RESEARCH CAPITAL CORPORATION

ANDRAS GROUP
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Happy New Year!

We hope that all is well with you and your families.

What happened in 2023:

As we entered 2023, inflation was still a major concern. The United States Federal Reserve dramatically increased interest rates to counter this. This has largely been successful. Although still above the 2% target, inflation came down to 3.4% in December. Because of the downward trend and the underlying economic numbers, it is widely felt that rates have peaked and will likely come down.

The probability that rate cuts will occur in 2024 is likely. The equity and bond markets appear to have aggressive cuts priced in; however, it is likely that the pace will be more moderate and data dependent.

In Canada, the Bank of Canada rate was 0.5% in March 2022. As inflation rose to 8.1% in June 2022, interest rates also rose and exited the year at 4.5%. Rates continued to increase to peak at 5% in July where they remain. After beginning the year with inflation running at 6.3%, Canada exited 2023 with core inflation at 3.4%.

The Canadian economy is not performing as well as the U.S. The unprecedented influx of permanent and temporary immigrants has led to lower real wages, increased housing costs and lower consumer confidence. Although the U.S. may avoid recession, Canada may well already be in a mild contraction.

Although increasing population may offset aging demographics and should be a benefit to Canada in the long run, short-term it appears to be a drag on productivity.

Canada also faces mortgage re-financing which will limit consumer spending as individuals adjust to rising payments.

The geopolitical outlook in 2023 became a primary issue and 2024 looks to be a continuation. As we entered 2023, the Ukraine conflict was the primary focus. The war continues and appears to have become a static war of attrition. We now face conflicts in the Middle-East, tensions in Taiwan with China and a looming U.S. election.

What this might mean:
Although there are many potential events that could cause the markets to correct in the short-term, we see these as potential opportunities. Markets tend to climb a wall of worry.

We should see interest rates decline as inflation continues to moderate.

Performance on both sides of the border has been driven by a limited number of companies in the technology sector labeled as the magnificent 7 (Apple, Nvidia, Microsoft, Alphabet, Meta, Tesla and Amazon). At some point the rally in the S&P 500 should expand to other sectors and this will impact the TSX as well.

The equity markets have moved sideways for two years now and are basically back where they were in 2021 after extreme volatility in the meantime. The S&P 500 is a little ahead over that time and the TSX hasn't yet recovered the old highs. With rates likely topping out, the markets should be able to trend higher after some consolidation.

Dividend growth equities have struggled in a high interest rate environment as the yield on money market, bonds and GICs have proven popular alternatives to dividends. As rates fall, funds should flow back into dividend producing equities elevating share prices. Market breadth should broaden out as rate sensitive sectors recover. Utilities, pipelines and telecoms, which carry large debt loads, should benefit from lowering rates going forward. However, until rates start falling, balance sheet strains may keep reactions muted.

Energy stocks have trended somewhat higher as companies trimmed debt and they are rewarding investors with share buy backs and increasing dividends and are producing in record volumes. A positive is that the record volume of oil and gas being produced in North America mitigates any impact of potential global disruption.

The other positive is that the sector is focusing on becoming carbon neutral and emphasizing green production as we transition away from fossil fuels. This is going to take time and it is prudent to make the best choices as we get there.

Technology should continue to provide growth as AI continues to evolve and productivity expands.

Economic numbers have been sound in 2024 thus far. The markets have been under pressure recently because with good numbers the chance of rate cuts moves back farther. The reality is likely that if rates are cut aggressively, it is because there are storm clouds on the horizon. Ultimately, good news should be good news if one thinks longer term through the economic cycle.

A measured approach to interest rate cuts based on incoming data is warranted. Investors, however, tend to be impatient. Inflation will be sticky at these levels and take some time to get to 2%. This will likely fuel continued short term volatility.

Ultimately, we are constructive for 2024.

As always, if you have any questions or just want to touch base, please call or e-mail us. we’re here to help.

Best Always,

The Andras Group.

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