RBC Dominion Securities Inc.

The Sandler Quarterly

Wealth Management Dominion Securities

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Are we there yet?

KEY INSIGHTS

- Equity markets end quarter at new lows
- Negative sentiment and consensus give hope for relief rally
- Inflation subsides, declines each month since June
- Home prices fall across Canada amid interest rate hikes
- Higher rates reward savers, hurt borrowers

Uncertainty continues to be the name of the game. Investors are grappling with a host of unknowns: When will the next recession arrive (or are we already in it)? Has inflation peaked now that commodity prices seem to have retreated? Will central bankers continue on their aggressive path of increasing interest rates? What will higher rates mean for the housing market?

If you feel a sense of déjà vu - thank you! It means that you are a regular reader of this newsletter. The paragraph above is taken directly from last quarter's newsletter and three months later, these same questions remain top of mind for investors.

Bank of America's Bull & Bear Indicator
Stays at 0.0

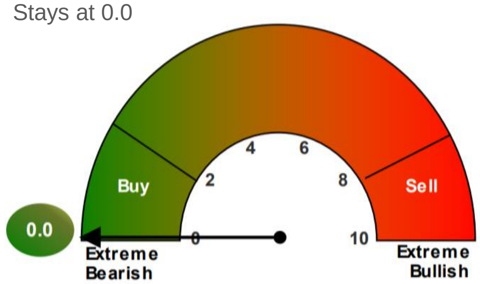

***Figure 1:** Bull & Bear Indicator*, as of Oct 6th
(Source: Bank of America)

Above all, the question on everyone's mind is - when will the market stop going down?

Market Watch

Markets hate uncertainty, and while the questions above remain unanswered it is likely that volatility will continue with some potential for further downside. That said, with the passage of time, we believe some clarity is beginning to appear. Below we will attempt to address the key issues.

Today's market differs from the Covid bear market in many ways. Longevity, however, is one key defining difference. In March of 2020, the S&P500 declined 34% in a rapid 33 days before beginning its climb back higher. The 2022 market decline, from its high point achieved in early January, is now more than 9 months old. The Covid bear market was gut wrenching but passed quickly; today's market just seems to drag on and on – the waiting is the hardest part! So, when might this period of weakness end?

Like most bear markets, the bottom will occur when we least expect it. The point of maximum negative sentiment (see

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Figure 1) is typically when markets reverse course. Right now, sentiment is about as negative as it gets. We would not be surprised to see some relief in the coming weeks. When headlines and economic conditions are at their worst markets tend to make moves higher in anticipation of future growth and improvements.

Recession Watch

Since the 1930s, markets have bottomed approximately 5 months before the recession ended (see *Figure 2*). It's all very well to know that equity markets start to improve during the recession, but when will the recession begin? Or has it already?

RBC predicts that Canadian and US recessions will arrive in the first half of next year (at time of writing "next year" is only about 10 weeks away). In reality, recessions are officially identified after the fact. Unfortunately, nobody fires a starter's pistol at the beginning (or end) of a recession. That said, a number of indicators are now pointing to us being in recessionary territory (see *Figure 4*).

Summing up the situation as best we can, it would appear that we are in the 7th or 8th inning of the current economic cycle. Inflation appears to have peaked (see *Figure 3*) and we believe that interest rates will top-out sooner than the media would have you believe. We are optimistic that we are far closer to the end than the beginning, but we also recognize that there will most likely be some further turbulence ahead.

Fasten your seatbelts

Market volatility is unnerving for the vast majority of investors. Turbulence when flying is similar. It happens to some degree on almost every flight and most of us are used to it. When it gets extreme however, even the most seasoned flyers are affected and grip the armrest a little tighter. Yet even through the worst turbulence, calmer skies always follow and we reach our destination safely.

We believe that owning top quality businesses will allow us to reach our destination safely and create wealth over time. Our investment philosophy has proved itself in the past. Notably through the financial crisis of 2008/09, the European debt crisis and Covid to name a few. Companies like BMO, CP Rail, Apple and MasterCard have navigated tougher times than this and gone on to grow their earnings and achieve new heights. Even our laggards this year, Disney and FedEx, are leaders in their respective industries, with tremendous capacity to grow their businesses and earnings in the future.

	S&P 500 decline details			Recession-related details		
Recession dates	Market peak date	Days to bottom	% Decline	Recession length (months)	Did the market bottom before the recession ended?	No. of months from market bottom to end of recession
May 1937 - Jun 1938	03/10/1937	386	-54%	14	Yes	3.0
Nov 1948 - Oct 1949	06/15/1948	363	-21%	12	Yes	5.1
Jul 1953 - May 1954	01/05/1953	252	-15%	11	Yes	9.1
Aug 1957 - Apr 1958	07/15/1957	99	-21%	9	Yes	5.0
Apr 1960 - Feb 1961	08/03/1959	449	-14%	11	Yes	4.0
Dec 1969 - Nov 1970	11/29/1968	543	-36%	12	Yes	6.1
Nov 1973 - Mar 1975	01/11/1973	630	-48%	17	Yes	6.1
Jan 1980 - Jul 1980	02/13/1980	43	-17%	7	Yes	4.1
Jul 1981 - Nov 1982	11/28/1980	622	-27%	17	Yes	4.1
Jul 1990 - Mar 1991	07/16/1990	87	-20%	9	Yes	6.1
Mar 2001 - Nov 2001	03/24/2000	929*	-49%	9	No	N/A**
Dec 2007 - Jun 2009	10/09/2007	517	-57%	19	Yes	4.1
Feb 2020 - Apr 2020	02/19/2020	33	-34%	3	Yes	1.0
Average		381	-31.8%	11.5		4.8

***Figure 2**: S&P500 corrections surrounding recessions (Source: RBC Portfolio Advisory Group)*

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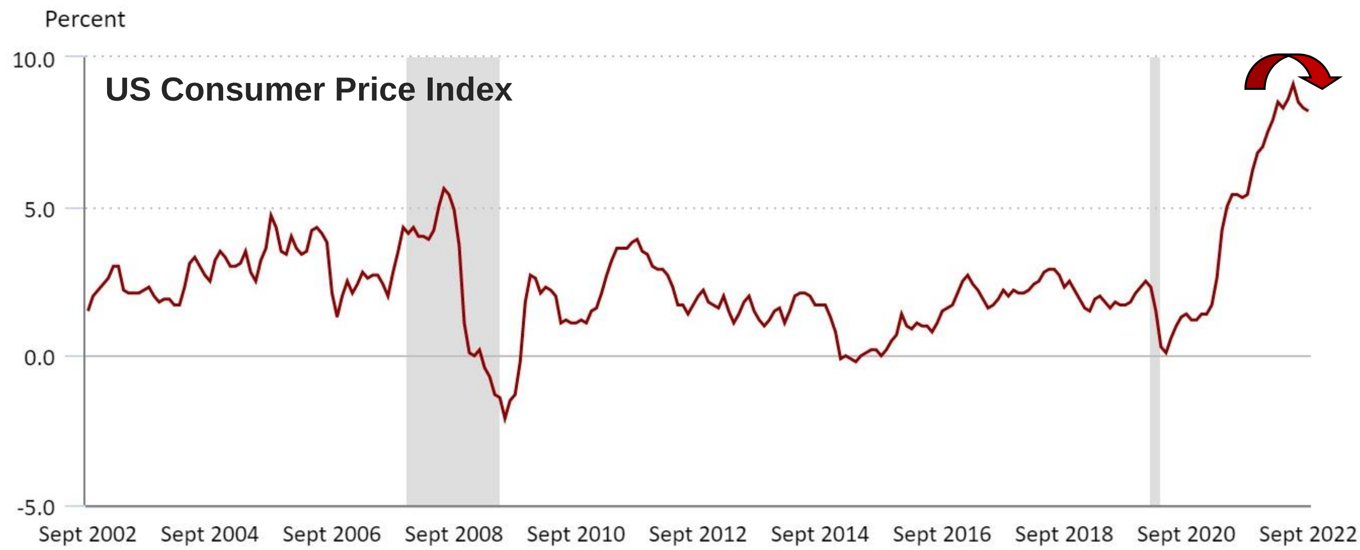

Figure 3*: Consumer price index, 12-month percentage change (Source: U.S. Bureau of Labor Statistics)*

Word Games

You may have noticed that we typically use the words *company* or *business* when speaking about our equity investments. While we will sometimes refer to the *stock market*, we never describe our investments as *stocks*. This may seem like a subtle distinction but in our mind it is an important one. The term *stock* conjures up images of ticker symbols, traders and prices that change by the minute. An investment in a *company*, on the other hand, places focus on the business, profitability and longer term return.

At times like this, the individual that buys Apple *stock* is driven to distraction watching it go up and down on a daily basis. Conversely, the individual that views their investment as an ownership stake in Apple's *business*, eagerly looks forward to the future growth in profits and dividends. Warren Buffett does not buy stocks, he buys companies - we should all strive to do the same.

Indicator	Status		
	Expansionary	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Economic Index			✓
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories			✓
Fed funds rate vs. nominal GDP growth	✓		

Figure 4*: U.S. recession scorecard (Source: RBC WM)*

Stay the course

It is important to remember that the equity market is always trying to predict the future. The S&P500 is down ~25% through the end of September not because of current corporate profits or economic conditions, but because of what profits are predicted to be next year. Similarly, should profits fall next year as anticipated because we enter a recession, investors will already be looking forward to the growth that occurs as we emerge from that recession. It is a certainty that this series of events will occur; the timing on the other hand is impossible to predict.

Because none of us know when the market will bottom, it is essential to stay the course and remain invested. If anything, we should be greedily looking to buy more equities as they decline in price. As Buffett famously said, we should be fearful when others are greedy, and greedy when others are fearful. Last quarter we included a graph that illustrates the importance of remaining invested rather than timing the market; given the current environment we have included a similar graph but with a longer time horizon this time (see *Figure 5*).

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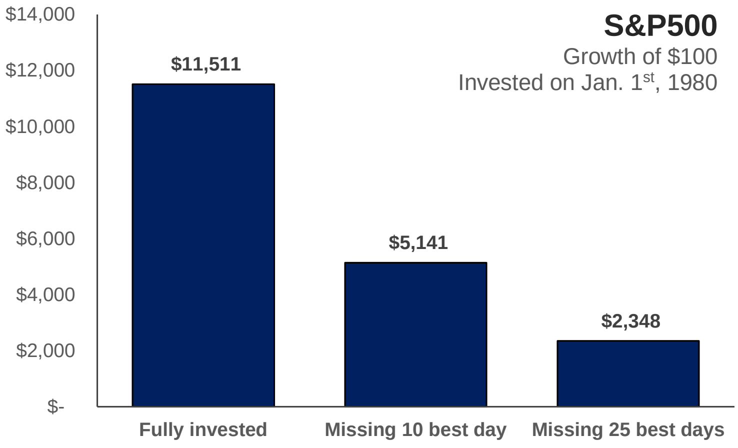

***Figure 5**: S&P500: Growth of $100 invested Jan 1st, 1980 (Source: RBC WM)*

We fully understand that times like this can be unsettling for many. Please remember a few very important things:

- *You are an owner of some of the best businesses in the world*
- *The media is not your friend, please change the channel*
- *When everybody has a similar opinion, get ready for the opposite to happen*
- *It's not all about the equity market, we also hold cash, bonds, preferred shares and gold*

Most importantly, if you ever want to discuss how your investments are affected by the current environment, please get in touch with us. You will receive your quarterly portfolio report in the coming days. It details your personal asset allocation, performance and holdings. If you have any questions we encourage you to pick up the phone right away. We are always available and happy to take your call.

	Q3	YTD
Indices		
S&P/TSX	-2.21%	-13.09%
Dow Jones	-6.66%	-20.95%
S&P 500	-5.28%	-24.77%
Nasdaq	-4.11%	-32.40%
Euro Stoxx	-3.96%	-22.80%
Japan Nikkei	-9.91%	-9.91%
India Sensex	8.31%	-1.42%
VIX (Volatility)	10.14%	83.62%
Commodities		
Gold	-8.12%	-9.22%
Silver	-6.17%	-18.36%
Copper	-6.92%	-21.12%
Oil	-24.84%	3.25%
Natural Gas	-2.17%	73.86%
Currency		
CAD	-6.91%	-8.61%
EUR	-6.51%	-13.79%
JPY	-6.22%	-20.47%
AUD	-7.29%	-11.88%
GBP	-8.28%	-17.45%

Values as of September 30th, 2022

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