CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment: September 2024

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Market Comment

Interest rates continue to fall. On Wednesday, the Bank of Canada (the "Bank") announced another 25 basis point rate cut, bringing its policy overnight rate to 4.25%, down from its peak of 5.0% from earlier this year. As inflation continues to gradually decline and is now within the Bank's target range of between 1%-3%, it's likely the Bank's focus will shift to economic growth and employment, barring any unexpected inflationary flare ups.

The Bank noted in its announcement that inflation has continued to decline in line with its expectations, and its measures of GDP show that growth was slow in June and July. Wage growth is elevated as are certain inflation measures including shelter prices.

Market expectations are that the Bank will cut its interest rate at nearly every upcoming meeting up to July 2025. Should inflationary pressures increase during that time we are likely to see fewer cuts, while negative shocks to GDP growth and/or employment would likely trigger a faster pace of cuts.

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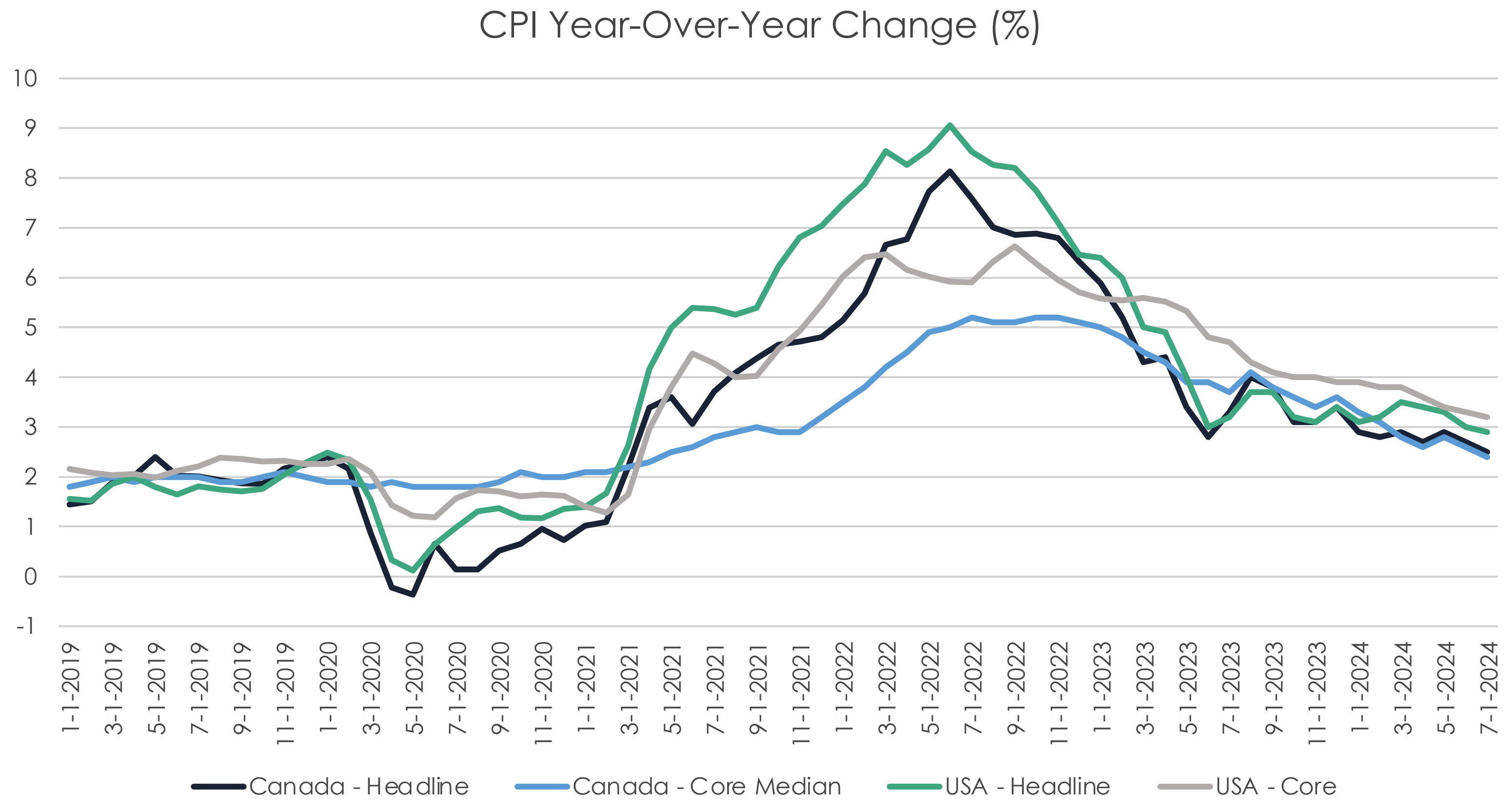
Inflation



CPI inflation continues to decline. The data now shows inflation at around 2.5% in Canada and around 3% in the US. Decelerating inflation at or near these levels should clear the way for significant interest rate cuts from the Central Banks.

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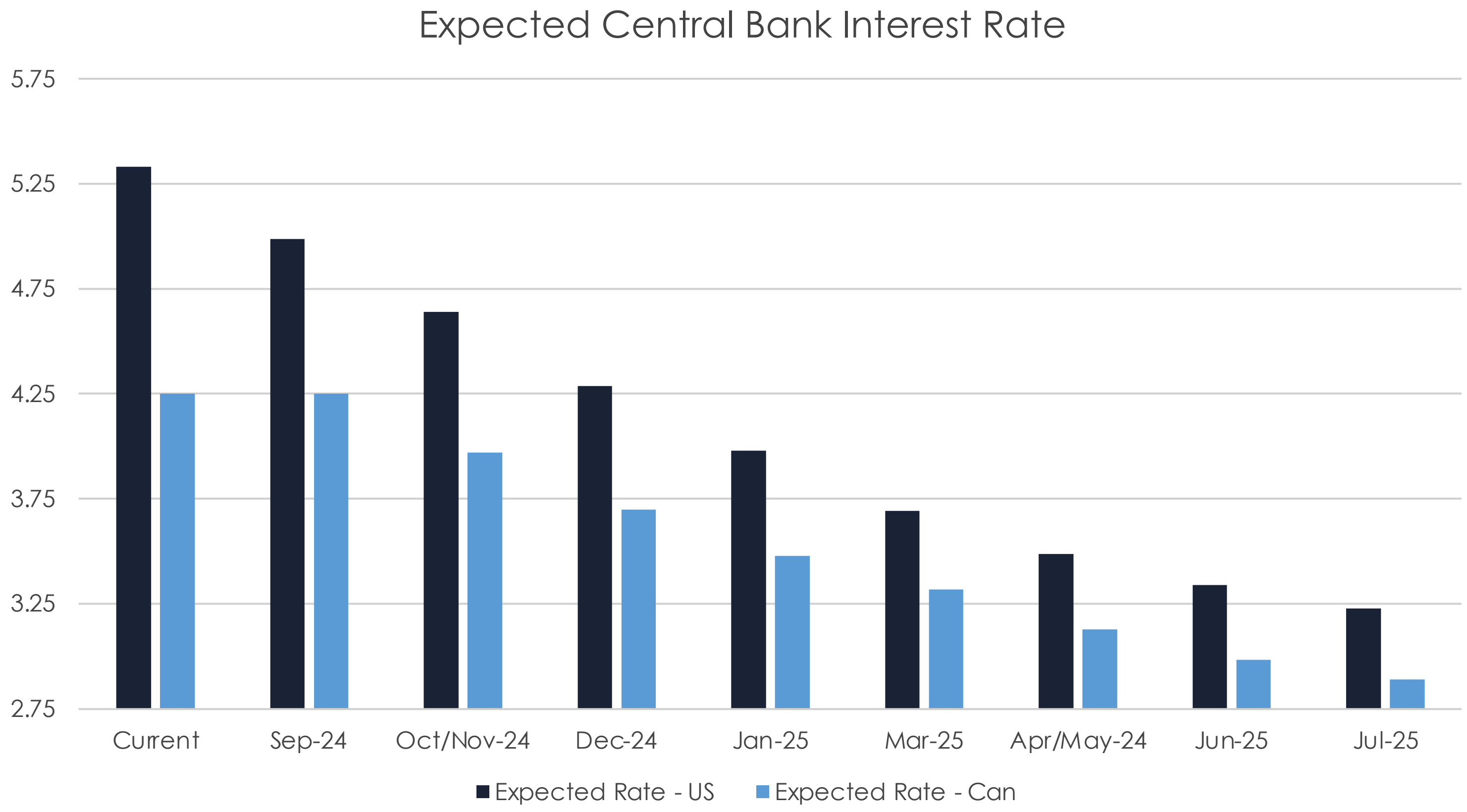
Interest Rate Expectations

Markets are now pricing in a year-end interest rate of 3.75% from the Bank of Canada, and 4.25-4.5% from the Federal Reserve. Rates are expected to decline to the 3-3.5% range over the next 12 months.



Data: Overnight Index Swap markets as of September 4, 2024

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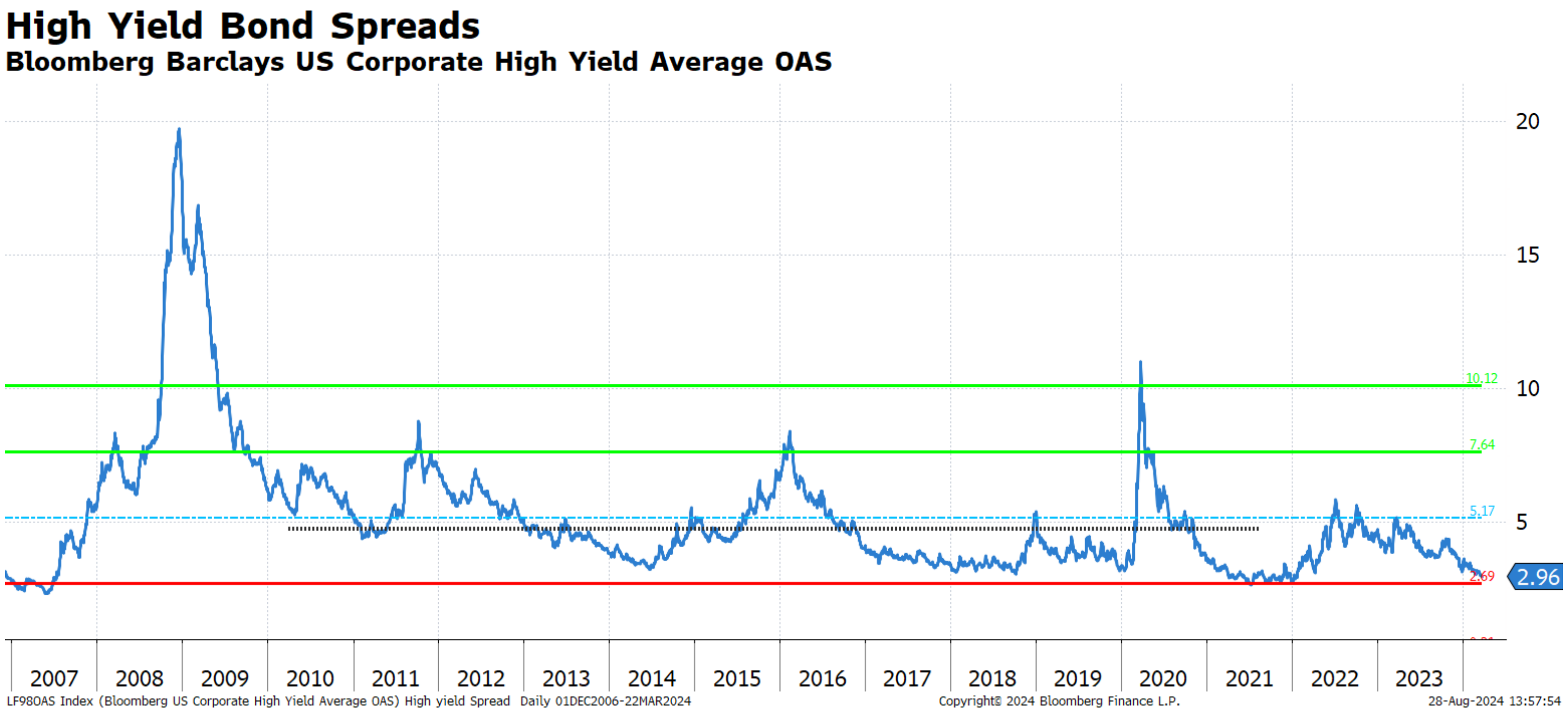
High Yield Bonds



The high yield bond spread is the difference in yield between riskier high yield bonds and low-risk government bonds. This spread is currently at a very low level, nearly one full standard deviation below the mean, meaning that investors generally see a relatively low amount of additional risk in these bonds.

There's typically a lot of value to buying high yield bonds during times of market stress, like the COVID Crisis of 2020 and the Global Financial Crisis. You can see in the chart that there was a lot of additional yield during those periods. We typically see this spread begin to rise in advance of recessions and other periods of stress. Currently, there is no sign of stress here.

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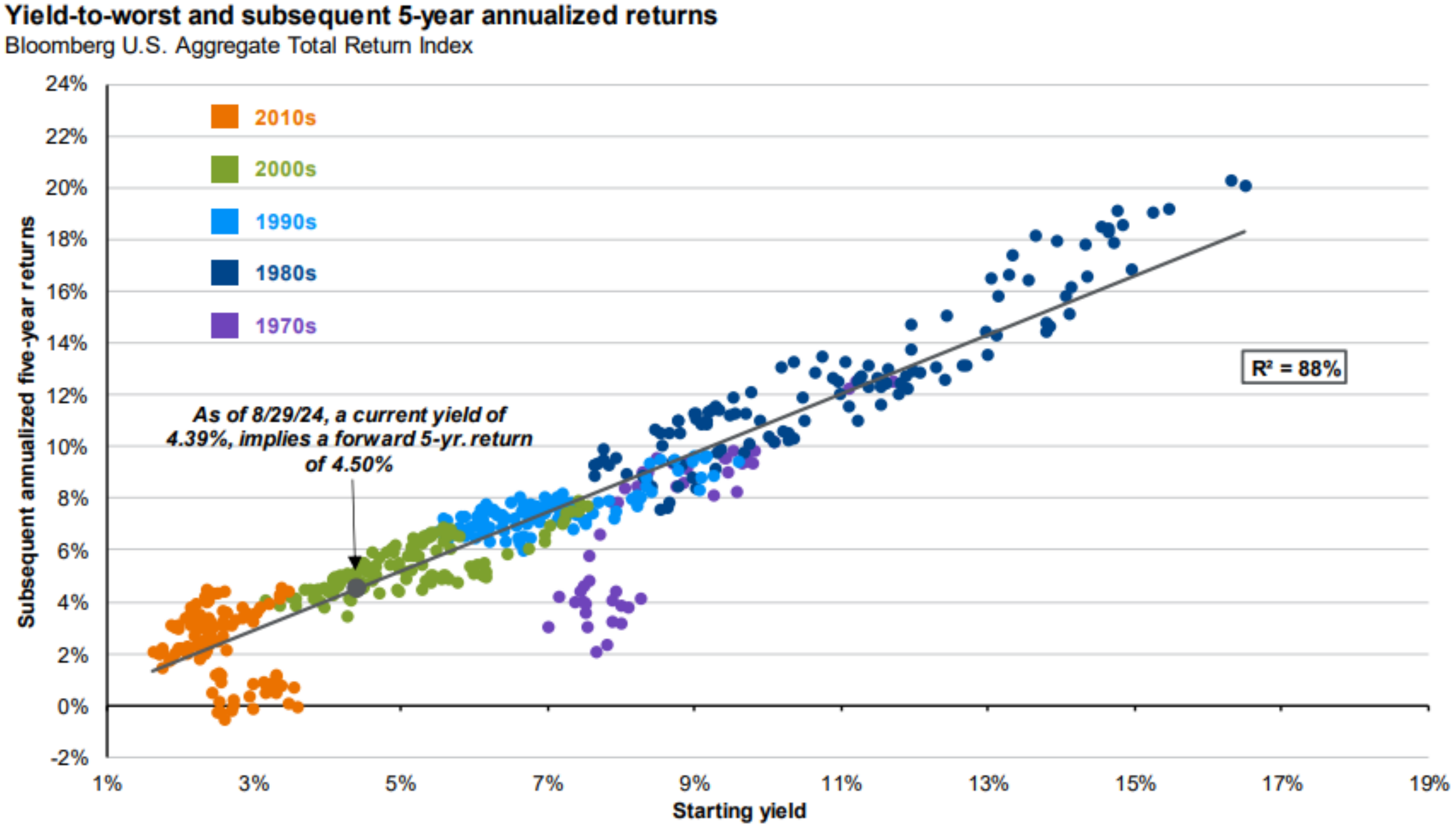
Bond Yields and Forward Returns



The quoted yield on a bond fund at the time of purchase is typically a good predictor of the return the investor will receive on the fund over the next few years. The relationship between starting yield and subsequent 5-year annualized returns exhibits an 88% correlation in the data in the chart, with the current yield of 4.39% implying a forward 5-year return of 4.5%. That's a solid return on low-risk, investment grade bonds.

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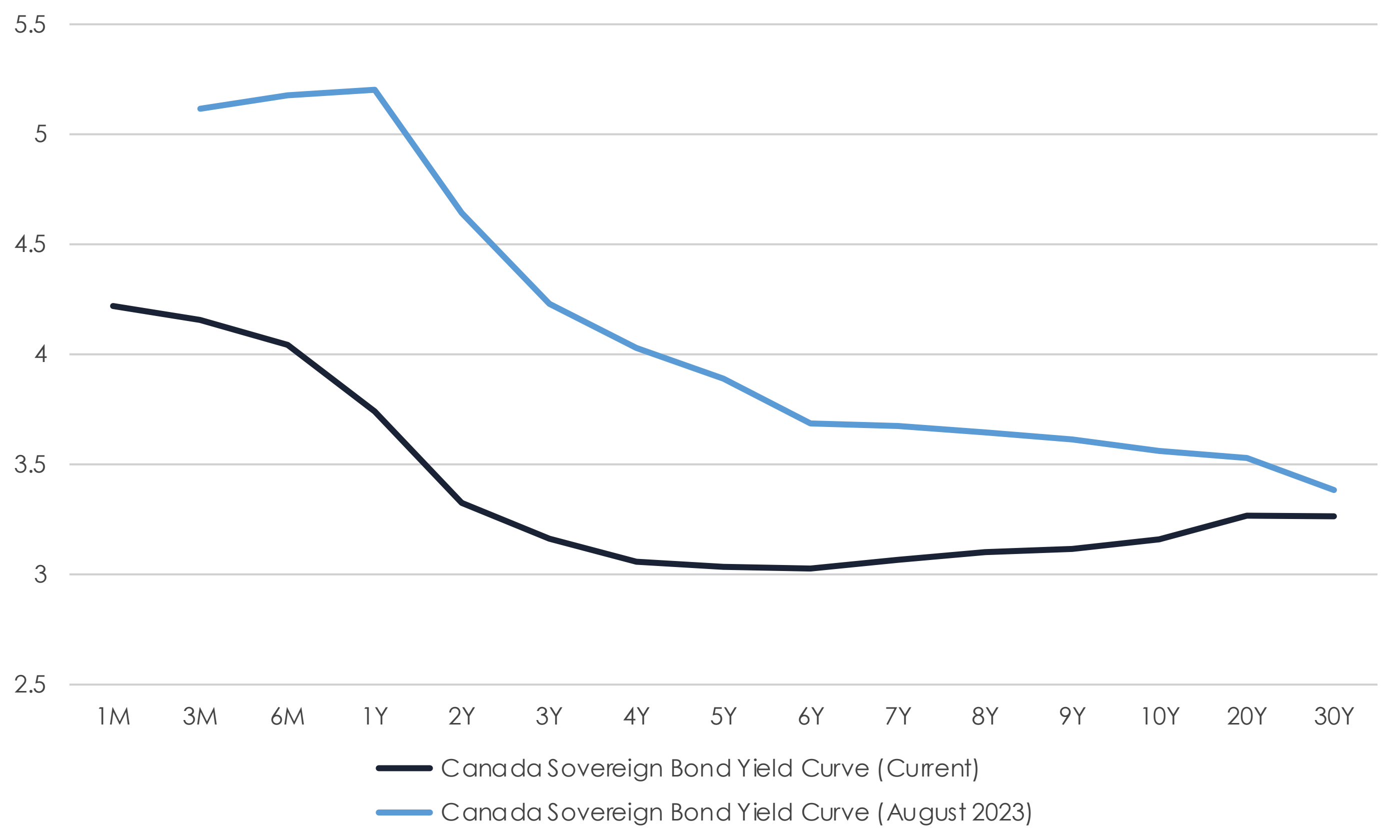
Yield Curve



Bonds yields along the yield curve are down over the past year, from the very short end all the way out to 30 years. At current yields, bonds are less attractive than they were a year ago, but still offering a solid yield, especially when compared to the ultra-low yield environment pre-COVID.

 Source: JP Morgan Asset Management, OceanFront Investment Counsel

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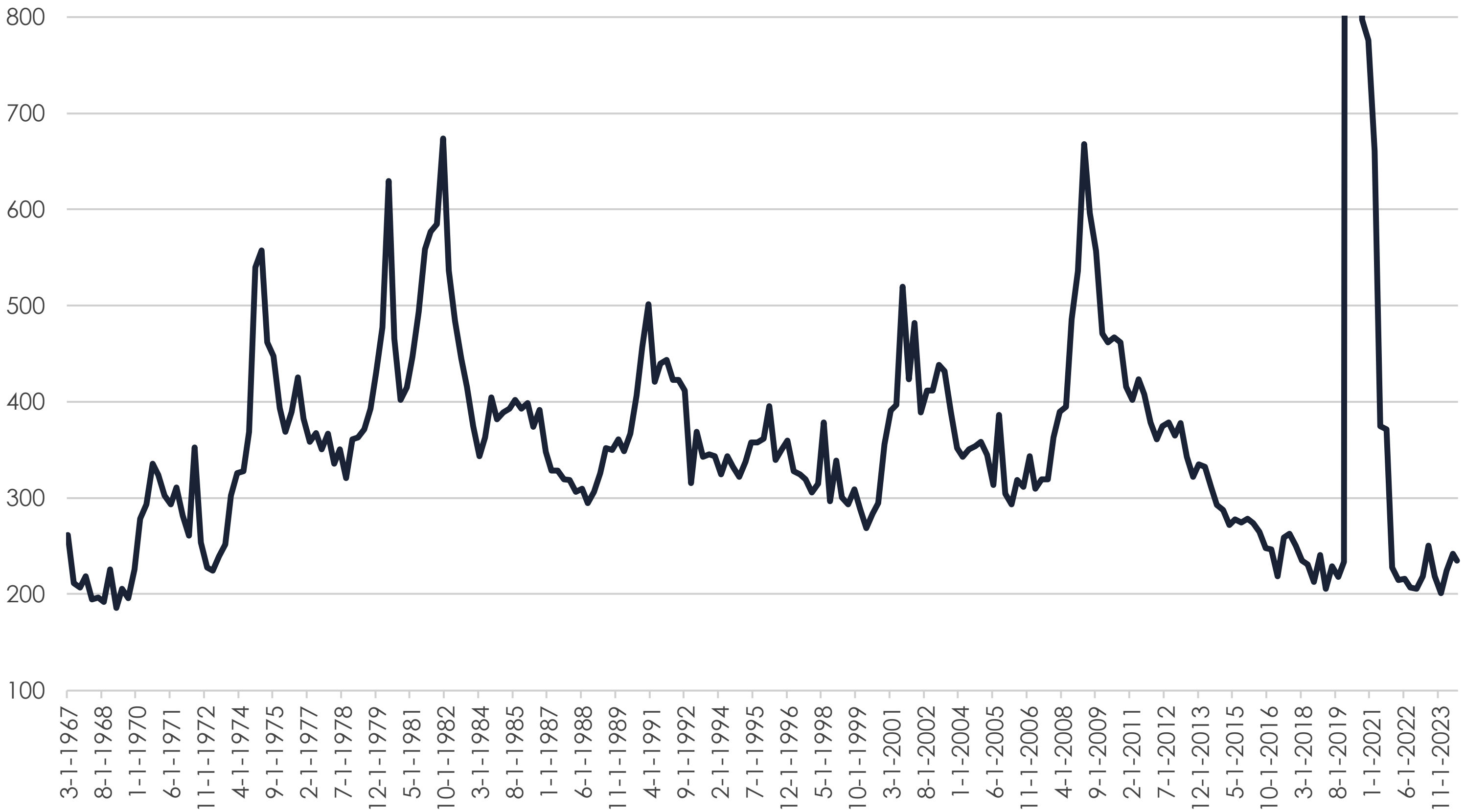
Initial Jobless Claims - USA



Data as of August 16, 2024

Initial unemployment claims are typically a leading indicator of economic slowdowns and recessions. Currently, these are near the lowest levels in history, no signs of stress here yet.

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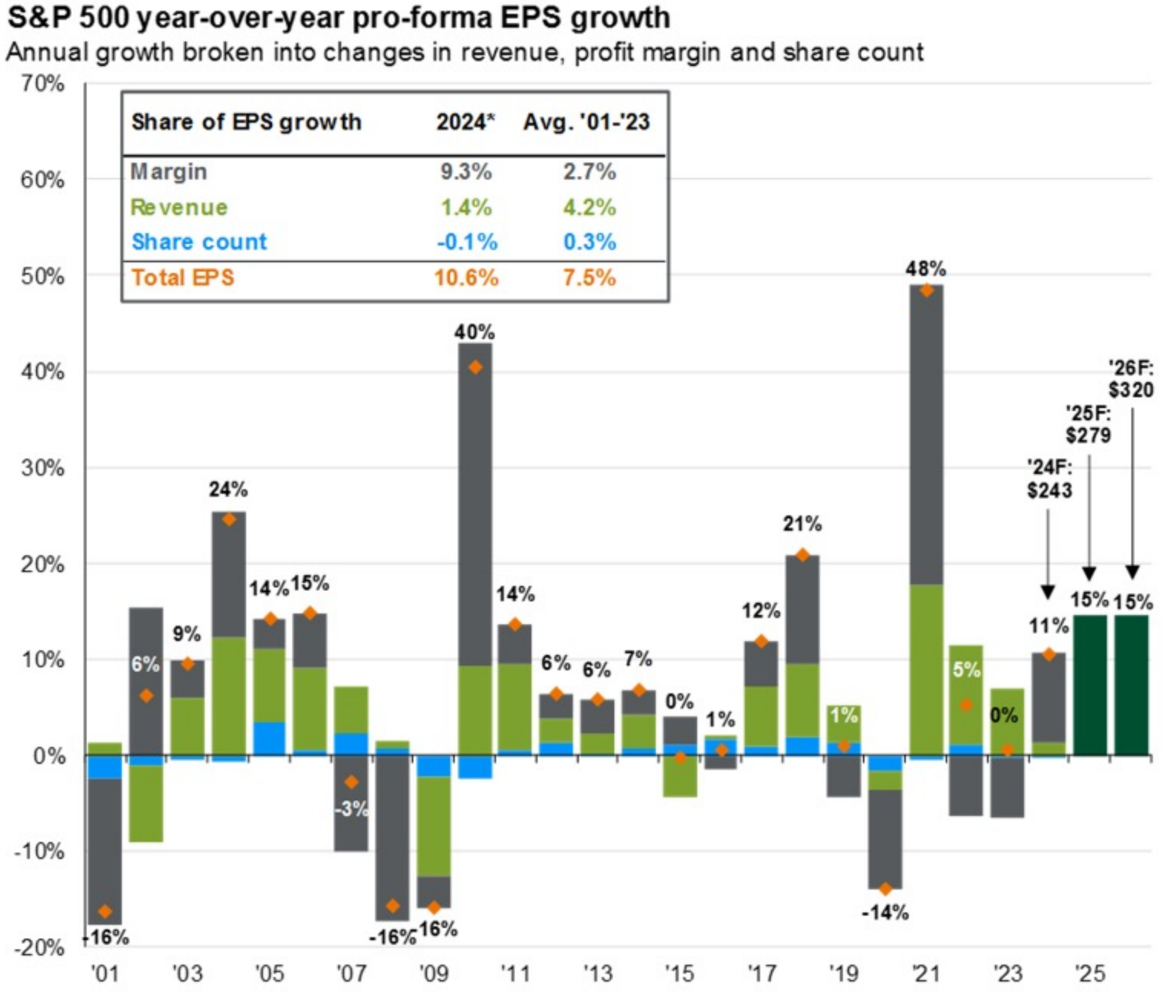
S&P500 Earnings



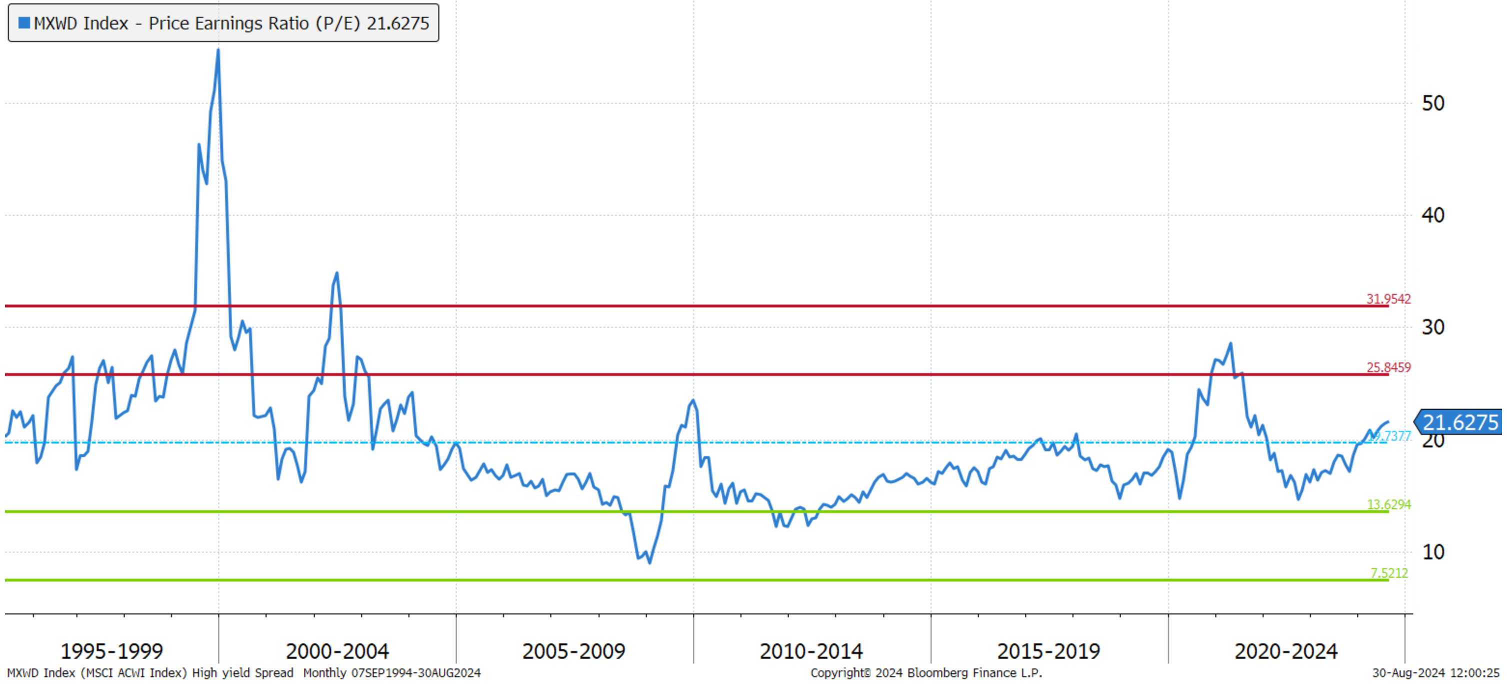
This chart shows the attribution of earnings growth from S&P500 companies, the main components being margins and revenues. In 2022 and 2023, revenues grew while margins contracted significantly. This is a very logical outcome in an inflationary environment where revenues are growing but margins are contracting due to higher costs.

On the other hand, the forecast for 2024 shows a small amount of revenue growth and a large margin expansion. This suggests that inflation is normalizing.

 Source: JP Morgan Asset Management, OceanFront Investment Counsel

Valuations

Looking at stock valuations on the MSCI All Country World Index, we see that they are slightly above average compared to their historical range.



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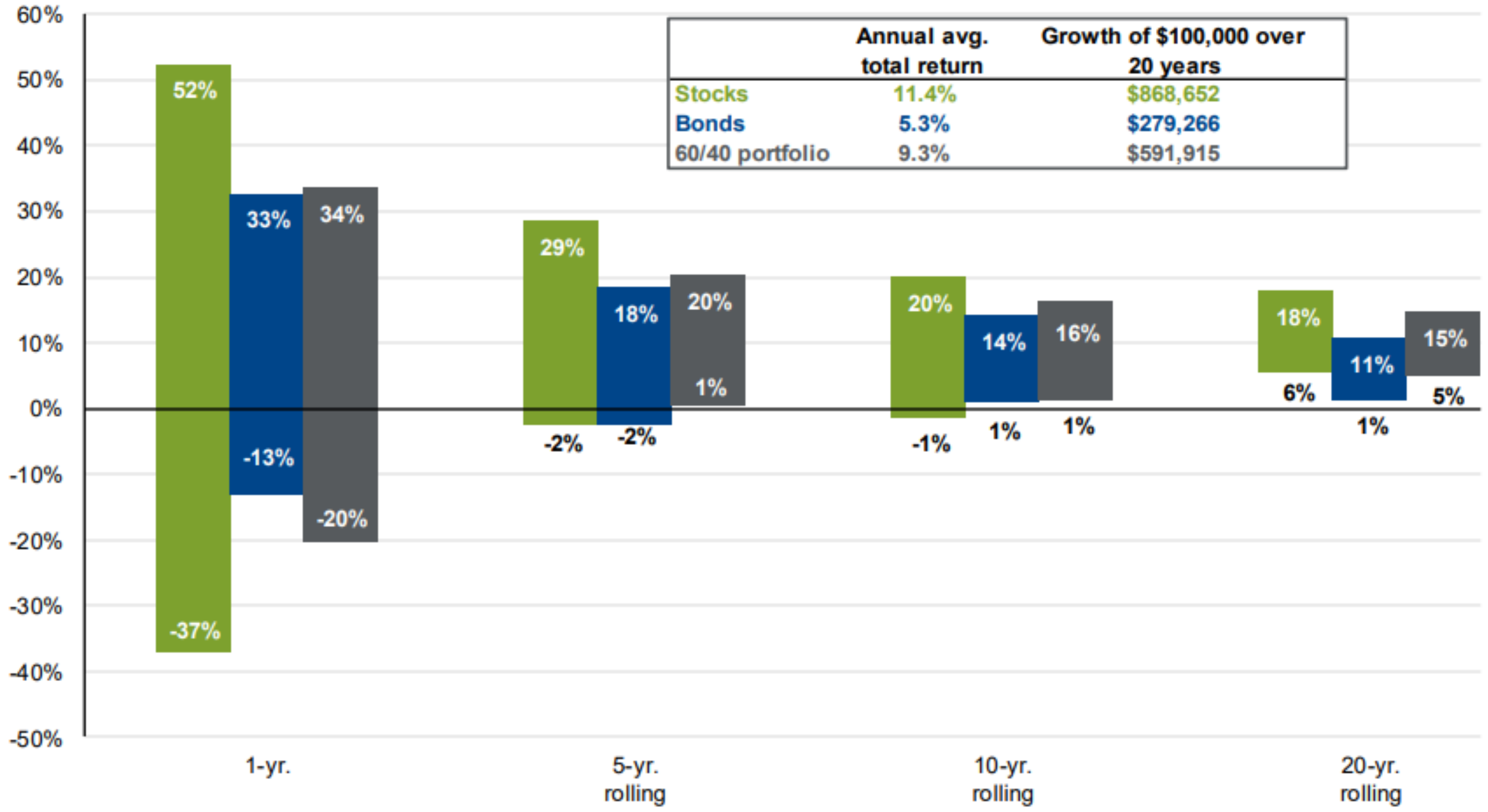
Range of Returns over Time

Range of stock, bond and blended total returns
Annual total returns, 1950-2023



Short term returns can be highly unpredictable. The longer the time horizon, the more consistent they become.

The chart shows data on average annual returns for various time horizons. The 1 year returns are highly volatile, ranging from -37% to 52% for stocks, while the 20 year rolling periods have a very low range of outcomes, between 6% and 18% for stocks.

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