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Q1 2024 Market Commentary

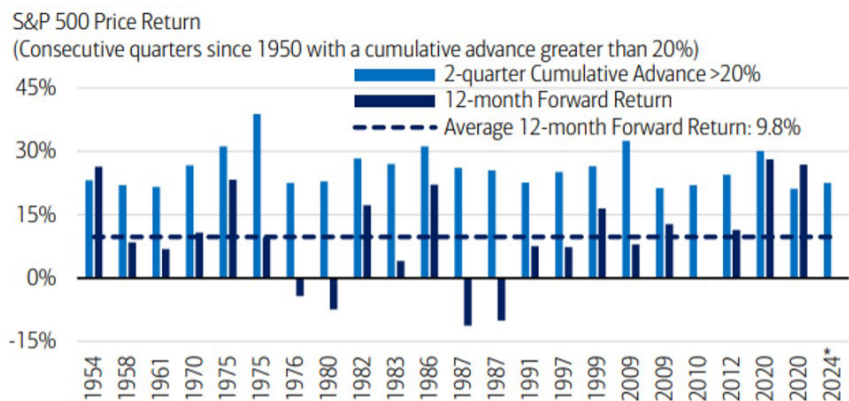
Benchmark performance as at March 31, 2024

Index	March	3-Month Trailing	YTD Return
S&P/TSX Composite TR	4.1%	6.6%	6.6%
S&P 500 TR	3.2%	10.6%	10.6%
Nasdaq Composite	1.8%	9.1%	9.1%
WTI OIL	5.9%	16.8%	16.8%
Natural Gas	-5.2%	-29.9%	-29.9%
10-Year US Treasury Bond	0.8%	-1.6%	-1.6%
USD/CAD FX	-0.3%	2.2%	2.2%

Source: FactSet

Investors enjoyed another month of gains in March and for Q1 2024. It has been a banner start to the year piggybacking on the 2023 year-end rally. The S&P 500 has now posted strong a cumulative return of 22.5% over the past two quarters. Since 1950, when the S&P 500 gained in consecutive quarters with a combined advance of greater than 20%, equities rose over the next 12 months 77.3% of the time with an average return of 9.8% (see Chart 1).

Chart 1: Back-to-back quarterly advances have led to further equity market gains



Source: Bloomberg

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Since the U.S. Federal Reserve (Fed) signaled the end of its tightening campaign in late 2023 and shifted to an easing bias, equity markets have been off to the races around the world. Global stock market indexes, such as the MSCI World Index, are up 25%, leading indicators have started to improve, measures of financial conditions have eased, economic forecasts for gross domestic product (GDP) growth in 2024 have been rising, and inflation measures have picked up again. Both the three-month and six-month measures of the consumer price index (CPI) and personal consumption expenditures (PCE) price index and their “core” versions, which exclude food and energy for a better gauge of underlying inflation, bottomed around the time of the Fed’s pivot, and have been rising more than expected in 2024 (see Chart 2).

Positive fundamentals have fueled the strong equity performance. Resilient job creation and solid wage growth continued to support consumer spending. Better-than-expected corporate earnings were also a catalyst. S&P 500 companies delivered a strong 4% earnings beat for Q4 2023. Analysts expect earnings to continue to accelerate this year with consensus estimates calling for 12% earnings growth for the S&P 500 in 2024 (source: FactSet).

Expectations for easier financial conditions also underpinned gains. The latest Fed projections estimate a median of three rate cuts this year even amid warmer inflation signals recently. Under the surface, mega-cap technology stocks continued to drive the market, but market breadth has improved.

By the end of Q1, more than 80% of S&P 500 constituents crossed above the 200-day moving average, which aside from a brief cross in

Chart 2: Inflation reaccelerating since Fed pivot

	48-month average	Latest 3 months	Q4 3-month low	Latest 6 months	Q4 6-month low
Consumer Price Index (CPI)	4.66	3.99	1.91	3.20	2.99
CPI excluding food and energy	4.23	4.18	3.34	3.85	3.08
Personal Consumption Expenditure (PCE) Price Index	4.00	3.39	0.61	2.51	2.05
PCE excluding food and energy	3.73	3.52	1.55	2.89	1.88

Source: Bureau of Labor Statistics

January, marks the first sustained period since 2021. Stocks have historically fared well when market breadth increased with the S&P 500 up 13.2% on average over the next 12 months (source: Bank of America Securities).

From a sector perspective, communication services (read: Meta) dominated the quarter, followed by energy and information technology, but financials and industrials also held up with both sectors outperforming the broader index.

Small-caps still trailed large-caps but could see further support, especially with a larger earnings growth rebound expected for the Russell 2000 compared with the S&P 500. Growth outperformed value, but value could be staged to catch up given the positive cyclical forces.

From a global perspective, U.S. equities led both international developed and emerging markets, though Japanese equities staged a strong rally following more optimism around improvements in Japan’s economy.

The S&P TSX posted a rare relative outperformance in March, up 4.1% compared with the S&P 500 gain of 3.2% and the Nasdaq Composite 1.8% return.

A review of the performance attribution of the S&P TSX shows the energy (in particular, heavy oil producers) and materials (gold, copper) sectors did the

heavy lifting, gaining 7.3% and 15.4%, respectively. These two sectors are key components of the Canadian market, responsible for 18% and 11% of the benchmark index (see Chart 3). The S&P 500 has a lesser weighting in cyclical sectors and more secular growth exposure leading to the relative underperformance in March.

Gold has been a standout performer in 2024. Positive money flows from central banks into gold and out of U.S. treasuries is due to the concern over persistent inflationary conditions and the view that the U.S. debt levels are unsustainable.

Chart 3: The Canadian index is resource-rich

Sector	S&P 500	S&P TSX
Information Technology	30%	9%
Financials	13%	31%
Health Care	13%	0.5%
Consumer Discretionary	10%	3.5%
Communication Services	9%	3%
Industrials	9%	14%
Consumer Staples	6%	4%
Energy	4%	18%
Materials	2%	11%
Real Estate	2%	2%
Utilities	2%	4%

Source: RBC Capital Markets

Oil has started to move higher with gains over 5% in March and 16.8% YTD 2024. Oil prices have firmed in the face of rising oil production, which recently reached record levels of output in the U.S. (see Chart 4). The U.S. secured a

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top spot on the list of the world's largest energy exporters in 2023, helping to meet rising global energy demand amid OPEC production restraint and Russian sanctions.

However, production growth is not the only factor determining U.S. exports. For example, U.S. infrastructure capacity, shifts in domestic consumption, global supply-and-demand dynamics and regulatory policies can all play important roles. Each of these factors can be either headwinds or tailwinds to U.S. energy exports in 2024.

Key factors have been supportive to high oil prices in 2024, including the fact that global oil demand has been resilient, heightened geopolitical stress in the Middle East and Russia has added a risk premium, OPEC has kept production cuts in place, and non-commercial financial speculators have been bidding up oil future contracts.

In the final week of March, Ukraine attacked Russian oil refineries for strategic military purposes. According to RBC Capital Markets, there are now five refineries in Russia facing substantial throughput disruptions. We estimate that Russia's refineries have lost about 13% of their capacity. Russia remains the world's second largest oil producer.

The U.S. has continued to lobby for Ukraine to avert attacks on Russian oil supply to contain higher energy input costs for consumers in an election year.

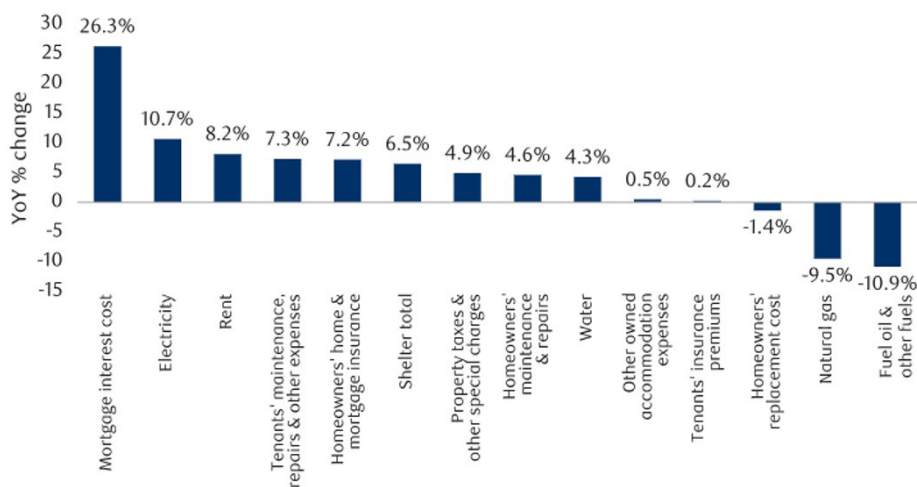
In my February commentary, I discussed how the Canadian Economy is faltering. The cost of living in Canada is high, but growth per capita income is negative. Immigration is certainly a contributing factor with temporary foreign workers increasing from 248,000 in 2015 to 597,000 in 2022 at a time of a housing affordability

Chart 4: U.S. crude oil field production hit a record level of output



Source: RBC GAM

Chart 5: Canadian shelter costs are mounting



Source: Statistics Canada

crisis. Government spending is soaring, but the delivery of essential government services is declining. Debt service costs are compounding at higher interest rates while government spending, deficits, and debt continue to balloon.

Canadian CPI Shelter Index is a crucial data point we can observe to evaluate the health of the Canadian consumer (see Chart 5), and it is concerning.

Mortgage interest costs have risen 26.3% and total shelter costs have increased by 6.5% year over year.

The only area of relief is related to natural gas and fuel inputs that have declined over the same period.

According to RBC Economics, there are \$900 billion worth of mortgages set to renew with chartered banks at significantly higher interest rates over the next few years. Mortgage payments are forecasted to increase an additional 32% to 48% now through 2026.

By contrast, another example of U.S. exceptionalism lies in the fact that U.S. homeowners do not face the same mortgage rollover stress,

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and they benefit from the tax deductibility of mortgage interest. While the 30-year, fixed-rate mortgage has become a staple in the U.S., Canada does not offer anything remotely similar. The longest term for a home loan in Canada is 10 years, with the amount amortized over a 25-year period, but most Canadians commonly use a five-year term.

This means Canadians can never count on having a particular loan interest rate last more than five years, while U.S. counterparts have locked in low mortgage rates for 30-year terms.

Last month, Bank of Canada (BoC) officials held their key policy rate steady at 5% for a fifth straight meeting. The BoC acknowledged progress on inflation while reiterating that it was too early to consider easing.

Canada's labour market unexpectedly lost 2,200 jobs and the unemployment rate rose 0.3% to 6.1% according to Statistics Canada. This is the first job loss since July, and the highest unemployment rate since the COVID-19 pandemic. Canada's unemployment rate has not been this high since 2017, and this data should test the BoC's patient position on interest rate cuts.

More than ten (10) central banks met earlier this month around the world, showing that monetary policy decisions are becoming gradually less synchronized. Most central banks in developed economies remained on hold, while in emerging economies we had a mixed bag of cuts and hikes.

The Fed surprised with a dovish message, dismissing the recent inflation surprises, validating higher inflation risk premium. The significant upward revisions to growth did not lead to similar declines in unemployment or much higher inflation. When putting everything together, the Fed's view behind the dovish tone seems consistent with a positive supply-side narrative.

The Bank of Japan scrapped NIRP (negative interest rate policy) and YCC (yield curve control) as telegraphed, and we expect more hikes in October and April 25. The Reserve Bank of Australia remained on hold, but removed the reference to further tightening, and we expect the first cut in February.

In Europe, the Swiss National Bank delivered a surprise cut, while Bank of England remained on hold, with a dovish and hawkish bias, respectively. I expect the first Bank of England cut in August.

In emerging markets, we had a mixed bag of doves and hawks as well. Mexico started the easing cycle cutting 25 bps (basis points), as expected, while Brazil delivered 50 bps and committed to another 50 bps. In EMEA, the Central Bank of Turkey delivered a large surprise, hiking the policy rate by 500 bps ahead of the local elections (although their monetary policy does not follow any rational economic theory), while Czech National Bank delivered 50 bps as expected. In Taiwan, the Central Bank of the Republic of China surprised by hiking the policy rate by 12.5 bps to 2%.

All this to say, that desynchronization of monetary policy suggests that countries are pursuing what they believe are the best policies for their specific economies in contrast with previous periods of coordinated rate cuts during the COVID-19 pandemic and the Great Financial Crisis.

As we enter Q2 2024, I remain constructive on risk assets because we are in a secular bull market. There is no doubt that the S&P 500 is near-term over-bought, but can remain in that position for a long time given the positive economic backdrop in the U.S., a dovish Fed, and rising corporate profits. Further, broker margin debt is still lower than it was in 2021, there is over \$6 trillion in cash in money market funds, and inflation is sticky but has moderated over the past year.

I continue to ensure that my discretionary client portfolios have commodity exposures as an inflation hedge, U.S. equity exposure to benefit from secular growth companies exposed to Artificial Intelligence (AI), semi-conductors, cyber security, and fixed income to increase portfolio income and reduce volatility.

-R.K.



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