Eastport FINANCIAL

MARKET & ECONOMIC SUMMARY

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MARKET SUMMARY

First Quarter 2023

S&P/TSX Composite TR

Q1	YTD	1 year
⬆ 4.6%	⬆ 4.6%	⬇ 5.2%

S&P 500 TR (USD)

Q1	YTD	1 year
⬆ 7.5%	⬆ 7.5%	⬇ 7.7%

MSCI EAFE GR (C$)

Q1	YTD	1 year
⬆ 8.5%	⬆ 8.5%	⬆ 7.4%

ICE Bof AML Canada Brd Mkt TR

Q1	YTD	1 year
⬆ 3.0%	⬆ 3.0%	⬇ 2.2%

FIRST QUARTER HIGHLIGHTS

- S&P/TSX Composite hits 8-month high of 20,843.20 on February 2nd
- S&P 500 hits 5-month high of 4,195.44 on February 2nd
- Canadian dollar range bound in Q1 closing at $0.7395 USD on Mar 30th
- WTI Oil hits 16-month low of $66.93 USD on March 17th
- Bank of Canada increases overnight rate by 0.25% to 4.50% in Q1

SUMMARY

Investors had lots to cheer by the end of Q1 as stocks rallied, bond yields fell, central bank hiking slowed and inflation cooled again. It's a promising start to 2023 but there were a few shocks along the way. Equity markets dipped in February over concerns "hot" economic data coming in might mean the U.S. Federal Reserve would have to keep interest rates higher for longer. Then in mid-March there was a scare as U.S. regional banks Silicon Valley Bank and Signature Bank were forced to close which dragged down banking stocks. The fallout spread overseas, affecting Credit Suisse. However, following a coordinated response by central banks to maintain market functionality, liquidity and protect deposits, Canadian, U.S. and global equities recovered to wrap up Q1 with impressive gains. The tech sector led the way, offsetting banking volatility. It was also a bright beginning to 2023 for bond markets as prices rose and yields fell on more signs inflation is easing and as a result lower expectations for interest rates.

There were several market-friendly Canadian and U.S. economic indicators during the quarter. Job creation on both sides of the border continued to be resilient. Canadian retail sales rose, and home sales slowed while U.S. GDP grew a respectable 2.7%. There was promising economic news overseas as well. Surveys of manufacturers, the services sector and consumer sentiment in the U.K. and eurozone revealed an improved outlook and an easing of supply chains. Economic activity is also picking up in China as it reopens for business after lifting its "zero-covid policy" pandemic restrictions. The Canadian federal government released its 2023 annual budget at the end of March. Highlights included health and dental care spending, green initiatives and a grocery tax rebate. It also featured proposals to raise the alternative minimum tax rate and threshold and increase limits for some RESP withdrawals.

Federal Reserve chairman Jerome Powell indicated the end of its tightening cycle is near adding a soft landing for the U.S. economy, as opposed to a recession, is still attainable. He also stressed the Fed would be prepared to increase rates further if tighter financial conditions do not effectively slow economic activity. Inflation moderated in Canada as well, from 6.8% to 5.2%, the largest deceleration since April 2020. According to Statistics Canada this was mainly due to lower gasoline prices although grocery and mortgage interest costs continued to rise. The Bank of Canada did raise its benchmark rate in Q1 by an additional

0.25% to 4.50% in January. Bank of Canada governor Tiff Macklem then indicated rate hikes would be on hold to assess the effects of hiking so far. He added, if needed, the bank would hike again to get inflation back to 2% target.

What can we expect going forward? Thanks to a swift response from central banks the recent banking troubles have likely been contained. The probability of a global economic slowdown has risen due to tightening credit conditions, which should lead to decreased spending and lower prices. The rate increases over the last year have a delayed impact so are still gradually impacting the economy and monetary policy decisions. The likelihood of interest rates moving lower by the end of 2023 is increasing, potentially setting the stage for the next bull market.

"Proper diversification is essential to reducing risk, even in the supposedly safe world of fixed-income." – *Cy Korun*

STRATEGIC NOTES

How did two regional US banks fail amid rising interest rates? Banks are required to hold a certain percentage of deposits as cash and cash equivalents (such as government bonds) to give clients their money back when they need it. These assets are so stable in surety and price, generally, that they're considered equivalent to cash and the banks are allowed to categorize them accounting wise as "Held-To-Maturity" (HTM) which means any changes in price, up of down, does not get run through their income statement because they're going to receive interest and 100% of their principle at maturity so the current market price is not relevant. This is important because the market price of these securities can decrease significantly if a material rise in interest rates occurs (just like our investors saw with their fixed income holdings in 2022).

However, a problem can arise if more bank clients withdraw their deposit holdings than would be anticipated. This could be for numerous reasons – inflation requires a client to withdraw more money to cover basic living needs, or maybe a more attractive yield is being offered at a different institution.

In this situation, additional securities must be sold at the current market price to create the cash needed for withdrawals and the gain or loss incurred on this sale must be run through the income statement. When investors see these losses, it compounds the problem as they may grow concerned with a bank's liquidity and withdraw even more of their deposits, necessitating even more securities to be sold at significant losses. This creates the classic downward spiral definition of a bank run. We have always recommended our clients to have proper diversification in their portfolios, not just for their equity holdings, but also for their fixed -income holdings and cash holdings above $100K (the amount insured through CDIC). This avoids any material exposure in the event a financial institution cannot meet its liquidity requirements.

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