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ECONOMIC COMMENTARY & OUTLOOK

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The Economy

Coming into 2023 and 2024, much of the talk on Bay and Wall Streets surrounded the potential for, and timing of, an upcoming recession. The general narrative for both years was that inflation and interest rates were too high and would suffocate consumer borrowing and spending, leading to a decline in growth. With the benefit of hindsight, we now know those pessimistic views were not correct as the global economy continued to expand at a healthy pace. A significant portion of this growth can be attributed to a buoyant U.S. economy supported by a resilient labour market that allowed for high levels of consumer spending.

Additionally, while there were some regional differences around the world, based on publicly available data, the overall rate of inflation decreased substantially almost everywhere during the last 12 months. This receding global inflation profile gave the most influential central banks the ability to ease their monetary policy stances, effectively removing some economic restrictions still in place from the inflation spike coming out of the global pandemic.

In Canada, the latest measure of total annual inflation fell back to below 2%, which is pretty much right at the Bank of Canada's (the BoC) target for inflation. This decline allowed the BoC to reduce its policy interest rate by 1.75% in the second half of the year in an attempt to breathe some life into the Canadian economy. This was the largest reduction by any of the major global central banks in 2024.

Impressively, the global economy remained resilient in the face of some serious challenges surrounding geopolitical and global trade relations, and that resilience translated into a very strong year for financial markets. We saw positive absolute returns in nearly every corner of the markets, with some above average performance generated from return-enhancing strategies like equities, corporate bonds, and preferred shares.

The mixture of still-positive growth, milder inflation, and monetary policy easing underpinned the strong returns across asset classes for 2024.

The Markets

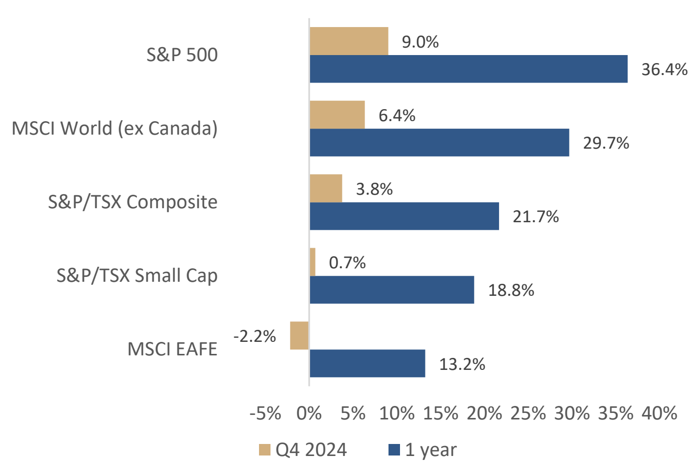
Equity Markets

It was a very strong year for equity markets globally. Even though we saw a little bit of volatility in the quarter compared with the full year, nearly every major equity index generated very strong absolute returns in 2024.

The leader of the pack was once again the U.S. equity markets where we witnessed some higher-than-average performance. For example, the S&P 500 Index returned 36% in Canadian dollars in 2024. What makes this performance even more extraordinary is that it followed a very strong 2023 where the same index returned over 23% in Canadian dollars.

Even though it wasn't quite as strong as its U.S. counterpart, Canada's S&P/TSX Composite Index also generated strong gains in 2024, mostly in the second half of the year, with the index hitting all-time highs during the final quarter of the year.

Equity Index Performance (CAD) at December 31, 2024



Source: FTSE Canada, MSCI, and Bloomberg

Outside North America, some political instabilities led to some regional divergence, but when viewed collectively, returns were still solid. The MSCI EAFE Index – capturing 21 developed markets in Europe, Australasia and the Far East – was up 13% in Canadian dollars in 2024 despite a soft fourth quarter. In the Asia-Pacific region, Chinese and Japanese equities put together a solid year while South Korean equities declined.

Fixed Income Markets

Canadian fixed income markets declined modestly in the quarter but generated positive absolute returns for the entire year. There was a divergence across the yield curve as shorter-term yields – five years and under - dropped, reacting mostly to the BoC's monetary policy changes. Longer-term yields – 10 years and over – rose, primarily influenced by increasing yields in other global fixed income markets, specifically the U.S. Treasury market. As with other return enhancing assets, Canadian corporate credit generated strong performance during the year as credit spreads tightened considerably in the second half of 2024.

Currency Markets

Reacting to resilient economic growth, the potential for less-than-previously expected rate cuts, and a new political environment, the U.S. dollar (USD) gained value in the quarter when viewed against many major global currencies. The U.S. Dollar Index (DXY), a measure of the value of the USD relative to a basket of U.S. trading partners' currencies, reclaimed some lost ground from earlier in the year to have a very strong quarter to end the full year on solid footing. The Canadian dollar (CAD) did not fare nearly as well, losing some significant ground against the USD in the quarter. This performance is a direct result of the mixed underlying Canadian fundamentals and major new uncertainty regarding potential U.S. tariffs which certainly clouds the trade outlook.

Outlook

We expect 2025 to be an interesting year for global economies and for financial markets as both will almost certainly be impacted by the incoming U.S. administration's policy decisions, including major trade actions.

We believe uncertainty and volatility will continue as we remain in a unique market environment where valuations of certain financial assets seem high while others appear more reasonable. While financial markets performed very strongly in 2024, and even though we expect to see positive absolute returns again in most financial assets in 2025, these returns will likely struggle to match the pace set in 2024.

Given the expected slower pace for returns coupled with ongoing uncertainty, some degree of caution is warranted, especially in parts of the financial markets where valuations appear to be extended.

DISCLOSURES

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