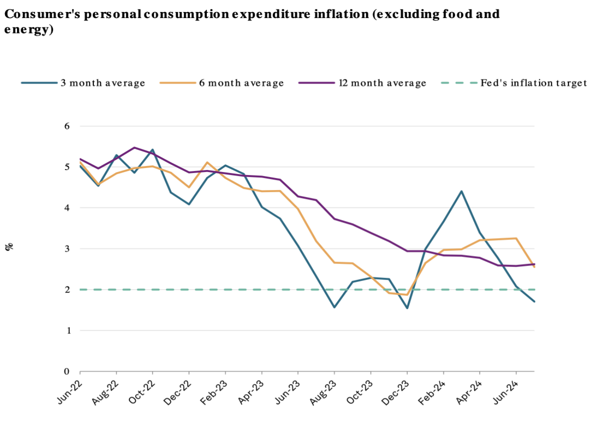
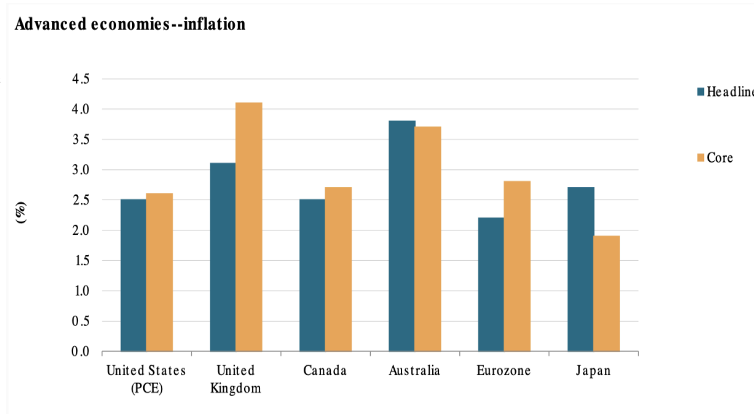
Economic & Market Outlook Q4 2024

1. Global Macroeconomic Trends

In the United States, inflation continues to move steadily towards the Central Bank's sustained



Sources: Bureau of Labor Statistics and S&P Global Ratings calculations. Data through July 2024.



Numbers reference latest data. PCE--Personal consumption expenditure. Sources: Country websites.

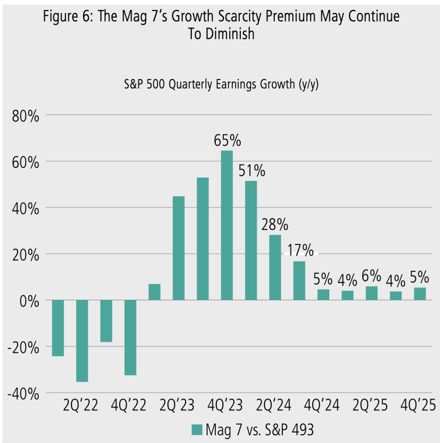
target of 2.0%. In the left figure, we see different calculations of change in core inflation, a measure which excludes more volatile goods such as food and energy, over windows of 3, 6, and 12 months respectively. With consistent downward trending, and the 12-month window hitting the target already as of June, inflation has been stable. As of more recently, core inflation in the United States was reported to have ticked upward from September and October, sitting at 2.6% compared to September's 2.4%. In the right figure, we get a better picture of inflation in developed markets internationally and observe notable inflation still present in the UK and Australia. Eurozone inflation, with headline measures at 2.2% as of September 2024 and decreasing steadily, hit a record low of 1.8% in October, surpassing the European Central Bank's target of 2.0%.

The United States labor market remains firm, with job openings and quits, according to recent JOLTS statistics, on a steady path towards pre-pandemic, stable levels. Unemployment reached 4.2% as of September, and as of October sits at 4.1%. Compared to a low of 5% in mid-2022, Canada's unemployment rate sits at an unhealthy 6.5% as of October, set to exceed 7% in early 2025. However, with a 50 basis point rate cut from the Bank of Canada in late October and signs of more to come later this year, the unemployment rate may reverse course. EU employment rate sits at 5.9% as of September 2024, compared to 6.1% in September 2023. In general, rate cuts around the developed world suggest that unemployment rates will gradually decrease.

The American GDP grew by 2.8% in Q3 earlier this year, slightly below expectations. The Federal Reserve's probability model indicates a 57% chance of a US recession sometime within the next 12-months. There is an expectation of a 2.0% growth in Q4, down from 3.2% Q4 growth in 2023. The Chinese GDP expanded 4.6% in Q3, and is expected to grow another 4.6% in Q4, down from earlier forecasts of 4.8%. Sharp Chinese property market decline and weak domestic spending account for this less optimistic correction. The Eurozone experienced a 0.4% GDP growth in Q3, higher than the expectation of 0.2% from economists polled by Reuters and no credit to Germany, which is undergoing a manufacturing recession debilitating GDP growth.

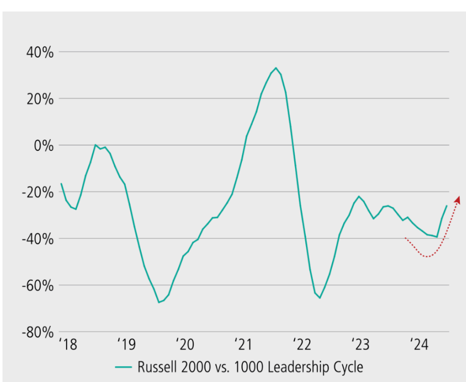
2. Global Equity Market

In the American equity market, the valuations of the so-called Magnificent 7–comprising Apple, Amazon, Alphabet, Microsoft, Meta, Nvidia, and Tesla–have receded since last quarter, although still trading at a 28% premium according to Neuberger Berman. The left figure illustrates the described, hindered earnings growth. In other words, the differential between Magnificent 7 and non-Magnificent 7 equity in the S&P 500 is diminishing. In 2023, according to Forbes, the collective Magnificent 7 returned 90% in 2023 compared to the S&P 500's overall 24%. This year, the Magnificent 7 are up ~30% compared to the S&P 500's ~20%. This is a generally positive result. Having substantial domination over the S&P 500 index leads to sector, and more generally, index, vulnerability. The overall performance of the index becomes heavily reliant on that of the already volatile technological leadership. With the diminishing differential, other sectors will begin to experience more investment and hence more growth and economic productivity. As a result, investors should begin to look towards diversification into other areas of the market.



As of recently, concentration in the Technology and Communications Services sector within the S&P 500 remains elevated at 39.8%, although down from 41.8% earlier this year in June.

More broadly, since July 1, the Russell 1000 Value Index, which focuses on companies that are trading undervalued equity, has outpaced the Russell 1000 Growth Index by 624 bps according to Neuberger Berman. Where the vertical axis is relative return, the left figure illustrates, in addition, increase in performance by the Russell 2000 small-cap Index compared to Russell 1000 large-cap. There are strong signs that point towards market sentiment shifting away from high return high volatility large-cap stock to more stable and diversified value small-cap stock. One of many reasons is the growing uncertainty over the near future as a result of recent election results.

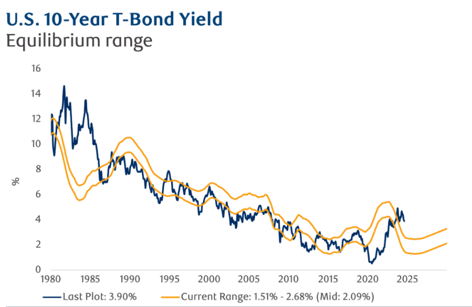


Internationally, STOXX Europe 12-month Price-to-Earnings, excluding the UK, indicate that European equities are being traded at below average valuations. In fact, recent reports show that European stocks closed 2% lower daily, constituting their biggest daily decline since August. Mining stocks led the losses in particular, dropping 4%. Technology stocks managed to inch up 0.04% nevertheless. European mid-small cap stocks are trading around 12 to 13 times earnings, versus their American counterparts at 28 times earnings. Chinese underperformance continues in the equity market due to the housing crash. India's equity market capitalization jumped by more than 50% year-on-year as of June 2024, with signs towards a slowdown.

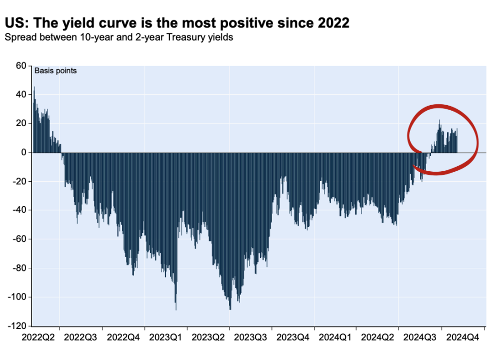
3. Global Rate Treasury Market

As mentioned earlier, the Bank of Canada introduced a substantial rate cut of 50 basis points to 3.75%, with possibly more to come. This was done in an effort to combat unemployment by boosting consumer spending, now that inflation is under control. For the same reasons, the United States Federal Reserve introduced a 50 basis point cut in mid-September, and a 25 basis point cut in early November. The European Central Bank introduced a 25 basis point cut in September, while the Bank of England introduced a 25 basis point cut. The People's Bank of China introduced a rate cut going into Q4 2024 by 50 basis points on interest rates for existing mortgages to combat the housing crash. All these rate cuts have significant impacts on treasury markets in developed markets.

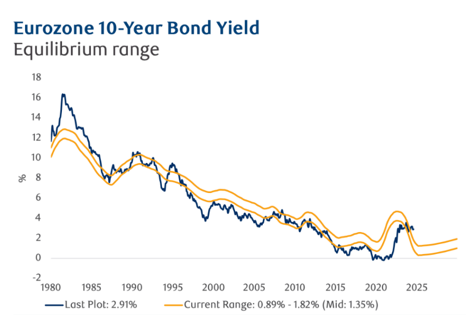
In September, 10-year United States treasury yield dropped to 3.63%, a notable decrease from the 3.80-3.90% range through August. By late October, the 10-year Treasury yield approached 4.28%, an increase of 0.65%. As of November, the number sits at 4.47%. The left figure shows projections for 10-Year T-Bond Yield as of August, 2024. What can explain the dip in yield, followed by a surge? Firstly, interest rate cuts increase the yield of longer term bonds more sharply than shorter term bonds. Additionally, the magnitude of the initial rate cut was largely unexpected. This kind of strong correction likely left investors in uncertainty over the state of the economy, over its stability in coming years. This led to increased demand for the longer term 10-Year T-Bonds, which in turn increased their price and hence decreased their yield. However, after initial sentiments, investors realized that the American economy is growing strong and steady, as explored above, and that interest rates would likely see hikes to combat inflation in the near future sooner than anticipated. Higher interest rates disproportionately impact longer term fixed income securities, which led to a reduction in demand, hence a reduction in price, and finally an increase in yield. Additionally, the left figure shows that the differential between 10-year and 2-year T-bonds is the most positive it has been in recent years.



Note: As of August 30, 2024. Source: RBC GAM



Internationally, more rate hikes in Japan by the Bank of Japan will pressure the Japanese yield curve flatter, as higher interest rates decrease the demand for existing bonds, pushing their yields up. The 10-year Eurozone yield is at 2.97%, compared to 3.02% the previous market day and 3.49% last year. This is still higher than the long term average of 2.46%. The right figure illustrates the projected general growth of Eurozone yields, as of August 2024.

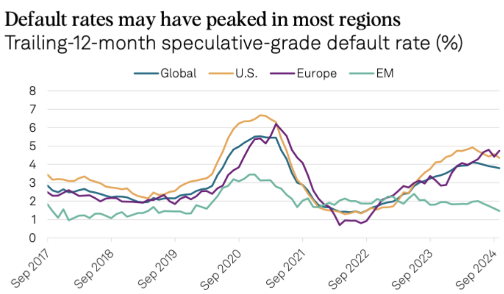


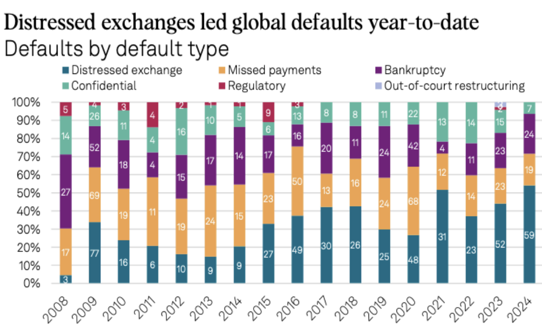
Note: As of August 30, 2024. Source: RBC GAM

4. Global Credit Bond Market

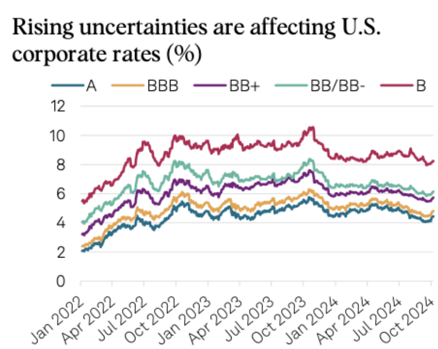
Under current strong economic conditions, including decent and improving unemployment rates which promote higher stability and a resulting lower risk of default, stronger credit securities should continue to flourish going into Q4 of 2024. However, there are increased risks of defaults for more volatile credit securities and more vulnerable companies, with speculative grade debt projected to rise sharply in early 2025.

Reports indicate that defaults may have peaked. This is illustrated in the bottom left figure, where there is gradual curbing around September 2024 for markets worldwide. Corporate defaults decreased to 31 in the third quarter from 41 in the second quarter. In Europe, even with year-to-date defaults hitting record highs seen most recently in 2008, the number of defaults dropped by two points, suggesting a gradual reversal.





Furthermore, distressed exchanges continue to drive defaults, accounting for 65% of quarterly defaults, up from the previous quarter of 46%. The growth in distressed defaulting is illustrated in the bottom left figure. Distressed defaults refer to those in which companies default because of insolvency, or insufficient cash flow. The large proportion of distressed defaults indicates slowing economic growth under recession-like conditions. As inflation is getting under control, and as developed countries begin cutting interest rates to address unemployment and help boost consumer spending, investors can expect a curbing of such defaults.



The right figure illustrates the volatility of corporate rates of various grades in the United States in recent years. Net dips in rates are consistent across all the grades. Furthermore, in the bottom right figure, we similarly observe dips in European corporate bond yields. We can again attribute the relative declines in these rates and yields to the relatively unproductive developed economies in recent years in environments of high interest rates, as well as lower consumer spending and investment into the private sector. As a result of sharp rate cuts around the developed world, we may see this begin to change going into 2025.

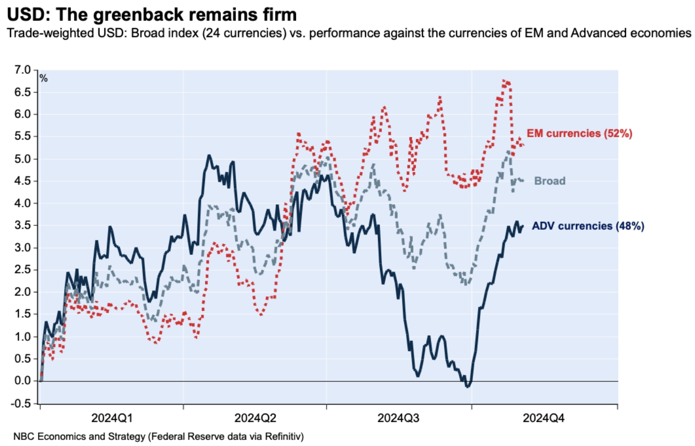
Outstanding global rated corporate debt is up 3.2% since the beginning of the year, sitting at $24.3 trillion.

Exhibit 4: European Corporate Bond Yields are Falling but Remain Elevated

As at 30 September 2024
Source: LSEG Datastream

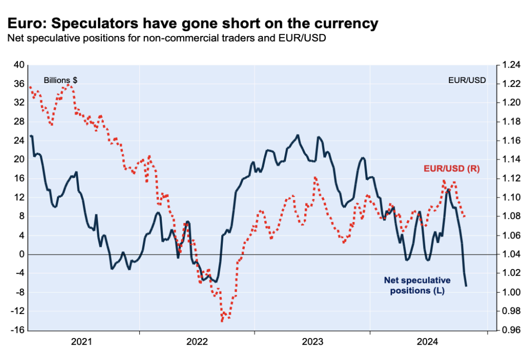
5. Foreign Exchange

Going into November, the weighted broad-dollar index, which measures the US dollar's value against 24 currencies, is 4.5% higher than at the start of the year. In the left figure below, we can observe clear appreciations of the USD's value, particularly against advanced market currencies and the broad index, less so against EM currencies. This appreciation is likely due to strong GDP growth in Q3 and into Q4 of 2024, as well as high interest rights just before the rate cuts in late Q3 that attracted investors, boosting the relative strength of the greenback. Even with the rate cuts, the greenback is still attractive. As of today, the index sits at 106.88, compared to the 104.20-104.30 range in late October. This can be explained by the fact that developed countries all around the world are cutting rates at similar or even steeper rates than the United States, meaning that the United States' interest rate is not relatively less attractive.



The Canadian dollar has struggled, reaching its worst levels since the pandemic at 1.406 CAD on the greenback as of November 2024. This can be rationalized by Canada's weak GDP growth and overall weak economy. Into Q4 of 2024, Canada's GDP growth is projected to hit 1.0% at most, short of the Bank of Canada's revised estimate of 1.5%, and well short of its estimated 2.1% to 2.8% growth potential. Estimates put the rate at 1.45 CAD to the greenback by the end of this month, to potentially worsen further in coming months.

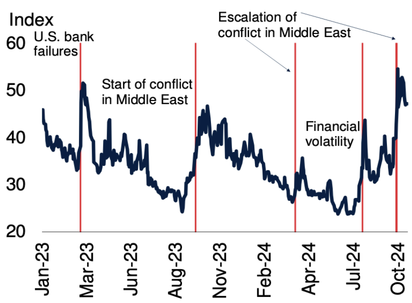
The Euro has crashed, sitting at around 1.05 USD/EURO, slumping more than 6% in September after one-year highs. Experts estimate that it is not unforeseeable for the Euro to hit a rate of 1 USD/EURO. With EUR/USD being the world's most traded pair by far, making up around 23% of the foreign exchange, compared to the runner up of USD/JPY at roughly 14%, there will be noticeable impacts in the months to come. The left figure illustrates this downturn. This crash is a result of United States tariff scares under the upcoming Trump presidency, which has not only affected the Euro. Compared to the Euro's fall of 4.5%, the Mexican Peso has fallen by 6%, and the Korean won by 5.4% according to Reuters. The left figure also illustrates pessimistic outcomes for the EURO in coming months and suggests further deterioration on the horizon.

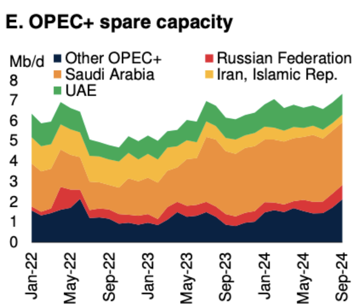


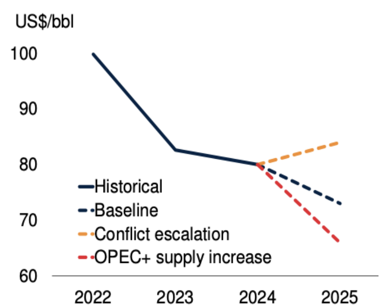
After Beijing's slate of stimulus measures, the Chinese yuan strengthened to 6.995 on the greenback in late September, the strongest since May 2023, and sits now at 7.245, as a result of growing tensions with China worrying investors.

6. Commodities Market

Starting with energy, geopolitical tensions have led to unstable oil prices in recent months. Brent oil, for instance, shot to a record $90/barrel earlier this year in April. More recently, as of November, the price sits at $73/barrel. In the left figure, we can observe sharp climbs, in units of the index, in oil price volatility in recent times. Even with high prices earlier this year and high volatility as of right now, oil price has been declining. This can be attributed to several reasons. Firstly, global oil consumption is decelerating. In 2023, global oil demand increased by roughly 2 million barrels per day. In 2024, this figure sits at 1 million barrels per day. A strong driver is China's recent contraction in demand, with China being the engine of global oil consumption. Secondly, global oil supply continues to diversify, with market share of non-OPEC+ producers gradually increasing. Part of this is the gradual shift to clean energy alternatives. Thirdly and finally, OPEC+ holds spare oil capacity of roughly 7% of current global consumption, a high. This can lead to excess supply in an already well-supplied oil market. The left figure clearly illustrates this growth in supply, with wider spread on the right side in September 2024 compared to the left in January 2022. The right panel illustrates different possibilities for oil price trends going into 2025.



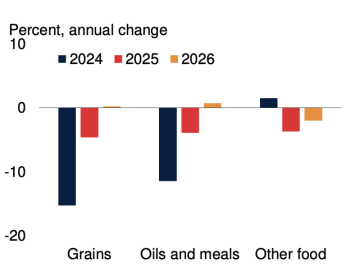




The World Bank's natural gas price index increased by 10% in Q3 of 2024. Demand for American natural gas has hit a record high, undermining energy transition efforts. European natural gas prices have been rising sharply, reflecting supply concerns, namely from strained relations with Russia during the ongoing Russian-Ukraine war. As such, the European natural gas benchmark increased by 15% in Q3 of 2024. In China, consumption rose by 10% in the last quarter. Overall, natural gas demand increased by 2.8% throughout 2024 thus far.

In metal markets, prices have climbed in late September due to stimulus measures in China, which led to increased economic activity and naturally a greater Chinese demand for metals, driving prices up worldwide. Globally, from sustained demand with a positive outlook from the energy transition, the World Bank base metals price index was up 10% in September. Gold prices sit 27% above their December 2023 level, while iron has underperformed.

As a result of favorable weather conditions, supply for agricultural goods is remaining steady, and prices are expected to fall by 4 percent within the next year. The global agriculture market size has grown considerably in recent years, from $13,272.75 billion in 2023 to $14,356.23 billion in 2024 at a CAGR 8.2%.



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