Wealth Management
Dominion Securities

www.philipflostrand.com

Suite 3200 Royal Centre
1055 West Georgia Street
Vancouver, BC V6E 3P3

Telephone: (604) 257-7380
Fax: (604) 235-9950

INSIGHTS & OBSERVATIONS

Philip Flostrand
B.A. (Econ.), CIM
philip.flostrand@rbc.com

YOUR GUIDE TO FINANCIAL MARKETS AND INVESTMENTS **August 2023**

Welcome back. A few months ago we suggested the ongoing to and fro of rising interest rates and slowing inflation was very tough to forecast, and that the best course was taking a 'wait and see' stance. Well, it was, and it still is.

Stock markets have slowly begun to believe after inflation falling for months now, interest rates are probably nearly done rising at least for now. The stock markets' July move higher reflects this expectation as investors eye future growth in profits and, maybe, even lower borrowing costs further out.

All of this adds up to a more positive tone for some, but to the majority of pundits who called for a 2023 recession last January, well they've postponed it until next year. This could definitely occur but once again, we prefer to wait for more data and then act accordingly.

From a big picture perspective we are facing the highest inflation and interest rates in 20+ years, and have just experienced the fastest rise of rates in 40 years. Coming at a time of record government indebtedness and very weak political decision-making, investors should stay on their toes and remain aware of the risks of debt as we've noted for the past several years.

Interest rates at 20-year highs hurt all borrowers; over-levered companies, individuals, and many younger people as they borrow to buy housing and support growing families. The positives go to savers who now actually receive meaningful interest, and the higher cost of capital will also weed out weaker businesses and questionable concepts. Importantly, when recession eventually arrives the government now has much more room to cut rates if required.

Interest rates today are actually around their very long-term average level, as anything within a percent or two of current levels is manageable and we are slowly adjusting to this return of 'normal' borrowing costs. IF the economy can successfully muddle along for another quarter or two with stable rates and inflation we'd take that outcome quite happily. However should we be surprised (again) by the unexpected, inflation or rates could quickly reverse direction and investors would need to make the appropriate changes.

As we stay vigilant and pay very close attention to everything which may influence our investment approach, there is much to think about and follow while we keep a close watch on all your investments. Post the usual summer slowdown, we expect an 'interesting' last half of this year.

Enjoy the sunshine and take care.

Philip

August's Articles

Debt is the traditional end for most empires throughout history. Over the past couple decades Western governments have basically given up on fiscal prudence and the old-fashioned idea of keeping debt to a sensible minimum. Accelerating this error had been steadily falling interest rates which, until a year or two ago knew only one direction of travel. Naturally politicians kept spending even more, voters got used to the largess, and since nothing bad happened for so long the trend continued.

COVID provided the perfect excuse to abandon the few last traces of responsibility; politicians spent as if it was World War III and wasted huge sums while degrading their nation's credit status faster and more comprehensively.

In the article linked below by **Jeff Stein** writing in the Washington Post, we find an inevitable consequence of these actions – a US debt downgrade from the credit ratings agency Fitch. This is the second downgrade for the US, with the first coming from S&P in 2011, which was also the first from one of the three big agencies. With this second ratings change it gets harder for US officials to deny the difficult reality of their own creation. Canada retains a AAA rating – for now – but the longer interest rates remain at current levels, many more countries should expect to hear bad news on their creditworthiness.

Longer term this problem cannot solve itself so the downgrade by rating agencies is an alarm bell which they are meant to provide. Whether this leads to better decisions by future politicians very much remains to be seen.

https://www.washingtonpost.com/business/2023/08/01/downgrade-federal-government-fitch-debt-ceiling/

Economics is ultimately the study of people – the decisions and motivations which drive our spending, saving, and determine our relationship with money.

It also turns out the university level economics I was taught at UVIC did not really describe the reality I faced entering the real world. And as recent years show this gap has only widened. However economists persist in forecasting and surprisingly many people pay attention, but the best takeaway lesson is to be skeptical of these predictions and to rely more on understanding people's behavior vs what economists say they are about to do.

In the below linked article from the Atlantic, by **Derek Thompson**, we take a look at the failed recession forecast which was universally held last January. Certainly many historical indicators were strongly suggesting recession and prior similar circumstances did not go well. Thus, pessimism seemed to be the correct stance at the time. As we now know (at least so far), eight months later we're avoiding recession and doing much better than 'everyone' thought.

While his explanation is not ideal, there likely is no perfect answer to this question. The post-mortem is interesting though, and reminds everyone to remain skeptical and flexible of thought.

https://canadanewsmedia.ca/how-the-recession-doomers-got-the-u-s-economy-so-wrong-the-atlantic/

WHAT THEY SAID

"A national debt, if it is not excessive, will be to us a national blessing."

Alexander Hamilton