CIBC PRIVATE WEALTH

“WHEN DOVES CRY”

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By Brahm Satov

Dig if you will the picture, of central banks aggressively raising interest rates, and stock markets heading higher. We know that the higher the rates, the more it slows the economy and negatively impacts stock values, so why with this huge increase in rates, are stock markets not lower? After all if the economy is slowing, shouldn’t companies perform, not as well, and therefore their value fall? I believe here lies the rub, we have value and price. Yes, generally as rates rise, company values fall, but sometimes, the price can rise even when values do not, usually we call those periods, bubbles. And usually, when it comes to the stock markets, bubbles do not end well, I have seen it before, can you picture it? Thank you to Prince Rogers Nelson, aka Prince, for the song title, “When Doves Cry”.

We have seen a shift which I believe is helping fuel stock markets, this shift is a move by central banks to a more dovish stance. Keep in mind when central bankers are dovish, they tend to lower interest rates or keep them low which helps fuel economic growth. Conversely when central bankers are hawkish, they have a tendency to raise interest rates, often to fight inflation, and this puts downward pressure on the economy. I believe the stock markets are anticipating lower interest rates in the near future, and as such are moving higher. However, as long as stock markets move higher, lower rates are less likely. In other words central banks do not want to lower interest rates when stock markets are heading higher as this would likely stoke further inflation.

It is my opinion that eventually higher rates will have their desired effect on the economy and in due course the stock markets. Do not forget the adage, “don’t fight the Fed”. I believe many investors get caught up in the hoopla of outperformance by a few stocks. By the way the Magnificent 7, the 7 stocks that did most of the heavy lifting to help push the S&P 500 and NASDAQ higher last year, are now down to the Formidable 4, as three have had negative performance so far in 2024. Moreover, Canada’s stock market index, the TSX has still not pierced the high it made in 2021, and with bond yields much higher than they were in 2021, (therefore bond prices lower), the average Canadian investor has not made any gains since late 2021. When doves cry.

Source: Tradingeconomics

Although I believe as most do, that central bankers will eventually lower rates, I do not expect that to happen until stock markets begin to correct. Historically, by the time central banks start lowering rates, the economy is already on a downward trajectory and even as rates are being lowered it takes quite a while until the economy improves. It is my opinion, that stock markets sometimes get ahead of themselves, like the Dot.com bubble or the tech bubble. Some of you may have experienced the anguish of owning stocks through these periods. Although any bubble can get bigger, I believe it continues to be a time to be cautious.

Recently, I went on a holiday with my family and we had to take one of those smaller propellor planes for one leg of our journey. It was not comfortable and not just for me, it was bumpy. Sometimes, I see my job in a small way like a pilot, I will try to position the portfolios so it is not uncomfortable, less bumpy if you will, but still get to our destination.

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

Sincerely,
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