MONTHLY COMMENTARY

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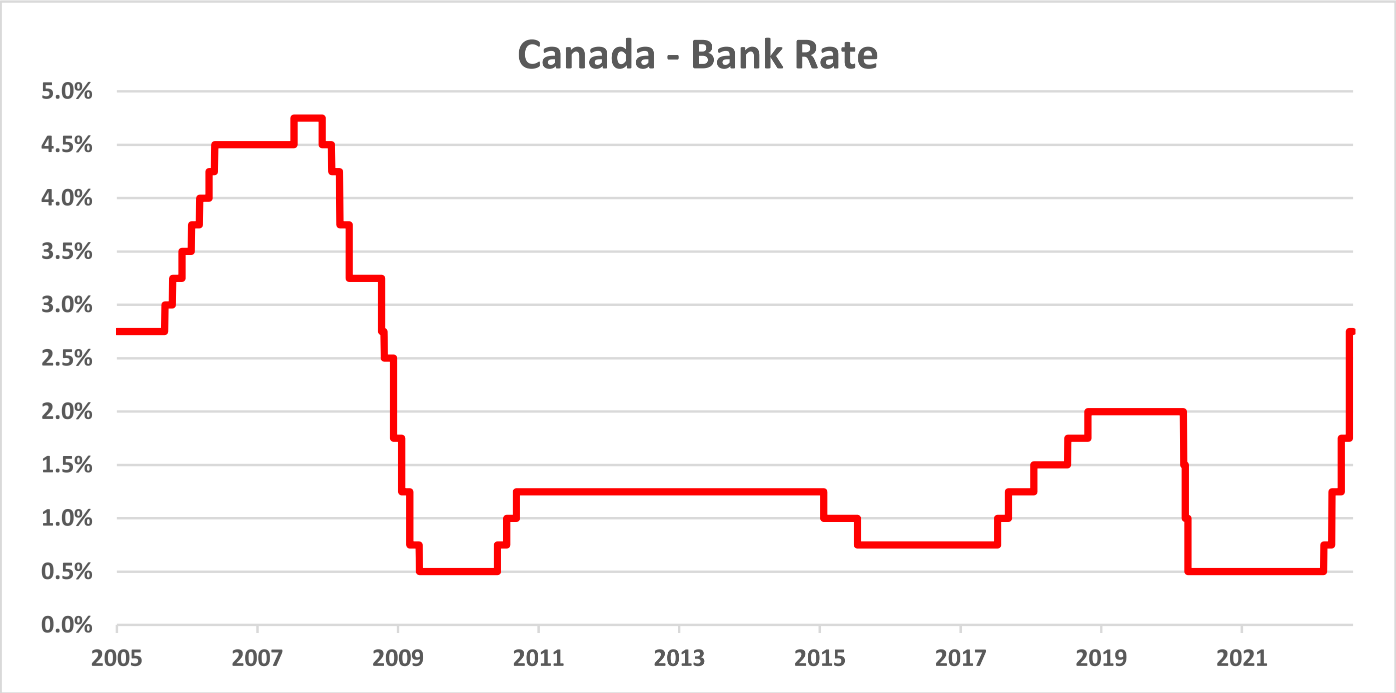
Alfred Lam, MBA, CFA
Senior Vice-President & Chief Investment Officer
CI GAM | Multi-Asset Management

Richard J. Wylie, MA, CFA
Vice-President, Investment Strategy
CI Assante Wealth Management

Bank of Canada hikes rates



Source: Statistics Canada

MARKET FOCUS

Canada's monetary policy tightens

At the conclusion of its latest policy meeting, the Bank of Canada (BoC) announced that it was raising administered interest rates, with its lending target moving up 100 basis points (a basis point is 1/100th of one per cent) to 2.50%. This is the largest single move since the BoC raised rates by the same amount on August 27, 1998. The new range for overnight borrowing was set at 2.25% to 2.75%. The cumulative 2.25% increase over the 133-day period is the most rapid tightening move since January 11 to February 16, 1995 (250 basis points in 36 days). The statement that accompanied the announcement continued to indicate "interest rates will

need to increase.” In addition, the BoC released its updated Monetary Policy Report, which reflected higher forecasts for inflation and lower forecasts for economic growth. The annual increase in CPI for 2022 is now expected to be 7.2% (compared to the 5.3% forecast provided in April) and 4.6% in 2023 (2.8%). Annual growth in GDP is now expected to be 6.0% in 2022 (5.9%) but only 0.3% in 2023 (2.2%). Even though the 100-basis point increase in administered rates was greater than the market consensus, many analysts continue to view the BoC as behind the curve in its efforts to deal with inflation at 8.1% (June), the fastest pace since January 1983 (8.2%) and well above the Bank of Canada’s 2% target. The next policy announcement is scheduled for September 7, 2022.

U.S. job market gaps remain

The U.S. Bureau of Labour Statistics reported that non-farm payroll growth slowed in June. The 372,000 jobs added during the month was the softest figure since April 2021 (263,000). In addition, the prior two months were revised downward by a cumulative 74,000. Gains had averaged 493,000 over the prior six months. Despite steady advances over 18 months, overall payrolls remain more than half a million ***below*** the pre-pandemic peak recorded in February 2020. The participation rate (the percentage of the working age population that is either working or looking for work) edged lower to 62.2% from 62.3% in May. This figure also remains below the February 2020 peak of 63.4%. Despite the very low unemployment rate (3.6% in the June report), dislocations within the job market remain. The number of unemployed workers stood at 5.9 million (June) even though the total number of non-farm job openings stood at 11.3 million (May). Going forward, as interest rates continue to rise, the U.S. Federal Reserve’s dual mandate of maximizing employment while maintaining price stability may come into question.

LONGER VIEW

After witnessing several market drawdowns and the following rallies, investors should be realizing that this type of volatility is just noise over the long term. The immediate issue in the economies is rising inflation. Central banks have ignored the issue for too long and it is now being addressed with one of the most aggressive hiking cycles in history. It is widely expected the Fed Fund’s rate will rise to 3% to 3.5% in a year before it reaches its terminal. This range is by no means aggressive compared to historical rates, but how quickly we get there is. Economies will, without doubt, slow along with inflation. Stocks, at current levels, have already been re-priced for lower earnings. Further lows are possible, but prices appear to be low enough already, especially considering inflation leads to higher nominal growth in both economies and earnings. Bond yields have risen aggressively this year and bond prices have declined. With the 10-year yield of government bonds exceeding 3%, there is some opportunity for investors.

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