

Wickham Investment Counsel Inc.

Quarterly Review

June 2023

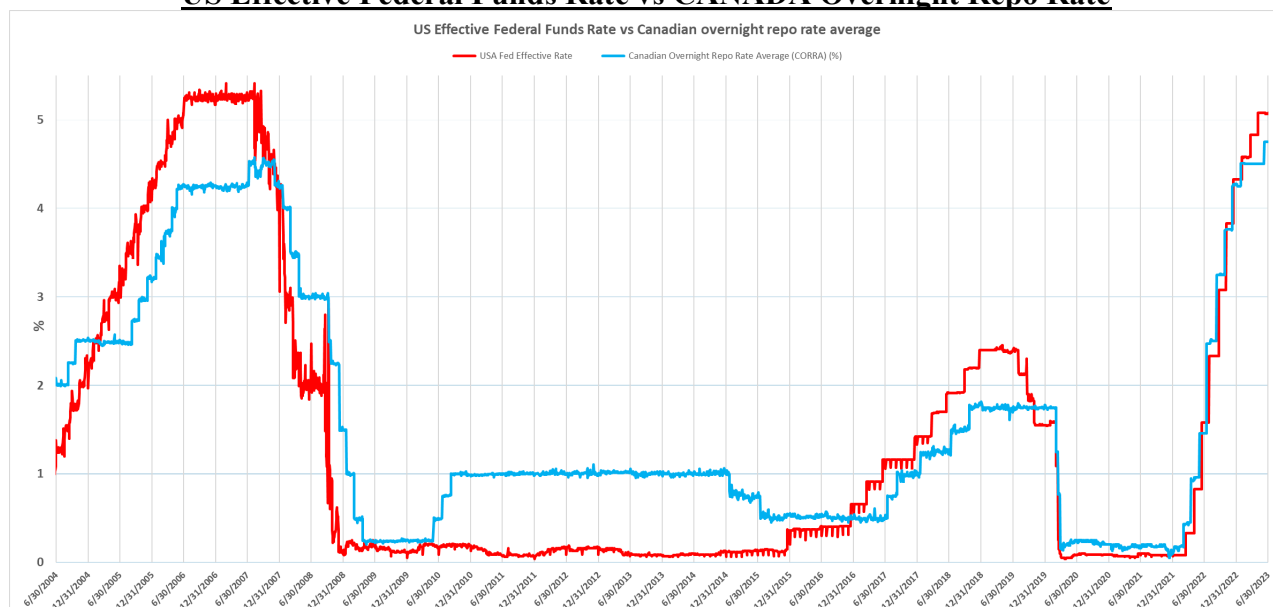
Rates Going Up

The predominant policy theme continues to be the need to push interest rates higher and maintain them longer to break inflation. The US Federal Reserve decided to pause the Fed funds rate at 5.25% in June but advises that more increases are likely. Another quarter point, or even a ½ point increase is expected in July. Headline inflation is 4% in the US and GDP was revised upwards to 2% in the first quarter. The annual inflation target is 2%. The Bank of Canada abandoned its own pause earlier in June and raised the rate to 4.75% even though there was a sharp slowdown in Canada's annual inflation to 3.4%.

As the attached chart shows, rates are now approaching the levels before the great recession in 2007, but the speed of rate increases over the past year has dominated. Rates were held at exceptionally low levels during Covid to support economic growth. Now the effects of the higher rates are evident in an inverted yield curve, where two-year government bond yields are well above ten-year yields, money supply is declining, commercial bank credit is contracting, and commodity prices are weakening. All the preconditions are in place for an economic recession, which is exactly what the central banks want to engineer. Some economists argue that the push for higher rates may already be going too far, and that inflation will indeed prove to be transitory.

Higher rates provide opportunities for fixed income investors. Yields on investment grade corporate bonds are available in the 5 – 6% range. A two-year US Treasury bill is close to 5%. Lower quality bonds are trading in the 6 – 8% yield range. Our preference is for the bond terms in the 2 – 5-year range. Investors get a decent risk adjusted return even if interest rates go higher. With respect to equity markets, we have spoken about the emergence of **artificial intelligence** in recent quarters. Excitement was widespread in the second quarter and developments in artificial intelligence could be the most important technological change in many years. The real value is in turning raw corporate data into dollars and unleashing the productivity enhancing power of software. Data is the new oil. Next generation software companies represent one of the greatest opportunities over the past forty years. From an investment standpoint, chipmaker Nvidia has tripled in value with the potential growth for its products. A handful of other major technology companies, the “magnificent Seven” have also caught fire, including Apple, Microsoft, Amazon, Tesla, Alphabet and Meta. These were all impressive businesses before, but investors still need to be wary of valuations. Although the breadth of the markets is starting to improve, these companies account for about 30% of the S&P 500 index, which showed a 15.9% gain over the January - June 2023 period. This compares to a 4.0% gain in the S&P/TSX composite index. The Canadian market index is heavily weighted to financials and energy with low exposure to technology by comparison and is struggling with rising interest rates.

US Effective Federal Funds Rate vs CANADA Overnight Repo Rate



Sources www.bankofcanada.ca & www.newyorkfed.org/markets/reference-rates

	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Dec 31, 2022	Jun 30, 2023	% Change Dec-Jun
<u>Stock Market Indices</u>									
S&P/TSX Comp.	15,288	16,209	14,323	17,063	17,433	21,223	19,385	20,155	3.97%
Dow Jones Ind.	19,763	24,719	23,328	28,538	30,607	36,338	33,147	34,408	3.80%
S&P 500	2,239	2,674	2,507	3,231	3,756	4,766	3,840	4,450	15.90%
Nasdaq Comp.	5,383	6,903	6,635	8,973	12,888	15,645	10,466	13,788	31.74%
<u>Commodities</u>									
Gold - US\$	1,252	1,309	1,281	1,523	1,895	1,829	1,826	1,929	5.66%
Crude Oil WTI - US\$	53.72	60.42	45.41	61.06	48.52	75.21	80.26	70.64	-11.99%
Natural Gas - US\$	3.74	2.95	2.94	2.19	2.54	3.73	4.68	2.67	-42.95%
<u>Currencies</u>									
€ in Cdn \$	1.42	1.50	1.56	1.46	1.56	1.44	1.45	1.44	-0.72%
£ in Cdn \$	1.66	1.69	1.74	1.72	1.74	1.71	1.63	1.67	2.48%
US\$ in Cdn \$	1.34	1.26	1.37	1.30	1.27	1.26	1.36	1.32	-2.59%
<u>Interest Rates</u>									
Cdn Prime rate	2.70	3.20	3.95	3.95	2.45	2.45	6.45	6.95	7.75%
US Prime rate	3.50	4.50	5.50	4.75	3.25	3.25	7.50	8.25	10.00%
Cdn 10 Yr bond	1.72	2.04	1.95	1.64	0.70	1.45	3.30	3.26	-1.21%
US 10 Yr bond	2.44	2.40	2.69	1.92	0.93	1.52	3.88	3.71	-4.38%

Source: The Globe & Mail