a prudent thing to do to make sure that we have that product available out of that global supply chain, so we can get it to our regional distribution centers and our stores in a timely fashion."

- Marvin Ellison, Chairman & CEO, Lowe's Cos. Inc.

"We're always concerned about everything globally that affects the business, whether it's geopolitical or otherwise or COVID-based. It all has an impact, but it really comes down to timeframe. If it's one to three weeks, it's no problem; if it's three months or more, then it's a challenge. And there are always ways to work around problems. For example, if the port in Shanghai is closed, the goods that we ship out of Shanghai can be trucked down to other ports where there are less flare-ups. There is a cost to that. There is a time factor to all that but, at the moment, we are not concerned. If it goes on for a longer period of time, we will find alternatives."

- Neil Rossy, President & CEO, Dollarama Inc.

"Environments like now are ones that we've thrived in over our history, whether you want to call it anxiety or uncertainty or even times of dislocation. We've always viewed these as times of opportunity for Danaher and there are examples of that. If you think back to the financial crisis, we acquired SCIEX at that time, which has turned out to be a fantastic asset. Also, if you think about some of the anxiety around our Cepheid or Pall deals, we couldn't be more proud of how these teams have performed to turn those businesses into real powerhouses. And so, we sit here in this environment with a rock-solid portfolio, an outstanding team, and a strong balance sheet, giving us a great deal of optionality. We like this set-up."

- Rainer Blair, President & CEO, Danaher Corp.

"Given how significantly and rapidly wage costs have increased and the business relationships that our key clients represent, it may take some time to achieve all of the needed price adjustments and margins may, therefore, continue to be impacted in the near term. However, we are moving with a great sense of urgency on this matter, and we are also not relying solely on these key-client price increases. Given our excessive levels of work, we are endeavoring to prioritize our production toward higher-margin business as well as raising prices where possible. We're also suspending business relationships with a few lower margin accounts in order to better serve our core clients and accelerate our margin recovery efforts."

- Timothy O'Day, Pres. & CEO, Boyd Group Services

"I think we're maintaining a pretty steady hand in this environment, making sure that we're supporting a broad set of customers and a broad set of markets. If you go back and look at Q4-19, and we tend to use that because it's kind of a clean "pre-COVID" period of time, we've been able to grow revenue in every end market since that quarter by making sure that we're doing the best we can across the entire customer set. It's a lot of work. It's hard work, but our team has done that well and they have put added emphasis on where we're going in industrial and where we're going in automotive. And I think you see that in the numbers when you just look at where our revenues are and where the support is. So I think we've navigated this environment well and I think it's going to set us up well for the long term."

- Rich Templeton, Chairman, Pres. & CEO, Texas Instruments