Wealth Management
Dominion Securities

Adding Value

A newsletter produced for our clients and friends

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More zigs and zags for 2024?

By Steven Mayo

Through 2023, the North American stock markets were able to absorb many body blows, such as rising interest rates, the U.S. regional banking crisis, the U.S. debt ceiling crisis (which could happen again in early 2024), and the Israel-Hamas war, to name a few. Also, the often-predicted recession once again did not occur. All these negatives were at maximum extremes in October, and it was reflected in the markets at that time.

Then the tune changed.

By December, the Canadian and U.S. central banks indicated rates were not going higher, inflation was coming down, and that interest rate cuts may begin this March. The market psychology changed from "fear" to "fear of missing out." Money poured into the beaten-up bond and equity markets resulting in one of the strongest year-end rallies ever.

As we enter 2024, most market analysts are now positive on the U.S. economy (slow down but no recession), with the direction of interest rates likely to be lower, and earnings to remain quite good. This is where it gets tricky.

Many stocks in December had big 10% to 15% jumps already anticipating an improved 2024. However, I wonder if too much buying already occurred in certain sectors and stocks.

Market consensus is so positive that my level of caution is beginning to rise. Risks seem low now, which is why we must be careful entering 2024. For example, geopolitical risks remain my number one concern.

The market swings are normal: too much love, followed by too much hate. Of course, each client's portfolio has specific goals and tolerances. We always keep this in mind. Our benchmark is not an "index" but helping clients meet or beat their goals.

For example, many clients need or like to see dividend and interest income, require liquidity for withdrawals from Retirement Savings Plans (RSPs)/Retirement Income Funds (RIFs), or for other needs (homes/cars/weddings etc.), or they prefer investing with the objective of capital preservation, minimizing volatility, using Guaranteed Investment Certificates (GICs). In addition to these considerations, we look to add high quality stocks at attractive prices when opportunities come along, if suitable for the portfolio. In 2023, we had three such market opportunities, and I expect the same for 2024, as it is a U.S. presidential election year. I'm sure there will be some fireworks.

We will continue to navigate 2024 in a prudent and opportunistic manner. As Warren Buffet wisely said: "When investing, pessimism is your friend, euphoria the enemy."

Happy New Year!

2024 TFSA contribution limit: $7,000

The annual Tax Free Savings Account (TFSA) contribution limit is now $7,000. If you have not started a TFSA, and you were 18 years of age or older in 2009, you have accumulated $95,000 of contribution room as of 2024. The RBC Dominion Securities TFSA has a 1% annual fee and allows for 16 trades per year at no commission. This account is suitable for those investors who are comfortable with buying stocks or equity mutual funds. Please call us to open your TFSA, or to discuss maximizing the contributions within your existing TFSA.

It's RSP time again!

The deadline to contribute to your Retirement Savings Plan (RSP) for the 2023 tax year is February 29, 2024, by 3:00 p.m.

If you have already made your RSP contribution for the 2023 tax year, thank you!

The maximum contribution for 2023 is $30,780 (or 18% of your 2022 earned income, whichever is less). Please refer to your Canada Revenue Agency Notice of Assessment received in May 2023 to verify your allowable/unused RSP contribution room for 2023.

RSP contributions can be made in any of the following ways:*

1. **Via cheque:** Payable to RBC Dominion Securities, and mailed to our branch in Windsor.
2. **By phone:** Call us to authorize a transfer/contribution from your investment account(s) to your RSP(s).
3. **Online:** If you are an RBC Royal Bank client, and view your RBC Dominion Securities accounts online, you can contribute via RBC Online Banking using the "transfer funds" tab. Please let us know if you do this so we can watch for it.
4. **Via transfer:** If you deal with another bank, you can transfer funds by setting up RBC Dominion Securities as a payee and entering your full 10 digit RSP account number, with no dashes. Please let us know if you do this so we can watch for it.

*Must be done three business days prior to deadline to ensure receipt.

2023 Tax Package mailing dates

Registered Accounts

• Contribution Receipts:	
• April 1/2023-Dec 31/2023	January 10, 2024
• First 60 days 2024	January 10, 2024, and every three to five business days thereafter
• T4s for RSP/RIF/RESP:	February 15, 2024

Non-Registered Accounts

• T5 Packages:	February 17-24, 2024
• T3s for Income Trusts:	March 10-31, 2024
• T3s for Mutual Funds:	March 2024, mailed directly by Mutual Fund company

Thinking hard about a soft landing

Recession or soft landing? That's the big question. Proponents of both have evidence they think they can hang their hat on, but the debate won't be settled for months. Amid the uncertainty framing the investment picture, we explore how to position portfolios and what types of stocks investors should be on the lookout for.

The debate rages on

The question on everyone's mind is whether the U.S. economy will enjoy a soft landing in 2024 or succumb to a recession — with each piece of data dissected and interpreted according to market participants' biases. Such scrutiny stems from the U.S. Federal Reserve's reliance on "data dependency," which leaves markets at the mercy of each data release.

Take the recent data, for example. After U.S. nonfarm payrolls rose by 199,000 in November (consensus expectation: 185,000), most on the Street agreed that it suggests a very healthy labour market, and hence a strong economy with a soft landing in sight. Those concerned an economic contraction may be in the offing focused instead on average hourly earnings rising at an annual rate of four percent, a level inconsistent with the Fed's two percent inflation target. In this line of thinking, such high wage growth indicates interest rates will have to be maintained at current levels for longer, which may eventually propel the economy into recession.

In the feature article from our Global Insight 2024 Outlook, RBC Dominion Securities Inc. Investment Strategist Jim Allworth points out the debate will not be settled definitively for a while. In fact, it is the Business Cycle Dating Committee at the National Bureau of Economic Research which determines the official start date of any recession that arrives. And that announcement usually comes about a year after a recession has begun.

A useful framework

With economic data volatile—offering contradicting clues at best or being of poor quality at worst—using a framework to assess the macroeconomic backdrop can be a useful tool.

We are in the camp of those expecting a mild recession in the U.S. next year. The combination of high interest rates and restrictive bank lending standards that is in place today has historically resulted in recessions. Soft landings, on the other hand, have featured rising interest rates but no overt tightening of lending standards.

RBC Global Asset Management Inc. Chief Economist Eric Lascelles concurs, estimating the probability of a recession at 70 percent over the next 12 months.

Still, that leaves the probability of a soft landing at 30 percent, not an insignificant level. For our part, we acknowledge that shifts in monetary and fiscal policy over recent years could mean merely lower growth, as opposed to a recession.

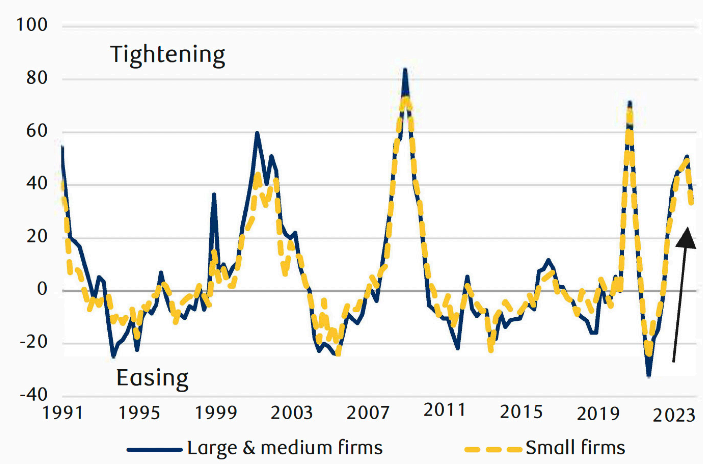
So, it's worth looking at episodes of soft landings and observe how the S&P 500 reacted.

Soft influence

Since the mid-1950s, there have only been three soft landings, admittedly a small sample: in the 1960s, mid-1980s, and mid-1990s. In each of these episodes the S&P 500 performed very well, gaining on average more than 30 percent.

U.S. business lending standards have tightened

Net percent of banks tightening credit standards for commercial & industrial loans



Note: October 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices

Source - Federal Reserve Board, Macrobond, RBC Global Asset Management, RBC Wealth Management

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Paul Danis, head of asset allocation at RBC Brewin Dolphin, points out that specific or idiosyncratic circumstances contributed to each of these rallies. In the 1966 soft landing, the Fed loosened monetary policy very quickly, fuelling the rally. That resurgence proved short-lived, however, because the Fed was forced to resume its monetary policy tightening to rein in inflation which had flared up again, and the stock market duly corrected.

Heading into the 1984 episode, the real fed funds rate was over six percent. The steep decline, to one percent, was instrumental in driving robust equity returns.

The third soft landing occurred in the mid-1990s, a time of rapid globalization that both contained inflation and boosted profit margins. These factors fuelled the longest and strongest rally of all three.

Continuing to be constructive

To our mind, the recent rise in nonfarm payrolls suggests a lower chance of an imminent recession. This opens the road to new highs in equity markets, in our opinion. The S&P 500 has rallied 14 percent since the end of October as the Fed paused its rate hikes and the soft landing narrative gained traction. The rally suggests to us some discounting of the soft landing scenario, but we think stock markets may have more room to run.

It seems to us the U.S. economy is poised to start the new year on a strong enough footing to keep S&P 500 earnings growing, although probably not by as much as the current consensus estimate for 2024 ($245 per share, up 11.4 percent from 2023's expected $220) would suggest. In our opinion, any growth in earnings would leave room for share prices to advance between now and the end of 2024, even if the path for getting there remains in debate.

We continue to recommend a Market Weight position in global equities as well as U.S. equities. Our stance takes into account the wide range of possible outcomes for the U.S. economy: soft landing, average growth, mild recession, or otherwise.

We believe, however, that investors should consider limiting individual stock selections to high-quality businesses, or those they would be content holding through the economic cycle. This means companies with solid business models, quality management teams, robust cash flow generation, and strong balance sheets.

In our view, portfolios that have held their value to a better-than-average degree will be best-equipped to take advantage of the opportunities that are bound to present themselves when a stronger pace of economic growth reasserts itself.

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Thank you for taking the time to read our newsletter. If you have any questions, please feel free to contact us.