October 17th, 2022

Global equity markets have experienced significant volatility from the March highs. Many markets are down over 20%, which constitutes a bear market. The S&P/TSX Composite Total Return Index (TSX) declined 1.4% in the quarter and is down 11.1% for the year to date. The TSX has been one of the better performing markets this year due to strength in the energy sector. In the US, the S&P 500 Total Return Index (S&P 500) declined by 4.9% in the quarter to reach a total year-to-date decline of 23.9%. Globally, the MSCI World Index, which tracks the price return of companies in Developed Markets, is down 19.5% and the MSCI Emerging Market Index is down 22.2%.

The year 2022 has been dominated by a continual stream of significant economic and geopolitical obstacles: from surging inflation and rising interest rates to the lingering pandemic; still disrupted global supply chain; European war; and an energy shock. Most disruptive has been the rise in inflation to levels not seen in forty years. As a result, central banks continue to aggressively raise interest rates to slow the economy and combat high inflation, steps that potentially may induce a global recession.

Over the last century, investors have been vexed by virtually all of these issues. And yet, in the fullness of hindsight, almost every point in time has subsequently proven to be a good time to be an equity investor. Investments in equities, even at the most inopportune time, generate returns that are superior to other financial assets over a long-term time horizon.

While short-term declines in share prices can be unsettling to investors, it is the avoidance of permanent capital loss that is most important for long-term success

In the marathon of building wealth, we know it is inevitable that companies will go through multiple recessions and their own industry-specific challenges. While short-term declines in share prices can be unsettling to investors, it is the avoidance of permanent capital loss that is most important for long-term success.

At Seymour, our investment strategy is to invest with a long-term time horizon with a focus on high-quality companies that are well-capitalized and trade at reasonable valuations, which we can own through a full economic cycle.

We focus on businesses that have strong management teams, low debt levels, and durable cash flows. Companies that are well positioned to weather a downturn through a combination of cutting costs, high-grading talent and executing on acquisition opportunities, will emerge stronger. We continue to use market volatility as an opportunity to find compelling buying opportunities with a long-term view of generating excess returns through a full market cycle.

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Inflation and Interest Rates

There continues to be a lot of uncertainty surrounding geopolitical issues and the ongoing issues created by Covid. While we do not wish to diminish the economic or social impact of any of these concerns, they have not been the primary reason behind the market volatility. It is the resulting inflation and increase in interest rates which have led markets lower.

In our view, inflation is the one issue that has the potential to remain stubbornly high and to negatively impact financial asset returns for an extended period of time. The 1970's stand out as a decade of persistently high inflation, and very low but positive, inflation-adjusted equity returns. The remedy for this high inflation was excessively high interest rates engineered by central banks.

We believe that in the current cycle, central banks have been quicker off the mark to address inflation and will remain committed to that course in comparison to the early 1970s. central banks around the world responded swiftly to surging inflation by raising policy rates with the goal to relieve some of the price pressures by slowing spending in the economy so supply can catch up with demand.

The return to low and predictable inflation will not be easy with tight labor markets and supply chain challenges. However, central banks recognize the destructiveness of high inflation, and will likely remain steadfast in their commitment to combat inflation with continued interest rate hikes.

Fixed Income and Equities in a Rising Rate Environment

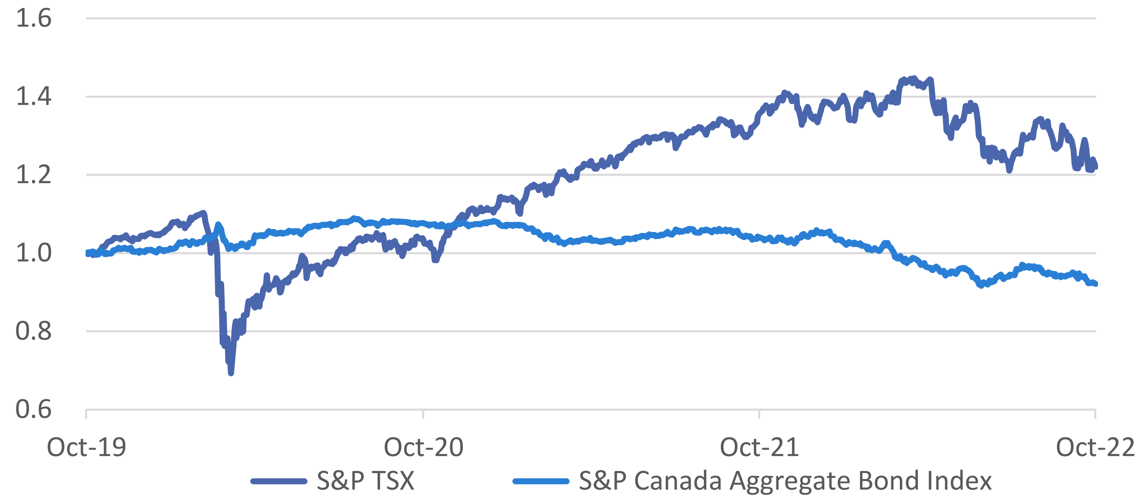
The recent spike in short and long-term interest rates was felt in all corners of the investible universe. From bonds to stocks to real estate, there have been few places to hide from the impacts of inflation and increasing interest rates.

It has been an exceptionally volatile year for equity markets which have or are close to dipping into bear market territory (considered a decline of more than 20% from its previous peak). For reference, Canada has experienced 15 bear markets since 1956, a fairly regular occurrence for long-term investors.

Bonds, however, have experienced even greater shock with 2022 touted as potentially the worst year for bonds since at least 1926 and potentially since reliable record-keeping began.

The TSX has declined 11.1% this year, which is similar to the Canadian Broad Composite Bond Index, which experienced a decline of 11.8% year to date. Although very similar year to date, the graph below details the comparison of both indices since the pandemic began.

Exhibit 1: Three Year Comparison between Canadian Equities and Bonds



Source: FactSet

Even if inflation remains sticky, we expect equities to outperform other asset classes in an inflationary environment.

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As shown in the chart below, real or inflation adjusted returns in the 1970s were below long-term levels for virtually all financial assets. However, equities provided an opportunity to generate positive real returns superior to other asset classes.

Exhibit 2: Average Annual Nominal and Real Returns by Decade

	S&P 500 Returns		S&P/TSX Returns		US 5yr Government Bond Total Return		US Treasury Bills	
	Nominal	Real	Nominal	Real	Nominal	Real	Nominal	Real
1950s	19.7%	17.6%	16.1%	13.9%	1.4%	-0.7%	1.9%	-0.2%
1960s	8.4%	6.1%	10.2%	7.9%	3.5%	1.2%	3.9%	1.6%
1970s	**7.4%**	**0.3%**	**11.7%**	**4.9%**	**7.1%**	**0.0%**	**6.3%**	**-0.8%**
1980s	17.3%	11.8%	13.1%	7.2%	12.2%	6.7%	8.9%	3.4%
1990s	18.5%	15.5%	11.3%	9.3%	7.4%	4.4%	4.9%	1.9%
2000s	1.2%	-1.4%	7.3%	5.3%	6.3%	3.7%	2.8%	0.2%
2010+	13.1%	10.8%	6.6%	4.4%	3.2%	0.9%	0.5%	-1.8%

Source: FactSet, CIBC World Markets Inc., SBBI

The market outlook remains uncertain in the short term and equities may continue to see some downward pressure. However, with some markets down almost 25%, it's quite possible they have already discounted a mild recession. Most important for investors is to recognize that equity markets have always recovered, and then moved on to new highs. Selling into large market declines is a guaranteed way to lock in a permanent loss in capital.

Higher Volatility in Smaller Companies

Smaller capitalization companies have corrected significantly more than broader market averages. This heightened volatility is typical during periods of uncertainty and perceived risk. Although it makes for a bumpier ride, at Seymour, we believe strongly that investors are compensated for the higher volatility of small and mid-sized stocks in the form of higher long-term returns.

The graph below highlights the significant correction experienced in the small capitalization space to date, with price to earnings valuations, a measure of relative expensiveness, at their lowest point since the 90s.

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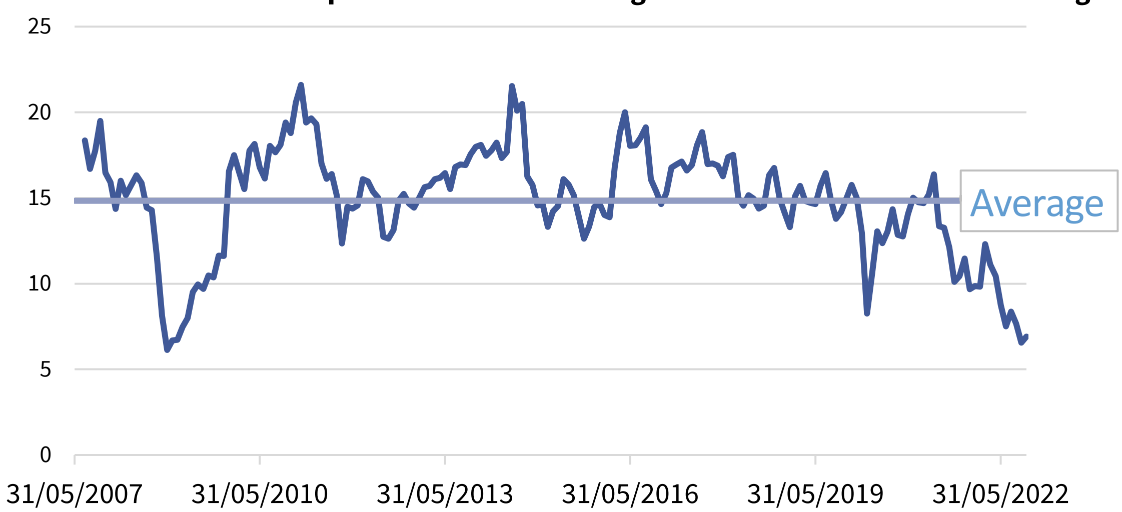
Exhibit 3: S&P TSX Small-Cap Index: Price to Earnings Ratio Based on 12 Month Trailing Earnings



Source: FactSet

The volatility experienced in smaller capitalization companies is amplified due to the relative illiquidity compared to their large capitalization counterparts and the inefficiency of the often underfollowed market. It is this inefficiency that leads the way for impactful active selection and outsized long-term returns. As noted earlier, following the sell-off we are finding many compelling buying opportunities, particularly in the small- and mid-cap space.

What Course of Action Should Investors Take?

The near-term direction of equity markets is extremely difficult to predict. What is significantly more predictable is the long-term direction of equity markets: they go up! Equities have been the best performing asset class over longer time frames of five years, ten years and beyond.

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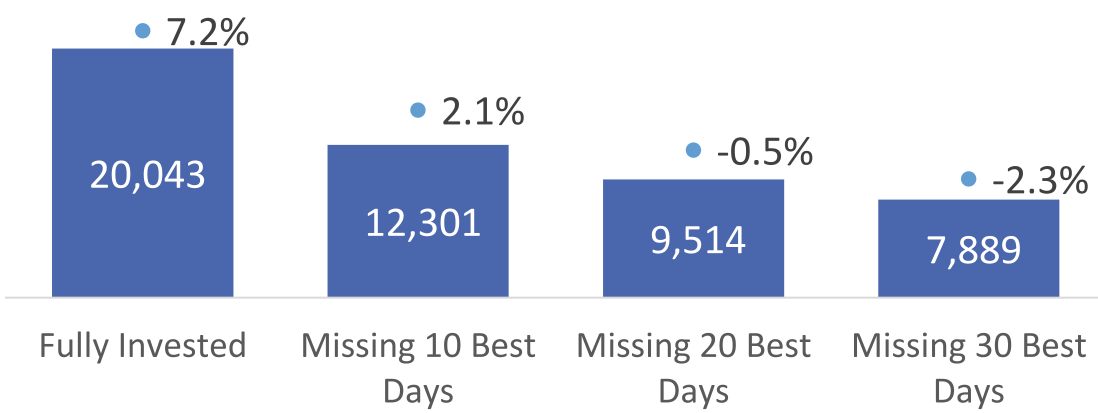
We believe investors that try to time the markets are doomed to frustration and failure. It is often during times of extreme uncertainty and pessimism that equity markets can exhibit days with sharply positive performance. History demonstrates that on average, the best performing days occur within just two weeks of the worst performing days. Investors who miss these positive days (sometimes inflection points) can experience markedly lower equity returns over the long term.

Exhibit 4: Staying Fully Invested: Performance of $10,000 in the TSX from 2012 - 2022



Source: TSX Total Return, Thomson Reuters Eikon

As demonstrated by the exhibit above, over the past ten years, equity returns were more than halved by missing just ten of the best performing days. Hence, our oft repeated line: it is not about timing the market, it's about time in the market.

Investors who exhibit perseverance and discipline are rewarded with higher long-term returns.

Please reach out to us anytime with any questions or feedback, or to schedule a meeting with your Portfolio Manager.

Sincerely,

The Seymour Team

Suite 900 - 1285
West Pender Street
Vancouver, BC, V6E 4B1

info@seymourinvest.ca
seymourinvest.ca
604.659.1722