A Tricky Recipe

Good morning,

You've probably noticed the volatility wreaking havoc in the markets over the past few weeks. For example, on Tuesday, September 13, the Dow fell over 1200 points.[1] To understand what's going on, let me tell you a story.

Imagine you are inside a fancy restaurant, waiting for your meal to be prepared. While you wait, you can watch the chefs as they work. Suddenly, though, you notice there seems to be some uncertainty going on in the kitchen. By listening closely, you can just barely make out what the chefs are arguing about: Does the recipe call for two teaspoons of salt, or two tablespoons? Or is it even two cups?

One by one, the other diners start paying attention to the debate, too. Each voices their opinion to the other. Some diners want the chefs to add two teaspoons of salt. They rationalize that, while you can always add more salt later, you can't ever un-salt your food. Too much salt will ruin both the meal and everyone's night. Others point out that there are no saltshakers on the tables, meaning if more salt is needed, the chefs will have to do it themselves. That will delay the meal, and people need to eat now.

Better to just use two tablespoons. Sure, maybe the food will end up a little too salty, but that's better than overly bland food — or no food at all.

As the wait drags on, the diners start getting nervous. They decide to amend their order and ask for less food. Other diners decide to leave the restaurant entirely. Finally, the head chef announces the restaurant is committed to adding just the right amount of salt, so they will add it gradually, little by little, until they know they have it right.

Unfortunately, this little speech, while providing clarity as to the chef's intentions, does nothing to quell the concerns of all the diners. Some applaud loudly, others boo. Some rush to order more food, while others ask for the check. Before long, the noise is deafening.

Maybe, you think, we should have just ordered a pizza.

Crazy as it may seem, this little play actually describes some of what's going on in the markets right now. (Except that the chefs are the Federal Reserve, the food is the economy, the recipe is for bringing down inflation, and the salt is interest rates.)

For the last nine months, the Federal Reserve has been trying to follow an incredibly tricky recipe: Bring down inflation without bringing down the economy. Just as chefs use salt to flavor food, our nation's central bank uses interest rates to help moderate runaway consumer prices. The problem both face is it can be difficult to know how much of that magical ingredient to use. Just as too much salt can make food unbearable to eat, raising interest rates too high, too fast can trigger a recession. Raising interest rates too little, however, might do nothing to quell inflation. And like those diners in the story who needed to eat, consumers need relief from inflation now.

Those diners, of course, are investors. Every investor has their own opinion on what the Fed should do. More importantly, every investor is trying to guess what the Fed will do. That guessing is the prime reason for all this volatility. Investors who believe rising interest rates will hurt corporate earnings and trigger a recession decide to eat somewhere else, bringing the stock market down. Investors who still see the restaurant as the best place in town – regardless of interest rates – order more food and drive the markets back up.

Remember in the story how the head chef came out and made a big speech? Well, that's my attempt at describing what Fed Chairman Jerome Powell did two weeks ago. Every year, Powell delivers a speech in Jackson Hole, Wyoming where he reveals the Fed's views on the economy. In the days leading up to his speech, some investors thought he might announce the Fed would look to dial back on hiking rates much further. Their reasoning? Some data released earlier this summer showed inflation as peaking, so there's no need to keep raising interest rates. Powell wasted no time in dashing those hopes, however. In his speech, Powell said that this is "no place to stop or pause."[1] Fighting inflation will remain the Fed's number one priority for the foreseeable future. That means the Fed will continue to gradually raise interest rates, likely around 0.5% to 0.75% every few months. Powell further said:

"While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain."[2]

In other words, bringing down inflation is simply more important than stimulating economic growth right now. (Or propping up the markets.) This is why there's been so much volatility in the markets lately. It's also why we can expect volatility to continue, at least in the short-term. Many economists expect the Fed to hike rates by at least another 0.75% later this month. That bet became even more likely on September 13 when the Labor Department announced that inflation remained stubbornly high in August, to the tune of 8.3%.[1] So, don't be surprised to see more volatility before and after that announcement, if it comes.

The reason I'm telling you all this, is to assure you that, while volatility is never fun, it is not unexpected. It has not taken us unawares. Nor, frankly, do we feel it's something you need to stress over. You see, here at National Bank Financial, we act more like "financial dietitians" than anything else. (This is the last food metaphor, I promise.) A dietitian focuses on using the fundamentals of good nutrition to help people eat better, healthier foods so they can achieve their health goals – regardless of what's "in style" or what celebrity fad-diet is trending. As your wealth advisors, our job is to help you achieve your financial goals, in part by making sound, long-term decisions, not overreacting to what the Fed does – or says - or what the market thinks about it.

To put it simply, the volatility we've seen lately is the same old story we've been reading about all year long. It's the same story we'll probably continue to read about moving forward. For that reason, my advice is to enjoy the end of summer rather than stressing about market headlines. My team and I will continue to monitor your portfolio, and we'll let you know the instant anything changes. And of course, if you ever have any questions or concerns, please let us know. That's what we're here for!

Now, I need to get something to eat – all this talk about food is making me hungry.
Have a great month!

Sincerely,

Graeme Sivertson, CIM®, CFP®, BComm.
Wealth Advisor & Portfolio Manager

Bruno Mercier, CIM®, CFP®, FCSI®, BSc.
Wealth Advisor & Portfolio Manager

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

MERCIER GROUP | WEALTH MANAGEMENT

[1] "Stocks Fall on Hotter-Than-Expected Inflation Data," The Wall Street Journal, https://www.wsj.com/articles/global-stocks-markets-dow-update-09-13-2022-11663065625
[2] "Powell warns of 'some pain' ahead as the Fed fights to bring down inflation," CNBC, August 26, 2022. https://www.cnbc.com/2022/08/26/powell-warns-of-some-pain-ahead-as-fed-fights-to-lower-inflation.html

MARKET SUMMARY

For a summary of key market performances, currencies and interest rates, we invite you to read our daily commentaries. Clear and concise, they will keep you informed of the latest economic and financial news that can influence the value of your investments, and serve as a guide for your discussions with your advisor.

Click here to consult the Daily Market Review.

WEEKLY ECONOMIC WATCH

The Economic Weekly is an excellent and simple way to stay abreast of a series of important economic and financial indicators affecting the North American, provincial and global backdrops. It offers an analysis on a current economic or financial topic, together with a brief commentary on developments in the economic environment as depicted by economic indicators released during the week.

Click here to consult the Weekly Economic Watch.

Click here to access your online account and statements

Click here to learn more about the team

Click here to make an appointment with us

Bruno Mercier
Senior Wealth Advisor & Portfolio Manager

1-780-412-6614
Bruno.mercier@nbc.ca

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

MERCIER GROUP | WEALTH MANAGEMENT

CIPF Canadian Investor Protection Fund MEMBER