Quarterly base-case scenario

CIO Office | Q4 2024

Landing underway

The third quarter brought good news for investors, with considerable gains in most asset classes, although equities were confronted with much higher volatility than in the first half of the year. In the face of this turbulence, several lagging market segments managed to make up ground, as was the case not only for Canadian equities, but also for bonds, which performed particularly well over the period.

A surprise increase in the US unemployment rate fuelled much of the volatility over the summer months. However, with inflation now largely under control, the Federal Reserve responded to the deteriorating labor market by surprising markets with a 50bps rate cut, formally marking the start of a new cycle of monetary easing. This decision follows in the footsteps of other central banks, notably the Bank of Canada, which has already cut rates three times in response to a more pronounced weakening of the job market and inflationary pressures on our side of the border.

At the margin, the balance of risks is now more positive than it was last quarter, so that our base case scenario now sees a recession being narrowly avoided. On the other hand, although relatively unlikely, a more optimistic scenario where economic growth remains above potential cannot be ruled out. However, recession risks remain significant, as weak activity in the construction and manufacturing sectors, combined with the potential for further increases in unemployment, could ultimately lead to a slowdown in consumer spending — the backbone of economic growth. Given this uncertainty, investors should brace for sustained equity volatility over the coming quarters as central banks seek to stabilize rates at neutral levels — or potentially lower if the economy falters. That said, the good news is that we can count on bonds to play their diversification role should the situation indeed deteriorate, now that inflation is no longer the problem it used to be.

Against this backdrop, a balanced approach between stocks and bonds within the tactical asset allocation remains justified, although a shift toward a more defensive or offensive stance may be considered depending on how economic conditions develop over the coming months. Geographically, our overweight position in U.S. equities remains unchanged, reflecting the resilience of the S&P 500 and the signals sent by our quantitative model.

	Q4 2024	Key elements and investment implicationss
Bull case	**Above-trend growth (10%)**	• The labour market is in equilibrium and inflation is stabilizing around the 2% target. • Central banks gradually lower their policy rates to neutral by the end of 2025. • Strong economic activity and rising productivity support corporate earnings growth. • Rate cuts and the artificial intelligence boom stimulate capital expenditures. **Economic implications:** Real GDP growth > 2%, stable unemployment rate. **Market implications:** ↑Equities ↕Bond yields ; Canada & EM > U.S. & EAFE
Base case	**Sub-trend growth (50%)**	• Unemployment rises only slightly and inflation stabilizes around the 2% target. • Central banks rapidly lower their benchmark rates to neutral by mid-2025. • Companies are reluctant to reduce their workforce, limiting the deterioration in the labour market. • Lower borrowing costs, a low saving rate and strong household balance sheets support consumption. **Economic implications:** Real GDP growth between 0-2%, slight increase in unemployment. **Market implications:** ↕Equities ↕Bond yields ; U.S. & EM> Canada & EAFE
Bear case	**Recession (40%)**	• Unemployment rises above expectations and inflation slows below target. • Central banks rapidly lower their benchmark rates into accommodative territory. • Households tighten their belts and increase savings, leading to a slowdown in consumer spending. • Overseas, growth is uneven; in China, a sustained recovery remains out of reach. **Economic implications:** Real GDP contraction, sustained increase in unemployment. **Market implications:** ↓Equities ↓Bond yields ; U.S. & EAFE > EM & Canada

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CIO Office
CIO-Office@nbc.ca

Martin Lefebvre
Chief Investment Officer
martin.lefebvre@bnc.ca

Louis Lajoie
Senior Director
Investment strategy
louis.lajoie@bnc.ca

Simon-Carl Dunberry
Senior Director
Portfolio strategy
simon-carl.dunberry@bnc.ca

Nicolas Charlton
Director
Quantitative strategy
nicolas.charlton@bnc.ca

Mikhael Deutsch-Heng
Director
Investment strategy
mikhael.deutschheng@bnc.ca

Zaid Shoufan
Associate
Portfolio strategy
zaid.shoufan@bnc.ca

Julien Gordon
Analyst
Quantitative strategy
julien.gordon@bnc.ca

General