

Quarterly Update – Third Quarter of 2024

Financial Markets Update

Inspired by verse.

*“I’m learning to fly, but I ain’t got wings.
Coming down is the hardest thing.” – Tom Petty*

Everyone has been waiting for interest rates to come back down. Well, here we are, but the story is far from over. The Bank of Canada faces a tricky balancing act. If they get the timing and magnitude of interest rate decreases just right, they could pull off the elusive “soft landing”, where they tame inflation without causing an economic crash. As of September, inflation is back below 2% annually, so we should see the rate cuts keep coming. That said, signals in the economy are mixed.

- ◆ GDP growth averaged around 2% annually since the year 2000 but is expected to finish at only 1.1% for 2024 and 1.7% in 2025.
- ◆ Some sectors like energy and mining are showing resilience because of strong commodity prices, while high borrowing costs have reduced consumer spending.
- ◆ Unemployment rose to 6.6% in August and the labour force participation rate (the percent of working age people that have a job or are looking for one) sits at 65.1%, half a percent below the long-term average. That might not sound like much, but it equates to about 200,000 extra Canadians who don’t have a job and aren’t looking.

Where do interest rates go from here?

*“Pick up my guitar and play. Just like yesterday.
Then I’ll get on my knees and pray we don’t get fooled again.” – Pete Townshend (The Who)*

It’s human nature to guess at what comes next. In the case of interest rates, we can use the prices of financial instruments like futures and swaps to figure out what the market expects to happen. These instruments are bets on the future of interest rates. When traders expect rates to decrease, the prices of these instruments immediately change to reflect expected lower future rates.

Predictions like these appear in financial media whenever interest rates are in vogue. If you ever hear the comment, “there’s an X% chance that interest rates will decrease next week” or “interest rates are expected to be X% by the end of the year”, that person is probably relying on the price of these instruments to come up with their expectation. Watch out, though, because this approach just tells us what financial markets expect to happen. Markets get things wrong all the time.

Case in point, let’s look at what the market expected back in 2023, where rates have gone since then, and what the market expects to happen next.

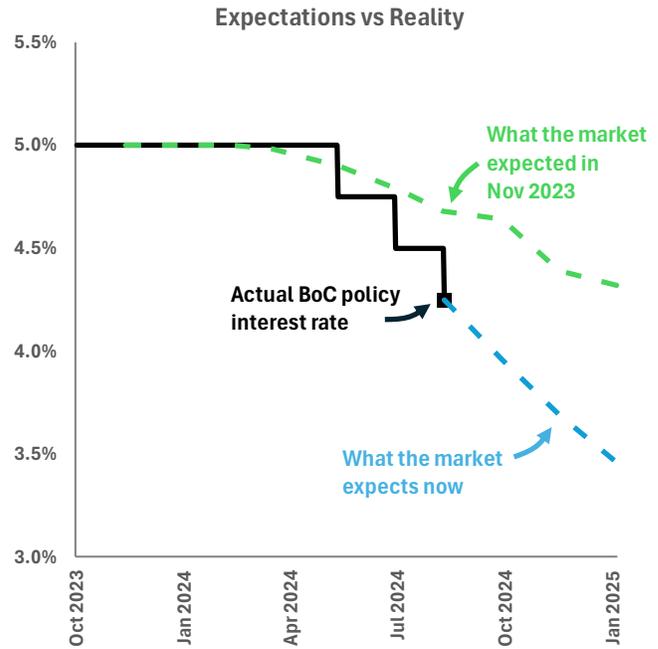
The **black line** is the actual Bank of Canada policy interest rate. It currently sits at 4.25%.

The **green line** is what the market expected if we had asked them in November 2023. The expected it to be around 4.7%.

Turns out the market wasn't exactly right. In November, they guessed that today's policy rate would be around 4.7%, but it's actually 4.25%. Rates have decreased more than the market expected.

The **blue line** is what the market expects the future to hold as of today.

Today, the market expects rates to continue to drop almost another full percentage point by early 2025. If we extended the chart to the end of 2025, we'd see that the market expects rates to come down a total of 2%.



Source: Bloomberg

So, the market can give us an idea of where things are headed, but if we want to know exactly what will happen next, all we can do is guess and hope we don't get fooled again.

On to another story that caught our attention.

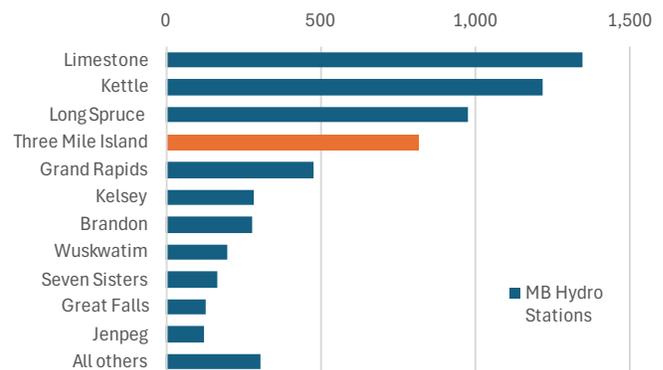
“The problem’s plain to see; too much technology. Machines to save our lives; machines dehumanize.” – Denis DeYoung (Styx)

Microsoft just signed a 20-year deal with Constellation Energy to buy power from the nuclear plant at Three Mile Island, agreeing to pay around two times the going rate per megawatt-hour. That is an amazing sentence for a lot of reasons.

After the meltdown of Unit 2 at Three Mile Island in March 1979, Unit 1 continued to operate for 40 more years. It powered up to 800,000 homes and generated the equivalent of 60% of the energy of Limestone Generating Station, Manitoba's largest Hydroelectric dam on the Nelson River.

Recently, the plant was facing competition from lower-priced natural gas and soft public sentiment towards nuclear energy. Then-owner Exelon failed to get government support and closed the plant in September of 2019.

Comparing Generator Capacity



Data from Manitoba Hydro and the International Atomic Energy Association

Now, US company Constellation Energy, backed by one of the worlds largest companies, plans to restart Unit 1. So, why is Microsoft, a technology company, willing to pay a premium to secure a significant energy source for decades into the future? And why nuclear energy?

First, Microsoft has made a commitment to the future of Artificial Intelligence. Computations for AI models are done in huge data centres that require a tremendous amount of power. So, Microsoft's deal is a decisive step towards securing an energy source to power its role in the future of AI.

Turning to nuclear energy probably had something to do with Bill Gates. Gates is a strong supporter of nuclear energy and has invested billions of dollars into researching next-generation reactors. Gates also happens to be a big fan of using AI to help solve long-standing human problems. For example, Gates talks confidently about curing malaria in his lifetime, something he wouldn't have said 5 years ago.

The crux with AI, as usual with humans and technology, is the outcome depends on how we use it.

On that sentiment, Joanna Maciejewska said it best: "I want AI to do my laundry and dishes so that I can do art and writing, not for AI to do my art and writing so that I can do my laundry and dishes."

If you think this sounds like the conversation we had during the rise of the internet in the late 90s, you're right. And that's not the only parallel. Media is ripe with predictions about AI being a future-changing technology and a profitable investment. The technology has clear potential, but if the DotCom bubble taught us only one thing, it's that success as a technology doesn't necessarily guarantee success as an investment.

Financial Planning Update – Planning for Incapacity

In September, we had the pleasure of hosting Nathan Spaling and Dr. Richard Shulman from **Capacity Clinic** for a discussion about planning for incapacity. Their message was clear:

- ◆ You won't be able to detect when you become incapable of making decisions. This means you won't be the one to say, "now I'm incapable, so my Power of Attorney should take over making my decisions." You can take back control from a vulnerable situation by creating a plan before you become incapacitated.
- ◆ Incapacity planning is different from estate planning. An estate plan talks about what happens once you're gone. An incapacity plan identifies your PoAs and gives them instructions about topics like how you want to be assessed for incapacity and how you want them to manage your health and property on your behalf while you are still alive. When done properly, an incapacity plan sets your PoAs up for success.

- ◆ Make sure the people around you know about your plan. Tell your Powers of Attorney, lawyers, doctors, Wealth Advisors, accountants, and family about your wishes and their role in your plan. Planning can avoid mistakes, time delays, costly litigation, and (worst of all) conflict within your family.

If you want to talk about your situation, please give us a call. If you want more resources on incapacity planning, check out the Capacity Clinic's website at www.capacityclinic.ca.

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