RAYMOND JAMES®

PRIVATE CLIENT SOLUTIONS

ASSET ALLOCATION QUARTERLY

- **Global economic slowdown and mild recessions expected in both Canada and the U.S.**
- **Inflation is down from its peak, but the fight to get from 4 per cent to 2 per cent targets could drag into 2025, with policy rates being held "higher for longer"**
- **Good opportunities in fixed income with rates at decades highs**

How much further for inflation and interest rates?

October 2023

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2. | 2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

Summary

Neil Linsdell, CFA
VP, Head of Investment Strategy

Tavis C. McCourt, CFA
Institutional Equity Strategist

Eugenio J. Alemán, Ph.D.
Chief Economist

Charlotte Jakubowicz, CMT, CIM
VP, Fixed Income and Currencies

Douglas Drabik, CFA, CMT
Senior Retail Fixed Income Strategist

Ed Mills
Washington Policy Analyst

Eve Zhou
Multi-Asset Analyst

How will it end? This year has confounded many investors and even central bankers. The global pandemic and ensuing global supply chain disruptions and unprecedented government fiscal measures, created an environment in which conventional monetary policy actions were less effective than expected. Despite the resiliency of the global economy (and U.S. economy specifically) so far, the lagged effect of tighter monetary policy is likely to finally deliver that long awaited recession in the first half of 2024.

We anticipate mild recessions in both Canada and the U.S. While Canada has already experienced modest GDP contractions in both 4Q22 and 2Q23, the U.S., on the other hand, presents a more hopeful picture of a soft-landing scenario, buoyed by its resilient economy, robust consumer consumption, and significantly government spending. However, we still foresee the U.S. facing some contraction, at least in the first half of the next year, due to the slowing global economy and domestic pressure from higher interest rates. There is also a slight possibility that the recession could be more severe than our base case, considering the prolonged duration of the yield curve inversion, which has lasted for ~390 days, just exceeding the one before the 2008 Great Recession.

With recessions, we expect inflation relief, allowing the easing of policy rates and more stable financial markets. We foresee policy rates starting to decline in 2024, although more likely into the second half of the year and perhaps only in 2025, depending on how inflation, the economy, and employment data play out.

Key Takeaways:

- **North America's Economy: Resilient Yet Challenged** – North America's economy has proven to be more resilient than expected so far this year. Labour markets remain tight, and there has been continued strength in retail sales. However, efforts to slow the economy are beginning to take hold, with already slight GDP contraction in Canada. High household debt levels and increasing mortgage payments have helped to curb Canadians' spending habits, while in the U.S., there is growing consumer debt, and major package carriers are experiencing slowdowns.
- **Rates to Stay Higher for Longer** – While we are likely near the end of rate hikes, we remain cautious about the prospect of one more minor rate hike, in each of Canada and the U.S. A resurgence in inflation remains the biggest concern for policymakers in both countries, forcing central bankers to keep potential increases on the table.
- **Stay Invested -** Timing market tops and bottoms is exceedingly difficult, if not impossible, and markets can react quickly at, or ahead of, the first signs of an improving economy. Staying invested in the right assets for your long-term objectives and risk tolerance is usually the most prudent approach.
- **Opportunities in Fixed Income** - The high interest rate environment has created opportunities in fixed income markets that we haven't seen in decades in both the U.S. and Canada. Fixed income investors are poised for a dual benefit. Not only are yields now more comparable to equity returns, but a rate reversal could provide additional gains as bond prices appreciate. Extending duration may benefit investors.
- **Equity Positioning** - When excluding the mega-cap tech stocks that have driven index performance in the U.S., returns have been quite muted, yet volatile. We would maintain a balance between the U.S. and Canada. We also favour a defensive posture given our base case of mild recessions in the first half of 2024.

Contents

ASSET ALLOCATION RECOMMENDATIONS 4

STRATEGIC ASSET ALLOCATION RECOMMENDATIONS 4

MARKET COMMENTARY 5

CANADIAN ECONOMIC OUTLOOK 9

U.S. ECONOMIC OUTLOOK 12

CANADIAN EQUITIES 13

U.S. EQUITIES 15

CANADIAN FIXED INCOME 18

U.S. FIXED INCOME 19

WASHINGTON POLICY: THE END OF GLOBALIZATION? RISKS AND OPPORTUNITIES OF A NEW ECONOMIC ERA 21

ASSET ALLOCATION COMMITTEE 23

Asset Allocation Recommendations

Strategic Asset Allocation Recommendations

CURRENT POSITIONING	Ultra Conservative	Conservative	Moderate	Balanced	Balanced Growth	Growth
Equity	**10%**	**30%**	**50%**	**60%**	**70%**	**90%**
Canadian Equities	4.0%	10.0%	20.0%	25.0%	25.0%	30.0%
US Equities	4.0%	10.0%	15.0%	17.5%	20.0%	30.0%
Developed Markets Equities (ex NA)	2.0%	10.0%	15.0%	17.5%	25.0%	30.0%
Fixed Income	**88%**	**68%**	**48%**	**38%**	**28%**	**8%**
Canadian Aggregate Fixed Income	60.0%	45.0%	30.0%	38.0%	20.0%	8.0%
Canadian Short-term Fixed Income	28.0%	23.0%	18.0%	-	8.0%	-
Cash	**2%**	**2%**	**2%**	**2%**	**2%**	**2%**

ASSET CLASS DEFINITIONS

Canadian Equities: S&P/TSX Composite: the benchmark Canadian index, representing roughly 70% of the total market capitalization on the Toronto Stock Exchange with about 250 companies included in it. The Toronto Stock Exchange is made up of over 1,500 companies.

US Equities: S&P 500: is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

Developed Markets Equities (ex NA): MSCI EAFE: is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 21 countries.

Canadian Aggregate Fixed Income: FTSE Canada Universe Bond: tracks the performance of investment-grade (BBB or better), government and corporate bonds in Canada.

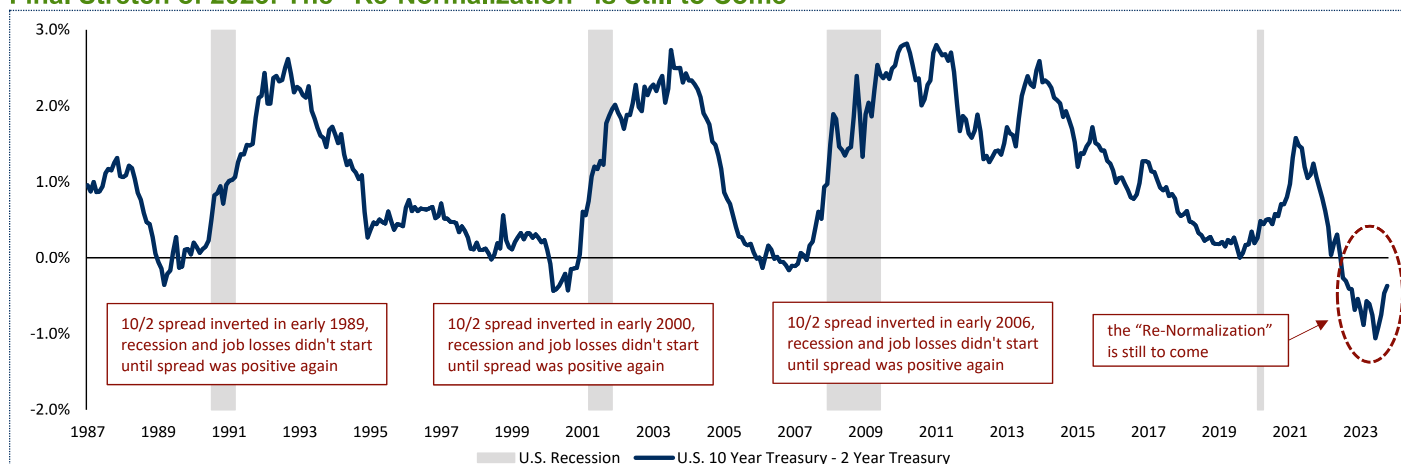
Canadian Short-term Fixed Income: FTSE Canada Short Term Bond: intended to represent the Canadian short-term bond market. It contains bonds with remaining effective terms greater than or equal to one year and less than or equal to five years.

Cash: FTSE 91 Day T-Bill: tracks the performance of 3-Month Government of Canada Treasury Bill. The index is designed to reflect the performance of a portfolio that only owns 3-Month Government of Canada Treasury Bill, the current on the run T-Bill for the relevant term, switching into the new T-Bill at each auction.

Market Commentary

As we head into the final stretch of 2023, we remain cautious about the prospect of one more minor rate hike, in each of Canada and the U.S. Then, the question remains as to when and how the yield curve will renormalize, with short-term rates dropping back below long-term rates. Historically, and on average, recessions only hit about four months after the yield curve is renormalized. Heightened uncertainty and anxiety as we watch for data that paves the way through the build-up to this recession could lead to still more market volatility over the next few months or quarters, although we do look forward to a more stable and supportive environment as inflation gets under control and policy rates provide a little relief in the latter part of 2024, or perhaps into 2025. Patience is crucial and investors should take this opportunity to ensure that portfolios are properly balanced to ride through any potential volatility, and equally well equipped to benefit as the economic situation stabilizes and markets pick back up. Timing market tops and bottoms is exceedingly difficult, if not impossible, and markets can react quickly at, or ahead of, the first signs of an improving economy. Staying invested in the right assets for your long-term objectives and risk tolerance is usually the most prudent approach.

Final Stretch of 2023: The "Re-Normalization" is Still to Come



Source: St. Louis Federal Reserve, Raymond James research; Data as of October 17, 2023.

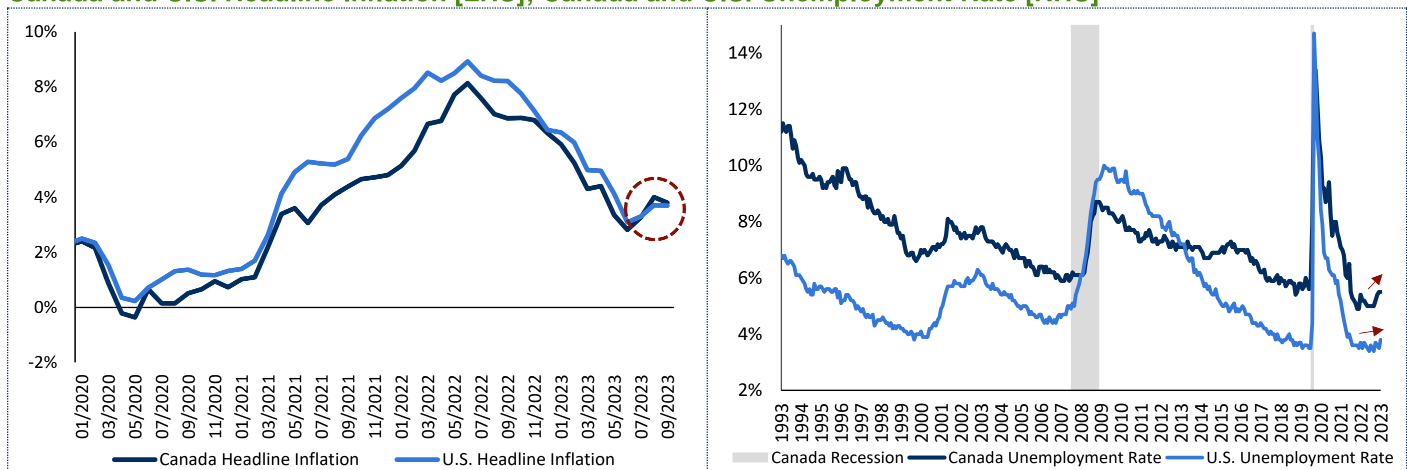
Our base case scenario is for mild recessions in 2024 in both Canada and the U.S. While Canada has already shown modest GDP contraction in both 4Q22 and 2Q23, the U.S. economy has been buoyed by various factors that have given hope of a soft-landing scenario. However, we still foresee the U.S. facing some contraction, at least in the first half of the next year, due to the slowing global economy and domestic pressure from higher interest rates.

Along with the softening of the economies, we foresee policy rates starting to decline in 2024, although more likely into the second half of the year and perhaps only in 2025, depending on how inflation, the economy, and employment data play out. The primary consideration will be inflation. Headline inflation numbers in both the U.S. and Canada reaccelerated in July and August, due to unfavourable base effects and increased energy prices. Despite a slight decrease in the September figures, there is no guarantee that this disinflationary trend will continue in the short-term and the future trajectory remains choppy. Central banks are tasked with maintaining price stability and employment, so as long as the employment situation looks good, the bankers have more flexibility to maintain monetary pressure.

The U.S. is currently experiencing an extremely tight labour market, with only 70 workers seeking employment for every 100 open jobs. Canada is faring better, with a larger percentage of the population as 'working age', it has approximately 170 job seekers per 100 open positions.

If inflation persists above the 2 per cent target range and the job markets remain tight, as is still the case in both the U.S. and Canada, central bankers are likely to keep interest rates higher than many people would hope. This cautious approach aims to prevent the risk of a resurgence in inflation. This is also what we should expect under the soft-landing scenario, where the economy remains so resilient that we skirt a recession, growth continues, and inflation remains above target, dragging out the "higher for longer" environment. If the economies slip into recession, we expect that would mean that unemployment ticks up and consumer spending declines, taking down inflation, and enticing central bankers to slowly reduce rates to limit job losses and ensure a mild and short-lived recession, but having still achieved the ultimate goal of bringing down inflation. It's a difficult needle to thread, and the risk of overtightening and/or waiting too long to ease policy rates brings the threat of a longer and/or deeper recession than necessary, with more job losses and leaving more damage to the economy, requiring perhaps more dramatic rate cuts and a longer recovery period, overall.

Canada and U.S. Headline Inflation [LHS]; Canada and U.S. Unemployment Rate [RHS]



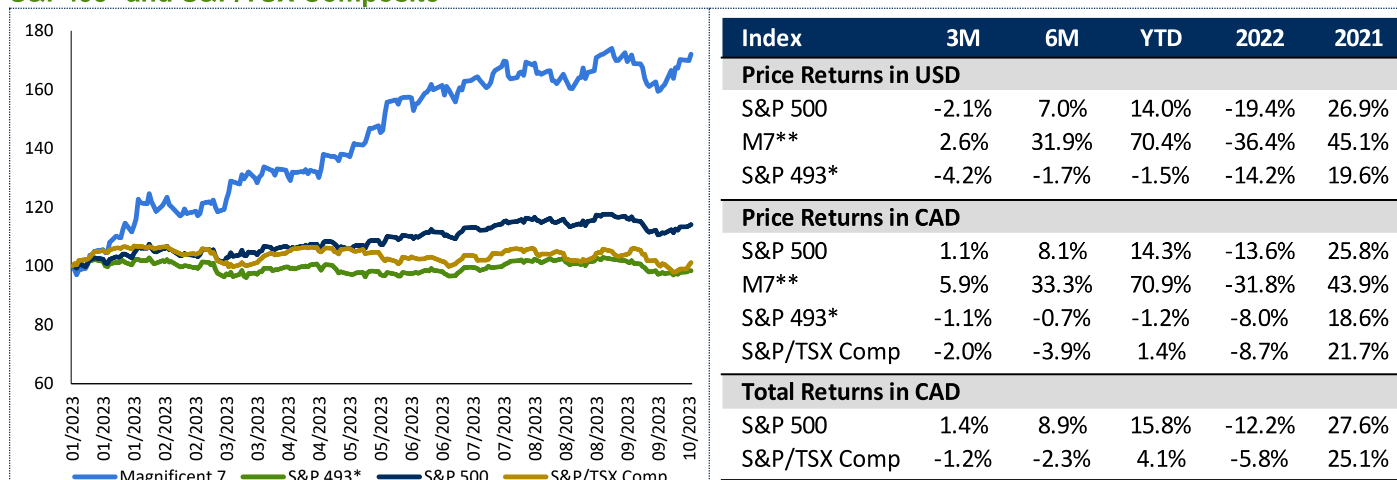
Source: FactSet; Raymond James Ltd.; Data as of September 30, 2023.

For investors, the interest rate environment has created opportunities in fixed income markets that we haven't seen in decades. In certain cases, this is allowing investors to lock in returns that somewhat rival certain equity investments, making this a very opportune time to review portfolios for the right balance of return expectation and risk level to achieve longer-term goals. Fixed income products have seen surprisingly high volatility recently, and valuations could still face some pressure if policy rates rise further, but locking in longer-term outcomes and having the potential for capital gains, assuming rates start to fall in the foreseeable future, should be considered. We delve into this topic extensively in the fixed income sections for both the U.S. and Canada.

For North American equity markets, when excluding the mega cap tech stocks that have driven index performance in the U.S., returns have been quite muted, yet volatile. As fixed income has become a more viable asset class and as short-term cash and money market vehicles have been increasingly attractive and safer alternatives, most equities have suffered in comparison. With cash increasingly sitting on the sidelines, there are undoubtedly pockets of value that investors should consider after discussions with their financial advisors. We are not yet past this period of volatility and the potential for pullbacks as recessionary effects likely impact corporate earnings and expectations, yet as the market looks forward, the best returns are typically achieved early in the cycle before the masses are convinced that the coast is clear, and so it remains a prudent idea to remain invested in high quality businesses rather than trying to time the market.

The major Canadian stock indices, the S&P/TSX Composite and the TSX 60, have both peaked at least three times over 2023, to being up 6-7 per cent from the start of the year, before pulling back to where they started. When factoring in dividends, the TSX Composite has returned approximately 4 percent, which may seem low compared to the 16 percent (in Canadian dollars) total return from the S&P 500, unless we remove the "Magnificent 7" tech stocks that now account for 30 percent of the U.S. index, and the vast majority of its gains. Excluding these U.S. companies ends up putting the Canadian market a few percentages ahead of the U.S. (S&P 493, if you will).

Year-To-Date Price Change (Indexed to 100) [LHS] and Return Comparison [RHS] for Magnificent 7, S&P 500, S&P493* and S&P/TSX Composite



Index	3M	6M	YTD	2022	2021
Price Returns in USD					
S&P 500	-2.1%	7.0%	14.0%	-19.4%	26.9%
M7**	2.6%	31.9%	70.4%	-36.4%	45.1%
S&P 493*	-4.2%	-1.7%	-1.5%	-14.2%	19.6%
Price Returns in CAD					
S&P 500	1.1%	8.1%	14.3%	-13.6%	25.8%
M7**	5.9%	33.3%	70.9%	-31.8%	43.9%
S&P 493*	-1.1%	-0.7%	-1.2%	-8.0%	18.6%
S&P/TSX Comp	-2.0%	-3.9%	1.4%	-8.7%	21.7%
Total Returns in CAD					
S&P 500	1.4%	8.9%	15.8%	-12.2%	27.6%
S&P/TSX Comp	-1.2%	-2.3%	4.1%	-5.8%	25.1%

Source: Bloomberg; FactSet; Raymond James Ltd.; Data as of October 11, 2023. *S&P 500 ex "Magnificent 7"; **"Magnificent 7" Apple Inc., Microsoft Corporation, Alphabet Inc., Amazon.com, Inc., NVIDIA Corporation, Tesla, Inc., Meta Platforms Inc. Price return only captures price movements (capital gain/losses), total return captures both the price movements and dividends.

The Canadian stock market is trading below its 20-year median (P/E) valuation multiples, while earnings expectations remain modest, reflecting a generally conservative stance, indicative of what we would expect entering a recession. For the U.S. market, we see more enthusiasm in both valuation multiples and earnings expectations, reflecting more of a soft-landing outlook. We would maintain a balance between these two geographies and perspectives.

Once we manage through this challenging period, we are optimistic regarding opportunities in the U.S. and Canada, specifically as North America could enter into a reindustrialization phase, driven by the U.S. repatriating manufacturing capacity, in part to avoid a repeat of supply chain issues aggravated by the pandemic.

International markets have been interesting and volatile. China was expected to lead global growth coming out of 2022, but despite stimulus from policymakers, growth has disappointed. China typically accounts for a quarter of global growth, so its struggles are noteworthy. Elsewhere, we see exceedingly high inflation and economic struggles in the U.K., while Germany is already technically in recession.

International equities remain a small but important component of a diversified portfolio, but the breadth of options available can vary widely. Looking at performance to the end of Q3 and converting to Canadian dollars, Europe, Australasia, and the Far East (EAFE) has returned approximately 6.7 per cent so far this year, while emerging markets (EM) have generated around 0.7 per cent.

European markets pulled back in Q3 as economic activity slowed in the region with Germany posting two consecutive quarters of contraction. The U.K. economy is facing some particularly difficult times with especially high inflation and labour strife on the heels of strain from both

the pandemic and Brexit disruptions. Europe has also faced more challenges from the war in Ukraine and disruptions of Russian energy supply. Despite this, Europe is still up nicely YTD, with P/E multiples that are generally just below their median ranges.

In Asia, Japan has also held up well and is trading at a slight premium while Hong Kong and China, suffering from a real estate crisis, have turned in the most negative returns and are currently trading at a discount. As forecasters consider Chinese growth at 3-5%, down considerably from performance over recent decades, we must keep an eye on India, which seems poised to displace China as the growth champion, and Mexico as the U.S. puts more focus on its North American supply chain.

Global Equities Performance

Select Global Equity Indices	Q3			YTD			Current	Historical	Premium /
	(in LCL)	(in USD)	(in CAD)	(in LCL)	(in USD)	(in CAD)	P/E NTM	P/E	Discount
Canada									
S&P/TSX Composite	-2.0	-3.8	-2.0	3.4	3.6	3.4	12.7	14.5	-1.9
S&P/TSX 60	-2.3	-4.2	-2.3	3.0	3.3	3.0	12.9	14.3	-1.4
S&P/TSX Small Cap	-1.1	-3.0	-1.1	-1.1	-0.9	-1.1	11.9	17.0	-5.1
Canada Growth	-3.8	-5.6	-3.8	5.3	5.5	5.3	18.5	18.1	0.4
Canada Value	-1.6	-3.5	-1.6	-1.8	-1.5	-1.8	10.2	12.2	-2.0
U.S.									
NASDAQ Composite	-4.0	-4.0	-2.1	27.1	27.1	26.8	24.7	19.7	5.0
S&P 500	-3.2	-3.2	-1.4	13.1	13.1	12.8	18.0	16.1	1.8
S&P Mid Cap 400	-3.7	-3.7	-1.8	4.3	4.3	4.0	13.0	13.7	-0.7
S&P Small Cap 600	-4.1	-4.1	-2.3	0.8	0.8	0.6	12.3	14.9	-2.7
S&P Composite 1500	-3.3	-3.3	-1.4	12.2	12.2	12.0	17.4	15.8	1.5
S&P Composite 1500 Growth	-2.5	-2.5	-0.9	17.1	17.1	15.7	19.9	18.6	1.3
S&P Composite 1500 Value	-4.2	-4.2	-2.8	7.0	7.0	5.1	15.2	13.9	1.2
Europe									
Euro STOXX 50 (Europe)	-3.8	-6.6	-4.8	13.4	9.2	8.9	12.0	13.2	-1.2
FTSE 100 (U.K.)	3.4	-1.9	0.0	5.5	3.6	3.4	10.5	12.5	-2.0
CAC 40 (France)	-2.3	-4.9	-3.1	13.4	12.5	12.3	12.6	13.3	-0.6
DAX (Germany)	-3.5	-6.0	-4.2	10.5	9.6	9.4	10.7	12.6	-1.9
Asia Pacific									
Hang Seng (Hong Kong)	-5.3	-5.4	-3.6	-6.8	-7.1	-7.3	8.6	12.5	-4.0
Nikkei 225 (Japan)	-3.7	-6.8	-5.0	24.4	10.0	9.8	17.9	16.5	1.4
MSCI China (China)*	-2.7	-3.6	-2.0	-4.2	-8.9	-9.1	10.0	10.8	-0.8
Major Aggregates									
World (Global)*	-3.5	-3.5	-1.4	11.1	11.1	10.8	16.0	15.7	0.3
EAFE (DM ex U.S. & Canada)*	-4.9	-4.9	-2.9	6.9	6.9	6.7	12.7	13.5	-0.8
EM (Emerging Markets)*	-4.1	-4.1	-2.0	0.9	0.9	0.7	11.7	11.7	0.1

Source: FactSet; Raymond James Ltd.; Total returns, data as of September 30, 2023. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 9/30/2023. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

In the last column of the table above, we consider current price-to-earnings multiples (on next-12 months EPS forecasts) against the median since 2000. As you would expect, the NASDAQ Composite is trading at the highest premium valuation, while small cap in Canada is trading at the greatest discount.

Canadian Economic Outlook

Overall, we believe that the Bank of Canada (BoC) will hold interest rates at the current level, with a slight chance of one more hike. We see the BoC maintaining a ‘higher for longer’ stance for as long as it takes to ensure that inflation gets under control. As the BoC Governor Tiff Macklem has stressed, it sees the 2 per cent target in sight, but that being close to 3 per cent is certainly not good enough. The BoC is forecasting that it may take until mid-2025 to achieve that goal, and that further hikes might still be necessary if recent improvement stalls. If the economy stays resilient, we could imagine the BoC waiting until late 2024 or into 2025 before lowering rates, although with our expectation of a mild recession, we could see inflation decline more quickly, and if accompanied by significant weakness in employment, we could see rates start to decline sooner.

Still, inflation remains the overarching theme in discussions about the Canadian economy, as the BoC maintains its tightening mandate after raising its policy rate 10 times since it began its hiking cycle in March 2022. Its last hike was in July, with a pause at 5.00 per cent at the September announcement. If we see another rate hike in Canada this year, it would be at either the October 25 interest rate announcement and Monetary Policy Report, or at the December 6 interest rate announcement. Our view is that the Canadian economy is still digesting the previous rate hikes and that we would be best served by allowing those effects to further work themselves through.

Complicating this however is that the rate of inflation remains stubbornly high and after bottoming out at 2.8 per cent in June, CPI rebounded to 3.3 per cent in July and 4.0 per cent in August, before showing a bit of relief in September. The decline into June was attributed two-thirds to the drop in energy prices, but similarly the rebound since then has also generally been blamed on the increasing price of oil, which started to rise at the end of June. Despite the increase in gasoline prices, the 3.8 per cent inflation number in September shows a broad-based deceleration stemming from lower prices for some travel-related services, durable goods, and groceries, but it is still not close to the 2 per cent target.

Inflation Breakdown (NSA): Broad-based Deceleration in September, But Not There Yet

		2021				2022												2023								
	Weight	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept
All Items	100%	4.4	4.7	4.7	4.8	5.1	5.7	6.7	6.8	7.7	8.1	7.6	7.0	6.9	6.9	6.8	6.3	5.9	5.2	4.3	4.4	3.4	2.8	3.3	4.0	3.8
Shelter	28%	4.8	4.8	4.8	5.4	6.2	6.6	6.8	7.4	7.4	7.1	7.0	6.6	6.8	6.9	7.2	7.0	6.6	6.1	5.4	4.9	4.7	4.8	5.1	6.0	6.0
Food	17%	3.9	3.8	4.4	5.2	5.7	6.7	7.7	8.8	8.8	8.8	9.2	9.8	10.3	10.1	10.3	10.1	10.4	9.7	8.9	8.3	8.3	8.3	7.8	6.8	5.9
Transportation	16%	9.1	10.1	10.0	8.9	8.3	8.7	11.2	11.2	14.6	16.8	14.4	10.3	8.7	9.5	8.5	6.0	5.4	3.1	0.3	1.3	-2.4	-3.4	-1.0	2.3	3.2
Household Operation*	14%	1.5	1.8	1.6	2.0	1.9	2.7	4.5	4.1	5.5	5.6	5.0	5.1	5.4	5.1	5.2	4.6	3.7	4.1	3.3	3.0	1.1	0.3	-0.1	0.0	-1.1
Recreation**	10%	2.1	3.4	2.5	1.9	2.5	4.1	5.8	4.1	5.4	6.2	6.2	5.7	5.2	4.1	4.1	3.4	2.9	2.3	1.6	3.1	3.1	1.2	1.8	2.2	1.8
Health & Personal Care	5%	3.0	2.8	2.7	2.6	2.9	3.1	3.4	3.4	3.6	3.9	3.9	4.4	4.4	4.9	5.5	6.1	6.2	6.2	6.5	6.4	6.4	6.2	5.8	5.8	5.6
Clothing & Footwear	5%	0.2	0.6	0.7	1.1	1.6	1.2	0.9	0.2	2.2	2.7	1.4	1.4	1.5	1.8	0.4	1.8	0.4	1.9	2.4	2.5	0.7	0.3	1.0	1.7	1.0
Tobacco & Alcohol	5%	2.1	2.1	2.6	2.5	3.3	3.1	3.3	3.1	3.0	3.0	3.8	3.5	3.8	4.1	4.5	4.8	4.7	4.9	5.4	5.3	5.5	5.4	5.3	5.2	5.3

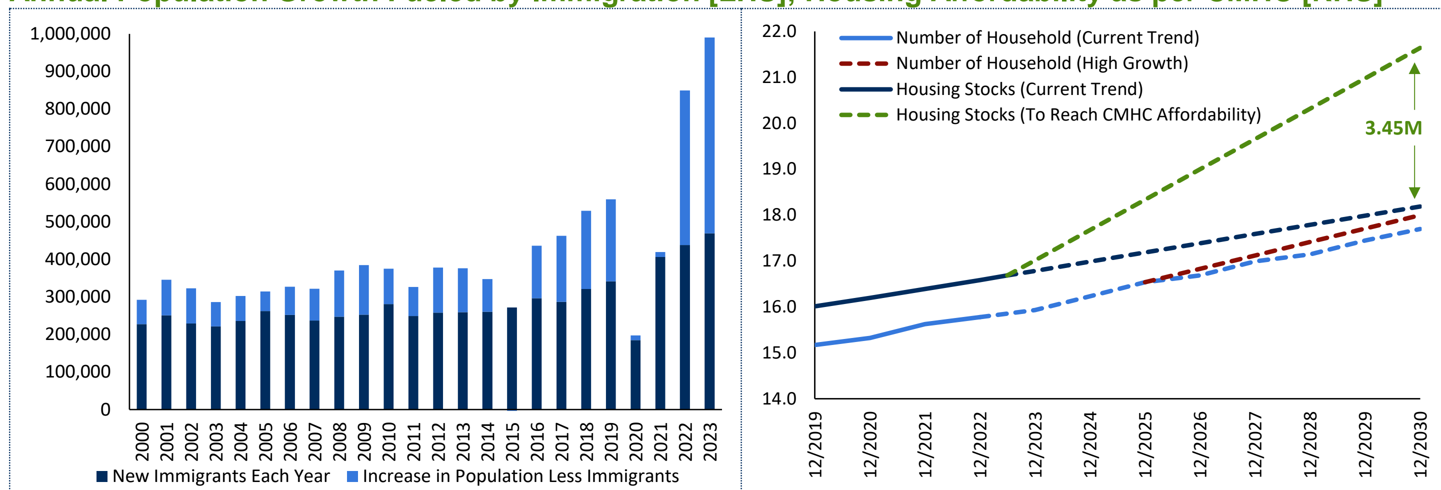
Source: Statistics Canada; Raymond James Ltd.; Data as of September 30, 2023, not seasonally adjusted; *Household Operation and Furnishings **Recreation, Education, and Reading

To delve deeper into the inflation numbers, wages/services has been the stickiest aspect, and as the labour market remains tight, we could continue to see pressure here, although heightened immigration in Canada has provided some relief by bringing more working age population into the labour force. As employers have been challenged to find workers, they have been somewhat more aggressive in pay. Bringing more immigrants into the working age

population, Canada is helping to alleviate some of that short-term labour tightness and is offsetting additional longer-term demographic issues from an aging population.

A recently more open immigration policy in Canada has helped to bring more working age people into the country, but this approach has some drawbacks, including creating additional pressure in an already tight residential housing market. So, while it does help to alleviate short-term labour constraints and helps the longer-term demographic issue of an aging population with not enough younger population to support retirees and certain social programs, there is the downside of further aggravating the housing crisis and affordability issues. In the latest Canada Mortgage and Housing (CMHC) update, it was estimated that to return residential housing affordability to 2003/04 levels, Canada would need to more than triple the number of housing starts to add 3.45 million more homes than are currently expected to be built, to achieve affordability by 2030. That seems very ambitious.

Annual Population Growth Fueled by Immigration [LHS]; Housing Affordability as per CMHC [RHS]

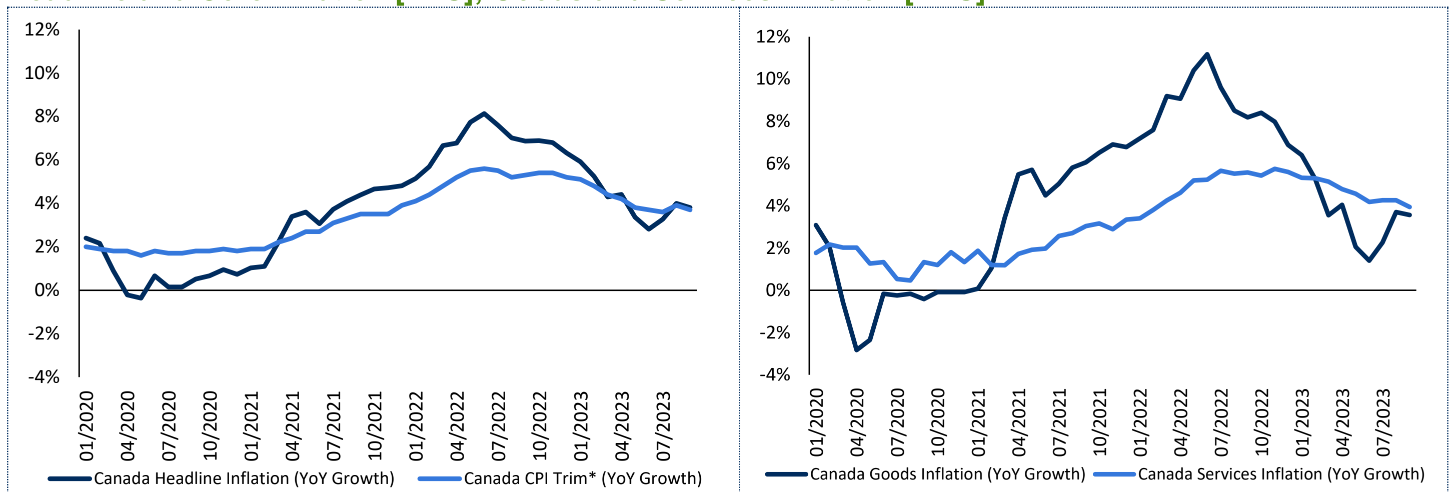


Source: Statistics Canada; CMHC; Raymond James Ltd.

One of the items having the biggest impact on CPI inflation currently is mortgage interest costs. On October 2, we published our Monthly Insights & Strategies report titled *Housing Crisis or Opportunity?*, which looked at the housing crisis facing our country and how investors could invest in sectors such as multi-family residential housing, as we see this crisis likely only deepening in the coming years, with the supply and demand relationship putting long-term upward pressure on housing despite short-term pressure and volatility due to borrowing costs and affordability limiting the entrance of new buyers. This pushes more households into the rental market. By excluding mortgage interest costs, the BoC itself indicated that CPI inflation would be closer to 2.5 per cent (from a September 7 speech[1]), although putting this strain on household budgets is part of the methodology to reduce the demand and inflation in other areas of the economy. Although the BoC's CPI-trim measure has excluded mortgage interest costs for over a year due to it exhibiting the largest upward swings, that measure is still 3.7 per cent, in line with the headline CPI as it also excludes components with the largest declines. The takeaway is that inflation pressures are still quite broad and efforts to bring them down to the 2 per cent level will continue to take time.

[1] https://www.bankofcanada.ca/2023/09/economic-progress-report-target-in-sight-but-were-not-there-yet/

Headline and Core Inflation [LHS]; Goods and Services Inflation [RHS]

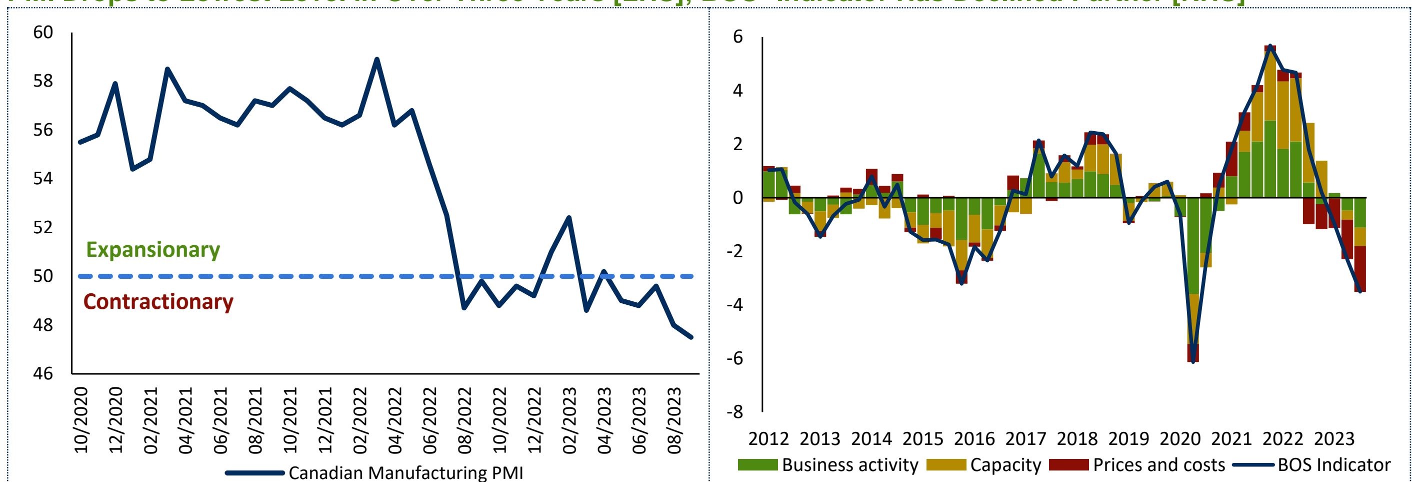


Source: Statistics Canada; Raymond James Ltd.; Data as of September 30, 2023

Ultimately, we expect that inflation will come down to the 2 per cent target level as supply and demand come into better balance. Supply includes the normalization and efficiency of supply chains, which were thrown into disarray during the pandemic. Demand includes normalized spending, which was restricted during the pandemic as consumers had fewer opportunities to spend on things like travel, restaurants, and other entertainment, but then as opportunities re-emerged, government stimulus put excess cash in certain pockets that subsequently started competing for goods and services that were in short supply. From the Purchasing Managers Index and Business Outlook Survey charts below, we see a more cautious environment.

GDP contracted at an annualized rate of 0.2 per cent in 2Q23 as consumption growth weakened and housing activity declined. Consensus expectations are for real GDP growth at 0.4 percent annualized in each of 3Q and 4Q before a 0.5 per cent contraction in 1Q24, at the generally anticipated start of our recession.

PMI Drops to Lowest Level in Over Three Years [LHS]; BOS* Indicator Has Declined Further [RHS]



Source: S&P Global; Bank of Canada; Raymond James Ltd.; Data as of September 30, 2023. *Business Outlook Survey conducted by Bank of Canada each quarter. Contributions to BOS indicator are standardized units, A reading of zero aligns with the historical average.

U.S. Economic Outlook

Although headline inflation increased on a year-over-year basis for a second consecutive month in August, core consumer inflation continued its slow disinflationary process during the same period of time. Shelter costs continue to weaken on a month-over-month basis and we expect this weakness to continue during the rest of the year and aid core prices further. However, higher oil and gasoline prices are still putting pressure on the headline number. Since economic growth has remained stronger than expected during the third quarter of the year, we have moved the start of our mild recession to the first quarter of 2024 instead of the fourth quarter of 2023 due to the strength in non-residential investment as well as the drawdown of excess savings accumulated during the COVID pandemic. However, we expect higher interest rates to start affecting investment and consumption during the next several quarters and thus we continue to expect a very mild recession that will last for two consecutive quarters. We expect the Federal Reserve (Fed) to increase the federal funds rate once more before the end of this year by 25 basis points and remain on hold during the first half of next year. Downward employment revisions have put the job situation on a weaker path going forward but we are not expecting job losses until early next year. The US dollar has strengthened somewhat after weakening during the first half of the year. This will help reduce the inflationary effects of higher oil prices but higher-than-target inflation remains one of the bigger risks for policymakers as well as for the US economy.

A Pulse Check on the U.S. Economy

Economic Indicator	Status	Comments
GDP Growth	Neutral	GDP growth is expected to continue to moderate over the next several quarters and we expect a mild recession to start in 1Q24.
Employment	Neutral	Nonfarm payrolls have remained strong during the year's first half, but the labor market has been cooling down and we expect to start contracting in 2024.
Consumer Spending	Neutral	Consumer spending has remained relatively strong, but it is likely to weaken over the next quarters as excess savings from the pandemic are fully depleted and student debt repayments resumed.
Business Investment	Neutral	Despite higher interest rates raising borrowing costs, the passage of several bills last year, including the Inflation Reduction Act (IRA), the CHIPS Act, and the infrastructure bill are contributing positively to business investments.
Manufacturing	Concerning	Although the ISM manufacturing index remains in contraction, manufacturing output, as measured by the manufacturing production index, has remained positive but weak.
Housing and Residential Construction	Neutral	High mortgage rates and rising construction costs due to a scarcity of construction workers are negatively impacting the housing industry. Despite these headwinds, the low supply of homes is keeping prices stable.
Inflation	Neutral	Inflation is likely to continue to stabilize as economic activity weakens over the next quarters. Shelter costs should slow down further and barring any economic shock, headline inflation should go lower over the next quarters.
Monetary Policy	Neutral	The Fed remains very hawkish and is likely to have at least one more hike before reaching its terminal rate and keeping rates higher for several more months.
Long-Term Interest Rates	Neutral	The yield curve remains deeply inverted as expectations for Fed rate hikes continue to linger. We expect the curve to remain inverted until the Fed pivots to an easier policy stance next year, however, longer-maturity yields should gradually decline as growth and inflation decelerate.
Fiscal Policy	Neutral	The debt ceiling issue is now in the review mirror, and contributions to GDP from government spending this year are unlikely to change significantly.
The Dollar	Good	The US dollar has strengthened during the summer months, and softer global growth may prevent a sustained decline due to the US dollar's role as a safe-haven currency.
Rest of the World	Neutral	We continue to expect a weakening global economy during 2023 as central banks continue to either increase or hold interest rates high.

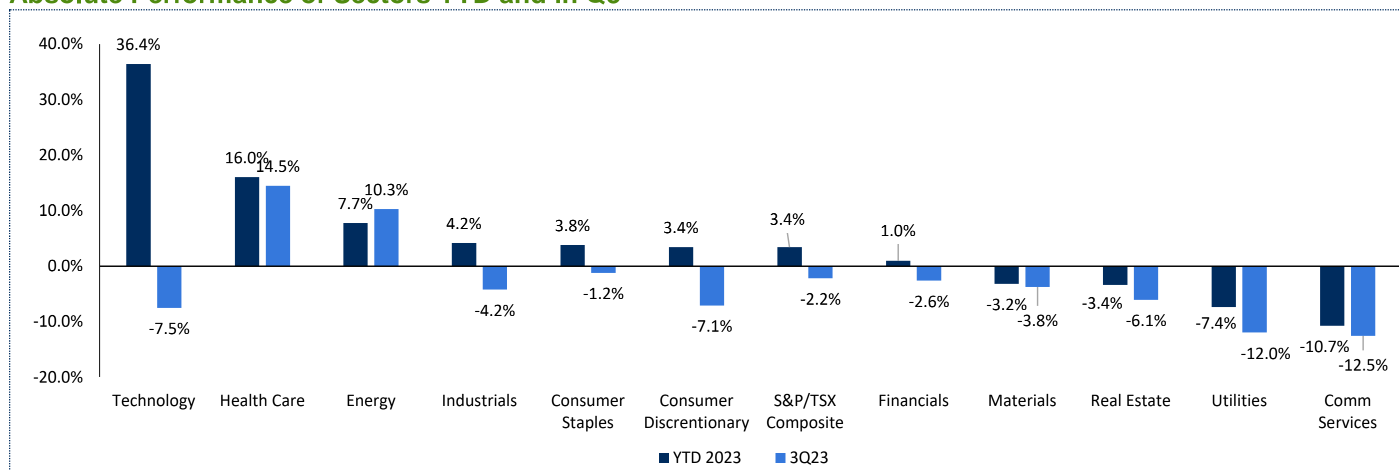
Source: Raymond James & Associates; Raymond James Ltd.; Data as of October 5, 2023.

Canadian Equities

Similarly to the U.S. market, there were some standout companies in Canada, mostly in the tech sector, which delivered a 36.4 per cent year-to-date return. Unlike the 30 percent weighting of the Magnificent 7 in the S&P 500, Canada's entire tech sector represents just 7.5 per cent of the TSX Composite. Financials have the most weighting in our index, at 30 per cent, but that sector only generated 1 per cent, while our 19 per cent weighted energy sector provided a 7.7 per cent gain. Other moderately positive boosts came from industrials and consumer staples, which were up 4.2 per cent and 3.8 per cent, respectively.

As we look toward the remainder of the year, we continue to expect pressure on earnings amid the global slowdown. Valuations are attractive on a historical basis, although we remain cautious of negative surprises and guidance adjustments through the Q3 earnings season.

Absolute Performance of Sectors YTD and in Q3

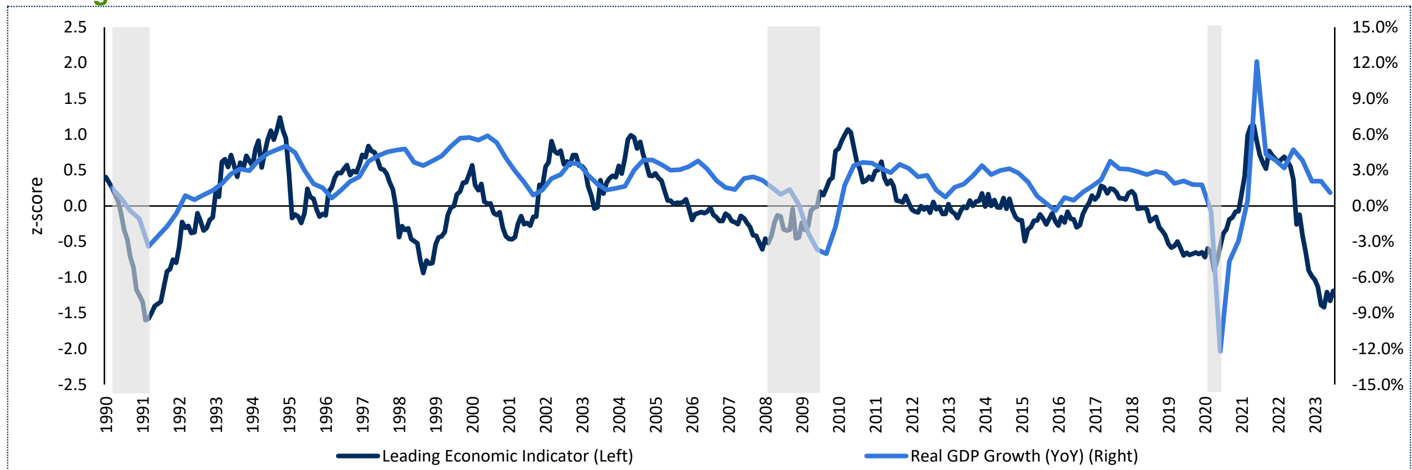


Source: FactSet; Raymond James Ltd.; Data as of September 30, 2023.

Our proprietary economic indicator model consists of 11 components that include various macro variables, such as the yield curve, money supply, manufacturing, labour market, housing, commodities, stock market, and consumption. A reading of zero aligns with the historical average (1990 – present) at an overall level. Readings above zero, for example, a reading of one, should be interpreted as being one standard deviation above the average, indicating that the economy is stronger than usual. Conversely, readings below zero suggest the economy is weaker than the norm.

From the following chart, our index and the real GDP year-over-year growth generally follow a similar trend, with the index slightly leading the way. In our sector performance analysis, we have categorized periods with readings above zero as robust growth periods and those below zero as periods of weakening growth or contraction. Not surprisingly, during robust expansion, most cyclical sectors performed exceptionally well. Conversely, during periods of growth slowdown or contraction, defensive sectors like consumer staples and utilities outperformed others. Considering our prediction of a mild recession in 2024, we are favouring these defensive sectors.

Leading Economic Indicator



Source: Bloomberg; Raymond James Ltd.; Data as of July 31, 2023.

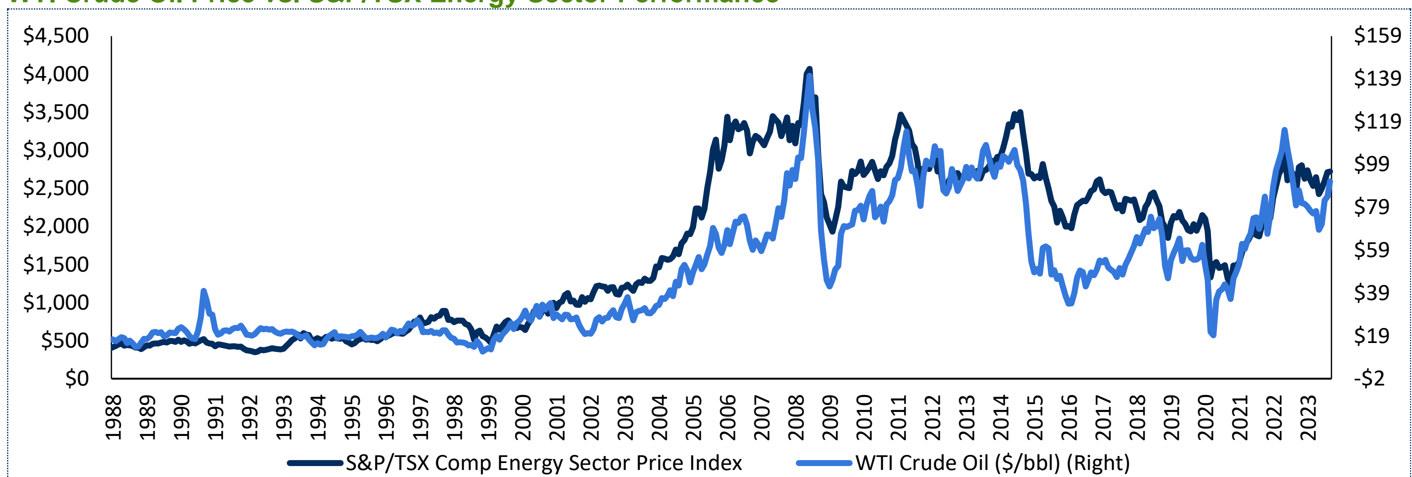
Sector Performance – Robust Growth [LHS] Sector Performance – Weakening Growth/Contraction [RHS]

Start Date / End Date	01/1993 12/1997	06/1999 07/2000	10/2001 11/2005	06/2009 09/2014	10/2016 02/2018	12/2020 06/2022	Average
S&P/TSX Composite	17.9%	45.7%	13.7%	10.3%	6.2%	8.4%	17.0%
Technology	20.5%	169.8%	-9.1%	-9.1%	22.8%	-34.6%	26.7%
Comm Services	15.7%	74.9%	4.1%	17.6%	3.3%	15.4%	21.8%
Energy	14.8%	16.5%	28.4%	8.0%	-9.4%	52.6%	18.5%
Industrials	19.1%	30.9%	6.6%	22.1%	18.8%	3.7%	16.9%
Financials	27.4%	10.7%	18.2%	14.2%	14.8%	13.8%	16.5%
Consumer Staples	13.9%	9.8%	9.8%	17.7%	-0.4%	13.6%	10.7%
Consumer Discretionary	10.8%	9.5%	7.5%	17.8%	16.9%	-1.2%	10.2%
Real Estate	13.7%	-0.2%	15.6%	14.8%	9.5%	5.1%	9.7%
Utilities	13.6%	-22.4%	17.1%	9.7%	0.3%	8.6%	4.5%
Materials	7.6%	-12.6%	14.4%	-2.0%	-2.1%	-3.0%	0.4%

Start Date / End Date	12/1997 06/1999	07/2000 10/2001	11/2005 06/2009	09/2014 10/2016	02/2018 12/2020	06/2022 09/2023	Average excl. 2018 - 2020	Average
S&P/TSX Composite	4.6%	-27.1%	1.6%	2.5%	7.8%	6.4%	-2.4%	-0.7%
Consumer Staples	20.9%	32.1%	-0.8%	21.5%	8.9%	12.2%	17.2%	15.8%
Utilities	-4.1%	38.3%	-0.4%	9.8%	17.0%	-14.8%	5.8%	7.6%
Materials	-4.2%	5.4%	14.4%	4.5%	13.4%	5.9%	5.2%	6.6%
Energy	-7.3%	24.0%	-0.4%	-8.6%	-6.7%	9.4%	3.4%	1.7%
Consumer Discretionary	16.6%	-17.9%	-4.8%	9.0%	5.8%	13.5%	3.3%	3.7%
Technology	30.1%	-78.7%	10.2%	17.3%	47.5%	35.6%	2.9%	10.3%
Financials	-6.9%	13.1%	-1.0%	6.6%	4.9%	2.5%	2.9%	3.2%
Comm Services	23.1%	-20.6%	1.1%	15.5%	5.2%	-10.0%	2.4%	2.4%
Industrials	-3.9%	-19.6%	0.3%	1.4%	13.7%	13.0%	-1.8%	0.8%
Real Estate	-15.2%	7.7%	-10.8%	5.9%	5.4%	-2.6%	-3.0%	-1.6%

Source: Bloomberg; Raymond James Ltd.; Data as of September 30, 2023. Annualized total return in CAD, ranked by average return.

WTI Crude Oil Price vs. S&P/TSX Energy Sector Performance



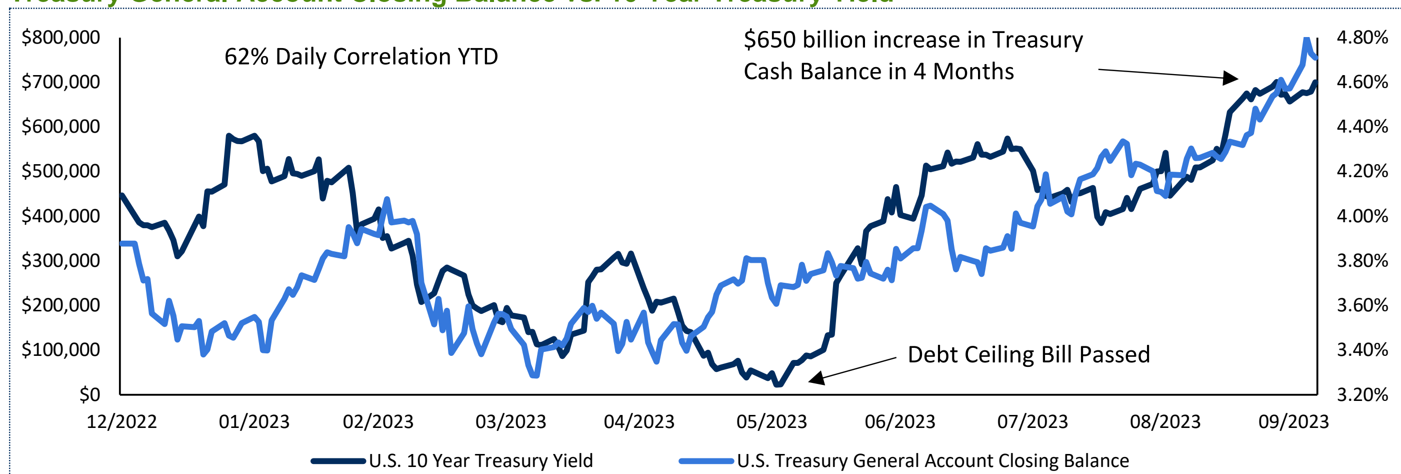
Source: Bloomberg; Raymond James Ltd.; Data as of September 30, 2023.

It is also worth noting that during periods of weakening growth, the energy and materials sectors have overall performed well. This can be somewhat attributed to price increases, as demand for oil and essential raw materials are increasing, becoming more fully realized in the latter growth stage, with the most profitable financial results lagging into the period when growth starts weakening. However, considering that these sectors are highly integrated with the global markets, it is essential to take into account global economic conditions and geopolitical issues alongside domestic economic factors. Historically, the performance of the energy sector has a ~91 per cent correlation with the WTI crude oil price, which has recently rebounded due to concern regarding the Israel–Hamas war.

U.S. Equities

As 3Q23 progressed, a resilient economy in the U.S. brought with it higher Treasury yields, which ultimately caused weakness across the equity indexes as the quarter came to a close. The 10-year Treasury yield has been the story in equity markets as is has increased from a low of ~3.3% in late May to ~4.8% today, driven by economic data being a bit better than expected (economic resilience), and we suspect a big impact from tremendous levels of new Treasury issuances after the debt ceiling bill was signed, as the Treasury has not only funded monthly deficits from June, but rebuilt its cash reserves from less than US$50 billion to nearly US$700 billion. The "excess" treasury issuance required to achieve this will likely start tapering off now, and although it doesn't guarantee lower rates, it should be helpful in stopping the rapid rate rise given the correlation of 10-year Treasury yields this year with the Treasury General Account cash balance.

Treasury General Account Closing Balance vs. 10 Year Treasury Yield

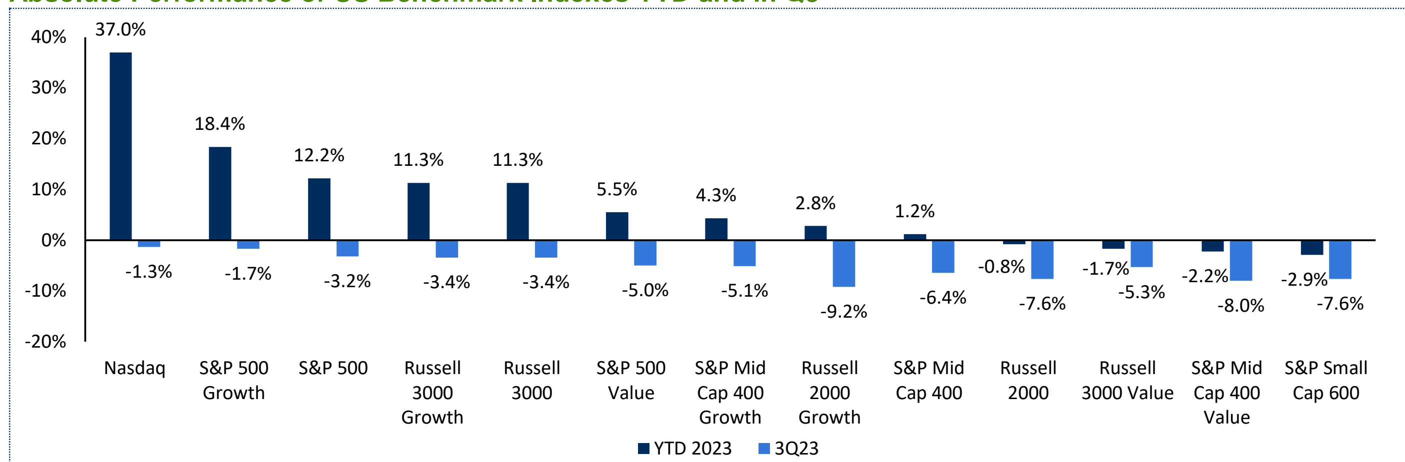


Source: FactSet; Raymond James & Associates; Raymond James Ltd.; Data as of October 6, 2023.

On the year in the US equity market, it's very much a case of the Magnificent 7 tech stocks up materially and the remainder of the S&P 500, as well as mid and small cap indexes, flattish YTD. As student loan payments resume in the U.S., its impact on consumer spending and overall economic trends will likely dominate 4Q market conversation. As one can see, YTD performance is very biased to Nasdaq, S&P 500 and growth over value, or basically completely dependent on how much weight any index may or may not have to the Magnificent 7. Since June 30, performance has been universally negative, but still with a slight bias in performance to large cap and growth (Magnificent 7).

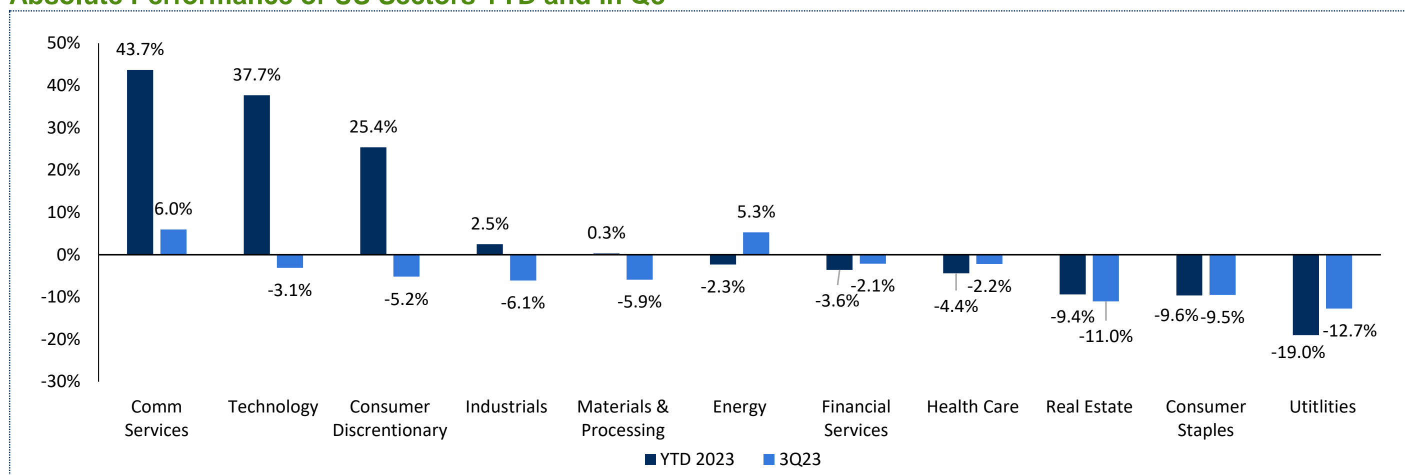
From a sector perspective, the three sectors with meaningful weightings of the Magnificent 7 are up 25%+ on the year, with just about every other sector down YTD, although performance since June 30 has been more universally weak with interest rate sensitives especially weak as rates increased (utilities, real estate, staples).

Absolute Performance of US Benchmark Indexes YTD and in Q3



Source: FactSet; Raymond James & Associates; Raymond James Ltd.; Data as of September 30, 2023

Absolute Performance of US Sectors YTD and in Q3



Source: FactSet; Raymond James & Associates; Raymond James Ltd.; Data as of September 30, 2023.

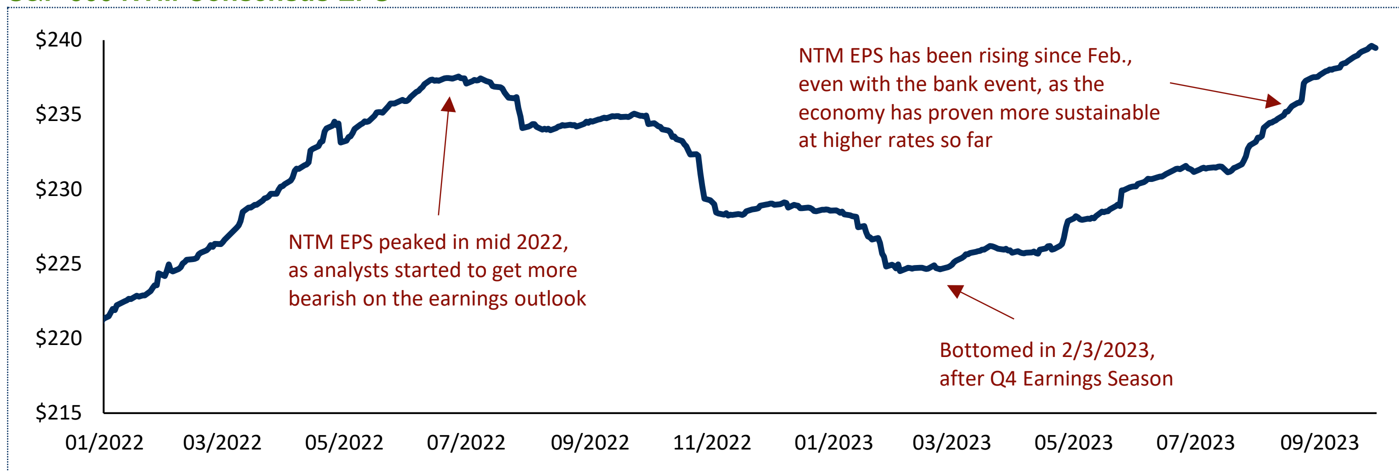
What's causing the substantial outperformance of the Magnificent 7? A bit of an EPS rebound in the stocks after a very weak 2022, but we suspect also significant money flow from global portfolio managers that appear to use the mega cap tech stocks in the U.S. as a sort of money market fund (a place to hide) in global portfolios when international economies look wobbly. And they do look wobbly.

So for the year, the S&P 500 is up ~12%, with all of that gain due to seven large tech stocks. with the rest of the S&P 500, midcap 400 and small cap 600 essentially flat to slightly negative on the year.

Finally, the consensus next-twelve-month (NTM) EPS forecast for the S&P 500 has been modestly increasing since February. Since 2000, S&P 500 equity prices have been correlated at ~94% with consensus NTM EPS. It's therefore not surprising that this equity market has rallied as consensus EPS has increased. However, we take the recent optimism on re-accelerating EPS growth of analysts with a grain of salt. First and foremost, consensus NTM EPS continued to rise last year until mid-June even though it was plainly obvious that higher rates and a commodity spike were going to hurt earnings in 2022/2023. Secondly, if one just puts the same seasonality on S&P 500 EPS that occurred in 2022, consensus EPS in 2023 would be ~US$210 rather than the published consensus of US$220. Right now, consensus EPS for the S&P 500 calls for increases from US$216 in 2022, US$220 in 2023 and US$246 in 2024. To us, this makes

very little sense in a rising rate and slowing nominal GDP environment. We expect NTM EPS expectations will come down later this year and next year, and our sense is the market has gotten a little concerned that earnings expectations have become a bit optimistic as well.

S&P 500 NTM Consensus EPS



Source: FactSet; Raymond James & Associates; Raymond James Ltd.; Data as of September 30, 2023.

There are only two yield curve outcomes from the current level of yield curve inversion. There has been much made of the inversion of the yield curve in July of last year, and what it means for the economy. But we would point out that economies tend to struggle 1+ years after the inversion, as yield curves return to being positively sloped. Since 1985, every yield curve inversion has preceded a recession, but its worth noting, the recession and job losses that accompany it did not occur until the yield curve became positively sloping again. In this regard, its not important to recognize the current yield curve as inverted, but important to wonder in what way the yield curve will return to positively sloping again. There are broadly two ways:

1. **Soft Landing** – in a soft landing, the economy can handle higher rates than most believe, and the 10-year Treasury yield will keep moving up until the whole curve becomes positively sloping between 5-6%. This is the scenario the bond market has increasingly priced in since June as 10-year Treasury yields have increased from ~3.3% to ~4.8%. In this scenario, EPS would likely be fine, or even better than expected, but P/E ratios likely come down. Generally, we view this scenario as unlikely, but it is a higher possibility today than it looked like a year ago, and in such a scenario, one would expect cyclical companies to outperform from today's valuation (financials, energy, materials, consumer discretionary). This is largely the scenario that the equity and bond markets have started pricing in as the yield curve has become more normalized, through higher long-term rates, in 3Q23.

2. **Classic Recession** – in this scenario, the economy keeps weakening, likely faster as COVID benefits continue to go away for the consumer (student loan payment resuming in October will be a big test), leading ultimately to the Fed lowering rates to stoke demand in 2024. In this scenario, equity markets are under pressure because earnings expectations are coming down, though P/Es may actually expand. Generally, in the U.S., we would expect defensive/interest rate sensitive sectors to outperform (health care, utilities, staples, real estate), while growth indexes should outperform value modestly.

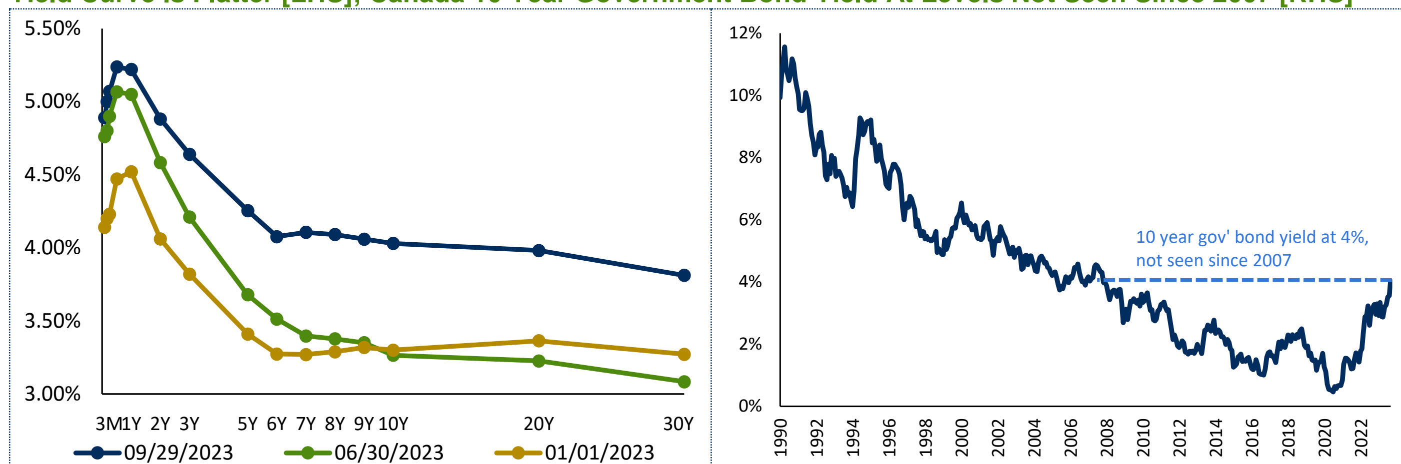
Ultimately, it's a choppy outlook for stocks, and likely one where they remain in this broad trading range we've been in since early 2021. We believe scenario two is the more likely scenario for the next year, and thus prefer those areas of the equity market that would benefit from lower rates, which tend to be interest rate sensitive and defensive sectors along with secular growth.

Canadian Fixed Income

Benchmark yields have continued to increase since our last quarterly publication. More notable, however, is the degree by which rates in different tenors have shifted, causing a change in spread between different points on the curve. We have seen a comparably greater rise in longer-dated bond yields, resulting in a yield curve that is flatter. Since June 30, Government of Canada benchmark securities under one year to maturity have risen by a modest ~15-20 basis points, whereas 10- and 30-year bonds have increased by over 70 bps. Although the yield curve continues to remain inverted, we note that there is a de-inversion occurring; the difference (or spread) between short term yields and longer-term yields is narrowing.

We maintain our view that yields will remain at or close to current levels into the near future, and that extending duration may benefit investors. This would allow them to capitalize on today's environment, as we believe that chances of yields decreasing from here is greater than seeing them (meaningfully) increase over the next year or so. With longer-dated bonds seeing the largest price declines (i.e., greatest yield increases) over the last quarter, generally speaking, extending term is even more attractive than in previous periods. For example, the Government of Canada 10-year bond is at levels not seen since 2007, rising comfortably above 4% over recent months, with spread product such as high-quality corporate bonds yielding approximately 175 basis points higher.

Yield Curve Is Flatter [LHS]; Canada 10 Year Government Bond Yield At Levels Not Seen Since 2007 [RHS]



Source: FactSet; Raymond James Ltd. Data as of September 29, 2023.

However, as we have seen in numerous markets and asset classes, investors are becoming more sensitive to the moment when tides will turn. Today, it is clear that risks of higher yields are no longer the key concern, and chatter of an economic slowdown is getting louder. Fears over the growing amount of negatively-amortizing mortgages have at least caught the attention of regulators, namely OSFI, who proposed changes on key metrics / guidelines to reduce risks related to such loans. It is estimated that approximately $250 billion in loans now have amortization periods of 35 years or more, as fixed payments are increasingly unable to cover the entire interest portion of each payment, and the balance owing starts to grow rather than decline, further pushing out amortization periods. This is something that at the very least requires monitoring in the months ahead. And yet on the other hand, CPI has remained sticky, and jobs numbers have been robust, putting the Bank of Canada (BoC) in a tough position.

In the case of a recession, it is highly likely that interest rate cuts will follow, helping to encourage spending and spur economic growth. Bond yields and prices are inversely related, so as yields fall, bond prices will increase, setting up a great opportunity for both generating

income today and potentially positive total returns in the future. We believe that short-end rates may see the bulk of the initial change, given that this is the area of the curve that central banks can directly influence. However, since benchmark yields further out on the curve are more driven by sentiment, we can assume to see shifts in expectations to be revealed throughout the rest of the curve.

U.S. Fixed Income

The U.S. fixed income retail market is enjoying some of the best yields seen in over 16 years. The 10-year Treasury last closed at 4.91 per cent matching the level from July 2007. To put some perspective to this yield level, the average annual return of the S&P Index since the turn of the century (nearly 23 years) is 6.62 per cent. High quality spread product presents an opportunity for yields well north of 6 per cent. By example, 10-year BBB-rated corporate bonds spread 168 basis points to the Treasury are providing investors with 6.69 per cent yields. In other words, much safer fixed income products allow investors to lock into yields close to mirroring growth-like returns.

Similar Case in the U.S., 10 Year Treasury Bond Yield at Levels Not Seen Since 2007

Source: Raymond James & Associates; Raymond James Ltd.; FactSet; Data as of October 18, 2023.

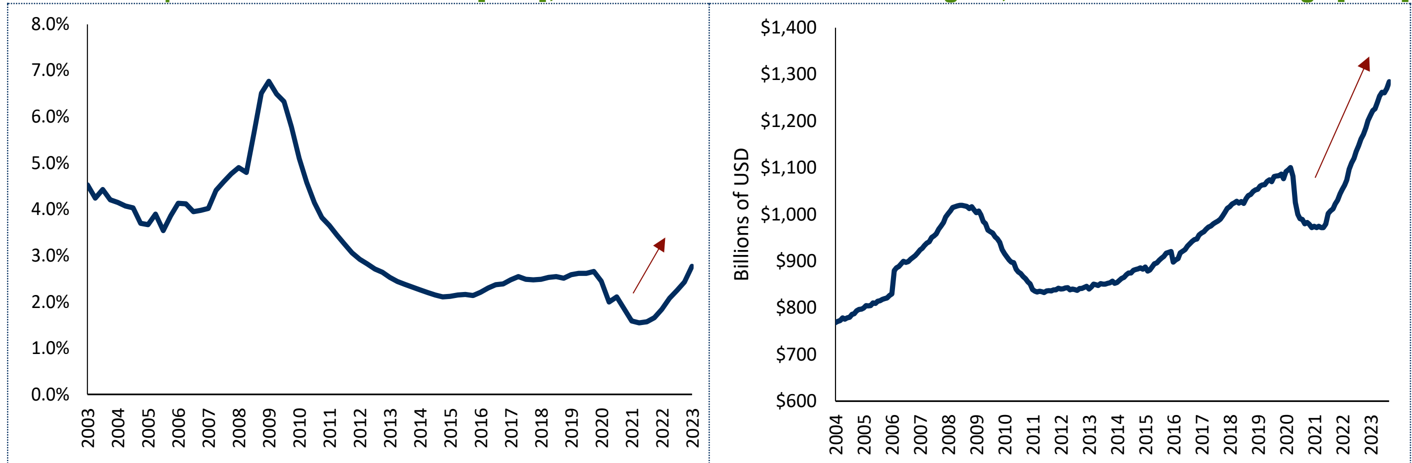
For U.S. investors in the highest tax brackets, the tax-equivalent yields are even higher, in some cases reaching 7.0-8.0%+. The municipal curve presents an opportunity to pull in higher income as income increases with added duration. On whole, the corporate curve, although flat, is elevated and optimizing yields in the 2-10 range whereas the upward sloping municipal curve provides attractive income for investors from 10 years through 30 years.

The window of opportunity could be temporary. Should the Fed reverse monetary policy and/or a recession surfaces, it is highly likely that interest rates drop. The Fed has in essence, been given "permission" to continue their quest to control inflation. Employment numbers continue to show strength, while the economy continues to march consistently positive. Should this pattern play out, fixed income participants are poised for a dual benefit. Not only are current income opportunities elevated, but a rate reversal could provide future total return benefit from the corresponding price appreciation. Timing is sensitive as there are big looming signs that this higher interest rate environment is unlikely to persist.

Although credit card delinquencies are on the rise, they sit below 20-year averages. However, since mid-2021, the outstanding level of consumer debt (revolving credit) has soared higher, well above 10- and 20-year averages. This is occurring while Americans have depleted their personal savings. During COVID, savings hit record highs while businesses closed or slowed. Consumers have made up for lost time by spending discretionary income and savings over the

last couple of years, pushing overall levels down. Student loan payments have resumed, and mortgage rates have rocketed. The higher debt levels are being met with the current high interest rate environment.

Credit Delinquencies Are On the Rise [LHS]; Consumer Debt Has Soared Higher, Well Above 20Yr Average [RHS]



Source: Bloomberg; Raymond James Ltd.; Raymond James & Associates. Credit delinquencies data as of June 30, 2023; Consumer debt data as of August 31, 2023.

Major package carriers are experiencing significant traffic slowdowns. In addition, the yield curve, which has arguably been one of the most consistent precursors to recessions, has been inverted for ~390 days. The duration just exceeded the "pre" Great Recession inversion (388 days) and becomes the longest one in modern economic history. If a correlation exists, the Great Recession was a deep economic setback. Although there are very mixed opinions about whether 2024 will even bring a recession, we believe there is mounting evidence that not only will there be one, but it may be deeper and longer than many are expecting.

Given all the dynamics, fixed income rises as a sector of interest with a reasonable potential double benefit of current income as well as future positive total returns. We also believe that the potential for a near future lower rate environment is greater than that of a sustained and higher one.

Yield Curve Has Been Inverted for ~390 Days

Source: FactSet; Raymond James Ltd.; Raymond James & Associates. Data as of Oct 18, 2023.

Washington Policy: The End of Globalization? Risks and Opportunities of a New Economic Era

Are the U.S. and Chinese economies decoupling, or are we seeing a more strategic approach to national security priorities and supply chain resiliency? The answer to this question depends upon the policy decisions over the next several years and could have massive implications for the global economy and equity markets. We are of the view that a broad-scale decoupling and the formation of regional economic blocs is less likely, but a trend of reindustrialization and de-risking will be a market theme that investors will navigate in the years ahead. We also argue that recent U.S. policy decisions are the foundation for an industrial renaissance aimed at building up the economic base of the U.S. and protecting it against some of the geopolitical and supply chain risks that have had significant impacts in recent years—most acutely felt during the COVID supply chain shortages of critical materials. Key aspects of this industrial renaissance are the series of 'carrots' in the form of tax subsidies and direct support vs. the initial phase of 'sticks' in the form of tariffs, blacklistings, and technology restrictions.

U.S. and China at a Crossroads: A Shift in the Global Economic Order

Concern over China's longer-term geopolitical ambitions and the threat posed by China's military to the U.S. and key allies has been a major focus of U.S. policy in recent years. During the Trump administration, concerns about China's unequal market access and intellectual property theft led to the 2018 'trade war' with tariffs levied against a broad set of China's imports into the United States. A key concern was that U.S. technology designed for civilian use could be repurposed for military application. This led to U.S. policy viewing technology as a national security asset, thereby implementing new export restrictions, and blacklisting various Chinese companies from receiving access to U.S. technology, especially in the semiconductor space. The flow of U.S. capital into critical sectors in China that finance China's economic competition with the U.S. also came under enhanced scrutiny. While this economic confrontation was initially driven by national security considerations, the COVID-19 pandemic exposed additional vulnerabilities around global supply chains, particularly with technology components and medical goods that drove shortages and spiked prices. These conditions set the stage for a rethinking of U.S.-China economic relations that quickly became a bipartisan consensus in Washington.

Government Response: Securing Supply Chains and Investing in the Domestic Industrial Base

In response to these dynamics, the U.S. government has enacted policies with both 'sticks' and 'carrots' that create challenges and opportunities for investors navigating the shifting global environment. Export controls, tariffs, and economic restrictions through the blacklisting of certain companies have created revenue and cost challenges for U.S. companies with significant exposure to China's market. However, policymakers have also unleashed more than US$1 trillion in domestic investment across pandemic relief measures and new funding for domestic infrastructure, semiconductor manufacturing, and the energy transition. These new policies direct federal funds and catalyze private sector investment toward what we refer to as the 'reindustrialization' of North America. The goal of these policies is to fortify the U.S. domestic industrial base and limit future economic dependencies that can drive economic disruptions or be used against the US as economic leverage. Even with this level of new investment, we still see significant appetite in Washington to build on, and supercharge, certain aspects of the domestic economic agenda, including permitting reforms, investments in critical minerals, and preserving a role for legacy energy to limit transition risks. Vulnerabilities experienced by countries with oil and gas dependencies following Russia's invasion of Ukraine have prioritized projects that build out legacy energy infrastructure and limit potential vulnerabilities around critical minerals as the energy transition gains pace. In this sense,

policymakers are wary of replacing dependence in the oil and gas space for critical mineral dependencies with supply chains heavily concentrated in China.

Overall, the events of the last several years have placed national security and economic disruption concerns as leading drivers of policymaking in Washington – with clear winners and losers from an investment perspective. As federal funding is deployed and the reindustrialization theme plays out, we expect Industrials to be a beneficiary. New investment and market opportunities for the energy transition will be a material boost for clean energy equities. We see the transition as balanced across the energy space with permitting reform boosting the buildout of energy infrastructure and increasing demand for liquified natural gas. In terms of potential headwinds, the technology sector will be a space that is exposed to risks as the policy impact unfolds. Emerging technologies such as artificial intelligence, quantum computing, and robotics will be in the crosshairs of new controls and regulations which can limit the ability of certain companies to scale and penetrate China's market. Biotechnology and pharmaceuticals are other areas to watch which could see similar controls in the future.

What's Next?

Investors should be aware of critical trends that will impact the evolution of this emerging theme. First, China's response (such as targeting U.S. companies as a retaliatory step) can increase market risks if U.S. policy actions are seen less as 'derisking' and more as 'decoupling' by another name. The fate of Taiwan and the outcome of its presidential elections in January 2024 will also be important to monitor – currently with the pro-independence incumbent party favoured. While the Biden administration is taking steps to deescalate tensions around Taiwan, China perceiving Taiwan as moving closer to independence could accelerate the timeline for a regional conflict that could drive global economic disruption on a significant scale. Political instability within the U.S. Government could also play a role, but not always in a straightforward manner. Perceived U.S. weakness has been generally viewed as a reason for Beijing to wait, but internal Chinese domestic concerns could cause a recalculation. Lastly, the inflationary impact of a shifting global economic order will have important consequences for the direction of monetary policy. Higher costs and elevated spending could weaken the Federal Reserve's tools to fight inflation and prolong high interest rates—a 'higher for longer' scenario. We expect attention to increase on these issues over the next year, especially as the U.S. prepares for the 2024 presidential election campaign that will help determine the trajectory of a changing macro investment environment.

Asset Allocation Committee

Neil Linsdell, CFA (Chair)
VP, Head of Investment Strategy
Raymond James Ltd.

Tavis C. McCourt, CFA
Institutional Equity Strategist
Raymond James & Associates

Ellis Phifer, CFA, CMT
Institutional Fixed Income Strategist
Raymond James & Associates

Ed Mills
Washington Policy Analyst
Raymond James & Associates

Nicole Svec, MBA, CFA
Head of Equities, Institutional Sales Toronto
Raymond James Ltd.

Eugenio J. Alemán, Ph.D.
Chief Economist
Raymond James & Associates

Charlotte Jakubowicz, CMT, CIM
VP, Fixed Income and Currencies
Raymond James Ltd.

Douglas Drabik
Senior Retail Fixed Income Strategist
Raymond James & Associates

Eve Zhou
Multi-Asset Analyst
Raymond James Ltd.

Sean Boyle, MBA
Co-head of Institutional Sales
Raymond James Ltd.

Important Investor Disclosures

Complete disclosures for companies covered by Raymond James can be viewed at https://raymondjames.bluematrix.com/sellside/Disclosures.action

This newsletter is prepared by the Private Client Services team (PCS) of Raymond James Ltd. (RJL) for distribution to RJL's retail clients. It is not a product of the Research Department of RJL.

All opinions and recommendations reflect the judgement of the author at this date and are subject to change. The author's recommendations may be based on technical analysis and may or may not consider information contained in fundamental research reports published by RJL or its affiliates. Information is from sources believed to be reliable but accuracy cannot be guaranteed. It is for informational purposes only. It is not meant to provide legal or tax advice; as each situation is different, individuals should seek advice based on their circumstances. Nor is it an offer to sell or the solicitation of an offer to buy any securities. It is intended for distribution only in those jurisdictions where RJL is registered. RJL, its officers, directors, agents, employees, and families may from time to time hold long or short positions in the securities mentioned herein and may engage in transactions contrary to the conclusions in this newsletter. RJL may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this newsletter. Securities offered through Raymond James Ltd., Member-Canadian Investor Protection Fund. Financial planning and insurance offered through Raymond James Financial Planning Ltd., not a Member-Canadian Investor Protection Fund.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated. The results presented should not and cannot be viewed as an indicator of future performance. Individual results will vary and transaction costs relating to investing in these stocks will affect overall performance.

Information regarding High, Medium, and Low risk securities is available from your Financial Advisor.

RJL is a member of Canadian Investor Protection Fund. ©2023 Raymond James