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STRATEGIC INVESTMENT ANALYSIS

SIACharts Quarterly Outlook & Chartbook – Winter 2022

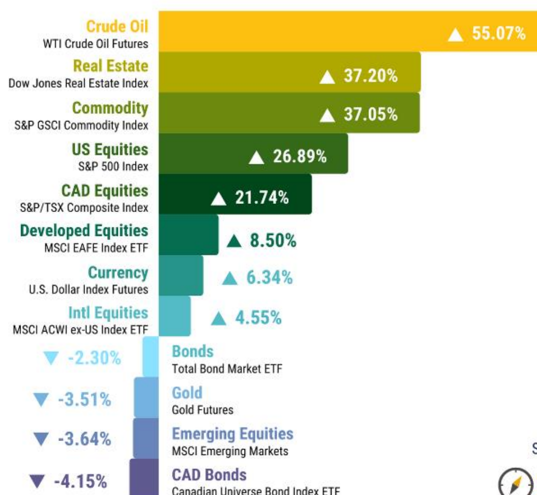
Growing Divergences between Sectors & Asset Classes highlight the Power of Relative Strength Analysis

For many investors, the quarter and year end has been a frustrating one. Although a few large cap stocks pushed US indices to new all-time highs, for many stocks and sectors, it has been a year of stops and starts.

For much of the year, stock market indices, particulalry broad based ones like the Russell 2000, found themselves trapped in a sideways trend of rolling takedowns and rebounds across sectors offsetting each other and leaving investors bewildered.

Even more frustrating, just as it seemed by early November that the stars were aligning for a new broad based uptrend for indices, including breakouts by the Russell 2000 and Dow Transports (see the chartbook), along came the COVID Omicron Wave in late November to upset the apple cart, and knock indices back into their range bound ways.

Similarly into 2022, just as it appeared that the Santa Claus Rally was going to extend into a lasting New Years Rally, hints the Fed could become more hawkish this year sent stocks and commodities into another tailspin.



One of the best tooks for making sense of what has been a confusing and troubling year for trading has been relative strength analysis. While diverging sector and asset class moves left many broad markets trending sideways, looking under the hood, the year saw both stellar and dismal performanes, that created significant opportunities for investors with the tools to find them.

Asset performance diverged dramatically last year. Even with a late year correction, it was a stellar year for commodities in general and Crude Oil in particular, with Real Estate also turning in a strong performance. On the other

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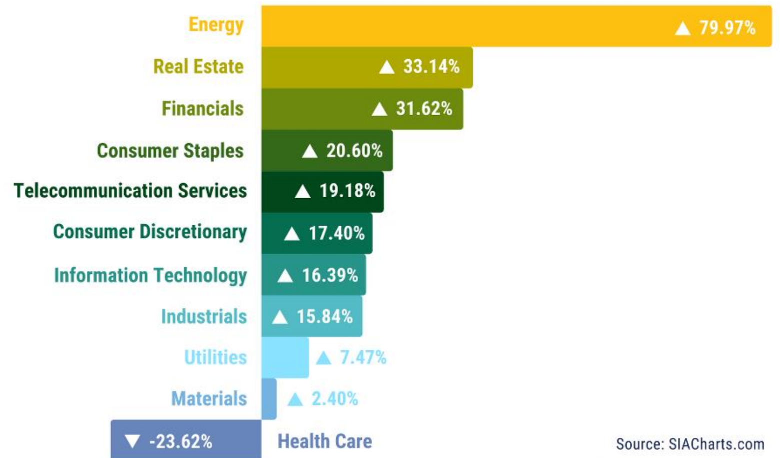
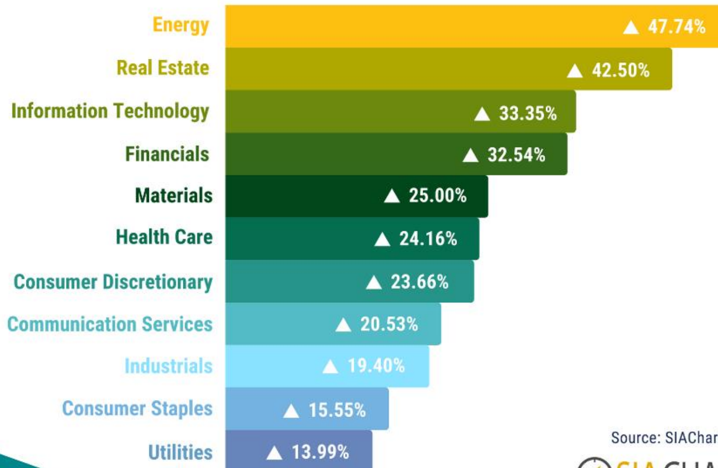
hand, bonds struggled as investors started to anticipate rising interest rates (more on this later). The third theme was a decisive decrease in risk appetite, shown most clearly here in the significant difference between Developed Equities and Emerging Markets.

Although many sectors had periods of outperformance and underperformance throughout the year, looking back over the full year, some clear differences in relative strength emerged. In Canada, it comes as no surprise that the Energy sector dominated with a return of almost 80%. Real Estate and Financials also posted a strong year. Two things that were most interesting were that health care did so poorly last year, likely due to pot stock underperformance, and that the defensive Consumer Staples group outpeformed the cyclical Consumer Discretionary group.

2021 S&P/TSX Composite Sectors Returns



2021 S&P 500 Sectors Returns



In the US, relative performance across groups didn't have quite the extreme differences that we saw in Canada, but there were still clear tiers. Once again Energy and Real Estate were the leaders, but in the US, Information Technology (perhaps due to a big cap effect), Health Care (more mainstream pharmaceutical and vaccine producers in the US) and Materials (less sensitive in the US than Canada to gold which underperformed in 2021) were stronger than they were then Canada.

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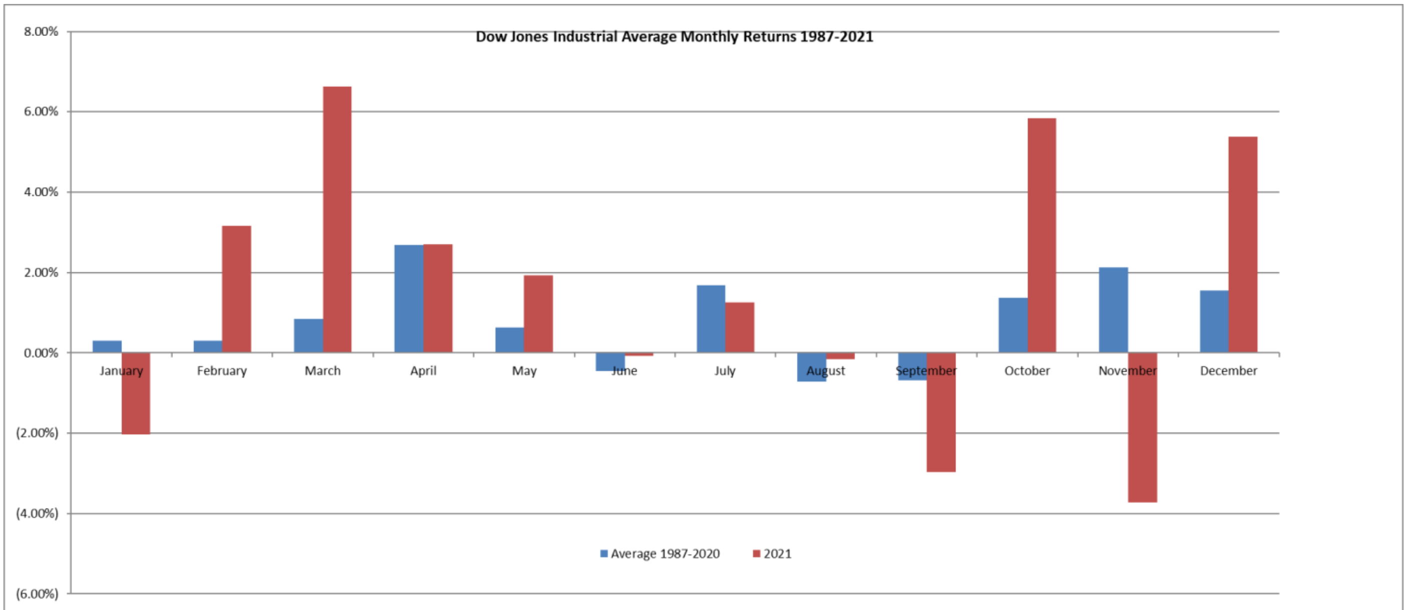

Historically, the first four months of the year have been postive for the Dow Jones Industrial Average with upward momentum building into March and April before dropping off in the spring. The chart above shows that equity markets in 2021 (red bars) diverged signficantly from their average seasonal performance, especially Q1 and Q4.

Many of the key themes that played out in the latter part of 2021 appear to be carrying over into the opening months of 2022. How this quarter ends up depends a lot on whether recent trends accelerate, stabilize or reverse course.

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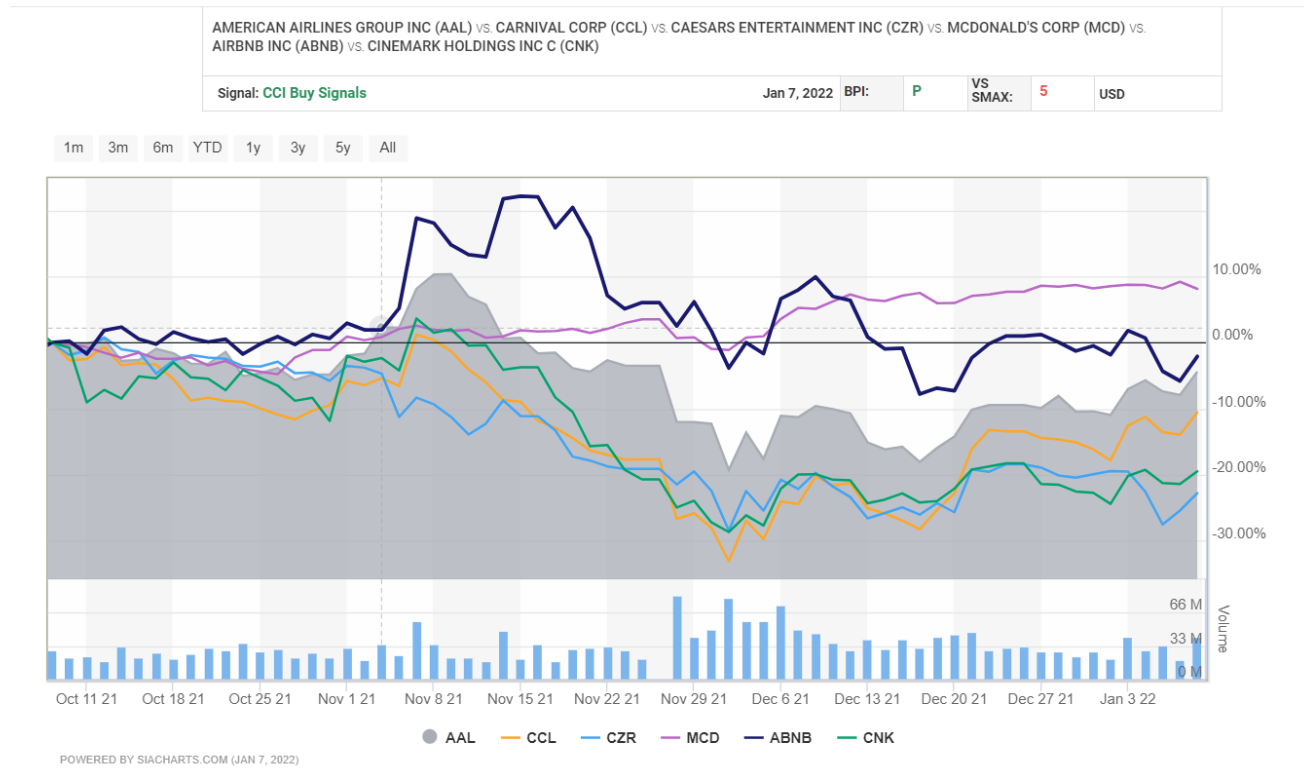
Key Investing and Trading Themes for the Coming Quarter

The Impact of Omicron on Stocks has been Different from Previous Waves



The discovery of the COVID Omicron variant over the US Thanksgiving weekend in late November had a swift and decisive impact on equity and commodity markets. Having seen several waves come and go over the last two years, investors quickly zeroed in on sectors which were most at risk of seeing their demand curtailed by new restrictions on movement, particulalrly airlines (American-AAL), cruise lines (Carnival-CCL), movie theaters (Cinemark-CNK), and casinos (Caesars-CZR). Crude Oil sold off briefly but quickly rebounded as investors recognized that even if demand did slow, supply is still being tightly managed by OPEC+.

There have been some differences this time around. Restaurants (McDonalds-MCD) and lodging stocks (AirBnB-ABNB) in the US were not as impacted by shutdowns this time around.

Perhaps most importantly, stay-at-home stocks have not received the boost they did in previous waves. Take video conferencing provider Zoom (ZM) as an example.

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Zoom rallied and sometimes soared during the first four waves of COVID, particulalry diverging from COVID impacted stocks like Carnival in the first wave. This time around, howver, during Omicron, Zoom not only didn't rally, it's downtrend accelerated. This suggests that some investors are thinking the pandemic is close to an end and may be anticipating that 2022 is more likley to see a return to normal than more rounds of lockdowns.

Recent trading action in pharmaceutical stocks suggests that how investors are viewing how health care systems deal with the disease is changing. Moderna (MRNA), which only has a vaccine soared in the first half of 2021 as vaccine programs rolled out. When Omicron arrived and booster programs, Moderna only received a brief boost and then resumed its downtrend, suggesting that investors are not expecting vaccines to remain the first line of defense. Recent trading action in Merck (MRK) which has a COVID drug treatment, and Pfizer (PFE) which has both a vaccine and a drug, suggest that investors are anticipating that over time dealing with COVID may focus more on targeted treatments for ill patients rather than vaccinations for everyone.

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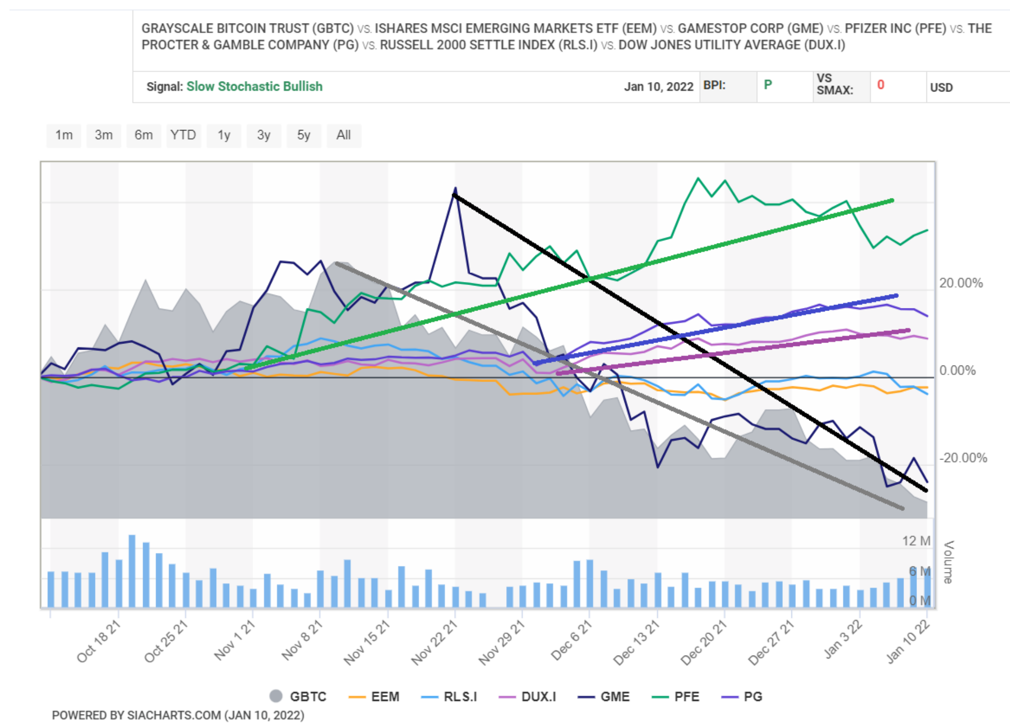
Reduced Risk Appetite at the Margins



One trend that emerged over the course of 2021 and really accelerated in the last few months has been a flow out of capital from risk markets that investors turn to when feeling aggressive, to defensive havens where capital flees when investors are feeling more cautious. In particular, cryptocurrencies such as Bitcoin (GBTC) and meme stocks like Gamestop (GME) have been hammered over the last six weeks. The small cap Russell 2000 (RLS.I) and emerging markets (EEM) have drifted down into the red as well. On the other hand, the Dow Jones Utilities Average (DUX.I), drug companies like Pfizer (PFE), and consumer staples companies like Proctor & Gamble (PG) have been attracting capital.

Based on what the market has been telling us about investor sentiment surrounding Omicron, COVID doesn't appear to be the main driver of renewed caution in the market place, although it may be a contributing factor.

Rather, this shift in sentiment appears to be related more to rising inflation forcing central banks to become increasingly hawkish and reducing liquidity, which we will cover in the last section.

Last Call For the Easy Money Party!

In 2020 and 2021, central banks unleashed massive amounts of monetary stimulus, and as is common across cycles, much of it has followed the path of least resistance into the stock market. Although some of the concentrated large cap, like the Dow Industrials, or resource sensitive indices, like the S&P/TSX Composite, have managed to keep climbing to new highs, broader indices like the Russell 2000 have been trending mostly sideways since March.

For the last nine months, many markets have been in what we call the *Mid-Cycle Pause*, where central banks start to take their foot off the gas, reducing the amount of money flooding the system and the

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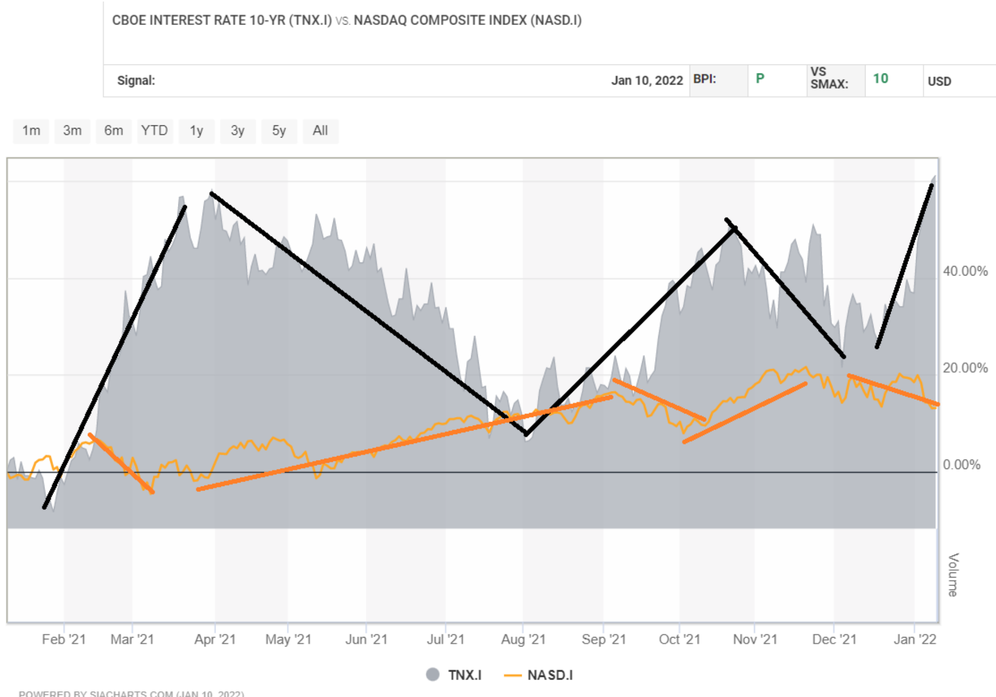
demand for stocks from cheap borrowing, and limiting market upside. On the other hand, the main reason why central banks are responding to increasing inflation pressures and cutting stimulus is because economic conditions are improving, raising the fundamental floor under stock markets.

2021 saw some central banks cut back on stimulus already. The Bank of Canada completed its asset purchase program and is not maintaining its balance sheet while preparing to start raising interest rates perhaps as soon as April based on previous hints. The Bank of England and the Reserve Bank of New Zealand both raised interest rates in 2021.

Investors appear to have been rattled by the big swing from dovish to hawkish at the US Federal Reserve Board, who started tapering asset purchases, then accelerated cutting purchases, moving up the planned end of its asset purchase program to March from June. The Fed has also suggested that there could be several interest rate hikes this year with some speculating that the first hike could come as soon as March and has hinted at shrinking its balance sheet as well. In addition to the Fed, the European Central Bank and the Reserve Bank of Australia are also winding down their asset purchase programs with the RBA expected to finish QE and perhaps start raising rates as soon as February.



The chart shows that generally speaking, as would be expected, there has been an inverse relationship between the 10-year treasury note yield (TNX.I) and the NASDAQ Composite Index (NASD.I) with investors pulling out of momentum stocks in times of rising rates and jumping back in when rate hike expectations eased. As we move through the winter quarter, economic reports may continue to be assessed through the lens of whether the news increases or decreases pressure on central banks to become more hawkish which could impact sentiment toward stocks.

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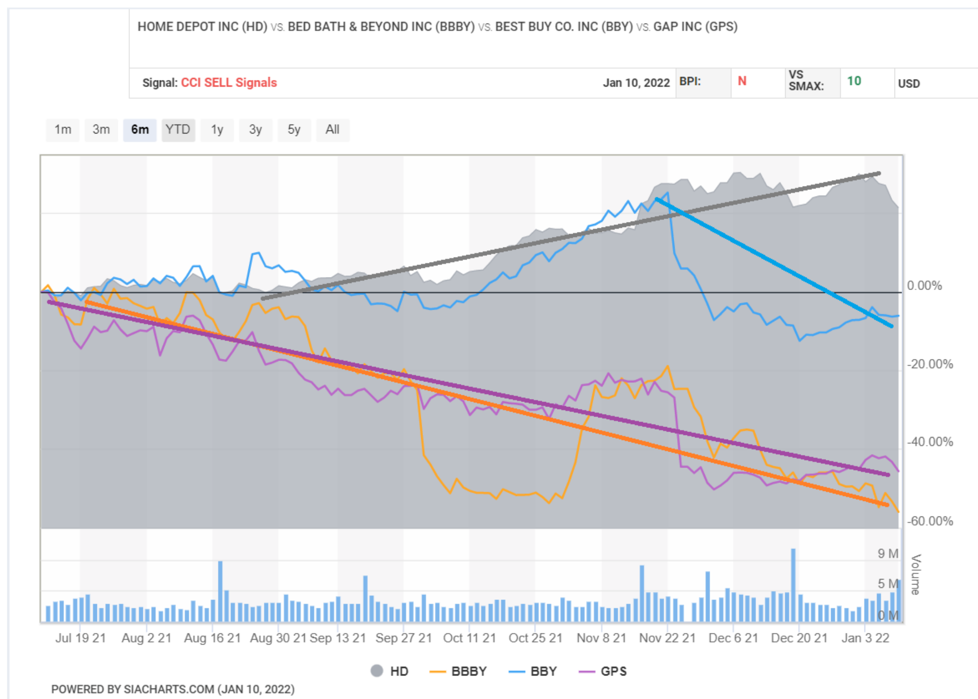
Changing Spending Habits

Over the last two years, consumer spending habits have changed dramatically. The early days and waves of COVID in 2020, for example, saw consumers shifting their spending away from travel and leisure to stockpiling household supplies and setting up home offices. In Q4, we saw a clear shift in stock market performance with stocks related to spending on home improvement (Home Depot-HD) outperforming stocks sensitive to spending on clothing (Gap-GPS), household softlines (Bed, Bath & Beyond-BBBY), and consumer technology (Best Buy-BBY).



Upcoming retail sales and earnings reports may indicate not only how much of an impact Omicron has had on holiday season shopping and consumer spending in general, but also whether spending patterns are continuing on their current course, or shifting again.

Summary: Sideways market action and ongoing rolling takedowns and rebounds has continued into 2022. While the COVID Omicron wave has captured much of the headlines, investors appear to be more concerned about inflation and central bank tightening. As we move through the first round of central bank earnings, the Omicron wave peaks, and quarterly earnings/guidance reports roll out, we could see another quarter of choppy trading as investors try to make sense of it all.

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Asset Class and Sector Ranking Analysis

SIA Charts Asset Class Ranking		
As of Dec 31, 2021		
Asset Class	Change*	
US Equity	+2	
Commodity	-1	
CAD Equity	-1	
International Equity	none	
Cash	none	
Bond	+1	
Currency	-1	
*Change in Ranking Since Sept 30, 2021		
Source: SIA Charts		

After a quiet Q3, there were several notable changes to the SIA Asset Class Rankings in Q4. Commodities dropped down from top spot to second, dragging resource-sensitive CAD Equity down a rung as well. This enabled US Equity to leapfrog both rising 2 positions to top spot.

Interestingly, at a time when traded interest rates have been on the rise, a trend that would usually be bearish for bond prices, the Bond asset class climbed up out of the basement, indicating that bonds were attracting interest as investor sentiment turned defensive at the margins.

With the three equity asset classes plus commodities in the top four spots, and the non-equity Cash, Currency, and Bond asset classes stuck at the bottom of the rankings, the current Asset Class rankings continue to support a Favored SIACharts Equity Action Call™.

There were a lot of changes in the top-level industry groups this quarter with only Consumer Discretionary remaining steady in top spot.

The biggest move upward was Materials, which jumped 5 spots, likely boosted by a rally in forest products stocks as the price of lumber surged once again.

Health Care stumbled into the bottom spot, while Consumer Staples and Communications Services also dropped more than one position in the rankings. Even though investors became a bit more cautious, defensive sectors struggled suggesting recent declines are more likely a correction in an uptrend than a significant downturn.

SIA Charts Sectors Ranking		
As of Dec 31, 2021		
Sector	Group	Change*
Consumer Discretionary	Cyclical	none
Energy	Resource	+1
Industrials	Cyclical	-1
Financials	Interest Sensitive	+1
Materials	Resource	+5
Communications Services	Cyclical	-2
Real Estate	Interest Sensitive	+1
Information Technology	Cyclical	-1
Consumer Staples	Defensive	-3
Utilities	Interest Sensitive	+1
Health Care	Defensive	-2
*Change in Ranking Since Sept 30, 2021		
Source: SIA Charts		

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A look at the 31 market sectors also indicates that despite the ups and downs of the broad market, the relative positioning of most sectors remained the same with only a few notable changes.

Energy remained strong as it did throughout the year. Construction moved up into the green zone from yellow boosted by renewed interest in homebuilders. Computer Hardware showed some signs of life moving up into the yellow zone from red.

The Omicron impact can most be seen in the Leisure group continuing its downward trend and tumbling into the red zone, while Specialty Retail fell out of the green zone into the yellow zone.

Market Sector / Industry	Symbol	Q1 2021	Q2 2021	Q3 2021	Q42021
Energy	EWI345	Green	Green	Green	Green
Materials	EWI330				
Metals & Mining	EWI352	Red	Red	Red	Red
Chemicals	EWI340	Green	Green	Yellow	Yellow
Industrials	EWI335				
Aerospace & Defense	EWI454	Green	Yellow	Yellow	Yellow
Transportation	EWI524	Red	Red	Red	Red
Manufacturing	EWI466	Yellow	Red	Yellow	Yellow
Construction	EWI457	Yellow	Yellow	Yellow	Green
Conglomerates	EWI360	Red	Yellow	Red	Red
Diversified Services	EWI476	Red	Red	Red	Red
Consumer Discretionary	EWI310				
Leisure	EWI487	Green	Green	Yellow	Red
Retail	EWI506	Green	Green	Green	Green
Specialty Retail	EWI517	Green	Green	Green	Yellow
Consumer Durables	EWI367	Yellow	Green	Yellow	Yellow
Automotive	EWI362	Green	Yellow	Red	Red
Consumer Staples	EWI332				
Consumer Non-Durables	EWI377	Green	Green	Green	Green
Wholesale	EWI532	Yellow	Green	Green	Green
Food & Beverages	EWI386	Red	Red	Red	Red
Tobacco	EWI396	Red	Red	Red	Red
Health Care	EWI334				
Drugs	EWI436	Red	Red	Red	Red
Health Services	EWI444	Red	Red	Yellow	Yellow
Financials	EWI333				
Banking	EWI399	Yellow	Yellow	Yellow	Yellow
Insurance	EWI419	Red	Red	Red	Red
Financial Services	EWI410	Red	Yellow	Green	Green
Real Estate	EWI425	Red	Red	Red	Red
Technology	EWI337				
Computer Software	EWI550	Red	Yellow	Green	Green
Computer Hardware	EWI543	Yellow	Red	Red	Yellow
Electronics & Semiconductors	EWI559	Yellow	Yellow	Green	Green
Communications Services	EWI573				
Internet	EWI568	Yellow	Red	Red	Red
Media	EWI495	Red	Red	Red	Red
Telecommuncations Services	EWI572	Red	Red	Red	Red
Utilities	EWI338	Red	Red	Red	Red
Source: SIA Charts					

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SIACharts Quarterly Chartbook: Winter 2022

Dow Jones Industrial Average (DJI.I)

The Dow Theory relationship between the Industrials and the Transports which we outlined in the Autumn 2021 chart book continued to provide insights this quarter.

Last time around, the failure of the Transports to confirm a new high by the Industrials was most significant. This time around, the more important observation is that the Industrials did not follow a downturn by the Transports, indicating that the pullback was more of a correction or a short-term downswing than the start of a new downtrend.

Over the last few months, the Dow Jones Industrial Average has continued to steadily climb, extending its trend of higher lows, and adding two bullish Double Top breakouts to a previous Triple Top breakout. Based on horizontal counts, next potential resistance appears near 38,700 then 40,270 with initial support possible near 34,685 based on a common 3-box reversal.

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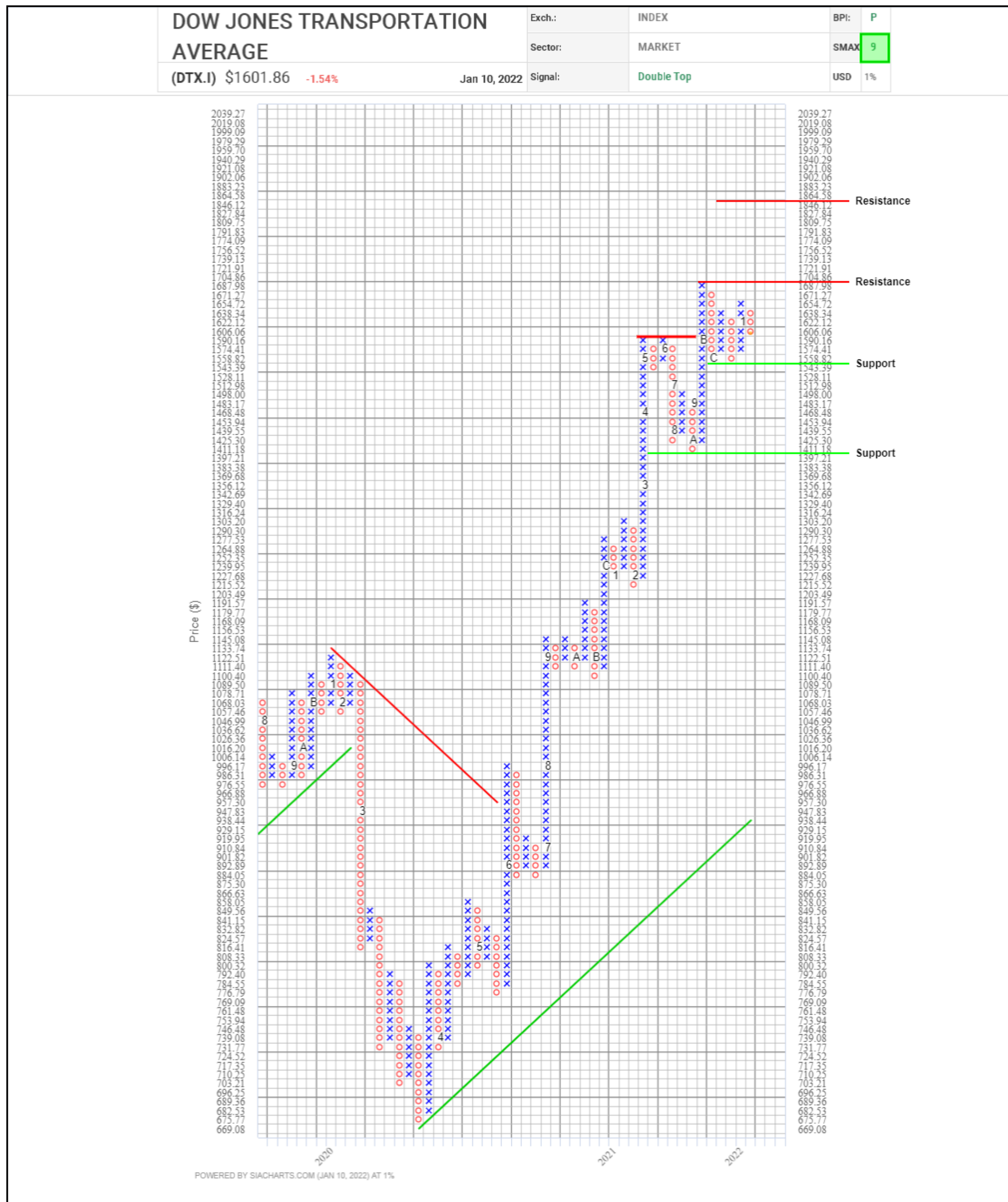
Dow Jones Transportation Average (DTX.I)



Since world stock markets bottomed out in the spring of 2020, the Dow Transports have been steadily climbing in a step pattern of rallies followed by periods of consolidation at higher levels.

After trending sideways through the summer, the Dow Transports (DTX.I) broke out in October in what looked like the start of a new rally phase, but this was short-circuited by the arrival of the Omicron wave and renewed travel restrictions.

A big retreat didn't really materialize either and with support moving up toward 1,540, the Transports appear to have settled into another higher consolidation range. A breakout over the previous high near 1,705 would signal the start of a new rally phase and confirm the recent breakouts made by the Dow Industrials.

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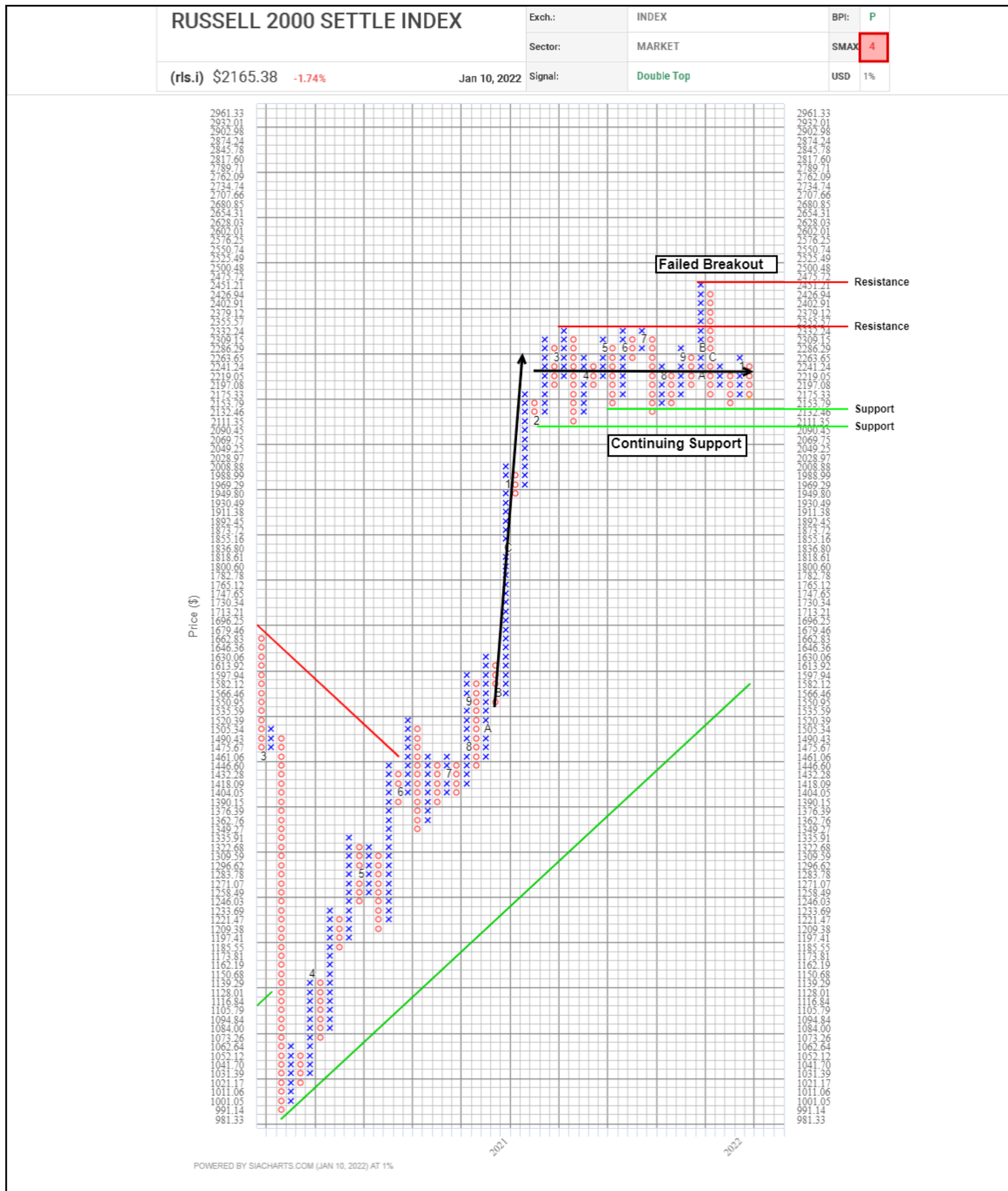
Russell 2000 Index (RLS.I)



The broad-based, small-cap Russell 2000 (RLS.I) continues to be the best example of the sideways market trend which has been in place since March.

Things were looking up back in October and particularly in early November when RLS.I broke out of its range in what appeared to be the start of a new rally phase.

That turned out to be a false breakout, however, as support evaporated with the arrival of the Omicron wave.

The good news for the Russell 2000 is that support in the 2,090 to 2,130 range remained intact. After an initial correction, the index resumed its primary sideways trend, declining to break down further. At this point, RLS.I remains stuck in a range between 2,100 and 2,350 waiting for a reason to break in one direction or another.

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S&P/TSX Composite Index (TSX.I)

The last three months have turned out to be a mixed bag for the S&P/TSX Composite Index (TSX.I). The quarter started off with the Canadian market on a roll, particularly with energy prices and energy stocks soaring.

A November selloff in crude oil took the wind out of the market's sails for a while, but in recent days it has started to bounce back with the banking and forest products sectors attracting renewed interest.

TSX.I currently finds itself in a symmetrical triangle of higher lows and lower highs, which is indicative of a consolidation period within a larger upward trend. A breakout over 21,515 would complete a bullish double top with next resistance at the November peak near 21,945, then 23,530 based on a vertical count. A break below 20,265 would complete a bearish double bottom pattern with next support near the 20,000 round number or the September low near 19,870.

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Crude Oil Continuous Contract (CL.F)

Q4 was both the best and the worst of times for Crude Oil (CL.F). The quarter started off with CL.F on a roll, blasting through its 2018 peak near $77.50 to trade at its highest level since 2014.

The impact of higher energy costs on already rising inflation pressures became a concern, and once Omicron related travel restrictions kicked in, it didn't take long for oil drop back.

Selling pressure against oil didn't last very long as OPEC+ continued to indicate that is has the supply side under control and seasonal demand kicked in as winter heating season arrived. Through all of this, crude oil maintained its upward, if bumpy trend of higher lows.

Initial upside resistance currently appears at the November peak near $86.00. If that hurdle is overcome, the path could be open for a retest of the $100.00 round number. Initial support currently appears near $70.00, then $62.10.

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STRATEGIC INVESTMENT ANALYSIS

Gold Continuous Contract (GC.F)

Between September of 2019 and September of 2020, Gold (GC.F) staged a spectacular run, soaring from near $1,180/oz to a peak near $2,080/oz. In the ensuing correction that ran into March of 2021, gold slumped back toward $1,670/oz before establishing support that remains in place.

The last nine months have found gold stuck in sideways consolidation mode, with a series of higher lows and lower highs forming a symmetrical triangle. When markets started to slide in November, it appeared that gold could be a beneficiary of changing sentiment, particularly as it staged a bullish Triple Top breakout.

The ensuing rally turned out to be short-lived and peaked at another lower high, indicating that the market pullback was a trading correction rather than a downturn. While sentiment did shift from enthusiastic to cautiously optimistic, at no time did it shift into panic let alone truly fearful. Initial resistance for gold currently appears near $1,882/oz followed by $1,920, with initial support near $1,755, followed by $1,720.

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