

In this issue:

- **Investors are bullish and driving equities higher**
- **The economy is poised for a soft landing**
- **Artificial intelligence is a top-of-mind concern**

Dear friends,

In Canada and elsewhere around the world, the end of the first half of 2024 is quite positive for equities. A soft landing for the economy seems to be becoming a matter of course for the majority of investors. This has propelled several US indexes to new all-time highs, day after day. The S&P 500 and the NASDAQ continue to defy expectations with their relentless enthusiasm for technology and AI. In a bull market, bad news is good news. This is indisputably the case at the moment. The VIX, also known as the fear index, hit its lowest level in five years. The fear of missing out on the stock market has overtaken the fear of losing or paying too much for shares.

Is it the fear of missing the boat that made Nvidia the most valuable company in the world? The manufacturer of chips widely used in AI reached \$3,300 billion (USD) on June 18. We believe that Nvidia's generative AI journey is truly transforming businesses around the world, and this may only be the beginning. While Nvidia seems to be positioning itself as a leading supplier of chips that will build the backbone of the infrastructure supporting AI development, it's not clear yet how other companies will manage to make their massive investments pay off. The AI frenzy has undoubtedly driven up a group of stocks related to AI, either directly or indirectly. As a result, numerous stocks have reached astronomical valuation levels. Investor expectations are out of line with reality. This has happened before with other innovations. Therefore, there is a risk that stocks of companies not achieving perfection will undergo corrections even with good results.

Despite a patchy second quarter in Canada, the energy and natural resources sectors continue to provide leadership thanks to encouraging manufacturing data worldwide. Factory restarts in Asia are helping these companies to perform well. The price of oil, gold and copper, used to manufacture cables, television sets and more, were up by 15%, 13% and 12% over six months. The Toronto index ended the half-year with a 4.4% gain, but down 1.3% in the second quarter.

	Closing 28-Jun-24	Change** Quarter	2024
Stock Indices (% in C\$)			
S&P/TSX	21,876	-1.3%	4.4%
S&P 500	5,460	5.0%	18.2%
MSCI EAFE*	2,315	-0.3%	6.9%
Currencies			
CAN\$ (US\$/C\$)	0.7310	-1.0%	-3.2%
Euro (US\$/EUR)	1.0715	-0.7%	-2.9%
Commodities (US\$)			
Oil (WTI)	\$ 82.83	-1.3%	15.2%
Gold	\$ 2,326	5.1%	12.6%
Volatility Index			
VIX	12.44	-0.57	-0.01

* MSCI Europe, Australasia and Far East (US\$)

** Changes are expressed in C\$ for Stock Indices.

July 15, 2024

Valuation at the antipodes

Justin Trudeau's new capital gains tax measure came into effect on June 25. This will take some pressure off Canadian equities. The S&P/TSX is trading at 13.9x expected earnings over the next 12 months, below its

historical average of 14.5x. Another plus for the Canadian market. The opposite is true south of the border. The price-earnings ratio of the S&P 500 is in a highly overvalued zone. At 21.5x forward earnings, the S&P 500 is very expensive. The average level has been 15.7x since 1985. The index has been driven upwards by large tech companies. This high-growth sector trades at over 30x expected earnings. Without the "Magnificent Seven," the other 493 stocks would not even have seen earnings growth since Q4-2022. But the AI and IT craze is unsustainable. A pause in the stock market would be healthy. Fortunately, the Q2-2024 earnings announcement will be the first consensus rise for the "S&P 493" in five quarters. Expectations are 10.6% for the full index and 7.3% for the S&P/TSX.

	Q1 (R) 2024	Q2 2024	Q3 2024	Q4 2024	Year 2024	Year 2025	Forward P/E
Forecasted Earnings Growth (Year over Year) and Forward Price-Earnings Ratio							
S&P/TSX	10.6%	7.3%	4.5%	5.7%	6.5%	13.6%	13.9
S&P 500	8.1%	10.6%	8.6%	15.0%	10.6%	14.6%	21.5

* Earnings per share (EPS) for the indices (R: realized).

Inflation and interest rates

As far as inflation and interest rates are concerned, we can say that in this first half of the year the economy has moved into a mode where inflationary pressures are gradually receding, allowing for a process of gradual policy rate cuts. Although job creation remains strong, pressure on the labour market is easing. Unemployment is starting to rise slightly, and it is taking longer for workers to find jobs, particularly young people. The result is a sharp decline in both wage growth and job change rates.

The strength of the US economy has allowed the Fed to be patient so far in its restrictive policy. However, the inflationary forces of 2022-23 have greatly diminished, and the Fed will act accordingly. The challenge is to stay on course toward traditional inflation targets while avoiding a recession. Indeed, the central banks of Canada and Europe, with economies weaker than the US, have already cut rates in early June this year, and have announced that more may follow as the victory against inflation is confirmed. Further south, we are confident that the Fed will cut rates in September. While it will not drop too much until it is assured of returning to its 2% target, the Fed will not want to make decisions during the presidential campaign. Consequently, we believe that the most plausible scenario is a September cut followed by a second in December.

Conclusions and outlook

Canadian and global equities are not in the highly overvalued zone that they are in the United States. We have recently seen Apple, Microsoft and Nvidia exchange the title of largest capitalization in the world, each exceeding the GDP of Canada, Italy or France. It's vital to avoid paying too much for stocks, especially tech stocks. In recent days, Mr. Powell's speech, the weak CPI report and Mr. Biden's missteps may have created the small tremors that have begun to appear in so-called "growth" stocks. The fear of a real stock market downturn may return quickly if investors, who have inflated expectations for AI and tech, are disappointed. The recent attempt to assassinate Donald Trump shows us just how polarized and fast-moving the world is.