GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

SEPTEMBER 2023

UPCOMING 2023 BNN SHOWS

Christine: October 23 @ 12 PM

Alexander: October 30 @ 12 PM

Christine: November 23 @ 12 PM

Christine: December 21 @ 12 PM

The spectre of "higher for longer" dampened both stock and bond prices in the third quarter. The 10-year U.S. Treasury bond yield rise to its highest level since late 2007 was partly driven by optimism about the U.S. economic outlook, which has caused investors to scale back expectations on future Federal Reserve rate cuts. Higher bond yields, however, weigh on stock valuations with all the major broad stock market indices posting negative returns this quarter.

Looking back, the drivers behind the era of near-zero interest rates accompanied by low inflation, especially since the global financial crisis, are behind us. Recent structural shifts that will determine the course of inflation in the coming years suggest a higher base Fed funds interest rate compared to the last decade is more than likely. This is not a prediction, just an observation.

Inflation

With inflation being the key focus over the past year, there is increasing discussion about the drivers behind inflation. Inflation is often described as consisting of two components: cyclical and structural. Cyclical inflation occurs as an outcome of the economic cycle such as higher commodity prices due to strong demand. Structural inflation is more embedded in the economy and tends to have a more lasting impact.

We will focus on three drivers of structural inflation: deglobalization, demographics, and debt.

A key structural driver of low inflation over the past few decades was globalization. Whereas a reversal of globalization is not likely, geopolitical shifts and policies encouraging onshoring mean a slowing of globalization or as some pundits label it "deglobalization". A reduction in globalization that sees significant reshoring of production could lead to a higher level of trend inflation in goods if it shifts the production of goods away from locations with lower (trend) production costs.

Demographics are another structural driver of inflation. The coming decades will see continued shifts in labour markets around the world. The working-age population has started to shrink in some advanced economies. In China, it is projected to fall by about one-fifth over the next three decades. A shrinking working-age population may also lower future migration flows and labour supply. Reduced labour supply will put upward pressure on wages. However, the post-pandemic shift to hybrid and/or remote work has the possibility to expand the available labour pool by broadening the geographic scope and encouraging higher levels of labour force participation, thereby easing wage pressure.

Another potential force adding to inflationary pressures is the extraordinary rise in public and sovereign debt during the pandemic. For example, U.S. federal debt to nominal GDP rose to 119.5% in June 2023 from 107.0% in March 2020 (chart 1). Governments borrow money to fund their deficits by issuing bonds, and as deficits increase, the supply of treasury bonds increases. "Bond vigilantes" as coined by market strategist Ed Yardeni, are bond investors who demand higher interest rates on treasury bonds, in response to the rising supply required to fund government deficits. The rise in the 10-year U.S. Treasury bond yield since August is a signal that bond vigilantes are reawakening.

The North American Economy

Restrictive monetary policy is working. Inflation has steadily declined from its peak in June 2022 (8.1% in Canada and 9.1% in the United States) to 4.0% and 3.7%, respectively. The lagged impact of higher interest rates is being felt in the economy. Excess savings built up during the pandemic have dampened the impact of tight monetary policy, but the household sector has now whittled down its stockpile of excess savings. Consumers have also reduced their savings rate to finance spending.

In contrast to restrictive monetary policy, U.S. fiscal policy has been and remains expansionary, counteracting the impact of rising interest rates on the economy. Since the start of the pandemic, fiscal policies announced to support growth include three rounds of pandemic relief cheques to U.S. households, the Infrastructure Investment and Jobs Act, the

CHIPS and Science Act, and the Inflation Reduction Act. These stimulus plans have supported consumer spending and spurred construction job growth to boost domestic chip manufacturing, rebuild the nation's infrastructure, and support new renewable energy projects.

The U.S. economy has been more resilient than the Canadian economy – U.S. real GDP in the second quarter grew 2.1% and is expected to be over 4.0% in the third quarter. Cracks, however, are starting to appear. Households are increasingly relying on credit to make purchases with credit card debt steadily rising. Delinquency rates have edged up and have normalized to pre-pandemic levels. Increasing debt servicing costs, and the resumption of student debt payments will soften consumer spending in the coming months.

In Canada, real GDP in the second quarter contracted at an annualized rate of 0.2%, coming in below consensus expectations. More worrisome, real GDP per capita fell at an annualized rate of 3.3%. Canada's record population growth is masking a faster deterioration in economic growth than implied by the overall measure. Population growth of 3% as of July 1st marked the highest rate recorded over a 12-month period since 1957. Net international migration accounted for nearly 98% of the growth. While inflation in Canada reaccelerated in August, stagnant economic growth should eventually mute prices for goods and services. Moreover, the Canadian economy is relatively more "interest sensitive" than its American counterpart given our country's household debt-to-GDP ratio of 103% versus 74% in the United States and the popularity of shorter-term variable rate mortgage financing.

Economic Indicators

The historically accurate leading indicators we track continue to signal a high likelihood of a recession. The U.S. Treasury yield curve remains inverted and has been since July 2022, with the current spread between the 10-year and 2-year treasury bonds at negative 47 bps. Notably, the 10-year yield has been slowly normalizing back to where it was from 2003 to 2007 before the global financial crisis (chart 2).

The Conference Board Leading Economic Index (LEI), a composite of multiple leading indicators, including manufacturing orders, consumer expectations, and lending conditions has declined for 17 consecutive months, signalling an economic contraction will materialize (chart 3).

Corporate Profit Growth

Corporate profit growth turns negative when a recession hits. Corporations in the S&P 500 Index are not guiding to a profit recession this year. While year-over-year earnings per share (EPS) growth was negative in the first two quarters this year and expected to be marginally down in the third quarter, EPS growth is expected to turn positive in the fourth quarter to up over 9% and be up for the whole year. The consensus view is that profit growth will continue in 2024, implying a soft landing (not a recession).

Commentary from management teams in the upcoming earnings season will provide clarity regarding the profit outlook for the next 12 months. As it stands now, corporations appear to be keeping their eyes on many of the same risks that investors are. As chart 4 shows, corporate CFOs are becoming increasingly worried about inflationary pressures and

the resulting monetary actions that will be taken by central banks. Interestingly, their concerns about labour availability are diminishing. Given the sustained series of strong jobs numbers in the U.S. since the depths of the pandemic, we will be watching to see whether this means there will be a slowdown in hiring over the coming periods. As a reminder, the Federal Reserve has a dual mandate that involves keeping inflation low, but also maximizing employment. Thus, an increase in the unemployment rate would give the Fed more reason to move to the sidelines, all else equal.

Conclusion

Making accurate economic forecasts is difficult and when combined with unexpected policy changes and/or exogenous events that may occur, nearly impossible. High short-term interest rates are having the intended impact of slowing economic growth and easing inflation. Should economic conditions deteriorate sharply, central banks will respond accordingly.

Time is one of the best assets investors have. For long-term investors, time in the market overrides timing the market. Our disciplined process of staying invested in financially strong, reasonably priced income and growth stocks will continue to build wealth in your portfolios throughout economic cycles.

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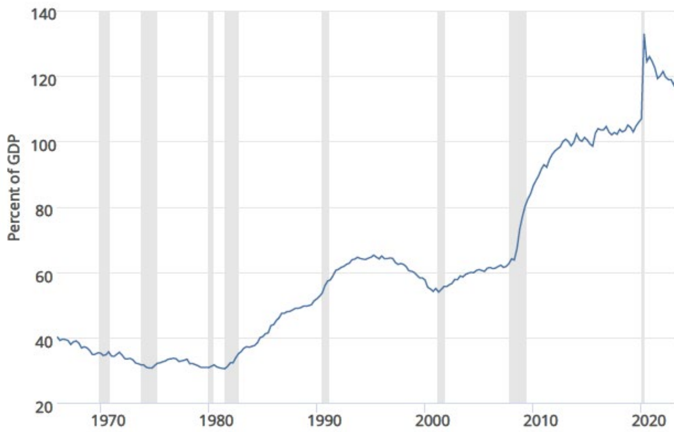
CHART 1: Federal Dept: Total Public Debt as Percent of Gross Domestic Product
- OMB; St. Louis Fed



Shaded areas indicate U.S. recessions

CHART 2: Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis
- Board of Governors of the Federal Reserve System (US)

Shaded areas indicate U.S. recessions

CHART 3: Leading Economic Index (Six-Month Average of Monthly Change)
- The Conference Board and Wells Fargo Economics

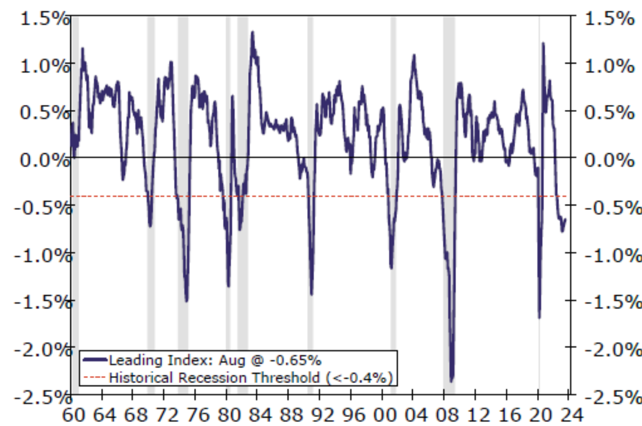
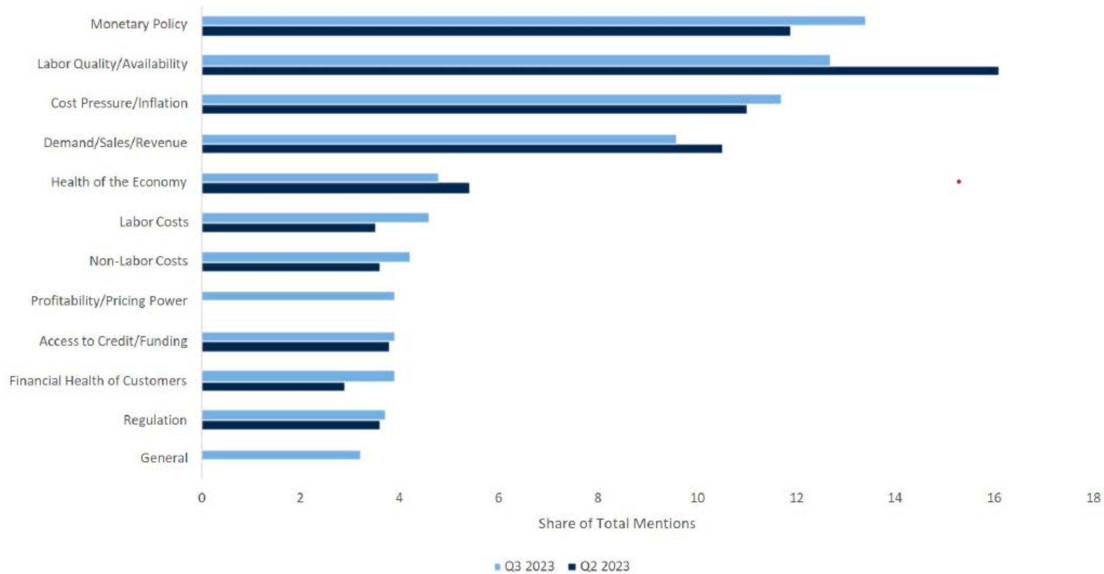


CHART 4: Firms' Most Pressing Concersn
- RBC US Equity Strategy, Duke I Richmond Fed I Atlanta Fed. 3Q23 survey conducted August 21 - September 8, 2023.



Note: Percentages do not sum to 100 because only the top ten topics (and ties) are shown. Results from Q2 2023 survey (May 24 - June 9, 2023) are shown for comparison. A topic without a Q2 frequency of mentions is one that moved into the top ten in Q3 2023.

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RECENT BNN SHOWS

Christine: September 21, 2023

Christine: August 25, 2023

Alexander: August 14, 2023

Christine: July 13, 2023

Christine: June 13, 2023

Christine: May 17, 2023

Christine: April 18, 2023

Christine: March 21, 2023

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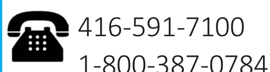
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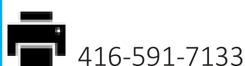
416-591-7133

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SEPTEMBER 30, 2023 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	1 YEAR
S&P TSX COMPOSITE TOTAL RETURN (CAD)	-2.2 %	3.4 %	9.5 %
S&P 500 TOTAL RETURN (CAD)	-0.8 %	13.3 %	19.4 %
S&P 500 TOTAL RETURN (USD)	-3.3 %	13.1 %	21.6 %
DJIA TOTAL RETURN (USD)	-2.1 %	2.7 %	19.2 %
NASDAQ COMPOSITE PRICE RETURN (USD)	-4.1 %	26.3 %	25.0 %
MSCI WORLD INDEX PRICE RETURN (CAD)	-1.3 %	9.9 %	17.8 %
MSCI WORLD INDEX PRICE RETURN (USD)	-3.8 %	9.6 %	20.0 %
CANADIAN UNIVERSE BOND INDEX	-3.9 %	-1.8 %	-1.4 %

COMMODITIES	QTD	YTD	1 YEAR
GOLD	-1.7 %	3.3 %	13.7 %
SILVER	-1.8 %	-5.9 %	19.0 %
COPPER	-1.3 %	-1.8 %	7.4 %
NATURAL GAS (NYMEX)	4.7 %	-34.5 %	-57.4 %
WTI	28.5 %	13.1 %	11.8 %
BRENT	25.2 %	8.6 %	6.5 %

TREASURY BONDS	09/29/23	12/31/22	09/30/22
2 YEAR (CAD)	4.91 %	4.06 %	3.79 %
2 YEAR (US)	5.03 %	4.41 %	4.22 %
5 YEAR (CAD)	4.30 %	3.41 %	3.32 %
5 YEAR (US)	4.60 %	3.99 %	4.06 %
10 YEAR (CAD)	4.06 %	3.30 %	3.16 %
10 YEAR (US)	4.59 %	3.88 %	3.83 %
30 YEAR (CAD)	3.86 %	3.28 %	3.09 %
30 YEAR (US)	4.73 %	3.97 %	3.79 %
CPI (CAD)	4.00 %	6.80 %	7.00 %
CORE CPI (CAD)	4.10 %	5.40 %	5.30 %
CPI (US)	3.70 %	7.10 %	8.30 %
CORE CPI (US)	4.30 %	6.00 %	6.30 %

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