



Personal experiences may vary

Equities Commentary

Performance was somewhat mixed for developed equity markets over the second quarter, as investors digested a mix of countervailing positive and negative forces across the economy. The MSCI EAFE Index, comprised of equities from 21 Developed Market economies in Europe and Asia, rose 3.0% in US dollar terms. A lull in economic momentum in China, and a European Central Bank resolute on raising interest rates dampened enthusiasm for stocks. Markets in the United States fared better, with the S&P 500 Index rising 8.7% in US dollar terms as high-growth Consumer Discretionary and Information Technology stocks stood out for their contribution to overall gains. The Canadian dollar strengthened slightly over the quarter, diminishing these returns for Canadian investors. Domestically, the S&P/TSX Composite Index increased 1.1%, with weakness in the key sectors of Energy, Materials and Financials offset strong gains across Information Technology stocks.

Both MSCI EAFE and S&P 500 Total Return indices sit with impressive year-to-date total returns of 11.7% and 16.9%, respectively, extending a rally that began in late 2022 with the reopening of the economy in China. The recent softness in Canadian markets has limited the return for the domestic benchmark to just 5.7% over the first half of the year, making the home market for Canadians a notable laggard versus other regions.

Looking ahead, equity market performance globally will be contingent upon the balance of economic headwinds and tailwinds currently underway. Negative forces include higher interest rates impacting consumer borrowing and a tempered “return to office” movement reshaping commercial property markets. Positive forces include an abatement in inflationary factors across several industries and, for many stocks, comfortable valuation levels as a starting point for investors following the market pullback over 2022.

Fixed Income Commentary

It has been yet another volatile quarter for fixed income markets. Financial stability concerns that arose following the collapse of three regional US banks and the stress-induced sale of a once-venerable Swiss financial institution in March gave way to renewed concerns that persistently resilient economic activity could drive upside risks to inflation.

Against this, expectations that global central banks would soon be forced to pivot toward an easier policy were quashed, with rates now anticipated to move higher and stay elevated for longer. Market yields rose back toward the higher end of their trading range over the last year, and the curve inverted further accordingly, resulting in the benchmark FTSE Canada Universe Bond Index declining 0.7% over the three months ended June 30. This decline ended the streak of three consecutive quarterly gains. The more interest rate-sensitive government bonds (FTSE Canada All Government Bond Index -1.0%) underperformed their corporate counterparts (FTSE Canada All Corporate Bond Index +0.2%).

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Ongoing uncertainty about the near-term path for policy rates and their ultimate terminus likely means that volatility in bond markets will remain elevated in the coming months. Indications that inflationary pressures are continuing to abate amid signs of moderating; suggest that the upside in rates appears to be fairly limited from this point. As such, the bond market backdrop remains fairly constructive, with underlying government yields at multi-year highs and credit spreads providing among their best prospects for returns in more than a decade while also offering some cushion to absorb an increase in rates.

Commentary

Equity markets have staged a significant comeback from last year's prolonged selloff, with major indexes across the globe up by double-digits year to date. The main global equity benchmarks increased over 20% from their October 2022 lows, which indicates a new bull market has officially begun (though stocks remain roughly 10% below their earlier peaks).

For many investors, however, their personal experiences this year vary drastically from these robust overall market gains as a rising tide has not lifted all boats in the market. Instead, it has been a (historically) narrow subset of stocks soaring while the rest have been treading water.

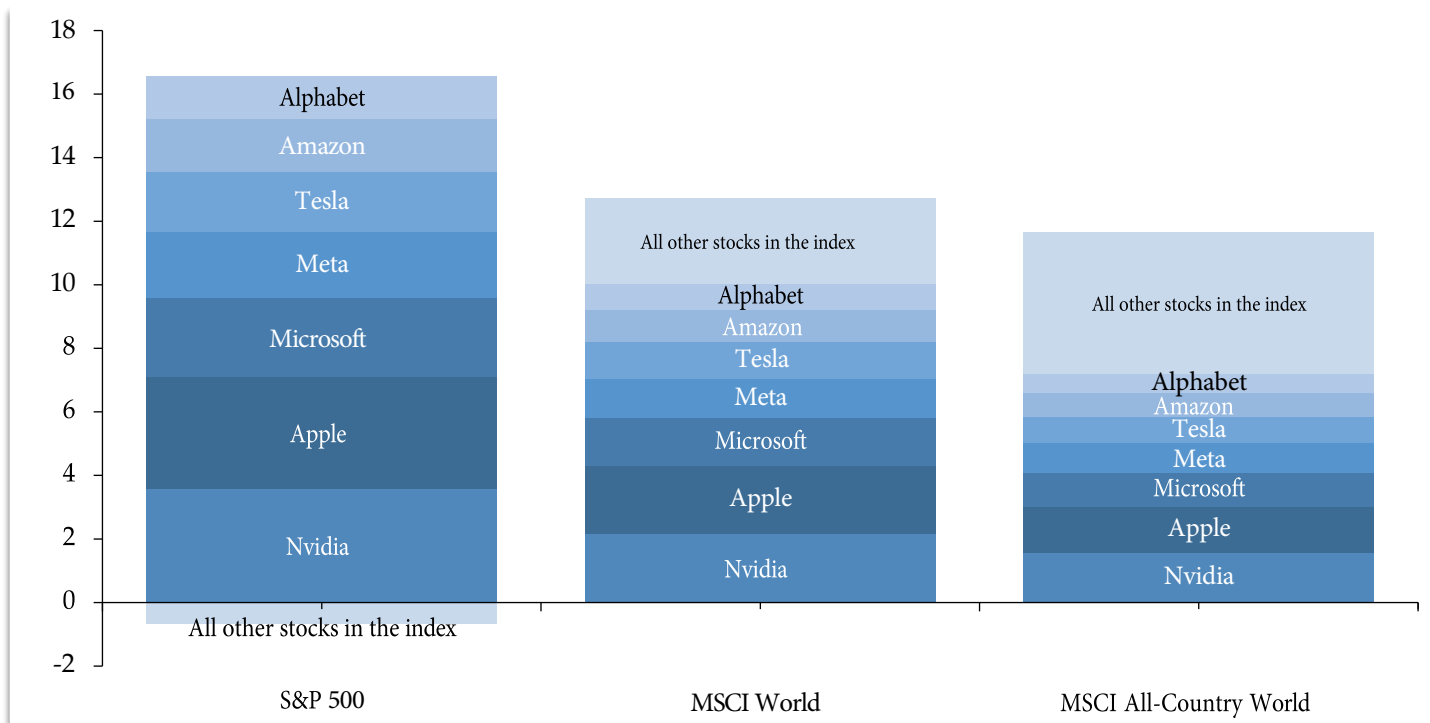
The American S&P 500 Composite Price Index is up 15.9% to the end of June; however, the entire gain can be attributed to just seven stocks (Nvidia, Apple, Microsoft, Meta, Tesla, Amazon and Alphabet) that account for one-quarter of the market-capitalization-weighted index. The other 493 stocks in the gauge of equities of the largest US companies are down by a combined 0.9% year to date.

Moreover, the nearly 70% weighted-average increase in the stocks of these seven US companies is responsible for 80% of the 12.7% year-to-date gain in the MSCI World Index (the benchmark for Developed Market equities), while the other 1,499 stocks that account for 85% of that index weight are cumulatively up by just 3.2%; for the MSCI All Country World Index (which is comprised of 2,883 Developed and Emerging Market stocks), these magnificent seven have driven two-thirds of the 11.6%.

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Contribution to 2023 year-to-date price return (Percentage points)



Source: Guardian Capital based on data from Bloomberg to June 30, 2023

In other words, any global equity portfolio that did not hold these stocks, or was underweight relative to the market benchmark (such as value or income-biased strategies), is very likely underperforming year-to-date by a fairly significant margin.

Looking forward, narrow leadership raises concerns about the prospect of further gains in the second half of 2023, particularly if recent enthusiasm surrounding developments in Tech, and especially artificial intelligence, that have propelled the gains-starts to subside — after all, market rallies are typically more durable when they have wider participation.

Positively, there is scope for the rest of the market to play some catch-up in the months ahead.

For starters, economic growth, albeit moderating from last year's brisk pace, continues to hold up fairly well despite numerous headwinds, underpinned by a resilient consumer — ebbing inflation and firm labour markets suggest that the verve in spending could persist in the months ahead.

Against this, earnings momentum has turned for the better in recent months, with corporate profits broadly beating lowered expectations and earlier forecast downgrades being partially unwound as some clouds lingering over the outlook dissipate, generating fundamental support for equities.

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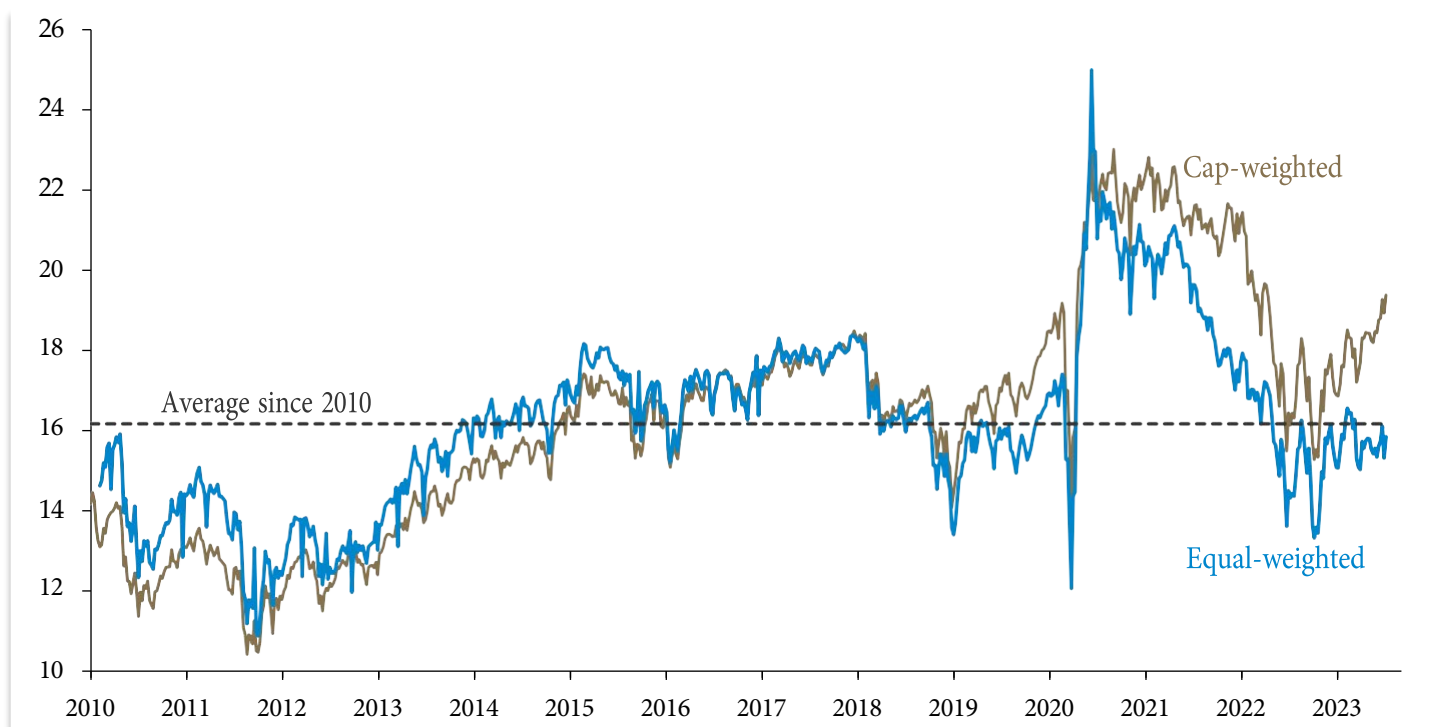


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The broadly better earnings backdrop comes as the vast majority of stocks have traded sideways meaning that valuations are not stretched. For example, while it is the case that the overall forward price-to-earnings ratio for the market-capitalization-weighted S&P 500 is now nearing one standard deviation above its average since 2010, the equal-weighted version of the index is trading at a below-average level, comparable to those in other Developed Markets.

Forward price-to-earnings ratio, S&P 500

(ratio)



Source: Guardian Capital based on data from Bloomberg to June 30, 2023

Add in the likelihood that any further upside in interest rates at this point is limited, and the outlook remains constructive for equities, suggesting that the rally still has room to run — though the “headline” increases may well be somewhat muted by internal churn within market indexes as this year’s laggards close the gap with the leaders.

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