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# CHARTBOOK
## Market Comment

Prepared by OceanFront Investment Counsel Inc.

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# Market Comment

Last week, the Bank of Canada announced a 25 basis point hike to their overnight interest rate, as was expected. More importantly, the bank announced a "pause" to the rate hiking policy. The bank will assess the impact of their previous hikes, the economy's strength, and the inflation level before making any more changes to their interest rate. It is, therefore, possible that this is the peak in the Bank's policy interest rate.

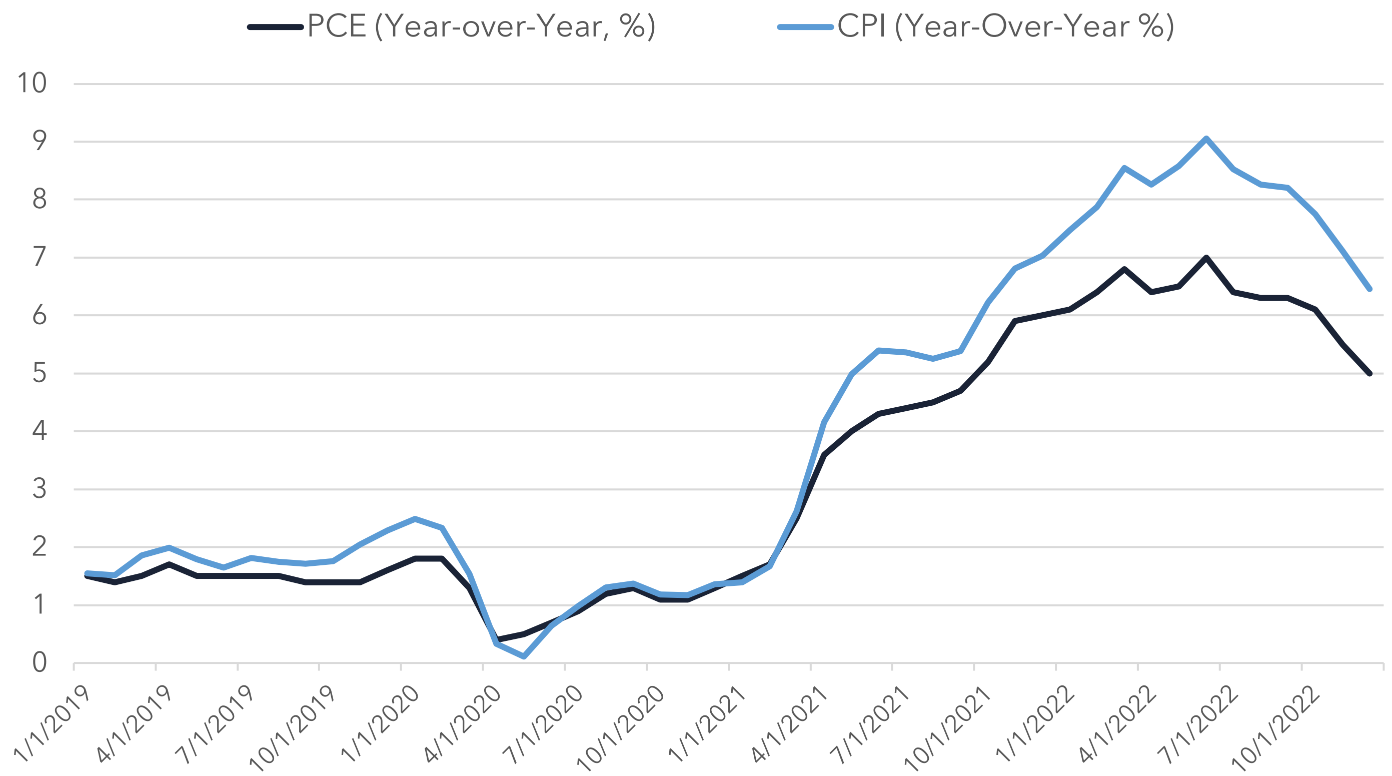
The Bank commented that it is projecting a dramatic decline in inflation in 2023: "Inflation is projected to come down significantly this year. Lower energy prices, improvements in global supply conditions, and the effects of higher interest rates on demand are expected to bring CPI inflation down to around 3% in the middle of this year and back to the 2% target in 2024."

The Bank also commented that despite higher interest rates dragging on the economy, growth remains strong: "The Bank estimates Canada's economy grew by 3.6% in 2022, slightly stronger than was projected in October. Growth is expected to stall through the middle of 2023, picking up later in the year. The Bank expects GDP growth of about 1% in 2023 and about 2% in 2024, little changed from the October outlook."

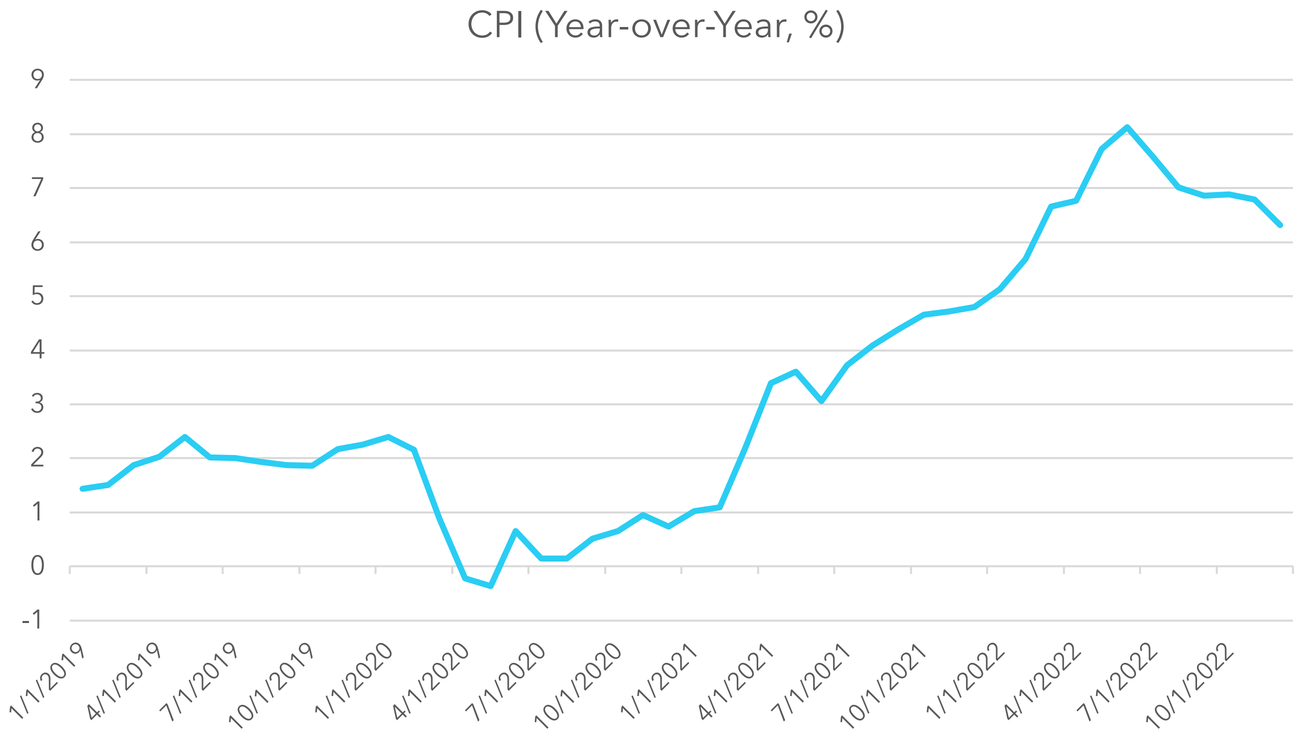
So we continue to have strong economic growth, strong corporate earnings, and strong employment with much higher interest rates as inflation is steadily declining. These facts are all consistent with a "soft landing" scenario where inflation returns to a normal level without a significant increase in unemployment. The key to this is and will continue to be if inflation can remain at a reasonable level without future flare-ups.

# Inflation – USA

Personal Consumption Expenditure (PCE), the Federal Reserve's preferred measure of inflation, recently measured at 5.0%, falling 2% from the high of 7% in June.  Consumer Price Index inflation is on the same trend.



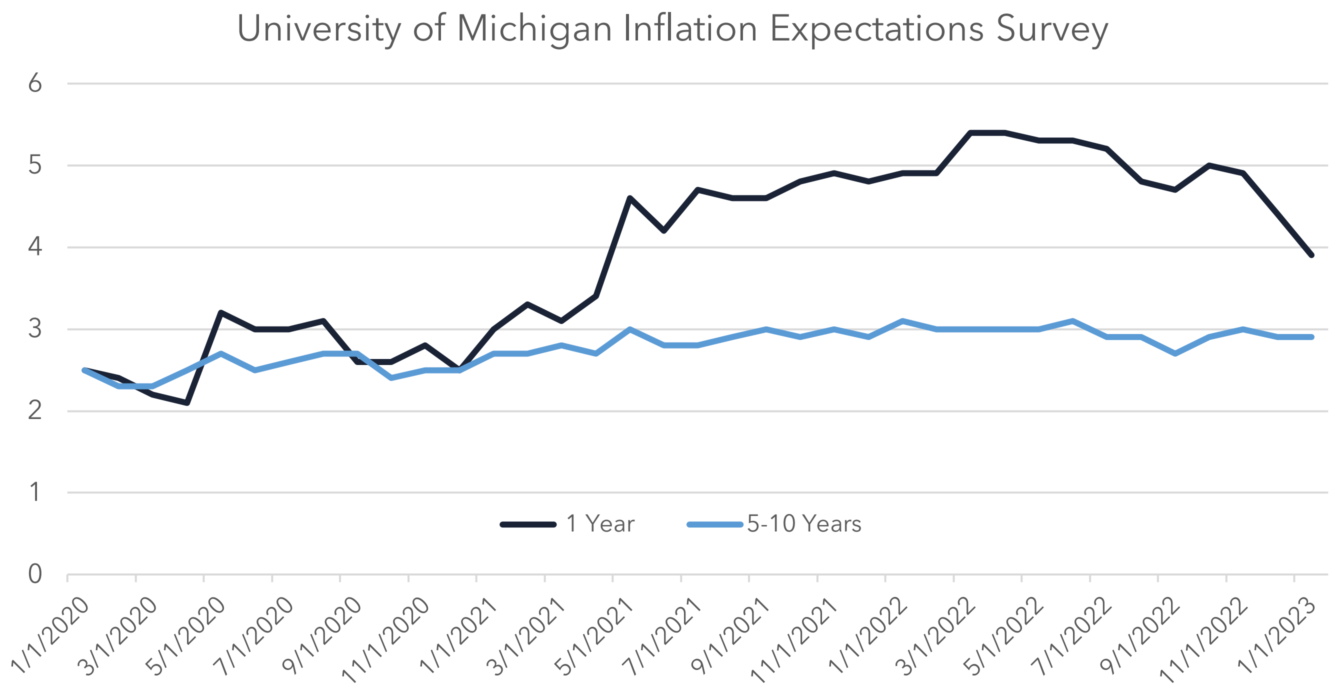
# Inflation - Canada




Inflation in Canada has fallen from over 8% to 6.3%.

# Inflation Expectations

Inflation expectations are a key driver of realized inflation.  Long-term inflation is expected to hover around 3%, while short-term expectations have been falling dramatically.



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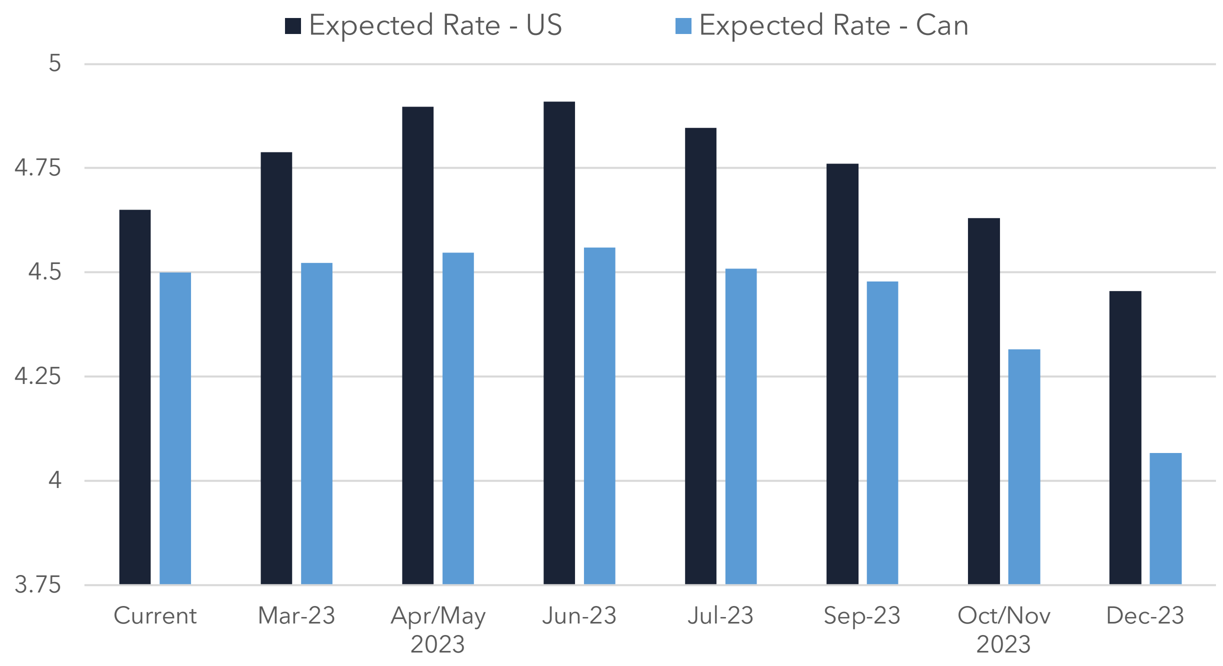
# Interest Rate Expectations

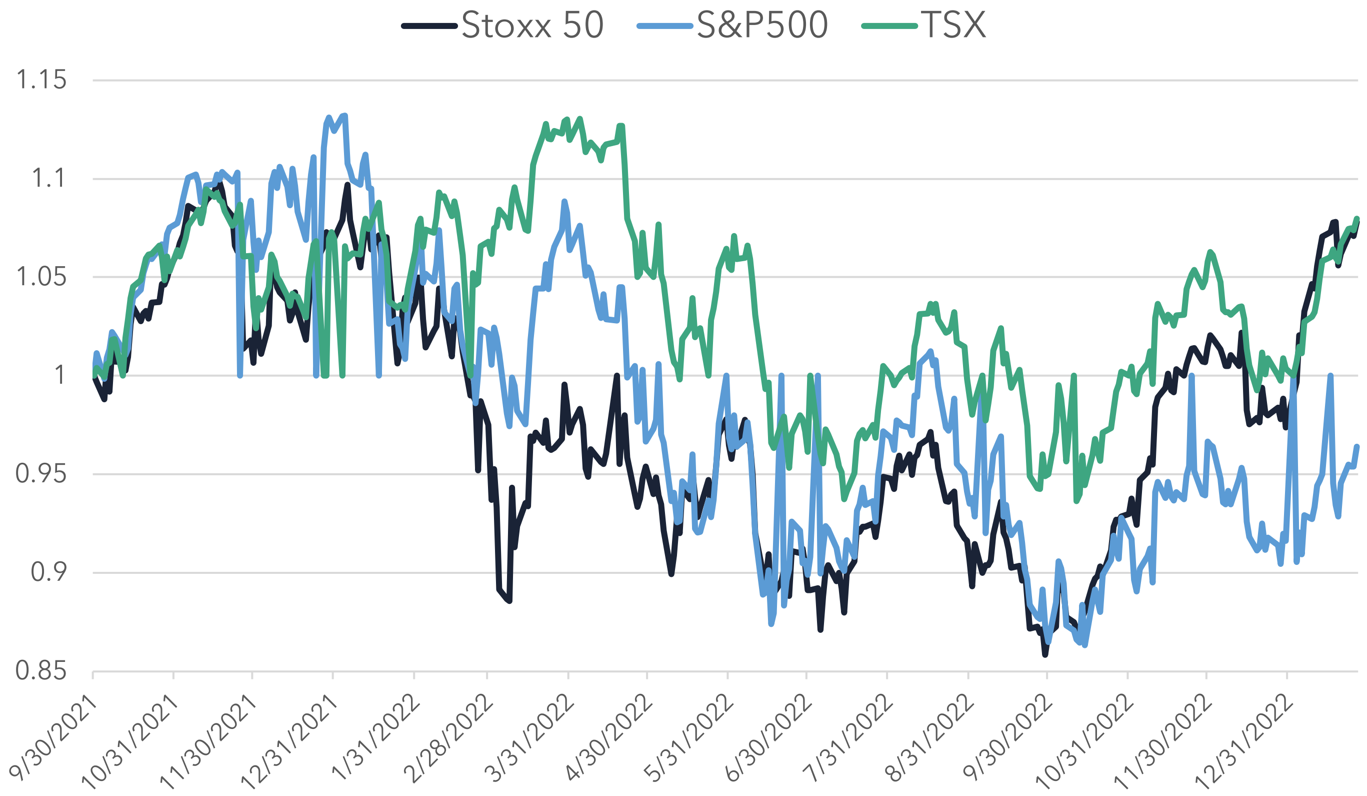
Market interest rate expectations are pricing in no further hikes from the Bank of Canada in 2023 and, surprisingly, pricing in one or two rate cuts by the end of the year. It's hard to imagine a scenario where rates are cut by the end of the year unless there is a recession.

The Federal Reserve is projected to reach a peak of just under 5% in the US with its policy rate. Similar to Canada, markets are pricing in a rate cut or two from the Fed by the end of the year.




Data as of January 30, 2023

# Index Returns




Lately, US stocks (represented by the S&P500 in the chart) have been underperforming their peers in Canada (TSX) and Europe (Stoxx 50). Dating back to the 4th quarter of 2021, Canadian and European stocks are up about 7%, while US stocks are down about 4%.



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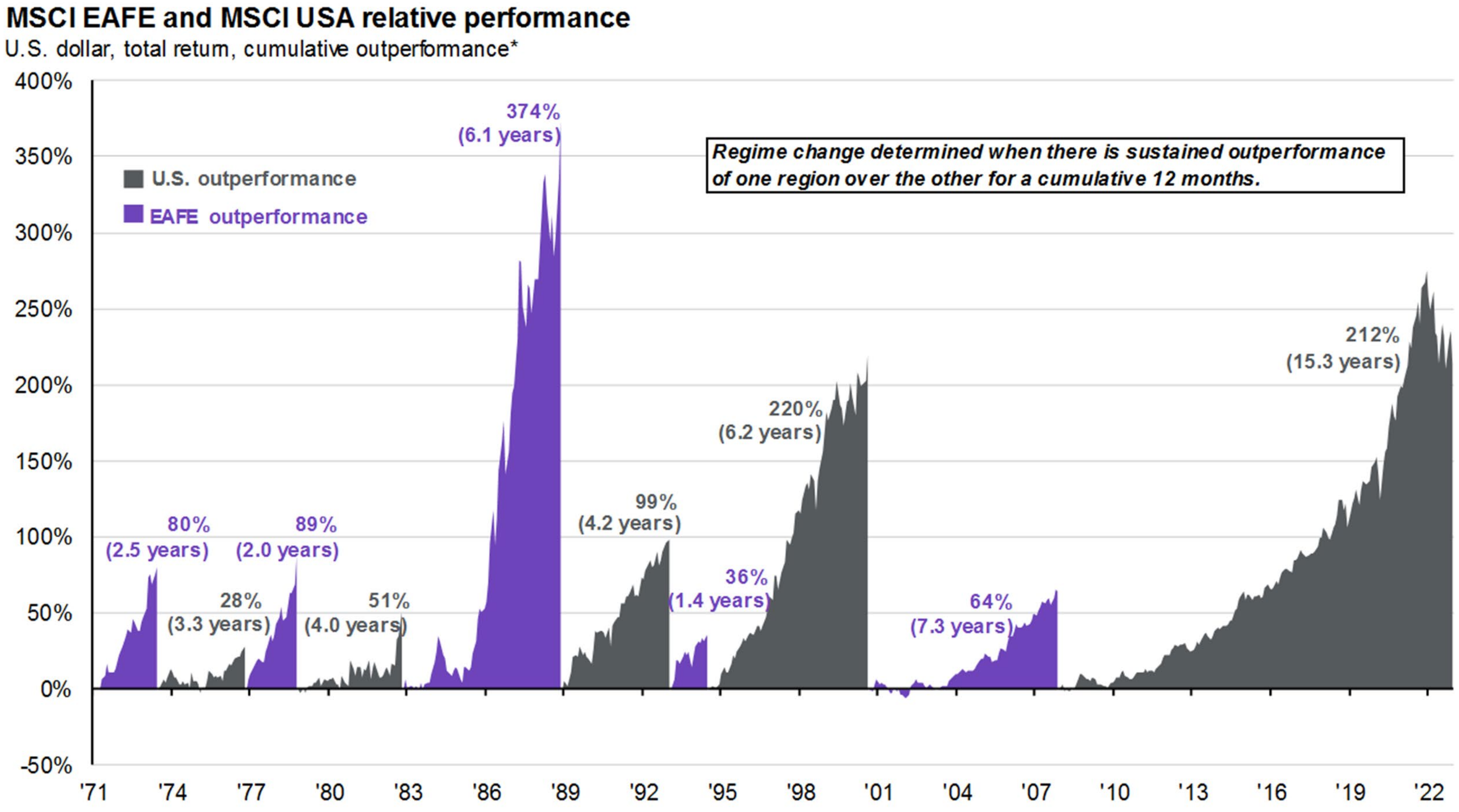
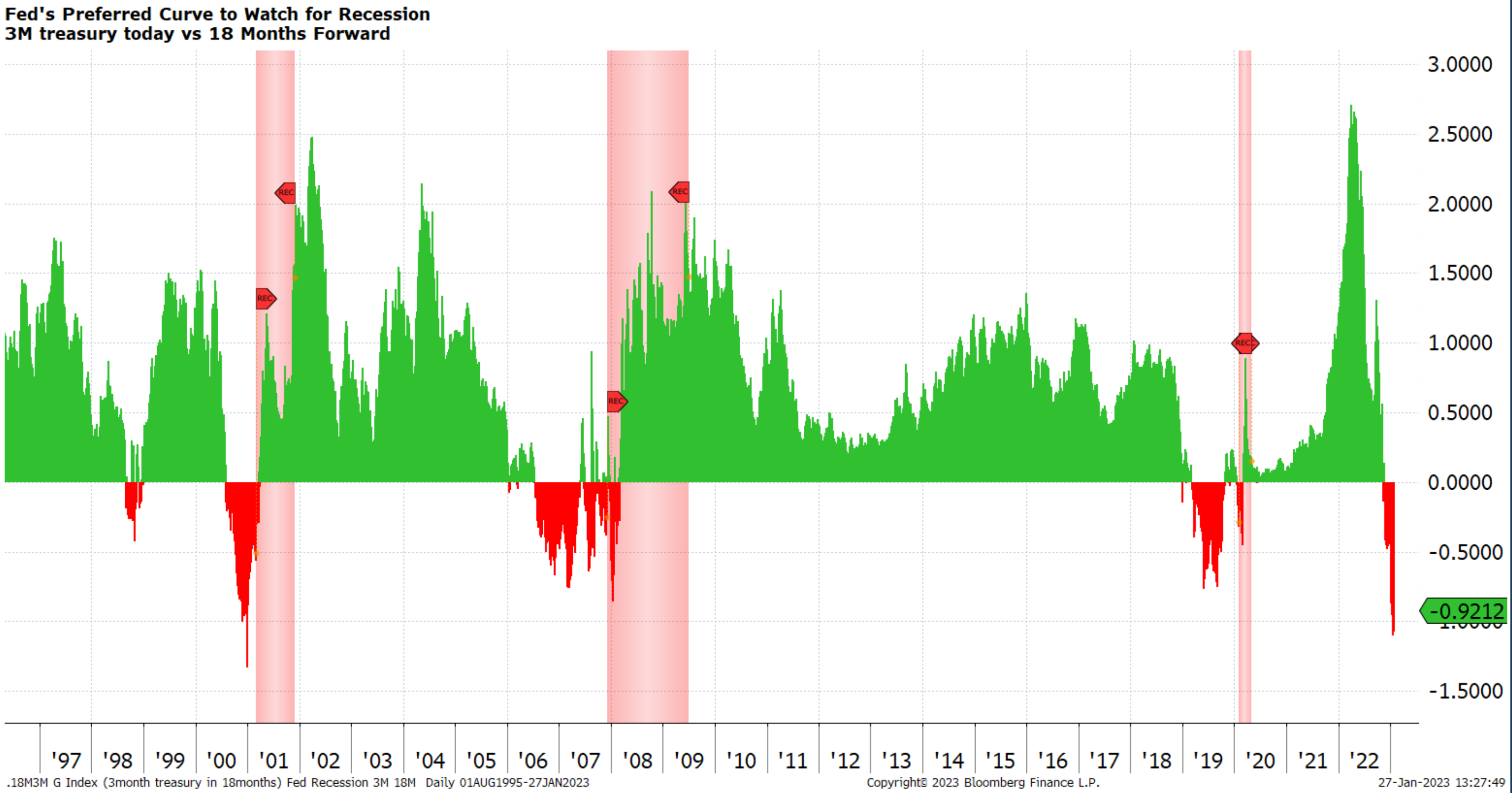
# USA Versus EAFE Performance

Historically, stock markets have seen cycles where certain regions outperform others for a sustained period of time.  The US has recently outperformed the EAFE region (developed markets of Europe, Australasia, and the Far East) for over 15 years.  Perhaps the recent underperformance of US stocks is the beginning of a new trend.




 Source: JP Morgan Asset Management, OceanFront Investment Counsel Inc.

# Recession Forecast




The Federal Reserve's preferred yield curve model is predicting a recession. A negative spread between the 3-month US Treasury Yield today and the 18-month forward yield has historically preceded recessions (red-shaded areas of the chart).



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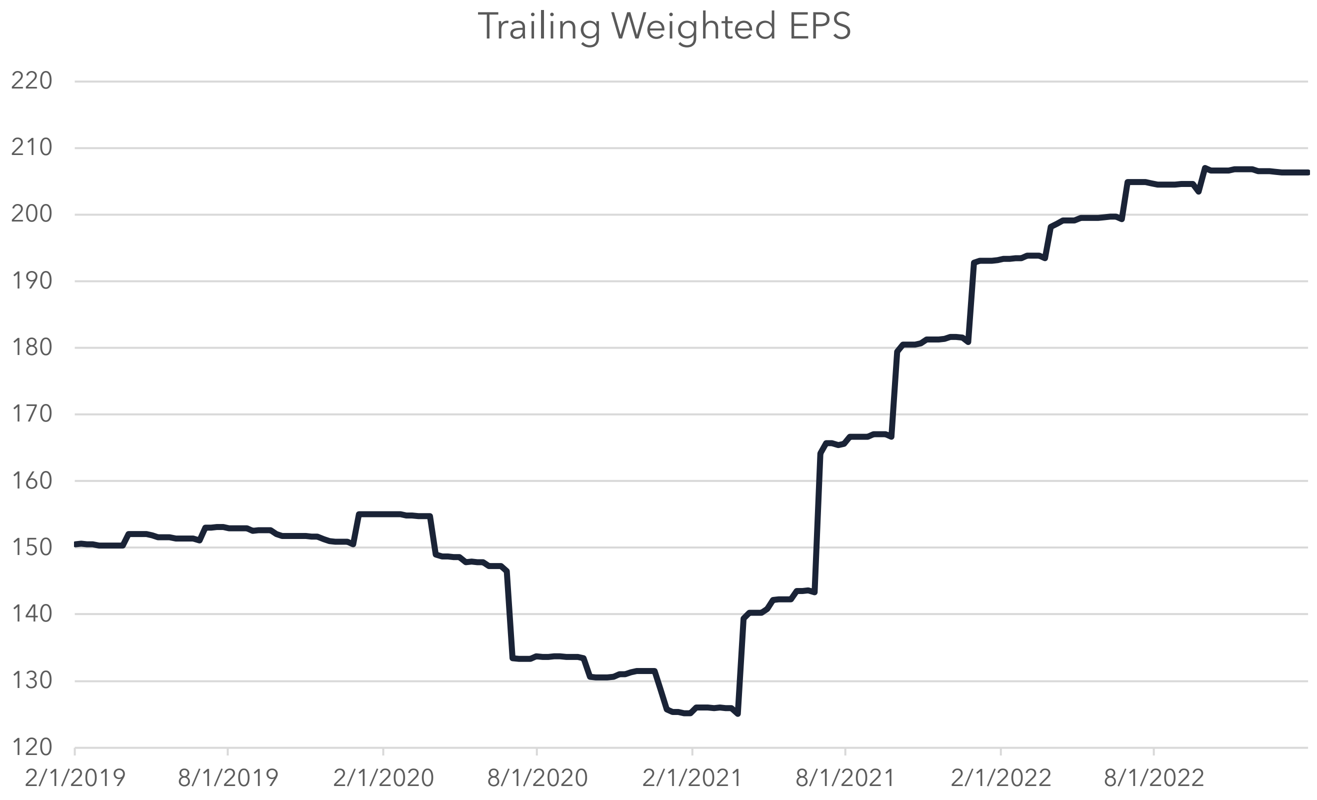
# S&P500 Earnings

Despite recession predictions and the substantial drop in stock prices, which typically precedes an economic recession or slowdown, we are yet to see a material decline in earnings among S&P500 companies overall.



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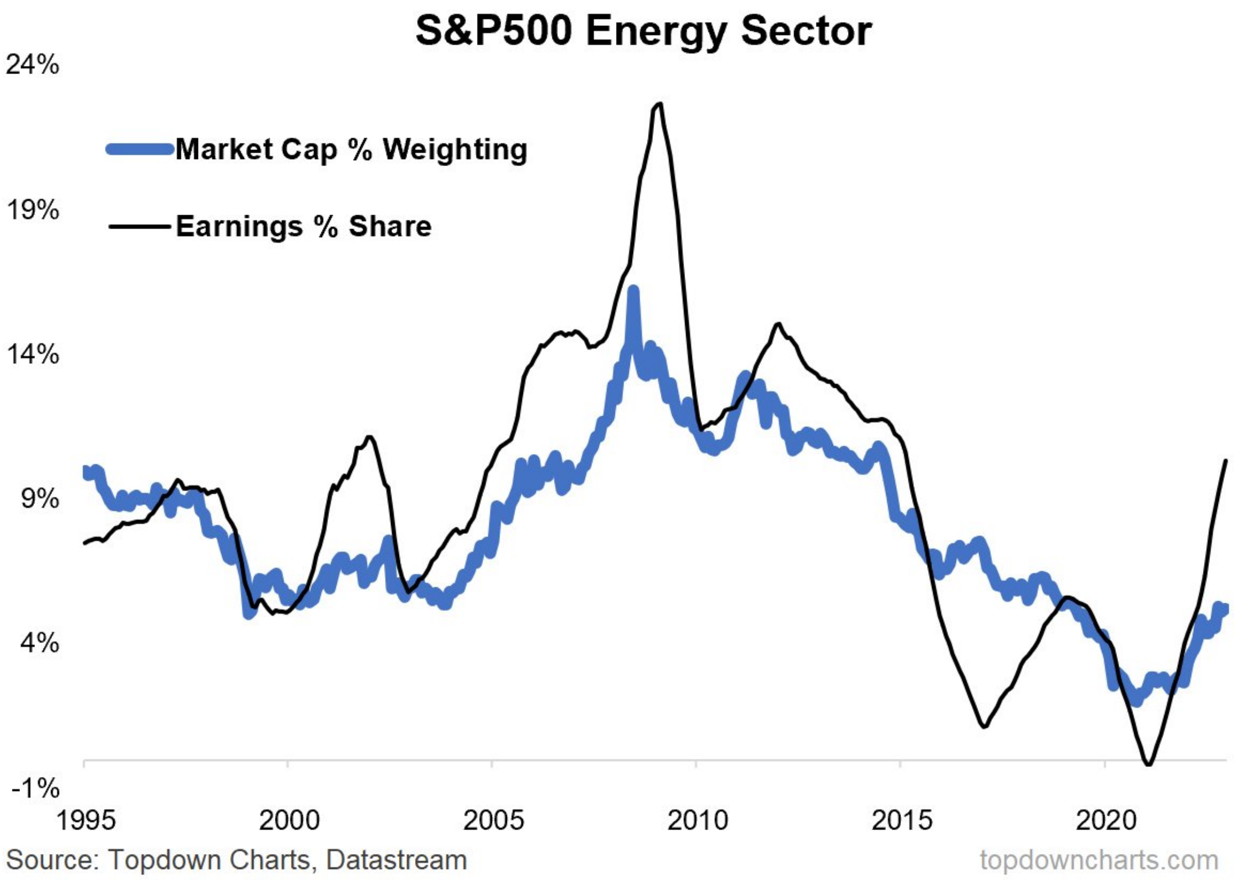
# Energy Sector




This chart shows the percent of total earnings of S&P500 companies that are represented by companies in the energy sector and the market value of the energy sector as a percent of the total S&P500 market value.

There is a substantial disconnect between earnings and the market value of the energy sector here. There are several possibilities for why this may be, including:

1. Energy stocks have more upside potential as prices catch up to earnings.
2. The market is discounting a slowdown in earnings or a recession.
3. The energy sector is out of favor with investors, perhaps due to ESG concerns.

At this time, energy companies are among the most profitable and cash rich in the world. Chevron recently announced it plans to buy back US$75 billion of its own stock, which is more than the entire market value of the Bank of Nova Scotia.

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## E&OE





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