A TALE OF TWO JANUARYS

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January 3, 2022, exactly a year ago as this is being written was the all-time peak of the S&P 500 stock market index.

In the last 365 days the S&P 500 is down 19.67%; the Toronto Stock index peaked a few weeks later then the S&P 500, and declined 10.9% over the last twelve months.

The Nasdaq US Exchange which has many growth and "New to Market" companies has declined 34.4% since it peaked January 3, 2022.

It's also interesting to note that a representative trust of the Canadian Bond Market (XBB) has also declined by 12.84% over the last twelve months.

The raising of interest rates by our central bankers has damaged valuations in both stocks and bonds.

2022 was the first losing year for equities following three years of positive returns. The losses during 2022 motivated significant tax selling pressure in November and December as investors elected to recover capital gain taxes from the three prior years.

The stimulus for the decline in asset values (including real estate) has been the increase in central bank interest rates throughout 2022. The prime lending rate in Canada has increased from 2.45% in January 2022 to 6.45% at year end.

When interest rates move up such as they have recently the cost of doing business and owning/developing real estate increases. That impacts corporate profit as well as the after interest expense return on assets and hence their values decline.

Bond prices decline as well due to newer bonds being issued at higher rates of return (if you own a bond that pays 3% and a new bond of similar credit worthiness is issued at 4% your 3% bond will devalue in market price).

The reason for raising interest rates by central bankers is to control and reduce inflation which peaked at 8% in Canada a 39 year high. It was running at 6.9% in September with most indicators showing declining numbers.

This may not sound like good news, but it is important to control inflation. If the cost of doing business and maintaining our lifestyle is allowed to continue upward eventually we can't afford to live at the standard we do. All well and good you say, but if my net worth keeps declining I won't have enough!

The good news is there is and always has been a business cycle and as the economy slows due to central bank restrictive policies, inflation declines and investment opportunities begin again.

In addition, the restrictive phase of the business cycle is usually short lived and lasts 18 to 24 months +/- where as the expansion phase that follows can last 7 to 10 years or longer. That is the reason the baby boomer generation is the wealthiest. They started building their assets base shortly after the second world war and have been longer lived than previous generations. Our parents taught us to avoid the risk of a long-term economic contraction such as the Great Depression by building a conservative lifestyle with a conservative approach to overspending their capacity to earn and maintain their lifestyle.

An explanation of the cause of inflation is "too much money chasing to few goods". Covid contributed two influences to economics, governments gave out capital in the form of subsidies and goods flow was limited due to the shut down of production and supply chains. The perfect inflation "storm" and as the covid influence was abnormal and not expected to persist our central bankers reacted slowly but as inflation continued to climb, they raised interest rates to cool demand for goods (demand destruction).

The good news is it finally appears to be working and the decline in inflation should accelerate over the coming months. The inflation rate is a trailing twelve months comparative number and as we enter the third quarter of this year the 12-month comparisons get much easier.

The uncertainty at this point is what the pending economic slowdown will look like and what will the impact be for corporate earnings. Will they decline and if so, has the stock market priced it in or do we have further to go to the downside?

Whatever the answer is we're close to entering the next business cycle. Central bankers will revert to accommodative policy's reducing interest rates and increasing money supplies. Good companies will have advantage of opportunities and expand their business's along with earnings. The new bull market will begin. Your patience and conviction to being an owner of good business will be rewarded.

It is a good time to acquire good companies at bargain prices! If you are invested it's a good time to review your portfolio and upgrade from any holdings that have found the recent period difficult. As interest rates decline sustainable dividends become important and add value.

Essential materials to rebuild the economy are early performers. Technology to provide efficiency will be in demand, financials will see more demand as capital becomes cheaper to access and due to those "baby boomers" there will be numerous demographically driven investment opportunities (I personally seem to be using a lot more CBD oil infused liniment these days as one example). Communication advances continue driven by advancements in semi conductors and satellite technology. In every phase of the business cycle there are companies leading the way to make our life easier.

2022 was a humbling year for most investors as excesses and speculative valuations came back down to earth. I suspect 2023 will be much more rewarding for us as we stick to the fundamentals of building suitable portfolios.

Have a Happy New Year everyone!

GB, AG, RL