

# Wickham Investment Counsel Inc.

Quarterly Review

Sept 2022

## FED UP YET ?

The question markets are asking now is how high should central bankers raise interest rates to contain inflation? As we entered this year, US Federal Reserve policymakers saw three increases in the Federal funds rate as appropriate in 2022. Policymakers also saw the need for three more increases in 2023 and two in 2024 to bring the Federal funds rate to 2.1% (from 0.25%). The Fed flagged concerns over the new Omicron strain, indicating that risks remain for the economic outlook. Although inflation was already exceeding the 2% target, the emphasis remained on maximum employment. Both the Bank of Canada and the US Federal Reserve thought the neutral rate was between 2 and 3%. The neutral rate is that which neither accelerates inflation or reduces it when the economy is operating at its potential growth rate (of about 2%).

By September, the Fed raised the Federal funds rate by 75 basis points to 3 – 3.25%. This was the Fed's third successive .75% increase and fifth upward move this year. There remained an unchanged and laser focus on inflation. It is expected that there will be two more increases in rates by year end of 1.25% in total to 4.25 – 4.50%. Furthermore, the year end 2023 rate has been lifted to 4.50 – 4.75% and that restrictive rates may be needed through 2024 to contain inflation. Similarly, markets are braced for the Bank of Canada overnight rate to hit 4.0% by March, next year. Consumer inflation is now 7.1% in Canada and the unemployment rate is 5.4%, the lowest level in fifty years.

Yield spreads, as attached in the chart show fears of a policy error on the part of the central banks, as short-term government interest rates are well above ten-year rates. This interest rate inversion points to slower economic growth ahead and, perhaps a recession. Note that a recession has never occurred without an inverted yield curve. Fed Chairman Powell says that the Fed is determined to "keep pushing" rates until inflation comes down.

Following the exceptional gains made during the covid years of 2020 – 2021, this year has been a bumpy ride as we experienced a market correction as valuations repriced for higher interest rates. These extreme swings are stressful, as it is unusual to have higher rates batter fixed income prices and preferred shares, while equity prices are weighed down by weak investor sentiment. At the end of September, the S&P/TSX Composite index had declined by - 13.1%, the S&P500 index by - 24.8% and the S&P Global 100 index by - 23.7%. While Canadian market has been less weak than others, the Canadian dollar has been anemic and closed under 73 cents US.

It may take time, but a rebound will occur, and history has proven that investors will be rewarded, if they can keep their emotions at bay. We are finding attractive valuations on equities; high dividend income and bonds yields are moving higher than we have seen for some time. Alternative investments have proven their metal this year, with their low correlations to traditional equities and bonds.

## Chart: 10-2 Year US Treasury Yield Spread

10-2 Year Treasury Yield Spread, United States, NYSE:US2US10=RR, M



Source: Investing.com

	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Sep 30, 2022	% Change Dec-Sep
<b><u>Stock Market Indices</u></b>									
S&P/TSX Comp.	13,010	15,288	16,209	14,323	17,063	17,433	21,223	18,444	-13.09%
Dow Jones Ind.	17,425	19,763	24,719	23,328	28,538	30,607	36,338	28,726	-20.95%
S&P 500	2,044	2,239	2,674	2,507	3,231	3,756	4,766	3,586	-24.76%
Nasdaq Comp.	5,007	5,383	6,903	6,635	8,973	12,888	15,645	10,576	-32.40%
<b><u>Commodities</u></b>									
Gold - US\$	1,060	1,252	1,309	1,281	1,523	1,895	1,829	1,672	-8.58%
Crude Oil WTI - US\$	37.04	53.72	60.42	45.41	61.06	48.52	75.21	79.49	5.69%
Natural Gas - US\$	2.35	3.74	2.95	2.94	2.19	2.54	3.73	6.77	81.50%
<b><u>Currencies</u></b>									
€ in Cdn \$	1.50	1.42	1.50	1.56	1.46	1.56	1.44	1.36	-5.56%
£ in Cdn \$	2.04	1.66	1.69	1.74	1.72	1.74	1.71	1.54	-9.94%
US\$ in Cdn \$	1.38	1.34	1.26	1.37	1.30	1.27	1.26	1.37	8.73%
<b><u>Interest Rates</u></b>									
Cdn Prime rate	2.70	2.70	3.20	3.95	3.95	2.45	2.45	5.45	122.45%
US Prime rate	3.50	3.50	4.50	5.50	4.75	3.25	3.25	6.25	92.31%
Cdn 10 Yr bond	1.41	1.72	2.04	1.95	1.64	0.70	1.45	3.17	118.62%
US 10 Yr bond	2.27	2.44	2.40	2.69	1.92	0.93	1.52	3.80	150.00%

Source: The Globe & Mail