# THOUGHTS FROM HOME


## 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 Wealth Advisor

Anne McDougall
Financial Planner

## Our Team

Pamela Townsend

Maddy Bodden

Rachel Cooper

Karen Charlesworth

Holly Kelly

Austin Coles

## The Tide and the Flood

*"There is a tide in the affairs of men, which taken at the flood, leads on to fortune."*
*- William Shakespeare*

In the worst six month performance for stocks and bonds since 1970, June will be remembered for the tide of red ink that flowed for most of the month. Led by higher

than expected Consumer Price Index numbers in the U.S. and the Federal Reserves Chairman Powell's determination to raise interest rates to fight inflation. These items led to a bear market sell off across most major stock exchanges, all be it very light on volume. The tide is definitely high when you add in the fear of a potential recession and the continuing war in the Ukraine. This month, we will explore Shakespeare's observation and try to determine if the flood of bad news is over and we can resume our journey to fortune.

The recession/inflation narrative drove the sell off at the start of the month but the third week of June led to a strong rally in equities. There were many reasons for this which give us cause for optimism in the weeks ahead. To begin with, commodity prices, particularly oil, natural gas, copper and iron ore all sold off sharply, with natural gas falling over 17% month to date. High global commodity prices were at the core of the recent inflation scare but this month, the Commodity Research Bureau (CRB) Index, which represents a broad basket of global commodities, is down 6.68%. Also, bulk commodity transportation costs were down 10.74%. The CRB is still up 29% this year, largely due to oil, but this month has brought some welcome relief.

Globally, consumers have begun a marked shift from purchasing goods to services, with both Target and Walmart announcing their inventory levels are now to high and Amazon shipments back down to pre Covid levels. This reduced demand for goods should help ease inflationary pressures further. In fact, there is early evidence that the upward trend in inflation has at least paused, as the PCE Index for May (which tracks personal consumption expenditures in the U.S.) came in at +6.3% year over year, the same as April. This is the Federal Reserve's preferred measure of inflation and hopefully with June's commodity price declines, this number is headed lower. A surprise decrease of 50 basis points in the U.S. 30 year mortgage rate was another encouraging sign. In turn, this should let the Fed be less aggressive in raising interest rates and reduce fears of recession. It is interesting to note that neither the European Union (EU) or Japan has raised interest rates, while China has actually cut rates slightly. Japan has no intention of raising and the EU is looking at 25 basis points by the fall. The market is actually already pricing in a 50 basis point cut in U.S. rates in 2023. Clearly, the market does not believe that the Fed will fight inflation with interest rate increases for long.

The market's primary concern seemed to have pivoted this past week from inflation to fear of recession. Attention has now turned to the upcoming U.S. earnings season to see how badly the Ukraine war/China shutdowns/supply chain issues, as well as the elevated U.S. dollar, have impacted quarterly earnings and affected the corporate outlook for the balance of the year. Investors who are negative on the market believe earnings estimates are too high and that a weak earnings season, with weak future guidance, will lead to

lower share prices. However, this chain of negativity is only as strong as its weakest link. Let's start with the U.S. dollar. It is at a multi year high versus both the Euro and the Japanese yen due to the Fed's aggressive interest rate policy and the uncertainty of the Ukrainian conflict. A resolution to either of these situations will send the dollar back down towards pre crisis levels.

The fear of recession is worse than an actual recession, which is defined as two consecutive quarters of Gross Domestic Product (GDP) declines. According to the U.S. Bureau of Economic Analysis, U.S. GDP was down 1.6% in the first quarter of 2022 and is forecasted to be down a further 2.1% in the second quarter ended in June, so it is our view that the US. is likely already in recession by definition. It appears that the battle with inflation will be brief as commodity prices have started to fall and housing and hiring have rolled over and started too slow. This should allow the Fed to turn its attention to fighting recession and thereby easing up on interest rates. Given the decline in both stocks and bonds this year, the market has already priced in a full recession and we believe the sell off has been overdone.

It does appear that the flood of bad news may be starting to ease. One of the strongest confirmation signs is the recent action of the U.S. 10 year Treasury bond. Two weeks ago, the yield had climbed to 3.5% and appeared poised to move higher as the inflation fight was in full swing. With the worry now shifting to recession, the yield sank to 2.8%, a 20% drop, before edging back to 3%, where it has been for most of the year. The bond market is already pricing in their belief that the Fed will not reach its 3.5% target rate and that they will stop raising rates sooner than expected.

The market's reaction to this quarter's U.S. corporate earnings will also be crucial, particularly their forecasts for the balance of the year. If the market sees earnings momentum noticeably slowing, the belief is that the Fed will be more willing to stop raising interest rates sooner, for fear of pushing the U.S. deeper into recession. Conversely, if earnings are strong and forecasts positive, they might be encouraged to keep going with interest rate increases. Our view is that the earnings this quarter will be temporarily weaker in enough sectors such as retail, housing, manufacturing and international companies due to the high U.S. dollar, inventory buildup, continuing but easing supply chain issues and the Covid related shutdowns of major Chinese cities. It is our hope that all our portfolio companies post strong results but even if they fail to do so, the market has already priced in significantly bad news into names such as Apple and Microsoft so we believe that they are at or near their short term downside limits.

The Canadian market also turned negative this month as oil fell from its March $140 high to just under $100 a barrel. The overall drop in commodity prices, coupled with recession

fears punishing the banks definitely made it a tough month. However, the banks will benefit from the interest rate increases and our oil companies still make a lot of money at $100, or even $80 per barrel, so we continue to believe the recent sell off won't last.

In conclusion, we believe the flood of pessimism is beginning to ebb. There will still be the occasional surges of bad news but with inflation fears fading, they should be less severe. All eyes will be watching Fed Chairman Powell in the coming days and if he can push back fears of a worsening recession, there will definitely be brighter days ahead.

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

Until next month, remember bad times don't last and there is no such thing as a wealthy pessimist.

Yours truly,

Trevor, Walter and the Cooper Wealth Management team

Privacy & Security | Legal | Accessibility | Member-Canadian Investor Protection Fund

RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. ®Registered trademarks of Royal Bank of Canada. Used under licence. © RBC Dominion Securities Inc. 2022. All rights reserved.