



Kogan Wealth Management of RBC Dominion Securities



Ron Kogan, MBA
Senior Portfolio Manager
ron.kogan@rbc.com
416-842-7280

Jerry Rawlik, CFA
Associate Advisor
jerry.rawlik@rbc.com
416-842-1019

Jeremy Wilkes
Associate Advisor
jeremy.wilkes@rbc.com
416-842-3604

Catherine Minard
Associate
catherine.minard@rbc.com
416-842-3619

Natalie Hohenstein
Associate
natalie.hohenstein@rbc.com
416-842-7336

Joanne Kutchera
Associate Advisor
joanne.kutchera@rbc.com
416-842-3230

RBC Dominion Securities
181 Bay St., Suite 2200
Brookfield Place
Bay-Wellington Tower
Toronto, ON M5J 2T3
Private fax: 416-842-7360
Website:
koganwealthmanagement.com

Q1 2025 Market Commentary

Benchmark performance as of March 2025

Index	March	2025 YTD Return
S&P/TSX Composite TR	-1.5%	1.5%
S&P 500 TR	-5.6%	-4.3%
Nasdaq Composite	-8.2%	-10.4%
WTI Oil	2.7%	-2.6%
Natural Gas	5.1%	12.6%
Copper	11.2%	25.9%
Gold	9.9%	17.7%
10-Year US Treasury Bond	0.4%	4.1%
USD/CAD FX	-0.5%	0.0%

Source: FactSet

The first quarter of 2025's weak equity performance and heightened volatility can be attributed to the threat of US Tariffs.

The drawdowns experienced in March were modest relative to the Global Equity market reaction to President Trump's trade policy announcement.

Trump's attempt to reorder the world trade system, using tariffs as a blunt instrument was a campaign promise and on April 2nd it became a sad reality.

The absurdity of the levels of the tariffs and the methodology for their calculations offer some hope of bilateral negotiations but this will be a lengthy process. It is unlikely that the baseline 10% tariffs applied to all countries will be reversed. Countries that attempt to escalate will be punished with more punitive tariffs leaving two options – negotiate or do nothing. This is a difficult position given that most countries already have high debt and deficits and in the case of Canada a high economic dependency on the US consumer.

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The US has imposed 25% tariffs on Canadian goods that are not compliant under the Canada-US-Mexico Agreement (CUSMA), with a 10% carve out for energy and potash, due to what the Trump administration claims are concerns regarding border security and fentanyl. If these tariffs are lifted, Canada would still face a 12% tariff on non-compliant CUSMA products based on the new retaliatory tariffs. There is also a 25% tariff on steel, aluminum, and vehicles that Canada has now matched. The U.S. is set to more than double the duty it charges on softwood lumber imports from Canada, with the planned new rate set at 34.45%, up from the previous 14.54%. Other nations face tariffs ranging from 10% to 50%.

By executive order, President Trump invoked his authority under the International Emergency Economic Powers Act of 1977 (IEEPA), noting “the national emergency posed by the large and persistent trade deficit that is driven by the absence of reciprocity in US trade relationships and other harmful policies like currency manipulation and exorbitant value-added taxes (VAT) perpetuated by other countries.”

In 1978, the famous economist, Milton Friedman wisely said, “if you introduce protection, tariffs, restrictions on trade, they become matters for government-to-government wrangling and they are an enormous source of division. So, in the name of both prosperity and world peace there are few steps that we could take which would contribute more than a complete move toward free trade.”

The US Dollar is the world’s reserve currency, and the US is the largest economy in the world, so trade deficits are to be expected when compared to smaller less wealthy nations.

Ironically, tariffs will only serve to punish US consumers through higher inflation and slower US economic growth. The tariffs will also reduce product selection for US consumers as foreign products get redirected to countries with lower or no tariffs. For example, Land Rover just announced that they will not ship their vehicles to the USA for the next 30 days.

JPMorgan just ratcheted up its odds for a 2025 U.S. and global recession to 60% (from 40%), with tariff distress threatening to sap business confidence and slow down global growth.

This situation places the US Federal Reserve (Fed) in a difficult position. On April 4th, US Fed Chair Jerome Powell noted, “You have inflation that is going to be moving up, and growth is going to be slowing. It is not clear at his time what the appropriate path of monetary policy will be.” This certainly sounds like stagflation is a near term risk.

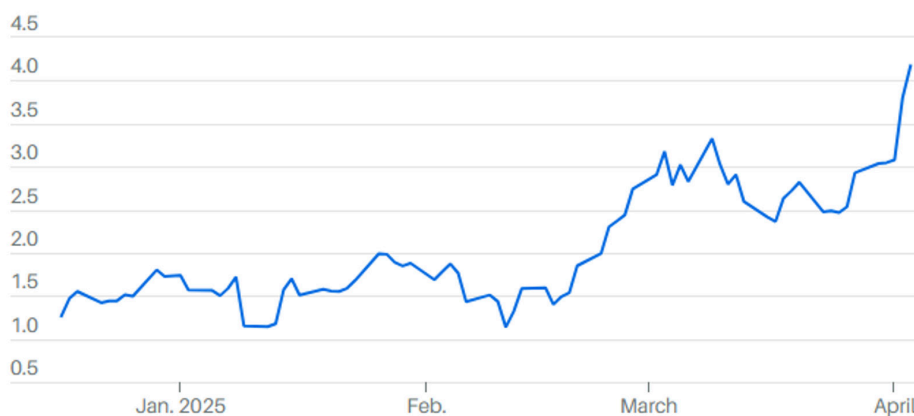
Historically, equity markets have relied on the Fed “put” via lower interest rates in times of stress. The market expects four Fed interest rate cuts in 2025, but the timing and magnitude of the cuts remains uncertain as long as the economic data shows solid US GDP growth and inflation remains above the Fed’s 2% target (See Chart 1).

Chart 1: Four Fed Rate Cuts Expected in 2025s

Rate Expectations

Futures traders have sharply boosted their bets on Federal Reserve interest-rate cuts this year amid rising economic uncertainty. Will Powell & Co. follow?

Futures Market Estimates of Number of Quarter-Point Rate Cuts By Year-End 2025



Source: Barron’s

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The Fed’s preferred inflation gauge, the core PCE Index, remains sticky as it rose 0.4% in February and 2.80% year-over-year.

In times of heightened uncertainty, investor sentiment erodes quickly, and this is evident in the most recent AAI Sentiment Surveys. Bearish investor sentiment stands at 62% compared to an historical average of half that amount.

Investors poured more than \$60 billion into money-market funds in the first few days of April. That has sent assets in US money market funds to a record \$7.4 trillion. Cash is still paying higher yields than before the pandemic, even with the Fed’s rate cuts last year. The average return on money-market funds is at 4.2%, down from 4.3% in December 2024.

Market watchers have closely monitored the trillions of dollars that have piled up in cash investments over the past few years, with some anticipating that much of it would eventually flood into stocks and power the market’s next leg higher. Those expectations are on hold for now given the uncertainty around trade policy.

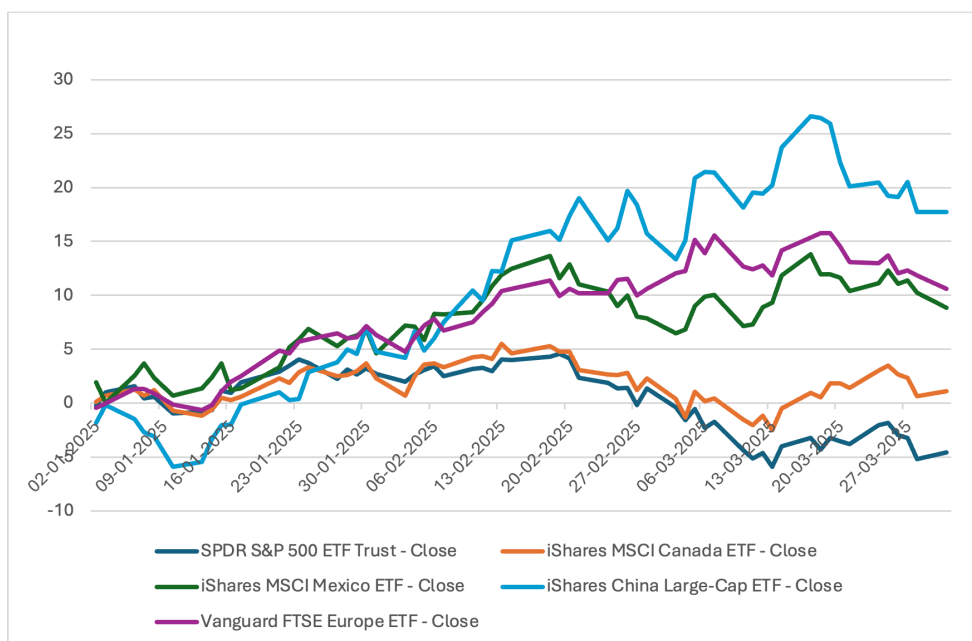
The past two years of US equity outperformance has started to unwind as the countries most threatened by tariffs have outperformed the S&P 500 YTD 2025 (see Chart 2).

While Canada has been in Trump’s crosshairs since his inauguration our equity markets have outperformed. I expect this relative outperformance to slip given that the two largest sectors are facing new pressures. The Canadian banks will see increased loan loss provisions and lower loan demand if Canada enters a recession. The Oil and Gas sector will be pressured by tariffs and a budding oil glut because OPEC and its allies are ramping up production just as demand looks set to stagnate. OPEC announced an unexpectedly sizable increase in output scheduled for May, planning to bring back production of 411,000 barrels of oil per day. The Materials sector has been a standout performer with gold equities rising 34% YTD 2025.

The YTD 2025 S&P 500 underperformance can be explained by a broadening out of the market as illustrated by the Equal Weight S&P 500 outperformance compared to the Magnificent 7 ETF (See Chart 3). The Price Earnings (PE) multiple for the MAG 7 companies average 28x while the S&P 500 Equal Weight trades at a more modest PE of 19x.

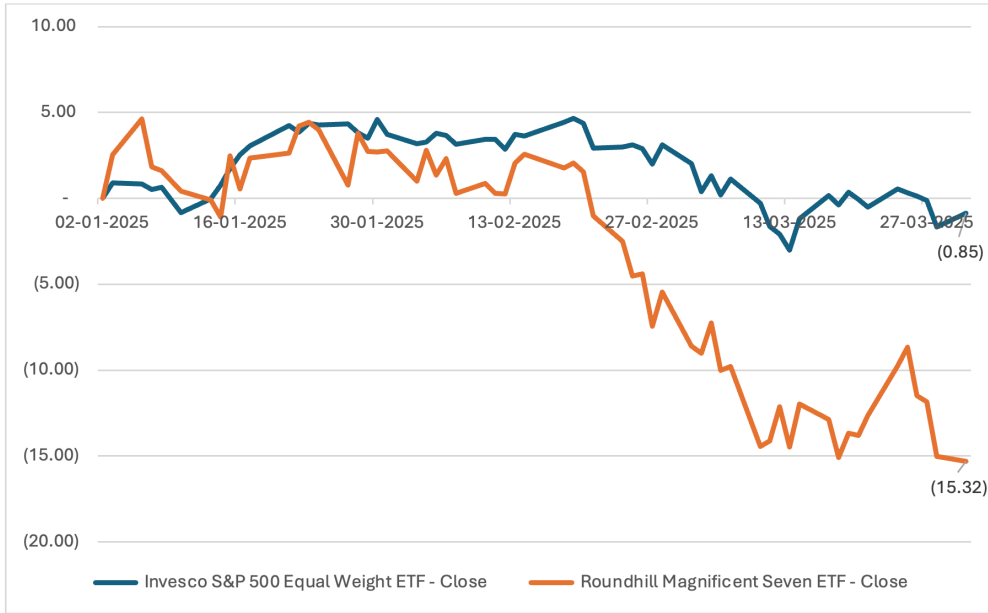
What is Trump’s true motivation behind his trade policies? It is evident that Trump does not separate commerce and politics when dealing with foreign friends and adversaries alike.

Chart 2: S&P 500 ETF Underperforms Canada, Mexico, Europe, and China



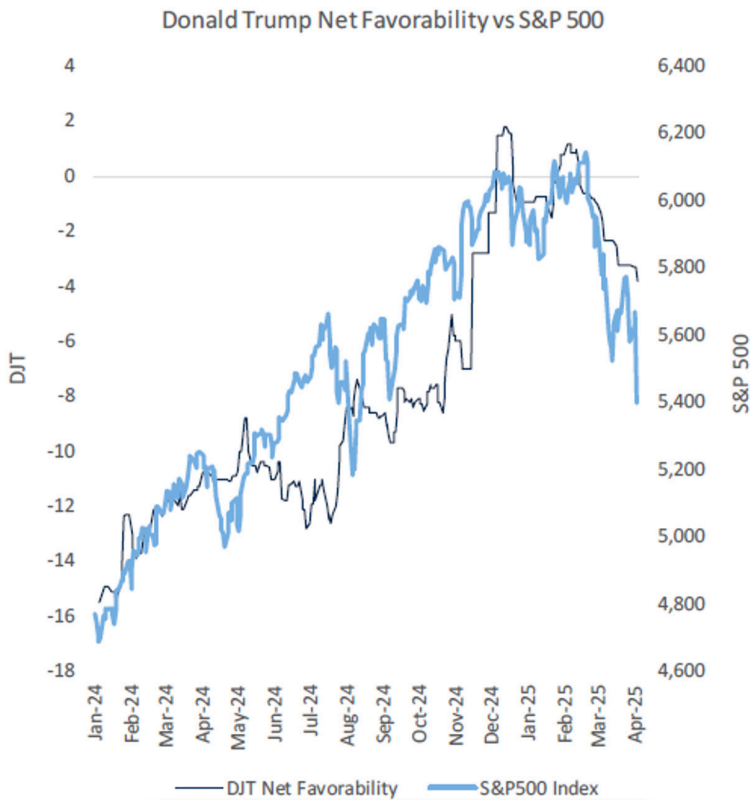
Source: FactSet

Chart 3: The Mag 7 sold off due to Sector Rotation and PE Multiple Compression



Source: FactSet

Chart 4: S&P 500 Performance and Trump’s Approval Ratings are Highly Correlated



Source: RBC US Equity Strategy, Bloomberg

His main motivation appears to be to drive more foreign and domestic investment into US manufacturing to rebuild factories and jobs.

This is economic folly because the US is a service based economy and low margin goods such as textiles, shoes, and electronics are more efficiently produced in lower wage countries. Further, manufacturing jobs in the US were replaced by technology as labour was replaced with capital and productively gains were realized.

Trump has broken the basic tenet of capitalism. Companies invest capital to earn a return on their investment for investors. With no path to profitability or predictable operating rules management will not deploy capital or hire incremental workers.

If the US were to enter a recession it would be manufacturing jobs that would be lost first making the tariff exercise futile. In the Covid recession, according to the US Bureau of Labor Statistics (BLS), 578,000 US manufacturing jobs were lost.

Why would the US want to allocate scarce resources to such lowly pursuits when they could continue to lead in areas of information technology, cloud computing, robotics, semi-conductor design, and artificial intelligence? Onshoring semiconductor production and accessing

Chart 5: History Suggests that S&P 500 Recovery One Year Forward

S&P 500 after 2 Consecutive days of <= -4.5% Returns
Since 1950

S&P 500 Daily Chg.			S&P 500 Forward Returns									
Day 2	Day 1 % Chg	Day 2 % Chg	1D	2D	5D	10D	1M	2M	3M	6M	12M	
1	10/19/1987	-5.2%	-20.5%	5.3%	14.9%	1.3%	13.7%	9.2%	10.8%	12.1%	15.5%	22.4%
2	11/6/2008	-5.3%	-5.0%	2.9%	1.6%	0.7%	-16.8%	-3.2%	2.5%	-8.0%	-0.1%	14.5%
3	11/20/2008	-6.1%	-6.7%	6.3%	13.2%	19.1%	16.4%	18.0%	13.0%	4.8%	20.7%	45.3%
4	3/12/2020	-4.9%	-9.5%	9.3%	-3.8%	-2.9%	6.0%	12.5%	18.1%	28.6%	34.3%	54.9%
5	4/4/2025	-4.8%	-6.0%									
Average			6.0%	6.5%	4.6%	4.8%	9.1%	8.8%	9.4%	17.6%	34.3%	
Median			5.8%	7.4%	1.0%	9.9%	10.8%	10.3%	8.4%	18.1%	33.9%	
Win Ratio			100%	75%	75%	75%	75%	85%	75%	75%	100%	

Source: Fundstat

rare earth materials is sensible for national security reasons but does the US need to manufacture socks and underwear?

Another Trump motivation may be to reduce interest rates by triggering a brief recession. Lower interest rates will assist with interest related to the US Debt and the cost of borrowing for households. The US Federal Government is currently spending \$7 trillion and collecting only \$5 trillion in taxes annually so something needs to change.

Trump and his cabinet are targeting the 10-year US Treasury yield that has declined from 4.80% in mid-January to 4.00% today.

The 30 year US mortgage rate at 6.64% has barely budged trailing one year and this has been an issue for home buyers and builders alike.

Tipping the US economy into recession is a very precarious approach and will cost the country more to recover from than they project they will receive in tariffs. Slipping into a recession is easy but recovering from one is an arduous process often required aggressive fiscal and monetary stimulus.

The impact of the DOGE firings is deflationary. The coincidental OPEC oil production increase the day

after the April 2nd tariff announcement reduced energy prices – again, deflationary. The painful drop in asset prices, especially stocks is also deflationary because it reverses the wealth effect enjoyed in the previous two year bull market. With \$11.9 trillion lost in market value since the market's peak in February, and \$7.6 trillion since last November's election I expect even consumption to slow as even the wealthiest US consumers pull in their spending.

For risk assets, any upside would have to come from either a more dovish than expected Fed or near-term progress on tariff negotiations that clearly offers a path for lower tariff rates.

We are close to earnings season and there may be some positive surprises, but forward guidance will be pulled due to the uncertainty regarding trade.

The silver-lining is that unlike the Covid market decline this period of economic uncertainty is 100% self-inflicted by US trade policy which can be readily adjusted. I am referring to the illusive Trump put that equity markets relied on during Trump's first term in office. It is possible but not probable that further equity market weakness and/or recessionary conditions may revive the Trump put. Chart 4 shows how Trump's popularity correlates with the performance of the S&P 500. At some point,

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Trump may find his slumping popularity an issue and moderate some of his more radical trade policies.

Trump's approval rating may be a more pressing issue going into the US Congressional mid-term elections.

Finally, there is also the future possibility of tax cuts and deregulation that would be helpful but have now taken a back seat to trade policy.

Historically, when markets decline precipitously (1987 crash, 2008 Great Financial Crisis, 2020 Covid pandemic) as they did post Liberation Day the S&P 500 gained 34.3% on average one year forward with a 100% win ratio (see Chart 5).

During periods of market volatility, it is important to remain disciplined and invested because markets always recover in time, and you do not want emotions to undermine your long term return objectives. - RK



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