The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, Sharon Mitchell, and Lincoln Jiang
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

"Easter is the only time when it's perfectly safe to put all your eggs in one basket."

- Evan Esar

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,565	+0.20%	- 4.88%
S&P 500	4,447	-0.77%	- 6.70%
TSX	21,838	+0.23%	+ 2.90%

The Perfect Storm

Officially known as the *Hallowe'en nor'easter* of 1991, the fierce storm that appeared off the coast of New England would go on to become the basis for the movie "The Perfect Storm." What made it so deadly was that it was not one, but three storm systems coming together at once. There are parallels to the 1st quarter of 2022.

The first storm was "a little, innocuous low-pressure system" that formed over the Great Lakes and headed east. We can compare this to the well-telegraphed plan by global central banks to raise interest rates through 2022. Periodic small hikes at each Fed meeting were expected to produce little in the way of surprises.

The second storm in 1991 was a powerful high-pressure arctic system rolling down from Canada. Canada sends winter storms south every year, but this one was especially strong. We can compare this to the burst of inflation that began in 2021 and intensified in 2022. Inflation is now running at 6% annually in Canada and 8% in the U.S. – the highest rates in decades.

In 1991, the "innocuous" eastern system hit the Canadian arctic one over the North Atlantic and started a large storm. Not unlike how Q1 of 2022 began for financial markets.

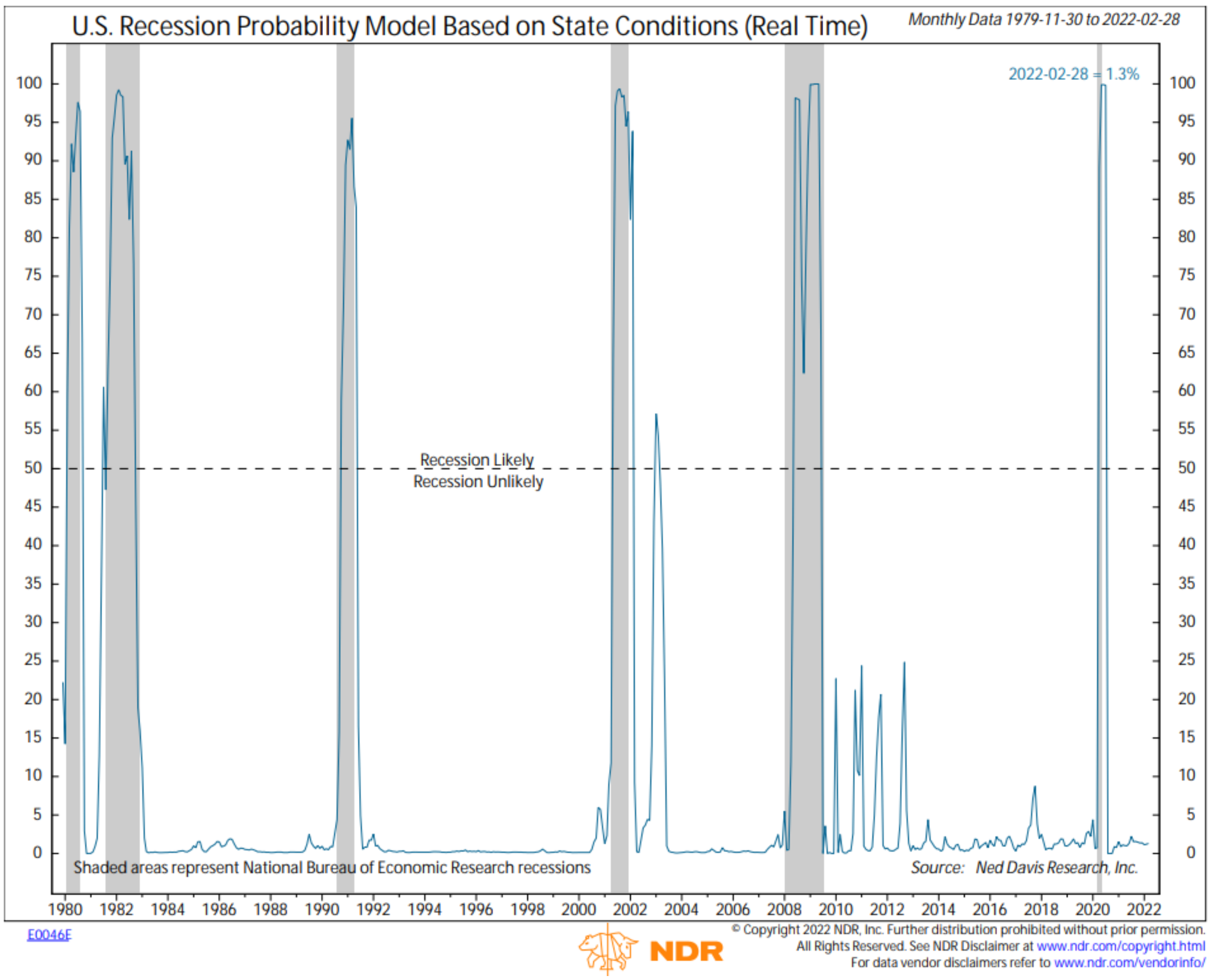
But what turned the *Hallowe'en nor'easter* into the Perfect Storm was a late season hurricane that blew up from the south and collided with the two storms in the North Atlantic. Winds rose to over 100 mph, waves 30 feet high destroyed 200 homes along the New England coast, and rogue waves were measured at over 100 feet high.

This third storm for financial markets was the Russia-Ukraine invasion that began February 24th. Now displacing over 6 million people, the war sent oil prices to $130 per barrel, fertilizer prices to multi-year highs, and wheat in storage to record lows as spring crops were delayed or destroyed. The war ramped commodities, which then accelerated inflation, which then drove Federal banks to tighten faster. The perfect financial storm, in other words. Bond markets, while not as negative as equity markets, have seen their worst returns since 1994. And the interest rate hiking cycle has barely begun.

However, (there is always a however)...

The current likelihood of a U.S. (and Canadian) recession is low.

It is certainly higher in Europe, China, and Russia, but for now, North American economies continue to generate jobs and grow.



What needs to be seen, happens on page 17

Years ago, a financial commentator named Donald Coxe, pointed out that the most important page to read in the newspaper was not page 1, but page

17. Page 1 told you what people were most concerned about and interested in. This meant those events had already been ‘digested’ by the market.

Page 17 alerted you to stories that were brewing – small, anecdotal tidbits that often grew into bigger issues in the weeks ahead. Think of the Covid-19 pandemic. It was news from China that didn’t concern us, until it did.

“There is only one kind of shock worse than the totally unexpected: the expected for which one has refused to prepare.”

— Mary Renault

So, I decided to have a look at page 17 of the business paper today. There’s just one problem – have you tried to buy a paper copy of *Barron’s* or *The Wall Street Journal* lately? Many stores no longer even stock them, and many “papers” have gone fully digital.

Fortunately, Barron’s publishes an electronic version of its venerable weekly, so there actually is still a page 17. What does it discuss this week?

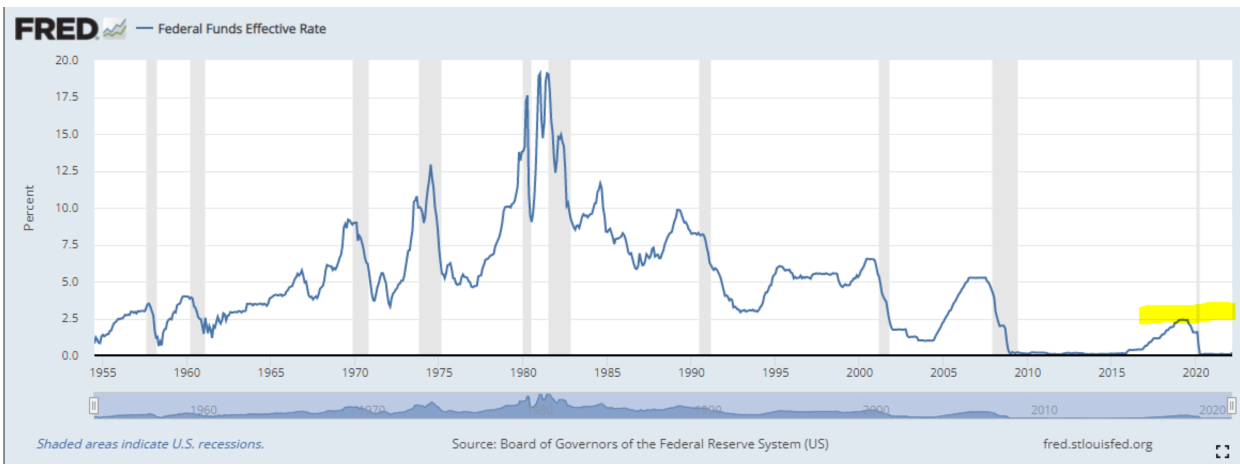
The horrid returns of bonds. High grade corporate bonds are -7.1% so far in 2022. 20-year government bonds are -13.6% and U.S. municipal bonds are a staggering -16.6% in just three months.

Readers of our letters know that interest rates have been rising sharply this year and bond prices have been falling. As this story moves from page 17 to the front of page 1, expect to read these headlines in the months ahead:

- **Real estate sales plummet**. Mortgage rates are going up, which means real estate cools off. Home sales are slowing in both New York and Toronto. Lumber prices are already down sharply.
- **The end of “T.I.N.A.” – *There Is No Alternative***. TINA was a saying when cash and bonds yield so little that stocks were the only place to invest. Well, bonds are increasingly competitive with stocks once again. Some money is moving back to bonds, causing some of the weakness in stocks.

By the time the story about bond yields rising moves even to page 10 or page 5, most of the damage will be over. In fact, it is worth asking "*how far can rates go?*" right now.

The U.S. Federal Reserve expects short-term interest rates to rise to approximately 2.5% by the time they are done in 2023. Canada is likely to follow the same path, as our economies and currencies are tied closely together.



However, because interest rates are rising at the same time the Fed is dumping bonds it bought during the pandemic (to lower interest rates and held funds all the stimulus measures), some think T-Bills can only get to 1.70% before the economy shudders to a halt.

Whether or not this is true, it does suggest that short-term bonds, term deposits, and guaranteed investment certificates with 1-2 year terms are very attractive right now. Some are already at the "terminal rate" peak in rates seen for 2023:

	1 year yield	2 year yield
Canada Government Bonds	2.00%	2.18%
US Government Bonds	1.65%	2.10%
Corporate Bond (banks)	2.46%	3.04%
GICs	2.50%	3.10%

Bottom line? Short-term bonds and GICs are very attractive for excess cash right now.

"Ninety-nine percent of individual investors think rates are going higher. But a lot of that is already priced into markets."

- Bryn Torkelson, Matisse Capital (in Barron's)

Get Me Some of that Lithium

The war in Europe has caused a great deal of interest in electric cars, simply because they are much cheaper to "fill up" than a standard gasoline-powered vehicle. There are already year-long waits for some electric models, as a result.

The problem is not <u>how</u> can we build enough faster - it is <u>can</u> we build enough at all?

In a letter delivered to the British Committee on Climate Change by researchers at research program SoS Minerals, they examined the amount of rare earth minerals needed for the U.K. to switch to an all-electric fleet. Bear in mind, this excludes both commercial light and heavy goods vans and trucks.

"To replace all UK-based vehicles today with electric vehicles…represents just under two times the total annual world cobalt production, nearly the entire world production of neodymium, three quarters of the world's lithium production and 12% of the world's copper production."

And building the wind farms to power all those cars would require years' worth of production of all of these metals.

Britain has 67 million people – the U.S. has 5 times as many. Canada has pledged to go completely electric as well. We will be competing with the UK, the U.S., China, and all the other nations wanting to electrify.

The numbers suggest that oil usage must continue, even as the world electrifies, because there are not enough minerals yet to switch over completely. It also suggests that countries such as Argentina and Chile (lithium), Mexico (copper), and Canada (nickel, copper) could become the Saudi Arabia's of tomorrow. But in metals, rather than petroleum.

And the Amazon's and Google's of tomorrow may be battery and electricity management companies…

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca
sharonmitchell@raymondjames.ca
lincoln.jiang@raymondjames.ca

(250) 405-2417

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Prices shown as of April 13th, 2022