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CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment: August 2024

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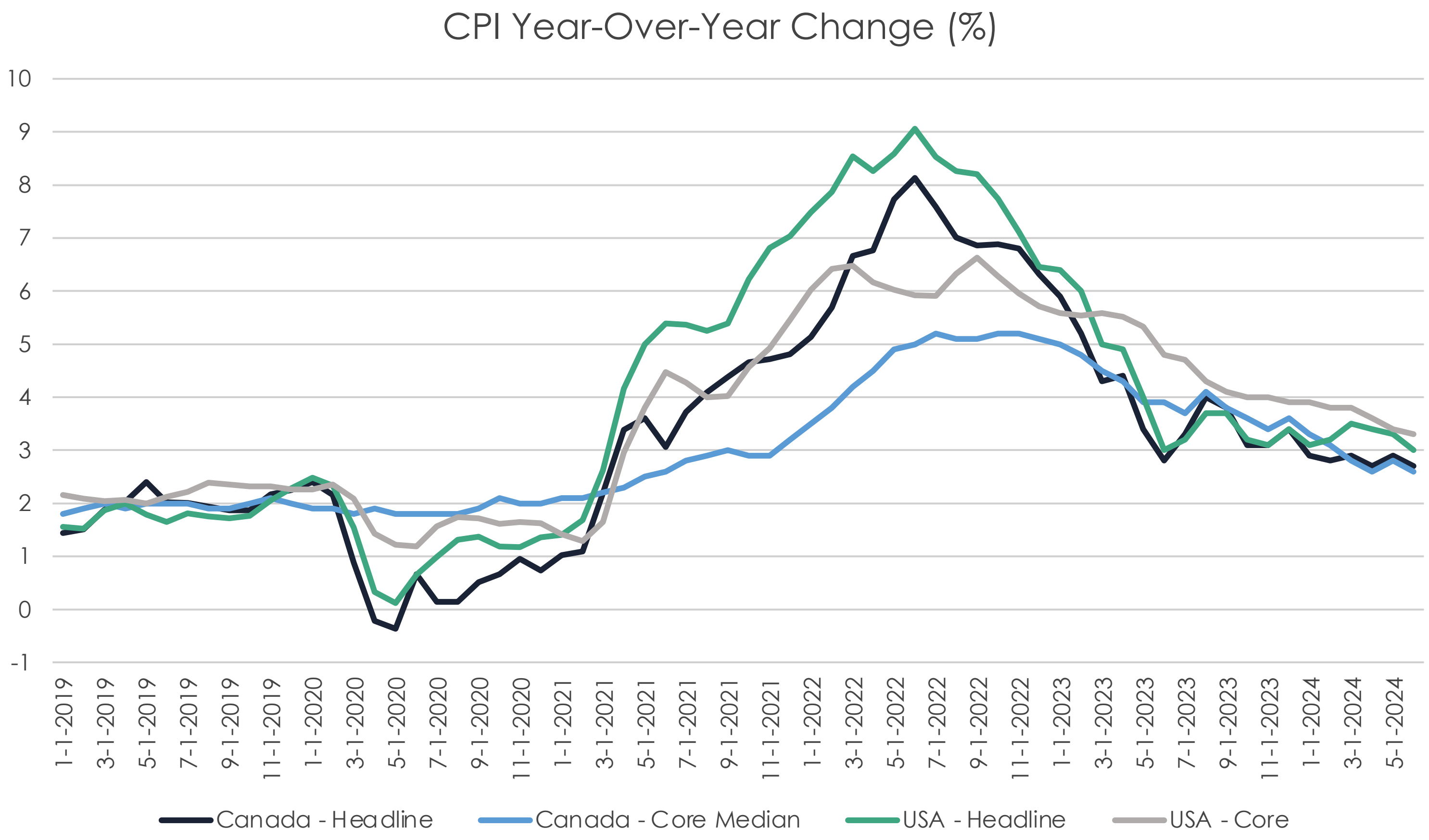
Market Comment

Last week, the Bank of Canada ("the Bank") announced a 25 basis point cut to its overnight policy interest rate, bringing the rate to 4.5%. In its announcement, the Bank noted that growth has moderated across major economies and a slowdown has materialized in the United States. Inflation has also moderated although is still above target levels in most major economies.

The Bank commented on the Canadian economy, saying that GDP growth for the first half of the year will likely be around 1.5%. Due to population growth, excess supply has increased while demand has been weak. Unemployment has risen to 6.4% and is growing at a lower rate than the population. Thus, there is slack in the economy that should help dampen inflation.

Lower rates will be a welcome sight for mortgage holders in Canada, especially those needing to refinance soon. According to CMHC, 45% of all outstanding mortgages in Canada will come up for renewal in 2024 and 2025. Most of these mortgages would have been initiated at much lower interest rates, so there will likely be a big payment shock upon refinancing which will eat into disposable income for these borrowers. Ideally, the Bank of Canada would like to get ahead of the negative effects of these refinancings by getting rates significantly lower over the next year or so. Whether they will be able to do so depends on the path of inflation and the economy.

Inflation



The latest inflation data was constructive, coming in below expectations. This is a positive development which will very likely lead to further rate cuts should it continue.

 Source: Bloomberg, OceanFront Investment Counsel Inc.

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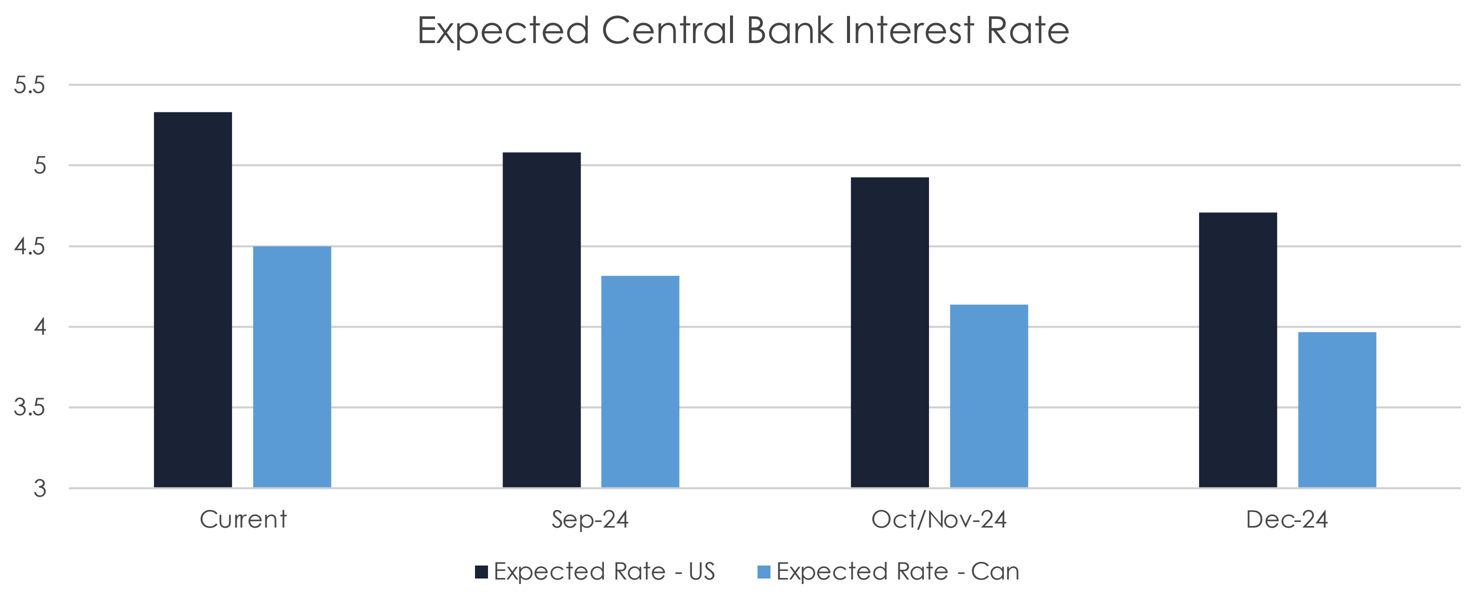
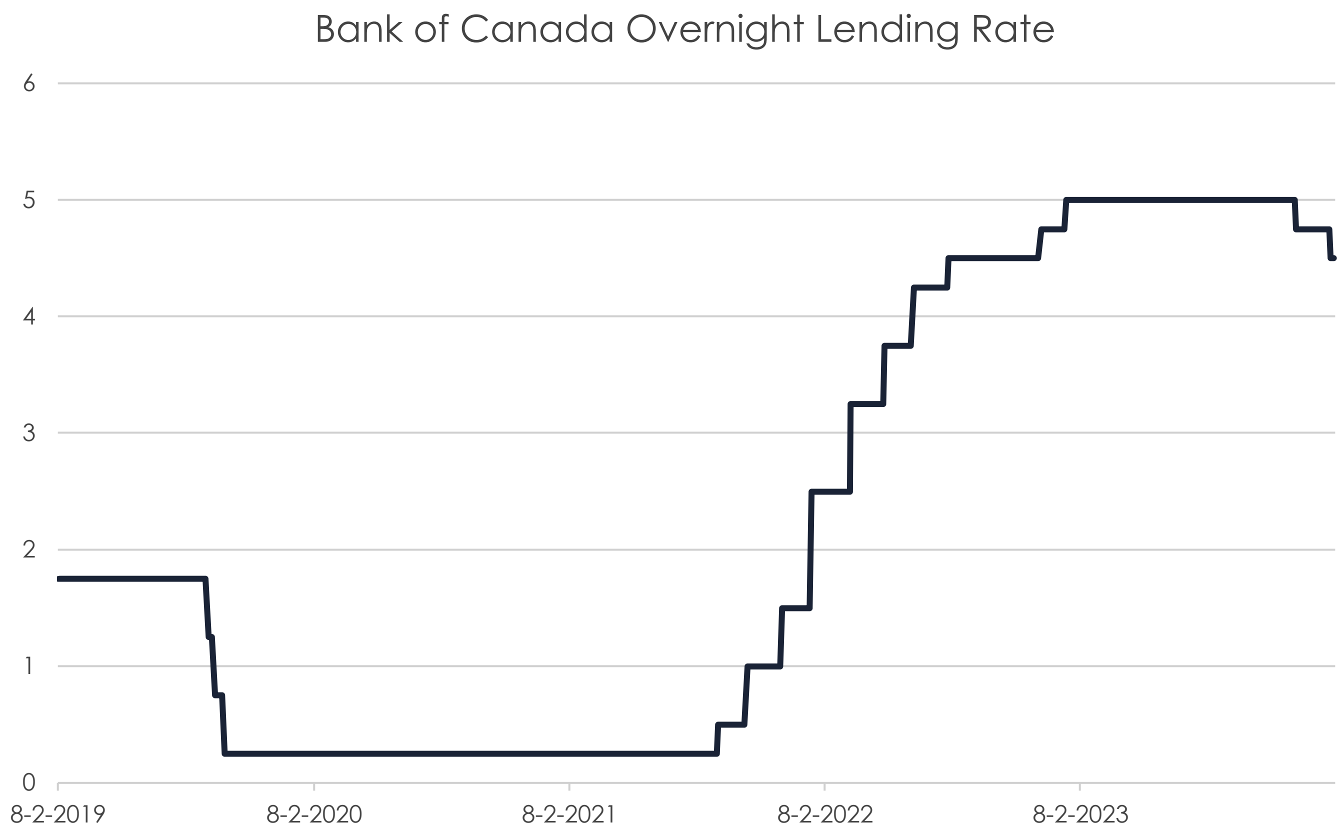
Interest Rate Expectations

Markets are now pricing in a year-end interest rate of 4% from the Bank of Canada, and 4.75% from the Federal Reserve.



Data: Overnight Index Swap markets as of June 27, 2024

Bank of Canada Overnight Rate



The first two cuts of this cutting cycle are in, with potentially several more to come. It seems unlikely that we will see rates reach pre-COVID levels due to the higher inflation present in the economy today compared to the low inflation environment from back then.

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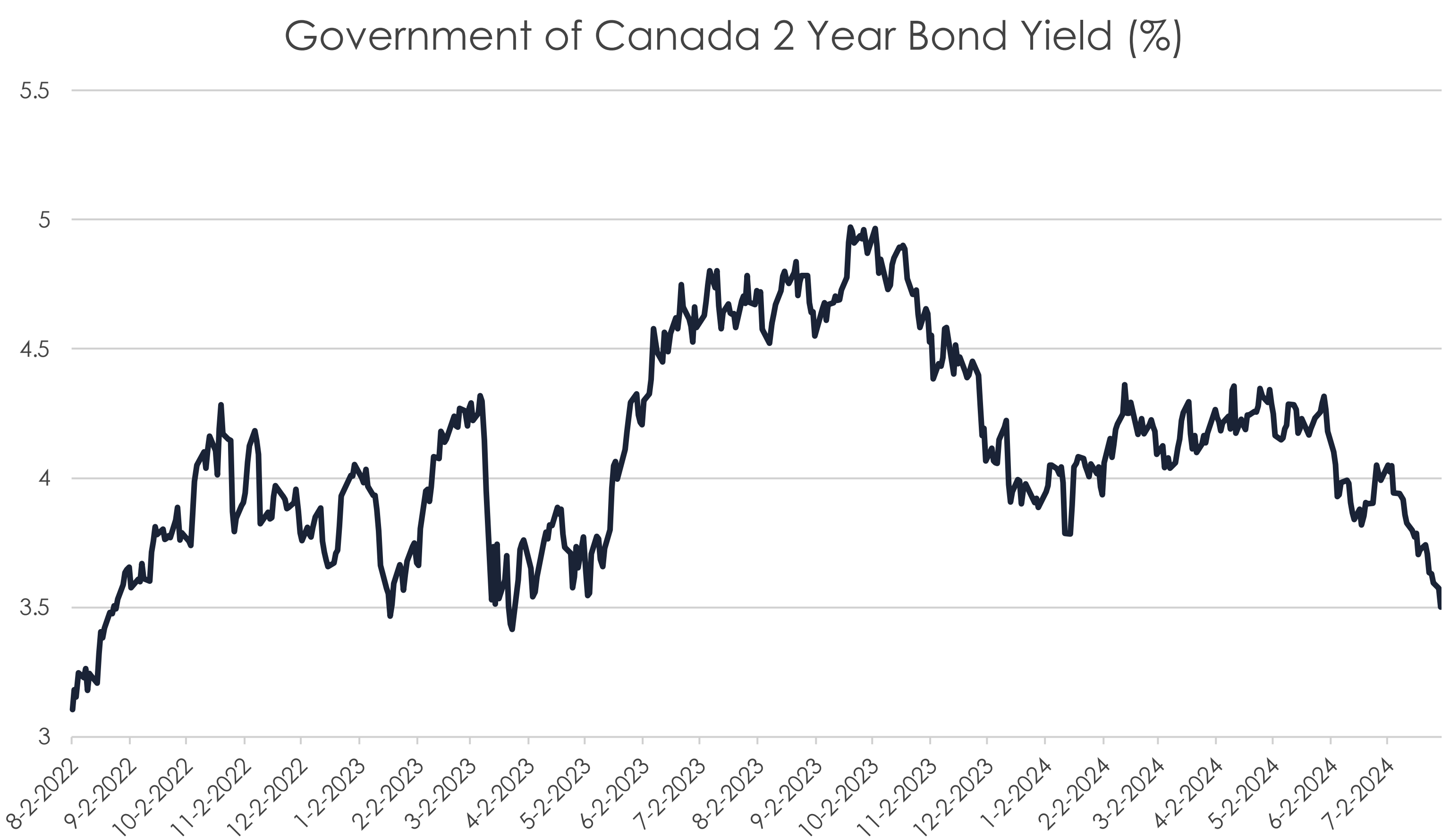
Canada 2 Year Bond Yield



As the Bank of Canada has cut rates by 50 basis points since May, the yield on the Government of Canada 2 Year bond has dramatically declined. It has fallen from around 4.3% in May to 3.5% as of July 30, the lowest yield since mid-2023. At this rate, we could see this yield reach the 2-3% range by the end of the year.

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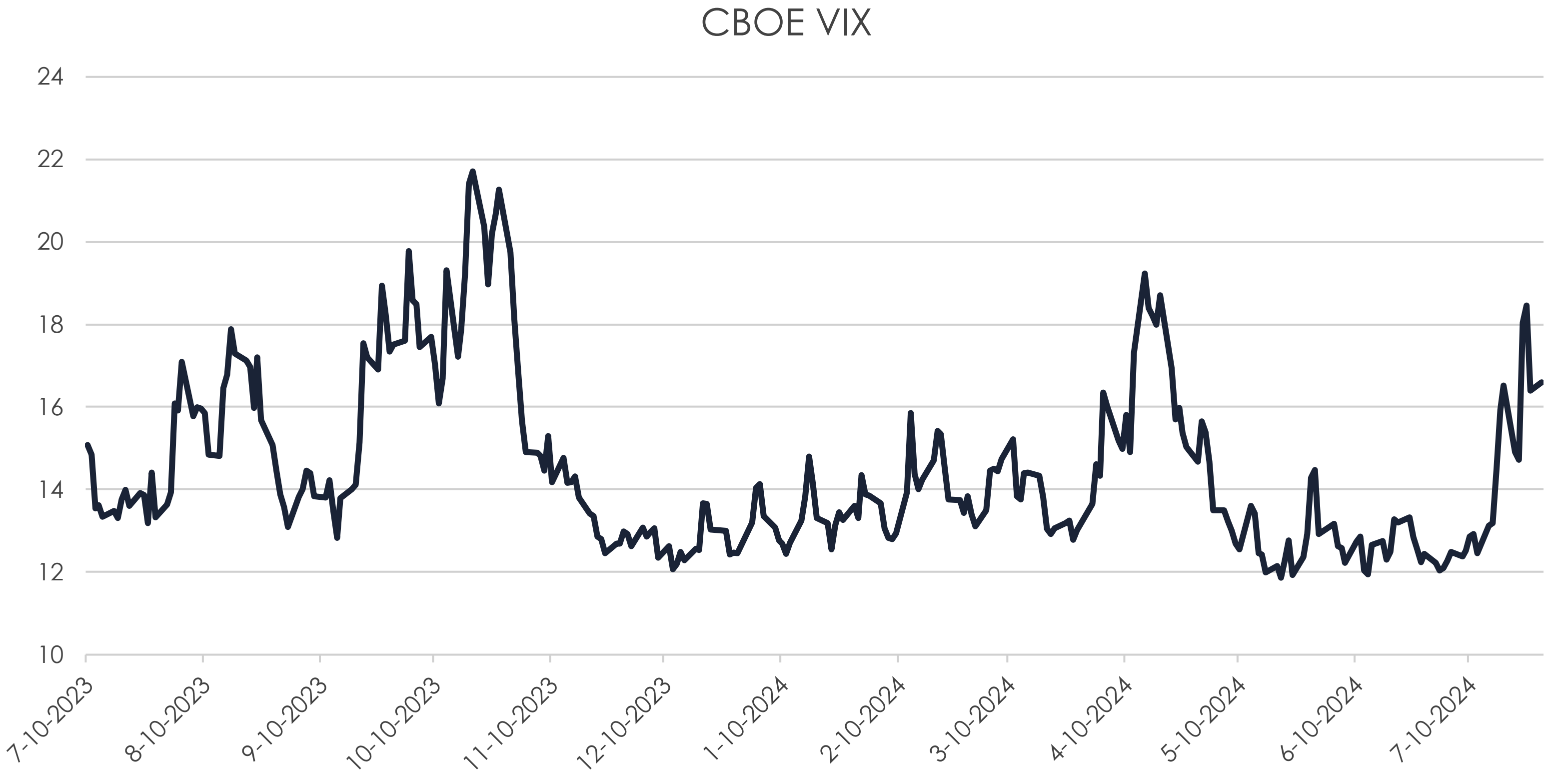
Volatility Index

In our last update, we noted that recent market volatility had been very low for an extended period, and that it would lead to a period of higher volatility eventually. This came to pass in July, as markets experienced a minor correction led by some of the large US technology names like Nvidia and Google.



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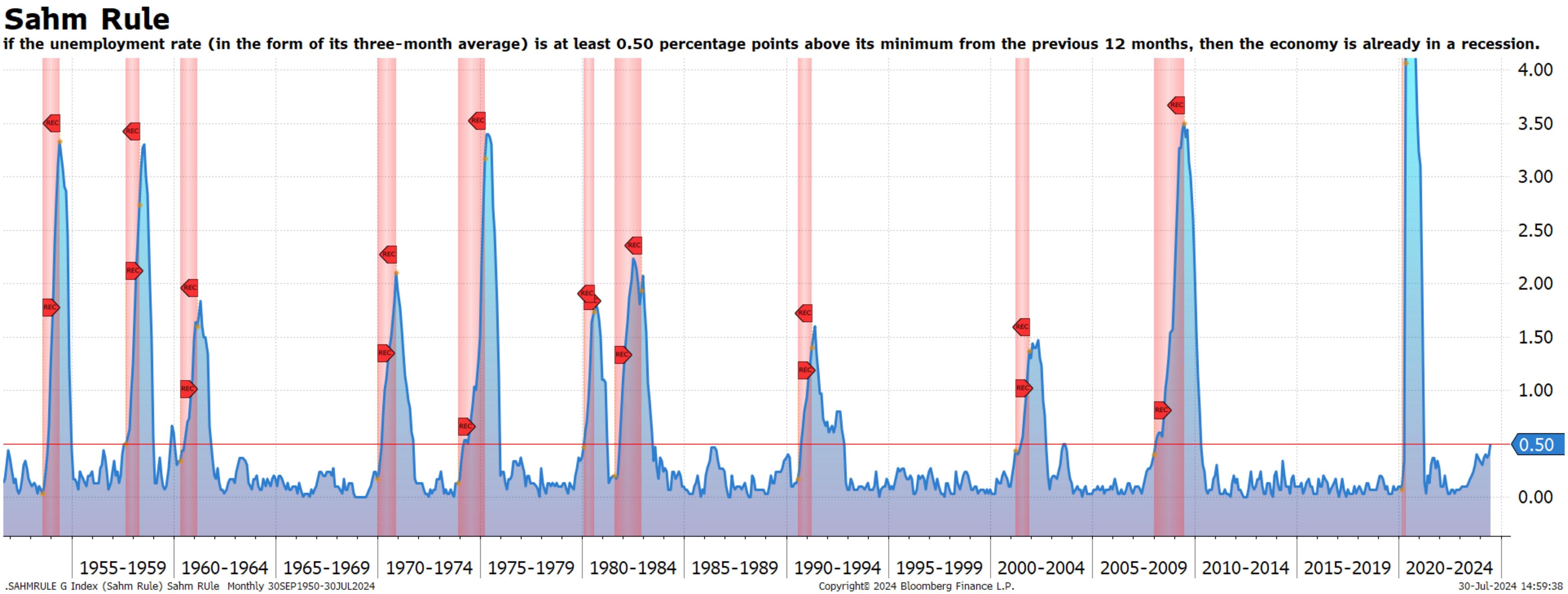
Sahm Rule Recession Indicator



The Sahm Rule is a recession indicator that forecasts an upcoming recession when the 3-month average of the unemployment rate has increased at least 0.5% from its recent low. This rule recently triggered, which means it is now forecasting an impending recession. In the chart, you can see that it has historically been successful in forecasting recessions.

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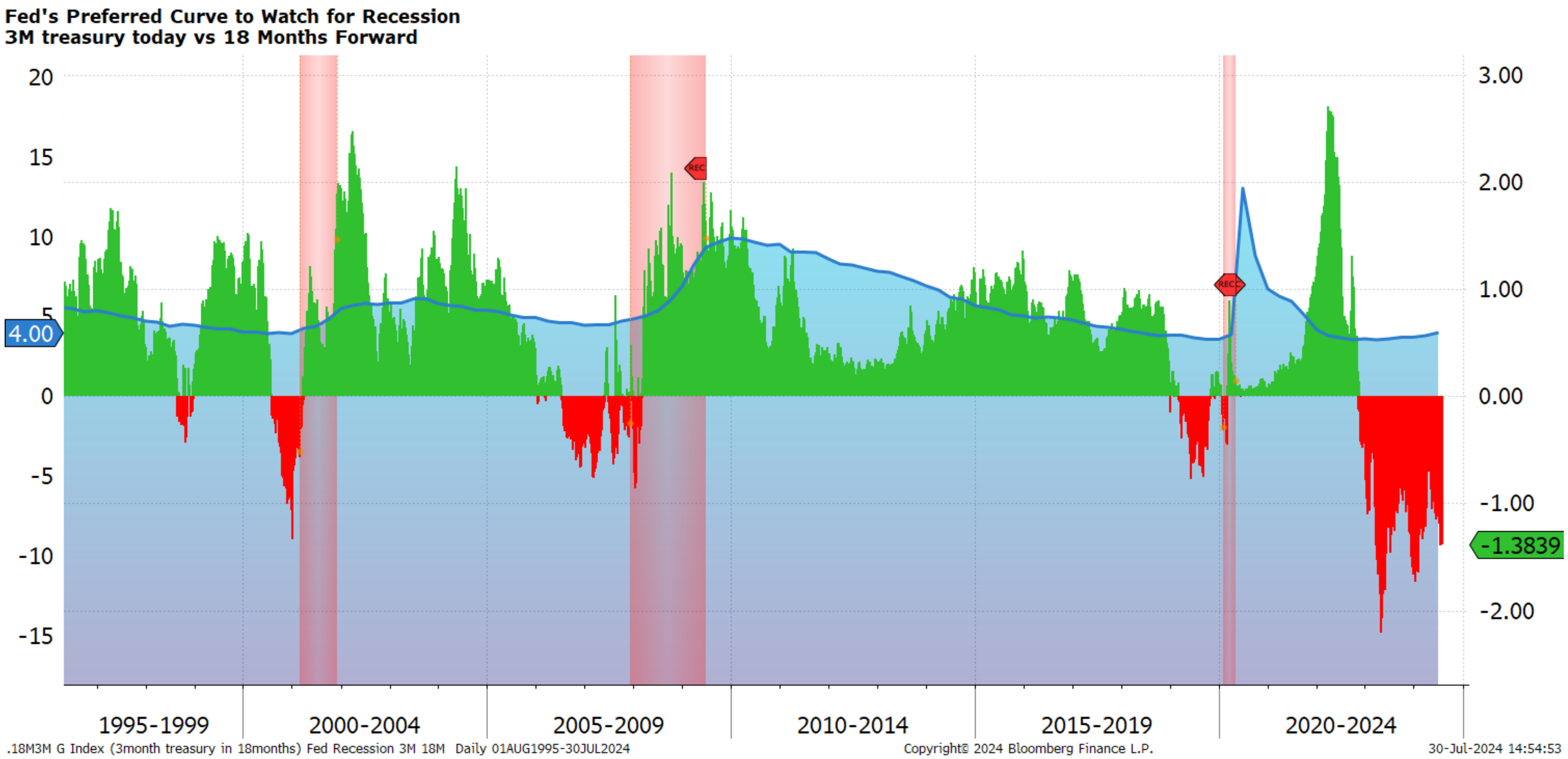
Fed Recession Model



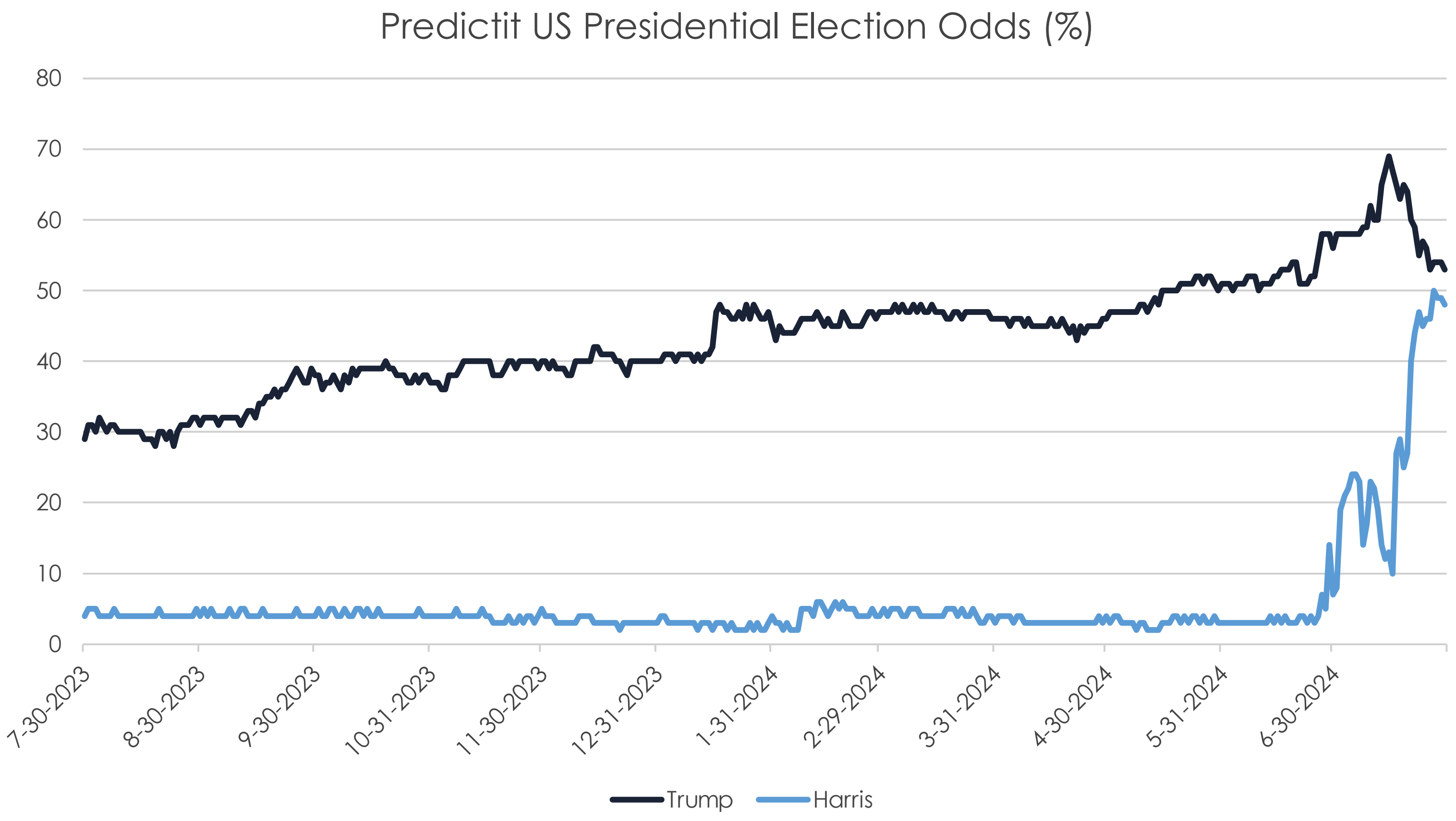
The Federal Reserve has a recession forecast model that looks at the rate on the 3-month Treasury Bill versus the forward rate (the expected future rate) on the 3-month Treasury.

When this is negative it means a recession is forecast because future rates are expected to be much lower than today's rates, which is what happens when rates are cut in a recession.

The model is currently forecasting a recession. Interestingly, it first triggered a recession prediction in late 2022, which has yet to pass.

US Election

Following the withdrawal of Joe Biden from the upcoming election, betting markets place the race between Donald Trump and Kamala Harris as nearly a toss up.



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