Financial Echo 2023

Dear clients,

Investors will be happy to say goodbye to 2022 and its numerous pressures on the economy: the invasion of Ukraine by Russia, inflation at record levels and a looming global recession the horizon. Arguably, the past year has been challenging on many fronts as the effects of geopolitical tensions have made a marked comeback on the international scene.

For investors, this context gave rise to simultaneous declines in the two major asset classes, namely bonds and equities, a first in more than 40 years. Although there was little to no place to seek refuge, we must acknowledge the relatively good performance for assets linked to commodity prices, of which the Canadian stock market is a part. In contrast, the bottom of the charts belongs to the securities most sensitive to interest rate movements, such as the American technology giants which has enjoyed a golden decade.

Bond markets

The reversal in interest rate trends was much sharper than expected as central banks adopted restrictive monetary policies, threading rate hikes at a rate not seen in 30 years, honoring their mandate to fight inflation. The latter was initially estimated to be temporary ultimately proved to be considerably more anchored. A good portion of the inflation still stems from a restriction in the supply chain of products and services.

Raising key interest rates, however, is like driving a car while looking in the rear-view mirror: sooner or later, we will have to slow down to get a grasp as to where we are at. That said, there may still be a tap on the brake pedal or two left in the cycle before a pause.

Regarding values of bond securities, a large part of the observed fall in prices is directly attributable to these rate increases. It is understandable that a bond purchased in 2021 paying a low coupon is now much less attractive than those available to date, and which pay rates that have doubled, or even tripled in the last 10 months. Of course, the bright side of this is that fixed income will once again be able to play its part in investors' portfolios by bringing in a stream of interest income that had been anemic for quite some time.

Stock markets

For their part, stock market valuations depend on two important factors: the ability of companies to generate profits and interest rates.

As mentioned before, for almost 10 years, the markets had been evolving in an environment of interest rates and inflation close to zero. That changed almost instantly in 2022, and most people were caught off guard. In response, investors quickly lowered their expectations of forecasted profits, shedding away the values of equity securities at the same time.

In the current environment, companies will have to expect pressure on profits, which should in turn also impact the job market. The snowball effect could impact discretionary spending and real estate right after. It is with this in mind that we anticipate to remain cautious for the time being, a strategy that served us rather well in 2022.

For the two major asset classes, a pivot in monetary policy in the second half of the year could clear the skies.

Portfolio structure

However, all is not dark of course. At the time of writing these lines, several economic indicators have shown signs of a trend reversal and we can hope that this washdown will make certain sectors shine again, and make others grow!

Over the next year, we will continue to ensure that our asset allocation respects the risk tolerance, return objectives and liquidity needs of each of our clients. A usual rule of thumb is to keep a sufficient reserve of cash for short-term needs and invest the balance in quality equity securities, as well as short- and medium-term bonds.

We wish you a year filled with opportunities, health and happiness.

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