

In our last monthly review in May, we reported that financial players were increasingly apprehensive about a U.S. rate hike in view of persistent inflation. In June, a U.S. central bank governor even hinted that they were prepared to raise rates. Fortunately, U.S. inflation indicators eased in May and June, which reassured financial markets. With inflation seemingly back on track, the focus has shifted to the labour market, where unemployment is on the rise. A cooling labour market and falling inflation should see the Fed initiate an interest rate cut in 2024.

In May, the S&P 500 returned 1.2% and the Dow Jones 4.5% in local currency. In the U.S. stock market, small-cap stocks are gaining in popularity as investors look to disinflation and the hopes of lower interest rates. The RUSSEL 2000 index climbed over 10% in July. In Canada, the S&P TSX index returned 5.9%, erasing the

June losses that followed the new federal capital gains tax legislation. In Europe, the main stock market indices posted positive performances: 2.5% for the FTSE 100 (UK), 0.8% for the CAC 40 (France) and 1.5% for the DAX 30 (Germany). In China, the Shanghai Se index continues its decline, with a performance of -1%.

The bond market enjoyed a positive month, with the FTSE Canada Universe Bond Index returning 2.4%; rate cuts were widespread across the yield curve.

On the economic front, the Bank of Canada reported a second cut, to 4.5%. The accommodative tone of communications underscored the Governing Council's mounting concerns about the slowing labour market and downside risks to the Canadian economy. Following this decision, financial markets expect two further cuts in 2024. In the U.S., the Federal Reserve opted for the status quo. Comments justifying

this decision indicate a shift in the committee's general sentiment, as the focus moves from inflationary risks to easing the labour market. Without explicitly indicating that a rate cut was on the table for the upcoming September meeting, the latest economic data points in this direction. Markets now anticipate a 0.70% cut in the key rate by year-end, i.e., almost three 0.25% cuts.

Please note that we will not be publishing our monthly publication in August. We will return in September with our quarterly publication and comments from our managers.

In the meantime, on behalf of the entire Eterna Financial Group team, we wish you a wonderful end of summer.

**Bobby Bureau, MBA, CIM<sup>®</sup>**

Senior Manager, Fixed Income  
Portfolio Manager

## LEADING INDICATORS OF INFLATION

**Preamble:** Some economic and financial players use the term "indicator" to justify their forecasts. However, a distinction needs to be made between historical data and indicators. The latter should be a leading indicator of the future performance of the variable to be forecast.

For example, the graph below illustrates the relationship between, on the one hand, the inflation rate and, on the other, a survey of American entrepreneurs concerning their inflation forecasts. It turns out that the so-called "indicator" correlates with the inflation rate (correlation: 0.70). As a result, it has no predictive value whatsoever. It is simply data, not an indicator.



However, if it is fundamentally likely that global supply chain pressures are influencing the U.S. inflation rate, those pressures, brought forward ten months, can be termed an inflation bellwether. The pink line is merely the forecast that results from these pressures on potential inflation in ten months' time. It reflects the rightward shift of the indicator to maximize the correlation.



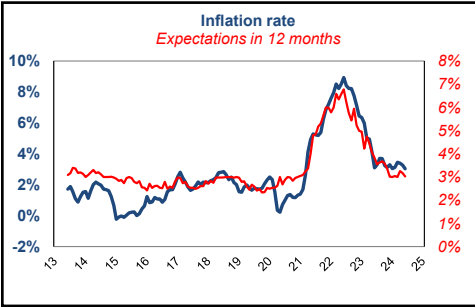
**Popular belief:** Some stakeholders, including Fed executives, are closely monitoring consumer expectations of what they expect to pay later. Surveys are based on 12-month, 3-year, 5-year and 10-year expectations. This is because the Fed considers it important to ensure that inflation expectations in the short, medium and long term are kept in check and do not become entrenched.

The Committee noted that longer-term inflation expectations that are well anchored at 2 percent foster price stability...

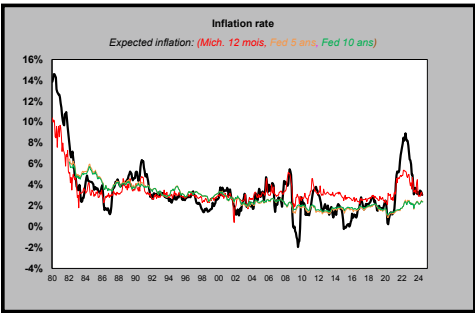
In order to anchor longer-term inflation expectations at this level, the Committee noted that it seeks to achieve inflation that averages 2 percent over time.

Facts: These surveys have had little predictive value in the past.

- 1. This one is compiled by the Federal Reserve.



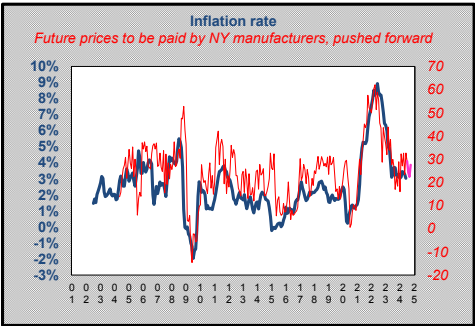
- 2. Others are just as unconvincing.



Future inflation is based on several factors, including the leading indicators below:

Indicators forecasting moderate inflation:

- 1. Fed Empire: weak four-month lead



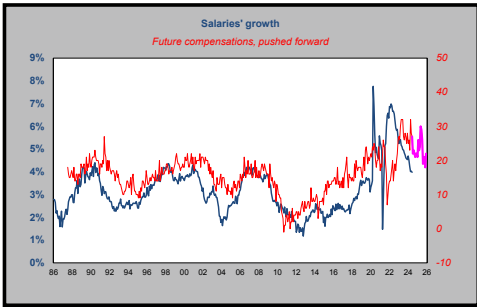
- 2. Wages, consistent with inflation, have not been a good predictor of future inflation.



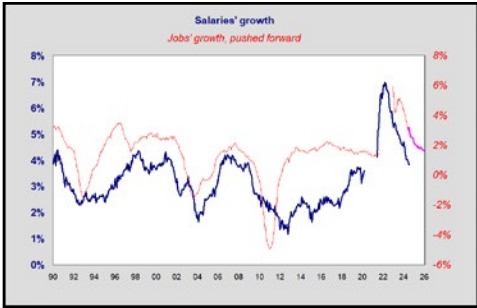
However, some indicators predict moderate growth in these wages.



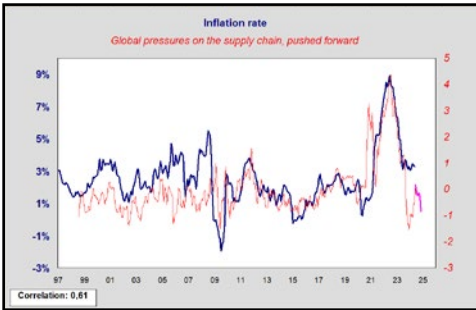
Compensation planned by SME entrepreneurs for their employees.



And if we exclude the pandemic period, moderate job growth would have little inflationary impact on wage growth.

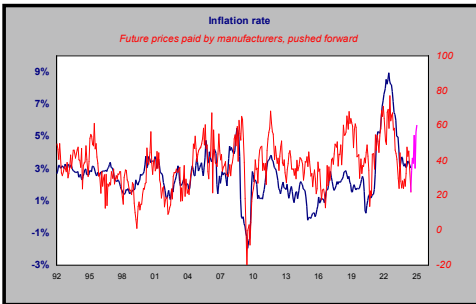


- 3. This, already mentioned at the beginning of this document.



Indicators of higher inflation:

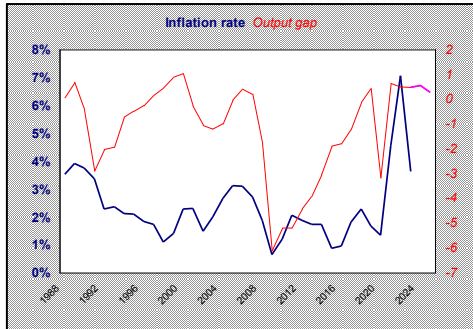
- 1. Fed survey of U.S. manufacturers: solid seven-month lead.



- 2. Service sector prices have recently risen.

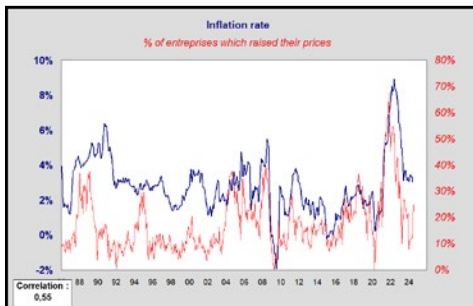


3. The Output Gap calculates the difference between the present economy and its potential. Among other things, it is calculated on the basis of a regression. Monetary authorities place great importance on it, even if the relationship with inflation is not immediately obvious. When interest rates are expected to tighten, the impact on prices can be upward.

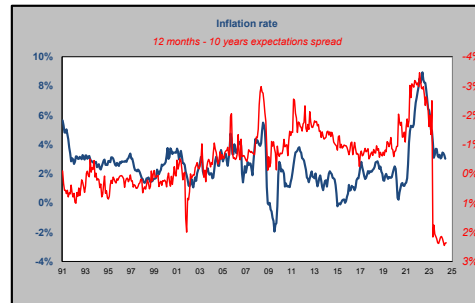


## Questions

1. The number of companies raising prices is nearing an all-time low. This is not an indicator in the true sense of the word since it does not lead the inflation rate. However, economic growth is unlikely to surprise on the upside. This could be tempting for corporate executives.



2. If, as mentioned, consumer inflation expectations hold little predictive information, the chart shown below, without having a lead, may cause concern. Indeed, if the gap between inflation expectations in 12 months' time and inflation expectations in ten years' time were to close, it could mean that an inflationary low that had been reached could start to rise again.

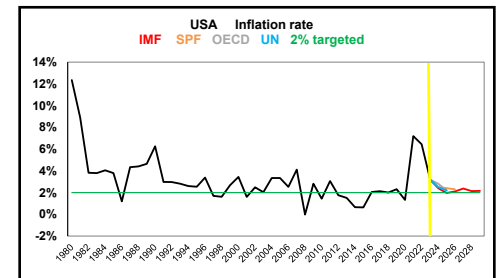


However, there is no fundamental justification for this relationship. It may well be that this graph is merely the result of a data mining process, i.e., getting two variables to correlate positively without being able to explain it.

3. Politics: not a leading indicator. If, during a Republican presidency in the United States, Israel was to bomb Iran's nuclear facilities, as they are only a few months away from being able to produce an atomic bomb, the price of a barrel of oil might not suffer.

## Conclusions:

1. It appears that the Fed, which had taken too long to counter an inflation rate that was in fact more cyclical than temporary, has now compensated for it by significantly raising its key rate.
2. The major institutions also seem to be on board with their forecasts of moderate future inflation.



3. Moreover, some may question the need for unnecessary rate cuts without a significant economic slowdown in the offing. Indeed, policy rate cuts are arrows in the quiver of monetary authorities when they believe the economy could falter, triggering a significant spike in the high unemployment rate while inflation poses little threat. A real economic growth rate coupled with an inflation rate of 2% would be the ideal scenario. This appears to be taking shape.

**Important caveat:** These observations were made on historical data, which are no guarantee of the future.

**Data source:** World Bank, BEA, Bloomberg, Federal Reserve, United Nations, OECD.

**Pierre-Dominique Lussier**

Vice-President and Senior Advisor

## STATISTICS ON JULY 31<sup>ST</sup>, 2024

CANADA			UNITED STATES			CURRENCIES	
Unemploy. rate (June)	6,4 %	↑	Unemploy. rate (June)	4,1 %	↑	\$ USA / \$ CAN	0,72 ↑
C.P.I. (June)	2,7 %	↓	C.P.I. (June)	3,0 %	↓	\$ USA / € Euro	1,08 ↓
3 months treasury bills	4,42 %	↓	3 months treasury bills	5,28 %	↓	¥ Yen / \$ USA	149,98 ↑
Bonds 5 years	3,09 %	↓	Bonds 5 years	3,91 %	↓	The arrow indicates the trend since the publication of the last monthly data or end of the month.	
Bonds 10 years	3,16 %	↓	Bonds 10 years	4,03 %	↓		
S&P/TSX	23 111	↑	Dow Jones - Industrial	40 843	↑		
			S&P 500	5 522	↑		

## MARKET INDICES IN CANADIAN DOLLARS AS OF JULY 31<sup>ST</sup>, 2024

	YTD	3 months	1 year	3 years*	5 years*
FTSE Canada 91 Day TBill Index	3,03%	1,30%	5,21%	3,21%	2,24%
<b>BONDS</b>					
FTSE Canada Universe Bond Index	1,99%	5,36%	7,34%	-1,34%	0,39%
FTSE Canada Short Term Overall Bond Index	3,13%	3,21%	7,33%	1,03%	1,71%
Indice adapté gestion privée Eterna <sup>1</sup>	2,90%	4,23%	7,65%	0,17%	1,38%
FTSE Canada Mid Term Overall Bond Index	2,53%	5,77%	8,05%	-1,16%	0,84%
FTSE Canada Long Term Overall Bond Index	-0,40%	8,15%	6,25%	-4,67%	-1,80%
<b>NORTH AMERICA STOCK MARKETS \$ CAN</b>					
Canada - S&P/TSX	12,28%	7,26%	15,73%	7,72%	10,46%
United States - Standard & Poor's 500	22,01%	10,47%	28,11%	13,37%	16,13%
United States - Dow Jones	14,50%	8,94%	22,95%	11,22%	12,15%
<b>INTERNATIONAL STOCK MARKETS \$ CAN</b>					
United Kingdom - FTSE-100	16,32%	6,70%	18,32%	10,89%	7,95%
France - CAC-40	1,98%	-4,16%	3,46%	4,74%	6,84%
Germany - DAX	12,85%	4,87%	15,91%	6,30%	9,14%
Japan - Nikkei-225	14,28%	6,89%	16,70%	4,97%	6,59%
Hong Kong - Hang Seng	6,35%	-1,87%	-9,57%	-9,72%	-8,06%
Australia - S&P/ASX 200	6,50%	6,71%	11,23%	2,52%	3,43%
<b>CURRENCY</b>					
USD versus CAD	4,27%	0,22%	4,69%	3,44%	0,92%

\* Annual compounded total return.

<sup>1</sup> The Eterna Adapted Private Wealth Index is made up of 60% of FTSE Canada Short Term Overall Bond Index and of 40% of FTSE Canada Mid Term Overall Bond Index.ada..

Source : Bloomberg