Quarterly Commentary

2024

Year-in-Review

AMERICAN EXCEPTIONALISM – DÉJÀ VU ALL OVER AGAIN

As we look back to the start of 2024, even the most optimistic of market bulls would likely have felt the proverbial limb bending considerably with a promise of a 20+% annual return for the S&P 500 during the year ahead. Having just exited 2023 with a 26% total return — a year in which recession forecasts were the biggest game in town — statistics alone would have left one feeling pretty exposed at that level. After all, consecutive years of 20+% annual returns had only previously been recorded three times in the prior 100 years of S&P 500 history, notwithstanding the fact it had already recorded three years in excess of 20% in the prior five. To highlight the degree to which forecasters chose not to venture out on the limb too far, by the end of January 2024 alone, the market had already surpassed most prognosticators year-end targets for the S&P 500; levels it would go on to decidedly pummel over the remaining 11 months. As we said in our 2023 annual letter, markets are a constant source of humility, but bears have felt the true sting of that statement much more than bulls in recent years — a reality we can all be thankful for.

While 2024 might be statistically surprising, the fact the U.S. markets led all other developed markets is perhaps not. Indeed, 2024 is a continuation of a trend of U.S. exceptionalism that has evolved into somewhat of an expectation since the Global Financial Crisis (GFC) of 2008-2009. As of October 2024, the FTSE All World Index, which tracks over 4200 mid- and large-cap stocks from countries around the world, had risen 216% in USD-terms since the GFC. The U.S. contributed 181% of that total. In 2008, U.S. equities made up 41% of that index. By the end of 2024, that weight had increased to over 65%; over 11 times greater than the next closest country (Japan at 5.5%). At the time, the GFC may have led many to question what lay ahead for U.S. markets following their epic collapse. And yet, 16 years on, the very market responsible for kicking-off the crisis has led annual global market returns in 10 of the last 16 years. The flourishing growth of the U.S. Tech sector has played no small part in this dominance. As technology has steadily worked its way into nearly all facets of modern life, so too has it worked its way to the top of the market, successfully displacing traditional industries as the primary driver of growth.

While the U.S. continued its global leadership in 2024, equity investors the world over were generally treated to double-digit returns over the year. Even China, which spent much of the year in a malaise of stubbornly slow growth — thanks to a struggling real estate market, weak consumer confidence, and a government hesitant to stimulate — produced returns in excess of 15%. Bond investors, too, enjoyed a positive year, as central banks around the world began cutting interest rates in response to falling inflation.

Given all this, one would be forgiven for thinking global conditions were ripe for growth. Indeed, it's easy to forget 2023 was a year in which many were calling for a U.S.-led global recession. When one failed to materialize, markets were left with the uneasy feeling such a recession might be lurking on the horizon in 2024. If one was to be avoided, forecasters would need to embrace a shift in mindset towards expanding growth and broader optimism beyond just artificial intelligence, all while debating how truly soft a 'soft landing' could be. With interest rates still at multi-decade highs and central banks steadfast in their determination to stamp inflation out, this was not a trivial ask. Ultimately, however, markets did just that, and more.

Looking back on the year, there was no shortage of sources that could easily have derailed positive sentiment. Geopolitical crises worsened: Ukraine and Russia continued their brutal standoff; conflict between Israel and Palestine spread to a broader regional crisis in the middle east; trade tensions between China and the developed world continued to escalate. Over 40% of the world's population held national elections, many of which were gripped in standoffs between incumbents and populist constituents on opposing sides of the political spectrum, a reality in which Europe's two leading economies – France and Germany – remain mired. Perhaps most notably, the world's leading economy once again tapped President Elect Donald Trump to lead their country forward, and, though markets have reacted optimistically, his leadership brings no shortage of uncertainty to the global political landscape — much less U.S. monetary policy. Still, not many would have predicted the stiffest test the market would face in 2024 was a shift in Japanese monetary policy that would prompt an unwind of a popular foreign-exchange trade that would have cascading (if short-lived) effects on equity markets.

As the old saying goes, it is difficult to make predictions, especially about the future.

It may be that 2024 will be remembered as the year where markets brushed off all naysayers and powered higher, but what lies ahead for 2025? At Borger Griffiths Wealth Management, we are aware of the folly of predicting what markets have in store for us over the next year. Rather, we endeavour to build durable portfolios that will perform in a range of conditions, all with an eye on capital preservation and risk-management. That said, we spend a lot of time thinking about and researching potential sources of risk that may affect our portfolios, how we might mitigate those risks, and what opportunities may be uncovered in the process.

Below, we lay out the key themes we believe may be critical in driving markets over the next year, along with how we are positioning client portfolios in light of such themes.

MARKET THEMES FOR 2025

Artificial Intelligence (AI), Valuations, Market Concentration, and Compound Risk

Momentum around AI has been at a fever pitch since the release of ChatGPT in the first quarter of 2023. Since then, market performance has been dominated by the Magnificent Seven. In 2023, these companies accounted for 63% of the S&P 500's annual return; in 2024, they contributed 55%.

NVIDIA has been the standout winner as tech companies around the world have scrambled to get hold of their advanced chips needed to build-out the massive datacenters required to run AI models. NVIDIA rose nearly 179% in 2024 on the back of a 226% rise in 2023.

By and large, the Magnificent Seven have benefitted from the early phases of AI development with higher profit margins and stronger earnings growth than the rest of the market. Their share prices have outperformed accordingly. However, they have also been the benefactors of massive speculation around AI's future potential in the form of higher price multiples. At the end of 2024, the top 10 stocks of the S&P 500 index (i.e. the Magnificent Seven plus Berkshire Hathaway, Broadcom, and JP Morgan) traded at a combined price to earnings ratio of 29.8x, compared to an historical average of 20.6x, with the Magnificent Seven trading in

excess of 35x. The remaining ~490 stocks in the index traded at an aggregate P/E of 18.2x, much closer to the historical average for the S&P 500 of 16.6x. Additionally, the Magnificent Seven now account for more than 33% of the total aggregate value of the S&P 500 Index.

By one popular measure, the S&P 500 today is the most concentrated it's been since the 1950s. What's more, much of the momentum in other areas of the market has been directly tied to the momentum in AI. One example is the Utilities sector. Utilities are generally regarded as a low-growth sector with returns and volatility much more subdued than flashier, higher-growth sectors like Tech. This year, however, the Utilities sector powered its way to an aggregate total return of 23.4%. Much of this momentum is thanks to the drastic increase in forecasted energy use associated with AI infrastructure over the coming years. According to McKinsey & Company, energy consumption associated with U.S. datacenters is set to nearly triple by 2030, rising to approximately 600 TWh, or nearly 12% of total U.S. power demand. (This says nothing of anticipated growth in electric vehicles over the same time period.) Industrials, which serve to facilitate the physical build-out of AI infrastructure, is another example of an industry benefiting broadly from the rise of AI. That sector produced a total return of 17.5%. in 2024.

The result of so much momentum being tied to the same theme creates obvious and potentially compounding risks if that momentum falters. This is only exacerbated by the degree of market concentration in the largest, most heavily watched stocks in the world. Artificial Intelligence is in the very early stages of development. How this technology will impact our economies and the degree to which it improves productivity remains to be seen, and it may take much longer to come to fruition than momentum alone can sustain. Major tech companies are spending enormous amounts of capital on this technology, while also forcing historically slow-moving industries, like utilities, to re-evaluate their business models, all while questioning how much stock to truly put into AI's promises. Tech companies will need to demonstrate considerable return on investment over the coming years to justify their valuations and continue spending at such lofty levels.

Tariffs

It was not long ago globalization was being lauded as a powerful global force responsible for breaking down international boundaries and providing developing nations the opportunity to participate in a more globally focused economy. What a difference a few years makes.

The pandemic highlighted legitimate risks of supply chains being too spread out and dependent on cooperating nations. Political sentiments, too, have shifted considerably. Donald Trump ran on a platform of 'America First' in his first term as president. He instigated tariffs on friends and foes alike, and spent considerable energy tearing apart existing free-trade agreements. Four years removed from office, his interest and determination in this regard appear only to have gotten stronger. As well, such nationalist mentality has increasingly gained political momentum in both developed and developing nations globally.

A common refrain batted around about Donald Trump is you should take him seriously, though maybe not literally. It is highly likely he will instigate tariffs; will they be as high as 60% on China and 25% on Canada? Perhaps not, but no one really knows, and who else will he target? The ongoing threat of increasingly insular policies by the world's leading economy will undoubtedly force nations to look inward with a view to protecting their own interests.

Tariffs will increase input costs for any company utilizing foreign-sourced products. Price impacts will be widespread as a result, and very difficult to forecast. Companies with more locally sourced supply chains have the potential to fair better. One silver lining is that tariffs are a one-time inflationary impulse; once implemented, prices will adjust higher, but unless tariffs increase the following year, the inflationary effect is limited to the prior year.

All of this threatens to make many of the goods and services common to everyday lives more

expensive, a reality that has real knock-on effects for inflation, interest rates, the health of household and corporate balance sheets, and the strength of our broader, consumer-based economies.

U.S. Monetary Policy vs. Rest of the World

The U.S. Federal Reserve cut interest rates for the first time in four years in 2024, though it took until September to do it. A weaker-than-expected jobs report in August finally provided a glimpse of weakness in a U.S. economy that had been incredibly resilient. Having made significant progress on the battle against inflation, the Fed finally shifted their sights to the other half of their dual mandate — jobs and employment. Since that time, however, economic strength in the U.S. has continued to surprise to the upside, and, though the Fed cut rates again in October and December, the outlook for further cuts in 2025 changed drastically with the election of Donald Trump.

It is unclear how much of Donald Trump's fiscal agenda will truly be enacted. However, tariffs and tax cuts undoubtedly raise the risk of a secondary wave of inflation. Projected record deficit levels, at a time where annual interest payments on U.S. national debt have surpassed total Defense spending, make the long-term outlook for rates that much more uncertain. The recent move higher in longer-term U.S. bond yields reflects just that, a trend that's unlikely to reverse (beyond temporarily) unless deficits are reigned in.

Jerome Powell, Chair of the U.S. Federal Reserve, has spent the last three years correcting the 'transitory inflation' policy misstep that ultimately led to the highest inflation levels seen in decades, peaking at over 9.0% in June 2023. Powell wants to be remembered as the modern-day Paul Volcker — the Fed Chair who has attained almost mythical status as the slayer of runaway inflation in the 1970s and 80s — not his predecessor, Arthur Burns, who let it run away.

The combination of Powell's legacy and the uncertainty associated with Trump's policies means U.S. interest rates will likely stay higher for longer. The Fed itself acknowledged this fact at its December policy meeting. This is in stark contrast to most other developed nations, where falling inflation, slowing economies, and reduced consumer spending broadly point to continued rate cuts. The U.S. Dollar is the strongest it has been relative to developed-market currencies since the dot-com bubble at the turn-of-the-century. With an Administration expected to be pro-business and light on regulation backing an already strong U.S. economy, it's difficult to bet against continued U.S. exceptionalism over the year ahead.

Increasing Geopolitical Risks

This is the third year-end letter where the Russia-Ukraine conflict has featured. Unfortunately, it may not be the last. This year brought the first Ukrainian aggressions in Russian territory, and, at this point, a diplomatic resolution appears to remain a distant hope. Beyond the human tragedy, the ongoing conflict continues to raise political tensions and realign trade relations. China has been the most meaningful supporter of Russia, and, as political relationships between China and the Western world have become increasingly strained, the alliance has intensified into an us-versus-them mentality determined on bending the global economic balance their way. Add-on intentionally subversive political interference and targeted cybersecurity attacks, and the walls being built around nations are surely to get taller.

Unfortunately, 2024 also saw the Israel-Palestine conflict devolve into a broader regional middle-eastern conflict involving numerous states, including Iran. Trump’s history doesn’t suggest he will be a bastion of peace for the region. Even if a locally brokered resolution is agreed to, the ramifications of the conflict are surely to leave behind a much more tenuous regional balance.

China’s intentions for Taiwan remain unclear, though they continue to posture an eventual takeover. This would no doubt present a very challenging and costly situation for the Western world to respond to, and would surely force further decoupling of economic ties.

China, Russia, and the Middle East are rich in natural resources. Their isolation presents challenges to Western nations acquiring commodities (and other goods) necessary to run their economies. Middle Eastern conflict raises energy-supply risk, although up until now this has been overshadowed by lower global demand outlook, record North American production, and OPEC+ threatening to increase their own production quotas. We have seen China strategically block exports of critical resources in the past. These have included items such as rare earth elements used in green energy applications and battery production. Increasingly, China is also strategically investing in developing nations' resource industries as a means of securing future supply. Take a look at Indonesian Nickle production—a critical element in electric vehicle batteries—and you can see the impact of such investments, and the potential risks this presents to other nations. The U.S.'s own export controls designed to block China's access to advanced computer chips and associated technology shows this is not a one-way street either.

Realigning trade relations can be a painful and costly process, something Europe has experienced first-hand as they have decoupled themselves from cheap, abundant Russian energy supply. The dismal condition of their manufacturing sector is emblematic of the challenges such shifts can inflict on an economy.

All this to say, geopolitics are becoming increasingly unstable. With instability comes uncertainty and the potential for higher levels of volatility.

Canadian Malaise

We have written numerous times about the challenges Canada is currently facing, so we won't belabor it too much here. Despite record immigration (the highest of any G7 country) our productivity and GDP growth remain remarkably weak (the second worst of the G7 in terms of GDP per capital). Housing prices are at record highs across much of the country, and the rise in interest rates have inflicted much pain on heavily indebted household balance sheets; a condition which may worsen as fixed-rate mortgages renew at higher rates over the next several years. As a result, The Bank of Canada (The BoC) has been forced to drop rates significantly faster than the U.S., which has driven the Canadian dollar to its lowest level against the U.S. in nearly a decade.

Although headline job growth has been strong, new jobs have almost entirely been supplied by the public sector (i.e. government). These jobs don't do much for expanding competitive industries and driving business growth, and they create longer-term challenges for the economy given the pension entitlements tied to those jobs. Despite public-sector job growth, unemployment in Canada has risen considerably as a result of the loss of private-sector jobs. November unemployment came in at 6.8%, nearly a percentage point above pre-pandemic levels. Meanwhile, the U.S. rate remains at 4.2%.

Canada faces a real threat from Trump's proposed tariffs. Although this may be part of a negotiating tactic for the scheduled review of the U.S.-Canada-Mexico Agreement in 2026, you can bet Trump will be intent on maximizing everything he can get out of the "51st state".

Canada's economy needs a shot in the arm, with a focus on improving productivity and creating internationally competitive businesses that can serve as durable growth engines for the economy in the future. We have the skill and know-how required, we need the proper allocation of resources and regulation (or deregulation) to back it up. At the time of finalizing this letter, Prime Minister Justin Trudeau announced his resignation. With Trump coming into power, the timing of this announcement, however inevitable it had become, is certainly lamentable. Whoever is tapped as the next leader, we hope they will be a positive force for growth and momentum for our great country.

BORGER GRIFFITHS WEALTH MANAGEMENT INVESTMENT STRATEGY

Every year new risks appear; some change, and some are resolved. We consistently stay abreast of evolving risks—we research them, analyze how they may affect markets and asset classes, and then formulate our investment strategy to mitigate those risks as much as possible. All while being cognizant of our clients' individual financial goals and risk tolerances.

Below we have outlined how we are thinking about and aligning our portfolios in light of the risks outlined above:

Fixed Income

We have been proactive in allocating to fixed income assets over the prior two years given the very positive rates of return available. We had also anticipated higher interest rates would impact Canadian households sooner, and to a greater degree, than the U.S., which has indeed been the case. Canadian interest rates have dropped considerably over the last year, which has been positive for our bond positions. However, forward yields on Canadian fixed income have dropped in tandem. Canadian rates are likely to continue to drop, as are yields in the majority of developed markets globally. We will be opportunistic and selective in our Canadian fixed-income allocations, with a current bias to high-quality, medium-duration assets.

Though we do expect U.S. rates to drop, there is considerable uncertainty associated with Trump's policies. Therefore, barring a secondary inflationary impulse, they will likely drop less quickly than other markets at a minimum. This presents opportunity for higher yields in U.S. assets, though we remain cognizant of the potential for widening credit spreads in the face of policy uncertainty; agency bonds and high-quality investment-grade bonds will therefore remain the target.

With the outlook for rates to drop, we have also been allocating to several globally diversified fixed-income funds, all of which have very strong performance records in maximizing yield and return potential in global bond markets. The tax-efficiency of these funds, along with the income being generated from the assets they hold, make these compelling diversifiers to our fixed-income allocations.

Though trending lower, yields remain well above average rates seen over the last 15 years, and provide very solid income opportunities as well as risk-management attributes to portfolios.

Equities

Equities have performed exceptionally well, particularly in the U.S. What's more, volatility has been remarkably subdued, with little in the way of significant market corrections. With Trump in power, among other potential catalysts discussed above, we anticipate this will change.

We have been gradually taking profit on higher-growth positions, particularly those with exposure to the Magnificent Seven. We believe downside risk is higher in these names given valuations and market concentration. Earnings growth from these companies is anticipated to converge with the rest of the market in 2025, leaving opportunities for the rest of the market to gain momentum from much more reasonable starting valuations. That said, successful monetization efforts of AI infrastructure could prove to be a catalyst for continued momentum of select Magnificent Seven stocks.

Although Canada's economy has been weak, falling rates have been positive for dividend-paying equities, which comprise the bulk of our Canadian exposure; this should continue with falling rates in 2025.

Small and mid-cap stocks may fair better in the face of Trump's tariffs. As well, global stocks are trading at record valuation discounts to the U.S., which may provide opportunities for relative bargains if political hurdles can be overcome and manufacturing momentum picks up.

To summarize our equity positioning:

- Cautious overall with a view for volatility to rise and a high probability for an eventual correction within the next 12 months
- Continue to overweight exposure to strategies that have embedded downside mitigation strategies built-in, including active hedging and long-short strategies
- Expect U.S. equities to continue to outperform with a bias towards continued improvement in breadth — Favour more fairly valued large- and mid-caps stocks versus mega-caps
- Limit Canadian equity investments to quality companies with a strong history of paying and raising dividends, and with limited risk associated with potential tariffs
- Shift opportunistically to increasing global developed-market equity exposure with valuations of primary importance

Market Performance

All developed-market equity indexes globally produced a positive return in 2024. The U.S. market led the way with the S&P 500 finishing the year with a 23.3% return. Communication Services and the Information Technology sectors outperformed all others at 38.9% and 35.7%, respectively. Materials were the laggard at 0%, followed by Health Care at 2.6% after a late-year, Trump-associated drubbing that saw the sector retreat by 10.3% in Q4. The NASDAQ returned 28.6%.

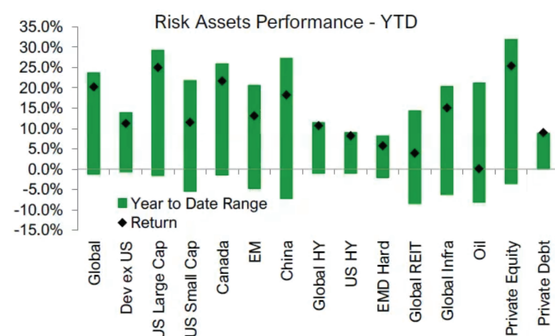
The S&P/TSX Composite Index produced a positive 18.0% return. The Information Technology sector rallied in sympathy with the U.S., while falling rates provided momentum to dividend payers. The Tech sector led, finishing the year up 37.7%; Financials were second at 25.0%. The Communication Services sector was the standout underperformer, finishing the year down a staggering 26.5%, thanks primarily to the collapse of the Canadian Telecom giants (Bell, Rogers and Telus).

The Japanese Nikkei 225 finished the year up 19.2%, despite the historic day in August where it dropped 12.4% in a single session in response to a surprise interest rate hike by the Bank of Japan, and the associated unwind of the popular 'Yen Carry Trade'. It recovered most of that ground by the end of August and had a strong finish to the year, finally eclipsing its previous year-end high set way back in 1989.

The MSCI China (USD) index had a solid finish to the year thanks to significant government stimulus efforts announced in the fall. Overall, it registered a 16.3% return in 2024, though the economy continues to face challenges associated with weak consumer confidence and a flagging real estate/ property market.

The Euro Stoxx 50 had a tough quarter as Germany and France struggled with internal political and fiscal challenges. Overall, the index finished the year up 8.3%. The UK FTSE 100 finished up 5.7%.

In North American fixed income, the FTSE Canada Universe Bond index finished the year up 4.2%, while the Bloomberg U.S. Aggregate Bond Index finished up 1.3%.



Source: FactSet, Wealth Investment Office, as of December 31, 2024

Annual TFSA and RRSP Contributions

The 2025 TFSA contribution limit is $7,000 and the cumulative contribution limit is now $102,000.

For those of you who make annual RRSP contributions, the deadline for inclusion in the 2024 tax year is March 3rd, 2025. The limit for 2024 contributions is 18% of earned income up to a maximum of $31,560 (subject to pension adjustments). The 2025 limit is $32,490.

The Borger Griffiths Wealth Management team thanks you for your business and continued trust in us. We look forward to continuing to work with you and your family as we help navigate your financial journey with deep knowledge, diverse experience, and commitment on your side. If you have any questions or issues you would like to discuss, we would be happy to receive your call.

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