

Summer 2024



Our thoughts on the state of the market

Global equities have been mixed recently, with Canadian and European equities showing weakness in recent weeks, though year-to-date gains remain respectable. Meanwhile, the US equity markets are near all-time highs, largely driven by the large-cap technology sector and stable, inflation is decreasing, and upcoming rate cuts are anticipated.

Interest rates are reasonably high with a bias to move downward.

We believe lower inflation and rate cuts will materialize, though it may take longer than the market expects. The market is driven by narratives, and the “Inflation is coming down” narrative has been quite effective. We’ve been able to build a solid base of fixed income in portfolios. Incorporating more private credit managers in portfolios has also enhanced yields.

Many equity market averages are nearing their highs, but these averages can be misleading. Often, investment manager newsletters highlight the performance of the seven largest technology stocks, known as the “Magnificent Seven.” These giants have averaged year-to-date gains of well over 30%, whereas the rest of the S&P 500 has seen an average gain closer to 5%, and the small-cap index has averaged around a 1% gain. The message is that without owning the super-caps, markets aren’t up all that much.

Despite the disparity, there are hundreds of companies with a positive return so far this year. Our approach is to participate in what is working by owning stocks like Google, Microsoft, Nvidia, and Apple. We further diversify by focusing on high-quality companies, particularly those with strong earnings, robust free cash flows, and high returns on equity. This methodology directs us to hold a larger proportion of technology, consumer, and industrial companies in our equity selections.

National elections will be a significant focus for investors in the second half of 2024. The election calendar is packed, with countries representing 60% of the world’s GDP heading to the polls this year. Investor uncertainty tends to heighten stock market volatility leading up to election day, which decreases afterward. Elections don’t typically dictate long-term market trends and we recommend sticking with a diversified investment strategy.

Fixed Income

Fixed income yields are close to the highest they've been in many years. Two years ago, client portfolios held the minimum levels of fixed income as allowed by their personal investment policies. We began increasing allocations to fixed income at the end of 2022 to capitalize on the higher yields available.

Most client portfolios hold slightly above their long-term target levels of fixed income, which typically is approximately 40% for balanced portfolios and 15% for growth portfolios. The graph to the right shows that investors are predicting bank rates to fall more than central banks are suggesting. Short-term rates in the United States are expected to decrease by around ½% by the end of the year. However, the Federal Reserve recently projected only a ¼% cut, indicating that higher rates may be necessary for a longer duration.

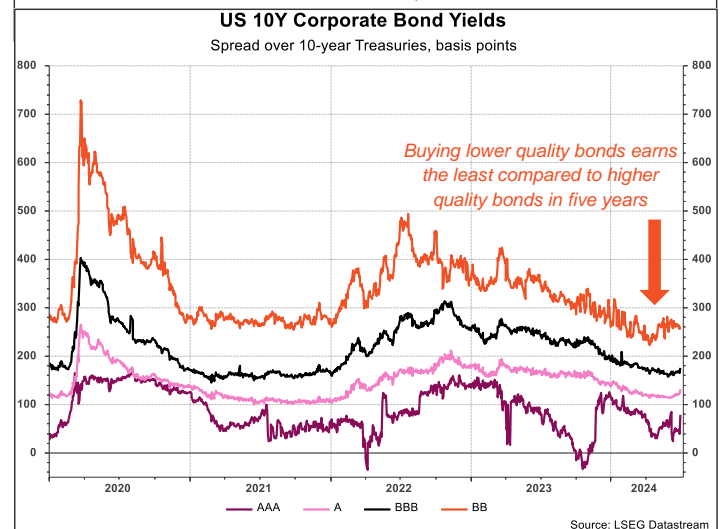
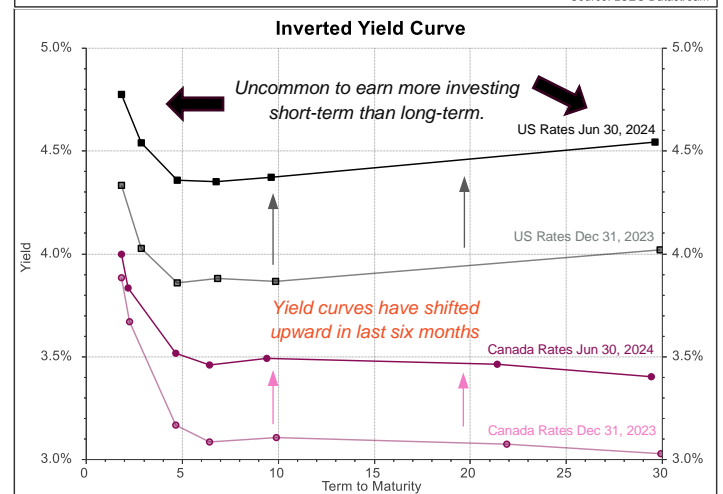
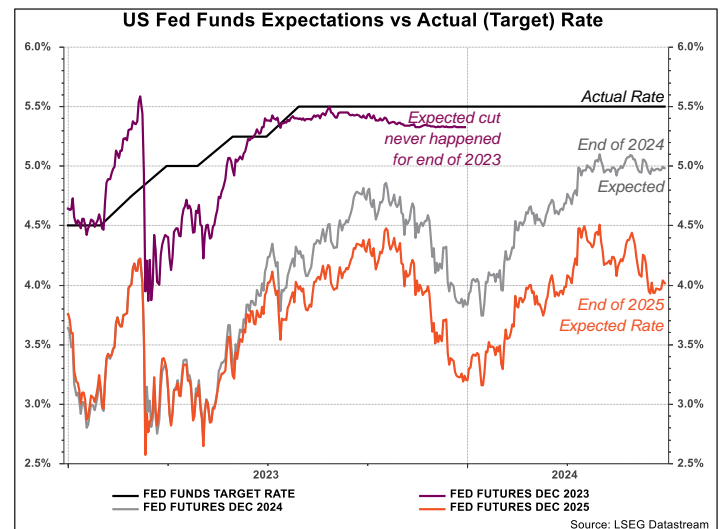
The Bank of Canada has just cut interest rates, with the potential for an additional ½% or more cuts later this year. The relatively higher interest rates in the US compared to Canada, along with the likelihood of further Canadian rate cuts, suggest that the US dollar could remain firm.

While higher yields are a positive incentive to own fixed income, **we have not overly increased allocations due to two concerns:**

Inverted Yield Curve: The yield curve is inverted, meaning shorter-term rates are higher than long-term rates. This indicates investor expectations of future rate declines, and the entire curve has shifted upward in the last six months, reflecting market expectations for prolonged higher rates. Consequently, buying long-term bonds is less attractive as short-term bonds offer better returns.

Compressed Yield Spreads: The spread between yields on riskier credit ratings and government bonds is near its lowest in five years. Investors are receiving minimal additional compensation for the risks associated with lower credit-rated bonds.

The current fixed income conditions have made us focus on lower-risk, shorter-duration bonds, complemented by private credit offerings with short-term loan profiles to enhance yield. See these discussed in Private Credit on page 6.



Equity Markets and Their Earnings

Stock prices typically rise at a similar rate to their underlying earnings over time.

Hence, our strategy focuses on owning companies with consistent earnings growth. However, in the short term, stock prices are influenced by numerous factors, both macroeconomic (broader financial environment) and microeconomic (company-specific news and results).

The accompanying graphs of Canadian and American stock markets with their underlying earnings illustrate how external factors can impact short-term movements. Yet, over the long term, the growth in equities aligns closely with the growth in underlying earnings.

The 2020 post-COVID rally in stocks was notably rapid.

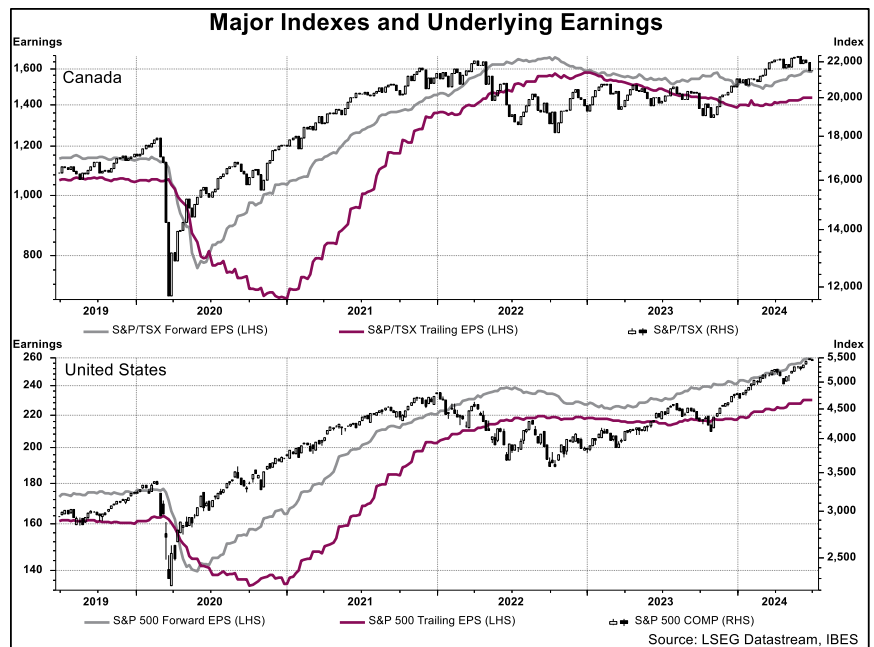
Despite earnings declines over the subsequent three quarters, stock prices surged. Forward earnings expectations began improving by May 2020, well ahead of actual earnings. Stock prices rose in tandem with faster earnings increases throughout 2021. Investors viewed COVID-19 as a temporary disruption, focusing more on longer-term operations rather than short-term earnings fluctuations.

In 2022, stock prices fell significantly, driven by rising inflation and interest rates. Typically, inflation benefits equities, as owning stocks and real assets is a primary way to protect portfolio values. However, inflation soared to four times its twenty-year average, and short-term interest rates increased by 4%. This changed company valuations and reduced the price investors were willing to pay for earnings. The higher discount rate applied to future earnings resulted in lower current valuations. Similar to the COVID-19 uncertainty, investors overreacted and oversold equities.

Earnings growth was slow but stabilized in 2023. The Canadian commodity-based stock market outperformed in 2021-2022 due to booming oil and commodity prices following COVID-19 underinvestment. However, commodity stocks struggled more than other sectors in 2023 as prices retreated from their highs, while other market sectors saw firming earnings and stock prices.

Equities experienced a significant rally starting in November 2023, driven by the belief that central banks had finished raising interest rates and that inflation had been cut by over half from its peak. Despite a higher interest rate environment, underlying earnings consistently rose. This led to the view that inflation might take longer to return to historic levels (2.70% in Canada and 3.25% in the US versus the historic 2%). Short-term interest rates may remain elevated. The Bank of Canada cut the bank rate by a quarter of a percent in June, and both the Bank of Canada and the US Federal Reserve might cut rates once in 2024. Rate cuts typically strengthen stock markets, but if the economy shows too much strength, further cuts may be delayed.

We remain committed to maintaining our target allocations for equities in client portfolios, reflecting our confidence in the favorable outlook for overall earnings growth and potential for easing interest rates. However, with valuations rising and several sectors nearing their highs, we have been trimming positions to maintain balance and manage risk. This approach ensures that we capture growth opportunities while protecting against potential overvaluation.



Sector Analysis: Beyond Market Averages

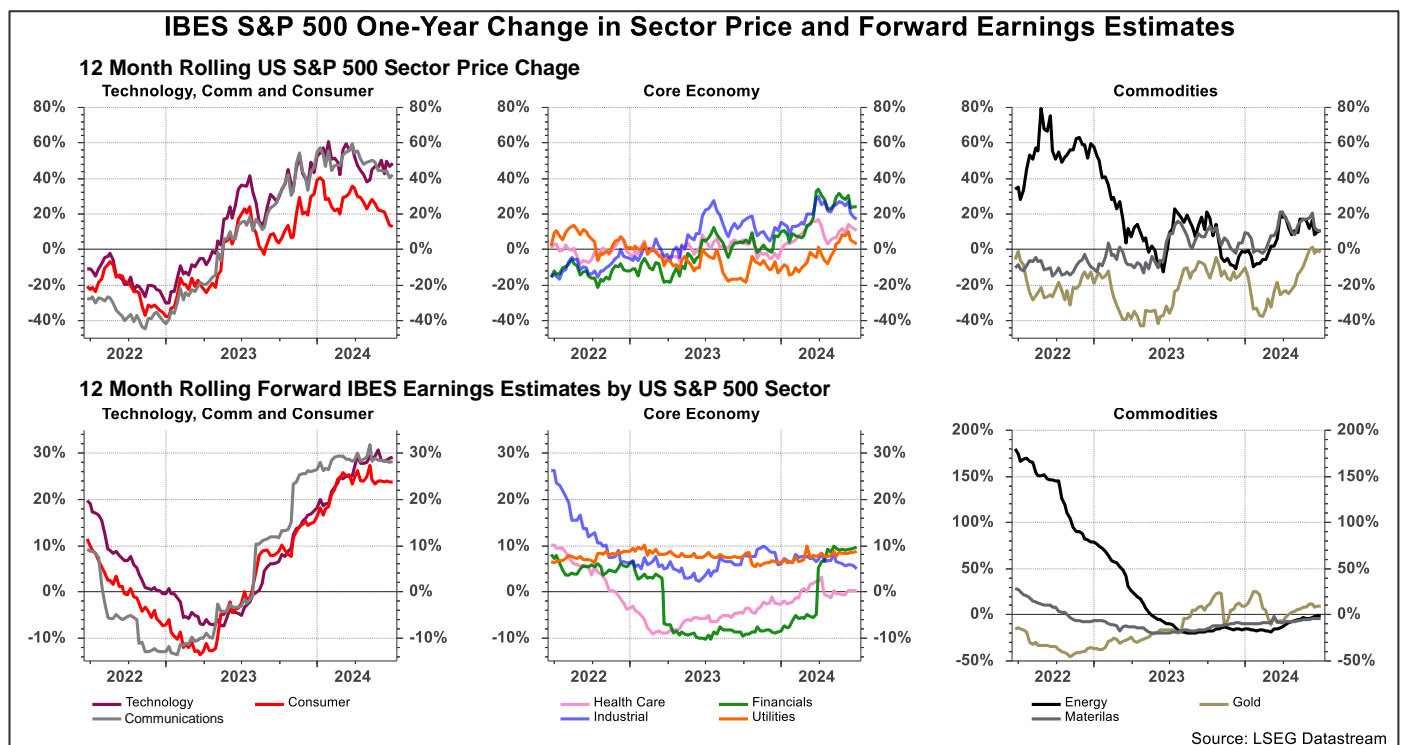
It's not enough to simply discuss average market performance. We delve deeper to identify sectors with the greatest potential and leadership, aiming for consistency, predictability, and reduced variability in our investments. Our focus is on sectors that demonstrate strong underlying earnings growth along with stock price leadership.

Leading Sectors: Technology, Communications, and Consumer. Over the past twelve months, Technology, Communications, and Consumer sectors have shown exceptional performance. These sectors continue to grow at impressive rates, with earnings increasing by 25-30% year-over-year, significantly outpacing other sectors. Despite a slight slowdown in growth, these sectors remain attractive, and we favor including them in our portfolios due to their robust earnings and leadership in the market.

Commodity Stocks: High Variability and Trading Opportunities. The commodity sector, particularly energy stocks, experienced a significant surge in earnings and share prices post-COVID, driven by inflation and stimulative policies. However, since 2022, the sector has seen a contraction in earnings and flatter share prices. Due to the inherent variability and lack of consistent long-term growth, we view commodities more as trading instruments rather than long-term holdings. The cyclical nature of commodities contrasts with the brand pricing power seen in core consumer and technology companies, which add value and minimize such cyclical fluctuations. Consequently, our ownership in commodity sectors remains low, with a focus on active trading when appropriate.

Core Economy Stocks: Stability and Consistency. Core economy sectors, such as Industrials and Financials, provide essential diversification, stability, and consistency to our client portfolios. These sectors often offer attractive valuations and dividend income, making them a crucial component of a balanced investment strategy. Compared to higher-growth and more variable technology stocks, core economy stocks deliver less fluctuations and more predictable performance, which aligns with our goal of maintaining a stable and resilient portfolio.

By focusing on sectors with strong earnings growth and market leadership, while also maintaining diversification and stability through core economy stocks, we aim to achieve a balanced and effective investment strategy that aligns with long-term financial goals.



Equities: Focus on the Investment Process

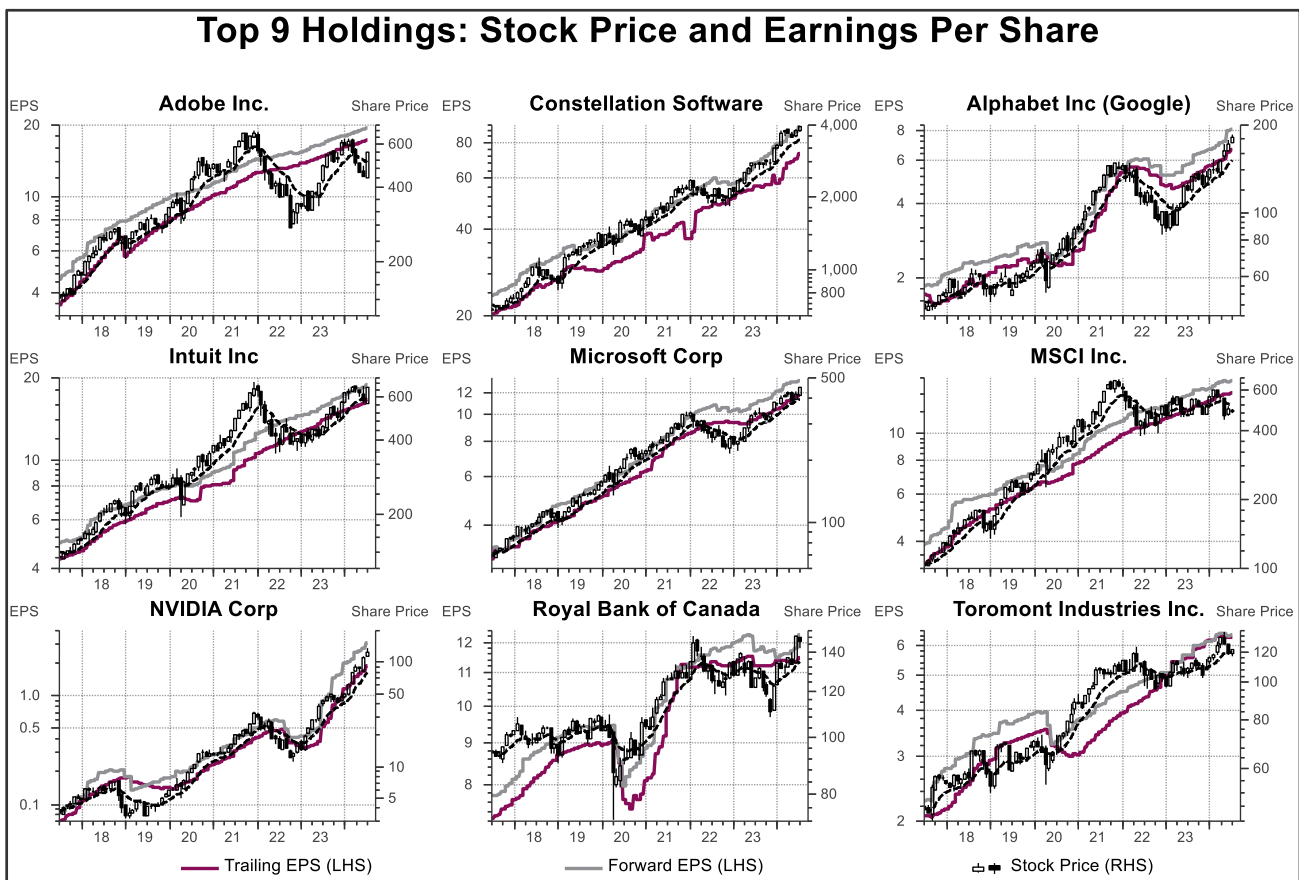
We are long-term, goal-focused, and planning-driven portfolio managers. Our primary objective is to formulate an individualized financial plan for each family, crafting investment strategies aimed at achieving the specific goals outlined in these personalized plans.

Our approach prioritizes the underlying business fundamentals over short-term market fluctuations. In an era where the average holding period for stocks is often measured in months rather than years, maintaining a long-term perspective can be challenging for many investors. However, we see this short-term focus as an opportunity to implement strategies that emphasize long-term growth.

We invest in companies that can sustain consistently high returns on capital. To ensure these returns are maintained, we seek companies that demonstrate resilience to competition, inflation, and interest rate changes. We focus on businesses that not only achieve high returns on capital but also grow their free cash flow. This growth ideally comes from a combination of increasing sales, pricing power, upward earnings revisions, and share buybacks.

Our goal is to own high-quality businesses. We believe that diversifying investments across 20-30 companies in various regions and sectors provides adequate diversification. A critical aspect of our evaluation process is assessing the competitive advantage and profitability of the companies we select. We closely monitor return on capital, margin development, sales growth, earnings estimates and correlations, and changes in the competitive landscape.

We believe that buying a share of a company means taking ownership of that company, even if only in a small way. Our direct equity strategy centers on high-quality businesses that we respect and have monitored over the years. By employing both quantitative and qualitative analysis, we construct portfolios characterized by below-average risk. This careful scrutiny and seasoned judgment form the cornerstone of our investment selection process.



Source: LSEG Datastream

Private Credit: Getting Higher Yields

We have included several offering memorandum private credit products to our portfolios, classified either as fixed income or alternatives. These products, available to accredited investors, offer higher yields in exchange for reduced liquidity, meaning they are not as easily bought or sold.

Private credit involves non-bank lenders providing loans to businesses, often through regulated asset management firms that pool investor funds to finance various enterprises. These lenders capitalize on the demand for business capital, especially during the property construction and development phase, as traditional banks have reduced lending due to tighter regulations. Key to assessing private credit managers is understanding collateral valuation, client diversification, loan terms, and their historical loan loss and recovery experience. Additionally, we evaluate their business assessment process, fund size, impairment management, expenses, and achievable interest rates. This thorough analysis ensures we select managers who aim to deliver high returns while effectively managing risks.

Advantages of Private Credit:

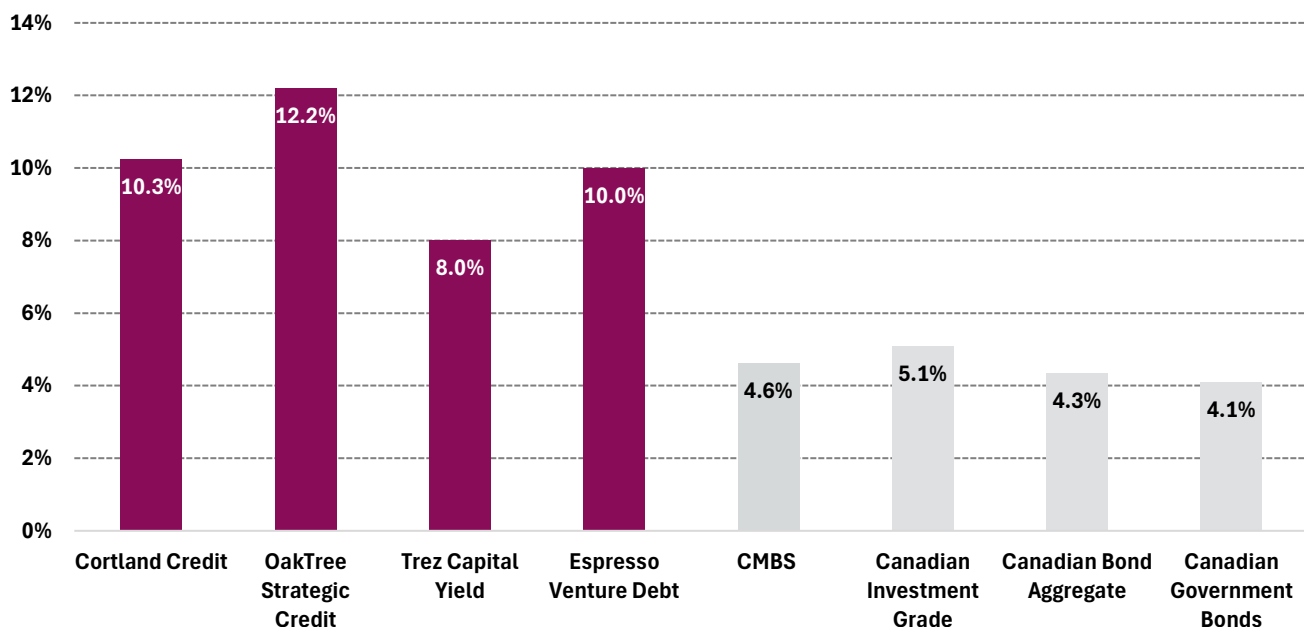
Higher Yields: Private credit products typically offer yields significantly higher than traditional fixed income assets. For investors able to lock up their capital, these direct lending opportunities can generate enhanced income, often exceeding public market returns.

Reduced Market Sensitivity: Private loans are less affected by market sentiment because they are not traded on exchanges. This means they are less influenced by news and other mark-to-market dynamics. Direct lenders generally hold these loans to maturity, providing stability.

Structural Support in Difficult Markets: In the current challenging macroeconomic environment, private credit managers are becoming more selective, securing better spreads, lower leverage, and stronger covenants. These tough market conditions provide structural support to the asset class, enabling direct lenders to match financing needs with ample dry powder available.

In the first six months of 2024, our private credit managers have delivered mid-single digit positive returns, aligning with return expectations. Given the current credit conditions and the quality of investments in these managers' portfolios, their yield to maturity is highly attractive when compared to more traditional fixed income options.

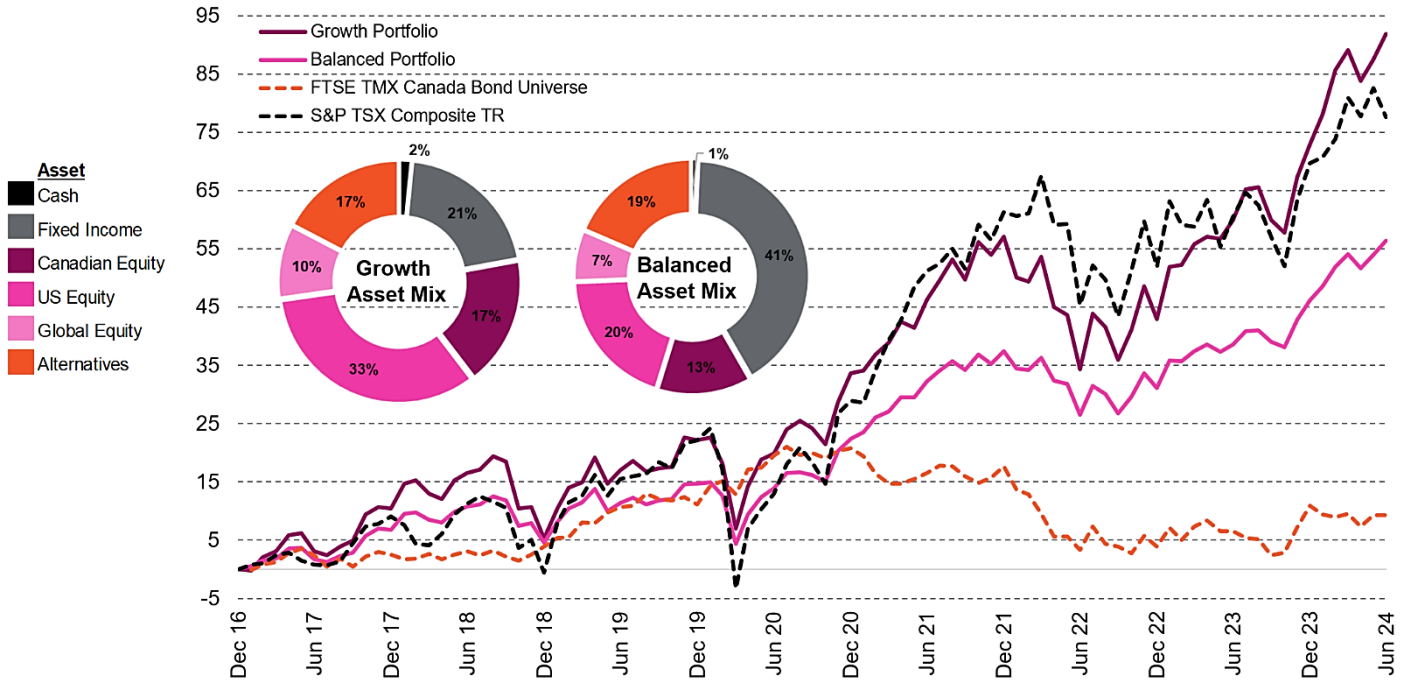
Yield to Maturity



Source: Cortland Credit Group Inc., Oaktree Fund Advisors, Trez Capital, Espresso Capital. Richardson Wealth Limited as at June 30, 2024

Managed Account Performance

Growth & Balanced Portfolio Cumulative Performance
From December 31, 2016 to June 30, 2024



Source: Richardson Wealth Limited, net of fees, unaudited.

Growth Portfolio is one specific growth mandate managed account. The asset mix currently is approximately 60% equity, 21% fixed income, and 17% alternatives, and 2% cash

Balanced Portfolio is one specific balanced mandate managed account. The asset mix currently is approximately 40% equity, 41% fixed income, 19% alternatives.

Selected accounts are considered representative of maximum growth and balanced portfolios across most managed client accounts. The level of cash varied throughout the period. Individual managed accounts vary in results due to customization. Deposits or withdrawals to portfolios, and the resulting implementation of changes in securities held represents the largest cause for differences in accounts. Client-directed and non-model securities held in managed accounts can also result in a significant performance difference from the average experience.

Our balanced portfolio, which includes a mix of equities and fixed income, has provided more stable returns compared to a purely equity-focused approach. While it has not matched the growth portfolio's performance, it has offered a smoother ride, demonstrating the benefits of diversification.

Our growth portfolio of mainly equities, represented by the solid purple line, has generally provided returns comparable to the S&P/TSX Composite Total Return index over time, while exhibiting less volatility due to the inclusion of some alternative investments and fixed income. Returns for US securities have also enhanced results.

The Canada Bond Universe, indicated by the orange dashed line, has underperformed significantly over the past seven years. The rapid increase in interest rates between 2021 and 2022 led to negative returns for bonds, highlighting the challenges faced by fixed income investors during this period.

The black dashed line depicting the S&P/TSX Composite, has shown strong performance, especially in the post-COVID recovery period. This demonstrates the importance of maintaining equity exposure in portfolios to achieve superior returns although with added volatility. This reinforces the idea that long-term growth is driven by equity investments, while fixed income serves as a stabilizer.

November 2024 Presidential Election and Investment Implications

The upcoming November 2024 US presidential election has implications for various sectors, depending on whether Biden or Trump secures the presidency.

Under a Biden administration, sectors such as clean energy, infrastructure, financials, and semiconductors could thrive. Biden has consistently promoted renewable energy initiatives, which means companies involved in solar, wind, and other sustainable energy sources may see increased support and investment. His focus on infrastructure, as seen with the Infrastructure Investment and Jobs Act, suggests continued backing for construction and public works projects. Financial and semiconductor sectors could benefit from policies designed to strengthen US domestic manufacturing and innovation, including the US CHIPS Act, which supports semiconductor production and technological advancement.

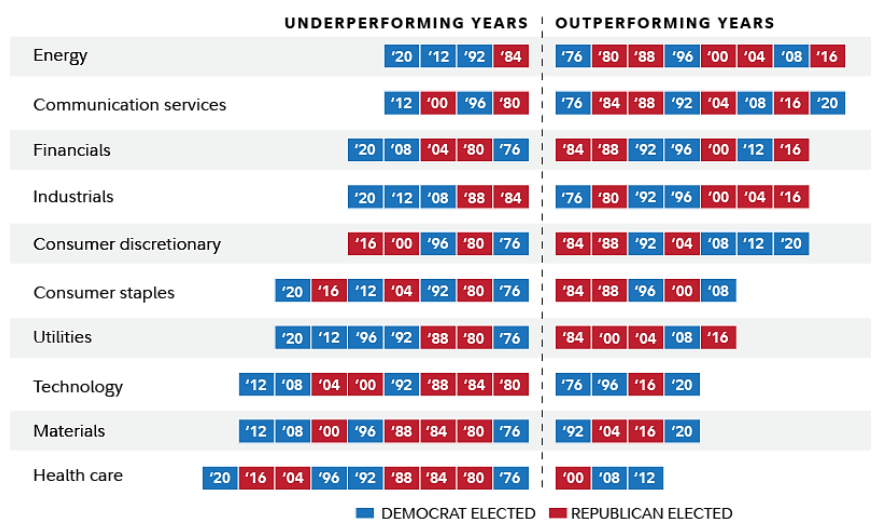
A Trump presidency might favor sectors like energy, defense, real estate, and small caps. Trump's policies from his previous term, including deregulation and increased energy production, hint at potential benefits for traditional energy companies involved in oil and gas. His criticism of NATO and emphasis on other countries providing for their own national defense could boost the aerospace and defense sectors, particularly European defense contractors. Trump's affinity for real estate and small business could lead to supportive measures for US real estate markets and small-cap stocks, aligning with his "America First" agenda.

While both candidates have different approaches to tariffs and trade, Trump's proposed tariffs on imports, especially from China, could impact global trade dynamics and benefit domestic industries. Biden's tariffs on Chinese imports, particularly in steel, semiconductors, and electric vehicles, aim to protect and boost US manufacturing capabilities. Both parties are implementing measures that make it more challenging for foreign companies to compete in the lucrative US market. This reinforces our strategy of maintaining a substantial proportion of US companies in our portfolios. These companies benefit from fewer operational hurdles in the attractive US market and often have diversified global sales.

Historical market performance suggests that while elections introduce volatility, they do not typically dictate long-term market trends. Instead, the broader economic environment often plays a more critical role. For example, the stock market rally post-2020 election was influenced by positive vaccine news, highlighting the influence of external factors beyond election outcomes.

We remain focused on long-term financial strategies, adjusting portfolios based on sector-specific insights rather than reacting emotionally to election news. We feel well positioned in portfolios as we approach the election, preferring to wait for specific policy announcements. These policies often take months or even years to implement and demonstrate their full effects.

Sector performance in presidential election years since 1976
Number of years in which each sector underperformed or outperformed the S&P 500



Each box represents 1 calendar year of performance for a calendar year that included a US presidential election. Underperforming indicates that price performance was lower than the S&P 500, while outperforming indicates price performance exceeded the S&P 500. Color of each box indicates whether a Democrat or Republican candidate was elected to the presidency that year. Real estate is omitted due to a lack of sufficient performance history, as it was not established as an independent sector until 2016. Each sector is represented by companies included in the S&P 500 that are classified as members of that sector.

Source: Strategas Research Partners, as of November 5, 2023.

Discretionary Management

Money is fuel. It enables you to pursue your desires and achieve your goals, or it restricts you when resources are insufficient.

Financial management means matching your current investments and future earnings to the things you want to spend it on over your lifetime. A financial plan maps this out. It helps you confidently live your life, knowing you have planned out the “fuel” to do it.

The rate of return on your investments is key to making your financial plan work. A written Investment Policy Statement outlines the rules and strategies for managing these investments. Regular reporting allows you to compare portfolio results against the plan, ensuring you remain confident that you are on track.

With discretionary management, each family is placed into multiple securities models uniquely based on their goals and risk tolerance. When we change a security in a model, management software consolidates all individual client purchases into a single bulk trade. This ensures that all clients get their proportionate share of the transaction’s fill, making the process both fair and efficient. In contrast, non-discretionary Investment Advisors must call dozens or even hundreds of clients to obtain authorization for each transaction, resulting in a significant amount of valuable time spent merely securing permission to trade.

Having the discretionary ability to enact trades proactively has significant benefits. It frees clients from having to make constant and numerous decisions. The relationship and communications between the Portfolio Manager and his or her clients focus on understanding the client’s situation, designing solutions, and finding appropriate securities. It allows for consistent and simultaneous management across all portfolios.

The person with authority to trade bears responsibility for results. If you seek advice from an Investment Advisor to stay involved, that’s commendable. However, the returns are ultimately your responsibility, and effective management requires clear communication with the Advisor. If you prefer to have a professional manage and be responsible for your results, delegate to a Portfolio Manager who provides discretionary management. The decision-maker is the manager.

I sincerely appreciate your business. I strive to earn your trust. I appreciate introductions to any family, friends, or business associates that might benefit from our services.

Warm regards,



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