

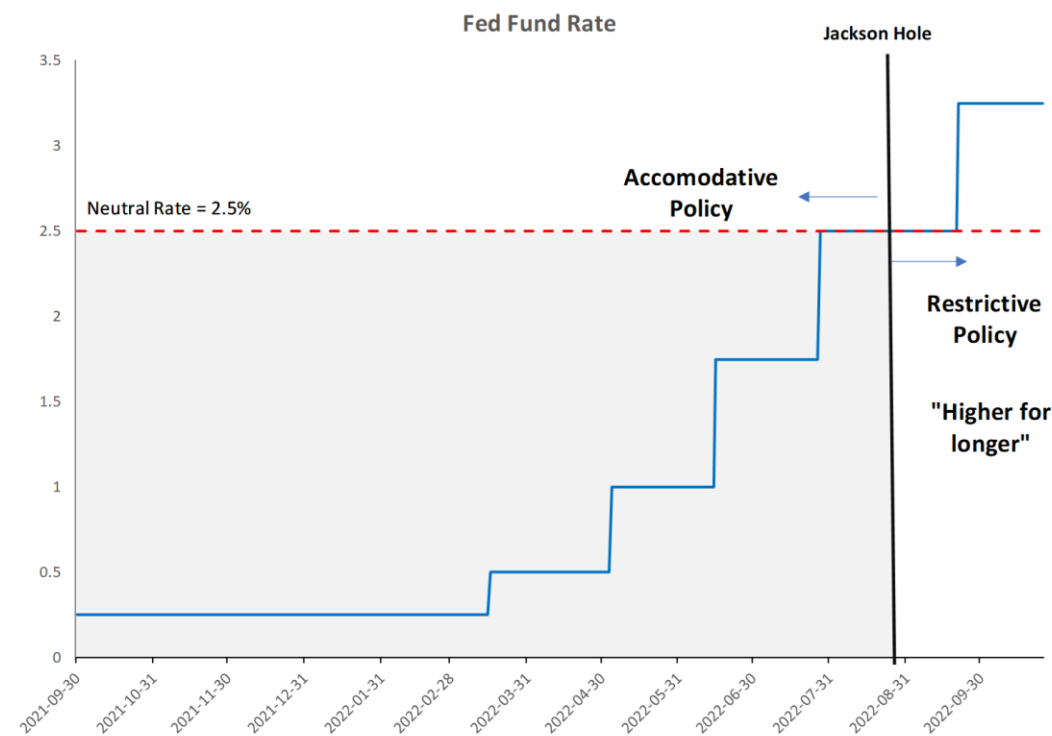
Crucial Rate Condition Pave Ways to Fight Inflation

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The Bank of Canada and the US Federal Reserve hiked interest rates in 2022. At the beginning of the year, Canada’s overnight and US Fed Funds rates rose from 0.25% to 3.25%. However, economies and job markets have felt very little pain, and inflation has only cooled marginally, which is considered bad news as it means more hikes to come. Note high interest rates typically lead to recession.

We suspect current rates are above neutral, meaning financial conditions are tighter than normal, resulting in typically lower risk appetite and spending. Since rates were coming from floor, even they have risen aggressively. Up until September, they were only below neutral, but this helps to explain why economies remained strong and inflation did not cool more.



*Source: CIGAM Multi-Asset Management, Bloomberg.

Higher rates are not enough to impact inflation. The tone and mood of the markets must also change. In other words, you need people to take the situation seriously. While the central banks were aggressive, for a while, the markets and consumers thought the Fed would “pivot” to lower rates as early as 2023. Spoiled by decades of loose monetary policy, it is not hard to imagine why so many made this assumption.

We have seen some crucial developments in the last few weeks:

- 1) rates are above neutral
- 2) general consensus expects rates to stay high for longer
- 3) central bank’s tone has grown hawkish, and consumers and employers are cautious

We think these are important conditions to fight inflation, and we should see some incremental results in the next few months.

We have likely passed the portion of the market correction where markets consistently headed for “lower lows.” There will no doubt be volatility ahead but expected returns for the 3-5 year horizon have also improved for risk taking. In the next few weeks, my team and our investment management team colleagues will meet with some of the underlying managers to evaluate their results. We look forward to sharing their insights in the next Portfolio Construction piece.

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