GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

MARCH 2024

UPCOMING 2024 BNN SHOWS

Alexander: May 8 @ 12 pm

Christine: June 13 @ 12 pm

Optimism in equity markets continued into the first quarter of the year, largely driven by the same factors in the prior quarter. Exuberance about the business opportunity in artificial intelligence technology, a resilient economy, and expectations for eventual interest rate cuts propelled the North American equity indices to new closing highs. Meanwhile, bonds lagged with the Bond Universe Index down 1.2% in the quarter, as investors reined in their expectations for the number of rate cuts this year.

Auspiciously, inflation continued to move lower, but at a slower pace than many expected at the start of the year. Investors have shrugged this off, though, as the promise of a soft landing has superseded a higher for longer rate scenario.

The Return of the Fed (Powell) Put

Federal Reserve Chairman Jay Powell's press conference on March 20th exuded a dovish tone. He reaffirmed the central bank's projected three rate cuts for this year, lifted inflation and growth expectations, and brushed aside February's hotter-than-expected inflation reading as a fluke. Powell's prepared remarks mentioned that an unexpected weakening in the labour market could also warrant a policy response, then repeated that phrase three more times during the question & answer session.

With inflation having receded but the unemployment rate creeping higher (albeit still sub-4%), Powell has conveyed that Fed policy has begun to tilt from being focused squarely on fighting inflation to a more balanced approach that stresses both price stability and maximum employment.

The key takeaway from the Fed's views from the last meeting was its increase of both inflation and GDP projections for 2024, while still maintaining its planned rate cuts, thereby lowering the bar for its planned policy easing.

The Economy

The U.S. economy entered 2024 on solid footing with recession risks abating. Q4/23 GDP was recently revised up to a 3.4% annualized rate, driven by strong consumer outlays in services. The consumer is the U.S. economy's 800-pound gorilla, accounting for 68% of nominal GDP.

Consensus forecasts Q1/24 GDP growth to be 2.8%, then slowing as the year unfolds due to weakening consumer spending. Real disposal personal income growth is softening, pandemic savings are dwindling, and household debt is increasing. For example, the personal savings rate declined to 3.6% in February from 4.1% in January; a year ago the rate was 4.7%, and it was 7.7% before the pandemic (Chart 1). Household debt levels are rising (Chart 2) and except for student loans, delinquencies are trending upwards (Chart 3). Waning income growth and higher debt servicing costs are weighing on consumer confidence and should translate to a slower pace of spending as households become increasingly dependent on income to feed their spending habits.

Fortunately, the U.S. job market is strong, as the unemployment rate remains below 4.0%. Going forward, the health of the U.S. job market will be crucial to keep the American economy on solid footing.

The Canadian economy managed to eke out a 1% annualized GDP gain in Q4/23, after contracting in the prior quarter. The outlook is not encouraging. According to Statistics Canada, the number of business closures rose to a multi-year high in December 2023, while new business openings fell to a five-month low. As a result, the number of active businesses declined 0.2% from a year earlier (Chart 4). Outside of the pandemic recession, this is the first annual decline in the number of active businesses since 2017. Back then, the bulk of the weakness was concentrated in energy-producing provinces.

This was not the case in December; eight of ten provinces reported an annual decline (Chart 5). Job growth will be hard pressed to keep up with surging growth in labour supply driven by rising immigration, with most economists forecasting the unemployment rate to keep ticking up from February's 5.8% level.

The fortunes of the two North American economies continue to diverge and increases the likelihood the Bank of Canada eases interest rates ahead of the Federal Reserve.

Lagging Canadian Productivity

Carolyn Rogers, senior deputy governor with the Bank of Canada, gave a speech in Halifax at the end of March where Canada's productivity problems was discussed. As she pointed out:

Back in 1984, the Canadian economy was producing 88% of the value generated by the US economy per hour. That's not great. But by 2022, Canadian productivity had fallen to just 71% of that of the United States. Over this same period of time, Canada also fell behind our G7 peers, with only Italy seeing a larger decline in productivity relative to the United States.

There is currently no consensus agreement about why Canada's productivity has lagged. Unfortunately, that means there aren't any easy answers for how to improve it. On a recent BNN Bloomberg appearance we were asked about one factor that drives productivity, capital investment, and how Canada has fallen behind the U.S. on that front. The issue we highlighted was our country's disproportionate emphasis on investing in residential real estate versus other, more productive areas of the economy. As shown in Chart 6, Canada is an outlier in the G7 when it comes to residential investment's share of investment in all assets that are intended for use in the production of goods and services. Put plainly, every dollar Canadians are investing in residential real estate is a dollar they aren't investing to support other, more productive areas, like R&D, machinery, and infrastructure.

There is strong evidence that a country's obsession with residential investments – bigger, nicer detached homes with smaller families living in them – explains at least part of its decreasing productivity since the late 1990s. As Scotiabank Economics has pointed out, "The core issue is this: are many folks across modern societies making themselves house-richer in the shorter-run, but poorer in the longer run if it comes at the expense of productivity growth as the single biggest determinant of rising living standards over time?"

Unfortunately, the problem does not seem to be going away anytime soon. Nine of this country's ten provincial budgets have been unveiled so far this year, with most of them introducing measures that continue to stimulate housing demand, all while the country's productivity continues to wane. While there is no doubt that a strong housing sector is a key part of a thriving economy, Canada is now demonstrating that it can go too far when this spending comes at the expense of supporting other long-term economic investments.

Leading Economic Indicators

Two stalwart leading indicators that had been signaling a potential recession in the U.S. recently turned positive. Market strategist, Ed Yardeni, has characterized this development as the rolling recession in manufacturing turning into a rolling recovery.

The February Conference Board Leading Economic Index (LEI) notched its first positive monthly gain in 23 months (Chart 7). Digging into the report's components, an improving labour market in the manufacturing sector and favourable financial conditions in both the equity and credit markets were behind the upturn. Similarly, the ISM manufacturing index surprised to the upside in March and rose by the most in three years to an expansionary reading of 50.3 (Chart 8). The new orders and production components were especially strong, signaling a potential trough in inventory levels.

The U.S. Treasury yield curve remains the holdout and has been inverted since July 2022, with the spread between the 10-year and 2-year treasury bonds at negative 33 basis points. Notably, the spread has narrowed from a year ago when the spread was negative 58 basis points.

Outlook

The strength in equity markets since last November appears to reflect investors' belief that the U.S. is on the path to a soft landing that will lead to a meaningful decline in interest rates. The first rate cut, however, keeps getting pushed out due to data points supporting a rolling recovery and along with that, an uneven path for inflation to recede towards 2%. The bond market is starting to take note, with the bond yields across the U.S. Treasury yield curve moving up over the quarter. In addition, the interest-sensitive sectors continue to underperform, another sign interest rate cuts may not be on the horizon. Barring a serious recession or unforeseen crisis, interest rates may not decline as rapidly or as substantially as many investors anticipate. Ironically, the resilience and potential reacceleration of the U.S. economy is the biggest risk to a benign inflation forecast.

Surprises, both downside and upside, are just that – no one sees it coming! Markets have priced in optimistic expectations and require an upside surprise to corporate profit growth to justify present price levels. There is a level of complacency in financial markets since central banks around the world stand ready to pivot from a restrictive to an accommodative monetary policy and provide policy support should a downside surprise materialize.

Our philosophy of staying invested in a diversified portfolio consisting of financially sound companies is the optimal path to building wealth over the long term.

Christine Poole, MBA, CFA
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CHART 1: Personal Saving Rate (percent, sa)
- *LSEG Datastream and © Yardeni Research.*

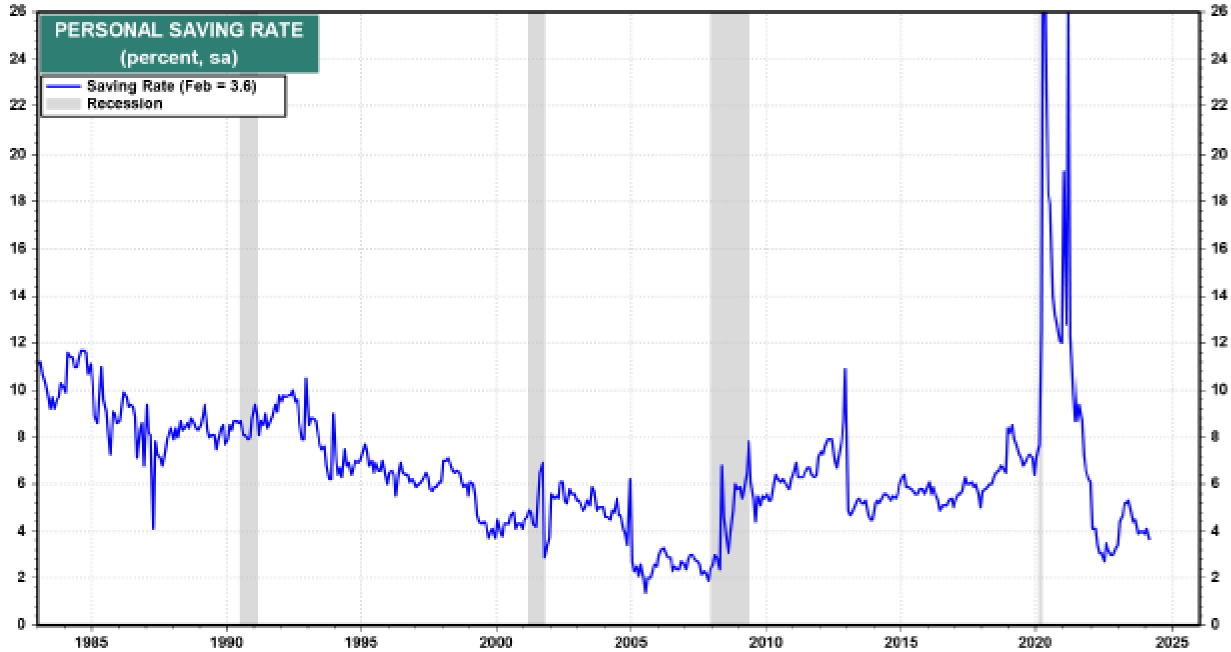

CHART 2: Total Debt Balance and its Composition
- *New York Fed Consumer Credit Panel/Equifax*

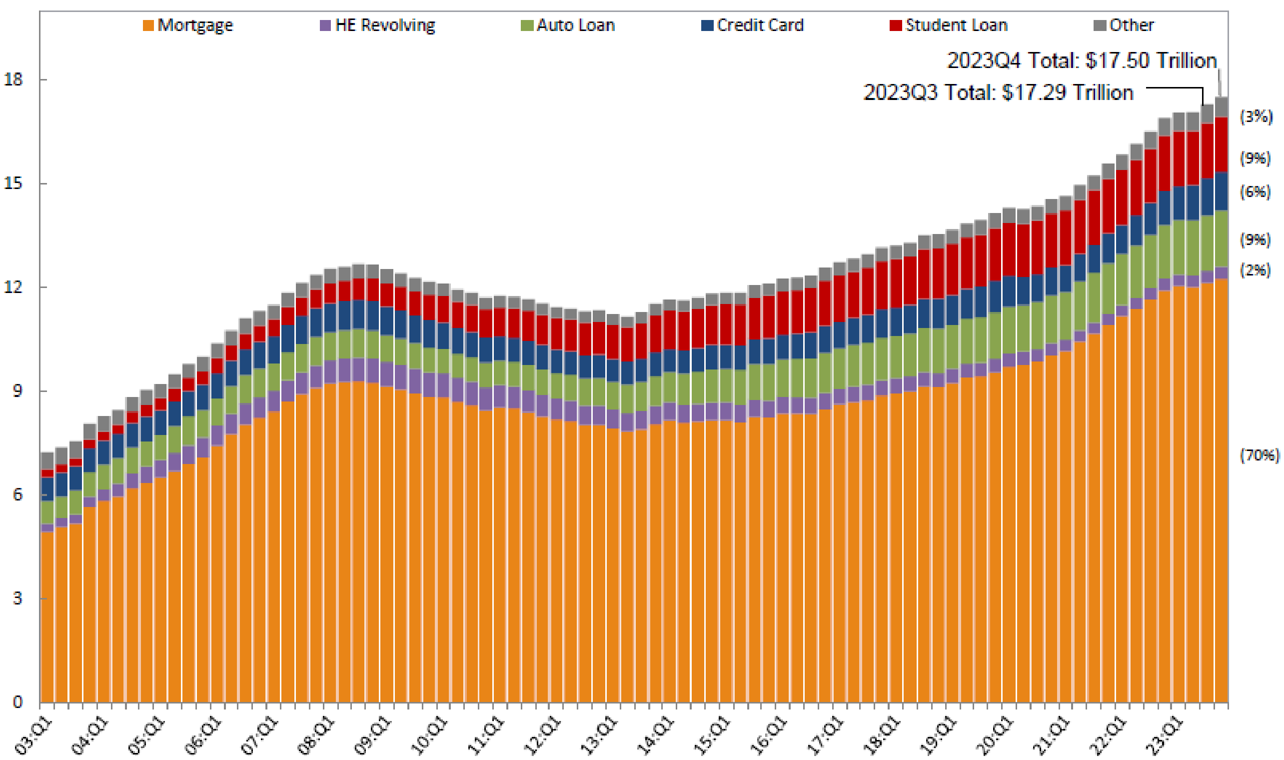

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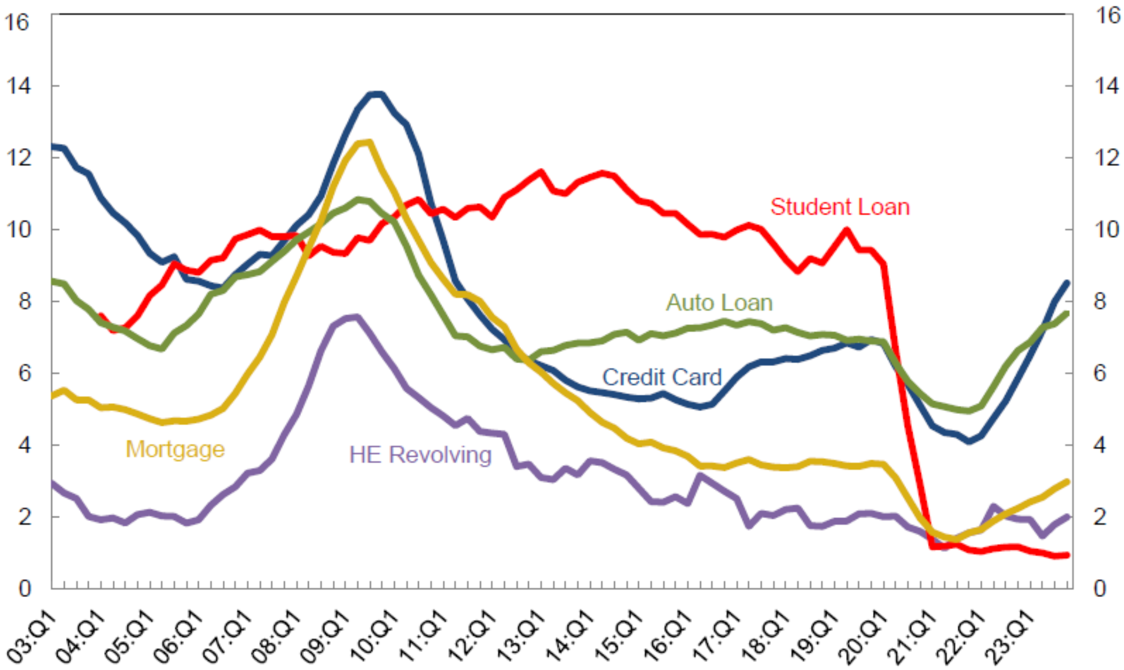
CHART 3: Transition into Delinquency (30+) by Loan Type
- New York Fed Consumer Credit Panel/ Equifax



Note: 4 Quarter Moving Sum. Student loan data are not reported prior to 2004 due to uneven reporting.

CHART 4: Change in the number of active businesses in Canada
- NBF Economics and Strategy (data vis Statistics Canada)

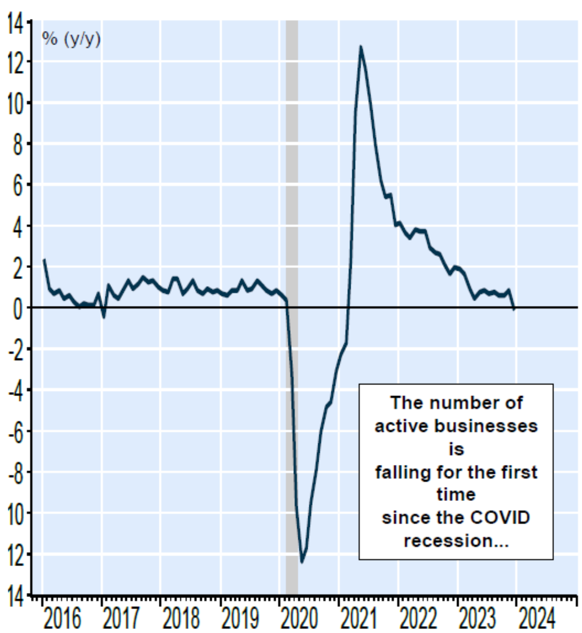


CHART 5: Change in the number of active businesses by province
- NBF Economics and Strategy (data vis Statistics Canada)

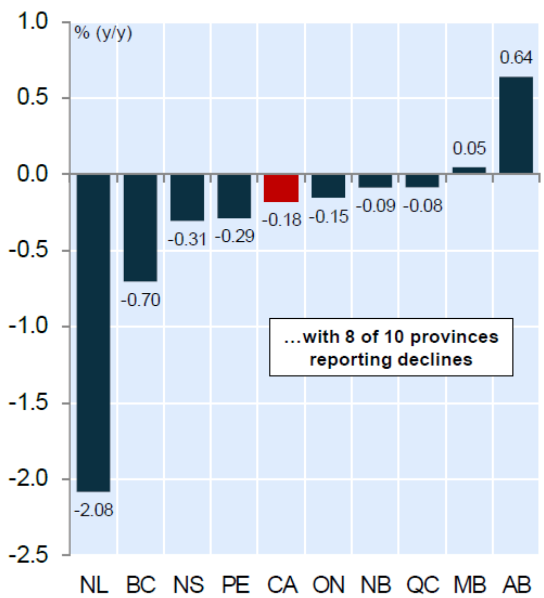


CHART 6: Residential Investment as a share of total Grossed Fixed Capital Formation
- OECD

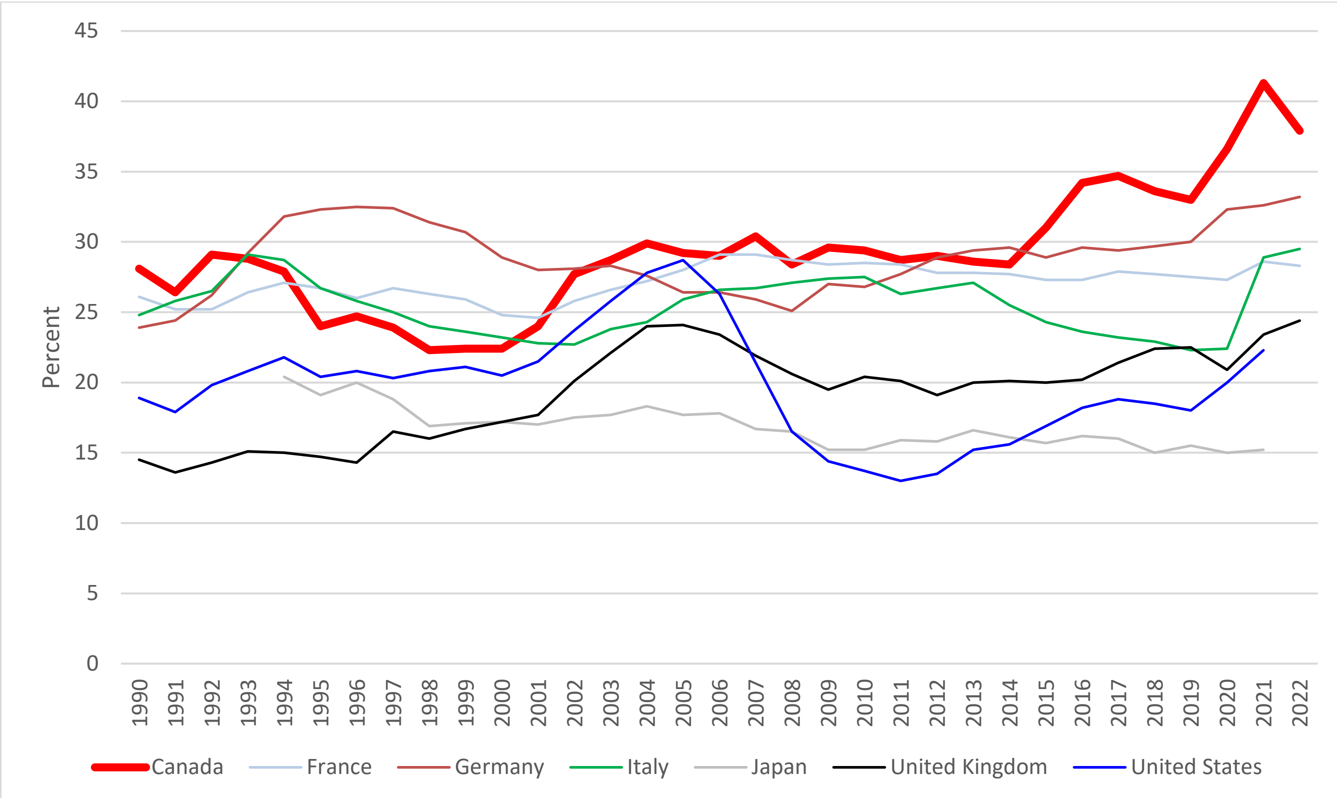


CHART 7: Leading Economic Index (Month-over-Month, Percent Change)
- The Conference Board and Wells Fargo Economics

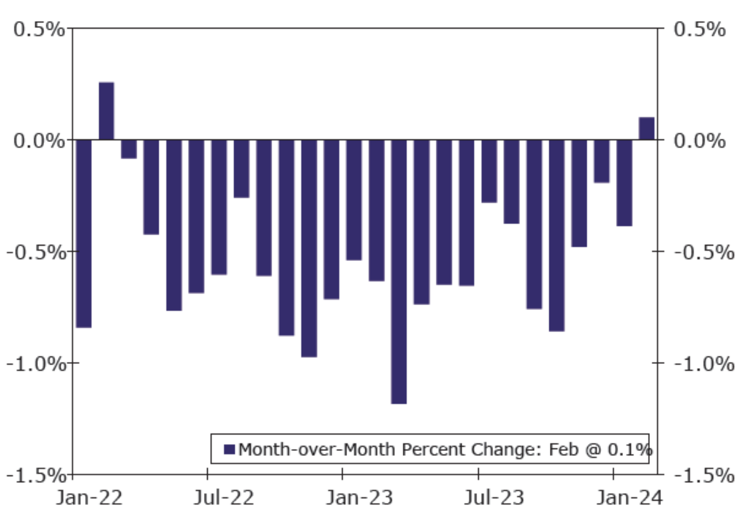
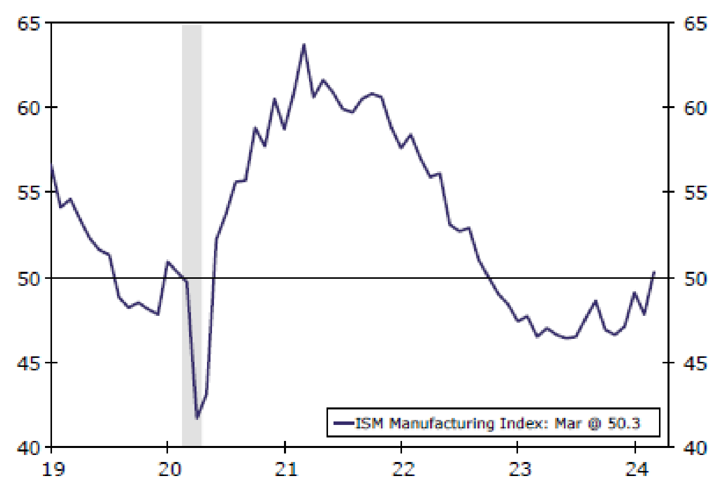


CHART 8: ISM Manufacturing Composite Index
- Institute for Supply Management and Wells Fargo Economics



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RECENT BNN SHOWS

Christine: March 21, 2024

Christine: January 22, 2024

Christine: December 21, 2023

Christine: November 23, 2023

Alexander: October 30, 2023

Christine: October 23, 2023

Christine: September 21, 2023

Christine: August 25, 2023

Alexander: August 14, 2023

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MARCH 28, 2024 STATISTICAL SUMMARY

STOCK MARKETS	QTD	1 YEAR
S&P TSX COMPOSITE TOTAL RETURN (CAD)	6.6 %	14.0 %
S&P 500 TOTAL RETURN (CAD)	13.0 %	30.1 %
S&P 500 TOTAL RETURN (USD)	10.6 %	29.9 %
DJIA TOTAL RETURN (USD)	6.1 %	22.2 %
NASDAQ COMPOSITE PRICE RETURN (USD)	9.1 %	34.0 %
MSCI WORLD INDEX PRICE RETURN (CAD)	10.8 %	23.3 %
MSCI WORLD INDEX PRICE RETURN (USD)	8.4 %	23.1 %
CANADIAN UNIVERSE BOND INDEX	-1.2 %	2.1 %

COMMODITIES	QTD	1 YEAR
GOLD	7.0 %	12.3 %
SILVER	2.3 %	6.5 %
COPPER	3.6 %	-2.7 %
NATURAL GAS (NYMEX)	-29.9 %	-13.2 %
WTI	16.1 %	13.6 %
BRENT	13.4 %	13.7 %

TREASURY BONDS	03/28/24	12/29/23	03/31/23
2 YEAR (CAD)	4.17 %	3.88 %	3.74 %
2 YEAR (US)	4.59 %	4.23 %	4.06 %
5 YEAR (CAD)	3.51 %	3.17 %	3.02 %
5 YEAR (US)	4.21 %	3.84 %	3.60 %
10 YEAR (CAD)	3.45 %	3.10 %	2.90 %
10 YEAR (US)	4.20 %	3.88 %	3.48 %
30 YEAR (CAD)	3.34 %	3..02 %	3.02 %
30 YEAR (US)	4.45 %	4.03 %	3.81 %
CPI (CAD)	2.80 %	3.10 %	5.20 %
CORE CPI (CAD)	2.80 %	3.50 %	4.80 %
CPI (US)	3.20 %	3.10 %	6.00 %
CORE CPI (US)	3.80 %	4.00 %	5.50 %

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