The Heward Global Leaders Investment Strategy

Summer 2021

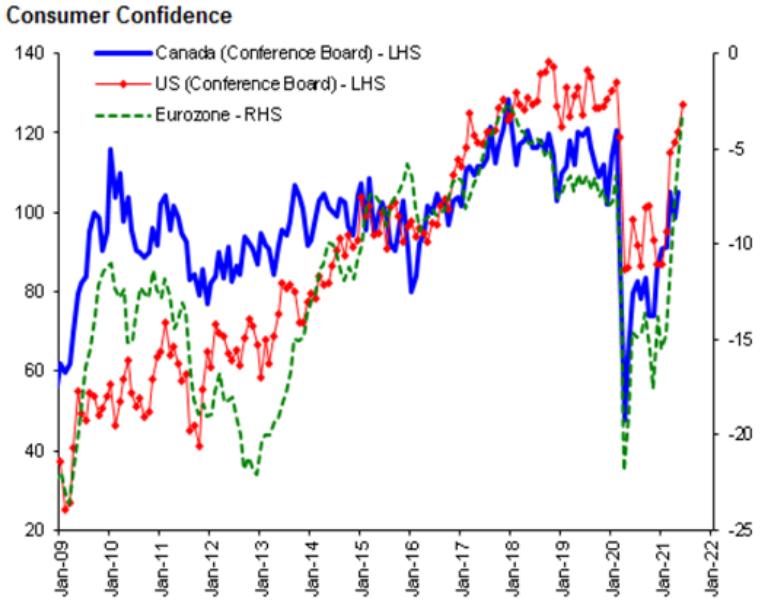
HEWARD
INVESTMENT MANAGEMENT INC.

"Anybody can jump a motorcycle. The trouble begins when you try to land it."

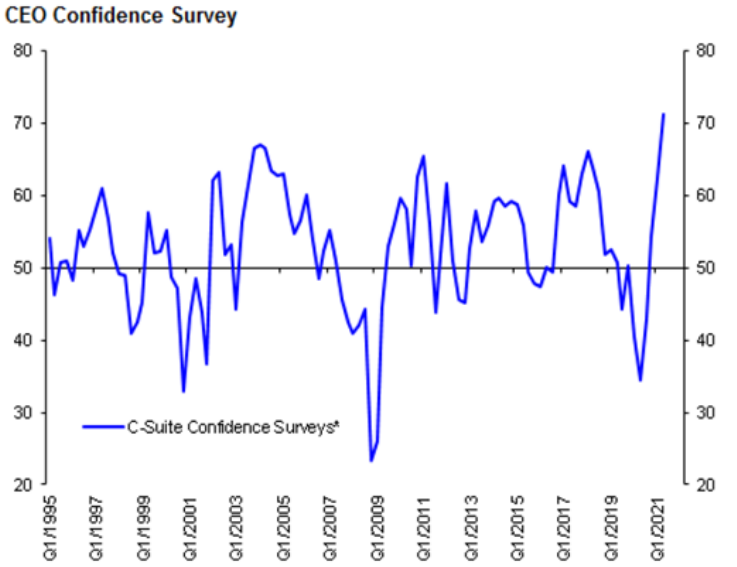
-Evel Knievel

Anyone who has studied economics or business realize that interest rates generally rise when economies are doing well. There is an old expression from bond traders that "Money Plus Confidence = Price" should be in play with rising interest rates given there is excess money (compliments of many global central banks) and excess confidence (rampant speculation perhaps?) in most asset classes. Yet with financial repression by central banks led by the US Fed with teammates being the European Central Bank, Bank of Canada and Bank of Japan, interest rates are being manipulated and being kept artificially low. The key debate that we are hearing is "how long can this go on for" given inflationary expectations and inflation conditions and the massive debts incurred around the world that need to be funded and eventually paid back (or inflated away?) As the quote above from legendary motor cycle stuntman Evil Knievel is applied to monetary policy, how we exit this mess and get on with things will be anyone's guess as to the outcome!

According to a recent Scotia Capital research report; "*In the US Conference Board's latest survey, the mood of U.S. consumers kept improving in June. Its confidence index surged seven points to 127, which is almost back to its pre-pandemic level of 132. To put things in perspective, the unemployment rate was much lower around 3.5% back then vs. a still-elevated 5.8% at this point. Readings of 130+ are also at the top end of the historical range. Consumers are feeling particularly upbeat about the job market prospects (just shy of the all-time high hit in July 2000). Moreover, they have rarely been this optimistic on future job prospects and future business conditions. Consumer confidence has been recovering rapidly across countries. Eurozone consumer confidence is almost back to its 2017 high, itself a 17-year high. The recovery appears somewhat behind in Canada, likely due to the COVID third wave in March/April/May which interrupted the overall improving mood (note that the June survey isn't out yet). High confidence levels are shared by top business executives, with business confidence surging to its highest level since at least the mid-2000s. Surging consumer confidence bodes well for discretionary spending, while strong business confidence levels should lead to higher capex, larger hiring plans, and more capital return to shareholders (buybacks & dividends).*



Source: Scotiabank GBM Portfolio Strategy, Bloomberg.



*Vistage, Business Roundtable & Conference Board CEO surveys + Duke CFO survey

Source: Scotiabank GBM Portfolio Strategy, Bloomberg.

A common theme across global markets this last quarter has been the expectation that US (and global) economic growth will peak this quarter as vaccine rollouts decelerate in many developed markets and the most disruptive restrictions are lifted. These concerns have now morphed into fears over a material growth deceleration in the 2nd half of the year

following weaker-than-expected economic data, a large decline in China's services PMI and spread of the Delta variant. Despite these worries, looking forward we remain constructive on the global economy and global markets. While we believe equity market volatility is likely to rise, we do not think this is the time to turn negative on equities given technology and innovation-driven growth, signs of a capex boom, and continued supportive monetary and fiscal policy.

After nearly six decades of falling interest rates, rates are ticking up, and the debate on inflation expectations is among the most critical topics facing equities. We believe the rapid price escalation in so many markets will take time to see if they are in fact "transitory" as claimed by the US Fed. Against the background of strong global growth, we would expect equity markets to weather rate hikes and the tapering of quantitative easing, as long as they are gradual and well-telegraphed. After years of uncertainties that have hamstrung companies' investment decisions, capex intentions have risen sharply, which is consistent with our view of the need to upgrade obsolete equipment especially given favorable financing conditions. With valuations generally high, selectivity is key to distinguish between companies with limited pricing power that are relying on cheap liquidity to fund their expansion from those with solid recurring revenues with sustainable business models.

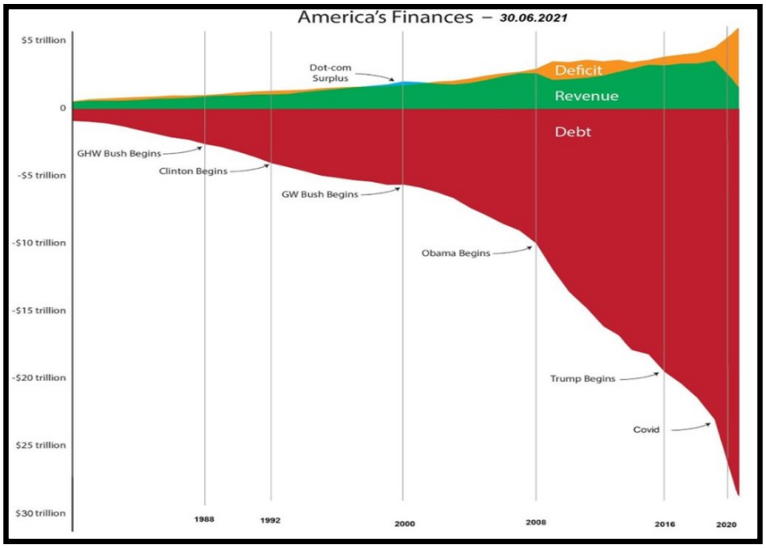
We see investment opportunities across the full spectrum of "growth" and "value," in companies with solid business models that are often cash-rich with impressive margins and strong cash flow generation. We view recent selloffs and volatility as opportunities to buy or add to such attractive names.

TECHNOLOGY AND "INNOVATION-DRIVEN" GROWTH

We view digitization, cloud technology and automation as critical long-term growth drivers in equity markets. Innovation is a key theme that is driving a radical shift in most business models in almost every industry. The goal for management's is to significantly reduce the cost of production while becoming ever more tailored to the end customer's needs, while trying to add higher levels of service and added value for the customer. The way companies achieve this will be important given the increasing costs and penalties associated with "Environmental, Social, and Governance (ESG)" expectations dealing with climate impacts, resource intensity, and labor practices. The speed of change is likely to be swift, testing management skill: yesterday's winners may not be tomorrows! We maintain solid exposure to these global leading companies that are adapting to this "new reality" and also focused on shareholder returns. For the record, it is not just in the technology and communication sectors, we own Mondelez and Nestle in the consumer sector where both companies are industry leading in their respective businesses and are constantly evolving and innovating and also generating good margins and returning money to shareholders via dividends.

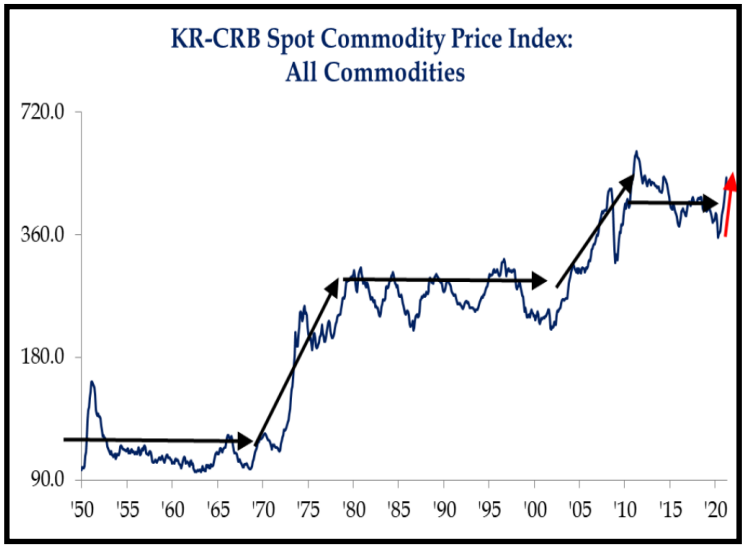
We have written about our investment stance towards owning gold and having exposure to precious metals and certain commodities. As Strategas Research wrote; "the gusto with which policymakers are embracing deficit spending globally leads us to be somewhat cautious on all fiat currencies, especially versus hard assets like crude oil and other extractive materials that are so critical to fully embrace the global subsidy for electric vehicles. We believe that we will see higher gold and silver prices in the years ahead as inflation and excessive government spending continues. Government largess is easy to implement but more difficult to stop (as legendary motor cycle stuntman Evil Knievel once described jumping a motor cycle is relatively easy, LANDING one is the challenge!)

RECENT INCREASES IN US GOVERNMENT DEBT ARE NOT NEW!!



Source: Blackrock, Ned Davis Research

… AND COMMODITIES HISTORICALLY HAVE MOVED IN LONGER CYCLES

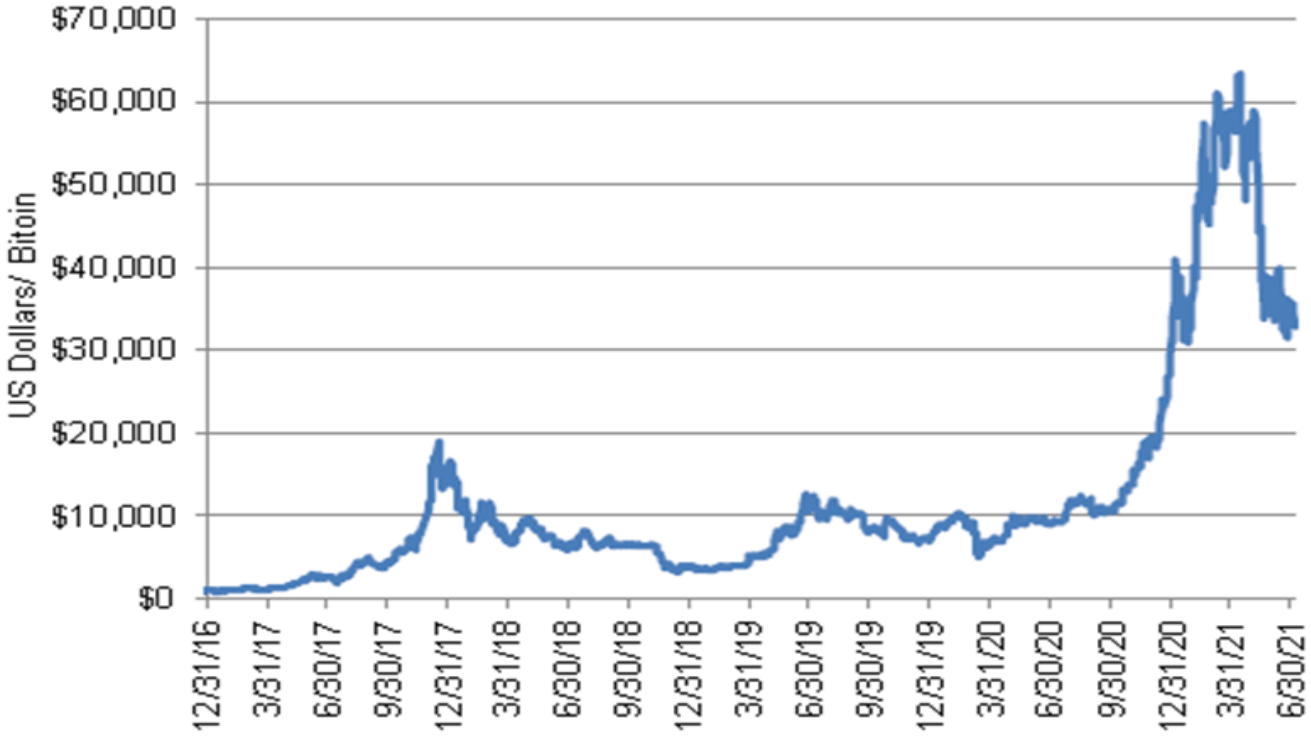


Source: Strategas Research Partners LLP.

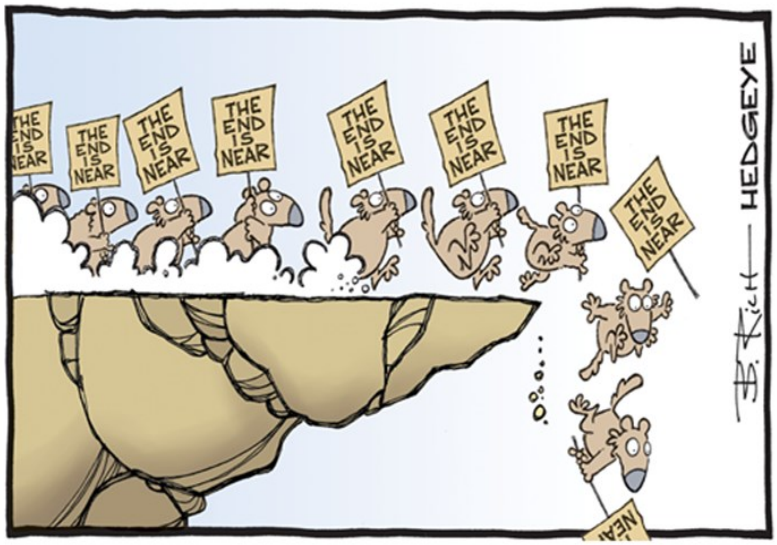
GOLD HAS RETREATED FROM 2020 HIGHS AS INVESTORS HAVE EMBRACED RISKIER ASSETS

SOURCE: Oppenheimer Research

Bitcoin traded on July 8, 2021 at around $32,815 about 48% below its all-time high of $63,410 reached on April 15, 2021. Bitcoin remains under pressure as China's central bank takes efforts to curb its usage in China and as regulators elsewhere around the world consider the potential risks it could present for institutions and consumers. In addition, other digital currencies have begun to chip away at bitcoin's first-mover advantage in the crypto-currency market. Caveat emptor?

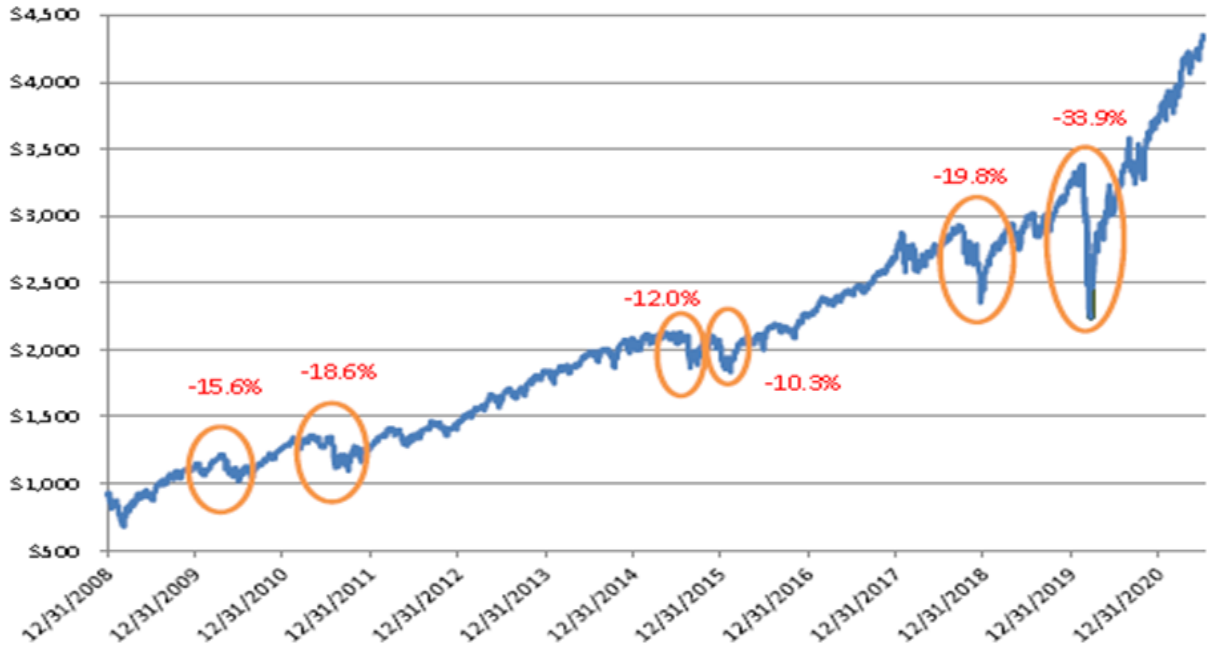


SOURCE: Oppenheimer Research



We constantly hear and read predictions of gloom and that stocks and markets have peaked. From 2008, despite the various issues affecting the world, markets have followed earnings and the path has been higher. Looking at markets, remember that pullbacks can take place when such a catalyst or confluences of catalysts appear. Investors should keep in mind that stocks tend not to move in a straight line higher unchallenged for long. However, such pullbacks (depending on the catalyst for profit-taking) can often present opportunities to buy "babies that get thrown out with the bathwater."

THE S&P 500 INDEX SINCE 2008:
CLIMBING THE WALL OF WORRY DOESN'T MEAN IT'S A STRAIGHT PATH UPWARD

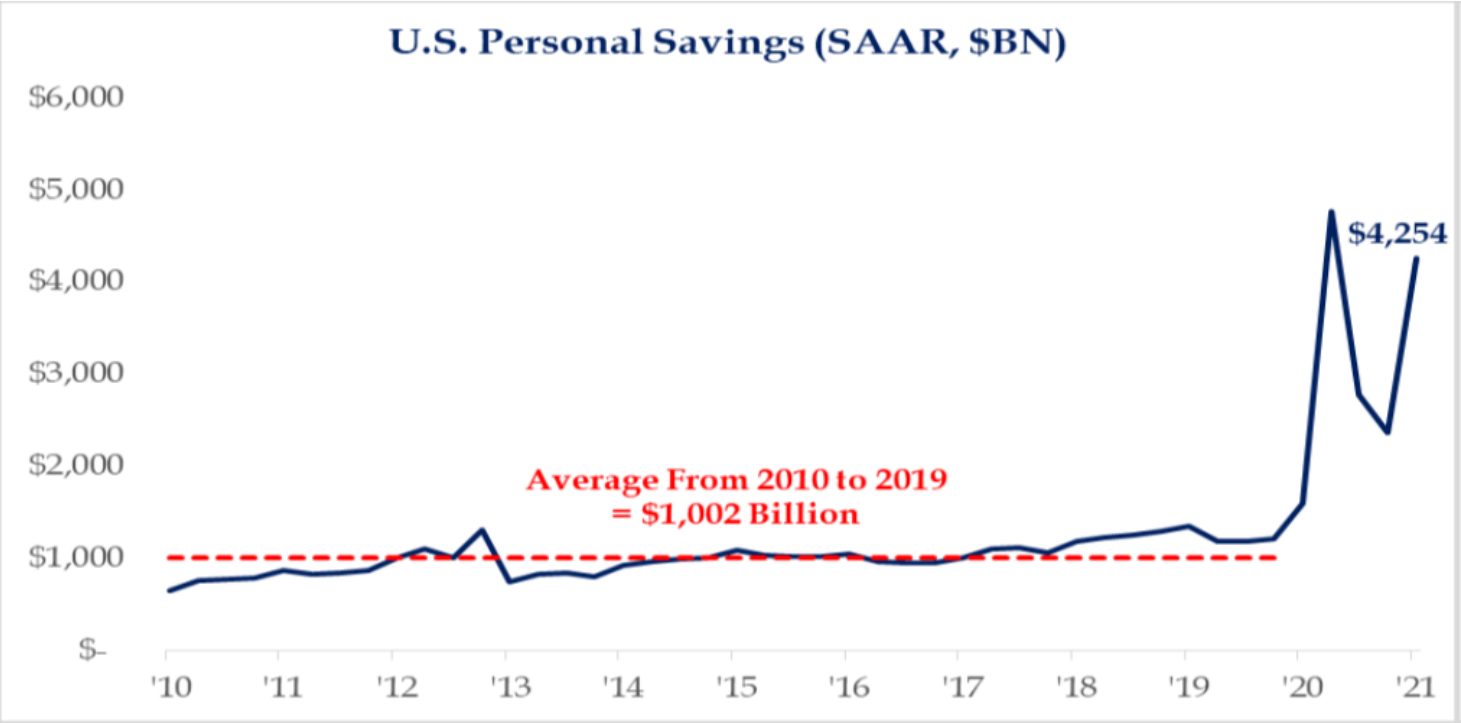


SOURCE: Oppenheimer Research

	Stock Market Growth (ex-dividends) July 1, 2008 – Dec 31, 2020	Annualized Real GDP Growth
U.S.	8.15%	1.46%
Japan	5.90%	0.33%
U.K.	2.42%	0.53%
Germany	6.42%	0.78%
Canada	1.55%	1.24%
Australia	2.26%	2.15%

Source: Pyrford International Q1, 2021

One of the reasons we remain positive on US and global growth is because of the strength in the consumer. US consumers have not been in this kind of financial shape in over 6 decades. Remember that consumer spending drives the US economy…



SOURCE: Strategas Research Partners LLP.

IN SUMMARY: WHERE WE STAND

One of the things we have learnt about studying the markets and investing is that a little bit like golf, horse betting and romance, once you think you have it all figured out, something surprises you and fate reminds you about expecting the unexpected. Despite all of our research work, we are always learning and adjusting to what we are learning. Last quarter clearly "the sky was the limit" too when it came to fiscal and monetary stimulus as yet another COVID-relief bill of $1.9 trillion – approximately 9% of US GDP was passed, and the Fed was still very much in the not changing their policy stance despite inflation hitting 10-year highs. We might be wrong but we are skeptical that inflation will wind up being as transitory as people think and despite the recent volatility in sectors like Financials, Energy, Basic Materials, and Industrials, we see it as yet another head fake. While rising valuations have made it more challenging to source new ideas, we see opportunities in cash-rich companies with solid business models, impressive margins, and strong cash flow generation that are driving secular growth, diversification, and new business.

Our global investment thesis continues to factor in the excess liquidity fueling a stronger-than-expected economic recovery, with strong consumer and business confidence in many parts of the world, rebounding to near 2019 levels. As we mentioned in previous commentaries, our investment positioning has a barbell approach and has our global investment strategy focused on the financial, energy, materials and industrial sectors. We hold leading global health and consumer companies and have gold exposure.

Last fall we reduced our holdings in several leading technology stocks but added them back last quarter given the improving fundamentals.

THE HEWARD GLOBAL LEADERS FUND AND STRATEGY

The Heward Global Leaders Fund and strategy seeks to generate consistent returns over the long term by identifying high-quality growing global businesses that are attractively priced. The companies we invest in are leaders in their respective business field, have high defendable barriers to entry, great management teams, with solid balance sheets and high returns on invested capital and consistent return of capital via dividends. **Essentially, we Invest in global, high quality stocks, gaining exposure to opportunities not generally seen in Canada.**





THE HEWARD GLOBAL LEADERS FUND AND STRATEGY CORE INVESTMENT THEMES

- Technology / Digital
- E-Commerce
- Demographics: Rise of the Millennial and Gen Z & Health and lifestyle of the aging population
- Infrastructure Spending
- Gold

For more information or to schedule a meeting;

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