PALOS

CONTENTS

Investment Themes for 2022 – What's on our Radar 1

Palos Funds vs. Benchmarks (Total Returns) 3

Disclaimer & Contacts 4

Weekly Commentary

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Investment Themes for 2022 – What's on our Radar

To "kick off" Super Bowl week we thought we'd have look at some themes that are likely to dominate the minds of investors over the next "four quarters". In addition, we'll comment on what a "playbook" for a prudent investing "game plan" could look like. In no particular order, these are the 2022 investing themes we have on our radar.

Inflation: Labour markets are tight. Wages are on the rise and some sectors of the economy are having trouble filling vacant positions. Supply chains continue to be disrupted and this has caused shortages in many sectors of the economy, including manufacturing. Consumers, who saw their savings accounts rise during Covid shutdowns, are "flush with cash" and willing to spend. A global shortage of semiconductors has impacted assembly lines in the auto industry and wait times for new vehicles are extended, driving car prices higher. Why is inflation a concern? The U.S. Federal Reserve (Fed) is signalling a tighter monetary policy moving forward. This means higher interest rates which in turn has implications in the real estate, consumer, banking and manufacturing sectors (see below).

Interest rates: For most of 2020, Fed Chairman Jerome Powell was adamant that rising inflation was "transitory" in nature rather than "permanent". In other words, rising prices were mostly a by-product of Covid shutdowns and supply chain disruptions. Powell professed that given time to resolve these issues, inflation would veer back towards the Fed's 2% target. However, as the year progressed, Powell's view has clearly shifted towards inflation being "persistent" rather than transitory. Rising inflation usually leads to higher interest rates as the Fed tries to manage the delicate balance or hitting inflation targets and maintaining optimal economic growth. The trajectory of rates could take some steam out of a very hot residential real estate market.

Consumers: During lockdown, consumers learned to shop "online", and the e-commerce phenomenon went mainstream. The dramatic shift in consumer preferences clearly benefited companies like Amazon, Peloton, and Netflix. Shopping online went mainstream for everything from groceries, electronics, clothing/footwear, and fitness. The "stay-at-home" economy thrived as traditional services and "brick and mortar" retail suffered. While we believe e-commerce is here to stay, the "real" economy stands to benefit from consumers

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who have a pent-up appetite to spend on travel and entertainment. As society returns to a sense of normalcy, demand for air travel, hotel rooms, cruises, live entertainment and car rentals should increase dramatically.

Geopolitics: As we write this, President Macron of France is scheduled to meet with Russia's Vladimir Putin to diffuse rising tensions on the Ukraine border. Washington has made it clear that while a U.S./NATO military intervention is currently off the table, economic sanctions resulting from a Russian incursion into Ukraine would be severe. Russia is the third largest producer of oil and revenues from exports are critical to GDP. In addition, final approval of Russia's Nord Stream 2 natural gas pipeline would be at risk. Russia supplies roughly one-third of Europe's natural gas needs. Russia and Ukraine are also the world's third and ninth largest huge exporters of wheat. While diplomacy is the preferred outcome, we are prepared for heightened volatility in commodity and financial markets should Russia act militarily.

Energy: Crude oil prices are at their highest levels in seven years. Years of paring back exploration, whether due to pressure from climate activists or fiscal prudence, has profoundly impacted the ability to ramp up supplies. Increasing production is not as simple as "flipping a switch". As the world emerges from lockdowns, rising demand for gasoline and jet fuel will push prices higher. The potential for a disruption in supply leaves prices vulnerable to an upside spike. This has obvious implications on the world economy. Higher prices at the pump would be a tailwind for the electric vehicle industry (EVs). Widely accepted is the "consensus" that EVs are the future, and this carries implications for the materials and mining sectors. EVs won't run without batteries. To meet Battery demand, unprecedented amounts of materials like copper, lithium, nickel, and graphite will be needed. This is good news for miners which is also good news for Canada.

The Unknown: We learned long ago that forecasting on the economy or making stock picks is best left for TV personalities or bloggers who earn their keep predicting the unpredictable. We prefer to take a pragmatic approach which is to prepare for various scenarios, manage risk accordingly, and capitalize on investing opportunities that arise at times when other investors behave irrationally. With the recent elevation in "risk" based on investor worries about interest rates, inflation, geopolitics, energy and the "next variant", volatility in financial markets has been markedly higher. Many will perceive this as "risky". We prefer to maintain a long-term view. Worries about the above are being "priced in" and markets are in the process of adjusting risk. The volatility will eventually subside. In the meantime, we strongly believe that our time-tested approach to active investing will present us with new opportunities. We are prudent and patient investors, and we look forward to an interesting and opportunistic new year.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$9.90	0.68%
Palos Equity Income Fund - RRSP	PAL101	$7.27	0.43%
Palos Merchant Fund L.P. (Dec 31, 2021) [2]	PAL500	$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	$17.88	-5.67%
Palos-Mitchell Alpha Fund [3]	PAL300	$10.38	0.93%
S&P TSX Composite (Total Return with dividends reinvested)			0.42%
S&P 500 (Total Return with dividends reinvested)			-5.47%
S&P TSX Venture (Total Return with dividends reinvested)			-9.02%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			1.91%
Canadian Government 10-Year			1.86%
Crude Oil Spot			US $92.31
Gold Spot			US $1,806.60
US Gov't10-Year/Moody BAA Corp. Spread			191 bps
USD/CAD Exchange Rate Spot			US $0.7833

[1] *Period ending February 4th, 2022. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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