Quarterly Market Commentary

Fourth Quarter 2024

A single-market rising tide fails to lift all stock boats.

- Global equity markets, as measured by the MSCI ACWI Index, recorded modest losses in U.S. dollar terms over the fourth quarter, but still finished in positive territory for the 2024 calendar year. Strength in the U.S. could not offset downturns in other developed countries and emerging markets, which declined significantly in U.S. dollar terms during the quarter. Notably, in Canadian dollar terms, global equities had a strong quarter.
- Global fixed-income assets lost ground during the quarter. U.S. Treasury yields declined for all maturities under one year, and moved higher across the remainder of the yield curve. (Prices move inversely to yields.)
- We maintain our strategic recommendations for investors to stay diversified globally and focus on profitable companies with strong earnings momentum trading at reasonable prices.

SEI's Domestic View

In our last outlook, we said that the fourth quarter of 2024 promised to be at least as interesting as the third quarter had been, and that certainly proved to be the case. Looking ahead to 2025, investors are surely in for an interesting year. We'll examine some of the risks, both positive and negative, facing Canada's economy, as well as some of the "known unknowns" investors may want to keep an eye on.

The Canadian economy continues to chart its own path in terms of economic growth, inflation, and central bank policy. Relative to other advanced economies, inflation remains well behaved, giving the Bank of Canada (BOC) ample room for further interest-rate cuts. That should be supportive of economic activity, although as we noted last quarter, a widening divide between Canadian and U.S. interest rates could put downward pressure on the Canadian dollar at times.

Recent purchasing manager surveys have also shown an interesting divergence between Canada and the rest of the world. Whereas most countries were recently seeing still-healthy sentiment in services and slumping sentiment in manufacturing, the latest surveys in Canada showed the opposite.[1] Although tempting to attribute Canada's services downturn to constrained consumers and manufacturing strength to a weaker Canadian dollar (which makes Canadian goods cheaper for foreign buyers), the underlying causes might prove more temporary. For example, some services survey respondents placed blame on the postal strike, while some respondents to the manufacturing survey believed recent strength might be attributable to U.S. buyers front-running expected tariff hikes from the incoming administration of Donald Trump. Time will tell. The good news, in these reports and others, is that the Canadian economy seems likely to continue avoiding recession barring any major surprises (more on those later). It should also be noted, however, that both surveys reported some strengthening in price pressures. While we don't expect inflation to reaccelerate dramatically in Canada, it does fit with SEI's view that central banks' "last mile" in the inflation fight could be a long one.

In addition to weaker sentiment in the services sector and the impacts of port- and postal-worker strikes on an already slow-growing economy, there are some clear and present risks to account for, listed roughly here in terms of potential impact. First, the federal government's decision to markedly reduce immigration of temporary workers may cause the labour market to tighten and thus contribute to a modest reacceleration of inflation, all else equal (though it may also reduce housing-price pressures at the margin). Second, household balance sheets in aggregate are still overextended and home affordability remains at a generational low.

Finally—and most obvious at the moment—are the punitive tariffs rates being threatened against Canada and other trading partners by U.S. President-elect Trump. The only point of clarity thus far is that U.S. trade barriers will be higher, while the specifics of what these will look like are anyone's guess. Businesses and consumers on both sides of the border will have to adapt as the trade battles unfold and actual U.S. trade policies become clearer. The widespread hope is that, as with the first Trump administration, tariffs are used as a negotiating tool to reconfigure trade patterns or gain immigration concessions without massively undermining the current trading system.

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Despite these risks, the Canadian economy should enjoy some tailwinds in 2025 beyond the rebound in manufacturing sentiment. The goods-and-services-tax holiday, although only a couple months in duration, should be welcomed by consumers. Two important tweaks to mortgage regulations—increasing the price cap on insured mortgages, which should reduce down payments, along with extending maturities to 30 years from 25 for first-time buyers or new construction—should provide some support to residential real estate activity. And most importantly, the progress made on inflation should allow interest rates to continue falling, which would be supportive of housing and consumers more broadly. None of these will solve Canada's economic challenges overnight, but they point in a positive direction.

In addition to the policy risks emanating from the U.S., domestic politics are clearly in turmoil. With his recent resignation, Prime Minister Trudeau joins the list of incumbent casualties around the world. Unfortunately, it now appears the Canadian federal government will be less than fully functional as the Trump administration takes office. That said, the 44th Parliament has had a long run by historic standards, as has the Liberal Party leader, so perhaps a change of the guard was in order. The Canadian electorate certainly seems to think so, as we pointed out last quarter. Similar to trade relations with the U.S., much remains to be seen with domestic politics and policies. The Conservative Party still looks poised to assume power. However, based on historical timeframes, that might not happen until spring or even summer of 2025. Suffice to say, when it is finally formed, the new government will have its work cut out for it.

Foreign-exchange volatility is another area of concern. The U.S. dollar rallied sharply in the fourth quarter against a wide range of currencies, including the Canadian dollar. Developments on the domestic and U.S. fronts could cause exchange-rate volatility in either direction. For now, the widening interest rate differential between Canada and the U.S. (something we touched on last quarter) could keep the loonie under pressure.

Finally, public health risks are an issue that's probably flying under most investors' radars. While we're all dealing with pandemic exhaustion to varying degrees thanks to COVID-19, we should keep an eye on avian influenza ("bird flu") and the current H5N1 strain. Related to this risk, it's interesting (and a bit troubling) to note that, in many countries, disability rates have increased in recent years. For example, in Canada, disability rates increased by a statistically significant extent across all age groups between 2017 and 2022,[2] and in the U.S., disability numbers have climbed steadily in recent years, approaching 35 million individuals at the end of 2024. If there's a silver lining to these data, it's that that a higher percentage of disabled individuals have been able to join the workforces in some countries. But if disabilities are truly rising, that could add to the challenge of slow-or-no productivity growth (another theme we've touched on in recent quarters).

The increasing-disability phenomenon isn't limited to North America, and it is reported to have multiple causes. However, the after-effects of COVID-19 infections are believed to be a contributing factor, and a recent study estimated that the cumulative number of people worldwide who've suffered with "long COVID," or lingering health effects following acute infection, is around 400 million.[3] Taken by itself, this is a challenge that societies will continue to manage with varying degrees of success. But it would become far more worrisome in a pandemic caused by certain strains of avian influenza. Thus far, reported symptoms of individuals infected with H5N1 have ranged from mild to severe, and public health institutions have not identified any cases of human-to-human transmission, which is reassuring. But this is one of those low-probability, high-impact events that, should it come to pass, could cause significant market volatility and economic disruptions.

The world is as interesting as ever, and there is a raft of challenges facing businesses, consumers, politicians, policymakers, and public health officials. By comparison, an investor's job is pretty simple. Be sure your portfolio is suited to your financial objectives and provides ample diversification of risks, and stick with it.

SEI's Global View

Global investors weathered quite a year in 2024, including global central bank pivots to easy monetary policy, voter pivots to opposition parties, rapidly rising national debt levels, and escalating geopolitical strife. Markets responded with solid returns for risk assets as monetary stimulus was added to the fiscal stimulus punch bowl. Fixed-income returns struggled, with rising longer-term yields fostered by stubborn inflation and swelling government debt. Precious metals and cryptocurrencies were notable performers on heightened demand from central banks and retail investors, respectively, while familiar themes repeated themselves—including another banner year for the "Magnificent 7" mega-cap tech stocks in the U.S. and another disappointing (if not slightly encouraging) year for Chinese stimulus expectations. Lastly, investors were treated to a lump of coal from U.S. policy-makers in December, as the Federal Reserve (Fed) took a hawkish turn, calling into question the future path of policy rates in the world's largest economy.

Within the equity markets, corporate earnings have surprised to the upside and have shown strength outside of big tech, while lower taxes and less regulation should be a bigger boost to mid- and small-sized companies. In addition, markets outside of the U.S. are far from priced to perfection as both earnings expectations and valuation multiples have more room to move higher. We expect additional stimulus from the European Central Bank given weakness in the core of Europe and further efforts from China to find the right mix of both fiscal and monetary stimulus measures.

Not surprisingly, we maintain our strategic recommendations for investors to stay diversified globally and focus on profitable companies with strong earnings momentum trading at reasonable prices. Given our views on the likelihood of higher interest rates and heightened volatility, we continue to lean into value and active management across our equity strategies. We favor sectors such as financials, industrials, and staples.

Within fixed-income markets, we remain cautious on interest rates and sanguine on credit. We believe the Fed is still biased toward lower rates (although we may see a pause in early 2025) despite core consumer price index and gross domestic product readings both above 3%. In addition, the reality of tariffs and immigration reforms may add additional fuel to the inflation fire early in the year. Therefore, given our outlook for higher long-term interest rates, we see headwinds for fixed-income returns. On a more positive note, while credit spreads have limited room to tighten, absolute yields remain attractive, defaults remain low, and maturities have been extended. Carry strategies in high-yield bonds and collateralized loan obligations (CLOs) should perform well.

Economic Backdrop

Global equity markets, as measured by the MSCI ACWI Index, recorded modest losses in U.S. dollar terms over the fourth quarter, but still finished in positive territory for the 2024 calendar year. Strength in the U.S. could not offset downturns in other developed countries and emerging markets, which declined significantly in U.S. dollar terms during the quarter. Notably, in Canadian dollar terms, global equities had a strong quarter. There was a brief, sharp rally in the U.S. in the first half of November in response to former President Trump's victory in the presidential election, as investors expressed optimism that the new administration's proposed tax cuts and loosening of regulations will boost economic growth. All three major U.S. equity market indexes—the Dow Jones Industrial Average, the broad-market S&P 500 Index, and the tech-heavy Nasdaq Composite Index—established record highs during the quarter. Among developed markets, Europe was particularly hard-hit amid concerns about political stability in France and Germany, as well as economic weakness. Emerging-market stocks lost ground due to investors' concerns about the potential impact of Trump's proposed tariffs on goods imported to the U.S., as well as disappointment regarding the Chinese government's fiscal stimulus.

North America, the only region to end the quarter in positive territory in U.S. dollar terms, was the top performer among developed markets, lifted by the rally in the U.S. Conversely, the Nordic countries were the weakest-performing developed markets due mainly to downturns in Denmark, Sweden, and Finland. The significant underperformance of Europe was attributable mainly to weakness in Portugal and Ireland. The Gulf Cooperation Council (GCC) countries led the emerging markets for the month, due largely to strength in the United Arab Emirates (UAE) and Kuwait, which garnered positive returns for the quarter. The weakest-performing emerging markets for the month included Latin America and the Association of Southeast Asian Nations (ASEAN), hampered mainly by market declines in Brazil and Indonesia, respectively.[4]

Global fixed-income assets, as measured by the Bloomberg Global Aggregate Bond Index, declined 5.1% in USD for the quarter. High-yield bonds posted modest gains and were the strongest performers within the U.S. fixed-income market, followed by investment-grade corporate bonds, mortgage-backed securities (MBS), and U.S. Treasurys. Treasury yields declined for all maturities under one year over the quarter, and moved higher across the remainder of the curve. Yields on 2-, 3-, 5- and 10-year Treasury notes rose by corresponding margins of 0.59%, 0.69%, 0.80%, and 0.77%, ending the quarter at 4.25%, 4.27%, 4,38%, and 4.58%, respectively.[5] The spread between 10- and 2-year notes widened from +0.15% to +0.33% over the quarter, as the yield curve remained positively sloped (longer-term yields exceeded shorter-term yields). A positively sloped yield curve generally indicates that the economy is expected to grow in the future.

Global commodity prices, as represented by the Bloomberg Commodity Index, dipped 0.4% in the fourth quarter. The West Texas Intermediate (WTI) and Brent crude oil prices rose 5.2% and 4.1%, respectively, over the quarter due initially to concerns about the escalation of the military conflict in the Middle East (possibly leading to supply constraints) and, later in the quarter, a decline in inventory in the U.S. The gold spot price was down 0.7%, pressured by Trump's election victory, which sparked a rally in the U.S. dollar. (The gold price typically moves inversely to the greenback.) The 6.0% upturn in the New York Mercantile

Exchange (NYMEX) natural gas price during the quarter was attributable to increased demand spurred by below-average temperatures in much of the U.S. in December, as well as forecasts for continued cold weather in January. Wheat prices were down 5.6% for the period, hampered by increased production in Argentina, as well as U.S. dollar strength. (The wheat price typically moves inversely to the U.S. dollar.)

Trump, a Republican, defeated his Democratic Party opponent, Vice President Kamala Harris, winning majorities in both the Electoral College and the popular vote. Trump is the first U.S. president since Grover Cleveland—who served from 1885 to 1889, and 1893 to 1897—to be elected to two non-consecutive terms. The president-elect ran on a populist platform focused on illegal immigration, crime, tariffs, and tax cuts.

On the geopolitical front, Ukraine launched U.S.-made long-range missiles into Russia for the first time in November. This action prompted Russian President Vladimir Putin to approve amendments to the nation's nuclear doctrine, expanding the conditions under which Russia may use nuclear weapons. In Syria, Hayat Tahrir al-Sham (HTS), an Islamist militant group, led a rebellion against the government of President Bashar al-Assad in late November and early December. HTS initially occupied Aleppo, Syria's second-largest city, and then captured Damascus, the nation's capital. Assad fled to Moscow, and the Russian government granted his request for asylum. The HTS subsequently formed a new transitional government in Syria.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, consumer prices (as measured by the change in the Consumer Price Index (CPI)) rose 0.1% in November as price increases broadly moderated. The 1.9% year-over-year increase was slightly below the prior reading as gasoline and air transportation costs were less than the prior year, meanwhile grocery price increases continued to outpace overall inflation. Producer prices were mixed in November, as the Industrial Product Price Index (IPPI) jumped 0.6% while the Raw Materials Price Index (RMPI) slid 0.5%. Year-over-year prices were largely in line with consumer prices and increased 2.2% and 2.0%, respectively, for the IPPI and RMPI. Over the past year, gains have been concentrated in metals, lumber, and certain agriculture products, while energy and petroleum products have been weaker. The Canadian economy added 91,000 jobs in December and the unemployment rate dipped 0.1% to 6.7%. In total for 2024, 413,000 (+2%) were added—similar to the prior year.

- The U.S. Department of Labor reported that the consumer-price index (CPI) rose 0.3% in November, marginally higher than the 0.2% increase in October. The 2.7% year-over-year advance in the index was up slightly from than the 2.6% annual rise in October and was in line with expectations. Housing costs increased 0.3% and 4.7% in November and year-over-year, respectively. Transportation services costs were flat for the month but climbed 7.1% versus the same period in 2023. Prices for fuel oil and gasoline posted identical upturns of 0.6% in November, but tumbled 19.5% and 8.1%, respectively, year-over-year. The 3.3% rolling 12-month rise in core inflation in November, as measured by the CPI for all items less food and energy, matched the annual increase in October. According to the third estimate from the Department of Commerce, U.S. gross domestic product (GDP) grew at an annualized rate of 3.1% in the third quarter of 2024—up from the 2.8% initial estimate and slightly higher than the 3.0% increase in the second quarter of the year. The largest contributors to GDP growth for the third quarter included consumer spending, exports (which are added to the calculation of GDP), and nonresidential fixed investment (purchases of both nonresidential structures and equipment and software). Imports (which are subtracted from the calculation of GDP) increased over the quarter. The government attributed the quarter-over-quarter uptick in the GDP growth rate to increases in exports, consumer spending, and federal government spending. These positive contributors offset a decline in private inventory investment and a larger decrease in residential fixed investment (a measure of the changes in values of inventories from one time period to the next).

- The Office for National Statistics (ONS) reported that inflation in the U.K., as measured by the CPI, ticked up 0.1% in November, down from a 0.6% rise in October. The CPI advanced at an annual rate of 2.6% in November, higher than the 2.3% upturn for the previous month. Costs for health care, alcohol and tobacco, and education posted corresponding increases of 6.9%, 5.5%, and 5.0%, year-over-year, while prices for transportation and furniture and household goods declined 0.9% and 0.4%, respectively, over the previous 12-month period. Core inflation, which excludes volatile food, energy, and alcohol and tobacco prices, rose by an annual rate of 3.5% in November, up modestly from the 3.3% year-over-year increase in October.[6] The ONS also announced that U.K. GDP dipped 0.1% in October, but edged up 0.1% over previous three months (the most recent reporting periods). The marginal decline in GDP for October matched the downturn in September. Output in the services and construction sectors rose 0.1% and 0.4% for the three-month period ending October 31, while production and construction output fell 0.3%.[7]

- Eurostat pegged the inflation rate for the eurozone at 2.2% for the 12-month period ending in November, a slight decrease from the 2.3% annual upturn in October. Costs in the services sector rose at an annual rate of 3.9%, down marginally from the 4.0% gain in October. Prices for food, alcohol and tobacco increased 2.7% year-over-year in November, modestly lower than the 2.9% annual rate for the previous month. Energy prices fell 2.0% over the previous 12-month period in November following a 4.6% year-over-year downturn in October. Core inflation, which excludes volatile energy and food prices, increased at an annual rate of 2.7% in November, matching the year-over-year upturn for the previous month.[8] Eurostat also reported that eurozone GDP rose 0.4% in the third quarter of 2024, modestly higher than the 0.2% increase in the second quarter. The eurozone economy expanded by 0.9% year-over-year—an improvement from the 0.6% annual growth rate for the previous quarter. The economies of Lithuania and Cyprus were the strongest performers for the third quarter, expanding 1.1% and 1.0%, respectively. In contrast, GDP in Hungary and Latvia declined by corresponding margins of 0.7% and 0.4% during the quarter.[9]

Index Data (Q4 2024)

- The S&P/TSX Composite Index gained 3.76%.
- The FTSE Canada Universe Bond was essentially flat, declining 0.04%.
- The S&P 500 Index, which measures U.S. equities, climbed 9.02%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was up 5.41%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -0.16% (currency hedged) and 6.63% (unhedged).
- The Chicago Board Options Exchange Volatility Index, also known as the “fear index,” a measure of implied volatility in the S&P 500 Index, moved higher from 16.73 to 17.35 as it spiked to above 27 in mid December.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose from US$68.17 to US$71.72 a barrel to end the quarter.
- The Canadian dollar notably weakened to C$1.44 per U.S. dollar. The U.S. dollar was materially stronger versus the world’s other major currencies as well, ending December at US$1.04 versus the euro, US$1.25 against sterling, and at 157.16 yen.

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[1]See J.P. Morgan Global Composite PMI®, "Global growth accelerates as solid service sector expansion offsets manufacturing weakness," 6 January 2025, available at https://www.pmi.spglobal.com/Public/Home/PressRelease/f94e193ddf214de5bdfa79062611f26c, S&P Global Canada Services PMI®, "Service sector activity falls in December," 6 January 2025, available at https://www.pmi.spglobal.com/Public/Home/PressRelease/50c8fdd2032b4750bbe90efebd005496, and S&P Global Canada Manufacturing PMI®, "Growth of manufacturing sector sustained in December," 2 January 2025, available at https://www.pmi.spglobal.com/Public/Home/PressRelease/61ac7ce9e2bb49cf83177f4b4d6be765.
[2]Statistics Canada, "Canadian Survey on Disability, 2017-2022," released 2023-12-01, available at https://www150.statcan.gc.ca/n1/daily-quotidien/231201/dq231201b-eng.htm.
[3]Al-Aly et al (09 August 2024), "Long COVID science, research and policy," Nature Medicine 30, 2148-2164, available at https://www.nature.com/articles/s41591-024-03173-6.
[4] All equity market performance statements are based on the MSCI ACWI Index.
[5] According to the U.S. Department of the Treasury. As of December 31, 2024.
[6] According to the ONS. December 18, 2024.
[7] According to the ONS. December 13, 2024.
[8] According to Eurostat. December 18, 2024.
[9] According to Eurostat. November 14, 2024.