IG WEALTH MANAGEMENT

2025 MARKET OUTLOOK

Navigating the new, new normal

IG Investment Strategy Team

A look back at 2024

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It's rather easy to sum up 2024. "It exceeded expectations," is the most obvious way to put it. Even the most optimistic projections were well shy of the eye-catching gains investors experienced across equity and fixed income markets in 2024. Positive market surprises shouldn't come as too much of a shock though, as the markets have a way of making forecasting the year ahead a futile and frustrating exercise. The markets don't operate on a timeline dictated by forecasts, which is why we prefer to focus on the trends with any forecast, rather than try and hit the bullseye.

In our 2024 outlook, we asked, "What if it goes right?" We believed that many market participants were too pessimistic heading into the year and so focused on calling for a recession, they couldn't see the trees from the forest, as we put it a year ago. What we meant was that there were signs that things were improving within the U.S. and global economies, with equity valuations and bond yields also suggesting a better possible outcome to be the likelier path.

As we look back, the end result was indeed a better outcome (at least at the time of writing). Yes, there was hand-wringing along the way, given the global landscape that included tensions in the Middle East, the U.S. elections and the ongoing war in Ukraine, but none of this translated into any meaningful market volatility. The S&P 500 Index, for example, got through the first 10 months of the year without a dip greater than 8.5% (which happened between July 16 and August 5).

Inflation continued to fall, central banks initiated an easing cycle, economic growth held in, and corporate profits grew. Whether we want to call it a soft landing, a mid-cycle slowdown or a resumption of a normal economic cycle, 2024 will go down as a resilient year that rewarded the patient investor.

> *There are always opportunities; you just need to know where to find them.*
>
> *– Philip Petursson*

Looking ahead to 2025 and the new, new normal

Predicting the future is impossible. Preparing for the future is indispensable.

Shortly after the great financial crisis of 2008, the phrase “the new normal” started to pop up. The general premise was that the consequences of the great financial crisis would usher in long-term and somewhat permanent changes to consumer behaviour (in the form of less debt), the banking industry (tighter regulations and greater risk controls) and interest rates (lower for longer). Over the following 10 years through to the beginning of the COVID-19 pandemic, consumers reduced their debt (in the U.S. at least), banks de-risked, and interest rates did indeed remain at historic lows. In fact, the belief in the new normal of lower for longer for interest rates perhaps went too far, with US$17 trillion in negative-yielding debt globally.

Fast-forward to today, and there isn’t a single government bond with a negative yield. Today’s inflation and interest rate environment looks a lot like it did before the new normal. So, does that make the *new, new normal* simply *the old normal*? We are starting to think so.

We would argue that the post-COVID-19 economic environment will see inflation stabilizing closer to the 100-year average of 3%. With that view, we expect the Bank of Canada and U.S. Federal Reserve (the Fed) benchmark policy rates to average between a half and one percentage point above inflation, while 10-year government bond yields will range around two percentage points above inflation. In this prospective environment, lower for longer is no longer. What remains is a fixed income environment that boasts characteristics of higher yields that favour the fixed income investor.

Following two strong years of returns driven mainly by expanding valuations, equities in 2025 may demand a more selective approach. With valuations elevated, success this year could hinge on focusing on quality earnings and disciplined stock picking, rather than broad index performance. While the broader economic backdrop remains supportive, the key will be identifying sectors and regions where valuation aligns with the potential for sustainable growth. Investors should balance optimism with caution, as higher yields present an alternative that may pressure stock prices if earnings growth falls short of expectations.

Trends fade, but diversification is always in style. It’s a classic phrase but one that rarely fails to deliver. Given the economic, fixed income and equity backdrop for 2025, we believe diversification across asset classes, geographies, styles and size will remain investors’ best approach.

Five themes for 2025

Click on each theme for more information.

1. The global economy: moving in the right direction

In the new, new normal, which is a lot like the old normal, we see the global economy as advancing through 2025, but the pace of growth will differ by country and region. We believe the fundamentals of the U.S. economy remain stable, whereas Canada and Europe face challenges. China's performance will depend on its current stimulus efforts and its economy's reaction to it, which could be a boost to global growth if successful.

2. Central bank policy: finish what you started

Even though the fight against inflation has been won, central banks need to finish what they started. It will require a balance of economic priorities between price stability, unemployment and growth to bring policy rates to neutral.

3. Fixed income: navigating the old normal

As central banks do their part to lower short-term interest rates, government deficits and right-sized inflation will keep longer-term yields higher. Meanwhile, with spreads near 15-year lows, corporate bond investors may have crossed the line from confident to over-confident.

4. Equity markets: valuation always matters

Value in equities should be favoured where it can be found, be it security, sector or geography. In 2023 and 2024, equity returns were driven primarily by higher multiples and less so by earnings growth. We believe success in 2025 will come down to the right price for quality earnings. This suggests that returns may be less about the index and more about individual stock picking favouring value and a margin of safety.

5. Post-election: the unknown unknowns

Following the U.S. election, policy shifts in trade, taxation and regulation may bring both opportunities and uncertainties that could impact corporate profits and sector performance. However, history reminds us not to overinterpret these expectations, as sectors anticipated to benefit under certain administrations haven't always delivered market success.

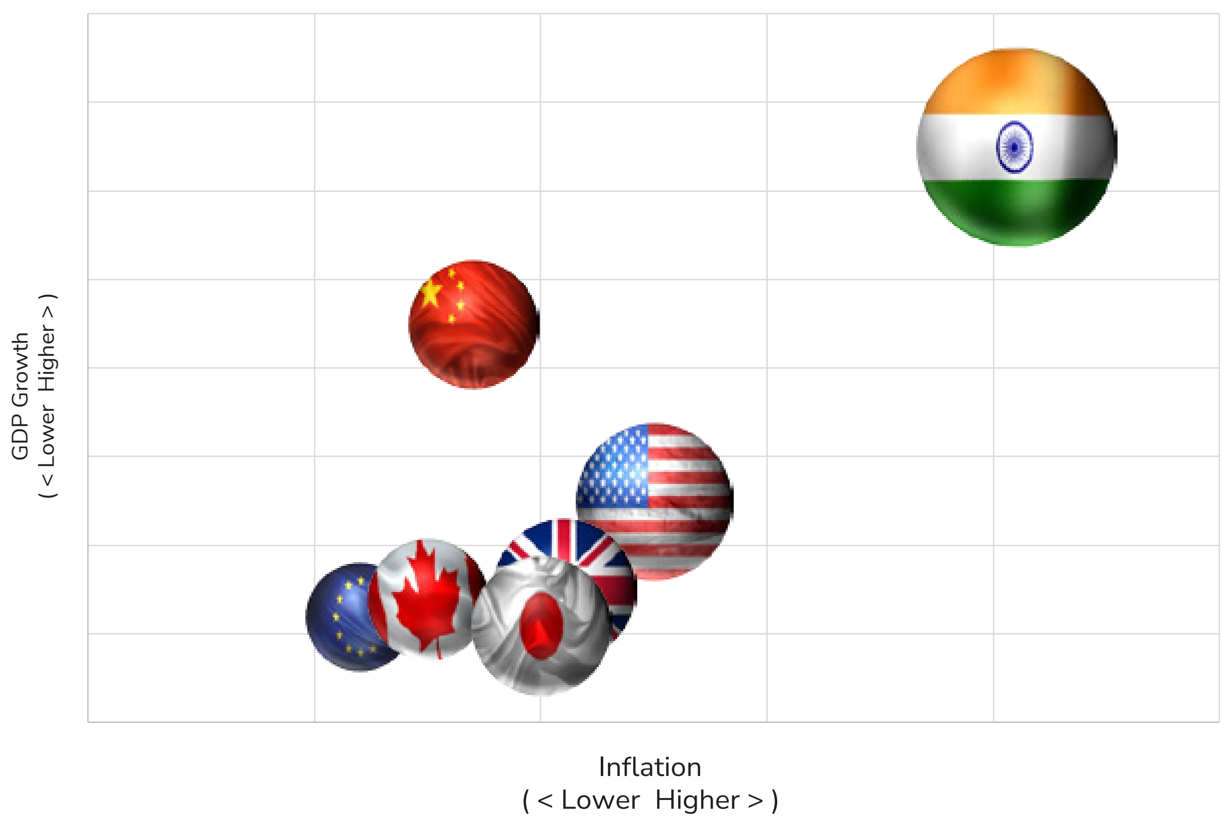
1. The global economy: moving in the right direction

We see the global economy as advancing through 2025, but the pace of growth will differ by country and region. We believe the fundamentals of the U.S. economy remain stable, whereas Canada and Europe face certain challenges. China's performance will depend on its current stimulus efforts and its economy's reaction to it. It could be a boost to global growth if successful.

Inflation has returned to normalized levels in most areas, while worries of a recession have eased. We wouldn't go so far as to say that we are in a Goldilocks economy, as challenges remain specific to each region. However, the trend for growth remains on the positive side and should be further supported by central bank policy.

Geopolitical risks remain, with military conflicts in the Middle East and Eastern Europe, alongside the aftermath of the U.S. elections. For the time being, these do not seem to bear any greater risk than what we saw in 2024. With lower recession risk, lower inflation risk and a general easing of monetary policy, the economic backdrop for 2025 is likely to be an early replay of 2024.

2025 gross domestic product (GDP) and inflation growth projections



Source: IMF October 2024 World Economic Outlook, IG Wealth Management assumptions.

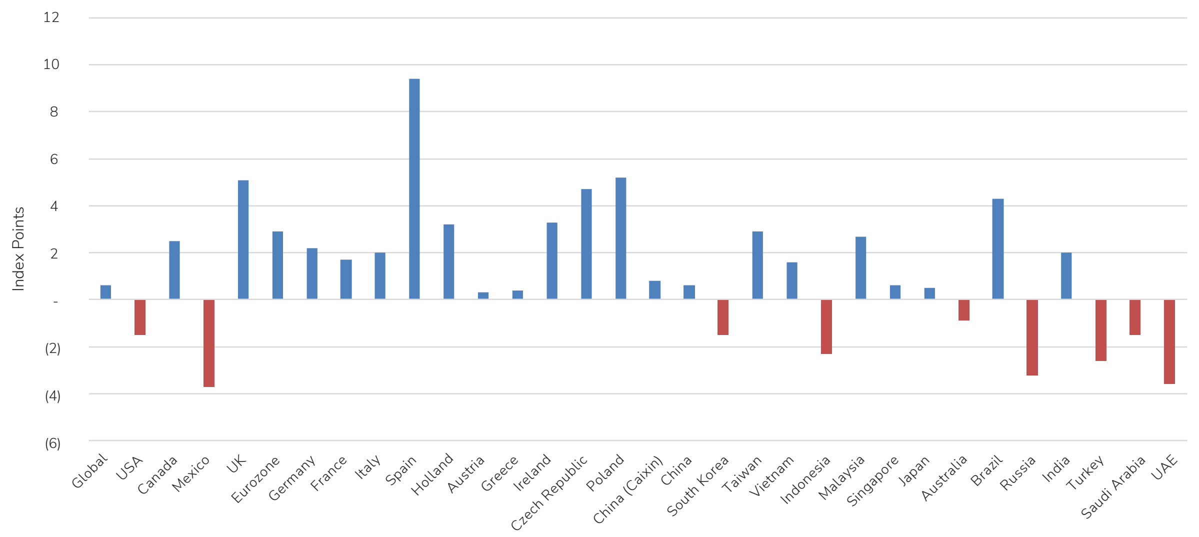
Global demand is showing signs of improvement

Global manufacturing and exports are two of the key indicators that we pay attention to with regards to the health and direction of the global economy and global corporate profits. Along with export activity, manufacturing activity tends to lead corporate earnings by three to six months. As measured by the regional purchasing managers' index, we have seen improvements in global manufacturing on a year-over-year basis when comparing the most recent results (October 2024) to those of a year ago. The weakness of 2023 gave way to improvement in 2024. Twenty-three of the 32 regions we follow showed improvement on a year-over-year basis. While short-term results are subject to volatility, the month-over-month data for October showed improvement in manufacturing activity for 21 out of the 32 regions we follow. We believe this positive trend will continue into 2025.

In addition to manufacturing activity, global exports also highlight demand; here too, we have seen improvement over 2023. And while the results for the five largest exporters oscillated through 2024, on aggregate, exports have shown year-over-year gains. This is an improvement over 2023 and continues to showcase a stabilizing global economy.

Global purchasing managers' index 2023-2024

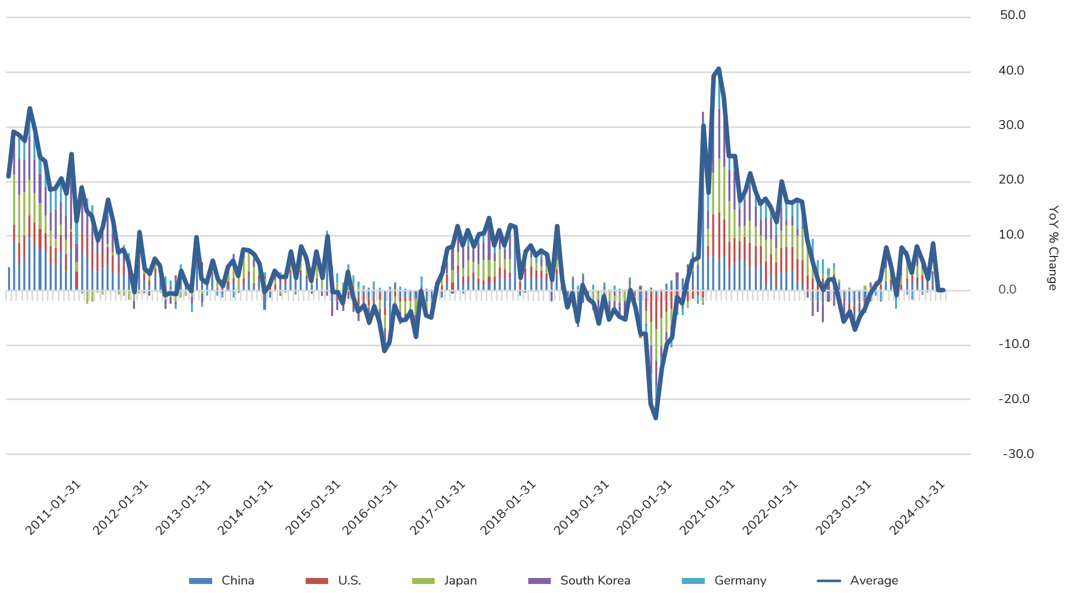
S&P Global PMI change year-over-year
October 2023-October 2024



Source: Bloomberg, IG Wealth Management as of October 2024.

Global exports 2010-2024

Global exports % change year-over-year
2010 to current



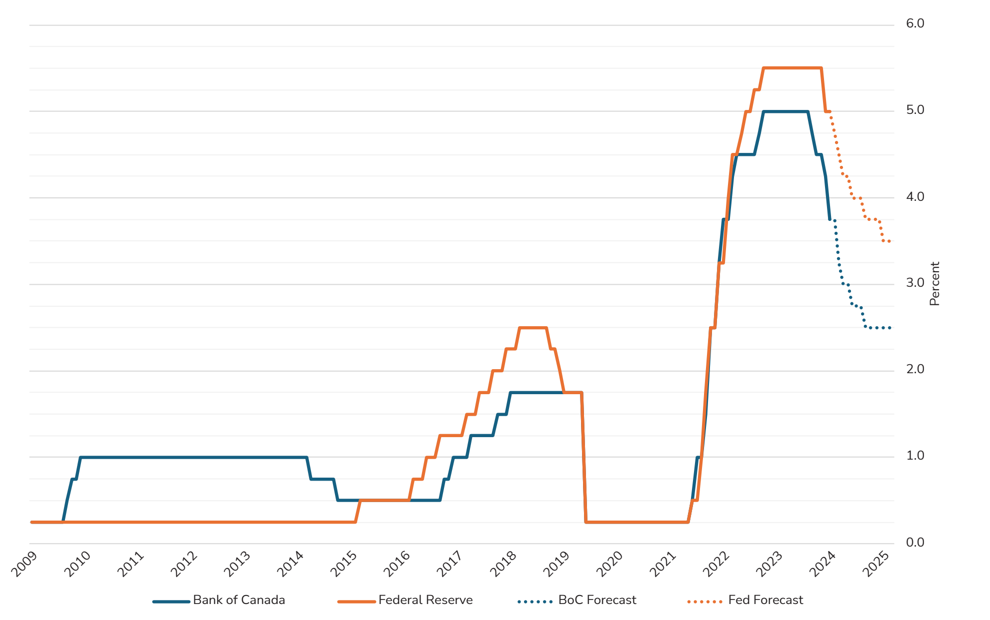
Source: Bloomberg, IG Wealth Management as of October 2024.

2. Central bank policy: finish what you started

Even though the fight against inflation has been won, central banks need to finish what they started. This will require a balance between economic priorities of price stability, unemployment and growth to bring policy rates to neutral. Unemployment has risen in Canada and the U.S. over the past year, from 5.7% to 6.5% and 3.8% to 4.1% respectively (ending October). While we have seen gains in the jobless rates of both countries, they are well within historical norms. Unemployment rates demand attention but are not overly concerning at this point in time. It is therefore up to central bankers to moderate the rate environment commensurate to the economic growth environment. In short, policy rates will continue to come down to their neutral rate, with the neutral rate varying region by region. Historically, in a non-recessionary easing cycle, the Fed has cut the effective funds rate by 25%. With this and other considerations in mind, we see the Fed's neutral rate concluding its easing cycle at 3.5%, while we have the Bank of Canada's overnight rate falling to 2.5% through 2025.

Central bank policy forecasts

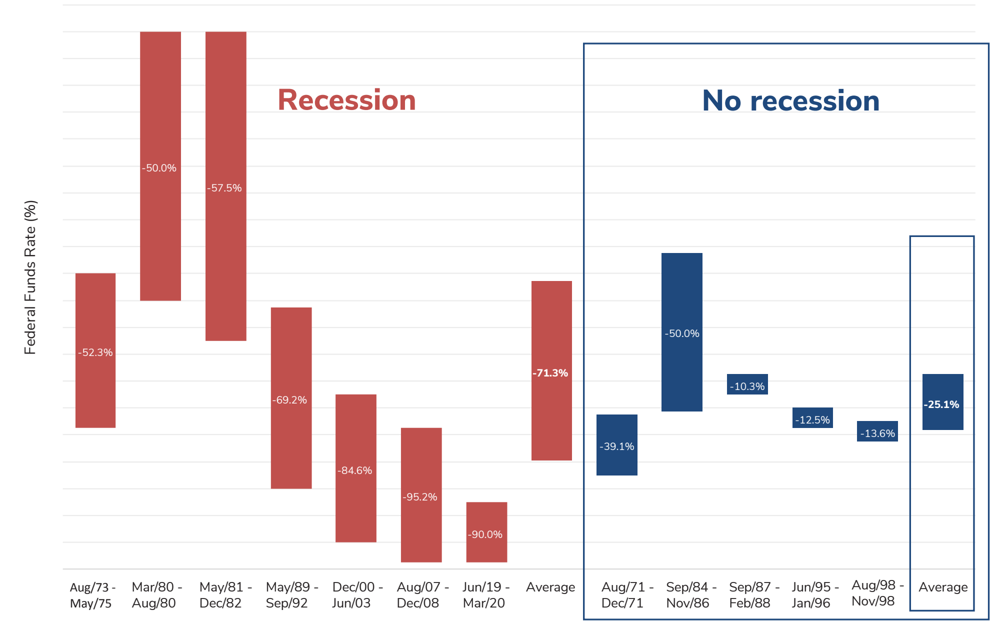
Central bank policy rate
Bank of Canada and U.S. Federal Reserve
Last 15 years through December 2025 (with forecast)



Source: IG Wealth Management, Bloomberg as of October 31, 2024.

U.S. Federal Reserve historical easing cycles

Relative amount of Fed rate cuts during easing cycle
1973-2020



Source: IG Wealth Management, Bloomberg as of October 31, 2024.

Bank of Canada policy and the unintended consequences of a weaker loonie

One theme of our outlook is a global economy in gradual recovery, though growth rates will differ across regions. The U.S. economy holds steady, while Canada and Europe face specific challenges, and China's path depends heavily on its stimulus efforts. With inflation risks subsiding, central banks are likely to steer towards more neutral policies, balancing growth risk with price stability.

As the balance of these risks varies greatly by region, rate differentials are widening. This divergence has contributed to a weaker Canadian dollar against the U.S. dollar, a trend we expect to continue. Our fair value model indicates further potential downside for the loonie, with the two-year spread between U.S. Treasuries and Canadian Government bonds at its highest in over a decade.

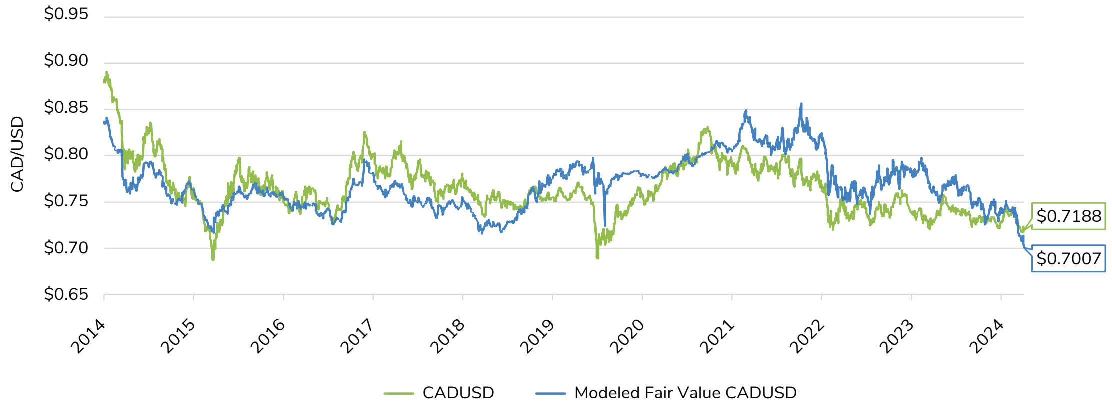
We see the potential for further downside for the Canadian dollar relative to the U.S. dollar to a low end of US$0.70 and the upper range of US$0.72 for now. Should the interest rate differential widen further, that would lead to a potential further decline below US$0.70. For investors, a weaker loonie favours U.S. dollar-denominated securities, as foreign gains translate into stronger local returns. It also benefits Canadian exporters reliant on U.S. markets, potentially improving profit margins.

Canadian dollar exchange rate model 2014-2024

Two-year spread U.S. Treasury less Canada Government bond: last 10 years to current

Source: IG Wealth Management, Bloomberg, as of November 8, 2024.

Modelled CAD/USD exchange rate versus actual CAD/USD exchange rate: last 10 years to current



Source: IG Wealth Management, Bloomberg, as of November 8, 2024.

Central banks and dollar diplomacy: why gold's rally has room to run

Some might say the gold rally is already stretched, with prices climbing over 60% since the lows of September 2022. Yet, we believe the forces driving this rise may only strengthen. Gold's renewed appeal hasn't come from retail or institutional buying; on the contrary, they've been net sellers of gold ETFs. Still, prices continue to rise. So, if traditional buyers are stepping back, who's stepping in? The answer points to major players: the People's Bank of China and other central banks with deep pockets and global influence.

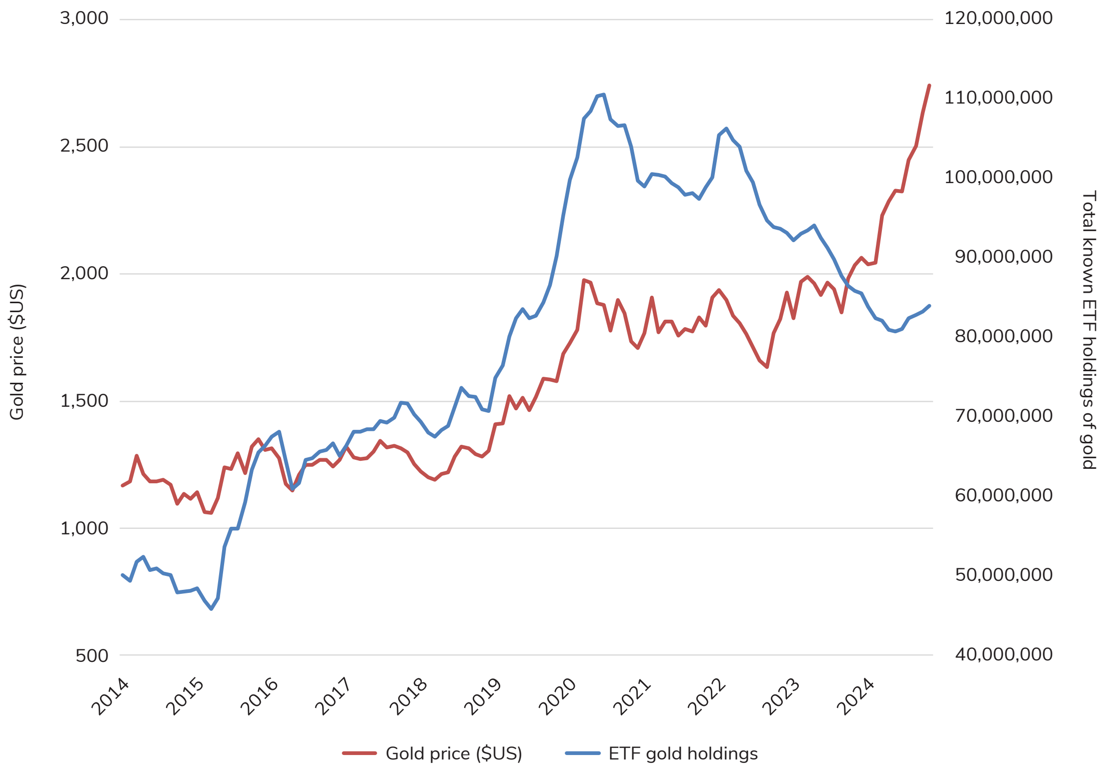
Geopolitics has changed the game. The U.S. flexed its economic power in response to Russia's actions in Ukraine, freezing assets and sending a clear signal to Moscow, Beijing and beyond: the U.S. dollar is a club, and the Fed holds the membership card. Watching US$600 billion in Russian reserves frozen in New York was a wake-up call for every nation holding U.S. dollar reserves.

At the same time, U.S. deficits have surged past US$2 trillion, with national debt approaching US$34 trillion, which is a double-edged sword for the dollar. Fiscal discipline feels increasingly outdated, and if current trends continue, gold will remain a compelling hedge against dollar diplomacy risk, ballooning debt and geopolitical uncertainty.

These geopolitical tailwinds, combined with potentially lower real rates, could further boost gold. In the U.S., if rates fall while inflation holds steady, history suggests this could support gold prices. Although the inverse relationship between real yields and gold prices recently weakened, a return to this trend would likely attract both institutional and retail demand, not just central banks.

The gold market

Total known ETF gold holdings versus gold price



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

3. Fixed income: navigating the old normal

Fixed income markets are positioned for a favourable environment going forward. With central banks globally shifting to more neutral stances, short-term rates are gradually falling, while longer-term yields remain steady. This dynamic may not generate the sizeable capital gain returns we might prefer, but it does create a strong long-term backdrop with expectations for mid-single-digit returns.

As central banks have been easing, corporate credit spreads have fallen to 15-year lows. This suggests a great deal of confidence in the corporate bond market, perhaps bordering on over-confidence. We favour sovereign bonds, rather than the broad basket, because historically tight credit spreads make corporate debt currently less attractive. The premium for taking on additional fixed income risk is at decade-long lows. Given the current high yields of sovereign debt, we believe it is more prudent to favour sovereign bonds over corporate.

As yields stabilize, sovereign debt now offers a balanced mix of safety, protection and income potential. High-quality fixed income assets provide good yield opportunities, with minimal difference in yield compared to lower-quality assets.

While the 10-year yield appears elevated by recent standards, it aligns closely with longer-term historical averages, particularly those seen in the 2000s. This reinforces our earlier view that we are returning to an "old normal", a more typical yield environment. This normalization further supports sovereign bonds as a core component in fixed income strategies, offering attractive returns with robust protection against economic risks in the coming years.

Long-term interest rate trends

U.S. 10-year Treasury yield (decade average)

Decade range	Average %
1962-1969	4.84
1970-1979	7.49
1980-1989	10.59
1990-1999	6.64
2000-2009	4.42
2010-2019	2.37
2020-2024*	2.63

Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

Steeper and wider: yield curves and spreads

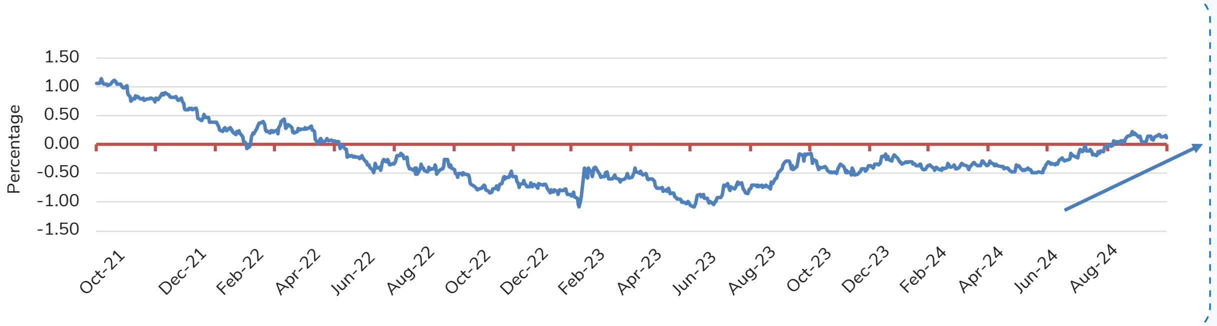
When it comes to central bank policy, you can't always get what you want. But sometimes you get what you need. While we all appreciate the boost from falling yields for both equity valuations and bond prices, a return to a normalized, positively sloped yield curve was inevitable. In the end, long-term yields that are higher than short-term yields (and positive real yields) create a healthier, more natural environment for investors.

This shift to a normal yield curve is already evident. While the U.S. Federal Reserve cut rates by three-quarters of a percentage point since September, yields on 10-year Treasury bonds have climbed by the same amount. Expectations for 2025 are changing, and the long end of the yield curve is starting to reflect that shift.

For equity markets, this yield environment carries mixed implications. So far, they appear largely unfazed by the rise in the 10-year yield, which is encouraging. However, if yields were to reach the 5% threshold, we would expect a higher likelihood of equity markets responding with caution. At that level, fixed income would become even more appealing compared to equities, adding further pressure on stock valuations.

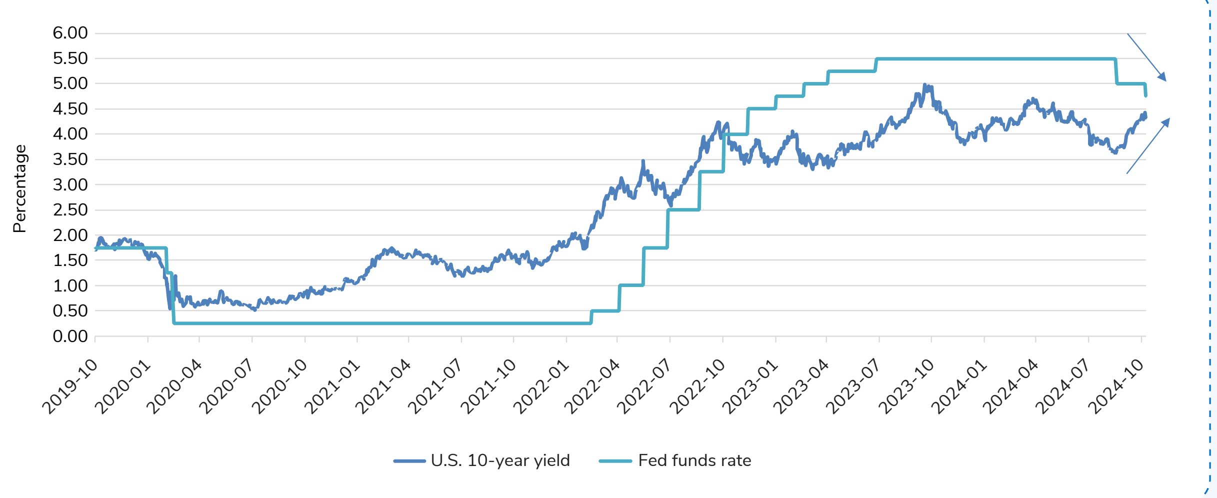
The Fed's impact on yields

U.S. Treasury yield curve
10-year yield less 2-year yield 2021-2024



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

U.S. 10-year Treasury versus Federal funds rate
Last five years through October 31, 2024



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

4. Equity markets: valuation always matters

After two very strong years of equity returns, many are tempted by the gambler's fallacy; the notion that a winning streak means a downturn is just around the corner, as if the market needs to even the score. It's a common and potentially costly mistake.

So, what would it take for us to go three for three in consecutive double-digit returns and notch another great year in the equity markets?

Valuations represent the first challenge; equity multiples are currently high, which could make future gains challenging to achieve if earnings growth fails to meet expectations. Shifting market expectations around central bank rate cuts, long-bond yields and inflation expectations will also impact valuations.

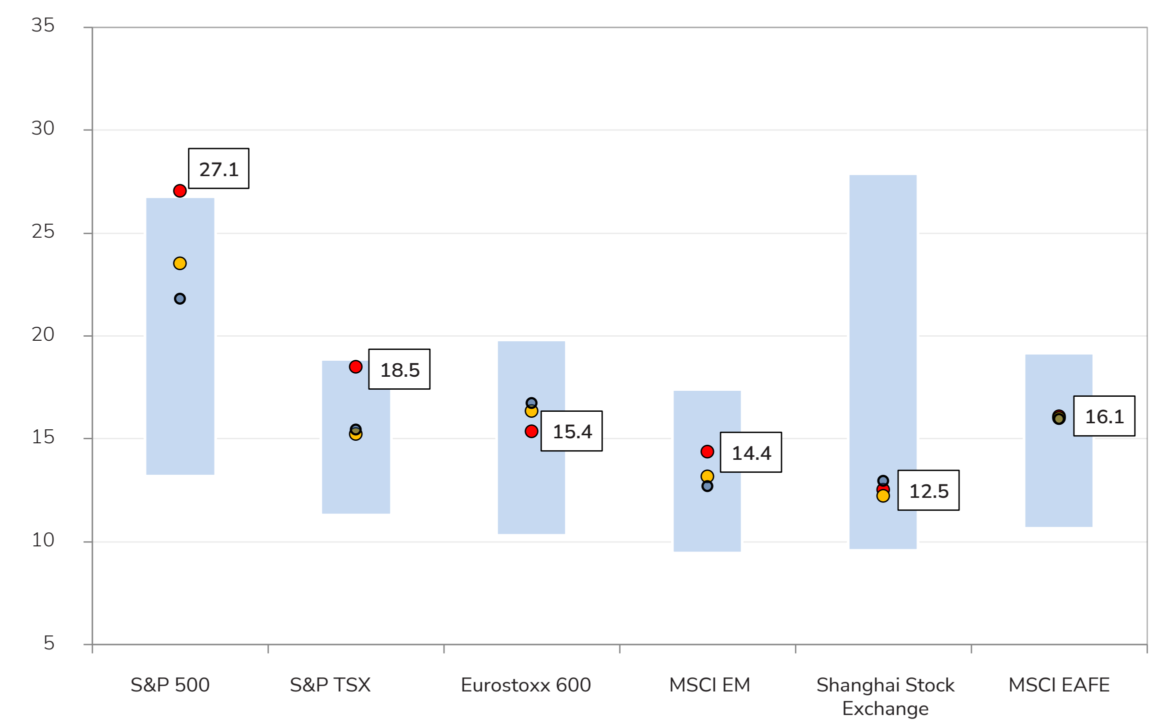
Higher yields would raise the discount rate for equities, lowering their present value, and could also lower the equity risk premium, which can lead to favouring fixed income. Both are potential headwinds for stocks. Regardless of where yields end up, if analysts are correct in their 2025 assumptions of strong earnings growth, we could expect a corresponding multiple contraction, resulting in mid- to upper-single-digit returns for equities. Historically, double-digit equity returns coincide with multiple expansions, while single-digit returns are associated with earnings-driven markets.

Regardless of valuations, the U.S. economy could surprise to the upside, fuelled by increased spending from renewed tax cuts. This would be beneficial to many areas of the market, particularly those that have lagged in recent years, such as small-cap stocks. Additionally, trade tensions could prompt central banks outside of the U.S. to cut policy rates more aggressively, bolstering local markets.

Even though markets have already priced in several positives, there are others that suggest the potential for growth in various regions.

Global indices' valuation

Trailing P/E ratio (adjusted for positive earnings)
Last 20 years to current (bars represent 5th to 95th percentile)



Source: IG Wealth Management, Bloomberg as of October 31, 2024.

Favour value when equity and credit markets appear priced for perfection

By nearly every measure, global markets look expensive; some more than others, of course, but none are particularly cheap.

Now, “expensive” doesn’t necessarily mean “too expensive.” And even if it did, “too expensive” doesn’t necessarily signal an imminent discount. What’s unlikely, though, is a continued rise purely on valuations alone. Markets might climb further, but that will rely on earnings growth rather than expanding multiples.

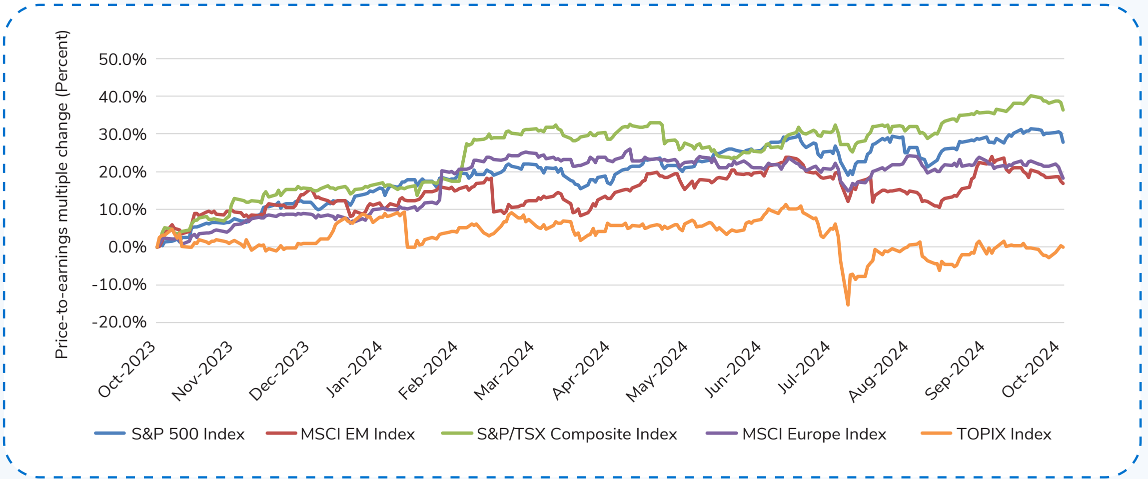
We’ve seen this pattern before. Markets can shift from expensive to fairly valued without a sharp correction, as long as earnings per share growth can outpace stock prices. With some patience, you end up with a reasonable multiple; just look back at 1993 to 1995 as a prime example.

The same logic extends to credit markets. With corporate and government bond spreads near historic lows, the additional yield for taking on extra credit risk offers little appeal. It may be wiser to focus on the most defensive assets in fixed income — sovereign bonds more specifically — rather than stretching for every last bit of yield. In other words, investors should not look to pick up pennies in front of a steamroller.

For now, we prefer to focus on quality at a fair price instead of chasing the most overhyped, overvalued areas. Within equities, we believe this favours Canada and emerging markets, as well as the financials and energy sectors. And if investors choose to pay a premium, it should be for assets that provide some margin of safety through growth and strong balance sheets. We’re not counting on the classic “dash for trash” that often marks the early stages of an economic cycle; quality seems poised to be key in 2025.

Contribution to return from valuation

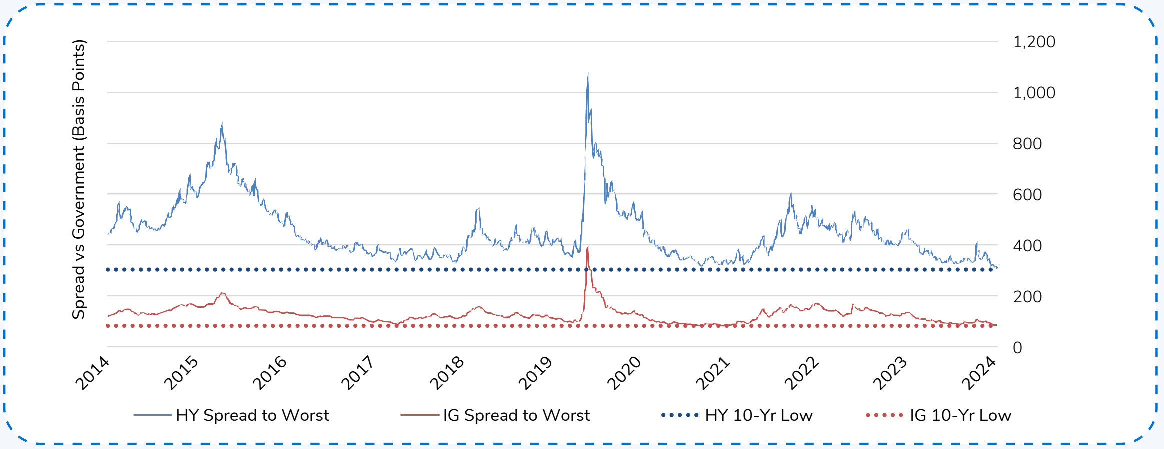
Year-over-year PE multiple expansion October 31, 2023-October 31, 2024



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

Credit spreads

U.S. high-yield and investment-grade bond spreads last 10 years



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

5. Post-election: the unknown unknowns

Market reaction has been strong following the election, as investors once again tried to predict which sector would most benefit from the incoming administration.

We advise setting aside any preconceived ideas about how specific sectors will fare under a president's watch; history shows that presidents rarely influence market outcomes as much as we might expect.

Let's take a look at the past: when Joe Biden was elected, conventional wisdom pointed to a tough road for the energy sector, with expectations of tighter regulations, reduced production and a push for green initiatives. Yet under his administration, energy outperformed global markets significantly.

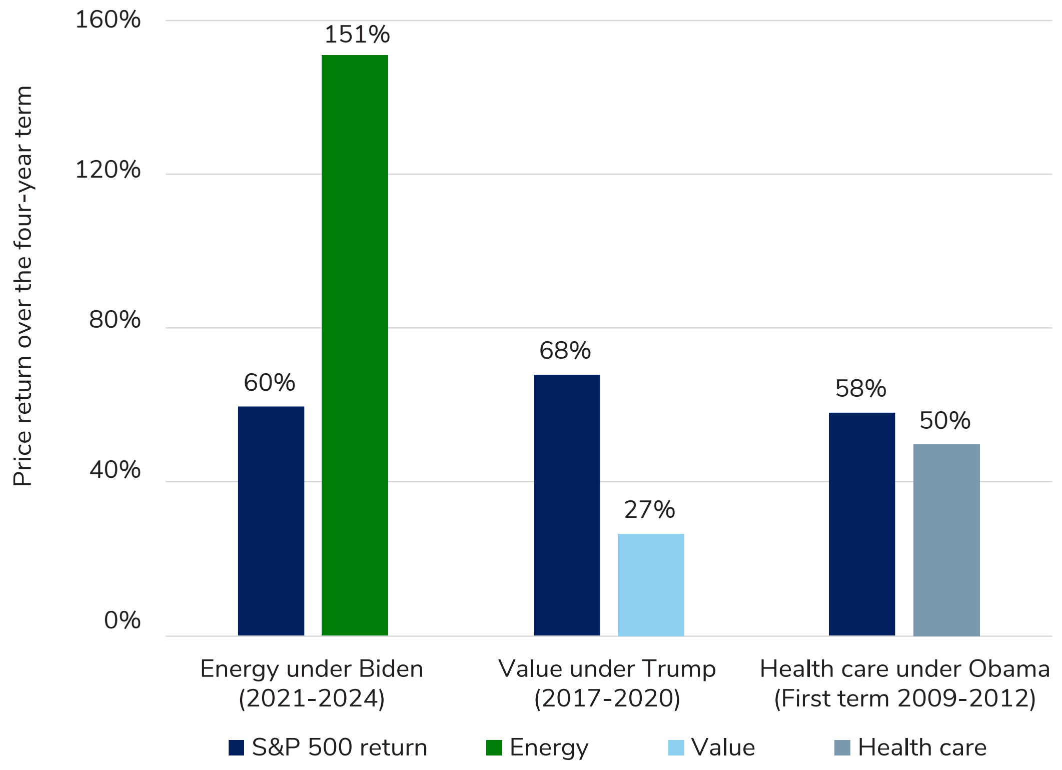
Similarly, when Donald Trump took office in 2017, market chatter predicted a boon for value stocks, pushed by tax cuts and stimulus measures that typically benefit the lowest-priced stocks. However, value stocks ultimately returned only half of what the S&P 500 delivered.

Finally, consider the health care sector under Obama's first term. With the Affordable Care Act at the forefront, many expected healthcare stocks to rally. Instead, the sector underperformed the broader market.

Ultimately, markets follow their own path, influenced by far more than presidential policies. While politics may sway sentiment, the broader economic forces and fundamentals drive lasting outcomes.

Index versus sector performance by administration

Favoured sectors that faltered:
A historical look at presidential priorities and market outcomes



Source: IG Wealth Management, Bloomberg as of October 31, 2024.

Focus on policy, not politics

With Donald Trump set to take office in 2025, the political landscape is set up for a series of "known knowns, known unknowns and unknown unknowns", to paraphrase Donald Rumsfeld. For investors, expected reforms in tax policy, immigration and trade tariffs represent clear shifts that will likely increase protectionist trends in global trade.

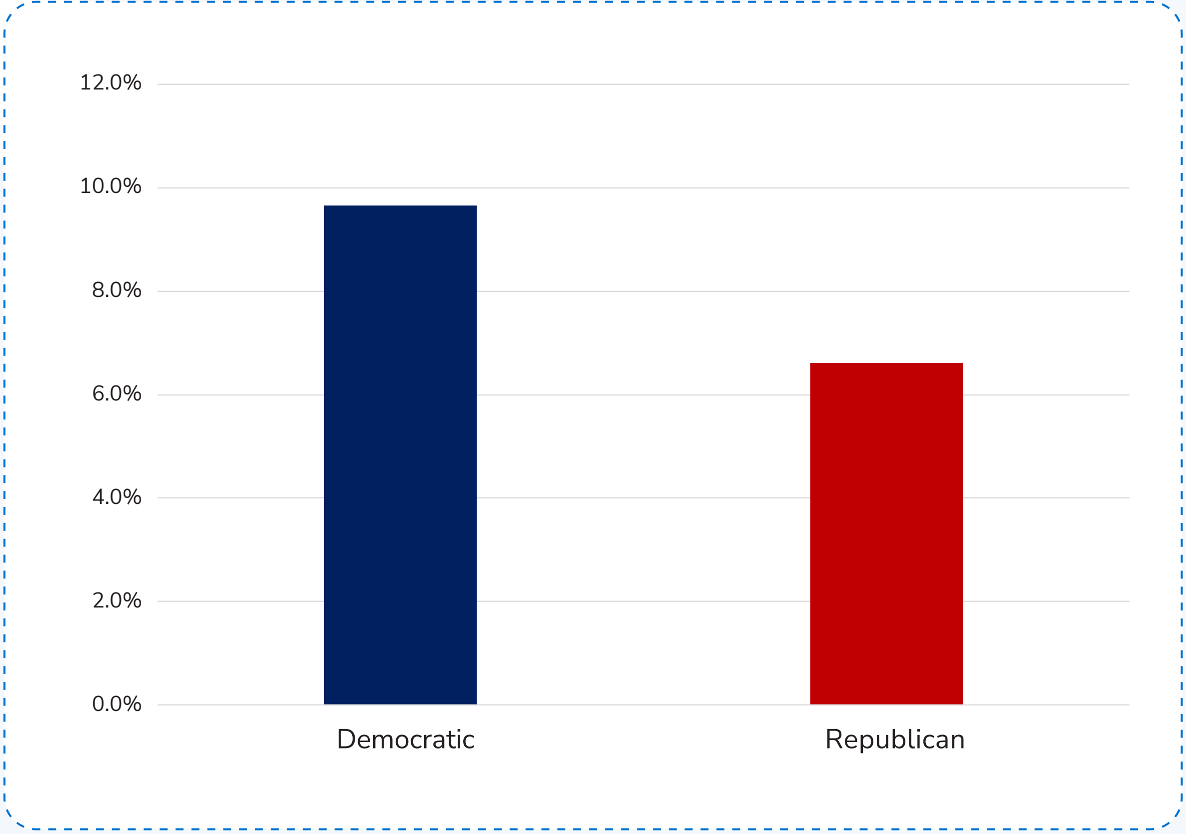
Tax reform should bolster corporate profits and drive consumer spending, supporting economic growth. Changes in immigration policy, however, could complicate the recruitment of skilled labour, potentially affecting productivity. Meanwhile, tariffs — a cornerstone of Trump's economic approach — will influence trade dynamics with key partners like Canada, Mexico and China.

Yet, these policies come with risks. Continued federal deficit spending and additional tariffs are expected to add inflationary pressure.

Beyond the immediate political shifts, keeping a long-term perspective on the business cycle is essential. As the landscape evolves, staying focused and strategically invested will be key to navigating what's ahead.

Returns by political party

Average - S&P 500 Index return (annualized)
Presidential term by party since 1945



Source: IG Wealth Management, Bloomberg, as of October 31, 2024.

Trends fade, but diversification is always in style.

– Philip Petursson

Here comes the new, new normal. Spoiler: it's the old normal.

As we wrap up our 2025 Outlook, the message is clear: adapting to a world returning to the "old normal' requires both caution and opportunism. The macroeconomic landscape is improving, and if the world itself isn't going back to normal, at least the yield curve is. Regional disparities and shifts in policy will present a challenging yet fertile environment for disciplined investors.

Our focus remains on quality and tactical asset selection, particularly as valuations realign and fixed income once again offers competitive yields. Maintaining a balance across asset classes, styles and regions will be crucial. With diversified positioning and our eye on economic fundamentals, we're prepared to capture the benefits of a normalizing economy; one that rewards patience, prudence and adaptability.

IG Investment Strategy Team

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