High Interest Rates Are Good…

Many have been talking about the negative consequences of higher interest rates, but few have been talking about the positive.

Before finishing the sentence, “High interest rates are good…,” let’s discuss a few other items.

For almost one year now, central banks have been increasing interest rates. We have not seen this acceleration of rate hikes in decades. For the most part, central banks are raising rates to bring inflation under control.

In fact, for approximately the last 40 years, North American consumers have not experienced what it is like to be in a rising rate environment—nor have businesses. In addition, many investment professionals, real estate agents and other business professionals have not experienced a rising rate environment either.

Both consumers and businesses have been able to borrow at nearly zero per cent prior to 2022. Consumers were accustomed to rolling over or renewing maturing debt such as a mortgage at a lower rate, taking out equity from their ever-appreciating home, or consolidating debt to lower monthly payments (does refi sound familiar?). Corporations were able to buy back bonds and reissue at lower rates. New business ventures were able to raise billions in cash and burn through it, knowing they could raise more as needed.

Fast-forward to 2023 and rates are no longer at or near zero. With higher rates, there will surely be higher defaults—both personal and business. Casualties already include the housing market and I expect corporate defaults to increase, as debt-heavy companies have to renew or reissue debt at much higher rates.

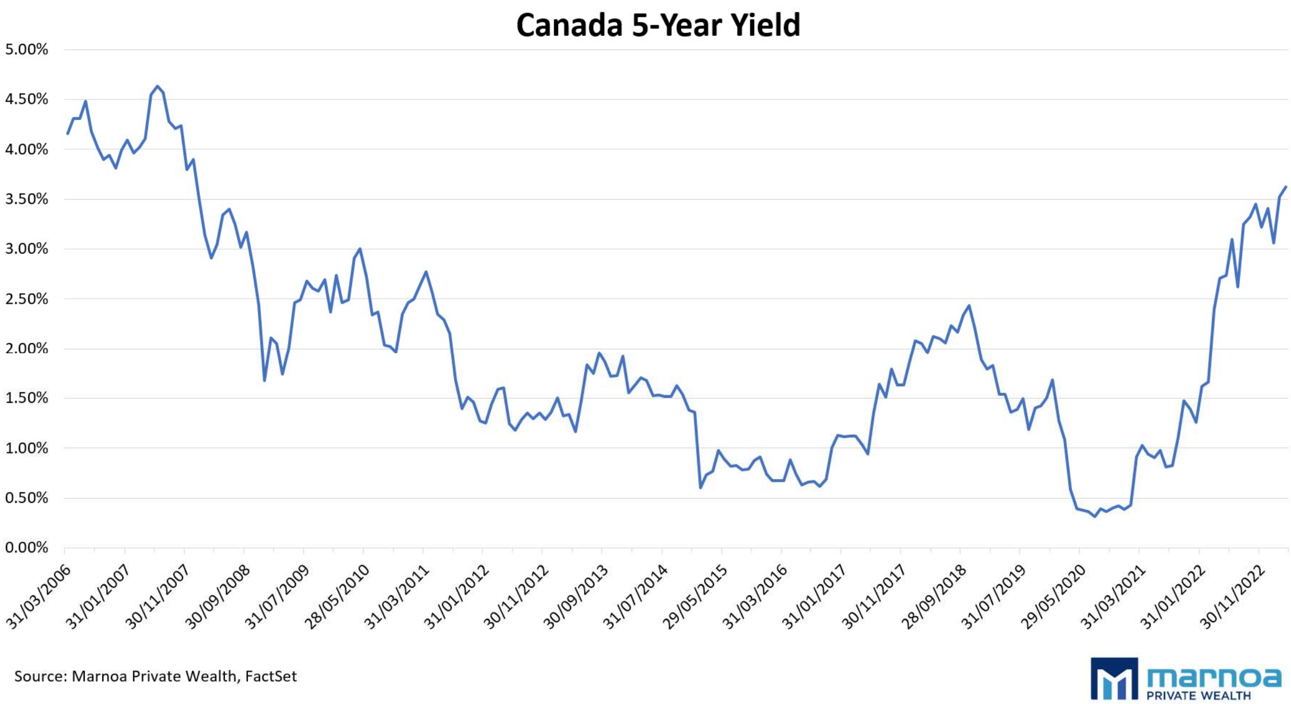
At the beginning of the year, the bond market priced in rate cuts or a pivot by central bankers in the latter half of 2023. As a result, bond yields pulled back. This means, interest rates were expected to decline. One reason for this to happen so quickly is the expectation of a hard economic landing (major slowdown in the economy). If the economy were to slow down significantly, central banks would once again lower rates to stimulate the economy.

As of February, the bond market had a different view. That was expressed in higher bond yields.

Today, bond yields are once again up and approaching their October highs as the bond market is now pricing in higher rates for longer. The expectation of higher rates for longer may be related to higher inflation for longer. Higher inflation may be directly related to a healthy jobs market (more job openings than workers available), elevated consumer savings, China re-opening and/or the importation of inflation – more on the importation of inflation in future letters.

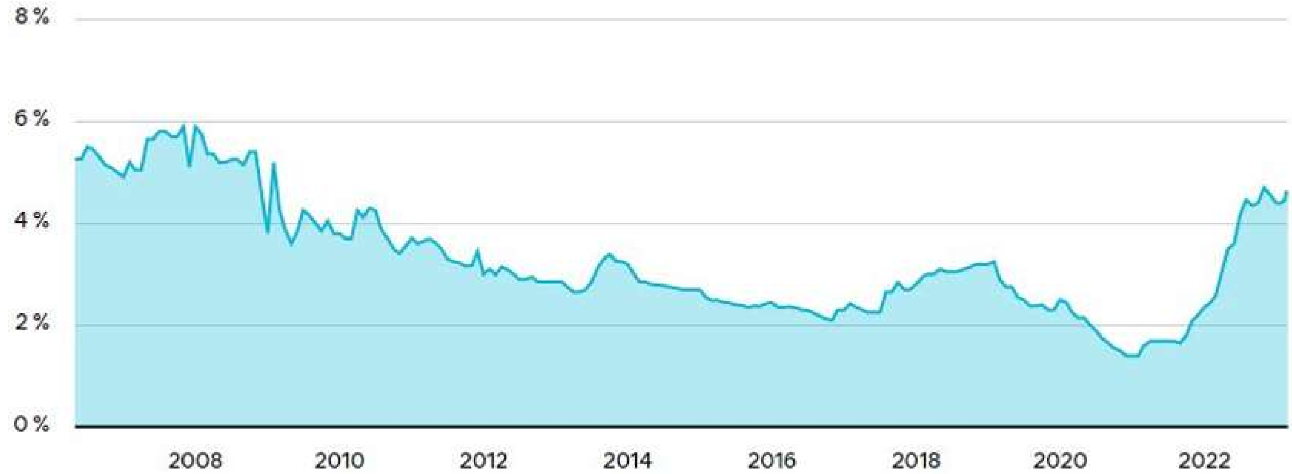
Can Canadians Handle Higher Rates?

Below, we provide two charts. The first chart shows the Government of Canada five-year bond. The second chart shows the historical five-year fixed Canadian mortgage rate.



Historical Discounted 5-year Mortgage Rates

From 2006 - Today



Source: RateHub.com

It’s pretty clear to see how mortgages correspond to bond yields. Homeowners who took out five-year mortgages in 2018 are now facing renewal. However, the rate is no longer around the three per cent range. According to the website, RateHub.ca, a five-year fixed rate mortgage is 4.59 per cent or approximately 50 per cent higher than the three per cent in 2018.

These rates are a far cry from the 10 per cent to 21 per cent that some of our clients experienced when they had to renew in the 70s, 80s and even 90s. But the magnitude of rate increases over the past year has many questioning whether Canadians can handle higher rates.

I do not expect interest rates to go into double-digit territory, but if you have a chance to speak to someone that did experience those rates, that may be a conversation very well worth having. Remember, most of us have no experience in a rising rate environment and for those that think rates can only go down, I encourage you to speak to someone that has lived through it.

History indicates that the impact of rising rates do not get reflected in the economy for at least 6 to 12 months after they start to rise.

We’re now at that point.

Higher Rates Are Good… For Retirees

On the bright side, higher interest rates are good for retirees, savers and even some investors.

For the last decade or so, savings accounts, money market funds, GICs and comparable investments have generated very little returns. Lower rates may have forced some into higher risk products in an attempt to generate decent returns.

I remember, as a child, I had a student bank account that actually earned interest. Before online banking and debit cards, I would have to go into my bank branch and hand the teller my bank book so that she could update it. I would eagerly wait for the dot matrix printer to finish printing on those little pages so that I could see how much interest I earned the previous month. Today, we don't use bank books and I can't remember the last time a bank account earned any interest.

For retirees and risk averse investors, bonds and high-interest savings accounts now have the potential to provide an attractive return.

If you're one of our retired PIMG clients, you will notice the addition of investment grade bonds in your RRIFs, LIFs, etc.

We have been able to add investment grade bonds with annualized yields of over five per cent. Cash sitting on the sidelines can now earn as much as 4.85 per cent in certain high-interest savings account products.

While we do not know how long rates will remain at current levels, we can certainly take advantage of these rates and provide stable income solutions to our clients. Those saving for a down payment on a home or another major purchase can comfortably earn a little bit of interest on "cash."

Risk averse investors can use investment grade bonds to earn what is, in my opinion, a decent yield.

Alternative investments providing short-term private debt have the potential to earn higher rates of return as they pass on higher rates to borrowers. As a result, investors may also benefit.

The opportunity, especially for retirees, has encouraged us to launch a new mandate named "Marnoa Income" focused on investment grade bonds and alternative investments. Please reach out to learn more and determine if this model portfolio is suitable for you.

As always, please do not hesitate to reach out, should you have any questions or wish to discuss any matter in further detail.

Yours truly,

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Performance as of February 28, 2023

Gross performance results as of February 28, 2023 for our discretionary model portfolios are as follows:

Performance Summary (%) as of February 28, 2023								
Portfolio Mandate	3 months	6 months	9 months	Year-to-date	2022	2021	2020	2019
Marnoa Strategic Allocation	-2.43	1.78	0.80	1.59	-12.70	12.38	18.01	15.78
Marnoa Conservative	-1.31	2.77	2.41	2.37	-12.05	10.86	9.90	19.86
Marnoa Moderate	-1.24	3.21	2.64	3.02	-13.55	12.92	20.79	25.52
Marnoa Growth	-1.75	2.34	2.04	3.69	-17.26	15.00	29.74	28.70

The returns above are gross of fees. Individual performance may vary based on cash flows and fees. Performance figures for periods greater than 1-year are annualized. The performance data quoted represents past performance. Past performance is no guarantee of future results.

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The returns presented are gross of fees. Individual performance may vary based on cash flows and fees. Performance figures for periods greater than 1-year are annualized. The performance data quoted represents past performance. Past performance is no guarantee of future results. The above performance data is current as of February 28, 2023.

Inception date is January 1, 2019 for Marnoa Strategic Allocation, Marnoa Conservative, Marnoa Moderate, and Marnoa Growth.

Generally, mandates with higher returns entail higher levels of risk. Investors should consult with their advisor prior to making an investment decision to help ensure their investments are suitable for their particular situation.

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