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Ep115: 2025 Mid-Year Investment Review

Keith Matthews: Marcelo, how are you?

Marcelo Taboada: Keith, it's good to be back. Lots have happened in the last year. I would say a lot has happened since January as well. We're going to get into it today and.

Keith: Yeah, well, great to see the enthusiasm, Marcelo. It's been five or six weeks since we did a podcast together, so looking forward to today's mid-year review. Yep. So, we're doing 2025 mid-year review and like you said, a lot has happened. So, listen, let's jump into the review, Marcelo. Let's first start by talking about just some of the big issues that have occurred in the first six months of the year. And then we'll talk about market returns.

Marcelo: I think the biggest one is the election in the U.S. so the comeback of Donald Trump, that's a big one for, you know, geopolitically, the markets. It was a big shock for Canada and a lot of the trading partners that the US had. Geopolitically, you know, it's a big shock for NATO and the G7, I mean, name it. I think everybody's followed the news on that for Canada. We have a new government as well. Liberals were out and completely done. Some people were even talking about the end of the Liberal Party. Here we are back with a liberal government. So that happened. And then, you know, geopolitically, I think we're all following as well. It's still very turbulent. We have wars in. The war in Ukraine is still going on. Israel's conflict with Hamas is still going on. You have now a new conflict with Iran, which seems to be resolved now. But I think time will tell what will happen in the region. But very turbulent times in the world, I would say.

Keith: Yeah, absolutely. And you know, from an investor's perspective, many say, wow, that's a lot of things to worry about. It feels tough. And in particular, we had some market volatility in and around Trump's liberation day in early April. His Liberation Day was April 2, where he clamped down and put all these very High tariffs. And then there was counter tariffs. Just in those four or five days after that period, markets were down anywhere from 10 to 18%, depending on the region of the world.

Marcelo: Right.

Keith: So that was a big blow. Tremendous volatility. And then we had massive recoveries based on the US Administration walking back and kind of softening some of their trade positions.

Marcelo: Yeah.

Keith: Let's start by reviewing maybe the dip. How big were these dips in that period?

Marcelo: So that's a good point. Canada went down 12%. US by measured by the S&P 500 went down 18%. The MSCI looks at developed markets, Europe mostly, it was down 14% and your emerging markets were down about 15%. All those figures, Keith, in Canadian dollars.

Keith: That US one is the most striking because that's almost what we call bear market.

Marcelo: Which is 20%.

Keith: Negative 10% is called a correction. Negative 20% is what we call a bear market. So, you're on the verge of a bear market, which doesn't happen often. And this all happened in a matter of literally a month and very, very sharp decline. And then we started to have a quick comeback. I remember being in the car looking at, actually not while I'm driving, but I was parked looking at the market and all of a sudden it.

Marcelo: Yeah, that was. Yeah.

Keith: And do you remember that day when it went up 9%?

Marcelo: I remember I called you and I said, I don't think I've ever seen such a big day in the market.

Keith: Yeah, I remember kind of a close day. And that would have been recently in the pandemic. When we were talking, I think it was late November or mid-November when the large pharmaceutical companies came out with a statement at 4:00 clock in the morning that they had discovered the cure, and it was 90% effective. Well, when I woke up, I checked the market and it was up like 7%, but not as high as that, 9.5%. And that was because essentially, they said there's a 90 day pause, and they were going to rethink things. And then that's when people said, okay, maybe there's going to be some solutions coming. So that was sort of the steep decline, and we know that the markets have recovered. So, let's take a moment now and actually review the year-to-date numbers. So, you know, markets went up in sort of January, February and Canada and in Europe they kind of went up a bit more. Then we had these sharp declines and now we've had recoveries in most markets.

Marcelo: Right.

Keith: But let's take a moment and review Asset class returns for the last six months.

Marcelo: Right. So, you have your 30-day T bill, which is, you know, your shortest type of bond or fixed income. That was up 1.4. Canadian short-term bonds were up 2%. Canadian long-term bonds were up 1%. Canadian stocks were up 10%. I'm rounding up here as well.

Keith: Yep.

Marcelo: And U.S. stocks were up 0.6%. International stocks were up 13%. Emerging market stocks were up 9%. And global REITs, you know, it's real estate investment trust, were down with 1%. So very good year if you ask me.

Keith: Well, you know, it's not even a year, Marcel, it's a half a year. Yeah, it's a half a year. And Ian McGoogan out of the Globe and Mail, I thought, had an amazing quote this week, and he summed it up nicely in the article that he wrote stating, it's been a wild six months, but don't tell that to the stock market. As far as it's concerned, the first half of the year has turned out just great.

Marcelo: Yeah.

Keith: Which, you know, if you go back in time and if you were to tell an investor we're about to go through all of this, what do you think will happen? I think nine out of ten investors will say, there's no way. Oh, my goodness, the stocks will be down 20 or 30%.

Marcelo: There's no way. Yeah.

Keith: And here we are halfway through the year and a globally diversified, all equity portfolios. Let's just round things out. Sort of a third Canada, third US, a third international would be up about 7%.

Marcelo: Right.

Keith: And there's no way people would have thought that.

Marcelo: Yeah.

Keith: And so, the other thing I find really interesting here in this evolution of this trade war that we're in, is the aggressor being the United States administration. And the U.S. economy has the worst returns coming in basically at flat numbers. And the countries that have been picked on or perhaps bullied or pushed, Canada, Europe, Asia, actually have the best returns, and not by a little, by a long shot. We're talking, you know, 10% or 13% return versus zero. So that's quiet, quite a big gap. Why do you think that might be?

Marcelo: First of all, when you think about where the US Is coming from, they're coming from a remarkably strong economy. Their stock has crushed every other market in the last five years. So, they're coming from a very strong place. Even when you look at productivity versus Europe and Canada, they're crushing everybody how much they produce per worker. So, I think from that point of view, you're Coming from a very strong position, it makes sense that you're going to underperform. I think what accentuates this today is what we were talking of, Mike, which is the fact that I think the market's priced in that Canada, Europe, they have to pull it together now. They have to invest in their economy; they have to become more productive. They have to look for other markets to find partnership in trading. You know, for Europe, that means trading more within themselves and maybe Europe, maybe China. For Canada, it's more interprovincial trading and finding partners everywhere. It's not going to fix the whole problem. And then on a second layer is you now have to invest in your economy; you have to become more productive. It's a big wake up call for a lot of these economies. And I think this is the positive, the silver lining of this situation with the United States that now everybody's looking at themselves in the mirror and saying, we need to do something right. Like, we cannot just keep kicking the can down the road. I think that's what's happening.

Keith: Oh, I think that's very astute assessment. I mean, listen, we're not here to try to predict.

Marcelo: No.

Keith: And we actually can't tell if that's the issue, but I think that's a very valid hypothesis and very telling. Like, so it's a nice kick in the pants for everybody to kind of sharpen up and get in the game. And investors like that.

Marcelo: They love that. Yeah.

Keith: You know, one of the things that you see a little bit in some of the journalists is this. Make Canada investable a game.

Marcelo: Oh, yeah. So don't start making hats. Okay.

Keith: No one's going to do that. But it's an interesting concept which is for the last 10 years, Canada didn't feel like a place that was investable. It was over regulated, wasn't looking to improve their resource development, wasn't looking to become more productive. And now all of a sudden it is flipping itself upside down and looking at all these things and trying to move forward. And I think investors are taking notice and more freely investing in Canada and in Europe for that matter.

Marcelo: Well, I mean, Europe, I think the biggest driver in Europe's market, it's been military spending. And every time since, when Donald Trump came to power, I think it was a wake-up call for NATO and the Western alliance because of how things were shifting and how Donald Trump was like essentially saying, you have to invest in your defense, we're not coming for help anymore. And there's been a big push for, you know, European Mostly led by the United Kingdom, Keir Starmer, to bringing the countries together, creating European military companies and investing in those. So, I think that has been a big push for Europe. Even Carney announced recently that he was going to be a target by 2035, if I'm not mistaken, which is big because Canada has always been under the NATO target.

Keith: Yeah, yeah.

Marcelo: So, I think that has played a role too.

Keith: Yeah, yeah. Sure enough, Marcel, 10-year returns. So, we just did sort of the six month returns, but we wanted to mention 10-year returns because there's a couple of interesting observations here. So, look at the returns and tell me what you think about any of them.

Marcelo: Right. So, when you look at your fixed income, none of the returns are above 2%. So that is very surprising. So, you look at the short-term Canadian bonds, that was up like about 1.9. The long-term bonds were up 0.9. It's not a great number for 10 years. Those are also the safest. Right. Like we were discussing off Mike. So, people have essentially, when you count inflation and if you're in a taxable account, you've lost money by holding bonds. You look at stocks, it's a bit more promising. So Canadian stocks are up 9% for the 10-year period. US stocks about 14%. International stocks, you're looking at 7% returns. Emerging markets is 5% and global REITs is 5%.

Keith: Yeah. So, 10-year return, I mean we've essentially, if you have owned stocks, it's been a bull market. When I looked at this graph, the first thing I saw was how low bond returns were.

Marcelo: Right.

Keith: And in particular the bond universe. The last five years you have an annualized return of -1%. So, what's interesting about that is here we have gone through all of this sort of geopolitical turmoil, pandemics, wars in certain regions, trade wars. And if you would have said, let me be secure safe, you would have a stable portfolio, but with absolutely no growth versus what appears to be on the stock side and for that matter on the real estate side, not necessarily REITs, but residential property in Canada in the last 10 years has done well, stocks have done well, but bonds have not. And so, part of that is because the interest rates have gone up in the last four or five years. So, we're kind of resetting ourselves. But that movement of interest rates going up has created poor, longer backdated returns. You know, it is telling. Most of our client portfolios are, you know, balanced with high proportions of equities.

Marcelo: Yes.

Keith: Most of our retirees are Running with portfolios of 60 or even 70%, stocks diversified, some are higher, some are lower. But it is very telling, those 10-year numbers.

Marcelo: Absolutely. But I mean, you were a bond trader, like, why do you think, like, you hear a lot in the news now about the, you know, bond market, like, yields going up, all related to the new bill happening in the United States because it's going to push up budget deficits and US Debt. Even across the Western world. You keep hearing this like countries are getting into a lot of debt. Like, how does that play out in the fixed market, in the fixed income?

Keith: Well, if you look at U.S. treasuries coming in at like, you know, four and a half or just shy of that, I mean, that's a higher rate now.

Marcelo: Yeah.

Keith: And so, if you've held bonds five or six years ago at lower rates and these yields go up, your bond returns have been squeezed, your price goes down. Right, your price goes down. But for those who have to finance anything, whether it's a mortgage, buying a car, investing in a business, these are all the financing costs are dramatically higher today. And, you know, we talk to a lot of individuals, you know, and we hear things like individuals are feeling like investing in real estate is becoming more difficult, construction costs are higher, and the cost of financing is higher.

Marcelo: Right.

Keith: So that's the flip side of higher deficits.

Marcelo: Right.

Keith: Higher deficits mean countries have to have higher yields in order to entice people to buy their bonds and finance the deficit.

Marcelo: And that means more interest costs for those countries holding the debt. Right?

Keith: Correct.

Marcelo: Yeah.

Keith: So, you look at the US Government with their big, beautiful bill that they just passed, a lot of people are speaking to that being much more deficits in the future. Well, that means higher interest rates.

Marcelo: Right.

Keith: And that's not a good thing.

Marcelo: No.

Keith: So that's an interesting whole scenario, which we'll have to wait and see how that all plays out.

Marcelo: Yeah, for sure.

Keith: Marcelo, one of the things we're talking about with regards to returns, and this was in McEwen's article, is valuations. So, valuations, United States are still more expensive than valuations in Canada or Europe or Far East. Can you take a moment and just highlight the gap and why that might make some sense for real diversification outside of the United States.

Marcelo: Right. I mean, look, the valuations, I think it's a minefield for jargon when we're talking to clients. So, I think the best way to describe it is the higher you pay for something, the lower the expected return. That's pretty much what it is. So, when you look at the US market now, you're paying about $22 per every unit of earnings when you measure that in the stock market. Right. So, this is just a measure that finance people use to measure how expensive things are. So, they look at the market as a whole and they say, how much the price to earnings? How much do I have to pay for an extra unit of earnings? So, the US right now is around 22. You look at Canada right now, which is the. Looking at the TSX, you're paying about 18. And when you look at developed markets, mostly Europe, you're paying about $15 per every unit of earnings. So, the most expensive is the United States. So, if you put a dollar today in the United States just based the expected return is lower. That's just the way I look at it.

Keith: And that also is in line with the reports that we see out of firms like Vanguard. They're talking about expected returns where they suggest that the higher expected returns will be on the equity side in areas that have lower PE levels. So, Canada, Europe, Asia, and the lower future expected returns might come from countries that are considered more expensive now, like the United States. But that might also help us understand why Canada and Europe have done better in the last six months. Potentially.

Marcelo: Yes.

Keith: What are the other things, some of the dynamics that people are talking about with regards to why markets are able to potentially absorb all these shocks right now? Because there is certain optimism in the market. It has to do with AI in terms of allowing people to sort of think that the future will be better for companies from a profitability perspective.

Marcelo: I think there's two layers that there. I think the first one is obviously the AI players, which would be Google, Facebook, AI and Anthropic, I think, is the other one. So those are the big movers in. In AI, the ones driving the bus, so to speak. So, they're taking in a lot of the profits as first movers, obviously. But I think the second layer of that, which is, I think what the market is pricing, is that, you know, even your small company operating on the fringes, who maybe is not even a public company, will see a boost in profitability because they'll be able to use the tools, right? So, you go through the whole stock market, small cap, mid cap, large cap, even companies that are not technology companies will benefit from this. And that means more efficiency, more productive, more profits down the line. So, I think we're still not sure what it's going to do to unemployment and people's, you know, livelihoods but that's sort of what the market is pricing in. I mean, one of the theories that I read, I don't know if you've read this, but is the fact that because companies are going to be way more efficient now, we're going to be able to tax them more without sacrificing too many profits and we're going to be able to divert those taxes to paying universal basic income and kind of like get away from the mass unemployment that may come from AI. I'm not sure I buy that, but that's some of the things that I hurt.

Keith: Well, there's so much, I mean these are all very good points, Marceau. There's so much uncertainty here. We just don't know. So yesterday the Ford CEO Jim Farley came out and said that, you know, within the next five years, 50% of his white-collar workers will not have a job because AI is going to replace them. The company will be more efficient, more productive, more profitable, but people will lose jobs. And so, you're Starting to see CEOs make these statements and then there's others that are say, well, okay, the jobs are just going to change. There'll be different types of jobs and with any, every technology that's come, there's displacement and then there's emergence of new industries, new jobs, new responsibilities. So, I think it's way too early to figure out exactly how things will play out. That said, I think that's still part of the optimism that people have in terms of investing in companies which are, there's some changes coming. They can't quite put their fingers on it, but they feel it will be good for company profits.

Marcelo: Yeah, I agree.

Keith: Okay, Marcelo, that was a great wrap up, a great mid-year wrap up. Thank you so much. Final comments.

Marcelo: You know, it's the same thing as always, right? Like we've been here before, there's always something to worry about. Don't forget I always tell all my clients and even people I know the media is there to sell fear and you know, that's why most of the news are negative and you know, it doesn't play well with our brains. So, we just have to stay in our seats, so to speak, and stay invested, diversified, tune out the noise and just be aware that everything we hear in the news may sound more negative than what it actually is. And you know, there's cause for concern in a lot of the issues that we're having. You know, wars, people die 100%. But when it comes to your money, I think it's a big mistake to start making changes and moving things around every time there's a headline.

Keith: So absolutely fair enough. 100%. The only thing I'll add is we've just gone through now another high volatility period, and it was with a deep drawdown and those investors that added money to their portfolios did well and then all the investors that stayed the course did very well and patience paid off. So, it's another reminder of making sure you have a long-term plan and stick to it. So, Marcel, thank you so much for the mid-year wrap up and to our listeners, thank you for tuning in and we wish you a great month of July.

Marcelo: Thank you.