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Desjardins
Global Asset Management

Market Outlook – Top Down Approach

December 2024

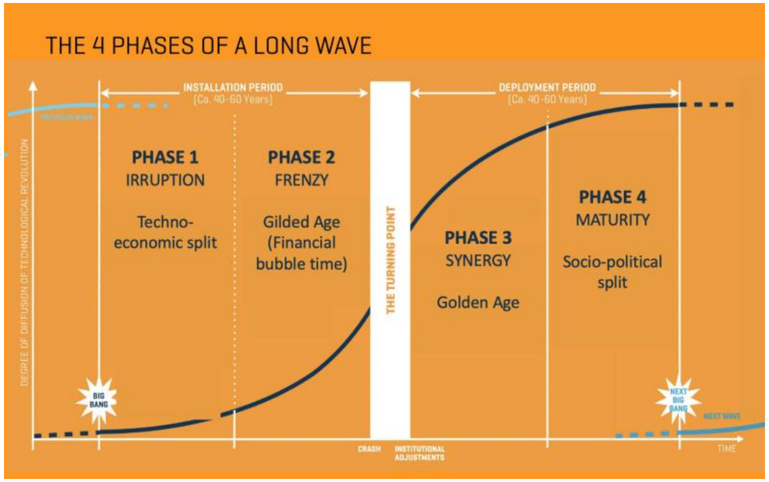
The long cycle of technological revolutions in the financial markets

Technological revolutions have given rise to extensive research and reporting on their economic impacts. Even though major innovations cause significant disruption, especially in the labour market, they enhance productivity and prosperity over the medium and long terms.

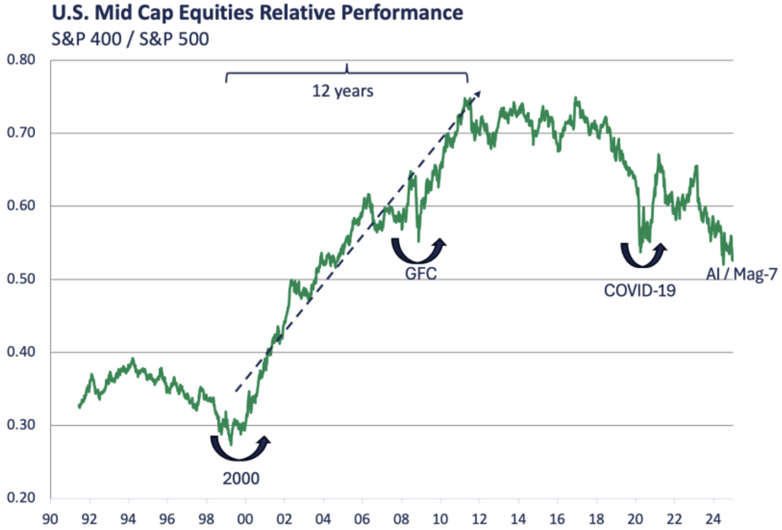
In the financial markets, investor behaviour tends to repeat itself with each revolution. The technological revolution of the 1990s and 2000s is a perfect illustration. Initially, the innovators and key players that contributed to the digitalization of the economy, led by Cisco, Dell, Intel, and Microsoft (the Four Horsemen), dominated the stock markets. As investors extrapolated their strong growth, the market went into overdrive, and a feeling of invincibility, fuelled by sustained returns, became widespread, leading to a speculative bubble. Then came the stock market selloff.

Subsequently, the dissemination of technology and its rapid adoption by Main Street completely changed the dynamic. After the winner-takes-all period, which came to an abrupt end, a new phase emerged: one in which the productivity gains from new technology benefited more companies and then the economy in general. During this phase, small and mid caps outperformed mega caps for a dozen years. At the same time, the innovators' monopoly was eroded by the arrival of new competitors.

The current technology cycle has many points in common with the digitalization of the 1990s and 2000s and even the advent of the railway late in the 19th century. It remains to be seen how quickly artificial intelligence technologies will become widespread, benefitting the great majority of people rather than a handful of firms, which will sooner or later face increased competition.



Source: Thinkergy, 2021



Sources: DGAM, LSEG, December 2024

Trump 2.0: A much different starting point from 2017

Empirically, neither of the two U.S. political parties is associated with better equity returns or tighter fiscal discipline. In fact, the stock market's reaction to last November's election has so far been normal. The S&P 500's behaviour corresponds to the average trends observed historically after a winner is announced.

Even though the colour of the party in power doesn't directly influence stock market returns, the same can't be said about equity valuations at the beginning of the mandate. Not surprisingly, the more expensive the market is at the start of the presidential cycle, the lower the return tends to be at the end of the four-year term. And the starting point of the Trump 2.0 mandate is anything but enviable. In fact, it's the second-most-expensive market in more than 100 years for the S&P 500, the record belonging to that of the November 2000 election.

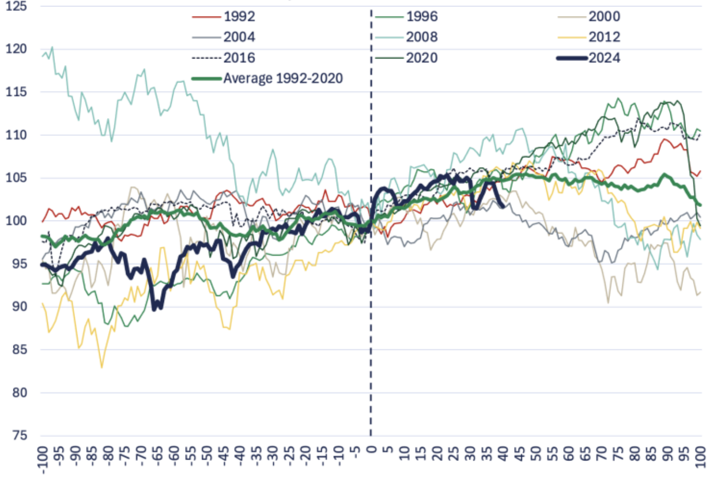
As for investor sentiment, according to our composite index, it was neutral at the start of Trump's first term, a more favourable level for risk assets than the current euphoria zone.

The starting point of Trump's second term is also very different from the first on the economic front: interest rates, the public deficit and the business climate were all more favourable than they are today.

But the most optimistic observers are counting on the Trump administration's deregulation ambitions (energy, environment, financial markets, employment, etc.) to boost the economy. Although supply-side economics can support long-term growth effectively by promoting local investment, innovation and lower inflation, the impact on public finances and consumer spending is uncertain (to wit: the net effect of Ronald Reagan's policies is still up for debate). In addition, deregulation targets some areas under state jurisdiction. The reforms may not enjoy smooth sailing everywhere in the country.

S&P 500 Around Presidential Elections

Rebased at 100 on election day



Sources: DGAM, Bloomberg, December 31, 2024

	End 2016	2024
S&P 500 valuation	87th percentile (fwd P/E = 17)	**100th percentile (fwd P/E = 22)**
Sentiment	**Neutral**	**Euphoric**
Corporate Tax Rate	35%	21%
Inflation	**2.1%**	**2.6%**
CPI vs. 5-year Low	**+6.5%**	**+23%**
Fed Funds Rate	**0.5%**	**4.75%**
10-Year Yield	**2.4%**	**4.3%**
30-Year Mortgage Rate	**3.9%**	**7%**
Unemployment	4.7%	4.1%
Manufacturing ISM	**54.4**	**46.1**
Deficit (% of GDP)	**3%**	**6.5%**

Sources: DGAM, LSEG, November 2024

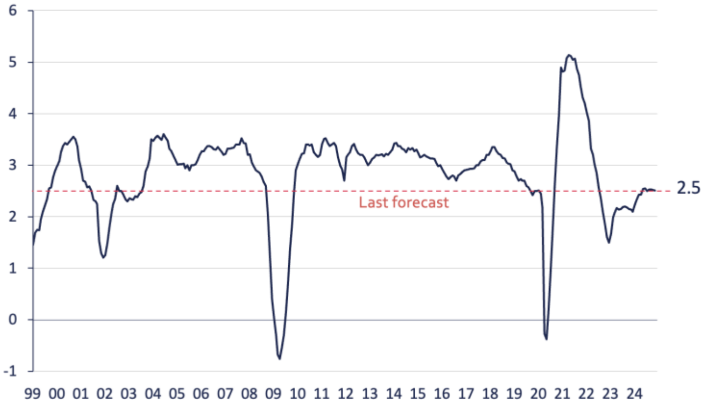
Rather modest global growth is forecast for 2025

The consensus global growth forecast for 2025 remains modest, although it is higher than the forecast at the same time last year.

Economists are forecasting global growth of 2.5%, a rate comparable to that observed in 2024. American exceptionalism has been extrapolated to 2025, with growth expected to remain stronger in the United States (2.0%) than in Europe (1.0%), Canada (1.7%) and Japan (1.2%). In emerging markets, deceleration from the pace in 2024 (from 4.5% to 4.0%) is expected. It should be noted that growth in 2024 came in above expectations almost everywhere, except in Japan. And the consensus forecasts remain conservative, so they could well be proven wrong in 2025 as well, especially if central banks lower their key rates quickly – provided that inflation is no longer an issue in 2025, as forecasters hope.

Evolution of Forecasted Economic Growth - World

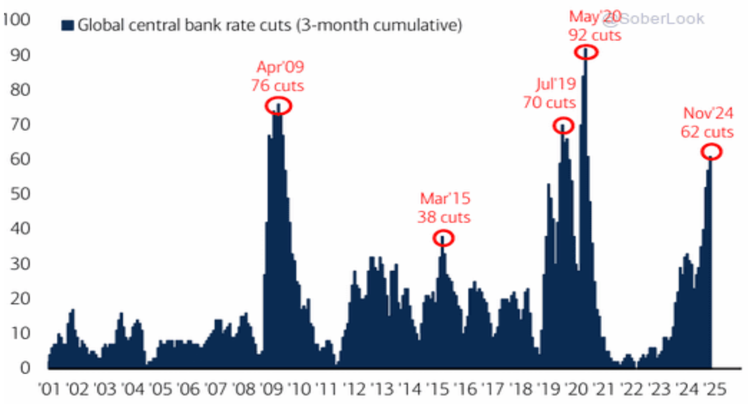
Forecast for the next 12 months



Sources: DGAM, Consensus Economics, December 2024

3-Month Cumulative Rate Cuts

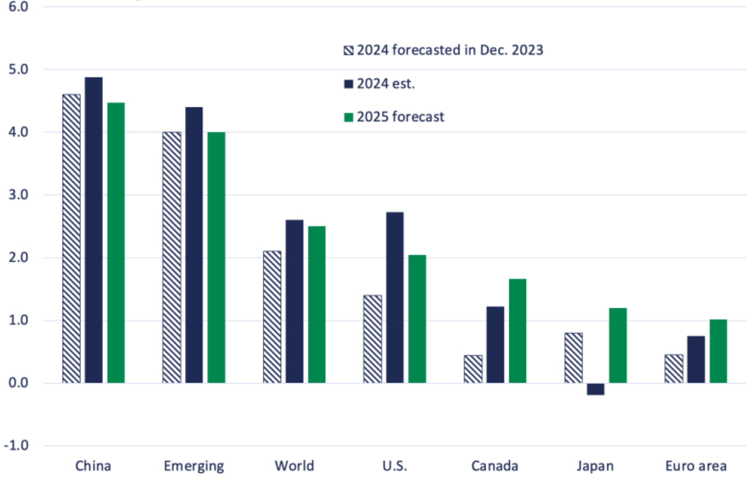
Policy rate cuts from central banks, World



Sources: BofA Global Investment Strategy, Bloomberg, December 2024

Forecasted GDP Growth

Estimated growth for 2024 and forecasted for 2025



Sources: DGAM, Consensus Economics, December 2024

United States: Buying a soft landing by borrowing three years of future growth

According to the IMF, the U.S. federal deficit will reach 6.5% of GDP by 2024 and could exceed 7% in 2025, or more than three times the average for the other developed countries. Such deficits are usually incurred during a recession, when tax revenues fall and social spending rises.

But this time the cause is simply borrowing from future growth to boost the economy in the short term. Excluding the multiplier effect, higher government spending alone accounts for one-quarter of the GDP growth recorded over the past two years. The contribution of government transfers to household income is of the same order of magnitude.

The cheques sent by the government, in a period of full employment, and the wealth effect from the stock and real estate markets have probably contributed to households' strong propensity to consume. For every additional dollar of employment income, they spent an unprecedented $1.32.

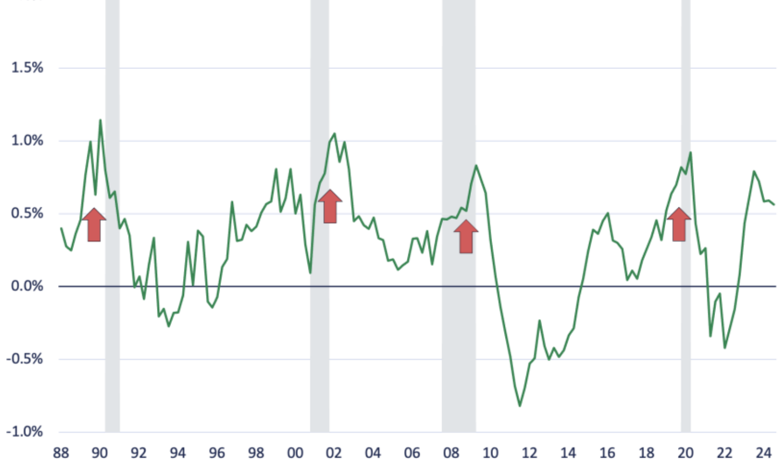
In this context, the leading indexes and the indicators of recession probabilities, calibrated with past economic cycles, have been overridden. Boosted by government largesse, the economy held up despite signals that the cycle was over.

But how long can we borrow from future growth? For the time being, budgetary austerity isn't on the Trump administration's agenda. On the contrary, it is contemplating tax breaks.

The IMF estimates that the deficit has added 0.5% to inflation in the United States, helping keep interest rates high. It has also pointed out that a 1% increase in U.S. interest rates translates into a 0.9% increase in other developed countries and a 1% increase in emerging markets. So U.S. fiscal laxity has global implications.

Government Spending - United States

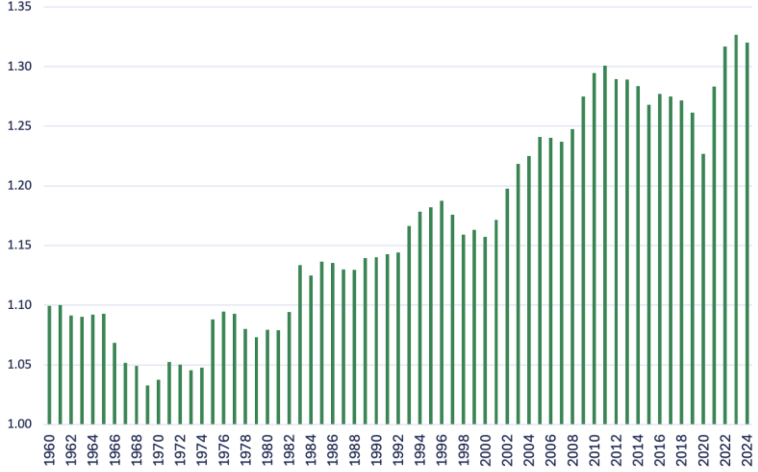
Contribution to annual GDP growth



Sources: DGAM, LSEG, December 2024

Propensity to Consume – United States

Personal consumption expenditures / total compensation of employees



Sources: DGAM, LSEG, December 2024

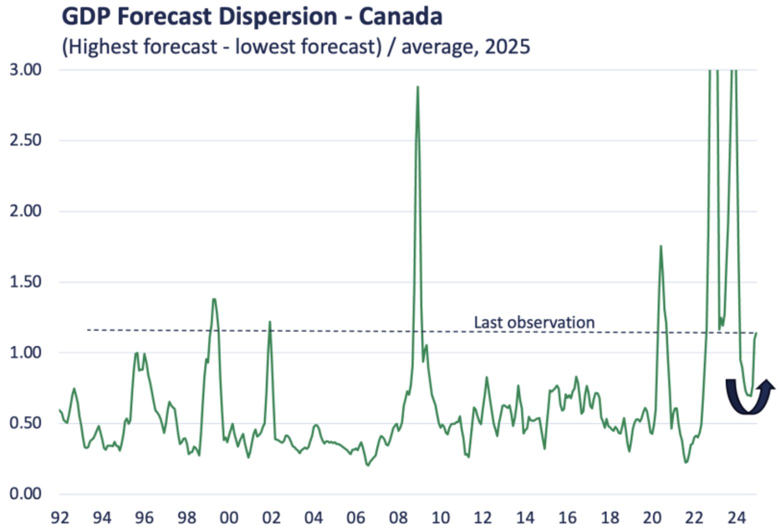
Canada: An increasingly uncertain outlook

From the divergence of opinions among forecasters, it appears that the Canadian economy will encounter opposing winds in 2025. The optimists expect growth to be 2.2%, whereas the most pessimistic think it will be only 0.4%. This is a wide dispersion of 1.8% around a forecast average of 1.6%. Donald Trump's threat to impose a 25% tariff on Canadian imports is undoubtedly contributing to the uncertainty.

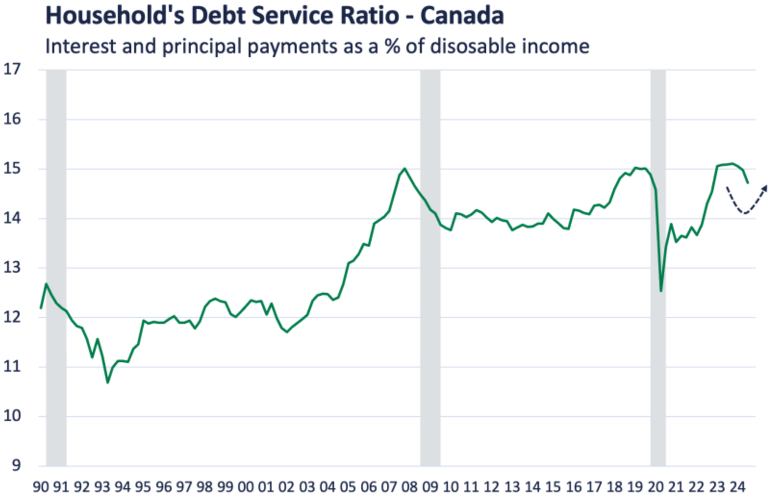
As for domestic demand, residential investment has been detracting from economic growth in Canada for the past three and a half years; that being said, the bloodletting seems to be coming to an end. This malaise partly justified the recession scenario that many predicted for 2024. Even so, the rest of the economy has held up better than expected, especially consumer spending.

Consumer reaction to the wave of mortgage refinancings that will increase in 2025 will play a key role. The household debt burden was already very high in 2024. Fortunately, lower inflation gave the Bank of Canada some leeway to partially mitigate this restrictive effect. The decision to cut its key interest rate by 50 basis points in December was undoubtedly welcomed by consumers.

As for external demand, the imposition of 25% tariffs by the United States could hurt Canadian growth, not only by dampening exports but also by undermining corporate investment. Even though Canada has benefited from U.S. fiscal laxity through its exports over the past two years, the situation could reverse itself. Let's hope the tariff threat was only a negotiating tactic and won't be implemented fully.



Sources: DGAM, Consensus Economics, December 2024



Sources: DGAM, Statistics Canada, December 2024

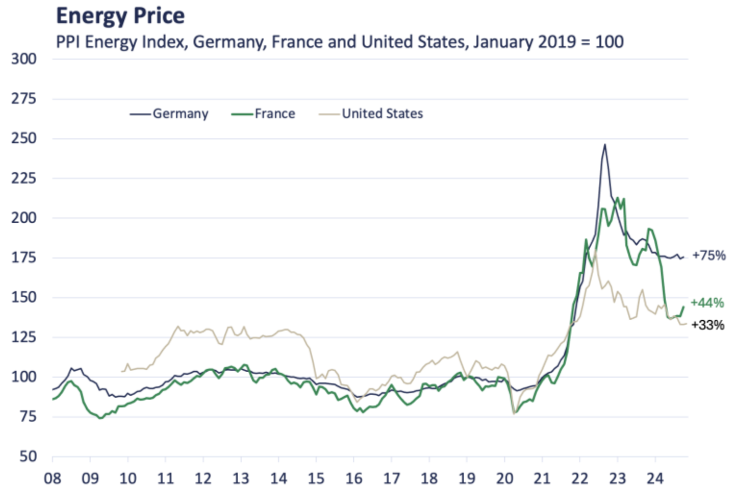
Euro zone: A sluggish economy, potential tariffs and political storms

Germany, the world's third-largest economy and second-largest exporter of manufactured goods, is suffering from a deep malaise. The sharp rise in energy prices since the start of the war in Ukraine has weighed on its competitiveness. It has also been affected not only by competition from China but also the weakness of the Chinese economy and the demand for German products.

U.S. tariffs could exacerbate the situation in 2025. The German central bank has revised its growth forecast downward and warned that a trade war could push the country into recession. The country's numerous challenges call for a profound restructuring and will affect the outcome of the early elections in February in a context where Germans are increasingly dissatisfied and polarized.

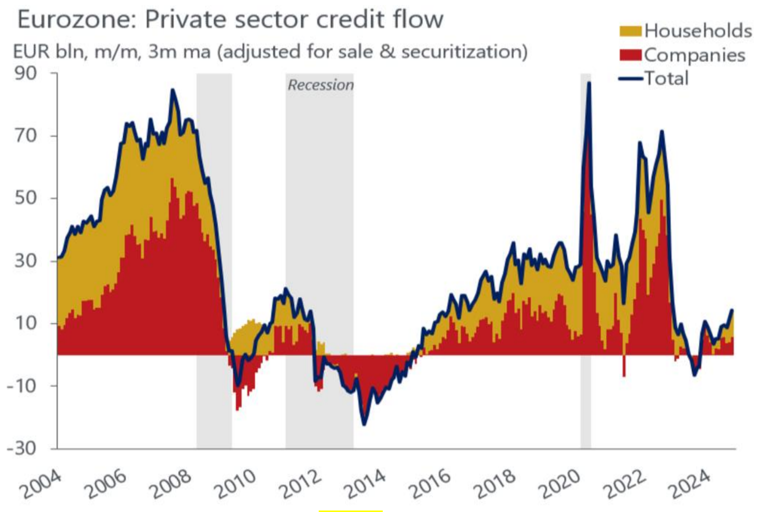
France is not to be outdone in terms of political division; it went through four prime ministers in 2024 alone, although its economy is doing better than Germany's.

As we will see later, European stock prices are already pricing in a lot of bad news. But there are some positives. The countries on the periphery are experiencing more dynamic growth and the Chinese stimulus measures, which this time target consumers, are encouraging for European exporters, especially manufacturers of luxury goods. Finally, in a sign of renewed confidence and of the effect of interest rate cuts, credit growth has picked up in recent months.


Energy Price

PPI Energy Index, Germany, France and United States, January 2019 = 100

Sources: DGAM, LSEG, December 2024


Eurozone: Private sector credit flow

EUR bln, m/m, 3m ma (adjusted for sale & securitization)

Sources: Oxford Economics/Haver Analytics, December 2024

Asia: U.S. allies could (perhaps) benefit from trade tensions

In a global economy that is more integrated than ever, tariffs and export restrictions will be a two-way street affecting the global supply chain. Comparisons with past situations or with tariffs aimed at protecting specific industries (steel, automotive, agriculture, etc.) are of little relevance when we assess the potential impacts of a trade war today.

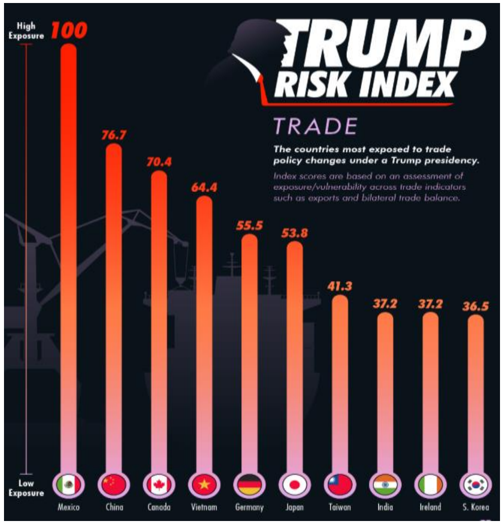
Judging by China's immediate response to the latest round of U.S. restrictions on semiconductor exports, an escalation of tensions can't be ruled out.

Will the United States' Asian allies, including South Korea and Japan, still be able to benefit from the reorganization of the supply chain outside China? Nothing could be less certain. By the end of 2024, Trump had still not met with South Korean and Japanese officials, raising fears of significant tariffs.

In January 2017, Trump accused Japan of manipulating its currency. Since then, the yen has fallen by 25% against the greenback, a development likely to irritate the new U.S. administration.

Even for the United States' traditional allies, visibility is low. But if, as we hope, the threat of tariffs is used mainly as a negotiating tactic, the disputes could ultimately take a pragmatic turn.

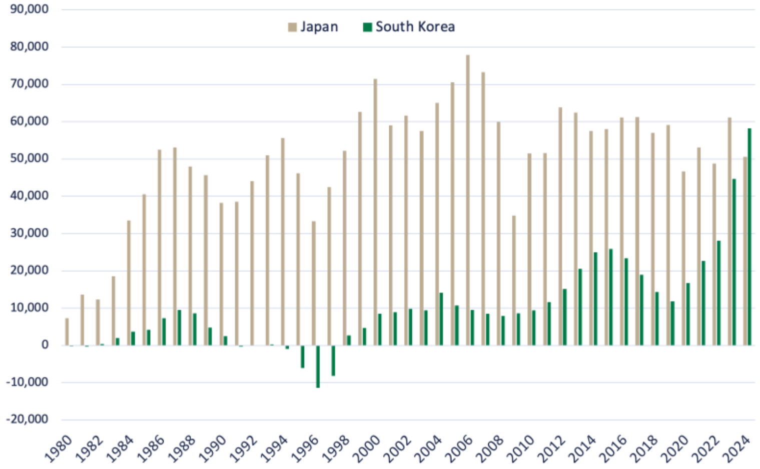
Finally, we will see whether Asian multinationals, which already have considerable production capacity in the United States, will make strategic decisions geared to the four-year U.S. presidential cycle.



Source: The Economist, August 2024

Trade Balance with the United States

Millions of dollars



Sources: DGAM, LSEG, December 2024

The S&P 500’s valuation again reaches the 100th percentile of its historical distribution

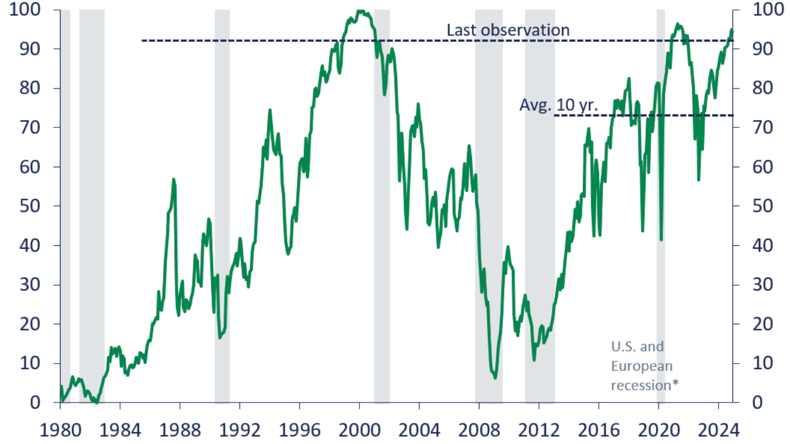
The S&P 500’s valuation again reaches the 100th percentile of its historical distribution. The aggregate valuation of the MSCI World Index was at the 94th percentile of its historical distribution as at December 31, the highest level since 2001 if we exclude the distortions caused by the pandemic in 2021.

The United States was still, by far, the most expensive stock market as the S&P 500’s valuation reached the 100th percentile for the first time since the 2000 speculative bubble. The rest of the global stock market was slightly above the historical median at the 61st percentile. Canada, which was a bargain at the start of 2024, now has a rich valuation at the 94th percentile of its historical distribution. Europe’s valuation improved during the quarter, falling to the 72nd percentile, while Asia-Pacific remained stable at the 70th.

Finally, emerging markets valuation fell from the 81st to the 74th percentile in the fourth quarter. China’s valuation is close to its historical median at the 53rd percentile.

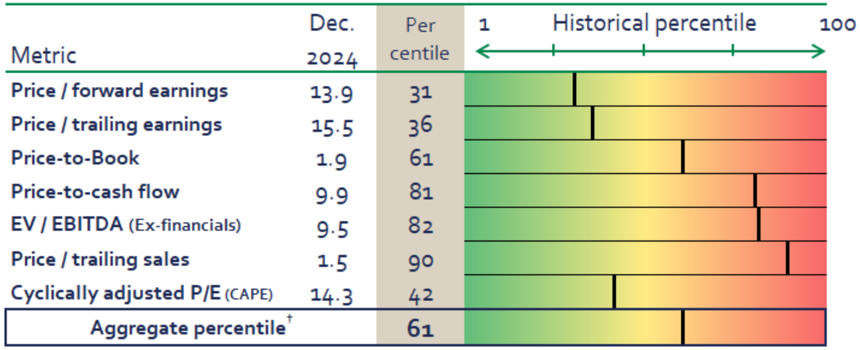
Historical Valuation - Aggregate Percentile

MSCI World



Sources: DGAM, LSEG, MSCI, IBES, NBER, *ECRI, Bloomberg, December 31, 2024

MSCI World excl. U.S. Valuation

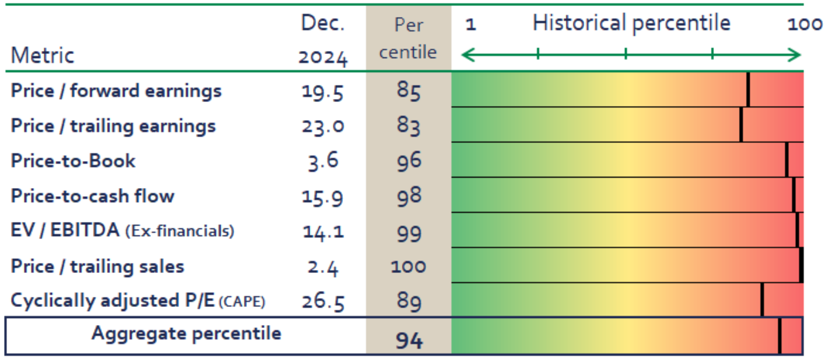


Metric	Dec. 2024	Per centile	1 Historical percentile 100
Price / forward earnings	13.9	31	
Price / trailing earnings	15.5	36	
Price-to-Book	1.9	61	
Price-to-cash flow	9.9	81	
EV / EBITDA (Ex-financials)	9.5	82	
Price / trailing sales	1.5	90	
Cyclically adjusted P/E (CAPE)	14.3	42	
Aggregate percentile†		61	

Sources: DGAM, LSEG, MSCI, IBES, Bloomberg, December 31, 2024

†Average percentiles for the seven valuation indicators

MSCI World Valuation



Metric	Dec. 2024	Per centile	1 Historical percentile 100
Price / forward earnings	19.5	85	
Price / trailing earnings	23.0	83	
Price-to-Book	3.6	96	
Price-to-cash flow	15.9	98	
EV / EBITDA (Ex-financials)	14.1	99	
Price / trailing sales	2.4	100	
Cyclically adjusted P/E (CAPE)	26.5	89	
Aggregate percentile		94	

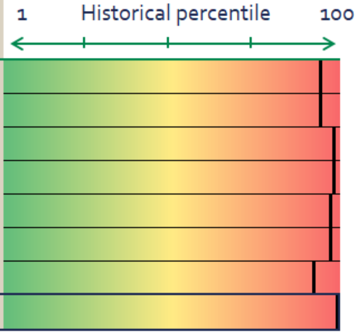
Sources: DGAM, LSEG, MSCI, IBES, Bloomberg, December 31, 2024

VALUATION

In absolute terms, bargains are scarce on a regional basis

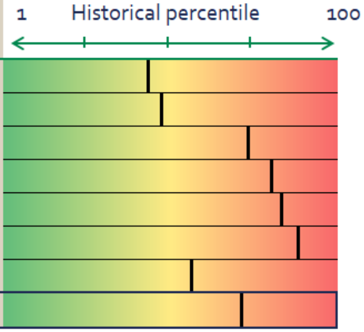
S&P 500 Valuation

Metric	Dec. 2024	Per centile
Price / forward earnings	22.3	95
Price / trailing earnings	28.6	95
Price-to-Book	5.1	99
Price-to-cash flow	19.6	99
EV / EBITDA (Ex-financials)	16.5	98
Price / trailing sales	3.1	98
Cyclically adjusted P/E (CAPE)	35.1	93
Aggregate percentile		**100**



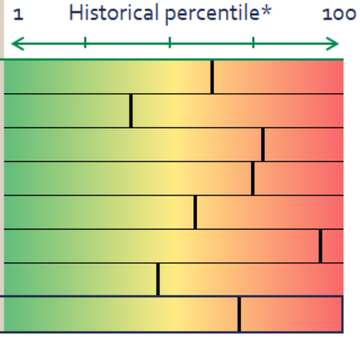
MSCI Europe Valuation

Metric	Dec. 2024	Per centile
Price / forward earnings	13.3	44
Price / trailing earnings	14.7	48
Price-to-Book	2.0	74
Price-to-cash flow	9.7	81
EV / EBITDA (Ex-financials)	10.1	84
Price / trailing sales	1.4	89
Cyclically adjusted P/E (CAPE)	17.9	57
Aggregate percentile		**72**



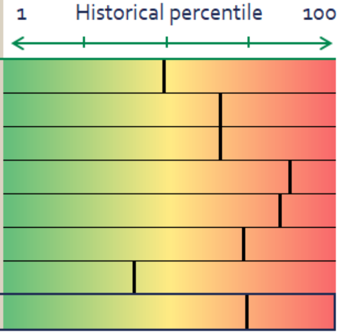
MSCI Asia Pacific Valuation

Metric	Dec. 2024	Per centile
Price / forward earnings	15.0	62
Price / trailing earnings	15.9	38
Price-to-Book	1.6	77
Price-to-cash flow	9.6	74
EV / EBITDA (Ex-financials)	8.0	57
Price / trailing sales	1.4	94
Cyclically adjusted P/E (CAPE)	20.1	46
Aggregate percentile		**70**



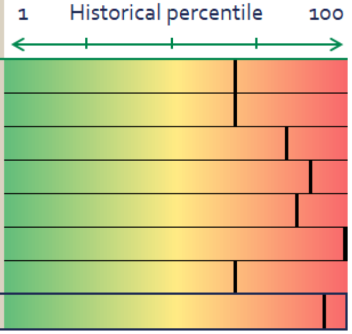
MSCI Emerging Markets Valuation

Metric	Dec. 2024	Per centile
Price / forward earnings	12.1	49
Price / trailing earnings	15.4	66
Price-to-Book	1.8	66
Price-to-cash flow	10.4	87
EV / EBITDA (Ex-financials)	9.4	84
Price / trailing sales	1.1	73
Cyclically adjusted P/E (CAPE)	13.9	40
Aggregate percentile		**74**



MSCI Canada Valuation

Metric	Dec. 2024	Per centile
Price / forward earnings	15.4	68
Price / trailing earnings	19.6	68
Price-to-Book	2.2	83
Price-to-cash flow	11.6	90
EV / EBITDA (Ex-financials)	10.0	86
Price / trailing sales	2.3	100
Cyclically adjusted P/E (CAPE)	22.1	68
Aggregate percentile		**94**



*Since 2024

Sources: DGAM, LSEG, MSCI, IBES, Bloomberg, December 31, 2024

†Average percentiles for the seven valuation indicators

The 2000 narrative on outdated valuation metrics resurfaces

What do you do when valuation metrics are lofty, but stock prices just keep rising?

Those who were working in the financial industry back in 2000 will recall that many analysts questioned the traditional valuation metrics. They argued that such metrics were no longer adapted to the so-called new growth model. In his book *Irrational Exuberance,* published in March 2000, Robert J. Shiller debunked such arguments. Twenty-five years later, we are again hearing and reading that the valuation ratios used for decades have (again) become obsolete.

A frequent argument is that we cannot compare the valuations of 2000 with those of 2025, because, unlike today, those companies had little or no profits. In other words, "This time it's different." Oh, really?

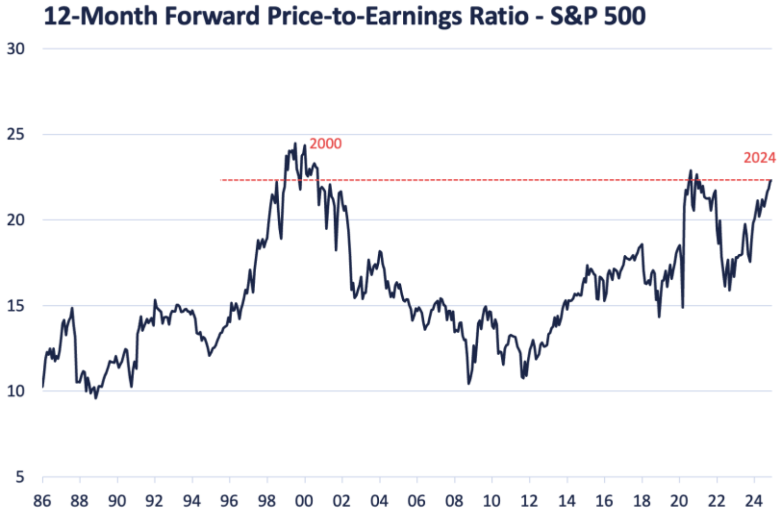
Let's take the case of Cisco, a mega-cap stock that was very profitable in 2000 but was trading at 135 times earnings, which analysts hoped would grow by 30%. According to the rule that previously applied, the price-to-earnings ratio should not exceed forecast earnings growth, namely a price/earnings-to-growth ratio (PEG) ratio of 1. But Cisco's PEG was 4.5 in March 2000 (135/30). How can such a ratio be justified for a mature company? Analysts then switched to the price-to-sales ratio, which they said was more suited to the new growth model. And the rest is history.

As at December 31, many profitable companies in the S&P 500 (including Cisco!) had extremely high PEG ratios, many of them above 5. Is this the new standard?

Time will tell whether that is the case, but one thing is clear: this is not the first technological revolution that has inspired overenthusiastic investors to push valuation metrics up into the stratosphere.

Non-Financial Market Capitalization / Non-Financial Corporate Gross Value-Added

Sources: Financial Times, US Federal Reserve, Hussman Strategic Advisors, Standard & Poors, December 12, 2024



Sources: DGAM, IBES, December 2024

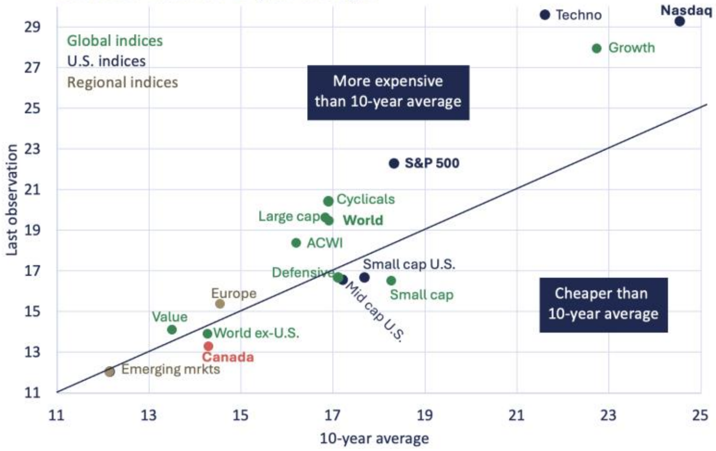
Appealing market segments and the case for mid caps

Valuation has never been a useful tool for forecasting short-term returns. The recent performance of the Magnificent 7, despite their extreme costliness, is a fine example. But investors looking for a long-term absolute return that is not relative to an extremely expensive and concentrated index like the S&P 500 today can still find reasonably valued investment opportunities, even in today’s market.

Mid-cap stocks fall into this category. As in 2000, they are reasonably valued in absolute terms, and very attractive relative to large caps (S&P 500). When the speculative bubble burst in 2000, they proved to be very resilient and outperformed for a dozen years. On the basis of valuation, we think today’s entry point is attractive, especially because this market segment also outperforms over the long term.

Price-to-Forward Earnings

Last observation vs. 10-year averages



Sources: DGAM, IBES, MSCI, December 2024

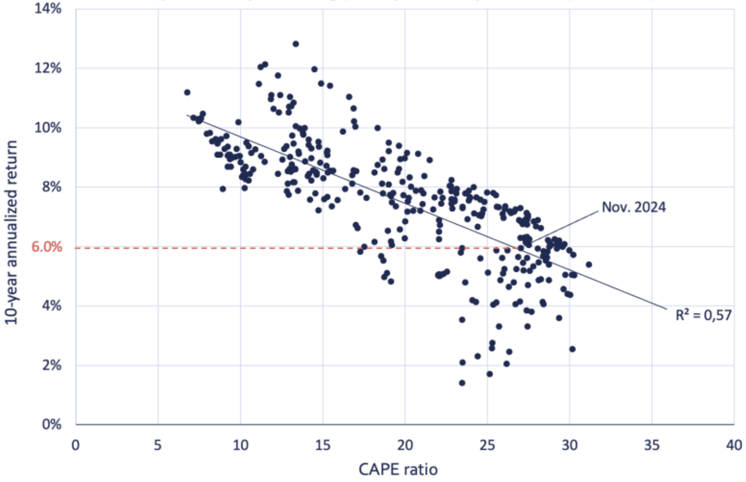
U.S. Mid Cap vs. Large Cap Equities, 2000 to 2015

March 2000 = 100

Sources: DGAM, IBES, December 2024

Equity Valuation & Subsequent Return - S&P 400

CAPE ratio (price-to-10-year earnings) & 10-year subsequent return (1973-2024)



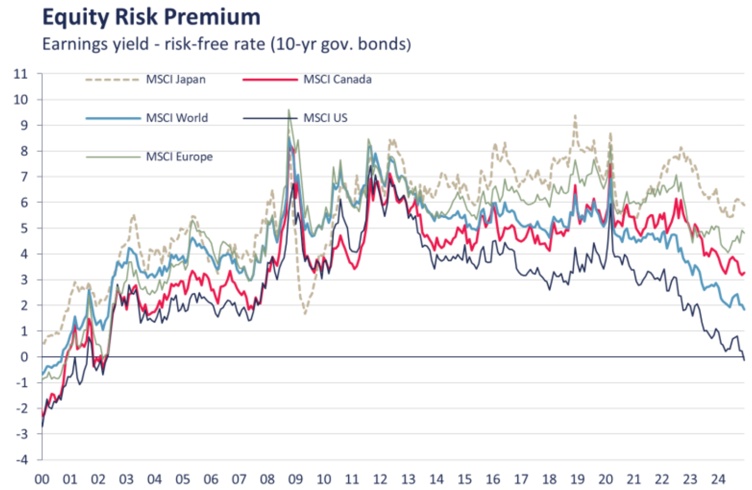
Sources: DGAM, LSEG, December 2024

A negative risk premium for U.S. equities

In the fourth quarter, the rebound in risk-free rates and the strength of the stock markets dissolved the equity risk premiums in North America. The risk premium for U.S. equities even moved into negative territory for the first time in 23 years. It goes without saying that investors receive very little compensation for the risk of investing in the S&P 500.

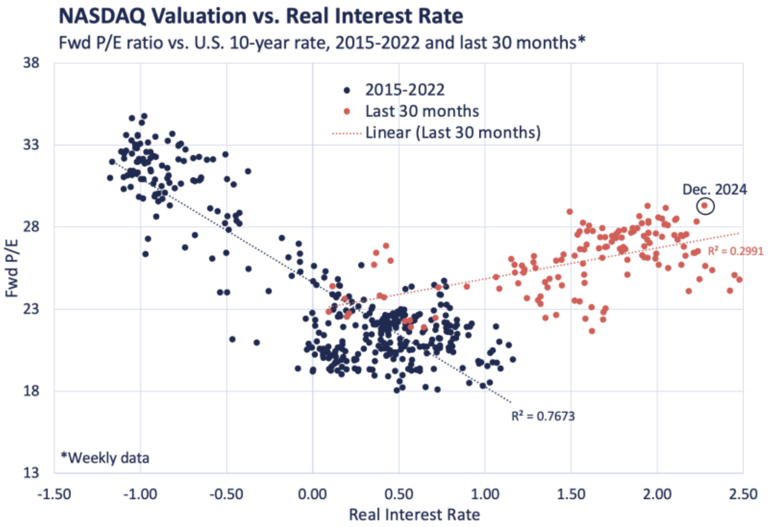
In contrast, the risk premium for European equities rose during the quarter, while Japan's, the highest of the group, remained more or less stable.

The start of a widespread decline in rates, which some investors and analysts said justified the high valuation of growth stocks, was cut short at the end of the year. President-elect Donald Trump's proposed tariffs, recent changes in inflation and the economy's resilience pushed interest rates back up.


Equity Risk Premium

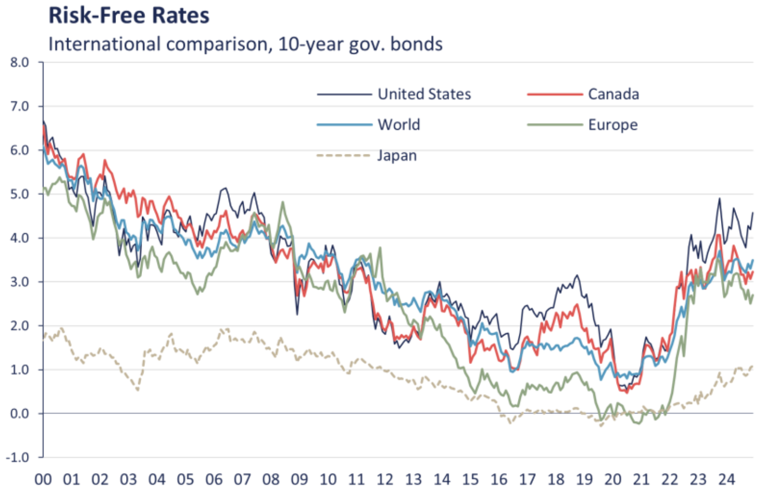
Earnings yield - risk-free rate (10-yr gov. bonds)

Sources: DGAM, MSCI, LSEG, as of December 31, 2024


NASDAQ Valuation vs. Real Interest Rate

Fwd P/E ratio vs. U.S. 10-year rate, 2015-2022 and last 30 months*

Sources: DGAM, IBES, LSEG, as of December 31, 2024


Risk-Free Rates

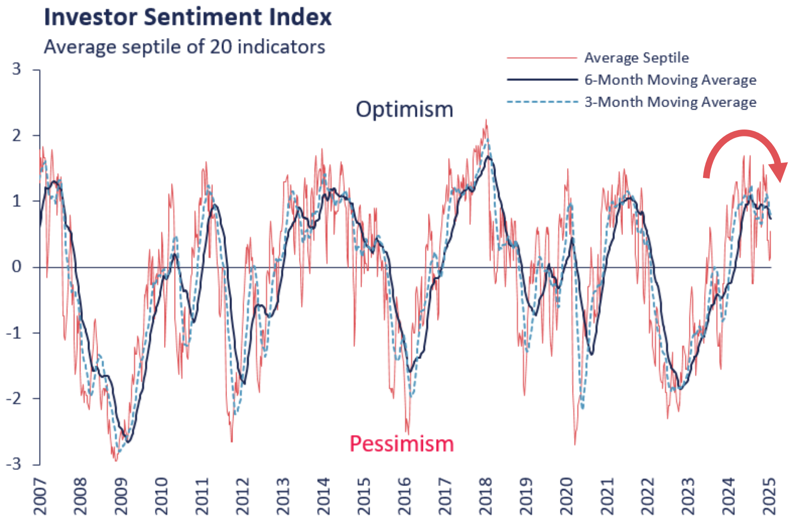
International comparison, 10-year gov. bonds

Sources: DGAM, LSEG, December 2024

Our sentiment index rises at the end of the year

The somewhat more cautious tone we perceived in the third quarter from our aggregate sentiment index later disappeared. The vast majority of the indicators that make up the index were in the euphoria zone at the end of 2024. Surveys of U.S. retail investors and financial advisors showed levels of conviction rarely seen, resulting in extremely high exposure to risk assets. Only institutional investors seemed a little less reckless.

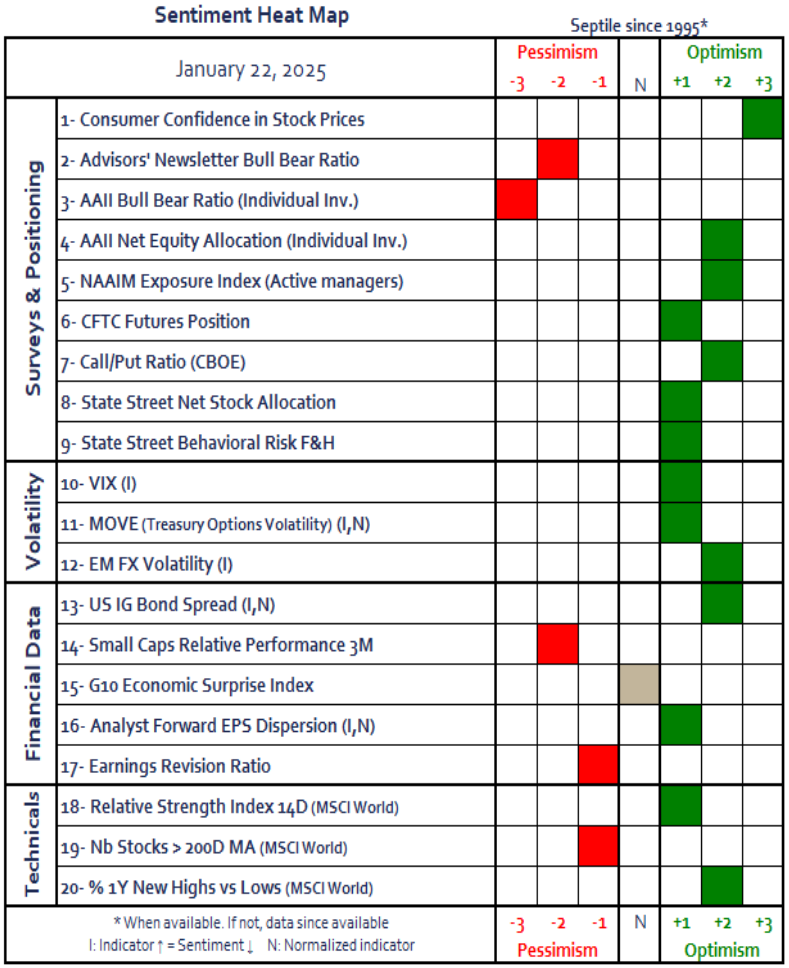
It should be noted that the direction of our investor sentiment index is as significant as its level in our analysis. A high but rising level remains generally favourable to risk assets. That said, our index is a quantitative decision-aid tool and not a systematic signal that determines a portfolio’s beta. A number of indicators are encouraging us to be cautious.



Investor Sentiment Index

Average septile of 20 indicators

Sources: DGAM, LSEG, Bloomberg, State Street Global Markets, December 2024



Sentiment Heat Map

Septile since 1995*

	January 22, 2025	Pessimism			N	Optimism		
		-3	-2	-1		+1	+2	+3
Surveys & Positioning	1- Consumer Confidence in Stock Prices							🟩
	2- Advisors' Newsletter Bull Bear Ratio		🟥					
	3- AAII Bull Bear Ratio (Individual Inv.)	🟥						
	4- AAII Net Equity Allocation (Individual Inv.)						🟩	
	5- NAAIM Exposure Index (Active managers)						🟩	
	6- CFTC Futures Position					🟩		
	7- Call/Put Ratio (CBOE)						🟩	
	8- State Street Net Stock Allocation					🟩		
	9- State Street Behavioral Risk F&H					🟩		
Volatility	10- VIX (I)					🟩		
	11- MOVE (Treasury Options Volatility) (I,N)					🟩		
	12- EM FX Volatility (I)						🟩	
Financial Data	13- US IG Bond Spread (I,N)						🟩	
	14- Small Caps Relative Performance 3M		🟥					
	15- G10 Economic Surprise Index				▨			
	16- Analyst Forward EPS Dispersion (I,N)					🟩		
	17- Earnings Revision Ratio			🟥				
Technicals	18- Relative Strength Index 14D (MSCI World)					🟩		
	19- Nb Stocks > 200D MA (MSCI World)			🟥				
	20- % 1Y New Highs vs Lows (MSCI World)						🟩	
	* When available. If not, data since available I: Indicator ↑ = Sentiment ↓ N: Normalized indicator	-3	-2	-1	N	+1	+2	+3
		Pessimism				Optimism		

Sources: DGAM, LSEG, Bloomberg, State Street Global Markets, December 2024

A feeling of invincibility rarely seen among retail investors (and their advisors)

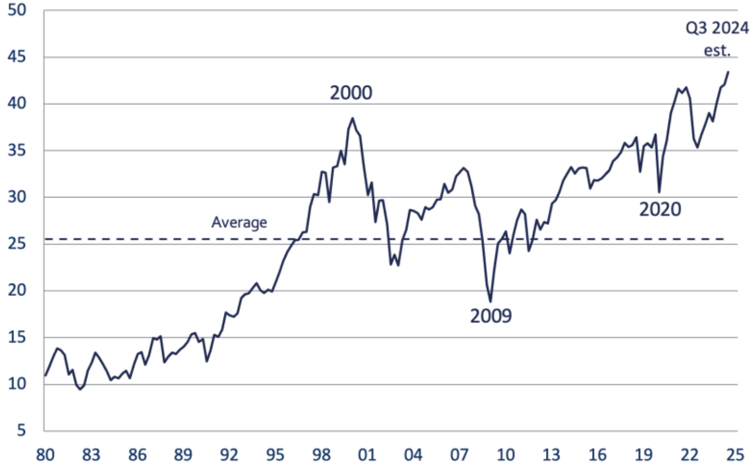
Never before have U.S. households been so exposed to equities. Even at the height of the speculative bubble that cast a spell over the general public in 1999-2000, their appetite for the stock market was lower than at the end of 2024. Despite extreme valuations in the United States, financial advisors continued to encourage their clients in the fourth quarter, such that the trading volume increased sharply.

Meanwhile, among insiders, the seller-to-buyer ratio was at a dangerously high level of six to one. As for professional managers, they remained heavily invested in equities, even after a year of exceptional returns.

This picture raises questions about what comes next. Are there still marginal buyers of equities? And how would retail investors (consumers) react to an extended correction, given that some of them are also exposed to cryptocurrencies? In our view, record exposure to equities and to highly speculative assets is a potentially explosive mix.

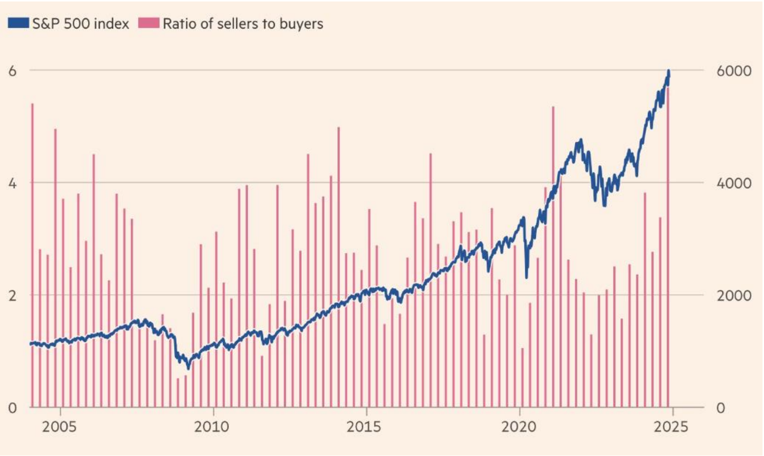
Household Holdings of Equities, United States

As a % of financial assets



Sources: DGAM, Federal Reserve, December 2024

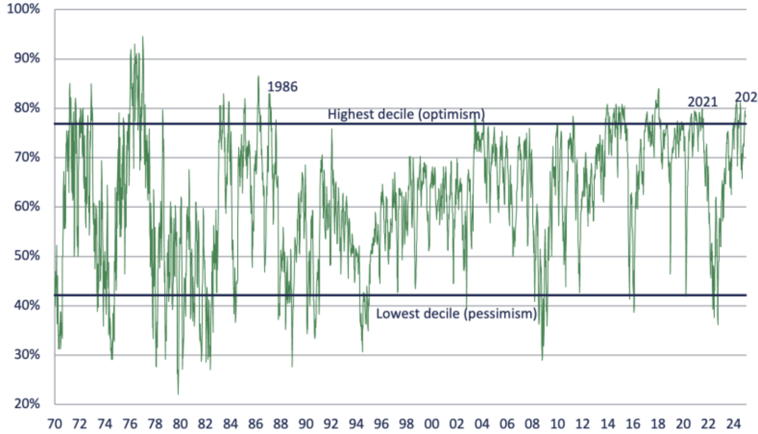
Corporate Executive Stock Sales Reach All-Time High



Sources: VerifyData, LSEG via markets.ft.com, Financial Times, November 2024

Advisors Sentiment Survey - Bull/Bear

bull /(bull+bear)



Sources: DGAM, Investors Intelligence, December 2024

Portfolio managers also give in to the siren song

Retail investors have given in to the siren song and the lure of quick gains just as they did 25 years ago. But the appetite for risky and extremely expensive assets is also very evident among professionals. Yet, they are much better equipped to assess performance prospects and identify excesses than individuals are.

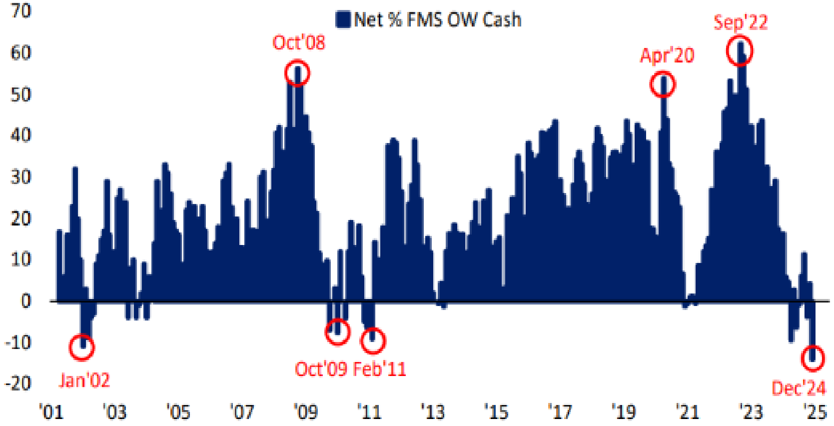
Risk-free interest rates have not risen enough to convince professionals to increase their cash balances. On the contrary, according to Bank of America's survey of fund managers, cash was at an all-time low in December 2024.

There are exceptions, however. Warren Buffett took advantage of the euphoria in the markets to take profits and increase his cash to a record high in the fall of 2024. Time will tell who is right: the Oracle of Omaha or managers who knowingly expose themselves to risky assets whose prices are already discounting exceptional growth scenarios.

Asset Allocation
Institutional investors, normalized measures

Source: State Street Global Markets, December 2024

FMS Cash Allocation
% saying overweight - % saying underweight



Source: BofA Global Fund Manager Survey, December 2024

Berkshire Hathaway Cash Allocation
Cash and cash equivalents as % of assets

Sources: Glenview Trust, Bloomberg, November 2024

CONCLUSION

GLOBAL OUTLOOK	Macroeconomic environment ⬆	Valuation ➡	Sentiment ➡
June 30, 2024	- -	- - -	-
September 30, 2024	-	- - -	- -
December 31, 2024	**Neutral**	- - -	- -

MACROECONOMIC ENVIRONMENT: GROWTH IS NO LONGER A MAJOR CONCERN BUT ONLY IN THE SHORT TERM

The United States will continue to borrow against future growth to support its economy in 2025, with a projected deficit of 7% of GDP, despite full employment. The Trump administration definitely won't want to take the blame for a slowdown. This "resilient" growth implies more persistent inflation and much higher interest rates than are currently expected. In the medium term, Trump's promised deregulation could support investment, but the lack of visibility on economic policies will create a headwind. Unpredictability is not conducive to investment. Elsewhere in the world, expectations are low, and U.S. threats of high tariffs, even on traditional allies, are darkening the outlook. The tense or polarized political climate in a number of countries, a phenomenon often seen after episodes of high inflation, does not help. In Europe, there are some encouraging signs that credit is picking up, and China's stimulus measures will help exporters. We have raised our macroeconomic vector to neutral but only for the first half of 2025. Visibility after that point is much too limited.

MARKET VALUATION: S&P 500 AT ITS MOST EXPENSIVE SINCE THE TECH BUBBLE

Global equities were very expensive at the end of the fourth quarter, with the MSCI World's valuation reaching the 94th percentile of its historical distribution, the most expensive level since 2001, excluding the distortions caused by the pandemic in 2021. Meanwhile, the S&P 500's valuation touched the 100th percentile. Despite these extreme and speculative conditions, a few market segments were still attractively valued or in line with the economic situation or historical norms, especially mid caps, some cyclical sectors of the "traditional economy" and some defensive sectors. In contrast, information technology and industrials, which are riding the AI wave, were extremely expensive. Lastly, there were few bargains across regions, but all were cheap relative to the United States. In this context, we have maintained a triple-negative rating on valuation.

INVESTOR SENTIMENT: RECORD EQUITY EXPOSURE

The somewhat more cautious tone we saw in the third quarter according to our aggregate sentiment index completely disappeared at the end of the year. Investors' sense of invincibility is noticeable in all our metrics. Retail investors, financial advisors, and professional and institutional managers all have extremely high exposure to equities, so there are very few marginal buyers left. The euphoria surrounding artificial intelligence has led to unprecedented market concentration that exposes even passive investors to specific risks related to a handful of overvalued and overbought securities. At year-end, our aggregate index was in overheated territory but still rising and therefore favourable for risk assets. For that reason alone, we have not lowered our sentiment rating and are keeping it at double-negative.

Our analysis of the three vectors encourages us to maintain a defensive bias. Our valuation and sentiment vectors reflect a level of euphoria rarely seen in the equity markets. Their levels are reminiscent of those seen just before the 2022 stock market correction. We are also concerned about the lack of macroeconomic visibility since Donald Trump's re-election.

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