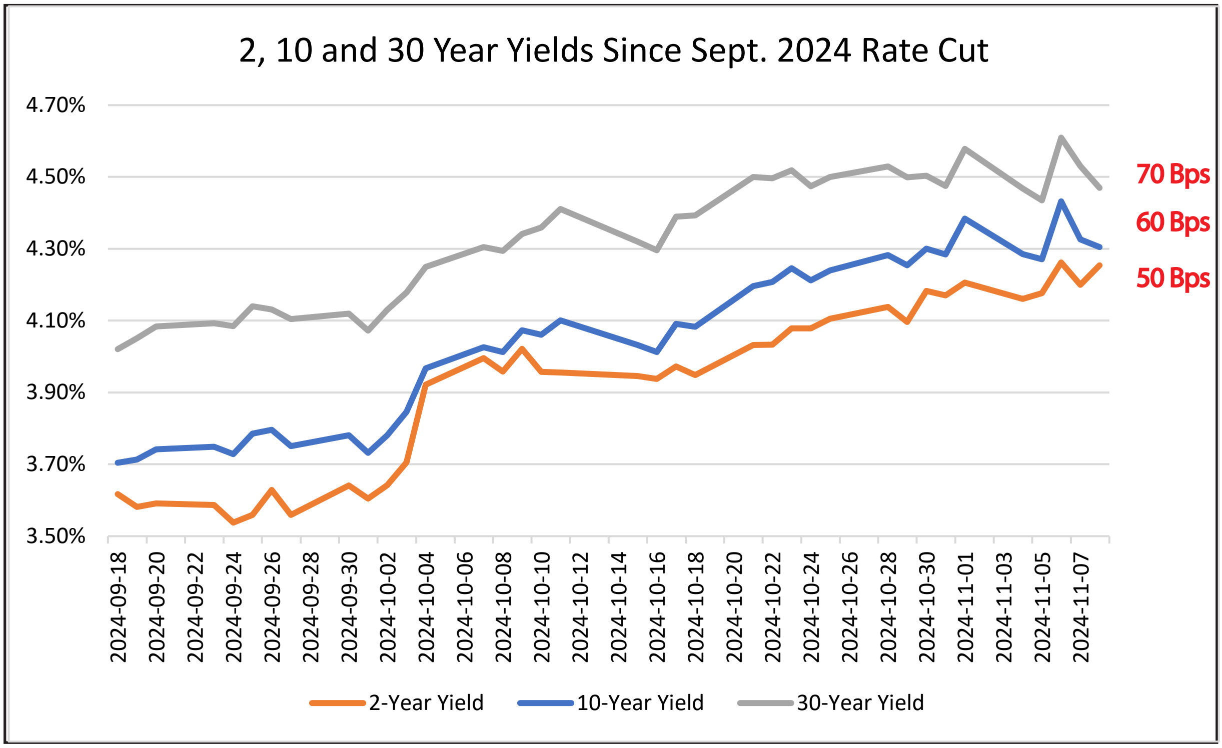
Central Bankers are cutting rates, not really?

For about 2 years, the CEOs, CFOs, analysts, investors, strategists, and economists (pretty much the entire financial universe) have screamed non-stop that "we need lower rates" and that "lower rates are coming". Indeed, after a very long delay, we finally saw the FED cut rates on September 18th by 50bps. What unfolded next was not part of the lower rates playbook as we saw the 2-, 5-, 10- and 30-year yields move up significantly. For instance, the US 30-year yield has spiked from 3.93% to 4.63% (a 70 pts increase) per Bloomberg since that FED cut.

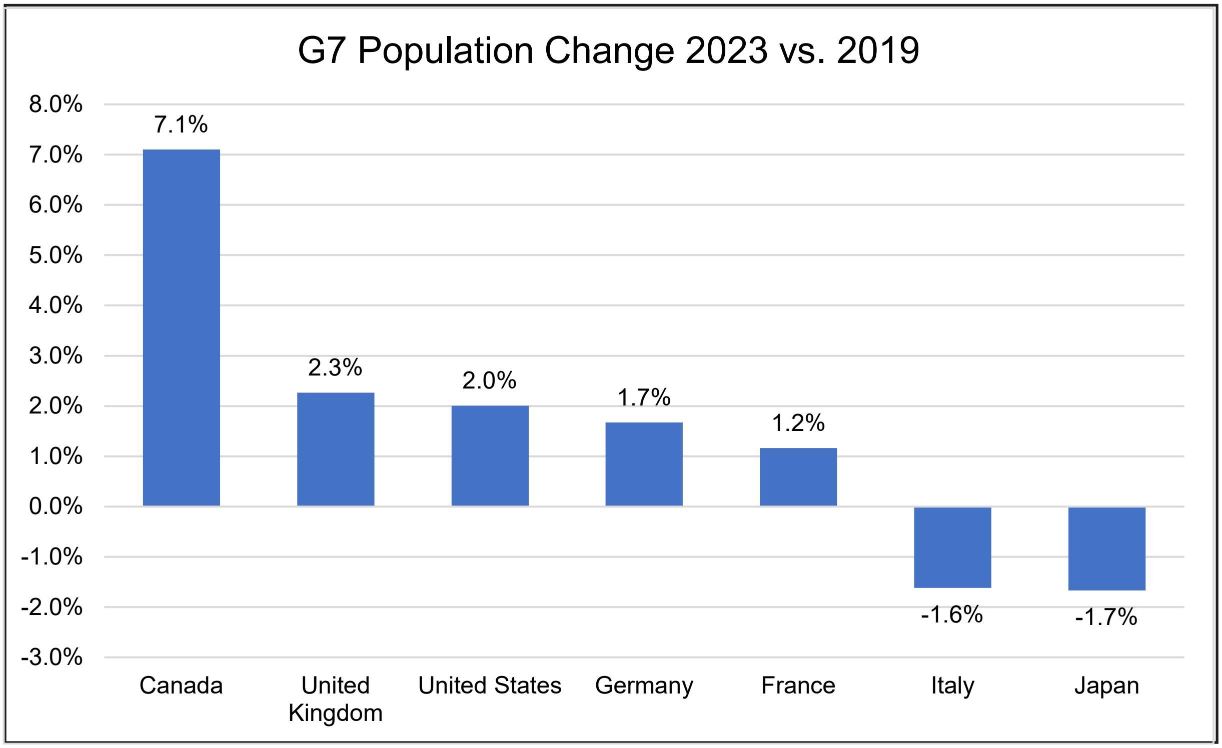
This is a very important metric for the US consumer as mortgage rates are commonly based on the 30-year yields, which have now spiked higher since the start of the rate cut cycle. Despite the yield curve move that was unexpected by most, stocks, specifically the home builders are trading at or near all time highs. Higher long-term yields are also not good for the US deficit which is already too high and unsustainable. Stan Druckenmiller and Paul Tudor Jones have apparently been shorting US long bonds. Point being, if they are right and yields continue to go up, eventually it is likely to hurt the economy in a meaningful way.



Source: Bloomberg, as of November 8th 2024

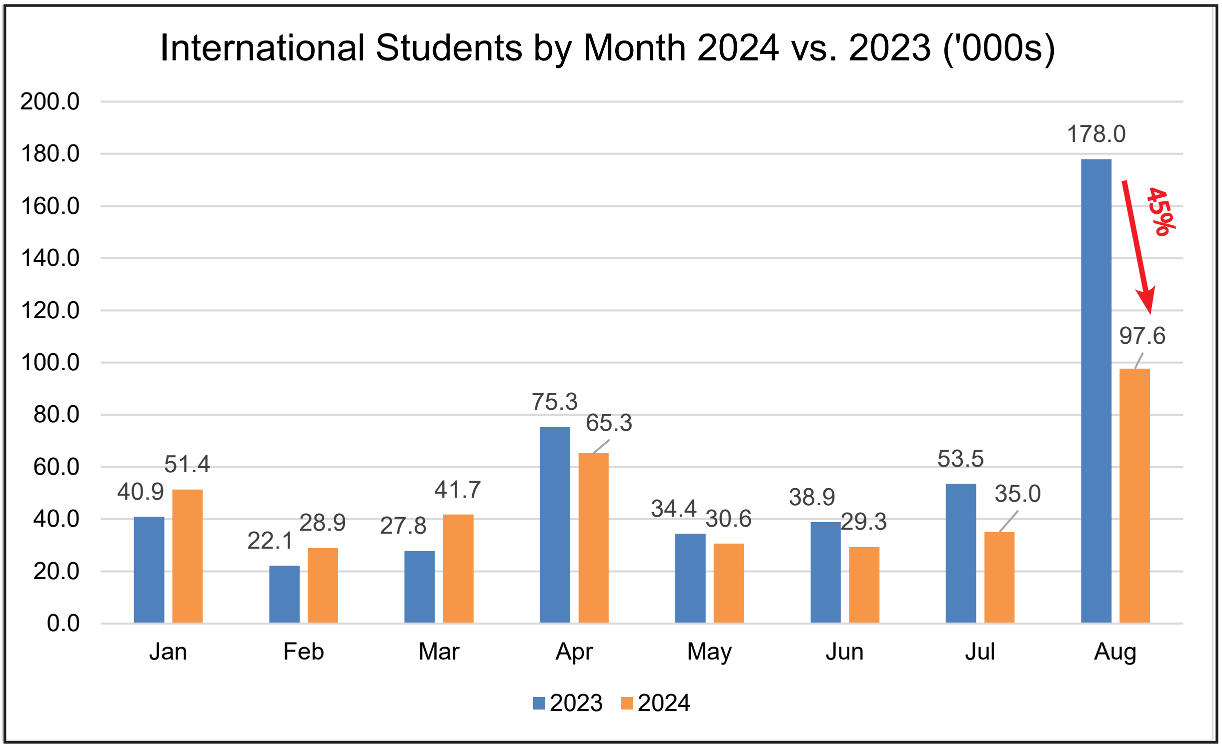
Canada's Big Change for 2025 and 2026

For the last four years Canada has seen blazing fast population growth rates relative to its G7 peers. This has led to various challenges including GDP decline per capita, productivity decline, housing shortages, social services strain, huge rent increases and affordability challenges, alongside infrastructure strains.



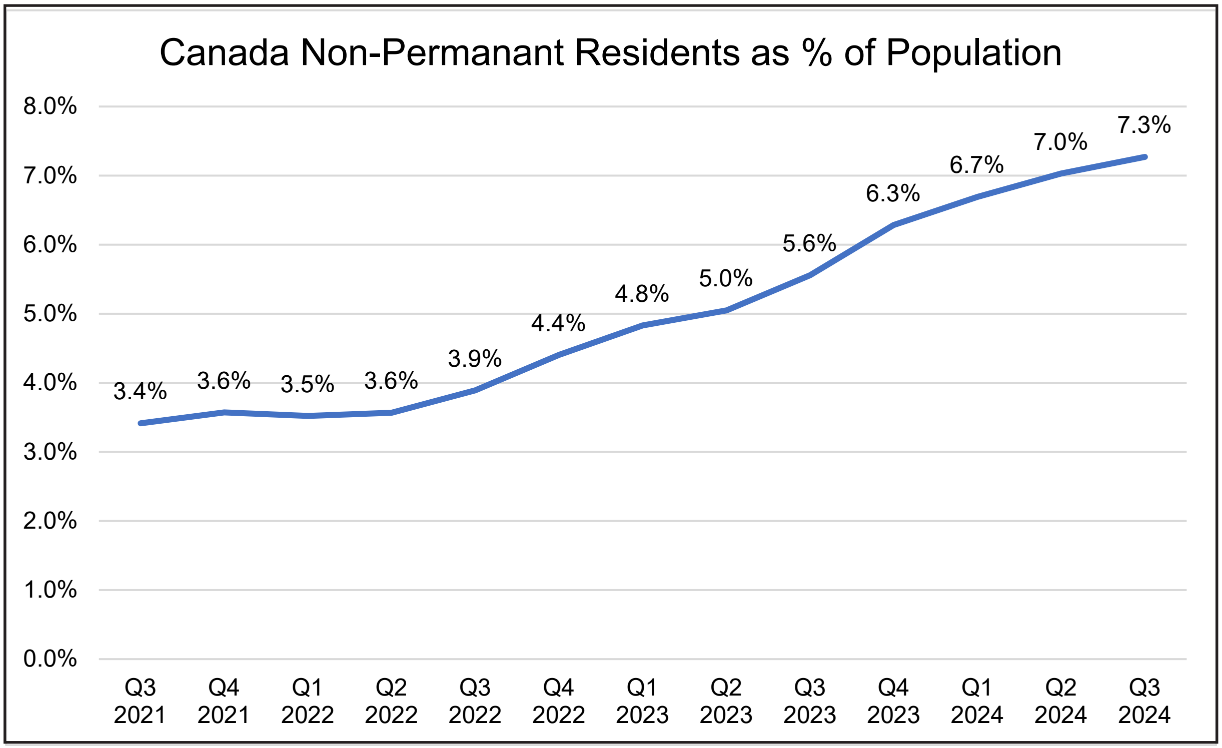
Source: Statscan, FRED

But this is all changing. Since the start of 2024, we have seen multiple significant changes to the immigration policies of Canada. First, in January 2024, Canada put a cap on international students, effectively reducing the total size by 45% over 3-4 years. This is already starting to show up in the number of international student permits being approved, with August, normally a peak period, showing a 45% decline year-over-year. Year to date as per the Government of Canada we are at a 19% decline.



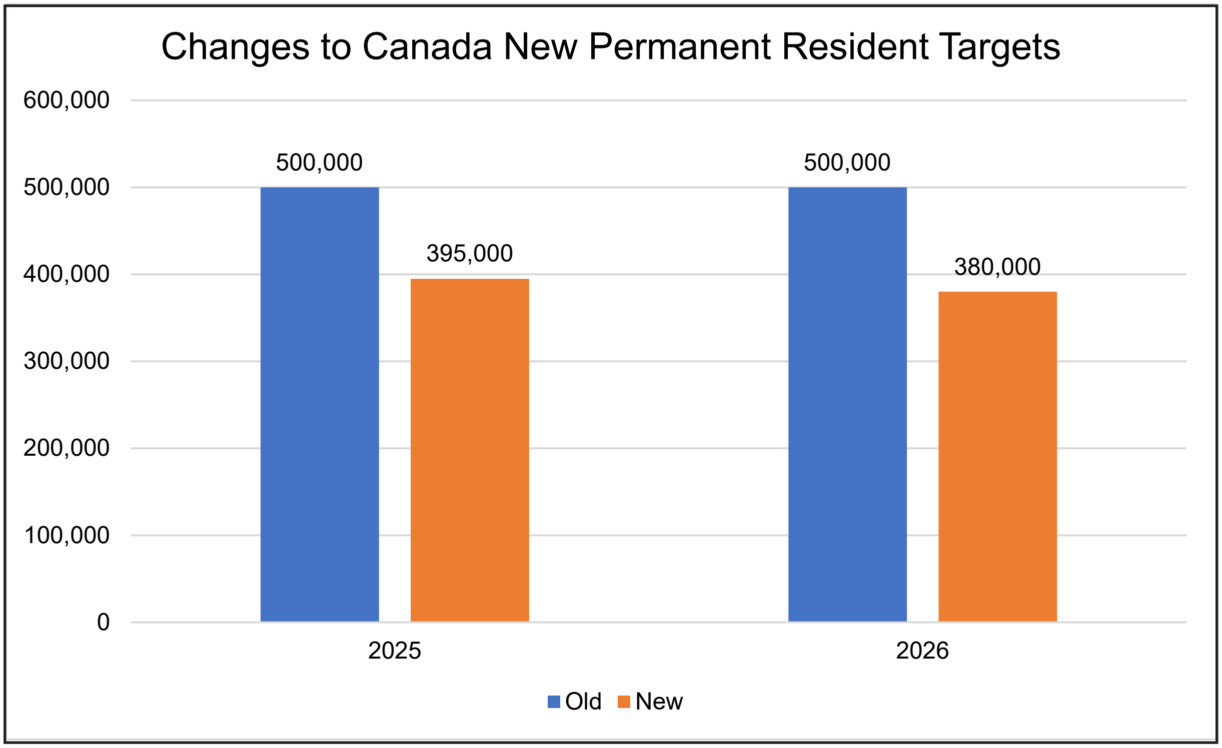
Source: Government of Canada

Next came the goal of cutting the number of temporary residents in Canada to 5% of the total population. Current levels are at roughly 7.3%, **this implies a near 900k population decline from these levels.**



Source: Statscan

Lastly, Canada has now decreased the targeted number of permanent residents it hopes to take in per year, declining from 500k for both 2025 and 2026 to now 380-395k as per the Government of Canada.



Source: Government of Canada

The bottom line is this: There could be a -0.2% population decline per year for 2025 and 2026 in Canada, vs. growth of 3.0%-3.2% over Q1-Q3 2024.

What does all this mean and how are we thinking about the impact on the Canadian markets?

First, we have written before about how the per capita GDP of Canada has failed to keep up with our population growth. This was largely driven by lack of capital investment to keep up with the population increase.

We also believe that many parts of the Canadian consumer market have been large beneficiaries of this population growth which has effectively masked the underlying growth issues that Canada faces. Now we are about to see a significant change in demand.

For example, Timelo predicts:

- Grocery stores: same store sales should be around 0% growth
- Canadian restaurants: as the economy weakens, we could easily see negative same store sales of 3% to 5%
- Canadian retailers: could easily see negative same store sales growth of 3% to 5%.
- Canadian telecom companies: the whole industry could see net subscriber additions now close to 0% and, with average revenue per user continuing to trend negative (they have been in a price war for a whole year already), there could be negative revenue growth for the whole sector
- Canadian dollar: as the divergence of our economy vs. the U.S. potentially worsens, we could see the CAD fall further, a continued move towards our long term April 2024 prediction of 50c
- Short Term rates: as the Canadian economy underperforms the USA, we could expect our short-term rates to fall faster than short-term rates in the US (thus dragging the CAD further down along with that)
- Long Term rates: in a recession environment, the Canadian deficit could worsen even more, putting upward pressure on long term rates

Portfolio Positioning

With the above in mind, we have a short position in a basket of Canadian names we think will be negatively impacted from these changes coming to Canada. While we think certain parts of the market are well aware of the population changes coming (REITs), we think other parts of the market are missing it with expectations for growth to continue. We believe at some point in 2025 there will be a realization of this change for many market participants which will result in a negative reset of expectations alongside share prices.

Jean Francois Tardif
President & Portfolio Manager
Timelo Investment Management Inc.

For more information please contact:
Timelo Investment Management Inc.

647-725-2865
Info @riskreward.ca

372 Hollandview Trail Suite #305
Aurora ON L4G 0A5