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Market Ethos

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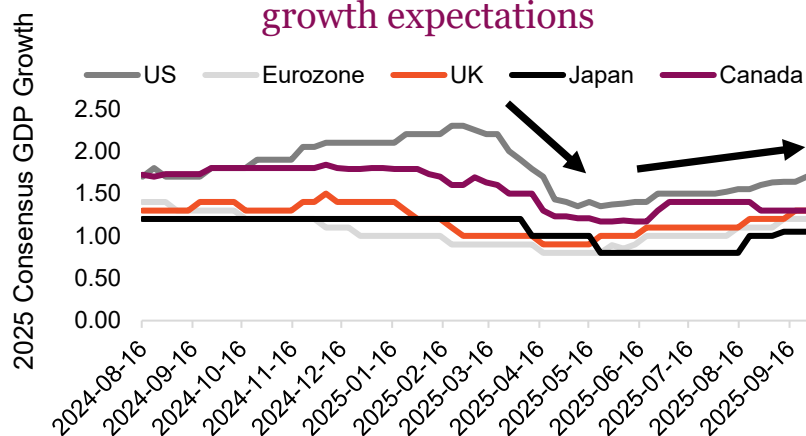
Craig Basinger

Not too hot, not too cold

We would never support criminality, even if we were just stealing some porridge from a few dumb bears that didn't lock the door. B&E is B&E. But, it may be that perfect temperature porridge that can help explain 2025. There have been many things that have happened or escalated this year that are not market friendly. It is a rather scary list and yet markets are not just resilient but thriving. That is because despite the dramatic headlines, the real drivers of markets are kind of middling, not too hot or too cold.

Let's start with economic growth. Despite the implementation of tariffs, now running 15-20%, and a good amount of uncertainty, the global economy has remained relatively resilient. We had thought these factors would manifest in a period of economic weakness but so far there is limited evidence. Decent global fiscal spending has certainly countered these headwinds. And now economic growth forecasts, that had softened a bit, have firmed up. Not too fast to get people worried about inflation implications, but fast enough to ease growth concerns.

Soft patch in Q2 but now gently rising growth expectations



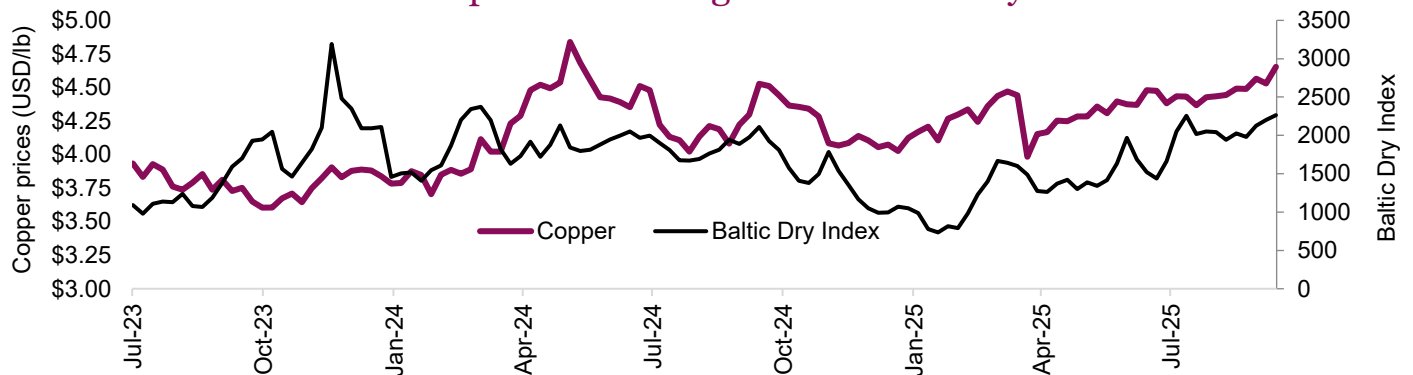
Source: Bloomberg, Purpose Investments

The path for 2026 forecasts follows a very similar pattern. Looking beyond the consensus view, other factors are encouraging for global economic growth. Citigroup economic surprise indices have firmed up. Purchasing manager indicators have as well, signaling rising manufacturing activity. Two of our preferred market barometers for global economic growth, namely copper and shipping rates, also point to reasonably improving economic growth.

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So here we have an economy that has proven resilient to headwinds. But the news gets a bit better as the economy at the moment isn't growing fast enough to push inflation back to being a problem. Inflation has been stickier than most would like, but it also hasn't accelerated. Kind of middling as well.

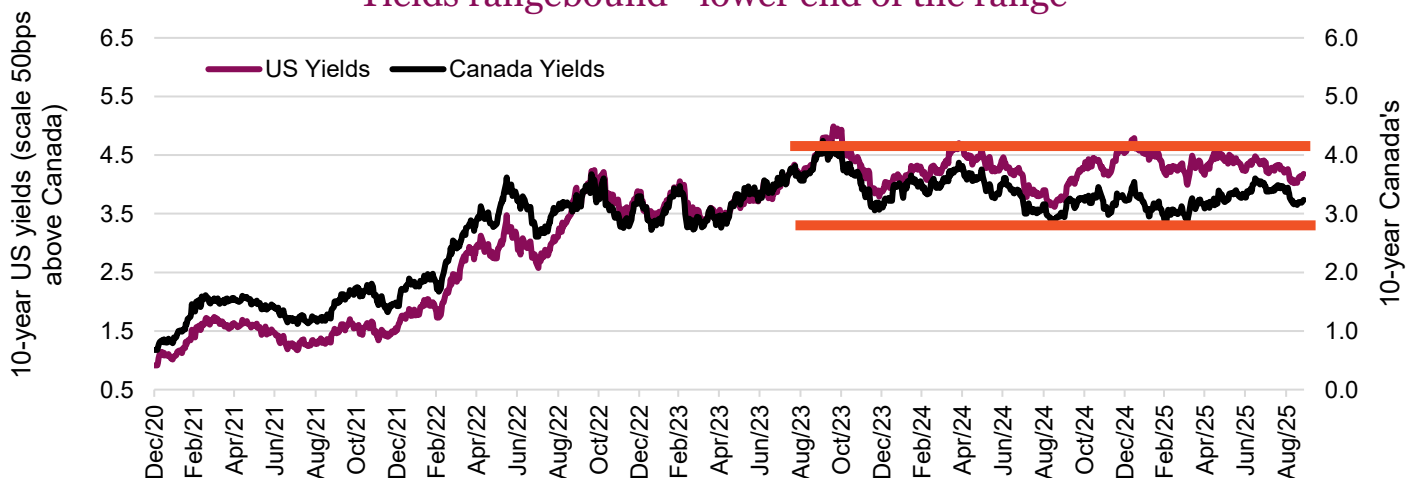
Honourary PhD in Economics recipients copper & Baltic Dry rates also point to firming economic activity



Source: Bloomberg, Purpose Investments

Please don't jump to the conclusion that inflation is no longer a risk, quite the opposite. With short-term rates coming down, fiscal spending turning up and a delayed impact of tariffs and changes in labour, inflation is one of our bigger concerns going forward. Especially with a still-absent economic growth slowdown, which would ease inflation. But for now, inflation has proven not too hot or cold. This has allowed bond yields to come down somewhat, which provides a tailwind for equities.

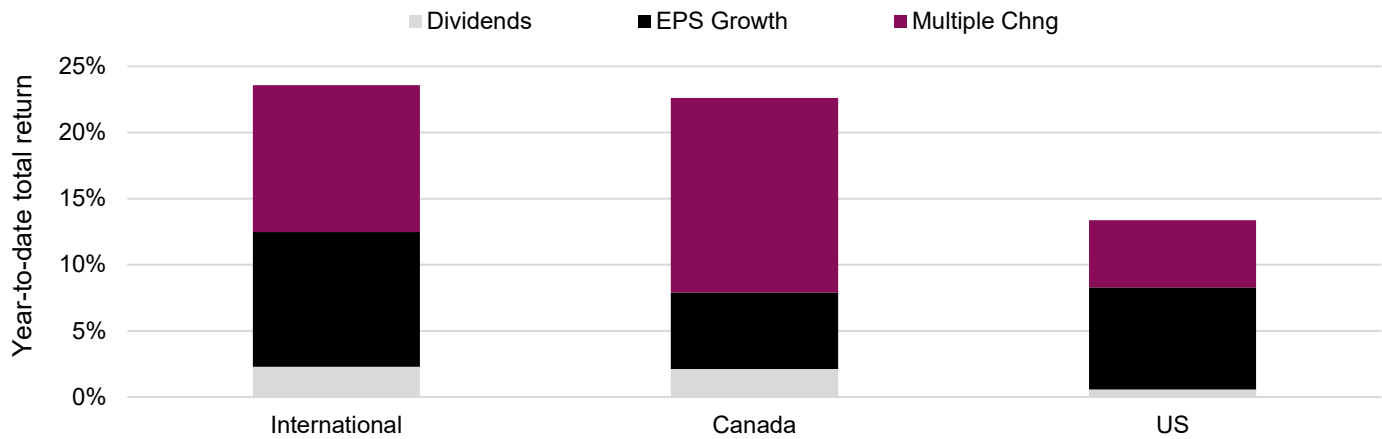
Yields rangebound - lower end of the range



Source: Bloomberg, Purpose Investments

Add yields trending lower and credit following a similar path, and you get multiple expansion. At the fundamental level, equity markets move based on three factors: dividends, which are relatively stable, earnings growth and multiple expansion/contraction. For the TSX it has mainly been multiple expansion, more balanced between multiple and earnings growth for international equities while the US has seen limited multiple expansion. Remember, international markets have not enjoyed strong earnings growth in previous years and started from a low valuation. So, some catchup clearly. U.S. market was already expansive, so any further multiple expansion is likely hard to come by.

Multiple expansion is the main driver of these markets



Source: Bloomberg, Purpose Investments

Final thoughts

The simple fact is an economy, inflation and yields that are neither too hot nor too cold leads to multiple expansion. Add reasonable earnings growth, and you have a great combination for markets. Have markets gone too far? Maybe. Leaning a bit more defensive after such a good year seems prudent. In 2025, international equities have gone from 13.5x to 15.5x, TSX from 15x to 17x and the U.S. from 22x to 22.5x price-to-earnings. Not crazy but no bargain. However, this rally likely gets interrupted when one of those lukewarm porridges either gets too cold or too hot. Until then, bon appétit.

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

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