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Canadian Banks: The Trend Continues

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In Canada, the Big Five banks are the market's cornerstone and, oddly enough, the domestic versions of “FANG” stocks. This week, all five reported their Q4 results, which felt like groundhog day as this quarter was very similar to those of three months ago.

What did we learn?

Credit Quality: The biggest story in a pretty quiet set of results is the ongoing slow increase in provisions for credit losses (PCLs). The Big Five have had several years of lower provisions as they took the opportunity to flow the reserves into profits for shareholders; however, the trend has now reversed. Across the board, bank management teams pushed reserves higher to prepare for a choppier future as consumers face strain from higher interest rates and a pinch in real incomes. Scotiabank was the most aggressive, taking a big step higher of nearly $700 million to catch up to their peers that had been more proactive in raising provisions. It's essential to emphasize we are early in this journey. The credit cycle is incorrectly viewed through the prism of interest rates, but it is actually driven by unemployment, and on that front, we have hardly seen any weakness.

Consumer Behavior: One of the highlights of this earnings season was the comments by Scotiabank Chief Risk Officer breaking down the impact of fixed vs. variable mortgage on the Canadian consumer. “Variable rate mortgage customers continue to spend less than their fixed-rate counterparts, with total spending down 11% year-over-year. In contrast, spending for fixed-rate customers is only down 5%.” Consumers are undoubtedly making difficult choices when it comes to consumption, especially with variable rate mortgages, which are fully reflecting the current interest rate environment. Over the next 24 months, the majority of fixed rate mortgage holders will refinance into the current rate regime, which I expect to continue putting pressure on the consumption of discretionary goods in Canada.

Putting it all together, I walked away with few surprises and changes to the broader investment case for the Canadian banks. We are in the tug-of-war phase between discounted valuations and mixed fundamentals. Banks tend to reflect the state of the economy they lend into. Lately, Canadian economic data has been mixed and recessionary on a per-capita basis, which makes sense as the Big Five banks are reflecting this reality.

Have a great weekend!

Open AI: Don’t Call It A Comeback!

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

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For the creators of Chat GPT, it’s been a rollercoaster of a week. After building the first mass-adopted AI service GPT-4, the parent company OpenAI has seen a spectacular level of financial success with the upcoming valuation round coming in at a rumoured ~$90 billion. But, out of the blue, the board of OpenAI fired CEO Sam Altman over a Zoom call last Friday. In the days that followed, nearly all of the 770 employees signed a letter vowing to resign if the CEO wasn’t reinstated and the current board resigned. The craziest part of all—it worked! Sam’s back, and the board that fired him just got replaced.

What was all this about? (my guess)
In short, it’s about whether AI is a public good or a private product that can be commercialized. We’re still very early in the journey, but there was a spirited debate among many in the AI community about what controls and guardrails we need when experimenting with and building this technology, especially as it reaches its apex, artificial general intelligence (AGI). Depending on your view, AGI is either a gift to humanity, helping solve countless problems, or a tool that demands caution.

To some members of the OpenAI board, their core mission was the responsible development of AI tools and capabilities. On the other hand, CEO Sam wanted to keep innovating and maintain their leadership in this burgeoning field of work. Part of that approach was to transform OpenAI from a quasi-foundation to a more conventional for-profit company. After this week’s events, OpenAI is pro-development first and foremost.

What are the long-term implications?
We can conclude that the frantic pace of research and investment in AI technology will only accelerate from here. Microsoft, with its OpenAI partnership, is now more likely to invest even more aggressively in capabilities, and other tech giants like Google will certainly push forward as well.
In the last few days, we also learned just how scarce talent in this nascent field truly is. In just a few hours after Sam was initially fired, he was hired, along with several senior leaders, by Microsoft with a blank cheque to continue his work. As further validation of this, the 700 employees who signed the letter did so confidently, knowing they would be guaranteed employment at dozens of technology companies, including Salesforce, which openly tried to recruit them online. Ironically, one of today's bottlenecks in developing AI faster is a shortage of people.

As we look ahead, the ripple effects of this week's events will become clearer. AI development is pushing ahead, and a relatively small group of exceptionally talented people are bringing the rest of us along. For Sam, as the Old/New CEO of OpenAI, this is a huge stamp of approval of his vision for AI. I’ll be keeping an eye on safety as an acknowledgment of the concerns the prior board voiced so aggressively. One thing's for certain — don’t call it a comeback!

Have a great weekend!

Oil: Stranger Than Fiction?

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Oil plays a uniquely important role in the global economy as a critical resource that powers our daily lives. What is equally unique about oil is the supply side, with specific basins proving critical in supplying oil to the global economy. So, it's no surprise that when major geopolitical events take place in Russia, Venezuela, and the Middle East, a frequent question investors ask is, "How much is oil up because of X, Y, or Z?"

The reality is that not only have oil prices come down meaningfully after the initial stages of the Russia/Ukraine war, but they have also recently dropped from a September 2023 high of $90/barrel to $71/barrel. Looking even further out, oil prices remain over 30% lower than a decade ago, providing a substantial long-term stimulus and reprieve for the global consumer. Oil prices can be accurately thought of as a wealth transfer from one group of countries to another. Large oil-consuming countries such as India, China, and Germany, in a regime of higher energy prices, are transferring more of their "national income" to energy-producing nations such as Russia and Saudi Arabia.

You'll be surprised to hear that the United States is almost energy independent and easily the largest oil producer in the world, with a staggering 17.7 million barrels per day in 2022. That's 19% of global oil production. So, when we think about the US, it's essential to consider regional differences where a state like New York is an energy importer, while Texas is energy-rich. Higher oil prices provide a stimulus to the economy in Texas, with the bill being sent to New York City.

Putting the pieces together, despite a very volatile few years in the geopolitical landscape, it's essential to see the current energy environment as quite constructive for consumers. Oil prices in real terms have been stagnant and falling for over a decade now, with periodic increases here and there. Energy has been a plentiful resource and an indirect boost to consumer purchasing power for a long time now. I don't have a strong view on oil prices, but we can all agree that most consumers hope the party keeps going!

Have a great weekend!

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