The Market in Review

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This week's articles and insights

"Been Down So Long It Looks Like Up to Me"

- *Richard Fariña, novelist*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	29,927	-7.27%	-17.64%
S&P 500	3,667	-8.74%	-23.07%
TSX	19,004	-7.59%	-10.45%

Farewell Bull Market

The pandemic recession of 2020 was – officially – the shortest recession on record. It started in March and ended in June of that year.

This week ended the shortest bull market in history. It began in June 2020 and ended in June 2022 when the S&P 500 officially fell more than 20 per cent from its peak in

January. Canada's S&P/TSX is down only eight per cent, and so is not in an official bear market, even though it may feel like exactly that.

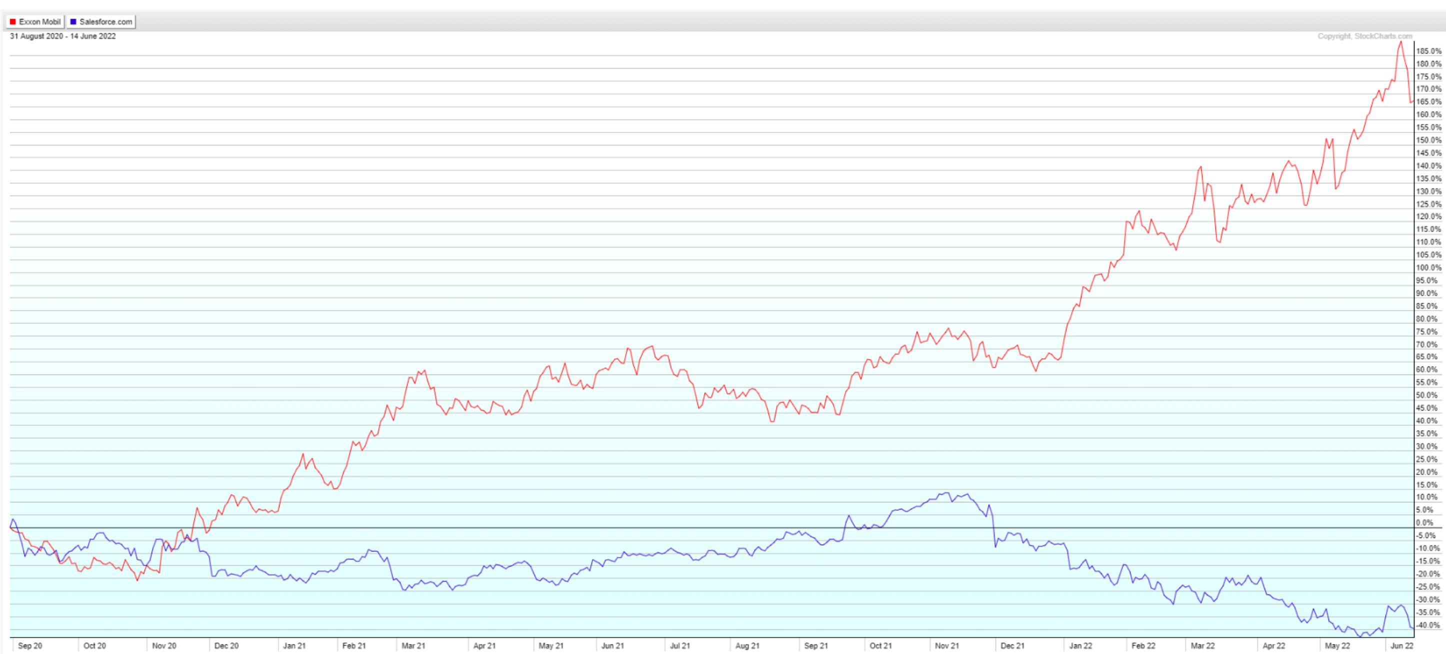
What makes this one especially painful is the decline in the bond market. Bonds are considered a safer place to invest – a life preserver when stock markets get rocky. This time, however, bonds have been hit with sharply higher interest rates, and returns on many bonds are close to -10 per cent. Some of the worst returns on record.

Even gold is faltering in the face of rising rates.

The only sector that has shown any life this year is energy. Oil hitting US $123 per barrel means oil and gas companies are making huge profits, and their shares have risen accordingly.

In fact, it is ironic that Exxon Mobil (**NYSE XOM**) was booted out of the Dow Jones Industrial Average in August 2020 to be replaced by Salesforce (**NASDAQ CRM**), a technology company. A "yesterday" company replaced by a "tomorrow" one.

Exxon has gained 165 per cent since leaving the index while Salesforce is down 40 per cent.



How's that for bad timing?

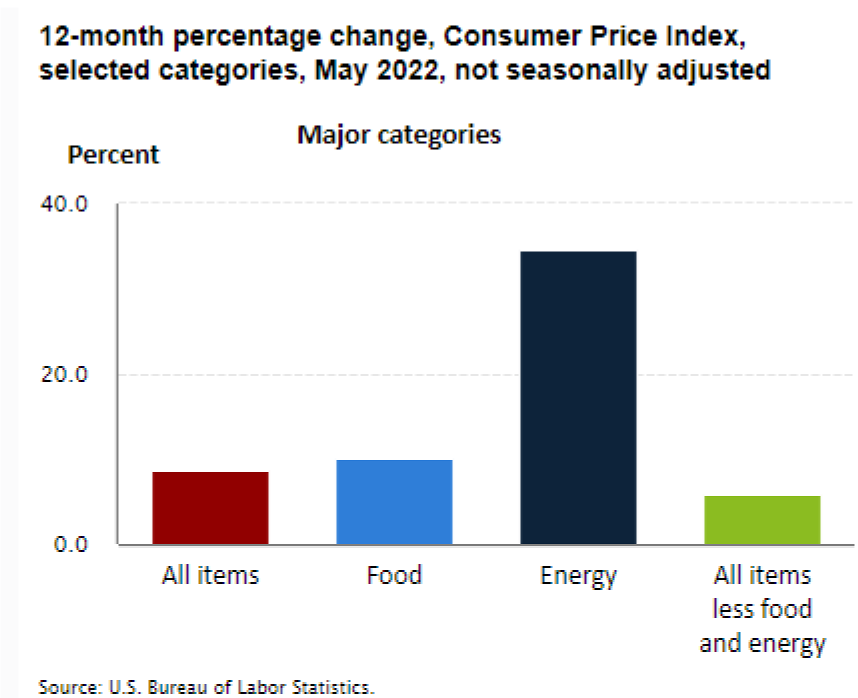
In hindsight, zero per cent interest rates, trillions in newly printed money, and pandemic idleness fueled a stock market bubble. All this money led to skyrocketing inflation, which is forcing central banks to push interest rates higher.

On Wednesday this week, the U.S. Federal Reserve increased its key lending rate by 0.75 per cent to 1.50 per cent - the biggest one-day jump since 1994. And there are likely more hikes to come.

On Thursday, the Swiss Central Bank lifted its rates for the first time in 15 years – a big change for that small country.

Double, Double, Oil and Trouble

The root of almost all of the inflation? Oil prices – up 60 per cent in the last year. Oil affects almost every component of the Consumer Price Index (CPI): food, transportation, housing, etc.



The global environmental movement convinced most voters that we could switch easily from dirty energy sources – oil, natural gas, nuclear – to clean sources such as wind and solar. The reality is, we can't. At least not yet.

This was driven home to me in my recent trip to Portugal. Portugal produces almost 78 per cent of its electricity from renewable sources, which are primarily wind and hydro dams. Portugal is blessed with a number of rivers and so has built 60 dams.

The rest comes mainly from natural gas. This will be harder to replace by renewables, especially with solar energy. Why? The sunniest places are the best ones to plant solar cells, and those also happen to be the best places for tourism (the Algarve in the south) and the wine region in the north (the Douro Valley).

When faced with the choice of solar panels or grapes, many would argue that it is far more economic to plant grapes up to the top of every hill.

So, getting to 100 per cent renewables using solar is not really an option for Portugal.

To power our energy-hungry world, our choice is not either renewables *or* conventional sources. It is both. The two industries can – and have to – work together over the next 30 years to transition most efficiently.

Meanwhile, rising interest rates are causing home sales to decline rapidly as well as automobile purchases. Discretionary purchases like cruises and hotel bookings may be next. Retail stores are also seeing slowdowns due to substitutions of things like food products - hamburger for steak, etc. We will likely be reading more about layoffs in the coming months rather than labour shortages.

A recession will lower oil demand temporarily. But, as it always does, demand will come back even stronger due to our increasing use of computers, air conditioners, electric devices, and desire to travel.

Is a recession imminent? The data says no, but the experts seem to reveal the figures well after the fact. So, we may be in one and not realize it for another six months.

The Bottom Line

The stock market is a leading indicator of what we expect to happen over the next 12-18 months. The market is telling us that the economy is going to slow down and there could be more bad news, like layoffs.

However, the market decline suggests that some – maybe most – of this bad news is largely priced in. What we need to see is declining inflation. We expected 8.3 per cent or less in the June report and got 8.6 per cent instead – exactly the wrong direction. And that was why stocks sold off.

The U.S. market – the largest in the world – has experienced the following losses in each of the last four bear markets. In every case, markets worked back to new highs over several years.

2000-2002	**-$7.0 trillion in market losses**
2008-2009	**-$8.1 trillion**
2020	**-$9.8 trillion**
2022	**-$9.3 trillion (so far)**

Each period highlighted above, except the 2020 pandemic decline, resulted from speculation in one area. This mania took the rest of the stock market too high, which then corrected.

- In 2000, it was the dot.com stocks.
- In 2008, it was NINJA mortgages (No Income No Job or Assets).
- In 2022, it was cryptocurrencies and cloud stocks.

Cryptocurrencies are now down in overall value by almost 70 per cent. About the same for the cloud stocks.

We – you, our clients – survived all these bear markets because we held reasonably priced stocks that declined less in value. We – you – will once again.

Are we at the bottom? Probably not. Central bankers are set on raising rates until inflation cools off. The minute we see this, interest rate hikes will slow or even stop. And then stocks can prosper again. Interest rate hikes have a ways to go yet.

2022 has seen one of the fastest declines in the history of the U.S. stock market, and our comments are not intended to downplay that. But just as most investors were very bullish last year, most are very bearish right now. The crowd is always wrong at both ends.

In the meantime, oil can't go up forever. Same for inflation. Values are appearing in various industrial, drug, and finance stocks – companies making extraordinary profits that the market is currently ignoring.

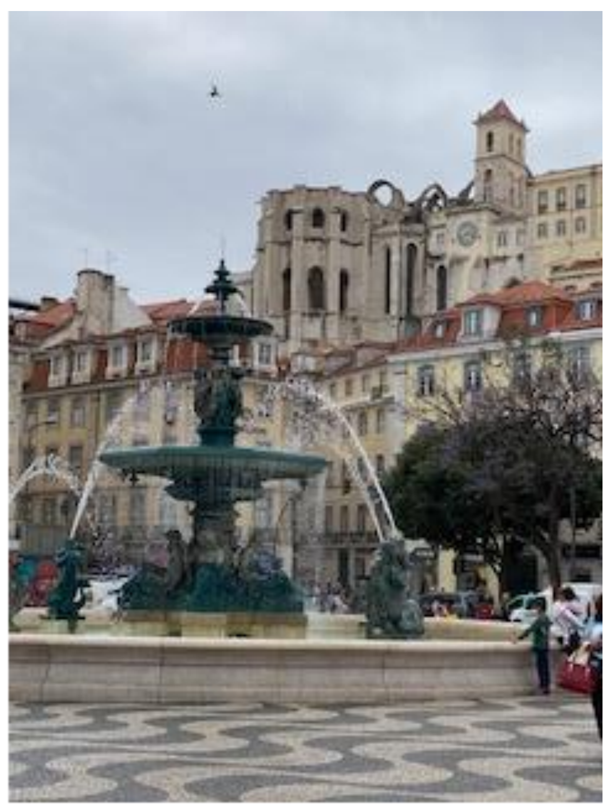
Portugal Perspectives

I travelled to Portugal recently, a trip delayed for two years because of Covid. You can't escape the movement of markets wherever you travel, but Portugal does help take your mind off it for a time.

There are Moorish castles to explore.

Catholic ones too.

Charming squares.



And of course, the wine country of the Douro Valley with its giant port industry.

Portugal is one of the poorer European Union countries, but it is on the mend with tourism returning.

Prices are lower than in Canada by a little. I did the Big Mac comparison and found that the famous burger costs about $5.40 in Lisbon compared to $6.00 in Canada. Wine and taxi fares are definitely cheaper there than here.

I met a number of travellers from Germany, all of whom are still shaking their heads at the sudden decision to spend $100 billion on defence after years of passivity and the rapid cancellation of energy purchases from Russia. These are real sea-changes for Germany.

I ran into an American senior officer of a global tool company who said they have raised prices by close to 40 per cent this year and their profits are still shrinking because costs are rising even faster. Inflation is a global issue.

I tried to determine the price of wine acreage and the profitability of winemaking in Portugal and came to the conclusion that it is the same as Canada's Okanagan Valley. Investors don't make much selling wine. Rather, they make the money selling wineries.

We visited the *Dinheiro Museu* – the Money Museum – in Lisbon and learned that the Bank of Brazil was one of the world's first banks to issue paper money that could be exchanged for coin – the modern model of the gold standard. It was set up in 1809 to finance the overspending of the Portuguese court.

It was the first bank to print paper to finance government deficits. Some things never change.

Thank you for your referrals this month! They are always handled with great care and discretion.

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