Wealth Management
Dominion Securities

RBC Dominion Securities Inc.

Thompson Wealth Management

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Happy New Year! I hope you all enjoyed a wonderful Christmas holiday with your friends and family. Our home was quite busy (and noisy) this Christmas. With the addition of our second daughter who is now 4 months old, and along with our two year old daughter, my wife and I literally had our hands full as we visited family and hosted two dinners at our home. However, no complaints from me as it was lots of fun.

By comparison, remembering the frigid weather and correction we had to endure in late 2018, with equity markets hitting bottom on Christmas Eve of all days, Christmas 2018 seemed a bit less fun. Even though relatively sound economic data at that time made us quite confident that it would be a short term event (which proved correct), corrections are never a fun experience. In

pleasant contrast, this Christmas season we saw markets reach new highs, an experience I much prefer.

2019 Markets in Review

To say 2019 was eventful would be an understatement. What stood out for me was the strong rally in equity and fixed income markets immediately following the selloff in late 2018 and the inversion of the yield curve in March of 2019.

We think the following three factors contributed most to the surge in markets in 2019:

1) Fed rate cuts—just enough and at the right time: As recession and trade war risks were rising, the U.S. Federal Reserve delivered three 25 basis point rate cuts providing "insurance" for the economy and in doing so, elongating the longest-ever economic expansion cycle. The Canadian central bank kept rates steady, and now hold the highest rates globally.

2) Prospects for continued economic growth: In an economy that garners about 70% of its activity from household spending, the continued strength of the U.S. consumer was key to the 2019 story. With unemployment at 50-year lows and wages rising nicely, the table is being set once again for higher U.S. consumer spending in 2020. And, with the U.S. remaining the world's largest economy by a good measure, U.S. consumer trends (positive or negative) influence the global economy.

3) Decreasing U.S.-China trade tensions: The constructive signals sent by Washington and Beijing helped boost the market for the last couple months of 2019, and the recent announcement of a "phase one" trade deal has been embraced by markets globally. While

we think much of this positive news is now largely priced into markets, the deal diminishes the risks of any meaningful trade headwinds for 2020.

<u>2020 Investment Outlook – *Constructive yet Vigilant*</u>

As we survey the global economic environment we see higher ground for equities in 2020, with three reasons to bullish:

- ✓ With accommodative monetary conditions remaining the order of the day, the start of the next U.S. recession looks to us to be at least one year or more away.
- ✓ With U.S. unemployment at a 50-year low, the savings rate high and home prices are back to pre-financial crisis levels, the dominant U.S. consumer should be able to sustain spending.
- ✓ The internals of the stock market look good:
    - ➢ Corporate earnings estimates have stabilized at a reasonable level
    - ➢ The breadth readings of the market are healthy—i.e., indexes are moving higher on the back of a majority of stocks advancing, not a select few
    - ➢ Equity valuations are not overstretched in North American markets and they are inexpensive in Japan and Europe.

Nevertheless, there are also reasons to be cautious:

1) The U.S. yield curve inverted in March 2019, historically a reliable indicator of a recession occurring about a year down the road. Usually, an inversion is

caused by short term rates rising above long-term rates and considered an indication of an unhealthy economy. This time the inversion was most likely a result of external factors (negative interest rates overseas caused an influx of foreign dollars into U.S. 10-year treasuries, causing the 10-year rates to dip below short-term rates and thus inverting the yield curve), however it still inverted. The US yield curve has since re-inverted, which is good news but it does not give us the all clear. The yield curve in Canada remains inverted.

(2) Recession probabilities are increasing: if you refer to the recession scorecard, the majority of the indicators remain a healthy green, however, several of these indicators are moving closer to flashing a cautionary yellow from this time a year ago.

(3) Slower growth makes for a more challenging investment environment with bull markets usually peaking before a recession starts—sometimes as much as a year before, so markets could conceivably peak in 2020.

RBC Wealth Management U.S. economic recession scorecard

Indicator	Status		
	Expansion	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)	–	–	✓
Unemployment claims	✓	–	–
Unemployment rate	✓	–	–
Conference Board Leading Economic Index	✓	–	–
ISM New Orders minus Inventories	–	✓	–
Fed funds rate vs. nominal GDP growth	✓	–	–

Source- RBC Wealth Management, Bloomberg, St. Louis Federal Reserve FRED Economic Data

In summary, we believe most developed economies should continue to grow, albeit slowly, through at least 2020 and major central banks have signaled a willingness to safeguard the expansion by easing monetary policy further if necessary. Yes we like the set-up for equities in 2020 and we do not think a US recession is imminent, but there's plenty for investors to think about, and it's prudent to be actively tuned in to the challenges in 2020. All of this leaves us constructive but more vigilant than we have been in the last 10 years.

Final Thought

We recommend putting political angst and biases aside when it comes to investing: The media, both mainstream and alternative varieties on each end of the ideological spectrum, is quite adept at inflating the importance of U.S. presidential elections. While the person occupying the Oval Office certainly can help or hinder the country's economic progress and overall direction, many other factors also determine U.S. asset class returns. Financial market performance has greater linkages to the state of the business cycle, corporate earnings, and monetary policy than it does to actions that emanate from the White House and Capitol Hill. The Fed actually has a bigger influence on recessions and recoveries than the president, in our view. We advise investors not to allow the roar of 2020 election coverage to get in the way of sound portfolio management.

RRSPs & TFSAs & New Year Review

Just a friendly reminder that the deadline for 2019 RRSP contributions is March 1st 2020.

Not unlike previous years, I will be reaching out to the majority of you in Jan and Feb with a phone call to touch base, provide a review of your portfolio and discuss making your TFSA 2020 contributions. Many of you have already provide authorization to complete the TFSA contributions each year; the 2020 contribution limit remains at $6,000.

All the best, Evan.

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