Global Asset Allocation Perspectives & Investment Backdrop

MANAGED ASSET PROGRAMS
First Quarter 2025 Preview

Scotia Global Asset Management®

Market Review

A look back and ahead

Overall, 2024 was a robust year for both fixed income and equity markets. Although the fourth quarter introduced some volatility in the fixed income asset class and equities saw some short-term noise mid-year, volatility throughout all of 2024 was quite muted. With mega-cap and AI-focused stocks reaching high valuations while corporate profits remain strong, we anticipate a resurgence in market breadth, benefiting those who diversify their investments. However, risks persist, including the potential for recession, which could trigger a swift sell-off in the most expensive stocks. In this environment, we firmly believe in the value of a diversified, actively managed total portfolio approach – perhaps more than ever. Here's a look back at what drove markets during the quarter, along with some key trends our team is monitoring closely.

FIXED INCOME

Federal Reserve Actions in Response to Inflation Trends:

- In the fourth quarter, the Federal Reserve cut interest rates twice for a total of 0.50%, with the first cut in November and the second in December.
- During the December announcement, the Fed projected a slower pace of rate cuts as we enter 2025, citing the ongoing battle with inflation that has dominated headlines throughout the year.
- Inflation came in close to expectations in November and has been trending lower toward targets. Inflation has proven to be stickier than expected, supported by continued strong employment and healthy corporate profits.
- As we head into 2025, uncertainty persists due to the potential inflationary effects of President-elect Donald Trump's proposed policies, including tax cuts and tariffs, which may dampen expectations for further rate cuts.

U.S. Bond Market Challenged:

- Despite decreasing policy rates during the quarter, U.S. long-term bond yields rose which resulted in a challenging December; however, with the U.S. dollar strengthening, the Barclays U.S. Aggregate Index return (C$) was positive for both the month and the quarter.
- High yield bonds led the market as spreads contracted again during the quarter, indicating lowered perceived risk by the market.

Canadian Bond Market Ends Flat:

- The Bank of Canada also reduced rates during the fourth quarter, with two cuts of 0.50% in October and December.
- The Canadian bond market, represented by the FTSE Canada Universe Bond Index, was flat for the quarter after a challenging October and slightly negative December.
- Short-term yields decreased during the quarter, while high-yield and investment-grade corporate bonds posted modest gains.

Global Accommodative Policy Continues:

- Other major central banks continued the rate-cutting cycle, with the European Central Bank cutting rates by 0.25% in October and December; more reductions are likely in 2025 due to a challenging macroeconomic environment and stunted growth.
- The United Kingdom also reduced interest rates by 0.25% in November in response to weakening economic data and softening demand.

Market Review (cont'd)

EQUITY

U.S. Growth and Momentum Trade Returns:

- U.S. stocks rose by 9.0% in Canadian dollars (C$); however, in local currency, the returns were much more muted due to strong U.S. dollar appreciation compared to Canadian dollar.
- The fourth quarter saw the return of mega-cap tech and AI-focused stock dominance.
- Top-performing sectors during the quarter included consumer discretionary (+21.5%), communication services (+15.7%), and financials (+13.6%).
- The U.S. outlook remains cautiously optimistic; despite pockets of rich valuations, the potential for higher growth and lower rates should favour cyclical sectors over defensive ones.
- Additionally, the president-elect's policies may result in increased growth, reduced regulation, and the introduction of more business-friendly policies.

Canadian Technology Dominates:

- Canadian stocks contributed modest returns this quarter, with the S&P/TSX Composite Index gaining 3.8% (C$).
- This gain was driven primarily by the information technology sector, which returned 22.1% (C$) and saw significant growth beginning in November.
- December was a challenging month for the index, influenced by the slower pace of rate cuts in the U.S.

Global Stock Performance:

- Global stocks were also up, as represented by the MSCI World Index, which returned 6.4% (C$), with growth outpacing value during the quarter given the impact of the U.S. constituents.

To help guide the forward-looking positioning of Scotiabank's managed asset programs, the Multi-Asset Management team meets regularly with the Portfolio Managers at 1832 Asset Management L.P. This preview captures the team's current views and portfolio positioning.

Global Themes from the Multi-Asset Management Team

ECONOMIC GROWTH

The short-term acceleration in economic activity is countering expectations for a more meaningful slowdown in the global economy due to the lagged impact of tighter monetary policy. As such, global growth is expected to be stable but slower relative to recent years. Economic growth in the U.S. is expected to be higher than in most other developed economies. U.S. consumer spending, a key driver of the economy, remains resilient due to stable employment, inflation that has trended lower, and increased household wealth. The European economy is expected to be supported by continued monetary easing which will promote consumption and investment, but growth is expected to remain low. Additionally, Chinese stimulus in response to below-target growth could lead to upward revisions in growth forecasts for the next 12-18 months.

BUSINESS CYCLE

Global Purchasing Managers' Indices (PMIs) have started to improve following recent weakness. The U.S. PMI has been more resilient than expected, supported by strong consumer demand and low unemployment. Service-oriented business spending has continued to grow given that service PMI levels have expanded. In contrast, Eurozone PMIs remain weak due to international and domestic pressures. Meanwhile, China's PMIs have been stable, but the outlook is mixed amidst concerns over housing and deflation.

MONETARY POLICY

Overall, the stance remains dovish, but central banks are constrained by still elevated inflation in many regions. Rate cuts are likely to continue at a modest pace, coinciding only with further declines in inflation. The global central bank easing cycle has begun in earnest, potentially amplified by China's fiscal policy.

INFLATION

Easing supply challenges and weakening demand have helped to bring inflation lower. However, still tight labour markets, particularly in the U.S., are keeping wages elevated. It will take either more time or a sharper slowdown in the global economy to bring inflation more confidently to low and sustainable levels.

COMMODITIES

Anticipated below-trend growth in the global economy will prevent significantly higher prices for the remainder of the year. Higher supply has driven oil prices down, and absent a shock, they will remain under pressure. Meanwhile, precious metals prices have seen significant gains, partially driven by geopolitical tensions.

CURRENCIES

We maintain a balanced stance of both cyclical and safe-haven currencies, with a modest bias towards high-carry EM currencies at this stage. Safe-haven currencies will benefit from either an unexpected downturn in global economic growth or the normalization of monetary policy. Cyclical currencies could benefit from either scenario of lower valuations or higher carry, which would be supported by strong domestic conditions.

RISK

Markets are richly priced with high concentration and lofty valuations. Central banks' response to a potential growth slowdown requires continued progress on inflation. Additionally, rising geopolitical tension and increasing polarization globally present another source of risk to markets.

Asset Allocation Positioning

	Outlook	Comments
FIXED INCOME		
Overall Fixed Income	–	Our modelling continues to reflect stabilization in global economy and receding recession risk. Our base case is that earnings growth will remain positive, and markets continue to grind higher. Under this environment, we prefer equities over fixed income, although bond yields remain attractive, both from an income and capital appreciation perspective.
Rates		
Canada and U.S.	0	The Bank of Canada cut interest rates by 1.75% over 2024, while the Federal Reserve lowered rates by 1.00% but cast doubt on speed and scope of future cuts. Firmer inflation prints and fear of potential inflationary policy has driven yields back higher. We remain positioned for yield curve steepeners, on the assumption that the front end will deviate from the longer rate. Under scenarios of further cuts being required, the short end would fall more or if the neutral rate of interest is in fact higher, the long end should rise to incorporate term premium.
Global	+	Growth is expected to be challenged outside of North America, and we therefore prefer adding duration internationally. The European Central Bank is likely to continue to lower interest rates to help stimulate the European economy. Higher inflation and budgetary concerns have driven yields much higher in the United Kingdom, exasperated by low liquidity, offering an attractive entry point for a modest duration position.
Credit		
Investment Grade	+	Credit spreads remain tight by historical standards, however corporate fundamentals are strong with a backdrop of continued earnings growth and prospects for a lower tax environment in the U.S. Even without further spread compression the additional yield offered by Investment Grade bonds remains attractive.
High-Yield	–	High yield borrowers were able to refinance their debt last year as yields lowered, pushing out their maturity dates and helping insulate companies from the reversion higher. Labour markets remain firm, yet unlike the Investment Grade segment, a modest slowdown in growth or earnings could lead to spreads widening quickly with structurally higher interest rates stressing fewer stable companies.
EQUITIES		
Overall Equities	+	We have moved to a modestly overweight view on global equities as our modelling reflects a stabilization in the global economy and receding recession risks. Our base case is that earnings growth will remain positive and global equity markets continue to grind higher. While further easing by the Federal Reserve continues to be priced out, this a reflection of U.S. growth and the U.S. labour market coming in above expectations. From a secular perspective, AI infrastructure investments also continue to support a large proportion of cap-weighted indices. Although high valuations will likely subdue forward-looking returns, if a recession can continue to be avoided, then equities should outperform fixed income, especially if rates remain higher for longer. Additionally, sentiment remains positive that business-friendly policy changes in the U.S. could further bolster economic growth, even as threats of tariffs dampen excitement in other markets.
Region		
Canada	+	We continue to maintain a modestly overweight view to Canadian equities. The Bank of Canada has provided considerable easing to the Canadian economy while the Canadian dollar remains very weak relative to our largest trading partner which should help support exports. Although the Canadian Federal Government is currently in disarray, an election will take place in the coming months and the expectation is that the outcome will be a more growth-focused direction supported by business-friendly policies. Additionally, although President Trump's recent statements are garnishing big reactions from Canadian politicians, ultimately all parties are incentivized to come to acceptable deals. Finally, from a valuation perspective, Canadian equities are very attractively priced relative to their U.S. counterparts.
U.S.	+	We have an overweight view to U.S. equities. The market continues to see very positive momentum as economic growth remains surprisingly resilient. Despite stretched valuations, U.S. equities continue to have among the largest proportion of companies benefitting from the emerging AI ecosystem, whether it be AI infrastructure investment, AI training and inference, or AI applications. Additionally, the incoming U.S. administration is focused on business-friendly, pro-growth policies along with a strong desire to cut taxes, regulations, and the overall size of the Federal government.
International	–	We maintain our underweight view of international equities due to a pessimistic view of Europe. Europe continues to face structural headwinds which affect its global competitiveness. The old business model of selling into the U.S. and China is coming under pressure due to rising protectionism in the U.S. and the shift from China to a key competitor from a key customer previously. Europe's high energy and labour costs and increased regulation place it at a disadvantage. Cyclical indicators like PMI remain depressed with no signs of a recovery. We remain neutral in non-European international markets such as Japan and Australia.
Emerging Markets	0	We have a neutral view on Emerging Market Equities. China faces structural challenges related to the property sector adjustment, broad deleveraging by consumers and local governments, and geopolitical tensions with the U.S. However, these factors are well known and its equity markets trade at a significant discount. With the weak economy now the primary focus of policymakers, stimulus measures are expected to be rolled out over 2025 to support growth. However, given the uncertainty around stimulus and the ongoing structural risks, we are not aggressively pursuing Chinese equities and remain neutral. In other emerging markets outside of China, we remain neutral overall as compelling valuations are offset by the risks to global trade.

Legend: ++ Overweight + Neutral-overweight 0 Neutral - Neutral-underweight - - Underweight

Performance – As at December 31, 2024

FIXED INCOME						
Bonds	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
FTSE Canada Universe Bond C$	-0.04%	4.62%	4.23%	4.23%	-0.60%	0.79%
Universe Canada All Corporate C$	1.03%	5.75%	6.97%	6.97%	1.47%	2.31%
Morningstar CAN High-Yield Fixed Inc C$	1.49%	5.63%	9.28%	9.28%	2.99%	3.61%
BAML U.S. Corporate C$	-3.26%	2.00%	1.63%	1.63%	-2.85%	-0.22%
BAML U.S. High-Yield Master II C$	6.63%	10.87%	18.04%	18.04%	7.46%	6.23%
Barclays U.S. Agg Bond U$	-3.06%	1.98%	1.25%	1.25%	-2.41%	-0.33%
Barclays Global Agg U$	-5.10%	1.53%	-1.68%	-1.68%	-4.52%	-1.94%
EQUITIES						
Canadian Equities	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
S&P/TSX Composite C$	3.76%	14.71%	21.65%	21.65%	8.93%	11.29%
U.S. Equities						
S&P 500 C$	9.02%	13.97%	36.36%	36.36%	13.76%	16.92%
Dow Jones Industrial Avg C$	7.44%	15.33%	25.42%	25.42%	12.31%	12.86%
NASDAQ C$	13.22%	14.86%	40.92%	40.92%	13.24%	20.05%
Global Equities						
MSCI World C$	6.39%	11.82%	30.01%	30.01%	11.58%	14.04%
MSCI Asia Pacific ex-Japan C$	-1.42%	8.53%	20.47%	20.47%	2.64%	4.16%
MSCI Japan C$	2.65%	7.30%	18.54%	18.54%	7.74%	7.39%
MSCI Europe C$	-3.85%	1.22%	11.72%	11.72%	6.35%	7.74%
MSCI Emerging Markets C$	-1.88%	5.47%	17.85%	17.85%	2.88%	4.24%

Source: Bloomberg, Morningstar

MULTI-ASSET MANAGEMENT TEAM

Craig Maddock, CFA
Head, Multi-Asset Management Team and Sr. Portfolio Manager

Wesley Blight, CFA
Vice President & Portfolio Manager

Ian Taylor, CFA
Vice President & Portfolio Manager

Yuko Girard, CFA
Portfolio Manager

Mark Fairbairn, CFA
Portfolio Manager

Jenny Wang, CFA, MA
Portfolio Manager

Team supported by:
2 Associate Portfolio Managers | 9 Analysts | 1 Trader

As Portfolio Managers for ScotiaFunds and Dynamic Funds managed-asset programs, the Multi-Asset Management Team oversees approximately $121 billion* in multi-asset solutions and strategies. The Team is responsible for portfolio construction, asset allocation policy, and investment strategy research and selection. The Team is also involved in the due diligence and day-to-day management of all portfolio solutions.

*As at December 31, 2024

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