STONEBROOKE
ASSET MANAGEMENT

The Commentary

CommonSense Investing

Spring 2024

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Signals Still Mixed

The Canadian economy has seen a reasonable start to 2024. Recent economic indicators remain mixed indicating a slower yet stable outlook. Though the expectations in the labour market were for a gain of 25,000 jobs, the labour market weakened in March shedding 2,200 jobs. The unemployment rate rose to 6.1%, from 5.8% in February, its highest level since November 2021. According to Statistics Canada, the rise in the unemployment rate was attributable to population growth that saw an additional 60,000 people looking for work in March.

The weak employment report for March is unlikely to trigger an earlier than expected interest rate cut. Comments from the Bank of Canada suggest that inflation, particularly the level of core inflation (ex food and energy), will determine the timing of the first rate cut. It is expected the Bank will wait for core inflation to fall sustainably below 3% before considering a rate cut.

Earlier forecasts were leaning for a potential rate cut at the June meeting. This now seems unlikely as inflation is expected to remain troublesome. Moreover, the growth in GDP is robust enough suggesting there is no immediate justification for the Bank of Canada to stimulate the economy by lowering interest rates.

In the U.S., economic activity is also mixed however the rate of growth is generally higher. GDP is expected to remain respectable with forecasts for the first half of the year in the 2 to 3% range. This is up from the consensus forecast at the beginning of the year. Recent data has shown a decline in new orders in both the manufacturing and services sectors. Growth in the technology sector however continues strong. The consumer sector continues to show resilience with positive spending trends. The growth in jobs has averaged about 300,000 per month in the first quarter keeping the unemployment rate low and stable. Wages and salaries continue to rise providing steady income growth.

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S&P/TSX : 22,167	90 Day T-Bills : 4.99%	Oil : $83.20 US	Cdn $: .738 US
S&P 500 : 5,254	10 Yr Cda Bond : 3.45%	Gold : 2,217 US	Euro : 1.46 Cdn

"Sticky" Inflation

Just a few short months ago it was a near certainty that the path of inflation was in a downward trend towards 2%. Inflation would be tamed and return to pre-pandemic levels. While encouraging going forward, we are not returning to the *price levels* of 3 years ago. Statistically the level of inflation has jumped by almost 20% in the past three years. The inflation witnessed to date is *permanent*. Wages have not caught up to this increase. To the extent that they will, inflation will be with us for quite some time.

In the U.S. the markets have changed course and are now expecting 1 to 3 rate cuts for the year, (down from 6 rate cuts at the start of the year). The market is now pricing in September for the first rate cut. GDP and inflation estimates continue to rise, casting a doubt whether any rate cuts will be necessary in 2024. According to Neel Kashkari, President of the Minneapolis Federal Reserve, who had forecast only two rate cuts earlier this year, "if inflation continues to move sideways… that would make me question whether we need to do those rate cuts at all."

The "last mile" of disinflation necessary for the U.S. Federal Reserve to reach its 2% inflation target is proving difficult to achieve. Without an economic slowdown bordering on recession, it is feared inflation will remain "sticky" in the 3% range. Perhaps we have already reached the bottom.

The Ghost of Inflation Past

We were curious to know the prices and values of certain items in the past and how much they have appreciated. Specifically, we wanted to know the price of a few major consumable items along with economic metrics including government debt and deficits. We asked ChatGPT to assist. The table below is the result and while we believe the numbers are fairly accurate, ChatGPT may not have retrieved the data from the best available sources. In some cases, we varied our questions and got slightly different results. Nevertheless, the data below give a fairly meaningful and important reading of how inflation has increased prices through the past five decades;

The 1970's were a highly inflationary decade. By some measures, inflation was more subdued in the 1990's. Not surprisingly, the rise in government deficits and debts is truly astonishing. A huge multiple over the rate of growth of the Consumer Price Index (CPI), which has increased by a factor of 8 times over the 5+ decades. Had the debt increased at the rate of a MacDonald's hamburger, which tracked the CPI perfectly, government finances today would be considerably healthier!

The IMF has weighed in recently, warning the U.S. that its massive fiscal deficits pose a significant risk to the global economy. The U.S. is expected to record a deficit this year of 7.1%. According to the IMF, the U.S. "critically needs to take policy action to address fundamental imbalances between spending and revenues" They also cited China, along with the UK and Italy as countries with excessive accumulated debts.

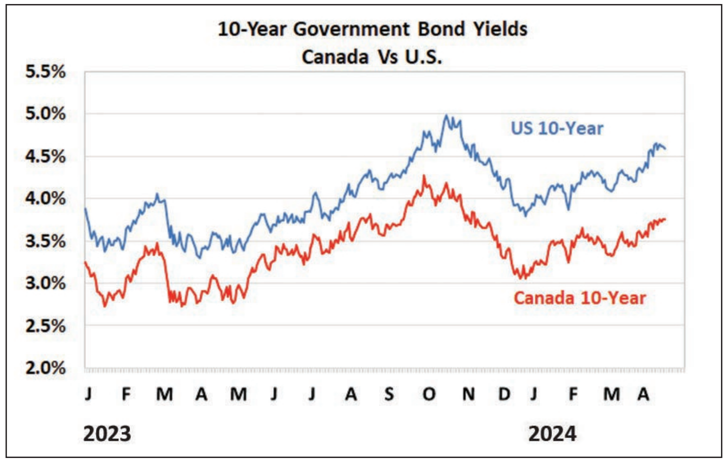
Five Decades of Inflation (U.S.): (1970 - 2024)

	1970	1980	1990	2000	2010	2024
Average U.S. House Price	23,000	68,700	123,000	166,400	221,800	492,300
Average Price of a Car	3,900	7,200	16,000	21,850	29,217	47,244
Average Household Income	8,734	21,023	29,943	42,148	49,445	75,000
U.S. Federal Budget	195.6 Billion	590 Billion	1.25 Trillion	1.79 Trillion	3.46 Trillion	6.2 Trillion
U.S. Federal Debt	370.9 Billion	909 Billion	3.23 Trillion	5.67 Trillion	13.56 Trillion	34.6 Trillion
U.S GDP	1.08 Trillion	2.86 Trillion	5.96 Trillion	10.29 Trillion	14.96 Trillion	27.96 Trillion
Oil Price (WTI)	3.39	37.42	24.53	30.38	79.48	84.82
CPI Price Index	39	82.5	131	172	218	312
Big Mac Hamburger	0.65	1.6	2.59	2.51	3.71	5.15

Bond Market

Interest rates are rising again. The adjacent chart shows the yields on 10-year Government bonds both in Canada and the U.S. Having declined at the end of last year, they have started to move up again here in 2024.

The consensus opinion on the bond market has changed dramatically. The U.S. 10-year yield could again rise to over 5%. With a backdrop of rising oil prices and geo-political tensions, bond investors are adjusting to the higher risk environment. Investors should overweight shorter-term bonds as they offer a higher yield and have less volatility.



Commodity Markets

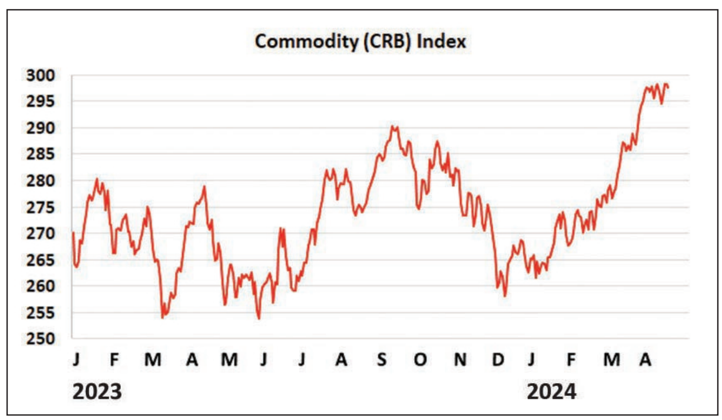
Global economic growth over the next several years will be propelled by sectors such as renewable energy, electric vehicles, big data, and artificial intelligence – sectors that are just burgeoning and promise vast economic potential. Central to this growth is a critical, yet often overlooked element: copper.

Copper is indispensable in today's technological and green revolutions. For instance, the AI sector is experiencing a meteoric rise in demand, anticipated to increase copper demand by one million tonnes per year by 2030, as data centers expand to manage the digital world. The construction of these facilities requires substantial amounts of copper due to its excellent conductivity. Case in point, Microsoft's recent $500 million data center in Chicago utilized a remarkable 2,177 tonnes of copper.

This scenario presents a golden opportunity for Canada, a country rich in natural resources and gifted with significant copper reserves. For Canada to capitalize on this opportunity it will require not only the full operational capacity of existing mines but also the development of new mining projects. This will likely necessitate higher copper prices, reminiscent of the early 2000s when copper prices surged in just three years to meet the demands of China's rapid growth.

Over the coming years, Canada will need supportive government policies and regulatory frameworks that encourage sustainable resource development. With its vast mineral resources and favourable position, Canada has the potential to be at the forefront of supplying the raw materials that will power the future.

Commodity markets generally have begun to move higher. Global industrial production appears to be emerging from its roughly two-year slump, as China and Europe recover. The chart below shows the CRB index plotted over the last fifteen months. This index measures the price direction of a basket of 19 commodities, including crude oil, natural gas, agricultural commodities such as corn and soybeans, and metals, such as copper and aluminum.



The index is up almost 15% this year. The price of oil, a larger component of the index has risen about 20% this year to $85 U.S., while copper has moved up almost 18% to over $4.50 U.S. dollars per pound.

The rise in commodity prices suggests improving global industrial activity. Importantly, the "sticky inflation" narrative is beginning to take hold. The U.S. Federal Reserve will be reluctant to lower interest rates if inflation remains stubbornly above 3%. The Fed's mantra for quite some time has been "higher for longer". If these trends in commodity prices continue, a significant decline in interest rates should not be expected this year.

Gold

The recent surge in the price of gold has gone relatively unnoticed by the mainstream financial media, largely overshadowed by the rise in Bitcoin and the infatuation with the big technology companies. Gold is still considered a significant hedge against inflation, a fact well understood by central banks. Gold, and also silver, have not reached their real highs of 1980, adjusted for inflation. Both metals may be on track to exceed these levels in the period ahead.

The rise in the gold price may suggest a lack of confidence in current Fed policies. Unlike former Chairman Paul Volcker, who defeated inflation by raising interest rates well above the rate of inflation, current Chairman Jerome Powell faces significant constraints due to the overwhelming amount of public and private debt. The prospect of much higher interest rates already risks tipping the economy into recession. Debts are liable to explode higher, further undermining confidence in the Fed's ability to conduct sound monetary policy.

Gold's upward climb may be anticipating an eventual Fed pivot along with a return to Quantitative Easing (QT). This will again sow the seeds for another round of inflation. With the U.S. dollar's status as the world's reserve currency being increasingly questioned, the Fed will be reluctant to inflate the money supply. It is not surprising that foreign central banks are seeking to diversify by accumulating gold reserves.

Equity Market

A remarkable concentration of investment capital has been directed to just seven major companies – the Magnificent 7 – Alphabet, Apple, Microsoft, Meta, Nvidia, Amazon and Tesla. The trend highlights the confidence investors place in these proven technology giants, reflecting their robust performance and pivotal role in the economy. While such concentration might typically raise concerns, it underscores the strong investor belief in the stability and future growth potential of these industry leaders.

Despite a backdrop of high overall valuation levels and increasing competition from cash like deposits offering attractive yields, the technology sector continues to draw significant interest. This may be starting to change. The layoffs at Tesla and the drop in EV car prices has sent Tesla's stock price tumbling this year. Apple as well has declined in price, posting weak earnings and forward guidance. Their heavy concentration in the Chinese market is giving investors pause.

The tech industry's performance has brought comparisons to past technology booms such as during the Dotcom era. The Dotcom boom resulted in a bust which left many investors in a financial bind. It is a reminder for investors to maintain a balanced approach. Yet the anticipation around AI and other emerging technologies continues to drive optimism, suggesting that technology stocks, while volatile, present opportunities for growth and innovation over the longer term.

The transition towards green energy and sustainable technologies is poised to invigorate cyclical and resource sectors as well. The substantial capital investment projected for the green economy indicates a burgeoning field ripe with opportunities and will lessen the risk associated with the current tech-centric investment landscape. A broadening out of investor capital will be welcome and a healthier development for the financial markets.

The market has yet to fully adjust for the "higher for longer" inflation and interest rate environment. A rotation into inflation hedges and cyclical sectors is beginning. The next several months and quarters may be challenging for the stock market while it attempts to redeploy capital and adjust for higher-than-expected inflation.

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