Views from the Desk

Updates in the Equity and Fixed Income Market

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Canadian CPI & Currency

Inflation is still top of mind for investors in 2023. The Canadian CPI print came in ahead of expectations. The core was resilient, but the headline number is trending in the right direction. 4 months ago it was 7%, and the last 3 months 6.8%. The overnight interest rate, pricing in for next meeting, has a greater than 50% chance of a 0.25% rate hike at the January meeting. The BoC is probably going to take a pause. Supply chains are healing and with tighter money policy we are seeing inflation starting to recede on the goods side while Energy is resilient, given the Russian/Ukraine conflict. Housing market data across the country show listings are sitting stale and then relisted at lower prices. Globally the Fed is the furthest ahead in the inflation fight. If there is a rate differential, it's likely to increase in favour of Canada. The Canadian dollar more likely to strengthen, especially with the strength of the energy sector right now. Therefore, hedging currency exposure is a good idea in 2023.

International and Emerging Markets

There was a rebound in both International and Emerging Market equities in Q4 2022 and early 2023. Both did not rebound as drastically as CDN or US equities post-covid. Valuations did not get stretched to the same degree and that valuation advantage helps. As well the positive sentiment changes around Europe's economy helped drive performance. High energy prices during the winter were expected to cause an economic slow down. However, cost constraints have come down. Netherlands Natural Gas spiked to $300 and came down $50-$60. Inventories were managed and weather was milder. So Europe will be able to weather the storm better than expected, without having to rely on Russian oil and gas. A bounce off the bottom for Int'l currencies – Euro, Pound & Yen. Weaker against USD and CAD in 2022, but going forward a weaker USD favors those Int'l currencies. We favor maintaining a unhedged exposure, for Canadian investors. Emerging Markets bounce backed on China re-opening news. We saw China 3% GDP growth in 2022. Weakest growth in a number of years, but still a strong number. The risk is how widely Covid may spread through the country. The USD starting to weaken is a tailwind for emerging markets since EM debt is issued in USD, and that debt burden can lessened based on currency. 2023 should look better than 2022.

Gold

Gold has mounted a rally. Gold bullion is up about 17% in USD terms, since November 2022. Despite inflation receding, it still provides a hedge against the USD, and geopolitical and macroeconomic risks. If the strength of the USD reverses, this will be favorable for Gold. Gold bullion has a lower correlation to equities, so it serves the purpose of diversification. When markets are behaving in an orderly fashion, gold equities could outperform Bullion. Because of operational leverage from companies and higher beta to gold prices. Gold futures are upward sloping, this is a positive for gold companies. There are operational and political risks associated with individual gold mining companies. ZGD – BMO Equal Weight Global Gold ETF allows you to diversify across many larger cap companies. And with ZJG – BMO Junior Gold Index ETF the focus is on smaller cap companies. Gold is an interesting asset class for 2023 if the USD continues to fade.

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