

The Year Ahead 2024 – Annual Letter to Clients

A look back at 2023

2023 was a year of transition and adjustment to a higher interest rate environment. For investors, it was a year of recovery from the stock and bond market volatility of the previous year. For consumers, it was a year of adapting to higher prices and higher interest rates. For the economy in general, it was a year of slowing, but continued growth.

A year ago, as we looked forward to 2023, we anticipated that higher interest rates may reign in inflation and begin to slightly slow a booming jobs market and that we could see a slowing of economic growth. Because investment markets reflect future predictions, not current conditions, we suggested that a tougher economic environment in 2023 could portend the subsiding of investment market volatility that had defined the previous year. We furthermore reported our belief that central banks may ease off and even lower interest rates sometime after 2023.

Our prognostications for 2023 proved to be quite accurate. Client portfolios did prove to be resilient and experienced comfortable results. Interest rates seem to have stabilized but they remain high, particularly for short term durations. Fixed income investments resumed serving traditional roles in portfolios of capital preservation, income generation, and diversification. Equity returns varied across geographies, industries, and



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capitalizations, but were generally comfortably positive and proved once more the wisdom of diversification.

Geopolitical turbulence continued to be an unfortunate theme in 2023 and contributed to increasing ideological and political divisions at home. Severe weather events became even more frequent and disruptive, reminding us of the existential risks faced due to climate change. And, although inflation, the rate of price increases, has somewhat subsided, prices remain higher than is comfortable for many and, some pressures on supply-driven inflation persist.

The Year Ahead

Uncertainty

Heightened uncertainty is likely to remain an important theme in 2024. Wars persist on two continents and there are new shipping risks in the Red Sea. Geopolitical vibrations could continue to rumble, while new risks also loom. A US presidential election could increase divisiveness, as could elections elsewhere in the world. International trading relationships are also far from predictable.

Green Transition

We think the green transition and the increasing costs and risks of climate change will accelerate in importance as an investment theme going forward, qualifying as a mega-trend. Climate change affects every aspect of the economy, increasingly impacts geopolitics, and is becoming a matter of survival for more and more people every year. Recently COP28 was hosted in one of the world's petrostates and although the gathering was described by some as a COP-out, something fundamental did happen. For the first time there was agreement to move away from fossil fuel energy systems. We anticipate accelerating regulatory pressure in many parts of the world, including here at home, to adopt cleaner energy. The shift in transportation from fossil fuels to electricity will put significant pressure on our energy grid and much new investment will be called for. The transition to more cost effective and efficient

electricity systems presents what will likely be a decades-long investment opportunity. Even with the green transition, use of fossil fuels will likely persist and new technologies will be called upon to better control emissions. With such significant change as this there are sure to be winners and losers, and some volatility would be natural. But, for long-term investors, in particular the coming years should prove to be a good time to have investments aligned with one's values.

Artificial Intelligence

A theme we will be closely watching in 2024 is artificial intelligence (AI), which we also believe is emerging as a mega-trend. Many of us may have begun to experiment with generative AI tools such as Chat GPT or felt AI's effects in how our social media feeds have been tailored to our perceived preferences, or we may have interacted with AI bots as on-line consumers. It is likely that the effectiveness of AI and applications for its use will explode in the coming years, impacting many aspects of our lives and the economy. By enabling more efficient business practices, AI could begin to have a significant positive effect on growth. More and more companies are prioritizing AI, creating Chief AI Officer positions (just as Heads of ESG or Sustainability are proliferating). With the associated risks that AI brings to data and privacy and beyond, and questions about public accountability mount, we expect to see increasing regulatory involvement. In 2023's Responsible Investment conference we saw ethical AI emerge as a core theme and concern for the Canadian investment community. Questions such as what role responsible investors can play in advocating for and engaging to increase action and considerations from privacy concerns to job displacement, human rights, and environmental impact. We believe it will be important to understand this space in terms of how AI will impact us personally as well as investors in the year ahead.

Interest rates

Another important theme should be continuing high, although falling interest rates. As the effects of higher rates continue to make their way through the economy, growth should remain slower. Even as growth overall moderates, many companies continue to thrive with strong earnings and prospects. Once again, we doubt that whether Canada or the US technically experiences a mild recession or slow growth, that technical differentiation is unlikely to make much difference to what we experience, or to investment markets.

Interest rates could begin to have more negative impacts in certain areas, particularly for businesses and homeowners with a significant amount of variable or soon to mature, low interest debt. Highly leveraged companies facing higher borrowing costs could face new challenges. And, on the real estate front population growth in Canada continues to outpace housing supply growth, and higher mortgage costs have not yet dampened house prices significantly, as would typically be the case. At the same time higher interest rates are contributing to restricted rental supply growth even while demand increases, impacting continuing upward pressure on rental rates. We expect the housing market will continue to frustrate many would-be homebuyers as well as renters.

New ways of investing

While interest rates remain high, with likely some downward pressure later in 2024, there remains an interesting opportunity for risk-averse investors to turn to guaranteed investment certificates (GIC) to fill some shorter-term fixed income roles in investment portfolios. Although in this environment prospects for bonds have become quite positive, for short-term time horizons GICs can now provide a reasonable rate of return while eliminating the risk of short-term volatility. For longer term horizons, inflation risk and reinvestment risk (the likelihood of lower rates being prevalent upon maturity) may position bond portfolios as more attractive options.

With higher interest rates, life annuities have begun to look interesting, particularly for risk-averse, long-term income investors who have limited sources of guaranteed pensions. If you would like us to help you re-consider your risk profile and/or evaluate if a GIC ladder or an annuity could be right for you within your portfolio, we are here for you.

We are always considering the role that exchange traded funds (ETFs) could play in our clients' portfolios. ETFs, also commonly referred to as passive investments, have low-cost structures that are attractive, but are often less effective in managing negative volatility (the only kind that bothers investors). Currently, there is a very high degree of concentration, and thus greater risk, particularly in many U.S. indexes versus the actively managed portfolios we have favoured. The limited ability to engage responsibly as asset owners when it comes to EFT investing continues to be an issue as well. However, we are interested in evolutions in some smart EFTs and will continue to actively watch this investing space.

While uncertainty and risk in certain areas persist, so does opportunity. Thoughtful diversification, with a focus on clean balance sheets, and strong environmental, social and governance (ESG) integration will be important. This is what we will be focusing on as we help you align your money with your life and your values in the year ahead.

First Home Savings Accounts

In our last newsletter we wrote about the many advantages of First Home Savings Accounts (FHSA). These accounts are a powerful tool for Canadians hoping to purchase their first home. FHSAs offer the tax-free growth and withdrawals of Tax-Free Savings Accounts (TFSA) and the tax-deductibility of Registered Retirement Savings Plans (RRSP). If you are saving for your first home, or helping loved ones do so, a FHSA needs to be part of

the conversation. We are here to help. Please check out our YouTube Channel LeRoy Wealth Management Group to find an upcoming video with everything you need to know about the new FHSAs.

Gratitude

As we look back and contemplate the change and turbulence that defined the first few years of this decade, and we look forward to 2024 and the years ahead, one thing remains constant: our gratitude for our community of friends and clients. We consider it a great privilege to help you navigate the financial changes in your life as well as in investing environments. We look very much forward helping you plan for peace of mind by guiding you to align your money with your life and your values in the years to come. And we wish you a happy, healthy and prosperous 2024!

As always, if you have questions or if there is anything we can do for you, we are here for you.

Thank you,

Sonia & Adrian