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INVESTMENT COUNSEL INC.

CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

oceanfrontwealth.com

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Chartbook Market Comment: January 2023

OCEANFRONT INVESTMENT COUNSEL INC.

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Market Comment

The rate of interest is often called the “price of money.” It is the most important factor in finance. Interest rates have risen substantially after reaching 0% in 2020 in response to the pandemic, following a decline that had mostly persisted since the early 1980s when rates were in the double digits. This decline in rates produced a bull market in bond prices that lasted for a generation. Reaching rates of 0% was a logical place for this bond bull market to end; some regions even had negative rates for a period.

As the rate of interest is such an important factor to markets, shifting from an environment of falling rates to a stable or rising environment is profound. Many asset prices will behave differently and produce much different returns in such an environment. So, what happens to asset prices when rates go up? How do we diversify portfolios when the bond bull market ends? What assets are likely to perform well in such an environment? These are the questions that OceanFront sought to answer in 2020 and 2021, and this research served us well in 2022.

The Bank of Canada and Federal Reserve have stated that they are most likely near the end of their interest rate hiking cycles but steadfast in their resolve to bring inflation back to their 2% long-term targets. Rates are likely to remain high until Central Banks are confident that the specter of inflation is dead. We are unlikely to see a return to the ultra-low rate environment of the post Global Financial Crisis period for some time.

Looking ahead to 2023, we believe it will continue to be important to evaluate portfolio construction in the context of the new, higher interest rate environment. Among the most notable portfolio changes and opportunities is a shift in fixed-income yields from scarcity to abundance.

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2022 Returns

Comparing 2022 annual returns to 2021 annual returns shows a stark contrast. Long-term bonds and the technology heavy Nasdaq Index were among the very worst performers, while commodities and commodity related stocks were among the best.

The standout performer amongst the indices is the FTSE 100 Index in the UK, which has a relatively large concentration in energy and materials companies.

Stock Indices	**2022**	**2021**
S&P/TSX Composite Index	-5.8%	25.2%
S&P 500 Index	-18.1%	28.7%
Nasdaq 100 Index	-32.4%	27.5%
Dow Jones Industrial Average	-6.9%	21.0%
MSCI EAFE Index	-13.9%	11.9%
MSCI Emerging Markets Index	-19.9%	-2.3%
FTSE 100 Index (United Kingdom)	4.6%	18.4%
Euro Stoxx 50 Index (Europe)	-8.6%	24.1%
Nikkei 225 Index (Japan)	-9.0%	7.4%
Hang Seng Index (Hong Kong)	-12.6%	-11.8%
Shanghai Stock Exchange Composite Index (China)	-12.8%	7.1%
Bond Indices		
iShares Core Canadian Universe Bond Index ETF	-11.7%	-2.8%
Bloomberg U.S. Aggregate Bond Index	-13.0%	-1.5%
Bloomberg U.S. Corporate Investment Grade Index	-15.8%	-1.0%
Bloomberg U.S. 20+ Year Treasury Index	-31.1%	-4.4%
Commodities		
Gold	-0.3%	-3.6%
WTI Light Crude Oil	6.7%	55.0%
Bloomberg Commodity Index	13.8%	27.1%

Returns include dividends. It is not possible to invest directly into an index.

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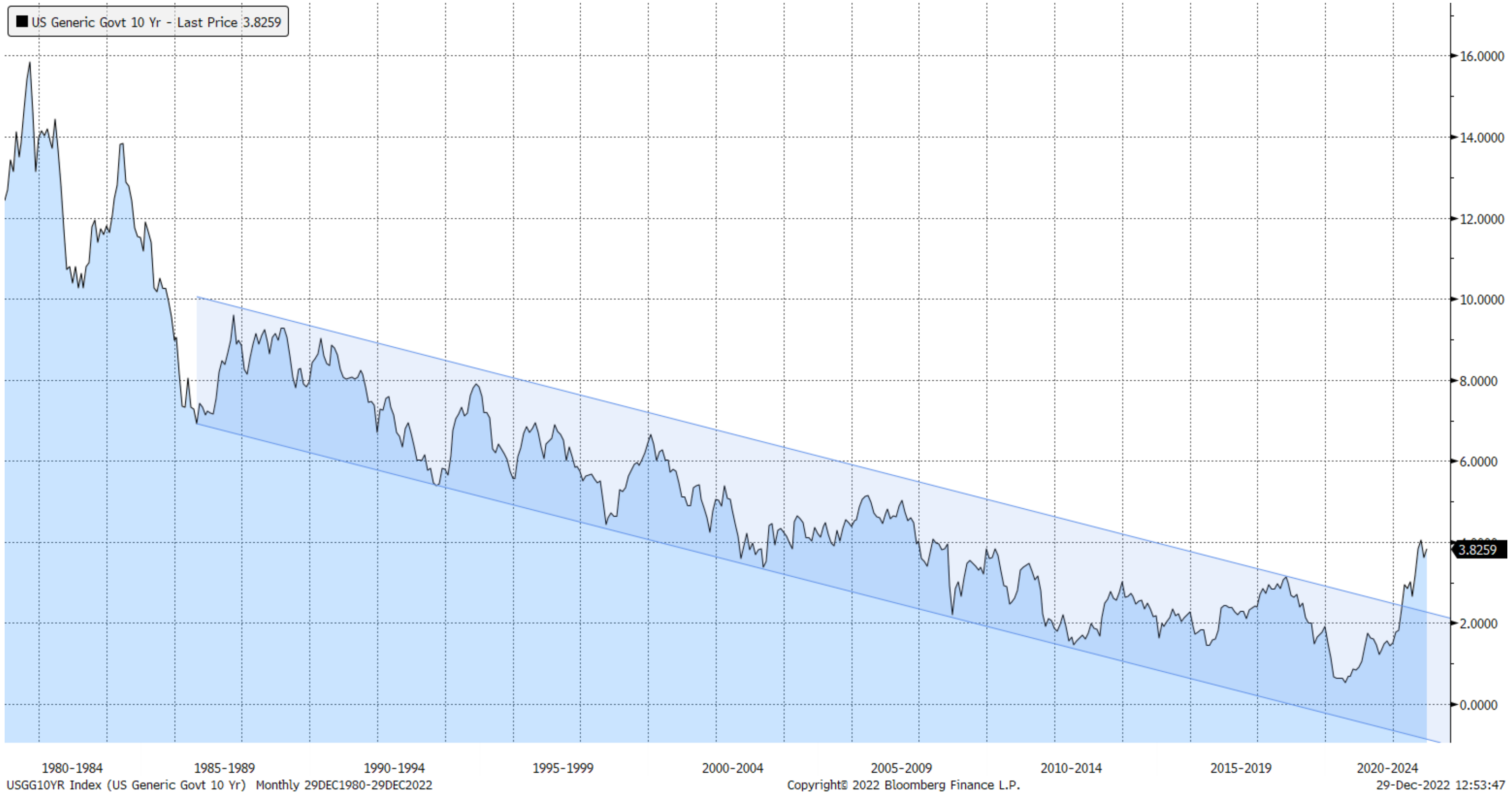
2022 Returns (cont.)

Charting the 2022 returns of stocks and bonds together really exemplifies how difficult of a year it was. By this measure, it was one of the worst ever, as it is so unusual to have such poor returns in both asset classes at the same time. 2022 was a poor year for stocks but the worst year in bonds in this data dating back to 1871.

Interest Rates – Sea Change?

Interest rates have been in a downtrend since the early 1980s, followed by the peak in rates after the high inflation environment of the 1970s. This period encompasses the entire investing career of most of today's finance professionals and their clients. The downtrend in rates appears to have been broken, which has profound implications for markets.

Renowned investor Howard Marks recently commented that investing in an environment of falling rates is like walking on a moving pathway; it makes everything easier. The future is likely to be different and more difficult for investors than in the recent past, which may surprise many market participants who are accustomed to investing in a declining rate environment.



Asset Correlation

Correlations and volatility

GTM | U.S. | 57

	U.S. Large Cap	EAFE	EME	Bonds	Corp. HY	Munis	Currcy.	EMD	Cmdty.	REITs	Hedge funds	Private equity	Gold	Ann. Volatility
U.S. Large Cap	1.00	0.89	0.76	0.25	0.85	0.34	-0.42	0.68	0.43	0.77	0.84	0.79	0.09	0.15
EAFE		1.00	0.90	0.24	0.87	0.37	-0.57	0.75	0.47	0.64	0.86	0.82	0.17	0.15
EME			1.00	0.30	0.82	0.42	-0.69	0.80	0.49	0.52	0.76	0.76	0.37	0.18
Bonds				1.00	0.37	0.86	-0.35	0.66	-0.18	0.41	-0.02	-0.08	0.56	0.04
Corp. HY					1.00	0.45	-0.49	0.86	0.50	0.68	0.81	0.72	0.26	0.08
Munis						1.00	-0.34	0.74	-0.12	0.55	0.14	0.16	0.47	0.04
Currencies							1.00	-0.57	-0.44	-0.20	-0.32	-0.53	-0.55	0.06
EMD								1.00	0.29	0.61	0.57	0.54	0.50	0.08
Commodities									1.00	0.32	0.62	0.58	0.34	0.17
REITs										1.00	0.59	0.54	0.17	0.16
Hedge funds											1.00	0.81	0.03	0.05
Private equity												1.00	0.04	0.08
Gold													1.00	0.15

Source: Bloomberg, Burgiss, Credit Suisse/Tremont, FactSet, Federal Reserve, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Indices used – Large Cap: S&P 500 Index; Currencies: Federal Reserve Trade-Weighted Dollar; EAFE: MSCI EAFE; EME: MSCI Emerging Markets; Bonds: Bloomberg Aggregate; Corp HY: Bloomberg Corporate High Yield; EMD: Bloomberg Emerging Market; Cmdty.: Bloomberg Commodity Index; REITs: NAREIT All Equity Index; Hedge funds: CS/Tremont Hedge Fund Index; Private equity: Time weighted returns from Burgiss; Gold: Gold continuous contract ($/oz). Private equity data are reported on a one- to two-quarter lag. All correlation coefficients and annualized volatility are calculated based on quarterly total return data for period from 9/30/2012 to 9/30/2022, except for Private equity, which is based on the period from 3/31/2012 to 3/31/2022. This chart is for illustrative purposes only.
Guide to the Markets – U.S. Data are as of November 30, 2022.

J.P.Morgan
ASSET MANAGEMENT

If the sea has indeed changed with regard to the interest rate environment, investors may have to look beyond bonds to provide diversification to the equity allocation in their portfolios. One potential source of this diversification is an allocation to commodities, which have historically exhibited a low correlation to stocks and a negative correlation to bonds.

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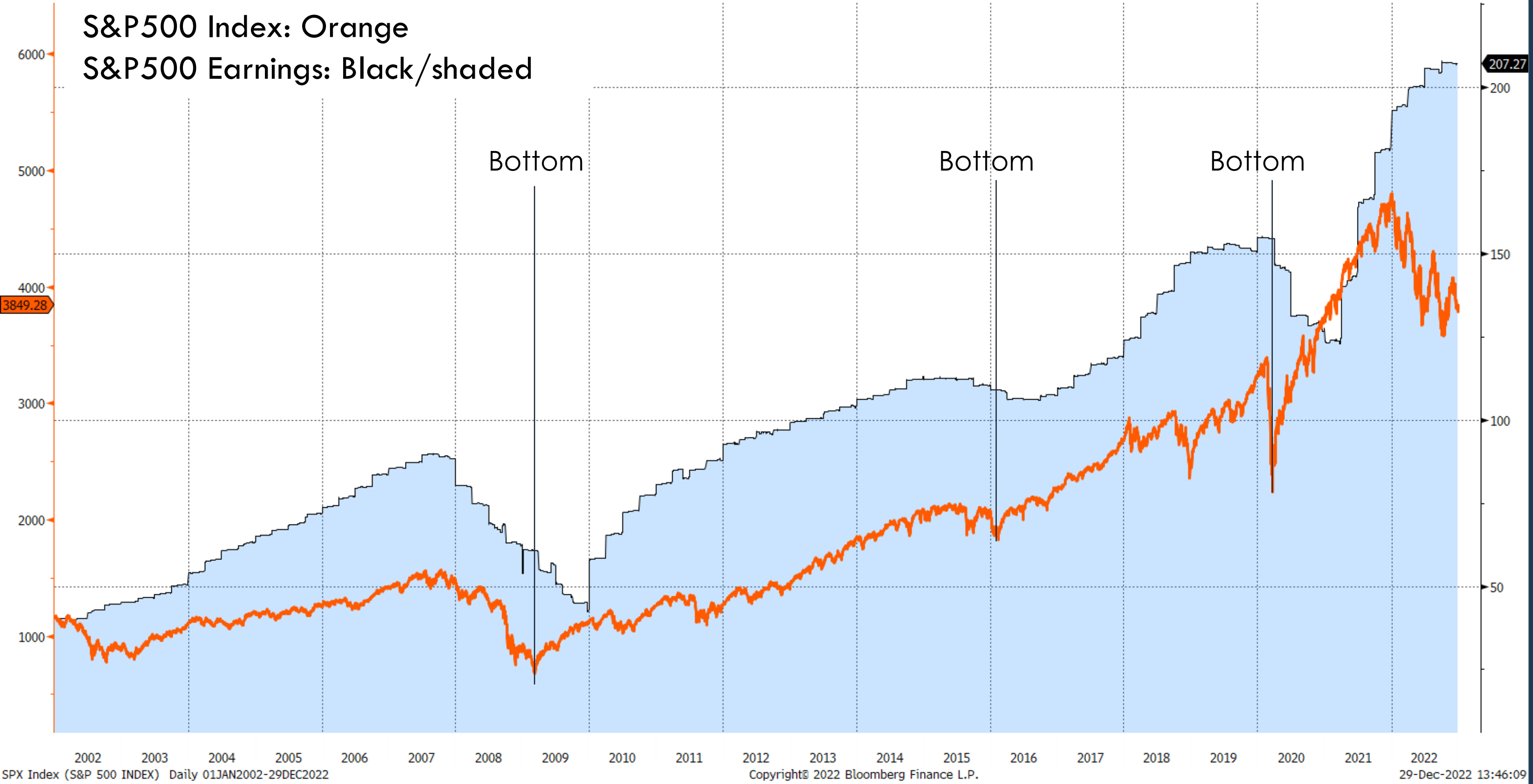
S&P500 Earnings

Stock prices tend to bottom before earnings



After a substantial fall in stocks in 2022, earnings remain near their peak. It is unusual to see such a large drop in equity prices without a significant contraction in earnings, and in 2023 this is something to watch for. But it is important to remember that stock markets are forward-looking and tend to front-run fundamental data like earnings. So even if we see a substantial economic contraction and a corresponding drop in corporate earnings, much of that is likely already priced into stock markets.

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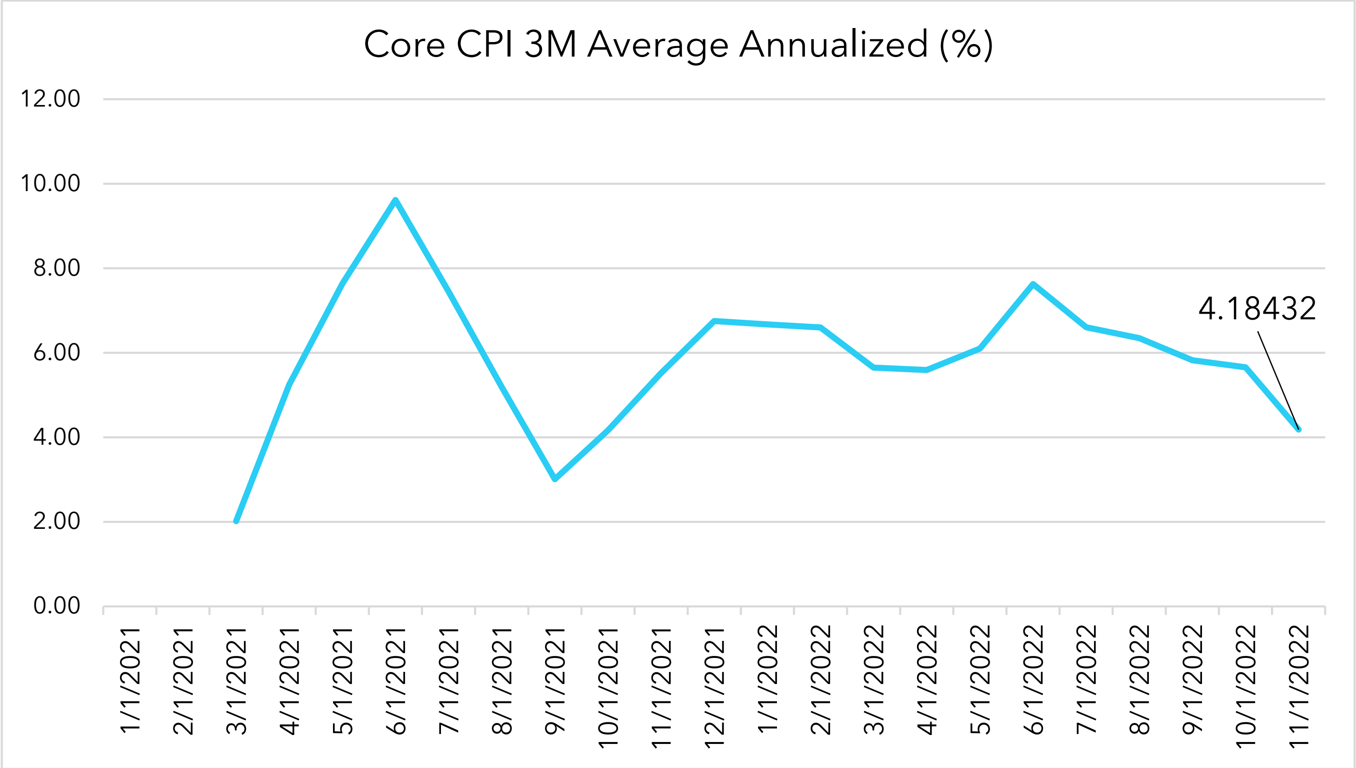
Inflation – USA

Viewing inflation data as a 3-month rolling average shows a more current picture than the typical year-over-year perspective. From this point of view, annualized inflation has fallen to 4.2% in November from a peak of nearly 8% in mid-2022, which shows substantial progress towards the Federal Reserve's 2% inflation target compared to the 7.1% year-over-year calculation.



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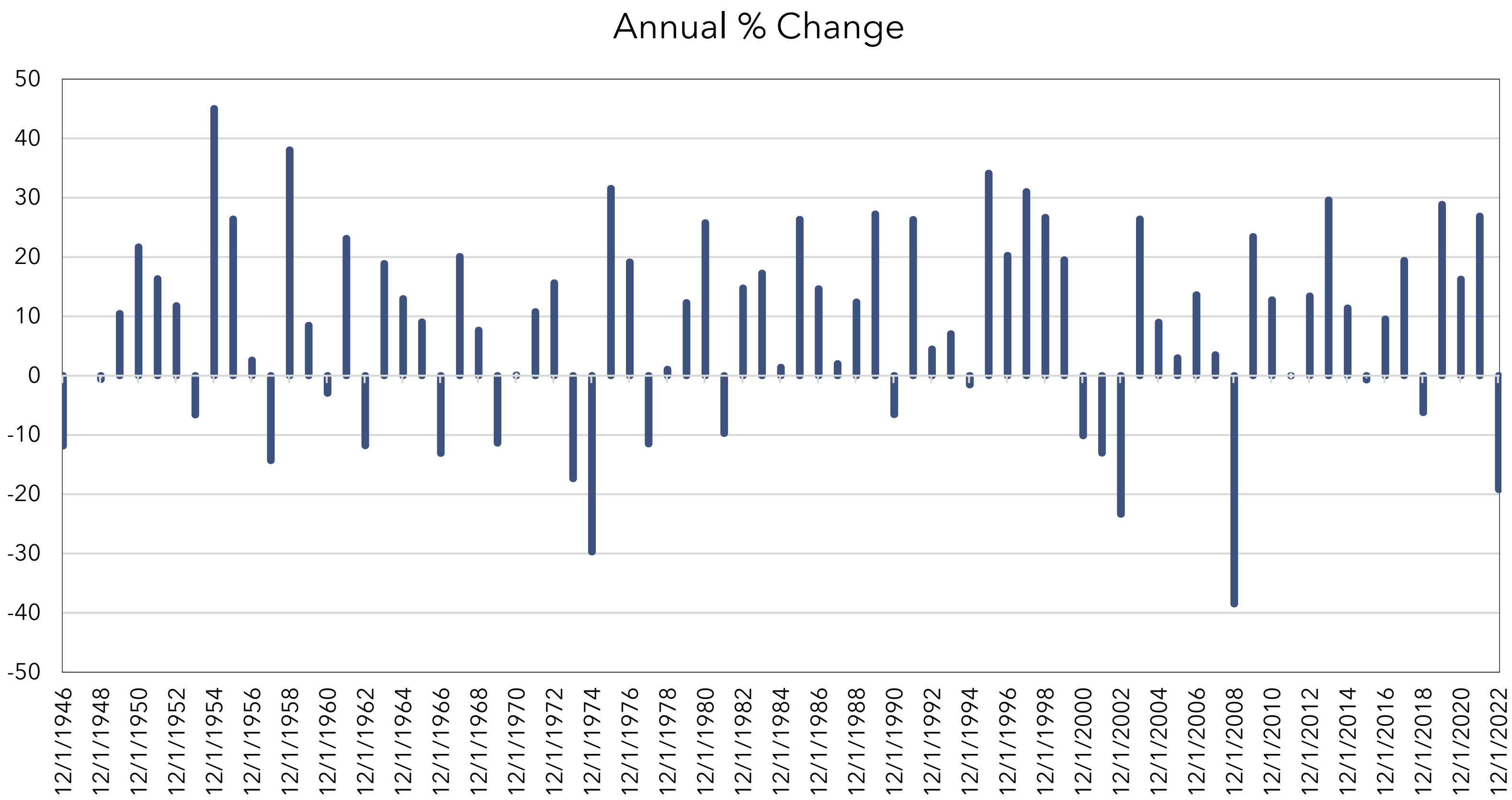
Historical S&P500 Returns



Historically, it is a rare event for stocks to have negative returns for consecutive years. In data dating back to 1946, the S&P500 has had consecutive negative returns only during 1973-1974 (2 consecutive negative years) and 2000-2002 (3 consecutive negative years).

In this data, large negative annual returns were often followed by a large annual return.

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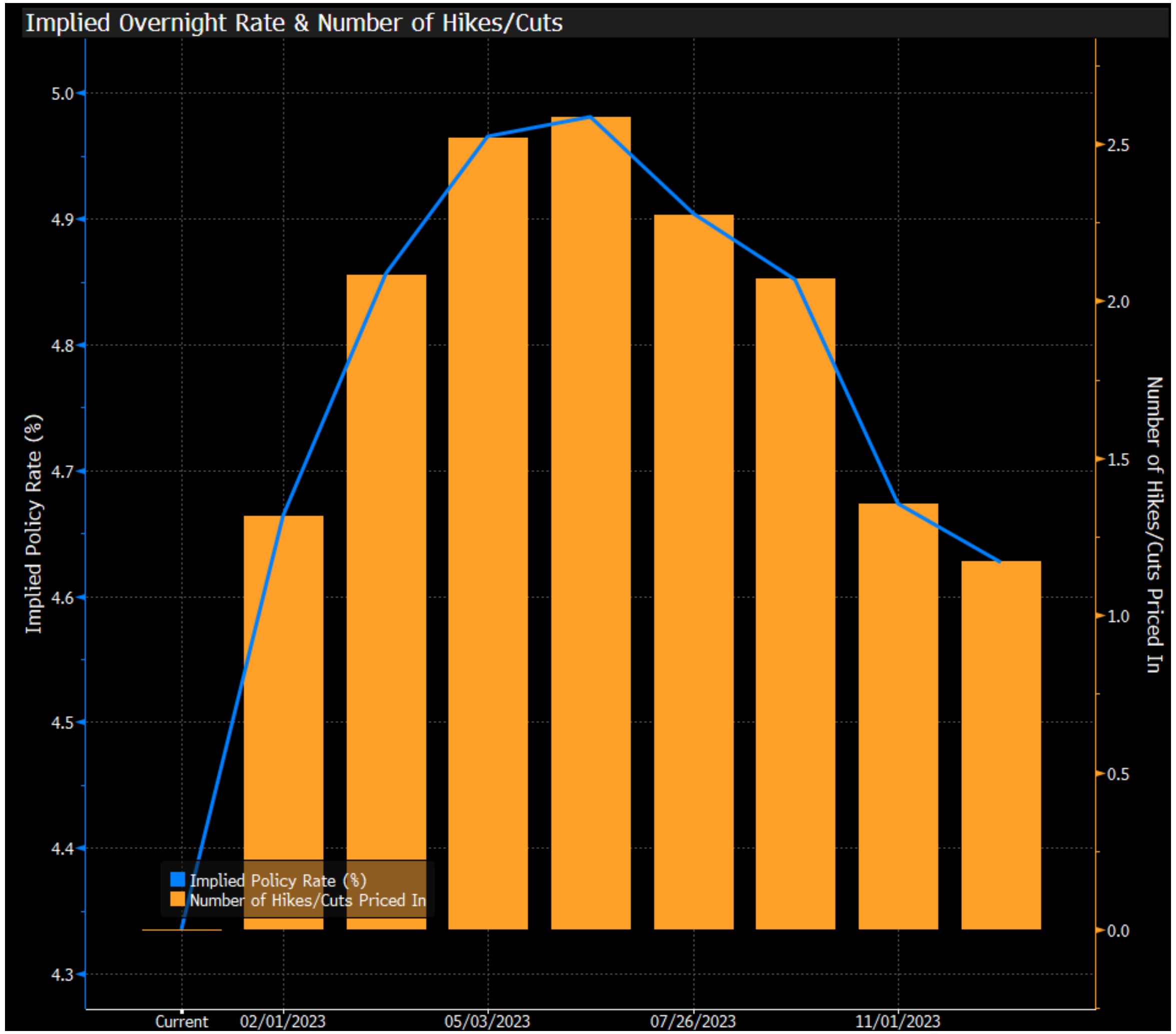
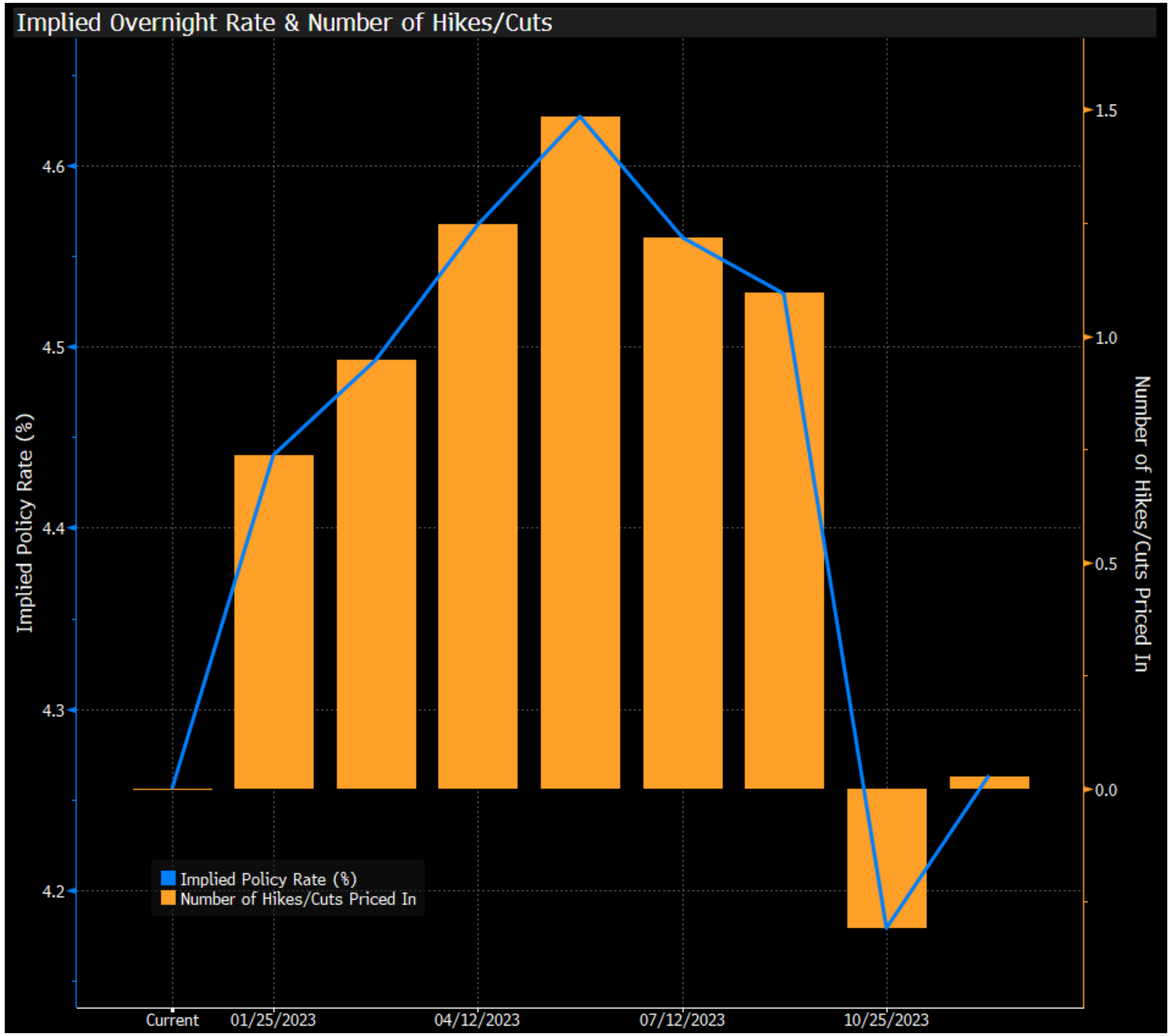
Interest Rates - USA



Markets are pricing in a likelihood of a further 50 basis points of hikes from the Federal Reserve, with a small chance of 75 basis points of further hikes. This would bring the top of the bank's target range to 5% from 4.5% today. Markets then expect a 25 basis point cut by the end of 2023.

Interest Rates - Canada



Markets are pricing in a probability of one more 25 basis point hike by the Bank of Canada in their hiking cycle, bringing the rate to 4.5% from 4.25% today. Markets now expect a 25 basis point cut toward the end of 2023, which would return the rate to 4.25%.

 Source: Bloomberg, OceanFront Investment Counsel Inc.

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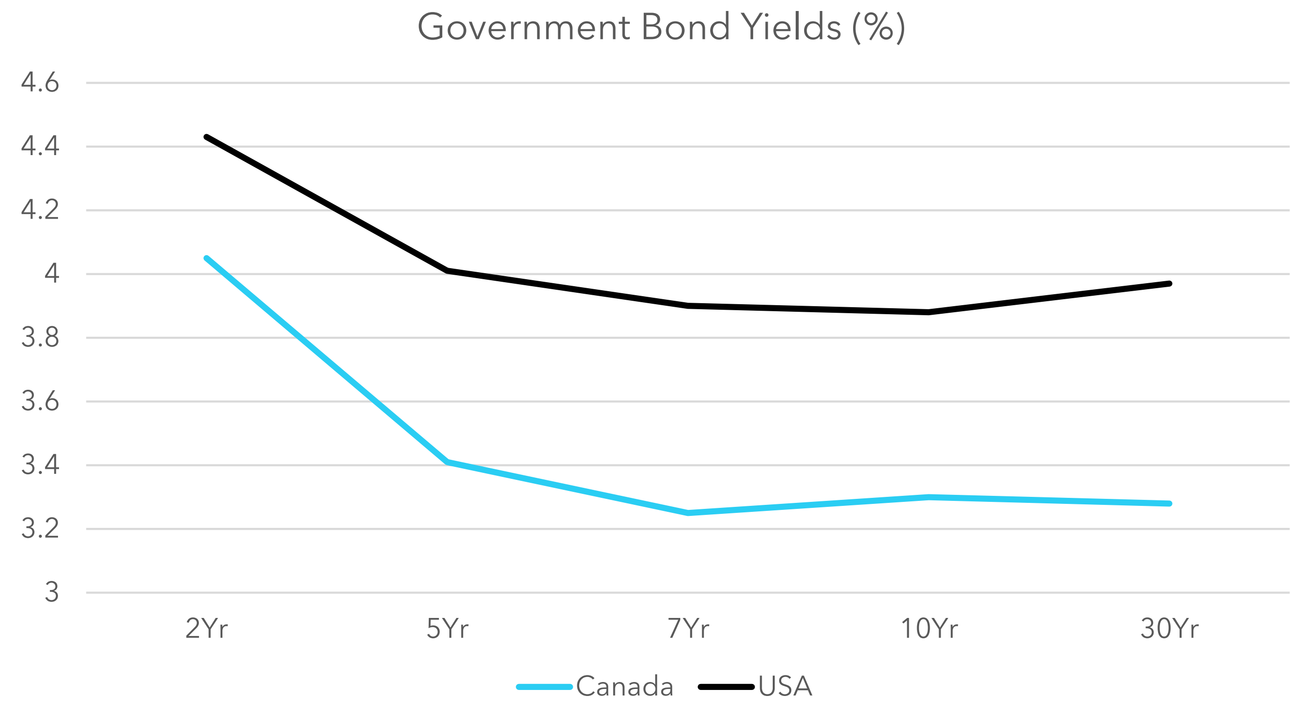
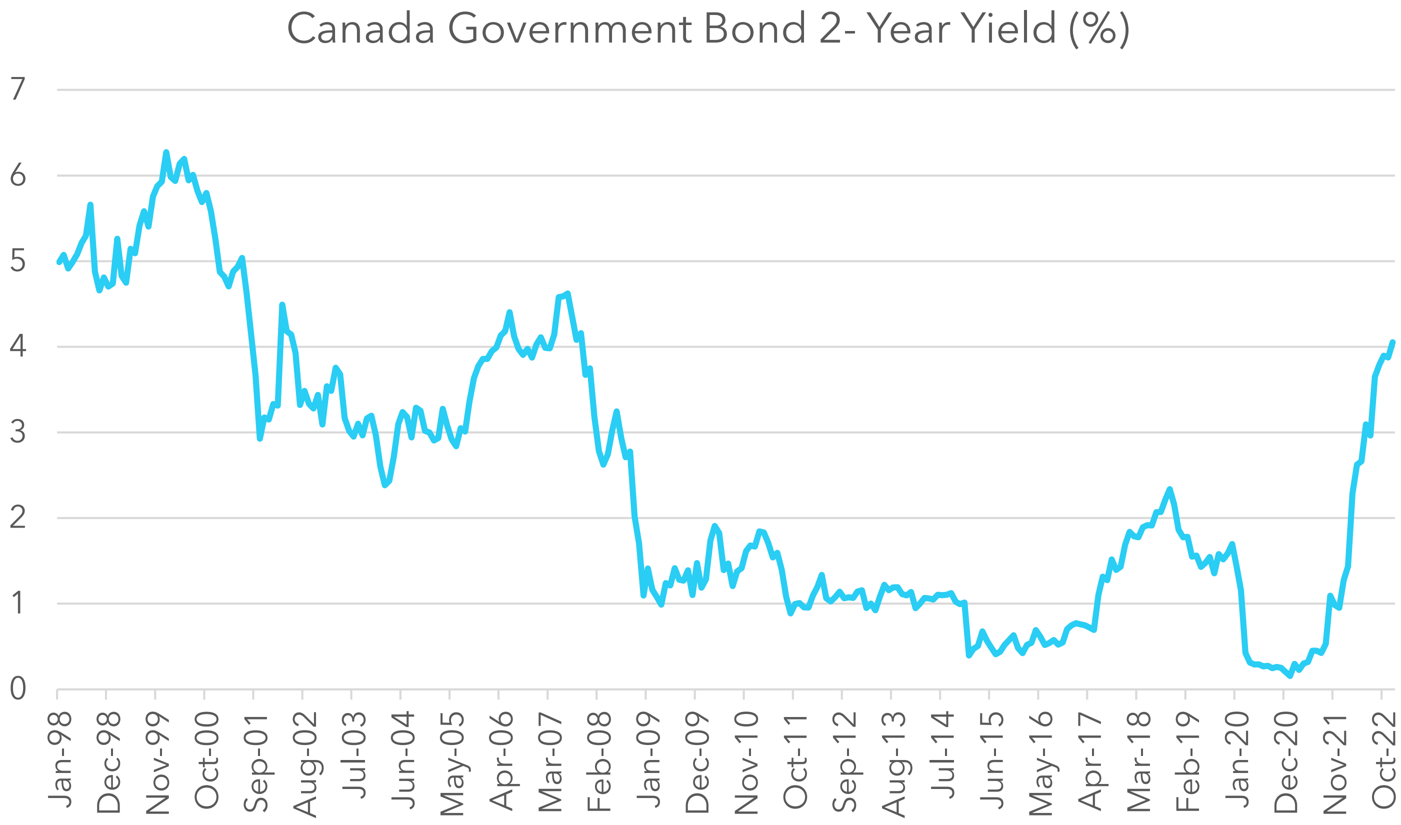
Bond Yields

The bond yield curve shows the yield on government bonds of different maturities. Typically, yields on longer-term bonds are higher than short-term bonds to compensate investors for the additional risk and uncertainty of a longer holding period. Currently, yields on 2-year government bonds are substantially higher than those on longer dated bonds, a rare occurrence which is known as an “inverted yield curve.”

This suggests that investors are expecting interest rates to be lower in the future than they are today. An inverted yield curve is considered a predictor of an upcoming recession for several reasons, including that lower future interest rates suggest upcoming rate cuts by the central bank, which typically occurs during a recession. In the present scenario of high inflation, it may also suggest that the market is expecting inflation to cool down in the short-to-medium term, at which point the higher interest rates of today will no longer be required.



Historical Bond Yields



Interest rates and bond yields have risen substantially over the past two years. This has been painful for bond investors, but the good news is that investing in bonds is likely to be far more profitable going forward.

As bond prices have fallen, their yields have risen. For very little risk, buyers of the 2-Year Government of Canada Bond can earn a yield of around 4% today, the highest the yield on this bond has been since 2007.

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 Source: Bloomberg, OceanFront Investment Counsel Inc.

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