Wickham Investment Counsel Inc.

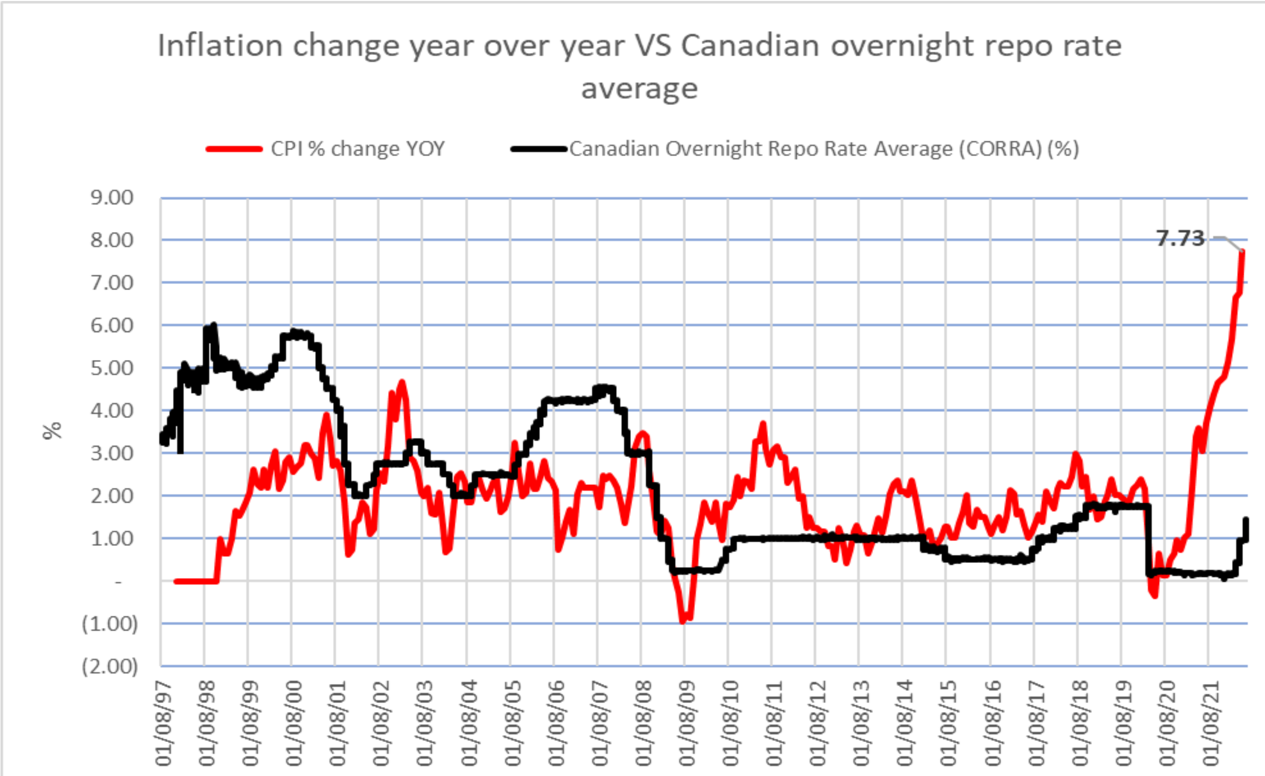
Quarterly Review **Jun 2022**

HAMMER TIME

To support economic growth and reduce unemployment, the US Federal Reserve, which controls monetary policy, doubled its assets during the COVID-19 pandemic from $4.2 trillion to $8.3 trillion in August 2021 (37% of GDP), with most of the expansion occurring in the first five months of 2020. The magnitude and speed of this unconventional monetary policy are unprecedented and dwarfs previous quantitative easing programs. There is a strong symbiotic relationship between the Fed's balance sheet and the stock market. A 10% expansion of the Fed's balance sheet is estimated to result in a positive 9.1% impact on cumulative stock market returns over the next five to ten weeks. As the Fed buys fixed income securities, bond yields fall, reducing the discount rate for equities and increasing stock prices. Also, this has an impact on expectations of future macroeconomic conditions and expected corporate earnings. The Fed's actions are a major driver of stocks returns and volatility in the near term. Other central banks around the world followed suite.

An unintended consequence of monetary and fiscal stimulus has been runaway inflation and excess demand for housing, autos, energy, food and other commodities. The Ukrainian war and supply chain problems have not helped the situation. For example, the attached chart shows the sharp increase in the consumer price inflation in Canada, which soared to 7.7% in May, the highest in 39 years. The objective is 2.0% inflation. The pandemic stimulus bill has come due and the policy focus is to hammer inflation hard. Central banks have moved aggressively in the second quarter to increase interest rates and vow to continue doing so until inflationary forces are tamed. The Bank of Canada carries out monetary policy by influencing short-term rates. It does this by adjusting the target for the overnight repurchase rate to Canadian banks on eight fixed dates each year. The Bank will also reduce its balance sheet.

The question is how much higher do interest rates need to go to turn back inflation and what will be the impact on the economy and corporate profits. The market expectation is for an over-night target rate of 3.5% by the end of the year, from 0.25% early this year. This is above an estimated "neutral" range of 2.00–3.00%, which would support economic growth consistent with the inflation target. A higher rate will slow growth and increase unemployment, perhaps to the point of bringing recessionary conditions. The enemy of the economy is not only higher rates over time, but rapidly rising rates, which is the case now. That is the challenge for both equity and bond markets. Over the first half of the year, bonds prices are down by more than 10%, the S&P TSX is down by 10% and the US S&P 500 is down by 20%. Many sectors have been hit hard, with only energy showing gains. Although Canada has held up better, the US has slipped into a bear market. This has created some attractive valuations in securities. The potential yield on an investment grade, bond portfolio over the next two years is over 7 % per annum, with interest rate risk hedged.



Source: Bankofcanada.ca, Statcan.gc.ca

	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Jun 30, 2022	% Change Dec-Jun
Stock Market Indices									
S&P/TSX Comp.	13,010	15,288	16,209	14,323	17,063	17,433	21,223	18,861	-11.13%
Dow Jones Ind.	17,425	19,763	24,719	23,328	28,538	30,607	36,338	30,775	-15.31%
S&P 500	2,044	2,239	2,674	2,507	3,231	3,756	4,766	3,785	-20.58%
Nasdaq Comp.	5,007	5,383	6,903	6,635	8,973	12,888	15,645	11,029	-29.50%
Commodities									
Gold - US$	1,060	1,252	1,309	1,281	1,523	1,895	1,829	1,807	-1.20%
Crude Oil WTI - US$	37.04	53.72	60.42	45.41	61.06	48.52	75.21	105.76	40.62%
Natural Gas - US$	2.35	3.74	2.95	2.94	2.19	2.54	3.73	6.50	74.26%
Currencies									
€ in Cdn $	1.50	1.42	1.50	1.56	1.46	1.56	1.44	1.35	-6.25%
£ in Cdn $	2.04	1.66	1.69	1.74	1.72	1.74	1.71	1.57	-8.19%
US$ in Cdn $	1.38	1.34	1.26	1.37	1.30	1.27	1.26	1.29	2.38%
Interest Rates									
Cdn Prime rate	2.70	2.70	3.20	3.95	3.95	2.45	2.45	3.70	51.02%
US Prime rate	3.50	3.50	4.50	5.50	4.75	3.25	3.25	4.75	46.15%
Cdn 10 Yr bond	1.41	1.72	2.04	1.95	1.64	0.70	1.45	3.22	122.07%
US 10 Yr bond	2.27	2.44	2.40	2.69	1.92	0.93	1.52	3.10	103.95%

Source: The Globe & Mail