THE COERENTE VIEW

3RD QUARTER 2024

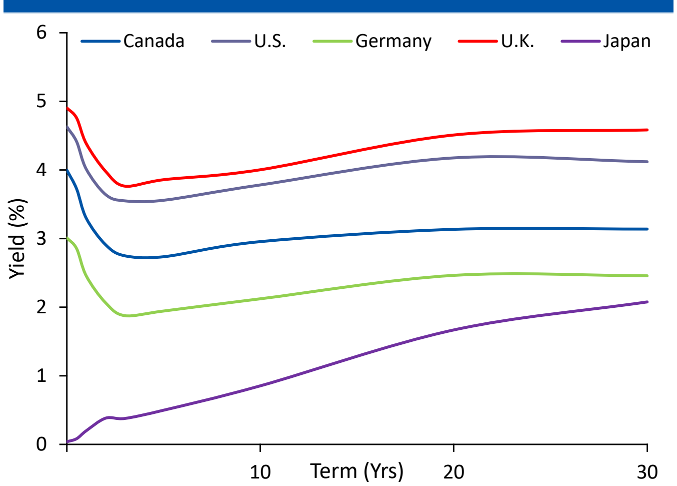
Market Statistics

	Sep/24	Jun/24	Mar/24	Sep/23
Yields (%)				
90 Day T-Bill	4.20	4.64	4.99	5.07
10 Yr. Canada Bond	2.96	3.50	3.48	4.02
30 Yr. Canada Bond	3.14	3.39	3.37	3.82
Rates				
C.P.I. (annual %)	2.00	2.70	2.90	3.80
US$/C$	0.74	0.73	0.74	0.74
Euro/C$	0.67	0.68	0.68	0.70
Prices (US$)				
Crude Oil (bbl.)	68	82	83	91
Natural Gas (mm)	2.90	2.60	1.76	2.93
Gold (oz.)	2,650	2,328	2,217	1,848

Market Returns

	Periods Ending Sep. 30/24			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	10.5	26.7	11.0	8.1
S&P 500 (C$)	4.6	36.4	16.5	15.5
S&P 500 (US$)	5.9	36.4	16.0	13.4
MSCI EAFE Net (C$)	5.9	24.7	8.6	7.7
MSCI EAFE Net (US$)	7.3	24.8	8.2	5.7
MSCI World Net (C$)	5.1	32.4	13.5	12.2
MSCI World Net (US$)	6.4	32.4	13.0	10.1
Bond Universe	4.7	12.9	0.6	2.3
91 Day T-Bills	1.2	5.1	2.4	1.6

Yield Curves



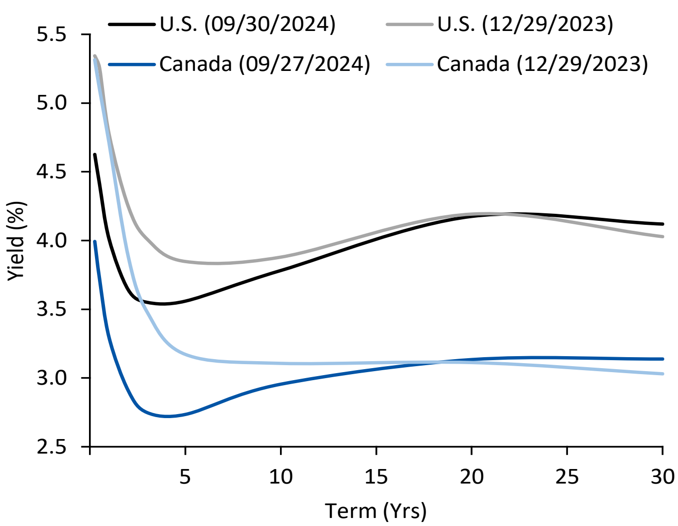
The Economy

This past quarter, economic news was centered around the lowering of interest rates, for the first time in two and a half years, by the North American central banks. Lower inflation, not quite reaching the 2% target, has provided for what is expected to be a period of successive rate reductions. While most central bank inflation indicators have been slightly above target, it has not prevented the Bank of Canada from reducing the bank rate (which directly affects short-term interest rates) with three 0.25% cuts. The US Federal Reserve lowered rates by 0.5% in September, indicating there will be more to come. A desire to navigate a "soft landing" (i.e. lower inflation without triggering an economic recession) prompted the early moves. The central banks, so far, appear successful as gross domestic product growth has remained comfortably above the 1% annual rate.

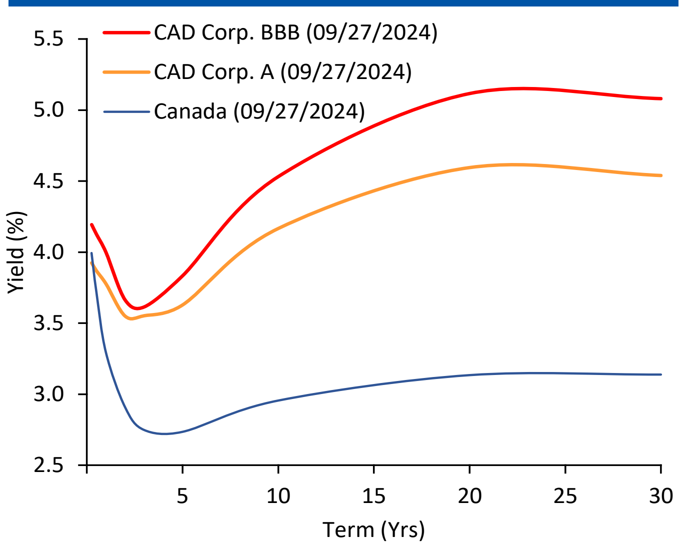
We are now past the post-Covid labour shortages and unemployment rates have begun to tick up. Inventory levels have also adjusted such that shortages of components and final products are no longer the norm and prices are not spiking upward. There is, however, a lingering labour cost issue as multi-year wage settlements beyond the 3% range will most likely result in some inflation stickiness above target levels. In both Canada and the US, the reduction of benchmark interest rates has resulted in yields declining across most of the yield curve except at the longer end (terms beyond the 10 to 15-year range) where yields have actually increased. This is usually an indication that investors are not convinced inflation will subside further. Long-term government bonds are currently yielding in excess of 3% in Canada and 4% in the US suggesting inflation expectations above the 2% rate. (Long-term bonds will normally provide a positive real yield – i.e. yield in excess of inflation.)

The overseas developed economies are experiencing similar interest rate trends with the exception of Japan. Commensurate with rising inflation, the Bank of Japan in fact raised rates, ending a long period of deflation and negative interest rates. Overall, the movement toward lower interest rates and easing credit conditions should favour the global economic environment but we are not without some headwinds. Pre-Covid, the Chinese economy contributed a significant portion of global growth. As it expanded rapidly, many countries benefitted with increasing exports to China in order to satisfy its population's newfound wealth. Today, the Chinese economy is grappling with a collapsing real estate market burdened by too much debt and banks that are questionably solvent. The Chinese government has reduced interest rates and implemented support measures but in the

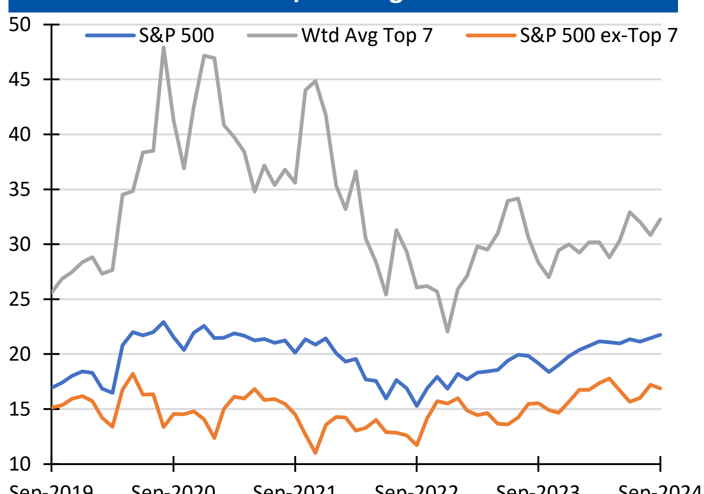
Canada & US Yield Curve Changes



Corporate vs. Government Bond Yields



Forward P/E – Magnificent 7



coming few years, China will not be able to provide the same significant contribution to global growth it did previously.

The Markets

Declining interest rates spurred sizable gains for both equity and bond markets in the third quarter. For the period, the World Equity index rose 5.1% while the Canadian S&P/TSX jumped 10.5% owing to its more significant weighting in interest-sensitive and high-yield stocks. The recent gains, added to the strong returns generated by technology related companies earlier this year, has resulted in exceptional equity performance year-to-date with the World index now sitting at a 21.5% gain and the S&P/TSX at a 17.2% gain. Bonds benefitted to a lesser extent with the Universe index appreciating 4.7% for the quarter bringing the year-to-date return to 4.3%.

Periods of declining interest rates are clearly beneficial for the capital markets but they are not the only factor that provide for a healthy investment environment. Moving forward, government deficits that ballooned during Covid will need to be addressed. As well, high equity valuations associated with artificial intelligence (AI) related companies will need to be justified by higher earnings and significant product and productivity improvements. Any delay or disappointment will affect share price valuations.

As evidenced by the bottom chart opposite, significant valuation differentials exist within the stock market today. Uncertainty and risk regarding the high valuations of some technology and AI-related stocks has resulted in our preference for maintaining a well-diversified equity portfolio that offers protection from a possible correction in these names. At the same time, the reasonable valuation levels of many other stocks have led us to continue favouring equities over bonds. With regard to bonds, the potential threat of a long-term embedded inflation rate above the 2% level has pushed us to cap the term to maturity of any bonds held, strictly avoiding longer-term issues so as to mitigate the risk of purchasing power erosion in a high government debt environment. We do, however, continue to carry quality, short and mid-term investment grade corporate bonds where needed as these can still provide yields above current levels of inflation (as shown in the middle chart on this page).

Sources: Bloomberg, National Bank Financial, Statistics Canada