RJL PCS: MARKET PERSPECTIVES

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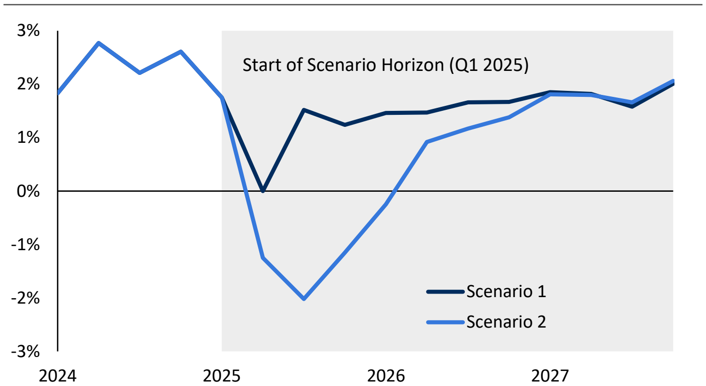
Market Perspectives: Examining how markets perform through economic contractions

There's been a lot of talk recently about the potential for recession (global, U.S., and/or in Canada). In its April Monetary Policy Report, the Bank of Canada (BoC) provided scenarios ranging from economic growth stalling temporarily in 2Q25, to a year-long recession. The possible outcomes are summarized in Chart 1, with the mild economic impact of Scenario 1, to the longer-term economic contraction reflected in Scenario 2. More details and context can be found in our Market Perspectives report published on April 16.

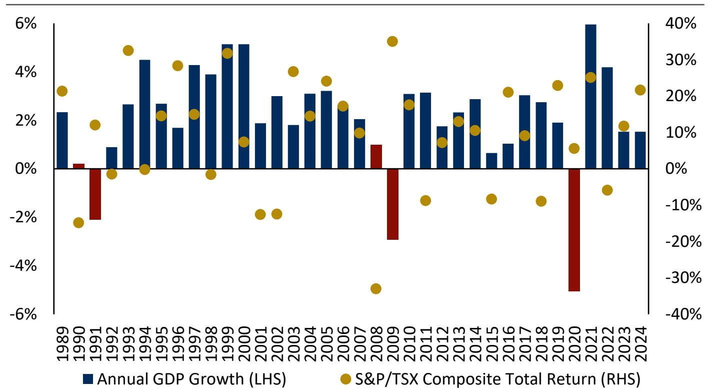
So, we consider the question: does it make sense to exit the stock market and wait to reinvest after the recession concern is behind us? Let's start by looking at annual GDP growth and TSX Composite returns over the last 35 years. In Chart 2, we illustrate the point that economic (GDP) growth is not always aligned with stock market performance. In Chart 3, we compiled the average market return leading up to, and then through, all the mild recessions and brief GDP contraction periods (similar to current forecasts) since 1967. Recession periods are usually determined in hindsight, but if we take the BoC's Scenario 2, with a recession most likely to start in 2Q25, we would currently be in the first month of an economic contraction. If we then imagined an investor that exited the market today, and then re-entered the market once they were satisfied that the economic damage had been reflected in share prices, their annualized return over the 12 months preceding and following the recession, based on historical performance, would average 5.5%. However, an investor that ignored the noise and stayed invested would average a 7.1% return.

Chart 1 - Bank of Canada's Projections on GDP Growth



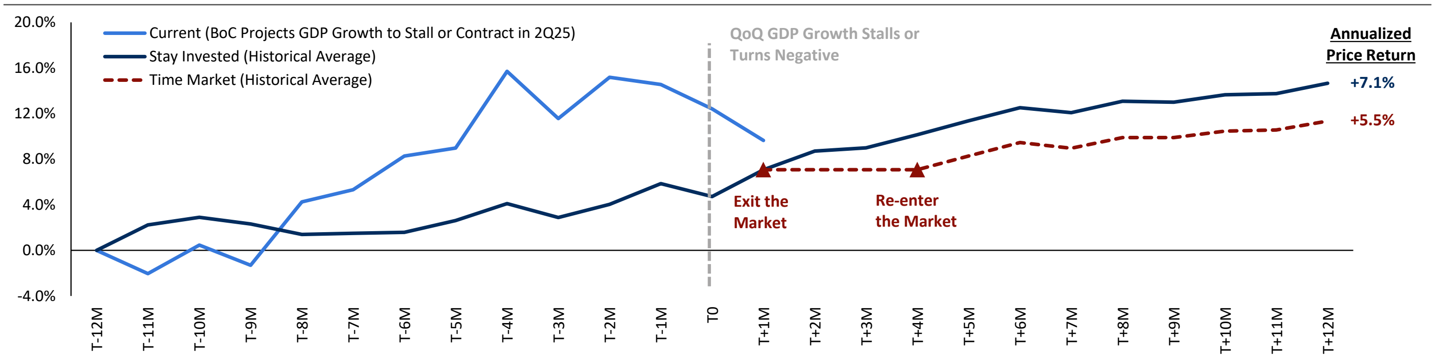
Source: Monetary Policy Report – April 2025, Bank of Canada. QoQ percentage change at annual rates, quarterly data.

Chart 2 - GDP growth vs. S&P/TSX Composite Index Return



Source: FactSet, Raymond James Ltd.; Data as of December 31, 2024. Annual GDP growth during recession periods are highlighted in red.

Chart 3 - S&P/TSX Composite Has Historically Shown Resilience During Brief Periods of Negative QoQ GDP Growth

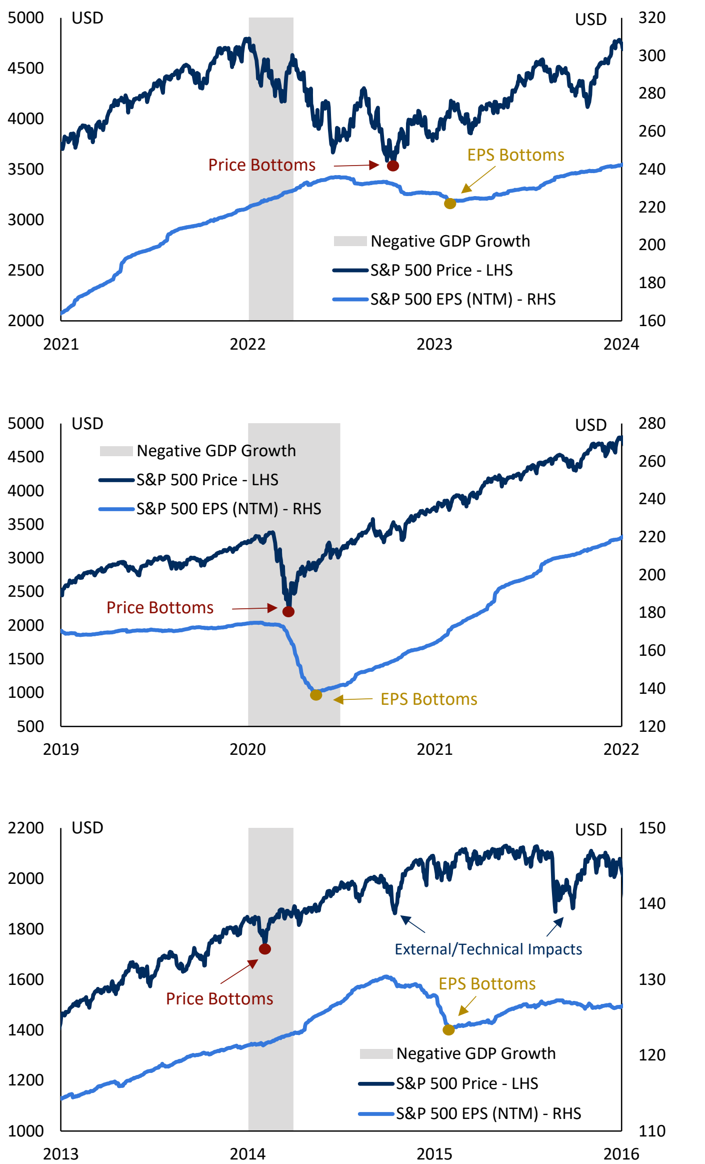


Source: FactSet, Raymond James Ltd.; Current performance data as of April 22, 2025. Historical data covers the period from 1967 to 2025. Severe recessions (1975, 1982, 1992, 2009, and 2020) are excluded, as a severe recession is not our base case for 2025.

While the past doesn't always give us great predictive power over future events, we can at least look back to find out if trying to sit out recessions and timing the market has been a winning strategy during previous economic contractions. Remember, that the stock market is always anticipating the future, reflected in part in the Price-to-Earnings (P/E) ratio that measures how much investors are willing to pay for $1 of anticipated corporate earnings. Those earnings, are metrics on the profitability of corporations, which are generally influenced by the macro backdrop, and are affected by economic slowdowns, but stock prices are generally reflecting expectations for next year, and sometimes expectations much further into the future. Basically, the economy is not the market, and the market is not the economy.

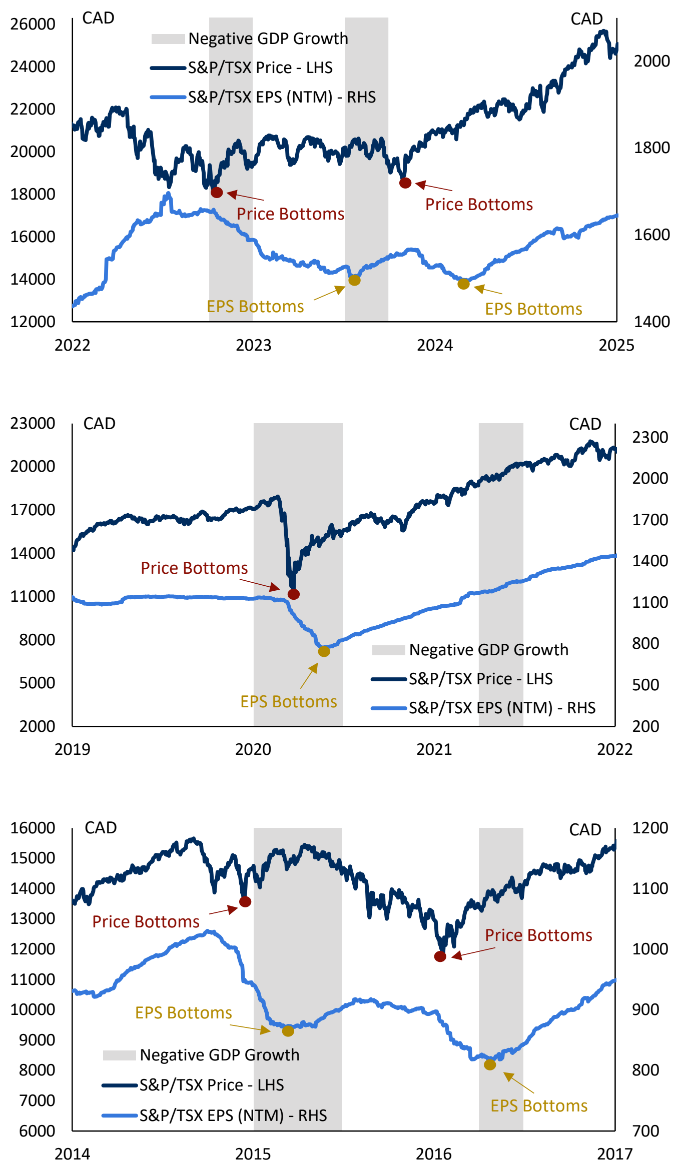
Below, on the left (Chart 4) we consider the most recent periods in which U.S. economic growth (GDP) had turned negative, and when the local bottom occurred in corporate earnings (EPS), versus when we saw the local bottoming in the main stock market index. On the right side, in Chart 5, we did the same exercise for the Canadian market. Other than the 2020 COVID period, when stock prices closely preceded a bottoming in corporate profits, in most other cases, there is lower correlation between stock market performance, earnings bottoms, and GDP contraction. Thus, waiting for EPS to bottom might result in missing any initial robust market recovery.

Chart 4 - S&P 500: Price vs. Earnings



Source: FactSet, Raymond James Ltd. External/Technical Impacts: 10/2014 - Fears of Ebola, ISIS, Global Economy, etc; 08/2015 - Flash crash due to "technical selling pressure".

Chart 5 - S&P/TSX Composite: Price vs. Earnings



Source: FactSet, Raymond James Ltd.

The bottom line is that rather than trying to time the market and getting caught up reacting to short-term noise, investors are almost always better off sticking to well established plans that are suited to their return objectives and risk tolerance.

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