A View From Here - Summer 2023

"They say that these are not the best of times but they're the only times I've ever known" - Billy Joel, Summer, Highland Falls

It's been a good summer so far

The current strength of the stock market might seem baffling in the face of another 25-basis point interest rate increase bringing rates to the highest level since April 2001. Raising rates is the bluntest tool in the Federal Reserve's arsenal to cool an economy that is deemed too strong. It's hard to believe that rates were just 0.25% two years ago when many feared that they could go negative, meaning investors would have to pay institutions to hold their deposits.

Now we can achieve well over 5% from a 1-year GIC, but that also means that servicing debt has increased as well. In the early days of the pandemic, policy makers flooded the system with liquidity including lowering rates to help the populace during what was reasoned to be a challenging economic period ahead. Yet, the economy remained strong, and prices started to increase while supply chain and manufacturing issues around the pandemic contributed to inflationary pressure.

A policy shift by the Federal Reserve to tighten aggressively in early 2022 initially created havoc in bonds, assets and the stock market in general, leaving even the most conservative investors reeling in losses and uncertainty. The economy, however, has remained resilient. Despite calls for a downturn that has yet to occur, over 80% of companies in the S&P reported higher than expected results in its latest quarter and inflationary data appears to be moving in the right direction. Perhaps more time is needed for these interest rate policies to affect the economy.

Higher for longer?

We’ve had over two decades of decreasing interest rates making monthly payments easier to carry while keeping prices at elevated levels. Perhaps a narrative that has crept into the market fabric is that at present, higher rates are transient and that they will start to taper as economic policy works its magic to lower inflation.

Or maybe aggressive rate increases over the past 18 months have taken them to the place where they should have already been had there been no pandemic. One of the key risks facing investors at this juncture is if inflation does not come under control, rates can stay higher for longer. This could have the effect of lower asset prices including things like real estate and presumably the stock market as well.

Maybe inflation is coming under control and rates have peaked.

The closely watched data at this point suggests that this is indeed occurring as the economy is cooling at a measured enough pace as to allow the economy to continue grow…a sort of ‘Goldilocks’ scenario. I remain skeptical of phrases like ‘soft landing’ that is bantered around when the economy is going through a potential shift; but for now, 2023 has been good to our investment selections.

The investment side of higher interest rates

With the safest of investments being GICs and Treasury Bills providing returns over 5%, they’ve become a formidable competitor to long-term returns most investors are promised but usually don’t see. This is good if you’re just entering the fixed income market, but many had already been invested for a low-rate environment where they (mostly) unknowingly purchased riskier assets that paid a higher rate of return in the form of distributions or dividends.

It should provide us with comfort that our biggest fixed income holding is in Canada’s second largest technology company, Constellation Software, a $56 billion juggernaut whose bonds we own adjusts for inflation. For an almost debt-free company that generates tremendous cash flow, we hold perhaps the only (or one of the only) bonds in the world that has increased in price over the past 18 months. While some have expressed concern that Constellation would be wise to call those bonds, the company just announced that they are issuing more, which squashes that theory, for at least the foreseeable future.

Outside of this unique offering, investors with large cash positions can now consider the attractive returns available from Treasury Bills and 1 to 5-year GICs with little risk to the investor.

Secular bull & bear markets

There is an associate in our Toronto office whom I enjoy an ongoing discourse with about all things markets. Almost every day or so, I'll say, "what ya thinking about now Don", and he most often replies, "It's all under control Adam." A few years ago, Don and I spent some time looking at the history of secular (long-term) bull and bear markets and came up with approximate lengths in terms of years. As a point of reference, a rising market is called a 'Bull' because when a bull attacks, it pushes its prey upwards, whereas a bear claws down.

What we found was that the typical length of a secular bull market is approximately 14 years, and a secular bear market is 7. Depending on when you ascertain the start of a bull or bear market, one might be able to provide a timeline as to its duration.

Many use March 2009 as the bear market low which began following the technology collapse in the year 2000. Using this as a guide, we might be nearing the end of this run, however, it's important to note that the secular bear market from 2000 - 2007 was quite fruitful for our accounts. It's the weakness, when it appears that takes the accounts down to some unprecedented level, but our experience tells us, that while we can't predict future markets, we can react in the face of it.

Reduced valuations lead to making strategic purchases which, if they recover, tend to lead to meaningful growth for our portfolios. Most of our accounts have reasonable cash and money market holdings that can take advantage if such an occurrence emerges.

It is important at this juncture not to get caught up in the ongoing narrative of knowable concerns (war, rates, geopolitical, China etc.) as a guide to making investment decisions for the future. It's always going to be surprise, not consensus, that moves markets and by extension, the share prices of individual companies. The known part is almost always priced in. Buying good investments and holding them until fruition will always exceed the fear of the unknown. The hard part is knowing when to sell. No one has perfected that yet.

We can take comfort in knowing that our long-term track record of success is one that few have been able to achieve and if history is any guide, our best days are ahead. Take look at where your account was 5, 10, or 20 years ago and all the craziness that has happened to the world during that time compared to where we are now.

It's pretty amazing…. these are good times, and the only times we'll ever know.

Thanks for taking a look, and as always,

All Good Things

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