

Winter 2024

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## CONTACT US:

Stonebrooke Asset  
Management Ltd.

Waterpark Place  
20 Bay Street, 11th Floor  
Toronto, Ontario, M5J 2N8

344 Lakeshore Rd. E., Suite B  
Oakville, Ontario, L6J 1J6

Tel: 416-850-2172  
Email: [info@stonebrooke.ca](mailto:info@stonebrooke.ca)  
[www.stonebrooke.ca](http://www.stonebrooke.ca)

## Summary 2023

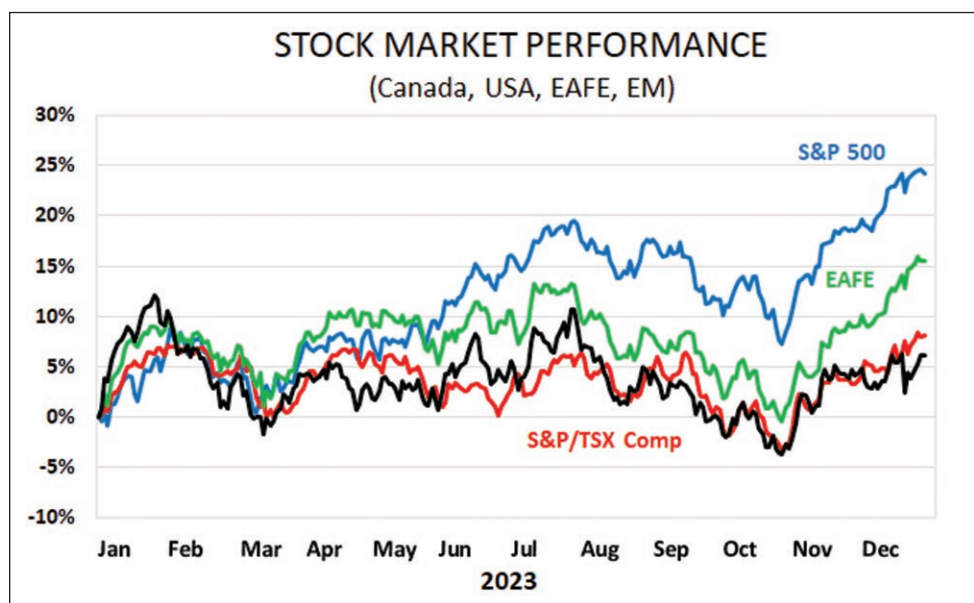
A spirited rally in the final two months of 2023 pushed financial markets to end the year in positive territory. The S&P/TSX Composite index, down in October, managed to finish up 8.1%, while the bond market similarly pulled itself up for a gain of 6.7%, as per the Universe bond index. The 10-year benchmark Government of Canada bond yield ended the year at 3.1%.

Led by the famous Magnificent7 technology stocks, in the U.S. the S&P 500 was up an impressive 24.2%. The major markets around the world advanced higher. The Europe Australasia & Far East (EAFE) index was up by 13% in local currency. The Emerging Market (EM) index was up more modestly, gaining 7.1%.



Commodity markets were predominantly lower in 2023. The price of Oil (WTI), declined by almost 11% to finish the year at \$71.70 USD. The Copper market was flat, while the price of Nickel fell 45%. Agricultural commodities performed poorly with Corn down by 33% and the price of Wheat down 18.5% (in USD).

The chart below shows the performance of the major stock market indices – the S&P/TSX Composite (Cdn dollars), the S&P 500, EAFE, and EM are in USD. Despite all the economic uncertainty, global stock markets did reasonably well last year. The U.S. stock market was the major outperformer in 2023.



# The Year the Fed Eases

There is a growing consensus the U.S. Federal Reserve will ease monetary policy this year and lower short-term interest rates. From a timing perspective this would be consistent with past business cycles which witnessed the Fed *cutting* interest rates about nine to twelve months following its final rate hike – (July 2023).

Many market analysts are using the “goldilocks” reference again, meaning that we have a perfect economy which is neither too hot nor too cold. It is possible the Fed may have engineered the elusive “soft landing”. After raising interest rates for almost two years, inflation is receding, and economic conditions and financial markets are stable. Nothing terribly bad has happened.

The goldilocks consensus may in fact be the underlying reason financial markets have done so well. The risk, of course, is that high expectations among investors may eventually result in disappointment should even a mild downturn occur. One year

ago, the majority was forecasting a recession for 2023. Consensus has a habit of getting it wrong.

It is still too early to suggest the Fed has succeeded. The lagging effects of higher interest rates have likely not yet run their course. There is no clear supporting evidence the economy will remain stable and healthy, and inflation is proving somewhat “sticky”. Though the Fed has stated it expects to lower interest rates three times this year, it has also telegraphed it is in no hurry to do so.

Politically, this is an election year in the U.S. While the Fed is an independent body, it will be under pressure to intervene and stimulate the economy. Chairman Jerome Powell, a Republican, is also determined to rein in inflation and is very aware that a failure to do so at this juncture could be a missed opportunity with potentially serious inflationary consequences in the years ahead. This is certain to be a year of fiery politics.

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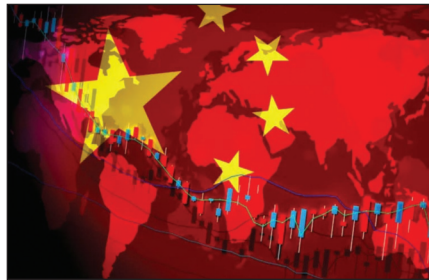
## Risks will Moderate

Considering all of the risks over the past year it is surprising the global economy has not already entered into a serious period of contraction.

The “mini” U.S. banking crisis in March of 2023 threatened to become a major and more serious financial collapse. The failure of Silicon Valley Bank (SVB), the 16th largest with over \$200 billion in deposits, was a classic bank run with depositors rushing to withdraw their funds. SVB and two other banks were quickly unwound and/or sold. A contagion was avoided as the Federal Reserve stepped in to effectively guarantee impaired balance sheets.

The U.S.-China trade relationship deteriorated amid rising tensions over Taiwan. China is the second largest economy in the world. A slowing Chinese economy is not a positive development for global growth. The Shanghai Composite stock

index is approaching its pandemic lows, while the Hong Kong Hang Seng stock index is below the 2020 pandemic low.



Looking ahead one or two years from now, despite the volatility, financial markets are likely to offer decent returns to investors. Inflation and interest rates will moderate, and an eventual end to the wars in Ukraine and the Middle East should improve the geopolitical landscape. Overall, financial and economic risks should moderate.

The longer-term view isn't without its challenges. We are possibly facing macroeconomic headwinds such as higher average inflation and interest rates, not to mention a geopolitical divide that is splitting the world into competing power blocks. Business cycles will continue to ebb and flow. The challenge will be in monitoring and acting on the changing global dynamics.

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## Mixed Signals

Economic indicators in the U.S. and Canada paint a more complex picture. While a soft-landing economic scenario is the current consensus forecast, some statistical trends show cause for concern. Employment data in the U.S. for 2023 was a pleasant surprise. However, the labour market is perhaps not as resilient as reported.

In a recent research report from Liz-Ann Sonders, Chief Investment Strategist at Charles Schwab, she highlights the Bureau of Labor Statistics (BLS) monthly job *revisions*. The BLS

publishes the monthly non-farm payroll report announcing the number of jobs created. It also then makes a revision to the previous months' numbers based on more accurate data. Sonders pointed out that ten of the last eleven months have had downward revisions, representing more than 450,000 jobs.

Sonders then compared the payroll data released in December of 2007, just before the Great Financial Crisis (GFC) of 2008/09. At the time, seven out of the eight prior months the jobs numbers

*(continued on page 3)*

### Mixed Signals (cont'd from page 2)

were revised lower. Furthermore, the BLS continued to post inaccurate jobs numbers throughout 2008 as the economy plunged into recession. According to the first BLS releases, the economy created 1 million jobs between April 2007 and December 2008. In fact, the final revisions showed the economy lost more than 2 million jobs over that period. Another concerning trend is the Institute for Supply Management (ISM) data for both the manufacturing and services sector. Recent data continues to indicate a weak and contracting economy. On the other hand, consumer spending is registering positive growth. As reported by the U.S. Commerce Department, retail sales were up 5.6% in 2023. However, this figure is not adjusted for inflation.

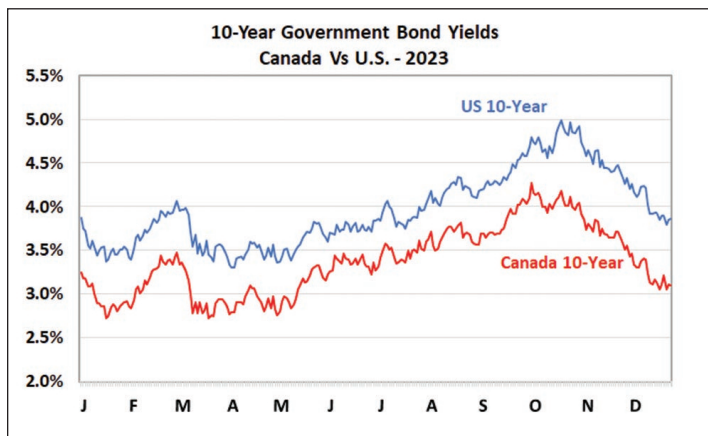
Importantly, consumer spending comprises about 70% of GDP. Conceivably this number will rise due to the YOLO (You Only Live

Once) consumer phenomenon. This behavioral change could come at the expense of savings and could become a dominant theme in the years to come. If so, it will contribute, at the margin, to economic growth. At least until the money runs out.

Also, with a labour market which is seemingly tight and abundant, there is less concern about being laid-off and losing a job. Another job is waiting and readily available. This shows up in the U.S. Jobs Opening report, or JOLTS data, showing a high turnover of jobs. This encourages the behaviour to spend, knowing that your employment opportunities are secure. That said, the situation in Canada may be more challenging. According to a recent survey from Desjardins, over half of Canadians expect a recession in the next year.

## Bond Market

During most of 2023 it appeared that bond investors would again lose capital, which would have made it the third year in a row. Then interest rates declined sharply in the final two months of the year, delivering respectable gains for bond investors. The benchmark Government of Canada 10-year bond yield fell to 3.1%. In the U.S., the equivalent bond yield fell to just under 4%.



Bond yields have started to move back up to start the year, sending bond prices lower. There is again some concern with

U.S. government debt and deficits. This issue may re-escalate as there is political deadlock in Congress around the budget. In the past 12 months the U.S. government has spent \$6.6 trillion. The Federal deficit is running at about \$1.7 trillion. The annual interest expense on the outstanding debt has now reached **\$1 trillion**.

The US Treasury Department appears undaunted and has stated there is ample liquidity to finance the debt burden. There are also measures that can be taken to provide liquidity such as changing Banking capital regulations to allow financial institutions to purchase more Treasury securities. Every effort will be made to calm bond investors and prevent volatile markets.

Importantly for the bond market, inflation is moderating and is now less of a concern. Consensus is that the heavy lifting is over, and inflation will decline in 2024 to the Fed's targeted level of 2%. Financial markets anticipate the Fed to cut short-term interest rates at least 6 times this year. The Fed meanwhile is forecasting the need for only 3 cuts. Still, bond yields are likely heading lower which should again result in decent returns for bond investors.

## Bitcoin, A Legitimate Asset

Bitcoin had an exceptional recovery in 2023, more than doubling in price. It has continued to rise in the new year with the approval from the Securities & Exchange Commission (SEC) of eleven new Bitcoin Exchange Traded Funds (ETFs). SEC chairman Gary Gensler was less than enthusiastic at the decision to approve the ETFs, having been forced to do so by the



courts after losing an appeal. Gensler issued the following statement: [note: ETPs include ETFs].

***"Though we're merit neutral, I'd note that the underlying assets in the metals ETPs have consumer and industrial uses, while in contrast bitcoin is primarily a speculative,***

*(continued on page 4)*



**Bitcoin, A Legitimate Asset** (cont'd from page 3)  
**volatile asset that's also used for illicit activity including ransomware, money laundering, sanction evasion and terrorist financing. While we approved the listing and trading of certain spot bitcoin ETP shares today, we did not approve or endorse bitcoin. Investors should remain cautious about the myriad risks associated with bitcoin and products whose value is tied to crypto".**

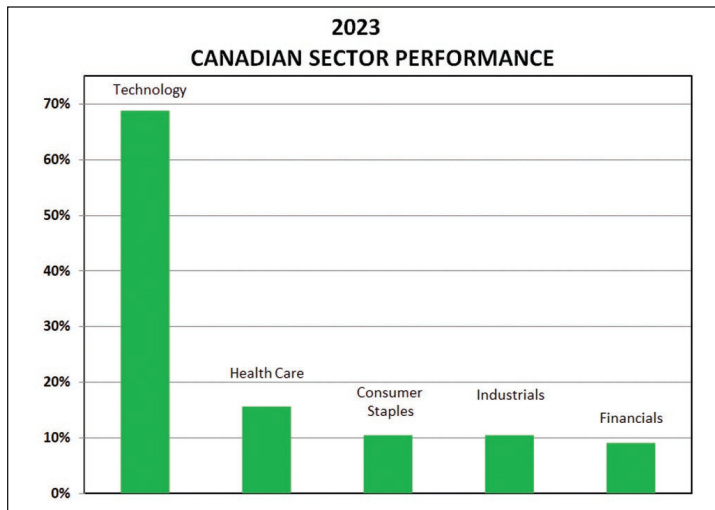
Not exactly a ringing endorsement. Importantly, investor demand will now follow as ETFs will make it easy to make an

investment in Bitcoin. Regardless of the warning from Chairman Gensler, major financial institutions such as Blackrock and Fidelity have endorsed these ETFs giving Bitcoin some legitimacy and giving investors comfort.

The launch of Bitcoin ETFs will increase the number of investors interested in diversifying into a crypto asset. By some estimates, \$50 billion to \$100 billion in capital could flow into Bitcoin over the next year or two. If so, this is bound to lift the price.

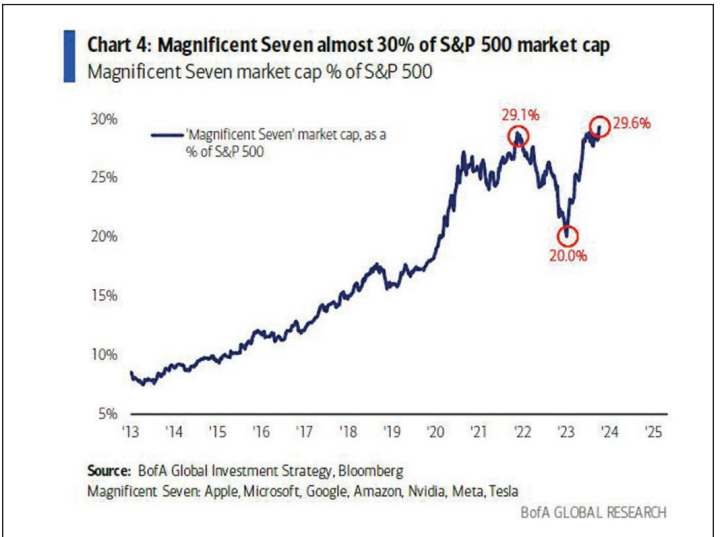
## Equity Market

The S&P/TSX Composite price index managed to advance by 8% in 2023. One company, Shopify, was responsible for a large share of the index gains. The bar chart below shows the performance of the top five sectors in 2023. The technology sector was the stalwart, advancing by 70%. The Financial sector, Consumer Staples, and Industrials performed in line with the index.



The excitement with Artificial Intelligence (AI), was the single most important factor in driving stock prices higher in 2023. In the U.S., the Magnificent7 advance has been quite remarkable. As shown in the adjacent chart, courtesy of BofA Global Research, the S&P 500 index weighting for the seven Mag7 stocks, i.e. Microsoft, Apple, Google, Amazon, Meta, Nvidia, and Tesla, is roughly 30% of the index. This is at an extreme and unsustainable level.

AI is destined to be a remarkable technology and will no doubt increase productivity and promises to advance scientific discovery. The infatuation with technology stocks drove investor capital into this sector at the expense of almost all other stocks. Without the performance of the Mag7, the S&P 500 index would have been essentially flat in 2023.



The markets appear disconnected with many inconsistencies. The two-month end-of-the-year stock market rally was primarily based on the belief the Fed will pivot and lower interest rates. Many companies have guided down expectations and yet the consensus growth rate for corporate earnings in 2024 is 12%. Corporate insiders, according to a recent survey sourced from Thomson Reuters, are getting more nervous about the state of the economy. Insider transactions show an overwhelming number are selling their company stock.

The concentration of investor capital in a handful of companies suggests a lack of broader investor confidence. The high valuation levels for technology stocks are a concern. Our investment strategy remains cautious, favoring defensive sectors like Consumer Staples and Utilities and companies generally with higher dividend yields. While these are challenging times, opportunities will always present themselves to purchase stocks at a good price. In the meantime, a prudent and balanced approach is recommended.