Taylor Wealth Management

BMO Nesbitt Burns

Market Sense

In an effort to continually improve our communication, we are pleased to be launching a new series of regular newsletters. *Wealth Matters* is a financial planning-focused periodical that will attempt to explore real-world tax and estate planning concepts that you or your family members may be thinking about. *Market Sense* is an investment-focused newsletter, with the goal of combining a short summary of current market dynamics with important portfolio concepts that inform our ongoing recommendations and decisions.

These twin newsletters were set to officially launch in the new year, but after a year unlike any other, it seems that there is no time like the present! We welcome your feedback, and we hope you enjoy the read...

Do You Believe (...In a Santa Claus Rally)?

A 'Santa Claus rally' is a common market refrain this time of year.

Despite its admittedly optimistic namesake, it's also an occurrence that is well-supported by market history. Over a century of data suggests that December has the highest probability of any single month during the calendar year to be a positive one. Furthermore, this is true for both Canadian (TSX) and US stock markets (S&P 500), with the chances of gain at 77% and 76%, respectively. The average monthly increase for the TSX (+1.9%) is the highest among all months, while the S&P 500's average of +1.4% is a close second place, after July. December is usually kind to equity portfolios.

With the TSX and S&P 500 charging ahead by 6% and 8% respectively in October, and up a further 5% each in November, it sure seems that Santa came early this year. The bigger question remains: will this Santa Claus rally make it all the way through to the New Year? 2023 is only three weeks away, and yet three weeks in this market has felt much longer at times. In any year - and especially this year - any analysis of December's historical investment performance only seems relevant when we consider it with the added context of where we find ourselves at the end of this year, in this December.

Historically speaking, both equity and fixed income markets perform well when central banks finally end interest rate tightening cycles. These periods often coincide with slower economic growth and there is no reason to believe that it would be any different this time. With slowing economic growth and recession-probabilities increasing, there are also numerous corroborating signals that core inflation has finally peaked. This has been the single most significant headwind faced by investors in a year when there was no shortage of such items. The Bank of Canada (the earliest and most aggressive of all the major central banks in raising interest rates this year to try to cool inflation) will also likely become the first one to end its hiking cycle in early 2023. Others, such as the Federal Reserve in the US, will eventually follow suit. None of this appears imminent, but the markets are always first to move.

We believe that the current market rally reflects the initial stages of a change in investor positioning. With the proverbial light at the end of the tunnel suddenly appearing, the risks and rewards have now become more balanced than they have been at any time in the past 18 months. To be clear – overall growth will slow further. 2023 will likely not be marked by optimism and exuberance. Instead, it will reflect the simple reality of where we are today; a time when major financial headwinds are starting to turn. Put another way, we are starting to see the market environment become less bad, and that is always the first step towards improvement.

If we are in fact headed for recession in 2023, it's not the just equity markets that are expressing concern in an unusual way. The job market continues to run at near-record levels, corporate spreads have narrowed, and the U.S. dollar has walked back some of its recent strength – all of these items bode well for markets as we turn the page on 2022.

Going forward, we expect that investors will begin to shift their focus away from inflation concerns and towards the health of the economy. New challenges await, certainly, and many of the existing challenges are not likely to relent overnight. It will be bumpy at points. However, let's consider the heavy lifting that has been done already. Most financial markets have spent the entirety of 2022 adjusting to a world that, frankly, needed some adjustment. The tone is starting to change. Investor positioning is starting to change. Financial markets have started taking notice. Of all the gifts that Santa Claus brings this year, maybe it's the one that we have convinced ourselves would never arrive that matters most.

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