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CIO Commentary

September 30, 2023

Investment markets in the third quarter continued to reflect concern over inflation data and the outlook for corporate earnings. That concern was accentuated in the last weeks of September as markets adopted a dimmer view of the interest rate cycle, and how long it will be before Central Banks are able to usher in some administered rate relief. Rates on marketable securities rose, with U.S. 30-year mortgages eclipsing 7.5%; a 30 year high. Ten-year U.S. Treasury yields hit 4.6%, up from 3.8% at June 30. Canada ten-year rates rose in tandem, reaching 4.0% at Sept 30, up 76 basis points since mid-year. Notwithstanding the defensive attributes of low volatility companies, higher rates particularly impacted shares of interest rate sensitive sectors of the market (utilities, telcos and real estate). Normally, higher rates would also negatively impact valuations of all growth companies, but so far, the impact has been felt mainly by the mid and small cap growers. The mega large growth companies have yet to feel the impact of higher rates.

Investment markets of all stripes ticked lower in the quarter, reflecting investors' ongoing economic concerns. With rising interest rates, the FTSE Canada Universe Bond Index recorded a price decline of 4.7% in the quarter. The Canadian barometer of stock prices, the S&P/TSX Composite Index saw a price decline of 3.1%. In the U.S., the S&P 500 Index slipped 3.7% (in U.S. dollars). The tech heavy NASDAQ Composite declined by 4.1%. The Morningstar Developed Markets (ex north America) Index experienced a decline of 4.5%. The Canadian dollar closed at 73.96 U.S. cents at Sept 30. Over the course of the quarter, this marked a decline of 2.1%, which had the effect of reducing the losses on U.S. dollar investments.

Bond investors on both sides of the border were taken aback by the resiliency of the U.S. and Canadian economies. Progress on the inflation front has paused of late, with a recent uptick driven mostly by the price of energy. Core inflation (net of food and energy) continued down but is staying above target. The Fed, and the Bank of Canada continue to be vigilant, and data dependent. Both have delivered hawkish language, reserving at least one more potential rate hike, should inflation not come into check. Labour stats on both sides of the border remain robust. The pathway to the hoped-for soft landing is becoming narrow. Interest rates may have to remain higher, for longer. Today's higher yields are increasing the future return prospects for investors in Bond and Balanced Funds.

With this background, equity markets continued to demonstrate split personalities. Mega cap growth companies continued to carry the market averages, masking the material deterioration in the price of the average company. This has brought prices for the value sectors of the market into an attractive buying range. Many leading companies are trading at single digit price earnings multiples, while large technology companies continue to trade at multiples of 30 times. This divergence demonstrates both the risk and opportunity for investors. Large cap growth companies are unlikely to continue to hold their current valuations in the face of persistent higher interest rates. Meanwhile, the impact of rising rates has already been felt on interest sensitive securities, and economic cyclical companies, creating attractive purchase opportunities. Equity investors have an unusual opportunity to lock in attractive dividend yields for the long term.

Notwithstanding the current period of market angst, we remain constructive about the prospects for investment. Fixed income yields are as high as any time in the last 20 years. Many companies are now trading at lower valuations, already reflecting a weaker economy. By 2024, we will be in a U.S. election year, usually a time when the economy fares better, and investors are more optimistic about the future. If that holds true, investments would be expected to deliver attractive returns over the next 12-24 months.

Bond World

Interest rates and bond investments have been top of mind, even for equity investors in recent weeks.

No wonder. It is interesting to note, that until very recently, the current crop of bond portfolio managers has not seen interest rates on the rise, thus far in their careers. Until now, most bond strategies have been designed with an expectation of interest rates continuing a downward trajectory. Of course, one can also observe the implications between the tenor of the bond market and the stock market. Equities have undoubtedly benefited in recent years from low levels of interest rates, 'emergency rates', in some cases.

In looking back over 40 years, in 1982, when the U.S. was experiencing the worst economic downturn since the Great Depression, the Fed Funds rate had reached 14.6%. But the last time the Fed Funds rate exceeded 10% was in November 1984. Since then, events such as Black Monday (1987), the Savings and Loan crisis (1985-95), Long Term Capital Management's failure (1998), the bursting of the dot com bubble (2001-02), the subprime crisis (2007-10), and the Covid pandemic (2020), all helped to push interest rates to zero.

It was not until inflation reared its ugly head in 2022, was there a monetary policy response by central banks. In particular, the Federal Reserve and the Bank of Canada began raising their policy rates and overnight interest rates. Rising from a level of zero interest rates, up to 5.25% – 5.50% in the U.S. and to 5.00% in Canada, it took just six months to bring inflation from 9.1% to 3.7% in the U.S., and from 8.1% to 3.8% in Canada. But even with the higher interest rates, there have been few signs of a weaker economy. Most stubborn of all, the labor market has not lost its momentum. In the USA, the unemployment rate is at 3.8%, 'full employment', and well below the long-term average of 5.7%. In Canada, the unemployment rate is 5.5%, also below its long-term average of 8.1%. GDP has begun to slow, but still managed to advance in the U.S., by 2.1%, quarter over quarter. Canadian GDP growth has stagnated, but only in the most recent quarter.

We are nearing an inflection point for most economic indicators. Interest rates have been on the rise for about 18 months. Importantly, inflation is down significantly. Monetary lag should help quell the level of price increases even further. Inflection points by their very nature are tricky to navigate. Today, economic observers are split between the possibilities of a hard landing, a soft landing, or even a scenario of no landing, which would simply result in a continuation of good times.

The shape of the yield curve often provides clues as to the health of the economy. Canada's inverted curve, (short term rates higher than long term rates) points to an economic slowdown. However, the U.S. curve appears now to be in the process of normalizing (higher rates for longer dated maturities). In fact, ten-year U.S. Treasury yields recently hit the 5.0% resistance threshold, before buyers stepped in to rally bond prices from that level.

The soft-landing scenario is the hoped for outcome as we look ahead. But there are many moving parts - domestically, internationally, geopolitically. In this still uncertain environment, we are careful not to change our fixed income stance dramatically. Rather, incremental changes as the future unfolds, will be the most prudent course of action.

-- Beste Alpargun, MBA, CFA and Robert McKim, CFA, CEO, CIO

2022 Pooled Fund Capital Gains Tax Deferrals

	Tax Loss Carry Forwards*
SEAMARK Pooled U.S. Equity Fund	$ 21,176,234
SEAMARK Pooled Total Equity Fund	$ 16,899,095
SEAMARK Pooled Low Volatility Equity Fund	$ 1,697,814
SEAMARK Pooled Canadian Equity Fund	$ 4,844,990

*Audited Financial Statements, as at December 31, 2022

Some of these tax loss deferrals are significant compared to the assets in the respective Pools.

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Composite Performance Update

Calendar Year Performance

	2022	2021	2020	2019	2018	2017	2016	Since Inception	Inception Date
SEAMARK Balanced Composite (%)	**-4.0**	**18.3**	**5.8**	**14.6**	**-5.2**	**4.9**	**8.8**	**7.0**	12/31/2009
Balanced Benchmark* (%)	-9.2	11.6	9.3	15.3	-1.4	7.4	7.8	6.3	
SEAMARK Low Volatility Equity Composite (%)	**-1.6**	**24.2**	**0.3**	**15.5**	**-2.4**	**6.7**	**12.4**	**8.5**	12/31/2010
S&P/TSX Composite Index (%)	-5.8	25.1	5.6	22.9	-8.9	9.1	21.1	6.1	
SEAMARK Canadian Equity Composite (%)	**-4.4**	**25.8**	**-2.3**	**19.5**	**-12.7**	**5.2**	**19.8**	**5.6**	01/31/2011
S&P/TSX Composite Index (%)	-5.8	25.1	5.6	22.9	-8.9	9.1	21.1	6.1	
SEAMARK Total Equity Composite (%)	**-1.2**	**28.6**	**4.6**	**19.1**	**-6.0**	**5.9**	**12.2**	**10.7**	09/30/2011
Total Equity Benchmark** (%)	-8.6	23.9	9.6	22.8	-4.0	12.1	13.2	11.0	
SEAMARK Fixed Income Composite (%)	**-10.2**	**-3.0**	**8.1**	**5.6**	**1.6**	**2.6**	**1.8**	**1.5**	04/30/2012
FTSE Canada Universe Bond Index (%)	-11.7	-2.5	8.7	6.9	1.4	2.5	1.7	1.6	
SEAMARK U.S. Equity Composite (%)	**-1.1**	**31.7**	**11.3**	**17.5**	**2.4**	**3.4**	**13.9**	**15.6**	04/30/2012
S&P 500 Index (CAD) (%)	-12.5	28.2	16.1	25.2	4.0	13.8	8.6	13.2	

*Effective 30 Sep 2018, the SEAMARK Balanced Composite Benchmark is 5% FTSE Canada 91 Day TBill Index, 40% FTSE Canada Universe Bond Index, 27% S&P/TSX Composite Index, 20% S&P 500 Index, 8% Morningstar Developed Markets ex North America GR Index
**50% S&P/TSX Composite Index, 35% S&P 500 Index, 15% Morningstar Developed Markets ex North America GR Index

Links to Q3 2023 Pooled Fund Profiles

Balanced | Canadian Equity | Low Volatility Equity | Canadian Bond | U.S. Equity | Total Equity

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