SV Wealth - Newsletter

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Bad to Worse...

As the leaves started changing colours in September, any hope that the market would change its stripes was quickly dashed. After a rough start to the year, things only got worse as central banks continued tightening financial conditions.

For many indices, September was the worst month since March 2020, when the pandemic first arrived in North America. On top of that, the three American indices have now recorded three straight quarters of decline, the first time this happened since the financial calamity of 2009.

	Sept	Quarter	YTD
TSX Composite	-5.2%	-2.2%	-13.1%
S&P 500 Composite	-9.3%	-5.3%	-24.8%
Dow Jones Industrial Avg	-8.8%	-6.7%	-21.0%
NASDAQ Composite	-10.5%	-4.1%	-27.4%
Crude Oil - WTI	-6.6%	-24.9%	7.9%

Source: Raymond James Ltd.

Crude oil, one of the few bright spots in the market this year, had a nasty quarter. Crude oil is now back to the levels from February, before Russia invaded Ukraine. It might seem odd, but the endless Covid lockdowns in China and the looming global recession are denting oil demand.

Rising Rates Rattle Real Estate

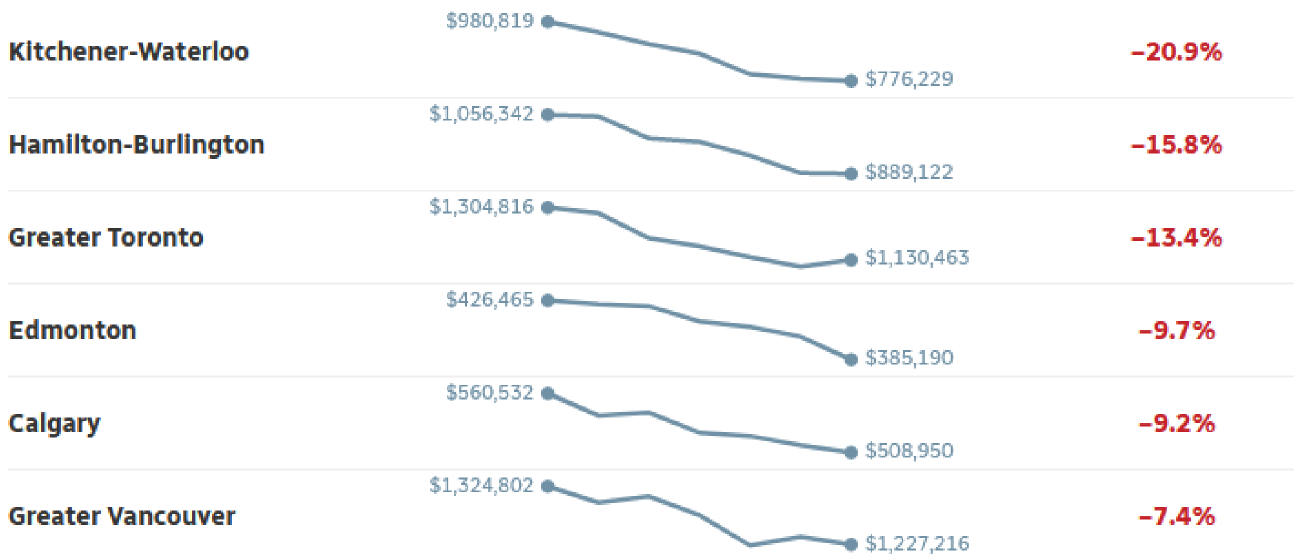
With inflation remaining stubbornly high, the central banks have taken to hiking interest rates aggressively in an attempt to slow the economy. Interest rates have jumped from 0.25 percent in January to 3.25 percent today, the highest level since before the financial crisis of 2008.

Source: CBC News.

Capital markets are scared of an unnecessarily deep recession due to excessive tightening, but the real stress might come in the housing sector as existing homeowners face ballooning costs and fewer people qualify for mortgages.

With the hikes, mortgage rates have risen from 1.5 percent at the start of 2022 to more than five percent now. Given that housing is a big portion of people's expenses, it's one area to watch for economic stress. In fact, the cracks have already started showing as average home prices in Canada are down over 20 percent since February. Sales have also fallen for six months in a row since the Bank of Canada started tightening in March.

Across Canada, Ontario suffered some of biggest declines in housing prices since the peak in February 2022:



Change in average housing prices from February 2022 to August 2022. **Source:**CBC News.

Getting Triggered

Rising rates cause anyone with a variable loan to pay more every month. Most variable rate mortgages give borrowers the option to keep their payments the same, even as rates are changing. As interest rates increase, the amount of each payment that goes to interest versus principal increases. This effectively extends the length of the repayment period, but at least the size of the payments doesn't increase.

If rates increase enough, the payment eventually becomes enough to cover just the interest, something that's not allowed under Canadian lending rules. At this point, the "triggering rate" is hit, and the amount paid each month is adjusted. For most people, this meant an increase of $200 a month on their mortgage payment. If enough people are triggered, there will be some forced sellers, putting further downward pressure on house prices.

According to one housing analyst, around 15 percent of the mortgages in Canada are facing trigger rates, which amounts to around 750,000 mortgages. The saving graces is that recent borrowers all passed the mortgage stress test, which last year would have required them to qualify for a loan at a hypothetical rate of 5.25 percent.

As rates continue their march, it will be important to keep an eye on people having trouble paying for their homes.