Wealth Management
Dominion Securities

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RBC Dominion Securities Inc.

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Relativity and Investing

"$E=mc^2$"

- Albert Einstein

Leonard Susskind, the noted theoretical physicist, famously quoted that Einstein proved that different observers, in different states of motion, see different realities. The markets are constantly in motion. Whether it is earnings, news, rumors, or just normal daily activity, every stock is reacting both to its own forces and in relation to the overall direction of the market. How any of those data points are perceived by the market is dependent on the intentions of the observer. For example, if I want to buy, I want the stock price lower and if I want to sell, higher. The entire basis of the market is opposing viewpoint, coming to a consensus price in order to trade. Each side of every trade believes they are making a good decision and both can be right. The ultimate goal is to be able to interpret the most important data points and correctly measure how it will affect our portfolio. This month, we'll focus on some of the key market information and try to turn the theoretical into a practical investment roadmap.

Let's start with the broad factors first. On the US political scene, there was definitely movement as the Republicans swept to power, taking the White House, Senate, and the House of Representatives. The stock markets reacted positively to the news, as it is now perceived that there is further potential for tax cuts and additional deregulation. The US bond market saw the same news but reacted in the opposite. Normally, after a 25-basis point interest rate cut by the US Federal Reserve as we saw earlier this month, bond prices rise, and yields fall. However, since the Fed's first rate cut in September, the US 10-year Treasury bond yield has risen by 70 basis points. This is the highest rise in 10-year yields of the last seven interest rate cutting cycles, going back to 1989.

From this reaction, the bond market is telling us a number of things. The direction of the US moves in yields suggest that the market has decided that the Fed won't be cutting interest rates as far or as fast as it had hoped. This view was confirmed by Fed Chairman Powell recently when he said that the Fed is remaining data dependent on further rate cuts. Given the continued strength of the US economy, particularly the low unemployment level, the market is pricing in only one or two more interest rate cuts. This news would previously have put a damper on the stock market, but we have seen no material signs of that yet. There has been much discussion and concern over the Republicans view on tariffs. Tariffs are widely seen as inflationary, which tends to keep interest rates higher. They are often used as a negotiating tactic to achieve other objectives. Our view is that tariffs tend to cause a one-time inflationary hit on imported goods and will not have an ongoing impact other than the base price of those good higher. Given the US dependence on imported goods, this is not good for consumers, particularly lower income households if they are introduced.

Another concern is that the US government will continue to run ever increasing deficits as part of the Republicans "America first" plan. This too can be inflationary, but so far, demand for US government debt remains strong. Adding more stimulus to a US economy that has gross domestic product growing at 2.8% is as unnecessary as that 3rd cup of morning coffee: it seems like a good idea at the time, but it leaves you jittery, which is just how the US bond market seems to be at the moment.

We mentioned GDP growth in the US is at an annual rate of 2.8%, or in dollar terms, $27.36 trillion. This represents 25.95% of the economy of the entire world. From the 2020 Covid low point of $21.3 trillion, US economy has grown by over 28% in the last four years. By comparison., Canadian GDP is at 1% and generates $2.1 trillion, or 2.03% of the global economy. This US growth has been supported by low unemployment and strong consumer confidence. The US confidence survey did reveal one common theme that everyone agreed on which was at the overall level of prices needs to come down. The public is sending a strong message and hopefully this serves to minimize any further additional tariffs. The US economy has continued to grow despite the existing tariffs in place on China, but the Republican honeymoon could end in two years time at the midterm elections if nothing has been done about the general level of prices.

The US economy has continued to grow, and the US dollar has remained strong. With the exchange rate at $1.40, the Canadian dollar is at the lower end of its historic range, but we don't see that changing too much in the near future as US GDP growth continues to outpace Canada and we will likely have to cut interest rates further than the US in order to help lift our economy. On the positive side, the US holdings in our portfolio have all benefitted from the US dollar appreciation. At some point in the future, we do expect the US/Canadian exchange rate to moderate, but we believe the growth of our US stocks will continue to be positive moving forward.

While the market rally in the US is widening out to more companies, the Canadian market focus seems to be narrowing, even as the TSX hits new highs. Financial stocks continue to lead the way, with our portfolio holdings of Royal and National Bank at or near record highs, as both companies continue to benefit from their respective mergers earlier this year. With oil hovering around $70, oil stocks had stalled, but have steadily improved over the last two months as the weather has gotten colder. Since their September lows, both Suncor and Tourmaline have rallied over 10% and both companies continue to deliver significant free cash flow, as well as dividend and share repurchases, all of which will improve their long-term prospects further. Dividend stocks, such as Pembina and Enbridge should also continue to do well in a declining Canadian interest rate market.

We continue to expect the Bank of Canada will have to keep cutting rates ahead of the US, given the relative weakness of our economy. The fixed income market in Canada for both bonds and preferred shares were weaker post the US election but began to rally as US inspired inflation fears have eased. We will be watching both the US Fed and the Bank of Canada this month to see if further cuts are pending and what could be in store for interest rates in the coming year.

November was another strong equity month in a year to remember. It is interesting to note that while Apple did outperform the overall market last month, Nvidia, arguably the market driving stock of 2024, was virtually flat while more economically sensitive names in our portfolio, such as JP Morgan, Unum and Owens Corning were all up over 10% in November alone. While we still believe the US technology story will continue to lead the market in 2025 and beyond, investors have begun to widen their holdings to find better value. At this time, the market believes that the new Republican US government will continue their deficit spending ways, which will further stimulate the US economy. Infrastructure, housing, energy development and providing companies funds to bring jobs back to the US are seen as key priorities.

Our portfolio positioning remains at approximately 60% US and 40% Canadian. US equities remain primarily focussed on diversified growth across multiple sectors. Our Canadian holdings have a combination of defensive growth such as Waste Connections and Dollarama, along with tried and true dividend stocks such as Pembina Pipelines and Enbridge. At this point in the market cycle, stocks are performing well as the US economy continues to defy recession expectations. We will see a correction at some point and adjust the portfolio accordingly as required but the outlook remains positive at this time.

One final bit of good news that fueled a strong November was corporate earnings. For the third-quarter, 75% of S&P 500 companies beat analyst estimates. While the average earnings beat was only 4.3%, which is below long-term averages, analyst for forecasting a 12.2% year over year earnings growth for the fourth quarter. After multiple years of consecutive earnings growth, analyst estimates will likely drift higher, but this remains another indicator to watch.

In 2024, the market's motion has definitely been positive for investors. Consensus is a wonderful thing while working in our favour and we remain vigilant if the markets positive momentum should start to change. Until next month, stay well.

On behalf of the entire Cooper Wealth management team, we wish you and your families all the best for the holiday season and a healthy and happy New Year.

As always, questions, concerns, comments, and feedback are always welcome.

Yours truly,

Trevor, Walter, Charles, and the Cooper Wealth Management team

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