Quarterly Report
AUTUMN 2021

HEWARD
INVESTMENT MANAGEMENT INC.

Slowing Growth Rates & Delta Variant Notwithstanding, the Global Economy Remains on a Recovery Path Back to Normalization

OVERVIEW

Global reopening has taken a step back recently on account of re-emerging COVID fears, but we remain of the view that this latest wave will not derail the broader reopening process. While cases have gone up, deaths/hospitalizations remain low and manageable. Global mobility remains nascent and its normalization will continue to release pent-up demand, while tight inventories and new orders bode well for global growth. However, the U.S. has now returned to its pre-virus level of GDP. Due to a combination of smaller stimulus and longer lockdowns, the euro zone is still 3% below its pre-virus level of GDP, but it too is on track to get back. Due to this success, as most economies having recouped much of their lost output, growth in most major economies is likely to slow over the coming quarters. But, its important to put this slowdown in perspective. The recovery is not stalling, it means that economies are normalizing.

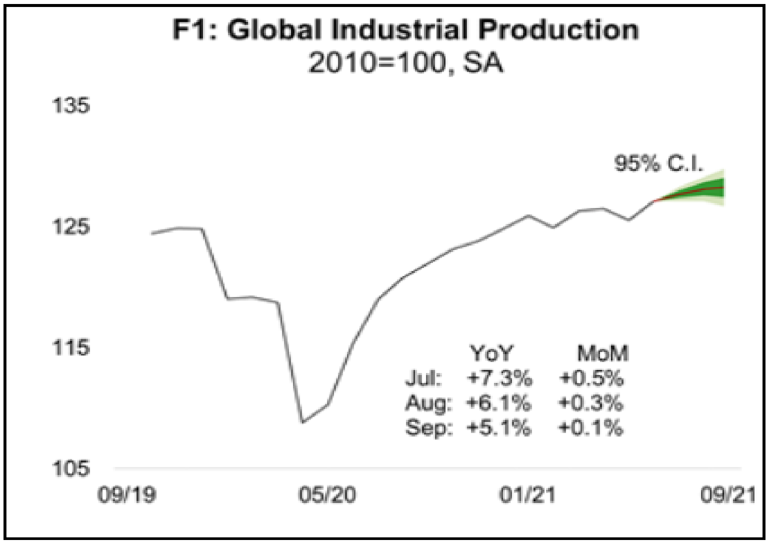
As the U.S. economy has normalised, economic growth rates will ease from great to good. At the same time, the drivers that pushed up corporate profits in the first half of 2021 will not be repeated. The Federal government will continue to run large deficits, but future spending packages, like the much-discussed infrastructure bill, will be more spread out over time and will be more budget neutral. As a result, the boost to corporate profits will be less powerful. Also, most of the public health restrictions have been scrapped so marginal gains from further re-openings will be less significant. These factors will be merely less positive for corporate earnings, not negative.

There is a growing scarcity across physical/commodity markets. Since last October, policymaker and investor focus has remained on the vaccine-driven recovery. Yet today, physical goods demand has reached such high levels that the system is becoming increasingly constrained. With the pandemic inventory glut run down, these markets are becoming increasingly exposed to any type of supply disruption or increased demand. The lower the inventory cover, the bigger the risk and the larger the scarcity premium when one of these events materializes (as in European gas and power today). It is important to emphasize that most of these shortages have very little to do with COVID. In fact, the seeds were sown after the financial crisis in 2008 when long cycle "old-economy" capex collapsed in favor of the short cycle "new-economy" capex.

Asian manufacturers are grappling with ongoing choke points hampering global supply chains. The frustration comes amid a daily drumbeat of negative news on how the spreading Delta variant is ricocheting through factories and ports in southeast Asia and China, with knock on consequences for world trade. The closure of the world's third busiest container port (Ningbo) in August didn't help exporters spirits as it worsened congestion at other Chinese ports. It's a similar story across the Pacific. The biggest U.S. trade gateway with Asia is clogged with the most inbound container vessels in six months. Supply chains problems have contributed to the recent deterioration in investor sentiment, as they have led to declining earnings expectations.

Gently, but steadily, economic expectations are coming down. It may be an over reaction to the new wave of cases caused by the Delta variant, or it may be a response to the incoming data. It could also be reflecting dampening hopes for an expansive new fiscal policy in the U.S. as the standing of President Biden also dampens. Whatever the reason, hopes for a big new reflation or even a post-COVID reopening have dwindled. One thing remains unchanged however. The great majority of investors are still convinced that there is no alternative to stocks. Even with drabber economic growth prospects, which should help fixed income (but yields keep rising) more than equities, the overwhelming consensus still calls for stocks to outperform bonds.

GLOBAL INDUSTRIAL PRODUCTION



Source: Numera Analytics

UNITED STATES

Monetary policy remains accommodative, but the late September statement by the Federal Open Market Committee (FOMC) strongly foreshadowed a Quantitative Easing (QE) tapering, putting markets on notice that “a moderation in the pace of asset purchases may soon be warranted”. The QE tapering could be finished by sometime in the first half of 2022, at which point the level of longer-term rates will help assess the “dots” showing that numerous rate hikes in 2023 are realistic. The Fed also lowered its real GDP forecast for 2021, but its worth noting that tracking estimates for the third quarter are well below Fed expectations. U.S. consumers have been hit by rising prices and a resurgent virus in recent months, but part of the reason the economy has remained so resilient is their willingness to spend. Because of hefty fiscal stimulus and employment growth, consumption by households has not only driven GDP growth, but the composition of their spending is now shifting from goods to services. With household finances at their best shape in decades, Mr. Powell suggested that there is less of a relationship now between the state of the pandemic and the economic picture than there had been in the past. Meanwhile, soaring demand has left U.S. ports choking on freight. Rail yards, ports and warehouses are overflowing with freight, with too few people to move it quickly, causing delays and rising prices for companies and consumers. Manufacturers are tacking on surcharges and bemoaning lost business while on the other end retailers are scrambling to secure enough products to sell for the holiday season. Large chains seem to be ordering larger amounts of inventory than normal, hoping that at least some of it will arrive on time.

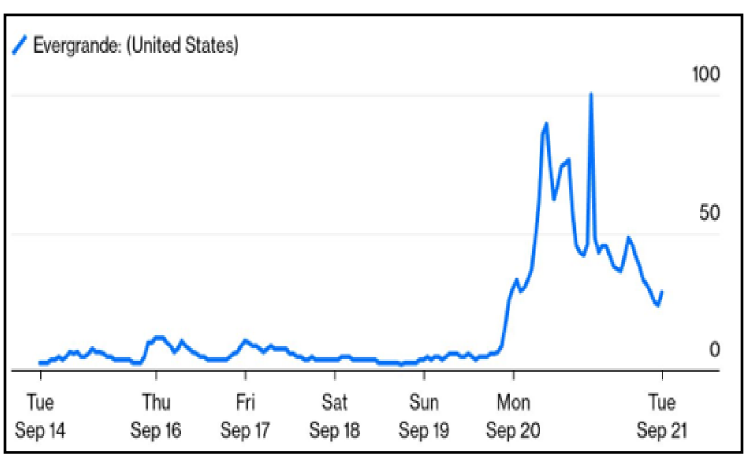
CANADA

To cure the COVID blues in July, it seems Canadians replaced a bit of retail therapy with a night out on the town. While retail sales saw a slight pullback, they came along side a surge in spending at restaurants and bars. Statistics Canada also estimated that the weakness in July would be temporary, with August sales rising to levels not seen since March. But, the economy (GDP) still finds itself 1.5% below February 2020 levels. Revisions were partly to blame for wrongfooting economists’ predictions, with the latest numbers revealing that the economy was on a weaker footing than previously suggested by Statistics Canada. However, the pullback also reflects a sharp drop in exports, driven in large part by chip shortages in the auto sector and other global supply chain disruptions that led to severe manufacturing dislocations. Housing was also a drag after a pandemic-driven boom. However, this is not a market facing a demand issue, but rather a shortage of supply. Corporate Canada has done a great job at containing cost inflation. Profit margins for the Canadian equity index (TSX) have reached levels not seen since before the Great Financial Crisis. It seems that the pandemic has provided businesses solid pricing power, helping them defend margins. This has probably contributed to inflation (along with housing) climbing higher than expected. Base effects are set to fade further and the fourth COVID wave may create another headwind for services. As a result, the Bank of Canada will stay the course, continuing to suggest that much of this latest rise is transitory and simply making up for weakness last year. Meanwhile, the market took the election results with a bit of a “yawn”.

EUROPE

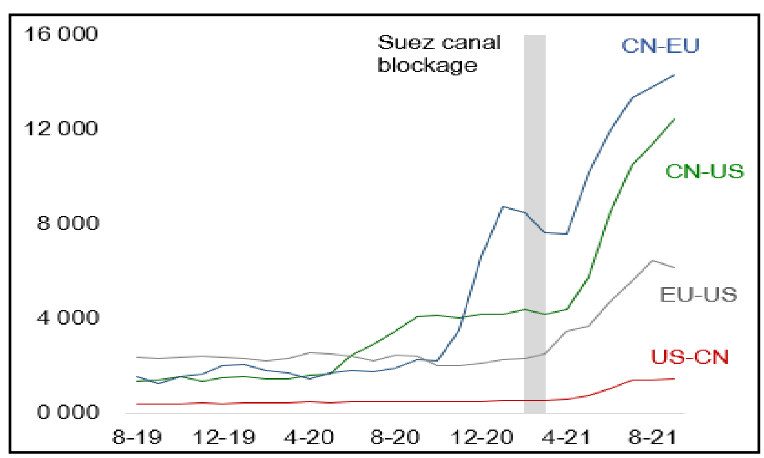
It may be worth offering a reminder that Germany will now be run by someone not called Merkel, and this does matter beyond Germany’s borders, as she provided an effective anchor for the European project during its most difficult days. Meanwhile, the third successive decline in the Ifo Business Climate Index in September provided further evidence that Germany’s recovery is losing steam, as supply chain difficulties and the surge in gas prices piles additional pressure on prices and production. But the supply issues should fade in 2022. As long as the Delta variant doesn’t halt the economic recovery in its tracks, investment should make a sizeable contribution to GDP growth this year and next. Business surveys published in August also provide some reassurance that the euro zone

EVERGRANDE BUT NOT FOR EVER MORE: U.S. GOOGLE SEARCHES FOR EVERGRANDE PEAKED MONDAY AT 9PM, THEN FELL 70%



Source: Google Trends/Bloomberg Opinion

F1: SHIPPING COSTS HAVE SOARED IN 2021
40 FT CONTAINER RATES BY ROUTE (USD)



NOTE: Chart compares freight rates for 40 foot containers between key ports in China (Shanghai), Europe (Rotterdam) and the U.S. (LA and NY) Source: Drewry economy continues to grow at a decent pace. Pipeline price pressures do continue to mount, pointing to higher consumer price inflation. But while there is arguably scope for a small rise in core goods inflation, subdued wage growth will keep services, and therefore underlying inflation, low. It is services inflation that matters more both in the headline rate and the European Central Bank's (ECB) assessment of underlying inflation dynamics. Recent data on the UK labor market have been stronger than expected, and indicators imply a smoother furlough unwind than previously assumed. Underlying wage growth is strong and inflationary pressures are firming more than anticipated. In addition, commentary out of the Monetary Policy Committee, suggests that a majority of the committee now view the minimum conditions for starting monetary policy tightening have been met.

EMERGING & DEVELOPING MARKETS

Amid slowing growth, an equity market debacle and fears of a "Lehman moment", China's currency has strengthened against the U.S. dollar. Furthermore, as investors have fretted that China's financial system is set to implode, Chinese Government bonds (CGBs) have handsomely outperformed almost all other government bond markets. Even more impressively, since mid-August (when Evergrande fears became front-page news), CGBs have offered positive returns while government bonds in the U.S., Germany, and Japan have all delivered losses. How can this be? The simplest answer as per Gavekal Research, is that the Lehman analogy is a gross over -simplification of a far less dangerous situation. While admitting that Evergrande is a problem and that Chinese real estate activity and overall economic growth will take a hit in the coming year, they don't see it to be the crisis so many apocalyptic commentators portray it to be. Also, in the past, the politburo had no qualms about leaning on banks to issue loans to struggling companies, encouraging a "too big to fail" view. But times are changing. What is happening around the Evergrande debacle shows that Chinese policymakers can no longer be relied upon to rescue those who have leaned to far in front of their skis. China needs (and likes to have) a strong domestic government bond market. Repeated bailouts would undermine the credibility of the renminbi. Meanwhile, factory activity has faltered across Asia with a resurgence in COVID-19 cases adding to the global supply chain disruptions and confirming fears of a slowdown in the region's economic activity. Higher input costs have hampered production and there are also signs that demand for some Asian goods has leveled off.

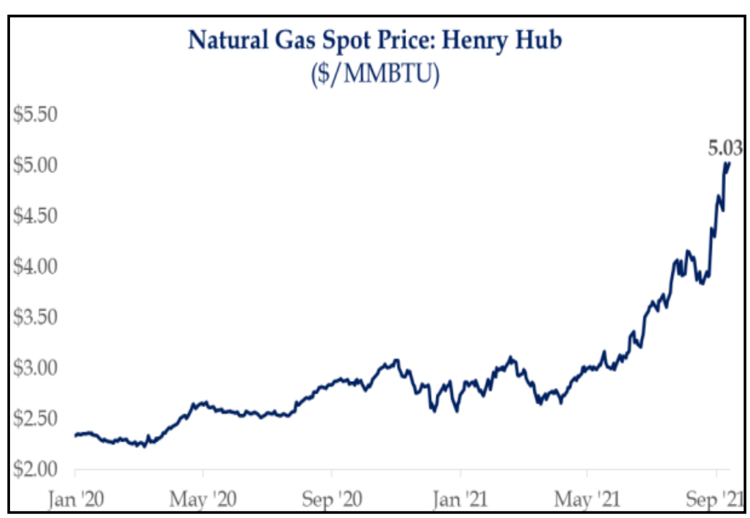
COMMODITIES

All of a sudden, the world seems short natural gas due to hurricanes, short coal due to policies, short hydro due to drought, and sometimes short wind, due to, well, a lack of wind. While earlier this summer oil markets were showing consternation over the spread of the pandemic variants and the weaker data flow out of China, here too supply is becoming an issue. China demand readings have come in as expected while globally they have been stronger than forecasted. Also, the physical oil market keeps tightening, due to non-OPEC supply gains lacking robustness as well as OPEC+'s commitment to supply restraint, targeting inventories. The draw on stocks (near 400 million barrels) since last July is the largest since the International Energy Agency began issuing inventory data. The hoo-hah in August related to President Biden's plea for OPEC to help lower gasoline prices was given a "hard pass". Because prices at the pump and the U.S. president's public approval rating have a strong inverse correlation, it would not be surprising to see other attempts made to manipulate prices lower ahead of the November 2022 mid-terms. There is also a constructive backdrop for the natural gas complex. Nations are more reliant than ever on natural gas to heat homes and power industries amid efforts to quit coal. But there isn't enough to fuel the post pandemic recovery and refill depleted stocks before winter arrives in the northern hemisphere. Countries are trying to out bid one another for supplies as exporters move to keep more for themselves. While the crisis is afflicting Europe right now, soon it may become a problem for the whole world. Prices have moved up sharply.

THE RENMINBI HAS BARELY BLINKED IN THE FACE OF TOUBLE: THE CNY AND ITS 200 DAY MOVING AVERAGE

Source: Gavekal Research

NATURAL GAS PRICES SKYROCKETING



Source: Strategas

RECOMMENDATIONS

Slowdowns in China and the U.S. should not be taken as evidence that the global recovery is stalling. Admittedly, it is not just some high-profile data from the U.S. and China that have weakened recently. Recoveries in retail sales, industrial output, and trade more broadly have generally flattened off, while the Purchasing Managers Indices (PMIs) have dipped too. But some commentators have cast these developments into too negative a light. While we have started to witness some negative revisions to 2021 GDP growth forecasts, these are being offset somewhat by more positive ones for 2022. Although the deceleration will be slow, it nonetheless makes investors uncomfortable, and has sprouted a number of short-term bearish calls from market strategists. Also, the latest from the American Association of Individual Investors revealed that the so-called bulls among retail investors had fallen sharply, with the number of bears surging. This is an encouraging sign (contrarian) for stock markets, along with the fact that the Leading Economic Indicators (U.S.) jumped again in August. Furthermore, the pandemic seems to have provided the corporate world with enough pricing power to defend profit margins. We continue to believe that any market weakness should be used as an opportunity to add to equities, focusing on: financials, industrials, technology and other late cycle sectors. Having trended downwards for most of this quarter, yields turned up in the last few weeks. Increasing talk about tapering bond purchases (central banks), as well as stubbornly high inflation rates, have started to impact the bond market. However, the moment of actual serious tightening is still several quarters away, and any move in rates should be considered an integral part of normalization. While the global economies continue to recover, inflation will slow but is likely to stay somewhat higher than we had been accustomed to (pre-pandemic). As a result, yields are expected to rise over the next few years, negatively impacting returns on bond investments. In order to diminish the impact on our portfolio, we will continue to diversify our fixed income holdings by concentrating on a variety of higher yielding vehicles (preferred shares, corporate & convertible bonds) while keeping a much lower than benchmark duration.

FORECAST 2021

	CURRENT 30-September-2021	**2021 RANGE**	**2021 YEAR-END**
INTEREST RATES			
Bank of Canada Overnight	0.250%	0.25%- 0.25%	0.25%
Federal Funds Rate	0.080%	0.00%- 0.25%	0.25%
10-year Canadian Treasury	1.509%	0.67%- 1.70%	1.65%
10-year US Treasury	1.500%	0.92%- 1.85%	1.80%
COMMODITIES			
Gold (US$/oz.)	$1,755	$1,675- $1,900	$1,875
Copper (US$/lb)	$4.10	$3.45- $4.77	$4.50
Oil WTI (US$/bbl)	$75.08	$47.00- $80.00	$78.00
MARKETS			
S&P/TSX Composite Index	20,070	17,300-20,950	20,900
S&P 500 Index	4,307	3,660– 4,550	4,425
CANADA DOLLAR/US DOLLAR	$0.79	$0.77- $0.84	$0.83

2115 rue de la Montagne, Montreal, QC H3G 1Z8
Telephone: (514) 985-5757
Toll Free: 1-800-567-5257
Email: info@heward.com
www.heward.com

HEWARD
INVESTMENT MANAGEMENT INC.