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INSIGHTS & OBSERVATIONS

YOUR GUIDE TO FINANCIAL MARKETS AND INVESTMENTS

May 2023

Welcome back. With Spring hopefully just around the corner, forward-looking markets and investors are already thinking about conditions this Fall. As you might recall from last month's edition, after doing the same exercise I came up with a firm 'I don't know' in regards to this outlook. We are at an unusually tricky time which has prompted my caution on the near-term direction of interest rates and the economy.

As we slowly get more information on inflation and of business conditions, we'll get to see how all of this plays out, making for an interesting summer!

Inflation has been falling for months now, and we've seen the Canadian central bank halt interest rate increases at the past two monthly meetings. Early this month the US central bank will probably raise US rates by another ¼% and then suggest a pause to their rate-hiking as the likely next step.

We will see whether the slowing of inflation continues as higher rates have curtailed price increases, and I expect it to take months before we've got a clear outcome. The best scenario is one where inflation does pull back to perhaps 2-4%, the economy slows but does not enter recession, and markets successfully adjust to a higher and more normal interest rate world.



As many of you have heard in our conversations, this environment is quite favorable for Canadian stocks compared to most other markets worldwide.

Based on history however the chances of an optimal outcome here are not great. While we have enjoyed these 'soft landings' in past cycles, the level of debt existent today particularly within governments, makes this result even less probable. The other complication is the ongoing effects of excessive Covid-related spending by most governments, which continues to distort large portions of the global economy.

Two months ago we saw the first real casualties of the jump in interest rates, as two US and one Swiss bank quickly went under. More surprises along these lines should be expected as debt service costs have risen dramatically during the past year. Overall we're hoping to see the soft landing play out, but we're remaining cautious and patient as we watch markets adjust.

Finally on the next page I'll introduce you to our new team member Charlie, whom Yuki and I think you will enjoy interacting with in his role as our new associate.

Have a great month, take care.

Philip

May's Articles

The past year's sudden resurgence of inflation and the resulting rapid rise of interest rates are THE story for markets. How this plays out will determine the environment for investors and taxpayers, and we should expect some surprises.

Considering how hard Central Banks worked (and failed) to create more inflation over the past decade, it is almost comical to watch them try and bring prices back down to their 2% inflation target.

Commentators and economists have written extensively during this period, frequently comparing today's inflation to that of the 1970's and earlier examples. While I am a fan of learning and considering economic history as a guide, there will always be new and unusual factors to include, making comparisons a challenge.

With that disclaimer in mind, the article by **Arnold Kling** linked below looks at US inflation after World War II and nicely contrasts those years with what may be in store for us today.

<https://arnoldkling.substack.com/p/the-2-percent-inflation-target-is>

Our Office News

*Some of you have heard a new voice when calling our office in recent weeks. We are very pleased to announce the addition of our new associate advisor, **Charlie Kelsch**, who has just joined the team last month.*

*Coming from our West Vancouver branch, Charlie has 11 years of experience with our firm and a great knowledge of the business. Yuki and I are very happy to have him on board, and you can reach him at: **604-257-3276** or Charlie.kelsch@rbc.com.*

For the second edition in a row we're including an article by hedge-fund titan **Ray Dalio**. In this next piece from a series he's written, we find a look at the very big picture of US/China relations. While this is a longer than usual article it is worth the read since it discusses many issues and influences which will touch us all. History illustrates how a shift in the world's dominant superpower has always been a tumultuous period, often taking a few decades to complete. It certainly feels as if we began such a transition a few years ago, and we should become aware of all the implications if we are indeed in this process.

Almost all nations are involved, with Canada clearly moreso than most given our location and coveted resource-heavy economy. As Dalio notes, with both the US and China anxious to be in the number one spot, 'picking sides' will become a greater issue in future perhaps setting up an either/or choice at some point. If we get to this stage we should also expect higher tensions and risks to accompany things like trade and travel.

While the essay is one person's opinion, he has clearly devoted extensive time and resources to the research done in forming these views. Lets hope the seeds of optimism win out as this race for global power continues.

<https://www.linkedin.com/pulse/what-i-think-going-1-china-us-relations-2-other-countries-ray-dalio>

WHAT THEY SAID

"One must maintain a little bit of summer, even in the middle of winter."

Henry David Thoreau