IG WEALTH MANAGEMENT

2023 FOURTH QUARTER
MARKET REVIEW

The last quarter of 2023 set a positive tone for the new year

IG Investment Strategy Team

QUARTERLY REVIEW

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Is the market getting ahead of itself?

The fourth quarter saw a rally in most asset classes and sectors. Yields went down, sending both stocks and bonds higher. The markets were aggressively pricing in an economic "soft-landing", impacting valuations across the board. In terms of U.S. stocks, the quarter began with a forward price-to-earnings (P/E) ratio in the mid-17s. Now, as we head into 2024, this ratio is closing in on 20, which is significantly higher. A similar trend is observed for bonds. Yields went up a lot during the year, and yet the fourth quarter's rally sent the U.S. 10-year Treasury yield down to 3.87%. Ironically, this is the exact same level at which it ended 2022.

We continue to believe that economic data indicates some aspects of the U.S. economy are more consistent with a recovery than a recession. Manufacturing activity is showing signs of bottoming out, housing prices are no longer falling and the Conference Board's Index of Leading Indicators appears to have reached a trough.

On a year-over-year basis, recessionary pressures in the U.S. have eased. While the risk of recession persists, we believe the probability will be much lower over the next 12 months compared to the previous year. In fact, certain sectors of the economy have already navigated their part in these economic developments.

Could this rapid market movement in the fourth quarter have been excessive? It's possible. We might see some volatility in the early stages of 2024 as the markets assimilate the latest macroeconomic data and assess whether their optimism at the end of 2023 was warranted.

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> *-Philip Petursson*

Index returns

2023 equity price returns and fixed income total returns

Table 1 - 2023 equity price returns

EQUITY BENCHMARK PRICE RETURNS	CURRENCY	Q4	YTD	1 YEAR
S&P/TSX Composite	–	7.25%	8.12%	8.12%
S&P 500	USD	11.24%	24.23%	24.23%
	CAD	8.46%	21.26%	21.26%
MSCI EAFE	USD	10.09%	15.03%	15.03%
	CAD	7.34%	12.29%	12.29%
MSCI Europe	EUR	6.11%	12.73%	12.73%
	CAD	8.22%	13.66%	13.66%
MSCI Emerging Markets	USD	7.45%	7.04%	7.04%
	CAD	4.77%	4.49%	4.49%

Table 2 - 2023 fixed income total returns

FIXED INCOME BENCHMARK PRICE RETURNS	CURRENCY	Q4	YTD	1 YEAR
FTSE Canadian All Government Bond	–	8.49%	6.11%	6.11%
FTSE Canada Universe Bond	–	8.27%	6.69%	6.69%
ICE BofA US Corporate Bond	USD	7.91%	8.39%	8.39%
	CAD	5.25%	5.49%	5.49%
ICE BofA US High Yield Composite	USD	7.06%	13.44%	13.44%
	CAD	4.42%	10.41%	10.41%
Bloomberg Global Aggregate Bond	USD	8.10%	5.72%	5.72%

Source: IG Wealth Management, Bloomberg; 1 year, December 30, 2022 - December 29, 2023.
Equity benchmark returns are quoted as price returns, excluding dividends.

Drivers of market performance: Q4 2023

Canadian equities

The S&P/TSX Composite Index increased by 7.25% for the fourth quarter, ending the year up 8.12%. Nearly all sectors posted gains for the quarter, with energy the exception, declining by 2.59%. The price of oil (WTI), which had hit its highest point within the quarter and over the past year, closed out the period at US$71.65/bbl.

Information technology, which makes up 8.66% of the S&P/TSX Composite Index, led all sectors with returns of 23.9% for the quarter and 68.8% for the year.

The most positive contribution during the quarter came from Shopify gaining 39.14% in the quarter and contributing to 17.11% of the S&P/TSX Composite Index's overall gain

U.S. equities

The S&P 500 Index finished the quarter up 11.24% after retreating by 3.98% in the month of October.

Energy was the only lagging sector, with all other sectors gaining ground. The real estate sector led the index with a gain of 17.7%, with information technology in second position with a 16.9% gain.

Indications from the U.S. Federal Reserve citing the end of additional rate hikes buoyed equity and bond markets.

Overall, the Magnificent Seven stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) drove equity price returns for U.S. equities with a price return of 106.6% for the year and contributing over 62% of the S&P 500 Index's performance.

International equities

Like its global counterparts, the Europe, Australasia and Far East (EAFE) Index witnessed notable gains, rising 10.09% for the quarter when measured in U.S. dollar terms and 7.34% in Canadian dollars.

The euro experienced a particularly robust quarter, appreciating over 4% against the U.S. dollar. This currency strength was explained by a change in rate expectations between Europe and America.

Overall, international equities benefitted from renewed optimism and finished the year in positive territory.

Fixed income

Bond yields fell during the quarter as the U.S. Federal Reserve hinted at a pivot in monetary policy. Inflation, while much lower than where it was a year ago and heading toward the target rate of 2%, remains above 3% and is proving sticky.

The Bloomberg Global Aggregate Index returned 8.1% in U.S. dollar terms, while the Canadian Universe Bond Index was up 8.27%.

The ICE US High Yield Index representing U.S. high yield bonds returned 7.06% during the quarter in U.S. dollar terms (4.42% in Canadian dollars).

Canadian equities

Chart 1 – S&P/TSX Composite Index performance: last four quarters

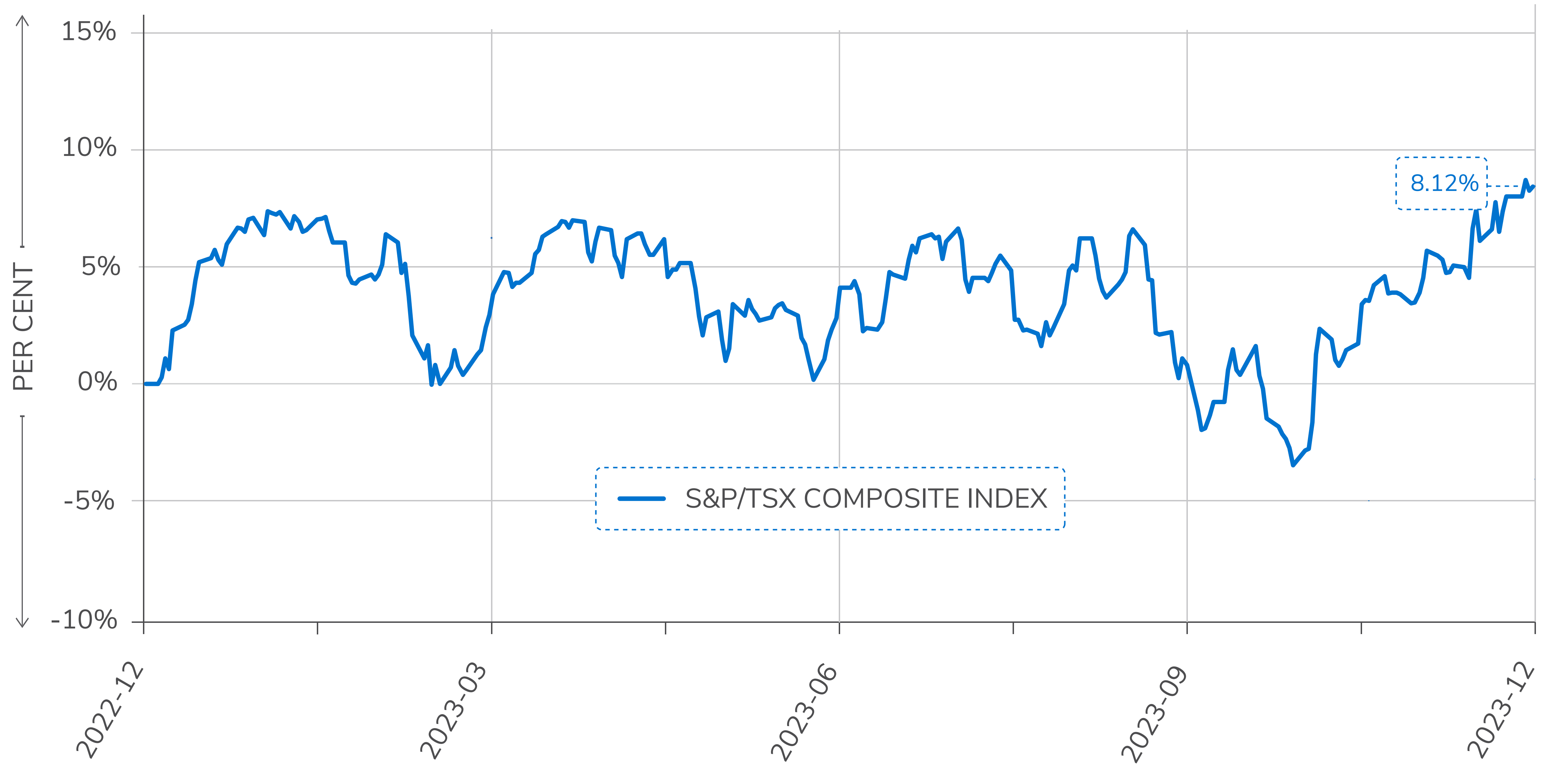
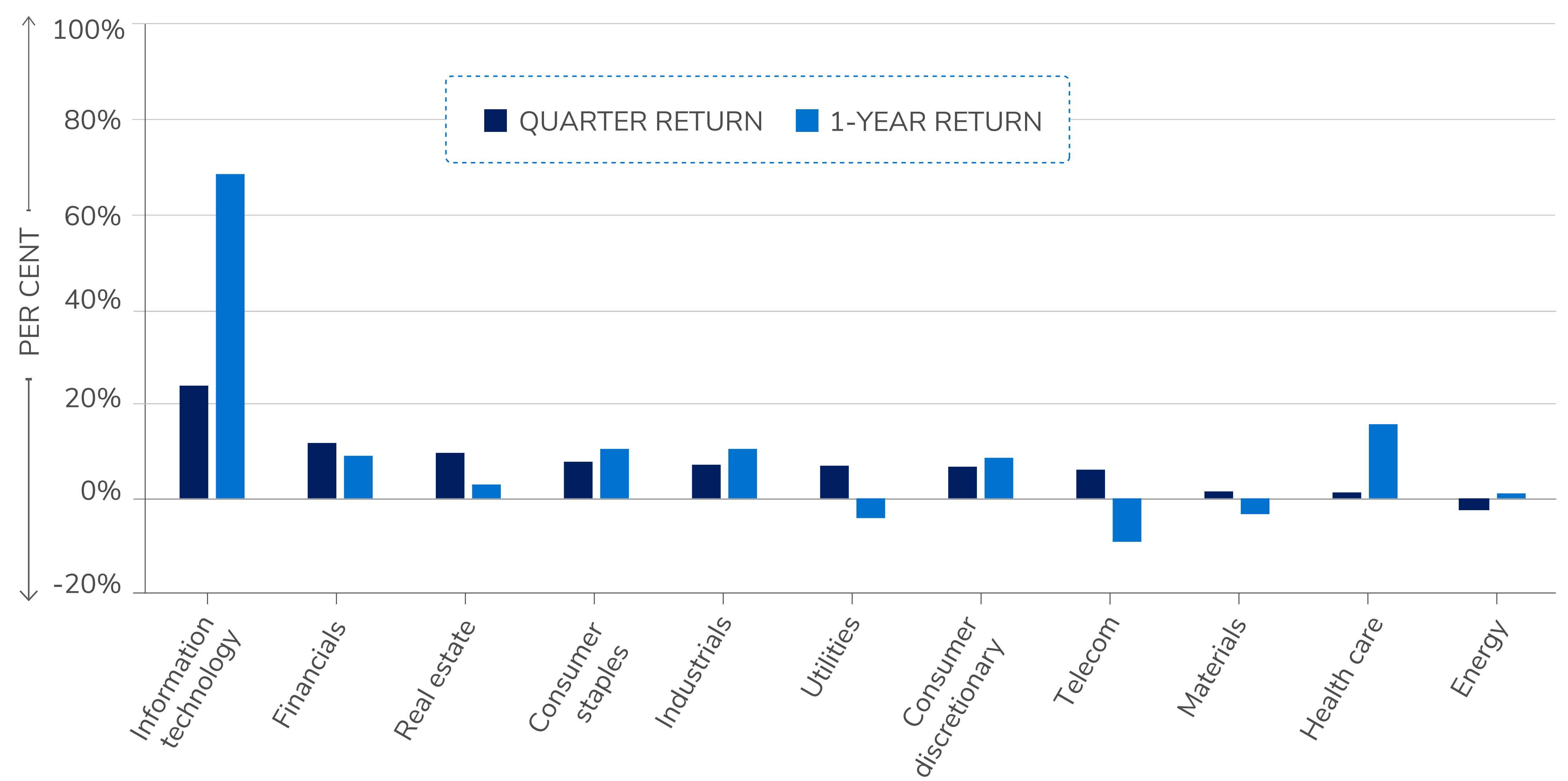


Chart 2 – S&P/TSX Composite sector level returns: Q4 and 1 year



Source: IG Wealth Management, Bloomberg as December 29, 2023.

U.S. equities

Chart 3 – S&P 500 Index performance (USD): last four quarters

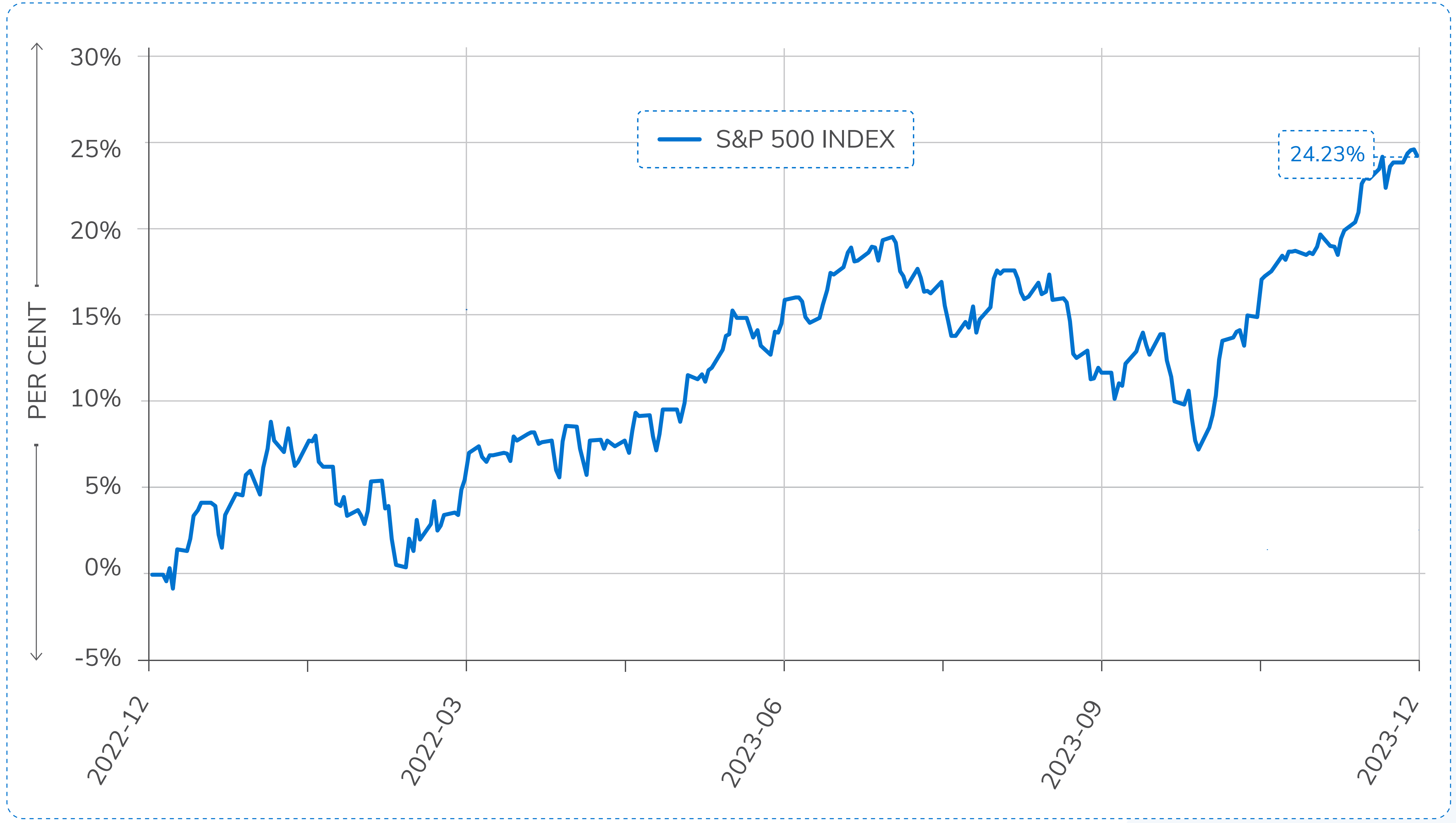
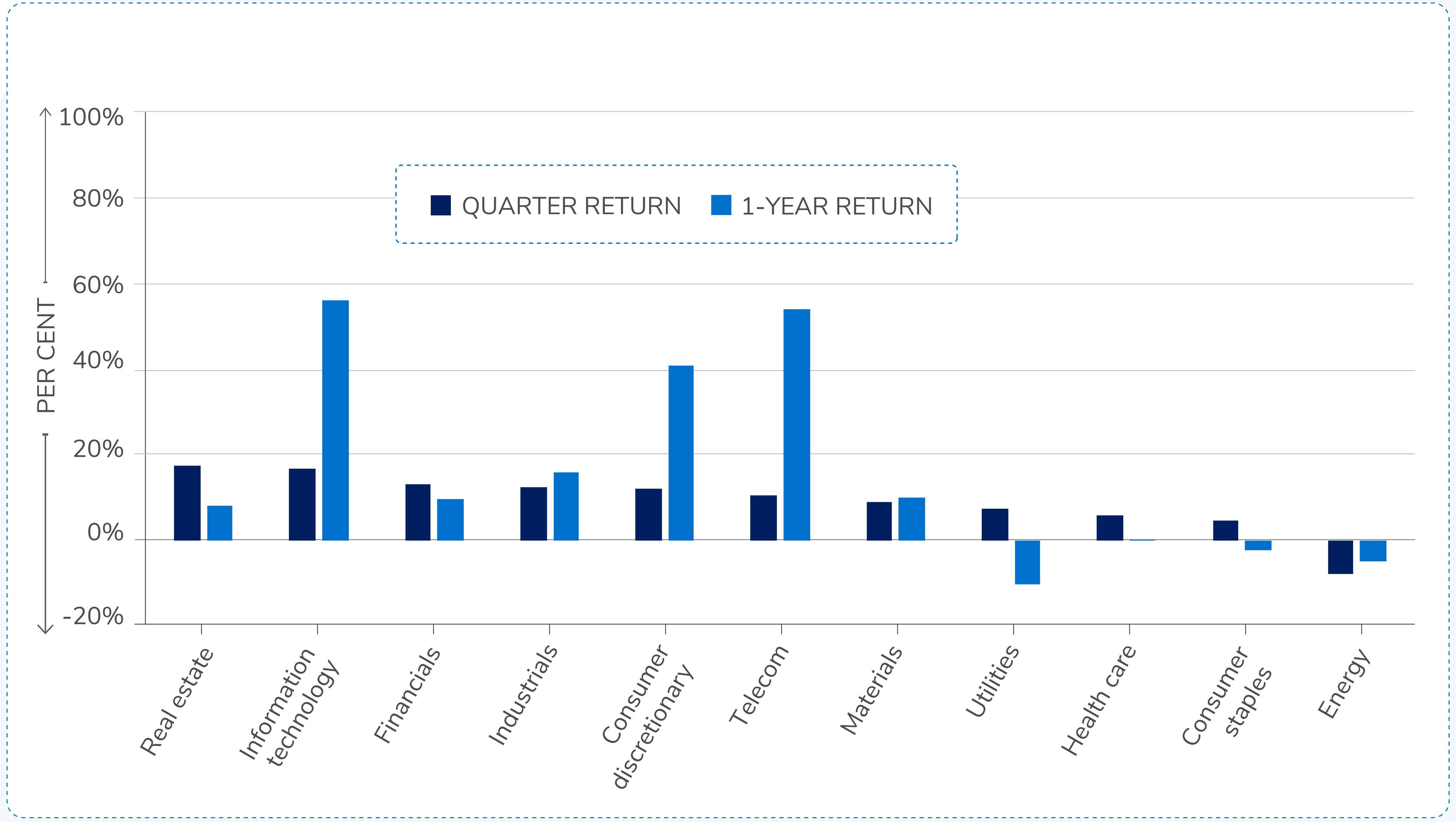


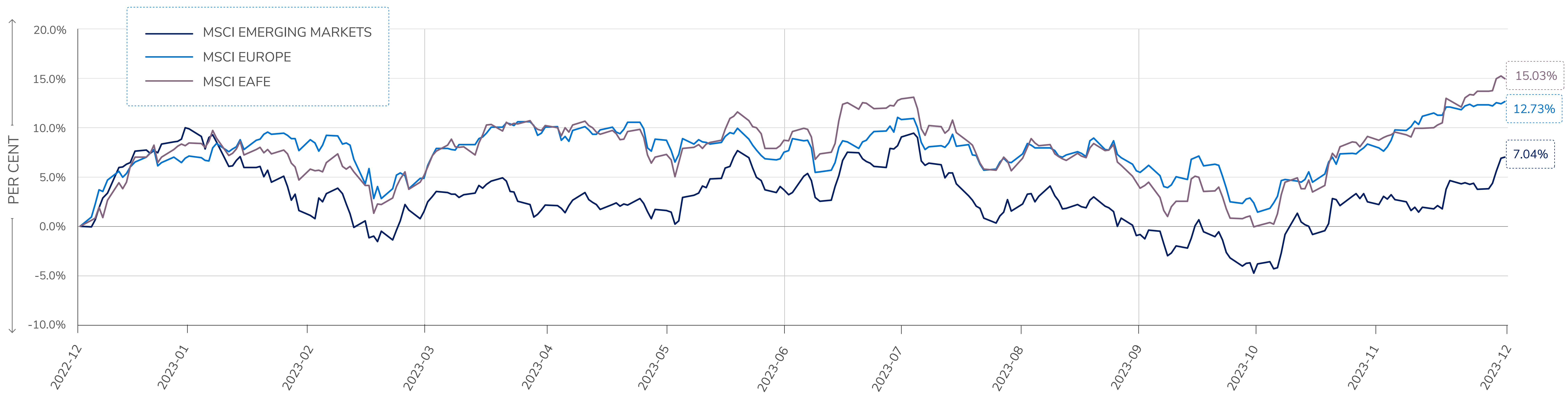
Chart 4 – S&P 500 Composite sector level returns: Q4 and 1 year



Source: IG Wealth Management, Bloomberg as of December 29, 2023.

International equities

Chart 5 – MSCI Emerging Markets (USD), MSCI Europe (EUR) and MSCI EAFE (USD) indices performance: last four quarters



Source: IG Wealth Management, Bloomberg as of December 29, 2023.

Fixed income

Chart 6 - Global central bank policy rates: last five years

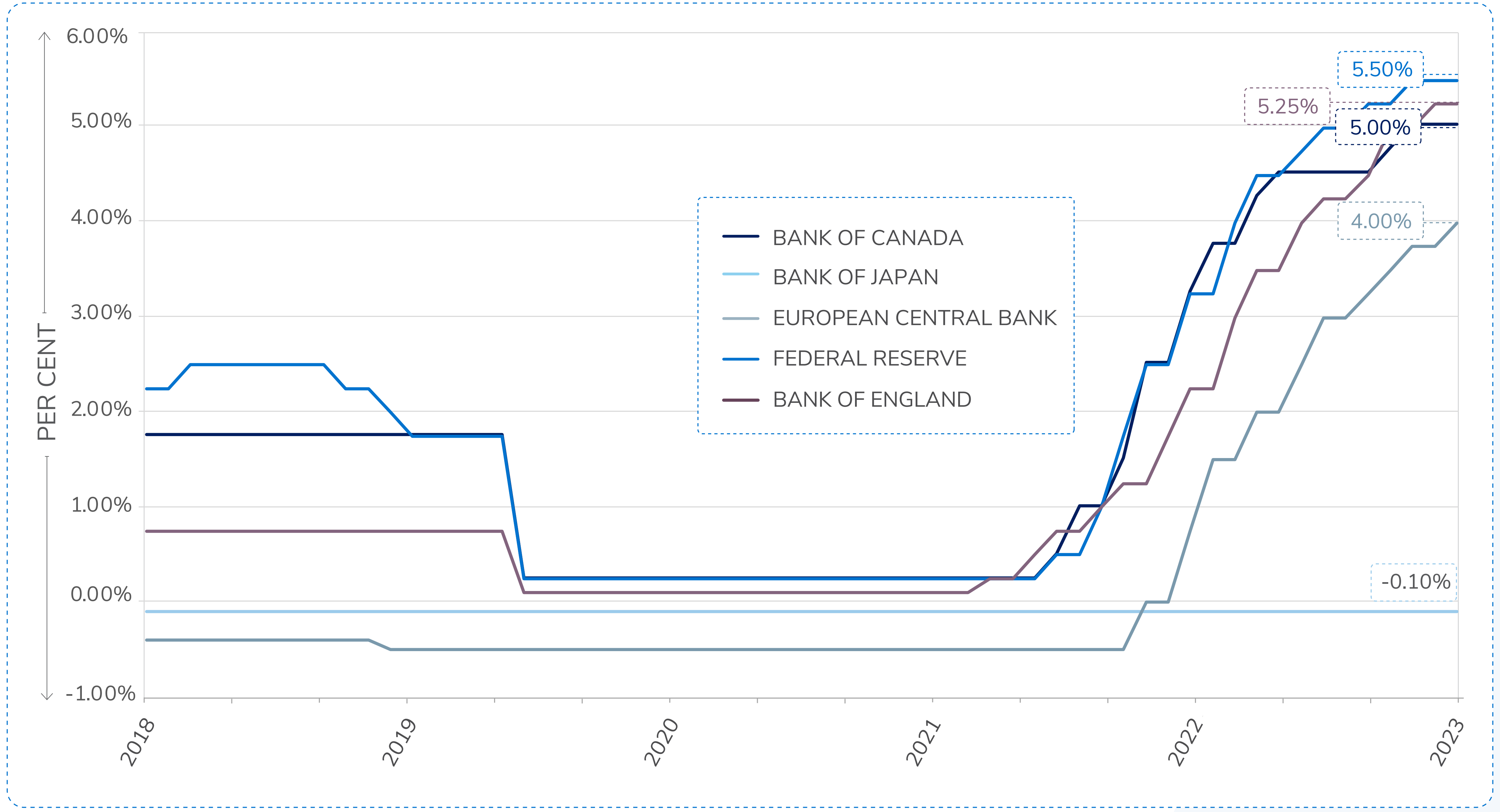
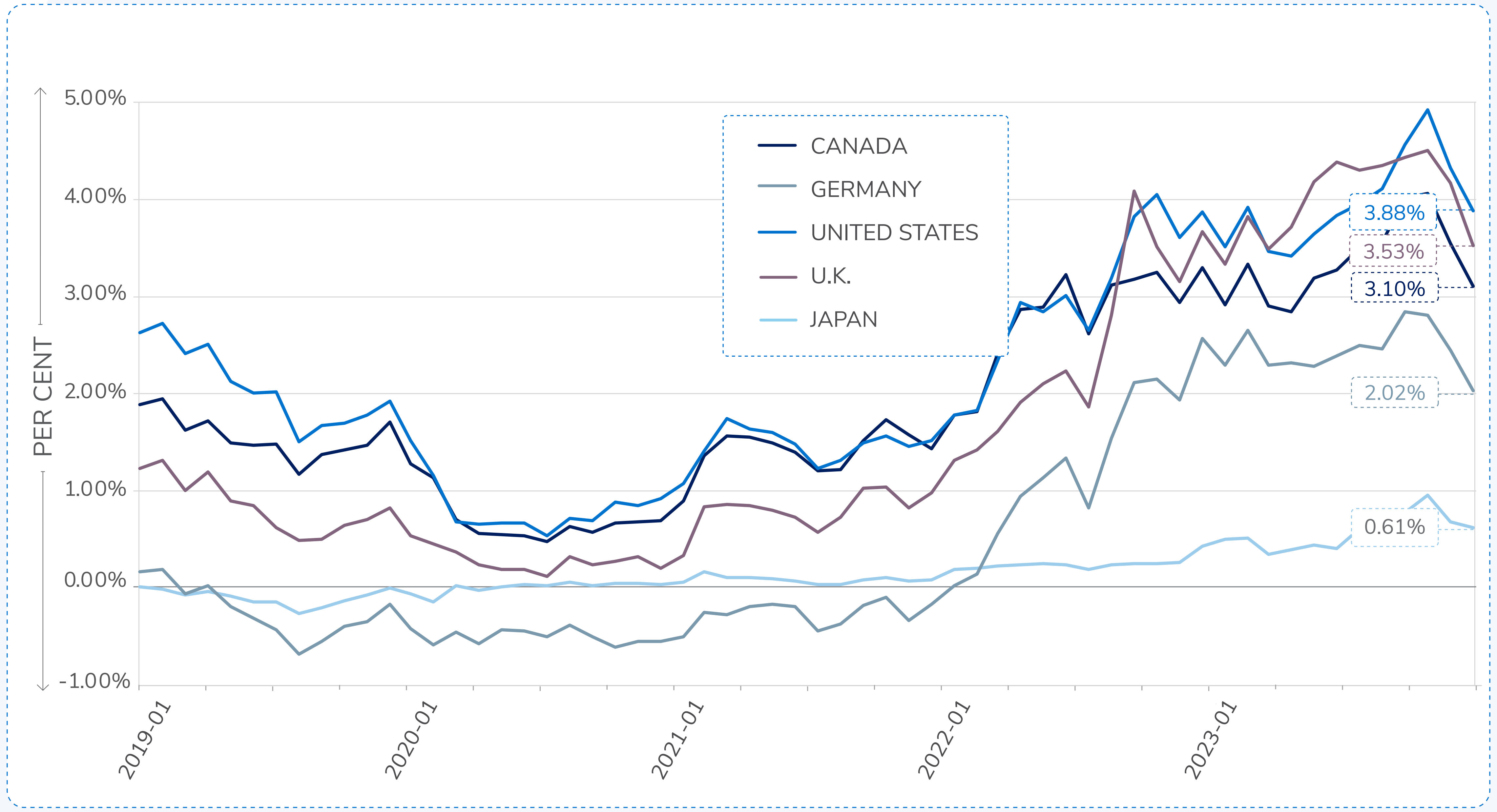


Chart 7 – Sovereign bond 10-year maturity yields: last five years



Source: IG Wealth Management, Bloomberg as of December 29, 2023.

Key benchmark performance

Chart 8 – Canadian dollar/U.S. dollar cross: last four quarters

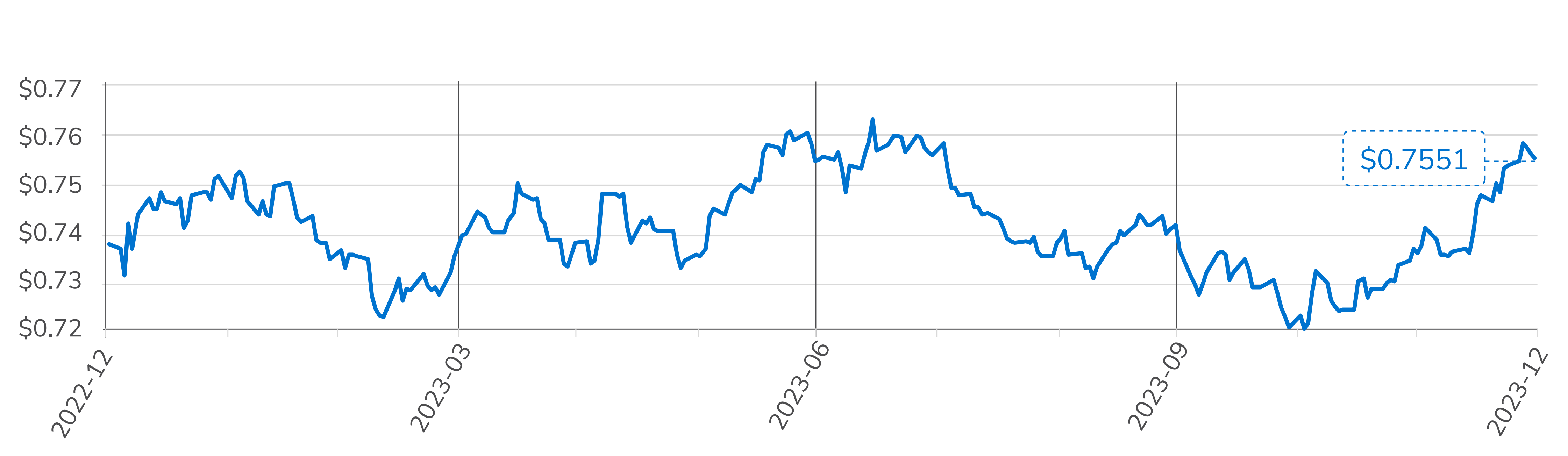


Chart 9 – Crude oil (WTI) US$/bbl: last four quarters

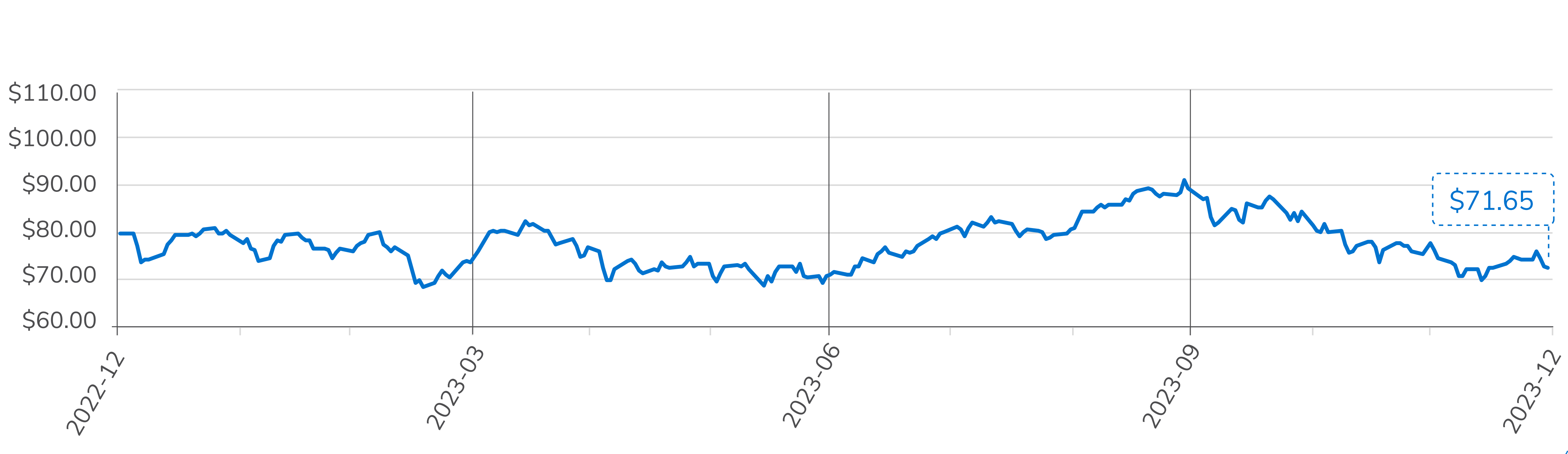


Chart 10 – Gold US$/oz.: last four quarters

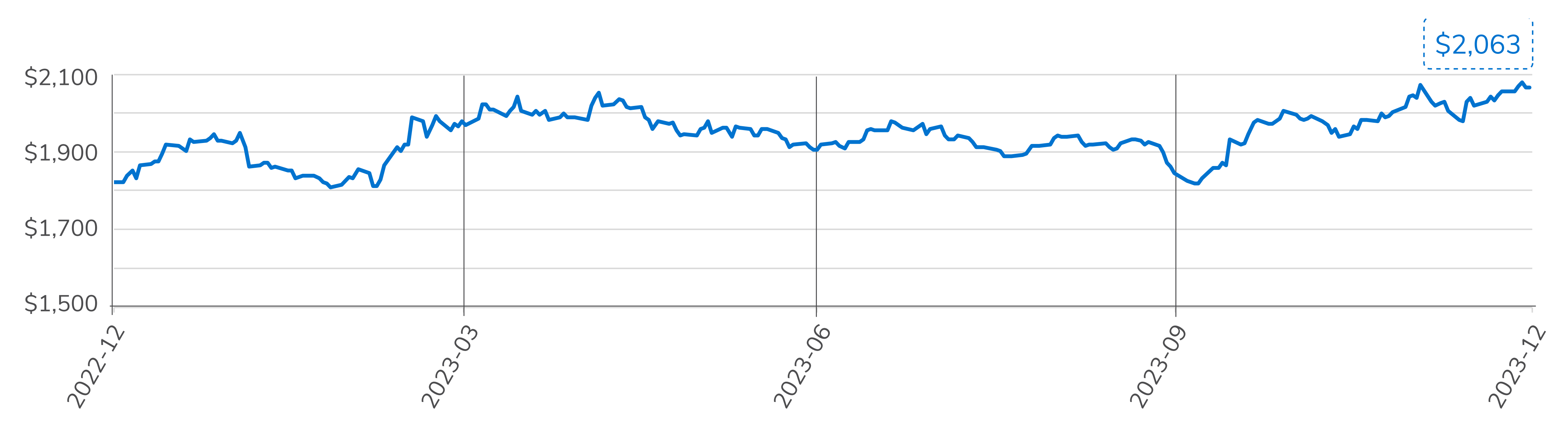
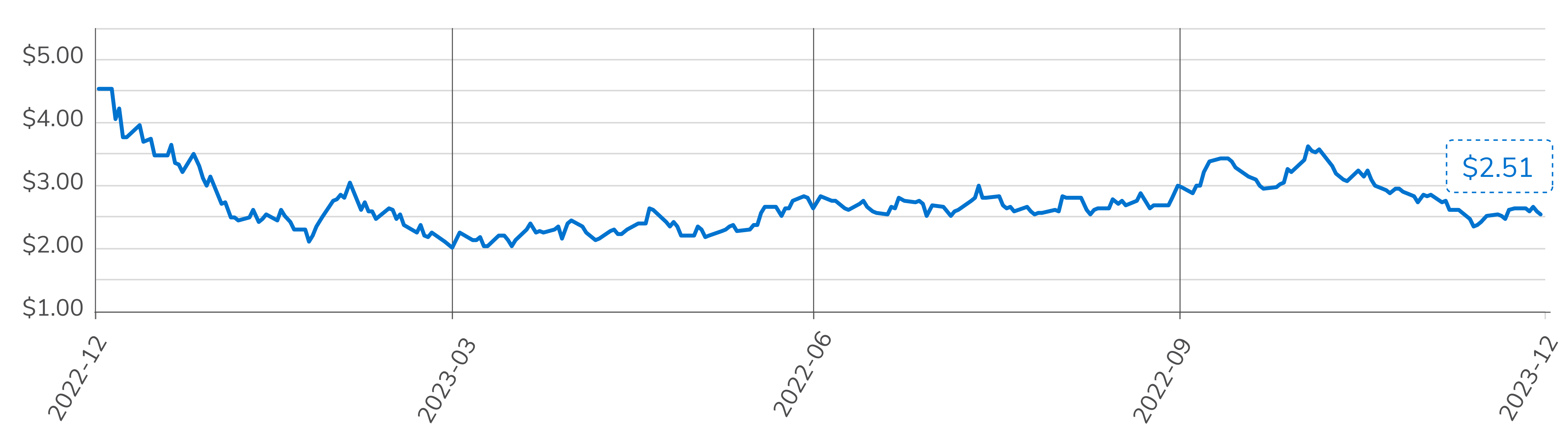


Chart 11 – Natural gas US$/mmbtu: last four quarters



Source: IG Wealth Management, Bloomberg as of December 29, 2023.

Market outlook

Recessions come in all shapes and sizes

Rolling recessions spotlight the rhythm of sectoral ebbs and flows within an economy. As one sector starts to recover, another might temporarily face a slowdown. Unlike a blanket recession that casts a uniform shadow, these manifest as fleeting soft patches in select sectors, with others either remaining untouched or on an upswing. This pattern, akin to an economic relay race, is more common than nationwide downturns.

This dance of rolling recessions isn't a sign of perpetual gloom, but a glimpse into the dynamic self-correcting nature of market economies, ensuring a perpetual motion towards long-term financial strength.

We are in a new labour paradigm

Demographics play a key role in future economic growth. This is because population growth and age distribution can influence the supply of labour and productivity. An aging population and declining fertility rates lead to a tight labour market.

This has been the case in many countries recently, as more individuals have been leaving the labour force through retirement than have been entering it.

A tight labour market can create competition among employers for employees. This can result in low unemployment and higher wage pressure, and a reluctance among employers to shed payroll for fear that they may not be able to re-hire at a later date.

Inflation is decreasing

In 2022 and into 2023, we experienced high inflation in many of the major developed economies. Over the past year, there has been a significant reduction in inflationary pressure.

For example, inflation in Canada and the U.S. has fallen by roughly half on a year-over-year basis.

Our models suggest inflation is likely to align closer to the U.S. Federal Reserve's and Bank of Canada's targets of 2%, with the eventual path to 2% taking some time.

Fears of runaway inflation are no longer relevant. We are solidly in the normalization phase for inflation, which also implies the normalization phase for interest rates.

Equity market valuations remain attractive

Within the S&P 500 Index, the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) contributed a disproportionate amount to the gains in 2023, pushing the index multiple higher, while the rest of the index's constituents saw valuations fall. Excluding the Seven, the S&P 500 Index reflects a valuation in line with the historical average.

We believe 2024 may see an improved earnings environment, driven by an economic recovery. Combined with an attractive valuation and continued easing of inflation, we believe equity markets are likely to deliver another year of positive equity gains across the major indices. Our indicators would suggest a return profile in the mid-to-upper single digits, with risk to the upside.

> *The earnings outlook is now brighter, as previous economic soft spots recede, and forward-looking indicators turn positive.*
>
> *-Philip Petursson*

Equity markets rallied in the last quarter, ending the year strong with most indices in the green. Driven by a robust U.S. consumer base, inflation control results and central banks signaling a pause on rate hikes, both equities and bonds saw gains.

Central banks in Canada, Europe and the U.S. are expected to potentially lower interest rates at some point in 2024. Signs show the manufacturing and earnings slump is fading, and the era of high inflation and high interest rates is coming to an end. There are more indicators pointing to a U.S. recovery rather than a recession.

The earnings outlook is now brighter, as previous economic soft spots recede, and forward-looking indicators turn positive. Valuations have shifted in the fourth quarter of 2023 to reflect this improved outlook. This means that some early-year volatility is possible as the markets digest the latest macro-economic data and determine if their optimism was warranted or exaggerated. As such, our approach is to maintain balance across asset classes and look for very strong diversification between and within asset classes.

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