FIRST CAPITAL FINANCIAL

WORLDSOURCE FINANCIAL MANAGEMENT INC.
Sponsoring Mutual Fund Dealer

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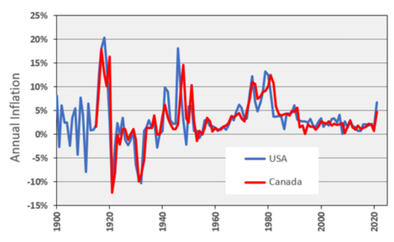
As of the end of November inflation in the U.S. hit its highest mark in 39 years -a whopping 6.8%. Here in Canada is was somewhat less at 4.7%, but nonetheless requires a look at inflation from an historical point of view.

"... but if daddy raised your allowance he'd be hurting the economy by stimulating inflation. You wouldn't want him to do that, would you?"

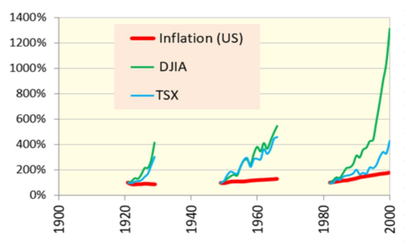
Figure 1 shows a high correlation between inflation rates in both countries, and identifies three distinct periods where inflation was north of 10%. This invites the question as to how asset classes performed during periods of high/higher inflation. Overall, equities have traditionally provided a hedge against inflation, though not in every time period.

Source: Advisors Edge



As summarized in **Figure 2**, history shows that equities beat inflation during secular bullish trends, the very environment that we believe we are in now and expect to be in 2022. Note that the performance of US stocks (using the bell-weather Dow Jones as proxy) significantly outperformed Canadian equities exact of these time periods. This strengthens the case for our asset allocations, which have roughly 55% of their weightings in US stocks.

Source: Advisors Edge



Noteworthy however is that Canadian equities performed better during secular sideways or bearish markets, reflecting the resource-heavy composition of the TSX, where energy, precious metals and real estate sub sectors dominate. Operating companies here are better able to pass along price increases to customers and maintain profit margins.

So what can we learn from history? First it is that inflation has an impact on retirement plans. Retired clients do not have the luxury of waiting for better markets, as they need structured withdrawals in lieu of a steady pay check.

In the case of RRIFs, these withdrawals increase with time, putting added pressure on portfolios to deliver returns above the core inflation rate. A rise of entrenched inflation from 2% to 4% necessitates an additional 20% more in withdrawals from the same sum of money, to achieve the same net return adjusted for purchasing power. This is materially significant, and as asset allocation is the primary determinant of portfolio returns, means that investors need to be positioned for such an eventuality.

Our view is that the higher bouts of inflation seen recently are transitory. We expect inflationary pressures to subdue over the next 1-2 years, reducing the risk to retirement portfolios. Longer term, we see inflation held in check by demographic realities, including the aging of Baby Boomers who will likely consume less with the passage of time (as we age, we consumer less). Time will tell of course whether our call is prescient, but heading into the Christmas holidays, lets not let overblown fears of inflation interfere with time with family and friends. We remain confident that our portfolios are well-positioned to deliver solid risk and inflation-adjusted returns going forward.

Merry Christmas to you and your families and thank you for reading! One more year-end Around-the-World blog to come next Wednesday for 2021 and then we'll be back in 2022!

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