Wealth Management
Dominion Securities

Pringle

PORTFOLIO MANAGEMENT GROUP
of RBC Dominion Securities

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Integrity, trust and experience

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Welcome and thank you

A warm welcome to the clients who have recently joined us, and a special thank you to the people who mentioned our name to them. We appreciate your trust and support.

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Removing the Froth

Central banks recently flooded the world monetary system with liquidity and forced interest rates down to offset the negative effects of the COVID-19 pandemic. Unfortunately, central bankers' policies cannot pinpoint areas of the economy that need help but, instead, are limited to flooding the system with ample money. The result has been asset inflation in stocks, crypto currencies, like Bitcoin, and real estate. Several aspects of the markets had shown signs of excess speculation.

Inflation has picked up noticeably and the U.S. inflation rate is 8.6% -- the highest rate in 40 years. There are several factors contributing to this higher inflationary environment, including: excess demand coming out of the pandemic lockdowns, increased wages due a tight labour market, commodity price surges following the onset of war between Russia and Ukraine, and supply chain disruptions resulting from COVID-19 lockdowns. While some factors that drove inflation will pass, some may take longer to resolve than policymakers hope. Further, globalization now seems to be receding, and this will increase prices and make conquering inflation harder.

Policymakers have increased interest rates and begun to drain excess monetary liquidity from the financial system in an effort to quash inflation before it becomes too entrenched. There will likely be more interest rate increases by central banks in the months to come. Markets reacted to the central banks' increase in interest rates negatively. Most markets sold off, and areas with high speculation were affected the most. Bitcoin is off 67% from its high, and the technology-heavy U.S. NASDAQ market is off some 27%, while the U.S. Dow Industrials were off about 15%, and the Toronto exchange off about 12% year to date. The bond markets also sank as higher interest rates pushed down valuations.

Meanwhile, unemployment levels in the U.S. and Canada are at multi-decade lows, and help wanted signs are abundant. It is reported that, in some places, the ratio of jobs available versus those looking for work is 2:1. The pandemic also triggered a lot of people of retirement age to do so, which has contributed to the current tight labour market. No wonder inflation has picked up.

In the months ahead, there remain many unanswered questions. How many more interest rate increases will it take to tame inflation? Will central bank policies result in a recession? Will they blink and back off increasing interest rates when the politicians and public cry out in pain? We'll see and, in the words of economists, it remains data dependent.

It should also be noted that policy actions today take several months to show their effect, so I think it quite possible that after another interest rate hike or two this summer, policymakers will pause and monitor their effects this fall. Part of the officials' intent is to cool the "animal spirits" evident in several markets. Some markets respond quickly, such as crypto currencies and stocks, while others, like real estate, take time to reflect the new environment of monetary policies. The "got to buy it as it's going up" mentality only contributes to the inflationary mindset we want to avoid. All in all, it takes time for central banks to remove the froth in markets that were created by easy monetary policies.

The U.S. dollar is hitting multi-decade high levels as investors flee back to the "safe haven" of the U.S. It is probably also due to the fact that many investors and speculators borrowed in U.S. dollars to invest elsewhere in the world and are re-patriating funds and paying off their loans. The high U.S. dollar is also problematic as many economies rely on U.S.-dollar borrowings to fund imports and function. If the strong U.S. dollar persists, we will see some issues in various markets.

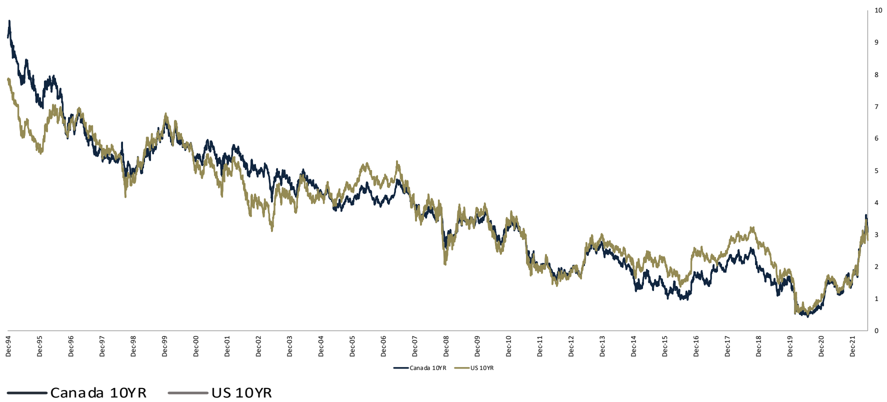
The war in Ukraine is an awful situation that should remind us that the world is not full of happy, peaceful people. It looks like it will be a long, drawn out affair destroying lives and infrastructure. It will also keep commodity prices elevated, such as oil, natural gas and food.

The obvious speculation in many asset classes and emphasis on momentum stocks (buying winning stocks regardless of valuations) never made sense to us. Quality, well valued companies lagged the ever increasing prices of the market darlings. The current market correction and return to sensible monetary policies is a sigh of relief. The laws of economics have not been repealed after all. It might just be that momentum investing with disregard to valuation and quality will be replaced by true old fashioned stock picking focused on quality and value. As always, we are focused on quality companies and will do our best to protect your interests.

Tony Pringle, CFA
June 30, 2022

Exhibit 1

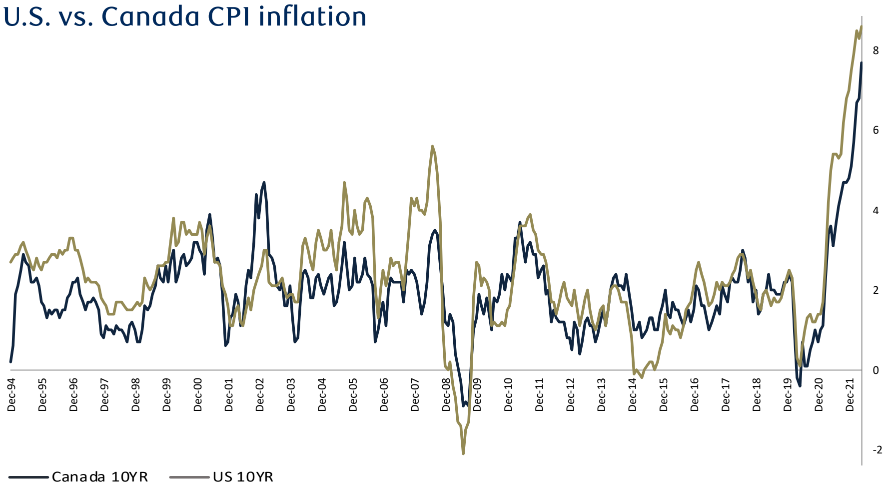
U.S. vs. Canada 10-year bond yield



Source: Federal Reserve Board, Statistics Canada

Exhibit 2

U.S. vs. Canada CPI inflation



Source: Federal Reserve Board, Statistics Canada

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