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May 2022 Market Update

These are uncertain times.

We head into the month of May – the month for flowers. Unfortunately, much of the political and economic news is showing a lot of weeds.

The global developments so far in 2022 show none of the forecasts made just six months ago. The world is rattled by the Russia invasion of Ukraine. Many nations, including Canada and the U.S., have brought about some severe sanctions on Russia for their actions. Sanctions bite both ways and also hurt the countries that impose them. Most of us are prepared to accept some of this 'hurt' in our attempts to bring more severe pain to Russia. Of the nations imposing sanctions against Russia, it is Europe that will feel the most pain, and the longer the sanctions remain in place, the more pain Europe will experience. Still, no one feels the pain as severely as Ukraine and all Ukrainians.

The attack on Ukraine, has resulted in serious supply disruptions. Ukraine is part of the bread basket of Europe through which a majority of agricultural and other commodities are shipped. Wheat, corn, soybean, fertilizers, oil, gas, just to name a few. These, with the Russia sanctions reduces the supply of copper, nickel, aluminum and most other metals. There is now a serious global shortage of all of these goods and commodities. We all know what happens when you don't have enough of something – the price goes up.

Add into this, the current political experiment in China with their Zero-Covid policy. The government shut down a city with a population that is about 2/3 that of Canada. Not allowed to leave your house. A less-than-minimal amount of food supplies gets delivered to everyone in isolation. No manufacturing, no shipment of goods. This worsens the shortage of food, goods and commodities, and prices go up even further. These problems put a strain on the supply-side of the economy and results in increased supply-side inflation.

Now we add in the Bank of Canada, US Federal Reserve and other world central banks. When faced with high or increasing inflation the main tool to deal with this is to increase interest rates. The problem with this, is that interest rates (monetary policy) is designed to deal only with demand-side inflation. Increase interest rates to get people to buy less. Reduce interest rates to buy more. Interest rates are ineffective against supply-side inflation. Yes, there is a desire to buy more stuff as we come out from the pandemic and interest rate increases can hopefully slow this down, but much of the current global inflation comes from the lack of supply. Increasing interest rates is not going to make the price of gas at the pump, cornflakes, or bicycles any cheaper. Any kind of resolution in

Ukraine, and China opening up their cities (hopefully soon) and economies will have a much bigger impact on bringing down some prices. There are so many cargo ships waiting outside China's ports that an accurate number is difficult to obtain. Eventually, an increased supply of goods will return.

Still, the Bank of Canada and the US Federal Reserve are raising interest rates. At the end of December 2021, many economists suggested the first interest rate increase would be in mid-to-late 2023. Oh, how quickly things change. Four months into 2022 and Canada has already raised rates twice. This next comment may sound sarcastic or cynical, but it is not meant to be. The Bank of Canada and US Feds are raising interest rates so that they can cut interest rates sometime in the future. The interest rate increases, and supply chain problems will most likely lead us into a recession. The main tool to get us out of a recession is to cut interest rates. If rates are at zero, there is nothing to cut. They are raising rates so that they can be cut when a recession comes. We do not know how high rates will go, but they won't need to stay there very long before they come back down. I do not see a recession starting very soon, but as I said earlier, change happens fast!

Where does all of this leave us as investors?

We are very much in a period of severe uncertainty. The daily price swings in the equity market is head-spinning. One area of investments that has been hit very hard is the fixed income markets. Bond and preferred share prices have been whacked. This comes from the uncertainty around interest rate increases. Preferred shares have also been impacted by institutional and ETF selling. If a preferred share, for example, averages 10,000 shares traded per day, and ETF sells 100,000 shares, the share price gets hit harder than it might otherwise. There are many good quality preferred shares trading well below their par value that could make a good investment for a long-term income-oriented investor. Patience is important in the equity markets and is even more important in the bond and preferred share markets. Bonds and preferred shares usually perform very well during recessions as interest rates come down.

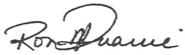
The next several months will test our patience. Volatility in all asset prices will continue. There have been, and will continue to be, sharp sell offs in equities, bonds, and preferred share markets. As with every other economic or financial crisis – this too shall pass. Prices do not go up nor down forever. The key is to remain calm and patient with your good quality investment portfolio. Fear and panic are an investors worst enemy. Fear can only cause certain loss without recovery. During these times, it is important for us to seek out good quality investments that have sold off and would make a great addition to our portfolios.

Friendly reminders and tips:

- Keep us informed of your carryforward capital loss, if applicable.
- Update your online passwords regularly to further protect your privacy. If you need to be set up for online access, please let us know. Isabella will provide you with a USER ID and a temporary password.

Stay healthy and, as always, remain optimistic yet cautious.

Best Regards,
CIBC Wood Gundy



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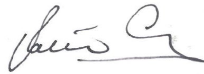

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