Johnstone Wealth Management
Market Commentary

December 31, 2024

Economic Review

In the fourth quarter, we saw a mix of economic and political outcomes that significantly impacted expectations for monetary and fiscal policy, corporate earnings, inflation, and foreign exchange rates. The defining moment was Donald Trump's decisive U.S. election victory, which boosted U.S. growth expectations and strengthened U.S. fixed income and currency markets compared to Canadian and global markets. The new administration's pro-U.S. growth policies led to a bearish steepening bias on U.S. yield curves, with longer-term yields rising more than short-term yields. This uncertainty has caused investors to demand a higher-term premium. The U.S. Federal Reserve's policy shift added to the bearish steepening in U.S. fixed income markets. The anticipated protectionist policies will particularly impact the growth rate of regions affected by new tariffs. In contrast, Canada's economy, already weaker in terms of growth, lagged further due to inflation expectations and productivity concerns related to economic tariffs.

Bond Markets

Despite consecutive interest rate reductions by the Bank of Canada in October and December, Canada's domestic bond market's return was flat for the quarter. Canada's nominal and real yields were not immune to the rise in global longer-dated yields led by U.S. treasury yields. U.S. fixed income markets were bearishly impacted by the combination of a decisive change in the U.S. political landscape, the resiliency of the U.S. economy, and the moderation of disinflationary trends in the fourth quarter. Risk markets were supported by continued monetary stimulus and expectations for pro-U.S. economic policies, sustaining a tailwind to domestic and global equity markets, which also supported corporate bond returns as corporate spreads narrowed further.

Equity Markets

Global equity markets were generally strong in the fourth quarter, led by U.S. equity markets gaining 9.0%, as represented by the S&P 500. President-elect Donald Trump's pro-growth, domestically oriented agenda buoyed stocks aligned with his policies and unleashed upward momentum in more speculative areas. Despite ongoing rhetoric about significant tariff increases for key trading partners, Canadian markets fared relatively well, up 3.8%. Foreign equity markets were more subdued due to concerns about increased U.S. tariffs and slowing growth in developed and emerging markets.

Technology-related sectors, including Communication Services (except in Canada), led the way globally after a brief pause in the third quarter. The excitement around Artificial Intelligence (AI), from both suppliers (mainly semiconductors) and users (big tech), drove equities in this space to new heights. Consumer Discretionary names, especially in the U.S., also performed strongly as expectations of pro-growth policies are likely to boost spending.

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Financials were solid too, with higher rates signaling a stronger-than-expected economy, easing fears of credit weakness, and raising hopes for better loan growth. In this strong equity environment, more defensive sectors like Health Care and Consumer Staples lagged behind.

Reflecting on the year, equity markets were very robust, primarily driven by U.S. indices, particularly the Technology-related sectors, with the financial sector also performing well in most markets. On the other hand, most defensive sectors significantly lagged as investors favored more cyclical, pro-growth areas. Despite the significant upward movement, the market breadth was narrow, with fewer than ten stocks accounting for half of the gains in global equity indexes.

Investment Outlook

The ongoing divergence between the U.S. and other regions, including China, Europe, Japan, and emerging markets, will likely increase risk asset and interest rate volatility in 2025. Despite uncertainty and geopolitical tensions, global equity markets continue to move forward, albeit narrowly. Valuations in most regions, notably the U.S., are elevated due to expectations of an enhanced growth agenda under President-elect Trump. Our fixed income portfolios are structured to respond to opportunities generated by higher volatility over the medium term. On the equity side, we continue to evaluate downside risk as sentiment is optimistic, and valuations leave little margin of safety in many sectors. In Canada, although we are concerned about the negative impact of potential tariffs, a large proportion of the portfolio consists of global leaders in resilient growth industries with high barriers to entry. The resignation of the Canadian prime minister and resulting leadership uncertainty adds risks and potential volatility.

Contact our team of experts

Jeffrey Johnstone
Senior Wealth Advisor
416-507-9137
jeffrey.johnstone@nbc.ca
Jeffrey Johnstone

Kimberly Wood, CFP®, CIM®
Wealth Advisor
416-869-8210
kimberly.wood@nbc.ca
Kimberly Wood

Kevin Diep CIM®
Wealth Associate
416-869-8092
kevin.diep@nbc.ca

Ini Nadar
Wealth Associate
416-869-7686
ini.nadar@nbc.ca

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