Desjardins Global Asset Management

Market Review

MARCH 2025

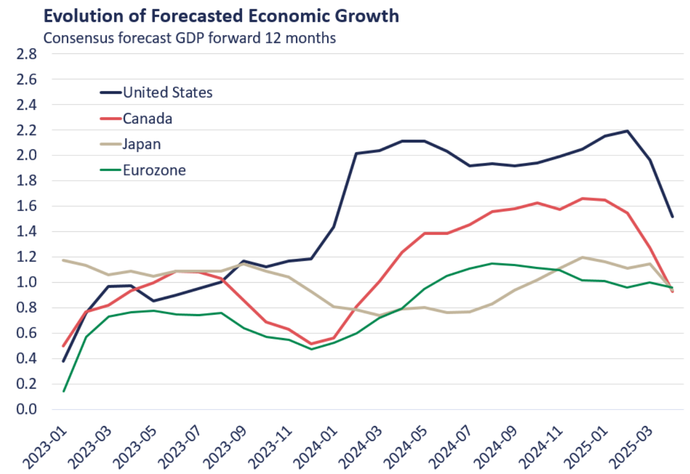
Economic Review

When isolationism and unpredictability upset the balance

The renewed optimism observed after the US elections in November was short-lived. From the moment the Trump administration took office, the unpredictable nature of its decisions and the prospect of a trade war completely reversed this momentum.

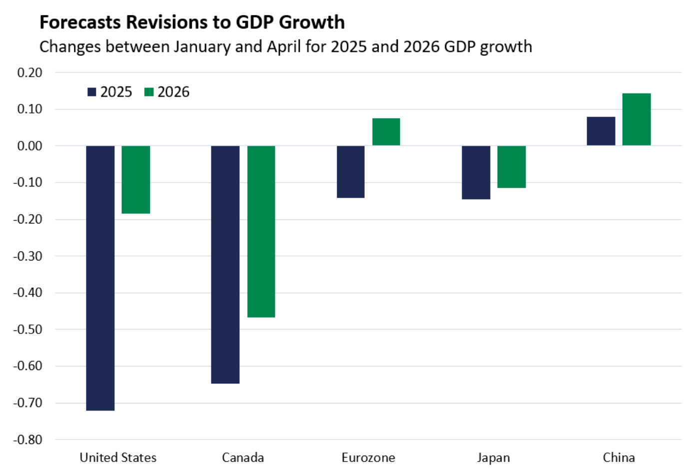
In such an uncertain environment, forecasting is a real challenge for economists. While they agree on downgrading the economic growth figures put forward at the beginning of the year, the extent of the decline will remain largely dependent on the effects of the tariff measures announced by the US government after the end of the first quarter and the resulting trade tensions. Unsurprisingly, data from the Bank of America's Fund Manager Survey show a significant increase in macroeconomic pessimism, with the second-largest monthly rise recorded since measurements first began in 1994. For instance, 63% of survey participants expect the global economy to weaken in the coming year.

To date, the figures collected by forecasters show global growth falling below 2% for the next 2 years, down 2.6% from 3 months earlier. Most countries and regions are affected, including the United States, whose growth rate is now below 2%. For its part, Canada has seen its growth forecast markedly downgraded, to below 1.3%. The figures for Europe have remained stable, with an average growth of 1.0%. Among emerging markets, China remains the exception, with a projected growth rate of around 4.5%.



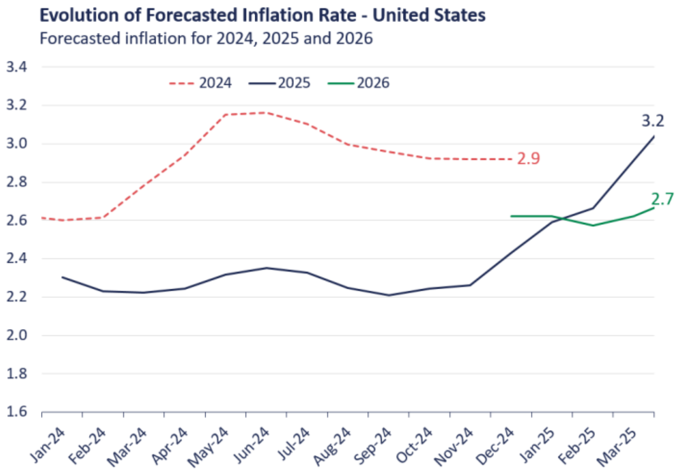
Sources: DGAM, Consensus Economics, LSEG, April 2025

In the US, uncertainty created by the tariff measures has been compounded by the changes put in place by the new government, either with respect to the role of the Department of Government Efficiency (DOGE), or to policies targeting energy, labour and immigration.



Sources: DGAM, Consensus Economics, April 2025

Furthermore, due to an inflation rate of 2.8% in February, which remains high, the Federal Reserve continues to exercise caution; it maintained its key rate at 4.25% to 4.50% at its January and March meetings, while aiming for 2 cuts of 0.25% by the end of the year. The Fed has very little leeway to act pre-emptively to moderate the effects of the current climate of economic uncertainty. The likelihood of an economic slowdown is in fact emerging, as tariffs increase the risk of higher inflation, lower business profits and weaken growth, which would result in the scenario known as stagflation.

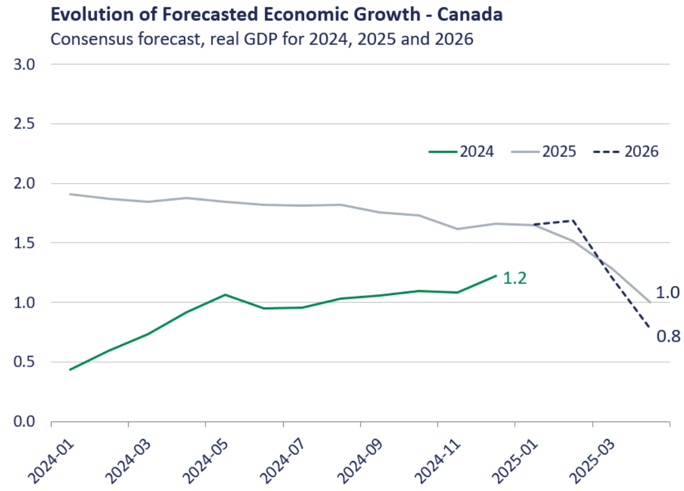


Sources: DGAM, Consensus Economics, April 2025

The Canadian economy proved more resilient than expected at the end of 2024, notably due to strong consumer spending. Unlike its US counterpart, the Bank of Canada has the necessary leeway to pre-emptively ease the country's credit conditions. It has in fact announced 2 consecutive cuts of 0.25% to its key rate since the beginning of the year, despite inflation remaining above its target, to counter the economic risks linked to trade tensions.

While to some extent conditions remain favourable for the Canadian stock market due to its strong exposure to companies in sectors that are managing to perform well, including materials, energy, utilities and financial services, significant challenges remain in a context that includes trade tensions, a weak Canadian dollar and the potential for recession.

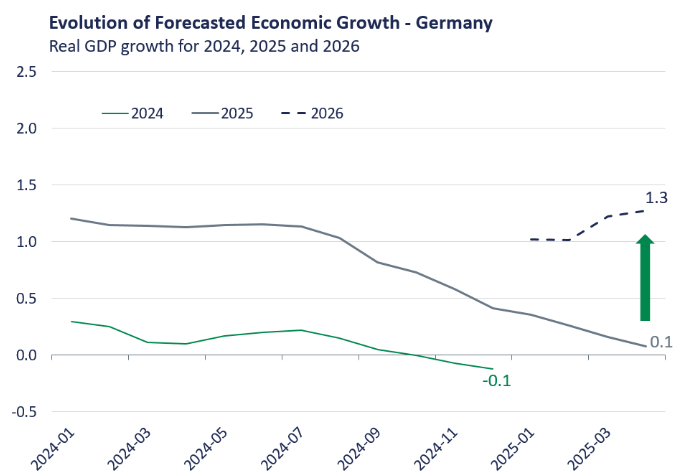
Moreover, since Canadian household debt levels remain high, businesses whose revenues depend on consumer purchasing power have no choice but to adjust in order to maintain financial balance. Unless we see a major change in tone in trade relations with the US, a recession will be difficult to avoid.



Sources: DGAM, Consensus Economics, April 2025

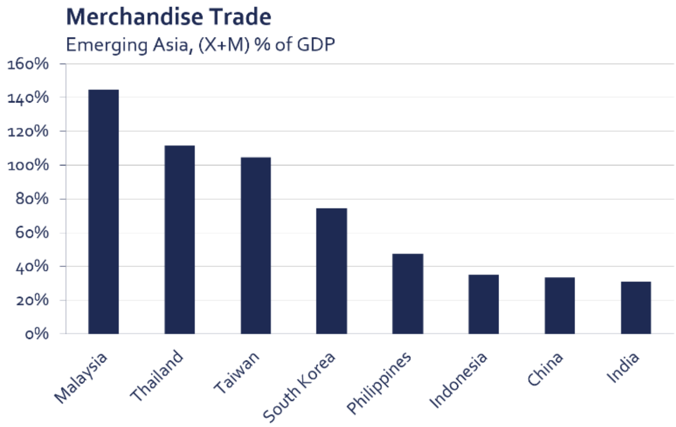
In Europe, all the signs suggest that the situation could evolve depending on the implementation of the German government's €500 billion stimulus plan for rearmament and infrastructure. The first step, a constitutional amendment required to authorize its financing, has already been taken. The plan could also generate economic benefits for neighbouring countries that can't afford to launch similar programs.

In addition, conditions seem favourable for the EU's 27 member states to undertake concerted efforts toward rearmament and the modernization of defence. While it's likely that US tariffs will ultimately lead to an economic slowdown in the short term, they could help revive Europe's growth ambitions over the longer term.



Sources: DGAM, Consensus Economics, April 2025

In Asia, unsurprisingly, China quickly responded by announcing reciprocal tariffs against those of the United States. The tensions resulting from such a trade war will inevitably impact the global supply chain and, consequently, the ability of manufacturing businesses in many regions to maintain their profit margins. Japan, which had been counting on favourable economic prospects at the beginning of the year, had to revise its forecasts given that the US is its largest export market and accounts for 20% of shipped goods, including about one third of its automotive production destined for foreign markets. However, the country can rely on strong domestic demand and the vitality of international tourism, a major sector of its economy, to support growth.



Sources: DGAM, LSEG, World Bank, March 31, 2025

South Korea, another major player in the region, is monitoring the situation with heightened vigilance. Highly dependent on its exports, particularly in the semiconductor and auto sectors, it is exposed to the double risk of a slowdown in global demand coupled with friction between its two main trading partners, the US and China. The South Korean government has also strengthened its industry support measures and diversified its markets to limit the effects of these tensions.

Canadian Fixed Income

In the first quarter, the 10-year yield on Canadian bonds went from 3.23% to 2.97%. Over the same period, the FTSE Canada Universe Bond Index returned 2.02%. For the corporate bonds making up the index, the return was 1.81%. The current yield and the general decline in interest rates have offset the widening of credit spreads.

Provincial Credit

The strong performance of provincial bonds recorded in December failed to extend into the first quarter. The spreads gradually widened as trade relations with the United States deteriorated. The tabling of provincial budgets also contributed to this widening by confirming high borrowing needs for the foreseeable future. Compared to Ontario's 5- and 10-year benchmark bonds, the spreads widened by 3 basis points (bps) to 27 and 65, respectively. For 30-year bonds, the spread rose to 95 bps, an increase of 10 bps. Quebec and British Columbia bonds slightly underperformed as the fiscal positions of these provinces weakened; investors are waiting for Ontario to release its budget to better assess the relative strengths and weaknesses of the provinces.

As in the previous fiscal year, the provinces will need to resort to foreign market issuances to support their large borrowing programs and keep domestic spreads in check. However, even with 38% of issuance abroad last year, this hasn't prevented spreads from widening amid uncertainty stemming from deteriorating trade relations with the US. We have started to increase our exposure to long-term bonds, while acknowledging that the geopolitical situation and its impact on the Canadian economy could lead to even wider spreads. From a strictly technical standpoint, we are seeing strong demand for short-term securities; the provinces could therefore choose to issue more of them, which would ease the pressure on credit spreads for long-term bonds.

Corporate Credit

For corporate bonds, we observed a widening of credit spreads of about 9 bps over the first quarter. No sector was spared, and the auto sector in particular experienced a particularly difficult quarter due to the US government's tariff threats. Ford Credit Canada saw the credit spreads of its bonds maturing between 2029 and 2031 widen by approximately 85 bps. In the US, the CDX index shows credit spreads widening by 11 bps, about half of which (5.5 bps) is explained by the transition from the former IG43 series to the new IG44.

In Canada, infrastructure and telecommunications were the two best-performing sectors. Because infrastructure companies have an excellent credit profile, their securities benefit from it and serve as a safe haven for many investors. As for the telecommunications sector, Bell Canada's hybrid debt issuance and long-term debt buyback demonstrated its commitment to maintain its BBB rating. Given the current climate of uncertainty, we are maintaining our defensive positioning in corporate credit. Corporate balance sheets are healthy, but credit metrics are likely to deteriorate.

Fixed Income Strategy

In the first quarter, the Canadian economy followed a path similar to that of the previous quarter, including its impact on financial markets. Our assumption regarding market normalization in 2025 seems increasingly likely to materialize. The yield curve continued to steepen, driven by the decline in administered and expected rates, while corporate and provincial bond credit spreads continued to widen. In fact, by the end of the quarter, the forward administered rates expected by financial markets were

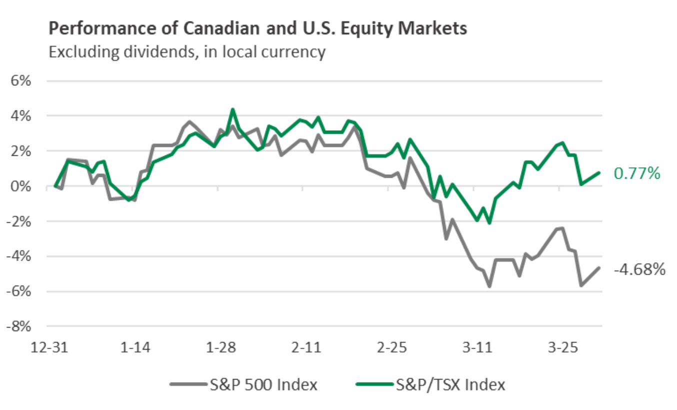
Sources: Bloomberg, LSEG and DGAM analyses as of March 31, 2025 converging toward 2.25%, which was our target at the lower end of the neutral range defined by the Bank of Canada, which is 2.25% to 3.25%. The growing threat of a tariff war and the geopolitical context have accelerated these trends in both Canada and the United States. These circumstances are also making us question the concept of American exceptionalism, since cracks seem to be appearing in the US markets and economy. This last factor could exacerbate the potential impact that new tariffs on US imports have on Canadian economic growth.

While credit spreads widened over the quarter, the extent of the movement varied from one sector to another. We took advantage of the rapid widening of corporate bond credit spreads to hedge certain positions in the short end of the curve. At the same time, the current environment led us to slightly reduce our long duration position relative to our benchmarks. We're maintaining an underweight position in long-term corporate bonds and are considering increasing our allocation to provincial credit.

Stock Markets

Canadian and US Equities

In the first quarter of 2025, North American stock markets decidedly delivered mixed performances, marked by very high volatility largely stemming from uncertainty over the new tariffs imposed by the Trump administration. That said, compared to its US counterparts, the Canadian market was relatively resilient, as the S&P/TSX Index ended the quarter in slightly positive territory with a return of 0.8% (price return excluding dividends in CAD). As for the US indexes, they posted their worst quarterly results since 2022. Tech stocks were particularly hard hit, as the S&P 500 Index saw its value fall 4.6% while the NASDAQ fell 10.4% (price return excluding dividends in USD).



Sources: DGAM, Bloomberg, March 31, 2025

In Canada, the threat of tariff measures on exports to the United States has put pressure on companies in a number of industries, including automotive, aluminum, aerospace and manufacturing. On top of that, the weak Canadian dollar is driving up the cost of imported products for businesses and consumers alike. Given the climate of uncertainty created by this situation, we're seeing market trends shift in favour of value and defensive stocks at the expense of momentum stocks. Investors are increasingly turning to securities in the financial and utilities sectors and moving away from the tech sector.

In the first quarter, the vast majority of industry sectors in the Canadian market posted a decline in the value of their indexes. The materials sector performed best, with a return of 19.9%, driven by gold securities whose appeal as a safe haven asset has increased, largely offsetting the decline of securities associated with other metals such as copper.

As mentioned earlier, defensive sectors performed well, notably utilities such as Altagas, Algonquin Power and Emera, whose securities posted an average return of around 15.5%, followed by Northland Power, Fortis and Hydro One, with an average return of 9.6%. The award for the top performer over the quarter goes to Innergex, which saw a return of 68.1% following the agreement with the Caisse de dépôt et placement du Québec to acquire all of its shares.

Companies in the financial sector also performed well, including TMX, which benefited from the market volatility to post a return of 18.7%. Great-West, Power Corporation, TD Bank and Intact also generated returns of 18.3%, 13.5%, 12.7%, and 12.3% respectively. In the telecommunications sector, Quebecor outperformed with a return of 15.3%, which contrasts with the 13.0% decline in Bell's share value; the sector as a whole posted a performance of 0.1%.

Meanwhile, businesses in the consumer discretionary sectors are feeling the impact of trade tensions. This is the case for Gildan, whose share value fell by 6.0% over the quarter. With a return of 9.7%, one exception to the rule is Dollarama, which continues to benefit from trends toward more affordable products; moreover, investors welcomed the announcement that it was acquiring the Australian company The Reject Shop.

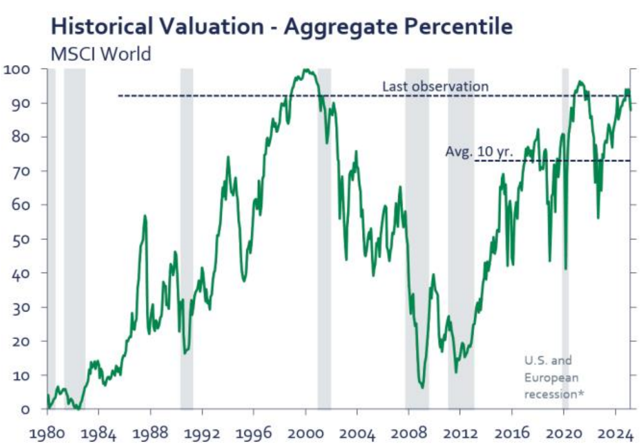
International Equity

According to the MSCI World Index, the value of global equities declined by 2.1% over the first quarter (net dividends reinvested, in local currency). As mentioned earlier, this was the worst quarter for US equities since 2022. On the other hand, Europe was the region with the best results, posting a 6.1% gain (net dividends reinvested, in local currency).

At the sector level, we observed a significant dispersion in results. The energy, utilities and finance sectors performed best, showing resilience and posting positive returns. The environment for technology, communication services and consumer discretionary was less favourable, and they were the only three sectors to see their index values decline. Such disparity clearly shows that the markets are experiencing significant volatility.

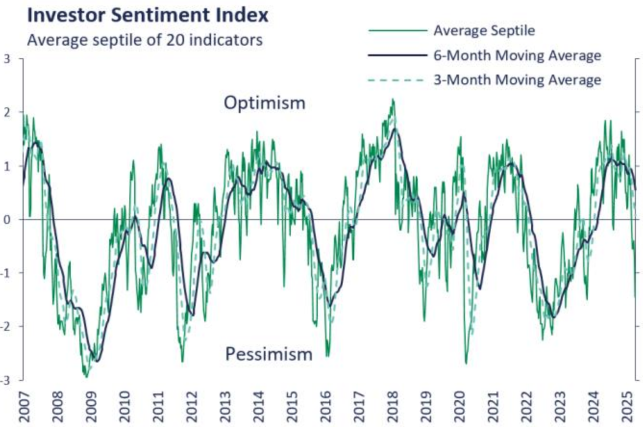
For businesses, one of the most important issues is whether they can pass on the increased costs resulting from the imposition of tariff measures to their product prices. Companies whose revenues are closely tied to consumer spending are increasingly cautious about the future, due to a slowdown in sales in recent weeks. The tourism industry in particular could suffer as non-US travellers react to the US tariff measures. In March, flight bookings by Canadians for summer travel to the US dropped by 70%, highlighting the real economic impact of the trade war.

Valuation indicators are also pointing to market turbulence. Although corporate earnings forecasts remained relatively stable, the overall valuation index fell by 5 points to reach the 92nd percentile. This contraction in multiples was observed in all regions, with US equities remaining the most expensive and those in the Asia-Pacific region at the bottom of the scale.



Sources: DGAM, LSEG, MSCI, IBES, NBER, *ECRI, Bloomberg, March 31, 2025

In the last weeks of March, investor sentiment deteriorated rapidly. Our internal index moved into bearish territory, indicating a significant regime shift. The 3-month moving average highlights this trend even more clearly, reflecting growing pessimism among investors.



Sources: DGAM, LSEG, Bloomberg, State Street Global Markets, March 2025

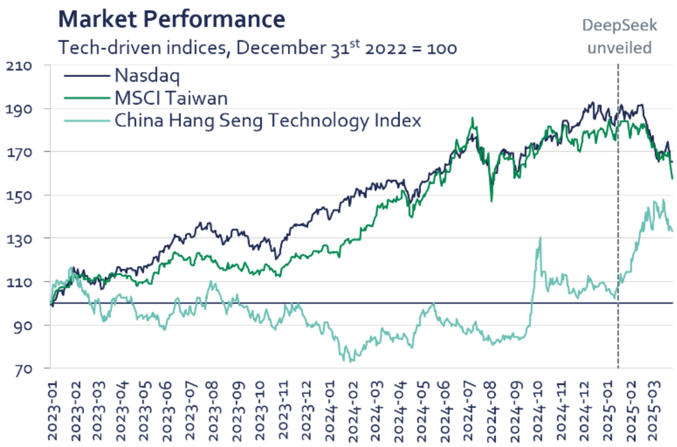
Emerging Markets Equity

While the economic indicators for emerging markets aren't showing any unfavourable signs, we believe that certain countries and sectors have benefited from advance orders placed by US companies ahead of the imposition of tariffs. This situation could lead to a decline in exports later this year that would add to the direct impact of the tariff measures. Moreover, the prevailing climate of uncertainty is likely to hinder investment and negatively impact the global manufacturing sector, on which emerging markets are particularly dependent.

Countries and sectors that benefit from greater local exposure should fare better. As a result, we have increased our positions in consumer staples and India. Countries that are able to support their economies through monetary easing or fiscal relief measures will also benefit from more favourable conditions. This is the case for China, which is expected to undergo fiscal expansion in 2025.

In terms of emerging market equity valuations, our standardized model shows a slight deterioration over the first quarter, moving from the 73rd to the 78th percentile of its historical distribution. Relatively speaking, emerging market valuations remain very attractive compared to developed markets, especially relative to US equities.

Unlike developed markets, and despite tariff risks, emerging markets posted stock market gains over the quarter. Chinese equities performed particularly well following the launch of the DeepSeek chatbot and the Chinese government's encouraging message toward private businesses.



Sources: DGAM, LSEG, March 31, 2025

Eastern European equities also advanced, given the increasingly likely signing of a ceasefire between Ukraine and Russia. In fact, we have observed fund inflows into emerging market equities since the beginning of the year. That said, investor positioning remains relatively weak.

Asset Allocation

Caution and agility are more important than ever

The climate of uncertainty, which has reached its peak worldwide, is prompting investors to demand an additional risk premium. Markets are currently factoring in the unprecedented US tariff measures, with the resulting stock market corrections. However, they have yet to price in the risks of a recession or the negative impact on corporate earnings.

The tariff measures are equivalent to doubling the corporate tax rate for US businesses, putting short-term downward pressure on their profit margins. Such a decline generally leads to reduced investment, hiring and economic growth. The US government will therefore need to quickly stimulate its economy to counter these negative effects.

Financial markets now understand that the tariff threats weren't intended to secure concessions, but rather to reinforce US hegemony and to finance the tax cuts set to expire in 2025. Most countries will retaliate or attempt to negotiate a reduction of these tariffs. However, business and consumer confidence are already shaken, and US exports are at risk of suffering from retaliatory measures. The economic and financial factors specific to the various stock markets seem to be becoming secondary.

Decisions by the US Federal Reserve will also need to be monitored. Given its dual mandate, it may soon become more concerned with employment than with inflation, which remains high. The inflationary effects of the tariff measures could cause it to delay its monetary easing process until it is convinced that the risks to employment are more concerning than inflation. Fears that the Federal Reserve will intervene too late could put downward pressure on the yield curve.

We will also be monitoring S&P 500 corporate earnings, which are generally affected by the economic slowdown and more subdued inflation. This index is more vulnerable to a trade war than the US economy as a whole, since 41% of the revenues of the companies it represents come from abroad, compared to 11% for the overall US economy. Forecast revenue growth for S&P 500 companies is higher than the growth rate of the US and global economies. The market is expecting a rise in profit margins, which are already at their historical peak. These forecasts seem optimistic given the current context of heightened political uncertainty, restrictive monetary policy, slowing government spending and a trade war.

We will also need to see what becomes of the exceptionalism of the US economy, which has largely been driven by fiscal stimulus and advances in artificial intelligence. It has been impacted by a number of events in recent months. On the one hand, the new 3-3-3 rule introduced by US Treasury Secretary Scott Bessent will reduce US fiscal stimulus. On the other, the arrival of the DeepSeek chatbot has dampened enthusiasm for American AI.

At the same time, the German government's easing of the public debt limit will boost its economy and those of neighbouring countries, even though major European economies have less leeway to imitate this decision. Recent data show that business and household confidence in Europe remains fragile, which was the case even before any US tariffs were imposed, while economic growth forecasts are struggling to exceed 1%. With its inflation target nearly reached, the European Central Bank can continue its monetary easing, which should boost spending by households with high savings.

For Canada, while the key rate is in the middle of the neutral range estimated by the Bank of Canada, analysts expect economic growth to fall below its long-term potential, with a decline in household and business confidence and a drop in exports following the pre-tariff acceleration in the first quarter. The strength of interest rate-sensitive sectors was short-lived given slowing demographic growth and the climate of uncertainty generated by the new US administration.

In addition, as the government bond yield curve has shifted lower, the risk associated with mortgage renewals has diminished. Further key rate cuts are expected, as the Bank of Canada aims to see the economy operate above its potential to reduce unused capacity. The S&P/TSX Index, which is sensitive to interest rates, is already benefiting from the steepening of the yield curve despite factoring in tariff-related uncertainty. Meanwhile, there seems to be a consensus that the Canadian economy is likely headed for a recession due to the imposition of tariffs.

The situation is also evolving rapidly in Asia. The Chinese government, which accounts for 28% of the MSCI Emerging Markets Index, is continuing its program of measures to support residential real estate, encourage private businesses and stimulate local consumption. More measures are expected in response to the US government's tariff measures, but the pace of exports could decelerate immediately after the pre-tariff surge.

Chinese stock markets recently reacted positively to these measures by outperforming their emerging market peers. Interest in the tech sector has been renewed thanks to advances in artificial intelligence, including the DeepSeek chatbot. Note that Asian economies, which make up about 75% of the index, have been hit by high US tariffs ranging from 25% to 50%.

These global economic conditions are leading us more than ever to exercise caution and agility in asset allocation. The table below presents our positioning recommendations as at March 31, 2025. We are lowering our recommendation on corporate bonds and emerging and global market equities in light of an impending trade war and economic slowdown. As a result, we are placing greater emphasis on cash.

POSITIONING	- -	-	0	+	++
CANADIAN EQUITY	☐	☑	☐	☐	☐
US EQUITY	☐	☑	☐	☐	☐
EMERGING MARKET EQUITY	☐	☑	☐	☐	☐
EAFE EQUITY	☐	☑	☐	☐	☐
WORLD EQUITY	☐	☑	☐	☐	☐
US 10Y BONDS	☐	☐	☑	☐	☐
CANADIAN 10Y BONDS	☐	☐	☐	☑	☐
CAN. CORPORATE BONDS	☐	☑	☐	☐	☐
PREFERRED SHARES	☐	☐	☑	☐	☐
CASH	☐	☐	☐	☑	☐

■ Fixed Income					
Yields to maturity - Canada	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Bank of Canada overnight rate	2.75%	3.00%	3.25%	4.25%	5.00%
2 years	2.46%	2.57%	2.93%	2.91%	4.18%
10 years	2.97%	2.90%	3.23%	2.96%	3.47%
30 years	3.23%	3.12%	3.33%	3.14%	3.35%
Credit market	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Mortgage rate (prime rate)	5.0%	5.2%	5.5%	6.5%	7.2%
5-yr credit spreads (CDX.IG)	61	49	50	53	51
5-yr High yield credit spreads (CDX.HY)	376	309	311	329	330
5-yr Emerging debt credit spreads	318	300	297	323	287
■ Fixed Income indices			**Total return**		
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
FTSE Provinces index	1369	-0.7%	1.9%	7.4%	0.1%
FTSE Municipal index	1489	-0.5%	2.1%	8.0%	0.8%
FTSE Corporate index	1466	0.0%	1.8%	8.8%	3.2%
FTSE Overall	1193	-0.3%	2.0%	7.7%	0.9%

■ Currencies			Variation		
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
CAD/USD	0.70	0.5%	0.0%	-5.9%	-2.2%
CAD/EUR	0.64	-3.6%	-4.3%	-6.1%	-0.3%
CAD/GBP	0.54	-2.1%	-3.2%	-8.0%	-6.0%

■ Fixed Income					
Yields to maturity - United States	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Fed rate	4.50%	4.50%	4.50%	5.00%	5.50%
2 years	3.88%	3.99%	4.24%	3.64%	4.62%
10 years	4.21%	4.21%	4.57%	3.78%	4.20%
30 years	4.57%	4.49%	4.78%	4.12%	4.34%
Credit Market	**Current spread**	**1 month**	**3 months**	**6 months**	**1 year**
Spreads Ontario - 10 years	65	62	57	66	63
Spreads utilities - 10 years	105	103	95	115	116
Spreads communications - 10 years (BBB)	143	141	132	147	152
Spreads banks - 10 years	38	36	30	44	69
■ Equities			**Total return C$**		
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
S&P/TSX Composite	24918	-1.5%	1.5%	15.8%	16.8%
S&P 500	5612	-6.1%	-4.4%	14.9%	18.9%
MSCI World	3629	-4.8%	-1.8%	14.1%	17.0%
MSCI Emerging Markets	1101	0.2%	2.9%	15.2%	8.6%
MSCI Global Small Cap.	539	-4.1%	-3.7%	6.4%	14.3%

■ Misc.			Yield / return		
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
VIX *(level)*	22%	20%	17%	13%	54%
Bloomberg Commodity Index	106	3.1%	7.6%	13.6%	11.7%
Gold	3124	9.3%	19.0%	40.1%	14.6%
WTI crude oil	71	3.1%	1.4%	-4.8%	10.0%

Legal notes