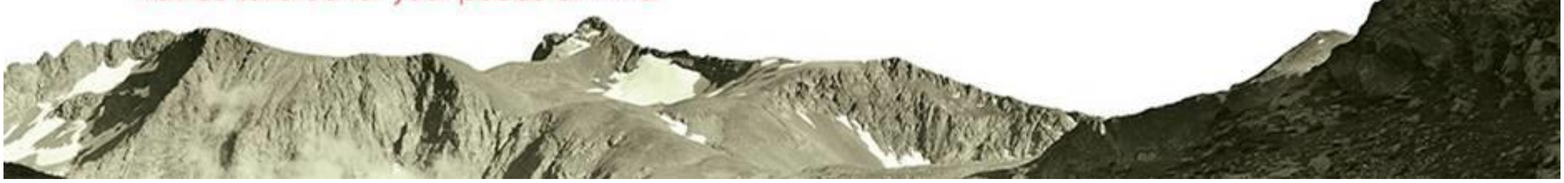
GOULET | ADVISORY GROUP
Advice tailored for your peace of mind



ECONOMIC OUTLOOK – SUMMER 2022

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

I hope you are having a great summer despite financial market turbulence ...

Sadly, the second quarter took the same path as the first. Stocks and bonds have both continued to fall in the face of economic and financial concerns, which have not really changed since my last writing. Here are the main items addressed today:

- Worst start to the year for the US stock market (S&P 500) in 50 years
- Coordinated decline in both the growth and income portions of portfolios
- The decline creates a much healthier environment for investing and lending, even if prices were to continue their fall this summer

RECAP – WORST START IN 50 YEARS The 20.6% decline in the S&P 500 index in the first half of the year is the worst since 1970. Other world stock markets, less focused on technology stocks and therefore less expensive to start, have done better. The Canadian bond universe is down a whopping 11.9% year-to-date.

The word recession entered the mainstream this quarter, but still without certainty. Some say we are already in recession while our strategists are prioritizing a scenario of a marked economic slowdown, with only a 25% probability of recession at this time.

COORDINATED DECLINE This quarter has definitely stoked investors' concerns, with a coordinated and significant decline in stock and bond markets, a very rare occurrence. The same causes have affected both these classes: the anxiety of war and trade disruption, notably in energy and food, due to it and Covid have led to diminished growth prospects – negative for the stock market – and a rise in rates by central banks. In the past, the latter's' response to any obstacle was to lower interest rates and inject money into the pockets of either banks or consumers. This time, inflation is preventing rates from falling.

This rising rate environment has punished the portfolio of any balanced investor and even worse conservative investor. As a consolation, rates are now higher than expected inflation for the first time in years, which bodes well for future returns.

Reminder: an increase in interest rates makes any interest-bearing investment less attractive. For example, if you buy a 5-year Bell Canada bond at a rate of 3% and rates go up to 5%, its price drops from 100 to 92 to match its rate to that of new bonds issued today at 5%. The longer the bond or the lower its initial rate, the more severe the impact. IMPORTANT: Despite the decline, bonds' guaranteed nature means that the price will rebound quickly in the near term.

OUTLOOK – A HEALTHY ENVIRONMENT According to several strategists including our own economists, rate hikes for 2-year to 10-year maturities should already account for most increases telegraphed by central banks, including the U.S. Federal Reserve. This means that your income portion will tend to do its job – stop falling as well generate income – which will make up for the decline received to date this year.

QUARTERLY REPORTS

We now have the possibility to drop reports and documents directly in your Client Access! This feature ...

- allows us to send you quarterly performance reports
- replaces BOX and/or email with password
- is in the same section as your tax slips and statements

Please contact Orith to obtain your password

NEW CONTENT

Please have a look at the Articles and videos section of our website

- Economic update from our strategists (video)
- The effect of rising interest rates on investors and borrowers (video)
- Other various topics

For the stock market, the recession issue hides a host of underlying factors that are too complex to simply sell equities. Wage increases, falling oil, corporate profit growth, normalization of world trade, and the end of the war are some of the favorable elements I see – over the next 3 years. On the flip side, some of these factors have a negative effect leading to a narrowing of companies' profit margins, adding to the weight of nations' indebtedness and deglobalization trends following Covid and the war.

POSITIONING Recent experience tends to disproportionately affect our view of the future. The recent decline in the stock market creates a negative emotional bias and a false impression of endless decline. In reality, a drop of 20 or 25% puts us closer to the end of average historic declines and in bargain territory, if we aim for success over three years and not three months. At the risk of repeating myself, to be successful investing in equities we must avoid risk (bankruptcy, permanent loss of capital) and tolerate volatility better than the average investor (realize that a fall in price is not a decrease in value). That's why your investments have been chosen for their ability to generate profits, pay dividends and weather storms.

Without being able to control the past and wishing to limit its influence on my view of the future, I try to limit my emotions by a methodology that evaluates investments of all kinds over this 3-year horizon, a horizon that lets all obstacles pass and does not unduly tax most investors' patience. In this context, US equities have fallen to their average historical valuation and most other major countries are well below their historical level, based on the ratio between the current price and profits. This means your companies' bank accounts and value are growing even if their price is dropping due to others selling.

Stock market math: if world stocks trade at 16X profits as is the case now (price-earnings ratio), the earnings yield or profit per dollar invested is 6.25%, or 1 ÷ 16. If we never see profits grow, our long-term return will be 6.25%. Add inflation, which drives up revenues and profits, and minimal real growth and you quickly end up with a 10% return – this calculation illustrates one of the ways I use to invest with thought rather than emotion.

With a portfolio of healthy companies that can benefit from inflation and some degree of economic normalcy, coupled with bonds that are finally paying a reasonable rate, I advocate that the pendulum has now swung out of the danger zone to opportunity – for those who can tolerate a few months or quarters of potentially uninspiring news on the way to success over my stated 3-year window. As most portfolios are currently underweight (underinvested) in equities, we will be looking for opportunities to add bargains.

As always, I invite you to reach out to me to discuss these points or any other. We wish you a beautiful summer until our next meeting.

Orith & Steve

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Benchmark Indices

to June 30th 2022

Please find the main indices reflecting the components of a diversified portfolio below. These are meant to help you put your performance report in context.

Asset Class	Qtr	YTD	Weight
Bonds	**-5,5%**	**-11,9%**	**=↑**
Canada gov't	-4,6%	-9,9%	–
Canada corporate	-4,7%	-10,9%	+
Hi-yield (U$)	-10,0%	-14,0%	=
Preferred shares	-7,5%	-9,9%	=
Global Equities	**-15,5%**	**-20,0%**	**=**
Canada (S&P/TSX)	-13,2%	-9,9%	+
USA (S&P500-U$)	-16,1%	-20,0%	+
Foreign - Developed (U$)	-14,3%	-19,3%	–
Foreign - Emerging (U$)	-11,3%	-17,5%	–

<u>Legend</u>

Qtr:	Quarter or 3-mo period to June 30th 2022
YTD:	Year-to-date to June 30th 2022
Weight:	+ : allocation over your target
	– : allocation below your target
	= : neutral allocation
	↑ : recently increased
	↓ : decreased

Source : National Bank Financial, data via Refinitiv