



CUMBERLAND

Private Wealth

Fourth Quarter 2021 Review

GLOBAL EQUITY AND INTERNATIONAL STRATEGIES

2021 was an interesting year for investors to say the least. Stocks surged on the back of a global vaccine rollout, investors embraced cryptocurrency as Bitcoin soared to new heights, and the Metaverse became a mainstream concept with Facebook changing its name to Meta Platforms in a symbolic move.

Compared to the roller-coaster year that was experienced in 2020, 2021 was a much steadier year that generated very strong returns for investors with significantly less volatility. The gains were generally broad based around the world with the MSCI World Index increasing by 20.1%, the S&P 500 Index rising 26.9%, and the Euro Stoxx 600 Index increasing by 22.3%. The Emerging Markets were notable laggards as the MSCI Emerging Markets Index declined by 4.6% during 2021. Volatility was muted in 2021 when compared with 2020. During the first quarter of 2020, the S&P 500 experienced a drawdown of approximately 34% as investors worried about the unfolding pandemic. This compares with 2021, when the S&P 500's maximum drawdown was limited to a downward move of just over 5%.

The robust stock market gains in 2021 were driven by ongoing improvements in the global economy and progress with vaccinations. We expect the economic recovery to continue in 2022 as economic data continues to be strong thereby providing further evidence that the global economy is recovering from the recession of 2020. In addition to strong economic data, vaccination rates continue to climb higher around the world with some people receiving their first or second dose while others are receiving their third dose in the form of a booster shot.

Portfolio Review

Portfolio activity was busy during 2021 as our research efforts were highly productive in terms of generating new ideas for our portfolios. As a result, we initiated several new holdings across the Global and International strategies. A brief description of each new holding follows:

- **Aon plc** is a leading global professional services firm that provides advice and solutions to clients focused on risk, retirement, and health. The company delivers a distinctive value proposition to its clients through innovative and effective risk management solutions that are under-pinned by industry leading data and analytics. As one of the world's largest insurance brokers, Aon plc is uniquely positioned to help its clients with their risk-management functions given that large brokers can search the insurance market in a highly efficient manner. The company has more than 50,000 employees and it provides solutions to clients in more than 120 countries around the world. Aon is headquartered in Ireland.
- **Capgemini** is a leading IT Services firm that provides consulting, technology, professional, and outsourcing services. The company provides a wide range of solutions including business process management & outsourcing, cloud services, consulting services, cybersecurity, digital customer experience, finance & accounting, supply chain management, and workforce management solutions. Capgemini provides significant value to its customers by leveraging its deep industry expertise and its command of fast-evolving fields such as cloud, data, artificial intelligence, connectivity, and software. The company has more than 270,000 employees and provides its services in approximately 50 countries. Capgemini is headquartered in France.



- **Experian** is the largest credit bureau in the world and is also one of the largest information services companies in the world. The company is well positioned to benefit from major structural tailwinds associated with the collection and use of consumer and business data. The growth in the market for big data and analytics, identity protection, and healthcare data is expected to drive future demand for Experian's services. Experian is a highly cash-generative company and it operates a scalable business model which allows the company to grow revenues quickly at a low incremental cost. The company employs 17,800 people and operates in 45 countries around the world. Experian is headquartered in Ireland.
- **Ferguson** is the world's leading value-added distributor of plumbing & heating products and it principally serves the repair, maintenance, and improvement markets. Ferguson has strong market positions across its business segments and it generates 70% of its revenue from end markets where it has No.1 or No.2 market share. As a market leader the company benefits from economies of scale across its technology, sourcing, and supply chain network, which many of its local competitors cannot compete with. The company provides a strong value proposition to its customers by providing innovative solutions and a great customer experience. The company employs 31,000 associates and distributes its products through more than 1,650 branches. Ferguson is headquartered in the United Kingdom.
- **Kering** is one of the world's largest luxury companies and it owns several iconic brands including Gucci, Yves Saint Laurent, and Bottega Veneta. The company has a strong presence across most of the major sectors of the luxury market including fashion, leather goods, jewelry, and watches. Like its peer and fellow Portfolio holding LVMH, Kering is a family-controlled business with a strong owner in Francois-Henri Pinault. The company operates through a multi-brand conglomerate approach, which has created value for shareholders. The company employs more than 38,000 people and it operates approximately 1,500 luxury stores globally. Kering is headquartered in France.
- **Bath & Body Works** is the No.1 fragrance specialty retailer in North America with leading market positions across several categories including body care, home fragrance products, soaps, and sanitizers. Management estimates that the company has 20%+ market share across 60% of its portfolio. The company was recently spun out from its parent company (L Brands) and we believe that management will unlock value as it expands its highly profitable and fast-growing business. The company operates more than 1,750 Bath & Body Works stores in the US and Canada, and it also sells its products online. Additionally, Bath & Body Works has approximately 300 stores in more than 30 other countries operating under franchise, license, and wholesale arrangements. Bath & Body Works is headquartered in the United States.
- **Marsh & McLennan** is a global professional services firm offering clients advice and solutions in risk, strategy, and people. The Company operates its business through two segments: 1) Risk and Insurance Services, which includes risk management, insurance, and reinsurance broking & services; and 2) Consulting, which includes health, wealth, and economic & brand consulting services. As one of the world's largest insurance brokers, Marsh & McLennan is uniquely positioned to help its clients with their risk-management functions given that large brokers can search the insurance market in a highly efficiently manner. The company has 76,000 colleagues worldwide and provides its services to clients in more than 130 countries. Marsh & McLennan is headquartered in the United States.



- **SVB Financial Group** is a fast-growing U.S. bank with strong roots in venture capital. The bank has significant exposure to high growth verticals such as Technology and Healthcare. For many years, the bank was considered the farm system for the larger banks. Although SVB Financial historically developed strong relationships with start-up companies, once these companies reached a certain size, they would often leave SVB Financial and take their business to the larger banks which offered much broader capabilities. In recent years SVB Financial has transformed itself from catering to start-ups only to now providing large companies with traditional banking products including capital markets products, personal banking products, and wealth management services. SVB Financial Group is headquartered in the United States.
- **Topaz** acquires royalty and non-operated energy infrastructure assets and through its original counterparty Tourmaline Oil Corp., it completed its initial public offering in October 2020. Topaz has 83% of its assets tied to the price of natural gas. As a non-operator, almost all of Topaz' royalty production and processing revenue converts to free cash flow supporting a reliable and sustainable dividend. Its dividend payout ratio is currently 50%-55% versus the Company's long-term target of 60%-90% so we expect ongoing dividend increases in 2022. With annual capital commitments from third party producers of \$1.5bn per year over next two years on their royalty lands, Topaz expects a 17% compound annual growth rate of production over next three years. Having reached a threshold of over \$2bn in market cap and expanded its float recently, Topaz was added to the S&P/TSX composite index effective December 20th, 2021. This can potentially broaden participation in a company's investor base. Topaz Energy is headquartered in Canada.

Outlook for 2022

As the New Year gets underway, the stock market is facing several obstacles including rising inflation, tighter monetary policy, the rapid spread of the Omicron variant, and a deceleration in both corporate earnings growth and global economic growth. While each of these obstacles present a challenge for investors, we do not believe they are insurmountable. We believe that there is a substantial amount of pent-up demand that will continue to provide support for the global economy. Given this view, we are cautiously optimistic on global equity markets as 2022 begins.

As we think about 2022, we view inflation as one of the key risks for the global economy given that inflation is rising at its fastest pace in the last 30 years. Economists and policy makers hope that inflation will be transitory. However, if inflation remains stubbornly high, central banks may be forced to start raising interest rates sooner and at a faster rate than the what the market currently expects. The question of whether inflation is transitory is important given that stocks have performed very well in the low interest rate environment that has existed over the last decade. Investors have coined the acronym TINA (There is No Alternative) to describe this phenomenon of investors paying higher prices for stocks with low interest rates as the primary justification. However, if inflation remains elevated for too long it may force central banks to raise interest rates sooner and at a faster pace than current market expectations. If this scenario unfolds, it is almost certain that investors will lose faith in TINA.

Figuring out whether the current wave of inflation will be transitory is a complicated exercise given that there are so many variables to consider. There are several questions that must be addressed to get to the bottom of the inflation debate. Some of these questions include 1) Will disrupted global supply chains be repaired in the next 6-12 months? 2) Is the housing market strength sustainable, and if so, can the supply side catch up? 3) Will enough people return to the workforce to resolve the severe labor shortages that exist today? 4) Will tensions between China and the United States result in a long-term move away from globalization, which has kept inflation under control for decades? 5) Will productivity surge on the back of new efficiency gains resulting from the pandemic, thereby reinforcing the decades-long disinflationary pressures that have existed around the world?



These are difficult questions and the answers are not obvious. It is therefore a significant challenge to model the future level of inflation with any degree of accuracy. Instead of trying to predict the future rate of inflation, we have positioned our portfolios for a wide range of scenarios. We believe that our portfolios have been constructed in a way that can hold up well in different types of economic backdrops including both inflationary and disinflationary environments. We believe the best way to accomplish our goal is to invest in high quality companies or what we refer to as Quality Compounders. High quality companies have strong market positions, sustained pricing power, and seasoned management teams that can adapt to changes in the economic environment. In a higher inflationary environment, we believe that our companies will be well positioned due to their strong pricing power which will allow them to raise prices at least as fast as their costs. High quality businesses typically have strong value propositions that allow them to pass on higher inflation to their customers. The ability to pass on higher inflation means that our companies can maintain or increase their expected future free cash flows in real, inflation-adjusted terms. In a disinflationary environment, we believe our companies' pricing power will enable them to prevent their prices from falling as fast as their costs. Furthermore, we believe that the dominant market positions and conservative balance sheets of our companies would allow them to survive and take market share from distressed competitors in a tougher economic backdrop. In a nutshell, our portfolio positioning is not determined by a view on whether inflation will be transitory or not. Instead, we have constructed our portfolios with high quality companies that can perform well across a wide range of different economic environments.

In summary, we believe that the global economy will continue to recover during 2022 and we are cautiously optimistic about global equity markets. We are even more optimistic about the companies that we own across our portfolios. Our global and international mandates continue to be constructed with high quality companies that are well positioned to compound the value of their business in the years ahead.

Phil D'Iorio

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Cumberland* Global and International Equities

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*Cumberland refers to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). CIC acts as sub-advisor to certain CPWM investment mandates including the CPWM Global and International mandates with Phil D'Iorio as its lead Portfolio Manager. Phil D'Iorio is a Portfolio Manager at CIC.

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