

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 implications

| | | |
|-------------------------|--|---|
| <p>Bull case</p> | <p>Above-trend growth (10%)</p> | <ul style="list-style-type: none"> • 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. <p>Economic implications: Real GDP growth > 2%, stable unemployment rate. Market implications: ↑Equities ↓Bond yields ; Canada & EM > U.S. & EAFE</p> |
| <p>Base case</p> | <p>Sub-trend growth (50%)</p> | <ul style="list-style-type: none"> • 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. <p>Economic implications: Real GDP growth between 0-2%, slight increase in unemployment. Market implications: ↓Equities ↓Bond yields ; U.S. & EM > Canada & EAFE</p> |
| <p>Bear case</p> | <p>Recession (40%)</p> | <ul style="list-style-type: none"> • 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. <p>Economic implications: Real GDP contraction, sustained increase in unemployment. Market implications: ↓Equities ↓Bond yields ; U.S. & EAFE > EM & Canada</p> |

CIO Office. Last update: September 26, 2024 (updated quarterly). Probabilities are subjective and can change without notice.

CIO Office
CIO-Office@nbc.ca

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

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

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

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

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

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

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

General

The information and the data supplied in the present document, including those supplied by third parties, are considered accurate at the time of their printing and were obtained from sources which we considered reliable. We reserve the right to modify them without advance notice. This information and data are supplied as informative content only. No representation or guarantee, explicit or implicit, is made as for the exactness, the quality and the complete character of this information and these data. The opinions expressed are not to be construed as solicitation or offer to buy or sell shares mentioned herein and should not be considered as recommendations.

Views expressed regarding a particular company, security, industry, market sector, future events (such as market and economic conditions), company or security performance, upcoming product offerings or other projections are the views of only the CIO Office, as of the time expressed and do not necessarily represent the views of National Bank of Canada and its subsidiaries (the "Bank"). Any such views are subject to change at any time based upon markets and other conditions, which could cause actual results to differ materially from what the CIO Office presently anticipate(s) or project(s). The Bank disclaims any responsibility to update such views. These views are not a recommendation to buy or sell and may not be relied on as investment advice.

These index providers may be included in this document: BofA, Merrill Lynch, Standard & Poor's, FTSE, Nasdaq, Russel and MSCI. These companies are licensing their indices "as is," make no warranties regarding same, do not guarantee the suitability, quality, accuracy, timeliness and/or completeness of their indices or any data included in, related to or derived therefrom, assume no liability in connection with their use and do not sponsor, endorse or recommend National Bank of Canada and its wholly owned subsidiaries any of their products and services. The above index providers do not guarantee the accuracy of any index or blended benchmark model created by National Investment Bank using any of these indices. No responsibility or liability shall attach to any member of the Index Providers or their respective directors, officers, employees, partners or licensors for any errors or losses arising from the use of this publication or any information or data contained herein. In no event shall the above Index Providers be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, legal or other expenses, or losses (including, without limitation, lost revenues or profits and opportunity costs) arising out of or in connection with the use of the content, even if advised of the possibility of such damages.

The FTSE/TMX indices are trademarks of the LSE Group. S&P Indices are trademarks of S&P Dow Jones Indices LLC, a division of S&P Global. MSCI indices are trademarks of MSCI Inc. BofA indices are trademarks of Merrill Lynch, Pierce Fenner & Smith incorporated ("BofAML"). Nasdaq index is a trademark of Nasdaq Inc. Russell 2000 ® is a trademark of the Frank Russell Company.

© 2024 National Bank Investments Inc. All rights reserved. Any reproduction, in whole or in part, is strictly prohibited without the prior written consent of National Bank Investments Inc.

© NATIONAL BANK INVESTMENTS is a registered trademark of National Bank of Canada, used under licence by National Bank Investments Inc. National Bank Investments is a signatory of the United Nations-supported Principles for Responsible Investment, a member of Canada's Responsible Investment Association, and a founding participant in the Climate Engagement Canada initiative.