GLOBEINVEST CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

DECEMBER 2023

UPCOMING 2024 BNN SHOWS

Christine: January 22 @ 12 pm

Christine: March 21 @12 pm

Financial markets ended the year with an impressive finish in the fourth quarter. Technology stocks extended their gains and, as measured by the NASDAQ Composite price return, staged a stellar rebound after their abysmal performance in 2022. The bond market also participated in the rally, posting a positive return after two consecutive years of negative performance.

Catalysts behind the shift from the dour mood of financial markets in late October included: (1) the retrenchment in the yield of the U.S. 10-Year treasury from its October 19th peak of 5.0% to 3.9% at year-end, (2) inflation receding at a steady pace towards the Federal Reserve's target range, (3) a healthy U.S. employment situation, (4) a widely anticipated recession that didn't materialize, and (5) U.S. Fed Chairman Jerome Powell's dovish pivot on the timing of interest rate cuts to prevent monetary policy from becoming too restrictive.

Lower interest rates, a growing economy, and corporate profit growth will likely be required for stocks to hold their price gains and further appreciate in 2024.

Interest Rates

As we enter 2024, there is widespread consensus that rate cuts are coming, and coming soon. While the market-implied odds of a rate cut at the Federal Reserve's next meeting at the end of January currently stand at just 11%, these odds increase to almost 80% for the following meeting in March. Cumulatively, by the end of 2024, the market expects the Fed funds rate to be 150 basis points lower than it is today. In Canada we see a similar story, with rate cut odds at 17% for the Bank of Canada's January meeting, increasing to 78% by early April; cumulatively, the market expects the Bank to cut rates by almost 125 basis points before the end of 2024.

On the one hand this monetary easing could be bullish for equities since lower rates increase the present value of a company's future cash flow. On the other hand, rate cuts frequently accompany a slowing economy, which would mean slowing revenue growth for these same companies. Chart 1 illustrates what history has to say on the matter. It shows the median performance of the S&P/TSX Composite Total Return Index around the start of Bank of Canada bank/target rate cutting phases since 1981. You can see that while equities typically sold off just before and just after the first rate cut, this underperformance didn't last long. By the end of the 52-week period following the initial cut, the index had bounced back significantly. Given that this market volatility has happened in a span of just a few weeks, this shows just how difficult – or perhaps impossible – it is to time the equity markets by anticipating the actions of central banks.

Inflation

The pace at which inflation comes down will dictate how quickly central banks cut interest rates. The U.S. Fed acknowledged at its December meeting that inflation has declined much faster than they previously expected. The Fed's preferred measure of inflation, the core PCE deflator, was 3.2% annualized in November, down from 5.0% at the start of the year. Goods inflation has plunged to deflationary levels while services inflation has been slower to recede. The latter is expected to dissipate as the rents component continues to drop. Powell noted interest rate cuts will start before inflation hits the 2% target because holding rates steady as inflation falls would lead real rates to rise and policy to become too restrictive.

Canadian CPI has held steady at 3.1% in recent months, with core CPI at 3.5%. The shelter component (rents and mortgage interest) is keeping core CPI resilient, an outcome of a deficiency of supply compounded by rising immigration.

The Economy

Economic growth in 2024 should continue to slow as the lagged impact of high interest rates is fully absorbed.

In Canada, economic growth, as measured by real GDP, contracted in the third quarter of 2023 and conditions have not improved since. Slower hiring and steady labour growth has continued to put upward pressure on the unemployment rate, which is now approaching 6.0%. Inflation should abate over time as these sluggish growth conditions persist.

In contrast to Canada, the U.S. unemployment rate has remained below 4.0% for 22 consecutive months, the longest stretch since the 1960s. The employment rate for prime-age (25- to 54-year-old) women hit an all-time high of 75% in 2023. Admittedly, the unemployment rate is not a leading economic indicator, but its resilience so far may be an important cushion against policy mistakes the Federal Reserve could make.

Leading Economic Indicators

Many leading indicators continue to signal a potential recession will materialize. The U.S. Treasury yield curve has been inverted since July 2022, with the spread between the 10-year and 2-year treasury bonds at negative 39 basis points. Notably, however, the spread has been narrowing.

The Conference Board Leading Economic Index (LEI) has declined for 20 straight months, a run that historically would indicate a recession is imminent (Chart 2). Ed Yardeni argues that this time the LEI's signal may be misleading. He notes the LEI's ten leading components collectively overrepresent the goods sector of the economy, which has been experiencing a rolling recession since early 2021 initially due to supply chain bottlenecks followed by weak demand and inventory destocking.

Corporate Profits

Based on consensus estimates, a profit recession is not expected in 2024. While earnings per share (EPS) for the S&P 500 companies are expected to be up a meager 3.1% in 2023, profit growth is expected to accelerate to 11.1% next year, suggesting a soft landing for the U.S. economy. For the TSX companies, EPS is forecast to contract 4.8% in 2023, and then grow 9.1%.

Over the coming months management teams will provide clarity regarding their profit outlook for 2024 and should current consensus forecasts hold, it will be supportive for stock valuations.

Geopolitics

Geopolitical tensions remain elevated around the world. The Russian/Ukraine war is ongoing, approaching two years in duration. The Israeli-Palestinian conflict, escalated by the Hamas invasion of Israel on October 7, continues. The authoritarian regimes of Russia, China, Iran, and North Korea are coordinating their efforts to maintain their respective dominance. The United States is increasingly divided politically and will be tested by the upcoming 2024 presidential election.

The world has always been a neighbourhood of conflicting forces, measured by periods of complacency. The global economy adapts to changing geopolitics and inevitably this presents investment opportunities within industries and companies. More recently, these include onshoring/nearshoring of production plants, defense spending and shift to renewable power sources.

AI

In January of last year ChatGPT was crowned the fastest-growing consumer software application in history, which helped kick off an incredible bull market for just about any stock related to artificial intelligence. The chipmaker Nvidia Corp. (NVDA-NASDAQ) was perhaps the biggest beneficiary of this exponential demand for AI-related tools, as its share price rose a remarkable 238% in 2023.

However, looking at the calendar-year 2023 returns of NVDA doesn't tell the whole story about how AI hype, and the corresponding stock performance, unfolded during the year. If we look at just the second-half 2023 returns of NVDA, we see that the stock was up a much more subdued 17%. This happened despite demand for the company's products continuing to increase at a staggering rate. For example, in August the company reported quarterly revenues that increased 88% from the previous quarter, well above consensus estimates of a 54% increase. Despite this, the stock decreased 2% on the back of the quarterly results. Similarly, when the next quarter's results were reported in November, revenue of $18.1 billion was well above consensus estimates of $16.1 billion, yet the stock also sold off almost 2% on the news.

To us, this highlights the difference between a good company and a good stock. While we do believe that AI is a revolutionary technology with much of its potential still untapped, we also believe that today's market valuations have already priced-in much, if not all, of this potential. We also believe that the market is not pricing in any potential missteps from or increased competition for many of today's AI incumbents. In other words, we think that many of today's AI stocks are priced for perfection, which leaves little margin of safety for the future disruption that inevitably comes to any early-stage, high-growth industry.

Staying Invested

We have always advocated for staying invested in quality income and growth companies over economic cycles and let the power of compounding to grow wealth over the long term. As chart 3 illustrates, since 1928, stocks, as measured by the S&P 500 Price Index, go up more often (about 70%) than they go down. For insight into 2024, historically, when the S&P 500 Index gains over 20%, subsequent year gains averaged 9.7%, barring a recession. Whilst losses averaged 10.1% in the following year when a recession unfolded, not all recession years are accompanied by losses. Our philosophy of investing in well-managed, financially sound companies remains undeterred.

Best wishes to all of you for a healthy and prosperous New Year!
Christine Poole, MBA, CFA
Alexander MacDonald, CFA, P.Eng., MBA

CHART 1: Performance of the S&P/TSX Composite Total Return Index Around Bank of Canada Rate Cuts
- *Bloomberg Finance L.P., Statistics Canada, GlobeInvest Capital Management Inc*

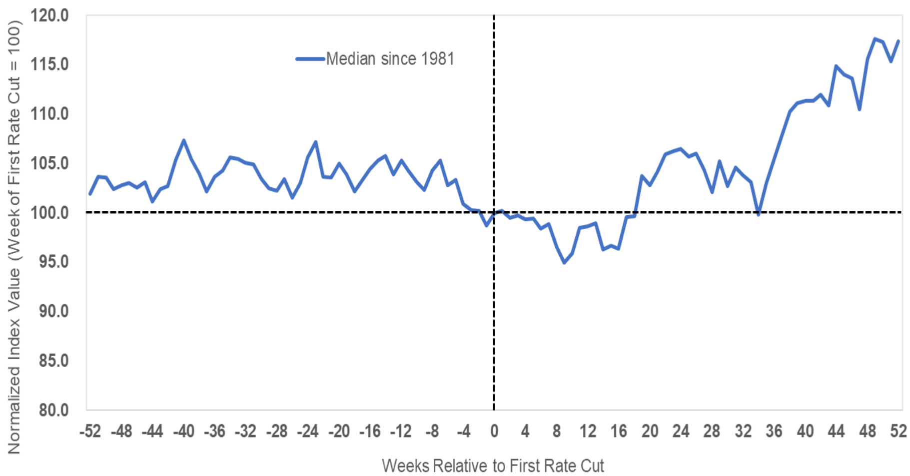


CHART 2: Leading Economic Index (Level, 2016=100)
- *The Conference Board and Wells Fargo Economics*

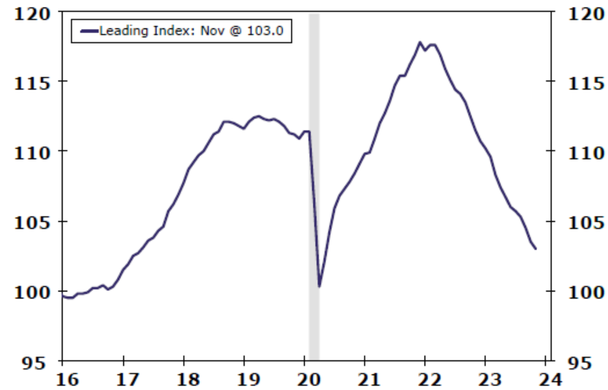
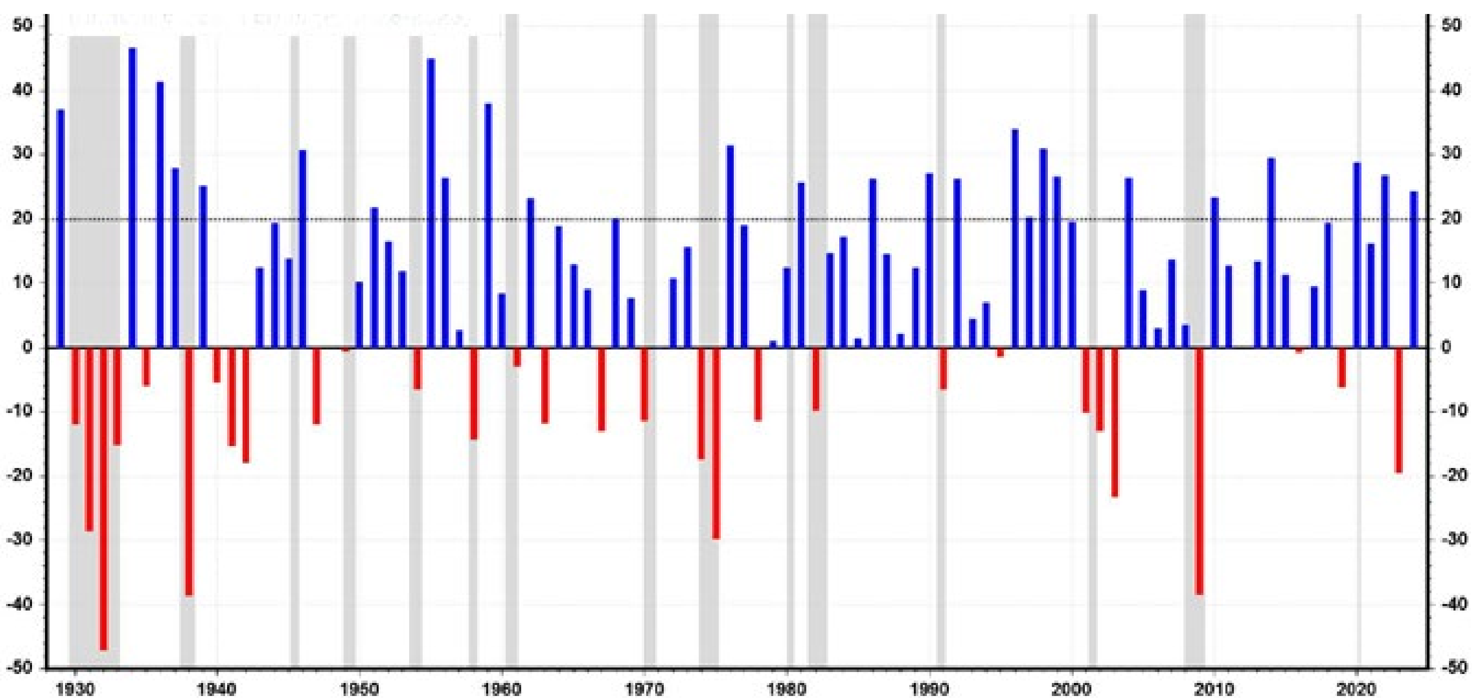


CHART 3: S&P 500 Stock Price Index (annual percent change, 1928-2023)*
- *LSEG Datastream and © Yardeni Research*



*Annual percent changes based on yearned value except 1928, which uses January 3, 1928 for yearned 1927

RECENT BNN SHOWS

Christine: December 21, 2023

Christine: November 23, 2023

Alexander: October 30, 2023

Christine: October 23, 2023

Christine: September 21, 2023

Christine: August 25, 2023

Alexander: August 14, 2023

Christine: July 13, 2023

Christine: June 13, 2023

Christine: May 17, 2023

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DECEMBER 31, 2023 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	3 YEARS*
S&P TSX COMPOSITE TOTAL RETURN (CAD)	8.1 %	11.8 %	9.6 %
S&P 500 TOTAL RETURN (CAD)	9.0 %	23.5 %	11.5 %
S&P 500 TOTAL RETURN (USD)	11.7 %	26.3 %	10.0 %
DJIA TOTAL RETURN (USD)	13.1 %	16.2 %	9.4 %
NASDAQ COMPOSITE PRICE RETURN (USD)	13.6 %	43.4 %	5.2 %
MSCI WORLD INDEX PRICE RETURN (CAD)	8.4 %	19.0 %	7.0 %
MSCI WORLD INDEX PRICE RETURN (USD)	11.1 %	21.8 %	5.6 %
CANADIAN UNIVERSE BOND INDEX	8.3 %	6.4 %	-2.8 %

*ANNUALIZED

COMMODITIES	QTD	YTD
GOLD	10.2 %	13.8 %
SILVER	8.5 %	2.1 %
COPPER	3.1 %	1.2 %
NATURAL GAS (NYMEX)	-14.2 %	-43.8 %
WTI	-21.1 %	-10.7 %
BRENT	-14.9 %	-8.1 %

TREASURY BONDS	12/29/23	09/29/23	12/31/22
2 YEAR (CAD)	3.88 %	4.91 %	4.06 %
2 YEAR (US)	4.23 %	5.03 %	4.41 %
5 YEAR (CAD)	3.17 %	4.30 %	3.41 %
5 YEAR (US)	3.84 %	4.60 %	3.99 %
10 YEAR (CAD)	3.10 %	4.06 %	3.30 %
10 YEAR (US)	3.88 %	4.59 %	3.88 %
30 YEAR (CAD)	3.02 %	3.86 %	3.28 %
30 YEAR (US)	4.03 %	4.73 %	3.97 %
CPI (CAD)	3.10 %	3.80 %	6.30 %
CORE CPI (CAD)	3.50 %	3.20 %	5.30 %
CPI (US)	3.10 %	3.70 %	6.50 %
CORE CPI (US)	4.00 %	4.10 %	5.70 %

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