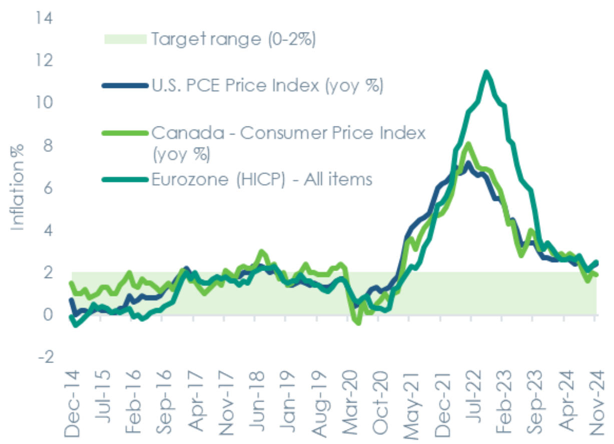
YEAR IN REVIEW

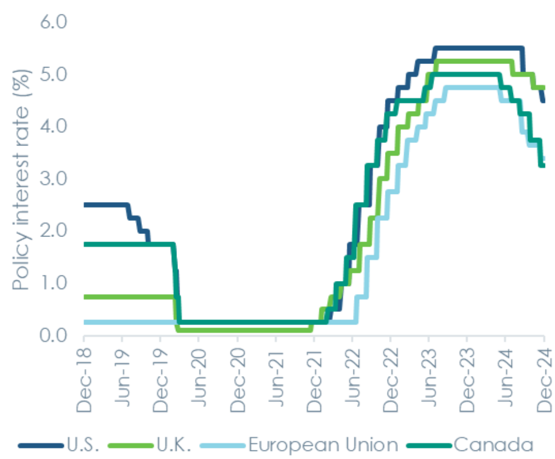
2024

In focus

- Global financial markets responded positively to falling interest rates and expectations that financial conditions would continue to ease. The U.S. Federal Reserve (the Fed), the European Central Bank and the Bank of England signalled their intention to reduce their benchmark rates of interest, but fell short of the more optimistic expectations, with inflation remaining stubbornly above central bank target rates of around 2.0%. Canada was an exception: year-over-year inflation declined to 1.9% in November, decelerating from the 3.4% year-over-year increase in December 2023. Equity and fixed income markets became more volatile toward the end of the year, given concerns about the outcome of the U.S presidential election, as well as the Fed's announcement in December that although it was, as expected, making an interest rate reduction, it also anticipated only two cuts in 2025, a hawkish swerve from it previous stance. While U.S. equities advanced in anticipation of more favourable reform agenda under President-elect Donald Trump, markets in the rest of the world were more cautious, given uncertainties related to the trade policies and tariffs the new U.S. presidential administration might impose.
- Gains in global equity markets, as measured by the MSCI All Country World Index, were driven by mega-capitalization companies in the information technology and communications services sectors. In these two sectors, cloud and semiconductor product companies benefited from artificial intelligence themes, beating earnings expectations and reporting a positive outlook for growth. Financials and consumer discretionary also reported strong gains. U.S. equities dominated their global peers, and now account for a little over 50% of global market capitalization, according to Bloomberg data. Higher levels of valuations emerged as a key concern for investors in the information technology sector, which traded at 26.6 times its 12-month forward earnings expectations at the end of December 2024, compared with its ten-year average price-to-forward earnings expectations of 20.6 times. In contrast, materials declined for the year, and gains in the energy and health care sectors were somewhat muted.
- Share buybacks, mergers and acquisitions, and rising corporate earnings triggered renewed optimism about Japanese equities, and domestic investment flows helped the Nikkei and the TOPIX cross peaks last seen in 1989. A weaker Japanese yen boosted the attractiveness of export-oriented companies and supported the rise in earnings. In China, inflation and interest rates hit new lows, while equities advanced on policy measures to support lagging economic growth.
- Fixed income markets attracted strong investment flows over the year, against the backdrop of an uncertain outlook for inflation and interest rates. The spreads between high-yield junk bonds and investment-grade and government-issued bonds have narrowed over the year. Both global and U.S. corporate high-yield bonds strongly outperformed their investment-grade and government bond counterparts in 2024. The Fed, in its final meeting of the year, forecast just half a percentage point cut in 2025, below market expectations; in response, ten-year Treasury bond yields rose to 4.57%, compared with the bottom of 3.62% reached in mid-September.

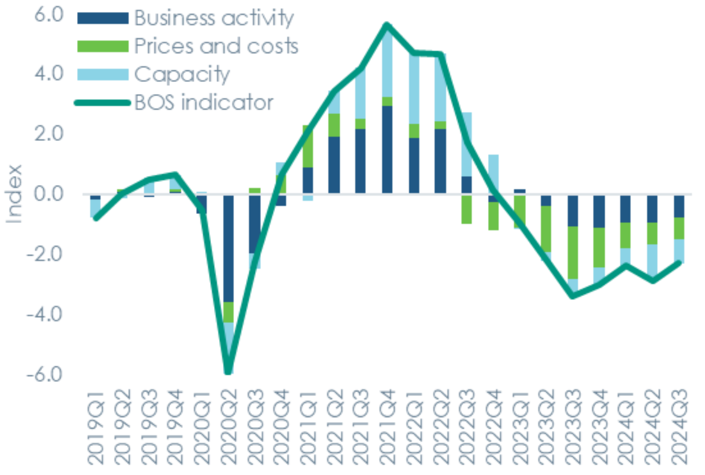
The decline in inflation has stalled above central bank target rates, with Canada being the exception. Central banks globally commenced monetary easing cycles.





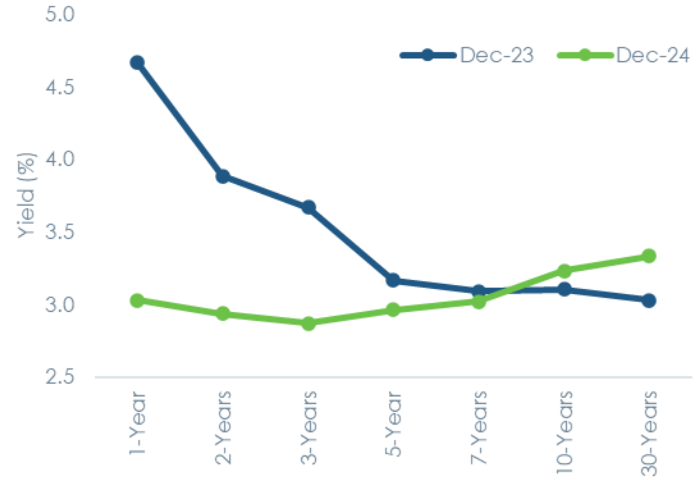
Source: Bloomberg and Refinitiv DataStream, inflation data as at November 30, 2024. U.S. PCE index is selected for the U.S., as it is the U.S. Federal Reserve's preferred index for inflation measurement.

Canadian business outlook survey shows signs of improvement from low levels.



Source: Bank of Canada Business Outlook Survey, October 2024.

Short-term Canadian bond yields declined as growth and inflation fell.



Source: Refinitiv DataStream, as at December 31, 2024.

Canadian equities advanced in 2024.

Canadian equities advanced even as economic growth faltered toward the end of the year. Ten of the eleven GICS sectors advanced. The information technology and financials sectors, where selected companies beat consensus earnings expectations, supported outperformance. The materials sector also rose as geopolitical uncertainty and central bank purchases lifted the price of gold. Consumer staples, utilities and industrials also advanced over the year. Conversely, the communication services sector declined sharply; continued competition among telecommunication services providers affected their share prices.

The overall strength of equity market performance masked a wide dispersion in returns across the market and within sectors. For example, gains in the information technology sector could be attributed mainly to e-commerce platform operator Shopify, which surged in November following better-than-expected earnings.

In terms of valuations, the S&P/TSX Composite Index is now trading close to its ten-year average valuation (as measured by the ten-year price to 12-month forward earnings). Among sectors, information technology currently trades at a premium to its historical valuations, one that is concentrated in just a couple of stocks in the sector. In contrast, energy and materials, despite their recent gains, trade at a discount, as do communication services and health care. Closing out the year, most other sectors are trading close to their historic valuations.

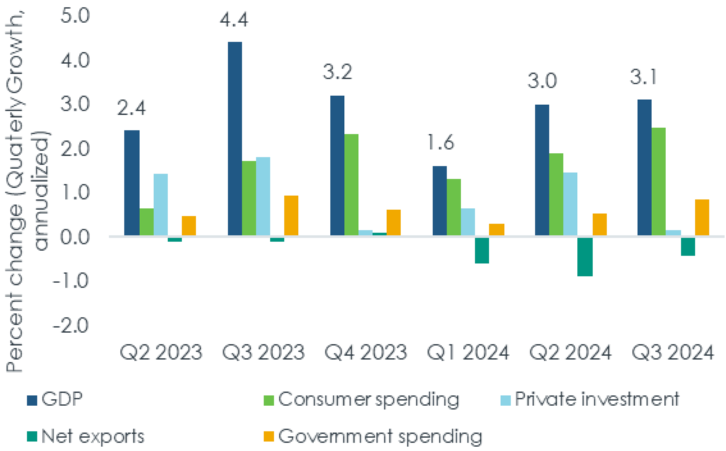
Volatile fixed income

Canadian investment-grade bonds, as measured by the FTSE Canada Universe Bond index, ended the year with positive returns as interest rates and inflation declined. A moderating near-term growth outlook for Canada, coupled with lower inflation, contributed to the fall in yields on shorter-term bonds, while yields on longer-term bonds rose, leading to a steepening of the yield curve. The yield curve steepened in the final quarter of the year, partly in response to changing inflation, the monetary policy outlook in the U.S. and the election of Donald Trump, which prompted concerns about a renewed tariff war.

Rate cuts announced as inflation falls.

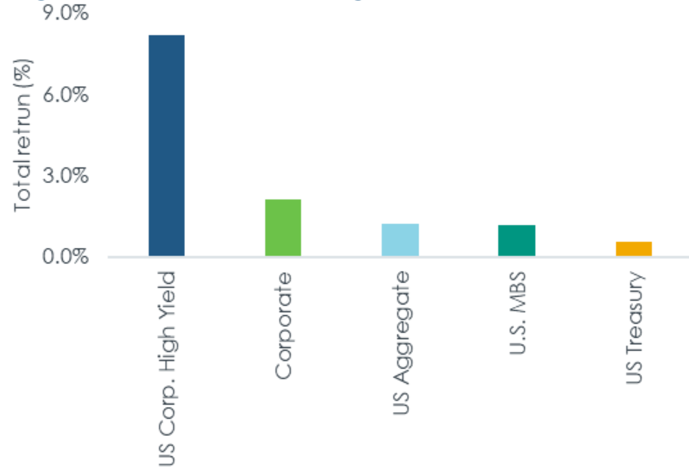
The continued moderation in inflation supported the Bank of Canada's decision to reduce its overnight rate to 3.25%, down from 5.00% at the start of the year. The Bank also continued its policy of balance sheet normalization, rolling back its quantitative easing program. Third-quarter annualized GDP in Canada grew by 1.0%, falling slightly short of expectations. While business investment, inventories and exports weighed on growth, housing activity and consumer spending improved. More recent data also pointed to weaker economic activity in Canada, which, coupled with an uncertain outlook for U.S.-Canada trade relations, may have added to equity and fixed income market volatility.

U.S. economic growth held up well amidst recessionary fears.



Source: Bloomberg, as at September 2024.

High-yield bonds strongly outperformed.



Source: Bloomberg, December 31, 2024. MBS= Mortgage-Backed Securities

U.S. equities advance on economic resilience.

Despite pessimistic expectations among market participants entering 2024, U.S. equities advanced for the year, with the U.S. economy exhibiting resilience. From a style perspective, growth continued to be favoured over value; a combination of healthy corporate earnings growth and robust economic data supported investor confidence. Volatility rose in the final quarter of the year; following the post-election rally, the Fed's guidance on fewer rate cuts in 2025 dampened sentiment toward the end of the year.

Investors were willing to overlook concerns about slower earnings growth and stretched valuations, supporting mega-cap companies such as Apple, Nvidia and Meta, among others. A combination of factors, including the continued rise in sales of semiconductor products and cloud infrastructure services related to AI, as well as expectations of productivity gains, supported the earnings outlook for most of these companies.

Financials and consumer discretionary were also among the better-performing sectors for the year. Higher disposable income, declining interest rates and low unemployment rates supported consumer spending, while financials benefited as banks reported better-than-expected earnings growth. In contrast, performance was weaker in cyclically sensitive sectors such as energy and materials, with a sharp sell-off in December eroding most of the year's gains in both sectors. Meanwhile, compared with 2023, mergers and acquisitions activity increased. Companies across sectors also announced share buybacks, supporting share prices.

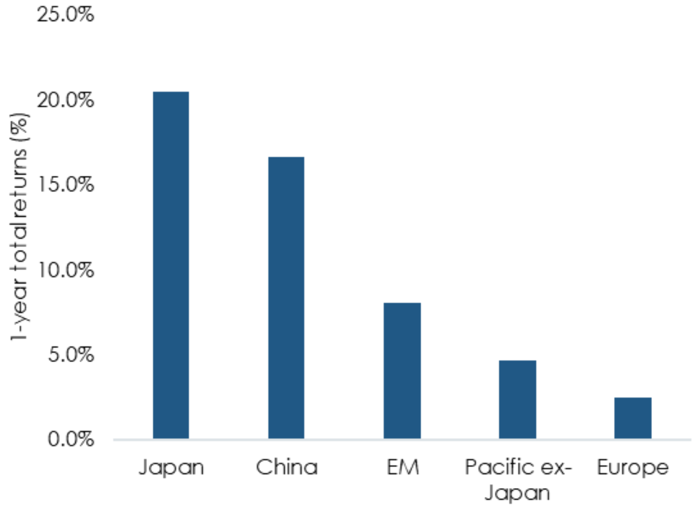
High-yield bonds outperformed.

After a rapid fall in 2023, the rate of decline in inflation slowed, with headline inflation falling from 3.1% year-over-year in January to 2.7% year-over-year in November 2024. The Fed's preferred inflation measure, the Personal Consumption Expenditures Index, rose by 2.4% year-over-year in November 2024. Against this backdrop, the Fed ended the year with a 0.25% rate cut, bringing its benchmark interest rate to a range of 4.25–4.50%, down from 5.25–5.50% at the end of 2023. In its statement following the announcement, the Fed signalled that it would adopt a slower pace of easing next year.

The U.S. ten-year Treasury yield remained volatile throughout the year. The yield on the ten-year Treasury reached a high of 4.70% in April, hit a bottom of 3.62% in September, and ended the year at 4.57%. According to Fed Chair Jerome Powell, rising yields resulted from expectations of a stronger economy rather than from higher inflation.

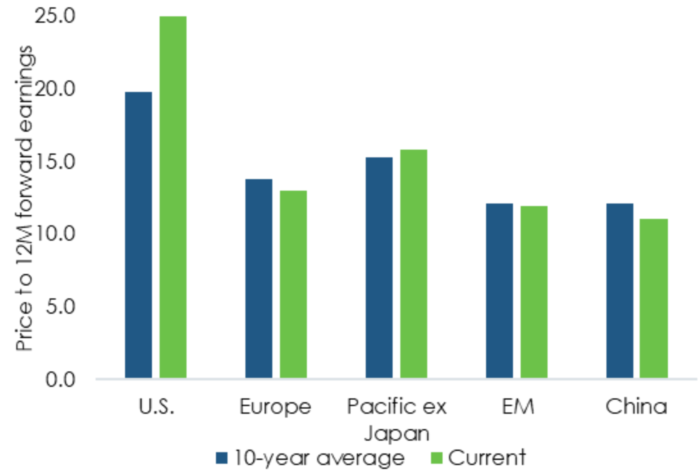
Against this backdrop, high-yield bonds outperformed their investment-grade counterparts, benefiting from higher yields and tighter credit spreads. Investors were also encouraged by low default rates among issuers.

Japanese and Chinese equities surged; Europe lagged.



Source: Refinitiv DataStream, as at December 31, 2024. EM = emerging markets. In U.S. dollar terms. MSCI emerging markets index includes China. MSCI indexes used for all markets except Japan. TOPIX Index used for Japan equity market performance in local currency terms.

Global equities more attractively valued, relative to history and the U.S.



Source: Bloomberg, Quarterly data in percentage points, as at December 31, 2024. EM = emerging markets. In U.S. dollar terms. MSCI emerging markets index includes China. MSCI indexes used for all markets except Japan and the U.S. TOPIX Index used for Japan equity market performance in local currency terms. S&P 500 Index used for U.S. equity market performance.

Japan and China outperformed Europe.

European equities started the year on a positive note in anticipation of a growth recovery and rising real income. Easing financial conditions further boosted sentiment, but sentiment turned more cautious through the year as economic data, particularly in Germany, disappointed, consumer sentiment turned more cautious, and high energy prices stalled the steady decline in inflation seen in the early parts of the year. The year ended with European equities losing ground across all sectors in the final quarter, with investors fearing that U.S. President-elect Trump's trade policies could have a negative impact on growth.

The European Central Bank reduced its benchmark rate of interest by 1.0% over the year, cutting its main refinancing rate from 4.50% at the end of 2023 to 3.15% at the end of 2024, while its marginal lending facility rate stood at 3.40% at the end of the year.

European equities ended the year with modest gains in U.S. dollar terms, mainly due to strong performance in the financials sector. The communication services, industrials and information technology sectors also advanced, offsetting losses due to weakness in the energy, materials and consumer staples sectors. The consumer discretionary, health care and utilities sectors also ended the year with losses.

In Asia, weakness in the Chinese property sector dominated sentiment, while economic data were largely mixed, with some signs of improvement toward the end of the review period. Chinese consumer sentiment and consumption growth remained weak. Given the broad-based economic weakness, policy makers announced a series of support measures, combining monetary policy measures, regulatory intervention and fiscal stimulus to trigger a virtuous growth cycle. Chinese equities ended the year with gains, but came under pressure in the final quarter of the year amid fears of a renewed trade war with the U.S.

Meanwhile, Japanese equities had a strong end to the year, and key indexes breached highs last seen in 1989. Japan's economic shift to moderate inflation and its impact on spending and investment decisions by households and corporates set the tone for a strong equity market. Share buybacks, rising dividends and a weaker yen also supported Japanese stocks. In August, the Bank of Japan announced an increase in a key policy rate that triggered an unwinding of the yen carry trade, leading to an increase in volatility.

An uncertain global economic outlook

According to the International Monetary Fund's world economic outlook, the global economy is expected to continue to grow in 2025, but at a slower pace, due to emerging geopolitical and economic policy risks. Analysts continue to believe that inflation and the monetary policy stance adopted by leading central banks will continue to set the tone for equity and fixed income markets.

Appendix

Global markets (returns in Canadian dollar terms)			
Indexes	**2024**	**2023**	**Returns (%)**
S&P/TSX Composite	24,727.94	20,958.44	21.65%
S&P 500	5,881.63	4,769.83	36.19%
NASDAQ	19,310.79	15,011.35	41.20%
DJIA	42,544.22	37,689.54	25.29%
Russell 2000	2,230.16	2,027.07	21.52%
FTSE 100	8,173.02	7,733.24	17.12%
Euro Stoxx 50	4,895.98	4,521.65	14.05%
Nikkei 225	39,894.54	33,464.17	18.16%
Hang Seng	20,059.95	17,047.39	34.65%
Shanghai Comp.	3,351.76	2,974.94	23.14%
MSCI ACWI	841.33	727.00	28.60%
MSCI EM	1,075.48	1,023.74	17.64%
Fixed income	**2024**	**2023**	**Returns (%)**
FTSE Canada Uni.	1,168.88	1,121.47	4.23%
BBG Global Agg.	463.4374	471.40	-1.69%
S&P/TSX Preferred Shares	2,108.00	1,690.47	24.70%
Bond yields	**2024**	**2023**	**Change (bps)**
10 yr Canada Govt.	3.23%	3.11%	12
10 yr U.S. Govt.	4.57%	3.88%	69
30 yr Canada Govt.	3.33%	3.03%	30
30 yr U.S. Govt.	4.78%	4.03%	75
Commodities	**2024**	**2023**	**Returns** (%)**
Oil ($/bbl.)	71.72	71.65	0.10%
Natural gas ($/Mmbtu.)	3.63	2.51	44.51%
Gold ($/Oz.)	2,624.50	2,062.98	27.22%
Silver ($/Oz.)	28.90	23.79	21.46%
Copper ($/lbs.)	4.03	3.89	3.50%
Currencies	**2024**	**2023**	**Returns* (%)**
CAD/USD	0.6952	0.7551	-7.93%
USD/EUR	0.9659	0.9059	6.62%
CAD/EUR	0.6715	0.6838	-1.80%
USD/JPY	157.2000	141.0400	11.46%
USD/CNY	7.2993	7.1000	2.81%
USD/MXN	20.8272	16.972	22.72%
GBP/CAD	1.7996	1.6871	6.67%
GBP/USD	1.2516	1.2731	-1.69%

Source: Bloomberg, Refinitiv DataStream. Total returns, *Price return. **Commodities are quoted in USD.

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