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LEROY WEALTH MANAGEMENT GROUP

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Sonia LeRoy
Sr. Wealth Advisor
B.A. Hons (Econ)
CFP®, RFP, RIS

Adrian LeRoy
Wealth Advisor
B.A. Hons (Econ)
RIS

1525 Carling Ave, Suite 504
Ottawa, ON K1Z 8R9

40 Eglinton Ave East, Suite 402
Toronto, ON M4P 3A2

Toll-Free: 1-800-700-3589
Fax: 1-866-559-2521

Email:
sonial.leroy@ipcsecurities.com
adrian.leroy@ipcsecurities.com
www.theleroygroup.com

Last year, 2022 began with a fresh covid wave, and a sense that economies that had begun to adapt to living with the virus may need to find new ways to do so longer term. Economic activity post-lockdown rebounded strongly, and employment levels reached new, all-time highs while interest rates fell to record lows.

Pent-up consumption demand increased, outpacing supply. The effect in the housing market was accentuated by lower costs of borrowing than had been seen in decades. Meanwhile, a brutal war in Ukraine, a zero-covid policy in China, and multiple climate-enhanced natural disasters continued to restrict supply chains, and inflation settled in.

Central banks in North America, whose primary mission is to control inflation, responded by increasing interest rates, and signaling further rapid increases. Stock and bond markets responded quickly to these economic cues, anticipating the slowdown that should eventually result from the central bank's medicine in 2023.

Another interesting development in capital markets has been the much more widespread adoption of environmental, social, and governance (ESG) integration as a risk management tool. Exposure to climate related risks is becoming increasingly recognized as material to a company's wellbeing, as is the corporate prevalence of diversity and inclusion, and taking responsibility for all types of risks in one's supply chain. These ESG capital market pressures are leading to increased transparency and regulation. At the same time, an increasing number of investors are choosing to invest with the environment, social considerations, and corporate governance in mind. According to the 2022 Canadian Responsible Investment Trends Report, in Canada responsible investments under management have remained steady at about $3 trillion.

What about a recession?

When the economy shrinks for two consecutive quarters a recession has occurred. Some economists have been predicting recession for Canada, and others forecast significantly slowing growth. There have been similar predictions for the U.S., while Europe is more widely expected to experience recession, primarily due to war-related energy impacts.

Whether we are in or may face a recession or not may not be very meaningful. By definition, a recession is always in hindsight. Furthermore, mild recession and very low, slow growth may feel similarly painful to those living through such times.

What should investors do?

The most important thing to remember for investors is that recessions are part of normal economic cycles and should not necessarily be something to be afraid of. Economic downturns create opportunity for companies to offer new solutions and revolutionize industries. They also create environments to force underachieving companies to either improve or be replaced. This translates to opportunity for active investment managers. Post-recession investing environments and results are usually improved from previously, thanks to recessions. Recessions happen, after all, to correct economic imbalances and excesses.

For active, long-term investors then, periods of economic slowdown or downturn, while painful to live through in the short term, almost always serve to improve investment outcomes over time. The first trick is to remain invested (most investors do not, abandoning investment markets when they feel scary, which in hindsight also is often the moment of greatest opportunity and the worst time to leave. Furthermore, most attempts at market timing fail for the same reasons). The second is to have a strategy in place to ride out the short-term effects of volatility. For investors at the saving stage, this can mean having a strategy of dollar-cost averaging in place: a plan of regular periodic, systematic investing regardless of economic news. Rebalancing is also a strategy that can take advantage of short-term market fluctuations. For those relying on portfolio income in retirement, for example, this can mean having a cash wedge strategy, combined with investments designed to generate consistent yield, regardless of price fluctuations. The trick is not to have to sell at moments where prices are down.

What could be next?

As 2023 unfolds, economic evidence may increasingly indicate that the central bank's measures are taking effect, and investment markets predictions may begin to take form as capital markets adjust to the new realities of inflation and higher interest rates, slowing growth and persistent geopolitical risks. But remember, investment markets build in future predictions, not current conditions. Just as 2022's market volatility coincided with strong growth and record strong employment, 2023's tougher economic environment could bring the end in sight for the challenging volatility that defined 2022 investment markets.

Already, financial markets seem to be predicting the central banks interest rate bitter medicine will work. Money markets responded to the most recent interest rate increase by actually dropping mid and longer-term rates, signaling a belief that inflation may stabilize and central banks will ease off and even lower rates sometime after 2023.

But, even if the fulfilment of the promise of bad news can foreshadow good news for investors, Canadians living through economic slowdown or recession may still need to navigate difficult economic conditions in their day to day lives for a little longer.

According to recent polls, inflation tops the list of financial concerns for Canadians, and debt re-payment is not far behind. According to StatsCan, food and housing costs remaining stubbornly high. Consequently, interest rates are expected to remain high throughout much of this year, even if they stop rising.

The good news for those in the work force is that strong employment persists. Even if employment levels ease somewhat, unemployment will likely remain historically low. The good news for retirees is that pensions and benefits, and even tax brackets linked to inflation are rising, making it easier to weather the storm. And, for those with investments, you are in control, even if sometimes it feels otherwise. Being faithful to a good retirement income strategy with good investor behaviour can help investors avoid any long-term damage, and even benefit post market-recovery, despite short term price drops that are beyond one's control.

A final word about responsible investing

Responsible investing is becoming firmly entrenched in its many forms, and choice continues to increase. But it may not be becoming easier to align your investment choices with your values. In fact, proliferating choice may have led to more confusion, as well as the risk of greenwashing. There are more responsible investing strategies than ever before, from the table stakes of ESG integration to corporate engagement, positive and negative screening, and impact investing targeting such things as the environment and diversity. The 2022 Canadian Responsible Investment Trends Report points out that there is a challenge in that most people do not understand the difference between these strategies, or their intended outcomes, let alone the underlying methodologies. All the different terminology does not help either: ESG investing, sustainable investing, responsible investing.

The investment industry is undergoing increasing pressure from investors, and regulators, and from other stakeholders to integrate environmental, social and governance considerations into investment processes. The industry is also currently considering a new, more standardized way of describing and identifying the different responsible investing methodologies, as well as requiring a heightened level of ESG disclosures for improved transparency. Hopefully these changes will bring more clarity to the responsible investing landscape.

In the meantime, as responsible investing specialists, we are here to help you navigate the ever-changing investment landscape to best align your money with your objectives and your values. And we remain here to help you ensure your financial strategy will help you weather the ups and downs of financial markets and navigate an uncertain economy.

May 2023, bring you love, friendship, prosperity, and peace of mind.

The LeRoy Wealth Management Group