



February 2024

## Highlights

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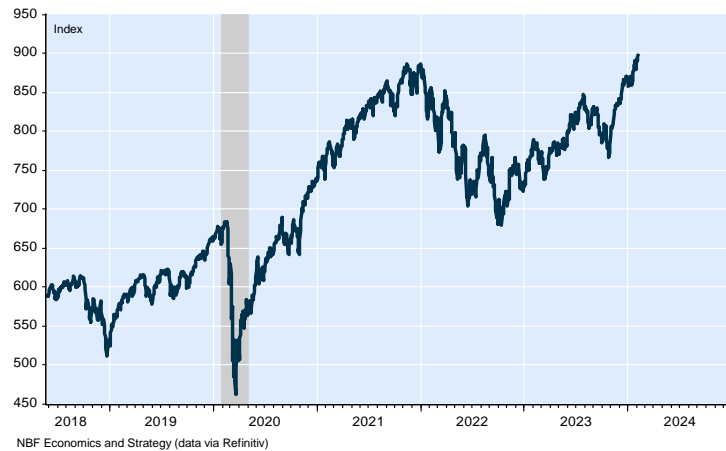
- After ending 2023 on a very strong note, global equities continue to rally into the new year, with the MSCI ACWI hitting a new record high on February 9. However, the 2024 surge is not widespread. While Japan and the U.S. continue to drive the MSCI ACWI to new highs, Europe and Canada show very little growth, and emerging markets show a negative return.
- The outperformance of the U.S. benchmark versus its global peers is driven by optimism in the markets that the Fed is on track to achieve its inflation target without causing undue damage to the economy. According to the consensus forecast based on company guidance, the worst of the earnings decline is already behind us. We continue to think that this view is aggressive, as non-U.S. GDP growth expectations for 2024 continue to be revised lower, which can't be good news for the U.S. multinationals that make up the S&P 500. On the domestic front too, there are reasons to be skeptical on the 2024 earnings outlook. Indeed, concerns about the falling value of commercial real estate have resurfaced after a U.S. regional bank was recently forced to write-down the value of certain assets.
- All things considered, we continue to believe that the rally in global equities ignited last November on the hope of rate cuts in early 2024 is overdone. We still think that economic growth and corporate profitability will surprise to the downside in the coming months. Monetary policy transmission lags may be slightly longer than historical averages, but they have not disappeared. The longer the Fed waits 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.

## World: The surge endures

After ending 2023 on a very strong note, global equities continue to rally into the new year, with the MSCI ACWI hitting a new record high on February 9 (chart).

### World: Equities reach a new record high

MSCI all countries world price index



However, the 2024 surge is not widespread. While Japan (+9.0%) and the U.S. (+5.3%) continue to drive the MSCI ACWI to new highs, Europe (+1.3%) and Canada (+0.5%) show very little growth, and emerging markets show a negative return (-1.4%) – table.

### MSCI ACWI: The U.S. and Japan are leading the charge

Price performance for MSCI indices (local currencies)

|                       | Month to date | Quarter to date | Year to date |
|-----------------------|---------------|-----------------|--------------|
| MSCI ACWI             | 2.7           | 3.9             | 3.9          |
| MSCI World            | 2.7           | 4.5             | 4.5          |
| MSCI USA              | 3.8           | 5.3             | 5.3          |
| MSCI Canada           | 0.2           | 0.5             | 0.5          |
| MSCI Europe           | 0.0           | 1.3             | 1.3          |
| MSCI Pacific ex Jp    | 0.1           | -1.1            | -1.1         |
| MSCI Japan            | 0.5           | 9.0             | 9.0          |
| MSCI EM               | 2.2           | -1.4            | -1.4         |
| MSCI EM EMEA          | 1.0           | 0.7             | 0.7          |
| MSCI EM Latin America | 0.3           | -2.8            | -2.8         |
| MSCI EM Asia          | 2.6           | -1.6            | -1.6         |

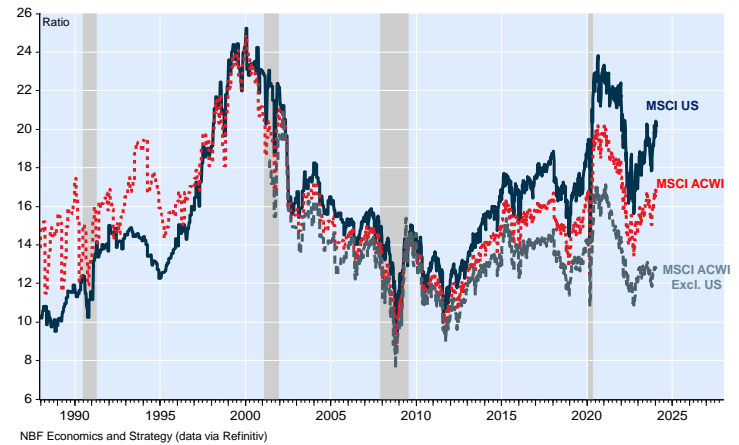
2/9/2024

NBF Economics and Strategy (data via Refinitiv)

While less than half of the increase in the MSCI ACWI has been driven by PE expansion, in the U.S. it is well over 50%. This explains why the MSCI U.S. trades at more than 20x forward earnings, close to a historical premium to the rest of the world (chart).

## World: The U.S. is trading at a near record premium to the ROW

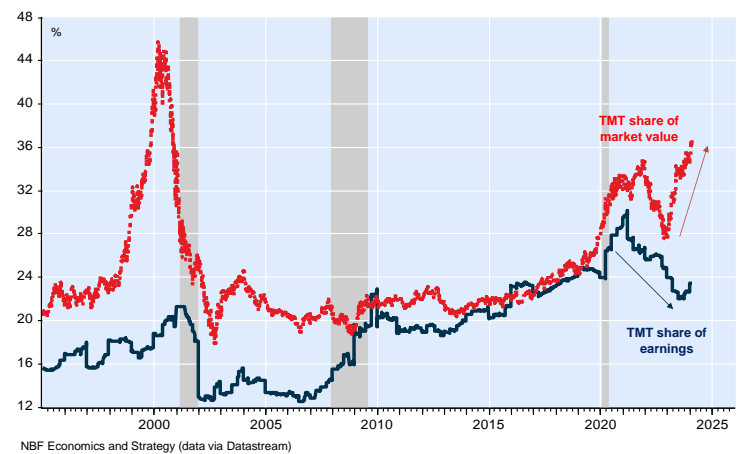
Forward PE ratio for the MSCI ACWI and MSCI U.S.



Much of this divergence comes from the technology sector, which typically commands a higher P/E ratio and whose share of the market value of U.S. equities is at a two-decade high of 36%, well above its 24% share of total earnings (chart).

## U.S.: TMT valuations improve despite falling earnings

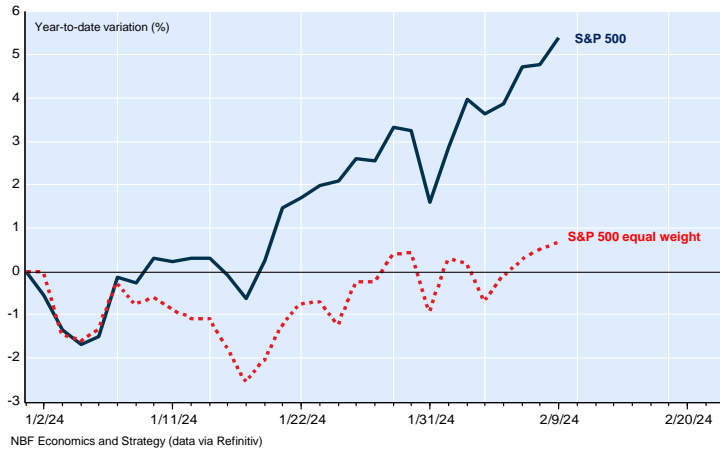
Share of TMT in total market value and earnings of U.S. benchmark (as of February 9)



The IT sector's role is such that the gains in U.S. equities would be less than one percent in 2024 on an equal weighted basis (chart).

### S&P 500: Divergence between the composite and equal weight indices

Year-to-date variation (%) in the S&P 500 and the S&P 500 equal weight price indices



## S&P 500: Will it continue?

Optimism for a soft landing of the U.S. economy is driving the outperformance of the U.S. benchmark versus its global peers. Advance estimates showed that GDP grew at an impressive 3.3% annualized rate in the final quarter of 2023, with strong gains in household consumption supported by continued job creation. This sign of the U.S. economy's resilience despite restrictive monetary policy, combined with some recent moderation in inflation, has fueled optimism in the markets that the Fed is on track to achieve its inflation target without causing undue damage to the economy. These expectations imply rate cuts at the start of 2024, which has pushed the 10-year Treasury yield down 100 basis points and propelled the S&P 500 to a new record high (chart).

### S&P 500: Perspective of a soft landing propels optimism

Yield on 10-Y treasury bonds and S&P 500 (as of February 9)

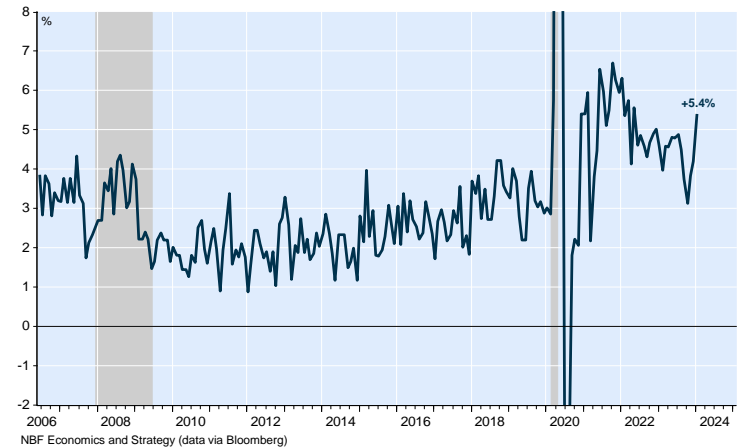


But expectations are just that, and sometimes things don't turn out as expected. For one thing, the Federal Reserve tried to dampen this optimism at its January rate-setting meeting when Chairman Powell mentioned that it was unlikely that the

Committee would reach a level of confidence to cut rates by the time of the March meeting. For another, inflation will have to cool a lot more for the Fed to even consider easing in the first half of 2024. And that is far from certain, given the very low unemployment rate (3.7%) and wage inflation at an annualized rate of 5.4% over the past three months (chart).

### U.S.: Wage growth incompatible with the Fed's inflation target

Average hourly earnings, three-month annualized gain



This leaves the S&P 500 vulnerable to negative surprises on inflation, as the 2024 rally has been led by telecom and IT, two sectors that are particularly vulnerable to a rise in the 10-year Treasury yield (table).

### S&P 500 composite index: Price Performance

|             | Month to date | Quarter to date | Year to date |
|-------------|---------------|-----------------|--------------|
| S&P 500     | 3.7           | 5.4             | 5.4          |
| TELECOM     | 6.7           | 11.9            | 11.9         |
| CONS. DISC. | 6.0           | 2.3             | 2.3          |
| IT          | 6.0           | 10.2            | 10.2         |
| INDUSTRIALS | 3.6           | 2.6             | 2.6          |
| HEALTH CARE | 2.6           | 5.5             | 5.5          |
| MATERIALS   | 1.1           | -2.9            | -2.9         |
| REAL ESTATE | 0.8           | -4.0            | -4.0         |
| FINANCIALS  | 0.7           | 3.6             | 3.6          |
| CONS. STAP. | 0.4           | 1.7             | 1.7          |
| ENERGY      | -0.1          | -0.7            | -0.7         |
| UTILITIES   | -2.0          | -5.0            | -5.0         |

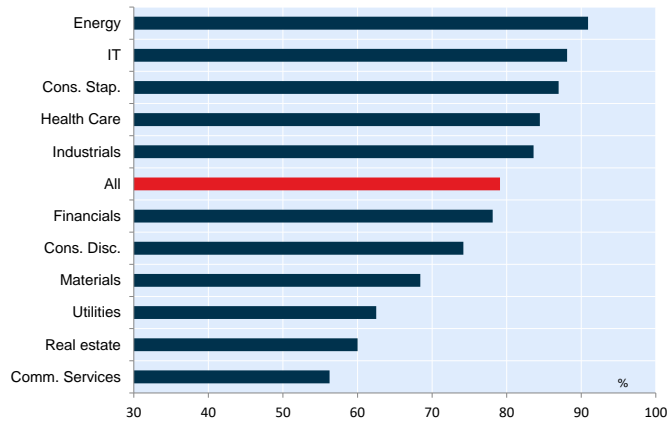
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Admittedly, the S&P 500 is not just about PE expansion. The robustness of the American economy is also visible in the earnings results. As of this writing, about 79% of companies that have reported fourth-quarter 2023 earnings have beaten analyst expectations, with particularly strong beats in energy, health care, IT, staples, and industrials (chart).

### S&P500: Earnings surprised on the upside in Q4

% of companies reporting higher than expected benefits (as of February 12, 335/500 companies reported)

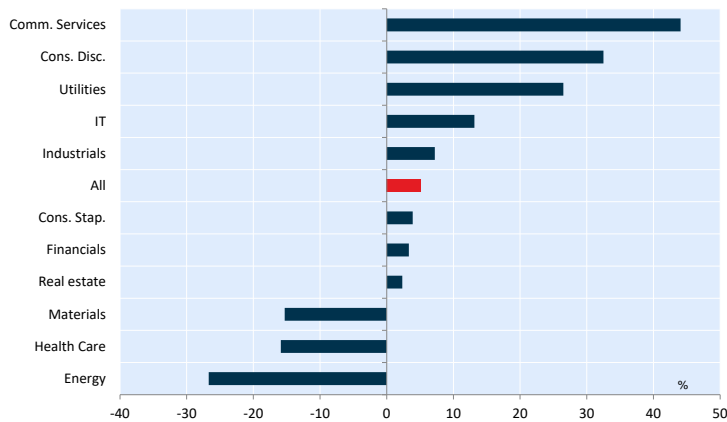


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This has translated in aggregate growth in earnings of 5.1%, with communication services and consumer discretionary faring the best while the energy and health care sectors registered declines (despite beating expectations).

### S&P500: Resilient growth in earnings in Q4

Average earnings surprise (as of February 12, 335/500 companies reported)



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According to the bottom-up consensus of analysts, the worst of the earnings decline is already behind us, and EPS is on track to grow just under 10% over the next twelve months, with decent to relatively strong gains in all major regions (table).

### MSCI ACWI: Consensus sees global earnings rebounding

Earnings per share (realized and expected)

|                       | 2023  | 2024 | 2025 | 2026 | 12 months forward |
|-----------------------|-------|------|------|------|-------------------|
| MSCI ACWI             | 0.2   | 8.8  | 12.4 | 11.0 | 9.6               |
| MSCI World            | 0.9   | 7.6  | 11.9 | 10.6 | 8.6               |
| MSCI USA              | 2.2   | 9.6  | 13.6 | 11.9 | 10.7              |
| MSCI Canada           | -8.7  | 5.1  | 13.3 | 9.3  | 4.8               |
| MSCI Europe           | -2.7  | 3.7  | 9.4  | 8.8  | 4.7               |
| MSCI Pacific ex Jp    | -3.2  | 3.6  | 4.3  | 5.9  | 4.2               |
| MSCI Japan            | 3.7   | 11.7 | 7.6  | 8.6  | 7.9               |
| MSCI EM               | -3.9  | 16.4 | 15.2 | 13.5 | 16.5              |
| MSCI EM EMEA          | 3.1   | 6.0  | 12.2 | 11.3 | 8.4               |
| MSCI EM Latin America | -20.4 | 5.5  | 5.6  | 10.1 | 5.9               |
| MSCI EM Asia          | -1.5  | 20.7 | 17.3 | 14.5 | 20.2              |

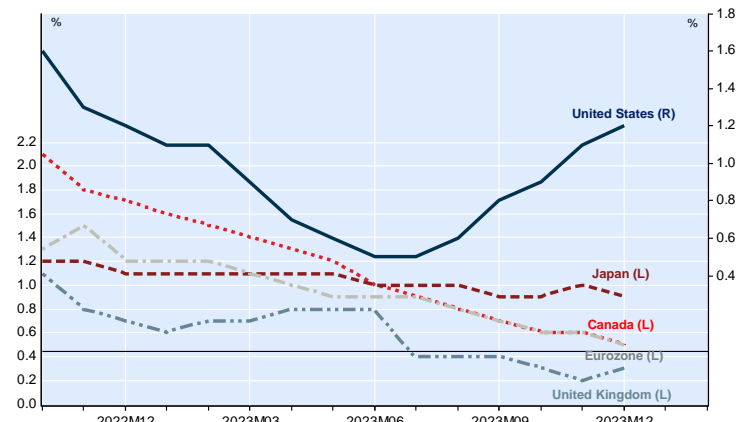
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NBF Economics and Strategy (data via Refinitiv)

We continue to view this forecast as aggressive, as non-U.S. GDP growth expectations for 2024 continue to be revised lower, which can't be good news for the U.S. multinationals that make up the S&P 500 (see chart).

### World: Positive GDP forecasts revisions limited in the U.S.

Real GDP growth consensus for 2024 in the G7 countries

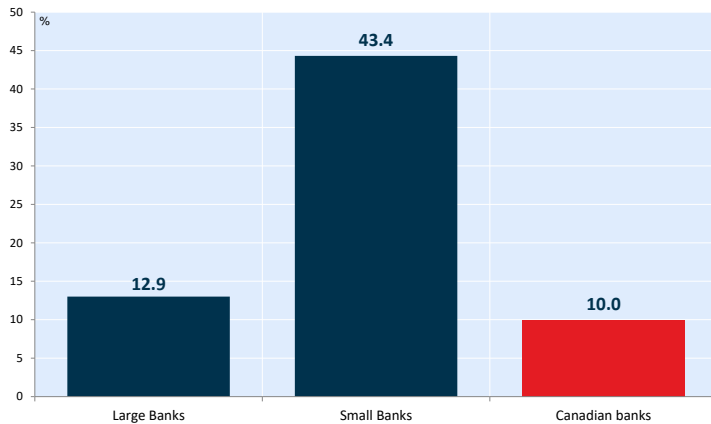


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On the domestic front too, there are reasons to be skeptical on the 2024 earnings outlook. Indeed, concerns about the falling value of commercial real estate have resurfaced after a U.S. regional bank was recently forced to write-down the value of certain assets. Recall that CRE accounts for more than 40% of the loan book of regional banks (chart).

### U.S.: Commercial real estate exposure is a risk

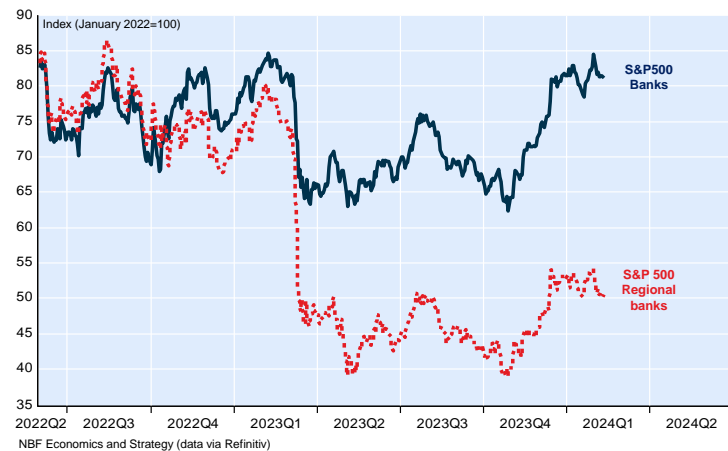
Commercial real estate loans as a percentage of total loan book



Concerns about the quality of their loan books continue to haunt the performance of regional banks, whose value is still down 50% from the levels seen in the spring of 2023, before three high-profile failures (chart).

### U.S.: Regional banks still under pressure

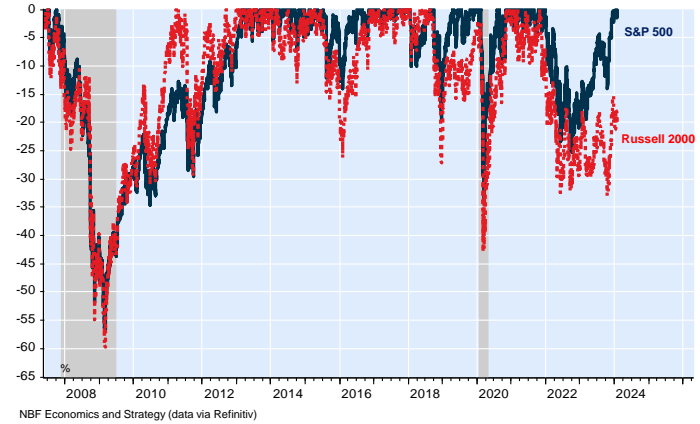
S&P 500 Regional Banks Index and S&P 500 Banks Index (January 2022=100), as of February 9



If regional banks are forced to limit credit expansion, small businesses are more likely to be negatively impacted. This would not be good news for the U.S. domestic economy, as SMEs typically account for more than 50% of job creation. This may explain why the Russell 2000 is still down about 20% from its 2021 peak (chart).

### U.S.: Small caps index points to potential pain for domestic economy

Variation (%) from peak (as of Feb 9, 2023)



## Asset allocation

The rally in global equities ignited last November on the hope of rate cuts in early 2024 is overdone. We still think that economic growth and corporate profitability will surprise to the downside in the coming months. Monetary policy transmission lags may be slightly longer than historical averages, but they have not disappeared. The longer the Fed waits 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) |
| <b>Equities</b>         |               |                        |             |
| Canadian Equities       | 20            | 18                     |             |
| U.S. Equities           | 20            | 16                     |             |
| Foreign Equities (EAFE) | 5             | 3                      |             |
| Emerging markets        | 5             | 3                      |             |
| <b>Fixed Income</b>     | 45            | 51                     |             |
| <b>Cash</b>             | 5             | 9                      |             |
| <b>Total</b>            | 100           | 100                    |             |

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## 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<br><i>Canada</i> |                  |                |
|--------------------------------------|------------------|----------------|
|                                      | <i>Actual</i>    | <i>Q4 2024</i> |
| <i>Index Level</i>                   | <i>Feb-13-24</i> | <i>Target</i>  |
| S&P/TSX                              | 20,585           | 18,000         |
| <i>Assumptions</i>                   |                  | <i>Q4 2024</i> |
| Level:                               | Earnings *       | 1398           |
|                                      | Dividend         | 711            |
| PE Trailing (implied)                | 14.7             | 13.8           |

\* Before extraordinary items, source Thomson

NBF Economics and Strategy (data via Refinitiv)

| NBF Market Forecast<br><i>United States</i> |                  |                |
|---|------------------|----------------|
|   | <i>Actual</i>    | <i>Q4 2024</i> |
| <i>Index Level</i>                          | <i>Feb-13-24</i> | <i>Target</i>  |
| S&P 500                                     | 4,953            | 4,000          |
| <i>Assumptions</i>                          |                  | <i>Q4 2024</i> |
| Level:                                      | Earnings *       | 222            |
|   | Dividend         | 70             |
| PE Trailing (implied)                       | 22.3             | 20.5           |

\* S&P operating earnings, bottom up.

## NBF Fundamental Sector Rotation - February 2024

| Name (Sector/Industry)                         | Recommendation       | S&P/TSX weight |
|--|----------------------|----------------|
| <b>Energy</b>                                  | <b>Market Weight</b> | <b>17.0%</b>   |
| Energy Equipment & Services                    | Market Weight        | 0.2%           |
| Oil, Gas & Consumable Fuels                    | Market Weight        | 16.8%          |
| <b>Materials</b>                               | <b>Market Weight</b> | <b>10.0%</b>   |
| Chemicals                                      | Underweight          | 1.3%           |
| Containers & Packaging                         | Market Weight        | 0.4%           |
| Metals & Mining *                              | Market Weight        | 7.9%           |
| Gold   | Overweight           | 5.6%           |
| Paper & Forest Products                        | Market Weight        | 0.4%           |
| <b>Industrials</b>                             | <b>Underweight</b>   | <b>14.5%</b>   |
| Capital Goods                                  | Market Weight        | 2.9%           |
| Commercial & Professional Services             | Underweight          | 3.7%           |
| Transportation                                 | Underweight          | 7.9%           |
| <b>Consumer Discretionary</b>                  | <b>Underweight</b>   | <b>3.7%</b>    |
| Automobiles & Components                       | Underweight          | 0.8%           |
| Consumer Durables & Apparel                    | Underweight          | 0.4%           |
| Consumer Services                              | Underweight          | 1.1%           |
| Retailing                                      | Market Weight        | 1.4%           |
| <b>Consumer Staples</b>                        | <b>Overweight</b>    | <b>4.3%</b>    |
| Food & Staples Retailing                       | Overweight           | 3.8%           |
| Food, Beverage & Tobacco                       | Overweight           | 0.5%           |
| <b>Health Care</b>                             | <b>Market Weight</b> | <b>0.3%</b>    |
| Health Care Equipment & Services               | Market Weight        | 0.1%           |
| Pharmaceuticals, Biotechnology & Life Sciences | Market Weight        | 0.2%           |
| <b>Financials</b>                              | <b>Market Weight</b> | <b>31.0%</b>   |
| Banks  | Market Weight        | 19.8%          |
| Diversified Financials                         | Market Weight        | 4.1%           |
| Insurance                                      | Market Weight        | 7.1%           |
| <b>Information Technology</b>                  | <b>Market Weight</b> | <b>9.2%</b>    |
| Telecommunication Services                     | Overweight           | 3.7%           |
| <b>Utilities</b>                               | <b>Overweight</b>    | <b>3.9%</b>    |
| <b>Real Estate</b>                             | <b>Underweight</b>   | <b>2.4%</b>    |

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



# Monthly Equity Monitor

Economics and Strategy



**NATIONAL BANK  
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FINANCIAL MARKETS

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