

# WATERFRONT

## ASSET MANAGEMENT

2022 1<sup>st</sup> Quarter – Quarterly Commentary

### **Waterfront Equity**

The first quarter of 2022 was plagued by a number of risks resulting in increased volatility across asset classes. Inflation measures have been elevated for several months but readings during the quarter hit 40 year highs. In response, the Federal Reserve shifted its stance on monetary policy toward a more hawkish bias and raised short-term interest rates in March. In addition, the committee's commentary in speeches and meeting minutes signal further interest rate hikes are likely with the pace faster than markets had previously thought. The S&P 500 ended January with the worst monthly return since March of 2020 (the onset of the pandemic). In late February, Russia invaded Ukraine, sending prices of many commodities higher due to concern over production disruptions and reduced supply. This exacerbated pre-existing concerns over inflation with growing uncertainty of the impact on the global economy from the war and a rapidly growing number of sanctions. On March 16<sup>th</sup>, the Federal Reserve raised short-term interest rates by 25 basis points, the first increase in over three years. Equity markets staged a relief rally in late March with the S&P 500 recovering roughly half of its losses over the first two months to end the first quarter down approximately 4.6%.

The Waterfront Equity strategy generated a decline of 2.0% in the first quarter, outperforming its benchmark, the S&P 500. Performance benefited from our valuation discipline as highly valued stocks disproportionately declined. In addition, our overweight of the energy and health care sectors were meaningful contributors to relative performance.

Positions in Canadian Natural Resources, Hess Corp, Berkshire Hathaway, American Express and Canadian Pacific Railway were notable positive contributors during the quarter. We took the opportunity to reduce our exposure to Canadian Natural Resources and Hess Corp as energy prices spiked in part due to temporary geopolitical factors. However, we maintain an overweight of the energy sector relative to the benchmark.

Positions in Meta Platforms (no longer a strategy holding), Autodesk, Infineon Technologies, Microsoft and Micron were notable detractors during the quarter. The outlook for revenue, earnings and cash flow growth at Meta Platforms deteriorated significantly driven by competitive behavior in the online advertising space. As a result, we exited the position. Infineon Technologies and Micron Technology were negatively impacted by deterioration in the macroeconomic growth outlook. However, we believe these companies will weather a slowdown in demand due to secular growth drivers like rapidly expanding demand for memory and electronics in autos, homes, phones and industry. We added to our position in Infineon Technologies during the quarter. We believe Microsoft and Autodesk are dominant players in their respective industries with durable business models that enable these companies to survive downturns and thrive in recoveries. We did reduce our exposure to Microsoft modestly during the quarter but our confidence in these businesses is unshaken.

As we look forward, the backdrop for risk assets has changed meaningfully over the last six months. The inflation dynamic is troubling and a meaningful risk to the outlook for asset values. The war in Ukraine is, first and foremost, a human tragedy, but also an unhelpful catalyst for higher prices as the region is rich in energy, agriculture, metals and industrial goods. However, we are encouraged by the consensus view that inflation rates will cool in the months ahead. We support the Federal Reserve policy of

# WATERFRONT

## ASSET MANAGEMENT

normalizing interest rates after many years of an effective federal funds rate near zero. It is of great importance in our minds that the normalization process be gradual in order to allow consumers and businesses to adapt and adjust to the new interest rate paradigm. To that end, a moderation in the inflation outlook is paramount to enable global policy makers to take a measured approach to normalizing interest rates. As that process plays out, we expect volatility to ease and risk assets to post positive returns.

Across economic cycles and irrespective of market moods, we seek to maintain an emphasis on finding high quality, growing companies whose securities are trading at a reasonable valuation with visible catalysts to drive relative performance over the next twelve months. This approach has served investors well over time, and our confidence in it has not waned.