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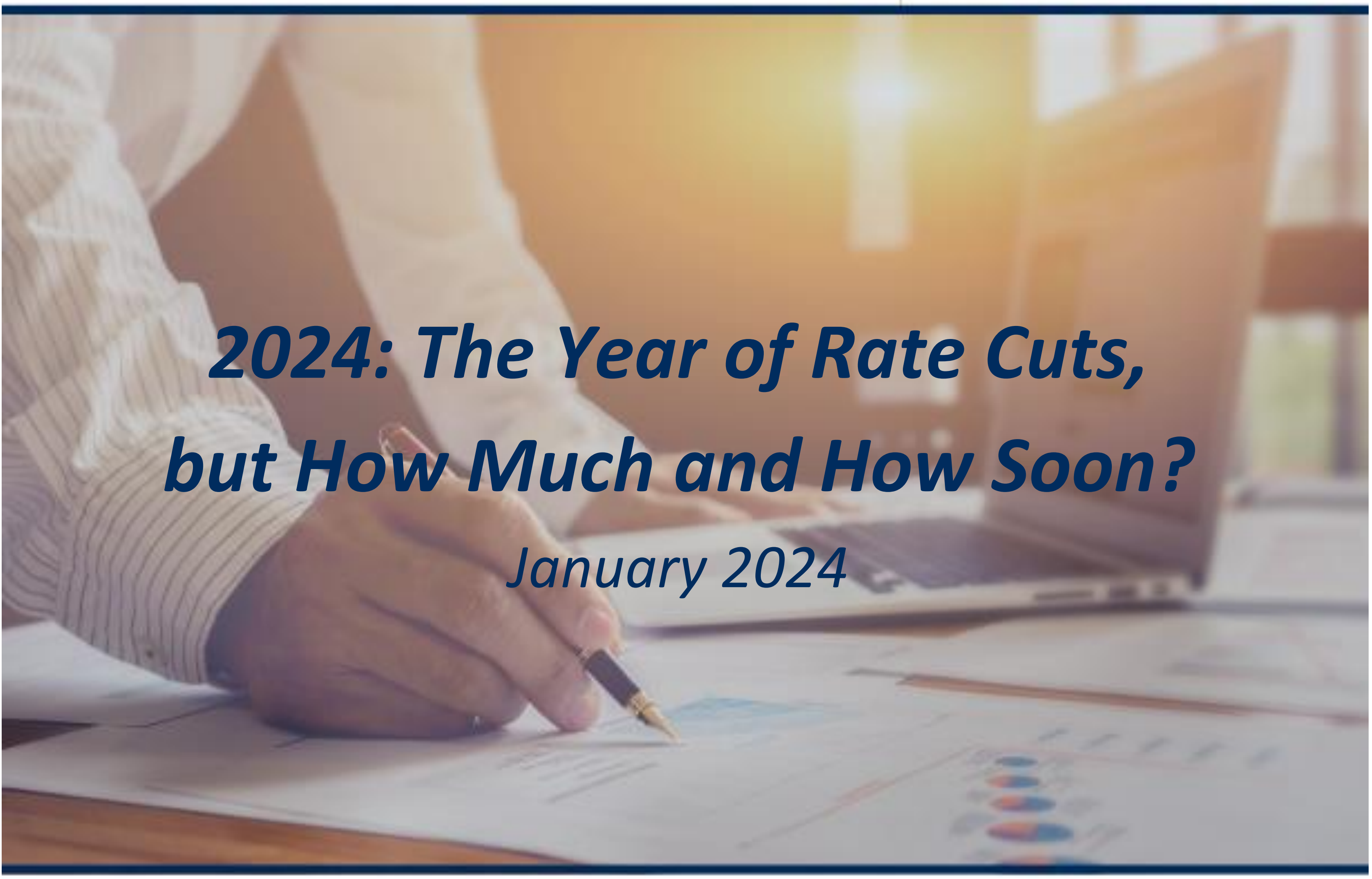
ASSET ALLOCATION QUARTERLY

Interest rate cuts are broadly expected in 2024, but timing and amount are the questions.

Mild recessions expected as monetary policy weighs on spending, but job losses should be minimal.

Equity markets likely to be more volatile this year, but with moderate gains, while fixed income presents good opportunities.



2024: The Year of Rate Cuts, but How Much and How Soon?

January 2024

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Summary

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For 2024, we are expressing our outlook as two parts as we see the first and second halves of the year progressing differently. In the first half of the year, we are expecting central banks in both Canada and the U.S. to maintain their policy interest rates at current levels. As the previously aggressive hiking cycles put increasing pressure on consumer and business spending, we see both countries entering mild recessions, with contracting GDPs, slightly increasing unemployment rates, and pressure on corporate earnings.

By the middle of 2024, we expect inflation rates to have declined sufficiently to allow central banks to begin reducing interest rates through the latter half of the year, and continuing into 2025, before we see rates stabilize, but at a level higher than was typical before the pandemic. Through the latter half of 2024, although inflation will still not yet be down to the 2% targets, we expect that concerns of a resurgence of inflation will be reduced, and although corporate earnings will likely still be under pressure, we would expect investors to start looking beyond the recessions towards growth in 2025. As such, we see 2024 as a slightly positive environment for equities, but perhaps more so through the latter half of the year.

Key Takeaways:

- **1H24: The onset of recession** – Through the first half of the year we expect pressure on corporate earnings as central banks hold policy rates at current levels to ensure that inflation continues its downward trajectory towards the 2% target levels. As consumer spending slows and corporate earnings are pressured, investors will likely favour more defensive sectors.

- **2H24: The rate cuts** – As we enter the second half of 2024 we expect the focus to be on the decline of policy rates as bankers see enough disinflation momentum to ease off their restrictive policies as the economies slow and unemployment rates rise. Economists will be watching for the bottoming of the economy, and investors will be counting on the start of a new business cycle and start bidding up valuations even as corporate earnings bottom out.

- **Stay Invested -** Timing market tops and bottoms is exceedingly difficult, if not impossible, and markets can react quickly at, or ahead of, the first signs of an improving economy. Staying invested in the right assets for your long-term objectives and risk tolerance is usually the most prudent approach.

- **Opportunities in Fixed Income** - The high interest rate environment has created opportunities in fixed income markets that we haven't seen in decades in both the U.S. and Canada. Fixed income investors are poised for a dual benefit. Not only are yields now more comparable to equity returns, but rate cuts could provide gains as bond prices appreciate. Extending duration may benefit investors this year.

- **Equity Positioning** - When excluding the mega-cap tech stocks that have driven index performance in the U.S., returns have been more muted, yet volatile. We would maintain a balance between the U.S. and Canada. We also favour a defensive posture given our base case of mild recessions in the first half of 2024, shifting to more cyclical sectors in the second half of the year. Overall, in the US equity market, we would favour Real Estate, Utilities, Staples, and Health Care. On the TSX, we would favour a more defensive sector such as Utilities in 1H24, rotating to more cyclical sectors such as Info Tech, Energy, and Financials through the end of the year.

Contents

Asset Allocation Recommendations

Strategic Asset Allocation Recommendations

CURRENT POSITIONING	Ultra Conservative	Conservative	Moderate	Balanced	Balanced Growth	Growth
Equity	**10%**	**30%**	**50%**	**60%**	**70%**	**90%**
Canadian Equities	4.0%	10.0%	20.0%	25.0%	25.0%	30.0%
US Equities	4.0%	10.0%	15.0%	17.5%	20.0%	30.0%
Developed Markets Equities (ex NA)	2.0%	10.0%	15.0%	17.5%	25.0%	30.0%
Fixed Income	**88%**	**68%**	**48%**	**38%**	**28%**	**8%**
Canadian Aggregate Fixed Income	60.0%	45.0%	30.0%	38.0%	20.0%	8.0%
Canadian Short-term Fixed Income	28.0%	23.0%	18.0%	-	8.0%	-
Cash	**2%**	**2%**	**2%**	**2%**	**2%**	**2%**

ASSET CLASS DEFINITIONS

Canadian Equities: S&P/TSX Composite: the benchmark Canadian index, representing roughly 70% of the total market capitalization on the Toronto Stock Exchange with about 250 companies included in it. The Toronto Stock Exchange is made up of over 1,500 companies.

US Equities: S&P 500: is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

Developed Markets Equities (ex NA): MSCI EAFE: is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 21 countries.

Canadian Aggregate Fixed Income: FTSE Canada Universe Bond: tracks the performance of investment-grade (BBB or better), government and corporate bonds in Canada.

Canadian Short-term Fixed Income: FTSE Canada Short Term Bond: intended to represent the Canadian short-term bond market. It contains bonds with remaining effective terms greater than or equal to one year and less than or equal to five years.

Cash: FTSE 91 Day T-Bill: tracks the performance of 3-Month Government of Canada Treasury Bill. The index is designed to reflect the performance of a portfolio that only owns 3-Month Government of Canada Treasury Bill, the current on the run T-Bill for the relevant term, switching into the new T-Bill at each auction.

Market Commentary

As we kick off 2024, we are facing recessionary environments through much of the developed economies. This situation was spurred on by restrictive monetary policies as central bankers continued to tackle high inflation caused by fiscal stimulus during the pandemic that put more cash in consumers' pockets, and disrupted manufacturing and supply chains, which reduced the supply and availability of goods for that excess cash to be spent on. In addition, many people chose to leave the workforce during the pandemic, causing tight labour markets that put upward pressure on wages, further increasing costs for businesses, that were then passed through to consumers via higher prices, hence further inflationary pressure.

In Canada and the U.S., inflation rates peaked in mid-2022. 2023 was then the year of inflation fighting and then disinflation as the supply and demand of goods came more into balance. Moving into 2024, we are relatively satisfied that the higher policy rates and more restrictive lending have cooled the economy sufficiently to avoid a significant resurgence of inflation. Now we move into a period of evaluating how much damage might have been done to the economy. Much focus is now on how quickly or significantly central bankers will lower rates, and to what ultimate levels. Here, we look at how both equity and fixed income markets will react to these headwinds and tailwinds, and how we should look forward to the growth of a new business cycle.

Views from our CIO on the U.S. markets

Throughout this publication, we will look at both Canadian and U.S. Economics, Equities, and Fixed Income markets, plus we examine how markets might be affected by the U.S. elections. As an overall guiding summary, here are some of the most recent forecasts and pertinent comments from our U.S.-based Chief Investment Officer, Larry Adam:

- The U.S. economy has lost some momentum heading into 2024, with high borrowing rates, Fed tightening, and slowing job growth dampening consumption. U.S. GDP is expected to be +1.0% in 2024, with a mild recession mid-year.
- With a sharp deceleration in inflation, the Fed is now likely to cut rates in 2024 with the U.S. 10-year Treasury yield moving lower in advance, to 3.5% by the end of 2024.
- The S&P 500 is forecasted to end the year around 4,850. Overbought conditions could lead to a near-term pullback, but cautious optimism provides a modest gain for the year, with an EPS forecast of US$225 (below consensus of US$245, although analyst consensus forecasts tend to decline about 4% as the year progresses, which would imply US$235 by year-end) and P/E multiple of 21.5×.
- Volatility in the equity markets will be higher in 2024, prompted by geopolitical flare-ups and fiscal dynamics. In a typical year, we would also expect 3-4 pullbacks of 5% or more.
- The price of oil is expected to drift higher through 2024 to a year-end target of US$85 for WTI as global demand recovers and the U.S. refills its Strategic Petroleum Reserve.

Potential upside/bull scenario on equity markets

New this quarter is a contribution from our new quantitative/technical analyst Javed Mirza, who looks at the U.S. equity market from a cycle perspective. While he sees short-term sentiment of "risk-off", indicating that the equity market run-up at the end of 2023 may mean that investors were too optimistic and could move to less risky or more conservative investments in the short-term, he still sees overall equity market performance being very positive for the full year. Javed's more optimistic S&P 500 target of 5,466 would imply a 14.6% upside from the 2023 close. This upside case is closer to our economics team's (25% likelihood) bull scenario of 5,200, which would imply that the U.S. economy avoids recession, that the global economy recovery unfolds, that corporate profit margins expand, and that the U.S. dollar weakens. This upside scenario would also be more aligned with the current analyst consensus forecast of US$245 for the S&P 500. We expand on his model and forecasts in the Quantitative/Technical Analysis section at the end of this report.

Risks and downside potential

While we assign the highest probability of mild recessions in both the U.S. and Canada, there is always the potential for negative surprises. Mostly, we could see these come in 2024 from geopolitical tensions. With wars still waging in Ukraine and Israel/Gaza, the concern in North America of an economic or investment impact would likely be escalation or spreading of these conflicts affecting oil production or supply, dramatically driving up the price of oil and subsequently inflation. Separately, we could see a rebounding in inflation or otherwise more severe recessions that could hit investor sentiment and/or corporate profits. With a 15% probability of a bear case, our downside forecast on the S&P 500 goes to 4,300, or a 9.8% decline for the year. Under a severe recession scenario, we would expect a reduction of interest rates from central bankers, which in turn would be more favourable for fixed income investors, supporting the concept of balanced portfolios helping to reduce short-term volatility.

Where in the world to invest?

Global diversification will likely always be an important element of Canadians' portfolios. Canada represents only 2.7% of the US$109 trillion global stock market. The U.S. represents the largest chunk at 42.5%, but that still leaves almost 55% outside these borders.

Looking at consensus forecasts in the tables below, we see generally flat or mildly positive GDP growth expectations through developed economies in 2024, led by the U.S., with consensus expectations of 1.6% U.S. GDP growth, above our more conservative 1.0% forecast. Emerging Markets look more compelling from a GDP growth perspective, although inflation expectations are still slightly higher, on average.

Historical and Consensus Forecasted Real GDP Growth [LHS] and Headline Inflation [RHS]

17-Jan-24	Average 2000-2020	2021	2022	Forecasts 2023	Forecasts 2024
World	**3.2%**	**7.0%**	**2.0%**	**3.6%**	**2.6%**
Advanced Economies	**1.4%**	**5.6%**	**2.6%**	**1.5%**	**0.7%**
US	***1.8%***	***5.8%***	***1.9%***	***2.4%***	***1.6%***
Canada	***1.8%***	***5.3%***	***3.8%***	***1.0%***	***0.0%***
Euro	1.0%	5.9%	3.4%	0.5%	0.0%
UK	1.2%	8.7%	4.3%	0.3%	0.2%
Japan	0.6%	2.6%	0.9%	2.0%	0.4%
Australia	2.6%	5.6%	3.8%	1.9%	1.2%
Emerging Economies	**4.7%**	**7.8%**	**1.6%**	**4.8%**	**3.8%**
Emerging Asia	6.1%	8.6%	0.8%	6.3%	4.7%
China	7.3%	8.4%	3.0%	5.0%	4.5%
India	6.4%	8.9%	6.7%	7.0%	6.3%
Russia	3.6%	5.6%	-2.1%	3.3%	3.0%
Brazil	2.1%	4.8%	3.0%	3.3%	1.3%
Mexico	1.6%	5.7%	3.9%	3.5%	1.8%

17-Jan-24	Average 2000-2020	2021	2022	Forecasts 2023	Forecasts 2024
World	**3.4%**	**3.5%**	**6.9%**	**5.1%**	**3.4%**
Advanced Economies	**1.7%**	**3.2%**	**7.5%**	**4.7%**	**2.3%**
US	***2.1%***	***4.7%***	***8.0%***	***4.1%***	***2.5%***
Canada	***1.9%***	***3.4%***	***6.8%***	***3.9%***	***2.2%***
Euro	1.7%	2.6%	8.4%	5.4%	1.8%
UK	2.0%	2.6%	9.1%	7.3%	1.8%
Japan	0.1%	-0.2%	2.5%	3.3%	2.6%
Australia	2.6%	2.9%	6.6%	5.7%	3.0%
Emerging Economies	**4.8%**	**3.8%**	**6.6%**	**5.3%**	**4.0%**
Emerging Asia	3.7%	2.4%	4.3%	3.3%	2.6%
China	2.2%	0.9%	2.0%	0.2%	1.0%
India	6.2%	5.1%	6.7%	5.7%	4.8%
Russia	10.1%	6.7%	13.8%	5.9%	8.5%
Brazil	6.2%	8.3%	9.3%	4.6%	4.3%
Mexico	4.5%	5.7%	7.9%	5.5%	4.3%

Source: Capital Economics; Raymond James Ltd.; FactSet; Data as of January 17, 2024.

Similarly to North America, we are watching for if and when the ECB will enact rate cuts. Although ECB President Christine Lagarde indicated in December that it was too early to discuss cuts, in January she acknowledged that the next move would likely be down, and could be expected as soon as they had certainty that inflation was on-track to fall to 2% in 2025, which also seems to be expected by mid-year.

Global Equities Performance

Select Global Equity Indices	4Q23 (in LCL)	4Q23 (in USD)	4Q23 (in CAD)	2023 (in LCL)	2023 (in USD)	2023 (in CAD)	Current PE NTM	Historical PE Median (Since	Premium (RED) / Discount (GREEN)
Canada									
S&P/TSX Composite	8.1	10.8	8.1	11.8	14.8	11.8	13.7	14.5	-0.8
S&P/TSX 60	8.8	11.5	8.8	12.1	15.1	12.1	14.1	14.3	-0.3
S&P/TSX Small Cap	6.0	8.7	6.0	4.8	7.7	4.8	13.2	16.9	-3.7
Canada Growth	10.0	12.8	10.0	15.8	19.0	15.8	20.2	18.1	2.0
Canada Value	7.0	9.7	7.0	5.1	8.0	5.1	11.1	12.1	-1.1
U.S.									
NASDAQ Composite	13.8	13.8	11.0	44.6	44.6	40.8	26.8	19.6	7.1
S&P 500	11.7	11.7	8.9	26.3	26.3	22.9	19.6	16.2	3.4
S&P Mid Cap 400	11.7	11.7	8.9	16.4	16.4	13.3	14.5	13.6	1.0
S&P Small Cap 600	15.1	15.1	12.3	16.1	16.1	12.9	14.2	14.9	-0.7
S&P Composite 1500	11.8	11.8	9.0	25.5	25.5	22.1	19.0	15.9	3.1
S&P Composite 1500 Growth	10.2	10.2	7.1	29.0	29.0	23.9	25.0	18.6	6.4
S&P Composite 1500 Value	13.7	13.7	10.3	21.6	21.6	16.0	15.1	14.0	1.1
Europe									
Euro STOXX 50 (Europe)	8.6	13.0	10.2	23.2	23.4	20.1	13.0	13.1	-0.2
FTSE 100 (U.K.)	2.3	6.2	3.5	7.9	10.0	7.0	11.0	12.4	-1.4
CAC 40 (France)	5.9	10.5	7.8	20.1	24.4	21.0	13.6	13.3	0.3
DAX (Germany)	8.9	13.6	10.8	20.3	24.5	21.2	11.6	12.6	-1.0
Asia Pacific									
Hang Seng (Hong Kong)	-3.9	-3.6	-6.0	-10.5	-10.5	-12.9	8.3	12.5	-4.3
Nikkei 225 (Japan)	5.2	11.4	8.6	31.0	22.6	19.3	18.3	16.6	1.7
MSCI China (China)*	-3.5	-3.5	-5.9	-11.2	-11.2	-13.6	9.4	10.8	-1.4
Major Aggregates									
World (Global)*	11.6	11.6	8.9	24.0	24.0	20.6	17.3	15.7	1.6
EAFE (DM ex U.S. & Canada)*	10.7	10.7	8.0	18.4	18.4	15.2	13.3	13.5	-0.2
EM (Emerging Markets)*	8.0	8.0	5.3	9.0	9.0	6.1	11.9	11.7	0.2

Source: FactSet; Raymond James Ltd.; Total returns, data as of December 31, 2023. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 12/31/2023.
*Indices are represented by their corresponding iShares ETFs, serving as proxies.

Equities vs. Bonds

The aggressive rate hiking cycle through 2022 and 2023 created opportunities in fixed income that we have not seen in 15 years. Suddenly returns on bonds have approached equity-like yields, and with the prospect of declining interest rates through 2024 and 2025, bond investors can finally look forward to both respectable yields and the potential for capital appreciation. This feels like payback for the previous two years.

Equity investors are now faced with balancing headwinds and tailwinds. On the downside, recessions generally have a negative affect on corporate earnings, and it is sometimes difficult to know how long and how deep those are going to be – although we maintain our forecasts for relatively mild and short recessions in both Canada and the U.S. On the positive side, lower interest rates mean that equity investors can discount future earnings and cashflows at a lower rate, boosting their present value. This is also reflected in the price-to-earnings (P/E) multiples that forward looking investors apply to earnings forecasts, which can more than compensate for currently depressed profits. This is reinforced by the fact that the majority of gains in equity markets occur at the beginning of a new business cycle, before the recovery is broadly evident. This reinforces the adage to “stay invested” and in the immortal words of Warren Buffett, “to be fearful when others are greedy and to be greedy only when others are fearful”.

Investment themes for 2024

There was no doubt that artificial intelligence (AI) was a major investment theme in 2023 and was credited with the exuberance that helped drive shares of the “Magnificent 7”, which also gave a shot of adrenaline to the S&P 500 index. We believe that 2024 will be an interesting year to judge how quickly and impactfully AI advances might improve the profitability of a broader range of industries and companies.

Sustainable Investing, and the ‘ESG’ acronym specifically, can elicit strong reactions, both positive and negative, but from the environmental perspective, we are likely to see more extreme weather from climate change prompting more conversations about decarbonization and energy transition. Investors may want to look for opportunities as governments direct more funding and other incentives into this area. Electrification will likely be an important theme in 2024, as government incentives to promote renewable energies, and reduce reliance of fossil fuels gains attention, along with the rapid adoption of electric vehicles.

Without delving into the awful humanitarian impacts, geopolitical uncertainty has been a major theme over the last couple of years, with the war in Ukraine and sanctions against Russia whipsawing certain food and energy prices, and concerns that the Israel-Hamas conflict could broaden into a regional war with far-reaching impacts. Most recently, Houthi rebels have prompted shipping companies to divert traffic from the Red Sea to longer and more expensive routes. At the same time, drought has prompted the Panama Canal to reduce traffic by 36%. All of these events have the potential to somewhat disrupt supply chains and possibly aggravate inflation in certain areas.

In Canada, a surge in immigration has put further strain on a housing affordability crisis. We expect that government support, with tax credits and other incentives, will continue into 2024, although considering the size and complexity of the problem, we believe that much broader initiatives at the provincial and municipal levels will be required. Ultimately it will have to be private markets and developers that mobilize in order to alleviate some of these stresses, but that will ultimately be dependent on both government cooperation and an overall more stable macro and interest rate environment that brings confidence to these investors and developers.

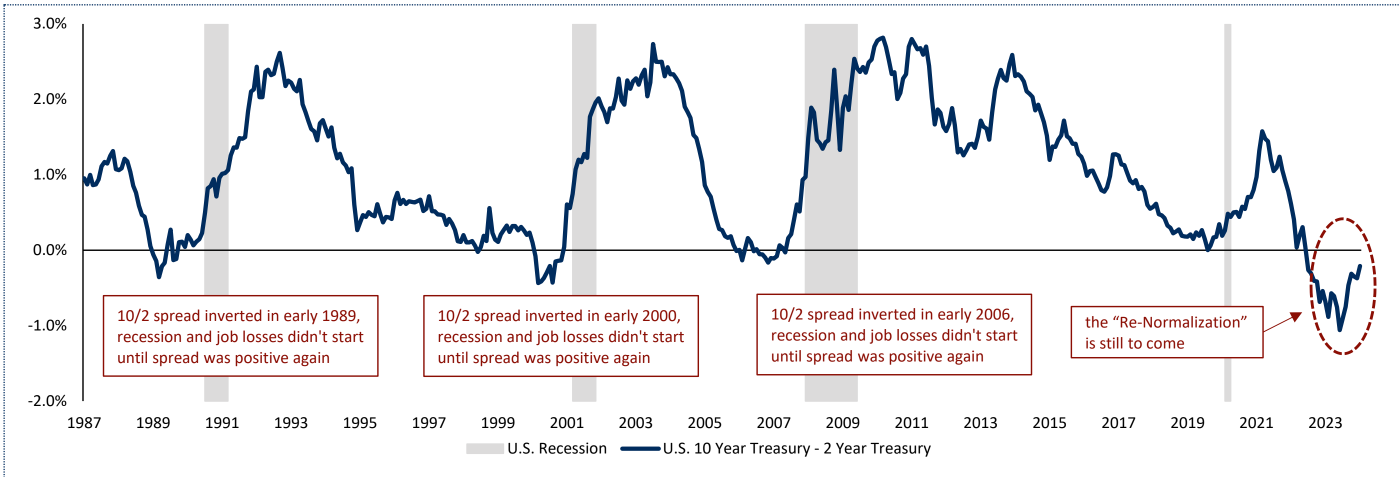
Ballooning government debt has been a prevailing theme for years, and despite debt ceiling drama in the U.S. last year, and threats of government shutdowns, the fight against inflation and high policy rates still garnered more attention. As inflation looks more and more to be under control, the cost and ramifications of government debt (and deficit) levels could gain more mindshare.

U.S. politics will obviously play into 2024 with the Presidential election in November and possible rematch between Biden and Trump. We will delve more into that dynamic as it evolves through the year, and our U.S. Political Analyst, Ed Mills, provides a comprehensive review of potential market impacts later in this report. A key area of focus for next year will obviously be the election’s subsequent impact on the U.S. relationship with China.

The re-normalization of the yield curve

With the new year, we also see a softening of tone from central bankers. While some still warn that it is too early to discuss rate cuts, there is no doubt that concerns of a resurgence of inflation and need to further hike policy rates are lessening. The question remains as to when and how the yield curves will renormalize, where short-term rates yield below long-term rates. Historically, and on average, recessions only hit about four months after the yield curve is renormalized. Heightened uncertainty and anxiety as we watch for data that paves the way through the build-up to this recession could lead to still more market volatility over the next few months or quarters, although we do look forward to a more stable and supportive environment as inflation gets under control and policy rates provide a little relief in the latter part of 2024, or perhaps into 2025. Patience is crucial and investors should take this opportunity to ensure that portfolios are properly balanced to ride through any potential volatility, and equally well equipped to benefit as the economic situation stabilizes and markets pick back up. Timing market tops and bottoms is exceedingly difficult, if not impossible, and markets can react quickly at, or ahead of, the first signs of an improving economy. Staying invested in the right assets for your long-term objectives and risk tolerance is usually the most prudent approach.

Final Stretch of 2023: The "Re-Normalization" is Still to Come



Source: St. Louis Federal Reserve, Raymond James research; Data as of January 12, 2024.

Along with the softening of the economies, we foresee policy rates starting to decline in 2024, although more likely into the second half of the year, depending on how inflation, the economy, and employment data play out. The primary consideration will be inflation. Headline inflation numbers in both the U.S. and Canada have been trending down, although the future trajectories remains choppy. Central banks are tasked with maintaining price stability and employment, so as long as the employment situation does not deteriorate seriously, the bankers will have more flexibility to maintain monetary pressure.

Canadian Economic Outlook

Overall, we believe that the Bank of Canada (BoC) will hold interest rates at the current level before starting to lower its policy rate in the second half of 2024. The BoC has eight dates scheduled each year when it announces the setting of the overnight rate target. For 2024, those dates are January 24, March 6, April 10, June 5, July 24, September 4, October 23, and December 11. Also recall that the last increase to 5.00%, a 22-year high, occurred in July 2023 following a string of hikes from the 0.25% level before March 2022.

At last report, the headline inflation number in Canada was 3.4% in December 2023, following a 3.1% increase in November. The headline inflation aligned with the consensus estimate, and the acceleration is primarily attributed to the unfavourable base-year effect of gasoline prices. Gasoline prices have actually decreased on a monthly basis for the past four consecutive months, but were still up from a year-ago. Additionally, the shelter component, which holds the heaviest weight in the CPI calculation, experienced only a modest 0.4% month-over-month increase. This marks the smallest rise since March 2023, signifying a more modest impact from the earlier decline in house prices and a deceleration in the rise of mortgage interest costs.

Likely more concerning for the BoC in the December numbers was the increase in the core measure. Expect that to result in them maintaining a hawkish tone in the next meeting. Nevertheless, it has been nearly two years since the initial rate hike in March 2022, and the effects of elevated interest rates will likely become more noticeable in the upcoming months as they have impacted consumer spending. The pain is now being felt by businesses as well. According to the fourth-quarter Business Outlook Survey[1], firms' pricing behaviour is slowly returning to normal, and top concerns have shifted to demand and uncertainty. Business sentiment has fallen sharply recently, along with shrinking investment spending to expand operations. If the economy and labour market conditions deteriorate more rapidly than the BoC expects, there is also a slight chance that the first rate cut could come sooner than the second half of 2024, but for now with an only modest economic slowdown, combined with still relatively low unemployment, and sticky inflation, we still expect that we'll have to wait until mid-year for interest rate relief.

Inflation Breakdown (Not Seasonally Adjusted):

		2022												2023											
	Weight	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
All Items	100%	5.1	5.7	6.7	6.8	7.7	8.1	7.6	7.0	6.9	6.9	6.8	6.3	5.9	5.2	4.3	4.4	3.4	2.8	3.3	4.0	3.8	3.1	3.1	3.4
Shelter	28%	6.2	6.6	6.8	7.4	7.4	7.1	7.0	6.6	6.8	6.9	7.2	7.0	6.6	6.1	5.4	4.9	4.7	4.8	5.1	6.0	6.0	6.1	5.9	6.0
Food	17%	5.7	6.7	7.7	8.8	8.8	8.8	9.2	9.8	10.3	10.1	10.3	10.1	10.4	9.7	8.9	8.3	8.3	8.3	7.8	6.8	5.9	5.6	5.0	5.0
Transportation	16%	8.3	8.7	11.2	11.2	14.6	16.8	14.4	10.3	8.7	9.5	8.5	6.0	5.4	3.1	0.3	1.3	-2.4	-3.4	-1.0	2.3	3.2	-0.4	-0.1	3.2
Household Operation*	14%	1.9	2.7	4.5	4.1	5.5	5.6	5.0	5.1	5.4	5.1	5.2	4.6	3.7	4.1	3.3	3.0	1.1	0.3	-0.1	0.0	-1.1	-1.2	-1.5	-1.7
Recreation**	10%	2.5	4.1	5.8	4.1	5.4	6.2	6.2	5.7	5.2	4.1	4.1	3.4	2.9	2.3	1.6	3.1	3.1	1.2	1.8	2.2	1.8	2.9	3.8	1.7
Health & Personal Care	5%	2.9	3.1	3.4	3.4	3.6	3.9	3.9	4.4	4.4	4.9	5.5	6.1	6.2	6.2	6.5	6.4	6.4	6.2	5.8	5.8	5.6	4.9	4.2	3.7
Clothing & Footwear	5%	1.6	1.2	0.9	0.2	2.2	2.7	1.4	1.4	1.5	1.8	0.4	1.8	0.4	1.9	2.4	2.5	0.7	0.3	1.0	1.7	1.0	-0.5	0.6	0.9
Tobacco & Alcohol	5%	3.3	3.1	3.3	3.1	3.0	3.0	3.8	3.5	3.8	4.1	4.5	4.8	4.7	4.9	5.4	5.3	5.5	5.4	5.3	5.2	5.3	4.7	4.6	4.3

Source: Statistics Canada; Raymond James Ltd.; Data as of December 31, 2023, not seasonally adjusted; *Household Operation and Furnishings **Recreation, Education, and Reading.

The Canadian Economy Is Showing Signs of Weakening

In 3Q23, Real GDP experienced a decline of 0.3%, following a 0.3% increase in 2Q23. As the economy continues its slowdown, government spending has now taken on the role of the primary contributor to GDP growth, while exports, inventories, and acquisitions of non-financial assets are trailing behind. In contrast to the robust surge in U.S. government spending, Canada's government spending remains stable. However, this stability may not be sufficient to ensure a relatively softer landing as the economy transitions from a consumer-centric to an investment-centric focus. According to BoC's October Monetary Policy Report[2], economic activity is projected to be modest throughout most of 2024, with annual GDP growth expected to be just under 1%. More importantly, the more evident decline in the real GDP per capita growth indicates that Canada may have already been in recession if we exclude the working population growth fueled by immigration.

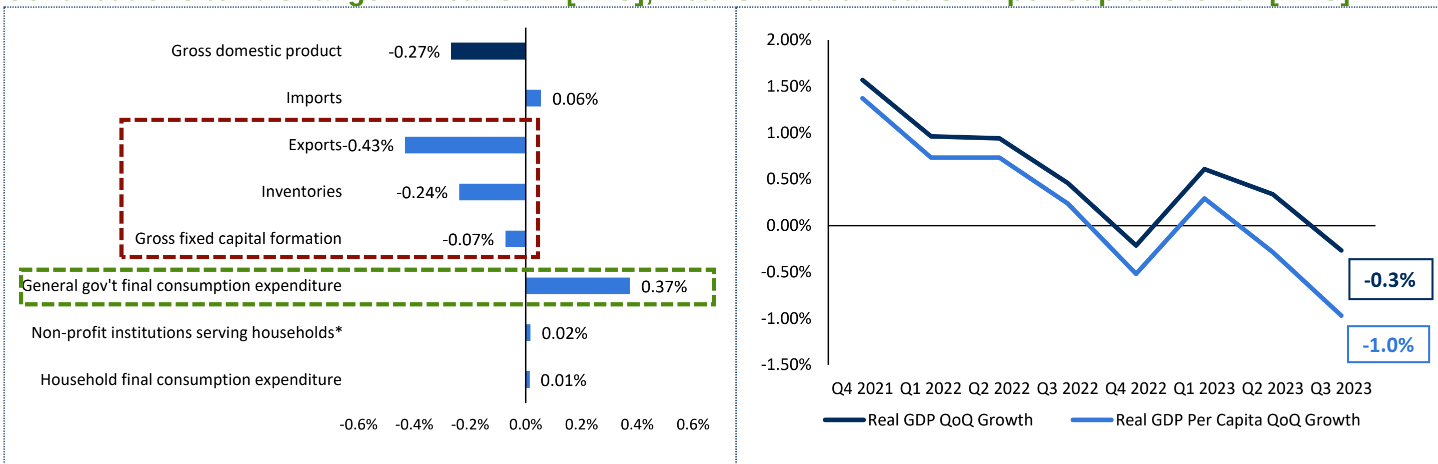
There are numerous metrics that show the slowing, including that, as seen in the exhibits below, inventories-to-sales has risen above 1.0, which indicates that manufacturing capacity and available products have grown beyond sales levels, consistent with the negative contribution of inventories to GDP growth that we observed. Excluding the pandemic spike, this is the highest level that we have seen since the early 1990s and should also lead to excess supply driving down the cost of goods, having an easing effect on inflation. We are additionally seeing the S&P Composite PMI and CFIB Business Barometer dipping well below 50, or contraction territory. We have also seen stresses on the consumer, with record high credit card

[1] Bank of Canada, Business Outlook Survey – Fourth Quarter of 2023, Bank of Canada, https://www.bankofcanada.ca/2024/01/business-outlook-survey-fourth-quarter-of-2023/

[2] Bank of Canada, Monetary Policy Report – October 2023, Bank of Canada, https://www.bankofcanada.ca/2023/10/mpr-2023-10-25/

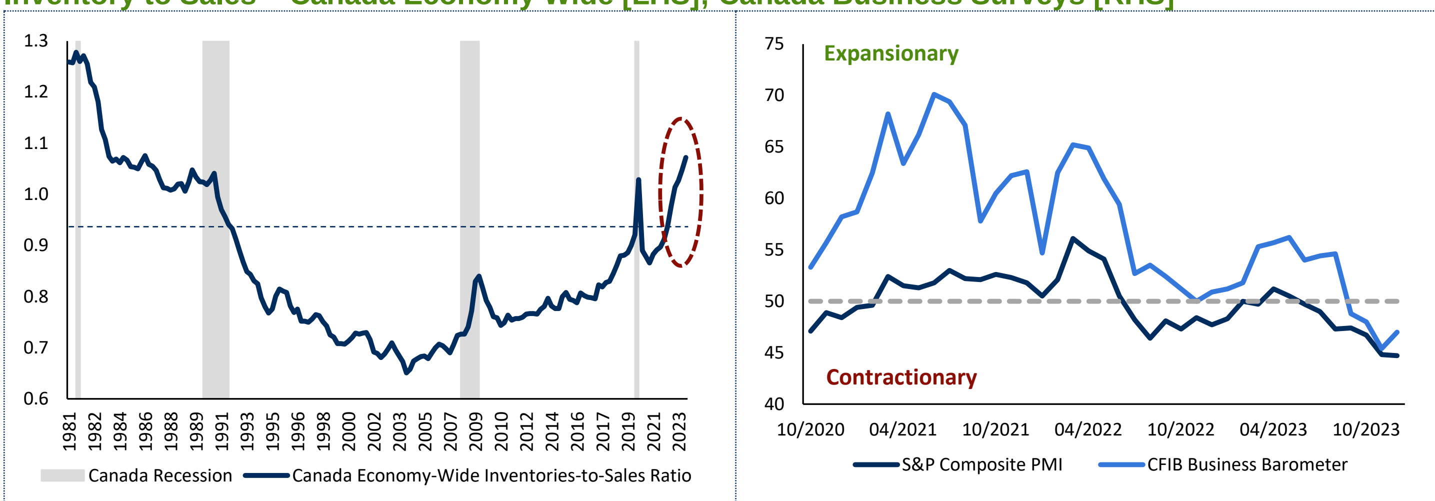
balances, totalling $113.4 billion at the end of 3Q23, up $15.6 billion over the previous 12 months according to Equifax[3].

Contributions to % Change in Real GDP [LHS]; Real GDP and Real GDP per Capita Growth [RHS]



Source: Statistics Canada; Raymond James Ltd.; Data as of September 30, 2023; Real GDP per capita calculation: gross domestic product at market prices / population aged 15 to 64 years.

Inventory to Sales – Canada Economy Wide [LHS]; Canada Business Surveys [RHS]



Source: Statistics Canada; Bloomberg; Raymond James Ltd.; Data as of December 31, 2023.

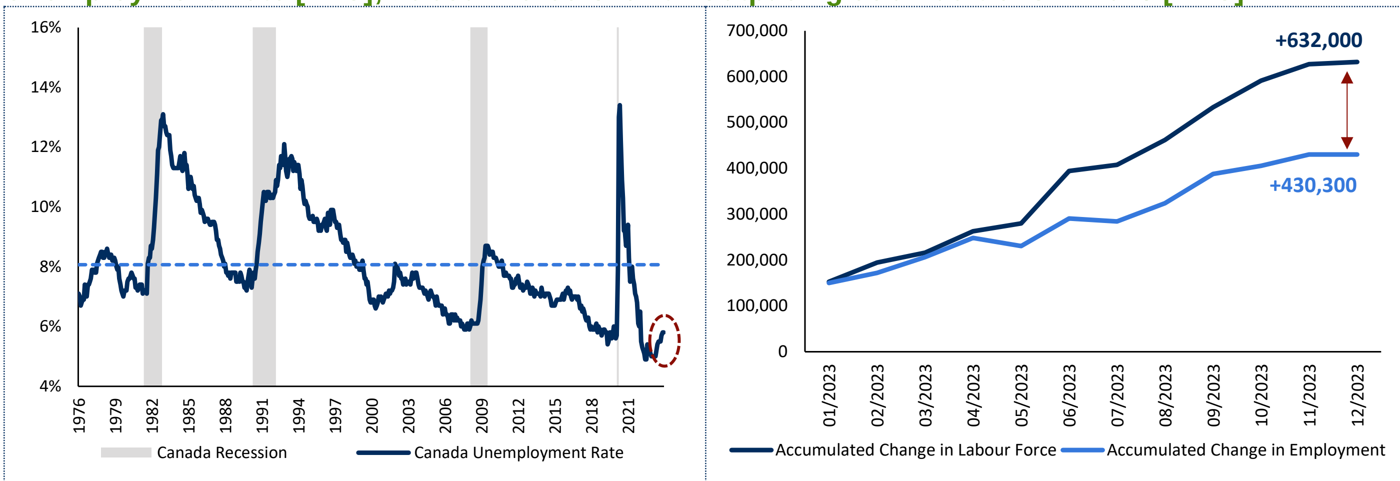
In terms of the labour market in Canada, the unemployment rate remained virtually unchanged last month but has been gradually increasing from 5.0% to 5.8% throughout 2023. It still stands at a relatively low level compared to the historical average of ~8.0%, providing the BoC with some leeway to maintain a higher interest rate in the first half of 2024. However, it's important to note that an upward movement in the unemployment rate can occur very quickly. Observing a spike of approximately 1.0% over two to three months during past recessions is not uncommon.

Despite a net increase of approximately 430,000 jobs in 2023, this growth was surpassed by a surge in the labour force, driven by robust immigration. Anticipating a continuation of this trend in the coming months, we expect the unemployment rate to continue its upward trajectory in 2024.

[3] Equifax Inc., Q3 2023 Consumer Credit Trends & Economic Insights Webinar, Equifax Inc., https://www.consumer.equifax.ca/videos/q3-2023-consumer-credit-trends-economic-insights-webinar

Nevertheless, with our baseline forecast suggesting a mild recession, though not necessarily predicting a spike of the same magnitude as seen in previous recessions, there remains a possibility that rapid shifts in the labour market could prompt an earlier-than-expected first rate cut.

Unemployment Rate [LHS]; Labour Force Growth Outpacing Job Additions in 2023 [RHS]



Source: Statistics Canada; Raymond James Ltd.; Date as of December 31, 2023.

U.S. Economic Outlook

Just as pilots assess conditions before landing, Federal Reserve (Fed) Chair Jerome Powell analyzes the U.S. economy as we enter the final leg of the post-COVID-19 journey. Meanwhile, as investors fasten their seatbelts and hope for a soft landing, economists fine tune their forecasts for the year. The U.S. economy is expected to fluctuate as we expect a wide range of headwinds and tailwinds to challenge the U.S. consumer, but despite some turbulence, we continue to believe that there will be a safe landing.

The U.S. Consumer Price Index (CPI) continued its disinflationary path toward the end of 2023, bringing significant optimism to investors. Hopes of a soft landing and expectations of inflation hitting the 2% target faster than many had expected have pushed markets to believe that the Fed will cut rates several times in 2024, starting in the first quarter. We disagree with the markets because we believe that the Fed is more concerned about a potential reacceleration of inflation, especially if the U.S. economy can avoid a recession, and it will be very cautious in moving rates lower.

If we assume the economy continues to be strong and experiences a soft landing, what would be the rationale for lower rates if the economy can handle a 5.5% federal funds rate and still grow unabated? In this case, we believe the Fed would be more mindful to preserve the opportunity to ease monetary policy if a future recession requires it. For example, along with quantitative easing, the reason the Fed was able to ease monetary policy in the wake of the COVID-19 pandemic was because it raised the fed funds rate from 0-0.25% in 2015 to 2.25-2.50% in 2019. On the other hand, if rates were already lower in 2020, the Fed would have had less ‘cushion’ to work with.

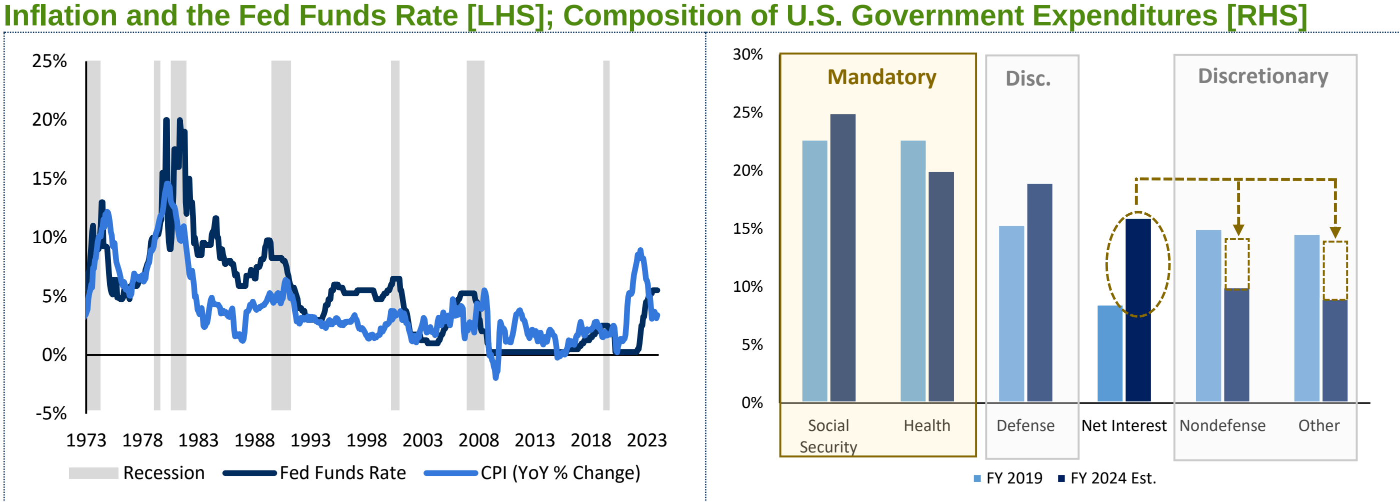
Even if the economy goes into a mild recession as we are still expecting, the Fed is going to be reluctant to move interest rates much lower, fearing that lower interest rates could push inflation higher again. That is, if the Fed starts lowering interest rates, the credit cycle is going to start again with an increase in lending and then potentially generate much higher increases in home prices, which have the potential to reignite inflation again by the end of 2024. If we add continued geopolitical uncertainty or a successful effort by the OPEC+ cartel to push oil prices much higher on top of this, it will be very difficult to see Fed officials accepting the potential for reacceleration of inflation in exchange for stronger economic growth. This is especially true given home prices are on the rise again and the inflationary effects of the 2023 increases in home prices are going to start making their rounds in 2024.

National Debt: Sustained Crosswinds

The impact of interest rate increases, amounting to more than 500 basis points since the hiking cycle began, has adversely affected both consumers and the government. The government's annual interest expenditure on the public debt is projected to surpass US$1 trillion in 2024, marking the highest figure on record. However, the challenge lies not in the ability of the U.S. to meet its debt obligations; rather, the biggest issue with the U.S. debt is that the political system needs to agree on an already stretched budget to include these interest payments, as well as a long-term solution to the debt problem.

Today, about two-thirds of government expenditures are earmarked for non-discretionary, or mandatory, programs. That is, unless there are changes to current laws, they need to keep paying those expenditures. This is something much like ‘fixed costs’ in terms of business parlance: there are no degrees of freedom to change those expenditures in the short-to-medium run unless there is agreement between the parties in Congress. The remaining one-third of government expenditures are discretionary, which the U.S. government could potentially adjust to allow for payment of higher interest payments on the debt, but these outlays also require political agreement to decide on a solution. The University of Pennsylvania's PENN WHARTON Budget Model estimates that the U.S. has approximately twenty years for corrective action under current policies before facing inevitable government default. Nevertheless, there is an urgent need for decisions regarding the U.S. budget to be made promptly despite this projected timeframe.

Inflation and the Fed Funds Rate [LHS]; Composition of U.S. Government Expenditures [RHS]



Source: RJ Economics; FactSet as of December 15, 2023.

Labour Market: Turbulence Ahead

The U.S. labour market added over 2.7 million jobs in 2023, but nonfarm payrolls started to slow during the last few months of the year. Job openings have been on a downward trend since peaking in 2022 and we expect this trend to continue in the first quarter of 2024. As the economy continues to slow, we expect the labour market to contract slightly starting in the second quarter of this year. This should push the unemployment rate higher, to ~4.8% in the third quarter of 2024, but we expect the labour market to start to recover before the year ends. While layoffs are always painful and costly for individuals as well as for the U.S. economy, we expect them to be much less severe in 2024 than in previous recessions. The average recession experiences ~2.5 million job losses, while we are only forecasting ~1 million jobs lost during the upcoming slowdown. Additionally, the U.S. tax system integrates ‘automatic stabilizers’, which provide a natural buffer during an economic slowdown by softening the burden on families through unemployment insurance, income support programs, and tax incentives.

The Bottom Line: Cleared for Landing

Stable and lower inflation, lower job growth, and a weaker consumer are going to slow economic growth from the strong expansion experienced in 2023 to ~1.0% in 2024. While we continue to expect a very mild recession that lasts for two quarters, we want to emphasize that the overall growth for the year will remain positive. With currently available resources, the U.S. is estimated to be able to grow sustainably at ~1.9% without triggering higher prices. Therefore, our GDP forecast for the U.S. economy, if it materializes, should not only be welcomed by investors but also by the Fed as inflation will be less likely to reaccelerate.

Additionally, the concept of ‘asynchronous recessions’ should soften a downturn. That is because several sectors of the economy already experienced a contraction last year. Therefore, as some of last year’s expansionary sectors start to weaken, those that contracted in 2023 might start to experience growth. The reason the U.S. economy did not experience a recession in 2023 was because consumer demand, supported by still-strong employment and real income growth as inflation has slowed, has kept the U.S. consumer spending.

The economic outlook for 2024 should not be the year of ‘recession’ but rather a year of ‘sustained disinflation with weak economic growth’. In fact, according to our forecast, the upcoming recession would not only be very mild, with fewer job losses and declines in fixed investments, but also shorter in duration than the average recession. While we expect consumer spending to weaken, we expect government and nonresidential fixed investment to grow more and provide a cushion to the economic slowdown. This is because government spending tends to increase during a slowdown and fiscal incentives such as the Inflation Reduction Act, the CHIPS Act, and the Infrastructure Investment and Jobs Act, are likely to continue to incentivize spending despite the high costs of borrowing. The bottom line is that the U.S. economy has been cleared for landing, but in our opinion, it is unlikely to be as soft as many are predicting.

Canadian Equities

After a volatile year, Canadian equity markets experienced a broad 11% rally from a dip in October, with the S&P TSX Composite ending 2023 up 8.1% on a price basis, or 11.8% on a net total return basis, with reinvestment of all dividends, excluding the impact of withholding taxes. This was in contrast to -8.7% and -5.8%, respectively in 2022.

Information Technology was the best performing sector on the TSX in 2023, up 69%, led by Shopify (SHOP-CA), which surged 118% on the year. However, due to the sector’s 52% decline in 2022, we still observed the sector down 19% over a 24-month period from where it started in 2022. The Financial sector was the second-best performing sector in 2023 at 14%, primarily fueled by insurance companies. Three other sectors achieved modest double-digit growth in 2023. Consumer Staples experienced a 12% uptick, building on the solid 10% growth from the previous year, driven by Couche-Tard (ATD-CA). Industrials posted a 12% increase, with the Construction and Engineering industry standing out with a remarkable 39% total return. Consumer Discretionary rose by 11%, primarily due to the performance of Dollarama (DOL-CA) and Restaurant Brands International (QSR-CA), which owns quick-service restaurant brands, such as Tim Hortons and Burger King. Real Estate gradually rebounded from its 2022 low, posting a 7% gain in 2023. Residential REITs and Industrial REITs outperformed significantly, while Retail, Diversified, Office, and Healthcare REITs performed poorly. Energy had a relatively flat year, showing improved performance in the second half, with mixed results among the underlying companies. Finally, Utilities, Materials, and Communication Services notably lagged behind the market. Within Communication Services, both Bell (BCE-CA) and Telus (T-CA) experienced around a 10% loss. Overall, we witnessed more evident signs of sector rotation into defensive sectors. In terms of defensive sectors or industry groups, we are generally referring to Utilities, Consumer Staples, Insurance, Telecommunications, Software, and IT Services.

Sector Performance and Valuations

Index Name	2022	2023	2022 - 2023 (Not Annualized)	1Q23	2Q23	3Q23	4Q23	Since BoC Pause (7/12/2023)	Current PE NTM	Historical PE (Since 2000)	Premium (+) / Discount (-)
S&P/TSX Comp	-5.8%	11.8%	5.4%	4.6%	1.1%	-2.2%	8.1%	6.3%	13.7	14.5	-0.8
INFO TECH	-52.0%	69.2%	-18.8%	26.5%	16.6%	-7.5%	24.0%	21.5%	33.7	22.3	11.5
FINANCIALS	-9.4%	13.9%	3.2%	1.7%	2.0%	-2.6%	12.8%	8.1%	10.2	11.4	-1.2
CONS STAPLES	10.1%	12.2%	23.5%	7.9%	-2.6%	-1.2%	8.1%	10.7%	15.8	15.8	0.0
INDUSTRIALS	1.5%	11.9%	13.5%	6.6%	2.1%	-4.2%	7.4%	5.9%	21.7	15.7	5.9
CONS DISCRET	-6.0%	11.0%	4.3%	4.6%	6.4%	-7.1%	7.3%	1.1%	14.2	14.3	-0.1
REAL ESTATE	-21.5%	7.1%	-16.0%	5.8%	-2.8%	-6.1%	10.8%	1.9%	14.7	14.6	0.0
ENERGY	30.9%	6.7%	39.6%	-2.3%	0.3%	10.3%	-1.3%	10.9%	11.5	14.8	-3.3
UTILITIES	-10.6%	0.2%	-10.4%	6.7%	-1.5%	-12.0%	8.2%	-3.7%	17.5	17.9	-0.4
MATERIALS	1.8%	-1.3%	0.5%	8.1%	-6.9%	-3.8%	1.9%	-6.9%	16.4	16.9	-0.6
COMM SVC	-2.6%	-3.9%	-6.4%	3.2%	-1.1%	-12.5%	7.6%	0.0%	16.4	15.8	0.5

Source: FactSet; Raymond James Ltd.; Data as of January 12, 2024. All returns are total returns, in CAD.

Expectations in 2024

For 2024 we expect to see a mild recession, with rate cuts starting mid-year, as inflation continues to trend towards the BoC's 2% target. Similar to our approach with U.S. equities, we expect pressure on EPS, but offset by lower discount rates and higher P/E multiples as the markets look towards economic growth through the end of 2024 and into 2025.

Sector preferences in each half of 2024

If we look at what sectors we would favour in each half of the year, we can look at which TSX sectors generally do well during a BoC pause in interest rates. When the BoC pauses at a level above 2%, we generally see Utilities, Financials, and Consumer Staples providing the best returns. However, if we adjust those returns for price movements that we have already seen since the BoC's pause in July, we see Utilities and Materials, potentially offering the best performance through the end of this period.

Looking towards the latter half of 2024, we reviewed periods over the last 30 years when the BoC lowered its policy rate from a level above 2%, but remaining above or equal to 2% after the cuts were completed, as we would expect in this scenario, absent a more severe recessionary environment prompting more drastic cuts to stimulate the economy. In these instances, we saw the TSX Composite rising by an average of 15.8% on an annualized basis during the rate cut periods. So, for our purposes, this would assume to be from mid-2024 to mid-2025. TSX sectors that tended to outperform during these periods were generally Information Technology, Energy, and Financials.

While Information Technology is currently trading at elevated P/E multiples compared to its historical median, it has actually come down from its peak at the end of 2021, which remained above 70× for about 18 months. More importantly, the Information Technology sector has justified these high P/E multiples through its robust EPS growth, and we see this as an example of growth at a reasonable price.

Sector preferences in Canada for 1Q24

In the table below, we summarize our viewpoints on various sectors of the TSX Composite for the first quarter of 2024, as we expect to see more of an economic slowdown. By mid-year we expect the BoC to begin cutting rates and to have a more visibility towards an economic recovery, as discussed earlier, which would then provide more confidence in rotating into more cyclical sectors.

TSX Sector Weightings (within the S&P/TSX Composite) and Our Ratings

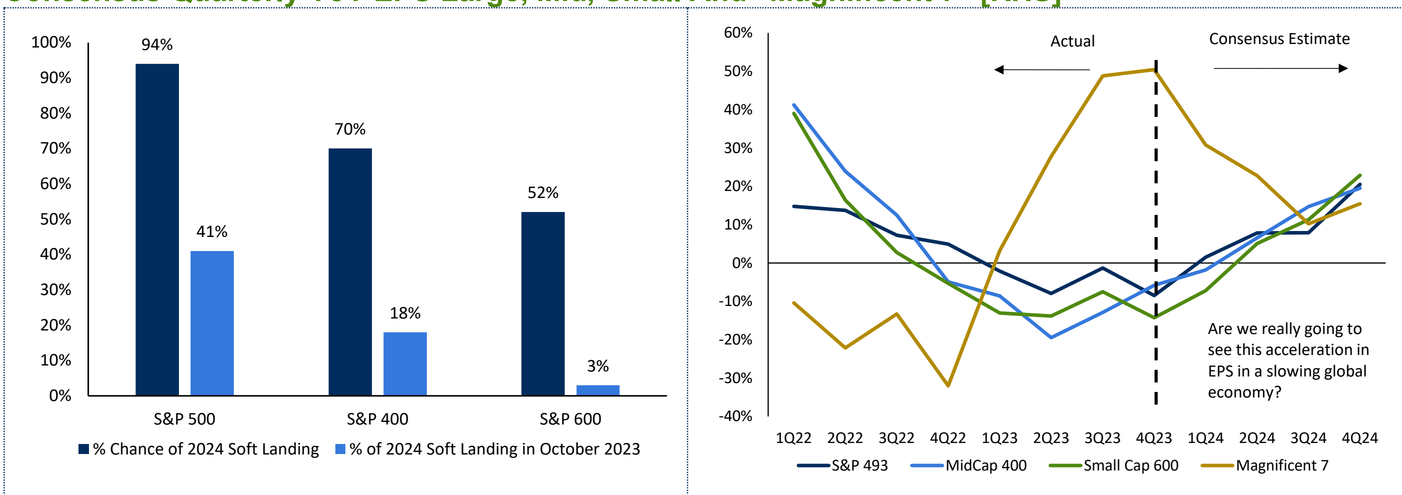
GICS Sector	TSX Weighting	Rating	Comments for 1Q24
Communication Services	3.7%	MARKET WEIGHT	Trading at slightly above average P/E multiples, we expect this generally defensive sector to hold its value through the economic slowdown and without the threat of further interst rate hikes.
Consumer Discretionary	3.6%	UNDERWEIGHT	Trading at its historical median P/E level, Consumer Discretionary experienced an 11% rise in line with the TSX Comp in 2023 and 7.3% in 4Q23. As the effects of elevated interest rates work through the economy, indicated by a softening in consumer spending and weakened expectations for wage growth, we anticipate a shrinking of disposable income and EPS pressure in 2024.
Consumer Staples	4.2%	OVERWEIGHT	Trading at its historical median P/E level, Consumer Staples shows consistent growth in EPS NTM. Historically, it has often outperformed when the BoC paused. Anticipating the BoC to maintain the interest rate unchanged until mid-2024, we recommend an overweight position in Consumer Staples at the beginning of the year as we see more economic pressure.
Energy	17%	MARKET WEIGHT	Currently trading at a discount, Energy is fundamentally harder to predict as it is a highly cyclical sector and relies on the supply. We generally expect a reduction in demand as economies slow, but growing geopolitical tensions may disrupt supply and drive up prices. We expect to see more opportunities in the Energy sector when the Bank of Canada starts to cut rates and the global economy recovers, so we will reserve any more positive weighting at this juncture. In the near-term, we see this is a likely volatile sector.
Financials	31%	MARKET WEIGHT	Trading at a discount to historicals, but we could still see more EPS softness in the short-term, although we see concerns about loan losses easing as the path of interest rates is more convincingly downward. The insurance industry significantly outperformed the sector in 2023 as markets shifted gradually toward defensive stocks. Historically, the Financials sector has, on average, outperformed the TSX Composite during Bank of Canada rate pauses.
Health Care	0.3%	NO RATING	
Industrials	14%	MARKET WEIGHT	The industrial sector is highly cyclical and is currently trading at a premium. With the onset of a recession and persistently high interest rates, it could encounter challenges in earnings growth, although with a diverse set of companies with exposure to U.S. and international markets, we are cautiously optimistic to settle on a Market Weight rating, looking more forward to an economic recovery, especially with potential opportunities under the scenario of re-industrialization of the U.S.
Information Technology	8.7%	MARKET WEIGHT	Info Tech was the best-performing sector on the TSX Comp in 2023, however, given its 52% decline in 2022, we still observed the sector down 19% over a 24-month period. While Info Tech is currently trading at elevated P/E multiples compared to its historical median, it has actually come down from its peak at the end of 2021, and can be justified through its robust EPS growth.
Materials	11%	MARKET WEIGHT	Materials sector performance has remained essentially flat over the last 2 years, and one of the worst-performing sectors in 2023, but is trading only slightly below its historical average. Sentiment could turn more positive once we can look confidently to an economic recovery, with the overall of demand for many metals through an electrification and energy transition theme. Historically, the sector has generated a higher average return than the TSX Comp during past BOC pauses when rates were above 2%.
Real Estate	2.4%	MARKET WEIGHT	Real Estate rebounded from its 2022 low, posting a 7% gain in 2023. Residential REITs and Industrial REITs outperformed significantly, while Retail, Diversified, Office, and Healthcare REITs performed poorly. We expect Residential REITs to continue outperforming, given the anticipated rate cuts in 2024 and the increase in population fueled by strong immigration. Commercial REITs may still face challenges as we approach a recession. Considering the mix of components, we have a Market Weight rating while the diminished concerns of rate hikes is favourable to the sector as a whole.
Utilities	4.0%	OVERWEIGHT	Trading at its historical median P/E level, Utilities' performance trailed behind the TSX Comp in both 2022 and 2023. However, being a traditional defensive sector, we expect it to outperform as the economy heads into a recession. It has consistently been the top performer among TSX sectors during past BoC rate pause periods, and we anticipate a further rebound this time. We recommend an overweight position in Utilities until we see rate cuts and signs of economic recovery in 2024.

U.S. Equities

The Santa Claus rally just kept on moving forward over the last three weeks of December. The global equity rally, which began on October 28, led to a stunning mid-high teens return for large cap indexes, 20%-ish returns for mid-cap indexes and mid-20% returns for small cap indexes, with no meaningful difference between growth and value (they both rallied spectacularly). Real Estate was by far the best performing sector, while energy was the worst performing sector during this final rally.

This brought us from a significant discounted P/E relative to the 5-year average across all benchmark indexes, to very near parity with the 5-year average. A word of caution heading into 2024 is that the equity market seems as convinced about a soft landing today as it was convinced of a recession in 2022. In both cases, the short-term lesson is not to stand in the way of a market that wants to express an opinion, while the longer-term lesson is that the economy is a tortoise, and no matter the conviction level the equity market wants to have, the economy will take longer than most think to reveal its ultimate answer.

Percentage Chance of Soft Landing In 2024 Priced Into Equity Indexes [LHS]; Consensus Quarterly YoY EPS Large, Mid, Small And "Magnificent 7" [RHS]



Source: FactSet; Raymond James Research.

Our overall views of 2024 are that inflation will progress lower, rates will also be reduced (3.5-4.0% 10-Year Treasury by year-end), and that U.S. equities will be somewhat flattish, with corporate profitability (EPS) relatively flat and under pressure from the slowing economy, but with strong P/E multiples reflective of the lower interest/discount rates, with the financial markets looking forward to the post-recession recovery.

In this environment, we favour U.S. stocks in the insurance, real estate, utilities, consumer staples, and health care sectors. As the economy slows, we see earnings risk in the energy, industrial, and consumer discretionary sectors. Consumer spending has been supported by low savings rates, but we do not see this as sustainable. This tidal wave of spending is receding, but not quickly in the U.S. (far more quickly outside the U.S.). With a resilient economy and still tight labour market, we do not anticipate any major negative shocks, just a softening of spending.

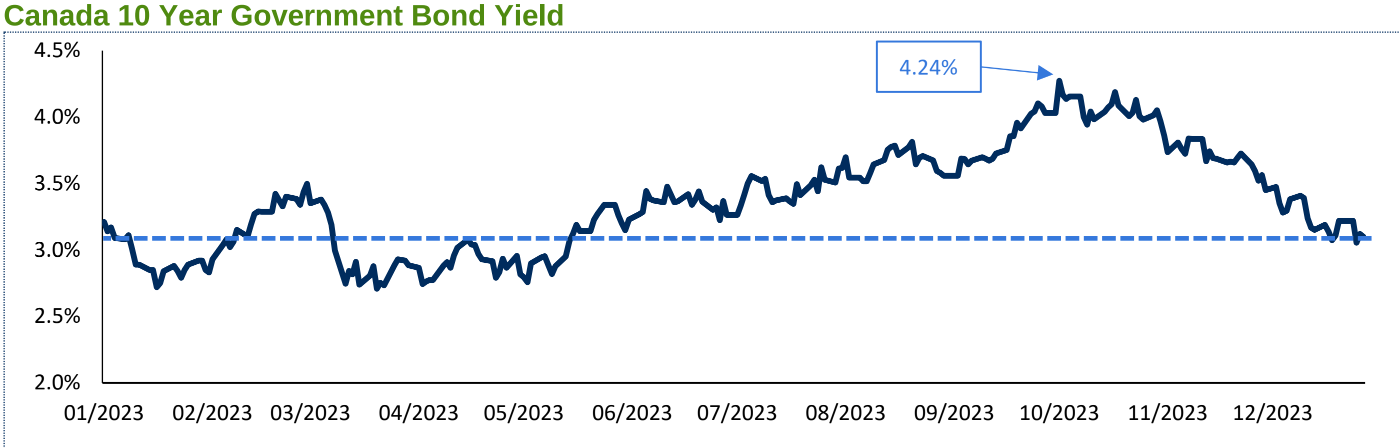
The biggest influence in U.S. equity markets will likely be how quickly the Fed recognizes that the inflation problem has been resolved and that it's time to lower rates. By some measures, specifically replacing shelter cost inflation with more real-time data, we could argue that we are already at that 2.0% target, and at a minimum we are on our way there. Our biggest concern preventing rate cuts, which will be needed to support the economy and financial markets, would be a spike in commodity prices, likely in the energy space, and as a result of supply disruptions and/or geopolitical tensions.

Our outlook for 2024 maintains a base case of a mild recession, with consensus EPS expectations coming down through the year, as they did in 2023, when the consensus EPS for small cap stocks declined 17%, mid cap stock EPS pulled back 9% and large caps EPS (cushioned by AI) ended the year 4% below where it started. That was all within the backdrop of a stronger than expected economy. Offsetting our only modest EPS growth forecast for 2024 is that we expect P/E multiples will remain strong, and could strengthen as interest rates decline and as the market looks beyond the current weakness in the economy.

Canadian Fixed Income

As we start a new calendar year, we begin by looking back at the performance of the Government of Canada 10-year bond in the year previous, which can give us a good sense of sentiment over that time period. And indeed, we saw the highest yield on the 10-year since November 2007 (over 15 years!), when it hit 4.24% in early October. The funny thing is, calendar performance doesn't care for the movements from day-to-day, or month-to-month, but looks solely at the opening day of the year and compares it to the closing one. If we look at this value, then, the year was essentially flat, with the GoC 10-year closing a mere 11 basis points lower than where it started in 2023.

Canada 10 Year Government Bond Yield



Source: Raymond James Ltd.; FactSet; Data as of December 29, 2023.

This retracing of yields was not limited to the ten-year security, as similar effects were seen in both longer and shorter maturities, leaving a curve that was reminiscent of the beginning of last year. In the past Quarterly, we suggested that investors look to extend duration, allowing them to capitalize on the historically high rates. We based this on our view of yields having a greater chance of decreasing from their previous levels – and this did materialize over the final quarter. However, we don't believe that the boat has fully sailed, meaning that investors still have time to move into longer-dated securities and potentially profit if bonds move as anticipated.

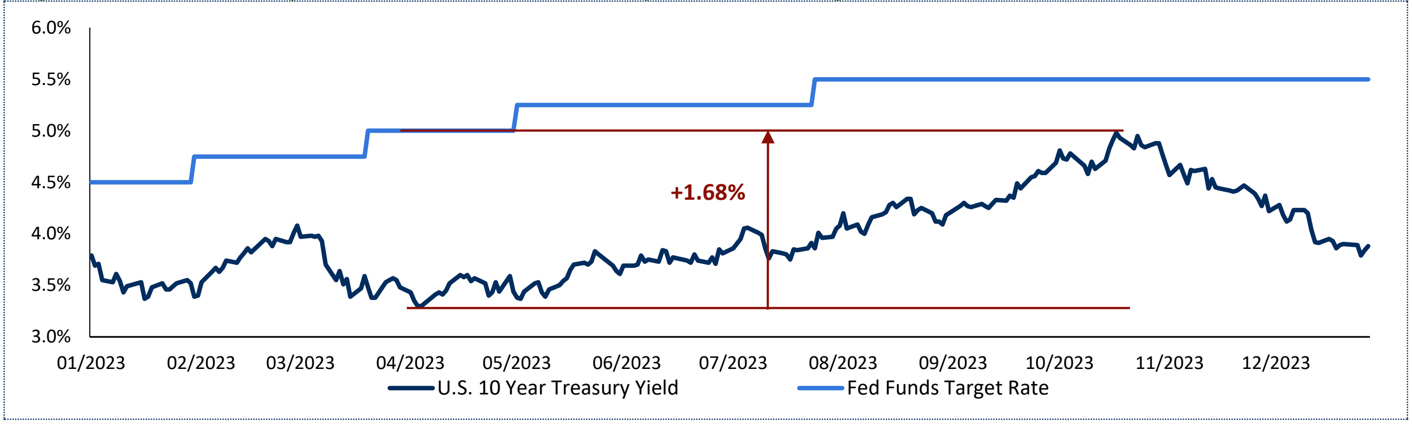
The Bank of Canada recently published its Business Outlook and Consumer surveys for the past quarter, which are the result of numerous interviews with business leaders (Business Outlook) and heads of households (Consumer). In both cases, inflation expectations have been trending downward, though notably a quarter of firms believe that it will take longer than four years for inflation to return to the 2% target. Consumer expectations for price growth in areas such as food and gas have fallen, however other categories remained stickier. This survey also highlighted that uncertainty in the economy is increasing vs previous quarters. This does align with what yields are telling us as they continue to fall with increasing expectations for an upcoming rate cut.

We do agree with the vast majority that Canada should see its first rate cut this year, although the expected timing of that event differs from person to person. Some expect to see this in April, but consensus is looking to June, which sounds more reasonable to us. When looking at the number of rate cuts in 2024, we have seen estimates suggesting five, but we believe that may not materialize. In our view, the Bank of Canada will take a more cautious approach, pausing and waiting to see how the market and economy reacts to the change before cutting again.

U.S. Fixed Income

A lot was going on with rates in 2023, yet, at the end of the year how different were things? The 10-year Treasury yield's lowest closing was 3.30%, while its highest close was 4.98%. This 168-basis point swing represents a 13.7-point price swing under today's 10-year Treasury bond ($110.02 versus $96.29). That's a lot of volatility. Yet, we started the year at a 3.79% yield and ended the year 9 basis points higher at 3.88%, or only a 0.76-point price swing. The year's interim volatility is attributed to the market's uncertainty towards economic data releases, geopolitical events, upcoming domestic elections, inflation, a potential recession, and the perception of the Federal Reserve's action or inaction.

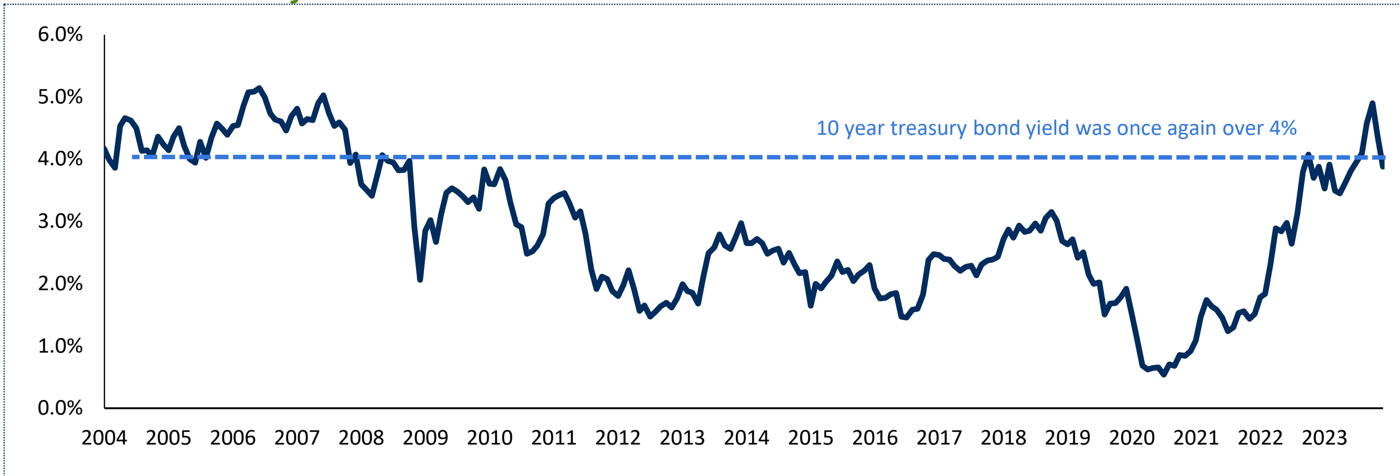
High Interim Volatility on U.S. 10 Year Treasury Yield Throughout 2023



Source: Raymond James & Associates; Raymond James Ltd.; FactSet; Data as of December 29, 2023.

The blue line on the graph above represents the upper bound Fed Funds rate. The four stair steps show the four Fed hikes throughout the year. In March, the market took a big pause, fearful that the collapse of Silicon Valley Bank might be the start of a more expansive banking crisis. The Fed continued its focus and perseverance to combat inflation with continued hikes.

U.S. 10 Year Treasury Bond Yield at Levels Not Seen Since 2008



Source: Raymond James & Associates; Raymond James Ltd.; FactSet; Data as of December 29, 2023.

The market relaxed its fears and the trend of rising rates resumed and continued through October. Since October, the market has not only signaled its confidence that the Fed is done but is likely pricing in a consensus total of 75 basis points in Fed rate cuts (3 x 25bp) in 2024. There are a couple of important takeaways to observe from 2023. It would be easy to cultivate a rate bias or anchor bias to the peak rates experienced in October. Don't – the current rate levels can't be matched without going back in time over 15 years! In other words, our current rate environment provides fixed income buyers with historically strong levels of income. Recently, the 10-year Treasury was once again above 4.0%.

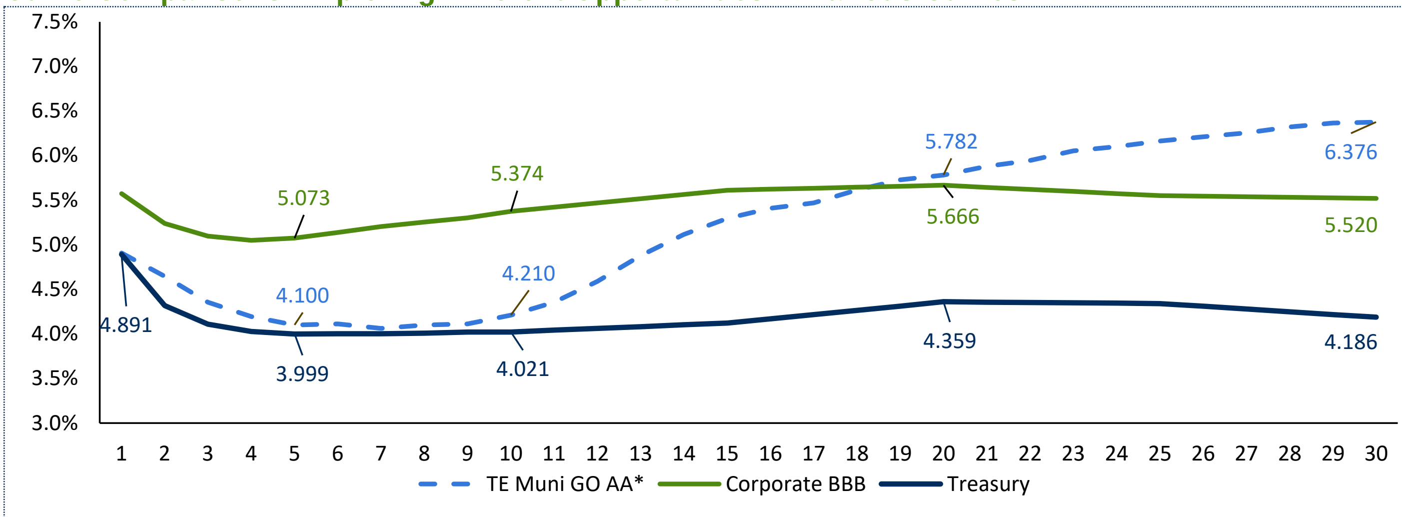
Should the economy avoid a deep or meaningful recession and remain strong through full employment and continued consumer participation, a slowdown will likely be met with a shift in monetary policy with a consensus 2-4 small cuts in the Fed Funds rate, fitting the majority consensus that the U.S. will experience a mild or no recession at all. However, changes in employment, earnings and/or consumer behavior could lead to a deeper recession and impact policy change pushing the Fed to move more decisively. History shows that the Fed will not hesitate to cut rates quickly in hopes of accelerating positive influence on a faltering economy.

Regardless of whether the economy slows a bit or extensively, nearly all investors and pundits see lower interest rates ahead, giving more credence to locking in high-income levels through increased duration. In addition, with income levels high, total return prospects are raised. Fewer investors turn to fixed income for total return promises but rather mostly for income, cash flow and principal protection. The market can offer both total return and income investors what they seek.

The dreaded "R" word, recession, can be overplayed. Recessions are part of the economic cycle in a way resetting the economy for what is typically a longer period of expansion. It has been said that this period lacks a major shock that often accompanies deeper recessions. It might be argued that our pandemic was that shock. The government took drastic steps to circumvent catastrophe. Half the businesses shut down or cut production and services to minimums. Had the government not stepped in, we may have been in a depression; however, the can may have been kicked down the road. Consumer spending is responsible for ~70% of U.S. GDP. Deferring student loans and rent payments allowed consumers time. Government backstops and money injected into the economy held the pandemic's fury at bay. There were consequences such as the U.S. debt ballooning to over US$34 trillion and consumer credit reaching unprecedented levels. Personal savings that peaked during the pandemic have dissipated back to norms. The consumer now sits with inflated debt, no more government aid, wages that haven't kept pace with inflation, and the prospect that the Fed is still a distance from price control.

Each of the economic scenarios leads fixed income investors to a plausible strategy; be prepared for the unexpected (a deeper recession), capture the income opportunity in hand and utilize the product that fits individual risk profiles.

Curve Comparisons: Exploring Different Opportunities in Various Curves



Source: Raymond James & Associates; Raymond James Ltd.; Bloomberg; Data as of January 9, 2024. *Tax Equivalent U.S. General Obligation AA Municipal bond, tax equivalent yield: 37% Fed tax bracket + 3.8% Affordable Care Act.

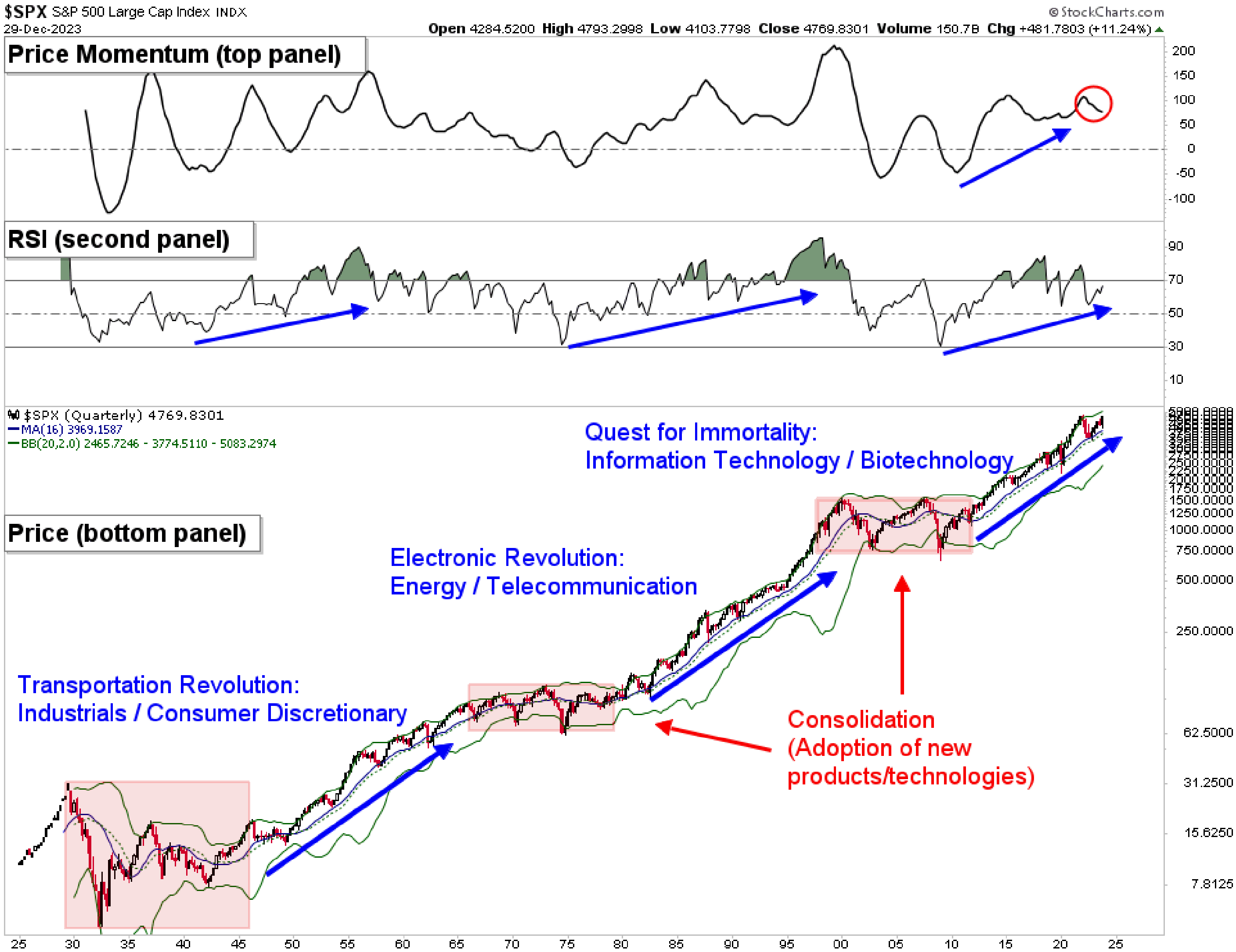
Municipals in the short-to-intermediate range have been distressed by low supply and heavy demand. However, the municipal curve remains the steepest upward-sloping curve providing the optimum returns in the extended 20-30-year maturity range. Most municipal structures include call features inside of 10 years keeping some long maturity durations modest. Although the corporate curve remains flat, it is elevated to other curves in the short-to-intermediate range optimizing after-tax returns (for U.S. taxpayers) versus alternatives. Although volatility remains high, many fixed income strategies are long-term and don't require spot-on market timing. The current environment is providing both income and potential total return prospects. Grab the opportunity while the window remains open.

Quantitative/Technical Analysis

Our longer-term cycle work suggests that a secular bull market in equities is in place that began in 2011 and has upside, by time, into ~2030.

This long-term chart of the S&P 500 visually illustrates the last *three* major investable themes (see blue arrows, secular bull markets), as well as a decade-long digestion period (see red shaded boxes, secular bear markets) prior to the next secular growth themes emerging.

S&P 500 – 100-Years - Yearly



Source: Stockcharts.com, Raymond James Ltd.

The chart below highlights all the previous 4-Year Cycle lows in the S&P 500 since 1950.

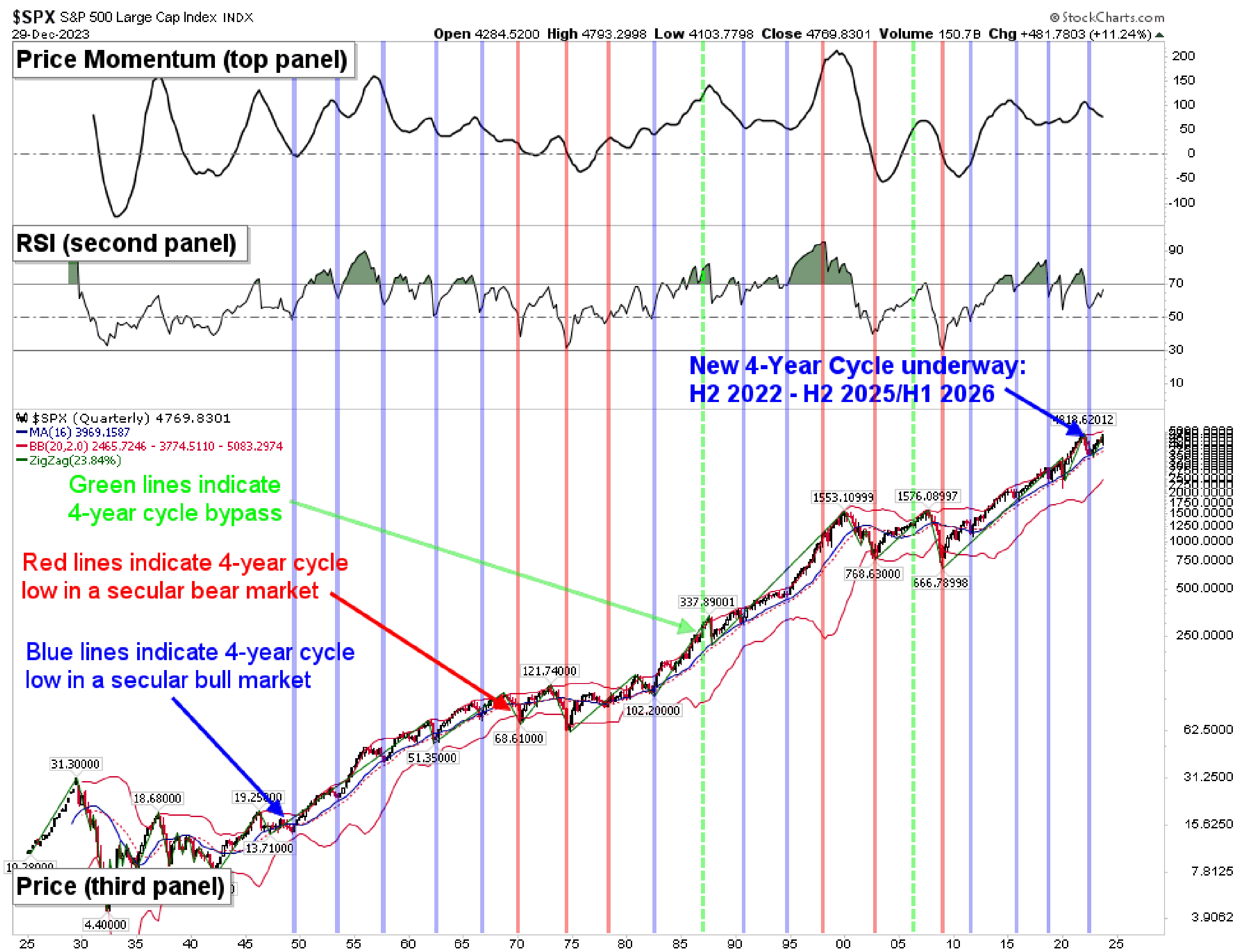
Our longer-term technical work suggests that a new 4-Year Cycle (3-5 year cyclical bull market) began at the October 13th, 2022, lows. We are calling this cycle the *Higher For Longer* cycle, or ***HFL*** cycle.

A year ago, at the start of 2023, our longer-term cycle work suggested a target for the S&P 500 of ~4,864, or 27% upside from the 2022 close. Recall this was against the backdrop of very bearish market sentiment. The S&P 500 finished 2023 ~4,770 or up 24% for the year.

Our 2024 quantitative/technical target for the S&P 500 is 5,466 or 14.6% upside from the December 29 close.

Our longer-term cycle work suggests the current 4-Year Cycle has upside, by time, into H2 2025 / H1 2026.

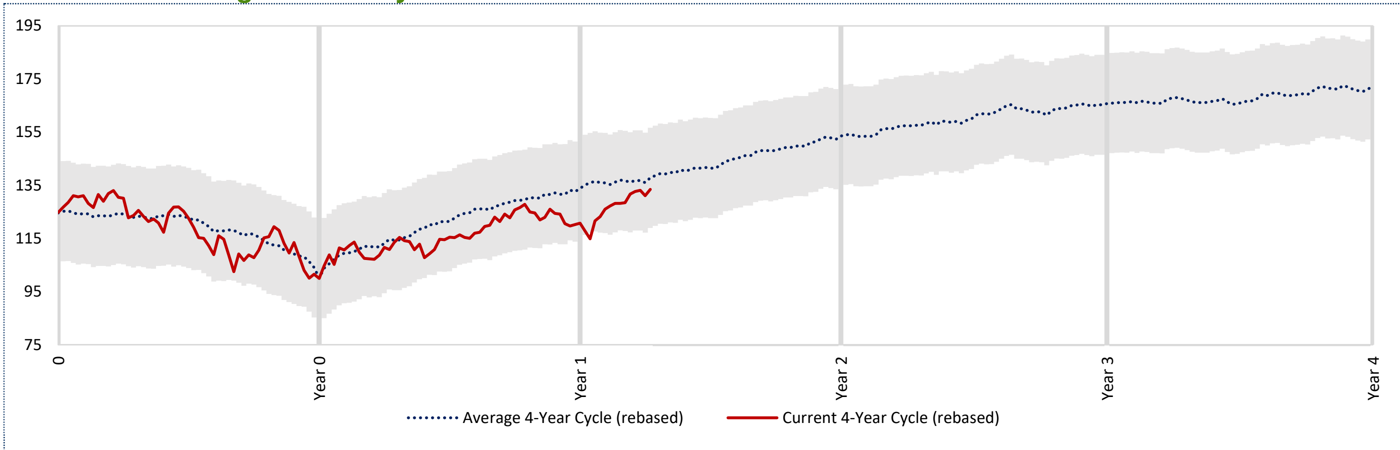
S&P 500 - History of the 4-Year Cycle – 100 – Years – Quarterly



Source: Stockcharts.com, Raymond James Ltd.

The next chart illustrates our longer-term work on the 4-Year Cycle.
The blue dotted line is the average track of all the 4-Year Cycles on the S&P 500 since 1949.
The red solid line is the track of the current cycle since the October 13th, 2022, low.
Given the average track of the 4-Year Cycle, this strongly suggests the path of least resistance remains higher for equity markets through 2024.

S&P 500 – Average 4 Year Cycle Since 1949

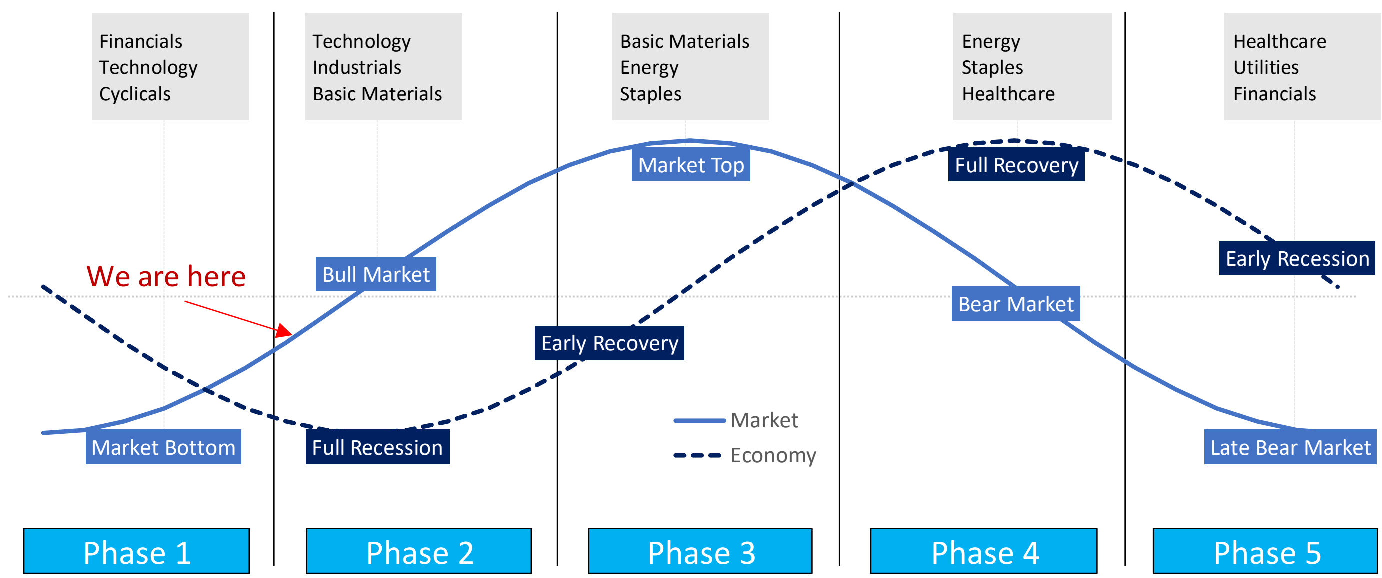


Source: CapIQ, Raymond James Ltd.

This last chart illustrates the underlying basis for the 4-Year Cycle, namely the business cycle.

In our view, the recent intermediate-term (1-3 month) corrective phase in equity markets, that began in the summer of 2023, marked the transition for equity markets moving from Phase 1 into Phase 2 of the Market Cycle Model (see 'We are here'). Phase 2 of the Market Cycle Model is when the underlying economy shows signs of strengthening (see blue dotted line) and is typically supportive of outperformance by Information Technology, Industrials, and Basic Materials (see blue box). In addition, our technical work suggests that Financial Services and Real Estate are likely to see a "catch-up" trade take hold. A strengthening economic backdrop should remain a strong tailwind for all these sectors through 2024.

Business Cycle



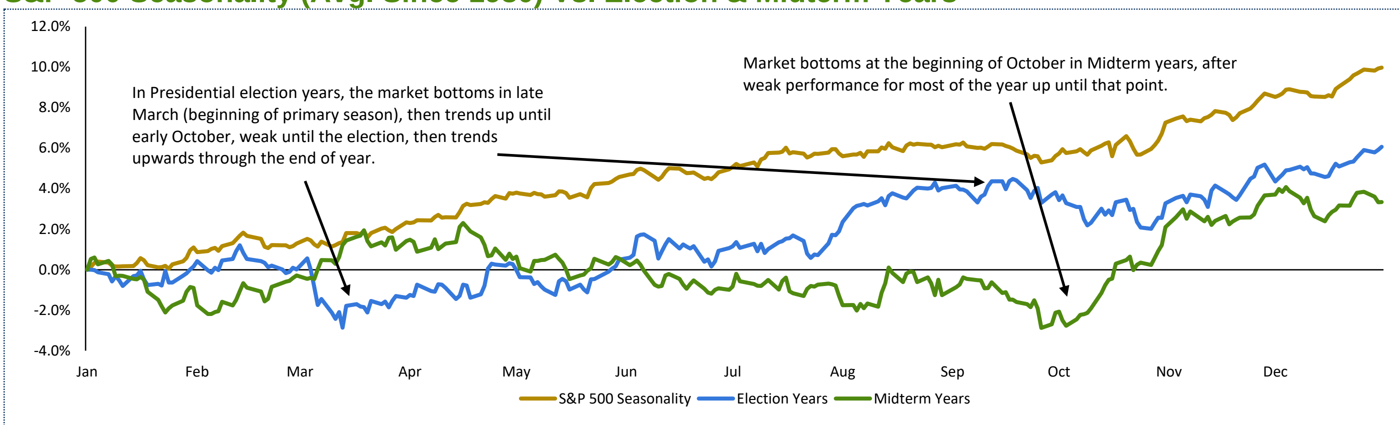
Source: Raymond James Ltd.

Washington Policy

Market Performance in a U.S. Presidential Election Year

U.S. presidential election years usher in considerable uncertainty. While the most likely scenario remains a rematch of the 2020 election, there seems to be a persistent nagging feeling that something could happen to reset the race and produce an unexpected outcome. This uncertainty, the potential for surprise, and the polarized nature of the political environment may cause investors to be cautious in the upcoming election year. Adding to this uncertainty is lingering geopolitical risk, concerns over the trajectory of the debt and deficit, recession risk, and unresolved government spending decisions. From a market perspective, we would not be surprised to see 2024 track traditional presidential election years, where there are pockets of weakness during periods of the greatest uncertainty, but a market rebound and renewed strength as we receive clarity on key issues. In this section, we will provide our outlook for the 2024 elections and provide an update on other key issues that DC will tackle in 2024, with impacts for the U.S. fiscal picture and geopolitical risk.

S&P 500 Seasonality (Avg. Since 1980) Vs. Election & Midterm Years

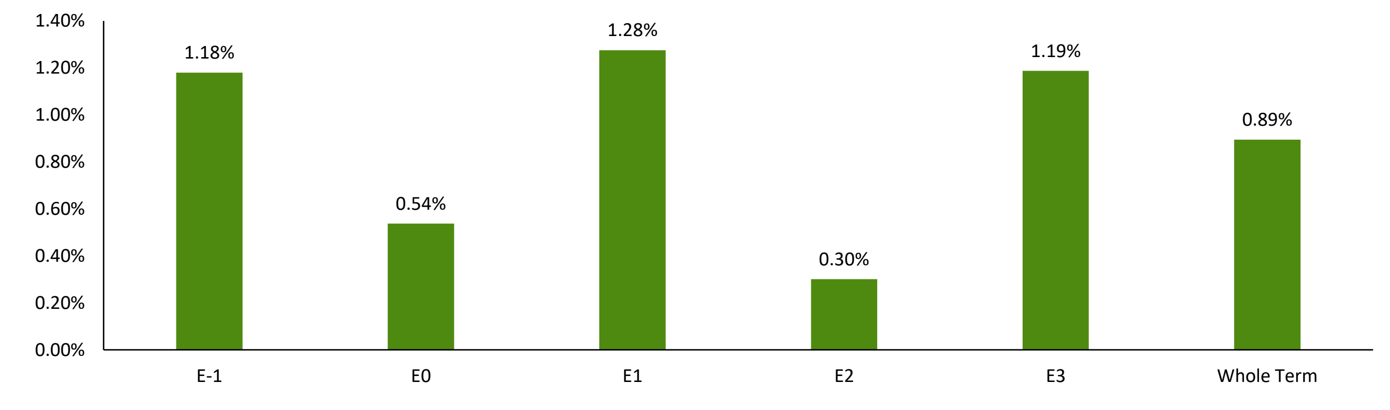


Source: Raymond James Financial; Bloomberg; Data as of December 31, 2022.

How could the 2024 electoral calendar impact market performance?

The state of play for the 2024 race will remain fluid ahead of Election Day, but a 2020 presidential rematch remains the most likely situation at this stage of the race. However, many unanswered questions remain in the months ahead, with implications for market sentiment at various turning points. Overall, election years have historically seen the second lowest market returns of the presidential term cycle, with an average monthly return of 0.54%. However, markets quickly play catch-up after election year uncertainty is resolved, averaging a monthly return of 1.28% during the year after the election. Midterm election years are the weakest point for markets in a presidential term, historically seeing average monthly returns of 0.3% regardless of the party in control of the White House.

Average Monthly Equity Price Returns In Each Term Year (1980-2020)



Source: Raymond James Financial; Bloomberg; Data as of December 31, 2020.

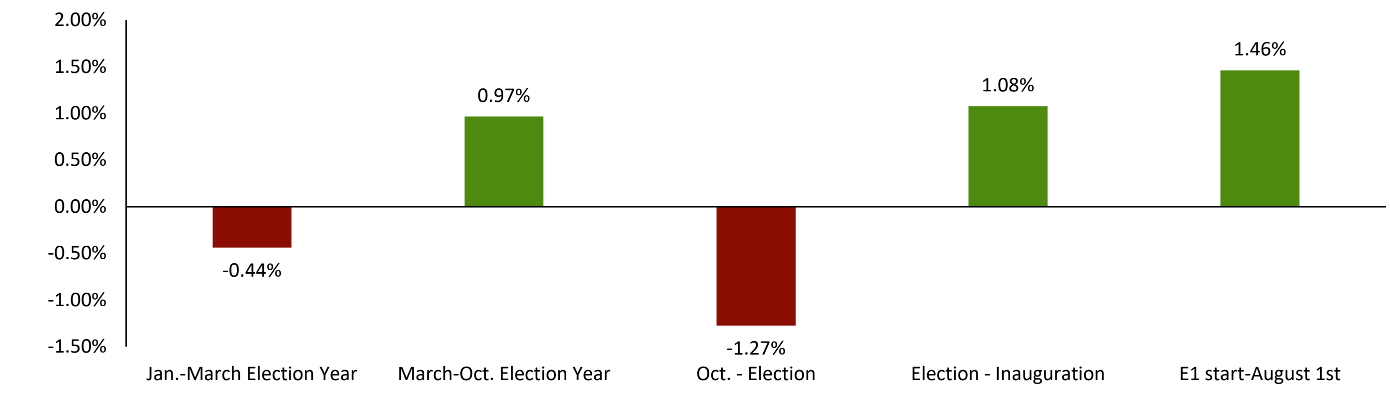
At the start of the year and the election cycle, we would highlight to investors that the beginning of election years (January-March) historically sees negative U.S. market returns as the primary process – and associated political volatility – hits its peak, with average monthly returns of -0.44%. The primary cycle began on January 15 in Iowa for Republicans (where former President Trump secured a decisive victory) and the first “official” primary will be on February 3 in South Carolina for Democrats. Two key measures of strength for an incumbent president are his favourability ratings and the right track/wrong track trajectory of the country. In each of these measures, there are warning signs for President Biden and we will be watching to see if this provides an opening for weaker-than-expected primary election results for Biden. Biden has two long-shot candidates running against him, but anything less than 75-80% support will set-off renewed alarm bells for his campaign.

As Republican voters continue to head to the primaries, Trump’s sustained polling dominance and early win in Iowa suggest his likely nomination to the Republican presidential ticket; however, his legal challenges remain a wildcard ahead of the primary process. If there is a surprise in the Republican primaries, we would need to see voters coalesce around a clear alternative to former-President Trump, picking up momentum in the early states in the coming weeks and months. Should Trump emerge as the Republican nominee, a key debate for the general election will be how much of the election is a referendum on Biden vs. Trump, as Trump also has similarly unfavourable ratings as Biden.

Key electoral inflection points for the market: March, October-November.

March remains an important inflection point in the electoral calendar, with 34 primary elections, including 16 states holding their primaries on Super Tuesday. The end of the month will provide important clarity on who the prospective nominees might be, with more than half of both parties’ delegates awarded ahead of the Republican convention in July and Democratic convention in August. Given this clarity, the period between March and October during an election year historically has seen positive returns (0.97% average monthly returns). Any remaining uncertainty over nominees should be resolved at the nominating conventions – July 15-18 for Republicans and August 19-22 for Democrats. Beyond first quarter volatility, the most significant downside risk is seen in the immediate run-up to the election (October through Election day), with an average monthly return of -1.27%.

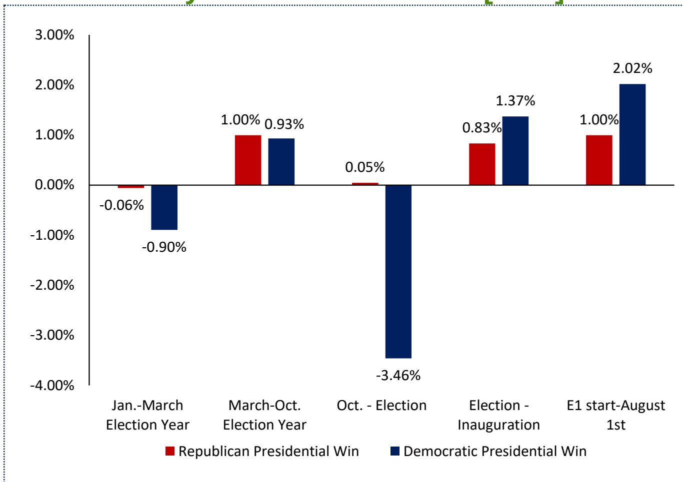
Average Monthly Equity Price Returns Around Elections (1980-2020)

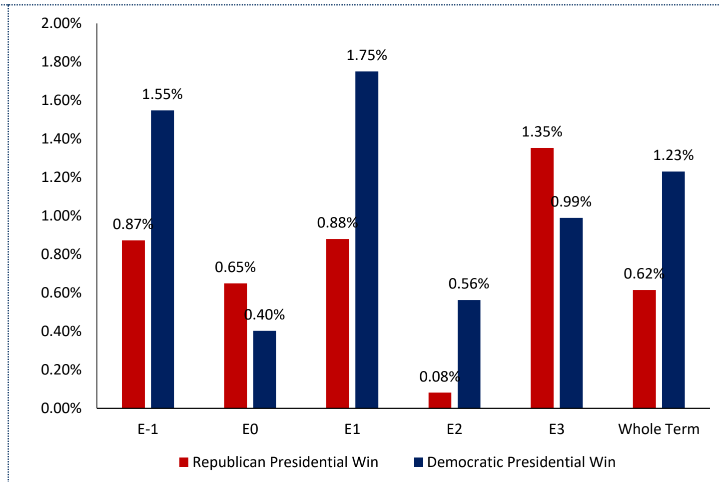


Source: Raymond James Financial; Bloomberg; Data as of December 31, 2020.

While the race is likely to remain close until the polls open on November 5, historically we have seen more market weakness in the run-up to a Democratic presidential victory vs. a Republican presidential victory, but these numbers are a bit skewed by the impact of the global financial crisis in 2008 preceding President Obama's victory. Despite this pre-election volatility, markets tend to quickly play catch-up and see an outsized market return. If Democrats retain the White House, we expect to see a greater positive rotation in the first 100 days of a Democratic presidency compared to a GOP victory – on average, markets rise 1.75% monthly the year following a Democratic presidential win, compared to 0.88% for Republicans. Given this historical correction, we would caution to avoid using the election as too much of a catalyst for investment decisions.

Average Monthly Returns With A Republican Vs. Democratic Presidential Victory Since 1980 [LHS]; Since 1980 By Election Term Year [RHS]

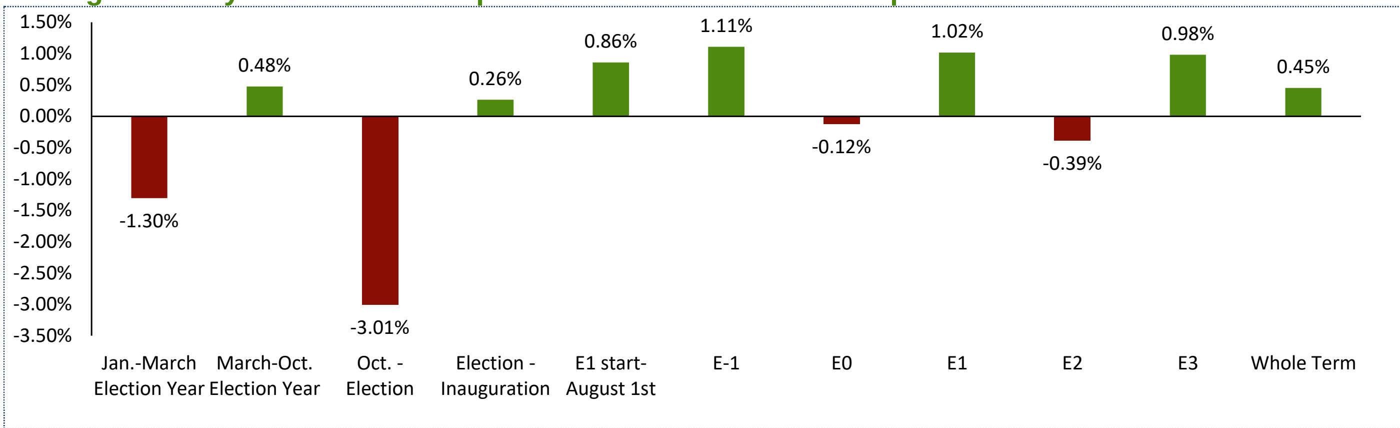




Source: Raymond James Financial; Bloomberg.

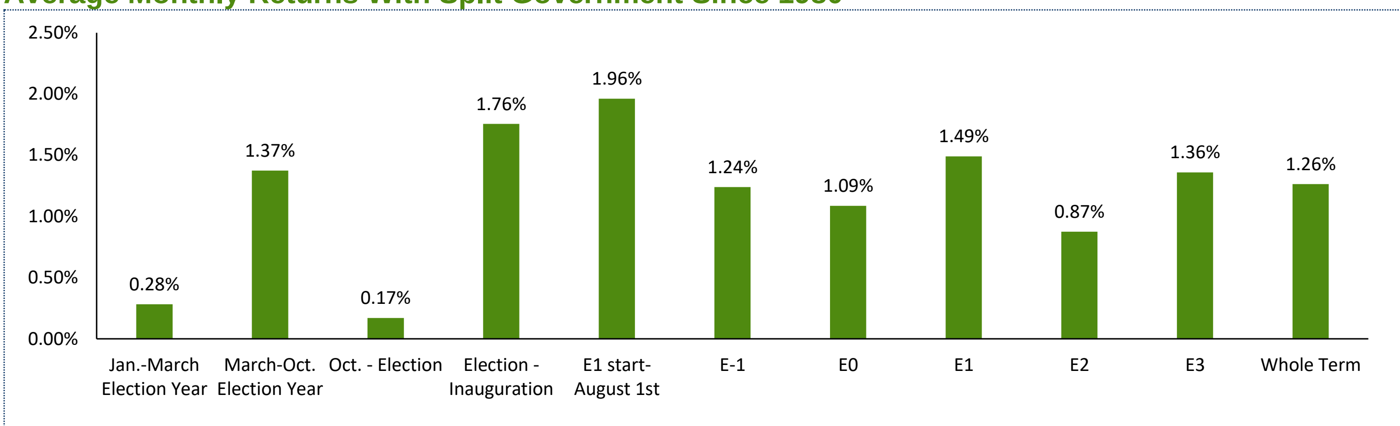
Control of the House and Senate will also be up for grabs next November, and we would highlight to investors that expectations of a partisan sweep in either direction tend to drive more volatility, seeing -3.01% average monthly returns in the pre-election period. In contrast, expectations of a divided government set the conditions for calmer waters, seeing positive average monthly returns both ahead of the election (0.17%) and in the years after. The race for Congressional control will similarly remain fluid up to election day, but the retirement of Senator Joe Manchin (D-WV) will compound an already challenging map for Senate Democrats, while a slow-to-restart fundraising operation under new House Speaker Mike Johnson (R-LA) could limit the flow of funds to vulnerable House Republicans in key swing districts.

Average Monthly Returns With Republican Or Democratic Sweep Since 1980



Source: Raymond James Financial; Bloomberg.

Average Monthly Returns With Split Government Since 1980



Source: Raymond James Financial; Bloomberg.

What else does DC need to achieve in 2024?

Aside from electing a president and a new Congress, DC will enter 2024 with an important to-do list, including government funding and responding to a changing global security environment. The ongoing government funding debate has raised investor concerns around temporary government shutdowns and triggers of a 1% across-the-board spending cut, which could add to market volatility in the first quarter. While near-term economic concerns have been raised about a potential slump in near-term fiscal support given the spending cut discussions, we would point to the implementation of major infrastructure legislation (including the bipartisan infrastructure law and the Inflation Reduction Act), which will continue to be deployed and have significant macroeconomic impacts.

Geopolitics will be another priority for DC to address throughout 2024, with parallel wars in Ukraine and in Israel/Gaza alongside ongoing Indo-Pacific security concerns likely to shape key legislative, political, and regulatory outcomes throughout the year. Amid heightened concerns around fiscal spending and under the leadership of House Speaker Mike Johnson, additional military aid for Ukraine and Israel will continue to come under close scrutiny in the halls of Congress. While the path for a joint package pairing the supplemental defense spending with border security provisions passing into law still exists, it continues to narrow as Congress struggles to reconcile competing partisan priorities on the border. We do not expect the bill to pass before March – if at all – with negative near-term impacts for defense sector sentiment. However, we expect to see a longer-term setup that is more supportive of higher defense spending given national security's reemergence as a core legislative and regulatory theme in DC.

Finally, the U.S.-China relationship will also remain in focus in 2024 as DC and Beijing try to maintain stabilized contacts through recently-resumed channels of communication. We view the incentives for both parties to escalate as limited in the near-term, but caution that further national security initiatives (such as updated restrictions on the export of advanced technology and new tariffs) and associated reactions remain a risk. Volatility in the Taiwan Strait is another possibility given the recent election of William Lai of the incumbent DPP to the Taiwanese presidency; however, we expect any reaction from Beijing will likely be limited in scope in order to preserve future escalation space. A hawkish tilt in Congress (compared to the White House) can drive additional headlines, but we view the likelihood of a comprehensive package being passed this year as low.

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