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Summary 2024

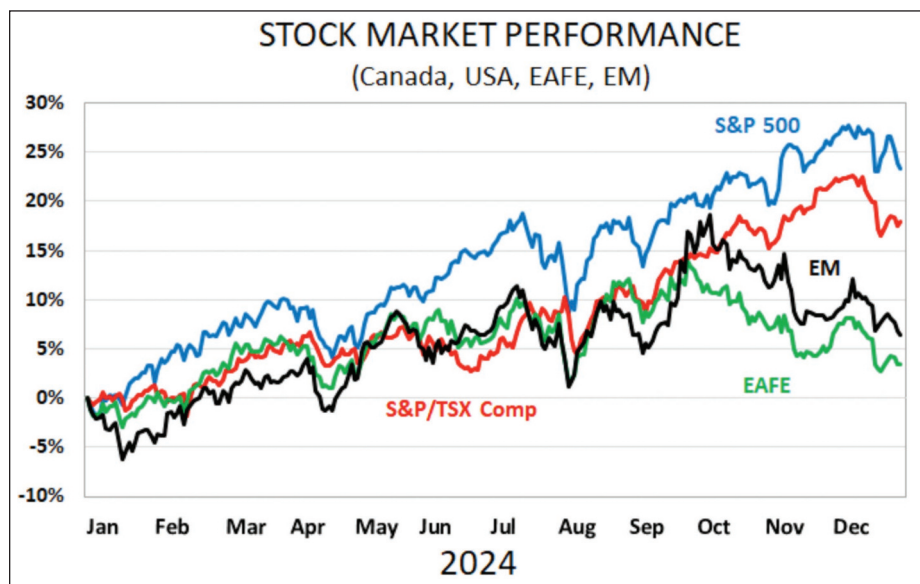
Financial markets performed well in 2024, led primarily by a modest economic growth environment and an improvement in the inflation data. Artificial Intelligence (AI) was the headline story, with the anticipation of exciting and prosperous times ahead.

The U.S. stock market, as per the S&P 500 index, advanced by 23%, while in Canada the S&P/TSX Composite price index was up 18%. Overseas markets fared poorly with Europe and Asia (EAFE) up only 4% and Emerging markets (EM) up 6.5%. In the bond market, yields were fairly stable, showing a rising trend in the last quarter. Canada 10-year bond yields finished the year at 3.2%, and investors received only modest returns from bonds of just under 3%.

The broad commodity index was up about 5.5%, restrained by weak demand in China. However, gold prices surged by 27%, partly reflecting investor concerns over fiscal matters. Oil markets were essentially flat with the WTI (West Texas Intermediate) price finishing at \$71.7 USD. Aluminum was up 8% and Nickel was down by 8%.

The Canadian dollar dropped about 8% vis-a-vis the U.S. dollar, which reached its highest level since 1973, influenced by relatively robust U.S. economic performance and higher interest rates.

The chart below shows the performance of the major stock market indices represented by the S&P/TSX Composite, the S&P 500, EAFE and the EM index. Performance is in USD except for Canada. The US stock market was again the outperformer in 2024.



A New Year of Uncertainty

As we begin 2025, the economic and political landscape is marked by heightened uncertainty, presenting investors with an unusually complex set of challenges. From the policies of the incoming Trump Administration to global geopolitical tensions, distorted cyclical and inflation signals, and the unrealized promise of AI, a myriad of factors will shape the year ahead. Some of the key risks include potential policy errors in China and Europe, debt and leverage in government and the financial system, and a likely U.S. equity bubble driven, to a large degree by “giddy” investors’ faith in the AI revolution. This uncertainty underscores the need for cautious and adaptive strategies, as the potential outcomes for portfolio returns could diverge widely.

Having escaped recession last year, the U.S. economy faces a higher likelihood of entering a recession in 2025, or 2026, although the possibility of ongoing stimulative policies driving moderate growth cannot be dismissed. A stimulative fiscal policy kept the U.S. out of a recession in 2024. Similarly, while the Federal Reserve is expected to ease, a cautious and delayed approach could increase the risk of a policy misstep. Focusing

on precise economic data or data believed to be important to investors, is often fraught with disappointment. There are potentially multiple paths ahead adding to the uncertain environment in the period ahead. It is a time to be emphasizing the importance of diversification, patience, and flexibility.

Trump 2.0 starts his second term with a debt of \$36.5 trillion. In 2016, his first term in office, he inherited a debt of \$19 trillion. The size of the economy, or Gross Domestic Product (GDP) in 2016 was \$20 trillion, today it is \$30 trillion. The debt is growing much faster than the rate of economic growth. If maintained, Trump will exit in four years with a debt of almost \$45 trillion. Current estimates range from \$4 to 8 trillion in additional debt over the next four years.

Given the growing concern with rising debts and the risk of a market correction, it is an opportune time to adopt a selective and safer approach to equities. By staying disciplined and ready for opportunities, we are prepared to navigate the uncertainties of 2025.

Do Rising Yields Matter

The stock market has shown remarkable resilience over the past two years in the face of higher interest rates. Historically, high and rising interest rates have been associated with downward pressure on stock valuations. This has primarily been significant during extreme rate increases of 3% or more. For the most part, modest and more gradual rate increases, when combined with stronger nominal economic growth, can actually support earnings growth and provide a solid foundation for equity markets. While the bond market will remain a critical factor, higher rates suggest that equity leadership may continue to concentrate in sectors less sensitive to interest rate fluctuations.

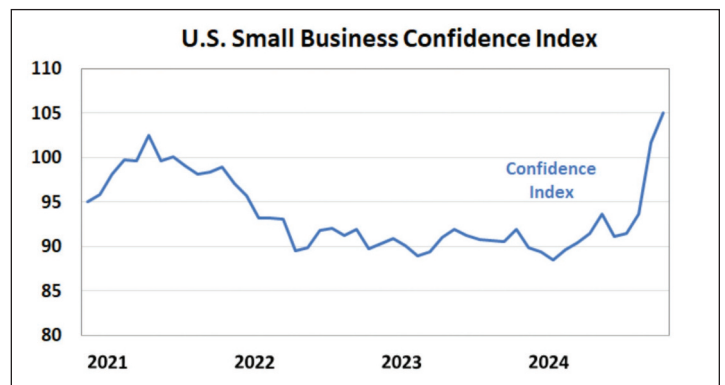
Despite a year-end dip, equities delivered good returns in 2024. Though inflation remains a concern, and long-term yields are still elevated, higher rates may not necessarily spell trouble for stocks. Interest rates and equities share a complex relationship, with small rate increases historically having minimal impact on valuations. Faster economic growth often accompanies rising rates, offering a silver lining for investors. By focusing on

companies with strong earnings potential and cash flow, the equity market can navigate the challenges posed by higher rates while continuing to provide opportunities for growth.

Rate increases during a strengthening and growing economy are typically taken well by the markets. For example, the period from 2016 to 2018 was characterized by a progressive and steady rise in yields, starting at around .5%. Stock markets performed well throughout until the final quarter of 2018, when short-term interest rates climbed to almost 3%. The stock market responded with a decline of almost 20%.

Looking ahead, higher interest rates may continue to encourage investors to purchase the large cap growth and technology companies that are less affected by rate changes. These businesses, with robust balance sheets and cash-flow momentum, are well-positioned to again lead the market. Conversely, sectors reliant on raising capital or refinancing debt, or those primarily valued for their dividend yields may face headwinds.

Small business confidence has recently turned up sharply. The percentage of U.S. business owners expecting the economy to improve rose to its highest reading since the 4th quarter of 1983. The surveys have turned very positive since the U.S. election. Uncertainty had prevailed in 2024 with one third of CFO's indicating they were postponing capital investments and hiring ahead of the election. While these surveys are “soft” indicators, they often give way to actual business expansions.



The Threat of Tariffs

The new Trump administration is threatening to impose tariffs on all goods entering the U.S. He has singled out Mexico and Canada for a 25% tariff, in order to stop the flow of fentanyl and illegal migrants into the U.S. Trump is considering 10% tariffs on imports from China and on the European Union.

A 25% tariff would be shocking for the Canadian economy. Approximately 75% of Canada's exports are sent to the U.S. The Canadian Chamber of Commerce has stated that \$3.6 billion per day in goods cross the Canada-U.S. border, fueling a \$1.3 trillion annual trade relationship, and accounting for 3.7 million jobs for Canadians and Americans.

The USMCA trade agreement between Canada, Mexico and the U.S. is scheduled for review in 2026. If the Trump administration goes ahead and increases tariffs, it would violate the terms of the agreement. It seems unlikely therefore to be a genuine threat. According to Oxford Economics, a leading global advisory firm, the imposition of a 25% tariff across the board, would reduce trade by 50 to 60% and plunge Canada into a

recession. It would also harm the U.S. and push up inflation. North America has a highly integrated economy which if disrupted will harm all parties. For this reason, it is unlikely tariffs of 25% will be implemented.

Using tariffs as a bargaining chip is not the way to solve illegal migration and the illegal drug trade. This is likely a trial balloon and a warning to negotiate a better USMC trade deal. Moreover, Scott Bessent, the new U.S. Treasury secretary is not partial to tariffs. He has suggested instead that tariffs should be introduced gradually and at lower amounts.

Importantly, tariffs impact three parties: the exporter; the importer; and the end consumer. They all share the costs. To the extent the additional costs reach the consumer and add to inflation depends on many factors and whether prices can be absorbed with reduced profit margins, or passed on due to competition dynamics for the products involved. While complex, tariffs are not necessarily a catastrophic event providing the level is low. Businesses will adapt.

Bitcoin & Gold

Bitcoin continues to gain acceptance as a new asset class. Investors are eagerly purchasing the newly created Bitcoin exchange-traded funds. In just their first year, the 12 new Bitcoin exchange-traded funds in the U.S. have amassed almost \$120 Billion. A remarkable rate of growth for a new investment product.

Bitcoin's most recent price advance breaching \$100,000, has occurred post the U.S. election with the Republican victory. This new administration is decidedly more crypto friendly. Cabinet appointments at both Treasury and Commerce departments are crypto advocates, as is the new Chairman of the Securities and Exchange Commission (SEC), replacing Gary Gensler who was notoriously anti-crypto.

To some extent, Bitcoin, similarly to Gold, is being characterized as a safe-haven asset. This positions Bitcoin as an investment offering protection against the risks of hyperinflation, banking system failures, or expropriation.

However, Bitcoin has a unique advantage over Gold. It is easily divisible and can be instantly transacted. This gives Bitcoin significantly more appeal as an asset class. With a market cap just over \$2 Trillion, investors regard Bitcoin as a viable new

asset class worthy of diversification. While volatility has been an unwelcome feature, the desire to buy and hold Bitcoin could see it reaching valuations approaching that of Gold, at approximately \$18 Trillion.

At a New York Times summit in December the head of the Federal Reserve, Jerome Powell said he is fine with crypto companies doing business with banks as long as they do not threaten their "health and well-being". Regarding Bitcoin, he said it is not a competitor for the U.S. dollar, it's a competitor for Gold.

There have always been, and still are, naysayers claiming Bitcoin is just a "Ponzi scheme" with no useful value. Still, in just over 15 years since its inception, it appears vindicated having firmly established itself as a financial asset. With a new Bitcoin friendly administration entering the White House, the longer-term outlook appears promising.

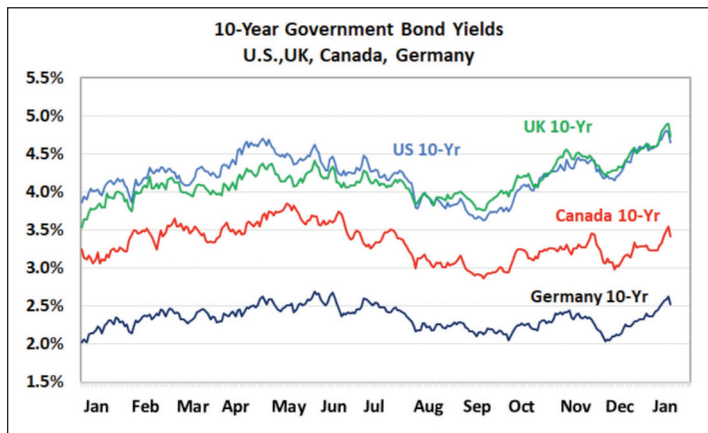
In the case of both Gold and Bitcoin, their value comes from the collective belief that they cannot be easily confiscated in a fiat monetary system. For investors around the globe, a certain proportion of total wealth held in these assets makes sense, as an insurance against hyperinflation, banking system failure, or state expropriation.

Bond Market

Global bond markets recently, are witnessing a rise in yields, with 10-year government bond yields climbing across the major economies. The adjacent chart shows the bond yields for the U.S., U.K., Canada and Germany. Bond yields are even rising in Japan. This upward trend in global long-term yields can be viewed from two key perspectives: expected inflation, and the

risk premium, which accounts for uncertainty. While there is some recent increase in inflation expectations and concerns about fiscal sustainability, this only partially explains the rise in yields. The larger and more serious factor is the bond market's unease and its readiness to price in higher uncertainty.

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The rise in inflation expectations is still modest and therefore not the primary driver of higher yields. Inflation expectations have barely changed, and international surveys, along with evidence of wage moderation, suggest inflation pressures are relatively contained. Instead, fiscal policy and geopolitical tensions are gaining prominence in explaining the increase in yields, pointing to the critical role of the risk premium. This reflects the additional

compensation investors demand to hold long-term government bonds, influenced by growing uncertainty and a shift in market confidence. This is being observed in France with French sovereign bond yields edging higher than corporate bond yields. Perhaps this is a sign of things to come in other western markets.

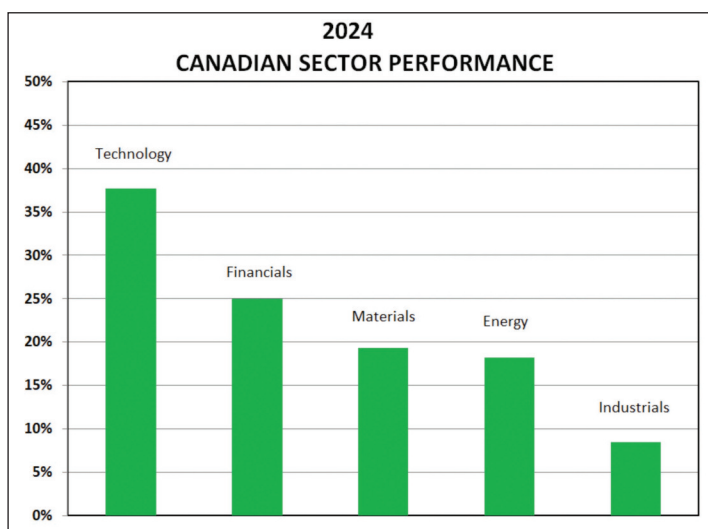
Looking ahead, greater clarity is likely to emerge in the coming months, with key developments such as fiscal policy decisions and trade negotiations shaping the direction of bond yields. This environment presents both challenges and opportunities for investors, as markets adapt to shifting expectations and rising uncertainties. As the global economy navigates these changes, the resolution of current uncertainties could pave the way for more stable and informed investment decisions, signaling a potential return to confidence and equilibrium in bond markets. Ultimately, rising bond yields are always problematic for the stock market.

High-quality corporate bonds and shorter-term government bonds are currently recommended. While near-term risks remain in the bond market, conditions for long-term outperformance are expected by year-end. In the interim, the higher interest rates on T-bills and shorter-term securities offers an attractive option for cautious investors.

Stock Market

Investors' narrow focus was again a feature of the stock market in 2024. The big U.S. technology companies dominated at the expense of the broader market. Investor capital concentrated on a handful of companies - Apple, Amazon, Google, Meta, Microsoft, and Nvidia. As a result, the S&P 500 index was up 23%, while small cap stocks were up 11.5%, and global stocks, excluding the U.S. and Canada were up 4.3%.

The S&P/TSX Composite price index was up by 18% in 2024. The bar chart below shows last year's performance of the top five sectors. The Technology sector outperformed in 2024, advancing by 38%. The Financials, Materials and Energy sectors performed well. Not shown on the chart was the dismal performance of the Communications sector, down 26.5%. BCE, the heaviest weight in the sector, declined by an astonishing 36%.



There is a huge valuation differential in global stock markets. Growth stocks in the U.S. are priced at historically peak valuations with price-to-earnings (P/E) multiples at extreme levels. This is reflected in the main international indices. According to FactSet, the MSCI all-country index has a forward P/E ratio of 13.4, while the S&P 500 has a forward P/E ratio of 22. Furthermore, a number of these U.S. large growth companies, Apple and Tesla in particular, have recently had very mediocre results.

Capital flows from foreign sources are certainly a factor elevating U.S. stock markets. The slowdown in China and in Europe is bringing money to the U.S. as investors seek better returns.

According to Ed Yardeni, a renowned economist and president of Yardeni Research, foreigners have been purchasing U.S. stocks at a record pace, \$76.5 billion over the last three months. Foreign investment is typically trend following and usually late to the party. As Yardeni mentions, "Their buying has a record of being a contrary indicator. They tend to be big buyers right before bear markets."

A good lesson from history comes from Princeton professor of computer science Arvind Narayanan. He recently told Bloomberg, "I have no doubt that AI will eventually create wonderful products and terrific businesses built upon them once again, but it may take, "a decade or two," "When a new technology appears, it attracts huge amounts of capital. There is physical investment on a massive scale. This inevitably leads to overinvestment, creating bad returns, and then the whole thing collapses. It's usually in the ruins of the first investment bubble where you can identify the truly productive uses of the new technology."

In equity markets, selectivity and a defensive focus will be important in 2025. Purchasing companies with good fundamentals and priced appropriately to their underlying growth prospects will be an important factor in managing risk.