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Investor Strategy

The latest market insights from Richardson Wealth

RICHARDSON Wealth

Outlook 2025: Three in a row?

Executive summary

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A November to remember

Equities were riding high in November, thanks to the post-election rally following Donald Trump's win and a decent earnings season. What was more encouraging about November's gains was that returns have broadened out from the Magnificent Seven, which drove most of the gains in the first half of 2024. November was the best month of 2024 for the TSX, S&P 500, and Dow, all closing at record highs, and posting total returns of 6.4%, 5.9% and 7.7%, respectively. Small-cap stocks were the clear winner last month, as investors saw the group benefiting from Trump's potential tax cuts. The Russell 2000 also rose almost 11% in the month, notching its biggest monthly gain of the year.

Although investors were optimistic following the U.S. election, not all concerns were abated. A Trump win is not without its complexities, and investors have already been forced to navigate what the new landscape will look like for the next four years. Trump threw down the gauntlet in November, declaring his intention to apply a 25% tariff on all products coming to the U.S. from Canada and Mexico on his first day in office. Trump vowed the tariffs would be upheld until issues such as border protection and preventing the illegal flow of drugs into the U.S, were resolved. Despite the concerns surrounding what trade will look like, Trump's nomination of Scott Bessent as Treasury secretary encouraged investors. The market viewed the pick favourably and sees the hedge fund manager as someone who will be supportive of the equity market and may help mitigate some of Trump's most extreme protectionist policies. And while Trump did seem to dial back some of his rhetoric, the Loonie finished lower for the month.

On the economic front, Canada's economy grew by an annualized 1% in Q3, slightly below the Bank of Canada's 1.5% forecast and economists' 1.1% projection, reflecting slowing momentum after stronger growth in prior quarters. Preliminary October data suggest GDP rose 0.1%, matching September's weak growth. While household consumption rallied 3.5% (its fastest pace in 2023), business investment declined sharply, offsetting gains. On the other hand, Canada's inflation rate rose to 2% y/y in October, up from 1.6% y/y in September, exceeding expectations and driven by factors like rising municipal property taxes and gas prices. Core inflation measures also accelerated, averaging 2.55% y/y, complicating the BoC's decision-making ahead of its final 2024 rate decision on December 11, and leaving markets split on whether the central bank will cut rates by 50 bps at their next meeting or opt for a smaller 25 bps rate cut. The 10-year Canadian yield steadily rose throughout the month but eventually reversed course, sending bonds higher and helping the FTSE TMX Universe Bond to finish 1.7% higher in November.

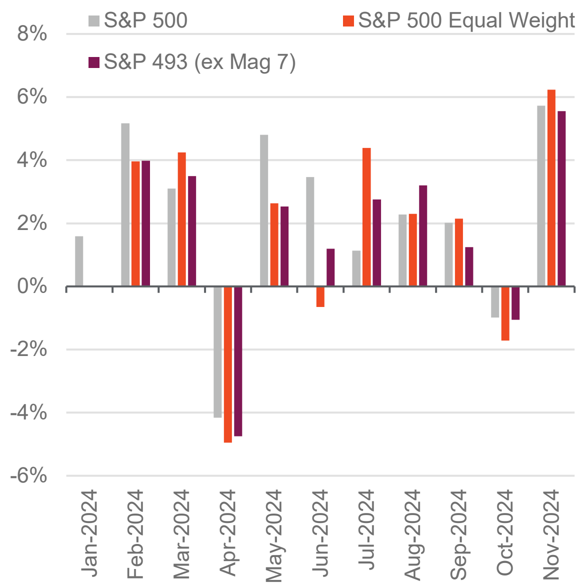
The Fed also faced persistent inflation, with the Core Personal Consumption Expenditures Price Index rising 2.8% y/y in October and 0.3% from the previous month. Consumer spending edged up slightly,

Good month for N Am equities

	Nov-2024	YTD
S&P/TSX TR	6.4%	25.8%
S&P 500 TR	5.9%	28.1%
Nasdaq	6.2%	28.0%
Europe	-0.5%	6.3%
Japan	-2.2%	14.2%
China	1.4%	11.8%
FTSE Can Bonds	1.7%	5.0%
U.S. Bonds	1.1%	2.9%

** local currency*

Better market breadth in 2h24



Loonie pushed to 4-year low

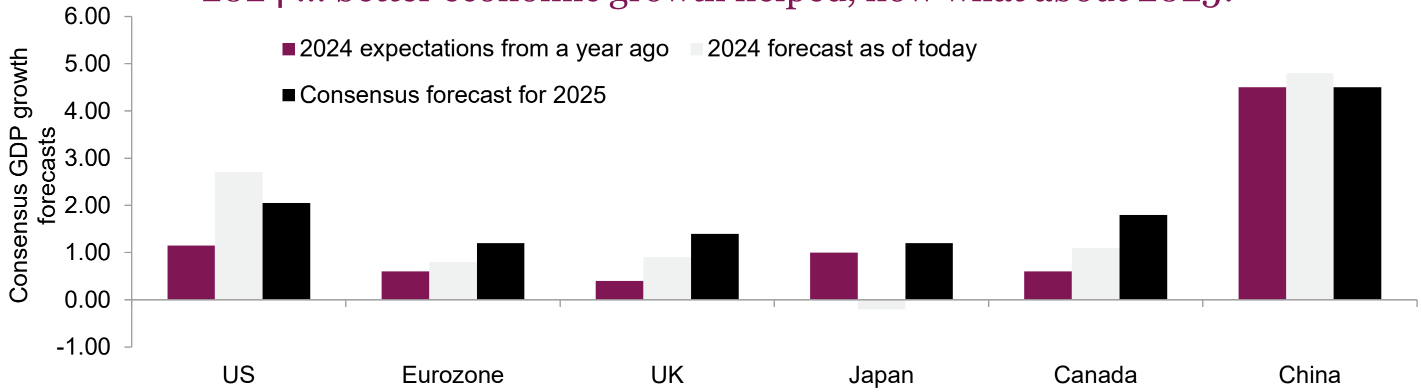
driven by services like healthcare, while disposable incomes saw strong growth, supported by higher wages. A surge in service prices, partly tied to stock market gains, contributed to the inflation rise. The data underscores the Fed's cautious approach to interest rate adjustments, balancing inflation pressures against resilient economic growth. Still, bond yields were able to come down towards the second half of the month thanks to some Trump administration picks and encouraging economic data, with the U.S. Aggregate Bond index finishing 1.06% higher for the month.

Good 2023 and 2024, three in a row for 2025?

Before we jump into our thoughts and analysis for 2025, let's give a big round of applause for 2024! It has been a great year so far for markets – just about all markets, in fact. With one month left to go, global equities are up about 18%. Led once again by American exceptionalism, with the S&P up about 26%, followed by Canada at 21%, then Asia at 15% and finally Europe at 5%. A strong equity market that was complemented by a quieter bond market, albeit up. Canadian and U.S. bonds are up about 3%, with greater gains depending credit. Once again, nobody is complaining about the positive correlation between equities and bonds when they both go up.

The biggest drivers of these returns were better economic growth than widely expected and continued progress on inflation. A year ago, expectations were for a modest 2.6% global economic growth, which now looks to be coming in closer to 3.1%. The U.S. economy led this improvement, but most regions enjoyed better growth than originally expected.

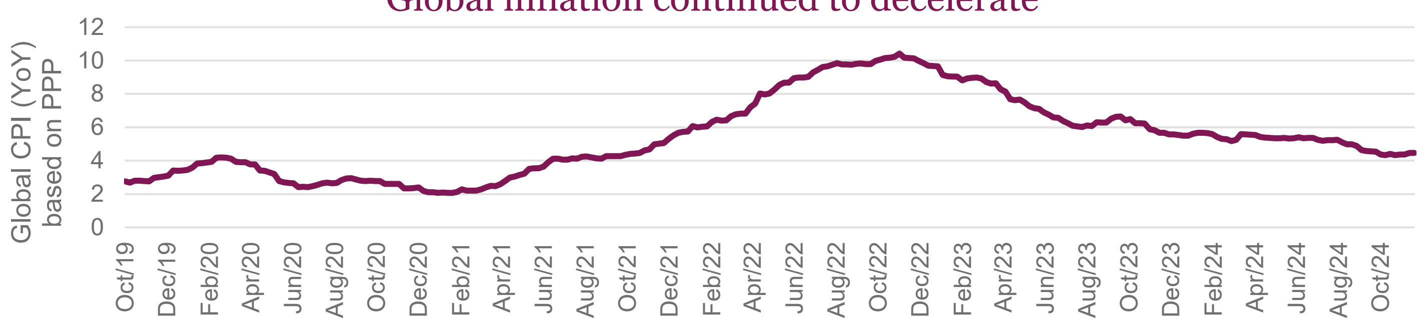
2024 … better economic growth helped, now what about 2025?



Source: Bloomberg, Purposee Investments

Not saying it was smooth sailing from an economic perspective though. Ongoing geopolitical wars weighed on Europe; there was the 'carrymageddon' (more in Investor Strategy: August 2024 issue) as the yen carry trade unwound briefly, and China has continued to grind out the impacts of their real estate bust. The U.S., too, experienced a bit of a soft patch in the summer as concerns about higher rates and inflation would start to show up in less hiring. We will talk 2025 shortly.

Global inflation continued to decelerate



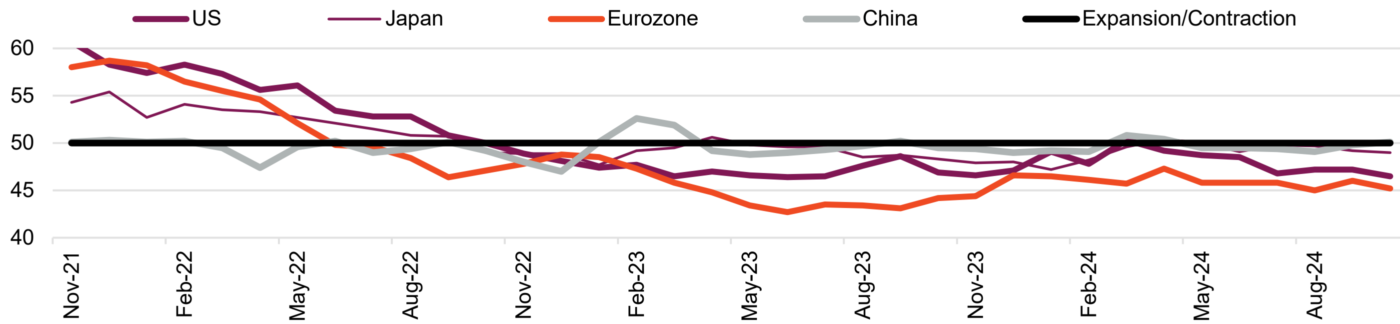
Source: Bloomberg, Purpose Investments

The other big positive? Inflation. Make no mistake, prices have not come down if you haven't noticed it in your day-to-day life, but the pace of inflation has slowed substantially. Improving economic growth plus slowing inflation is a very strong combination for risk assets, namely equities.

Moving into 2025, things certainly get a bit more challenging albeit with some positive aspects as well. Based on current consensus forecasts, you can see from the chart above that economic growth is set to broaden. The U.S. and China are expected to decelerate somewhat, but Japan, Europe and Canada tick higher. There are some big wildcards for 2025. The U.S. consumer has remained resilient even with higher rates and inflation. While some cracks are evident, they are not material at this point. The European consumer is actually pretty healthy and could play some catchup on spending, trying to keep up with the Joneses (Joneses being the U.S. consumer). China's stimulus plans are also variable. The optimistic view is more stimulus in 2025.

Tariffs could prove to be a negative but don't get too excited just yet. It is all talk at this point, and time will tell if threats become policy and what retaliation would ensue. The first round of tariffs a few years ago occurred when global trade was growing at a faster pace. Today, it's rather lacklustre which could mean tariffs will have a bigger economic impact. Even ignoring the tariff narrative, global manufacturing has remained rather muted based on PMI survey data. Combine this with rising inventories, and a positive growth surprise may be harder to come by in 2025.

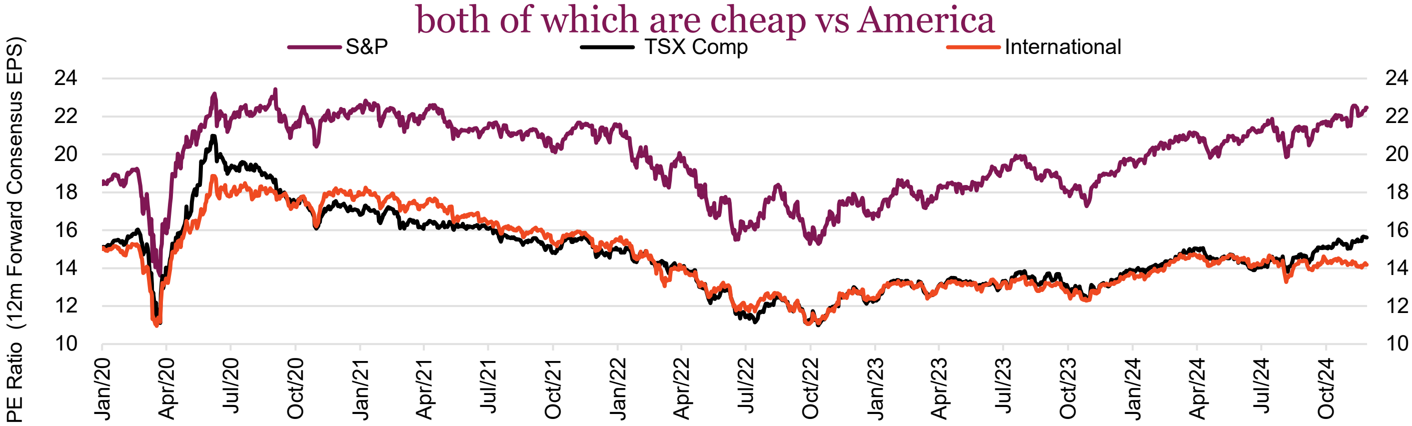
Manufacturing activity remains muted



Source: Bloomberg, Purpose Investments

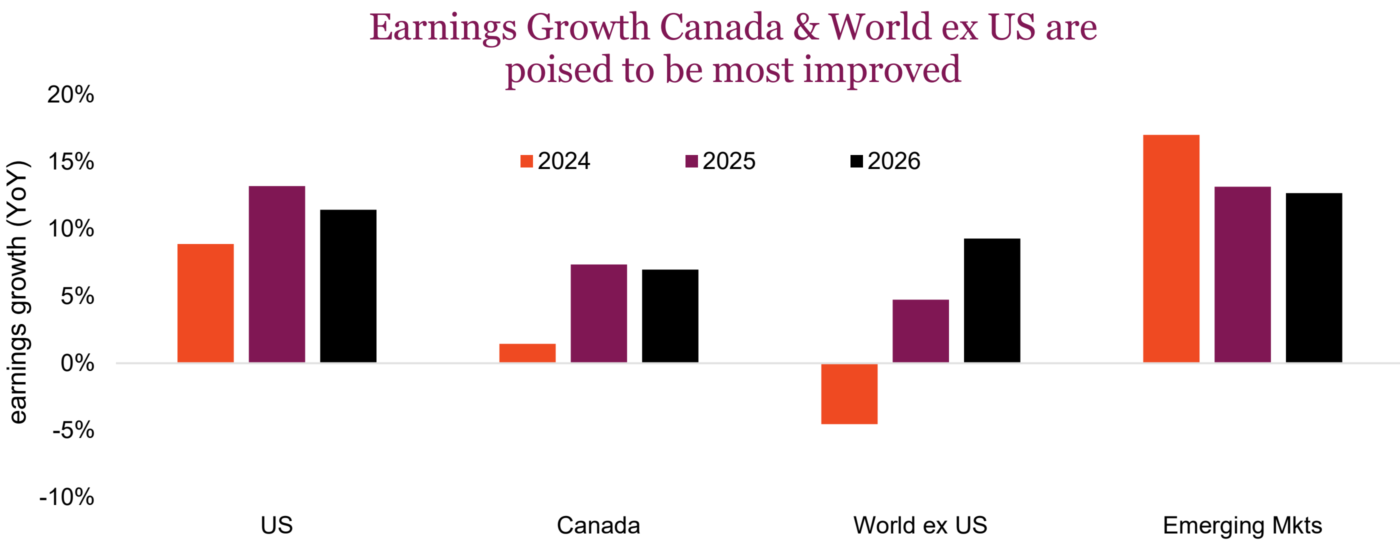
Finally, valuations. Let's first acknowledge that valuations by themselves only tell a part of the story. As you likely know, the U.S. market has been on the high side of the valuation spectrum for a number of years, yet posted great gains. This is because higher valuations have to be looked at in relation to earnings growth. The S&P 500 can easily trade at 22x earnings as long as those earnings are growing at a good pace, which has been the case.

Valuations - favour international and Canada, both of which are cheap vs America



Source: Bloomberg, Purpose Investments

For the past few years, it has been much more important to focus on where the earnings growth is compared with valuation levels. 2025 poses a potential rotation, though. The U.S. market still enjoys stronger earnings growth, but one could argue that this is priced at 22.5x multiple. Canada, though, at 15.5x, is expected to move from near-anemic earnings growth to almost 10%. And world ex U.S. is by far most improved, from negative earnings growth to solid mid-single digits.



Source: Bloomberg, Purpose Investments

Overall, we expect both economic activity and earnings growth to go more global than just a U.S. story. This should help broaden market leadership. Of course, revisions to both economic growth and earnings expectations will be crucial, and they may be impacted by tariff talks. Inflation, too, will be critical. There are some signs inflation is starting to pick up again in the U.S., Canada and the UK. If this occurs, the market may be disappointed in the number of rate cuts in 2025. Things are rather well balanced, though – sorry that isn't very exciting.

Trump 2.0

As we embark on a four-year journey with President Trump at the helm of the world's largest economy, there are both knowns and unknowns. Given the sizeable sweep of all three branches of government, policy will be easy to implement. From a market perspective, the clearest known is there will likely be lots of headlines. Many probably inflammatory and with the likelihood of moving markets, at least temporarily. Currently, the big topics are tariffs, regulation and tax/spending.

But who knows which announcements will move markets the most?

Investors clearly have a positive memory of Trump's first term, based on market gains. And as humans, we all like causal relationships – it makes us feel better and more in control. Unfortunately, this is rather simple thinking. In our opinion, markets started to perform better earlier in 2016 before the election because, for the first time since before the 2008 financial crisis, we had global synchronized economic growth. After '08, the U.S. and Asia started to recover, but Europe faltered. Then, when Europe improved, the U.S. hit a soft patch economically. Then, when the U.S. re-accelerated, Asia fell flat. But in 2016, the three major economic zones started all growing together! That is what moved markets higher over the coming years.

The other challenge is starting points; they really matter. Looking at the economy, GDP growth for the U.S. and globally was moving from a tepid to a higher growth pace in 2016. Today, economic growth is decelerating. Back in 2016, interest rates were super low and accommodative, and quantitative easing was flowing. Today, they are much more restrictive and higher yield, with quantitative tightening on the go. And then the equity markets. In 2016, equity markets were much cheaper and had modest earnings growth expectations. Today, it is more expensive with high growth expectations. The tax cuts in 2016 were a lift because corporate taxes started so high. Will we get the same impact trying to cut corporate taxes from a much lower start point?

Very different starting points for Trump 2.0 vs 1.0

Economy		US GDP		Global Economy	
		Now	Next Year	Now	Next Year
	2016	1.60%	2.30%	2.90%	3.60%
	2024	2.70%	2.05%	3.10%	3.10%

Rates		Fed Funds	10-year Yields	High Yield Spreads	QE/QT
	2016	0.50%	1.80%	422	QE
	2024	4.75%	4.30%	296	QT

Market		S&P 500 PE Ratio	Expected EPS Grwth	Corporate Tax Rate
	2016	17.0	1.4%	28%
	2024	22.3	12.7%	19%

Source: Bloomberg, Purpose Investment, tax rate UBS

Trump game plan

We think there are two choices here: Act or Watch.

Act

The act option is to take announcements at face value and try to adjust exposures quickly. For instance, at the time of writing in late November, Trump announced tariff plans that would hit Canada and Mexico. If you took it at face value, that would have us reduce Canadian equity exposure, notably exports (think there are still a few) or reduce exposure to the Canadian dollar. This approach has some benefits, including the positive emotional impact of taking action, and it may sound smart.

But we think there are a number of challenges with this approach. Trump is going to say a lot of things over the next four years, and based on the previous term, many of these will not come to reality. Or the policy announcement is the first move in a longer process that will become evident over time. For instance, the recently announced 25% tariff on Mexico may turn out to be a bargaining chip in future discussions to see if Mexico will aid in border security. We also think the frequency of announcements will make it really challenging to try and react. You could very easily just be chasing your tail.

Watch

There are very few constants when it comes to investing and the markets. However, one constant is the markets often overreact in the short term. We could blame the financial media, which will cover the bejesus out of anything Trump-related but lightly glance over important economic news. One is more fun to talk about and certainly gets more clicks/eyeballs. We could blame fast money algorithm trading systems. It doesn't matter though.

Watch the market, and only if it really overreacts should any action be taken. Of course, we are not sure how much the market will react under Trump Term 2.0. Markets adapt pretty quickly, and in the first term, the style of announcement and frequency was unprecedented. That increased the market reaction function. Now, we are all a bit more numb to the headlines, as is the market.

Nonetheless, we can expect to hear more announcements that grab the headlines, which could increase the noise in the market. Underneath this noise, there is the economy that drives earnings, and earnings drive the market. Policy can nudge the economic path, but the macroeconomic forces are likely much more powerful.

Of course, listen to the noise, but don't necessarily react. In fact, watching to see if the market materially overreactions and then acting may prove better for your portfolio.

Equities – Can U.S. exceptionalism persist?

2024 turned out to be one of the best years for equity investors in recent and even not-so-recent years. While we're writing (the year is not done), the S&P/TSX Composite is up 25%, while the S&P 500 is up 27.5%. Add on another 7% when you factor in currency moves. Pretty impressive. This marks back-to-back 20%+ return years for the S&P 500, a run that's occurred just four times in the past 100 years. It also marks the fourth 20%+ return in the past six. Obviously, one of the biggest questions from an equity positioning standpoint is whether this run of U.S. exceptionalism can continue.

Below, we break down the historical U.S. sector returns. This quilt is a good way to easily spot the winners. It should also be pretty clear that sector winners can drastically change one year from the next. Surprisingly, Technology isn't in the top spot in 2024, as Financials are now the best-performing sector this year, up 37%. Big Tech is still no slouch up 33%, nearly on par with its average returns over the past six years. It's noteworthy that it's consistently been one of the best in recent years (we'll ignore 2022).

Sector Quilt

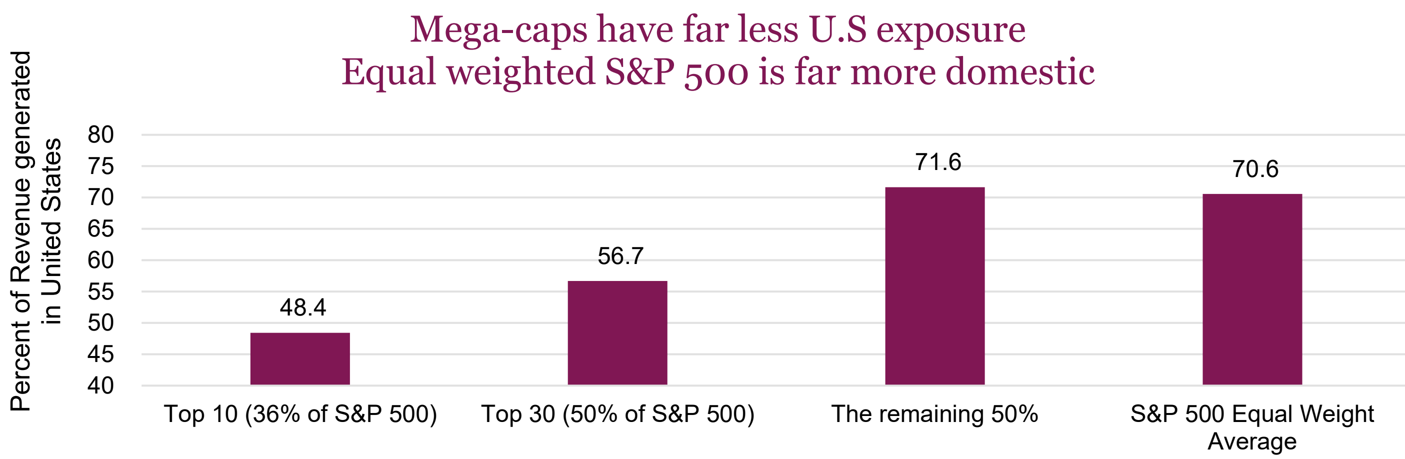
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD
Materials (US)	5%	-10%	14%	21%	-16%	22%	18%	25%	-14%	10%	10%
Energy (US)	-10%	-24%	24%	-4%	-20%	8%	-37%	48%	59%	-5%	13%
Industrials (US)	8%	-5%	16%	19%	-15%	27%	9%	19%	-7%	16%	26%
Consumer Disc (US)	8%	8%	4%	21%	0%	26%	32%	24%	-38%	41%	25%
Consumer Staples (US)	13%	4%	3%	10%	-11%	24%	8%	16%	-3%	-2%	18%
Health Care (US)	23%	5%	-4%	20%	5%	19%	11%	24%	-4%	0%	8%
Financials (US)	13%	-3%	20%	20%	-15%	29%	-4%	33%	-12%	10%	37%
Real Estate (US)	26%	1%	0%	7%	-6%	25%	-5%	42%	-28%	8%	13%
Info Tech (US)	18%	4%	12%	37%	-2%	48%	42%	33%	-29%	56%	33%
Telecom Svs (US)	-2%	-2%	18%	-6%	-16%	31%	22%	21%	-40%	54%	33%
Utilities (US)	24%	-8%	12%	8%	0%	22%	-3%	14%	-1%	-10%	31%
S&P 500	11%	-1%	10%	19%	-6%	29%	16%	27%	-19%	24%	26%

Source: Bloomberg, Purpose Investments, as of 11/27/2024

Earnings to be tested – Compared to the past couple of years, expectations for earnings growth are more subdued for 2025. Ever since 2022, there has been a forecasted earnings slowdown or economic slowdown that continually keeps getting pushed out. Hat tip to the central bankers which, whether it's by their own doing or not so far, who have kept North American economies remaining on a steady path. 2025 EPS estimates are expected to grow 13.1% in the U.S. and 13.5% in Canada. It's worth noting that these estimates are likely lofty, and both countries are already seeing 2025 earnings estimates continue to trend lower. Margins are already just about back at all-time highs, so top-line growth is going to be rather important. Is 2025 going to be the year of moderation? Perhaps, especially with a new president who's determined to shake things up. One trend that will surely continue into next year is the resilience of the consumer and adaptability of businesses.

How much are you willing to pay? – The S&P 500 is currently trading at 22.4 times blended forward earnings, a significant premium to the average forward P/E of 18.4 seen over the last ten years, and even more expensive if you look back further. Any way you slice it, U.S. markets are overvalued. Canada is decidedly less so, trading at just 15.6 times forward earnings, which is just above its 10-year average. To put this into perspective, U.S. markets have only been this expensive for 2% of the time since 1960. The only other times were in late 1999 and early 2000. We're not going to get into the compare and contrast to the dot-com bubble. We've all heard about it for the past few years, and so far, there has been no ‘pop’. The megacap tech companies largely responsible for the elevated earnings are making buckets of money, unlike then.

Valuations don’t always matter; they matter most at turning points. For now, the only thing that matters is how much investors are willing to pay. We can’t predict how others will spend their money, but we see far better value in the equal-weighted index, which is trading at just 18.5 times forward earnings. The index does not have the same exposure to AI, but it is still trading at reasonable valuations. One added benefit is that the equally weighted index is considered more domestically focused as it dilutes the influence of large globally oriented companies and gives more weight to smaller companies which generate more of their revenue from inside the United States. If 2025 is going to be all about making America great again and bringing back trade wars, this domestic focus should be rewarded.



Source: Bloomberg, Purpose Investments

How to position

Fervent risk appetite is pushing markets to a strong finish in 2024. Heading into next year, investors should stay flexible in their pro-growth positioning. Despite high valuations and tempered earnings expectations, the market momentum remains strong. Everyone has a plan to get out or reduce risk before the inevitable correction. That rarely happens. We prefer a defensive tilt in our equity exposure and have a slight underweight to U.S. equities with a specific focus on broad equal-weight exposure. We also favour dividend stocks, focusing on valuations and favouring defensive sectors. During periods of volatility, being active and pivoting towards increased risk exposure might be warranted should macro conditions remain supportive.

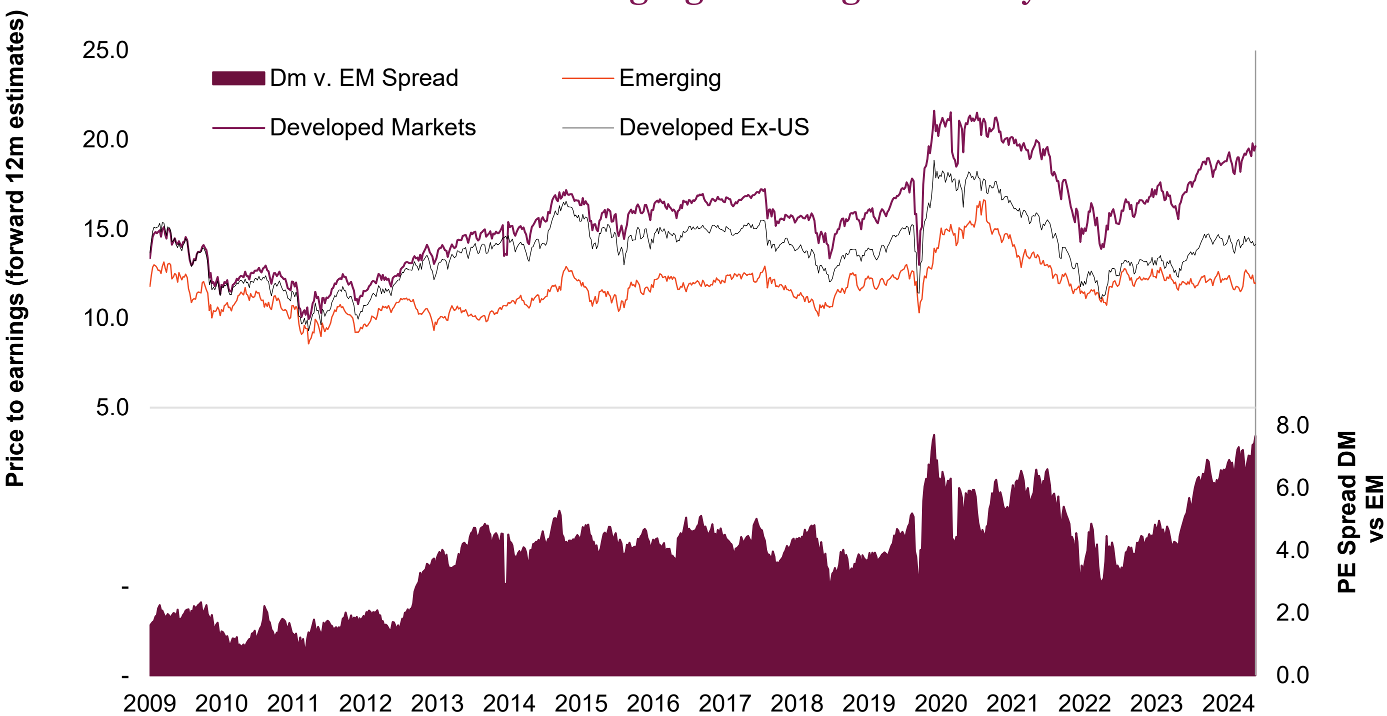
2024 was a year with not much equity market volatility. The VIX has averaged just 15.5, the lowest since 2019. Neither the S&P 500 nor the TSX saw any “official” corrections. The largest drawdowns for each were -8.3% and -5.3% respectively. Compared to this year, we’d expect elevated levels of volatility next year as markets adjust to more erratic government policy. Big changes in tariffs, immigration policy and yields will likely be influential at these lofty valuations.

Pledging allegiance to international equities

International equities have posted some excellent returns in 2024. But with such U.S. dominance, do many people know? The allocation decision for many investors to overweight U.S. equities has been justified to the highest degree. There has been an astronomical outperformance of U.S. equities to the world over the last 15+ years. You have to go back to the mid-2000s during China’s rapid expansion to see any sort of sustained international outperformance. Looking forward, we believe there is a potential for mean reversion between the U.S. and international, albeit anyone saying this for the last 10 years has been quite wrong. However, some cycles take longer than others, and at this point in time, the setup for international, specifically emerging markets, looks particularly positive.

Valuations – Comparing valuations from one market with another is akin to apples and oranges, as different markets have differences in underlying compositions, sector weights and growth characteristics. But they do still matter. While valuations are at the high end globally, there is certainly a larger cushion within the international markets. The higher valuations in the U.S. have been justified as there has been higher growth, higher earnings, and certainly higher sentiment.

Valuations offering a good margin of safety

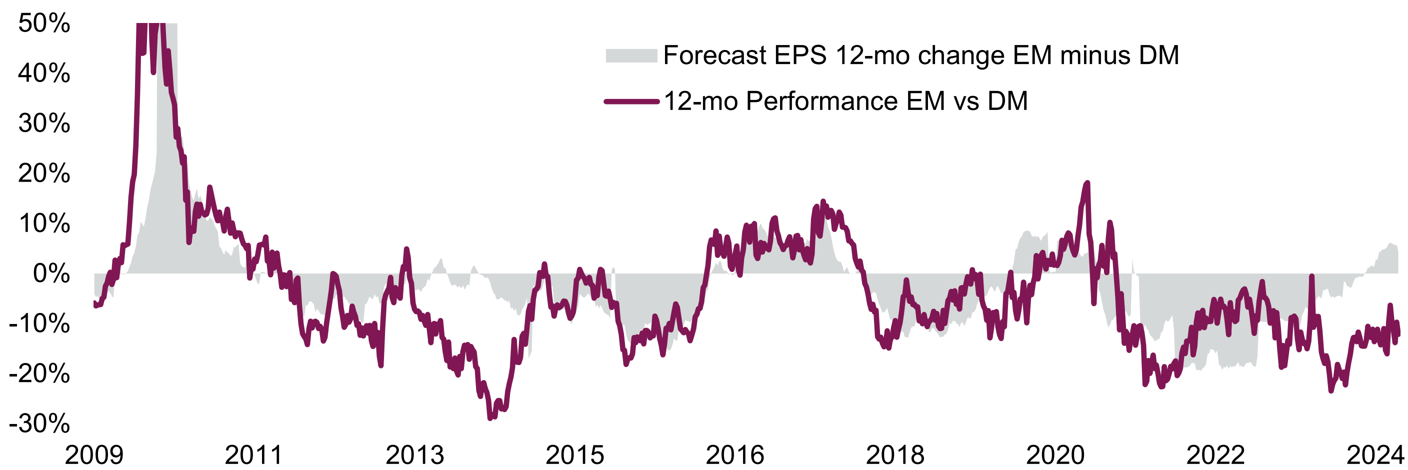


Source: Bloomberg, Purpose Investments

Looking ahead, two things can be true: Emerging markets (EM) are almost always cheaper than developed markets (DM), and valuation gaps tend to attract attention when they reach historic extremes. That is certainly the situation with the spread between Forward P/E ratios for developed and emerging markets. This spread has climbed to over 7.5 points, with a 1.5-point increase coming in the last few months. The emerging markets are composed of more cyclical economies, and earnings can be highly variable; therefore, a cheaper market is justified, but the current valuation gap is at very extreme levels when compared to history, which has not lasted long. The spread provides a compelling valuation argument for emerging markets and developed ex-US markets to view them more favourably, or at the very least, temper fears about potential downsides.

Earnings – In the middle of 2024, earnings growth forecasts were very high in the U.S. and low internationally. However, earnings estimates for 2025 have started to soften across the globe. The risk of this seems to be largely ignored; perhaps the ignorance of the U.S. earnings expectations falling is due to coming off such high highs. However, the risk is likely higher for U.S. equities, given how much the elevated valuations are supported by their earnings growth. The simple truth is if earnings growth falls short, markets trading at a low valuation will not be hurt as much compared to those at a high valuation. A resurgence in inflation, a slowing of top-line growth, and an increase in costs would not be supportive for a market with extended valuations, strengthening the case for international.

Earnings growth favours emerging

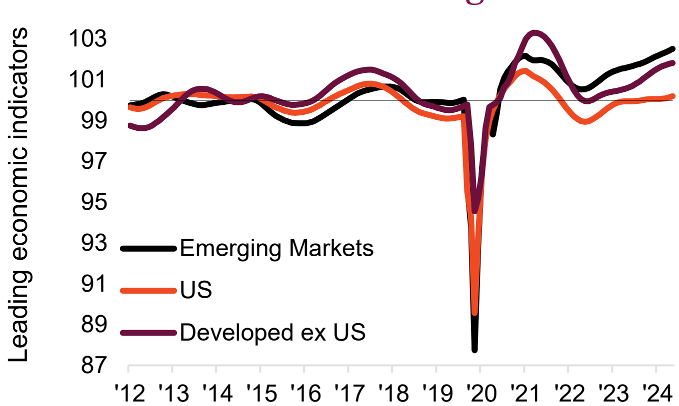


Source: Bloomberg, Purpose Investments

To no one's surprise, if one market has stronger expected earnings growth than another, performance tends to trend in the same direction. This is the case for the correlation between EM & DM. It has been a challenging decade for EM, largely due to DM earnings dominance. However, forward earnings growth for EM is now meaningfully outpacing DM. What's surprising, though, is that this shift doesn't seem to be reflected in the performance of EM just yet. If this trend continues, EM could be set for a much stronger run.

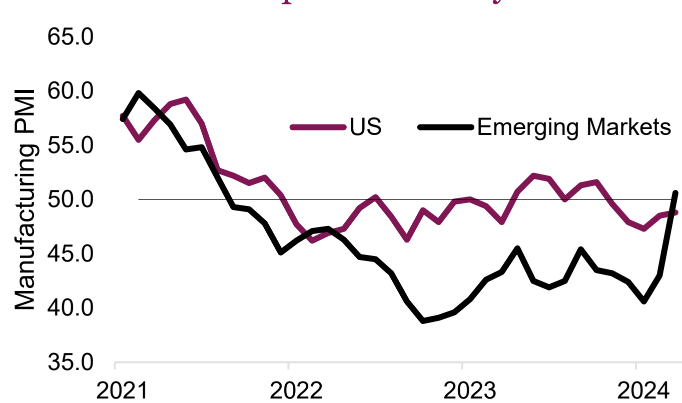
Economy & trade – Across the globe, we are seeing a broadening out of economic activity. Many central bank policies have begun their easing cycles (ex-Japan). This is favourable for international markets, specifically emerging markets, as many EM central banks started easing sooner than most nations. Additionally, if the Fed continues to cut rates, we could see US dollar weakness, easing financial conditions in EM and supporting economic growth. Internationally, the leading economic indicators look strong. International has been outperforming for quite a few years but has recently increased the spread against the U.S. Emerging markets have taken off, led by manufacturing, which has seen a quick recovery after trailing the U.S. for much of the 2020s.

International leading



Source: Bloomberg, Purpose Investments, OECD

EM quick recovery



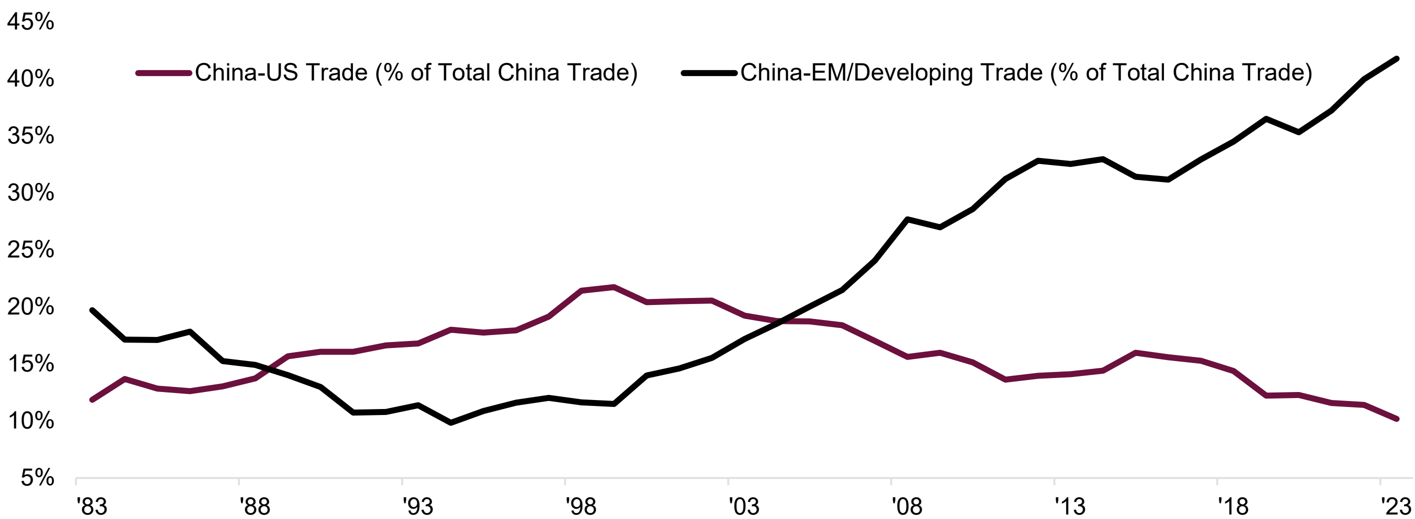
Source: Bloomberg, Purpose Investments

Today, tariffs are certainly the talk of the town. It is too challenging to opine on whether tariffs will be implemented, their magnitude, when they will be implemented, and what reciprocal measures will be taken against them. If we focus on the economic trends, it is clear that global trade is turning higher, a strong historical indicator for the outperformance of international vs. U.S. – more specifically, EM vs. DM. The strength is encouraging, and if there is a continuance of improvement in global trade, this will likely prove to be better for international exposure.

Last year, the largest trade partners with the U.S. were Canada and Mexico; therefore, it is no surprise that President-elect Trump has dialled in on tariff threats to those economies first. In the end, tariffs on China on top of existing ones will likely be the heaviest. However, no opining here … these policies are not 100% guaranteed. While there will be some economic impact if tariffs are increased, we expect the reaction to be slightly more muted from an equity perspective for a few different reasons.

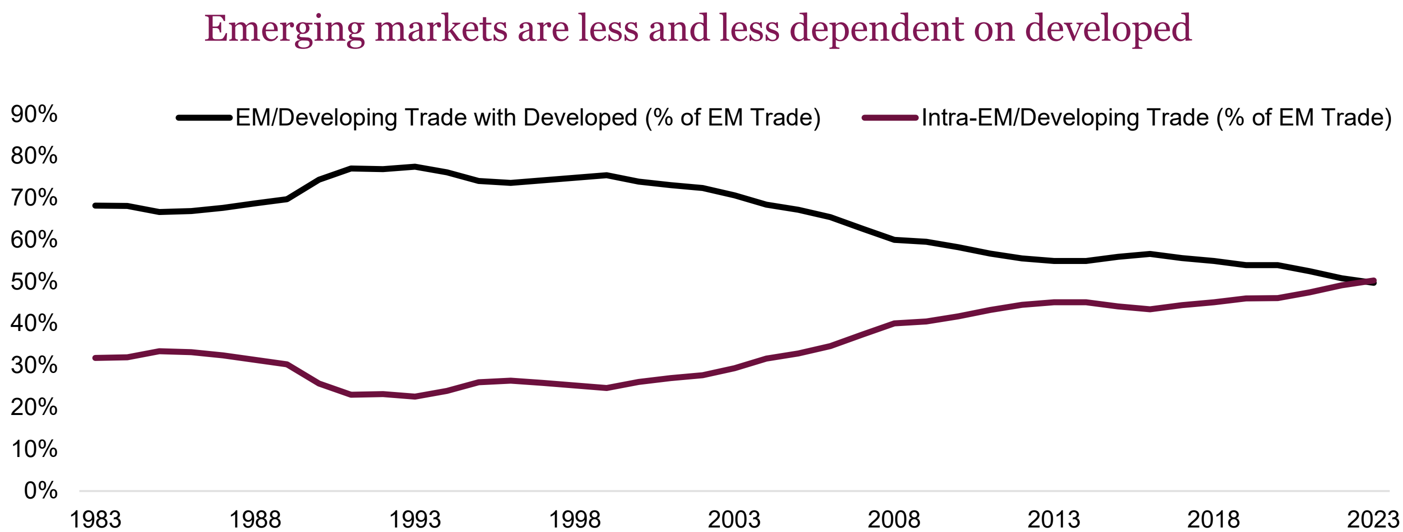
First off, China has diversified away from much of its trade with the U.S. Keep in mind that the U.S. is still the largest country they exported to last year. Still, when looking at the percentage of China's total trade, we have seen a meaningful increase in China's trading with other EM and developing nations. Only 10% of China's total trade is currently with the U.S., while a meaningful 42% is EM. This trend has been happening for a while but certainly took a meaningful uptick at the start of Trump's first term in 2016. On top of that, China has injected a recent round of stimulus, and if we get more stimulus measures in China, this may outshine any bad news inflicted by American tariffs.

China Trade: US influence the lowest back to 1980



Source: Purpose Investments & Bloomberg

Looking more broadly at the emerging markets, we have seen a much more balanced approach to trade than we have seen over history. What used to be largely about the emerging market's dependency on trading with developed nations, has now shifted to accommodate growing demand within these markets themselves. The exciting part? A large part of this shift is fueled by long-term trends like rising incomes and youthful, growing populations – factors that are expected to keep the momentum going.



Source: Purpose Investments & Bloomberg

Yes, this is the classic demographic argument, but this increased trading amongst emerging market economies is proof this demographic trend is strong.

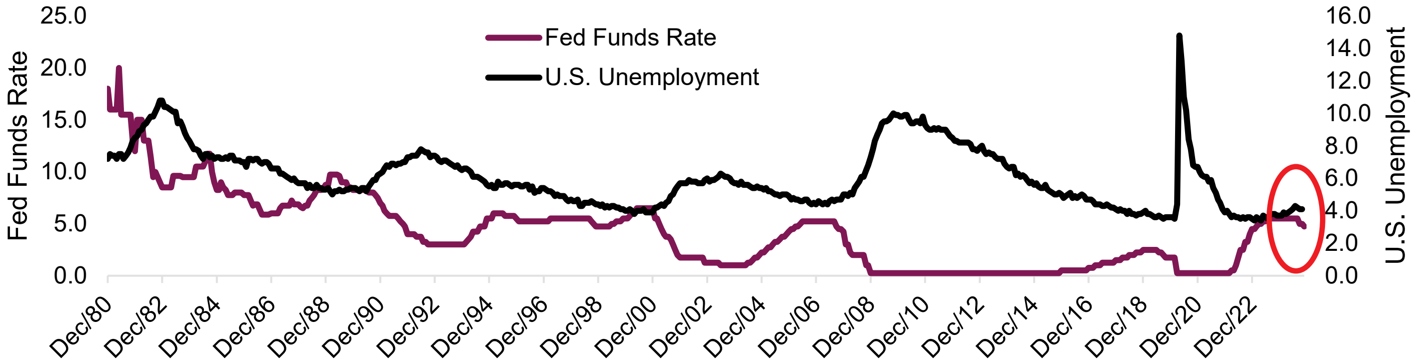
While tariffs remain a risk to international equities, their impact may not be as meaningful as they were in the past. More diversified supply chains paired with global trade being less dependent on the US could lessen the blow. As we look ahead to 2025, the combination of attractive valuations, strong earnings growth, and an improving global economy encourages an overweight position in international equities. By staying focused on our economic indicators and monitoring the evolving landscape, we aim to capture the international growth that lies ahead.

Bond market dynamics and macroeconomic landscape

The red-sweep outcome of the U.S. election is expected to reinforce pro-growth policies, providing a robust foundation for domestic risk assets. This shift is likely to be driven by fiscal initiatives aimed at stimulating economic activity, bolstering corporate earnings, and sustaining investor confidence in U.S. markets. However, these domestic gains may come at a cost to global markets, as restrictive trade policies threaten to disrupt supply chains, add strain to international economic relationships, and increase geopolitical tensions. The focus on prioritizing growth in the U.S. could worsen economic divergence between domestic and international markets and amplify volatility in the global markets.

The macroeconomic landscape is undergoing a significant shift, with interest rates appearing to have peaked and central banks lowering policy rates in response to easing inflation rather than economic weakness. In U.S. markets, rates are converging toward neutral levels, with the majority of the adjustments expected to occur by the end of 2025. However, this policy easing unfolds against a backdrop of historically tight labour markets approaching full employment, and inflation rates for core and services sectors remaining above pre-pandemic norms, between 2% and 3%. This unusual convergence of monetary easing and labour market constraints introduces a complex dynamic rarely seen in prior cycles.

Near-record low unemployment does not support cutting rates



Source: Bloomberg, Purpose Investments

Adding to this complexity is upward pressure on longer-term bond yields. This expectation is shaped by a combination of near-term economic resilience, growing concerns over fiscal deficits, and, most importantly, the potential inflation risks posed by the Federal Reserve cutting rates in this constrained environment. The interplay between rate cuts and persistent structural pressures suggests a more volatile and unpredictable path for bond markets. Inflation risks will likely remain a key determinant of yield trajectories, with longer-term yields expected to rise as markets adjust to this evolving landscape.

Bond supply and budget deficits

A critical factor influencing the fixed-income market is the significant increase in bond supply, driven by the U.S. government's efforts to finance a growing budget deficit. In 2024, the Treasury substantially ramped up bond issuance to meet elevated spending requirements, worsened by rising costs and ongoing fiscal support programs. This surge in supply exerted upward pressure on yields, particularly longer maturities, as higher term premiums are required to attract buyers. The expanded budget deficit adds another layer of complexity to the bond market landscape. Rising deficits imply more borrowing and spending by the government, leading to an increased supply of Treasury securities and potentially higher yields if investor demand does not keep up.

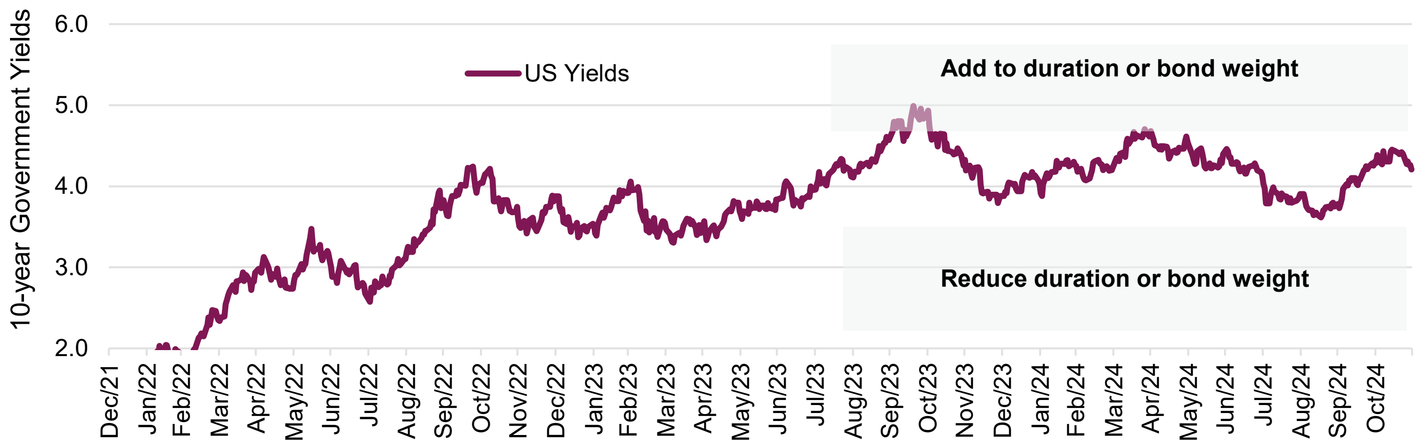
This interplay of rising bond supply, fiscal imbalances, and market demand underscores the delicate balance required to manage yields and maintain stability in the bond market. Furthermore, higher yields at longer maturities could influence borrowing costs for corporations and households, indirectly affecting broader economic conditions. Understanding this intricate balance is essential for navigating the fixed-income market in 2025, as it highlights not only the immediate pressures on yields but also the broader implications for market stability, liquidity, and economic resilience.

Portfolio construction

In today's evolving market landscape, a strategic recalibration of fixed-income allocations is essential. As yields approach levels of 4.5% or higher, a shift from underweight to neutral duration becomes significant, with potential opportunities to adopt a long bias if yields rise further. This approach enables investors to capitalize on enhanced income potential while positioning for future rate stabilization.

Although short-term volatility may persist, the core fundamentals of fixed income remain robust. Periods of market turbulence are likely to create opportunities to selectively increase exposure to risk assets at more attractive valuations. The pro-cyclical and unstable correlations between bonds and equities, often driven by elevated inflation, diminish fixed income's traditional diversification benefits over time. Yet, this does not diminish the overall importance of fixed income. Elevated yields have enhanced its return potential relative to equities, even as equity markets face heightened cyclical risks and stretched valuations.

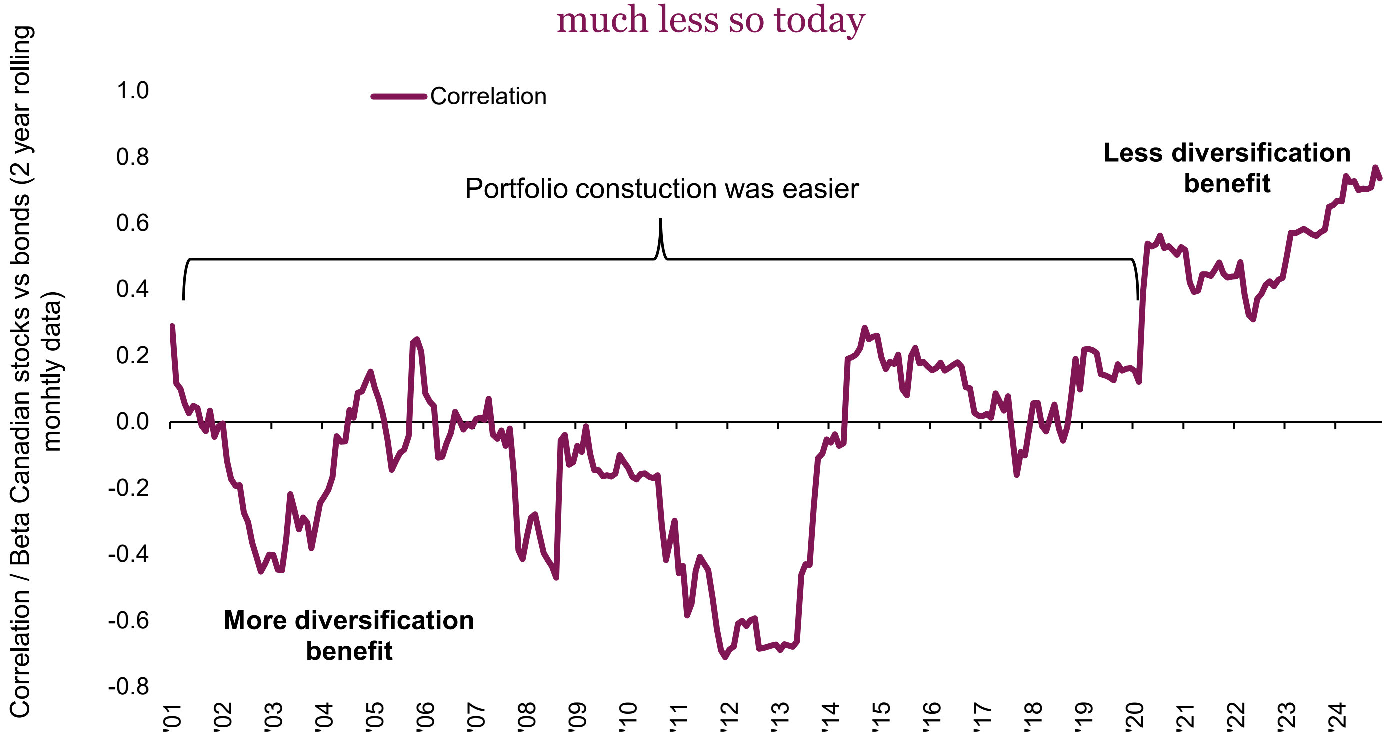
Will remain rangebound, fostering a more tactical approach to bonds



Source: Bloomberg, Purpose Investments

These dynamics challenge the traditional 60/40 portfolio framework, as shifting correlations result in a flatter efficient frontier. In this context, fixed income assumes a critical role not only as a source of stability but also as a dependable generator of income. A deliberate, forward-looking strategy is key to navigating this increasingly complex economic environment, allowing investors to balance risk, capture opportunities, and maintain resilience.

Finding diversification was much easier during past few decades, much less so today



Source: Bloomberg, Purpose Investments

Diversifiers – old and new

Over the last few years, investors have experienced an increase in the correlation between many asset classes. This has made finding diversification more challenging than in the past two decades, which had enjoyed an abnormally low correlation between many asset classes. This can be seen by the recent performance of the popular 60/40 portfolio (60% equity / 40% bonds) in both directions. 2022 was one of the worst years as both equities and bonds fell. 2023 & 2024 were great years, as both equities and bonds rose. Seems nobody cares about cross-asset correlation in up markets, but you should.

Higher cross-asset correlations don't mean the core building blocks of portfolios have changed. It remains the combination of equities and bonds. However, this higher correlation will increase the portfolio volatility, sometimes in a good way and sometimes in a bad way. In an attempt to offset this increased volatility, it is advisable to look for different sources of diversification, even if just on the edges of a portfolio.

Real assets such as commodities, real estate, and infrastructure are often a component of portfolios that serve this purpose. Having something that is considered 'rare' or not an asset that can see its supply double overnight, has long been seen as an important part of portfolios. Real assets also tend to do well when inflation is higher or more volatile, as their value tends to follow inflation. Since inflation is one of the causes of higher bond/equity correlations, real assets certainly help provide a different kind of portfolio diversification.

During this recent experience, there have been assets that have performed well as diversifiers, and it offered an important reminder of why they are part of a portfolio. Let's dive into perhaps one of the original real assets, gold, and touch on what some are calling the newest real asset, Bitcoin.

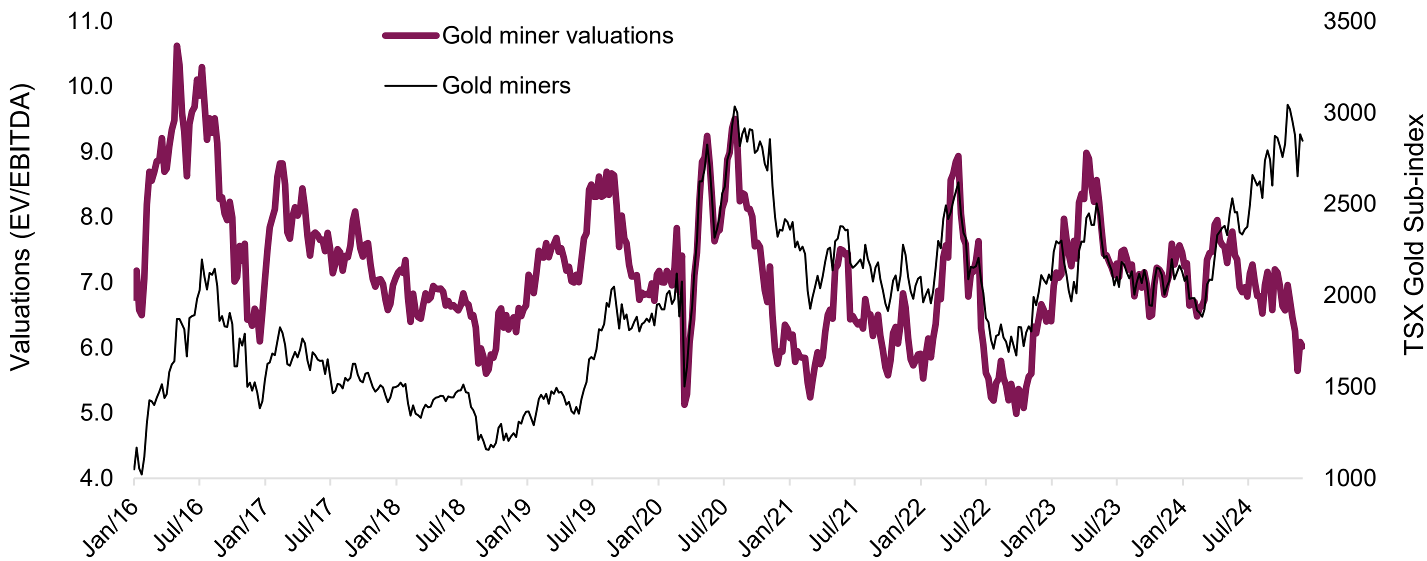
Gold can often be seen as the original 'real asset.' It has been around for thousands of years and served as both a form of currency as well as an investment. The supply of gold is relatively fixed; you just need to find it. However, it can be argued that the 'easy to find' gold has been discovered, and new sources of supply will have to come from more difficult projects in riskier jurisdictions, which will cost more to produce. While scrap supply of gold is a swing factor, as in periods of spikes, some will decide to sell their jewelry – it's small. On the demand side, we have seen a huge increase. Gold has been an asset class that was made open to many investors in the early 2000s with the launch of physically backed ETFs; however, a new investor has been dominating that investment follows over the last few years with central banks buying.

Geopolitical risk has been spiking over the last decade. After many years of global trade and integrated economies, the trend appears to be reversing. During the period of calm, most central banks held the bulk of the reserves that backed their currency in US treasury bills. As trade tensions increased, and for many, the desire to have their saving held in US$ decreased, we have seen switching from treasuries to gold. The last five years have seen the highest level of central bank buying of gold ever. This has been led by the BRIC nations as well as the Asian economies. The seizure of Russian central bank assets (and cancellation of held treasuries) post-invasion of Ukraine made this risk clear to many countries, making it difficult to see the gold-buying trend reverse anytime soon.

What is even more impressive, with gold prices hitting record prices this year, is that it has been happening during a period of a strong US$ and higher real yields. When an asset goes up against strong headwinds, take note.

Within portfolios, there are several ways to gain exposure to gold. Having direct exposure to the commodity can be seen as the cleanest, and adding a position in a physically backed ETF will offer the diversification that investors have been seeking. The other option is to seek exposure to gold through an investment in gold mining companies. This sector has been under pressure for years and is often cited as a destroyer of value by many investors. This has led to the valuations of these companies falling to near-record low levels and dramatically lagging the performance of gold bullion. Investors will need to get comfortable with adding more equity risk, yet at these levels, getting exposure to gold through both the commodity and miners looks attractive.

Worth noting that miners are kind of cheap



Source: Bloomberg, Purpose Investments

But what of Bitcoin – the 'new gold'? Many of the same trends that have helped to lead gold to record levels can be seen within the cryptocurrency market. The supply of Bitcoin was laid out in the initial document that announced its creation, with an eventual maximum number of coins at 22m over 100 years from now. With supply somewhat structured, it all comes down to demand, which received some big tailwinds in 2024. This included the rapid adoption of the Bitcoin ETFs; putting Bitcoin in an ETF form has allowed both retail and institutional investors the ability to add to their portfolios in a seamless manner. More demand plus constrained supply – anyone who took ECO 101 has an idea of what that usually means.

The recent U.S. election is an additional positive for the crypto market. President-elect Trump has made it clear he wants to make the U.S. very crypto-friendly and has appointed the most crypto-positive cabinet in history. Many investors that had been on the sidelines were concerned that the risk regulation would change and affect these instruments, which seems to be a very minimal risk over the next four years.

Within portfolios, the use case for Bitcoin is a hot topic and will likely remain so for some time. There is no debate it has been a volatile asset throughout its short existence and has behaved more as a 'high-risk asset.' That may change over time. In any case, it certainly behaves very differently than most other investments, which is a source of diversification. With a total worth of nearly $2T, this is an asset class that all investors need to have an opinion on.

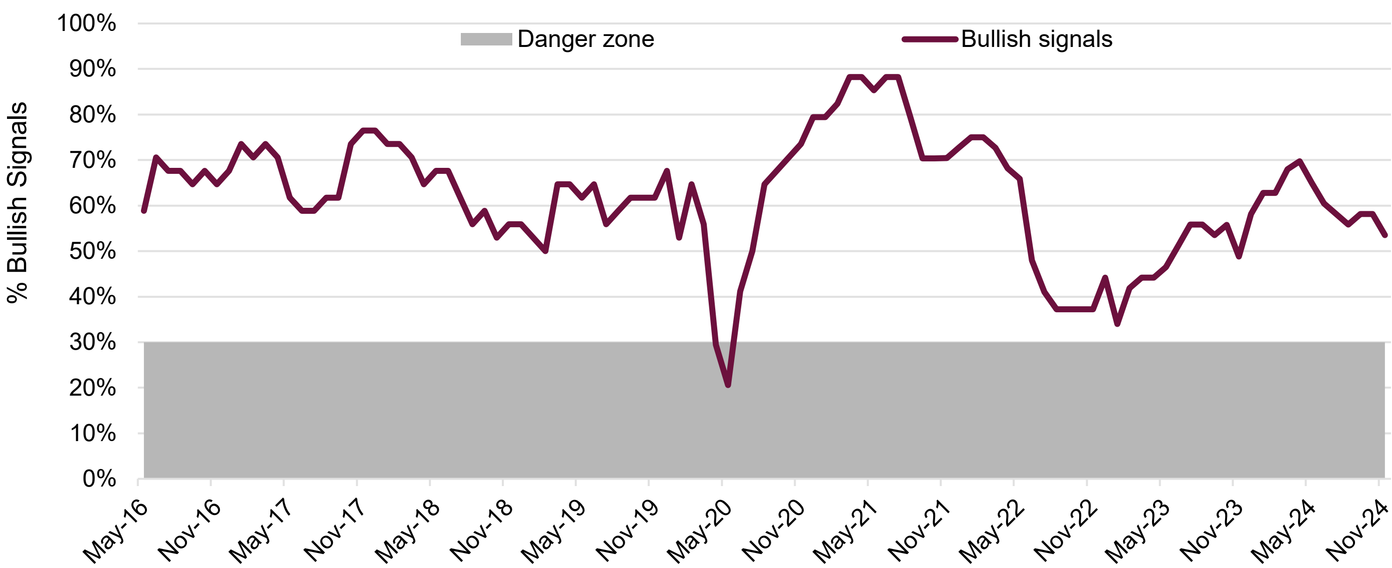
It seems for the past two years, we have entered the year looking for an increase in volatility. As we head into 2025, it's hard to think it won't work this year. Central banks are trying to thread the needle of a 'soft landing' while winning the war against inflation. A new president bent on leading first with tariffs doesn't seem like a backdrop for calm markets. Gold and Bitcoin have both hit record highs recently and with a positive supply-demand backdrop, both assets look to be in an excellent position to do so once again in the new year.

Market cycle and portfolio positioning

Can markets post another consecutive year of outsized gains in 2025? Of course, but it does become less likely, as gravity or mean reversion is an enduring characteristic of markets. 2025 will be an interesting one as markets have already enjoyed the lift from falling inflation and a positive growth uptick from the global economy. Where could the positive surprise come from in 2025?

On the positive side, we have a global economy that appears alright, far from ideal, but equally far from trouble at the moment. Corporate earnings are growing, and in the long run, that is what drives the stock market, albeit with a lot of noise around that trend. Valuations are a bit high but not crazy. Everything seems to be kind of in the middle; sorry, that makes for a less exciting outlook.

Market cycle indicators - Slipping a bit



Source: Purpose Investments, Bloomberg

Market cycle indicators have started to erode a little bit of late. The U.S. economy still has much more positive than negative, with housing starting to show some weakness. But generally, the data is improving. Same with the global economy, which has many more bearish signals. It's the trend that is improving. The concern we have is on the fundamentals. Not alarm bells at this point, but we have been seeing negative earnings revisions for a while now. That is a tough combination for an equity market that is going up; most of the time, they row in the same direction. But overall, decent.

Market cycle indicators

Grouping	Metric			Better/ Worse
Rates				**3 / 0**
	Net Cuts	✓		+
	Yield Curve		✓	+
	Yield Curve 3m	✓		+
US Economy				**13 / 6**
	Leading Ind (3m)		✓	+
	Leading Ind (6m)		✓	+
	Phili Fed Coincident	✓		-
	Credit (3m)	✓		+
	Recession Prob (NY Fed)		✓	+
	Recession Prob (Clev Fed)		✓	+
	Citi Eco Surprise	✓		+
	GPD Now (Atlanta Fed)	✓		-
	US Unemployment	✓		
	Consumer Sentiment (3m)	✓		-
Manufacturing	PMI		✓	-
	PMI New Orders		✓	+
	Energy Demand (YoY)	✓		+
	Truck Demand (YoY)	✓		+
	Rail (YoY)	✓		+
Housing	Starts (6m)		✓	+
	Months Supply (6m)		✓	+
	Home Sales		✓	-
	New Home Sales		✓	-
	NAHB Mkt Activity	✓		+

Grouping	Metric			Better/ Worse
Global Economy				**5 / 3**
	Global PMI	✓		+
	Copper (6m)		✓	-
	DRAM (3m)		✓	-
	Oil (3m)		✓	+
	Commodities (3m)	✓		+
	Baltic Freight (3m)		✓	+
	Kospi (2m)		✓	+
	EM (2m)		✓	-
Fundamentals				**3 / 9**
	US: PE		✓	-
	US: EPS Growth	✓		-
	US: EPS 2FY v 1FY	✓		-
	US: 3m EPS Revision	✓		-
	Canada: PE	✓		-
	Canada: EPS Growth	✓		+
	Canada: EPS 2FY v 1FY	✓		-
	Canada: 3m EPS Revision	✓		+
	International: PE	✓		+
	Int: EPS Growth		✓	-
	Int: EPS 2FY v 1FY	✓		-
	Int: 3m EPS Revision		✓	-

Source: Purpose Investments, Bloomberg

From a positioning perspective, this has us neutral on our equity allocation, mild underweight in bonds and holding extra cash. We believe this allocation balances us nicely heading into 2025. Cash provides some options should we see weaknesses or opportunities. On the bond side, we believe yields will remain rangebound and will potentially be added if yields tick high enough, as we are likely sellers if yields move too low. Among bonds, we are tilted more on the quality side, given how tight credit spreads are and the availability of attractive yield everywhere.

The equity allocation has us underweight on Canada, with a smaller underweight for the U.S. and overweight international. It is part valuations and part safety. We further manage the concentration risk of the US equity market by tilting some of our allocation towards equal weight.

Asset allocation guidance

	House view	Underweight		Neutral	Overweight	
Overall	Equity			•		
	Bonds		•			
	Cash				•	
Equities	Canada		•			
	U.S.		•			
	International				•	
	Emerging Markets	•				
	Style Allocation (Value<--->Growth)			•		
	Size (Small <---->Large Cap)				•	
Fixed Income	Government			•		
	Credit			•		
	Investment Grade				•	
	High Yield		•			
	Duration		•			
		Passive				Active
	Management Approach			•		

Final note

2024 was great. As was 2023. Could we make it three in a row? Inflation fears have faded, recession risk is low, and central banks are easing – that is a lot of good news already baked in. And certainly helps explain the past year of strong markets and the rise in valuation. It is changes or surprises that will move markets in 2025. There could be a few more good news surprises out there but you have to admit we have already enjoyed a good share of them.

Headline noise may well ratchet higher if President Trump's first term is any guide, that may create more volatility. Then again, after such a low volatile year in 2024, we are due for an uptick. While hard to do, ignore the noise and listen to the economy; that is what drives earnings and earnings drive markets.

If the Kansas City Chiefs and the Chicago Bulls can three-peat, maybe the market can too.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.