

SUNDOWN

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By Brahm Satov

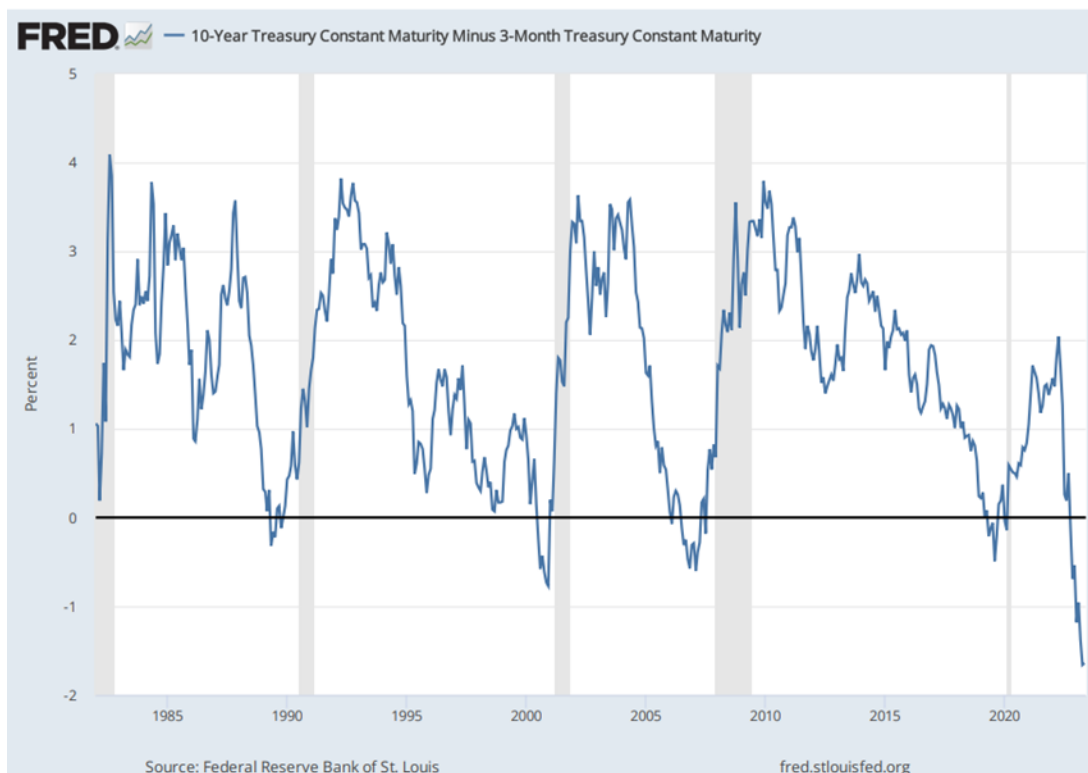
It just so happened that I was driving through Orillia on Sunday May 7th, the day Gordon Lightfoot happened to be buried in that exact same place. Now, you may be familiar with some of my favorite songs from this Canadian folk-rock singer, like *"The Wreck of the Edmund Fitzgerald"*, *"If You Could Read My Mind"* and *"Sundown"*. Much of his music was not just meaningful but piercing and had the ability to transport you to another place and time.

It was also a coincidence that, just a day earlier, I was driving down Muskoka Road 38 with my boys and father-in-law, when I noticed a march for the First Nations people coming towards me on the other side of the road. As I slowed down to show my respect, some saw that I was, by yet another coincidence, wearing my orange shirt. Many smiled and waved to me, and it was a moment I will not soon forget.

It is my amazing wife who I have to thank for this connection that I felt, as she continues to show me another side, bringing light to my ignorance.

In terms of the title, “Sundown”, I do think it is likely that this economic cycle is ending. We have seen higher costs across the board, not just in terms of mortgages, and wages are not keeping up. This means lower disposable income and many families finding it more difficult to manage. The cycle is as such: spending slows, then sales fall leading to lower earnings, layoffs ensue, leading to even lower sales, and even more layoffs. I dedicate this newsletter to Gordon Lightfoot, the amazing Anna Mae Bullock, (aka Tina Turner, the Queen of Rock and Roll), and to my wife and family.

As I have mentioned in the past, the economy is a cycle, it is non-linear, and I think it remains highly likely that we are in a slowdown. The yield curve is still inverted! When this indicator is both persistent and pervasive in terms of its inversion, the probability of recession is very high. You can see by the chart below, every time the inversion has been deep (well below zero), a recession has followed, (grey areas are recession). The spread between the three-month to ten-year yield is the most it has been in decades, a negative sign for the economy.



Moreover, the top 10 stocks in the S&P 500 have generated nearly 90% of the index's total return so far in 2023. That's an all-time record!

Source: (<https://www.fool.com/investing/2023/05/16/this-stock-market-indicator-has-never-been-worse/>).

This upward movement by only a few stocks, is another negative sign for the markets, (weak or negative market breadth). I would compare this to the game of Jenga, as you make the tower higher and higher by taking out blocks from lower and adding them to the top, the structure gets more likely to topple. In a healthy market rally, most stocks are heading higher. This divergence, that stock markets are trending higher on negative market breadth often happens at the end of a market cycle, "sundown".

Recently, I have been feeling like the boy who cried wolf in Aesop's tale, as I continue to see a high probability of recession. Although the boy in the story may be trying to fool others, I certainly am not, and like my friend reminds me from time to time, the wolf does show up. On this, I should reiterate that although I am not certain of a coming recession, I am certain that the probability remains elevated and as such one should be positioned for that likeliness. Currently, the stock market indexes, are not reflecting the possibility of a recession, and given the heightened probability, to me it makes little sense to have a meaningful position in certain segments of the equity markets.

In 1972, Tina Turner released, "*If I Knew Then (What I Know Now)*", the title may be ironic given what she was going through in her relationship at that time. In that same vane, I think many investors a year or so from now, may be able to look back at this title with a knowing smile. Although, I think it is likely that we experience a recession and a correction in the markets, on the positive side, this usually leads to an excellent buying opportunity. Some may not realize that the TSX is down by over 5% over the past month, whereas most US markets are higher, another disparity. One more thing I should mention - when I was younger, my mom, who was a very smart lady, would say "there are no such thing as coincidences". Perhaps, the fact that you are reading this newsletter, is no coincidence.

Thank you for taking the time to read this, please feel free to e-mail me any feedback or comments.

Sincerely,

CIBC Wood Gundy

Brahm Satov

Investment Advisor

Portfolio Manager

905 762-2249

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