THE **COERENTE** VIEW

4TH QUARTER 2022

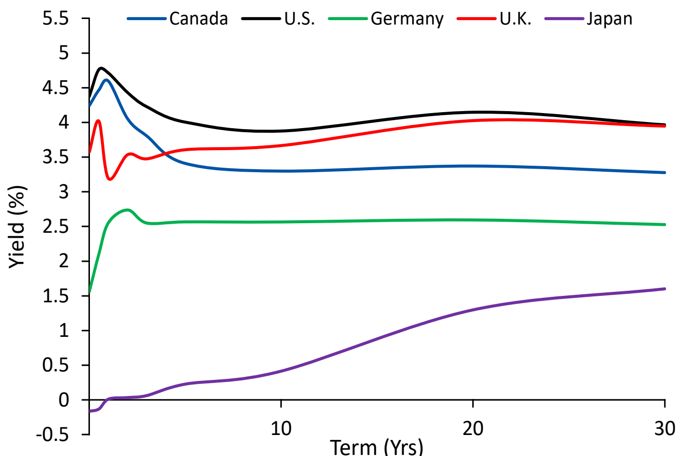
Market Statistics

	Dec/22	Sep/22	Jun/22	Dec/21
Yields (%)				
90 Day T-Bill	4.25	3.58	2.08	0.16
10 Yr. Canada Bond	3.28	3.16	3.30	1.52
30 Yr. Canada Bond	3.23	3.10	3.28	1.70
Rates				
C.P.I. (annual %)	6.80	6.86	8.13	4.80
US$/C$	0.74	0.73	0.78	0.79
Euro/C$	0.69	0.74	0.74	0.69
Prices (US$)				
Crude Oil (bbl.)	80	79	106	75
Natural Gas (mm)	4.48	6.77	5.42	3.73
Gold (oz.)	1,820	1,662	1,804	1,828

Market Returns

	Periods Ending Dec. 31/22			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	6.0	-5.8	6.9	7.7
S&P 500 (C$)	6.3	-12.5	11.1	16.1
S&P 500 (US$)	7.6	-18.1	9.4	12.6
MSCI EAFE Net (C$)	16.0	-8.6	3.1	8.0
MSCI EAFE Net (US$)	17.3	-14.5	1.5	4.7
MSCI World Net (C$)	8.5	-12.5	7.8	12.3
MSCI World Net (US$)	9.8	-18.1	6.1	8.9
Bond Universe	0.1	-11.7	0.3	1.6
91 Day T-Bills	1.0	1.8	1.2	1.0

Yield Curves



The Economy

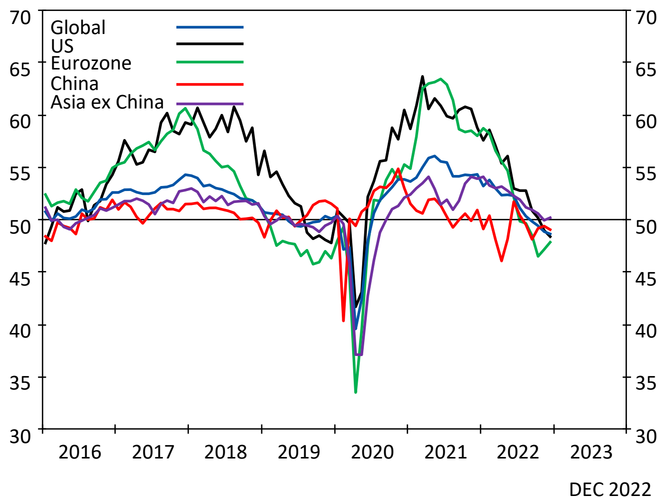
The Bank of Canada and US Federal Reserve remained aggressive and raised interest rates twice in the fourth quarter as quelling inflation continues to take precedence over economic growth. There was a total of seven increases in 2022, as bank rates have moved from a pandemic low of 0.25% in the first quarter to 4.25% at year end. More importantly, the prime rate (used for lending by banks to their most credit worthy customers) has reached the 6.45% level in Canada and 7.5% in the U.S. A much higher hurdle rate when justifying any investment.

As the year has come to a close, central banks have been very clear that further increases in interest rates are likely as inflation remains high and growth has yet to meaningfully contract. Coming out of the pandemic-induced recession, consumers have unleashed pent-up spending. Demand has been very strong for most goods and services and has exceeded supply in many sectors.

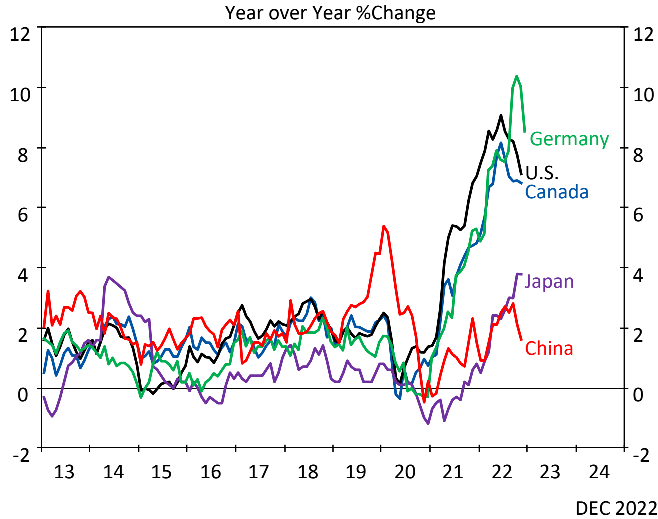
Nevertheless, the increase in interest rates is having an effect as leading indicators, such as the Purchasing Managers Index (see first chart on page 2), are suggesting that economic growth will slow and that a recession may be on the horizon for 2023. Inflation also appears to have peaked (see second chart on page 2) but remains high. Transitory inflation was the original term used for the price increases that resulted from the inability by corporations and government agencies to meet the unexpected strong post-Covid demand. While supply chain issues are slowly being resolved in North America, a shortage of labour is driving salaries higher and multi-year wage settlements to the 3.5-4.0% per annum range. Therefore, we should expect inflation to remain well above the 2% central bank target for at least a few years if not longer. The corollary is that interest rates will most likely remain higher for longer and any eventual decline will result in a level that is not below any embedded rate of inflation.

Monetary policy and the increase of interest rates is widely accepted to be an effective but blunt instrument in the control of inflation as it also reduces economic growth and can cause personal hardship. There appears little room for relief in the concurrent use of new fiscal policy initiatives. Most countries justifiably spent heavily during covid times and government debt levels have risen significantly. In Britain, a move to aggressively offset slower economic growth with tax cuts was met with spiraling higher long-term bond yields as investors were unwilling to accept any further significant growth in government debt or deficits. A warning for all governments contemplating expansionary fiscal policies.

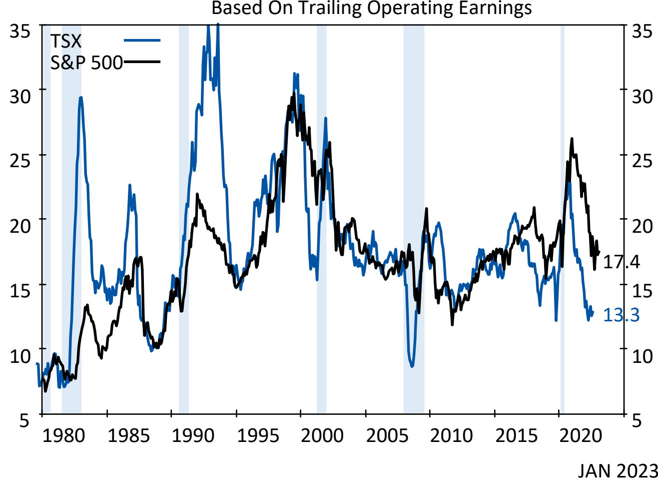
Purchasing Managers Index



Inflation



P/E Multiples



The Markets

The fourth quarter was very strong for equity markets as they rebounded from the September lows. There was a set-back in December reflecting the realization that both inflation and economic growth were cooling at only a gradual pace and therefore we could expect further increases in interest rates. A 9.8% gain in the MSCI World equity index for the fourth quarter resulted in an 18.1% loss for year. A weak Canadian dollar reduced the annual loss to 12.5% for Canadian investors.

As is typical during times of rising interest rates, the most overvalued stocks corrected the most. In the World index this resulted in the technology sector declining 31% in 2022 and the consumer discretionary sector (where Tesla is counted) falling 33%. Interest sensitive sectors were also severely hit as real estate fell 24%. The conventionally stable consumer staple and healthcare sectors held up well, each declining only 5%. The war in Ukraine boosted oil and gas prices as Russia reduced supply and the energy sector was the best and only positive performer for the year with gains of 49%. The Canadian stock market is more heavily weighted in energy companies and therefore one of the leading global index performers. For the fourth quarter, the S&P/TSX gained 6.0% resulting in an overall loss of 5.8% for the year 2022.

Bonds were not a safe haven with the Universe index losing 11.7% in 2022. Some small gains were experienced in the fourth quarter as the index returned 0.1%. While short term interest rates have increased significantly, long term yields have not moved to the same extent. With inflation well ahead of the 2% central bank target, and being buoyed longer term by the sizable percentage increase in wages and salaries, the prognosis for long bond returns remains mixed and uncertain as current yields may not exceed the sustained rate of inflation.

As we have stated in the past, the best way to maintain purchasing power in a rising interest rate environment is by owning recession resilient companies with strong balance sheets that can pass along cost increases. Our portfolios are laden with shares of such companies.

Most companies are still hiring in this post-Covid environment. There are some exceptions in industries that particularly benefited from the surge in online services and sales and are now seeing reduced activity levels. Overall, the continued lack of supply for products and services along with low unemployment levels should result in any potential recession being shallow and short. As a result, corporate earnings are expected to remain relatively flat or decline marginally. Combined with the stock market correction in 2022, equity valuations today are more attractive and at relatively low levels compared to recent years.

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Sources: TD Securities Inc., Bloomberg