CIBC PRIVATE WEALTH

YEAR AHEAD OUTLOOK

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As we look forward to potential opportunities and challenges in 2024, a quick look back to 2023 can help us with perspectives on where we are today. Broadly, public market performance was better than many expected. Growth prevailed despite a challenging backdrop and good news came by way of resilient global growth, declining inflation, a healthy job market and the emergence of generative Artificial Intelligence (AI) demand.

In addition to our comments below, we are pleased to share with you our firms latest Monthly World Markets Report. The attached report provides a great overview of what drove the markets in 2023 along with some good insight into what to expect in 2024.

2023 was still in many ways, a recovery year from the pandemic as central banks continued working towards bringing inflation under control. There are however many signs of normalcy, as inflation seems poised to decline to “target” levels in most developed economies. This was a welcome relief for markets in 2023 and caused a nice year-end rally as markets priced in 2024 interest rate cuts - to both the bond and stock market. On top of this, movie buffs returned in droves to theatres and travel came roaring back (air traffic is now overall back to pre-pandemic levels).

For the first ten months of 2023, the only areas of the stock and bond market that performed well were some of the large cap U.S. technology stocks (the ‘Magnificent Seven’ as they are called) plus broad-based exposure to European and Asian equities. Everything else was flat as a pancake. The former (U.S. tech stocks) performed very poorly in 2022, but some of them came charging back in 2023.

As we wrote in our last newsletter (November 9th, 2023), we expected a comeback in more value oriented high dividend paying equities and we saw just that in November and December. Thus, we closed off the year with returns close to our long-term target rate of return.

As we look ahead to 2024, we feel client portfolios are very well positioned for the future. As the interest rate environment begins to normalize and shorter-term interest rates move lower, we expect yield-oriented investors to make their way back to good quality dividend paying stocks, which remains a large part of our model portfolio.

Despite our general optimism, we must carefully consider the risks that are present today. Above average geo-political risk, large government debt levels, expensive valuations in certain market areas, and the potential for inflation to remain sticky are just some examples of risks that we consider in terms of portfolio positioning. By ensuring significant diversification, emphasizing good quality dividend paying stocks, and by staying away from very popular (and therefore expensive areas of the market), we are comfortable that portfolios are positioned appropriately - from both a return and risk standpoint.

Portfolio Update

Recently, we decided to take some partial profit on a couple of our stock positions. Both Lululemon and Uber had a large run-up in price which caused us to take a close look at the positions and sizing in accounts. Choosing whether to sell all or part of a company is always a challenge because "Our preferred holding period is forever" as Warren Buffet often says; however, position sizes in accounts were growing fairly large. And valuation wise, both of these stocks are more expensive than our typical stock holding. As we still believe these companies have a good runway of growth ahead, we decided to just sell half of our current positions. For clients investing in our model portfolio since 2009, this will the fourth time we have sold a one-half position in Lululemon.

The proceeds from these sales were added to our existing investment in 'Vanguard's Russell 2000 ETF' (which owns two thousand of the smallest sized companies listed on the New York stock exchange). The average market capitalization of these stocks in this index is $2.9 Billion. To provide a comparison, the largest companies in the world now have market caps in excess of one trillion - with Apple now valued at a massive three trillion.

Companies in the Russell 2000 index are usually newer, faster growing, and historically a little more volatile than larger more mature businesses. The Russell 2000 index is currently trading at a historical low valuation (compared to the S&P 500) with a current price to earnings ratio (P/E) of 14.7, with healthy expected growth in future earnings. A few of the companies in this index may become the next "Apple," or Lime, or Orange, but hopefully not Blackberry! … ha-ha.

Education Corner

Some clients may not be familiar with investment terms we use on a frequent basis. Because of this, we are starting an education section in our newsletter to go over concepts and products we feel will be relevant to understanding your investments. This time, we decided to talk about ETFs, plus an investment strategy called "Covered Call Writing."

To start with, what is an ETF? An ETF or 'Exchange Traded Fund' is like a mutual fund in that it allows investors to own a portfolio of publicly traded investments through one single purchase. This provides instant diversification, and as they are traded on public markets, ETF's can be bought and sold like individual stocks or bonds.

The main reason we use ETF's (aside from the diversification) is that they are some of the lowest cost investments on the market. Our lowest cost ETF (which tracks the Canadian stock market) has management fee of just 0.06%. This is extremely low in comparison with most Canadian equity mutual funds which charge in the range of 1.5% to 2%.

ETF's can be both active and passively managed. Passively managed ETF's simply track a broad market index. Actively managed ETF's have managers that individually select the underlying holdings based on some sort of investment style or philosophy.

One of our ETF's (Invesco Dow Jones Average Dividend ETF) is passively managed but weights the individual holdings in the Dow Jones Industrial Average according to their dividend rate. The higher a company's dividend, the higher the weighting that individual company gets in the ETF. In comparison, most passively managed ETF's are 'market cap weighted.'

ETF's also provide an effective way to diversify portfolios into international markets as trading efficiency for all Canadian investors (regarding individual stocks) is limited to Canadian and U.S stock exchanges.

For our next topic, we will explain an interesting trading strategy called "Covered Call Writing." This is the strategy behind this year's TFSA investment, an ETF called "Horizons Equal Weight Canadian Covered Call." This ETF owns Canada's largest six bank stocks and "writes" (sells) call options on half of the positions - to earn additional income. And it yields a very heathy '12.85%.'

Here is an overview on how 'covered call writing' works. A call option, if bought, provides an investor the right (not the obligation) to buy a stock on a future specific date, regardless of what price the stock trades for - on that date. This contract has an expiration date where the call option will expire worthless if the underlying stock trades below the contract price; but if the stock trades higher than the contract price, an investor can now purchase the stock at a price lower than the stocks trading price, or simply sell the call option for a profit. Buying call options is typically a very risky trading strategy that we would never employ and historically, returns on average (for call buyers) have been poor, therefore if one does the opposite of 'call buying', namely 'call selling', returns historically have been pretty good. To hedge risk though, it's important to own the stock that one is selling an option against. This is what this Horizons ETF does.

For example, if you own shares of a stock and sell that stocks call option, at a contract price a bit above that stock's current price, you earn money through the sale of the call option while also earning the stocks dividend. In addition, there is still some capital gains potential. One is then obligated to sell the company shares if the stock price (at the expiry date of the call option) is trading higher than the contract price. Thus, you earn a high current yield in exchange for simply agreeing to sell that stock in future a bit higher than its current share price. While upside potential is higher by simply owning the stock, income is significantly enhanced by combining call writing with stock ownership

Bits and Bites

This year's TFSA limit has been increased to $7000. For most client situations, as said above, we are investing in the Horizons Covered Call ETF. Most clients have asked us to automatically fund TFSA contributions using proceeds from their non-registered accounts.

The 2023 RRSP maximum is $30,780 (deadline is end of February). The 2024 maximum RRSP contribution is $31,560. Please check your CRA notice of assessment for your RRSP limit.

We employed some tax loss harvesting this year for clients in their taxable accounts. Any net capital loss can be carried back up to three years, or forward indefinitely to offset future capital gains.

As we head towards tax season, please look out for your 'investment management fee report' which will be mailed to you. The fee for non-registered accounts is tax deductible.

A new account was launched this year called the FHSA (First Home Savers Account). This is a fantastic tax-deductible account for first time home buyers. Contribution room of 8,000 per year accumulates once one opens the account. A maximum of $40,000 can be contributed. Funds grow tax sheltered and can be pulled out tax free towards your first home purchase. We are currently funding these for clients using an off-book account through Fidelity. Our firms FHSA's will be coming out later this year so unless there is a rush to open it, we would ask clients to wait until our firm's in-house FHSA account is available.

BC resident children (ages 6 to 9) are eligible for a $1200 grant (fully BC government funded) towards a 'Registered Educational Savings Plan.' We help clients apply for the funds when the child turns six if requested. Please talk with Cheryl (or any other team member) regarding how to take advantage of this program.

We have been very fortunate to have several new clients join our practice this past year. Welcome to anyone who has joined us!

Thanks for mentioning us to your family, friends, and colleagues. Our minimum for new clients is $600,000; but we of course are always pleased to work with children or parents of existing clients, regardless of how much they have to invest.

Each year, via our firms 'Childrens Miracle Day,' we give a portion of client revenues from the past year to charity. Pathways supports individuals with mental health challenges by helping them in a variety of ways – including seeking employment. Athletics for Kids pairs underprivileged children wanting to participate in sports with high school athletes for support and friendship. They also assist financially with sign-up and equipment costs. Kids Up Front provides access to arts, culture, sports, and recreation for children who otherwise would not have the opportunity. It goes without saying that without you clients, we would not be able to aid these worthy charities, so thanks very much for your support! And thank-you for the trust that you have placed in us.

Please call us for any questions you have whatsoever; and/or call or email to book a time for a review meeting in person, virtually or by phone. We look forward to 2024!

Sincerely,

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Please click the applicable link(s) below to view important disclosures that relate to this email and the investment recommendations and/or products mentioned in it.

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