LA PRESSE

Strong Start to the Stock Market

TRANSLATED FROM FRENCH

February 4, 2023

Richard Dufour
La Presse

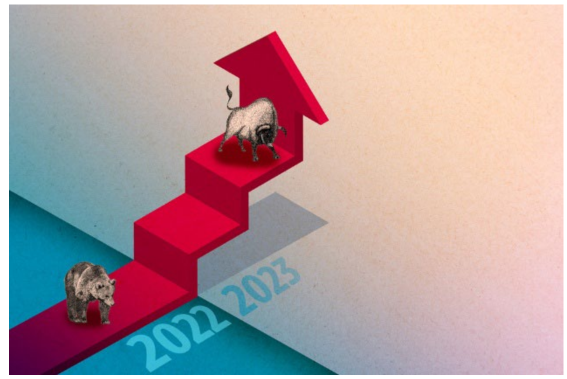

ILLUSTRATION LA PRESSE

After a very tough year in 2022, stock markets have shown some signs of euphoria since the beginning of the year. Are we heading for another crazy year like 2021?

The excitement and anticipation among investors have been palpable since the beginning of the year, as the Bank of Canada and the U.S. Federal Reserve have once again raised rates in an effort to calm inflationary pressures.

The NASDAQ gained 11% in January, while the main index of the Toronto Stock Exchange and the S&P 500 index recorded increases of 7% and 6% respectively.

Markets are focusing on the future, which is why long-term interest rates have already started to fall and stock prices have stabilized, says portfolio manager Stephen Takacsy of Montreal-based Lester Management.

“Investors who panicked have so far missed a strong rebound since the lows of mid-October 2022,” he adds.

The early-year agitation reminds Jean-Philippe Bouchard, portfolio manager at Giverny Capital, of the importance of being present in the market at all times. “If you miss the 10 best days of the year, you miss a large percentage of returns.” According to him, there’s no point in trying to time the market. One must have the humility to admit that predicting increases is impossible, he notes.

The Taste for Risk

IA Investment Management strategist Sébastien McMahon notes an outperformance of growth stocks and meme stocks – popular with retail investors in 2021 – as well as a rebound in the most shorted stocks. This leads him to believe that the quality of the rebound may not be sufficient to support a sustainable rally.

In January 2021, cryptocurrencies and meme stocks (such as GameStop and BlackBerry) were sharply pushed up by retail investors.

Portfolio manager Marc L'Écuyer of Cote 100 also notes that the "riskiest" stocks rose sharply in January, particularly tech sector stocks and cryptocurrencies.

"We saw euphoria return. Anglophones speak of FOMO [fear of missing out]," he says.

"I wouldn't go as far as to say it will last very long. It will be short-lived."

Historically, the year following a negative year is positive most of the time, says portfolio manager Ian McLean of McLean Capital.

He estimates that the probability of the stock market recording two consecutive negative years is less than 20%.

"So, just because everyone is gloomy and anticipating a recession doesn't mean it won't be a good year. The market is clearly saying: 'inflation is over, and we are moving back to more accommodating fiscal and monetary policies.'"

Ian McLean, portfolio manager at McLean Capital

Stephen Takacsy explains that the first signs of an easing labor shortage and a decline in prices in the "overvalued" real estate market should lead to a reduction in housing costs, which are an important component of inflation measures.

He adds that inflation expectations have "significantly" decreased and as the economy and inflation slow down, monetary policy should eventually shift towards lower short-term interest rates and thus an injection of liquidity into the financial system. "All of this is part of the normal economic cycle and will create a much more favorable environment for financial asset prices."

"The market seems to believe that we may have seen the worst of inflation," adds Ian McLean.

"Some people think central banks were wrong and went too aggressively. Others find that 2022 was a strange year. And yes, it was in many ways, but at the same time, previous years were strange. Zero rates for so many years is not normal. It has abnormal impacts on all markets [bonds, real estate, stocks]. People got used to a very accommodating financial world. It's possible that we now spend several years in a more normal world in that regard," says Ian McLean.

The Competition from Bonds

His colleague Marc L'Écuyer admits that the market can continue to do well, but calls for reflection. "We are in a period where it will be much more difficult to generate gains because today, we have options that we didn't have a year or two ago."

He mainly thinks of bonds.

"Bonds at 5% – for many people, that's where the money is going, not the stock market. There may be money on the sidelines waiting to be reinvested, but it won't necessarily go into the stock market."

Marc L'Écuyer, portfolio manager at Cote 100

A reallocation of assets towards fixed income is to be considered due to rising rates. "Even for us, as portfolio managers, it had been years since we asked ourselves the question. We want to be in the stock market as much as possible, but now, we're taking a step back and there are discussions to be had. A yield of 5% or 5.5% is attractive. We continue to favor the stock market, but let's say we have more interesting discussions about asset allocation than in the past," confides Marc L'Écuyer.

As an example, he says he bought municipal bonds before the holidays. "It was one of the best rates I've had since the beginning of my career at Cote 100 in 2003. That goes way back. It's been 20 years since we had such attractive rates. Even during the financial crisis, it didn't go up as much."

For his part, Stephen Takacsy believes that as the year progresses and central banks begin to reduce interest rates due to lower inflation, leadership should shift towards the stock market.