

Cardinal Update

When Inflation is in Fashion

What's Driving Rising Prices and What Will It Take to Rein It In?

Central banks around the world continue to tackle inflation by increasing interest rates, albeit with smaller and smaller hikes, but consumers are anxious to see prices return to a more manageable level.

Year-over-year inflation in December was 6.3 per cent, down from 6.8 per cent in November, a result of many inputs to the Consumer Price Index (CPI), such as food, shelter and transportation, coming down from mid-2022 peaks.

And while that's certainly an improvement from June's 8.1 per cent rate, it's still a long way from the Bank of Canada's target of two per cent.

So, how do we get there? Well, for starters the eight interest rate increases over the past year need time to impact consumer behaviour. Then economic growth needs to slow while unemployment inches up.

Mark Carney, former governor of the Bank of Canada, believes central banks will maintain high interest rates longer than

many forecasters believe so they can avoid raising them again if inflation pops back up.

"The recession obsession is overplayed," he told the audience at the CFA annual forecast dinner earlier this month in Vancouver.

Carney cites a number of reasons for his belief that inflation may have some staying power.

While core inflation has been on the decline in recent months, employment remains strong so consumer spending hasn't faltered. Canada also has lower household debt than many other countries, enabling Canadians to manage higher prices and higher interest rates without too much difficulty. Spending on health, defense and clean energy will continue to put upward pressure on inflation, he says.

Regardless of whether GDP slows to a technical recession – two consecutive quarters of negative growth – Carney believes the situation will be manageable for investors.

After a decade of low inflation, it's not surprising that many investors didn't think about needing returns to outpace rising prices until inflation ticked upwards starting in early 2021.

But regardless of where inflation is going, clients at Cardinal know their portfolios continue to own great businesses that not only pay dividends but increase them over time, which is the perfect antidote to rising inflation.

While we may sound like a broken record for the number of times we repeat this mantra, this old-fashioned, tried-and-true method of investing for the long term, has found itself in fashion once again.

MONTHLY COMMODITY PRICES 2022

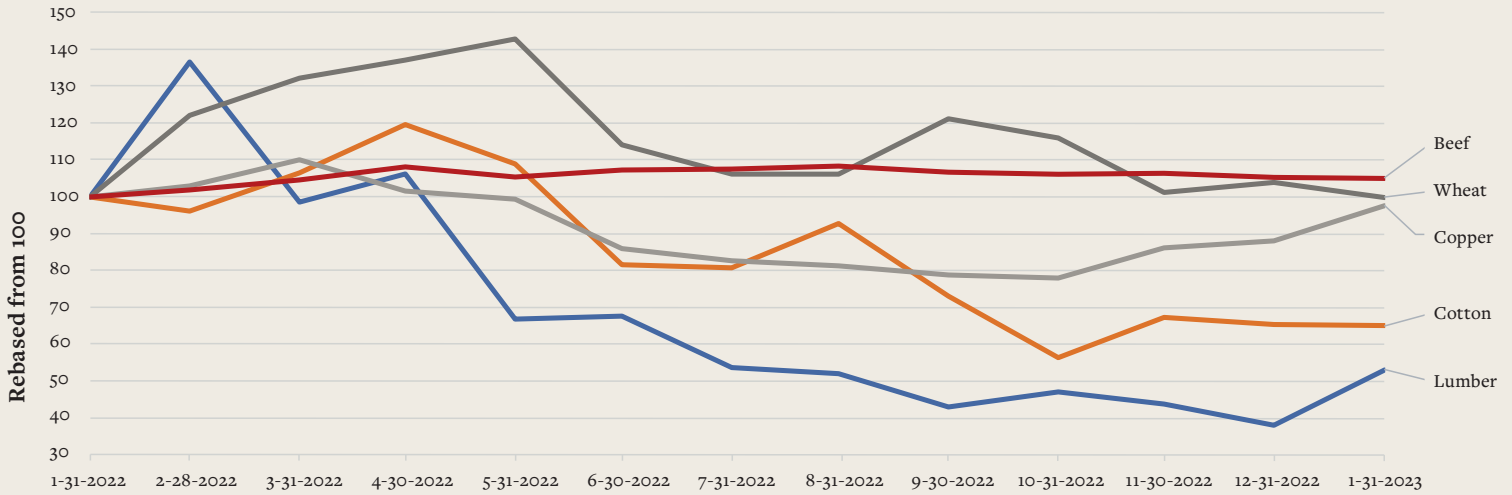
COMMODITY	31-Jan	28-Feb	31-Mar	30-Apr	31-May	30-Jun	31-Jul	30-Aug	30-Sep	31-Oct	30-Nov	31-Dec	31-Jan(23)
ENERGY													
Crude Oil, WTI (\$/bbl)	88.15	\$95.72	\$100.3	\$104.7	\$114.7	\$105.8	\$98.6	\$89.6	\$79.5	\$86.5	\$80.6	\$80.3	\$78.9
Natural Gas, U.S (\$/mmbtu)	\$4.9	\$4.4	\$5.6	\$7.2	\$8.1	\$5.4	\$8.2	\$9.1	\$6.8	\$6.4	\$6.9	\$4.5	\$2.7
RAW MATERIALS													
Lumber (\$/1000 board feet)	\$980	\$1,337	\$965	\$1,040	\$654	\$663	\$527	\$509	\$423	\$462	\$429	\$374	\$521
Cotton (\$/lb.)	\$1.3	\$1.23	\$1.36	\$1.52	\$1.39	\$1.04	\$1.03	\$1.18	\$0.93	\$0.72	\$0.86	\$0.83	\$0.83
Copper (\$/lb.)	\$432	\$444	\$475	\$440	\$430	\$371	\$357	\$352	\$341	\$338	\$373	\$381	\$423
Aluminum (\$/mt)	\$3,047	\$3,374	\$3,484	\$3,036	\$2,764	\$2,433	\$2,501	\$2,365	\$2,164	\$2,220	\$2,455	\$2,350	\$2,618
AGRICULTURE													
Wheat, U.S (\$/bu.)	\$761	\$928	\$1,006	\$1,044	\$1,088	\$869	\$808	\$809	\$922	\$882	\$772	\$792	\$761*
Coffee, Arabica (\$/lb)	\$235	\$234	\$226	\$223	\$231	\$234	\$217	\$239	\$222	\$178	\$168	\$167	\$170*
FOOD													
Bananas, U.S (\$/lb.)	\$0.630	\$0.628	\$0.628	\$0.637	\$0.642	\$0.640	\$0.640	\$0.643	\$0.643	\$0.634	\$0.631	\$0.628	\$0.639
Beef (\$/lb.)	\$4.55	\$4.63	\$4.76	\$4.92	\$4.79	\$4.89	\$4.89	\$4.94	\$4.86	\$4.84	\$4.85	\$4.80	\$4.79

Source: Bloomberg



Cardinal Update

Commodity Prices



COMPANY FOCUS: SONY GROUP

Sony’s share price had a rough 2022 but a great start to the New Year.

After hitting an all-time high in December 2021, shares in the Japan-based electronics giant fell by more than 35 per cent over the next nine months. Since the calendar turned, however, they’ve rebounded by more than 30 per cent.

One driver of the downturn was completely unrelated to the fortunes of Sony’s electronics and other business units – the historic decline of the Yen compared to the U.S. Dollar. From early 2021 to Oct. 2022, its value versus the greenback dropped by 30 per cent. (It has since recovered more than 10 per cent.)

Beyond the foreign exchange rate and share price volatility, we remain confident in Sony’s strong fundamentals.

We believe there was a disconnect between how the market viewed the company coming out of the pandemic and reality. Some areas of Sony’s business, such as TVs and video game software sales, were big winners in a stay-at-home world.

As expected, sales of televisions have declined sharply since the height of the pandemic while video game sales are returning to pre-pandemic levels.

Other divisions weren’t as fortunate. Supply chain issues impacted the production of the PlayStation 5 console while the Chinese government’s COVID-19 lockdowns cut into Sony’s image sensor business.

While the latter should begin to recover with the easing of restrictions in China, PS5 production is now in full swing and that’s reflected in the company’s most recent quarter. Year-over-year gaming revenues jumped 53 per cent, as 7.1 million consoles were sold, up from 3.9 million the previous year. Higher console sales boosted software revenue and the segment posted incredible results, far outpacing rivals such as Microsoft.

We believe Sony’s best days are still to come, driven by leading global franchises in gaming, music, smartphone sensors and TV/movie studios, all of which should propel long-term earnings and dividend growth.

DIVIDEND INCREASES

Canada	% Increase
CN Rail	7.8
Allied Properties	2.9
U.S.	
Comcast	7.4
International	
NXP Semiconductors	20.0

(For the period Jan. 1 – Jan. 31, 2022)

