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September Market Analysis

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The Markets

	September	Change in Month	Year –To-Date
S&P TSX	23998	2.8%	14.5%
S&P 500	5762	2.0%	20.8%
Dow 30	42330	1.8%	12.3%
Oil	$68.22	−7.2%	−4.8%
Gold	$2654	5.0%	28.1%

September began on a weak note but in the end, it was a strong month. Forecasters warned that September is typically the weakest month of the year. That all changed after 3 announcements. The first was the release of US CPI. For the last 12 months CPI was 2.5% which led economists, and others, to believe the Federal Reserve would certainly lower rates, maybe by up to half a percent. The second announcement was the Federal Reserve's announcement they would decrease rates by 50 basis points or half a percent. As investors began to worry that the world economy might be slowing, China announced a major stimulus program. The Chinese market rose 20% in a week. All in all, it was a good month for investors.

Energy stocks were the only sector of the TSX with negative performance in September. The Energy sector was pulled down by weakness in the price of oil. Fears of a recession and slowing in China caused investors to expect weaker demand for energy products. This followed weakness in August. At the other end of the spectrum were Health Care and Interest Sensitive stocks. The Health Care sector is small and is dominated by the cannabis stocks. Lower interest rates sparked interest in copper and other base metals to make the Base Metals sector the second-best performer with an 11% return in the month. As you would expect rate cuts led REITs, Income Trusts, Utilities and the Banks all to have one month returns in excess of 5%.

The chart on the next page presents the performance of the S&P 500 and the S&P TSX for the last 6 months.

6-Month Performance S&P 500 and TSX

TSX, S&P 500 source google.com/finance

Economic Indicators

1. Canada inflation

What everyone has been waiting for… inflation, as measured by the Consumer Price Index (CPI) hit the Bank of Canada's 2% target rate. For the year-over-year period ending August, CPI fell to 2.0% compared to 2.5% in July. One issue with inflation is how do you measure it? Some like to exclude volatile items such as food and energy, others like the Bank of Canada like to exclude the biggest movers in the period to focus on the less volatile items in the period. Others accept the standard CPI. There is no right measurement but this can lead to disagreements.

CPI rose at is lowest rate since February 2021. I guess inflation has moved from Justin-flation to just inflation. At these levels it has become less of a political issue. The primary reason for the decline was lower gasoline prices caused by weakness in the global price of oil. Ironically, one factor holding inflation up is the cost of mortgages which is influenced by the higher interest rates used to bring inflation pressures down. As the Bank of Canada lowers rates this will help reduce this drag on the economy.

As we mentioned earlier there is more than one definition of inflation. The CPI-common is the rate we discussed on the previous page. CPI-median records the rate of inflation of the items at the 50th percentile, that is, half the goods rose more in price and half rose less in price. And CPI-trim, which is the Bank of Canda's preferred measure. CPI-trim that excludes CPI components whose rates of change in a given month are located in the tails of the distribution of price changes. In other words, it eliminates the more volatile items in any month. CPI-common rose 2.0%, CPI-median rose 2.3% and CPI-trim rose 2.4%. Based on this, inflation did not hit the Bank's target of 2% using its preferred measure. However, what is probably more important all three measures saw the rate of inflation decline by more than 0.5% since March.

2. CHINA Stimulus

What does it take to prevent further weakness in the Chinese economy. The answer the biggest stimulus package since the pandemic.

The People's Bank of China held a press conference to announce a massive change in monetary policy. Not all the details were released but the outline was provided.

They:

a) Announced they would cover 100% of the principal for loans to local government to cover the purchase of unsold homes. They previously covered 60%. This should help clean up the backlog of unsold homes
b) Cut the minimum down payment for those purchasing a second home to 15% from 25%. This should stimulate the housing market.
c) Indicated they would cut the bank reserve requirements by half a percent. This should add 1 Trillion yuan in new liquidity. Note, they did not give a date for the policy to be implemented. They alluded to the potential for further cuts of a quarter to half percent.
d) Cut mortgage rates by half a percent
e) Reduced the seven-day reverse repo from 1.7% to 1.5%
f) Introduced a 500 Billion yuan swap program that allows brokers and insurers easier funding to purchase stocks.

Since these announcements many Asian markets, not just China's, are up more than 10%. This tells you how much of an impact people expect these changes will have. The yuan hit a 16-month high relative to the US dollar. This is the first time the central bank used its own money to support the stock market. One key item to consider is that lower rates are one factor that will contribute to economic growth but people have to take advantage of the lower rates. If investors are still worried about the housing market a half percent interest rate decrease will not necessarily increase demand, just look at Canada after we lowered rates by three quarters of a percent.

Reflection

Some random thoughts

I had a conversation with someone who has their own diversified portfolio and they mistook me for someone looking to provide free financial advice. Just joking, we did discuss his stock trades. He told me he sold half of his holdings of a stock in the retail sector as it now trades at 60 times earnings. He said he could not justify a stock trading at 60 times earnings. He asked my opinion. My first thought was no matter what he did he would be wrong and right. If the stock continues to rise the sale was a mistake but he still had half of the funds still in the stock. If the stock declines, he should have sold everything but made the correct decision to make a sale. The real answer is, if you think the stock is too expense at 60 times earnings what are you doing owning any shares? Even expensive stocks go higher.

There was an old commercial for a chocolate bar that asked, how do you like your coffee?

The answer was I like my Coffee Crisp, that being the name of the chocolate bar. You can ask investors how do you like your income. Some clients like the tax advantages of dividend income, especially in a corporation and will only hold dividend paying stocks. Some want to be able to make a monthly withdrawal without touching their principle. To meet their needs, you need to structure a portfolio with some stocks with monthly payouts but you can add REITs and other structured products to generate higher yields. A friend and I have debated the benefits of shares created by some investment firms. My friend likes to get income on his investments. There are some shares with a small quarterly distribution but a large distribution if the underlying portfolio rises. I told him this was them just paying you back with your own money. He countered that they were distributing the gains. This product is not right if you need steady income but works if you understand that in a rising market you will get enough income to go to the local convenience store and buy a good bottle of wine vs. a six pack of beer. There are others who want to collect the dividend on a stock and sell it and try to collect the dividend on another. This also works in a rising market but theoretically the stock should drop by the amount of the dividend. The payment of dividends is generally straight forward but there are some small nuances. Dividends are often paid weeks after they are earned. A company declares a dividend to those who hold the share on the 27th of the month. The stock should drop by the amount of the dividend as anyone who buys the stock after the 27th is not entitled to the dividend. Often the cash will hit your account on the 15th of the next month. This frustrates me as clients see their portfolio drop by the amount of the dividend one month and wonder why their portfolio dropped but the next month the extra cash appears in their account. How do you like your income? Steady dividends, lumpy but larger payments, capital gains or some combination? Or Crisp?

Free mugs. The other day we were cleaning our cupboards. We took out the coffee mugs and thought we don't have that many people over for coffee so we don't need so many mugs. Some were gifts with phrases like best mom or dad or tea drinker. What I found more interesting were some free mugs. I had a Nortel mug I received when the stock was trading below $20 on its way to over $100. The company subsequently had, to put it politely, had financial difficulties and laid off more people than fit into the Rogers Centre and the old Air Canada Centre combined. The other free mug was from Stelco before it had to restructure more than 15 years ago. A friend is changing employers and noticed a coffee mug of the company he was about to leave. Free mug, maybe he is lucky to get out before the company has to restructure. This is a lesson for those who see patterns and make investment decisions based on them. Patterns without causation is just a co-incidence. Either way I am not giving out any mugs with my company's logo on them, just in case.

Summary

"In the factory we make cosmetics; in the drugstore we sell hope." Charles Revson

September was a month when the central banks lowered interest rates and sold the hope for continued economic growth. People hoped for lower inflation so the central banks could lower interest rates. Inflation is basically at the target level in both Canada and the US. The US Federal Reserve took decisive action and lowered rates by half a percent or 50 basis points in bank speak. The Bank of Canada lowered rates by a quarter of a percent for the third time. The People's Bank of China made several steps to support the economy. The question is whether lower rates are enough to help the economy and the housing market. If lower rates do not induce increased activity the people did not buy the hope that was being offered by the central banks.

For a while we have looked at a portfolio skewed to dividend paying stocks and questioned when others might see the value we saw. As rates have begun to decline, interest sensitive stocks like the pipelines have started to rally. There is a phrase that you get paid to wait when you own a dividend paying stock. This means the dividend gives you a realized return while you wait for the capital appreciation on the investment. We remain focused on portfolios that have companies with steady dividends with the prospect of dividend growth. It is a portfolio, not a collection of stocks, so we include some stocks with different attributes as we want to avoid over concentration in one sector of the market.