2024 Mid-Year Investment Review

Announcer: Welcome to the Empowered Investor Podcast. Have you ever felt overwhelmed by the sheer volume of choices and voices telling you how to plan or invest for your future? With a straightforward approach, host Keith Matthews of Tulett, Matthews & Associates cuts through the noise to help you create a winning action plan for you and your family. The decision-making framework discussed in this show can transform you and your investment experiences and will increase your odds of becoming financially secure. Learn more and subscribe today at TMA-invest.com.

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

Lawrence Greenberg: I'm doing very well. It's great to be back on the show.

Keith Matthews: You're a co-host and you've done many, many shows, but Marcello's on paternity leave right now, and you're going to jump in for a couple of shows. I think you were on here a few months ago. So, fantastic to have you back. How are you doing?

Lawrence Greenberg: I'm doing very well. It's been a great summer so far. I actually went to Japan for the first time with my wife Danielle. We had a wonderful experience, really the trip of a lifetime.

Keith Matthews: You're the second person that I know who went to Japan this year. Was it a great trip? How did you find it?

Lawrence Greenberg: Yeah. I mean, it's become quite popular now, especially because the yen is quite weak and people are kind of flowing in as tourists. My experience was that it's a wonderful place to travel, exciting culture, great cities, and very affordable.

Keith Matthews: Because in my mind, I'm thinking Japan's got to be an expensive place to be. I mean, it always historically feels that way. Are you saying it wasn't as expensive as you thought?

Lawrence Greenberg: Yeah, so I think that's a stigma from maybe 10 or 15 years ago when the currency was very strong, but now it felt quite weak. It actually felt like I was traveling at a discount compared to even Europe, which is quite surprising.

Keith Matthews: How much was your flight from Montreal to Tokyo?

Lawrence Greenberg: I got quite lucky; it was $1,300 round trip. And spending, shopping, travel within the country was very affordable and very efficient. So, I think Japan isn't going anywhere in terms of a travel destination for Canadians.

Keith Matthews: Wow, that's fantastic. $1,300. A lot of Europe is $1,300 from Montreal. Sometimes you get $900 or $1,100, but $1,300 isn't a lot. How about traveling inside of Japan?

Lawrence Greenberg: Oh, it's so efficient. With their very elaborate systems of subways, trains, and metros, the bullet train got us the equivalent of Montreal to Toronto in about two hours, and it would have been a fifth of the cost of flying from Montreal to Toronto. It would have been $60-70. Wow, it's unbelievable.

Keith Matthews: Wow, so that is great value. And you were telling us offline that your restaurants, meals, and food were amazing quality at a fantastic price. It goes to show you how much things can change over a decade. And it's a nice segue into today's episode because we're going to be talking about the decade that we're in, the mid-year review, and how things can change over time. So, nice to have you back, and we're ready to go. Alright, in today's show, we're calling this the 2024 mid-year review. We're going to review portfolios and investments up until the end of July. We'll discuss asset class returns, broad asset class returns, styles, technology, NVIDIA, the importance of global diversification, interest rates, inflation, debt, and what that means to Canadians. Finally, we'll have a quick chat about U.S. elections. They're coming up in four or five months, and we'll ask ourselves how much we should care about this relative to investment returns.

Lawrence Greenberg: Yeah, very topical.

Keith Matthews: So, Lawrence, let's jump into asset class returns. These numbers that you're going to share with us are asset class returns up until June 30th.

Lawrence Greenberg: Yeah, so this is for the first six months of the year. Very strong year overall. 30-year treasuries up 2.5%, short-term bonds up 1.5%, longer-term bonds in Canada about flat on the year. Canadian stocks up 6%, U.S. stocks up 19%, and international and emerging up 9.5%, with global REITs flat on the year. So overall, a well-rounded six months for equities, with U.S. equities really charging ahead.

Keith Matthews: Yeah. So, 60/40 portfolios are doing well just as a benchmark. All equity portfolios are doing very well, really pushed by U.S. equities again. This is a very powerful start. What's driving it?

Lawrence Greenberg: Yeah, so the big storyline again for the start of this year, similar to last year, was U.S. technology driving the overall returns. Obviously, 19% on the year for the S&P 500. The big stock name that everybody's talking about in equities is definitely NVIDIA. NVIDIA has had a historic run, making it one of the most, if not the most valuable companies in the world. It's incredible to see, and those who have experienced the ride have seen the surge, but who knows what the future holds.

Keith Matthews: Yeah, and for our listeners, just to make sure everybody's on the same page, NVIDIA is a manufacturer of microchips and microprocessors specific for the AI industry and for allowing AI to be implemented. This company has grown incredibly, and I think it's the largest company in the United States right now with a $2.76 trillion market cap.

Lawrence Greenberg: It's a measure of how big it is, how valuable it is. To put that into context, that is roughly the same valuation of the Canadian stock market, which is incredible.

Keith Matthews: Yeah, that's unbelievable. One U.S. stock is the same valuation as the entire Canadian economy. We had a couple of other stocks; it was Microsoft and Apple which were getting really close. And now we actually have one that's surpassed. If we strip away technology, how would the S&P 500 have done? Would it be lower returns?

Lawrence Greenberg: It would have been kind of in line with global performance, not nearly as eye-popping, right? So those handful of tech firms really drive the overall returns. We've seen that over the last couple of years, and so far this year, it's not any different.

Keith Matthews: So how do we respond to individuals who say things like, "Well, should my entire portfolio be U.S. equities? The U.S. market has just been going gangbusters now for eight, nine years, but particularly for the last five years, and really supercharged for the last couple of years." How do we respond to individuals who say, "Well, why shouldn't my portfolio be entirely U.S. equities?"

Lawrence Greenberg: It is a question we see from clients and just people talking. It's hard to ignore. But the important thing with investing is it's the process that you need to look at, not the results. You need to stay diversified. You don't know what the future holds, even though U.S. stocks have performed incredibly well. Valuations still matter.

Keith Matthews: For example, the prices of firms in the U.S. are relatively expensive. I'd also add that every decade is a different decade. Certain regions outperform, and we are clearly in the decade where the United States looks like it is the strongest return asset class, but it hasn't always been that way. From 2000 to 2010, the U.S. stock market was the worst-performing asset class. That's when Canadian stocks looked amazing, and emerging markets looked amazing. We see these reversals, and it's very hard to identify in the prior decade who will be the best. You can use things like valuations to help you understand how expensive stocks are relative to others.

Lawrence Greenberg: So it's very important to have a sound process. It's not about chasing things. It's very easy in the investing industry to chase the shiny new object, these new types of stocks or a region, but you expose yourself to higher risk. You don't want to start rotating portfolios and making predictions. For example, over the last couple of years, all the large institutions that put up their expected future returns for certain asset classes have been saying to expect lower returns in the U.S. on a go-forward basis. That isn't how things shaped up, but the important thing is they're factoring in that, relatively speaking, compared to historical norms or other stock markets, U.S. stocks are relatively pricey, and we do not expect this type of run to continue over the long term. Prices do matter.

Keith Matthews: I remember the year 2000, after a decade of incredible returns in the United States, if investors were surveyed and asked what they thought the return would be in the next decade, the average return was something like 16%. What did investors get? They got zero in that last decade. That's not to say that's a prediction on our behalf. It's not. Even though certain regions are expensive relatively speaking, we will still continue to hold them in their full allocations in the portfolio. That is absolutely critical to keep in mind. Vanguard came out last year and talked about expected returns. Based on valuations, they put Canadian stocks, international, and emerging market stocks as having the highest future returns. They also put value companies and small company stocks having higher returns than large company stocks. Has that happened in the last year?

Lawrence Greenberg: This year, so far in 2024, it still is a large growth environment, but it's important to note that these things can be extremely lumpy. Styles of stocks come in and out of favor very quickly. In June and July, especially July, small and value securities have rebounded significantly on the optimism or hopes that rates will come down. If you had exposure to U.S. small stocks, U.S. small would have outperformed the S&P 500 by almost 11% in one month. Zoom out over the year, and it's still closer to being at par or even large growth being a little bit ahead. These things can come very suddenly, and these swings happen quickly.

Keith Matthews: Small company stocks have been out of favor for a while, but their valuations are more attractive. All this has come in 14 to 20 days. In the investment world, they call that rotation. There's been a rotation out of larger, more expensive securities into cheaper, more reasonably priced ones in the last three weeks. The question is, does it continue or not? We continue to do the same thing: recommend that investors hold the line and hold globally diversified portfolios that include Canada, the United States, international, and emerging market stocks. We think weightings that are reasonable are 30-40% in the United States, 30-33% in Canada, and that same weighting in international and emerging markets. The last thing I'll say about AI is that stocks that make the microprocessors and the chips get a lot of attention, as do the big seven technology companies. But AI can help all the different types of industries become more productive, save costs, and do things quicker and faster.

Lawrence Greenberg: Absolutely. This is a growing theme that seems to be emerging. AI will benefit and add value to all the different industries out there in the different regions. As a global investor, you'll feel that bump as firms become more profitable and more productive.

Keith Matthews: That speaks to being invested in a process that is sound, well diversified globally, and with the correct allocations for each person. We're very much optimists about the future with regards to expected equity returns long term. Let's switch gears a bit and go into inflation and interest rates. I know that has an impact on equities, but let's start with inflation. How is it going, and what does that mean for interest rates right now?

Lawrence Greenberg: Rates and inflation have been at the forefront for investors for the last year or two. In Canada, we've seen two cuts this summer, going from a 5% policy interest rate to 4.5%. In the U.S., the Fed is anticipating cuts, and that's their language. The market is expecting interest rate cuts. There have been none so far in 2024, and the European Central Bank has cut rates once by 25 basis points, 0.25%.

Keith Matthews: So, we seem to have inflation not being totally tame but coming down, and that helps all families and investors. I'm looking at this chart you put together. It's a fantastic visual showing Bank of Canada interest rate policy for the last 24 years. From 2000 to 2008, interest rates were hovering between 6% down to 3% up to 4%. From 2009 after the great recession when banks around the world had to drop rates dramatically, rates went all the way down to 0.25%. They stayed there until 2022, averaging about 1%. Then there's this massive Everest of interest rate spikes. It shows we've just lived through this decade of incredibly low interest rates. I can't help but think that with super low interest rates, people thought money was cheap and borrowed a lot, showing up in the numbers now. With interest rates spiking, all the borrowings individuals undertook have become way more expensive to maintain and manage.

Lawrence Greenberg: It's hard to adjust. Canadians have taken out large amounts of debt, whether for an expensive real estate market or personal spending. Canada ranks among G7 nations at the top of debt as a ratio of disposable income. Canadian households will feel the pain as fixed-rate mortgages are renewed at higher rates, and there's less disposable income. Their debt overall is pricey and taking a toll on the Canadian household.

Keith Matthews: I can't help but think that individuals unfortunately picked up some bad habits, whether we want to call them saving or spending habits. When interest rates are that low, the numbers you're showing have Canada at just over 180%. We are more indebted than the United Kingdom, France, Japan, the United States, Germany, and Italy on a per capita basis by a significant margin.

Lawrence Greenberg: That's right. Not by a little, but by a lot based on these numbers. Just to put that in perspective, the average American has a debt ratio of 100% of disposable income. We're at 180%, almost double. The lowest is Italy at 90%.

Keith Matthews: I heard you can buy a home in Italy for a dollar. You have to spend some to invest back into the home, but there are a lot of regions that are more reasonable.

Lawrence Greenberg: Maybe I'll stick up and go to Italy.

Keith Matthews: In today's world, you can telework, but not necessarily in our business. We like to be in person with all of our clients and relationships.

Lawrence Greenberg: Absolutely.

Keith Matthews: It's a striking chart. It shows Canadians have really strapped on the debt. Now, the debt interest rates are higher, and the interest rate chart shows rates started to come in at higher levels in 2023 and 2024. Interest rates are coming down, but nobody believes they'll go back to the low ones and twos. Even if they stay at threes and fours, personal rates might be higher. Canadians will feel that. If they have a line of credit still at 4.5-5%, that's a lot more expensive than at 1-3%.

Lawrence Greenberg: Absolutely. It's important to have a firm grasp on household finances and make good decisions. We work with our clients a lot on balancing these things, being aware of the risk, and deciding where money should go. The conversation of paying down debt or investing has changed drastically over the last couple of years. Debt used to be very cheap. It was easier to say, "Hey, my free cash flow will go towards my investment portfolio." Now it's a trickier conversation with variable rate mortgages being 7% or a fixed rate being 5 or 6%.

Keith Matthews: These are all relevant points in our mid-year review. The last one we wanted to cover is the pending election in the United States. This is not intended to be a long podcast episode but a good brief update on what's going on. But we couldn't have done it without saying, "What about this U.S. election coming up? Should we be worried? Should we be doing anything in our portfolio? Should we make any asset allocation changes based on who we think may win or may not win?" Again, this is not a political podcast, and we're not going into policies, but just into data and how things have looked in the past. Any general comments on your side?

Lawrence Greenberg: Every couple of years, this pops up. The U.S. is such a force on the global stage, and people look to it. Should we do anything if one candidate gets elected versus another? How have markets behaved under the tenure of different presidents from both parties? The consensus and the data show that there is no clear trend that a certain party or president in office will dictate how stocks behave. We have data going back almost 100 years on how markets have performed in the U.S. The long-term average for the U.S. stock market over the past 100 years has been 9.5% per year. There's all these lines for the returns of different presidents in blue and red, and they all hover around that long-term average. There isn't a causality that investors should look at.

Keith Matthews: Excellent points, Lawrence. I'm looking at blue lines for the Democrats and red lines for the Republicans. One might think that a more pro-business, maybe a Republican platform might be more attractive for equity returns. The reality is it's very mixed. It's very noisy. It's also random. Most presidents have had decent returns. Ironically, three presidents—George W. Bush, Nixon, and Roosevelt—had negative returns during their years. But everybody else is kind of mixed and in the middle, plus or minus anywhere from 7% to 12%, depending on who the president is. There's no ability to interpret.

Lawrence Greenberg: Yeah, and we have the data for it. If there was a clear trend, investment professionals and the overall market would price that in as well. So, what's your takeaway on this? What should investors do?

Keith Matthews: As with everything, you do not want to make predictions. It's not part of a sound investment philosophy. You want to have a plan in place that is sound and one that you can stick to long term.

Lawrence Greenberg: I think those are excellent points, Lawrence. We're going to wrap up the show. The only thing I would add is that mid-year, we've seen incredibly strong returns again, very robust portfolio returns, which is fantastic. The month of July continues to be very good. We always recommend keeping your portfolios globally diversified. Do not do market timing. Do not try to figure out what kind of major shift is going to come and then be smart and shift out and then back into something else. Typically, they don't produce the results that you want.

Keith Matthews: So with that, folks, have a great week. We're gearing up for more podcasts in August. We took a little bit of a break here. It's great to be back with Lawrence. Have a great week, and we'll see you in a couple of weeks.

Announcer: You've been listening to the Empowered Investor Podcast, hosted by Keith Matthews. Please visit TMA-invest.com to subscribe to this podcast, learn more about how his firm helps Canadian investors, or to request a complimentary copy of The Empowered Investor. Investments and investing strategies should be evaluated based on your own objectives. Listeners of this podcast should use their best judgment and consult a financial expert prior to making any investment decisions based on the information found in this podcast.