COOPER WEALTH MANAGEMENT
RBC Dominion Securities
Trevor Cooper W.Frank Cooper Walter Harmidarow

# THOUGHTS ON THE MARKET

## Our Advisors

Trevor Cooper
Portfolio Manager &
Senior Wealth Advisor

Walter Harmidarow
Portfolio Manager &
Senior Wealth Advisor

W. Frank Cooper
Senior Wealth Advisor

Christopher O'Connor
Associate Advisor

Rachel Cooper
Associate Advisor

Anne McDougall
Financial Planner

## Our Team

Pamela Townsend

Karen Charlesworth

Holly Kelly

Philip Swan


## Probabilities for 2023

*"The idea that you can actually predict what's going to happen contradicts my way of looking at the market."*

*- George Soros, Renowned Hedge Fund Manager*

George Soros built his hedge fund fortune by investing in the most likely probabilities for stocks based on the existing market conditions. He never stopped to worry about what was predicted for the market. Forecasts are often based on the emotional bias of recent history and can be either too pessimistic or too rosy. Rather than try to predict the future, this month we will compare current market conditions with historical precedents in order to evaluate the probabilities of what is most likely to occur in 2023.

As a basis for comparison to 2022, we will use the years 2000 and 2008 as they most closely match last year's results. The year 2000 saw the U.S. economy in a significant recession after the frenzy of technology spending in 1999 in preparation for Y2K. In 2008, we had the financial crisis that threatened the global economy. In 2022, we had rising interest rates, inflation and the invasion of the Ukraine.

Here's how the markets performed during these periods:

| | TSX | S&P 500 | Nasdaq |
|---|---|---|---|
| 2022 | -8.7%. | -19.4%. | -33.1% |
| 2000 | +6.2%. | -18.7%. | -28.3% |
| 2008 | -35.8%. | -38.5%. | -35.6% |

In percentage terms, the market priced in a scenario between a serious recession and the threat of economic collapse, yet neither of these was happening. The key factor in 2022 was the U.S. Federal Reserve's massive 4% interest rate increase to battle inflation. As there is virtually no chance this will be repeated in 2023, the market outlook can only be brighter.

As to probabilities for 2023, let's begin by looking at U.S. interest rates. The Fed has stated they intend to increase interest rates 75-125 basis points this year in order to continue to fight inflation. While rising rates are not good for markets, it is much easier to manage a smaller range of increases than the unprecedented scope of last year's numbers. The Fed has also stated they don't expect any rate decreases in 2023 either but it is interesting to note that the U.S. government bond market is actually betting on only a 50 basis point increase and then rates beginning to come back down. The probability is likely somewhere between these two views, though we don't anticipate a rate cut within the next year unless inflation falls much faster than the Fed expects.

Inflation is also moving lower as supply and demand come back into balance. The Core Personal Consumption Expenditure Index (PCE) which measures the cost of everything we buy except for food and energy fell to a 4 month low of 4.7% last month. This is the Fed's favourite measure of inflation and if trends continue, they will likely pause on further rate hikes. Energy prices have come down considerably, with natural gas dropping 50% from its peak. Unfortunately, we will have to wait and see how crops grow this year and if agricultural products continue to be shipped out of the Ukraine before we see a further decline in food prices. A further sign that the price of goods will trend lower is the World Container Index which tracks the cost of shipping around the world. As of December 22nd, this metric decreased to $2,120 U.S., which is 21% lower than the 10 year average. Overall, the most probable trend for inflation this year is lower.

The fear of recession remains a concern. Consumers have been slowing their spending on both goods and services but U.S. GDP is still positive, meaning the economy is continuing to grow but at a slower pace. Unemployment has not increased as expected, remaining steady at 3.5% in the U.S. The probability is unlikely to change as the number of unfilled jobs remains at almost 2:1 to available workers . In 2024, the U.S. will reach Peak 65, where more Americans will turn 65 than at any point in history. Currently, 10,000 people per day in the U.S reach the traditional retirement age. However, the number of layoffs, particularly in the higher wage technology sector, has created enough economic uncertainty such that wage increases in general are coming in at a rate lower than the current inflation level. So far, so good for the Fed and their battle against inflation but what remains to be seen is how quickly the Fed will adjust when the economy normalizes.

One of the key elements of inflation is energy costs. Here there has also been good news. Oil has settled into a $70-80 per barrel range and natural gas is in the mid-$4 range. A fairly mild winter in both North America and Europe has tempered demand. U.S. oil production is currently at 12.1 million barrels per day and expected to rise to 12.4 million this year. This is above 2019 levels and allows the U.S. to be energy self-sufficient. Continued demand from Europe to replace Russian supply as well as overall increased global demand and the U.S. restocking its Strategic Petroleum Reserve should keep demand healthy while the increased supply will help keep prices stable. Canadian energy producers like Suncor should have another profitable year and we are also adding Valero, a U.S. oil refiner, to take advantage of this trend as refineries in the U.S. are running at full capacity.

With the energy market looking stable, even without Russian supply, the outlook for the Canadian market will be largely dependent on the bank sector. Historically, mortgage defaults in Canada have remained very low and the probability is that this will continue, in part due to the higher mortgage qualification criteria the government has put in place. Barring any major write-downs, we expect bank earnings to increase due to higher net interest income from variable rate credit products. Combined with the energy outlook, this should set the stage for a positive 2023 for Canadian equities.

Analyst estimates for 2023 U.S. corporate earnings have come down as we expected, just as they did in 2001 and 2009. In both cases, earnings outperformed these lowered expectations and equities began to recover. Given that the current economic conditions are nowhere near as dire as during those previous periods, probability again favours the market and a positive outcome.

Coming into 2023, stock prices and inflation are both lower and the Fed is much closer to the end of its rate increase cycle. There will certainly be some surprises, either from the Ukraine, China or other sources, but with last year's sell off, the markets did price in most worst case scenarios.

As we get further clarity from the Fed, we expect market conditions to improve. We are maintaining our balance between growth and defensive names, with a continuing focus on cash flow through dividends and our covered call program.

Given the history of the market after major sell offs and the improving global economic conditions, the probability of a positive market outcome this year seems much higher than another negative year. However, we remain ready to adjust to market conditions as Mr. Soros wisely reminds us. Until next month, stay well.

As always, questions, comments, concerns and feedback are always welcome.

Yours truly,

Trevor, Walter and the Cooper Wealth Management team