CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment December 2022

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Market Comment

After making new lows for the year in October, the TSX and S&P500 staged massive rallies of over 17% each to the beginning of December. This rally was driven by a drop in long-term interest rates and bond yields and an overall loosening of financial conditions as Central Banks are widely expected to be near the end of their rate hike cycles, which are being guided by inflation.

On Wednesday, the Bank of Canada announced it had raised its overnight interest rate to 4.25%, an increase of 0.5% from the previous rate. In a statement, the Bank indicated they might pause their rate hikes.

"Governing Council will be considering whether the policy rate needs to rise further to bring supply and demand back into balance and return inflation to target," the bank said.

A key requirement to ending this bear market is a peak in inflation and interest rates. There are indications that we are near the peak in interest rates in Canada, as markets are pricing in a likelihood of just one more hike of 0.25% by the Bank of Canada, with the Federal Reserve not far behind in their hiking cycle. Certain data also suggest that the peak in inflation may be in, and if this is the case, the worst of the bear market may be behind us.

Bear Market Statistics

Was This An Average Bear Market? Didn't Feel Like It, But It Was

S&P 500 Bear Markets And Length To Recover From A Bear Market

Month of Peak	Month of Low	Length of Bear (Months)	% Decline	Length of Recovery (Months)	Recession?
August-56	October-57	14	-22%	11	Yes
December-61	June-62	6	-28%	14	No
February-66	October-66	8	-22%	7	No
December-68	May-70	17	-36%	21	Yes
January-73	October-74	21	-48%	69	Yes
September-76	March-78	18	-19%	17	No
November-80	August-82	21	-27%	3	Yes
August-87	December-87	4	-34%	20	No
July-90	October-90	3	-20%	4	Yes
July-98	August-98	1	-19%	3	No
March-00	October-02	31	-49%	56	Yes
October-07	March-09	17	-56%	49	Yes
April-11	October-11	6	-19%	4	No
September-18	December-18	3	-20%	4	No
February-20	March-20	1	-34%	5	Yes
January-22	October-22	9	25%	?	?
Average For All Bear Markets		12	-30%	19	
Average Bear Market (In Recession)		18	-36%	27	
Average Bear Market (No Recession)		7	-24%	10	

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Source: Carson Investment Research, YCharts 11/10/2022
@ryandetrick

Dating back to 1956, the average bear market decline on the S&P500 is 30%. Bear markets that have coincided with recessions have been more severe on average than those that haven't, with declines of 36% and 24%, respectively.

The maximum S&P500 decline during this bear market is 25%, which is consistent with the average decline for a bear market *without* a recession. The occurrence of a near-term recession or lack thereof could determine whether we see a further decline in stocks or not.

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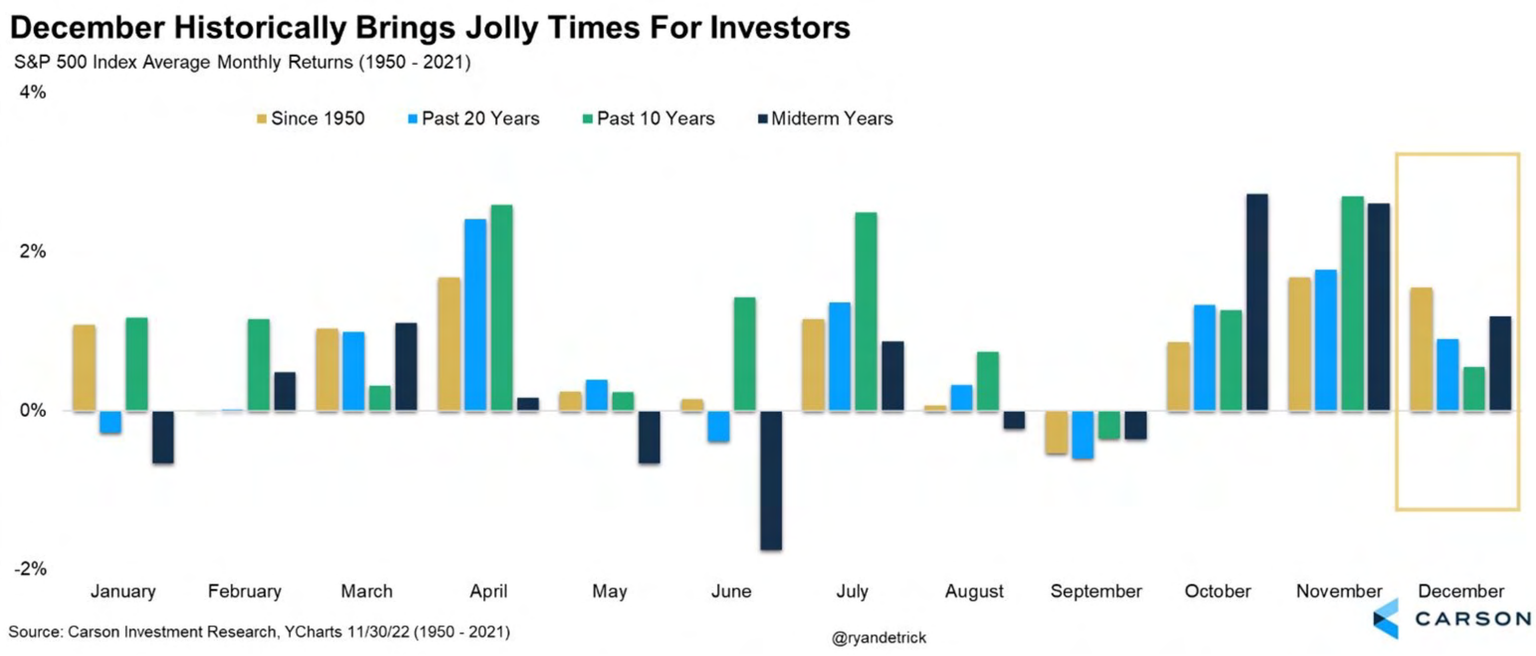
Seasonality

Historically, December is a seasonally strong month for stocks. This may be a tailwind for investors this month.



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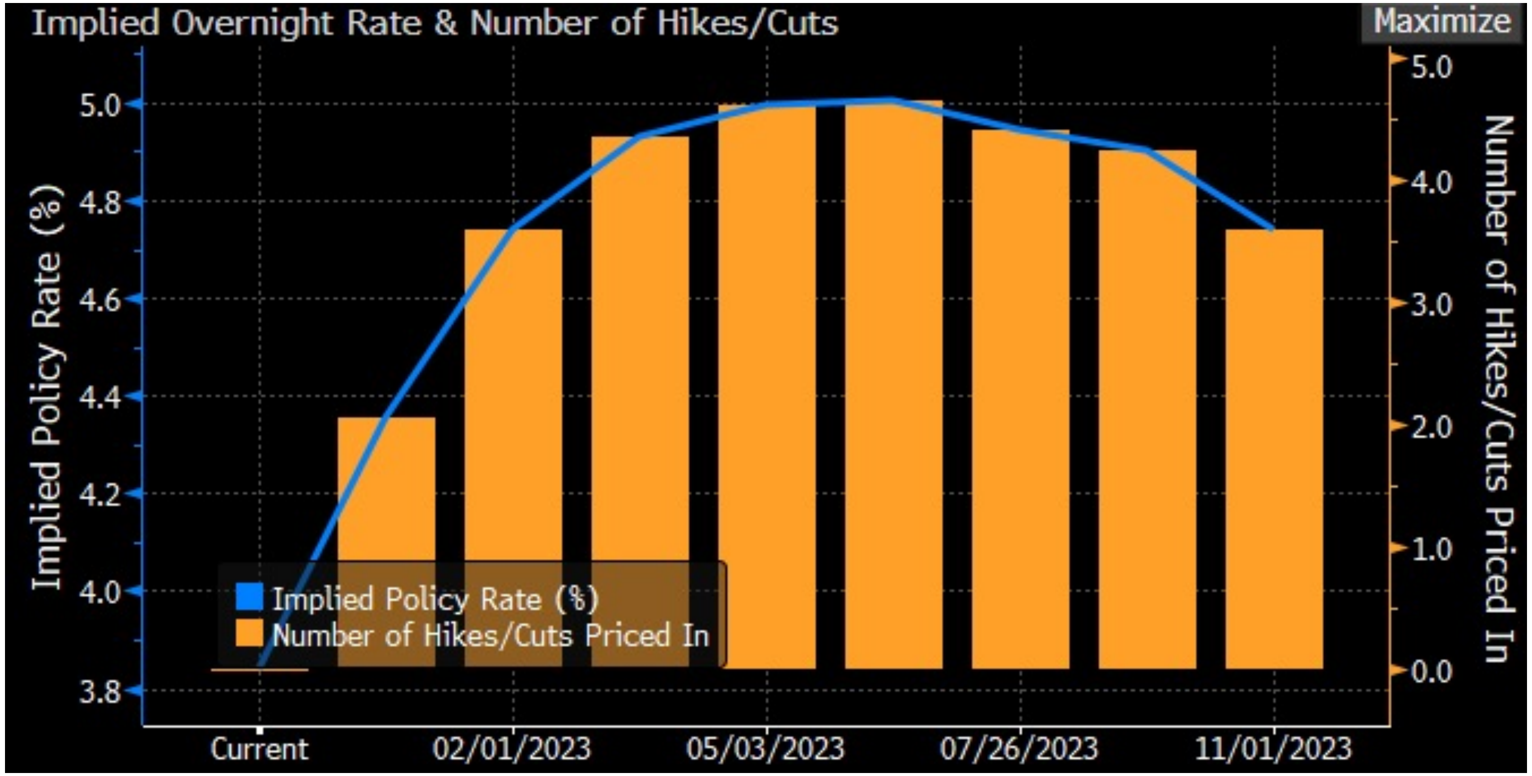
Implied Interest Rate - US



Based on market expectations, the Overnight Rate in the US is still roughly 1.25% below the peak, which is expected to be 5% in mid-2023.

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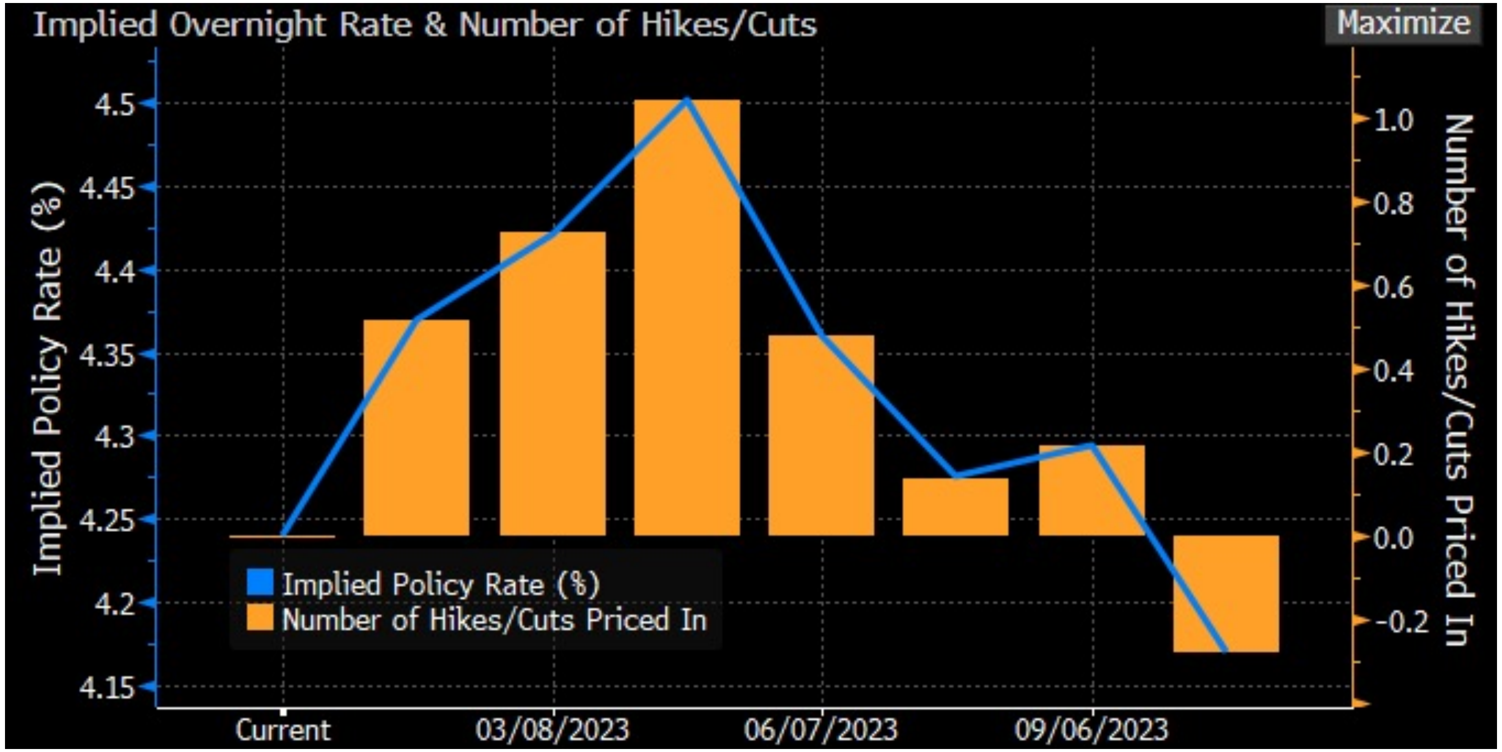
Implied Interest Rate - Canada

Based on market expectations and guidance from the Governor of the Bank of Canada, we are nearing the peak in the Overnight Interest Rate set by the BoC. The current rate of 4.25% is just 0.25% below the expected peak.



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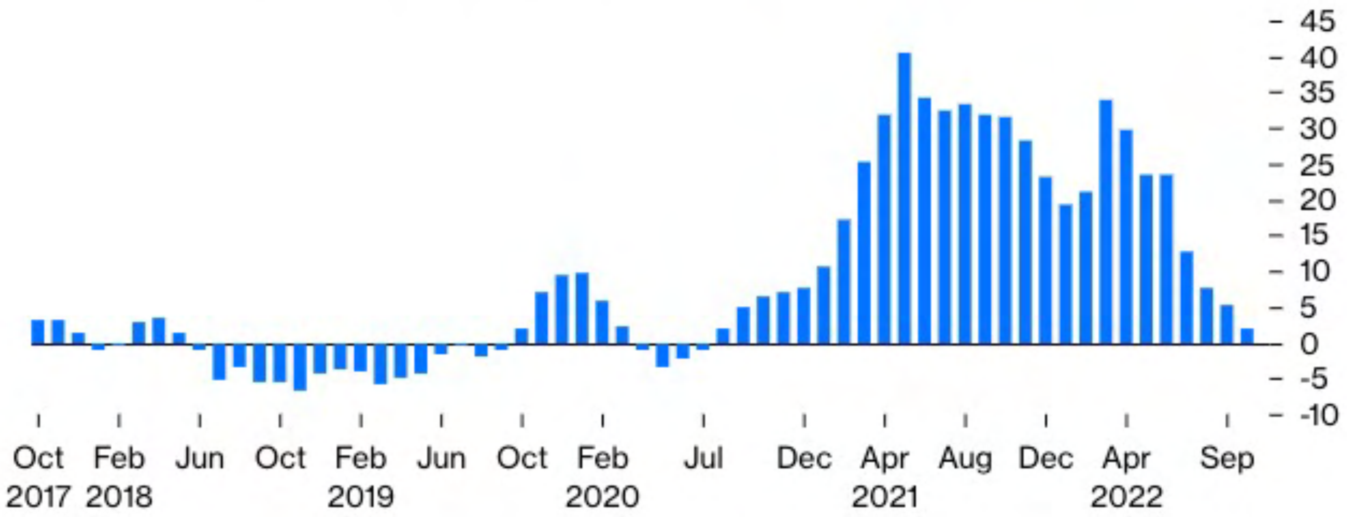
Inflation - Food

Food Deflation

After two years of large annual price increases, the FAO food-price index is about to post its first year-on-year percentage drop



Source: FAO and Bloomberg

The FAO food-price index recently registered a negative, or deflationary, reading year-over-year. File this under "signs that inflation has peaked." Certain components of the Consumer Price Index (CPI) are now negative contributors to the overall index, while others, like the large shelter component, which tends to be lagging, remain large positive contributors.

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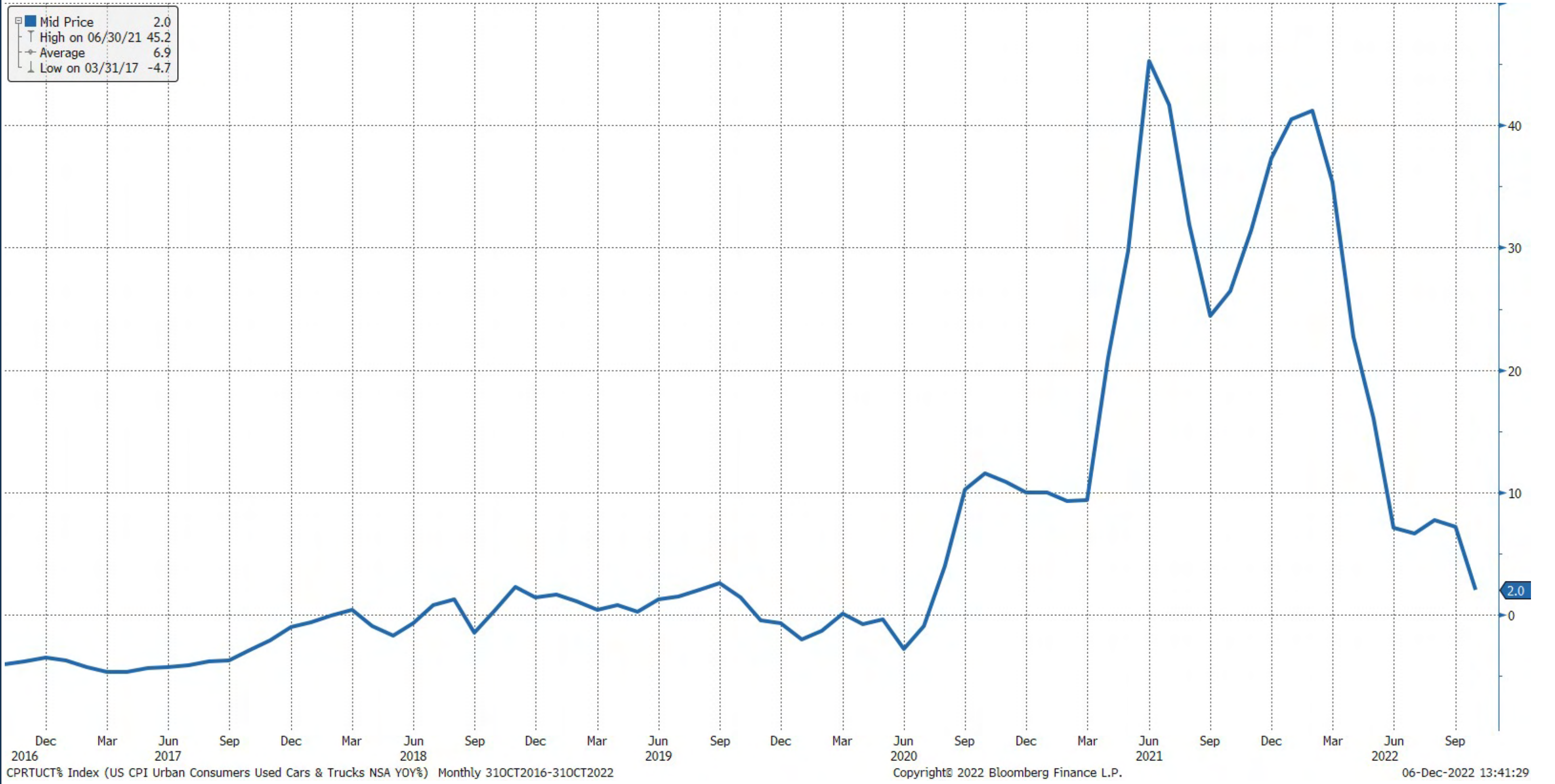
Inflation- Used Cars

Used cars, once among the most inflationary goods, have come back to earth. A recent reading of year-over-year inflation was just 2%, down from the high of 40%+ earlier this year.



 | Source: Bloomberg Professional, OceanFront Investment Counsel Inc.

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Bond Yields

As short-term interest rates continue to rise, many longer-term rates are on the decline. Ten-year bond yields on Canadian (blue) and US government (black) peaked in October and have steadily declined.

Falling interest rates tend to be bullish for stocks; it's no coincidence that the June-August and October-December declines in rates have coincided with the largest rallies in stocks of the year.

US Dollar

The US Dollar and financial conditions are closely related. A high/rising US Dollar typically coincides with tightening financial conditions, which puts global markets and economies under pressure.

The chart shows the DXY US Dollar Index (black) and the Goldman Sachs US Financial Conditions Index (blue), which have been tightly correlated this year. Interest rates and bond yields are important components of financial conditions and the level of the US Dollar. As interest rates have increased in the United States at a fast pace relative to most other countries, the dollar has risen. Like the previous chart, it is no coincidence that the largest stock market rallies of the year have coincided with the largest declines in the US Dollar and financial conditions index.

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