Third Quarter 2024 Commentary

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Schacter Palazzi | Wealth Management

TD Wealth

TD Wealth Private Investment Advice

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Can Politics and Investing both Serve the Common Good?

At the time of our last commentary, the U.S. presidential race was a tight Biden-Trump race that seemed to be moving to favour Trump in the wake of a less than stellar showing from Biden in the first presidential debate. Just a few days later, the race was upended as Biden stepped aside and indicated that his preferred successor was the current Vice-President of the United States, Kamala Harris. The Harris-Trump election race has been in full swing for 3 months now and it remains very close according to polls.

One philosophical concept that seems lost of late in political circles in both the United States and Canada, is the idea of serving the common good. Close to home, the Quebec based Bloc Quebecois, is offering to support our minority Liberal government so long as the can leverage the support they give for goodies for themselves. I am sure there are a few Canadians out west and out east are raising an eyebrow. It wasn't that long ago we came together as a country to cheer on our Olympians but amongst politicians the concepts of being cordial and legislating for the common good seem to have been forgotten.

We believe that politics can have a lasting impact on our investment choices so let's dive into your questions, including one on the US election (we had to limit it to one).

Q: Do you think the interest rate cut in the U.S. will benefit our Canadian stock holdings and does it mean the U.S. economy is in decline?

We are a firm believer that, in life, you must be careful of what you wish! What was interesting is that rate cut announced in September 2024 was the first interest rate cut in the U.S. in more than four years. Our team had expected a cut of 25bps and so were surprised by the 50bps cut. We began to wonder if perhaps the Federal Reserve was seeing something in the data suggesting the economy was not as rosy as it seemed. The Bank of Canada has been more measured in its approach, using 25bps cuts. We initially worried that the larger cut might undermine confidence in the economy and its ability to avoid a recession, but recent jobs data out of the US suggest things continue a decent path with unemployment in the US showing a decline in this latest report.

We have been speaking about the attractive valuations of Canadian equity holdings, particularly our long suffering, Canadian dividend holders. This extraordinary interest rate cut by the Federal Reserve continued to support higher prices for all dividend paying stocks both in Canada and the U.S. We are still constructive on many of our U.S. holdings as they continue to show signs of strength in their business models through higher EPS (earnings per share) growth and forward forecasts in their quarterly reports. We will be watching closely though over the next two quarters for any signs of weakness from our holdings and sectors.

Q: During our reviews and conversations you and the team have pointed out the exposure our North American portfolio has to Artificial Intelligence (AI). Can you explain why you think we need to have it as part of our portfolio going forward since you have stated it increases the volatility?

Artificial Intelligence (AI) needs to be thought of in terms of what it means to all of us and in particular its effect on investment choices.

Many of you have used it on platforms like ChatGPT but the real potential is so much more than generating funny pictures or crafting an essay. Why does this matter for investors? Because it has the potential to make companies more efficient, allowing management teams to focus on profit and growth goals. Think about the last time you were on an airplane. AI is used in flight operations to analyze weather and air traffic. Sensors also run predictive analytics that identify potential problems with an aircraft. In defense, AI provides tools for strategic decision-making, threat monitoring and cybersecurity. When defending against cyber-attacks, technology can learn patterns and create improved layers of protection. In construction and engineering, AI can optimize the design process, using advanced algorithms and simulations to identify the best configurations and optimal product performance.

Argus Research has predicted that AI in manufacturing will be a $21 billion market by 2028 (no matter who is the next President).

We see AI themed investments to be part of our North American Model (which employs both Growth and Income) as we feel the growth opportunities outweigh the increased volatility which comes with such investments.

Q: While you have been preaching patience with our dividend investments (we are happy to see many of our bank stocks and utilities recovering nicely) do you still think it is a good time to add to them with the state of the world?

We must start to the answer to this question with a statement about our dividend-based investors: they own our dividend model for the income. And so, with the income stream the important goal, dividend investing is not about big growth. Owning a utility, bank, pipeline or any other similar type of business is not about investing for innovation and hyper growth. While rates of return tend to be lower, the volatility of the portfolio's value is also lower. It can be distracting just getting a regular income when you look across the isle and see an investment like Meta (formerly Facebook) up +68% YTD in 2024.

We believe that dividend stocks continue to offer opportunities, particularly given the speculation over the trajectory of interest rates both in Canada and the US (think of all the mortgage holders in Canada who are hoping for faster interest rate reductions from the Bank of Canada). This speculation has made people question the market timing for rate sensitive equities. In our minds, the major factors attracting us to these companies are the higher dividend yields and lower valuations in comparison to their growth counterparts. We have, in the past, written about the Magnificent Seven and their valuation and volatility.

While the attractiveness of fixed income is beginning to wane, we still feel it can offer some value over a 2 year horizon, after which we believe that returns may drop should the economy stay on its current path in Canada and the U.S.

Q: Are you making any adjustments based on who becomes the next President of the US?

A: We recently listened to an internal TD conference call from the Washington Research Group which is part of what TD Securities acquired when acquiring Cowen Inc. 18 months ago. One of the speakers, Jim Johnson, spoke about the merits and flaws of both the Trump and Harris platforms and potential Presidency. After listening to his analysis which he feels point to a strong probability of a Republican-led Senate, it occurred to us that no matter who succeeds, that candidate will face gridlock to make any major lasting policy changes. Capital markets tend to like gridlock because it holds the status quo and therefore, companies navigate in a stable economy. However, between here and getting the election outcome there could continue to be some volatility. Holding onto companies that are not on the radar of government bodies (Department of Justice, Federal Trade Commission, Consumer Financial Protection Bureau, et al.) makes the most sense no matter who wins.

As far as making any changes we remind everyone that Canada's capital gains tax for our highest income earners stand at 26.76% for the first $250,000 and 35.69% for capital gains above $250,000. For some of our larger client portfolios, giving the government almost 36% of your gain makes no economic sense in the short-term. Recent polls in this election are quite close and being able to determine what policies could be enacted by both the new incoming US President, the US Senate, and US Congress are far from assured. We will continue to focus on companies that have both a defensible moat of excellence and superior product in the marketplace versus other competitors.

We had many more questions than usual this quarter so we could not answer all of them. With the U.S. election around the corner and a possible Canadian election in the cards, if you have further questions or concerns surrounding your personal or family situation, please reach out directly to Jeff, Andrew, James or Jessica.

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