April 4, 2024

Investors had lots to cheer for in the first quarter of this year. Equities posted stellar returns, U.S. corporate earnings were strong, AI continued to excite and there was optimism that Fed rate cuts are getting closer.

U.S., Canadian and global equities climbed steadily through January, February, and March to end the quarter with a fifth straight month of gains. U.S. and Japanese equities in particular posted record highs. Bond markets saw U.S. and Canadian yields rise through January and February on strong economic growth before moving lower at quarter-end after the Fed reaffirmed its commitment to rate cuts this year.

U.S. job creation also continued to be resilient, although hourly earnings came in lower than expected. This paints a picture of a still healthy labour market but showing some signs of slowing, which would be welcome by the Fed in its inflationary fight. Canada's job numbers showed a similar pattern, with headline job creation strong and unemployment slightly higher.

China announced a 0.5% reduction in its reserve requirement ratio for financial institutions and a 0.25% cut in SME and agriculture relending and rediscount interest rates. These measures aim to boost liquidity, support credit extension, and stimulate activity and growth. China's central bank also reduced its five-year loan prime rate, dropping it from 4.2% to 3.95%. This cut is expected to lower mortgage costs and help revitalize the Chinese real estate market.

The Bank of Japan introduced its first rate hike in 17 years, marking the end of an era of negative interest rates due to inflation exceeding its 2% target for 22 months and evidence of rising wages. Its new range is still a modest overnight interest rate target of 0-0.1%. As expected, the European Central Bank (ECB) and Bank of England joined the Fed and Bank of Canada in keeping interest rates unchanged. The ECB also hinted at potential rate cuts beginning in June, dependant on incoming data.

U.S. CPI came in at 3.8%, up 0.4% since the turn of the year, but cooler from February onward. This is still significantly down from its 9.1% peak in the summer of 2022, a 40-year high, suggesting the Fed is achieving a "soft landing" for the economy where inflation falls without triggering a recession. Inflation was mainly driven by food and shelter costs, although transportation services also increased. Most other categories showed marginal improvement. The Fed kept interest rates at 5.25-5.5% and projected three rate cuts later this year. Fed Chair Powell added there still needs to be clear signs of declining inflation before reducing rates.

Canadian CPI cooled through the quarter to 2.8%, back within the Bank of Canada's 1-3% range and close to its 2% inflation target. Inflation slowed across the board, although food prices remain high and shelter costs, exacerbated by limited housing supply, remain problematic. As expected, the Bank of Canada held rates at 5%. The Bank of Canada wants to see a continuation of this downward trend before it considers rate cuts but should be gaining comfort that inflation is sustainably moving towards its target.

Capital Markets in Q1

The S&P/TSX Composite Index ended the quarter up 6.62%, the S&P 500 Index up 13.27%, the Nasdaq Composite Index up 8.26%, the MSCI World Index up 11.68% and the MSCI EAFE Index up 8.52%.

After the holiday season rally in December, the forecast was for a performance hangover at the start of Q1, but it ended up being “steady as she goes” as equity markets rose through January into February. There was a slip mid-February when U.S. CPI came in higher than hoped, but stocks recovered and then went up another level in March, buoyed by the Fed’s reassurances that rate cuts are still on its radar. U.S., Canadian and global equities wrapped up the quarter confidently, with impressive gains. The S&P 500 Index logged its best start to a year since 2019 while the Dow Jones ended near 40,000 for the first time. The MSCI World Index as well as Japan’s Nikkei 225 Index also closed at record highs.
Tech continued to be a standout performer driven by investor excitement over AI. However, performance is broadening to other sectors boosted by a strong U.S. corporate earnings season. Fueled by its move into AI through its investment in ChatGPT maker Open AI, Microsoft became the second company to reach a market cap of US$3trillion, joining Apple which achieved this last year. AI chipmaker Nvidia also announced another round of exceptional results for Q4 2023, which prompted a global equity rally.

Bond markets, which tend to move in the opposite direction to equities, saw U.S. and Canadian yields rise through Q1. However, yields are still lower than their October 2023 peak, which was their highest level since 2007. Yields were stable at the turn of the year before rising in January and February, though arguably for the right reason - on optimism about strong economic growth rather than concern about inflation and rate hikes. Yields then started to move lower at quarter-end as despite a small uptick in U.S. inflation, the Fed held rates steady and projected three rate cuts later this year.

After sliding at the end of 2023, the price of oil recovered to end Q1 hovering near US$84 a barrel.
Oil initially rose through January and February on falling U.S. inventories, optimism Chinese stimulus measures are working and concern about continued Houthi militia attacks in the Red Sea. Oil then got a second wind in March after the International Energy Agency warned about a potential supply shortfall due to dwindling US inventories and the Saudi Arabia led OPEC production cuts last year.

Q1 also saw the eagerly anticipated increase of the Trans Mountain pipeline’s capacity to Canada's west coast, with reports of substantial orders for Canadian crude from Asia. While the full economic benefits may unfold gradually due to ongoing investment and regulatory challenges, the first signs are promising.

In currency markets the loonie was down versus the greenback due to a widening gap between U.S. and Canadian short-term interest rates, although the Canadian dollar remains within its 2023 range. Falling U.S. Treasury yields towards the end of Q1 also pushed gold prices to an all-time peak. The rise caught many investors off guard but buying has since picked up. Provided these higher prices can be sustained, the benefits will filter through to large producers in the form of expanded margins which should prove supportive for the sector.

What we can expect now?
Equity markets are reaching new all-time highs, led by U.S. and Japanese stocks. Market performance has also broadened beyond tech to other sectors. In addition, U.S. firms are delivering strong earnings, reflecting a resilient economy. Although positive for investors, the pace of these rallies and the rising valuations are causing a bit of a concern and could lead to some near-term consolidation. Meanwhile, Chinese equities have rebounded on the back of China's regulatory changes and stimulus measures.

Regardless of where we are in the market cycle, it's important to take a disciplined approach to investing and stay focused on your long-term goals. This strategy helps you keep your emotions out of investing, typically buying high and selling low like many investors do. Ongoing monitoring and reviewing of your portfolio also ensure it remains on track. Diversifying investments reduces risk as well.

Thank you for your continued trust in me and my team for the opportunity to assist you in working toward your financial goals. We are with you every step of your investment journey. Should you have any questions regarding your portfolio, please do not hesitate to contact my office, 250-785-9603.

Sincerely,
Dean Falkenberg

Glossary of Terms:
Liquidity: The degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price. Cash is considered to be the most liquid asset, while things like fine art or rare books would be relatively illiquid.

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