NORTH AMERICAN EQUITY STRATEGY

First Quarter 2025 Review

The S&P500 and TSX hit new highs in January and February only to lose steam in recent weeks. In the US, concerns about inflation due to tariffs and policy uncertainty that could lead to slower economic growth are not helping what was a pretty decent fourth quarter earnings season. In Canada, shifting concerns from tariffs related to fentanyl and the border to annexation are impacting emotions as we head into an election. Perhaps surprisingly though, the impact on the markets during the first quarter was relatively small, although the intra-quarter swings were larger. During the first quarter of 2025, the S&P500 total return was -4.27% in U.S. dollars. Adjusting for currency, the S&P500 returned -4.37% in Canadian dollars, as the Canadian dollar remained flat only changing by 0.02 cents, closing the quarter at $0.6950. The TSX total return was +1.51% in the first quarter.

At its March Federal Open Market Committee (FOMC) meeting the Federal Reserve (Fed) decided to maintain the target range for the federal funds rate at 4.25 to 4.5 percent, while still favouring two interest rate cuts later this year. Comparing its Summary of Economic Projections (SEP) forecast in March to its previous December outlook **(Exhibit 1)**, Fed Chair Powell essentially summarized the weaker GDP growth forecast, but higher inflation forecast as more or less "cancelling each other out". Hence, there was no change in the projected, appropriate interest rate policy path. However, the key takeaway for us was not the actual economic forecast, which hardly changed in the later years, rather Powell's reference to pages 10-12 of the SEP **(Exhibit 2)**. This shows each FOMC participants' assessment of the uncertainty and risks around their economic projections which, as indicated in the Exhibit, have increased significantly. With uncertainty about the forecast, it's not surprising they were reluctant to make any changes to interest rate policy projections at this point in time.

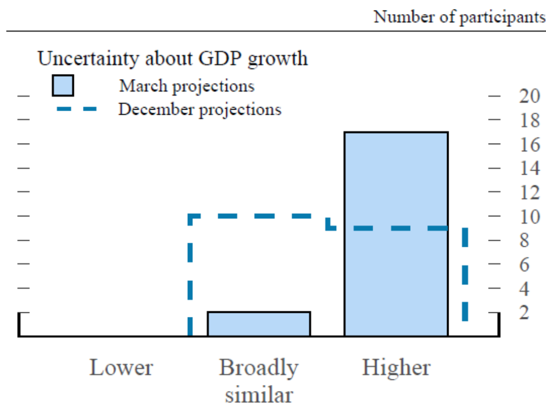
Exhibit 1: Summary of Economic Projections (SEP, Federal Reserve)

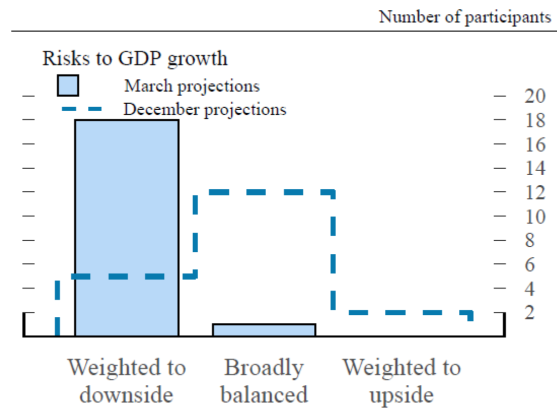
Variable [in %]	Median			
	2025	2026	2027	Longer Run
Change in real GDP	1.7	1.8	1.8	1.8
December projection	2.1	2.0	1.9	1.8
Unemployment rate	4.4	4.3	4.3	4.2
December projection	4.3	4.3	4.3	4.2
PCE inflation	2.7	2.2	2.0	2.0
December projection	2.5	2.1	2.0	2.0
Core PCE inflation	2.8	2.2	2.0	
December projection	2.5	2.2	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	3.9	3.4	3.1	3.0
December projection	3.9	3.4	3.1	3.0

Source: Federal Reserve, Summary of Economic Projections, 3/19/2025

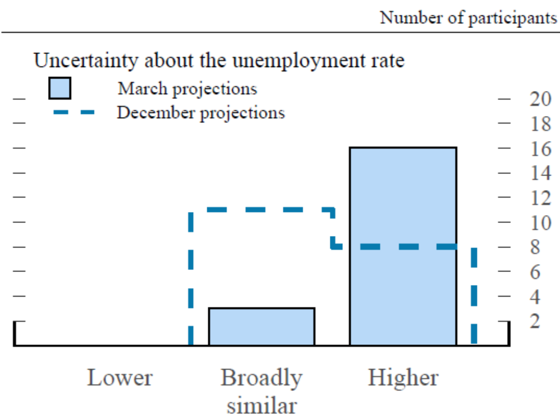
Exhibit 2: FOMC Participants' Assessments of Uncertainty and Risks Around Their Economic Projections

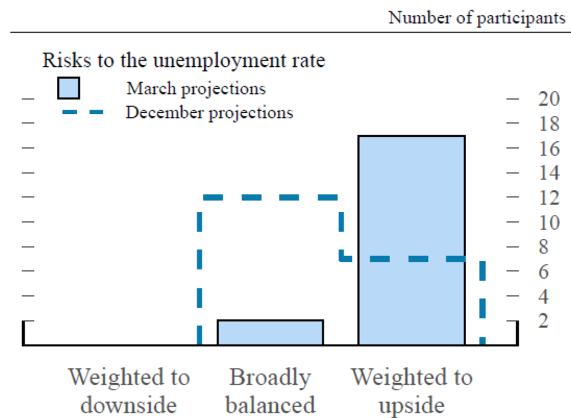
Growth



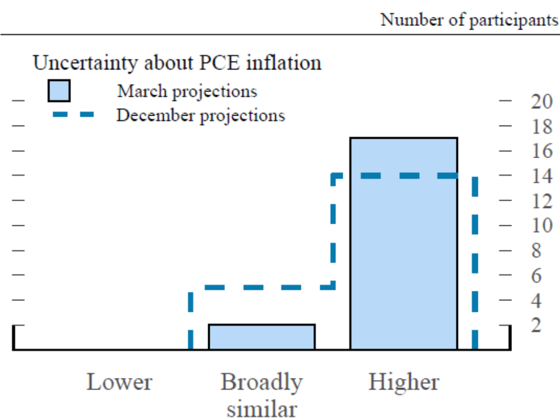


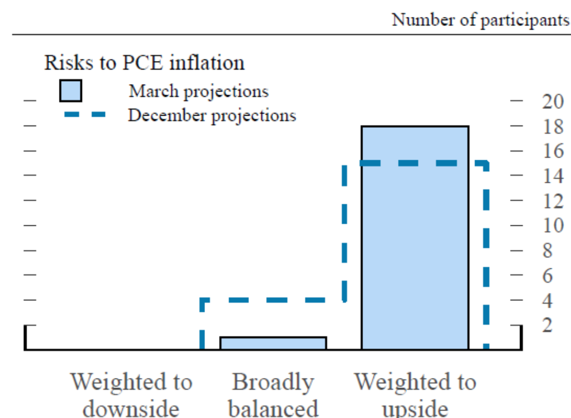
Unemployment





PCE Inflation





Source: Federal Reserve, Summary of Economic Projections, 3/19/2025

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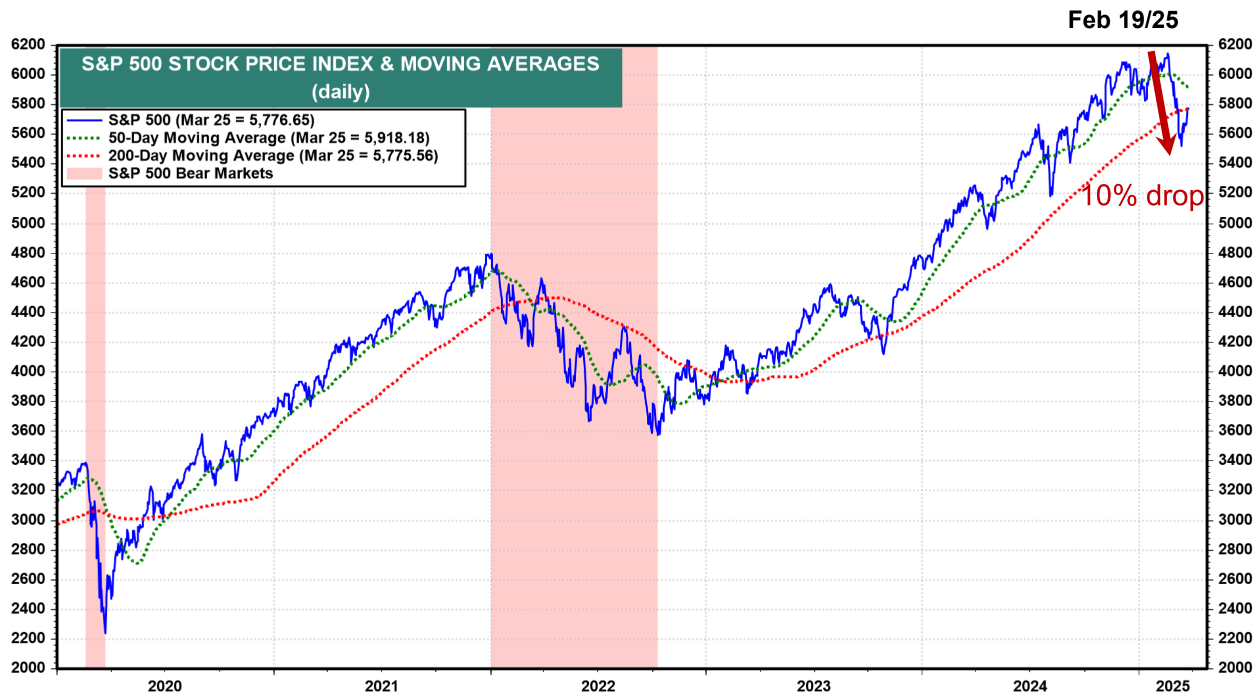
Exhibit 3 shows that we entered a correction phase for the S&P500 on March 13th. A correction is defined as a decine of 10%, which is the magnitude of change from the previous high on February 19th, 2025. Corrections are fairly common and tend to happen on average almost every year at some point in the year. According to Ed Yardeni, a strategist we follow, corrections occur when the stock market starts to price in a recession that doesn't occur. It is almost always attributable to a drop in the forward price/earnings multiple (P/E), while forward earnings continue to rise or remain stable. A bear market (defined as a drop in valuation of 20% or more) typically occurs when a recession happens, sending both the valuation multiple (P/E) and earnings expectations tumbling. There have been a few bear market occurrences where no recession unfolded like we saw in 2022; however, they are rare.

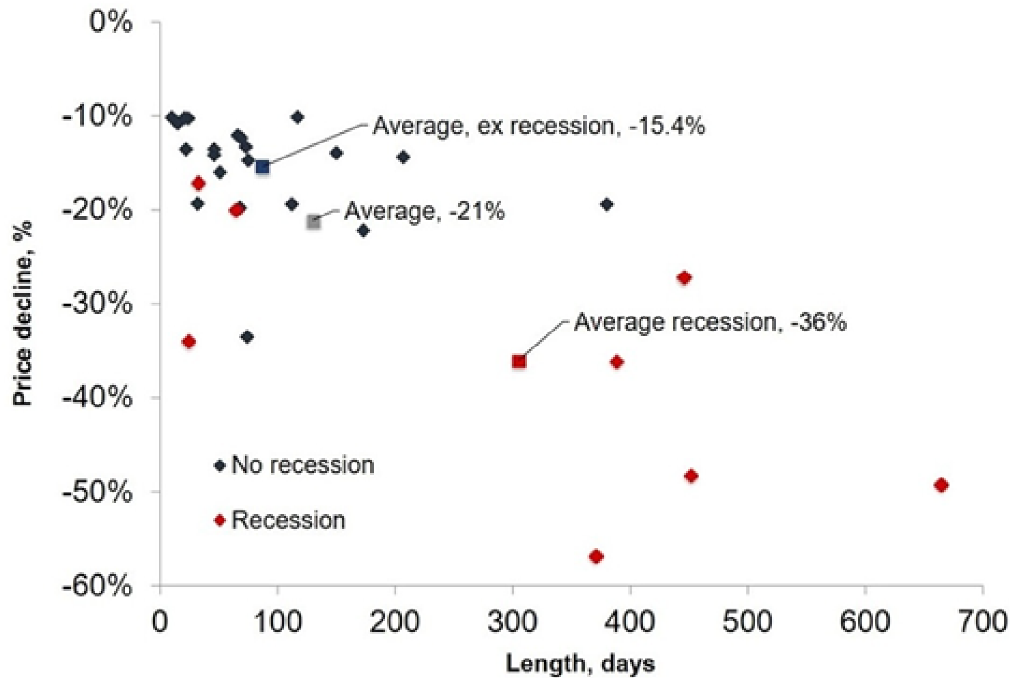
So, the question is where we are going from here as the outcomes on average are quite different. Non-recessionary corrections tend to be short, sharp and usually shallow, whereas recessionary corrections or bear markets tend to see larger drawdowns that last much longer. **Exhibit 4** compares the historical averages of both recession and non-recession corrections since 1965. In the recession case, the average decline is approximately-36% for the S&P500 and lasts about 300 days. In the no-recession correction case, the average decline is-15.4% lasting slightly less than 100 days. The U.S. market has now given up its post-election gains and from peak to trough (February 19th to March 13th, 2025) the S&P 500 was down-10.1% while at quarter end March 31st, we are 40 days into the correction. Time will ultimately tell how things will play out, so it is probably worth reviewing both the bear and bull case.

Exhibit 3: S&P 500 Price Index & Moving Averages (to March 25, 2025)



Source: Yardeni Research

Exhibit 4: Historical S&P500 Corrections Since 1965



Source: Oxford Economics/ Refinitiv Datastream

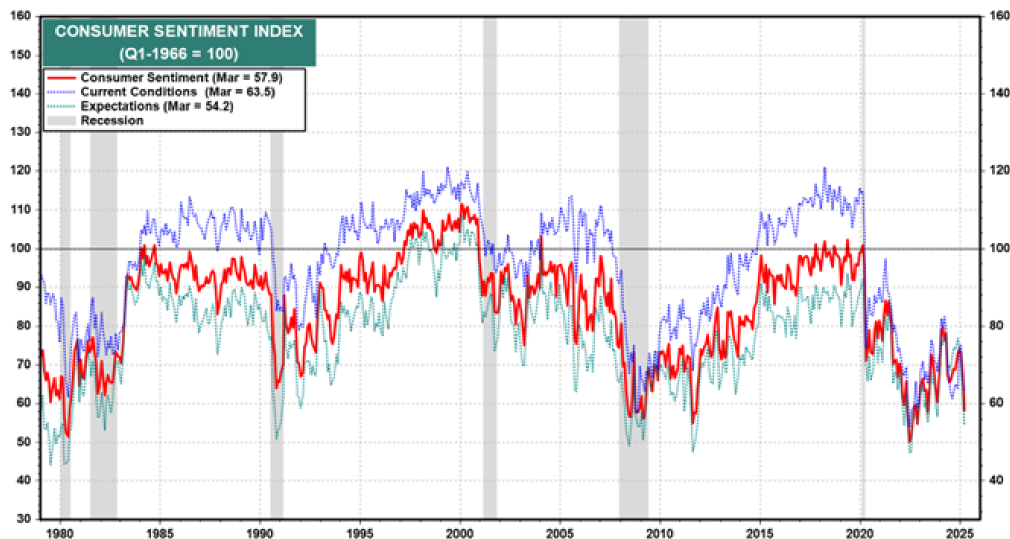
The Bear Case

Exhibit 5 shows that the University of Michigan consumer sentiment index (CSI) for the U.S. plunged to 57.9 (red line) during the second week of March 2025, the lowest since November 2022, from 64.7 in February and well below consensus forecasts of 64.0. Sentiment declined for a third straight month, with many consumers citing the high level of uncertainty around government policy and other economic factors including personal finances, labor markets, inflation, business conditions, and stock markets. Note that the grey shaded areas show recessions going back to the 1980's and consumer sentiment (red line) is currently at or below all previous recession levels.

In Exhibit 6, consumer sentiment index inflation expectations surged in March, with the year-ahead gauge (red line) rising from 4.3% to 4.9%, the highest reading since November 2022. With the pain of 2022 inflation still lingering, consumers now are feeling more pessimistic than the Fed, which currently forecasts inflation under 3%. Also, five-year consumer sentiment inflation expectations (blue line) surged from 3.5% to 3.9% in February, well above the Fed's stated goal of 2% and the largest month-over-month increase seen since 1993 (source: University of Michigan). Both the Consumer Sentiment Index survey and CSI Inflation expectations for March support the bear case in which consumers'

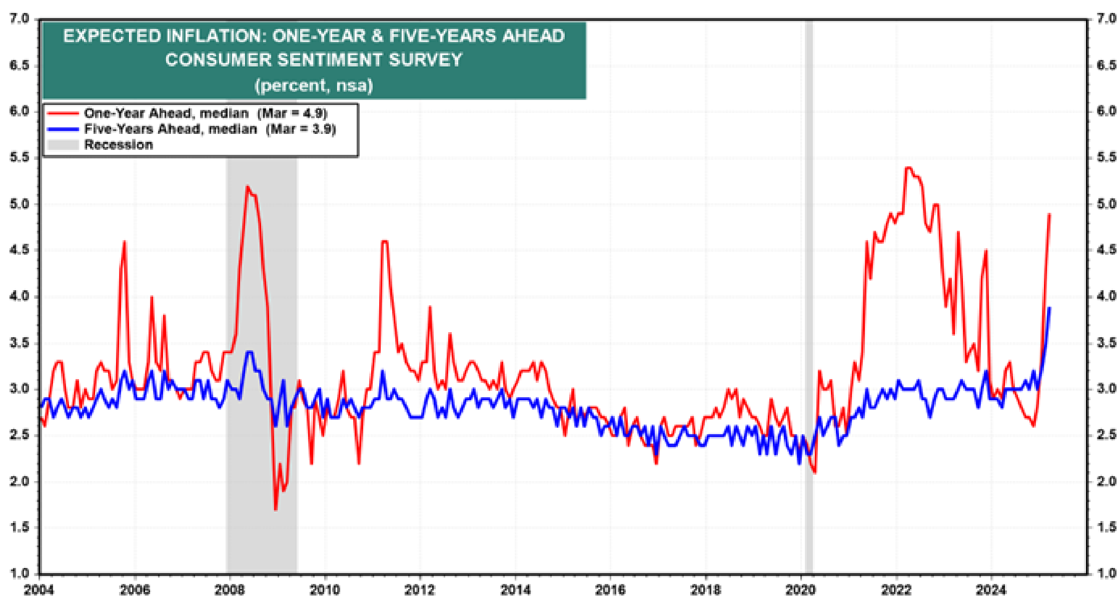
concerns about an uncertain future cause them to reduce their spending, causing a recession in effect creating a self-fulfilling prophecy worse than tariffs alone. At the same time, the bear case includes higher inflation that prevents the Fed from lowering interest rates.

Exhibit 5: Consumer Sentiment Index



Source: Yardeni Research

Exhibit 6: Expected Inflation (One-Year & Five-Years Ahead)



Source: Yardeni Research

Turning to the corporate sector, **Exhibit 7** shows the National Federation of Independent Business (NFIB) survey for the Small Business Optimism Index and **Exhibit 8** shows the NFIB Uncertainty Index. The NFIB Small Business Optimism Index fell by 2.1 points in February to 100.7. After a strong spike in optimism post-election, this is the second month in a row the index has dropped and is 4.4 points below its most recent peak of 105.1 in December. The Uncertainty Index, on the other hand, rose four points to 104 – the second highest recorded reading.

The NFIB Chief Economist had this to say,

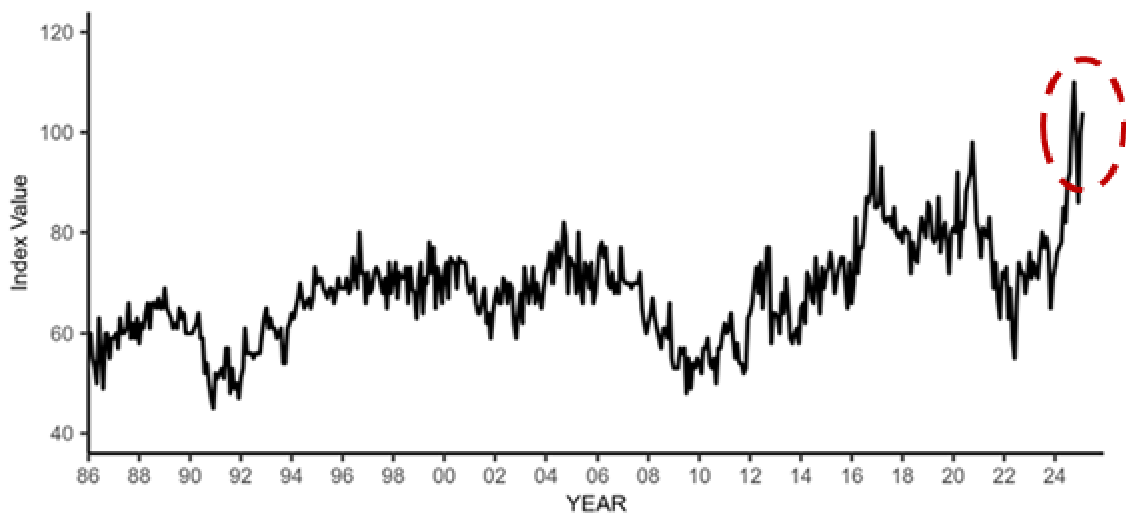
> "Uncertainty is high and rising on Main Street and for many reasons. Those small business owners expecting better business conditions in the next six months dropped and the percentage viewing the current period as a good time to expand fell but remained well above where it was in the fall. Inflation remains a major problem, ranked second behind the top problem, labor quality"

Policy uncertainty and fears of a trade war have shaken business confidence and made it difficult for corporate executives to plan, which is likely to put downward pressure on capital expenditure and hiring unless some of the uncertainty is removed. Both the Small Business Optimism index and the Small Business Uncertainty index have been volatile since the election; however, they are clearly moving in the wrong direction currently.

Exhibit 7: Small Business Optimism Has Receded

Source: National Federation of Independent Business (NFIB), February 2025 Small Business Economic Trends

Exhibit 8: Small Business Uncertainty Has Risen to Nearly All-Time Highs



Source: National Federation of Independent Business (NFIB), February 2025 Small Business Economic Trends

Finally, to complete the bear case, we can't rule out the old political trick of engineering a recession in your first year in office, blaming it on the previous president, and then taking credit for the subsequent recovery.

Exhibit 9, courtesy of Ned Davis (NDR), shows the S&P500 performance pattern (top section) and the NDR proprietary monetary and fiscal policy index (bottom section), as measured respectively by monetary supply growth and net federal expenditures, during presidential cycles since the early 1960's. The pattern shows stimulus tends to peak out in the first year of the presidential cycle and roll over in the second midterm year causing a market correction. **Exhibit 10** shows the actual Monetary and Fiscal policy by president by year and the median impact for both the first and second term of the presidential cycle. In the case where a president has had a second term, the percentage of times there has been a positive monetary and fiscal impact in year 5, or the first year of the second term, is at a low of 20% (shown in orange). This would seem to support that old political conspiracy theory.

Exhibit 9: S&P 500 Index and Monetary & Fiscal Index Presidential Cycles

Trend Is More Important Than Level

S&P 500 Index Presidential Election Pattern Based on Daily Data (1964-12-31 - 2024-12-31)

Source: *S&P Dow Jones Indices*

1st Presidential Year | 2nd Presidential Year | 3rd Presidential Year | Election Year

Monetary and Fiscal Policy Index based on Real M2 Money Supply Year-to-Year Change Plus Federal Expenditures Year-to-Year Change Minus Federal Receipts Year-to-Year Change

Real Monetary and Fiscal Policy Index Presidential Election Pattern Based on Monthly Data(1964-12-31 - 2024-12-31)

Source: *Federal Reserve Board*

2025 | 2026 | 2027 | 2028

Source: Ned Davis Research #S01643

Exhibit 10: Government Policy Tightening Common in First Year of 2nd Term

NDR Real Monetary & Fiscal Policy Index by President								
President	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Johnson**	4.6	-0.6	8.5	36.9				
Nixon	-14.7	9.2	16.1	4.4	-6.4			
Ford		-5.6	25.7	0.5				
Carter	-0.3	-4.4	-9.3	2.0				
Reagan	1.5	11.7	15.2	1.0	5.8	6.7	-7.4	-2.1
Bush I	1.0	3.8	2.2	2.4				
Clinton	-9.6	-6.5	-1.9	-1.2	-3.5	3.3	-2.6	-1.9
Bush II	17.1	20.2	11.3	1.2	-4.9	-2.5	0.3	26.9
Obama	29.9	-6.6	3.9	-1.5	-13.7	1.5	3.8	7.6
Trump	4.8	6.4	6.8	74.5				
Biden	-17.7	-28.0	1.8	2.4				
Trump					4.3*			
Median	**1.3**	**-0.6**	**6.8**	**2.0**	**-4.9**	**2.4**	**-1.2**	**2.8**
% Positive	**60.0**	**45.5**	**81.8**	**81.8**	**20.0**	**75.0**	**50.0**	**50.0**

Source: Ned Davis Research SMF_60.RPT

NOTES TO EXHIBIT 10

*Readings are values at end of year, except for the current year, which is through 01/31/2025, and not included in summary statistics.

**Johnson became president in Kennedy's third year, but because Johnson could have run for reelection in 1968, 1965-68 is treated as a first term.

Real Monetary & Fiscal Policy Index based on real M2 money supply year/year percent change, plus federal expenditures year/year percent change, minus federal receipts year/year percent change.

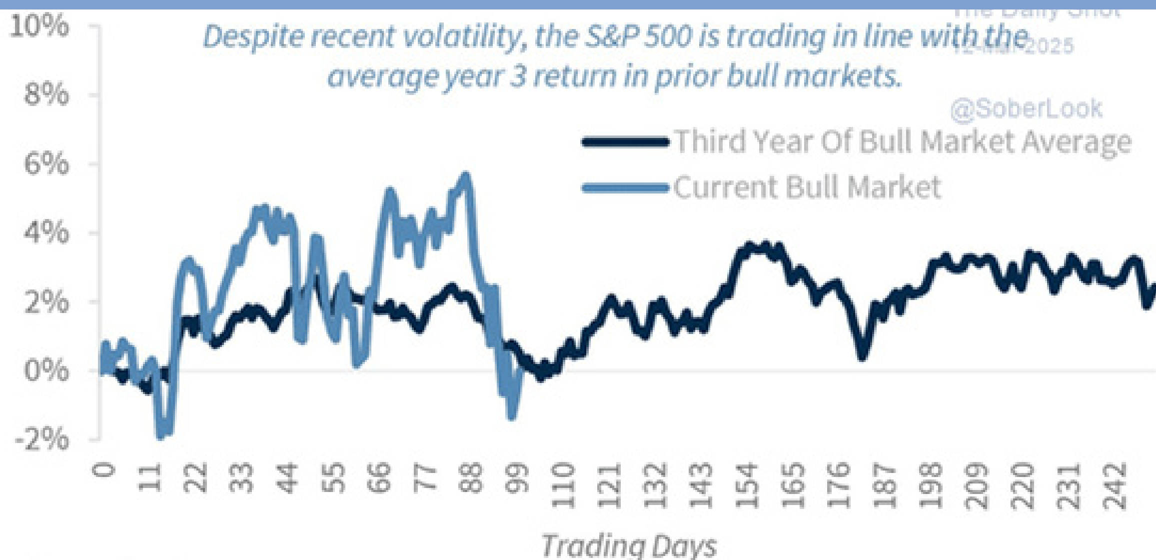
In conclusion with respect to the bear case, the economy is clearly being stress-tested by Trump's tariff campaign and cuts in federal expenditures. At the same time, Fed officials have said that they are going to take a wait and see approach to cutting interest rates, which in the past often marked a stock market bottom. While the immediate impact has been a rapid correction in the Nasdaq and S&P 500, we should point out, other than the presidential cycle data, the data presented to support the bear case is what we refer to as "soft" data. In other words, it is based on survey data of perceptions as opposed to "hard" data like actual inflation, unemployment and real GDP. Even the Federal Reserve Chair Jerome Powell said, during his March press conference, "the relationship between survey data and the actual economic

activity has not been very tight". There are plenty of examples where a deterioration in the soft data does not follow through to the hard data and it's possible that could be the case here should we start to get some clarity particularly with respect to tariffs and the uncertainty does not go on for too long. So, with that, let's turn to the bull case.

Bull Case

After back-to-back gains north of 20% in 2023 and 2024, what should we expect in year 3 of a bull market? **Exhibit 11** shows the current year (light blue line) as compared to the historical pattern (dark blue line) in year 3 of a bull market. What it shows is that gains tend to be more muted but not negative and the current performance in 2025 is about in line with the historical averages. It is also worth considering that in 2022, the S&P500 was down -19.4% so the average compound annual return of +7.3% for the three-year period 2022-2024 is lower than the 30-year annualized return of +8.9%.

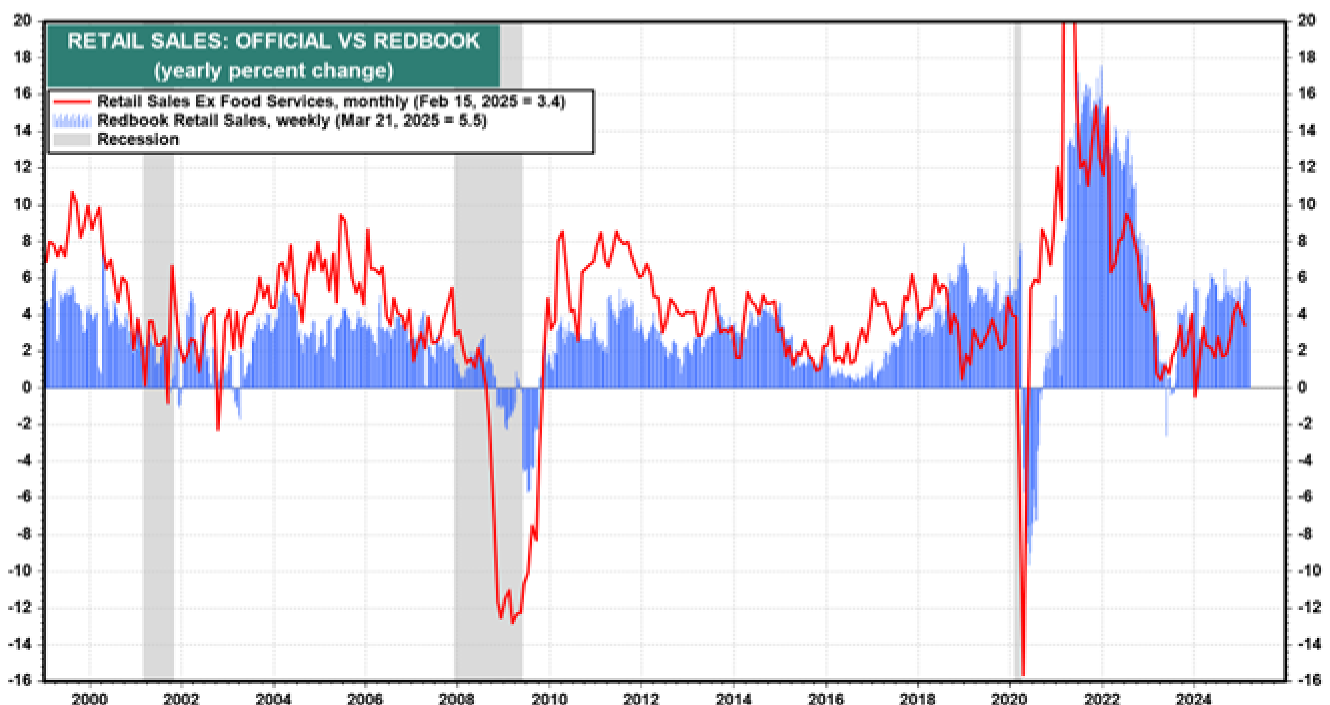
Exhibit 11: Muted Returns in Year 3 of Bull Market



Source: DailyShot, Raymond James

Hard data such as retail sales suggest the consumer is still resilient. **Exhibit 12** shows the weekly Redbook Research retail sales series (in blue), which is highly correlated with the monthly retail sales data compiled by the Census Bureau. As indicated in the chart, weekly retail sales continue to be strong during the first two weeks of March, up +5.5%. This follows the bounce back we saw in the official February retail sales, which excluding volatile items such as gasoline and autos, the retail sales control group, bounced back 1.0% in February after a weather induced decline of almost -1.0% in January. It appears that despite the headlines from Washington, the US consumer continues to spend at least at this point in time.

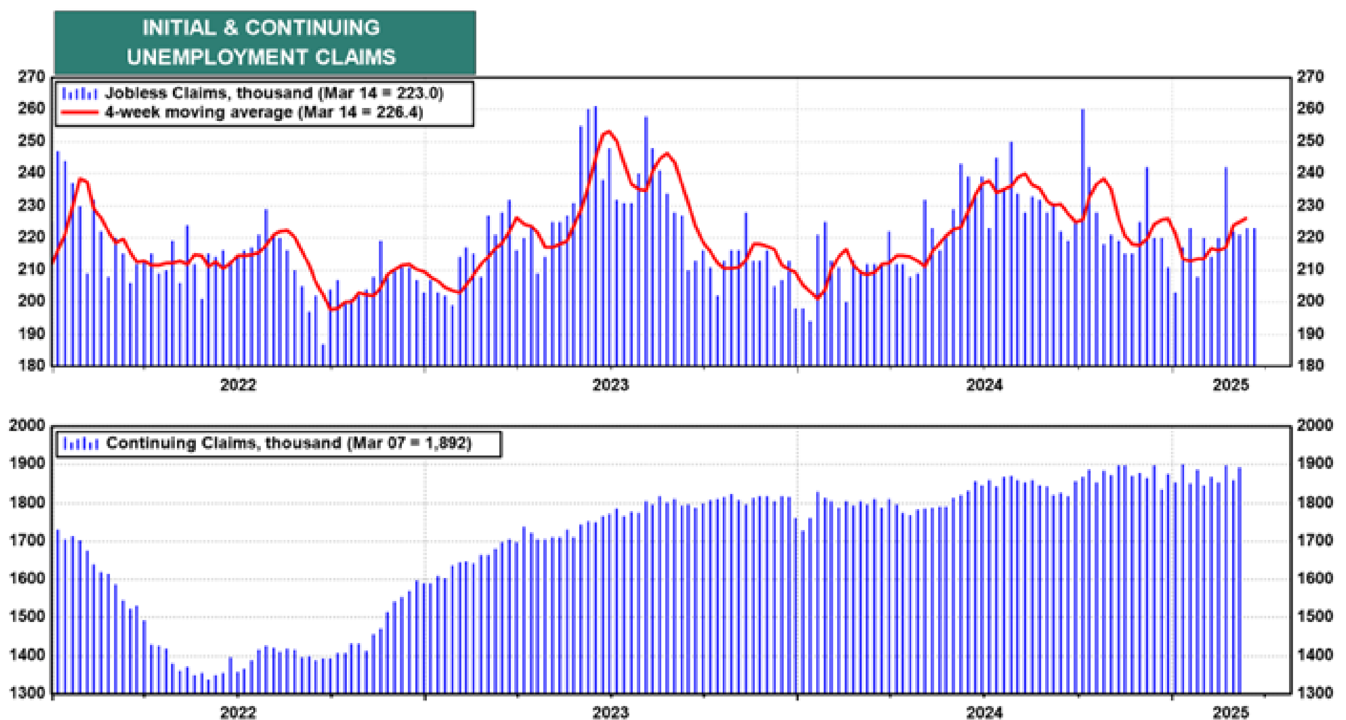
Exhibit 12: Retail Sales – Official versus Redbook



Source: Yardeni Research

This may be in part due to the strong labour market. **Exhibit 13** shows the Weekly Jobless Claims as of March 14th at 223,000. With the four-week average at 226,400, it suggests strong job growth, low layoffs and a tight labour market and supports the continuation of relatively low unemployment. Recall the February Unemployment rate came in at 4.1%. This compares to the 50-year average unemployment rate of 5.8% and only slightly above 3.4%, the lowest reading since May 1969.

Exhibit 13: Initial & Continuing Unemployment Claims



Source: Yardeni Research, March 14, 2025

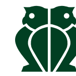


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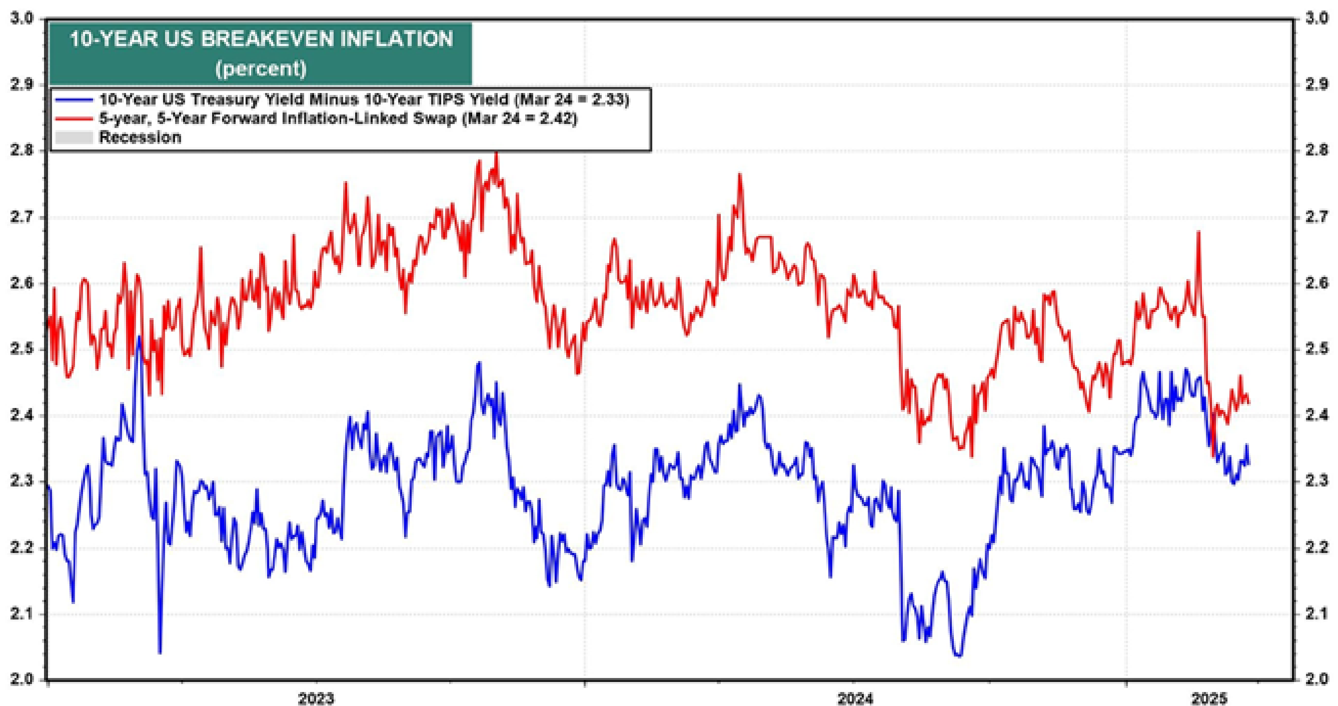
Exhibit 14 compares the difference between nominal 10-year U.S. Treasury yields and 10-year Treasury Inflation-Protected security yields (TIPS, the blue line). These are essentially U.S. government bonds issued by the U.S. Treasury that provide protection against inflation. Hence the difference between the two represents the market based inflation outlook over the next ten years. The red line is a similar instrument that measures the market based five year inflation outlook. As indicated in the chart, at 2.3% and 2.4%, they are a little above the Fed's longer run inflation target of 2%, but nowhere close to the Consumer Sentiment Survey inflation expectations shown in **Exhibit 6**. From the Fed's perspective, the biggest risk is that a transitory price increase, perhaps due to tariffs, morphs into a persistent inflation shock. At least at this point, market-based inflation expectations are not signaling a concern.

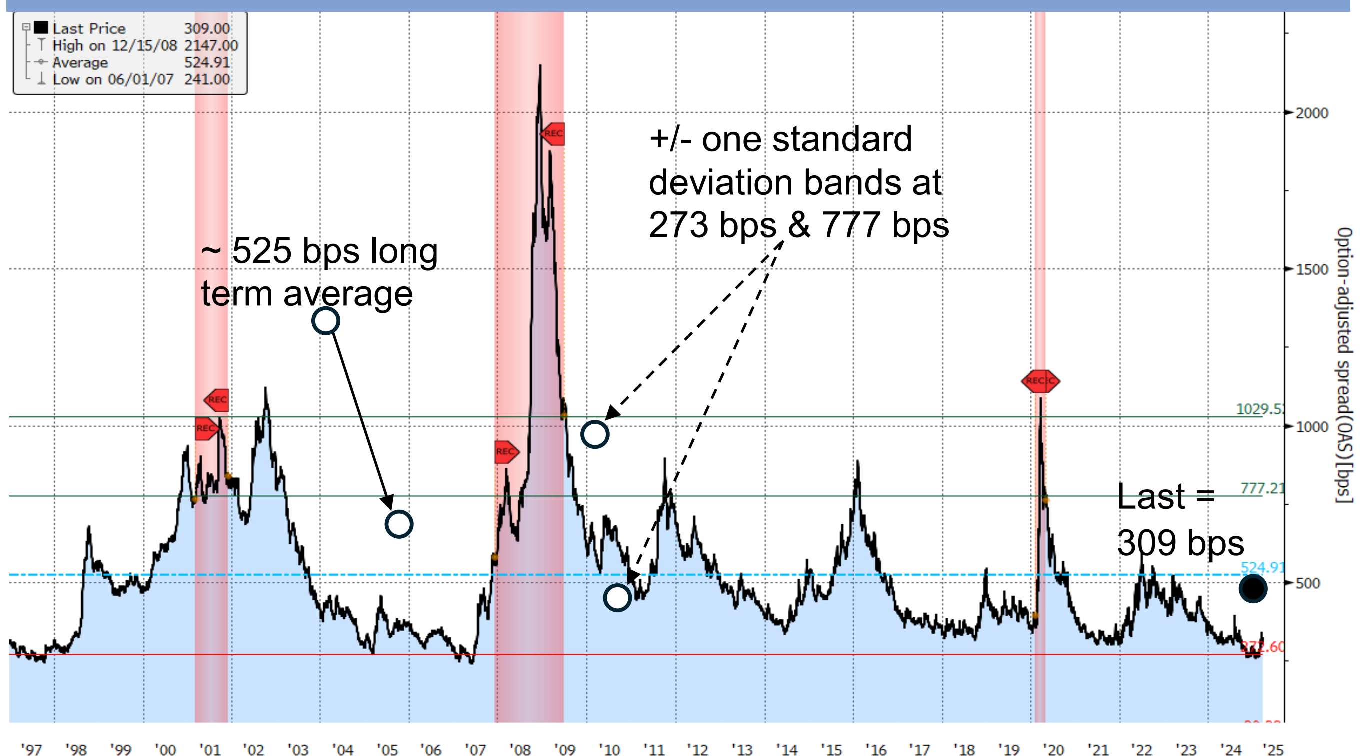
Exhibit 14: Market based Inflation outlook



Source: Yardeni Research, Morning Brief 03/26/2025

Exhibit 15, the black line, shows high yield credit spreads (yield on high yield bonds relative to U.S. treasuries) going back to the 1990's where the blue horizontal line represents the average spread over time and the shaded red vertical areas represent recessions. As indicated in the chart, during periods of economic stress (i.e. recessions), historically, credit spreads increase considerably as bondholders demand a higher premium for taking on more risk. Even with the recent volatility in the stock market through the end of February and March, it has not been enough to cause credit spreads to blow out meaningfully, suggesting the market is not worried about an elevated risk of default. For the record, Canadian high yield credit spreads have in fact increased even less than their U.S. counterparts.

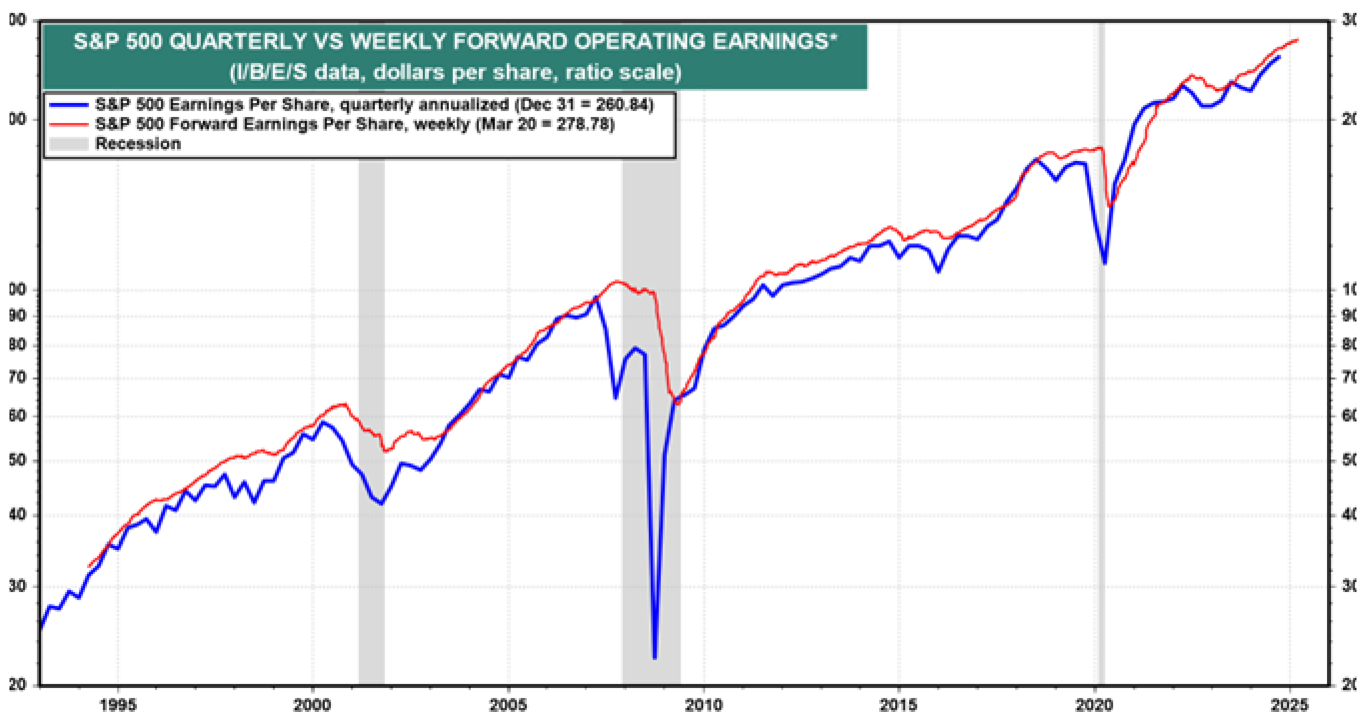
Exhibit 15: U.S High Yield Corporate Spread (Option-Adjusted Spread vs U.S. Treasuries)



Source: Bloomberg, ICE BofA US High Yield Index, 3/25/2025, Red bars shown above = U.S. Recession

As for earnings, during the fourth quarter of 2024, actual Q4 earnings rose 14% as compared to consensus estimates of 8% at the end of the quarter, and actual earnings beat the long term 25-year average of 8.4%. **Exhibit 16** compares the weekly estimated forward earning per share (red line) to actual quarterly annualized earnings (blue line). Note the strong correlation between the estimated 12M forward earnings estimates in red and actual reported quarterly earnings shown in blue. While estimates could change, currently, the consensus estimate for S&P 500 forward EPS implies that the actual EPS will also rise to a new high during Q1-2025.

Exhibit 16: S&P 500 Actual Quarterly vs Weekly Forward Operating Earnings Estimates



Source: Yardeni Research, March 26, 2025

Asset Allocation for our North American Equity Strategy As of March 31, 2025	
Equities	93%
Fixed Income	0%
Cash	7%

Our overall equity exposure decreased 3% to 93% and cash increased from 4% to 7%, respectively, since December 31, 2024. Our U.S. equity exposure decreased from 57% to 53%,while our Canadian equity exposure increased from 39% to 40% as of March 31st. 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 allocation to international companies.

Reflecting a somewhat more cautious stance, the biggest changes we've made over the past three months were to reduce both technology and industrials in favor of more defensive sectors such as healthcare, cash and gold. New positions include AstraZeneca PLC., Brookfield Corporation and S&PTSX Global Gold ETF.

We don't normally buy gold companies, given the volatile and inconsistent nature of their profitability. However, if there were ever an environment where would consider it, it is probably today. We have taken the approach of buying a gold ETF to avoid company specific risk. Whether it is escalating trade tension uncertainty and/or potential for inflation, gold has historically been a store of value in periods of increasing prices. Also, during periods of geopolitical uncertainty, it has historically been a safe haven in times of economic and political instability.

Brookfield is a high-quality earnings compounding company that has generated an 18% compound annual return for shareholders over the past 30 years. At present, it trades at a substantial discount in terms of valuation, with higher forecasted earnings growth than its two closest U.S. comparable companies, Apollo Global Management and KKR & Co. AstraZeneca Plc is a U.K. based pharmaceutical company that operates globally. The company has had one of the best growth profiles amongst large-cap pharma companies with a current valuation and outlook for growth that remain attractive.

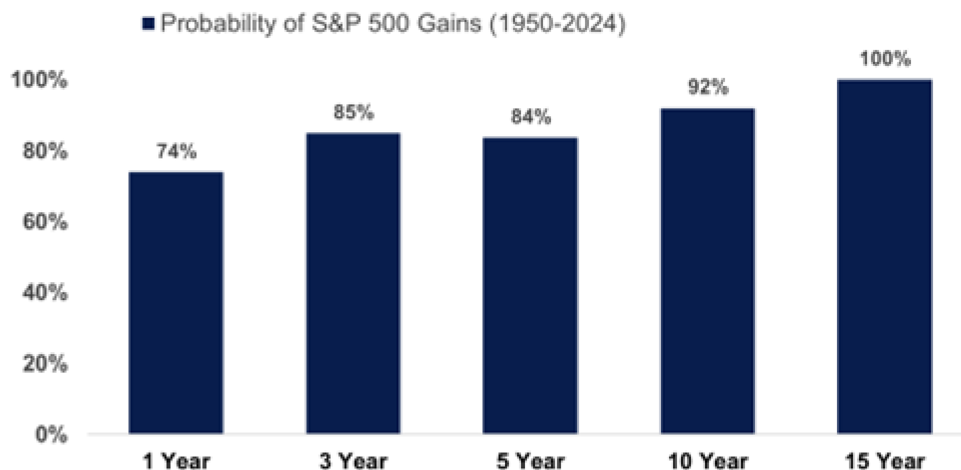
A complete review of the business and fundamental outlook for new companies purchased during the quarter can be found in **Appendix 1.**

Closing Comments and Outlook

Sentiment declined for a third straight month, with many consumers citing the high level of uncertainty around government policy and other economic factors including personal finances, labor markets, inflation, business conditions, and stock markets. At the same time, the FOMC participants' assessments of uncertainties and risks around their economic projections did not demonstrate a lot of confidence either. We can't dismiss the possibility that the swift correction in late February may develop into something worse, however the hard data discussed earlier does not support the soft data, at least so far. As discussed, we have assumed a more cautious stance and are prepared to take more precautions, however the earnings outlook, particularly for the companies we own, remains solid, valuations are cheaper than they were at the beginning of the year, and there are no signs of stress in the bond market as measured by credits spreads. The question is, how far do we go to derisk portfolios with the potential for this to turn out to be just a typical mild correction?

Exhibit 17 reminds us that the odds are compelling in investors' favor for staying in the market. In fact, for all rolling one-year periods back to 1950 using monthly data, the S&P 500 Index was higher 74% of the time. For those with a three-year time horizon, the odds improve to 85%.

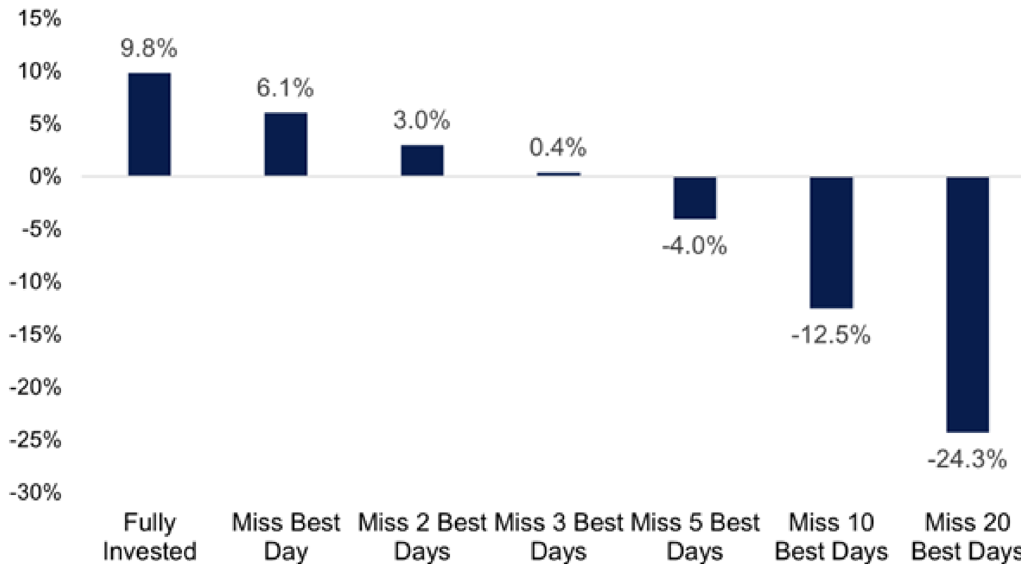
Exhibit 17: Percentage of Time S&P 500 Rose Over Various Time Periods



Source: LPL Research, 03/11/25 Link

Exhibit 18 reminds us of the cost of missing just the one best day of the year, as it reduces the annual gain since 1990 from 9.8% to 6.1% (excluding dividends) per annum. Take out the two best days and the annual gain drops to about 3%, about the equivalent of investing in bonds. Since it's impossible to know exactly when those best days of the year will occur, particularly since they can come after times of market distress, investors are likely best served by staying in the market through periods of volatility in order to achieve the equity-like return they aim for in choosing the asset class, all things equal.

Exhibit 18: The Cost of Market Timing and Potentially Missing the Best Days



Source: LPL Research, 03/11/25 Link

In summary, it has been an extremely emotional time in the markets lately. We have taken a step back in terms of a more cautious approach; however, the reality is the economy is still quite strong, interest rates have come down and are projected to fall further, earnings are still increasing, and valuations are lower today than they were three months ago. We reserve the right to change our opinion, but for now we are staying the course.

Peter Jackson
Chief Investment Officer
March 31, 2025

*Cumberland and Cumberland Private Wealth refer to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). CIC acts as sub-advisor to certain CPWM investment mandates.

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Appendix 1
New Equity Investments:
Cumberland North American Equity Mandate

United States

AstraZeneca PLC ADR

AstraZeneca Plc is a U.K. based pharmaceutical company that operates globally and manufacturers and sells drugs across a wide range of therapeutic areas, principally Oncology, Cardiovascular, Kidney and Rare Disease. The company has had one of the best growth profiles amongst large-cap pharma companies and with the 2021 acquisition of Alexion, revenues have more than doubled over the last 5 years. Their drug pipeline also remains robust with seven new molecular entities entering Phase 3 trials in 2025 along with leading opportunities in Breast and Lung cancer, and potential new blockbuster drugs in kidney and hypertension. A diversified revenue base across segments and geographies including 22% exposure to emerging markets drives an expectation that AstraZeneca can deliver mid-single digit revenue growth and double-digit earnings growth over the mid-term. We believe the valuation at 16.5x FY25 P/E and outlook for growth remain attractive.

Canada

iShares S&P/TSXGlobal Gold Index ETF

We recently added the iShares S&P/TSX Global Gold Index ETF (XGD) which offers exposure to a basket of gold mining companies. The current environment is providing a tailwind to gold companies and the price of gold. Tariffs are causing economic uncertainty and the potential for inflation in the medium term. Further, gold has always been a good long-term store of value and holds its value in periods of higher inflation. Geopolitical uncertainty is apparent in the Middle East (Israel/Hamas/Houthis/Iran), Eastern Europe (Russia/Ukraine), and even here in North America (USA/Canada/Greenland/Panama). Gold is a safe haven during economic and political instability. Individual gold mining companies can bring unwarranted specific risk to the portfolio, so we use a basket approach to diversify our exposure.

Brookfield Corporation

Brookfield is a high-quality compounding earnings company that has generated an 18% compound annual return for shareholders over the past 30 years. However, it trades at a substantial discount in terms of valuation, with higher forecasted earnings growth than its two closest U.S. comparable companies, Apollo Global Management and KKR & Co.

While Brookfield Corporation has built an exemplary high teens growth track record as a leading alternative asset manager, it has evolved in recent years through some well-timed acquisitions. With its acquisition of Oaktree, it has participated in the growth of private credit, which has been the fastest growing area of alternatives, as they take share from traditional banks. With some well-placed insurance company acquisitions, Brookfield has participated in the fast growth of the annuity market where they use Oaktree's credit origination capability to fund annuities for a growing baby boomer retirement wave.