Wealth Management
Dominion Securities

APRIL ’23 EDITION

not your ORDinary newsletter

Spring Cleaning

Sweeping away some recent market narratives

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With the calendar flipping to April, that means that we've officially exited winter and are primed and ready for several annual traditions.

These include The Masters golf tournament, NHL playoffs, Easter egg hunts, and of course... **spring cleaning!** That time of year where you round up all the extra stuff that has accumulated around the house, and get rid of it! What does this have to do with the market, you may ask? Well, there have been a couple of common narratives that have hovered over every investor's heads for a year now:

higher inflation and increasing interest rates.

While these issues were already showing signs of abating on their own, the recent events in the U.S. banking sector may finally allow investors (and central banks) to grab a broom and sweep those issues away.

We won't spend too much time on the intricacies of what happened in the U.S. banking sector last month, as there has been plenty written about it already. For a good summary of why we feel this is more of a "specific bank" issue and less of a "banking industry" issue, please take a look at this recent article from RBC's Kelly Bogdanova **(What's calmed markets during the banking stress?)**. What should be clear from the collapse of Silicon Valley Bank (combined with the hurried takeover of Credit Suisse by their rival UBS in Switzerland), is we are now seeing the effects of raising interest rates at a historic pace. Central bank policy is notorious for having "lagged effects", as interest rate hikes can take a while to filter through to the actual economy and change consumer and lending habits. That lag has arrived, but it's not necessarily all bad news for investors.

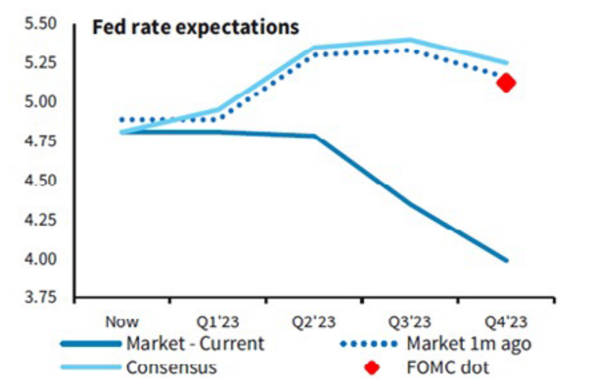
Let's start our house cleaning by tidying up the expectations of "higher for longer" interest rates.

The market has repriced rates drastically since the onset of the crisis at Silicon Valley Bank. The prevailing narrative in February was for the U.S. Federal Reserve to raise rates at the next two meetings and then pause for a while. That was despite the fact that the Fed was already seeing signs they were winning the battle against inflation. However, the additional stress in the banking system has changed that calculation, as it basically has a similar effect by tightening financial conditions and reducing the need for further rate hikes to achieve the same goal. As you can see in the following graph, the bond market more than agrees with that assessment as the expectations for additional rate hikes by the Fed all but evaporated in March. Now, the market is even pricing in rate cuts in the back half of the year. In Canada, the Bank Of Canada had previously announced they were pausing rate hikes, and confirmed this by holding the current 4.50% rate at their last meeting.

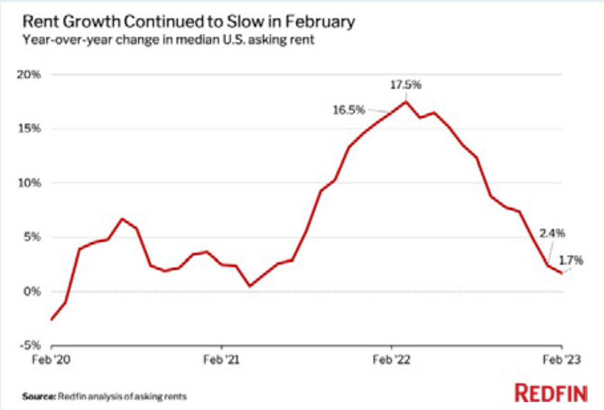
For both central banks, the question now becomes how long will they pause before they consider cutting?

Now let's move to the next room and see if we can vacuum up this inflation mess. Let's start with the facts: Inflation has been on a steady path lower since the peak of June 2022. In the U.S., it has fallen from 9.1% to 6.0% YoY as of February. In Canada, from 8.1% down to 5.2% over the same time frame. We have now seen 8 months in a row without a higher YoY inflation reading for both countries. The trend continues to point to inflation falling further, and if we do eventually see a weakened economy (or even recession), that sure won't lead to a reversal of that trend. At the current time, most of the remaining causes of inflation are due to services and not goods. The largest service sector is Housing, which in recent months has been doing the heavy lifting to keep the Consumer Price Index (CPI) elevated. However, there is reason to believe that the housing sector will soon have a "deflationary" effect on CPI, and that is due to the "lagging" effects we mentioned earlier. Housing is perhaps the most lagging indicator that the Fed looks at, simply because their calculations of rent and housing costs use numbers that are several months to a year old when they are posted. If you instead look at current rent numbers (such as the attached chart from Redfin), you will see that February was the ninth straight month in which rent growth slowed on a year-over-year basis, and is now only 1.7% higher than a year before. As this story begins to play out in the delayed CPI data, that will help in lowering inflation further.

FIGURE 2. ...and post re-iteration of the end of year Fed dot at 5.10%, the current market price ~4.00%, is significantly below Fed's year end view



Source: Bloomberg, Barclays Research



We have been pointing out the downward trend on inflation since late last year. However, when you combine this with the potential end to the rate hike cycle, you'll understand why we feel this is so important.

Falling inflation combined with falling interest rates have historically been the best period to invest in stocks (see charts below).

Markets have been in the early stages of pricing in this lower inflation/interest rate environment. So far, this has been a boost to growth stocks with the tech-heavy NASDAQ significantly outperforming the S&P 500 by almost 10% YTD as of March 31st. Both indices are up roughly 20% from their lows in October. **Now that's cleaning up!**

Average S&P 500 total returns: 1929 – 2022			
	Rising Inflation	Falling Inflation	Entire Period
Average	7.4%	14.0%	**11.2%**
Median	6.2%	18.0%	**13.9%**
% Positive	61%	80%	**72%**

S&P 500 Long Term Average Return: 1929 – 2022					
	Rising ST Rates	Falling ST Rates	Rising LT Rates	Falling LT Rates	Entire Period
Average	10.2%	12.0%	8.5%	14.3%	**11.2%**
Median	12.4%	13.9%	11.8%	15.9%	**13.9%**
% Positive	75%	70%	71%	74%	**72%**

Source: RBC Wealth Management, Bloomberg; data through 12/31/22

Introducing the Tax-Free First Home Savings Account

More from Ord Private Wealth about buying homes. We wanted to take this opportunity to introduce you to the Tax-Free First Home Savings Account (FHSA). As you may have heard in the news already, this is a new registered account designed to help more Canadians purchase their first home. The FHSA will allow investors to contribute $8,000 a year, up to a total of $40,000 on a tax-free basis to purchase their first home. These contributions will also be tax-deductible, similar to an RSP.

Subject to CRA approval, the FHSA is slated to be available to RBC Dominion Securities clients by May. At which time, they will be able to open, contribute, withdraw and trade select securities within the initial offering. Please take a moment to read **The Navigator article** on FHSAs for a better understanding of what this account will offer.

As noted in the article, these accounts will function with aspects of both RSPs and TFSAs. Like both of these accounts, unused contribution room can be carried forward into future years. Carry-forward amounts only start accumulating after you open a FHSA for the first time.

As such, clients should consider opening a FHSA immediately in order to access the contribution room for 2023, even if they are not ready to make a contribution just yet.

Doing so would allow for $16,000 to be available to contribute in 2024.

Even if the account is not eventually used to purchase a home, funds can be transferred from an FHSA to an RRSP or RIF on a tax-free basis. These transfers will not reduce, or be limited by, available RRSP contribution room so this is an excellent opportunity for tax-free growth regardless.

We expect these accounts will be beneficial to a number of our clients and look forward to being able to offer them in the coming weeks. To be eligible, you or your spouse must not have owned a home as a principal residence in any of the past four calendar years.

Please reach out to us if you would like to learn more about opening a Tax-Free First Home Savings Account.

AS ALWAYS, PLEASE REACH OUT TO US DIRECTLY IF YOU HAVE ANY QUESTIONS OR CONCERNS RELATED TO YOUR PORTFOLIO.

ORD PRIVATE WEALTH MANAGEMENT

Best regards, John, Tim, Liam & Mikail

Respecting your privacy and preferences for electronic communications is important to us. If you would prefer not to receive emails from me, please reply with "UNSUBSCRIBE" in the subject line or body of the email. If you would also prefer not to receive emails from our firm, please cc: unsubscribeRBCDominionSecurities@rbc.com in your reply. Please note that you will continue to receive messages related to transactions or services that we provide to you. To speak to us about how your preferences are managed, please email: contactRBCDominionSecurities@rbc.com.