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ALTA CAPITAL MANAGEMENT
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Economic Outlook

Winter 2022

This economic outlook commentary is authored by Guardian Capital LP*

SUMMARY

- Change can be difficult to digest, especially at first, and the attendant uncertainty that comes with the change in the policy environment likely means that volatility will remain elevated over the near term.

- When the dust settles and the outlook clears, especially if the pandemic begins to subside in earnest, as anticipated, in the months ahead (a very welcome change), it appears that the constructive macroeconomic fundamentals should keep growth momentum on a decidedly upward trajectory.

- The strength in consumer finances, potential upswing in business investment and the boost associated with a broader/full reopening of activity (especially in services) should mean that the economy can absorb modestly higher interest rates. Additionally, it is important to recognize that rates globally are still at historically low levels and real rates remain deeply in negative territory, while the likes of the European Central Bank and Bank of Japan are maintaining highly accommodative monetary policies and are continuing to add liquidity into the financial system.

- That suggests that the odds remain low that monetary tightening this year will be sufficient to knock global economic growth off its track.

- As the expansion matures further out on the forecast horizon, however, the question of whether "*this time will be different*" will again rise. Central banks have historically struggled to calibrate monetary policy in such a way that financial conditions do not tighten too much, too quickly — and ultimately, efforts to find a remedy for inflationary pressures end up being worse for growth than the disease itself.

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One more time, with feeling

One phrase that instills doubt and fear in the minds of economists and historians alike is "*this time is different.*" It is not often that this ends up being the case and, at best, to borrow a quote from American humorist Mark Twain, "*history doesn't repeat itself, but it often rhymes.*"

So, as the world rides yet another wave of COVID-19 infection, there is much trepidation over the growing discussion about how this new wave, and its resultant impact, *actually is* different from the last three. As such, it may well represent the beginning of the end of the pandemic and set the stage for the return to an economic environment that sounds more familiar to what played out before.

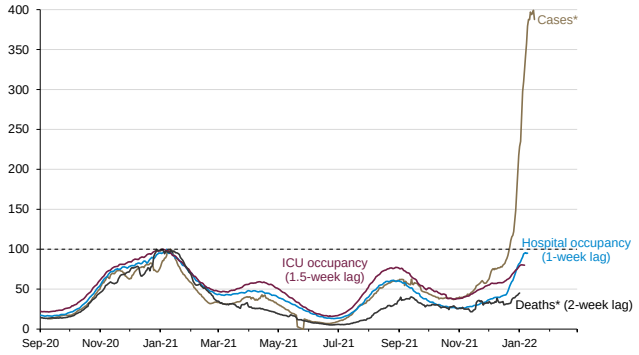
Down with the sickness

While the new dominant strain of the virus (B.1.1.529 or "omicron") is clearly highly transmissible as evidenced by confirmed case counts (which, undoubtedly, vastly underestimate the true scope of contagion) skyrocketing worldwide, it has so far proven to be less virulent (lower ability to cause severe symptoms) than its predecessors.

Rates of hospitalizations, especially those requiring intensive treatment, and deaths have largely decoupled from those for infection, holding at comparatively lower levels than earlier waves — and an early study[1] of the first cases in South Africa indicated that those that do end up in hospital have stays that are less than half as long.

CHART 1: CONSCIOUS UNCOUPLING

COVID cases, hospital occupancy & deaths, G7
(percent of last winter peak)



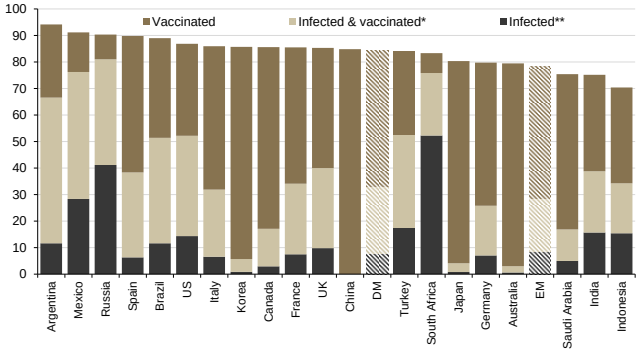
**seven-day moving average; data to January 18, 2022*
Source: Our World in Data; Bloomberg; Guardian Capital

Undoubtedly, a big factor behind the relatively better health outcomes is the increased resistance to infection across populations this go-around, brought about by prior illness and vaccination — not to mention the significant progress at managing and treating illness with effective therapeutics.

But that a, seemingly, more benign iteration of the virus appears to have outcompeted other more dangerous strains means that this wave could end up accelerating the establishment of the necessary degree of herd immunity globally to close this chapter of history, without the level of devastation a more lethal variant would wreak.

CHART 2: SHORING UP DEFENSES

Estimated population with immunity to COVID-19, G20
(percent of total)



**Assumption that prior infection does not impact vaccination decision, so overall vaccination rate applied to infected tally; **Infected is the average of the cumulative total infection mean estimates from "true" infection models less deaths attributed to COVID-19; data at January 14, 2022*
Source: Our World in Data, Bloomberg, Guardian Capital

Of course, the end of the pandemic does not mean that COVID-19 disappears, just that the disease progresses to become endemic. That is, the virus remains a constant within the population but no longer represents an "emergency" — infections could arise predictably and at consistently low rates in the future, with few people becoming severely ill.

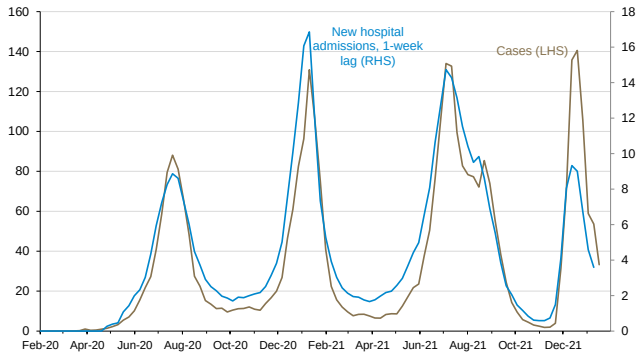
Upon achieving this point, we can expect life to return slowly to something akin to what we used to consider normal, with restrictions on daily life fully rolled back and economic activity permitted to resume at full capacity once again.

And current thinking is this normalization process may not just be a story for 2022, but potentially for the first half of the year.

Indeed, judging by the progression of the disease in South Africa, the omicron epicenter, the current wave could well be expected to crest in the coming weeks, with a fairly rapid ebbing coming thereafter.

CHART 3: ROLLING OVER

Weekly COVID-19 cases and new hospital admissions
(thousands)



Data to January 17, 2022; source: Our World in Data; Guardian Capital

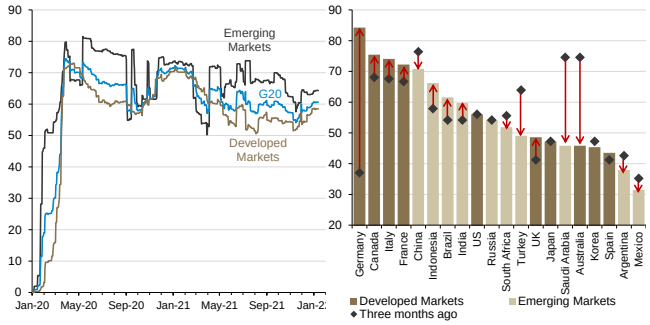
Break on through (to the other side)

The fact that the pandemic has been part of life for two years now has meant that people and businesses have adapted their lifestyles and operations to fit the backdrop. This has been a key reason why each successive wave, and consequent introduction of stringency measures, has generated a smaller macroeconomic wake.

The prospect of a quickly receding wave could give policymakers the ability to scale back stringency measures, which were reintroduced in fairly short order, in the weeks ahead. In fact, many regions (the US and UK, perhaps, most notably) barely saw anything in terms of renewed restrictions.

CHART 4: TEPID RESPONSE

Government response stringency index[2], G20
(index; higher indicates more stringent measures in place)



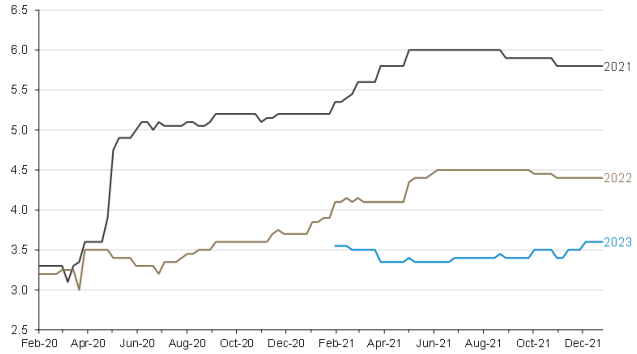
(L) Data to January 21, 2022; (R) data as at January 11, 2022
Source: Oxford COVID-19 Government Response Tracker, Guardian Capital

This would seem to suggest that the impact on global growth could be nothing more than a blip, especially if activity is permitted to resume to its pre-pandemic extents across even the hardest hit industries once we find ourselves on the other side.

The effective lack of movement in global growth forecasts would indicate that this view is in line with the current consensus — growth is expected to slow over the coming 12 months versus the robust recovery rate of 2021, but still remain well above the trend rates that prevailed prior to the pandemic.

CHART 5: HOLDING STEADY

World annual real gross domestic product growth forecasts
(year-over-year percent change)



Bloomberg consensus forecasts to January 21, 2022
Source: Bloomberg; Guardian Capital

To be clear, the anticipated slower pace of growth going forward, from the robust rate recorded over the previous year, does not so much reflect a loss of momentum but the expected evolution of the cycle.

Last year's strong growth was largely a function of the crisis-induced weakness in 2020. In contrast, 2021 was about recovering lost ground, with real gross domestic product across the G7 economies (Canada, France, Germany, Italy, Japan, the UK and US, which, together account for one-third of total global output) expected to have returned to pre-pandemic levels by the end of the now-closed calendar year.

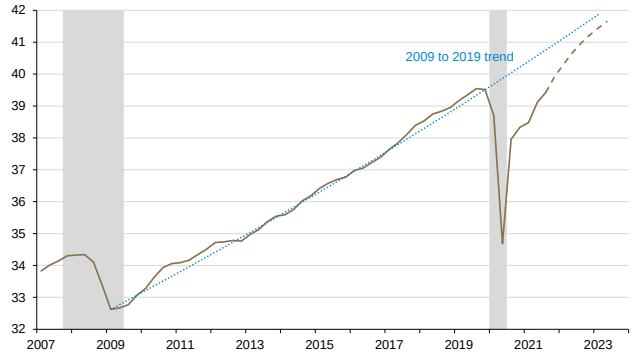
With a bulk of the idled capacity now brought back online, the months ahead will represent a transition in the global economic cycle from "recovery" to "expansion".

So, although there is still some catch-up to be played in terms of getting the economy back to the

pre-pandemic path, which will permit above-trend growth in the near term, activity in the months ahead will be increasingly constrained by the structural factors that act as a speed limiter. Namely, the growth in the productive capacity that is driven by the pace of technological innovation, capital investment and labor force growth.

CHART 6: GETTING BACK ON TRACK

Real gross domestic product, G7
(trillions of 2015 US dollars)



Data to Q3 2021; dashed line represents Bloomberg consensus forecasts as at January 21, 2022; shaded regions are periods of US recession
Source: OECD, IMF, Bloomberg, Guardian Capital

Can't buy a thrill

A primary reason that the recovery to this point has been so rapid, and the global economy is already running up against capacity constraints, is the fact that this time *has,* in fact, been different.

In sharp contrast to the periods after previous economic crises, restraint on growth has not so much been due to a weakness in demand but primarily thanks to constraints on the supply side.

For sure, the pandemic-related shutdowns and resultant job loss created adverse impacts globally, however, governments unleashed an unprecedented amount of support to fill the income void that resulted from lockdowns.

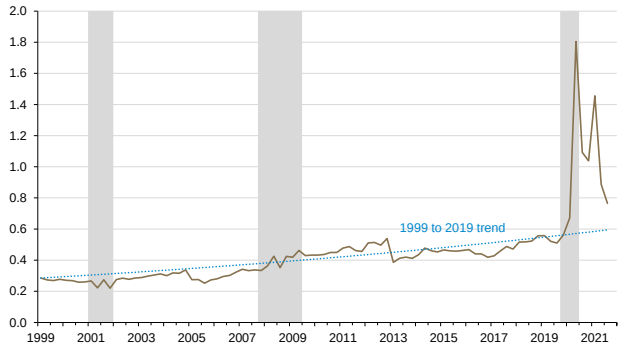
G7 governments rolled out massive slates of relief measures amidst the crisis (estimated by the International Monetary Fund at US$14 trillion, roughly 20% of the G7 group's gross domestic product) to support their domestic economies.

The transfer of funds to households, combined with restrictions that significantly constrained spending (especially on services, which typically accounted for two-thirds of household budgets prior to the pandemic), resulted in a surge in savings globally.

Since the start of 2020, households across the G7 economies have socked away US$3 trillion more than was typical pre-crisis.

CHART 7: INCUBATING NEST EGGS

Personal savings, G7
(trillions of US dollars)



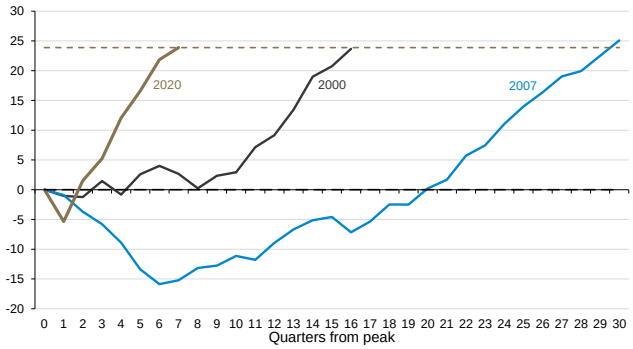
Data to Q3 2021; shaded regions are periods of US recession
Source: OECD, Bloomberg, Guardian Capital

That "excess saving" has been compounded by the strength in global financial and residential real estate markets over the last two years, despite the historic shock created by the pandemic.

Aggregate household net worth has surged, now standing 25% above its pre-crisis peak in Canada and the US — it took 7½ years for Americans to get to this point after the financial crisis.

CHART 8: FOR WHAT IT'S WORTH

US household net worth
(percent change from pre-crisis peak)



Data to Q3 2021; source: US Federal Reserve Board; Guardian Capital

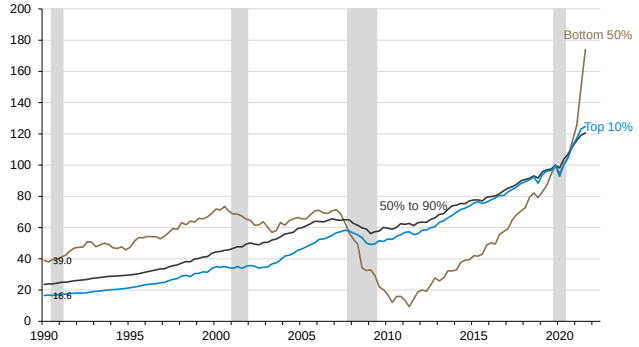
Furthermore, it is noteworthy that it has not strictly been a case of the rich getting richer.

Economic household data from the US[3] and Canada[4] indicate that wealth gaps have actually

narrowed since the onset of the pandemic, as those households at the lower end of the wealth spectrum have recorded comparatively larger gains in net worth over the period.

CHART 9: SPREAD THE WEALTH

US household net worth by wealth percentile
(index; Q4 2019 = 100)



Data to Q3 2021; shaded regions represent periods of US recession
Source: US Federal Reserve Board; Bloomberg; Guardian Capital

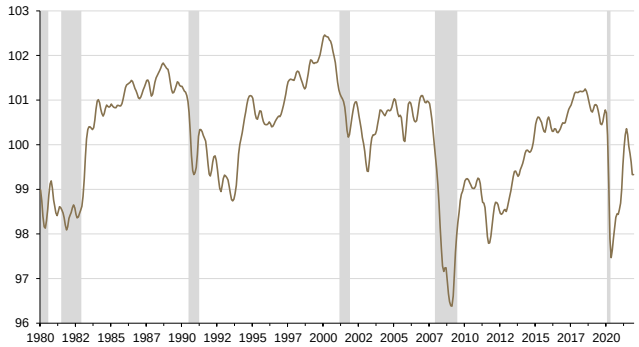
This rapid, substantial buildup of wealth (particularly among the less wealthy cohorts that typically spend more of their gains in net worth) has underpinned strength in household spending on goods over the last year, and there is little reason to anticipate consumers will feel a need to hold back once activity is permitted to fully resume.

There appears to be no need to rebuild lost savings, something that historically has been a factor limiting the speed of recovery from past economic crises.

In other words, it would appear that there remains plenty of scope for consumer spending (which accounts for roughly 60% of global economic activity) to continue to be a driving force for over the coming year — and that is especially the case should the ebbing pandemic provide more clarity on the outlook and a needed lift to consumers' spirits.

CHART 10: A LOSS OF CONFIDENCE

OECD consumer confidence index[5]
(index)



Data to November 2021; shaded regions represent periods of US recession
Source: OECD; Bloomberg; Guardian Capital

Taking care of business

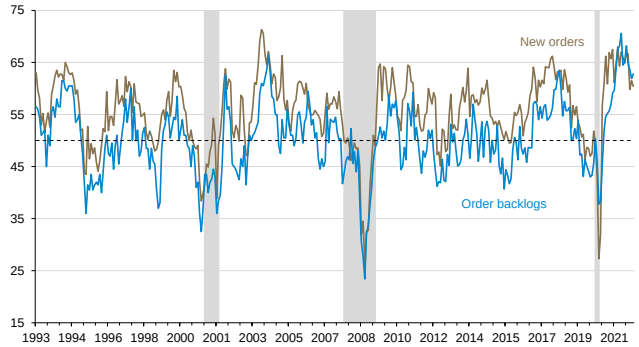
The accumulation of household wealth is clearly a positive for the outlook for spending, but people need comfort with the prospects for future cash flows to really loosen purse strings now. And on that score, there is reason for optimism.

While there are ongoing, and some newly reinstituted, restrictions on the service sector, the environment has been an embarrassment of riches for goods producers (especially those peddling consumer goods and inputs to make those wares).

Current data and forward-looking surveys indicate that order books are bulging and, among the biggest problems, are keeping storerooms stocked as production, both domestic and internationally, has been hampered by pandemic-related disruptions and struggled to keep up.

CHART 11: EVERYTHING ON ORDER

ISM manufacturing *Report on Business*[6]
(diffusion index; >50 denotes expansion)

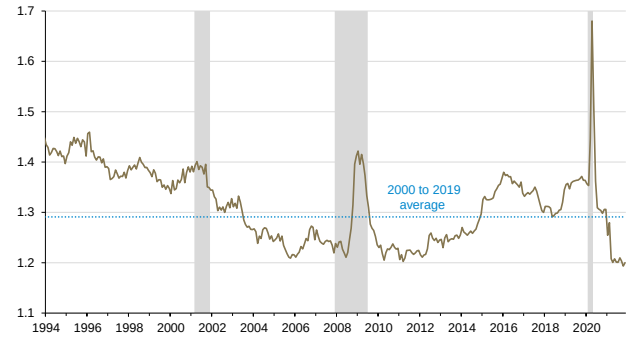


Data to December 2021; shaded regions represent periods of US recession
Source: Bloomberg; Guardian Capital

Inventories have been drawn down significantly throughout the supply chain, compounding underlying demand strength, with the need to replenish depleted stockpiles — and likely to higher levels than prevailed pre-pandemic, given the recent experience of difficulties maintaining supply channels — adding to the backlogs and bottlenecks.

CHART 12: IN NEED OF A REFILL

Total business inventory-to-sales ratio, US
(ratio)



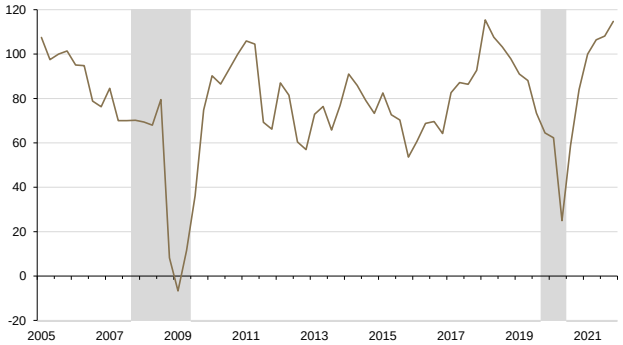
Data to November 2021; shaded regions represent periods of US recession
Source: Bloomberg; Guardian Capital

In response to the clear need for increased capacity against the strong demand, buoyant business sentiment, low costs of capital and improved clarity on the outlook (in spite of the latest COVID-19 wave), businesses are ramping up capital spending plans.

The latest survey of American CEOs showed record highs in the plans for investment in plant, property and equipment for the coming six months.

CHART 13: WHAT A CAPITAL IDEA

US CEO economic outlook capital spending plan index[7]
(index)



Data to Q4 2021; shaded regions represent periods of US recession
Source: Business Roundtable; Bloomberg; Guardian Capital

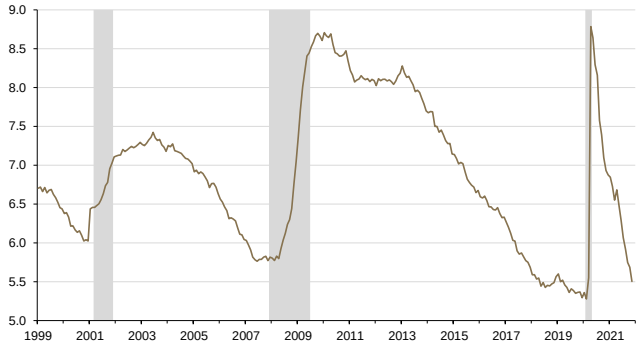
A prospective flood of productivity-enhancing investment is a positive development, especially with respect to the longer-term growth outlook, however, it takes time for the fruits of these labors to come to bear — there is a lag between signing-off on a project and it being up and fully operational.

More immediately, businesses have been turning increasingly to the labor input to production. As a result, despite the ongoing pandemic and resultant restriction keeping areas of the economy from returning to full operations, labor markets globally have tightened materially.

The aggregate unemployment rate across the 38 major industrialized economies that comprise the Organisation for Economic Co-operation and Development (OECD) is back within arm's reach of pre-crisis (and historically low) levels.

CHART 14: FEW IDLE HANDS

Unemployment rate, OECD
(percent)

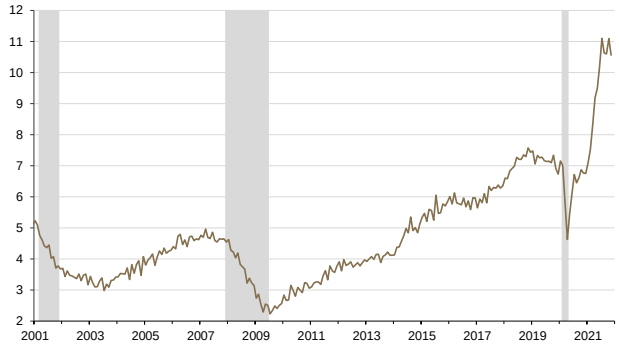


Data to November 2021; shaded regions represent periods of US recession
Source: OECD; Bloomberg; Guardian Capital

Those rates would be even lower if not for the fact that there is ample unmet labor demand — for example, there were more than 10 million unfilled job openings in the US as at the end of November.

CHART 15: HELP WANTED

Job openings, US
(millions)



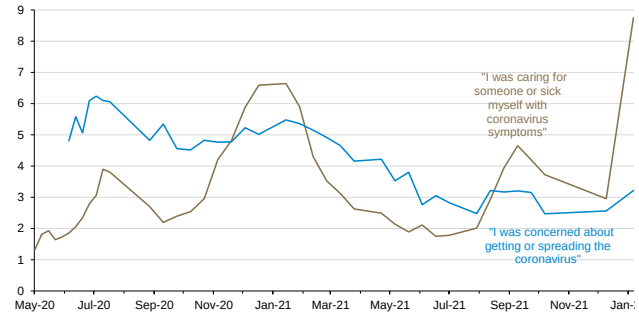
Data to November 2021; shaded regions represent periods of US recession
Source: Bureau of Labor Statistics; Bloomberg; Guardian Capital

While part of this reflects a skills mismatch (jobseekers do not have the qualifications for the job openings), a bigger factor appears to be that the pandemic is keeping people out of the labor market due to concerns over getting sick, being sick or having to look after someone who is sick.

The US Census Bureau estimates that a pandemic high of nearly nine million people were unable to work in early January because they either had the coronavirus or were tasked with looking after somebody else who did, while another three million were on the sidelines out of fear of getting sick.

CHART 16: CALLING IN SICK

Americans not working due to COVID-related reasons
(millions)

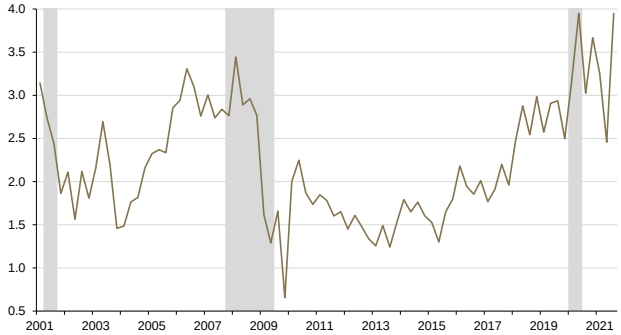


Data to January 10, 2022; source: US Census Bureau; Guardian Capital

For those actively in the job market right now, the abundant demand for labor is a boon, as not only does it ease concerns about the ability to find gainful employment, it also has the effect of putting upward pressure on compensation as employers are forced to compete for available qualified hires.

CHART 17: REAPING THE BENEFITS

Employment cost index, G7*
(year-over-year percent change)



**GDP-weighted average growth rate of employment cost indexes; data to Q4 2021; shaded regions represent periods of US recession*
Source: IMF; OECD; Bloomberg; Guardian Capital

Price tag

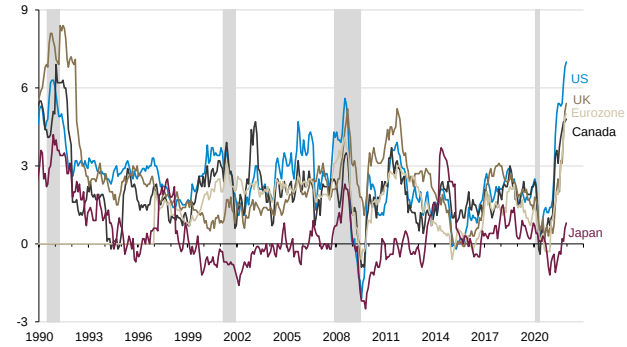
Rising labor costs, as well as increases in other inputs to production, such as raw materials (which have been subject to demand/supply imbalances that have seen commodity prices rise to seven-year highs), represent "cost-push" inflation — businesses raise selling prices to pass-through higher costs to end clients and maintain their margins.

The excess consumer demand against constrained supplies is also putting upward pressure on prices on goods and services ("demand-pull" inflation).

Combine these factors with the impact of the low base level on year-over-year calculations (referred to as "base effects") and the result is that inflation rates have jumped to multi-decade highs globally.

CHART 18: UP, UP, AND AWAY

Consumer price indexes
(year-over-year percent change)



Data to December 2021; shaded regions represent periods of US recession
Source: Bloomberg; Guardian Capital

Sustained high inflation can be detrimental to the outlook for growth — rapidly increasing prices act as

an escalating tax that erodes purchasing power and can hinder consumer spending and business investment decisions.

Importantly, the potential for full-scale production with minimal disruptions in the months ahead should help further work through supply backlogs, while the ebbing of the pandemic and a broader reopening should go some way toward helping ease dislocations in labor markets.

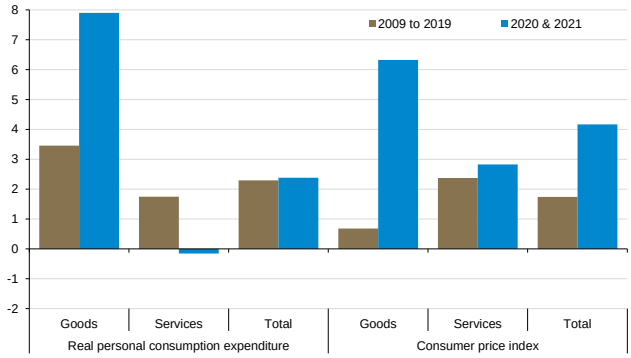
Further, the removal of restrictions on the service sector activity will not only pull many idled workers back into the fray, but also support a shift in spending behavior.

As mentioned, household expenditure on goods has been robust and has driven price increases. Effectively, all of that strength has come at the expense of services. The growth in the overall volume of spending over the last two years has largely matched pre-crisis trends, even though real services spending has declined.

A transition back toward services spending will lessen pressure on the goods sector, while also putting more emphasis on services, which have seen far more modest pricing pressures.

CHART 19: A GREAT DIVIDE

Real consumer spending & inflation
(annualized percent change)

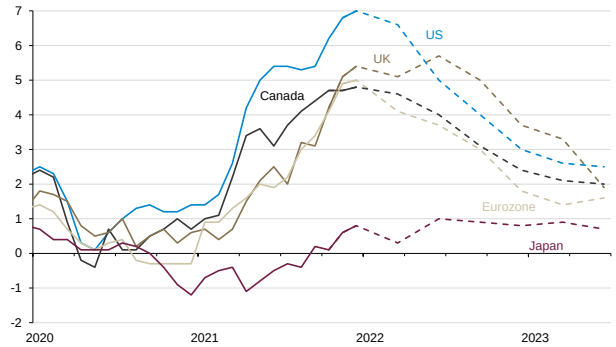


Data to December 2021; shaded regions represent periods of US recession
Source: Bloomberg; Guardian Capital

Add in the fading base effects and current baseline expectations are that these elevated readings will not last for long. Instead, inflation is anticipated to peak in the coming months before moderating toward rates more consistent with central bank inflation targets by the end of the year.

CHART 20: BACK FROM WHENCE WE CAME

Consumer price indexes
(year-over-year percent change)



Data to December 2021; dashed lines represent consensus forecasts as at January 18, 2022; shaded regions represent periods of US recession
Source: Bloomberg; Guardian Capital

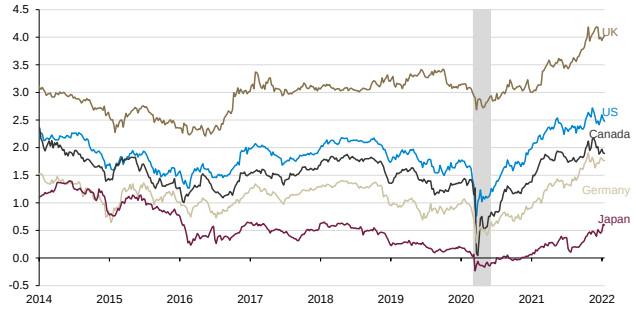
With that said, however, the price pressures have, so far, proven to be more persistent than previously assumed and there is scope for this "stickiness" to continue in the New Year. One of the bigger potential upside risks being that further disruptions in activity in China, a key link in global supply chains, due to the country's adherence to a "COVID zero" policy, could crimp supply-side recoveries — and that would further compound concerns around the domestic economy, most notably within its real estate sector.

As well, commodity prices may not be expected to repeat the outsized gains recorded over the last year, but ongoing supply constraints and firm demand appear poised to provide further price support. And while expectations are that crude oil supply increases should be sufficient to return the market back to balance, output among the members of the Organization of the Petroleum Exporting Countries (OPEC) has persistently undershot quotas, raising doubts that the cartel can meet recently agreed upon production increases.

It is indeed the case that market-based measures of longer-term inflation expectations have increased steadily over the last year, suggesting that while inflation may not be destined to remain at current levels, it is anticipated that it will hold above previous norms going forward across the globe.

CHART 21: TRYING TO BREAK EVEN

10-year break-even inflation rates
(percent)



Data to January 14, 2022; shaded region represents period of US recession
Source: Bloomberg; Guardian Capital

Under pressure

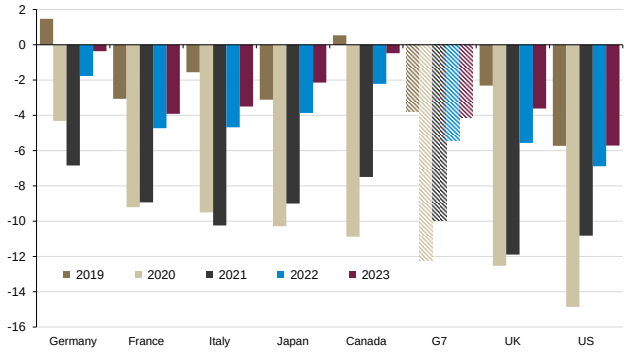
The outlook for growth, employment and inflation has raised the pressure on policymakers worldwide to begin to unwind their crisis-era policy stimulus to help temper demand and contain price pressures.

For their part, governments are refraining from expanding pandemic-related supports and instead letting existing programs lapse.

That means public spending is set to decline fairly sharply in the year to come — and serve as a modest drag on overall growth — as focus shifts from underpinning the recovery to reining in gaping budget deficits.

CHART 22: FISCALLY DRAINED

General government fiscal balance
(percent of gross domestic product; <0 denotes deficit)



Forecast data as per IMF's October 2021 World Economic Outlook
Source: IMF, Guardian Capital

That general certainty with respect to the path of fiscal policy — notwithstanding the back-and-forth on the infrastructure package in the US — contrasts with the monetary policy.

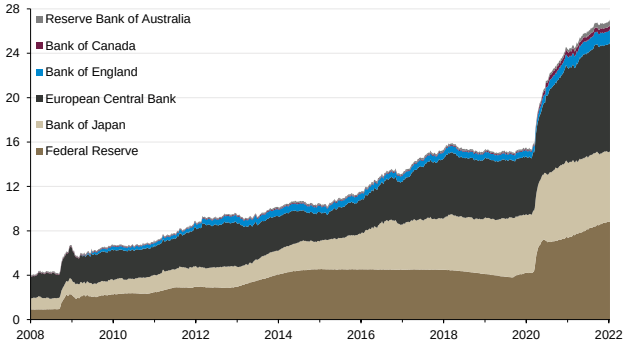
Recent months have seen central banks eschew a more balanced and cautious rhetoric against the uncertainty plaguing the forecast horizon in favor of a more hawkish bend, with the ground being laid for an unwind of crisis-era stimulus measures.

Asset purchase programs have either been wound up or will be in the coming months (aside from those in Japan and the Eurozone, which are expected to continue largely unabated).

How and when central banks will begin to reduce the size of their balance sheets —now standing at US$27 trillion, equivalent to 40% of the market value of the global bond market — is something that will garner more attention as the year progresses.

CHART 23: TILTING THE BALANCE

Central bank asset holdings
(trillions of US dollars)



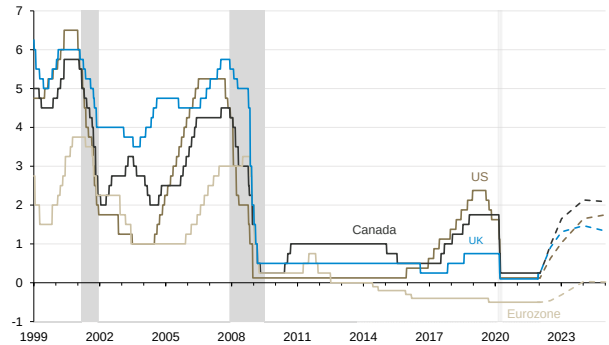
Data to January 21, 2022; Source: Bloomberg, Guardian Capital

More imminently, central banks appear set to make their opening volleys on the more conventional side of policy, taking their short-term interest rate benchmarks off their zero lower bounds (the Bank of England kicked this off in December).

Baseline market expectations are for moves to come within the current quarter and continue in a fairly aggressive manner — though there is plenty of uncertainty around the timing and ultimate magnitude of the moves.

CHART 24: MOVIN' ON UP

Central bank policy rates
(percent)



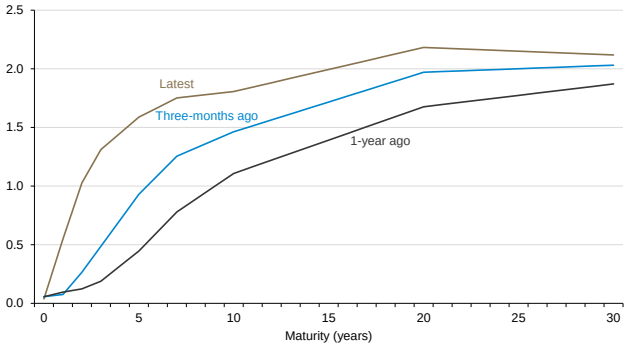
Data to January 21, 2022; dashed lines represent overnight index swap-implied policy rates as at January 21, 2022; shaded regions are periods of US recession; Source: Bloomberg, Guardian Capital

Yield not to temptation

The repricing of the path for policy rates has put notable upward pressure on market yields, particularly at the front-end of the yield curve (longer-term yields have seen smaller increases and remained generally anchored) while the uncertainty about the specifics of this tightening cycle has resulted in a pickup in volatility.

CHART 25: CURVE YOUR ENTHUSIASM

US Treasury security yield curve
(percent)

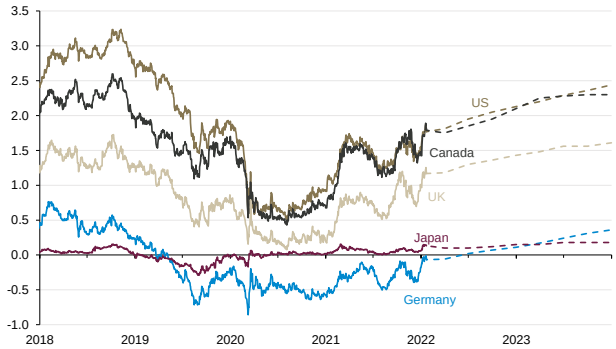


Data as at January 21, 2022; Source: Bloomberg, Guardian Capital

While the rise in market yields represent a fairly notable adjustment, the outlook suggests that further increases across the yield curve are likely over the year ahead.

CHART 26: THE PATH OF LEAST RESISTANCE

10-year government bond yield
(percent)



Data to January 21, 2022; dashed lines represent Bloomberg consensus forecasts as at January 21, 2022; source: Bloomberg, Guardian Capital

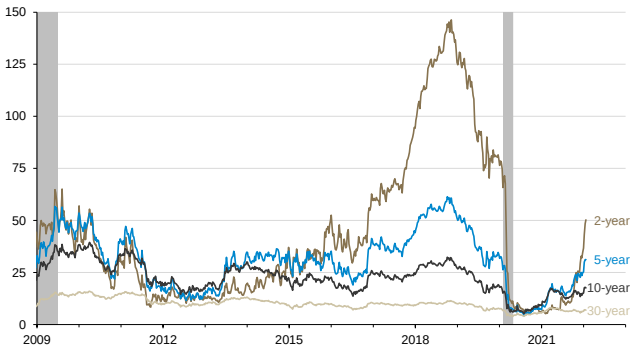
In the near term, however, there is potential for rates to remain somewhat range-bound until there is more clarity with respect to the actual path of policy "normalization" planned by central banks.

Further, while the path of least resistance may ultimately prove to be higher, the fact that so much tightening has already been priced into the front-end of the curve creates asymmetric risks, with the potential for repricing against the not insignificant odds of a more tepid than expected response from central banks possibly resulting in downward pressure on rates for shorter maturity bonds.

As such, shorter duration fixed income securities would appear to provide better relative value than those with longer maturities at the moment — and the now-higher coupon available serves to provide a larger cushion against any potential further rate increases.

CHART 27: ADDED PADDING

Ratio of yield-to-duration for US Treasury securities
(basis points)



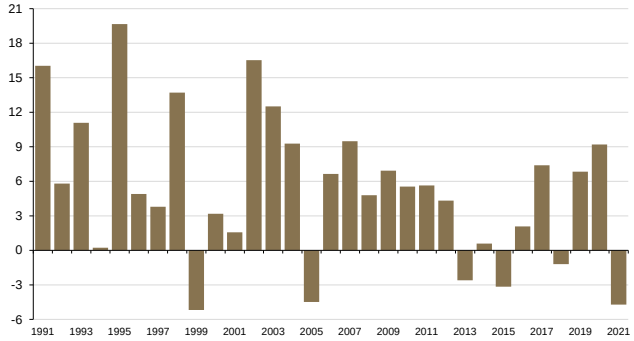
**Rise in yields required to wipe out 1-year total return; data to January 21, 2022; shaded regions represent periods of US recession*
Source: Bloomberg, Guardian Capital

When the credits roll

More generally, however, a rising rate environment does not exactly make for a compelling outlook for fixed income securities given that prices move inversely to yields. While it has not happened in the last three decades, it may well be different this time as forecasts suggest that 2022 could see the second straight year of negative performance for the broad asset class.

CHART 28: UNHAPPY RETURNS

Bloomberg Global Aggregate Bond Index total return[8]
(percent)



Data to December 31, 2021; Source: Bloomberg, Guardian Capital

All fixed income assets are not created equal, however, and there does appear to be some value available in the corporate credit space.

The combination of higher yields and lower average duration on corporate debt versus that of governments means that corporate credit offers an added buffer against rising market interest rates.

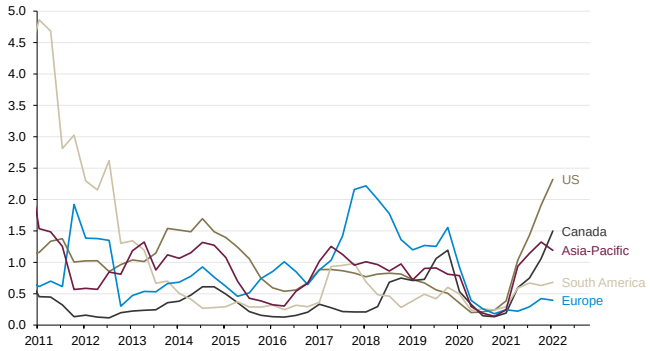
Furthermore, a backdrop of firm inflation underpinned by strong demand is constructive for credit since companies tend to be able to pass any cost increases onto customers via higher prices, effectively insulating corporate margins and supporting profitability.

As well, fundamentals in corporate credit have improved over the last two years (in contrast to governments, where increased debt burdens have eroded the health of balance sheets), with leverage ratios and interest burden relatively low — the latter a product of firms taking advantage of the ultra-low rates on offer in the market to refinance.

Default rates globally have plunged while the ratio of credit rating upgrades-to-downgrades has trended for the better across all regions globally.

CHART 29: (UP)GRADING ON A SCALE

Ratio of S&P credit rating upgrades-to-downgrades
(ratio; 12-month moving average)



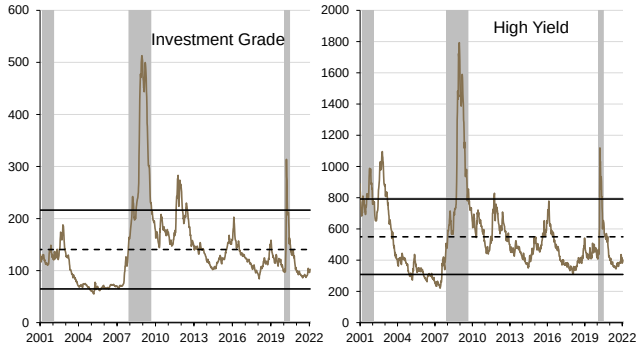
Data to January 21, 2022
Source: Bloomberg, Guardian Capital

The outlook suggests that credit events should remain limited in the days ahead, barring some shock to the system, keeping pressure on credit risk premia and supporting asset class performance.

However, while credit risk exposure seems to offer more upside potential than interest rate risk, from an absolute return perspective there is fairly limited compensation for assuming that risk, as it stands, as credit spreads remain at the lower end of the historical range. This market tightness is something particular of note for the more speculative end of the market, where investors' hunt for yield has compressed spreads and leaves these securities more vulnerable to a change in market sentiment.

CHART 30: SPREAD 'EM

Global option-adjusted bond yield spreads
(basis points)



Data to January 21, 2022; shaded regions are periods of US recession; dashed line is average; black lines are +/-1 standard deviation
Source: Bloomberg, Guardian Capital

Earned it

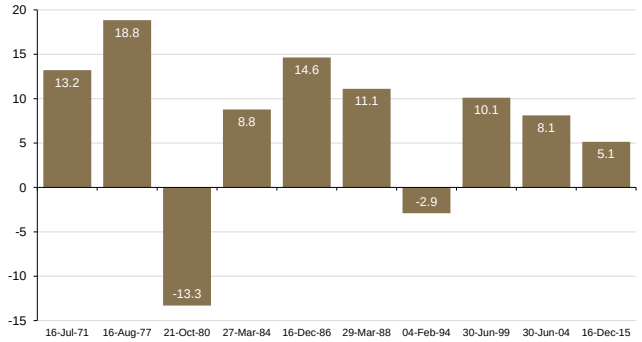
Despite ongoing challenges and risks that cloud the forecast horizon, the general macroeconomic outlook appears to look as though it will continue to be constructive for equity market performance.

Clearly, concerning stimulus, less is not as supportive as more, but it is important to realize that when policy accommodation is being withdrawn it is because the economy is judged as being quite strong.

Indeed, historically, the first forays into policy tightening have been taken in stride by the stock market. The MSCI World Index[9] has increased over the year following eight of the last 10 first rate hikes by the US Federal Reserve (Fed), and by an average of 7.4% (median 6.7%).

CHART 31: NOT A KILLSHOT

MSCI World Index[9] return 12-months after first Fed hike
(percent)



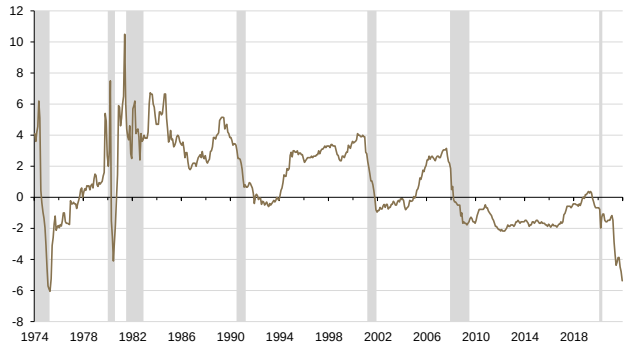
Source: Bloomberg, Guardian Capital

From a fundamental perspective, there is good reason to anticipate that the months ahead should see history repeat itself in this sense.

For starters, the beginning of a tightening cycle does not mean that policy has suddenly shifted to being "tight". Monetary policy is very much on the "easy" side of the dial, with liquidity still ample and credit conditions easy, and real (or inflation-adjusted) policy rates remain deeply in negative territory.

CHART 32: WELL BELOW ZERO

Real fed funds rate target*
(percent)

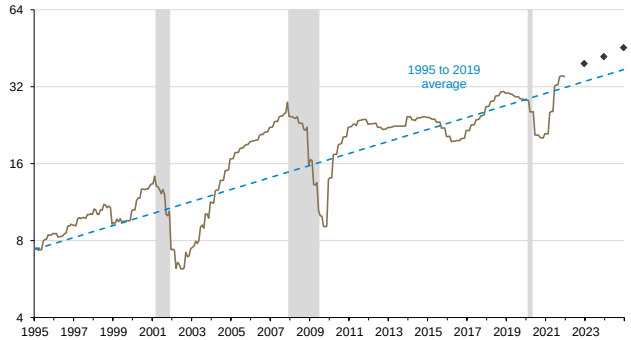


**mid-point of fed funds rate target less year-over-year percent change in core consumer price index; data to December 2021 shaded regions are periods of US recession; Source: Bloomberg, Guardian Capital*

More importantly, the anticipation for above-pre-crisis-trend economic growth in 2022 coincides with consensus forecasts for earnings growth to hold above their long-term trends as well — albeit, like economic growth, profit expansion is expected to slow from the accelerated pace recorded in 2021.

CHART 33: STAYING ABOVE THE LINE

MSCI All Country World Index[10] (MSCI ACWI) earnings per share
(US dollars; log scale)

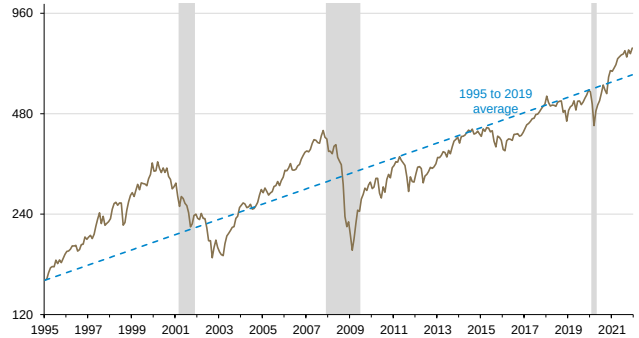


Data to December 2021; dots represent consensus full-year forecasts as at January 21, 2022; shaded regions are periods of US recession
Source: Bloomberg, Guardian Capital

History shows that above-trend earnings growth has meant above-trend average equity market performance — creating the potential for another year of good returns.

CHART 34: GOOD OMENS

MSCI All Country World Index[10]
(index; log scale)



Data to December 2021; shaded regions are periods of US recession
Source: Bloomberg, Guardian Capital

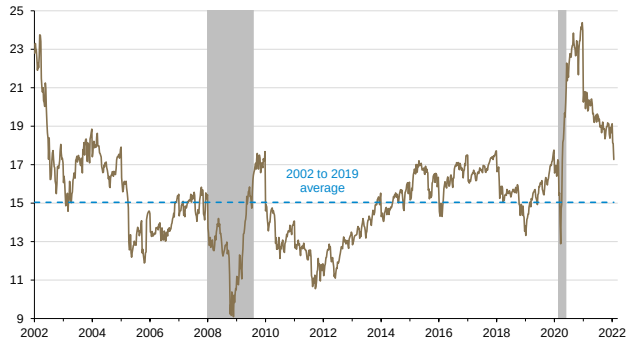
Of course, this underlying support does not preclude the possibility of market corrections against swings in sentiment — the start of the year, so far, can serve as proof of that.

The ample uncertainty with respect to the progress of the pandemic, geopolitics (particularly rising tensions with China and Russia, and the impending midterm election in the US), and the path of monetary policy are likely to keep market volatility elevated and create bouts of investor angst.

That will likely keep upward pressure on equity risk premia, compounding the impact of the rising market interest rates and work to further compress equity market valuations — price-to-earnings multiples have come down markedly from earlier, as earnings have made good on the promise implied by the post-crisis market rally, but still remain historically elevated.

CHART 35: FEELING COMPRESSED

MSCI ACWI[10] **forward price-to-earnings ratio**
(ratio)

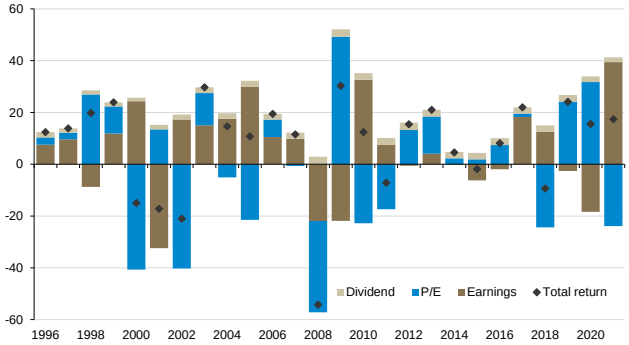


Data to January 21, 2022; shaded regions are periods of US recession
Source: Bloomberg, Guardian Capital

So, valuations are likely to restrain equity performance following three very strong years, but a constructive backdrop should be supportive for continued decent earnings-driven performance in the year ahead nonetheless.

CHART 36: BREAKING IT DOWN

Decomposition of MSCI ACWI[10] **total return**
(year-over-year percent change)



Data to December 2021; source: Bloomberg, Guardian Capital

Change is gonna come

Change can be difficult to digest, especially at first, and the attendant uncertainty that comes with the change in the policy environment likely means that volatility will remain elevated over the near-term.

As the dust settles and the outlook clears, especially if the pandemic begins to subside in earnest as anticipated (a very welcome change), it appears that the constructive macroeconomic fundamentals should keep growth momentum on a decidedly upward trajectory.

The strength in consumer finances, potential upswing in business investment and the boost associated with a broader/full reopening of activity (especially in services) should mean that the economy can absorb modestly higher interest rates. Additionally, it is important to recognize that interest rates globally are still at historically low levels and real rates remain deeply in negative territory, while the likes of European Central Bank and Bank of Japan are maintaining highly accommodative monetary policies and continuing to add liquidity into the financial system.

That suggests that the odds remain low that monetary tightening this year will be sufficient to knock global economic growth off its track.

As the expansion matures further out on the forecast horizon, however, the question of whether this time will be different will again rise. Central banks have historically struggled to calibrate monetary policy in such a way that financial conditions do not tighten too much, too quickly — and ultimately efforts to find a remedy for inflationary pressures end up being worse for growth than the disease itself.

Balanced fund summary views

Equities	+	Fixed Income	—
Canadian Equity	+	Government Bonds	—
US Equity	+	Investment Grade Credit	+
EAFE Equity	+	High Yield Credit	Neutral
Emerging Markets	Neutral		

Source: Guardian Capital as at January 21, 2022

Market Returns at December 31, 2021 All returns in USD except where noted.

CANADIAN EQUITIES – CAD

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P/TSX Composite	3.1	6.5	25.1	25.1	10.0	9.1
S&P/TSX 60	3.4	7.8	28.0	28.0	10.8	9.9
S&P/TSX Completion	1.7	1.9	14.9	14.9	7.4	6.8
S&P/TSX SmallCap	1.2	3.0	20.3	20.3	5.7	5.0
S&P/TSX Composite High Dividend	5.1	7.5	36.1	36.1	8.8	8.2
S&P/TSX Composite Dividend	4.7	7.9	27.8	27.8	9.5	9.4

S&P/TSX SECTOR RETURNS (%) – CAD

Communication Services	3.8	4.8	24.7	24.7	9.1	10.3
Consumer Discretionary	7.3	7.8	18.4	18.4	10.5	15.0
Consumer Staples	9.2	7.8	22.4	22.4	9.9	15.9
Energy	2.6	5.7	48.9	48.9	0.2	1.3
Financials	6.2	9.4	36.5	36.5	11.6	13.3
Health Care	-5.6	-18.3	-19.6	-19.6	-9.0	-10.9
Industrials	-0.2	5.0	16.5	16.5	14.9	15.5
Information Technology	-6.6	-1.4	18.5	18.5	36.0	26.2
Materials	3.4	10.7	4.0	4.0	8.8	1.0
Real Estate	6.5	9.2	37.4	37.4	11.8	12.2
Utilities	5.9	5.4	11.6	11.6	12.3	8.9

U.S. EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P 500	4.5	11.0	28.7	28.7	18.5	16.6
Dow Jones Industrial Average	5.5	7.9	20.9	20.9	15.5	14.2
NASDAQ	0.7	8.3	21.4	21.4	23.8	19.6
Russell 1000	4.1	9.8	26.5	26.5	18.4	16.5
Russell 2000	2.2	2.1	14.8	14.8	12.0	13.2
Russell 3000	3.9	9.3	25.7	25.7	18.0	16.3
Russell 1000 Growth	2.1	11.6	27.6	27.6	25.3	19.8
Russell 1000 Value	6.3	7.8	25.2	25.2	11.2	13.0

S&P 500 SECTOR RETURNS (%)

Communication Services	2.5	0.0	21.6	21.6	11.5	11.6
Consumer Discretionary	-0.3	12.8	24.4	24.4	21.3	19.6
Consumer Staples	10.3	13.3	18.6	18.6	11.8	12.2
Energy	3.1	8.0	54.6	54.6	-1.4	1.2
Financials	3.3	4.6	35.0	35.0	13.3	16.3
Health Care	9.0	11.2	26.1	26.1	17.6	17.2
Industrials	5.3	8.6	21.1	21.1	12.8	14.2
Information Technology	3.4	16.7	34.5	34.5	32.1	24.0
Materials	7.6	15.2	27.3	27.3	15.1	12.8
Real Estate	10.2	17.5	46.2	46.2	14.9	N/A
Utilities	9.6	12.9	17.7	17.7	11.8	11.1

INTERNATIONAL EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
MSCI World Index (Net, US$)	4.3	7.8	21.8	21.8	15.0	12.7
MSCI EAFE Index (Net, US$)	5.1	2.7	11.3	11.3	9.5	8.0
MSCI ACWI (US$)	4.0	6.7	18.5	18.5	14.4	11.9
MSCI France (US$)	7.1	7.1	19.5	19.5	11.9	9.8
MSCI Germany (US$)	5.6	0.8	5.3	5.3	7.1	8.2
MSCI Japan (US$)	1.9	-4.0	1.7	1.7	8.5	8.3
MSCI UK (US$)	7.3	5.6	18.5	18.5	6.2	5.1
S&P/IFC Investable (Emerging Markets)	2.3	-1.0	0.4	0.4	10.5	6.5
MSCI EAFE Growth (Gross, US$)	4.3	4.1	11.6	11.6	14.0	10.5
MSCI EAFE Value (Gross, US$)	6.0	1.2	11.6	11.6	6.0	6.4

INTERNATIONAL EQUITIES

MSCI EAFE SECTOR RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	-0.5	-5.6	-5.7	-5.7	3.5	4.7
Consumer Discretionary	3.7	2.9	10.7	10.7	10.8	10.5
Consumer Staples	6.2	5.2	7.3	7.3	8.3	7.7
Energy	6.1	-0.5	22.9	22.9	1.6	0.1
Financials	5.9	1.2	16.6	16.6	5.6	7.3
Health Care	5.2	3.0	8.6	8.6	12.1	10.4
Industrials	6.3	2.6	13.5	13.5	11.7	9.6
Information Technology	3.9	3.8	20.9	20.9	20.2	14.0
Materials	7.1	5.9	10.4	10.4	12.6	6.9
Real Estate	2.3	-0.5	4.1	4.1	4.0	N/A
Utilities	6.1	8.8	0.0	0.0	10.4	6.0

Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

Market Returns at December 31, 2021 All returns in USD except where noted.

CANADIAN FIXED INCOME – CAD

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada 91 Day TBill	0.0	0.1	0.2	0.2	0.9	0.9
FTSE Canada Short Term Overall Bond	0.4	-0.5	-0.9	-0.9	1.9	2.0
FTSE Canada Mid Term Overall Bond	1.1	0.3	-2.7	-2.7	3.1	3.5
FTSE Canada Long Term Overall Bond	3.6	4.8	-4.5	-4.5	5.3	4.8
FTSE Canada Universe Bond	1.7	1.5	-2.5	-2.5	3.3	3.3
FTSE Canada High Yield Overall Bond	0.4	0.0	6.2	6.2	6.7	6.8
FTSE Canada Real Return Bond Overall	3.6	6.4	1.8	1.8	4.6	3.0

SECTOR RETURNS (%) – CAD

FTSE Canada Federal Bond	1.2	0.8	-2.6	-2.6	2.1	2.2
FTSE Canada Provincial Bond	2.2	2.4	-3.3	-3.3	4.0	3.8
FTSE Canada All Corporate Bond	1.5	1.1	-1.3	-1.3	3.9	4.1

GLOBAL FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE World Government Bond	-0.6	-1.1	-7.0	-7.0	2.9	1.0

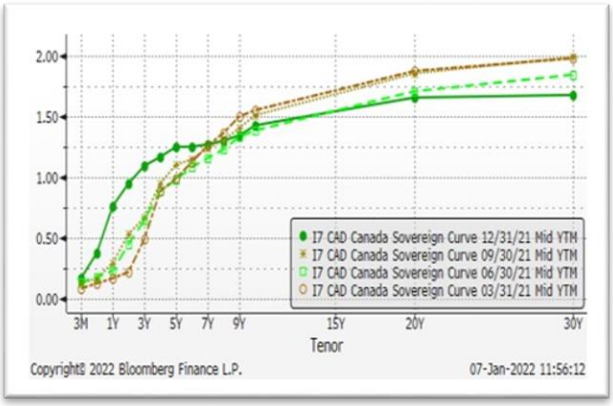
COMMODITY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Bloomberg WTI Cushing Crude Oil Spot Price	16.3	2.6	58.7	58.7	7.5	-2.5
Bloomberg European Dated Brent BFOE Price	11.1	-1.7	51.4	51.4	6.9	-3.2
Edmonton Crude Oil Syncrude Sweet Blend FOB Spot	14.0	-1.2	64.0	64.0	6.4	-3.3
S&P GSCI Nat Gas Index Spot	-18.3	-36.4	46.9	46.9	0.0	2.2
S&P GSCI Copper Index Spot	2.8	9.0	25.5	25.5	12.0	2.5
S&P GSCI Gold Index Spot	2.9	4.1	-3.5	-3.5	9.7	1.6

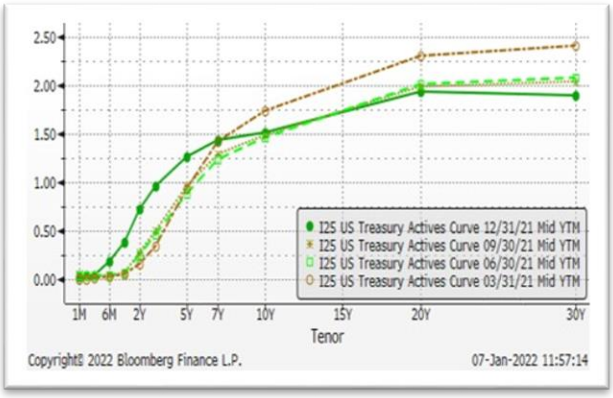
CURRENCY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
CAD/USD (% chg)	3.1	0.6	1.7	1.7	2.5	-4.2
CAD/Yen (% chg)	-1.4	-3.1	-10.3	-10.3	0.3	-3.9
CAD/GBP (% chg)	2.4	0.5	-0.9	-0.9	1.9	-1.4
CAD/Euro (% chg)	1.0	-1.9	-7.1	-7.1	1.5	-1.3

GOVERNMENT OF CANADA YIELD CURVE



U.S. TREASURY YIELD CURVE



Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson

For definitions of the indices listed above, please contact Alta Capital Management at compliance@altacapital.com.

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The information and statistics contained in this report have been obtained from sources we believe to be reliable but cannot be guaranteed. Any projections, market outlooks or estimates in this letter are forward-looking statements and are based upon certain assumptions. Other events which were not taken into account may occur and may significantly affect the returns or performance of these investments. Any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur. These projections, market outlooks or estimates are subject to change without notice. Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. All indexes are unmanaged and you cannot invest directly in an index. Index returns do not include fees or expenses. Actual client portfolio returns may vary due to the timing of portfolio inception and/or client-imposed restrictions or guidelines. Actual client portfolio returns would be reduced by any applicable investment advisory fees and other expenses incurred in the management of an advisory account. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Alta Capital Management, LLC. To the extent that a reader has any questions regarding the applicability above to his/her individual situation of any specific issue discussed, he/she is encouraged to consult with the professional advisor of his/her choosing.

February 2022

FOOTNOTES

[1] Abdullah, F. et. Al., *Decreased severity of disease during the first global omicron variant covid-19 outbreak in a large hospital in tshwane, south Africa,* International Journal of Infectious Diseases, Volume 116, March 2022, Pages 38-42. *https://www.sciencedirect.com/science/article/pii/S120197122101256X*

[2] Oxford Covid-19 Government Response Tracker (OxCGRT) collects systematic information on policy measures that governments have taken to tackle COVID-19 and are scored into a suite of policy indices, and reported in the COVID-19 Stringency Index. This index is a composite measure based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest). Source: University of Oxford, COVID-19 Government Response Tracker *https://www.bsg.ox.ac.uk/research/research-projects/covid-19-government-response-tracker*

[3] US Federal Reserve, *Distribution of Household Wealth in the U.S. since 1989*, Distributional Financial Accounts to Q3 2021, Last Updated December 17, 2021. *https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/chart/#range:1989.3,2021.3;quarter:128;series:Net%20worth;demographic:networth;population:all;units:levels*

[4] Statistics Canada, *Distributions of household economic accounts for wealth of Canadian households, first and second quarters of 2021*, The Daily, Released October 26, 2021. *https://www150.statcan.gc.ca/n1/daily-quotidien/211026/dq211026b-eng.htm*

[5] The OECD Business Confidence Index is a composite measure for the 38 OECD member countries that provides information on future developments, based upon opinion surveys on developments in production, orders and stocks of finished goods in the industry sector.

[6] The ISM Report On Business, also known as the ISM Report, is the collective name for two monthly reports, the Manufacturing ISM Report On Business and the Non-Manufacturing ISM Report On Business, published by Institute for Supply Management.

[7] A composite index of CEO plans for capital spending and employment, and expectations for sales over the next six months. Source: Business Roundtable, CEO Economic Outlook Index: U.S. Businesses Expect Strong First Half of 2022, See Risks from New COVID Variants, Tax Increases, released December 1, 2021. https://www.businessroundtable.org/media/ceo-economic-outlook-index.

[8] The Bloomberg Global Aggregate Bond Index is a flagship measure of global investment grade debt from twenty-four local currency markets.

[9] The MSCI World Index captures mid- and large-cap representation across 23 developed market countries.

[10] The MSCI All Country World Index is a market capitalization weighted index of equities in both Developed and Emerging Markets.