PALOS

Weekly Commentary

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On our Radar for Summer of '23

To our readers, please note that this will be our last weekly newsletter prior to our summer hiatus so we thought we'd take the opportunity to highlight what will be on our radar over the next eight weeks. We will continue with publishing performance during this time and our regular newsletter will resume on Monday September 11.

Although the summer months have traditionally been a quiet time in financial markets, the news reels don't pause and there will be plenty of things to monitor. Below, we have highlighted what we'll be closely watching this summer.

Inflation: This has arguably been the most followed story over the last year. Well documented is the fact that the accommodative fiscal policies that began in 2020 and were designed to lessen the economic impact of the pandemic, culminated in "easy money" being the culprit of the highest inflation rates in decades. To battle rapidly rising inflation, central banks began aggressively raising interest rates with the objective of slowing down the economy and taming inflation. In the U.S., the Federal Open Market Committee (Fed) raised rates ten times between March 17, 2022 and May 3, 2023. The Fed's "target rate" rose from 0.25% to 0.50% in March 2022 and rose to a target of 5.00% to 5.25% at the most recent meeting. In Canada, rates rose in similar fashion.

Interest Rates: The Fed's next meeting will be on July 26. Last month, Fed Chairman Jerome Powell announced that a strong labour market and stubbornly high inflation would require a continuation of restrictive monetary policies. Powell clearly signaled that his expectation was for an additional 50 basis point hike this year. The likely path is a quarter-point increase at the July meeting followed by another quarter-point in the fall. There's no Fed meeting scheduled in August. Fed policies have become one of the most hotly debated topics on Wall Street and hence a key focus of investors. The big question is, "has the fed tightened too much or too little?" Eventually the Fed will take a pause, and many believe at some point an interest rate cut might be needed if in fact the Fed went too far. Of course, only time will tell but something to keep in mind is that we are surely closer to the end of an aggressively hawkish Fed than the beginning. Historically, rising interest rates act as a headwind for stocks and falling rates a tailwind.

Second quarter earnings: It would be an understatement to say that Q1/2023 earnings were much better than anticipated. The primary argument for the bearish camp has been that a slowing economy would "eventually" weaken corporate profits. This did not happen. In fact, earnings multiples remained robust in the face of rising rates. With the bears steadfastly sticking to their guns, their argument has been that the "weaker earnings" scenario would ultimately translate to falling stock prices. Meanwhile, the bullish camp has argued that the "earnings recession" scenario has already played itself out and that this was factored into equity prices during a bear market that ran from a late 2021

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peak through an October 2022 bottom. This position certainly has merit as global stock markets are materially higher than they were last fall.

Geopolitics: There are two significant geopolitical matters playing out. Firstly, with the war in Ukraine surpassing its 500th day, the big question is when does misery ends? Throughout history virtually every war has ended with a negotiated peace. The unfortunate reality of the current conflict appears to be nowhere near a conclusion. However, as witnessed a few weeks ago, events can materialize and potentially change things in an unexpected fashion. While there are no significant signs of a slowdown in the conflict, we will certainly have events on our radar.

The second major geopolitical issue are relations between China and the West. The economic ramifications of deteriorating relations are many and includes the impact on trade, access to critical materials, energy, and technology. We have become increasingly dependent on China's dominant position as the world's chief supplier of the materials needed for transportation electrification and in Taiwan for semiconductors. In fact, the Taiwan conundrum has ushered in a new era of onshoring which should be a positive for our tech sector. However, building a domestic semiconductor industry will take years (some say a decade). In what could turn out to be a positive development, U.S. Secretary of the Treasury Janet Yellen embarked on a visit to Beijing last week where the outcome has been described as "a step forward" in building stronger relationships and improving diplomacy.

Commodities: The price of metals like copper (construction, electric vehicles), oil and gas (cost of transportation, home heating and cooling), and agricultural commodities (food) are highly corelated with inflation and for obvious reasons they serve as important economic indicators that must be monitored. Crude oil prices, as measured through the West Texas Intermediate (WTI) futures markets, are an important barometer with regards to inflation. Since peaking in June 2022, prices have dropped by roughly 30% despite sanctions imposed on Russian oil. This is good news for consumers, airlines and the cost of transporting goods. Lower energy costs ultimately transition to lower prices.

After reaching all-time highs in March of 2022, copper prices corrected over the ensuing three months and volatility has recently moderated. A similar pattern has emerged in iron ore. Prices in industrial metals are indicative of trends in economic activity and inflation. In the agricultural sector, the prices of wheat and corn are near one-year lows while prices in live cattle contracts are treading near all-time highs; perhaps this explains the price of a steak at the grocery store or at your favorite restaurant! Coffee futures are near a two-year low while cotton prices, a key input for the apparel industry, have recently trended higher but remain well off the June 2022 high. To summarize, we see no clear evidence of inflationary pressures in the price of input materials.

As always, experience has taught us that "unexpected surprises" are omnipresent in this business and that these can be of either a positive or negative nature. While we will be taking a short break from writing our newsletter, we will continue to monitor markets and economic developments daily and we'll continue to manage portfolio risk and pursue good investment opportunities accordingly.

The Palos team would like to extend our wishes to you and your loved ones for an enjoyable summer. Enjoy the pleasant weather and please note that if you missed any of our previous issues and you would like to catch up on some reading, past issues of our Palos Weekly are accessible on our website at www.funds.palos.ca/news/

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.19	4.15%
Palos Equity Income Fund - RRSP	PAL101	$6.67	3.30%
Palos WP Growth Fund - RRSP	PAL213	$10.87	-12.64%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.73	22.97%
S&P TSX Composite (Total Return with dividends reinvested)			4.18%
S&P 500 (Total Return with dividends reinvested)			15.58%
S&P TSX Venture (Total Return with dividends reinvested)			7.92%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.06%
Canadian Government 10-Year			3.57%
Crude Oil Spot			US $73.86
Gold Spot			US $1,932.50
US Gov't10-Year/Moody BAA Corp. Spread			182 bps
USD/CAD Exchange Rate Spot			US $0.7534

[1] *Period ending June 7th, 2023. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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