Inside Perspectives: An AGF Podcast Series

How Low Can Interest Rates Go?

Speaker Key:

DP	David Pett
JC	John Christofilos
KM	Kevin McCreadie
DS	David Stonehouse

Time Code	Speaker	Text
00:00:00	DP	Welcome to AGF Inside Perspectives. Guys, gents, welcome.
00:00:06	JC	Been a while.
00:00:07	DP	Been, yes, a few weeks at least. You guys have been on the road, though. So that's probably part of the reason we haven't adjourned this meeting recently. John, in particular, you've been coast to coast.
00:00:19	JC	Coast to coast.
00:00:20	DP	So where exactly did you start, and where did you end up?
00:00:24	JC	Well, we started in Edmonton, it feels like a year ago, but it's only been six or seven weeks. And then we ended up in Halifax. We hit 12 beautiful cities in Canada, met a lot of clients, did a lot of presentations. It was a blast. It was a lot of fun.
00:00:40	DP	And Kevin, you were on a few of these shows, I think.
00:00:45	KM	I was on four of our big client events, so yes. So I didn't do all 12. I had a few other things going on.
00:00:54	DP	And did you get outside of Ontario or…?
00:00:57	KM	Yes, I did. I did mostly the East District, Montreal, Halifax.
00:01:02	JC	Quebec City.
00:01:03	KM	Yes.
00:01:03	DP	So as you mentioned, John, all the places you went to…
00:01:06	JC	Yes.

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00:01:06	DP	Lovely. Beautiful.
00:01:07	JC	Beautiful.
00:01:08	DP	Great places to be.
00:01:08	JC	Great country.
00:01:09	DP	But if you had to pick one, what's your favorite?
00:01:12	JC	It's a good question, actually. Probably Halifax, which was our last stop. I'll tell you that that city's grown up considerably over the last number of years. Had a chance to walk along the boardwalk, and they've got fantastic restaurants, a great view of the water. It's got the military feel, with the big ships and the like. Yes, I would say probably Halifax. It was a lot of fun there.
00:01:35	KM	He and I never agree on anything. I'm going to agree on Halifax. I just think in the last, I don't know, five years, it's got a vibe. It's younger, tech-influenced, and to John's point, I think what they've done with the waterfront and being on the water is pretty… For Canada, I think, is a real different kind of vibe.
00:01:57	JC	I will say this though, David. So we typically spent a day in each city, and we had an event most evenings that we were there. So it wasn't like we had a lot of time to tour around. But yes, Halifax still wins the checkmark there for sure.
00:02:12	DP	So on that front, John…
00:02:13	JC	Yes.
00:02:13	DP	Any tips for business travel? What's the essential thing that you need to do when you're on the road as much as you are?
00:02:18	JC	Yes. Stay longer than one day. How about that as my tip? Because we went literally from airport to car, to hotel, to event, back to the airport, onto the plane, to the next city and the like. So maybe staying a little bit longer than 12 or 14 hours is a pretty good piece of advice.
00:02:36	DP	And let me ask both of you. And Kevin, obviously you have a place in Toronto where you are, but you also have roots in Baltimore. And John, you're born and raised in Toronto.

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00:02:45	JC	Right here.
00:02:46	DP	If you could live anywhere else in the world…
00:02:49	JC	Yes.
00:02:49	DP	Do you ever think about that in terms of where that might be?
00:02:52	JC	For me, it's pretty simple. It's San Diego. I went to school in San Diego. I spent four years there. I think it's one of the most beautiful cities in the United States. The weather is terrific. That city's grown up since I was there as well. So it's got downtown is revitalized. It used to be a bit of a scarier spot, but it's been revitalized. They've got the Petco Park where the Padres play. It's right downtown. They've got the Miramar Naval Base where Top Gun was filmed. They've got Coronado Island, which is a beautiful place to visit. Yes, it's the place I'd want to be.
00:03:24	KM	Yes, and the weather's terrible, so.
00:03:26	JC	Yes, the weather's terrible. Every day is 75 and sunny, minimum. I have a very good friend that lives out there who was originally from High River, Alberta, who stayed out in San Diego after graduating. And I love going out there. That would be my place.
00:03:38	DP	And what about you, Kevin?
00:03:40	KM	Yes, I've lived in Europe, so I'd probably think about going back. There's some great places in Europe that you can think about, Italy, Spain, Portugal, that give you the same kind of… Not exactly San Diego, but you can find places that give you a little bit of that, with a little bit more history and culture, maybe. Weather might be not as good, but…
00:03:55	DP	I love it. I love it. Okay, let's get to our guest. Just a quick, little introduction. He's a former two-time Ontario University water polo all-star. He's a present-day curler. And he's also a fan of sci-fi fantasy and Peter Gabriel, which I love that answer. I'm a big Gabriel fan too, all the way back to his Genesis days. So without further ado, let's introduce David Stonehouse, AGF Investment Inc's Head of North American and Specialty Investments.
00:04:37		David, welcome.

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00:04:38	DS	Thanks very much, David.
00:04:39	DP	Thanks for being here. So as you probably were just listening, we're just talking about maybe places to live other than Toronto. I believe you're born and raised in the GTA as well or…
00:04:51	DS	No, actually, I was born in Scotland.
00:04:52	DP	Scotland, okay.
00:04:53	DS	But came over here when I was an infant and lived in a whole bunch of places in Canada. We moved around a dozen times in my first 12 years of life. So we were in Ottawa for a couple of years. We were in Winnipeg for a number of years. We were in Guelph three different times, and a bunch of little moves in between, in Toronto for a bit. So all over the place.
00:05:14	DP	Yes. So given that you've had that wealth of experience in terms of different places to live, is there any dream place for you that you might want to live, outside of Toronto?
00:05:23	DS	I'm pretty happy here, but I will say, if you think about Canada alone, there's a ton of spectacular places. And John alluded to that in the trip. He made every single one of the destinations on this roadshow. I was out West with him and then in London as well. West was really nice. We got some spectacular weather. So Calgary is really appealing if the weather's good. And the problem is the weather's so variable that you can't rely on it all the time.
00:05:50		And one of the most beautiful places in the world is Vancouver. That'd be great. And again, the problem is there are a few months of the year where the weather's less reliable. But other than that, I think those would be amazing places to live.
00:06:02	DP	Yes, we certainly do live in a beautiful country. And the weather, today, we're recording… It's October 30, and it's, what, 22-23 degrees out in Toronto. So we've had just a spectacular fall. Okay, let's get to business. And as always, we'll start with a little bit of a recap over the last month in terms of how markets have performed. Kevin, I'll get you to start us off, and then we'll go around the table, if that works for all of you.

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00:06:31	KM	It's been an interesting five or six weeks. You had the much-anticipated and finally decisioned rate cutting in the U.S. The surprise was that the U.S. Fed jumped out there with a big 50-basis-point cut. And they immediately, I think, have switched their focus from inflation now to basically the job market. They have a dual mandate in the U.S., inflation and full employment, and I think rightly so.
00:06:58		But since that point, you've seen data coming in, whether it be the jobs report for September that we got in October, whether it be retail sales that we got, whether it be even the preliminary Q3 GDP report that we got this morning, which was near 3%, that would argue that maybe things didn't justify 50 basis points out of the gate. And you've seen some repricing of that, interestingly enough, more of that being in the actual bond market.
00:07:27		And part of that, we can talk about that, also may be a reflection of different policies, depending upon where the election comes out and what that means for deficits and spending. But the bond market has gone the other way. It's backed up something like 65-70 basis points since the Fed cut. So on one hand, the Fed has eased short rates, but we've tightened longer-term rates. And at the same time, the equity market, if you think about that period of time, has actually gone up, higher rates signaling that economic growth is probably okay, which therefore means profits are probably okay.
00:07:59		So we're getting two different signals. Bond market is worried about something, and the equity market is telling you maybe the soft landing is really pretty good. What all markets are going to tell you is that maybe we don't have to go as fast, cutting rates, though, as we all thought after the initial September Fed cut.
00:08:14	DP	And then John, I'll go to you. And then, David, I do want to talk a little bit about that disconnect between yields and what the Fed is doing.
00:08:21	JC	So David, we're on the eve of a pretty monumental event. Next week is the U.S. election. And I think many market participants for the last six or seven weeks have been pre-positioning, one way or the other for their

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		preferred results. So we've seen volumes on the heavier side of normal over the last six or seven weeks. To Kevin's point, we saw the markets rally quite considerably over the last six or seven weeks, but we saw a narrowing of the market as well. So as rates, as Kevin talked about, started to jack higher, small caps start to sell off. And we've narrowed that, not MAG7, I hate using that term anymore, but it's narrower than it was.
00:09:01		We thought we were starting to break out and get better breadth in the market, and we've narrowed back in. So we'll see what rates do over the next little while here. I had an interesting conversation with a trader this morning, who had said, if you go back in history and look at rate cuts in the U.S. per se, typically the first move is higher in long-term rates, and then the market comes back, and then the rates come back in. So we've seen 60 or 70 basis points of a move. We'll see what happens over the next little while. But that's probably what's interested me the most, volumes are higher, and then narrowing in the market over the last six or seven weeks.
00:09:34	DP	And so, David, maybe I'll get you into this in terms of from that fixed income perspective or just broadly that perspective in terms of that disconnect that we are seeing a little bit on the rates side.
00:09:47	DS	Yes. I think if you think about things from the fixed income side, the fixed income perspective, it's exactly what both Kevin and John have already alluded to, that you start in on an easing cycle, you've got a larger than anticipated cut until probably the last week, week and a half before the Fed actually moved. That's when the market started to shift and actually contemplate the notion of 50 as opposed to 25. And since then, the bond market's done nothing but go north in yield and south in price. And that's probably not what people would have anticipated.
00:10:16		But actually, history would suggest that if you're on a reasonably sound footing, that tends to be the path that it follows more than if you are in trouble. And so I think the encouraging news you could take from that so far, and it's still early days, is that if we're not staring a recession in the face, and frankly, the markets have over anticipated that over the last 18 months or more, you're probably on

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		a reasonably solid ground here. And while it's unwelcome, obviously, if you're in bonds or in long bonds the last little while, broadly speaking, you're still in a range, and it probably reflects a healthier backdrop, which is a good thing.
00:10:52		From my perspective, the surprise of the last six weeks is we've had volatility, but it's been very range-bound volatility. So some of the volatility metrics have been trending a little bit higher. They are showing more angst. But typically, you would've expected to see a little bit more of a correction going into the election and then a rally coming out of it. I think maybe the two candidates are perhaps less unknown to some extent, notwithstanding the switch from Biden to Harris in the summer, perhaps more known entities, perhaps a little bit less angst around the fear of the unknown.
00:11:31		Perhaps it reflects the very tight race and the fact that that would increase the odds of a split Congress, which markets tend to like. But I do think we might be underpricing the risk that we actually don't have a clean outcome for a little while. And that would be where maybe the markets have done better the last six, eight weeks than we would have anticipated, and ironically, maybe November has a little bit of a correction surprise at some point. Not predicting that, but we've had a good move here, and we're probably a little more susceptible.
00:12:02	KM	Yes. David is just spot-on on this. We have to also remember, this has probably been the ugliest month or 30 days for the fixed income market in two years. When you have this, quote/unquote, easing by the central bank, and it cuts 50 basis points and the longer end of the yield curve actually backs up this quickly, you're going to leave people with a little bit of a dent. So there are disconnects in here right now.
00:12:26		And that's about the firming story, the Goldilocks story. If you really believe you want the soft landing, then you'd better be prepared for the fact that rates may be stickier. Maybe central banks may not go down as quick in terms of cutting, but rates may also not come down as quick as you may want. And to John's point on small caps, they

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		work when you have to aggressively start cutting rates. And in the first instance, that means you have a problem.
00:12:50		And that means you've had to really get after it to avoid a recession, and you've gone and cut rates so far and so fast that you actually now are stimulating demand at a greater pace. We're not there yet. So I'd say this backup in rates in the short term is a sign that maybe growth is not as weak as we think. And certainly, the data on the employment market does not feel as weak as what the Fed is worried about yet.
00:13:11	JC	David, just one other thing I neglected to say, and it's a home country comment. So since the Fed cut, the TMX is actually one of the top five performing markets globally, believe it or not. And if you look close enough, TMX now is up 17% year to date, relative to the S&P being up 21%. So that gap is closed considerably. So a bit of a, let's wave the Canadian flag here a little bit. We talked about Canada earlier.
00:13:37	KM	Part of that too, and I'll defer to David, this is really in his bailiwick, but you've actually seen the Bank of Canada on a serial…
00:13:43	JC	Yes.
00:13:43	KM	Rate-cutting cycle. Three are out of the gate at 25, and then 50. And they're worried about something different. They've put inflation, I think, aside, and they're just worried about growth right now. And I think part of that explains the… That easing inside of Canada is probably explaining a little bit of what the TMX is telling you.
00:14:03	DS	Yes, I think we can go to the divergence aspect of central bank policy, probably on your list, David. But the other thing that I would factor in before we go there is the sectoral makeup of the Canadian market and what's been going on in the last couple of years. So we've got very high debt to disposable income levels. We've got very extended consumers because of the very high price to income ratios of our housing market, and affordability's been a problem for a long time. The moves that we've seen from the Bank of Canada are more welcome in terms of alleviating some of those concerns.
00:14:36		And the banks have been, I don't know if I'd call it a bear market, John, but they've been struggling in Canada for

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		the last couple of years anyway. And a lot of that is the frontrunning of the issues of the rate hike cycle coming home to bear fruit on the mortgage side of things. Now we're starting to see signs of relief potentially, and I think the market's starting to look past the worst of this for the banks. That's encouraging for the Canadian stock market. The other factor is gold. There are a bunch of things moving gold, which I'll leave aside for the moment, but the TSX has among the largest gold weights in the world, if not the largest.
00:15:13		And you put those together, our industrials are doing okay, a couple of other areas, our tech has rebounded, all of a sudden, you've got a pretty healthy market that actually, not just in the last six weeks, but over the third quarter, outperformed the U.S.
00:15:27	JC	So, David, we've talked a lot about the Canadian dollar and the reaction of the Canadian dollar over the last number of months. Your thoughts on, if the Bank of Canada continues to do what they're doing, and then the Fed actually pauses and the differential becomes that much greater, what happens to the Canadian dollar relative to the U.S. dollar?
00:15:45	DS	Yes, so maybe we can just move towards that divergence in policy over the last little while.
00:15:49	JC	Yes.
00:15:50	DS	And this is, I will say, fairly sudden. So if we go back to mid-September, the date the Fed cut 50, at that point in time, the Bank of Canada had cut 75, the Fed only 50. But that's really close. You're only off by one rate cut. Since then, Canadian economic data have continued to disappoint, broadly speaking. The Bank of Canada has telegraphed that they were anticipating better GDP growth than they thought. The government has come out and talked about curtailing immigration, which results in a slowdown in GDP growth, all other things being equal, because the population slows down, population growth rate slows down.
00:16:26		And now you've got a more significant divergence, where the prospect of a second 50-basis-point rate cut in a row from the Bank of Canada is of increasing likelihood relative to before, while in the meantime, as Kevin was

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		talking about early on, U.S. economic data have been pretty resilient. So now there's a possibility that you're probably going to get a cut out of the Fed next week after the election. We'll see what happens with employment and the election. But that's just going to result in a farther gap. And if the Fed does pause, to your point, John, then you're starting to see significant divergence.
00:17:05		Now, a lot of that's already priced into the currency, because the currency's moved from 1.32 to 1.39 lickety-split. That's a pretty rapid move in a little over a month. I think you start to get closer to a problem if you move into the 1.40s. And the Bank of Canada has said they're not at that point yet. They can still tolerate this. But it does result in unwelcome divergence in potential import inflation rising and those sorts of things. And I think that would become more of a challenging prospect.
00:17:36		Finally, when you think about the two economies, they tend to be fairly closely interlinked. It's hard to see too much of a deviation in economic performance over the long term. So I tend to think that maybe we start seeing this reverse a little bit, but we'll see.
00:17:50	KM	I want to go back to something you said, John. The next Fed meeting is the day after the election, with the next announcement. If they pause, which is not priced in anywhere, you're going to see a lot of volatility in the bond market and in the equity market. The initial reaction is that rates spike, I think, a bit higher than where they even are now. And then I think on the equity market, it's going to say, wait a minute, you're making a mistake. So not priced in. I think it's low probability.
00:18:19		I think, in fact, we get up the day after that election and we don't know in the U.S. who the actual winner is at that point in time, which is a high probability, given how close this is. My guess is that probably, even if we get strong labor data this week on Friday in the jobs report, I suspect they move 25. It then puts December in question if the data stays this strong. But I think November feels like they'd be making a big mistake.
00:18:45	DS	Yes, and the interesting thing, if they pause in one of these two meetings, is ironically, that's probably going to alleviate a little bit of pressure at the margin on the long

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		end. Because if they stick around in the fours, notwithstanding the fact that it's hard to argue that policy has been restrictive, given the health of the economy and the health of the capital markets, the markets are probably going to look at that and say, well, all other things being equal, a 4.5% rate is going to retard future economic growth more than a 3.5% rate, it may actually support the long end a little bit.
00:19:16		You'll get some flattening for sure in that respect. It's going to hurt the short end of the curve if they pause more than the long end, most likely.
00:19:23	KM	To give an everyman practical spin on this, the ten-year bond we talk a lot about, but the world, a lot of things work off of that rate, not what the Fed does. And to the extent that that backs up, it affects mortgage rates, actually, not what the Bank of Canada does or what the U.S. Fed does. It's actually what the ten-year bond does. So we've had this, call it, 70 basis points. So think about that as almost being three rate hikes for those people who are tied to borrowing something that is linked to the ten-year, so residential mortgages, corporate bonds.
00:19:54		You flip the other side of the coin, people who benefit from cutting short rates, people with credit cards, people with home equity lines, they go down immediately. But the poor guy who couldn't go to the bond market and issue debt at very cheap rates and lock in, think about that small business owner who's been stuck in these much higher rates, they're only coming down very, very small, incrementally, even in Canada, even in the U.S., even in the 50s. So you're getting this bifurcation of this impact of, as short rates drop, a few people get benefited as the yield curve backs up on the ten, some people get hurt.
00:20:29	DS	Yes. And it's interesting, anecdotally, just talking to a few people off the street, sort of thing, like friends and family, that sort of thing, in the last couple of weeks, they've been a little bit surprised. They're thinking, well, I know that the Bank of Canada is easing, and I hear it in the headlines and all that sort of stuff, so where's my lower mortgage rate? I'm going to renew, sort of thing. And they're looking at it, and the guy's giving them the same sort of quote as he would have given them months and

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		months ago. And they're going, how is that possible? So it's exactly to Kevin's point.
00:20:53	DP	So on that front, as the Fed gets ready to make its next decision, do they take into consideration the backup on the longer end of the curve, or do they just stick with…? They've talked about being data dependent. Does being data dependent include where yields have gone?
00:21:11	KM	One of the things you look at is what's this backup? It's a source of tightening. Think about the mortgage or the housing market. Housing, and you're looking at contribution to GDP, was negative. And when you keep rates this high, homebuilders get worried about digging a hole and building a building and all the follow-on things that happen, electronics that go in there and the roofing and the landscaping. It's a big economic pull-through. So if you keep rates too high because the ten-year backs up and mortgage rates don't come down, you probably are slowing the economy a bit.
00:21:44		So they probably do look at that as a measure of saying maybe, even though we're easing over here, we're not truly impacting the economy. What they're really worried about is the labor market. And they're trying to get in front of hoping companies don't lay people off. Because once you get laid off, you go into survival spending. You stop spending. The companies that you would buy your stuff from, their demand goes down, their profits go down, and they start laying people off.
00:22:09		And that's what they're trying to avoid is this, if we're not quick enough to ease things and create some ability for people to borrow at a cheaper rate, to buy things, you can get into this place where, if the labor market unwinds quickly, demand starts to drop faster. So I do think they worry about this back-up a bit.
00:22:29	JC	Yes, I'd argue, Kevin, we had the ADP number out today, which was a blowout number, labor feels pretty good in the U.S. for now.
00:22:37	KM	Yes. But I think they're clearly worried now about… Remember, all this works with a big lag.
00:22:41	JC	Yes.
00:22:43	KM	It works both ways with a lag.

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00:22:45	DS	Yes. I think there are a number of data points that suggest the labor market's been more resilient than anticipated. The initial jobless claims the last few weeks have held in remarkably well. We've all been waiting for the impact of some of the big strikes and the hurricanes, and it hasn't played out so far. But there are some softer data points, too. The JOLTS data yesterday were softer. So you can look at it both ways. We'll see how good a correlation there is between ADP and non-farm payrolls on Friday.
00:23:12		But I think Kevin's exactly right with his comments in terms of the sorts of factors that the Fed's going to consider in terms of their next move. One thing that's going to be tricky for them in a world of 2.5-3% GDP growth, tack on another… You're still at 2.5% inflation. You're at 5.5% nominal. Your ten-year yield is probably below, in some respects, what people would view neutral to be. Because a rule of thumb would be it should be in the range of nominal GDP growth. Never precisely. It'll move around.
00:23:45		And the other thing is if you cut aggressively, your yield curve will steepen, and the market will price in a better future. And the better future will be potentially higher GDP growth, but also potentially more inflation. So let's be silly about this. If the Fed were to cut 50 basis points the next three meetings in a row, you might not drive mortgage rates lower, because they key off the ten-year, the 30-year, as Kevin was saying.
00:24:10	KM	One of the things, the last big data point the Fed's going to have is this jobs report for the month of October that comes out on Friday. And it also has maybe… Even though late in the game, it's going to have, whatever… If the number's too big or too cold, it's going to be influenced a lot by these hurricanes. You could actually see a negative number, because a lot of people, in the period that they did this in, were impacted. And you had a large number of states that were impacted, which is a rarity. Usually, you see a few states.
00:24:40		So I would say the reaction function on Friday and then the political reaction function over the weekend, based upon if that number's negative, you can hear one camp saying, you see, the economy is in terrible shape, if it's

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		too strong, we're worried about inflation again. So I think we're maybe going to read way too much, maybe, into a report that's going to be a lot impacted by a lot of weather stuff, I think.
00:25:02	JC	And the Boeing strike.
00:25:03	KM	And the Boeing strike, 45,000 people's jobs.
00:25:05	JC	That's 45,000 jobs, right? Yes.
00:25:06	KM	Good point, John. Yes. So again, a lot of noise here.
00:25:10	DP	Yes. And obviously a delicate balance that the Fed and other central banks have to achieve. If we think about a rate-cutting cycle and that we are in one now, albeit maybe not as aggressive as some might anticipate and hope for, where do we end up at the end of this? Are we going back to… I don't want to say the good old days, but are we going back to near zero again? Or do we need to get to a point where we understand that rates are never… Not never, I'll never say never, but they're not going to get back to the zeros for a while here?
00:25:52	DS	I think it's important to understand just how anomalous the post-GFC period has been, post-global financial crisis period has been. Those half dozen years of 0% interest rates in the U.S., the better part of 13 years of 0% to 2% interest rates around the world, actual bond yields being negative in a number of jurisdictions and a substantial amount of debt outstanding, those aren't normal circumstances. That's not normal capitalism. You should not be paying people to borrow. They should be paying to borrow. So there were some highly unusual circumstances there.
00:26:29		There was potentially some justification in the central banks' minds for trying to push for an ignition of better GDP growth. But under the circumstances, it wasn't a feasible way to go and probably exacerbated some of the problems that we're facing now in terms of just the distortion of capital allocation decisions, the monstrous amount of debt that we're facing now. Obviously, a lot of that's from the pandemic, but it's not an ideal situation. This is far more normal, and it is by no means high in the global historical context. This is pretty reasonable, and it's a much healthier place to be.

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00:27:10		I do think that we are sowing the seeds of a systemically and sustainably higher inflation environment, which is not the same thing as saying we're going back to eight, where we were two, three years ago. What it is saying is that we're probably not going into the ones again for a sustained period of time. And when we face things like rebuilding supply chains, we've got disruptions geopolitically, potentially more global conflicts, which tend to be inflationary, a whole bunch of other factors.
00:27:43		If we've reset inflation to, to take your term, a semi-permanently higher level, I think we've probably also reset rates to a more normal level. And frankly, I think that's a really good thing.
00:27:56	KM	Yes. And three quick points on this. One is David's right, they're 15 years after the crisis. Remember, we were fearing deflation. Banks weren't lending money. Banks were fearing. We had a bunch of banks collapse. And so when people can't get loans, they can't expand. Deflation means prices are going down. And therefore, profits go down, people get laid off, they stop buying, like we talked about. We're at the other side of that now. So point two is we're now worried about inflation. We're going to constantly be keeping an eye on inflation, because we've had a lot of stimulus in the economy.
00:28:25		There's been a lot of cash built up. So we may conquer the unemployment thing, but we've always got to keep an eye open on the other side about, are we overstimulating if we're cutting too fast? So I don't think we have to worry about going back to zero. Think about the last point I want to make. If you really believe the soft-landing camp, you're probably stopping, take the case of the U.S., at a 3.5% level. And if you think you're going to be in a recession, you're probably going to a 2.5 level. You're not going back to zero. So I think we have a group of investors who probably haven't seen this for a long time.
00:28:59		Last comment. If you go back to right before the crisis in 07/06, mortgage rates had a six handle on them, the ten-year bond had a 4.5% both in Canada and the U.S., and inflation was shy of 3%. Does that sound familiar?

Time Code	Speaker	Text
00:29:16	DP	And the point there is that that's not a bad thing for markets [overtalking].
00:29:21	JC	No, but we got spoiled. We got spoiled for a decade and a half.
00:29:23	KM	Yes. But free money, to David's point, wasn't real. The negative interest rate, like I put $1 in the bank and I get less than that back, wasn't real.
00:29:31	JC	I will tell you this, trying to explain this to my kids, it doesn't resonate, because all they know is 15 years of zero to slightly higher than zero rates. And…
00:29:42	KM	It was so…
00:29:42	JC	We've lived a little longer, David.
00:29:43	KM	If we think it was restrictive, David, that mortgage rate was so, quote/unquote, restrictive, we created housing bubbles pretty much all over the world.
00:29:51	DS	Yes, and to my earlier point, a lot of capital misallocation too. There were a whole bunch of business models that looked pretty good in the second half of the 2010s that ran into a brick wall. And that's unfortunate. It's not an ideal situation. So I think the key on one other point that Kevin made, I think his view of a 3.5-ish kind of level for the Fed is very plausible. I think that, and we've seen this over the last 18 months, we probably had now three kicks at the can in terms of pricing and six, seven rate cuts in a pretty rapid sequence, only to have that walked back.
00:30:28		And I think for the U.S., barring the slippery slope of what Kevin described before of that downward spiral of layoffs, less consumption further, which we still don't see as being in the cards as our base case right now, you are not likely to see a really rapid pace of rate cuts, because they're not probably necessary. This has demonstrably not been a very restrictive environment.
00:30:58	DP	Okay, last question for each of you. As we noted earlier, we're just days away from the U.S. election. Question is, what role could the U.S. election play in central bank policy in the immediate term, if you will?
00:31:17	JC	I'm going to make the assumption that we're going to have a winner. And I hope that the Fed stays, and the Bank of Canada stays, independent, and whoever wins

		the election has no interference with what the central banks are doing, generally speaking. I don't believe that an elected politician should have any say in Fed policy.
00:31:37	KM	I agree with you, John. I think that even though the rhetoric has been about having a seat at the Fed, I think that's a hard place to get to.
00:31:45	DS	Yes, I was going to key in on exactly that point. I think that the conflicts of interest are so obvious. There's a reason why the structures were created the way they were. They'll just work far more effectively. And we've seen in other jurisdictions, over time, the problems associated with interfering with that whole process. So I would hope that that holds. I think the bar is high even for the president to actually accomplish very much. They can do a fair amount with rhetoric. There can be some influence. But to actually shoehorn their way into an institution like that, the bar is going to be a lot higher.
00:32:23		There's going to be a bunch of hurdles that you would have to cross. So I would hope that that provides enough protection. I think John's right, that's something we definitely do not want to see. It's interesting that both Trump and, in Canada, Poilievre have talked about meddling with the central bank policy. It's just a bad-news situation. I would say two other things. One, I agree with Kevin that if you have a lot of turmoil and unrest, you probably see the Fed move a little bit right away and get a bit of insurance in there. It's not going to cost them very much, probably means yields go a little bit lower.
00:32:59		I think there's a good chance that you don't know who it is within a day or two, when the Fed's got to make their decision. But if you don't actually have unrest and we're just working our way through the counts, and they're both putting their hands up, saying, it was me, it was me, that's not going to be as big a problem as if you actually have contested outcomes in various jurisdictions. That's a bigger challenge. The final thing I would say is that for Canada, we're probably in a somewhat better place. Our deficits are 1-1.5%. Conservatives look likely to get in. You won't see the deficits climb a lot.
00:33:33		For the U.S., it's the opposite problem. Doesn't matter who gets in, you've got a 6-7% deficit. You can argue with the policies and what the ramifications are going to be, but we're still running with some pretty big problems there. That means a lot of treasury issuance and supply. That's not good for the bond market. And I think the stimulus that

		you get from that is probably unwelcome if you're an FOMC member as well. So short term, we may get a little bit of support for the bond market if some of the turmoil transpires that we hope doesn't. Medium term, the outlook is probably a little bit more challenging.
00:34:11	KM	Yes, I just think if we get a lot of volatility because we can't figure out who it is, and the longer that goes on, markets hate uncertainty. So what does that mean? If you get a lot of negative equity market because you can't make this decisioning, and the rhetoric is loud, and there are lawsuits everywhere, you probably have an equity market that's soft and sells off a bit. It won't be the same playbook even if Trump is out there declaring that he's won, if we haven't validated that anywhere. It's not going to be the big small-cap rally that we saw in 16, because there'll be this uncertainty.
00:34:40		Bond market probably rallies pretty good because it's going to be a defensive asset in here. Once you declare where the winner is, and if it's a shorter-term issue, then I think this is really a shorter patch. The longer it takes, we'll sort through it, but I think that it's going to be a period, I believe, and I hope I'm wrong, but that we have a fair bit of volatility, which would favor again. Even though we've got a backup, your fixed income assets probably help you as a defensive asset in here.
00:35:10	JC	I know where I'll be next Tuesday night and early Wednesday morning. Because back in 2016, we were up and Kevin and I were chatting back and forth on email at…
00:35:20	KM	Like four in the morning or something.
00:35:21	JC	At four in the morning about the results. I think we're going to get a similar type environment. So it's must-watch TV. Get the pop and the popcorn ready. It's going to be quite the evening.
00:35:31	DP	Absolutely. And to David's point, it looks like we may be headed for Canadian election soon enough as well. Let's end it there, guys. As always, fabulous content. Really appreciate you being here, David and Kevin and John. We'll see you next time.
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