

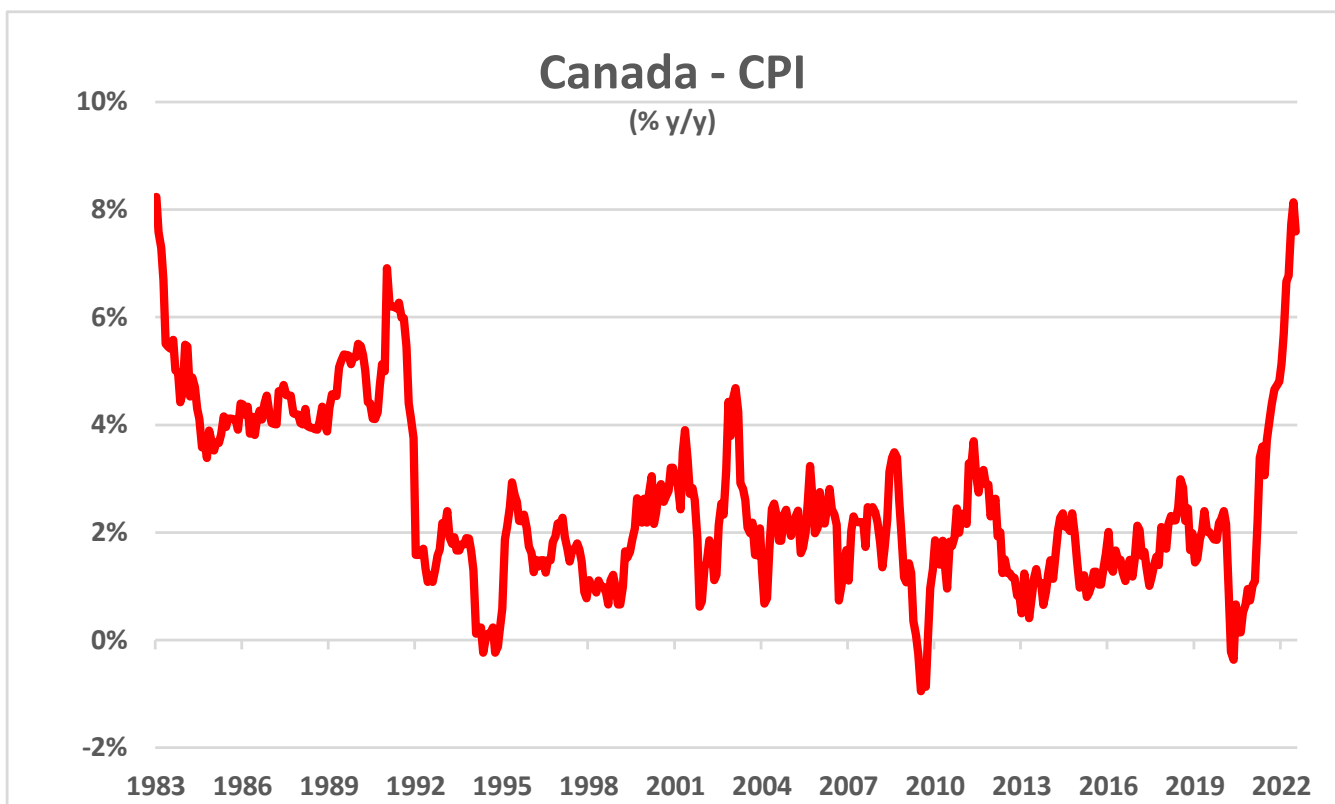
MONTHLY COMMENTARY

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Inflation edges down



Source: Statistics Canada

MARKET FOCUS

Price pressures ease, but remain elevated

Statistics Canada reported that the Consumer Price Index (CPI) rose 0.3% (seasonally adjusted) in July. This follows a 0.6% advance in June. Five of the eight main CPI subgroups moved higher during the month. Food prices (0.7%) reported the largest gain, while

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transportation (-0.6%) recorded the largest decline. Gasoline prices, which were up 54.6% on a year-over-year basis in June, recorded a somewhat less dramatic 35.6% annual increase in July. As can be seen in the accompanying graph, on a year-over-year basis, the overall CPI was up 7.6% in July. This is down from the 8.1% figure recorded in June, which was the fastest pace of inflation since January 1983 (8.2%). This is now the first decline in the annual pace of inflation since June 2021, when the inflation rate dropped to 3.1% from 3.6%. Regardless, even *if* the peak of inflation has passed, it remains well above the established 2.0% target. Two of the Bank of Canada's (BoC) core inflation measures moved higher during July and ranged from 5.0% to 5.5%. CPI common, which the central bank says is most closely correlated with the output gap, rose from 5.3% to 5.5% in the July report. The BoC's next monetary policy announcement is scheduled for September 7, 2022, and most observers expect another increase in administered interest rates.

U.S. economy contracts again

The U.S. Bureau of Economic Analysis reported that gross domestic product (GDP) contracted at an annualized rate of 0.9% in the second quarter of 2022. The decline in output followed and even larger 1.6% contraction (on the same basis) in the first quarter of 2022. These are the first back-to-back quarterly declines in GDP since the recession recorded at the beginning of the pandemic (Q1 2020/Q2 2022). While two consecutive quarters of negative growth in output have traditionally marked a recession, a different entity, the National Bureau of Economic Research, is responsible for dating U.S. business cycles. In the case of the last recession, the April 2020 economic trough was determined in July 2021. Accordingly, the determination of a recession, if it takes place, may sometimes be off. Either way, it is widely expected that the U.S. Federal Reserve will continue to tighten monetary policy in an effort to lower inflation.

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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