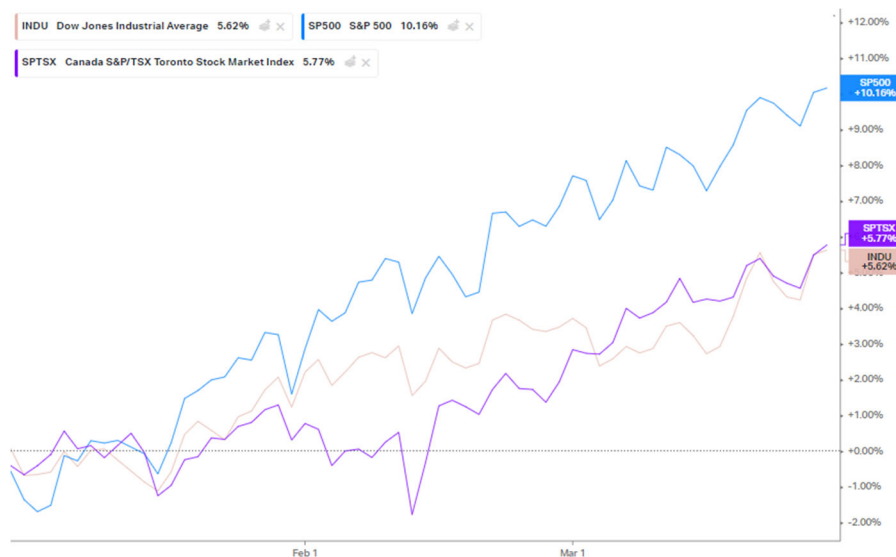


**Review**

Optimism and bullish sentiment from the final months of last year carried into the first quarter of 2024. Central bankers, economists and politicians continued to tell investors that the overall health of the economy was not too hot, not too cold, but just right. After digesting their porridge of economic data, monetary policymakers decided that interest rates were also just right, keeping them status quo for the quarter.

And while they reiterated that the economy was healthy, with a primary focus on inflation trending as intended, they also continued to tease investors with the idea that multiple interest rate cuts may come this year. As a result, investors priced in very high expectations for these decreases to materialize, driving a strong performance in equities to start the year based on the belief that growth and profitability will follow.



The S&P TSX ended the quarter up +6.6% on a total return basis and +5.8% on a price basis. This was largely driven by the energy and industrials sectors, while telecommunications was a drag on the index.

The Dow Jones Industrial Index +5.6% ended the quarter slightly behind the Canadian counterpart and the S&P 500 finished +10.2% driven by all things Artificial Intelligence related.

Throughout the quarter, some intriguing divergence between the Canadian and US economies began to arise. Canada saw near-zero GDP growth (but not negative), while the US proved resilient. Canada saw inflation tick down, while the US' crept up. Employment data also demonstrated further strength south of the border, while the situation deteriorated closer to home for three consecutive months.

**Forecast:**

With this divergence in mind, we wonder if one economy is running not too hot, not too cold, but just right. Both North American economies are likely within the range of (or moving towards) being just right – and now the Bank of Canada and Federal Reserve need to somehow navigate a 'soft landing' or 'no landing' from the peak of the economic cycle. Meaning they do not want to see any type of recession, or if need be, a brief and shallow one.

As things stand, it would seem Canada's monetary policymakers would have the rationale to decrease interest rates before the US (which will have its own negative implications on the Loonie). We see signs of cracks in the economy that indicate we are in recession, or very near one. However, fiscal policymakers have implemented measures that we believe to ultimately be inflationary. An increase in the carbon tax – intended to combat emissions – will see higher input



costs passed on to consumers. Wage inflation, including higher minimum wages across the country and cost of living adjustments intended to alleviate rising prices are very sticky and will funnel more money into the economy. Surging immigration numbers intended to offset stalling population growth will drive demand for almost everything, particularly shelter. Further, oil & gas – well known for its geopolitical risk – has seen a recent steady climb in prices. As we have shown before, energy's oscillating price volatility has a very high correlation with inflation. With these factors in mind, we believe there is little incentive for the central bank to make changes to its policy rate if there is this much potential inflationary noise still to be absorbed in the economy. Loosening monetary policy too soon may see runaway inflation 70s style, which is why we think rates will likely stay higher for longer.

In the US, we may certainly see tightening if hotter-than-just-right performance continues, although we see rate hikes as unlikely for now as it risks causing more damage than good. Like Canada, an appetite for rate cuts seems more likely if evidence of prolonged softness in certain areas occurs. Keeping their economy's temperature just right will have plenty of consideration and will be no easy feat.

### **Strategy:**

Accepted tolerance for relatively higher interest rates and higher inflation may be the new business-as-usual. Quality businesses and management teams have likely understood this scenario and should now be able to operate in this new environment without the risks posed in the last 18-24 months. By now, they should have a solid grasp of how it will impact the fundamentals of their businesses.

While we wait to see how things unfold in the economy, we can tell you we believe bonds are still too cold. The asset class still does not present the right characteristics we seek when allocating your capital. For income, we still like preferred shares, where our expectations of the interest rate path intersect with valuations that are just right. Dividend payers in common equity sectors like financials, telecommunications and energy are poised to benefit from those fiscal policy measures mentioned above. Industrials and materials, which typically pay lower dividends, are also well-positioned to participate in some price growth. We see some interest rate and inflation risk in the real estate sector and consumer discretionary. Our holdings in real estate are limited to retailers with national grocers as anchor tenants – we see limited tenant risk here. Consumer discretionary holdings are largely limited to quick service restaurants, which should see some upside from trade-down behaviour.

It is far too difficult to consistently predict the short-term performance of both the market and economy accurately. While we have our theses and certainly factor these into our analyses, predicting the daily or weekly volatility that may or may not result from economic events will do us little good versus staying focused on the long-term opportunities to invest in great businesses that meet your investment objectives. Economic reporting is backward looking, and we prefer to stay looking far ahead.

### **Our communication with you**

We are pleased to announce the launch of our new online platform, Ndex, designed to provide you with digital access to your account statements, balances, and transactions. If you would like to activate your account and discontinue mailed quarterly packages, please email [revor@lee-turner.com](mailto:revor@lee-turner.com) and let us know. Thank you.