Quarterly Market Commentary

July 2023

Performance Returns YTD

S&P TSX Comp (PR):	1.80%
DJI (PR):	2.35%
S&P 500 (PR):	14.04%

As of June 30, 2023

The markets started off with benign gains in April and May as investors pondered the structural integrity of banks and politicians' ability to work together on a debt-ceiling resolution. As those issues were resolved, investors turned their focus to supporting big-cap tech names in June, driving the market to its highest monthly return for the year.

The proliferation of artificial intelligence (A.I.) has been predicted to have as large an impact as the Industrial Revolution. In Q2 2023, A.I.'s largest impact was propelling tech stocks increasingly further away from their 2022 lows. Unlike the forecasted wide-reaching potential for A.I., the impact on stock returns was not very broad. The seven largest stocks in the S&P 500 (Apple, Google, Microsoft, Meta, Nvidia, Tesla and Amazon) accounted for over 90% of the gains of the market in 2023. The concentration of market gains is a lingering issue that has yet to be settled, and there are only two methods of resolution; the magnificent 7 stocks fall back down to earth, or the market broadens, and the other 493 companies lead the market higher. For the latter scenario to happen, the other 493 will have the challenge of growing earnings in an environment where a less accommodative Fed is committed to slowing inflation at all costs. What is interesting to note is that while the overall market is trading at 19x earnings, when you back out the magnificent 7, the rest of the market is a more reasonable 12x earnings. I recognize that A.I. will have a meaningful long-term impact, however, whenever I see stocks going up so much because of new technology, I'm reminded of Amara's Law: "We overestimate the impact of technology in the short term and underestimate the effect in the long run." This might explain why A.I. associated stocks have gone up so much in value. I think it's time to focus on the other 493 stocks.

In fixed income, the pace of rate increases has slowed in 2023 and in some cases, there was a pause. However, interest rates drove higher over the quarter as the economy and labour market continued to exceed expectations forcing central banks to start raising rates again. As interest rates increase, the value of bonds goes down. Although we own bonds that are short in duration, the prices have fallen. There is comfort, however, in knowing that when we hold the bonds to maturity, we are guaranteed the income and capital. I think central banks around the world are happy to see inflation come down from almost double digits last year to close to 4% today. The tight labour market, combined with sticky service sector pricing, should force a few more hikes and then likely a long pause before contemplating cuts.

The continuation of rising interest rates has presented attractive opportunities in the fixed income space. Investment grade bonds, including government, are now offering yields not seen since before the Great Financial Crisis of 2008. While the central banks are expected to raise rates one or two more times, it does appear as if their most recent tightening cycle is nearing its end. Despite this expectation, the path of rates remains uncertain and a possible recession, because of the high rates, is not out of the question. Our belief is that given the risks that remain, the importance of a high-quality bond portfolio is as important as ever.

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Source: https://ycharts.com/indicators/sp_500_monthly_return.

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