

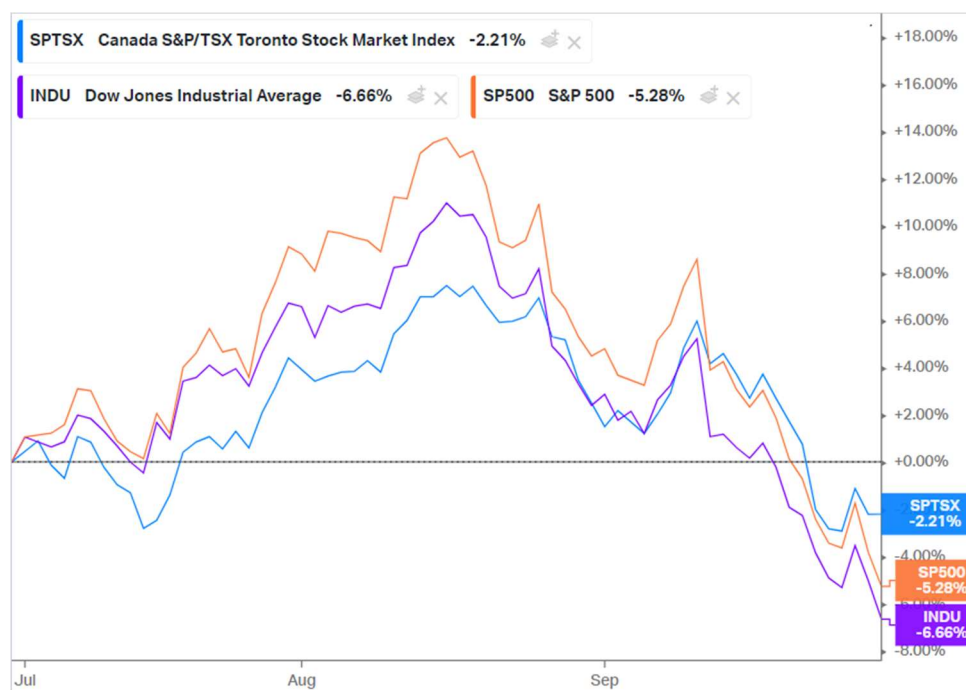
**Review**

*Is this the real life? Is this just fantasy? Caught in a landslide ...*

The opening lyrics to *Bohemian Rhapsody*, as serenaded to the world by Canada's Prime Minister in September, turned out to be a poignant snapshot of the markets over the past few months. The first half of the quarter saw the S&P/TSX climb 7.5%, and the S&P500 jump 13.7%, only to have it caught in a landslide and erased by the end of the quarter. *Easy come, easy go, little high, little low.*

The slide was sparked by speech from US Fed Reserve Chair Jerome Powell, where he reaffirmed his objective to fight inflation, even if it brings some pain in the short run. Before this speech, The Bank of Canada had already hiked their rate 100bps in July, followed by another 75bps in September. The US and Canadian benchmark rates now both sit at 3.25%.

Compounding the negative sentiment, chaos ensued in the UK after new leadership proposed tax cuts. Attempting to get ahead of a recession, the plan backfired and triggered a sell off as the measures were deemed to be inflationary, further weakening the GBP. This, layered with the complexities from the Ukraine war and China's zero Covid policy added plenty of tremors in the market this quarter.



All said, equity and bond markets were rather bearish on the global economy.

The S&P/TSX closed the quarter down 2.2%, largely driven by a correction in the Energy sector, while the S&P 500 fell 5.3%, and the Dow Jones Industrial Average was lower by 6.7%.

**Forecast**

*No escape from reality. Open your eyes, Look up to the skies and see ...*

With the temerity to claim inflation was transitory only a year ago, monetary policy leaders now come to realize that they 'gotta leave it all behind and face the truth'. Inflation is not transitory. Telling indicators such as higher sticky costs for groceries, gas, and housing confirm consumers are still in control. Furthermore, this summer's airport/travel chaos due to 'unanticipated' vacation demand tells us that after 2 years of closed borders, demand is still pent up – *Mama*



*Mia, let me go!* The result of this will likely be a similar cycle to what we have seen this year: strong spending leads to higher than target inflation rates which mean interest rates will likely increase again in 2022.

However, are we close to the end of high single-digit inflation? We expect that it might be. First, inflation statistics are driven by backward-looking indicators, and interest rate increases need time to work. The monetary tightening will eventually make its way through the economy and slow the flow. Second, if you recall our July 2021 newsletter, we referenced high shipping costs that could contribute to a supply chain problem, and hence inflation. They certainly did. Now those prices have come down significantly. As have prices for commodities, energy, and alternative assets like the secondary market for luxury watches, cryptocurrencies, and used cars. Lastly, inflation figures since June have been decelerating month-over-month. It's early, and it's still far too high – but the trend is encouraging.

We are uncertain if central bankers will stop increasing rates in 2023. Employment data might be the cause for confusion amongst economists. While the early trend is that inflation is coming down, employment figures still point to an overheated market. Low unemployment rates and increasing wages are still being reported by many outlets. With borders re-open for immigration, government supports ending, and such high costs of living, will we see a higher participation rate to fill the void? Or will labor markets continue to be tight across most sectors due to early retirements, career changes, and people simply leaving the workforce? For rates to slow down, this has become a key area that we will be watching. What we do believe, however, is that when rate increases do stop, will be when our economy will have entered a recession, or be close to it. As most data that the monetarists rely on is backward-looking, we just might possibly already be in the early stages of one.

### **Strategy**

*Carry on, carry on as if nothing really matters ...*

For the coming months, you can expect to see negative economic and financial headlines. We would not be surprised to see articles about GDP turning negative, rattled consumer confidence, extreme loss from overvalued items during the pandemic (remember NFTs?), real estate sales plummeting, hedge funds or SPACs reporting heavy losses, and the like. We don't see this as particularly material to your portfolios in the short run. We will remain focused on finding quality companies for you to own for the long term. We were not distracted last year when assets were hotly priced, and we aim to maintain the same discipline this coming period as asset prices correct. We will continue to allocate capital where we see a mismatch between market values and our intrinsic value.

An example of mismatched value is emerging in the bond market. Previous newsletters discussed their relative unattractiveness to common and preferred equities. Typically, bonds interact inversely with equities, but major asset classes have sold off together. For bonds, as prices go down, yields are pushed higher. For bonds to be attractive, our market expectations will need to tell us that when viewed against equities, they will generate the appropriate trade-off along with balanced interest rate risk and inflation risk. They are still not quite there yet but we are readying our bond appetite for if the time comes.

### **Our communication with you**

If you would like to opt for emailed quarterly packages and discontinue mailed quarterly packages, please email [trevor@lee-turner.com](mailto:trevor@lee-turner.com) and let us know. Thank you.