3Q22 | MARKETS FIXATED ON THE FINE PRINT OF U.S. FEDERAL RESERVE COMMUNICATIONS

INVESTMENT ENVIRONMENT

- Markets remain concerned that the U.S. Federal Reserve will continue to move too far and too fast in the fight to tame inflation.

EQUITY MARKETS

- Escalating macro concerns damaged sentiment and reversed an intra-quarter rally. Past peaks in bearishness often coincided with market bottoms.

FIXED INCOME MARKETS

- Yields on short term bonds moved sharply higher and mid duration bonds quickly adjusted to revised central bank forecasts.

INVESTMENT ENVIRONMENT | PRICE DISCOVERY IN A TIME OF FED HAWKISHNESS

Financial markets began the quarter with a promising rally that was neutralized by shifting expectations for the path forward for U.S. Federal Reserve (The Fed) actions. Enthusiasm regarding a potential near-term pivot towards easing monetary policy faded as The Fed continued to aggressively raise rates and detailed a strong resolve to contain elevated inflation.

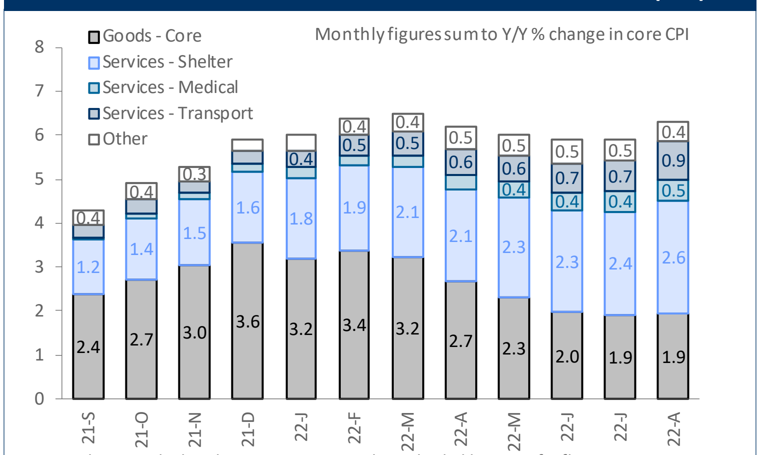
As the year has progressed, the narrative surrounding inflation evolved from a focus on headline numbers including food and energy to more of a spotlight on core items. With this in mind we pulled data from the U.S. Bureau of Labor and Statistics to better understand individual core components contribution to the Consumer Price Index to gain insight to what was driving the numbers. **Findings from this analysis reveal that while core inflation readings remain near recent highs, the source of pressure has rotated from rising goods prices to increasing service costs (Figure 1).** Shelter now represents the single largest component of inflation taking the mantle from core goods earlier in the year.

Although it is difficult to forecast inflation, we do endeavour to understand certain high-level drivers that could meaningfully influence future releases. To that end, we can look to industry data to gain real-time insight to important inputs. **Differing methodologies of measurement and certain pass-through considerations prevent direct read through to government statistics, though it is encouraging to see marketplace sourced accommodation rental and used car pricing decelerate from recent highs (Figure 2).** Continued strength in the labour market will likely support additional rate hikes by The Fed, though lags between these actions and their filtering through the economy argue for more measured moves beyond what has been explicitly messaged in the near-term.

Europe continues to adapt to the war in Ukraine as several countries have introduced windfall taxes on electricity producers to fund consumer relief with winter approaching and Russian sourced natural gas supply remaining disrupted. The protracted conflict has likely contributed to an already growing number of reshoring initiatives to North American soil initially motivated by supply chain struggles brought on by Covid-19. Recent U.S. government initiatives such as the Chips and Science Act and the Inflation Reduction Act provide further incentive for multi-national corporations to reimagine their manufacturing footprints and may portend a longer-term trend.

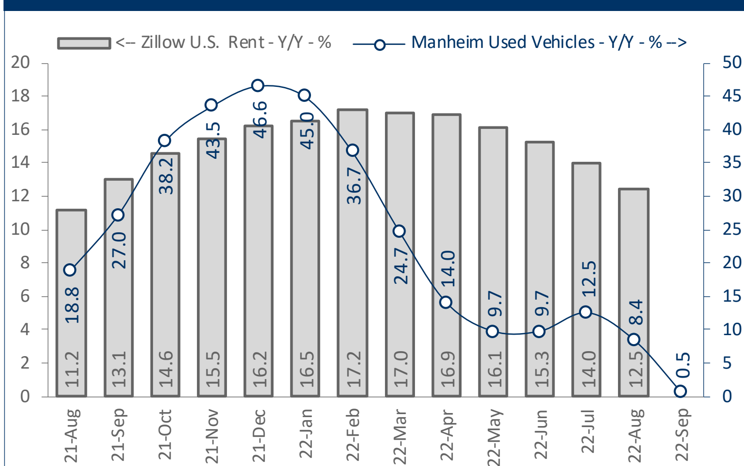
Despite several challenges, it is important to recall that markets operate as a discounting mechanism for future expectations. Exchanges have quickly priced in hawkish Fed economic projections that have been very fluid in recent times and could yet change again soon. Interestingly, time periods of elevated bearish sentiment have often preceded rebounds which is a topic we expand upon in the Equity Markets section that follows. September is host to many investor conferences and offers up some corporate "boots on the ground" commentary in the face of relentless macro discussion in the financial press. With notable exceptions, industrials highlighted a relatively healthy demand environment, and consumer names offered a nuanced view with food products seemingly better positioned than retail goods at this time. In aggregate, companies appear more enthusiastic about their prospects relative to the headlines currently dominating the media.

FIGURE 1: EVOLVING CORE U.S. INFLATION PRESSURES (CPI)



Contribution calculated as component weight multipled by rate of inflation
Source: U.S. Bureau Of Labor Statistics (Some Rounding May Occur)

FIGURE 2: HIGH FREQUENCY INFLATION INPUTS DECELERATING



Source: Bloomberg | Note that Zillow U.S. Rent data yet to be updated for September

EQUITY MARKETS | FALSE START LOSES STEAM AS QUARTER PROGRESSES

Equity Index Returns				
	3Q22 (CAD)	3Q22 (USD)	YTD22(CAD)	YTD22(USD)
Global (Net)	-0.1%	-6.2%	-18.9%	-25.4%
Canadian	-1.4%		-11.1%	
CDN Small Cap	-2.5%		-16.0%	

An encouraging rally in July could not sustain momentum through the duration of the quarter as The Fed continued to rapidly raise rates and reiterate a commitment to rein in high inflation. An absence of positive surprises related to pre-existing issues such as the war in Ukraine did little to lessen growth concerns and general sentiment remained subdued.

Worries about the economy have dominated the narrative of late and are readily apparent in market psyche. **The American Association of Individual Investors measures negative sentiment at levels not witnessed since the time of the Global Financial Crisis (Figure 3). Interestingly, past peaks in bearishness have often coincided with market bottoms.**

BIM EQUITY FRAMEWORK

Despite a slowing trajectory of revenue growth, most companies retain a relatively optimistic outlook for the remainder of the year while acknowledging certain headwinds. Forecasting uncertainty has increased as the sustained pass through of cost inflation could test elasticity of demand, though industries with healthy order backlogs are less at risk. Companies with greater exposure to cyclical end markets that have come off peak conditions have been less sanguine in their commentary and in some cases have pre-emptively reduced guidance eliciting weakness in their share price and peer group.

Inflation has been a broad based source of margin pressure for companies over the past two years. While expected to persist in the near term, there are some pockets of improvement that have recently started to surface. Logistics costs, supply chain constrains and commodity prices are examples of this, which should help offset other areas that are exhibiting worsening inflation trends. Companies that have been disproportionally hurt by these items may get some relief in the near term. More broadly, we are always on the lookout for businesses with leadership positions that could emerge from a period of macro uncertainty with increased market share or greater competitive advantage and interesting value opportunities have opened up in the current environment.

GLOBAL MARKETS

Global companies with greater exposure to European and Asian economies have experienced a higher level of concern over growth rates. China continues its struggle to move beyond Covid lockdowns and Europe is faced with critical questions regarding availability of natural gas. As a result, companies with more exposure to these regions have seen their share prices fall much more than average, not to mention the weakening currency pressures as well. This has also dragged down the share prices of certain high-quality companies with global exposure, even if their revenues are not as tied to the economic cycle. This is one area where we are currently finding more attractive opportunities.

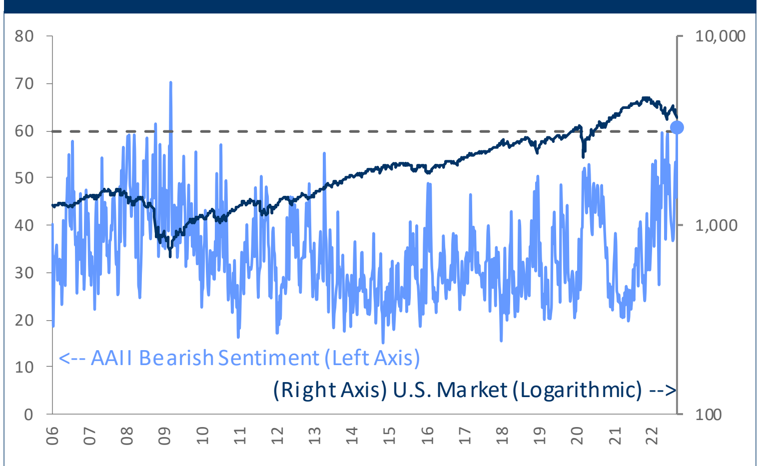
An example of this would be in our long-term holding of Thermo Fischer which has operations all over the world. They are a key provider of tools for pharmaceutical companies to create new drugs as well as analytical instruments used in a variety of industries. Their revenues have become increasingly less cyclical than the average company and are well positioned for long term structural growth despite near term uncertainty in the economic environment.

CANADIAN ALL-CAP MARKET

While most Canadian listed equities have a majority of their operations in their home country, a good number have established global footprints across several geographies. Such expansions are underpinned by long-term business opportunities, though during periods of volatility, the translation of financial results into Canadian dollars can either be bolstered or hindered by currency swings. The U.S. dollar has been a key beneficiary of recent developments due to an aggressive central bank, relative economic strength, and a general flight to safety, while many other major currencies have weakened (Figure 4).

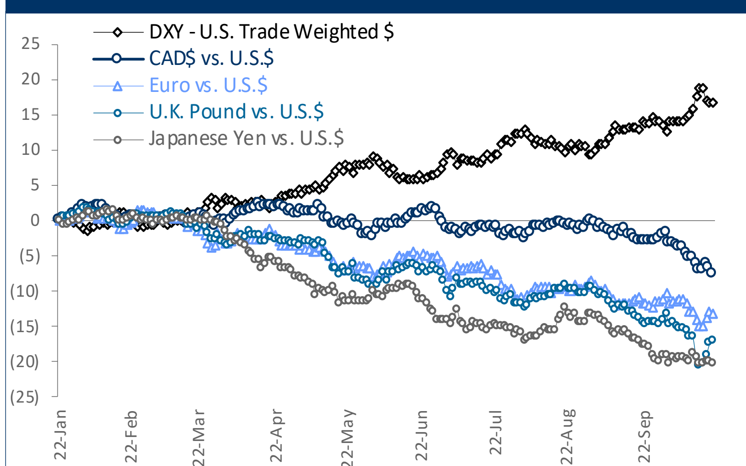
All else being equal, companies with meaningful operations south of the border will enjoy a bit of a tailwind should the strength of the U.S. dollar persist. Canadian based businesses can also benefit should their products be tied to an international market as is the case for commodities. For example, energy producers have locally denominated operating costs while selling products tied to global benchmarks priced in U.S. dollars. This dynamic alongside well publicized geopolitical and supply concerns helps to explain why the energy sector has held up well in the face of economic uncertainty that would historically have led to weak performance.

FIGURE 3: BEARISH SENTIMENT AND MARKET BOTTOMS



Source: Bloomberg

FIGURE 4: U.S. DOLLAR CONTINUES TO CLIMB



Source: Bloomberg - % Change Indexed To Beginning Of 2022

CANADIAN SMALL-CAP MARKET

The risk off tone prevailed during the period with large intra-quarter swings for many stocks. We have written previously that in periods of heightened volatility and negative sentiment, small caps can bear an oversized share of the burden. This year has been especially volatile, so we researched the historical data.

Year-to-date 2022, ~60% of trading days for the Small Cap index returned greater than +/-1%, more volatile than any calendar year period we examined back to the year 2000. To provide context for the above figure, this is higher than the credit crisis (2008: ~50%) or the COVID crash (2020: ~45%), more than double the average over the period (~25%) and ~10x a low-vol year (2019: 6%).

We raise the point as evidence that it is emotion, rather than fundamentals currently driving markets, which can lead to dislocations that plant the seeds for future attractive returns. This bears out in the data for small caps, as well as the broader large cap Canadian and U.S. exchanges: after periods of excess volatility, (1) future expected returns were considerably higher than average, and (2) the probability of seeing positive future returns increased.

Like a pendulum, investors rarely experience an "average" environment, and equities often overshoot when sentiment swings to heightened fear and volatility. Enduring these periods of pain paves the way for higher expected future returns.

BIM EQUITY THESIS SPOTLIGHT

RWE is a German based electric utility and global leader in renewable energy generation (offshore/onshore wind, solar, hydropower, biomass, natural gas, and batteries/storage). Geographically, RWE has a large renewable presence in Germany, U.K., and the U.S., but also has renewable operations in Italy, Spain, Poland, and France. The current energy crisis in Europe has lifted the need for energy security and renewable investments in the region which triggered the launch of the multi-billion REPowerEU energy initiative earlier this year. With RWE's excellent track record in commissioning, financing, and operating renewable power generation, they are expected to be a key beneficiary of this program. Elsewhere in the world, countries are also incentivized to build out their green initiatives, including using government stimulus packages such as the Inflation Reduction Act in the U.S.

RWE will invest heavily into renewable generation in the coming years, with clear near-term project commissioning targets and a robust pipeline. While the majority of RWE's renewable generation is long term contracted, the company stands to benefit in the short-to-medium term from its merchant exposure to an elevated power price and a proposed EU price cap that is much higher than historical norms. Finally, RWE's shares trade at an attractive valuation relative to their global renewable peers, which is driven partly by the market's heightened concern regarding their European exposure.

FIXED INCOME MARKETS | SHORT END ROCKETS HIGHER; LONG END FINISHES SIMILAR TO PRIOR QUARTER END

Fixed Income Index Returns	3Q22	YTD22
Canadian	0.5%	-11.8%

The battle to control the narrative on inflation continues, as central banks around the globe maintain their focus on returning this measure to target levels. Year-to-date we have seen aggressive rate hikes from the Bank of Canada (BoC) and The Fed, raising rates by 300 basis points and more modest increases by the Bank of England and the ECB at 200 and 125 basis points respectively. The front loading of rate hikes by the BoC and The Fed have the futures market pricing a peak in rates around 4.50% in 2023 coinciding with The Fed's projection for median rates in 2023 at 4.625%. Chairman Powell continues to note that the future path for interest rates remains data dependent.

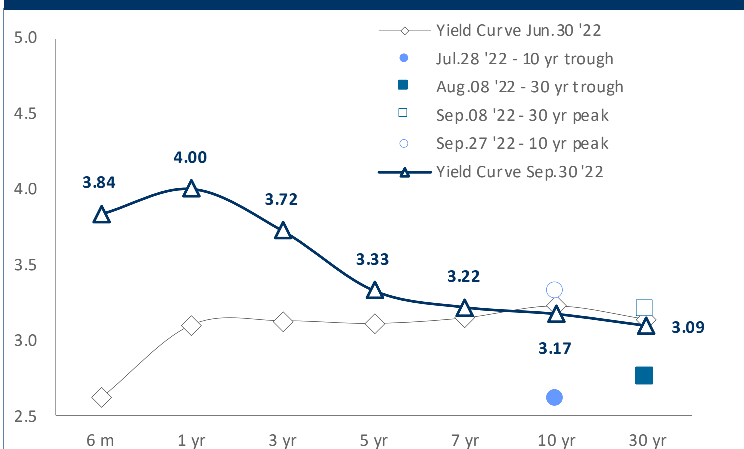
While continuing to surprise to the upside versus forecasts, several headline inflation measures trended lower into quarter-end. Similarly, the University of Michigan consumer survey reported a downtick in inflation expectations for respondents polled in September versus those contacted in June. Movements in shipping costs, used car prices, and rents also fed into the narrative that headline inflation may have peaked. A caveat to the discussion is the very strong labour market in the U.S. and Canada that could continue to influence wages higher as employers compete for a limited supply of available candidates. Nonetheless, absent an unforeseen supply shock, we would expect a couple remaining hikes into year-end prior to The Fed taking a pause to assess how their actions have impacted the economy with any further action driven by incoming data.

While the long-end of the government of Canada yield curve was almost unchanged from Q2-end to Q3-end, the intra-quarter volatility was something to behold. 30-year yields fluctuated 45 basis points, and the peak to trough move in the 10-year was 70 basis points. Also of note was the curve inversion at Q3-end with the 2-year outyielding the 30-year by 70 basis points (Figure 5). These actions resulted in the 10+ year end of the curve outperforming short and middle issues. Credit spreads widened over the quarter with a pickup in new issues that was particularly notable in non-bank sectors.

BIM FIXED INCOME FRAMEWORK

Central banks continue to closely monitor financial conditions and stress that further actions will depend on economic data. During the quarter we reduced the duration of the corporate holdings and focussed on liquidity with a mind that spreads could widen. Should volatility continue, we will look to take advantage of any dislocations that arise in the market. The yield to maturity of the portfolio at quarter end was 4.39%.

FIGURE 5: CANADIAN YIELD CURVE (%)



Source: Bloomberg

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