THE WEEKLY BEACON	DECEMBER 22, 2023

We will be giving some macro economic market updates on a weekly basis. No equity recommendations will be given in this commentary and we encourage you to contact us if you have questions regarding any observations.

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BEACONS OF THE WEEK

The two main purposes of a Lighthouse are to serve as a navigational aid and to warn ships (Investors) of dangerous areas. It is like a traffic sign on the sea.

Cape Byron Lighthouse, Byron Bay, Australia

This lighthouse also known as Cape Bryton Light station stands at 23 meters tall and opened in 1901. The lighthouse is an active heritage listed lighthouse and is home to a museum, retail space, and tourist attractions.

Caribou Island Lighthouse, Caribou Island, Lake Superior, Ontario, Canada

This lighthouse was opened in 1886 and stands at 31.5 meters tall. The lighthouse was automated in 1970 and has a hexagonal shape. It lies entirely within the territorial waters of Canada although only about three miles from the international border between Canada and the United States.

**Feel free to send us your photos of Lighthouses to be featured in our weekly market observations. **

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<u>The FED's pivot</u>

We commented on the FED's last interest rate decision and Chairman Powell's press conference in last week's edition of this publication. However, there were a few things that we wanted to go over a week later.

The announcement was very much a dovish pause. The FED currently is forecasting the FED funds rate to hit 4.6% by the end of 2024. This is a 0.5% change from September's release by the FED.

Variable	Median[1]					Central Tendency[2]					
	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run	2023
Change in real GDP	2.6	1.4	1.8	1.9	1.8	2.5–2.7	1.2–1.7	1.5–2.0	1.8–2.0	1.7–2.0	2.5–2.7
September projection	2.1	1.5	1.8	1.8	1.8	1.9–2.2	1.2–1.8	1.6–2.0	1.7–2.0	1.7–2.0	1.8–2.6
Unemployment rate	3.8	4.1	4.1	4.1	4.1	3.8	4.0–4.2	4.0–4.2	3.9–4.3	3.8–4.3	3.7–4.0
September projection	3.8	4.1	4.1	4.0	4.0	3.7–3.9	3.9–4.4	3.9–4.3	3.8–4.3	3.8–4.3	3.7–4.0
PCE inflation	2.8	2.4	2.1	2.0	2.0	2.7–2.9	2.2–2.5	2.0–2.2	2.0	2.0	2.7–3.2
September projection	3.3	2.5	2.2	2.0	2.0	3.2–3.4	2.3–2.7	2.0–2.3	2.0–2.2	2.0	3.1–3.8
Core PCE inflation[4]	3.2	2.4	2.2	2.0		3.2–3.3	2.4–2.7	2.0–2.2	2.0–2.1		3.2–3.7
September projection	3.7	2.6	2.3	2.0		3.6–3.9	2.5–2.8	2.0–2.4	2.0–2.3		3.5–4.2
Memo: Projected appropriate policy path											
Federal funds rate	5.4	4.6	3.6	2.9	2.5	5.4	4.4–4.9	3.1–3.9	2.5–3.1	2.5–3.0	5.4
September projection	5.6	5.1	3.9	2.9	2.5	5.4–5.6	4.6–5.4	3.4–4.9	2.5–4.1	2.5–3.3	5.4–5.6

The market interpreted this even more dovish than the FED as market expectations are forecasting the FED funds rate to be 4.0% by the end of 2024. Currently, the FED's benchmark rate sits at 5.25-5.5%.

Market participants are forecasting a 68.9% probability that the FED will cut rates at its March announcement. Numerous firms have also forecasted the same cut.

We think inflation could continue to be sticky and rate cuts will not be as aggressive as many market participants believe. The obvious thing that would make us wrong would be a recession in the U.S. which would certainly result in interest rate cuts. We think the pending election could also impact the FED's policy – even though they are supposed to be a non-political institution.

Speaking of 2024's election, here are the live odds of who will win the presidential election in November.

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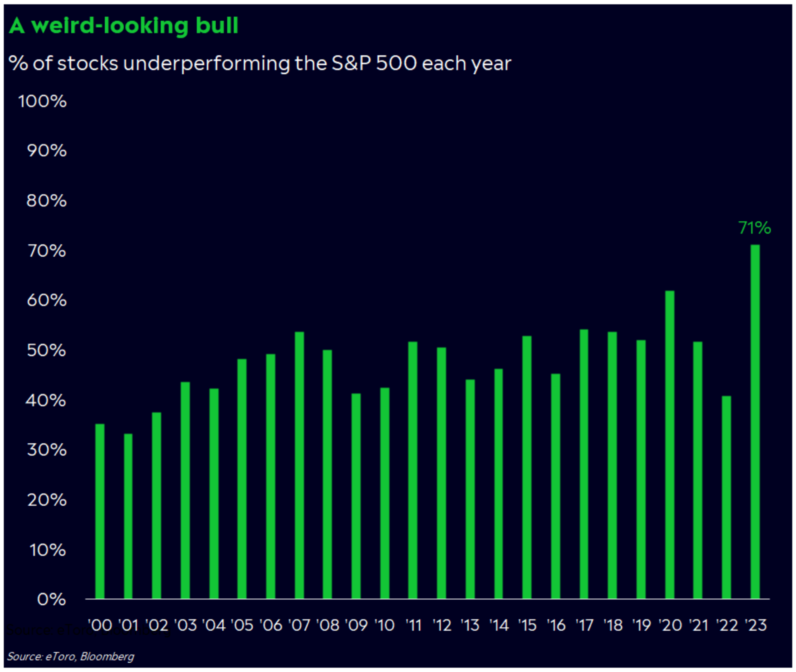
Donald Trump	+140
Joe Biden	+245
Gavin Newsom	+1300
Nikki Haley	+1300
Robert Kennedy Jr.	+2800
Michelle Obama	+4100
Kamala Harris	+5900
Ron DeSantis	+5900

Polling for President Trump has surged in recent months against President Biden. Trump is extremely far ahead in the Republican primary and will almost certainly be the party's nominee. Trump is also reportedly polling ahead of Biden on a head-to-head basis in numerous battleground states. We only highlight this as the election has significant impacts on global financial markets. Play 2024 accordingly……

A year like no other

The 2023 bull market was strong. Markets were up and new all-time highs were reached to end the year (as of this writing). However, despite the S&P 500 being up 23% year-to-date, and the Nasdaq-100 being up 54%, many stocks and even sectors have poorly performed this year. We understand there are poor performers even in great years for the market. This year, markets were led by the Magnificent 7, which had remarkable years, these 7 stocks carried the S&P 500 for most of this year.

However, 71% of stocks on the S&P 500 underperformed the underlying index. This is the largest percentage since 2000 according to Bloomberg.



Over the last 23 years, no year has come close to this feat. This further confirms what we all know - that the largest companies on the index – the Magnificent 7, were primarily the drivers of 2023's bull market. Market breadth for most of this year was extremely low. This extreme reliance that the market has on these large companies (that trade at expensive multiples) is an added risk that we have not seen in decades.

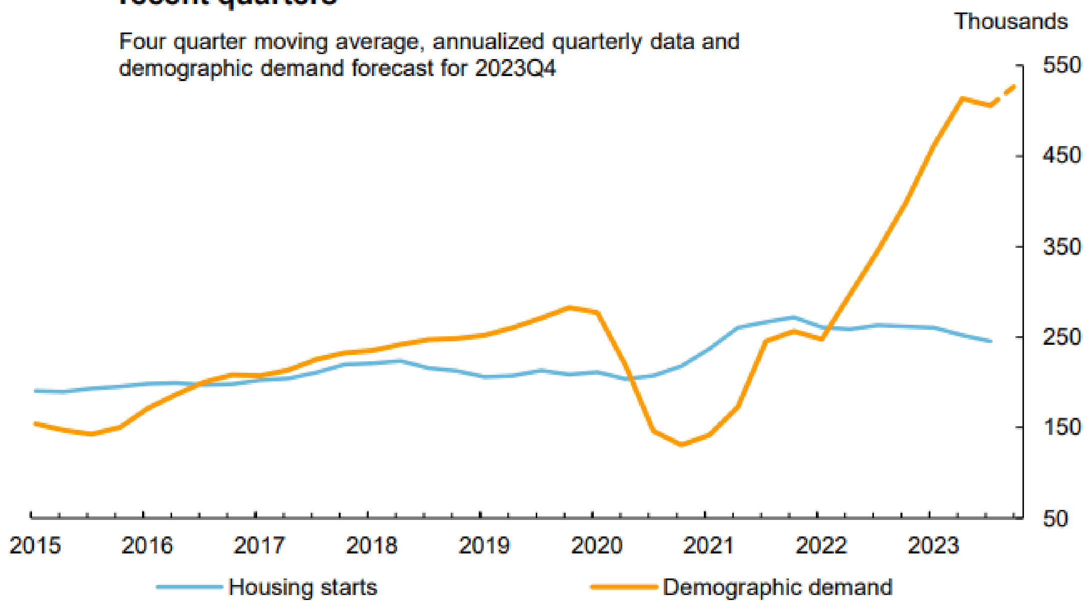
A harsh reality

The Canadian housing market has appreciated quite substantially over the last 10-15 years. The reason that this has happened is primarily to do with supply and demand as demand has surged and supply has not kept up. This is why housing prices remained elevated over the last 18 months even interest rates surged. The Canadian housing market is as tight as it has ever been.

In a recent data release, the Bank of Canada estimates that Canada is running a structural deficit of 250,000 residential units, every quarter, over a million per year. We are glad the Bank of Canada is at least acknowledging this issue as it seems the Federal Government never wants to accept this reality.

Chart 7: Demographic demand has far outpaced housing construction in recent quarters

Four quarter moving average, annualized quarterly data and demographic demand forecast for 2023Q4



Note: Demographic demand is a measure of the change in the number of households per quarter.

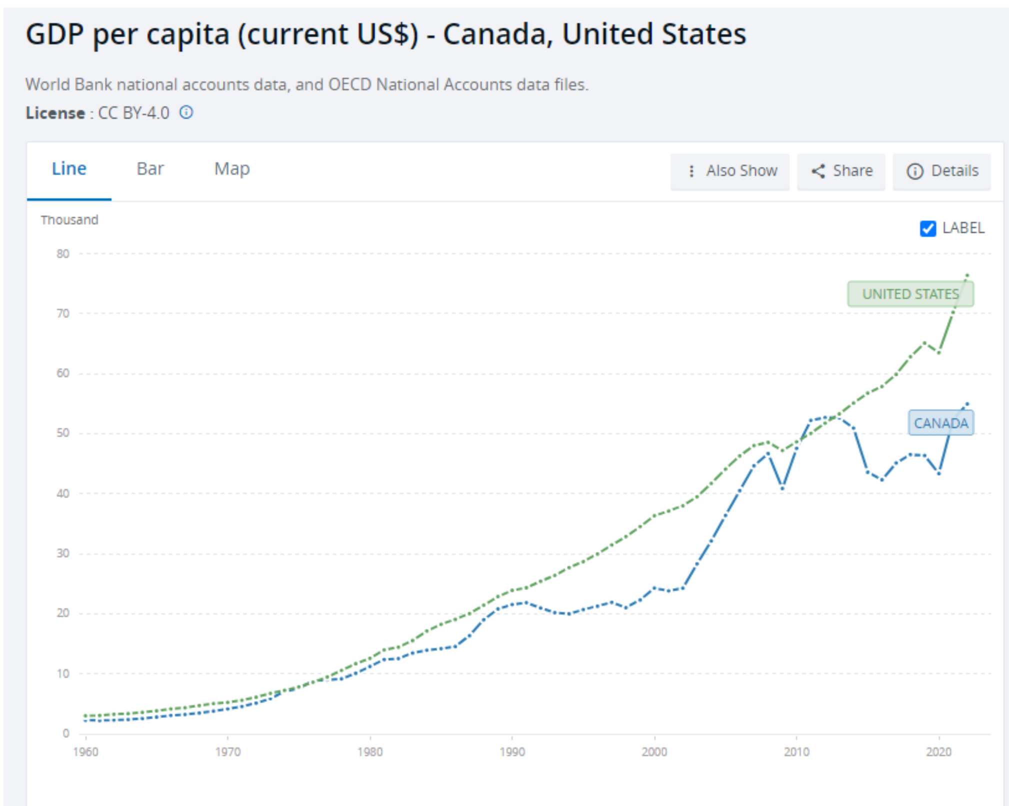
Sources: Canadian Housing and Mortgage Coroporation, Statistics Canada and Bank of Canada calculations

Last data plotted: 2023Q4

A major driver of this deficit in Canada is record immigration and a lack of planning for that surge in immigration. The boost in Canada's population has arguably masked the struggling Canadian economy over the last year. The boost has also allowed home prices to remain high despite a breakdown in macroeconomic conditions across the country.

Housing affordability and supply has become a major issue in Canada and is a reason why Prime Minister Justin Trudeau is lagging in polls so much to Conservative leader Pierre Poilievre. In a recent poll, Poilievre was forecasted to have the largest majority government since 1984 (any party). It seems Canadians are growing tiresome with their stagnant economy that has grown through immigration and not innovation.

Here are Canada's and the U.S.'s GDP per capita since 1960, notice the U.S.'s growth since 2010 and Canada's stagnant data set.



The housing deficit will not fix itself and will take years if not decades to solve. We hope young Canadians take advantage of the tools at their disposal like the First Home Savings Account. Open your FHSA today and contribute by December 31, 2023, for a tax deduction.

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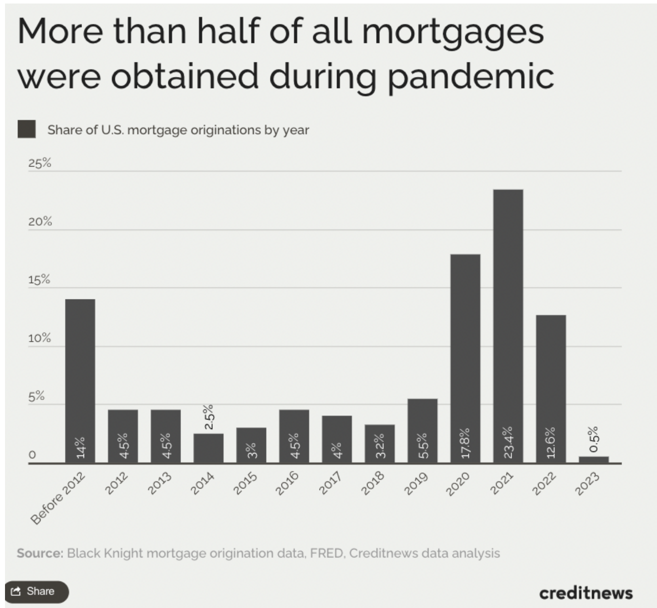
Home buyers pounced

According to Creditnews, 40% of active mortgages were obtained in 2020 and 2021 in the U.S. when interest rates were at rock bottom during COVID-19.



This phenomenon has put U.S. homeowners in a good space even as interest rates have risen over the last 18-24 months.

On the other hand, only 0.5% of mortgages were obtained during 2023, a 10+ year low. Homeowners simply did not want to lock in a much higher rate south of the border.

The U.S. housing market slowed down this year as rates were high for buyers. Homeowners do not face the need to renegotiate, and force sell their homes this year as their mortgage terms and length are the same. U.S. homeowners can amortize up to 30 years at a fixed rate with no re-negotiations over the mortgage lifetime, compared to Canada which has a 25-year amortization period and 5-year terms (Mortgage terms in Canada can range from 6 months to 10 years, with 5 years being typical). This forces many Canadians to re-negotiate the interest rate on their mortgage with lenders on an ongoing basis. This makes Canadian homeowners much more vulnerable to interest rate increases than their American counterparts.

The streak continues

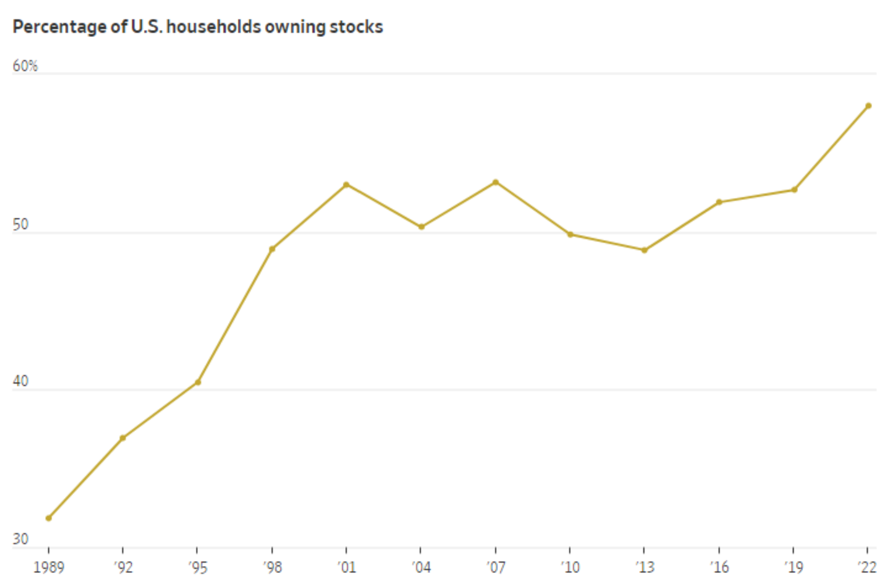
Markets have hit numerous all-time highs this month after 22 months of failing to do so. This continues the now 11-year streak of the Dow Jones Industrial Average reaching an all-time high in said year (data courtesy of Charlie Bilello).

Dow Jones Industrial Average: Number of All-Time Highs (1900 - 2023)

Year	# ATH	Year	# ATH	Year	# ATH	Year	# ATH	Year	# ATH	Year	# ATH
1900	8	1921	0	1942	0	1963	14	1984	0	2005	0
1901	12	1922	0	1943	0	1964	62	1985	36	2006	22
1902	0	1923	0	1944	0	1965	39	1986	30	2007	34
1903	0	1924	1	1945	0	1966	9	1987	56	2008	0
1904	0	1925	65	1946	0	1967	0	1988	0	2009	0
1905	31	1926	9	1947	0	1968	0	1989	8	2010	0
1906	10	1927	50	1948	0	1969	0	1990	16	2011	0
1907	0	1928	58	1949	0	1970	0	1991	11	2012	0
1908	0	1929	33	1950	0	1971	0	1992	22	2013	52
1909	0	1930	0	1951	0	1972	12	1993	33	2014	38
1910	0	1931	0	1952	0	1973	4	1994	13	2015	6
1911	0	1932	0	1953	0	1974	0	1995	69	2016	26
1912	0	1933	0	1954	14	1975	0	1996	44	2017	71
1913	0	1934	0	1955	49	1976	0	1997	39	2018	15
1914	0	1935	0	1956	15	1977	0	1998	30	2019	23
1915	0	1936	0	1957	0	1978	0	1999	35	2020	14
1916	14	1937	0	1958	26	1979	0	2000	4	2021	45
1917	0	1938	0	1959	39	1980	0	2001	0	2022	2
1918	0	1939	0	1960	1	1981	0	2002	0	2023 YTD	3
1919	11	1940	0	1961	19	1982	2	2003	0		
1920	0	1941	0	1962	0	1983	30	2004	0		

CREATIVE PLANNING — Note: Closing Prices as of 12/15/23 — @CharlieBilello

This is the second longest streak on record, the longest being from 1989 to 2000 when the DJIA hit record levels 12 years in a row. Even with a market crash in 2020 and the extremely poor performance equities had in 2022, markets continue to find a way to hit all-time highs. Investor optimism and sentiment have been major drivers of this as investor participation has hit an all-time high.



Note: Includes direct and indirect stock ownership
Source: Federal Reserve Survey of Consumer Finance

According to the Federal Reserve, a record 58% of Americans own stocks.

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Our point on this record run that markets have been on is that 2022 and even 2020 were different types of bear markets and in the grand scheme of things not near as catastrophic as other bear markets. After the Internet Bubble popped in 2001 and the Financial Crisis began it took over 5 years for the DJIA to return to an all-time high.

Red Sea blockage

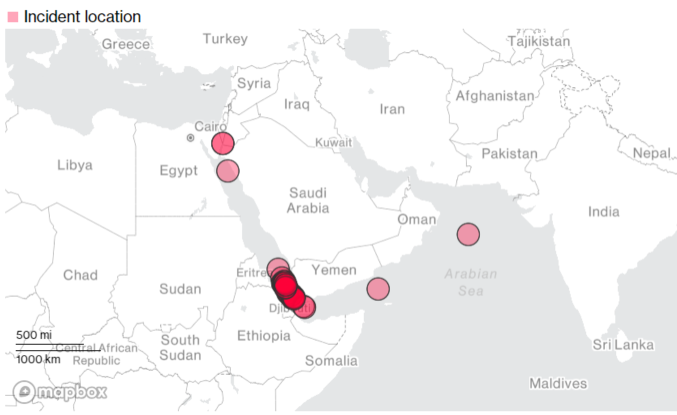
It has been a few weeks since the Iran-backed Houthi rebels from Yemen began attacking commercial vessels in the Red Sea and it does not look like things will improve anytime soon. The Houthi rebels have attacked numerous ships using ballistic missiles and drones, some of which have been shot down by American forces. The Houthi rebels have stated that they will continue to block Israeli ships from passing through the Red Sea until Israel halts operations in Gaza. In Yemen it is extremely popular to support Palestine.

The Houthi rebels are attacking the southern part of the Red Sea and are making companies avoid the passage through the Suez Canal altogether. Companies have chosen to divert vessels in recent days as the risk of traveling through the Red Sea grows in the region. The Suez Canal is critical for global trade as it's the quickest route between Asia and Europe. The canal is especially critical for global energy markets. About 9.2 million barrels per day of oil flowed through the canal in the first half of this year, approximately 9% of global demand. 4% of global LNG flowed through the canal over the same period. Overall, approximately 12% of global trade flows through the canal. Insurance costs for travel across the Red Sea have already jumped substantially since these attacks began.

For information purposes, here is a map of the attacks:

Conflict Builds Around the Red Sea

Incidents of attack or capture in recent weeks against vessels in the Red Sea and the wider region



Source: Ambrey Analytics
Note: Nov. 19–Dec. 18 and includes attempted attacks.

By avoiding the Suez Canal, both time and costs add up for shipping companies as they are forced to take a longer route to protect their employees and cargo. As trip length increases for these ships, available global shipping capacity decreases, decreasing global trade volume. Since November 19th,

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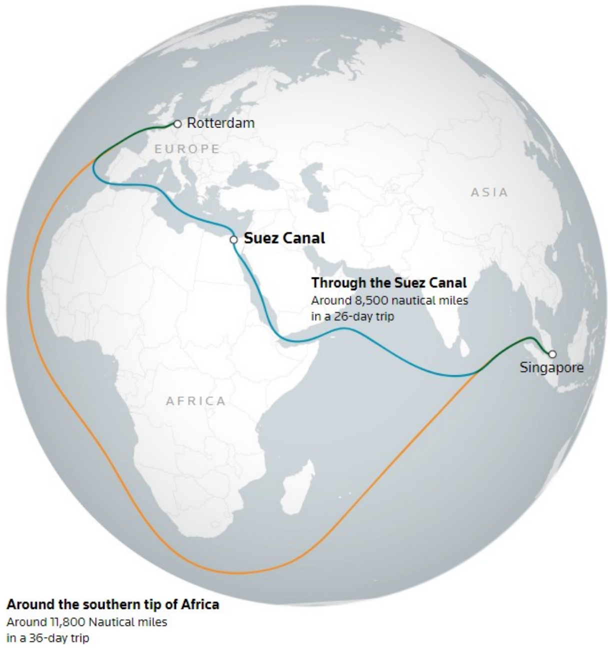
55 ships have rerouted to go the longer way below South Africa while over 2,000 have travelled through the canal. Disruptions to date have been minimal but could increase quite soon.



This week, many firms have decided to pause all trips through the canal as tensions look to have worsened. The Houthis attacked several new ships this week including U.S. oil tankers and chemical ships. MSC, the world's largest container shipping line on Saturday announced that they would avoid the Suez Canal moving forward. British Petroleum made a similar announcement on Monday, joining the likes of Hapag-Lloyd, CMA, CGM, Evergreen, and Maersk who all have suspended travel through the canal.

These disruptions, that look to be getting worse, could cause global supply chain issues impacting markets around the world. This could potentially cause a new round of cost-push inflation just as inflation appears to be under control. If COVID-19 taught us anything, it’s that the global supply chain is very fragile and events like these can cause prices to jump.

Crude prices jumped a few percent to start this week of the shipping disruptions. Shipping rates and the world container index have jumped over the last few weeks as many believe these disruptions could escalate.

Merry Christmas and a Happy New Year to our readers as well as their families and friends.

MacNicol & Associates Asset Management
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