SV Wealth - Newsletter

Sabu Varghese, MBA, CIM
Portfolio Manager

Ramzy Saad, CFA, MBA
Associate Portfolio Manager

SV Wealth
Raymond James Ltd.

www.SVwealth.ca

416-499-1555

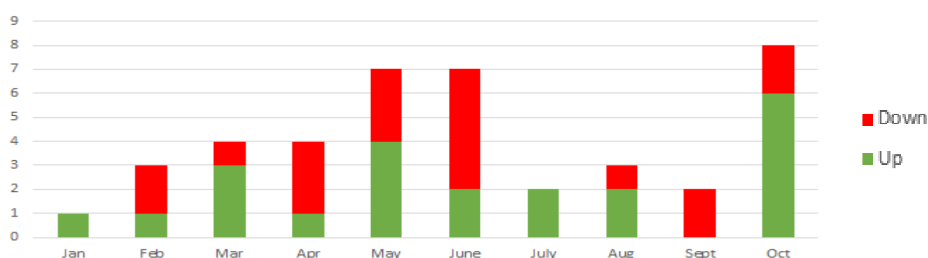
8500 Leslie St, Suite #450
Markham , ON

The Month That Was

Historical seasonality says October is often a rough ride in the markets. While the 2022 edition was wild, it also trended to the upside, providing a welcome relief to the large declines wintessed in September.

The Canadian TSX Composite finished the month higher by more than five percent while the S&P 500 index was up by almost eight. October also proved to be one of the most volatile months of the year, with the index having a daily move greater than two percent on eight of October's twenty-one trading days.

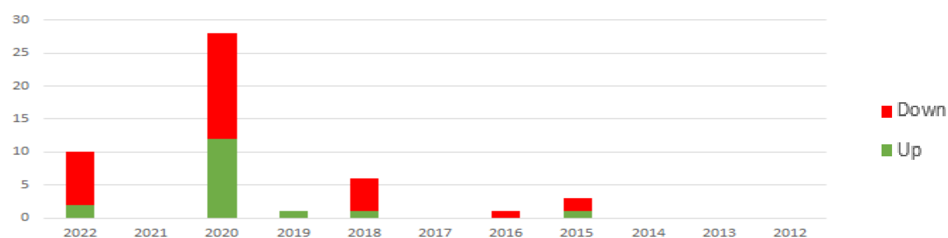
Number of days S&P 500 moved more than 2%



Source: SV Wealth, FactSet

The inflation flare-up that began last year and the resultant rate hiking cycle by central banks has made 2022 one of the most volatile years of the past decade. While nothing compared to the mass uncertainty that prevailed in 2020 with the arrival of the Coronavirus, we've had quite a few days of massive moves of three percent or more this year.

Number of days S&P 500 moved more than 3%



Source: SV Wealth, FactSet

How Rate Hikes Trickle Through Markets

When central bank raise interest rates, the effects tend to first show up in the financial markets before hitting corporate earnings and finally, appearing in the real economy in the form of layoffs and unemployment.

The aggressive tightening of financial conditions has markets fearing that central banks could be hiking rates too far, too fast. Without giving the economy time to digest the hikes, the monetary authorities might be triggering a deeper and longer recession than perhaps necessary to rein in inflation.

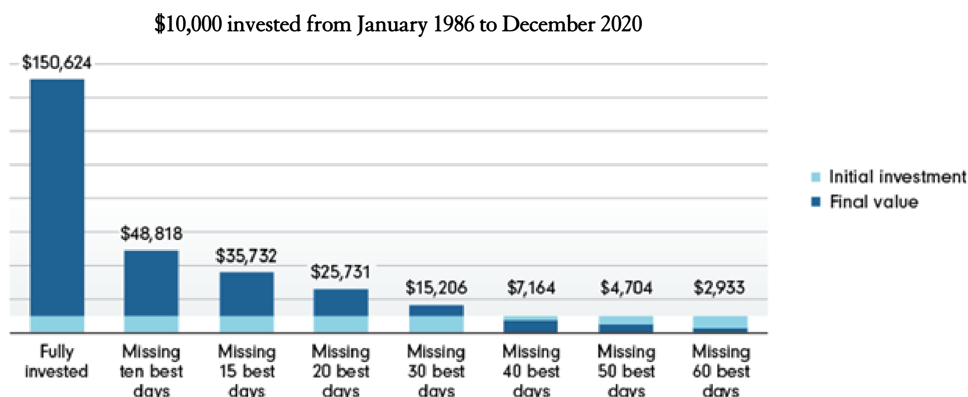
So where are we now? The impact of the current hikes has been reflected in the financial markets, ergo all the volatility. Corporate earnings are still growing but have started softening, gaining only 2.5 percent in the third quarter. For the remainder of the year, analysts are now expecting corporate earnings to decline 1.8 percent, a dramatic reversal from their previous forecast of an 8.7 percent gain. No revision of this size to earnings has historically been made outside of a recession.

In terms of the real economy, unemployment continues to remain low and steady. Cracks are beginning to show, at least in the technology sector that boomed during the pandemic. Layoffs and hiring freezes have been announced at many companies once considered market leaders, including Facebook, Google, Microsoft, and Amazon. In other sectors, the labor shortage appears to be easing rather slowly, with many job openings remaining unfilled.

Overall, it still looks like a recession is on the horizon. Corporate earnings will begin to come down in earnest early next year as the effects of higher interest costs start to bite. As those earnings fall, we can expect to see more broad-based layoffs, leading to an increase in unemployment. At that point, the hope is that inflation will be heading lower.

The Importance of Staying Invested

While October and the year in general have been volatile, they have also had a few days of strong performance. It's those kinds of days that highlight the importance of staying invested. If you were invested in the TSX Composite in January 1986 and missed the ten best days of returns, your portfolio's size would've been one-third those of someone who stayed invested.



Source: Fidelity Investments.

Looking Ahead

We think more caution is warranted in the months ahead. While inflation is beginning to soften, it remains far above the central bank's two percent target. This will likely lead to a continued cycle of rate tightening in 2023, although not nearly as dramatic as what we saw this year.

We continue to believe that preferred shares offer best of both worlds, providing upside price participation in the common stock while paying us to wait. With yields in excess of five percent readily available, the fixed income space is worth a second look. And preferred shares are a compelling place to be.

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