We hope that you are well and a we wish you a belated Happy New Year!

Global Equity markets were affected by the cross currents of fear and hope in 2022. This was caused by concern that higher interest rates used to combat inflation would constrain economic activity, possibly leading to a global recession. This created volatility in both the equity and bond markets causing them to end the year lower. The S&P 500 closed down 19.4%, the S&TSX closed down 8.7% and the Canadian All Bond index was down 12.3%. Higher yields on GICs and short-term money market funds caused investment dollars to be re-allocated to perceived safety.

Higher servicing costs also impacted earnings for many debt-heavy growth companies in the technology and green energy sectors. The US Dollar also increased in value because of a flight to safety and defensive positioning fueled by global economic uncertainty.

Although there are many challenges facing markets in 2023 the tone appears to be more constructive. Interest rate hikes will likely moderate and end in 2023 as we are seeing inflation beginning to trend downwards. Recently we have seen declines in wage growth and the service sector, which are essential to reaching the 2% inflation target of Central Banks. The economy is slowing, however the savings rate of individuals remains elevated and there are still high job vacancies which bodes well. If this trend continues, we may avoid a pro-longed recession and see a rebound in equity and bond prices.

The key question at this point is how much of the restrictive interest rate policy is priced into the markets already and what is the fair value of asset prices? If a recession is already priced in, then further downside may be limited. However, if rates continue to rise past expectations and earnings weaken, then a re-test of the lows of 2022 is possible. We are hopeful that a deep recession will be avoided and that the trough in the equity and bond markets may have been reached in 2022. It is possible that we have been seeing, and will continue to see, a series of rolling recessions that are sector and industry specific and not a dramatic slowdown all at once. This would be positive for the equity markets as there would be specific opportunities in certain sectors even if the overall market trend is downwards.

The Global Markets, which tend to look ahead at least 6 months, appear to be anticipating economic recovery in the second half of 2023. The Bond markets are signaling that rates will ultimately decline as we are seeing short term rates trading at higher valuations than longer durations. This indicates that conditions will ease and this is good for both bond prices and equities. It is unlikely that we will see interest rate cuts in 2023.

Overseas markets are gaining traction as the US dollar declines and U.S. multinationals are seeing renewed momentum. The Geo-political environment remains very unstable and will impact any recovery both to the upside and downside.

We also have negative investor sentiment which is often a contrarian signal that markets are bottoming as selling subsides and positioning becomes too defensive. Investors are beginning to seek out value as opposed to growth, looking at depressed bond prices and equities with solid dividends and cash flow to back them up.

The key focus is now shifting to earnings and corporate guidance. Companies that miss earnings estimates or provide weak guidance will be punished in terms of share price. If the overall tone of first quarter reporting is negative, the markets will likely lose ground and we will see the indices decline. Estimates have been lowered so the bar isn't as high, however the forward projections are essential. Earnings expectations need to be reduced to a level that is realistic and sustainable before a true bottom can be realized.

We will continue to remain focused on dividend paying equities that have solid cash flow and track records of dividend increases as well as shorter duration income generating vehicles. Although there will be negative surprises from time to time and the market will likely remain volatile, we believe that interest rates will stabilize in 2023 and that good yielding equities will appreciate in anticipation.

As always if you have any questions or just want to touch base, we're here to help!

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