Bessette Wealth Management
of RBC Dominion Securities

Turning the Page

2022 was one for the financial history books. Global stocks and bonds were negative for the third time in the past 45 years, with global stocks down 18% and global bonds down an eye-opening 16%. The only other two years this has happened since 1977 were in 2015 and 2018, yet those two years both experienced more modest declines, with bonds down less than 5% in each instance and stock prices down 3% and 10%, respectively. It was one of the worst years in a century for U.S. and global stock markets and the worst year ever for long-duration bonds.

Where We Stand Now

We enter 2023 with risks of an imminent recession. Several signals suggest it may begin by the middle of the year. Based on the investment community, most developed markets in North America and Europe reflect a 70% chance of a recession occurring in 2023. It is the consensus view at this time.

Why does recession seem so likely? Inflation is still high; rate hikes are expected in the near term; disposable incomes and profitability are deteriorating; geopolitical challenges are as central as they have been in many decades, and consumer and business confidence is falling. As a result, there is not a lot of positivity for the economic outlook as we exit 2022.

Yet we see several recent positive developments that may defer the start of a recession, or perhaps, if we are fortunate, it could be avoided altogether.

The Fight Against Inflation Is Being Won

U.S. inflation peaked in June at 9.1%, an ascent that began in May 2020 with inflation near zero and steeply rising beginning in early 2021. There was a confluence of negative factors impacting the higher levels of inflation. First, commodity prices were rising rapidly during re-openings, particularly in energy and agriculture, with the invasion of Ukraine beginning in 2022. Second, labour markets became tight, resulting in significant wage growth for the first time since the Great Financial Crisis. Third, pent-up demand for services created a considerable strain on services and products. Compounding these issues was marginalized supply chains as manufacturing economies like China remained shuddered while geopolitical risks emphasized changes in global supply chains to protect supply security.

Most of the factors that created rising inflation are now reversing. Central Bank tightening has lowered demand for goods and services. Commodity prices have normalized as Covid lockdowns have ended, and the world has come to terms with the fact that the war in Ukraine may be prolonged. From the June 2022 highs, a global basket of commodity prices has fallen nearly 20%, including crude oil, which is 34% off highs. Wage growth has slowed, and there is increasing evidence of layoffs across various industries that will lessen the negotiating power labour has had to its advantage coming out of the pandemic. Lastly, China has abandoned its punitive Zero-Covid policy, resulting in the most constrained global supply chain in the past 25 years. While supply chains had been meaningfully improving throughout 2022, China relaxing lockdown measures and travel in December will propel supply chains to significantly healthier operating levels in 2023.

When Central Banks worldwide began their fastest monetary tightening campaign in history early in 2022, the intended outcome was a rolling over of inflation and a reduction in demand-driven inflationary pressures. Policy decisions are having their intended consequences heading into 2023, and the necessity for significant future rate increases has diminished.

These Times They Are A-Changin'

We have entered a new time in financial markets unlikely to look like the past decade. Geopolitical considerations have not been at this level since the Cold War, with governments and companies worldwide re-tooling and re-locating their supply chains. In addition, the baby boom generation is retiring, having been savers for the better part of their lives now to begin spending and transitioning the largest wealth transfer in history. The aging population means global growth will be more difficult to achieve, particularly in the developed west, where Canada is one of the only countries expected to experience population increases in the coming decades, largely due to the most aggressive immigration policy of the G7.

The outlook for wall street opposed to main street, is very different heading into a recession. Looking back at bear markets, recessionary markets and pronounced sell-off periods in markets, we find all have very robust returns in the years following. We entered 2022 playing defence, unaware of what would upset the apple cart but that valuations were stretched and markets were priced for perfection. We adjusted our client portfolios in 2022 as these dynamics violently tilted the other way, creating opportunities in government bonds and high-quality global stocks that had not been available in many years. Looking back at global stock market returns, there have only ever been two times since World War II when markets declined two years in a row, the last of which was during the Dot Com era.

We begin this year more optimistic than last, recognizing challenges on the horizon. The years of easy money with a rising tide lifting all boats seem to be behind us. However, we are optimistic as active managers of our client's capital. We are well suited to continue to add value during volatile markets that may be on the horizon. In addition, we have the advantage of a deeper tool belt, with many areas of financial markets at more attractive levels and at higher anticipated returns than we have seen since coming out of the Great Financial Crisis.

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