RESEARCH CAPITAL CORPORATION

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We hope this e-mail finds you well and staying warm!

It is said that equity markets climb a wall of worry and 2021 was no exception. As we look forward to 2022, we can learn from the past, as we pave the way to the future.

Covid remains the top story facing global markets and they are responding accordingly to the uncertainty surrounding the emergence of new variants, specifically Omicron. Global markets initially pulled back with the news out of South Africa, only to recover going into year end. The New Year has seen multiple contractions in the high-flying technology sector which has spilled over into the broad indexes.

The Federal Reserve and Bank of Canada are poised to raise interest rates 3 to 4 times in 2022 in order to combat inflation. Constraints on supply chains and the labour markets are driving this. The U.S. Federal Reserve will also end quantitative easing and may reduce the bond positions held on their balance sheets. The pace of this tightening is unclear, and this has caused the equity and bond markets to revalue asset prices. This should lead to higher interest rates across the yield curve and may constrain growth and equity valuations in 2022 and beyond. Financials should perform well in this environment as yield spreads widen while bond yields edge higher.

We anticipate that returns for 2022 should be moderate compared to those generated in 2021. Higher interest rates typically lead to poor performance for bonds. There can also be a repricing of equities as fixed income yields become relatively more attractive. The Global

Central banks have done a good job engineering the recovery to this point and now need to normalize conditions. Global credit remains stable and economic growth continues. If this normalization is done in a consistent, data dependent fashion, then a “soft landing” may be attained. The risk is that there will be policy mistakes that may slow economic growth too quickly and build up recessionary pressures.

China’s continued lock down/Zero COVID continues to disrupt the flow of goods. If ports and factories are shut down, supply chain issues will continue, leading to even higher prices for consumer goods. Once Omicron has peaked it may be possible that the global supply chain bottlenecks and backlogs will ease, and consumer goods will become more widely available leading to a more sustainable inflation level.

The situation in the Ukraine also needs to be monitored as an escalation could cause natural gas prices to spike in Europe. It could also affect the global growth picture if tensions escalate between Russia and the United States.

As we begin 2022, we are seeing a reversion of valuations and prices. High flying equities with little or no earnings and cash flow have seen their multiples compressed leading to a move towards tangible assets with the ability to generate revenue. This bodes well for the TSX due to the Canadian focus on financials, energy, and materials. We anticipate that commodity prices for oil, natural gas and a wide range of base metals may remain elevated as lack of drilling and exploration have not allowed supplies to keep pace with demand.

Companies with the ability to raise dividends and buy back shares should perform relatively well in this environment as the dividend increases will help offset the impact of higher inflation. Financial services, pipelines and some utilities should benefit especially those which are self-funding. Utilities with high debt ratios and limited ability to increase rate base, some REITs and indebted growth companies with little to no earnings could suffer as debt rolls over at higher interest rates. Large cap technology stocks should offer value when the technology sell off settles.

It is important to note that historically equity markets have moved higher as rates rose, although at a subdued pace. This is because the underlying economy was strong. We may see a corrective phase in the near term with equity markets declining, however this will likely be followed by a recovery. The equity markets should be able to grow slowly but steadily in this climate with rates remaining accommodative at historically low levels.

As always, if you have any questions or just want to touch base, we are just a phone call or e-mail away.

Have a great month,

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