THE COERENTE VIEW

2ND QUARTER 2023

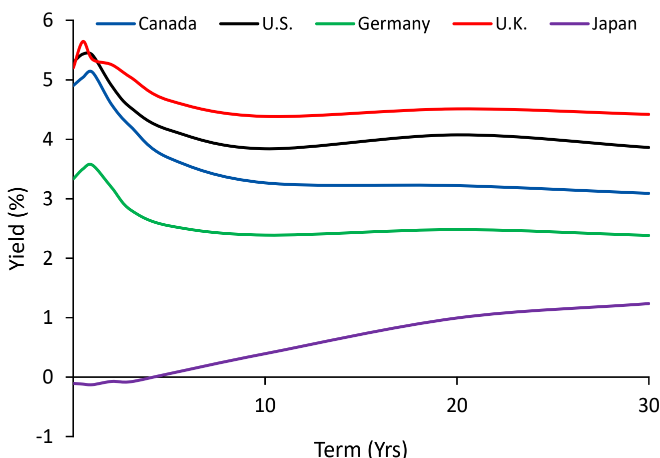
Market Statistics

	Jun/23	Mar/23	Dec/22	Jun/22
Yields (%)				
90 Day T-Bill	4.90	4.34	4.23	2.08
10 Yr. Canada Bond	3.26	2.90	3.28	3.30
30 Yr. Canada Bond	3.09	3.04	3.23	3.28
Rates				
C.P.I. (annual %)	3.36	4.30	6.32	8.13
US$/C$	0.75	0.74	0.74	0.78
Euro/C$	0.69	0.68	0.69	0.74
Prices (US$)				
Crude Oil (bbl.)	71	76	80	106
Natural Gas (mm)	2.80	2.22	4.48	5.42
Gold (oz.)	1,921	1,969	1,820	1,804

Market Returns

	Periods Ending Jun. 30/23			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	1.1	10.4	7.6	8.4
S&P 500 (C$)	6.4	22.9	12.4	15.5
S&P 500 (US$)	8.7	19.6	12.3	12.9
MSCI EAFE Net (C$)	0.7	22.0	4.5	7.9
MSCI EAFE Net (US$)	3.0	18.8	4.4	5.4
MSCI World Net (C$)	4.5	21.8	9.2	12.1
MSCI World Net (US$)	6.8	18.5	9.1	9.5
Bond Universe	-0.7	3.2	0.7	2.1
91 Day T-Bills	1.0	3.7	1.5	1.1

Yield Curves



The Economy

A perusal of the Market Statistics on the left of this page illustrates the rapid increase over the last twelve months in Canadian short term interest rates as the 90 Day T-Bill rate has moved from 2.08% to 4.90%. Similarly, the Consumer Price Index - CPI (inflation rate) has declined from 8.13% to 3.36%. The Bank of Canada has been very aggressive in increasing interest rates in order to bring inflation down and it has clearly had some success but it has not been able to reduce inflation to its decreed 2.0% target.

Despite the aggressive move upward in interest rates the Canadian economy has not fallen into recession. The post-Covid pent-up demand for goods and services along with reasonably strong balance sheets on the part of consumers and corporations have resulted in a good pace of spending to date. A very low unemployment rate, partially caused by early retirements and a slowdown in immigration during Covid, has also resulted in wage escalations and contract settlements that are in excess of the 2.0% inflation target. As a result, the Bank of Canada has publicly stated that there will be further rate increases and that it may still take some time to achieve their stated inflation objective.

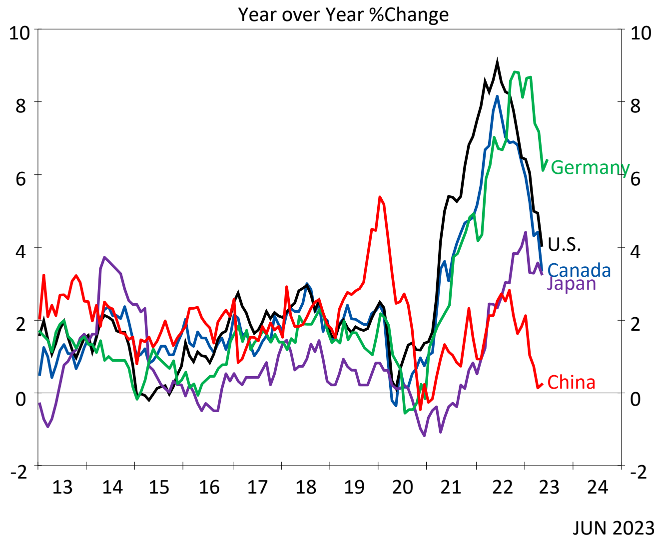
The situation is similar in the U.S., Europe and U.K. where inflation rates remain high and the heads of the central banks have stated there will be further increases in interest rates. The yield curves on the bottom left of this page all (except Japan) indicate higher yields for short-term notes than for longer-term maturities. Such inverted yield curves are reflective of slowing economies. In Japan, the Consumer Price Index has declined to 3.4% with Gross Domestic Product growth at the 1.8% level. A far better situation than pre-Covid when the Japanese economy was mired in disinflation and negative growth. Their yield curve now looks relatively normal as yields increase with term (though short-term rates remain negative to discourage saving and induce spending).

The middle chart on page two shows the Purchasing Managers Index for various geographic regions. It is frequently cited as a leading indicator for recessions. An index value above 50 suggests economic growth while below 50 economic contractions. Beyond the Asian region the index value has now fallen just below the 50 level. Our interpretation is for continued slow global economic growth with any potential recession being mild.

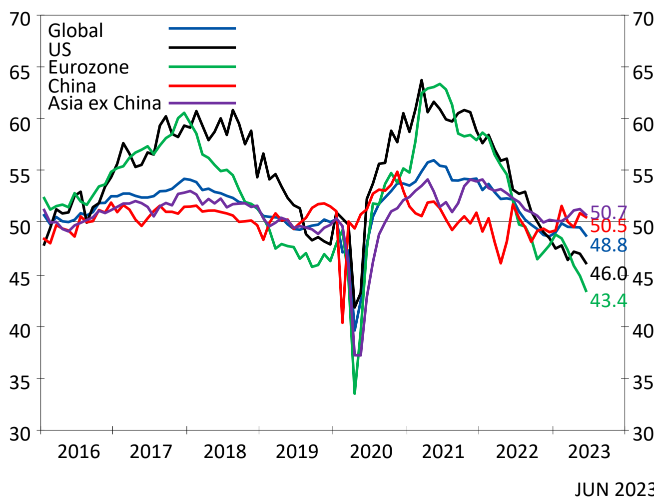
The Markets

Equity market returns for the second quarter of 2023 continued to be powered by the seven largest technology related companies in the U.S. **The share prices for these companies (Alphabet (Google), Apple, Amazon, Meta (Facebook), Microsoft, Nvidia and Tesla) provided virtually all the 6.4% S&P 500 return in the quarter with the rest of the market moving very little.** The spark for these technology related companies was the introduction of Artificial Intelligence (AI) apps to the marketplace. At such an early

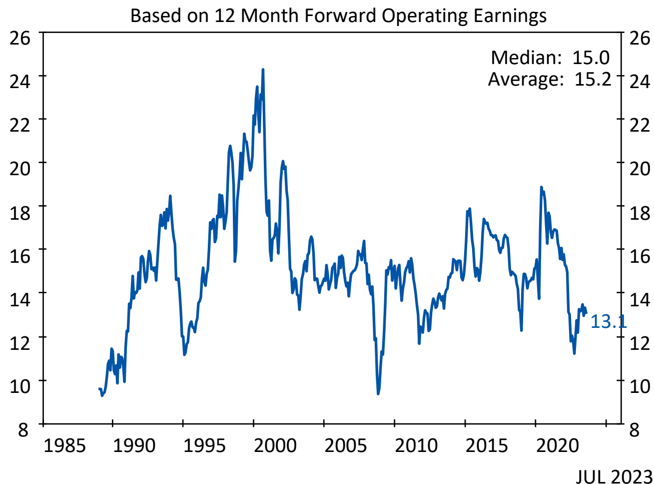
Inflation



Purchasing Mangers Index

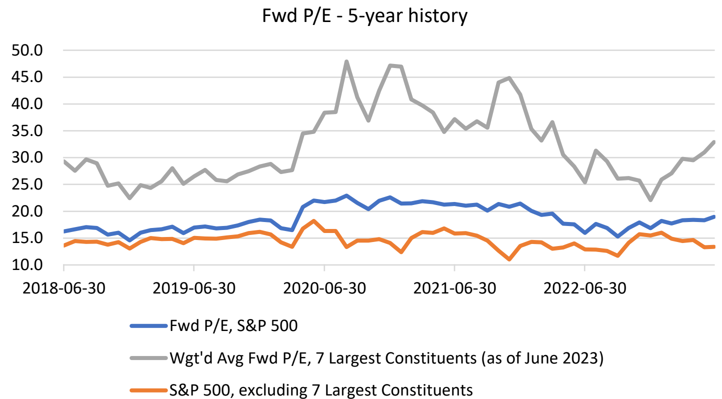


S&P/TSX Forward P/E



stage in development it is impossible to quantify how much this new technology will contribute to earnings for the companies listed, except Nvidia the semi-conductor chip manufacturer. For most of the others, the integration of AI will most likely be necessary for the competitive survival of their existing products arguably making any benefits of the new technology defensive as opposed to spurring new revenue streams. A rebound from historical lows provided some relief in a few of the overseas markets as the overall World Index returned 4.5%. The Canadian market returns were much weaker at 1.1%.

The speculation behind the share price gains is not new. The usual pattern is initial euphoria eventually giving way to rationality. The chart below illustrates how the valuation of these stocks has affected the overall index. They now make up approximately 30% of the S&P 500 and 20% of the World index. The chart below illustrates that the weighted average multiple of these seven stocks is almost 35 times earnings whereas the rest of the market is 13.5 times. The chart on the bottom left of this page indicates the Canadian market (S&P/TSX) is at 13.1 times having little direct exposure to AI related companies.



Given the expected slower economic growth environment along with rising interest rates, it is not surprising to see the modest returns provided by most stocks in the equity markets to-date. Even with some earnings disappointment, share price multiples today, beyond the aforementioned technology related companies, are not expensive in a historical context. As well, a 5% return for cash and short-term corporate bonds may satisfy some near term needs and liabilities, however, it is uncertain whether this will be adequate in an inflationary environment longer term.

We added some short-term bonds to accounts where fixed income is needed. The term to maturity of any purchases remains in the five-year range given the uncertain outlook for inflation and the fact that the yields provided at longer durations are not higher (and in some cases lower). Equities are still the favoured long-term investment vehicle with shares of companies that can pass along cost increases being preferred.

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Sources: TD Securities Inc., Bloomberg