Economic outlook.

Third Quarter 2022.

Inflation: Another import from the U.S.

By: James R. Solloway, CFA, Chief Market Strategist and Senior Portfolio Manager

SEI recently released its third-quarter Economic Outlook. A summary of the conclusions is provided below:

- Canada and the United States are both suffering from significant inflationary challenges.
- Central banks, in both advanced and emerging economies, are adopting similar policies aimed at creating the economic slack necessary to push inflation down.
- The Bank of Canada (Bank) and the U.S. Federal Reserve (Fed) have been quite clear with their intentions to return inflation levels to their respective longer-term targets of 2.0%. Bond markets currently reflect aggressive interest rate hikes going forward with at least another 75 basis points of increases expected over the 2 remaining Bank of Canada meeting dates for 2022 to bring the rate to 4.0%.
- Recent and expected rate hikes will be the most significant percentage increase in borrowing costs over the shortest period in Canadian history. The move in rates has been the prevailing force behind record-setting bond market losses for 2022.
- A global recession is appearing on the horizon, with Europe and the United Kingdom more vulnerable to a downturn than Canada or the United States in the months immediately ahead.
- Similar to the COVID-emergency of 2020, fiscal policy is once again being used by European governments to lessen the pain, this time to shield households and businesses from the full impact of the energy crisis.
- The United Kingdom, under the newly installed Truss government, has been especially aggressive in its tax-reduction and spending proposals; it is paying the price in the form of a sharp interest-rate spike across the maturity spectrum in its sovereign bonds and a decline in sterling to record-lows against the U.S. dollar.
- Risk assets more generally have come under pressure. We expect further up-and-down volatility across asset classes. We would not rule out another relief rally in the equity markets, given the extent of bearish sentiment currently prevailing and an oversold condition that matches what was seen in mid-June.
- The U.S. dollar also appears vulnerable to some sort of pullback given traders' extreme long positions in the currency.
- Inflation in the U.S. has probably peaked, but we do not expect it to fall as rapidly or as far as the Fed is projecting. We look for wage growth to be sticky because labour markets are still very tight. The drop in productivity this year is an aggravating factor, but also a puzzling one that economists have yet to resolve.
- The Fed historically has stopped raising rates close to the time the economy enters a recession. The central bank usually begins to cut its policy rate aggressively as the recession deepens and unemployment climbs.
- Corporate profits have held up well in the U.S., but the coming slowdown should pressure margins lower. We anticipate a mild-to-moderate recession in the United States and a more severe downturn in the U.K. and Europe. Profits could decline about 20% in the U.S. and a bit more in Europe when all is said and done.
- Equity prices are already anticipating an earnings hit, with U.S. large-cap stocks down already some 20% in the year-to-date. Although further stock-price weakness probably lies ahead, it is possible that the worst of the damage to equities may have already occurred.

A full-length paper is available if you wish to learn more about these timely topics.

Important Information

SEI Investments Canada Company, a wholly owned subsidiary of SEI Investments Company, is the Manager of the SEI Funds in Canada.

The information contained herein is for general and educational information purposes only and is not intended to constitute legal, tax, accounting, securities, research or investment advice regarding the Funds or any security in particular, nor an opinion regarding the appropriateness of any investment. This commentary has been provided by SEI Investments Management Corporation ("SIMC"), a U.S. affiliate of SEI Investments Canada Company. SIMC is not registered in any capacity with any Canadian regulator, nor is the author, and the information contained herein is for general information purposes only and is not intended to constitute legal, tax, accounting, securities, or investment advice, nor an opinion regarding the appropriateness of any investment. You should not act or rely on the information contained herein without obtaining specific legal, tax, accounting and investment advice from qualified professionals. This information should not be construed as a recommendation to purchase or sell a security, derivative or futures contract. You should not act or rely on the information contained herein without obtaining specific legal, tax, accounting and investment advice from an investment professional. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. There is no assurance as of the date of this material that the securities mentioned remain in or out of the SEI Funds.

This material may contain "forward-looking information" ("FLI") as such term is defined under applicable Canadian securities laws. FLI is disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action. FLI is subject to a variety of risks, uncertainties and other factors that could cause actual results to differ materially from expectations as expressed or implied in this material. FLI reflects current expectations with respect to current events and is not a guarantee of future performance. Any FLI that may be included or incorporated by reference in this material is presented solely for the purpose of conveying current anticipated expectations and may not be appropriate for any other purposes.

There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. There may be other holdings which are not discussed that may have additional specific risks. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity. Bonds and bond funds will decrease in value as interest rates rise.

Information contained herein that is based on external sources is believed to be reliable, but is not guaranteed by SEI Investments Canada Company, and the information may be incomplete or may change without notice.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.