THE **COERENTE** VIEW

2ND QUARTER 2022

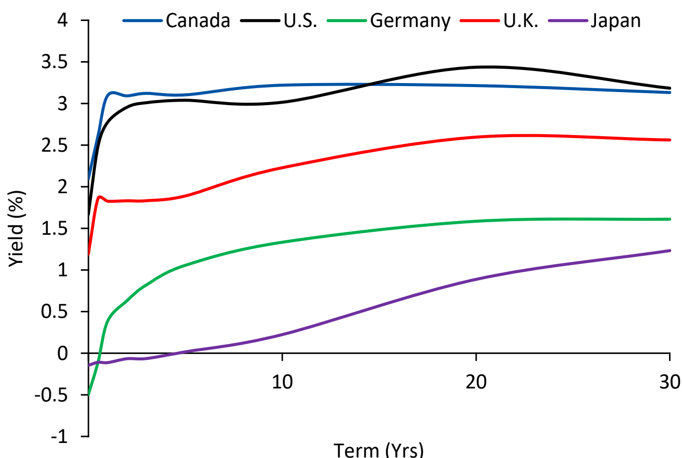
Market Statistics

	Jun/22	Mar/22	Dec/21	Jun/21
Yields (%)				
90 Day T-Bill	2.09	0.60	0.16	0.15
10 Yr. Canada Bond	3.30	2.49	1.52	1.48
30 Yr. Canada Bond	3.28	2.45	1.70	1.84
Rates				
C.P.I. (annual %)	7.73	6.66	4.80	3.06
US$/C$	0.78	0.80	0.79	0.81
Euro/C$	0.74	0.72	0.69	0.68
Prices (US$)				
Crude Oil (bbl.)	106	100	75	73
Natural Gas (mm)	5.42	5.64	3.73	3.65
Gold (oz.)	1,804	1,949	1,828	1,771

Market Returns

	Periods Ending Jun. 30/22			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	-13.2	-3.9	7.6	8.2
S&P 500 (C$)	-13.5	-7.1	11.2	15.6
S&P 500 (US$)	-16.1	-10.6	11.3	13.0
MSCI EAFE Net (C$)	-11.8	-14.5	2.1	7.9
MSCI EAFE Net (US$)	-14.5	-17.8	2.2	5.4
MSCI World Net (C$)	-13.6	-10.9	7.5	12.1
MSCI World Net (US$)	-16.2	-14.3	7.7	9.5
Bond Universe	-5.7	-11.4	0.2	1.7
91 Day T-Bills	0.2	0.4	0.9	0.8

Yield Curves



The Economy

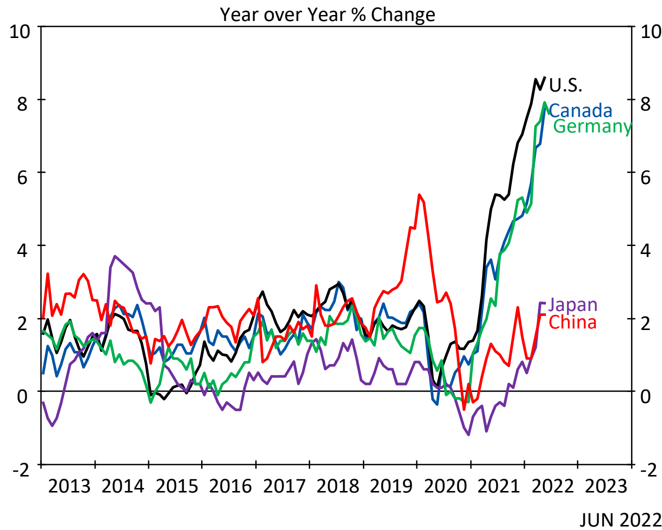
There is a generation of consumers within the larger developed economies that have never experienced any significant level of inflation. The financial pain of rising costs of living exceeding wage gains is easily understood in the current environment. A sustained multi-year high level of inflation, which will result in a longer-term erosion of standards of living, is what central bankers globally are now trying to avoid by raising interest rates. Historically, inflation becomes a problem after a long period of economic growth and capacity limits result in demand exceeding supply for goods and services. The current surge in inflation is the result of pent-up demand from Covid fatigued consumers who have unleashed spending on an economy where many industries are unprepared and capacity constrained. The war in Ukraine compounded commodity supply issues as Russia is a major global energy producer and Ukraine a major grain producer.

The inflation rate in the U.S. has reached 9.1% and in Canada 7.7%. Central banks in both countries have, as a result, moved quickly and aggressively to raise interest rates hoping to slow economic growth, but interest rates are a blunt instrument. Raising them will slow consumer spending but may also constrain the investment needed by businesses to increase capacity resulting in a recession. Thus, the economic recovery from Covid remains uneven and messy. Europe has been more pragmatic given negative interest rates were prevalent over the last few years. They have allowed longer-term interest rates to float upward back into positive territory and are expected to announce their first short-term interest rate hike this month. The Bank of Japan, with its relatively closed economy, has stated that they will not significantly raise interest rates for the time being. Outside of North America there is a definite preference by central banks to be more moderate given slower economic growth rates. The war in the Ukraine also has a more direct impact and there is a firmer belief that some of the current inflation is temporary.

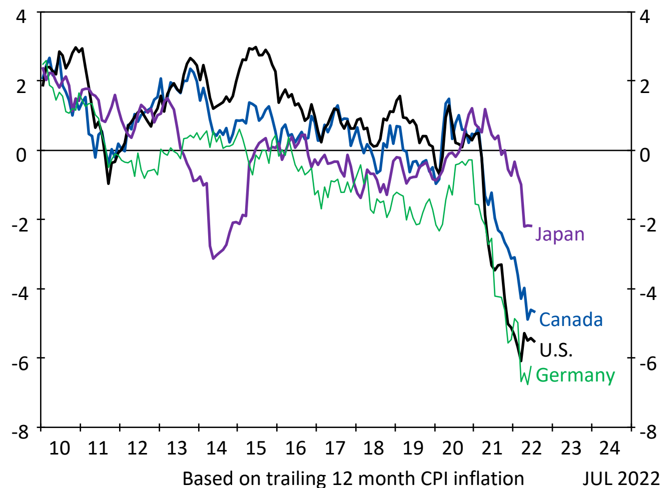
There are a number of reasons to suggest that much of the current inflation is indeed transitory. Numerous industries are facing product shortages due to transportation logistics issues and trade constraints/tariffs that stem from the pandemic. These problems are expected to ease as workers gradually return and the U.S. unwinds some of the trade restrictions imposed on China. A lack of immigration during Covid has created a general labour shortage, particularly for hospitality and service industries, which will be solved as borders re-open and visa backlogs clear. Commodity shortages and the resulting price effects of the Ukraine war on energy and grain will also dissipate as other countries increase supply. Nevertheless, in North America the belief appears to be that this will take time and current interest rate policy is focused on ensuring that inflation does not imbed itself into the economy. Clearing of the aforementioned logistic and supply problems may still not be enough to avoid a recession although it may help keep it short and shallow.

Sources: TD Securities Inc., BlackRock, Bloomberg

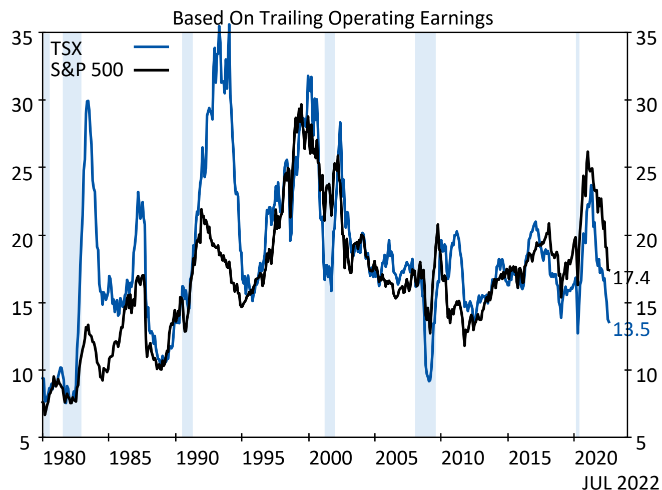
Inflation



Real Long-Term Government Bond Yields



P/E Multiples



The Markets

Returns were decisively negative in the second quarter for both the stock and bond markets. Rising interest rates have lowered share price/earnings multiples and reduced expectations for earnings growth. The World equity Index fell 13.6% in the second quarter bringing the year-to-date return to -19.2%. The S&P/TSX fell 13.2% in the quarter and returned -9.9% year-to-date as energy helped support the Canadian index. Bonds have not provided any refuge as the Universe index fell 5.7% in the second quarter and returned -12.2% year-to-date. The hardest hit in this correction have been the shares of more speculative companies with the highest valuations. In fixed income, bonds with the longest maturity have declined the most. Year-to-date, the Long-Term Index has returned -22.1% versus the Short-Term index at -4.4%.

So far in 2022, negative returns have been experienced by virtually all capital market investors. However, the magnitude of declines has been significantly reduced for our accounts as a result of our ownership of shares in large recession resilient companies and only short-term fixed income securities. The protection of purchasing power is paramount for clients and our emphasis continues to be on companies that can more readily pass along cost increases and maintain earnings growth. Fixed income does not protect against inflation when interest rates are lower than inflation rates as they are today (see opposite chart). As well, the yield curves on page one indicate that there is no higher interest rate earned, as there normally would be, for buying longer-term maturities, i.e., the yield curve is relatively flat. Therefore, any fixed income held should be short in maturity and the amount held limited and dependent on a clients' risk tolerance and cash needs near term. Overall, owning quality investments helps weather any difficult economic environment.

Interest rates may eventually reach a level that provide a more reasonable real (after inflation) rate of return but it remains unclear as to what the sustainable level of inflation will be in North America. It certainly looks like it will be higher than the 2% level experienced over the last decade but most likely not at the current high single-digit level. In our view, a good leading indicator will be wage contract settlements. So far there have been a few multi-year agreements with 3-4% per annum increases. We have seen some corporate bonds with maturities in the 4–5 year range where yields have reached the 5% level. While we find this more attractive, any purchases will be moderate as the immediate outlook for inflation remains high and monetary authorities have expressed the potential for continued tightening that will result in higher short and long-term interest rates.

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Sources: TD Securities Inc., BlackRock, Bloomberg