GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

JUNE 2022

UPCOMING 2022 BNN SHOWS

Christine: July 19 @ 12 pm

Christine: August 23 @ 12 pm

Christine: September 20 @12 pm

Equity markets posted double-digit negative returns in the quarter reflecting growing pessimism on the outlook for the global economy. There was no escape - all industry sectors as well as bonds generated negative performance.

The S&P500 Index officially became a "bear" market on June 13th, when it closed down 21.8% from its Jan 3rd high. In comparison, the S&P/TSX Composite Index has fared somewhat better, down 14.6% at quarter-end from its March 29th high, owing to outperformance from the energy sector.

The pullback this year has been the result of a compression in the price-to-earnings (P/E) multiple for the broad equity indices. For now, corporate profits are still expected to grow this year and next. Negative profit estimate revisions are likely given a strong U.S. dollar, rising interest rates, inflationary pressures, and supply chain related expenses.

Aggressive monetary policy tightening combined with reduced consumer purchasing power are weighing on economic activity and raising the likelihood of a recession in major economies. Many of the indicators we track are flashing yellow.

Monetary Policy

Persistently high inflation is driving many central banks to adopt an aggressive monetary tightening policy. The U.S. Fed has been steadily increasing its projections for the Federal Funds rate, and now expects it to be 3.4% by the end of this year and 3.8% by the end of 2023 (compared to 1.75% now).

Layered on top of rate hikes is quantitative tightening (QT), which went into effect on June 1st . Compared to the last QT cycle, following the financial crisis, the current QT schedule is starting earlier and ramping up faster due to a much larger balance sheet (at US$9 trillion) and higher inflation. Federal Reserve Chairman Powell has indicated that QT might have the same effect as an additional quarter-point increase in the Fed Funds rate.

Typically, there is about six-month lag to feel the impact of monetary policy throughout the economy. The fixation by central bankers to quell inflation increases the risk of overly aggressive tightening in the near-term without regard for the longer-term impact. Chair Powell has conceded that while higher rates necessary to bring down inflation could cause an economic downturn, allowing high inflation to become entrenched could be more painful than a recession. Hence, the Fed plans to continue raising interest rates until there is compelling evidence that inflation is moving down.

Inflation

We have previously discussed the events leading up to the current economic situation that has inflation in Canada at 7.7% and 8.6% in the United States. The surge in demand for durable goods during the pandemic appears to be abating with consumer spending patterns shifting towards travel and entertainment services. Excess inventory piling up at large retailers such as Target and Walmart are providing a boon for liquidators and reduced prices for household items including appliances, home and garden furniture as well as comfortable apparel.

Commodity markets are also exhibiting downward price patterns with the following commodities down from their peaks: lumber -54%, copper -25%, nickel -47%, steel -33%, CBOT wheat -39%, WTI -20%, and natural gas -40%.

Inflation measures the rate of price change across a wide category of goods and services, so the observed price declines in durable goods and key commodities suggest a disinflationary trend on the horizon.

Financial markets do not expect high inflation to become entrenched, as depicted by the U.S. 5-Year and 10-Year Breakeven Inflation Rate of 2.48% and 2.29%, respectively (Charts 1 and 2). The bond market is also signaling lower inflation and economic growth with the U.S. 10-Year Treasury Bond Yield declining to 2.90% from 3.48% in mid-June.

The Consumer

Consumer spending is a major source of economic growth. In the United States, consumer spending accounts for more than two-thirds of economic activity and in most industrialized economies, consumer spending accounts for about 60% of GDP.

The pandemic accelerated consumer bifurcation in North America. White collar jobs were able to freely pivot to remote work, wealthier households saw the value of their assets appreciate, and savings was disproportionately concentrated among higher income households. The savings rate in the United States shot up above 30% during the pandemic and has since receded to 5.4% in May, below the pre-pandemic level of between 7% to 8% (Chart 3). High energy and food prices may be eating into savings, but money is still being put aside, adding to cash reserves accumulated during the pandemic.

Federal Reserve data show that as of the end of the first quarter, U.S. households held a record high of US$17.9 trillion in cash and cash equivalents, much higher than the US$13.7 trillion they had at the end of the first quarter of 2020 (Chart 4). America's cash hoard built up over the past two years from multiple rounds of government relief and a sharp reduction in expenditures on services could blunt the depth of any downturn.

The employment situation in North America remains healthy with unemployment rates of 5.1% in Canada and 3.6% in the United States. Among all the 12 post-World War II recessions in the United States, the median increase in the jobless rate was 3.5 percentage points with the unemployment rate rising to a minimum of 6.1%. Viewed as a coincident indicator, the jobless rate has not yet deteriorated against a backdrop of a slowing economy.

More Economic Indicators

Recession concerns are rampant. Inevitably, the global economy will experience a recession at some point. Indicators that we track to assess the health of the economy are signaling slowing growth and a rising likelihood of a downturn.

The U.S. Treasury yield curve remains flat and has recently inverted again for the third time this year (following its brief inversion in late March and June) with the 10 Year/2 Year spread at negative 4 basis points. The inversions suggest that while investors expect higher short-term rates, there is a growing concern about the Fed's ability to control inflation without hurting growth longer-term. An inverted yield curve is one of the best leading indicators of a recession albeit the timing between the inversion and the start of a recession varies anywhere from 6 months to 24 months.

The high-yield bond (HYB) spread is the difference between the yield on high-yield or non-investment grade bonds and investment grade/Treasury bonds. The spread is an economic indicator because it narrows with improving economic conditions and widens with deteriorating conditions. In a slowing economy, a widening spread reflects growing concern of default risk and thus, investors demand higher interest on owning high-yield bonds. The HYB spread has been widening since the spring and is now 5.99%, although it remains below levels seen in prior recessions (Chart 5).

In some respects, the U.S. consumer has lost their swagger. The Conference Board Consumer Confidence Index and University of Michigan Sentiment Index have declined sharply this past year with high inflation weighing on consumers' purchasing power (Chart 6).

The National Federation of Independent Business's Small Business Optimism Index provides a timely read of the pulse of the economy and is providing a mixed view. The Index has been trending lower this year, running below its 48-year average every month this year, although the current reading remains consistent with modest economic growth (Chart 7). While business owners remain concerned about the economic outlook and profit margins, a growing number are planning to add staff and a record number report they currently have job openings.

The ISM Manufacturing and Services Indices are considered leading indicators of future economic activity. While both indices remain above the 50-threshold designating expansion from contraction, activity has been cooling (Charts 8 and 9). Manufacturers still have a record amount of backlog to move through, which may help support manufacturing activity even amid a softening in new demand.

Conclusion

Restrictive monetary policy will slow economic growth- that's part of the goal. Unfortunately, it has historically been the exception and not the rule that the Fed can engineer a soft landing while embarking on a path of higher interest rates. The task is even more challenging with inflation at 40-year highs and geopolitics contributing to a spike in energy and food costs. Inflation is a global theme and central banks around the world will tighten aggressively to prevent price growth from becoming entrenched in their respective economies.

The financial health of consumers and businesses is generally in good shape to absorb the dual impact of rising interest rates and inflation. Households have delevered significantly since the Great Financial Crisis of 2008. The banking sector is well-capitalized as evidenced by the latest Federal Reserve annual stress test which concluded the nation's biggest banks could withstand a severe recession.

In today's uncertain environment, we are reminded of Warren Buffet's quote, "It's only when the tide goes out do you discover who's been swimming naked." The companies you own are fully clothed with sound balance sheets, capable management, and profitable businesses. They are well-equipped to weather periods of economic uncertainty.

Christine Poole, MBA, CFA

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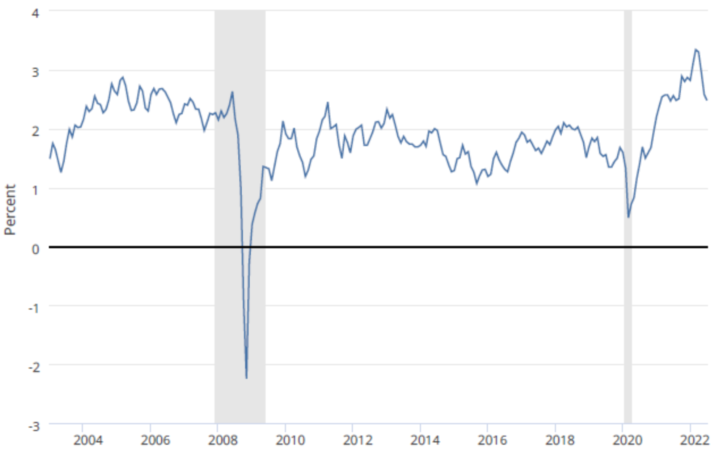
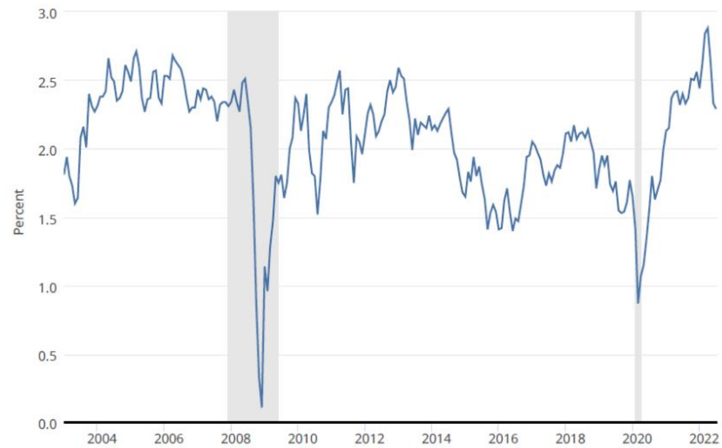
CHART 1: 5- Year Breakeven Inflation Rate
- Federal Reserve Bank of St. Louis



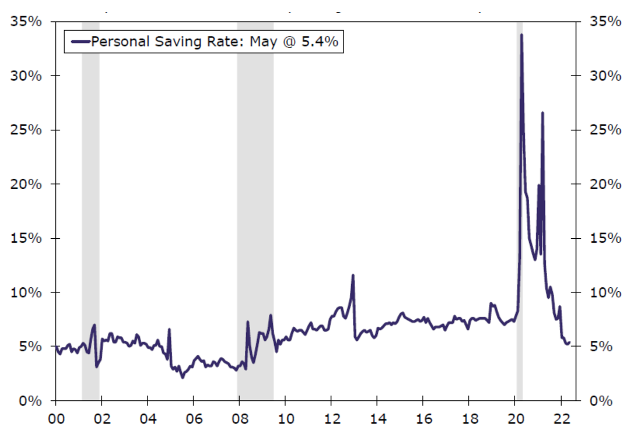
Note: Shaded areas indicate U.S. recessions

CHART 2: 10 Year Breakeven Inflation Rate
- Federal Reserve Bank of St. Louis



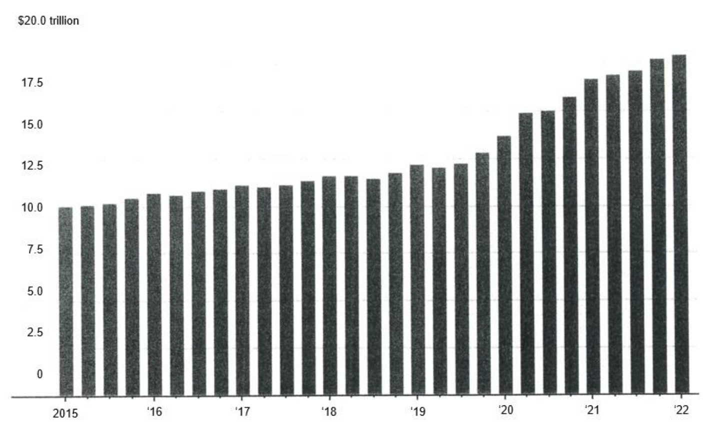
Note: Shaded areas indicate U.S. recessions

CHART 3: Personal Saving Rate
- U.S. Department of Commerce and Wells Fargo Economics



Note: Disp. Personal Income Less Spending as a Percent of Disp. Income

CHART 4: U.S. Household Holdings of Cash and Cash Equivalents
- Federal Reserve



Note: Cash and cash equivalents include currency, checkable deposits, time and savings deposits and money market funds

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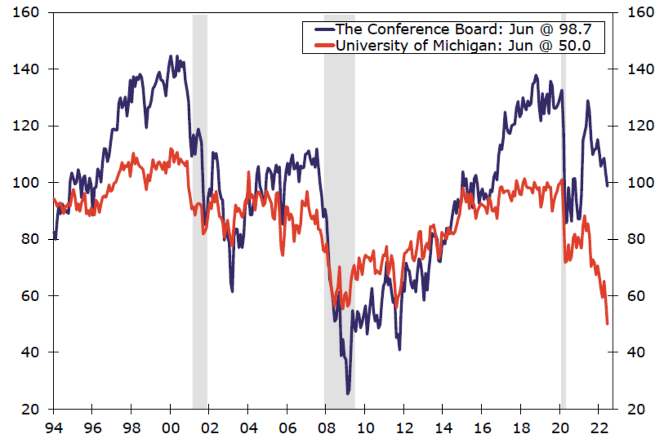
CHART 5: ICE BofA US High Yield Index Option-Adjusted Spread
– *Ice Data Indices, LLC*

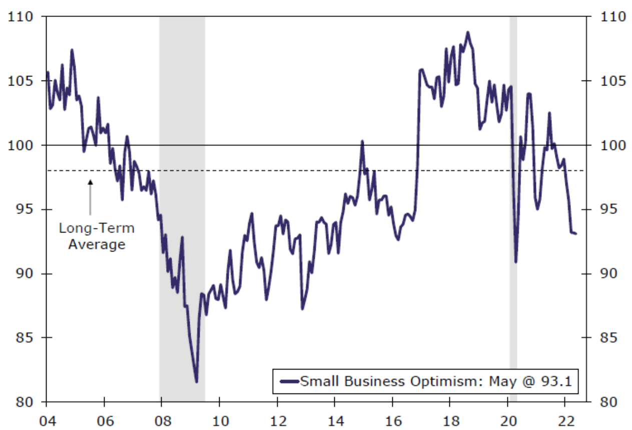
Note: Shaded areas indicate U.S. recessions

CHART 6: Consumer Confidence
– *The Conference Board, University of Michigan and Wells Fargo Economics*



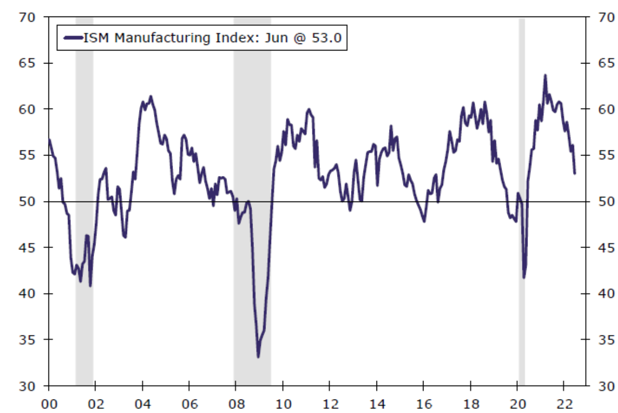
Note: Conf. Board Index 100= 1985, SA, Univ. of Mich. Index 100=1966, NSA

CHART 7: NFIB Small Business Optimism
– *NFIB and Wells Fargo Economics*



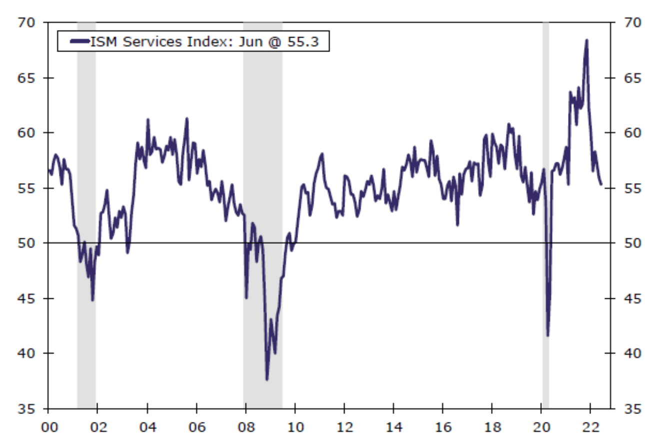
Note: Overall Index 1986=100

CHART 8: ISM Manufacturing Composite Index
– *Institute for Supply Management and Wells Fargo Economics*



Note: Diffusion Index

CHART 9: ISM Services
– *Institute for Supply Management and Wells Fargo Economics*



Note: Composite Index

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RECENT BNN SHOWS

Christine: June 14, 2022

Christine: May 17, 2022

Christine: April 14, 2022

Christine: March 15, 2022

Christine: February 15, 2022

Christine: January 18, 2022

Christine: December 14, 2021

JUNE 30, 2022 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	1 YEAR
S&P TSX COMPOSITE TOTAL RETURN (CAD)	-13.2 %	-9.9 %	-3.9 %
S&P 500 TOTAL RETURN (CAD)	-13.6 %	-18.5 %	-7.2 %
S&P 500 TOTAL RETURN (USD)	-16.1 %	-20.0 %	-10.6 %
DJIA TOTAL RETURN (USD)	-10.8 %	-14.4 %	-9.1 %
NASDAQ COMPOSITE PRICE RETURN (USD)	-22.4 %	-29.5 %	-24.0 %
MSCI WORLD INDEX PRICE RETURN (CAD)	-14.1 %	-19.7 %	-12.4 %
CANADIAN UNIVERSE BOND INDEX	-5.7 %	-12.2 %	-11.4 %

COMMODITIES	QTD	YTD	1 YEAR
GOLD	-5.7 %	-0.4 %	3.2 %
SILVER	-18.0 %	-12.0 %	-21.2 %
COPPER	-20.4 %	-15.3 %	-11.7 %
NATURAL GAS (NYMEX)	-3.9 %	45.4 %	48.6 %
WTI	5.5 %	40.6 %	44.0 %
BRENT	5.0 %	41.9 %	48.5 %

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TREASURY BONDS	06/30/22	12/31/21	06/30/21
2 YEAR (CAD)	3.10 %	0.98 %	0.45 %
2 YEAR (US)	2.92 %	0.73 %	0.25 %
5 YEAR (CAD)	3.10 %	1.28 %	0.97 %
5 YEAR (US)	3.01 %	1.26 %	0.87 %
10 YEAR (CAD)	3.23 %	1.45 %	1.39 %
10 YEAR (US)	2.98 %	1.52 %	1.45 %
30 YEAR (CAD)	3.14 %	1.72 %	1.84 %
30 YEAR (US)	3.14 %	1.90 %	2.06 %
CPI (CAD)	7.70 %	4.80 %	3.10 %
CORE CPI (CAD)	6.30 %	4.00 %	2.20 %
CPI (US)	8.60 %	7.00 %	5.40 %
CORE CPI (US)	6.00 %	5.50 %	4.50 %

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