Roosdahl Wealth Management Newsletter

Autumn 2024

In this edition

Delayed Landings

We find ourselves in a period where sentiment could be aptly described by Charles Dickens' classic line: *"It was the best of times, it was the worst of times…"* Today's narratives are seemingly contrasting. On one side, we are living in an era of unprecedented technological advancements and some of the highest standards of living in history, marked by improved quality of life, increasing wealth positions and one of the highest life expectancies. On the other, however, rising living costs, heavy debt burdens, sluggish productivity and ongoing geopolitical tensions are casting shadows over this progress. Economically, we find ourselves in a transition, with an economy that's neither great nor terrible.

Some have termed it a "delayed landing," with the markets unusually quiet in the first half of 2024 as we lingered in this middle ground. Since the start of the year, market observers have been closely watching central bank monetary policy decisions as economies averted a hard landing. Let's not forget that the multiple rate cuts anticipated at the start of the year did not largely materialize as economies, especially the U.S., performed better than expected. Over the summer, the S&P 500 made headlines for going 377 days without a selloff greater than two percent — the longest stretch since the financial crisis. The CBOE Volatility Index (VIX) fell to its lowest levels not seen since November 2020.

This period of calm was abruptly interrupted when the Bank of Japan surprised the markets with a rate hike at the end of July. While central banks globally were raising rates to fight inflation in 2022 and 2023, Japan had been the exception. As a result, the Japanese yen became the currency of choice for "carry-trade investors," who borrowed low-interest-rate yen to invest in assets denominated in higher-interest-rate currencies. At the end of these trades, investors converted funds back into yen to repay the loans, in a leveraged strategy known for its considerable risks. Indeed, the yen's rapid appreciation in August, prompted by the rate hike and other factors, led to significant losses in these carry positions, prompting the Nikkei to experience its worst day since Black Monday in October 1987. North American markets jittered, and the VIX spiked to its third-highest level in its history.

A Note of Thanks

During this Thanksgiving season, I am reminded of the many things to be thankful for: we live in a nation of peace, prosperity, inclusivity and resilience. I am grateful to you, our clients, for entrusting us to be stewards of your wealth.

If you have family, friends or colleagues who could benefit from my experience, support and advice, I continue to welcome new clients and appreciate any introductions.

Yet, seasoned investors accept that volatility is an inherent part of the markets. A look back at the S&P/TSX Composite since 1985 reminds us just how common volatility is:

- A 5 percent drawdown is almost guaranteed each year, occurring 95 percent of the time;
- Double-digit drawdowns of more than 10 percent have happened 56 percent of the time;
- Despite positive annual returns over 70 percent of the time, the average intra-year drawdown has been -15 percent. The market declines even when it rises (see page 3).

Periods of volatility should always be anticipated. During these times, it is important not to let short-term fluctuations disrupt long-term financial plans. One of the most challenging aspects of investing is resisting the temptation to follow the herd. Consider the merits of having a solid investment plan — and sticking to it.

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U.S. Election Fever: Do Presidential Elections Impact Investments?

U.S. presidential election fever is in full force! Election years are often fuelled by uncertainty about future policies, regulatory shifts and their potential impact on economies — and this year's U.S. election has been no exception. While public policy can indeed influence specific industries, sectors and even the broader economic and social climate, the actual impact of the election may have less significance to the markets than many investors might expect.

In fact, historical data shows that, since 1850, the annual compound return for a balanced 60/40 stock/bond portfolio invested in U.S. markets is similar in both election and non-election years. Election years have returned an average annual return of 8.7 percent, compared to 7.7 percent in non-election years.[1]

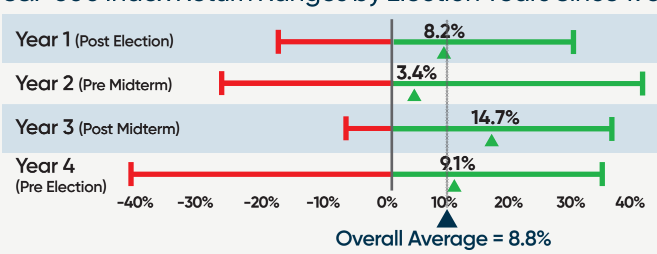
How Does a Balanced Portfolio Fare?

8.7% Presidential election years (41 periods)

7.7% non-presidential election years (122 periods)

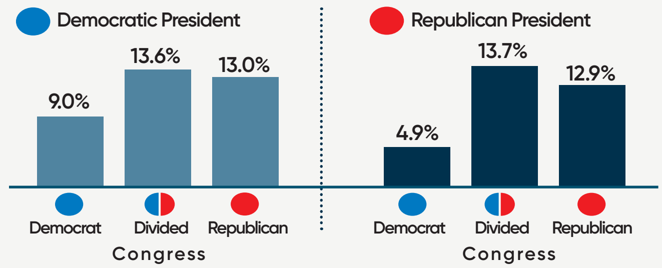
Similarly, since 1950, the S&P 500 Index has averaged a return of 9.1 percent in an election year ("Year 4," chart below), not significantly differing from the overall average of 8.8 percent. Interestingly, the 12 months preceding an election have exhibited the widest range of market outcomes compared to other times in an election cycle.

S&P 500 Index Return Ranges by Election Years Since 1950[2]



A common misconception is that one political party is better for market returns. However, historical data does not support this theory (chart, top). The S&P 500 has historically averaged positive returns under every partisan combination. Moreover, stronger market returns have been correlated with a divided government; some suggest that government gridlock may create less policy uncertainty.

Average Annual S&P 500 Returns Based on Party Control, 1933 - 2022



https://www.fidelity.com/learning-center/trading-investing/election-market-impact

Finally, consider also that there are few consistent outcomes for sector returns during election years.[2] While many investors are watching carefully to see how potential policy changes may impact the markets, sectors or even a company's performance, consider that making changes to an investment strategy at this point comes with risks. Campaign promises sometimes do not translate into policy changes. Consider also that the success of policies depends on a variety of factors, including the composition of Congress or the Senate, economic and social conditions and many others.

The Bottom Line

Presidential election years often generate significant headlines, sometimes causing market volatility or tempting investors to adjust their investing programs. Yet, it's important to distinguish between short-term noise and longer-term outcomes. As these perspectives highlight, the actual impact of an election may have less significance to the markets than many investors assume. Perhaps this is good food for thought for those of us nervously anticipating the outcome this November!

1 https://investor.vanguard.com/investor-resources-education/article/presidential-elections-matter-but-not-so-much-when-it-comes-to-your-investments
2 https://fidelity.com/learning-center/trading-investing/election-market-impact

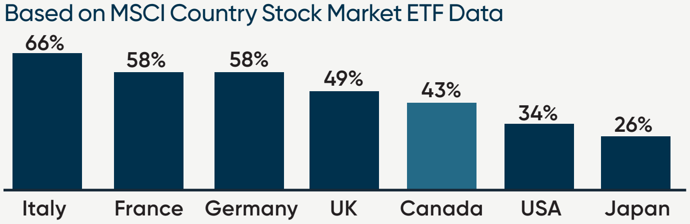
Equity Market Gains: Perspectives on Concentration & Valuations

With volatility returning to markets over the summer, a renewed sense of uncertainty reemerged. There has been much discussion centred around the mega-tech stocks, with some suggesting their relative concentration and lofty valuations pose risks to future equity market gains. Here are some perspectives:

1. Market concentration is the norm, not the exception. A look over time at the S&P 500 shows that concentration is more common than we think. In the 1950s and 60s, the top 10 stocks regularly made up about one-third of total market capitalization. This jumped to more than 40 percent in the 1970s, during the time of the 'Nifty Fifty' stocks. Though the concentration of the top 10 stocks fell below 20 percent in the 1980s, it rose to almost 30 percent by the early 2000s.[1]

In fact, this concentration is not limited to the U.S. markets. With the G7, most countries are far more concentrated than the U.S. (graph below). Canada's top 10 holdings make up around 43 percent of the total index, as measured by the MSCI country stock market ETFs.[2]

G7 Countries: Top 10 Holdings as % of Total Stock Market Cap Based on MSCI Country Stock Market ETF Data



Based on MSCI country stock market ETFs as proxies: EWC, EWQ, EWG, EWI, EWJ, EWU, SPY. https://awealthofcommonsense.com/2024/02/is-the-u-s-stock-market-too-concentrated/

Of course, given the tech sector's concentration in U.S. markets, it is a reminder that no sector is impervious to downturns — just one reason to highlight the importance of diversification within a portfolio.

2. Multiple expansion is not at historical highs. While valuations have increased over the long term, often measured by the CAPE ratio,[3] multiple expansion may play a smaller role than most people assume. This is supported by work done by the late renowned investor John Bogle, who used the following formula to estimate expected returns:

Expected stock market returns = Dividend Yield + Earnings Growth +/- Change in Price/Earnings (P/E) Ratio

How Do Fundamentals Match Actual Returns?

Decade	Dividends	Earnings Growth	P/E Change	Annual Returns
1950s	6.9%	3.9%	9.3%	20.1%
1960s	3.1%	5.5%	-1.0%	7.6%
1970s	3.5%	9.9%	-7.5%	5.9%
1980s	5.2%	4.4%	7.7%	17.3%
1990s	3.2%	7.4%	7.2%	17.8%
2000s	1.2%	0.8%	-3.2%	-1.2%
2010s	2.0%	10.6%	1.0%	13.6%
2020s	1.6%	7.8%	2.5%	11.9%

https://awealthofcommonsense.com/2024/02/whats-driving-the-stock-market-returns/ based on "Don't Count On It!" John Bogle.

Financial strategist Ben Carlson recently updated Bogle's S&P 500 return data by decade (chart, above) to observe what may be driving returns. The P/E change — or multiple expansion/contraction — may be viewed as a gauge of investor sentiment or emotions, or what people are willing to pay for earnings. While there has been multiple expansion in the 2010s and 2020s, it isn't quite as significant as that of the 1980s and 1990s. Earnings growth has been the main driver of stock market returns since the Global Financial Crisis. One likely reason is efficiency and productivity gains from advances in technology.

Keep in mind that these observations are not pertinent to short-term market movements. However, they do show that, over the longer term, fundamentals like corporate earnings have been a key driver of stock market returns. Over time, the underlying growth trend in equities has generally mirrored the growth in corporate profits and the economies in which these companies participate. Of course, there can be substantial swings around the trendline based on investor behaviour — consider periods of euphoria and fear, when stock prices get ahead of themselves or fall to levels at bargain prices.

This may be good investing food for thought: The human condition to advance, progress and grow is unwavering and is likely to drive corporate profits into the future. Investors, should we choose to participate, can share meaningfully in the growth yet to come.

1 https://awealthofcommonsense.com/2024/02/is-the-u-s-stock-market-too-concentrated/
2 Using MSCI country stock market ETFs as the means of measurement.
3 The CAPE ratio or Shiller Price Earnings ratio is a valuation measure that uses real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.

FHSA Carryforward Rules — Not All Registered Plans Are the Same

If you've opened a First Home Savings Account (FHSA), be aware that the carryforward rules differ from those of other registered accounts.

When the FHSA is opened, the account holder is able to contribute $8,000 in annual participation room. Any unused amounts can be carried forward to the following year, but only to a maximum of $8,000 and subject to a lifetime limit of $40,000. This differs from the Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) where unused contribution room is carried forward indefinitely (or until age 71 for the RRSP) — there is no limit.

For example, consider an individual who opened the FHSA in 2023 and contributed $4,000. In 2024, the FHSA would have $12,000 in participation room — $8,000 of new room for 2024 and $4,000 carried forward from 2023. However, if the individual doesn't contribute in 2024, they would have $16,000 — not $20,000 — of participation room in 2025, as only $8,000 carries forward from 2024.

Why Is This Important?

Similar to other registered accounts, the CRA applies a penalty of one percent per month on excess FHSA contributions. In the example above, a $4,000 over-contribution would result in a penalty of $40 per month or $480 per year, which is not insignificant. Additionally, since the FHSA generally closes at the end of the year of its 15th anniversary, or the year after the first qualifying withdrawal, if you don't contribute the full $8,000 each year, you may run out of time to contribute the lifetime maximum of $40,000 and miss out on the full tax-deductible opportunity. By not maximizing contributions from the outset, you might also forgo the opportunity for tax-free growth — contributing $8,000 in each of the first five years from the plan's inception allows for the greatest potential tax-free growth when it comes to timing.

Here are additional tips to consider before year end for other registered accounts:

RESP — While there is no annual contribution limit (the lifetime limit is $50,000 per beneficiary), there are carryforward limits for the Canada Education Savings Grants (CESGs), which offer a 20 percent matching grant on contributions of up to $2,500 each year for a grant maximum of $500. If there is unused grant room from a previous year, this can be carried forward to a maximum grant of $1,000 per year. So if you haven't made contributions in a prior year, the CESG limit can be achieved with an annual RESP contribution of $5,000.

TFSA — Remember that contribution room resets itself at the start of every calendar year. So, if you need to access funds from your TFSA, consider withdrawing before year end. If you wait and withdraw funds in January 2025, this amount will only be added back to your available contribution room on January 1, 2026.

RRSP — Don't forget that both unused RRSP contribution room and unused RRSP deductions can be carried forward. While making RRSP contributions as early as possible allows for tax-deferred growth, deferring the deduction may provide tax-planning opportunities. For instance, if you make a contribution, you can choose to delay the RRSP deduction to a future year, perhaps one in which you will have a relatively higher income, to offset the higher potential tax.

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