

Investment Commentary

Fourth Quarter 2024

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Equity Markets

This quarter capped off two consecutive years of strong equity returns. The Federal Reserve's 50 basis-point rate cut in September, followed by a 25-basis-point reduction in December, provided a tailwind for equities. The central bank did telegraph that further rate cuts are getting more difficult as they want to see further progress on inflation, and we could have to contend with inflationary fiscal decisions. Still, investors continue to be generally happy with resilient economic indicators and easing monetary conditions. US equities performed the best for Canadian investors as the greenback benefited from the threat of US tariffs on its trading partners. Canadian equities also performed well, while international equities lagged.

Our Canadian equities continued their leadership from the previous quarter, when measured in local currency. The S&P/TSX added 3.8% this quarter, which capped off the year with a very healthy 21.7% return. Interestingly, the quarterly performance was quite narrow from a sector standpoint. Only five of eleven sectors generated positive returns. Thankfully, the more impactful sectors performed the best with Technology (+22%), Financials (+7%) and Energy (+7%) leading the charge. Those three sectors represent almost 60% of the S&P/TSX Composite weight. Rising interest rate expectations were partly to blame for Telecommunications (-19%) and Real Estate (-10%) experiencing a difficult period.

US equities finished the last quarter of the year up 2.4% in USD. The strength of the US dollar relative to the loonie significantly positively impacted returns for Canadian investors, with US equities finishing up 9.0% in CAD. Looking at a sectorial basis, the dispersion from Trump policies was evident with 7 sectors posting negative returns. The decline was led by healthcare (-10%) which is expected to be negatively impacted by the nomination of RFK Jr. as the Health and Human Services secretary. Interest-sensitive sectors like Real Estate (-8%), Utilities (-6%) and Consumer Staples (-3%) were also hurt by higher interest as investors fear Trump policies could re-accelerate inflation. In contrast, Consumer Discretionary (+14%), Communication Services (+9%) and Information Technology (+5%) were the main outperformers, led by most of the magnificent seven and continued optimism around generative AI. Financials (+7%) also performed very well as investors expect Trump's emphasis on deregulation to be favourable, easing capital requirements for the sector. In 2024, the US market proved to be once again the core winner delivering a ~25% return in USD. It was buoyed by rapid progress around generative AI, a resilient economy, a clear resolution to the election, and rising valuation from the mega-cap technology.

Meanwhile, things looked much different in Europe with weakening economic growth as the region continues to be burdened by the high energy costs, damaging regulation, and political turmoil. Economic weakness and limited exposure to AI led to a stark contrast in performance versus its US counterpart with international equities ending the year up 13.3% in CAD. The last quarter of the year was eventful with a surprise decisive election result in the US. This added further pressure on international equities given concerns around Trump's potential new trade policies. Overall, international equities finished the fourth

quarter down 2.2% in Canadian dollar. Similar to the US, the three weakest sectors were Healthcare (-9%), Real Estate (-8%) and Utilities (-8%), while Financials (+4%) performed the best.

Tighter monetary policy has been rather successful in taming inflation while inflicting limited damage to the economy. While they still need to be watchful for signs of inflation rearing its ugly head again, central banks are in a good position to loosen monetary conditions for the economy. Unfortunately, we believe that we have replaced the soft-landing risk by new political & trade war risks. We are expecting that the ultimate outcome will be reasonable but feel that the process to get there could create some market weakness. US markets are on the expensive side, benefitting from excitement around artificial intelligence. We continue to find attractive value in other geographies, but these other geographies will be challenged by US policies. These factors lead us to advocate being slightly defensive in the short-term with our equity allocations, preparing us for an opportunity to add to our position on weakness. Looking further out, we are more optimistic. We appreciate that the current level of monetary policy provides two-way flexibility to adjust policy, a condition that has not existed for much of the past 15 years. We believe that policy flexibility should contain equity volatility making conditions attractive for long-term equity investors.

Fixed Income Markets

The fourth quarter ended the year with higher bond yields and a steeper curve as developments on both the monetary and fiscal policy front drove longer term bond yields higher and shaped market sentiment. The task for central banks has become increasingly more difficult as uncertainty around external factors such as geopolitics, political leadership and fiscal spending measures make the effectiveness of monetary policy even more challenging, particularly when policy rates are nearing an inflection point toward neutral. The US election and resulting win by Republican leader, Donald Trump, featured prominently during the quarter as fiscal spending and protectionist policies including tariffs have created added uncertainty to the trajectory of global growth. The threat of retaliatory tariffs could further slow economic growth as higher prices and lower profit margins impact both consumers and businesses. Canadian politics was also not immune to political drama during the quarter as the resignation of the Federal Government Finance Minister intensified concerns around the effectiveness of Federal Government policy and leadership. In Canada, additional fiscal policy measures and a larger projected budget deficit leaned further against the efforts of the Bank of Canada to subdue inflation. The final quarter of the year closed with heightened uncertainty as political events and uncertainty around public policy in both Canada and the US dominated the outlook going forward.

During the quarter, the yield curve in Canada steepened as shorter-term bond yields declined driven by two consecutive 50 basis point rate cuts, while at the same time, longer term bond yields rose due to stronger economic data and concerns around larger fiscal spending programs and increase to the deficit. The Bank of Canada cut policy rates by 100 basis points during the quarter to 3.25% while 66 basis points of further rate cuts were priced into the 2025 forward curve at year end. The monetary policy stance of the Bank of Canada has become increasingly sensitive to the political policy measures in both Canada and the US as government spending programs and tariffs will have a direct impact on the economy. While the Bank of Canada reduced policy rates by 175 basis points over the last six months, the US Federal Reserve has cut policy rates by 100 basis points since their respective rate cutting cycles began. US economic growth and labour markets, supported by gains in productivity have proven to remain resilient in the face of elevated interest rates. In Canada, overall growth in 2024 is projected to be 1.3% while US growth over the same period is expected to come in at 2.8%. The trajectory for growth in 2025 is increasingly uncertain due to the magnitude of potential tariffs and fiscal spending programs. Still, with lower policy rates and excluding the potential impact of tariffs, Canada should expect growth to improve to 2% next year.

Economic data in Canada was mixed during the quarter as growth resurged, while the unemployment rate and inflation rose slightly. During the quarter, the unemployment rate in Canada rose to 6.9% as population growth outweighed gains in growth. The growth outlook continues to improve as interest rate cuts provide added support to consumption and business spending. The outlook for fourth quarter GDP growth in Canada improved to 1.7% (annualized) while the third quarter is expected to show a 1% (annualized) gain in growth. Inflation in Canada was mixed throughout the period, closing the quarter at higher levels with both a headline rate of 1.9% Y/Y and a core median rate of 2.6% Y/Y.

Over the fourth quarter, the yield curve steepened considerably, as policy rate cuts, mixed economic data and fiscal deficit spending measures drove bond yields higher. During the quarter, two-year Canada bond yields increased by 2 basis points to 2.93%, while five-year yields increased 23 basis points to 2.96%. The ten-year Canada yield increased by 27 basis points to close the quarter at 3.22%, while thirty-year yields rose by 19 basis points to 3.33% over the same period.