



CHARTBOOK

Market Comment

Prepared by OceanFront Investment Counsel Inc.

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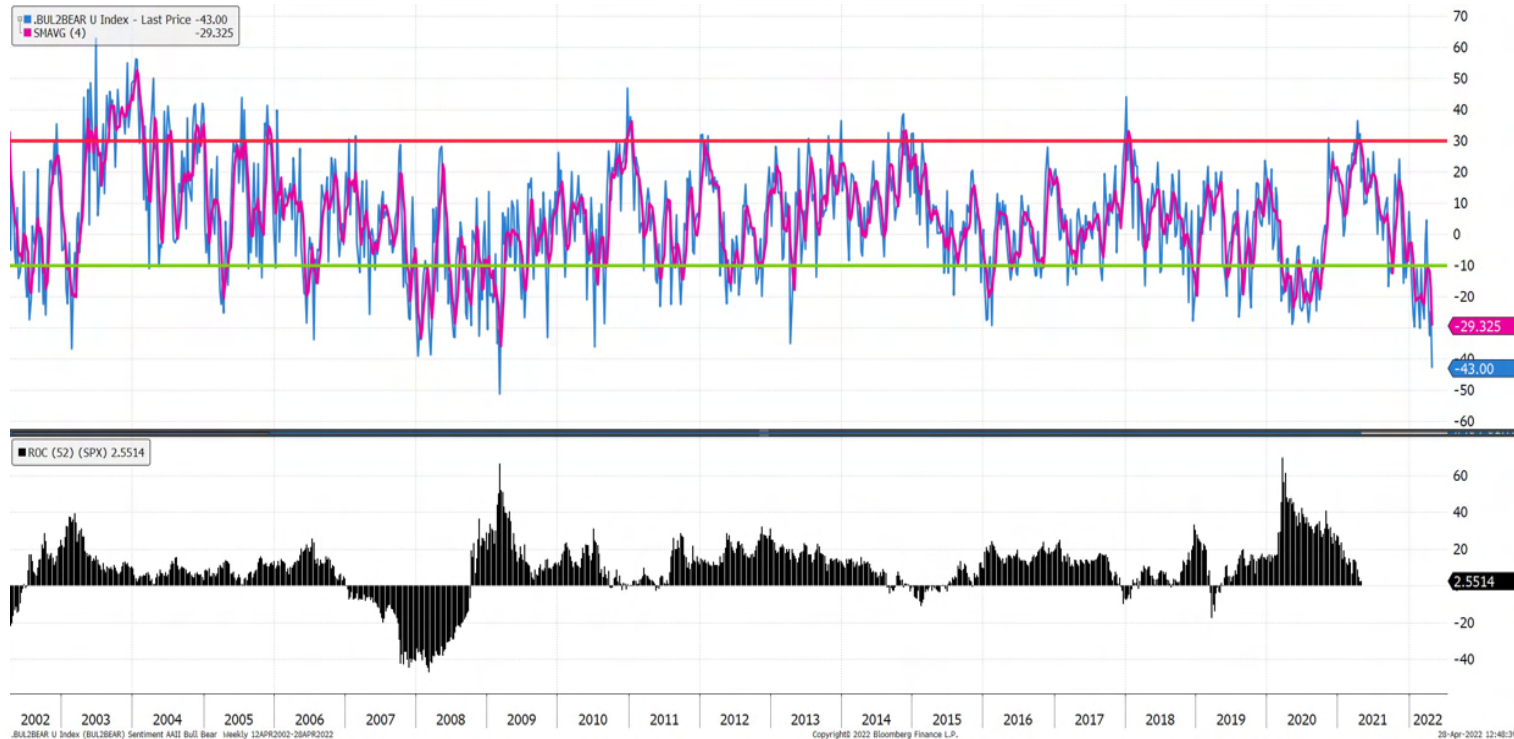
Market Comment

The challenging year for markets continued in April, as most asset classes saw negative returns. For the most part, bonds and stocks declined together and didn't offer a diversification benefit like they so often have in the past.

Hampered by supply chain bottlenecks, the US economy saw Gross Domestic Product (GDP) contract in the first quarter. After a rapid rebound in growth following the 2020 recession, a slowdown is to be expected, but this GDP number was still a surprise. Meanwhile, central banks continue to hike interest rates which are expected to be much higher by year end. However, longer term interest rates have already had a rapid rise to adjust for rising inflation while central banks have been slow to adjust to this environment. For that reason, while we will likely still see several hikes of short-term rates by central banks, it's possible that interest rates in general have completed most of their advance.

Against this difficult backdrop for investors, there have been some pockets of strength. Commodities and commodity related stocks continue to be top performers in general. The Canadian energy sector has been booming as oil prices have risen, which has boosted the TSX Index and helped it outperform its peers year-to-date.

Investor Sentiment



Fear has gripped markets lately. The American Association of Individual Investors surveys its members each week on their opinion of the market (bullish, bearish, neutral). These investors are more bearish (a negative outlook on the market) than at any time dating back to the financial crisis of 2008/2009.

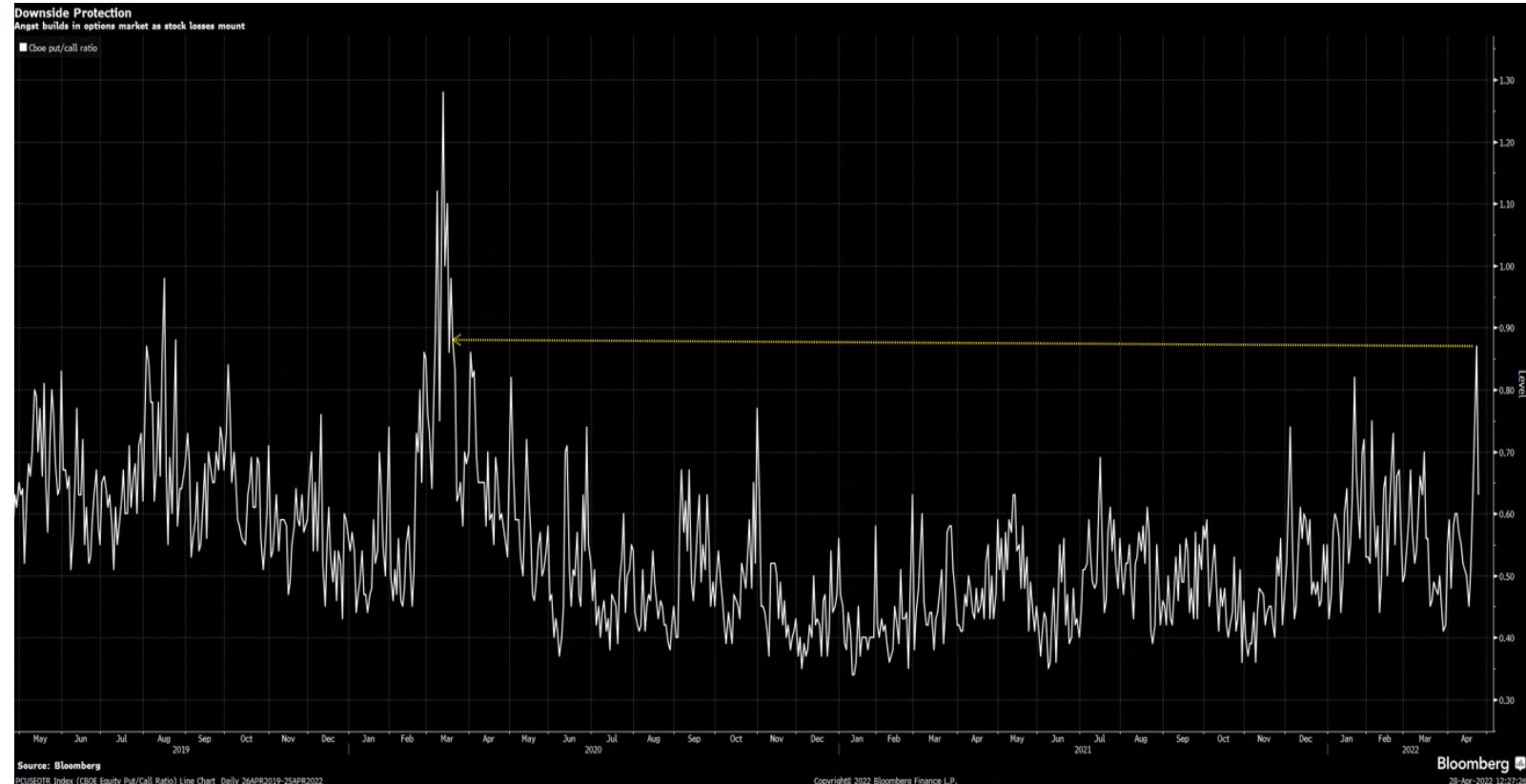
This is a contrarian indicator that is often associated with strong future returns, because when investors are bearish it usually means they've already completed their selling.

The top panel of the chart shows the survey result, high numbers mean bulls outnumber bears, and vice versa. The bottom panel shows the S&P500 return one year later.

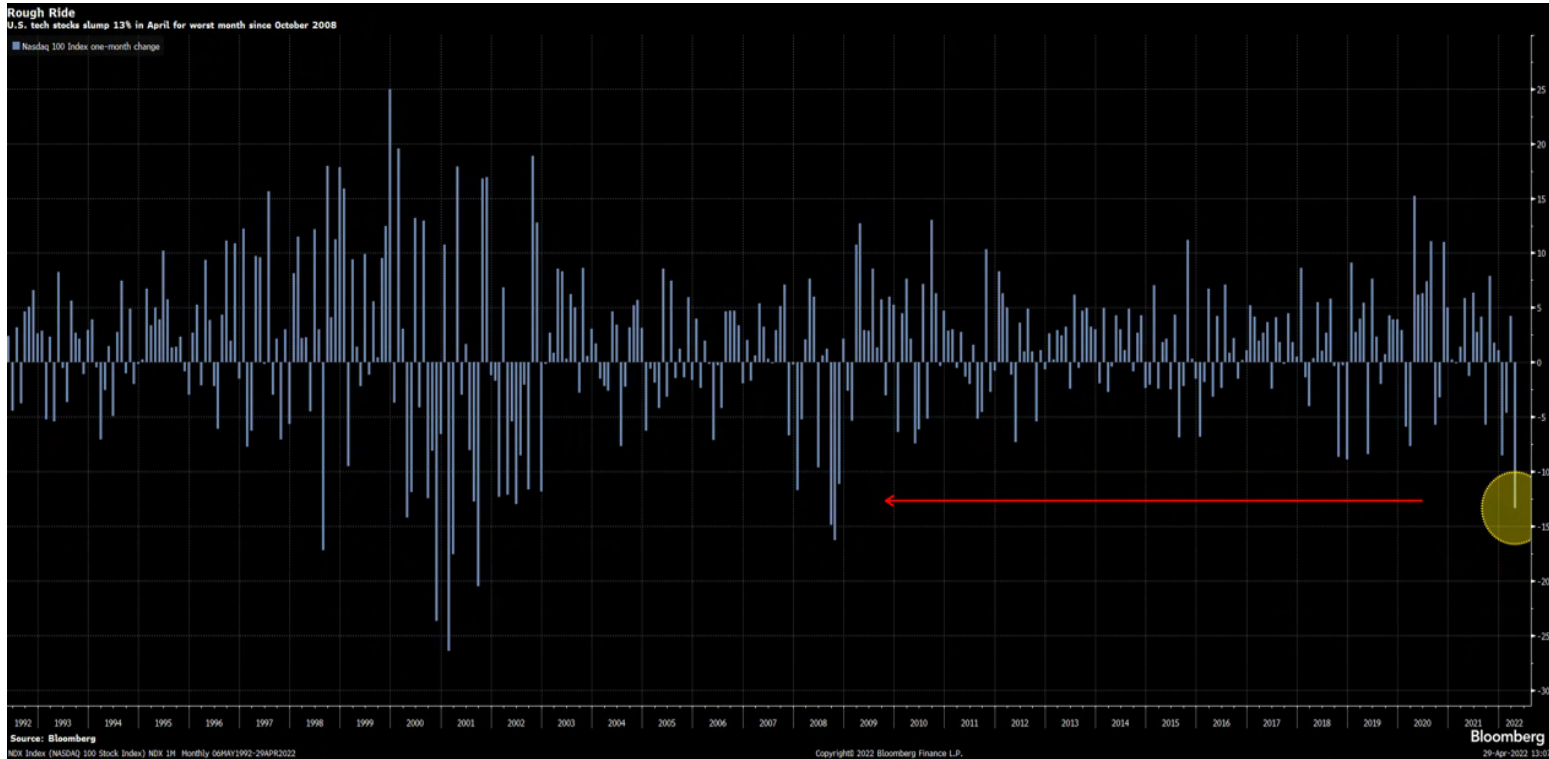
Put/Call Ratio

Another measure of sentiment is the ratio of put options bought to call options bought. Buying put options is a way of protecting a portfolio against downside, so investors tend to buy more puts than calls when they are fearful that markets will fall.

This measure is recently had its highest reading since the COVID crash in March 2020, meaning put options being bought far outnumber calls. This is another contrarian indicator that is associated with strong future returns.



Nasdaq



The technology heavy Nasdaq 100 index fell 13% in April, which was its worst monthly return since October 2008, the height of the Global Financial Crisis. It's no wonder investors are bearish when they are getting monthly returns like this.

High Yield Bonds

High Yield Bond Spreads

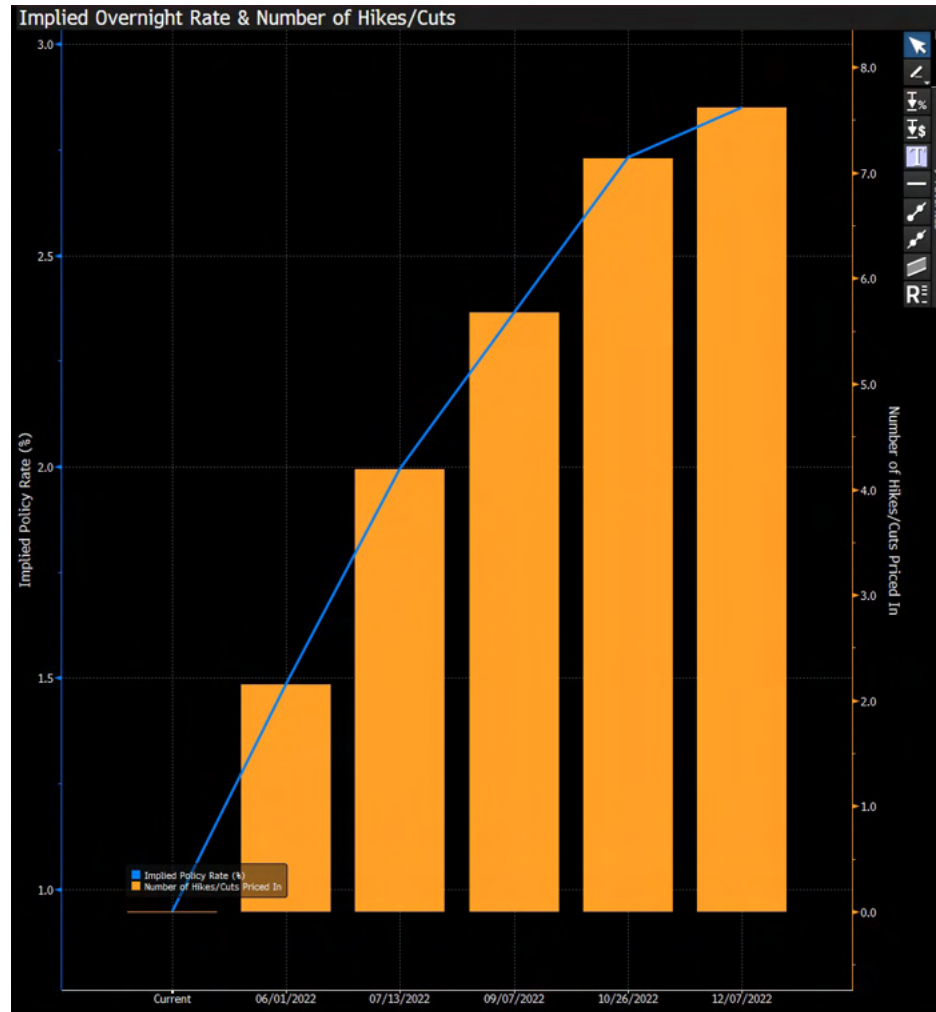
Bloomberg Barclays US Corporate High Yield Average OAS



During periods of market distress, the yield spread between high yield bonds and government bonds tends to rise substantially. This is because investors usually sell the riskier high yield bonds (causing the yield to rise) and purchase the safer government bonds (causing the yield to fall).

While this yield spread has increased a small amount lately, it still remains well below the historical average (the pale blue line), and has not reacted at all like it did in previous periods of distress like 2020, 2015 and 2011. If the current market correction were to get significantly worse, we would expect to see much more distress in high yield bonds than we are now.

Interest Rates



Interest rate futures markets are currently expecting the Bank of Canada overnight interest rate to be 2.75% by December 2022, which would be an increase of 1.75% from where it is now.

10 Year Bond Yields

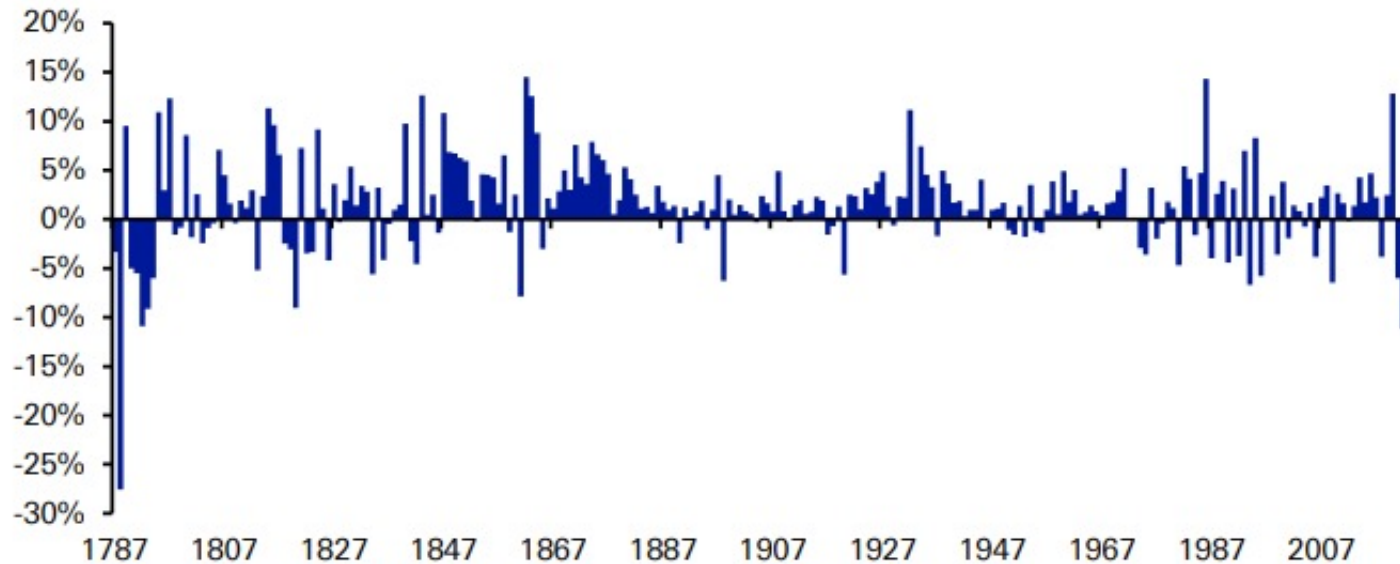
The yields on 10-year government bonds in Canada (red line) and the US (blue line) are currently just below 3%, having risen dramatically over the past 2 years by about 2.5%.

This has resulted in poor returns on bonds, but with such a rapid increase in yields, especially on long term bonds, the worst may be over even though central banks are still in the process of hiking their overnight interest rate.



Bond Returns

Figure 1: YTD Performance of 10yr Treasuries* up to end April each year ...
2022 has seen the worst start to the year since 1788!



Source : GFD, Deutsche Bank.

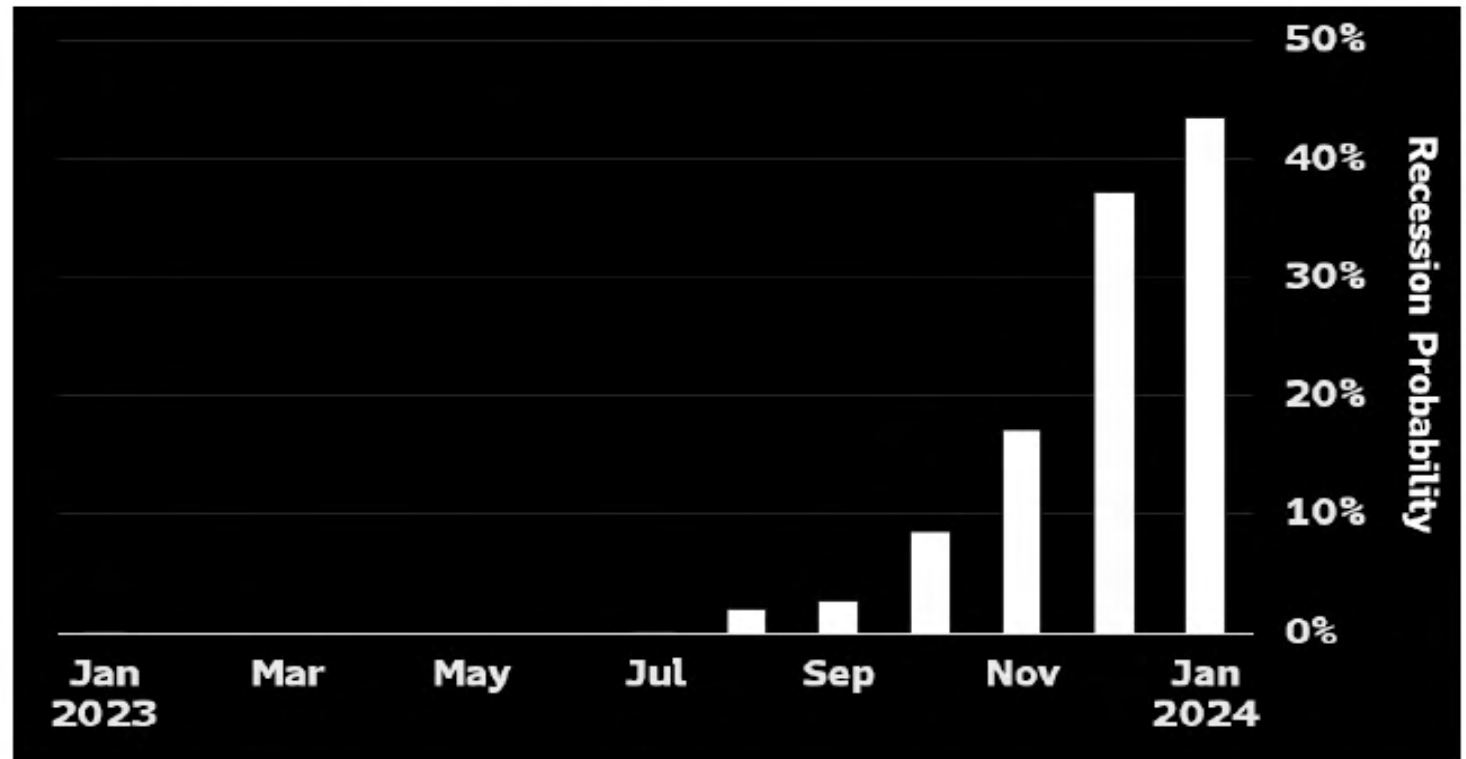
*Note that before 1941, various proxies were used for 10yr Treasuries including other maturities and state bonds where no federal bonds are available.

How bad has the start to the year been for bonds? According to data from Deutsche Bank, the first four months of 2022 are the worst four months for US 10 year government bonds (and proxies) since 1788!

Recession Probability

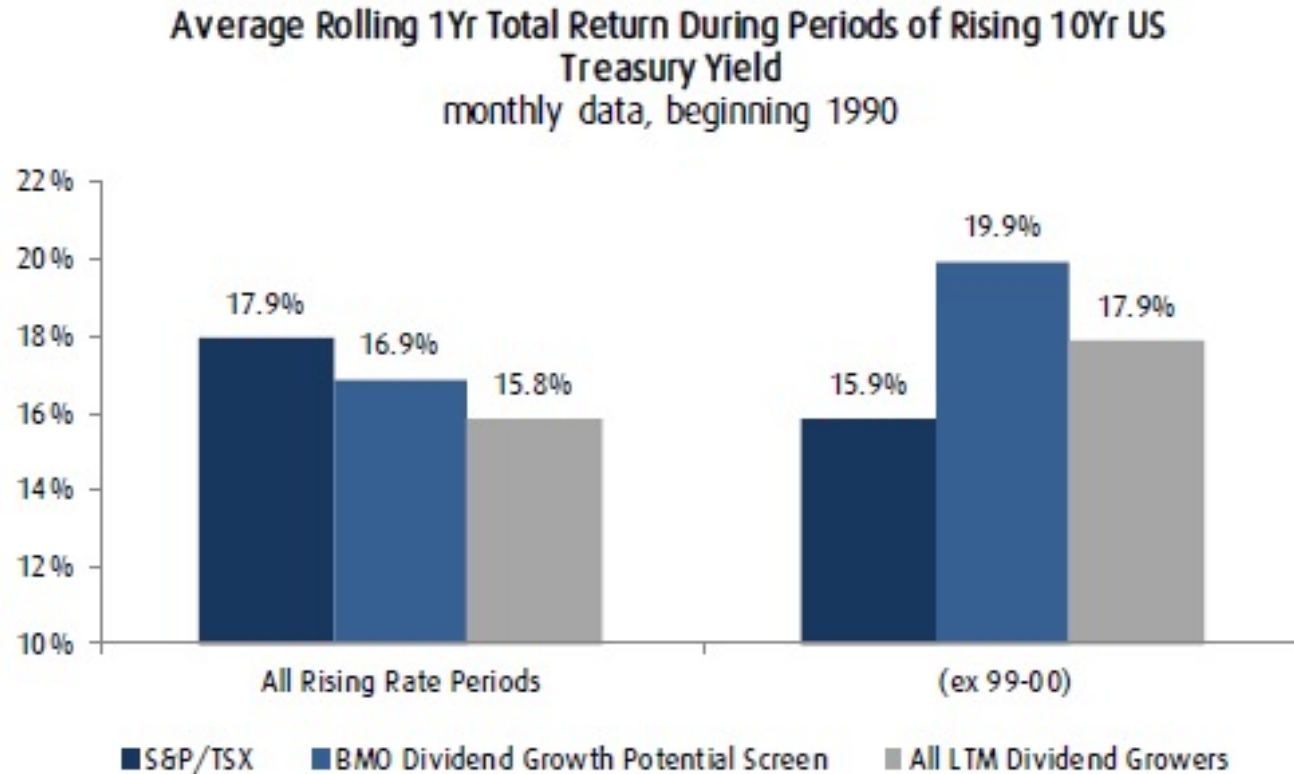
Bloomberg Economics' recession probability model sees only a tiny chance of a recession occurring until late 2023 or early 2024, when the probability rises to over 40%.

Recession Probability Rises Sharply in Late-2023



Source: Bloomberg Economics. Note: Each bar on this chart represents the outcome of the model associated with the time-horizon, i.e. the Jan. 2024 bar reflects the predicted probability for a recession occurring within 22 months.

Dividend Growth



Source: BMO Capital Markets Investment Strategy Group, Factset, Compustat, IBES.

BMO Capital Markets research shows that Dividend Growth stocks can be strong performers during periods of rising rates.

Excluding the dot com bubble period, dividend growth stocks outperformed the TSX by 4% during periods of rising rates dating back to 1990.

Canadian Energy

Commodities, and particularly the energy sector, continue to be one of the only areas of strength in markets. Year-to-date to the end of April, the Canadian energy sector has returned nearly 50%!



DISCLAIMER

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E&OE

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