Lee Turner

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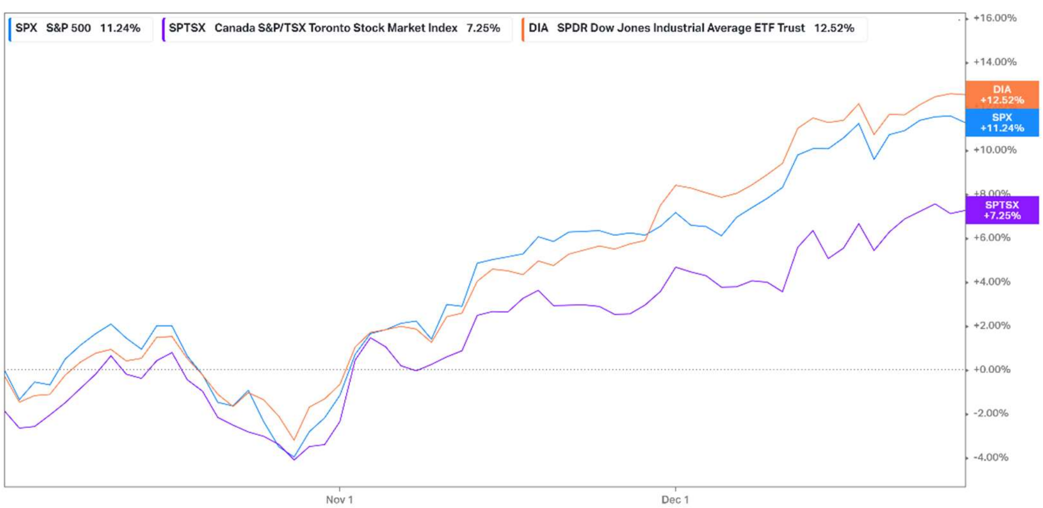
Review

Looking back at 2023, the predominant theme is unquestionably ongoing volatility. This trend, reminiscent of inflation, has not abated but has, in fact, intensified in investor expectations for the future. After decades of relatively low volatility attributed to "peace dividends" and central bank dominance, investors are still grappling with adapting to new market regimes. As an analogy, most of us have grown accustomed to air travel, experiencing it as akin to boarding a high-security bus, where the primary concerns revolve around lost luggage or delays (certainly not a window blowing out). Like the pilots on your flight, we intend for wealth management to be a smooth, largely uneventful trip from working to retirement to inheritance. But we can't totally avoid the turbulence as much as we would like to and, unfortunately, we think it is likely to remain bumpier for some time.

For the year, the TSX was up 8.12% in price, with a total return of 11.75% but that headline number doesn't really tell the story. For comparison, at the end of October, the TSX was -2.64% for the year, and flat (0.06%) on a total return basis. In the space of a quarter, there was an 11% swing. Slice it however you want, that's volatile. However, when looking at the year, between September 1 and October 31, there was an 8% decline and in March, we had an intramonth decline of 6.5% followed by a rapid recovery over the following month. Again, pretty erratic. While we like to ascribe meaning to calendar year beginnings and endings, there is plenty of chance that occurs between and after.



Koyfin data. January 8, 2023

koyfin

During the December quarter, the TSX was up 7.25% in price (8.1% in total return), while the Dow Jones and S&P 500 were up 12.5% and 11.2% respectively. By sectors in the TSX, technology led the way, growing 23.9% while financials played runner up at 11.7%. Energy was the laggard at -2.6%. Outside of equity markets, the FTSE Canada Universe Bond Index was up 8.3%.

Forecast

Most developed economies have managed to stay afloat amid recessionary concerns. In the US, strength persists, with markets anticipating a smooth "safe landing" for inflation returning to a 2% target and stable employment. Conversely, Canada's economic optimism is waning, marked by a mere 100-job addition in December and a sluggish 0.1% growth estimate for November 2023 GDP. Anticipating cooling inflation in the US and economic contraction in Canada, market participants have priced in several interest rate cuts in 2024, commencing in March.

We remain of the opinion that these cuts, or more specifically, the cadence of these cuts, is far too optimistic. Despite sluggish employment growth in Canada, wage growth surged to an annual rate of 5.4%, inconsistent with a rate cut aimed at achieving a 2% inflation target. We continue to predict that labor, rather than capital or goods, will be the persistent inflationary driver. If wage inflation does slow sufficiently to warrant a cut, the Bank of Canada still faces a dilemma regarding front-running the US Federal Reserve and impacting the Loonie. We also believe that, having been so late to the inflation party, central banks will be hesitant to cut until they can be sure that it is well and truly dead. With shipping inflation increasing in the Red Sea and oil reviving amid two wars, the risk of another acceleration in "transitory" inflation remains. Better a hard landing from holding onto rates a little bit longer than is optimal than "no landing" ultimately followed by a stall and crash caused by having to re-raise interest rates in the face a reemerging inflation.

Strategy

Optimism abounds in the markets, with momentum going from strength to strength in stocks. The expectation of rate cuts injected drive into technology, industrial, and consumer staples sectors during the quarter. Meanwhile, even amid high oil prices, energy and materials names have begun to look more and more attractive as the peak inflation narrative has become absorbed by market participants. We remain largely positioned as we have been with regards to sectors and do not have plans at this stage for adjusting our weights between them to any large degree.

With bonds, the market belief is that the worst for interest rates is over, with cuts inevitable in the short-term. As we have said, we do not agree. The risk of a buy-and-hold investor purchasing a five-year bond yielding 3.2% (as of December 29) even while wages have accelerated to 5.4% does not seem favorable in our view. Unfortunately, this decrease in the five-year bond yield also means that the repricing of some preferred shares is possibly going to be at less of a premium than would have been the case a month prior in November when the five-year Canadian was 4%. Relative to the last decade though, 3.2% is still a good reset rate for the income investor. For preferreds that have already reset, this is good news as the value ascribed to their income has increased share prices, but we hope that if rates do in fact decline, that we get a few more opportunities to reset at these relatively high levels. For now, our view continues to be that a diversified mix of preferreds presents a better relative value than a buy-and-hold strategy toward medium term bonds.

Our communication with you

With 2023 at a close, we hope that in the upcoming quarters you will be receiving these missives and statements through a new system, which we expect to fully implement here at Lee, Turner & Associates over the next couple months. We hope that this tech solution will make communications with you for statements and performance much simpler, allowing you to look at historical statements and holdings through a simple online portal. Finally, we also hope that it will make our annual informational updates a much more straightforward process to go through. If you have questions on this process, please let us know.

Until then, if you would like to opt for emailed quarterly packages and discontinue mailed quarterly packages, please email trevor@lee-turner.com and let us know.