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CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment: July 2023

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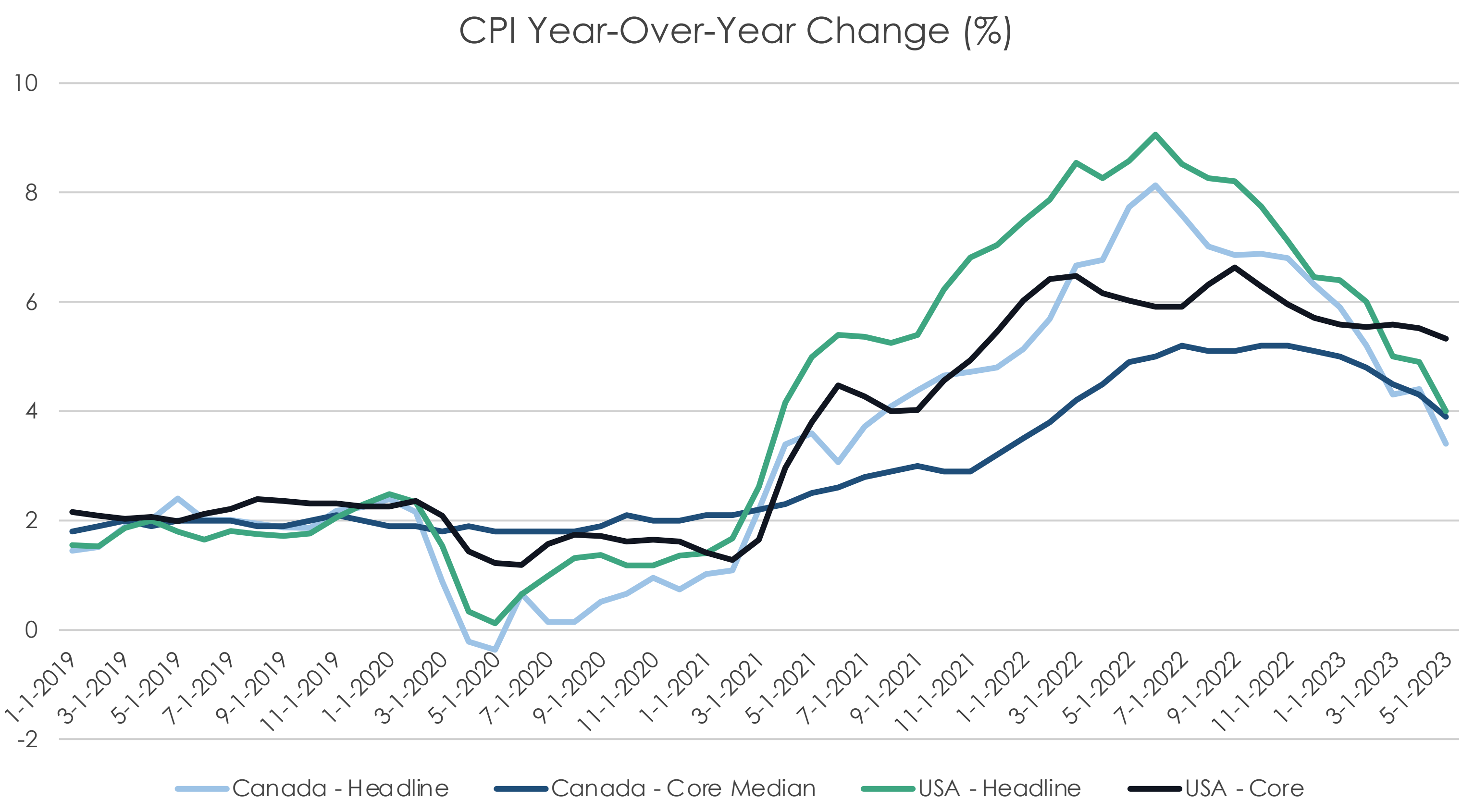
Market Comment

The Bank of Canada (“BoC") and the Federal Reserve (“Fed”) each met in June, the BoC raising its policy interest rate by 25 basis points and the Fed electing to make no change. However, the Fed indicated that it believes one or two more hikes will be required this year, and the BoC also indicated that further rate hikes may be necessary.

Since the rate hiking cycle started last year, markets have consistently been pricing in rate cuts from each central bank 6-12 months or so into the future, despite the communication from the central banks that rates will need to be “higher for longer”. Whom to believe, the market or the central banks? No one knows the future, so the correct answer is unknowable. We do know that central banks have been wrong many times in the past, it’s difficult for them to forecast what their own actions will be, and circumstances can change in unpredictable ways, which they will react to. In any case, we know that rates are likely to remain high relative to the recent past until inflation is stabilized.

There is much talk about the potential for an upcoming recession, with many pundits and models predicting that a recession is imminent. It is certainly difficult to predict, and we can’t know the future. What we can do is focus on identifying the most attractive investments today relative to the risks they face.

Inflation



 Source: Bloomberg, OceanFront Investment Counsel Inc.

Recent data in the US and Canada showed YoY CPI headline inflation of under 4% in each country. Core inflation, which strips out volatile energy and food prices, has been higher than headline inflation, particularly due to the effect of energy prices which have dramatically declined since early last year.

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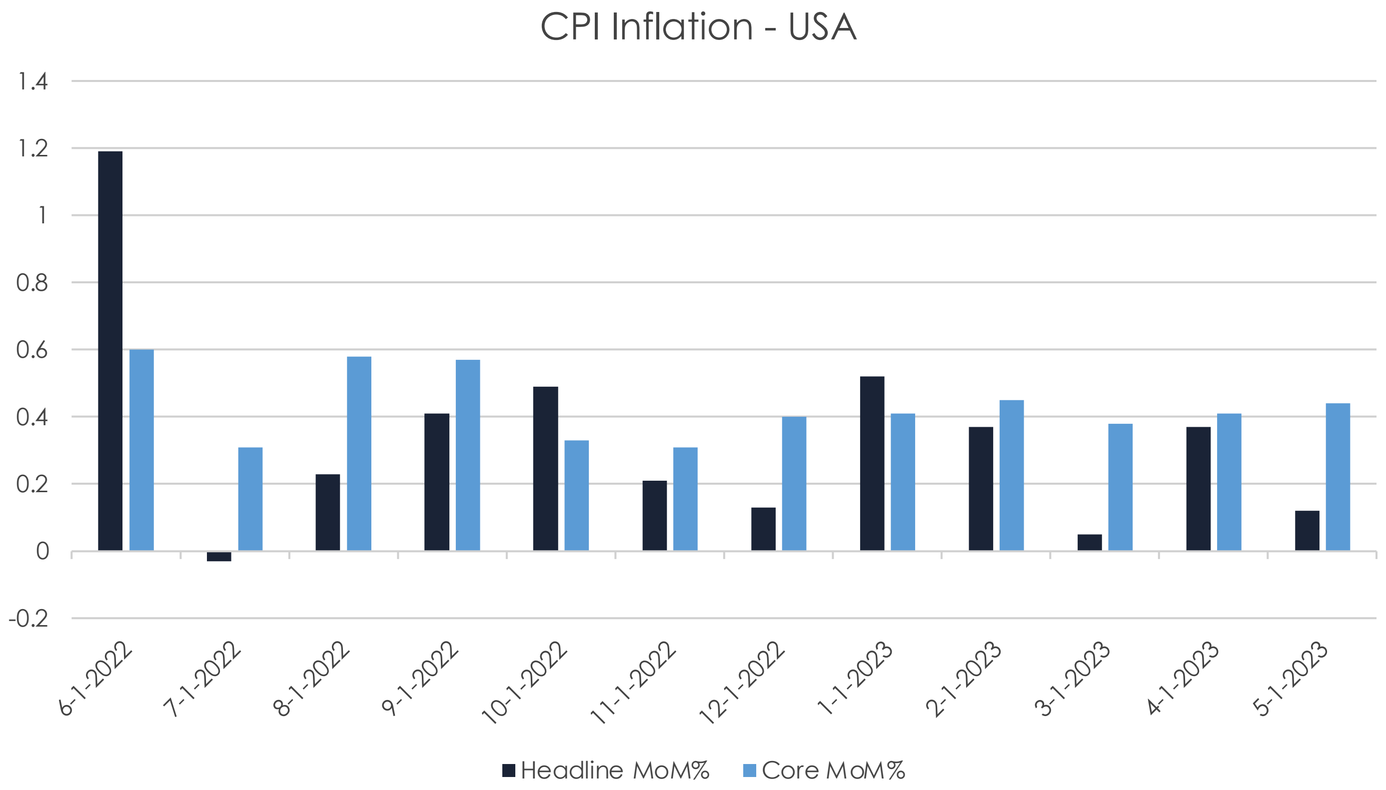
Inflation - USA

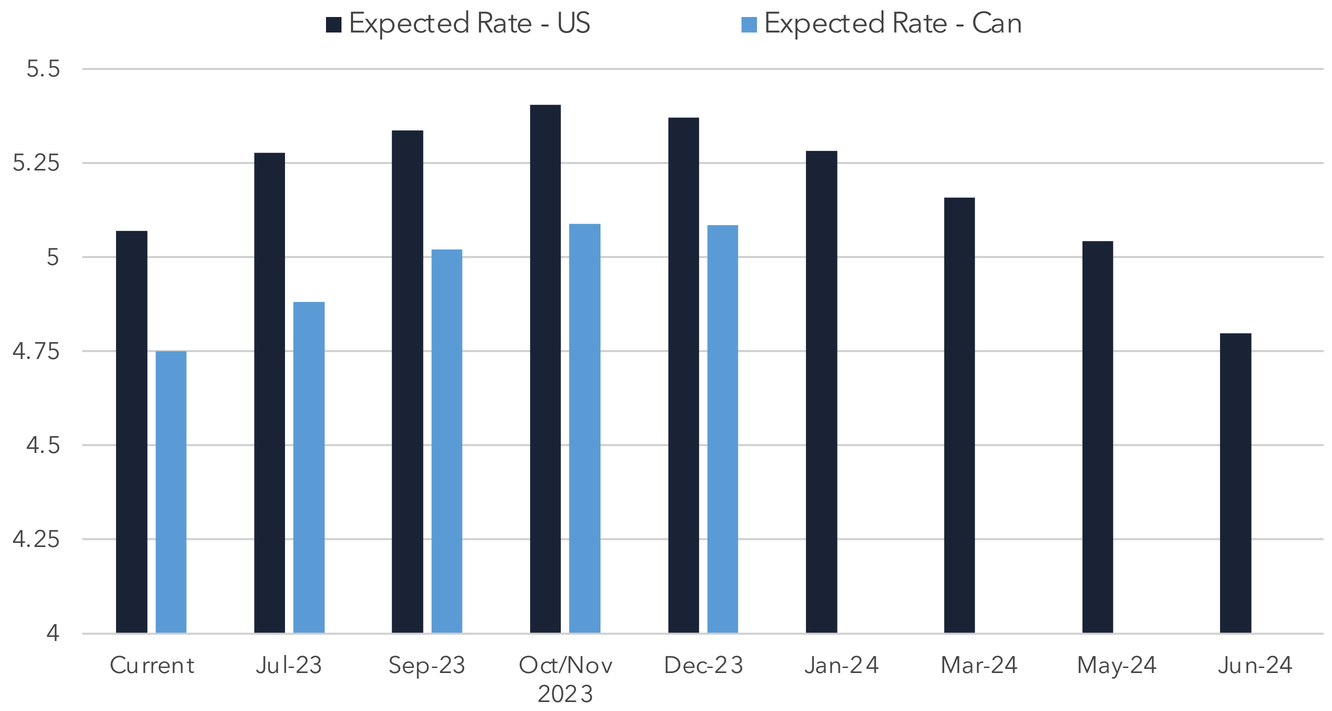


Looking at monthly inflation, the upcoming data for June 2023 should further improve the annual number as the large June 2022 reading falls off the calculation. However, after June it will become much more difficult to lower the 12-month inflation number as there are no remaining large, outlier monthly numbers in the previous 12 months.

 Source: Bloomberg, OceanFront Investment Counsel Inc.

Interest Rate Expectations

The market still expects at least one rate cut from the Fed in early 2024, following an increase of 25-50 bps into the end of 2023. As previously referenced, this contradicts the guidance from the Fed that rates will remain high.



Data as of June 30, 2023

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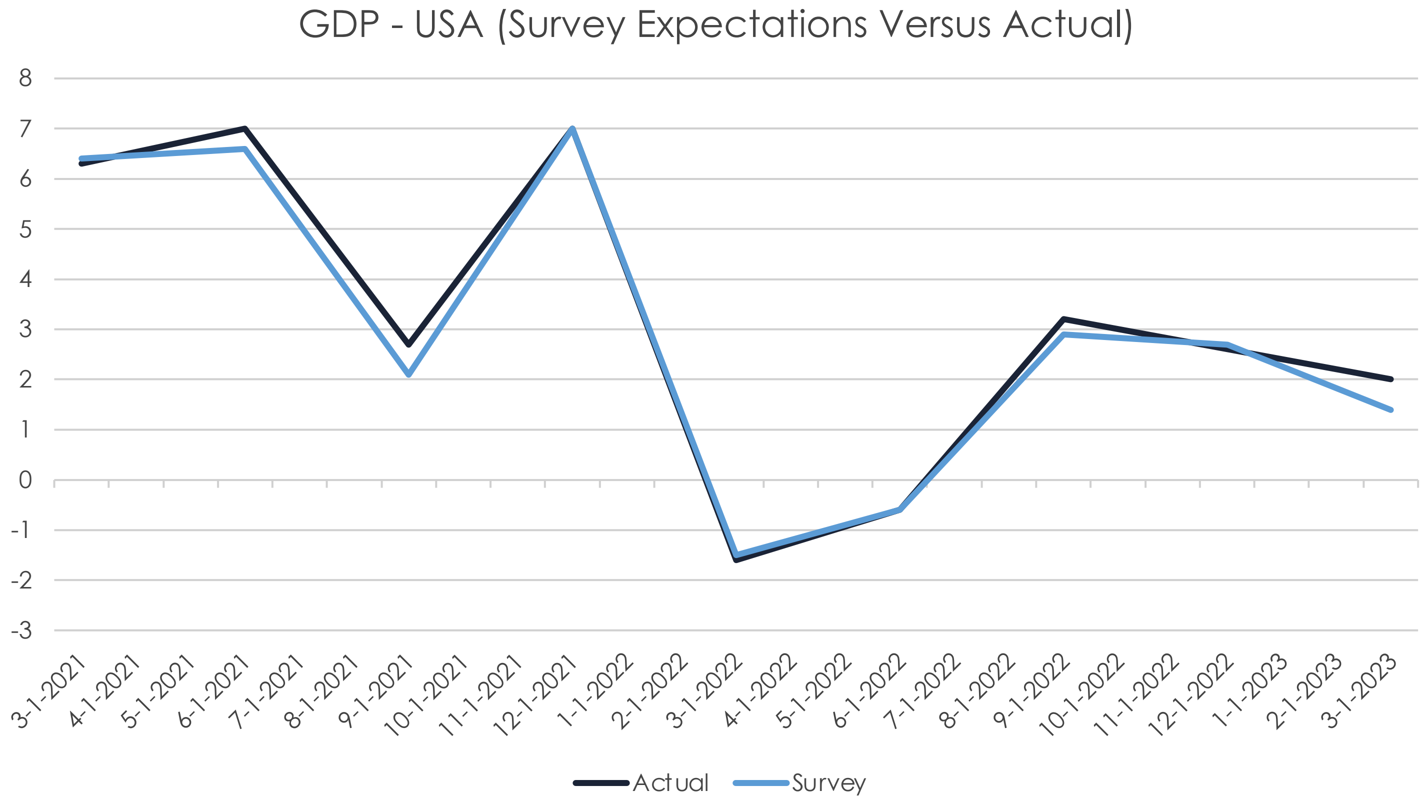
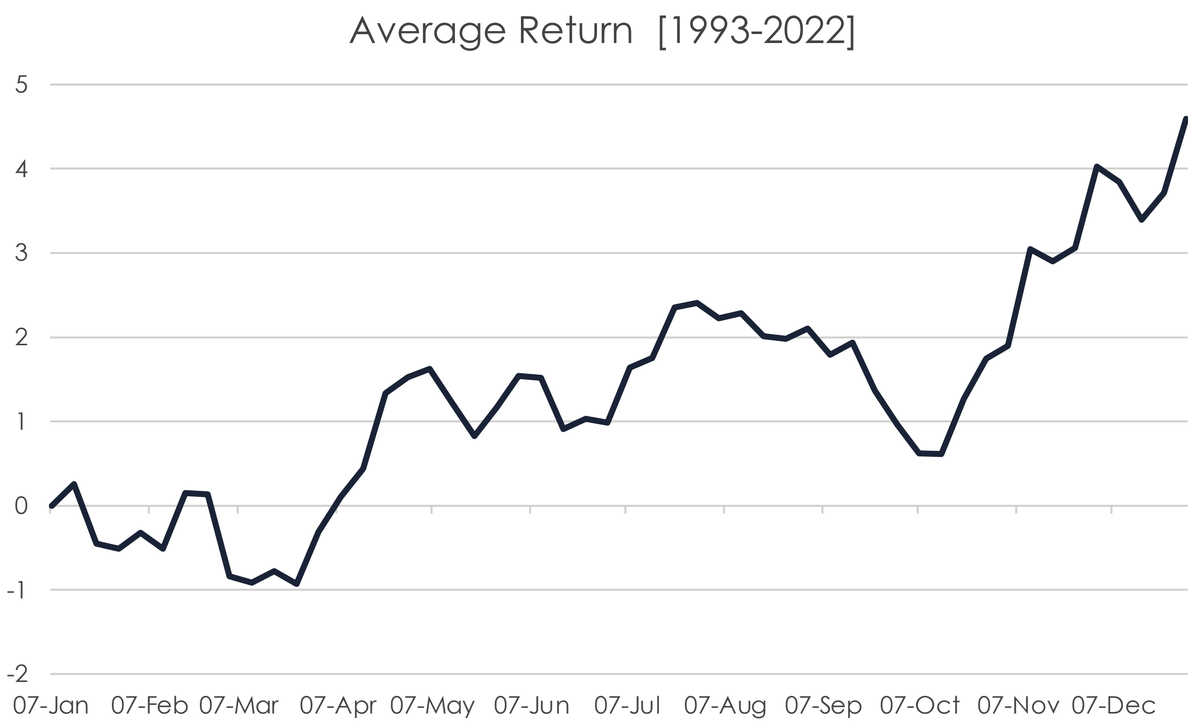
GDP – USA



This chart shows the actual GDP measurements against the survey of expectations from economists. You can see that the most recent data came in about 0.5% higher than expectations (2% versus 1.5% expected). The economy has continued to surprise in its resilience to higher interest rates.

Seasonality – MSCI World Index



The average returns of the MSCI World Index for the past 30 years show the seasonal tendency of global stock markets. The second half of the year, from July onwards, tends to see positive returns historically.

 Source: Bloomberg, OceanFront Investment Counsel Inc.

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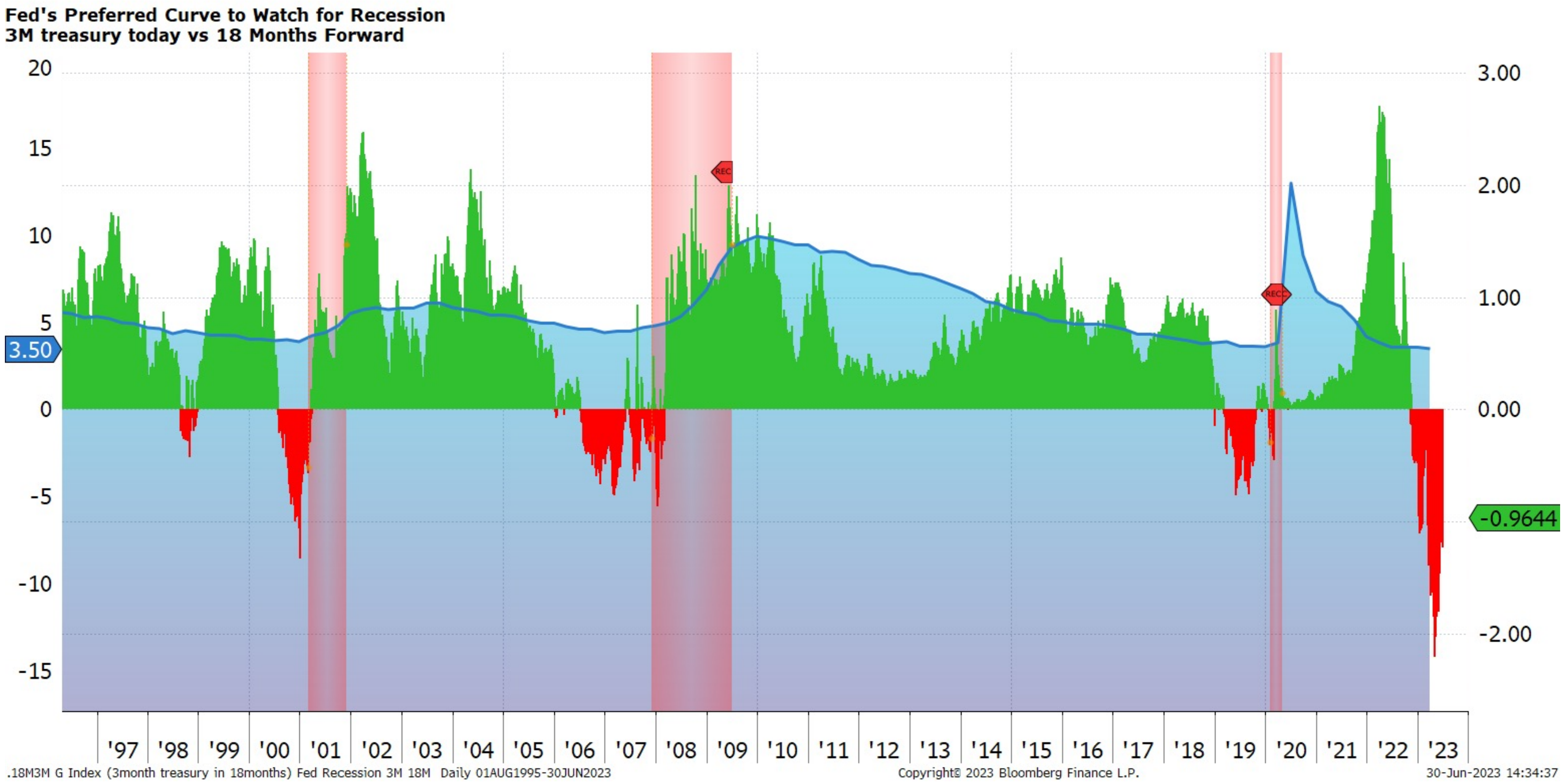
Recession Model



This chart shows the Federal Reserve's preferred recession forecast model. It is based on the spread between the 3-month T-bill rate and the 3-month T-bill rate 18 months forward. It is currently deeply negative (red), which means the market expects future interest rates to be significantly lower than today, which is generally what occurs in a recession when central banks cut rates to stimulate the economy. The red-shaded areas show where recessions occurred (2001, 2008/09, 2020). So far, we have no recession.

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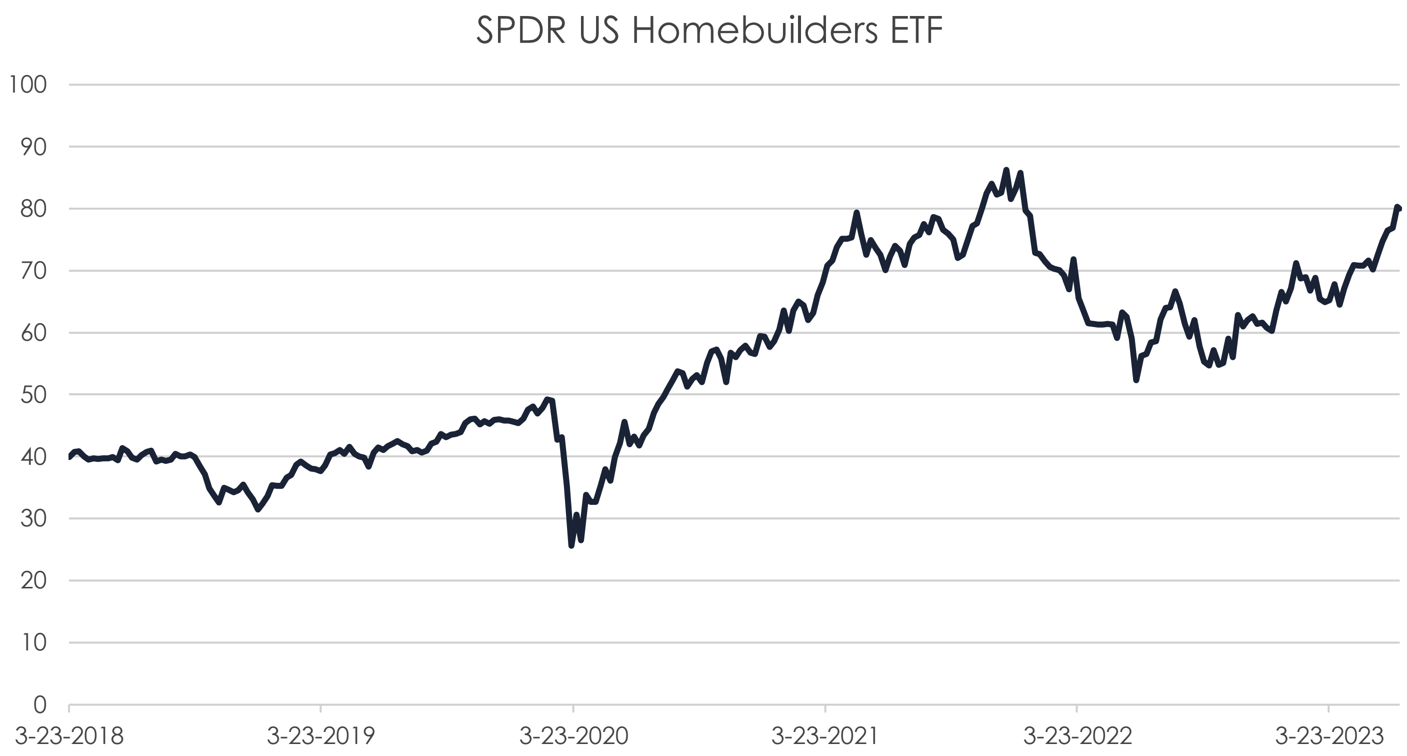
Homebuilder Stocks

Homebuilders, one of the most economically sensitive areas of the economy, have been performing very well of late, approaching their highs set in 2021. This generally reflects economic strength rather than the weakness one might expect if the economy were headed into a recession.



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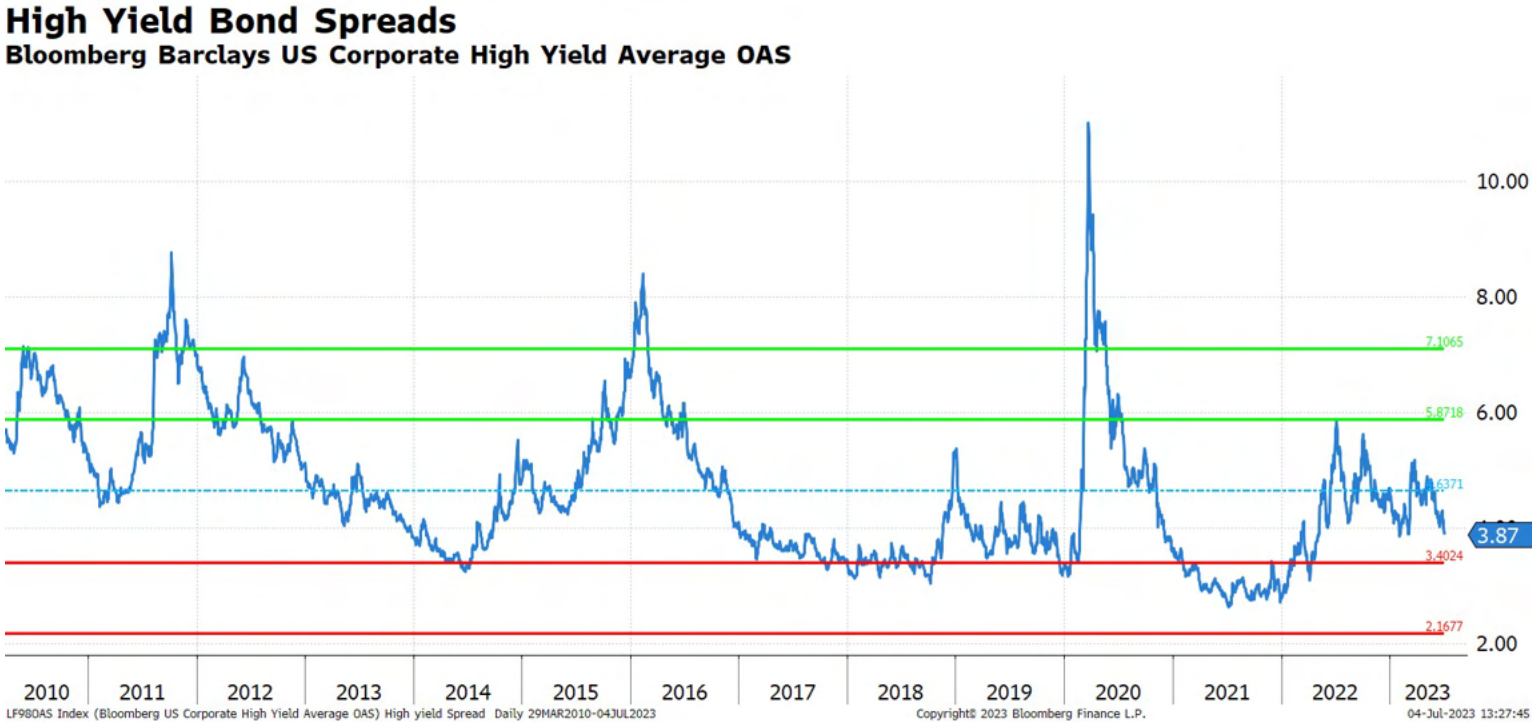
US High Yield Bonds



High yield bond spreads tend to be a leading indicator of the economy, as these risky bonds begin to see poor performance as the economy starts showing weakness. We are not seeing that today, as they remain slightly expensive relative to their long-term average.

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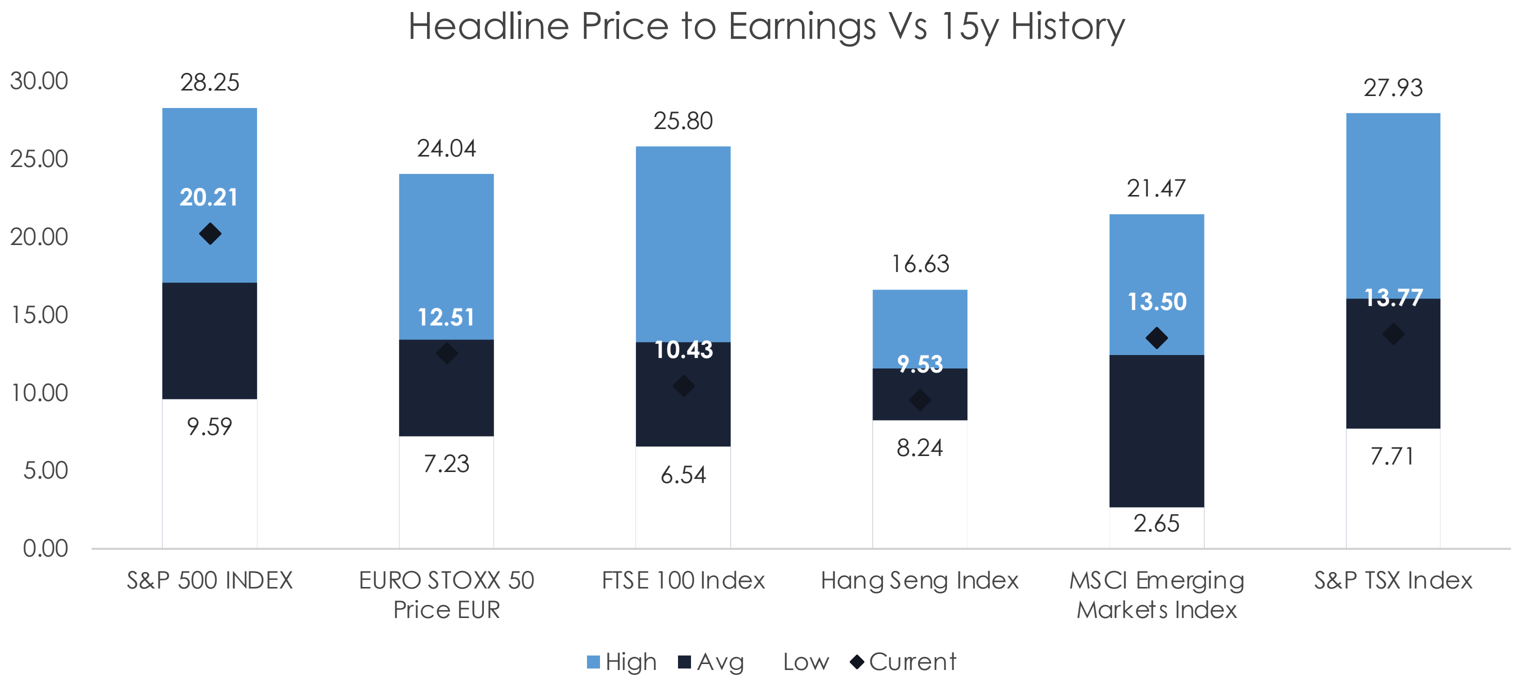
 Source: Bloomberg, OceanFront Investment Counsel Inc.

P/E Ratios by Market

Looking at valuations of markets by region we can get an idea of what is relatively expensive and what is relatively cheap. Relative to their 15-year average P/E ratio, the US is the clear outlier, much more expensive than the rest. This is likely to be a headwind for US stocks in the future, as they have been popular buys in recent years which is reflected in the price.



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