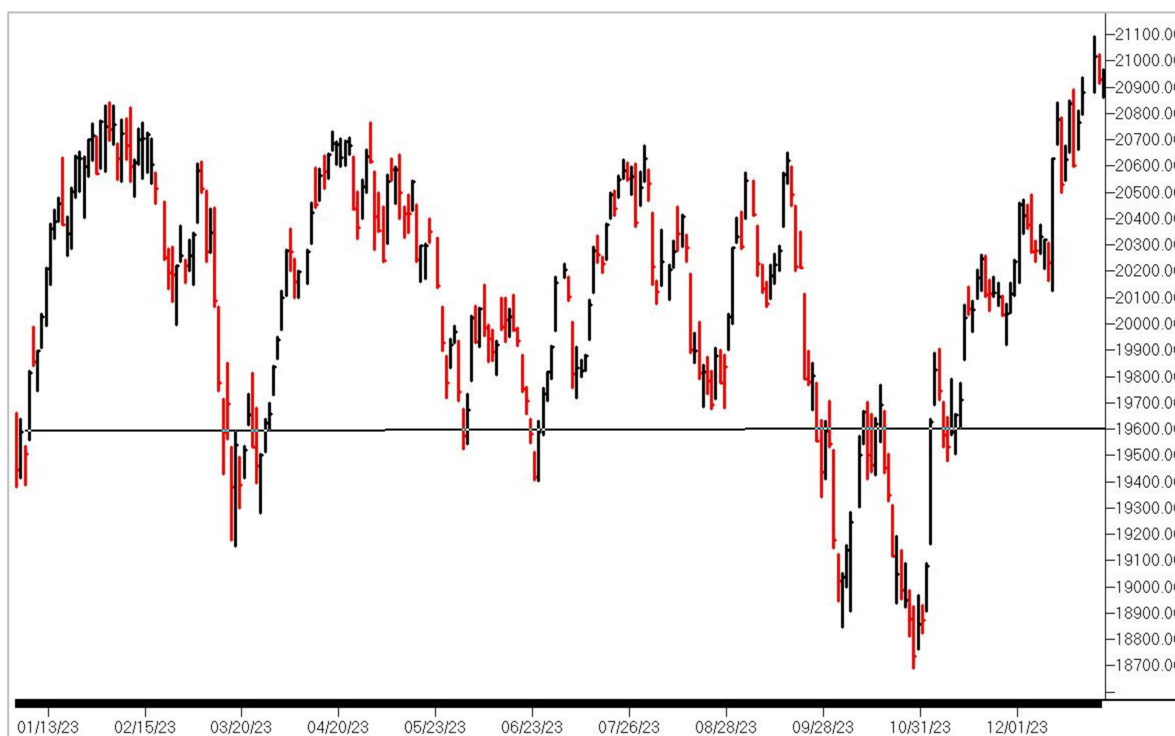
WINTER 2024

Info SIGMA

Markets review

The year 2023 is over and 2024 is in its first months. As shown in the chart below, representing the TSX's performance for the year, 2023 has been volatile, with no real direction, submitting the investor to numerous whipsaws. Fortunately, good performance during the months of November and December allowed us to end the year in positive territory. That performance has continued so far this year.



Source : FBN – Thomson One

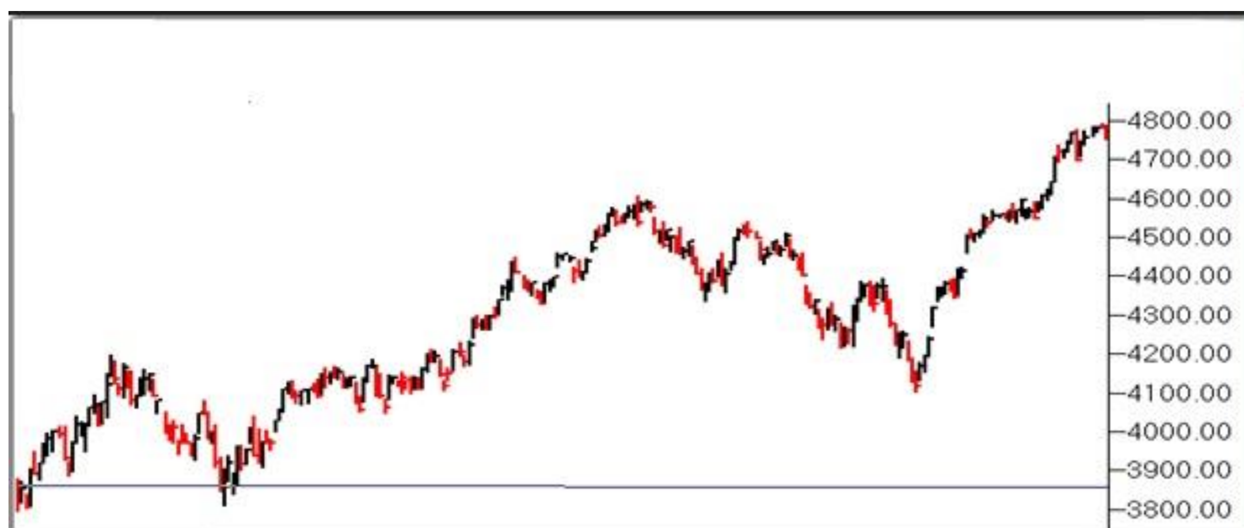
Such a lack of clear direction is common during periods of economic transition such as the one we have been experiencing for the past 2 years. The various central banks have raised interest rates in their efforts to slow down an overheating economy and tame inflation. The various sectors of the economy do not all react at the same speed to these interventions, which leads to an uneven outcome. In the face of this uncertainty, markets cling to every bit of economic news in search of direction, and overreact, both to the upside and the downside. Just as the car driver who does not look far enough ahead down the road, the investor who focuses too much on the short term is inclined to continually micro-adjust his direction rather than stay the course and maintain a straight line.

Despite the gains for the year, few investors are feeling much satisfaction from 2023. Investor fatigue is understandable. Deep, repetitive peaks movements can be exhausting, investors not quite knowing what to expect from month to month. Each upward push has been followed by a loss of those gains. It was only during the months of November and December that the stock market managed to maintain a sustained uptrend.

Markets are notorious for their unpredictability, as we often remind you. This is especially true during periods of transition because trends are unclear. This uncertainty has made life even more difficult than usual for those who venture to make predictions.

This type of assertion does nothing to help the investor in their efforts to ignore the noise and remain disciplined. We have come to doubt their usefulness over the years.

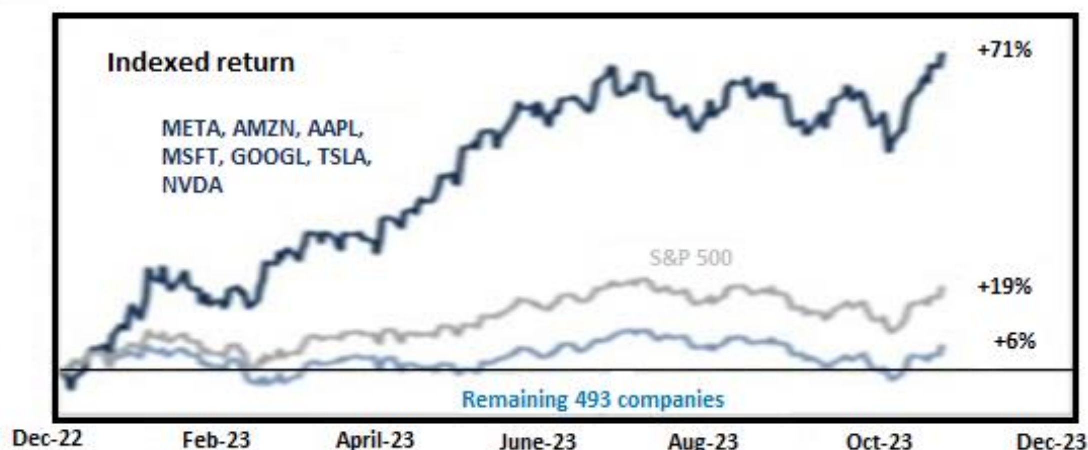
Big tech, online consumer stocks and of course the AI craze stole the show in 2023 and early 2024, propelling the S&P500 and NASDAQ indices up 24% and 37% respectively.



Source : Thomson/Reuters

The index's performance is somewhat misleading because it does not reflect the reality of most stocks that it represents, and therefore the real health of the stock market. More than half of the S&P 500's 2023 return is attributable to just seven stocks in the index, which the industry has become accustomed to calling the Magnificent Seven. As we can see in the chart below, the remaining 493 stocks in the S&P 500 returned 6% for the year, with the Magnificent Seven accounting for 13% of the S&P 500's 19% return (as of mid-November).

Exhibit 23: The Magnificent 7 has led the index higher in 2023



Source: FactSet. Goldman Sachs. Global Investment Research

Given that these seven stocks have had a virtual monopoly on financial headlines, the investor expected to see sky-high returns in his portfolio. But the reality is that while the year ended with respectable returns for most asset classes, the fact remains that their returns were considerably lower than the S&P500 and the NASDAQ that everyone is currently comparing themselves to.

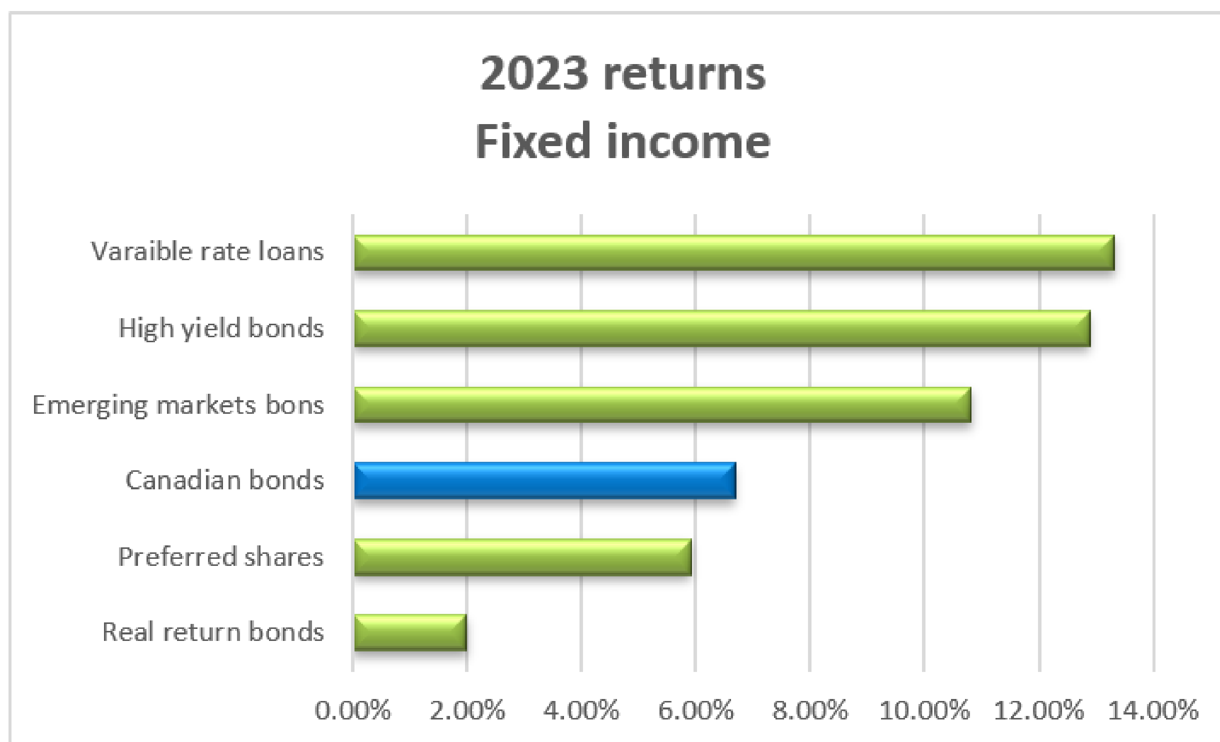
Source: Blackrock, Investors Fasttrack data services

In terms of the asset classes and stock market segments of our portfolios, we can see that the S&P 500 (IVV) has outperformed. Also south of the border, we note the peculiarity of U.S. dividend stocks (DVYs) have narrowly avoided a loss for the year, a reminder that the stock market segment often has more of an impact than geography.

As we have mentioned, the rally took place in the months of November and December. We also see an underperformance of dividend stocks in Canada (8,5% vs. 12%), although this is much more moderate than in the U.S. (2% vs. 27%).

Geopolitical uncertainty has allowed gold to shine in 2023. Usually, the yellow metal, safe haven par excellence, is inclined to perform less well during periods of rising interest rates. Since gold does not pay any dividends or interest, higher interest rates increase the opportunity cost of holding gold. It seems that the level of uncertainty is weighing heavily enough on markets to compensate investors for this opportunity cost.

U.S. real estate investment trusts (REITs) outperformed their Canadian counterparts (XRE). Rising interest rates have been particularly challenging for the commercial real estate sector. As the U.S. market is more diversified across several sectors, it has been able to benefit from the meteoric growth in demand for data storage centers. On the other hand, there seems to be more appetite for a return to the office. Companies are increasingly seeing a direct link between productivity and physical presence at the office in the presence of colleagues. For their part, some employees say that the isolation of remote work is starting to take its toll. We could expect more traffic in office towers and shopping centers in a new equilibrium between virtual and in person, which would be good for some of the real estate sectors most affected by the pandemic.



Source: Blackrock, Investors Fasttrack data services

Following the historic decline in government bonds prices in 2022, fixed income has managed a significant rebound for 2023. Still, the theme of corporate and floating rate outperformance remains well anchored even in this rebound environment. High-quality bonds (XBB) returned 6.75% following their 15% drop in 2022. Floating Rate Backed Loans (BKLN), High Yield Bonds (HYGs) and Emerging Market Bonds (EMBs) all significantly outperformed in 2023, against all expectations of strategists and forecasters who almost unanimously expected corporate bonds to correct in a context of the widely forecast recession forecast that has not yet materialized.

Preferred shares, weighed down in 2022 by a proposal to increase the taxation of their dividends, regained a lot of momentum at the end of 2023 when these proposals were finally abandoned. Real Return Bonds (XRB) posted a meagre gain of 2% for the year, following their 2022 fall.

Rebalancing

There was no need to rebalance portfolios in the last quarter of the year. Given that most of the rebalancing in the previous quarter consisted of profit-taking in our equity index positions and buying bond indices to bring them back to their target weightings, especially as the recovery in November and December was equally pronounced for almost all markets, Weights remained within their target ranges.

Asset class rotations

Given the ups-and-downs of 2023, the asset class rotation baskets experienced several minor month-over-month rotations. In other words, we've had a position change almost every month, but usually only one position each time, always across the different equity indices. The biggest constants were the S&P500 and International Equities (VEA). Then, to a lesser extent, the TSX (XIC) on the equity side and high yield bonds (HYG) and floating rate back-to-back loans (BKLN) on the fixed income side. In terms of real assets, gold earned a spot in the portfolio from April to November. In general, investments that are more sensitive to rate hikes have had very little presence in the portfolio since the rate hike began in November 2020.