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CHARTBOOK
Market Comment

Prepared by OceanFront Investment Counsel Inc.

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Chartbook Market Comment: December 2023

Market Comment

Market expectations for interest rates are now firmly pricing in the peak in rates, now expecting significant cuts in 2024. Officials from the Bank of Canada and Federal Reserve have mostly remained cautious and have sought to dampen expectations of imminent rate cuts. However, Federal Reserve Governor Christopher Waller recently broke from the trend, speaking optimistically about the progress towards the Fed's inflation goal, one of the first central bank officials to indicate a light at the end of the tunnel.

"I am encouraged by what we have learned in the past few weeks—something appears to be giving, and it's the pace of the economy. Data for October indicated an easing in economic activity, and forecasts for the fourth quarter show the kind of moderation that is more in keeping with progress on lowering inflation", said Waller. "I am increasingly confident that policy is currently well positioned to slow the economy and get inflation back to 2 percent."

In contrast, Federal Reserve Chairman Jerome Powell gave a speech shortly after the comments from Waller which reiterated the cautious approach to declaring victory on inflation.

"It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease. We are prepared to tighten policy further if it becomes appropriate to do so", Powell said.

In any case, there are clear signs of a slowing economy, particularly in Canada, and it is these signs that markets believe will lead to lower interest rates in 2024. Falling interest rates would provide a nice tailwind for returns in many asset classes going forward.

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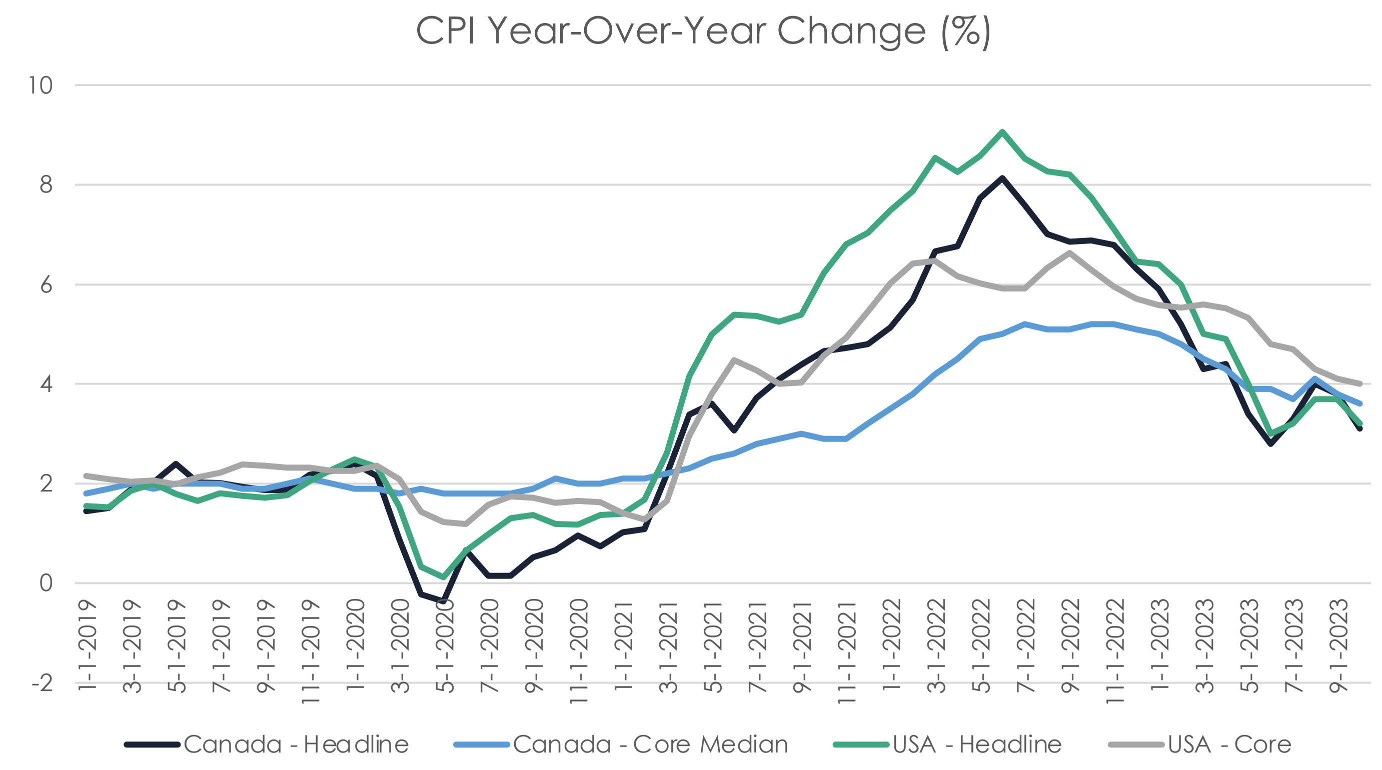
Inflation



Measures of inflation in the US and Canada are now in the mid 3% to 4% range, a dramatic fall from the highs of 2022 and a clear downtrend.

 Source: Bloomberg, OceanFront Investment Counsel Inc.

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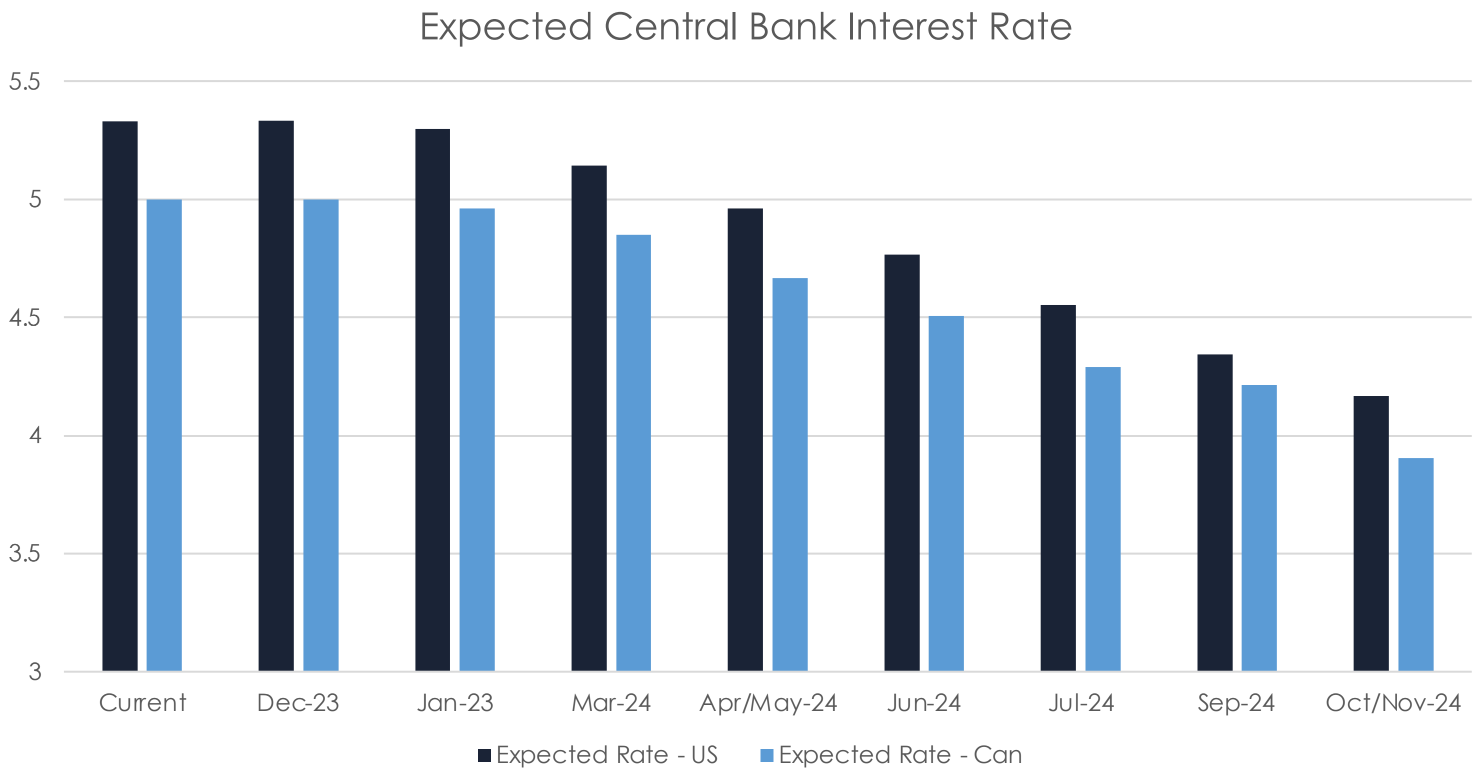
Interest Rate Expectations

As inflation subsides, markets are pricing in about a 1% decline in the both the Federal Reserve's and Bank of Canada's policy interest rates by the end of 2024.

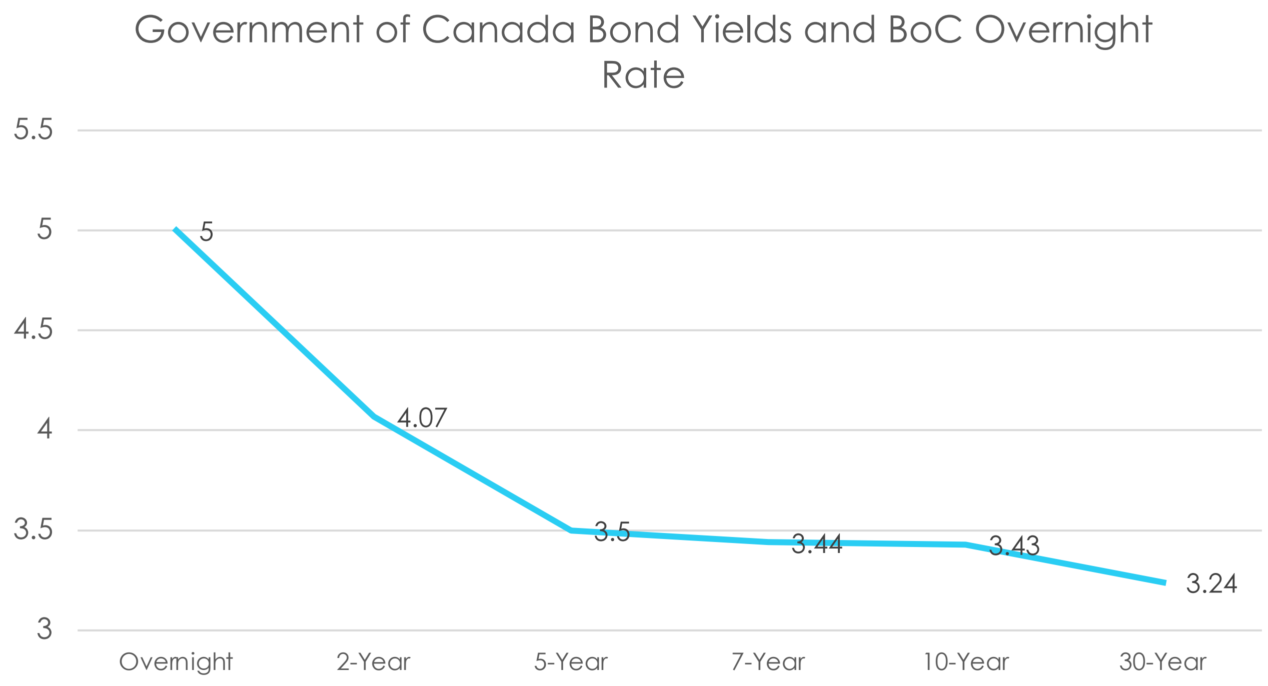


Data: Overnight Index Swap markets as of December 1, 2023

Yield Curve

Yields on longer dated Government Bonds are much higher than the Bank of Canada's overnight rate, suggesting that short term interest rates will decline from here.

The yield on the 2-Year Government of Canada bond is often looked to as an indication of where the overnight rate will be in 2 years time, which would indicate a 1% cut to the current rate.



Data as of December 1, 2023.

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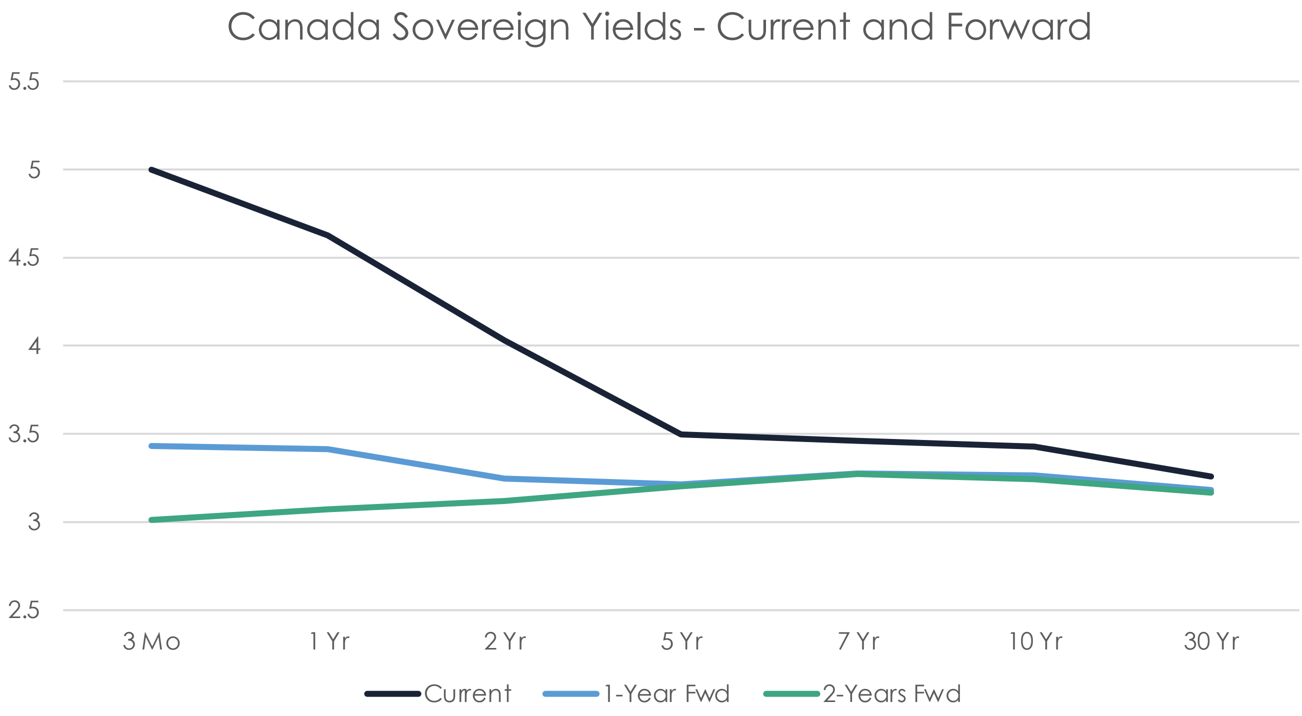
Forward Yields

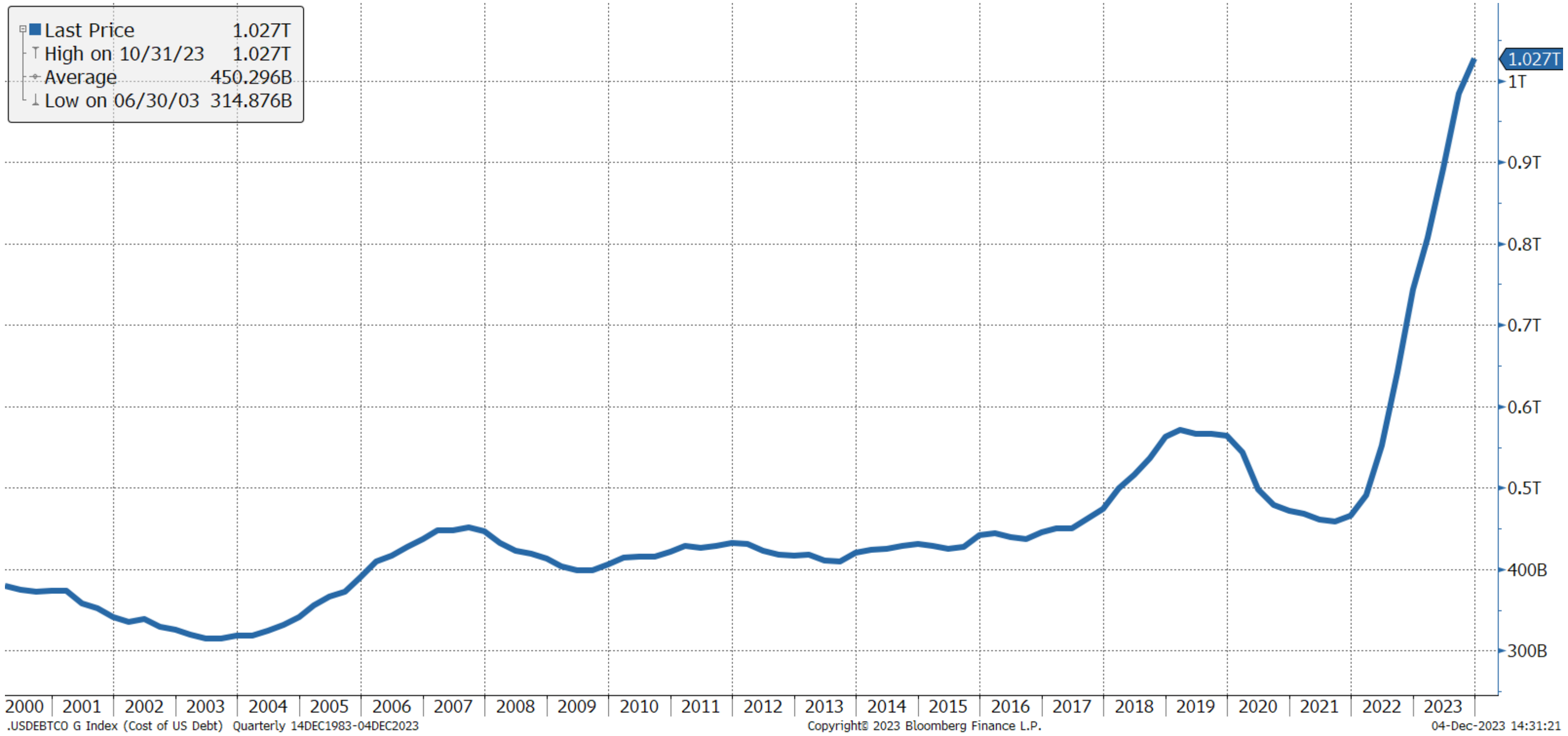
Looking at forward yields, the yields that markets expect 1-year and 2-years from now, we see a substantial decline from where yields are today, including an expected 2% decline in the 3-month rate over 2 years.



Source: Bloomberg, OceanFront Investment Counsel Inc.

Cost of US Debt

Since the beginning of 2022, interest expense on the US debt has more than doubled. It is now more than a trillion US Dollars per year. It is clearly unsustainable that the US economy can continue to pay such exorbitant interest costs. There are a number of ways to deal with this debt problem, but the quickest way to make this more manageable is to lower the rate of interest.



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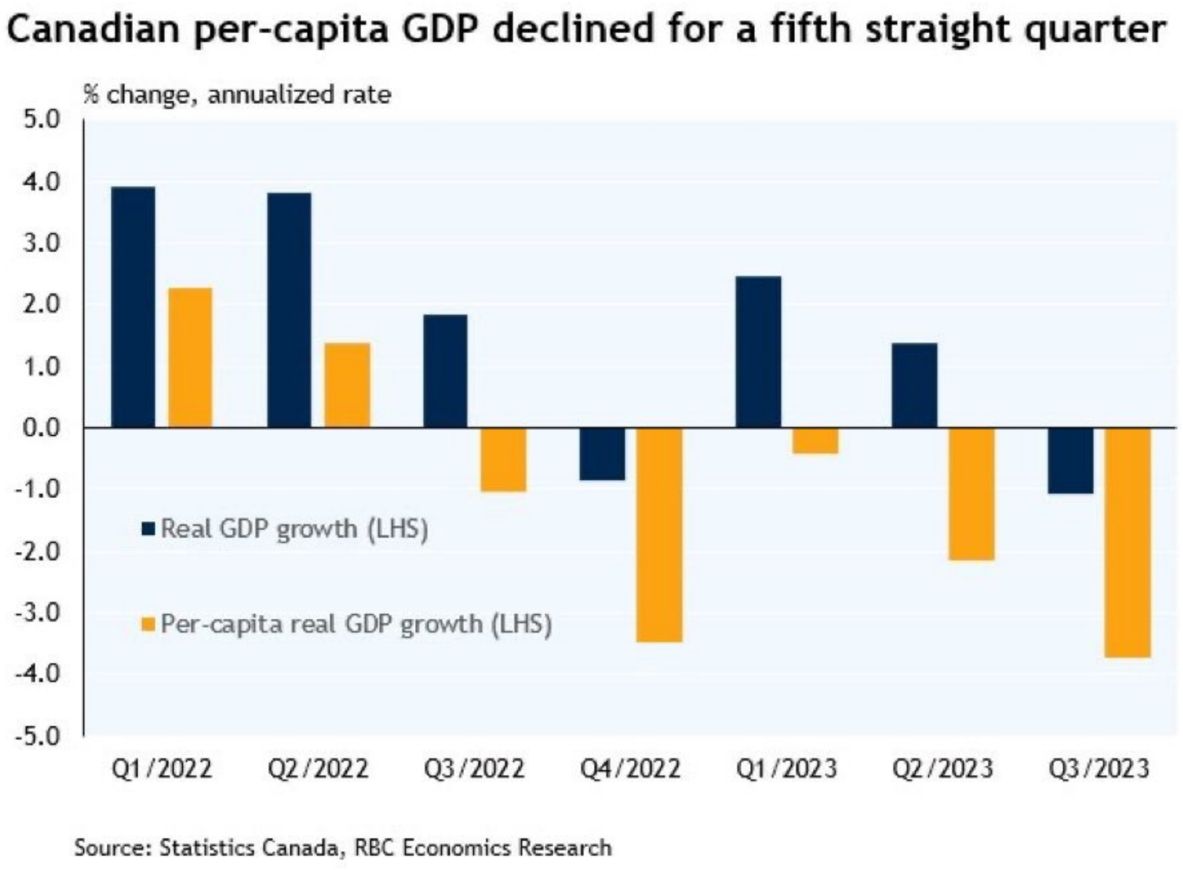
GDP

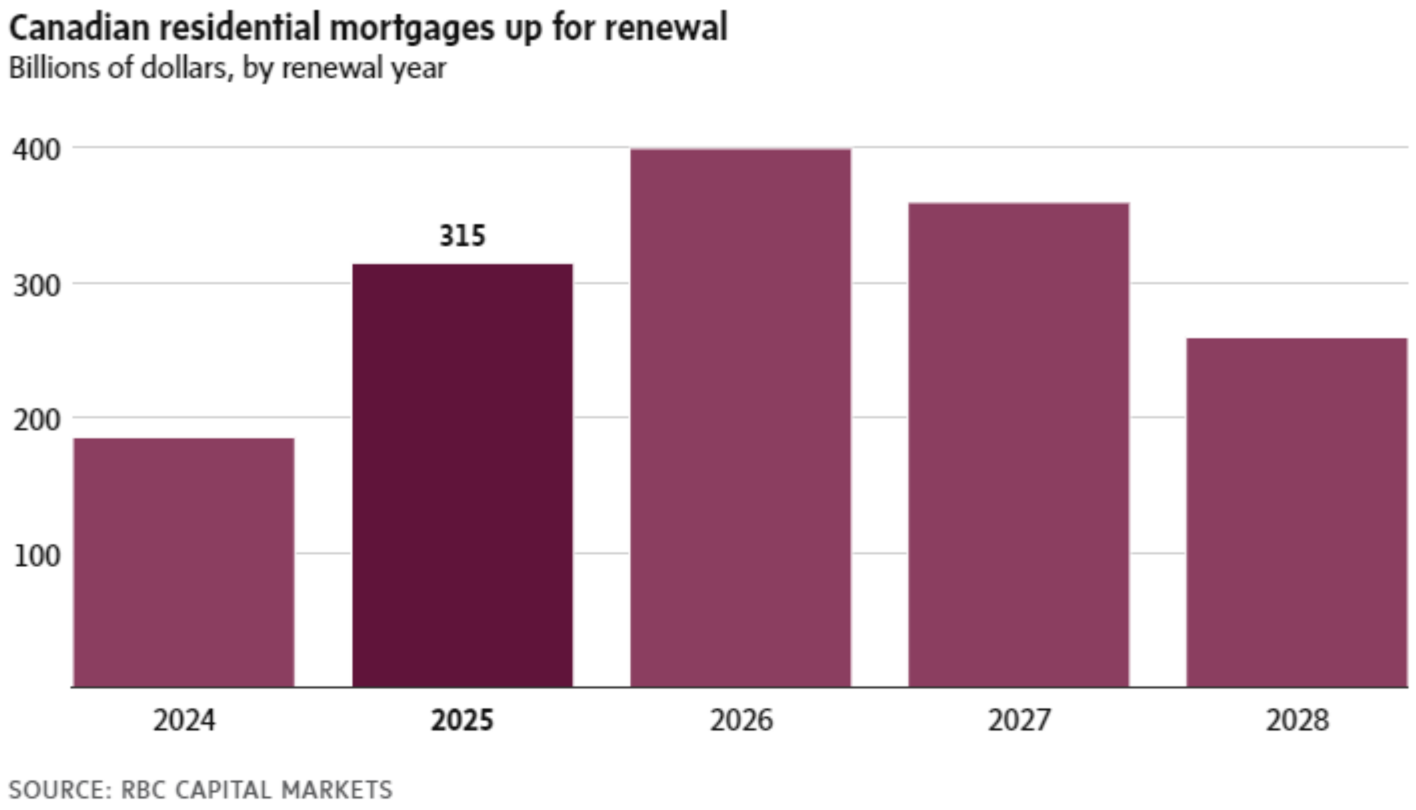


GDP growth continues to be very weak in Canada. Over the past 5 quarters, 2 have shown negative growth. Per capita GDP growth, on the other hand, has been negative for 5 straight quarters. Typically, in such a weak growth environment, the Bank of Canada would be considering interest rate cuts to stimulate a sluggish economy.

Mortgages

According to RBC Capital Markets, there will be about $700 billion in residential mortgages up for renewal in the next 3 years. Refinancing at the higher, prevailing interest rates of today would put significant financial pressure on these consumers. By extension, this is also bad for the economy as it leaves less disposable income for these consumers to spend on other goods and services.

As set out in the Bank of Canada act, the objective of the bank is: "to promote the economic and financial welfare of Canada". Thus, there is a significant incentive here for the Bank to promote a policy of lower interest rates in the future to ease the burden on consumers.



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Bitcoin: It's Alive!

Bitcoin rises from the ashes to become one of the best performing assets of 2023 and is up over 180% since the lows in December 2022. Bitcoin appears to like lower interest rates, so this performance could suggest that the demand has been driven by the anticipation of interest rate cuts. Bitcoin also seems to be a barometer of risk appetite, so this also suggests "risk on" sentiment in the market.

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