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## The Punch You Don't See Coming...

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As an avid amateur boxer, I find hitting the heavy bag and sparring in the ring to be an excellent workout, not to mention a wonderful stress reliever after a hard day of work. However, despite all the time and effort I have spent training over the years in this sport I love, it still sucks to get knocked out, which happens more often than not. Let me explain. Each week I face-off with a new sparing partner, and as soon as I figure out that person's boxing style and weakness, my opponent changes the following. **I am often reminded of the quote from Katherine Dunn that, "in boxing, it's the punch you don't see coming that knocks you out."** And while I have yet to figure out how to anticipate the punch I can't see coming from an opponent who changes each week, for investors looking to avoid a knock-out blow in their portfolios, I have good news for you. Unlike boxing, there are some simple steps we recommend investors take to avoid a knock-out blow, including but not limited to building well-diversified portfolios both within the major asset classes (e.g., equities, bonds, etc.) and also across global asset classes (e.g., US equities, Canadian equities, International equities, Canadian bonds, US bonds, etc.).

As we have highlighted in our past research, over short periods of time, markets will remain highly unpredictable even for the smartest minds on Bay Street. Also, uncertainty/volatility comes with the territory of investing, especially in publicly traded securities. This is normal, so get used to it if you haven't already! Moreover, assets perform very differently over time, as we show in the below table, and there is no clear pattern or way of knowing precisely ahead of time which asset classes will perform the best/worst in a given year. **However, below we demonstrate that maintaining a balanced portfolio within/across global asset classes can help to minimize the chances of getting knocked out!**

### 2012-2022: Selected Asset Class Returns

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	YTD
Emerging Mkt Equities 16.0%	US Equities 41.3%	US Equities 23.9%	US Equities 21.6%	Canadian Equities 21.1%	Emerging Mkt Equities 28.7%	US Bonds 9.1%	US Equities 24.8%	Emerging Mkt Equities 16.6%	US Equities 27.6%	Canadian Equities 3.1%
International Equities 15.3%	International Equities 31.6%	US Bonds 15.5%	US Bonds 20.5%	US Equities 8.1%	International Equities 17.4%	US Equities 4.2%	Canadian Equities 22.9%	US Equities 16.3%	Canadian Equities 25.1%	Cash 0.0%
US Equities 13.4%	Balanced Portfolio 15.1%	Balanced Portfolio 12.8%	International Equities 19.5%	Emerging Mkt Equities 7.7%	US Equities 13.8%	Cash 1.3%	International Equities 16.5%	Balanced Portfolio 9.5%	International Equities 10.8%	Balanced Portfolio -4.8%
Balanced Portfolio 8.2%	Canadian Equities 13.0%	Canadian Equities 10.6%	Balanced Portfolio 9.6%	Balanced Portfolio 6.4%	Canadian Equities 9.1%	Canadian Bonds 1.0%	Balanced Portfolio 14.5%	Canadian Bonds 8.6%	Balanced Portfolio 10.2%	US Bonds -5.1%
Canadian Equities 7.2%	US Bonds 4.6%	Canadian Bonds 8.3%	Canadian Bonds 3.3%	Canadian Bonds 1.3%	Balanced Portfolio 9.0%	Balanced Portfolio -0.1%	Emerging Mkt Equities 12.9%	International Equities 6.4%	Cash 0.0%	Canadian Bonds -6.7%
Canadian Bonds 3.4%	Emerging Mkt Equities 4.3%	Emerging Mkt Equities 7.0%	Emerging Mkt Equities 2.4%	Cash 0.5%	Canadian Bonds 2.4%	International Equities -5.6%	Canadian Bonds 7.3%	Canadian Equities 5.6%	US Bonds -2.6%	US Equities -7.1%
US Bonds 1.5%	Cash 0.8%	International Equities 4.1%	Cash 0.5%	US Bonds -1.1%	Cash 0.6%	Emerging Mkt Equities -6.5%	US Bonds 3.0%	US Bonds 5.6%	Canadian Bonds -2.8%	International Equities -7.5%
Cash 0.8%	Canadian Bonds -1.3%	Cash 0.8%	Canadian Equities -8.3%	International Equities -2.0%	US Bonds -3.2%	Canadian Equities -8.9%	Cash 1.6%	Cash 0.5%	Emerging Mkt Equities -3.1%	Emerging Mkt Equities -8.7%

Source: FactSet, Raymond James Ltd. Data as of March 21, 2022. All returns are in CAD. Asset classes are represented by: S&P/TSX Composite TR Index (Canadian Equities); iShares Core Canadian Universe Bond Index ETF (Canadian Bonds); S&P 500 TR Index (US Equities); iShares Core U.S. Aggregate Bond ETF (US Bonds); MSCI EAFE (International Equities); MSCI EM (Emerging Market Equities); iShares Premium Money Market ETF (Cash); The asset allocation of the Balanced Portfolio is 20% Canadian Equities + 20% US Equities + 10% International Equities + 10% Emerging Market Equities + 20% Canadian Bonds + 20% US Bonds

Please read domestic and foreign disclosure/risk information beginning on page 5.

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2.

2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

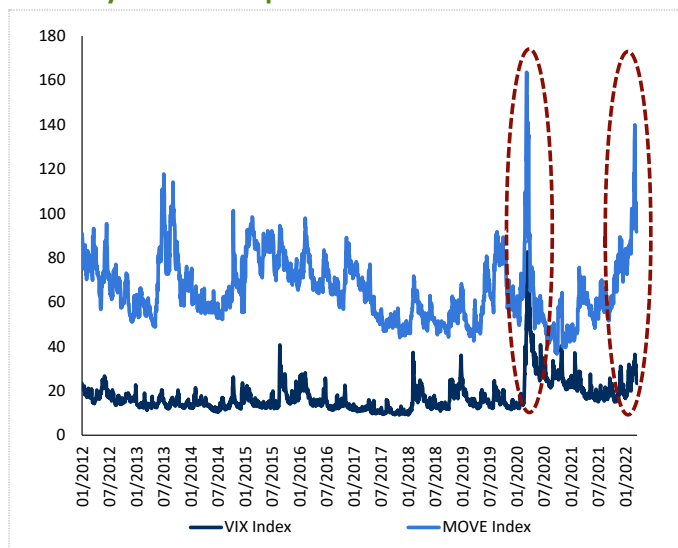
## Volatility Measures – A Right-Hook for Markets

The VIX and Move index are commonly referenced volatility measures for the US equity and bond markets, and as an extension, reflects investor expectations for volatility on global equity and bond markets. The higher the number registered by each of these indices, the greater the volatility expected by market participants.

As the below chart shows, volatility has surged periodically over the past 10 years, driven by one factor or another. The largest spike observed over this period occurred during the early days of the COVID-19 pandemic, when the global economy went into lockdown. This has been followed by the recent surge in volatility in 2022.

We believe several factors have contributed to the recent spike in volatility/uncertainty including: **1)** policy tightening and the uncertainty associated with the removal of stimulus by central banks globally; **2)** new COVID-19 variants and lockdowns; **3)** Russia's invasion of Ukraine; and, **4)** soaring/stubbornly high inflation.

### Volatility Measures Spike in 2022...Now What?



Source: FactSet; Data as of March 21, 2022

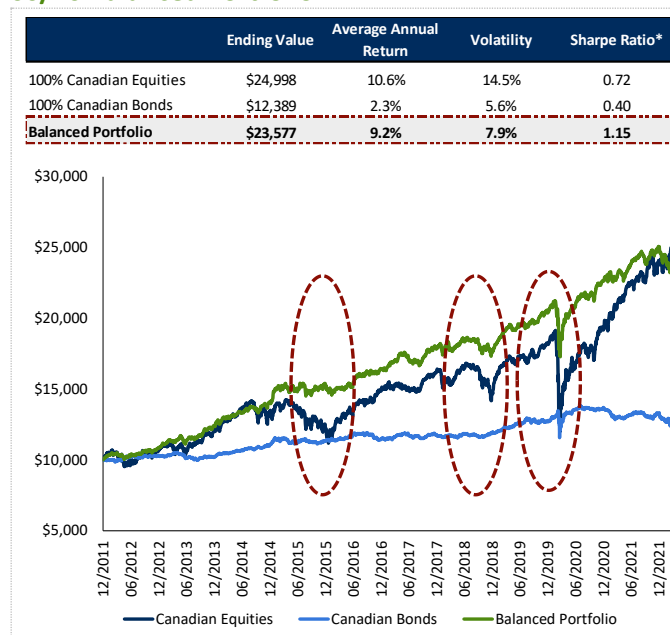
### Avoiding the Knock-Out Punch!

While some may argue the case of selling everything and running for the hills amid all the uncertainty, **we would prefer to avoid making fourth quarter calls in the first quarter.** While we do agree that the outlook remains more uncertain than it did at the beginning of the year, how things play out over the next several quarters is really anyone's guess. But this does not suggest that investors should maintain the status quo. Rather, as we demonstrate in the following chart, Canadian equity investors can make some modest adjustments to their

portfolios to help improve the risk/reward profile of their portfolios and, more importantly, cushion the blow from periodic and frequent pikes in volatility/uncertainty by adding global asset classes to their portfolios.

In the following simple illustration, we use a 60/40 balanced portfolio with the same asset allocation breakdown as the balanced portfolio in the above chart (2012-2022: Selected Asset Class Returns). What this simple example demonstrates is that rather than attempting to predict the unpredictable knockout punch, investors are better served by focusing on what they can actually control. That is, diversifying their portfolios within and across global asset classes, and more importantly, staying invested! The end result is a portfolio that generates a return comparable to a 100% Canadian equity portfolio, with much less volatility and a more attractive risk/reward profile as reflected by the Sharpe ratio - measures the performance of an investment, such as a security or portfolio after adjusting for its risk; the higher the number the greater the return achieved for a given unit of risk.

### 100% Canadian Equities vs. 100% Canadian Bonds vs. 60/40 Balanced Portfolio



Source: FactSet; Data as of March 21, 2022. All returns are in CAD. Asset classes are represented by: S&P/TSX Composite TR Index (Canadian Equities); iShares Core Canadian Universe Bond Index ETF (Canadian Bonds). \*The return of iShares Premium Money Market ETF is used as the risk-free rate in the Sharpe ratio calculation.

**Nadeem Kassam, MBA, CFA, Head of Investment Strategy**  
**Eve Zhou, Multi-Asset Analyst**

## Be Aware of the Home Country Bias

Our top-down research suggests a more constructive stance on Canada, given our market's inherent exposure to cyclical sectors such as financials, energy, materials, etc., which we favour amid the current macroeconomic backdrop. Despite our preference for the Canadian market, investors should be mindful of home country bias. Home country bias refers to an investor's tendency to allocate a substantial proportion of their investments to domestic companies over those in other countries/regions. This makes sense as individuals are familiar with products and services offered by companies in their home markets and may be consumers of them. In fact, an underlying investment characteristic of renowned investors like Warren Buffett and Peter Lynch is to "buy what you know." However, while Canada represents only ~4% of the MSCI World Index, the average Canadian allocates ~45% to local securities, or 41% greater than the global benchmark. Of course, this tendency is not unique to Canadians as other global investors hold a similar bias.

### Reducing Concentration Risk

The problem with the home country bias, and why investors should pay closer attention to it, is that portfolios can become concentrated, or may overexpose investors to unnecessary systemic risks that could otherwise be diversified away by adding non-domestic exposure. To address home country bias, Canadian investors may consider allocating to US equities or international equities through American Depositary Receipts (ADRs). Investing outside Canada introduces currency risk (i.e., risk of adverse or unfavorable moves in exchange rates), but thanks to CIBC's recently introduced Canadian Depositary Receipts, or CDRs, Canadian investors can now gain access to 23 of the largest US companies on a currency hedged basis, which can facilitate portfolio diversification in a cost-effective manner.

### Access to World Markets in Canadian Dollars

CIBC launched CDRs in 2021, intending to help Canadians reduce their home country bias. Modelled after ADRs, these securities represent shares of a foreign company and trade locally, as any other Canadian security would. The largest benefit of CDRs is the notional currency hedge, which allows investors to buy shares of foreign companies in Canadian dollars. As opposed to US equities or US-listed ADRs, Canadian investors would not need to exchange their Canadian dollars into US, minimizing FX costs and reducing currency risk. In other words, CDRs allow investors to "own the company, not the currency."

CDRs are also more affordable. With an initial price of \$20 per unit, CDRs allow holders to own a fraction of the underlying

security's actual shares. **One way to think about CDRs is they are akin to a CAD-hedged ETF that only owns one stock.**

Fractional ownership not only makes CDRs affordable but also gives smaller investors access to certain high-priced stocks. Nasdaq-listed Alphabet (GOOG-US) shares are trading at over US\$2,800 per share, or around CAD\$3,600. However, the equivalent CDR is currently priced at CAD\$24.76 per unit. While investors gain ownership of only a small fraction of a share of Alphabet (0.007 of a share in this case), their portfolios gain exposure to price moves in GOOG-US irrespective of moves in the USD/CAD. In summary, key features of CDRs include:

- *Trade on local stock exchange:* trade in CAD
- *Less currency risk:* through currency hedge
- *Affordability:* a lower price point

### List of Canadian Depositary Receipts

Company Name	US Ticker	Price per US share (USD)	Price per US share (CAD)	CDR Ticker	Price per CDR (CAD)	CDR Ratio
AMD	AMD-US	\$123.23	\$154.28	AMD-CA	\$24.74	0.160
Alphabet	GOOG-US	\$2,865.00	\$3,586.98	GOOG-CA	\$24.76	0.007
Amazon.com	AMZN-US	\$3,386.30	\$4,239.65	AMZN-CA	\$21.10	0.005
Apple	AAPL-US	\$178.96	\$224.06	AAPL-CA	\$27.33	0.122
Bank of America	BAC-US	\$43.44	\$54.39	BOFA-CA	\$23.72	0.436
Berkshire Hathaway	BRK.B-US	\$355.12	\$444.61	BRK-CA	\$27.81	0.063
Costco Wholesale	COST-US	\$569.98	\$713.61	COST-CA	\$27.34	0.038
Goldman Sachs Group	GS-US	\$339.66	\$425.25	GS-CA	\$17.69	0.042
Home Depot	HD-US	\$317.71	\$397.77	HD-CA	\$21.29	0.054
IBM	IBM-US	\$131.94	\$165.19	IBM-CA	\$21.00	0.127
JPMorgan Chase	JPM-US	\$141.18	\$176.76	JPM-CA	\$19.55	0.111
Mastercard	MA-US	\$367.55	\$460.17	MA-CA	\$24.09	0.052
Meta Platforms	FB-US	\$229.86	\$287.78	MVRS-CA	\$13.37	0.046
Microsoft	MSFT-US	\$315.41	\$394.89	MSFT-CA	\$23.99	0.061
Netflix	NFLX-US	\$391.82	\$490.56	NFLX-CA	\$15.91	0.032
NVIDIA	NVDA-US	\$286.56	\$358.77	NVDA-CA	\$28.33	0.079
PayPal Holdings	PYPL-US	\$121.18	\$151.72	PYPL-CA	\$9.47	0.062
Pfizer	PFE-US	\$52.74	\$66.03	PFE-CA	\$25.32	0.383
salesforce.com	CRM-US	\$221.29	\$277.06	CRM-CA	\$18.43	0.067
Tesla	TSLA-US	\$1,099.57	\$1,376.66	TSLA-CA	\$35.31	0.026
Visa	V-US	\$228.12	\$285.61	VISA-CA	\$22.50	0.079
Walmart	WMT-US	\$147.23	\$184.33	WMT-CA	\$22.01	0.119
Walt Disney	DIS-US	\$142.38	\$178.26	DIS-CA	\$17.27	0.097

Source: FactSet; Priced as at March 30, 2022; USD/CAD rate of 1.252. CDR ratio = approximate number of shares that each CDR represents.

### Another Tool in the Diversification Toolkit

CDRs are an additional tool that allow Canadian investors to reduce their home country bias and diversify their portfolios geographically with the added benefit of reducing currency risk. The current CDR lineup includes 23 blue-chip US companies, which are listed above, counting companies such as Amazon.com, Costco and Tesla, among others, and the lineup continues to expand. To learn more, please reach out to your Raymond James financial advisor.

**Larbi Moumni, CFA**  
Portfolio Manager & Senior Equity Specialist

## A Bond for Stability

When investors think of predictability, fixed income asset class may come to mind and with good reason. Historically, bond returns tend to stay within a narrower range/less volatile than their equity, commodity, and currency counterparts. Fixed income prices show greater consistency, meaning that large negative returns in any given year are not as likely. However, since risk and return are correlated, the lower risk that comes with fixed income dictates that outsized returns are also abnormal. This “steady as she goes” characteristic of fixed income helps to provide stability for portfolios throughout periods of volatility/uncertainty in the business cycle.

### Bond Effects on Portfolio Volatility

Bonds can play an important role in a well-diversified portfolio, helping to minimize overall volatility while providing a predictable income stream. Generally, in years where Canadian equity returns fared poorly, Canadian bonds usually performed better, helping to smooth out the risk/return profiles of the portfolio.

### Applications in Practice

Because of their less-risky nature (as an asset class overall), some investors look to fixed income for capital preservation. For others, the ability to align bond maturities or coupon payments with future obligations such as a house down payment or educational needs is the reason they invest in bonds. Predictability and a lower risk profile are strong characteristics of most fixed income investments.

In the past, many investors turned to bonds for a stable income stream for retirement or as supplementary cash flows. However, in recent years, yields have fallen dramatically, making such strategies more difficult to rely just on bonds. Although we expect that interest rates will rise in 2022 (and beyond), they may remain lower in a broader historical context. To address this issue, one should view fixed income as contributing to an overall financial plan, where combined with other investments like equities, long-term goals and objectives can be achieved.

### Diversifying Effectively

Diversification does not end at the asset class level – investing in a variety of bond types, issuers, credit qualities and maturities can create a stronger bond sleeve and portfolio overall. Deciding how to allocate within a bond sleeve depends on many aspects, including the investor's time horizon, risk tolerance, and need for income.

- **Issuer:** Bonds are issued by a number of entities, including governments (federal, provincial, municipal), crown

corporations, and corporations. In general, corporate bonds carry a higher yield than government debt, all else equal.

- **Credit quality:** There are several credit rating companies that are paid by the issuer to apply a rating to their bonds, including Standard and Poor's, DBRS and Moody's. Credit ratings can largely be grouped into investment grade (AAA+ to BBB-) and non-investment grade (or high yield / junk, with a rating of BB- or lower), and reflect trust in the issuer making every interest payment and the final principal payment on time.
- **Maturity:** Time to maturity describes the number of days/years for the bond to be repaid in full. Issuers usually need to pay bondholders a higher yield to hold onto their capital for a longer period of time - thus yields increase the further out on the curve. Maturities can be viewed as short-term, medium-term, or long-term.
- **Features:** Some bonds may have unique features, like inflation adjustments (TIPS or real return bonds), changes in rates (step-ups), or lock-in provisions, like GICs. Clients should ensure that they are aware of the pros and cons of any security that could affect the liquidity or return of their investment.

When building a diversified portfolio, fixed income definitely has a seat at the table. Including this asset class allows investors to balance out riskier holdings, smoothing out the highs and lows in the return profile for a portfolio. We encourage investors to periodically review their investments and adjust when necessary to reflect current financial goals and market conditions. We also remind investors to consider the security makeup as well, as choosing a variety of products with differing characteristics can also be beneficial to achieving your investment goals.

*Charlotte Jakubowicz, CIM, CMT  
VP, Fixed Income & Currencies*

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