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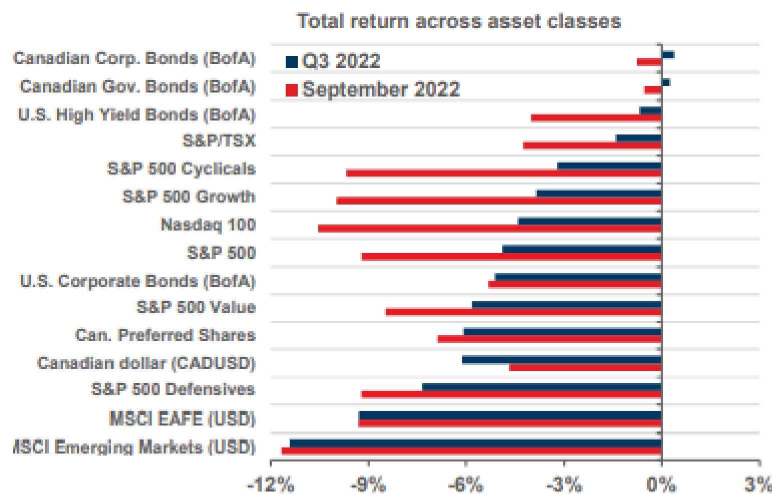
# Third quarter 2022 market update

## The quarter goes out like a lion

September closed out on a low note, one of the tougher months and quarters for the markets, with the last few days showing particularly high volatility in nearly all equity sectors, currencies, and commodities. Then, just as dramatically, the market had a super-charged rally the first trading days of October, with US markets up 6% in two days.

**A volatile month and quarter:**




Source: National Bank (data via Refinitiv)

**A challenging year so far:**

| | Sep-2022 | Q3-2022 | YTD |
|---|---|---|---|
| S&P/TSX TR | -4.3% | -1.4% | -11.1% |
| S&P 500 TR | -9.2% | -4.9% | -23.9% |
| Nasdaq | -10.5% | -4.1% | -32.4% |
| Europe | -5.7% | -4.0% | -22.8% |
| Japan | -7.7% | -1.7% | -9.9% |
| China | -5.6% | -11.0% | -16.9% |
| Canadian Bonds | -0.5% | 0.5% | -11.8% |
| U.S. Bonds | -4.3% | -4.8% | -14.6% |

Source: Richardson Wealth (data via Bloomberg)

The extreme volatility we are experiencing has been triggered by the unprecedented speed and magnitude of interest rate hikes, led by the Federal Reserve in the US, but in close tandem with other major central banks. The race is on globally to rein in inflation that hit high single-digits in North America and around 10% year over year in recent readings in the UK, levels not seen since the 1980’s. Canada, Australia, Europe, and the UK all started an interest rate hiking cycle in tandem over the last 6 months to dramatic effect on equities, bonds, and commodities markets.

The big jump in inflation was caused by the extraordinary money printing that went into the economy over COVID-19, via CERB and payroll protection schemes, as well as the outright purchasing of billions of dollars of government bonds in the open markets by central banks, in amounts that far outstripped the spending of the financial crisis. Inflation in Europe is being exacerbated by extreme energy prices, in part caused by the war in Ukraine, and largely by the divestment and lack of investment in fossil-fuel based energy supplies over the last decade, while lacking secure alternative sources to replace them. Transportation issues out of Ukraine, and sanctions against Russia have led to strained supplies of commodities like natural gas, fertilizer, and grains in Europe, Africa and beyond.

The US is leading the charge on tightening monetary policy, and as such has the strongest currency in the world right now:

Source: National Bank (data via Refinitiv)

The Canadian dollar has held in better than most currencies, being down -8.1% year to date; whereas the Euro is down -14%, and the British Pound is down -17.5% against the USD. The Bank of Canada has raised interest rates more assertively than many countries, raising five times so far this year, starting from 0.25% in January to 3.25% at their last meeting on September 7.  Keeping pace with other countries’ interest rate hiking, plus the fact that our economy is a beneficiary of higher commodity prices, has helped relatively protect the value of the Loonie.

There are a few indicators that interest rate hikes are starting to have their desired impact. Interest rates peaking are one of the most important signals the market wants to see before buying comes back. Interest rates play a role in cost of capital for companies to borrow and grow their businesses; for mortgages, and the confidence of the consumer to keep spending. These factors all play a role in future company earnings, and the price investors are willing to pay for them.

**Signals we are getting closer to the end of interest rate hikes and tightening monetary policy.** The goal of the Fed is to push inflation back down to the target 2-3% range, while also being mindful of keeping employment reasonably strong. The central bank has stated that they want to negatively impact unemployment numbers by no more than 1% through this process, while encouraging workers to come back post-covid, a delicate balancing act to achieve.

**Speculation is down**: non-profitable tech and theme stocks that exploded in value during COVID-19 lockdowns – such as Door Dash, Peloton, Beyond Meat, or Snowflake – are all down 50-90% over the last year. Crypto assets are under increasing regulatory scrutiny, and the market capitalization of this space has also dropped significantly.

The market for IPOs went over a cliff in 2022: IPOs raised $155 billion in the US in 2021, with big names like Robinhood and Rivian leading the way, and just $4.8 billion so far in 2022 as appetite for new issues has all but disappeared (CNBC). Last month, bankers were forced to carry on their own balance sheets $6.5 billion of debt to fund the leveraged buyout of Citrix, after they couldn't find willing buyers to take on the debt financing.

**1 Year chart for Bitcoin: From $65,000 to $20,000 per unit**

Source: Yahoo! Finance

**House sales are slowing.** Mortgage rates doubled over the last year in the US to 6.75% for a 30-year mortgage, the first time they have been over 6% since 2008. From an affordability perspective, the monthly mortgage cost of a median priced home in the US ($437,000) has risen from $1,000 to $2,500 (Forbes). The trends are similar in Canada, with inventories creeping up and volume of sales continuing to drop year over year, in many urban markets. Between February and July this year, average home prices declined 10% in British Columbia and 15% in Ontario (CTV News).

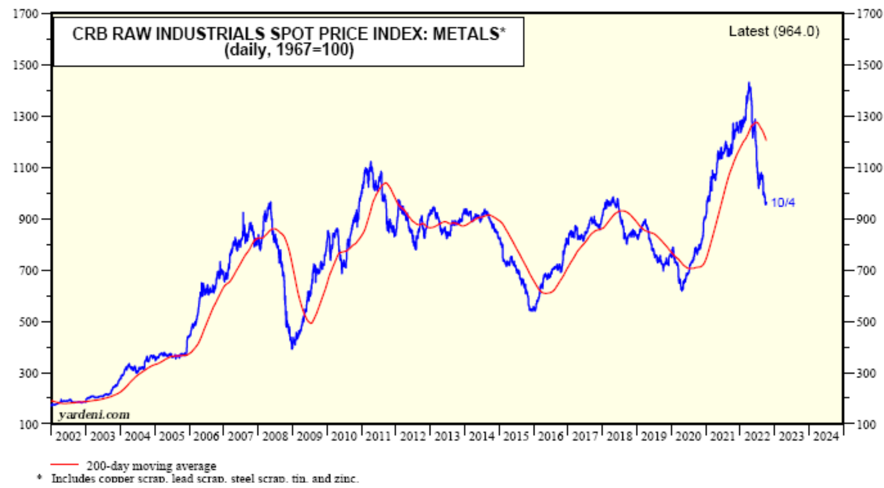
**Borrowing costs and mortgages are priced off the 10-year Treasury bond:**

Source: National Bank (data via Refinitiv)

**Recent job numbers indicate that job openings may be shrinking**. Wage price inflation as a result of labour dislocation post-COVID is a major concern for the Federal Reserve. However, there are signs that workers who left the work force during covid are coming back. Furthermore, layoffs and hiring freezes are being reported in certain sectors like Big Tech and Finance (especially mortgage divisions). Meta Platforms (formerly known as Facebook) has officially implemented a hiring freeze, but there are unofficial reports that they are in the process of cutting 15% of their workforce in coming weeks (Business Insider); Peloton has cut its workforce by 50% over the last year; DocuSign will lay off 9% of its 7,400 employees; Wells Fargo has let go 400 employees since April; Snap (Snapchat) will lay off 1,200 staff, around 20% of employees.

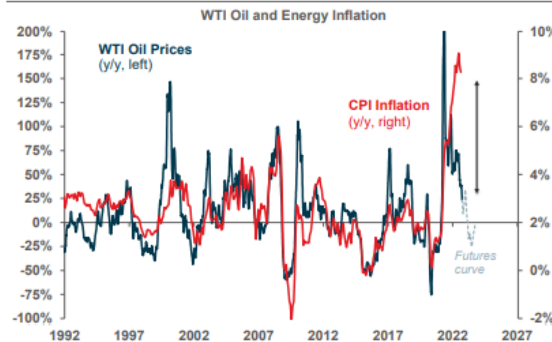
Source: Financial Times (data via Refinitiv)

**Commodity prices have fallen dramatically from summer peaks**. This should translate into lower consumer prices for finished goods in the coming quarters.

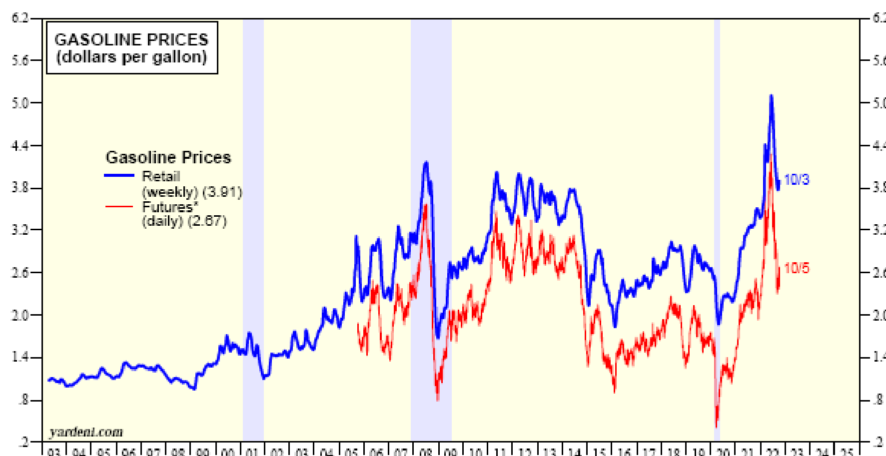



Source: Haver Analytics

**Oil prices are back to January levels**. Oil is back to where it was trading before the Russian invasion of Ukraine, and down 35% from June peaks, a positive we are already seeing at the gas pumps:



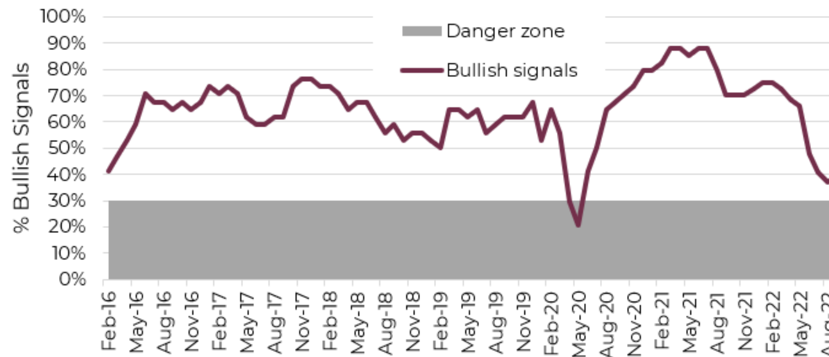

Source: National Bank (data via Refinitiv)



Source: Yardeni, Energy Information Administration, and Haver Analytics

**Caution is still warranted.** While the reasons for the Federal Reserve to slow down on interest rate hikes are mounting, it remains to be seen whether they will be successful at slowing down the economy without triggering a meaningful recession. We are at a very oversold period in the market, but some decisive positive signals will need to be seen for buyers to come back with confidence. The market cycle indicators we follow that track Interest Rates, Economic, and Market valuation signals, are weak but stabilizing – for now.

**Market cycle indicators are stabilizing**:




Source: Richardson Wealth (data via Bloomberg)

Investors are highly sensitive to signals from the Fed this fall. Each time there has been a data point that indicates central banks could be motivated to stop raising rates, or when we see rates in the bond markets go down via 10-year treasury yields weakening, then stock markets go back into risk-on mode. The first week of October for example, Australia announced a pause in interest rate hikes while the UK central bank intervened in adding liquidity to markets by buying bonds. There was also a positive signal that unfilled job openings in the US were shrinking. The same day, stock markets moved up nearly 3%.

Thinking about stock market returns and investing going forward, we will be watching Q3 earnings season closely, which has begun and carries through the end of October, for the real-time view on how corporate leaders are projecting their business activity for coming quarters.

**The market is not as expensive as it was last year:**

Source: Financial Times, Factset

We do see opportunities in stocks, particularly in high dividend payers that have solid balance sheets and won't need to go to the market to raise capital to fund operations. Many oil and gas producers fall into this category now. Utilities, pipelines, and some healthcare stocks have been a boost to our portfolios, holding in their values and paying attractive dividends.

**Bond markets:** An especially striking difficulty this year for portfolios has been fixed income investments. With interest rates rising so quickly, bond fund managers were caught flat footed holding their lower yielding bonds, and performance has broadly been nearly as poor as stock markets. Balanced portfolio mutual funds, which are generally a 40% fixed income/ 60% equity split, are commonly down 15% or more this year.

| | | YTD |
|---|---|---|
| iShares Canadian Corporate Bond ETF | XCB | -11.04% |
| iShares iBoxx $ Investment Grade Corp Bond ETF | LQD | -21.24% |
| iShares Core Canadian Universe Bond ETF | XBB | -12.09% |
| iShares Core US Aggregate Bond ETF | AGG | -14.38% |
| iShares iBoxx $ High Yield Corporate Bond ETF | HYG | -15.75% |

Source: Richardson Wealth (data via Bloomberg)

However, as interest rates are getting closer to the end of the tightening cycle, we are starting to see opportunities in bonds, and have spent time this past month connecting with our fixed income specialist managers. They are encouraged by the opportunities in front of them going forward. In certain cases, we are moving cash straight into investment grade corporate bonds and can now earn 4.5% for one-year maturities. Short term no-risk cash deposits now earn 3.5%, a level not seen since pre-financial crisis. Note though, that while seemingly attractive, the fixed coupon on bonds is fully taxable as income and pay out well less than current inflation rates. Dividend paying equities can have similar dividend yields, the ability to raise the dividend rate, and have the potential for capital upside over the holding period that can keep purchasing power of savings protected against inflation.

For now, we remain defensive in the stocks we choose to own. We are starting to add to bonds, and cash levels are generally higher than usual in portfolios. We own alternative strategies that can sell short stocks, with the design to make returns in falling or volatile markets.

We look forward to connecting in the coming weeks to discuss these ideas further.

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