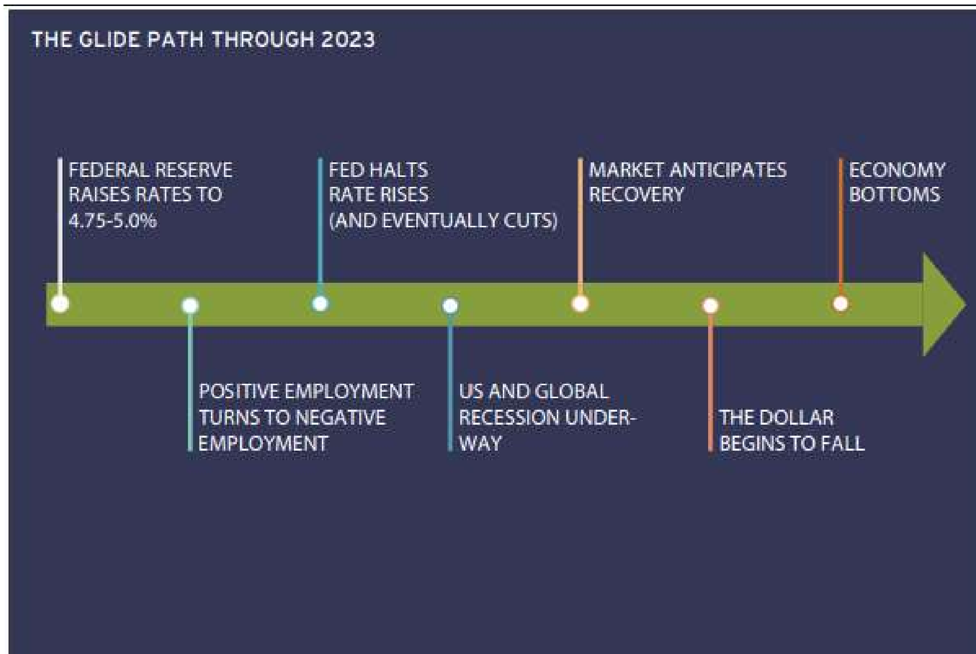
Good afternoon investors,

As the adage goes, time waits for no one. As we are already halfway through 2023, we thought it would be a good time to reflect on the past and present. You may recall the graphic below from our January publication. As you can see, the path to recovery is long and can take many months (we appear stalled in Phase 2). Over the last 14 months, the Federal Reserve (Fed) has raised rates 500 basis points (5%). There is evidence that the rate hikes are just now beginning to work across the labour force. The U.S. and Canadian unemployment rates are rising, and job growth is also beginning to slow down. However, inflation remains sticky and future rate hikes are not off the table.

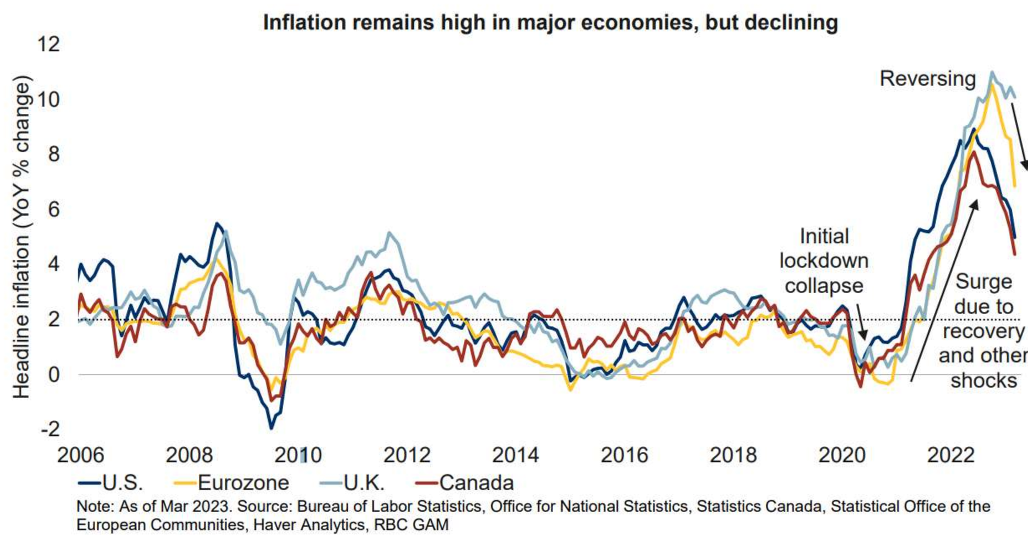


Source: CGWI Office of the Chief Investment Strategist, as of October 11, 2022. All forecasts are expressions of opinion, are subject to change without notice, and are not intended to be a guarantee of future events. Indices are unmanaged. An investor cannot invest directly in an index.

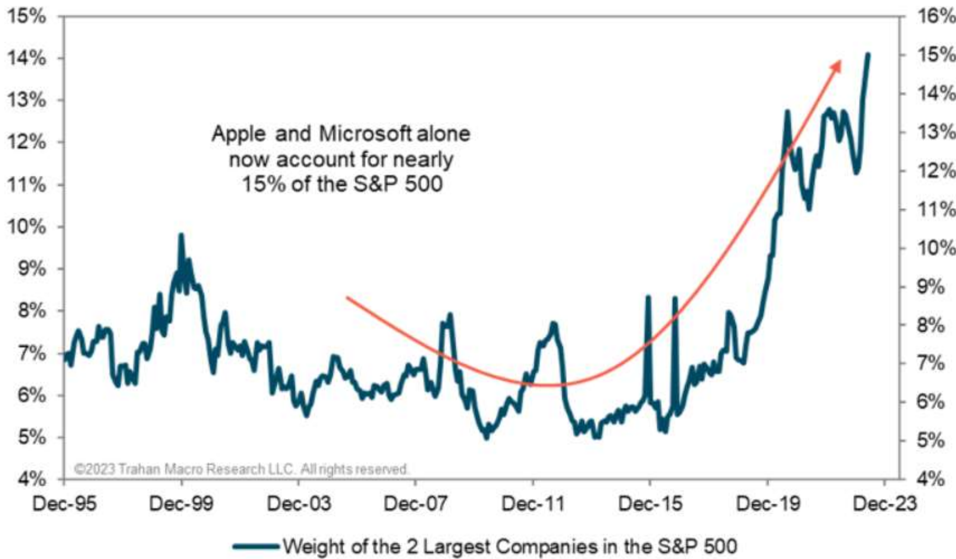
The playbook for the Central Banks is to continue to raise rates to a level where businesses and individuals begin to suffer -- thus cooling the economy and taming inflation. Although painful on an economic and social scale, this pain must be endured as part of the road to recovery. The question that remains, and a key factor in the volatility we are experiencing, is when will the Fed pause (and eventually cut) interest rates?

Based on the number of rate hikes, and the pace of the hikes, we believe we are closer to a pause in the cycle. Even without many further rate increases, we expect the economy to slow. The impact of the rate hikes is having a delayed effect, similar to a wave formation. When the full impact is delivered, we anticipate Gross Domestic Product (GDP) and inflation to decrease. Using the wave analogy, a soft landing is a wave that doesn't break, whereby a hard landing is a wave that breaks after it crests. One scenario for a hard landing could be an exogenous shock that could suddenly roil the markets. If this were to play out, our anticipated rate cut(s) could come much sooner. Our base case is for no rate cuts in Canada for 2023,

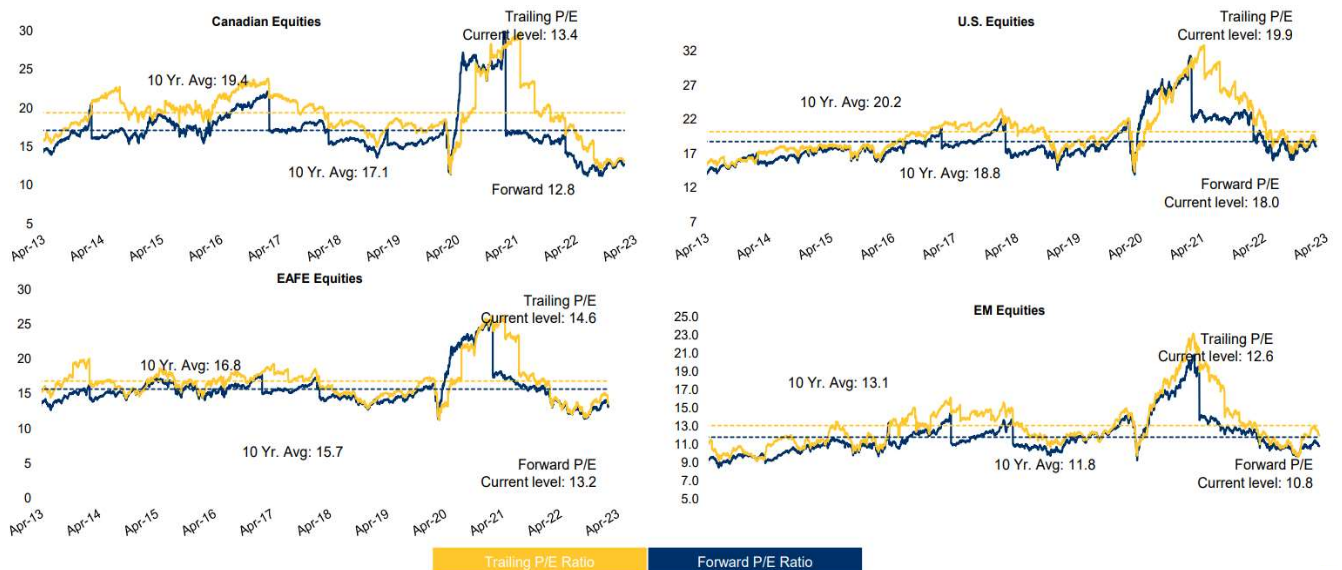
but a potential rate cut in the U.S. by year-end, predicated on the fact that inflation both inflation and employment is cooling quicker in the U.S. than it is in Canada. Furthermore, we believe the Bank of Canada may not be able to raise rates as much as the Federal Reserve due to the structural differences in Canada's housing market. In the U.S., inflation is rolling off but remains historically high (see chart below). Employment, until recently, just started showing signs of cooling. Recent figures show unemployment rose from 5.0% to 5.2% in Canada. Similarly, in the U.S. the unemployment rate rose from 3.4% to 3.7%.



We continue to believe this year will be the tale of two halves. The first half of the year proved that moving back into large tech companies was lucrative. They were oversold last year and a vital component to the economy. We did participate in this tech run-up, however, to a lesser degree compared to the index. Both Capital Group Global Equity Fund and Fidelity Global Innovators Fund have meaningful technology exposure using a diversified, but flexible approach. We have written about this in the past, many of the indices are concentrated in a few names (interestingly, many of the names have artificial intelligence exposure). A shift in sentiment or an earnings correction could be nasty. We believe the expectations on large cap tech are too high based on current valuations. We feel there are better opportunities in other sectors; hence diversification has not lost its importance.



It's clearer now that the second half of 2023 may require more patience and continued caution. Valuations are not quite to a point where businesses look cheap, albeit in line with historical norms. Broadly, we prefer high cash flow businesses, low debt, and strong management teams. Canadian equity markets appear to offer more value versus our neighbours to the south -- as such we will stand by our home bias.



Source: Bloomberg, RBC GAM. Data as of April 30, 2023. Canadian Equities represented by S&P/TSX Index. U.S. Equities represented by S&P 500 Index. EM Equities represented by MSCI EM Index, EAFE Equities represented by MSCI EAFE Index.

We continue to hold higher than normal cash positions and more fixed income compared to previous years. Late last month we rebalanced, putting approximately 5% of free cash to work. We purchased more of the high conviction companies we currently own in the large models (such as Brookfield Corporation, Nutrien, Royal Bank, Suncor Energy, TD Bank and Tourmaline Oil). In addition, we added exposure to the Canoe Equity fund in our small model. We expect the volatility to continue, and we have the dry powder to seize on future opportunities.

Although we don't like to predict, at the start of 2023 we were constructive – believing markets would provide average-like returns. We are now halfway through the year and performance has been stronger than expected. Although that is good news, we aren't seeing a catalyst for markets to move materially higher from here. The rally has been concentrated in few names, mostly in the tech sector as discussed earlier. The S&P 500 Index as of the end of May was up +8.9%. If you removed Nvidia, Meta, Salesforce, Microsoft, Tesla, Alphabet, Apple, Amazon, Oracle, and Adobe from the S&P 500, its return would be approximately -2.0%. Our belief is, we must see a broader rally across all sectors and market capitalizations before a bull market is underway. It's tough to know exactly when this will begin, so staying invested and committing to an investment process continues to be our approach.

We are grateful for your continued support and wish you, and your family, a safe and memorable summer.

Best regards,

Northlake Wealth Management

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