Wickham Investment Counsel Inc.

Quarterly Review **Dec 2022**

Bursting the Inflation Bubble?

With the onset of the global pandemic early in 2000, economies were effectively shut down and unemployment soared in the most exposed sectors. Governments were forced to find a way to quickly support those in the most need for their necessities, while others could work remotely or retained their jobs.

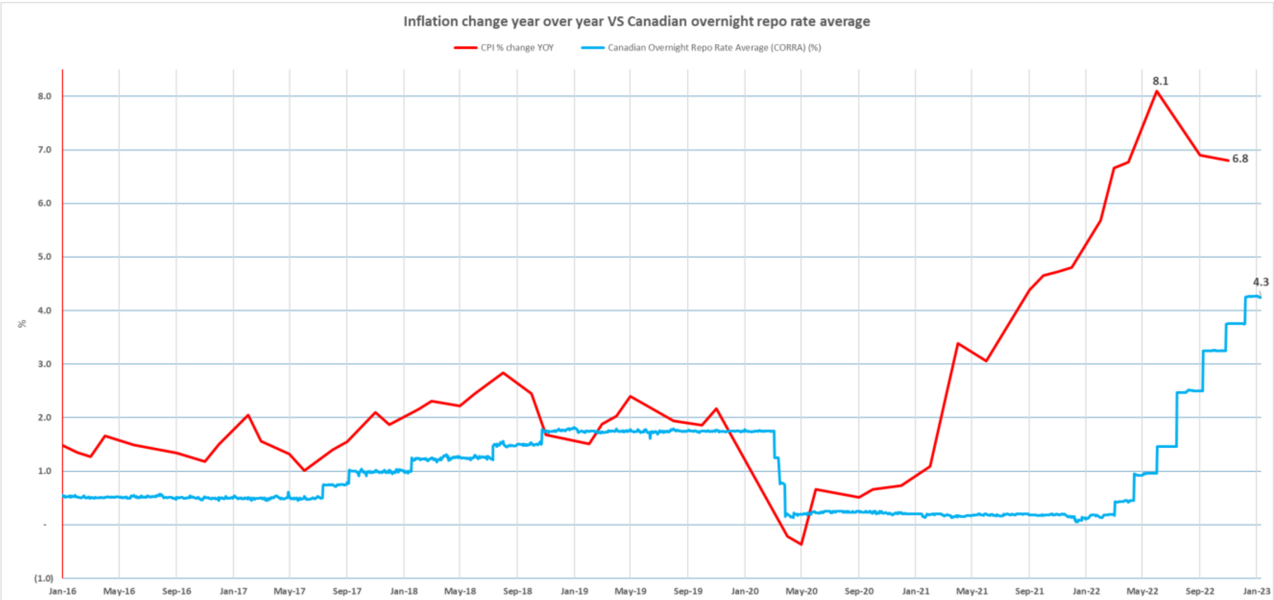
The policy response was a sharp rise in government deficit spending and loans, as well as a monetary policy of buying federal bonds and printing money to pay for them, in an effort to reduce interest rates to zero. The money supply increased in the United States and Canada by more than 30%. Under the waves of stimulus, economies bounced back. While the experiment was successful, this prescription was a classic recipe for future inflation. This is what we got. Higher taxes could have been imposed to pay for the redistribution and support of a wide part of the economy but would be politically unbearable. So, the de facto tax outcome was a higher inflation imposed on everyone to pay for the increased redistribution costs. Costs go up for those working, or not, in the form of higher prices for goods and services, instead of higher tax bills. Perhaps, this is more palatable.

The expansion of government debt during the pandemic, supported by zero interest rates and money creation, has resulted in soaring inflation, much higher interest rates and now a looming recession and rising unemployment. High inflation in 2022 has resulted in the most aggressive monetary tightening in decades to correct the previous policy error. Hiking by the Bank of Canada and the US Federal Reserve has resulted in the most inverted yield curves in over thirty years, significant market volatility and a probable economic recession this year. US policy makers point to a range of 5.0 – 5.25% by the end of the first quarter, before taking a pause to assess the impact.

The speed and extent of the upward adjustment in interest rates has caused global bond indexes to post their worst performance ever. For example, the US aggregate bond index was down 16 % in 2022, in line with the 19% decline in the S&P 500 index for equities and a 33 % decline in the Nasdaq. In effect, gains in markets made in 2021 were effectively reversed in 2022. The Toronto S&P TSX Composite index faired a little better with a decline of 9 %. Energy was one of the few bright lights.

Oddly, bad economic news will be good economic news for bonds and stocks in 2023. A recession caused by rising rates will increase unemployment, reduce demand and put downward pressure on consumer prices. Only then will monetary authorities pause their upward push on interest rates. In fact, it does appear that inflationary forces are already subsiding in the goods sector, but not yet in the wages and services. The CPI in December in the US was 6.5 %, a good omen.

Markets are forward looking and will bounce back at any hint of a return towards the norm. Analysts anticipate an 8 – 10% gain in the equity markets this year, and it is probable that bonds will rally as well. Price-earnings multiples have come down throughout 2022 so there is room for multiple expansion. Canadian markets in particular, are set up nicely for a better year and could advance to the 22,000 level by the end of 2023 (and maybe surpassing the record high of 22,087 set on March 29, 2022).



Source: www.bankofcanada.ca & www150.statcan.gc.ca

	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Dec 31, 2022	% Change Dec-Dec
Stock Market Indices									
S&P/TSX Comp.	13,010	15,288	16,209	14,323	17,063	17,433	21,223	19,385	-8.66%
Dow Jones Ind.	17,425	19,763	24,719	23,328	28,538	30,607	36,338	33,147	-8.78%
S&P 500	2,044	2,239	2,674	2,507	3,231	3,756	4,766	3,840	-19.43%
Nasdaq Comp.	5,007	5,383	6,903	6,635	8,973	12,888	15,645	10,466	-33.10%
Commodities									
Gold - US$	1,060	1,252	1,309	1,281	1,523	1,895	1,829	1,826	-0.16%
Crude Oil WTI - US$	37.04	53.72	60.42	45.41	61.06	48.52	75.21	80.26	6.71%
Natural Gas - US$	2.35	3.74	2.95	2.94	2.19	2.54	3.73	4.68	25.47%
Currencies									
€ in Cdn $	1.50	1.42	1.50	1.56	1.46	1.56	1.44	1.45	0.69%
£ in Cdn $	2.04	1.66	1.69	1.74	1.72	1.74	1.71	1.63	-4.68%
US$ in Cdn $	1.38	1.34	1.26	1.37	1.30	1.27	1.26	1.36	7.94%
Interest Rates									
Cdn Prime rate	2.70	2.70	3.20	3.95	3.95	2.45	2.45	6.45	163.27%
US Prime rate	3.50	3.50	4.50	5.50	4.75	3.25	3.25	7.50	130.77%
Cdn 10 Yr bond	1.41	1.72	2.04	1.95	1.64	0.70	1.45	3.30	127.59%
US 10 Yr bond	2.27	2.44	2.40	2.69	1.92	0.93	1.52	3.88	155.26%

Source: The Globe & Mail