December 31 2024

Fourth Quarter Review and 2025 Outlook

NORTH AMERICAN EQUITY STRATEGY

The S&P500 and TSX moved higher heading into year end with the help of another decent earnings print for the third quarter and a decisive victory for Donald Trump and the Republican Party, only to be somewhat spoiled by the Federal Reserve's more cautious tone on further interest rate cuts in 2025. During the fourth quarter of 2024, the S&P500 total return was +2.41% in U.S. dollars. Adjusting for currency, the S&P500 returned +9.10% in Canadian dollars, as the Canadian dollar depreciated about 4.42 cents, closing the quarter at $0.6952. The TSX total return was +3.76% in the fourth quarter.

While the Federal Reserve lowered interest rates for the third time in December, it surprised markets with a relatively hawkish outlook in its Summary of Economic Projections (SEP, **Exhibit 1**). It removed two interest rate cuts in 2025 from its earlier September projection of four cuts and the committee looked unified with 14 of 19 members in favour of two or fewer rate cuts for all of 2025. As shown in **Exhibit 1,** the Fed raised expectations for real GDP and inflation for 2024 and 2025, while also lowering unemployment expectations. In the Fed press conference, the message seemed clear, with real GDP growth tracking around +3.0% in the third quarter of 2024, it would be taking it slower with respect to rate cuts to guard against the risk of undermining their progress on inflation.

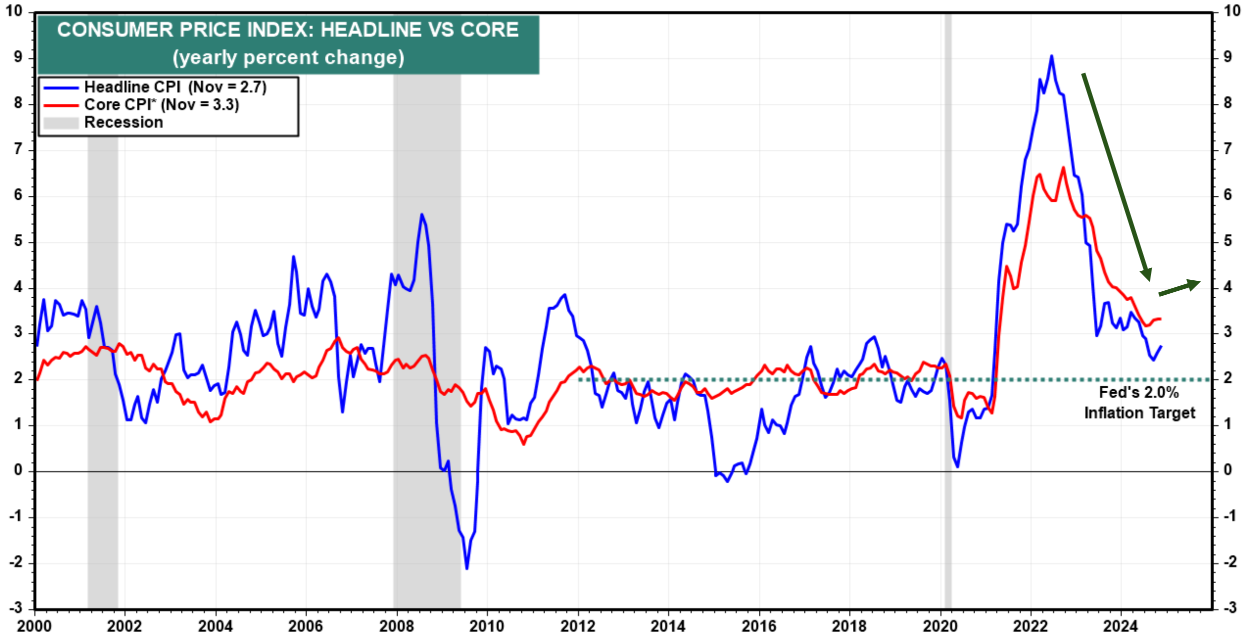
Exhibit 1: Summary of Economic Projections (SEP, Federal Reserve)

Variable [in %]	Median				
	2024	**2025**	**2026**	**2027**	**Longer Run**
Change in real GDP	2.5	2.1	2.0	1.9	1.8
September projection	2.0	2.0	2.0	2.0	1.8
Unemployment rate	4.2	4.3	4.3	4.3	4.2
September projection	4.4	4.4	4.3	4.2	4.2
PCE inflation	2.4	2.5	2.1	2.0	2.0
September projection	2.3	2.1	2.0	2.0	2.0
Core PCE inflation	2.8	2.5	2.2	2.0	
September projection	2.6	2.2	2.0	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	4.4	3.9	3.4	3.1	3.0
September projection	4.4	3.4	2.9	2.9	2.9

Source: Federal Reserve, Summary of Economic Projections, 12/18/24

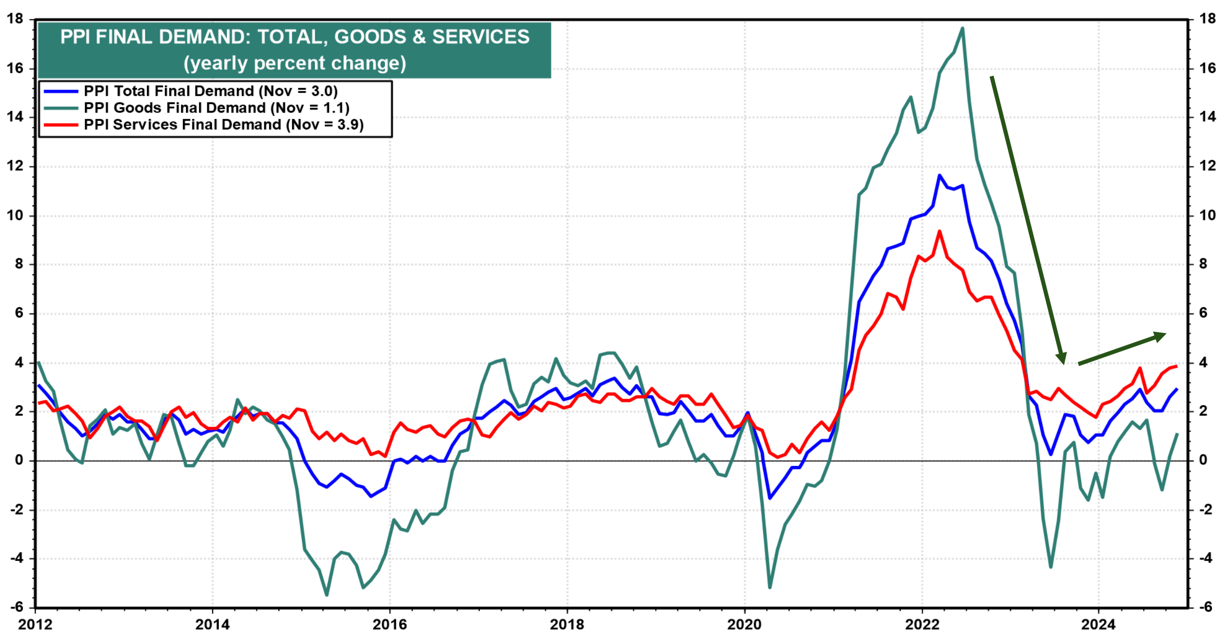
Exhibits 2 and 3 show the Consumer price index (CPI) and Producer Price Index (PPI) or wholesale inflation. Both have been coming down from lofty levels in 2022 and 2023, but recently have stalled or ticked slightly higher. There was also an acknowledgement by Federal Reserve Chairman Powell regarding fiscal policy under Trump 2.0 during the December press conference Q&A: *"some people (Federal Reserve board members) did take a very preliminary step and start to incorporate highly conditional estimates of economic effects of policies into their forecast at this meeting and said so in the meeting".* We are not surprised by the Fed's cautious approach, but they still cut interest rates by 100 basis points in 2024 and are continuing to project lower rates in 2025 and 2026. Two days after the Fed meeting, the Fed's preferred inflation measure, the Personal Consumption Expenditure (PCE) was released, and it came in lower than expected. So, in conclusion, while the data may be choppy, our bias is to accept the Fed's SEP projections and that rates will likely continue their trajectory lower in 2025, just not at the same pace seen in late 2024.

Exhibit 2: Consumer Price Index



Source: Yardeni Research

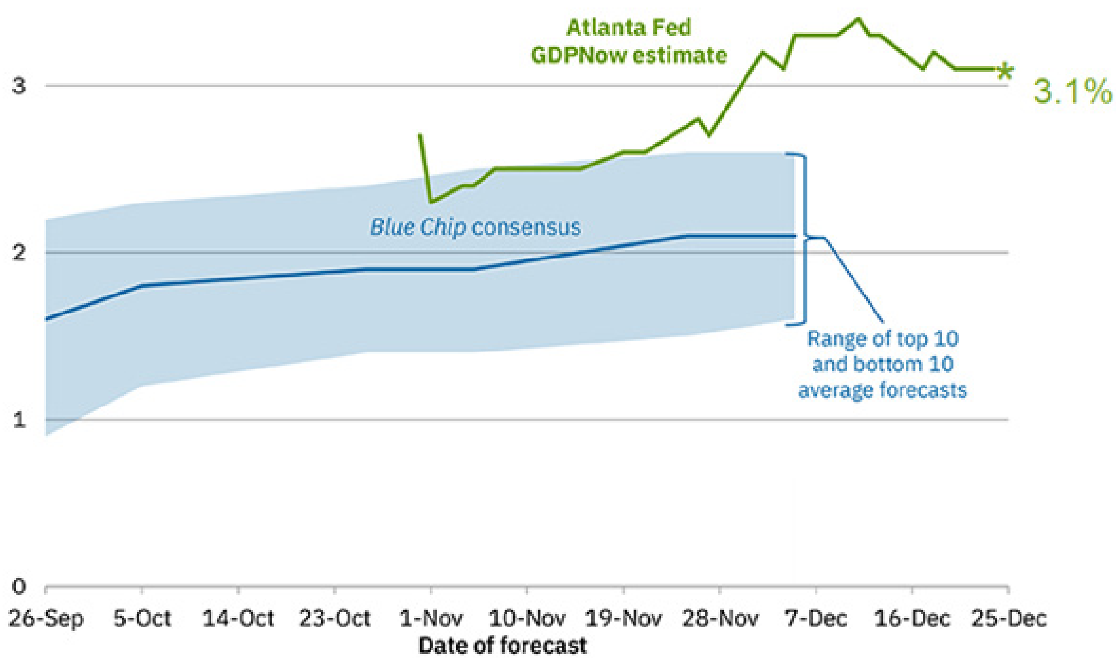
Exhibit 3: Producer Price Index



Source: Yardeni Research

As we mentioned above, the final read on third quarter US real GDP was quite strong, revised up to +3.1% from +2.8% a month ago and compares to +3% for the second quarter. **Exhibit 4** shows the Atlanta Fed's GDPNow forecast for the fourth quarter also estimated at +3.1%. Clearly, the US economy is performing well, even with higher rates. In Canada, October's latest read on real GDP was better than expected, coming in at a +1.9% annualized rate. After cutting interest rates by 50 basis points in both October and December, and a total of 175 basis points (or 1.75%) cut in 2024, the Bank of Canada is clearly focused on growth picking up in 2025.

Exhibit 4: GDPNow estimate of Q4 GDP [Quarterly percent change (SAAR)]



Source: Federal Reserve Bank of Atlanta, 12/24/2024

Exhibit 5 shows the outlook for calendar 2024, 2025 and 2026 earnings growth for the S&P500 along with the respective calendar forward price/earnings multiple (P/E). The S&P500 2025 P/E, shown in the top clip, has expanded from 19.6x (the equivalent 2024 P/E last year at this time) to 21.8x compared to its 10-year average of 18.4x. What gives us some comfort with this higher valuation is the one-month acceleration of 12M forward earnings growth of almost +1% for the S&P500 (and the TSX) that we noted in our December Asset Mix review, which we believe helps support the higher valuation. According to FactSet Earnings Insight, the third quarter earnings actual growth for the S&P500 was +5.9% exceeding market expectations of +4.2% from September 30th and fourth quarter growth estimates of 11.9% represent the highest estimates in three years and exceed the 10-year average earnings growth rate of +8.5%. The 2024, 2025 and 2026 calendar earnings growth estimates for the S&P500 also accelerated month over month.

Why is this important? It was well put by Ed Yardeni, one strategist we follow who said:

The key driver of the forward P/E is investors' perception of how much and for how long earnings can grow before the next recession depresses earnings and the valuation multiple. Economic growth drives earnings growth, and investors' expectations for both drive the forward P/E or the value the market will pay for that future earnings growth.

Take 2022 for example. There was much anxiety about an imminent recession as reflected by the -25.4% drop in the S&P500 from January to about mid-October. Over that period, industry analysts lowered their consensus expectations for calendar operating earnings per share of S&P500 companies for 2022 and 2023. The cuts at the time were modest but directionally lower. The Federal Reserve also raised interest rates seven times from essentially 0% to 4.5% in 2022, which was one of the most aggressive interest rate hiking cycles in history. The 12M forward P/E declined from 21.7x in January 2022, bottoming at 15.3x in October. That's about a -29.5% decline in the forward P/E versus the -25.4% decline in the market over the same period, implying that the 12M forward earnings expectations rose +5.8%. Nevertheless, the recession fears led to a multiple-driven bear market contraction.

This leads us to where we are now. The Fed has been cutting the Federal Funds rate since September 18, 2024. That should reduce the risk of a recession and increase the probability that the current economic expansion will continue. As discussed above, calendar earnings estimates for the S&P500 continue to increase for 2024, 2025 and 2026. In fact, the earnings growth rates for 2025 vs. 2024 and 2026 vs. 2025 are +12.2% and +11.9%, respectively, as shown in the top clip of **Exhibit 5**. If these tailwinds persist, current valuations may justifiably be where they should be.

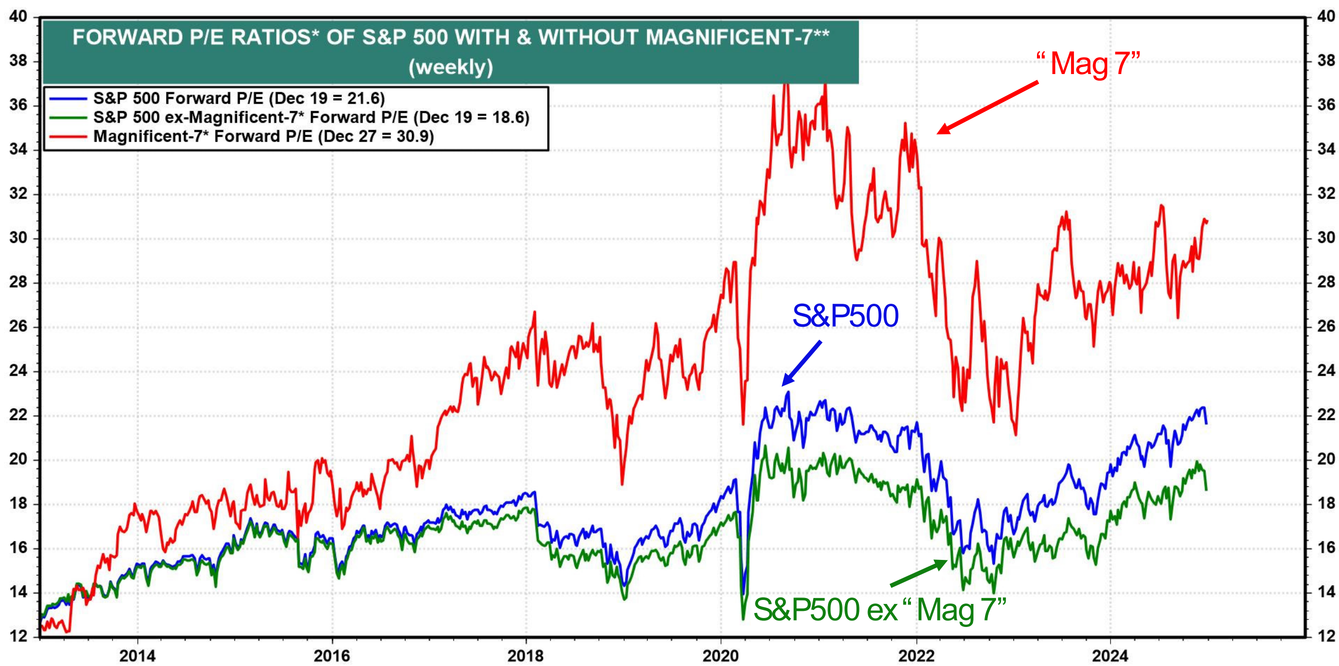
Exhibit 5: S&P500 Earnings Growth and Forward P/E's

S&P 500			
	EPS	EPS Growth	Forward P/E
24'E	$242.14		
25'E	$271.66	+12.2%	21.8
26'E	$303.94	+11.9%	19.5
10y Average*			18.4
Magnificent 7 ("Mag 7")			
	EPS	EPS Growth	Forward P/E
24'E	$709.7		
25'E	$821.16	+15.7%	32.4
26'E	$942.43	+14.8%	28.2
10y Average*			28.2
S&P493 (S&P500 ex. "Mag 7")			
	EPS	EPS Growth	Forward P/E
24'E	$97.79		
25'E	$108.97	+11.4%	19.4
26'E	$121.6	+11.6%	17.4
10y Average*			17.7

Source: Bloomberg, 12/23/24. S&P 500 (SPX Index), Mag 7 (BM7P Index), B500 ex Mag 7 (B500XM7P Index) using fiscal/calendar (FY) year estimates. *10 year average uses the blended forward 12 month (BF12) estimates

Exhibit 6 shows the 12-month forward P/E for the S&P500 (in blue) and separates out the Magnificent 7 stocks (Apple, Nvidia, Microsoft, Alphabet, Amazon.com, Meta Platforms, and Tesla or "Mag 7") 12-month forward P/E (in red) and the S&P493 (S&P500 excluding the "Mag 7") in green. The obvious conclusion is that the "Mag 7" P/E does skew up the overall P/E multiple for the index. Looking back to **Exhibit 5**, the bottom two clips break out the "Mag 7" and the S&P493 by earnings growth and forward P/E and compare them to their respective 10-year average historical P/E's. On 2025 earnings, the overall indices do look expensive relative to their 10-year averages; however, on 2026 earnings, the valuation multiples look more reasonable and given we are now in 2025, it's probably reasonable to start considering 2026 earnings given that markets are always forward looking. Even the "Mag 7" 2026 multiple of 28.2x is trading right in line with its long-term average of 28.2x.

Exhibit 6: Forward P/E for the S&P500, the S&P 500 with & without Magnificent 7 ("Mag 7")



Source: Yardeni Research

Exhibit 7 shows the outlook for calendar 2024, 2025 and 2026 earnings growth for the TSX along with the respective calendar forward P/E multiples. While we currently have a bias in our equity asset mix towards the U.S. given its stronger economic outlook and higher earnings growth expectations, we still hold just under 40% of our assets in high quality Canadian equities in the North American Capital Appreciation Strategy. As evident in the table below, the TSX is cheaper than the S&P500 as it still trades at a reasonable valuation level of 14.9x and 13.5x 2025 and 2026 earnings, respectively, which is below the 10-year average historical forward P/E of 15.1x. And the earnings growth expectations of +11.4% and +10.1% respectively, while not as high as the S&P500 (or MAG-7) are still forecasted in the double digits for 2025 and 2026.

Exhibit 7: TSX Earnings Growth and Forward P/E

S&P/TSX Composite Index [Canada]			
	EPS	**EPS Growth**	**Forward P/E**
24'E	$1,484.40		
25'E	$1,654.13	+11.4%	14.9
26'E	$1,821.49	+10.1%	13.5
10y Average*			15.1

Source: Bloomberg, 12/23/24. SPTSX Index using fiscal/calendar (FY) year estimates. *10 year average uses the blended forward 12 month (BF12) estimates.

Asset Allocation for our North American Equity Strategy As of December 31, 2024	
Equities	96 %
Fixed Income	0 %
Cash	4 %

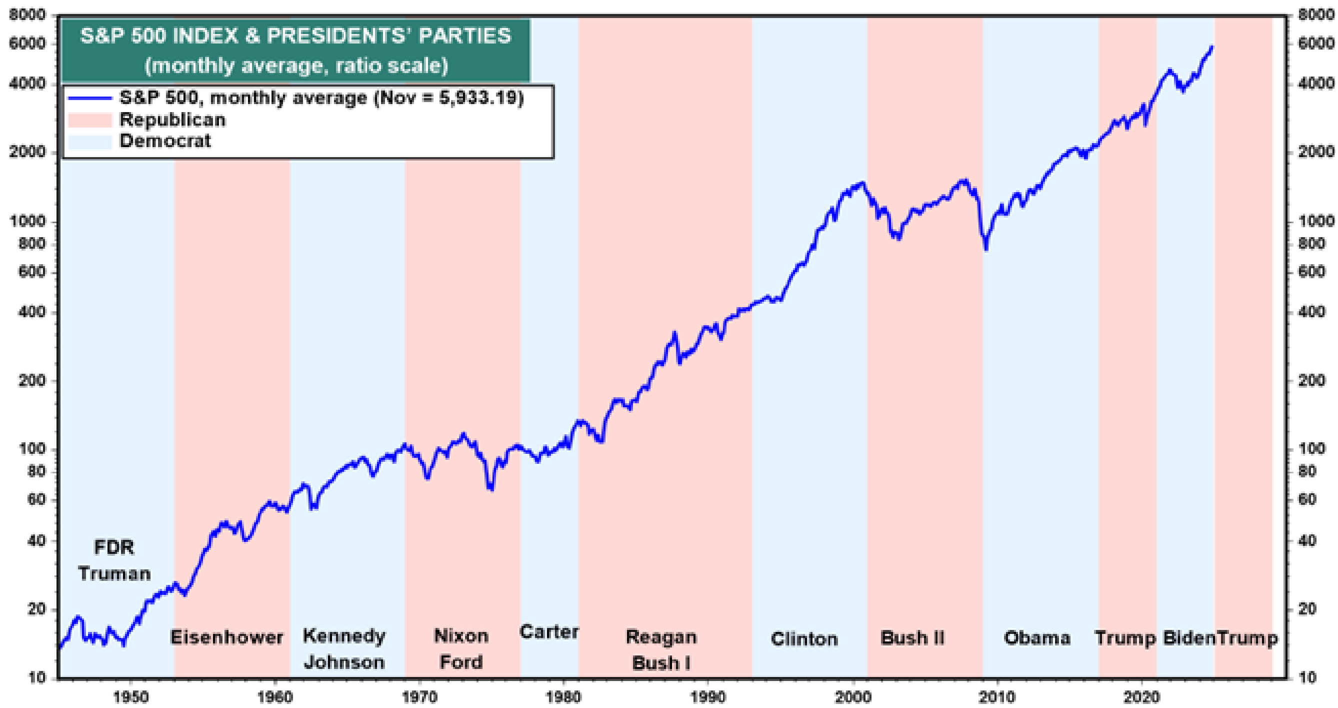
Our overall equity exposure decreased by 1% to 96% and cash increased marginally from 3% to 4%, respectively, since September 30th, 2024. Our U.S. equity exposure increased to 57%, up from 55% on September 30th while our Canadian equity exposure declined to 39% from 42% on September 30th. Compared to a year ago, our exposure in Canada has declined 9%, while our US exposure has increased 10%. It is important to note that many of our clients' portfolios are invested in our North American plus International Equity strategy, meaning that the actual weights of US and Canada within their equity holdings will be proportionately less than this given the approximately 20% allocation to international companies.

Over the past 12 months, we continued to shift our allocation in favour of US equities over Canadian equities and remained fully invested in equity to the extent that clients' individual limits allow. The US economy and earnings growth for the S&P500 continued to outpace the Canadian economy and earnings growth for the TSX so far in 2024, and this is estimated to continue in 2025 and 2026. Having said that, interest rates are declining faster here in Canada than in the US, which may mitigate the risk of a slowdown in Canada, as the Bank of Canada is clearly focused on trying to accelerate growth in 2025. It is worth noting that our Canadian companies have growing earnings, and many are globally diversified in terms of revenue sources despite having a Canadian headquarters.

Closing Comments and Outlook

There are a lot of "known unknowns" regarding fiscal policy under Trump 2.0 that could impact our market outlook. Both tax cuts, which could boost demand for goods and services, and tariffs may put upward pressure on inflation unless they are offset by a stronger US dollar. Deregulation, reductions in federal government spending and more energy production in the US may have the opposite effect, however as they can be viewed as disinflationary. It's easy to get bogged down in situations like this with multiple unknowns, but we like to go back to our chart in **Exhibit 8**, which shows that historically, regardless of whether the Republicans or Democrats are in the White house (or Mar-a-Lago), the S&P500 has continued to move higher over time.

Exhibit 8: S&P 500 Performance & Presidents' Parties



Source: Yardeni Research

In assessing our thoughts for 2025, we like to take a systematic and process-driven approach, similar to that of Ned Davis Research, which collectively looks at data since the 1950's, follows their models and changes strategy only when the indicators change, not when they think they might change in the future based on speculation. This data-driven approach has kept us in the market during the past two years despite broad-based investor concerns over Fed policy, economic growth, and "Mag 7"-dominated returns. The Ned Davis Research 2025 year-end target for the S&P500 is 6,600 or about +9% above current levels and is in line with the average return over the past 50 years. There are four inputs to their target as shown in **Exhibit 9**. The first input is the top-down **Earnings & P/E multiple** targets derived from their internal estimates of real GDP and inflation. They forecast +8.0% earnings growth and some multiple contraction typical at this point in the cycle, which seems conservative relative to the bottom-up +12.2% consensus earnings growth estimate for 2025 shown in **Exhibit 5**. The second input into their S&P 500 target is the **Stock Market Cycle**. A slowing pace of gains is characteristic of maturing bull markets. Months 27-39 of cyclical bull markets have risen to a median of 5.5%. Recall that the S&P500 bottomed out in October 2022 so 2025 represents months 27-39. The third input is the **Monetary Cycle** and 2025 represents months 3-15 of the monetary easing cycle, which began in September of 2024. On average, the S&P500 has risen +15.0% during months 3-15 of easing cycles and is especially bullish when the Fed is cutting rates gradually as opposed to drastic cuts, which are more common when Fed policy is trying to ward off an imminent recession. The final input, the **Presidential Cycle**, is the S&P 500's median return of +9.1% during the first year of presidential terms. Post-election year gains have been front-end loaded, suggesting the first half of 2025 may be stronger than the second half.

Exhibit 9: Ned Davis Research 2025 S&P500 Index Target (up +9% in 2025)

NDR S&P 500 Index Target for 2025

Cycle	Metric	Comment	S&P 500 Target
Earnings & P/E	EPS slows, P/Es contract slightly	8.4% EPS Growth & -0.6%pt P/E	6422
Stock Market Cycle	Months 27-39 of cyclical bull	Post-war median of 5.5%	6386
Monetary Cycle	Months 3-15 of easing cycle	Post-war median of 15.0%	6961
Presidential Cycle	Post-election year	Post-war median of 9.1%	6604
Target		**Round to 6600**	**6593**
Target % (from current level of 6053)			**8.9**

Source: Ned Davis Research, 12/10/24

According to Bespoke Investment Group, another research group we subscribe to, Wall Street strategists pretty much always look for gains of +5%-10% and never predict down years. Collectively, for 2025, they are looking for gains north of +10% more or less in line with the Ned Davis prediction above. However, that compares to an average prediction of +3% in 2024 versus the actual total return of +25%. So clearly, these Wall Street predictions should be taken with a grain of salt as they can and have been very wrong at times in the past. Markets are difficult to predict with any certainty and we are thrilled just to have gotten the direction right in recent years despite overarching market gloom and pessimism.

Putting this altogether, 2025 will not be without its challenges and with valuations higher than they have been in the past, it could imply higher risk. That said, the outlook for inflation, interest rates, economic growth and earnings remains constructive and general expectations are that Trump 2.0 should be supportive of economic growth. Within that context we remain constructive on the market outlook.

Peter Jackson
Chief Investment Officer
December 31, 2024