Serber Speaking

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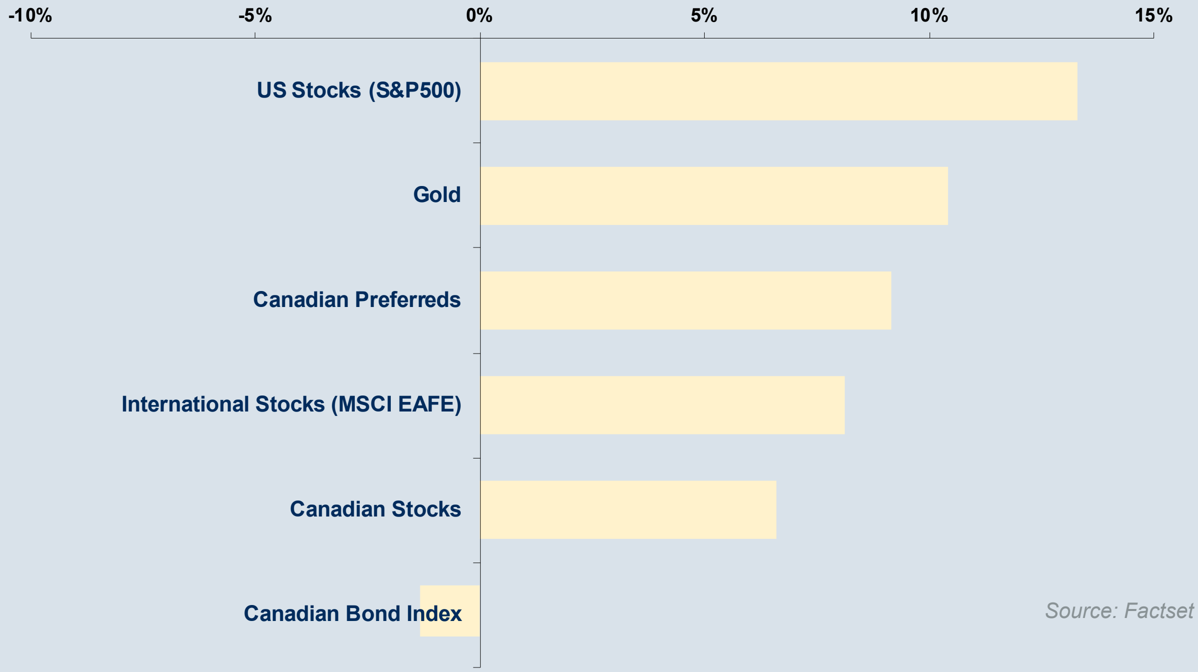
2024 is off to a good start

Financial markets have been on a tear since early November, when the US Federal Reserve indicated it would pivot from raising rates, as they had been doing through most of 2022 and 2023, to likely cutting them in 2024. Since November 1, stocks are up about 20 percent (MSCI Global Index, in CAD$). As can be seen on the performance chart below, the US market led that charge in this year's first quarter. Gold staged an impressive run in the first quarter as well, hitting new all-time highs. Canadian preferred shares joined in, with an impressive gain in Q1 of about nine percent, while bonds provided slightly negative returns overall.

Performance by Asset Class: January 1 to March 31, 2024 (in Canadian $)



The Current Consensus

Not surprisingly, strong markets and generally encouraging economic news, such as continued low unemployment levels and falling inflation, have had a positive impact on investors' moods. According to the latest numbers from the American Association of Individual Investors, about half of those surveyed are bullish on equity markets and only about one-quarter are bearish, whereas the average for these figures over time is about 38 percent bullish and 31 percent bearish. As I have written in the past, sentiment is a contrary indicator, so when there are significantly more bulls than bears, compared to the long-term average, I start to worry. In my last two reports, I maintained that the set-up was looking good for short-term gains, and this proved to have been the case. I also warned that short-term gain could be followed by some medium-term pain.

Sell optimism, buy pessimism

It is hard to go against the crowd. Maybe this is due to evolution, where humans who generally conformed to the will of the collective had a survival benefit. Who knows? Whatever the reason, I have found time and again over the years that, when it comes to investing, it is very hard to go against the crowd. However, these instincts are best overcome, if achieving a superior return over time is the goal.

Currently, investors are generally optimistic and enjoying high returns. In addition to individual investors' bullish sentiment mentioned above, surveys of traders, advisors and active investment managers are all indicating high levels of bullish sentiment. Excitement over hot sectors such as Artificial Intelligence is widespread. The party will likely continue for some time, but it will end at some point and will be followed by a reckoning - a hangover, if you will. I think this will begin somewhere in the coming three-to-nine months.

There is nothing new about the pattern of stock market euphoria followed by disappointing returns. To wit, in the five-year period after the peak of the dot-com bubble, from 2000 to 2005, the S&P500 index of US stocks posted a total return of negative 27 percent.

This does not mean that the excitement back then over the potential of the Internet was misplaced. What it does mean is that stocks became overpriced. For example, Cisco Systems was a go-to investment back in the Internet's early days. The stock price was doubling every year, and, at its peak, the company traded at a valuation of about 37 times sales. Since then, sales and profits at Cisco are up over 10 times, proving that the business opportunity was indeed huge. However, the stock price today is about 35 percent below its March 2000 peak (US$50 now vs. US$77), indicating that the company was overvalued. NVIDIA, a go-to stock today to invest in the potential of artificial intelligence, coincidentally trades at a valuation of around 37 times sales - similar to Cisco back in 2000. Does NVIDIA have huge potential over the next 20 years? Absolutely. Is the stock overvalued at the recent peak near $1,000? I'd say yes. It is possible that NVDIA's share price goes higher over the near-term - but I expect it, and that of other currently "hot" stocks, will be quite a bit lower once the party ends.

So what's the plan?

The plan is to reduce exposure to equities as 2024 progresses and increase holdings of both government bonds and cash. Government bonds will benefit if and when the next recession arrives, and interest rates fall. If you buy a 10-year government bond today at, say, four percent, and sell it a year from now when the 10-year rate may well be closer to three percent, you'd make a total return of about 13 percent.

I plan to increase cash balances to 10 percent or more of portfolios as the year progresses. Higher cash balances will be earmarked to buy back equities at lower prices, possibly sometime next year. Peter Berezin, market strategist at BCA Research, makes the case that the S&P500 index of US stocks could fall by some 30 percent from current levels if a recession arrives by next year, which he thinks is likely. As mentioned above, in the middle of a recession, with bad news in the headlines and the stock market falling like a stone, it will be very hard to summon the will to buy, for fear that declines will continue. That's why it's good to have a plan in place - it then becomes a matter not of summoning the will, but of executing the plan.

The point of all this

For me, it is also important to keep in mind that the point of investing and thinking about investment strategy is not to be some kind of hero who "beats the market." Rather, the point is to have a well thought-out investment strategy that will protect and ideally grow capital over time and provide income in retirement. And because every person is different and all circumstances are unique in some way, there is no one-size-fits-all plan that works for everyone.

That is why we are here. To assist you in developing a strategy that is customized for your unique situation; to help execute the plan; to monitor results; to manage all the small details that need attending to; and to regularly review the plan together to confirm that it continues to be a good fit for your needs, and to make adjustments as required.

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From the Planning Notebook

Canada's progressive income tax system: What are the numbers?

Everyone knows that the higher one's income, the higher the percentage of income is paid in income tax. However, many people are not familiar with the actual numbers, so I thought I'd provide a quick overview. Here are the tax rates (in Ontario) at a few selected levels of income:

Income	Marginal Rate	Overall Rate
$ 50,000	20%	14%
$ 80,000	30%	19%
$100,000	32%	22%
$150,000	45%	28%
$240,000	53%	36%

Marginal rate means the tax rate on the next dollar of income you would earn at that income level. Overall rate means the total tax payable at that income level, divided by total income. So - someone earning $50,000 per year would pay 20 percent tax on the next dollar they earn. Their overall income tax payable would be about $7,000, which is 14 percent of $50,000.

As can be seen, there is a significant increase in the marginal tax rate as income gets higher. At $100,000, the marginal rate is 32 percent, whereas at $120,000 it is 43 percent. That's a big jump, which could be relevant to financial planning. For example, if RRIF income kicking in at age 71 is going to suddenly bring taxable income above $120,000, you may be better off starting RRIF withdrawals earlier, say at age 65, so that your RRIF withdrawals are taxed at a lower rate.

Effective use of registered savings plans such as RRSPs, TFSAs and FHSAs is also an important component of minimizing tax and maximizing your financial well-being. And for seniors, knowledge of the clawback regime for Old Age Security can be important. As well, the fact that dividends and capital gains are taxed more favourably than interest income has a significant impact on your portfolio's after-tax rate of return.

It may be obvious, but is worth emphasizing, that any financial plan must pay close attention to taxation's impact. Our tax system includes many elements, and there are important nuances that should be understood and taken into account.

Our *myGPS* financial projection system allows us to try "what-if" scenarios to see the impact on your overall financial well-being, including the impact of taxation. If you or someone you know would like to update or create a *myGPS* projection, feel free to reach out to us at 416-974-3530 or send me a note at david.serber@rbc.com.

Until next time, best regards,

David Serber

If you would like to discuss your personal situation please feel free to contact me. Also, feel free to forward this copy of ***Serber Speaking*** to anyone you think would find it of interest.