Wealth Management
Dominion Securities

Cooper Wealth Management of
RBC Dominion Securities

Thoughts on the market

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RBC Dominion Securities Inc.

The Alignment of the Stars

“Second star on the right and straight on till morning”

- *J.M., Barrie*
  Peter Pan

In the children’s fantasy novel, Peter Pan, these are the directions to Neverland, home of Peter Pan and the Lost Boys. With investing, it is often difficult to know which star to follow as the investment horizon is ever changing, and never totally clear. In recent months, market focus has shifted among inflation, interest rates, corporate earnings, and even politics. All these items can have a profound effect on markets that must be carefully navigated. This month, we will review these points to determine the best investment path forward.

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The biggest short-term distraction on the immediate horizon is the upcoming US presidential election. As we approach November, we expect the political rhetoric and media attention to ramp up to fever pitch. The result either way really will not affect the market but a split between the House of Representatives and the Senate between both parties would be the best outcome for global markets. Should the Republican presidential candidate win, there is some concern about a possible replay of past election events similar to 2020 but given that they do not control the White House, it is a smaller risk.

There are two key issues that have risen in recent days that bear watching. The first is the US East Coast dockworker strike, now postponed to January. Approximately 50% of all containers that arrive in the US each day are handled at these ports and if the strike is prolonged, it will have a negative impact on US Gross Domestic Product and contemporarily spike inflation upward. The two issues at stake are firstly wages, which was settled quickly as US dock workers are among the highest paid blue-collar employees in the US. The real issue the union is fighting is automation. They want a complete ban on adding any further automation at the shipyards. A total ban on further automation is literally impossible as worker safety could eventually be compromised, but hopefully they negotiate a quick settlement like their union brothers on the West Coast.

The next item of global importance is the flooding of the town of Spruce Pine, North Carolina, population 2200. Hurricane Helene left 2 feet of flood water over the entire town. Normally, this would never make the news, but this small town is the world's main source of high purity quartz needed to make the silicon wafers that are the basis for semiconductors and solar panels. Any major delay in reopening the mine could actually disrupt global computer chip production. There are no reports yet on any damage to the mine, but we will keep our eyes open for developments.

Our first navigation point is market sentiment, both present and for the future. While September has historically been a weaker month for equities, this month prove to be positive as all the major US and Canadian indexes moved to new records. While some market participants are concerned that some valuations may be climbing too high too fast, particularly among the US technology names, the broadening of the market advance to more equities is definitely a positive sign and investor sentiment remains solid.

Next, we come to corporate earnings in the US that are set to be announced shortly. Another strong quarter of earnings growth will lead equities higher, but a poor showing could cause a market correction. In the midst of the strong year we are having, a temporary downturn would likely present a further buying opportunity, but we will gauge the numbers and make our decisions accordingly. We're off to a great start with both JP Morgan, and Wells Fargo coming in with earnings above expectations, which also triggered a rally in Canadian baking shares. Lower than expected write offs also helped to strengthen the markets, increasing the optimistic view of the US economy.

On the inflation front, the US Consumer Price Index came in slightly better than expected at 2.4%, but it's still trending towards the Fed's 2% target. While the inflation number was higher, we also saw an increase in the US unemployment rate, which was not high enough to raise recession concerns but did dampen some market enthusiasm. We expect the US Fed to continue to lower interest rates, but likely at a slower pace than the last 50 basis point cut. In Canada, we expect to see interest rates dropped down to around 2.75% over the coming year. This will definitely begin to deliver some relief to borrowers and is the Bank of Canada's neutral rate, the rate which the economy is neither positively nor negatively affected by interest rates. The 10-year bond was recently yielding 3.21% and had briefly slipped below 3%, while in the US the rate is 4.07%. We expect this gap to narrow over the coming year as yields move lower in both countries. For bond investors, we feel that most of the price appreciation has already occurred, but we believe the preferred share market continues to offer good value with many investment grade issues offering over 6% yields and room for further appreciation.

Declining interest rates should be very positive for the Canadian equity market given its large weighting in interest sensitive stocks. Our favourite banks remain Royal and National, as they continue to integrate their new acquisitions and reduce costs. One area of concern centers on TD Bank. They were recently hit with a $3 billion fine from US regulators for their poor anti-money laundering policies. While the fine is bad enough, they were also hit with the limit on any growth in the US banking segment, as well as being subject to much higher regulatory requirements, which will add to costs. For longtime TD shareholders, there's no need to immediately sell here, but we will not add new money to this holding until a clear path forward reveals itself and we see how the new CEO fares in these challenging circumstances beginning in January.

As the conflict in Israel rages on, oil prices have firmed up and oil companies are still generating large cash flow, and using the funds for dividends and share purchases, both of which will be beneficial in the long term. Among our holdings in the sector are Canadian Natural Resources, Tourmaline, and Suncor.

So far, most key indicators for continued market strength are in place: the US economy, falling interest rates and inflation, slightly rising, but still low unemployment, good level of consumer spending and overall positive market sentiment. However, we have now had two solid market years and at some point, increased expectations will get ahead of actual results, and we will have a market sell off. Corrections are necessary and ultimately healthy for markets. For now, the stars are aligned for a further market advance, and we remain vigilant for any changes. As the year end approaches, we will be looking for opportunities to realize any capital losses to offset capital gains in our taxable accounts as well.

Our four key themes remain in place: the growth of US technology, interest sensitive stocks, such as banks and pipelines to take advantage of falling rates, energy stocks for their significant cash flows, and strong consumer driven stocks such as Dollarama and Amazon for participation in our economy. As US corporate earning season rolls on, we will continue to monitor these items and ensure the overall portfolio continues on the right path. 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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