RJL PCS: INSIGHTS & STRATEGIES

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January 2025 Insights & Strategies: Our 2024 Recap and 2025 Outlook

Highlights of 2024

- In Canada, we saw an economy continuing to weaken, with average annual real GDP growth of approximately 1.2% in 2024, down from 1.5% in 2023. However, the good news is that consumer spending seems to have picked up in 4Q24. Inflation cooled down from 3.4% at the end of 2023, to just under the 2.0% target, with core measures still above 2.5%, but within the 1-3% control band, and the BoC started easing its policy rate in June to end the year at 3.25% after holding at 5.00% for just under 11 months.
- In the U.S., the economy remained remarkably strong, with the estimated real GDP up 2.8% in 2024, after a 2.9% gain in 2023. Inflation cooled down more slowly, from 3.4% at the end of 2023 to 2.7%. The Fed also slowed from its first big cut in September, to end the year at 4.5%, after 14 months at 5.5%.
- Both Canadian and U.S. equity markets were strong in 2024, up 21.7% and 25.0%, respectively. The Magnificent 7 stocks and A.I. enthusiasm continued to carry the U.S. market. The TSX performance was more broad with Technology, Financials, Energy, and Materials all gaining over 20%.

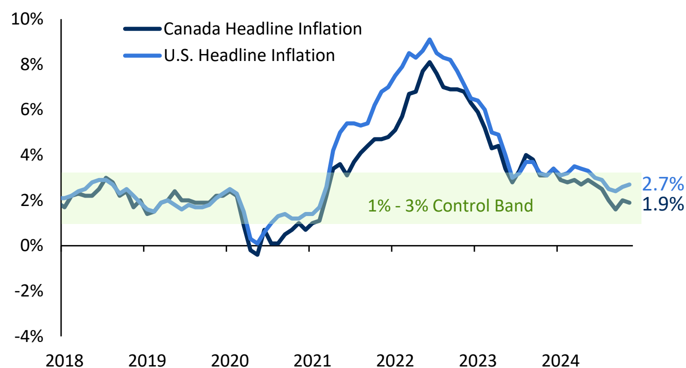
Macro Forecasts for 2025

- Canadian interest rates are likely to continue declining to the 2.25% level by mid-2025, amid a still weak economy, although the lower rates should also start to show up in better GDP growth through 2025, with consensus expectations for over 2% growth this year. Continuing uncertainty of U.S. tariffs having potentially profound negative impacts on the Canadian economy remains the wild card.
- U.S. policy interest rates are likely to decline only a little more in 2025, to 4.0%, as we expect economic growth to slow only slightly to 2.4%, as inflation remains sticky above the 2% target (2.7% headline, 3.3% core), with mild softness in the labour markets.
- A widening spread in policy rates and contrasting economic outlooks, with overhanging risks of tariffs, likely puts continuing pressure on the Canadian dollar against the U.S. dollar.

Market Forecasts for 2025

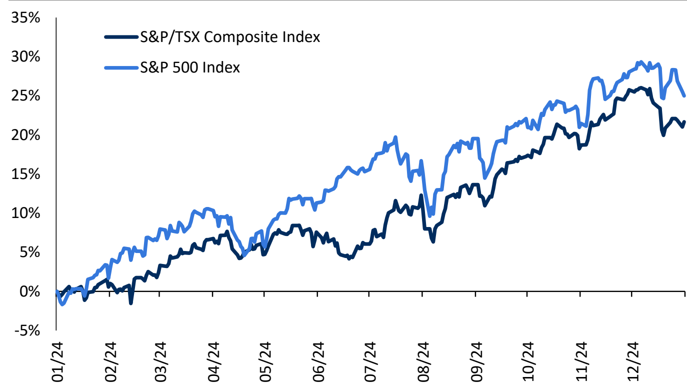
- Our overarching expectations are for equity markets to move higher in 2025, on the back of the economic and corporate profit backdrop, but with more muted gains than the 20%+ returns of the last couple of years. Also expect heightened volatility, which could include multiple pullbacks along the way. Our (U.S. Investment Strategy Group's) S&P 500 target to the end of 2025 is 6,375 using 23.5x EPS of US$270, with a preference for Technology, Industrials, and Health Care. For the TSX Composite, we forecast 26,300 by year-end for an 8.5% total return.
- Rotation is likely to be a major theme in 2025 as stocks (including small and mid-caps) that were left behind during the Magnificent 7 run, but with now positive earnings growth, gain more investor attention. We do not see investors fleeing the Magnificent 7, but we expect the benefits of A.I. to broaden out to (smaller) companies that can monetize those technology opportunities and benefits.
- The U.S. equity markets likely remain the most attractive option geographically due to the strong economy and relative insulation from tariffs. Canadian markets could swing wildly as the reality of tariffs take hold, or as Canada strikes a longer-term trade agreement, potentially under a renegotiated USMCA. Additionally, the performance of Canadian markets can be closely tied to commodity prices, such as crude oil and gold. Other international markets look generally weaker over the next 12 months, especially with the unpredictability of trade war impacts, although low expectations currently could provide opportunities for select regions to outperform.

Chart 1 - Canada and U.S. Headline Inflation



Source: FactSet; Raymond James Ltd.; Data as of November 30, 2024. Not seasonally adjusted.

Chart 2 - S&P/TSX Composite and S&P 500 2024 Performance



Source: FactSet; Raymond James Ltd. Data as of December 31, 2024. Price return in local currency.

Executive Summary

As customary, the turn of the new year is a prime time for resolutions and predictions. Here, we do our part, with a quick recap on the year that was, and our expectations for the year ahead.

In the following pages, you can read our thoughts and predictions on multiple metrics, with a focus on the following themes:

- **Economic growth to continue.** While the U.S. seems poised to continue its significant growth rate, we do expect some slowing to 2.4% for 2025, from 2.8% in 2024. In Canada, we are starting to see benefits from the aggressive rate cutting cycle; growth is expected to improve to 2.0% from 1.2%, notwithstanding any significantly negative impacts from tariffs.
- **Tariffs could be a huge factor in 2025.** President Trump is very open about his enthusiasm for tariffs and his willingness to use them to achieve a variety of goals. Complicating negotiations that could avoid or at least alleviate the impact of any tariffs directed at Canada is the political quagmire that was created with the proroguing of Parliament and an uncertain process leading up to an election in Canada. While tariff policies, especially if the Energy sector is included, have the potential to have unfavourable impacts on U.S. inflation and consumers, we cannot count on actions being completely rational, and we cannot expect to see any leniency while we sort out our political house.
- **Stock market returns will likely be positive**, but much more muted that the 20%+ returns of the last two years, and investors should be prepared for **significant volatility**, including significant pullbacks as P/E multiples remain at stretched levels and many stocks are pricing in optimal conditions. It is possible that companies could end up beating earnings expectations that support their share price valuations, but underwhelming against exaggerated expectations, leading to more median-like valuation multiples.

2024 Recap

Entering 2024 most of the commentary was on slowing economies and oncoming recessions with rate cuts expected, mostly for the latter half of the year and into 2025. Inflation seemed to be heading sustainably in the right direction and rate hikes were on hold as the Fed and BoC waited for data and enough confidence to start lowering policy rates. The economy had been boosted by pandemic-fueled fiscal stimulus and economists were calculating how much excess savings consumers still had left to continue propping up the economy. U.S. economic growth was expected to slow from 2.9% in 2023, with consensus expectations for 2024 U.S. real GDP growth of only 1.2%, but the U.S. economy proved much more resilient. Exiting 2024, we saw still robust GDP growth of around 2.8%, with inflation down to 2.7% from its peak of 9.0% in June 2022. GDP was propped up by consumer spending that was boosted by a healthy labour market and record net worth. Conversely, the Canadian economy did weaken, from 1.5% growth in 2023 to a currently estimated 1.2% in 2024. However, Canada's inflation has been normalizing ahead of the U.S., hovering around the 2% target for four months. We are also seeing some hope for a rebound in GDP growth with consumer spending picking up towards the end of 2024, helped by the more aggressive rate cutting.

Weakening oil prices helped with disinflation and supported consumer spending on other items, as WTI declined throughout most of the year from US$87 in April to under US$70 per barrel with gasoline at the pump at around US$3 per gallon.

Financial markets were forecasted to provide more subdued gains in 2024 after a massive 2023, where the total return on the S&P 500 was 26.3% and the TSX Composite returned 11.9%. Again, equities provided a positive surprise, with the S&P 500 returning 25.0% and the TSX Composite 21.7%, in local currencies.

Although mega cap stocks continued to be the best game in town, better breadth worked its way into markets later in the year, as the remaining S&P 500 companies started to generate positive earnings growth in the last three quarters of the year, after more than a year of lower earnings, and all 11 sectors of the index posted positive returns for the year. Expectations of lower interest rates, that benefit smaller cap companies, with promises of deregulation and more favourable U.S. tax policies helped to spread optimism. Running through December, expectations on U.S. rate cuts were scaled back, and equity markets retrenched slightly.

Canadian Macro Discussion

The Canadian economic outlook has brightened a bit heading into year-end, as evidenced by improved retail sales, home sales, and increased activity in both the manufacturing and services sectors, thanks to the rate cuts that started in mid-2024 gradually trickling through the economy. We are likely to see a pickup in 4Q24 GDP, and the setup going into 1Q25 is relatively more optimistic compared to what we expected three months ago. However, challenges remain, the main ones being the significantly lower target for immigrants and the tariff threats from the U.S. Last but not least, there are ongoing issues with residential/business investment and weak productivity growth.

GDP Growth — Turning the Corner?

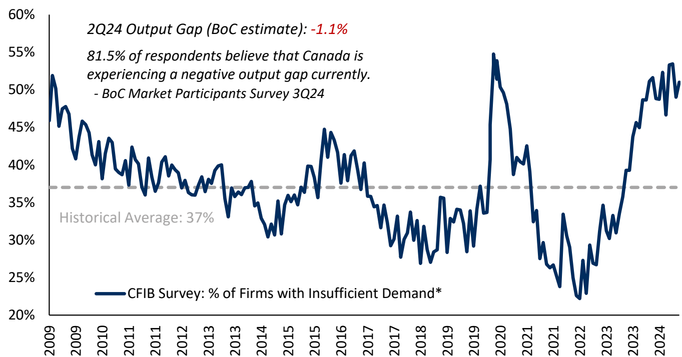
Key Takeaways: There are signs that Canada's economy is picking up, thanks to three 25bp rate cuts and two 50bp rate cuts since June 2024. Consumer spending improved in 3Q24, and business confidence got a boost towards the end of the year. While we still need stronger demand to absorb the excess supply indicated by elevated inventory levels (Chart 3), we're cautiously optimistic about GDP growth in 4Q24 and early 2025. We see both challenges and opportunities in our future trade relationship with the U.S. Additionally, the expected flat to slightly negative population growth could pull back GDP, especially in residential investments. However, the main long-term challenge remains weak productivity growth due to a lack of capital investments.

Observations: Canada's economic growth had been stagnant since mid-2023 due to the impact of previous interest rate hikes. As 2024 began, the Bank of Canada (BoC) initially forecasted a modest 0.5% quarterly annualized GDP growth for Q1 in their January Monetary Policy Report (MPR). However, thanks to strong immigration offsetting weak productivity growth, the BoC revised their Q1 forecast significantly upward to 2.8% in April. The actual GDP growth for 1Q24 ended up at 2.0%, driven mainly by consumer spending. Combined with 2.2% growth in Q2, largely due to inventory increases, the first half of 2024 saw GDP growth slightly above the long-term average of 2%.

In 3Q24, GDP growth slowed to 1.0%, falling short of the BoC's forecasts of 2.8% in July and 1.5% in October. Despite this, the situation wasn't as dire as it seemed, as consumer spending picked up again following initial rate cuts, while more volatile factors like inventories pulled the growth rate down. Looking at 4Q24, October's GDP showed a solid 0.3% month-over-month increase, but November's preliminary estimates indicate a 0.1% decline (Chart 4), influenced by earlier port and Canada Post strikes. The BoC's latest forecast predicts real GDP year-over-year growth of 1.8% for 4Q24, up from the 1.6% forecast at the start of the year.

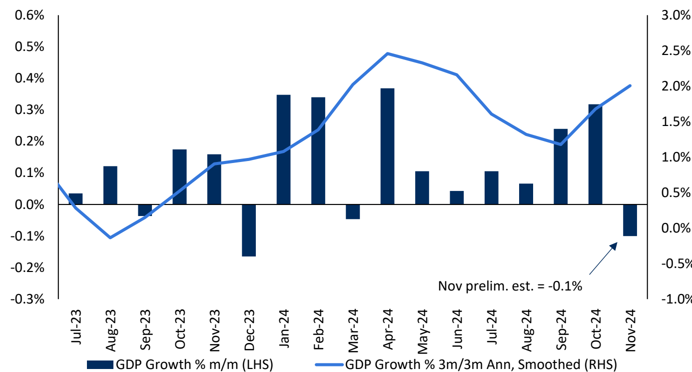
In contrast, GDP per capita growth has been negative since 2Q23, but the BoC expects it to turn positive in 1Q25.

Chart 3 - Excess Supply Continues to Grow in the Canadian Economy



Source: CFIB, Raymond James Ltd.; CFIB survey as of December 31, 2024. *Domestic demand prior to 2024, domestic and foreign demand from January 2024 onward.

Chart 4 - GDP Growth Beats Expectations in October



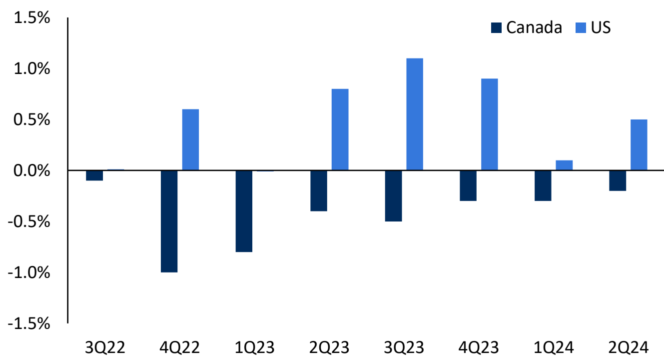
Source: Statistics Canada; Raymond James Ltd.; Data as of October 31, 2024.

Our View: Canada's economy may turn a corner in the last quarter of 2024, with improvements in retail sales, home sales, and increased activity in both the manufacturing and services sectors, along with a boost in business confidence. As the first G7 nation to begin the rate easing cycle, Canada has cut rates most aggressively, and these cuts are gradually taking effect by boosting demand to absorb excess supply in the economy. However, the recovery may still be choppy due to several strikes in November, possible disruptions from the holiday tax break, and threats from Trump, that may or may not materialize, but could still dampen investment interest in Canada. Nonetheless, if Canada can position itself as a key ally to the U.S., particularly in re-industrialization and energy security, it stands to benefit significantly from U.S. economic exceptionalism.

Another factor that may increase the downside risk to Canada's GDP in the near future is the declining population. With the government's latest immigration targets, population growth is expected to be -0.2% in both 2025 and 2026. The sector likely to be hit hardest is residential investment, which could drag down overall GDP growth. Developers rely on pre-construction sales to secure financing, so even though there's a long-term issue of housing undersupply, near-term government policies or a drop in demand can significantly cool down housing starts, especially for projects aimed at owner-occupiers or individual investors.

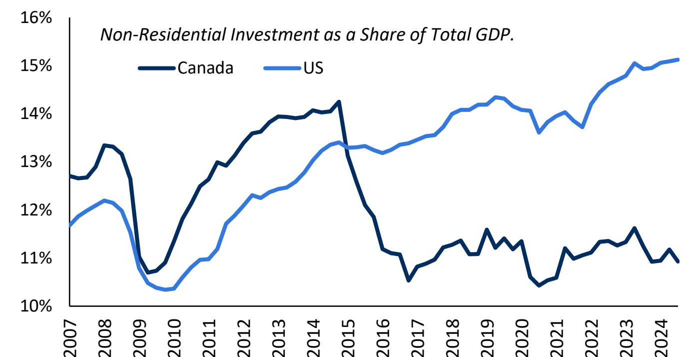
However, what we are particularly concerned about is Canada's GDP per capita, which is often used as a proxy for the standard of living. Admittedly, the recent slowdown in GDP per capita growth can be partly attributed to the sudden increase in immigration. However, as discussed in our June 2024 report (*Connecting the Dots on the Productivity Problem*), productivity remains the dominant long-term driver. While strong immigration can mask weaknesses in overall GDP growth, it doesn't solve the underlying productivity issues (Chart 5). What truly matters for productivity are capital investments and technological advancements. Since the 2014 commodity price crash, inflation-adjusted capital expenditures in Canada have been declining (Chart 6), and the recent Business Outlook Survey (BOS) by the BoC continues to show below-average investment intentions among Canadian businesses. Therefore, to improve Canada's long-term welfare, it is crucial to create a more welcoming environment through both monetary and fiscal policies that encourage business investment and attract foreign direct investment (FDI).

Chart 5 - Labour Productivity Continues to Decline in Canada



Source: Statistics Canada; Percentage change from the previous quarter.

Chart 6 - Business Investment Lagging Significantly in Canada



Source: Statistics Canada, Bureau of Economic Analysis, Raymond James Ltd.; Data as of September 30, 2024. Includes non-residential structures, machinery, equipment, and intellectual property products.

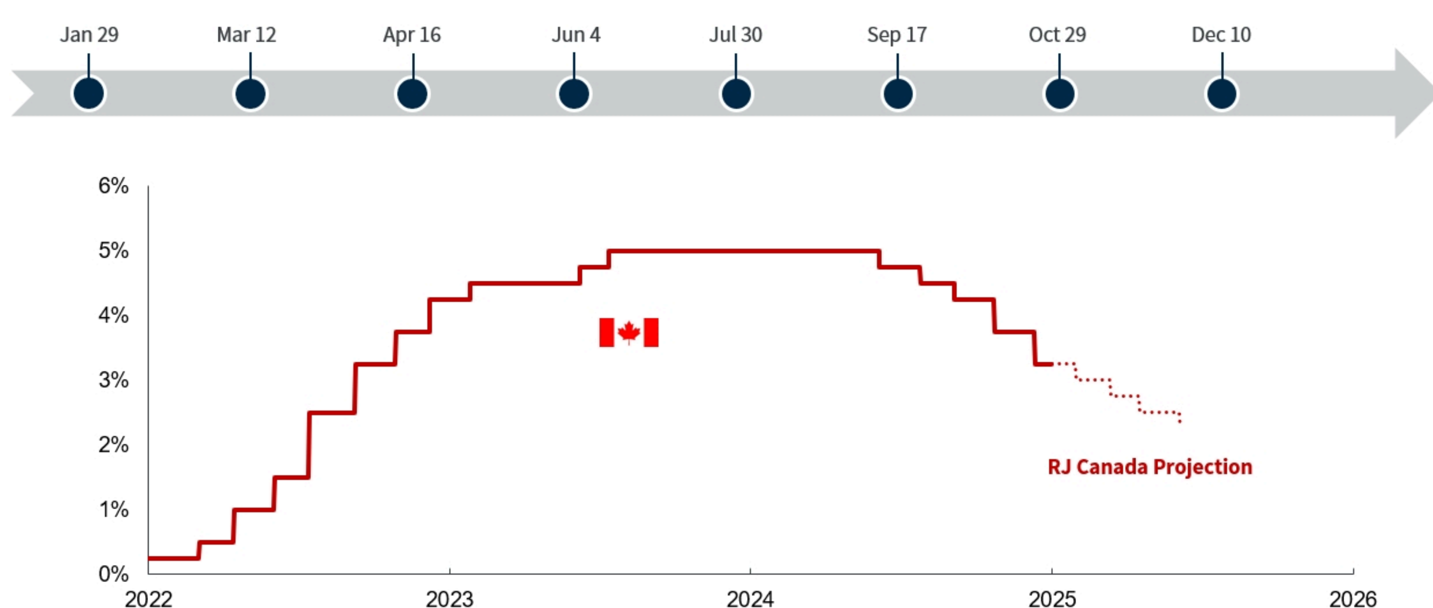
Interest Rates — Continued Easing Cycle

Key Takeaways: The BoC started cutting its policy rate earlier and more aggressively than many anticipated in 2024. Despite the widening spread between Canadian and U.S. policy rates, we expect Canada's interest rates to continue declining to 2.25%, the low end of the BoC's nominal neutral interest rate range, by mid-2025. This expectation is based on Canada's below-potential GDP growth, projected flat to negative population growth in 2025 and 2026, and concerning productivity growth. Although it's not our base case, Canada's policy rate may face additional downward pressure if tariff threats from the U.S. materialize and more stimulus is needed.

Observations: Following the aggressive rate hike cycle of 475 bps from March 2022 to July 2023, and maintaining the policy rate steady for about 11 months, the BoC has reduced the policy rate at every meeting since June 5, 2024. This included a 25 bp cut on June 5 and at the following two meetings, and 50 bp cuts on October 23 and December 11, totaling 175 bps through 2024. Consequently, the policy rate has decreased from 5.0% to 3.25%, and is now sitting at the high end of the BoC's nominal neutral interest rate range (Chart 7).

During the latest BoC meeting's press conference on December 12, Tiff Macklem stated that the BoC anticipates a more gradual approach to monetary policy if the economy evolves as expected. To clarify what "gradual" means, he explained: "We just cut by 50 bps at the last two meetings, so more gradual is more gradual than that. That is obviously a pretty wide zone. That's deliberate. We're going to take our decisions one meeting at a time."

Chart 7 - BoC Policy Interest Rate and 2025 BoC Rate Announcement Schedule



Source: Factset, Raymond James Ltd.; Data as of December 31, 2024.

Our View: In January 2024, we predicted that the BoC would begin cutting rates in the second half of the year. In reality, the BoC started rate cuts one meeting earlier, on June 5, 2024. Additionally, the BoC has been more aggressive in its cuts than we initially anticipated. While we had already forecasted three 25 bp cuts in 2024 back in July, compared to the consensus of two, the actual cuts have been even more substantial. This has been positive news for Canada's economy and stock market, especially with concerns about excess supply looming and inflation normalizing relatively quickly compared to most G7 countries. It's crucial for the rate cuts to keep pace with the decline in headline inflation to ensure that the real rate (policy rate minus headline inflation) becomes less restrictive.

Although some may view the opening statement of the most recent BoC meeting as more hawkish despite the 50 bp cut, we still expect policy rates to continue declining in 2025. There are three main reasons for this:

1. While there are early signs of improvement in retail sales and activity in both the manufacturing and services sectors, which could lead to a pickup in GDP growth for 4Q24 and 1Q25, Canada's economy is still growing below its potential, with output remaining in negative territory. The policy rate needs to be less restrictive to allow demand to continue improving and eventually absorb the excess supply.

2. With lower immigration targets, we expect the population to decline by 0.2% in both 2025 and 2026, a stark contrast to the average annual population growth of approximately 3.0% in 2023 and 2024. Slower population growth will likely hold back near-term residential investment and consumer spending. The BoC may consider a more accommodative rate environment to mitigate the downside risks to the economy.

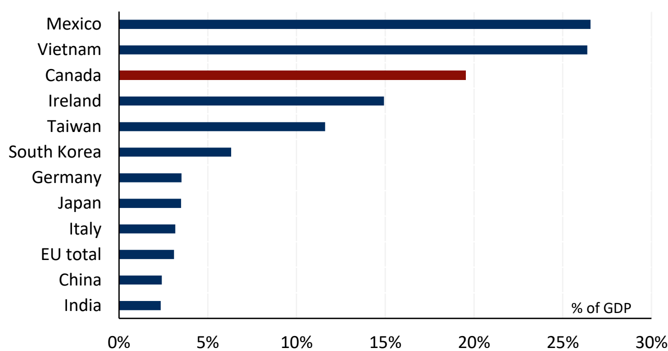
3. Canada's GDP per capita remains a big concern, with a cumulative decline of 3.4% since the rate hiking cycle began, compared to a 4.9% increase in the U.S. As noted in our June 2024 monthly report, productivity is the key driver of GDP per capita, and business investment is crucial for productivity growth. Therefore, the policy rate needs to continue decreasing to encourage business investments.

Another concern is the potential 25% tariffs on Canadian goods exported to the U.S. While central banks typically avoid speculating about policy impacts, these tariffs, though not our base case, still bring significant uncertainty. Given that Canadian exports to the U.S. account for 20% of Canada's GDP (Chart 8), if these tariff threats materialize, the policy rate may need to be reduced further. With the release of the January 29 rate decision, we will see an updated Monetary Policy Report (MPR). This will include consideration from the time period that includes Trump's election victory, ensuing tariff threats, and a week of the new U.S. administration that will allow us to possibly gauge if Trump's vows to act "on day one" were solid promises or negotiating tactics.

Some may argue that there is a limit to the spread between Canadian and U.S. policy rates, which is now at 125 bps, the widest since 1997. However, it is notable that the policy rate spread tends to move in tandem with the output gap spread between Canada and the U.S. Given Canada's below-potential economy, the BoC may have no choice but to allow the policy rate spread to widen if a more accommodative environment is needed (Chart 9). Additionally, a cheaper loonie versus the greenback (due to the widening policy rate gap) may help offset the impact of potential tariffs.

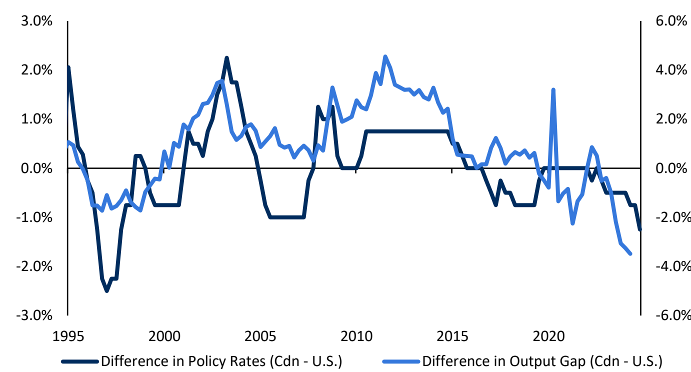
All things considered, we now expect the downward path of the BoC policy rate to continue further to the 2.25% level, or lower end of the estimated neutral rate range. If the BoC continues with 25 bp cuts at every meeting, we would achieve this level by June 4, which is our new base case. If the BoC slows to every other meeting, we would see this level by September 17.

Chart 8 - Export Dependence on the U.S. as a Percentage of Each Country's GDP



Source: Statistics Canada, U.S. Census Bureau, Raymond James Ltd.; For the year ending December 31, 2023.

Chart 9 - GDP Output Gap Differences Justify Policy Rate Divergence



Source: FRED; Statistics Canada; FactSet; Raymond James Ltd.; Policy rates data as of December 31, 2024, output gap date as of June 30, 2024.

Inflation — Mission Almost Accomplished

Key Takeaways: Our base case expectation is that Canada's inflation will stay on track, stabilizing around the 2% target in 2025 as the economy continues to absorb the excess supply in goods. Shelter inflation is expected to continue to come down, although very gradually. However, the potential imposition of retaliatory tariffs on goods imported from the U.S. could introduce additional inflationary pressures.

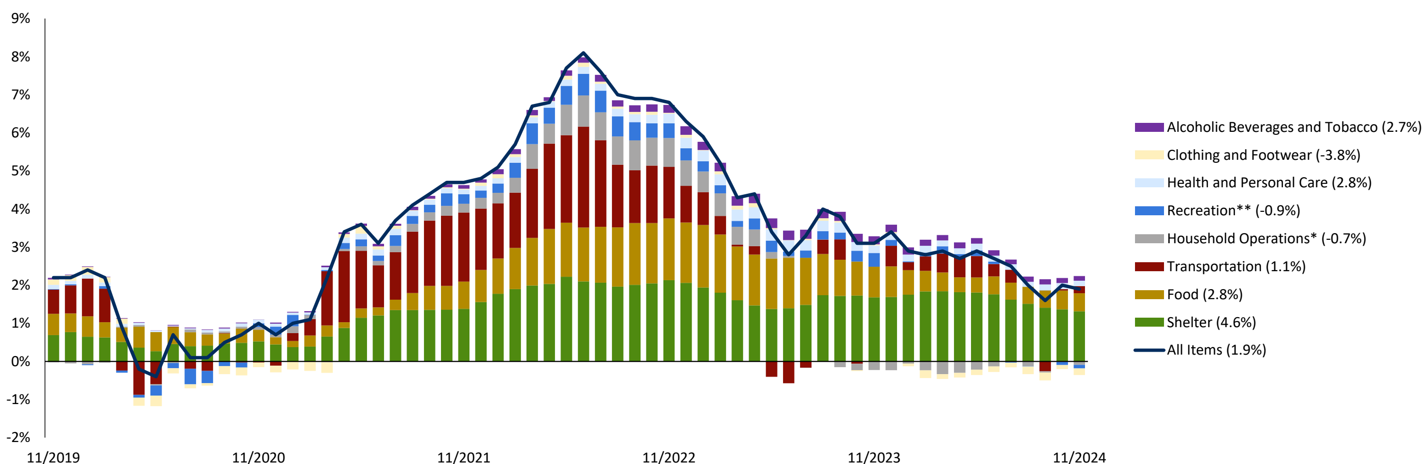
Observations: We ended 2023 with headline inflation of 3.4%, down dramatically from 8.1% in June 2022. Through 2024, that number declined further, even dipping below the 2.0% target briefly, to 1.6% in September. Shelter has remained the stickiest component, while a few categories such as clothing & footwear, and household operations were actually deflationary through the year (Chart 10).

Our View: We expect Canada's inflation to stay on track, stabilizing around the 2% target in 2025. Since August 2024, headline inflation, excluding shelter, has been steady at about 0.5%. With high inventory levels indicating excess supply, goods inflation should remain subdued. However, if the U.S. imposes 25% tariffs on Canadian exports and Canada retaliates, it could create some challenges. The depreciation of the CAD against the USD might also add some moderate inflationary pressure. Predicting shelter inflation, which makes up 28% of headline inflation, is trickier due to various factors. However, we anticipate a gradual decline in shelter inflation as we move into 2025.

Canada's housing undersupply issue will only be slightly eased, not resolved, by the lower immigration targets over the next three years. Therefore, we do not expect housing prices to become significantly more affordable in the near future. However, the near-term negative population growth may have a more immediate impact on rental accommodation, which makes up 24% of the shelter CPI calculation (Chart 11). Real-time average asking rents, which lead the official measure, have shown a more convincing trend of year-over-year growth stabilization, from 9.3% in May 2024 (close to the official rent CPI of 8.9%) to -1.6% in November 2024, in stark contrast to the still elevated official rent CPI of 7.7% (Chart 12).

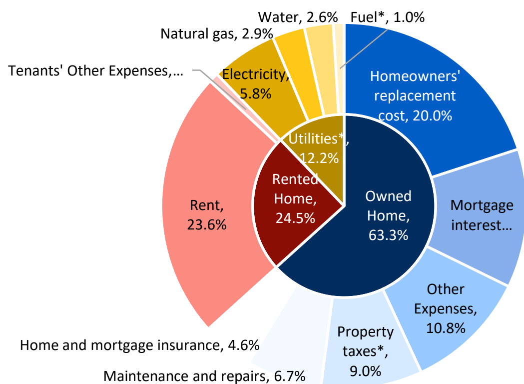
Mortgage interest costs, which account for 12% of the shelter component of CPI, are influenced by falling variable rates and 5-year renewals occurring at higher rates than the expiring terms. This combined effect may still lead to a net ongoing slowdown in mortgage interest cost inflation, as over half of the mortgages have already seen increased payments. However, homeowners' replacement costs, which make up 20% of the shelter CPI, may start to rise as the rate easing cycle progresses. The declining rate environment could make home purchasing more attractive to more people, pushing up prices. Although this may be tempered by the declining population, the impact on home sale prices will not be as significant as on rent prices. The rise in home sales could potentially add upward pressure to inflation in the Household Operations and Furniture basket. Nevertheless, we anticipate shelter inflation to decline, although very gradually.

Chart 10 - Major Components' Contributions to Canada CPI (Stacked Bars) and Latest Monthly CPI (Bracket Beside the Legend)



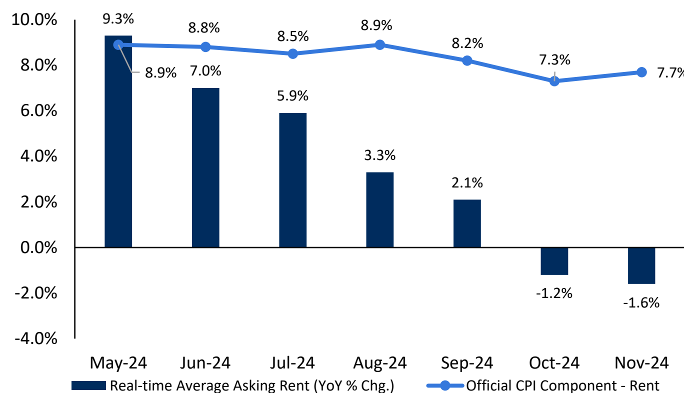
Source: Statistics Canada; Raymond James Ltd.; Data as of November 30, 2024. *Household operations, furnishing and equipment; **Recreation, education and reading.

Chart 11 - Shelter Component Breakdown



Source: Statistics Canada, Raymond James Ltd.; Data as of September 30, 2024.

Chart 12 - Official Rent CPI Tends to Lag Behind Real-Time Data, Quite Significantly This Time



Source: Statistics Canada, Urbanation Inc, Rentals.ca Network; Data as of November 30, 2024.

Labour Market — Cooled Down As Expected

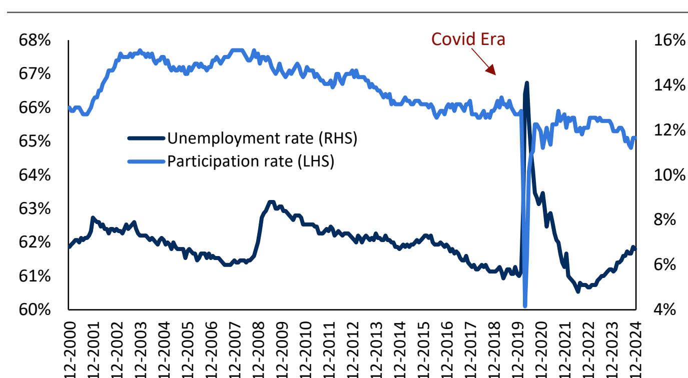
Key Takeaways: The labour market in Canada further cooled down in 2024. The labour force grew faster than job openings, pushing the unemployment rate up to historical long-term average levels. We believe the actual labour market conditions may be softer than the headline data suggests, due to the dip in the participation rate (fewer working-age individuals looking for jobs) and possibly overstated job gains in the Labour Force Survey (LFS). However, the recent improvement in business sentiment, the expected economic pickup fueled by rate cuts, and the lower immigration target will likely prevent the labour market from deteriorating further as 2025 progresses.

Observations: The unemployment rate in Canada increased from 5.8% at the end of 2023 to 6.7% in December 2024. The breakdown shows that the increase in unemployment is concentrated among youths and immigrants who have been in the country for less than five years. The participation rate, which measures the share of the working-age population (15 or older) that is working or looking for work, has been on a long declining trend since the global financial crisis (GFC). It dropped to 64.8% in October 2024 but rebounded slightly to 65.1% in December 2024 (Chart 13). Even with this rebound, it remains at historically low levels, excluding the anomalies during the COVID-19 pandemic.

The labour force grew by a substantial 661,700 in 2024. While the Labour Force Survey (LFS), which provides a timely picture of overall labour market conditions with a monthly sample size of approximately 68,000 households, showed a solid gain of 413,400 in employment for 2024, the Survey of Employment, Payrolls and Hours (SEPH), which is a census of all payroll employees in Canada with a two-month lag, showed an increase of only 136,700 in the first ten months of 2024.

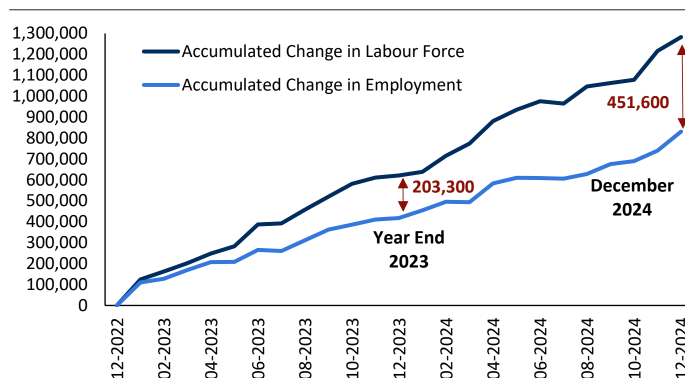
Wage growth is around 4% across the board, but growth in the public sector (+6.3%) is higher than in the private sector (+2.7%). There have been numerous union strikes and wage negotiations this last year as many groups are looking to normalize from concessions made through the pandemic period.

Chart 13 - Long-term Participation Rate and Unemployment Rate



Source: Statistics Canada, Raymond James Ltd.; Data as of December 31, 2024.

Chart 14 - Growth of the Labour Force Continues to Outpace Job Additions



Source: Statistics Canada; Raymond James Ltd.; Data as of December 31, 2024.

Our View: The unemployment rate has risen mainly because the increase in the labour force is outpacing the increase in job openings (Chart 14). This trend is also evident among youths and newly landed immigrants (Chart 15), who are the primary contributors to labour force growth. Although the unemployment rate is still slightly below the long-term historical average, we consider there are more cracks beneath the surface.

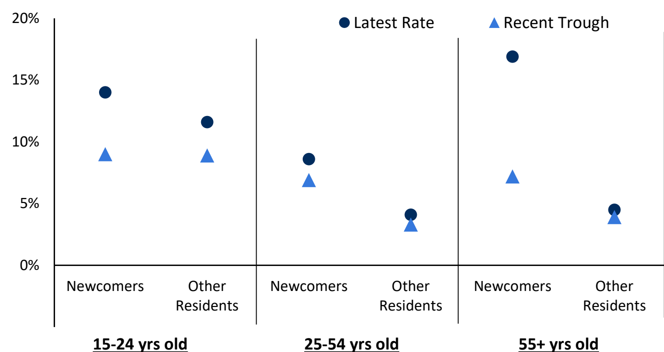
One concern is that the further dip in the participation rate over 2024 has likely masked weak employment data. If the participation rate were a more normalized 65.5% from the 2022-23 timeframe, the unemployment rate would already be around 7.5% instead of the currently reported 6.8%.

Another issue is the widening discrepancy between the net employment gains reported by the Labour Force Survey (LFS) and the Survey of Employment, Payrolls and Hours (SEPH) since the second half of 2023. Notably, the SEPH data for September and October 2024 shows Canada losing more than 44,000 jobs in total, while the LFS reports a gain of over 60,000 jobs for the same period (Chart 16). Although the LFS includes agriculture and self-employment jobs, which SEPH does not, this difference is difficult to reconcile. The LFS is subject to sampling error due to its methodology for achieving timeliness, while the SEPH, based on payroll data, tends to be more reliable but has a two-month lag.

Given these factors, we are no longer fully convinced by the reported employment growth from LFS, and therefore remain cautious about job creation strength in the Canadian market. However, on the bright side, as the policy rate continues to ease, we have seen some improvement in business sentiment, including hiring intentions. If we are correct that the economy will start to pick up in 2025, this should be a tailwind for job

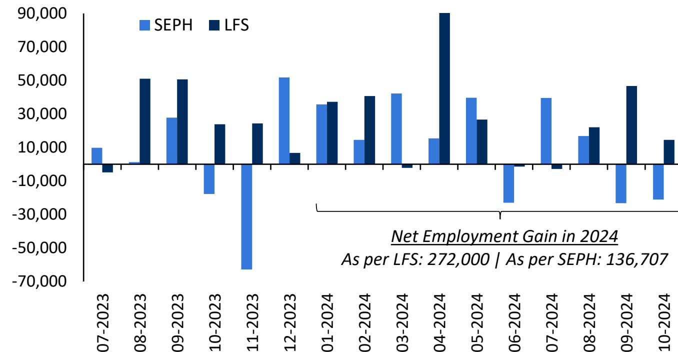
growth. Additionally, with flat to negative population growth due to the lower immigration targets, we expect this will put downward pressure on the unemployment rate. Therefore, although the actual labour market conditions may not be as strong as the most commonly cited LFS metrics suggest, it seems we may have already weathered the worst. This is not to say the unemployment rate won't go up any further from this point, but rather to suggest that most of the negative events have already played out.

Chart 15 - Unemployment Rates, 3-Month Moving Average, NSA



Source: Statistics Canada and Bank of Canada calculations; Newcomers are who have arrived within the last five years. Recent trough is the lowest recorded rate between 01/2022 to 12/2024.

Chart 16 - Discrepancy Between the Monthly Net Employment Gains Reported by the LFS and SEPH



Source: Statistics Canada, Raymond James Ltd.; Data as of October 31, 2024.

Housing Market — Mortgage Renewals Will Continue To Plague Canadians

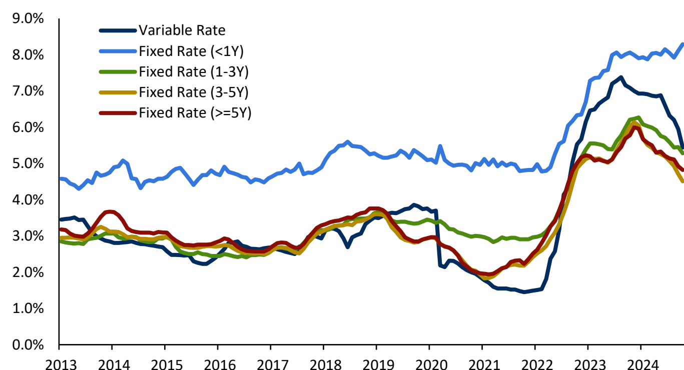
Key Takeaways: The housing market is expected to experience positive growth as borrowing costs fall and more favourable mortgage rules are introduced. However, the existing affordability challenges and higher mortgage renewal rates may hinder the overall growth.

Observations: According to the Canada Mortgage and Housing Corporation (CMHC), at least 1.05 million mortgage customers face renewals in 2025 at significantly higher rates than when they were previously contracted (Chart 17). Despite declining short-term policy rates from the BoC, many Canadians tend to rely on 5-year terms, with rates that are more aligned with longer-term bond rates as lenders match up their assets and liabilities. These renewals will be occurring as unemployment has been rising and both inflation and price level resets have already squeezed discretionary spending patterns. In response, the federal government has introduced new policies, effective December 15, 2024, aimed at mitigating some of these challenges, complementing the Bank of Canada's recent policy rate cuts. While the home sales have experienced an uptick in recent months (Chart 18), the long-term impact is not too certain.

Our View: The changes in mortgage rules would support the Canadian housing recovery, but the extent to which these measures can counteract the financial strain of higher renewal rates remains uncertain. The expanded eligibility for mortgage insurance on homes valued up to $1.5 million reduces the upfront cost burden for buyers in high-priced markets, while the extension of maximum amortization periods to 30 years lowers monthly payments for first-time homebuyers and new builds. Additionally, removing the stress test for borrowers switching lenders at renewal provides greater flexibility for existing homeowners to seek more competitive terms.

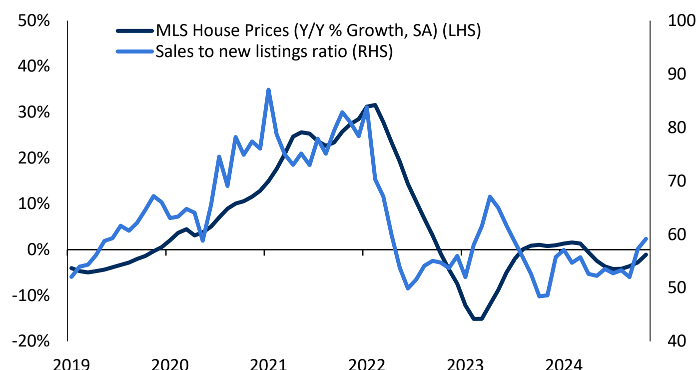
These initiatives may provide short-term relief and support for certain segments of the housing market, specifically first-time homebuyers, but their broader impact is likely to be limited by existing affordability challenges and the persistent mismatch between housing demand and supply. Given the current economic pressures, these policies may ease, but not fully offset, the financial challenges faced by many Canadians entering or navigating the housing market in 2025.

Chart 17 - Households Likely to Face Higher Mortgage Rates Upon Renewal, Despite Declining Policy Rates



Source: Statistics Canada; Data as of October 31, 2024

Chart 18 - Home Sales Continue to Rise, But Prices Remain Modest



Source: CREA; Raymond James Ltd.; Data as of November 30, 2024.

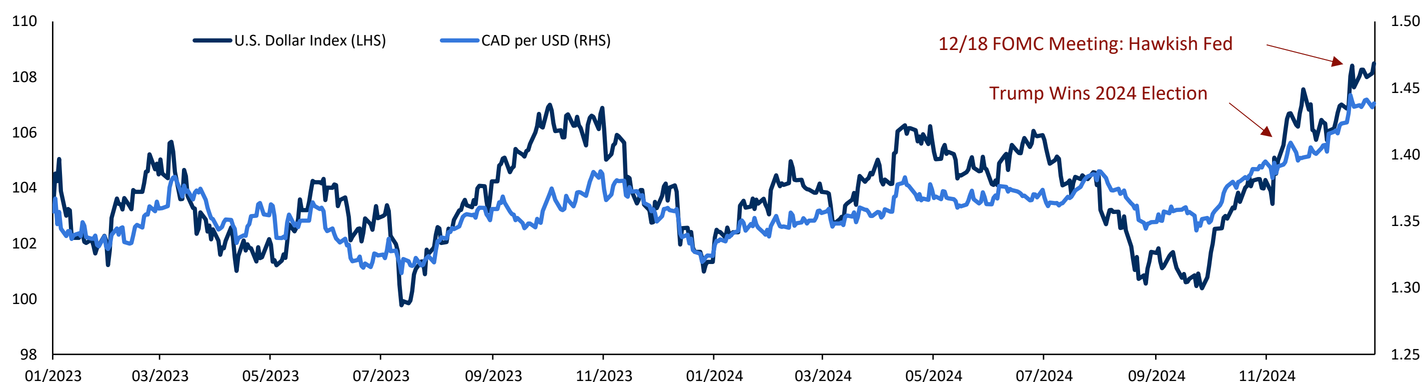
Foreign Exchange — Expect A Weaker Canadian Dollar

Key Takeaway: Our base case is that the Canadian dollar will face continued pressure against the U.S. dollar through 2025.

Observations: The Canadian dollar depreciated by over 5% against the U.S. dollar through 2024, almost 5% against the Euro, almost 4% against the U.K. pound, and about 2% against the Japanese yen.

Our View: The one that most Canadians will care about is the U.S. dollar exchange rate. Given the differences in the economic strength between U.S. and Canada, the growing interest rate differential, and the lingering threat of a trade war, all the headwinds are against the Canadian dollar (Chart 19). The only factors that could turn sentiment positive for the loonie would be a quick, and modestly favourable settlement of trade agreements with the U.S. with a long-term time horizon, and a significant uptick in demand for Canadian exports such as energy and other natural resources combined with supportive government policies. Our base case is for further pressure on the Canadian dollar through 2025.

Chart 19 - Trump's Victory and Hawkish Fed Fueled USD Rally



Source: Bloomberg; Raymond James Ltd.; Data as of December 31, 2024.

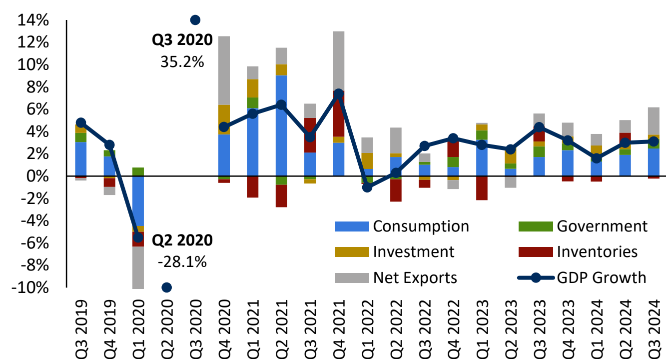
U.S. Macro Discussion

U.S. exceptionalism is on full display as we roll into 2025. The 'Goldilocks' conditions of strong economic growth (Chart 20) and low unemployment rate, with inflation slowly moving in the right direction (Chart 21), corporate earnings still growing, and the Fed still in easing mode, set the stage for another good year. We also have continuing fiscal stimulus with ~75%, or US$1.7 trillion, under the CHIPS and IRA programs yet to be distributed. What could possibly go wrong?

While we've already discussed the dramatic potential for tariffs to upend the Canadian economy, a new trade war could still harm the U.S. economy, and threats to expel over 10 million undocumented migrants could have significant impacts on sectors, such as agriculture and construction, that currently benefit from low-cost labour. The direction of inflation could reverse, and that easing cycle could swing with it. Then, as many of Trump's policies are likely to increase the U.S. deficit and the already record debt and interest burden, some questions arise; how far can this debt go, and how willing are countries that the U.S. is instilling economic harm on to continue funding the growth in the U.S's national debt?

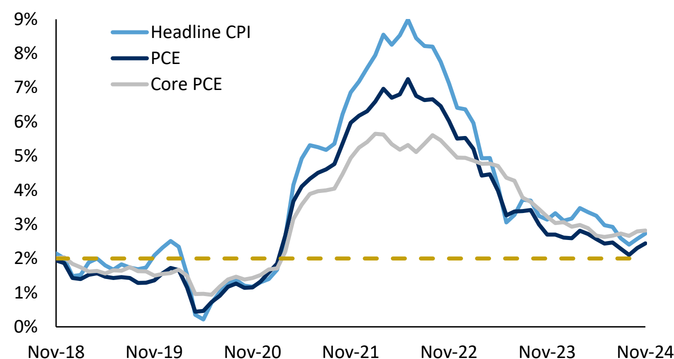
While the U.S. economy is massive, with positive inertia, we cannot ignore the impacts that Trump's policy proposals might have on the economy, both over the next couple of years, and well beyond. For the most part, if we consider his major platform promises as (i) tariffs, (ii) immigration/ deportations, (iii) deregulation, and (iv) tax cuts, we see all of these putting upward pressure on inflation, most putting upward pressure on the debt/deficit, and a mixed effect on economic growth.

Chart 20 - US GDP Annualized Quarterly Growth



Source: Factset, Raymond James Ltd.; Data as of September 30, 2024.

Chart 21 - US Inflation (Y/Y Percentage Change)



Source: Factset, Raymond James Ltd.; Data as of November 30, 2024.

What can Trump actually do?

President-elect Trump has razor-thin majorities in the House and Senate, and we should expect him to push through Legislation Action needing congressional approval quickly to avoid losing any leverage after mid-term elections. However, much of what Trump has promised, or threatened, to do can be accomplished through Executive Action, and so we expect that to be his vehicle of choice, specifically on tariffs.

Legislative Action will be focused on items that require a simple majority, in a process called Budget Reconciliation, which essentially will involve actions that are core to the Republican agenda to avoid any dissenting votes.

On taxes, when the Tax Cuts and Jobs Act (TCJA) passed through Congress in 2017, the corporate provisions were permanent, but the individual portions expire. The provisions that were set to expire at the end of 2025 will likely be extended, but the full extension would cost approximately US$4.6 trillion over the next 10 years. This would be difficult to pass with the majority required, and so there is the possibility that the extension could be reduced to 4-5 years, cutting the headline cost in half, to be more politically palatable, with clawbacks under other programs such as Biden's Inflation Reduction Act (IRA) or other programs with undisbursed amounts that can offset some of this cost, to get the price tag somewhere in the US$1.5 trillion range, with claims that proposed tariffs will cover that remaining amount. (*For further detailed insights we refer readers to reports from our Washington Policy Analyst, Ed Mills.*)

Tariffs, tariffs, tariffs

We still have a few weeks before we get the first insights into how large and quickly Trump's tariff threats are imposed, or if they remain dangling as negotiation tactics and leverage. This could play out very quickly, or over a protracted period, but will likely be met with some kind of response from targeted countries. We must also remain mindful that Trump is very transparent in that he uses (the threat of) tariffs to gain leverage in negotiations outside economic considerations. We also know that Trump has been very critical of Canada's low defense spending, so expect a push for that to increase, beyond the current Canada-U.S. border demands.

The bottom line is that there will almost assuredly be more tariffs by the end of 2025 than existed at the end of 2024. The devil is in the details as to how much, how soon, and against whom. Targets, in order, are likely China, Mexico, and now perhaps Canada, then Europe, and lastly just the rest of the world.

Prime Minister Trudeau was quick on the charm offensive after the 25% tariff threat against Canada and Mexico was broadcast on November 25, with a visit to Mar-a-Largo a few days later on November 29. The dinner was reportedly a friendly event, with Trump even joking about Canada becoming the 51st state, with Trudeau as its governor - which Trump doubled down on multiple times afterwards on social media referring to "Governor Justin Trudeau of the Great State of Canada". Ultimately there were no assurances or indications that the tariff threat would be rescinded following the trip, although Canada did promise to beef up the Canada Border Services Agency and the RCMP to address border concerns, with $1.3 billion pledged on the Fiscal Economic Statement (FES) in December, but spread out through 2030. Trudeau so far

has threatened retaliation from Canada, citing the 2018 response to U.S. tariffs on Canadian steel and aluminum, when Canada imposed its own tariffs on similar products, with additional targeted tariffs on items such as bourbon and Harley Davidson motorcycles. With the more recent prorogation of Parliament, and resignation of Trudeau, uncertainty about the Liberal Party leadership, and an inevitable general election, Canada would appear to be at a disadvantage in any kind of negotiation at the current time. Lastly, Trump has recently indicated his willingness to use "economic force" to entice Canada to become part of the United States. This is definitely setting up to be an interesting year.

China has been Trump's biggest target due to the 'Mexico backdoor', where China has built up manufacturing capacity in facilities in Mexico to finish goods that might otherwise have been produced in China. U.S. policy currently states that tariffs are placed on where a finished good is completed. By virtue of the USMCA, these goods have then entered the U.S. tariff free. China has some leverage in that it could restrict the supply of rare earth metals and older generation semiconductor chips, so this is another front in the coming trade war that promises to be very interesting.

Massive U.S. debt

One factor that may become an even bigger issue in 2025 is the record US$36.2 trillion national debt (Chart 22). This is exacerbated by the annual deficit, which continues to grown and is now at 6.2% of GDP, with no signs of any political will to change course and campaign pledges from Trump that would likely only increase that divide.

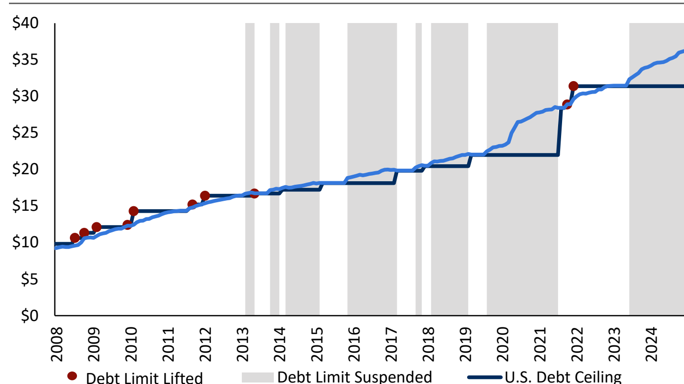
The U.S. debt ceiling was just reinstated on January 1 at the level at that date, which means that the U.S. will not be able to add any additional new debt (although it can still roll over existing maturing debt) until a new debt limit is set and approved. While suspended, over the last 18 months, the national debt increased by US$5 trillion, or 16%. The debt limit is one of the items that needs a 60 vote majority in the Senate, and so there will have to be some negotiation to gain the additional Democratic votes to pass. Mechanisms such as 'extraordinary measures' will likely extend this negotiation into mid-2025 before the urgency reaches its climax. As we have written before, the chances of this causing the U.S. to default is essentially zero, but there will likely be much discussion and negotiation around that time. Net interest expense will be the second biggest government expense in 2025, after Social Security, and slightly more than Medicare, Income Security, National Defense, and Health.

Once the debt ceiling limit has been addressed, the U.S. will need to issue more debt, likely steepening the yield curve, as investors look for better yields as the increased supply becomes available. The good news is that demand for U.S. Treasuries has not yet wavered. According to the U.S. Department of the Treasury, the Fed is no longer the main buyer of government debt due to massive quantitative tightening (QT). However, there has been a significant increase in private investors, who are more price-sensitive, picking up the slack. Foreign demand for U.S. Treasuries has been tepid due to the stronger USD leading to higher FX-hedging costs, but it has still increased over the past 12 months.

U.S. consumer remains resilient

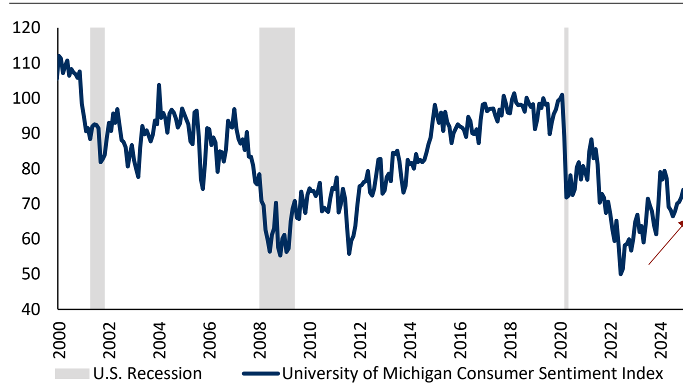
Despite continuing concerns that the U.S. economy is slowing, consumer spending, which makes up ~70% of U.S. GDP continues forcefully. The consumer sentiment index rose to 74 in December, marking the fifth consecutive month of increase (Chart 23). The world's largest retailer (Walmart) beat same-store-sales estimates in 3Q24 and raised full-year guidance, pointing to the resilience of the U.S. consumer. Black Friday sales were up 3.4% over 2023, with online sales up 15% and in-store up 1%, while items (appliances, clothing) with the largest discounts saw the most strength. A persistent theme in 3Q24 earnings calls however has been how discerning the consumer is getting as they look for value and lower cost options. The more selective shopper potentially indicates coming softness in economic growth.

Chart 22 - U.S. Government Debt Has Exceeded $36 Trillion



Source: Bipartisan Policy Centre; FactSet; Raymond James Ltd.; Data as of December 31, 2024, in trillions of U.S. dollars.

Chart 23 - U.S. Consumer Sentiment Continues to Improve



Source: Bloomberg; Raymond James Ltd.; Data as of December 31, 2024.

Labour market slowing

The U.S. job market remains stable, with limited firings, but a slight slowdown in hirings. The December payrolls report showed a gain of 256k jobs and brought the streak of positive job gains to 48 months. This is the second longest streak, matching July 1986 – June 1990. The longest streak of record, at 113 months, was broken by the pandemic in March 2020. Job gains could stay positive through 2025, but are likely to slow their growth.

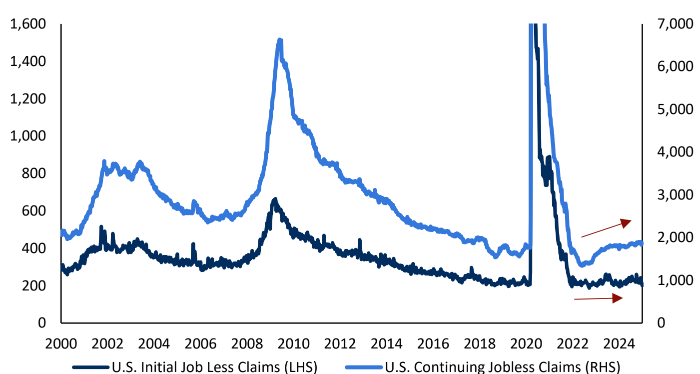
Initial jobless claims reflect how many people are filing new unemployment claims, presumably due to a recent job loss. This number was 213k in mid-November, the lowest since April, implying that the rate of layoffs is low. However, continuing claims, measuring the number of people that are collectively receiving benefits, rose to a three-year high of 1.87 million (Chart 24), as the median time to find a new job is at a two-year high of 10.5 weeks, implying that it is taking longer to find a job after getting laid off. However, the unemployment rate remains low at 4.1%.

Fed fund rate declining slowly and likely to remain higher than previously expected

The Fed used the interest rate hiking cycle to slow the economy to allow supply to catch back up to demand, so that inflation would come down to its 2% target level. As the Fed eases its policy rate, we expect it to be reduced to a level that allows the economy to grow at a controlled rate, keeping inflation near target and maintaining full employment. With unemployment still near 4% and the economy surprisingly strong, it's worth considering that the current policy rate level is just fine around the current level of 4.50%, especially as the inflation rate is making progress, but only slowly.

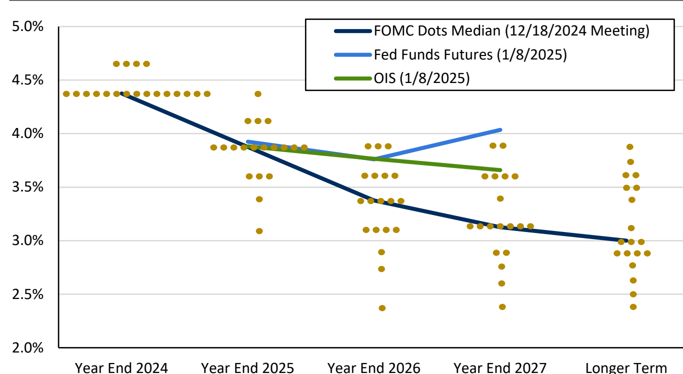
The Fed provides a Dot Plot that shows the longer-range forecasts from the FOMC members. At the last meeting in December, the Fed surprised the market somewhat with a hawkish shift in how gradually it expects to reduce the rate going forward, and how it could stop cutting rates at a higher level. The longer-run estimate, increasing throughout 2024, is now for a 3.0% rate (past 2026), up from 2.9% the previous quarter, with much more gradual easing over the next two years (Chart 25). This is why we have very modest expectations of only two more 25 bp cuts through 2025, which would be roughly half the rate cuts that many were previously expecting.

Chart 24 - U.S. Continuing Jobless Claims Reached Three-Year High



Source: FRED; Raymond James Ltd.; Data as of January 3, 2025. Jobless claims in thousands.

Chart 25 - Fed Dot Plot



Source: Federal Reserve; Bloomberg.

Financial Markets Discussion

The S&P 500 and TSX Composite both rallied well beyond what most expected in 2024

In 2024, both the TSX Composite and the S&P 500 had stellar performances, delivering total returns of 21.7% and 25.0% in local currency, respectively, far exceeding expectations. For the TSX Composite, this marked the sixth-best calendar year return of the millennium, while for the S&P 500, it was the seventh-best. Notably, the last time the S&P 500 achieved consecutive years of 20%+ returns was leading up to the late 1990s dot-com bubble. However, as December progressed, hopes for a "Santa Claus Rally" began to fade due to weakening short-term price momentum in both indices, which is unusual for such strong years. Additionally, market breadth is narrowing, with a significant drop in the number of stocks trading above their 100-day moving averages. These signs suggest that buying at market highs is challenging, and there are still many uncertainties as we head into 2025.

Nonetheless, we expect the U.S. will likely remain the most attractive equities market in 2025. Despite what could be a volatile ride due to pullbacks from exaggerated growth expectations and generally high multiples, the economic backdrop remains solid and with all other countries in the world potentially being negatively impacted by Trump policies, the U.S. will remain a favoured environment for investors, domestic and international.

The mega-cap stocks are therefore likely to remain mostly in favour, although the high valuations will likely entice more investors to give greater consideration to other stocks in the S&P 500, and even in the mid-cap and small-cap areas, as those companies have also shown resilience and still stand to benefit from coming tax cuts, deregulation and more favourable U.S. banking environment, and yet still offer more palatable valuation multiples.

Canadian Markets

In Canada, we expect the economy to improve as we head into 2025, but it will likely face pressure from U.S. tariff threats and flat to slightly negative population growth. Our base case would then be for the BoC to continue reducing its policy rate to boost domestic spending and investing. This puts bond investments in a good position as yields drop and bond values increase, although only modestly as there is less possible easing room.

This situation also shifts more focus back to equity investments. Interest rate-sensitive sectors, such as Industrials (machinery, railways) and Financials, stand to benefit the most from soft-landing signals and normalizing yield curves. As the likelihood of a soft landing increases, the resulting demand pickup can absorb excess supply and encourage businesses to expand their capacity. Railways also typically respond positively when the economy starts to improve, although they are also at risk from reduced Canada-U.S. goods trading. For Financials, lower rates reduce the risk of loan defaults and encourage businesses and consumers to invest and take out new loans, which should more than offset the impact of reduced net interest margins (Chart 26). Lower rates also tend to be favourable for the markets, providing a tailwind for the capital markets industry. However, the projected negative population growth remains a notable downside risk to demand.

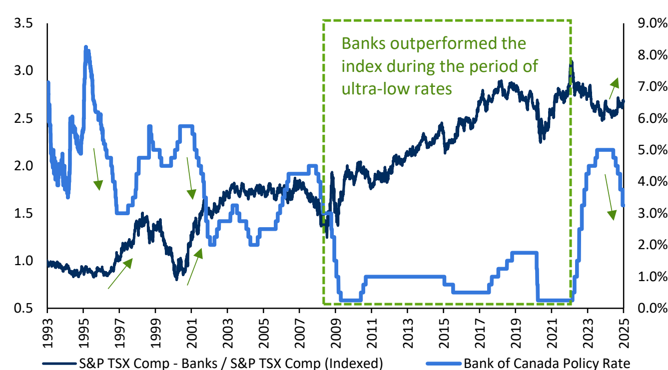
Looking at Energy, OPEC+ announced in December 2024 that they will begin gradually increasing oil production from April 2025, which is three months later than previously planned. The supply waiting on the sidelines may offset any future increase in demand that might occur in the second half of 2025, leading us to expect oil prices to remain relatively stable throughout the year (Chart 27). However, considering the energy sector is trading at its historical median, if Canada can position itself as a key ally to the U.S., particularly in re-industrialization and energy security, the sector might avoid significant tariffs as per our base case and benefit from multiple expansion.

Canada's Materials sector, with about half of its weight in gold, has historically shown a negative correlation with the USD. This means that when the USD appreciates, gold prices tend to weaken. While correlation doesn't necessarily imply causation, one possible explanation is that since both gold and the USD are considered risk-free assets, a strong USD and high U.S. Treasury yields make gold less attractive. However, this negative correlation hasn't held recently as central banks continue to increase their gold reserves. This trend may persist, especially for China and its allied countries.

On the other hand, the TSX's Info Tech sector could benefit from the appreciation of the USD. The substantial revenue exposure to the U.S. could act as a tailwind for Canadian technology companies, in addition to the ongoing A.I. enthusiasm. We are also working under the assumption that Services will not be subject to U.S. tariffs, which could favour software-as-a-service providers.

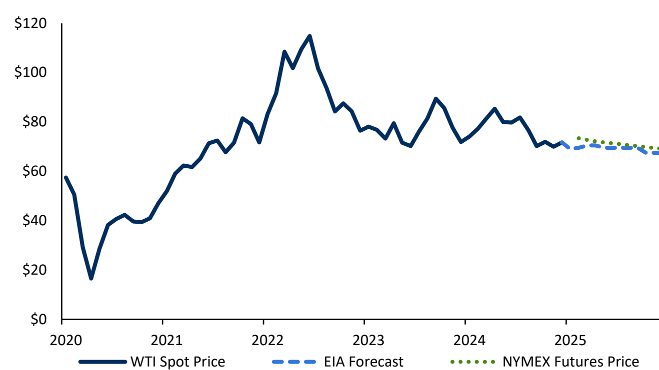
We will provide more detailed commentary and individual TSX Composite sector ratings in upcoming Tactical Asset Allocation reports.

Chart 26 - Banks Tend to Outperform When the Rates Are Lower



Source: FactSet; Raymond James Ltd.; Data as of December 31, 2024.

Chart 27 - Oil Prices Expected to Remain Stable Throughout 2025



Source: EIA short-term energy outlook; Bloomberg; Raymond James Ltd. Data as of December 31, 2024.

December Recap for Major Equity Indices

In December, the TSX Composite, Canada's main stock market index, saw a -3.6% price return and a -3.3% total return, slightly underperforming the U.S. large-cap benchmark, the S&P 500, which posted a -2.5% price return and a -2.4% total in local currency. The decline in the TSX Composite was broad-based, with all 11 sectors posting negative returns. Consumer Staples and Financials experienced the smallest losses. The situation was somewhat different for the S&P 500. As uncertainty increased and the Fed signaled fewer rate cuts ahead, capital seemed to flow back to the Magnificent Seven in December. Sectors containing Magnificent Seven members posted positive returns, while the rest of the sectors were negative. As shown in Chart 28, among the major equity indices, the Russell 2000, which represents U.S. small caps, was the biggest laggard with a total return of -8.3% in December, almost erasing the gains following Trump's election win in November. The S&P 500 Equal-Weighted Index was the second biggest laggard, reflecting the decline in market breadth in December (Chart 28).

4Q24 Recap for the TSX Composite

In 4Q24, the top-performing sectors of the S&P/TSX Composite were Info Tech, which rose by 22.2%, and Financials and Energy, both increasing by 6.6%. On the other hand, the sectors that lagged were Communication Services, down 19.2%, Real Estate, down 10.5%, and Materials, down 4.7%. The overall leaders and laggards for 2024 were quite similar to those in Q4: Info Tech surged by 38.0%, Financials by 30.1%, and Energy by 24.0%, while Communication Services fell by 21.1%, Real Estate increased by only 5.5%, and Industrials by only 9.7% (Table 1).

Top 3 Sectors (4Q24):

- **Info Tech**: The big surge after Trump's win in the 2024 presidential election made Info Tech the standout performer in 4Q24. In Canada, this sector is dominated by Shopify, and to a lesser extent Constellation Software, and then CGI. Despite high volatility following the initial one-week rally and even a dip in December, Info Tech is still showing stronger momentum compared to the overall index as we head into 2025. This is thanks to ongoing optimism around A.I. and the sector's substantial (services) revenue exposure to the U.S.
- **Financials**: This sector has continued to react favourably to the BoC's ongoing easing. The lower provisions for credit losses seem to more than offset the downward pressure on net interest income as the rate easing cycle progresses for the banks. The increased likelihood of a soft landing should also encourage businesses and consumers to invest and take out new loans, providing a boost to banks' revenue. Companies in the capital markets industry are outperforming due to strong year-to-date market performance. Insurance stocks are benefiting from forward earnings momentum, which supports their solid returns.
- **Energy**: The jumbo rate cut announced during the FOMC's September meeting helped crude oil prices partially recover from the summer sell-off, as lower rates typically support economic activities and boost oil demand. The energy sector had a good run in October, and Trump's election win gave it an extra push. However, in early December, with the Fed expecting fewer rate cuts in 2025, the energy sector lost most of its gains from the quarter. It then rebounded in the second half of December when OPEC+ announced a delay in production increases until April 2025. Additionally, the rally in natural gas contributed to the energy sector's 4Q24 performance.

Bottom 3 Sectors (4Q24):

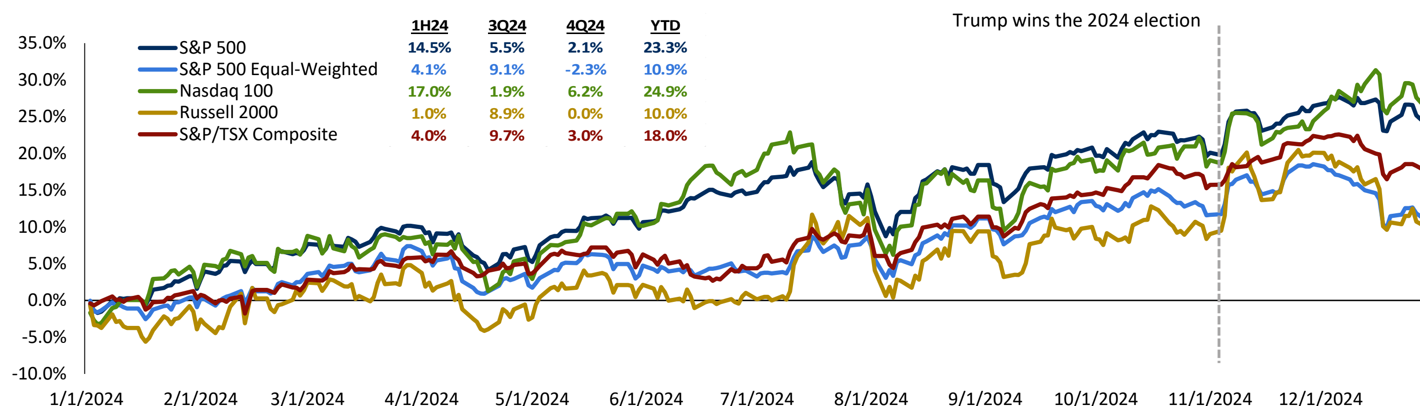
- **Communication Services:** 2024 has been a tough year for this sector, with intensified competition and regulatory issues remaining significant concerns. The lower immigration targets could also lead to decline in new users which would negatively impact revenue.
- **Real Estate:** This sector experienced a strong rally when the rate easing cycle began in June, but it lost a substantial amount of its Q3 rebound in Q4. With the loosening rates, there are early signs of upward momentum building again, but macroeconomic headwinds, namely reduced immigration targets potentially leading to two consecutive years of negative population growth, may weigh on its future performance.
- **Materials:** The TSX materials sector has been quite volatile in 2024, with gold making up nearly half of its weight. Its underperformance in Q4 was partly due to the lackluster gold prices, which have been under pressure since Trump's win in the 2024 presidential election. This is because reduced uncertainty and higher expectations of a high-rate environment have weighed on gold prices. Additionally, the sector continues to face challenges from the decline and gloomy outlook in China's demand for base metals.

Canadian Equities Outlook for 2025

2025 promises to be exceptionally volatile, driven in large part by political and policy uncertainty in both Canada and the U.S. Looking at the current consensus expectations in Canada, earnings from the TSX Composite are currently forecasted at $1,644, up from an estimated $1,469 in 2024. On average, consensus expectations decline by roughly 6% through the year, and so we adjust down to a 2025 EPS forecast of $1,545,

implying just over 5% growth. This seems reasonable as we are looking for a modest pick-up in GDP, with the BoC easing cycle. The lower interest rate environment can also be more favourable to valuations, and so if we apply a mid-range 17x P/E multiple we achieve a year-end target for the TSX Composite of 26,300. Including dividends, that would imply a total return for 2025 of approximately 8.5%.

Chart 28 - Selected Indices Price Returns



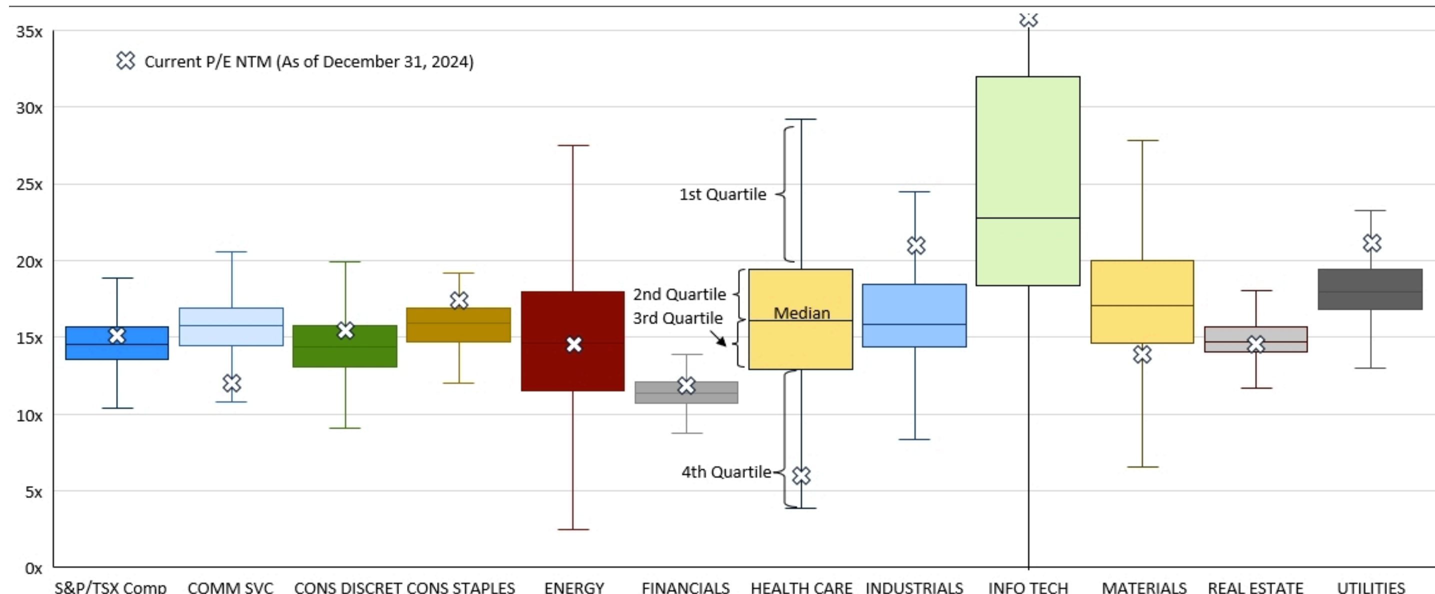
Source: FactSet, Raymond James Ltd; Data as of December 31, 2024. Price return in local currency.

Table 1 - S&P/TSX Composite Sector Performance and Valuations (Ranked by Quarter-to-Date Total Return)

Sector Name	Sector Weight	2024 Calendar Year Total Return	4Q24	1M Total Return	Current P/E NTM	Historical P/E NTM
Information Technology	10.1%	38.0%	22.2%	-4.2%	36.1	22.8
Financials	33.0%	30.1%	6.6%	-1.6%	12.0	11.4
Energy	17.1%	24.0%	6.6%	-3.6%	14.7	14.6
S&P/TSX Composite	--	21.7%	3.8%	-3.3%	15.1	14.5
Consumer Staples	4.0%	18.9%	3.6%	-0.6%	17.3	15.9
Consumer Discretionary	3.3%	11.9%	0.8%	-2.9%	15.3	14.4
Industrials	12.6%	9.7%	-0.4%	-3.7%	21.2	15.9
Utilities	3.8%	13.7%	-1.5%	-3.2%	21.1	18.0
Health Care	0.3%	8.2%	-3.7%	-4.3%	5.4	16.0
Materials	11.4%	21.4%	-4.7%	-5.3%	13.6	17.0
Real Estate	2.0%	5.5%	-10.5%	-6.1%	14.3	14.7
Communication Services	2.4%	-21.1%	-19.2%	-9.2%	12.0	15.7

Source: FactSet; Raymond James Ltd.; Data as of December 31, 2024. The S&P/TSX Healthcare sector has been excluded from the performance commentary due to its minimal representation in the S&P/TSX Composite Index.

Chart 29 - S&P/TSX Composite Sector Current vs. Historical P/E NTM



Source: FactSet; Raymond James Ltd.; Data as of December 31, 2024. Historical P/E: 1/1/2000 – 12/31/2024. Excluding outliners.

U.S Equities Outlook for 2025

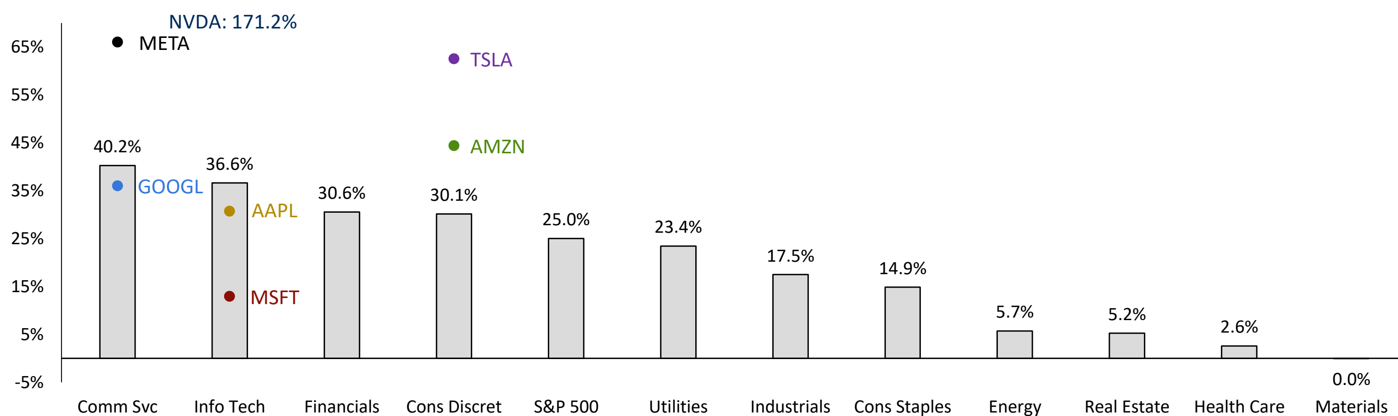
Our (U.S. Investment Strategy Group's) S&P 500 target to the end of 2025 is 6,375 using 23.5x EPS of US$270, with a preference for Technology, Industrials, and Health Care, as well as mid-cap stocks that could benefit from a broadening out of the market and catch-up trades. Including dividends, that provides a total return of approximately 8.5%, which would be below the 20%+ gains of the last two years, but closer to the longer-term average of 10-12%, with a P/E multiple still on the higher-end of the 20-22x average.

The target comes with the caveat that if the economic and corporate earnings growth can be sustained, the target could be revised higher. The caution in that current target is due to stretched valuations, uber-bullish investor sentiment, and two years of 20%+ returns suggesting that the market may have gotten ahead of the fundamentals.

Although interest rates are not currently forecasted to increase over the next year, we are closely watching the 10-year Treasury yield. While we expect it to remain near the 4.5% level, recent moves to 4.7% are noteworthy and any significant moves towards or past 5.0% could dampen enthusiasm and valuation multiples for equities and make fixed income a more attractive alternative for investors that also want to scale back on risk amid market volatility.

The consensus expectation is for S&P 500 EPS growth of 15% in 2025. With the economic backdrop, expected deregulation and lower taxes, this seems entirely possible. Even if some of the earnings growth from the Magnificent 7 stocks slows through 2025 (from 43% down to 28% growth expected), we could see broadening support and contribution from the other 493 companies (-0.3% up to 10% growth forecast).

Chart 30 - S&P 500 Sector and "Magnificant Seven" Year-to-Date Total Returns



Source: FactSet; Raymond James Ltd.; Data as of December 31, 2024.

Fixed Income & Treasury Yields

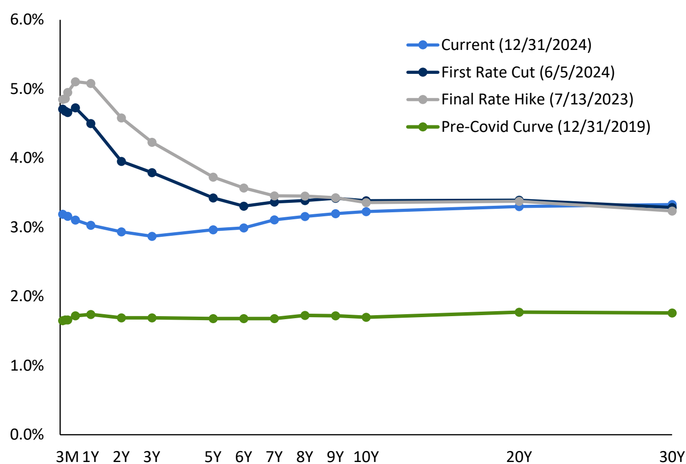
The U.S. and Canada's treasury yield curves have behaved quite differently throughout 2024. While both countries' yield curves are "uninverting," Canada's curve has normalized mainly by dropping the front end. In contrast, the U.S. curve has seen a drop in the front end, with the two-year maturity being an inflection point, but more importantly, a rise in the long end that is almost as significant as the drop in the front end. As a result, the entire U.S. curve remains well above Canada's.

Why did this happen? First, the BoC started easing rates earlier and more aggressively, causing the front end of Canada's curve to drop more significantly than the U.S.'s. Second, the middle and long ends of the curves reflect bond investors' expectations for economic growth, inflation risk, and national debt. In Canada, the outlook hasn't changed dramatically, so the mid to long end yields have stayed relatively stable, with its dropping front end resembling a typical "bull steepening" normalization. In contrast, mid to long end yields in the U.S. have risen significantly. This is largely due to Trump's key policies on tariffs and immigration, which could increase future inflationary pressure, while deregulation and corporate tax cuts may boost company profitability and long-term return expectations. Overall, these policies may keep the U.S. yield curve higher than expected. However, we anticipate that after the current rate easing cycle, the yield curves in both countries will remain above their corresponding pre-COVID levels.

Cash

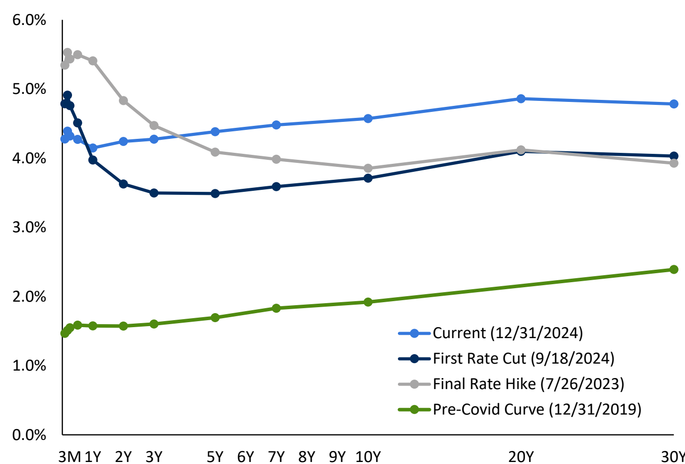
Despite short-term interest rates starting to fall, the cash being parked in money market funds has continued to grow. According to weekly Investment Company Institute (ICI) data, that amount hit a peak of US$6.8 trillion on December 31, 2024, up from US$6.5 trillion on October 2. With the Fed easing slowly, and cash yields still above 4.5%, we could see cash remaining popular for an extended period.

Chart 31 - Canada Government Yield Curves



Source: Factset, Raymond James Ltd.; Data as of December 31, 2024.

Chart 32 - U.S. Treasury Yield Curves



Source: Factset, Raymond James Ltd.; Data as of December 31, 2024.

International Equities

The current consensus view seems to be that the U.S. remains the place to be for 2025. There is a lot of reason to believe so, as we have described above, as looming trade wars threaten almost every country to some extent, pushing international investors to the relative safety of the U.S. On the other side of the argument is that many international markets are priced for destruction amidst weak economics and cautious outlooks, while the U.S. is priced for perfection amidst its Goldilocks scenario. The contrarian, with the risk tolerance and timeframe, may want to look for opportunities in this very diverse basket.

Both Japan and India have shown positive fundamental trends, and could fare relatively better than other countries under U.S. tariffs. Similarly, Vietnam and Taiwan may stand to gain market share against bigger targets like China.

In Europe, the ECB cut rates by 25 bps to 3.0% on December 12, for a total of 100 bps of easing since cutting began in June, the same week as in Canada. Also, similar to Canada, inflation is around the 2% target, averaging 2.2% in the Euro zone and 2.5% in the broader E.U., with concerns about political uncertainty and tariffs. Within Europe, we have seen a lot of variance, including between France and Germany. Germany has been facing economic headwinds (including vulnerability in a trade war, with strong trade ties to China and a big trade surplus with the U.S.), yet its stock market hit record highs, up 18.8% in local currency, helped by software giant SAP (+61%). The French benchmark, on the other hand, is up only 0.9%, weighed against with a heavy concentration in luxury goods (impacted by China growth projections) and political uncertainty.

The U.K. might fare better than Europe due to less reliance on exports to the U.S., but the upside potential may be limited due to its lower exposure to A.I. hype.

For emerging markets, the big rally in China’s equities throughout most of September sparked some hope that their two-year-long underperformance might be coming to an end. However, the policy support soon turned out to be largely insufficient, and performance since then has been disappointing. Given the weak fundamentals in China’s equities market, unless there is another round of strong and sustained stimulus to restore confidence, we expect China’s equities to continue lagging in 2025.

On the other hand, India’s macroeconomic backdrop is more positive than China’s and doesn’t seem to be significantly impacted by potential U.S. universal tariffs. However, its GDP growth is expected to slow down after a stellar year in 2024. Additionally, the combination of slowing economic growth and stretched equity valuations suggests that India’s equities rally is unlikely to last. The Trump trade policies have also been putting pressure on the Indian rupee, which will dampen returns in USD, making it less attractive to foreign capital.

Table 2 - Global Equities Performance

Select Global Equity Indices	Dec (in LCL)	Dec (in USD)	Dec (in CAD)	4Q24 (in LCL)	4Q24 (in USD)	4Q24 (in CAD)	2024 (in LCL)	2024 (in USD)	2024 (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Major Aggregates												
World (Global)*	-2.7	-2.7	-0.1	-0.2	-0.2	6.2	18.7	18.7	29.5	18.9	15.9	3.1
EAFE (DM ex U.S. & Canada)*	-2.9	-2.9	-0.2	-8.5	-8.5	-2.5	3.4	3.4	12.8	13.8	13.5	0.2
EM (Emerging Markets)*	-1.0	-1.0	1.7	-6.9	-6.9	-0.9	6.9	6.9	16.6	12.0	11.7	0.2
Selected Developed Markets												
Nikkei 225 (Japan)	4.5	-0.1	2.6	5.4	-4.1	2.1	21.3	8.8	18.7	18.8	16.8	2.1
Euro STOXX 50 (Europe)	1.9	-0.1	2.6	-1.7	-9.2	-3.3	11.9	1.5	10.7	14.2	13.2	0.9
FTSE 100 (U.K.)	-1.3	-2.8	-0.2	-0.2	-7.4	-1.4	9.7	3.8	13.2	11.3	12.4	-1.0
CAC 40 (France)	2.1	0.1	2.9	-3.2	-10.1	-4.3	0.9	-5.4	3.2	14.3	13.4	0.9
DAX (Germany)	1.4	-0.3	2.4	3.0	-4.2	2.0	18.8	11.7	21.9	13.5	12.6	0.8
Hang Seng (Hong Kong)	3.3	3.5	6.3	-4.9	-4.9	1.3	22.9	23.6	34.8	9.4	11.9	-2.5
Selected Emerging Markets												
CSI 300 (China)	0.6	-0.1	2.7	-1.7	-5.5	0.7	18.2	15.0	25.3	14.7	13.7	1.0
Nifty 50 (India)	-2.0	-3.2	-0.5	-8.2	-10.1	-4.3	10.2	7.2	16.8	22.2	18.6	3.5

Source: FactSet; Raymond James Ltd; Total returns, data as of December 31, 2024. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 12/31/2024. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

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