The Sandler Quarterly

Wealth Management Dominion Securities

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Lower interest rates?……not so fast

KEY INSIGHTS

- Equity markets run hot in Q1 but cool as Q2 begins
- Inflation's positive trajectory stalls as US economy remains strong
- Central Bankers expected to delay rate cuts until later in the year
- Gold moves up sharply to new all-time highs
- Canada increases capital gains rate for some individuals and corporations

Markets began the year anticipating multiple interest rate cuts, lower inflation, and the hope that a recession could be avoided. On the back of this outlook, equities turned in a strong first quarter. Fast forward to today and the thinking has shifted on a couple of fronts. There is now greater conviction that a US recession can be avoided (see *Figure 1*) – clearly this is good news. A stronger economy, however, makes the fight against inflation a tougher slog and will cause the Fed to hold off on anticipated rate cuts.

Canada's economy is underperforming the US and current expectations are for the Bank of Canada to cut rates first. At time of writing, markets are pricing first cuts in July for Canada and November for the US. Note that these are market expectations and as such, they move around continuously.

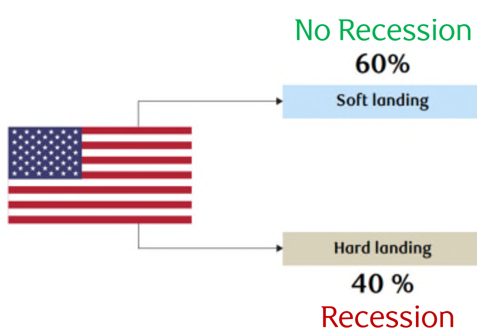

***Figure 1**: RBC's two main macro scenarios for the U.S. in 2024 (Source: RBC GAM)*

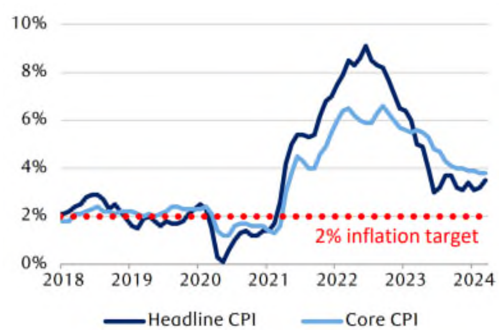

***Figure 2**: US Inflation – CPI vs. the Fed's 2% target (Source: Bloomberg)*

After falling sharply through 2023, the downward trajectory in inflation has flattened out and ticked higher recently (see *Figure 2*). Economic strength, strong employment and higher prices for energy and services (housing & transportation) are to blame. Against this backdrop it is hard to see central bankers adding fuel to the fire in the form of cheaper money. Until something changes, we may continue to see them kick the rate-cut can down the road.

Quarterly Review
Q1 2024

Equity Markets

After a remarkably strong first quarter, equity markets have retreated to some extent in April. While the scenario described above certainly has a lot to do with April weakness, it is also a necessary breather for markets. Following strong gains for the first three months it was only a matter of time before we hit the pause button - annualizing returns of that magnitude is clearly unsustainable.

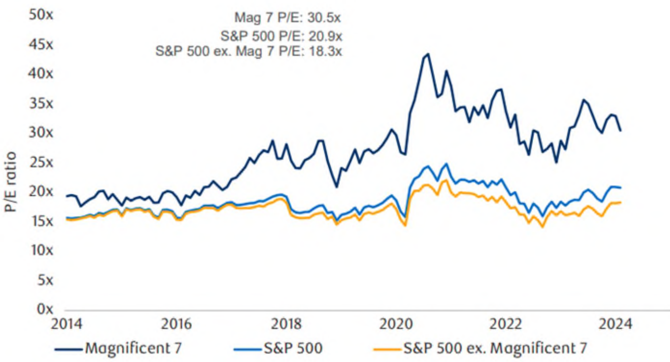

***Figure 3**: 'Magnificent 7' forward P/E ratio (Source: RBC GAM) – includes Apple, Microsoft, Google, Amazon, Nvidia, Tesla and Meta*

At current levels, equity valuations for the S&P500 are demanding. This, however, is largely driven by the outsized contribution of the tech heavyweights. Earnings growth expectations for the "Magnificent 7" are extremely high and only time will tell if these expectations are justifiable. At current levels, these seven companies would need to grow earnings more than 20% every year for the next 15 years to justify their current valuation premium (see *Figure 3*). Stripping out just these companies reveals the balance of the index to be more reasonably valued.

Fixed Income

There are positives to be found in the "higher for longer" interest rate story. Investors and savers will continue to benefit from better rates on cash deposits and bonds (see *Figure 4*). Having spent so many years with ultra-low interest rates we don't mind taking advantage of better yields for a little longer.

In 2023 we took advantage of higher yields and extended the average length of our bond maturities. Simply stated, we locked in higher rates for longer. That said, we still hold some shorter bonds and would be happy to roll these at maturity into a higher yielding environment.

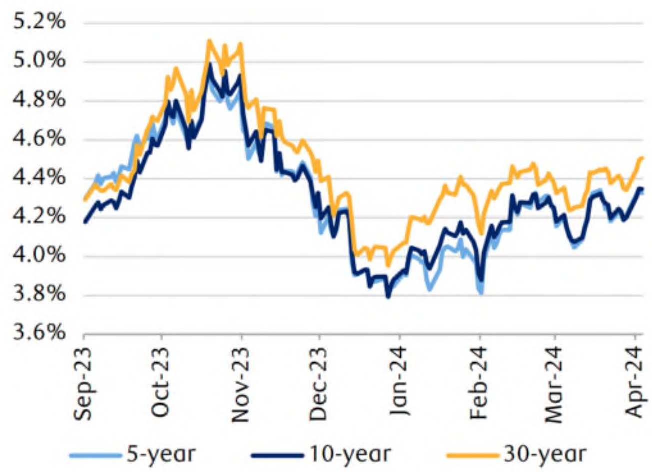

***Figure 4**: US Treasury yields (Source: RBC GAM)*

Bonds are near their most attractive levels in 20 years. Compared to stock market valuations and expected returns, bonds are deserving of consideration for almost all portfolios. Please speak to us about your current asset allocation – it is always important to examine your exposures to equities versus fixed income. Additionally, cash held in chequing and savings accounts at the bank needs to be looked at. Of course, we all need a comfortable bank balance, but amounts in excess of month-to-month requirements should be invested in higher yielding money market or short-term bonds. Please get in touch with us to discuss.

Gold

We have owned physical gold and/or gold companies for many years. At times it has tried our patience, but recently it has been playing nice. At current prices, gold has broken out of a long trend that saw it unable to crack the ~$2,100 range. At $2,400 gold has clearly moved to a higher trading range and our hope is that the $2,100 level will now become the lower end of a new trading range (see *Figure 5*).

Gold's strength is very interesting in this time of higher interest rates. As an investment that does not pay an income stream, it competes with cash that currently pays in the 4% to 5% range. In this regard, gold should not be moving to new highs, but geopolitical tensions and central bank buying seem to be trumping income. Lower interest rates, when they come (don't hold your breath, keep in mind opening paragraphs), will be a positive for gold relative to cash as yields decrease.

Quarterly Review
Q1 2024

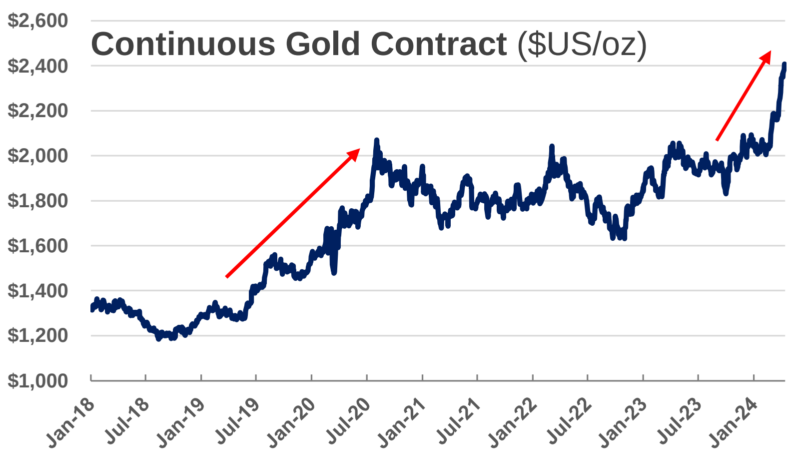

***Figure 5**: Continuous gold contract (Source: FactSet)*

Gold mining companies have yet to see their prices increase in line with the physical metal. It may take a little time before the impact of higher prices is apparent in the miners' earnings, but we are confident that if the gold price can sustain current levels that it is only a matter of time before the equities play catch up.

Tax Time

As we near the tax deadline, we hope that you have received all of your necessary tax documents in an efficient manner. Keep in mind that we have the ability to deliver all tax forms electronically to your online portal (along with monthly statements and quarterly reports). We can also set up your accountant to receive copies of all your tax documents directly. If you have not set up either of these options but would like to do so, please be in touch.

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	Q1	1 Year
Indices		
S&P/TSX	5.77%	10.28%
Dow Jones	5.62%	19.63%
S&P 500	10.16%	27.86%
Nasdaq	9.11%	34.02%
Euro Stoxx	12.43%	17.81%
Japan Nikkei	40.21%	43.96%
India Sensex	1.95%	24.85%
VIX (Volatility)	4.50%	-30.43%
Commodities		
Gold	8.09%	13.23%
Silver	4.91%	3.59%
Copper	3.58%	-2.63%
Oil	16.08%	9.91%
Natural Gas	-40.31%	-26.67%
Currency		
CAD	-2.20%	-0.18%
EUR	-2.26%	-0.46%
JPY	-6.83%	-12.24%
AUD	-4.35%	-2.53%
GBP	-0.84%	2.33%

Values as of March 31st, 2024

Federal budget 2024: Key measures that may have a direct impact on you

Read RBC's report on the proposed federal budget measures, and the effect they may have on Canadians and their families.

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