THE COERENTE VIEW

3RD QUARTER 2022

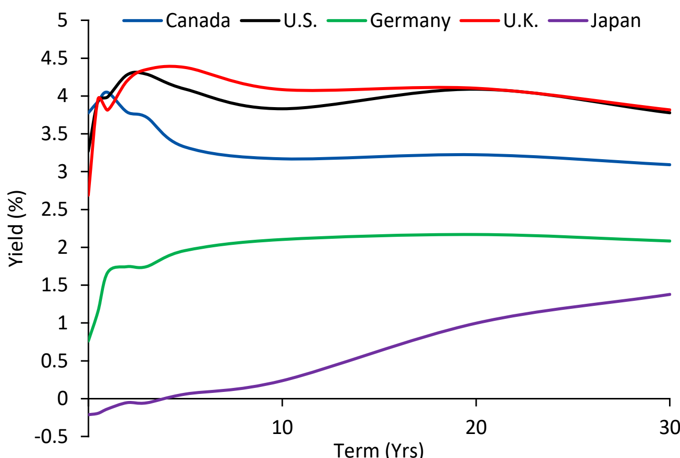
Market Statistics

	Sep/22	Jun/22	Mar/22	Sep/21
Yields (%)				
90 Day T-Bill	3.58	2.08	0.60	0.12
10 Yr. Canada Bond	3.16	3.30	2.49	1.56
30 Yr. Canada Bond	3.10	3.28	2.45	2.00
Rates				
C.P.I. (annual %)	7.01	8.13	6.66	4.38
US$/C$	0.73	0.78	0.80	0.79
Euro/C$	0.74	0.74	0.72	0.68
Prices (US$)				
Crude Oil (bbl.)	79	106	100	75
Natural Gas (mm)	6.77	5.42	5.64	5.87
Gold (oz.)	1,662	1,804	1,949	1,755

Market Returns

	Periods Ending Sep. 30/22			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	-1.4	-5.4	6.5	7.3
S&P 500 (C$)	1.2	-9.1	11.3	15.5
S&P 500 (US$)	-4.9	-15.5	9.2	11.7
MSCI EAFE Net (C$)	-3.6	-19.5	1.0	7.2
MSCI EAFE Net (US$)	-9.4	-25.1	-0.8	3.7
MSCI World Net (C$)	-0.2	-13.5	7.3	11.8
MSCI World Net (US$)	-6.2	-19.6	5.3	8.1
Bond Universe	0.5	-10.5	0.7	1.7
91 Day T-Bills	0.5	0.9	1.0	0.9

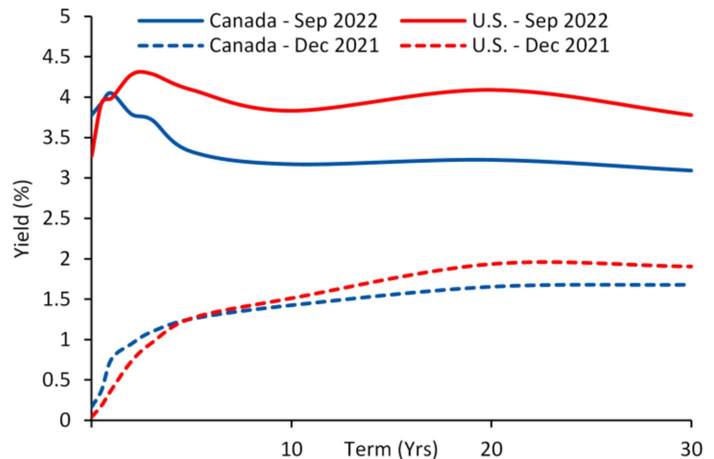
Yield Curves



The Economy

The unexpected strength and speed of the post-Covid economic recovery has continued with demand exceeding supply for most goods and services. Companies have been caught short and so far, have not been able to hire enough people nor build inventories due to either input shortages or logistics problems. As a result, prices have been increasing for raw materials, finished goods and services in most industries. The problem has been exacerbated by the war in Ukraine which has further constrained the supply of energy (from Russia) and grains (from the Ukraine). The current sources of global inflation are not like the past where multiple years of strong economic growth built up and spurred higher prices. The current circumstances are historically unique.

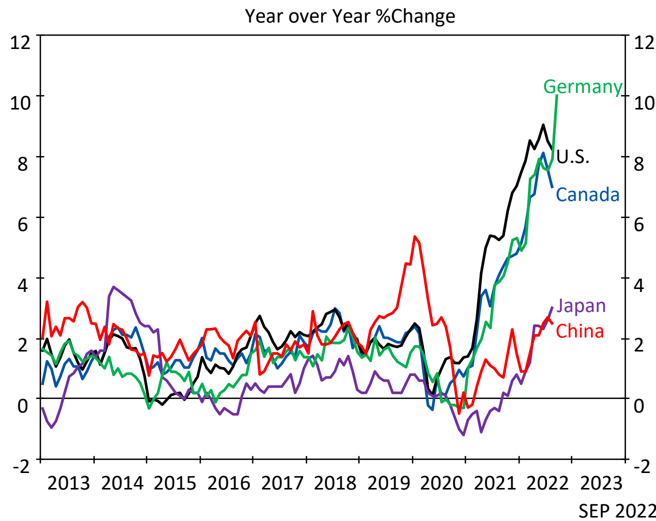
As with past inflationary periods, the economic policy response has been for the world's major central banks to aggressively increase interest rates. Unfortunately, the rate rise also brings slower economic growth. Inflation has been quick to appear in North America and the interest rate increases by the U.S. and Canadian central banks have been equally quick, numerous (five so far) and sizable in 2022. The chart below illustrates the upward shift in the yield curves since the beginning of the year.



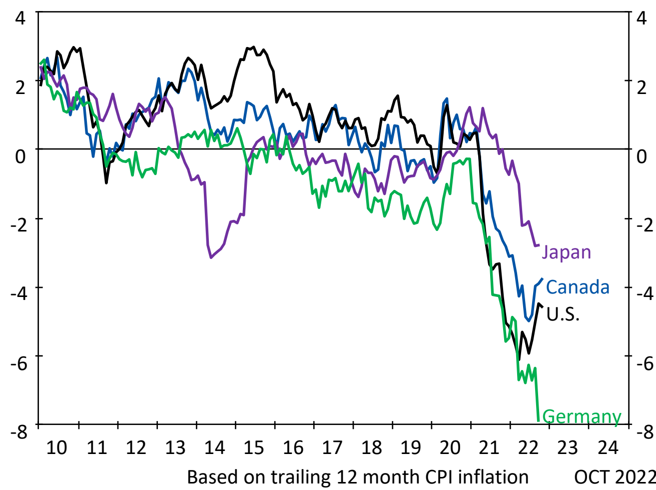
The higher short-term interest rates reflected on the yield curves are the result of rate increases by central banks. However, the fact that longer term yields are slightly lower suggest investors believe there will be an imminent economic slowdown if not recession. We have proposed that any potential recession could be short and shallow as consumer and corporate balance sheets remain strong and inflation will be reduced when logistics issues are resolved in the coming quarters. Furthermore, renewed momentum in immigration will alleviate the labour shortfall. The grain shortages will also be eased with the planting of additional acreage beyond the Ukraine but energy admittedly is a wild card with OPEC not yet increasing supply. So far, higher interest rates appear to have capped inflation but evidence as to what level it settles at is inconclusive and therefore central bankers have stated that rates are expected to continue to move upward.

How governments manage the added debt taken on to assist

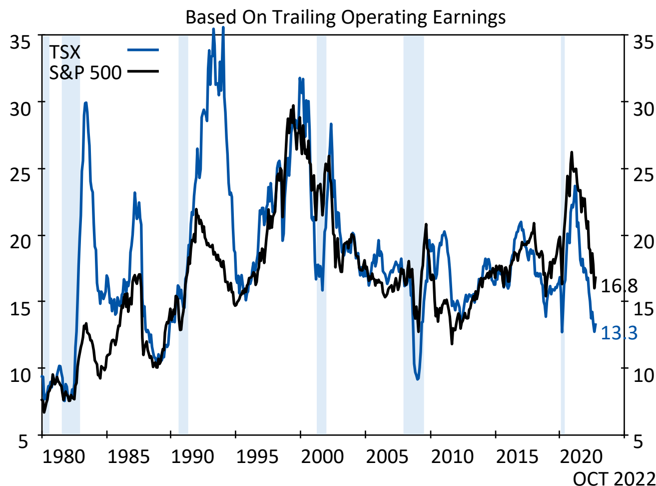
Inflation



Real Long-Term Government Bond Yields



P/E Multiples



consumers and businesses during Covid as well as the subsequent increases in interest rates and rising inflation will likely weigh on the value of their currency. Investors will favour the currencies of those countries that they perceive will best manage their way in a post Covid environment. The U.S. dollar is clearly the current safe haven.

The Markets

Equity markets provided more volatile performance during the third quarter. What initially appeared to be developing into a positive quarter of returns rapidly reversed in September as the U.S. Federal Reserve strongly reiterated its policy of continuing to increase interest rates. Overall, returns for the quarter were slightly negative as the S&P/TSX fell 1.4% and the World Index declined 0.2%. For Canadian investors, foreign equity market returns were supported by the 6.0% decline of the Canadian dollar relative to its U.S. counterpart. In local currency terms the Global stock market index fell 6.2%, while the U.S. based S&P 500 returned -4.9% and the overseas EAFE index -9.4%.

The U.S. dollar has become the currency of choice as other major economies battle added regional issues in 2022. Europe remains vulnerable to the effects of the Russian – Ukraine war with Russia cutting natural gas exports therefore ensuring European energy shortages this winter. Japan remains plagued with little if any growth in its insular/closed economy while China's preference for zero Covid infections regularly results in the shutdown of swaths of its country. Finally, the U.K. finds itself with new leadership that wishes to implement expansionary fiscal policy that could negate the inflation controlling effects of rising interest rates. The smaller float and commodity sensitive Canadian dollar has also weakened but could gain some strength in the winter months if the price of oil were to find some seasonal strength.

Despite rising interest rates, long bond returns were positive during the quarter as the prospects of a recession held back long-term bond yields. Long-term bond yields however remain negative on a real basis as inflation rates are still higher. Expectations as to what level inflation finally settles at will decide the level of acceptable bond yield for investors. There is some evidence that the recently reported 7-8% inflation level is near the peak. Recent major wage settlements contain 3-4% annual inflation protection which suggest a measuring indicator for the sustainable level of inflation. Bond yields would therefore need to be above this level to become attractive for longer-term investors. Nevertheless, uncertainty still prevails with regard to the longer-term rate of inflation and as a result, equities of companies that can pass along any potential cost increases remain preferred. The table opposite also highlights that equity valuations are significantly lower as prices have come down while earnings have continued to increase.

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Sources: TD Securities Inc., BlackRock, Bloomberg