# The Just Word Podcast

**Transcript of Episode 39: Mid-year Market Update**

**Guest: James Gauthier**

**Pat Bolland** 00:00
James, happy summer. Great to see you again.

**James Gauthier** 00:03
Thanks, Pat. Great to see you, too.

**Pat Bolland** 00:05
Okay, I indicated in the introduction, that has been a tough year for the markets overall, how tough.

**James Gauthier** 00:13
Pretty tough. It's been. I mean, in the magnitude of a market sell, often we've seen it's we're not at all time worst yet. Not even close. But it's bad enough that we're considered to be in bear market territory. So a drop of more than 20% in the equity markets, you know, different equity markets perform. Some are better, some are worse. But overall, you know, equity markets globally are down more than 20% bonds are down at the same time. So it's kind of a double whammy, there has really been no place to hide. So when you have that kind of start to the air can be discouraging for a lot of investors.

**Pat Bolland** 00:50
Yeah, no kidding. Okay, then if you had to break it down, is there an investment class that is done better than the others, for instance?

**James Gauthier** 00:59
Well, within within the broader economy, I mean, the energy sector has done very well. If you put all your eggs into the energy basket, that's being a little risky, but it would have paid off very handsomely, so far year to date. And the fact that has to do with, you know, a lot of the supply chain problems that we're seeing the price of oil, you see that at the pumps, it's all a result of the economic environment that we're in. And energy is about the only thing that's kind of gone up. So all other sectors in the markets are pretty much down, alternatives are down, bonds are down. So it's energy is really the only bright spot so far

**Pat Bolland** 01:40
You know, it's interesting, you say bonds are done. That's not typically what happens, you know, bonds are considered a safe haven, aren't they?

**James Gauthier** 01:48
Well, I wouldn't say necessarily, bonds are a safe haven, they're a less risky asset class, for sure. And when you compare them to equities, but generally speaking, I mean, bonds have risks as well. So when interest rates go up, bond prices go down. So that's the environment that we're in right now, interest

rates are on the rise. It's been priced into markets leading up to the central bank moves that we've seen so far, multiple times this year. So there's there's no free lunch, I mean, bonds are not a guaranteed moneymaker, they continually pay interest, which is great. So you're always getting income from bonds, but when interest rates go up, bond prices are gonna go down. So when you come off of all time lows in the in interest rates, you know, there's only one direction you can go and it's not going to work out in favor of the bond investor.

**Pat Bolland** 02:37
Okay, so then, I mean, you're a portfolio manager, you run all the stuff at Justwealth are all different mixes, if you will, out there. How did you manage through all those declines? How did you do it?

**James Gauthier** 02:51
Well, there's not much you can do, the markets are going to do what the markets are going to do. It's not something that you can control, what we try to do is we try to address risk with each individual clients, and we're proactive, and how we manage our assets. So we plan for ups and downs in the markets, because it's inevitable that they're going to occur, markets just don't go straight up forever. It's not that easy. So if you plan knowing that at some point, markets are going to go down, it's a lot easier to manage through it. The problem that you get sucked into many people get sucked into it, including professionals, is trying to react to market conditions. So you know, you think you have to move here, you have to move there, markets are moving all the time. So if you're continually trying to chase things, you're going to make mistakes and you know, lose sight of what the purpose of investing is. So taking that proactive approach with clients anticipating that there are going to be times when it's not that fun, but persevering through that. That's the way that we like to approach it.

**Pat Bolland** 03:50
You know, it's interesting, your point is well made, the stocks had had a really good run of late and the bond market, you anticipated, higher interest rates would eventually come. But by the same token, people were talking about a recession happening, and that's why the stock market fell off. I we haven't seen a recession yet at least I don't think ... the recent numbers indicate you have to have two quarters in a row of negative growth. And we haven't had that yet.

**James Gauthier** 04:16
Technically, that's the definition ...

**Pat Bolland** 04:18
Right? So why did the markets go down so hard and so fast?

**James Gauthier** 04:25
Well, the market is supposed to be forward looking. So market takes into account future events that mean the market is the discount of future profits that are going to be paid back to their owners. That's that's the definition. That's how stocks are priced. So when it's well known that inflation is running at very high levels, what people start doing is expecting that central banks are going to raise interest rates in the future, which they have. But I mean this these fears go back to you know, late 2021. People were starting to fear rising interest rates. and central banks do that, to try to cool down economies economies

get too hot. And that pushes the prices of everything up, there's just too much money chasing too few goods. So they try to slow the economy down to bring bring price pressure down. When they do that, though, the flip side is, you know, it's going to be worse economic environment, and potentially recession. So it's the goal of the central banks to try and coordinator or be the architect of a soft landing. So something smooth, so there's not a, you know, a big jump from robust economic growth to, you know, a bust, basically, you go from boom to bust, they don't want that to happen. But it's, it's tricky. And with inflation being persistent for so long, highest levels, we've seen in 40 years, central banks have been aggressive in rise in raising their interest rates. And that's leading people to think a recession is coming. And that's what's priced into the markets now.

**Pat Bolland** 06:01
Okay, so the question is, have they been too aggressive with interest rates, number one, or were they slack before in not raising interest rates earlier? And don't throw any politics into it?

**James Gauthier** 06:15
Never. It's fair to say that the central banks were slow to react, I mean, going back to 2020, central banks took emergency actions to try and offset the impacts of COVID. And how that was going to impact the economies globally. So there was really a globally coordinated movement to bring interest rates down to zero everywhere, or there abouts. So that was done in COVID, still hasn't gone away. So I think a lot of central banks are the, you know, the governors responsible for making decisions have been reluctant, or, you know, maybe they didn't believe that the initial readings on inflation were going to be long lasting. In fact, they call them transitory, initially, which was in now in hindsight, a mistake. So central banks have been slow to get on this. And that's, you know, maybe they're making up for lost ground now, with these large increases, that they're making 50 basis points, 75 basis points. Those are extreme measures that, you know, haven't been done too often in the past. So they're trying to play catch up.

**Pat Bolland** 07:21
Okay, and I get why COVID threw a monkey wrench into their planning. And they responded, and maybe as you say, we're a little slow to, but then you throw in geopolitics, you throw in Russia and Ukraine and that situation. I mean, the central banks, obviously could not have seen that coming. And still, they're raising interest rates in face of that do those geopolitics.

**James Gauthier** 07:43
Yeah, that's how bad inflation is. Because normally, I mean, if you had a shock, a geopolitical shock, like a war, that's negative for the economies, so government banks would, or government central banks would tend to be a little more on the supportive side, but they're still going, you know, fully in tightening mode, which, which tells you how bad the inflation problem is.

**Pat Bolland** 08:06
Okey, so then how can you hedge inflation? People in the past have talked about gold, for instance, but I don't think it's given the protection people thought it would

**James Gauthier** 08:16

No, well, in past cycles it has ... gold typically performs well, when equity markets go down. That's there's an inverse correlation in those unique environments, but it has worked so far this year. I mean, gold is down as well, it's not down as much as equity, it's down marginally. So you could have lost less by investing in gold. But generally speaking, I mean, gold is not a really productive asset. It's not like other financial assets to create wealth. Gold is sometimes thought of as diversifier. And to the extent that it might help out during down periods. You know, that's, that's great. There's a purpose for it. But that really is a very small amount of time, markets don't tend to go down for prolonged periods of time, they tend to drop quickly and rise slowly. So there's really not that much of a benefit to owning gold. In the long run, you know, gold is going to underperform the equity indexes. So or even bonds for that matter. So owning it. It's almost like having insurance for down periods, but it comes at a cost.

**Pat Bolland** 09:24
Yeah. Okay. Then we began the discussion about talking about the markets. And you talked about the energy sector in particular, what are your thoughts on oil, and in we've seen skyrocketing gasoline prices, for instance, you go to fill up your car and cost twice as much as it used to cost you. And that's, in part, I guess, why the oil sector has done. So well. The energy sector has done so well. But I mean, is it becoming an inflation hedge? Do you think?

**James Gauthier** 09:52
Well, it's a form of hedging, I guess. It's, again, like I mentioned earlier, if you're investing exclusively in energy, that's a very risk He proposition energy is a, it's a volatile asset class that it's doing well now, and that's great, but it can underperform by a lot in different other periods. So it's a risky proposition. It's not a direct hedge, per se, like if you buy, you know, an energy ETF as a supplement to the rest of your portfolio, and energy prices go up, you know, and gas prices go up at the same time. That's kind of an offset. But to try and measure that and make it a one to one ratio that's very difficult to predict. So it's, it's not really a practical hedge in any sense.

**Pat Bolland** 10:39
OK, but as you just pointed out, markets tend to fall quickly and rise slowly. The question is, is it time to buy now because they've already declined, or wait, hold your powder, maybe sell something until they get the lower levels.

**James Gauthier** 10:57
While going back to my earlier points about about trying to be proactive, if you're making guesses on what to do immediately, buy, sell or hold, what you're doing is you're focusing on the short term, you're speculating, and we try to avoid that playing that game, I would say what you want to do is stick to what you know is going to work. And that's planning for the long term planning for ups and downs and sticking to it. When you start reacting by buying or selling on a on a gut feeling. You're going to get into trouble because you become a trader and not investor.

**Pat Bolland** 11:30
Okay, yeah. So that's what some people would call market timing.

**James Gauthier** 11:35

Exactly market timing? Yes!

**Pat Bolland** 11:37
What? What kind of a time horizon do you take? Typically? I mean, you're right, on a year to year basis, things can swing wildly. But I mean, what is the proper timeline?

**James Gauthier** 11:50
Yeah, it's different for everybody. I mean, everybody has a unique individual situation, and we try to address them one by one. And not everybody has a long term time horizon, we respect that. And so we would say, you know, somebody in that position should not take a lot of risk in their portfolio. So, you know, over the over the year to date, period, I've had lots of clients contact me, you know, what's going on with the markets, wiser everything going down? And what should I be doing. So anyone that has the long term timeframe, I say, you should do nothing, nothing differently than what you were doing already stick exactly to what you were doing, do not react, do not change the pattern, not pull money out, do not put a bunch of additional money and stick to your plan. And it will work out as the short term fluctuations kind of go away. But for those that have short term timeframes, you know, we'll address them one by one. So, you know, one particular person I can remember was contacting me he had a house payment due in six months, and he was invested very conservatively. But like I said, you know, bonds are down, which is the your conservative investment. So, you know, I told him to take all his money out now, don't wait for another six months, and hope it comes back, do the do the prudent thing, take your money out of the market, remove the uncertainty. And, you know, those are the types of decisions that we make for clients.

**Pat Bolland** 13:08
Yeah, I wonder though, if there are sectors that are a little bit safer. And I'm talking now about preferred shares, so they pay a dividend stocks for that matter, whether that's banks or life insurance companies or anything along those even, I don't know, real estate as a as an investment, although I got to point out real estate's pretty volatile as well. What are your thoughts?

**James Gauthier** 13:33
Well, I'd say of all those different asset classes that you mentioned, real estate probably has the dimmest near term prospects, again, with interest rates going up. That means mortgage rates are going up as well, things become a lot less affordable. And we've already seen market prices come down market activity come down the outlook for real estate, I would be a little concerned if I was to be a seller in the near term. Again, that's speculation. So so take it for what it's worth. But generally speaking, the other asset classes you don't I don't think there's anything that's more safe. Everything has risked in the long term risks associated with bonds tends to be lower than equities, preferred shares, there's somewhere in the middle, the short term who knows what's going to happen, but in the long term, you can kind of gauge that risk level based on the long term performance history. So bonds are the least volatile, preferred equity and you know, higher yield bonds are kind of somewhere in the middle. And then equities are at the other extreme, so there's always going to be a risk. No sector is ever safe.

**Pat Bolland** 14:43

Right? But people have traditionally said, invest in companies that pay dividends, for instance, not necessarily preferred shares, but companies that pay dividends because at some point, the dividends give you a cushion, right or wrong.

**James Gauthier** 14:59
Well, what I'd say It's different. It's diversification because you have a combination. So typically dividend paying companies are more stable, they're more mature, they're profitable, which is great to have, but they don't have much upside potential. So these kinds of companies are going to come in and out of favor over time. They might be a little more stable and down periods, putting up periods where people want growth, they're going to be going after, you know, the high tech companies, the ones that might not have profits now, but are going through rapid growth and have lots of promise for the future. So everything is cyclical, and things are going to come in and out of favor, but over the long term, you know, they're gonna be much more predictable in terms of what they're going to return.

**Pat Bolland** 15:45
Right. So your message, James, overall, stick to your plan.

**James Gauthier** 15:49
That is always the message. Yes.

**Pat Bolland** 15:54
James, it's great to chat.

**James Gauthier** 15:56
Good to see you again. James Gauthier, Chief Investment Officer, Justwealth Financial.