

In this issue:

- **Down more than 20% in 2022, the Bear is back on Wall Street!**
- **The Canadian stock market and economy are better positioned**
- **Know how to take advantage of opportunities when they arise**

Dear friends,

The first half of the year is finally behind us! We can now rejoice. While the Canadian Index has been one of the best performers in the world, it is a different story south of the border for the S&P 500. The Wall Street Index ended the first six months of 2022 with a loss of 20.6%, or the equivalent of US\$8.5 trillion in market value (-19.1% converted to C\$). Earlier in June, the S&P 500 entered the bear market territory, defined as a decline of 20% or more. This was the sharpest first-half decline since 1970. If it's any comfort, the S&P 500 rebounded 27% in the second half of 1970 – a reminder here to remain calm and carefully assess the current financial situation. As we indicated in our last issue, the Canadian economy and stocks are always a good bet.

Inflation is everywhere! Problems with the supply of goods and generous giveaways to counter the pandemic are having an impact on the economy. Inflation is breaking new records in Canada. Combined with sharply rising interest rates, cost pressures are intensifying for consumers and businesses. Gone are the days of cheap money. But just how high will rates go? After two 50 basis points (bps) increases in April and June, the Bank of Canada surprised many by accelerating the pace on July 13. With its full percentage point increase, more aggressive than that of the Federal Reserve in June, the BoC is sending a clear signal that it is serious about curbing inflation. Its aggressive approach raises the prime rate to 2.50%, the highest level in 40 years. Returning to the so-called “neutral” range (2% to 3%), the BoC no longer indicates in its statement that it will have to act forcefully, but simply that the pace of future increases will be dictated by its assessment of the economy and inflation.

Despite what consumers may think, the rise in interest rates brings with it attractive opportunities for investors. For the first time in more than 10 years, investment grade corporate bonds are offering yields to maturity of 3%, 4% and even 5% in the short term. Short-term rates have risen more than long-term rates, prompting this leap in bond yields – an investment opportunity for the cash we are holding or for the cash sitting in bank accounts.

	Closing 30-Jun-22	Change**	
		Quarter	2022
Stock Indices (% in C\$)			
S&P/TSX	18,861	-13.8%	-11.1%
S&P 500	3,785	-14.0%	-19.1%
MSCI EAFE*	1,846	-12.9%	-19.5%
Currencies			
CAN\$ (US\$/C\$)	0.7769	-2.9%	-1.8%
Euro (US\$/EUR)	1.0484	-5.3%	-7.8%
Commodities (US\$)			
Oil (WTI)	\$ 107.66	7.4%	43.1%
Gold	\$ 1,807	-6.9%	-0.9%
Volatility Index			
VIX	28.71	+8.15	+11.49

* MSCI Europe, Australasia and Far East (US\$)

** Changes are expressed in C\$ for Stock Indices.

The TSX maintains its appeal

With the yield curve flattening, making a soft landing of the economy less obvious, eyes are now turned towards employment and earnings reports. The third week of July marks the kickoff for earnings announcements.

After many downward revisions in early July, earnings expectations for the second quarter and the year are reassuring (21.6% and 19.5% for the S&P/TSX). The resilience of the EPS forecast for the Bay Street Index reflects the fact that we benefit from high resource prices, which should continue to favour Canadian stocks. The S&P/TSX continues to offer a frankly attractive valuation (11.4 vs. 16.1 for the S&P 500). Here, the forward P/E is at its lowest level in a decade, and the price-to-book ratio (1.7) along with the dividend yield (3.2%) are equally favourable. Several other securities, including banks, are trading at a discount following the decline in stocks. Banks are trading at 9.3 times the expected earnings and offering a good dividend yield of 4.5%. Notably, Q2 earnings in the U.S. would be down without the Energy sector.¹

	Q1 2022 (R)	Q2 2022	Q3 2022	Q4 2022	Year 2022	Year 2023	Forward P/E
Forecasted Earnings Growth (Year over Year) and Forward Price-Earnings Ratio							
S&P/TSX	18.6%	21.6%	20.6%	15.1%	19.5%	4.6%	11.4
S&P 500	11.4%	5.6%	10.7%	10.1%	9.3%	8.9%	16.1

* Earnings per share (EPS) for the indices. (R: realized).

Source: Refinitiv (Thomson)

The case of the oil companies

In June, oil decreased in value for the first month since November. In its wake, oil companies took a beating. Despite a decline of 12.5%, the S&P/TSX Energy sector is the only one in positive territory in 2022 (23.5%). With a recession seemingly inevitable, should we expect oil prices to fall? In our opinion, given a much tighter oil supply, the answer is no. Supply conditions should keep oil afloat due to sanctions against Russia, impending capacity constraints at OPEC, and oil companies finally seeking to prioritize shareholders' return on investment. Knowing that demand is inelastic and that refiners and the U.S. government will want to replenish their inventories, we believe that the WTI will remain above US\$100 in the second half of the year. Factors related to demand will also help oil companies in the final stretch of 2022. In general, supply has more influence than demand in dictating the direction of the price of oil. The opposite is true for non-energy resources. We are more cautious about mining, with the exception of gold companies, which remain interesting.

Conclusions and forecast

The economic outlook is dimming for the United States, Europe and elsewhere. Inflation shock is lasting longer than expected. To curb the highest inflation in 40 years, the Federal Reserve raised its rates by 75 bps in June. To achieve their inflation targets, we believe that the central banks will need to sacrifice their employment goals. The labour shortage and employment levels will enable them to do so. While we believe that inflation above the growth rate of the economy signals a recession, we expect it to be a shallow recession, especially in Canada, where commodities will remain relatively firm. We favour short-term corporate bonds, private debt, securities offering protection against inflation, and quality stocks. Remember that stock market lows normally foreshadow the official start of recessions. The worst of the stock market is behind us or very close to being behind us, and there are bargains on the way, including technology stocks from well-established, high-quality companies.

¹ The consensus expectation of 5.6% growth for the S&P 500 in the second quarter would be -3.4%, excluding the Energy sector.