Home Country Bias from Toronto to Rio de Janeiro!

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

DISCLAIMER: The portfolios managed by the author is not exposed to holdings of the company discussed below.

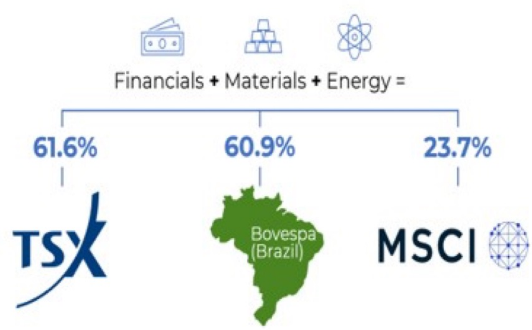
"If you took a flight into Toronto, you would see a sea of green TD Bank branches. I'm proud to say that tourists would see we're the only game in town."

– Former TD Bank CEO Ed Clark

It's almost 10 years since I met with Ed Clark at a small group lunch, and I remember that line as if it were yesterday. Ed's comment perfectly encapsulated the state of the Canadian market and economy: financial services and banking in Quebec and Ontario, agriculture in Central Canada, and resource extraction in Western Canada. As Canadians, we have an economy and a stock market that are concentrated in a few select industries. We can easily lose sight of this state of affairs and reinforce our home country bias by believing that diversification means owning not just TD but also RBC and CIBC. But that approach doesn't diversify our portfolio; instead, it concentrates risk in a handful of historically cyclical sectors while harvesting a cyclical dividend yield.

As investors with a global mindset, we can look around the world and see many parallels to our predicament here in Canada. Surprisingly, a country with a similar-sized economy and stock market breakdown is Brazil. The Brazilian stock market is almost the same as Canada's, with a significant concentration in the same three sectors: financials, materials, and energy. When a small handful of sectors makes up more than 60% of your stock market, diversification is impossible because there's simply very little to choose from.

In addition, these three sectors are known to have higher levels of cyclicality than other parts of the market. Energy and materials stocks are clearly in the cyclical-yield category, because no individual company can control its revenue with certainty; various global factors move oil and gas prices every day. Financials also exhibit volatility over time, amid fears of credit losses during downturns and recessions.



That said, the parallels don't stop there; we see a similar story when we dig deeper and look at the top 10 companies in Brazil and Canada.

Given the backdrop for these markets, it's no surprise that the largest stocks in both countries are heavily concentrated in a few sectors. In Brazil, we have a very similar breakdown of the banking system, with the Brazilian RBC being Itau Unibanco and the TD Bank peer being Banco Bradesco. In fact, we see similarities with all five of the big Canadian banks and their counterparts in Brazil.

But no two economies are the same, and we do see some divergence, with Canada having a slightly more significant industrial footprint, specifically CP and CN Rail, as well as e-commerce enabler Shopify as our domestic technology champion. Brazil has world leader Ambev, which is part of the brewing giant Anheuser-Busch, the maker of Corona, Stella Artois, and other brands. Brazil also has a successful industrial sector, with world leader WEG SA catering to global markets.

Canada (top 10)	Brazil (top 10)
RBC (Financials)	Petrobas (Energy)
TD Bank (Financials)	Vale (Materials)
CNQ Resources (Industrials)	Itau Unibanco (Financials)
Enbridge (Energy)	Banco Bradesco (Financials)
CP Rail (Industrials)	Banco do Brasil (Financials)
Shopify (Technology)	Electricas Brasileiras (Utilities)
CN Rail (industrials)	Bolsa Balcao (Financials)
BMO (Financials)	Ambev (Consumer)
Scotiabank (Financials)	WEG SA (Industrials)
Brookfield Corp (Financials)	Itausa (Financials)

The story In many parts of the world, including Canada, Australia, Brazil, Chile, and Mexico, is precisely the same: a stock market dominated by financial services and resource extraction, with the exception of a handful of stocks in other industries that have grown to become national champions in their own right.

We can crisscross the world, from Toronto to Rio de Janeiro to Sydney to Mexico City, and see the same issue all local investors face: a glaring lack of diversification in local markets and a home country bias driven by clients' familiarity with local stocks.

I think this context makes the conversation about going global, anchored by a quality-focused dividend growth strategy, such as the Global Dividend (iA) Fund, critical to your asset allocation for clients. This fund offers a one-of-a-kind combination of stocks that are proven global leaders in their industries, with a very small weight in the Canadian market. We realize that building a fully diversified portfolio is a marathon, not a sprint. Our promise to you as the iAGAM Global Dividend team is that you can make your clients' global investment journey as seamless as possible by partnering with us – a passionate, dedicated group specializing in the ocean of opportunity that is global equities.

Dan Rohinton

P.S. Official definition of "home country bias": Investors' tendency to favour companies in their own country over those in other countries or regions. The tendency to invest in our own backyard is neither unusual nor surprising; far from being unique to Canadian investors, it's a worldwide phenomenon.

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Canadian Tire: A Lens Into Consumer Psychology

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

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There are few retailers in Canada quite like Canadian Tire. As you go down the almost hundred aisles, you will see a collection that starts with tires and goes to pots, pillows, shovels, and finally seasonal Christmas knick-knacks. So when they report earnings, it provides a great read-through on how Canadian consumers are navigating the current economic environment and their state of mind. So, what did we learn?

Focusing on Essentials: There was a clear mindset shift this quarter in the consumer, highlighting the greater emphasis they are placing on essential products at the expense of non-essential/"discretionary" items. It's natural for consumers with higher interest rates to be cautious about spending on seasonal items, but the area that was most clear was one of the secondary banners within the Canadian Tire group, Sport Chek. Sales at Sport Chek were a dismal -7.4% year-over-year, which shows the magnitude of the shift in consumer mindset from just last year. Consumers are voting with their feet that the new pair of Air Jordans can wait until a future date, but essential services like tire changes are going ahead as normal. I see this trend continuing until wages and consumer confidence improves.

Geographic Disparity: The language couldn't be clearer about the uneven consumer confidence across geographies. Canadian Tire specifically called out "the soft consumer spending experienced in Q2 persisted into Q3, particularly in Ontario & BC." It's not a coincidence that both Ontario and BC have the highest national home prices and the most leveraged consumers. These are the exact consumers that are most likely to feel the pinch from higher interest rates, forcing them to make difficult decisions about spending.

The global story we have seen with consumers becoming more cautious about their spending habits around the world is even more meaningful in Canada. On average, Canadians have more debt and don't have the luxury of refinancing their mortgage for 30 years like our US peers. I expect consumers will focus on essentials and staples for the foreseeable future, creating opportunities in certain areas and risks in others.

Have a great weekend!

Make It Make Sense: Inflation Down, Markets Up Strong?

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

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Markets are always evolving. We've recently have seen periods where bad economic news = markets up and good economic news = markets down, which can be confusing for many casual market observers. Now, inflation has become the primary focus for markets. We are in a world where strong inflation means markets are down, and weak inflation means markets are up. But what's going on here, and why is the market behaving this way?

Why is inflation bad?

First, let's appreciate why high and unpredictable inflation is harmful for both Wall St and Main St. Inflation is arguably the most regressive tax you can imagine, with the "tax" from higher prices weighing heaviest on the lowest-income consumers in the economy. This has always been true historically because the average low-income family has far less saved and spends nearly all their salary on necessities. Higher inflation makes it harder each year to maintain the same standard of living. However, for their businesses, high inflation and limited visibility make business planning difficult, creating inefficiencies in the system that impact profit margins and business resiliency. This is why the Fed cares about the rate of inflation and its underlying drivers. It's their top priority, and it should be!

Federal Reserve credibility?

After one of the fastest interest rate hiking cycles in decades, the question now is, what is the impact of these hikes on inflation. This is primarily credibility debate because investors rely heavily on the ability of central banks to maintain control of inflation and employment. If their interest rate and quantitative easing/tightening tools don't work over time, markets are losing the monetary anchor they've had for a century. It's natural, then, for the market to see signs of softening inflation across more sub-categories as a positive and constructive trend. Fed credibility is being rebuilt with every softer inflation data point. This also has the important effect of lowering the likelihood of more interest rate increases and opening the door for rate cuts in the future.

As a massive oversimplification, as inflation has been coming down and interest rates have been falling on the longer end of the yield curve, there is more breathing room for corporations and consumers alike. Their likelihood of avoiding severe economic stress also declines because there's relief on consumer loans, and corporate borrowing costs. Only after putting all these pieces together does the market reaction start making sense. Markets are reacting to inflation because investors are looking ahead and predicting how the economy will react and how central banks will adjust policy with the new information. For the near future, the debate will be inflation. So when you see inflation down, expect markets to likely be up, or vice versa. That's the playbook until the next paradigm shift we move into.

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About iA Global Asset Management (iAGAM)

ROOTED IN HISTORY, INNOVATING FOR THE FUTURE.

A magnet for top investment talent, iA Global Asset Management is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths, and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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