Johnstone Wealth Management Market Commentary June 30, 2023

In the second quarter, financial markets put aside concerns over growth, inflation, and US regional banks, generating gains in most equity markets. In contrast, bonds lost ground as interest rates rose by a meaningful amount with central banks continuing to raise policy rates, albeit at a more modest pace.

Canadian GDP was flat in April, but it is expected to reach an annualized pace of 1.4% for the second quarter, which is just slightly above the Bank of Canada's April Monetary Policy Report forecast of 1.0%. Canadian inflation matched expectations, slowing to 3.4% year-over-year in May—its weakest pace in two years. Canada's job market had an unexpectedly strong start to the year and continues to show momentum into the second quarter even with May's data ending the longest run of job gains since 2017. Internationally, with the backdrop of high and sticky core inflation, economic activity moderated across developed markets as central banks continue to push policy rates higher.

Equity markets continued their upward trajectory in the second quarter, with most global markets posting solid gains (gains in Canadian dollars terms were tempered). US markets were notably strong, as technology rallied significantly on optimism surrounding all things related to artificial intelligence (AI). This extended to the Consumer Discretionary sector, where trends remained positive despite ongoing monetary tightening by central banks. Lagging global sectors included lower-growth utilities, telecoms and real estate. International markets (EAFE) were also generally positive, where Japan has been a more noticeable outperformer versus European markets. The Canadian market also posted gains, with technology shares helping to offset a weaker performance in materials and energy.

Financial markets had been expecting interest rate cuts in the second half of the year, but those expectations have largely disappeared as central banks reinforced the view that their job of slowing the rate of inflation is not over. The change in tone led to the sharp underperformance of short-term bonds relative to long-term bonds, resulting in further inversion of the yield curve.

After pausing in the spring, the Bank of Canada hiked its benchmark interest rate by +0.25% (to 4.75%) in June. This move by the Bank ended a conditional pledge it made in January to pause and assess how the more than 400 basis points of tightening in less than a year would impact Canada's economy. The US Federal Reserve, however, chose to skip a hike in June after increasing its overnight rate by 0.25% (to 5.25%) in May. As well, the US federal debt ceiling concerns were resolved during the quarter when a two-year compromise was reached.

Johnstone Wealth Management Market Commentary June 30, 2023

The main Canadian bond index was negative for the quarter, primarily due to rising yields in the short-and mid-term portions of the yield curve. The provincial and corporate sectors broadly outperformed federal bonds, due in part to somewhat attractive valuations and a growing sense that inflation could moderate without the need for a recession.

The current economic climate remains highly uncertain, and investors should expect market volatility to continue for some time. The persistence of recession calls from financial indicators stands in contrast to the real economic indicators which have been slowing but remain at relatively strong levels. Financial markets may be faced with a weaker economic growth environment, which would negatively impact earnings growth, but we expect the positive influence of declining inflation to outweigh the negative influence of slower growth.

As we move forward, the range of possible scenarios is wide as markets navigate an environment of rising interest rates and slowing economic growth. We believe what's most important is being disciplined in adhering to the variables that we can control, such as risk management, active management and asset allocation. Given the wide range of possible scenarios, we remain balanced in our approach in an effort to build resilience over the long-term and not being overly exposed to any one outcome.

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

JOHNSTONE
WEALTH MANAGEMENT GROUP