JUNE 16TH POST-HIKE UPDATE

June 16, 2022

On Wednesday, June 15, 2022, the U.S. Federal Reserve Board (Fed) raised its benchmark interest rate by 75 basis points. While this move was priced into futures markets, it was the most aggressive increase in decades. CIBC Asset Management portfolio managers and analysts share their immediate reaction below.

Equities

"The Fed is showing they are committed to get ahead of the curve with respect to inflation. They are orchestrating a necessary slowdown by raising rates, but they are re-establishing credibility and the possibility of a soft landing."

— Craig Jerusalim, Senior Portfolio Manager, CIBC Asset Management

After our equity update on June 14, the Fed raised interest rates by 75 bps on June 15, intensifying their fight against inflation. This was the largest rate hike since 1994. While equities rallied after the announcement on Wednesday, stocks dropped sharply on Thursday giving up all of their gains from the previous session. At close on Thursday, the S&P 500 was down approximately 3.25%, and the Nasdaq down 4.08%. The see-saw action in equity markets illustrate the conflicting emotions that are currently top-of-mind for investors. On one hand, investors are happy the federal reserve is taking aggressive steps to contain inflation, but are conversely worried about these steps increasing the possibility of a future recession. Nevertheless, these developments over the last two days do not change our outlook for equities. We continue to prefer stocks with short-dated cashflows, and have an overweight to areas such as energy and financials. As mentioned recently, we do believe volatility is likely to continue, but accumulating well-managed businesses at attractive prices, while focusing on longer-term fundamentals, remains the most effective strategy to accumulate wealth for clients.

Fixed Income

"What would have been a surprise as little as a week ago, came as no shock to investors today as the Fed hiked its rate by 0.75%. The Fed took the opportunity to move quicker to bring the Fed Funds rate closer to its neutral target, given the futures market had already priced in the more aggressive action. A similar move remains priced into the futures market for the Fed's September meeting, which would take the Fed Funds rate to 2.25%-2.50%."

— Pat O'Toole, Vice President, Global Fixed Income, CIBC Asset Management

Canada government yields tightened post FOMC announcement yesterday after leaking materially wider in the days leading up to the announcement. In the press release, Chairman Powell warned 75 bps will not be the norm, a dovish comment against any otherwise hawkish policy move. The volatility continued overnight where initially much of the tightening reversed. As we approach market close on June 16th the 10-year Canada yield has come almost roundtrip from last night's closing level.

The knock-on effect of all this here in Canada is that a 75 bps in the July BoC meeting looks increasingly likely.

MARKETS WAIT FOR AGGRESSIVE CENTRAL BANK MOVE

June 14, 2022

Equities

Markets continued their sharp YTD sell-off late last week, which continued on Monday after the U.S. CPI reading came in at 8.6%, a year/year increase that was higher than market consensus

- Optimism related to China's reopening quickly stalled after a new Covid-19 outbreak was discovered in Beijing leading to over 200 cases. This added to the negative sentiment seen within equity markets.
- Over the last four days, the S&P 500 Index has lost close to 10%, declines not seen since the pandemic related downturn in 2020.
- YTD (to June 13, 2022) the S&P/TSX Composite Index is down 6.97%, compared to 21.33% for the S&P 500 Index and 30.91% for the NASDAQ Composite Index. The relative strength in the Canadian market is primarily attributable to strong performance in the energy and materials sectors, up 38.82% and 1.94%, respectively. U.S. equity markets are now technically in bear market territory, declining in excess of 20% from record highs earlier this year.
- Broader equity performance has been negatively affected by growing concerns of a Fed-induced recession as rates rise. Yields on U.S. 10-years have risen from 1.51% on December 31, 2021 to 3.36% on June 13, 2022. Inflation continues to gain, contributing to rising expectations of a more significant Fed response.
- Despite the rising rates and market concerns, corporate operating results have remained quite robust and company balance sheets are strong. In addition, to-date consumers have been buoyed by previous savings and the current strong employment environment.
- Volatility is likely to continue. As in past periods of uncertainty, accumulating well-managed businesses at attractive prices, while focusing on longer-term fundamentals, remains the most effective strategy to accumulate wealth for clients.

Positioning

Although many of our portfolios are fundamental bottom-up and do not take into account macroeconomic factors when selecting stocks, we do realize that stocks with long-dated cash flows are impacted by high inflation and interest-rate increases. Throughout the year, we've increased our exposure in a number of our portfolios to companies with near-term cashflows. For example, in many of our portfolios we've been underweight information technology throughout 2022.

- **Canada:** In many of our Canadian portfolios, we've an overweight to energy, financials, etc. These are areas that tend to outperform in higher-rate environments. This is due to their ability to pass-through increases in prices or, in the case of financials, have increased profit margins known as NIMs (Net Interest Margins).
- Our Core Canadian equity portfolios, which are led by the Canadian Equity Research team, remain sector neutral. The team continues to look for companies that are considered mispriced relative to their long-term fundamental stock value.
- **Global Portfolios**: Starting in Q4 2021 and throughout 2022 we've been assessing our conviction levels and valuation estimates on all stocks on our watch-list and within our portfolios. We always operate with a capital-preservation mindset and aim to be more conservative in our approach to valuation and forecasting than the market. Therefore, all of the work we've done ensures the portfolio is constructed with only our highest-conviction names, and ones that have strong upside despite our added layers of conservatism. We

continue to focus on investing in high-quality businesses with strong management teams, trading at attractive valuations that will outperform over the long-term.

Bonds

Bond markets experienced a steep selloff on June 13, 2022, with 10-year federal government bond yields spiking 17 basis points and 20 basis points(bps), respectively in Canada and the U.S.

Market participants increasingly appear to share the view that central banks have:

1. Waited too long to start hiking;
2. Begun hiking as the economy was already starting to signal a slowdown but with a continuation of persistently high inflation—the dreaded stagflation scenario;
3. Decided they'll continue hiking to tame inflation even if they drag the economy into a recession by materially tightening financial conditions.

The futures market is signaling a growing expectation of a 75 bps hike at the Fed’s June meeting and 200 basis points of hikes over the next three meetings. In Canada, it’s a similar story with the futures market expecting 200 bps of hikes over its next three meetings.

The combination of deteriorating consumer sentiment, inflation pressures, and hawkish central bank rhetoric are creating turbulence across fixed income markets and a growing expectation the Canadian and U.S. economies will tip into recession.

Positioning

We remain cautious on high yield as there’s room for spread widening given a potential slowdown in the economy. In investment-grade corporates, we're focused on adding to lower beta shorter-dated corporates where valuations are attractive but credit risk is lower—improving portfolio yield in a defensive manner. As yields move up, we’re looking to leg-into a longer portfolio duration.

Keep it in perspective

While volatility has the potential to continue a little longer, history tells us that such periods of volatility never last indefinitely. Financial markets always stabilize and recover over time. We also know from history that, in periods like this, it is best to put aside our emotions, which can cloud our judgement and prevent us from keeping things in proper perspective and making sound, long-term investment decisions.