PRIVATE CLIENT SOLUTIONS

December 1, 2023

Market Commentary

Recapping 2023

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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, supressing 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.

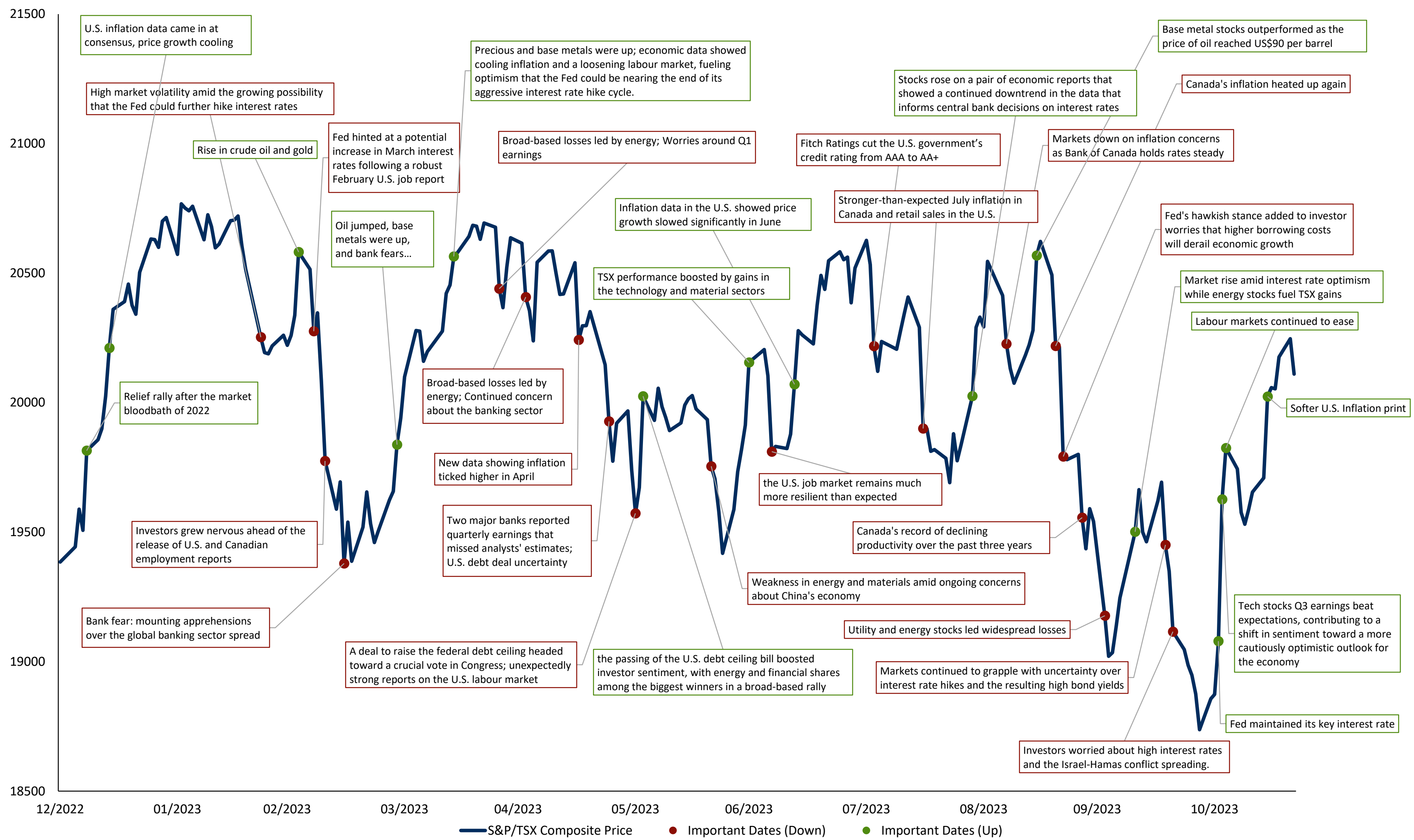
U.S. stock indices outperformed the rest of global equity indices, notably the Nasdaq Composite given its higher weighting in the technology sector. Most developed countries' stock indices achieved high double-digit year-to-date returns, with exceptions in Canada and the U.K. Meanwhile, China and Hong 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.

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.

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