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CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment: February 2022

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Market Comment

Central banks began 2022 by gearing up for a cycle of interest rate hikes to combat persistently high inflation. In January, both the Bank of Canada and Federal Reserve chose not to raise their benchmark interest rates, but warned that hikes will be coming this year, which are widely expected to begin in March. This may have caused some jitters in the markets, as stocks experienced volatility during January, more so in the US than in Canada. Despite the headwind of (expected) higher interest rates, economic growth is expected to continue to be strong following 2021. The IMF projects 4.4% global GDP growth in 2022.

Although most stock indices dipped in January, the energy sector surged higher. This is an interesting development that we have been monitoring, with energy having been in a years long decline but roared back to life in 2021. Meanwhile, many large cap US technology companies, market darlings for years, have shown significant weakness and dragged down the S&P500. A change in market leadership from technology to energy would be a major development that could lead US stocks to underperform the rest of the world.

 Source: IMF, Stockcharts.com, Bank of Canada, US Federal Reserve, OceanFront Investment Counsel

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Energy vs. Technology

Following the early 2000's bull market in energy, where the price of WTI Light Crude Oil peaked at nearly US$150/barrel, the energy sector entered a decade long bear market where technology stocks emerged as the market leaders.

This period saw several large cap companies surpass the market capitalization of the entire S&P500 Energy Sector (white), including Tesla (blue), Apple (purple), and Amazon (orange).

This trend has perhaps begun to reverse, as energy stocks have vastly outperformed the technology sector of late. The white line illustrates, recently creeping higher on the chart, signifying we are potentially entering a new bull market. This chart illustrates how far these trends can go (in both directions).

 Source: Bloomberg Professional, OceanFront Investment Counsel Inc.

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TSX vs. S&P500

As volatility hit markets in January, the TSX outperformed the S&P500 by ~4.6%, thanks in large part to its higher allocation to the energy sector.

The Canadian energy sector was up 17.7% for the month.

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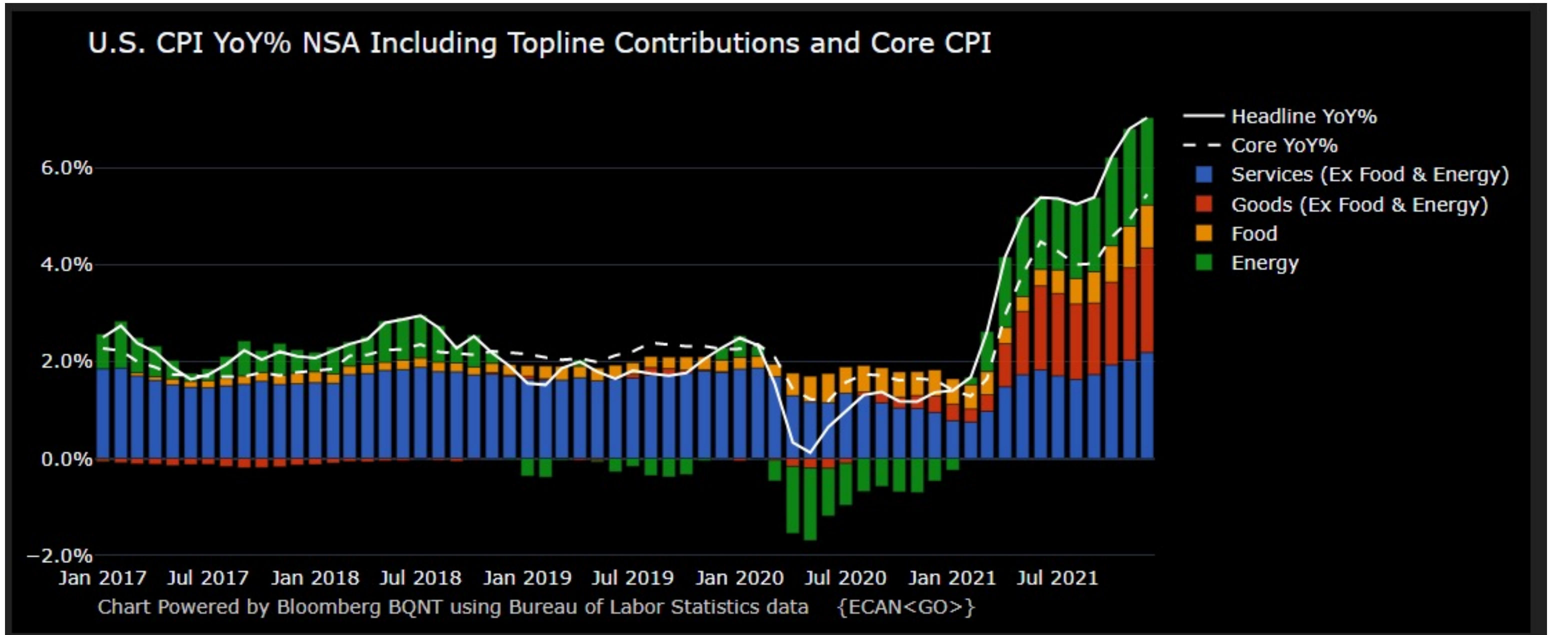
Inflation

Over the past several months, the rising price of goods (red) has grown to become a major component of overall inflation, due in part to supply chain issues. Inflation in goods can put significant stress on the finances of consumers.



Contributions are calculated by multiplying a component's percent change by its weight

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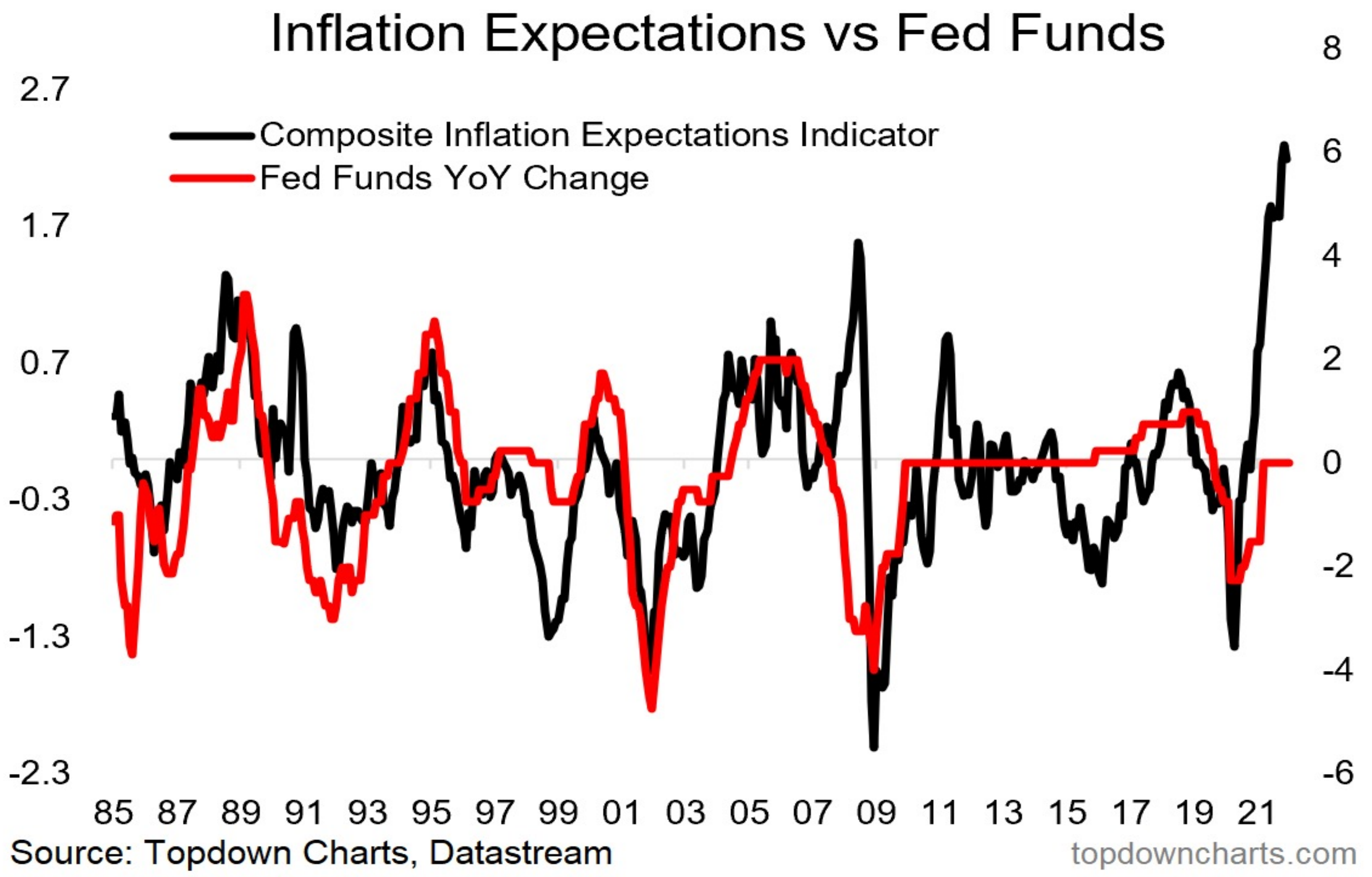
Inflation Expectations

Historically, inflation expectations and interest rates have a close correlation. The Federal Reserve tends to raise its Fed Funds rate of interest in response to higher inflation, but as inflation has spiked recently, rates have yet to rise.

The pattern in the chart implies that the Fed will raise the Fed Funds rate significantly in response to inflation, with consensus expectations that there will be five rate hikes this year.



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Rate Hikes & Stock Returns

Fear A Lot Of Rate Hikes In 2022?

Federal Reserve Bank Hikes Per Year (Since 1970)

Year	Rate Hikes	S&P 500 Index Yearly % Change
1971	4	10.8%
1972	5	15.8%
1973	16	(17.4%)
1974	13	(29.7%)
1975	4	31.5%
1977	6	(11.5%)
1978	15	1.1%
1979	12	12.3%
1980	27	25.8%
1981	7	(9.7%)
1984	4	1.4%
1987	5	2.0%
1988	4	12.4%
1994	6	(1.5%)
2004	5	9.0%
2005	8	3.0%
2006	4	13.6%
2018	4	(6.2%)
Average		3.5%
Median		2.5%
% Positive		

Source: LPL Research, Bloomberg 01/27/2022

How does the market behave when rates are rising?

In isolation, higher interest rates are not bullish for stocks. However, cycles of rising rates often occur during a period of strong economic growth in the market cycle.

As the chart illustrates, market returns have been mixed during past rate hike cycles.

S&P500 Correction Frequency

S&P500 Intra-Year Decline	% of Years (since 1928)	Occurs Every XX On Average
-1%	100%	Year
-5%	94%	1.1 Years
-10%	63%	1.6 Years
-15%	39%	2.5 Years
-25%	26%	4 Years
-25%	20%	5 Years
-30%	11%	9 Years
-40%	6%	16 Years
-50%	2%	47 Years

As the table represents, historical precedent says we should expect market pullbacks of 5% nearly every year and 10% pullbacks roughly every 18 months. The recent market volatility is hardly extraordinary, and rather ordinary, in this context.

While these periods of volatility are not enjoyable, it's important to remember the opportunities they can present, especially for investors with long-term time horizons.

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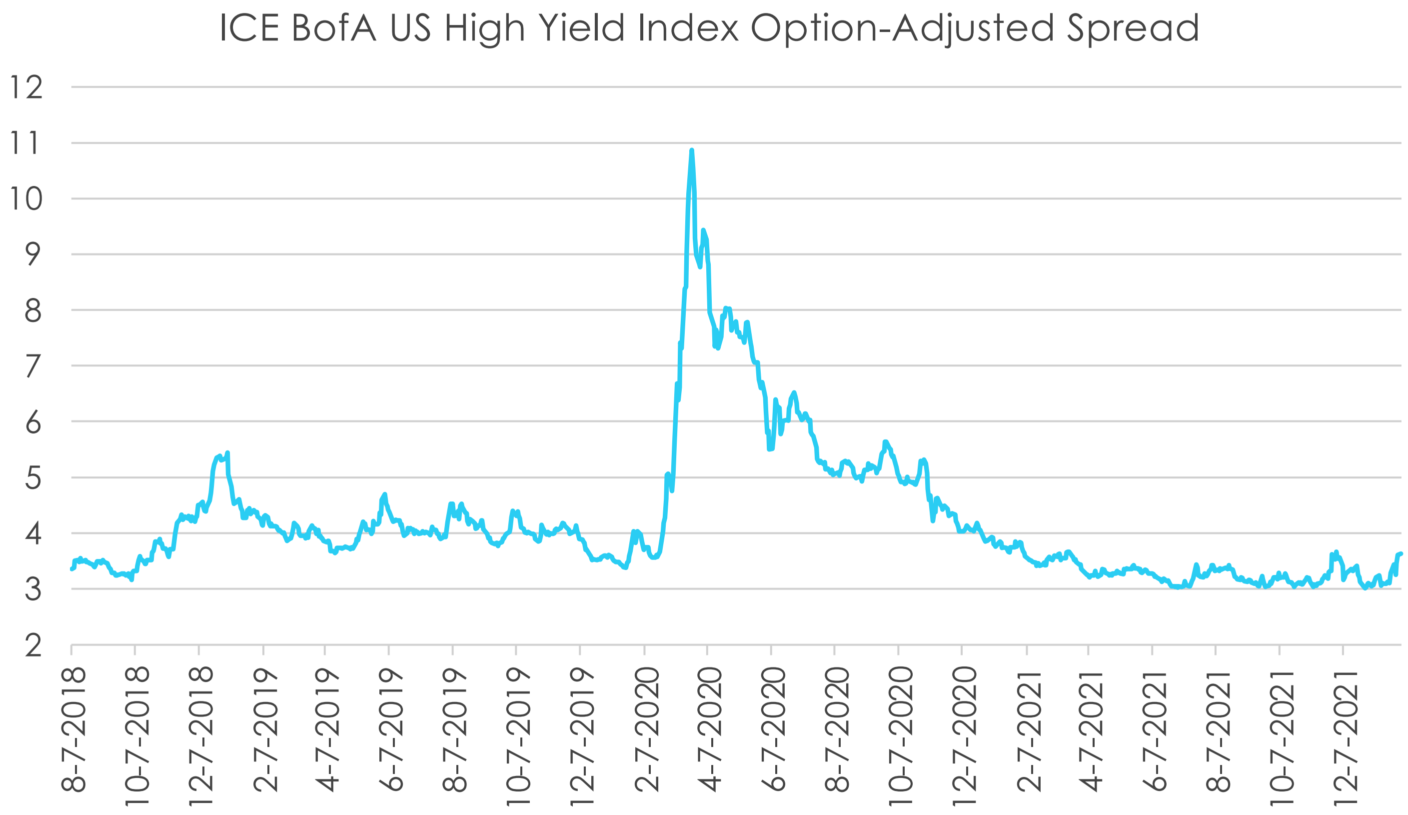
High Yield Bonds

The high yield spread (the difference in yield between the high yield bond index and US Treasury bonds) remains historically low. In times of significant market turmoil (March 2020, for example), this spread tends to spike as investors panic-sell high-yield bonds and buy the safer treasury bonds.

If market volatility were to worsen, we would expect to see signs of trouble in the bond market here, but currently this is not the case.



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The Value of Remaining Invested

Performance from January 3, 2000, to December 31, 2019

Time Invested Since Jan. 3, 2000	Dollar Value	Annualized Performance
Fully invested into S&P 500	$32,421	6.06%
Missed 10 best days	$16,180	2.44%
Missed 20 best days	$10,176	0.08%
Missed 30 best days	$6,749	(1.95%)
Missed 40 best days	$4,607	(3.8%)
Missed 50 best days	$3,246	(5.47%)
Missed 60 best days	$2,331	(7.02%)

DATA SOURCE: JPMORGAN.

It is not possible to invest directly in an index.

Market volatility can be stressful and make it tempting to sell and take risk off the table. However, this comes with an opportunity cost in the form of missing out on future returns.

The chart shows the return an investor would have received from investing in the S&P500 from January 3, 2000, to December 31, 2019, which was 6.06% annualized. If this investor had missed just the ten best days over this 20-year period, that return would drop to just 2.44% annualized.

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E&OE

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