Monthly Equity Monitor

Economics and Strategy

March 2024

Highlights

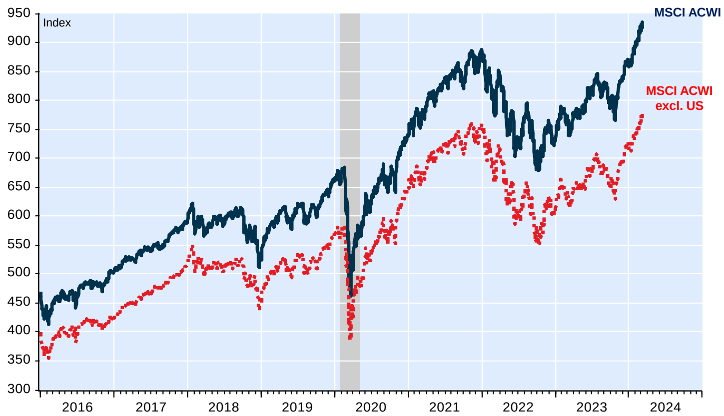
By Stéfane Marion / Matthieu Arseneau / Alexandra Ducharme

- Global equities have continued to rally over the past month with the MSCI ACWI hitting a new record high. This comes against a backdrop of uninspiring economic growth and widespread downward earnings revisions outside the U.S. and Japan. We remain skeptical that expectations of rate cuts alone can continue to justify an equity market rally based solely on P/E expansion, given that two G-7 countries are in technical recessions and four others are flirting with stagnation.
- The S&P 500 continues to defy gravity, except when it comes to real estate and consumer discretionary. Investors remain confident that a rate cut is imminent but inflation data has been anything but Fed friendly in recent weeks. The consensus that the U.S. economy will achieve a perfect soft landing with an imminent acceleration in earnings growth may soon be tested again.
- March has been a good month for the S&P/TSX so far, with the Canadian benchmark up 2.3% by mid-month, more than half of its year-to-date advance. Strong gains in energy and materials reflect rising commodity prices against a backdrop of more resilient global inflation and geopolitical uncertainty. Momentum in the other sectors of the S&P/TSX has been muted as the Canadian economy has shown clear signs of weakness against a backdrop of declining productivity. A friendlier business environment is urgently needed in Canada for output per worker to resume. In our opinion, the upcoming federal budget on April 16 will be important for the future direction of the economy and Canadian equities.
- Despite another month of positive returns in global equity markets, we continue to believe that economic growth and corporate profitability will surprise to the downside in the coming months. We maintain our defensive asset allocation, with equities underweight and fixed income and cash overweight.

World: Downward earnings revisions

Global equities have continued to rally over the past month with the MSCI ACWI hitting a new record high – chart.

World: Another month, another record
MSCI ACWI: Total and excluding the U.S.



NBF Economics and Strategy (data via Refinitiv)

This comes against a backdrop of uninspiring economic growth and widespread downward earnings revisions outside the U.S. and Japan – table.

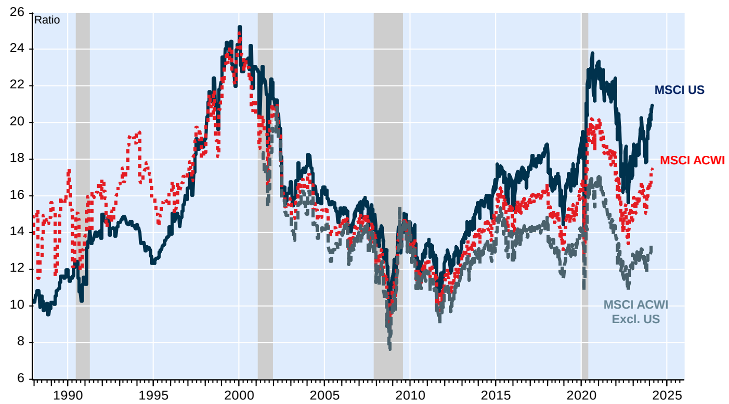
World: Downward earnings revisions in most regions
Change in 12-month forward earnings for the main regions that compose the MSCI ACWI

	3-month change		1-month change		1-month diffusion (% up)	
	3-month change	10 year historical average	1-month change	10 year historical average	1 month diffusion	10 year historical average
MSCI ACWI	-1.0	-0.4	-0.1	-0.4	43%	45%
MSCI World	-0.9	-0.4	0.0	-0.4	49%	47%
MSCI USA	-0.4	-0.3	0.2	-0.3	53%	48%
MSCI Canada	-3.7	-0.5	-1.4	-0.5	38%	45%
MSCI Europe	-3.0	-0.6	-0.7	-0.6	42%	45%
MSCI Pacific ex Jp	-1.1	-0.5	-0.3	-0.5	46%	41%
MSCI Japan	2.8	-0.1	1.4	-0.1	56%	50%
MSCI EM	-1.8	-0.5	-0.6	-0.5	36%	41%
MSCI EM EMEA	-0.4	-0.3	-0.6	-0.3	48%	46%
MSCI EM Latin America	-1.0	-0.5	-1.4	-0.5	46%	43%
MSCI EM Asia	-2.2	-0.6	-0.4	-0.6	34%	40%

3/15/2024
NBF Economics and Strategy (data via Refinitiv)

At the time of writing, the 12-month forward PE ratio for the global benchmark is approaching 18x, which is high by historical standards. While the U.S. remains the primary driver, the rest of the world has also seen PE expansion over the past month – chart.

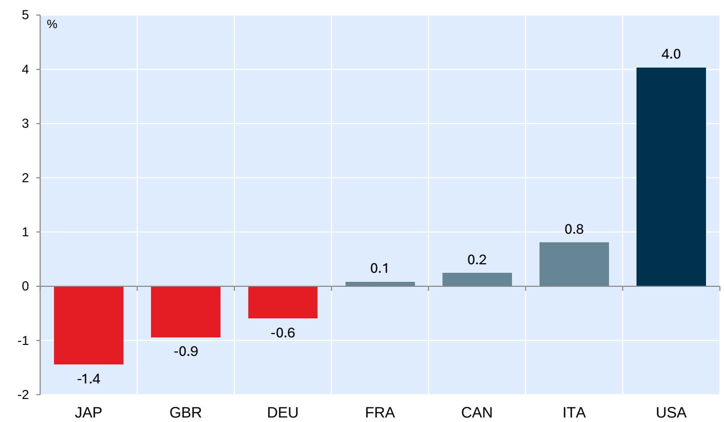
World: It's all about PE expansion
Forward PE ratio for the MSCI ACWI and MSCI US and MSCI ACWI ex U.S.



NBF Economics and Strategy (data via Refinitiv)

We remain skeptical that expectations of rate cuts alone can continue to justify an equity market rally based solely on P/E expansion, given that two G-7 countries are in technical recessions and four others are flirting with stagnation, according to our monthly Economic Monitor – chart.

World: The economy less resilient than advertised
Real gross domestic product in G-7 countries, annualized change between 2023Q2 and 2023Q4



NBF Economics and Strategy (data via Bloomberg)

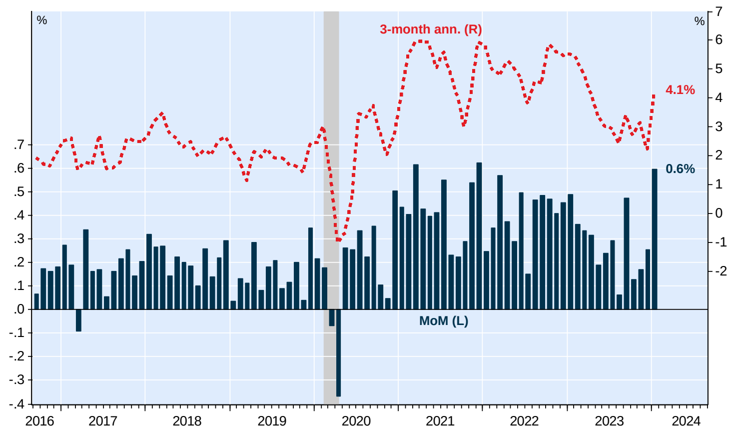
Such a development is consistent with further disappointments in corporate earnings in the coming months. Despite the recent wave of downward revisions, we still believe that expectations of 8.9% EPS growth for the MSCI ACWI in 2024, with widespread increases across all major regions, are too ambitious - table.

MSCI composite index: EPS Performance

	2023	2024	2025	2026	12 months forward
MSCI ACWI	0.2	8.9	12.7	11.0	10.1
MSCI World	1.1	7.7	12.2	10.7	9.0
MSCI USA	2.7	9.8	13.8	11.9	11.2
MSCI Canada	-8.4	2.6	13.7	11.5	5.7
MSCI Europe	-3.3	3.4	10.0	9.2	5.1
MSCI Pacific ex Jp	-4.3	5.1	4.0	4.3	4.5
MSCI Japan	4.5	13.2	8.2	9.0	7.9
MSCI EM	-5.0	17.3	15.7	12.7	17.0
MSCI EM EMEA	4.0	3.6	13.3	9.0	7.4
MSCI EM Latin America	-26.3	11.9	7.1	8.7	10.6
MSCI EM Asia	-1.7	21.2	17.5	14.0	20.1

3/15/2024
NBF Economics and Strategy (data via Refinitiv)

U.S.: Fed's preferred inflation gauge picked up sharply in January
Personal consumption expenditures (PCE) deflator, core services deflator excluding housing



NBF Economics and Strategy (data via Bloomberg)

S&P 500: Unfriendly inflation

Last month, when we commented on the dynamics of the U.S. equity market, we questioned whether the prevailing optimism was sustainable. One month later, the S&P 500 continues to defy gravity, except when it comes to real estate and consumer discretionary – table.

S&P 500 composite index: Price Performance

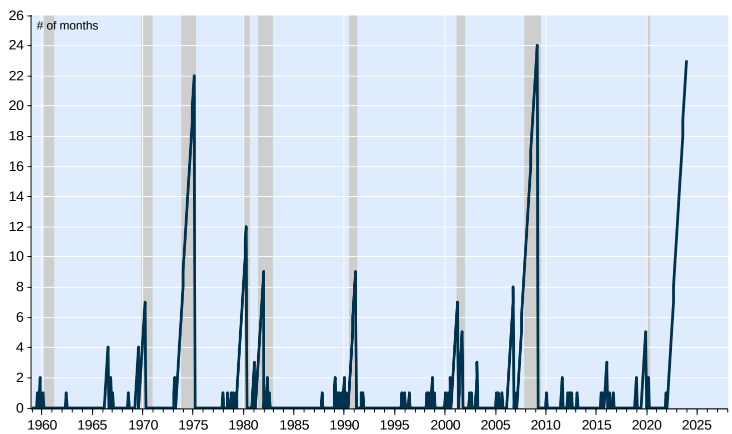
	Month to date	Quarter to date	Year to date
S&P 500	0.4	7.3	7.3
ENERGY	6.2	8.3	8.3
MATERIALS	3.5	5.7	5.7
UTILITIES	1.9	-0.7	-0.7
CONS. STAP.	1.3	4.9	4.9
FINANCIALS	1.0	8.1	8.1
INDUSTRIALS	0.8	6.8	6.8
TELECOM	0.3	11.1	11.1
IT	0.3	10.7	10.7
HEALTH CARE	0.2	6.3	6.3
REAL ESTATE	-1.1	-3.6	-3.6
CONS. DISC.	-3.4	1.2	1.2

3/15/2024
NBF Economics and Strategy (data via Refinitiv)

Investors remain confident that a rate cut is imminent, bolstered by Federal Reserve Chairman Jerome Powell's comments to the Senate Banking Committee on March 7 that the FOMC is "not far" from having sufficient data to be "confident that inflation is moving sustainably at 2%". Maybe Mr. Powell got ahead of himself. As argued in our latest fixed income monitor, inflation data has been anything but Fed friendly in recent weeks. The CPI, PPI and core PCE deflator have indeed all surprised on the upside. In fact, in January, the PCE deflator for services excluding housing even posted its largest monthly increase since 2021, with the 3-month inflation rate back up to 4.1% on an annualized basis – chart.

The resilience of inflation is such that our fixed income strategists wouldn't be surprised to see the voting members of the FOMC remove one of the three rate cuts they signaled in December for 2024 at their upcoming rate-setting meeting on March 20. Such a decision could unsettle investors. Indeed, delaying monetary easing because of inflation could undermine earnings growth expectations at a time when leading economic indicators have pointed to weaker growth for 23 consecutive months – chart.

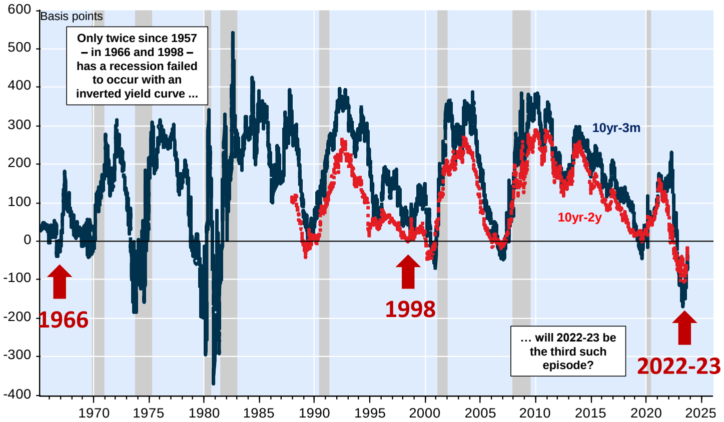
U.S.: Leading indicators index fell for 23rd month in a row in January
Consecutive monthly declines of Conference Board Leading Economic Indicators Index



NBF Economics and Strategy (data via Bloomberg)

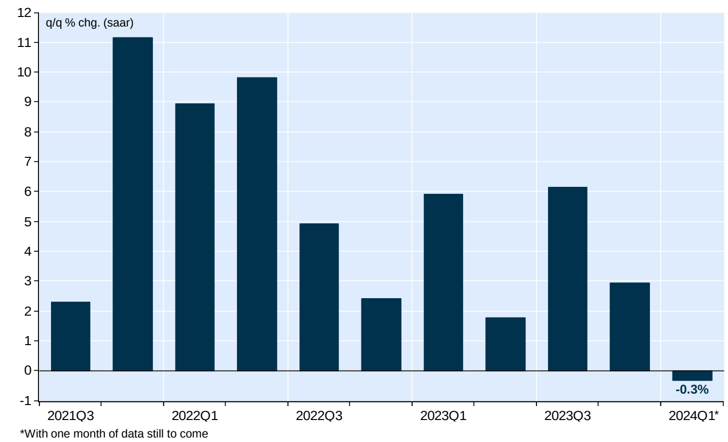
The consensus that the U.S. economy will achieve a perfect soft landing with an imminent acceleration in earnings growth could be tested again in the coming weeks. Recall that only twice since 1966 has the yield curve inverted without being followed by a recession: 1966 and 1998. In both cases, however, the amplitude of the inversion was much smaller than that observed since November 2022 - chart.

U.S.: Yield curve and business cycles
10-year Treasury yield minus 3-month T-bill and 2-year Treasury yields



NBF Economics and Strategy (data via Refinitiv)

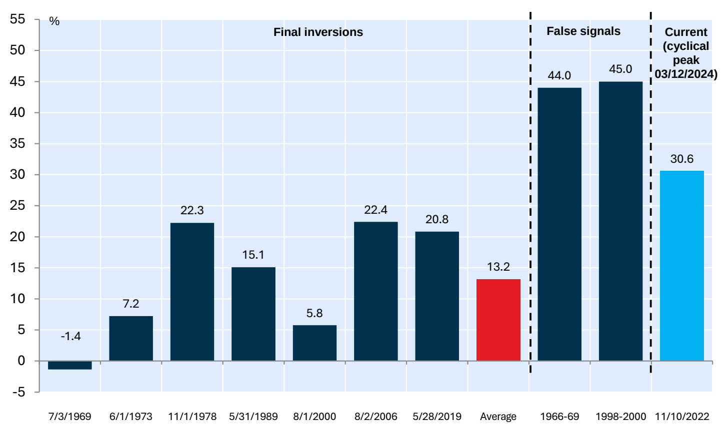
U.S.: Core sales hint at sharp slowdown in goods consumption in Q1
Retail sales excluding food services, auto dealers, building materials, and gasoline stations



*With one month of data still to come
NBF Economics and Strategy (data via Refinitiv)

Interestingly, the S&P 500 has already gained 30.6% since the start of the YC inversion, a return that was only surpassed in the previous soft landings – chart.

S&P 500: Historic performance after a curve inversion
Cumulative returns of the S&P 500 index up to its cyclical peak after a yield curve inversion



NBF Economy and Strategy (data via Bloomberg)

In our view, even the world's largest economy is not immune to restrictive monetary policy. Weak full-time job creation in recent months has led to weak retail sales, which are on track to decline in Q1 – chart.

However, the consensus continues to expect double-digit EPS growth for the S&P 500 over the next twelve months (table). In our view, EPS is more likely to fall than rise over this period.

S&P 500: Profits are expected to be strong in the next year
Consensus EPS expectations for the S&P 500

	Earnings per share					EPS % growth		
	2023	2024	2025	12m Trail.	12m Forw.	2024	2025	12m Forw.
S&P 500	217	239	271	224	249	10	14	11
ENERGY	58	54	60	57	55	-8	11	-3
MATERIALS	27	26	31	27	28	-2	16	3
INDUSTRIALS	44	48	55	45	50	9	14	11
CONS. DISC.	51	57	66	53	59	11	15	12
CONS. STAP.	38	39	43	38	40	4	9	6
HEALTH CARE	76	88	99	79	91	15	13	14
FINANCIALS	40	43	48	41	44	6	11	7
IT	108	126	149	115	136	17	18	18
TELECOM	12	14	16	13	15	17	13	16
UTILITIES	18	20	22	19	21	12	8	11
REAL ESTATE	7	6	7	7	7	-2	9	1

3/15/2024 N.M.=Not meaningful

NBF Economics and Strategy (data via Refinitiv)

S&P TSX: Rebounding

March has been a good month for the S&P/TSX so far, with the Canadian benchmark up 2.3% by mid-month, more than half of its year-to-date gains. The materials and energy sector fared exceptionally well, with respective gains of 10.7% and 3.2% so far this month – table.

S&P/TSX composite index: Price Performance

	Month to date	Quarter to date	Year to date
S&P TSX	2.3	4.2	4.2
MATERIALS	10.7	1.4	1.4
ENERGY	3.2	8.3	8.3
INDUSTRIALS	2.1	10.1	10.1
BANKS	2.0	-0.2	-0.2
FINANCIALS	1.5	2.6	2.6
UTILITIES	1.3	-3.2	-3.2
REAL ESTATE	0.7	-0.5	-0.5
IT	0.6	5.7	5.7
CONS. STAP.	0.0	7.2	7.2
CONS. DISC.	-0.6	2.6	2.6
HEALTH CARE	-1.2	2.7	2.7
TELECOM	-5.7	-7.6	-7.6

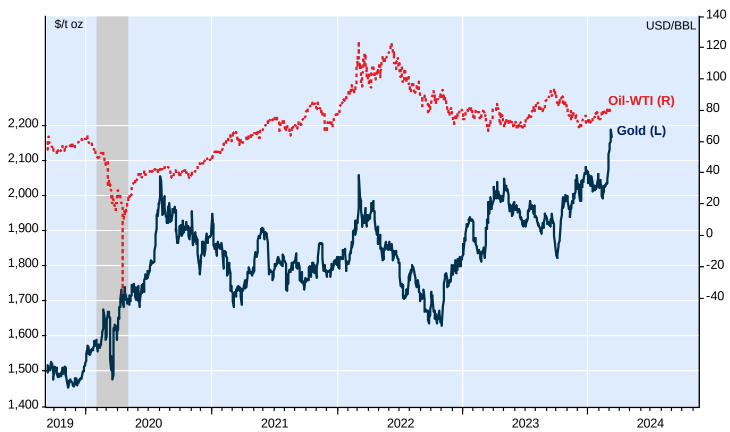
3/15/2024

NBF Economics and Strategy (data via Refinitiv)

Strong gains in energy and materials reflect rising commodity prices against a backdrop of more resilient global inflation and geopolitical uncertainty. Indeed, the price of oil and gold have been boosted, with gold reaching levels not seen since the pandemic and the start of Russia's invasion of Ukraine - chart.

Commodities supported by the resilience of U.S. inflation

Price of Gold Bullion and of oil-WTI

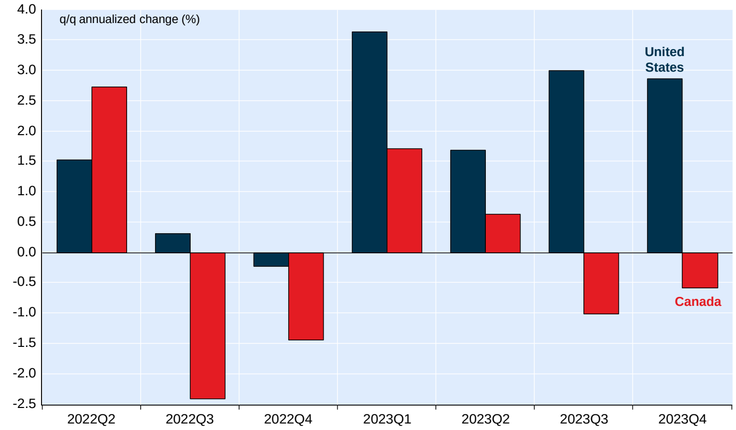


NBF Economics and Strategy (data via Refinitiv)

Momentum in the other sectors of the S&P/TSX has been muted as the Canadian economy has shown clear signs of weakness. While we've described the surprising resilience of the U.S. economy, Canada's GDP has been disappointing, with private domestic demand falling for two consecutive quarters – chart.

Canada: Private domestic demand has contracted for 2 quarters now

Quarterly annualized change in private domestic demand, Canada and United States

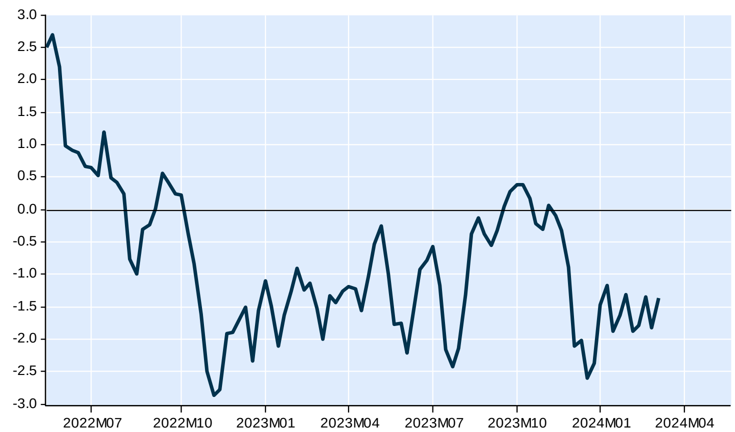


NBF Economics and Strategy (data via Refinitiv and Statistics Canada)

This weakness in domestic demand is undermining earnings growth expectations, as one-month revisions to 12-month forward earnings continue to be revised lower - chart.

S&P/TSX: Earnings revisions remain negative

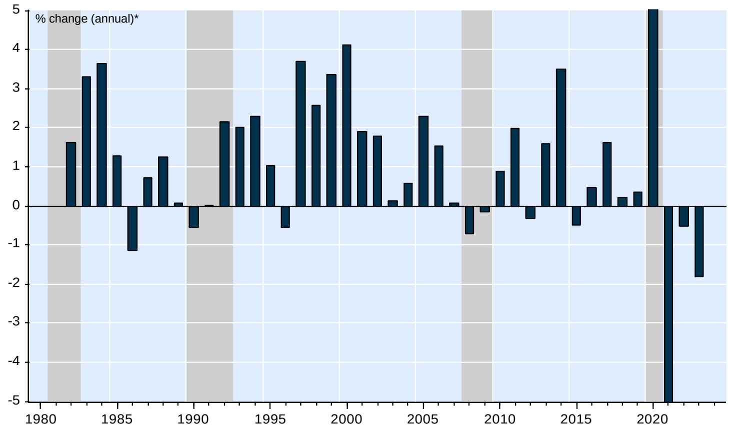
One-month change in 12-month forward earnings



NBF Economics and Strategy (data via Refinitiv)

But it's not just tight monetary policy that's undermining earnings expectations. Productivity, or the lack of it, is also a major drag on valuations. According to Statistics Canada 2023 will go down in the record books as the third consecutive annual decline in output per worker, the worst sequence in at least 41 years – chart.

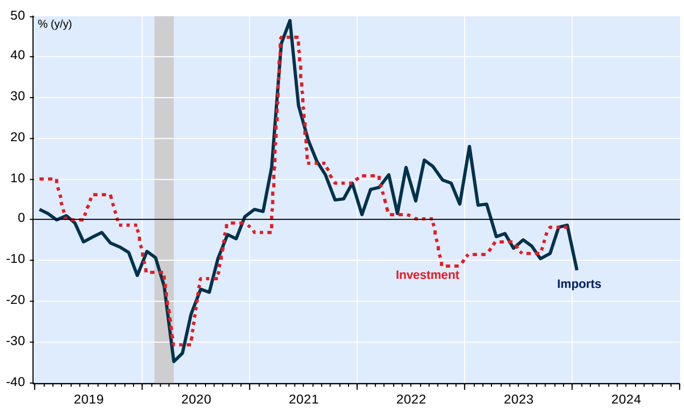
Canada: Down for three consecutive years
Labour productivity in Canada's business sector



* truncated scale because of COVID recession
NBF Economics and Strategy (data via Statistics Canada)

So how do we stop this erosion? Canada has one of the most educated workforces in the world, but what we make up in human talent is more than offset by a lack of private investment in our country. On this front, recent trends remain a cause for concern. For example, business investment in machinery and equipment has been declining since mid2022. Unfortunately, the just-released January trade data does not suggest a rebound in early 2024, as the volume of investment goods imports fell 12% from a year ago, the worst performance since the COVID recession – chart.

Canada: Business investment continues to fall
Volume imports of machinery & equipment vs. business investment in machinery & equipment



NBF Economics and Strategy (data via Statistics Canada)

A friendlier business environment is urgently needed in Canada for productivity growth to resume. In particular, large institutional investors need to be offered attractive long-term domestic investment opportunities across asset classes. In our opinion, the upcoming federal budget on April 16 will be important for the future direction of the economy and Canadian equities.

Asset allocation

Despite another month of positive returns in global equity markets, we continue to believe that economic growth and corporate profitability will surprise to the downside in the coming months. As Nobel Laureate Milton Friedman once said: "monetary actions affect economic conditions only after a lag that is both long and variable". The longer central banks are forced to wait to cut rates, the more likely it is to trigger a deleveraging episode, which has characterized every business cycle since the 1960s when monetary policy is brought to restrictive levels. We maintain our defensive asset allocation, with equities underweight and fixed income and cash overweight (table).

NBF Asset Allocation	Benchmark (%)	NBF Recommendation (%)	Change (pp)
Equities			
Canadian Equities	20	18	
U.S. Equities	20	16	
Foreign Equities (EAFE)	5	3	
Emerging markets	5	3	
Fixed Income	45	51	
Cash	5	9	
Total	100	100	

NBF Economics and Strategy

Sector rotation

Our sector rotation remains unchanged this month, with a preference for more defensive sectors (Consumer Staples, Communications Services and Utilities).

NBF Market Forecast
Canada

Index Level		*Actual* **Mar-15-24**	*Q4 2024* **Target**
S&P/TSX		21,849	18,500
Assumptions			Q4 2024
Level:	Earnings *	1399	1300
	Dividend	693	644
PE Trailing (implied)		15.6	14.2

** Before extraordinary items, source Thomson*
NBF Economics and Strategy (data via Refinitiv)

NBF Market Forecast
United States

Index Level		*Actual* **Mar-15-24**	*Q4 2024* **Target**
S&P 500		5,117	4,200
Assumptions			Q4 2024
Level:	Earnings *	224	195
	Dividend	71	62
PE Trailing (implied)		22.9	21.5

** S&P operating earnings, bottom up.*

NBF Fundamental Sector Rotation - March 2024

Name (Sector/Industry)	Recommendation	S&P/TSX weight
Energy	**Market Weight**	**17.7%**
Energy Equipment & Services	Market Weight	0.2%
Oil, Gas & Consumable Fuels	Market Weight	17.5%
Materials	**Market Weight**	**10.8%**
Chemicals	Underweight	1.3%
Containers & Packaging	Market Weight	0.4%
Metals & Mining *	Market Weight	8.7%
Gold	Overweight	5.9%
Paper & Forest Products	Market Weight	0.4%
Industrials	**Underweight**	**14.5%**
Capital Goods	Market Weight	2.9%
Commercial & Professional Services	Underweight	3.7%
Transportation	Underweight	7.8%
Consumer Discretionary	**Underweight**	**3.6%**
Automobiles & Components	Underweight	0.7%
Consumer Durables & Apparel	Underweight	0.4%
Consumer Services	Underweight	1.1%
Retailing	Market Weight	1.3%
Consumer Staples	**Overweight**	**4.3%**
Food & Staples Retailing	Overweight	3.8%
Food, Beverage & Tobacco	Overweight	0.5%
Health Care	**Market Weight**	**0.3%**
Health Care Equipment & Services	Market Weight	0.1%
Pharmaceuticals, Biotechnology & Life Sciences	Market Weight	0.2%
Financials	**Market Weight**	**30.8%**
Banks	Market Weight	19.7%
Diversified Financials	Market Weight	4.0%
Insurance	Market Weight	7.2%
Information Technology	**Market Weight**	**8.8%**
Telecommunication Services	**Overweight**	**3.3%**
Utilities	**Overweight**	**3.7%**
Real Estate	**Underweight**	**2.3%**

** Metals & Mining excluding the Gold Sub-Industry for the recommendation.*

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA")which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.