RJL PCS: QUARTERLY ASSET ALLOCATION

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Quarterly Asset Allocation (July 2024): Rate Easing Cycle Kicks off in Canada, with U.S. to Follow Soon

Summary

As we settle into summer, we are relieved to have started into an interest rate easing cycle, at least in Canada, as the Bank of Canada (BoC) finally has enough confidence that inflation is on a sustainable path back to its 2% target level. Overall, we anticipate another three rate cuts in the four remaining meetings before the end of the year, allowing us to end the year with a 4.00% policy rate. (Note that our Canadian Fixed Income committee member more conservatively leans towards only two rate cuts by the end of 2024.) While this will take a little pressure off consumers and businesses, it will still leave many upcoming mortgage renewals to face higher rates than when they last renewed, and still result in pressure on a still fragile economy. We expect policy rate cuts to continue into 2025, reaching 3.00% around mid-year.

We have a lot of confidence that the Federal Reserve (Fed) in the U.S. will similarly join the rate cutting party before the end of the year, but opinions vary as to whether the Fed will start easing in September, or wait until as late as December. Our U.S. Economics team is forecasting the first U.S. rate cut in November, two days after the election, with another in December, to end the year with a Fed funds rate of 5.00%. The easing should keep U.S. GDP near trend at 2.1% in 2024 and 2.0% in 2025, but the differential in policy rates between the two countries is likely to put some downward pressure on the Canadian dollar against the U.S. dollar, and for the most part, we wouldn't be surprised to see the Canadian dollar depreciate slightly from the US$0.73 level currently to a US$0.71-0.72 range, with the risk of getting closer to US$0.70 if the Fed delays rate cuts to the end of the year, or even pushes into 2025 while the BoC continues easing.

The easing of rates was a relief, especially as we continue to see signs that the Canadian economy is weak, and perhaps weakening further. Despite a slight uptick in inflation in May, we expect the overall trend on inflation to be down and for the BoC to continue easing, providing some relief to the soft economy. We are not expecting any kind of (significant) recession, but we are seeing signs from consumer confidence, business intentions, declining productivity, and a growing unemployment rate, that keep us cautious, yet optimistic that continuing rate cuts will keep economic growth just mildly positive. By contrast, the U.S. economy, which has been remarkably resilient, continues to achieve good growth, although we similarly see softening as the higher interest rate environment has been more gradually adding pressure to the U.S. consumer. Still, we are looking for a soft landing in the U.S., with modestly stronger growth than in Canada.

Key Takeaways:

- **U.S. Economy:** Economic activity in the U.S. has remained relatively strong since the recovery from the pandemic recession, even as the Federal Reserve has kept its foot on the brake. However, we are starting to see some signs of weakness as the "long and variable lags" of monetary policy continue to put downward pressure on both consumption and investment. The variations in employment measures also show a cooling labour market. Inflation, as measured by the PCE Price Index, is very close to target as we begin the second half of 2024. Given these warning signs pointing to slower economic growth, our U.S. economists think the Fed should move ahead sooner rather than later with several rate cuts to accommodate this lower economic growth before other sectors of economic activity start to falter under the pressure of high interest rates.
- **Canadian Economy:** We believe Canada's economy is likely to achieve a soft landing with inflation under control. During this rate easing cycle, even though GDP growth may continue to slow and the unemployment rate may continue to rise, we do not anticipate dramatic impacts. Our biggest concern related to negative impacts on GDP is the wave of mortgage renewals at significantly higher rates than the expiring terms, which would increase consumer debt burden and negatively impact spending. However, future rate cuts should help moderate this pressure. We see the risk of significant layoffs as low at this time, but the labour market will likely continue to soften as workforce (population) growth outpaces job creation.
- **U.S. Equity Positioning:** The second quarter of 2024 was mixed for U.S. equities, with growth and large-cap indexes performing significantly better than small-cap and value indexes again. Both equity performance and earnings have been quite narrow. Our U.S. equity strategist

expects U.S. equities to remain relatively flat from current levels, although there may be some rotation between big tech and other sectors. The two biggest influences on U.S. equity markets will be the timing of the Fed's rate cuts and the outcome of massive Artificial Intelligence (A.I.) investments. If rates decrease in the second half of 2024, rate-sensitive sectors such as Staples, Health Care, Utilities, and Real Estate should outperform, along with secular growth. However, any changes in market expectations for A.I. will likely impact tech and growth stocks more than rate movements. Our quantitative/technical analyst however, uses a Market Cycle Model to suggest that we are moving through a phase where we should expect leadership from Information Technology, Industrials, and Basic Materials sectors, while Financial Services and Real Estate could potentially benefit from a “catch up” trade.

- **Canadian Equity Positioning:** In the first half of 2024, Canadian equity markets achieved a total return of 6.1%, driven entirely by the first quarter, as the second quarter delivered a -0.5% total return. We continue to expect increased volatility for the remainder of the year. A positive development is the start of the rate easing cycle in Canada, which we expect to foster growing optimism among investors in the Canadian equity market and potentially lead to some expansion of price-to-earnings multiples. This could help mitigate potential earnings pressure in the latter half of the year due to the economic slowdown, although the current consensus for 2024 EPS growth remains around 4%, consistent with the long-term average. Given our expectation of a soft landing, we maintain our forecast that the S&P/TSX Composite will end 2024 with a high single-digit total return. We continue to favour Consumer Staples for their defensiveness and Energy, aided by the completion of the Trans Mountain pipeline.
- **Fixed Income Positioning:** In Canada, we continue to see attractive yields but caution that the longer-term trend is likely toward lower rates, at least at the front end of the curve. We recommend investors consider extending duration to some degree or adopting a laddered approach if a conservative stance is warranted. In the U.S., strategically, cash in fixed income should be utilized by adding duration in high-quality credits. The corporate yield curve presents its best value in the 5 to 15 year maturity range.

Market Commentary

RJL Investment Strategy Team

Looking at equity markets around the world, we see the U.S., technology-heavy, S&P 500 and Nasdaq 100 indices leading the way, up 15.3% and 17.5% in 1H24, although the Japanese Nikkei 225 has posted a similarly impressive 19.3% return in local currency. Canada's TSX Composite clocked in only 6.1% in 1H24.

A.I. continues to be the dominant investing theme and driver of U.S. returns halfway into 2024, with Nvidia temporarily overtaking Microsoft and Apple to become the most valuable company on the index with a market capitalization of over US$3.3 trillion. By comparison, the market capitalization of the entire TSX Composite is approximately US$2.6 trillion.

Although we saw some signs of market breadth improving on the S&P 500, momentum quickly shifted back to the mega-caps with the index continuing to be driven by the largest U.S. companies, commonly referred to as the Magnificent 7 (Nvidia, Microsoft, Apple, Alphabet, Amazon, Meta, and Tesla), although it is debatable as to whether Tesla should be evicted from that group, which would presumably require the group being renamed, as the electric car company declined approximately 43% in 1H24 before rebounding to be essentially flat YTD. A nod should probably be given to our U.S. Investment Strategy group that has consistently excluded Tesla from such commentaries and preferred the moniker MAGMAN to represent the other six companies in that mega-cap group. Nevertheless, investors have continued to flock to the relative resilience of the U.S. equity markets, and generally towards the mega-cap and technology focused names as we progress into an A.I. fueled world. The S&P 500 recorded more than 30 record highs during the first half of 2024.

Despite 10 of 11 S&P 500 sectors posting positive returns in 1H24, we continue to see a concentration of investor focus on quality large cap companies, with growing earnings in a somewhat uncertain and challenging macro environment as an indicator that we are in the late stages of an economic cycle. This is evidenced in the vast outperformance of the market cap-weighted (and mega cap focused) S&P 500 versus the equal-weight S&P 500, where each constituent gets a 0.2% weighting, which is up ~4% in 1H24, the largest underperformance gap at mid-year in at least 35 years.

Equity valuations in the U.S., among the largest S&P 500 constituents and technology names remain high, although supported by earnings growth expectations. Our U.S. Investment Strategy team is also forecasting a 5,400 target for the S&P 500 to the end of 2024, based on US$245 in EPS, using a 22x P/E multiple. The 12-month target to mid-2025 is 5,700. We are cautious however of volatility and potential pullbacks in prices in the next few months. Overall, especially if we see the expected Fed rate cuts, we would hope to also see continued overall strength in the equity markets and specifically broadening strength into 2025 amongst small and mid-cap stocks.

International

Much fuss was made (in Canada) about the BoC being the first G7 central bank to start cut interest rates on June 5. However, its also useful to consider the broader G10, which groups G7 countries France, Germany and Italy into the broader European Union (UN) or Eurozone (EZ) moniker, and then includes the U.S., Canada, the U.K., and Japan, before adding in other developed countries Australia, New Zealand, Denmark, Switzerland, and Sweden. Considering this G10 grouping, Switzerland and Sweden both started cutting rates in March and May, respectively, with the Swiss National Banking following up with a second cut in June.

The European Central Bank (ECB) also did as was widely expected and started its own easing cycle the day after the BoC, cutting from 4.00% to 3.75%, after holding steady for nine months, but sounds to be cautious on subsequent cuts, perhaps only following up with a second cut in September, and then perhaps again in December. Australia seems to be signaling that it will be the last developed economy to join the rate cutting party, perhaps after having waited longer than most to start hiking rates, and is apparently even still considering further hikes, facing a more extended fight against inflation. Then to the far end of the spectrum is Japan, which is in the midst of a modest tightening cycle, albeit after a multi-decade period of negative interest rates. In the middle, the Bank of England (BoE) continues to be concerned about services inflation, although softening labour markets might still lead to a cut in August from its current rate of 5.25%.

As far as equity market performance outside Canada and the U.S., we would look to Japan, where strong corporate governance, domestic inflows, and a reversal in f/x towards a strengthening yen, once the Fed starts cutting rates, could bolster performance. Elsewhere, Emerging Markets could be set to shine, with attractive valuations, healthy earnings growth, and easing central bank policies. In this context, we would lean towards India as it is investing heavily in infrastructure and supporting manufacturing sectors such as electronics, autos, pharma, and textiles. If projections of 6.5-7% growth over the next few years are attained, India could soon pass Japan and Germany to become the third largest economy.

Table 1 - Global Equities Performance

Select Global Equity Indices	2Q24 (in LCL)	2Q24 (in USD)	2Q24 (in CAD)	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	2023 (in LCL)	2023 (in USD)	2023 (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Canada												
S&P/TSX Composite	-0.5	-1.6	-0.5	6.1	2.2	6.1	11.8	14.8	11.8	14.0	14.5	-0.5
S&P/TSX 60	-1.3	-2.4	-1.3	4.9	1.1	4.9	12.1	15.1	12.1	14.3	14.3	0.0
S&P/TSX Small Cap	0.8	-0.3	0.8	8.8	4.9	8.8	4.8	7.7	4.8	13.7	16.7	-3.0
Canada Growth	-2.3	-3.4	-2.3	5.0	1.2	5.0	15.8	19.0	15.8	20.5	18.4	2.1
Canada Value	-2.5	-3.5	-2.5	2.7	-1.1	2.7	5.1	8.0	5.1	11.1	12.1	-1.0
U.S.												
NASDAQ Composite	8.5	8.5	9.7	18.6	18.6	23.0	44.6	44.6	40.8	28.1	19.7	8.4
S&P 500	4.3	4.3	5.4	15.3	15.3	19.6	26.3	26.3	22.9	21.1	16.3	4.8
S&P Mid Cap 400	-3.4	-3.4	-2.4	6.2	6.2	10.2	16.4	16.4	13.3	15.2	13.8	1.4
S&P Small Cap 600	-3.1	-3.1	-2.0	-0.7	-0.7	3.0	16.1	16.1	12.9	14.1	14.9	-0.8
S&P Composite 1500	3.7	3.7	4.8	14.3	14.3	18.7	25.5	25.5	22.1	20.4	16.0	4.4
S&P Composite 1500 Growth	8.6	8.6	9.6	22.4	22.4	26.6	29.0	29.0	23.9	27.4	18.7	8.7
S&P Composite 1500 Value	-2.3	-2.3	-1.7	5.2	5.2	7.9	21.6	21.6	16.0	15.4	14.0	1.4
Europe												
Euro STOXX 50 (Europe)	-1.6	-4.5	-3.4	11.1	5.0	9.0	23.2	23.4	20.1	13.6	13.2	0.4
FTSE 100 (U.K.)	3.7	2.7	3.9	7.9	4.7	8.6	7.9	10.0	7.0	11.3	12.4	-1.1
CAC 40 (France)	-6.6	-7.3	-6.2	1.9	-1.2	2.6	20.1	24.4	21.0	13.6	13.4	0.2
DAX (Germany)	-1.4	-2.1	-1.1	8.9	5.6	9.6	20.3	24.5	21.2	12.1	12.6	-0.5
Asia Pacific												
Hang Seng (Hong Kong)	9.0	9.2	10.5	6.2	6.2	10.2	-10.5	-10.5	-12.9	8.7	12.5	-3.7
Nikkei 225 (Japan)	-1.8	-7.6	-6.6	19.3	4.6	8.5	31.0	22.6	19.3	20.3	16.7	3.6
MSCI China (China)	6.6	6.6	7.8	4.0	4.0	7.9	-11.2	-11.2	-13.6	9.6	10.7	-1.1
Major Aggregates												
World (Global)*	2.6	2.6	3.8	11.8	11.8	16.0	24.0	24.0	20.6	18.6	15.8	2.8
EAFE (DM ex U.S. & Canada)*	-0.2	-0.2	0.9	5.8	5.8	9.8	18.4	18.4	15.2	13.9	13.5	0.4
EM (Emerging Markets)*	4.4	4.4	5.6	6.7	6.7	10.7	9.0	9.0	6.1	12.4	11.7	0.6

Source: FactSet; Raymond James Ltd; Total returns, data as of June 30, 2024. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 6/30/2024. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

Canadian Economic Outlook

RJL Investment Strategy Team

Economic Growth

The Canadian economy picked up in 1Q24 after stalling out in 2H23. 1Q24 growth of 1.7% was still weaker than the BoC had been forecasting, but domestic spending was solid, with consumption growing by about 3%, in line with population growth. Purchases of motor vehicles and several categories of services contributed to the rise in consumption growth. Business investment grew more than expected and contributed positively to growth, as did residential investment and exports. Weaker investment in inventories was the main factor that held back economic activity in the quarter, which we would attribute to businesses being more cautious about future sales. We similarly see an increasing savings rate, with stronger growth in income, indicating cautiousness from consumers and households preparing for higher debt repayments when they renew their mortgages, and rising concerns about the labour market.

We expect to see further slowing of growth, as we strive to achieve a soft landing scenario, without the economy tipping into a (mild) recession. Our biggest concern related to negative impacts to GDP would be the wall of mortgage renewals, at rates significantly higher than the terms expiring, that would increase consumer debt burden and negatively impact spending. Canada's banking regulator, the Office of the Superintendent of Financial Institutions (OSFI), cited that 76% of mortgages held in February 2024 will be coming up for renewal by the end of 2026. Depending on the term and rate chosen for the renewal, compared to the expiring term, many homeowners could be looking at significantly higher payments. We see a continuation of the BoC's easing cycle as moderating this risk, although anyone renewing a mortgage over the next two years is still likely going to be doing so with a higher monthly payment obligation, notwithstanding techniques such as extending amortization periods to ease the monthly payment shock at the expense of increasing total debt payments through the remaining life of the mortgage.

Inflation

Consumer Price Index (CPI) inflation edged down in June to 2.7%, after a slight uptick in May to 2.9%, from 2.7% in April. The May uptick was released well after the BoC had cut its policy rate on June 5, and some may have questioned if the BoC had moved too soon, but the return to 2.7% in June (released July 16) likely reduces those concerns. We continue to see the overall trend in inflation coming down and believe that the June 5 cut was well warranted and that the BoC should continue its easing.

The BoC's preferred measures of core inflation also eased in April, growing at around the same rate as headline inflation. Three- and six-month measures of core inflation have been running lower than year-over-year rates, providing more confidence in the BoC being able to continue with cuts.

The share of CPI components growing above 3% on an annual basis has continued to decline and was close to its historical average in April. However, shelter inflation was still high and remained the largest contributor to total CPI inflation.

Interest Rates

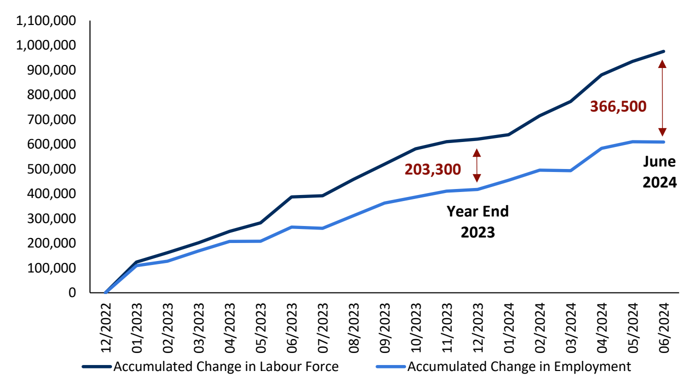
The big event this last quarter was the start of policy rate easing on June 5, as the BoC took the first step by lowering its policy rate from 5.00% to 4.75%. This was not much of a surprise, as inflation (as represented as headline CPI) has remained in the 1-3% comfort range since January, and we have argued CPI was already well under the 2% target if we exclude Shelter, which has been the biggest anchor on inflation, despite being high in part because of higher rates that were meant to reduce inflation. In addition, the Canadian economy has been weak for several quarters and underperforming other developed countries on a GDP-per-capita basis for a while. Further, as the unemployment rate has been rising, we would have been very much surprised if the BoC had not seen it reasonable to ease its restrictive bias, to relieve undue pressure on Canadian consumers and businesses.

With four more meetings and announcements planned before the end of the calendar year, specifically on July 24, September 4, October 23, and December 11, we expect to see three more cuts. Influencing factors would be any significant acceleration or deceleration in GDP, inflation, and unemployment rates, as well as Canadian dollar weakness beyond the BoC's comfort levels, which might be tested by the Fed further pushing out its own easing timeline. As long as the Fed starts cutting by its last 2024 announcement on December 18, and perhaps with an additional cut on September 18 or November 7, we would expect the BoC easing cycle to continue through the first half of 2025 towards a policy rate around 3.00%.

Chart 1 - Canada Unemployment Rate Reached 6.4% in June

Source: Statistics Canada; Raymond James Ltd.; Data as of June 30, 2024.

Chart 2 - Labour Force Continues to Grow As Job Creation Stalls



Source: Statistics Canada; Raymond James Ltd.; Data as of June 30, 2024.

Labour Market

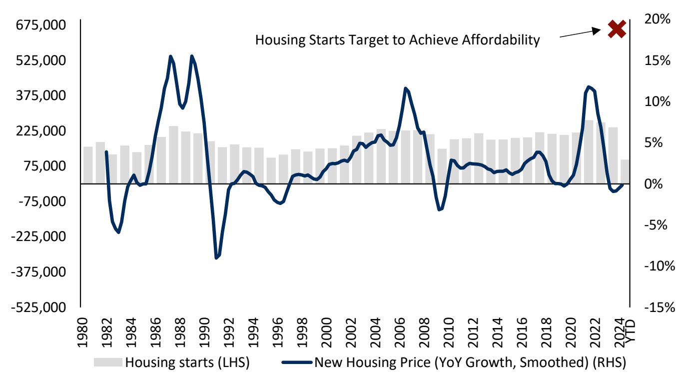
The Canadian labour market is still trying to return to normal from the massive disruption caused by the pandemic, where three million Canadians were laid off, and another two million had their hours cut back, resulting in the unemployment rate shooting up above 14%. As vaccines rolled out, a relatively rapid reopening of the economy left businesses scrambling to find workers and the unemployment rate fell to a 50-year low of 4.8% in July 2022 — the lowest level since the 1970s — with almost one million job vacancies. The tight labour market led to wage growth, which helped to push up inflation. As supply and demand for labour has since normalized, the unemployment rate has been picking up in Canada, to 6.4% in June (Chart 1), above the level before the pandemic when the economy was considered to be near full employment, with vacancies as a percentage of the labour force and the unemployment rate both being fairly low. Canada lost 1,400 jobs in June after increases of 27k in May and 90k in April (Chart 2). The situation is worse however when you consider that the population continues to grow at a faster pace, of approximately 80k people per month, and with a labour participation rate of ~62%, we would have to be adding 50k jobs per month on average just to stay flat. It is likely that we will see further increases to the unemployment rate.

Job vacancies fell 3.6% to 648k in 1Q24. That was the seventh consecutive quarterly decline from the record high of 983k in 2Q22. This shows some relief from the extremely tight labour market earlier in the pandemic recovery, when employers were having trouble finding staff and were having to offer higher compensation to attract workers. The market is now in better balance and signals that wage inflation could see some relief. It also however indicates a weakening economy as vacancies fell more for full-time jobs (-15,400; -3.1%) in 1Q24 than for part-time jobs (-8,900; -5.1%), and as total labour demand (filled and vacant positions) slipped 0.1% from 4Q23 to 1Q24 and was essentially unchanged from 1Q23. Again, with a rapidly increasing population, this shows a deterioration in the labour market. We don't necessarily expect large numbers of layoffs, but more employers are reducing their hiring needs and even canceling previous job postings. This is emphasized by the job vacancy rate, which measures the total number of vacant positions compared to the total labour demand, which dipped from 3.8% to 3.6% in 1Q24, to its lowest level since 1Q20. We are also seeing the unemployment rate among newcomers to the country at over twice the level of existing residents, further highlighting the need for the government to act more quickly to properly accommodate the rapid population growth.

Canada now has 2.0 job seekers per job vacancy, compared to 0.8 unemployed person to each job opening in the U.S. The ratio of job seekers to openings has been trending up since 3Q22 as the number of unemployed had grown by 214,100 while the number of job vacancies declined by 309,400.

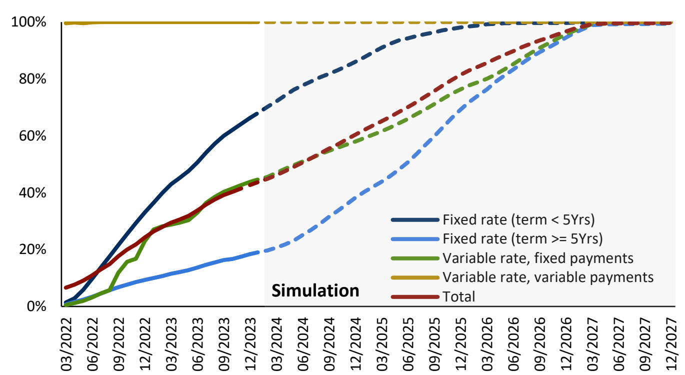
Annual wage growth rose to 4.5-6% during the tight labour market following the pandemic, but has now moderated to around 4%, but with volatility among the different measures. This level of wage growth, combined with weak productivity (output per worker) growth, means that unit labour costs continue to increase at an above-average pace, with a corresponding unfavourable impact on corporate profit margins and/or on inflation. The target should be wage growth in the 2-3% range as we saw before the pandemic. As changes in wage growth tend to lag changes in employment, we can expect the (recent) weakness in employment to translate into these lower wage gains going forward. What we want to see are wage gains that are backed by productivity improvements that do not increase unit labour costs or inflation. Unfortunately, Canada has been suffering from lagging productivity, as we have written about in other publications (June 2024 Insights & Strategies: Connecting the Dots on the Productivity Problem), with low levels of competition and business investment.

Chart 3 - Housing Starts Declined in 2023 and Housing Market Remained Muted Due to Elevated Borrowing Cost



Source: Statistics Canada; Raymond James Ltd.; Data as of May 31, 2024.

Chart 4 - Around Half of Mortgages Have Not Yet Seen Increased Payments



Source: Regulatory filings of Canadian banks and Bank of Canada calculations; Scenario: Rates evolve according to financial market expectation as of December 1, 2023.

Housing

The housing market was soft in May, as prices and sales volumes edged down, but we are watching for gradual improvements going forward as rate cuts stimulate activity, or at least are less of a restriction. Of course, much of the focus and concern in the Canadian housing space is on affordability and what we have often written about as a housing crisis, which was in part driven by immigration growth and low building activity. Although rate cuts to-date will not result in any immediate change to the situation, and government policies to limit immigration seem only to be contemplated for 2025 or later, we are starting to see increased activity from developers adding to supply in the coming years, with housing starts of 264.5k (annualized) in May, but still well below the 650k housing starts that we see as needed to bring affordability to Canadian Mortgage & Housing Corporation (CMHC) targets. While we are not out of the woods yet, we at least might be starting to move in the right direction, especially with the rate easing cycle now underway. The total housing starts in the first five months this year are lower than the same period in 2021 and 2022 but higher than 2023 (Chart 3).

While mortgage holders are looking for some relief as rate cuts take effect, the homeowners renewing in the next couple of years will still likely face higher monthly payments than they previously supported. According to the BoC, of the mortgages outstanding in February 2022, about 45% had already been subjected to a payment increase by November 2023, and the share will climb up to about 80% by the end of 2025 (Chart 4). A 4Q23 report from Equifax Canada calculated monthly mortgage payments increasing by $457 on average, with residents in Ontario and British

Columbia facing monthly increases of over $680. While we see measures such as extending amortization terms as alleviating short-term payment challenges, higher interest rates have continued to weigh on many homeowners.

New renters, or those changing units that are not somewhat insulated by rent increase controls, saw national rents growing by 9% y/y in May, a similar pace to the last 18 months. While this, along with new financing initiatives, helps to incentivize developers, the rising costs can still place a lot of burden on renters, including many new immigrants.

U.S. Economic Outlook

Eugenio Alemán - Chief Economist; Giampiero Fuentes - Economist

U.S. Economic Growth Still Positive, But Risks Are Increasing

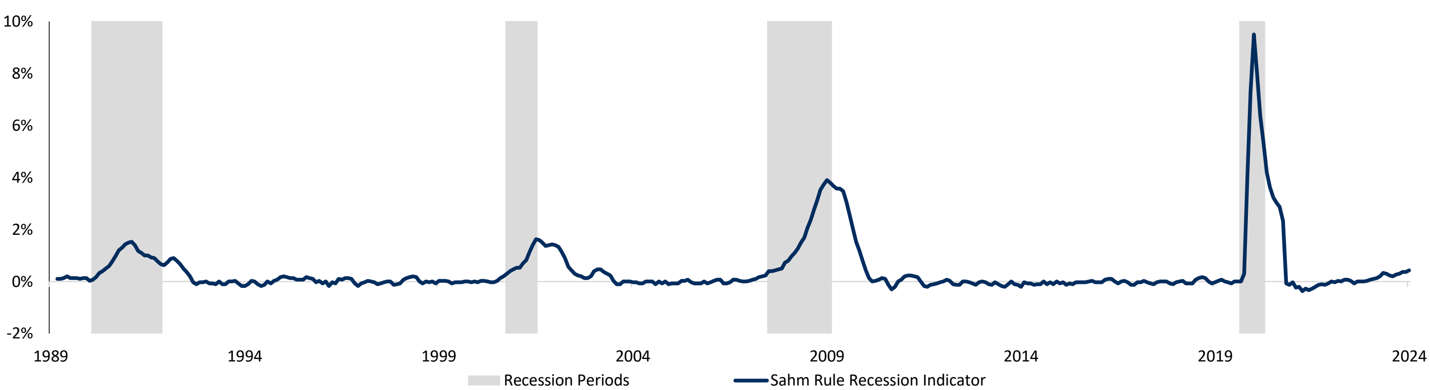
Economic activity in the United States has remained relatively strong since the recovery from the pandemic recession, even as the Federal Reserve has kept its foot on the brake. However, we are starting to see some signs of weakness as the very, very "long and variable lags" of monetary policy continue to put downward pressure on both consumption and investment.

Consumption had an advantage coming out of the pandemic recession due to federal government transfers, but those monies started to dwindle at the beginning of this year. The U.S. labour market helped to complement this fiscal support at first, and then continued as a substitute to keep disposable income relatively strong. At the same time, the slowdown in inflation has pushed the purchasing power of income higher, lending another helping hand to keep consumption relatively strong.

However, employment has started to show signs of slowing and even though the establishment employment survey has remained strong, the household survey has continued to show a relatively strong increase in the rate of unemployment. The rate of unemployment increased from 3.4% back in April 2023 to 4.1% in June of this year. Although this rate of unemployment is still very low compared to historical levels, the fact that it has increased by 0.7 percentage points during the last 15 months has started to raise eyebrows.

A recession indicator based on the increase of the rate of unemployment is starting to flash a warning sign. The indicator is called the Sahm Rule and is calculated as the three-month average rate of change in the rate of unemployment. If this rule increases by 0.5 percentage points compared to the low of the previous 12 months, this may be an indication that the economy may be in a recession. The Sahm Rule increased to 0.43 in June of this year (Chart 5).

Chart 5 - Real-time Sahm Rule Recession Indicator

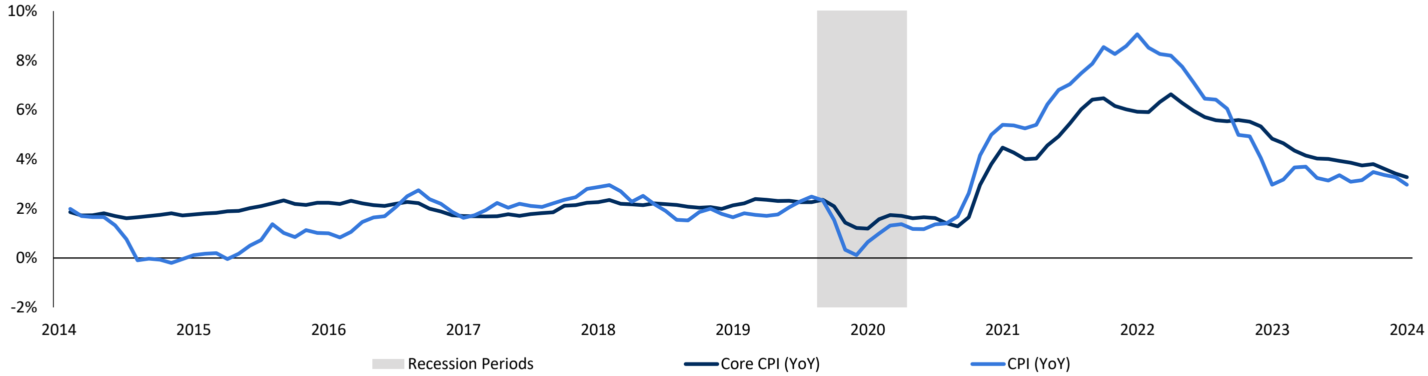


Source: FRED; Raymond James Economics; Data as of June 30, 2024, seasonally Adjusted.

Of course, we don't estimate economic growth by just watching only one indicator and we are still not predicting a recession this year, just a slowdown in economic activity. However, the Federal Reserve (Fed) has to realize that there are several warning signs pointing to slower economic growth, and it should go ahead sooner rather than later with several rate cuts in order to accommodate this lower economic growth before other sectors of economic activity start to falter under the pressure of high interest rates.

We understand that Fed officials are still concerned and remain unconvinced that inflation will continue its path toward the 2.0% target according to the Personal Consumption Expenditures (PCE) Price Index. But inflation as measured by the PCE Price Index is very close to the target as we begin the second half of 2024. The Fed is also not looking for inflation to come down to 2.0% immediately, but to reach that level by 2026—so it already recognizes that the process is going to be a long one (Chart 6).

Chart 6 - U.S. Inflation



Source: U.S. Bureau of Labor Statistics; Raymond James Economics; Data as of June 30, 2024.

However, waiting too long to start lowering interest rates under the current economic environment could risk sending the U.S. economy into recession. We understand that the Fed remains concerned with the U.S. government's fiscal stance, which is still very expansive, taking into consideration the fiscal packages/bills passed during the last two years and the potential to keep inflation higher than it would like.

But we see the risks of higher inflation today as less dangerous than the risks of recession; thus, we don't see the risks as "two-sided," as the Fed Chairman has recently suggested. Inflation has continued its disinflationary path even as economic growth has exceeded expectations since COVID. We view that as a clear signal that the inflation normalization process has continued (i.e., supply chain disruptions, effects of the Ukraine-Russia war, etc.), and remains independent of what monetary policymakers are doing. The "long and variable lags" of monetary policy seem to have become infinite rather than just long.

As we have said many times since the recovery from the pandemic recession, monetary policy has not been binding. Since the increase in inflation was not due to a monetary policy cycle, but a fiscal policy cycle combined with the disruptions created by the pandemic, monetary policy has not been effective in bringing down inflation. It has definitely prevented more gasoline being thrown onto the fire, and that has been an important contribution. However, the most important reason for the disinflationary process has been the normalization process after the pandemic disruptions, plus the drawing down of excess savings.

Thus, the Fed must remain aware of these dynamics and be careful to not overextend its hand by keeping interest rates high for too long. The longer it stays at these levels, the higher the risks for the economy.

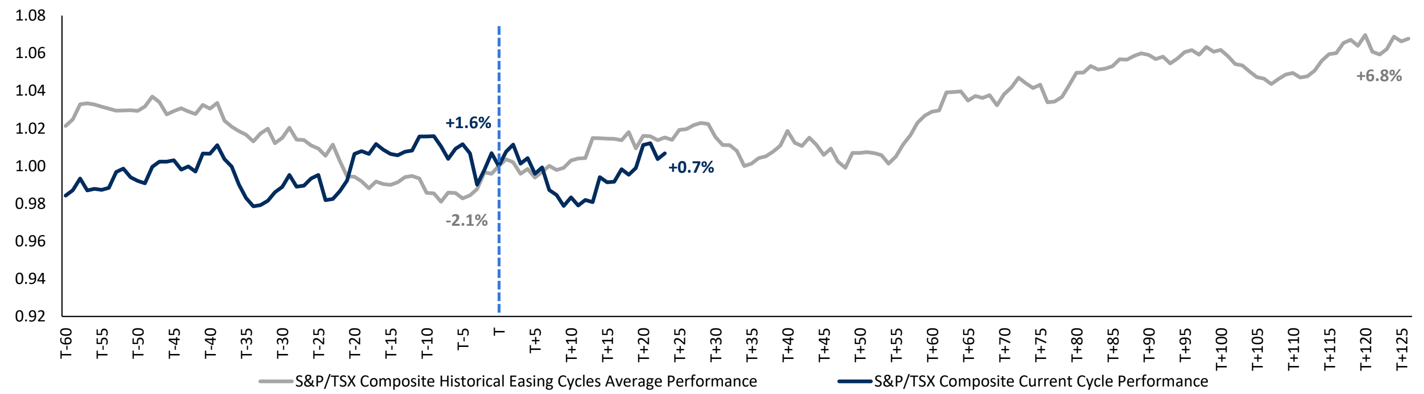
Canadian Equities

RJL Investment Strategy Team

In the first half of 2024, Canadian equity markets saw a broad total return of 6.1%, driven entirely by the first quarter, as the second quarter posted a -0.5% total return.

A positive development is the start of the rate easing cycle in Canada, which we expect to foster growing optimism among investors in the Canadian equity market and potentially lead to some expansion of price-to-earnings multiples. Historically, following the initial rate cut, the S&P/TSX Composite has averaged around a 6% total return in the first six months (Chart 7). This could help mitigate potential earnings declines in the latter half of the year due to the economic slowdown, although the current consensus for 2024 EPS growth remains around 4%, consistent with the long-term average. Given our expectation of a soft landing and inflation on track to meet its 2% target, we maintain our forecast that the S&P/TSX Composite will end 2024 with a high single-digit total return.

Chart 7 - S&P/TSX Composite Performance (Indexed, Day Prior to First Rate Cut = 1)



Source: FactSet; Raymond James Ltd. Data as of July 9, 2024. T: day prior to first rate cut; T +/- number of trading day(s). The March 2020 rate easing cycle is excluded due to its short duration of only one month.

Canadian small caps have outperformed large caps, and growth stocks have outpaced value stocks through the first half of 2024. This trend reflects the market's anticipation of a new economic cycle, coupled with reduced uncertainties following the first rate cut on June 5 by the BoC. It's important to also monitor the rate decisions of the Fed in the U.S., given the S&P/TSX Composite’s approximately 30% revenue exposure to the U.S and other strong ties between the two countries.

Interest rate differentials may favour specific stocks. With expectations of continued easing from the BoC and ongoing uncertainty about the Fed's rate reduction timeline, these policy rate differentials could put pressure on the Canadian dollar. Investors may therefore benefit from stocks or sectors that export in USD while maintaining manufacturing or other supply costs in CAD. Industries to watch include automobile manufacturers, transportation, and tourism. However, it's crucial to remain selective and focus on high-quality companies due to the overall economic slowdown in both the U.S. and Canadian economies. For more detailed sector commentary, please refer to the sector ratings table on the next page.

Table 2 - S&P/TSX Composite Sector Ratings Table

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Communication Services	3.9%	-11.6%	-3.4%	13.7x	15.8x	UNDERWEIGHT	UNDERWEIGHT

The Communication Services sector is currently trading at a discount, but it has lagged the most in performance among all sectors in 1H24. Increased competition among major players has led to a decline in per-user revenue. With dominant players already established in the Canadian market, gains for one typically result in losses for others, leading to modest growth in new users. The sector may improve slightly in 2H24 as the BoC's rate easing cycle begins, since it is considered capital-intensive and its attractive dividends will become more appealing as government bond yields decrease. However, it remains uncertain whether the intensified competition can be mitigated.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Consumer Discretionary	3.8%	3.0%	-1.5%	14.4x	14.3x	MARKET WEIGHT	MARKET WEIGHT

The Consumer Discretionary sector is currently trading at its historical P/E median and slightly lagged behind the TSX Composite in the second quarter and 1H24. As the economy continues to slow down, we expect discretionary spending to decrease, negatively impacting firm performance, though not as severely as initially anticipated. However, the sector's significant exposure to dollar stores, which are known for their resilience in various economic cycles, provides a layer of defensiveness.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Consumer Staples	4.4%	8.3%	4.1%	17.0x	15.9x	OVERWEIGHT	OVERWEIGHT

The Consumer Staples sector is currently trading at a modest premium and has outperformed the TSX Composite in the second quarter as well as 1H24 overall. Given the macroeconomic backdrop of a slowdown, this sector stands to benefit as its main industries—such as grocery stores, gas stations, food production, and pharmacies—are essential for everyday life. Consumer Staples typically have the highest average total return during the first six months after the initial rate cut and experience the smallest drawdowns across past rate easing cycles. Therefore, we continue to favour this sector. The significant exposure to U.S. gas stations may contribute to performance as the summer driving season begins, although attention is needed as fuel margins are expected to normalize over the next few quarters.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Energy	18.1%	14.1%	0.9%	12.6x	14.7x	OVERWEIGHT	OVERWEIGHT

The Energy sector is currently trading at a discount and achieved the highest total return among the sectors in 1H24. As a highly cyclical sector, it is sensitive to global economic conditions. Notably, the potential soft landing in the U.S. and Canada and the need to refill the U.S. strategic reserve have kept oil demand resilient. The completion of the Trans Mountain expansion in May has the potential to boost oil exports by 15%. This project will also enhance the marketability and logistics of Alberta crude, reducing the differentials between WCS and WTI and thus improving profitability. This improvement should offset any possible decline in oil prices as OPEC+ gradually unwinds its voluntary output cut starting in October. Although it will take time to ramp up to full capacity and logistical hurdles at the port may affect transportation to the west coast and Asian countries, we still anticipate significant potential upside for the oil and gas industry moving forward.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Financials	30.4%	4.3%	-1.2%	10.3x	11.4x	MARKET WEIGHT	MARKET WEIGHT

The Financials sector is currently trading at a discount and slightly lagged behind the TSX Composite in the second quarter as well as in 1H24. The lower policy rate in 2H24 will have mixed effects on banks' earnings. While it may ease pressure on loan books and allow banks to gradually reduce provisions for credit losses, it will likely squeeze net interest revenue. Additionally, as the economy slows down, we expect fewer individuals to have discretionary funds for insurance, potentially leading to increased withdrawals. Asset management firms may also face heightened market volatility for the remainder of the year. Historically, the Financials sector has performed relatively in line with the TSX Composite during the first six months of the rate easing cycle. Therefore, we maintain a market weight on the Financials sector overall.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Health Care	0.3%	-3.6%	-18.6%	5.3x	16.2x	NO RATING	NO RATING

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Industrials	13.3%	7.3%	-3.4%	21.8x	15.8x	OVERWEIGHT	▼ MARKET WEIGHT

Industrials are currently trading at a relatively high premium, partly justified by their decent EPS growth. While the sector outperformed the TSX Composite overall in 1H24, it underperformed during the second quarter. There are concerns regarding uncertainty on the demand side, particularly in ground transportation, which accounts for nearly half of the sector. As the economic cycle shifts from slowdown or potential recession to early recovery, Industrials tend to lose momentum. Looking at past rate easing cycles, Industrials generally performed in line with the TSX Composite but slightly underperformed on average. However, we believe the general waste collection industry within this sector could provide some defensive characteristics. Overall, we are revising the sector rating for the Industrials sector down to a market weight.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Information Technology	8.5%	-1.0%	-5.6%	30.9x	22.5x	OVERWEIGHT	OVERWEIGHT

The Information Technology sector is currently trading at higher P/E multiples compared to its historical median, although it has decreased from its peak at the end of 2021. These elevated P/E ratios are justified by robust EPS growth, which we still view as growth at a reasonable price. However, it underperformed the TSX Composite index in 1H24, particularly in the second quarter. One contributing factor is the sector's high concentration, with the top company accounting for almost half of the weight and the top three companies comprising over 80%. Any company-specific concerns or negative surprises could weigh down sector performance. Nevertheless, we anticipate growth to accelerate later in the year during the rate easing cycle, and the current excitement around A.I. is expected to persist, thus we maintain an overweight rating on Info Tech. However, the absence of the fastest-growing industry, semiconductors, in the TSX Information Technology sector is likely to result in underperformance relative to its U.S. counterpart.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Materials	11.1%	13.7%	7.4%	17.7x	17.0x	MARKET WEIGHT	MARKET WEIGHT

The Materials sector is currently trading slightly above its historical median. It performed in line with the TSX Composite in the first quarter but emerged as the best-performing sector in the second quarter. In the short term, we expect that precious metals, which constitute over 40% of the sector's revenue exposure, will continue to perform well due to central bank purchases and investor hedging against economic uncertainty, particularly noticeable in China. This trend may gradually normalize by the end of the year; however, potential rate cuts by the Fed could support declines in real yields and weaken the USD, which would also be supportive of gold prices. Regarding base metals, their short-term performance is heavily reliant on global economic growth, which is currently slowing down. Nonetheless, in the longer term, demand remains robust due to government support for clean energy initiatives.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Real Estate	2.3%	-4.1%	-5.7%	13.5x	14.6x	UNDERWEIGHT	UNDERWEIGHT

The Real Estate sector is currently trading below its historical median P/E level and has been one of the worst-performing sectors in the second quarter and throughout 1H24. The primary reason for this underperformance is the delayed rate cuts. Despite the recent 25 basis point rate cut in June, the policy rate remains elevated, continuing to strain developers' financial conditions. Non-residential REITs may face significant challenges during the economic slowdown, whereas residential REITs may see improved prospects as the rate cut cycle begins. However, affordability remains quite stretched at this time, and new house prices are not expected to rebound notably until the end or after the rate easing cycle.

Sector Name	Sector Weight	2024 YTD Total Return	2Q24 Total Return	Current P/E NTM	Historical Median	2Q24 Rating	3Q24 Rating
Utilities	4.1%	-0.9%	0.2%	18.6x	17.9x	MARKET WEIGHT	MARKET WEIGHT

The Utilities sector is currently trading slightly above its historical median P/E level. Its performance has been subdued since August 2022 but showed slight outperformance compared to the TSX Composite in the second quarter. The independent power and renewable energy segment has been the strongest contributor within the sector, while multi-utilities have lagged behind. The onset of the rate easing cycle brings positive news for the Utilities sector, given its capital-intensive nature. Additionally, the dividend yield of utility companies could become more attractive as government bond yields gradually decline. Furthermore, we see long-term opportunities in Utilities linked to the clean energy trend and increasing electricity demand. However, historical analysis of rate easing cycles since 1995 (excluding March 2020 due to its short duration) shows that Utilities have tended to underperform significantly in the first six months of rate easing cycles, occurring five out of six times. Therefore, we maintain a market weight rating on the sector.

Source: Raymond James Ltd. Historical P/E Median: 1/1/2000 - 6/30/2024.

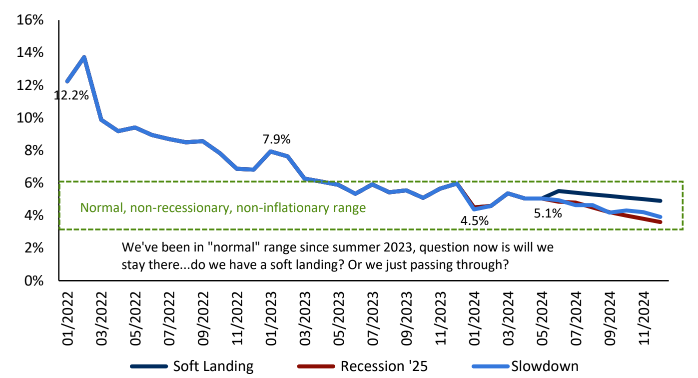
U.S. Equities

Tavis McCourt, CFA - U.S. Institutional Equity Strategist

Q2 was a mixed quarter for U.S. equities, and quite narrow, with growth and large cap indexes doing far better than small cap and value indexes (again), as weaker economic data built some fear into cyclical company earnings trends, while continued investor fervor over the benefits of artificial intelligence sent a handful of companies meaningfully higher, driving the S&P 500 higher in the quarter by 3.9%, even as the equal-weighted Russell 1000 was down (3.3%). Equity performance has been narrow, but EPS growth has been very narrow as well as we enter the sixth consecutive quarter of EPS being down y/y for the average public company.

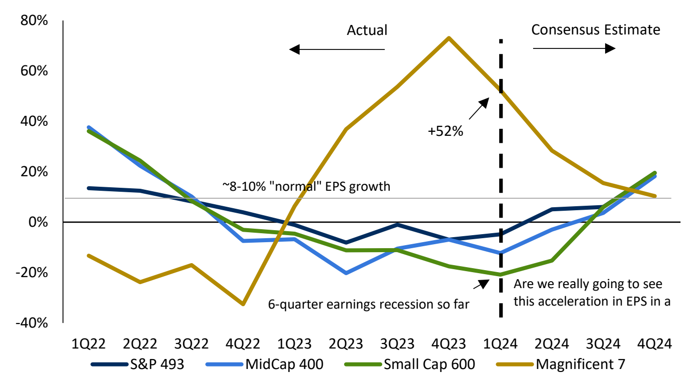
Equities have increasingly been pricing in a “soft landing” in the economy since the current rally started in October of last year, and the earnings trend is expected to turn broadly positive as this year progresses. In Q2, it appears that the economy has continued to decelerate as has inflation (Chart 8), which likely leads to the Fed lowering rates, hopefully ceasing the deceleration in the real economy. The degree to which it is successful or not in this endeavor will determine whether we truly do have a “soft landing” or ultimately end in a recession, with corporate earnings not recovering as is broadly priced into equities today.

Chart 8 - Y/Y Forecasted Nominal Consumer Spending For 2024 - We’re Just Decelerating Y/Y



Source: FactSet; Raymond James Research.

Chart 9 - Consensus Quarterly Y/Y EPS Large, Mid, Small and “Magnificent 7”



Source: St. Louis Federal Reserve, Costar, Raymond James Research.

Our overall expectations for 2024 are that inflation will progress lower, rates will also be reduced (3.5-4.0% 10-Year Treasury by year-end after a small rise in 1H24), and that U.S. equities will be somewhat flattish from current levels (but potentially with some rotation between big tech and other sectors), with overall corporate profitability (EPS) relatively flattish y/y (but improving through the year), but with strong P/E multiples reflective of the lower interest/discount rates, with the financial markets looking forward to improved growth in 2025. We note S&P 500 index level EPS in 2024 will likely be up due to the EPS impact of a handful of AI-impacted stocks (Chart 9).

The biggest determinant of the path for U.S. equity markets will likely be how quickly the Fed recognizes that the inflation problem has been resolved and that it’s time to lower rates. By some measures, specifically replacing shelter cost inflation with more real-time data, we could argue that we are already near the 2.0% target, and at a minimum we are on our way there with economic growth still decelerating. Our biggest concern that would prevent rate cuts, which will be needed to support the economy and financial markets, would be a spike in commodity prices, likely in the energy space, as a result of supply disruptions and/or geopolitical tensions. The second biggest risk in U.S. equity markets is the hundreds of billions of investment dollars that are now being put to work to develop Artificial Intelligence products and services. The success of this investment theme is still uncertain, and any delay or failure to develop enough productivity enhancing applications from all this A.I. spending will surely create a hangover. If applications drive significant productivity, it likely ushers in a far better future for equities over the next several years than would have existed without A.I.

Our base-case outlook for 2024 is for a modest slowdown in the economy (but no major labour market dislocation), with consensus EPS expectations pretty flattish broadly, but with A.I.-driven large cap names keeping S&P 500 EPS positive on the year. After a slight increase in rates in 1H24, we should see rates coming down in this scenario in 2H24, providing some cushion for the market as EPS likely comes in a little disappointing relative to consensus expectations of a significant H2 ramp. In this environment, rate sensitive sectors (Staples, Health Care, Utilities, Real Estate) should outperform along with secular growth, although any positive or negative change in the market’s expectations for A.I. is likely to impact tech and growth stocks more than rates.

Technical Analysis

Javed Mirza, CMT, CFA - Quantitative/Technical Analyst; Majd Hijazi - Equity Research Associate - Quantitative/Technical

Summary

Looking Forward: **Seasonality for equity markets supports a strong July, followed by weakness through August and September. This is within the context of the "boring middle" of a new 4-Year Cycle (3-5 year cyclical equity bull market)**. The Vanguard Total Stock Market ETF (**VTI**) historically supports positive seasonality through July before stalling in August and September (see Exhibit 6). The **VTI** is composed of a variety large, mid, and small cap stocks in both the growth and value categories. This implies that strength in July is an opportunity to position for weakness through the summer doldrums of Q3. We highlight Uranium and Homebuilders as two sectors at particular risk of a summer correction (see Tactical Ideas below).

Our technical work suggests that equity markets are in Phase 2 of the Market Cycle Model, which we view as the "boring middle" as the underlying economy begins to show signs of strengthening and is typically marked by leadership in Information Technology, Industrials, and Basic Materials (see Exhibit 5). As a result, the bulk of our Best Ideas for 2024 (see below) are direct beneficiaries of this potential sector rotation. Our technical work indicates that the equity market correction that developed from late July – October 2023 marked a transition from Phase 1 to Phase 2 of the Market Cycle Model.

Our longer-term cycle work supports a 2024 year-end target of 5,466 or another 14.6% upside from the December 29, 2023, close. Our longer-term cycle work supported a 2023 target for the S&P 500 of 4,864 or another 27% upside from the December 2022 close. The S&P 500 closed out 2023 near 4,770, for a yearly gain of 24%.

Our longer-term cycle work suggests a new 4-Year Cycle (3-5 year cyclical bull market) began at the October 13, 2022, price low and that has upside, by time, into H2 2025/H1 2026. We are calling this new 4-Year Cycle the ***H***igher ***F***or ***L***onger (***HFL***) cycle as our technical work strongly suggests this cycle has ushered in a long-term secular shift to higher yields.

Tactical Ideas – Q3 2024:

- *Seasonality Supports Summer Correction in Uranium Stocks* – **The weakening technical profile of the Global X Uranium Index ETF (URA, see Exhibit 8), in conjunction with poor seasonality, suggests reducing exposure**. Materials remain one of our favoured sectors for Phase 2 of the Market Cycle Model. However, our technical work is showing signs that **URA** is weakening. In addition, seasonality is a headwind in Q3 versus the S&P 500 for the **URA** (see Exhibit 7), and by extension Uranium equities.
- *Summer Doldrums and Weakening Technicals Support a Pullback* – **The weakening technical profile of the S&P Homebuilders ETF (XHB, see Exhibit 10), in conjunction with poor seasonality, suggests reducing exposure.** Our technical work is showing signs that **XHB** is weakening. This is consistent with a pending shift into Phase 3 of the Market Cycle Model, which puts the early cycle Consumer Discretionary at risk, as a source of funds. In addition, seasonality versus the S&P 500 for the **XHB (**see Exhibit 9) is likely to be a headwind for Q3.

Raymond James clients can refer to Javed's regular weekly reports for more details and insights into his charts and models.

Exhibit 1 - U.S. 10-Year Treasure Yield – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

Exhibit 2 - U.S. Dollar – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

A new long-term uptrend is in place in U.S. 10-Year Yields. Since 2011, the U.S. Dollar has been in a secular uptrend, coincident with the secular bull market in equities. Ongoing strength in Yields has been a tailwind for the U.S. Dollar. However, our Market Cycle Model work suggests a sideways consolidation is in store for the U.S. 10-Year for 2024 (see black box), which should see the U.S. Dollar move sideways as well (see black box).

Our longer-term view has been that the Federal Reserve will attempt to increase interest rates during the life of this secular bull market in equities, which should be a tailwind for the U.S. Dollar. A pause in the current Federal Reserve hiking cycle should see the U.S. Dollar remain in a choppy sideways trading range for the bulk of 2024, bounded by 107.50 to the upside and 97.50 to the downside. Our longer-term technical work suggests that the next Federal Reserve hiking cycle could begin as early as H2 2025 / H1 2026, as a strong economy brings back the specter of rampant inflation.

Exhibit 3 - S&P 500 – 20 Years – Monthly

Source: StockCharts.com, Raymond James Ltd.

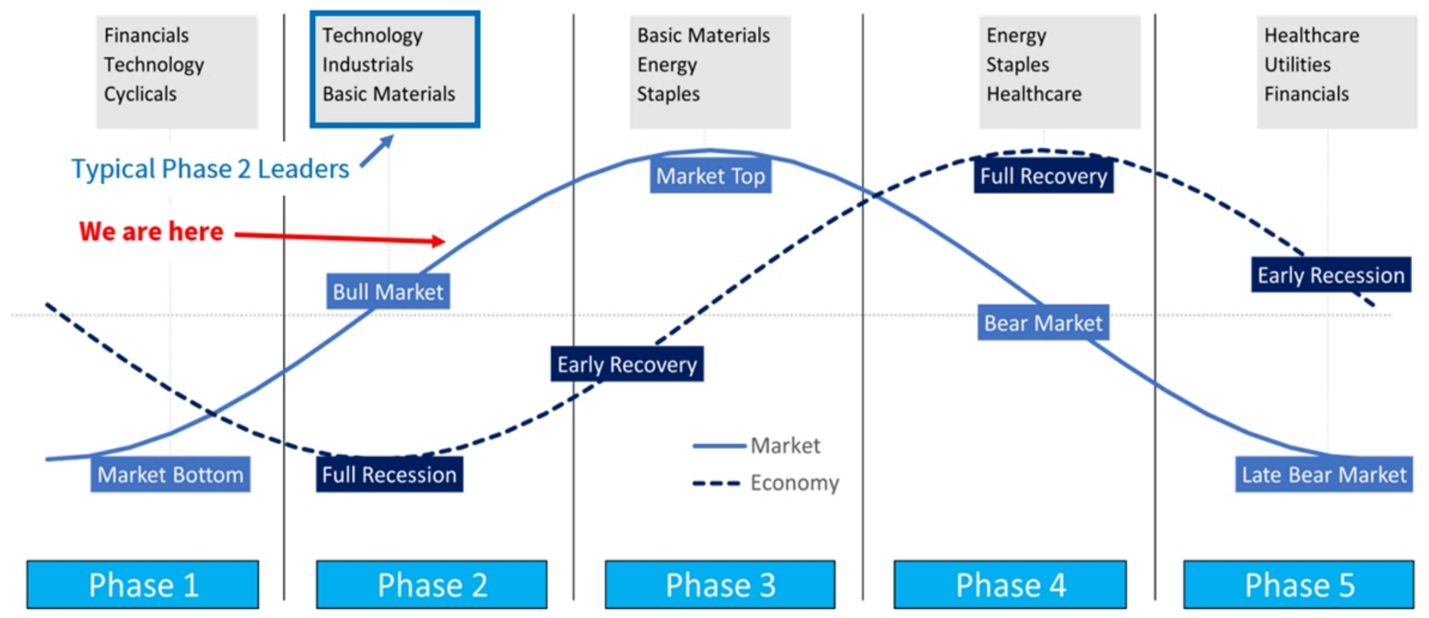
Exhibit 4 - CRB Commodity Index – 20 Years - Monthly

Source: StockCharts.com, Raymond James Ltd.

Equities are almost two years into a new 4-Year Cycle (cyclical bull market), after a 4-Year Cycle reset (cyclical bear market) took hold in 2022 (see green shaded box). Commodities have broken out of the downward sloping trend channel which has defined the bear market that began in 2009 (red arrows with dotted line).

The CRB Index is showing signs of strength, consistent with the shift into the "boring middle" of a new 4-Year Cycle, as demand for Commodities begins to increase. Basic Materials should perform well in 2024 as our longer-term cycle work suggests the recent equity market correction from July – October 2023 marked a transition from Phase 1 to Phase 2 of the Market Cycle Model. In late 2024 equity markets should begin to transition into Phase 3 (the market top) which should see Energy begin to outperform. A shift into Phase 3 of the Market Cycle Model should be the catalyst that sees Commodities reaccelerate in 2025 as Phase 3 is when the economy is firing on all cylinders. This should be supportive of strength in both Basic Materials and Energy. Broad strength in Commodities will also be the catalyst that sees the Federal Reserve begin its next rate hiking regimen to fight inflation and cool down the economy.

Exhibit 5 - Market Cycle Model – Shift into Phase 2 Supports Ongoing Strength In Technology, Industrials, and Materials



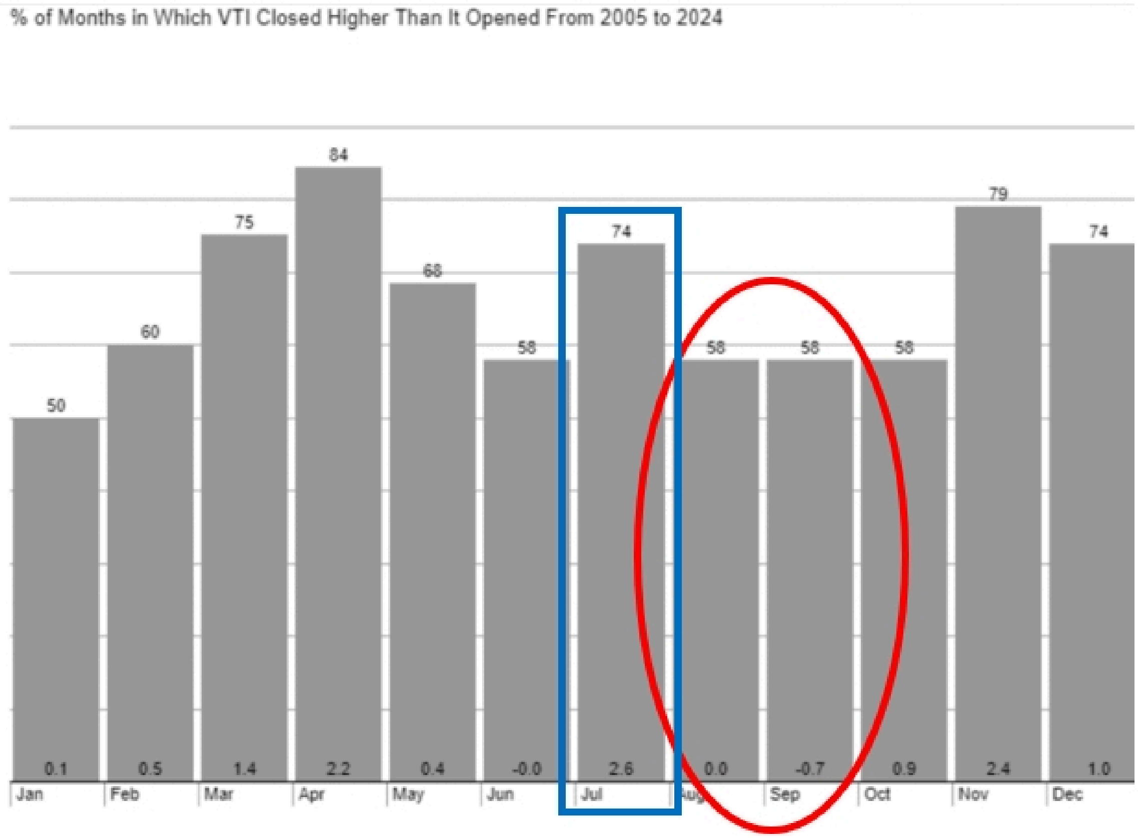
Source: StockCharts.com, Raymond James Ltd.

Our longer-term technical work suggests a new 4-Year Cycle (3-5 year cyclical bull market) began on October 13, 2022. We are calling this cycle the ***H****igher* ***F****or* ***L****onger* cycle, or ***HFL*** cycle. This is within the context of a secular bull market in equities that began in 2011 and has upside, by time, into ~2030.

In our view, the intermediate-term (1-3 month) corrective phase in equity markets from July 2023 – October 2023 marked the transition from Phase 1 into Phase 2 of the Market Cycle Model (see We are here).

Phase 2 of the Market Cycle Model is when the underlying economy shows signs of strengthening (see blue dotted line) and is typically supportive of outperformance by Information Technology, Industrials, and Basic Materials (see blue box). In addition, our technical work suggests that Financial Services and Real Estate are likely to see a "catch-up" trade take hold. A strengthening economic backdrop should remain a strong tailwind for all these sectors through 2024.

Exhibit 6 - VTI – Seasonality – 20-Years – Seasonality Suggests Consolidation in Q3 (July - September)



Source: StockCharts.com, Raymond James Ltd.

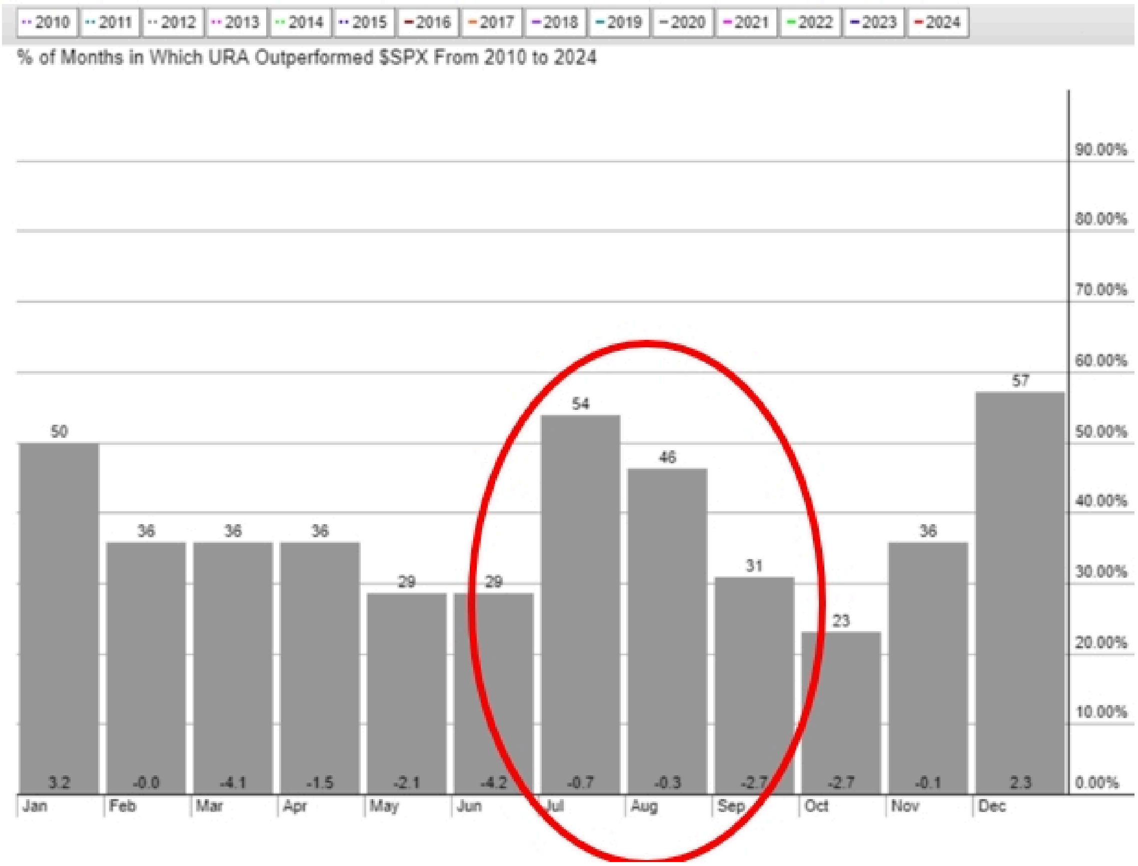
The Vanguard Total Stock Market ETF (**VTI**) is a good proxy for the U.S. Stock market as it holds ~ 3,700 names broadly distributed amongst, large, mid, and small capitalization stocks as well as growth and value.

Historically, **VTI** sees an average return of +2.6% in July, 0.0% in August, and -0.7% in September.

July has registered a positive return 74% of the time since 2005, followed by 58% positive returns in August and September.

Historically, August and September are the most challenging from a seasonality perspective for equity markets (see red circle). This suggests that investors utilize the positive tailwinds through July (see blue box) to begin shifting towards "defense" in anticipation of the summer doldrums starting in August.

Exhibit 7 - Global X Uranium Index ETF (URA) - Seasonality – 14 Years – Monthly



Source: StockCharts.com, Raymond James Ltd.

The Global X Uranium Index ETF (URA) underperforms the S&P 500 from July to September (see red circle), which supports trimming exposure. Historically, weakness through November offers a more attractive entry point, and is followed by a strong rally from December to January.

Historically, the **URA** sees an average underperformance versus the S&P 500 of -0.7% in July, -0.3% in August, and -2.7% in September.

The **URA** outperforms the S&P 500 54% of the time in July, However, it only manages to outperform the S&P 500 46% of the time in August, and only 31% of the time in September. Weakness through October should offer an attractive longer-term entry point into Uranium stocks.

Exhibit 8 - URA – 10 Years – Monthly – Seasonality Supports Summer Correction in Uranium Stocks

Source: StockCharts.com, Raymond James Ltd.

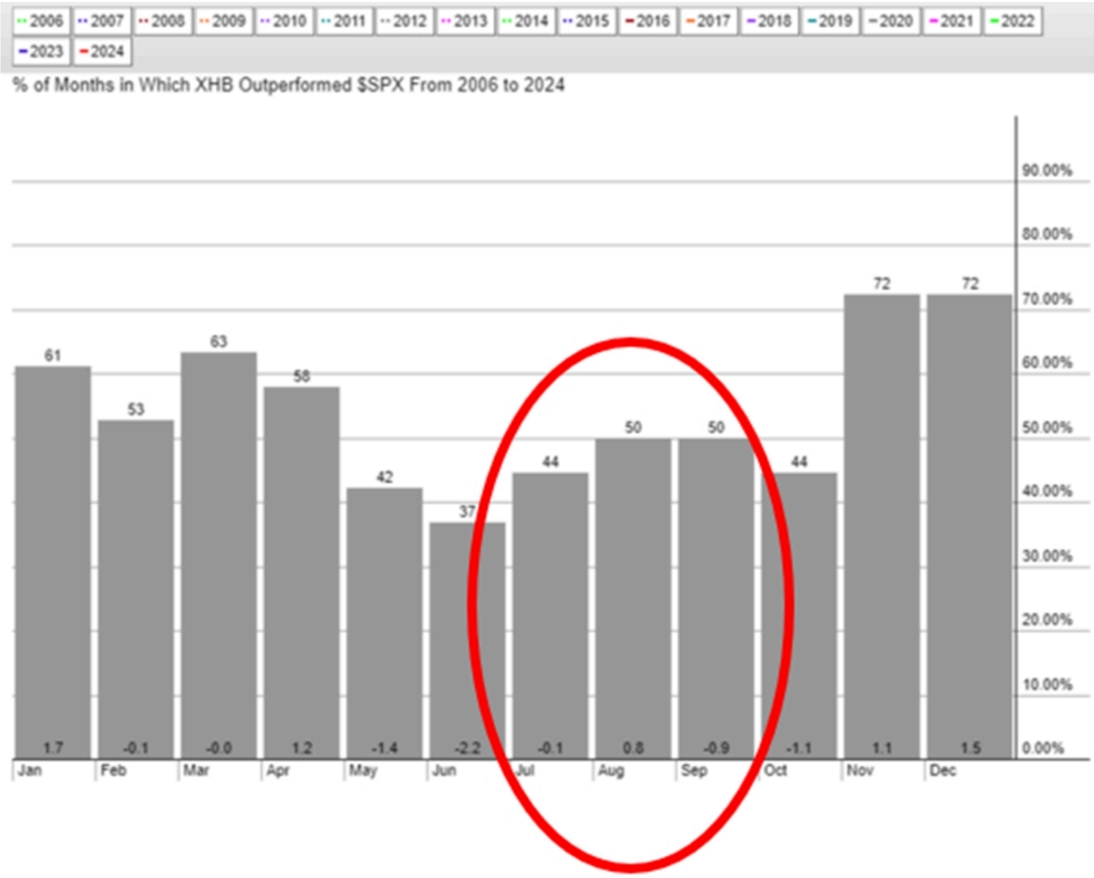
URA recently triggered a new monthly "mechanical buy" signal, a strong technical positive. **However, upward momentum is slowing, an early technical negative.**

Relative Strength is **weakening** versus the S&P 500, a technical negative.

URA remains above a key technical level at the 4-Year (~48-month) moving average (see thin blue line), currently ~20.38. This confirms the long-term trend is up, a strong technical positive. First support is ~27.28, with important support ~24.45**.** Important resistance is ~32.21. A close above this level sees next upside technical target ~37 (not shown).

Volume and On-Balance-Volume show early signs of selling pressure, another early technical negative.

SPDR S&P Homebuilders ETF (XHB) – Seasonality - 18 Years – Monthly



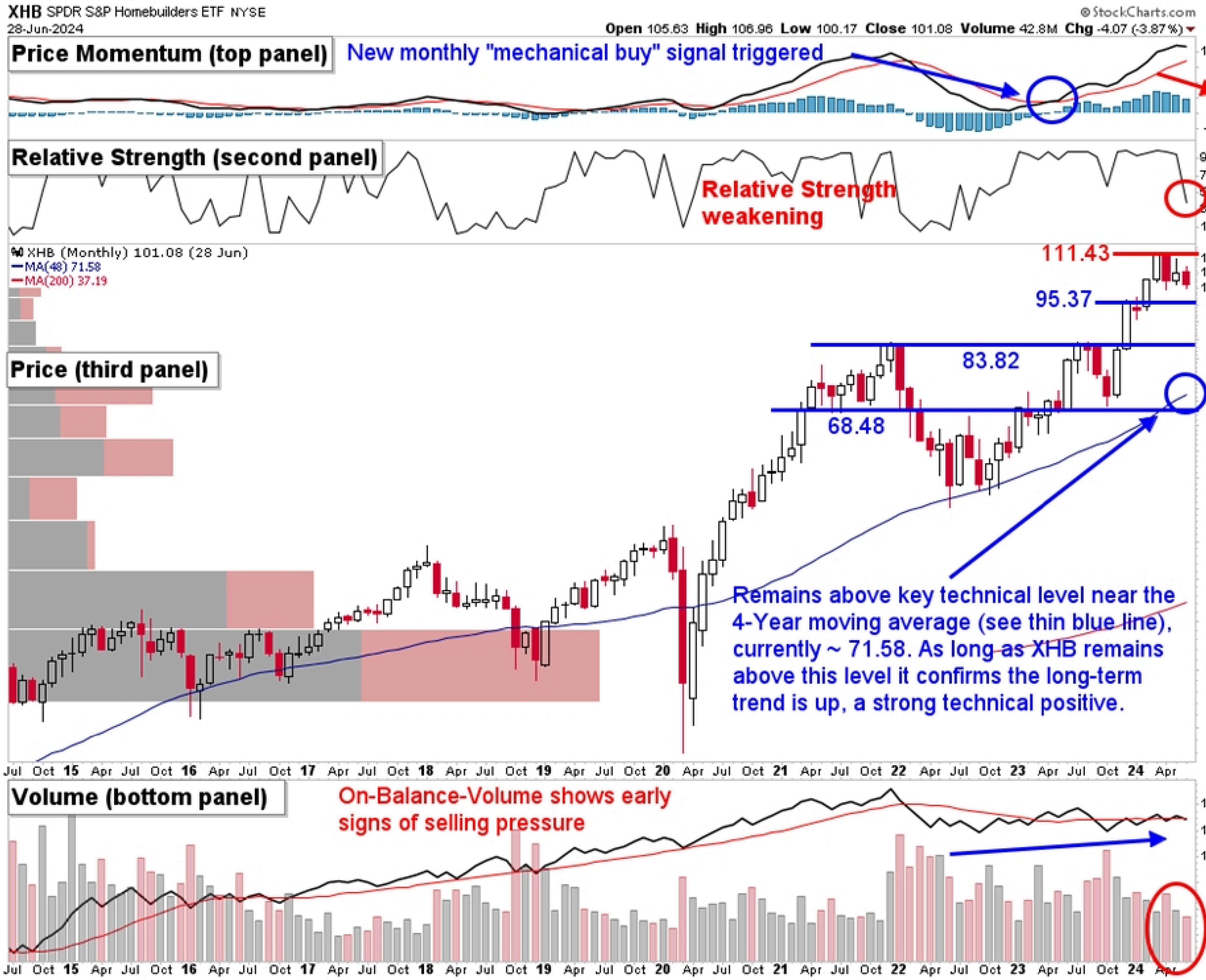
Source: StockCharts.com, Raymond James Ltd.

The SPDR S&P Homebuilders ETF (XHB) underperforms the S&P 500 from July to September (see red circle) which supports trimming exposure. Historically, weakness through October offers a more attractive entry point, and is followed by a strong rally from November to January.

Historically, the **XHB** sees an average underperformance versus the S&P 500 of -0.1% in July, outperforms by 0.8% in August, and then underperforms again by -0.9% in September.

The **XHB** outperforms the S&P 500 only 44% of the time in July, and 50% of the time in August and September.

Exhibit 9 - SPDR S&P Homebuilders ETF (XHB) – Summer Doldrums and Weakening Technicals Support Pullback



Source: StockCharts.com, Raymond James Ltd.

XHB recently triggered a new monthly "mechanical buy" signal, a strong technical positive. **However, upward momentum is slowing, an early technical negative (see red arrow).**

Relative Strength is **weakening** versus the S&P 500, a technical negative.

XHB remains above a key technical level near the 4-Year (~48-month) moving average (see thin blue line), currently ~71.58. This confirms the long-term trend is up, a strong technical positive**.** First support is ~95.37, with important support ~83.82. A monthly close above first resistance ~111.43 sees next upside technical target near 125 (not shown).

On-Balance-Volume shows early signs of selling pressure, another early technical negative.

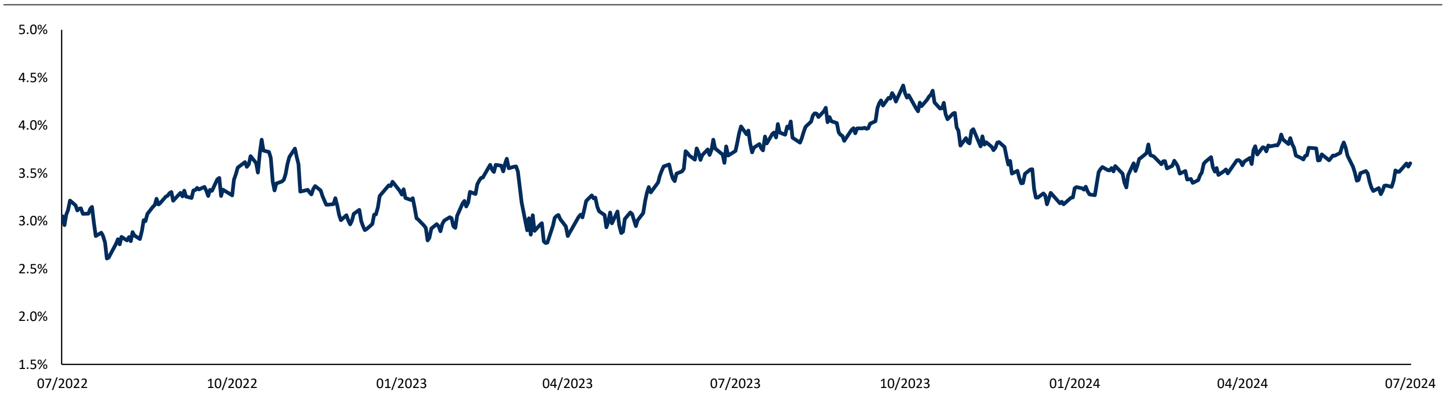
Canadian Fixed Income

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

After a long wait, too long in the opinion of many investment participants, Canadians received their first rate cut of the cycle on June 5. This made Canada the first G7 country to lower its overnight rate, although the ECB followed with its own cut the next day. There are several things to make note of since:

- **CPI:** The CPI data post-rate cut surprised to the upside. For the month of May, it rose to 2.9% year-over-year versus expectations of 2.6% and came in higher than the previous month at 2.7%. It is understandable that we will not see positive progress every month, but to keep us on track, this print needs to be an anomaly and not a trend. The June CPI value was 2.7%, providing some clarity that the increase in the month prior was most likely a one-off event.
- **BoC commentary:**
  - BoC Governor Macklem believes we are on track for a soft landing, but we cannot be certain of the assumptions the Governing Council has used to reach this conclusion. Each scenario may be accompanied by a different prediction on inflation, jobs numbers, wage growth, number of rate cuts, and even external factors such as key elections in other countries.
  - In the BoC's summary of deliberations, it admitted that discussions were had on whether to delay the first cut until July in order to allow for more data releases to confirm suspicions on the trajectory of inflation. Ultimately, as we now know, it concluded that four months of slowing price pressures was enough to justify moving in June. The Council also acknowledged that there is a limit to the divergence that Canada's interest rate could take from the U.S., however stating, "the limits were not close to being reached".
- **Mortgages and Housing:** Mortgage renewals and their effects on spending / economic activity is a clear risk, which could be reduced by lower interest rates. However, it is unclear how much the overnight rate would have to be reduced by before homeowners may feel less burdened by mortgage costs. The BoC must also balance the potential of unleashing a number of investors who may be sitting on the sidelines, which could trigger an overheating of the housing market.
- **Market Reaction:** Government of Canada benchmark bonds had a muted reaction to the rate cut announcement, as by the time of the release, it was partially priced in. As an example, five-year bonds fell by roughly 9 basis points once the overnight rate was lowered. Since then, yields have contracted another 14 basis points, before turning around and heading higher once again. By early July, the bond carried a yield of 3.604%; higher than the 3.421% on June 5th (Chart 10).

Chart 10 - Government of Canada Benchmark Bond 5 Year



Source: FactSet; Raymond James Ltd.; Data as of July 4, 2024.

In our previous publication, we did not rule out a June rate cut, but felt the chances had been reduced given the BoC's continued verbiage around adopting a more cautious approach. Since we did see the overnight rate fall by 25 basis points in June, and hold a lower conviction of a back-to-back cut, we do not anticipate a July rate cut, but with June's CPI numbers showing that inflation continues to stabilize/fall, it is possible that we may need to reassess our current position. Today, consensus estimates point to roughly a 90% chance of another rate cut at the end of July, putting us in the minority. Nevertheless, expectations for a 25 basis point reduction at or before the September meeting are almost a perceived guarantee at this time. Today, the market is pricing in at least two additional rate cuts this year (leaning heavily into a third), a view which we fall more conservatively on as well.

It is important that investors remember that the end of the calendar year means very little to the interest rate cycle, and that rate cuts are expected to continue well into 2025 unless economic data suggests taking a different path. While we may still arrive at the same place at the end, it may take longer (or shorter) than current expectations to reach the terminal rate of this cutting cycle. Policymakers have maintained that their decisions have been, and will remain, data dependent with easing taking a gradual approach. Although they had mentioned that it was reasonable to expect that additional rate cuts would follow, the timing of these future policy changes is not certain.

Some investors believed that the first-rate cut would signal that the "party was over" in fixed income, but it is clear from market action post-announcement that this is not true. We continue to see attractive yields available but do caution that we anticipate that the longer-term trend is indeed one of lower rates, at least in the front end of the curve. We continue to recommend investors look to extend duration to some degree or adopt a laddered approach if a slant towards conservatism is warranted.

U.S. Fixed Income

Douglas Drabik, CFA, CMT - Senior Retail Fixed Income Strategist

We've reached the halfway mark of 2024

Has the first half of the year's market performance changed what the second half of the year's fixed income strategy should be? From the peak of interest rates in October 2023, the market sensed the end of Federal Reserve rate hikes. July 2023 saw the last of 11 rate hikes, totaling 525 basis points. The timing played a profound role in the 2024 economic predictions. Many pundits earmarked 5 to 6 Fed rate cuts for 2024 starting in March. Economic activity was foretold to slow at the very least, develop into a mild recession, or become a full-blown recession in the more extraordinary forecasts. Inflation was to drop to below 2.5% if not to the Fed's 2% target.

In fairness, these predictions were all over the board and generalizing is an inexact science. The 2024 consensus, however, was for a distinct slowdown in economic activity and lower interest rates led by a series of Fed rate cuts. Now, as we are only halfway through the year, a lot is to be revealed going forward into the 3rd and 4th quarters.

I believe that we are experiencing a generally commonplace economic cycle but that it is not unfolding at the pace the market anticipates it should. We are emerging from a very extraordinary circumstance in the pandemic. Businesses were shut down and unprecedented government aid, backstops, debt deferral/forgiveness, and money infusions have held the economy up. Full employment and wage increases allowed consumer spending to remain resilient, which also contributed to deferring a recession.

Key Macroeconomic Indicators and Market Stats

	Growth	Inflation			Stocks		Rates		Debt & Savings		
	GDP YoY	CPI YoY	Core	PCE YoY	S&P 500	DJIA	1Yr Treasury	10Yr Treasury	Revolving Credit	Personal Savings	30Yr Mtge Rate
Jun-24					5,460	39,119	5.10	4.38			7.29
Mar-24	2.9	3.5		2.83	5,254	39,807	4.92	4.21	1.34trl		7.25
Dec-23	3.1	3.4		2.94	4,769	37,690	4.96	4.02	1.32trl	760bn	6.99
Sep-23	2.9	3.7		3.59	4,288	33,508	5.44	4.38	1.29trl	864bn	7.74

Source: Bloomberg LP, Raymond James.

The yield curve remains inverted, but its predictive consistency should not be ignored. Recessions typically occur months after the curve reverts to a normal slope.

The mid-year report card is good (for the economy, not for pundit/investor predictions). GDP has remained strong. Steady high employment and wage increases have allowed consumer spending to stay resilient and thus have been translated into strong corporate earnings. Consumers have performed their role in sustaining the economy. Both the S&P 500 and Dow Jones Industrial Average (DJIA) are hovering around historic highs. Raised housing prices have given consumers a sense of inflated wealth.

Gross Domestic Product (GDP) measures the final market value of goods and services produced and as indicated in the chart, it has held up, undeniably beating expectations and inspiring optimism. The wealth effect is more than psychological. Investors in the stock markets have benefited from soaring stock prices. Investors buying individual bonds have gained an advantage with purchases boasting elevated income levels.

So, what's not to like?

Inflation has stubbornly held well above the Fed's desired 2% goal, but it goes much deeper than the latest inflation data release. The surge and continued elevated price increases are beginning to change consumer behaviour. Inflation going down does not mean prices are down. It merely means that prices are not increasing at as fast a pace. The average consumer is stuck with the higher prices that this inflationary period has produced — and barring an extended deflationary period, likely forever.

The final section of the table expresses part of the scope of worry. Huge consumer savings that were built during the pandemic have been depleted and then some. The general consumer savings balance is below long-term averages. Worse, consumer debt is at historic levels. Housing has been brought to its knees with high mortgage rates keeping homeowners with low mortgage rates locked into their current homes, and potential buyers unable to afford swollen mortgage payments created by elevated rates.

The economic cycle is methodically moving forward as it always does. Eventually the economy will slow down, the Fed will reverse policy, and interest rates will follow downward. However, it still isn't there. The positive consequence that has unfolded is that interest rates are as high as they have been in over 17 years. Since January, we have encouraged investors to capitalize by locking into higher rates for longer — for as long as your risk tolerance will allow you. At some point in the future, investors will look back at this moment in time and realize the opportunity at hand. Lock into growth-like returns in more conservatively structured individual bonds. The story will not change until interest rates fall. Investors are reacting to the Fed while the Fed is reacting to inflation data.

Corporate spreads have recently widened, compensating investors when Treasury rates have fallen. Even so, investment-grade corporate bond spreads remain ~30% below the long term 20-year average. High yield corporate spreads remain ~23% below the 20-year average. Strategically, until things change, cash in fixed income should be put to use, adding duration in high quality credits.The corporate yield curve presents its best value in the 5 to 15 year maturity range.

Washington Policy

Ed Mills - Washington Policy Analyst; Ellen Ehrnrooth - Research Associate

How Could the 2024 U.S. Election Shape Inflation in 2025?

Two pending fiscal cliffs and the 2024 U.S. presidential election will act as key factors shaping the U.S. economic backdrop in 2025, and investors are beginning to explore the outlooks under the various scenarios that could await the markets following the results of the election in November. A returning debt limit debate in January and the expiration of the 2017 Tax Cuts and Jobs Act (TCJA) will be key catalysts to monitor from an inflation perspective given growing concerns in DC around the U.S. fiscal situation. Various outlooks under a second term of President Biden or former President Trump could see headline risk around the negotiation process for both in the near term and longer-term impacts for U.S. government spending and tax policy, with the potential for a partisan sweep in either direction likely super-charging the debate. As the election cycle in DC heats up, greater attention is being paid to other market-relevant policy areas including tariffs, immigration, and housing. At this stage, DC signals suggest that a second term under Trump would bring a higher number of inflationary policy actions, while President Biden could take relatively more hawkish fiscal actions – particularly on tax policy and potential upwards revisions to the corporate rate.

Fiscal cliffs emerging in 2025. 2025 will be bookended with two major fiscal cliffs, with the suspension of the debt limit expiring on January 1, 2025, and many of the individual tax provisions passed in the Tax Cuts and Jobs Act (TCJA) of 2017 expiring on December 31, 2025. Beginning on January 1, 2025, the federal government will take "extraordinary measures" to delay a default on the debt once the current suspension expires, which we estimate would push the "X-date" of default until mid-2025 (based upon the previous debt limit debate in 2023). The U.S. federal debt is currently over US$35 trillion, with the government running a nearly US$2 trillion deficit and approaching a US$1 trillion annual price tag for servicing that debt. The debt limit will be the top priority of the next president in January, and we expect the growing size of the U.S. national debt will shape the debate over raising the limit – potentially encouraging policy concessions regarding fiscal spending and revenue, particularly from members of the GOP. Some degree of brinkmanship around the debt limit debate is likely, especially under a split government where calls for significant concessions will be made – for example, a repeal of parts of the Inflation Reduction Act as a probable target. While we expect a debt limit deal to eventually be struck, the process towards reaching a deal could see headline risk and market volatility. The second fiscal cliff is the TCJA tax cuts, the individual portions of which are set to expire at the end of 2025. The debate about the extension of the tax provisions will be determined by whoever is in the White House in 2025, and if there is a partisan sweep, the party in control will have the ability to pass their tax plan without the other party through a process called reconciliation (which only requires a simple majority to pass 10-year revenue-related bills). A 10-year extension of the TCJA tax cuts is estimated to cost US$4.6 trillion, per recently updated CBO estimates (and up from the US$1.1 trillion estimate in 2023), and DC discussions are beginning to point towards the need to cover some of this cost with increased revenue if the tax cuts are extended. Key questions remain open around whether the individual tax cuts will be expected, as well as around potential adjustments to the corporate rate; while the 2017 revision of the corporate rate from 35% to 21% was made permanent, the passage of a reconciliation bill could see adjustments made under a range of scenarios.

Outlook under Trump. A second term for former President Trump in 2025 would likely raise more questions about the inflationary impacts of key policy priorities, including taxes, tariffs, housing, fiscal spending, and immigration. The expiration of the individual provisions of the 2017 TCJA on December 31, 2025, will be an immediate focus for Trump, with a GOP sweep the most favourable scenario toward extending most, if not all of these provisions. In contrast, a split government scenario would likely lead to compromises, which could include increasing the limit on state and local taxes (SALT) deduction from US$10,000 to US$20,000, adjusting business income pass-throughs, extending provisions for lower individual tax rates, and maintaining a high standard deduction provisions. Debates around the U.S. fiscal situation will be another area of focus once the debt limit returns, with a GOP sweep as a likely less dramatic outcome relative to a likely volatile split government scenario under Trump. This could potentially result in a smoother process for raising the debt limit – though intraparty disagreements remain. In contrast, a split government scenario could lead to more complex negotiations, headline risk, and economic uncertainty, with potential brinkmanship tactics placing pressure on both parties to accept serious policy and/or spending concessions to avert default. On tariffs, we would anticipate a greater push for tariffs on Chinese goods under Trump – while his specific threats of a 60% universal tariff on Chinese imports and a 10% tariff on global imports may not fully materialize, the high probability of some form of elevated tariffs would likely lead to increased consumer good inflation. A more aggressive trade policy with China, including stricter tech restrictions, could also disrupt supply chains and elevate costs for U.S. businesses, further exacerbating inflationary pressures. A Trump administration would also take a more aggressive stance against immigration and call for more restrictive border security measures, which economists have highlight could lead to labour shortages and higher labour costs, especially in the service and construction sectors – which could have impacts on housing.

Outlook under Biden. While inflation has been a key issue during the Biden Presidency, a second term under President Biden could be relatively less inflationary than a second term under Trump, with the likely follow-up to the expansive fiscal support seen during his first term coming in the form of higher tax rates – though a split government scenario could act as a moderating effect on the extent of these hikes. Biden has indicated a desire to raise the corporate tax rate from 21% currently to 28%; while this would likely be difficult absent a Democratic sweep/under a split government scenario, increasing conversations around the U.S. fiscal backdrop and the reported openness of certain Congressional Republicans to adjusting the corporate rate support the possibility of changes. At this stage, we also see strong political incentives for Biden to allow the 2017 individual tax cuts to expire. While DC expectations had been that he would have to extend at least part of the cuts, we would highlight that inaction on his part would see individual rates return to what they were under former President Barack Obama and the existing US$10,000 cap on state and local tax deductions go away – to the benefit of several high-tax Democratic states. On tariffs, we would expect to see more of the same; namely, the maintenance of existing tariffs with targeted adjustments and tariff hikes on strategic technologies, in line with the administration's May announcement that it would extend the Trump-era tariffs on US$300 billion in Chinese imports and impose new tariffs on US$18 billion in imports of key tech. Affordability concerns are likely to continue to drive Biden administration's housing agenda through policy levers including rental assistance and the expansion of federal incentives for affordable housing. While we have seen some recent tightening in Biden's immigration posture through the issuance of a border security executive order, we would not expect his immigration policies to be overly restrictive in terms of labour pressures. One area where the outlook diverges is on government spending; while higher tax rates could offset some of the impact of sustained spending, we would highlight the possibility of additional support for priorities including clean tech/building on the 2022 Inflation Reduction Act and re-shoring the U.S. industrial base. Questions also remain open as to the future of Biden's student relief agenda following two major legal setbacks for the administration's income-driven repayment plans and given that his second attempt at debt relief remains ongoing from a regulatory perspective; if the plans are upheld by the courts, this could act as another inflationary input.

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