

# Markets Made Simple

Chan and Brown Wealth Management



Wealth Management  
Dominion Securities

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## THE YEAR OF LIVING IN UNCERTAINTY

Before smart phones and cars that drove themselves, back to a time when everyone had a physical map stored in the glove compartment of their car, my girlfriend at the time (we'll call her Alexa, not her real name) and I went on our first trip to LA. According to her, I was too much of a planner and she wanted more 'spontaneity' in our lives, so I decided to let her take charge of our vacation plans.

We landed late at night into LAX, exhausted, and ready to collapse in bed. After picking up our rental car from the deserted lot I slid into the driver's seat, ready to let 'Alexa' direct us to the hotel she had booked. Unfortunately, my 'Alexa' does not work the same way as voice activated Alexa we have in our homes today. To me, the role of the navigator is to be like Google Maps, providing a detailed list of step-by-step directions to arrive at our destination. To my Alexa, the role of the navigator started and ended with our hotel name. She had no idea how to get there and assumed that by telling me "Doubletree Hotel", I would instantly provide her a comprehensive list of the eight Doubletree Hotel locations in downtown LA allowing her to choose the appropriate one she had booked to drive towards. Fortunately, she brought the address but unfortunately, prior to the advent of smart phones and google maps, navigating a massive city like LA, at night, in 10 lane traffic, without even a paper map is similar to doing the same in the Amazon rainforest and about as safe.

Our 30 min drive turned into a two-hour ordeal, much like the chase scene in Mad Max with us racing ahead of danger through parts of LA I hope to never see again. This included a brief tutorial from the LAPD who kindly pulled us over to let us know that the area we were driving through was very dangerous and we should do as the movie title says and head "Straight Out of Compton".

We eventually arrived at our hotel and as we checked in, I had a feeling this vacation may not unfold as I expected.

After the events of the last three months, investors are probably feeling the same way about the economy and stock market in 2025.

### **2025, the Year of Living in Uncertainty**

In the 1982 movie, the Year of Living Dangerously starring Mel Gibson and Sigourney Weaver, the story is set during the 1965 political upheaval in Indonesia. Today in 2025, we are in the Year of Living in Uncertainty. Tariffs enacted, paused, reversed, retaliated, increased, and increased again. A new US President who is changing global relations and trade policies, a new Canadian Prime Minister, an upcoming Canadian election maybe another new Canadian Prime Minister, and a war against a former beloved brand of electric cars with dealerships and vehicles being set ablaze and vandalized. As the Terminator franchise predicted, "...The war against the machines has begun...", and it's starting with Tesla.

Investors, businesses, farmers and owners of Elon's cars are very worried.

### **The Flow of Capital**

Over the years we have written about the flow of capital and how it generally moves to where it can earn the best return. Fear and uncertainty from daily news about tariffs, recessions, and economic upheaval has caused many investors to lose sight of this principle, so it would be a good idea now to take a step back and look at the big picture.

Interest rates dictate where money goes. When rates move lower, such as during COVID, interest paying vehicles such as saving accounts look unattractive. We dislike having our money sit in the bank doing nothing so we move it into investments such as stocks, bonds, and during COVID, into toilet paper because apparently that is the most valuable thing you can have in a pandemic. As capital flows into investments, their prices rise.

Capital also moves in the opposite direction as rates move higher. When rates began to rise in 2022 and reached over 5% in 2023, special offers of 5.5%, one-year GIC's, and other high 'promotional rates' at banks attracted many investors. After being starved for years with low rates, these offers looked like warm, soft, freshly baked cookies straight from Granny's oven and many investors grabbed these bank GIC's by the bag full. Stocks, bonds and other investments all fell in value as investors moved their funds into banks and other saving vehicles causing cash holdings to surge to record highs<sup>1</sup>.

After peaking last year, rates reversed course from their highs and are now dropping. The Overnight Rate in Canada fell from 5% to 2.75% and the US FED Rate dropped from 5.5% to 4.5%. Investors who locked-in incredible rates for their GIC's in the past few years are disappointed with the low rates being offered as their GIC's mature. Those previously soft yummy cookies are now rock hard and crusty as they had an expiration date. As investors have come back for more, they now need to look elsewhere. When we saw investors abandon stocks and bonds for GIC's in 2022 and 2023, we took the opportunity to pick-up many of the discarded bargains that arose resulting in strong returns for our clients in 2023 and 2024.

Rates looked as if they would continue to fall at the end of 2024, but the start of the new year brought a much different environment than investors had expected, just like my expectations for a nice, relaxing vacation in California, things were not going to go quite as planned.

When Alexa and I went to LA, I dreamed about lounging at Huntington beach, working on my tan and frolicking in the waves. Instead, we spent most of the time getting lost everywhere we went and seeing much of LA that are not tourist attractions. Part of that was due to the different definitions of planning that she and I have. A vacation plan for me includes a daily itinerary of what we plan to do along with clear directions on when and how to get there. Her plan includes booking a flight, accommodations, rental car and a vague idea that we should go to some fun places. I don't think the many run-down housing projects we drove by while we were lost in LA would be considered 'must see' attractions.

The next exciting leg of our trip involved a four-hour drive to Las Vegas. This time I was not worried. I had solved our navigation problem by replacing Alexa's questionable directions with a new and superior navigator...a rented GPS! This (at that time) was a highly advanced technology that could pinpoint our location within half a city block and plot our route flawlessly through the labyrinth that is LA county towards the entertainment capital of the US, Vegas! What could go wrong?

We left LA early to avoid the traffic and to beat the heat. Alexa had secured our hotel in Vegas at an amazingly low price, likely due to the small number of tourists who enjoy wandering around a city in the desert in the middle of July with temperatures ranging upwards of 50 degrees Celsius. But I said nothing, why spoil her fun?

However, there was one flaw in my new navigation technology, I did not double check the 'Las Vegas' that Alexa entered into our GPS. I would soon learn that there is another Las Vegas....in Tijuana...Mexico.

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<sup>1</sup> <https://www.marketwatch.com/story/money-market-fund-assets-rise-to-record-as-investors-love-cash-even-as-stocks-climb-in-2024-ff5071e6>

### Dealing with the Uncertain

This year, uncertainty around trade has reached all-time highs and business confidence has reached all-time lows with businesses sentiment now lower than during the 9/11 terrorist attack, the tech crash in 2000, the 2008 financial crisis, and the 2020 Coronavirus Pandemic.

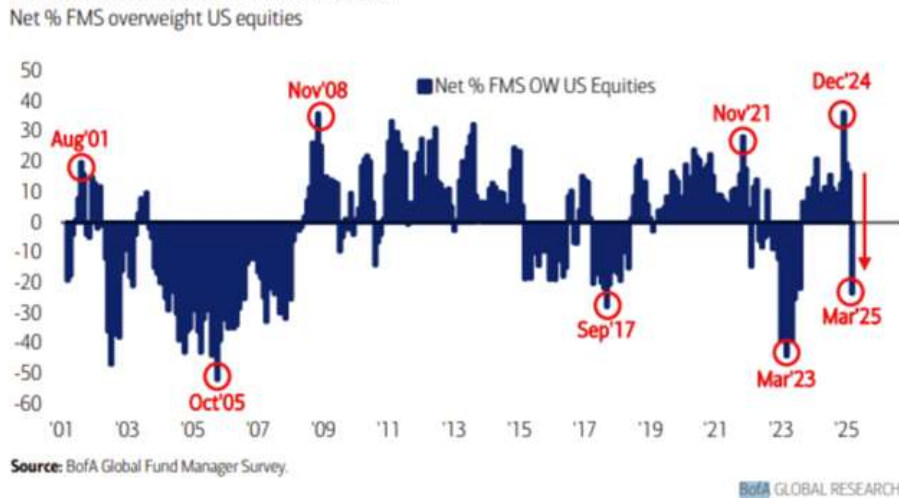
**Chart 2: Canadian Small Business Sentiment...it's worse than 9/11, Lehman & COVID**



Hedge funds have turned the most bearish in the last five years<sup>2</sup> and investors have only been this negative on the markets six times in the past 38 years<sup>3</sup>. The backlash against Musk and DOGE is so bad that Tesla owners are trying to disguise their Cybertrucks as large waste bins to confuse potential vandals.

We are psychologically wired to avoid uncertainty and the unknown while we crave stability and predictability. The start of 2025 has been anything but stable and investors have shunned the markets faster than BC liquor stores shunning US booze. In December of 2024, markets saw a record rotation into US stocks, now in 2025 we are seeing a massive rotation out of them.

**Chart 14: Record rotation out of US stocks**



### The Future Direction of Rates

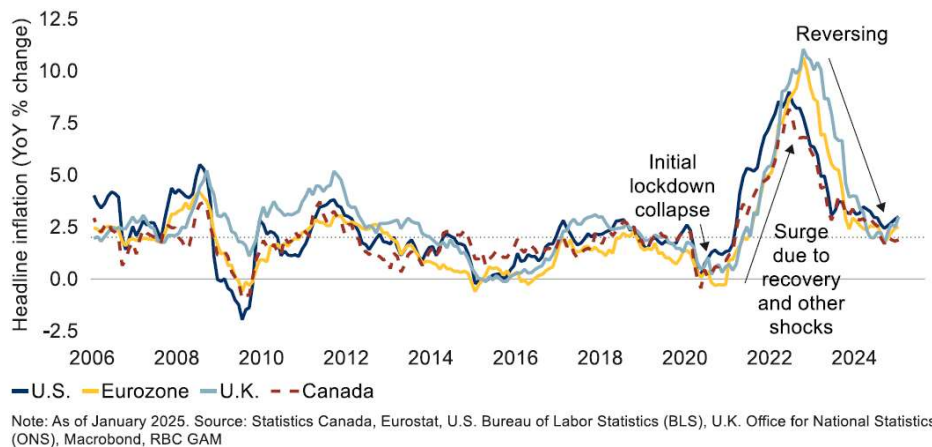
Tariffs and trade wars have brought up the question of the future direction of rates. Will tariffs push inflation higher causing interest rates to start rising to control it, or will they continue their downwards trajectory?

<sup>2</sup><https://www.reuters.com/markets/wealth/hedge-flow-hedge-fund-pessimism-over-wall-street-hits-5-year-high-goldman-says-2025-03-21/>

<sup>3</sup> <https://realinvestmentadvice.com/resources/blog/bearish-sentiment-surges-as-if-the-market-just-crashed/>

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Inflation has fallen in North America from their highs but have started to rise again as tariffs are increasing prices for consumers. Tariffs are inflationary but they are a one-time tax. Once the 'tax' is applied, inflation spikes, then levels off from that new number and does not necessarily keep going up unless the tariffs go up.



With the uncertainty around the economy and the recent uptick in inflation, central banks have turned more cautious and have slowed their pace of rate cuts. Rates are still expected to fall, just at a slower pace with the US FED stating they expect to cut rates twice more this year<sup>4</sup> and the markets pricing in around the same for the Bank of Canada.

### What Will Capital Do?

Each month more and more investors are facing the dilemma of seeing their GIC's mature, and renewals being offered at much lower rates. With re-investment options for cash looking less and less favorable as rates continue their slow grind down, the investments we currently hold for clients are looking more and more appealing. Small and mid-cap stocks in the US that have been trading at two and a half decade lows relative to their large cap US counterparts, international companies trading at record low valuations compared to the US and yields in our corporate fixed income ranging from 3.5% to over 6%. These holdings that we moved into over the past year look much better than low-interest rate alternatives, even with all the uncertainty today including the start of a global trade war.

### The Pre-Flight Check

A little pre-trip planning would have gone a long way for Alexa and I on our trip to LA, especially in hindsight after our misadventures. As a pilot performs a rigorous pre-flight check before take-off, we also have our own pre-flight checklist in managing our client's investments before we make investment decisions.

On a weekly basis, our team Investment Committee meets to review and identify the risks in the markets, their potential impacts, and our exposure to them. We then prepare and implement strategies to limit their impact on our clients' portfolios. We also assess opportunities and evaluate the best way to take advantage of them. Our team pulls from a broad base of external and internal experts with extensive experience to ensure we consider a comprehensive picture of what is happening on the landscape all around us, and to help us focus on the relevant events impacting our clients' funds.

We have also engaged external firms to review our portfolios and put them through rigorous stress testing under a variety of different scenarios such as a recession, a spike or rapid drop-in interest rates, an oil price shock, or policy changes.

Our process allows us to manage through the storms that come our way and give us the ability to take advantage of the unique opportunities when they arise. We can take positive action in times of crisis instead of having to ride the ups and downs of the markets like many investors who can do little but watch.

<sup>4</sup> <https://www.ccn.com/analysis/business/projected-us-interest-rates-in-5-years/>

### **The Risks Today**

Over the past year we have highlighted several risks we are paying attention to which include:

1. Long-Term Inflation
2. Expensive US Valuations in Certain Stocks and Sectors
3. A Trade War
4. The Overextended Canadian Consumer

We took several steps to protect portfolios from these risks heading into 2025. In our fixed income we reduced our exposure to long-term bonds which would be most impacted by higher inflation resulting from increasing and unsustainable government deficits. We also added bonds with inflation protection such as US Treasury Protected Securities (TIPS) and reduced exposure to areas of the fixed income markets that are overvalued, like high yield bonds.

In our stock holdings, we took profits and reduced our exposure to expensive US large-cap names while increasing our weightings to areas such as US small and mid-cap companies that are more attractively valued with better upside. Since these companies generate around 80% of their revenues from within the US, they are also much better insulated from increasing tariffs. With a potential trade war brewing after the US election, we reviewed our exposure to our Canadian and International holdings evaluating how they would be impacted. Our research concluded the impact would be minimal as many of the stocks we hold do not ship directly to the US. Our holdings outside the US have performed well this year and are net positive. Over the past several years we have also minimized our holdings to companies in Canada that are tied to the weak Canadian consumer who have been struggling to pay down their high debts and under pressure from interest rates.

At the end of 2024 we took profits in our equities and increased our fixed income holdings to rebalance portfolios and provide more stability to prepare for the potential for increased market volatility in 2025.

### **Navigating the Storm in 2025**

As we did in 2020, and again when markets sold off in 2022, by positioning portfolios for the anticipated risks we saw in the market, we were able to outperform and weather the storm in the markets this year providing clients with much better downside protection.

The start of the second quarter saw “Liberation Day” with the markets on track for one of the fastest selloffs since WWII<sup>5</sup>. Markets were not expecting such broad sweeping tariffs, and it has caused many investors to hit the panic button and dump their stocks for fear of a global recession.

With our positioning from the start of this year, we are very satisfied with how well our holdings have held up to date and we feel that as markets and investors adjust to the new global environment, there are opportunities for the securities we own especially the ones outside of North America to outperform. International countries will benefit from the need to build stronger trading alliances with their partners and companies in these countries that have been lagging in competitiveness against the US, now will be working hard to innovate and catch up fast. These companies are already trading at attractive valuations relative to their US counterparts and their push to become more efficient can result in stronger growth in their earnings and ultimately better returns.

In the first three months of 2025 the US S&P500 fell by close to 5%, the NASDAQ by over 10%<sup>6</sup> and the Canadian markets fared slightly better with the S&P/TSX up by 1.5%<sup>7</sup>. Bonds finished the quarter with the Canadian Universe Bond Index up 2%<sup>8</sup> and S&P U.S. High Yield Corporate Bond Index up just over 1%. Our equity models handily beat the US and Canadian indices producing returns several hundred basis points above them, and our fixed income holdings performed in line with the Canadian bond indices.

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<sup>5</sup> <https://www.bnnbloomberg.ca/investing/2025/04/07/the-sp-500-is-flirting-with-a-bear-market-as-tariffs-hit-everything/>

<sup>6</sup> <https://www.nasdaq.com/articles/first-quarter-2025-review-outlook>

<sup>7</sup> <https://www.blackrock.com/ca/investors/en/products/239837/ishares-sptx-capped-composite-index-etf>

<sup>8</sup> <https://www.blackrock.com/ca/investors/en/products/239493/ishares-canadian-universe-bond-index-etf>

The sell-off we have seen in 2025 has been mostly concentrated in areas of the markets we have been avoiding, such as expensive US technology and large cap companies which has allowed us to weather the storm of this year much better.

### “Last” Vegas

Minutes and hours passed as we continued our drive to ‘Las Vegas’, and the scenery turned increasingly lush and greener, with giant palm trees and towering tropical plants. Not very much like the desert that I know Vegas should be. I suggested that we pull over and double check that we are going in the right direction, but Alexa insisted that we were making excellent time, and our GPS was telling to continue, so onwards we drove.

An hour later, we passed a sign for the exit to the San Diego Zoo. Hmmmm...San Diego is nowhere near Vegas, so against the protests of an adamant girlfriend, I took the next exit and stopped at a gas station to confirm where we were. The attendant pointed to Las Vegas on a map, and it was in the opposite direction of where we were driving. We were most of the way to Mexico. I considered not telling Alexa to see if she would notice when we drove through the Mexican border and are surrounded by people speaking Spanish. However, my highly developed survival instinct decided that she might be angry enough to sell me to the cartels and drive home alone claiming the gangs had kidnapped me and that she didn’t have the money to ransom me back.

So, after driving three hours in the wrong direction we now had to back track with a six-hour drive ahead of us. With no safety supplies, extra food, or water and only a vague idea of where we were heading, we would now be driving through a mostly empty desert in scorching July heat where a flat tire or overheated engine would turn us into dinner for the flying vultures that I observed following our car much of the way.

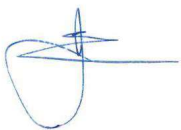
The temperature continued to soar as we drove on through the day. On a food stop, I accidentally spilled some water on the asphalt only to see it disappear faster than the Canucks playoff chances. I prayed that our tires wouldn’t melt in the heat and leave themselves and us as nothing more than a black smear on the road.

For many investors it is easy just to go with the flow and follow what everyone else is doing. Instead, they would be better off to stop to check and make sure they are heading in the right direction. In addition, unlike Alexa and I, investors should be prepared for risks along the way. That way, they could arrive safely at their desired destination with a minimum of detours along the way.

With the sun starting its descent, and after close to ten hours of driving we finally arrived in Las Vegas, the one with the bright lights, gambling, and pool parties. We survived the drive.

Planning can be boring and spontaneity in life can be fun, but when it comes to investing, boring is usually good and spontaneous is usually accompanied by ‘combustion’ of your money. After this trip Alexa saw the value in having a plan and left all the future trip planning to me. If I planned a trip with Alexa again, it would be someplace cooler, like Greenland.

-Kind regards,



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Portfolio Manager and Wealth Advisor



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