BMO Global Asset Management

April 15 to April 19, 2024

Jerome Powell Was Right

Weekly Commentary

Inflation

Last week, U.S. inflation numbers for March came in hotter than expected, prompting yields to rise and markets to reevaluate their rate cut expectations. The data highlights that the last leg of the inflation fight—from the 3% range to the 2% range—is going to be difficult, and may not come down in a straight line (as evidenced recently). We don't think there's a risk of inflation flaring back up to 2022 levels. The problem instead is that the U.S. Federal Reserve (Fed) and other central banks have specific inflation targets, and they may not feel comfortable cutting interest rates until they're certain there's enough momentum to get to the 2% range. January and February weren't great months in this regard, and the March numbers were a continuation of that trend, likely pushing rate cuts further down the road. Markets now appear to be getting the message: at the start of the year, they were assuming six rate cuts; then it was three, but markets didn't move because they still felt cuts were going to occur in 2024 and were just delayed; now, the most likely scenario is only one or two rate cuts in 2024, and we wouldn't be surprised if there were zero. What happened with yields was a delayed reaction—markets are resetting because they finally believe the Fed's "higher for longer" messaging. It was almost a reversal of the drop in yields that we saw in November when the Fed indicated that a pause was imminent. While some may be questioning whether Fed Chairman Jerome Powell can still guide the economy to a soft landing, we don't think markets have lost confidence in the Fed at all. In fact, with the benefit of hindsight, Powell was right—CPI didn't come down as much as everyone had expected. Now, the Fed will have to determine whether they'll need to see 2% inflation in the next couple of months in order to cut rates, or whether they'll be happy reaching 2% over the course of several months or the next year, which would allow cuts to come sooner.

Bottom line: We continue to expect at least one rate cut from the Fed this year—the question is whether it will come in the summer, the fall, or as late as December.

Expert

Sadiq S. Adatia
Chief Investment Officer BMO Asset Management

Mr. Adatia joins BMO AM from Sun Life Global Investments, where he most recently held the role of Chief Investment Officer. Prior to that, he held investment roles at Russell Investments Canada and Mercer Canada. He holds an Honours Bachelor of Mathematics degree in Actuarial Science & Statistics from the University of Waterloo. He is also a CFA Charterholder and is a Fellow, both of the Society of Actuaries (Investment Specialty Track) and the Canadian Institute of Actuaries.

Earnings

Earnings season is around the corner, and it's reasonable to wonder whether the rate cut trajectory will affect how companies provide guidance. In our view, the interest rate situation likely won't be a significant talking point, but the state of the consumer could be. In particular, we'll be paying close attention to Consumer Discretionary and Consumer Staples—if companies like Walmart indicate that they're seeing a rotation within their own stores from higher-value items to lower-value items, that could be proof that consumer spending habits are changing. More broadly, portfolio managers and analysts from our Global and Fundamental Equity teams will be monitoring earnings announcement with a focus on three areas: geopolitical risks, inflation, and the consumer. They'll convey those insights to the broader investment team to make sure everyone is attuned to the latest developments, just as they do after their frequent trips to conferences and meeting with corporate leaders.

Bottom line: We believe consumer spending patterns are changing—that's why we've shifted to neutral on Consumer Discretionary vs. Consumer Staples from our previous tilt toward Discretionary.

Oil

We've believed for a while that $80-$90 per barrel was the right price range for oil, and that's exactly where it's been trading for the past several weeks. Given geopolitical risks, it's possible that it could cross the $90 mark. But for now, we've moved back down to neutral on Energy because we've already had a good run-up and we're happy with our gains. While we haven't eliminated our position entirely, we don't necessarily want to threw new money at it, and we've sold some call options on the sector in order to crystallize our profits. Looking ahead, we believe the supply-demand balance in the oil market is appropriate: the economy is not likely to experience a hard landing, so demand should stay up, and OPEC should feel comfortable enough in the $80-$90 range that they won't need to unlock additional reserves.

Bottom line: Given supply and demand dynamics, we believe that oil prices are currently within an appropriate range, so a neutral stance makes sense.

Positioning

For a detailed breakdown of our portfolio positioning, check out the latest BMO GAM House View Report, titled ***Delayed Again: The Soft Landing that Never Comes***.

GAM Monthly House View

Apr 12, 2024

Read Article

Market Update

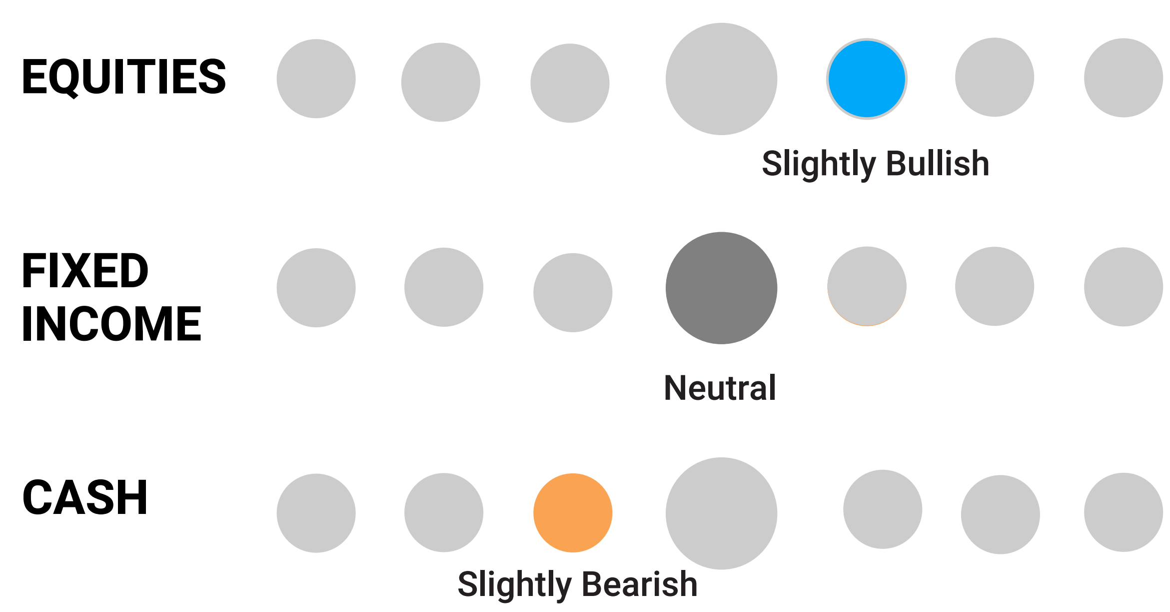
- Equity markets struggled this week as a tough U.S. inflation print further dialed back rate-cut expectations.
- The S&P 500 fell 1.6%, with financials, health care and materials posting the deepest declines. A mixed bag of early bank earnings also weighed late in the week.
- Meantime, the TSX gave back 1.6%, as health care was trounced more than 12%, while higher-yielding names struggled.

Asset class views, as of April 2024

Monthly Perspectives

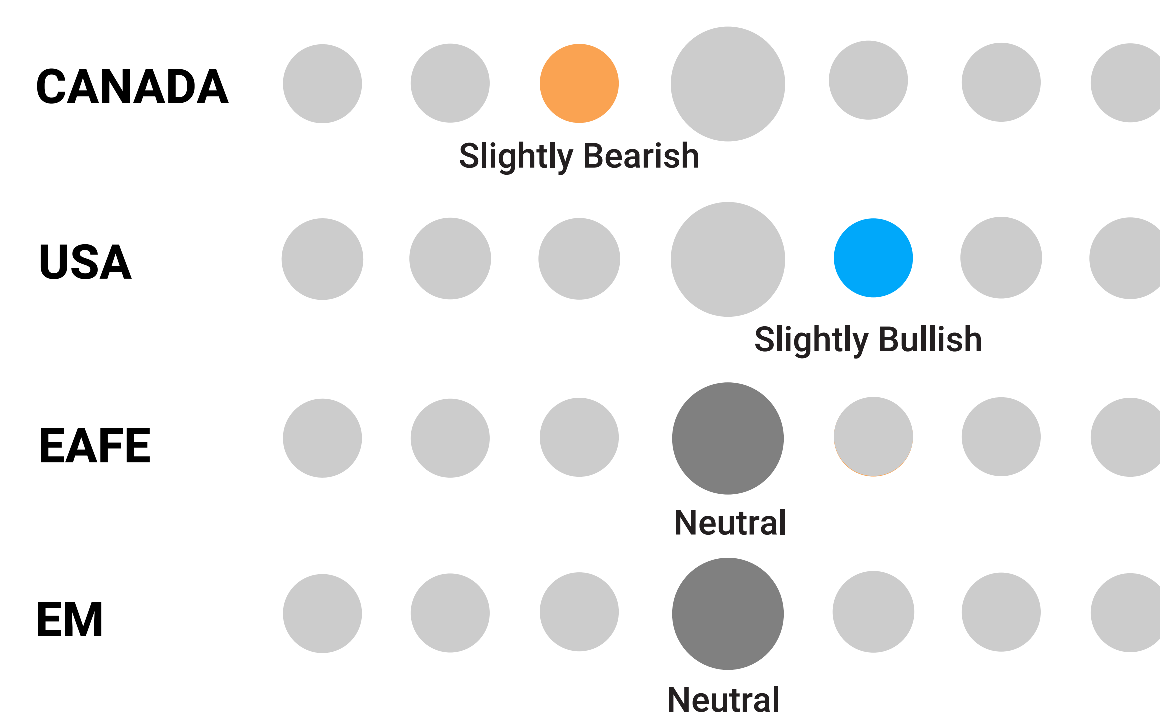
Asset mix

- We maintained our small tilt to equities as the U.S. economy continues to perform above expectations and looks capable of maintaining favourable momentum during the first half of the year.
- We continue to prefer fixed income over cash on a longer-term basis as U.S. Federal Reserve (“Fed”) and Bank of Canada (BoC) monetary policy is widely expected to pivot to rate cuts later this year.



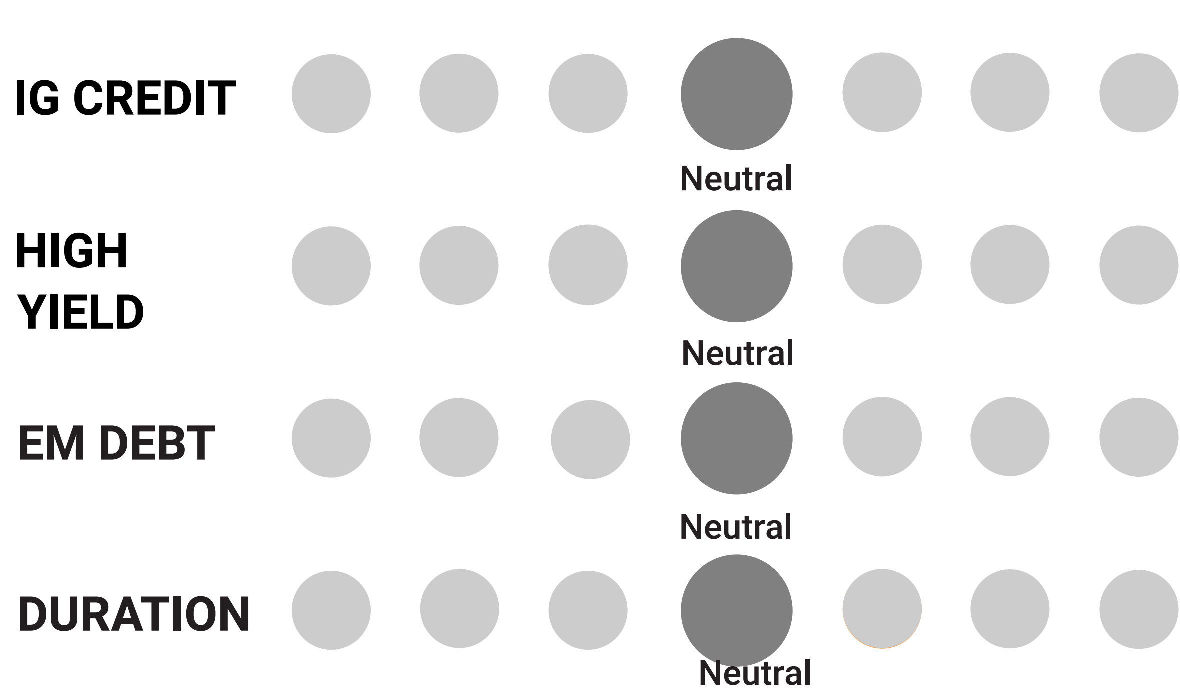
Equity

- Our regional equity mix remains unchanged this month.
- We remain underweight Canadian equities and continue to prefer U.S. equities.
- We prefer to be tilted toward higherquality and tech-oriented companies and benefit from the far more robust U.S. economy.
- We expect the Canadian economic outlook to continue to soften in 2024 as rate hikes are weighing on the economic outlook and the loonie.



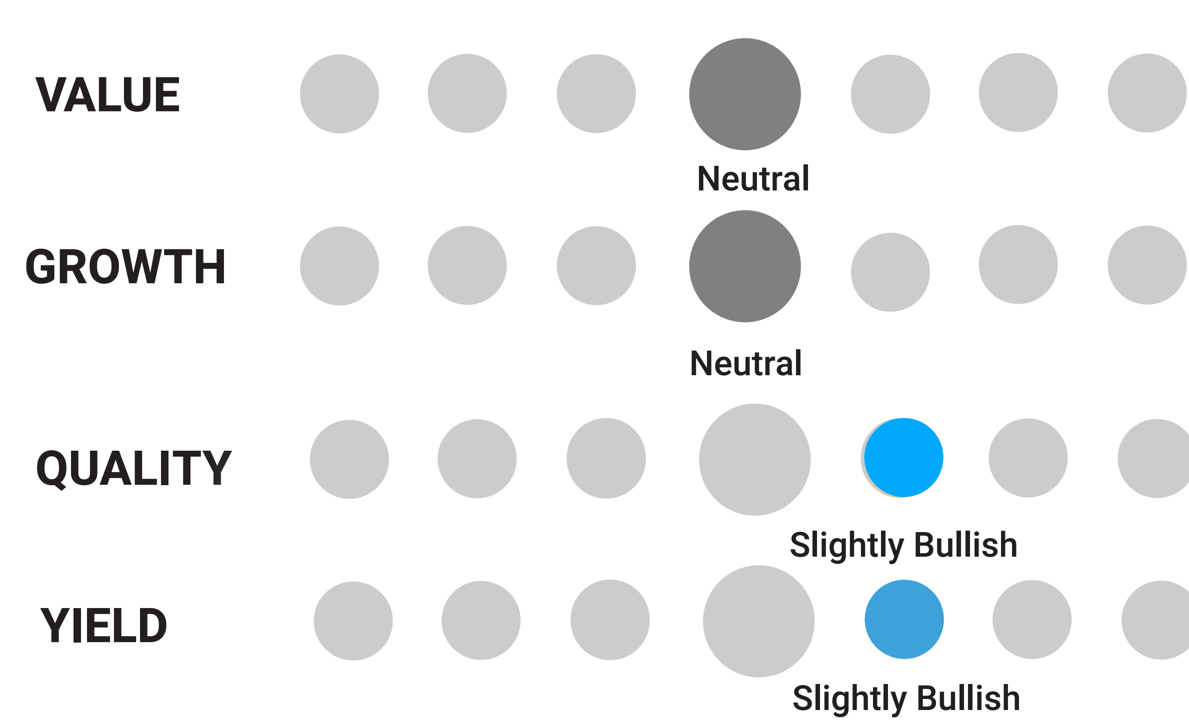
Fixed Income

- We remain neutral across fixed income as the near-term outlook for monetary policy remains uncertain regarding the timing and amplitude of Fed and BoC rate cuts.
- We stay neutral duration on a robust U.S. growth outlook which could continue to push back rate cut expectations.
- We continue to like gold as a hedge against another backup in long-term interest rates or if the U.S. economy were to cool faster than expected.



Style/factor

- We continue to prefer higher quality companies that enjoy stronger balance sheets and pricing power, which enables them to have more resilient and wider profit margins.
- We are bullish on firms that can improve and deliver strong dividends. If rate cuts materialize this year, we expect investors to rotate in favour of this sector.



Implementation

- We continue to like gold as a hedge against downside macro risks.
- We think gold could continue to shine if investors were surprised with renewed bank stress or inflation anxiety. The latter would push back Fed rate cuts and re-ignite a risk-off U.S. Dollar rally, weighing on the loonie.
- Central bank demand remains strong with room to increase further, which will help support gold prices going forward.