2022 Portfolio Manager Outlook.

VCIM Pooled Funds

VCIM Short Duration Bond Fund

VCIM Bond Fund

VCIM Canadian Equity Fund

VCIM Income Fund

VCIM Global Equity Fund

Vancity Investment Management

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Year Ahead 2022

2021 was a year of extraordinary growth and unforeseen headwinds. The roll-out of the vaccine during the first half of the year precipitated the release of pent-up economic demand that fueled economic recovery and led US stock markets to all-time highs. Simultaneously, the emergence of the Delta variant slowed global reopening and exacerbated the extreme backlog in the supply chain, leading to higher rates of inflation with headline and core inflation hitting multi-decade highs in the US. Global consumers, who were locked down at home for extended periods, collectively looked to splurge on capital goods (cars, home repairs etc.) and services (restaurants, travel etc.). Consequently, the global supply chain, which was already facing myriad issues, was unable to keep up. The average transit time for a good to traverse Shanghai to Los Angeles more than doubled from what was typical pre-COVID.

Companies that have strong audit programs for ESG factors throughout their supply chains tend to be more resilient to supply chain disruptions. This monitoring helps them understand where key components of their supply chain are sourced and can help them be proactive in managing shortages and delays. This will be especially important in the coming year as supply chain pressures, while likely to ease somewhat, do appear poised to persist with extreme weather events, pandemic related disruptions and human rights related import bans continuing to complicate the movement of goods worldwide.

Heading into 2022, the stage is set for a difficult operating environment. Management teams will have to scramble to source inventory and see goods delivered within reasonable timeframes. A tight labor market will also act as a headwind as companies struggle to fill open roles. At the same time companies will need to maintain a cap on costs as commodity prices, wages and global shipping rates have increased substantially.

We remain confident consumer demand will remain robust as economies continue to open and consumption normalizes. Although nobody has a crystal ball, over time we also expect the supply chain issues to alleviate as elevated demand eases somewhat throughout the year. A key question will be whether the exacerbated inflation picture is transitory as proclaimed by central banks, or newly entrenched leading to a more permanent situation.

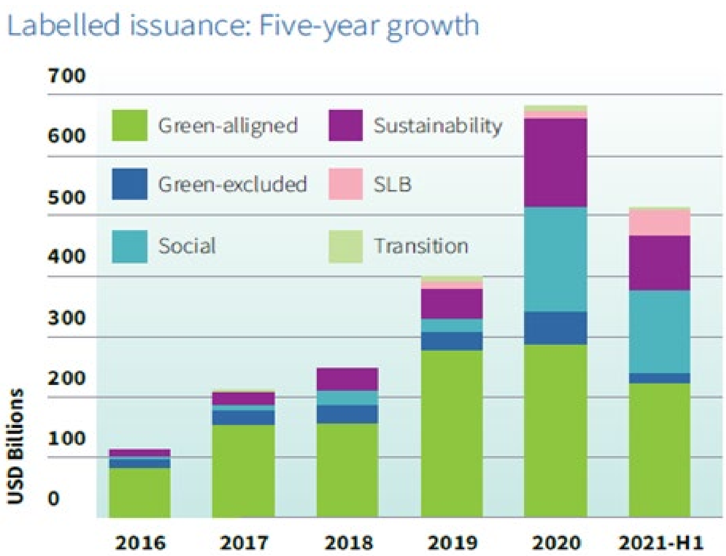
Where are the opportunities?

As in most years, within the equity markets there are areas of over-valuation and under-valuation; however, we continue to identify opportunities that fit our process of investing in high-quality, ESG-leading companies with ample runway to reinvest at high incremental returns. Within our five-year view we are currently sourcing potential investments within sectors such as Information Technology, Consumer Discretionary, and Industrials, where temporary issues have pushed valuations down to more reasonable levels when considering potential growth rates.

Fixed Income markets experienced significant volatility in 2021 as interest rates moved higher, reflecting a strong rebound in the economy, elevated inflation, and the reduction of asset purchases by the Bank of Canada. While these conditions create uncertainty heading into 2022, they also present opportunities. The normalization of interest rates across the yield curve increases the potential for higher returns over the long run, while also improving the risk-return relationship between Government and Corporate bonds. Active management will continue to be utilized to take advantage of elevated interest rate volatility by continually assessing and re-optimizing positioning along the dynamic yield curve.

Corporate bonds continue to offer the potential for higher total returns compared to Government bonds, however, the opportunity for outperformance has declined with relative yields and spreads trading near cyclical tights.

The growth of ESG bond issuance has continued to rise rapidly as new Government and Corporate issuers enter the market. The evolution of this market provides additional opportunities to ensure our Fixed Income investments are invested responsibly and have a positive impact within Canada and across the world.



Source: Climate Bonds Initiative © September 2021

What are the challenges?

There are numerous question marks heading into 2022, including the aforementioned inflation and supply chain issues. Most of these questions, however, are unanswerable until after the fact and consequently, our optimal approach is adherence to our bottom-up investment process. The future always contains elements of uncertainty and unpredictable events happen, the last couple of years are a stark reminder of this. Ultimately, we look to own businesses that we believe can survive and even thrive under conditions of intense uncertainty.

The path of inflation in 2022 will be a key variable in determining both the direction of interest rates and shape of the yield curve. Imbalances generated throughout the economic recovery have created uncertainty, with Central Banks forecasting that inflation will be transitory, while market-based inflation expectations suggest inflation may remain more persistent. The divergence of opinions means interest rate volatility is likely to continue, with the ultimate outcome having potentially far-reaching implications for Central Bank policy and long-term growth.

Similar to the Taskforce for Climate Related Financial Disclosures (TCFD), the Taskforce for Nature Related Financial Disclosures (TNFD) is expected to launch by 2023. The services provided by well-functioning ecosystems are estimated to be double the world's GDP and it is estimated that losses from the 'business as usual' scenario could cost the global economy $10 trillion dollars by 2050. Measuring biodiversity impacts can be even more complicated than measuring carbon emissions and climate impacts. Companies need to be preparing for biodiversity related disclosures and focused on identifying biodiversity impacts that are material to their operations. We expect to see increasing focus on biodiversity impacts both by regulators and investors in 2022 as TNFD prepares to launch.

How are you positioning the Funds?

No matter the environment or macro-outlook, we are constantly assessing our investments. We start each day as if operating with a clean slate, evaluating our portfolios without bias. Our goal is to ensure that we are invested in our highest conviction names so that we are optimally positioned to outperform over full market cycles. We invest in companies with a sustainable lens, which includes assessing the sustainability of business models and competitive advantages, so that we are well positioned regardless of economic conditions.

Bond yields in Canada remain attractive relative to other global bond markets and continue to be the primary focus of our fixed income investments. With increasing uncertainties regarding the path of inflation, we continue to position defensively along the yield curve, with an underweight in the long end. We remain cautiously optimistic that credit will continue to outperform Government bonds, positioning with an overweight to high-quality short-term Corporate bonds and maintaining a small exposure to defensive Preferred Shares. Positive Impact Bonds have always been a core position within the Fund and we plan to increase our holdings as the market continues to evolve with new Green and Sustainable bond issuers on the horizon.

The highly anticipated COP26 UN Climate Change Conference held in November 2021 led to climate commitments including high priority areas such as methane emissions and deforestation. Governments have increased net-zero ambitions, resulting in 80% of global emissions now being covered by net-zero targets and investors responsible for almost 60% of the world's managed assets also committing to net-zero targets. We believe that companies with well-developed climate risk management strategies are best positioned to navigate the evolving regulatory environment and investment landscape.

Why is this the right approach for 2022?

As quality growth investors, we seek out companies that operate in industries with high barriers to entry and provide products or services that are critical to their customers. The result is above average margins, high returns on capital and strong balance sheets. These characteristics act as a shield, protecting companies from unforeseen events such as the current inflationary environment, as they are likely able to pass on input cost increases. It enables them to weather market downturns, as their balance sheets and recurring revenue profiles will allow them to not only survive but improve their competitive standing against lower quality peers.

With increasing uncertainty and volatility in fixed income markets, we believe it is prudent to be defensively positioned along the yield curve and within credit. With our active management approach, our current curve positioning and bias towards high-quality short-term Corporate bonds will allow us to opportunistically take advantage of any material relative value changes should some of the aforementioned risks be realized in 2022.

ESG integration has always been fundamental to our low-carbon investment process. Our long-standing climate strategy and stakeholder-focused approach helps mitigate unpredictable events, such as increasingly frequent extreme weather events, and benefits from growing investor focus on ESG issues resulting from the ongoing global pandemic. We believe that this strategy will continue to mitigate risks and capture market opportunities.

Disclaimer

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Vancity Investment Management is located on the unceded territories of the Coast Salish territory, represented today by the Musqueam, Squamish and Tsleil-Waututh Nations. They have been custodians of this land for thousands of years and we would like to pay our respect to the elders both past and present.

Invest in opportunities that contribute to a better world.