RICHARDSON Wealth | The Wronski Cann Group

The Wealth Report

Q1 2023

Markets Turn Positive as Inflation Eases in H1 2023

Global markets rebounded in the first quarter of 2023. It was a nice reprieve from the challenges of 2022. That is the good news. Unfortunately, the quarter also revealed some new market concerns.

Clearly, we would enjoy extended periods of tranquil markets and uneventful social and political times. This is not one of those periods and there is a limitless group of experts and media hungry commentators willing to speculate about the future.

The narrative of the market seems to change every other day as we swing from one speculative story or impending economic prospect to another. Investors are left to wade through the discord and determine whether the glass is half full or half empty. So, what are the issues?

1. **Debt and refinancing:** Consumers, governments and businesses have all borrowed and leveraged during a period of low interest rates. The tide has turned, and more expensive debt (higher interest rates) is causing some to feel squeezed, while others may need to tap out. And just a reminder, the US debt ceiling looms over markets, with the prospect of funds running ominously low as early as June. Will Congress push the limit to the 11th hour?!

2. **Inflation:** Discussing inflation over the past 30 years has largely been a look back at "ancient times." If you are younger than 35 or 40, you probably have never experienced the forces of meaningful price increases until 18 months ago. Higher inflation increases the odds of higher interest rates and the price of most goods and services rising… undesirable, particularly for those with debt and on fixed incomes.

In this issue

Markets at a glance

Quarter ending March 31st, 2023

Bonds Index	3.1%
S&P/TSX Index	4.6%
S&P 500 (USD)	7.5%
S&P 500 (CAD)	7.4%
Emerging Market Index	2.8%
Nasdaq	16.8%

Q1 in review

- Lakers LeBron James becomes the NBA all-time leading scorer with over 38,000 career points.
- Pocahontas revealed as the 12th great-grandmother of actor Edward Norton on PBS's "Finding Your Roots."
- Michelle Yeoh becomes the second woman of color to win an Oscar for best actress.

3. **Interest rates:** Central banks use interest rates to slow the economy before inflation rises too far. They want to maintain a level of price stability and higher interest rates is a means of taming inflation, but it comes at the cost of pressure on other assets, economic growth and higher costs for borrowers.

4. **Profitability:** Businesses are facing higher costs from interest rates, employee compensation, supply chain issues, reduced sources for borrowing and higher input costs. Raising their prices offsets some of the issues but in doing so, they are adding to the inflationary forces.

5. **Recession:** Many analysts fear that Central Banks will eventually "break something" and the economy will dip into a recession. Few will argue against a recession as there are signs of economic slowing but the debate about a soft or hard landing is boisterous.

6. **The Ukraine Russia conflict:** From inflationary prices of energy to food, concerns about a deeper conflict and the simple argument that war is neither a consumer nor a capital asset, the conflict in the Ukraine is without a doubt a tax we are all suffering. To provide prospective, in North America, the impact is trivial when we consider those in and around the conflict zone.

7. **Banking failures:** Two US banks failed during March and Credit Suisse, a formerly $75B global bank was taken over by UBS, with Swiss authorities' assistance for about $3B as it failed. In the US, the Central Bank and government officials declared that they would guarantee the deposits of all US banks… a concerning but necessary decision aimed at stopping "runs on the banks," particularly the small regional players. These bank failures were largely the result of bad management, but the rapid increase in interest rates made it easy to focus the Central Banks in the crosshairs of the media commentators and politically motivated.

These issues share similar overtones, and in some cases, each affects another or multiple other issues. Some commentators quickly spin how higher interest rates would affect the banking industry further as debt overwhelms borrowers and the economy spins lower. We readily admit, there are issues, but we've seen similar scenarios in the past too. History has shown that markets overcome challenging times, and patience plays a critical role for investors.

"History provides a crucial insight regarding market crises: they are inevitable, painful and ultimately surmountable."

- Shelby M.C. Davis

How should we react?

Instead of speculating about how things might be if one of these issues unfold, we are looking at what is occurring and there are a few immediate positives. Markets continue to rebound; employment remains strong and inflationary forces appear to be easing… more to follow!

After an extended process of lower highs and lower lows, the S&P 500 has marked a new cycle of higher highs and higher lows, even through the banking issues during March. In addition, the downtrend that started in January 2022 has been broken. See Chart 1. This market action is historically indicative of positive markets ahead. We are not completely out of the woods, however, as the largest 15 companies in the index of 500 stocks have earned the majority of the rise. There is a need to see an increase in the breadth of stocks participating.

Inflation has been more than a thorn to many, so the following is to discuss the issue, not diminish its recent impact. Inflation is almost certainly going lower. That's not to say that prices are falling, rather they are returning to levels more consistent with central bank targets in the short term.

This may seem hard to believe but this is largely a function of how the BOC calculates CPI.

In 2022 we experienced explosive inflation as markets tried to recover from COVID, Russia invading Ukraine and lingering supply chain issues.

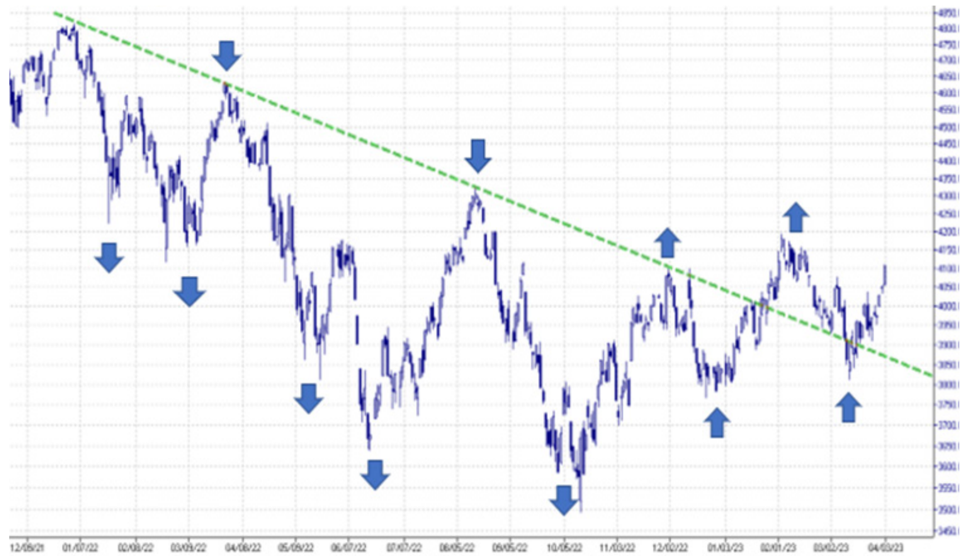


Chart 1: S&P 500 since December 1, 2021 to March 31, 2023
Source: Michael Cann

In January 2022 inflation spiked to 5.1% so inflation was on the rise, but then it was fueled by the invasion of Ukraine and spikes in energy prices. (pun unintended) This was the first occurrence of 5% plus inflation in Canada since September 1991. For perspective, Canadian CPI has averaged 1.8% annually since October 1991, the lowest level of inflation for a 30-year period for many readers of this note.

Interestingly, the period from January 2022 to June 2022 produced four of the highest nine months of month/month inflation since 1991, this includes March and May, highlighted in yellow below, in which the annualized month/month inflation rate was the highest at 17.2% and 16.8% respectively.

No other year since 1991 has experienced more than one of the top ten inflationary month/month periods while 2022 had four of the top nine in only six months. Inflation's sudden strength was something that we had not experienced in decades.

Stats Canada CPI index		(as posted by the BOC)									
Year	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2023	153.8655	154.5	155.3									
2022	145.3	146.8	148.9	149.8	151.9	152.9	153.1	152.6	152.7	153.8	154	153.1
2021	138.2	138.9	139.6	140.3	141	141.4	142.3	142.6	142.9	143.9	144.2	144
Annual CPI Rate												
2023	5.9%	5.2%	4.3%									
2022	5.1%	5.7%	6.7%	6.8%	7.7%	8.1%	7.6%	7.0%	6.9%	6.9%	6.8%	6.3%
2021	1.0%	1.1%	2.2%	3.4%	3.6%	3.1%	3.7%	4.1%	4.4%	4.7%	4.7%	4.8%
Month over month CPI												
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2023	0.50%	0.41%	0.52%									
2022	0.90%	1.03%	1.43%	0.60%	1.40%	0.66%	0.13%	-0.33%	0.07%	0.72%	0.13%	-0.58%
2021	0.58%	0.51%	0.50%	0.50%	0.50%	0.28%	0.64%	0.21%	0.21%	0.70%	0.21%	-0.14%
Monthly annualized												
2023	6.0%	4.9%	6.2%									
2022	10.8%	12.4%	17.2%	7.3%	16.8%	7.9%	1.6%	-3.9%	0.8%	8.6%	1.6%	-7.0%
2021	7.0%	6.1%	6.0%	6.0%	6.0%	3.4%	7.6%	2.5%	2.5%	8.4%	2.5%	-1.7%

Chart 2: Canada CPI Index, 2021 to present
Source: Bank of Canada

April and June missed the top 10 standings, but still ranked 49th and 39th in the past 410 months. Why is that important? Inflation is measured year/year which means the six-month spike in 2022 is being replaced by 2023 monthly results that are highly probable to be lower than the comparative 2022 figures.

We expect that the current month/month inflation is much lower and we are likely to see inflation as posted by the Bank of Canada bottom in the middle of the summer in the range of 3%. This decline in inflation is likely to keep the central banks on the sidelines and may even give room for a minor interest rate cut. We would not speculate on that occurring due to second half issues.

This inflation outlook reduces the fear of higher interest rates, providing relief for borrowers -especially those with high mortgages- and it will give the banks time to recover. In addition, investors could be enticed into investing some of the record $5 trillion that has moved to US Treasury deposits, pushing markets higher into the summer.

Unfortunately, that is only half the story. In the second-half of 2022 inflation as posted by the Bank of Canada rose from 152.9 to 153.1 or 0.13%! An annualized rate of inflation of 0.26%, as two of the six months were negative. Nobody is recalling this, nor the fact that December posted a negative 7% annualized month/month figure. This six-month period is important because, unless we experience a sharp recession, inflation is almost certainly going to rise from the summer lows into the end of the year. Without strong earnings this may push investors to back away and have debtors worried again about the central banks' inclination to restart raising interest rates in the latter half of the year.

For those wondering about the US inflation data… it is very similar. A little higher in the first 6 months of 2022, but 4 of the last 6 months in 2022 produced negative M/M inflation data.

Those willing to speculate and forecast need to do so often, as many of the issues discussed early in this note assume participants will react in specific ways. The inflation data is a basic math equation and our assumption that the incoming CPI data will be lower than the spikes of 2022. We believe this is a reasonable projection. As a result, we believe that those with half full glasses will lead in the coming months, but we are wary of economic activity igniting earnings growth in the second half of 2023.

We've been through similar cycles before. History has shown that this is a time for steady hands and calm thoughts. Our investments will focus even more on quality assets, preferring dividend payers and quality balance sheets overgrowth.

"The intelligent investor is a realist who sells to optimists and buys from pessimists."

- Benjamin Graham

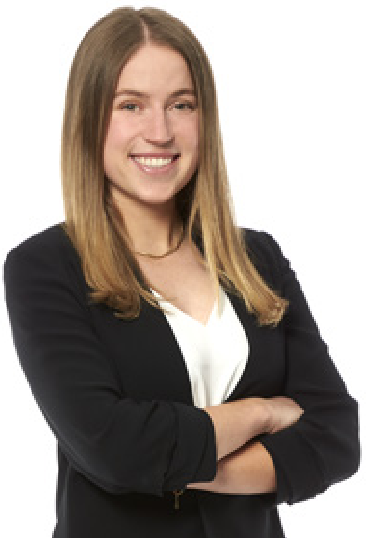
Some growth-oriented companies will be retained where they are financially sound and still growing without the need for new capital. We will look to stay clear of liquidity issues, private pools that require liquidity (like commercial real estate) and balance sheets that have significant debt.

Further, we continue to see Canada in an increasingly positive light. Demographics, and incumbent companies with meaningful barriers to entry provide a strong backdrop particularly as the TSX trades at 13x EPS versus the S&P 500's 18x EPS.

There is a common investment adage; the market climbs a Wall of Worry. We believe we are scaling that wall now. There are numerous good stocks with good yields, other stocks that have stumbled and are finally trading at attractive prices. Over our careers, we know that we can buy great companies at prices we wish to pay when others are unwilling to participate. We believe we are in one of those moments.

As we move ahead, we do so knowing that there are economic issues that cannot be dismissed, which means we will be prepared to change our opinion, if circumstances require us to rethink our belief that now is a sound time to buy quality investments.

Saying Goodbye to a Team Member

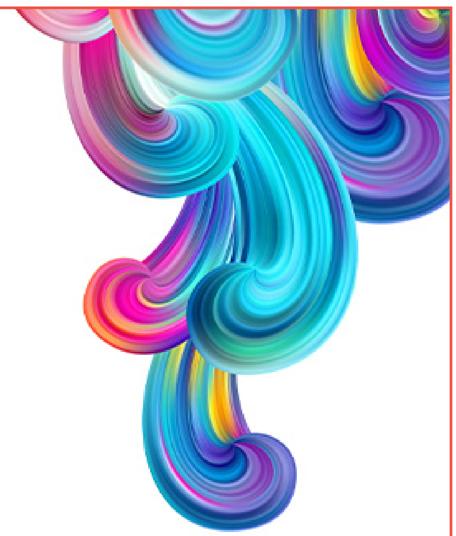


Madeline Cann has decided to leave our team after two years. She will remain in the investment industry, joining a fund company focused on ESG investing, a theme which interests her greatly. We wish her well and are grateful for her contribution.

We have hired a summer student, James Rory Bredin, who will be joining us in May. We believe in exposing interested students to markets and our business. James Rory will be helping us with special projects and general administration.

Please welcome him when he picks up your call.

You're invited



THE
ART
OF GATHERING

Please join us for a celebration of art, gathering and you while we showcase our new office by the lake.

Light fare, libations and parking to be provided.

Date:	Tuesday, May 16, 2023
Time:	5:00 pm - 8:00 pm
Location:	100 Queens Quay East, Suite 2500
RSVP:	Jorge.Saban@RichardsonWealth.com

We look forward to seeing you.

Tax-Free First Home Savings Account (FHSA)

When it comes to saving to purchase a first home, Canadians now have another option available to them: the Tax-Free First Home Savings Account (FHSA).

First introduced by the federal government in it's 2022 budget, the FHSA is a new registered account allowing prospective first-time home buyers the ability to save up to $40,000 on a tax-free basis.

Notable dates ahead

- May 02 - Jorge's Birthday
- May 06 - The Coronation of King Charles III
- May 14 - Mother's Day
- May 22 - Victoria Day
- Jun 18 - Father's Day

Snapshot

- Contributions are tax-deductible.
- Annual contribution limit of $8,000 and lifetime contribution limit of $40,000.
- Investment income and growth earned in the FHSA are tax-free.
- Withdrawals from both the Home Buyers' Plan (HBP) and FHSA are permitted to acquire a first home.

While we expect to offer this new account type shortly you can read more about eligibility, contributions, allowable transfers and withdrawals in our FHSA Planning Guide (available upon request).

As always, we would like to thank-you for your continued trust and ask you to reach out via phone or email if you have any questions.

The Wronski Cann Group

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