Investing Wisely

A Newsletter from Mike Wise

January 2025

Liz, Eashan, Carmen, and Mike

Our daughter and her family drove up from Los Angeles for Christmas this year. We were also joined by Edgar's sister Maureen, who came down from Edmonton. Edgar and Maureen lost their father earlier this year, so she would have been alone in the family home – it is good that she decided to come south and join us! It was sad to see them all leave, and the house seems empty without them around. The weather cooperated, and the California crew had no road issues on the long drive in either direction.

Since then, the big news is the LA wildfires. Liz et al are safe. They are tucked away in Burbank, on the north side of the "Hollywood Sign" mountain, not all that far from Universal Studios. The LA Equestrian Center, a short walk down the street, is serving as the shelter for displaced domesticated animals. The Eaton fire, southeast of Burbank near Pasadena, is the closest major fire, but they can see the smoke from the Palisades fire way off to the west from their home. Some of their friends have lost everything. Eshan says that the homes of a number of classmates at his school have been destroyed. Those who experienced the fire in Fort McMurray, either directly or indirectly, will know the emotions they are all going through. Liz and Edgar are helping out as best they can.

Where We Are

Table 1 shows how stocks, bonds and commodities performed last year. Most of my clients have a balanced portfolio. My pension-style Canadian Neutral Balanced Benchmark was up 14% in 2024. This is an after-fees benchmark with a weighting of 60% equities (2:1 CAD/US) and 40% fixed income.

The Bank of Canada has been very aggressive in lowering Canadian interest rates, and by extension the Prime Rate and GIC rates. The BoC dropped rates by 1¾% over the course of the year. The Prime Rate now stands at 5.45%. The cut in interest rates, while welcomed by borrowers, has hurt savers and has also adversely impacted the looney. As shown in Table 1, the Canadian dollar fell by almost 6c relative to the US greenback last year and continues its decline into January. This gets passed on to every one of us in the

PORTFOLIO STRATEGIES 30 YEARS

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Table 1
2024 Returns - Year to 31 December

	31 Dec 2023 Price	31 Oct 2024 Price	YTD Change
Equities			
TSX (CAD)	20958.44	24727.94	18.0%
S&P500 (USD)	4769.83	5881.63	23.3%
NASDAQ 100 (USD)	15011.35	19310.79	28.6%
Commodities			
Oil (WTI; USD)	$71.33	$71.87	0.80%
Gold (Comex; USD)	$2071.80	$2639.30	27.4%
Fixed Income			
DEX Universe Bond Index (CAD) - Total Return	1121.5	1168.9	4.2%
Govt of Canada 10-Yr Bond Interest Rate	3.128%	3.225%	0.097%
5-yr GIC Rate (rate as of Nov 20)	4.10%	3.10%	-1.00%
High Interest Savings Account (rate as of Nov 20))	5.00%	3.20%	-1.80%
Exchange Rates			
USD/CAD	$0.7549	$0.6951	-$0.0598
EURO/CAD	$0.6840	$0.6712	-$0.0128

price of imported goods at the grocery store and elsewhere.

The European Union and the United Kingdom have also started on a rate-cutting cycle. Not to be outdone, the US Federal Reserve cut their policy rate by ½% shortly before the election with 2 further cuts of ¼% late in the year.

US interest rates remain far higher than those in Canada even after the cuts. That gap is a large contributor to the weakness of the looney versus both the US dollar and the Euro. See Table 1.

Reminders

The deadline for 2024 charitable contributions has been extended to the end of February due to the postal strike.

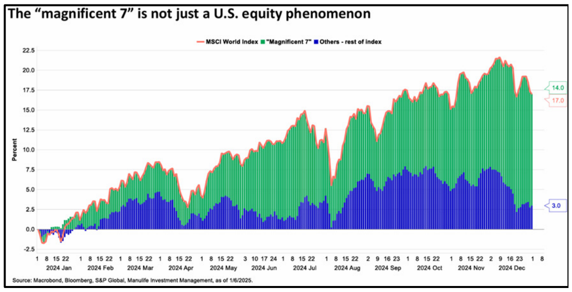
The 2024 contribution deadline for your RRSP is 3 March, 2025.

While short-term rates have declined, the interest rate on longer-term debt (from 10 years and up) rose during 2024. Specifically, on the same day – *even the same hour!* – in which the US Federal Reserve lowered its policy rate, the bond market began raising long term rates. It was an amazing spectacle to bond market watchers, and the subject of much discussion. It seems that the flinty-eyed bankers who rule the bond market decided that the Fed's move was likely to reignite inflation, so they increased the "term premium" attached to long-dated bonds. The term premium on a bond is an allowance, built into the interest rate charged, for the expected loss in purchasing power due to inflation, between when the lender lends money to the borrower, and when the borrower repays the loan.

I quote B2B Bank (part of Laurentian Bank) GIC rates in Table 1. Table 1 also shows that my favoured supplier of a High Interest Savings Account offers an "advisor-only" rate of 3.20% to my clients. This rate is for a standard bank savings account, CDIC-insured, with interest credited monthly. The supplier is one of the Canadian Big Banks.

Stock markets had another great year, powered by US Big Tech. Once again, the Magnificent 7 dominated and now represents 34% of the S&P500 Index, which is a market-cap weighted index. The 7 companies (Nvidia, Microsoft, Amazon, Apple, Meta (Facebook), Alphabet (Google), and Tesla) don't just dominate the US stock market; they also dominate when measured against the whole world! The mountain chart shown in Chart 1 (next page) shows the performance of the MSCI World Index, which is the gold standard against which all global equity managers are measured. It is a market-capitalization weighted index, which means that the largest companies have the greatest influence on the

Chart 1
The Magnificent 7 Dominated World Markets in 2024



results. The green part shows the performance of the Magnificent 7; the blue shows the performance of all other companies in the index, all around the globe. The MSCI World Index posted a return of 17% last year. The Magnificent 7 represented 14% of that return, while all the other companies in the index posted a paltry 3% gain.

The Magnificent 7 represent a huge concentration risk to any stock market investor, but on the other hand, these companies have shown over the past decade that they have higher growth rates and higher profit margins than the rest of the companies in the index. They aren't fly-by-night operations similar to what we had in the Tech Bubble a quarter-century ago. It's just a matter of valuation: are investors paying too high a price for the prospects of future growth?

Toronto did well last year, but continues to lag the US markets, mostly because of the lack of Technology exposure.

On the commodities side, oil essentially tread water, bouncing around the $70/bbl mark but ending up little changed. Gold, however, did well and was up 27% on the year. I don't track them, but Bitcoin and other crypto currencies also did well.

Where We're Heading

It looks as if 2025 is shaping up to be a year dominated by political change, particularly in Canada and the United States.

I'm writing this letter in the week before President-elect Trump's inauguration. Historically, the 1st year of a new President's term has been favourable for the stock market, so we'll see if history holds this time. The signs are currently mixed. The S&P500 is down about 2.4% in the first couple of weeks in January. But it is early days. (It is the 2nd year of the presidential cycle that has historically been the bad year for markets – 2022 being the most recent example.)

Want to Elect the Next Prime Minister?

The next Liberal leader, to be elected by members of the Liberal Party of Canada, will be our next Prime Minister.

If you want to participate, you must be a member of the Liberal Party on or before January 27. Membership is free. https://liberal.ca/register/

Here are the requirements:

- 14 yrs old or more;
- Canadian citizen, permanent resident, or status Indian;
- Not be a member of any other federal political party;
- Not stand as a candidate for any other party while a member of the Liberals;
- Support the purposes of the Liberal party.

The election process gives equal weight to each constituency, so members in ridings with fewer members (for example those in Alberta) will have more influence on results than members in Liberal strongholds.

Here in Canada, we're finally into Prime Minister Trudeau's long-awaited goodbye period. The convention to select the new leader, and therefore Prime Minister, will be held on March 9. It might be a short reign, however, as Parliament resumes on March 23 and the 3 major opposition parties have vowed to move non-confidence immediately after the Speech from the Throne, throwing us into an election. I certainly don't trust Jagmeet Singh to keep his word, but if he does, and the government falls, we'd be looking at a federal election in early May.

Over in Asia, I can't figure out who the good guys are and who the bad guys are in South Korea. The current President has been hiding out in the presidential palace after declaring a state of emergency that lasted 1 day before being overturned by the legislature. He surrendered to the police last night, to avoid bloodshed between the police and presidential security.

Depending upon who you talk to, China might be heading for an economic disaster, or on the road to future prosperity. And maybe it is preparing to invade Taiwan, or maybe it isn't. I don't trust any news coming out of China.

Europe is trying to figure its way out of the triple whammy of unchecked migration, unrealistic climate change policy and the cancel culture philosophy of the Intolerant Left.

Germany just ended its 2nd year of recession. The "powerhouse of Europe" is in deep, deep trouble. In Germany, and elsewhere in continental Europe, more conservative political parties (Populist? Far-right?) have gained strength and in some cases topped the polls in recent elections. But most countries have multiple parties, and the old-line left-leaning parties have tried to keep the winners out of power. They have even had their compliant Supreme Court annul the election in some countries! To save Democracy, of course!

On the other side of the English Channel, the newly-elected Labour government had probably the world-record shortest honeymoon period after winning a massive majority. It is now coming out that the Prime Minister, Keir Starmer, might have had a hand in suppressing the gang-rape stories while he was a senior public prosecutor.

Meanwhile, the bloodbath and destruction continues in Ukraine. The death toll on both sides is staggering. Modern warfare is frighteningly efficient at mutilating bodies. I'm going to make the prediction that there will be a ceasefire sometime this year and Ukraine will end up as 2 states – a Russian-speaking state on the east and a Ukraine-speaking state on the west.

Last but not least, we have the Middle East. Syria is now ruled (apparently) by a faction that until recently was labelled a terrorist organization and the leader had a multi-million-dollar bounty on his head. I fear for the sizeable Christian minority in the country. We might see a large refugee problem arising during 2025. The Kurds, in eastern Syria, still prefer that they be left alone to form their own independent country (preferably including part of Turkey). And the Druze, another sizeable minority, have publicly said that they'd like to be annexed by Israel!

Speaking of Israel, the TV news channel just announced a ceasefire between Israel and Hamas

Mighty Woodsmen on the Hunt for the Perfect Christmas Tree

Magpie

that included an exchange of a small number of Israeli hostages, some dead, for several hundred Palestinian prisoners. I'm pleased that the killing has ended (at least for a little while) but am saddened that once again in the Middle East it is Evil that seems to have won the war.

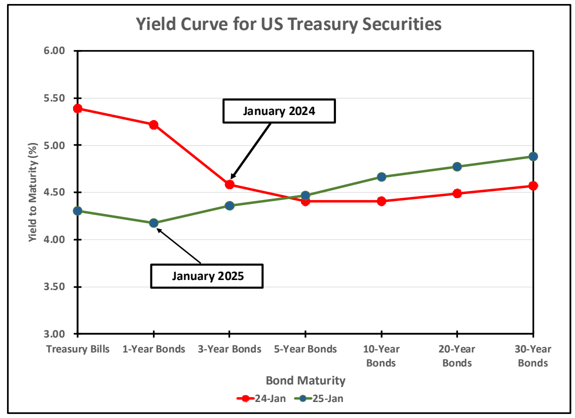
The Houthis continue to blockade the Red Sea, and now seem to have the armaments capable of flying missiles and/or drones across the length of the Arabian Peninsula to strike at Israel. I remain mystified why Egypt, which is really the country most adversely affected by the blockade and closure of the Suez Canal, stays silent and apparently out of the fray.

All in all, Canada and the US look pretty good compared to the rest of the world!

United States

Donald Trump is a dealmaker. He sees life as a series of deals, and his preferred strategy appears to be to create chaos and confusion in the ranks of his opponent so that he comes out ahead. He's not even President yet, and we're already buried by a daily blizzard of tweets, threats and general bombast, some over-the-top jests, but others not-very-subtle warnings. But I think there is method in his madness. Teddy Roosevelt described his foreign policy as "speak softly and carry a big stick". President Trump's policy might be "shout loudly and wave a big

Chart 2
Yield Curve for US Treasuries
Source: Federal Reserve Bank & Barrons



stick". (*ed. note: while Pres. Trump's tactics might work to chase away a black bear, they could be disastrous when faced with a grizzly! I always used baby-talk when face-to-face with a grizzly in the bush. Luckily, they never wanted to eat a baby!*). His warnings might have encouraged the Hamas-Israel ceasefire. Certainly, Iran would have heard them. His big foreign policy success in his first term was the Abraham Accords; I think he is aiming for a Russia-Ukraine peace deal in his second term.

We'll get into Canada and the 51st state in the next section, but this is supposed to be a financial newsletter, so let's talk about that for a bit.

As always, we'll start off with interest rates, and specifically the yield curve. See Chart 2. A positively-sloped yield curve (longer-dated bonds have a higher yield than short-term bonds) is considered good for the economy, while a negative slope to the yield curve is unfavourable. The yield curve a year ago (red line) was negative, but the Fed reduced short term rates by 1% last year, and Mr. Market raised longer-term rates, so that the yield curve as we enter 2025 is now positive (green line). The flinty-eyed bankers who rule the bond market are now saying that the US has performed a miracle and achieved the fabled soft landing, and there is smooth sailing ahead. This is big news!

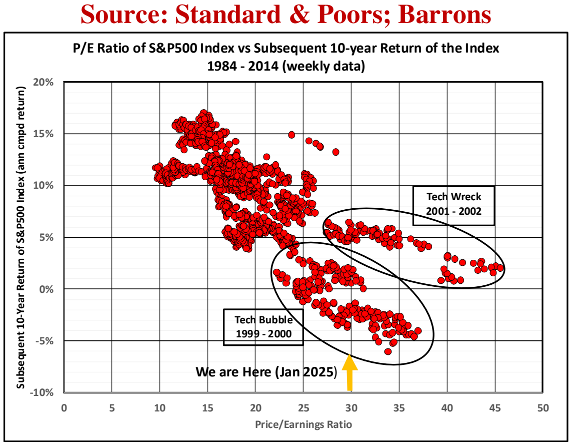
I think that the bond market would be happy if rates stayed unchanged for the rest of the year. Bond investors can get a risk-free coupon of close to 5% on long-dated US Treasuries, and better than 4% while sitting on cash held as short-term T-Bills. Investors in corporate debt can do better than this. Way back in the Middle Ages, my teachers taught us that corporate bonds can give investors equity-like returns, but at lower risk. I use that strategy in many of my client portfolios.

What about the stock market? The positive-sloped yield curve is signalling that we should have a decent-to-good economy, and President Trump's economic policies in his 1st term were pretty good for business, so shouldn't that be good for stocks?

I am moderately optimistic. The only nagging issues are the over-concentration of the US stock market in the Magnificent 7, and that 2025 is starting out at all-time highs and close-to-record valuation. The US stock market has never experienced as great a concentration of the market in so few names as today; we are in uncharted territory in that respect.

Looking forward, market history says that it is difficult to get double-digit returns from an expensive market, when "expensive" is defined as the price that an investor has to pay for 1 year of a company's earnings. This is the well-known price/earnings ratio (P/E Ratio). There is no correlation over shorter periods, for example 1 year, but Chart 3 shows that there is a negative correlation between the P/E Ratio and the subsequent return over the next 10 years. Chart 3 shows that if you buy the S&P500 Index when stocks are on sale and the P/E Ratio is less than 20, odds are pretty good that you'll be very happy over the next decade, scooping up double-digit compound returns.

Chart 3
S&P500 P/E Ratio and Subsequent 10-Year Return of the Index
Source: Standard & Poors; Barrons



But Chart 3 also indicates that if you buy the Index when the P/E Ratio is above 25, the returns over the next decade might be pretty meager, and might even be negative over the decade.

The P/E Ratio of the S&P500 Index is currently sitting right around 30. If history is any guide, a buy-and-hold investor who plans to hold the S&P Index for the next decade might be disappointed. But as I said before, there is no correlation over the short term, so 2025 may still be a decent year for the market. I'm cautiously optimistic.

Canada

Canadian politics is finally getting interesting.

Polls have indicated that the Liberals are unpopular with Canadians from coast to coast, and that the Conservatives are headed towards a massive majority whenever the next election comes around. But Jagmeet Singh and his NDP party supported the Liberals in every non-confidence vote, so Prime Minister Trudeau hung onto power.

Then came the fateful day, just a couple of weeks ago, when PM Trudeau tried to reassign Finance Minister and Deputy Prime Minister Chrystia Freeland to another post, and install his buddy Mark Carney in her stead as Finance Minister. She refused to "take one for the team", and publicly resigned from Cabinet in a scathing open letter. Hidden divisions within the Liberal caucus burst open, and it wasn't long before the Prime Minister announced his intention to resign, but not before creating more chaos by proroguing Parliament until March 23.

We now have a Liberal leadership campaign underway. It is evident that Mark Carney is the choice of the Liberal insiders, but we'll find out on Friday if Chrystia Freeland is also going to throw her hat into the ring. I wrote earlier how you can join the Liberal Party and participate in the leadership election. The election for leader (and by default Prime Minister) will be on March 9. Parliament must resume just 2 weeks later, on March 23, with a

The Festival Chorus at Knox United Church

Speech from the Throne. There isn't much time for the new leader to get his or her act together!

All of this is going on while we have the tweets and threats coming north from President-elect Trump. It started in typical Trump fashion as dissatisfaction with Canada's immigration policy – something that a majority of Canadians would agree needs fixing. He coupled that with a threat of imposing a 25% tariff (he likes tariffs) on everything that Canada exports to the US, without exception. That certainly got the attention of federal and provincial politicians, and business leaders across the country! Panic ensued, and continues to this day.

Energy is Canada's biggest export to the US. Ontario and Quebec export electricity, but the biggest contributor by far is oil & gas from Alberta. The lame duck Federal government is trying to craft retaliatory measures that they could implement if the Trump tariffs were to actually occur, and the Feds being the Feds, looked immediately at Alberta's oil & gas exports. At which point the Alberta premier, Danielle Smith, basically said that wasn't going to happen because under the Constitution resources are wholly a provincial matter and she wasn't about to harm the people in her own province.

In the meantime, she also went to Florida and met President-elect Trump, and has been invited to the Inauguration. She is the only Premier who has done this; I'm not even sure if anyone from the Federal government has been invited to the Inauguration.

I don't think there is any reason to panic and run around like a chicken with its head cut off. I can forsee that there might be negotiations started within the next year, aimed at amending the existing Mexico-Canada-US trade agreement. In the near term, and after the upcoming federal election, the new government should focus on revising Canada's immigration policy and increase defence spending. These are major irritants in the Canada-US relationship. Hopefully Pierre Polievre, if he becomes Prime Minister, can develop a good personal relationship with President Trump. One of Pierre's confidants is Jamil Jivani, who happens to be good friends with Vice President-elect JD Vance. Jamil was mentioned favourably in JD Vance's autobiography *Hillbilly Elegy*.

Summing Up

I didn't discuss Canadian economic data in this newsletter because everything is now in flux with the potential for the Trump tariff. I don't think they will happen, but the threat will be sufficient to cause a big change in Canadian economic policy. We'll likely be getting a new policy direction in any case if the Conservatives win a majority in the next election.

The Canadian stock market is likely to follow the US market. The TSX will do well if the US market does well; it will fall if the US market falls.

I think that we'll be happy with single-digit returns from the stock market this year. This is more in keeping with long-term averages, but less than what we might have become used to over the past while.

I like the bond market, and a mix of short-term bonds and/or a high interest savings account, coupled with a high yield corporate bond fund, should give solid positive returns.

I remain a gold bug. I think an allocation of up to 5% in gold bullion is appropriate. Risk takers might prefer to put some of this allocation into crypto.

Liz, Edgar, Eshan and Maureen in Banff