RJL PCS: QUARTERLY ASSET ALLOCATION

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Quarterly Asset Allocation (October 2024): Attempting to Stick the Soft Landing

Summary

As we head into the home stretch of 2024, we seem to be in a good environment for equities. We continue to see strong economic data out of the U.S., despite signs that growth will weaken, resilient employment reports, with unemployment slowly pulling back after ticking up and triggering the Sahm rule, and further strength in the equity markets as we head into earnings season with optimism. All this is combined with a rate easing cycle that has lowered recession concerns and even brought the “no landing” scenario (2-3% GDP growth with high inflation) back into the discussion. For our part, we remain cautiously optimistic about the U.S. economy and markets continuing to forge ahead.

For Canada, we see a lot more weakness than in the U.S., with minimal economic growth in 3Q24, although the more advanced rate easing cycle helped the TSX Composite record double the performance of the S&P 500 in Q3. Despite a surprisingly better labour report for September (+47k jobs), the unemployment rate has risen as population and labour force growth has outpaced overall weak job creation. Year-over-year, employment was up 1.5% in September, while the population in the labour force (individuals aged 15 and older) is up 3.6%. We expect the rate cutting cycle in Canada to proceed with regular cuts, as the Canadian economy needs more support. As inflation in Canada is now firmly in the Bank of Canada’s (BoC’s) control band, the policy interest rate needs to drop further, and perhaps more quickly, to ease the still restrictive environment and to lessen the negative impact of a coming wave of pressure as mortgages that were locked in for five years at ultra-low rates from before the pandemic come up for renewal at considerably higher rates. Still, the easing rate environment and good corporate earnings has allowed the TSX to post strong Q3 and YTD performance.

From a geopolitical perspective, factors to watch include the upcoming election in the U.S. and the escalating tensions in the Middle East. In our Washington Policy section, and his other reports, Ed Mills provides in-depth analysis on his forecasts and potential impacts from the election. Additionally, our Chief Economist, Eugenio Alemán, delves into the impact of tariffs, a major policy issue that has been discussed throughout this political campaign. Switching to the siuation in the Middle East, aside from the horrific humanitarian impact playing out, there is also a potential economic impact in the disruption of oil, specifically with the risk of Iran disrupting shipping through the Strait of Hormuz. In the near-term, oil, which has been under pressure from growing supply and weaker demand forecasts, has settled down to around US$70/bbl despite starting Q3 around US$84/bbl, and spiking quickly to US$77/bbl recently. Any extreme or sustained jump could affect economic growth and inflation forecasts.

Key Takeaways:

- The U.S. economy seems well on track for a soft landing, with growing discussion about “no landing” as economic growth continues, with recent positive surprises in the labour market. While the Fed is likely to continue on its rate easing path, there appears little need for further 50 bp cuts as the economy seems resilient enough to accept more gradual easing with inflation slowly continuing toward the 2% target.
- In Canada, with a much weaker economic picture, we expect a continuation of 25 bp cuts from the BoC at each meeting until the policy rate reaches at least 3% by the April 16, 2025 announcement. We could also envision 50 bp cuts at one or more of those meetings, especially since the September CPI headline print of 1.6%. If we continue to see further weakening economic data over the next few months, we could see the BoC reducing the policy rate even further towards the 2.25% level.
- Equity markets generally seem to be well positioned as recession fears have been reduced, inflation seems increasingly under control, rate easing cycles are well under way, and although unemployment rates remain a concern (more so in Canada than in the U.S.), they seem primarily driven by labour force growth and constrained hiring activity than employers resorting to widespread layoffs.

Market Commentary

RJL Investment Strategy Team

Looking at equity markets around the world, the Canadian S&P/TSX Composite fared extremely well in Q3 (+10.5%), returning essentially double the return of the S&P 500, as the BoC settled firmly into a regular rate cutting cycle. The Composite was supported by a surge in the Financial Services sector, which makes up almost one-third of the index weight. The U.S. joined the rate easing party just a couple of weeks before the end of the quarter, with a splashy entrance - a 50 bp cut to its policy rate, bringing it down from 5.5% to 5.0%. The Fed's narrative is that it is preemptively cutting rates now that inflation's path is securely on-track to hit the 2% target with the labour market in balance, and to avoid any undue pressure on the economy. It could be argued that the oversized cut was a catch-up for what perhaps should have been a 25 bp cut at the July meeting, given pressure in the labour market and expectations for softening economic growth. Nevertheless, markets enthusiastically celebrated the relief and the expectations for a soft landing became firmly entrenched. We remain cautiously optimistic due to continuing resilient U.S. economic growth (slowing, but not crashing), good corporate earnings, and a firmly anticipated downward path in rates (another 50 bps through the end of 2024 and 100 bps in 2025, presumably in 25 bp increments). This sets up a good environment for breadth improving in U.S. equities as all sectors seem to be seeing improvements and smaller cap companies are catching some favour.

A.I. continues to be an important theme, although scrutiny on sustaining growth rates and profitability continues to grow. Overall, focus will shift from hardware to software applications and productivity improvements, but that transition could be years in development. For now, there appears no reduction in equipment demand as the datacentre buildout continues, and as we even see a nuclear power plant being restarted for the purpose of supporting this massive power demand, and more in development specifically for this use.

International

The international outlook is focused on China. For years, China dependably powered ahead with GDP growth averaging 7.5%/yr from 2000 until the pandemic, peaking at over 10% in some years, but now those expectations have come down to earth (to likely just under 5% for 2024 and slowing further next year, heading perhaps towards 2% by the end of the decade), and with that its massive demand for commodities. While manufacturing slows, and as the U.S. looks at tariffs and restrictions on trade of critical technologies, China is facing a problem of excess supply, on top of other domestic issues such as a weak housing market and shrinking tax revenues among local governments. The Chinese government recently launched aggressive, coordinated stimulus measures, and commodities such as copper responded favourably, but weakness in demand growth for oil (along with abundant supply potential) has resulted in pressure on that commodity. The current question is whether this coordinated package of stimulus measures, and the implied additional ones, will be able to jump-start the Chinese economy. Equities in China certainly expressed their opinion, surging ~20% in Q3, making China one of the best performing equity market this year, before retrenching somewhat.

Moving on to one of our favourite Emerging Markets, India boasts a large and growing population with a positive long-term outlook for economic growth, in the 5-7%/yr range for the next decade. It's worth questioning if India's growth, and demand for commodities, can offset the weaker demand from China. India's economy is roughly the size that China's was about 20 years ago. Currently, the outlook for India does not include the kind of massive industrial build and demand for commodities such as aluminum, steel, copper, coal, and oil, that China went through, and so we don't see that offsetting demand appearing. India's economy is more focused on services than manufacturing. As such, GDP growth in India requires less commodity consumption than China's did. We could however see increasing demand out of India for rice and wheat, as the population continues growing.

Table 1 - Global Equities Performance

Select Global Equity Indices	3Mo (in LCL)	3Mo (in USD)	3 Mo (in CAD)	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	2023 (in LCL)	2023 (in USD)	2023 (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Canada												
S&P/TSX Composite	10.5	12.0	10.5	17.2	14.4	17.2	11.8	14.8	11.8	15.1	14.5	0.6
S&P/TSX 60	11.2	12.6	11.2	16.6	13.8	16.6	12.1	15.1	12.1	15.5	14.3	1.2
S&P/TSX Small Cap	8.4	9.8	8.4	18.0	15.2	18.0	4.8	7.7	4.8	12.3	16.6	-4.4
Canada Growth	8.2	9.6	8.2	13.6	10.9	13.6	15.8	19.0	15.8	21.7	18.5	3.2
Canada Value	10.1	11.5	10.1	13.0	10.3	13.0	5.1	8.0	5.1	12.5	12.1	0.4
U.S.												
NASDAQ Composite	2.8	2.8	1.5	21.8	21.8	24.8	44.6	44.6	40.8	27.5	19.8	7.7
S&P 500	5.9	5.9	4.5	22.1	22.1	25.1	26.3	26.3	22.9	21.7	16.4	5.3
S&P Mid Cap 400	6.9	6.9	5.6	13.5	13.5	16.3	16.4	16.4	13.3	16.0	14.0	2.0
S&P Small Cap 600	10.1	10.1	8.7	9.3	9.3	12.0	16.1	16.1	12.9	15.6	14.6	1.0
S&P Composite 1500	6.0	6.0	4.7	21.3	21.3	24.2	25.5	25.5	22.1	21.1	16.1	5.0
S&P Composite 1500 Growth	3.7	3.7	2.2	27.0	27.0	29.4	29.0	29.0	23.9	27.1	18.8	8.3
S&P Composite 1500 Value	9.1	9.1	7.1	14.8	14.8	15.6	21.6	21.6	16.0	16.5	14.0	2.5
Major Aggregates												
World (Global)*	6.4	6.4	5.0	19.0	19.0	21.9	24.0	24.0	20.6	18.9	15.8	3.0
EAFE (DM ex U.S. & Canada)*	7.2	7.2	5.8	13.0	13.0	15.7	18.4	18.4	15.2	14.1	13.5	0.5
EM (Emerging Markets)*	7.5	7.5	6.2	14.9	14.9	17.7	9.0	9.0	6.1	12.6	11.7	0.8
Selected Developed Markets												
Nikkei 225 (Japan)	-3.5	8.5	7.1	15.2	13.5	16.3	31.0	22.6	19.3	21.0	18.9	2.2
Euro STOXX 50 (Europe)	2.5	6.4	5.0	13.9	11.7	14.5	23.2	23.4	20.1	14.2	13.2	1.0
FTSE 100 (U.K.)	1.8	7.1	5.7	9.9	12.1	14.8	7.9	10.0	7.0	11.8	12.4	-0.6
CAC 40 (France)	2.3	6.5	5.2	4.2	5.3	7.9	20.1	24.4	21.0	14.3	13.4	0.9
DAX (Germany)	6.0	10.4	9.0	15.4	16.6	19.4	20.3	24.5	21.2	13.0	12.6	0.4
Hang Seng (Hong Kong)	21.7	22.3	20.7	29.2	29.9	33.1	-10.5	-10.5	-12.9	9.8	12.5	-2.7
Selected Emerging Markets												
CSI 300 (China)	17.9	22.1	20.5	20.3	21.6	24.6	-9.1	-10.9	-13.3	14.7	13.6	1.1
Nifty 50 (India)	7.8	7.3	6.0	20.1	19.3	22.0	21.9	21.1	18.2	23.9	18.4	5.5

Source: FactSet; Raymond James Ltd; Total returns, data as of September 30, 2024. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 9/30/2024. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

Canadian Economic Outlook

RJL Investment Strategy Team

Economic Growth

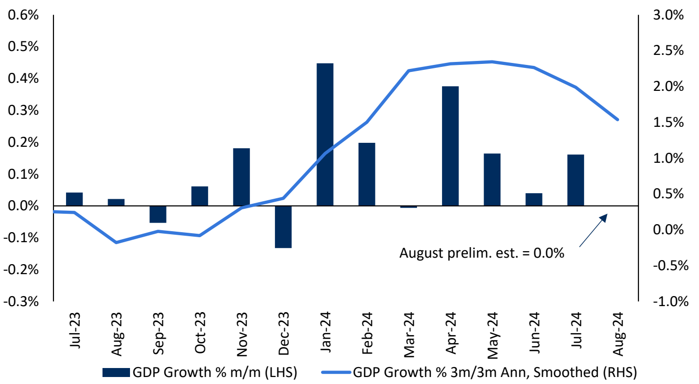
The Canadian economy grew by 2.1% quarter-over-quarter annualized in 2Q24, as measured by Gross Domestic Product (GDP), after 1.7% growth in 1Q24. Growth was higher than the consensus expectation of 1.8% and the BoC's own forecast of 1.5%. Unfortunately, while the full quarter result seemed good, the growth was primarily attributable to a big boost in April, while growth slid in May and ended up only slightly positive in June. Although we are now technically through 3Q24, the quarterly data is still to be announced. In July, GDP rose 0.2% month-over-month, but with a flash estimate of no growth (0%) in August, we are expecting to see a weak performance and only 1.2% growth in 3Q24, which would be well below the BoC's last estimate of 2.8% quarterly growth. Full year consensus forecasts are for year-over-year growth of 1.1% in 2024 and 1.8% in 2025.

A high policy interest rate from the Bank of Canada (BoC) has had the intended affect of slowing the economy to allow supply and demand to come into balance, with the intent of bringing inflation back to the 2% target level. The balancing act now comes into play as the BoC needs to reduce its policy rate quickly enough to ease pressure on consumers and the economy, without allowing inflation to pick back up.

Inflation

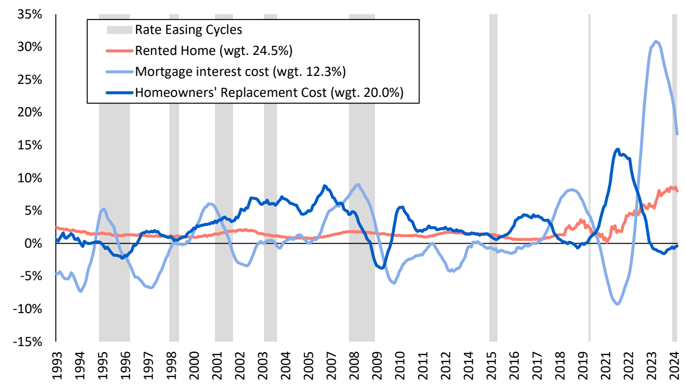
In September, Canada's headline inflation rate was 1.6%, firmly within the BoC's control band of 1% to 3%, and down from 2.0% in August. The BoC's preferred metric, CPI-trim, remained at 2.4% in September, although its three-month annualized growth declined to 2.1%. We have actually seen deflation - lower prices - in categories such as household operations and clothing and footwear for almost a year. The key sticking point remains shelter, which was up 5.0% in September and carries the largest sector weighting in the CPI at 28%. That shelter component is weighted towards rent (24%), homeowners' replacement cost (20%) and mortgage interest (12%). Rents have risen in part from structural problems in Canada, with extremely high population growth and relatively weak increases in housing supply, while house prices have been relatively stagnant through this period of higher mortgage rates. Interest costs have been a huge contributor to the inflation statistic as people renewed mortgages from ultra-low rates they enjoyed before and during the pandemic. While more homeowners will be renewing at higher rates over the coming year, the financial burden will increase on mortgage holders and that mortgage interest component will still see upward pressure, which could be moderated if the BoC lowers its policy rate faster.

Chart 1 - Canada GDP Growth (%m/m, %3m/3m Ann.)



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

Chart 2 - Key Components of Shelter CPI (Y/Y % Change)



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

Interest Rates

The BoC began cutting rates from their peak of 5%, and we now have a policy interest rate of 4.25%. With a weaker economy (than in the U.S.) and still higher unemployment, we expect further loosening of monetary policy. It is important to note that as the inflation rate declines, the policy rate needs to decline by the same amount or more to ease the restrictiveness of monetary policy. We expect a continuation of 25 bp cuts from the BoC at each meeting until the policy rate reaches at least 3% by the April 16, 2025 announcement. We could also envision 50 bp cuts at one or more of those meetings, especially since the September CPI headline print of 1.6%. If we continue to see further weakening economic data over the next few months, we could see the BoC reducing the policy rate even further towards the 2.25% level. The goal is to return to what is termed the 'neutral rate' or 'R-star', which is the rate that allows the economy to grow in a healthy and controlled manner. Although a theoretical measure that can change over time, the BoC most recently estimated that level to be in the 2.25-3.25% range.

Labour Market

Surveys in Canada indicate that the labour market tightness that helped to drive up inflation through the pandemic recovery is now history, with the share of firms suffering labour shortages and higher wage expectations, all lower than the pre-pandemic peaks. With a relatively soft economy and meagre job creation, exasperated by high immigration and a growing labour force, the unemployment rate in Canada rose to 6.6% in August before decreasing slightly to 6.5% in September. The labour market has weakened compared to the 5.5% unemployment rate in September last year and the cyclical low of 4.8% in July 2022. Also, it is worth noting that the modest decline in the unemployment rate in September was largely due to seasonal factors and a drop in the participation rate, indicating that fewer people were actively looking for work.

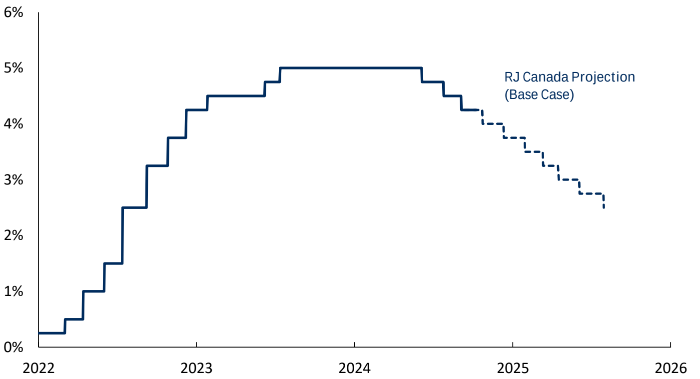
As job creation sputters, but the population and labour force continue to increase (+3.6% year-over-year labour force growth vs. +1.5% growth in jobs), we expect further upward movement in the unemployment rate, to at least 7%. Mid-year population data showed a surge of temporary residents to over three million, representing 7.3% of the Canadian population, and above the new 5% target. If the government follows through on pledges to limit temporary foreign workers in 2025, we could start to see the unemployment rate declining later next year.

Housing

Canada has a structural problem when it comes to housing. New home building has not been keeping pace with population growth. Nationally, shelter costs average approximately 50% of an individual's disposable income, with certain provinces being closer to 60%, and individual cities being even higher. Government goals to return affordability levels to the more stable 2003/04 timeframe would require homebuilding to triple immediately. Obviously this is not realistic, so we will likely face affordability issues for a protracted period of time. In the short-term, housing costs, including rentals, can be affected by interest rates and disposable income levels.

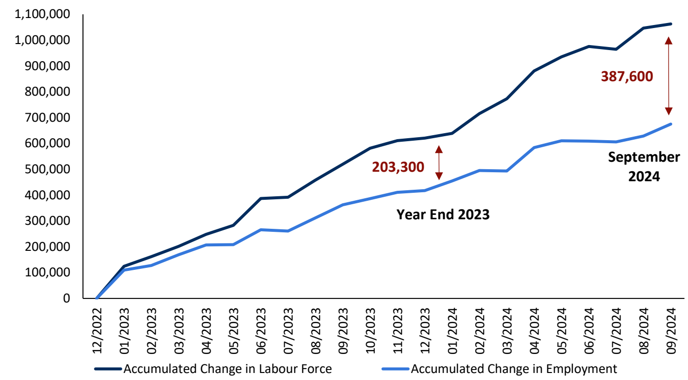
According to the Canada Housing and Mortgage Corporation (CMHC), in the six largest census metropolitan areas (CMAs), being Vancouver, Edmonton, Calgary, Toronto, Ottawa, and Montreal, total housing starts rose 4% in 1H24, to 68,639 units. Unfortunately, given the still growing population, this pace was not enough to meet growing demographic demand. As housing affordability remains prohibitive, rental construction is increasing to meet that need.

Chart 3 - Canada Policy Rate Projection



Source: Bank of Canada, Raymond James Ltd.; Data as of October 8, 2024.

Chart 4 - Growth of Labour Force Outpaces Job Additions



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

U.S. Economic Outlook - Trade and Tariffs: The Impact on Consumers

Eugenio J. Alemán, PhD, Chief Economist, Raymond James ; Giampiero Fuentes, Economist, Raymond James

A tariff is a tax assessed on imports. Historically, tariffs have been enacted to generate tax revenue or to protect domestic producers from competition in the form of cheaper foreign goods. In essence, tariffs artificially make domestically-produced goods more competitive in the local market by making imports more expensive. At the same time, tariffs allow domestic producers to increase the price they otherwise would have charged for their product had they faced foreign competition. In many ways, trade without tariffs keeps domestic producers' attempts to increase prices at bay. While tariffs have been utilized heavily in the past, both their usage and rates have fallen considerably over the past half century as countries have engaged in different stages of trade negotiations. The volume and value of global trade have grown exponentially as tariffs and barriers to trade have fallen over the decades. This has coincided with the growth of the global economy over the same period, which is, on average and in aggregate, more prosperous than at any time in human history.

While it is readily apparent that emerging economies have reaped outsized rewards because of freer trade, developed economies as a whole have benefited as well. The availability of cheaper imported goods has enabled consumers in developed economies to retain a larger share of their income for consumption, saving, or investment. The same holds true for companies, which benefit from lower input costs and higher profit margins when there are fewer barriers to trade. The strength and dominance of the U.S. dollar as the world's dominant currency, helped by the sizable and consistent demand for U.S. financial assets, the growth of the U.S. economy, as well as the large fiscal deficits over the years, have all contributed to the increase in U.S. consumption and thus to a sizable increase in imports from the rest of the world. This has created a large current account deficit (this includes the trade deficit in goods as well as the surplus in the trade of services), which needs to be financed with foreign savings. That is, the rest of the world has essentially financed the expansion of U.S. consumption by purchasing U.S. financial assets and investing in its economy. In exchange, the rest of the world has been buying U.S. physical assets as well as receiving interest and dividend payments from these transactions. Thus far, this arrangement has, on the whole, greatly benefited the U.S. economy and will remain a non-issue as long as the U.S. dollar remains the world's reserve currency and the U.S. economy the preeminent place to invest.

When tariffs are imposed or increased, the price of those goods affected by tariffs rise, potentially increasing inflation. Goods become more expensive to consumers and inputs become more expensive to companies, reducing both purchasing power and profitability, respectively. That is to say, the aggregate impact to the entire economy at large is negative. Furthermore, if nations engage in a 'trade war' wherein each nation retaliates with their own tariffs, which is what happened when the U.S. enacted tariffs the last time, the negative economic effects could be amplified.

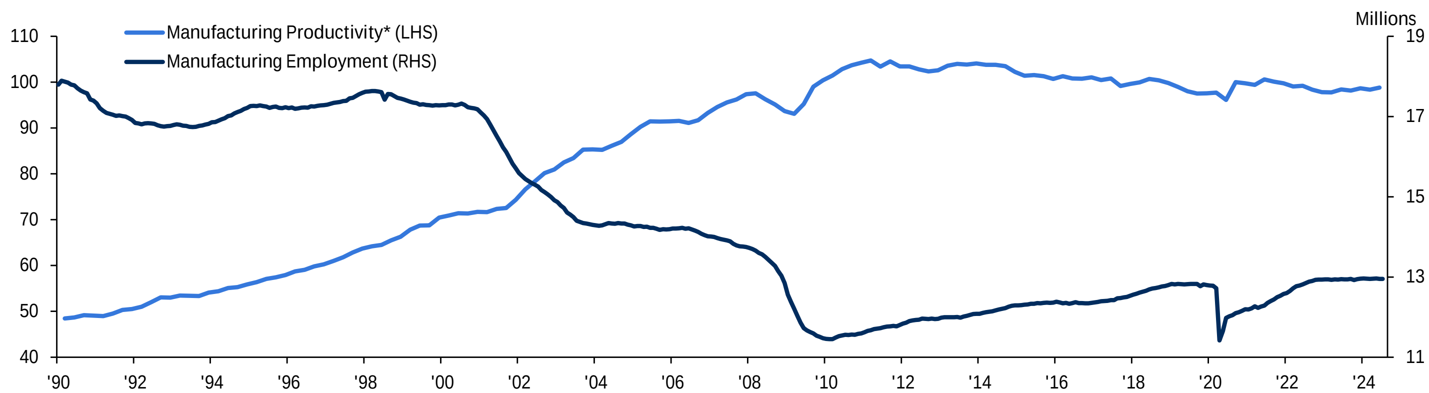
Trade is almost always better than no trade. And, as we mentioned above, the process toward freer trade over the last several decades has benefited the world economy as a whole, not only in terms of economic growth but also in terms of allowing countries to benefit from comparative advantage and produce, and export, products they are the most efficient at producing. We are not saying that there may be some arguments for the imposition of tariffs, but those instances have to be considered on a case-by-case basis. The imposition of blanket tariffs as an argument to solve trade imbalances is not a good way to tackle the root cause of these deficits. Sometimes, governments impose tariffs when they think that countries/companies are 'dumping' or selling products in the international market at prices that are lower than in their domestic market. Other times, governments impose tariffs to temporarily protect a company that is experiencing short-term issues at home, and politicians deem that the company's existence is at risk if the government doesn't intervene. Sometimes a country imposes tariffs if it believes that companies in the foreign country are being subsidized and are improving the competitiveness of their products vis-à-vis domestic companies, etc.

An alternative that can help to reduce the trade deficit, if this was the true reason for the imposition of tariffs, is to reduce the fiscal deficit. However, this is going to slow economic activity as well as economic growth and politicians are probably not going to be willing to consider this avenue for improving the trade balance.

The 2018 Trade War

The U.S. manufacturing sector has been transformed over the last several decades as cheaper imports have put pressure on the sector's competitiveness. Higher manufacturing wages in the U.S. compared to the rest of the world are probably the root cause of such a shift. According to the National Association of Manufacturers (NAM), the average salary of a manufacturing worker in the U.S. in 2022 was US$98,846, including benefits, compared to about US$13,638 in China and US$15,804 in Mexico. However, the sector's transformation has meant that it is using more machines and more skilled labor to produce goods, and this requires fewer workers to produce than in the past. This means that the sector has continued to specialize in the production of those goods that it is most efficient in producing. That is, although employment in manufacturing declined by nearly 30% since the 1990s, manufacturing productivity has doubled during the same period. This increase in manufacturing productivity has meant that manufacturing workers in the U.S. are highly paid compared to workers in the developed world.

Chart 5 - Manufacturing Productivity Has Doubled Since the 1990s



Source: FactSet, data as of 9/30/2024. *Productivity Index is measured as total output per hour worked.

During the Trump presidency, the U.S. raised tariffs on many U.S. trading partners, tariffs that the Biden administration has kept almost unchanged. China was affected the most, with over US$380 billion worth of steel, aluminum, washing machines, and solar panels impacted by tariffs, for a total increase in tariff revenues of ~US$80 billion. It has been estimated that the average household has paid an additional ~US$300 annually due to the 2018 trade war.

A Potential 2025 Trade War?

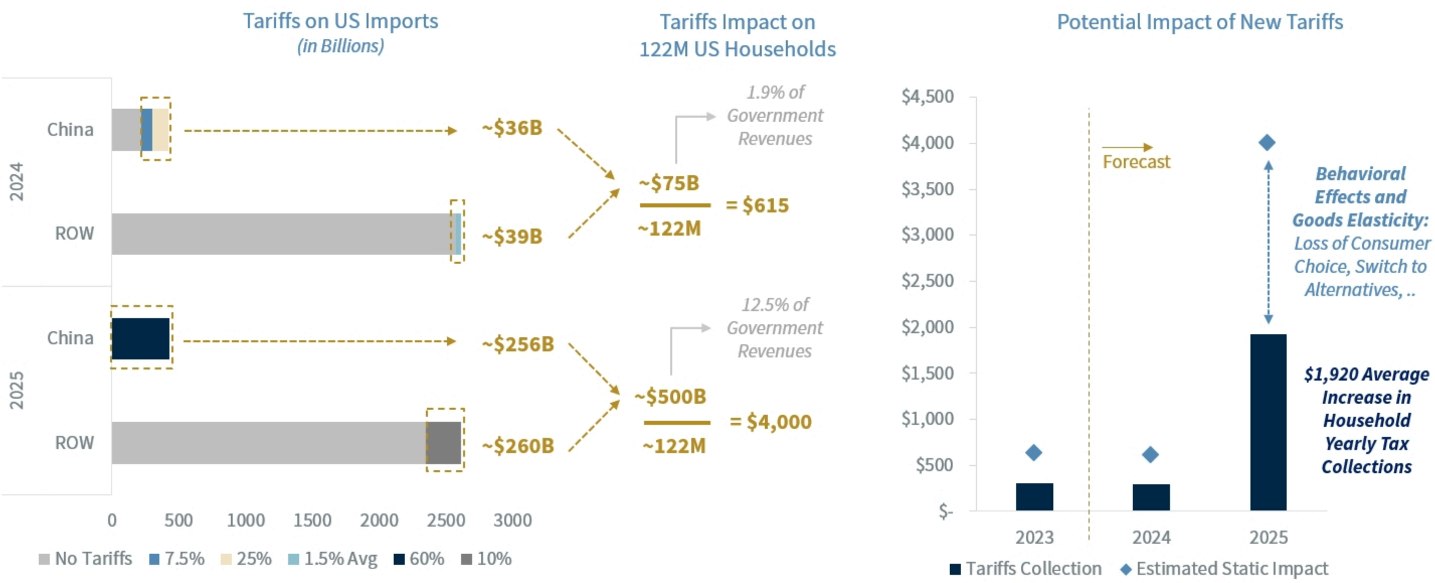
The COVID-19 pandemic, the government's massive fiscal package, the inflation spike of 2022, and the Federal Reserve's (Fed) monetary policy journey have certainly overshadowed any impact that the 2018 trade war might have had. However, that's behind us. Pandemic excess savings are depleted, inflation is close to the Fed's target, the Fed has started to ease rates, and we are now staring at the possibility of a new trade war. While trying to estimate the effects of additional tariffs, and potential retaliation from foreign countries, is an extremely complex task with lots of variables at play, we've tried to estimate the potential impact on the U.S. economy from the imposition of a 10% import tariff on all trading partners and 60% tariffs on all Chinese imports.

Under this scenario, the tariffs will generate ~US$500B in revenues, which could, on one hand, have a negative impact on GDP if the revenues from tariffs are not returned to the economy. Typically, higher tariffs are paid by consumers through higher prices for the goods they consume. Furthermore, the impact on consumers, especially those in the lower income quintiles, could be severe as not only are they likely to have fewer options, but may be forced to spend much more as businesses will likely pass the bulk of the price increase to consumers. On the other hand, domestic producers will likely attempt to use the impact of tariffs on imported goods to boost their profit margins by increasing prices of competing domestically-produced goods. Overall, if tariff revenues increase more than sixfold (from US$80 billion to US$500 billion) then the extra amount that the average household will have to pay increases from ~US$300 annually to ~US$1,900 annually and impacts the U.S. economy by as much as 1.9% of total GDP.

If these tariffs are enacted, a trade war is likely to ensue as trading partners retaliate by imposing similar tariffs on U.S. exports. In this escalation, the trade deficit will likely widen further, and U.S. exporters may experience as much as a ~US$400B hit on revenues depending on how much the quantity demanded by trade partners will decline. Additionally, if the U.S. dollar were to appreciate in response to the tariffs, U.S. exporters would have a harder time selling their products overseas, which would likely have a negative impact not only on exports, but also on U.S. production and the labor market.

Inflation is likely to increase as tariffs are implemented and prices increase, but unless the trade war continues over the years, the inflation spike may be short-lived. However, if inflation increases then the Fed may be pushed to either increase interest rates or keep interest rates higher for longer compared to a no-tariff-war scenario or until the effects from the tariffs are pushed through the U.S. economy. It is difficult to know the actual impact on overall inflation, but an across the board increase in tariffs has the potential to push inflation higher.

Chart 6 - Tariffs - Unlikely to Provide A Meaningful Dent in Revenue



Source: FactSet, TaxFoundation.org, US Census Bureau, US Customs and Border Protection, US Trade Representative.

Conclusion

Those who believe that freer trade is not good for a country believe that international trade is a 'zero-sum game,' which means that if one country loses, that is, has a trade deficit, then the country with the corresponding, and opposite, trade surplus, is the winner. However, trade is, typically, not a zero-sum game but a 'positive-sum game' in which everybody wins by engaging in trade. The idea that a trade surplus is better than a trade deficit comes from the old and discarded theory of 'mercantilism', a view of the world that lasted from the 16th to the 18th centuries and that considered the wealth of a nation dependent on the size of its trade surplus while limiting imports through the imposition of tariffs.

However, the reality is more complex. As discussed above, trade deficits and surpluses do not necessarily denote whether a nation is at an inherent economic advantage or disadvantage. In this sense, trade is more like a 'positive-sum game' with a variety of possible payoffs. Generally speaking, all nations stand to benefit by 'cooperating' in an environment of freer trade. However, tariffs and protectionist measures disrupt global supply chains, increasing costs and reducing profitability. In other words, nations stand to be harmed by 'defecting' from free trade and engaging in trade wars.

Canadian Equities

RJL Investment Strategy Team

While U.S. large caps, as represented by the S&P 500, achieved a higher year-to-date total return of 25.1% compared to the 17.2% return of Canadian equities represented by the S&P/TSX Composite, Canadian equities have notably outperformed in 3Q24, measured in CAD terms. The TSX Composite saw significant gains due to a strong rally in Financials, which make up over 30% of its weight. In contrast, the S&P 500's largest sector, Info Tech, along with the Magnificent Seven, lost some momentum as the long-anticipated rate easing cycle began. Additionally, other defensive and/or rate-sensitive sectors like Utilities and Real Estate outperformed in Canada, benefiting from the Bank of Canada's earlier rate cuts. However, the performance of other major sectors in the TSX Composite, such as Energy and Industrials, was negatively impacted by the global economic slowdown.

In the U.S., we have closely watched the rotation from mega-cap tech stocks to more value-oriented small and mid-cap stocks. We have a much less diverse stock market in Canada, but we have seen a somewhat similar trend. While the TSX Composite index is up 17.2% YTD, the largest companies, represented by the TSX60, have been up 16.6%, while the remainder of the companies in the composite, represented by the TSX Completion Index, has been up 19.9%.

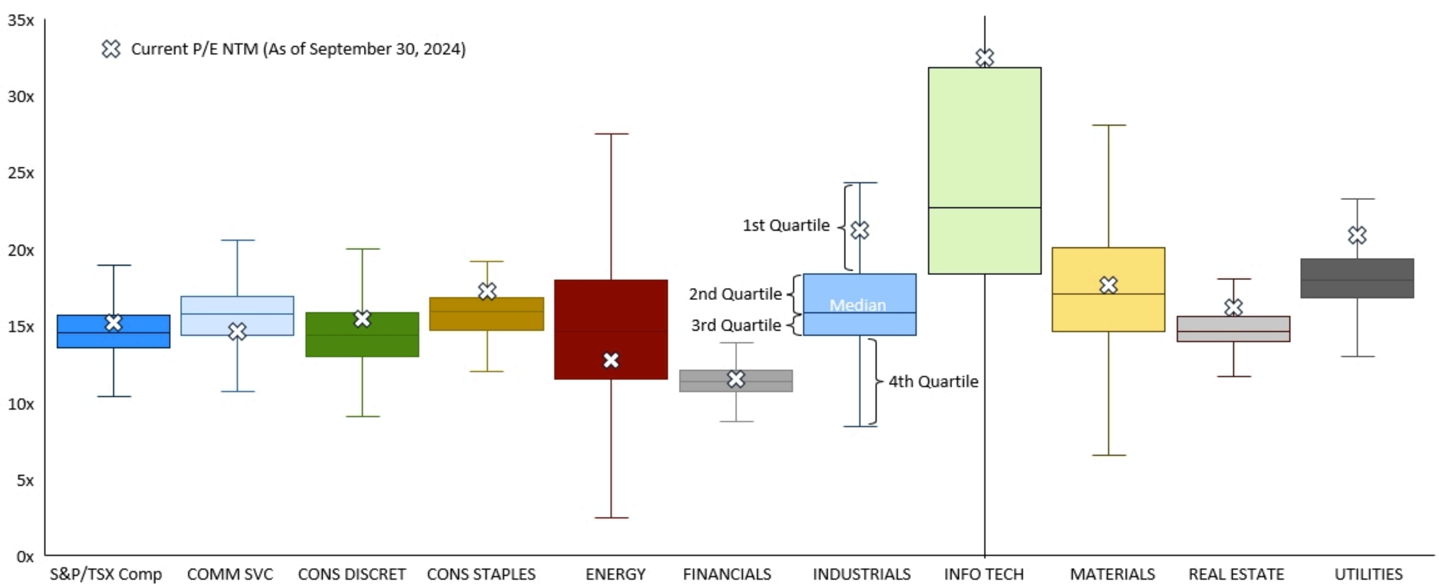
In the following table, we summarize our outlook for each TSX sector, along with their respective weightings in the TSX Composite, their total returns (including dividends) to the end of September, both YTD and for 3Q24 specifically, with their current price-to-earnings multiple versus their historical multiples. In addition, the following chart shows how those current P/E multiples compare to the historical averages, broken down into quartiles.

Table 2 - Sector Performance, Valuations and Ratings

Sector Name	Sector Weight	2024 YTD Total Return	3Q24 Total Return	Current P/E NTM	Historical P/E NTM	3Q24 Rating		4Q24 Rating
Financials	32.1%	22.0%	17.0%	11.6x	11.4x	MARKET WEIGHT		MARKET WEIGHT
Energy	17.5%	16.3%	2.0%	13.1x	14.6x	OVERWEIGHT	▼	MARKET WEIGHT
Industrials	12.7%	10.2%	2.7%	21.9x	15.8x	MARKET WEIGHT	▼	UNDERWEIGHT
Materials	12.4%	27.5%	12.2%	17.8x	17.0x	MARKET WEIGHT	▲	OVERWEIGHT
Info Tech	8.6%	12.9%	14.1%	32.9x	22.7x	OVERWEIGHT		OVERWEIGHT
ConsStaples	4.0%	14.8%	6.0%	17.6x	15.9x	OVERWEIGHT	▼	MARKET WEIGHT
Utilities	3.9%	15.5%	16.6%	21.0x	18.0x	MARKET WEIGHT		MARKET WEIGHT
Cons Discret	3.3%	11.0%	7.8%	15.5x	14.3x	MARKET WEIGHT		MARKET WEIGHT
Comm Svc	3.0%	-2.3%	10.5%	14.9x	15.8x	UNDERWEIGHT		UNDERWEIGHT
Real Estate	2.2%	17.9%	23.0%	16.3x	14.7x	UNDERWEIGHT		MARKET WEIGHT
Health Care	0.3%	12.3%	16.5%	6.1x	16.1x	NO RATING		NO RATING

Source: FactSet; Raymond James Ltd. Data as of September 30, 2024. Performance and valuation data are from FactSet, sector ratings are provided by RJL Investment Strategy Team.

Chart 7 - Current vs. Historical P/E NTM by Sector (S&P/TSX Composite)



Source: FactSet; Raymond James Ltd.; Data as of September 30, 2024. Historical P/E: 1/1/2000 – 9/30/2024. Excluding outliners.

Sector Commentaries

Financials (Market Weight): Lower interest rates are having mixed effects on bank earnings. While earnings have held up so far, with modest gains expected in 3Q24, the ongoing rate cuts will squeeze banks' net interest revenue. The key question is whether lower provisions for credit losses, driven by reduced pressure on loan books, can offset this revenue decline. Results will vary among major banks, depending on factors like asset quality and geographic focus. Additionally, as the economy slows down, we expect fewer individuals to have discretionary funds for insurance, potentially leading to increased withdrawals. However, insurance companies appear to maintain strong pricing power. Asset management firms may also face heightened market volatility for the rest of the year.

Energy (Market Weight): Oil prices (per barrel) have declined to multi-year lows. While the recent Iranian missile strike on Israel and China's aggressive stimulus measures briefly lifted prices, the broader decline in global demand remains the main factor preventing a sustained rally, not to mention OPEC+'s potential removal of production restrictions. However, valuation multiples in the Canadian energy sector remain depressed despite good cash flow, dividends, and share buybacks, so we see more long-term value even with short-term sentiment about commodity pricing weighing against a near-term boost.

Industrials (Underweight): As the economic cycle shifts from a slowdown to early recovery, industrials typically lose momentum. Key concerns include uncertainty around demand, labour disruptions (like strikes), and natural disasters (such as wildfires), especially in ground transportation, which makes up nearly half of the sector. On the other hand, we believe the waste management industry could offer some defensive characteristics. Overall, we see downside risks for earnings and mounting pressure on valuation multiples as industrials currently trade at a historically high premium.

Materials (Overweight): Expected rate cuts by central banks and the upcoming U.S. election will likely support precious metal prices, which make up about 45% of the sector's revenue. On the other hand, a key factor for base metals and critical minerals is demand from China. With concerns around China's overcapacity and a sharp slowdown in construction, we could see muted or declining demand for commodities such as copper and aluminum, despite recent aggressive stimulus measures. This could offset the growing global need for critical materials in green energy and electrification. Still, the Canadian materials sector, heavily weighted toward precious metals, has relatively small exposure to China, with only about 4% of revenue tied to that market. Thus, the impact of China's reduced demand on Canada is expected to be limited in the near term. Overall, we see short-term positive tailwinds.

Information Technology (Overweight): In the U.S., technology sector investing seems centred around the Magnificent 7 and the semiconductor space. While the debate over an A.I. bubble continues, in Canada our information technology sector is more weighted to e-commerce and software applications. As we expect a long transition from A.I. hardware providers into "A.I. 2.0" and the applications and productivity improvements that will enable, we see growth opportunities over the longer-term.

Consumer Staples (Market Weight): In this environment, consumer spending faces more headwinds, with consumers increasingly seeking value. While inflation has gradually stabilized, it's becoming harder for companies to justify price hikes for everyday goods, and consumer spending is driven more by discounts and promotions, which could hurt companies' pricing power as well as their profits. Since markets tend to look ahead of the economy, even with the current economic slowdown, staples may find themselves in a less favourable position compared to cyclical sectors as the excitement around the recovery phase of the markets rises. Additionally, with three companies (Couche-Tard, Loblaw, George Weston) dominating over 70% of the sector, their specific headwinds or tailwinds could meaningfully impact overall sector performance.

Utilities (Market Weight): The ongoing rate-cutting cycle is good news for the capital-intensive utilities sector. Utility company dividends are also becoming more attractive as government bond yields fall. While utilities saw a notable rally in the third quarter of 2024 due to renewed recession fears, if markets look ahead of the economy, it could put pressure on this rally as market excitement shifts to cyclical sectors again. Nonetheless, we see long-term opportunities in utilities linked to the clean energy trend and increasing electricity demand.

Consumer Discretionary (Market Weight): Within the context of a still weakening (but not crashing) economic environment in Canada, we remain cautious on discretionary consumer spending, although this sector in Canada is weighted towards fast food and dollar stores, followed by auto manufacturing, then clothing and general retail. So, there are a mix of companies with vastly different reliance on international markets and industry segments, making this sector somewhat more resilient.

Communication Services (Underweight): Lowering interest rates helped communication services companies make some gains in 3Q24, as they can gradually deleverage due to their capital-intensive nature. Their attractive dividends will also gain appeal as bond yields fall. The competitive landscape has somewhat stabilized following significant mergers and acquisitions, yet competition remains a concern. This intense rivalry has resulted in reduced pricing power and, consequently, weaker revenue. Additionally, in Canada's concentrated market, gains by one player often come at the expense of another, leading to only modest growth in net new users. Unlike in the U.S., Canada's lack of media and entertainment companies somewhat limits the sector's potential A.I. benefits.

Real Estate (Market Weight): Declining interest rates is certainly a tailwind to the real estate sector. Our cautious enthusiasm results from the dynamics between various segments of this sector. We have noted multiple times that Canada is in the midst of a housing crisis, which should make residential investments a relative bright spot, but commercial properties can be impacted by consumer shopping habits, office properties are still in flux as companies continue to balance floor space requirements with work-from-home policies, and industrial properties can be impacted by ever shifting trade outlooks and overall economic growth.

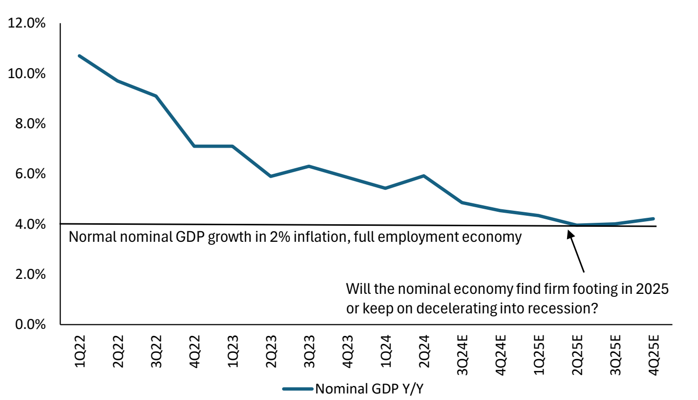
U.S. Equities

Tavis McCourt, CFA - U.S. Institutional Equity Strategist

Q3 was a mixed quarter for U.S. equities, with most indexes up single digits with a bias in performance to smaller cap equities and value equities doing a bit better, essentially reversing the Q2 trend a bit. The big picture is that U.S. equity markets have become more volatile since March, trading sideways, or maybe a slight upward bias, but with at least four distinct and meaningful pullbacks in the last six months. Of note, in Q3, performance was driven by decidedly defensive/interest rate sensitive sectors, with real estate and utilities posting double-digit returns.

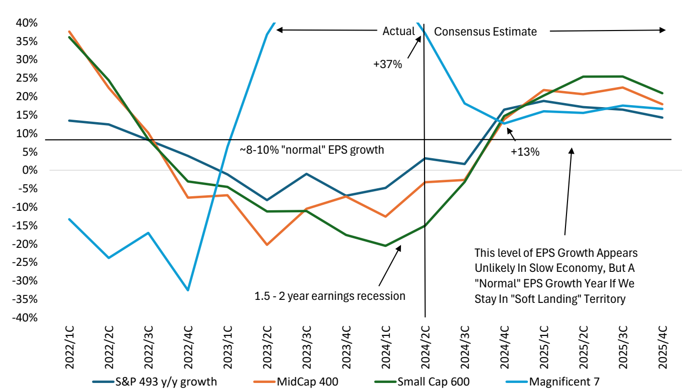
Equities have increasingly been pricing in a "soft landing" in the U.S. economy since the rally that started in October of last year, although the market is clearly acting as if it's a little concerned of a more severe slowing is upon us, as more defensive/interest rate sensitive sectors have started to meaningfully outperform in 3Q24. Economically in Q3, it appears as if the economy is continuing to decelerate, as is inflation, which has led to a meaningful decrease in long term interest rates in Q3, with the Federal Reserve starting to lower short term rates in September by a surprise 50 bps. The degree to which the economy stops its slowing and stabilizes at ~2% real growth and ~2% inflation as the Fed lowers rates will determine whether we have a "soft landing" or ultimately slip into a recession, with corporate earnings not recovering as broadly priced into equities today (see consensus 2025E EPS growth below).

Chart 8 - Raymond James Economic Forecasts 2022-2025 - We've Slowed To "Normal", Now What?



Source: Raymond James Economic, Raymond James Research

Chart 9 - Consensus Quarterly Y/Y EPS Large, Mid, Small And "Magnificent 7"



Source: St. Louise Federal Reserve, Costar, Raymond James Research.

Our overall views of 2024 are that inflation will continue to progress lower, long term rates will come down (3.5-4.0 per cent 10-Year Treasury by year-end, although to be fair, we have already reached that level), and that U.S. equities will be somewhat flattish from current levels (but potentially with some rotation between big tech and other sectors), and volatile, which is essentially what has been occurring since March. Earnings trends are improving for broader equities after ~1.5 years of modest Y/Y declines, while for the Mag 7 tech stocks are seeing Y/Y EPS normalize back down to a more sustainable ~15-20% range. As we look into next year, we would expect EPS to turn positive for most equities, although likely single digit growth rather than the ~20% growth the consensus expects.

Assuming the Fed can execute a series of rate cuts with inflation remaining subdued and economic growth remaining positive, we would expect modestly positive equity returns over the next 12-18 months as the U.S. economy enters the rate cutting phase of the economic cycle ("late cycle"). If the economy slips into a mild recession during this process, we would likely see some short term weakness in equities (and further gains for bonds). At this point, the "soft landing" scenario appears a little more likely now than the "recession" scenario, but both outcomes are real potentials over the next 12-18 months. In either case, we suspect the recent volatility experienced by the equity market will continue until the market becomes more convinced that the threat of recession near term is behind us.

Technical Analysis

Javed Mirza, CMT, CFA - Quantitative/Technical Analyst; Majd Hijazi - Equity Research Associate - Quantitative/Technical

Summary

Looking Forward: **Our technical work suggests that equity markets are in the process of transitioning into Phase 3 of the Market Cycle Model (see Exhibit 5), which supports adding Resource exposure. Phase 3 is the "exciting end" of a 4-Year Cycle (3-5 year cyclical equity bull market) and should be coincident with a rotation out of prior leadership in the more growth-oriented areas of the market (i.e. Information Technology) and into the more value-oriented plays (i.e. Energy and Basic Materials, see Exhibit 5).** We highlight Energy and Lumber as candidates to add exposure to for rallies from Q4 2024 – Q1 2025 (see Tactical Ideas below).

In our 2024 Outlook, we noted that equity markets appeared to be shifting into Phase 2 of a new 4-Year Cycle (see 2024 Technical Outlook – Trust The Process - HFL Cycle Supports Upside Though 2025, January 4, 2024). As a result, the bulk of our Best Ideas for 2024 were positioned for Phase 2 of the Market Cycle Model, also known as the "boring middle". Phase 2 is when the economy is showing signs of strengthening and leadership is typically in Information Technology, Industrials, and Basic Materials.

Our longer-term cycle work suggests a new 4-Year Cycle (3-5 year cyclical bull market) began at the October 13, 2022 price lows and has upside, by time, into H2 2025/H1 2026. We are calling this new 4-Year Cycle the ***H***igher ***F***or ***L***onger (***HFL***) cycle as our technical work strongly suggests this cycle has ushered in a long-term secular shift to higher yields.

Our longer-term cycle work supports a 2024 year-end target of 5,466 or 14.6% upside from the December 29, 2023 close. Our longer-term cycle work supported a 2023 target for the S&P 500 of 4,864 or 27% upside from the December 2022 close. The S&P 500 closed out 2023 near 4,770, for a yearly gain of 24%.

Tactical Ideas – Q4 2024:

- *Seasonal Softness Offers Attractive Entry Point Into Energy* – **"Smart Money" is positioned AT levels consistent with prior intermediate-term (3-6 month) rally phases on WTI Crude. This suggests softness in Q4 is an opportunity to position for a rally in Energy, and by extension Energy equities for the period of seasonal strength in Q1, 2025 (see Exhibit 11)**. This is reinforced by our view of a pending shift into Phase 3 of the Market Cycle Model.
- *Summer Buy For Halloween, Sell At The Superbowl* – **The strengthening technical profile of Lumber in conjunction with strong seasonality through Q4 (see Exhibit 13), supports adding exposure.** Materials is one of our favoured sectors for Phases 2 and 3 of the Market Cycle Model and the combination of improving technicals and positive seasonality offer a compelling technical setup.

Raymond James clients can refer to Javed's regular weekly reports for more details and insights into his charts and models.

Exhibit 1 - U.S. 10-Year Treasure Yield – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

Exhibit 2 - U.S. Dollar – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

A new long-term uptrend is in place in U.S. 10-Year Yields. Since 2011, the U.S. Dollar has been in a secular uptrend, coincident with the secular bull market in equities. Ongoing strength in Yields has been a tailwind for the U.S. Dollar. However, our Market Cycle Model work suggests a sideways consolidation is in store for the U.S. 10-Year for 2024 (see black box in Exhibit 1), which should see the U.S. Dollar move sideways as well (see black box in Exhibit 2).

Our longer-term view has been that the Federal Reserve will attempt to increase interest rates during the life of this secular bull market in equities, which should be a tailwind for the U.S. Dollar. A pause in the current Federal Reserve hiking cycle should see the U.S. Dollar remain in a choppy sideways trading range for the bulk of 2024, bounded by 107.50 to the upside and 97.50 to the downside. Our longer-term technical work suggests that the next Federal Reserve hiking cycle could begin as early as H2 2025 / H1 2026, as a strong economy brings back the specter of rampant inflation.

Exhibit 3 - S&P 500 – 20 Years – Monthly

Source: StockCharts.com, Raymond James Ltd.

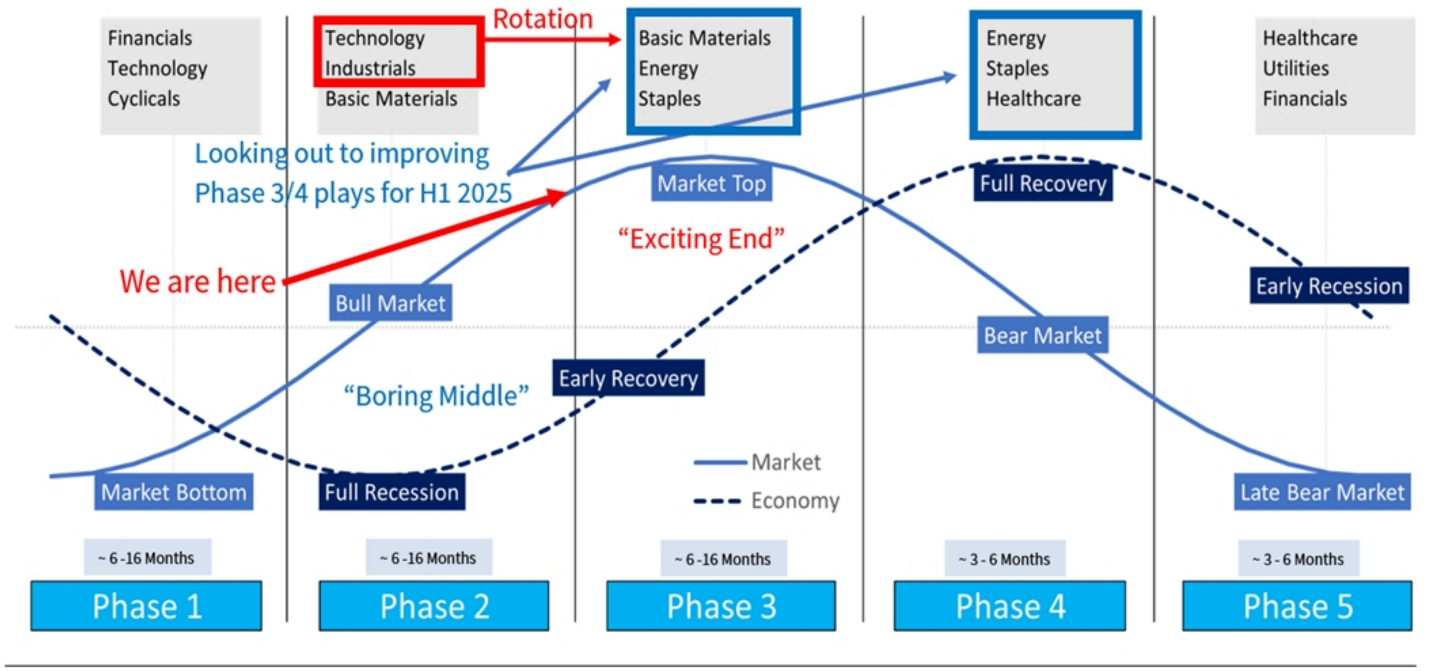
Exhibit 4 - CRB Commodity Index – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

Equities are almost two years into a new 4-Year Cycle (cyclical bull market), after a 4-Year Cycle reset (cyclical bear market) took hold in 2022 (see green shaded box in Exhibit 3). Commodities have broken out of the downward sloping trend channel which has defined the bear market that began in 2009 (red arrows with dotted line).

The CRB Index is showing signs of strength, consistent with the shift into the "boring middle" of a new 4-Year Cycle, as demand for Commodities begins to increase (Exhibit 4). Basic Materials should perform well in 2024 as our longer-term cycle work suggests the recent equity market correction from July – October 2023 marked a transition from Phase 1 to Phase 2 of the Market Cycle Model. In late 2024 equity markets should begin to transition into Phase 3 (the market top) which should see Energy begin to outperform. A shift into Phase 3 of the Market Cycle Model should be the catalyst that sees Commodities reaccelerate in 2025 as Phase 3 is when the economy is firing on all cylinders. This should be supportive of strength in both Basic Materials and Energy. Broad strength in Commodities will also be the catalyst that sees the Federal Reserve begin its next rate hiking regimen to fight inflation and cool down the economy.

Exhibit 5 - Market Cycle Model – Rotation Out Of Technology And Industrials Would Signal Shift Into Phase 3



Source: FactSet, Raymond James Ltd.

Our longer-term technical work suggests a new 4-Year Cycle (3-5 year cyclical bull market) began on October 13th, 2022. We are calling this cycle the ***H**igher* ***F**or* ***L**onger* cycle, or ***HFL*** cycle. This is within the context of a secular bull market in equities that began in 2011 and has upside, by time, into ~2030.

In our view, the intermediate-term (1-3 month) corrective phase in equity markets from August 2023 – October 2023 marked the transition from Phase 1 into Phase 2 of the Market Cycle Model (see We are here in Exhibit 5).

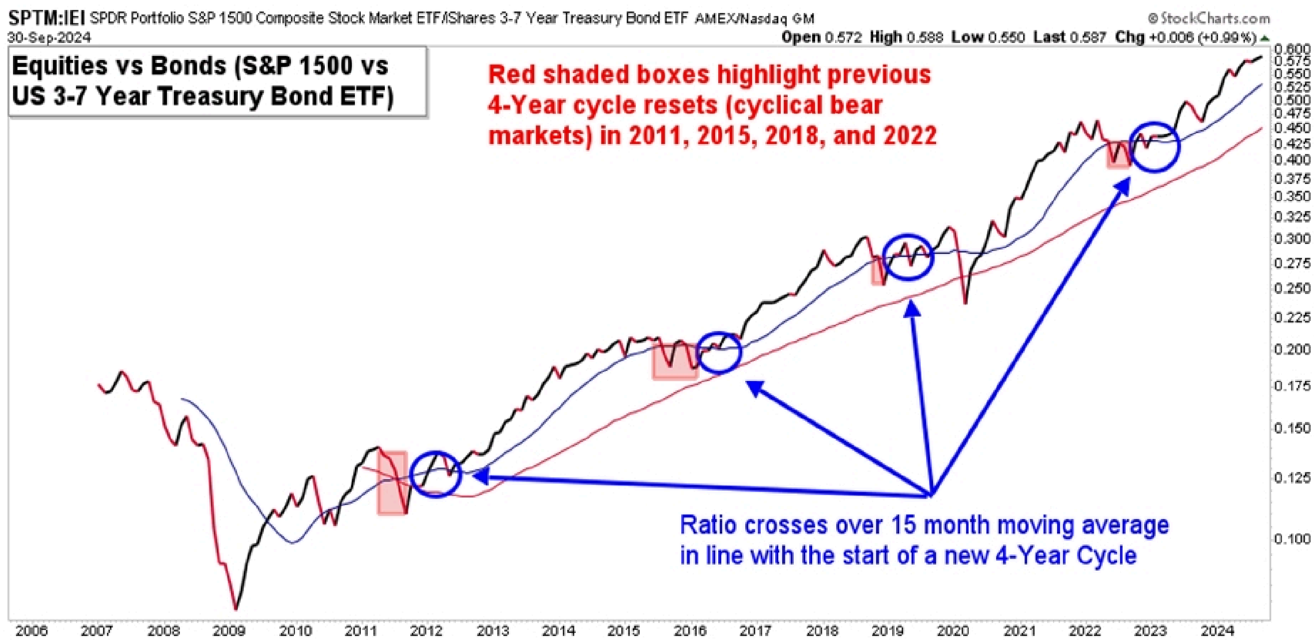
Phase 2 of the Market Cycle Model is when the underlying economy shows signs of strengthening (see blue dotted line) and is typically supportive of outperformance by Information Technology, Industrials, and Basic Materials (see blue box). In addition, our technical work suggests that Financial Services and Real Estate are likely to see a "catch-up" trade take hold. A strengthening economic backdrop should remain a strong tailwind for all these sectors through 2024.

Ongoing rotation away from Information Technology and into Basic Materials, Energy, and Staples (see red/blue arrow and red/blue box) would be consistent with a transition from Phase 2 to Phase 3 and would mark a shift towards the "Exciting End" of the ongoing *HFL* cycle.

Important Ratios

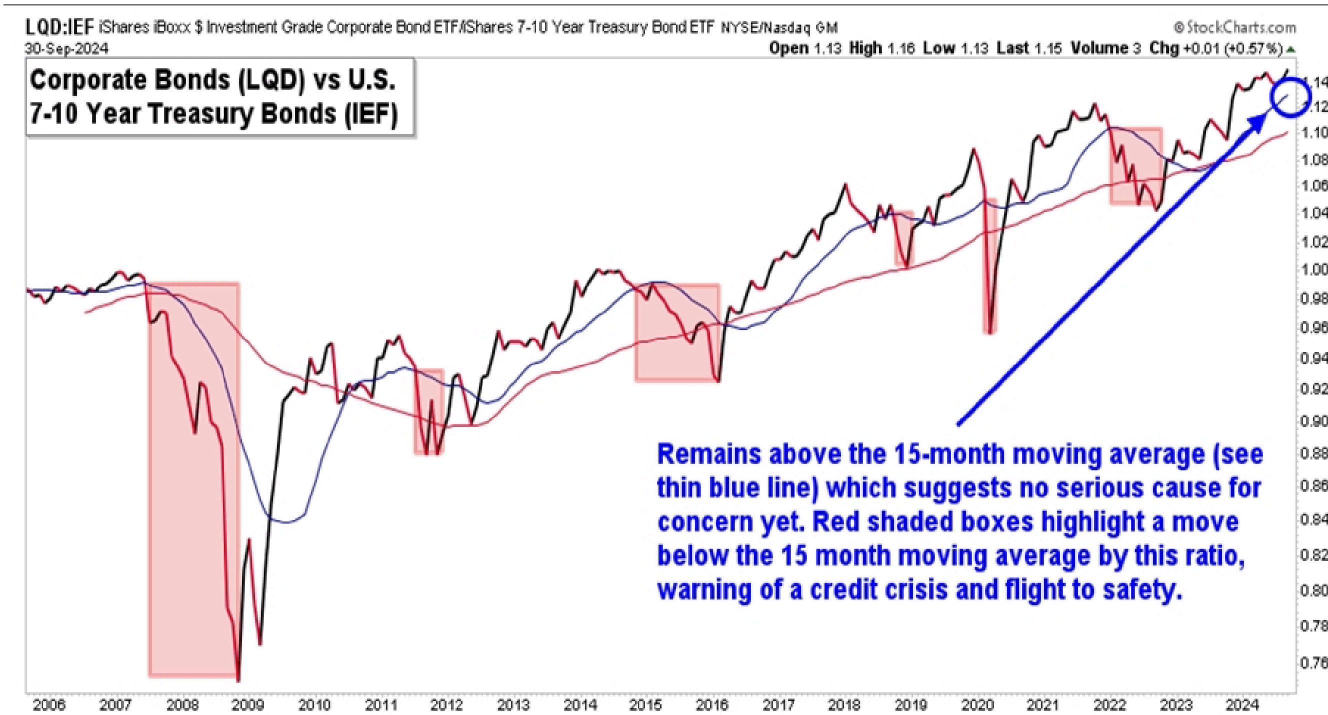
The ratio of Equities/Bonds (see Exhibit 6) and Corporate Bonds/U.S. Treasuries (see Exhibit 7) remains supportive of "risk-on" and further upside in equity markets. The ratios of Equities (S&P 1500, SPTM) / Bonds (U.S. 3-7 Year Treasury Bond, IEI) and Investment Grade Corporate Bonds (LQD) / 7-10 year Treasury Bonds (IEF) remain above their rising 15-month moving averages. This confirms the path of least resistance is up and remains supportive of "risk-on". A deterioration in these ratios would be an early cause for concern. A monthly close by these ratios below their respective 15-month moving averages would strongly suggest a 4-Year cycle reset (cyclical bear market) was taking hold.

Exhibit 6 - Equities vs Bonds Ratio – 20 Years – Monthly



Source: StockCharts.com, Raymond James Ltd.

Exhibit 7 - Investment Grade Corporate vs Treasury Bonds Ratio – 20 Years – Monthly



Source: StockCharts.com, Raymond James Ltd.

The ratios of Gold/S&P 500 (GLD, S&P 500, see Exhibit 8) and Mega Cap Growth stocks / S&P 500 Equally Weighted Index (MGK, RSP, see Exhibit 9) are showing signs of a potential trend change. Both ratios are testing key technical levels at their 4-Year and 40-week moving averages, respectively. A multi-month close above the 4-Year moving average by Gold versus the S&P 500 would indicate a transition towards Hard Assets and away from Paper Assets was underway. A multi-week close below the 40-week moving average by **MGK** versus **RSP** would support a transition to Phase 3 of the Market Cycle Model and would strongly suggest that the peaking phase of the ongoing HFL cycle was developing.

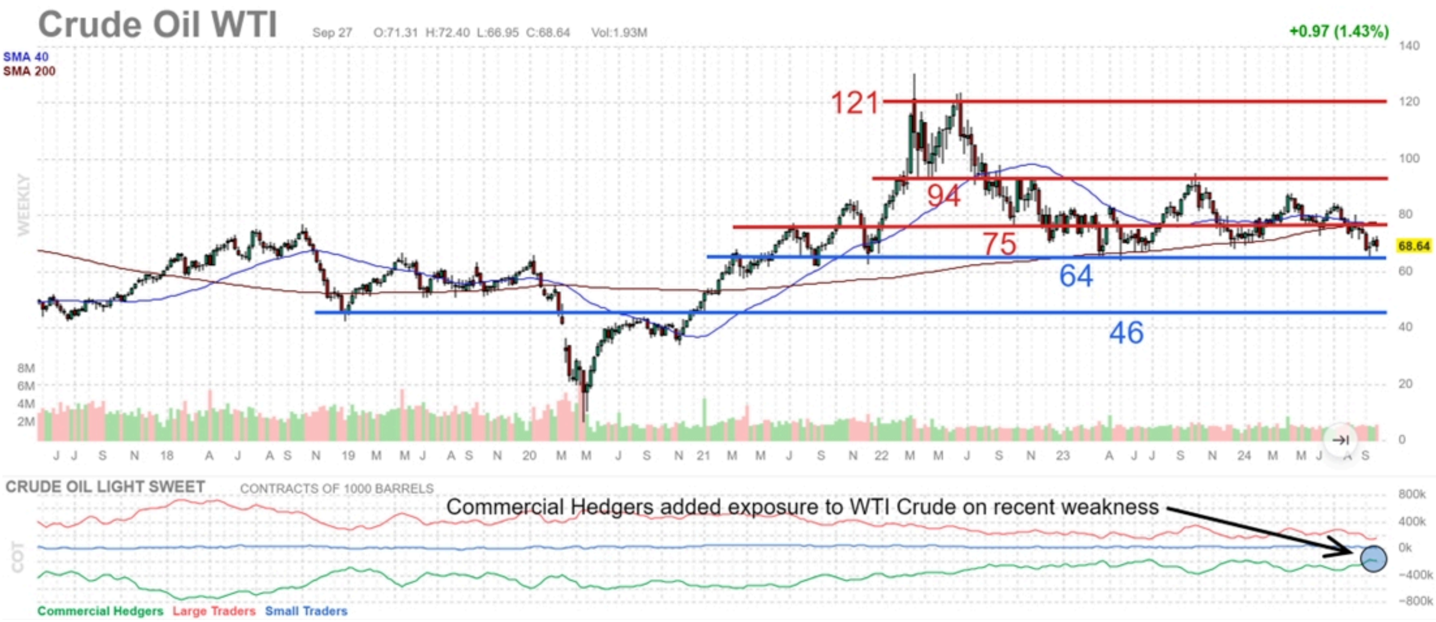
Exhibit 8 - Gold vs S&P 500 Ratio – 20 Years – Monthly

Source: StockCharts.com, Raymond James Ltd.

Exhibit 9 - Mega Cap Growth vs S&P 500 Equal Weight – 10 Years – Weekly

Source: StockCharts.com, Raymond James Ltd.

Exhibit 10 - WTI Crude Commercial Hedger – Weekly (5 Years) – Compelling Reward/Risk Ratio – Smart Money Long At Important Support



Source: FinViz, Raymond James Ltd.

Top Panel (Exhibit 10): Price: **An intermediate-term (1-3 month) corrective phase is underway on WTI Crude.** The move by WTI Crude below an important technical level near previous support ~ 75 (see red line) opens the door for a test of important support near 64.

Major support is near 46 (see blue line). First resistance is near 75. Important resistance is near 94 (see red lines).

Bottom Panel (Exhibit 10): Commitment of Trader Positions: **Commercial Hedgers continue to add exposure to WTI Crude on recent weakness. They are now positioned AT levels consistent with prior intermediate-term (3-6 month) rally phases, a technical positive (see blue circle, thin green line).**

Exhibit 11 - The Energy Select Sector SPDR Fund (XLE) - Seasonality – 19 Years – Monthly

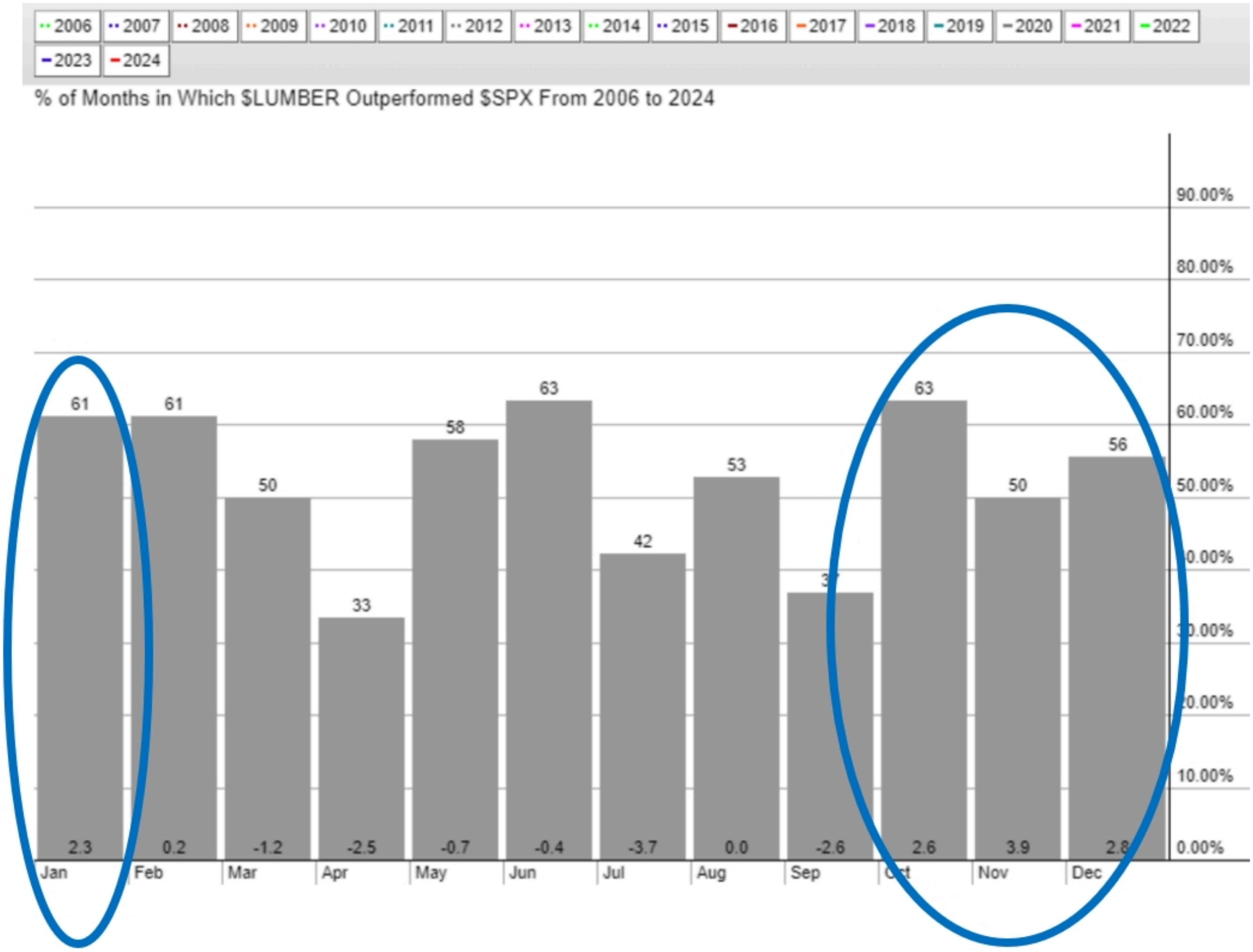
Source: StockCharts.com, Raymond James Ltd.

Weakness through November and December (see red circle) offers investors an attractive entry point for the Energy Select Sector SPDR Fund (XLE) into the seasonally strong period from January to April (see blue circle).

Historically, the **XLE** sees an average outperformance versus the S&P 500 of 1.4% in January, 1.2% in February, underperforms by -0.6% in March, then outperforms again in April by 2.4%.

The **XLE** outperforms the S&P 500 only 45% of the time in January and February. However, it manages to outperform the S&P 500 55% of the time in March, and 65% of the time in April. Weakness through November and December should offer an attractive longer-term entry point into Energy stocks.

Exhibit 12 - Lumber – Seasonality - 18 Years – Monthly



Source: StockCharts.com, Raymond James Ltd.

Lumber Outperforms the S&P 500 from October to January (see blue circles) which supports adding exposure at current levels. Historically, weakness in September offers an attractive entry point to a seasonal rally that lasts from October to January.

Historically, **Lumber** sees an average outperformance versus the S&P 500 of 2.6% in October, 3.9% in November, 2.8% in December, and 2.3% in January.

Lumber outperforms the S&P 500 63% of the time in October, 50% of the time in November, 56% of the time in December, and 61% of the time in January.

Canadian Fixed Income

Charlotte Jakubowicz, CMT, CIM - VP, Fixed Income and Currencies

The U.S. Federal Reserve joined the rate-cutting party in September, reducing the Fed Funds rate by an outsized 50 basis points. Though the decision was driven by economic conditions within the United States, we expanded on its implications to Canada in the October Insights & Strategies, noting, **“**Interest rates have numerous effects in the country in which they are amended, but beyond borders as well. The lower U.S. overnight rate should be encouraging for Canada’s central bank as a much-discussed concern was the maximum interest rate difference permissible between the two countries. When rates are not held in a suitable band, exchange rates may pay the price, causing goods to be more/less competitive internationally. Since maintaining a balanced exchange rate is crucial for sustaining competitive pricing and supporting the export market, we must observe not just Canada’s benchmark interest rate alone, but in relation to its key trading partners. The removal of this headwind, in addition to Canadian inflation improving and staying within the target range of 1-3%, should provide the BoC the room to continue with rate cuts.”

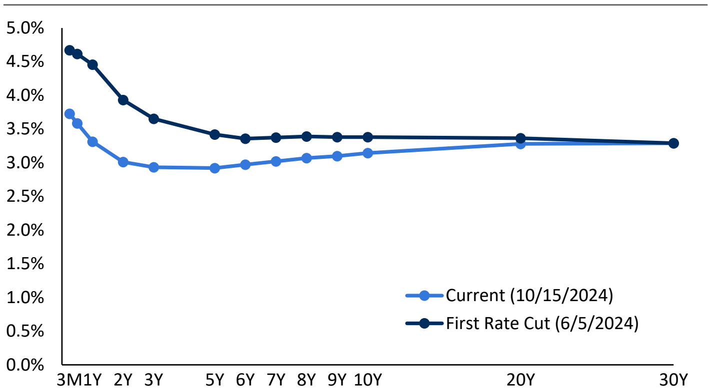
Our outlook for interest rate direction remains the same from the previous quarter, as we still anticipate that the BoC will continue with rate cuts well into 2025 as long as economic conditions are supportive. However, we must accept that conditions have changed and thus so should our estimates. Canadian economic factors continue to remain supportive of further easing and breathing room introduced by the Fed’s start of rate cuts appear to help justify more reductions than we thought previously for this calendar year. Looking out further, current consensus is to arrive at a 2.5% overnight rate in a year’s time, indicating an additional seven 25 bp rate cuts from here.

We also note that Canada’s unemployment rate continues to increase, hitting 6.6% in August 2024, the highest since October 2021. This can be explained, in large part, by the incredible growth in the labour force, which has increased at a much higher rate than new jobs. However a greater concern is youth unemployment which is disproportionally high. Despite the issues that may be present in Canadian jobs numbers, the Bank of Canada has a single mandate that solely prioritizes price stability and keeping inflation in the target range of 1% to 3%, meaning unemployment must always be framed with this lens. This is in contrast to other central banks like the Fed that have a dual mandate - maximum employment (achieve the highest level of employment without causing inflation) and stable prices (maintain low and stable inflation over the long term).

The yield curve has moved lower over the past quarter, but not in a linear fashion. The biggest changes were seen towards the middle of the curve, from one year to four, as this section would be baking in immediate changes to overnight rates, while also discounting longer-term market expectations as well. We remind investors that despite the retracement, yields remain significantly higher than years past. In fact, we must go back to 2011 (or earlier) to find similar investable bond rates. This underlines that there remain opportunities to both receive higher yields to maturity, while potentially benefitting from further reductions in rates (by way of increased bond prices).

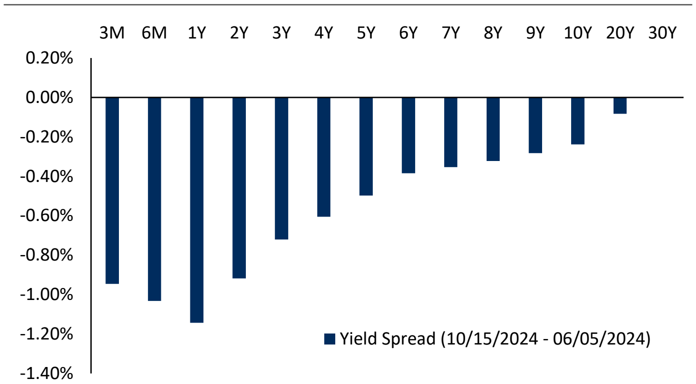
At the risk of sounding like a broken record, we recommended that investors extend duration / term to maturity longer, targeting five to ten years. If purchasing to one target does not best serve you, investors could consider adopting a laddered approach, gradually extending the term, and reinvesting as issues mature.

Chart 10 - Canada Sovereign Curve



Source: Bloomberg; Raymond James Ltd.

Chart 11 - Canada Sovereign Curve Spread (Current - First Rate Cut)



Source: Bloomberg; Raymond James Ltd.

U.S. Fixed Income

Douglas Drabik, CFA, CMT - Senior Retail Fixed Income Strategist

Fixed income strategy and output have changed very little from the previous quarter. However, the much-talked-about monetary policy change has commenced. U.S. Federal Reserve (Fed) chairman Jerome Powell and the Federal Open Market Committee (FOMC) cut the Fed Funds rate by 50 basis points on September 18th.

The Treasury yield curve has been inverted for an unusually long time span. Based on the last five Treasury curve inversion peaks (when the 3-month yield exceeds the 10-year yield the most), the average time it takes before the curve becomes positively sloped is around two months. Today's Treasury curve inversion is nearing two years in length and is already 17 months past its peak. This extraordinarily prolonged inversion can be interpreted as an economic misalignment. Or is it a misjudgment?

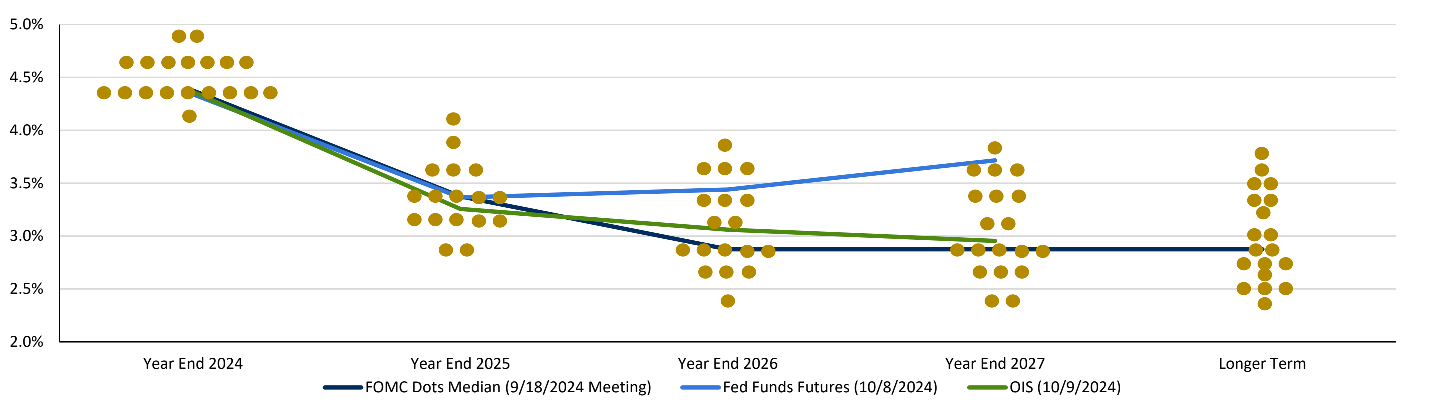
The U.S. economy has delivered since the 2008-2009 Great Recession. The gross domestic product which measures the final market value of all goods and services produced, has generated an average GDP of 2.1%, tagging over 3% GDP in 30% of the reports. It took the 2020 world pandemic (COVID-19) to slow the economy putting the U.S. in a short-lived 2-month recession. In full disclosure, a tremendous level of government intervention was appropriated to keep the recession at bay and ensure consumers engaged in the economy. The recovery was quick, but a price was paid – inflation.

This brings us to the present-day Fed dilemma. The economic stimulus and unintended personal savings accumulated during COVID have provided the consumer with an arsenal of cash to spend and consequently, it has elevated economic activity and potentially prolonged this economic cycle. This simultaneously created an inflationary spiral. One of the Fed's mandates is price stability. As prices peaked in June 2022, the Fed aggressively combatted rising inflation with 525 basis points in hikes over a 16-month period. The Fed kept this tight monetary policy for another 14 months, and it seems to have worked. Inflation has fallen more than 50% from its peak. Core Personal Consumption Expenditure (PCE), the Fed's favored measure of inflation, has fallen to 2.62% from its February 2022 peak of 5.57%. However, its goal is 2% and inflation, as measured by Core PCE, sits 0.62% above that level.

The other Fed mandate is keeping employment at maximum capacity. The lingering period of inflation may be taking its toll. At first glance, it hasn't appeared to decelerate consumer spending enough to slow down the economy. However, the personal savings rate is now well below any long-term average or time span examined. At the same time, consumer debt is climbing at an alarming rate, breaking all-time highs month after month. Consumers appear to be maintaining their spending but on borrowed dollars. The Bureau of Labor Statistics measure of job openings in the economy (JOLT) has fallen in eight of the last 12 months reported and is off 37% from the peak job openings offered in March 2022. Once corporations start slowing their hiring, there is very little the Fed can do to reverse the trend. The Fed's most effective way to support the labor market is to keep the economy growing.

Although GDP has surprised economists with solid upside results, government debt as a percentage of GDP has risen to a record high of 128%. With government debt high, consumer debt high, job gains at the very least slowed, and personal savings low, there are plenty of red flags to pause. The Fed made its initial move with September's 50 bp rate cut. Historically, initial rate cuts and inverted curves moving to normal positive sloped curves precede recessions.

Chart 12 - Fed Dots Plot (9/18/2024 Meeting)



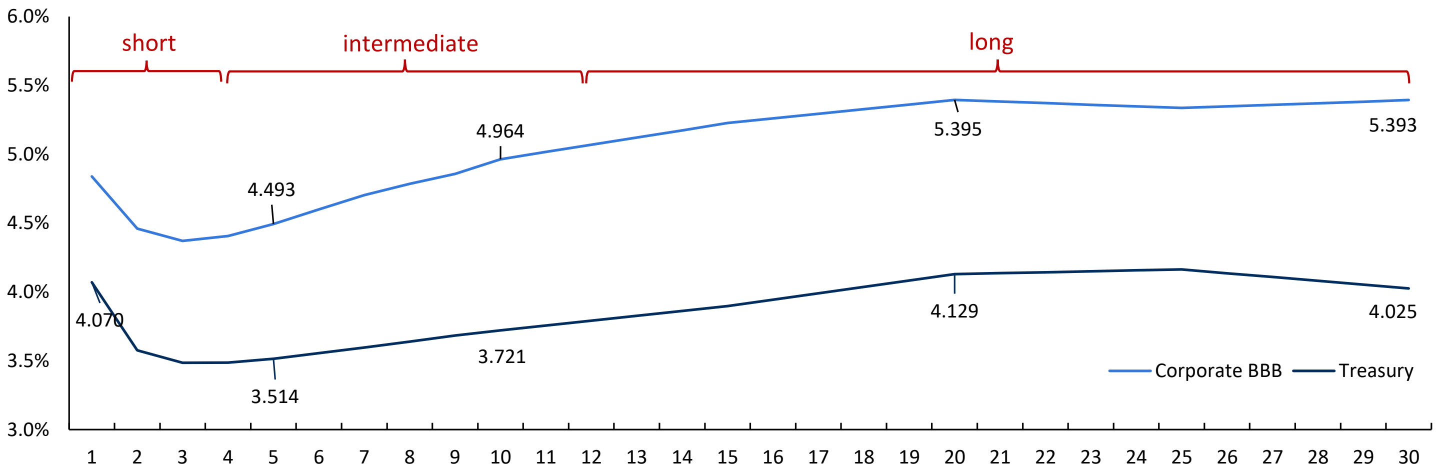
Source: Federal Reserve, Bloomberg.

All 19 Fed members are looking for future rate cuts. It is almost inevitable that Fed Fund cuts will bring down short-term Treasury interest rates. ICI reports that money market assets have swelled to over US$6.3 trillion. That is a lot of short money which has reaped the benefits of an inverted yield curve. How that money behaves as short-maturity yields begin to drop may impact all rates in general. Money earmarked for liquidity will likely stay short regardless of the overall interest rate environment. However, money designated to longer term wealth planning may eventually seek the higher rates associated with longer-term assets or even more speculative growth assets such as equities.

Volatility will likely be high as the various yield curves shift in shape while short term maturity yields expectedly drop. We believe a majority of the future monetary policy effects are built into the intermediate and long end of the curve. It is probable that there will be a disproportionate move throughout this part of the economic cycle. For example, during the month of August, the one and two-year Treasury rates fell nearly three times as much as the 10-year Treasury rate (34bps v 12bps). It may be a series of disproportionate rate moves that finally brings the Treasury curve to a normal upward slope.

With all of this in mind, investors can still lock into 4% or better yields for longer. Historically speaking, this is a coveted long-term return for a relatively safe asset often designated to preserving wealth. The ability to lock in income sets a solid base for fixed income allocations. High-quality, investment-grade corporate bonds continue to thrive in the short to intermediate range.

Chart 13 - Curve Comparisons



Source: Bloomberg LP, Raymond James; Data as of 9/18/2024.

Washington Policy

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Final Stretch Into the U.S. Election: What We're Watching

Since our last update, a series of unprecedented and historic events have completely shifted the candidates and dynamics of the race for the U.S. presidency and Congress – yet the key issues and likely market impacts of the race remain largely the same, following the entry of Vice President Kamala Harris as the Democratic challenger to former President Donald Trump. Despite a notable shift in sentiment and momentum behind Harris (compared to when President Joe Biden was the nominee) the race is likely to remain close in the final weeks before Election Day. Given this unpredictability, we caution against viewing individual incremental shifts in either direction (especially in polling) as clear evidence that either candidate is headed to victory. On the policy/market front, while both Trump and Harris have offered some additional insight into their respective agendas in the final stretch, key policy specifics still need to be filled – including monitoring who is selected for key roles in either administration. Control of Congress will also play a key role in the ability of either candidate to enact his or her agenda. Republicans have a clear advantage in the Senate and Democrats have a slight advantage in the House, but a sweep by either party remains a possibility – adding additional uncertainty to the 2025 agenda and market reaction. From now until November 5, we will be watching for a series of known factors (including longer-term momentum in polling trends and favorability statistics) and unknown factors—for example, whether the wave of momentum shifts behind either candidate heading into November, or whether the race definitively becomes framed as a referendum on either candidate.

How has the state of the race been upended? The biggest change in the race (aside from the nominees) has been the resurgence of momentum and enthusiasm within the Democratic base, compared to when President Biden was the nominee. While expectations of a 2020 rematch dominated much of the U.S. election conversation in the past year, we have consistently highlighted the possibility of unexpected events upending the race.

Those unexpected events have since occurred in spades, with the poor performance by President Joe Biden at the June presidential debate kicking off the series of events that led to his historic withdrawal from the Democratic nomination and Harris' rapid ascent to the top of the ticket. Harris' clinching of the nomination was met by a material uptick in Democratic voter enthusiasm—with likely down-ballot impacts—as well as fundraising dollars and polling numbers. This will be especially impactful in House races in New York and California, where there are eight Republican House members in races that are rated as "toss-up." While New York and California are unlikely to be competitive at the presidential level, higher turnout among Democrats could be decisive in these House races and potentially determine the outcome of the House majority.

How has the state of the race remained the same? To win the presidency, a candidate needs to secure 270 Electoral College votes, and the structure of the Electoral College favors Republicans. As in recent presidential elections, a small set of voters in a handful of swing states are likely to determine the outcome of the 2024 presidential election. Pennsylvania has emerged as a potential tipping state, with the candidate who wins Pennsylvania having the likeliest path towards the 270 Electoral College votes necessary to win the presidency.

A key metric we follow in presidential elections is favorability ratings – something we frequently highlighted as a significant warning sign of the reelection bid of President Biden. The favorability rating can be a proxy for an individual's willingness to vote for a candidate. In 2016 and 2020 each presidential candidate had a net-negative favorability rating, which led to a discussion on who can win votes, despite a negative view. We will be monitoring the favorable/unfavorable ratings of each candidate through the final stretch to see if it provides insight into who can win over a majority of undecided voters.

The market impacts of the range of electoral outcomes have also not changed on a fundamental level. We largely view Harris' policy platform as an extension of Biden's on key issues including trade (where we would expect a continuation of the current targeted tariff approach) and taxes, where we have seen calls to raise the corporate rate and potentially allow some (or all) of the individual provisions of the 2017 individual tax changes to expire. While we have received some additional clarity as to Harris' specific policy priorities with regards to the cost of living and taxation, the lack of a traditional nominating process has overall reduced the level of scrutiny of her platform and related need for policy details.

Recent calls from Trump for a 60% tariff on all Chinese goods and a 10-20% global tariff are a key example of a dynamic to consider when assessing the market impact of a potential second Trump term: these policy proposals should be taken seriously, but not literally. Our conversations with DC contacts reaffirm our expectation that while a Trump victory would likely bring changes on impactful policy areas including tax, immigration, tariffs, and geopolitics, the specifics are not set in stone—and will be heavily influenced by who is appointed to key roles. The changes in regulation would also be a notable change in a second Trump term compared to the Biden administration, with potential sentiment shifts for equities in heavily-regulated industries.

Arguments for and against each candidate. As we enter the final stretch of the 2024 election, the race between Harris and Trump remains highly competitive, and there are compelling arguments that either candidate could win. Arguments in favor of Trump include his strong base of support, the Republican advantage in the Electoral College, and historical polling misses that have underestimated his support. Conversely, there are concerns about stalled momentum, underwater favorability ratings and a 'low ceiling' (46% in 2016 and 47% in 2020) with voters in the previous elections.

For Harris, she has seen enthusiasm within the Democratic base, has achieved record-breaking fundraising numbers, has polling momentum compared to Biden's performance, and dramatically increased her favorability rating. However, we would also highlight the structural disadvantage for Democrats in the Electoral College, and previous polling misses overcounting Democratic support. Importantly, only one sitting vice president (George H.W. Bush in 1988) has been elected president in the last 188 years.

With weeks left until Election Day, both candidates are intensifying their efforts to sway undecided voters and energize their bases. In the remaining weeks and with the above arguments in mind, we are watching several key factors that could shape the final result of a very tight race, including how the race is framed in the media, performance in battleground states, polling, voter turnout, and campaign spending.

Battleground state electoral strategy. The election will likely be decided in seven key swing states: Arizona, Georgia, Michigan, Nevada, North Carolina, Pennsylvania, and Wisconsin. In addition to these seven states, swing districts in Nebraska and Maine, which award single Electoral College votes, will also receive significant attention. Increasingly, Pennsylvania is looking like the key state where a win for either side would make it very difficult for the other candidate to capture the 270 electoral college votes necessary to win the presidency. One important note about Pennsylvania is a law that forbids opening mail-in ballots until 7pm on Election Day. Like 2020, a close election in PA could take days to clearly identify a winner.

Polling data. We receive many questions about polls. While they can be a useful tool to get a general sense of the direction of a political contest, we recognize their limitations. In 2016, and again in 2020, public polls undercounted the final strength of Donald Trump at the national and swing state level. In 2016, polls under reported the final vote total for Donald Trump by 3.43% and 2.28% in the swing states. Polling errors can occur in either direction, with the 2012 election undercounting the strength of Barack Obama by 1.43%. The closer the final polling data, the greater the probability of another surprise on Election Day.

Market volatility around elections. As the election approaches, investors should be prepared for increased market volatility—typical in the lead-up to elections. We have seen periods of weakness when there is the greatest amount of uncertainty, especially when a sweep by either political party becomes increasingly likely. It is easier to provide narrower bands of policy outcomes when the election outcomes are known, especially when there is split government. When the House, Senate, and White House are all controlled by the same party, more policies become possible and outcomes become harder to predict.

That said, despite the current close race and potential for numerous factors to sway the outcome, it is crucial to maintain a long-term perspective. Historically, while preelection periods often experience heightened volatility, the first year of a new presidential term typically sees positive market returns, regardless of which party wins the White House.

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