Market Perspectives

The Year Ahead 2025

TD Wealth Asset Allocation Committee ("WAAC") Positioning Overview

- The TD Wealth Asset Allocation Committee ("WAAC", "we") **are overweight Equities entering 2025,** as we expect positive earnings growth to continue to drive attractive relative returns over the medium-term. While the U.S. market had a strong 2024, equity returns were broadly positive across many geographies and sectors. Earnings growth (as represented by the MSCI All Country World Index) has been partially captured by the market in valuations, and we believe current valuations are justified given the backdrop of modest economic growth.
- With the Bank of Canada ("BoC") policy rate now lowered to the top end of its estimated neutral range, additional rate cuts are expected to be delivered carefully in order for the BoC to maintain flexibility to respond to a wide array of domestic or international macroeconomic and political uncertainties. Given the extent to which the **Canadian bond market has outperformed other bond markets** over the past two years, we expect only modest low-to-mid single digit total returns over the next 12 to 18 months. Nevertheless, against a backdrop of continued monetary policy easing, we expect that bonds will continue to provide stable income and preserve capital.
- We believe that an allocation to **alternative assets** can benefit diversified portfolios especially when implemented over the long-term. Alternative assets can provide inflation protection and attractive absolute returns, while acting as long-term portfolio stabilizers via their diversification benefits and less correlated income streams. Given the nature of private asset classes as well as the present phase of value adjustment in several markets and asset classes, we believe that this may be an attractive time to increase or consider an allocation to alternative assets.

Economic Year In Review

The global economy succeeded in a “soft landing” in 2024, although some countries stuck the landing better than others. To the surprise of many U.S. equity markets rose at breakneck speed, and never looked back after Donald Trump won the U.S. presidential election. Expectations that the U.S. Congress’ “red wave” (broad support for the Republican party) would be good for business, outweighed concerns of renewed tariff wars. Policies are expected to come fast and furious in 2025, including changes to immigration policy, regulations, taxes, combined with the overlay of tariffs that will no longer be reserved only as a tool to address trade irritants on goods and services.

Fortunately, both the U.S. and Canadian economies are exiting 2024 in a stronger position than expected. As such, TD Economics’ forecasts were set to be revised higher for 2025 but backed away from this view due to tariff risks, as well as a tightening U.S. labour force. Likewise, areas that could become growth-enhancers, like corporate tax changes, are not incorporated into their forecasts in the absence of specific guidance from the U.S. Congress, which holds the purse on these decisions. That leaves some upside risk to the economic outlook.

The U.S. economy remains the envy of its peers, on track to grow by a healthy 2.7% in 2024. At the same time, inflation has cooled, and the job market has softened slightly. An unemployment rate at 4.2% is bang on the U.S. Federal Reserve’s (the “Fed”) long-run trend estimate. The incoming administration in Washington has inherited a solid economic backdrop and President-elect Trump will have every desire to keep the economy and stock market humming. This suggests some incentive to curb the most extreme policies proposed on the campaign trail, but there will likely be follow-through on priorities related to border control and tariffs.

Across the pond, Europe’s economic outlook has dimmed relative to last quarter, as the forecasted improvement in the latter half of 2024 has not transpired. Lower inflation has boosted real incomes, but consumers are still reluctant to spend. Now, we are layering on a potential hit from some U.S. tariffs on European exports. Fiscal policy is also a wildcard in Europe as challenges balancing the budget have toppled the Prime Minister in France. Conversely, Germany’s economic malaise could improve next year if a new government loosens borrowing rules.

Chart 1: Global Equity Index Returns

Name	1M	3M	12M	3Y	5Y	10Y
S&P 500 Index (Large Cap)	0.27%	9.02%	36.36%	13.76%	16.92%	15.58%
S&P/TSX Composite Index	-3.27%	3.76%	21.65%	8.58%	11.08%	8.65%
MSCI EAFE Index (Europe, Australasia, Far East)	0.38%	-2.18%	13.24%	6.14%	6.92%	7.50%
MSCI Emerging Markets Index (Emerging Markets)	2.62%	-1.88%	17.85%	2.88%	4.24%	6.31%

Source: TD Asset Management Inc. (“TDAM”). As of December 31, 2024. In Canadian dollars.

The Year Ahead 2025

Economic Outlook

Looking forward to 2025, the combination of potential extensions of the first Donald Trump administration's tax cuts enacted in 2017, with a lowering of the U.S corporate tax rate, and significant deregulation, could all drive positive for earnings growth for U.S. companies. In the view of the TD Wealth Asset Allocation Committee (the "WAAC", "we"), this growth could be in the 12% to 15% range. We are cautious, however, not only due to persistent geopolitical instability, but also with elevated stock valuations, particularly in the U.S., where the average forward price-to-earnings multiples remain elevated by historical comparison.

At the close of 2024, the U.S. economy was forecast to slow to a still solid 2.0% in 2025. This is not due to expectations on the new administration's policies, but rather a reflection of the natural business cycle path towards normalization. Excluding the pandemic, which was not a market-driven event, the U.S. is amid the longest expansion in history, suggesting at best an economy at mid-cycle. This creates a natural gravitational pull back to its sustainable, trend pace, particularly after sustaining a long period of restrictive interest rates.

In Canada, the economy has faced significant challenges over the past couple of years, with high interest rates weighing heavily on a highly leveraged household. However, the clouds may already be parting. Canada's traditional growth-drivers, the consumer and housing, are once again a source of upside momentum to the economy. Even with an expectation that Canada will absorb some tariffs from the U.S. administration, economic momentum in combination with lower interest rates should help it gain a step to 1.7% economic growth in 2025, versus a tepid 1.3% in 2024.

Canada's forecast will materially depend on how successful it will be at managing its relationship with the incoming Trump administration. Even if only a 10% blanket tariff is imposed on Canada, a period of extended stagnation would be expected over the next two years. Due to the energy-heavy nature of Canada-U.S. trade, we expect Canada will avoid the full 25% tariff, but the constant threat of tariffs could be enough to send a chill through businesses considering investing in domestic capacity.

Source: TD Economics

Outlook

Asset Class Outlook For 2025

Modest Overweight Equities

Sub Class	Allocation
Canadian Equities	Modest Overweight
U.S. Equities	Modest Overweight
International Equities	Modest Underweight
Emerging Markets	Modest Underweight

The BoC has cut rates significantly since the spring as inflation has subsided and the economy showed signs of slowing. We believe that these cuts are supportive of consumers and businesses, which should allow economic growth to reaccelerate. This contributes to the expected **S&P TSX Index ("TSX") 2025 earnings growth of ~11%**, which creates a supportive backdrop for returns. Within the TSX, banks could benefit from the stabilization of credit and resource companies generally have low leverage and attractive free cash flow.

S&P 500 Index 2024 returns were driven by both multiple expansion and earnings growth. While mega cap technology firms have been a significant contributor to returns, partly driven by AI opportunities, most sectors finished the year in positive territory. **The S&P 500 Index is expected to generate ~12% earnings growth in 2025.** While the Technology sector is a key source of growth, earnings are expected to accelerate outside of technology. The incoming U.S. administration appears to offer some potential business friendly policies, but could create uncertainty in terms of trade, etc. The S&P 500 Index commands a premium valuation due to its higher technology exposure.

International Equities returns might lag due to weak economic activity and political instability, particularly in the EU. Japanese equities look attractive on a relative basis, with momentum building behind a corporate reform agenda aimed at boosting profitability and valuation multiples. The Japanese stock market and yen might experience additional volatility depending on how the Bank of Japan continues with its process of raising rates versus the U.S. Federal Reserve (the "Fed") potentially cutting rates further.

Emerging Markets ('EM") central banks, including China, Chile and Mexico, have been cutting rates. EMs might face challenges from potential changes to U.S. trade and tariff policies. China continues to struggle with challenges in its property sector, but has recently announced monetary stimulus that could provide some stabilization for its economy.

Equities

Modest Underweight Fixed Income

Sub Class	Allocation
Domestic Government Bonds	Neutral
Investment Grade Corporate Credit	Modest Overweight
Global Bonds – Developed Markets	Neutral
Global Bonds – Emerging Markets	Modest Underweight
High Yield Credit	Neutral

We believe the BoC has room to reduce its policy rate further, however, we expect that it will be more measured in how quickly it cuts the policy rate given U.S. economic resilience, a stronger growth outlook, and higher expected political volatility at home and abroad over the next 12 to 18 months. As the easing cycle progresses, we expect yields on shorter **government bonds**, which are more sensitive to the monetary policy cycle, to fall faster than that of longer government bonds.

Investment grade spreads remain tight overall and reflect a modest softening of the global economic backdrop. We see Canadian investment grade corporate bonds as more attractive than U.S. investment grade corporates as spreads in Canada continue to be meaningfully wider.

As investors anticipate stronger growth following the U.S. federal election as well as more macroeconomic and political uncertainty, **global bond markets** are grappling with what implications this will have for inflation, fiscal deficits, global trade, and currency dynamics. Therefore, we expect opportunities across developed market bonds to vary over the next 12 to 18 months.

The recent strengthening of the U.S. Dollar ("USD") has led to a challenging environment for **emerging markets**, particularly those with large U.S.-denominated liabilities. Furthermore, the threat of tariffs along with sluggish economic growth outside of the U.S. will cause uncertainty to remain elevated and will likely impact growth expectations across many emerging market regions. However, we continue to believe that there will be tactical opportunities in countries with high and stable monetary policy rates, sound fiscal policy and resilient growth fundamentals.

All in yields remain relatively attractive and **high yield credit** spreads have tightened to levels not seen since 2007, in part absorbing the bulk of the recent sell off in Treasuries. At near-historic lows, spreads remain expensive and provide little protection from a deterioration in credit conditions, a weakening consumer or further increases in Treasury yields. While the overall quality of the high yield universe has been improving, there still remain companies with challenged capital structures that will become increasingly unsustainable with slowing growth and/or rising interest rates. We continue to find the best opportunities in the mid to higher quality cohort of the market including leveraged loans that are offering a yield advantage over equivalent bonds on a risk-adjusted basis.

Modest Overweight Alternatives

Sub Class	Allocation
Commercial Mortgages	Modest Overweight
Private Debt (Universe)	Modest Underweight
Domestic Real Estate	Neutral
Global Real Estate	Modest Underweight
Infrastructure	Modest Overweight

Commercial mortgages continue to provide accretive income while insulating investor returns from the increased volatility in interest rates.

High credit quality, in **Private Debt** and global diversification provides an income ballast in an uncertain economic environment. Incremental income and potential capital appreciation from interest rate moderation provide upside.

We believe a significant portion of the value adjustments in the **Canadian commercial real estate** space have been taken. Moving forward we see more reason for confidence in the multi-unit residential, retail and industrial spaces, while the flight-to-quality within office continues.

Within **Global Real Estate**, we believe the majority of the value adjustments have occurred in the U.S., UK and Nordic countries, while other regions, such as Australia, are in the midst of value adjustments.

Moderating risk-free rates have been reflected in lower discount rates which has led to strong valuations for infrastructure assets. We have seen a shift in focus from core **infrastructure assets** to core-plus and value add as investors seek greater growth and higher return potential from their infrastructure allocations.

Mixed Outlook for Sub-Asset Classes

Sub Class	Allocation
U.S. Dollar	Neutral
Commodities (Gold, Energy, metals, agriculture, carbon)	Modest Overweight

The USD has remained strong against global currencies as relative growth differentials still favour the U.S. economy, and by extension the USD. Some USD weakness may be expected in the near-term, however, currency risk is not expected to be a major factor affecting returns as any USD softness is expected to be modest. The USD provides diversification in portfolios considering the range of risks in the near-term.

Gold delivered solid gains in 2024 due to continued demand from central banks and investors. Investor demand could shift depending on the geopolitical environment and risk appetite. Gold has recently faced a headwind from U.S. long-term real yields, which have rebounded despite Fed rate cuts. Metals prices have been subdued and at this point the announced Chinese stimulus measures appear unlikely to significantly improve demand. Oil has been rangebound, but OPEC+ continues to support the market with its recent decision to delay supply increases.

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Market

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