September 2023 Financial Planning Email Update

On August 15, 2023 I visited the CI Financial offices in Toronto and met with a few key members of their Canadian Equity, International Equity, and U.S. Fixed Income management teams. Many significant insights were gleaned from these meetings.

Kevin McSweeney, Senior Vice President and Portfolio Manager for all CI Canadian Equity investments discussed the following very relevant points:

1. The Canadian investment market is undergoing a generic regime change. From 2009-2021 we invested in an environment of economic growth, low interest rates, monetary quantitative easing and ample liquidity. Today we are in an inflationary environment with higher interest rates, monetary quantitative tightening, and lower liquidity and expect this investment environment to continue going forward. We will not revert to historic valuations; therefore, we must pivot to succeed in this new world.
2. Inflation is coming down, albeit slower than desired. Inflation is now at 3.3%. Two future potential contributors to inflation include: (i.) the retirement of baby boomers resulting in a decrease in the labour supply, while labour demand remains the same, therefore likely initiating wage inflation, and (ii.) increasing interest rates, thereby increasing household interest payments.
3. The Canadian consumer is stressed but not distressed which has important implications for future returns. In Canada there are five million mortgages of which only 7,000 are in 90-day arrears today. This is good! Canadians are keeping up with the increase in interest payments so far and are likely giving up other spending. Canadian economic growth has gone to interest payments. A 1.2% decline in gross domestic product (GDP) growth in the economy is due to residential mortgage interest rate payment increases. The impact of reduced growth will continue as more mortgages renew.
4. Income equities and some fixed income asset classes are extremely cheap following this year's narrow runup in megacap technology stocks. Apple stock, for example, is selling at 30 times price earnings ratio with no growth. The market therefore is up on valuation alone not growth, as there has been no increase in earnings.
5. Variances are emerging in growth across the globe. China is having trouble meeting expectations but the U.S. is performing above expectations. Growth will slow but that's okay!
6. U.S. High Yield, Global Infrastructure and Canadian Equities are still very attractive. CI has experts in all areas. No one knows which will be the dominant asset class each year.

I also had the opportunity to visit with Brad Haughey of Black Creek Investment Management Inc. (a sub advisor to CI Financial) which is a collection of 11 global equity specialists with over 230 years of collective experience, all located in one office in Toronto. They focus on what they do well – stock picking. They are investment driven, independent minded, and have aligned their interests with their clients. Black Creek follows a process, and understands how to find winning businesses, normally holding 25-35 investments overall and replacing 5 per year which is very focussed. There is a philosophy of being truly global with less reliance on the U.S. Europe has become very attractive to them as it trades at a 35% discount to the U.S. with the same earnings growth.

Finally, Roberto Katigbak from Marret Asset Management (a sub advisor to CI Financial) gave his insights into the U.S. fixed income investment area. As there are many areas of fixed income to review, the challenge is to invest in the correct area based on where we are in the market cycle. As interest rates have nearly peaked, Marret is currently allocating mostly to government bonds with an average duration to maturity of over 6 years. Prior to interest rates increasing in 2021, the allocation was investment grade debt 11.6%, high yield debt 21%, cash equivalents 63.7% and bank loans 3.7%.

Marret Asset Management is calling for a hard landing recession in 6-9 months which will be priced into the marketplace by the end of 2023. They are calling for unemployment to rise from 3½% to 7½% in the U.S. with corporate earnings down by 30%. This would imply that interest rates would be cut by 2-3% in one year. When interest rates decline, the price of government and other bonds will increase which will be very favourable to fixed income portfolios. The U.S. Federal Reserve is calling for a soft-landing recession implying there will be a slight increase in unemployment and corporate earnings will fall by 10%. This will still initiate a 2-3% decline in interest rates but will take 2-3 years to complete.

Roberto noted that as the U.S. has primarily 30-year fixed mortgages. Canada has shorter fixed term and variable rate mortgages and is therefore more interest-rate sensitive. As a result, Canada will likely start to cut interest rates sooner than the U.S. In Canada, 55% of fixed interest-rate mortgages are coming due in the next 2 years. These mortgages had an interest rate on average of about 2½% so when they renew the rate will most probably at least double which of course will result in their mortgage payments at least doubling as well.

Amanda and I are both qualified CERTIFIED FINANCIAL PLANNER® professionals at your service to assist in all areas of comprehensive financial planning including financial goal discovery, cash flow/budget analysis, retirement income planning, tax savings, estate planning, insurance needs analysis, investment planning, education saving planning, special purpose or major purchase planning. I wish to thank you for your continued confidence and for the opportunity to serve you in all aspects of Financial Planning. As always, I will continue to keep in touch with you but if you have any questions or concerns, that you would like to discuss or review, please do not hesitate to contact either Amanda or I by email or by calling the office at 519-894-2661 or toll-free at 1-800-716-5538.

Have a great day!

Respectfully Yours,

Gary

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