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Our forecasts for equity market returns essentially line up with earnings growth projections. We see some room in certain markets (e.g., Canada) for P/E multiple expansion, but we are not relying on valuation expansion to drive our return targets. **Expectations for earnings growth in 2024 are respectable and in the range of long-term averages – a return to normal.**

**Our targets are 23,000 for the S&P/TSX Composite Index and 4,900 for the S&P 500 Index.**

### Our positioning

Our portfolios remain well diversified and balanced. We favour equities over fixed income but see opportunity across cash, bonds, stocks and selected alternative investment strategies to contribute to return or mitigate risk.

Overall, in our broadest representative portfolios, we are overweight Canadian and U.S. equities and neutral weight to international developed markets (Europe and Japan) plus emerging markets.

The current yield from our well-diversified bond positions is very competitive. We have taken steps to de-risk and extend the duration of our capital preservation strategies. These measures are designed to provide bond positions that deliver a level of safety in a recession.

Our base case sees inflation tamed enough to allow an easing in financial conditions, especially in economies where growth is already stalling. We think inflation can fall faster than the current zeitgeist forecasts but concede this issue is hotly debated.

Households and businesses are adapting to higher borrowing costs. We believe governments will need to do the same. Higher borrowing costs curb enthusiasm for government spending. This is part of the recipe to cool inflation. Bond yields will then have room to stabilize or retreat slightly. It may take several months for this scenario to unfold.

**Looking at today's levels, we see the potential for percentage gains in the low-to-mid teens for equities and mid-single digits for bonds.**

### Overview

Looking back on 2023, we can see progress in tackling major issues that loomed over the global economy and capital markets. The world enters 2024 faced with some unfinished business that will be a priority in the year ahead.

The good news: we see opportunities across cash, bonds, stocks, and alternative investments. We remain constructive on the investment outlook. The foundation is laid for a continuing return to normal, which is an environment where investors are rewarded across the risk spectrum. This has been absent for most of the previous decade.

Last December's 2023 Market Outlook, [The End of Free Everything? Could Simply Be a Return to Normal](#), outlined our view that the global economy and capital markets are in adjustment mode. Today, they are still dealing with pandemic aftershocks and saying goodbye to ultra-low borrowing costs that followed 2009's financial crisis.

Inflation is a symptom – not a cause – of our current situation. It was created when COVID-era excess savings and pent-up demand collided with supply-chain bottlenecks. These supply-chain problems are largely resolved, but excess savings and demand are lingering longer than expected. Companies welcome strong consumer spending. However, tight labour markets (when jobs are plentiful, but workers are scarce) are leading to rising wages. There is fear this has the potential to spark an inflationary feedback loop.

Outsize government spending during the pandemic crisis has been slow to reset to pre-crisis levels. Into this mix we can add the medium- to long-term costs of climate change, fighting wars, and reshoring (returning production and manufacturing to a company's original country). Globalization, the growing connectedness of world economies and cultures, is undergoing profound change.

## Macroeconomic Backdrop

In a typical soft landing, an economy avoids a recession but experiences a growth slowdown that allows inflation to recede and supply and demand to find a new equilibrium. In the U.S., inflation is gradually coming down, but growth remains very strong. Outside the U.S., inflation is falling, but the gains come with the traditional sacrifice of economic growth. As with everything in economics, perfect conditions do not exist, but trends and expectations matter.

### Canada

Economic growth in Canada is weak, and inflation is falling lethargically. Wage growth remains elevated. Coupled with weak [productivity](#), wage growth is too high for the Bank of Canada's (BoC) comfort. The BoC fears that persistently high wage growth will keep inflation above the bank's 2% inflation target. However, wages are lagging indicators, and some catch-up is expected. Our soft economy should see wage gains moderate. Canada's interest rates are high enough, but we need to keep them high long enough to achieve the desired outcome. We believe the BoC is finished its rate-hiking cycle and expect inflation to ebb sufficiently by spring to allow the central bank to ease rates in 2024. Markets anticipate the BoC will make between two and three cuts of 0.25% each by October 2024. We think three cuts are more likely than two, especially by year end.

### United States

U.S. economic growth is exceptionally resilient, leading some to call it a no-landing situation (strong economic growth and elevated inflation). A significant positive in this mix is U.S. productivity growth, which has rebounded smartly. Productivity provides breathing room; it can deliver solid corporate margins and wage growth without being inflationary. Key measures of U.S. inflation have fallen from high single digits to below 4%. For the U.S. economy, a soft landing is slowly unfolding.

However, there's always a caveat. Bond yields are the price of money. While inflation impacts that price, so do supply and demand. Profligate U.S. government spending requires mountains of government bonds to be issued. This increased supply inconveniently comes just when demand for U.S. government bonds is waning. Many global central banks are selling bonds they previously purchased (quantitative tightening), including U.S. government bonds. The Fed is at the vanguard of this quantitative tightening. The law of supply and demand (rumoured to have been repealed) still stands: when supply is up and demand is down, prices must fall. When bond prices go down, yields go up.

Higher-for-longer bond yields are justified if the U.S. economy faces inflation or strong real growth. But if bond yields are elevated because Uncle Sam can't break the spending habit then that can spell trouble. Thankfully, recent estimates of U.S. government funding requirements were lower than expected.

The strong U.S. economy is overheated but shows signs of cooling. Productivity remains a bright spot. Growth, although weaker, plus falling inflation are the very definition of a soft landing. That opens the door for easier monetary policy in 2024. **We are aligned with current market expectations that the Fed starts in May and cuts 0.25% four times by December.**

#### Volatility Likely in a U.S. Election Year

U.S. politics will no doubt be a source of volatility in 2024. Fed policy, messaging, and timing could get tricky as the Fed prefers to steer clear of politics and avoid scrutiny of its independence.

A lot can happen in 12 months; it's unclear where fiscal austerity might rank as a priority. At various times, voters have embraced (or at least tolerated) a message of austerity. Next year could bring a swelling political backlash against unchecked government deficits. Under the cold fist of free markets, net interest costs have shot up to 15% of tax revenues. This threshold has historically forced governments to embrace some tightening of the reins. "Do nothing" and "gridlock" are probable outcomes. This is familiar territory; equity markets like the former and can handle the latter.

## Europe

Currently, economic growth in Europe is lacklustre. Weakness in Chinese economic activity also plays a role because China is an important European export partner. The latest reading on European inflation shows a drop below 3%. If inflation continues to fall – and a sluggish economy suggests it should – **the European Central Bank can stop raising rates and likely begin cutting in 2024 alongside other global central banks.** Rate cuts, a strengthening Chinese economy, and a domestic rebound from depressed levels all point to a slight pick-up in European GDP growth next year.

## China

Chinese growth is weak. Deflation is of greater concern than inflation. Although global trade ties are not as strong as they once were, China can export deflation to the rest of the world. Weak Chinese economic growth still reverberates through the global economy. Authorities are pumping stimulus (easy monetary policy and government spending) to boost economic activity. At a time when Western economies are slow or slowing, a rebounding Chinese economy will be a welcome backstop. Swirling around China's domestic struggles are geopolitical and trade woes that will continue to dampen opportunities for international businesses, trade, and investors.

## Japan

Japan's economy is experiencing some of its best GDP growth in years although it slipped into reverse over the summer. The path has been bumpy as Japan's heavy export orientation is a to-and-fro between a strong U.S. and a weak China. Japan has endured decades of anaemic growth and low inflation; both have risen off the floor. However, having started from such weak levels, the country is now enjoying a Goldilocks moment of modest economic growth and some long-sought-after inflation. If anywhere is going to see a no-landing scenario it could be Japan.

The main area to watch is monetary policy. Japan's bond market is huge, and the country is a significant holder of U.S. debt. What happens in Japan doesn't stay in Japan. For decades, the Bank of Japan (BoJ) has manipulated Japan's bond market, setting short-term interest rates (like all central banks), but also controlling interest rates on longer-term debt. Given the new realities of inflation and growth, the BoJ is adjusting these tactics by letting Japanese bond yields go higher, making Japanese government bonds more attractive. This ripples through international bond markets, contributing to the higher-for-longer narrative for global bond yields.



While rising bond yields are a headwind for stocks, there are silver linings. Inflation and higher growth can both lead to higher earnings. Earnings are expected to grow with inflation. If companies aren't raising prices, inflation doesn't happen. If real yields are rising because economic growth and productivity are strong, companies thrive on these factors because they drive better earnings growth. Stocks are an attractive investment through time because they encapsulate these moving parts of inflation and growth. Despite trade-offs, in the long run equities have balanced those trade-offs to shareholders' benefit.

A return to normal for real yields lays the foundation for a healthier economic and investing landscape ahead.

### Fixed Income Market Outlook

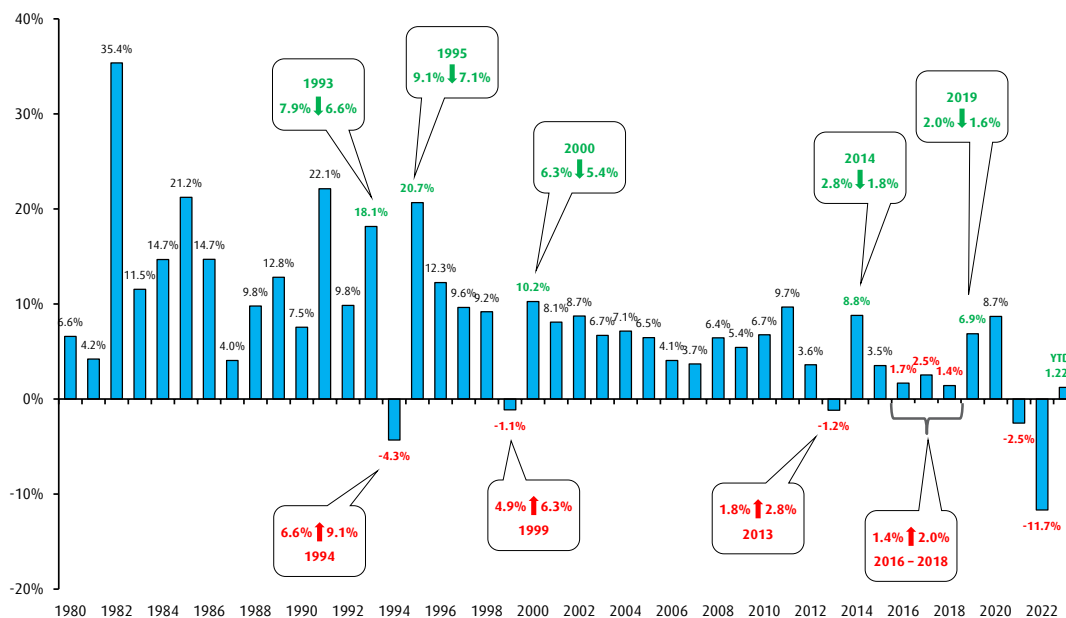
Bonds yields behave in just three ways: they go higher; they stay flat; or they fall. For two years, yields have been moving higher, which has been painful.

If yields stay flat (higher for longer), that delivers higher income for longer – a positive for bond and cash investors.

If yields retreat, the pain we have endured to reach higher yields will be like compressing a coiled spring: that elastic energy will release in the form of higher bond prices, delivering capital gains to investors (see Exhibit 2: Bonds Bounce Back Too!).

Exhibit 2: Bonds Bounce Back Too!

FTSE Canada Universe Bond Index Annual Total Return  
1980 – 2023 YTD (as of November 15, 2023)



Source: Morningstar (1980 – 2022); Bloomberg (YTD). Callouts are the change in Government of Canada 10-year bond yield for the year(s)

Bond yields can fall in two ways – one good and one bad. In the good scenario, inflation retreats, allowing central banks to lower interest rates gently. Bond yields would also head lower, and everybody wins.

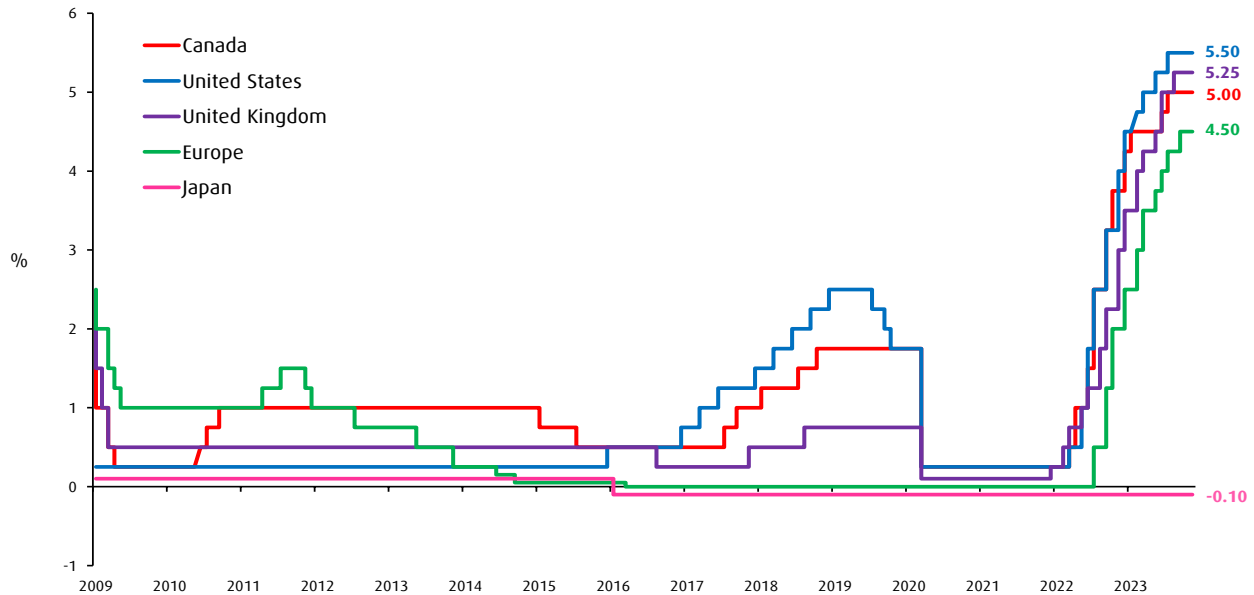
In the bad scenario, the economy unravels, and central banks quickly cut interest rates to stave off rising unemployment and recession. Under these circumstances, bond investors win, but the economy loses in the short term. Victory over inflation would be a silver lining.

We believe the end of rising bond yields is here. Central banks appear very close to ending their rate-hiking campaigns, and inflation is well off its highs (see Exhibit 3: Global Policy Rates Set to Pause and Exhibit 4: Inflation Well Off the Highs).

Exhibit 3: Global Policy Rates Set to Pause

Central Bank Policy Rates of Selected Global Economies

January 1, 2009 – November 15, 2023

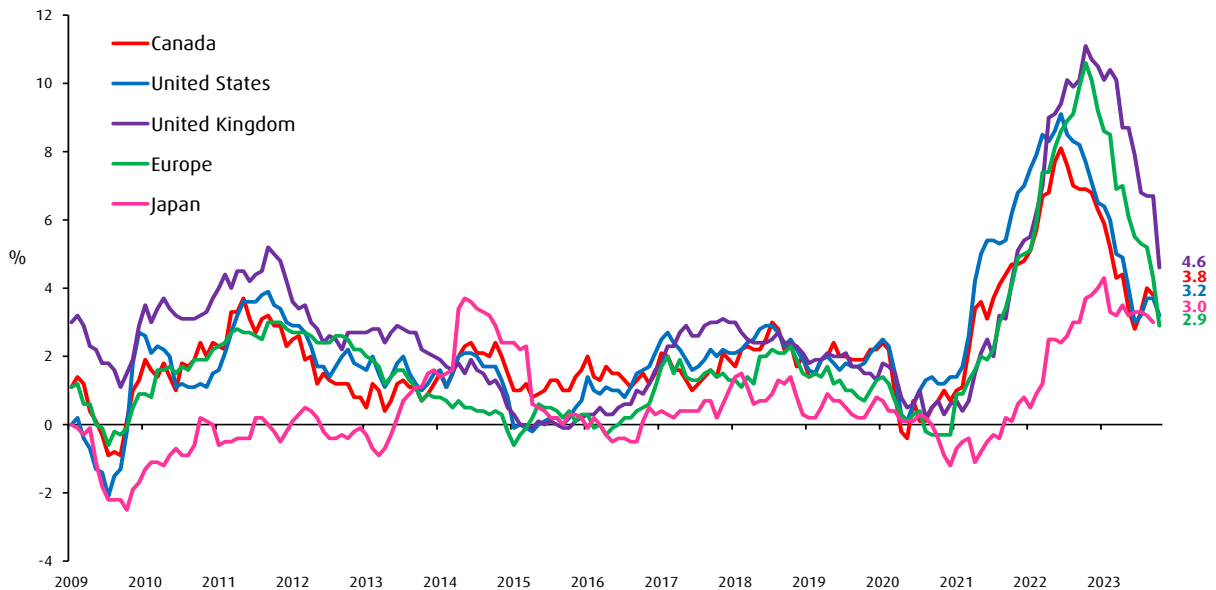


Source: Bloomberg

Exhibit 4: Inflation Well Off the Highs

Year-over-Year Change in CPI for Selected Global Economies

January 2009 – September 2023 / October 2023 (United States, UK & Europe)



Source: Bloomberg

This makes the outlook for cash (2023’s most coveted, although not best-performing asset) less attractive in 2024 – we emphasize less attractive, not unattractive. If central banks are cutting interest rates, returns on cash will fall from their current 5% perch. **We forecast interest rates available on cash balances will be in the 4.25% range by the end of 2024.**

In our base case scenario, **our end-of-2024 call is for the yield curve to steepen, with 2- and 10-year Canadian bond yields lining up at 3.75%. This should drive a total return from the broad Canadian fixed income market in the 6% range.**

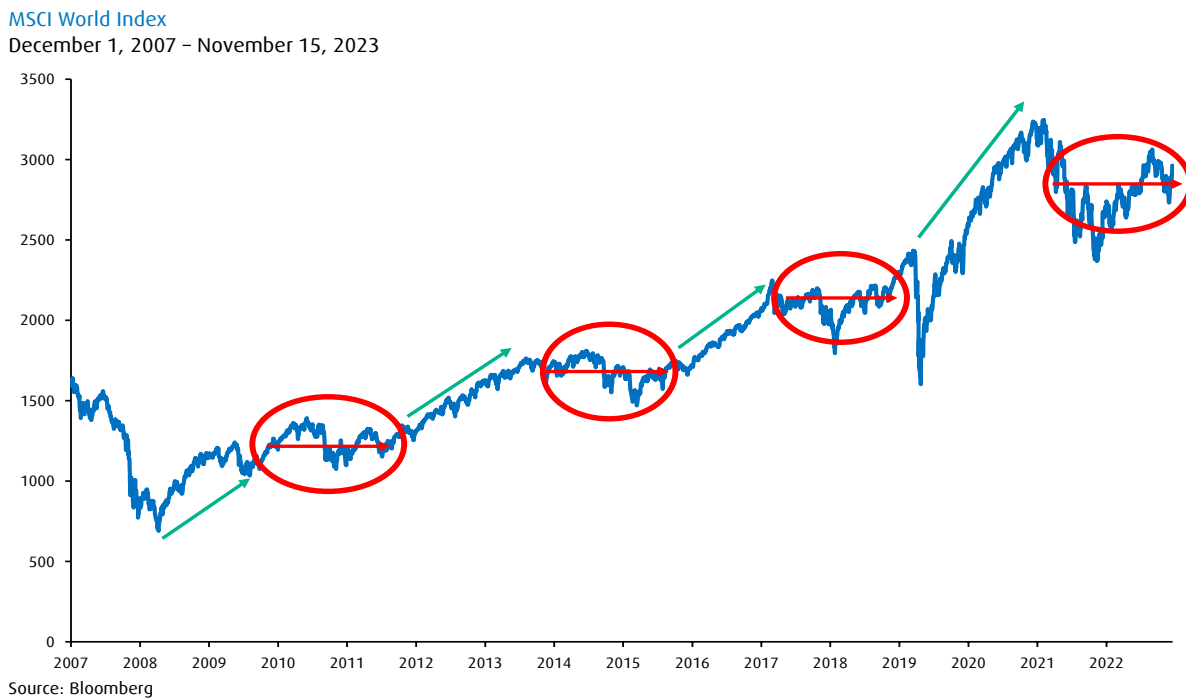
## Currency Outlook

**The outlook for the Canadian dollar is delicate.** Given the U.S. dollar's strength in 2023, a Fed shift next year toward easing monetary policy should see the greenback weaken against many major currencies. The loonie's weakness in 2023 has already priced in our slower growth and low productivity realities. As inflation on both sides of the border continues to ebb, we expect both central banks to start cutting rates by spring. It's likely the Fed will cut slightly more than the BoC next year. If so, a narrowing Canada-U.S. interest rate differential should see the Canadian dollar perk up. **We call for the loonie to appreciate through the year, with an end-of-2024 exchange rate of C\$1.28 or US\$0.781.**

## Equity Market Outlook

We have endured five quarters of no earnings growth. Earnings slumps are a normal part of the business cycle; this is the fourth since 2009. Like all the others, it will pass. We believe 2024 will mark the turning point. Previous earnings recessions lasted from four to seven quarters, and all featured sideways returns for equity markets plus heightened volatility. After five quarters of earnings slump, we are past the shortest ones and more than halfway through the longest ones (see Exhibit 5: Earnings Slumps and Sideways Markets Eventually End).

**Exhibit 5: Earnings Slumps and Sideways Markets Eventually End**

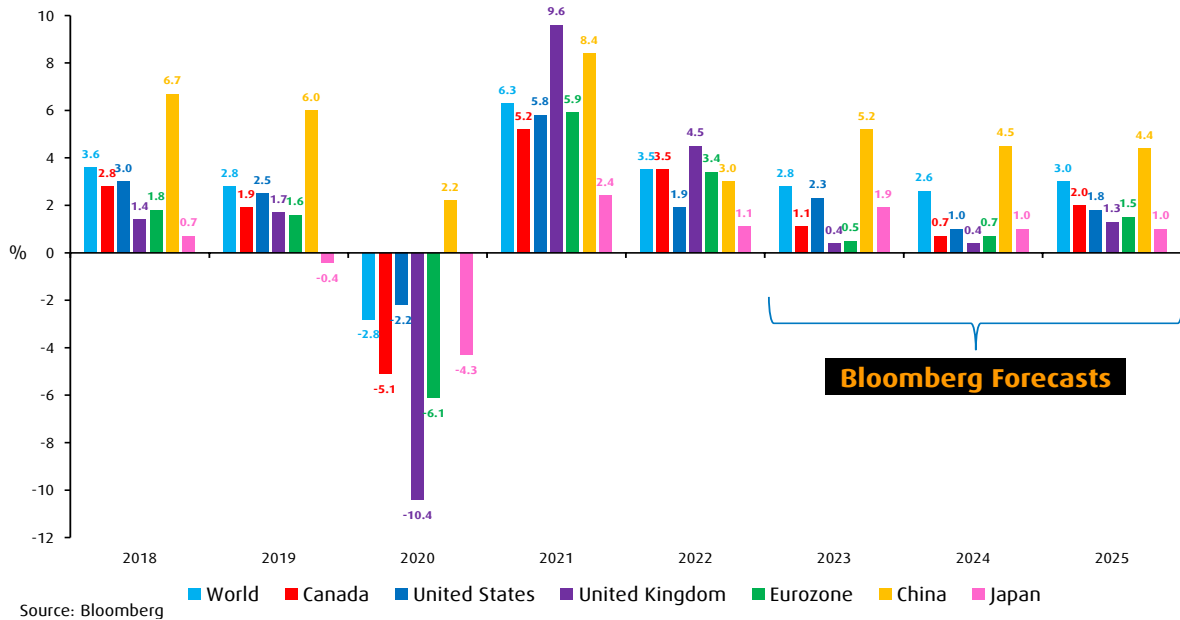


Looking ahead to 2024, once inflation is closer to being tamed, businesses and households will be poised to benefit from lower borrowing costs and other easing cost pressures. We expect growth outside the U.S. to stabilize and improve by late 2024, and U.S. growth to cool, not collapse (see Exhibit 6: Economic Growth Muddles Through).



Exhibit 6: Economic Growth Muddles Through

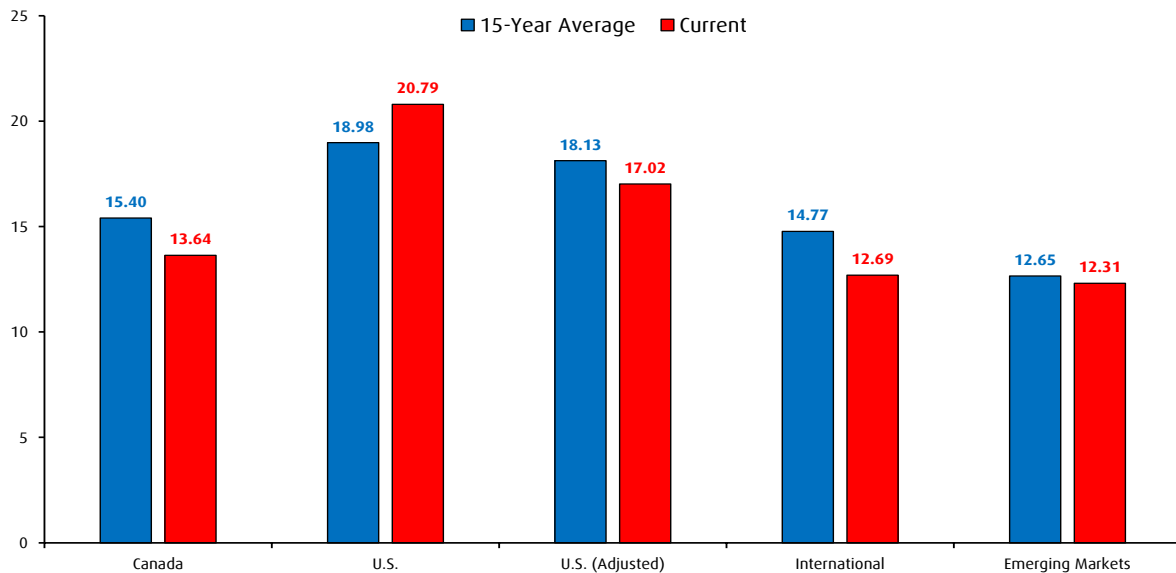
Actual and Forecasted Year-over-Year GDP Growth Rates of Selected Global Economies  
Actual: 2018 – 2022; Forecasts: 2023 – 2025 (as of November 15, 2023)



Stock markets will react positively in advance of these developments, as they always do. This is a fertile environment for stocks, especially when accompanied by today’s mostly reasonable equity market valuations (see Exhibit 7: Largely Reasonable Equity Market Valuations).

Exhibit 7: Largely Reasonable Equity Market Valuations

Current vs. 15-Year Average Price-to-Earnings Ratios of Global Equity Markets  
as at October 31, 2023



Source: Morningstar Direct  
Canada: S&P/TSX Composite Index; U.S.: S&P 500 Index; U.S. (Adjusted): S&P 500 Equal Weight Index; International: MSCI EAFE Index; Emerging Markets: MSCI Emerging Markets Index

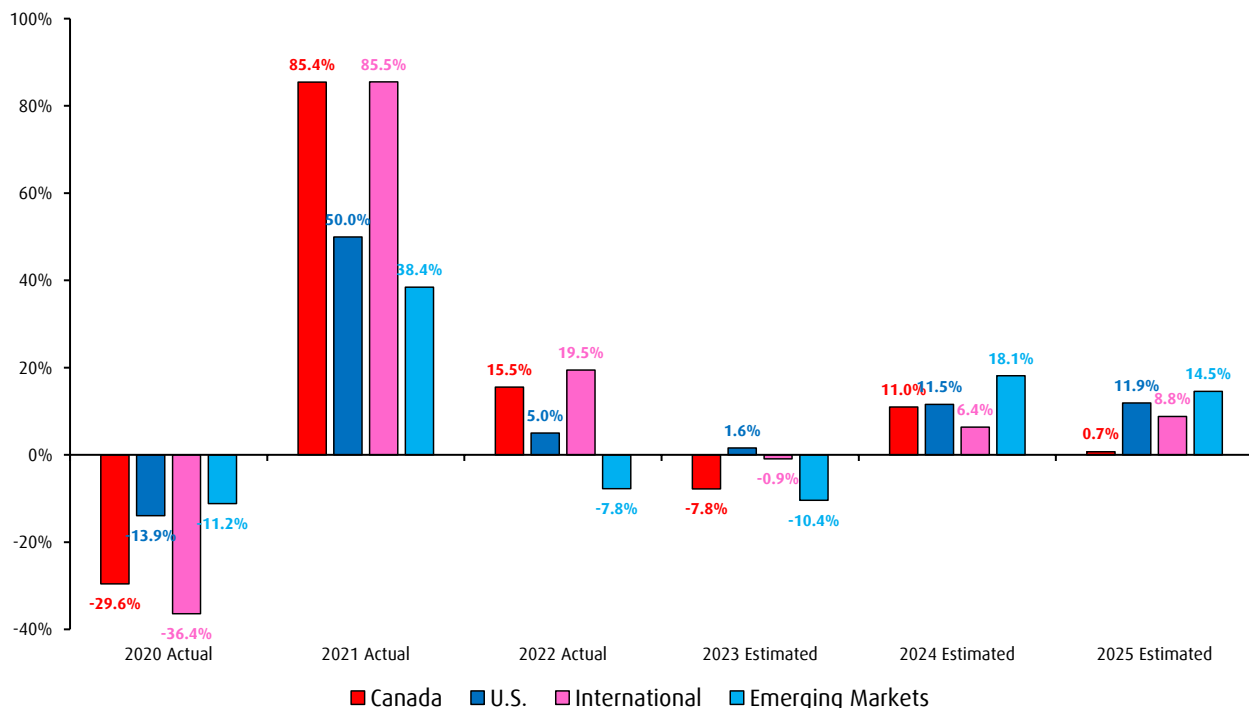
Even if we have a mild recession, equities may fare okay if investors take the victory over inflation as a signal to act and anticipate a strong rebound for earnings (more than 20%) in late 2024 or into 2025. There are many examples of equity markets looking past a soft patch, especially when valuations aren't excessive.

Our forecasts for equity market returns essentially line up with earnings growth projections. We see some room in certain markets (e.g., Canada) for P/E multiple expansion, but we are not relying on valuation expansion to drive our return targets.

**Expectations for earnings growth in 2024 are respectable and in the range of long-term averages – a return to normal** (see Exhibit 8: Earnings Growth Normalizing).

### Exhibit 8: Earnings Growth Normalizing

Earnings per Share Growth Estimates for Selected Global Markets  
as of November 8, 2023 (EM) / November 10, 2023



Source: FactSet  
Canada: S&P/TSX Composite Index; U.S.: S&P 500 Index; International: STOXX Europe 600 Index; Emerging Markets: iShares MSCI Emerging Markets ETF

**In this scenario, equities can deliver total returns in the low- to mid-teens. Our targets are 23,000 for the S&P/TSX Composite Index and 4,900 for the S&P 500 Index.**

### Our Positioning

Our portfolios remain well-diversified and balanced. We favour equities over fixed income but see opportunity across cash, bonds, stocks and selected alternative investment strategies to contribute to return or mitigate risk.

Overall, in our broadest representative portfolios, we are overweight Canadian and U.S. equities and neutral weight to international developed markets (Europe and Japan) plus emerging markets.

Canadian equities have underperformed in 2023. With the outlook shifting, everything that has held Canadian equities back this year will propel them forward next year. High-quality, dividend-paying Canadian equities levered to global growth are trading at attractive valuations. They are poised to perform well in an environment where yields fall and growth eventually perks up. The projected dividend yield for 2024 from the S&P/TSX Composite Index is a handsome 3.7%.

U.S. equities appear pricey on their face but don't seem unreasonable once you look under the hood. The above average 21-times forward P/E multiple for the S&P 500 is skewed by a handful of expensive technology, communications, and consumer stocks (the so-called Magnificent Seven: Apple, Microsoft, Amazon, NVIDIA, Alphabet, Meta, and Tesla). An equally weighted version of these same 500 companies reveals a forward P/E of 16.3, below the long-term average of 18.3. Our U.S. equity exposure combines the benefits of four distinct styles. We engage three active portfolio managers: one takes a large-cap growth approach; the second takes a large-cap value approach; the third has expertise in investing in small and medium-sized companies. To these we add some passive index exposure. We have moved some of the passive allocation to our active large-cap and mid-cap managers to capture the better opportunities we see outside mega-cap companies.

The current yield from our well-diversified bond positions is very competitive. We have taken steps to de-risk and extend the duration of our capital preservation strategies. These measures are designed to provide bond positions that deliver a level of safety in a recession.

### Risks to the Outlook

No risk, no reward. The headlines are full of negativity from geopolitics, politics, the environment, and more. Sadly, there will always be worries, unspeakable tragedies and strife in the world. Yet, progress is constant. We create, we innovate, we grow, we overcome.

In our view, the most significant risk stems from the speed and magnitude of interest-rate increases since March 2022. It's too early to tell if we will avoid a recession or other financial calamities. Central banks might have already gone too far. Or, if they keep interest rates too high for too long, economies could slow more than desired. In this scenario, we believe a violent flight to safety will benefit sovereign bonds and the highest-quality stocks.

We see this risk as moderate but have taken some defensive measures. In our bond portfolios, we have sold some riskier high-yield bonds to buy higher-quality bonds. Additionally, our overweight to U.S. equities should provide better relative performance in a risk-off scenario (a situation where the macroeconomic backdrop deteriorates).

### The Last Word

A hard landing is a recession – we could even call it a tough recession. A soft landing can mean many things. Economies are diverging. For some, the landing will be soft; for others, it will be bumpy (maybe a shallow, short recession). Some don't need to land at all (China needs to take off and Japan can keep on cruising).

Our base case sees inflation tamed enough to allow an easing in financial conditions, especially in economies where growth is already stalling. We think inflation can fall faster than the current zeitgeist forecasts, but concede this issue is hotly debated. If it takes more time to tame inflation, unrelenting investment losses are not inevitable. Investors can make gains through periods of inflation, although it's a little more challenging. After inflation, (real) returns might be lighter for a time, but that's not a foregone conclusion, either.

Households and businesses are adapting to higher borrowing costs. We believe governments will need to do the same. Higher borrowing costs curb enthusiasm for government spending. This is part of the recipe to cool inflation. Bond yields will then have room to stabilize or retreat slightly. It may take several months for this scenario to unfold. Looking at today's levels, we see the potential for low-to-mid-teens equity returns and mid-single-digit bond returns.

The patience and fortitude of investors are being tested. However, we're laying the foundation to support a solid, inflation-adjusted (and tax-preferential) investment return.

## GICs: Time to Look Past the Shiny Returns

Recently, the number one question we've been fielding is this: Why don't I just buy a GIC? This question is especially pointed when the bond market has generated a disastrous negative 8% cumulative return for the last two years.

A GIC is a good option for some investors. For example, it works if you're going to need or want this money in the next two or three years. In that case, a cash or cash-equivalent investment like a GIC is a perfectly suitable choice (but be sure to talk to us about the tax advantage of discount short-term bonds).

However, if your investment goals are longer term, settling for a fully taxable GIC at around 5% is, in our opinion, an inferior wealth-creation tool. That view is backed up by the overwhelming weight of historical evidence.

GIC Returns - Relative to Other Asset Classes  
1952 - 2022

Asset Classes	Return	Growth of \$1,000
Canadian Stocks	9.2%	\$521,810
Canadian Bonds	6.3%	\$78,982
GICs	5.7%	\$51,310
Inflation	3.4%	\$10,717

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Some argue using a GIC as a proxy for their bond exposure is a good idea. There may be some merit to that thinking, but we want to make sure investors have the facts straight. GIC interest rates around 5% have only been available for a little over a year. However, we hear repeatedly that people think they could have earned 5% on a GIC for the last two years. Remember that the Bank of Canada didn't raise interest rates until March 2022. One-, three- and five-year GIC rates in November of 2021 were all still less than 2%. Since November 2022, 5% GIC rates for one year have been available. This has beaten a portfolio of bonds over the last year.

So why not buy a GIC now?

- ✓ The current yield from a generic basket of Canadian bonds is above a 4%.
- ✓ If yields fall, GIC rates will fall with them. GIC investors face reinvestment risk when the GIC matures.
- ✓ The bond market offers the ability to lock in today's higher return potential beyond available traditional GIC maturities.
- ✓ If yields fall, portfolios of bonds are expected to go up in value just like they went down in value over the last two years when yields were rising.

Appreciation potential, the flexibility of selling bonds easily if you wish to use the money for something else, and some possible tax advantages are reasons to stick with bonds.

The bottom line is that GICs can have a place in your investment strategy. Historically, stocks and bonds have outperformed if you're investing for the long term. Most especially stocks.

Strategy Summary  
Asset Class Outlook

Category	Economy	Policy	Valuation(*)	Sentiment	Our Positioning			Rationale
					Under	Neutral	Over	
<b>Major Asset Class</b>								
Fixed Income					●			Attractive yields - inflation falling. We believe global central banks will pause.
Equities							●	Earnings revisions and margins stabilizing, valuations neutral. Recession fears abating.
<b>Equities by Geography</b>								
Canada							●	Expect outperformance if yields fall and growth picks up in late 2024. Attractive valuations. Handsome 2024 estimated dividend yield 3.7%.
United States							●	Earnings growth stabilizing. Strong momentum. Valuations less attractive, opportunities in active stock selection.
Europe						●		Geopolitical uncertainty remains. Economy and earnings better than feared. Attractive valuations.
Japan							●	Monetary policy less of a headwind. Export-oriented stock market dependent on global growth.
Emerging Markets							●	China growth lacklustre. Policy mildly stimulative. Deeply negative sentiment on politics and geopolitics. Valuations attractive.



As of November 15, 2023  
BMO Private Investment Counsel Inc.



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