Market Update

September 2022

An Important Note: Uncertainty? Always

The night before the D-Day invasion, a nervous Franklin Roosevelt asked his wife Eleanor how she felt about not knowing what would happen next.

"To be nearly sixty years old and still rebel at uncertainty is ridiculous, isn't it?" she said.

It is. But we do.

As we sit here today – the highest inflation in 40 years, rising interest rates, plenty of tech stocks down 50%+, a war in Ukraine, supply chains broken, a lingering pandemic, China on lockdown, on and on – it feels like economic uncertainty is rising, maybe even the highest it's been in years.

Headlines cry out, highlighting the uncertainty of these times. Hiring freezes due to uncertainty, profits falling amid uncertainty, mortgage rates rise due to economic uncertainty, etc. One gets the feeling that things are not only bad but unexpectedly so.

But the idea that uncertainty is higher now than it was, say, one or two or five years ago is a strange one. It implies that the future was more predictable in the past before all these events.

But it wasn't, of course. The risks were always there. People just forgot about them and thus felt more comfortable, more certain.

The future is always endlessly unpredictable. What changes isn't the level of uncertainty, but the level of people's complacency.

There is a thing called the Policy Uncertainty Index that attempts to quantify economic uncertainty. It tracks things like mentions of economic uncertainty in newspapers, changes to the tax code, and the variance of opinions among economic forecasters. By its metric, uncertainty bottomed – and hence certainty about the future peaked – at two distinct times over the last 20 years: In the year before September 11th, and in the year before the 2008 financial crisis. In hindsight those were perhaps the most uncertain periods in modern history, when everything we thought we knew about how the world worked was about to be upended. We just didn't know it at the time.

Here's how President Clinton explained the mood in his January 2000 State of the Union Speech. When reading this keep in mind what we know in hindsight: This was just before the stock market crashed, the economy was thrown into recession, and America was attacked for the first time since Pearl Harbor:

"Never before has our Nation enjoyed, at once, so much prosperity and social progress with so little internal crisis and so few external threats. Never have we had such a blessed opportunity.

We begin the new century with over 20 million new jobs; the fastest economic growth in more than 30 years; the lowest unemployment rates in 30 years; the lowest poverty rates in 20 years; the lowest African-American and Hispanic unemployment rates on record; the first back-to-back surpluses in 42 years; and next month, America will achieve the longest period of economic growth in our entire history. We have built a new economy.

My fellow Americans, the state of our Union is the strongest it has ever been."

Pointing this out isn't a criticism because everything he says here is accurate. But the good and accurate news of the era gave the impression that the future was predictable, and uncertainty was low, when reality was the future was extremely unpredictable (as always), but complacency was high. September 11th didn't make the future more uncertain – it was always uncertain. The attack just woke people up to a risk that was always a possibility, but one that was not thought about.

I think the opposite occurs when everyone thinks uncertainty is high. Uncertainty hasn't gone up this year; complacency has come down. People are more aware (reminded) today that the future could go any which way, that what is prosperous today can evaporate tomorrow, and that predictions that seemed assured a few months ago can look crazy today.

That's always been the case. But these days we're keenly aware of it.

To live through the last two years and still rebel at uncertainty is very human, but it is also ridiculous. Isn't it?

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September was a very difficult month with markets falling across the board and revisiting the lows reached in June. Central banks in the US and Canada made it clear that they intend to increase interest rates until "pain" is felt across the economy. To lower inflation they are set on killing demand. Lowering demand while maintaining the same or increased supply, should result in too many goods, and so lower prices. They would like to see spending/ demand fall off and so increased interest costs should result in less money available for spending.

However, after spending two years at home, many people are looking to spend, to go on vacations, to go out for dinners, to go see friends and family. The idea of curtailing one's spending at this time is not popular and being resisted.

The other way to kill inflation is to provide more goods. If demand remains intransient then increasing supply could meet the demand without an increase in prices. This however is proving difficult as the supply chain is still disrupted. China is closing entire cities to deal with COVID, the war in Ukraine has caused significant difficulties some apparently permanent, there are many countries that manufacture goods that are having difficulty filling orders and here at home, there are simply not enough truck drivers to transport goods, and more. There are considerable incentives to resolve these issues or to find ways around, but they do take time. One movement is the 'on-shoring' of manufacturing, that is bring manufacturing back to North America and not depending on others to produce the goods needed. This can make a significant difference and have other far-reaching effects, but this too takes time.

While things are 'fluid' and changing rapidly, it does appear that inflation and higher interest rates will remain longer than hoped. Fortunately, it does appear that inflation has peaked but instead of falling it appears to be bouncing around with a slight downward angle. One should expect markets to continue to fluctuate with fairly large movements triggered by the latest readings on inflation and supply disruptions/improvements.

The odd part of all of this is that the sooner rising rates curtail spending and slow the economy (recession or not), the sooner rates will have to be decreased to get us out of it. The longer it takes to curtail spending and slow the economy, the higher interest rates will have to go and the longer it will be until they are decreased.

So, the market's path forward is unknown (as always) and likely to be volatile and unnerving, but whichever way events unfold I believe it is reasonable to assume that markets will rally sometime in 2023 and if not, then in 2024.

This reality is important as most of us are investing for the long-term. We are not in the third period of the last game of the season needing a win to make the playoffs. Rather we are somewhere in the middle of the season with many wins and some losses ahead of us and comfortable that we are well positioned to do well overall.

And so, as always, the focus remains, and must remain, on the long term. One's focus should be on investments in strong companies that have the opportunity and the potential and can weather the inevitable storms and still prove profitable. One should invest for the long term and ignore short term fluctuations, and forces one cannot control. Mostly one should focus on one's own life, plan, and goals. At the end of the day that is all that truly matters.

Looking forward we are concerned but neutral in the short term, and positive in the medium and long term. We continue to invest new funds (finding some good opportunities) and monitor our positions closely.

Index	Month	Year to Date
Bonds FTSE Canada Universe Bond Index - CAD	-0.30%	-12.10%
Canadian Equity – S&P/TSX 60 Index - CAD	-1.80%	-11.20%
US Equity – S&P 500 - USD	-5.50%	-17.0%
International – MSCI EAFE Index - USD	-10.60%	-27.20%
Emerging Markets – MSCI Emerging Markets Index - CAD	-7.40%	-22.20%
Real Estate – Dow Jones® Global Real Estate Index - USD	-11.3%	-29.90%
S&P/TSX Preferred Share Index - CAD	-6.2%	-15.60%

Have a great month and let us know if there is anything we can do for you,

- Meir

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