



# CHARTBOOK Market Comment

Prepared by OceanFront Investment Counsel Inc.

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# Market Comment

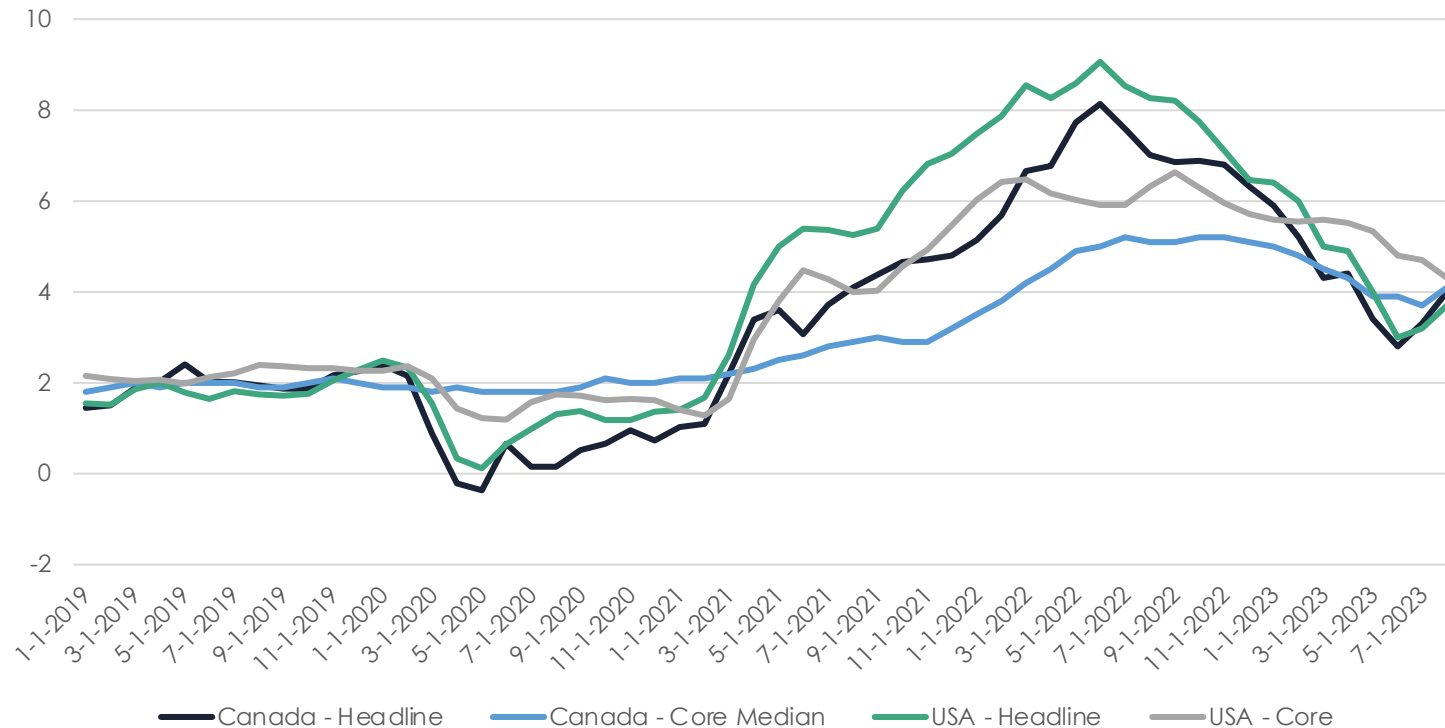
In September, the Bank of Canada announced no change to its policy interest rate, leaving it at 5%. The bank noted that inflation has come down, but core inflation (which excludes food and energy) remains elevated. Global growth has largely slowed other than in the US, which saw strong GDP growth in the second quarter. The bank noted that this slowing growth is necessary to relieve price pressures and that while inflation has increased of late, it expects inflation to ease again soon. The main factors the bank looks at to gauge its interest rate decisions, inflation, growth, and labour market tightness, appear to be moving in the right direction.

The Federal Reserve also announced no change to its Fed Funds rate after its meeting in September. The most notable difference in the economic data between Canada and the US is GDP growth, which has slowed dramatically in Canada but has remained very strong in the US. This is likely to contribute to rates being somewhat higher in the US than in Canada.

Despite the high-interest rates, valuations on most stock markets remain relatively high. This makes stocks as an asset class appear relatively expensive compared to bonds, especially short-term bonds which currently offer the most attractive yields.

# Inflation

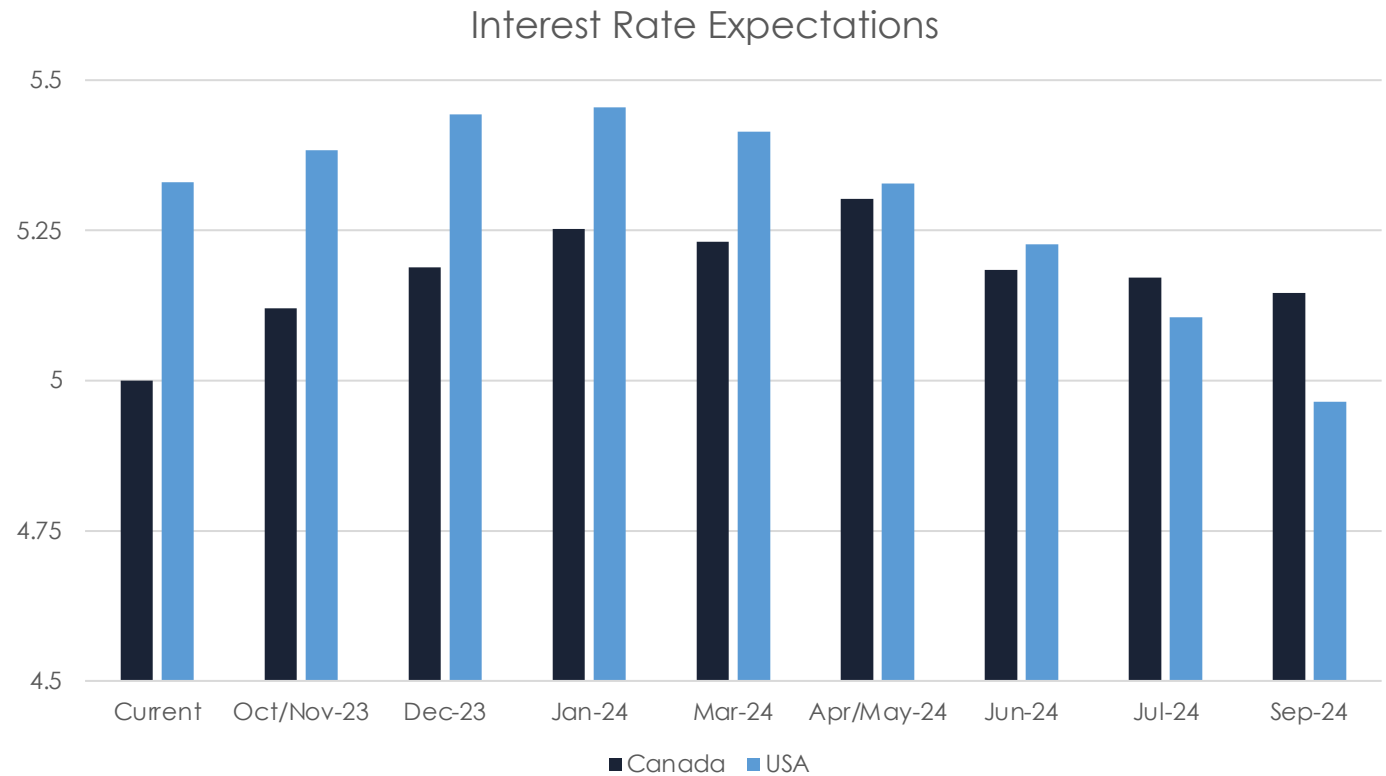
CPI Year-Over-Year Change (%)



Measures of inflation in the US and Canada remain around 4% year-over-year, still significantly higher than the central bank targets of 2%. While US Core Inflation (which excludes food and energy prices) continues to trend lower, the other three measures in the chart have moved higher since their lows in the summer. It's unlikely we see any rate cuts until these numbers are consistently under 3%.

# Interest Rate Expectations

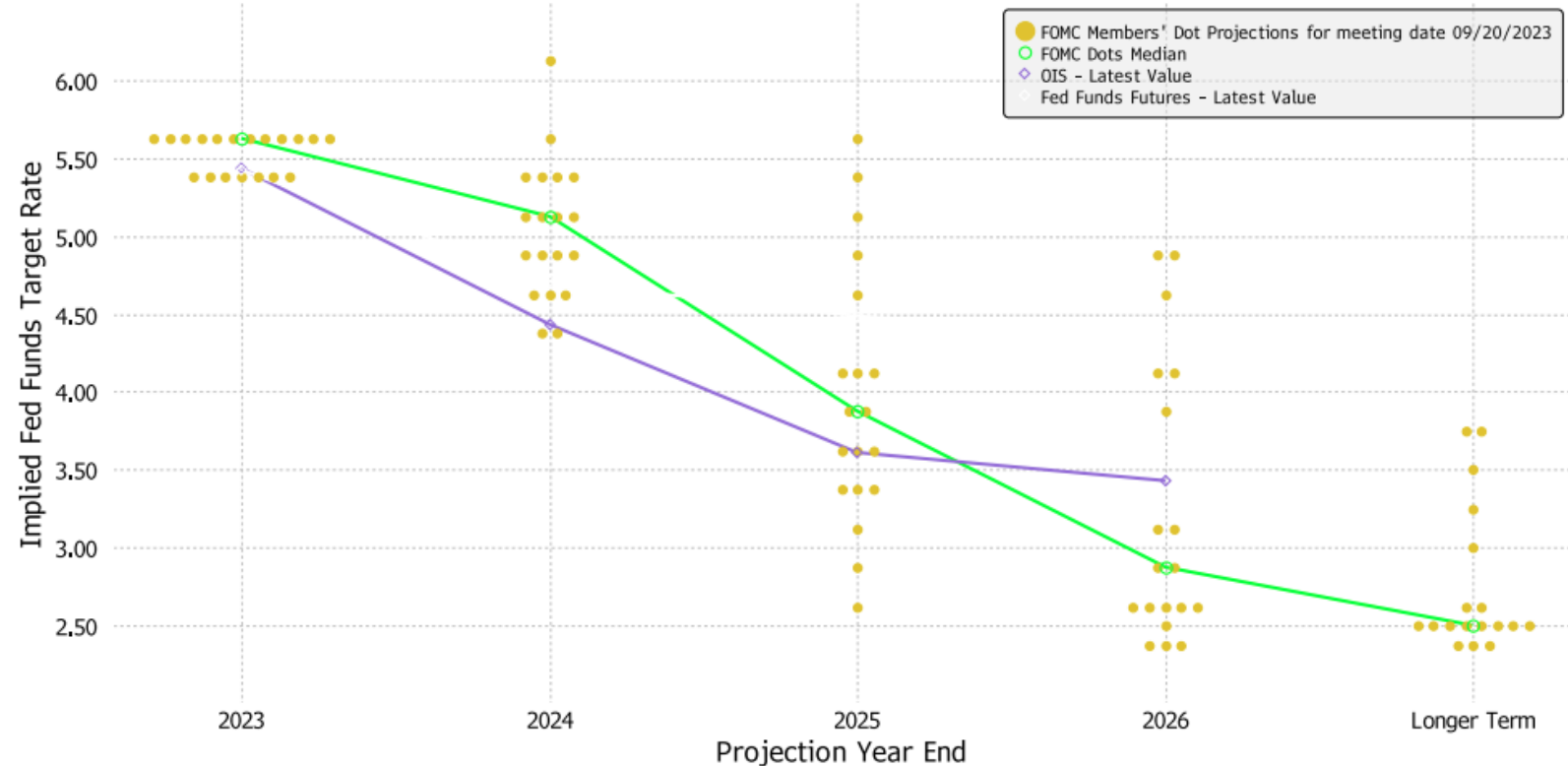
As inflation has remained higher than targeted, interest rate expectations continue to adjust to the upside. Based on these expectations, overnight rates set by the Bank of Canada and the Federal Reserve may rise slightly higher from here before modestly declining in 2024.



Data: Overnight Index Swap markets as of September 26, 2023

# Interest Rate Projections

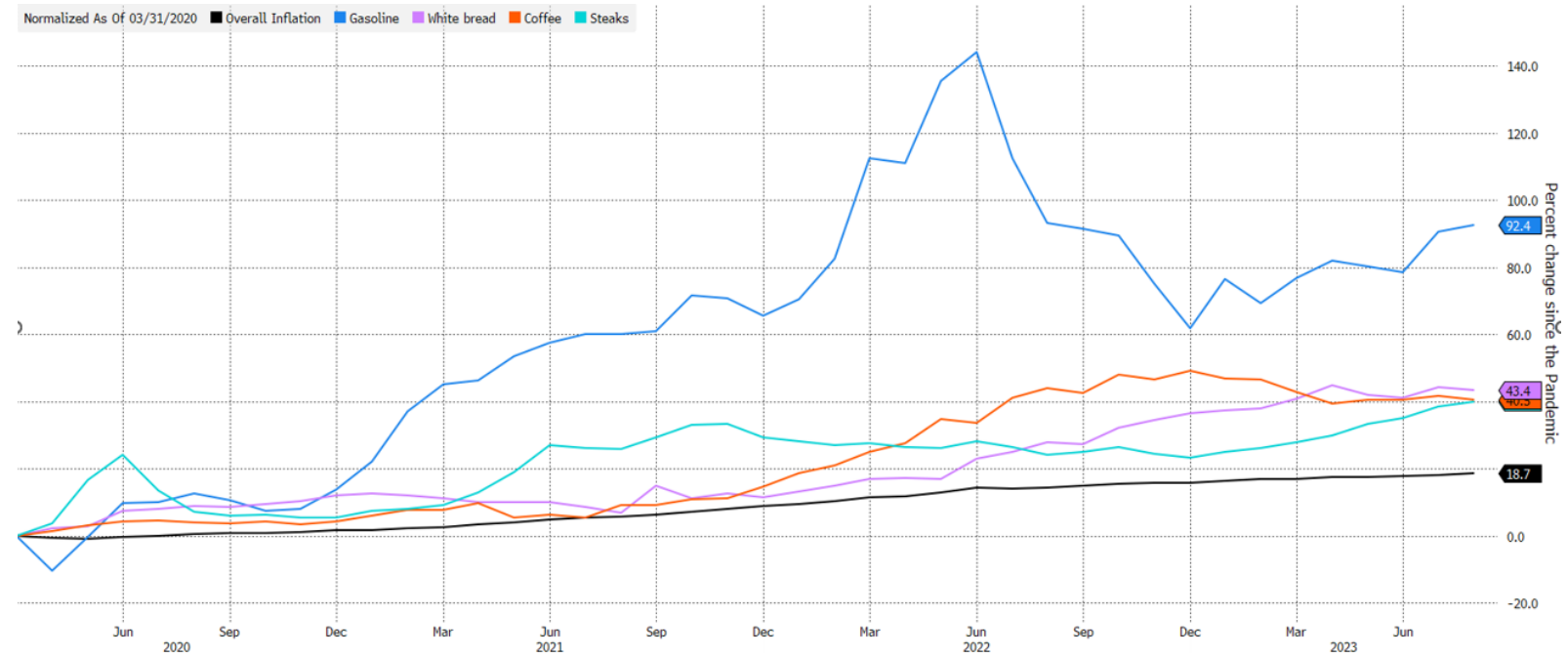
The Federal Reserve publishes a dot plot which shows where its board members believe their Fed Funds rate will be in the future. At the end of 2023 they expect their rate to be around 5.5%, declining to around 4.5% at the end of 2024, 3.5% in 2025 and under 3% in 2026.



# Inflation – Select Components

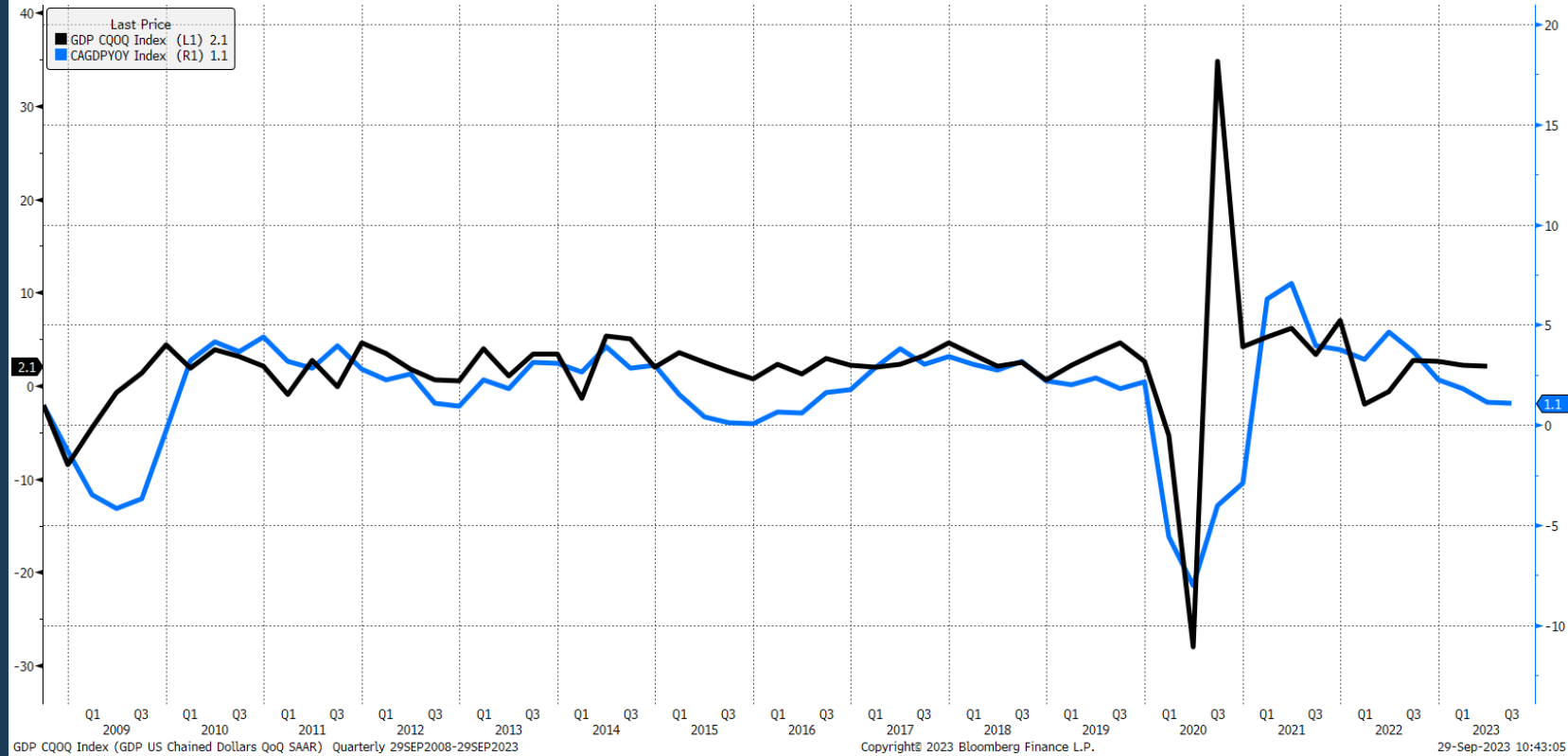
Inflation in certain goods and services is more damaging to the average consumer than in others. For example, everyone needs to buy food but not everyone needs to buy a yacht or private jet.

In the chart, the black line represents overall inflation in the US economy, the others represent inflation in gasoline (blue), white bread (purple), coffee (orange) and steaks (turquoise). These select goods have all inflated substantially more than the overall measure. Inflation may be more damaging to the average consumer than many realize.



# GDP

GDP growth in Canada (blue) and the US (black) is slowing. The latest year-over-year readings were 1.1% for Canada and 2.1% for the US. Theoretically, with slowing growth should come slowing inflation.





# Recession Forecast Model

## Treasury Term Spread: 10 Year Bond Rate - 3 Month Bill Rate

Percentage points (monthly average)



## Probability of U.S. Recession, Twelve Months Ahead of Term Spread Readings

Percent (monthly average)

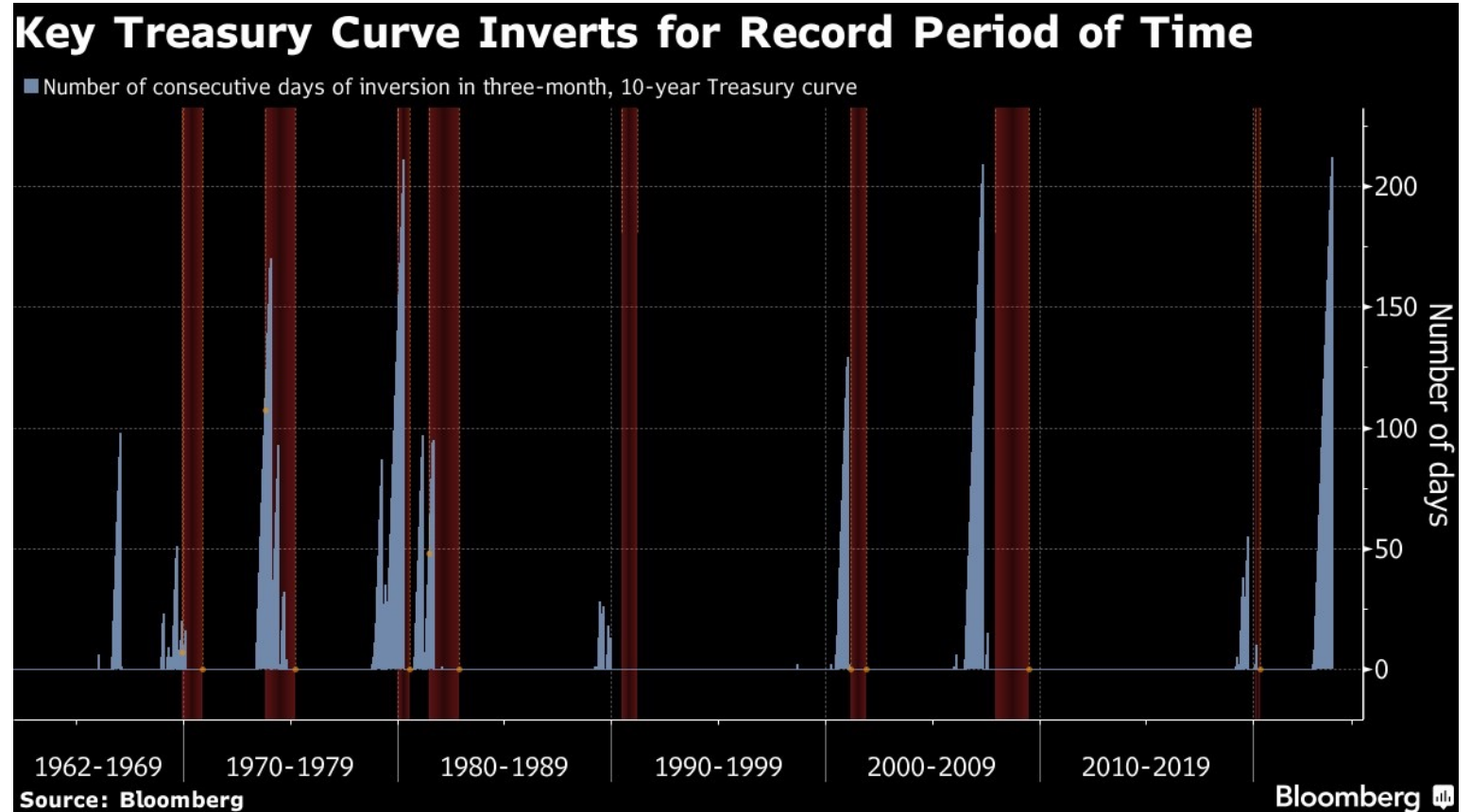


The Federal Reserve has a recession prediction model based on the spread between the yields of the 3-month Treasury Bill and the 10-year bond. This is the top panel of the chart. Typically, the yield on the 10-year is higher than shorter-term bonds because there is more risk and less liquidity for longer-term bonds. When the opposite happens and the 10-year yields less than the 3-month (called an "inversion"), it is generally an indicator of an upcoming recession. The shaded areas of the chart represent recessions, and you can see that the spread went negative prior to the recession each time.

In the lower panel, the recession model gives a 60% probability of a recession twelve months from now.

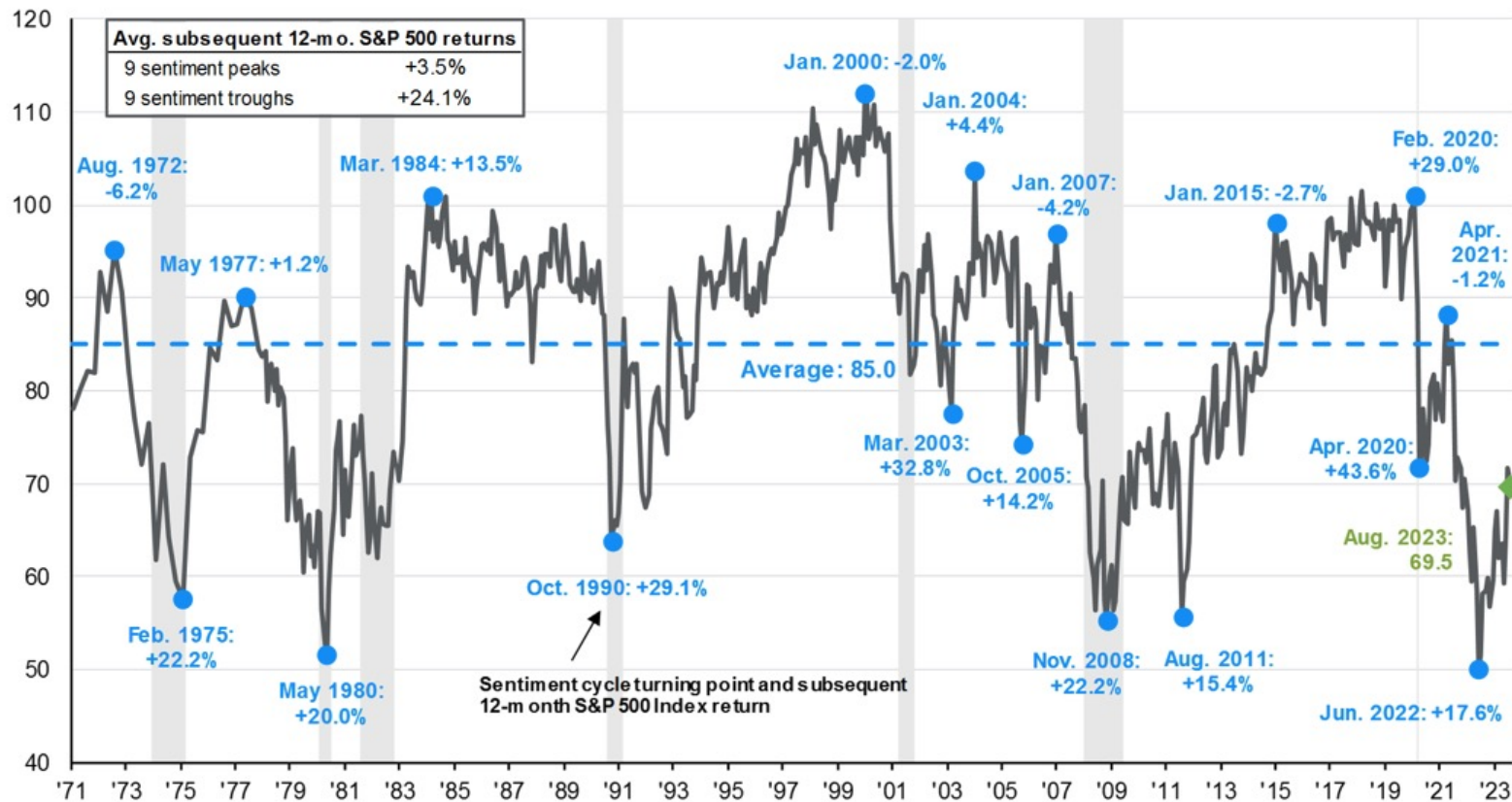
# Treasury Curve Inversion

The current inversion in the treasury curve has lasted longer than any dating back to the 1960s. This suggests it is a significantly strong signal for an upcoming recession.



# Consumer Sentiment

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management. Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only starting from the end of the month and excluding dividends. Past performance is not a reliable indicator of current and future results. Guide to the Markets - U.S. Data are as of August 31, 2023.

Lows in consumer sentiment, when consumers feel pessimistic about the prospects for the economy, tend to be good times to invest in stocks, while the opposite, when consumers are generally optimistic about the economy, tend to be relatively poor times to invest.

The chart shows a measure of consumer sentiment dating back to 1971. The average 12 month return of the S&P500 at peaks in sentiment is 3.5%, while the average 12 month return after troughs is 24.1%.

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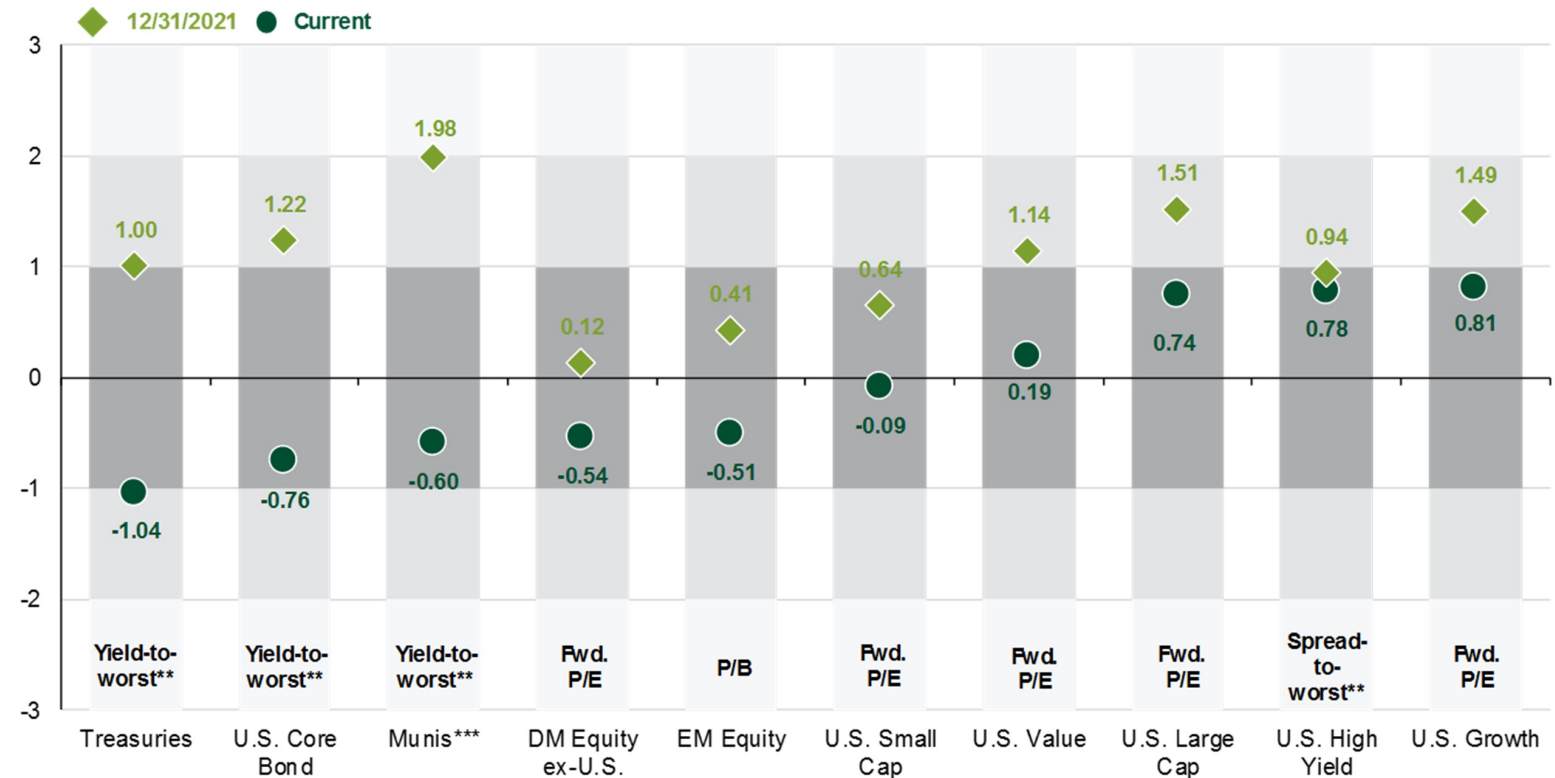
# Asset Class Valuations

Looking at valuations, we can see what is relatively cheap and what is relatively expensive. US stocks and high-yield bonds are generally expensive, in certain cases very expensive, while stocks from areas outside the US are cheap relative to their 25-year average and compared to US stocks.

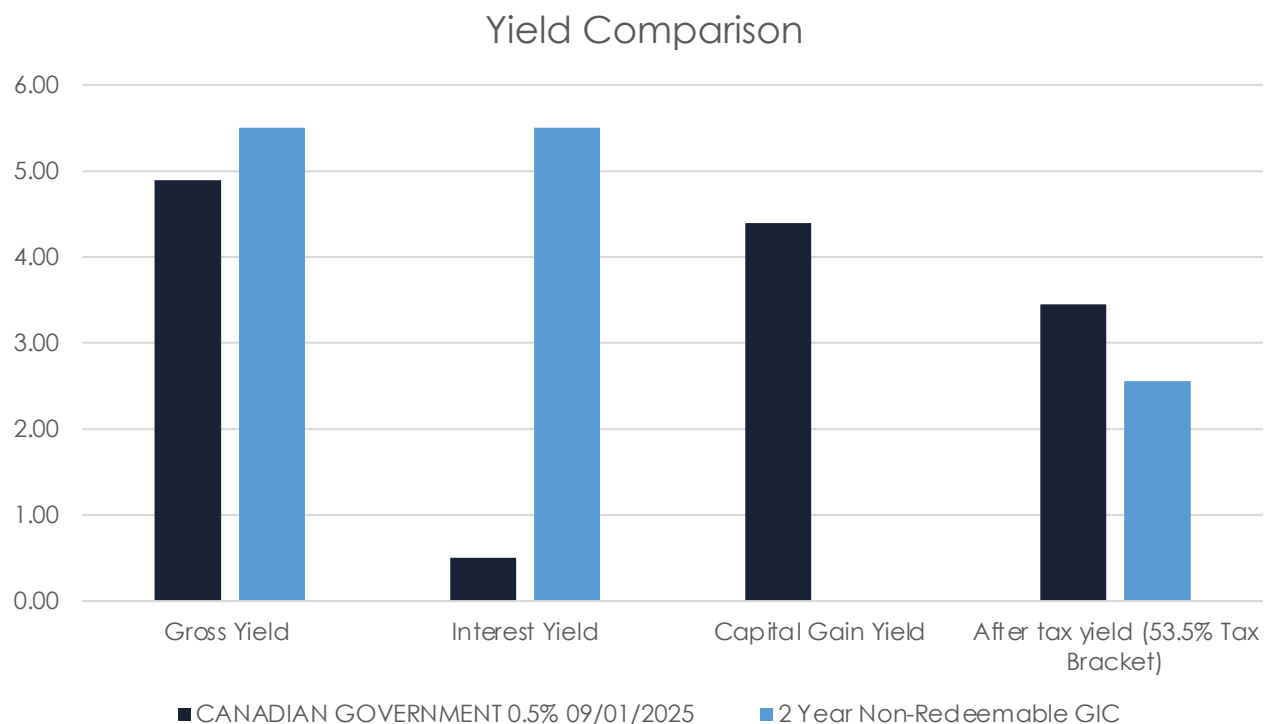
In particular, bonds (excluding high-yield bonds) show significant value relative to their 25-year average, as yields have risen so much lately.

## Asset class valuations

Z-scores based on 25-year average valuation measures\*



# Yields: GICs vs. Bonds



Data as of Sep. 26, 2023. Tax brackets vary depending on province of residence. Yields are gross of fees.

What's better, a GIC or a bond? Each has certain features which may offer benefits over the other. In particular, bonds can offer a return in the form of interest and/or capital gain, which can give a bond a more attractive after-tax return than a GIC which only pays interest.

The chart shows a comparison of a Canadian Federal Government bond with roughly a 2-year maturity and a 2-year GIC. The bond pays just 0.5% coupon interest, with nearly 4.5% of the yield coming from capital gain. The GIC pays a higher overall yield but all as interest.

You can see that after-tax the yield on the bond is much higher than the GIC. Another benefit is that this bond also offers high liquidity, while the GIC is non-redeemable.

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