2023 Financial Year in Review and Looking Ahead for 2024

Keith: Welcome to the Empowered Investor. My name is Keith Matthews and I'm joined by my co-host, Lawrence Greenberg. Lawrence, how are you today?

Lawrence: I'm doing great. Very happy to be on the show again. I think this is going to be a really good episode. Great to have you on board before we move on your holiday season.

Lawrence: It was a good holiday season. Very relaxing, which is what I needed. Great times with friends and family. Can't complain. And you?

Keith: My wife, kids, and I were fortunate enough to go away for 10 days at a beach in Costa Rica, Nosara. It was a wonderful experience.

Let's jump right into the show. Today we're going to be doing a year in review. What does that entail? We're going to review asset class returns. We're going to discuss key moments in 2023, key issues that popped up. We're going to look forward to 2024 and we're going to use some of the lessons learned in '23 to help get ready for the future. And then, of course, we've got our takeaways. So, let's jump right in and discuss asset class returns. What did the year look like?

Lawrence: I will start off by saying this was a particularly strong year. I think we could take a step back and look at very robust returns across the board. I'm looking at the asset class returns. So, we have Canadian bonds at 6.7%, the S&P TSX Composites, that's Canadian stocks, up 12%, the S&P 500 up 24%, and the MSCI EFI, so that's International Developed and Emerging Markets up 13%. So really, we're in double digits, we're in teens, and 24% for the US stock market. Those are really strong numbers.

Keith: Yes, absolutely. This is one of the years where all asset classes were positive, which is a bit unique in and of itself. Of course, you're rounding. So, in all those markets, the S&P was 23.59. But the point is valid in that stocks had a very robust year and even fixed income after its difficult. 2022 had a much more positive year, but that was to be expected because rates rose. Yes. And yield growth. We're starting to get positive numbers now. How did a 60-40 portfolio, so 60% stocks, 40% bonds, which is a classic benchmark that investment professionals use, how did the year go?

Lawrence: Yes, so the 60-40 portfolio of indices was up 12.4%. 12.38 in Canadian dollars, that's total return. So, a balanced portfolio with stocks and bonds had one of its better years, and a large part of that was yields being quite strong on the fixed income side. And that's something we haven't seen in 20 plus years.

Keith: Yes, absolutely. And our version of the 60-40 is the 60 equity is divided between a third Canada, a third United States, and a third international with some emerging markets. So that's just how we view the 60-40 benchmark. So how did that compare to the year before just in general, whether it's a 60-40 portfolio or asset class returns?

Lawrence: Yes. So, this past year was in stark contrast to 2022. A 60-40 last year of the same composition would have been down 10%. So, you made up that ground. You're basically back to even from the losses from 2022 and 2023. And we saw really across the board in all major asset classes, at least the ones we're looking at, are all positive. And a lot of them are making up the losses from 2022.

Keith: Yes. So, this is a bit of a catch-up here. Yes, absolutely. And it's one of these things where I guess if you look at 2022 versus 23, the stocks that went down the most in 22 were tech and growth and those stocks had the biggest lift in 23. And so, you go literally around all the asset classes and those that had the biggest drop had the biggest gain, and you did play catch-up. It's back to where we were two years ago. Yes, exactly. So, what happened underneath the hood? So those are general broad market fixed income and equity observations. What happened underneath the hood? What was going on? Because it was a very unique year.

Lawrence: Yes, the big theme of the year was the Magnificent Seven. So those large tech firms really masking a lot of, at least the start of the year, the first six or nine months. The markets were plucking away a little bit flat, but tech was really surging. And only later in the year did markets really pick up on all facets with a wave of optimism to produce these gains.

Keith: I remember doing a mid-year market review with Marcello mid-23 and the Magnificent Seven, which we're going to define in a second. The Magnificent Seven represented like 80 percent of the return of the US market. And as soon as you got into November, when the Fed cut, everything then rallied across the board. The last two months of the year were very strong for all asset classes, including value, small companies, and not just the tech companies. Which stocks exactly fit into this Magnificent Seven group? It sounds like a cowboy movie from the 60s and 70s, there's some bandit-type movies that kind of had those types of names. Who are they exactly?

Lawrence: They are the Disruptors, so it's quite fitting. The Magnificent Seven are Nvidia, Facebook, Tesla, Amazon, Microsoft, Apple, and Google. What happened to Netflix? That was part of the FANG. There was a FANG component. What happened to Netflix? They lost some subscribers, and then they had a tough couple of years, and now they're back. So, they're out, they're out, they're out, and they're back in, and that's how these things go.

Keith: So Magnificent Seven were some of the drivers of some of the returns in the US market in particular, and so let's look at a few of them just to try to get a sense of the size of these companies now. You've done some research on, you've got the top seven here, but let's talk just about a few of them and then actually compare them to countries.

Lawrence: Yes, because we were talking, it's quite striking how big these firms have gotten. They're all in that trillion-plus mark, and I'm looking at Apple at 2.84 trillion. That is the size of the Canadian stock market. That is quite striking that it's gone to the size where these companies, in aggregate, are almost

12 trillion in overall stock market cap, which is their overall size. They would be the second-largest stock market in the world if they were their own country.

Keith: Yeah, wow. And I guess the same could be said for Microsoft. Yeah. So, they're both coming in at 2.7, 2.8 trillion dollars. And it is remarkable. We did that review first thing this morning, and we, in fact, were surprised it's coming in exactly where Canada is.

Lawrence: The combination of Apple and Microsoft would be around the size of Europe, all the European stock markets. It's been a very strong decade or so for a lot of these stocks. Valuations now are very high.

Keith: Yeah. When you look underneath the hood, depending on how you diversify a portfolio, if you don't own any of those securities, your portfolio lagged. If you overweighted, lucky you, your portfolio was ahead. Obviously, in our portfolios, we have decent weightings in all of those securities on the U.S. side, but we do have underweights because we tilt towards value, and we include small companies and small value. But it is remarkable to see in a year like last year, just how much they came back contrary to what they did the year before. Exactly. What else happened? What else underneath the weeds? Some style factors, what was going on there?

Lawrence: We do a pretty detailed benchmarking to better understand the different segments of the stock markets in Canada, US, international and so on. And I'm looking at this now and I'm seeing value across the board doing relatively well, keeping up with the broad benchmarks. Small had a late surge. In the last two months of 2023, I'm seeing even emerging markets doing well, which we haven't seen in a little while as well.

Keith: What ends up happening, and I guess when you look at it in lieu of what you've just said, the Magnificent Seven really only show up in the United States. And so that market really looked a bit different because of those seven companies where growth really outperformed value. But around the rest of the world, what we saw was that value and growth often were fairly equal. So that's a look underneath the weeds on the equity side. Let's look at some general themes, Lawrence for 2023. What was one of the most major themes within the economy, within the stock market last year?

Lawrence: I'd say last year a lot of the headlines and a lot of the attention went towards the economy. You have interest and so rates and inflation really were the headliners and it really dictated the course of the year and the overall markets flowed with that data, especially with rates.

Keith: I can't remember another period where in the last few years, everybody's being drawn towards inflation. Where's inflation, whether it's just having discussions around how expensive life is, spending, etc. But there's been a real focus on where is inflation and is it under control?

Lawrence: And that's the big one. To take you through the past year and a half or so, it's been quite a ride. Inflation peaked at 9.1 percent in June 2022. We started off 2023 in January at 6.4. It dropped from nine to six and a half. Then by the end of the year, at 3.1, so the end of 2023, 3.1 percent was inflation. It really came down to that long term average, maybe quicker than we may have thought.

Keith: They want to get it down to two, but your point is absolutely bang on. I think you went from in the middle of 2022, a 9 percent inflation. Which stings. And people were talking about, this is going to be here for a long time. In fact, we're going to have sticky interest rates. I remember a couple of years ago, Lawrence, when the Fed was talking about inflation being transitory. And I guess people were thinking transitory might be six months, a year, and then it's going to come crashing down again. And by 2022, it wasn't crashing down, it was sticky. And there was a real concern that in fact, it wasn't transitory. And so what you're alluding to is it came down quite a bit in 2020.

Lawrence: Yeah, it was a big year for inflation. And that gave the opening for the Bank of Canada and the Fed and other central banks to start at least alluding to a slowdown of hikes. And maybe even cuts into the future.

Keith: You did a nice job here, pulling out interest rate policy when actual Bank of Canada and the Fed raised rates. In looking through this, we got the biggest rate increases in 2022, where you remember that Lawrence US reserve would come in and they would raise rates by 0.75 of 1 percent overnight.

Lawrence: Yes.

Keith: And they did a bunch of those in 2022. All in a row.

Lawrence: 2022 it was constant hikes every couple of months, only three hikes in 2023. And now it's been this quiet, hesitant, we're waiting to see what happens next. But the consensus really, in the overall market and what markets seem to be pricing in is that maybe the hikes are finished, which is the language that the central banks are using and potentially even cuts at some point in the future.

Keith: Yes, 2022 was like five, six big rate hikes all the way through, maybe even seven. 2023, like you said, three. Small rate hikes in Canada, four small in the United States, but the biggest thing was the impression that the rate hikes would no longer continue. In other words, no longer continue going up. There might be a pause and then in fact, there might be rate cuts. It's almost like the fever was broken. That's what happened in November and December. They were rejoicing and they started pushing up bond prices and then obviously stocks and stock returns.

Lawrence: Yes. Stocks like it when rates come down for sure.

Keith: Okay, that was definitely one of the big themes of the year, which was following inflation. Hopefully, as we go into 2024, the goal is for people to start seeing inflation coming in between two and two and a half percent, that would make people really happy. I think it would make the market happy, but it would also make mainstream people leading their lives happy too because you've got a better control of your spending.

Lawrence: Yes. And the big thing is how the economy performs now post-aggressive hikes, will a soft landing actually occur, which means that the economy growth is still strong or at least not negative. Or will there be a recession? We still don't know. The jury's out.

Keith: And you've got some nice charts here that you pulled up which show this incredible spike all the way through 22 and 23 with interest rates going up. And then it's got a few triangles which suggest where federal reserves are going. And it definitely implies cuts.

Lawrence: Yes, that's the consensus right now. That's the language we're getting. But again, we don't know. These things could change. You have to make sure you're well positioned for types of environments. What we've learned is that these things could change quite quickly, right? So, you want to make sure that you're set up and you don't react too much. To these small blips and have a long-term perspective.

Keith: Absolutely. Which then leads us into, if that was one of the major themes, the next major theme, which came right after that, was this idea that we might get a form of a soft landing or maybe not a severe recession. Remember a year and a half ago. We all know that everybody was predicting a recession. It was almost like that's going to happen for sure in 23, and it didn't happen.

Lawrence: You couldn't escape it. Anywhere you looked, that was the language you were getting. That was all the headlines, how to prepare for a recession. And if you built your portfolio or made trades or changes. forecasting recession, you missed out on a pretty significant year, which may have surprised a lot of people, including experts.

Keith: Yes. Canada's growth wasn't great. So, we've had a few quarters where it's almost flat, maybe even slightly negative. And maybe somebody could argue we're technically in a sluggish environment, but a sluggish environment still produced a 10 percent return on the TSX. So that's an interesting chart that you've pulled up, which shows this massive sort of, it's almost like a rocket ship going up, which is the interest rates going up, and then some suggestions of it coming down. What was the meeting that occurred in November that got the market really excited?

Lawrence: Yes, so that's when they finally use the language that they seem to have achieved what they wanted to achieve, the Fed, and they may start cutting rates. And then once that happens, That announcement was made. We saw this incredible surge in the final six or eight weeks of the year. I have some numbers here. In that last two months of the year, the U.S. market was up 8.26 percent. The Canadian market was up 11.5 percent. International markets were up 9 percent. And yields dropped a lot. 24 percent. So, the market was really had this huge wave of optimism.

Keith: Yeah, those are massive. And it wasn't just at this point, a few stocks going up. It was overall all markets going up.

Lawrence: Yes. And that's also a time where under the hood, we really saw Small cap, for example, really surged where it was quiet through the first part of the year. Those types of sub asset classes really took off with this. Maybe we will get out of this in a mild recession or no recession, and maybe rates will come down.

Keith: Many were even talking about the fact that Other than the sort of magnificent seven, most other stocks were priced for a recession, which means they were lower prices and individuals are expecting higher expected returns going forward. And as soon as there's a hint that there's no recession or straw or hard recession, people will be attracted to those securities. When we look at even our live client portfolios, what we see is that. The last two months generated maybe 60 percent or 70 percent of the entire year's return.

Lawrence: Yes, and that's why you have to stay invested. If you were waiting for a good time to buy, these things could change in a couple of trading days or a couple of weeks, and you feel like you missed the boat. It's always important to stay invested because you get those big waves, and that's what could end up shaping your entire outcome.

Keith: Yes, you're right. Last year's returns came in two months.

Lawrence: Yes, it may not have felt good in September, but then you look at the end of the year, Pretty well-rounded returns across the board. Yes, so we never forecast at all.

Keith: Let's look at a chart that you've got here, and it talks about what happens when the Fed actually cuts rates. And obviously, that might be something that occurs next year. Everyone, I think, is expecting it. But talk a little bit about this chart and what we're looking at, because I think it's very telling.

Lawrence: This is very interesting; it looks at the average stock market performance. In this case, it's the U.S. stock market. What happens before and after the Fed cuts rates? In terms of months, and I'm looking at a soft landing 12 months later on average. You're up 15 percent or so from the first cut on average after rate cuts over the last 60 years or so You're up about 5 percent after rate cuts a year later And if you get a recession, the average recession outcome is year slightly negative, maybe 2-3 percent a year out from the cuts. Generally, markets like rate cuts, especially stock markets. If rates come down, bonds will perform well. Now the question is, will it be more of a soft landing, more of a recession? The jury's out.

Keith: One hundred percent, but it is a great chart because what it essentially shows is that if in fact we've hit this point where rates might come down. You can't say you're out of the woods. Investing is a long-term process, 10, 15, 20 years, but you might be out of the woods in some negative bumps. But again, you just don't know. Okay, so let's go to the next section, which is essentially, that's what happened last year, 2023. How do we see things now in terms of either bond yields, valuations? What are the things that we're observing in globally diversified portfolios?

Lawrence: When we look forward, we don't know. What the market will hold next year or in two years and so on. But we can look at what the data shows. We know that for bonds, on the bond side, yields are quite high. They're the highest they've been in some time. Being a bond investor is truly paying off. You felt that gut punch in 2022 when rates went up, bond prices went down. Now yields are high. You're collecting more income. And if rates do come down, your bond prices will increase, will appreciate. On the fixed income side, on the bond side, investors are very well positioned. That's how we gauge what future expected performance can look like. And on the stock front, we look at valuations, where are the valuations? And again, we're looking at this chart, I think it's from Vanguard. That looks at if an asset class is undervalued, fairly valued, or if the valuations are stretched. So, this is the price compared to some data point. What are your thoughts on the valuations, Keith?

Keith: This is a bit of a reoccurring theme in the last few years. Take a few steps back. Reports from Vanguard and multiple organizations, when they talk about expected returns, they'll now say things like expected returns will be higher in Canada, Europe, emerging markets. On a go forward basis versus the U.S. market where valuations are fairly stretched and expensive. And individuals have a hard time sometimes digesting that because they look in the rear-view mirror and they go, yes, but the U.S. market has done so incredibly well in the last 10 years, it's the only place to be.

That kind of reminds me of what the year 2000 looked like, which is 20 years ago. But the U.S. valuations were very stretched. And other countries were not so stretched. And then we subsequently went into a lost decade for the United States. US equities didn't do very well. And we're not predicting that's going to happen because even in our diversified portfolios, we continually hold all these asset classes, but the Vanguard report does allude to lower returns US. Higher Canada, higher developed markets, higher emerging market. And within the United States, these reports allude to the fact that small company stocks, we never really talk to clients and our investors about undervalued value. That's more of a stock pickers kind of phraseology.

But yes. I think valuations do matter. And so small company stocks appear in this report to be cheaper than their traditional levels. Value companies are in the right zone, they're cheaper. Canada and Europe are reasonably priced. When we think about our portfolios and what investors at large have in front of them, is this opportunity to be fairly well diversified, own bonds that are trading and providing much better returns than we've seen in two decades. It would have been best, three months ago, 10-year U.S. Treasuries were trading at 5%, you could actually get 5%. You could get like a five and a half percent GIC even, maybe even six. Now they've rallied a lot in the last month. Our portfolios are built in such a way that we're fairly optimistic about the long term.

Lawrence: Absolutely, price matters. What we're saying is you want to make sure you have a well-rounded approach. The securities you're buying are not overvalued or you're not chasing those stocks because they've had good historical performance. Generally, what we see is when, Either an asset class or a sector or whatever has a great run. The valuations are high, they're stretched, and the future performance doesn't look quite as rosy, and you want to avoid that and not chase these things.

Keith: Add to that, this whole enthusiasm around artificial intelligence, that's one of the reasons why some of those big stocks took off. I look at that and go artificial intelligence, I think it's great for all companies. We're starting to use it in our firm. We're starting to use it from a productivity tool. You look at that and some people talk about this being another revolution in terms of industrial revolution. We don't know what that's going to look like, but I think that's good for companies in general, whether you're a small company, whether you're publicly traded or not, it's good.

Lawrence: This is really important as we've seen these big developments happen, we've seen the internet come in 2000 and all the .com stocks surging, and we don't know who the winners will be. This is a new industry. Obviously AI isn't going anywhere. It will become more and more important. But trying to place bets now on a fledgling sector like this, it's probably a losing bet. You want to wait and see how things hash out and not start chasing these things after you've seen a good run of performance.

Keith: Yes, a hundred percent, but I'd also go as far as I think it's good for all stocks in general. Let's switch gears here. As we start to wrap up, we're going to spend a little bit of time about what we saw as mistakes that you can get caught in, in 2023. There's a classic year where you can get yourself into trouble.

Lawrence: Now in my couple years of experience, I've been in the investment industry for seven, eight years now. What I've learned is that one of the biggest things you could do in investing to make sure you have a good outcome is to avoid errors, to avoid mistakes and pitfalls. It could be chasing, it could be making big changes based on predictions or whatever, this year was no different. We were talking at lunch, Keith, you and I, about electric vehicles and the surge they had, and they're all the rage. And you were saying that a lot of them are near bankruptcy.

Keith: They're not going anywhere. We have embraced the EV revolution, but is it a sound investment thesis? The jury was out. Tesla stocked it very well. And then you've got a whole series of securities, whether it's car companies, battery companies that struggled last year. If you chased into that bucket, you got yourself into trouble because a lot of them are down 95%. And there are some fairly sizable names. So chasing is something that will get you into trouble. And we've seen this almost every year. And that was a big year for it last year.

Lawrence: Yeah. But it's even chasing conservative things. Yeah. Remember three or four months ago, five months ago, there was a lot of chatter around if you put your money in money market, you can get a 5 percent HISA return. And we had conversations with clients talking about, it's okay to have some of that in a portfolio, but you don't want to be switching too much in because long term, their expected returns are not as high as other types of securities.

Keith: Absolutely. This was a year where we had tons of client questions on should I sell X and buy GICs or HISA, such high interest savings accounts, because the interest rate is now attractive where it hasn't been in the past two decades. But if you did that, if you made those types of changes, your opportunity costs, you lost out on bonds and stocks that outperformed and that did better. And making these predictions on assuming that rates will stay high, and then you could, renew your GIC at the same rate. Those are all risks you have when you buy GICs. And sure, for short term investments, if you want to buy a home in a year, or a cottage, or a boat, or whatever, that's great. But as a long-term investment thesis, there are still risks, and this is one of them, is you miss the boat.

Lawrence: Yep. Yep. For sure.

Keith: So, we're going to move into takeaways because it's going to piggyback off what you were just saying a second ago. What are the four main takeaways that we have for our listeners based on what we saw last year?

Lawrence: The first one is, it's a classic, but it's blocking out the noise. It's staying on the course for your investment process. It's avoiding the headlines and the stock tips, and the friends saying to do this and just stay with your investment thesis, your diversified pool of investments, and stay the course.

Keith: Yeah, absolutely. It's a lot of our classic ones that are built into our investment philosophy, but it's so telling that the last few years have really provided ammunition to support this idea.

Lawrence: The other big one, I think, is that we all learned that trying to build a portfolio, trying to move money within a portfolio based on predictions, based on what you think will happen in the next 12 months, it's a fool's game, and you cannot do it consistently, and you might win once. You might win twice, but if you're a 30-year investor or a 20-year investor or longer, really hard to do this consistently. It's nearly impossible. We've seen the data, investing in things like stocks, there's so many bumps in the road. There's so much randomness that's built into it. Your best course of action is to build a portfolio that makes sense for you and to stick to it.

Keith: Yes, stay away from predictions for sure.

Lawrence: The third one would be back to our famous, this for us is classic, but you got to make sure you have an investment philosophy. If you don't currently have an investment philosophy, do whatever you can to research it. You've got to have a process, a way of thinking, and there are winning strategies that you can adopt and continue.

Keith: Adopt that, stay with it, focus in on it. And lastly, what's the top takeaway?

Lawrence: To avoid mistakes. Which is a big one as well. You have to avoid those big mistakes that will derail your investment outcome. Making changes based on predictions, there's all types of errors that you can make as an investor. So less is more, right?

Keith: Yeah. It's an interesting concept because most people, when they think about wanting to win, they're thinking of what can I do? What bold action can I take to win? And what you're saying, and I wholeheartedly agree, is sometimes winning is just reduce your errors as much as possible.

Lawrence: Yes, absolutely.

Keith: All right, Lawrence, thank you so much for those takeaways, and thank you again for participating. This is an important episode. We always like to do a year recap, but also get our listeners, and clients, and family, and friends, and It's geared up for next year.

Lawrence: Absolutely. It's important to take stock of what the year held and look forward towards the future.

Keith: Thank you so much, everybody, and have a wonderful year and we'll see you in the next show.

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