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Investor Strategy

The latest market insights from Richardson Wealth

RICHARDSON Wealth

Cheers to 2024!

Executive summary

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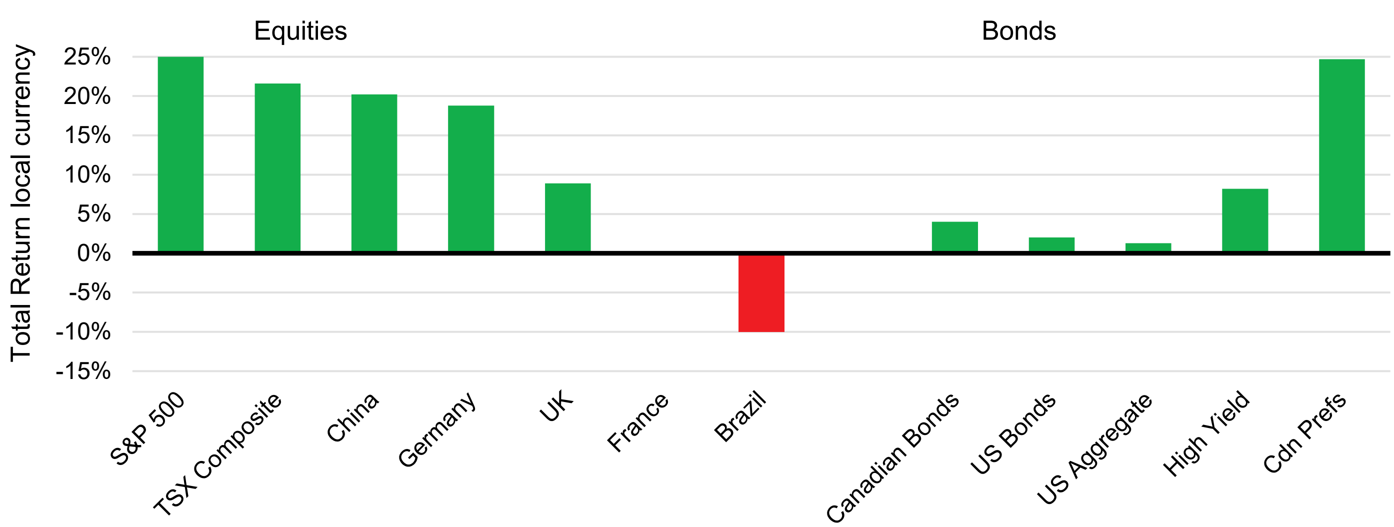
Sometimes not living up to expectations is a good thing. Investors walked into 2024 a little apprehensive, faced with elevated interest rates, lingering inflation, rising global tensions and recession fears. Despite those concerns, markets pushed ahead.

Year in review

Let us all raise a glass and give a cheer to 2024!! It was a pretty awesome year… at least from an investment perspective. Sometimes not living up to expectations is a good thing. Investors walked into 2024 a little apprehensive, faced with elevated interest rates, lingering inflation, rising global tensions and recession fears. Despite those concerns, markets pushed ahead, with global equities delivering strong returns throughout the year. Despite lacklustre returns in December, investors have little to complain about when looking at the bigger picture. Key drivers were stronger-than-expected economic performance and cooling inflation, which allowed central banks to cut interest rates and ease financial conditions. When it was all said and done, the TSX closed 21.6% higher in 2024 while the Nasdaq was up 29.6% for the year. On a total return basis, the S&P 500 finished 25% higher for the year, with the index also posting its best two-year stretch since 1998. Of course, AI deserves mention, helping mega-cap tech names dominate returns for the year, with the Magnificent 7 (now Mag 8, more below) accounting for over 50% of the S&P 500's gains for the year. Global markets, as measured by the Bloomberg World Index, gained +18%. And once again America was the star among the majors. But there were many stars, from Germany (+19%), Japan (+21%) and Canada (+22%). Obviously there were some laggards, France (0%), Brazil (-9%), but negative equity returns were few and far between in 2024.

Bonds performed positively, with Canadian bonds up over 4%, outpacing U.S. bonds which finished the year up 1.3%. Not sure having better bond performance than the U.S. really makes up for the relative equity performance over the past few years though. As you go down the credit scale, bond returns get better. U.S. high yield rose 8% and the Canadian preferred shares were up a whopping 25%.

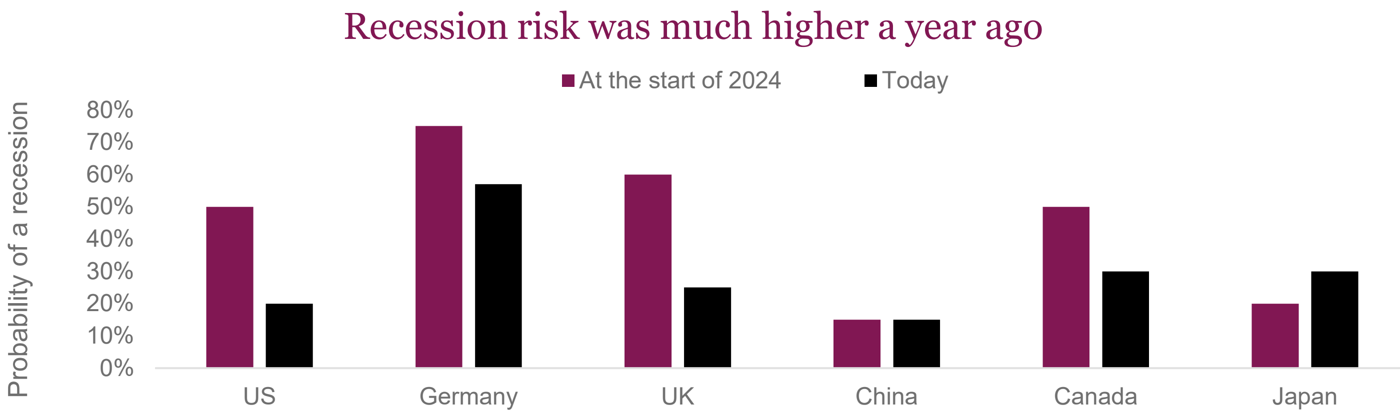
2024 was an awesome year



Source: Bloomberg, Purpose Investments

We believe two things really contributed to the strong returns of 2024 – the economy and inflation. No denying the markets and the economy have a loose connection at best, but the market does like positive surprises. Given muted economic forecasts at the start of '24, the final result was better than expected. Of course there were a number of oscillations along the way, both hotter and cooler, yet taken as a whole it was a stronger than expected economy.

An easy way to see this is the consensus view of recession risk over time. A year ago, there was a 50% chance of a recession in America over the subsequent year – today that is way down at 20%. In fact, recession risk has fallen across most major economies.



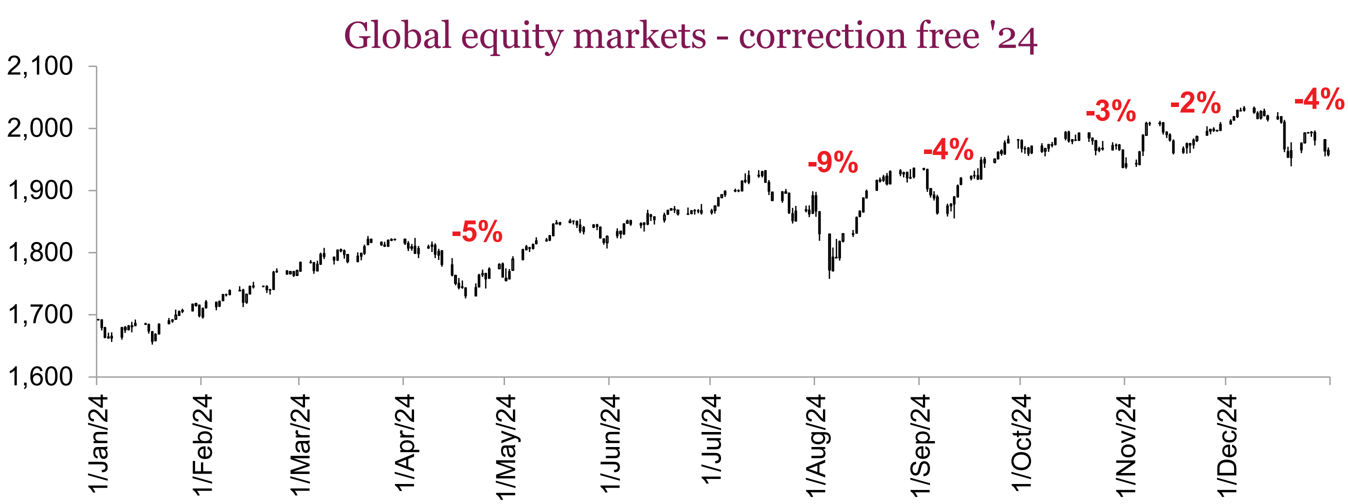
Source: Bloomberg, Purpose Investments

Good economic data combined with continued cooling of inflation. While inflation didn't cool as much as in 2023, the trend remained in a downward direction. This opened the door for most global central banks to begin cutting interest rates. We can all debate the speed and magnitude of rate cuts on the road ahead, but it is relatively certain the direction will be lower. Rate cuts combined with easing financial conditions.

Add all that up and you have a great year for markets.

Some bumps along the way

The S&P 500 did not experience a correction in 2024, measured as a 10% decline in prices. This isn't abnormal, in fact over the 75 years, about 30% of years were correction free. The TSX and global equities were also correction free. Now that doesn't mean there weren't some bumps along the journey. In April, markets softened when 10-year U.S. Treasury bond yields rose above 4.5% – there is a line in the sand and when bond yields cross it, the equity market gets a bit bent out of shape. The challenge is that the level of this line changes and maybe it has moved again, given bond yields are around 4.5% gain.



Source: Bloomberg, Purpose Investments

The bigger drop was in the summer. Softening economic data started this bout of weakness but it was central bank comments that really caused the stir. Softer data in the U.S. resulted in markets pricing in a lot of rate cuts in the coming months from the Federal Reserve. Meanwhile, the Bank of Japan was commenting about their plans to move in the opposite direction. Given the amount of global capital allocated along the yen carry trade (borrow in Japan, invest elsewhere), this triggered a rush for the exit. 'Carrymageddon' ensued and global markets tumbled.

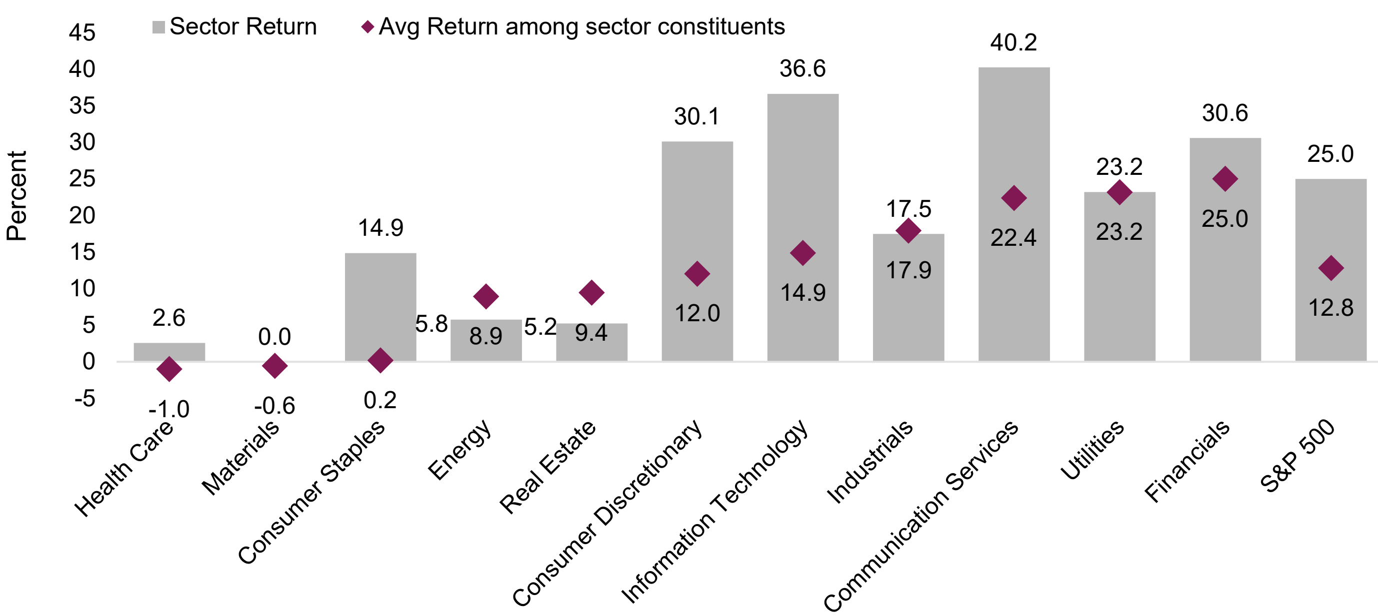
There were a few other brief periods of weakness, but markets recovered from all of these and put in a good year. Perhaps this is even more impressive given other global events as war continued in Ukraine and conflict escalated in the Middle East. It feels like geopolitical risk is still elevated. A number of big elections with changes in government leadership, are adding more volatility or risk to the equation.

Beneath the surface, things were much more volatile

The S&P 500 made 57 record highs last year, but that doesn't mean everything went up. In fact, it may surprise you what did best and worst. The top-performing sectors for the S&P were Communication Services (+40%) and Information Technology (+37%). Consumer Discretionary (+30%) and Financials (+31%) were among the outperformers as well. Underperformers were global cyclicals such as Materials (-0%) and Energy (+5%) as well as defensives such as Health Care (+3%).

In Canada the story was very much the same - Information Technology (+38%) and Financials (+25%) emerged as clear leaders, with both demonstrating exceptional momentum in the latter half of the year. Materials (+19%) and Energy (+18%) both did much better in Canada than in the U.S. Gold prices and an exceptional year for pipelines helped. Consumer Staples (+17%) provided stable returns mostly due to continued strength from the grocers. Conversely, Communication Services (-27% YTD) endured persistent selling pressure, making it the weakest sector of the year. Real Estate (+2% YTD) and Utilities (+9% YTD) also underperformed, weighed down by higher interest rates. These sector trends underscore the strength of growth-oriented areas like IT and Financials while highlighting challenges in rate-sensitive and structurally defensive sectors.

U.S. Sector return deviations

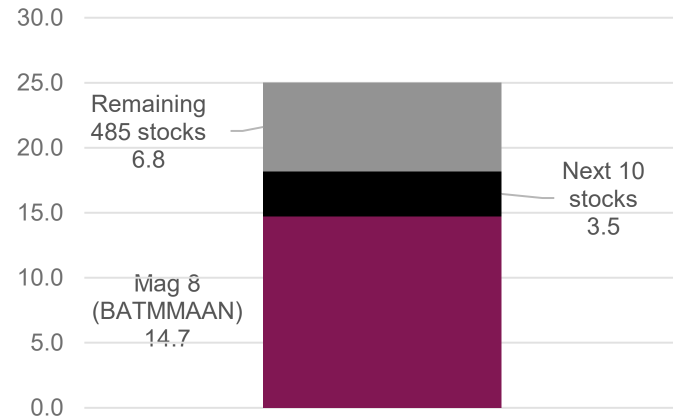


Source: Bloomberg, Purpose Investments

What's interesting is that despite the strong market returns from a headline level, the average return across the sectors and even the index diverged greatly. In the chart below, we have the U.S. cap weighted sector returns, but we've also plotted the average return within each sector for 2024. On average, Financials were the top-performing sector with an average gain of 25%. The sector did very well post-election. This contrasts greatly with what we see within the high-flying Tech, Communication Services and Consumer Discretionary returns where the average return within each sector was significantly below cap weighted returns.

The source of this divergence between each sector and its constituents is of course the megacaps. Telecom services includes Meta and Alphabet, while Consumer Discretionary includes Tesla. Mega-cap dominance was a defining theme throughout the year. Nvidia had a staggering return of 171% and was the biggest contributor to the S&P 500 gain. Besides Nvidia, we saw the usual cadre of mega-cap performers with one new addition. Broadcom rose 110% and became a new member of the trillion-dollar club in December. Its accension made the Mag 7, now 8 and even spurred a new acronym. The BATMAAN stocks (Broadcom, Apple, Tesla, Microsoft, Meta, Amazon, Alphabet, Nvidia) has now replaced FANGMAN. This new group accounted for 63% of returns for the S&P 500. The next 10 contributed to 12% of total return with the remaining names in the index contributing just a quarter of the year's returns. It's interesting when you look at best-performing stocks – it's not all tech, but there are a number of nuclear plays and three industrial companies that more than doubled. We saw a similar picture in Canada, with the top ten stocks driving over 50% of returns. The top ten had your usual names, the big banks (minus TD), Shopify, Brookfield and the two big pipelines Enbridge and TC Energy.

Source of S&P 500 returns in '24



Source: Bloomberg, Purpose Investments

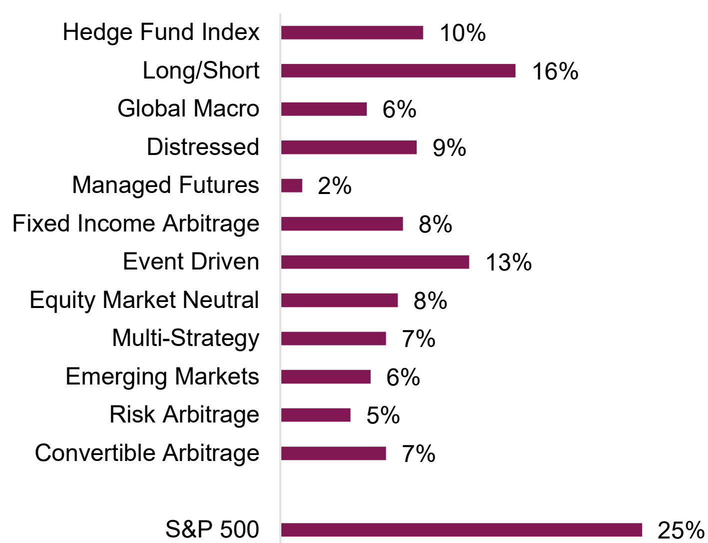
With hindsight, it's easy enough to explain why the winners were on top, but it's never as easy when you try to look forward. From our vantage point, concentration risk remains alive and well with just so few stocks driving much of the performance. We prefer equal weight, primarily to diversify away beyond the mega cap leaders into 2025.

Beyond equities and bonds

When everything goes up, few investors seem to care that correlations remain positive across many asset classes, including equities and bonds. Given elevated cross asset correlations, the need for diversifiers to help construct more resilient portfolios remains important. So how did they stack up in such a strong year for equity markets?

2024 was a solid year for alts, with all the strategies across the Credit Suisse Hedge Fund Indices ending in the green. Long/short strategies came out on top, pulling in a strong 16% return. That said, they struggled a bit to keep up with just plain old index exposure. Since the market didn't have many pullbacks, there wasn't much need for those short positions. Event-driven strategies took second place with a nice 13% return, and distressed assets followed with 9%. But let's be real, none of them could hold a candle to the S&P 500 in 2024.

Alternative Strategies
2024 Performance



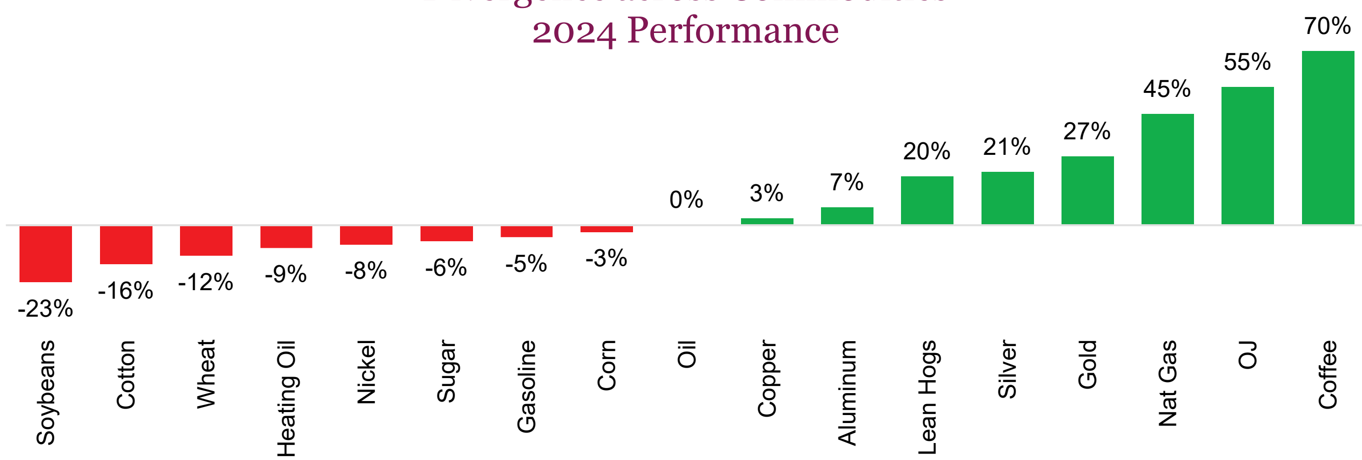
Source: Bloomberg, Purpose Investments
Alternatives s as of Nov 30, 2024, S&P 500 as of December 31, 2024

It is important to remember the role of diversifiers in the portfolio. It is certainly not to match the returns of the S&P 500, you would not want it to be on the downside, which makes it impossible on the upside. Market neutral posting a return of 8% is not very exciting, but a little bit of growth is appropriate considering the role in the portfolio is to add crisis alpha.

Aside from traditional alt categories, there was a notable divergence in performance within commodities. On the downside, Soybeans, Cotton, and Wheat led the way, while consumables like Cocoa (not shown because it's off the chart) Coffee, and OJ were incredibly strong.

2024 was an excellent year to be a supporter of Gold, surprising most with some solid growth. The yellow metal did more than hold its ground, even amidst what is normally a challenging environment. Declining inflation, a strong USD, and low market volume were not enough to keep it down. A partial catalyst was steady demand from central banks, particularly in emerging markets, who've been shifting their reserves away from the USD. In the end, gold proved to be a reliable asset, offering some stability and helping portfolios during uncertain times.

Divergence across Commodities
2024 Performance

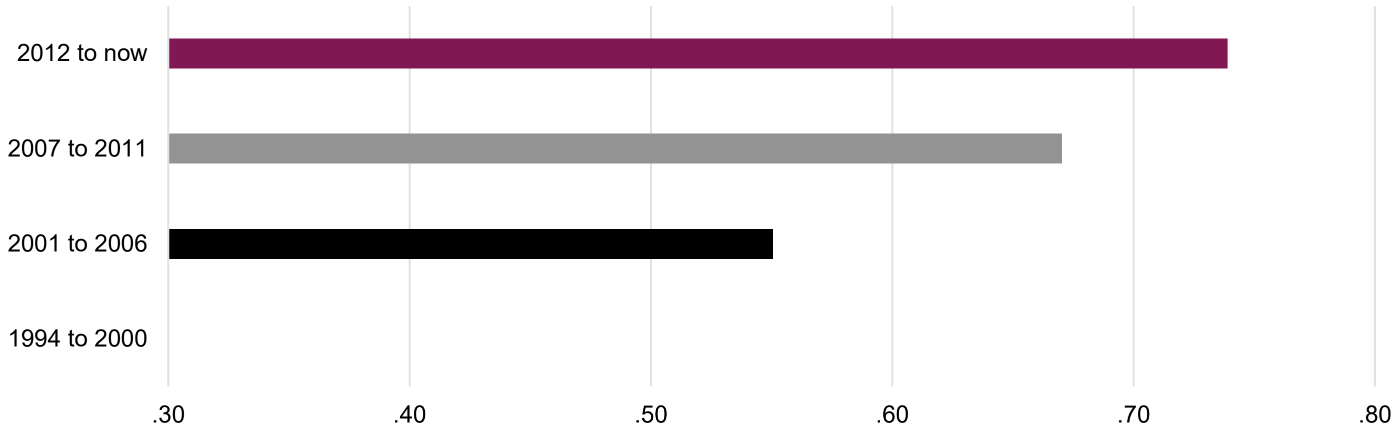


Source: Bloomberg, Purpose Investments

It was a relatively quiet year for Crude as oil prices ended the year in a very similar position to the end of 2023. Just after Q1, WTI climbed above US$84/bbl but has since been on a retreat. Demand remained strong throughout the year, especially from China, and supply was managed by OPEC+ cuts. There has been an abundance of geopolitical tensions that caused occasional price shifts but not enough to lead to anything meaningful.

Alternatives, including commodities, have increasingly been finding allocations in portfolios given higher correlations between more traditional equities and bonds. However, correlations of many alternatives to the equity market have also increased over time.

Alternatives correlation to S&P 500



Source: Bloomberg, Purpose Investments, Credit Suisse Hedge Fund Index vs S&P, as of Nov 30, 2024

The simple truth is we are investing in a more correlated world than in years past, and that makes diversification harder to find. This hasn't been an issue in the past couple years with markets going up, but after two years of outsized returns, the need for diversifiers may be opportune heading into 2025. This could make gold or other vol management solutions valuable considerations for portfolios. If the goal is to reduce correlation, commodities could be a strong option, with the 3-year correlation of commodities to the S&P 500 sitting at roughly 0.30. However, the biggest challenge for diversifiers in 2025 could be self-inflicted. Concentration or over-reliance on single strategies like private equity or income-driven solutions can increase the risk. It is important to not overlook the broad landscape of diversifiers available for portfolio construction. Remember, keep your diversifiers diversified.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.