CHARTBOOK

Market Comment

Prepared by Ocean Front Wealth Management

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OCEANFRONT WEALTH MANAGEMENT

iA Private Wealth™

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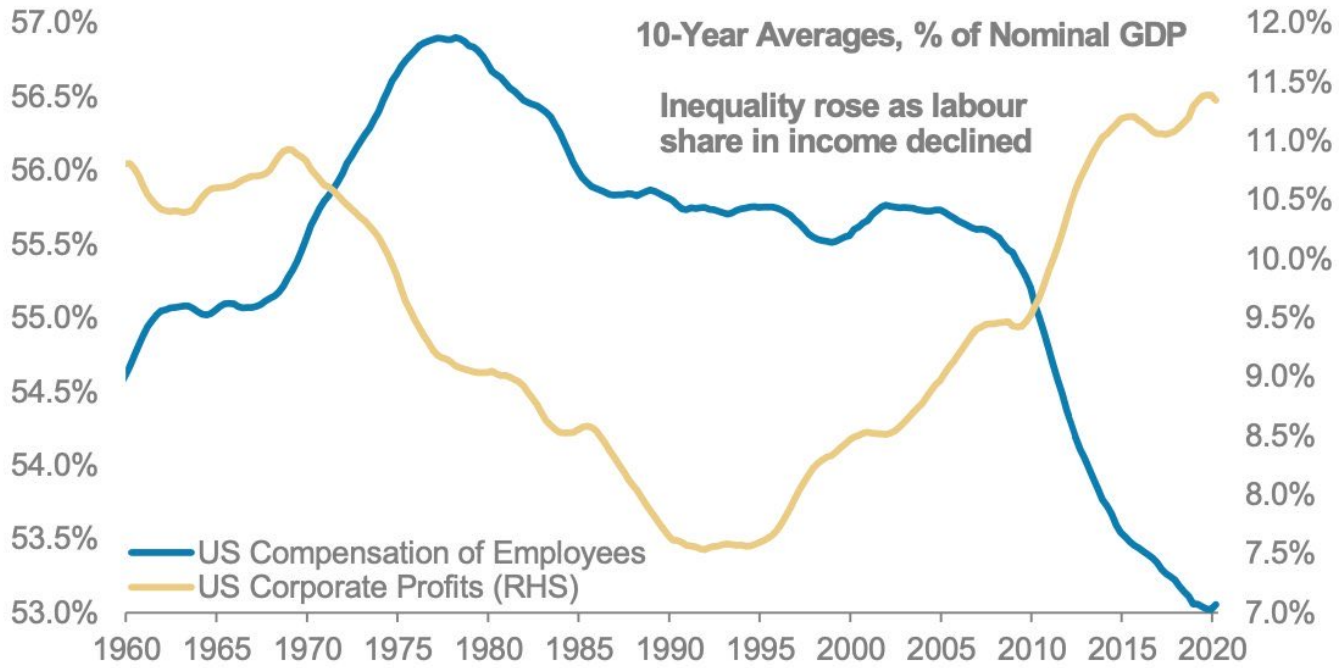
Market Comment

Stock markets around the world were mostly higher in June, as the TSX rose 2.5% and the S&P500 rose 2.3%. The global economic recovery has picked up steam as vaccinations have become widespread amongst populations.

The Federal Reserve, playing the role of Goldilocks, took the temperature of the economy and decided: “too hot!” A significant policy shift was revealed in June, which signaled the beginning of the end of the easy-money, quantitative easing program that markets have enjoyed since the beginning of the pandemic last year. Read on below as we discuss the implications this may have for investors and their portfolios.

US Wages – 40 Year Decline

Exhibit 1: US: Wage share in GDP has been on a 40-year decline

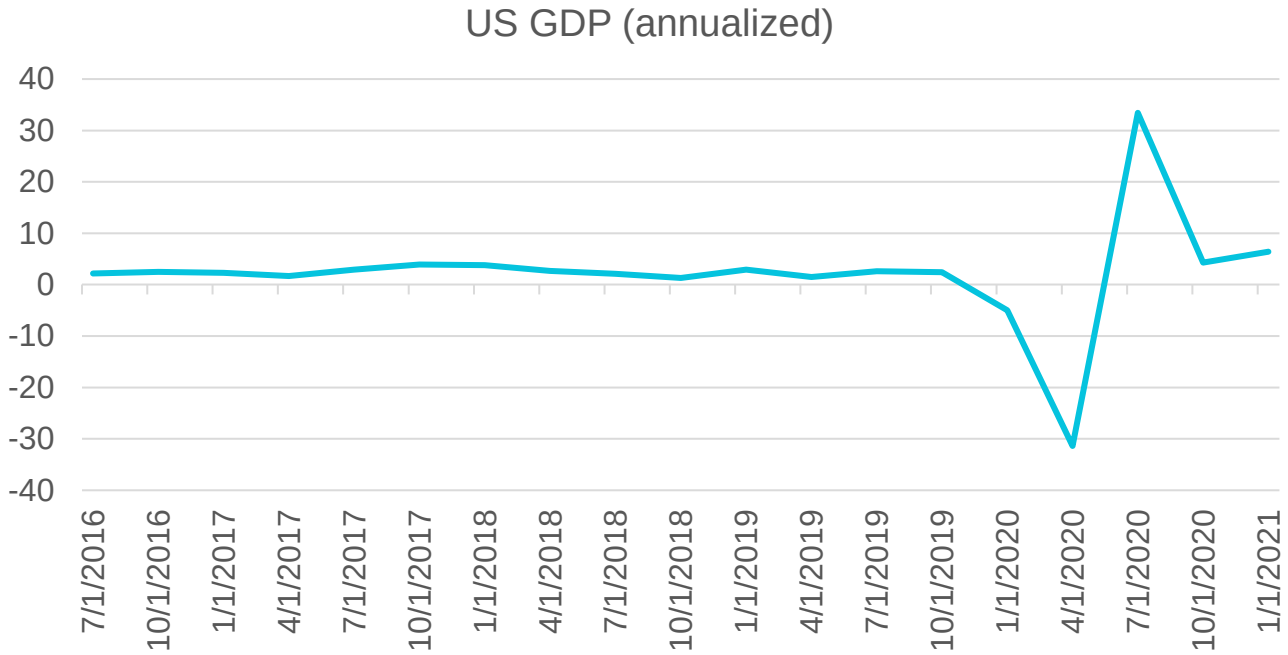


Source: Haver Analytics, BLS, BEA, Morgan Stanley Research; Note: We have taken 10-year averages to smooth out the fluctuations due to the business cycles. Note that compensation of employees and corporate profits do not sum to 100% because other components such as proprietors' income, rental income, net interest and miscellaneous payments, taxes on production and imports, business current transfer payments and current surplus of government enterprises are excluded.

US wages, shown here as a percentage of GDP, have declined since the 1970s. There have been many reports of labour shortages in the US, particularly in food service. Some companies now have to entice candidates to come off government pandemic benefits to work. Perhaps this will be the tipping point where this trend in wages begins to reverse.

If the trend does reverse and we see wage inflation, that could potentially spill over to inflation in other areas of the economy as well.

Recovery Accelerates



As the effect of mass vaccinations takes hold and economies begin to return to normal, we can expect to see big economic growth numbers in the near future. The current forecast for US GDP growth is 6.6% in 2021 and 4.1% in 2022. The downside of this is that high GDP growth is typically accompanied by rising inflation.

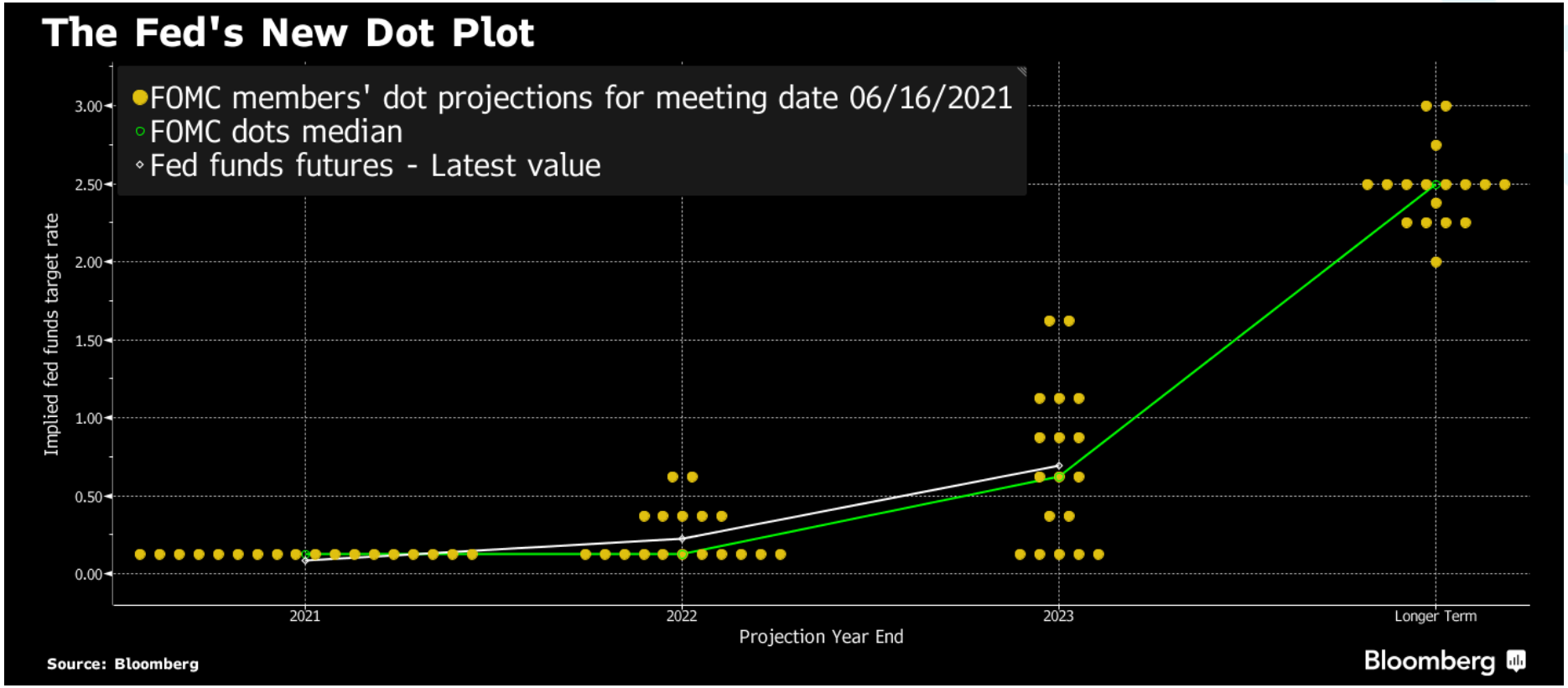
Returns in Different GDP Environments

S&P 500 Returns During Different GDP Environments					
Real GDP Range	# Instances	Average Return (Prior Year)	Median Return (Prior Year)	Average Return (Current Year)	Median Return (Current Year)
< 0%	11	-10.9%	-9.7%	13.4%	23.5%
0 - 2%	8	4.0%	6.0%	0.0%	0.0%
2 - 4 %	27	9.4%	8.5%	10.0%	11.4%
> 4%	28	16.0%	16.9%	8.6%	10.4%
All Years (1947-2019)	*73*	*8.1%*	*9.5%*	*8.9%*	*10.8%*

Source: RBC US Equity Strategy, Haver, S&P; through 2019, Consensus forecasts are as of 05/24/2021

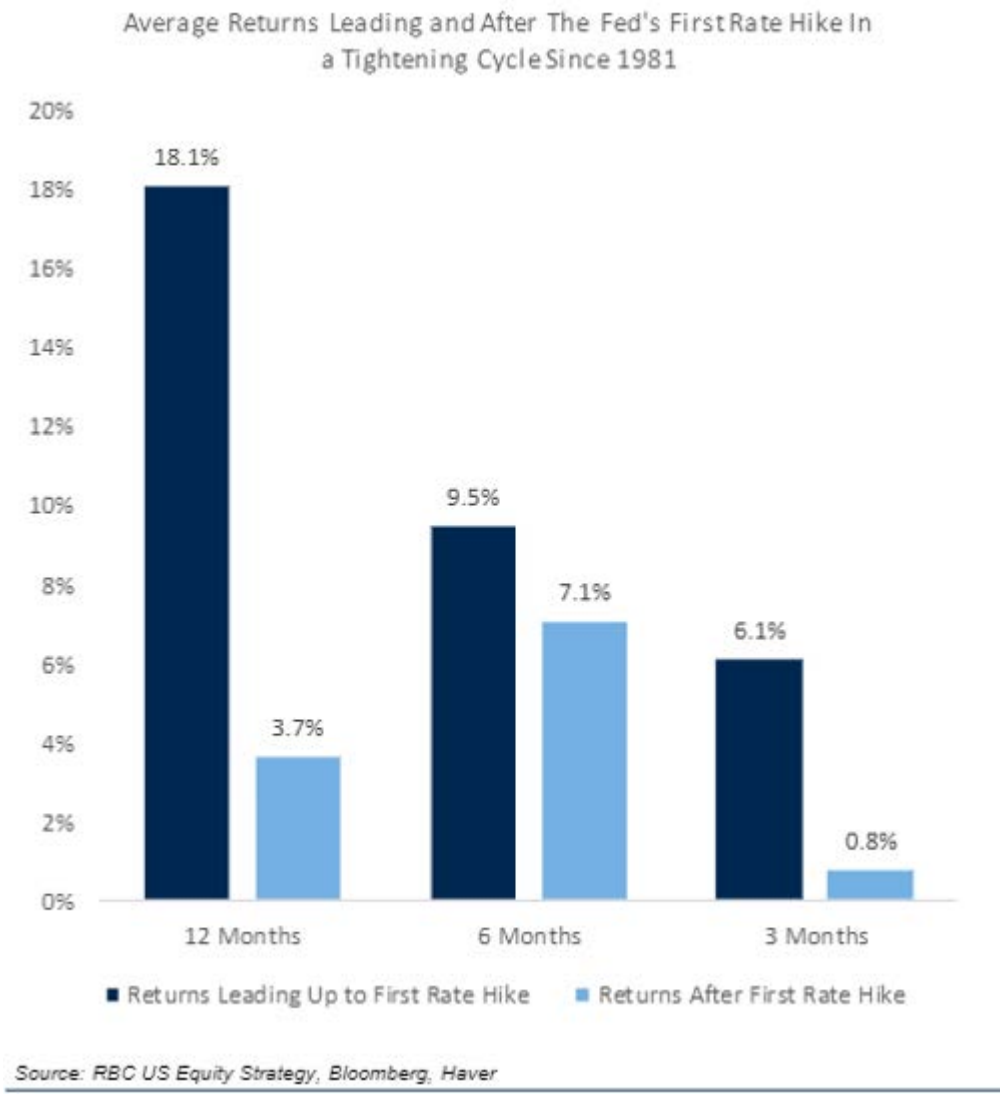
The current GDP environment is highlighted red, the current consensus is that US GDP will exceed 4% for 2021 and 2022. Historically, this has been an excellent environment for stocks. However, since returns have been so strong over the past year, some short-term weakness may be expected.

Federal Reserve Policy Shift



Another consequence of the rapidly recovery economy and inflationary risk is that the Federal Reserve has shifted its interest rate policy, and we may be in a rising rate environment before much longer. Projections from the Federal Reserve Open Markets Committee show that they anticipate that rates will be hiked to around 0.75% by the end of 2023, and to 2.5% in the longer term.

Rising Rates and Stocks



Rate hikes aren't all bad for stocks, the beginning of a rising rate cycle typically coincides with a strong economy, which is a positive environment for stocks.

The chart to the left shows average S&P500 returns leading up to and following the first rate hike of a rising rate cycle since 1981. You can see that the returns are quite strong, although they are better leading up to the first hike than following it.

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