REVIEW AND COMMENTARY
3rd QUARTER – 2023

Our expectations that more defensive stocks would outperform in the last half of 2023 has been undermined, so far, by increasing concerns about the economy. While the mantra of “higher interest rates for longer” resonated louder over the past month, the pressures on the US economy continue to grow. At the beginning of the year, we predicted that there might be, at worst, a mild recession in 2023. To date we have been right but economic production (or lack thereof) is a lagging indicator- the statistics are reported weeks, if not months, after that actual period being measured.

The US economy has been resilient, but concerns remain. Just as the 148 day Screen Writers strike was resolved in September, the automotive strike took centre stage only to be over-taken by the looming US government shutdown (which has been temporarily stayed until mid-November). The automotive business accounts for roughly 3% of the US GDP. The Movie and Creative Arts industry account for approximately 3.2% of the GDP goods and services. Add in the potential of a pending government shutdown in November given the recent dysfunction of the Republican led Congress, and the vulnerability of the U.S. economy is clear.

Short-term investors behaved predictably in September. This shouldn’t be a surprise. Beyond pure economics, September, historically, is the worst month of the year when it comes to performance of the stock market. Given the most recent quarter, are defensive stocks likely to outperform in the last quarter of 2023? If they don’t, they certainly should in 2024.

The stock market is a leading indicator- it moves in anticipation of future events. While September remained true to historic norms, the stock market may be offering some historic opportunities in the more defensive names. If we look only at the common shares of the five major Canadian banks, the average yield (if you were to own equal amounts in all of them as of October 1st, 2023), would be approximately 5.8% *, with a range of 7.2% to 4.7%. There are few times in recent history when the common shares of the major banks’ average yield has been close to/ higher than present levels. While this often happens in time of duress (like the financial crisis of 2008-2009 or during COVID in 2020), it is important to remember that the risk to our economy appears no where close to the stress levels of either of those time periods. There are many more defensive stocks that offer higher yields, such as Utilities. Most of the defensive names, if not all, are sensitive to the level of interest rates. If investors are worried that a recession is imminent, bond prices would be more likely to go up rather down (and yields down rather than up) making defensive stocks more attractive. If the economy does slow significantly, the same tools used to slow an economy can be reversed.

Interest rates are one of the most potent instruments to change the course of an economy. Rates have been on the rise for the past year and have yet to derail the economy. Higher rates have curtailed inflation and save the most recent decline in bond prices, the interest rate cycle appear close to, if not already, peaking. So investors who can lock in the present yields these defensive names presently offer will be rewarded for years to come.

*using the average share price in December 2008 and April 2020