GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

SEPTEMBER 2022

UPCOMING 2022 BNN SHOWS

Christine: October 18 @ 12 pm

Christine: November 18 @ 12 pm

Christine: December 16 @12 pm

Round trip. That's what equity markets did this past quarter. After bottoming in mid-June, the S&P 500 Index jumped more than 17% by mid-August on falling inflation expectations and anticipation of a more dovish Fed. Over the same period, the Nasdaq Composite Index gained 23.3% and the S&P/TSX Composite Index gained 6.7%. These advances were reversed over the last six weeks of the quarter, following the reiteration of hawkish comments and another significant interest rate hike from the Fed. This resulted in negative quarterly and year-to-date returns for equity indices around the world.

Good economic news, especially in the jobs market, is now being interpreted as bad news since it provides fodder for the U.S. Federal Reserve to continue to raise interest rates to combat inflation. These higher rates, in turn, would continue to put pressure on equity valuations.

Thus, a sustainable recovery in equity markets will not occur until the Fed's monetary tightening is put on hold. And that will not occur until the Fed is satisfied price stability has been restored.

Inflation Update

Inflation peaked in June when CPI in Canada and the U.S. was 8.1% and 9.1%, respectively. It has since been declining in both countries, albeit at a gradual pace. Central banks do not want inflation expectations to become entrenched. So far, these longer-term expectations appear to be well anchored, with U.S. 5-Year and 10-Year Breakeven Inflation Rates at 2.28% and 2.24%, respectively (Charts 1 and 2).

The September ISM Manufacturing Index reported the "prices paid" component, a proxy for wholesale inflation, plunged to 51.7 from over 80 just four months ago (Chart 3 - a reading over 50 indicates expansion). In due course, this will translate into weaker consumer goods inflation.

Prices of commodities that typically gauge economic activity have continued to trend lower since last quarter including lumber down 71% from its peak, copper down 29%, nickel down 48%, and crude oil down 33%.

Supply Chain Update

Supply chain bottlenecks are easing. Supplier delivery delays in the ISM Manufacturing Index, the bellwether proxy for supply bottlenecks, receded for the fifth consecutive month to its lowest level since before the pandemic (Chart 4). Anecdotally, companies are also reporting that goods are moving more quickly across oceans.

Daily freight rates have also been steadily declining. It now costs $3,900 to move a single container across the Pacific compared with $14,500 at the start of the year and more than $19,000 in 2021, according to the Freightos Baltic Index. Trans-Pacific shipping rates have plummeted from year-ago levels in the face of weaker demand, as big retailers cancel orders with vendors and cut inventories. FedEx recently said it would cancel flights and park cargo planes because of a sharp drop in shipping volumes.

The coincident timing of bottlenecks easing and deteriorating demand for consumer goods has resulted in retailers resorting to markdowns to clear inventory. This should contribute to price deflation in consumer goods.

Macroeconomic Forecasting

"There are two kinds of forecasters: those who don't know, and those who don't know they don't know." – John Kenneth Galbraith (renowned economist)

The U.S. Federal Reserve employs over 300 Ph.D. economists, and as history has proven, the accuracy of their economic projections is low. Despite this, their forecasts continue to be highly influential in financial markets.

In the supply-constrained economy we are in, the Fed is maintaining a restrictive policy to moderate demand so that it comes into better alignment with supply. They acknowledge "reducing inflation is likely to require a sustained period of below-trend growth, and there will very likely be some softening of labour market conditions."

Improvement on the supply side of the equation should help alleviate upward price pressure on consumer goods. Higher prices in the services sector could remain for longer, but they would not be immune to a slowdown in the overall job market.

We will not attempt to forecast the next recession, but the indicators we monitor closest continue to signal weaker growth ahead. These indicators include the U.S. Treasury Yield Curve (which has been inverted since June), a weakening ISM Manufacturing Index of 50.9 (indicating marginally expansionary activity (Chart 5)), and a contracting new orders index (chart 6).

Corporate Profits

As we have mentioned in the past, corporate profits are the primary driver of stock prices, followed by the valuation multiples applied to them.

Notwithstanding negative earnings revisions since the start of the year, the companies in the S&P 500 Index are expected to grow earnings per share (EPS) by 4.5% in third-quarter 2022 versus third-quarter 2021, 7.7% for all of 2022 versus 2021, and 7.8% in 2023 versus 2022. Similarly, profit growth for S&P/TSX Composite Index constituents is expected to be 20.3% in the third quarter, 18.8% this year and 5.7% in 2023. The higher expected growth rates this year for the Canadian index is attributable to the heavy weighting in the Energy sector.

Current consensus estimates are not baking in a recession, which has historically resulted in a 13% median drop in annual EPS. Should the current EPS estimates hold, there is valuation support for the broad indices given the price to earnings multiple (P/E) compression that has already occurred this past year. The forward P/E ratio for the S&P 500 Index is 15.5x, versus 20.6x in January, and for the S&P/TSX Composite Index it is 11.0x versus 15.7x.

Alternatively, a hard landing scenario would imply negative EPS growth and further downside to equity markets. This scenario also increases the likelihood of a Fed pivot in monetary policy.

Conclusion

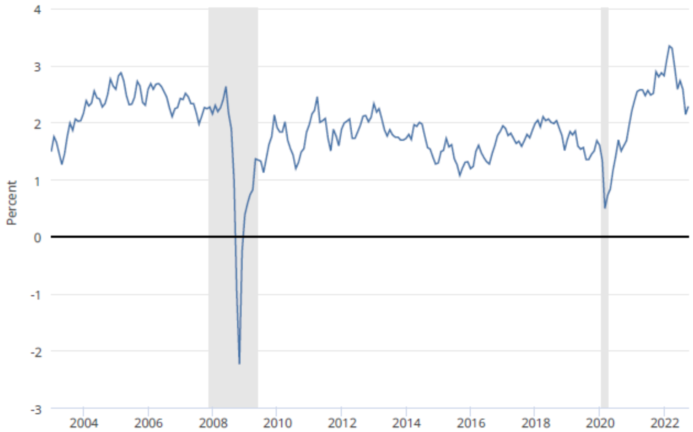
Financial markets are facing numerous headwinds: rising interest rates, elevated inflation, restrictive monetary policy by central banks around the world, and geopolitical turmoil. The decline in the broad equity indices this year reflects many of these concerns.

Economic cycles are inevitable, but the timing much less so. Macroeconomic forecasting is highly unreliable. We prefer to analyze incoming data, interpret their possible impacts on companies in our client portfolios, and respond only if we believe there will be long-term consequences.

On the positive side of things, volatility will create opportunities to invest in companies well-positioned to benefit from secular growth trends. We continue to adhere to a disciplined process of staying invested in financially strong, reasonably-priced growth and income stocks. We believe that over the long-term this will result in our clients continuing to build wealth through the power of compounding.

Christine Poole, MBA, CFA

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

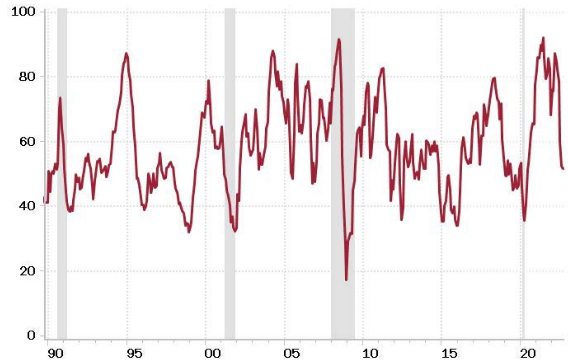


Note: Shaded areas indicate U.S. recessions

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

Note: Shaded areas indicate U.S. recessions

CHART 3: Prices Index | United States: ISM Manufacturing PMI
(index; >50 denotes expansion)
- Haver Analytics, Rosenberg Research

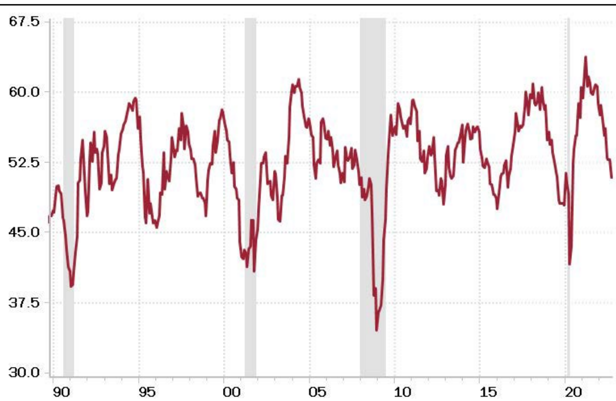


Note: Shading indicates recession

CHART 4: Supplier Deliveries Index | United States: ISM Manufacturing PMI
(index; >50 denotes slower)
- Haver Analytics, Rosenberg Research

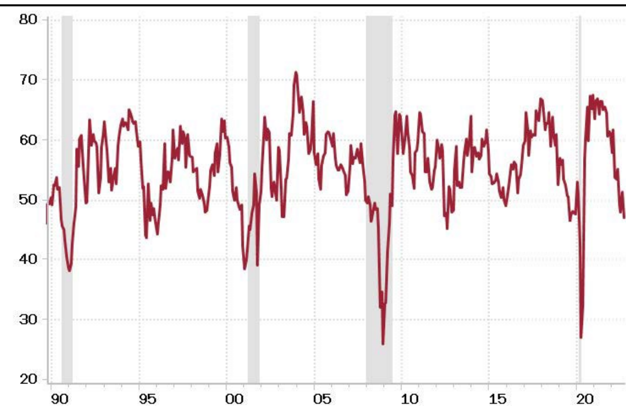
Note: Shading indicates recession

CHART 5: ISM Manufacturing PMI | United States: ISM Manufacturing PMI
(index; >50 denoted expansion)
– Haver Analytics, Rosenberg Research



Note: Shading indicated recession

CHART 6: New Orders Index | United States: ISM Manufacturing PMI
(index; >50 denotes expansion)
– Haver Analytics, Rosenberg Research



Note: Shading indicated recession

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RECENT BNN SHOWS

Christine: September 20, 2022

Christine: August 23, 2022

Christine: July 19, 2022

Christine: June 14, 2022

Christine: May 17, 2022

Christine: April 14, 2022

Christine: March 15, 2022

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SEPTEMBER 30, 2022 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	1 YEAR
S&P TSX COMPOSITE TOTAL RETURN (CAD)	-1.4 %	-11.1 %	-5.4 %
S&P 500 TOTAL RETURN (CAD)	2.2 %	-16.7 %	-7.8 %
S&P 500 TOTAL RETURN (USD)	-4.9 %	-23.9 %	-15.5 %
DJIA TOTAL RETURN (USD)	-6.2 %	-19.7 %	-13.4 %
NASDAQ COMPOSITE PRICE RETURN (USD)	-4.1 %	-32.4 %	-26.8 %
MSCI WORLD INDEX PRICE RETURN (CAD)	0.3 %	-19.5 %	-13.7 %
MSCI WORLD INDEX PRICE RETURN (USD)	-6.6 %	-26.4 %	-20.9 %
CANADIAN UNIVERSE BOND INDEX	0.5 %	-11.8 %	-10.5 %

COMMODITIES	QTD	YTD	1 YEAR
GOLD	-7.8 %	-8.1 %	-3.4 %
SILVER	-6.2 %	-17.4 %	-13.0 %
COPPER	-6.9 %	-21.1 %	-14.1 %
NATURAL GAS (NYMEX)	24.7 %	81.4 %	15.3 %
WTI	-24.8 %	5.7 %	5.9 %
BRENT	-20.9 %	12.3 %	12.6 %

TREASURY BONDS	09/30/22	12/31/21	09/30/21
2 YEAR (CAD)	3.79 %	0.98 %	0.53 %
2 YEAR (US)	4.22 %	0.73 %	0.28 %
5 YEAR (CAD)	3.32 %	1.28 %	1.11 %
5 YEAR (US)	4.06 %	1.26 %	0.98 %
10 YEAR (CAD)	3.16 %	1.45 %	1.51 %
10 YEAR (US)	3.83 %	1.52 %	1.52 %
30 YEAR (CAD)	3.09 %	1.72 %	1.98 %
30 YEAR (US)	3.79 %	1.90 %	2.08 %
CPI (CAD)	7.00 %	4.80 %	4.40 %
CORE CPI (CAD)	5.30 %	4.00 %	3.50 %
CPI (US)	8.30 %	7.00 %	5.40 %
CORE CPI (US)	6.30 %	5.50 %	4.00 %

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