WATERMARK PRIVATE PORTFOLIOS JULY 2022 COMMENTARY

Stock markets finally rallied in July as interest rates appear to have peaked, at least in the short run, allowing technology and growth stocks to have a good month, with the Nasdaq leading the charge higher. The S&P500 (in CAD) returned 8.7% for the month, while the TSX Composite was up 4.7%. With interest rates retreating from highs, bonds finally put in a good month, as the Canadian Universe Bond Index increased by 3.4%, cutting into this year's large loss on the Index. However, bonds rallied (and interest rates fell) on increasing fears of a recession, meaning future growth is expected to be lower, which would be positive if a recession curbs inflation.

Markets

Inflation and interest rates continue to move stocks both up and down, resulting in a volatile stock market. However, with interest rates looking like they peaked in June, the market (S&P500) had a roaring start to July, led by technology stocks. Furthermore, when the US Federal Reserve Bank (FED) raised rates near the end of the month but stated that they would be "data dependent" with future interest rate decisions, the S&P500 moved higher. It is clear the market believes peak inflation is behind us, which should allow the FED to change course from being aggressive to being supportive of markets. Further evidence of this occurred when US GDP came out negative for Q2, putting the US in a "technical recession" of 2 or more quarters of negative GDP growth. Yet the market once again rallied on expectations that the FED will provide accommodative monetary policy within 9 months.

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This once again leaves a tough market, where on one hand, stocks can rally if valuations increase, which typically happens when the FED is providing stimulus. On the other hand, if earnings come in weak during a recessionary period, then companies should sell off. Bloomberg, one of the top financial news outlets, shared the chart below, which shows the losses year to date, broken out between the price you pay for a company (P/E multiple) and the earnings of the company:

1. Blue Bar: The year-to-date fall in equity markets has been based on company valuations being reduced, as central bank policy has been tightening economic conditions and taking stimulus out of the economy. In this environment, stocks are not worth as much when one can now get a better rate of return on a GIC or a 5-year bond than they previously could and may not need to be as aggressively invested in stocks.

2. Black Bar: Companies earnings have been growing year to date, which is positive, however, should the recessionary period we are in continue, then it is likely that the average company in the S&P500 will also see their earnings go negative.

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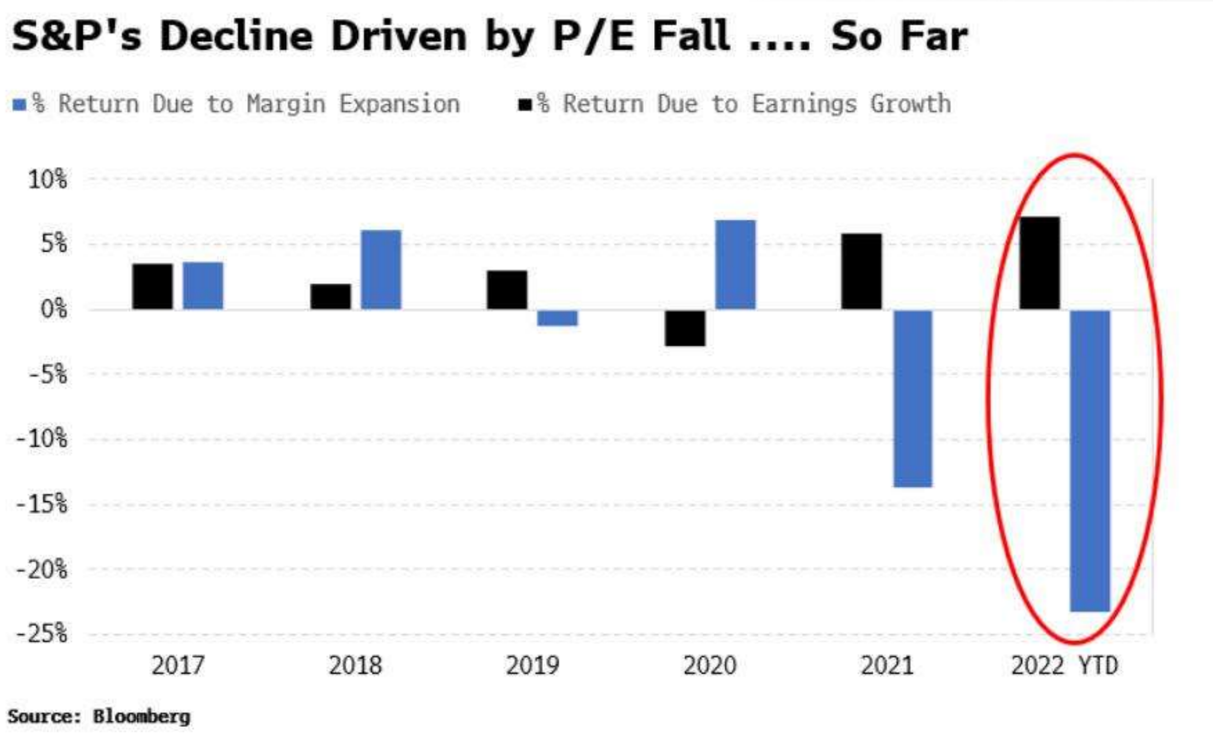

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This leaves us in an environment which should remain volatile as every economic data piece is scrutinized and bad news may actually result in the S&P500 rallying:

1. Poor economic news (ie. weak home sales, low Purchasing Managers Index, lower inflation, and weak employment data) may result in the S&P500 rallying in anticipation of future support from central banks.

2. Strong economic reports may result in the S&P500 falling in anticipation of more rate increases from central banks.

During the month, we moved out of cash and into a growth ETF (80% Equities and 20% Fixed Income) with the idea that it would participate in equity rallies, but also protect on the downside should we see more sell-offs. We will continue to watch how the market reacts to economic news and when we have more confidence that stocks have bottomed, we will increase their weights in the portfolios. It's important to remember that recessions are a normal part of the business/economic cycle and should not be feared and should we go lower, it will give us an opportunity to rebalance the portfolios into great companies at a lower price.

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