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# Tumultuous Times?

## Summary:

The main challenges that North America is going to face in 2Q 2022 is as follows:

- ❑ **Inflation:** As the data shows, this will create a tax on consumer spending almost immediately as food inflation bites the middle class. Consumer Discretionary companies will face a downturn as consumers look to reduced “luxuries”. However, Consumer Staples will also suffer, (albeit to a lesser degree) as consumers “tighten their belts”!
- ❑ **Interest Rate Hikes** – based on the above, it almost a certainty that both the Fed Res & the BoC will raise interest rates quite aggressively in the 2Q. Currently, the assumption was that the inflation rate was ‘mild’ or ‘transitory’. This will be beneficial to the banks as they get to raise mortgage rates and maintain low deposit rates in the short term. Now, a major concern in 2023 will be the extent of mortgage rate hikes which may have a damping impact on housing starts – that we cannot forecast now but to keep that in mind.
- ❑ **Supply Chain Challenges** – continued COVID problems in China / SE Asia will exasperate the current problem further. This will increase the costs of products imported adding to inflation/ cost of goods etc.
- ❑ **Auto Industry:** Semi-Conductor Chips (Taiwan etc.) – these will have a major impact on the auto-industry as both the COVID & raw material delivery challenges cause factory production declines. The Russian sanctions will also cause auto-industry reduction given that palladium’s major producer is Russia.
- ❑ **Fertilizer** – major shortage as Belarus & Russia are major producers of Potash. Added to that will be both the cost of shipping & price of natural gas. This will add to Food Inflation etc.
- ❑ **Crude Oil** – Despite Biden opening the SPR: 1 million barrels per day for 180 days, it is unlikely to impact crude oil prices. OPEC+ will not increase production until May 1, 2022. This will keep oil prices above \$ 100 in the short term.
- ❑ **Lumber Prices:** Cost of shipping ; Supply Chain Issues & Higher Cost of Houses will impact Forestry companies in the short term.

## So, what are we to look at:

- ❑ **Banks**
- ❑ **Energy Companies**

## USA

### **Personal Consumption Expenditures (PCE)**

The term personal consumption expenditures (PCEs) refer to a measure of imputed household expenditures defined for a period of time.

Personal income, PCEs, and the PCE Price Index reading are released monthly in the Bureau of Economic Analysis (BEA) Personal Income and Outlays report. Personal consumption expenditures support the reporting of the PCE Price Index, which measures price changes in consumer goods and services exchanged in the U.S. economy.

### **The PCE Price Index (PCEPI) is the method preferred by the Federal Reserve to measure inflation (as opposed to CPI).**

PCEs include how much is spent on durable and non-durable goods, as well as services. The PCEPI uses prices from all households, corporations, and governments into account, along with GDP.

Personal consumption expenditures are among the three main parts of the Personal Income and Outlays report. Personal income shows how much money consumers earn. Personal consumption expenditures are a measure of the outlays or how much consumers spend.

The PCE Price Index uses the personal consumption expenditures component of the Personal Income and Outlays report to derive the PCE Price Index, which is the third major component of Personal Income and Outlays showing how prices are periodically inflating or deflating.

Personal consumption expenditures are shown by the BEA in current dollars and chained dollars since 2012. Personal consumption expenditures form the basis for the reporting of the PCE Price Index, which is detailed both comprehensively using all categories of PCE and excluding food and energy, which is known as the Core PCE Price Index.

Personal consumption expenditures allow economists, individuals, and corporations to see how well the economy is faring. That's because it's a measure of how consumers spend their money. It includes more costly durable goods, cheaper necessities under the non-durable goods category, and services like banking. It also shows how people make changes to their buying habits when prices change. This makes it a very important figure because it provides a window into demand for products and services as well as **inflation.**

### **What Is the Relationship Between Inflation and Interest Rates?**

Inflation and interest rates tend to move in the same direction because interest rates are the primary tool used by the Federal Reserve, the U.S. central bank, to manage inflation.

The Federal Reserve Act directs the Fed, (as it is often called), to promote maximum employment and stable prices. Since 2012, the Federal Reserve has targeted annual inflation of 2% as consistent with the stable prices portion of its dual mandate.

The Fed targets a positive rate of inflation, defined as a sustained rise in overall price level for goods and services, because a sustained decline in prices, known as deflation, can be even more harmful to the economy. The positive level of inflation and interest rates also provides the central bank with the flexibility to lower rates in response to an economic slowdown.

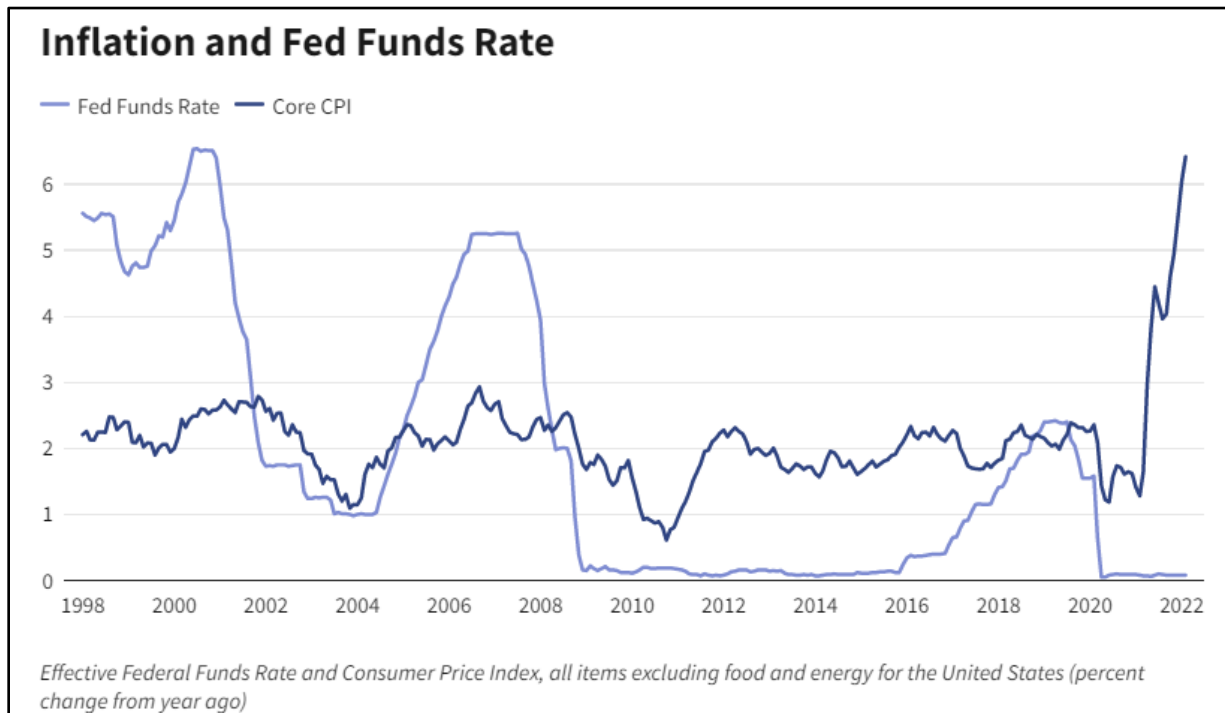
In August 2020, the Federal Reserve adopted average inflation targeting. That framework committed Fed policymakers to hold inflation above 2% for a time to compensate for stretches when the inflation rate fell short of that target.

### How Changes in Interest Rates Affect Inflation

When the Federal Reserve responds to elevated inflation risks by raising its benchmark federal funds rate it effectively increases the level of risk-free reserves in the financial system, **limiting the money supply** available for purchases of riskier assets. Conversely, when a central bank reduces its target interest rate it effectively increases the money supply available to purchase risk assets.

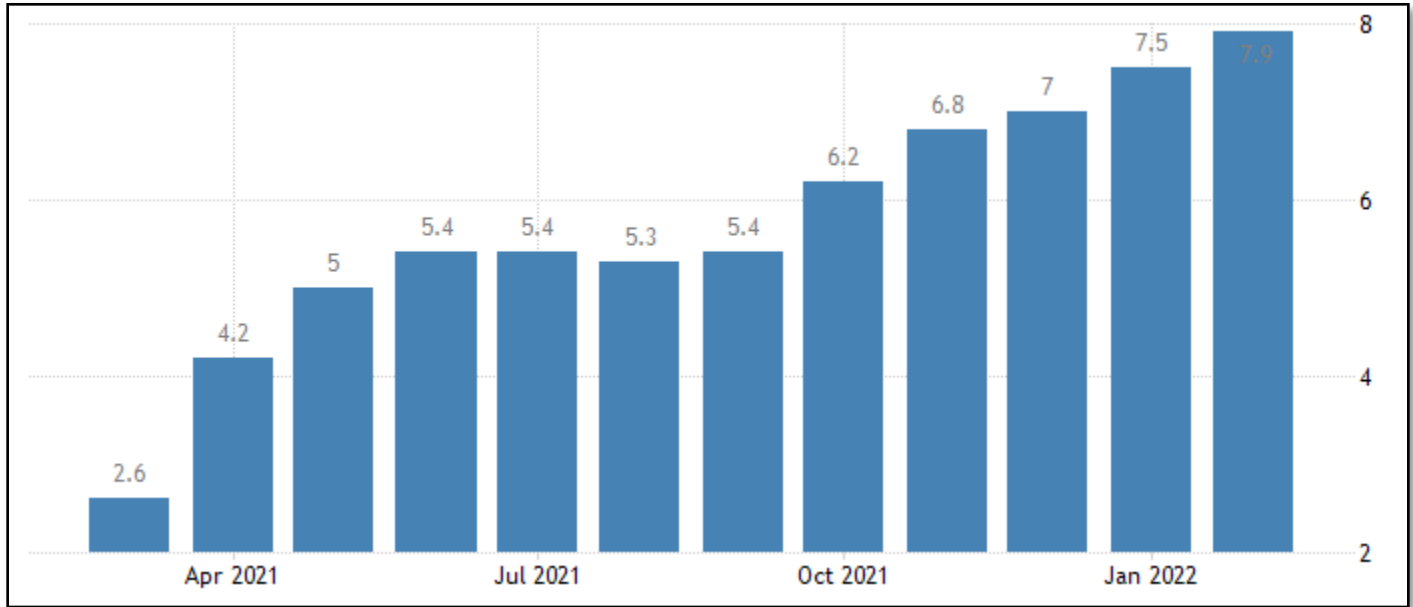
By increasing borrowing costs, rising interest rates **discourage** consumer and business spending, especially on commonly financed big-ticket items like housing and capital equipment. Rising interest rates also tend to weigh on asset prices, reversing the wealth effect for individuals and making banks more cautious in lending decisions.

Finally, rising interest rates signal the likelihood that the central bank will continue to tighten monetary policy, further tamping down inflation expectations.



### United States Inflation Rate

Annual inflation rate in the US accelerated to 7.9% in February of 2022, the highest since January of 1982, matching market expectations. Energy remained the biggest contributor (25.6% vs 27% in January), with gasoline prices surging 38% (40% in January). Inflation accelerated for shelter (4.7% vs 4.4%); food (7.9% vs 7%, the largest since July of 1981), namely food at home (8.6% vs 7.4%); new vehicles (12.4% vs 12.2%); and used cars and trucks (41.2% vs 40.5%). Excluding volatile energy and food categories, the CPI rose 6.4%, the most in 40 years. Still, the surge in energy costs due to war in Ukraine is still to come. The inflation was seen peaking in March but the recent developments in Europe coupled with the ongoing supply constraints, strong demand, and labour shortages will likely maintain inflation elevated for longer. *source: U.S. Bureau of Labor Statistics*

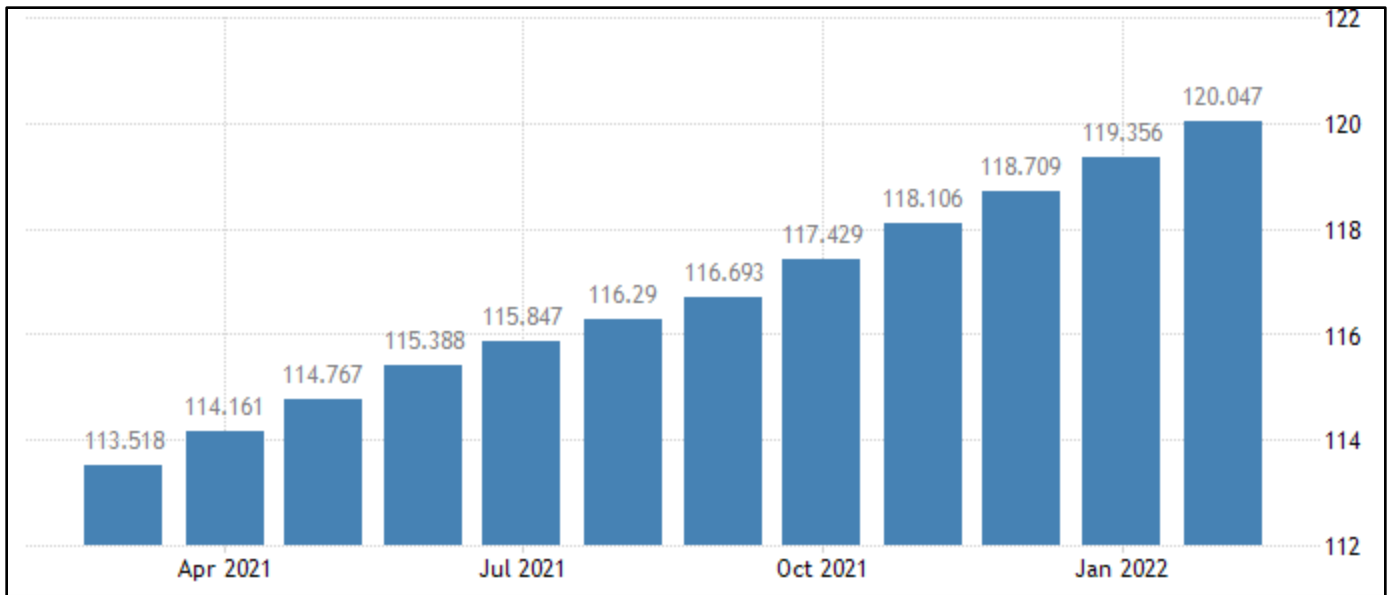


**United States Personal Consumption Expenditure Price Index**

The personal consumption expenditure price index in the United States climbed 6.4% year-on-year in February of 2022, quickening from a downwardly revised 6.0% increase in January. It was the steepest rise since February of 1982, reflecting stronger gains in prices of goods (9.6% vs 8.8% in January), while services rose at the same pace as in January (4.6%). Energy prices jumped 25.7%, while food prices were up 8.0%. Annual core PCE inflation, which is the Fed's preferred measure of price changes, rose 5.4% from a year ago, the highest since April of 1983 but slightly below market expectations of 5.5%, signaling persistent inflationary pressures. *source: U.S. Bureau of Economic Analysis*

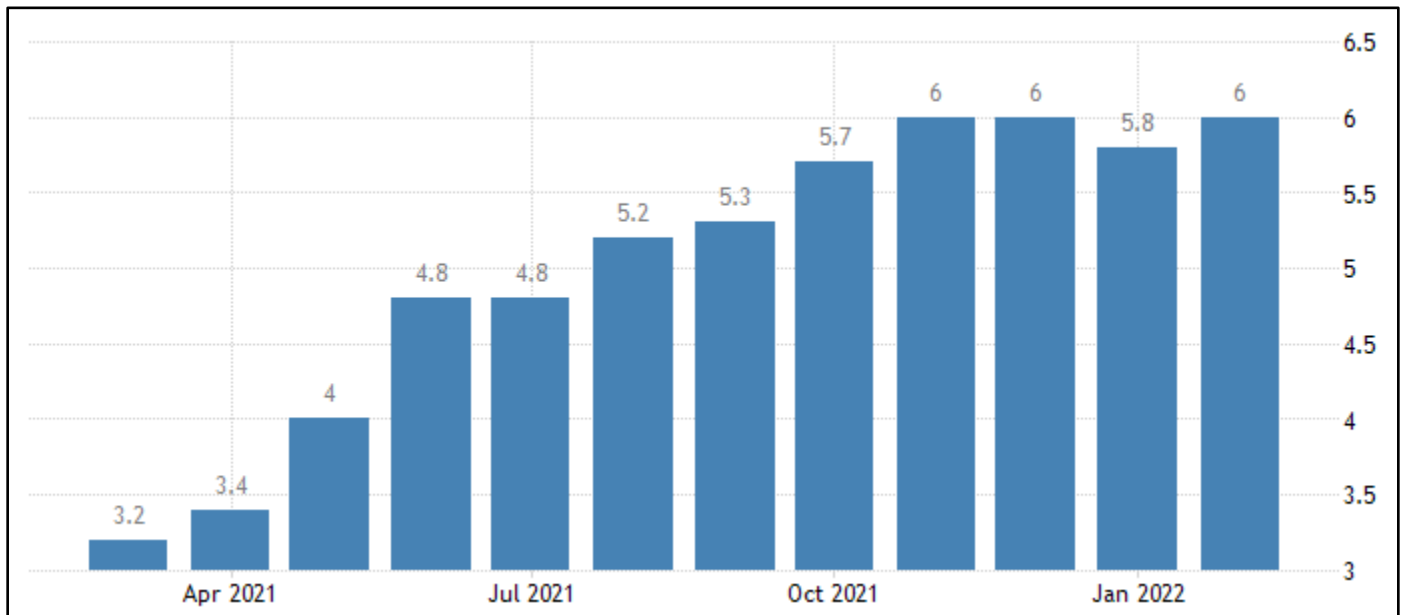
**United States Consumer Price Index (CPI)**

Consumer Price Index CPI in the United States increased 7.9% year-on-year to 284.18 points in February of 2022. It is the biggest annual rise since January of 1982, matching market expectations. Energy remained the biggest contributor (25.6% vs 27% in January), with gasoline prices surging 38% (40% in January). Inflation accelerated for shelter (4.7% vs 4.4%); food (7.9% vs 7%, the largest since July of 1981), namely food at home (8.6% vs 7.4%); new vehicles (12.4% vs 12.2%); and used cars and trucks (41.2% vs 40.5%). *source: U.S. Bureau of Labor Statistics*



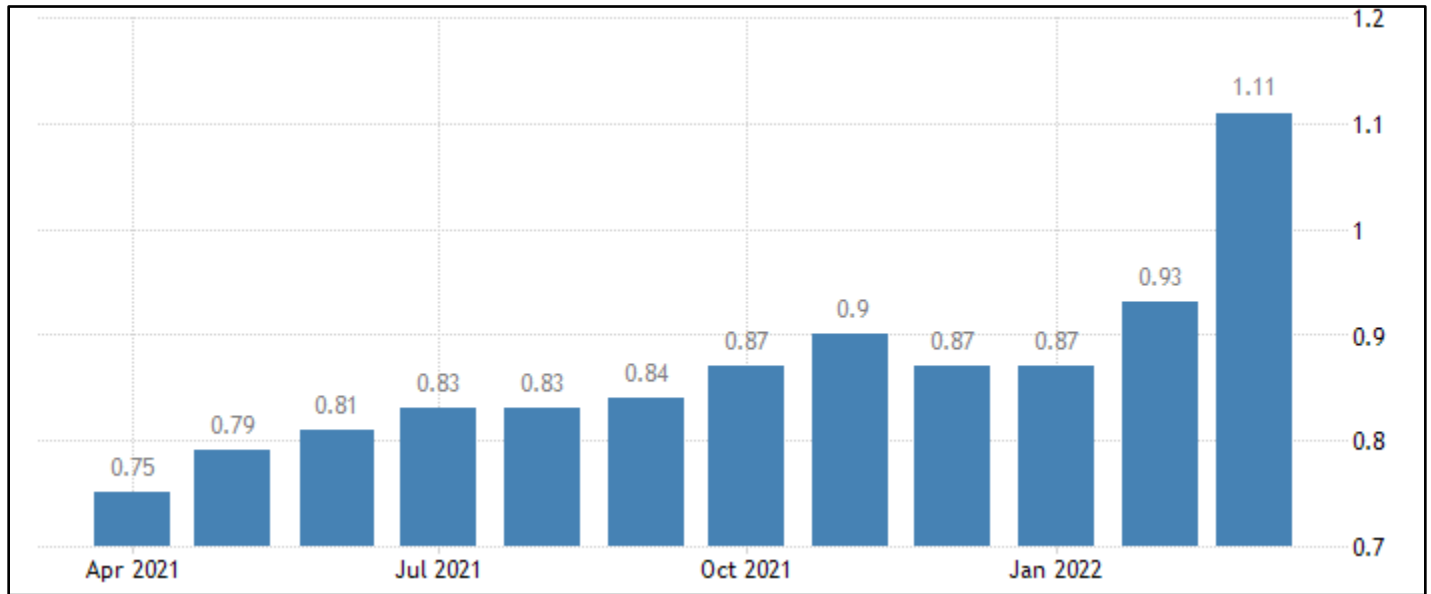
### United States Consumer Inflation Expectations

US consumer inflation expectations for the year ahead increased again to 6% in February of 2022, the same as a record 6% in both December and November and reversing some of January’s sharp declines. All the commodity price change expectations increased, namely for food (9.2%), gas (8.8%), medical care (9.6%), college education (9%) and rents (10.1%). Median home price expectations, on the other hand, declined (5.7%). Meanwhile, earnings growth expectations remained unchanged, while expectations about unemployment, perceived job loss, and job finding all improved and those for spending growth reached a new series high. Median three-year ahead inflation expectations also ticked up by 0.3 percentage point to 3.8%. source: Federal Reserve Bank of New York



### United States Gasoline Prices

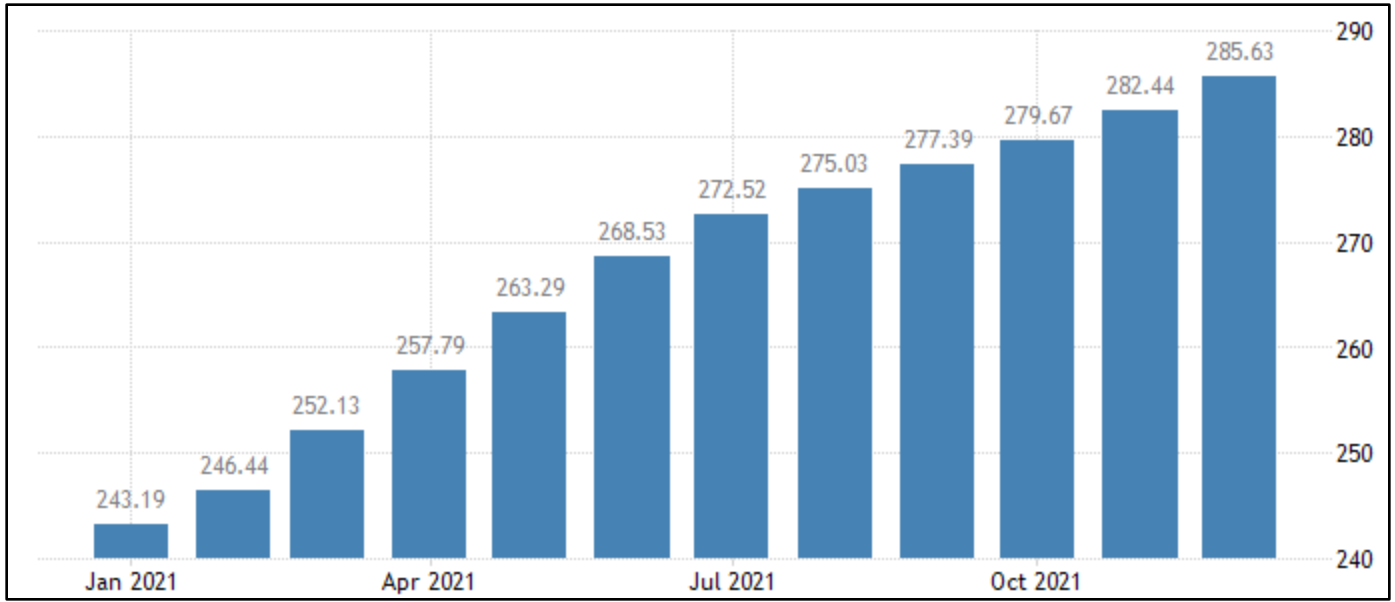
Gasoline Prices in the United States increased to 1.11 USD/Liter in March from 0.93 USD/Liter in February of 2022. source: U.S. Energy Information Administration



### United States S&P Case-Shiller Home Price Index

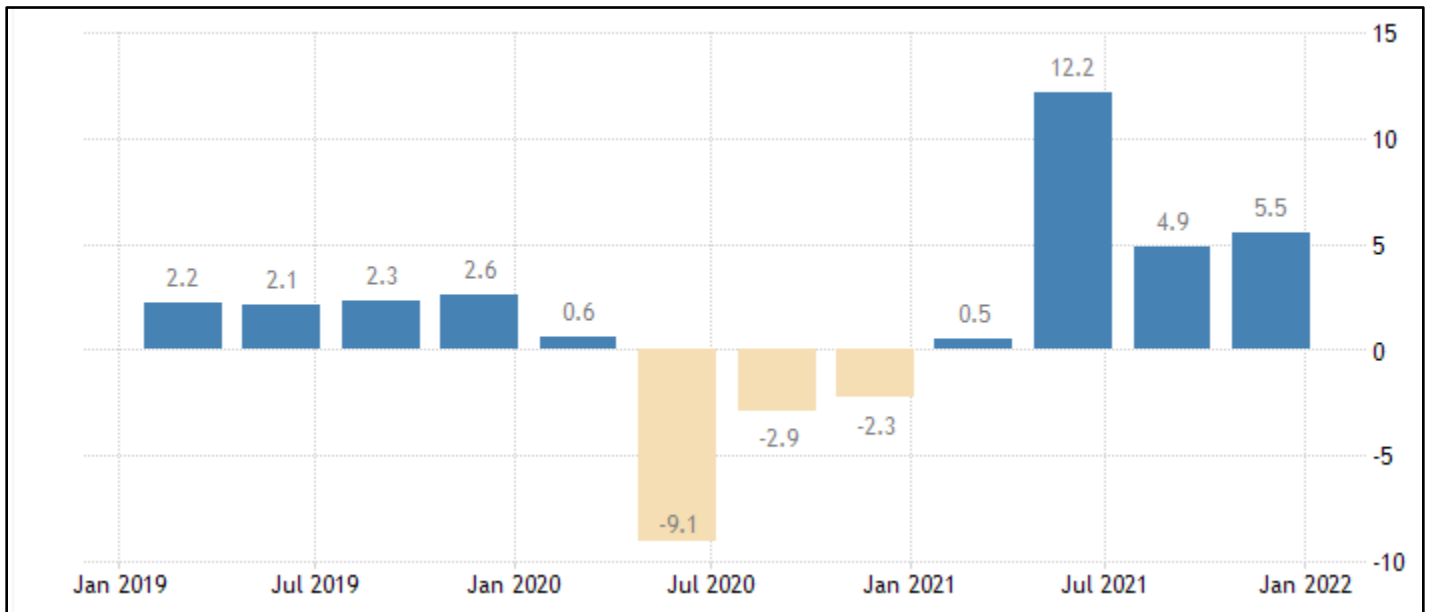
The S&P CoreLogic Case-Shiller 20-City Composite Home Price Index measures changes in residential house prices in 20 metropolitan regions in the United States: Atlanta, Boston, Charlotte, Chicago, Cleveland, Dallas, Denver, Detroit, Las Vegas, Los Angeles, Miami, Minneapolis, New York, Phoenix, Portland, San Diego, San Francisco, Seattle, Tampa and Washington D.C.

Case Shiller Home Price Index in the United States increased to a record high of 285.63 points in December from 282.44 points in November of 2021. source: Standard & Poor's



**United States GDP Annual Growth Rate**

The Gross Domestic Product (GDP) in the United States expanded 5.50 percent in the fourth quarter of 2021 over the same quarter of the previous year. source: U.S. Bureau of Economic Analysis

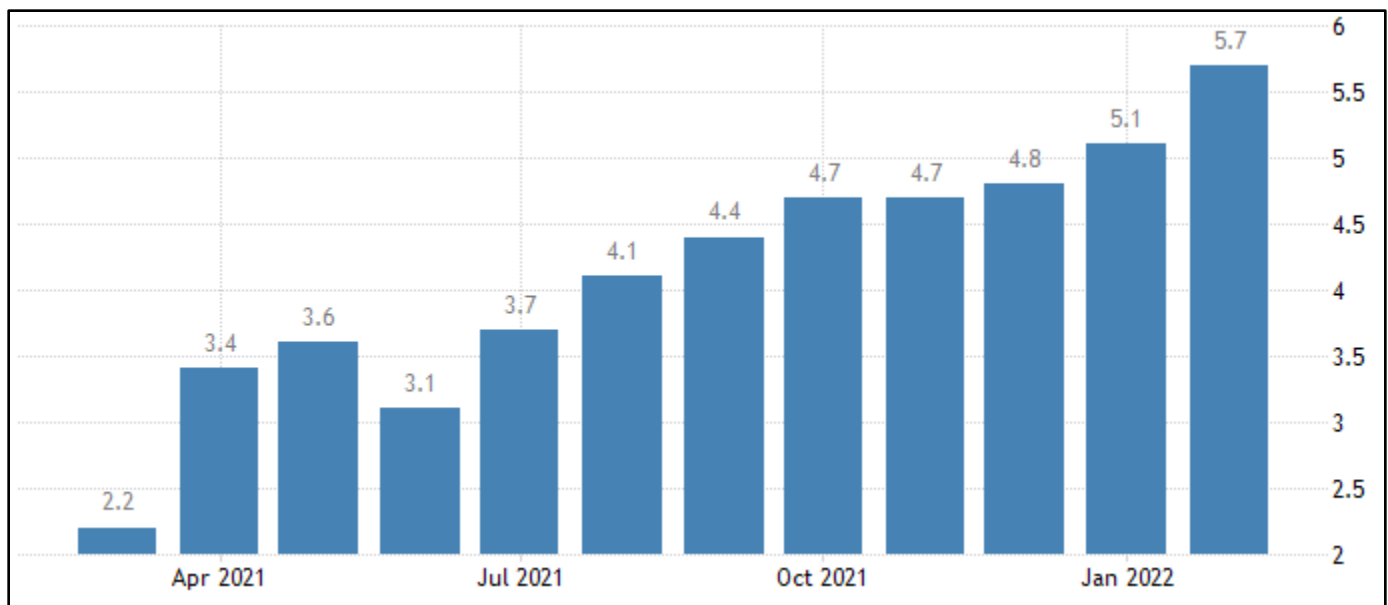




## CANADA

### Canada Inflation Rate

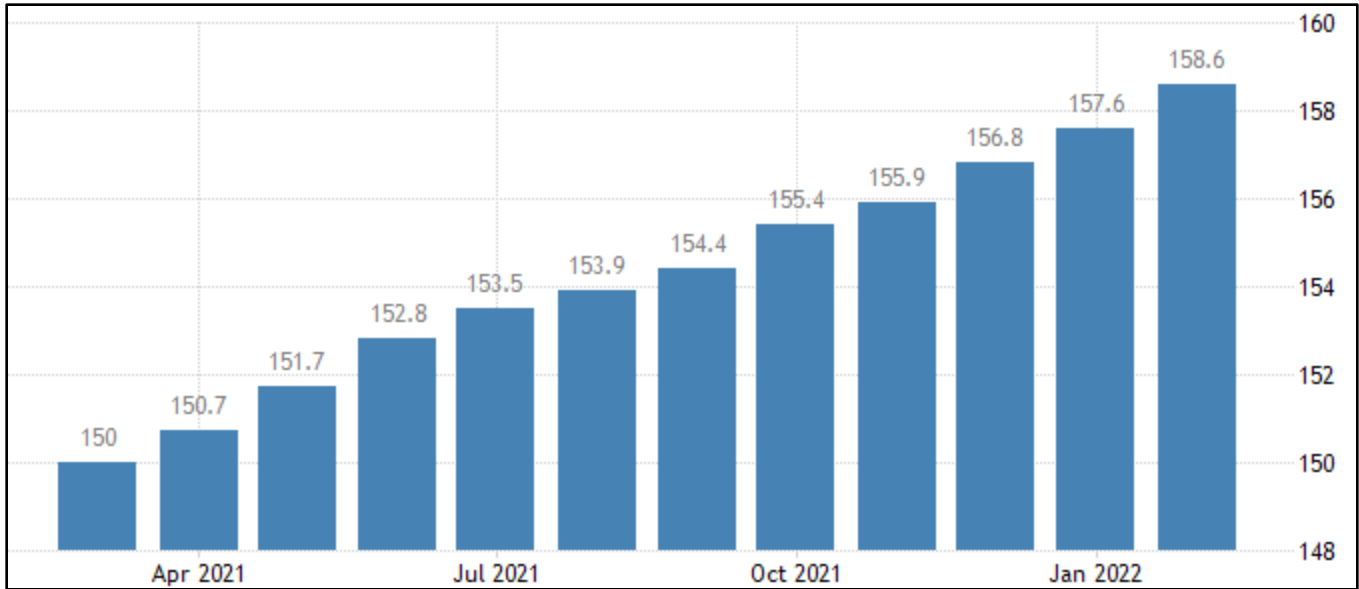
Canada’s annual inflation rate quickened to 5.7% in February of 2022, **the highest** since August of 1991, slightly above market expectations of 5.5%, as geopolitical risks and tight OPEC+ supplies fueled a rally in oil prices to over 13-year highs and logistical issues continued to underpin raw material and transportation costs. Prices rose faster in six of the eight major components, notably for shelter (6.6% vs 6.2% in January), which rose at the steepest pace since August 1983. Sharp price increases were also seen in transportation (8.7% vs 8.3%), bolstered by a 32.3% surge in gasoline charges at the pump; costs of food (6.7% vs 5.7%), as prices of food in grocery stores rose at the fastest rate in 13 years. Excluding gasoline, the CPI rose at a fresh record pace of 4.7%. On a monthly basis, consumer prices rose 1.0%, beating market forecasts of a 0.9% gain and marginally quicker than a 0.9% increase in January. source: Statistics Canada



In Canada, the most important categories in the CPI basket are **Shelter** (27.5 percent of the total weight) and Transportation (19.3 percent). Food accounts for 16.1 percent; Household Operations, Furnishings and Equipment for 11.8 percent; Recreation, Education and Reading for 11.8 percent; Clothing and Footwear for 5.7 percent; Health and Personal Care for 5 percent; Alcoholic Beverages and Tobacco Products for the remaining 3 percent. The CPI basket is reviewed every four years on the basis of household surveys. The current weights are based on spending patterns in 2009.

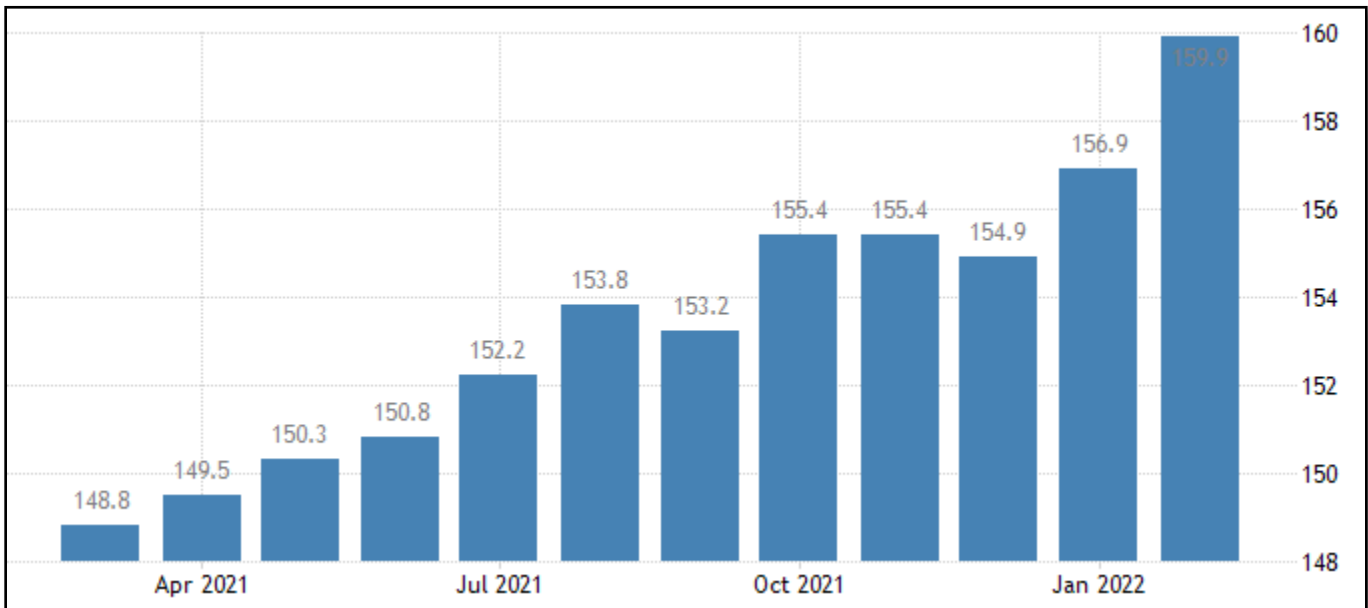
### Canada CPI Shelter

CPI Housing Utilities in Canada increased to 158.60 points in February from 157.60 points in January of 2022. source: Statistics Canada



**Canada CPI Transportation**

The transportation sub-index of the CPI basket in Canada increased to 159.90 points in February of 2022 from 156.90 points in January of 2022. source: Statistics Canada



### Canada Food Inflation

Cost of food in Canada increased 6.70 percent in February of 2022 over the same month in the previous year. source: Statistics Canada



## Global Economic News

### China Manufacturing Sector Sinks Into Contraction

The manufacturing sector in China slipped into contraction in March, the latest survey from Caixin showed on Friday with a manufacturing PMI score of 48.1.

That's down from 50.4 in February and it moves **beneath the boom-or-bust line of 50 that separates expansion from contraction.**

The drop in the headline PMI was partly driven by a renewed and solid fall in production at Chinese manufacturing firms in March. Furthermore, the rate of contraction was the steepest seen for 25 months. Companies frequently mentioned that the measures to contain the spread of COVID-19 had disrupted operations, supply, and dampened customer demand.

New orders likewise fell at the sharpest rate since February 2020 in March. Companies commented that both domestic and foreign demand had waned, with new export business declining at the fastest pace for 22 months. The pandemic, and difficulties shipping items to clients, as well as greater market uncertainty due to the Ukraine war had dampened sales, according to panelists.

Disruption to business operations and logistics due to containment measures led to a further deterioration in average supplier performance. Notably, the rate at which delivery times increased was the fastest since last October.

## **Taiwan Manufacturing PMI Slips To 54.1 In March**

The manufacturing sector in Taiwan continued to expand in March, albeit at a slower pace, the latest survey from S&P Global showed on Friday with a manufacturing PMI score of 54.1.

That's down from 54.3 in February although it remains above the boom-or-bust line of 50 that separates expansion from contraction.

Slower increases in output, new orders, employment, and stocks of purchases all weighed on the headline index. The supplier's delivery times index was the only component to have a positive directional influence on the headline figure, which showed a steeper deterioration in average vendor performance.

Goods producers in Taiwan signaled a weaker increase in output at the end of the first quarter amid reports of subdued client demand and low raw material availability. Notably, the rate of production growth was the slowest seen for four months and only marginal.

## **Japan Manufacturing Sector Accelerates In March**

The manufacturing sector in Japan continued to expand in March, and at a faster pace, the latest survey from Jibun Bank showed on Friday with a manufacturing PMI score of 54.1.

That's up from 52.7 in February and it moves further above the boom-or-bust line of 50 that separates expansion from contraction.

The improvement partly stemmed from a renewed rise in production volumes in March. Firms often attributed this to greater new orders, although growth was slightly held back by reports of higher raw material prices. Output volumes have now increased in five of the last six months.

Japanese goods producers also signaled a further expansion in new order inflows in March, the sixth in as many months. The rate of growth quickened from February as firms reported domestic sales in particular were boosted by the easing of COVID-19 restrictions. That said, stricter restrictions in key export markets, particularly China, led to a sharp reduction in export orders. The contraction was solid overall and the quickest since July 2020. Foreign sales were also hindered by the Russian invasion of Ukraine.

## **U.S. Weekly Jobless Claims Show Modest Increase jobless claims**

A day ahead of the release of the closely watched monthly jobs report, the Labor Department released a report on Thursday showing a modest increase in first-time claims for U.S. unemployment benefits in the week ended March 26th.

The report showed initial jobless claims edged up to 202,000, an increase of 14,000 from the previous week's revised level of 188,000.

Economists had expected jobless claims to inch up to 197,000 from the 187,000 originally reported for the previous week.

The figure originally reported for the previous week reflected the lowest number of jobless claims since September 1969.

"We expect initial claims to remain around 200k or lower as employers, who continue to struggle to attract and retain workers, are likely to keep layoffs to a minimum," said Nancy Vanden Houten, Lead U.S. Economist at Oxford Economics.

Meanwhile, the Labor Department said the less volatile four-week moving average slipped to 208,500, a decrease of 3,500 from the previous week's revised average of 212,000.

### **Biden To Release 1 Million Barrels Of Oil Per Day From Strategic Petroleum Reserve**

In an effort to combat the spike in oil prices spark by Russia's invasion of Ukraine, the White House on Thursday announced an historic release of oil from the U.S. Strategic Petroleum Reserve.

The White House said President Joe Biden plans to release an average of 1 million barrels of oil per day from the reserves for the next six months.

"The scale of this release is unprecedented: the world has never had a release of oil reserves at this 1 million per day rate for this length of time," the White House said. "This record release will provide a historic amount of supply to serve as bridge until the end of the year when domestic production ramps up."

Biden is also calling for an increase in domestic oil production, with the White House accusing some oil companies of choosing to make extraordinary profits without making additional investment to help with supply.

The White House claimed the oil and gas industry is sitting on more than 12 million acres of non-producing Federal land with 9,000 unused but already-approved permits for production.

The president is subsequently urging congress to make companies pay fees on wells from their leases that they haven't used in years and on acres of public lands that they are hoarding without producing.

Biden is also reiterating his commitment to achieving real energy independence by reducing U.S. dependence on oil altogether, calling on Congress to help speed the transition to clean energy that is made in America.

The price of crude oil moved lower on reports of Biden tapping the strategic reserves, with crude for May delivery currently plunging \$5.79 to \$102.03 a barrel.

Crude oil prices have seen substantial volatility since Russia's invasion of Ukraine, while prices at the pump have remained stubbornly high above \$4.20 a gallon on average.

PRICE OF CRUDE OIL (WTI) – March 31, 2022



Oil prices were lower on Thursday as the White House announced that it will release 1 million barrels per day of oil for the next six months from the Strategic Petroleum Reserve — in an effort to calm spiking oil and gas prices.

International benchmark Brent crude ended the day at \$107.91, for a loss of 4.88%. U.S. crude futures for May delivery settled 6.99% lower at \$100.28 per barrel.

“The scale of this release is unprecedented: the world has never had a release of oil reserves at this 1 million per day rate for this length of time. This record release will provide a historic amount of supply to serve as bridge until the end of the year when domestic production ramps up,” the administration said in a statement.

Oil prices dropped sharply Wednesday evening after reports that such a move was likely. President Joe Biden is set to give remarks later on Thursday.

“It is hard to overstate the scale of this intervention,” said ClearView Energy Partners. The firm noted that this is the largest-ever SPR release by a factor of 3.6X. The second largest on record was the 50-million-barrel release in November.

Gasoline prices have surged to record highs on Russia’s invasion of Ukraine and subsequent supply concerns, driving spikes in inflation across the global economy.

Russia is the world's second-largest exporter of oil, and unprecedentedly punitive international sanctions following the invasion have disrupted flows out of the country.

In a research note Thursday, Goldman Sachs commodity analysts said the release from U.S. reserves would help the oil market toward rebalancing in 2022, but would not resolve its structural deficit.

"This would reduce the amount of necessary price-induced demand destruction, the sole oil rebalancing mechanism currently available in a world devoid of inventory buffers and supply elasticity," Goldman Sachs said.

"This would remain, however, a release of oil inventories, not a persistent source of supply for coming years. Such a release would therefore not resolve the structural supply deficit, years in the making."

Oil markets are still going to be squarely focused on supply going forward, says analyst. They added that lower prices in 2022 would support oil demand while slowing the acceleration in U.S. shale production, leaving a deficit in 2023 and a likely need to refill the U.S. reserves.

The International Energy Agency will hold an **emergency meeting** on Friday to discuss oil supply concerns, Australian Energy Minister Angus Taylor announced on Thursday.

The Organization of Petroleum Exporting Countries and its allies including Russia (**known as OPEC+**) met on Thursday, deciding to hold production output largely steady. The group will boost output by 432,000 barrels per day beginning May 1.

It was noted that continuing oil market fundamentals and the consensus on the outlook pointed to a well-balanced market, and that current volatility is not caused by fundamentals, but by ongoing geopolitical developments," OPEC said in a statement following the meeting.

### A 'risky strategy'

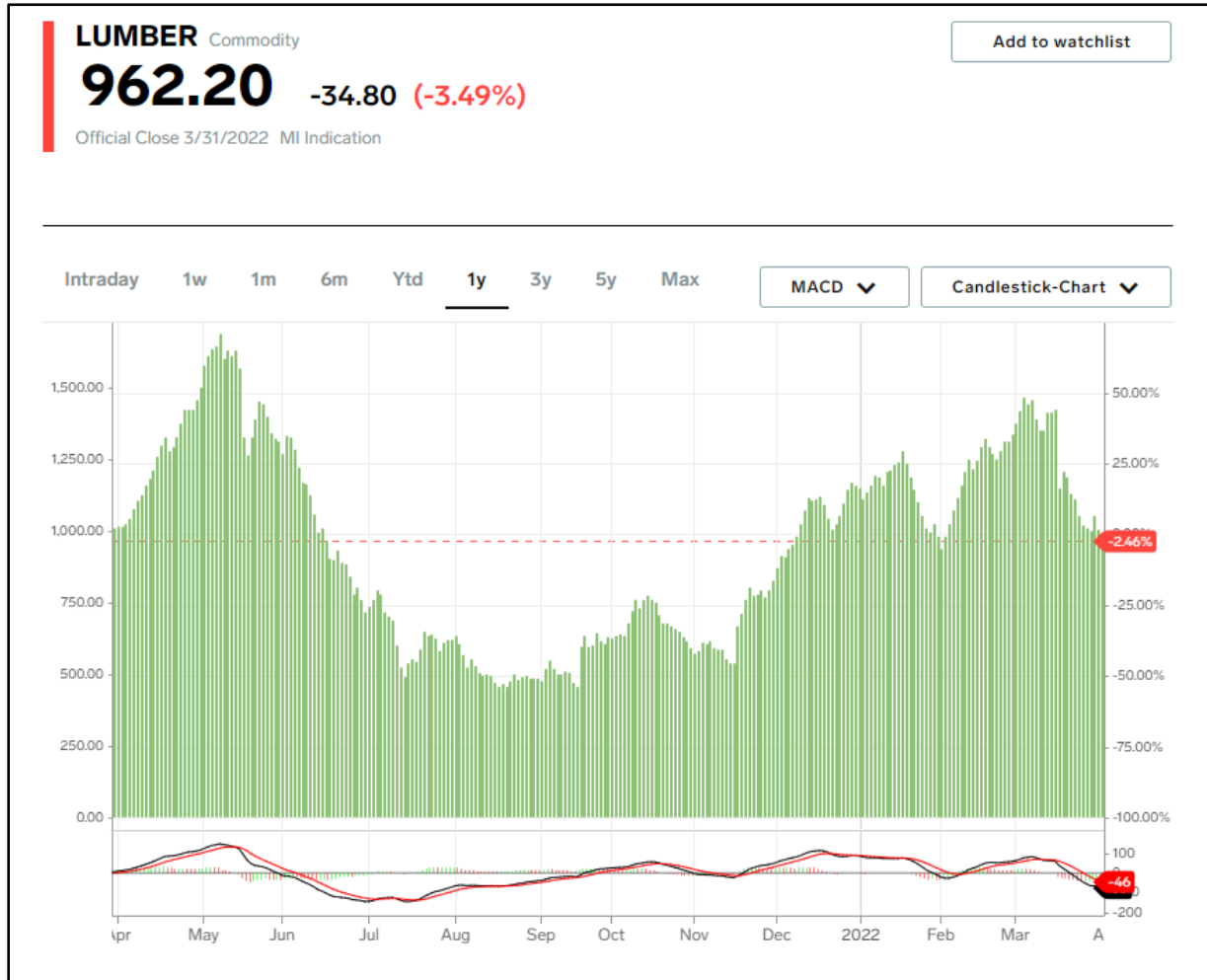
Ed Bell, senior director of market economics at Emirates NBD, told CNBC on Thursday that despite the record scale of the expected SPR release, an enormous downswing in its immediate aftermath would be unlikely.

"Markets are still going to be very much squarely focused on supply going forward and the lack of it that we're going to be seeing from Russia, the incremental additions we're going to be seeing from OPEC+ and so far, the real lack of price response from U.S. producers to high prices," Bell told CNBC's "Capital Connection."

"For the longer term though, I do think this is a bit of a risky strategy for the U.S. to draw down on its SPR so heavily if you think that we're going to be going into the heavier use summer months in the United States, we're going to be drawing down inventories just as we're going to be needing them in a time of uncertain supply conditions."

Bell added that if the oil market maintains a structural deficit for a prolonged period, drawing down on U.S. reserves could "help underpin a bullish case for oil prices" over the next 12 to 24 months.

PRICE OF LUMBER



Lumber trade flows changed almost instantly when Russia invaded Ukraine in late February. Trade sanctions and restrictions in financial transactions by Europe, North America, and major markets in Asia halted shipments from Russia and Belarus. In addition, exports from Ukraine were also disrupted. The total lumber exports from the three countries in the war zone were 34 million m<sup>3</sup> in 2021. Over 25 per cent of that volume was exported to countries with current sanctions against Russia and Belarus. In addition, the two major wood certification organizations, FSC and PEFC, have labeled all timber from the two countries as “conflict timber.” The removal of the labeling means that the timber cannot be used in certified products, which will impact any country buying wood from Russia and Belarus and manufacturing certified products, e.g., lumber, plywood, pulp, and paper for sales worldwide.

The total volume of softwood lumber that is now unlikely to reach the market in Europe and Asia (outside China) because of sanctions is an estimated 10 million m<sup>3</sup>, or just over 30 per cent of the total export volume shipped from Belarus, Russia, and Ukraine in 2021, reports the Wood Resource Quarterly. In addition, lumber sold to customers in China that require certified wood for manufacturing forest



products targeting Europe and North America will no longer be available from Russia. Europe, which imported 8.5 million m<sup>3</sup> of softwood lumber from the three countries in 2021, will be the hardest hit, as the lumber import volume accounted for close to 10 per cent of the total consumption on the continent in 2021.

Although the Chinese government has not set up any barriers to trade between them and Russia, it is still conceivable that there will be interruptions in shipments between the two neighbors. Some of the factors that may reduce trade even with countries that have no sanctions with Russia and Belarus include:

- Foreign investors in the Russian forest industry may withdraw their presence and financial funding, making it more challenging to produce and export to any market.
- A weak Russian Rouble (down over 20 per cent in three weeks since the war started) will make importing equipment and spare parts for logging companies and forest product manufacturers very costly.
- The removal of Russian banks from the international payment transaction system SWIFT will complicate payments for exported Russian products and imports of most equipment for the forest industry, from timber harvesters and forwarders to machinery for sawmills, plywood mills, and pulp mills.
- Russian manufacturers of pulp, paper, plywood, and lumber can no longer offer PEFC or FSC certified products.

Global trade flows of forest products have already changed significantly and will continue to change due to the Russian invasion of Ukraine. Even when peace is ultimately reached, it is improbable that trade will revert to pre-war patterns.

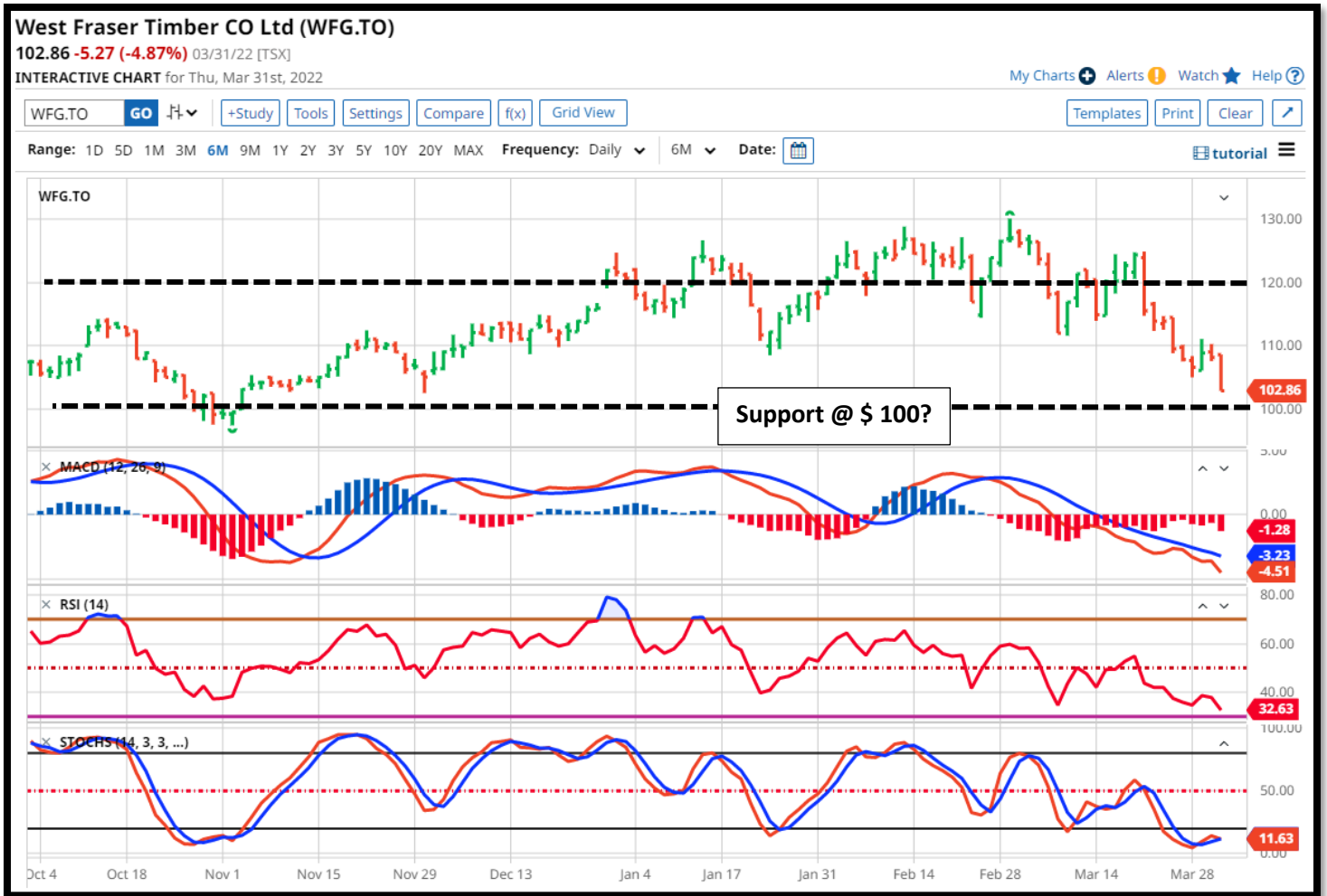
**Canfor** is reducing operating schedules at its B.C. and Alberta sawmills for at least four weeks beginning April 4, the company announced yesterday.

Canfor said the move is due to the “cumulative effects of the unprecedented global supply chain crisis,” and that the company will reassess as conditions evolve.

“We are experiencing extreme supply chain challenges that are significantly impacting our operations and it has become imperative to reduce operating schedules to address our unsustainable inventory levels,” Canfor president and CEO Don Kayne said in a statement.

“We regret the impact that the reduced operating schedules will have on our employees, contractors and communities and we will make efforts to mitigate the negative effects. We will continue to leverage our global operating platform to minimize disruptions in supply to our customers,” Kayne said.

Canfor expects the reduced operating schedules will impact production capacity by at least 100 million board feet.



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