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

THOUGHTS ON THE MARKET

Our Advisors

Trevor Cooper
Senior Portfolio Manager & Wealth Advisor

Walter Harmidarow
Senior Portfolio Manager & Wealth Advisor

Charles Cook
Senior Portfolio Manager

W. Frank Cooper
Senior Wealth Advisor

Christopher O'Connor
Associate Advisor

Rachel Cooper
Associate Advisor

Our Team

Pamela Townsend

Karen Charlesworth

Holly Kelly

Philip Swan

Stephanie Fletcher

Obvious Facts and the Stock Market

"There is nothing more deceptive than an obvious fact."
- Sherlock Holmes, The Boscombe Valley Mystery

In great mystery novels, the author lays out the clues, both real and false, and the reader is left to follow along as best they can. The plot often turns on facts that are deemed obvious but mean something different when viewed in a different light. Through the media, we are bombarded by facts, statistics and opinions on a daily basis and deciding how to process all this raw data is a major challenge. This month, we will review key market facts and how they are being interpreted for clues as to the future direction of the economy and markets in general.

Let's start with interest rates. Our first obvious fact is that the U.S. yield curve remains inverted, meaning short term returns are higher than long term. The usual deduction from this clue is that the U.S. is headed for recession. While this has been a leading indicator of recession in the past, the current evidence doesn't support that a recession is imminent. To begin with, U.S. Gross Domestic Product (GDP) grew at an annualized rate of 2.4% in the last quarter, which is a healthy level for the U.S., despite the pressure of the highest interest rates in the last twenty years.

Another supporting fact is that the U.S. unemployment rate for July was 3.5%, down from 3.6% in June, which basically means the U.S. economy is at full employment. Also, the U.S. consumer accounts for 70% of GDP activity and currently they are still spending at a consistent level and have a net savings rate over 4%. Faced with this evidence, even the U.S. Federal Reserve (Fed) has taken a recession scenario out of their forecasts. The view of the yield curve we should be taking is twofold: first, the negative slope between the two and ten year U.S. Treasury bonds have fallen from over 100 basis points to 70, which in plain English means that the bond market believes the chances of a recession are reduced but a recession remains a slight possibility if the Fed keeps raising rates. Second, short term yields have stayed around 5% while the ten year yield has risen to 4.3%, which indicates that the market believes that short term rates are near a peak as even more money pushes into short term investments. If the ten and thirty year bond yields climb much higher, we expect significant purchases of those bonds by insurance companies and other investors with long term liabilities which should help bring short rates lower and bring the yield curve closer to normal. All eyes will be on Chairman Powell this week at the Jackson Hole economic summit where we expect him maintain their position and state the Fed will continue to raise rates but only if required. We believe the Fed is reluctant to raise rates much further but they will not be in a hurry to lower them either.

Next, we look at U.S. corporate earnings. With all S&P 500 companies having reported, approximately 80% exceeded expectations which is slightly higher than the historical average. Some market participants have argued that expectations had been lowered going into the quarter but the fact of the matter remains that most companies met expectations with the majority of those maintaining positive forward earnings guidance which will help support stock prices moving forward.

On the inflation front, the U.S. July inflation reading was 3.2%, a slight increase from 3.0% in June. While this was a minor setback, many economists are still predicting a decline to 2.5% this year and through 2024. While food and housing costs have declined somewhat, they remain elevated. Drought in the U.S. south, combined with a record heat wave will reduce crop yields this year. The ongoing Ukrainian invasion will continue to limit world food supplies as Russia has ended the shipping treaty but some shipments are expected. Housing costs will likely remain elevated as interest rates stay at this level and it remains difficult for new buyers to enter the market. The only other area of concern is potential U.S. wage inflation. Particularly, we are watching the upcoming negotiations with the auto industry next month as it will set the tone for other industries and could potentially negatively impact U.S. GDP if there is a strike. However, we believe that as inflation moves lower, wage pressures will decrease.

Now we turn our attention to China. Economic activity in China has been slowing and the concern for commodity prices, particularly oil, is that prices will fall as Chinese demand slows. So far, the evidence doesn't fully support that conclusion. In 2022, China used 14.3 million barrels per day of oil, down from 14.9 in 2021, which verifies that the Chinese economy is slowing. However, world oil usage has continued to increase and oil prices have stabilized in the $75-80 range. While China remains a significant global force, the slowdown there has not spread to the U.S. so far but we continue to monitor developments as another major Chinese property developer seems headed to bankruptcy.

Stability in commodity prices is good news for the Canadian market. Oil and gas stocks have gained as optimism over the no recession scenario, along with OPEC cuts, has raised prices. While we believe that Canada's economy and stock market will follow the U.S., Canada is a strong candidate among G-7 countries to potentially begin cutting interest rates prior to the U.S. as over 25% of Canadian mortgages are variable rate and many homeowners are now paying interest only. A further 13% of all mortgages are coming up for renewal in the next year causing more stress for a greater number of Canadians. Affordable housing has now become a two-pronged problem for the Canadian government as Generation Z and new immigrants face the supremely difficult challenge of affording a home while many Canadians face the cost pressures of staying in their homes. This issue is very likely to bring significant political pressure to bear. There is no mystery here. Government belt tightening via interest rates will only work as long as the public can afford pants.

August is a notoriously slow month for both news flow and trading activity and so far this August has been no exception. September will see a return to normal volumes particularly as we approach the end of September quarterly reporting period. Money managers generally invest the majority of their cash by the end of the quarter as they don't want to show large cash balances.

The U.S. market has begun to follow the path of the economy with advances seen in both the industrial and consumer discretionary sectors, now joining energy and technology. This increasing market breadth is telling us there is improving investor sentiment regarding the outlook for the economy.

As the Fed has now also removed a recession from their forecasts, it seems obvious that market conditions will improve but we are remaining vigilant and waiting for confirming evidence of interest rates falling before we look to add more growth to the portfolio.

The last area we will review this month is the U.S. political landscape. While the election is not until next November, it seems clear that the Republicans will have a difficult time fielding an alternative candidate other than the former president. This could prove to be a major distraction for the U.S. population and lead to an even greater polarization between the two parties. We believe the market can weather the political storm but it may be rocky. On a positive note, it is very unlikely any new major legislation will be passed and this gridlock has generally been positive for markets.

In closing, most people enjoy a good mystery but not when it comes to investing. We will continue to review all factors, obvious or not, and actively search for the best path forward. Until next time, stay well.

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

Yours truly,
Trevor, Walter and the Cooper Wealth Management team