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# Walking a tightrope to a soft landing 2025 Annual Outlook



# We believe a version of a **soft economic landing** is the most probable outcome

## Executive Summary

The challenge of excessive inflation over the past several years has continued to normalize, both in North America and globally. The risks of inflation and interest rates becoming entrenched at elevated levels have significantly diminished.

At the same time, economic growth is decelerating. While slower growth is typically undesirable, in the context of economies that were slightly overheated due to tight labor markets, this moderation is both necessary and welcome. The current challenge is to stabilize the economy at this lower growth trajectory. Successfully navigating this “tightrope” leads to a platform of healthy economic growth and well-balanced labor markets. On either side, however, lie risks: geopolitical tensions that could disrupt economic activity on one hand, and the return of inflation on the other. Other potential disruptions remain, making it clear that the economy remains somewhat vulnerable to setbacks.

Given this landscape, we believe a version of a soft economic landing is the most probable outcome. Nonetheless, history shows that such soft landings following significant monetary policy tightening are rare and difficult to achieve. While the odds currently favor the continuation of the economic expansion that began in mid-2020, the range of possible outcomes underscores the importance of thoughtful portfolio construction as we approach 2025.

### **Continuation of the Economic Expansion: 60% probability**

Global central banks continue to lower interest rates. Although the benefits of lower rates will take some time before they successfully stimulate the economy, they will prove to be enough to stabilize global labor markets. Geo-political tensions remain but avoid intensification. President-elect Trump begins to utilize tariffs as an international trade tactic, stoking inflation fears that prove to be immaterial and relatively unfounded. The Canadian economy continues to struggle relative to other regions. With a pending federal election in October 2025, the Liberal party will be strongly contested, leading to a likely transition of leadership.

### **The tightrope walk leads to an Economic Stumble: 40% probability**

Global central banks continue to lower interest rates. Although the stimulus would be welcomed, it comes too little too late and labor markets deteriorate. Geo-political risks may intensify, disrupting businesses from continuing to hire at a healthy pace. Inflation risks also may re-emerge due to international trade negotiations reaching an impasse, a global spike in commodity prices or both. In either scenario, global growth contracts modestly, with regional recessions emerging. The risks of these scenarios is higher entering this year than most, at 40%.

# Themes for the **year ahead**

## **Fading Inflation, and a Labor of Love**

Over the past two years, central banks have worked to rein in runaway inflation, which significantly strained consumers through rising costs of groceries, household goods, and travel. By mid-2024, a turning point emerged as inflation trended closer to the 2% target central banks aim for. While cautious about declaring victory, policymakers are now shifting focus toward stabilizing labor markets. Though still relatively healthy, labor markets have weakened, with unemployment rates creeping up over the past six months. Expect fiscal, monetary, and legislative policies to prioritize labor market stability throughout 2025.

## **Interest Rates: Lowering the Landing Gear**

Central banks around the world are lowering interest rates. Within each regional economy, there are unique risks they are trying to avoid. In Canada, there's a wave of consumer mortgage renewals coming down stream in 2025 and 2026. The labor market has also shown signs of weakness, like the U.S. labor market. Globally there's one common goal: avoid an economic recession. Around the world, unique economic risks will dictate how gradually or more quickly each central bank lowers the interest rate landing gear. In 2025, look for this theme to be prevalent throughout the year. The Bank of Japan is the one outlier, for reasons unique to their economy, but that's a discussion for another day.

## **Valuation Nation**

Earnings growth is a key topic in investing, reflecting profitability increases for companies or the broader market. Over time, stock prices tend to align with profit growth, a principle central to Matco's investment approach and supported by historical data. Valuation also matters; buying overpriced stocks can limit returns, while buying undervalued stocks often leads to better outcomes. Currently, there is a wide valuation gap in the market, with some areas overpriced and others offering value. In 2025, companies with reasonable valuations are likely to perform well, while pricier stocks may struggle due to a slowing economy.

## **Canadian Dollar Doldrums**

The Canadian dollar peaked at 0.83 USD in May 2021 but has steadily declined since, driven by relative economic weakness compared to the U.S. Recently, the Bank of Canada has been cutting interest rates faster than the U.S. Federal Reserve. This trend, along with economic challenges and the possibility of U.S. tariffs on Canadian exports, is expected to persist through 2025. Thus, a rebound for the Canadian dollar appears unlikely. This could impact businesses, consumers, and retirees with U.S. dollar expenses. Within investment portfolios, U.S. dollar exposure is more likely to boost performance, while Canadian dollar exposure may weigh on returns.

# Canadian Outlook



Anil Tahiliani, MBA, CFA  
Senior Portfolio Manager

## Canadian Equities: The Quiet Underdog Catches Up

The Canadian economy grew at an annualized rate of 2% during the first half of 2024, with the Bank of Canada projecting a slightly slower pace of 1.75% for the remainder of the year. Inflation has been steadily declining, with the Consumer Price Index falling to 1.6% by the end of September from 2.7% in June. This decline has been driven by reduced energy and shelter costs, as well as weaker demand in certain sectors. The Bank of Canada's preferred inflation gauge, core inflation, stood at 2.3%, nearing the Bank's 2% target. As a result, the Bank has continued to lower interest rates aggressively to stimulate economic activity, with markets anticipating a further 1% reduction in the overnight rate by the end of October 2025.

For 2025, the Bank of Canada forecasts gross domestic product (GDP) growth of 2.1%, slightly above the 1.8% consensus among economists surveyed by Bloomberg. Globally, economic growth projections stand at approximately 3.2%, according to estimates from the International Monetary Fund and World Bank. As inflation recedes, central banks around the world are adopting more accommodative monetary policies, which are expected to support global growth. For an export-driven economy like Canada, this environment should attract increased foreign investment in Canadian equities.

Despite these tailwinds, uncertainties remain. President-elect Trump's announcement of a proposed 25% tariff on Canadian goods as part of his first day-in-office agenda could disrupt trade flows. While the U.S. has a modest trade deficit with Canada, deficits with other nations, such as China and Mexico, are significantly larger. Whether exemptions to these tariffs will be granted remains unclear, and the timing coincides

with the looming 2026 review of the US-Mexico-Canada Agreement. This development may serve as a negotiating tactic rather than an immediate policy shift. Importantly, exposure to companies heavily reliant on U.S. revenues have been avoided in Matco's Canadian equity strategies.

## 2024 Performance and Sector Highlights

In Matco's Outlook 2024, small-cap companies and the energy sector were highlighted as undervalued opportunities. By October 31, the iShares S&P/TSX Small Cap Index ETF (XCS) gained 19.3%, while the iShares S&P/TSX Capped Energy Index ETF (XEG) rose 14.9%, outperforming the broader iShares Core S&P/TSX Capped Composite Index ETF, which was up 17.1%. The technology, industrials, and materials sectors were anticipated to benefit from falling interest rates. These sectors delivered gains of 12%, 8%, and 30%, respectively, through the end of October.

In the first half of 2024, the Canadian market underperformed other developed markets due to its lower exposure to the technology sector and faster economic deceleration. However, in the third quarter, Canadian equities rebounded, driven by declining inflation and expectations of monetary easing by the Bank of Canada. The banking sector benefited from this shift, while higher commodity prices for gold, silver, and base metals further supported the market's performance.

## Outlook for 2025

Canadian equities are poised for continued growth, supported by corporate earnings expansion and reasonable valuations. Analysts forecast earnings growth of 13.5% for 2025, more than double the rate achieved in 2024. However, analyst estimates often start the year on the optimistic side, typically moderating as the year

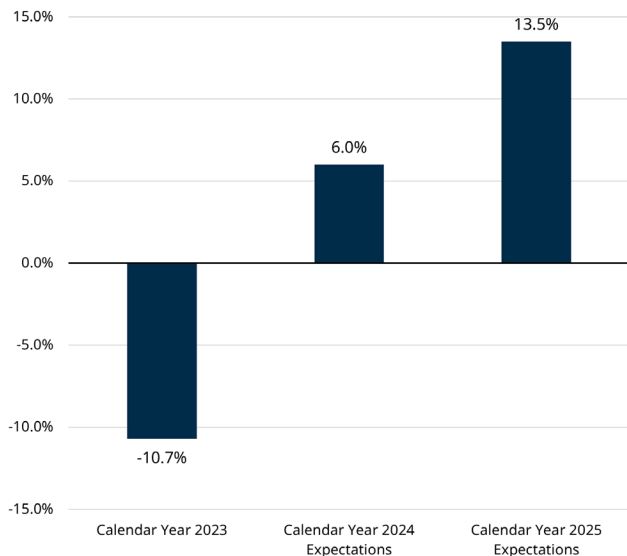
progresses. A more conservative projection of 7-8% earnings growth seems prudent.

Valuations, as measured by the forward price-to-earnings (P/E) ratio, currently sit at 16.6x, slightly above the historical average since 2001. This suggests that the market is fairly valued, with some room for upward momentum if corporate earnings exceed expectations.

Small- and mid-cap companies, alongside the energy sector, remain areas of opportunity. Small- and mid-cap companies offer the potential for higher earnings growth, attractive valuations, and company-specific catalysts that drive stock performance independently of macroeconomic conditions. Additionally, robust balance sheets among large-cap companies and private equity players suggest ongoing acquisition activity in this space.

In the energy sector, favourable dynamics include low price-to-cashflow valuations, low debt levels, and high free cash flow. These factors have enabled energy companies to return capital to shareholders through buybacks and special dividends. A potential shift in government policies following the 2025 federal election could further bolster the sector by reducing regulatory burdens and incentivizing new projects, attracting renewed foreign investment.

### S&P TSX Earnings Growth



Source: Scotiabank, FactSet, Matco Financial Inc. as at November 29, 2024.

### Key Investment Themes

Matco’s Canadian equity strategies are focused on three secular investment themes expected to drive returns:

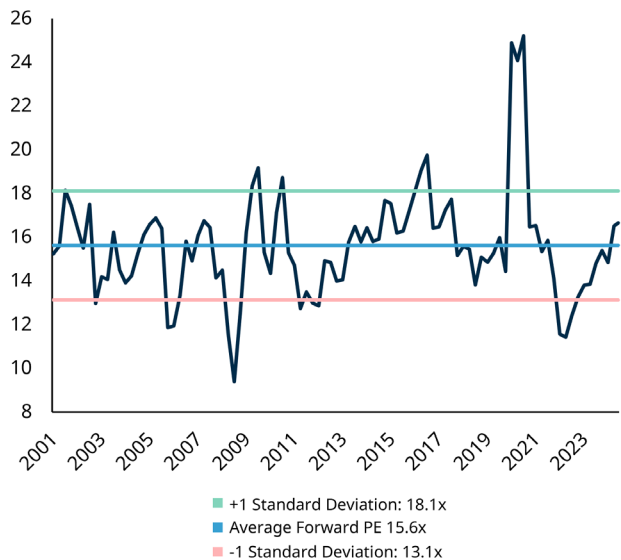
**Heightened Geopolitical Risk** - Increased global defence spending is anticipated as countries counter rising military and economic pressures from non-U.S.-aligned nations. This trend favours sectors such as surveillance, military equipment, and advanced technology.

**Rising Power Consumption in North America** - Growing demand for artificial intelligence applications and data centers will necessitate significant upgrades to the electrical grid and investment in new energy sources.

**Infrastructure Renewal** - Canada faces aging infrastructure. Investment in roads, highways, bridges, ports, terminals, and critical national security projects is likely to intensify, supported by fiscal spending.

Through these strategies, Matco remains well-positioned to capture opportunities in the evolving Canadian equity landscape while managing risks in a complex economic environment.

### TSX Index: Forward P/E Ratio



Source: Bloomberg, Matco Financial Inc. as at November 29, 2024.

# Global Outlook



**James Cook, CFA**  
Portfolio Manager

## Global Equities: A Historical Perspective and Future Outlook

The year 2025 marks the 233rd anniversary of the New York Stock Exchange (NYSE), which has evolved into one of the world's most prominent equity exchanges since its founding in 1792. For context, George Washington was president at the time of its establishment, and its rise to prominence overshadowed earlier exchanges like the Philadelphia Stock Exchange. While the NYSE's history is rich with transformative economic and political events, two fundamental principles that have guided its success remain relevant today: investors' pursuit of wealth growth and the powerful potential of stock ownership to drive compounding growth over the long term.

At Matco, the core belief driving our Global Equity Strategy is that earnings growth is the cornerstone of stock market returns. While markets may fluctuate in the short term as investors adjust to changing expectations of future earnings, over the long run, annual earnings growth across the broad equity universe averages approximately 7%. Individual regions and sectors naturally experience cyclical fluctuations, moving through phases of rapid expansion and contraction in line with the broader business cycle, but the long-term trend will inevitably prevail.

### The Current Economic Environment

In 2025, substantial declines in global GDP growth appear unlikely, given the backdrop of robust fiscal spending and easing monetary policies. Around the world, governments are prioritizing economic stimulus over fiscal austerity, a trend largely supported by voters. As a reminder, there were approximately 62 elections around the world in 2024. With this in mind the environment is



Image generated by AI.

expected to sustain growth, albeit at a measured pace.

Matco’s approach to earnings projections is grounded in conservatism, favouring surprises to the upside rather than the disappointment of overestimated growth. While valuations may experience some compression due to shifting investor sentiment, the pace of growth and innovation in the U.S. remains a compelling long-term investment case. As a result, the U.S. continues to represent a significant component of a well-diversified portfolio.

**Matco’s Global Equity Strategy**

The strategy is anchored in high-quality U.S. securities, reflecting a growth at a reasonable price (GARP) investment philosophy. This approach balances the pursuit of earnings growth with the critical understanding that valuation—the price paid for that growth—is a key determinant of investment success.

To enhance diversification, the portfolio incorporates exposure to international markets, which offer distinct growth drivers and valuation dynamics compared to the U.S. market. This geographic diversification helps to mitigate volatility while providing access to a broader array of investment opportunities.

**Market Compass**

Region	Expected EPS Growth	Current Dividend Yield	Expected Price to Earnings	Expected Return
U.S.	13.0%	1.3%	22.0	6.72%
International	8.5%	2.7%	13.7	9.24%

Source: FactSet, Matco Financial Inc. as at November 21, 2024.

**Key Themes for 2025**

Looking ahead, Matco has identified several investment themes that present compelling opportunities for global equity investors:

**Artificial Intelligence Monetization: The Enabler or the Adopter** - AI has been a major theme for years, evolving from machine learning to breakthroughs like ChatGPT. While infrastructure has been central, 2025 shifts the focus to monetization—whether through efficiencies or new business lines. Companies like Microsoft are leading the way, driving AI’s influence beyond tech.

**Pharmaceuticals for Weight Loss: Major investment to meet Growing Demand** - Novo Nordisk, the maker of Ozempic and Wegovy, is capitalizing on soaring global diabetes and obesity rates, projected to affect 784 million and 1.246 billion people, respectively, in the coming decades. To meet this demand, the company is heavily investing in production and innovation, driving significant earnings growth and positioning itself as a promising opportunity for investors.

**Cyber Security: How safe is our data?** - IBM’s 2024 Cost of Data Breach Report estimates the average breach cost at \$4.88 million. A notable incident was UnitedHealth’s Change Healthcare breach, impacting one-third of Americans. As cyber threats grow, businesses are investing more in data protection, boosting the cybersecurity sector, though for unfortunate reasons.

**New Home Construction: Now or later?** - The cost of new homes has surged as U.S. housing dynamics shift. Many homeowners with low mortgage rates are staying put, limiting existing home sales and boosting demand for new homes. However, construction is down 21% from 2000-2010 levels, and the median U.S. home age is 46 years, increasing maintenance needs. This creates strong demand for home improvement products, positioning companies like Home Depot and Lowe’s for growth.

Through disciplined portfolio construction and a focus on sustainable, long-term growth, Matco’s Global Equity Strategy is well-positioned to navigate the complexities of the current market environment while delivering value to investors.

# Fixed Income Outlook



**Trevor Galon, CFA**  
Chief Investment Officer

## North American Fixed Income: The Glide Path to a Soft Landing

As 2025 approaches, the North American fixed-income market finds itself at a critical juncture, influenced by macroeconomic factors, central bank actions, and evolving global conditions. Investors must navigate a landscape shaped by inflationary pressures, central bank interest rate policies, and geopolitical dynamics, which will have a mixed influence on bond market performance. A careful strategy and analysis will be essential to navigate this complexity.

## Economic Outlook for 2025: Inflation, Growth, and Central Bank Actions

In 2024, global economic recovery was uneven, with developed economies continuing to grapple with inflation above pre-pandemic levels. However, a tightening of financial conditions from 2022 to

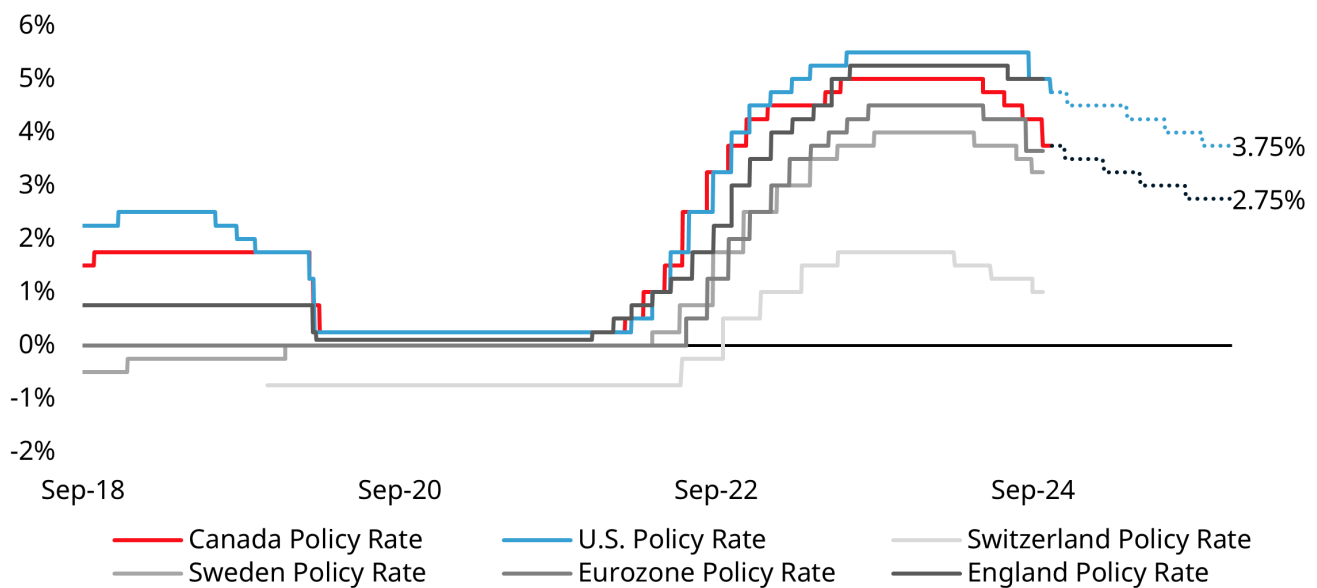
2024 has successfully brought inflation down to more manageable levels. While concerns persist regarding inflation's persistence in 2025, the outlook is more balanced.

Central banks across developed economies, including the Bank of Canada and the U.S. Federal Reserve, have begun to lower interest rates, signalling the start of a global monetary easing cycle. Global growth projections for 2025 vary, with modest expansions in developed markets, but challenges persist, particularly in China where slower growth could dampen international trade. Meanwhile, emerging markets may experience heightened volatility due to political uncertainties.

## Government Bonds: Opportunities and Risks

In the U.S. and Canada, sovereign bond yields will be shaped by central bank policies and fiscal strategies. If economic growth slows, bond prices

### Central Bank Rate Cuts



Source: Bloomberg, Matco Financial Inc. as at November 29, 2024.

are likely to appreciate, which has historically put downward pressure on interest rates. However, the volatile interest rate environment introduces term-premium risks that must be carefully considered.

Inflationary risks remain, particularly in the U.S. under President-elect Trump’s potential fiscal policies, such as increased spending and tariffs, which are typically inflationary. Rising government debt levels could add further inflationary pressures. In contrast, inflation in Canada appears more contained, with growth and labour market dynamics moderating faster than in the U.S. Exposure to mid- and long-term bonds presents a favourable risk-adjusted return opportunity for Canadian government bonds, with rates likely to move lower as the Bank of Canada continues to reduce the overnight rate. Caution is advised when considering long-term U.S. government bonds.

**Corporate Bonds: Stability and Strategic Selection**

Investment-grade corporate bonds continue to offer stability, making them a preferred option for cautious investors. However, with credit spreads at historically low levels, careful management and issuer selection will be critical. Corporate credits with strong balance sheets and resilient business

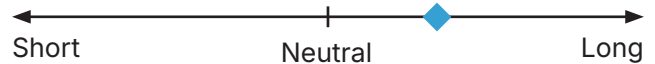
models are likely to be less exposed to widening spreads in a decelerating growth environment. Geopolitical tensions and trade conflicts may further exacerbate risks, increasing demand for safe-haven bonds and driving risk aversion in the markets.

**Navigating the Fixed-Income Landscape in 2025**

The fixed-income market in 2025 presents both opportunities and challenges. Central bank policies, inflation dynamics, and global growth trajectories will be key factors influencing market behaviour. To navigate this environment, investors should balance duration exposure, prioritize credit quality, and diversify across the yield curve.

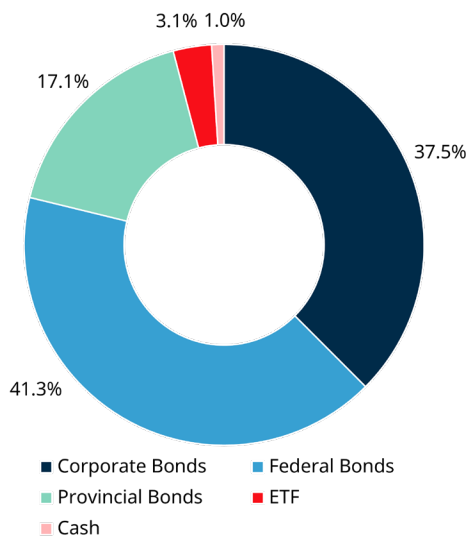
Our portfolio strategy for 2025 will focus on medium and long-duration government bonds, high-quality short and mid-term investment-grade corporate bonds, and modest exposure to private credit. This allocation will ensure a healthy yield while positioning the portfolio to benefit from potential bond price appreciation as interest rates decline. As market conditions evolve, we will continue to adapt our portfolio positioning with a focus on income generation and effective risk management.

**Duration**



Source: Matco Financial Inc. as at November 28, 2024.

**Diversified Income Fund Sector Allocation**



Source: Matco Financial Inc. as at November 28, 2024.

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