

# Market Ethos

The latest market insights from  
Richardson Wealth



Craig Basinger

## Opportunity knocks

Markets are really amazing things. Millions of people buying and selling different securities each day, determining the price of an asset in real time. Meanwhile, the vast majority of investors are not transacting at all, simply holding on to their portfolio and ideally watching their wealth grow. Some years, like the last couple, markets are extra kind to investors with strong double-digit returns for many markets. Some years, markets are kinda cruel, like in 2022 when stocks and bonds both went down together.

The challenge is that the art of investing – with the objective of earning a return to fund some future goal – is dealing with uncertainty. Will tariffs, or the threat of tariffs, trigger more inflation or cause markets to fall? Or will broadening economic growth prevail, helping improve earnings growth which is the ultimate driver of market performance. Much of the time the outcome may be closer to a coin flip, thankfully with a slightly loaded coin that favours a pleasant outcome. The equity market has gone up 70-75% of the years looking back a long time.



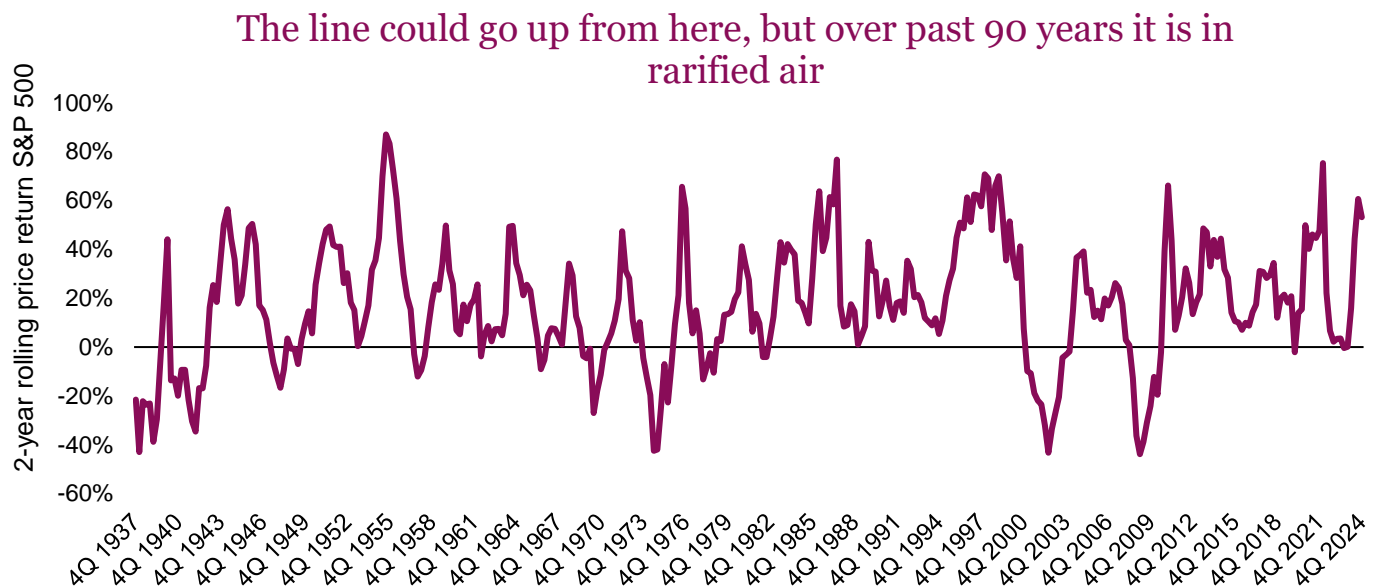
Source: Bloomberg, Purpose Investments, 1975 - 2024

But the market is not a coin flip because coin flips are independent, one flip has no impact on the next. If you flipped a fair coin five times showing heads each time, the next flip still has a 50% chance of coming up heads. If the market goes up or down five years in a row, the probability of it reversing course continues to mount. And this creates opportunities and increased risks. Successfully identifying when the odds are sufficiently tilted in your favour, well that is what makes a successful investor. However, this often requires a more contrarian mindset, which can be challenging and is often lonely.

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## 2025 opportunity?

The S&P 500 rose +26% and +25% over the past two years, TSX +12% and +22%, global markets +20% and +16%. Given that the average annual return for equities is in the high single digits, one could argue the coin is a bit loaded on the bearish side. Or you could take a longer view of things. The chart below is the S&P 500 rolling two-year price return. The past two years of strong gains is not unprecedented, but it is rare. And you may notice that many of those spikes up are followed by a rather quick spike down.



Source: Bloomberg, Purpose Investments

There are positive and negatives at this point for the market. Trailing returns, being so outsized, is a negative. As are valuations, especially in the U.S. Credit spreads are low, volatility is low. On the flip side, many other markets are not expensive, economic growth appears to be broadening and there is no shortage of liquidity. Let's say the coin is not fair, perhaps slightly tilted towards the bearish side. The chance of outsized returns from this point is probably a lower probability than normal.

In fact we could be in store for a normal year, even with all the noise out there. At this point, we believe this year will be a more normal one from a performance perspective, perhaps something in the single digits. But we also believe there will be some pretty big swings along the way. This kind of market, if it goes as we think, creates a few portfolio considerations:

**1. Avoid emotional mistakes** – Bigger swings may result in emboldening investors on the upside, while increasing the risk of poorly timed capitulations on the downside. The amount of noise (much from the U.S. political system) increases this risk.

We have already experienced some of this with the recent tariffs turned on and then delayed. The TSX opened on that Monday down 3%, then largely recovered as tariffs were delayed. Some reduced Canada months ago, and yet today it is sitting close to its high. As we have highlighted, this is not the year for making rash or sudden changes.

**2. Being active** – There's no denying that if markets are going straight up, it is best to just own beta. However, given the past few years and the backdrop, we do experience bigger swings this year in both directions, with a flatter finish. That increases the benefit of being more active and taking advantage of market drops, perhaps harvesting some gains on market pops.

This could be manifested in being more active with your asset allocation. Of course we have our preferred strategy to be tactical, but regardless of how you implement, a flatter and bumpier year augers from being tactical. Plus, with market breadth improving, this also favours active equity management over passive.

**3. Harvesting volatility** – A flattish year with bigger swings should help strategies that harvest volatility. While the VIX remains on the lower side these days, individual company volatility is rather high. This may prove to be a good year for option strategies that harvest yield. While there are many iterations in this space, given higher short-term rates, our expectation for flatter markets and bigger swings, we believe cash covered put writing is well constructed. The cash holding earns a decent return, plus the put premiums. And if we get a downswing in the markets, the strategy automatically does some equity buying. As long as the market doesn't drop too far, it becomes an automatic buy-the-dip strategy.

## Final thoughts

Don't make rash decisions, try to control emotions and survey the land for pockets where there may be a mispricing or overreaction. And most of the time, do nothing. Opportunities in the market often cluster at certain times and this is not a time that is rich with mispriced assets or opportunities. Maybe it will be a boring year ... with a lot of noise.

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

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\*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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