TD Wealth

At the quarter mile

The Year Ahead: 2025

Market Insights | December 2024

At the quarter mile.

I confess that my knowledge of horseracing is minimal. Sure, I spent a fair amount of time at the Hastings Racecourse in Vancouver as a boy, but most of that time was spent wishing I was at Playland. Conversely, my dad spent most of his time, with his issue of the *Racing Post* in hand, content that he wasn't. In those days, in the power struggle between parent and child, the former won. (Talk about speed of change.)

When we were brainstorming a title for this report, we realized, "Wait a minute, we're almost a quarter of the way through the 21st century!" This quickly led to the concept of the quarter-horse — the fastest breed over the quarter-mile. This seemed like a great analogy, given that this might have been the fastest start to a century ever. I know I'm opening myself up to charges of recency bias, but I'm certain that if one were to use technological advancement as the measure, no era has moved at this rate.

Consider this. If we were to use Moore's Law, which posits a stable rate of growth for the number of transistors on an integrated circuit, we would say that computer technology is doubling around every two years. Now Nvidia's CEO, Jensen Huang, has been talking about "Hyper-Moore's Law," where beyond the doubling of the transistor unit count every two years, we can now double or triple each transistor's impact on computer performance annually. It's the difference between arithmetic growth in the 20th century and exponential growth in the 21st.

I doubt any of us can comprehend where we are headed, but I do know that we are going to get there fast. For my own preparation, I've revisited Stanley Kubrick's *2001: A Space Odyssey*, treating it as a documentary, and Ian McEwan's *Machines Like Me* as a work of non-fiction. So, to help make the incomprehensible comprehensible, let us break down our journey to bite-sized pieces and consider where we are headed in the year ahead, 0.01 miles at a time — or for the AI geeks out there, one "FLOP" at a time.

Be well,

Brad Simpson

Chief Wealth Strategist, TD Wealth

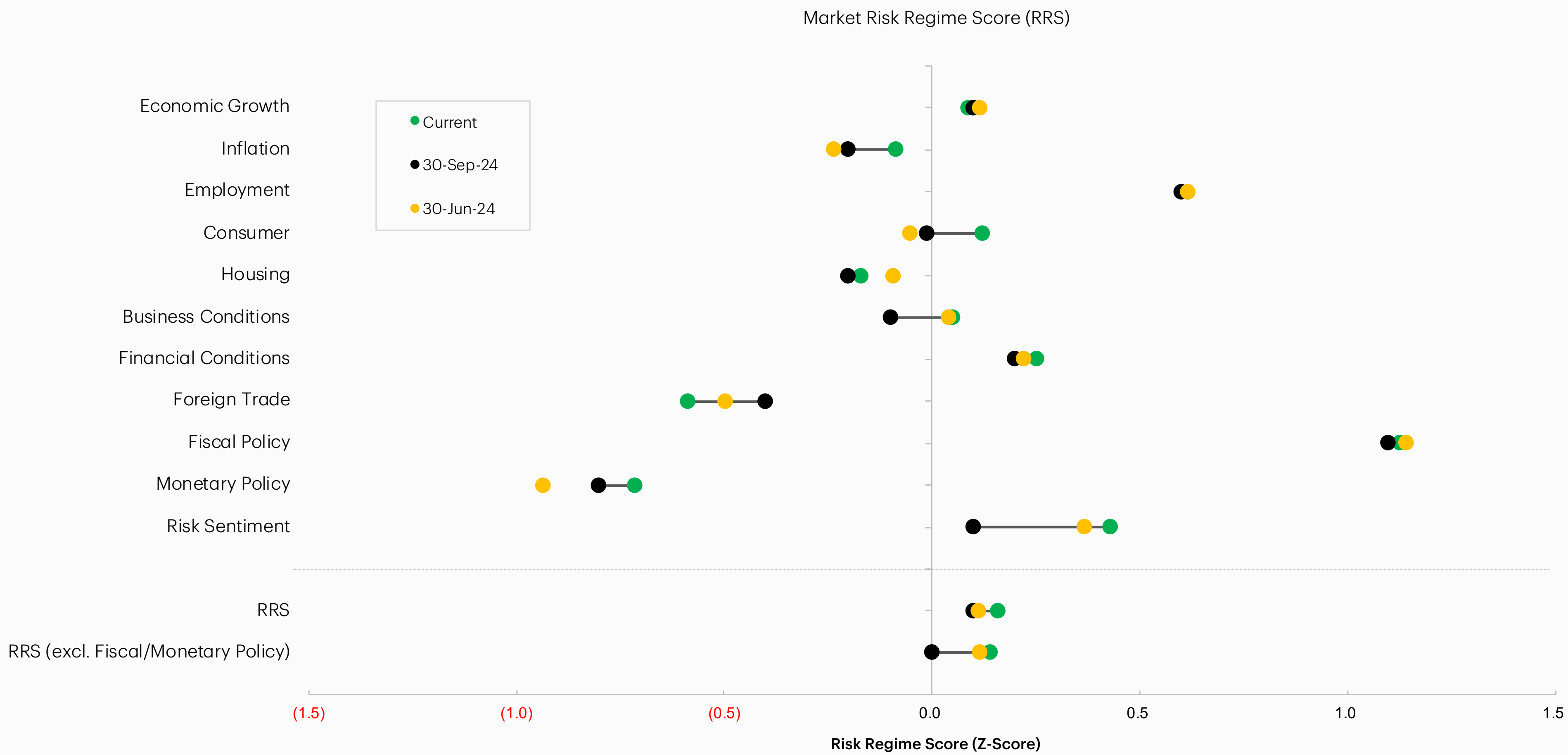
In this issue

Where we were

This past year has been quite interesting, and much better than investors had expected entering 2024. At this time last year, we were still adjusting to a major shift in expectations. Recall that investors had been anticipating an economic slowdown and a major rate-cutting cycle as early as 2023, but as U.S. economic data continued to surprise to the upside, forecasters began pushing those expectations into the future. By late 2023, however, it was becoming quite clear that the U.S. economy — and particularly the U.S. consumer — was much more resilient than many had expected. Corporate earnings were stronger than expected, and the Fed managed to hold off on its first rate cut until September 2024.

Figure 1: Then and Now

U.S. Macro Indicators



Note: scores represent number of standard deviations away from long-term average

Source: Macrobond, Wealth Investment Office as of December 10, 2024

There have been a few soft spots here and there. In August, the U.S. Bureau of Labour Statistics released its largest downward revision in the previous year's job numbers since 2009, with job gains down about 30% from reported figures. However, weak data this year has usually been quickly followed by better-than-expected economic data elsewhere.

Positive developments in artificial intelligence continue to drive equity markets, and the geopolitical risk premium continues to decline amid the stalemate in the Russia-Ukraine war and limited global impact from the war in Middle East. Ultimately, the U.S. economy remains the strongest among its peers, and against this backdrop, the U.S. stock market continued to roar. The S&P 500 has delivered an astonishing year-to-date return of 27% (as of December 13), following a 22% return in 2023. Returns for fixed income also turned positive as global central banks started to ease monetary policy.

Meanwhile, here in Canada, the story has not been as robust. It's still been a reasonably solid year, as aggressive rate-cutting by the Bank of Canada has had the intended impact of mitigating risks to the economy. In Europe, with inflation falling below target, equity markets and the beaten-down currency have gotten a lift recently, even as the ECB cuts rates to keep the economy afloat. Japanese markets proved highly volatile in 2024, with a historic move away from dovishness sending shockwaves around the world (including a 12.4% drop in the Nikkei 225 on August 5, its steepest in 37 years). And finally, emerging markets are just now starting to turn the corner, as China gets serious about stimulus, with a possible devaluation of the yuan in the cards.

Going into the new year, the markets are overjoyed with the incoming U.S. administration, and promised tax cuts and deregulation. This has led to a rise in the "animal spirits" that drive market bulls from time to time. Stocks, especially cyclical sectors, have rallied following the election date. Still, it's important to keep an open mind. At the end of the day, uncertainty is the only certainty.

Few analysts, for instance, expected at the start of the year that the Fed would start its policy-easing cycle with a 50-bp rate cut. Neither did they expect the fiscal and political situation in France to deteriorate, with government bonds now yielding higher than their Spanish and Portuguese counterparts (once among the "PIGS" cohort of fiscal delinquents). Nor did analysts predict that gold would reach all-time-high on the backdrop of stronger dollar and higher yields.

The point is, sentiment is currently euphoric, with markets anticipating an AI- and Trump-driven economic boom — so some hangover may be in the making. Risk management should be top-of-mind, and investors should aim to limit the cost of being wrong as we enter the new year.

Some of the trends we highlighted in January stayed in place throughout the year, while others were overtaken by events we had not, or could not, have anticipated. Herewith, a breakdown:

What we got right

Defence spending to rise amid heightened tensions.

This is one we wish we had gotten wrong. The Middle East conflagration that began on October 7, 2023, spread quickly to the neighbouring region this year. In Ukraine, meanwhile, both sides have escalated their tactics, with Ukrainian assaults on Russian territory, and heavier armament used against Ukraine. In the four years since Russia attacked, global military spending has risen 14.9% and that trend continued in 2024, with all global military powers spending more on defence.

Development of AI to power ahead, despite any slowdown.

We predicted that the tech boom would have long, long legs, and we were right. Nvidia, the top AI chip manufacturer (and poster child for the burgeoning industry), has seen its stock rise 169% year-to-date, with revenues in Q3 up 94%. That may seem surprising, given the relatively little revenue generated by AI products so far. Important to note, however, that many of the tech mega-caps have gone all-in on AI. These gigantic corporations have almost no debt and are flush with cash, with downstream hardware and cloud-services outfits the beneficiaries.

Reaching inflation will be a hard slog.

In 2023, inflation fell faster than expected in the U.S., mainly due to base effects related to the steep price increases seen during the pandemic. But we figured that the easy gains were behind us, and indeed they are. After falling to a low of 2.4% in September, U.S. CPI inflation has actually started to tick upwards again. As of November, inflation stood at 2.7%. What's more, reaching the 2% target will be even harder now that Donald Trump has won the presidency. His main policy agenda — tariffs and deportations — are widely perceived to be inflationary.

What we got wrong

Commodities to outperform.

We may have been early in this prediction. The mining and oil industries had seen over a decade of underinvestment and supplies were getting tight, even as geopolitical risk was ramping up. The flaw in our logic was China and its economic downturn, which has dragged on for much longer than expected and therefore dampened global demand for materials and energy. The Bloomberg Commodities Index YTD has returned -1.4%, compared to 27% for the S&P 500 and 2.1% for the Bloomberg Aggregate Bond Index.

China to recover from its economic woes.

Last year, we thought that policymakers in China were on the cusp of stimulating the economy and thus boosting consumer demand. Alas, it took the election of Donald Trump and his tariff-heavy agenda to focus the minds of policymakers at the People's Bank of China. While previous attempts to stimulate the economy were timid and uninspiring, Beijing is now considering a wholesale devaluation of the yuan to protect its weak economy from an inevitable tariff war.

Equity volatility likely to rise.

Early in 2023, we felt as though the Fed's unprecedented spate of rate hikes would weaken earnings growth, even as tech mania was driving stock prices up — this, along with rising geopolitical risk, seemed to signal a perfect storm for equity volatility. But we underestimated the resilience of the U.S. consumer. Americans, many of whom locked in their mortgages at ultra-low rates, have kept on spending despite monetary tightening. Nor have they been fazed by the wars. As a result, the CBOE Volatility Index actually fell from an average of 16.8 in 2023 to 15.5 so far in 2024.

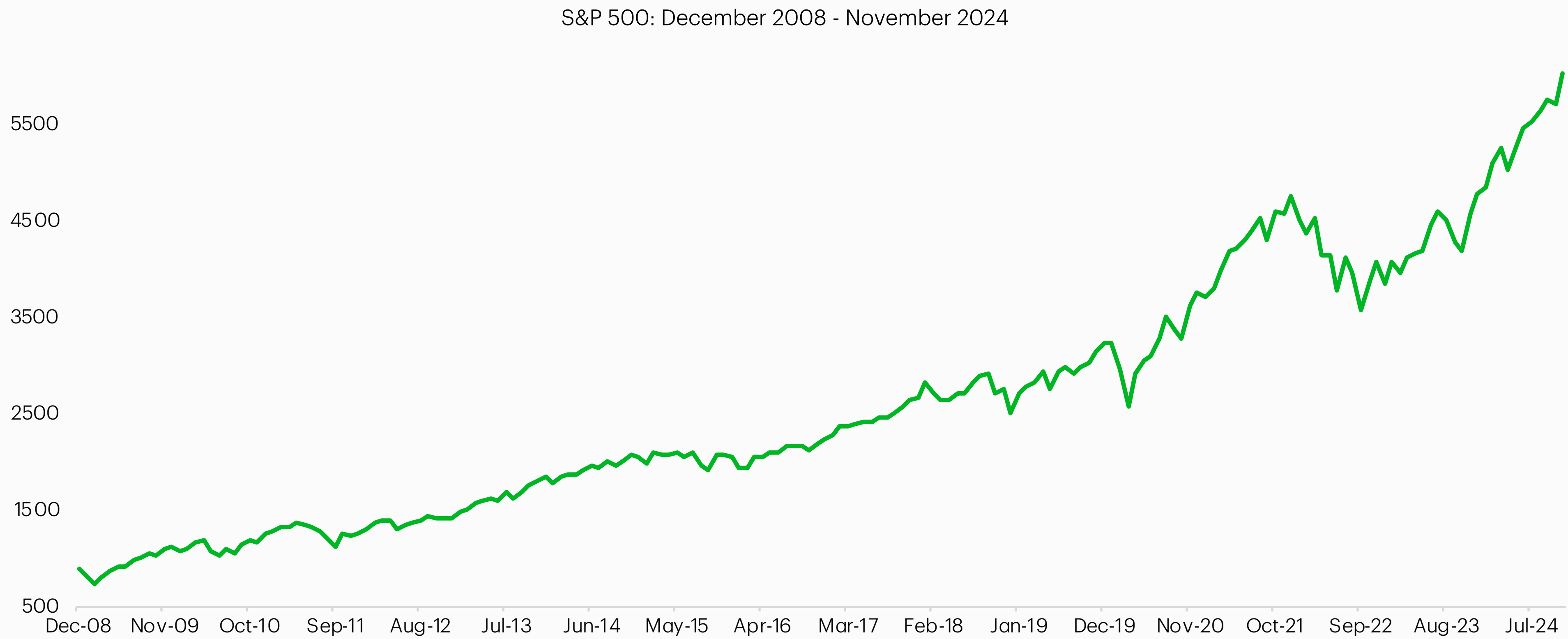
Where we’re headed

This is where we get down to the nitty gritty — those crystal ball prognostications that capture the attention of so many investors. Truth be told, we're always reluctant about publishing these sorts of forward-looking documents because we don't want to suggest we have enough conviction to heavily allocate towards any of these themes. We just can't stress it enough: take forecasts with a grain of salt, and if you're going to trade tactically, do it on the margins.

Having said that, there's one prediction that we won't have to go too far out on a limb for. *Drum roll, please.* ... **It is extremely likely that there will be a market correction in 2025.**

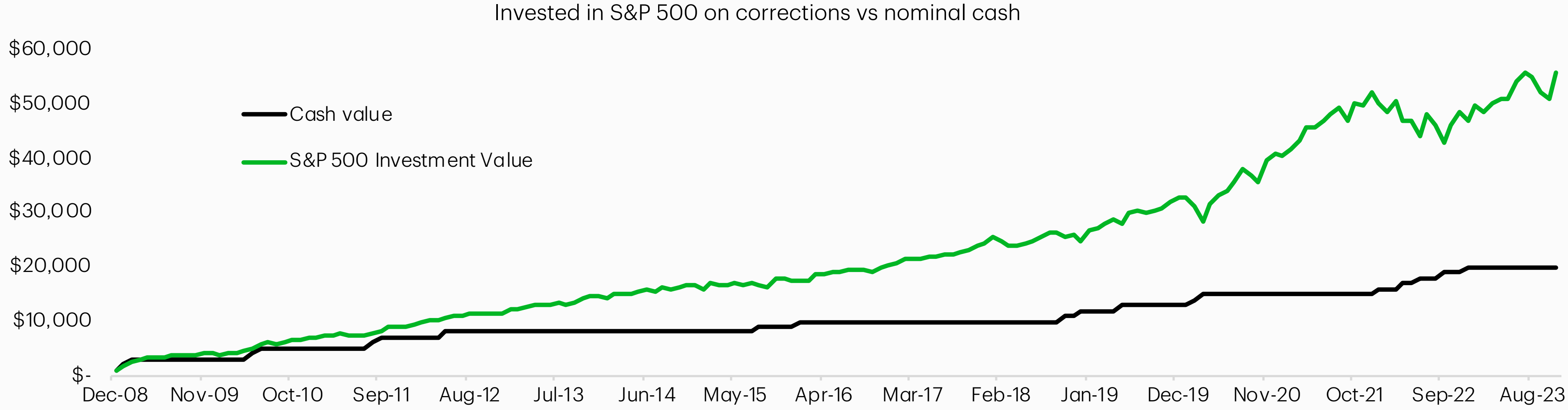
How can we be so sure? Because bull-market corrections are a normal phenomenon in markets that have become fundamentally and technically overbought. During the 16-year secular equity bull market, starting from the bottom of the bear market in March 2009, the S&P 500 has had nine meaningful drawdowns (or "corrections to trend") in excess of 10%, including a few over 20% (signalling a bear market). The biggest, of course, was the drawdown of more than 35% in 2020 (Figure 2).

Figure 2: S&P 500 Secular bull market through nine corrections



Source: FactSet and Wealth Investment Office as of December 6, 2024

Figure 3: Investing $1,000 every time the market corrects 5% at month-end from 12-month high



Source: FactSet and Wealth Investment Office as of December 6, 2024

These sometime violent pullbacks in market price are the reason the term "wall of worry" exists. Bullish stock-price trends can often go further than fundamentals can support in the immediate term; valuations continue to climb despite all the good reasons they shouldn't. Stocks can then become fundamentally expensive (i.e., when multiples approach historic highs), while the price chart may become technically overbought (i.e., when indicators suggest price behaviour itself may also be above-trend). When the market experiences these conditions, we tend to get a stock-market correction. Not a crash, not a bear market necessarily — a correction to trend, fundamentally and technically.

"Correction" itself implies something good has occurred (the correct answer, correcting a problem, etc.), but stock-market corrections, like the one from the highs of July 2024 to the lows of August 2024 — reflecting a drawdown of around 10% for the S&P 500 — certainly did not feel like something good. Nevertheless, these events allow investors who have less conviction in the bull-market cycle to exit by selling to investors who have more conviction in the market cycle and see the lower prices as a buying opportunity.

As we write this (December 2024), the S&P 500 is up over 6,000. At this level, the market is currently fundamentally expensive, at around 22x forward earnings, and technically overbought. That means there is likely to be a correction before too long — and highly likely before the close of 2025.

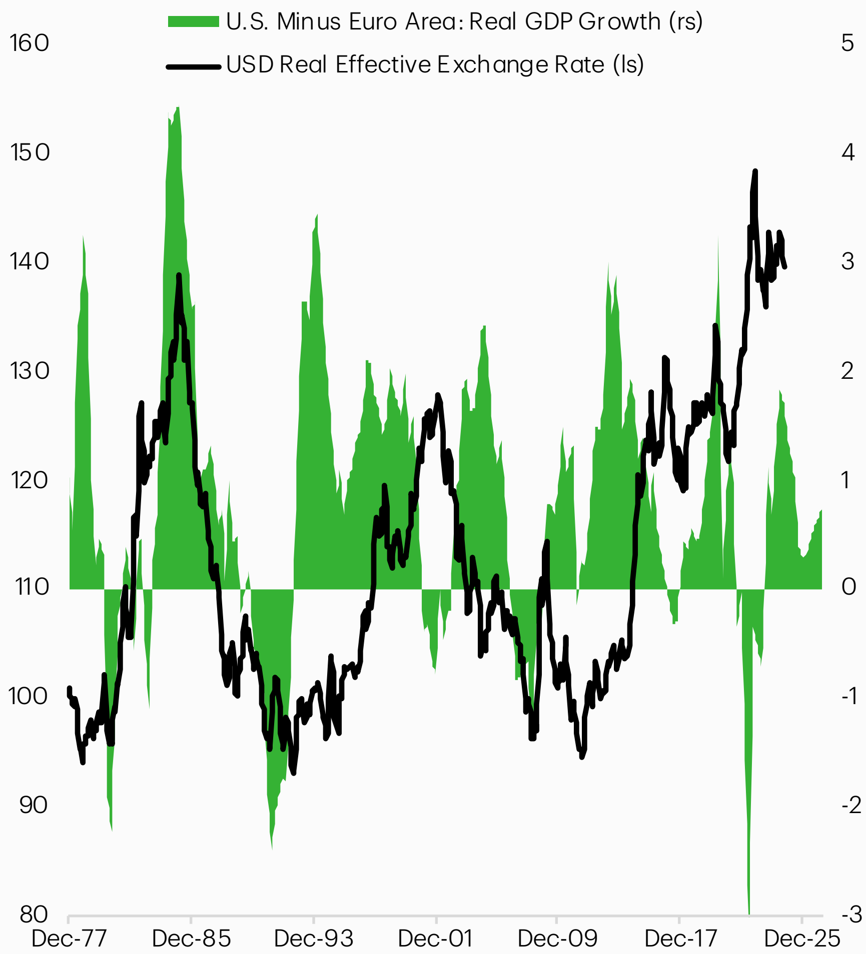
As we have seen time and again during this secular bull market, it's very difficult to know when exactly this will occur. When it does, however, we must continue to follow the best investing approach — by staying patient with current positions and buying into the correction (Figure 3).

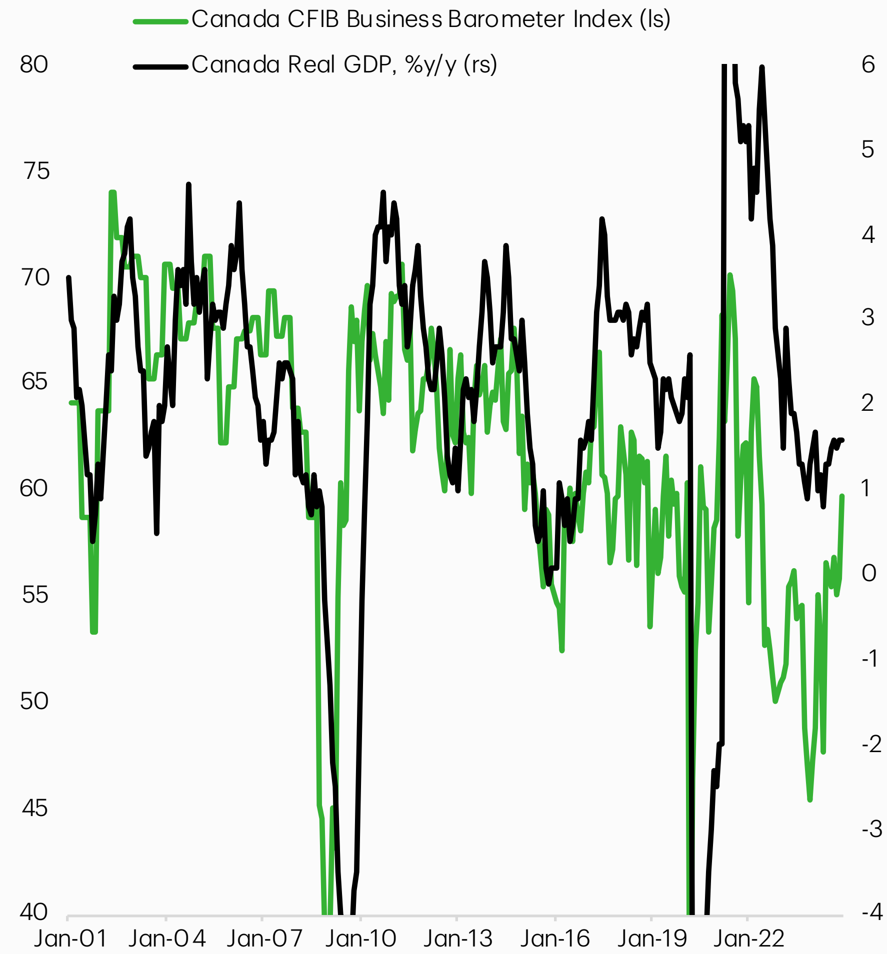
What we should not do is try to time the markets by holding a considerable amount of cash in anticipation of a crash. While we know that there will be corrections within bull markets, and that expensive equities will experience a pullback, waiting for that before investing is often a money-losing strategy. Remember, corrections tend to be relatively short-lived, and when they do happen, it's hard to ignore the many reasons that prices may continue to fall. As such, you likely miss the opportunity and would have been better off staying invested through the period.

Now, on to more uncertain predictions.

Theme 1: American Exceptionalism – The U.S. economy will continue to outperform peers.

Large contributions from domestic demand, including consumer spending, makes the U.S. economy less sensitive to what's happening globally, which can't be said for many European and Asian economies. Furthermore, the current geopolitical backdrop — elevated trade uncertainty, stagnating globalization, increasingly protectionist policies — have all made the U.S. a haven for capital. In this environment, expect the greenback to stay bid despite its overbought and expensive valuation. Meanwhile, the Canadian economic outlook will remain somewhat hinged to what's happening south of the border, and to oil prices.

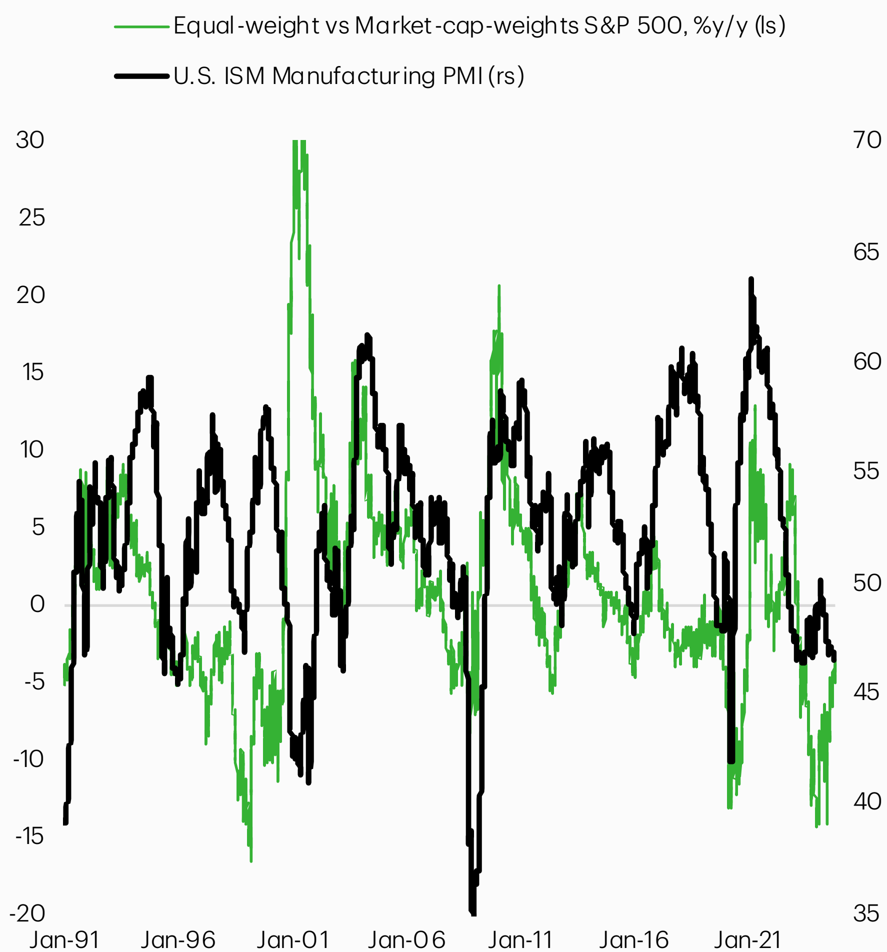


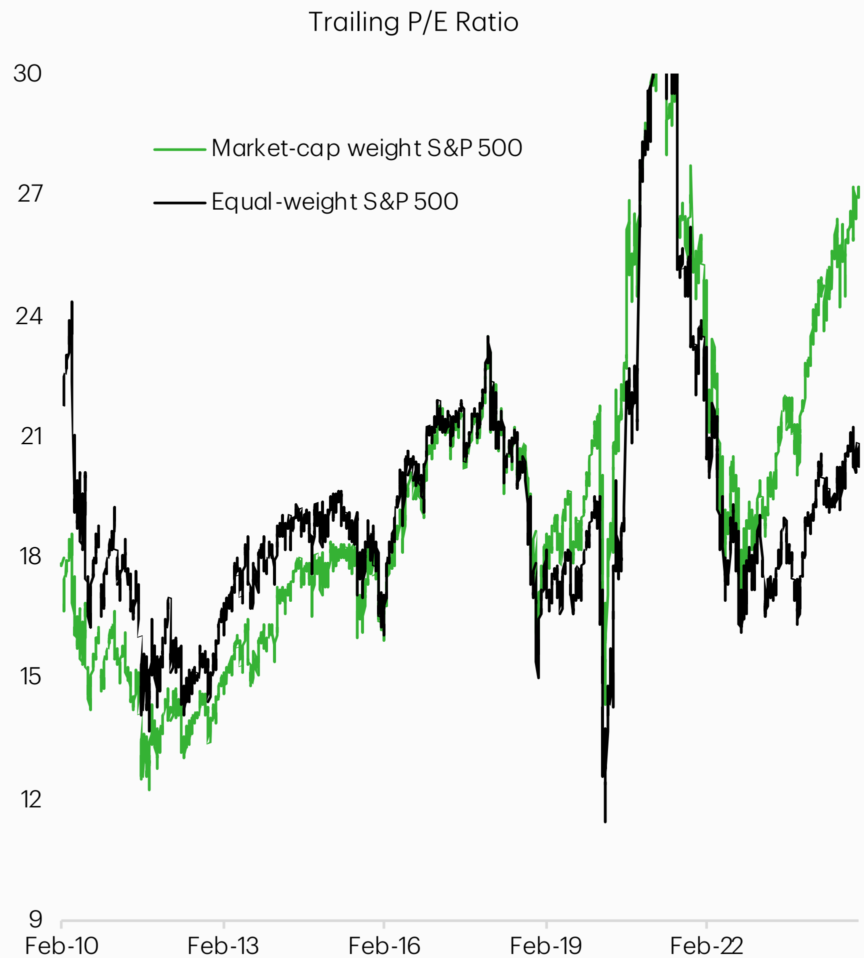


Source: Macrobond and Wealth Investment Office as of November 30, 2024

Theme 1: American Exceptionalism – U.S. equities will outperform, particularly small- to mid-caps.

An acceleration in the U.S. business cycle historically bodes well for companies in the small- and mid-cap tier. As manufacturing PMIs improve, the equal-weighted S&P 500 index tends to outperform its market-cap-weighted counterpart. In addition, mega-cap earnings growth is trending lower and converging with the rest of the index, while valuations for the equal-weighted U.S. stock index is much more attractive currently. The outlook for earnings growth in the U.S. is attractive.

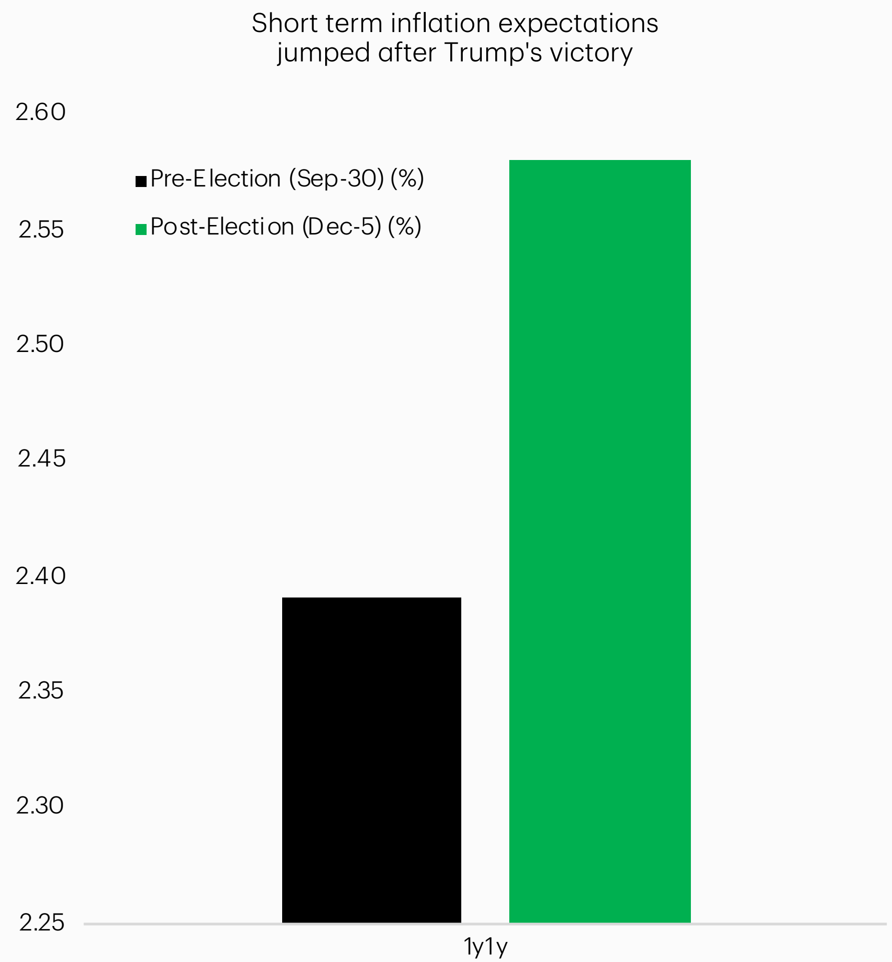


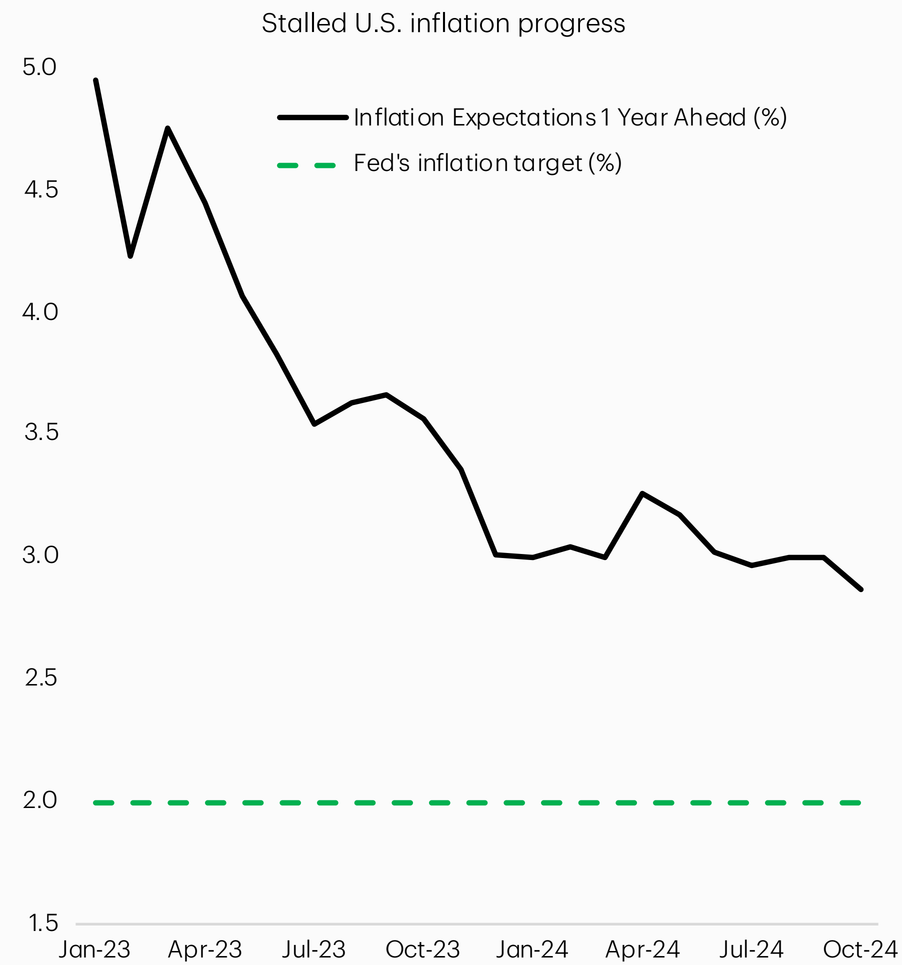


Source: Macrobond, FactSet and Wealth Investment Office as of November 30, 2024

Theme 1: American Exceptionalism – But U.S. inflationary pressures to resurface.

It's still uncertain how much of Trump's fiscal agenda will be implemented, but the Committee for a Responsible Federal Budget (CRFB) estimates that Trump's plans could add $7.7 trillion to the national debt over the next decade, potentially resulting in a debt-to-GDP ratio of 143% by 2035. While markets have already been pricing in an increase in inflation beyond 2025, we believe short-term inflation expectations are likely to remain elevated. If incoming data surprises to the upside, the market pressure to find answers from the Fed is likely to increase.

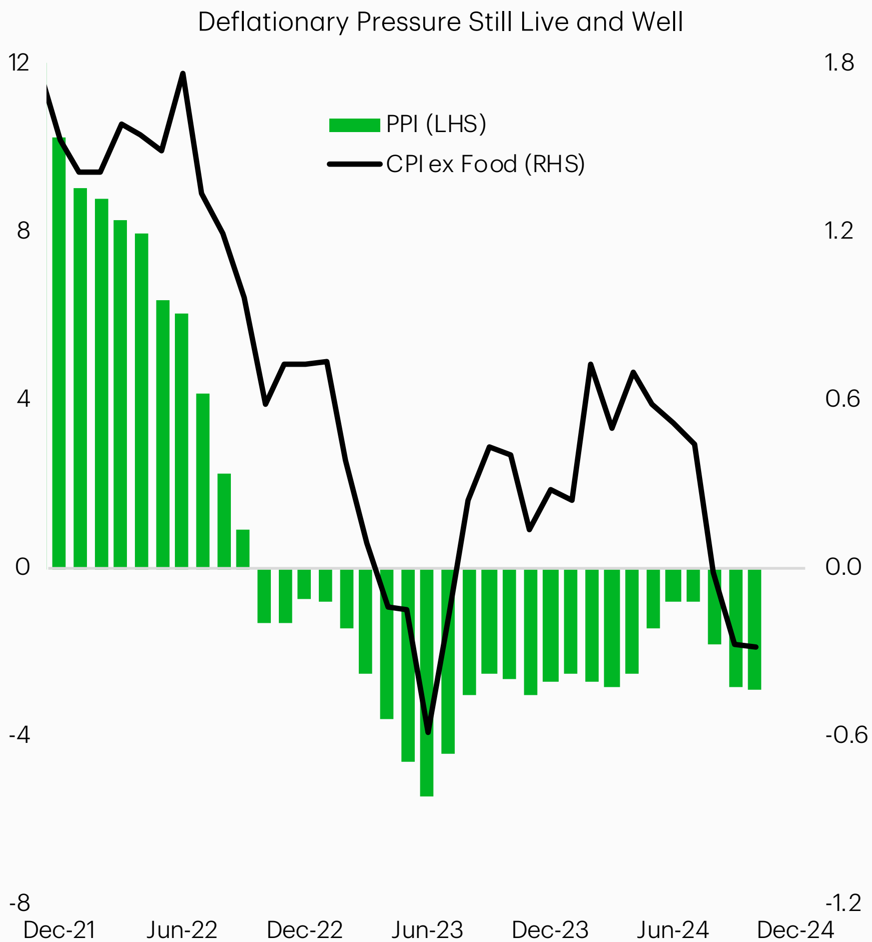


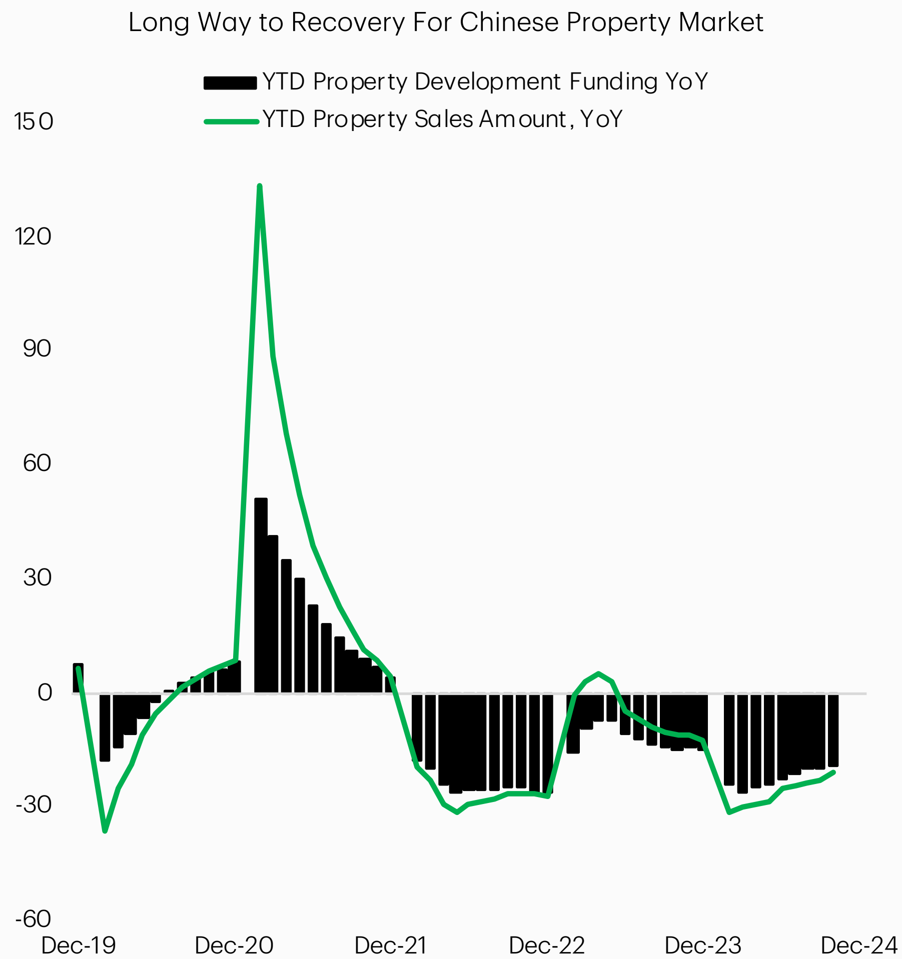


1y1y US forward inflation swap
1y1y : The 1-year inflation market expects one year from now
Source: Macrobond and Wealth Investment Office as of December 9, 2024

Theme 2: Middle Kingdom Malaise – Chinese stimulus will be hard to come by.

Chronic deflation in China is the result of weak consumer confidence. Investors have seen the value of their properties — which make up about a quarter of Chinese investment wealth — fall by nearly 10% since 2021, and there's little belief that policymakers will pivot to focus on the economy in any full-throated manner. That has led consumers to pinch their yuans. Looking at the indicators, we're still skeptical that Beijing is ready to do what's necessary to support economic growth and equity markets. A looming trade war with the U.S. may force a devaluation of the currency, but we should not expect a total about-face; China's government has in the past proven reluctant to support any speculation in the markets.



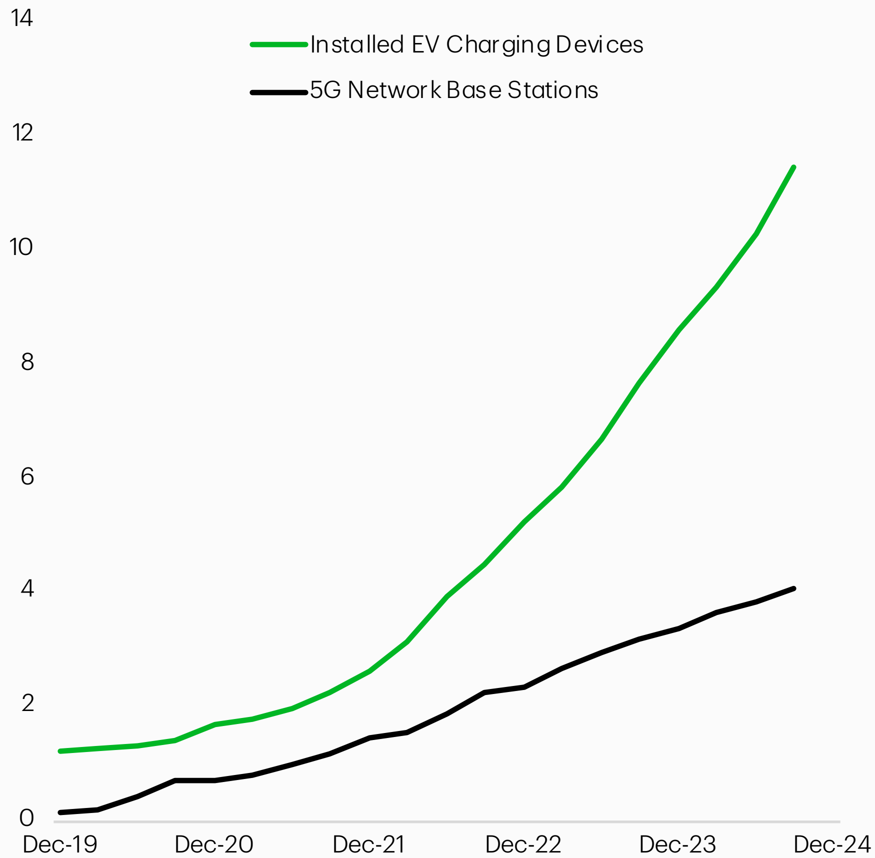


Source: Macrobond and Wealth Investment Office, as of December 4, 2024

Theme 2: Middle Kingdom Malaise – But there may still be opportunities in Chinese tech.

While broad equity markets in China may continue to struggle under inadequate stimulus, things are clearly moving in some key areas of technology. In the accompanying graphs, we show the staggering growth of EV infrastructure and 5G networks. Among the top 20 venture-capital funds today, the largest pools of risk capital to push these innovations forward are government-backed investment funds in China. The implications are obvious. The Chinese government is determined to upgrade its tech sector, and thus there are growth opportunities in China. The incoming U.S. administration has seemingly forged an alliance with tech and industrial elites, but it remains to be seen whether it can challenge China's growing capabilities in this area.

5G Network Growth 3.5x vs EV Charging Growth 5.1x



Source: Macrobond and Wealth Investment Office as of December 4, 2024

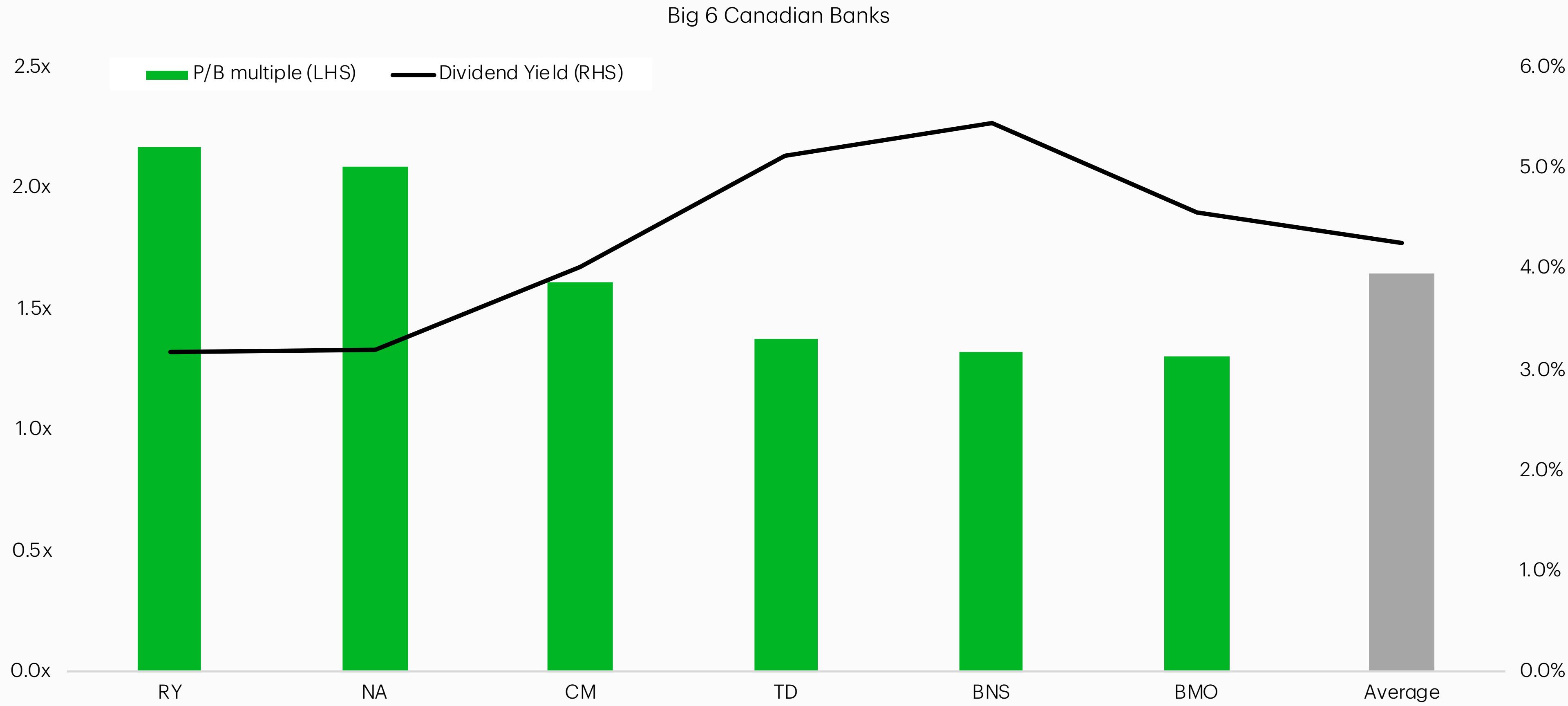
20 Largest Venture Capital Funds Today

Launch Year	Geographical Focus			Total
	China	North America	U.S.	
2015	13,319	-	-	13,319
2016	12,395	-	-	12,395
2017	13,918	-	-	13,918
2018	7,423	3,750	-	11,173
2019	-	-	-	-
2020	-	3,750	-	3,750
2021	4,295	19,255	15,000	38,550
2022	-	7,850	4,500	12,350
2023	29,460	4,600	-	34,060
2024	-	-	8,000	8,000
Total	**80,810**	**39,205**	**27,500**	**147,515**

Source: Preqin and Wealth Investment Office as of December 2024

Theme 3: Great White North – Oil producers and banks will reallocate capital to shareholders.

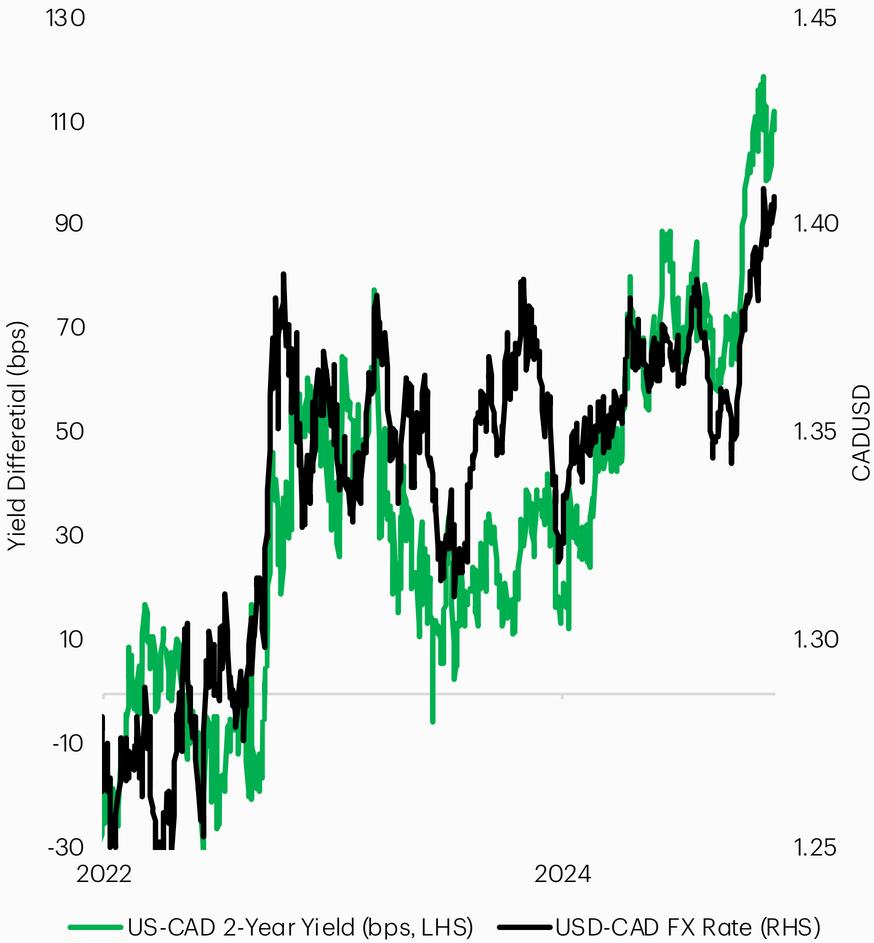
While the U.S. equity market has long been the home of cyclical growth, the Canadian equity market has become one of value and income. Canadian bank stocks have been perennial providers of growing dividends for Canadian investors, with the Big Six currently averaging a 4.3% yield. With the Bank of Canada having embarked on a rate-cutting cycle, forward bank earnings and dividends should be supported by improving credit conditions and stable net interest margins over time. Energy companies have also entered an era as dividend growth stocks. In the shadow of "energy transition," the sector has shifted from a focus on reinvestment to share buybacks and dividends. Most large-cap Canadian energy producers are generating double-digit free cash flow yields — even with WTI crude prices in the high US$60s — that management teams have pledged to give back to shareholders.

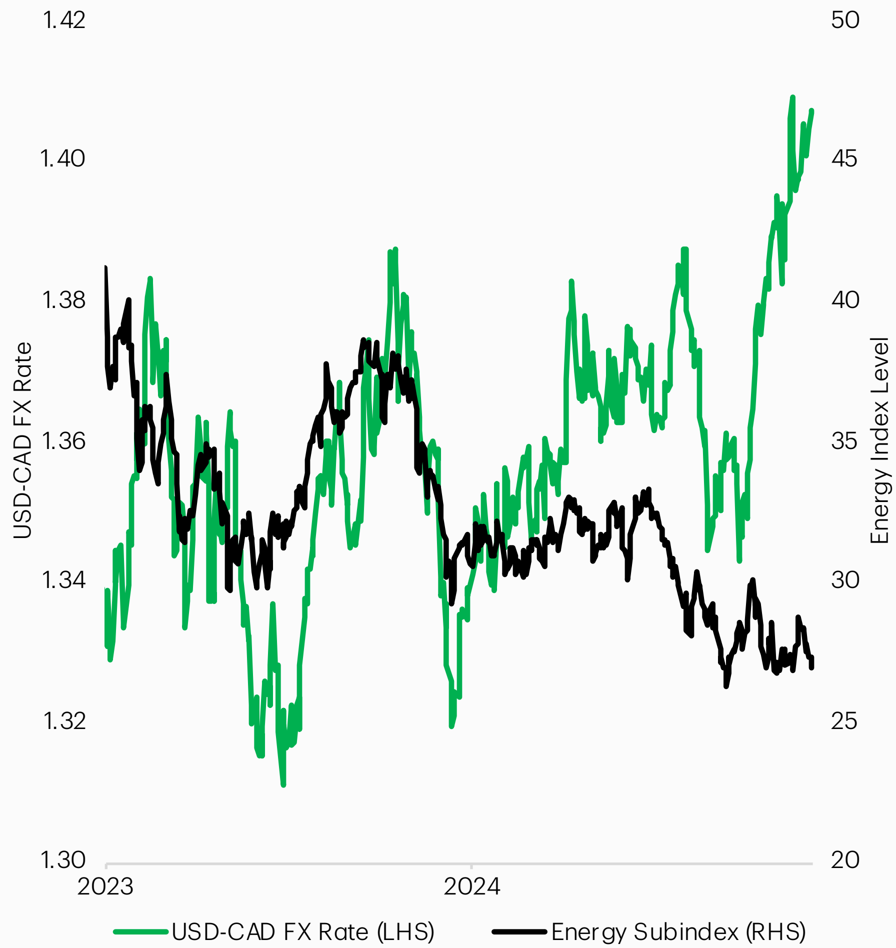


Source: FactSet and Wealth Investment Office as of December 9, 2024

Theme 3: Great White North – The loonie will remain grounded.

There are a few reasons for our negative outlook on the Canadian dollar. For one thing, the differential between the respective Canadian and U.S. policy rates is at an all-time high. While the Bank of Canada is trying to rescue its weak economy with rapid rate cuts, the Fed may be looking to tap the brakes in order to counter inflationary fiscal policy. On the trade front, meanwhile, investors will be bracing for changes to the USMCA trade agreement, which has a 2026 "sunset clause." Under a tough-on-trade White House, any modifications will most likely skew negatively for the CAD. Finally, while commodities are expected to perform well, the loonie's correlation with oil and metal prices has weakened this year and might stay that way in 2025.

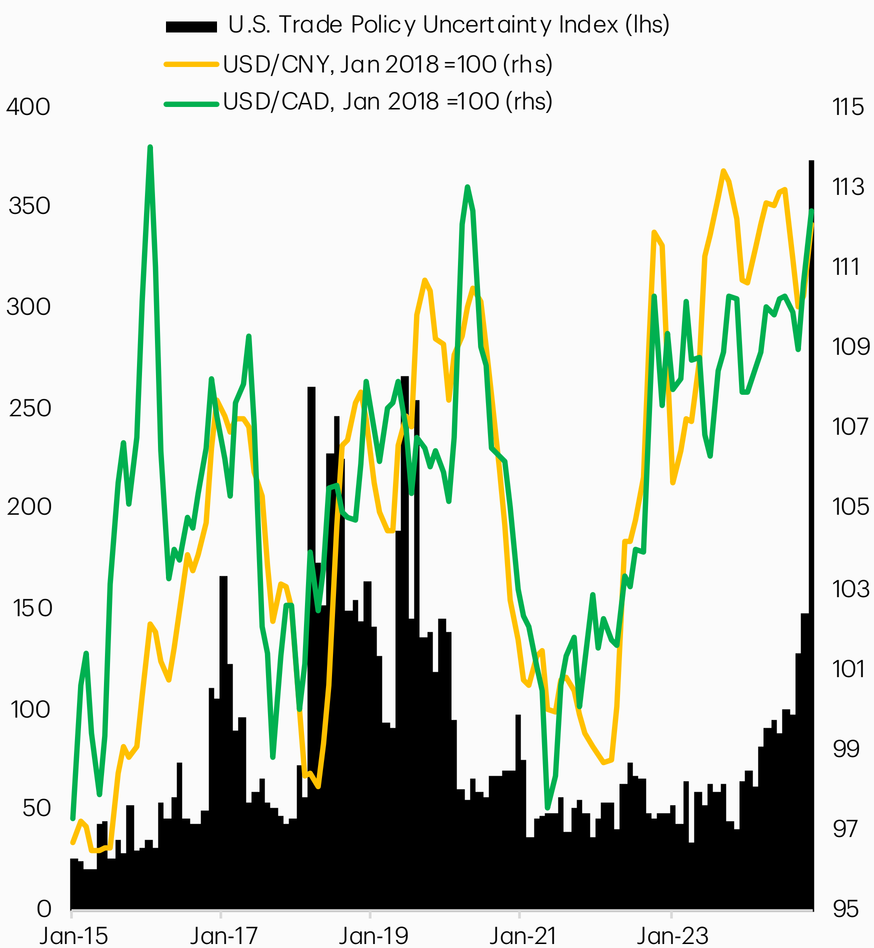


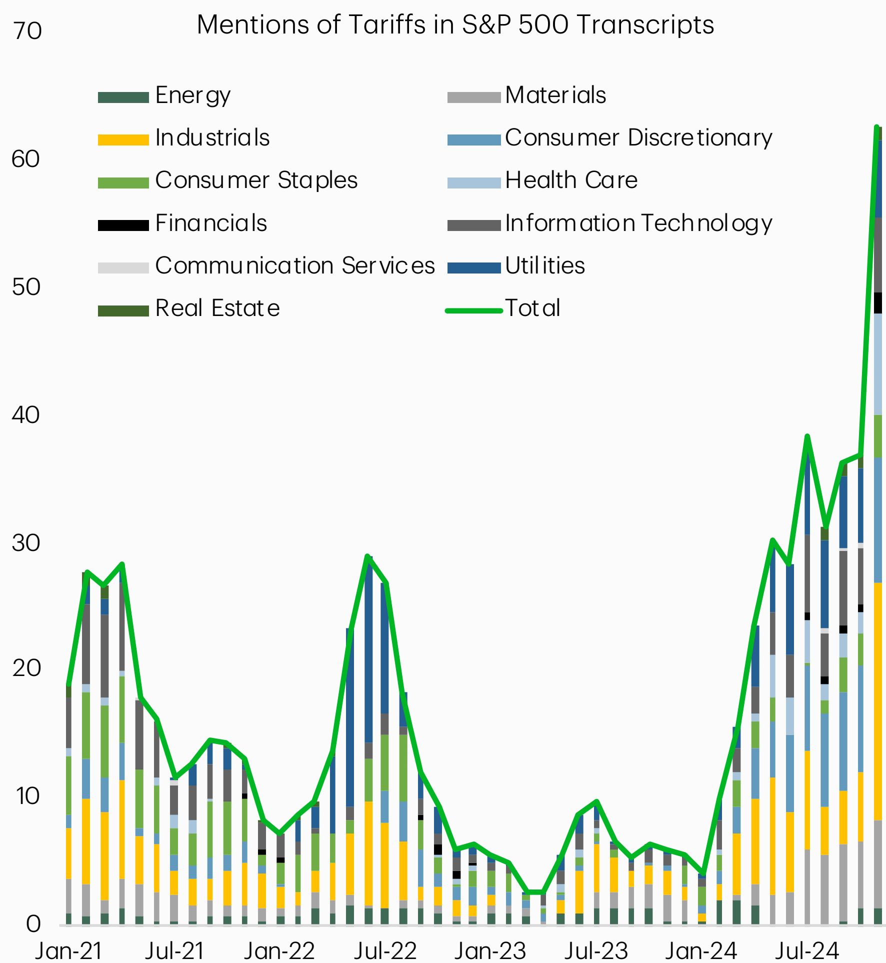


Source: FactSet and Wealth Investment Office as of December 6, 2024

Theme 4: Geopolitical Turmoil – Reshoring will accelerate amid rising global trade tension.

Rising uncertainty related to global trade bodes poorly for the currency of countries that rely on exports to the U.S., including the yuan, the Mexican peso and the Canadian dollar. The imposition of tariffs on U.S. goods will accelerate the reshoring trend seen since the 2018 trade war. Companies are increasingly rethinking their supply chain, especially those in the industrial and consumer discretionary sectors, due to their complex operation and dependance on parts from all over the world.



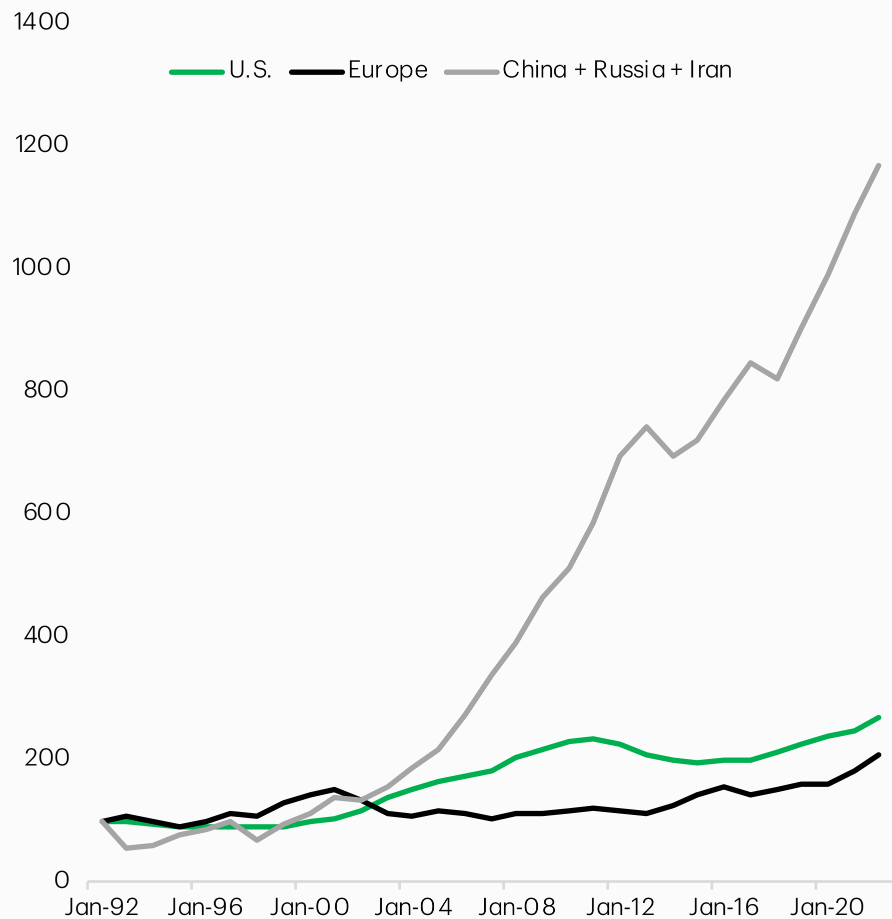


Source: Macrobond and Wealth Investment Office as of December 6, 2024

Theme 4: Geopolitical Turmoil – Conflict will give commodities a boost.

We live in a world where geopolitical competition continues to increase, military spending is growing, the energy transition is ongoing and where inflation is more volatile than it has been in decades. This is a world where commodities and gold — which tend to have minimal correlation with stocks and bonds — should fare well, providing strong diversification benefits to portfolios.

Military Expenditure in USD, rebased to 1992 = 100



Source: Macrobond and Wealth Investment Office as of December 6, 2024

DoD's Strategy Shift Is The Biggest Change In 40 Years

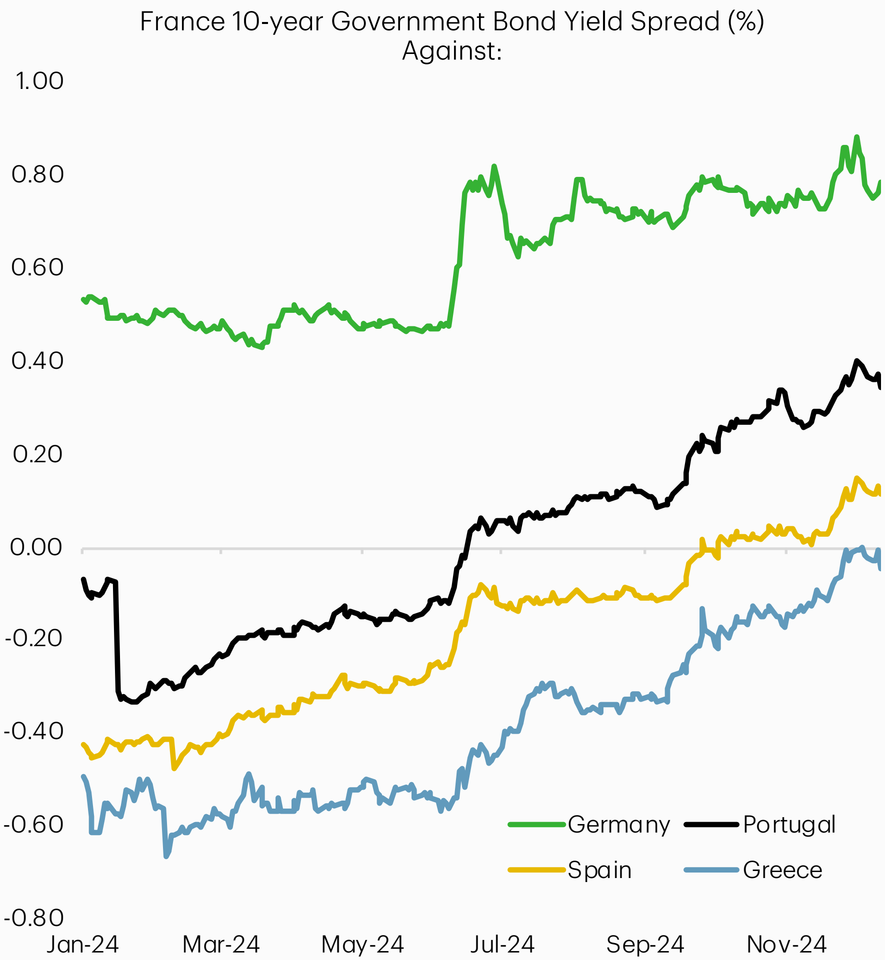
Alignment

Ground Forces	Smaller, lighter USMC Pacific-focused	**Nuclear Triad**	Columbia, B-21, GBSD budgets remain priority
	Smaller, tank-heavy Army European-focused		Execution & affordability of each a focus
Legacy Aircraft	Retire less capable aircraft	**Space**	Significant spending in Classified and other
	Retire expensive to maintain aircraft		Disruption from comm'l/ nontraditional
Manned Naval	Survivability of 'big decks' debate may be over	**Missile Defense**	Core programs being updated, key new starts
	New platforms - SSN(X) & DDG(X) - delayed		FMS still very strong: Europe, Asia, MENA
Static C41	Current systems vulnerable to attack	**NDS Weapons**	Hypersonics, directed energy and new weps
	Cannot operate in 'denied' environments		DoD restocking and increasing inventory
Traditional Presence	Shift forces from MENA to INDOPACOM	**Unmanned & Robotic**	Next-gen aircraft in development (e.g., CCAs)
	Shift forces from GER to E.Europe		Ground & Maritime next frontiers but delayed
	Deterrence & staging near TPE		Replicator real but below expectations
DOD Infrastructure	Defense-wide (e.g., MDA) continues to grow	**High-Tech Enablers**	Mixed bag of new tech: 5G, AI, etc.
	Difficult to shift money to R&D and procurement		C4I & Data links: JADC2

Source: TD Asset Management, Wealth Investment Office as of November 2024

Theme 5: Fixed Income Fluctuations – Fiscal imprudence will dampen demand for sovereign debt, lift yields.

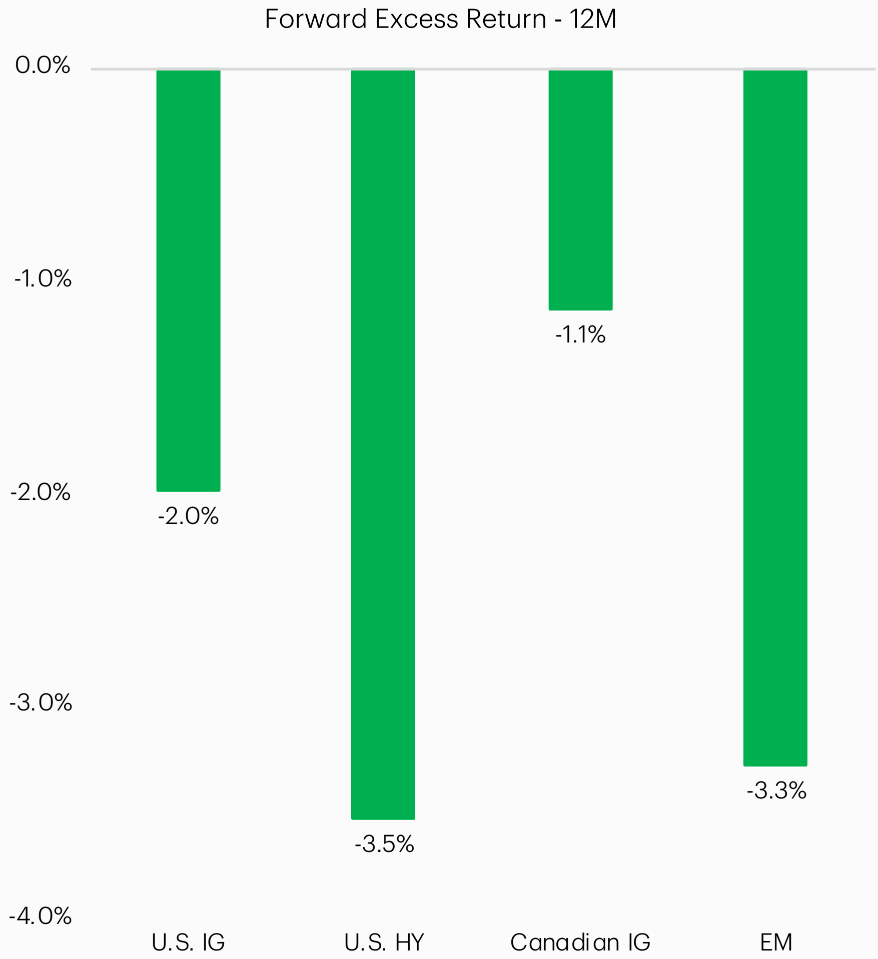
The rising share of non-discretionary fiscal spending across the developed world has already forced governments to enact greater spending discipline. This has led to political turmoil in France (with pressure from both far-left and far-right parties) that has lifted government yields above not only those in Germany, but even above those in Portugal and Spain. This is quite a reversal from the European sovereign debt crisis of 2012, when Portuguese, Spanish and Greek government bonds were yielding as high as 12%, versus 3% for Germany and France.

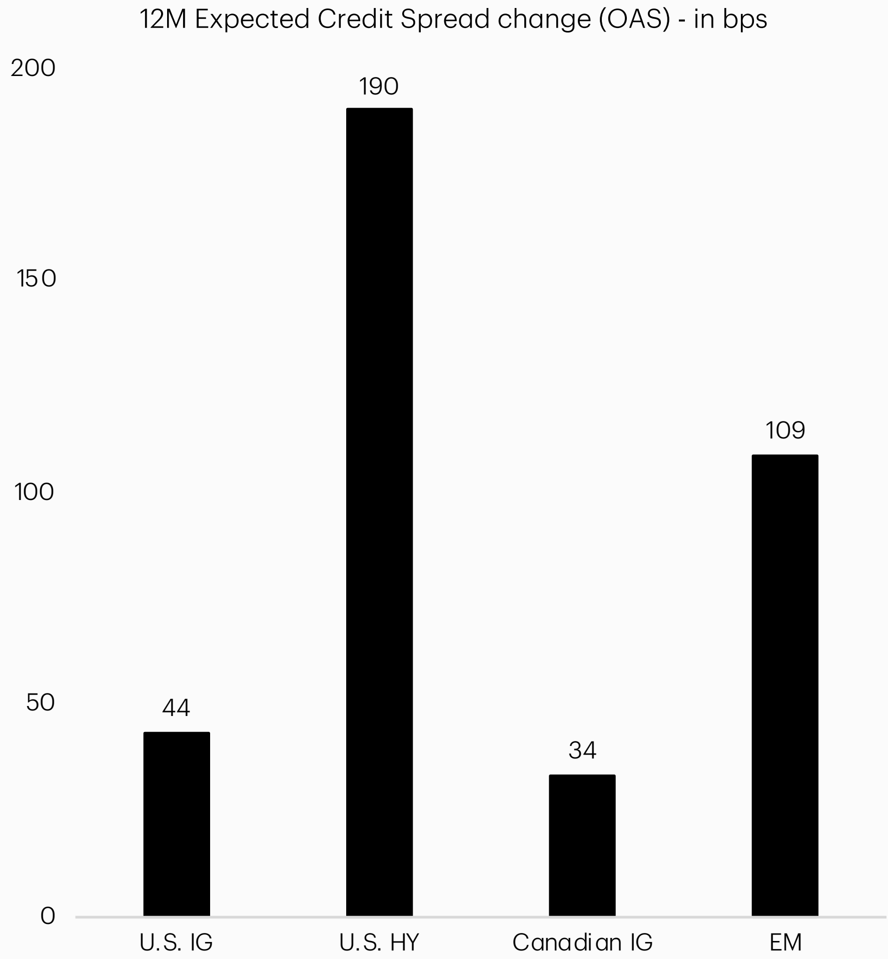


Source: Macrobond and Wealth Investment Office as of December 12, 2024

Theme 5: Fixed Income Fluctuations – Credit spreads will widen as uncertainties arise.

Positive sentiment has tightened credit spreads across various market segments, with many reaching multi-year lows. Historically, spreads trading at current tight levels have often led the market to reverse course, with bond prices falling and yields rising. Uncertainty regarding future fiscal policies, the impact of tariffs or inflationary pressures could lead to wider spreads. If these events appear temporary and not indicative of a broader economic downturn or structural policy changes, we expect investors to redeploy cash into the market when better entry points arise.

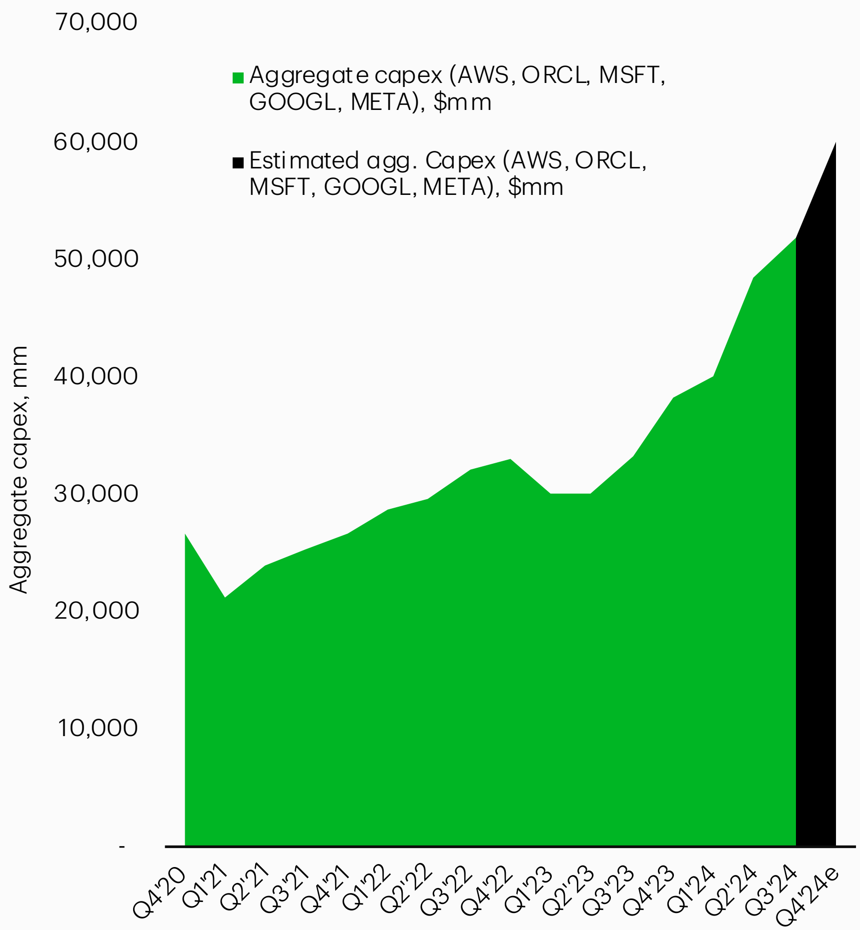


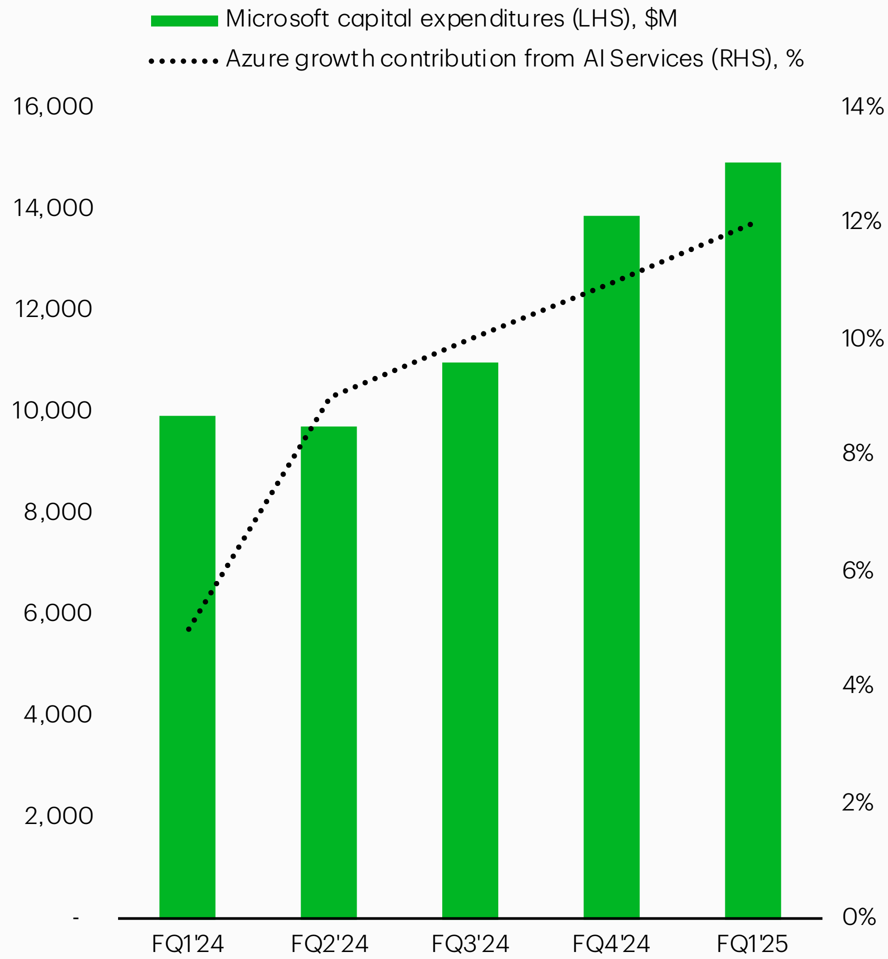


Source: FactSet and Wealth Investment Office as of December 6, 2024

Theme 6: Equities Shift – Big Tech will finally begin to monetize artificial intelligence.

The developmental stage that generative AI is in today looks remarkably similar to that of the early railroads at the end of the 19th century. The technology is still building out the infrastructure that will support the development of productivity-driving applications. Thus far, only a few semiconductor companies have been rewarded. We expect 2025, however, to be an inflection point in the development of generative AI, when giant software companies like Meta and Alphabet move from development to production and investments are finally monetized. The pace of this transition will largely determine the direction of equity prices for technology companies in 2025 and beyond.

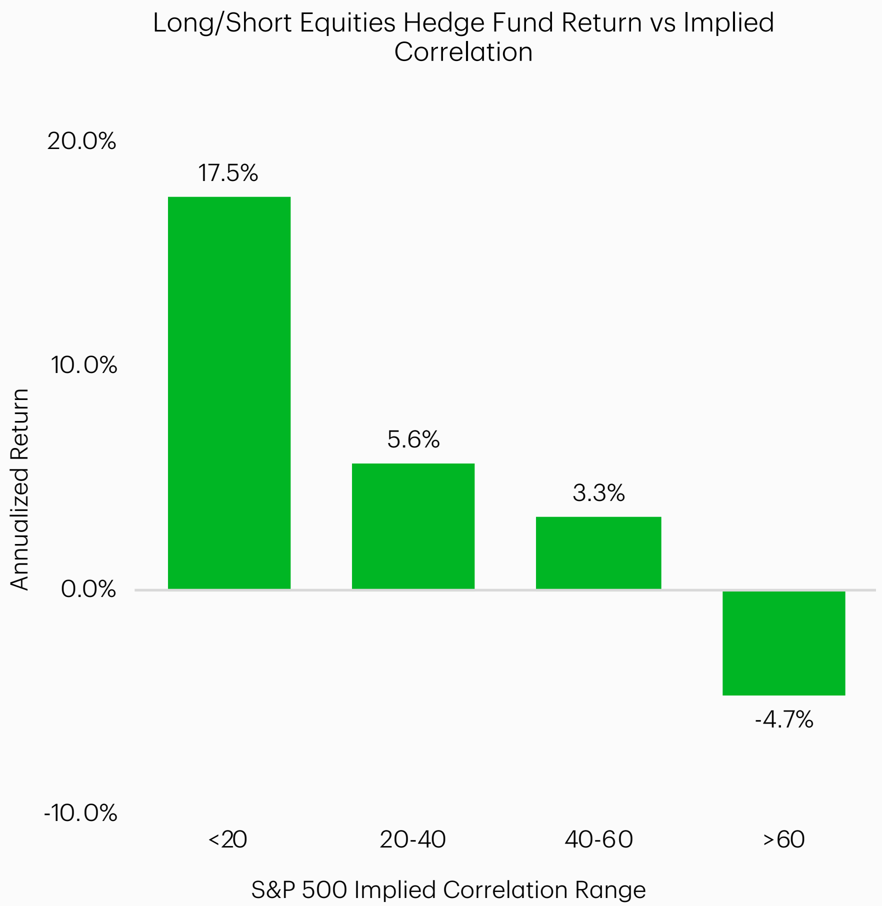




Source: Company reports and Wealth Investment Office as of December 6, 2024

Theme 6: Equities Shift – Long/short strategies will flourish.

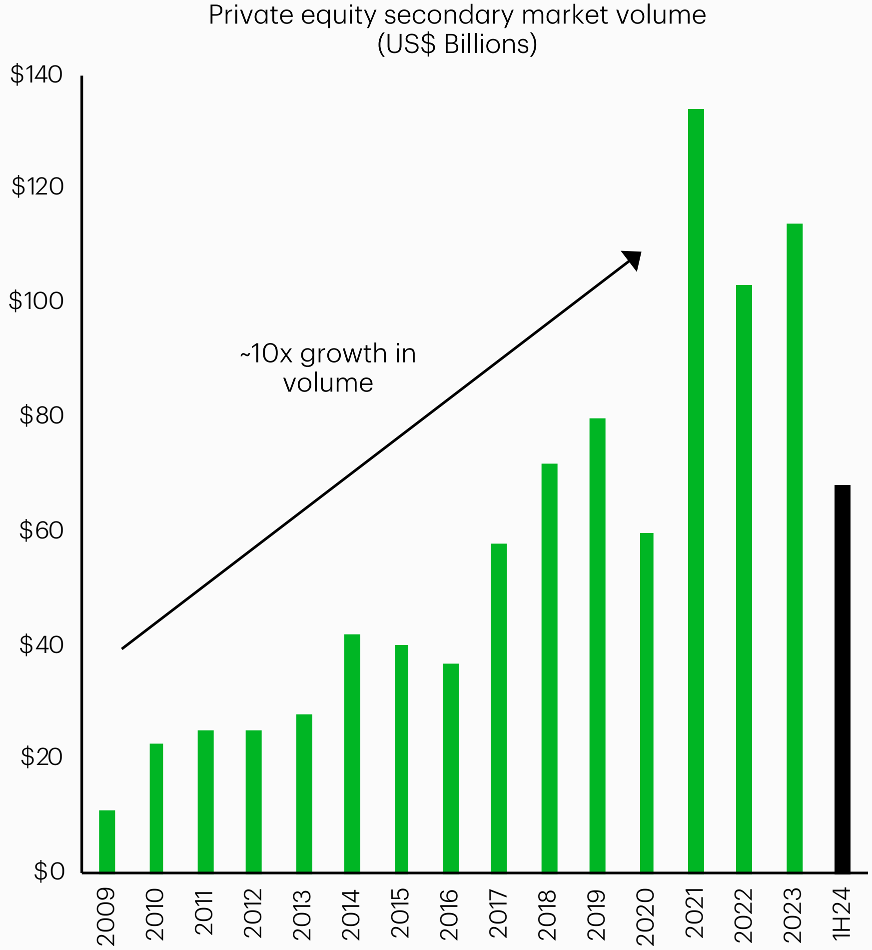
Over the past two years, equity markets have been anchored by a narrow group of large-cap growth stocks delivering top-line growth combined with improving profit margins. While we look for this to continue in 2025, we believe that market performance will also continue to broaden across sectors, factors and size. Further, volatility will increase. Market-neutral and long/short strategies should flourish in this sort of environment. The accompanying chart shows the low realized correlation among U.S. large-cap and small-cap equities since the U.S. election. Given that we will have the first 100 days of the new administration with a lot of practical business experience, winners and losers in equity markets could continue to diverge. This return dispersion provides great opportunities for long/short managers, especially the ones with a flexible process to incorporate political insight in their strategies.



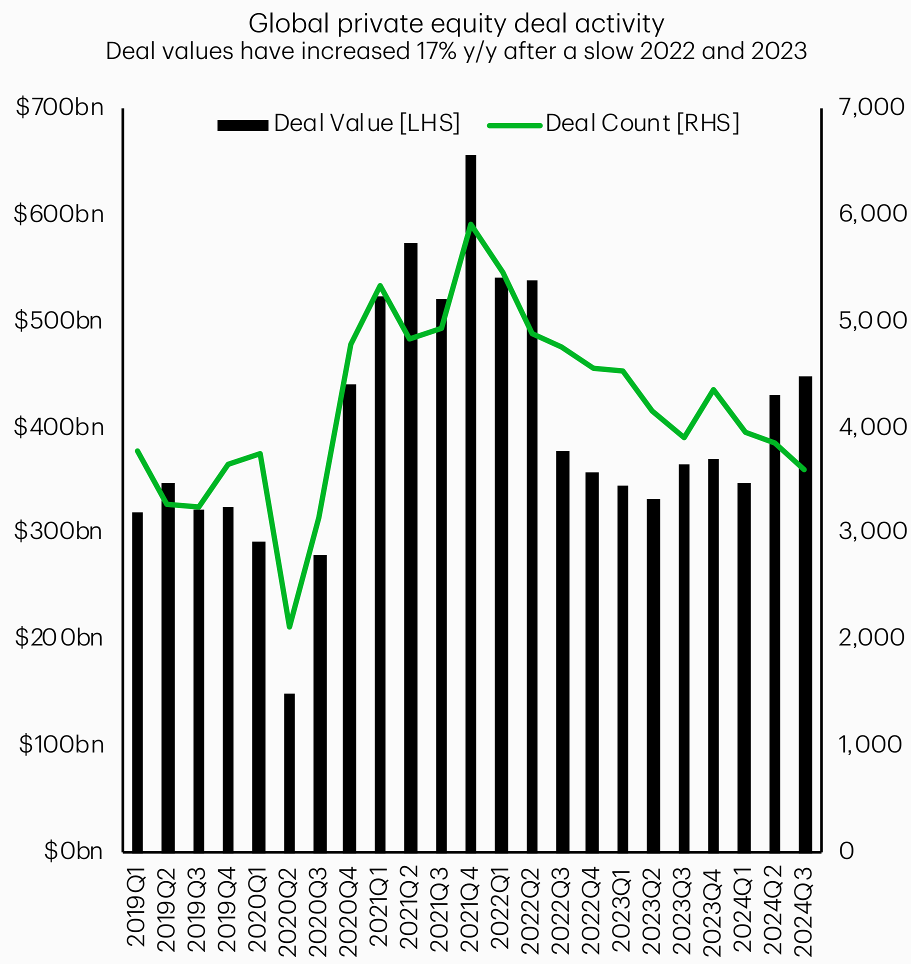
Source: FactSet, Morningstar and Wealth Investment Office as of December 13, 2024

Theme 7: Private Assets Prosper – PE transactions will rise as retail investors buy opportunistically.

Transaction volumes are starting to recover, as private equity becomes increasingly accessible, given the proliferation of evergreen semi-liquid fund structures that are designed for accredited investors. The run-up in private equity net asset value between 2018 and today has been dramatic. This, coupled with a slowdown in exit activity due to a higher cost of capital, has left many PE fund managers (limited partners) in a cash-negative position and looking for paths to liquidity. These dynamics have created a favourable environment for opportunistic liquidity providers in the secondary market that we anticipate will persist over the medium term.



Source: Wealth Investment Office, Blackstone as of September 30, 2024

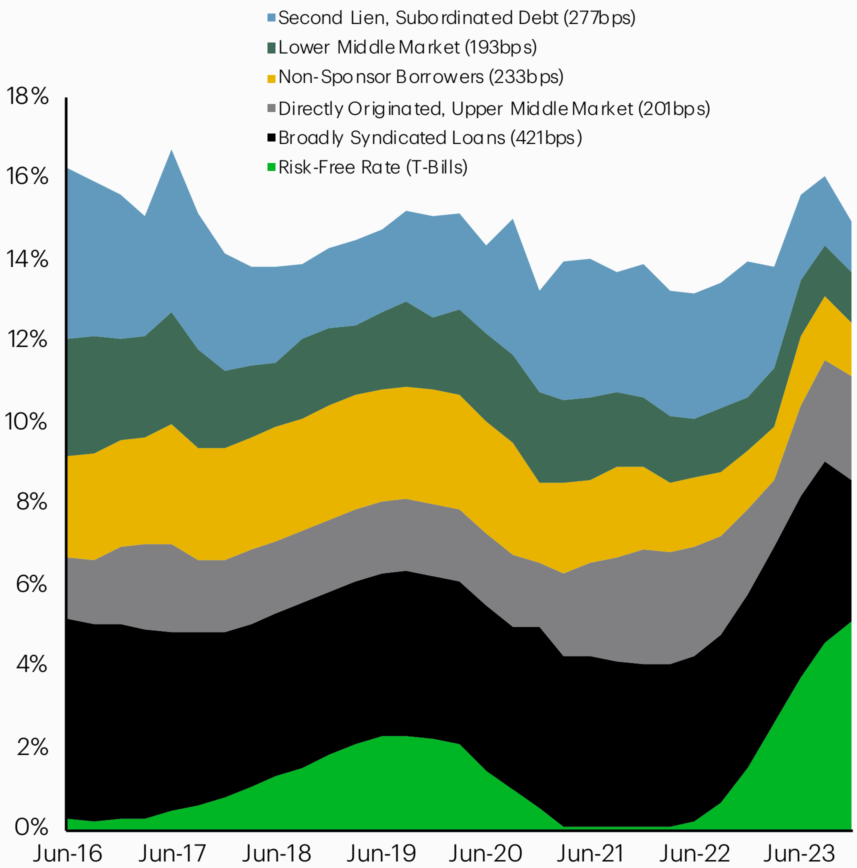


Source: Wealth Investment Office, Preqin, UBS Asset Management as of September 30, 2024

Theme 7: Private Assets Prosper – Direct lending will grow as bank requirements tighten.

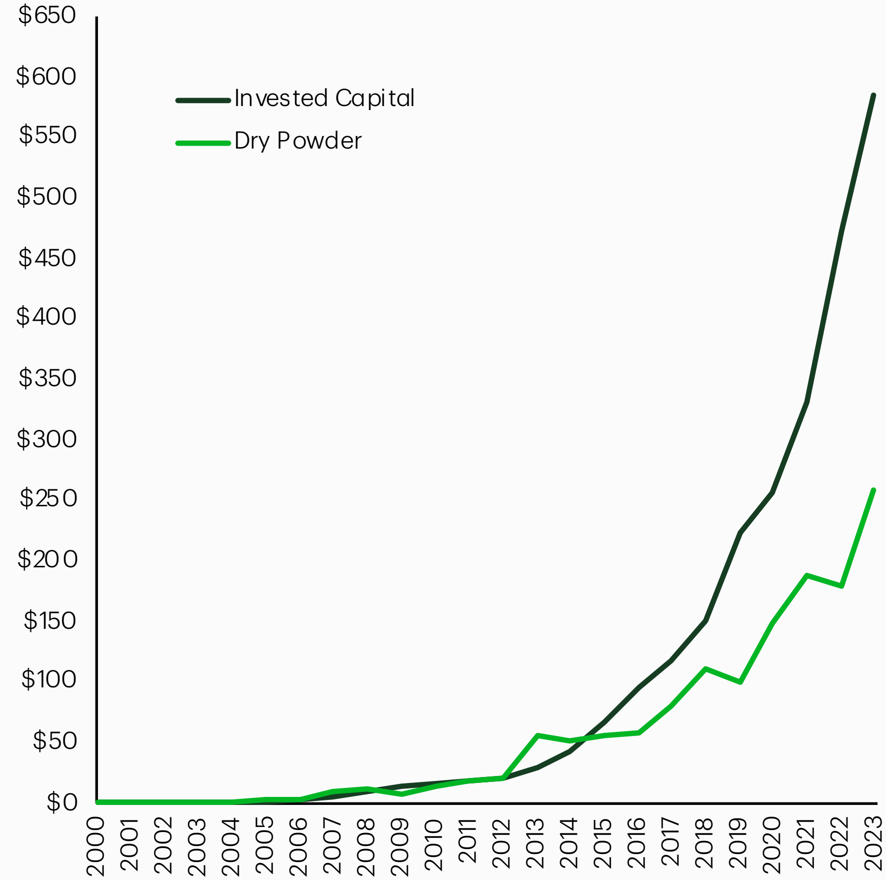
We expect asset-backed direct lending in the private-credit space to see attractive growth as capital requirements increase for traditional bank lending. These assets are part of a US$5.5-trillion universe and have low correlation to macroeconomic and market factors. Nonetheless, plain vanilla loans made to companies in the upper-middle market are expected to continue to deliver compelling high-single-digit returns for first-lien senior secured positions with conservative underwriting, asset stability and robust lender protections.

Building yield and income one risk premium at a time
The private credit universe has something for everyone



Source: Wealth Investment Office, Preqin as of September 30, 2024

Direct lending dry powder and invested capital
US$ Billions



Dry Powder is committed capital that is yet to be called and invested.
Source: Wealth Investment Office, Preqin as of September 30, 2024

Where we stand

Equities – Modest Overweight

Equities are set to outperform as the risk of economic slowdown diminishes. This improved economic outlook provides greater confidence in the earnings outlook, which is attractive for the U.S. and Canada. While valuations appear fair to elevated, this is somewhat justified given the greater contribution of issuers with high return on equity, the positive economic backdrop and declining interest rates. As this bull market extends, breadth is improving, with leadership from industrials, financials, and niche hardware manufacturers in the tech space. In Canada, we continue to focus on companies with attractive dividend growth prospects (such as those in the energy sector); leading companies within the materials sector; and Canadian banks that are in a strong market position. We also favour industrials with a focus on engineering, procurement and construction.

Fixed Income – Modest Underweight

With the start of the rate-cutting part of the cycle firmly underway in Canada and the U.S., fixed income markets have delivered relatively attractive returns year-to-date. We expect that returns going forward will closely align to current yields in the mid-single-digit range. At the same time, given that an economic slowdown is looking increasingly unlikely, we expect fixed income returns to remain rangebound in the next year. We also expect ongoing rate volatility, which calls for an active management approach for fixed income portfolios. Overall, bonds will continue to provide the benefits of diversification, reduce overall portfolio volatility and preserve capital.

Alternative Assets and Strategies

This is a diverse asset class where we are employing risk-mitigation strategies, such as market neutral, long/short strategies, and sub-classes, such as private assets, real estate and commodities. An allocation to alternative assets can benefit diversified portfolios, especially when implemented over the long term. Alternative assets can provide inflation protection and attractive absolute returns, while acting as long-term portfolio stabilizers via their diversification benefits and less correlated income streams.

Commodities

Elevated geopolitical risk, combined with attractive fundamentals over the long term (including a solid demand profile and limited supply growth) provide an attractive backdrop for key commodities such as copper and oil. Gold is also well positioned to exploit lower interest rates, geopolitical uncertainty and central-bank buying activity.

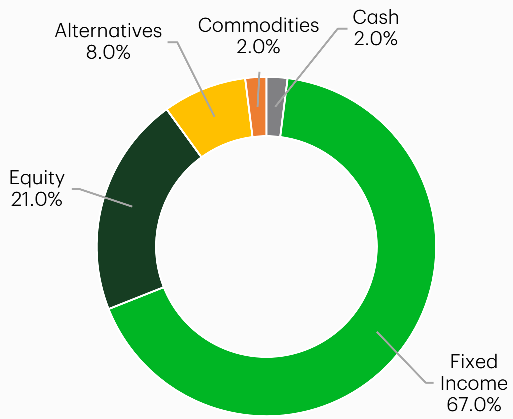
Current Asset Class Positioning – Overview

	Asset Class	Underweight		Neutral		Overweight
Cash & Equivalents I Modest Underweight	Cash		●			
Fixed Income I Modest Underweight	Domestic Government Bonds			●		
	Investment Grade Corp. Credit				●	
	High Yield Credit			●		
	Global Bonds - Developed			●		
	Global Bonds - Emerging		●			
Equities I Modest Overweight	Canadian				●	
	U.S.				●	
	International		●			
	Emerging Markets		●			
Alternative /Real Assets I Modest Overweight	Commercial Mortgages				●	
	Private Debt		●			
	Domestic Real Estate			●		
	Global Real Estate		●			
	Infrastructure				●	
Commodities I Modest Overweight	Commodities				●	
Sub-Classes	U.S. Dollar vs. Basket of Currencies			●		

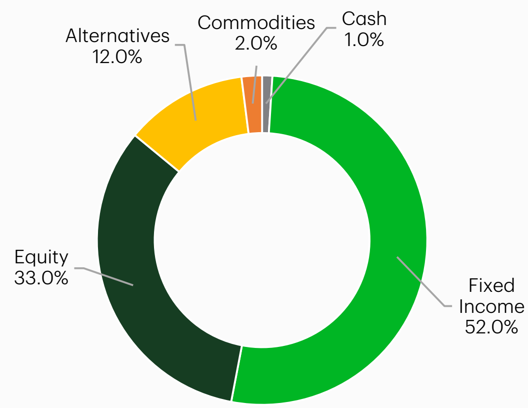
Source: Wealth Asset Allocation Committee, as of December 2024.

Current Asset Class Positioning – By Risk Profile

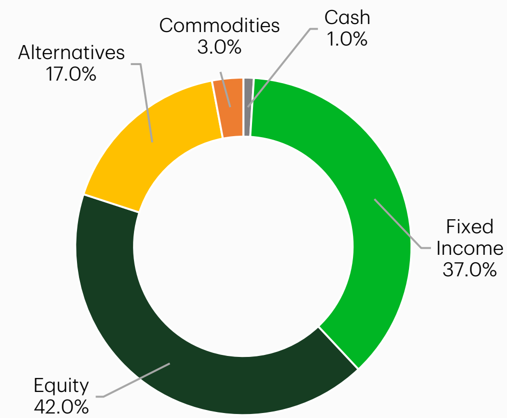
Conservative Income



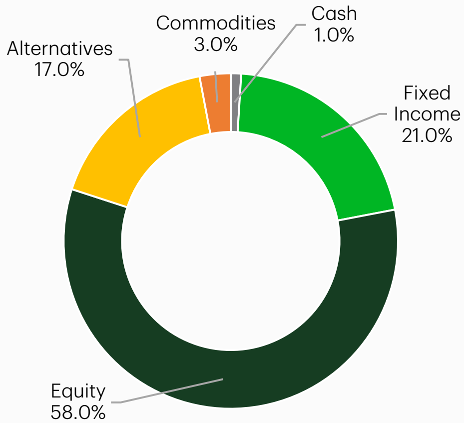
Balanced Income



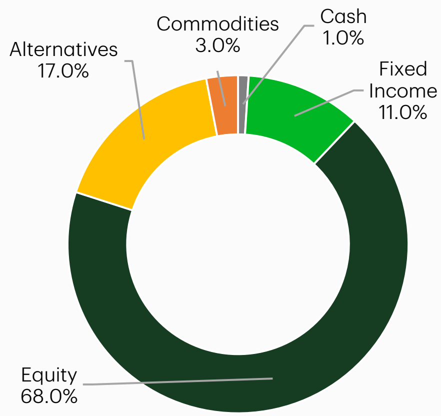
Balanced



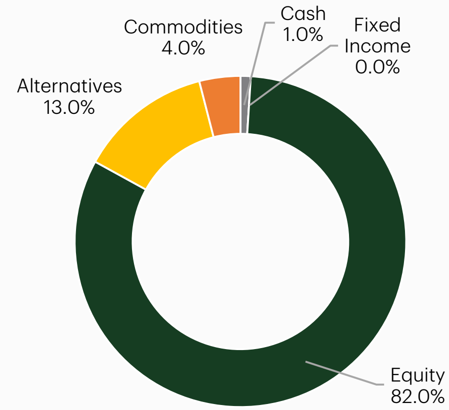
Balanced Growth



Growth



Aggressive Growth



Source: Wealth Investment Policy Committee, as of December 2024.

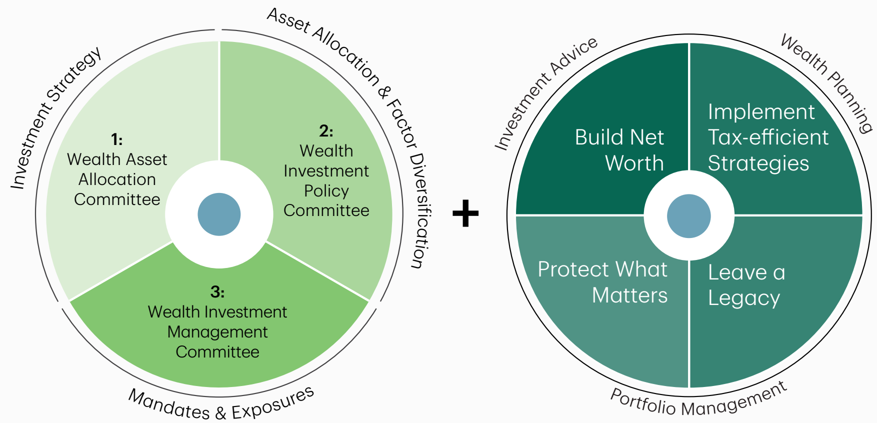
Current Asset Class Positioning – Strategic and Dynamic Weighting

Asset Class	Conservative Income		Balanced Income		Balanced		Balanced Growth		Growth		Aggressive Growth	
	Strategic	Dynamic	Strategic	Dynamic	Strategic	Dynamic	Strategic	Dynamic	Strategic	Dynamic	Strategic	Dynamic
Cash	2.0%	2.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%
Public Fixed Income	69.0%	67.0%	54.0%	52.0%	39.0%	37.0%	24.0%	21.0%	14.0%	11.0%	0.0%	0.0%
Domestic Government Bonds	28.0%	26.0%	22.0%	20.0%	15.0%	13.0%	9.0%	7.0%	5.0%	3.0%	0.0%	0.0%
Invest. Grade Corp Bonds	24.0%	25.0%	19.0%	20.0%	14.0%	15.0%	9.0%	9.0%	5.0%	5.0%	0.0%	0.0%
High Yield Bonds	5.0%	5.0%	4.0%	4.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	0.0%
Global Bonds - Developed	8.0%	8.0%	6.0%	6.0%	5.0%	5.0%	3.0%	3.0%	2.0%	2.0%	0.0%	0.0%
Global Bonds - Emerging	4.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	1.0%	0.0%	0.0%	0.0%
Public Equities	20.0%	21.0%	32.0%	33.0%	41.0%	42.0%	56.0%	58.0%	66.0%	68.0%	82.0%	82.0%
Canadian	6.0%	7.0%	10.0%	11.0%	11.0%	12.0%	16.0%	18.0%	19.0%	21.0%	22.0%	24.0%
U.S.	8.0%	10.0%	13.0%	15.0%	17.0%	19.0%	23.0%	26.0%	27.0%	30.0%	35.0%	37.0%
International	4.0%	3.0%	6.0%	5.0%	8.0%	7.0%	11.0%	9.0%	13.0%	11.0%	15.0%	13.0%
China/Emerging Markets	2.0%	1.0%	3.0%	2.0%	5.0%	4.0%	6.0%	5.0%	7.0%	6.0%	10.0%	8.0%
Alternatives	7.0%	8.0%	10.0%	12.0%	15.0%	17.0%	15.0%	17.0%	15.0%	17.0%	12.0%	13.0%
Commercial Mortgages	4.0%	5.0%	4.0%	5.0%	4.0%	5.0%	4.0%	5.0%	4.0%	5.0%	0.0%	0.0%
Private Debt	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	0.0%	0.0%
Real Estate	0.0%	0.0%	1.0%	1.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Infrastructure	0.0%	0.0%	2.0%	3.0%	5.0%	6.0%	5.0%	6.0%	5.0%	6.0%	9.0%	10.0%
Commodities	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%
Fixed Income	71.0%	69.0%	56.0%	53.0%	41.0%	38.0%	26.0%	22.0%	16.0%	12.0%	2.0%	1.0%
Equity	20.0%	21.0%	32.0%	33.0%	41.0%	42.0%	56.0%	58.0%	66.0%	68.0%	82.0%	82.0%
Alternatives	7.0%	8.0%	10.0%	12.0%	15.0%	17.0%	15.0%	17.0%	15.0%	17.0%	12.0%	13.0%
Commodities	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%

Source: Wealth Investment Policy Committee, as of December 2024.

The four pillars of wealth management

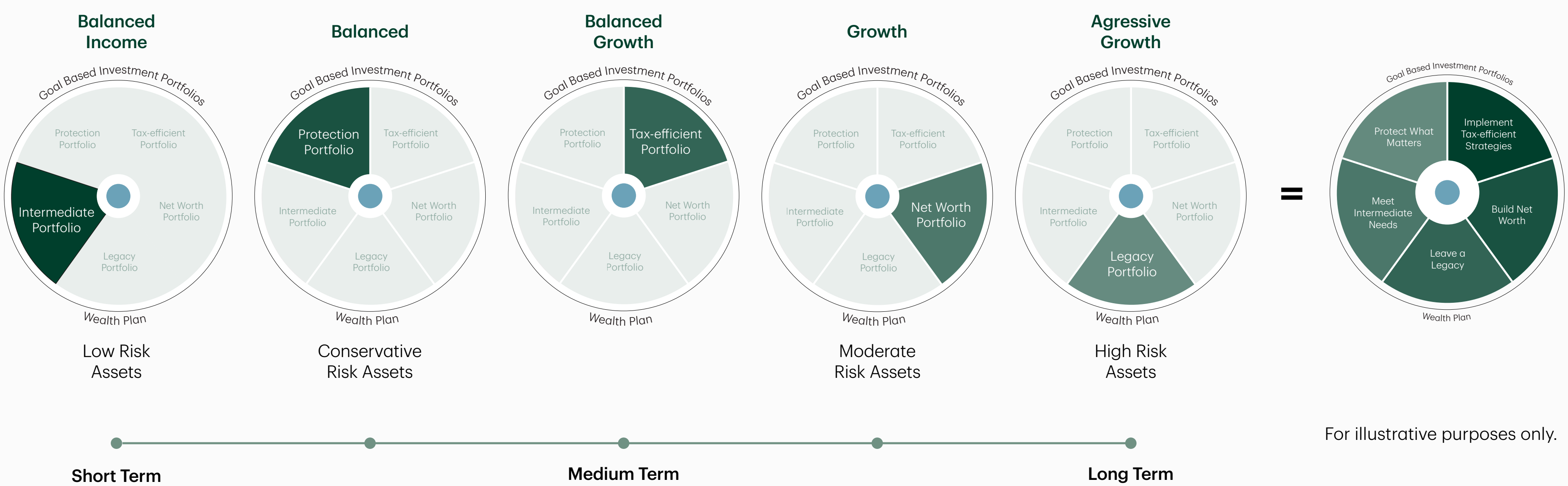
The foundation of process driven investment management



You want to know you are on track to achieve your goals. A goals-based approach to investing aims to bridge the gap between your goals and your portfolio's outcome.

We think a good starting point for any financial goal is to lay the foundation of a plan. While it's hard to be definitive, most investors share four common objectives: **(1) grow net worth; (2) preserve what they've earned; (3) protect what matters; and (4) build a personal legacy.** Instead of a one-size-fits-all solution, investors need to consider their primary objectives and, where it makes sense, create a specific portfolio to match the needs for each objective. We believe it is possible to structure portfolios based on investment time horizons while mitigating volatility through risk-factor diversification. This approach will help investors take the appropriate amount of risk to meet their goals.

Goal Based Portfolios



For illustrative purposes only.

Looking ahead

In these pages, we have stepped back and framed the near term and longer-term trends that will likely drive financial markets in the year to come. Remember, this is what might be. From our perspective, these are the trends that we are using to frame the challenges and opportunities we see as we approach the century's second quarter-mile.

Theme 1: American Exceptionalism

The U.S. economy will continue to outperform peers.
An inward-looking economy is less sensitive to global turmoil, while foreign investors will continue to perceive the U.S. as a safe haven.

U.S. equities will outperform, particularly small- to mid-caps.
The outlook for earnings growth is broadly attractive, despite some deterioration for mega-caps. All this bodes well for smaller issuers.

But U.S. inflationary pressures to resurface.
Trump's plans could raise the debt-to-GDP ratio significantly. As such, we believe short-term inflation expectations are likely to remain elevated.

Theme 2: Middle Kingdom Malaise

Chinese stimulus will be hard to come by.
A looming trade war with the U.S. may force a devaluation of the yuan, but China's government has in the past proven reluctant to stimulate markets.

But there may still be opportunities in Chinese tech.
The largest pools of VC risk capital in the world are government-backed investment funds in China. The implications are obvious.

Theme 3: Great White North

Oil producers and banks will reallocate capital to shareholders.
With rates coming down, improved credit conditions should support bank dividends, while the "energy transition" has led the oil and gas sector to shift its focus to share buybacks and dividends.

The loonie will remain grounded.
The Canadian and U.S. policy-rate differential is at an all-time high, while investors brace for trade battles with the U.S. All this bodes ill for the loonie.

Theme 4: Geopolitical Turmoil

Reshoring will accelerate amid rising global trade tension.
Tariffs on U.S. goods will accelerate the reshoring trend seen since the 2018 trade war, as companies reconsider their complex supply chains.

Conflict will give commodities a boost.
Geopolitical competition continues to increase, military spending is growing, the energy transition is ongoing. This is a world where commodities and gold should fare well.

Theme 5: Fixed Income Fluctuations

Fiscal imprudence will dampen demand for sovereign debt, lift yields.
A rising share of non-discretionary spending across the developed world has forced governments to enact greater discipline. This has led to political turmoil that has started to lift government yields.

Credit spreads will widen as uncertainties arise.
Uncertainty regarding future fiscal policies, the impact of tariffs or inflationary pressures could lead to spreads to widen from historically tight levels.

Theme 6: Equities Shift

Big Tech will finally begin to monetize artificial intelligence.
We expect 2025 to be an inflection point in the development of generative AI, when software giants move from development to production.

Long/short strategies will flourish.
We believe market performance will continue to broaden across sectors, factors and size. Further, volatility is expected to increase. Market-neutral and long/short strategies should flourish in this environment.

Theme 7: Private Assets Prosper

PE transactions will rise as retail investors buy opportunistically.
Many PE fund managers are looking for paths to liquidity, creating a favourable environment for opportunistic liquidity providers in the secondary market.

Direct lending will grow as bank requirements tighten.
We expect asset-backed direct lending in the private-credit space to see attractive growth as capital requirements increase for traditional bank lending.