The Dream Achiever

DD HUMES

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"The recurrence of fundamentals is essential to perpetuity."
~Harold B. Lee

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Trump 2.0 – There's a new tariff in town

A year ago, the outlook for U.S. and Canadian equities was cautiously optimistic following a strong 2023, particularly in the U.S. While there were moments in 2024 that required caution, the broader trajectory remained steadily upward. Major stock indices frequently reached new highs, making it another strong year for investors.

Expectations for declining inflation and lower interest rates were realized in 2024, helping to support a resilient U.S. economy. These favourable conditions, combined with dramatic gains in AI-driven big tech stocks, contributed to back-to-back double-digit gains for U.S. equities in 2023 and 2024, the best consecutive years since 1997 and 1998. In Canada, the S&P/TSX Composite Index had its best year since 2021, more than doubling its 2023 return.

The Canadian TSX Composite Index finished the year with a fourth-quarter gain of 3.76%, resulting in an annual return of 21.65%. The U.S. S&P 500, measured in Canadian dollars, was up 9.02% in the fourth quarter and finished the year with a gain of 36.36%. The MSCI World Index, which measures equity performance across 23 developed markets, gained 6.39% in the fourth quarter and ended the year up 30.01%. The FTSE Canada Universe Bond Index declined -0.04% in the quarter bringing its total annual return to 4.23%.* Meanwhile, the Canadian dollar fell sharply against the U.S. dollar, dropping 6% in the fourth quarter and ending the year down 7.9%.

The final quarter of the year was particularly eventful. Enthusiasm surrounding Donald Trump's election victory triggered major inflows into U.S. equities in November, pushing markets to fresh highs. The U.S. Federal Reserve cut interest rates by 25 basis points on November 7 and made another quarter-point reduction in December, bringing total rate cuts in 2024 to 100 basis points. However, U.S. equities retreated in the final weeks of the year after Fed Chair Jay Powell signaled that the pace of further rate cuts in 2025 could be significantly slower than markets had expected. Despite the December pullback, both U.S. and Canadian equities recorded strong annual gains in 2024.

Bond markets also experienced notable shifts throughout the year. Canadian and U.S. 10-year government bond yields declined by more than 100 basis points between April and mid-September as inflation eased and central banks began cutting interest rates. In September, the U.S. 10-year yield dropped to 3.6% as the Fed delivered its first rate cut. However, yields reversed course in the final quarter as bond prices fell due to stronger-than-expected U.S. inflation data in October and November. Additional upward pressure on yields came in December following Powell's comments on the potential for renewed inflation risks and policy uncertainty under the incoming Trump administration. By late December, the U.S. 10-year yield had returned to levels seen at the end of April.

Inflation and interest rates were major themes at the start of 2024, but both moderated significantly as the year progressed. Inflation declined first, followed by a delayed but meaningful reduction in interest rates. This shift provided critical support to equity markets. U.S. inflation fell from 3.4% in December 2023 to 2.4% in September before edging up to 2.7% by November. This steady downward trend allowed the Fed to begin easing monetary policy for the first time in four years, cutting its policy rate by 50 basis points in September, followed by two quarter-point reductions. These adjustments lowered the target range to 4.25%-4.5%, a level last seen in December 2022.

While the U.S. economy demonstrated resilience, economic conditions in Canada were far less favorable. The International Monetary Fund highlighted the U.S. economy's robust performance compared to other advanced nations, while Canada struggled with declining per-capita real GDP and stagnating productivity growth. The Bank of Canada responded by cutting interest rates earlier and more aggressively than the U.S. Federal Reserve, but the Canadian dollar weakened significantly against the U.S. dollar. Political uncertainty also played a role, with the resignation of Prime Minister Justin Trudeau on January 6 adding further instability to Canada's economic outlook.

A major development for cross-border shoppers and snowbirds was the continued decline of the Canadian dollar against the U.S. dollar, a trend in place since 2021. After weakening for most of the year, the loonie briefly rebounded in late summer, reaching 74 cents U.S. by September. However, a strengthening U.S. dollar in the final quarter sent the Canadian dollar sharply lower, ending the year at 69 cents U.S., its lowest level in more than 20 years.

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Market Overview Continued

What can we expect next? As we enter 2025, the divergence between Canadian and U.S. economic growth remains evident. Canada's economy struggled in 2024 despite the Bank of Canada lowering its key overnight lending rate five times, from 5% to 3.25%. The benefits of lower inflation and interest rates should continue to work through the economy in 2025. If economic growth remains weak and inflation stays subdued, further rate cuts are likely, which would provide relief for individuals, businesses, and the overall economy. A weaker Canadian dollar could benefit exporters but will make imports more expensive.

The U.S. economy is in a much stronger position, and President Trump has indicated his preference for policies aimed at supporting even higher growth rates. Historically, a strong U.S. economy has been beneficial for Canada, but Trump has also stated his intent to impose broad tariffs on multiple U.S. trading partners, including Canada. The exact details of these policies remain uncertain and could range from aggressive trade negotiations to actual tariffs that negatively impact key sectors. Significant tariffs could push Canada into a recession, making trade policy a critical issue for Canadian investors in 2025.

Regardless of the current market cycle, maintaining a disciplined, long-term investment strategy remains the best approach**. Staying focused on long-term financial goals helps investors avoid emotional decision-making**, such as buying high and selling low, which many investors tend to do. Regular portfolio monitoring ensures that investments remain aligned with financial objectives, while diversification continues to be one of the best ways to reduce risk and build sustainable long-term returns. Please reach out with any questions that you may have.

Planning items

- **RRSP Contribution Deadline:** For the 2024 tax year you need to contribute before March 3, 2025. The maximum limit for 2024 is $31,560. If you want to get started on your 2025 contributions, the maximum limit is $32,490. You may need to adjust your automatic savings plans for the coming year accordingly.
- **Registered Education Savings plan** (**RESP) contributions:** Quebec beneficiaries get the added 10% QESI grant from the provincial government increasing the overall grant to 30%! 2025 room now available.
- **Tax Free Savings Account (TFSA):** A new $7000 of room available since January 1, 2025. Total room since 2009 is $102,000.
- **Conversion to RRIF account:** Those of you who turn 71 years of age in 2025 (born in 1954) will need to convert their RRSPs into RRIF accounts before the end of the year. We will be in contact to assist you on how to get that done if you haven't done so already.
- **Your Annual Review:** It is important to inform us of any changes taking place in to see the effects on your plan.
- **$2K pension deduction:** Those who turn age 65 in 2025 or older and not already receiving recognized pension income.
- **Estate planning:** A friendly reminder that your **wills and mandates** should always be in order.

Planning corner – Deferring the capital gains change

In the 2024 federal budget, the Canadian government proposed changes to the capital gains inclusion rate, set to take effect for gains realized on or after June 25, 2024. Under these changes, the inclusion rate for corporations and trusts was increased from 50% to 66.67%. For individuals, the first $250,000 of net capital gains realized annually would continue to be taxed at the 50% inclusion rate, while any amount exceeding this threshold would be subject to the higher 66.67% rate.

However, the prorogation of the Canadian Parliament on January 6, 2025, introduced uncertainty regarding the implementation of these changes. Since prorogation effectively terminates all pending legislation, this raised questions about whether the increase in the inclusion rate for corporations and trusts, as well as the tiered rate for individuals, would proceed as planned. Despite this uncertainty, the Canada Revenue Agency (CRA) announced in November 2024 that it would begin administering the new inclusion rate as of June 25, 2024.

Following the prorogation, the CRA reaffirmed its position, stating that it would continue to apply the proposed changes unless the government explicitly indicated that it would not proceed with the legislation once Parliament resumed. This created a challenging situation for taxpayers, as they faced ambiguity regarding how their capital gains would be treated.

UPDATE:

On January 31, 2025, the federal government announced in a press conference that it is deferring the implementation of the capital gains inclusion rate changes to January 1, 2026. So it's status quo on this for you 2024 and 2025 taxes! More to come.