A View From Here - June, 2022

"How sad would November be if not for the knowledge of spring" ~ unknown

Fear of the Unknown

It is amazing how 6 months can change market and economic outlook. You would have been hard pressed to find a standpoint that wasn't dire. It was just over a year ago that the Federal Reserve kept its benchmark interest rate near zero in an effort to continue supporting economic activity due to the pandemic. During that time many 'experts' spoke of an extended period of interest rates so low that they might go negative.

The pendulum has now swung in the other direction.

Given a strong economy and inflationary pressures, which in my opinion is based on the pandemic, the Fed has made two significant interest rate hikes in 2022 and plans for additional ones in an effort to curb inflation. These actions are seen as part of the reason stock markets are reeling into bear market territory. A bear market is seen when indexes drop more than 20% from their highs. The S&P 500 index has fallen 22% at time of writing, the Nasdaq over 30%, and 18% on the Dow Jones Industrial average. The TSX has been the best performing index thanks to strength in Oil and Gas companies which make up large component of our markets.

What has changed so much that the world went from a positive view of our future, to one so dreary?

Inflation, rising interest rates, pandemic and the war in Ukraine are seen as the impetus of why stock markets have corrected so heavily. I am struck at just how negative most outlooks have become even though the economy remains strong. When I speak with management of the companies we hold, most marvel at how low their shares have fallen, and many are using this weakness to accumulate. It is a good sign for shareholders when management, who in our case, hold large positions in their shares, use weakness to purchase more.

It is important to note that the stock market acts as a voting mechanism for future economic activity based on its knowledge of the present. At present, companies are doing well, but many market weathermen are predicting stormy skies ahead, fickle investors with slant for the negative, react by selling and it takes on a life of its own. The thing is, nobody knows. Its like someone asking you today to predict the weather in on July 31st. You can guess that it would be warmer than November, but that’s about it.

Some key issues that has brought the negative forces out to play are:

1. Omicron & Fear of Long Covid: The pandemic has created discontent among the investing public who remain frustrated as we make our way in year three of Covid. No fiscal relief this time and western policy makers told us we can take off our masks, attend events and go to restaurants. China, not so much. In an effort to slow the spread, they locked down 25 million people in Shanghai for over two months, further frustrating economic activity. It’s worthwhile to note that Shanghai is the financial center of the country as well as the world’s largest port and manufacturer of goods. Being put into a self-induced coma further aggravates manufacturing, economic activity and supply chain issues that had been at the forefront of concern. The good news is that Shanghai has now reopened. Omicron has definitely played a role from its onset back in late November, but has since faded from headlines as other concerns have taken its place.

2. Inflation: It's Everywhere: Prices of 'things' had been increasing for a while now, whether it's food, gasoline, or just about anything we purchase. This might be a direct result of a lack of production due to the virus that has kept factories at reduced capacity all the way down to supply chain issues in receiving those goods to their ultimate destination. A little inflation is seen as ok because it keeps the economy moving at a sensible speed, but inflation staying high for too long is a concern.

Raising interest rates has the power to slow an economy right down but it is a delayed reaction and can take a while to see the full effect. Higher prices mean that employees will need higher wages and that has the effect of pushing up costs for businesses. Central bankers know this and when they act, they are actually trying to read the road ahead and while it may be a blunt tool, raising interest rates is the most powerful way to tame inflation. While markets might weaken in the short term due to investors interpretation of these events as catastrophic, nobody really knows. I believe for what it is worth, that raising rates from near 0% is only taking back part of what it gave to help us through the pandemic transition.

3. Interest Rate Policy: The Fed warned in early 2022 that the accommodative interest rate stance aggressively put into play in early 2020 will be reversed due to inflationary pressure of input costs and strong economic activity. The message was delivered with a table thud as if to say, no matter how loud you cry, we are doing this and it's going to be aggressive, so get used to it. Suddenly, investors and home buyers have to consider what the future of affordability looks like. Higher rates affect consumer demand for things and this has played a seminal role in market volatility as investors weigh the potential for economic fallout from these actions.

One can see the logic in the Fed's decision, especially given early pandemic accommodation, inflationary pressures on prices and the strong economy we've been witnessed throughout the pandemic. I remain unconvinced that this condition is more than transitory given the unique circumstances of the pandemic and how the world has had to shut down and reopen due to its spread.

4. **War in Ukraine:** As the war in Ukraine continues, there seems to be a divide among countries around the world. Condemnation of Russia's aggression sees potential support from China and perhaps India and many see this as a proxy war between opposing ideologies. Uncertainty surrounding the future of this conflict has added pressure to global economic outlook.

Stay the Course and Take Advantage of Opportunity

Market sell-offs are no fun as they make you feel foolish for what could have been done just a few short months prior when share prices were much higher. There are always pundits warning of collapse and more of them are brought onto the field to take their turn at predicting….but that's all they are doing. Our accounts are built for long-term results and if you look at a chart of any market over the longest period, you'll see the trajectory is upwards, however in the short term it's all over the place.

I believe that we are best served adding to our investments in the kind of increments that allow us to benefit from lower prices and what we believe will ultimately be a fortuitous outcome. Our long-term track record suggests that our future is still worth a lot more.

Thanks for taking a look, and as always, All Good Things

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