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To: Ermes Monaco <e.monaco@iaprivatewealth.ca>
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Source: Google Images

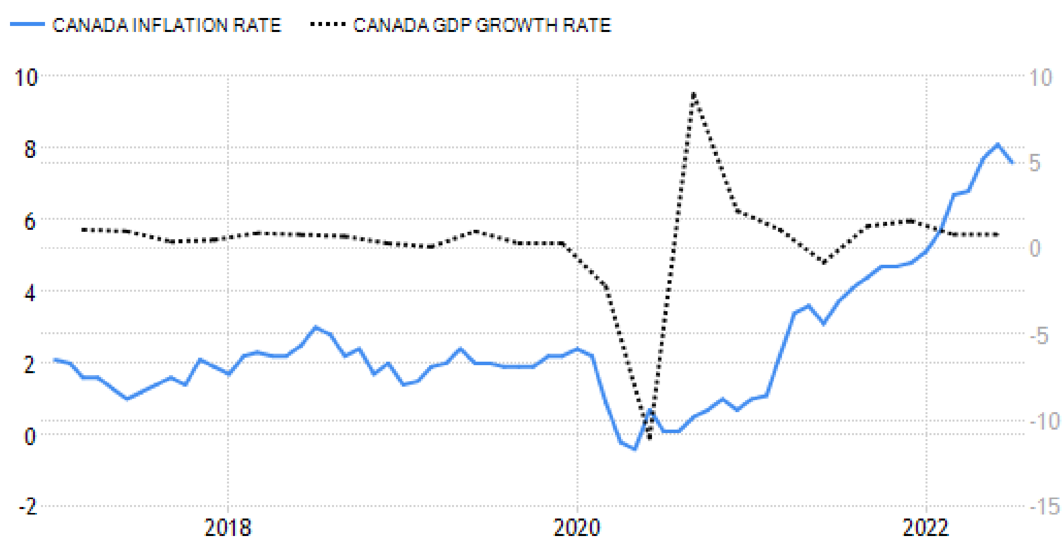
HOPING FOR A SOFT LANDING

WHAT was expected to be a gradual landing from an excessively high level of inflation is now shaping up to possibly be a bumpy touch down.

THE central banks in Canada and U.S. are committed to a program of interest rate hikes to demonstrate their determination to bring inflation back to target levels. The next planned announcements are September 7 for the Bank of Canada and September 22 for the U.S. FOMC.

BECAUSE inflation was allowed to build for fear of slowing down post-Covid recovery, the magnitude and resilience of the inflation has become so great that the banks consider aggressive measures have to continue to be taken to sufficiently counteract the inflationary strength. This means further <u>significant</u> rate hikes which they have been forewarning. The message here is that a 75 bp increase will send a stronger signal than 25 or 50 bps.

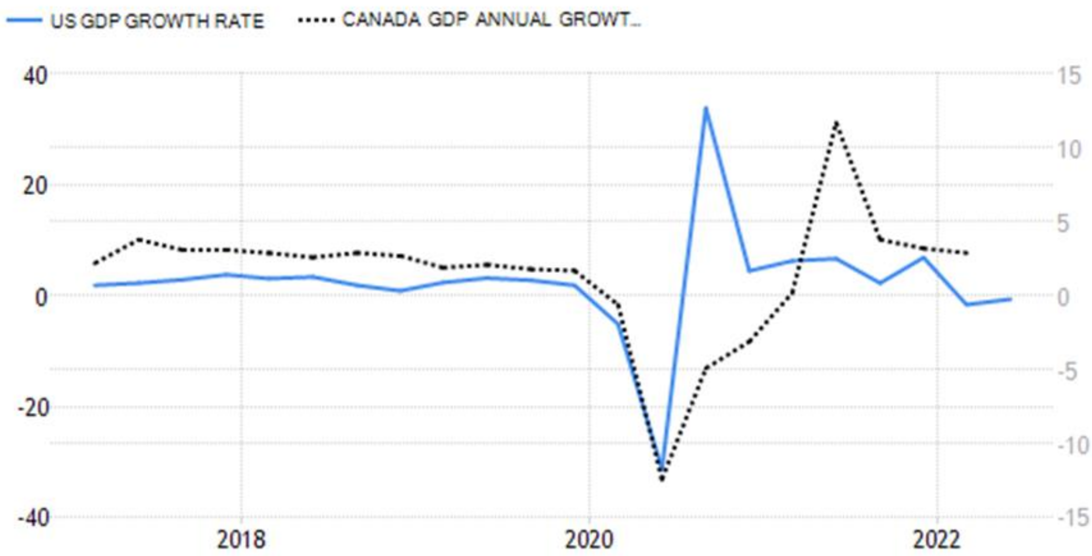
THERE is no question inflation does hurt growth. This has slowed GDP over the past year after allowing a dramatic recovery during the Covid cycle when inflation weakened and threatened disinflation.



Source: Tradingeconomics.com

HOWEVER, in fairness, inflation has begun to show some weakening in response to the interest rate increases already sustained this year with housing costs, fuel and other components declining.

GDP in Canada and the U.S. has actually begun to reflect a declining trend. Yet, the gradual rate of easing is insufficient for central banks purposes.



Source: Tradingeconomics.com

THE next rate hikes should cause GDP to continue to decline and trigger a recession. A technical definition of a recession is “a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters” (Oxford Dictionary). *<u>However, that does not mean GDP growth must go to 0 or negative.</u>*

THE fact that certain economic forces continue to be resilient is a promising sign that the expected recession hit may be moderated. A key factor currently is labour in its various forms, ie., employment, unemployment, job openings, labour income. Recent indexes are indicating employment and job openings continue to be healthy while salaries are stabilizing and unemployment in certain sectors is increasing.

HOWEVER, the mixed performance will only strengthen the resolve of the central banks to maintain a campaign of higher interest rates for longer.

THEREFORE, we should anticipate the possibility of a bumpy landing until the aircraft is safely on the ground.

HOW SHOULD WE DRESS FOR AN EXPECTED ECONOMIC “BAD WEATHER” FORECAST?

- **CASH REMAINS ROYALTY: It is volatility resistant and currently providing some yield to pay you while you wait.**
- **CONTINUE TO ENHANCE INCOME AND TAX EFFICIENCY: These alternative forms of return are working to offset current weak market prices.**
- **CONTINUE TO HOLD ASSET TYPES WHICH ARE NOT STOCKS: These include bonds and real estate trusts which have also declined but to a lesser extent and offer above average yields of return.**
- **DON'T SELL THE STOCKS BECAUSE THEY ARE STOCKS: Continue to hold the equities in core sectors such as utilities and financials as they are critical in all economic conditions and provide reliable above average dividend yields.**
- **CONTINUE TO HOLD A COMPONENT OF CONTRA MARKET HEDGE TYPE ASSETS: These help reduce volatility which contributes to capital preservation. One very good asset in this manner is the U.S. dollar which continues to appreciate against the loonie.**

LOOKING AHEAD HOW CAN WE POSITION OUR PORTFOLIOS TO BENEFIT FROM POST RECESSION RECOVERY?

- **This should only be undertaken once a stable recovery trend emerges. Don't try to second guess the market; its made up of many minds. The risk is otherwise experiencing "price whiplash" by re-balancing too soon.**
- **Core asset classes and sectors that will be key to the future economy and recovery should be identified and targeted for re-balancing. Only on exception, sectors that were highly speculative during Covid such as commodities, tech and esoteric currencies ie. Bitcoin, should be avoided as being irrelevant in the new economic environment.**
- **More to come as light is seen at the end of the tunnel.**

Regards

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Portfolio Manager

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