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# 2023 Q2 Commentary

## *“The Check Engine Light”*

It was a perfect Saturday morning. My senses were alive as I took in the early morning sunrise along the sea to sky highway with the mechanical sounds of my engine purring behind me.

But as I approached Lions Bay, my heart sank as I noticed the orange glow from the check engine light on the dashboard of my vintage car. My euphoria was instantly replaced with concern knowing that this warning could indicate anything from a minor glitch to a severe mechanical problem.

This is not unlike the uncertainty we are currently experiencing with the economy. The check engine light is flashing, yet the car still seems to be performing well. Has the much-anticipated recession been cancelled or just delayed?

Let's take a closer look under the hood to determine how concerned we should be.

At Westmount, we think about portfolio construction like a multi-cylinder engine with each cylinder playing a role in powering risk and returns. We can think about our Core Model portfolio like a six-cylinder engine with each cylinder representing an asset class:

1. Cash
2. Bonds
3. Stocks
4. Private Lending\*
5. Private Real Estate & Infrastructure\*
6. Private Equity\*

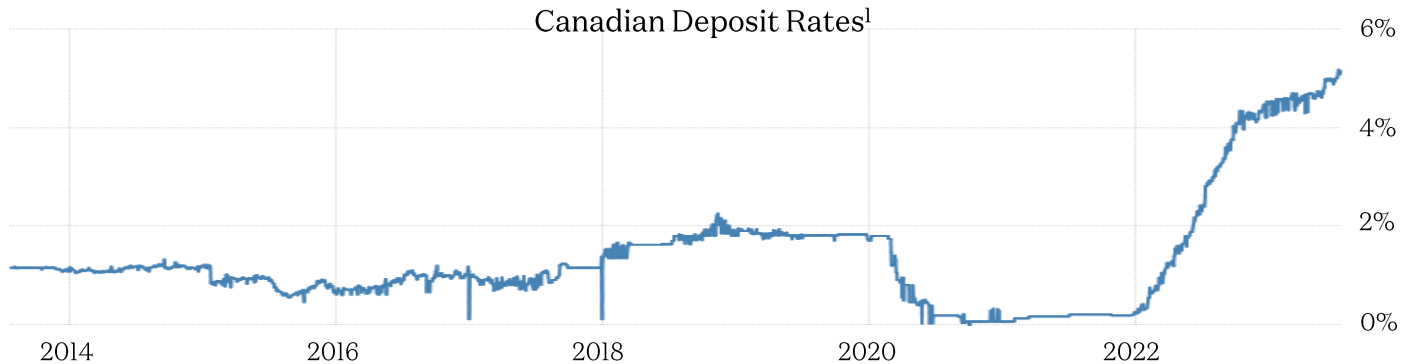
This diversification helps balance potential gains and losses, making the portfolio more resilient to market fluctuations. In this commentary we will be reviewing each of our six cylinders.

\*Alternative investments are generally less liquid than more traditional assets and are not appropriate for all investors. Your Portfolio Manager will determine if they are suitable for your personal situation.



# Cylinder 1 - Cash

For the past decade, bank deposits in Canada have generally hovered between 0% and 2%. This made it challenging for investors holding cash or even GICs to earn a return and keep up with inflation. In early 2022 the Bank of Canada started to increase interest rates, resulting in deposit rates moving to the 5.0% range, levels that have not been seen since the mid 2000s. Investors are finally being compensated to hold cash.



# Cylinder 2 - Bonds

Bonds are back again! For over a decade, North American bonds experienced historically low yield-to-maturities and carried the risk of capital losses if rates increased.

This led to once-in-a-generation loss for bond investors in 2022 as Central Banks in Canada and the US raised rates at an unprecedented speed to combat inflation.

Now bond investors can expect significantly higher yields and the potential to benefit from either a flight-to-quality trade should North American markets enter recession territory and/or some capital appreciation should Central Banks lower rates as they tend to do during economic downturns. This makes bonds an attractive diversifier once again.

FTSE <b>Canada</b> Universe Bond Index	<b>2.51<sup>2</sup></b> Q2 2023
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Bloomberg <b>US</b> Agg Bond Index (USD)	<b>2.09%<sup>3</sup></b> Q2 2023
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Bloomberg <b>Global</b> Agg Corp Bond Index (CAD)	<b>1.11%<sup>4</sup></b> Q2 2023
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1. Trading Economics, <https://tradingeconomics.com/canada/deposit-interest-rate>, – 10yr history from July 20, 2013 to July 20, 2023. Accessed on July 20, 2023;  
 Source: Bank of Canada – Deposit Interest Rate is the average rate paid by commercial banks to individuals or corporations on deposits  
 2, 3, 4. Bloomberg L.P., Accessed 26 Jul. 2023., Total Returns for the period of Jan 1, 2023 to Jun 30, 2023. 8 Bloomberg L.P.



# Cylinder 3 - Stocks

The second quarter saw mixed performance for equities with Central Bank policy and recession concerns weighing on markets.

The lack of breadth in the stock market recovery since the October 2022 low is still a concern. Index returns are positive year-to-date, but returns have been primarily driven by only seven stocks (Apple, Amazon, Google, Microsoft, Facebook, Nvidia & Tesla).

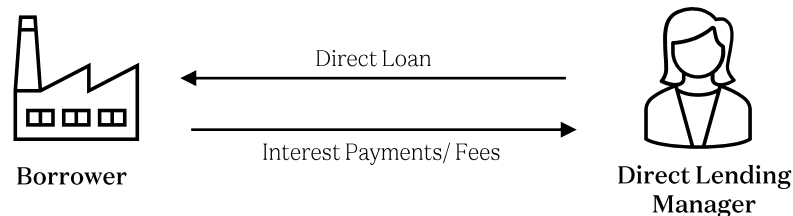
Although US markets have not recovered from their 2021 highs, our low-cost market cap exposure via indexing plus our tactical US equity overlay saw our US equity positions rebound nicely.

<b>Canadian Stocks</b> S&P/TSX Comp. Index	<b>4.56<sup>1</sup></b> Q1 2023
<b>US Stocks</b> S&P 500 (USD) Index	<b>7.48%<sup>2</sup></b> Q1 2023
<b>US Stocks</b> NASDAQ 100 (USD) Index	<b>17.05%<sup>3</sup></b> Q1 2023
<b>International Stocks</b> MSCI EAFE (CAD) Index	<b>8.59%<sup>4</sup></b> Q1 2023

# Cylinder 4 – Private Lending\*

Two shocks have reshaped the private lending markets over the past year: an upward adjustments in interest rates and the movement of financing volumes towards private lenders; both of which are positive developments for Private Credit<sup>5</sup> and Private Mortgages<sup>5</sup>.

Businesses looking to expand or fund day to day operations often tap the private credit markets. This direct approach—with no bank in the middle—can result in greater speed, certainty in execution, and flexibility in terms of structure for the borrower.



This type of lending involves applying a credit spread (risk premium) above a floating benchmark rate, such as the Secured Overnight Financing Rate (SOFR). The recent movement in SOFR plus healthy credit spreads have resulted in all-in yields around 10-12%, making Private Credit a very attractive position in a well diversified portfolio. Furthermore, these loans are traditionally the most senior assets in a company’s capital structure, giving them payment priority ahead of all other investors in the event of a default. We find this asset class (cylinder) the most attractive in the current environment.

\*Alternative investments are generally less liquid than more traditional assets and are not appropriate for all investors. Your Portfolio Manager will determine if they are suitable for your personal situation. 1, 2, 3, 4 Bloomberg L.P., Accessed 26 Jul. 2023., Total Returns for the period of Jan 1, 2023 to Jun 30, 2023. 8 Bloomberg L.P 5. Private Credit & Private Mortgages are held in the Westmount Alternative Income Fund. 6. SOFR rates & graph from <https://www.newyorkfed.org/markets/reference-rates/sofr-averages-and-index> ) Accessed Jul 26, 2023





# Cylinder 5 – Private Real Estate & Infrastructure\*

## Private Real Estate

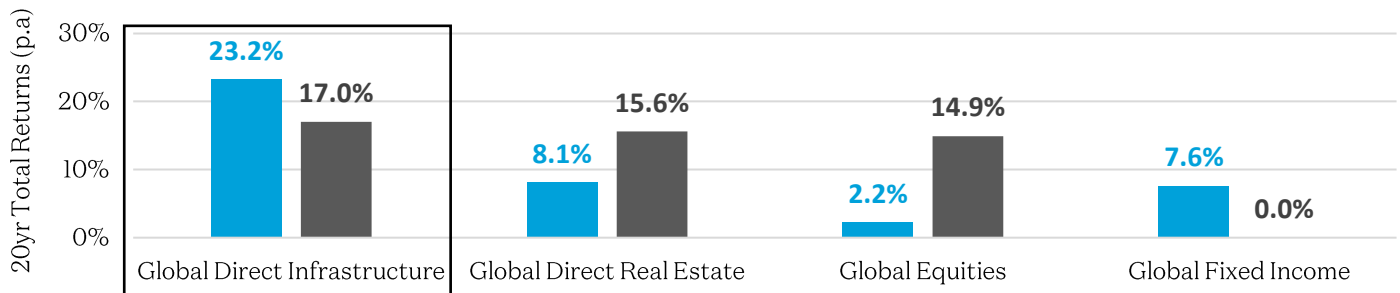
Private real estate funds performed very well in 2022. However real estate values are resetting in response to changing tenant demand and higher financing costs. This has led to disparate returns among regions, sectors and strategies in 2023.

In this more challenging environment, our approach will have an emphasis on:

- Sector** - Focusing on industrial, multi-family, & student housing over office and retail
- Region** – Focusing on markets with faster population & employment growth (e.g. US Sun Belt, Seattle)
- Strategy** – Tilting towards value-add (renovations, development) & opportunistic strategies relative to core (fully leased buildings)

## Private Infrastructure

Low Growth w High Inflation vs High Growth w High Inflation<sup>1</sup>



Infrastructure assets have the potential to diversify returns and provide stable cashflows. Assets like power plants and toll roads are often funded through long-term CPI-linked contracts. This helps insulate them from economic cycles and the effects of inflation. This is a reason why private infrastructure assets tend to do well in both high and low growth environments when inflation is high (see chart above).

The transition to a low-carbon economy continues to drive an enormous buildout in renewables. This sector received a further tailwind with the Inflation Reduction Act (2022) passing. The American legislation is providing \$270B in tax credits, almost half of which are in the areas of Solar, Wind and Energy Storage.

This additional tailwind bodes well for the Westmount Real Asset Fund that holds positions in both Wind & Solar

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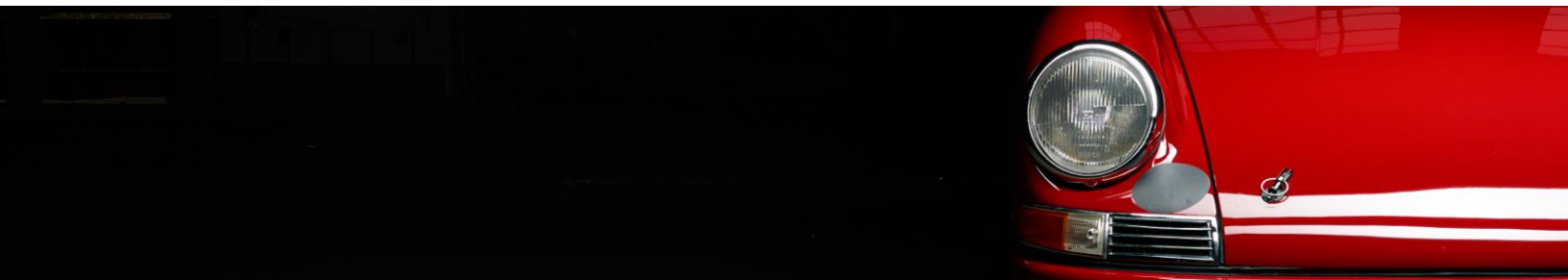
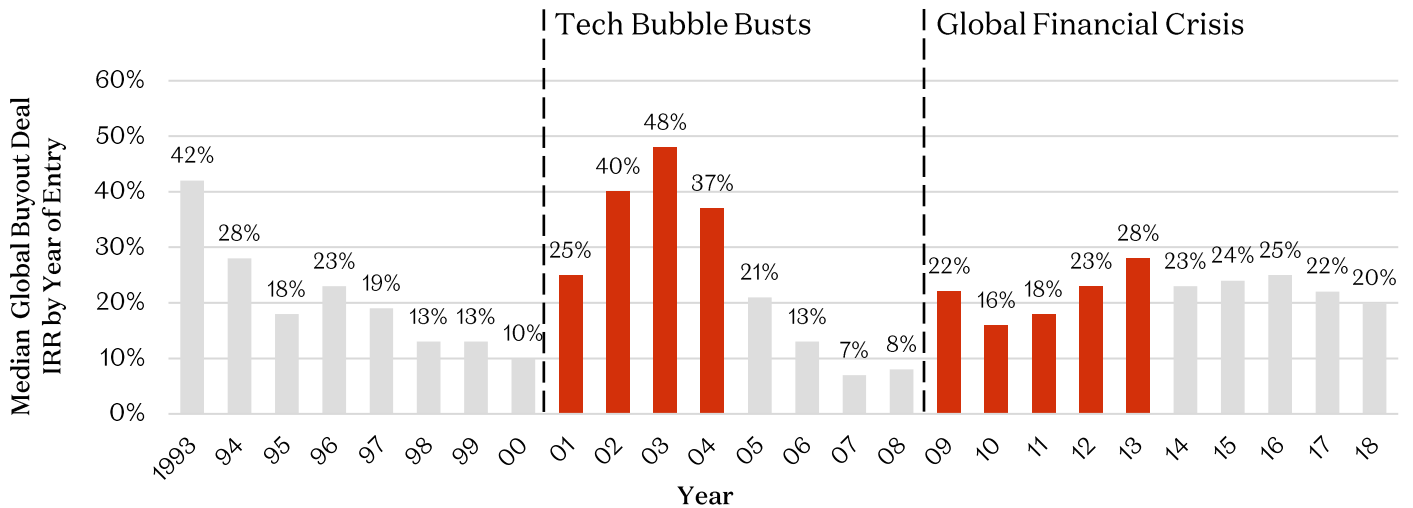
# Cylinder 6 – Private Equity\*

Private equity is the broad term for investing in a privately owned company rather than owning public shares traded on an exchange (market). Private equity is now the largest alternative asset class and among the fastest growing<sup>1</sup>. For instance, private equity is the largest holding in the Canada Pension Plan portfolio.<sup>2</sup>

One of the reasons for the growth in this asset class is opportunity. Only 15%<sup>3</sup> of companies with revenue greater than \$100M are publicly traded. This limits investor's ability to gain exposure to high growth businesses outside of private equity funds. However, the potential for higher returns comes at the expense of liquidity. Private equity funds have long lockups and holding periods, making this asset class unsuitable for many investors.

Today's higher rate environment has slowed deal sourcing, exits and fundraising by private equity managers. Despite these headwinds, private equity is currently sitting on approximately \$1.28T<sup>4</sup> of cash looking to be deployed. Poor economic conditions typically create opportunities and historically deals done in a downturn generate superior returns over time.

## Global Buyout Deal IRR by Year of Entry



\* Alternative investments are generally less liquid than more traditional assets and are not appropriate for all investors. Your Portfolio Manager will determine if they are suitable for your personal situation.

1. Preqin Forecasts, as of Q3 2021, 2021 figure is annualized based on data to March, 2022-2026 are Preqin's forecasted figures.
2. CPP Investments, 2023 Annual Report; [www.cppinvestments.com/wp-content/uploads/2023/05/ CPP-Investments\\_F2023-Annual-Report.pdf](http://www.cppinvestments.com/wp-content/uploads/2023/05/ CPP-Investments_F2023-Annual-Report.pdf)
3. Bain & Company: Why Private Equity is Targeting Individual Investors; [www.bain.com/insights/why-private-equity-is-targeting-individual-investors-global-private-equity-report-2023/#](http://www.bain.com/insights/why-private-equity-is-targeting-individual-investors-global-private-equity-report-2023/#). Notes: Includes fully and partially realized deals; all figures calculated in US dollars; post-2018 data not shown, as most deals entered later than 2018 are still unrealized Source: DealEdge powered by CEPRES data (as of December 22, 2022)
4. Guide to Alternatives Q2 2023 - PitchBook, J.P. Morgan Asset Management. Dry powder data is as of September 30, 2022.



# The Bottom Line

Despite the lingering fears of an economic slowdown or recession, many cylinders in our portfolio<sup>1</sup> are looking favorable.

- ✓ **Cash** – Deposit rates north of 5%
- ✓ **Fixed Income** – Attractive yields and portfolio insurance
- ✓ **Equity** – Markets have rallied this year, but recession clouds still looming
- ✓ **Private Lending**<sup>2</sup> - Probably the most attractive risk to return in the current investment landscape
- **Private Real Estate & Infrastructure**<sup>3</sup> - More muted returns expected this year as a result of lagged valuations and higher interest rates (especially in real estate)
- **Private Equity** – Deals and exits are slowing but private equity managers have cash for opportunities.

By viewing portfolio construction through the lens of a six-cylinder engine, investors can appreciate the importance of a balanced and well-diversified approach to achieve their financial objectives smoothly and efficiently.

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1. Westmount Wealth clients holds some or all of these asset classes depending on the model portfolio they hold  
2. Private Lending is held in the Westmount Alternative Income Fund  
3. Private Real Estate & Private Infrastructure are held in the Westmount Real Asset Fund