June 27, 2022

RICHARDSON Wealth

Market Ethos

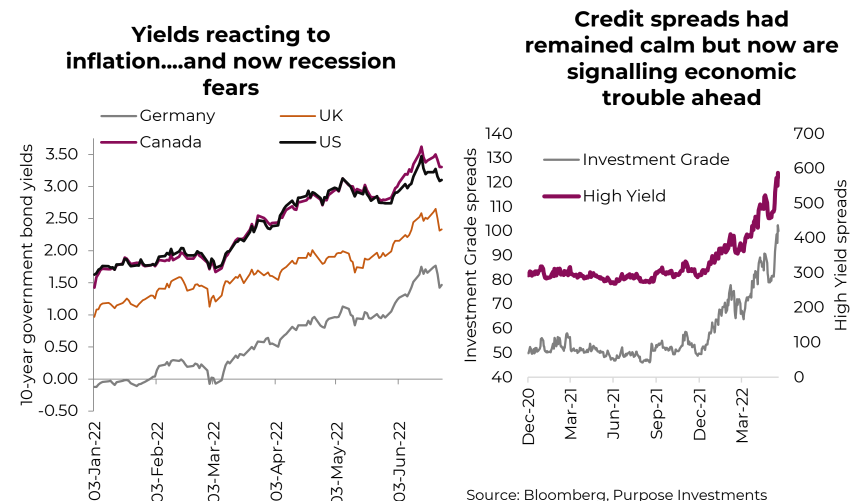
The latest market insights from Richardson Wealth

The good news and the bad news

We, and just about anyone else penning market missives, have been referencing the coming economic slowdown. And it is literally what tightening financial conditions are trying to achieve – with slow growth and lower aggregate demand, inflation will fall [even with supply bottlenecks and war issues].

It's good news as it will help the inflation pressures; however, the bad news is too much slowing, and we have a whole new set of problems.

Canada just posted a multi-decade high CPI of 7.7% year-over-year, yet the market is already looking past inflation to slowing economic growth. Bond yields across the globe have abruptly changed course over the past week and moved lower. Credit spreads, which had remained largely contained during the bond market weakness of 2022, have accelerated higher.



Source: Bloomberg, Purpose Investments

Tightening "financial conditions"

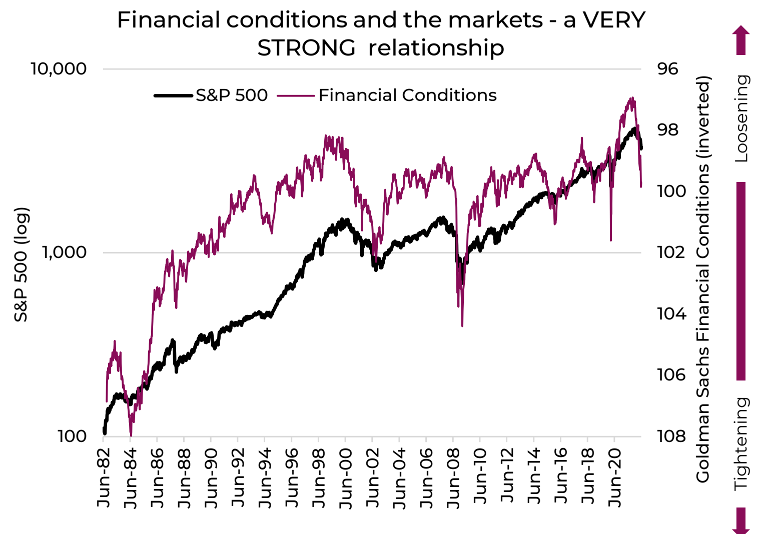
With higher bond yields (rising year-to-date until this past week), wider credit spreads, equity market volatility, plus almost all central banks raising their overnight lending rates, there's no denying financial conditions have tightened significantly.

Financial conditions is a catch-all phrase that attempts to capture how available credit is to investors and businesses, plus the cost of that capital. Numerous indices attempt to measure financial conditions – the chart below is the Goldman Sachs measure. Regardless of your favourite financial conditions measure, there is a strong correlation

Sign up here if you do not already receive the Market Ethos directly to your inbox.

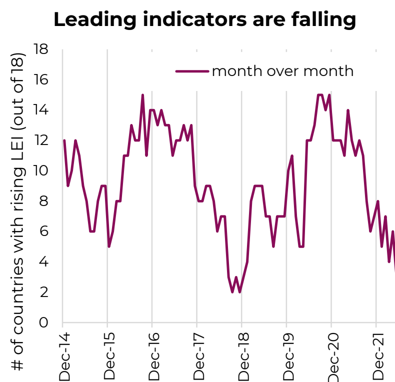
between changes in financial conditions and the equity market. Conditions get more relaxed, and markets rise; conditions tighten, and markets fall. And so far in 2022, **conditions have been tightening**.

Changes in financial conditions don't just make the markets move up and down, they affect the pace of economic activity. However, it does not chart as cleanly because the economy's reaction time depends on several factors. For instance, tightening financial conditions with solid economic momentum often doesn't register for quarters or even years. Also, changes in financial conditions appear quicker in parts of the economy and slower in others.

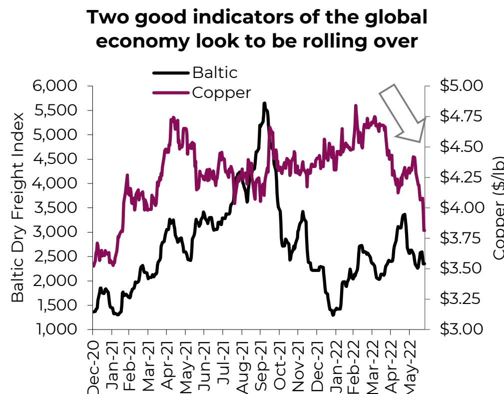


This year, it's showing up very fast. Perhaps because rate hikes are coming at a time of slowing economic growth, an historical anomaly. Usually, rate hikes and tighter conditions come as the economy expands too quickly. This time, between consumers pivoting from goods to services and the removal of pandemic fiscal supports, the economy was cooling before the financial conditions began tightening.

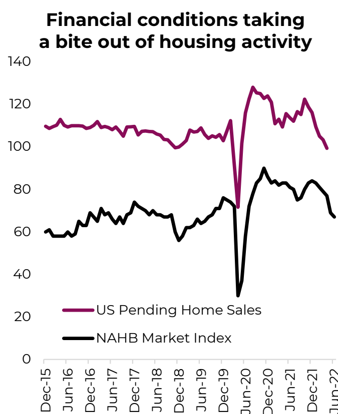
The old economic rule of thumb was that rate hikes – one of the key tools that impact financial conditions – don't impact the economy for a full year. But rules of thumb are not laws. Tighter financial conditions are having a faster impact than usual on economic activity.



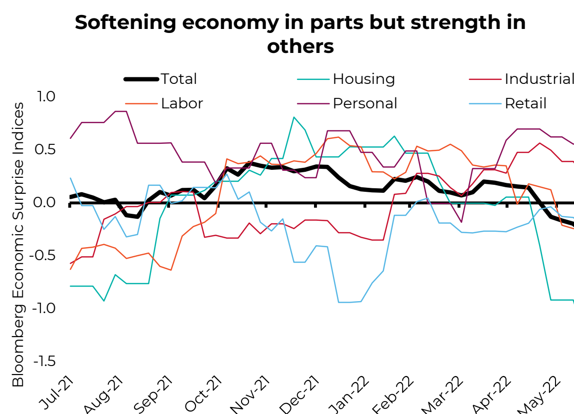
Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments

Recession talks will continue

The weaker economic activity will continue as the bite of tighter financial conditions digs in. **This is good news for inflation, which is increasingly showing signs of topping and hopefully coming back down**, raising the big question as to the timing of the next recession. We expect this recession talk to increase in the coming months but make no mistake, this is required to address inflation.

Our confidence in central banks managing a soft landing is low. Inflation makes the feat more difficult, as does the previous elevated pace of economic activity. It's hard to manage a soft landing when global growth in 2021 was as high as 5.8%. But the timing of the next recession is very uncertain. Industrial activity remains decent, consumers continue to spend, and Asia is emerging from COVID lockdowns.

Impact on portfolios

The markets are in a bit of a manic phase at the moment and are overreacting in different ways. While inflation risks may be starting to ease, recession risks are rushing in as a replacement. Meanwhile, markets have already priced in a good dose of bad news. 2022 is a tough year with the repricing of most assets.

We continue to believe inflation is a bigger risk for the markets than a recession, and as inflation concerns fade, markets could enjoy a decent reprieve bounce. We will take a closer look at recession risks in our second half outlook.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

The contents of this publication were researched, written and produced by Purpose Investments Inc. and are used by Richardson Wealth Limited for information purposes only.

*This report is authored by Craig Basinger, Chief Marke t Strategist, Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

Disclaimers

Richardson Wealth Limited

The opinions expressed in this report are the opinions of the author and readers should not assume they reflect the opinions or recommendations of Richardson Wealth Limited or its affiliates. Assumptions, opinions and estimates constitute the author's judgment as of the date of this material and are subject to change without notice. We do not warrant the completeness or accuracy of this material, and it should not be relied upon as such. Before acting on any recommendation, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice. Past performance is not indicative of future results. The comments contained herein are general in nature and are not intended to be, nor should be construed to be, legal or tax advice to any particular individual. Accordingly, individuals should consult their own legal or tax advisors for advice with respect to the tax consequences to them.

Richardson Wealth is a trademark of James Richardson & Sons, Limited used under license.

Purpose Investments Inc.

Purpose Investments Inc. is a registered securities entity. Commissions, trailing commissions, management fees and expenses all may be associated with investment funds. Please read the prospectus before investing. If the securities are purchased or sold on a stock exchange, you may pay more or receive less than the current net asset value. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.

Forward Looking Statements

Forward-looking statements are based on current expectations, estimates, forecasts and projections based on beliefs and assumptions made by author. These statements involve risks and uncertainties and are not guarantees of future performance or results and no assurance can be given that these estimates and expectations will prove to have been correct, and actual outcomes and results may differ materially from what is expressed, implied or projected in such forward-looking statements. Assumptions, opinions and estimates constitute the author's judgment as of the date of this material and are subject to change without notice. Neither Purpose Investments nor Richardson Wealth warrant the completeness or accuracy of this material, and it should not be relied upon as such. Before acting on any recommendation, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice. Past performance is not indicative of future results. These estimates and expectations involve risks and uncertainties and are not guarantees of future performance or results and no assurance can be given that these estimates and expectations will prove to have been correct, and actual outcomes and results may differ materially from what is expressed, implied or projected in such forward-looking statements. Unless required by applicable law, it is not undertaken, and specifically disclaimed, that there is any intention or obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

Before acting on any recommendation, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice.

The particulars contained herein were obtained from sources which we believe are reliable but are not guaranteed by us and may be incomplete. This is not an official publication or research report of either Richardson Wealth or Purpose Investments, and this is not to be used as a solicitation in any jurisdiction.

This document is not for public distribution, is for informational purposes only, and is not being delivered to you in the context of an offering of any securities, nor is it a recommendation or solicitation to buy, hold or sell any security.

Richardson Wealth Limited, Member Canadian Investor Protection Fund.
Richardson Wealth is a trademark of James Richardson & Sons, Limited used under license.