THOUGHTS FROM HOME

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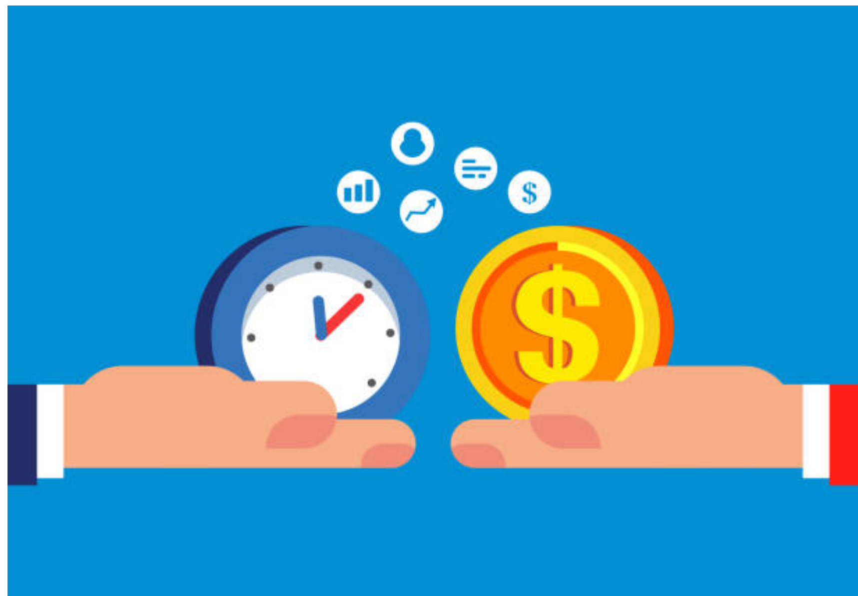

Patience and Recovery

"To lose patience is to lose the battle."

- Mahatma Gandhi

Gandhi's greatest strengths were his boundless patience in the face of adversity and the relentless pursuit of his goals. He never allowed setbacks to deter him nor allowed minor victories to change his course of action.

Our investment philosophy must have a similar mindset. This year has definitely been challenging but July brought the beginning of the market rally we predicted. This month, we will explore current market conditions to review how our patience is being rewarded and the outlook for further recovery.

July saw a significant rally across most markets with key portfolio names such as Apple, MasterCard, Amazon and Advanced Micro Devices all advancing more than 10%. The key themes this month include the market beginning to believe that the U.S. Federal Reserve is almost done raising interest rates, inflation presumed to be easing and the threat of recession seeming remote. The market interpreted Chairman Powell's July testimony before Congress as being less aggressive towards further rate increases, which led to a strong rally in growth type stocks and caused the 10 year U.S. Treasury yield to drop to 2.76%. The bond market still doesn't believe the Fed will get to its 3.5% target rate. At this time, the U.S. yield curve is actually inverted, with the 2 year bond at 3.2%, which is actually signalling to the Fed they are more worried about a recession than inflation. At this moment, the bond market is betting that the Fed will at least pause rate increases until more inflation data comes in. We expect this tug of war to continue until we get a series of weaker inflation numbers.

That being said, there are a number of positive developments on the inflation front. July saw the first shipments of Ukrainian wheat and fertilizer out of Odessa which eases some global supply concerns and marks a positive development in the Ukrainian war as weeks ago Odessa was under constant Russian attack. The price of oil dropped below $90 per barrel and we expect it to remain in the $80-90 range as further production comes on line. With the pending crop harvest, we also expect food prices to begin to ease lower. However, one major inflationary bottleneck remains and that is transportation costs. Shippers are still trying to deliver the massive backlog of consumer goods ordered during Covid, leading to extremely high costs. We expect this situation to improve in the coming months as fuel surcharges are reduced and consumer demand continues to shift from goods to travel and leisure. We have already seen transportation costs for bulk commodities drop 23.7% in the last month and expect this to flow into other transportation costs.

The second great concern in the U.S. after inflation is recession. We believe this worry to be overdone as well. U.S. corporate profits for the second quarter are coming in far better than expected. Earnings increased 8.1% over the year-ago quarter and 78% of companies beat estimates. While forecasts for the next two quarters have come down, S&P companies still estimate maintaining the 8.1% growth rate for the full year 2022.

The numbers currently show no signs of a recession of any duration or depth but here is how we see the next few months playing out. First, we do expect a slowdown in manufacturing as goods inventories continue to rise. As goods continue to come in over the next few months, we expect some major price reductions and sales going into the Christmas season to help reduce inventories by year end. Major retailers such as Walmart, Target and Home Depot have already stated that inventory levels are too high and they have been market leaders for too long not to address this issue.

U.S. unemployment remains near historic lows at 3.6% and job growth has continued. Some companies have trimmed staff, notably some leading software companies, but so far it has had no effect on general employment levels. We see the U.S. employment situation remaining strong for some time as Baby Boomers continue to retire and there is not enough immigration or new entrants to the work force to offset. The same demographics that came into play regarding the surge in inflation from 1973 to 1999 are now playing out in the U.S. labour market. Despite this tight labour market, wage inflation has remained low due to automation and more jobs being service oriented.

From a GDP standpoint, the U.S. economy may appear weaker as manufacturing has a heavier weighting than services but we expect the U.S. economy overall to continue what it has been doing. This leaves the Fed in a tricky situation. Raising interest rates has increased housing costs which is a core inflationary component. Continuing to do so will definitely dampen the housing market further but we believe it will do little to change consumer behaviour, aside from reducing housing sales. The Fed doesn't have another meeting until September and if the Consumer Price Index and Personal Consumption Expenditures continue to decline over the next few weeks, the Fed could be forced to soften their stance further, which would send markets higher. Given the current level of the 10 year U.S. Treasury, this is what the bond market believes at the moment and we agree with this view.

The outlook for Canadian markets is a little more muted. Job growth has fallen and weaker commodity prices have a larger impact in Canada than the U.S. However, at current commodity prices, especially for oil and gas, our resource companies will remain very profitable and that should be positive for shareholders. The Bank of Canada will likely continue to follow the U.S. on any interest rate decisions and the Canadian dollar should continue to be strong versus the U.S. as worries about Covid and any further escalation of the Ukrainian crisis continue to ease.

July was definitely a month of strong recovery and while conditions improve, we will remain vigilant and review any setbacks in the context of your long term goals, not just react to short term turbulence.

As Gandhi so wisely advised, the quest for investment returns continues and it is not measured in days or weeks but over time. In that same light, market setbacks must be viewed as opportunities rather than problems. Until next month, stay healthy and happy.

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

Yours truly,

Trevor, Walter and the Cooper Wealth Management team

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