PRIVATE CLIENT SOLUTIONS

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Insights & Strategies

Recapping 2023

RAYMOND JAMES®

Inside This Issue:

Recapping 2023

As we enter the final month of 2023, it seems that the recessions that we have been waiting for might finally arrive. The table below reveals that most key economic indicators are now signaling a downturn in Canada when compared to 2022. Central banks have been using monetary policy to slow economies with the goal of driving inflation down to their two per cent targets. Achieving this goal without tipping the economy into recession is like threading a needle – achievable, but difficult – and we believe that both Canada and the U.S. will go through recessions in the first half of 2024. The good news is that we have some confidence that these recessions might be some of the mildest on record – they've certainly been among the most anticipated.

It's worth reminding readers that in Canada, while the Bank of Canada (BoC) or finance minister might relay an official recession call based on Statistics Canada data, it is the C.D. Howe Institute's Business Cycle Council that helps to determine economic cycle and recession dates. While some simplify the determination to two consecutive quarters of GDP contraction, the true determination involves judging the amplitude, duration, and scope of a decline in economic activity.

There has been some notable progress in taming inflation this year. In Canada, headline inflation decreased from 8.1 per cent in June 2022 to 2.8 percent in June 2023 before rebounding slightly to 4.0 per cent, with the last reported October rate dipping back down to 3.1 per cent. We expect the path to 2 per cent to remain choppy. The BoC is expecting sticky inflation, averaging 3.5 per cent through mid-2024 before gradually easing to the 2 per cent target in 2025. This trajectory is of particular interest, as it affects the BoC's decision to maintain interest rates at the current high level, suppressing spending, to ensure that we continually pressure inflation down to that target. There is always a slight chance that a resurgence of inflation prompts another rate hike, and if the recession has a more severe impact, particularly on employment, we could see an earlier move to lower rates, but the most likely scenario is that the recession impact remains mild and that the BoC will only start lowering rates towards the end of 2024, as the path to the 2 per cent target is firmed up.

Canada Economic & Market Indicators Weakened In 2023

Indicator Name	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q3 2023E	Current	Q4 2023E
GDP growth (% y/y)	3.9	5.2	4.0	2.2	1.8	1.2	0.5	--	--	0.4
Headline Inflation (% y/y)	5.8	7.5	7.2	6.7	5.1	3.5	--	3.7	3.1[1]	3.3
Policy interest rate (%)	0.5	1.5	3.3	4.3	4.5	4.8	--	5.0	5.0[2]	5.0
Unemployment rate (%)	5.7	5.1	5.1	5.1	5.0	5.2	--	5.5	5.8[3]	5.8
Employment growth (% y/y)	4.9	5.3	3.3	2.3	2.7	2.1	--	2.5	2.5[1]	2.1
Consumer spending growth (% y/y)	5.1	8.0	3.1	3.0	3.7	1.6	--	1.5	--	1.2
Investment growth (% y/y)	0.2	-1.8	-0.5	-3.8	-6.0	-3.6	--	-1.1	--	-0.5
Government consumption growth (% y/y)	2.9	1.4	2.0	1.9	0.1	1.4	--	0.9	--	0.8
Housing price growth (% y/y)	30.3	18.8	6.8	-3.9	-14.1	-8.5	--	-0.3	--	1.5
Exports of goods and services growth (% y/y)	-2.7	4.6	6.4	3.1	7.9	5.9	--	2.7	--	2.3
Imports of goods and services growth (% y/y)	4.6	11.3	11.5	3.0	2.7	-3.2	--	-3.1	--	1.1
Service PMI	56.1	50.4	48.0	47.9	50.1	49.7	47.8	--	46.6[2]	--
Manufacturing PMI	58.9	54.6	49.8	49.2	48.6	48.8	47.5	--	48.6[2]	--
S&P/TSX Comp price level	21,890	18,861	18,444	19,385	20,100	20,155	19,541	--	20,236[2]	--
CAD/USD (CAD per USD)	1.25	1.29	1.38	1.36	1.35	1.32	1.36	--	1.36[2]	--
WTI Oil Price (USD/bbl)	100.3	105.8	79.5	80.3	75.7	70.6	90.8	--	76.0[2]	--

Source: Capital Economics; Bloomberg; The third and fourth quarter 2023 estimates as of November 22, 2023. [1]Data as of October 30, 2023. [2]Data as of November 30, 2023. [3]Data as of December 1, 2023.

The year-over-year improvement in October headline inflation was helped by lower gasoline prices (-7.8 per cent). When removing some of these more volatile components, the BoC's more preferred core inflation (CPI-trim) metric dropped from 5.6 per cent in June 2022 to 3.5 per cent this October. Canada continues to make slow but steady progress.

Canadians' disposable income has declined (~7%) from year-end 2022 on an inflation-adjusted basis, and credit card balances are also reaching an all-time high of $107.4 billion according to Equifax. Together with the surge in interest rate costs and lower excess savings, these factors led to weakening consumer spending trends. Softening domestic demand, a global slowdown, and various disruptions such as the BC port strike have led to a decline in both export and import growth in Canada. Both the service and manufacturing PMI are hovering just below 50, indicating a slide into a contraction period. In contrast to the U.S. government, which significantly increased fiscal spending to achieve a softer landing at the cost of soaring treasury yields, Canada's government spending has remained in line with its previous trend amid the economic slowdown. Against this backdrop, companies are adopting a more conservative approach to fixed capital investment. Unsurprisingly, Canada's real GDP stalled in 3Q23, and real GDP per capita growth shows a more pronounced decline, with both year-over-year and quarter-over-quarter growth entering negative territory. The BoC is forecasting full-year Canadian GDP of 1.2% in 2023, 0.9% in 2024, 2.5% in 2025.

One of the reasons that we expect the upcoming recessions to be mild is the still relatively tight labour markets in both Canada and the U.S. The year-to-date increase in the unemployment rate is only 0.8 per cent, to 5.8 per cent in November, and up from the historic low of 4.9 per cent in June 2022, keeping the unemployment level well below the historical (since 1976) average of 8 per cent. However, we are finally seeing more signs of easing as job vacancies have decreased in recent months, and the labour force participation rate – the proportion of the population aged 15 and older that was either employed or looking for work – has remained relatively high.

Industries that had the biggest job losses in October were wholesale and retail trade (-22,000; -0.7%) and manufacturing (-19,000; -1.0%), also signaling that consumer spending is losing momentum and we are facing an economic slowdown. Overall hiring has been most prevalent in the public sector. The easing labour market has helped to alleviate wage pressures, with the three-month annualized rate down to 4.0 percent. This is still too high, but with a recession and further modest increase to the unemployment rate, this is likely to decline further. The high immigration level in Canada has helped to bring more workers to the labour force to ease that labour tightness, and helps the much longer-term demographic issue of an aging population, but in the near-term, the influx has put even more pressure on an already challenging housing affordability crisis. You can see more details in our October Insights & Strategies Report (Housing Crisis or Opportunity?).

Looking to Canadian equity markets, the S&P/TSX Composite (TSX) experienced a relatively flat year amid the mixed signals, up mid single-digits. From the start of 2023 it fluctuated between approximately 19,400 and 20,800 points, as detailed in our chart of page 5. A relief rally in January saw a rebound of 7.1 per cent from the 2022 close. Subsequently, the market closely monitored and reacted to decisions on rate hikes and relevant indicators, including CPI prints, labour statistics, and GDP growth from both the U.S. and Canada. Bank fears stemming from the SVB failure in March, the debt ceiling debate in June, and fluctuating energy prices induced extra volatility in the TSX's performance. In October, seasonal effects, uncertainties about interest rate hikes, and concerns about the Israel-Hamas conflict led to the TSX breaking its support at 19,400, resulting in a drop to 18,737. However, a shift in sentiment toward a more cautiously optimistic outlook for the economy, driven by tech stocks' Q3 earnings, softer inflation print and easing labour markets, has brought it back to the 20,000 level.

Sector Performance & Valuations – S&P/TSX Comp

	Current PE NTM	Historical PE (Since 2000)	Premium (Red) / Discount (Green)	YTD Return
S&P/TSX Composite	12.8	14.5	-1.7	6.7%
Information Technology	31.2	22.2	9.0	60.4%
Consumer Staples	15.7	15.8	-0.1	10.3%
Energy	10.7	14.8	-4.1	9.1%
Consumer Discretionary	13.7	14.3	-0.6	8.3%
Industrials	20.5	15.7	4.8	4.7%
Financials	9.5	11.4	-1.9	4.4%
Health Care	6.1	16.4	-10.2	4.1%
Real Estate	13.5	14.6	-1.1	-2.9%
Utilities	17.0	17.9	-0.9	-4.0%
Communication Services	15.8	15.8	0.0	-4.7%
Materials	15.9	17.0	-1.1	-4.7%

Source: FactSet; Data as of November 22, 2023. YTD returns are total returns in CAD.

Sector Performance & Valuations – S&P 500

	Current PE NTM	Historical PE (Since 2000)	Premium (Red) / Discount (Green)	YTD Return
S&P 500	18.8	16.2	2.7	19.9%
Information Technology	26.7	17.6	9.0	51.8%
Communication Services	17.1	18.1	-1.0	51.8%
Consumer Discretionary	24.9	18.2	6.7	33.0%
Industrials	18.1	16.3	1.8	9.2%
Materials	18.1	15.4	2.7	5.4%
Financials	13.5	13.0	0.5	4.1%
Real Estate	16.2	18.1	-1.9	0.1%
Energy	10.6	13.5	-2.8	-1.1%
Health Care	17.3	16.2	1.1	-3.3%
Consumer Staples	18.7	18.1	0.7	-3.5%
Utilities	15.6	14.8	0.8	-9.6%

Source: FactSet; Data as of November 22, 2023. YTD returns are total returns in USD.

From a sector perspective, Information Technology is the clear standout in the TSX, up ~60 per cent, driven by companies like Shopify and Constellation Software, similar to the technology stocks that make up the Magnificent 7 in the U.S. On the negative side, sectors such as Communication Services, Utilities, and Real Estate/REITs, suffered as rising interest rates reduced the attractiveness of their distribution/dividend payers. The TSX Materials sector was down similarly, although individual stocks comprising that sector were highly variable.

In the U.S., the benchmark and market cap-weighted S&P 500 index is up ~20 per cent so far this year, driven by the technology sector, which rose ~52 per cent, similar to the Communication Services sector. Most other sectors were up (Financials, Industrials, Materials), or down (Consumer Staples, Energy, Health Care, Real Estate) by single digits, with Utilities barely making it into negative double-digits year-to-date.

U.S. stock indices outperformed the rest of global equity indices, notably the Nasdaq Composite given its higher weighting in the technology sector. Most developed countries' stock indices achieved high double-digit year-to-date returns, with exceptions in Canada and the U.K. Meanwhile, China and Hong Kong stock markets continued to exhibit sluggish performance. In terms of equity style, growth significantly surpassed value, and large-cap stocks outperformed small-cap stocks amid the backdrop of a pending economic slowdown. U.S. large-cap stocks are trading above their 23-year median P/E NTM, attributed to robust labour productivity growth and the chase of liquidity by global fund managers. In contrast, valuations for other countries are at a slight discount or around their historical median, possibly reflecting increased recession concerns.

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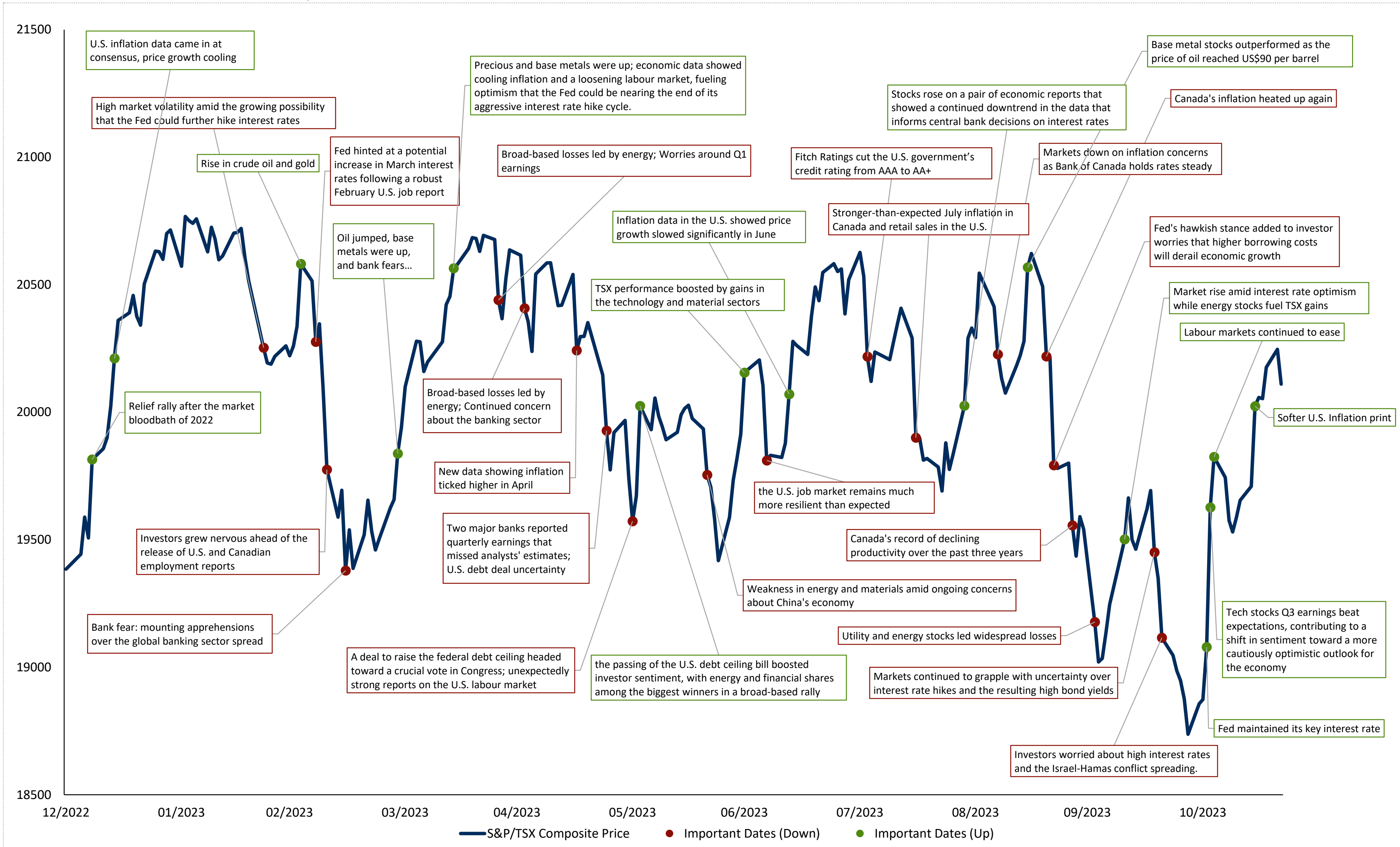
Major Global Equity Indices

Select Global Equity Indices	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	2022 (in LCL)	2022 (in USD)	2022 (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Canada									
S&P/TSX Composite	6.7	5.2	6.7	-5.8	-12.2	-5.8	12.8	14.5	-1.7
S&P/TSX 60	7.0	5.4	7.0	-6.2	-12.6	-6.2	13.2	14.3	-1.1
S&P/TSX Small Cap	-0.6	-2.0	-0.6	-9.3	-15.4	-9.3	12.4	16.9	-4.5
Canada Growth	12.2	10.6	12.2	-13.0	-18.9	-13.0	19.4	18.1	1.3
Canada Value	0.6	-0.9	0.6	-1.3	-8.0	-1.3	10.2	12.2	-1.9
U.S.									
NASDAQ Composite	36.7	36.7	38.7	-32.5	-32.5	-27.6	26.3	19.6	6.6
S&P 500	19.9	19.9	21.2	-18.1	-18.1	-12.2	18.8	16.2	2.7
S&P Mid Cap 400	5.8	5.8	6.9	-13.1	-13.1	-6.7	13.3	13.6	-0.3
S&P Small Cap 600	2.0	2.0	3.0	-16.1	-16.1	-10.0	12.6	14.9	-2.3
S&P Composite 1500	18.6	18.6	19.9	-17.8	-17.8	-11.8	18.2	15.9	2.3
S&P Composite 1500 Growth	23.8	23.8	24.1	-28.7	-28.7	-24.2	20.8	18.6	2.2
S&P Composite 1500 Value	13.1	13.1	12.7	-5.5	-5.5	-0.9	16.0	14.0	2.0
Europe									
Euro STOXX 50 (Europe)	17.9	16.8	18.5	-8.8	-17.2	-11.2	12.5	13.1	-0.7
FTSE 100 (U.K.)	4.0	3.8	5.3	4.7	-10.4	-3.9	10.4	12.4	-2.0
CAC 40 (France)	15.5	17.6	19.3	-6.7	-12.4	-6.1	13.0	13.2	-0.2
DAX (Germany)	14.2	16.3	18.0	-12.3	-17.4	-12.5	11.1	12.6	-1.5
Asia Pacific									
Hang Seng (Hong Kong)	-7.0	-6.9	-5.6	-12.5	-12.6	-6.3	8.4	12.5	-4.2
Nikkei 225 (Japan)	30.7	15.2	16.9	-7.3	-19.1	-14.3	18.5	16.6	1.9
MSCI China (China)*	-6.0	-8.6	-7.2	-17.5	-24.3	-18.8	9.7	10.8	-1.1
Major Aggregates									
World (Global)*	17.6	17.6	19.3	-18.0	-18.0	-12.0	16.5	15.7	0.8
EAFE (DM ex U.S. & Canada)*	11.7	11.7	13.3	-14.4	-14.4	-8.1	12.7	13.5	-0.7
EM (Emerging Markets)*	5.1	5.1	6.6	-20.6	-20.6	-14.8	11.7	11.3	0.3

Source: FactSet; Raymond James Ltd.; Total returns, data as of November 22, 2023. Historical P/E Median: 1/1/2000 – 11/22/2023. LCL: listed in local currency. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

A Look Back at the S&P/TSX Composite Index Performance in 2023



Source: FactSet; Raymond James Ltd.; Data as of November 21, 2023.

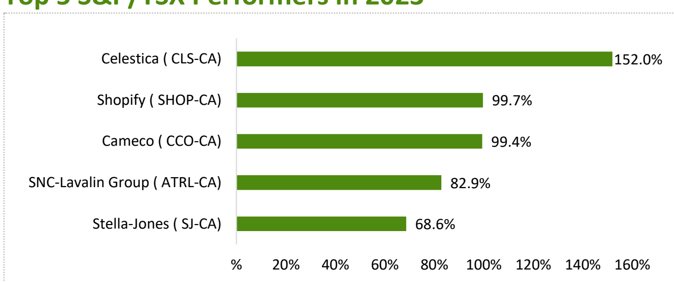
Canadian Leaders & Laggards

The Canadian market saw sharp contrasts this year, with certain companies struggling amid challenging conditions while others flourished. The S&P/TSX Composite index has seen a modest price increase of 4.1% as at November 17, 2023, with market dynamics influenced by macro trends as well as company-specific news. On the macro front, rising interest rates have impacted sectors such as real estate and utilities; and consumer demand patterns have been at the forefront for others. The rise of generative AI has also disrupted various areas, causing trouble for some while being a tailwind for others. In this article, we explore the top and bottom five stock performers (in no particular order), highlighting the underlying reasons behind their trajectories so far this year.

Leaders

Two information technology companies led performance so far this year with **Celestica (CLS-CA)** and **Shopify (SHOP-CA)** up 152.0% and 99.7%, respectively. Global electronic manufacturing services provider Celestica's performance was in part thanks to its focus on non-traditional high-growth sectors like industrial, aerospace, defense, and healthcare, from more traditional low-margin markets. Exposure to AI-driven data center expansion also contributed to the stock's stellar performance. As for Shopify, the cloud-based commerce platform operator's remarkable recovery from its 2022 lows can be attributed to its strategic restructuring, including a shift to an asset-light model, divestiture of its logistics unit, and workforce cuts. Shopify's focus on core offerings and AI integration has also improved its market position.

Top 5 S&P/TSX Performers in 2023



Source: FactSet. Performance data as of November 17, 2023.

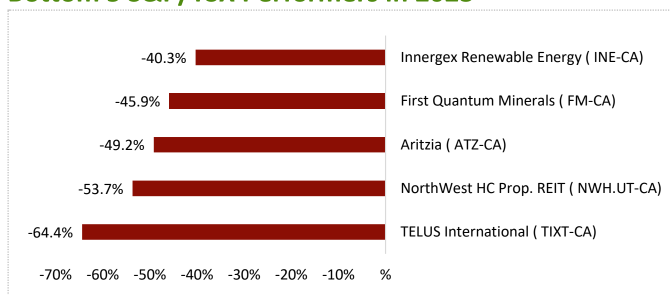
Cameco (CCO-CA) and **Stella-Jones Inc. (SJ-CA)** made it to the top five from the materials sector, up 99.4% and 68.6%, respectively. Cameco, one of the world's largest producers of uranium concentrates, increased 99.4%. Growing demand for uranium along with the commodity's price increase drove Cameco's nearly doubling stock price. The company's strategic acquisition of Westinghouse Electric Company also increased its downstream supply chain exposure and positions it well in the nuclear services sector. As for Stella-Jones, the pressure-treated woods producer's attractive margin outlook, strong demand, and possibly benefiting from US infrastructure spending supported its upward trajectory.

Rounding out the top five is construction & engineering firm **SNC-Lavalin (ATRL-CA)**, now known as AtkinsRéalis, which increased 82.9% on the back of its "pivoting to growth" strategy and record engineering services and nuclear backlog.

Laggards

At the bottom of the performers list is digital customer experience innovator **TELUS International (TIXT-CA)**, down 64.4%. TELUS International's performance has been harmed by a difficult macro landscape along with the threat of disruption from generative AI. Headwinds are more apparent in its customer service business, as AI technologies threaten to replace traditional service models.

Bottom 5 S&P/TSX Performers in 2023



Source: FactSet. Performance data as of November 17, 2023.

NorthWest Healthcare Properties REIT (NWH.UT-CA) declined 53.7%. The underperformance was due to the international healthcare REIT's aggressive growth strategy over the years and challenges with its balance sheet during a period of rising interest rates. **Innergex Renewable Energy (INE-CA)**, which lost 40.3%, was also impacted by the renewable power sector's pressure from rising interest rates and project cost inflation.

Women's apparel design house and fashion retailer **Aritzia (ATZ-CA)** nearly halved, down 49.2%, due to its shift to increased infrastructure investments amidst an uncertain consumer landscape, whilst grappling with margin pressures.

Finally, copper producer **First Quantum Minerals (FM-CA)** lost 45.9%, facing uncertainty due to geopolitical instability in Panama concerning its Cobre Panama mine, one of the world's biggest and newest copper mines.

Larbi Moumni, CFA
VP, Head of Portfolio Advisory

The Blue Supermoon of 2023

A blue supermoon refers to a rare event when a full moon coincides with its closest approach to Earth, making it look much larger than usual. According to NASA, this only occurs once every 10-20 years and those lucky enough to be looking up at the night sky this year on August 30th would have witnessed this amazing summer scene. As we review YTD fund flows, the money market category is acting as a "blue supermoon" of its own, raking in $20.7 billion in net flows YTD and dominating all other funds in what has otherwise been a challenging year for many categories. Observing strong fund flows like this in the money market category only comes once in a blue (super) moon!

ETF & Mutual Fund Flows ($M)

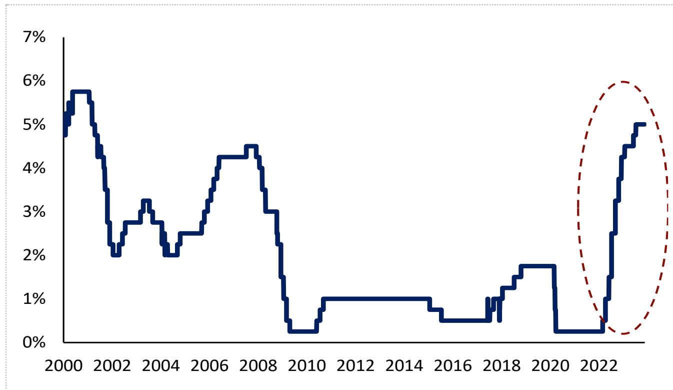
Category	YTD	1 Year	3 Year	5 Year
Canadian Money Market	20,743	24,642	20,456	13,892
Canadian Fixed Income	7,921	11,841	38,690	54,221
Multi-Sector Fixed Income	6,873	5,838	11,154	27,749
Global Fixed Income	6,814	5,951	7,624	12,954
Canadian Long Term Fixed Income	4,435	4,244	4,500	1,900
Global Corporate Fixed Income	4,151	3,497	11,304	13,885
Emerging Markets Equity	1,878	1,763	6,246	8,511
Global Equity	524	(1,399)	28,916	36,497
Canada Fund Sector Equity	311	239	5,472	5,728
Global Small/Mid Cap Equity	299	(453)	1,401	(4,867)
North American Equity	250	188	1,932	1,131
Canadian Corporate Fixed Income	61	608	2,401	1,907
Greater China Equity	(82)	(50)	561	760
Asia Pacific Equity	(83)	(62)	292	172
High Yield Fixed Income	(172)	103	2,246	7,312
Canadian Focused Small/Mid Cap Equity	(173)	(208)	(243)	(1,006)
Canada CE Tactical Balanced	(207)	(228)	(161)	126
International Equity	(221)	(1,993)	10,773	17,259
Asia Pacific ex-Japan Equity	(275)	(420)	473	(196)
Preferred Share Fixed Income	(666)	(986)	(752)	(2,084)
Tactical Balanced	(782)	(775)	601	(861)
Canadian Small/Mid Cap Equity	(785)	(884)	(2,020)	(3,750)
Emerging Markets Fixed Income	(848)	(960)	(1,528)	1,134
US Small/Mid Cap Equity	(1,263)	(1,472)	480	(350)
Canadian Short Term Fixed Income	(1,414)	(1,559)	(632)	424
Global Equity Balanced	(1,575)	(2,490)	13,456	11,653
European Equity	(1,582)	(2,324)	(3,180)	(4,747)
Canadian Equity	(2,033)	(1,923)	(2,190)	(1,627)
Canadian Fixed Income Balanced	(6,779)	(8,236)	(12,109)	(17,607)
US Equity	(7,857)	(7,951)	19,649	32,015
Global Neutral Balanced	(9,887)	(13,445)	14,487	16,105
Global Fixed Income Balanced	(10,402)	(13,288)	1,614	7,680

Source: Morningstar, Raymond James Ltd. Data as of October 31, 2023.

Why the Strong Flows in Money Market?

Demand for money market funds can be attributed to the rapid pace of 10 rate hikes from the Bank of Canada (BoC) between March 2022 to September 2023 in their efforts to stem inflation. The yields of money market strategies generally follow central bank rates making these strategies more attractive than we've seen in a very long time. In addition, as economists widely forecasted recessionary risks throughout 2023, the demand for ultra-conservative money market strategies grew as investors aligned their investments with a more risk-off approach.

Historical Policy Rates from the Bank of Canada (BoC)



Source: FactSet; Raymond James; Data as of November 22, 2023.

Money Market vs. Everything Else

As shown in the chart below, investor demand pivoted in Q1 2022 from long term funds into money market funds (long term funds include all CIFSC fund categories excluding money market funds). This Q1 2022 pivot unsurprisingly coincides with the BoC's March 2022 rate hike and since then, the Canadian Money Market category has ranked first in net flows for six consecutive quarters. As we wrap up the year, these cash strategies may continue to realize positive flows used for tax loss harvesting purposes for investors that are unsure of where to allocate their crystallized losses in the current market environment.

Net Flows ($M)

	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23
Total Money Market Funds	(3,482)	(2,606)	(591)	(721)	402	1,986	1,287	3,531	4,121	3,768	3,953
Total Long Term Funds	45,932	32,931	26,494	15,259	17,786	(22,290)	(18,091)	(28,542)	(4,460)	(16,813)	(21,732)
All Funds	42,450	30,325	25,903	14,538	18,188	(20,304)	(16,806)	(25,011)	(339)	(13,045)	(17,798)
Canadian Money Market Rank	57	58	59	54	10	1	1	1	1	1	1

Source: IFIC Industry Statistics, Data as of September 30, 2023.

Market Skies Ahead

As we approach the end of the year, it is widely believed that the BoC is nearing (or has met) its peak policy rate to tame inflation. As previously mentioned, money market funds can be vulnerable to sudden changes in investor perceptions of safety and central bank policy rates. Should central banks decide to hold or cut rates in 2024, the demand for money market strategies may slow (and potentially reverse) as investors consider other investment categories with more upside potential. Under this scenario, other categories will likely benefit from a potential drawdown of money market assets. Like the Blue Supermoon of August 2023, it appears 2023 will close out with the money market category looking much larger than usual however, it will be interesting to see how this theme unfolds in 2024.

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Mutual Fund and ETF Specialist

A Roller Coaster Ride for the Dollar

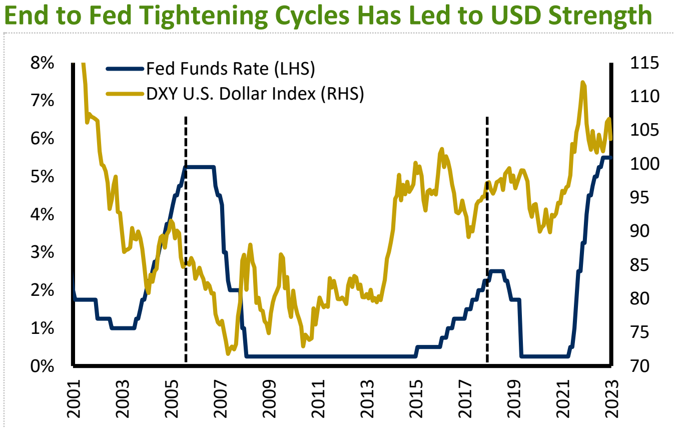
2023 has been quite a whirlwind for the broad U.S. dollar, as tight monetary policy anchored to a supposedly "higher for longer" theme, and a highly volatile U.S. rates market, boosted the greenback across the board. Given the degree by which U.S. yields have rallied this year, it comes as no surprise that the rate-sensitive Japanese yen holds the spot as the worst-performing G10 currency versus the U.S. dollar year-to-date – down nearly 12% at the time of writing.

However, as U.S. yields have pulled back to some degree over the past two months, coupled with a market that is now convinced that the Fed has reached the end of the road with respect to its rate hiking cycle, the broad U.S. dollar is heading into the final month of the year trading roughly where it started the year to begin with.

Historically, the DXY U.S. Dollar index tends to appreciate following the end of Fed rate-hiking cycles, which has been the case from the end of its previous two cycles going back to 2007.

The recent economic data run from south of the border has supported the market's notion that the Fed has done its job, with the focus now shifting to assessing when Powell & Co. will begin to dial things back. For now, over the short term, we may see some continuation of "buy the dip" events in the greenback before the market makes a decisive shift into a "sell the rally" approach. However, given the extent of the U.S. dollar's sell-off during the month of November, we may be in for a bit of a breather and a consolidation phase, absent any material changes to macro factors to drive markets.

End to Fed Tightening Cycles Has Led to USD Strength

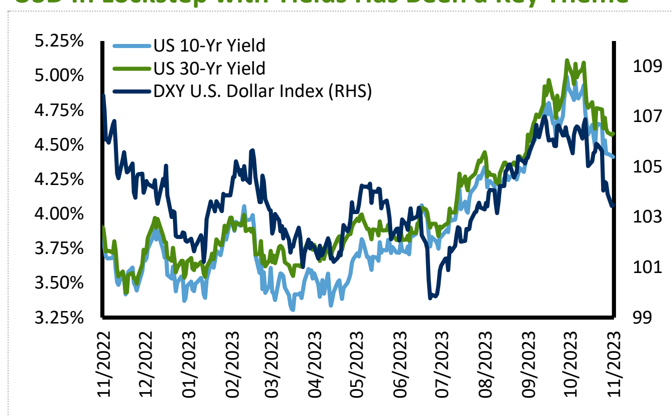


Source: FactSet; Raymond James, Ltd.; Data as of November 21, 2023

A Recession Scare Still on the Horizon?

While the market is now pricing in a nearly zero chance of any more rate hikes from both the Fed and BoC, we cannot rule out the possibility for a more pronounced economic slowdown and a possible recession scare, which may continue to bode well for the U.S. dollar and other safe-haven currencies over the short term. However, the U.S. economy may in fact be better positioned to cope with higher rates than other economies like Canada and Australia, where higher borrowing costs are weighing on consumers to a much higher degree. According to the latest data from the OECD, Canada and Australia have the highest levels of consumer-level household debt as a percentage of disposable income in the G20. Thus, a case can be made for the Fed to lag its major central bank peers when it comes to easing rates next year.

USD In Lockstep with Yields Has Been a Key Theme



Source: FactSet; Raymond James, Ltd.; Data as of November 21, 2023

A Recap of USD/CAD Performance Thus Far

Despite a wild ride with numerous periods of heightened volatility which saw USD/CAD trade within a wide range of ~1.3100-1.3900, the pair is actually up just shy of 0.50% year-to-date, at the time of writing.

An interesting observation this year has been the dislocation between crude oil prices and CAD. The first half of the year saw prompt WTI prices drop 8% while CAD appreciated by a modest 2.5%. Since the beginning of the second half of the year, prompt WTI prices have risen by 10% while CAD depreciated by 3%. This breakdown of a historically strong correlation between CAD and the price of oil can in large part be attributed to increased U.S. domestic production and a lack of Canadian investment in the sector.

Looking ahead, we expect the roller coaster to continue. For instance, the latest data from the Commodity Futures Trading Commission has shown the highest level of net short CAD positions since 2017, which may make CAD more susceptible to domestic risk events than usual.

Ajay Virk, CFA, CMT
Head Trader, Currencies

Past the Peak

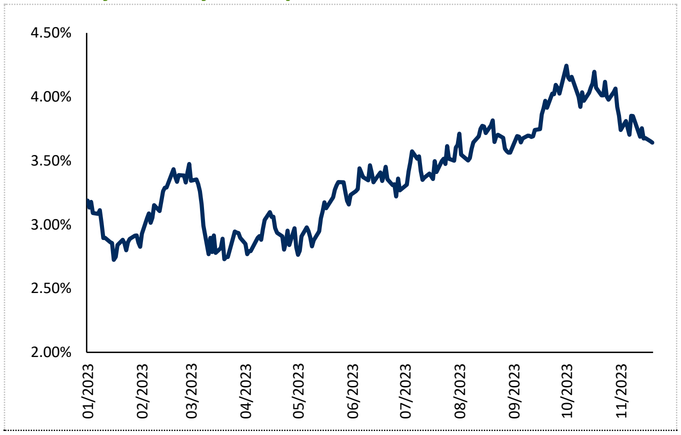
As 2023 comes to a close, we evaluate our previous year's outlook, review fixed income performance, and look forward to 2024.

Last Year's Call

At the end of 2022, we predicted "if inflation pressures subside, the BoC should ease raising interest rates, and we will reach the highest overnight rate of the cycle – also called the "terminal rate". We believe the BoC prefers to maintain a stable rate environment when possible. Thus, we do not foresee a rate cut in 2023." How did we fare?

Inflation is measured by CPI, which showed a negative trend this year. Year-over-year percentage change fell from 5.9% in January to 3.1% in October, a low for the year so far. Prices of goods and services are still increasing, but now at a much more manageable pace, and closer to the BoC's target of 2%. Looking at the overnight rate, the Bank of Canada increased rates by 0.25% three times but have held steady at the last few meetings with no indication that the last meeting of the year (December 6) will result in a rate cut. In comparison, 2022 saw a 4.00% total increase. Benchmark bond yields, which increased for much of the year, have begun to reverse course in 4Q23, leaving many investors convinced that we've hit the terminal rate as well. Overall, steadying inflation, fewer rate hikes, and the hitting of the peak of the interest rate cycle aligns with our call.

GoC 10-year may have peaked in October 2023



Source: FactSet; Raymond James Ltd.

Areas of Outperformance

The best performing term in 2023 (in price) were short-term instruments, as we largely experienced a rising rate environment. To illustrate, the GoC two-year bond increased by 16 cents whereas the 30-year note saw its value fall by $2.62. The yield curve displays continued inversion, but from around three years and beyond, we note that the curve is quite flat.

To see the full picture, we can track one security throughout the year. Looking at the 10-year GoC (above), investors may note that rates had a bit of a headfake in the spring, but then rose higher throughout the middle of the year before moderating slightly from the highest yield levels reached in October.

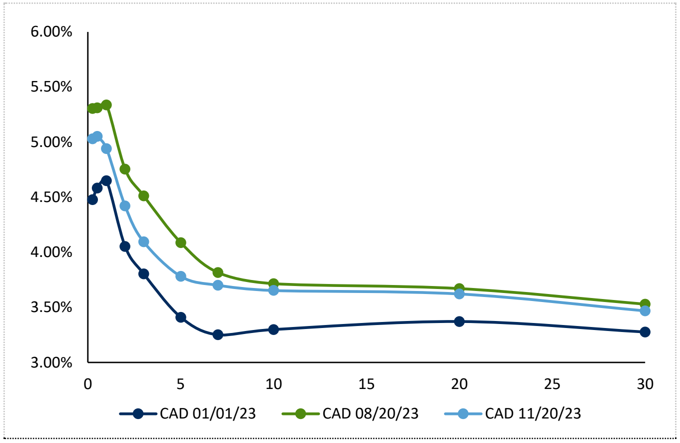
Corporate bonds for the most part tightened in 2023. In periods of rising rates, spreads, or the premium at which non-benchmark securities trade, generally decreases. To compound this effect, there were areas of product scarcity, especially in coupon-paying bonds priced at a discount to par. When numerous parties are in search of the same instrument(s), their value tends to increase in comparison to other alternatives in the same term.

2024 positioning

At this time, it is clear that the risk of yields falling is greater than them continuing to increase. We suggest extending term beyond short-term rates, despite their higher yields, to capitalize on elevated yields before they potentially fall in 2024. The current call is for central banks (US and Canada) to cut their overnight rates by 0.50% by Q3 of next year. However, it is important to note that these predictions have been pushed back numerous times through this hiking cycle and will be revised as more data is released.

We would be remiss if we did not highlight the importance of proper asset allocation to your portfolio. For years, investors neglected fixed income investments in favour of those that provided higher returns, like dividend-paying equities. Today, it is worth re-evaluating those positions, as opportunities in bonds have increased so substantially. If we do enter a falling-interest rate environment, bonds have the potential to increase in value and providing another benefit to bondholders.

Benchmark yields have risen this year but off the highs



Source: FactSet; Raymond James Ltd.

Charlotte Jakubowicz, CMT, CIM
Vice President, Fixed Income and Currencies

Celebrating Five Years of "Liquid Alts" in Canada

It's been roughly five years since Canada's mutual fund regulatory framework was modified to allow a new class of mutual funds to be created. The "alternative mutual fund", more commonly referred to as a "liquid alt", provides investors with additional options to create a well-diversified portfolio. Many investors have historically included alternative investments into their asset mix to diversify their portfolio beyond equities, fixed income, and cash. Alternatives can have several benefits within a portfolio such as lowering correlation to equities and fixed income, downside protection, reducing volatility, providing an alternative source of income, or the ability to enhance returns. Prior to this regulatory overhaul in late 2018, alternative investments were only available to sophisticated and high net worth individuals, otherwise known as "Accredited" investors. Liquid alts allow fund managers to take advantage of a more flexible investment framework (such as shorting, leverage, derivatives, and options) compared to what traditional mutual fund regulations have allowed, but with the advantage of being accessible to *all* types of investors. Other advantages include lower minimum investment thresholds, better liquidity, additional portfolio transparency, zero supplementary paperwork to purchase them, and better regulatory reporting obligations since they have the same transparency as traditional mutual funds and ETFs (offered by a prospectus). Our view has been for some time that alternative investments can help to bridge the gap between equities and fixed income, offering more diversification for one's investment portfolio as well as the potential to achieve a more favourable rate of return than fixed income, with less volatility than equities. It's difficult for investors to predict the performance of a particular asset class from year-to-year and diversification is the only free lunch that helps to ensure that one has exposure to the best performing asset class in any given year. Liquid alts are another tool in the toolbox to more fully diversify a portfolio without having to make significant liquidity sacrifices. In 2022, a tough year for most equities and fixed income markets, the Scotiabank Alternative Mutual Fund Index, which represents 62 funds across various Canadian alternative investment strategies and investment managers, was down -3.30% while Canadian equities were down -5.85%[1], US bonds were down -6.74%[1], Canadian bonds were down -11.78%[1], and US equities were down -12.19%[1]. Outside of money market funds and some private assets (with less liquidity), there were few places to hide. Turning to 2023, after several more interest rate hikes the risk-free rate is north of 5%, we now have over 150 liquid alts in the Canadian marketplace for investors to choose from, and returns have been more muted - the Scotiabank Alternative Mutual Fund Index is up 0.48% year-to-date.

Scotiabank Alternative Mutual Fund Index – Equal-Weighted

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
2023	1.6%	-0.6%	0.0%	0.8%	-1.1%	0.5%	0.4%	0.3%	-0.9%	-0.5%			**0.5%**
2022	-1.1%	-0.2%	0.4%	-0.9%	-0.6%	-2.2%	1.2%	-0.4%	-1.4%	1.2%	1.6%	-0.9%	**-3.3%**
2021	0.8%	1.6%	0.6%	1.8%	0.3%	0.8%	0.8%	0.8%	-1.0%	0.9%	-0.6%	1.8%	**8.9%**
2020	0.5%	-2.7%	-6.6%	4.6%	1.8%	0.7%	2.5%	0.9%	-0.7%	-0.6%	2.8%	2.2%	**4.9%**
2019	1.6%	0.7%	0.8%	0.8%	-1.1%	0.7%	0.4%	0.1%	-0.1%	-0.1%	1.2%	0.3%	**5.3%**

Source: Scotiabank

It's an important reminder that liquid alts should not be thought of as a "one size fits all" portfolio and should not replace the core portfolio of traditional investments. Since alternatives are not created equal and have different investment mandates, investors need to be mindful of each alternative investment's specific objective and risks, their personal liquidity needs and risk tolerance, and avoid being overly concentrated in any one fund or manager when building out their alternatives allocation.

What are alternative investments?

An alternative investment is an investment that does not fall into one of the traditional asset classes such as equities, fixed income, and cash, and is used to more fully diversify a portfolio (among other objectives). Here are some examples:

- *Real Assets (such as private real estate, infrastructure, natural resources)*
- *Private Equity (includes buyout, mezzanine, venture capital)*
- *Private Debt (such as factoring, asset-backed lending, distressed debt)*
- *Mortgage Products (MICs, mortgage investment trusts)*
- *Hedge Funds and Liquid Alts (various strategies such as market neutral, long/short equity, long-bias, merger arbitrage, multi strategy)*

Source: Raymond James

While the balanced portfolio (60% equities / 40% fixed income) had a challenging year in 2022 due to bonds and equities both declining from an aggressive interest rate hiking cycle and recession fears, it's been a recipe for success for long-term investors. While rates have reset higher and bonds are earning a decent yield again, we still believe that for certain investors alternative investments will continue to complement and further diversify their strategic asset mix to help them achieve their financial goals. While alternatives can be a great way to diversify portfolios, and with a steady stream of new liquid alts launching in Canada over the last 5 years, due diligence on the manager, their investment process, and understanding how liquid alts fit within the traditional portfolio is key. Investors should seek the advice of their financial advisor prior to investing in alternative investments.

Emma Querengesser
Vice President, Head of Investment Products

[1]Canadian equities = iShares Core S&P TSX Capped Composite ETF; US Bonds = iShares Core US Aggregate Bond ETF; Canadian bonds = iShares Core Canadian Universe Bond ETF; US equities = SPDR S&P 500 ETF.

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A member of the PCS team responsible for preparation of this newsletter or a member of his/her household has a long position in Shopify, Inc (SHOP-CA), SNC-Lavalin (ATRL-CA), and NorthWest Healthcare Properties REIT (NWH.UT-CA).

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