THE COERENTE VIEW

1ST QUARTER 2023

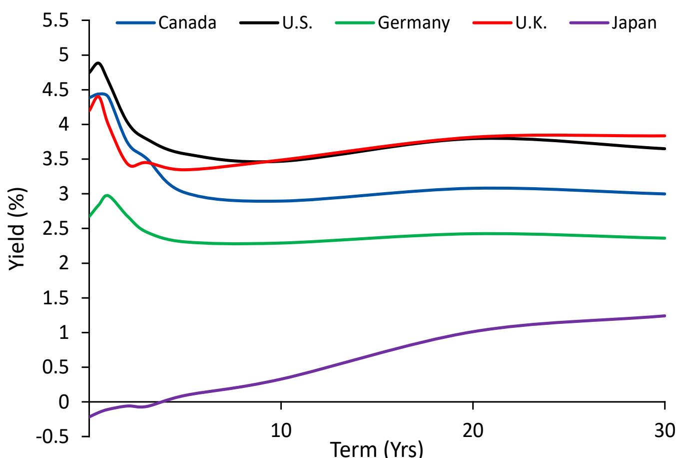
Market Statistics

	Mar/23	Dec/22	Sep/22	Mar/22
Yields (%)				
90 Day T-Bill	4.33	4.23	3.58	0.60
10 Yr. Canada Bond	2.90	3.28	3.16	2.49
30 Yr. Canada Bond	3.04	3.23	3.10	2.45
Rates				
C.P.I. (annual %)	5.25	6.32	6.86	6.66
US$/C$	0.74	0.74	0.73	0.80
Euro/C$	0.68	0.69	0.74	0.72
Prices (US$)				
Crude Oil (bbl.)	76	80	79	100
Natural Gas (mm)	2.22	4.48	6.77	5.64
Gold (oz.)	1,969	1,820	1,662	1,949

Market Returns

	Periods Ending Mar. 31/23			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	4.6	-5.2	8.8	7.9
S&P 500 (C$)	7.4	-0.1	12.3	15.5
S&P 500 (US$)	7.5	-7.7	11.2	12.2
MSCI EAFE Net (C$)	8.4	6.8	4.5	8.1
MSCI EAFE Net (US$)	8.5	-1.4	3.5	5.0
MSCI World Net (C$)	7.6	0.7	9.1	12.0
MSCI World Net (US$)	7.7	-7.0	8.0	8.9
Bond Universe	3.2	-2.0	0.9	1.9
91 Day T-Bills	1.1	2.8	1.3	1.0

Yield Curves



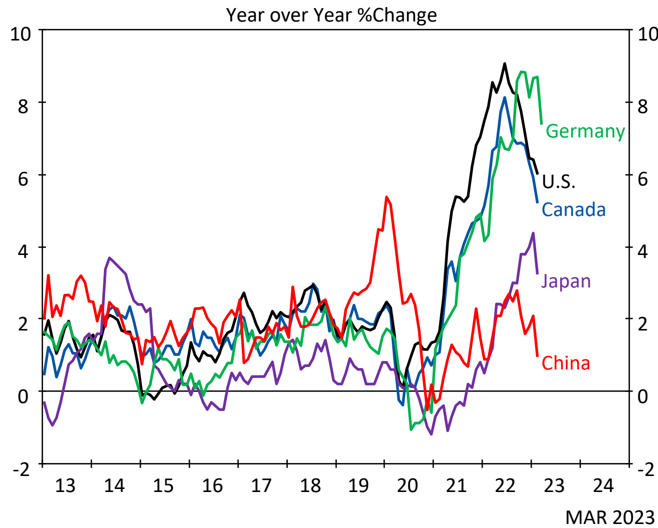
The Economy

It was more of the same in the first quarter of 2023. The U.S. Federal Reserve raised interest rates twice to the 4.75-5.0% level while the Bank of Canada moved up to 4.5% but left rates unchanged at their most recent March meeting. The pause in Canada was surprising given that Canadian economic growth has not yet turned negative despite some weakness in December. Meanwhile, the rate of inflation has only slightly declined and remains well above the 2% stated target. Employment and spending for goods and services are still relatively strong. Wage increases in particular are well above the 2% level and recent multiyear settlements in the 3-4% range suggest this as the potential baseline inflation rate. Unemployment levels are low and therefore pay increases are higher as companies fear losing people. (See economic charts on page 2 of this report.)

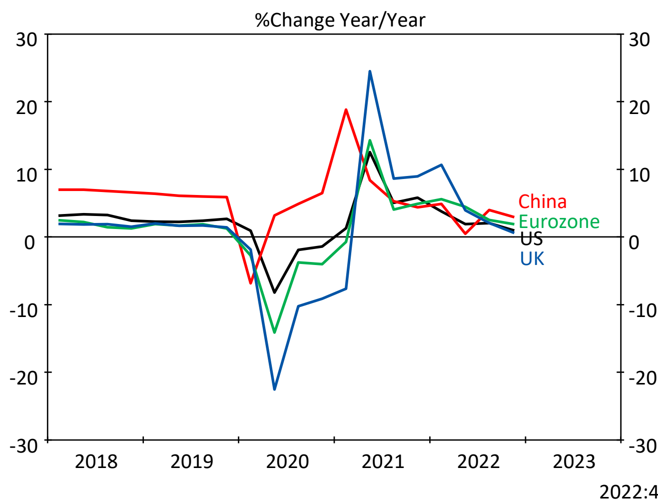
The rapid rise in interest rates has caused a strain at some banks. As the quarter came to a close there were two bank failures in the U.S. and the Swiss government forced the ubiquitous Credit Suisse into a takeover by UBS. In all three cases, bad management decisions were readily apparent and the main reason for their demise. Credit Suisse never recovered from the great recession of 2007-08 and it had been in trouble for a number of years. The two U.S. bank failures were the result of short-term deposits being used to buy longer-term bonds that declined in value with the rise in interest rates. Cash deposits can be withdrawn at any time but the bonds purchased with those deposits were set to mature in future years and fluctuate in value on a day-to-day basis. This would not normally be an issue if interest rates and the deposit base are steady. In the post-covid environment, the technology industry waned and the heavily exposed Silicon Valley Bank (SVB) experienced withdrawals, its bond losses increased and consequently the bank fell below its regulated capital requirements. When they attempted a sizable equity issue to raise capital, it became readily apparent that they were in trouble and consequently they experienced a "run" i.e., a massive withdrawal of deposits by clients. The US treasury was forced to act and guarantee all deposits in order to avoid any loss of confidence and potential "runs" at other small regional banks. A similar story occurred at New York-based Signature Bank where digital asset (cryptocurrency) clients were courted aggressively in recent years and amounted to nearly 30% of its deposit base.

It is not unusual to find banks with mismatched balance sheets but it is generally small and monitored by the regulator. The managements of SVB and Signature either did not understand or ignored the make-up of their deposit base, all in a greedy/risky attempt to boost earnings when short-term interest rates were near the zero level. The larger national and super regional banks are better capitalized, have a more diverse deposit base and the securities purchased with their deposits are mostly treasury bonds, not the esoteric mortgage-related securities of

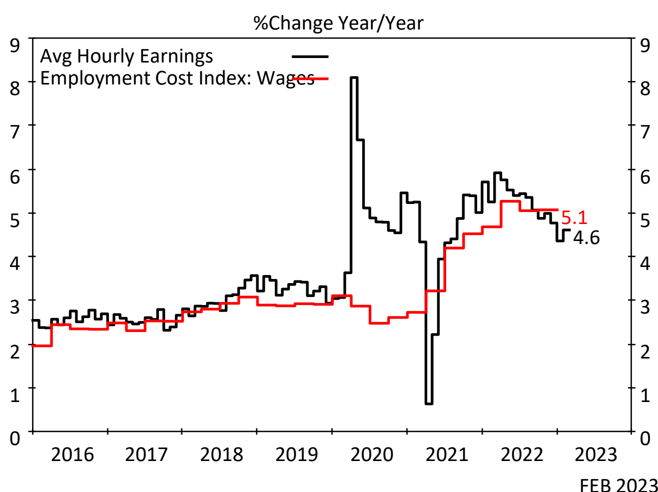
Inflation



Global Real GDP



U.S. Wages



questionable value that sank the banks in the 2007-08 crises. Despite the isolated failures, and there may be a few more, we would suggest the focus on curtailing inflation and slowing economic growth remains central bankers' paramount concern.

The Markets

Expectations that interest rates may have finally peaked drove both the stock and bond markets higher in the first quarter of 2023. The S&P/TSX returned 4.6%, the S&P 500 7.4%, the overseas EAFE index 8.4% and the MSCI World index 7.6%. However, a closer examination indicates a very narrow stock market recovery, led by large technology-related companies whose stocks originally declined significantly in 2022 as a result of overvaluation. Within the most broadly based S&P 500 index**, seven stocks provided 6.1 % of the total 7.4% S&P 500 return, or 82% of the total return as illustrated in the table below.**

Q1 2023 S&P 500 Contributions

	Price Return (%)	Weight (%)	Contrib. to Index (%)
Nvidia	90.1	1.1	1.0
Meta (Facebook)	76.1	0.8	0.6
Tesla	68.4	1.0	0.7
Apple	26.9	6.0	1.6
Amazon	23.0	2.3	0.5
Microsoft	20.2	5.7	1.2
Alphabet (Google)	17.4	3.1	0.5
TOTAL		20.0	6.1

The Bond Universe index returned 3.2% even though short-term interest rates actually increased. As indicated on the page one Yield Curves chart, for all of the major economies except Japan, interest rates available on longer-term bonds are lower than rates for short-term maturities (the curve is inverted). Investors are not compensated, as they normally are, with a higher yield when investing for a longer time period. The market expectation is that short-term yields will decline as a result of the oncoming economic slowdown. To be attractive for investors, the yield provided in any fixed income investment should at least match, if not exceed, the rate of inflation.

With the purchase of corporate bonds, where yields today exceed government bonds by approximately 1%, we can potentially achieve a satisfactory yield in the 1–5-year term. But the more certain approach to staying ahead of an unknown future rate of inflation is to own shares of companies that can readily pass along cost increases. While the expensive technology-related stocks that bounced back strongly in the first quarter have these characteristics, so do more reasonably priced companies in the grocery, food service, consumer product and health industries.

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Sources: TD Securities Inc., Bloomberg