STONEBROOKE
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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
www.stonebrooke.ca

Changing Narrative

The volatility in financial markets experienced this summer appears short-lived as central banks have shifted their focus from a restrictive to a more balanced approach between managing growth and inflation. With inflation pressures cooling, central banks worldwide have started to lower short-term interest rates, not because the economy is weak but as a preventive measure to avoid future economic weakness. The narrative has changed to pacify concerns over lowering interest rates. The aim is to stabilize growth and mitigate the risks of an economic downturn, rather than addressing any existing or pending crisis.

The recent cut in the Fed funds rate by 50 basis points, lowers the target range to 4.75% - 5%. With consensus expecting a .25% cut, it was a surprise move. The Federal Reserve statement noted: "The Committee has gained greater confidence that inflation is moving sustainably toward 2%, and judges that the risks to achieving its employment and inflation goals are roughly in balance."

While there is optimism that monetary easing can prevent an economic slowdown, the balance of risks may have risen, especially geopolitically. In addition, China, the world's second largest economy, is slowing, marked by reduced domestic demand. Increased competition in global export markets poses additional challenges, further complicating the global economic outlook. Still, policymakers are expected to reduce rates to their longer-term equilibrium levels. The U.S. Federal Reserve is expected to gradually reduce rates by 25 basis points at each meeting through 2025, dependent on domestic labor market conditions.

From a financial market perspective, lower interest rates could not come soon enough. The shift in policy to lower rates has been greeted enthusiastically. Central banks have significant room to lower rates more aggressively. This flexibility will be important since many countries face fiscal constraints due to large budget deficits and accumulated debts, making it challenging for government fiscal policy to support economic growth. Uncertainties remain, especially since central banks have often been criticized for mis-managing monetary policy. For now, investors believe the narrative that lowering interest rates is not a signal of near-term economic weakness developing.

S&P/TSX : 24,000	90 Day T-Bills : 3.96%	Oil : $70.60 US	Cdn $: .74 US
S&P 500 : 5,762	10 Yr Cda Bond : 2.95%	Gold : 2,663 US	Euro : 1.49 Cdn

Deficits Do Matter, Again

Until recently, the alarm bells on government debt and deficits had been silent for the past two years. Articles about their growing size and potential dangers are resurfacing. Some high-profile hedge fund managers have also weighed in on the expanding U.S. budget deficit. While deficits are an important issue, the U.S. election may be the catalyst for the sudden headlines. Each party is accusing the other of being responsible for the increase in debt. Historically, deficits have been non-partisan.

For the fiscal year ended September 30th the U.S. deficit came in at $1.83 Trillion. Below is a table of the U.S. budget going back to 2019, the pre-Covid fiscal year. In the five years since 2020, the deficits added up to almost $12 Trillion, increasing the total outstanding debt from $23 Trillion to more than $35 Trillion.

U.S. BUDGET

	2019	2020	2021	2022	2023	2024
Outlays -	$4,447	$6,552	$6,818	$6,272	$6,134	$6,752
Receipts -	$3,462	$3,420	$4,046	$4,896	$4,439	$4,919
Deficit -	-$985	-$3,132	-$2,772	-$1,376	-$1,695	-$1,833
Total Debt	$23,201	$27,027	$28,429	$31,124	$33,167	$35,465

Importantly, in the next year a total of $9 Trillion is scheduled to mature. This will need to be rolled over into new debt along with financing another expected deficit in 2025. There appears to be no end in sight to amassing large debts and deficits. After the next administration leaves office in four years, the total debt outstanding will likely surpass $40 Trillion, and easily on its way to $50 Trillion in the event of another recession.

Canada is also deeply indebted and ranks among countries with the highest household debt, which exceeds 100% of Gross Domestic Product (GDP). Federal government debt has soared in the past four years and now at C$1.14 Trillion. This is up from only C$721 Billion in 2020.

Bond Market

The bond market has witnessed some instability in recent weeks, as yields have firmed. Still, bonds are increasingly attractive for investors seeking steady returns. The 10-year U.S. Treasury bond currently yields 4.20%, up about .5% in just the past few weeks. Although some analysts are anticipating a rise towards 5%, recent economic trends suggest bonds are offering good value, particularly in a market that had averaged just over 2% for more than a decade. While there are concerns over fiscal and monetary policies, bonds are positioned as a sound investment choice.

In Canada, bond yields are lower with the 10-year government of Canada bond yielding about 3.25%. Canadian yields have trended lower than U.S. yields for quite some time. Still, investors are able to generate higher yields in shorter-term bonds and in corporate investment grade bonds. Several factors will likely support bond yields at these levels. A combination of global investment inflows and institutional interest at these higher yield levels are a strong source of demand. For those seeking safety and reduced volatility, bonds present a compelling and secure alternative.

With core inflation falling, the Bank of Canada is expected to lower short-term interest rates by another .5% before the end of the year. Some market strategists suggest that rate cuts of 1% or higher are possible. According to the Bank, some measures of inflation are already below 2%. Tiff Macklem, Bank of Canada governor, recently stated "with inflation getting closer to the target, we need to increasingly guard against the risk that the economy is too weak, and inflation falls too much".

Nevertheless, lingering fears of inflation remain. Less so in the short term as inflation expectations appear to be heading in the right direction. However, a common refrain is that inflation will be more difficult to vanquish over the next several years as global economic activity picks up. Bond investors will also demand higher longer-term yields due to the many geopolitical uncertainties in this multipolar world.

Moreover, the yield curve, which had been inverted for almost two years, i.e. short-term interest rates higher than longer-term rates, has now "un-inverted", or normalized. Some economists believe this signals the start of an economic slowdown. While this has been observed historically, it is typically accompanied by quick declines in the Fed funds rate. The conditions today do not suggest a need for drastic rate cuts.

BRICS Building Bricks

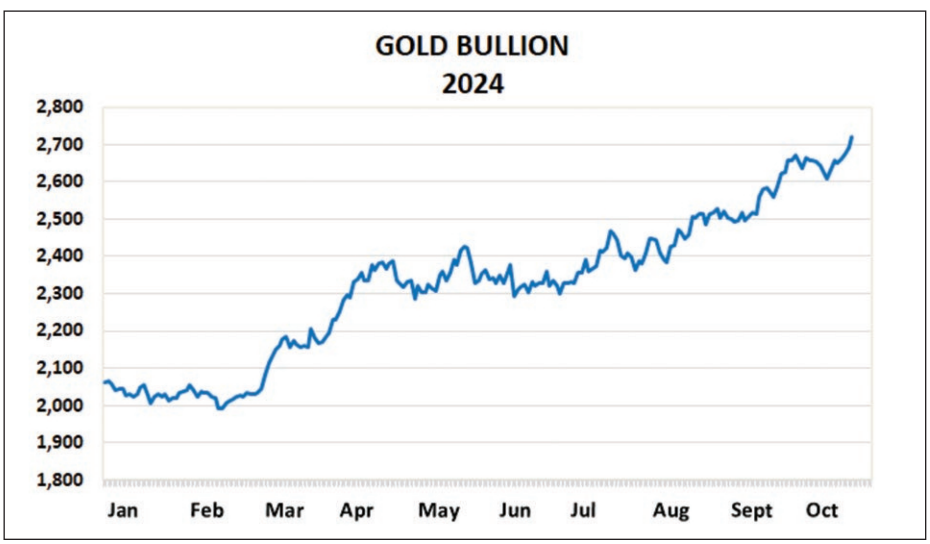
BRICS is the acronym for an intergovernmental organization consisting of Brazil, Russia, India, China and South Africa, along with other member states. It is expanding rapidly with the aim of building its own institutions to cooperate on trade and development. The combined GDP of the current BRICS nations account for 35% of global GDP, well ahead of the Western based G7. BRICS member states represent 45% of the world's population and the combined growth rate is projected at 4%, significantly higher than the G7.

BRICS is working on a settlement system for international financial transactions. In a recent statement the organization acknowledges "the need for a comprehensive reform of the global financial architecture to enhance the voice of developing countries and their representation." Russia and China, especially, are fully engaged and recognize the need to diversify away from Western controlled institutions.

For now, BRICS is welcoming the use of local currencies in international trade and is developing banking networks to enable them. While some are suggesting this is a strategic move away from the U.S. dollar, displacing the world's reserve currency is not an easy task, or even desired. It certainly will not be achieved overnight. Those claiming the U.S. dollar is destined to be dethroned as a reserve currency have been crying wolf for decades. BRICS may eventually be successful in establishing a common currency. It will likely take a decade, and as we have witnessed with the Euro, a bit of competition is not a terrible thing.

Gold

Gold remains a viable investment choice *over the longer term*, recognized for its ability to hedge against inflation and preserve wealth amid economic and political uncertainty. While recent investor attention has centered on tech stocks and digital assets like Bitcoin, gold's steady appreciation underscores its enduring role. Central banks globally acknowledge its importance and have been increasing their reserves as a safeguard against currency devaluation and market volatility. Notably, the price of gold, as well as silver, remain below their inflation-adjusted peaks from the 1980s. Both metals have performed well this year and the potential for further gains appear promising.



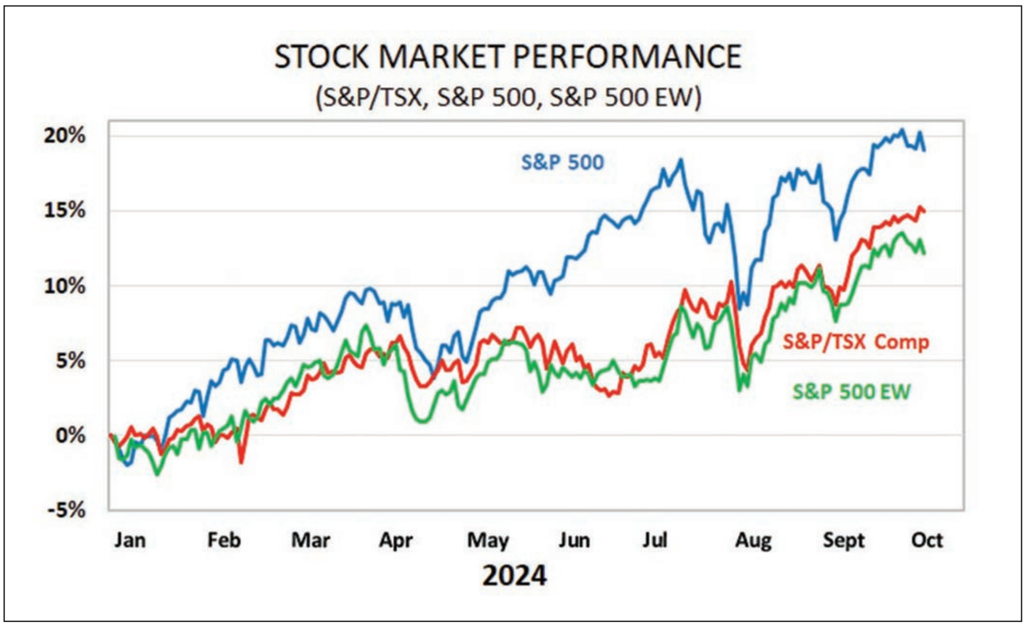
Investor interest in gold this year may reflect broader concerns over the effectiveness of current monetary policies. With the U.S. Federal Reserve constrained by significant public and private debt levels, aggressive rate hikes to counter inflation pose recession risks. This environment has heightened awareness of gold's stability compared to traditional assets, particularly as confidence in U.S. monetary policy faces challenges. Unlike previous cycles, when high interest rates effectively controlled inflation, today's economic landscape is more complex, leaving room for gold to play a critical role as a protective asset in uncertain times.

With the pivot in Federal Reserve policy toward easing and a potential shift away from the U.S. dollar as the global reserve currency, the case for gold grows stronger. Many foreign central banks and investors have increased their gold reserves to diversify. There appears to be a global trend towards greater security in tangible assets. As these economic dynamics unfold, gold not only provides a hedge against inflation but also serves as a prudent long-term investment, shielding investors from potential policy-induced inflation and fostering stability at a time of evolving financial conditions.

Portfolio Strategy

We continue to recommend a balanced portfolio structure as a prudent approach in today's market. While the U.S. technology sector has driven significant gains and added momentum to the overall market, current valuations remain high. Stocks, however, continue to show resilience and may advance further on positive investor sentiment. A balanced portfolio with a strong Canadian investment focus aligns well with current market dynamics, offering stability while remaining poised to capture growth.

Looking forward, we remain open to significantly increasing U.S. exposure based on favorable exchange rate movements or corrections in U.S. stock prices. This flexibility allows us to adapt to evolving market conditions while safeguarding capital and fostering sustainable returns. By maintaining a well-diversified portfolio, we aim to support steady growth and take advantage of opportunities across both Canadian and U.S. markets as conditions develop.



U.S. Hedge funds and investors continue to hold substantial positions in the top 10 technology & growth stocks. Bloomberg has reported that the average hedge fund is highly concentrated on just a select number of U.S. companies, more than at any time in the past 22 years. The average fund holds 70% of their portfolios in their top 10 positions. Portfolio concentration has always ended up being a risky strategy.

Gold is a component of our investment strategy, providing stability and growth potential in light of ongoing monetary expansion. Gold has performed well this year. We have investment positions in the Balanced Fund comprised of the gold ETF's GLD and GDX, and positions in the companies Agnico Eagle, Alamos Gold and Franco Nevada.

We believe this is an opportune moment to carefully position for longer-term opportunities. Markets will eventually adjust to a period of higher inflation and interest rates. A shift towards inflation-protected assets and cyclical sectors is already beginning. Certain commodity prices are rising. Copper demand is expected to rise significantly in the coming years with the growth of electric vehicles, datacenters and renewable power. According to some estimates, the coming Artificial Intelligence boom will require one million tonnes of copper per year by 2030.

Finally, regarding the U.S. election, it is too close to call. This is nothing new, nor is this election any more or less important than the last one. Every election seems to be crucial and the most important. The hysteria among some voters and the media is certainly high. When the dust settles and the election results are in, it will be back to business and politics as usual until the next election in four years time.

It is difficult to say whether the Democrats or Republicans are better for the economy *going forward*. The next administration starts with a huge fiscal mess. Deficits will need to be addressed, and the proposed trade tariffs promised by each party have the potential of making things challenging for international trade.

As we move forward into 2025, we are committed to carefully managing risk and making prudent adjustments to ensure that portfolios are well-positioned to navigate the evolving landscape.

Stonebrooke Asset Management Ltd.
Waterpark Place 20 Bay St., 11th Floor, Toronto, ON M5J 2N8
344 Lakeshore Rd. E., Suite B, Oakville, ON L6J 1J6
Tel: 416.850.2172 Email: info@stonebrooke.ca www.stonebrooke.ca