4th Quarter North American Market Commentary – 2024

Key Take-aways:

- U.S. December Headline CPI rose +2.89% Y/Y. CPI has risen each month since the low of September 2024 of +2.40%. Core CPI came in at +3.24% Y/Y. FED officials have begun cutting interest rates even as inflation remains consistently well above their 2% target. The FED's credibility continues to be under pressure.

- Q3 2024 GDP for the U.S. was +3.1% annualized, reflecting stronger than expected contributions from consumer spending and exports. The official unemployment rate in the U.S. has remained unchanged since the end of the 2nd quarter at 4.1%, compared to 3.7% at the start of the year and historical average of 5.7%, which while still low in absolute terms, is on an upward trajectory.

- After aggressively tightening policy in 2022 and 2023 the FED reversed course in September 2024. It would cut rates two more times before year end for a total of 100bps in cumulative rate cuts. The Bank of Canada has reduced rates at a more aggressive 175bps during the year.

- For 2024, the market cap-weighted S&P500 was up +24.88%, the TSX300 was up +21.84%, and the equal weight S&P500 was up +12.78%. The S&P500 is a clear example of market cap distortion, where a heavily concentrated index can be significantly skewed by the performance of just a few large companies.

Positioning:

- The CBOE Volatility Index (VIX) began 2024 at 11 and spent more trading days near the 20-level (historical average is 19.5) post Q3. For now, the situation remains quiet.

- Q1 2025 GDP for the U.S. remains poised for an acceleration, and we expect to see re-acceleration in inflation. With yields once again rising, the bond market continues to discount the probability of future FED rate cuts.

- Q1 2025 GDP for Canada remains poised for an acceleration, and we expect to see re-acceleration in inflation. Canadian equities remain attractive destinations of capital in comparison to US equities.

- Markets remain, understandably, concerned with reported CPI, health of the labour market, and the implications for the FED's rate cutting cycle. An accommodating FED supports allocations to technology, financials, consumer discretionary, high yield credit, and high-quality growth opportunities in select sectors focusing on investible volatility.

- We anticipate a reasonably favorable environment for risk assets in the first quarter of 2025. Consumer confidence surged in November to the highest reading in over a year, underpinned by strong labor market conditions and optimism about future job opportunities under a President Trump Administration.

In the U.S., reported Headline CPI for December came in at +2.89% Y/Y, versus 3.35% Y/Y previously, and +0.14% higher month over month. CPI has risen each month since the low of September 2024 of 2.44%. Recall, Headline CPI measures the total change in the cost of all goods and services purchased by households. This includes all categories, such as food, energy, housing, apparel, transportation, medical care, recreation, education, and other goods and services. Shelter, food away from home and shipping costs were the largest contributors to the December reading. In contrast, reported Core CPI excludes food and energy prices and includes all other categories, such as housing, apparel, transportation (excluding fuel), medical care, recreation, education, and other goods and services. Core CPI is often used by policymakers, like central banks, to gauge underlying inflation trends and to make decisions about monetary policy. It is considered, by them, to be an appropriate measure for setting interest rates because it is less affected by transitory price shocks, such as weather conditions and geopolitical events. We argue that their choice of CPI measure makes the extent of price increases and currency debasement less obvious. Core CPI came in at +3.24% year over year, versus +3.93% year over year previously. After aggressively tightening policy in 2022 and 2023, raising the FED Funds Rate by 525 bps, the FED reversed course in September 2024 with a 50bps rate cut. It would cut rates two more times before year end, with a quarter-point reduction at both the November and December FOMC meetings. The 100 bps in cumulative rate cuts brought the FED Funds Rate down to a range of 4.25% to 4.50%.

In Canada, December reported Headline CPI came out at +1.8% Y/Y. The economy grew by 1% in Q3, below expectations, and the 4th quarter also looks to be weaker than projected. The unemployment rate rose to 6.8% in November. On December 11th the Bank of Canada cut its benchmark interest rate for the 5th time this year by a further 50bps, with its benchmark rate now settling in at 3.25%. The FED has reduced rates by 100bps while the Bank of Canada has reduced rates at a more aggressive 175bps. That interest rate differential favors the US dollar evidenced with the CAD$ depreciating -6.2% versus the US$ during this period. The possibility President Trump's Administration will impose new tariffs on Canadian exports to the United States and the lack of effective government leadership here at home has increased uncertainty and clouded the near-term economic outlook. Currency levels are a function of many things, but fiscal policy, monetary policy and economic conditions (including productivity and GDP growth) are among the most important. Unfortunately, Canada is experiencing weak leadership, low productivity growth and weak GDP growth while posting enormous deficits – a particularly unhelpful trio of conditions. Until these factors change, our outlook for the CAD$ is muted at best.

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Inflation is caused by easy money policies and money printing, The US money supply since 2000 has increased 6.26% annually. The level of debasement in local currency of countries around the world since 1999 is staggering. While the US has debased the dollar by 78% or 6.26% annually since 1999, it is hardly the worst offender. Canada has wiped out 81.5%, increasing its money supply by 7.1% annually since 2000. Theoretically, if politicians were not appeasing today's voters with tomorrow's spending, we would not be in this battle to fight historically above average inflation levels. Governments around the world are collectively engaged in devaluing fiat currencies, eroding their purchasing power. Given this dynamic is virtually assured, that nations collectively will continue to print money and devalue their fiat currencies, it should come as no surprise that individuals and corporations are increasingly turning to gold, bitcoin, and real estate.

In the U.S., cumulative inflation since 2000 now sits at 86.97%. This means that today's prices are 1.8697 times as high as average prices since 2000. In Canada, cumulative inflation since 2000 is 67.49%. This means that today's prices are 1.6749 times as high as average prices since 2000. Inflation is a regressive tax, impacting households regardless of income, yet doing so with varying degrees of relative magnitude, is gradual and cumulative. As such, disinflation from record-high price levels offers little relief. Cost of things are not deflating; they are simply inflating less. Inflation for each person is individualized and cumulative. Real inflation simply means the destruction of the purchasing power of the currency. Inflation remains a huge concern in the real world. Consumers are not focused on what Wall Street is focused on which is the rate of change from M/M, Q/Q, Y/Y or the different categories. They are focused on the level of inflation on 'needs' and 'wants' and how things are drastically more expensive. The level of arrogance out of the FED, Washinton, Ottawa and the Bank of Canada is at all time highs (rising money supply and ridiculous deficit spending leads to persistent inflation prints). The point is underlying inflation has remained elevated and the cumulative decline in purchasing power of US and CDN dollars remains a major concern for consumers and investors.

Looking ahead, the outlook for U.S. inflation to retreat and stick to their target of 2% annually is not particularly encouraging, and the FED may regret not staying disciplined as we may have a more interesting re-acceleration of inflation supported by rising commodity prices. The expectation remains that inflationary pressures will persist, even at the producer level, which will continue to feed into consumer prices. Many market participants expect inflation to drop quickly. This seems unrealistic given commodities have soared since rate cuts started, government spending is out of control and money supply growth is at 30-month highs. Unfortunately, inflationist governments

have yet to accept the culpability of their own fiscal and monetary policies. Again, we focus on cumulative inflation and the rate of change along with GDP and monetary policy which dictates our core holdings and where we like to adjust our positioning. The trend in the data has been consistent, measured inflation will continue to trend away from the FED's 2% target and if this is the case market participants should expect the bond market to continue to discount the probability of future FED rate cuts.

Q3 GDP in the U.S. was revised up to +3.1% annualized (vs. +2.8% prior), reflecting stronger-than-expected contributions from consumer spending, exports and government spending. The upward revision to GDP highlights sustained strength in the U.S. economy, particularly from resilient consumer spending. On the labour front, initial jobless claims fell by 9k to 211k in the week ending Dec. 28th and a further 10k to 201k for week ending Jan 4th, the lowest since April 2024. Continuing claims declined by 52k to 1.844 million, marking a three-month low and incremental improvement in labor market conditions. On January 10th Nonfarm Payrolls were released rising 256k in December, well above expectations of 165k. The unemployment rate has ticked down to 4.1% (previously 4.2%), still well below the historical average of 5.7%, labor force participation rate remained unchanged at 62.5%, also reinforcing the strengthening labor market. The 256k payroll increase marks the strongest monthly gain since March 2024, which surprised many due to the higher borrowing costs and accelerating inflation. Initial jobless claims remain low, underscoring labor market resilience. Combining the upward revision in U.S GDP with a drop in jobless claims, the data suggests the U.S. economy retains momentum heading into 2025. The risk remains that inflation could accelerate more than anticipated, particularly with potential tariff increases and a growing deficit. This poses risks for the current path of monetary easing. We remain cautious as persistent inflation risks could also challenge the consumer moving forward.

For year ending December 31st, the market cap-weighted S&P500 is up +24.88%, the TSX300 is up +21.84%, and the equal weight S&P500 has managed to climb +12.78%. As at December 31st the five largest stocks (Apple, Nvidia, Microsoft, Amazon, Alphabet) in the S&P500 now represent 28.80% and has been responsible for a disproportionate share of its gains for some years now. In fact, as of year end, only 27% of SPX constituents were outperforming the index—a near-record low—highlighting that index concentration and narrow breadth remain key risk factors.

National Association of Active Investment Managers (NAAIM) member firms, consisting of active money managers, are asked to provide a number representing their overall equity exposure at the market

close on Wednesdays each week. We like to use the index as a contrarian indicator when it reaches extreme levels, either near 100% or near 40% exposure to equities. Historically, high level of exposure has been a contrarian indicator, suggesting that high exposure often precedes slight market pullback as excessive optimism generally signals an overbought market ripe for a pullback. Latest reading on January 15th came in at 70.21%, down from 86.64% when the 4th quarter of 2024 began. Of note, the lowest number in the year has been 53.54% (January 17th) and the highest number has been 104.75% (March 13th) with average for the year being 83.09%. For the majority of 2024 these market participants were essentially near their peak exposure and had nearly exhausted their buying capabilities, which means systematic funds may be broadly inactive in the near term.

On the topic of non-discretionary flow in the market (Volatility Control Funds and Passive Funds) we may have a more interesting setup with 1-month realized volatility for S&P500 crossing 3-month to the upside. These non-discretionary flows pay little attention to company fundamentals and can have a significant impact on market behavior. For example, in periods of high volatility these funds may sell large amounts of equities to reduce risk, which can exacerbate market declines. Conversely, in periods of low volatility, they may buy equities, potentially driving up prices. This is also why we study the options market, the main driver of volatility. Volatility drives flows, which in turn drives prices. The issue we are facing here is that Systematic Funds are forced sellers if 1-month realized volatility exceeds 3-month realized volatility. During the first few weeks of January this has taken place. With Systematic Funds primed to sell, the likelihood of a self-reinforcing cycle of deleveraging becomes increasingly likely. We're not sure if this deleveraging will hold but the conditions are in place for a modest rise in realized volatility. Also, geopolitical risks remain elevated and excessive complacency could prove concerning in a market that is broadly underhedged for a decline.

Macro is the principal risk to our outlook for the equity markets, particularly around the Federal Reserve's delicate balancing act of controlling inflation and not harming the expected trajectory of real economic growth. Governments up to now have been able to paper over weakness in economic data. We have a situation where a government's fiscal policy has ended up dictating the direction of monetary policy. The U.S. National Debt is over $36 trillion, over $13 trillion higher than where it stood just five years earlier. Debt is growing 2Billion per day and all this debt is becoming increasingly costly to service, with the interest expense on US Public Debt rising to over $1.1 trillion. At the current pace it will soon be the largest line item in the Federal budget, surpassing Social Security. With the debt ceiling currently suspended, the US government has no constraints. Over the

past decade, tax revenue has increased over 60%, a fact that would surprise many citizens. But this pales in comparison to the 99% increase in spending. The United States' unsustainable budget deficit is a problem, and interest expenses are rising because the government rejects any form of budget discipline. With employment levels still robust and inflation still above their target of 2pct, cutting rates by 100bps since September can only be explained away by saying the FED decision was directly correlated with the fact the Federal Debt levels are becoming so high and bond yields again soaring and global demand for US Treasuries are declining. This printing of money to fund the government's irresponsible spending is inherently inflationary. This is the opposite of what Washington, and the FED is telling us. They will have us believe that we should not be worried about debt levels as spending can always be absorbed by global investors. This is simply not true and the recent trend from the high of 33pct global ownership down to 22pct proves this. This all means there is a diminishing confidence level in the US government and its ability to navigate its financial obligations (existing and upcoming unfunded committed liabilities) and the incoming Trump Administration should not ignore these warning signs and continue to push the imbalances and patience levels of global investors. Budgetary decisions are a looming threat to economic stability. High debt levels limit fiscal flexibility, increase borrowing costs, and heighten the risk of a future financial crisis. Managing debt is a choice, and today's leaders face a critical decision point. These exact concerns exist for Canada as well.

Despite these issues, we anticipate a reasonably favorable environment for risk assets in the first quarter of 2025. Consumer confidence surged in November to highest reading in over a year, underpinned by strong labor market conditions and optimism about future job opportunities. Small businesses, the backbone of the U.S. economy, are riding a wave of optimism tied to expectations of tax relief, regulatory rollbacks, and pro-growth policies under President Trump. US Banks released latest quarterly results and spoke to an encouraging US economic and regulatory environment. After more than two years of broad deceleration the cyclical economy is flashing stabilization. The U.S. labor market remains resilient, as recent initial jobless claims data reflect no significant signs of softening. Tight labor conditions continue to support consumer spending, acting as a buffer against broader economic uncertainty despite persistent inflation.

With the FED beginning its next major policy pivot and no let up in fiscal spending that goes alongside, the outlook for rising debt/deficits remains firmly entrenched across the intermediate and longer durations. Fears of rising debt levels are at the forefront of investors' minds, as it will be challenging for any incoming president to deal with budget sustainability amid bloated discretionary spending and the growing burden from entitlement programs. The bond market could easily nullify the impacts

of another rate cut. That's because the bond market believes the FED is cutting rates by too much, too soon, and is therefore raising long-term inflation expectations. President Trump's economic agenda has sparked optimism in some sectors with expectations of business-friendly policies. That said, this has raised concerns about higher tariffs, immigration policies, and disruptions to supply chains. While this will take months to realize, higher volatility could be seen in 2025 as markets attempt to juggle inflationary pressures and the growth implications of new trade policies and tax reforms. We are currently positioned for acceleration in growth with inflation re-accelerating by being overweight technology (growth), financials, certain industrials, energy, commodities, and high yield credit. The message from the bond market has been clear, higher for longer on both inflation and yields. We are in extraordinary times. Patience remains our core allocation.

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Sincerely,

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The Portfolio Management Team

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