THE FORECAST FOR THE YEAR AHEAD

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INTRODUCTION

The Return of Policy Risk

Kevin McCreadie, CEO and Chief Investment Officer, AGF Management Limited

We believe 2025 will be another positive year for investors, but central banks and the incoming U.S. administration will play a role in the potential opportunities that arise.

Some investors may not want 2024 to end, given how well financial markets have performed this year. Global stock indexes have climbed more than 20% in some instances and have continued to reach new all-time highs in the process. As much as that might seem like a tough act to follow in 2025, it is clear that many of the macro conditions that fueled 2024's stellar results are still in play. Economic growth is solid, if unspectacular in many countries, and the interest rate environment has slowly become more accommodative since the summer. And while Donald Trump's next term as U.S. President brings a new wave of policy risk to the table and could dampen returns somewhat over the next 12 months, we believe that for investors overall, and particularly those with a well-positioned portfolio of stocks, bonds and alternatives, 2025 will be another positive year.

But just how positive? That is the big unknown, and the outcome may largely depend on the direction of monetary policy, which has become the great pre-occupation of markets in recent years. This is true globally, but especially as it relates to the U.S. Federal Reserve (Fed) and its ongoing pursuit of a soft landing for the U.S. economy. At question, specifically, is the Fed's easing cycle and the degree to which it may cut interest rates further in 2025. Current estimates suggest that two or three more cuts of 25 basis points each may be in the cards. But given the country's economic resilience to date and prospects of more stimulus from the new U.S. administration next year, that monetary easing is hardly guaranteed

and the spectre of "higher for longer" may continue to loom.

In fact, Trump 2.0 could be a double-edged sword for investors. For instance, the president-elect's pro-growth agenda, which promises lower taxes and reduced regulation, seems decidedly bullish for U.S. equities, but it could also work against the market should economic activity heat up too much and force the Fed to slow the pace of its easing cycle even further in response.

Then there is Trump's plan to slap tariffs on all imported goods, which, if they reignite U.S. inflation, could elicit a similar response from the Fed. That not only could be a drag on U.S. stock performance – all things being equal – but may also negatively impact the potential for capital gains from investments in certain bond markets globally. Indeed, yields on longer-dated Treasuries initially climbed post-election. However, they have since retreated as investors reassess the impact of other measures.

Even if Trump's tariffs don't fuel higher consumer prices as expected, they might still negatively impact global stocks that trade in jurisdictions caught in the crosshairs. China's fate is notably perilous on this front, but other economies with otherwise strengthening fundamentals, such as Canada, Europe and Japan, are likely susceptible, too.

Beyond these potential trade dynamics, Trump's administration could disrupt global markets in other ways. One is his anticipated foreign policy, which could stoke already heightened geopolitical tensions. Another is his potentially inflationary pledge to deport millions of immigrants and force many companies to "pay up" to replace lost workers.

All in, then, investors might find it challenging to garner positive returns in 2025 to the same degree as this past year. Yet the path ahead still seems ripe with opportunities for potential gains. In particular, AGF Investments' Asset Allocation Committee heads into the new year with an overweight to equity versus fixed income and has a preference for U.S. equities over other developed countries and the Emerging Markets (EM). While bond returns from capital gains may be limited by the pace of interest rate cuts going forward, we believe yields at current levels remain attractive; credit and EM debt should help bolster overall fixed income performance.

Of course, this view only represents a starting point for how 2025 may unfold. There are risks, but if investors remain well-diversified across asset classes, and as long as monetary easing doesn't veer off course too dramatically, they likely will not regret toasting the new year after all. ■

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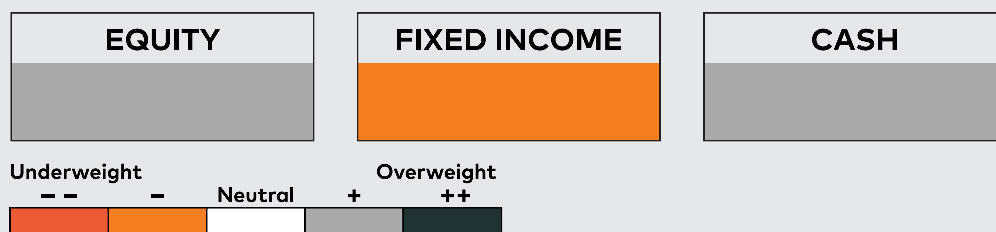
Asset Allocation Overview



Source: AGF Asset Allocation Committee Fourth Quarter Update (as of October 1, 2024). For Illustrative purposes only.

MACRO

What's in Store for Central Bank Policy?

David Stonehouse, SVP, Head of North American and Specialty Investments, AGF Investments

As many as three U.S. interest rate cuts have been pencilled in for 2025, but history shows financial markets rarely get central bank forecasts right.

At the beginning of 2024, economists and market observers were increasingly confident that the disinflation trend that began the prior year would continue, allowing central banks to shift their focus in favour of easing monetary policy. This view was bolstered by the U.S. Federal Reserve's (Fed) pivot toward a more dovish perspective as articulated by Fed Chair Jay Powell in December of 2023. Lingering concerns about the potential for a recession, exacerbated by gradually rising unemployment rates in the U.S., also supported the notion that central banks would shift to a more accommodative stance. Indeed, such was the optimism surrounding this scenario that global markets in January were pricing in almost seven 25-basis-point rate cuts by the Fed in 2024.

However, a combination of resilient economic growth and stickier than expected inflation forced markets to revise their rate cut expectations. In the end, the Fed only delivered about half the easing anticipated at the beginning of 2024, and many other central banks, constrained more by stubbornly slow disinflation than solid growth, followed suit. Canada was an exception, as faster disinflation, more rapidly rising unemployment and underwhelming GDP growth allowed the Bank of Canada (BoC) to meet expectations entering 2024 of five to six rate cuts.

So, what's in store for 2025? Central bank observers have embraced the strong U.S. economy thesis, and investor surveys indicate that fears of a recession are at the lowest levels in the past few years. In addition, the election of Donald Trump as the next U.S. president has caused rates markets to reassess prospects for both growth (due to potential tax cuts and deregulation) and inflation (due to potential tariffs and deportations). As a result, only two or three rate cuts have been pencilled in over the next year.

However, history has shown that the global markets rarely get central bank

rate forecasts right. In fact, in the case of the Fed, the market has swung between high and low rate cut expectations three times in the last 18 months as inflation and economic data fluctuated. It would be more of a surprise if the current consensus were realized than not. With that in mind, current optimism about U.S. growth prospects, with attendant modest rate cut assumptions, may be somewhat misplaced. It is reasonable to postulate that the Trump administration will be quicker to implement the part of its agenda that can be enacted by executive order without Congressional support. These items include tariffs and deportations, both of which have the potential to restrain growth and drive up the U.S. dollar, which could help offset any inflationary impact. A pro-energy policy, also at least partially within the purview of executive order, could also dampen inflation. This outcome may cause markets to reprice a more aggressive path of rate cuts in the early part of 2025, which is not the current consensus. Conversely, later in 2025, the Republican sweep of Congress makes an extension of the 2017 Trump tax cuts more probable, potentially with additional corporate tax cuts. Deregulation is also likely to pick up steam later in the year. This scenario could cause the pendulum to swing back toward fewer rate cuts as 2025 progresses, and if growth and inflation were to really accelerate, a premature end to the easing cycle (or even rate hikes) could be possible late next year. In sum, while the timing and size of rate cuts are likely to ebb and flow, we believe the Fed will remain on an easing path well into 2025.

One other thing for the Fed to consider is fiscal policy. Deficits are likely to remain high, so the Treasury will have to issue substantial amounts of debt, but the mix of T-bill and bond issuance will be key. This could have an impact on the Fed's quantitative tightening program. Regardless, the Fed is likely to wind down quantitative tightening in 2025 depending on the amount of liquidity and reserves in the system.

The outlook for the Bank of Canada is somewhat different, although some further easing should occur just as in the U.S. The BoC is already closer to its long run neutral rate than the Fed and has already cut rates more aggressively. Since it's farther along in its easing cycle, it may well stop lowering rates sooner than the Fed, especially if housing prices and/or economic growth start to pick up again. Early signs of improvement on that score as we near the end of 2024 support that view.

Finally, we believe monetary policy is likely to diverge in the rest of the world. Europe's prospects appear to be among the weakest given trade wars, geopolitical conflicts, little population growth and low productivity, so the European Central Bank, Bank of England and others like the Swiss National Bank and Sweden's Riksbank could continue cutting policy rates. The People's Bank of China (PBoC) may continue to ease policy in an attempt to revive the economy and combat potential tariffs, but the Chinese Communist Party is mindful of past episodes of over-stimulus, which may keep PBoC easing at a more moderate pace. The Bank of Japan is likely to raise rates in the face of somewhat higher inflation, along with a desire to continue moving away from the zero percent interest rate policy of the past decade. Lastly, Emerging Market rates may vary based on local circumstances, with some hiking rates in the face of high inflation while others reduce rates to stimulate more growth. In sum, we anticipate the prevailing backdrop globally is for lower policy rates as we enter 2025, which should be supportive for economies and capital markets, but the path is likely to have numerous twists and turns as the year unfolds. ■

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MACRO

Why the Geopolitical Climate Remains a Focus for Investors in 2025

Greg Valliere, Chief U.S. Policy Strategist, AGF Investments

Wars in the Mideast and Ukraine remain potential hot spots that could have an impact on financial markets.

Washington D.C. insiders are bracing for one of the most unpredictable four years in recent memory. Among the explosive issues: tariffs, wars in the Mideast and Ukraine – overseen by a hardline U.S. Secretary of State who is willing to confront China.

The American public hasn't focused much on foreign policy; voters have been far more concerned about food prices.

But president-elect Donald Trump has vowed to impose a muscular foreign policy – and he has vowed to end the Ukraine war in one day. The U.S. has spent an astonishing sum on Ukraine, as much as US$125 billion, according to some estimates.

U.S. aid to Israel since the Gaza war began has been about US$20 billion in the Mideast, where a guerrilla war could persist despite the recent ceasefire agreement in Lebanon between Isreal and Hezbollah, most U.S. officials believe.

There are two persistent geopolitical wild cards – first, the great provocateur in the Mideast, the Iranians. Radicals in Tehran have funded Hamas, the Houthis, Hezbollah and other militant groups.

More importantly, Iranian scientists are working rapidly on producing a crude nuclear bomb. A delivery system hasn't been perfected, but defence analysts think it's just

a matter of time before the Iranians have the bomb, which almost certainly would prompt a response from Israel.

The other wild card is Trump's pledge to raise tariffs on China (and other countries too). This policy will be coordinated by the very hawkish Secretary of State, Marco Rubio, who is a fierce critic of China. Rubio almost certainly will win Senate confirmation.

Several other Washington hardliners are determined to crack down on China's spying, its treatment of dissidents and designs on Taiwan. U.S. Congress is filled with hawks who want significantly higher tariffs – and sanctions if China continues to partner with Russia.

The Trump hawks have one major problem – the public's indifference to a hard-line U.S. stance on geopolitics. A mood of isolationism has taken hold in much of America – young conservatives in particular resist spending huge new sums on defence. Ukraine will not get another US$50 or $60 billion this year, that seems certain.

The U.S. will come close to spending US$850 billion on total defence outlays this fiscal year, despite the staggering budget deficit, now running at nearly US$2 trillion annually, with no sign of restraint in sight. Trump says he will pay for this new spending with his tariffs, but the math simply doesn't work.

There will be other sources of new spending – on Venezuela, Haiti, Korea, etc. And the friction between the U.S. and Canada may persist over Ottawa's reluctance to spend more on NATO, a huge issue for Trump.

Our bottom line: we're in for an unstable stretch – rhetorically, at least – as Trump seeks to push the limit. Most of his early nominees have shown a spectacular inconsistency, and at least one or two of these nominees may fail to win confirmation.

Second-term presidents often focus on foreign policy, not domestic issues, and it strikes us that with the U.S. economy in decent shape, Trump will have plenty of time to focus on Russia, China, North Korea, Iran and others.

Not everything will be gloomy, in our opinion, as Russia's losses – in morale, the battlefield and its economy – continuing to soar, and officials in Beijing have plenty on their plate. While the West can muddle through geopolitics in this coming year, the Mideast – as usual – will continue to be the greatest threat. ■

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MACRO

What Trump's First Presidential Term Says About What's Ahead

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AGF Investments Inc.'s U.S. Regime Model shows his policies may have significant economic effects, notably through tax reform and trade initiatives.

After Donald Trump won the U.S. presidential election on Nov. 5, U.S. stock markets surged, and probably for a few reasons. For one, the convincing Republican victory – the party of Trump also carried the Senate and the House of Representatives – erased any uncertainty that had hovered over markets for months during the campaign. For another, investors clearly expect Trump as President will introduce pro-growth policies centered around tax cuts and deregulation. Of course, only time will tell if those expectations become reality. In the meantime, how can investors begin to parse the likely macroeconomic impact of the U.S. power shift?

To find an answer, we turn to AGF Investments Inc.'s U.S. Regime Model, which is designed to help portfolio managers and analysts navigate complex macroeconomic environments by interpreting thousands of

data points on growth, inflation and market conditions. It classifies the economy into four regimes: Reflation, Defensive, Inflation and Goldilocks, assigning probabilities to each regime and providing actionable insights that guide asset allocation and portfolio strategies.

What makes our U.S. Regime Model unique is its forward-looking capability, offering a three-month regime forecast with solid accuracy.

What makes our U.S. Regime Model unique is its forward-looking capability, offering a three-month regime forecast with solid accuracy. It also allows for near-neighbour analysis, where today's economic data is compared to historical analogues.

This approach helps develop playbooks to navigate periods of uncertainty and proved invaluable in the post-COVID-19 period, when the U.S. Federal Reserve (Fed) drastically shifted its monetary policy from extremely loose conditions to a tightening stance aimed at curbing inflation. In response to rising inflation, driven by supply chain disruptions, labour shortages and strong consumer demand during the pandemic, the Fed undertook a series of aggressive rate hikes. Between March 2022 and July 2023, interest rates were raised 11 times, moving the target rate from near-zero to 5.5%, totaling 525 basis points over approximately 16 months.

More recently, the key question we faced was whether the U.S. would experience a recession or something less severe this past year. To address this, our near-neighbor analysis pointed us to the mid-1990s, which served as a strong historical analogue – particularly in terms of the Fed's "soft landing" and rate pivot strategy. Between 1994 and 1995, the U.S. central bank raised interest rates seven times, from 3% to 6%, followed by three rate cuts totaling 75 basis points. For over two years (1996-1998), rates remained elevated at around 5.25%-5.5% without triggering a recession. During this period, the U.S. economy was in Goldilocks and Reflation regimes, both of which were favorable for equities in a risk-on environment. From January 1, 1996, to December 31, 1998, the S&P 500 Index outperformed the Bloomberg U.S. Aggregate Bond Index by 62%.

This analysis provided us with confidence that the U.S. was in a similar "higher for longer" rate environment that could be positive for equities and global credit markets, while challenging for conventional government bond yields – all without triggering a recession. Indeed, this proved accurate, as rate hikes were followed by delayed cuts only when the Fed was comfortable with inflation levels. From April 1, 2024, to October 31, 2024, the S&P 500 outperformed the Bloomberg U.S. Aggregate Bond Index by 5.9%.

Fast forward to today, as Donald Trump prepares to begin his term as the 47th U.S. President, we analyzed his first term to anticipate the regime the U.S. may be entering in 2025. During Trump's first go-around, his policies had significant economic effects, notably through tax reform and trade initiatives. The 2017 Tax Cuts and Jobs Act provided substantial tax relief for corporations and individuals, spurring economic growth and market confidence while contributing to inflationary pressures. The trade war with China, marked by tariffs and counter-tariffs, further increased concerns about the rising cost of goods and disruption in trade flows. During this period, the U.S. was in a Reflation regime – marked

by higher growth and higher inflation – and equities significantly outperformed bonds. From Jan. 1, 2017, to Dec. 31, 2018, the S&P 500 outperformed the Bloomberg U.S. Aggregate Bond by 7.9%.

The U.S. may again enter a Reflation regime, prompting the U.S. Federal Reserve to respond with rate hikes to manage inflation—just as it did during Trump's first term.

As we approach 2025, there is anticipation that a lot of Trump's prior economic strategies will resurface, potentially creating a similar macroeconomic environment to his earlier presidency. Deficit spending, tax cuts, and tariffs, central features of his previous policies, are expected to be reinstated, potentially leading to inflationary pressures similar to those seen in 2018. If President Trump 2.0 follows a similar path, the U.S. may again enter a Reflation regime, prompting the U.S. Federal Reserve to respond with rate hikes to manage inflation – just as it did during Trump's first term. Of course, the risk is real that the regime model could move quickly from Reflation to Inflation, as it did in the second half of Trump's first term. Then, the economy started to overheat, inflation made a U-turn higher, and the Fed moved from cuts to hikes.

Against this backdrop, rising interest rates alongside strong real GDP growth do not necessarily derail markets. In fact, when the U.S. Federal Reserve manages this balance effectively, it can create a positive environment where equities outperform bonds, supporting overall market resilience and growth. ■

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EQUITIES

Will U.S. Tariffs Rain on Canada's Equity Parade?

Mike Archibald, VP, Portfolio Manager, AGF Investments

Canada's Investment landscape has largely improved this past year and we anticipate it could get even better in 2025.

Canadian equities offer both some unique opportunities and some potential challenges in the year ahead. After a solid 2024 that saw the S&P/TSX Composite Index (TSX) notch an all-time high in the summer and then continue to power higher in the fourth quarter on the back of better-than-expected earnings, declining interest rates and a weaker Canadian dollar, the focus has now shifted to how equities will handle another Donald Trump administration and what potential tariffs, related to Canada as well as other parts of the world, may mean for equities. On balance, we see a solid runway for Canadian stocks in 2025, supported by valuation upside and the potential for stronger global growth to propel cyclical sectors higher, leading to renewed interest in the Canadian market.

Let's start with the macro backdrop in Canada. The landscape as it relates to growth, inflation, interest rates and consumer spending has improved on all fronts from this time last year and looks likely to get even better as we enter 2025. Inflation is now back to the Bank of Canada's target range and is finally putting less pressure on consumer spending, which is showing early signs of starting to pick up after 18 months of weak readings. As a result, interest rates have been lowered and are on track to see several more downward adjustments over the first half of 2025. This could further alleviate concern around elevated debt levels across the country or the ability for consumers to simultaneously service those loans and spend to create economic growth. Lower rates should also help spur on the housing market, which has seen a lull in activity for the past 24 months. Given the high sensitivity of the Canadian economy to housing, any improvements could be a benefit to Canadian GDP. Finally, consumer confidence is on the mend; if that continues to get better, spending should follow suit with a slight lag.

On the earnings growth side – the primary determinant of long-term stock market movements in most global regions – the picture for Canadian equities is getting a little brighter. Recent consensus estimates (as of November 11, 2024) were that TSX earnings will expand by 12.8% in 2025, led by a resurgence in cyclical sectors including Materials and Industrials. All 11

subsectors in Canada are forecast to grow in 2025 compared to 2024. That would be a reflection of the improving landscape in Canada after a few years of less robust growth, due in large part to rising interest rates, which strained consumer finances and put incremental stress on the housing market.

Our thinking remains that cyclical industries with ties to consumption and global growth could outperform defensive industries, as pro-growth policies south of the border will extend into Canada. Areas like Financials, Industrials and Commodities stand to potentially benefit from a return to trend in long-term GDP growth, and these groups account for 75% of the TSX. An environment of more pro-growth policies and less regulation in the U.S. should benefit Canadian financials with exposure to the U.S, market, driving better loan growth and the potential for improved profitability as margins improve.

And then there are the potential challenges. Economic policies focusing on protectionism are likely to be a high priority in Trump's second term in office. His first term had a mixed impact on Canada; however, if the Trump administration implements immediate tariffs in his second term, it would create additional risks for the Canadian market in the next several years. Trade relations between the U.S. and Canada were strained during Trump's first term, with the renegotiation of NAFTA and the imposition of tariffs on several Canadian industries (steel and aluminum) being flashpoints. A second term could see continued pressure on Canada's trade surplus with the U.S., particularly in sectors like automotive and agriculture.

However, it's also possible that Trump's desire to further reduce U.S. reliance on China and other foreign producers could result in increased demand for Canadian materials and energy commodities, as well as greater access to U.S. markets for certain Canadian exports. We believe, if the U.S. continues to focus on energy independence, Canadian energy stocks could benefit as increased demand for Canadian oil and gas over other international sources would result in expanded access to the U.S. market. Higher cash flows and profitability would be the likely result.

Overall, then, we foresee a path to slightly above-trend returns for the TSX composite in 2025. Despite tariffs and other unknowns related to the political environment in the U.S., the Canadian economy is in a much better position than it was a year ago, and earnings growth suggests the TSX has decent upside from here. ■

Please see Disclaimer section for full disclosure.

All **11 subsectors** in Canada are forecast to grow in **2025** compared to 2024.

Source: Bloomberg LP as of November 11, 2024.

EQUITIES

U.S. Equities: A Mixed Bag of Opportunity and Risk

Auritro Kundu, Portfolio Manager, AGF Investments

2025 returns look positive, but may be subject to potentially significant shifts in the macro backdrop.

As we look ahead to 2025, several key factors will shape the U.S. investment landscape, particularly considering recent political developments and economic indicators. The reduction in political uncertainty, especially following the convincing outcome of the U.S. presidential election, is expected to drive positive year-end returns that could spill into the new year. Furthermore, the perceived shift towards a more business-friendly administration has sparked optimism in U.S. equity markets, with the S&P 500 Index surging to new all-time highs, led by small caps and financials.

Resilient economic growth data and more expected rate cuts by the U.S. Federal Reserve (Fed) further contribute to the healthy near-term outlook for U.S. stocks. Real GDP grew by 2.8% annualized in the third quarter, with solid contributions from consumer spending, business fixed investment and government spending (particularly on national defence). The Atlanta Federal Reserve's GDPNow tool shows expansion slowing just a little in Q4, with the disinflation trend remaining intact. Meanwhile, the latest Federal Open Market Committee update suggested further rate cuts are likely forthcoming, but that their pace and timing were dependent on incoming data. Fed Chair Jerome Powell also outlined that interim data have been stronger than expected in the aggregate and downside risks have diminished.

We see several areas of opportunity in this evolving climate:

Small caps: Small-cap stocks are poised for the potential of significant gain even after, in the wake of the election, notching their largest weekly gain since the COVID-19 pandemic. The Russell 2000 index is expected to continue outperforming. Small caps typically thrive in environments where the Fed cuts rates, and with moderating inflation and easing financial conditions, we believe this sector is well-positioned for growth.

Financials: Post-election, we saw a massive rally in financials, likely tied to anticipated de-regulation. The outlook for corporate mergers and acquisitions (M&A) and initial public offerings (IPO) activity is optimistic, as policy uncertainty is expected to decrease. The incoming administration may adopt a more lenient regulatory approach, enhancing CEO confidence, which is crucial for M&A engagement. Additionally, IPO activity is anticipated to recover, reflecting a more favorable macro environment.

Industrials: The industrial sector is poised for significant growth, particularly as domestic manufacturing gains momentum amid potential tariff increases. Key trends such as re-shoring and deglobalization, the transformation of data centres driven by generative AI, and the modernization of the grid for sustainability are all contributing factors. Additionally, the U.S. has seen substantial underinvestment in its fixed asset base since China joined the WTO in 2000. Together, these elements create a perfect storm of opportunities for the industrial sector to excel.

Technology, communication services and biotech: Companies in these sectors may benefit from increased investment and consumer spending. The focus on software and biotech also presents substantial opportunities, as these areas are expected to see robust growth driven by innovation and demand.

Modernization of defence spending: Trump's focus on the military is expected to continue, requiring funding. Despite prior promises to cut the Department of Defense budget, his first budget in FY2018 saw the largest procurement increase since 9/11. On the other hand, efficiency pushes on government spending, like those suggested by Elon Musk, could disrupt norms. In that world, companies tied to modernization spending may benefit, with Bank of America (BofA) Global Research predicting a 10% compound annual growth rate (CAGR) in defence budgets through 2027.

Of course, opportunities rarely if ever come without risks, and we see several potential challenges on the horizon. One is interest rate sensitivity. The recent climb in U.S. 10-year Treasury yields from 3.62% to 4.42% underscores the need for vigilance as the Fed continues to navigate its monetary policy. A sharp increase in yields could dampen stock price rallies. Historically, significant rises in yields have correlated with declines in U.S. equity prices.

Another area of concern is that Trump's promised tariff regime will create a downside risk to corporate earnings. According to Goldman Sachs, the new administration might implement an average 20-percentage-point increase in tariffs on imports from China, with a 40% chance of a 10%-20%

blanket tariff, which Trump proposed during the campaign. While companies managed to pass tariff costs on to consumers during the 2018-2019 trade conflict, this could change. Tariffs may still lower earnings due to reduced consumer spending, retaliatory tariffs on U.S. exports, and heightened uncertainty.

The reduction in political uncertainty and anticipated economic growth provide a solid foundation for stock market gains, particularly in small caps, financials and industrials.

Meanwhile, pressures may build in the U.S. housing market. If interest rates rise, that could hinder a rebound in 2025. While the Trump administration may implement supply-side solutions to improve housing affordability, the overall impact of tariffs on homebuilders remains uncertain. Some companies seem well-positioned to potentially benefit from policies favouring higher-income buyers, but the broader market may still struggle.

Finally, the Republicans' electoral victory casts renewable energy policy into uncertainty. The Republican sweep could jeopardize tax credits associated with President Joe Biden's Inflation Reduction Act, leading to downgrades in clean energy stocks. The outlook for onshore and offshore wind projects may also become less favorable, impacting companies reliant on these sectors.

In short, the 2025 outlook for U.S. equities presents a mixed bag of opportunities and challenges that are subject to potentially significant shifts in the macro backdrop as the year progresses. The reduction in political uncertainty and anticipated economic growth provide a solid foundation for stock market gains, particularly in small caps, financials and industrials. However, potentially higher interest rates, risks to earnings from tariffs, and housing market challenges mean that caution may be warranted. In our view, investors should remain agile, focusing on sectors poised for growth while being mindful of the broader economic landscape and the possibility that market leaders can quickly become laggards and vice versa in the current environment. ■

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Could European Equities Catch Up in 2025?

Richard McGrath, Portfolio Advisor, AGF Investments

Improving fundamentals and attractive valuations may lead to better performance relative to U.S. counterparts.

European equities have played second fiddle to the U.S. for years now. While the S&P 500 Index's new highs just seem to provide support for the next step up, Europe's all-time highs seem to act as glass ceilings or anchors. Even this year, with the S&P 500 up more than 20% to the end of October, the comparable STOXX Europe 600 Index is struggling to get to double-digit returns.

Several factors have driven the STOXX Europe 600's historical underperformance, namely, sluggish economic and earnings growth, as well as political volatility. Weak demand and macro uncertainty have created a severe lack of confidence. All those factors are well understood and seem to be reflected in equity valuations. The S&P 500 forward price-to-earnings ratio now stands at 22, compared with 13 in the STOXX Europe 600 Index . That represents a 40% discount – a multi-decade low for European stocks' comparative valuation, even after adjusting for sector differences between the two equity markets.

The headwinds look set to ease into 2025, however, providing a more positive backdrop for the region. Lower oil prices will keep energy prices and inflation down. The European Central Bank has cut interest rates three times already from the highs, which could support economic growth. Unemployment remains low and China is starting to accelerate, which is important for European exports. We expect these tailwinds

should provide a boost to economic growth and help to narrow the gap between Europe and the U.S., especially if, as expected, the American economy begins to slow.

It's a similar picture with corporate earnings. There is no denying that earnings performance in Europe for 2024 will be poor, with average expectations around the low- to mid-single digit levels. Next year, however, European earnings are expected to see growth rates approach the 10% levels, helped by the lower base, while the U.S. is expected to see earnings growth slow to around 15%. So, Europe may continue to lag, but by less than in 2024.

Value Gap

Forward price-to-earnings ratio

S&P 500 Index

22

STOXX Europe 600 Index

13

represents a 40% discount

Source: Bloomberg LP as of October 31, 2024. One cannot invest directly in an index.

One negative for Europe going into 2025 is the deficit reduction programs being forced on several countries, for example Italy and France. Under the European Union's Growth and Stability Pact, any country running an excessive deficit needs to show the parliament how it plans to pare it to 3% of gross domestic product (GDP). Meanwhile, the new Labour government in the United Kingdom introduced a "tough love" budget of its own. Lower government spending and higher taxes could adversely effect both economic growth and corporate profitability – a headwind for European equity valuations relative to the U.S., where president-elect Donald Trump is likely to expand an already sizable budget deficit. At least for now, the equity market is reacting negatively to Europe's fiscal conservatism, despite the balance sheet strength this might create over the long term, and focusing on the potential short-term growth benefits on offer in the U.S.

Meanwhile, the political gains of far right and far left parties across the continent – especially in Germany, Austria and the European parliamentary election in France – have made headlines this year. Each country's extremist parties promote slightly different agendas, but they can be summed up as being anti-immigration and focused on cultural protectionism. For the moment, the incumbent centrist parties retain power, and the new European Parliament and Commission, which will be in place by the end of the year, seems prepared to bend to the wishes of the people and begin to look for ways to ease populist concerns. It will also focus on adopting Mario Draghi's report on European competitiveness through focusing on economic growth and productivity, but also by also "preserving our values of equity and social inclusion."

The lack of confidence in Europe has not only translated into stock price underperformance, but also low levels of ownership. Equity investors are net short Europe and are at near maximum overweight positions in the U.S. The U.S. presidential election seemed to exacerbate this trend, as the Trump victory and his promised trade tariffs gave investors yet another reason to lighten up their weighting in Europe.

That said, much of the potential bad news for European stocks has clearly been priced into the equity market already. European stocks have under-performed, they are cheap, their fundamentals are improving, and Europe's governments are trying to fix imbalances in the system.

No doubt, Europe has a substantial amount of work to do, and it will not fix all its problems in 2025. But the old adage that "things are always darkest before the dawn" seems to be a fitting one here. ■

Please see Disclaimer section for full disclosure.

The 4Rs of Japan's Equity Market Resurgence

Stephen Way, SVP, Head of Global & Emerging Markets Equities, Portfolio Manager, AGF Investments

Why Japanese stocks may offer compelling potential for meaningful returns in 2025 and beyond.

In 2024, the Bank of Japan (BoJ) raised interest rates for the first time in over a decade, signaling a significant shift in monetary policy. Japanese equities responded positively, reaching new highs as investors anticipated that the driver of the BoJ rate hike – the strongest Japanese wage gains in years – would boost consumer spending and economic activity. Government support for wage increases has been central to the government's economic strategy, and the interplay between tighter monetary policy, wage growth and political backing has created a pivotal moment for Japan's economy, raising hopes for long-term stability and growth.

The economic rebound is being driven by a shift from deflation to reflation, marking a dramatic transformation after years of sluggish growth. For much of the past two decades, deflation stifled wage growth, consumer spending and overall economic activity. However, we believe the current environment is markedly different, as rising wages, increased inflation expectations and improved corporate pricing power support a more robust economic backdrop. Companies are now able to pass on rising costs to consumers, which is enhancing profitability. Goldman Sachs forecasts strong earnings growth for the Tokyo Stock Price Index (TOPIX), projecting earnings per share growth of 8%, 9% and 7% for fiscal years 2024, 2025 and 2026, respectively, assuming a yen/USD exchange rate of 150.

The Bank of Japan is expected to continue its path of gradual interest rate hikes towards its goal of normalizing the ultra-loose monetary policy that has been in place for years. Real interest rates should remain negative, however, maintaining a stimulative environment. This supportive monetary stance is likely to continue encouraging economic growth and corporate profitability.

One potential risk to this positive outlook is the possibility that U.S. president-elect Donald Trump makes good on his

campaign promise to impose a 10% tariff on all imported goods. Such a tariff could negatively impact Japan's economy, adding a layer of uncertainty to the outlook. Despite this risk, Japan's economic fundamentals appear strong, and the correlation between the yen and Japanese equities has weakened. Corporate earnings and structural reforms now play a more pivotal role in driving stock performance. We will closely monitor this transition from deflation to reflation as it unfolds.

Companies are now able to pass on rising costs to consumers, which is enhancing profitability.

Japan's market is underpinned by the 4Rs: reform, restructuring, reflation and reshoring. Government reforms are enhancing corporate governance and labour flexibility, while corporate restructuring is boosting profitability and efficiency. Reflationary trends support earnings growth, and reshoring is driving domestic job creation. These structural positives are improving Japan's global competitiveness and addressing economic challenges. Following losses in the lower house election, the Liberal Democratic Party (LDP) is expected to form a broader coalition with the Democratic Party (DPP), potentially leading to a supplementary budget exceeding last year's 13.2 trillion yen. This increased spending is anticipated to stimulate economic growth and enhance investor confidence in the short term.

The 4Rs of Japan's Equity Market Resurgence

Reform Restructuring Reflation Reshoring

One of the most compelling aspects of the Japanese equity market is its attractive valuation, particularly when compared to global peers like U.S. equities. Despite a strong rally this year, it is our contention that Japanese stocks remain undervalued and that the structural changes noted above are now gradually shifting investor sentiment. This virtuous cycle is creating a more dynamic and growth-oriented environment for investors.

A key driver of opportunity in Japan's equity market is the relatively low investor positioning. Despite the ongoing rally in Japanese stocks, investor interest remains subdued compared to markets like the U.S. This underexposure suggests Japan could see increasing inflows, particularly as global investors seek to diversify into less crowded, more compelling markets. Additionally, cash and deposits held by Japanese households still account more than half of total financial assets, significantly higher than the U.S., where cash and deposits account for barely 13%. Japan's elevated cash holdings were largely driven by the deflation, putting a large portion of household wealth on the sidelines. If reflation continues, it presents the potential future capital deployment into equities and other investments.

As investor confidence grows and if more capital flows in, Japan's equity market could see further upside. A surge in shareholder activism has also led to greater engagement and positive developments within companies. Moreover, share buybacks through the first 10 months of 2024 surpassed the total for all of 2023, reflecting growing corporate confidence and a favorable outlook for shareholder returns. With these dynamics in play, Japanese equities offer compelling potential for meaningful returns in 2025 and beyond. ■

Please see Disclaimer section for full disclosure.

EQUITIES

How Will Emerging Markets Stocks Fare if Global Trade is Disrupted?

Regina Chi, VP, Portfolio Manager, AGF Investments

A focus on regions with strong economic growth and supportive reforms may help navigate opportunities and risks inherent in developing economies.

The return of Donald Trump to the White House in 2025, often referred to as "Trump 2.0," is likely to bring renewed disruptions to China and Emerging Markets (EM). Trump's promised trade policies, including proposals for across-the-board tariffs of 10 to 20% and a specific 60% tariff on Chinese goods, could lead to significant volatility in global supply chains. Such measures could heavily impact China's export-oriented economy, potentially leading to further shifts in production to other countries. Emerging markets that are closely linked to China through trade or investment may also face adverse effects from these disruptions. At the very least, Trump's more protectionist and confrontational approach towards trade could exacerbate economic uncertainty, affecting investor confidence in both China and other EMs.

This scenario, however, might not provide a complete roadmap to the evolving landscape for Emerging Markets next year. The trade tensions between the U.S. and China during 2018-2019 provide potentially valuable insights into how EM's might navigate future challenges. Despite the imposition of tariffs during Trump's first term, China's export sector demonstrated resilience by redirecting trade flows towards other global markets, particularly within emerging regions. China is now less reliant on access to American markets compared to the last time Trump escalated tariffs.

The wave of American import duties that began under the Trump administration in 2018 and continued under Biden eventually impacted roughly US$400 billion in Chinese goods. In response, Chinese factories shifted their focus to customers in Southeast Asia and Latin America. Over the past six years, China's share of U.S. imports has fallen from 20% to 13%, according to TS Lombard, an investment research firm in London. This adaptability suggests that EMs might be able to mitigate some adverse effects of trade disputes through diversification and strategic partnerships.

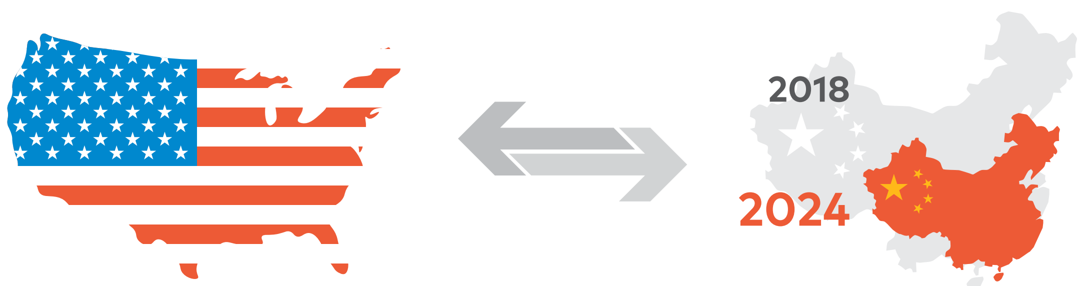
Importantly, the U.S.-China playbook may not follow the same path this time. First, the impact on global and Chinese corporate confidence might not be as significant compared to 2018-2019, as U.S.-China trade tensions have now persisted for seven years. Second, a new round of tariffs on China may generate less revenue, given China's already reduced share of U.S. imports. The U.S. trade deficit with China has also narrowed since 2018, with China's share of the trade deficit dropping from 50% to 25%. This suggests that tariffs on Chinese imports will have a more limited effect on the overall U.S. trade deficit.

Additionally, unlike during Trump's first term, when nearly two years were spent in tit-for-tat negotiations, trade talks could begin right away. China may also opt to de-escalate sooner and pursue a deal, given its weaker economic position as it attempts to stimulate its domestic economy and avoid a deflationary spiral.

Meanwhile, China is actively implementing measures to stimulate its economy and encourage growth. These efforts aim to support local government and boost confidence, potentially leading to sustained economic expansion. China has been striving for greater self-sufficiency, particularly in key sectors such as technology, energy and agriculture, out of a desire to reduce dependence on foreign imports and mitigate risks associated with global trade disruptions. By investing heavily in research and development, encouraging domestic production and supporting local industries, China aims to create a more resilient economy capable of sustaining growth independently of external influences.

Outside of China, several other emerging markets bear watching. For example, India is experiencing strong economic development fuelled by government investments in infrastructure and a supportive business environment. Growing corporate profitability, reduced debt levels and strong local investor interest, as well as increasing domestic demand, are also contributing to the positive outlook. India's ability to

The U.S. trade deficit with China has narrowed **since 2018**, with China's share of the trade deficit dropping from **50% to 25%**.



Source: Econovis as of September 7 2024

capitalize on its demographic dividend, with a young and growing population, further enhances its growth potential and attractiveness to foreign investors. It might also benefit from any heightening of U.S.-China trade tensions: the country is positioning itself as an alternative to China in global supply chains, particularly in the manufacturing and technology sectors, which could lead to significant economic gains in the coming years.

South Africa, meanwhile, has seen some positive developments recently, including the formation of a Government of National Unity (GNU) and the prospect of economic reforms and improvements. While political risks persist, there is hope that new policies will support growth and create opportunities for investment. The focus on infrastructure development and addressing social inequality could be a positive step towards creating a more stable business environment. Investors may find value in South Africa's efforts to stabilize its economy and implement growth-oriented reforms, despite ongoing challenges.

In Latin America, Brazil's central bank has taken a measured approach to managing the economy, which has helped maintain stability and could allow businesses to thrive despite existing political and fiscal challenges. A renewed focus on fiscal discipline and structural reforms, along with an increase in domestic demand, could help Brazil sustain its economic recovery and attract more foreign investment.

In general, the outlook for Emerging Markets presents both opportunities and challenges, but the potential for growth is clear even under Trump 2.0. China will continue to strive for self-sufficiency, India is well-positioned for continued expansion, while South Africa offers long-term opportunities despite short-term hurdles. Investors are encouraged to focus on regions with strong economic growth and supportive reforms, while being mindful of the inherent risks of investing in developing economies. A diversified approach can help manage these risks and capture the growth potential that Emerging Markets offer, particularly in places where government policies and economic initiatives are driving positive change. ■

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FIXED INCOME

Why We're Optimistic About Government Bonds Heading into the New Year

Jean-Sébastien Nadeau, Portfolio Manager, AGF Investments

On balance, our view is that the interest rate environment in the U.S. and Canada may continue to offer an attractive risk/return profile for investors in government bonds.

The financial markets' reaction to Donald Trump's U.S. presidential election victory on November 5 went pretty much according to script: risk assets such as equities and cryptocurrency responded positively to his anticipated pro-business policies, and U.S. bonds sold off, at least initially. On the surface, that looked like a replay of 2016 after Trump won the first time around, and it fed into the apparently accepted wisdom that the incoming administration's policies will mean "more of the same" for investors – robust stock markets, but a lot of upward pressure on interest rates (rates).

That assumption might not play out quite as expected, at least regarding rates. Indeed, our base case is that possible shifts in U.S. rates may be moderate next year, albeit with downside risk likely outweighing upside potential in the process. As for Canada, despite the supposedly inflationary impact of Trump's policies on the global economy, we do not see the Bank of Canada diverting from its current easing course. Yes, there are risks to this outlook, but on balance our view is that the rate environment – in the U.S. and Canada, in particular – may continue to offer an attractive risk/return profile for investors

in government bonds.

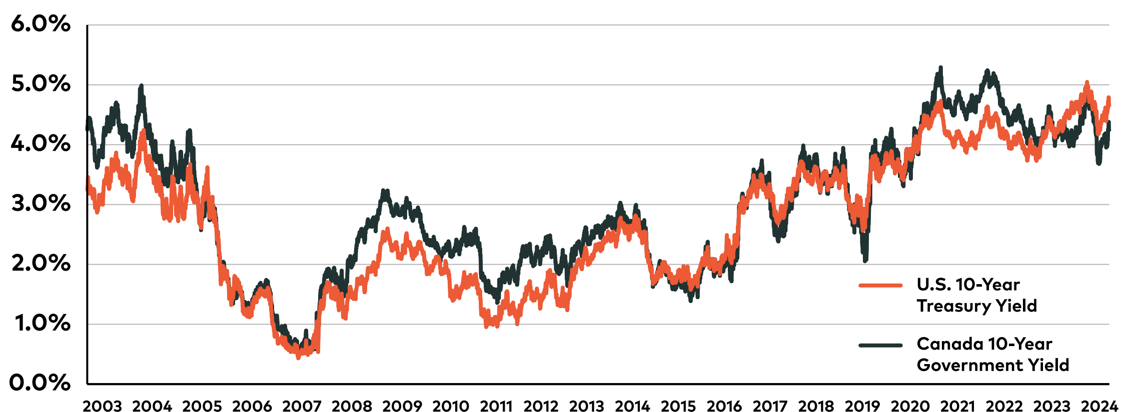
There are several reasons why the U.S. rate environment under Trump could be different this time around. First, unlike in 2016, the U.S. Federal Reserve (Fed) is now in a cutting cycle rather than a hiking cycle. Eight years ago, the Fed was trying to gradually normalize monetary policy after years of near-zero rates in response to the 2008 global financial crisis. Since September 2024, however, the Fed has been easing and we expect the U.S. central bank to maintain its current policy path until there is more clarity regarding Trump's potential policies and they are enacted by the new administration.

Second, unlike in 2016, Trump's victory in 2024 was not a complete surprise, meaning that the market had already largely priced in the likelihood of his win. For instance, yields on the 10-year U.S. government bond had already risen nearly 70 basis points ahead of this election, whereas they increased by just over 80 basis points following Donald Trump's 2016 victory.

Finally, the new administration's assumed lack of fiscal discipline may not turn out to be as severe as anticipated. It's uncertain that the Trump Republicans' policies will result in larger deficits than those of Democrats, who have run deficits higher than 5% of GDP since the beginning of 2023 even with the economy near full employment. Furthermore, the market has focused primarily on Trump's tax cut plans, but it has largely overlooked potential spending cuts. While a Republican sweep is generally perceived as likely to increase the deficit, we believe that a Republican Party (GOP)-controlled Congress would make it easier for the administration to implement cost-cutting measures alongside tax cuts.

For those reasons, we do not anticipate rates to rise as sharply as they did in 2016 and 2017 after Trump's first election. Generally, the 10-year U.S. government bond yield appears fairly valued for 2025. Fed projections suggest its rate will drop to 3.375% by the end of 2025 and to 2.875% by the end of 2026, contrasting sharply with the U.S. market's expected terminal rate of closer to 3.75%. Assuming the market's rate pricing turns out to be the better estimate, along with a positive 50-basis-point term premium (reflecting an upward-sloping curve by the end of the easing cycle), the 10-year yield would end the cycle around 4.25% – roughly aligned with current levels. But given the Fed's own expectation of more aggressive cuts than the market projects, we see additional downside risk to this forecast for 2025.

Government Bond Yields Near Their 20 Year Highs



Source: Bloomberg LP as of November 27, 2024

The primary risks to our outlook stem from potential tariffs and immigration policies. Should Trump impose duties on all foreign goods (including tariffs of 25% on Canada and Mexico and 60% or more on Chinese imports), we believe it could drive renewed U.S. inflationary pressure. Similarly, large-scale deportations could tighten the labour supply, likely driving up wages and, consequently, inflation. In either scenario, elevated inflation could prompt the Fed to reduce rates less than anticipated, resulting in an upward shift across the yield curve.

But what about Canada? Clearly, its economic landscape contrasts sharply with that of the U.S. Real GDP growth in Canada has remained below 2% since early 2023, while the U.S. growth rate was closer to 2.5%. Additionally, Canada's year-over-year inflation was 1.6% in September (or 1% excluding mortgage interest costs), whereas U.S. inflation remains above the Fed's 2% target. At 6.5%, Canada's unemployment rate is now well above the non-accelerating rate of inflation, or NAIRU – the minimum level of unemployment to spark inflation; in the U.S., unemployment is running at a much lower 4.1%. As a result, we anticipate the Bank of Canada will proceed with aggressive rate cuts in 2025, further driving down government yields.

Given our relatively optimistic outlook on rate trends, we remain positive on fixed income headed into 2025. Government bond yields across the curve, in both Canada and the U.S., are at levels near their highest in the past 20 years. We believe this environment may allow fixed income markets to generate substantial income for investors, meaning that any potential capital losses could be at least partially mitigated by income generation – a potential balanced risk-return profile illustrated.

Second, and importantly, we see fixed income as an effective hedge for equity exposure. After significant negative returns in both global equities and bonds in 2022, some questioned the relevance of the 60/40 portfolio. However, with inflation now below 3% in most developed markets, including the U.S. and Canada, we believe the inverse correlation between bonds and equities could return. ■

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FIXED INCOME

The Case for Credit Markets

Andy Kochar, Vice President, Portfolio Manager, Head of Global Credit, AGF Investments

A focus on the income attributes of credit instruments over their capital preservation attributes could make sense for investors in 2025.

The post-pandemic experience can be broadly summarized in one phrase: "Interest rate risk." This one factor explains much of the performance of a variety of asset classes in the world of fixed income. Credit categories that have exhibited higher degrees of interest rate sensitivity have underperformed; instruments that have commanded lower interest rate risk and higher income levels have done relatively better. This is not a short-term phenomenon, but one that has continued post-pandemic, regardless of prevailing narratives in the market that have oscillated between "lower for longer," "higher for longer," "growth scare" and "overheating." The uncertainty of the macro environment has been consistently overcome by the certainty of income.

It is widely known that fixed income, generally speaking, serves a dual role in a client's portfolio: income generation and capital preservation. In this era of "higher rates for longer," we believe it makes a lot of sense for investors to focus on the income attributes of credit instruments over their capital preservation attributes. Thanks to central banks, especially the U.S. Federal Reserve (Fed), lifting from near-zero interest rates and hitting a Fed funds rate of 5.5% at its peak, the structural case for income generation potential is better post-pandemic than it was in the prior decade. We are in a new paradigm, where investors are finally getting paid to take credit risk in their portfolios. These factors have been with us for the past three years and we expect it will likely continue next year.

U.S. Fixed Income Index Returns

Fixed Income Category	03/23-2020	2021	2022	2023	2024 TYD	Compound Annual Growth Rate
S&P U.S. Treasury Bond Current 10-Year Index	-0.50%	-3.60%	-16.30%	3.20%	0.00%	-3.20%
Bloomberg US Corporate Total Return Index Value Unhedged USD	22.00%	-1.00%	-15.80%	8.50%	2.30%	2.70%
JP Morgan Emerging Markets Bond Index	22.90%	-1.60%	-15.30%	9.10%	5.60%	4.40%
Bloomberg US Corporate High Yield Total Return Index Value Unhedged USD	33.50%	5.30%	-11.20%	13.50%	7.50%	9.50%
The Credit Suisse Leveraged Loan Index	28.10%	5.40%	-1.10%	13.00%	7.50%	11.10%

Source: Bloomberg LP as of October 31, 2024. One cannot invest in an index. **Past performance is not indicative of future results.**

Notwithstanding the current easing from central banks, we believe it is unlikely that rates go back to or approach near-zero this cycle. This bodes well for income as a dominant source of returns for fixed income investors on a more secular basis.

Combined with the income attributes of this asset class, there are technical considerations that could continue to favour corporate credit over conventional government bonds. Corporate balance sheets are fundamentally healthy, the economy continues to benefit from relatively supportive fiscal and monetary policy, and financial conditions remain benign. Another supportive technical factor has been the rise of private credit markets, which have been slowly taking share from public markets. The result: moderated growth in the available stock of debt. In other words, supply of public credit continues to be outweighed by demand as the private markets take marginal issuers from our markets. This is potentially bullish for public credit markets.

We hold a particularly optimistic view on the high-yield and syndicated bank loan markets. The significant repricing of coupons post-pandemic has enhanced the income component of their total return profiles, especially for asset classes with relatively low duration. This means investors could enjoy substantial upside potential without sacrificing much on the downside. Additionally, lower interest rate volatility suggests a smoother ride for bond investors, with reduced return volatility.

The relatively inflationary economic outlook favours commodities and, by extension, asset classes such as high yield. Moreover, with corporate balance sheets flush with cash, companies are continuing to deleverage, reducing their need for external financing to cover expenses such as capital expenditures and buybacks. In this higher interest rate environment, companies have demonstrated greater discipline in their debt financing practices.

While our outlook on the asset class is generally bullish, we are highly attuned to the risks that 2025 may bring along. We are specially focused on the fiscal uncertainty injected into global credit markets following the U.S. election. If that leads to a repricing of interest rate risk higher, it could dampen credit returns, especially in markets such as investment grade credit. Furthermore, a second wave of inflation, if realized, has the potential to impact certain cyclically sensitive segments of the credit market. ■

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FIXED INCOME

EM Bonds: Restructured and Ready for Select Returns in 2025?

Tristan Sones, VP, Portfolio Manager, Co-Head of Fixed Income, AGF Investments

The overall tone towards lower-rated Emerging Market debt has been helped by the tailwind of a broader risk-on sentiment.

One of the key opportunity sets (and risks) for investors in Emerging Market bonds over the past few years has been sovereign restructurings undertaken by developing countries swimming in debt. Prior to the pandemic, many Emerging Market (EM) sovereigns took advantage of low rates by loading up on cheap debt, only to face the harsh reality of ballooning servicing costs and, for some, the inability to pay when rates shot up after the pandemic. Typically, the restructuring process was long and drawn out, with many players both domestically and internationally vying to carve out the best possible outcome for themselves.

It's said that necessity is the mother of invention, and if there was one positive that came from the tumult of the recent post-pandemic years, it might be that a more robust approach to debt restructurings has emerged, sometimes incorporating tailored value recovery instruments, that could enable investors to recoup some or all of what they may have lost in the past. The perhaps better news is that, as 2024 comes to a close, many Emerging Market sovereign restructurings have come to an end as well, at least for this round.

In fact, many countries that were previously the worst U.S. Dollar-denominated EM sovereign bond performers are just coming out the other side and are near the top of the tables this year. The likes of Sri Lanka, Zambia and Ghana, for example, have helped high yield-rated countries beat their safer investment grade counterparts by more than fivefold. Even more stellar performers include countries that restructured their debt

a few years ago, but are still trying to cement their recovery – for instance, Argentina and Ecuador.

Are all these countries out of the woods from a debt perspective? Clearly, no. Yet the overall tone towards lower-rated Emerging Market debt has been helped by the tailwind of a broader risk-on sentiment. The U.S. Federal Reserve (Fed) finally starting to lower policy rates in September was instrumental in supporting this narrative, largely built on the hopes of more easing to come.

We believe focusing on countries that are just emerging from restructuring or that are experiencing an upswing in their domestic economy could also be good candidates as potential buffer zones from global trends.

Things didn't start out that way. As 2024 began, a more resilient than expected U.S. economy threw cold water on the size and scope of potential Fed easing. It did (finally) begin to ease, but today we are faced with a similar situation, where the U.S. economy is still the standout global growth driver. Now, global financial markets are once again grappling with how much further the Fed can ease or even if a pause might be in the cards.

Fed policy, as it always seems to be, will be a huge factor for EM bonds as we move into 2025. As important as the Fed is, however, we believe it may not be the biggest influencer of Emerging Market sentiment next year. Global financial markets are now digesting Donald Trump's presidential election victory and what a second Trump presidency could bring. Sentiment towards Emerging Market debt was already somewhat shaky in the run-up to the election, and the level of nervousness has only risen since then.

Much of the worry is on the trade front: who Trump will target, and what form of protectionism they will face. China is in the crosshairs again, having been a target during his first term. This time around, the focus could also turn to countries that are acting as go-betweens for Chinese goods entering the U.S. A prime example is Mexico, which has already been under pressure since a landslide election in the spring handed the incumbent party sweeping powers to implement desired reforms.

Countries tackling their own, more pronounced idiosyncratic risks may be somewhat removed from what is going on globally right now from both an economic and political perspective. Turkey, for one, has been a bright spot for investors as it is finally trying to tackle inflation in a more orthodox way. We believe focusing on countries that are just emerging from restructuring or that are experiencing an upswing in their domestic economy could also be good candidates as potential buffer zones from global trends.

Today's investing environment really stresses the need for a targeted focus on individual stories. However, even today's preferred trades could suffer tomorrow if the general risk tone on Emerging Market debt turns sour. If inflation fears return and make the Fed do an about-face on rates, all bets are off, and Trump's trade policies may have a big effect.

The recent batch of firmer U.S. economic data have markets nervous as they contemplate a slower pace to Fed easing. Should this occur, it would most likely dampen optimism around future cuts by Emerging Market central banks.

Emerging markets overall tend to be very influenced by the health of the global economy and we expect there would likely be big headwinds to this growth picture should a higher for longer rate narrative get reinforced again. ■

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FIXED INCOME

Currencies Strike Back

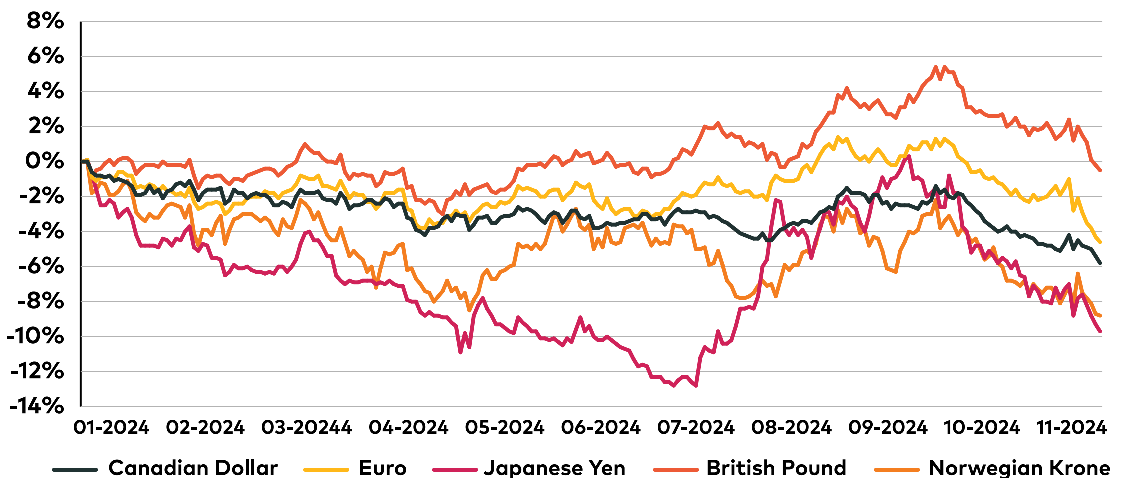
Tom Nakamura, VP and Portfolio Manager, Currency Strategy and Co-Head of Fixed Income, AGF Investments
Sherry Xu, Foreign Exchange Analyst, AGF Investments

There are reasons to believe the U.S dollar will appreciate in 2025 and reasons to believe it will not.

While there is never an easy year to forecast, 2025 might prove exceptionally difficult. The anticipation of the U.S. president-elect Donald Trump's new administration and the subsequent rollout of policies are likely to have profound impacts on currency markets.

The question is whether 2025, like a movie trailer with too many spoilers, will be predictable, or will it offer an unusually suspicious plot twist? Just as 2024 was a volatile year with varied results at many points in time, 2025 could be characterized as a movie that has three acts. In fact, at the time of this writing, we have already begun the first act.

Currencies had Significant Shifts in 2024



Source: Bloomberg LP as of November 14, 2024. **Past performance is not indicative of future results.**

Act I: Dollar days

In this act, the U.S. dollar (USD) is the protagonist and it is running strong. This act already started in late 2024, so maybe it's technically a prequel.

- Look for USD appreciation to multi-year highs.
- We believe Trump's mandate is strong, and he will push policies forward early and aggressively.
- Tariffs: As noted in AGF Investments Inc.'s recent U.S. election primer, studies suggest that tariffs tend to appreciate the currency of the country imposing the tariffs and weaken the currency impacted by tariffs.
- Inflation in the U.S. from looser fiscal policy and tariffs could truncate the U.S. Federal Reserve (Fed)'s rate cutting cycle, helping to boost the USD. The USD could remain the highest, or amongst the highest, carry currencies in the developed world, even as central banks likely need to continue lowering their rates.
- U.S. exceptionalism, from policies designed to keep investment in the U.S., draw foreign investments to the U.S.
- The trade agreement, United States-Mexico-Canada Agreement (USMCA), between Canada, Mexico and the U.S. may be revisited, putting currencies like our Canadian dollar under pressure.
- USD is still the dominant reserve currency.

Act II: We discover flaws

- USD retreats back to average levels seen in the past couple of years.
- Adoption of a weak USD policy: It is one thing to have a stable currency, or a modestly cheaper currency. Pursuing a weak USD policy could unravel confidence, quickly resulting in a sharp depreciation.
- Fiscal concerns: Like a character in a horror movie wandering out into the dark to investigate a noise, is the U.S. heading into a fiscal crisis? Markets know the risk. We know the risk. While a fiscal scare may prompt safe-haven flows and lead to USD strength, anything more damaging could seriously erode the reserve currency status of the USD.
- Tarnishing the reserve status: The points above contribute to an erosion of confidence in the U.S. Meddling with the Fed, or its mandate, could also cause damage. Overuse of tariffs could lead to the world fragmenting further away from reliance on the U.S.

ACT III: Into the darkness (coming not too soon...2025? 2026? In 15 years?)

In the absence of clarity on how long the first two acts last, we can look at some longer-run themes to focus on:

- Demographics suggest a slower growth rate of aggregate demand. But it also means a lower supply of labour. As the world ages, the propensity to consume declines. The working-age population shrinks compared to the general population, but also risks shrinking in absolute terms. Lower growth and higher inflation could be the result. Countries able to balance policies to support growth while limiting inflation could attract longer-term flows.
- In a world that is moving away from globalization, economic cycles are likely to be shorter and more volatile. A result of this is also likely to be structurally higher inflation with higher volatility. Central bank policymakers will raise rates to combat inflation, but their work might be complicated by the volatility. Interest rate-based strategies for currencies may become less reliable (but they could also become more rewarding). Steadier economies with decent real interest rates are likely to be more appealing for long-term investors.
- Demographics and de-globalization may both lead to strength in currencies with similar profiles. How 2025 unfolds may determine whether the USD benefits from these factors for years to come. ■

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SPECIALTY

The Rise and Rise of Dividend Stocks?

Stephen Duench, VP, Portfolio Manager, AGF Investments

Dividend growth stocks may get a relative boost if central banks cut interest rates to a lesser degree than expected in 2025.

For many investors, dividend-paying equities have taken a back seat in recent years to the high-flying growth potential of various secular theme stocks that generally don't pay dividends. But if history is any guide, investors should not forget about dividend payers. In fact, the long-term case for them is compelling: a dollar invested in the S&P 500 Index in 1927 without dividends reinvested would be worth $243 today, but the same dollar with dividends reinvested would be worth $3,737.

Thankfully, one may not need a hundred-year investment window to reap the potential upside in dividend stocks, and the nearer-term outlook seems to be improving. Already, in the second half of 2024, the global monetary easing cycle has generally led to lower bond yields, rendering fixed income less competitive to dividend payers. As well, the highest dividend paying companies in the market typically carry more leverage; declining bond yields help them better manage interest expense, supporting overall financial performance.

Looking ahead to next year, there is legitimate concern that rates might not come down as much as investors previously anticipated, particularly in the U.S. But central banks are still very likely to make at least some cuts, which could still be positive for dividend payers. At a minimum, the rate environment heading into 2025 is undoubtedly an improvement over the past few years.

There also may be an upside to rates not coming down as much as expected. If they don't, that likely means the economy is performing better than anticipated, which means we may have managed through an economic cycle without a significant slowdown or recession. If that happens, many of the more cyclical dividend payers could become even more attractive due to their business models potentially benefiting from any resurgence in global growth. These cyclical dividend payers are generally in sectors like Financials, Energy, selective Industrials, Consumer Discretionary and real estate investment trusts (REITs). Defensive dividend payers, by contrast, are in telecommunications, utilities and pipelines, for example. Importantly, the Canadian market has plenty of both cyclical and defensive dividend stocks.

If the prospect of a "no landing" or a "soft landing" for the economies, in both Canada and the U.S., becomes a reality and we do not get as many cuts as expected, the environment could become ripe for dividend growth, rather than dividend yield, as an investing theme. Companies that are increasing their dividends generally can do so because of the health of their business models, balance sheets and future earnings potential. These characteristics are obviously desirable, and the historical data shows that they are also rewarded by market participants. Dividend growers tend to outperform the rest of the market, with lower volatility.

Given this improving climate, it's no surprise that more and more companies are initiating dividends. Just a few years ago, it would be unthinkable that big tech companies would become dividend payers. But today the prospect pool for dividend stocks is clearly growing, and it is meeting an immense amount of capital that has been hedging interest rate risk by sitting in money market instruments. With short rates coming down, that capital will need to find a new home, and some will almost certainly flow into strong dividend-paying areas of the market. If it occurs, that trend would bode well for dividend stocks – and the investors who see their potential while others are focused on more trendy names. ■

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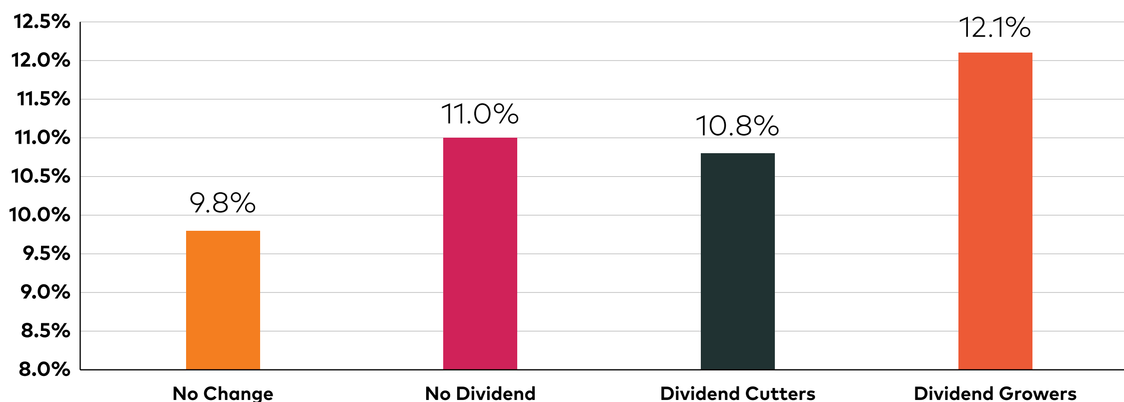
S&P 500 Index Annualized Returns for Different Types of Dividend Payers (January 1990 – August 2024)



Source: Strategas as of August 31, 2024. Based on S&P 500 Index constituents. Dividend cutters are companies that cut their dividend in any calendar year during the time frame noted. Dividend growers are companies that increased their dividend in any calendar year during the time frame noted. One cannot invest in an index. **Past performance is not indicative of future results**.

Why Sustainable Investing Can Overcome Increasing Political Turbulence

Martin Grosskopf, VP, Portfolio Manager, AGF Investments

The forces driving sustainable development, the energy transition and technological innovation are undeniable despite potential political or economic turbulence in the short term.

Our investment thesis is grounded in the belief that the shift toward sustainable development and the ongoing energy transition is not just inevitable, but still in its relatively early stages. This transition, driven by regulatory pressure and increasing societal demand for cleaner energy, is reshaping industries and creating long-term investment opportunities.

A key example of this shift is the projected impact of artificial intelligence (AI) on global energy demand. According to the International Energy Agency, data centres, cloud computing and AI-driven systems are expected to increase electricity demand by 3% annually, adding nearly 50 terawatt-hours of new demand by 2030. This surge is driven by the massive computing power

required to run large language models and complex algorithms. As AI continues to expand, renewable energy sources will become crucial to meeting demand. Solar energy, in particular, has become significantly more affordable, with costs dropping by 82% between 2010 and 2019, according to the International Renewable Energy Agency (IRENA). Advancements in solar technology would continue to make it a scalable and sustainable solution for growing energy demand. Additionally, innovations in battery storage and advanced cooling technologies will be critical in managing the energy demands of AI systems, positioning the renewable energy sector as a key beneficiary of this trend.

The transition to energy-efficient technologies, sustainable agriculture and circular economy practices should give rise to new industries and high-skill employment opportunities.

Looking ahead to the next five to 10 years, economic growth and job creation in sustainable development and the energy transition will likely be driven by the expansion of renewable energy infrastructure, electrification and the buildout of supply chains. Investments in solar, wind and battery storage are expected to create millions of new jobs in construction, manufacturing and maintenance. As global energy systems evolve, sectors like the electric vehicle market and green hydrogen technologies should also contribute to significant job creation in production, Research and Development and related industries. The transition to energy-efficient technologies, sustainable agriculture and circular economy practices should give rise to new industries and high-skill employment opportunities. These long-term trends will be supported by robust policy frameworks and rising long-term demand for clean energy globally, ensuring broad-based economic growth even amid geopolitical tensions or market fluctuations.

A major catalyst in this transformation is the U.S. Inflation Reduction Act (IRA), enacted in 2022, which has already sparked a transformative shift in clean energy investment. Nearly US$250 billion in investments have been made in alignment with IRA and Creating Helpful Incentives to Produce Semiconductor (CHIPS) Act credits. The real economic impact of these policies is particularly evident in certain sectors. For example, the IRA's emphasis on battery storage has allocated billions in tax credits for long-duration storage projects, which are crucial for stabilizing the grid, integrating renewable energy and creating jobs in energy storage technologies. As these technologies mature, they will play a critical role in addressing the intermittency of solar and wind power, enabling a more resilient and reliable energy system. The IRA also supports smart grid modernization, providing tax credits for deploying smart meters and upgrading grid infrastructure, helping optimize energy distribution and ensuring that the grid can handle increasing renewable energy inputs.

However, the IRA could face political risks in the future. President-elect Donald Trump has suggested that his administration might seek to repeal or scale back such investments, creating uncertainty about the longevity of IRA benefits. A reduction in IRA funding could disrupt momentum in sectors like clean energy, electric vehicles and infrastructure development. Despite this potential risk, certain aspects of the IRA – such as incentives for manufacturing and infrastructure – are likely to remain protected, even if broader provisions are

scaled back. For example, 18 Republican members of Congress have signed an open letter urging Speaker of the House Mike Johnson to prioritize business and market certainty, recognizing the importance of maintaining support for manufacturing and infrastructure.

Alongside the IRA, the CHIPS Act has incentivized semiconductor manufacturing, which has already driven nearly US$250 billion in private sector investments, reshaping the U.S. tech landscape. The CHIPS Act has spurred the construction of semiconductor plants, supporting job creation and economic reshoring, and reducing reliance on foreign supply chains. These efforts are critical for strengthening the U.S. economy, particularly in sectors like AI, clean energy and advanced technology, where semiconductor demand is expected to grow significantly. Together, the IRA and CHIPS Act are fostering economic resilience by diversifying critical industries and bolstering the U.S.'s competitive edge in the global market.

In short, despite potential political or economic turbulence in the short term, the forces driving sustainable development, the energy transition and technological innovation are undeniable. These trends will likely continue to create compelling investment opportunities, shape global industries and drive economic growth for decades to come. Investors who align their strategies with these transformative forces will likely be well-positioned to capitalize on the long-term opportunities created by the global shift to a more sustainable, energy-efficient and technology-driven future. ■

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Solar energy, in particular, has become significantly more affordable, with costs dropping by **82%** over the past decade.

Source: International Renewable Energy Agency as of June 2020. Data reflects cost improvements realized between 2010-2019.

SPECIALTY

If Growth Slows, What Happens to Real Assets?

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Richard Fisher, Senior Analyst, AGF Investments

Energy will remain a critical feature of the asset class.

The last 12 months have been a volatile period for real assets as markets adapted to rapidly evolving political and interest rate outlooks around the world. As we move on from the U.S elections and acutely watch the evolving political landscape in Europe and Asia, we believe the market is pivoting back to a "higher-for-longer" stance on interest rates and expectations for slowing global economic growth.

The incoming U.S. administration has made its initial policy intentions clear, with a focus on tariffs, immigration and taxes, all of which will have marked potential to be inflationary. Even before taking office, president-elect Donald Trump's announcement of cabinet selections has provided the U.S. market with greater clarity on the extent and likely intensity of the initiatives.

These policy developments are already reflected in the market, which is broadly reducing duration, leading flows back into quality companies with solid balance sheets and healthy dividends. We expect this broader rotation could support selective and cautious exposures to real assets going forward, because the impact will not be equally distributed across the class.

The explosion in demand for data centres has placed a renewed focus on the need for electrical energy availability and security.

The energy sector has been a critical feature of the real asset conversation over the last many years, and it will no doubt to be over the next year. But the focus within energy is shifting from oil to natural gas, and from upstream in the energy complex (that is, production and producers) to utilities and electrification. We believe the focus on oil will probably lessen; geopolitical risk has likely peaked, and supply is adequate to meet forecast moderate growth.

Meanwhile, the explosion in demand for data centres has placed a renewed focus on the need for electrical energy availability and security. This has been reflected initially in the nuclear power fleet, but it may be extended to the broader utilities market, including generation, transmission and interconnection. The trend could also stimulate rising demand for everything from real estate to cabling and electrical equipment.

Meeting this need for energy will create increasing demand not just for renewable energy generation, but also for existing fuel sources – notably, natural gas. Already, we are seeing balances in natural gas tighten and prices rising.

Of the broader basis of the U.S. policy initiative, whether one calls it "reshoring" or "onshoring" or "deglobalization," the net effect is the same: increased domestic industrial production will require commensurate increased demand on industrial real estate, construction and supply/logistics infrastructure. More broadly, in this investing environment of potentially slower global growth and higher rates, real assets may continue to provide a value-generating diversification tool for potentially stabilizing portfolio returns and mitigating market risks. ■

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It Takes a Tiger™

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