Quarterly base-case scenario

CIO Office | Q2 2024

Confusion on the tarmac

The upbeat sentiment that marked the end of last year continued on the markets in the first quarter of 2024, with the S&P 500 surpassing its previous record set in January 2022, thanks in part to the persistent outperformance of tech giants at the forefront of advances in artificial intelligence. Meanwhile, bonds continued to lag, as investors no longer expect as many rate cuts as they did three months ago, whereas precious metal prices appreciated in the face of a still uncertain geopolitical context.

On the economic front, although there has been some good news since the start of the year, the real state of affairs remains difficult to assess as contradictory signals multiply. For example, while manufacturing activity appears to be picking up, consumers appear less prone to spend, as evidenced by slowing retail sales growth and rising credit card delinquency rates. Lastly, the fog is still thick on the inflation front, with various price indices surprising both on the upside and the downside in Canada and the U.S.

Over a twelve-month horizon, our base scenario still anticipates a gradual slowdown in inflation, accompanied by more turbulence for economic growth. In this respect, we will have to keep a close eye on consumer spending and, ultimately, the resilience of the labour market, which could be challenged later this year. Nevertheless, in the shorter term, the fact that the Federal Reserve is opening the door to rate cuts potentially as early as June – despite inflation stalling around 3% – could provide further grounds for optimism in equity markets for a few months yet. Moreover, this suggests that the Fed will not hesitate to act quickly – as it did a year ago during the regional bank debacle – in the event of a significant deterioration in economic activity, thereby reducing the risk of a financial accident.

Under the circumstances, we gradually adjusted our equity allocation higher to a neutral stance during the first quarter, reflecting the better balance of risks in the near term. Geographically, within equities, we continue to overweight the U.S. and EAFE regions, both of which benefit from defensive properties, persistent momentum and a more supportive economic environment than Canada and emerging markets. Incidentally, we'll be keeping a close eye on forthcoming communications from the Bank of Canada, as a recognition of the weaker economic growth and inflation on our side of the border has the potential to see the loonie slide further.

	Previous		Q2 2024	Key elements and investment implications
Bull case	Immaculate disinflation (15%)	→	**Slow landing (40%)**	• Inflation stagnates between 2% and 3%, opening the door to a maximum of just three rate cuts by the Fed in 2024. • Labour markets cool down without a marked rise in unemployment; job openings drop, wage pressures ease. • Household consumption proves resilient, supported by solid balance sheets and a job market at equilibrium. • Overseas, economic growth stabilizes while manufacturing activity picks up. **Economic implications:** Positive GDP growth, stable unemployment rate. **Market implications:** ↑Equities ↕Bond yields ↓USD ; U.S. & EM > Canada & EAFE
Base case	Stagnation (50%)	→	**Mild recession (50%)**	• The cumulative impact of past rate hikes ultimately drives the unemployment rate into recession territory. • Faced with an economic slowdown and inflation near target, the Fed cuts its policy rate a minimum of three times in 2024. • Solid household balance sheets and elevated fiscal spending limit the extent of the economic slowdown. • Overseas, economic growth continues to fall short of expectations, while efforts by the Chinese authorities produce mixed results. **Economic implications:** GDP growth slightly below zero, moderate increase in unemployment. **Market implications:** ↓Equities ↓Bond yields ↕USD ; U.S. & EAFE > Canada & EM
Bear case	Recession (35%)	→	**Recession (10%)**	• Faced with a rapidly deteriorating job market, consumers cut spending significantly. A traditional recession takes shape. • Inflation slows promptly, paving the way for a series of interest rate cuts. • Unknown financial markets fragilities are revealed, putting pressure on policy makers. • Geopolitical tensions escalate. Volatility in commodity markets increases. U.S. presidential elections sow uncertainty about the future of the country's fiscal and trade policies. **Economic implications:** Recession; GDP contraction, job losses, material increase in unemployment. **Market implications:** ↓↓Equities ↓Bond yields ↑USD ; U.S. > EM

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