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## **Year End 2022**

After several very good years, 2022 was terrible for most assets. What changed, in a word, was liquidity, which went from being very cheap and plentiful to being restrictive.

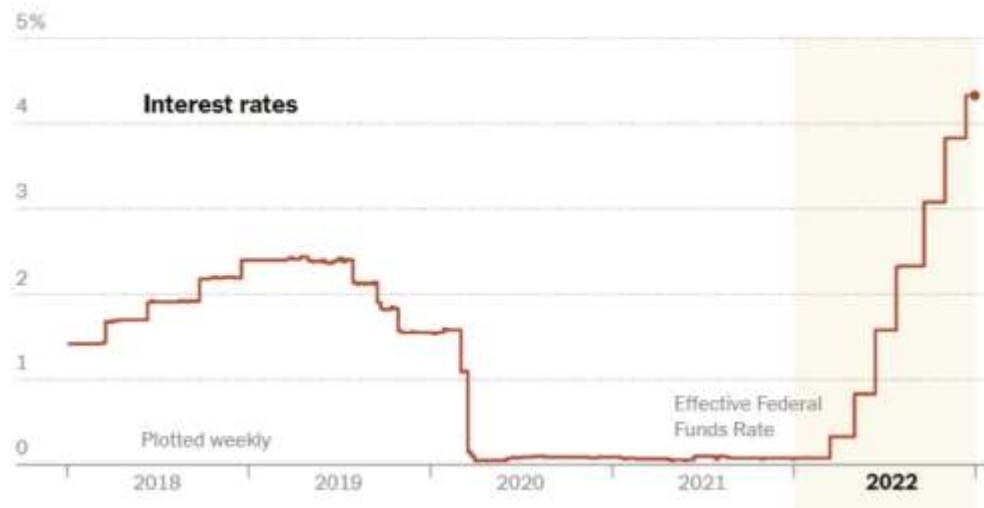
The invasion of Ukraine by Russia on February 24 set off a spike in the price of energy and food and the worst inflation in decades. The Federal Reserve started tightening a few weeks later and continued at a faster pace than at any time in a generation. After several 0.75% hikes, the central bank raised interest rates to the highest level since 2007. The yield on the 10-year U.S. government bond ended 2022 at 3.826% up 2.3%, its largest annual rise since the late 1970's. Similarly, the yield on 10-year Canadas rose from 1.42% to 3.34% in 2022. Bond prices were bombed.

As Sam Goldfarb wrote for WSJ.com, on January 2, 2023: "Normally a safe investment, U.S. bonds delivered losses over the past 12 months that far exceed anything investors have seen in their careers. The Bloomberg U.S. Aggregate Bond Index dropped 13%, easily outdoing its previous worst year in data going back to the 1970's, when it declined 2.9% in 1994."

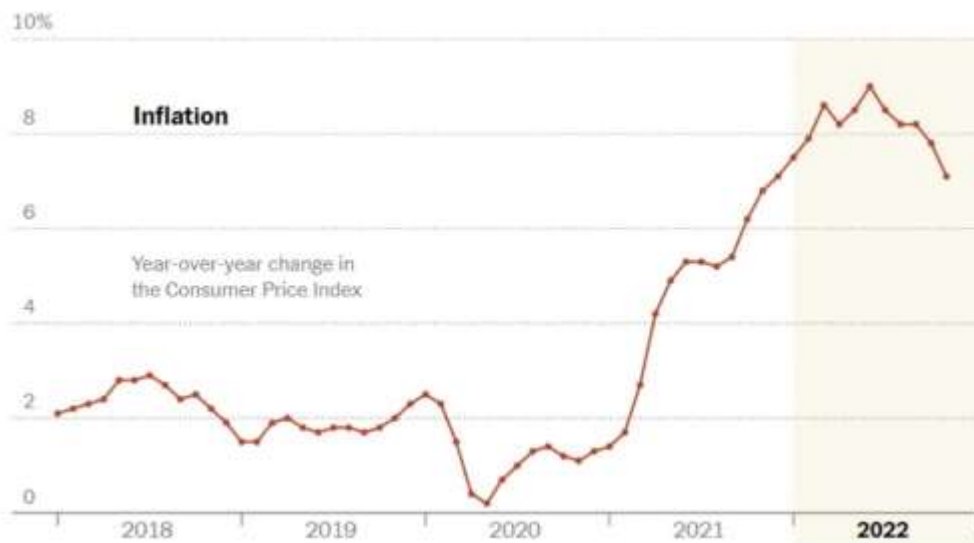
Since the Great Financial Crisis of 2008, investors had contended with little inflation, ultra-low interest rates and accommodative Fed policy. In 2022 that era ended.

Stocks had their first negative year since 2018 and their worst year since 2008. The S&P 500 was sunk 19% (in U.S., -12.2% in CDN), the tech heavy NASDAQ was torpedoed 33% (in U.S. \$, -28.3% in CDN). The TSX fell 5.8%. The S&P Energy Sector had its best year, up 59% (in U.S. \$). Unlike in most of the last 14 years, the more tech in an index the worse it did, the more energy the better. The mega-cap tech (FAANG plus) stocks, which are valued for their potential to generate profits for many years in the future, bore the brunt of the selling.

U.S. inflation reports in early November and again in early December were the best in more than a year. The price of energy, grains, lumber, and other commodities have about round-tripped back down from their peaks shortly after the invasion. Hopefully the Fed's efforts to control the worst inflation in 40 years are starting to work.



Sources: Bureau of Labor Statistics; Federal Reserve Bank of St. Louis; Refinitiv, Fundstrat Dec 30, 2022



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The inverted yield curve – the two-year U.S. bond yields 4.38%, the 10-year 3.77% - suggests an economic slowdown if not a recession, which may have already begun and is certainly widely expected.

The rise in the U.S. dollar, which was up 8.6% against a basket of currencies and up 7.2% against the Canadian dollar in 2022, was a drag on the corporate profits of the large international companies in the S&P 500. Weakness in the U.S. dollar would be an offset.

There is a new investment we hope to buy more of. Bail-In Notes, which are issued by the major Canadian banks, must have the ugliest name for a new investment product. They are called Bail-In because if the banks run into major financial difficulty the bonds could potentially be converted



into common shares. Canadian banks are slowly replacing their traditional bank deposit notes with bail-in notes to satisfy regulatory requirements. These major bank bonds carry A credit ratings or better and yields comparable in some cases to lower rated corporate bonds.

What is more, because of the unprecedented rise in bond yields and the slump in bond prices in 2022, it is now possible to buy a selection of short-term and mid-term bonds at large discounts to their face value. As it stands capital gains are taxed at a lower rate than interest income, so bonds bought at a discount have the potential to deliver much higher after-tax yields than Guaranteed Investment Certificates or bonds bought around par, when they are purchased in a taxable account for investors in a high tax bracket. We have not been able to buy highly rated bonds at big discounts to their par value since the 1990s.

The last year has been a trying one. I never thought I would see a war in Europe nor for that matter a pandemic. The simultaneous ferocious bear markets in bonds and stocks in 2022 have been awful.

Here's to the New Year. I hope you and your families have a good one. Thanks for reading.

Sincerely,

George Stedman, CFA

Senior Portfolio Manager

*Please visit us at [www.georgestedman.com](http://www.georgestedman.com)*

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