NATIONAL BANK OF CANADA FINANCIAL MARKETS

November 2024

Red wave, green screens

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Highlights

- After a challenging October, global equities have moved back into positive territory for the quarter. Market optimism is driven by the U.S. election results and expectations of monetary policy easing. However, not all major regions are benefiting equally in the face of an uncertain geopolitical landscape.
- The S&P 500 is soaring, driven by the U.S. election results in which Donald Trump reclaimed the Presidency, with the Republican Party winning the Senate and potentially securing the House of Representatives. While U.S. corporate profit growth is likely to benefit from this Republican "red wave", the bond market could introduce headwinds as rising government debt and higher import tariffs keep inflation resilient.
- The S&P/TSX reached a new record high in November, driven by strength in Financials, Energy, and IT, as reflation trades gain popularity following the end of the U.S. yield curve inversion. Meanwhile, sectors like Utilities, Real Estate, and Communication Services have struggled in Q4 due to rising long-term Treasury yields.
- Although our asset mix remains prudent, we are easing our defensive stance this month to reflect a more favorable outlook for U.S. corporate profits following the election results. However, we are cautious about going long on equities until there is more clarity on the new U.S. administration’s policies, particularly regarding potential protectionist measures.

World: Trump trade is positive for now

As of publication, the MSCI ACWI index has reached a record high, with most major regions experiencing a significant rebound in November. However, Europe and South America have lagged behind this month (see table).

World: Global equities are back in the black in Q4
MSCI composite index: Price Performance

	Month to date	Quarter to date	Year to date
MSCI ACWI	3.8	2.6	20.2
MSCI World	4.0	3.0	20.9
MSCI USA	5.2	4.4	25.7
MSCI Canada	2.9	3.6	18.8
MSCI Europe	-0.3	-3.2	4.9
MSCI Pacific ex Jp	2.2	0.0	9.5
MSCI Japan	1.8	4.2	16.7
MSCI EM	1.6	-1.2	14.4
MSCI EM EMEA	1.2	-0.9	4.7
MSCI EM Latin America	-0.2	-1.2	-7.0
MSCI EM Asia	1.9	-1.3	18.7

11/8/2024

NBC Economics and Strategy (data via Refinitiv)

The stock market rally is being driven by multiple expansion. With a forward P/E of 18.5x, the MSCI ACWI is at its highest valuation in nearly three years and stands 9.5% above its 10-year average. Notably, all major regions except Europe and Latin America are trading above their decade averages (see table). These two regions seem particularly vulnerable to shifts in U.S. economic and foreign policy.

World: Above-average PEs in almost every region
MSCI composite index: Valuation metrics (PE)

	11/8/2024	A year ago	10 year ave.	5 year average
MSCI ACWI	18.5	15.5	16.2	17.0
MSCI World	19.6	16.2	16.9	17.9
MSCI USA	22.8	18.5	18.6	20.1
MSCI Canada	15.6	12.3	14.5	14.1
MSCI Europe	13.4	11.9	14.3	14.2
MSCI Pacific ex Jp	16.6	13.6	15.3	15.5
MSCI Japan	14.6	14.1	14.1	14.7
MSCI EM	12.3	11.4	12.1	12.5
MSCI EM EMEA	10.3	10.0	10.1	10.4
MSCI EM Latin America	8.7	8.4	11.5	9.9
MSCI EM Asia	13.2	12.2	12.7	13.4

NBC Economics and Strategy (data via Refinitiv)

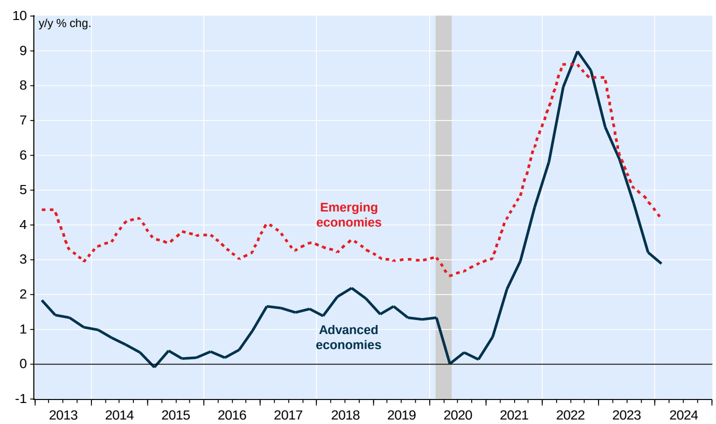
China, also facing the significant threat of potential tariffs from Washington, recently announced a 6 trillion RMB (approximately USD $835 billion) debt swap plan to ease the debt burden on local governments heavily affected by sharp declines in national real estate prices in recent quarters. It seems Beijing is holding back on a more substantial fiscal stimulus, potentially reserving its resources to shield the economy from headwinds posed by new trade policies from the incoming U.S. administration.

World: Beijing holds back on fiscal stimulus
CSI 300 index

NBC Economics and Strategy (data via Refinitiv)

The slowing pace of inflation across many regions has expanded the scope for further policy easing, which has, in turn, bolstered global equity markets. Although not yet at pre-pandemic levels, CPI inflation has continued to decline in both advanced and emerging economies (see chart).

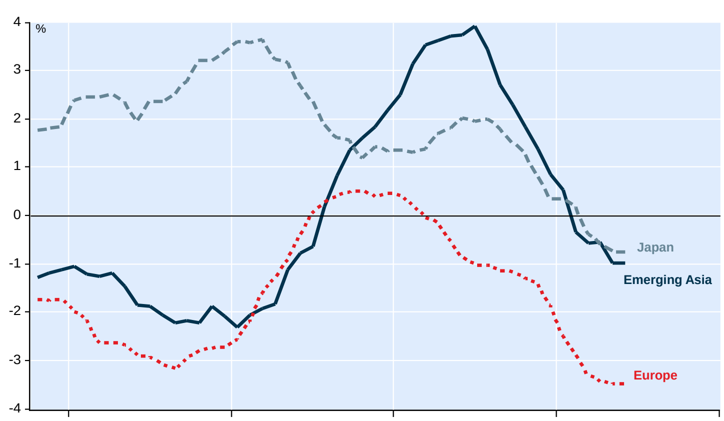
World: Slower inflation has opened the door to more rate cuts
Median CPI inflation



NBC Economics and Strategy (data via the IMF)

However, the slowdown in inflation has come at the cost of weaker economic activity and downward earnings revisions across Europe, Emerging Asia, and Japan (see chart).

World: Earnings continue to be revised down
MSCI ACWI 3-month change in forward EPS expectations



NBC Economics and Strategy (data via Refinitiv)

There is, therefore, a limit to how much a "Trump trade" can support the global economy—unless other regions also adopt themes of deregulation and corporate tax cuts to stimulate their own economic growth.

S&P 500: Red wave, green screens

President Trump has won the presidency, with the Republican Party maintaining control of the Senate and appearing poised to secure a narrow majority in the House of Representatives. As our geopolitical analyst recently noted (see **here**), Republican control of both chambers of Congress provides a substantial opportunity to advance key elements of their agenda, including expanded tax cuts and initiatives in infrastructure and tariffs. Additionally, this shift signals a likely reduction in regulatory oversight across sectors such as energy, infrastructure, finance, IT, and mining. The "red wave" has translated into gains (green screens) across the market, with the S&P 500 already up over 5% since the election. Leading sectors include Consumer Discretionary, Industrials, IT, Financials, and Energy (table).

S&P 500: Post-election surge
S&P 500 composite index: Price Performance (in %)

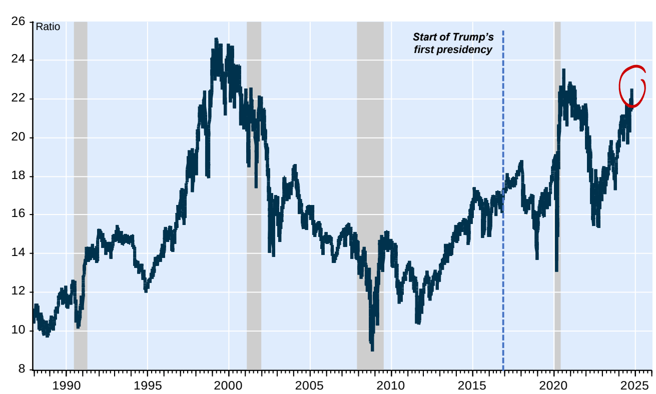
	Month to date	Quarter to date	Year to date
S&P 500	5.1	4.0	25.7
CONS. DISC.	10.2	8.5	22.8
INDUSTRIALS	6.1	4.6	24.4
IT	6.1	5.0	36.1
FINANCIALS	5.7	8.3	30.5
ENERGY	5.4	6.1	12.2
TELECOM	3.7	5.5	34.9
HEALTH CARE	2.2	-2.7	10.0
REAL ESTATE	1.3	-2.4	9.0
MATERIALS	1.3	-2.3	10.0
CONS. STAP.	1.1	-1.8	14.3
UTILITIES	-1.1	-2.1	24.7

11/8/2024

NBC Economics and Strategy (data via Refinitiv)

This recent surge has propelled the S&P 500's forward P/E ratio to 23, a whopping 35% above the 17x level seen at the start of Trump's first presidency. Excluding the COVID recession, this is the highest valuation in a generation (see chart).

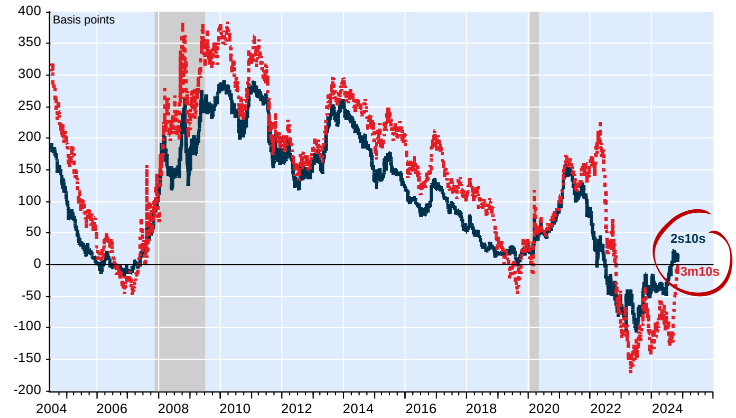
S&P 500: PE ratios currently much higher than at the start of Trump's 1st term
12-month forward PE ratio



NBC Economics and Strategy (data via Refinitiv)

This vote of confidence extends beyond equities to the fixed-income market, where the yield curve has steepened, marking its first non-inverted position in nearly two years (see chart).

U.S.: End of yield curve inversion
Treasury yield differentials: 2s10s and 3m10s



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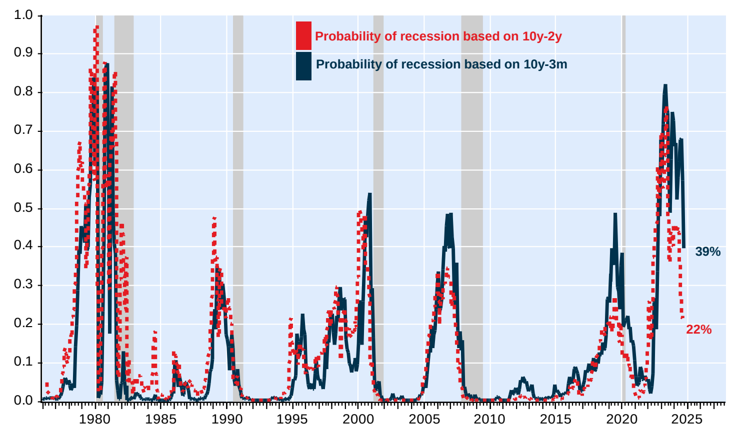
Historically, the yield curve has served as a reliable leading indicator of U.S. economic growth (see chart). Although still high, the probability of recession associated with the current level of steepening is lower than it has been in recent months.

U.S.: Recession odds are rapidly declining
Likelihood of a recession in twelve months based on the slope of the yield curve (1976-2024)



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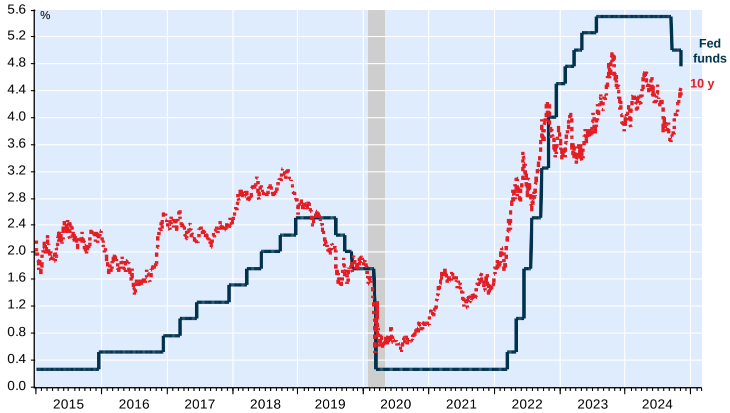
Overall, U.S. financial markets have already priced in a substantial amount of optimism. For equity markets to maintain an upward trend at current valuations, the Federal Reserve will need to continue easing monetary policy, inflation must stay contained, and the 10-year Treasury yield will need to stabilize rather than continue drifting higher (see chart).

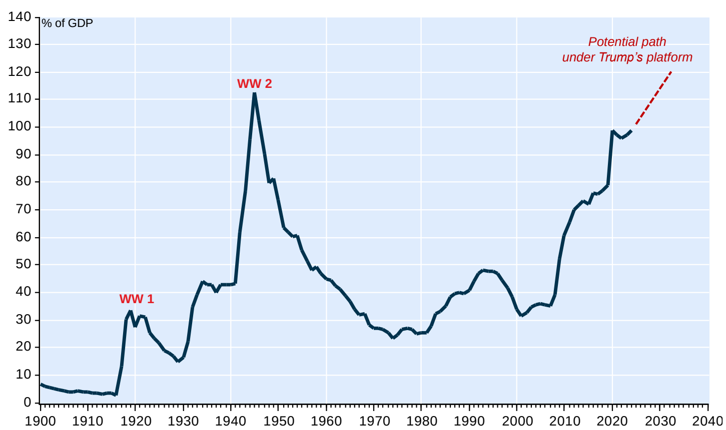
U.S.: Long-term rates are rising despite Fed easing
Fed funds rate vs. yield on 10-year US Treasuries



NBC Economics and Strategy (data via Refinitiv)

On the Fed's side, further easing remains likely, though the extent is more uncertain. The FOMC unanimously voted to lower the target range for the federal funds rate by 25 basis points on November 7, bringing it to 4.50%–4.75%. Unlike the 50 basis point cut in September, this decision was unanimous. While easing was a straightforward choice this time, the FOMC now faces a tougher challenge: the increasing likelihood of new fiscal stimulus could influence risk assessments, even if these potential policies aren't yet incorporated in baseline projections. The path for the fed funds rate will almost certainly be more gradual than anticipated before the GOP's recent election victory. The FOMC will need to closely monitor Treasury yields and investor sensitivity toward financing President Trump's electoral platform, which is projected to drive publicly held debt as a share of GDP beyond the previous record high of 110%, last reached at the end of World War II (see chart).

U.S.: Uncle Sam is poised to test new limits
Debt held by the public as a share of GDP



NBC Economics and Strategy (data via CBO, University of Pennsylvania and internal calculations)

S&P/TSX: Et tu, Canada?

Canada is likewise benefiting from the momentum in global stock markets, with the S&P/TSX Composite Index reaching a record high on November 7. This strong performance in Q4 aligns with a reflation trade, as investors position themselves for economic recovery. The Canadian benchmark has already risen 2.5% in November, with seven of the twelve major sectors showing positive growth.

Canada: Equities benefit from reflation trade
S&P/TSX composite index: Price Performance in %

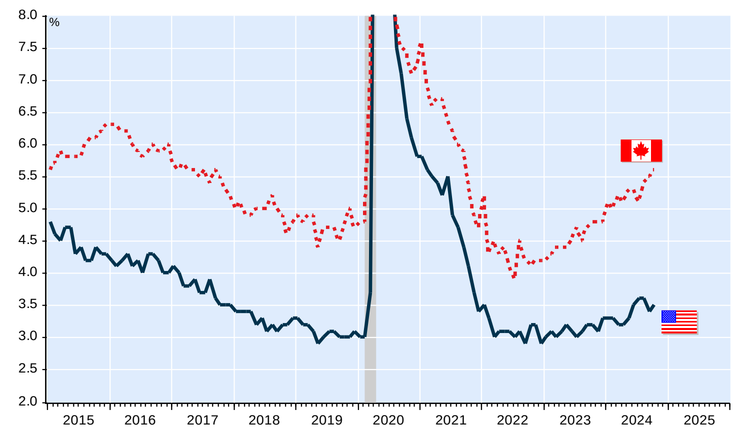
	Month to date	Quarter to date	Year to date
S&P TSX	2.5	3.2	18.1
IT	7.9	7.3	20.9
CONS. STAP.	4.3	1.3	15.0
FINANCIALS	3.9	4.2	23.2
CONS. DISC.	2.7	2.8	12.3
BANKS	2.5	1.3	14.9
INDUSTRIALS	2.3	0.8	10.1
ENERGY	2.3	7.2	20.2
REAL ESTATE	-0.2	-6.1	7.6
UTILITIES	-0.3	-2.1	9.1
HEALTH CARE	-1.3	3.2	13.9
MATERIALS	-1.6	2.0	28.3
TELECOM	-5.4	-9.5	-16.0

11/8/2024

NBC Economics and Strategy (data via Refinitiv)

Unlike the U.S., Canada faces less uncertainty regarding its central bank's commitment to swiftly shift monetary policy from restrictive to neutral. For one, inflation is declining more rapidly in Canada. Additionally, the Canadian labor market is softer, with the unemployment rate for prime-aged workers rising above 5.5% in October (see chart).

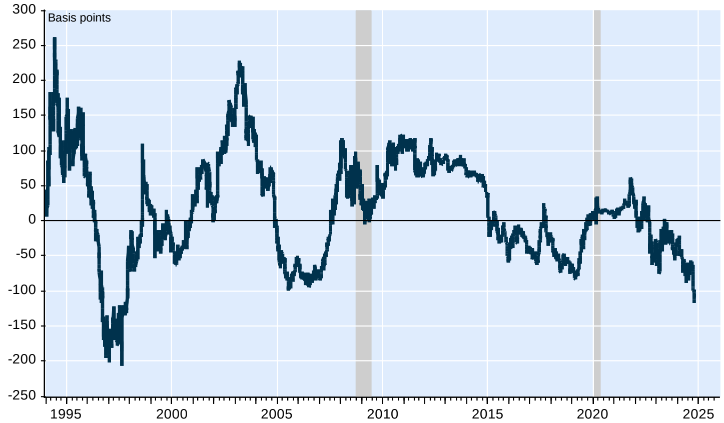
Canada: Jobless rate above 5.5% for key age group
Jobless rate for people aged 25-54



NBC Economics and Strategy (data via Statcan and Fred)

This supports a significant divergence in monetary policy, now reflected in the widest spreads on 2-year Treasury yields between Canada and the U.S. since the 1997-98 Asian crisis—a key driver of the exchange rate (chart)

Canada: Worst spreads since the Asian crisis
Canada-US spread differentials on 2-year Treasury yields



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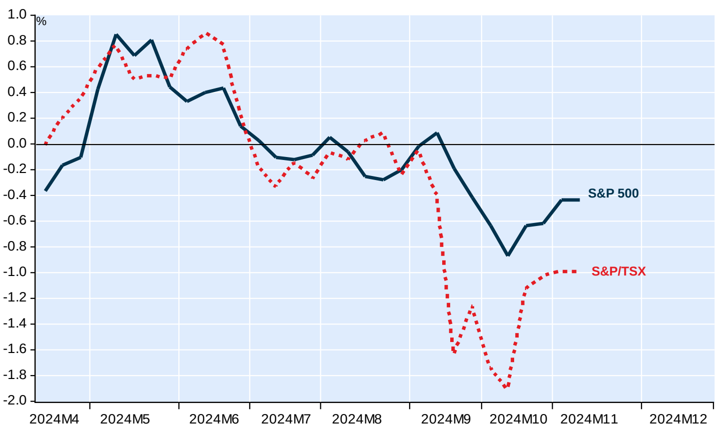
As outlined in our latest FOREX analysis (see **here**), these dynamics are paving the way for a potential depreciation of the Canadian dollar, with a target of 1.45 for USD/CAD. This anticipated combination of rate cuts and currency weakening should help offset the ongoing wave of downward earnings revisions for the S&P/TSX (chart).

Canada: Downward earnings revisions need to stabilize
1-month change in forward EPS expectations: S&P 500 vs S&P/TSX



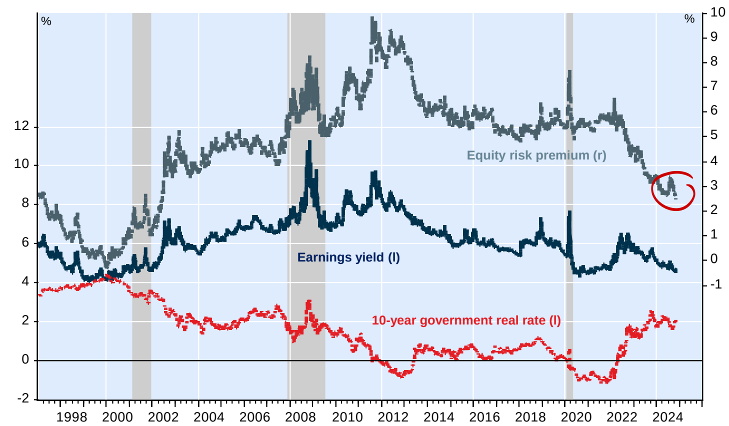
NBC Economics and Strategy (data via Refinitiv)

At this point, we are not ready to adopt an overweight position in Canadian equities. Although rate cuts and currency depreciation may be more pronounced north of the 49th parallel, Canada still lacks both a comprehensive industrial policy and a supportive energy strategy to attract business investment and drive higher potential GDP growth. This limits Canada's ability to fully capitalize on the expected economic direction of the new U.S. administration.

Asset allocation

While our asset mix remains cautious, we are slightly easing our defensive stance this month to reflect a more favorable outlook for U.S. corporate profits following the recent election results. Given the uncertain outlook for longer-term Treasury yields, we are reducing our fixed income exposure by 4%, reallocating those funds to U.S. and Canadian equities to align with our views on the Canadian dollar. However, we remain cautious about fully committing to a long position in equities until there is more clarity on the new U.S. administration's stance on potential protectionist measures, especially given that the equity risk premium is already at a generational low (see chart).

S&P 500: Lowest equity risk premium in a generation
Earnings yield (E/P), 10-year government real interest rate and equity risk premium



NBC Economics and Strategy (data via Bloomberg and Refinitiv)

NBC Asset Allocation	Benchmark (%)	NBF Recommendation (%)	Change (pp)
Equities			
Canadian Equities	20	18	+1
U.S. Equities	20	18	+3
Foreign Equities (EAFE)	5	3	
Emerging markets	5	3	
Fixed Income	45	53	-4
Cash	5	5	
Total	100	100	

NBC Economics and Strategy

Sector rotation

Our sector rotation is unchanged this month.

NBC Market Forecasts

NBC Market Forecast *Canada*			
		Actual	*Q4 2025*
Index Level		Nov-08-24	*Target*
S&P/TSX		24,759	22,800
Assumptions			Q4 2025
Level:	Earnings *	1447	1500
	Dividend	714	740
PE Trailing (implied)		17.1	15.2

** Before extraordinary items, source Thomson*

NBC Economics and Strategy (data via Refinitiv)

NBC Market Forecast *United States*			
		Actual	*Q4 2025*
Index Level		Nov-08-24	*Target*
S&P 500		5,996	5,400
Assumptions			Q4 2025
Level:	Earnings *	234	240
	Dividend	74	76
PE Trailing (implied)		25.6	22.5

** S&P operating earnings, bottom up.*

NBC Fundamental Sector Rotation – November 2024

Fundamental Sector Rotation - November 2024

Name (Sector/Industry)	Recommendation	S&P/TSX weight
Energy	**Market Weight**	**17.4%**
Energy Equipment & Services	Market Weight	0.2%
Oil, Gas & Consumable Fuels	Market Weight	17.2%
Materials	**Market Weight**	**12.2%**
Chemicals	Underweight	1.1%
Containers & Packaging	Market Weight	0.4%
Metals & Mining *	Market Weight	10.4%
Gold	Overweight	7.4%
Paper & Forest Products	Market Weight	0.3%
Industrials	**Underweight**	**12.7%**
Capital Goods	Market Weight	2.9%
Commercial & Professional Services	Underweight	3.6%
Transportation	Underweight	6.1%
Consumer Discretionary	**Underweight**	**3.4%**
Automobiles & Components	Underweight	0.5%
Consumer Durables & Apparel	Underweight	0.4%
Consumer Services	Underweight	0.9%
Retailing	Market Weight	1.6%
Consumer Staples	**Overweight**	**4.1%**
Food & Staples Retailing	Overweight	3.5%
Food, Beverage & Tobacco	Overweight	0.5%
Health Care	**Market Weight**	**0.3%**
Health Care Equipment & Services	Market Weight	0.2%
Pharmaceuticals, Biotechnology & Life Sciences	Market Weight	0.2%
Financials	**Market Weight**	**32.6%**
Banks	Market Weight	20.0%
Diversified Financials	Market Weight	5.0%
Insurance	Market Weight	7.6%
Information Technology	**Market Weight**	**8.9%**
Telecommunication Services	**Overweight**	**2.7%**
Utilities	**Overweight**	**3.8%**
Real Estate	**Underweight**	**2.1%**

** Metals & Mining excluding the Gold Sub-Industry for the recommendation.*

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