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Dear friends,

After a difficult 2022 for both major asset classes, expectations were moderate for equities at the start of the year. Our strategy of favouring dividend-paying stocks paid off in Canada, with the S&P/TSX advancing by just 0.3% in the second quarter for a cumulative gain of 4.0% in 2023. Foreign equities advanced at a similar pace in the first half (7.1%). Ignoring the biggest monetary tightening in a generation, the US flagship index bounced back to eclipse the competition. But don't be fooled by the S&P 500's 13.2% leap in 2023. The meteoric rise of mega-tech companies is blurring the results. The tech buzz is back, and the AI frenzy is everywhere.

The catalyst for this frenzy was chipmaker Nvidia, which reported unexpected results on May 25. Since then, investors have been flocking to companies playing a key role in innovation and highly invested in artificial intelligence. Nvidia's high-end chips are being used to power the data centres required by the new wave of generative AI products, such as ChatGPT.¹ This AI craze quickly propelled Nvidia, which crossed the \$1 trillion mark in market valuation on May 30. The company, which was worth US\$360G in early 2023, is the 6th in the world to join the exclusive Trillion Dollar Club (\$USIT). Artificial intelligence (AI) provides significant economic benefits, including task automation, improved decision-making, enhanced customer personalization, optimized operations, development of new products and services, and increased productivity. These advantages result in improved efficiency, profitability, and competitiveness for businesses. Advances in generative AI look promising.

Rising interest rates and interest in bonds

Over the past month, in the face of persistent inflation and a resilient labour market, the Bank of Canada ended its short pause and twice raised its key rate to reach 5%. Even though we expect one last rate hike before the end of 2023, we believe that the end of the rate rising cycle is approaching.

	Closing	Change**	
	30-Jun-23	Quarter	2023
Stock Indices (% in C\$)			
S&P/TSX	20,155	0.3%	4.0%
S&P 500	4,450	6.1%	13.2%
MSCI EAFE*	2,132	-0.2%	7.1%
Currencies			
CAN\$ (US\$/C\$)	0.7554	2.1%	2.4%
Euro (US\$/EUR)	1.0912	0.7%	1.9%
Commodities (US\$)			
Oil (WTI)	\$ 70.64	-6.6%	-12.0%
Gold	\$ 1,916	-3.1%	5.5%
Volatility Index			
VIX	13.59	-5.11	-8.08

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

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

¹ For demonstration purposes, we used ChatGPT to write two sentences of this text.

Last year, by reducing the average maturity of bonds, we avoided the depreciating effect of rising rates on the value of long-term bonds. What’s more, this gave us the flexibility to take advantage of higher rates as they rose. Indeed, high-quality corporate bonds are currently offering yields in excess of 5.5% for terms of 12 to 18 months, rates not seen in decades. Given the eventual stabilization of rates, our expectations for this asset class are high for 2023. As we approach the peak of rate forecasts, it will be interesting to gradually lengthen the maturity of securities. This will have the effect of stabilizing the portfolio’s yield and immunizing it when the markets, in 2024, anticipate the start of a rate cutting cycle. Currently, long-term rates are higher than the neutral natural rate, towards which they should return when a new economic cycle is in sight.

High IT valuation

Q2 results announcements will begin shortly. Expectations are low in Canada (-7.5%) and south of the border (-6.4%). However, we are paying close attention to the S&P 500’s P/E ratio. At 19.3 times expected

	Q1 (R) 2023	Q2 2023	Q3 2023	Q4 2023	Year 2023	Year 2024	Forward P/E
Forecasted Earnings Growth (Year over Year) and Forward Price-Earnings Ratio							
S&P/TSX	-9.3%	-7.5%	-3.4%	1.2%	-3.7%	9.2%	12.9
S&P 500	0.1%	-6.4%	1.1%	9.3%	1.0%	11.9%	19.3

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

Source: Refinitiv (Thomson)

earnings, we can’t expect the stock market to perform that well for the rest of 2023, especially from tech. The IT sector is trading at 27 times 12-month forward EPS. This makes no sense in the current environment. Investors are generally willing to pay a higher multiple for future growth. But beware of AI euphoria! Stocks seem inflated to us right now. For example, Nvidia is trading at over 220x realized EPS and 55x expected EPS. Buying opportunities will come to those who wait.

Conclusions and forecast

In 2022, despite a significant and simultaneous decline in equities and fixed income – something we haven’t seen in 40 years – we performed well thanks to alternative funds, equities, as well as short-term bonds. We plan to continue gradually extending the duration of fixed-income securities as the bonds we hold mature. Data is showing signs of a slowing global economy, but central banks may nonetheless continue to raise rates for some time due to persistent inflation. In Canada, the economy is doing better, and the end of rate hikes seems closer.

This year, we were surprised by the surge in US equities. With tech, the NASDAQ grew by over 30% and the S&P 500 by about 15%.² Generative AI, with its ability to learn and adapt, has created a frenzy. Superior AI could emerge rapidly and bring incredible gains in productivity and profitability. However, given the excessive valuation of US equities, weakening S&P 500 earnings forecasts and dwindling liquidity, caution is called for. What could be better than a quality, dividend-paying, well-valued stock at this point in the cycle? As we did last year, we recommend defensive stocks and avoid overvalued ones for the final stretch to 2023. The Canadian stock market stays interesting, as are certain alternative funds.

² The June 30 return is around 5% for the S&P 500 equal-weighted Index (an index that gives equal weight to all, including IT mega-companies).