First Covid. Now war. How much can the economy handle?

Managing Your Money

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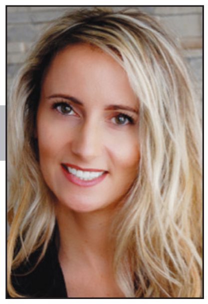

Without a doubt, Russia's invasion of Ukraine, has war on everyone's mind. The human toll, the destructio behaviors n of families and communities. The stress and anxiety. The effects of which will include long-term physical and psychological harm to children and adults. Not only in Ukraine, but possibly all over the world. My son asked me last week, "Mom, could this start WWIII?" We are all fortunate to live in Canada without the effects of war for decades, but if this conflict builds, we may start seeing its effects in our daily lives.

As the largest land war in Europe since World War II this will no doubt affect global energy supplies, and in turn worsen already fragile supply chain issues. We haven't even absorbed the supply shock from the pandemic, and now this. Inflation has not been a topic of conversation amongst the average Canadian for a couple of decades. But now, all of a sudden, even before this conflict began, everyone's talking about inflation. When you can see inflation with your own eyes, you know we've got a problem.

We are "feeling" inflation everywhere – from the gas pumps to the supermarket, to the price of cars, homes, and just about everywhere else. That's because we haven't had inflation like this in 40 years! What's causing it? How long will it last? Does anyone benefit from inflation? We'll touch on those questions and what you can do as individuals to help protect yourselves.

"We are "feeling" inflation everywhere, for the first time in 40 years!"

This current inflation is one more thing we can blame on Covid for many reasons. Now, we can add 'war' to that list. Firstly, the amount of financial support and stimulus that the governments provided during the pandemic is partly responsible. That support to individuals, while necessary, has made it harder for employers to hire back employees, some of whom may have been making less than the CERB* prior to the shutdown. Others may still be worried about the virus and not ready to go back to work. It is forcing employers to increase wages (and even at that they are still short staffed).

This, in turn, increases the cost to provide services or produce goods, so they need to increase their prices. Pandemic issues have also clogged up the supply chains. So, if goods (either goods needed for manufacturing or end-goods that we buy in the store) can't get through to where they need to go, demand is not being met, and prices go up. Add to this the war in Ukraine which will affect the supply of energy, wheat, and important commodities needed for manufacturing cars, cell phones, and so on….

Investors have options to offset the effects of inflation

How long will it last?

Because of the added stresses of war, things may get worse before they get better. The good news is that this pandemic related hyper-inflation is not likely to last. Governments have more "tools" (monetary & fiscal policy) today to deal with inflation than we saw in the 80's, which was the last time it was this high. That being said, the geopolitical situation in Russia and Ukraine does add some risks to the recovery.

Inflation is very psychological. Higher prices are manageable from an overall market / economic perspective if buyers and sellers view them as temporary. They become an issue when people start believing the pace of price increases will continue for a much longer period. Do I buy today or wait? If I wait, it will be more expensive? Do I demand a higher wage based solely on the rising cost of living? This mindset changes behaviours, and that can be economically dangerous.

How will inflation and interest rate hikes affect you?

All of us are being affected by the current economic situation. To what extent depends on our individual situation and spending habits. 'Need a new car, or home renovations this year? Be prepared to pay a lot more. Everyday items like food, gas, restaurants, etc., will all cost more, so everyone will see an increase in their cost of living. Our spending patterns changed abruptly during the past few years and supply chains / logistics are still struggling to adjust. The demand for durable goods has skyrocketed – for example, if you can't go to the gym, buy a treadmill. If you can't go to restaurants, remodel your kitchen. So, where demand has gone up, prices have gone up.

If you have debt – lines of credit, loans, credit card debt, and especially if you have a mortgage, this is a good time to re-evaluate your situation. Ask your banker – "how much will my payment go up if interest rates increase by 0.5%, 1%, etc.?" On a large mortgage, a 1% increase in interest rates could mean an increased mortgage payment of hundreds of dollars per month. Understanding how exactly your cashflow could be affected by increases in interest rates, could allow you to get better prepared, do some debt consolidation, and avoid stress as this year goes on.

From an investment standpoint, we believe tilting towards value will perform better than growth in this elevated inflationary world. Real assets like real estate and infrastructure, or other investments that can hold their purchasing power should remain a consideration for portfolio construction. As I pointed out last month, expect a bumpy ride in the markets… they don't like uncertainty!

*CERB: Canada Emergency Response Benefit

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