The Heward Global Leaders Investment Strategy

September 2021

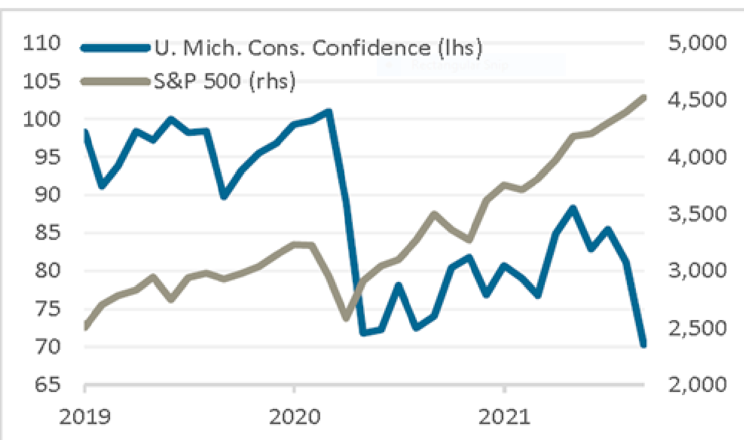
HEWARD
INVESTMENT MANAGEMENT INC.

"When all the experts and forecasts agree – something else is going to happen."

-Bob Farrell, Merrill Lynch Strategist

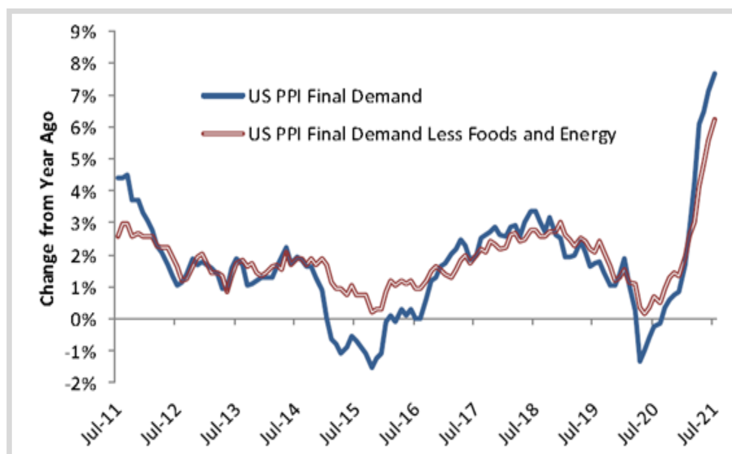
We hope this update finds you well and that you have had a great summer. We wrote several weeks ago, that we were concerned about the potential for a pullback in global equity and fixed income markets in the months ahead and came to believe in August, that the stock market was being too complacent about the impacts of the Delta variants and the collapse in consumer confidence and business confidence; two measures we watch closely for the "health" of the US economy. Today, we see growing risks to the two engines of global growth during the pandemic, the US and China. In the US, the Delta wave and supply shortages are weighing on the consumer outlook. Job growth also slowed significantly in August. China has managed to control the pandemic, but over-tightening of policy has led to a meaningful slowdown in economic activity. Recent commentary from many leading strategists over the past week that a "growth scare" is at hand may have surprised some people, however, many investors thought that economic growth was going to slow from the second quarter, but it wasn't supposed to happen so soon or so sharply. Over the past week, economists across Wall Street have shredded third-quarter gross-domestic-product forecasts: Goldman Sachs cut its forecast to 3.5% from 5.25%, Oxford Economics revised its call to 2.7% from 6.5%, and Morgan Stanley lowered its estimate to 2.9% from 6.5%, while the influential Atlanta Fed's GDP model now predicts 3.7% for the quarter, down from 5.3% at the start of the month.

CONSUMER CONFIDENCE AND S&P 500- HIGHLY CORRELATED



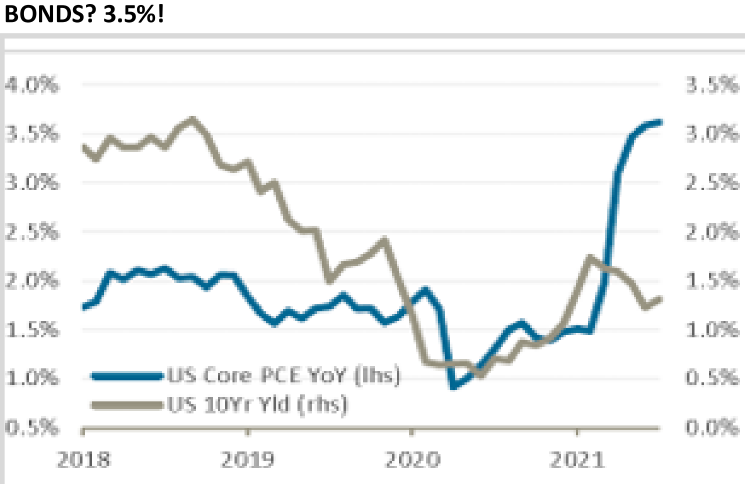
Source: Bloomberg, BTIG

PRODUCER PRICE INDEXES



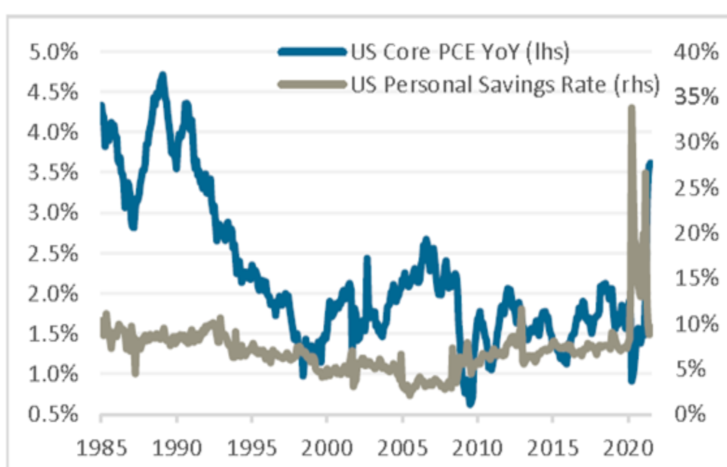
Source: Bureau of Labor Statistics, Bloomberg, and OAM Research

Q4/2018 LAST TIME YIELDS WERE 3%+ AND 2%+ INFLATION – BONDS? 3.5%!



Source: Bloomberg, BTIG

BOTH INFLATION AND SAVINGS MOVING HIGHER



Source: Bloomberg, BTIG

Significantly rising inflationary pressures, along with persistent shortages need to be watched, but we cannot emphasize enough how important the consumer (and consumer confidence) is to the US economy. There are positive and negative trends we are watching with the US consumer. First, American savings have gone up dramatically which is a positive. On the flip side however, it is worth mentioning how many Americans have depended on government cheques or "emergency money", and this is raising serious questions about what happens when the government assistance ends. In a recent Wall Street Journal article, they wrote: "*In the most recent week's survey, 41% of households said they used some form of government assistance to pay usual expenses. The data suggest that economic conditions are dire for a swath of America, with or without the Delta variant. The macroeconomic implications of emergency measures, including enhanced unemployment benefits, stimulus checks, and eviction moratoriums, are complicated, but one thing seems clear: A significant number of people have depended on the emergency money, raising questions about what happens as assistance fades*."

We feel we should also highlight another issue we are grappling with and that is the excessive speculation and some wild valuations in certain sectors and companies. Quoting the Wall Street Journal September 13 Opinion Section: *"Joby Aviation, which plans to begin an electric air taxi service in 2024, is <u>worth more than Lufthansa, EasyJet or JetBlue</u>. Does that seem right? In this market, why not? Heck, earlier this year, <u>Tesla was worth more than the next nine car manufacturers combined,</u> though now only the next six. Do fundamentals even matter? Used-car sales platform <u>Carvana is worth more than Volvo, Honda, Ford or Hyundai. Airbnb is worth more than Marriott and Hilton combined</u>. Crypto-exchange <u>Coinbase is worth more than the Nasdaq</u>! Venture capital is cuckoo. After investing $120 billion in the 2000 dot-com frenzy, and just $16 billion in 2002, U.S. venture capital invested $130 billion in 2020 and then $140 billion in the first half of 2021. Startups these days raise money as "the Uber of gardening" or "Space as a Service." Oh wait, the latter was WeWork's pitch, whose founder Adam Neumann declared in 2017, "our valuation and size today are much more based on our energy and spirituality than it is on a multiple of revenue." Is "spirituality" the S in SPAC? And check this out: In June, an Italian artist auctioned an invisible statue for $18,000, in reality it was an empty box the artist claimed was a "space full of energy. I live at the intersection of innovation and disruption, but when companies are worth more than any possible reality, watch out."*

The reality is that the Federal Reserve and central banks globally deserve most of the blame. As a sailor I liked their comment where the WSJ opined, "*near-zero interest rates means the market has no true north to help compare stock valuations with reality. So essentially, investors are navigating turbulent seas with a spinning compass."* Today's negative real yields don't reflect reality. The Fed has warned it plans on tapering bond and mortgage purchases later this year, the compass may stop spinning soon.

Investing in these periods of financial repression and excessive speculation is not easy, however, **our investment process and investment policy comes down to our firm's belief; <u>always</u> stick with fundamentals**. Owning solid businesses that are generating solid earnings and free cash flow that are reasonably priced, with strong management teams and who are industry leaders, interest us. 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 also wish to remind our clients to remember that market corrections will take place and stocks tend not to move in a straight line higher unchallenged for long**. However, pullbacks (depending on the catalyst for profit-taking) can often present opportunities to buy "babies that get thrown out with the bath-water."

IN SUMMARY - WHERE WE STAND

To be clear we are not negative or bearish! I have often quoted former Merrill Lynch strategist Bob Farrell's Rules for Investing before and rule# 9 is interesting and always has us thinking, "When all the experts and forecasts agree, something else is going to happen." So… we are cautious, and we expect periods of choppiness and market volatility for the remainder of the year. Sell-offs and corrections are normal and healthy and shouldn't be more than a "normal" 10% correction, which represents typical equity market risk.

We might be wrong but we are skeptical that inflation will wind up being as transitory as central bankers think. One risk that we are monitoring is the possibility that earnings growth for the S&P 500 may be weaker than investors can tolerate due to higher costs (the inflationary impacts) which in turn hit corporate margins. As we mentioned in previous commentaries, our investment positioning has a barbell approach and has our global investment strategy focused on the financial and information technology sectors and we also hold leading global health and consumer companies. We see opportunities in cash-rich companies with solid business models, impressive margins and strong cash flow generation. We continue to maintain gold exposure and we would opportunistically add on weakness.

As always, we appreciate your continued support and should you have any questions, please feel free to contact us at your convenience.

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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