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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to ensure you are well informed. We sift through the noise and only bring you important topics of discussion and planning points useful to you.

We believe Knowledge Pays and we want our knowledge to pay for you.

THE INFLATION MONSTER COMETH – HOW TO INVEST WHEN INFLATION RUNS RAMPANT

In May, inflation in Canadian and US climbed to its highest level in over a decade, stoking fears in consumers and investors. The damage inflation can cause consumers is easy to quantify. Those whose wage growth falls below the rate of inflation will experience lower purchasing power and they may need to cut back spending. The effect on investors is harder to quantify. How does inflation affect investments?

Bonds/Fixed Income

Inflation is notoriously bad for the majority of fixed income securities. All else being equal, higher inflation results in higher interest rates across the fixed income universe. Existing bond prices need to fall to reflect the higher inflation expectations. Short-term bonds will perform better in a high inflation and rising interest rate environment. Some bonds like real return bonds (TIPS) rise in value alongside inflation expectations and interest rates but these bonds have limited upside beyond inflation.

Stocks

It is a widely held belief that stocks do well during periods of elevated inflation and rising interest rates. While this is often true, *relative to bonds*, not all equities offer inflation protection. Overall, stocks tend to perform well during periods of mild to average inflation and underperform during periods of high to very high inflation. Historically, technology is the place to be in a low inflation environment, energy and materials are outperformers in mid-to-high inflation environments, and defensive stocks are the place to be in a hyperinflationary environment (due to recession risk).

Commodities

Commodities do well in times of high inflation as they drive inflation. Energy, base metals and precious metals all tend to do well during periods of high inflation.

Alternative Investments and Real Estate

Real estate tends to perform well during periods of high inflation as real estate is a core inflation input and real estate consists of many different commodities. Other alternative investments tend to do okay in any stable economic environment.

	Low Inflation (<2.3%)	Mild Inflation (2.3%-3.3%)	High Inflation (3.3%-4.9%)	Hyperinflation (>4.9%)
Best Asset	Stocks	Stocks	Commodities, TIPS	Commodities, TIPS
Best Stock Sector	Technology	Energy	Energy, Materials	Defensive Stocks
Best Commodity	Energy	Energy	Industrial Metals	Gold

Source: RMB Capital and BCA Research

<u>Despite the fear of rampant inflation, inflation is likely to return to normal levels by mid-to-late 2022 due to China's actions to cool its economy and waning pandemic-related stimulus globally.</u>

Current Rates & Data

Govt of Canada

90 day	0.13%
1 year	0.22%
2 year	0.45%
5 year	0.89%
10 year	1.27%
30 year	1.79%

U.S. Treasury

90 day	0.04%
1 year	0.05%
2 year	0.22%
5 year	0.79%
10 year	1.32%
30 year	1.94%

Canada Prime Rate

2.45%

U.S. Prime Rate

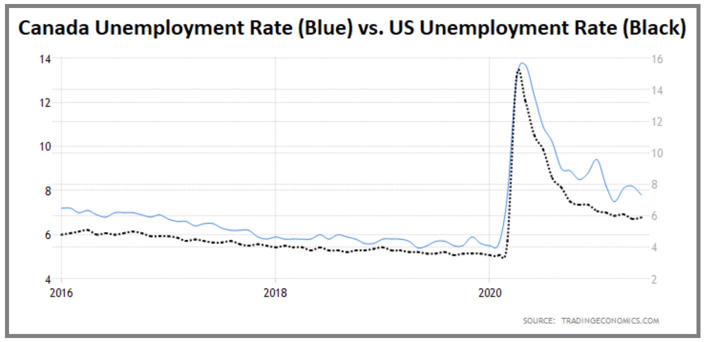
3.25%

Exchange Rates

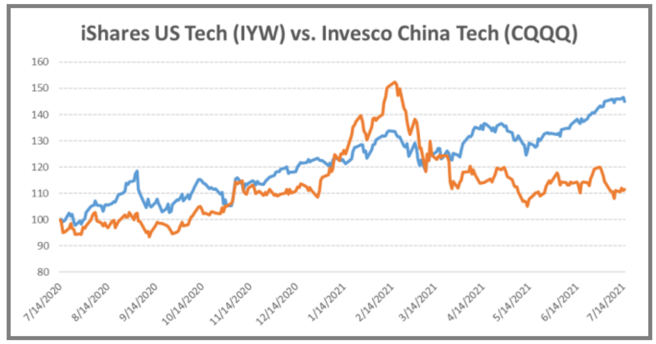
CAD/USD	0.794
USD/EUR	1.181
JPY/USD	110.2

ECONOMIC TIDBITS HIGH QUIT RATES DESPITE ELEVATED UNEMPLOYMENT & CHINA CRACKS DOWN ON BIG TECH

- Workers in Canada and the US are quitting their jobs at elevated rates in 2021. This is despite labour participation rates that are 1%-2% below pre-COVID levels and unemployment rates that are ~2% above pre-COVID levels. A reversal of below average quit and retire rates in 2020, some workers' reluctance to return to work with COVID still present and labour market skew help explain this phenomenon.



- In the past year, Chinese authorities reined in large Chinese tech companies that pose a threat to the ruling party. After panning Chinese banking practices, Alibaba CEO Jack Ma vanished and the IPO of Ant Group (an Alibaba subsidiary) was cancelled. Recently, Chinese regulators restricted user growth of rideshare company Didi Global. Perhaps central planning and data monetization are not compatible.



LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

Industrial Metals Best Hedge for Highly Inflationary (Though Not Hyperinflationary) Environment

- Industrial metal miners peaked in May following a slow and steady rally from the March 2020 lows. While industrial metals and associated miners may have further downside in the near-term due to China's efforts to cool commodity prices, trends such as the transition from oil/coal to natural gas and expanded electrification support long-term demand for copper, aluminum, cobalt, nickel and lithium in particular.
- **First Quantum Minerals (FM)** and **Alcoa Corp (AA)** are two ideas related to this theme.
- **First Quantum** is the closest you can get to a large cap pure play copper producer trading in North America. The company has large copper mining projects in Zambia and Panama and numerous undeveloped copper projects around the world. The company's all-in sustaining cost of production is ~40% of the current copper spot price so its operations are highly profitable at the current time.
- **Alcoa** is the largest aluminum producer and refiner in North America but has operations around the world. Aluminum production is highly energy intensive. If aluminum producers are eventually required to offset the carbon emissions of their aluminum production, Alcoa's access to low cost and relatively low emissions hydropower and natural gas could provide it with a long-term cost advantage relative to peers.

  Key risk points: Mining projects, especially in developing countries, come with additional regulatory and political risk. Commodity prices and stock prices rely on economic growth and overall investor sentiment.

JEANNINE'S TIP O' THE MONTH Cheer on Team Canada Starting July 23!

The 2020 Tokyo Olympic Games, which were postponed due to the pandemic, start on July 23 and end August 8. Another major milestone on our journey back to normalcy post-COVID and a global celebration of our unity as a species and our collective resilience.

Team Canada is sending 371 athletes, its largest contingent since the 1984 Los Angeles Olympic Games, so this year could be a historic one for Canadian athletes. Click here for the full Tokyo 2020 Olympic schedule.

This newsletter has been brought to you by Steele Wealth Management

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