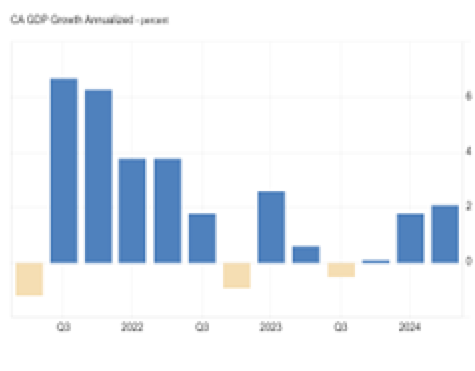
The Summer of Interesting Decisions

Kevin Dolan, September 2024

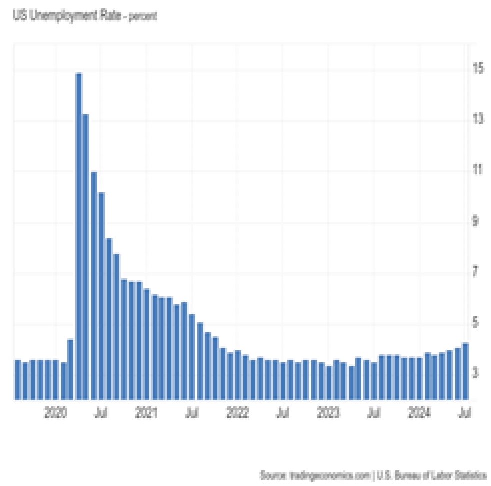
Unlike the old maxim of "Sell in May and go away," the summer of 2024 will be remembered for the **continued gains in markets and historic political events**. Stock Markets persistently climbed as a rotation took place from Growth into Value investments. In addition, Markets responded to changes in the Presidential and Congressional races. As always, I maintain a focus on the fundamentals of investments while factoring in the potential outcomes for Interest Rates and Elections.

Growth investments, specifically **Technology stocks**, saw a pause as investors re-evaluated the profitability of **Artificial Intelligence (AI)**. While billions of dollars are still being committed to AI spending, only a few companies can show how their profitability will increase in the near term. In contrast, **Value investments**, such as materials, utilities and pipelines, experienced strong gains as companies reported sustained earnings and investors anticipated Interest Rate cuts on lower Inflation.



The Bank of Canada (BofC) has forged ahead with three **Interest Rate** cuts of 0.25%, bringing its policy interest down from 5.0% to 4.25%. This policy change has resulted from a continued decline in the **Inflation Rate** to a July reading of 2.5% and recent annualized Canadian Gross Domestic Product grew by a better than expected 2.1%. In addition, the **Unemployment Rate** rose to 6.4%, Household spending fell in the second quarter by 1.3%, and Real Estate valuations are under pressure due to pending mortgage and financing renewals. While continued rate cuts over the next year are likely, the BofC will have to measure its path against Interest Rate decisions made by the US Federal Reserve, specifically to avoid an excessive decline in the Canadian dollar compared to the US dollar.

The US Federal Reserve (the Fed) has a dual mandate of stable prices and maximum employment. While US Inflation has started to moderate toward the Fed's target of 2%, there is a growing concern that the Fed has waited too long to start a rate cutting cycle, and **this may trigger a Recession**. US Inflation finally came in below 3% with the July reading of 2.9% after holding in the mid- to low 3% level since October 2023. The July reading was a welcome relief due to rising US Unemployment.



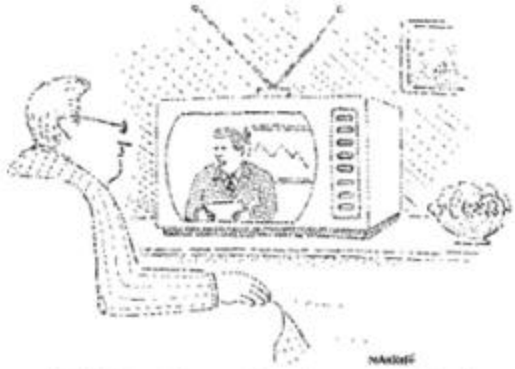
The US had seen declining levels of Unemployment since 2020, but the July reading rose to 4.3% causing concerns that US Unemployment may rise rapidly. **The consensus in the Markets is that the Fed will start to cut US Interest Rates** on September 18 by 0.25%. Some commentators are now speculating that the soft Unemployment report on September 6 will increase pressure for a cut of 0.50%. The current policy direction is for rate cuts over the next year, however, the potential outcomes for the US election may cause a spike in Inflation or pressure on US Treasuries that would necessitate an increase in Interest Rates despite rising Unemployment.

The summer also brought two major events that have shaped **the US elections** which are scheduled for November 5. The Republican Party coalesced behind Donald Trump after an assassination attempt and the Republican Convention as he gained control over the Party. In contrast, a poor debate performance by Joe Biden has led to his eventual withdrawal from the campaign and the subsequent elevation of Kamala Harris as the Democratic Party's nominee. Harris has gained significant support, financial backing and is now making the election more competitive. Historically, US elections are usually close contests, and the particulars of the US electoral system does not always result in the candidate with the most votes winning the Presidency.

With just two months to go, **the election outcome is uncertain**. Both Trump and Harris have laid out economic policies which can result in elevated Inflation and adverse impacts on the US economy. For example, **Trump** has advocated for significant increases in Import Tariffs (10% on all countries and 60% on China) which is Inflationary as it will increase the cost of goods; for a further restriction on immigration resulting in labour shortages and an increase in wage rates which is inflationary; and for increased Corporate tax cuts which increase the Government Debt by Trillions of dollars. **Harris** has proposed increased spending on Social Assistance which will increase the Deficit and an end to the Trump Tax cuts resulting in decreased corporate earnings and disposable incomes. **A divided result between the Presidency and Congress may be the best outcome** as it would limit both candidates from implementing the full extent of their policies and programs. Based on August 31 polling, this would result in a Harris Presidency, a Democratic House of Representatives, and a Republican Senate. The outcome may come down to a small number of voters toward the end of the campaign.

Source: www.realclearpolitics.com

The Fed's **slow action on rate cuts** has been seen by some as waiting to see the outcome of the election. This would allow the Fed to increase the rate of Interest Rate cuts in the face of a slowing economy, or to reverse course and raise Interest Rates in the face of higher Inflation, or to defend against selling of US Government bonds. Chairman Jerome Powell has repeatedly maintained that the Fed does not factor in political outcomes when making Interest Rate decisions. However, the Fed has been slow to react to developing economic data in the past and there is a valid concern that the Fed will be too late in cutting rates. This could result in an excessive slowing in the Economy to progress and result in a rapid increase in Unemployment. Previously, **a policy error** was seen in after the COVID pandemic as the Fed regarded the rise in Inflation as "transitionary" only to see it reach 9.1% in June 2022. As a result, the Fed rapidly increased Interest Rates from 0.25% in February 2022 to 5.5% in July 2023 to bring Inflation down to a more acceptable level. The Fed's objective now is to ease Interest Rates to allow the economy to continue to grow and maintain low Unemployment while not stimulating a spike in the Inflation Rate.



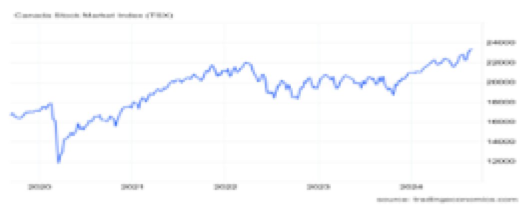
"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

As investors weigh the possible changes in policy by Central Banks and Political decision making, **fundamentals will become a greater factor in their outcomes**. Momentum investing has generated significant performance and headlines for several years, but eventually disappointment takes hold. In addition, numerous commentators espouse either an overly positive or excessively negative perspective on Markets and the Economy. The Economy has been slowing, and a Recession is possible, as it is part of the **Economic Cycle**. A focus on long-term and balanced outlook toward investing is necessary to achieve sustainable returns and goals.

If you have any questions or would like to speak, please do not hesitate to call or e-mail me.

Sincerely,

Kevin Dolan



S&P TSX Index 5 Year Chart

Sept 4 Bank of Canada Interest Rate Decision

Sept 6 US Unemployment Rate

Sept 6 Canadian Unemployment Rate

Sept 11 US Inflation Rate

Sept 12 European Interest Rate Decision

Sept 17 Canadian Inflation Rate

Sept 18 US Federal Reserve Interest Rate Decision

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