Investment Quarterly
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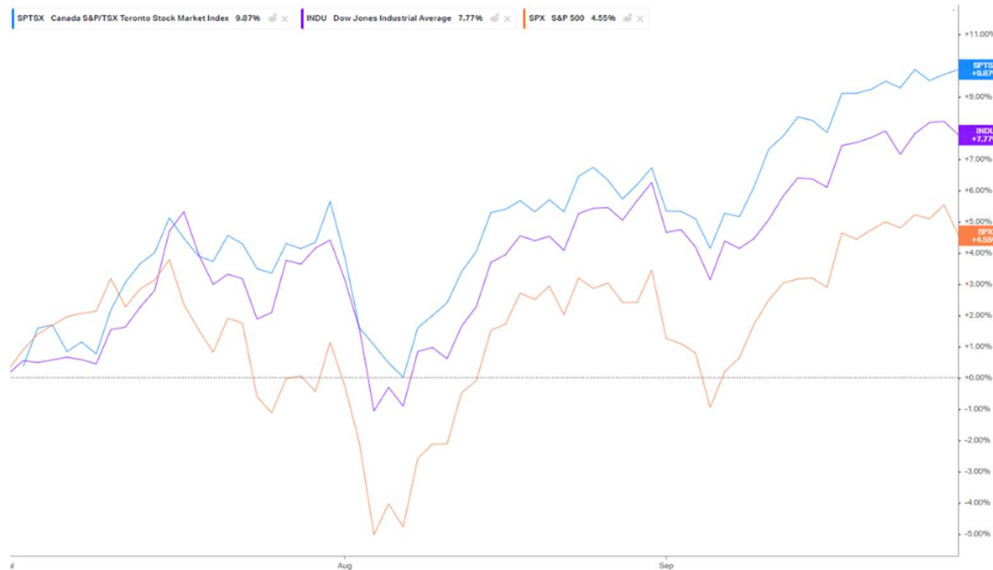
Review

With confidence that they have achieved a 'soft landing' for the economy, the Bank of Canada followed up June's initial interest rate cut with two consecutive cuts in July and September. The policy interest rate now sits at 4.25%. Canadian monetary policymakers believe they have the supporting data for an aggressive cutting cycle; August's year-over-year inflation measured at their targeted 2.0%, unemployment is slowly rising, and overall economic growth has stalled. They see this as the time to step in and stimulate the economy before it's too late and we enter recession. The US Federal Reserve shared a similar perspective, as they followed suit with a 0.5% reduction in their policy rate in September, from 5.5% to 5%. The Fed's decision was largely expected, with speculation largely centering more on not if, but how deep the cut would be; 0.25% or 0.5%.

Fixed-income investors reacted with muted optimism, as the nearly flat yield curve signals an expectation of limited growth or recession risk ahead. Meanwhile, gold prices soared to new highs, reflecting a strong demand for hedges against inflation and economic downturns.



And while some economic and market indicators are indicating weakness and bearish sentiment, equity markets are not. In fact, major North American markets ended the quarter at all-time highs, driven by enthusiasm and optimism of lower rates and its implied future growth. As a result, the S&P TSX Total Return Index returned 10.5% for the quarter and has returned 17.2% year to date, led by the financial sector. Our US counterparts, the Dow Jones Industrial Average returned 8.7% for the quarter and 13.9% year to date, and the S&P 500 returned 5.9% for the quarter and 22.1% year to date.

Forecast

Since 2020, markets have experienced large swings in both positive and negative returns. However, volatility of this magnitude and frequency is abnormal when compared to the past 30 years. The pandemic and its ripple effects have exposed investors to a compressed and accelerated experience of political, economic, and business cycles, which would normally unfold over a much longer period.

As time has passed, many investors are now questioning where we stand in the economic cycle. With central banks cutting interest rates in an effort to stimulate the economy, the question arises: are we at the beginning of a new cycle, or are these measures indicative of a cycle nearing its

end? We believe we're likely still in the early stages of a larger cycle set in motion by the pandemic—one marked by historically low interest rates, border shutdowns, supply chain disruptions, loose fiscal policies, and near double-digit inflation. The effects of these unprecedented events are still unfolding throughout the economy. As a simple illustration, the cost of a dozen eggs in Canada has increased by 40.5% between August 2019 and August 2024, according to Statistics Canada. It is apparent that the cost of living has reshaped consumption patterns, possibly for good.

It's reasonable to believe that long-run inflation hasn't been fully absorbed yet. Rising living costs are a pressing concern for the workforce, with average wages still increasing by 4.5% year-over-year, outpacing inflation. As labor contracts negotiated in the early 2020s come up for renewal, we anticipate more collective bargaining and potential labor disruptions as workers seek to reclaim lost purchasing power, which could further drive wage growth. Politicians are also acutely aware of their task to bring down the costs of living, and with notable general elections happening in the coming months, we anticipate proposed relief via partisan policies will rely heavily on the individual to determine if the outcome will be as intended (i.e. new tariffs, home purchasing assistance, etc.) Rapidly escalating conflict in the Middle East and Eastern Europe would bring further risks to price stability, particularly for commodities. Surprisingly, oil prices tested new lows despite the growing tension in Middle East. In other parts of the world, namely China, massive stimulus packages are being considered to reignite stalled economies, which would most certainly trickle through to our cost of goods.

Despite these sensitivities and challenges to controlling inflation, North American central banks appear set to continue cutting rates in the final quarter of the year. Key indicators—such as inflation, employment, and GDP growth—are aligning to support further cuts. However, the accelerated pace of these rate cuts is something we're monitoring closely. Navigating the current economic landscape is complex, and it's unlikely that a handful of policymakers will be able to tame inflation in such a short time.

Strategy

While the headlines above will undoubtedly influence Canada's growth, the extent, timing, and precise impact remain uncertain. In managing your portfolios, we are fully aware of both the headwinds and tailwinds we face. Yet, we also recognize that turbulent markets often bring opportunities for capital allocation. We are willing to embrace short-term risk when they align with the potential for long-term reward. Over the past few years, we have built positions in several outstanding businesses, and we will continue to focus on such opportunities with your investment objectives at the forefront. Our goal remains to seek high quality securities, even amid uncertain conditions.

Since equity markets are inherently forward-looking and lack maturity dates, we continue to favor this asset class. This allows us to look past potential market turbulence and focus on high-quality operators that may be trading at attractive relative valuations, without being constrained by a specific timeline for our investment theses to materialize. Consequently, fixed income will remain absent from portfolios until yields offer a more compelling alternative to the prospective total returns from equities. We are also excluding alternative asset classes like private asset funds and commodities from portfolios. We believe that the benefits of diversification and uncorrelated returns can be effectively achieved through portfolio construction of public equities. Further, there are publicly listed companies that we can invest in that specialize in areas such as private equity, credit, real estate, and infrastructure—fields where these managers often have more specialized expertise than we do. This approach allows us to capture the advantages of alternative investments without the complexities of direct exposure.