Institution Evolution

Monthly Perspectives
February 2022

15 minutes

The Institutional Advantage

Brad Simpson, Chief Wealth Strategist | TD Wealth

If you're looking for proof of resilience and adaptability in the face of historic change, look no further than the TD Wealth Annual Investment Strategy Conference. This year, same as last, the conference was held in mid-January, with dozens of guest speakers and hundreds of advisors in "attendance" — which is to say, virtual attendance. And yet, if you'll permit me a moment of immodesty, I think it was the best one we ever hosted.

Don't get me wrong. I'm looking forward to getting back to live events in the same venue with my colleagues (some of whom, to my dismay, I have yet to meet in person). But what the conference lacked in personal connection it more than made up for in the deluge of sophisticated analysis and polished data on display. It turns out that, without the canapés and coffee breaks, you can really cram in a ton of useful information.

This year's conference was particularly momentous because it also served as the launchpad for the Wealth Investment Office.

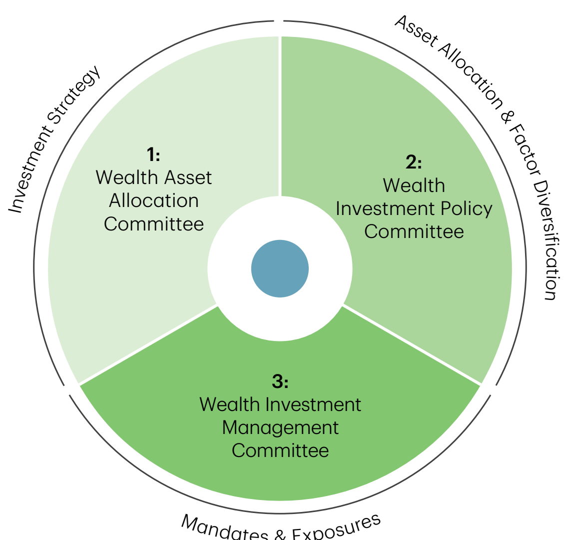
What is the Wealth Investment Office? We are a team of consultants, analysts, portfolio managers and communicators who have been brought together to create a powerful resource for wealth managers across the organization. For clients, it means more insightful analysis, more timely data, clearer messaging, a broader range of investment options — ultimately, we aim to empower advisors with the information and investment solutions they will need to level-up their service offering.

The launch of the Wealth Investment Office represents an important step forward for our institution — and I stress the fact that we are part of an institution. Watching the replay of the conference, the word kept cropping up. Institutional grade. Institutional style. Institutional processes. I started to think about the importance of being an institutional wealth manager, and how it plays into the calibre of our investment solutions and the depth of our resources.

Being part of an institution means that, when the market alchemists out there are straining to turn a stone into gold or fear-mongering in the pursuit of readership and clicks, we instead rely on professional analysis and disciplined thinking. As an institution, we produce our own research, led by thought leaders like Deputy Chief Economist Derek Burleton at TD Economics, who this year touched on the supply-chain recovery, the rise of inflation and the tightening monetary environment.

Being part of an institution means that, when we're generating our strategies and selecting the optimal vehicles for those strategies, we have at our disposal multiple committees to complement each other — and challenge each other — in order to determine the proper course of action (Figure 1).

Figure 1: TD Wealth Investment Committees



For illustrative purposes only

Our "investment management" committee, for instance, is tasked with scrutinizing every mandate we include in our portfolios. Our "investment policy" committee, meanwhile, sets allocations based on the firm's strategic positioning). That positioning, in turn, is determined by the "asset allocation" committee, which meets monthly to provide the firm's mid-range outlook on asset classes and sub-classes. This year, we invited a senior member of the asset allocation committee and incoming Chief Investment Officer at TD Asset Management, David Sykes, to give us his take on headwinds, tailwinds and crosscurrents ahead.

Finally, being part of an institution means that our clients are able to access exclusive investment mandates via the relationships that we have fostered with the top money managers in the world. This year, we invited two speakers from the world-renowned Carlyle Group: Head of Global Research Jason Thomas, who recently served as a White House economic advisor; and the luminary intellectual, co-Founder and co-Chairman of Carlyle, David Rubenstein, whom I had the great privilege of interviewing.

What follows are a series of lightly edited excerpts highlighting the most interesting and important parts of our lead presentations. It's the kind of analysis we're delivering every day to our wealth managers, and ultimately to our clients. This is just the tip of the iceberg, though. You can expect much more from the Wealth Investment Office in the months and years ahead.

2022 Global Economic Outlook: Derek Burleton

This year, as has become the custom, we launched the conference with a high-level overview from TD Deputy Chief Economist Derek Burleton. His presentation focused on the impact that Omicron is likely to have on global growth as well as the incipient supply-chain recovery, but also touched on the historic rise of inflation and the end of the "free money" era, as central banks around the world begin to hike rates and pull back on stimulative asset purchases. Here are just a few of his valuable insights.

"Let's start off with an overview as to where we saw the economy when we published our December outlook. We downwardly revised our view for 2022 and now expect world GDP growth of 4.4% this year, (Figure 1) which is down from 4.7% in the prior forecast. Much of the reduction is tied to concerns of ongoing supply-chain issues. The million-dollar question is, what has Omicron done to some of these numbers? We expect to see a significant hit in the January numbers, some impact in the February data, and then March could see a big rebound. ... What will be key to mitigating any impact from Omicron, however, is financial conditions. ... If financial conditions really head south, then you're dealing with a different environment.

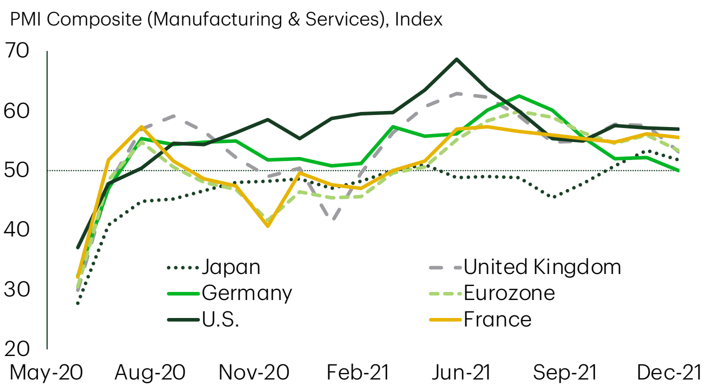
"... The growth cushion is quite strong (Figure 2). The momentum heading into the year suggests that the economy is holding up quite well, even though we are seeing some pullback on consumer spending due to Omicron.

Figure 1: Outlook still constructive, but downgraded on Delta, supply-chain disruptions

	Annual Average % Change		
	2020	2021E	2022F
World	**-3.0**	**5.8**	**4.4**
Advanced Economies	**-4.5**	**5.0**	**3.9**
U.S.	-3.4	5.7	4.1
Canada	-5.2	4.5	4.4
Eurozone	-6.5	5.1	4.1
Emerging Markets	**-2.2**	**6.3**	**4.8**
China	2.0	8.1	5.4

Source: TD Economics as of January 2022

Figure 2: Momentum will provide a buffer



Note: Below 50 = a majority of businesses reported a contraction
Source: IHS, TD Economics as of January 2022.

"It appears that October was the peak for the supply-chain impact. ... It's still a problem and it's still inflationary, but we believe we're past the peak on this front. ... While the best of the [recovery] growth is behind us, it's still going to be above-trend this year because there is still some catch-up to come, and in certain areas we are going to get a real lift from inventories being rebuilt (Figure 3). The rebuilding of inventories is going to create a growth thrust in the U.S. and Canada. This is, again, more cyclical in nature, but forecasters are still expecting some pretty attractive growth, with inventories accounting for part of that.

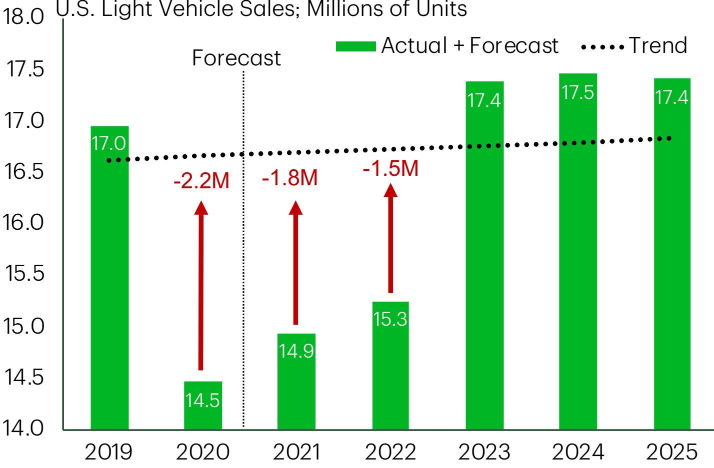
"... We've all been taken aback by some of the inflation numbers. It's been a historic jump. ... We thought Q4 would be the peak, but it's now looking like Q1 given some of the Omicron effects and supply-chain issues. But overall, we still think downward is the trend.

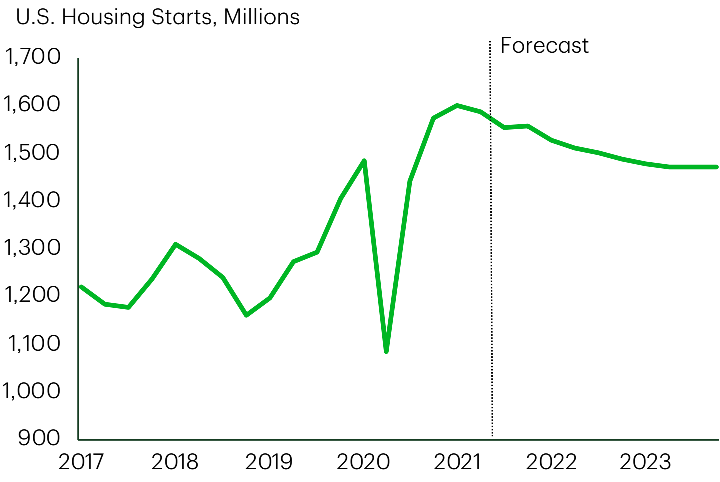
"I'll give you an example. In the U.S., the transportation component has accounted for a good half of year-over-year inflation. That includes used-car prices, new-car prices, gasoline, etc. That is not sustainable, and it will fade. Now, the million-dollar question is, what prices are likely to have more staying power? Rents, housing components, that's key — and wages, I think those really come up. But if you work through the math, even if rents increase 5% year-over-year from around 3% currently, it's still going to mean that, by the end of the year, inflation will be running closer to 4% than 7%.

"... The big risk is labour markets and how wages will lead to some of that 'second-round' inflation. Labour markets are historically tight. In fact, the unemployment rate has just gone back to where it was pre-pandemic (Figure 4). ... U.S. wage inflation is running at about 5%, whereas in Canada it's still down around 3%.

"... The inflation risk is partly tied to what central bankers actually do this year — how much they hike rates. ... There seems to be a view that both [Canadian and U.S.] central banks are going to raise rates four times in 2022 (Figure 5). In the U.S. this is due to Federal Reserve Chairman Powell and other federal officials saying they will do what it takes to keep inflation from becoming entrenched. The prevailing view, and we are part of this, is that the Fed will be getting that short rate up to 2% by some time in 2023. That's more or less a neutral rate."

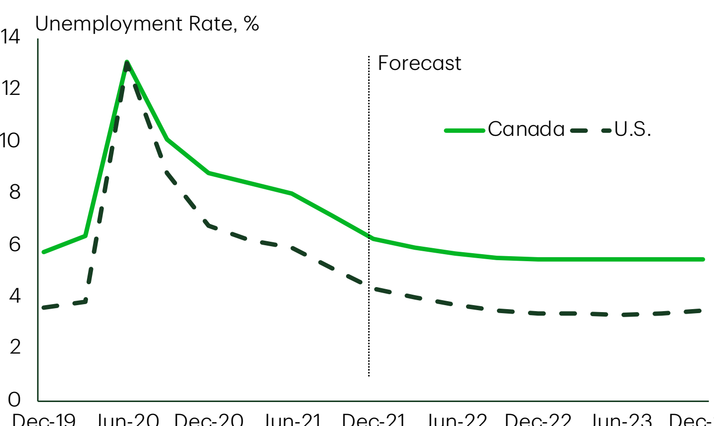
Figure 3: Inventories, production need to catch up





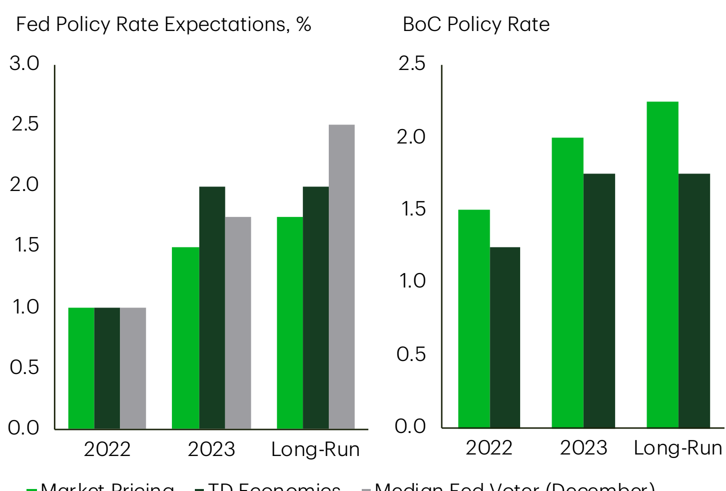
Source: Wards Automotive, TD Economics as of December 2021

Figure 4: Wages pose greatest risk to sustained inflation



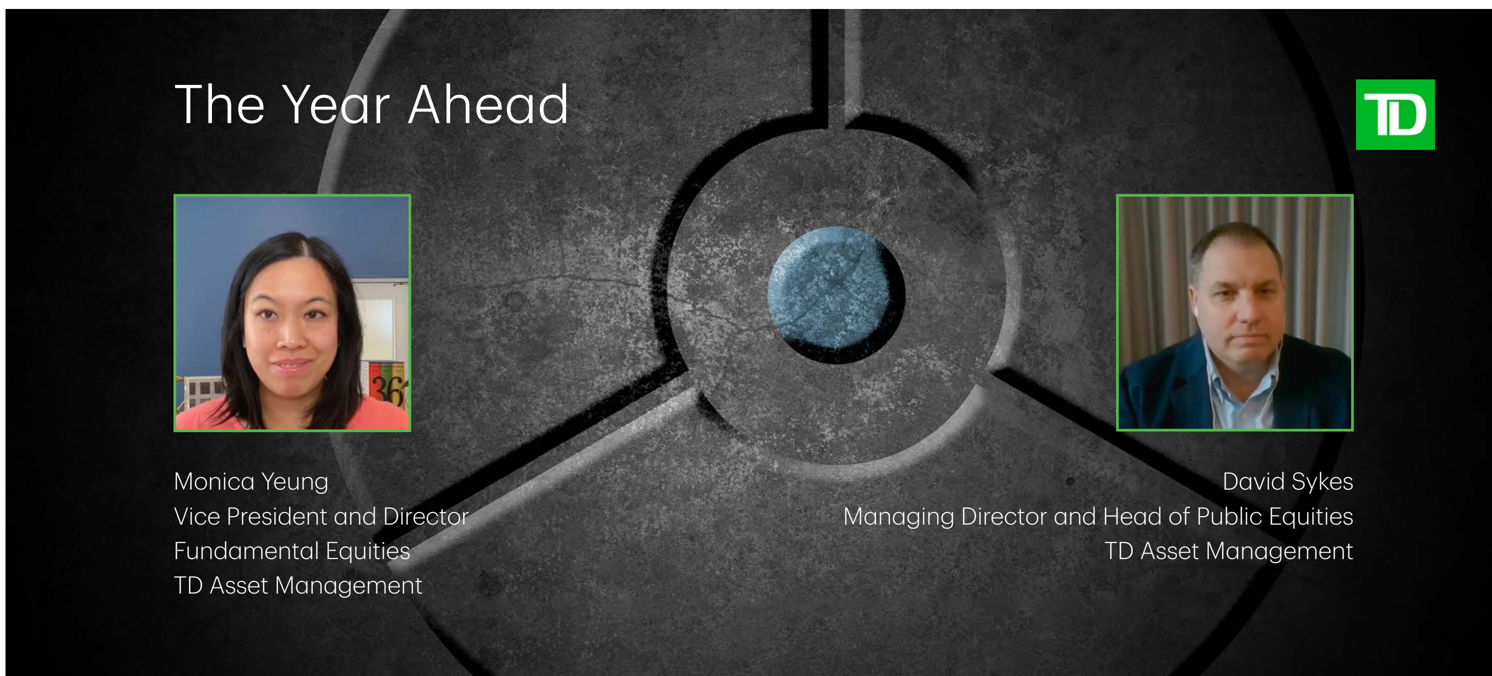
Source: TD Economics as of December 2021

Figure 5: Central banks prepare to hike rates



FOMC, Bloomberg Finance, TD Economics as of January 2022.

2022 Market Outlook: David Sykes, Monica Yeung



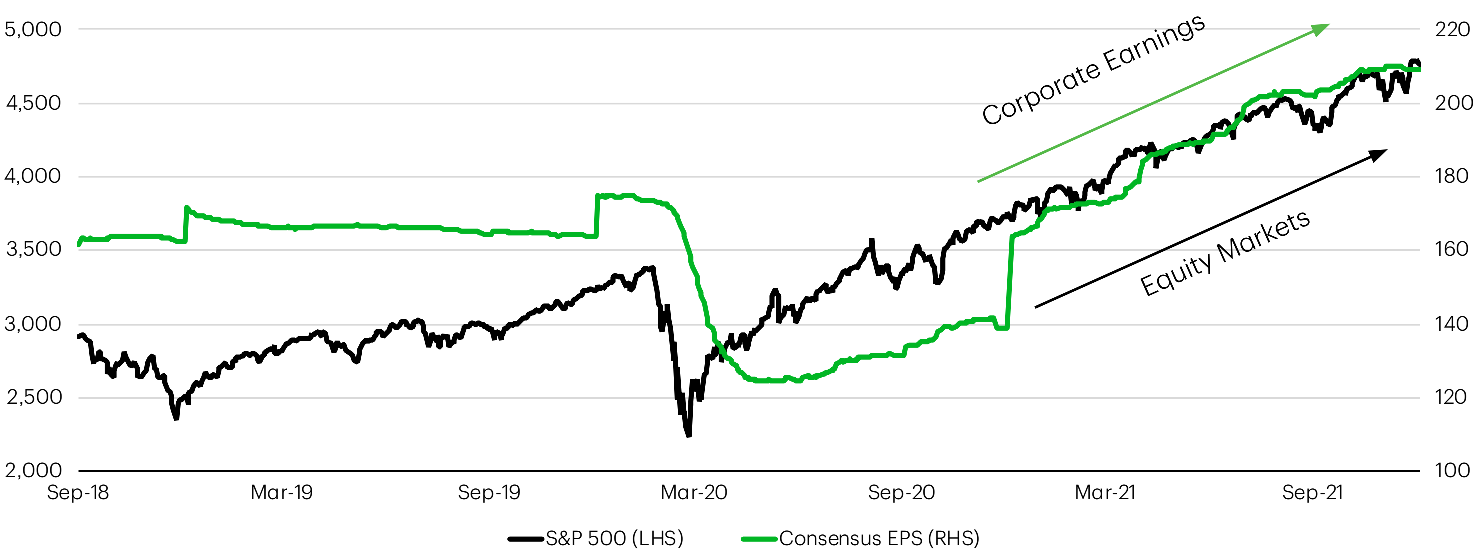
From the economic outlook, we then turned our attention to financial markets. This year, we were fortunate enough to have David Sykes, currently Head of Public Equities at TD Asset Management, share his thoughts on where the markets are headed as investors increasingly look forward to an end to the pandemic. He was interviewed by Monica Yeung, currently Vice President & Director, Fundamental Equities at TDAM. Effective April 1, 2022, Monica will become Co-Head of Research, Fundamental Equities, and David Sykes will become Chief Investment Officer.

Yeung: It was a monumental year last year for investment returns. Very strong returns across multiple asset classes — equities, alternatives, commodities. Maybe you could just spend a few minutes reflecting on 2021 and giving us your high-level thoughts on the outlook for the year.

Sykes: Sure. If there's one word in my mind, it's "normalization." We've clearly had this traumatic event, and I think policymakers around the world acted in accordance with what they should have done. ... If you look at the extraordinary fiscal and monetary stimulus, that was required, but now we're getting to a point where it's not. ... My focus is, how quickly does that monetary policy adjust? The market seems to think we're going to race to tapering, then hikes and then QT. I'm not sure we're going to see quantitative tightening quite as quickly as the market thinks, but there's no question that this year is going to be about that central-bank pivot.

Yeung: Let's talk a bit about equities. We finished last year at fresh all-time highs, and we're now two weeks into 2022 and we're seeing a massive rotation across sectors, across factors. Give us your read in terms of what's driving markets today, and then more specifically on valuation. How do you feel about valuation in the Canadian and U.S. markets?

Figure 1: Earnings recovery driving markets



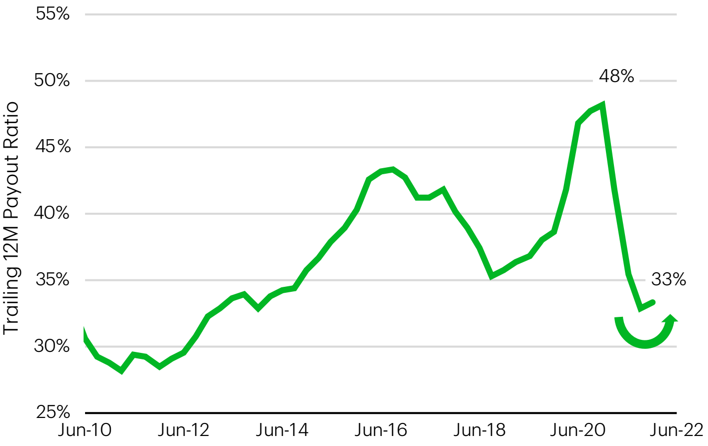
Notes: LHS= Left hand side. RHS= Right hand side. Source: TD Asset Management as of January 2022

Sykes: This is one of my favourite charts (Figure 1). … A lot of people last year were saying, 'We're in a bubble, and this is completely unjustified, and everything is going to weaken.' This slide shows a decline in earnings in 2020 of about 15%, so the S&P 500 earnings went from about US$164 to US$140, the green line. But thanks to that monetary policy and thanks to the fiscal stimulus, we saw a bounce-back in corporate earnings like we've never seen before. … Corporate earnings last year were up approximately 45%. … S&P 500 earnings for 2021 will probably come in somewhere around US$200 — just a massive increase. With that, you saw the strong rise in the market, and so I think that move was justified. … If you look at the broader market, there's no question it's been driven by four, five, six big stocks, but underneath all of that there are some companies that are in great shape, incredibly healthy, companies that have refinanced their debt at historically low rates. … You're probably not going to get any multiple expansion, but we do expect strong earnings growth this year. It's probably going to be super-exciting in terms of the volatility, but if you look at year-over-year upside in equity markets, I suspect it will be a low-single-digit kind of grinding year.

Yeung: A theme that keeps coming up in your comments is this idea of "normalization" — normalization in terms of the virus, in terms of inflation, in terms of valuations for the markets. As you think of all those different things on the horizon, how do you think about positioning your portfolios?

Sykes: We're in this rising-rate environment. That's probably really good for the financials. … We're significantly overweight financials, both in Canada and in the United States. … We've also seen a really nice move in the energy stocks. There's a lot going on in terms of ESG considerations … which likely means supply will remain constrained … so I think energy does well. We don't need higher prices, either; if energy prices just stay where they are, it'll be fantastic news for Western Canadian producers and U.S. producers, which really have streamlined their cost structures. … I still think technology is something you want to own but not what I would call "speculative" technology. I think we're looking much more at the proven names. And lastly, the one thing I really wanted to point out on this slide (Figure 2) is our expectation that the cash returns to shareholders are going to rise significantly. … If companies start to feel a little more confident, there's so much room for them to increase their shareholder returns through dividends. … As you can see here, about half of the earnings in the S&P were getting paid back to shareholders [in early 2021]. That dropped to something like 30%. In order to get from 30% of our US$140 to 50% of our US$200, there's 30% or 40% upside here. I don't think you're going to see it all at once, but I think companies over 2022 and 2023 are going to significantly start to ramp up those dividend increases.

Figure 2: Potential for payout ratios to rise



Note: Payout ratio calculated as % of trailing 12m earnings paid out as dividends. Source: Bloomberg Finance L.P. as of December 31, 2021

Keynote Speaker: Jason Thomas

The stage was then set for our keynote speaker, Jason Thomas, Managing Director and Head of Global Research at Carlyle Group. Thomas previously served at the White House as Special Assistant to the President and Director for Policy Development at the National Economic Council. His enlightening presentation walked us through the policy missteps and false assumptions that led to our current environment of heightened inflation and broken supply chains.

"The current environment is a product of two competing realities. First, from a macro perspective, is what we term the "Frustration of the Finite," which is related to inflationary pressures and the way that capacity constraints and the surge in goods demand have combined to push prices up. … The second is really what we term the "Beauty of the Infinite," which is related to investor interest and fund flows to those digital businesses that have become so popular and have exhibited really different growth mechanics.

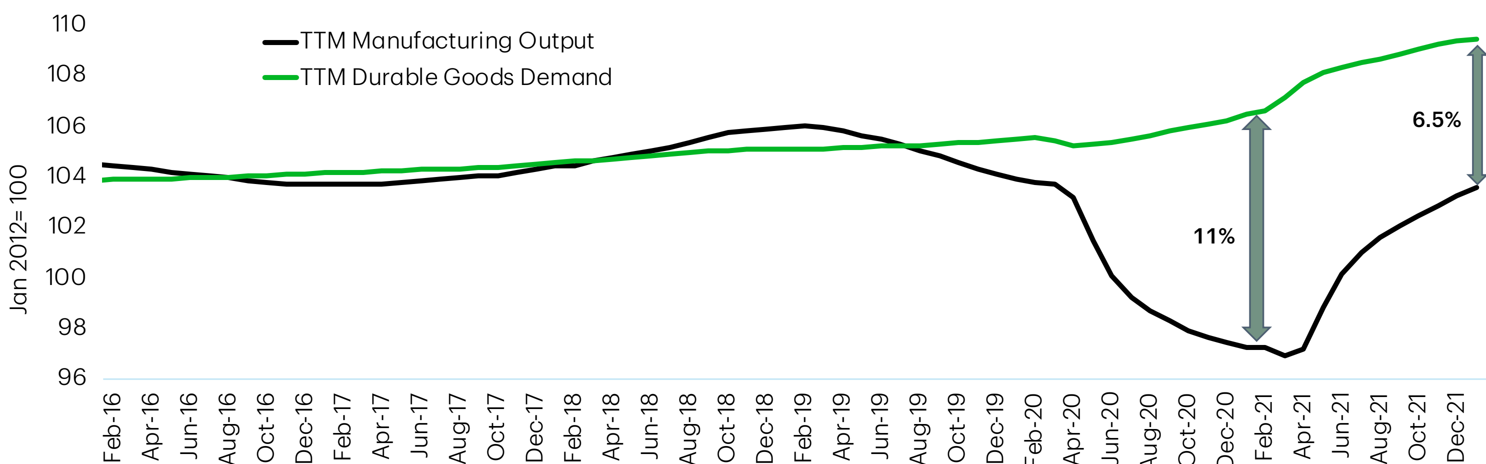
"… We'll start with the Frustration of the Finite. We have inflation on a global basis, according to Carlyle portfolio data, of 6% year-over-year in prices received, about a 13% increase in prices paid on key commodities, key inputs. So, inflation is extremely high, and we see no signs that price pressures are likely to moderate in the near term.

"Why has inflation remained a problem for so long? Well, elevated inflation didn't disappear because neither has the pandemic. … During the pandemic, we had in the U.S. an increase in household spending on durable goods, up about 18% as of year-end relative to prior trend. At the same time, we saw a big decline in spending on services — travel, tourism, live events, etc. So, money that was earmarked for a cruise or travel has been spent instead on electronics or furniture. , but you can't take that unused cruise ship capacity and magically convert it into those goods, so there's always going to be some degree of price pressure as a result of this dramatic shift in spending, as relatively cash-rich but locked-down households change their basic spending patterns.

"But it's actually even worse than that because, during the course of 2020, business managers responded to the pandemic as though it was going to be a replay of 2008. So, at the outset they dramatically cut production schedules, they substantially cut back orders for inputs and parts — things like semiconductors — and just really anticipated there was going to be a big decline in demand rather than the surge in demand for goods that we actually observed. Over the course of 2021, we found that overall output could not scale up to meet the new demand, largely because of capacity constraints. ... So, as a result, we ended up finishing 2021 with our estimated gap between supply and demand in these product markets of about 6.5% (Figure 1) — better than the widest gap observed at the end of the first quarter but still extraordinarily wide in historical terms.

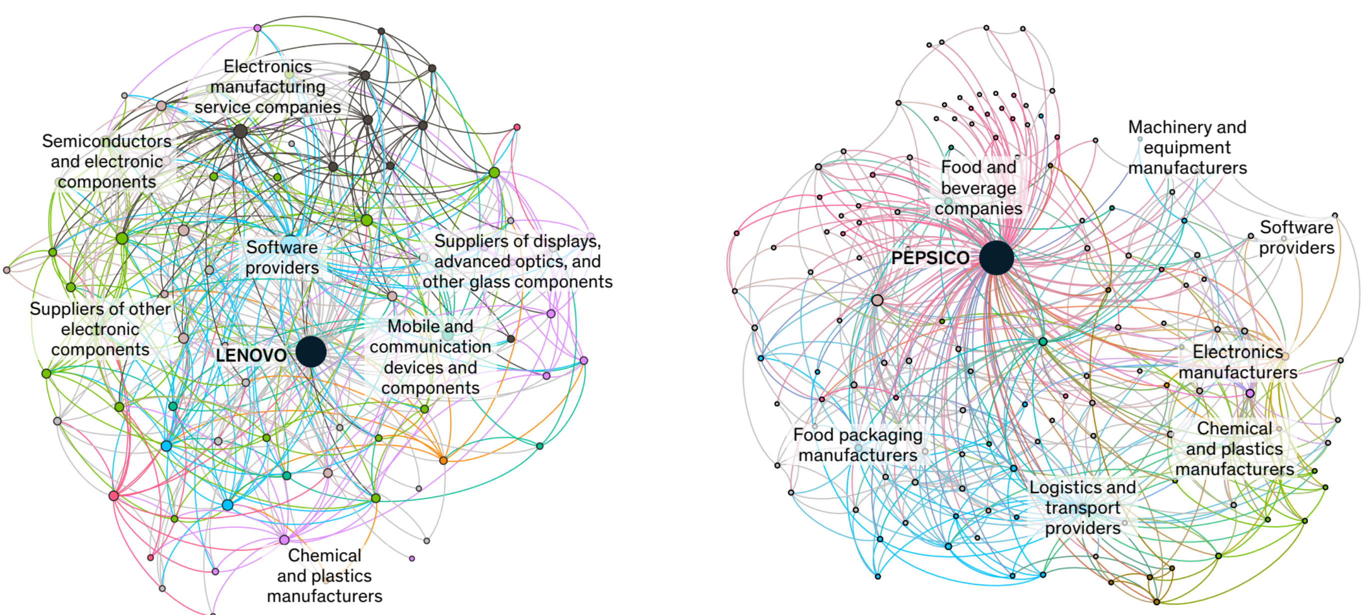
"And it's not just that demand is exceeding supply or that we have capacity constraints. We live in a world where production processes for the past 30 years have been progressively unbundled and have reached a degree of complexity that's hard to overstate. Very often you hear about "supply chains" being snarled. Well, to call these sort of neural networks supply chains is almost to trivialize how complicated they have become (Figure 2). In many cases, the production of a single device like a computer or a smartphone requires 30 different production processes and shipments, but that's also true of seemingly uncomplicated items like furniture. ... So it's not just the problems of supply and demand and these basics. It's actually that we've moved to a world where every product is actually the product of so many distributed tasks and distributed shipments that we're dealing with a level of complexity and a nonlinearity that really complicates any ability to scale up.

Figure 1: Physical constraints, supply-chain bottlenecks inhibit closure of supply-demand gap



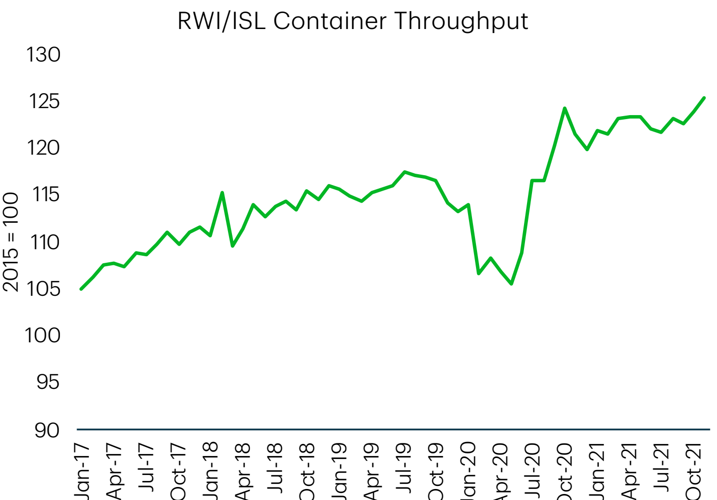
Source: Carlyle analysis of portfolio company data, St. Louis Federal Reserve as of January 2022

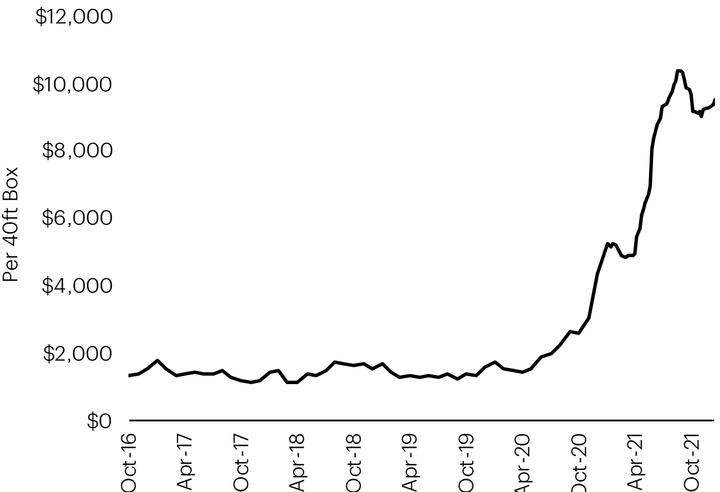
Figure 2: Scaling up / restocking inhibited by supply-chain capacity and complexity



Source: McKinsey; "Risk, resilience and rebalancing in global value chains" 2020

Figure 3: Container throughput volumes *above* system capacity





Source: Carlyle, Bloomberg Finance as of January 2022

"And so, interestingly, over the course of 2021, what we saw when you look at it on a global basis is that container throughput volumes were actually running above prior capacity (Figure 3). And as a result, you see an increase in the cost of transporting virtually any good between point A and point B — about eight times higher than it was in 2019. So, of course, inflationary pressures have spilled over to other goods, precisely because of this increase in transportation costs.

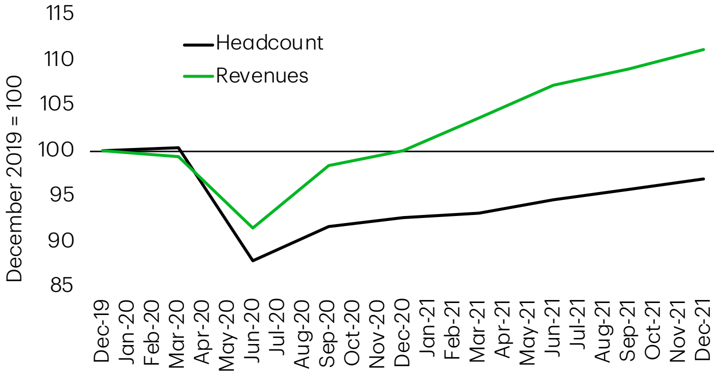
"… We have all heard so much about supply-chain dysfunction, dysfunction at ports in Vancouver, Los Angeles, etc. And that has been an issue, but what's really interesting about that is that it's not so much the dysfunction — as we've seen, cargo throughput volumes are at all-time highs. It's that, because of the pandemic, there are no longer any inventories of components parts or other intermediate goods, and that means that we've essentially created a series circuit. It's almost like the holiday lights where, if one light is out, the whole string of lights is out. With these sequential production processes, if you don't get the components or parts you need to do your part of the process or for final assembly … you have to shut down your production process, and if you do that, then of course everyone downstream from you has to do the same sort of thing. And this is how those very modest perturbations to the system, delays in shipping, have actually had an outsized impact.

"… What's really fascinating to me is, when we look through the portfolio data and see that, wow, we have these very significant supply constraints … we think that there must be a lot of investment coming online in more factories, more equipment, more terminals, etc. But in fact most of the investment that we've seen over the course of the past year and a half is in software, data, digital. So instead of investing in physical capacity to deal with these supply constraints, most businesses are actually taking their free cash flow and also external finance and plowing it into ways to get to the future faster. And I think this is really significant because it's sort of the opposite, again, of what one would expect, given the changes in prices and the pressures that we've observed.

"Much of this started out in the depths of the pandemic as a necessity. It was a real-world business continuity test where everyone had to lean in on digital to a greater extent than they had previously, but now the success of that, the ability to drive revenues, grow at a faster rate — by increasing digital engagement, by increasing data capture, data storage, data analytics — has actually become something that is self-perpetuating for these investments. And what we've seen across the portfolio is that, since the onset of the pandemic, portfolio-wide revenue per worker is up about 15% (Figure 4).

"… A big part of this has just flowed directly to the bottom line. …

Figure 4: Digitization and reinvention: portfolio-wide revenue per worker up 15% since onset of pandemic



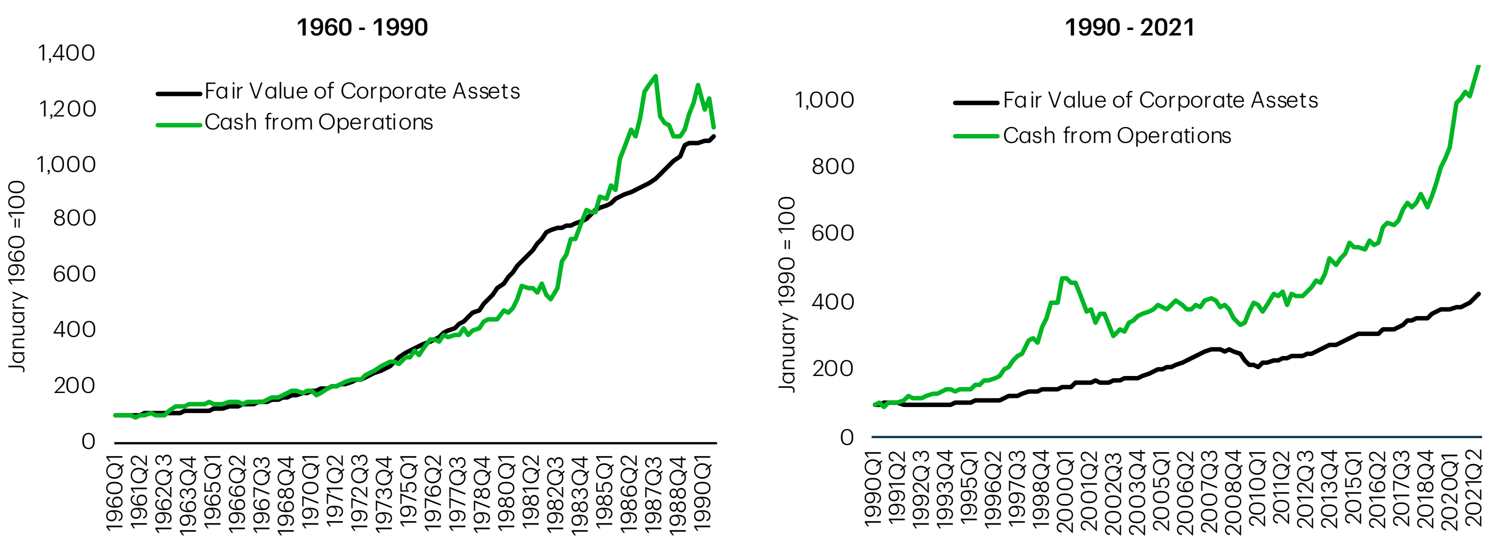
Source: Carlyle analysis, Bureau of Economic Analysis of portfolio data, Bureau of Labor Statistics as of January 2022

The S&P 500 is reporting net income margins that are up about 20% from their pre-pandemic average. Earnings growth for the fourth quarter 2021 relative to 2020, up 44%. Full-year earnings growth for 2021 of 45%. And virtually all of that is explained by this increase in margins. So it's not just better growth. The level of revenues at the end of the year are not too dissimilar from what was expected but much, much wider margins — more profitable, with a larger share of those revenues ultimately going to the equity holders.

"And this is really what sets up the second portion of this presentation, this notion of the "Beauty of the Infinite," the idea of digital growth where revenues can scale up without any incremental capex, without any incremental hiring.

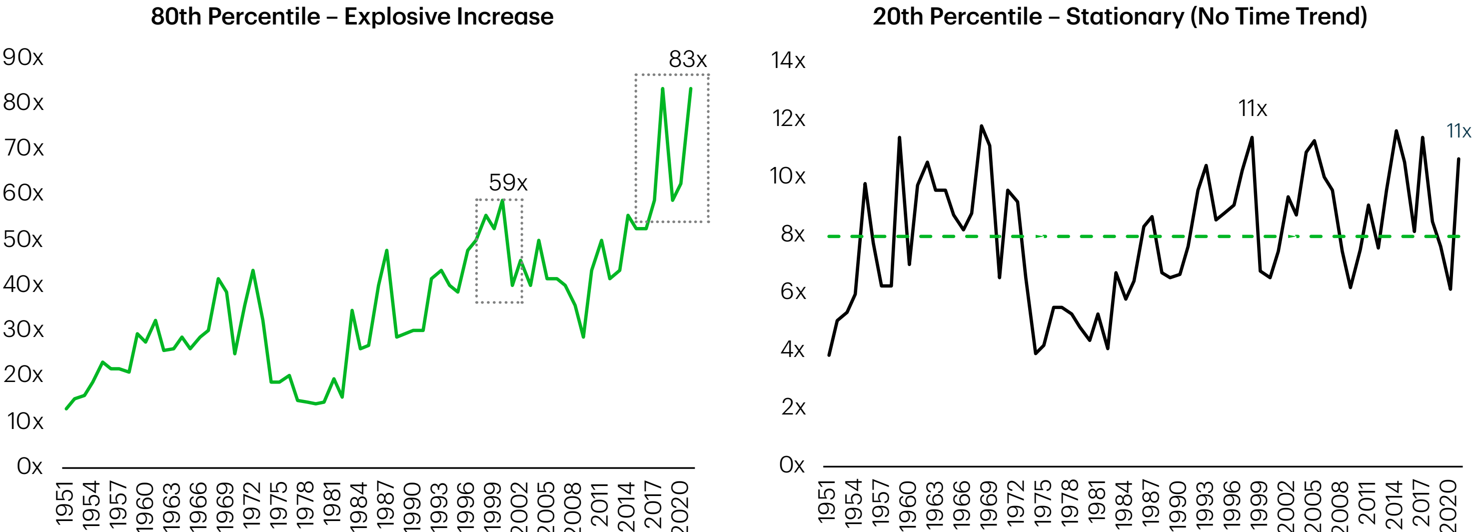
"... Growth in the industrial age was really constrained by the need for more factories, more workers, more equipment, distribution network for your products. So incremental revenues came with incremental costs. For many of the established mega-cap digital businesses, and many of the companies that are trying to catch up with them — you have a different environment entirely, where most of the returns accrue to intangible assets. And because of network effects and other aspects, these revenues can scale up without any incremental hiring, any incremental capex (Figure 5). ... People often say asset prices are high, valuations are high. Sure, yes, that's true. But interestingly, almost all of this is explained by those companies in the top 20% (Figure 6). ...

Figure 5: Digital businesses exhibit nearly infinite scalability, as revenues grow without incremental investment or hiring



Source: Carlyle analysis, Federal Reserve flow of funds data as of January 2022

Figure 6: Dot-com bubble vs. today, 80th percent of market-to-book

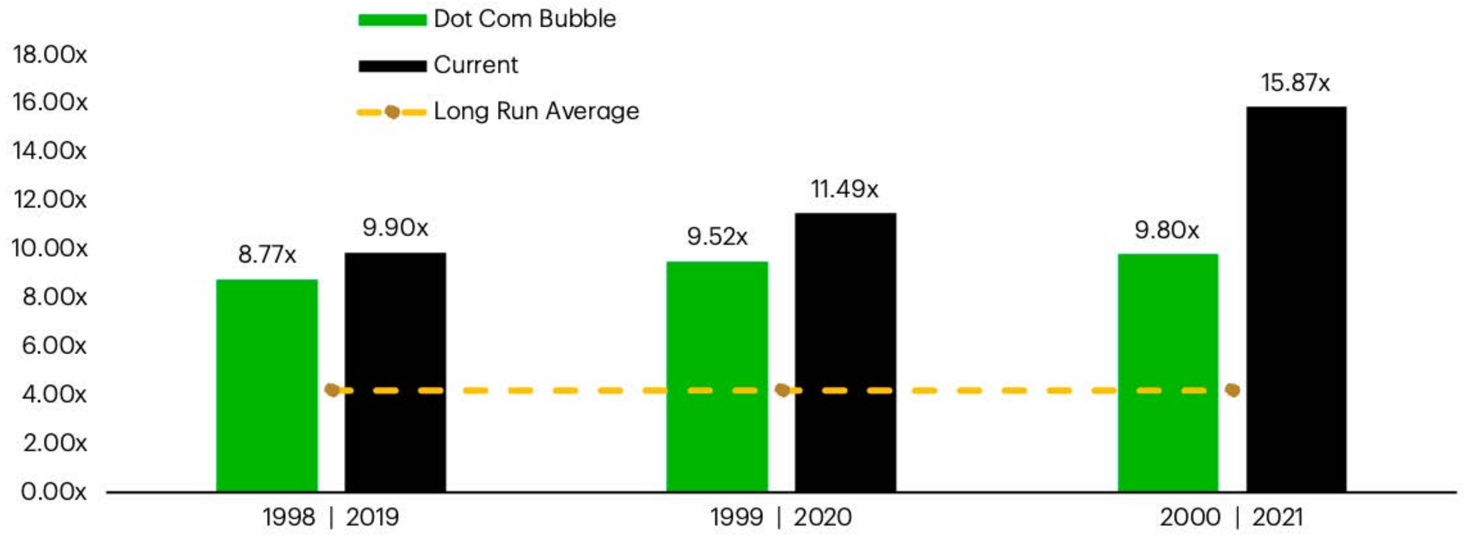


Source: Carlyle analysis, Ken French detail for portfolios formed on book/market as of November 2021

When you look today at the 80th percentile, it's very similar to how it was in the late '90s early 2000s, so again this enthusiasm for certain kinds of business models that we haven't observed at any point with the exception of the 1999, 2000 period (Figure 7). … Some people argue that this is different than '99 because the businesses are much larger and much older, but I think that you could say that, well, if they're larger and older and still aren't turning a profit, maybe that's a sign of more trouble with the model.

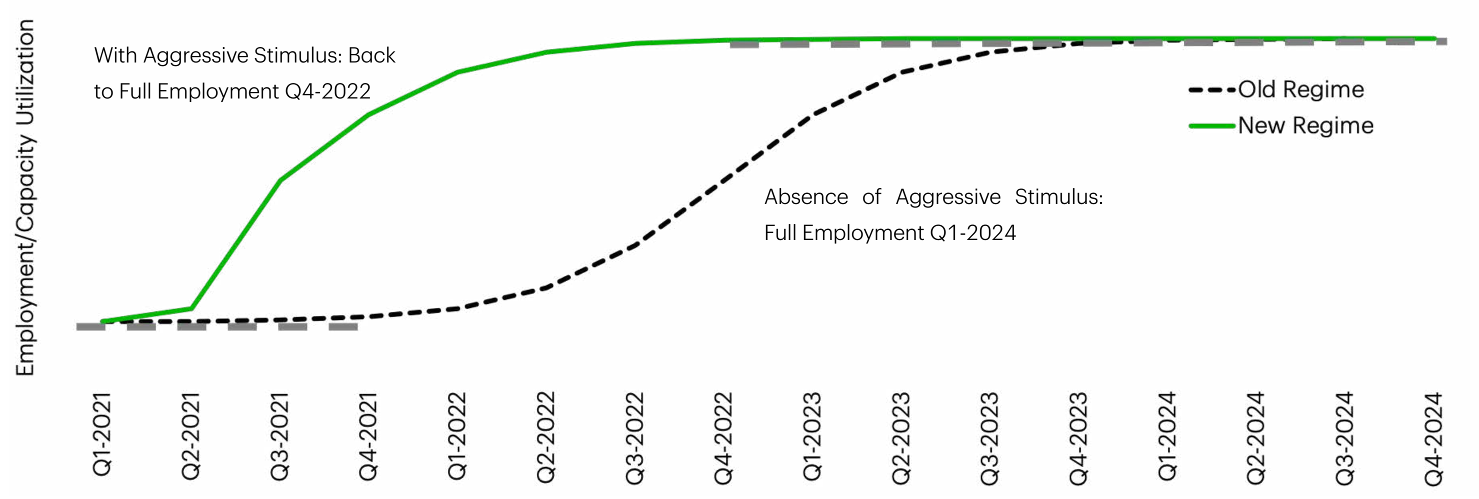
"… So we're left wondering what to expect going forward because of this dramatic change in the policy environment. So, first, I think it's important to note that, in the United States, there was a very strong consensus as the new administration came in about a year ago, that they wanted to really shorten this recovery, that instead of waiting for two to four years to get back to full employment, they wanted to get back to full employment in 12 to 18 months (Figures 8). That was effectively the goal of the administration, and as a result, they ended up injecting not only the US$900 billion that took effect in December of 2020, but also another package that ultimately totalled US$1.9 trillion in the 2021 calendar year. And so essentially what happened in the United States is that about 12% of GDP went into the economy as fiscal stimulus. … The result was much higher inflation in the U.S. than most other economies in the world.

Figure 7: Dot-com bubble vs. today, 80th percent of market-to-book



Source: Carlyle analysis, Ken French detail for portfolios formed on book/market as of November 2021

Figure 8: Stimulus designed to accelerate the speed of the economy's convergence to a full-employment equilibrium



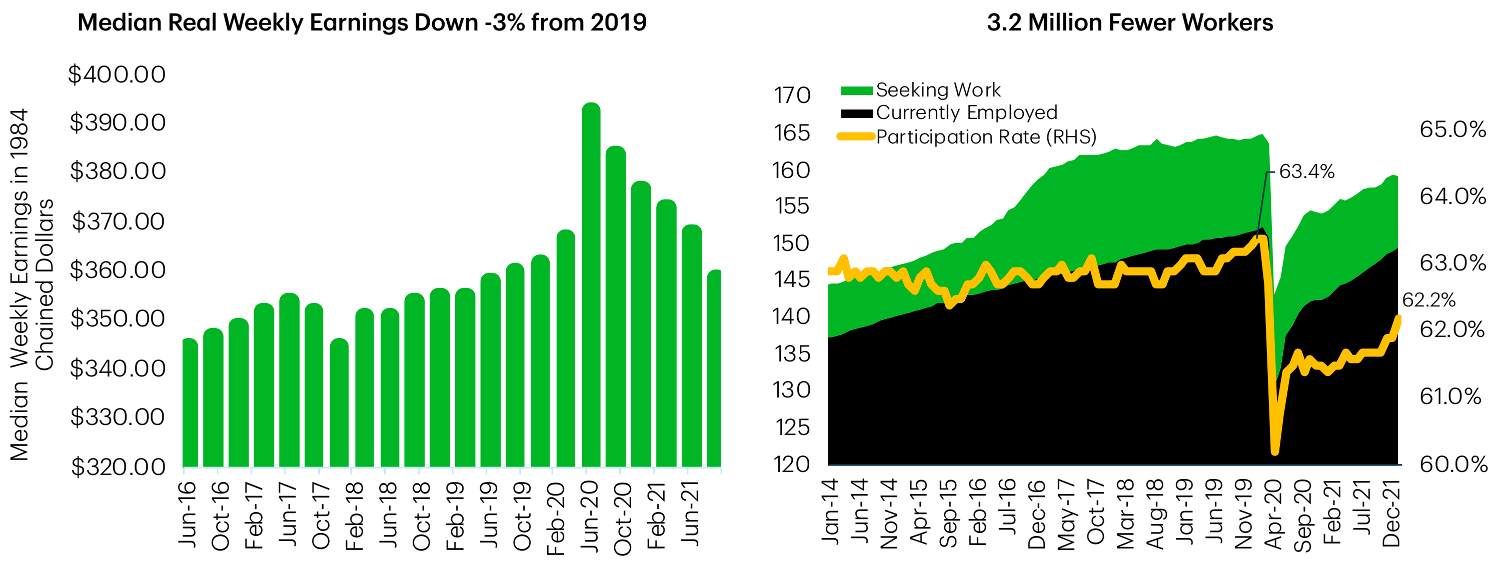
Source: Carlyle as of January 2022

"Because much of the transfers went to the household sector, it led people to take much longer to get back to the workforce (Figure 9). … Labour force participation declined by much more than many analysts had anticipated, and in fact when you look at the total people that have left the labour force, it leads to an unemployment rate that seems really understated in that the number of people out of a job is up by about 50% more than would be suggested by that unemployment rate. Much of this is voluntary, much of it associated with higher cash balances among those households. And as a result of what has ultimately led to worker shortages, because of the withdrawal from the labour force, and this very high inflation rate, public polls show that voters today are unhappy with the current state.

"There's always this question that economists grapple with as to whether the Fed is behind the curve. Well, I don't know, but we can certainly say that the Fed is behind the electorate. … It cannot be overstated just how dramatic this turn in policy is, to combatting inflation, and so now we expect, priced in the market is almost four rate hikes and then another two to three next year. And in fact, from my own perspective, I think it's more likely that we see six rate hikes in 2022. When we look at models of where interest rates should be based on savings and investment fundamentals, we actually see that rates are probably about two to four percentage points too low today.

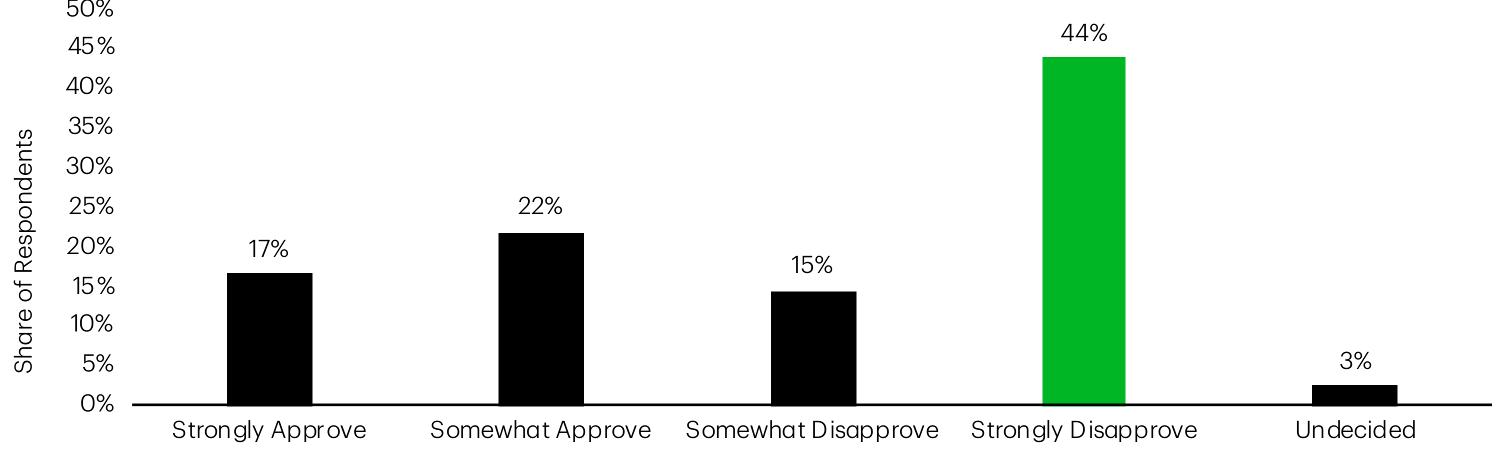
"… This is going to have a big impact on financial markets, and first and most obviously, we've seen tech valuations fall on increased interest-rate risk. … … Interestingly, these companies that have this infinite growth potential, that have become so exciting, with so much money chasing after them rather than diversifying away or insulating a portfolio from some of the inflationary pressures, they have actually borne the brunt of it. It's actually quite rational given that so much of their cash flows

Figure 9: Fiscal transfers and high inflation deter employment at prior market-clearing wage rates



Source: Carlyle analysis, Bureau of Economic Analysis of portfolio data, Bureau of Labor Statistics as of January 2022

Figure 10: More than 2 in 5 voters strongly disapprove of current direction of the economy



Source: Public Polling Project, Fall 2021 National Survey

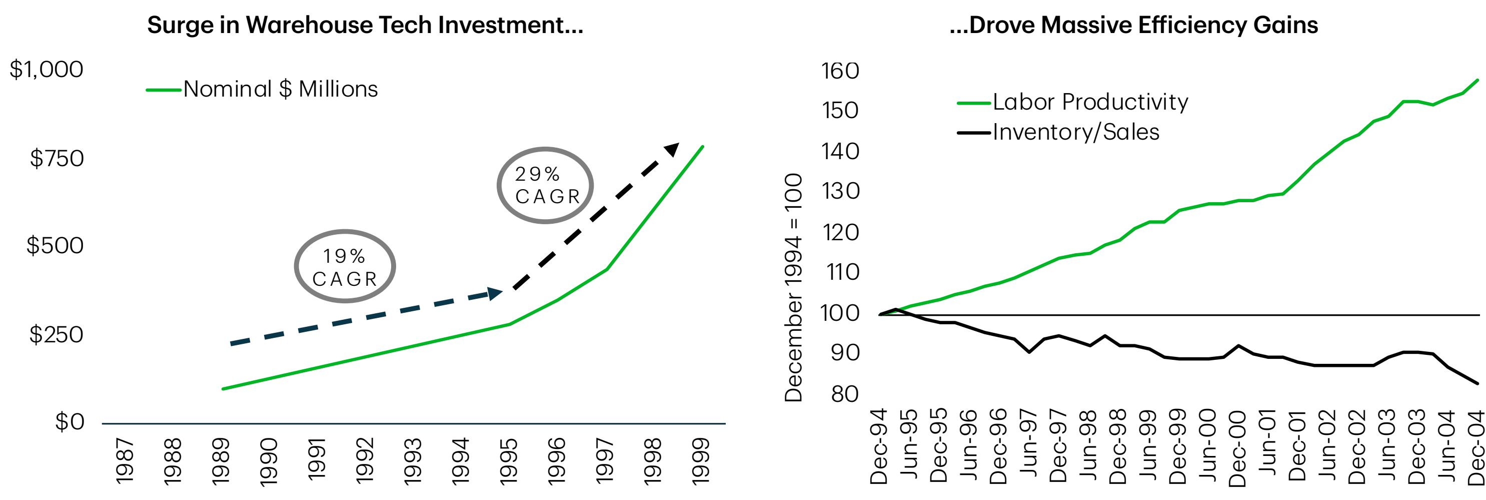
are expected to arrive in the very distant future.

"... I think the current dynamics are quite similar to late 1990s where investments in technology made by businesses in the retail and manufacturing sectors — warehousing technologies, barcodes, barcode scanners, computers, automation in warehousing — really ended up having enormous efficiency gains. Productivity rose by about 57% as a result of these investments. The inventory-to-sales ratio fell by about 25% (Figure 11). ... In fact, the businesses here in retail and manufacturing ended up, because of these tech investments generating far higher returns than the tech sector (Figure 12).

"So, to me, this is a period where the emphasis on technology is going to persist, and this digital revolution is going to persist, but the returns associated with it are going to shift from the tech sector per se to ... those businesses that can actually make greater use of the digital technology available today. Very often that's professional business services, IT services, some retail, hospitality. And so I can very much hear the echoes of the late 1990s in this potential shift in investor focus.

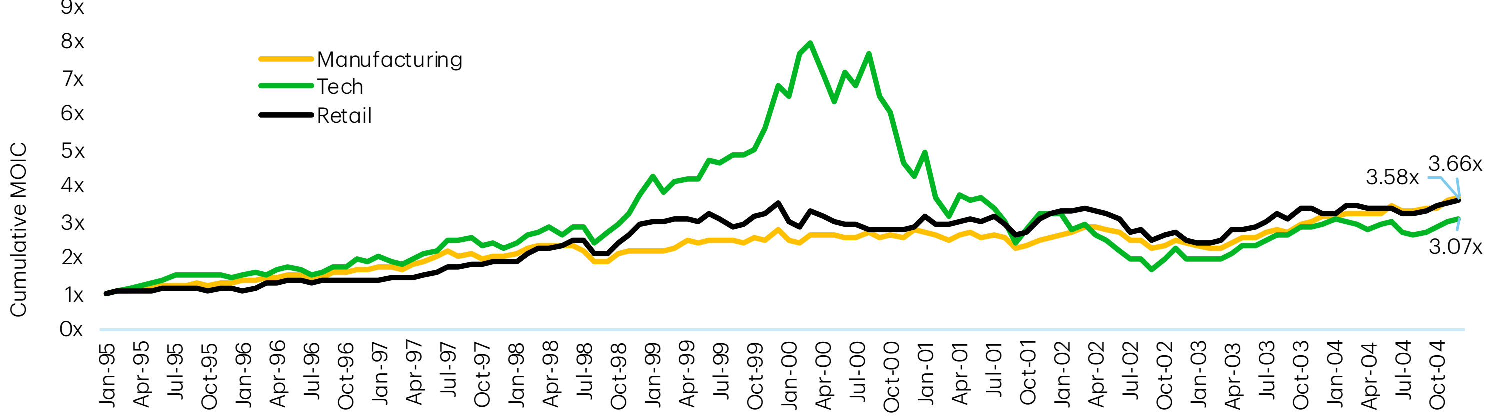
"So just to summarize, to call inflation transitory at the Fed was an error. In fact, I would say that this became the biggest risk to Fed credibility since Chair Bernanke said that subprime was contained in 2007. So the Fed had to pivot away hard from this when inflation remained elevated. But really it's much more than that. We have such a massive change in the political environment. The electorate is angry about elevated inflation, and policymakers are going to do something about it this year. This is going to be the story of 2022, I assure you. The effects of this policy boomerang are going to be mostly felt in frothy, rate-sensitive categories — mostly tech, growth — but it could spill over, and I think it could be a volatile year. But despite the increased volatility in these sectors, I think we're going to see very strong returns in those businesses that actually adopt and make great use of the new technologies."

Figure 11: Current dynamics similar to 1990s when tech investments boosted retail and manufacturing profitability ...



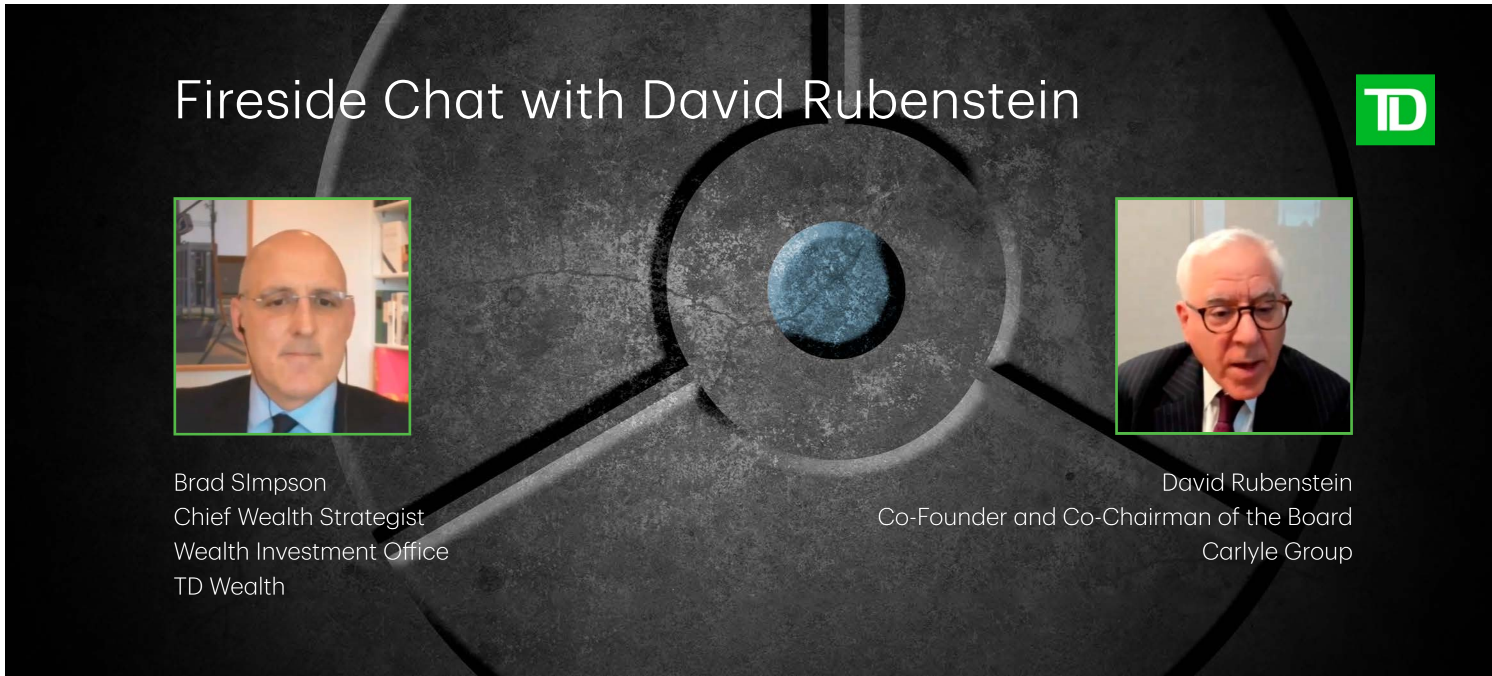
Source: McKinsey Global Institute, Carlyle analysis, Bureau of Labor Statistics, Bureau of Economic Analysis. As of January 2022

Figure 12: ... allowing returns to adopters of new technology to outperform those of its providers



Source: Carlyle analysis, CRSP database

Fireside Chat: David Rubenstein, Brad Simpson



I had the pleasure of welcoming to the conference a true legend in the private-equity world, David Rubenstein. Rubenstein is the Co-Founder and Co-Chairman of The Carlyle Group, which has been a prominent private-equity firm globally for a generation. He is the chairman of the John F. Kennedy Center for Performing Arts, the Council on Foreign Relations, the National Gallery of Art and the Economic Club of Washington, among many others board seats, and he is an original signer of The Giving Pledge. He also hosts two shows on Bloomberg TV and is the author of three books.

Simpson: Welcome, David, and thanks so much for joining us today.

Rubenstein: Thank you very much. Thank you for inviting me.

Simpson: We're reading numerous reports about the U.S. as one of the most politically divided, economically unequal, least vaccinated nations in the G7. … For the first time really that I can remember in my lifetime, we seem to be talking about the very foundation of the union itself. How concerned should we be about that?

Rubenstein: Well, I think we should be concerned. … The country is largely split down the middle. There are people who just do not believe in vaccinations, don't believe the election was fairly decided, who just don't believe anything coming out of the federal government can be good for them. I think the country is going through a metamorphosis, which is probably weakening … the image that we have built around the world. … Clearly, the effects of the Trump years I think have dissipated our image around the world, and I think President Biden has not been able to change that all that much because he hasn't been able to get that much through Congress. … I don't think the United States is falling apart tomorrow or going into Civil War, but clearly we have some challenges in our democracy and they are reflected in the way Congress is operating. We also have challenges in our economy. So, it's not as pleasant a situation as I would like it to be.

Simpson: On the other side, we have China, which seems to be weakening as well. The kind of economic growth that we got so used to seems to be in question ... and then there are the growing tensions with the United States that we saw during the Trump administration. We thought there would be a little bit of an opportunity with the change in administration, but it seems to have continued. How concerned should we be about this one as well?

> I don't think there's going to be anything other than a lot of sabre-rattling and a lot of talking.

Rubenstein: Well, this is another tough issue. ... Our biggest trading partner, other than Canada and Mexico, is China. We buy a lot from China and we send them a lot of dollar bills, so they are a big creditor of the United States. I think when Joe Biden was elected president, people thought that the turmoil in the U.S.-China relationship under President Trump would end ... but things haven't changed much. ... I think when President Biden took office, he didn't feel that the United States was in a strong enough position to negotiate anything with China and, therefore, he wanted to appear to be much tougher. ... The Chinese were looking forward to a stronger relationship with the United States than they had under Trump, but they saw the rhetoric out of President Biden not being so friendly. ... The bottom line is, I think until the Olympics are over, until Xi Jinping has been elected to the third five-year term, which is unprecedented since 1949, I think that the Chinese are not going to want to appear to be weak in front of the Chinese electorate. ... and the same is true of President Biden. He doesn't want to look weak on China. ... So, I don't think anything is going to change anytime soon. I don't think there's going to be anything other than a lot of sabre-rattling and a lot of talking, and I don't think there's going to be anything that either side is going to be able to do to bring the relationship to a better situation over the next year or so. I think it's going to be pretty much what we have now.

Simpson: Is it an overstatement to say we have these two global superpowers creating more and more tension that's difficult to contain? ... Are there any collateral changes that we should be concerned about?

Rubenstein: Well, I'm sure you are familiar with Graham Allison's book on Thucydides's Trap. In it he points out that over several hundred years there've been times when civilizations were dominant and then they were challenged by other civilizations coming along, or other countries coming along. And in about three-quarters of those cases, there was military conflict because the rising power was threatening the established power, and the established power in some cases went to war to protect its position. ... I don't think there's going to be a physical military confrontation between the United States and China. ... What we have now is a situation that's bipolar. After World War II, the United States dominated everything, and we had one rival really, which was Russia. But that was a military rival. Russia wasn't an economic rival. Now we have a rival, China, that is a military rival, a geopolitical rival, an economic rival, a technology rival, and really a rival that I think is interested in becoming the dominant country in the world again. ... So I think we'll have this standoff between these two superpowers for quite some time, and the rest of the world will have to look at it and say, well, which side should I be on? Or can I be friendly with both? Which is what most people would like to do, so they're not in harm's way.

Simpson: We've spent the last couple of years working out how our clients can get access to different parts of the world, where traditionally they had a very difficult time doing so. One of our starting points for that is private equity, and some of that goes into China. So, when we look at the sort of government crackdowns on technology companies, video gaming, there indeed is some reluctance to invest there. ... What are your thoughts on that from an investment perspective?

> It's hard to not invest in the biggest economy in the world — and by purchase price parity, China is the biggest — but you have to know what you're doing.

Rubenstein: People often ask me about political risk, and I often say — and I'm not trying to be cute — that there's a lot of political risk to investing in the United States as well. ... As Will Rogers, the famous humorist, once said, "The country's never safe as long as Congress is in session." ... I would say that right now China has decided to make it clear that the government is paramount, and its authority is absolute. I think the Chinese business community has recognized that, and so Chinese business leaders and entrepreneurs are keeping their heads down. Many of these businesses have enormous amounts of data, such that the Chinese government now is worried that Chinese technology companies have more data about citizens than the government does. So that's a concern as well. I think in terms of investing, we are at Carlyle a large investor in China. I believe they have been good investments historically. Clearly the values have been depressed a bit as of late, but it's hard to not invest in the biggest economy in the world, and by purchase price parity, China is the biggest economy in the world. By GDP, it will be the largest in our lifetime. So, I just think it's hard to

avoid investing when they have so many opportunities for great value creation there, but you have to know what you're doing, and I think it's helpful to have people on the ground to try to mitigate this risk. And you should also recognize that valuations will not be quite as high as they have been or robust as they have been, but in time I think they'll come back.

Simpson: Thinking more about where we are in terms of technology — with fake news and conspiracy theories and technology firms controlling the news flow and the narrative — do we need to worry about Big Brother more today, and who is Big Brother? What should be required in terms of proper governance in this digital space?

Rubenstein: Well, it was 1949, I think June of 1949, that George Orwell wrote his famous book 1984. … And here we are in 2022 and the things that people were worried about in that book seem to have come true in many respects. The government of China, the government of the United States and the technology companies … have enormous amounts of data about us. … I don't think there's any way to completely avoid it, unless you get rid of all of the technology and conveniences that people have today and a lot of people just can't live without them. … People seem to be generally not as worried about it as you might think they would be, though. The biggest concern is whether the government ultimately gets some of that data and uses it for political purposes. I can't say what's happening with respect to that in China. As for the United States, I'm not as worried about that happening, but I do think it's a concern that we should all recognize, that you are not as anonymous as you would like to be, no matter who you are.

Simpson: Orwell always thought that it was going to be the government doing it to us but, in a fascinating twist, it seems we have actually run towards it. I guess the last thing I'll ask you is this, does the governor's election in Virginia foreshadow something for the U.S. midterms this year?

> The world can change tomorrow, but if the midterm elections were held tomorrow, I think the Democrats would be in trouble.

Rubenstein: For those who may not know exactly what happened in Virginia, a former co-CEO of Carlyle, a person I hired 25 years ago and who ultimately was promoted to co-CEO when I became Co-Chairman, Glenn Youngkin, left the firm and ran for governor of Virginia. I told him at the time I thought it would be kind of hard to go right from private equity to being the governor of Virginia, but he was right and I was wrong. I think that does indicate that Democratic strongholds such as Virginia may not be so safe for the Democrats. Of course, as John Kenneth Galbraith, the famous Canadian, once said, "The conventional wisdom in Washington is almost always wrong." But if you put that aside for a moment, the conventional wisdom is that the House will go Republican. … I think that many Republicans believe they will be up by 35 seats. Normally, after a first midterm after a president is elected, the president in power loses about 30 seats, so it wouldn't be that unusual if the Democrats were to lose 35 or 40 seats. And I think President Biden's popularity is not so high that he's going to be able to hold onto a lot of seats. In addition, the Republicans have done a pretty good job in legislatures they control redistricting congressional districts to give them an advantage. … So I think that the House probably will go Republican and I think the Senate is likely to be very close, one way or the other, but probably leaning Republican. If that happens, Joe Biden is going to have a very difficult time getting anything through Congress. The world can change tomorrow … but if the midterm elections were held tomorrow, I think the Democrats would be in trouble.

Simpson: I had so many other questions I wanted to ask, but with respect to your time, I just wanted to say thanks so much. It was deeply appreciated, and I really wish you all the best, and I look forward to doing this in person.

Rubenstein: Well, thank you very much. … I hope to come back to see you at some point in person when it's possible to do that and more easily, but thanks very much for inviting me.

Market Performance

Canadian Indices ($CA) Return	Index	(%) 1 Month	(%) 3 Months	(%) YTD	(%) 1 Year	(%) 3 Years	(%) 5 Years	(%) 10 Years	(%) 20 Years
S&P/TSX Composite (TR)	79,537	-0.41	0.97	-0.41	24.98	14.13	9.76	8.63	8.08
S&P/TSX Composite (PR)	21,098	-0.59	0.29	-0.59	21.70	10.73	6.52	5.41	5.20
S&P/TSX 60 (TR)	3,931	-0.20	2.05	-0.20	28.48	14.92	10.52	9.42	8.38
S&P/TSX SmallCap (TR)	1,318	-1.08	-3.48	-1.08	18.44	13.05	5.40	4.01	0.05
U.S. Indices ($US) Return									
S&P 500 (TR)	9,470	-5.17	-1.61	-5.17	23.29	20.71	16.78	15.43	9.31
S&P 500 (PR)	4,516	-5.26	-1.95	-5.26	21.57	18.64	14.66	13.15	7.17
Dow Jones Industrial (PR)	35,132	-3.32	-1.92	-3.32	17.17	12.01	12.08	10.77	6.53
NASDAQ Composite (PR)	14,240	-8.98	-8.12	-8.98	8.95	25.05	20.46	17.60	10.50
Russell 2000 (TR)	10,503	-9.63	-11.46	-9.63	-1.21	11.99	9.69	11.33	8.86
U.S. Indices ($CA) Return									
S&P 500 (TR)	12,045	-4.86	1.05	-4.86	22.71	19.40	16.22	18.18	8.09
S&P 500 (PR)	5,744	-4.95	0.71	-4.95	21.00	17.35	14.11	15.85	5.97
Dow Jones Industrial (PR)	44,686	-3.00	0.74	-3.00	16.62	10.79	11.54	13.41	5.34
NASDAQ Composite (PR)	18,112	-8.68	-5.63	-8.68	8.43	23.69	19.88	20.40	9.26
Russell 2000 (TR)	13,360	-9.33	-9.06	-9.33	-1.67	10.77	9.16	13.98	7.65
MSCI Indices ($US) Total Return									
World	13,473	-5.27	-3.33	-5.27	17.03	17.16	13.84	12.15	8.51
EAFE (Europe, Australasia, Far East)	9,958	-4.82	-4.58	-4.82	7.52	9.85	8.36	7.44	6.84
EM (Emerging Markets)	2,928	-1.89	-4.06	-1.89	-6.94	7.56	8.68	4.53	9.66
MSCI Indices ($CA) Total Return									
World	17,137	-4.96	-0.71	-4.96	16.48	15.88	13.29	14.82	7.30
EAFE (Europe, Australasia, Far East)	12,666	-4.51	-2.00	-4.51	7.01	8.65	7.84	10.00	5.65
EM (Emerging Markets)	3,724	-1.56	-1.47	-1.56	-7.38	6.39	8.16	7.02	8.44

Currency	Index	1 Month	3 Months	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
Canadian Dollar ($US/$CA)	78.62	-0.33	-2.64	-0.33	0.47	1.10	0.48	-2.33	1.13
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	7,464	1.08	3.13	1.08	16.49	2.32	1.01	2.77	1.86
Hang Seng (Hong Kong)	23,802	1.73	-6.21	1.73	-15.84	-5.21	0.38	1.56	4.07
Nikkei 225 (Japan)	27,002	-6.22	-6.54	-6.22	-2.39	9.13	7.24	11.86	5.09

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	0.34	1.63	1.77	2.05
U.S. Treasury Yields	0.19	1.61	1.78	2.11

Canadian Bond Indices ($CA) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada Universe Bond Index	1,150	-3.40	-0.94	-3.40	-4.80	2.57	2.62	2.86
FTSE TMX Canadian Short Term Bond Index (1-5 Years)	757	-0.95	-0.36	-0.95	-1.99	1.90	1.63	1.85
FTSE TMX Canadian Mid Term Bond Index (5-10)	1,258	-2.65	-0.62	-2.65	-4.82	2.82	2.52	3.12
FTSE TMX Long Term Bond Index (10+ Years)	1,917	-6.86	-1.95	-6.86	-8.28	3.15	3.96	3.98

HFRI Indices ($US) Total Return (as of October 31, 2021)	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
HFRI Fund Weighted Composite Index	17,909	-1.73	-2.59	-1.73	6.95	8.91	6.45	5.31
HFRI Fund of Funds Composite Index	7,407	-1.27	-2.54	-1.27	5.38	7.05	5.20	4.22
HFRI Event-Driven (Total) Index	20,371	-2.30	-2.56	-2.30	7.50	7.74	6.00	5.75
HFRI Equity Hedge Index	28,544	-3.43	-4.44	-3.43	6.40	11.20	8.35	6.69
HFRI Equity Market Neutral Index	5,973	-0.86	-0.38	-0.86	6.83	2.27	2.35	2.97
HFRI Macro (Total) Index	17,500	0.85	-0.66	0.85	8.52	6.67	3.72	2.15
HFRI Relative Value (Total) Index	14,123	0.13	-0.14	0.13	6.34	5.33	4.34	4.97
HFRI Indices ($CA) Total Return (as of October 31, 2021)								
HFRI Fund Weighted Composite Index	22,741	-1.35	-0.22	-1.35	6.07	7.66	5.89	7.81
HFRI Fund of Funds Composite Index	9,406	-0.89	-0.17	-0.89	4.51	5.82	4.64	6.70
HFRI Event-Driven (Total) Index	25,867	-1.92	-0.18	-1.92	6.61	6.50	5.44	8.26
HFRI Equity Hedge Index	36,246	-3.05	-2.11	-3.05	5.53	9.92	7.77	9.22
HFRI Equity Market Neutral Index	7,584	-0.48	2.04	-0.48	5.96	1.10	1.81	5.42
HFRI Macro (Total) Index	22,221	1.24	1.76	1.24	7.63	5.45	3.17	4.57
HFRI Relative Value (Total) Index	17,933	0.52	2.29	0.52	5.47	4.12	3.79	7.46

Sources: TD Securities Inc., Bloomberg Finance L.P. TR: total return, PR: price return. As of January 31, 2022.

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