Monthly Equity Monitor

Economics and Strategy

NATIONAL BANK OF CANADA FINANCIAL MARKETS

April 2024

Highlights

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- Global equities are up about 19% on a six-month basis, the best performance in over ten years if we exclude the post-pandemic rebound. We continue to believe that this is not compatible with the macroeconomic backdrop. True, central banks around the world are widely expected to start cutting their interest rates this summer. But that does not mean that the global economy will bounce back.
- The surge in market momentum has pushed the S&P 500's 12-month forward earnings yield below the Federal Reserve's funds rate. Notably, this is only the second time such an event has occurred in at least the past 36 years. The Federal Reserve is certainly playing a role in supporting these high equity valuations with hints of monetary easing. Whether Mr. Powell will be able to deliver on this guidance remains to be seen. Lower inflation is harder to fathom in an increasingly complex geopolitical landscape, where the U.S. is threatening potential tariffs against China as import prices from the Middle Kingdom deflate by the most since the Great Financial Crisis.
- Breaking with the rest of the world, the S&P/TSX starts April in positive territory, led by energy and materials. The strong performance of the materials sector mirrors that of the S&P/TSX gold sector, which has been buoyed by soaring gold prices. The current geopolitical backdrop and the upcoming U.S. elections continue to favor the shiny metal.
- As for broader trends on the S&P/TSX, a key wildcard could very well be the federal budget on April 16th. Higher income taxes on corporations and wealthy individuals could be on the horizon to pay for new spending. We don't even rule out an increase in the capital gains rate, depending on the incremental size/nature of the new program spending announcements that could take place in next week.
- 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.

World: An incredible six months

Global equities got off to a strong start to the year, recording a 9% gain in the first quarter. This impressive performance was made possible mainly by Japan and the U.S., which each posted double-digits gains over that period. Notable increases were also registered in Europe and Canada, whereas Latin America declined in the quarter. Most equity markets pause for breath as April begins (table).

MSCI composite index: Price Performance

	Month to date	Quarter to date	Year to date
MSCI ACWI	-0.6	-0.6	8.4
MSCI World	-0.8	-0.8	8.8
MSCI USA	-0.8	-0.8	9.1
MSCI Canada	0.8	0.8	6.9
MSCI Europe	-1.2	-1.2	6.3
MSCI Pacific ex Jp	-0.3	-0.3	0.3
MSCI Japan	-0.5	-0.5	17.7
MSCI EM	1.1	1.1	5.2
MSCI EM EMEA	1.6	1.6	3.6
MSCI EM Latin America	1.2	1.2	-1.9
MSCI EM Asia	1.0	1.0	6.3

4/9/2024

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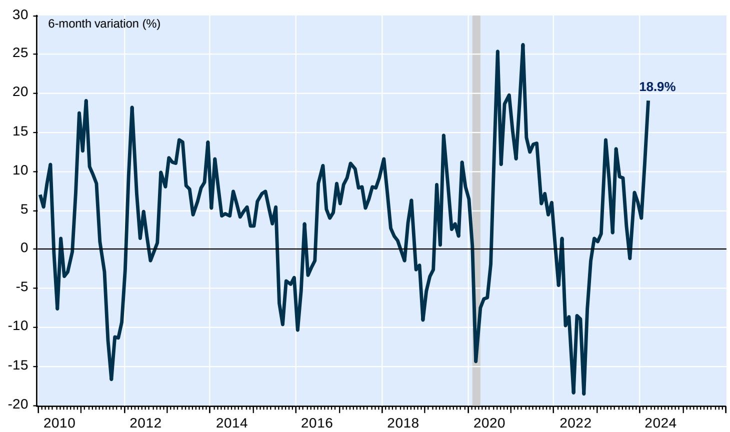
And with good reason. On a six-month basis, global equities are up about 19%, the best performance in over ten years if we exclude the post-pandemic rebound (chart).

MSCI AC: Best 6-month performance since post-pandemic rebound
6-month variation, price index



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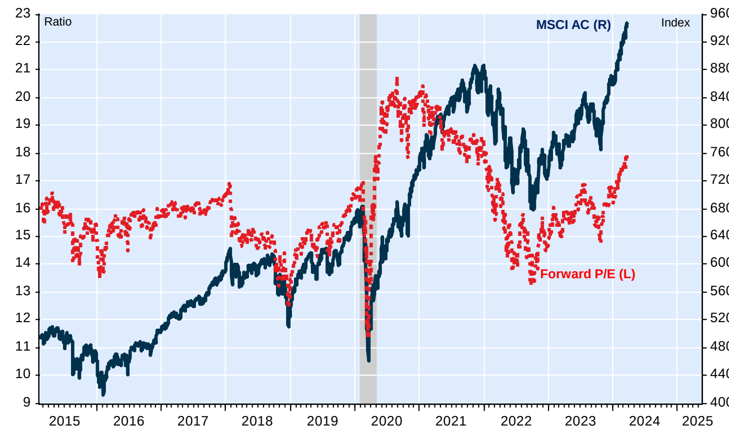
Unsurprisingly, this enabled the MSCI AC world index to set yet a new record high. Last month, as we commented the good momentum in global equities, we questioned its durability as it was clearly attributable to P/E expansion rather than to stronger than expected earnings. That assessment persists, as the forward P/E ratio has continued to rise in to reach 18x, a historically high level (chart).

World: PE expansion continues
Forward PE ratio and price index for the MSCI ACWI



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We continue to believe that this is not compatible with the macroeconomic backdrop. True, central banks around the world are widely expected to start cutting their interest rates this summer. But that does not mean that the global economy will bounce back. As inflation is continuing to fall, the decline in real interest rates should provide little relief to an economy that is already displaying signs of weakening. Nevertheless, EPS forecasts remain very optimistic, with analysts expecting a 9.2% rebound in 2024 (table).

MSCI composite index: EPS Performance

	2023	2024	2025	2026	12 months forward
MSCI ACWI	-0.1	9.3	12.8	10.7	10.4
MSCI World	1.0	7.8	12.4	10.8	9.2
MSCI USA	2.7	9.8	13.9	12.0	11.2
MSCI Canada	-8.7	2.9	13.5	8.9	5.9
MSCI Europe	-3.6	3.7	10.2	9.2	5.4
MSCI Pacific ex Jp	-5.7	5.1	4.6	4.6	5.0
MSCI Japan	4.5	13.6	8.6	8.8	8.3
MSCI EM	-7.0	19.5	15.6	10.5	18.6
MSCI EM EMEA	2.1	5.7	13.8	9.7	9.8
MSCI EM Latin America	-24.0	6.8	8.1	6.2	7.2
MSCI EM Asia	-4.7	25.0	17.1	11.3	22.6

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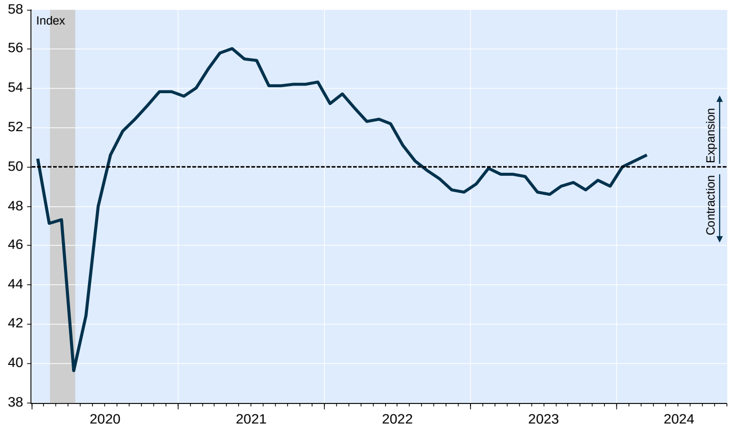
Yes, it is true that global manufacturing activity showed a slight increase last month, but that is still far from what is needed to meet or exceed current earnings expectations embedded in stock market valuations (chart).

World: Global factory index suggests slow growth
JPMorgan/S&P Global Manufacturing PMI. Last observation: March 2023



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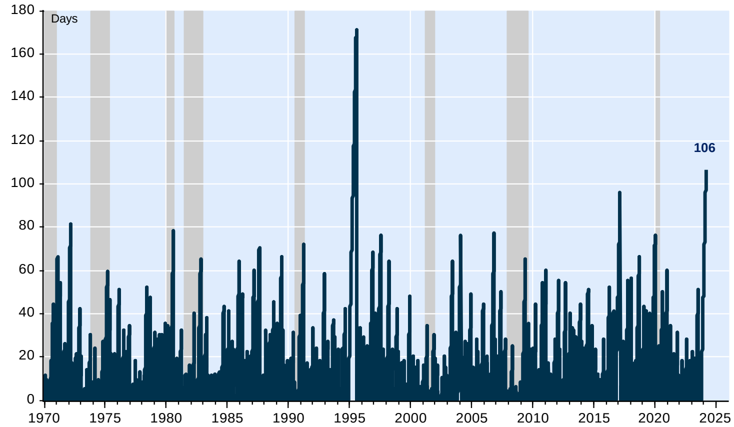
S&P500: Perspective on the RSI
Number of consecutive days that the relative strength index remained above 50



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S&P 500: Will the streak end?

The S&P 500 is on a streak of five consecutive monthly gains and is up 9.2% year-to-date, led by telecom, energy, IT, financials and industrials. Real Estate is the only major industry to show a decline so far in 2024 (table).

S&P500 composite index: Price Performance

	Month to date	Quarter to date	Year to date
S&P 500	-0.8	-0.8	9.2
ENERGY	3.3	3.3	16.4
TELECOM	2.4	2.4	18.4
UTILITIES	-0.1	-0.1	3.5
MATERIALS	-0.1	-0.1	8.3
INDUSTRIALS	-0.5	-0.5	10.1
CONS. DISC.	-1.1	-1.1	3.5
IT	-1.3	-1.3	11.0
FINANCIALS	-1.5	-1.5	10.2
REAL ESTATE	-2.2	-2.2	-4.1
CONS. STAP.	-2.8	-2.8	3.8
HEALTH CARE	-3.4	-3.4	4.7

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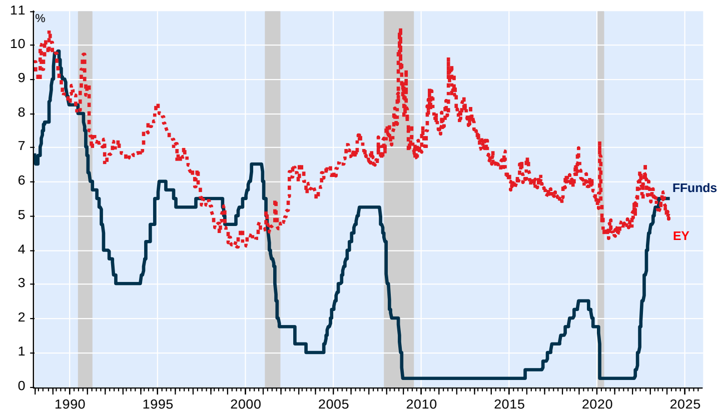
Investors are clearly embracing the scenario of an economic soft landing characterized by immaculate disinflation with central bank rate cuts, a strong labour market and a resurgence in corporate profitability. This confidence is exemplified by the fact that the S&P 500's Relative Strength Index (RSI) – a key indicator of market momentum – has remained above its neutral level of 50 for 106 consecutive days, the best such performance since 1995 (chart).

This streak in market momentum has pushed the S&P 500's 12-month forward earnings yield - a measure derived by inverting the price-earnings ratio - below the Federal Reserve's funds rate. Notably, this is only the second time such an event has occurred in at least the past 36 years, highlighting a rare financial climate in which the expected return on equities, as measured by the earnings yield, is lower than the central bank's benchmark interest rate (chart).

U.S.: Earnings yield below the fed funds for the first time since 1998
S&P 500 earnings yield vs. fed funds rate



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The Federal Reserve is certainly playing a role in supporting these high equity valuations with hints of monetary easing. Whether Mr. Powell will be able to deliver on this guidance remains to be seen (chart).

U.S.: Financial conditions easiest in a year
Federal funds rate vs. GS financial conditions index

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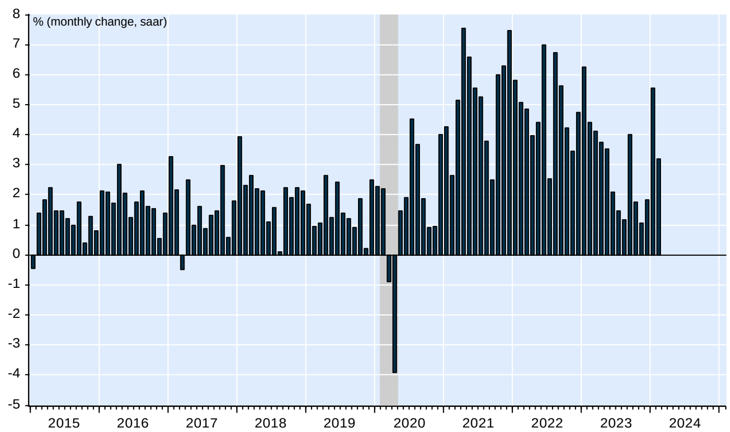
Yes, it's true that the Fed has been able to point to slower inflation in recent months, but there are signs that progress on that front may be harder to come by now because of a stronger economy. The annualized monthly change in the core PCE deflator has exceeded 3% in each of the last two months (chart).

U.S.: Core inflation is sticky
Core PCE deflator



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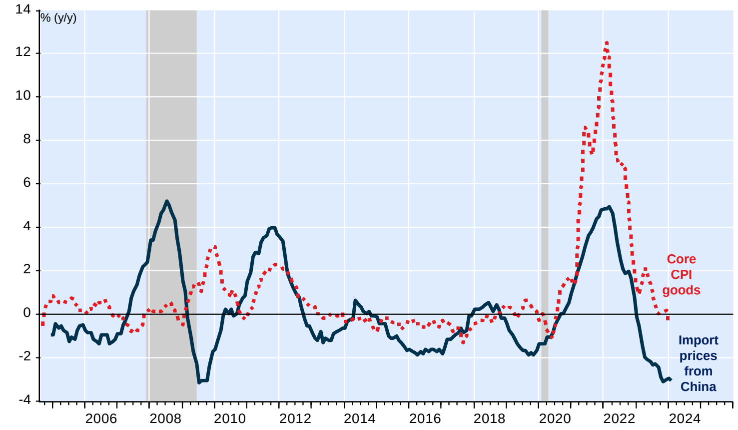
Lower inflation is harder to fathom in an increasingly complex geopolitical landscape, where the U.S. is threatening potential tariffs against China as import prices from the Middle Kingdom deflate by the most since the Great Financial Crisis (chart).

U.S.: Chinese import price deflation worries Washington
CPI goods inflation (excluding food & energy) and import prices from China



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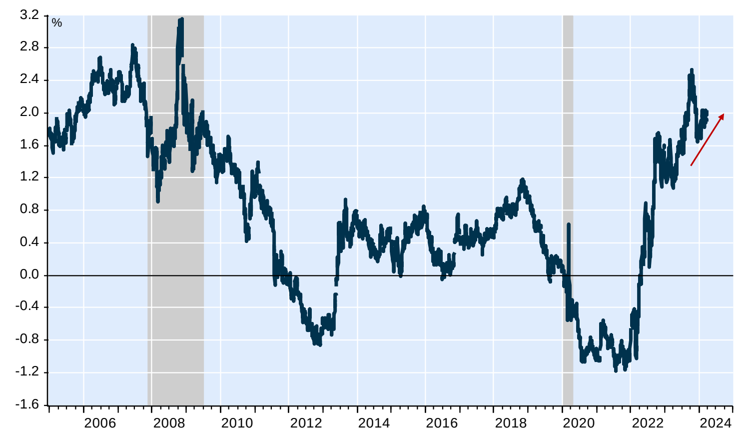
Treasury Secretary Janet Yellen recently issued a stern warning to Beijing that the United States would not tolerate a repeat of the "China shock" of the early 2000s, when a flood of Chinese imports destroyed American manufacturing capacity. A rise in US protectionism would limit the downside of inflation and reduce the Fed's ability to cut rates. In our view, the renewed uptrend in real bond yields could become a significant challenge for equity markets (chart).

U.S.: More protectionism = higher real rates
Yield on 10-year TIPS



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NATIONAL BANK OF CANADA
FINANCIAL MARKETS

S&P/TSX: Federal budget looms

Breaking ranks with the rest of the world, the S&P/TSX starts April in positive territory. But the strength is mostly limited to materials (+7.0%) and energy (+3.3%). Most other industries are down early in Q2- see table.

S&P/TSX composite index: Price Performance

	Month to date	Quarter to date	Year to date
S&P TSX	0.9	0.9	6.7
MATERIALS	7.0	7.0	12.7
ENERGY	3.3	3.3	15.3
BANKS	0.0	0.0	2.0
INDUSTRIALS	-0.2	-0.2	10.5
FINANCIALS	-0.3	-0.3	4.1
TELECOM	-0.3	-0.3	-10.2
CONS. DISC.	-0.9	-0.9	3.0
CONS. STAP.	-1.4	-1.4	2.2
UTILITIES	-1.7	-1.7	-4.0
IT	-1.8	-1.8	2.9
REAL ESTATE	-1.9	-1.9	-1.2
HEALTH CARE	-7.6	-7.6	8.8

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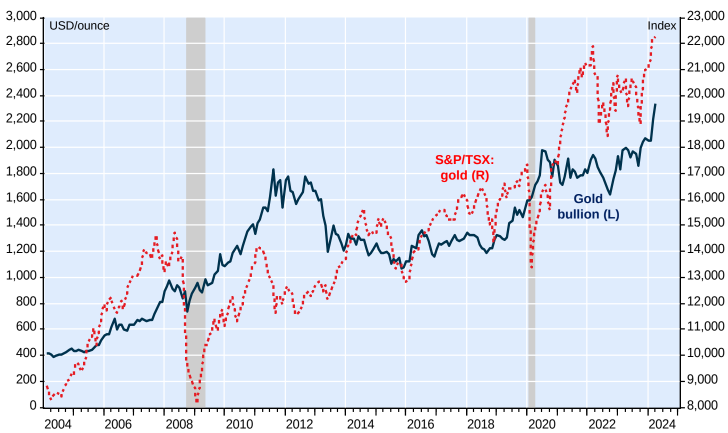
The strong performance of the materials sector mirrors that of the S&P/TSX gold sector, which has been buoyed by soaring gold prices. Indeed, the nominal price of gold has reached record levels in recent weeks amid persistent fears of sticky inflation, high government debt and an uncertain geopolitical environment (chart).

S&P/TSX: Gold prices propel the gold equity subcategory
Nominal price of gold and gold category of the S&P/TSX



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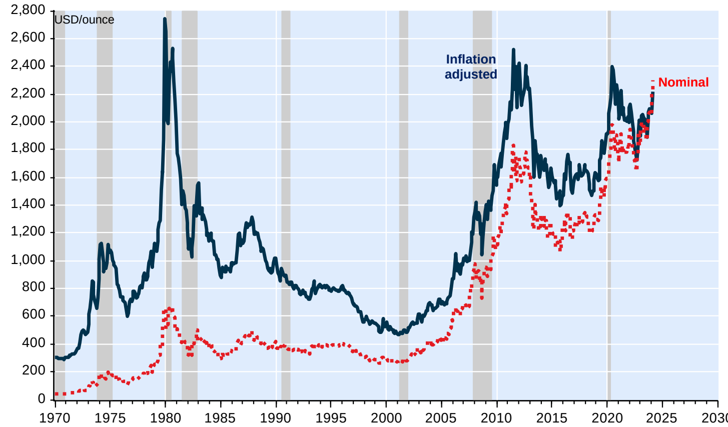
Despite the record in nominal terms, it's important to put prices into perspective. In inflation-adjusted terms, gold is still 7% below its peak at the height of the pandemic, 12% below its peak during the financial crisis, and 19% below its all-time high in the 1980s (chart).

Bullion: A lesser surge in real terms
Price of gold: Nominal and real (2024 dollars)



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While analysts remain cautious on gold prices (down 11.6%), the futures market still sees some upside for the coming quarters. We agree with this view. The current geopolitical backdrop and the upcoming U.S. elections continue to favour the shiny metal (table).

Commodity prices expectations

	Copper	Gold	Crude Oil	Natural Gas
Current Price	9330	2330	87	1.79
Analyst assumptions				
Q+2	9000	2134	80	3.00
Q+4	9213	2060	77	3.50
Growth (Q_t/Q_0)				
Q+2	-3.5%	-8.4%	-8.0%	68.1%
Q+4	-1.3%	-11.6%	-11.4%	96.1%

Current Forward Prices

	Copper	Gold	Crude Oil	Natural Gas
Current Price	9330	2330	87	1.79
Forward prices				
Q+2	9479	2366	80	3.34
Q+4	9535	2423	76	3.21
Growth (Q_t/Q_0)				
Q+2	1.6%	1.6%	-7.8%	87.1%
Q+4	2.2%	4.0%	-12.3%	79.7%

4/7/2024

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As for broader trends on the S&P/TSX, a key wildcard could very well be the federal budget on April 16th. After promising to limit the deficit to no more than $40 billion, Ottawa has since announced more than $10 billion in new spending initiatives. Higher income taxes on corporations and wealthy individuals could be on the horizon to pay for new spending. We don't even rule out an increase in the capital gains rate, depending on the incremental size/nature of the new program spending announcements that could take place next week.

Asset allocation

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	

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Sector rotation

Our sector rotation remains unchanged this month, with a preference for Golds, Consumer Staples, Communications Services and Utilities.

NBF Market Forecast
Canada

		Actual	*Q4 2024*
Index Level		**Apr-08-24**	***Target***
S&P/TSX		22,260	19,000
Assumptions			Q4 2024
Level:	Earnings *	1337	1250
	Dividend	670	627
PE Trailing (implied)		16.6	15.2

** Before extraordinary items, source Thomson*

NBF Economics and Strategy (data via Refinitiv)

NBF Market Forecast
United States

		Actual	*Q4 2024*
Index Level		**Apr-08-24**	***Target***
S&P 500		5,202	4,300
Assumptions			Q4 2024
Level:	Earnings *	223	200
	Dividend	71	63
PE Trailing (implied)		23.3	21.5

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

NBF Fundamental Sector Rotation - April 2024

Name (Sector/Industry)	Recommendation	S&P/TSX weight
Energy	**Market Weight**	**18.5%**
Energy Equipment & Services	Market Weight	0.2%
Oil, Gas & Consumable Fuels	Market Weight	18.3%
Materials	**Market Weight**	**11.5%**
Chemicals	Underweight	1.3%
Containers & Packaging	Market Weight	0.4%
Metals & Mining *	Market Weight	9.4%
Gold	Overweight	6.4%
Paper & Forest Products	Market Weight	0.4%
Industrials	**Underweight**	**14.2%**
Capital Goods	Market Weight	2.9%
Commercial & Professional Services	Underweight	3.6%
Transportation	Underweight	7.7%
Consumer Discretionary	**Underweight**	**3.5%**
Automobiles & Components	Underweight	0.7%
Consumer Durables & Apparel	Underweight	0.4%
Consumer Services	Underweight	1.0%
Retailing	Market Weight	1.4%
Consumer Staples	**Overweight**	**4.0%**
Food & Staples Retailing	Overweight	3.5%
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**	**30.6%**
Banks	Market Weight	19.7%
Diversified Financials	Market Weight	4.0%
Insurance	Market Weight	7.0%
Information Technology	**Market Weight**	**8.4%**
Telecommunication Services	**Overweight**	**3.1%**
Utilities	**Overweight**	**3.7%**
Real Estate	**Underweight**	**2.2%**

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

Economics and Strategy

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