Dave's Diary

June 2008

As we move into June it seems that we are reaching a watershed period for the market environment looking forward to year-end. So far this month the European Central Bank and the US Federal Reserve have made it clear that no longer is economic growth their primary concern, but *inflation* concerns are now front-and-centre for those economies. Even more surprising, on June 10th the Bank of Canada also stunned market watchers here by failing to cut interest rates by another 25 basis points, as had been the near-unanimous analyst forecast. Until now Canada had been largely insulated from rising prices by our currency, which has also been rising, but clearly the inflationary effects of $130+ oil is starting to make itself felt and governments are becoming concerned.

I find this newfound concern with inflation prudent, but also "funny" in the sense that only a few months ago (or even last month in Canada's case) this threat was being actively downplayed by the North American central banks despite the historical correlation between high energy prices and rising costs in-general. But I do applaud the central banks for doing what is necessary as the situation evolves rather than sticking dogmatically to a "grand scheme".

As we move through the summer there are some implications that investors should be aware of in the event interest rates do go up in the next two or three quarters.

Firstly, no asset classes respond *well* to rising interest rates, but equities typically outperform fixed income in such an environment. Bond prices may be flat to weaker over the next several months, although there are other factors out there right now (ie. developments in the global credit crisis) that could overshadow this.

Secondly, rising rates in the US could bring relief to the US dollar in the form of some strengthening vis-à-vis other major currencies. If this happens we could expect to see some downward pressure on oil prices (crude oil being priced in US dollars), which will be a welcome event for consumers at the pump, but may be a cause for some near-term concern to investors in energy stocks, the Loonie, and the Canadian market in-general. That being said, a significant near-term correction in the oil and gas sector will probably represent a great entry opportunity for those who have been waiting, as the longer-term outlook for energy stocks remains fundamentally strong.

My Best Regards,

Dave Hagenow