Wealth Management
Dominion Securities

Cooper Wealth Management of
RBC Dominion Securities

Thoughts on the market

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RBC Dominion Securities Inc.

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Facts vs. Predictions

“There is no substitute for facts.”

- *Harry S. Truman*

After a strong year in 2024, our thoughts now turn to the year ahead. The number one fact that very few predicted would actually come to pass was the US placing a 25% tariff on Canadian goods and 10% on oil and gas. The threat of tariffs had been widely seen as a negotiating tactic as the potential damage to both countries could be massive and is in violation of established trade agreements. With some last-minute negotiations, the tariffs have been avoided and Canada will be bolstering its border security and drug enforcement. We expect the next deadline will either involve full funding of our NATO commitments and/or an early renegotiation of the USMCA free trade agreement (formerly NAFTA). Once again, we don’t see tariffs as a viable option for America as it will increase prices on many basic commodities such as oil, gas, aluminum, and electricity and raise their inflation rate. They can buy these commodities elsewhere but not at the favourable price they receive from us. We see the President using tariffs to bully the rest of the world to better trade terms and concessions. By tackling his closest allies first, as he did in his first term, he is setting the tone for the balance of his presidency. It is interesting to note he has done all this via executive order, rather than going through the House and Senate. It is doubtful he would receive enough support if this issue was put to a broader vote.

The facts against tariffs stack up pretty quickly. US inflation would likely rise by approximately 0.5% due to increased costs, cross border opportunities would be lost to US businesses, and they would ultimately collect only a few billion dollars more than they already collect from us in excise taxes. If the average American has to pay $3,000 more for a new car because of tariffs, that translates into zero votes for the Republicans at the midterm elections.

Predictions are based on best guesses but often, too much emphasis is placed on them, and investment decisions are avoided or delayed based on the hope the prediction will be achieved. Rather than guessing at the future, we prefer to use a facts-based approach to analyze the current market conditions, so we can best react to changes that need to be made. A great example of predictions versus facts was then Senator Harry S. Truman predicting in 1943 that he could save $100 million for the US war effort by reducing government over spending. Many ridiculed this as a waste of time for too little money and if Truman had simply relied on his prediction, he might've been talked out of moving forward. Truman pressed on, and by the time his committee was finished, the actual savings were estimated to be between $100-150 billion or approximately $2 trillion in today's dollars. It will be interesting to see if Elon Musk and the new Department of Government Efficiency can match that feat.

The greatest set of facts we get every quarter is US corporate earnings. The fourth-quarter reporting began last week with Wells Fargo and JP Morgan, both beating their estimated earnings but also increasing their guidance for the year. This is an excellent indicator of the strength of the US economy. Strong bank earnings early in the year have historically led to strong market performance. These reports helped finally snap the US market weakness of the recent weeks, but the big test will be the earnings performance of the technology sector. Expectations are running high, and analyst and investors alike will be sifting through every report seeking clues as to who might be winning the race for supremacy in artificial intelligence. The recent arrival of DeepSeek on the AI scene has put somewhat of a damper on technology but in the end, we believe that the depth of expertise, funding and experience of the major US players will ultimately win the day. However, we believe the best information on the US economy comes from housing, consumer, discretionary, and infrastructure companies. As long as the numbers for these companies remain strong, so will the US economy and the stock market.

By all measures, the US economy remains strong. Unemployment has fallen to 4.1%, which is basically full employment. Up until the middle of this year, an average of 12,000 people per day will turn 65 and with the new Administration's proposed tough stance on immigration, we see the unemployment rate staying low for the foreseeable future. As we have said before, it is near impossible to have a recession if everyone who wants to work has a job. The US Gross Domestic Product (GDP) came in at $28.176 trillion, up from $27.356 trillion in 2023 for an increase of $820 billion or approximately 3%. To put this in a global perspective, Canada's GDP came in at $2.51 trillion and it would take the combined GDP of the next three largest economies, China, Germany, and Japan, to roughly match the US economy's growth. The US has far outpaced the rest of the world with technology and productivity and this gap seems poised to widen in the coming years.

Another important market fact to be aware of is corporate buybacks. The most recent data to the end of September 2024 show US corporate stock purchases at $918.4 billion, up from $787.3 billion over the previous year. The top 20 S&P 500 companies accounted for 53.2% of these buybacks and 13.7% of companies reduced their share count by at least 4% with Apple, Nvidia and JP Morgan leading away. This high level of buybacks will help to support the overall market averages.

Turning to Canada, our GDP growth rate to the third quarter of 2024 was 2.3% but showing some signs of slowing. However, some recent market data points to the economy improving. Demand for oil and gas has been strong as North America has experienced a recent cold snap. Given the demand for power supply from the artificial intelligence data centres that are being built, we expect the demand for Hydro electricity, natural gas, and uranium to remain high. Also, any further decrease in interest rates would be a positive for both the interest rate sensitive TSX, but also the housing market, which is one of the largest contributors to our GDP. Lower interest rates will also be a net positive for our principal bank holdings Royal and National while Sun Life will continue to benefit from positive markets. On the fixed income front, we expect price appreciation for our preferred shareholdings as interest rates fall in Canada. The US market will be more difficult to navigate as last year's interest rate cuts led to increased yields as the market was afraid of continued deficit spending and fewer US Federal rate cuts. Overall, we expect US interest rates to remain largely unchanged, barring pressure from the new administration. The fear of US based tariffs is naturally a concern, but we still see this is more of a negotiating stance by the US.

Inflation, the hot topic of 2024, has noticeably cooled. Headline inflation in Canada is currently 1.8% and 2.9% in the US. This divergence between the two poses challenges for both the Bank of Canada and the US Federal Reserve. The Bank of Canada clearly has to cut interest rates based on inflation alone, but if the gap between the US and Canadian interest rates continues to widen, the Canadian dollar could weaken even further that what it is today. On the other hand, the US economy is performing just fine where interest rates are currently and while the Fed has stated that further cuts would be dependent on economic data, the market is predicting no more than two rate cuts for 2025. With a gap between the US and Canadian 10-year bond rates currently at 1.33%, (US at 4.62% and Canada at 3.29%), the fact is it will be difficult for the Bank of Canada to make its projected five interest rate cuts without negatively impacting the Canadian dollar, all else being equal. However, the Bank of Canada's hand might be forced to move lower faster if any form of US tariff is actually enforced.

A key area where we see growth for the coming year is US infrastructure spending. The US electrical utilities will have to build significantly more capacity to accommodate the build out of AI data centres across America. The California wildfires have destroyed over 12,000 homes and businesses and these will be rebuilt over the next few years. Hurricanes in Florida also caused significant damage. These initiatives will be on top of the government's projected spending, which will provide solid support to the economy and benefit our portfolio holdings in Home Depot and Owens Corning.

In our portfolio, we are focused on companies with predictable earnings and have competitive advantages over their peers. Our principal growth focus remains on US technology with core holdings in industry leaders, Apple, Microsoft, and Palo Alto. For further growth diversification, we have positions in Waste Connections, Dollarama, Walmart, and Amazon. Finally for dividend income, Enbridge, Pembina Pipelines and our Canadian and US financial services holdings.

On an administrative note, we will be sending out the 2024 income tax packages shortly. If you would like us to send these directly to your accountant and we are not already doing so, please contact our office and we will arrange to have the information sent directly.

In closing, the facts available to us on both the economy and corporately are pointing towards another positive year for the stock market. Tariffs and other challenges will undoubtedly be coming along the way in both Canada and the US, but as long as earnings and the economy continue along their current path, we anticipate a positive outcome. Until next month, stay well.

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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