Asset Allocation Strategy

CIO Office | January 2025

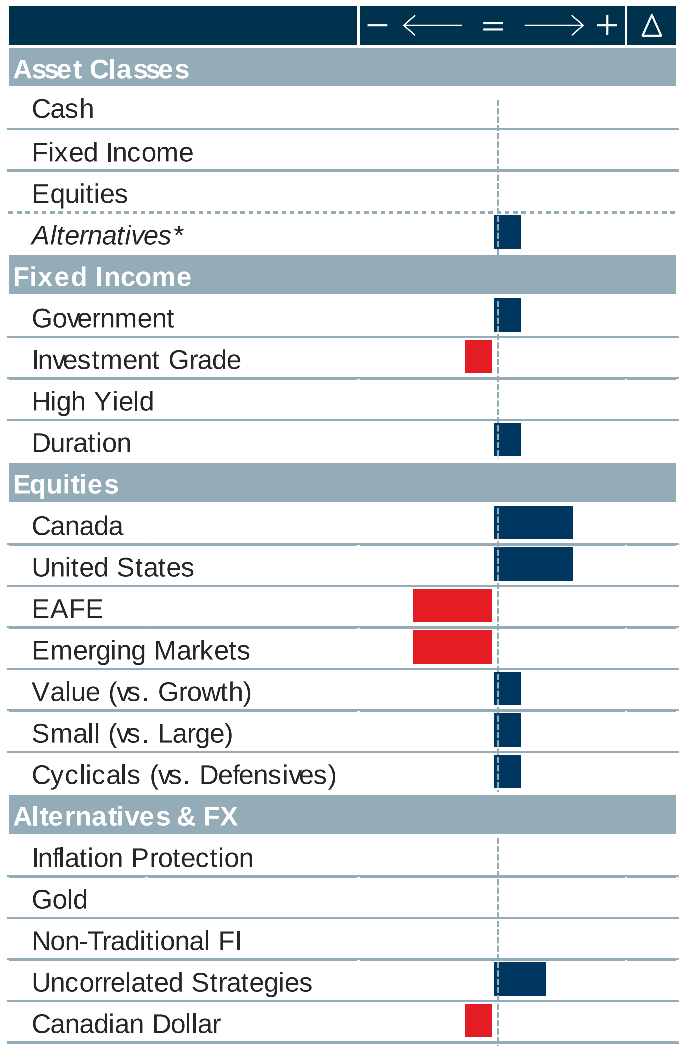
Optimism prevailed: a look back at 2024 in 10 key charts

Highlights

- In keeping with tradition, we're taking advantage of this special January edition to look back at the key events of 2024 through 10 charts.
- In 2024, (1) investors enjoyed a second consecutive year of above-average gains, thanks in large part to (2) the significant outperformance of U.S. equities supported by (3) an economy that continued to grow at a stronger-than-expected pace.
- However, the year did not unfold entirely without a hitch. In the Summer, (4) the rapid rise in the U.S. unemployment rate triggered the Sahm rule, a recession indicator that had never been wrong before, leading to an episode of volatility in the markets. Fortunately, (5) inflation continued to slow, allowing (6) central banks to begin a new cycle of monetary easing. Rate cuts were more significant on our side of the border, given (7) the more pronounced weakness of the Canadian economy, which contributed to the Loonie's significant depreciation against the Greenback.
- Finally, a review of 2024 would not be complete without mentioning (8) the victory of Donald Trump and his "America First" policy. Against this backdrop, (9) the S&P 500 recorded one of its best years in almost the last 100, supported by (10) the colossal and ever-growing weight of its tech giants.
- Happy reading and best wishes for the New Year!

Global Asset Allocation Views

Table 1 Global Asset Allocation Views



This table is for illustration purposes only. Bars represent the degree of preference of an asset relative to the maximum deviation allowed from a reference index. The further to the right (left) they are, the more bullish (bearish) our outlook for the asset is. No bars indicate a neutral view. The column under the delta sign (**Δ**) displays when our outlook has improved (↑) or worsened (↓) from the previous month. Consult **Table 3** to see how they translate into a model balanced portfolio. *For tactical portfolios featuring alternative assets, the position is financed by bonds.

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Market Review

Fixed Income

- The Canadian fixed-income universe fell back slightly at the end of the year, but still posted annual gains for the second year running. Corporate bonds benefitted most from the risk appetite of investors, while long-term bonds lagged.

Equities

- Equity markets lost some steam in December, but this slight downturn came at the end of an excellent year for equities. Leadership was firmly in North America, with the S&P/TSX and S&P 500 recording annual returns of over 20%, while the EAFE region and Emerging Markets posted more modest gains in 2024.

- In the U.S., it was the three sectors associated with the tech giants (Comm. Services, Consumer Disc., Information Technology) that strongly outperformed while the more cyclical segments, such as the small caps of the Russell 2000 and the Energy and Materials sectors, lagged behind.

FX & Commodities

- Oil prices rebounded during the fourth quarter, supported by an upward revision of growth expectations. Gold, meanwhile, ended the quarter virtually unchanged, but performed spectacularly over the year as a whole, with a gain of 27% which was in line with S&P 500 returns.

- With the resilience of the U.S. economy and the prospect of tariffs from the incoming Trump administration, the USD appreciated sharply against most currencies, notably against the Canadian Dollar (+8.6%).

Table 2 Market Total Returns

Asset Classes	Dec	Q4	2024
Cash (S&P Canada T-bill)	**0.3%**	**1.0%**	**4.9%**
Bonds (ICE BofA Canada Universe)	**-0.5%**	**-0.1%**	**4.1%**
Short Term	0.5%	0.6%	5.7%
Mid Term	0.0%	-0.4%	4.6%
Long Term	-2.2%	-0.8%	1.2%
Federal Government	-0.2%	-0.5%	3.4%
Corporate	0.0%	1.1%	7.1%
U.S. Treasuries (US$)	-1.7%	-3.3%	0.5%
U.S. Corporate (US$)	-1.8%	-2.8%	2.8%
U.S. High Yield (US$)	-0.4%	0.2%	8.2%
Canadian Equities (S&P/TSX)	**-3.3%**	**3.8%**	**21.7%**
Communication Services	-9.2%	-19.2%	-21.1%
Consumer Discretionary	-2.9%	0.8%	11.9%
Consumer Staples	-0.6%	3.6%	18.9%
Energy	-3.6%	6.6%	24.0%
Financials	-1.6%	6.6%	30.1%
Health Care	-4.3%	-3.7%	8.2%
Industrials	-3.7%	-0.4%	9.7%
Information Technology	-4.2%	22.2%	38.0%
Materials	-5.3%	-4.7%	21.4%
Real Estate	-6.1%	-10.5%	5.5%
Utilities	-3.2%	-1.5%	13.7%
S&P/TSX Small Caps	-3.3%	0.7%	18.8%
U.S. Equities (S&P 500 US$)	**-2.4%**	**2.4%**	**25.0%**
Communication Services	3.6%	8.9%	40.2%
Consumer Discretionary	2.4%	14.3%	30.1%
Consumer Staples	-5.0%	-3.3%	14.9%
Energy	-9.5%	-2.4%	5.7%
Financials	-5.4%	7.1%	30.6%
Health Care	-6.2%	-10.3%	2.6%
Industrials	-7.9%	-2.3%	17.5%
Information Technology	1.2%	4.8%	36.6%
Materials	-10.7%	-12.4%	0.0%
Real Estate	-8.6%	-7.9%	5.2%
Utilities	-7.9%	-5.5%	23.4%
Russell 2000 (US$)	-8.3%	0.3%	11.5%
World Equities (MSCI ACWI US$)	**-2.3%**	**-0.9%**	**18.0%**
MSCI EAFE (US$)	-2.3%	-8.1%	4.3%
MSCI Emerging Markets (US$)	-0.1%	-7.8%	8.1%
Commodities (GSCI US$)	**3.3%**	**3.8%**	**9.2%**
WTI Oil (US$/barrel)	6.1%	5.4%	0.8%
Gold (US$/oz)	-1.3%	-0.3%	27.1%
Copper (US$/tonne)	-2.7%	-10.7%	2.2%
Forex (US$ Index DXY)	**2.6%**	**7.6%**	**7.1%**
USD per EUR	-2.0%	-7.2%	-6.3%
CAD per USD	2.7%	6.3%	8.6%

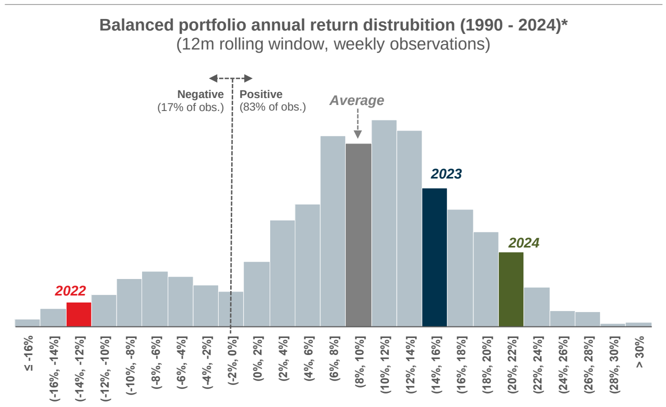
CIO Office (data via Refinitiv, as of 2024-12-31)

Optimism prevailed...

At the start of 2024, a climate of cautious optimism had settled over the markets. Indeed, while the previous year had just ended with a spectacular rebound, central banks were still faced with the daunting challenge of starting to lower interest rates. At that time, inflation was not yet back on target and several previously unmistakable recession indicators had already been triggered.

Ultimately, optimistic investors prevailed, with a balanced portfolio even exceeding the excellent performance of 2023 to deliver a second consecutive above-average year (**Chart 1**). This was largely due to spectacular equity returns, while bonds had a somewhat lacklustre year.

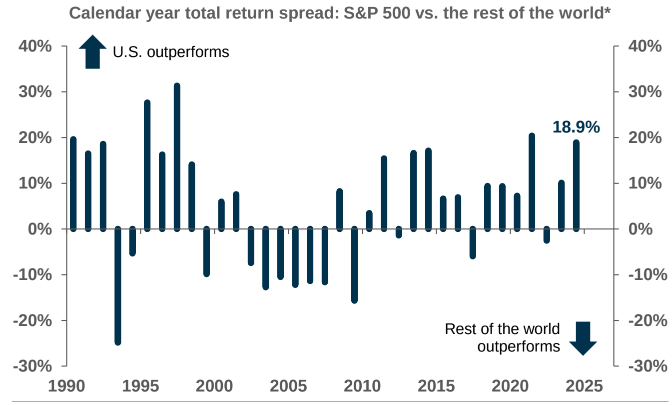
1 | A year well above average...



CIO Office (data via Refinitiv).

As in 2023, it was the U.S. stock market that topped the ranking, this time thanks to a performance gap of almost 20% vis-à-vis the rest of the world. Although U.S. equities were not as dominant in the early 2000s, they have outperformed in 12 of the last 15 years – quite a feat (**Chart 2**).

2 | ...with U.S. stocks outperforming



CIO Office (data via Refinitiv). *MSCI ACWI ex US

... faced with an ideal scenario in the U.S.

Fundamentally, the buoyant environment of 2024 is largely explained by the strength of the U.S. economy, which has continued to easily surpass the expectations of even the most optimistic forecasters. To put things in perspective, economists generally estimate potential growth[1] at around 2% in the USA; since Q3 2022, no less than nine out of 10 quarters have exceeded this threshold (**Chart 3**). A long way from recession!

3 | Growth exceeds expectations in the United States...

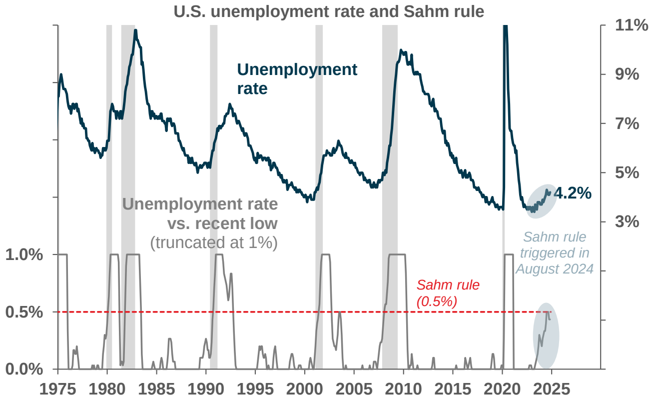
CIO Office (data via Refinitiv). *Q4 2024 is the latest estimate of the Atlanta Fed's GDPnow model.

However, this is not to say that the year went off without a hitch. Beyond the escalation of geopolitical tensions in the Middle East, a major source of concern arose during Summer when the rapid rise in the U.S. unemployment rate triggered the Sahm rule (**Chart 4**, next page), a recession indicator that had never been wrong before.

Fortunately, the unemployment rate stabilized over the following months, and the good news didn't stop there. After a short, more volatile period in the

[1] Estimate of real GDP growth in an economy that fully utilizes its resources in a sustainable manner.
For more details, see https://www.stlouisfed.org/open-vault/2021/august/understanding-potential-gdp-and-output-gap

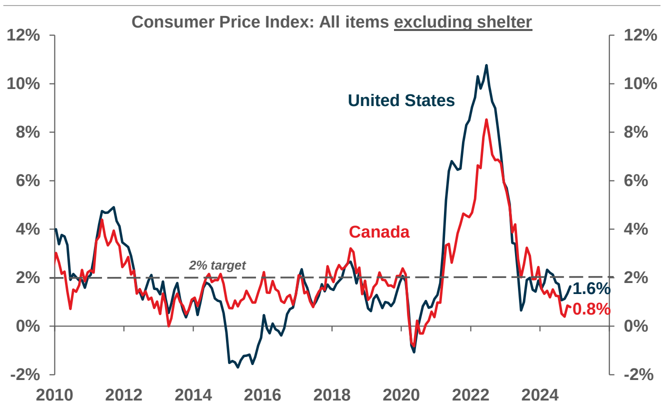
4 | ..but the labour market became more fragile...



CIO Office (data via Refinitiv).

Spring, inflation slowed sharply in North America. In fact, with the exception of housing costs, which remain problematic for reasons beyond the control of monetary policy, annual inflation even remained below the 2% target for much of the year in the United States, and over the entire period in Canada (**Chart 5**).

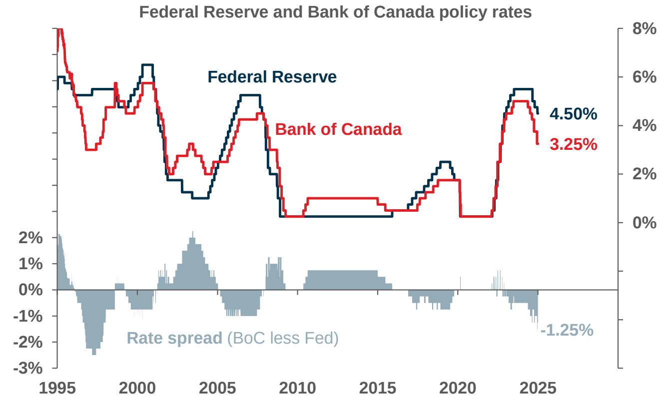
5 | ... and inflation continued to decelerate



CIO Office (data via Refinitiv).

In these circumstances, it was no surprise to see the Bank of Canada and the Federal Reserve begin a new cycle of rate cuts during the year. It's worth noting that, to date, rate cuts have been more significant on our side of the border, given the more pronounced weakness in the Canadian economy. To put things in perspective, the current spread between the two countries' policy rates (1.25% in favour of the U.S.) is the widest since 2004. However, we're still a long way from the 1997 record (2.50% in favour of the U.S., **Chart 6**).

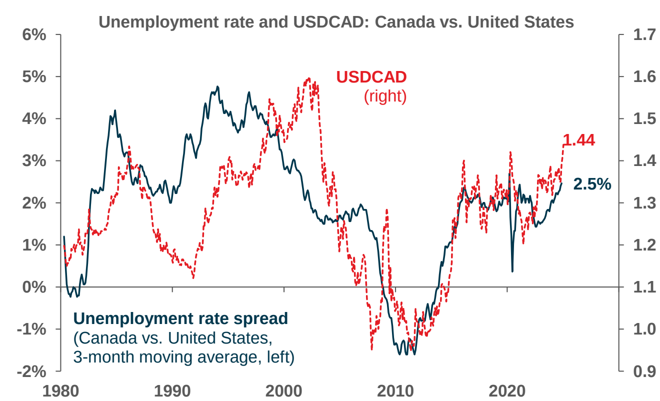
6 | Steeper rate cuts in Canada...



CIO Office (data via Refinitiv).

In any case, this divergence between our two countries – which can also be seen in the unemployment rate – weighed heavily on the Canadian currency in 2024, with the Loonie depreciating to one of its weakest levels since the early 2000s (**Chart 7**).

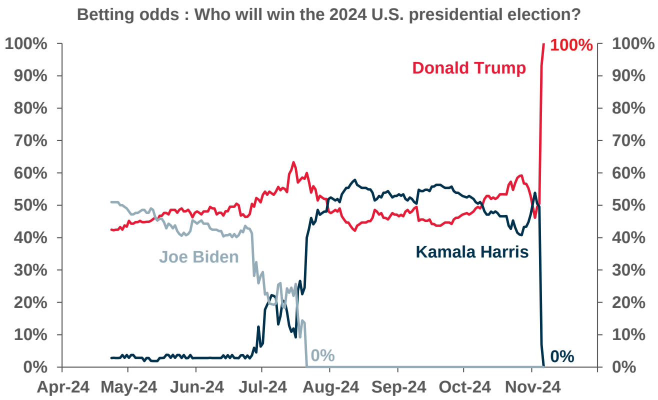
7 | ... in a difficult economic context for the Loonie



CIO Office (data via Refinitiv).

Lastly, a review of 2024 would not be complete without a look back at the race for the American presidency, which was full of twists and turns. A compromising performance for Joe Biden in the first televised debate, two assassination attempts against Donald Trump, the arrival of Vice-President Kamala Harris at the head of the Democratic ticket... Clearly, reality can be stranger than fiction. But in the end, although the probabilities surrounding the outcome of the November 5 election fluctuated widely throughout the year, it was the former Republican president and his "America First" policy that won handily (**Chart 8**).

8 | An election full of twists and turns

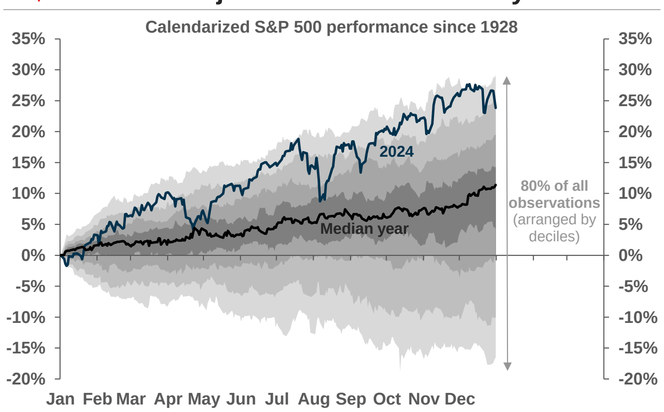


CIO Office (data via Predictit).

While the threat of tariffs on imports is causing its share of worries, for the time being, the political orientations of the next U.S. president, considered to be "pro-business," have been greeted with some enthusiasm in the United States. Their hope is that modest tariffs would, above all, make it possible to finance a cut in the corporate tax rate.

It was thus against an almost ideal backdrop of falling interest rates, receding inflation, and strong economic growth that the S&P 500 performed so well during the year, its trajectory approaching the top 10% of its best years in almost 100 (**Chart 9**).

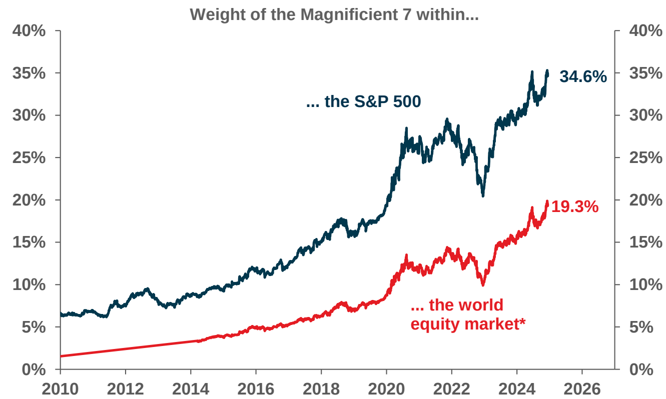
9 | The S&P 500 just had one of its best years...



CIO Office (data via Bloomberg).

Behind this performance lies a second consecutive exceptional year for the Magnificient Seven.[2] These seven U.S. technology giants now occupy a record weighting within the S&P 500 (35%) and also, by extension, within the global equity market (19%, **Chart 10**).

10 | ... supported by the growing weight of the *Mag 7*



CIO Office (data via Refinitiv). *S&P Global Broad Market Index (BMI)

Now, after two consecutive years in which the U.S. economy and U.S. equities have beaten the odds, will 2025 prove to be the "never-two-without-three" scenario? One thing is certain: while some economic signals look promising, expectations are high and the political fog is thick between Mar-a-Lago and Washington.

For more details, check out our 2025 outlook (available here for National Bank employees) and, until then, we wish you all a Happy New Year in 2025!

[2] Apple, Microsoft, Google, Amazon, Nvidia, Meta and Tesla.

Table 3 Global Asset Allocation - Model Portfolio Weights (in CAD)

	Benchmark		Model Portfolio				Comments
			Total		Asset Class		
	Total	Asset Class	Allocation	Active Weight	Allocation	Active Weight	
Asset Classes							
Cash	0%	-	0.0%	0.0%	-	-	While recession risks remain high over a one-year horizon, less restrictive financial conditions and low inflation could continue to support equity markets in the short term. Overall, this context argues for a balanced strategy across asset classes. Alternatives allow for better control of the total risk of the portfolio through their diversification effects.
Fixed Income	40%	-	38.0%	-2.0%	-	-	
Equities	60%	-	59.0%	-1.0%	-	-	
Alternatives	0%	-	3.0%	3.0%	-	-	
Fixed Income							
Government	29%	74%	28.3%	-1.1%	75%	0.9%	With central banks gradually moving towards a neutral policy stance, long-term yields should remain stable, while an economic slowdown would see them fall rapidly. This backdrop justifies a slightly longer duration as an insurance policy against a recession, with credit exposure close to the benchmark.
Investment Grade	11%	26%	9.7%	-0.9%	25%	-0.9%	
High Yield	0%	0%	0.0%	0.0%	0%	0.0%	
Duration	*7.3 yrs*	-	*8.3 yrs*	1.0 yrs	-	-	
Equities							
Canada	21%	35%	19.0%	-2.0%	32%	-2.8%	Macro conditions and momentum are undermining the outlook for EAFE and Canada compared to the US. In the US, the Equal Weight Index offers better upside potential should manufacturing recover, as does the value style in Canada. The strategy remains prudent, however, with a mix of stable-dividend, high-quality, and Japanese equities (in yen).
United States	21%	35%	24.0%	3.0%	41%	5.7%	
EAFE	12%	20%	10.0%	-2.0%	17%	-3.1%	
Emerging markets	6%	10%	6.0%	0.0%	10%	0.2%	
Alternatives							
Inflation Protection	0%	0%	0.0%	0.0%	0%	0.0%	A systematic quantitative strategy that takes advantage of market trends while aiming for maximum decorrelation with equities and tight control of volatility (NALT) plays an important role as a diversifier, while offering exposure to high risk-free rates.
Gold	0%	0%	0.0%	0.0%	0%	0.0%	
Non-Traditional FI	0%	0%	0.0%	0.0%	0%	0.0%	
Uncorrelated Strategies	0%	0%	3.0%	3.0%	100%	100.0%	
Foreign Exchange							
Canadian Dollar	61%	-	57.0%	-4.0%	-	-	The overall portfolio strategy involves an overweight in the US dollar and the yen. This positioning reflects the geographic allocation within equities, as well as a willingness to underweight the Canadian dollar against safe-haven currencies in an uncertain global economic context, and a more challenging one in Canada.
U.S. Dollar	21%	-	27.0%	6.0%	-	-	
Euro	5%	-	2.7%	-1.9%	-	-	
Japanese Yen	3%	-	4.8%	1.7%	-	-	
British Pound	2%	-	1.0%	-0.7%	-	-	
Others	9%	-	7.6%	-1.1%	-	-	

CIO Office. The fixed income benchmark is 100% FTSE Canada Universe. There are no alternative assets in the benchmark as their inclusion is conditional on improving the risk/return properties of traditional assets (60/40). The amplitude of the colour bars under the "Active Weight" columns are proportional to the maximum deviations of the portfolio (+/- 10% for stocks and bonds, +10% in cash, +20% in alternative assets).

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