Investment Commentary
Third Quarter 2021

28 October 2021

Q3 2021 Investment Commentary

"You never count your money when you're sittin' at the table…"
-Kenny Rogers

There are no shortage of brilliant minds to quote in the investment industry but sometimes, with a subject as complex as investing, the simplest mantras provide the best food for thought.

By the end of this commentary perhaps the words of Kenny Rogers will have you thinking, and not just about the great returns you may have seen in your equity holdings over the last decade, but also about the risk you may still have on the table.

The strong run in equity markets that investors have become so accustomed to for the previous five quarters has finally paused for a moment of consolidation.

Developed-market equities experienced a muted Q3 as weak September performance clawed back the majority of July's and August's gains. Several factors pushed gains early in the quarter, including positive earnings, vaccination trends, and continuing signs of economic recovery. Other issues came to the forefront in a volatile September. The Fed signaled more hawkish policy and the tapering of quantitative easing, political uncertainty over the debt ceiling and a new infrastructure bill, inflation prospects and continuing supply-chain concerns. In the end, these push and pull factors netted out to a relatively flat quarter for developed equities.

The Emerging Markets suffered more volatility than their developed counterparts in Q3.

Chart 1: Risk Asset Rally Consolidates (Indexed to 100)

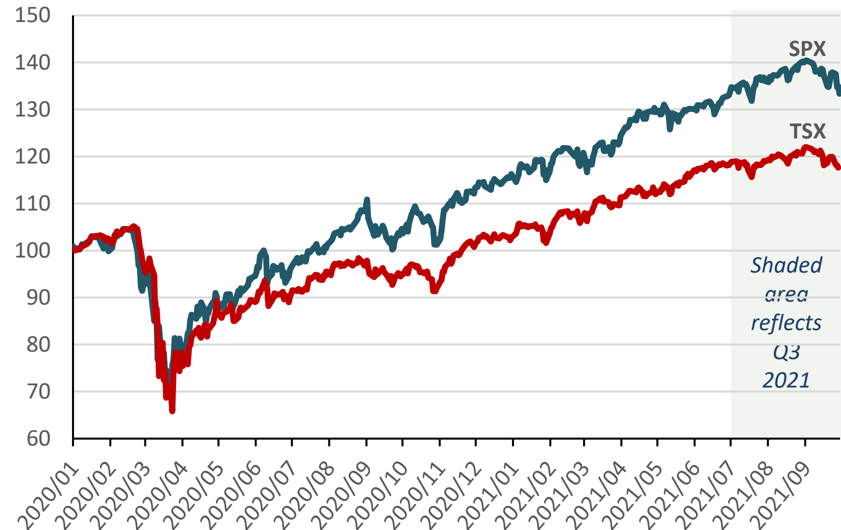

Table 1: Summary of Global Equity Returns

	2020	YTD 2021	Q3 2021
Canadian Large Cap: TSX Comp	5.6%	17.5%	0.2%
US Large Cap: S&P 500	18.4%	15.9%	0.6%
US Small Cap: Russell 2000	20.0%	12.4%	-4.4%
US REITs	-4.7%	21.1%	0.3%
International: MSCI EAFE	1.3%	14.7%	1.4%
Japan: TOPIX	7.4%	14.7%	5.3%
UK: FTSE 100	-11.6%	13.1%	2.0%
Eurozone: Euro Stoxx 50	-2.6%	16.5%	-0.1%
Emerging Markets: MSCI EM	19.5%	1.0%	-6.6%

China, being the most significant market in the emerging basket, led the way down in the quarter as investor sentiment weakened considerably for a handful of reasons. Looming concerns over the debt problems of Chinese property developer Evergrande Group, increased government regulation of certain industries in the tech and education sectors and the re-imposition of some COVID-19 restrictions in certain areas were all significant headwinds.

The Emerging Markets, however, are a diverse group and some segments had very strong performance in the quarter. These were primarily countries that have heavy exposure to the energy sector and benefitted from increasing commodity prices (Russia, Saudi Arabia, UAE).

As is always the case with financial markets, there are a host of potential risk factors, such as inflation, geopolitical issues, hawkish central banks, and the global pandemic. The truth of the matter is that nobody can accurately predict when or if these issues will come to a point where they severely impact global markets.

So, what should investors do to protect their portfolios against a myriad of potential risks with uncertain timing? The answer lies in asset allocation.

If you happen to have a portfolio with heavy exposure to equities (like the very common traditional 60% stock / 40% bond model portfolio) you may want to heed the lyrics of Kenny Rogers and consider taking some money off the table. Unrealized gains are only profit on paper until they are realized.

Table 2: Commodities (USD)

	2020	YTD 2021	Q3 2021
Commodities	-3.1%	29.1%	6.6%
Agriculture	14.9%	17.8%	-1.1%
Copper	25.8%	15.1%	-4.6%
Natural Gas	-45.9%	120.3%	59.6%
Crude Oil	-20.9%	55.6%	2.3%
Gold	24.4%	-7.3%	-0.8%

Table 3: Global Currencies vs. USD

	2020	Q3 2021	Q3 USD Direction
EUR	6.84%	-2.33%	USD Stronger
JPY	4.93%	-1.11%	USD Stronger
GBP	2.99%	-2.60%	USD Stronger
AUD	10.04%	-3.60%	USD Stronger
CAD	2.21%	-2.30%	USD Stronger
CHF	7.68%	1.66%	USD Weaker

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The other side of traditional portfolios (the 40% in bonds), although perhaps less risky than the equity portion, still deserves examination.

With the onset of inflation and a more hawkish Fed, expectations of rate hikes have increased since Q2. Rates are an important factor in fixed income because bond prices tend to react inversely to rates (simplistically - if rates go up bond prices go down).

Certain measures can be taken to protect a portfolio against the potential of increasing rates. One strategy is to lower the duration of the fixed income segment of the portfolio. Duration is a measure of a bond's price sensitivity to changes in interest rates. Moving fixed income from higher duration holdings to lower duration can help protect capital in a rising rate environment.

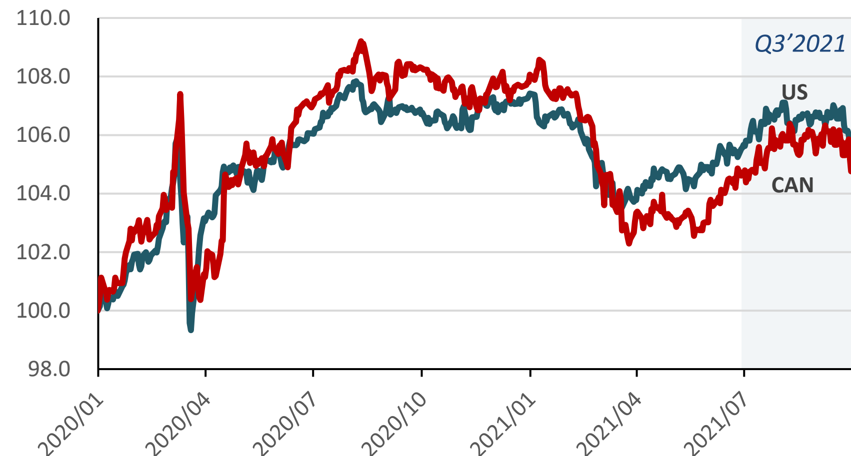
At Our Family Office our portfolios are much lower in both traditional equity weightings and duration of fixed income because we select investments from a much wider opportunity set than just the traditional stock and bond options.

We focus on building portfolios which include meaningful allocations to many Non-Traditional asset classes, including mortgages, diversified income, private debt, and direct lending.

Including these asset classes vastly improves the diversification of a portfolio beyond what can be achieved with only stocks and bonds. These investments can produce excellent returns whether the public markets are going up or down because they have lower correlations to these traditional asset classes. The result is All-Weather portfolios with superior risk adjusted returns that can withstand volatile market environments while protecting client capital.

Chart 2: Ten Year U.S. Treasury Yield (%)

Chart 3: Cdn & U.S. Bond Market Performance



Contact Us

161 Bay Street, Suite 2700
Toronto, Ontario M5J 2S1

t 416.304.9800
www.ourfamilyoffice.ca

Neil Nisker
Co-Founder, Executive Chairman & CIO
t 416.304.9870
e neil@ourfamilyoffice.ca

Tim Cestnick
Co-Founder & CEO
t 416.304.9877
e tim@ourfamilyoffice.ca

Charlie Scharfe
Investment Advisor
t 416.304.9866
e charlie@ourfamilyoffice.ca