iA Private Wealth

MONACO CAPITAL MANAGEMENT

FINALLY!

SOURCE: Google Images

THE BANK OF CANADA FINALLY moved to reduce its key interest rate June 5 by 25 bps in response to improving inflation conditions.

OVER THE PAST 2 YEARS it has only acted to increase its interest rate with the last interest rate cut 4 years ago.

Canadian Inflation vs Central Bank key rate

Source: Trading Economics.com

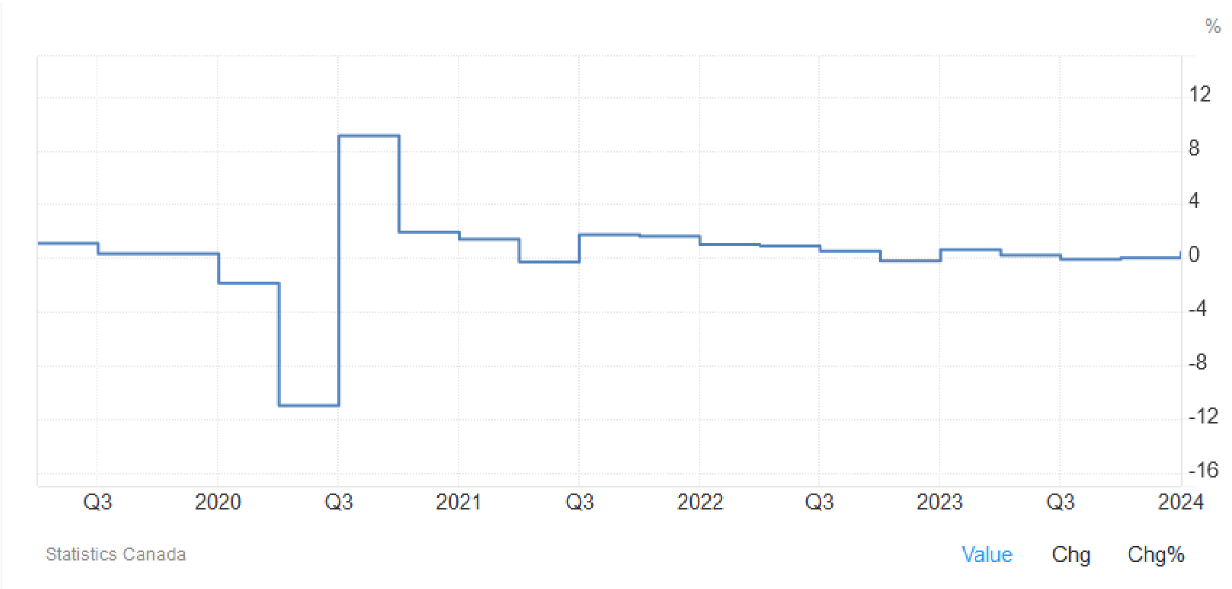
THIS IS SIGNIFICANT because it signals the Bank has greater confidence inflation is demonstrating an easing trend and the same level of interest rates when inflation hit 8% is no longer necessary. Canadian inflation is currently 2.7%.

THE MODEST SIZE of the reduction is not likely to create great immediate relief to consumers and producers although further cuts will allow economic growth to improve should inflation continue to ease. Inflation effectively "steals" from economic capital available to go back into the economy to foster growth. Higher costs of production and borrowing costs reduce profits and the ability of the consumer to purchase. Nonetheless it is positive sentiment and a sign that stagflation is dissipating.

HOWEVER THE PROCESS OF REBUILDING is cyclical with the reduction in the interest rate having really come at the expense of lower growth. Therefore, while we can expect the financial markets to react positively to the change in the near term, it also means that growth will need time to recover during which there will likely be periods of interim weakness and volatility. <u>And, the pace of</u>

__recovery will also depend on the rate at which the Bank of Canada continues to reduce its key rate.__

Canadian GDP Growth



Source: Trading Economics.com

A KEY MECHANISM to help offset the impact of inflation has been to take advantage of higher investment rates of return to create income flows as a source of alternative positive returns. __During the period of highest inflation pressure financial market values declined and have only now returned to previous levels prior to the interest rate increases.__

INCOME INVESTMENT RATES OF RETURN will also decline with interest rates until market value growth rates of return improve to compensate although we should manage expectations and anticipate this will be a gradual cycle.

Toronto Stock Exchange Last 5 Years

Source: Trading Economics.com

THEREFORE, GIVEN THE PROSPECT OF ECONOMIC IMPROVEMENT the following management applications are recommended:

- **A systematic and measured re-balancing of the defensive component toward greater growth according to the rate of further interest rate declines.**
- **Continue to manage an income component to help offset interim volatility and market value weakness as the recovery cycle improves.**
- **Maintain liquidity to have the immediate capital to take advantage of the new opportunities as they occur.**
- **Continue to hold only the highest quality core industrial names in key business sectors because of their resilience and ability to provide consistent growth over time.**
- **Recognize that speculative sectors such as gold, crypto currencies and expensive tech holdings which attracted capital and benefited from inflation as an alternative to the core economy during the period of weakness will now likely trend downwards as the core economic recovery improves.**

IMPORTANTLY, A PROGRESSIVE RETURN TO A MORE BALANCED APPROACH BETWEEN DEFENSIVE AND GROWTH IS NOW APPROPRIATE AS DECLINING INTEREST RATES PERMIT.

Regards

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