RJL PCS: INSIGHTS & STRATEGIES

MARCH 7, 2025 | 9:37 AM EST

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March 2025 Insights & Strategies: The tariff threat train continues to roll

Macro Highlights for February

- The Canadian economy was stronger than expected in the fourth quarter of 2024. Annualized q/q growth came in at 2.6%, while the third quarter's growth was also revised to 2.2%, up from the initial estimate of 1.0%. On an annual basis, real GDP growth is forecasted by the BoC in the January outlook to be 1.8% in both 2025 and 2026 (down from 2.1% and 2.3%, respectively, in the October outlook), but up from 1.3% in 2024. The improvement over 2024 can be partially attributed to the easing of monetary policy (lower interest rates) by the BoC that stimulated both consumer spending and business investment, and increasing export capacity for oil and gas. The reduced outlook however, versus the October report, can be partially attributed to government policies implemented to slow population growth.

- The U.S. economy finished off the fourth quarter of 2024 with annualized q/q growth at 2.3% q/q, and 2.8% for the full year, down only slightly from 2.9% in 2023. This is a very solid growth rate and continues to be supported by the U.S. consumer. We expect this above-average growth to continue, but at a slightly weaker pace, at 2.4% for 2025, and then 2.2% for 2026. Government investments are expected to further support that growth as the majority of the stimulus money committed under various programs (IRA, IIJA, CHIPS) has still yet to be spent.

- The Atlanta Fed's GDPNow forecast, which provides a running estimate of real U.S. GDP growth based on current economic data, has sharply declined to -2.8% for 1Q25 due to a surge in imports. Businesses have reacted to tariff threats by front-loading imports and increasing inventory levels. This will lead to noise in the official results, when announced, but should be understood as an exceptional or one-time impact.

Financial Markets in February

- In February, the TSX Composite, Canada's main stock market index, recorded a -0.5% price return and -0.4% total return. Meanwhile, the U.S. large-cap benchmark, the S&P 500, saw a larger decline with a -1.4% price return and -1.3% total return, all in local currency. YTD returns to February 28, were +3.1% for the TSX Composite and +1.4% for the S&P 500.
- U.S. 4Q24 earnings season is coming to a close with strong EPS growth of 17%, above expectations, although guidance for 2025 has been somewhat underwhelming as companies are remaining generally cautious in this uncertain environment and 2025 EPS expectations are being revised down. 1Q25 EPS growth is now expected to be 8% versus 14% before earnings season. A rotation however is unfolding, with capital flowing into cheaper market segments, particularly those demonstrating steady earnings growth. With two-thirds of Canadian companies, representing 84% of the market capitalization, reporting, 57% had EPS beats in 4Q24, with growth of over 10%.
- Tariff threats disrupted the TSX Composite's performance in February. Unlike January, when cyclical sectors outperformed defensive ones due to an improved economic outlook, February saw better performance from sectors that are more services-oriented or have stronger defensiveness amid the tariff threats. Utilities, Materials, and Info Tech are the three sectors we consider more insulated from the tariffs and benefiting from stronger sector-specific tailwinds.

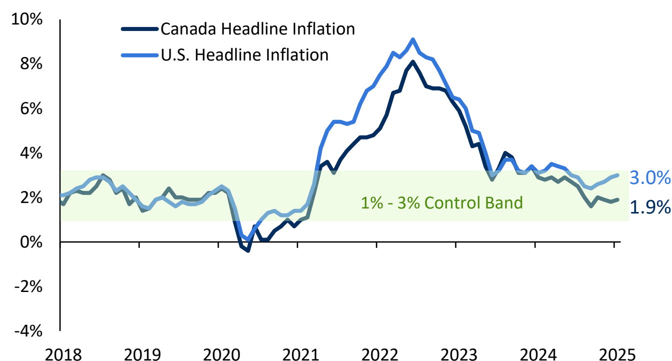
Upcoming

- We expect further threats of tariffs throughout the year, with the next big wave of announcements on April 2. We also expect a push to accelerate the renegotiation of the USMCA trade agreement, from its current mid-2026 timetable, towards the goal of setting a new playing field.

Please read domestic and foreign disclosure/risk information beginning on page 20

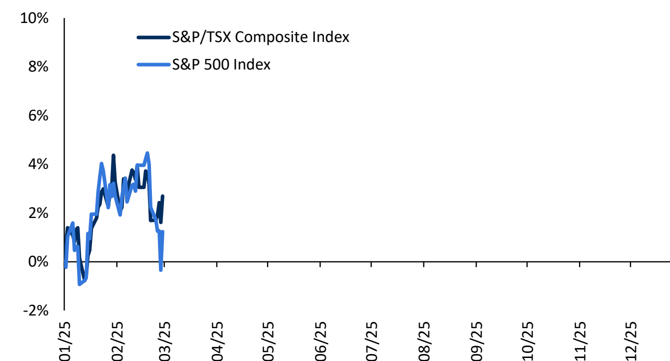
- Notwithstanding the disruptive aspects of tariffs, our overarching expectations are for equity markets to move higher in 2025, on the back of the positive economic and corporate profit backdrops, but with more muted gains than the 20%+ returns of the last couple of years. We also expect heightened volatility, which could include multiple pullbacks along the way. Our (U.S. Investment Strategy Group's) S&P 500 target to the end of 2025 is 6,375 using 23.5x EPS of US$270, with a preference for Technology, Industrials, and Health Care. For the TSX Composite, we forecast 26,300 by year-end for an 8.5% total return in 2025.
- The next BoC meeting is March 12. We expect a 25 bp rate cut to 2.75%. After that, the next meeting will be on April 16, when we are expecting another cut to 2.50% and the release of the updated Monetary Policy Report. The Fed is likely to cut more slowly while economic growth remains strong, the unemployment rate remains low, and inflation data in January was hotter than expected. We still expect to see 25 bp cuts mid-2025 and towards the end of the year, to bring the U.S.policy rate down to 4.00%.

Chart 1 - Canada and U.S. Headline Inflation



Source: FactSet; Raymond James Ltd.; Data as of January 31, 2025. Not seasonally adjusted.

Chart 2 - S&P/TSX Composite and S&P 500 2025 Performance



Source: FactSet; Raymond James Ltd. Data as of February 28, 2025. Price return in local currency.

Executive Summary

The tariff threat train continued to roll through February, with additional threats being added, although the biggest event occurred after the month ended with the enactment of the fentanyl-driven tariffs on March 4, after a 30-day reprieve expired. Within a day, a further 30-day delay was granted to just the automotive sector to allow more time for those companies to unwind complicated supply chains where possible, and the following day all other tariffs were delayed again to April 2. The growing uncertainty around tariffs has further dominated the outlook for the economy and financial markets. We expect volatility to remain high as markets anticipate which country or sector will be targeted next, and for further carve-outs or negotiations. While threats are unlikely to be taken off the table quickly, we can expect delays, temporary reprieves, shifting priorities, and varying tariff rate levels to keep the uncertainty high.

In the following pages, you can read our thoughts and predictions on multiple metrics, with a focus on the following themes:

- **Tariff threats overhang everything.** While we make forecasts based on macroeconomic drivers, tariffs threaten to upend many of our assumptions. Canada and Mexico are now working through the impacts of, and responses to, the fentanyl-driven tariffs. We expect these and other tariff threats to expand to defence spending and more targeted trade imbalances. The next significant wave of tariffs is expected to be announced on April 2, and encompass global, country-specific, and industry-specific tariffs, including reciprocal tariffs that promise to consider value-added taxes, regulations, and retaliation for currency manipulation. For Canada specifically, our hope is that an early renegotiation of USMCA terms, currently expected mid-2026, will bring some finality to threats and certainty to the trade relationship with the U.S. On the plus side, this situation has prompted discussions and incentives towards reviewing trade barriers between Canadian provinces and territories that could offset some of the negative impacts from U.S. tariffs. Investors should be prepared for volatility and high-pressure negotiations in the meantime.
- **Economic growth to continue.** While the U.S. seems poised to continue its significant growth rate, we do expect some slowing to 2.4% for 2025, from 2.8% in 2024. Recent declines in consumer sentiment in the U.S., partly driven by growing concerns of tariffs and their inflationary potential, give further support to this slowing expectation. In Canada, we are starting to see benefits from the aggressive rate cutting cycle; growth is expected to improve to 1.8% in 2025, from 1.3% in 2024, notwithstanding any negative impacts from tariffs, that could be expected if tariffs remain in effect for an extended period of time (6+ months).

- **Stock market returns will likely be positive**, but much more muted that the 20%+ returns of the last two years, and investors should be prepared for **significant volatility**, including significant pullbacks as the S&P 500's P/E multiples remain at stretched levels and many stocks are pricing in optimal conditions. On the positive side, the S&P 500's 4Q24 earnings were strong, and double-digit growth expectations continue into 2025, which should support equities. Growth expectations for 2025 have been reduced slightly as the potential for expanded or long-lasting tariffs are given growing consideration and as companies have remained cautious or suspended guidance due to ongoing uncertainty. We see the rotation narrative continuing to play out as large-cap growth enthusiasm shifts towards large-cap value and towards mid-cap stocks as market breadth improves. Investors should remain focused on their long-term goals, with asset allocations and diversification consistent with their return requirements and risk tolerance.

February Recap

Aside from the escalating tariff drama through the end of January and into February, the Bank of Canada (BoC) also continued easing its policy interest rate on January 29, by 25 bps, to 3.00%, as the Consumer Price Index (CPI) inflation rate picked up slightly to 1.9% for January, from 1.8% in December, and the core measures of CPI-trim and CPI-median similarly both rose to 2.7%, from 2.5% and 2.6%, respectively, with shelter (+4.5%) continuing to be one of the most problematic components, although improving gradually. In January however, energy prices rose 5.3%, from just a 1.0% increase in December, driven by higher prices for gasoline (+8.6%) and natural gas (+4.8%), although these can be very volatile month-to-month. Excluding gasoline, CPI was just 1.7%.

The BoC January Monetary Policy Report (MPR) update stressed the heightened uncertainty from the volatile political landscape and tariff threats. Baseline expectations are for the global economy to continue growing by about 3% over the next two years. The rate cuts in Canada, which began in June, have started to boost the economy, with strengthening in both consumption and housing activity, although business investment remains weak. Following growth of 1.3% in 2024, the BoC is now projecting GDP growth of 1.8% in both 2025 and 2026, absent the potential impact of tariffs (see below). Job growth has improved recently while the labour market remains soft with the unemployment rate at 6.6% in January, but the good news is that wage pressures are starting to show some signs of easing, which helps to bring down inflation.

In the U.S., the Federal Reserve (Fed) paused its campaign to lower interest rates, as economic growth remained solid and inflation remains somewhat elevated above the 2.0% target. In its January update, the Fed also pushed out its timeframe to achieve the 2.0% target from 2026 to 2027, acknowledging that this will be a longer than previously expected process. Headline CPI rose to 3.0% in January, from 2.9% in December, and the Fed's preferred measure, the Personal Consumption Expenditure (PCE) price index, moved down to 2.5% in January, from 2.6% in December, while Core PCE also slightly eased to 2.6%. The economy remains solid as real GDP grew by 2.8% in the 4Q24, employment growth was much stronger than expected, and the rate of unemployment declined to 4.0% in January, from 4.1% in December. However, the U.S. economy also faces a degree of uncertainty from potential tariffs from multiple trade partners.

Tariffs

We might as well start with the latest tariff update as that is by far the elephant in the room. Unfortunately, a lot can change over a relatively short period of time. Nevertheless, let's delve into what's changed in the last month, and put such threats and concerns into context.

There's a couple of overarching points that we should start off with. First, tariffs do not have to be enacted to cause changes to behaviours and business decision-making, as we can already see, at least anecdotally, businesses deferring investment commitments, scaling back operations, withdrawing forward guidance, stocking up on inventory, and considering moving manufacturing operations. Second, even dramatic tariffs will not decimate the Canadian economy, although they could be devastating to segments of the economy. Certain industries will experience more pain than others, and certain individuals' lives will be significantly impacted, but the Canadian economy will certainly not grind to a halt.

Tariffs can cause disruption to both the country being targeted and the country imposing the tariff. As a case in point, consider cross-border dependency in sectors such as the automotive industry, with highly integrated supply chains that do not react well to disruptions, as we may well remember from the pandemic. These then impact product availability, prices, and customer satisfaction. Unfortunately, Canada certainly stands to suffer more than the U.S. through this process, but the faster and more aggressive the tariffs are enacted, the quicker the pressure will build to establish a resolution. This is somewhat evidenced by the quick but temporary exemption for the auto industry within a day of the enactment of the March 4 tariffs.

Worst-case scenarios from a Bank of Canada (BoC) analysis put economic contraction and recession on the table, although a lot depends on specific details and responses, and time frames may be relatively short given that the renegotiation of the USMCA terms are slated for mid-2026,

and are likely to be moved sooner. Renegotiation could provide rule stabilization, and allow everyone to get back to growth.

Most of our forecasts beyond this section are based on the assumption that each round of threats can be managed with negotiations or that enacted tariffs will be relatively short-lived and not create undue and wide-spread stress on the economy, other than limiting upside potential. We should also note that services have not been discussed as subject to tariffs, so at least for now, when we look at the impact of tariffs we are focused on physical goods crossing the border.

Sector-specific and reciprocal tariffs

Trump also renewed his promise for global reciprocal tariffs, indicating that they will kick in on April 2. The reciprocity narrative has been a key driving force behind the Trump 2.0 tariff agenda, with Trump pointing to a range of countries which levy higher tariff rates on the U.S. than those imposed by the U.S. in justifying the pending policy move. While we do expect, in line with Trump's comments, to receive some updates on the reciprocal tariffs on April 2, we remain skeptical that April 2 will bring with it the full implementation of all of the reciprocal tariffs. We would expect to see countries that the U.S. maintains a large trade deficit with (*e.g.,* Vietnam and the European Union) to be prioritized in this process. The logistical challenges associated with implementing an individual tariff for each and every one of the 190 countries in the world underscore the likelihood that countries like Vietnam will see the announcements of their reciprocal tariff rate and implementation come ahead of other countries that the U.S. maintains a lower trade deficit with.

Tariffs — the story so far

President Trump has lobbed multiple tariff threats on multiple fronts, with sometimes conflicting messages as to the justification and timing of each wave. Here, we track the most significant tariffs, specifically the ones that would be expected to impact Canada most directly. It is also worth noting that so far, Trump has indicated that various tariffs will be cumulative, such that a 25% country-specific tariff combined with a 25% industry-specific tariff would generally imply an overall tariff impact of 50% on that specific sector, from that specific country.

Fentanyl-driven tariffs

After lots of threats both before and after the election, the first real salvo was fired by President Trump on February 1 with an executive order for 25% tariffs on all goods entering the U.S. from Canada and Mexico (with a reduced 10% tariff on Canadian energy), and a 10% tariff on Chinese goods, incremental to an already aggressive campaign on that country which already included 25-100% tariffs on a wide assortment of Chinese products. This round of tariffs was primarily justified as addressing the issue of the influx of fentanyl into the United States.

Both Canada and Mexico managed to secure a one-month delay (to March 4) in these tariffs by assuring continuing efforts to improve border security. Likewise, Canada put a pause on retaliatory tariffs on $155 billion on targeted U.S. goods. On March 4, that reprieve expired and the tariffs and retaliatory tariffs came into effect. Within a day, another 30-day extension was granted to just the automotive sector to allow further time to seek alternatives to the currently complex supply chains, and then a day later, a full delay until April 2 was announced. Mexico's retaliatory measures were expected to come on Sunday, March 9, until a similar delay until April 2 was announced.

The initial 10% tariffs on about US$450 billion of Chinese imports were imposed as planned, and the Chinese government retaliated with up to 15% tariff hikes coming into effect March 10, on various food and agricultural goods, U.S. coal and LNG, crude oil, agricultural machinery, and some automobiles, for a total of US$20 billion, or 12% of goods imported into China from the U.S. Plus, China added five critical minerals (tungsten, tellurium, bismuth, indium, and molybdenum - essential inputs for industries such as electronics, renewable energy, and defence) to its export control list and restricted exports to 15 U.S. companies to put further pressure on the U.S. In response to these retaliatory responses, President Trump subsequently raised the tariff level from 10% to 20%.

Steel & aluminum tariffs

Steel & aluminum products are expected to have a 25% tariff placed on them effective March 12. This one, on U.S. imports from any country, with no exceptions (except maybe an exemption for Australia due to the U.S. trade surplus position) would carry an incremental 25% levy. This tariff threat seems similar to a June 2018 action where President Trump enacted a 25% tariff on steel and 10% tariff on aluminum in his first term and may therefore be more likely to be implemented. That round resulted in Canadian exports to the U.S. falling approximately 20% over the following year before rebounding after the USMCA ratification in May 2019. Canada is the most exposed economy to this specific tariff as it represents approximately 20% of such U.S. imports and 90% of Canada's exports of these goods, equivalent to approximately US$24.4 billion, or roughly 1% of Canada's GDP. China, by comparison, is already subject to a 47.5% tariff on steel and 32.5% tariff on aluminum and so any incremental tariff there would be of negligible impact, although that country still sold US$15.4 billion of steel and aluminum into the U.S. last year.

April 2 reciprocal tariffs

President Trump's original executive order set an April 1 deadline for cabinet recommendations sought in the America First Trade Policy memorandum. As a result, there is the possibility of tariffs of up to 25% being placed on specific sectors such as autos, semiconductors, pharmaceuticals, and lumber, coming from specific countries. Details of how, when, and which countries would be targeted in this wave is still unclear. Tariff rates will be calculated based on a combination of existing tariffs levied by the impacted countries and other, non-tariff considerations such as regulation, value-added tax (VAT), and currency manipulation. This may end up taking into consideration Canada's GST, the digital services tax, and impacts of regulation such as supply management in the dairy, poultry, and egg industries.

As part of that April 2 announcement, it would appear that certain more globally applied tariffs have already been decided on. These seem to include copper, automobiles, agricultural products, semiconductors, and pharmaceuticals.

Lumber

An investigation into global lumber imports and derivative products was launched on March 1, and is to be completed within 270 days. After that, a final determination will be made on tariffs (likely 25%). The expectation is for an increase in anti-dumping duties on Canadian softwood lumber from 7.66% to 20.07%, in combination with countervailing duties of 6.74%.

Tariffs on automobiles

Tariffs on automobiles is building up to be one of the cornerstone issues. President Trump has previously been very critical on both the EU and Japan for not buying enough American vehicles. Tariffs on automobiles have an interesting backstory and include the "chicken war tax". In the 1960s Germany put a tariff on chickens being imported from the U.S. The U.S. retaliated with a 25% tariff on trucks imported into the U.S. The chicken tax disappeared relatively quickly, yet the truck tariff still remains and encompasses vehicles that include SUVs and CUVs - protecting the U.S. auto industry from foreign competition in this broad and profitable category even decades after the justification for this tariff was long resolved. This protectionism (along with the shifting preference to SUVs and CUVs) has helped light truck sales to increase to now represent approximately 80% of total U.S. vehicle sales, from roughly 20% in the early 1980s.

Tariffs on the EU

President Trump has indicated that a 25% tariff on the EU will be coming "very soon". It is unclear at this stage whether this would be charged in addition to the reciprocal tariffs or if this just implies that the reciprocal tariff rate for this region will be 25%.

Tariffs as a replacement for income taxes?

It is clear that one of President Trump's intents with his universal or reciprocal tariffs is to establish a permanent government revenue stream, to be collected by a new department, the External Revenue Service, replacing the function of the Customs and Border Patrol, and presumably to segment these taxes as an identifiable line item to be used to justify his tax cut proposals. However, the question becomes if this project could be further extended to act as an actual replacement of U.S. income taxes.

The IRS collected over US$5.1 trillion in tax revenue last year, which came from income taxes, corporate taxes, and other sources. Over US $2.3 trillion of that amount was from individual income taxes. Considering that the U.S. imported goods valued at US$3.3 trillion last year, the government would need to place 70% incremental tariffs on all goods flowing into the country, without exception, to offset personal income tax revenues. This would also require no changes to other factors, trade volumes, or from retaliatory tariffs.

U.S. federal income taxes were first introduced in 1861, to help fund the Civil War, at 3-5%. While this war-time tax expired in 1873, it was reimposed in 1894 at 2% of income over US$4,000, affecting only 10% of households. The income tax was to offset lost revenue from tariff reductions, which had represented 53% of the U.S. federal government's US$385 million in revenues in 1893, with excise taxes making up another 42%. Last year, the U.S. federal government collected US$85 billion in tariff revenue and US$98 billion in excise taxes, collectively making up less than 4% of its tax revenue. Presumably, President Trump might be considering drastically changing that balance.

Are tariff threats more about trade deficits?

We know that trade deficits are a particular sore point with President Trump. Unfortunately, the U.S. trade deficit with the world reached a record US$122 billion in December and then set another record in January, at US$153 billion — as imports to the U.S. surged, while exports fell. We can probably attribute most of this increase to businesses rushing to front-run expected tariffs while USD strength has made U.S. exports less attractive.

President Trump has thrown around various figures of what he perceives to be the U.S.'s trade deficit with Canada, which he also expresses as the U.S. subsidizing Canada. He has most recently indicated that the U.S. pays "hundreds of billions of dollars to subsidize" Canada. According to the U.S. Census Bureau, in 2024, the U.S. exported US$349.4 billion of goods to Canada, while importing US$412.7 billion of goods, leaving a trade deficit of US$63.3 billion. A much cited adjustment to the goods trade number is the crude oil that Canada supplies to the U.S. The structure of Canada's pipelines results in 97% of exported crude being directed to the U.S., or roughly 4 million barrels per day. In 2023 this represented approximately US$92 billion, and so excluding oil, we can rationalize that the U.S. actually has a sizeable trade surplus with Canada. This heavy, sour crude oil is directed to U.S. refineries that are specifically tuned to refine this oil into gasoline. Alternative sources of this heavy crude are Mexico, Venezuela, and Colombia, which would make switching somewhat problematic. Thanks to the captive supply chain and the type of oil Canada produces, the U.S. can export about 4.1 million barrels per day of its light, sweet crude oil (Chart 3). This type of oil achieves a higher price, generating around US$117 billion in revenue. This makes it a profitable trade for the U.S., which we would expect the President not to upset.

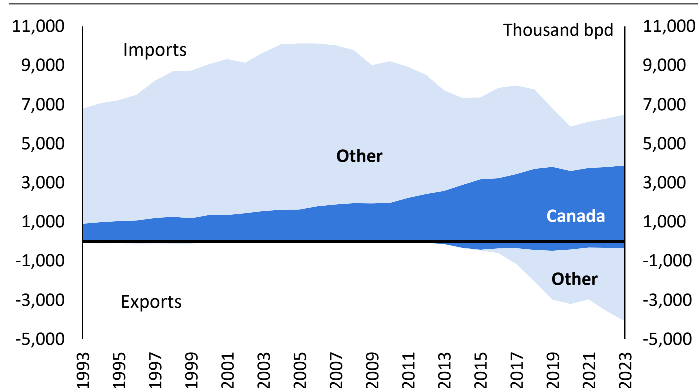
Defence spending likely to enter the discussion soon

Another frequently quoted concern by President Trump is defence spending. He has been vocal about pushing all NATO countries, including Canada, to increase defence spending. He has even gone to the extent of suggesting that NATO should set a target of 5% of each member country's GDP, as opposed to the current target of 2%. Canada is among eight NATO allies out of 30 that are estimated to be falling short of this target and has faced persistent criticism from allies. According to a NATO report, Canada was estimated to spend roughly 1.37% of GDP on defense in 2024. This could be another issue where President Trump might threaten tariffs to gain greater negotiating power in pushing Canada to increase its military spending.

Tariffs raise costs for U.S. manufacturers

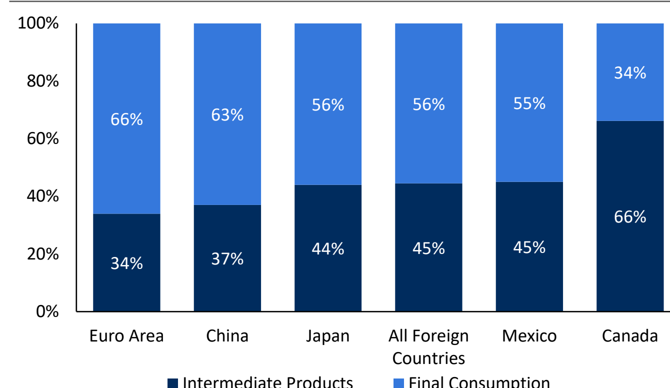
As we are seeing from the U.S. automotive companies, production lines and supply chains can be complex and have been built cross border, under NAFTA and the USMCA frameworks in order to take advantages of certain technological, regional, or labour benefits. Two-thirds of imports from Canada are for intermediate goods that are then input costs to U.S. manufacturing (Chart 4). Depending on the product or industry, quickly switching suppliers is not always an option (as we pointed out with crude oil). Suppliers can sometimes endure long and arduous qualification processes and have contracts that secure volume commitments and quality assurances. Many U.S. importers may have no choice but to accept the higher prices caused by tariffs in the short-term, and will likely balance out the direct and indirect costs of switching suppliers and/or moving manufacturing facilities if they expect the tariffs to be short-lived, or even resolved with a renegotiated USMCA. The point is that, although we can expect disruption in certain industries, changing some complex supply chains can take months or years.

Chart 3 - U.S. Crude Oil Imports (+) and Exports (-)



Source: EIA, Raymond James Ltd.; Data as of December 31, 2023.

Chart 4 - Majority of U.S. Imports Reflect Intermediate Inputs to the Production of American Goods



Source: Federal Reserve Bank of San Francisco.

Possible GDP impacts in Canada

As long as the threat of tariffs hang over Canada, there will be uncertainty that drives new manufacturing capacity to be added in the U.S., rather than in Canada, and it could lead to investments being deferred in both countries until the future playing field is better defined. The Bank of Canada (BoC) provided a report, as part of the January Monetary Policy Report, on the potential impacts of U.S. tariffs. Its benchmark calibration puts the first-year impact of 25% across-the-board tariffs at a 2.4 percentage point negative adjustment, meaning that a previous forecast of 1.8% growth for the year — along the lines of what we were trending to — becomes a contraction of 0.6% (Chart 6). In the second year, the benchmark calibration is 1.5% lower, and by the third year, GDP growth would be expected to return to normal. Different scenarios put the cumulative impact at 3.4% to

4.2% negative adjustment to GDP from the baseline forecast, over the time period. For context, GDP contracted 5.0% in 2020 due to the pandemic, by 2.9% in 2009 during the Great Financial Crisis, and by 2.1% in 1991 during a global economic slowdown and oil price shock from the Gulf War.

We can explore how this could play out in Canada. While the impact of tariffs on growth rates is temporary, they cause a permanent reduction in GDP, reflecting a long-term decline in Canadian productivity due to the distortion created. On the other hand, as the cost increases from Canada's retaliatory tariffs are gradually passed on to consumer prices over three years, CPI inflation faces sustained upward pressure. In the first year, considerable excess supply and declining commodity prices largely offset the direct impact of tariffs, but as excess supply is gradually absorbed in subsequent years, inflation begins to rise. The BoC is currently expecting the growth rate of potential output to slow from 2.5% in 2024 to roughly 1.5% in 2025 and 2026, resulting in excess supply being absorbed. Overall, different scenarios could lead to a cumulative impact of 0.7% to 2.7% increase in annual average CPI inflation. Overall, if we get a sustained 25% country-wide tariff that lasts more than six months, we could see Canada subject to at least a mild recession. However, we are somewhat optimistic that a USMCA renegotiation would bring some confidence and certainty for businesses to recalibrate their operations and expectations. Some businesses and industries will likely have less of an advantage at the end of this process, but that is all the more reason for investors to remain diversified and invested within their risk tolerance.

A reminder on how tariffs work

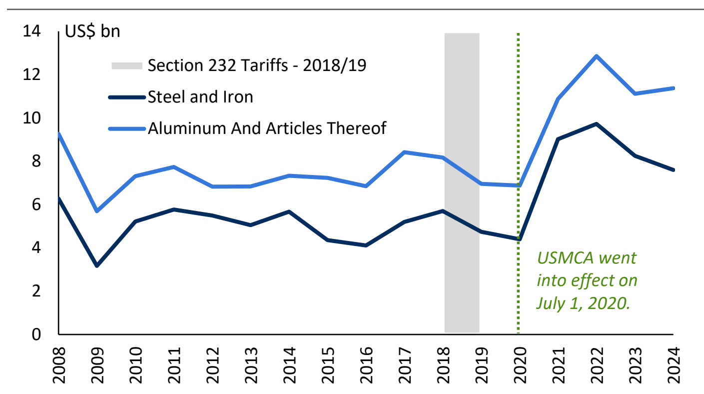
Contrary to how tariffs are being portrayed by certain commentators, tariffs are not paid by the exporting nation (Canada). Tariffs are collected by the importing nation's government (in this case the U.S.) as a tax, although it is possible that the (U.S.) retailer, (U.S.) distributor, or (Canadian) manufacturer might decide to reduce their profits and absorb some of the impact, so as not to increase prices dramatically for the (U.S.) consumer. If these parties don't absorb some of this impact, then the end (U.S.) consumer sees the entirety of the price increase and then has the option to accept the higher price, not purchase the product at all, or seek a lower cost alternative. Domestic (U.S.) manufacturers therefore are deemed to have an advantage if this now makes their product cheaper by comparison, although it can also entice a domestic manufacturer to increase their price to this new higher level, therefore driving up the price for all of the products. In the case of products that are imported because of a specialized nature, such as a medical device or aircraft part, importers might be facing a lack of alternatives, or long processes to get an alternative manufacturer certified or ramped-up for volumes required, and therefore they have to continue purchasing the tariffed piece for the immediate future and perhaps are willing to accept the heightened price in the short-term if the tariffs are expected to be over a limited time frame. As such, this may not affect the volume or value of goods being exported (from Canada), but ultimately still raise their costs and likely lead to price increases for (U.S.) consumers in one way or another.

One of the factors that somewhat offsets the impact of tariffs on the (U.S.) consumer, is that tariffs in this case would be likely to put upward pressure on the USD and downward pressure on the CAD. Therefore, if the Canadian exporter left its CAD price unchanged, the USD importer could see some of the tariff burden alleviated by the increased purchasing power of the USD. Unfortunately, this has the opposite impact on a U.S. exporter as their product becomes more expensive in international markets because of the change in foreign exchange rate, plus the possibility of retaliatory tariffs. This ends up putting pressure on U.S. based manufacturers right as the U.S. is trying to advantage those same companies.

Will the USMCA renegotiation mark the end of this?

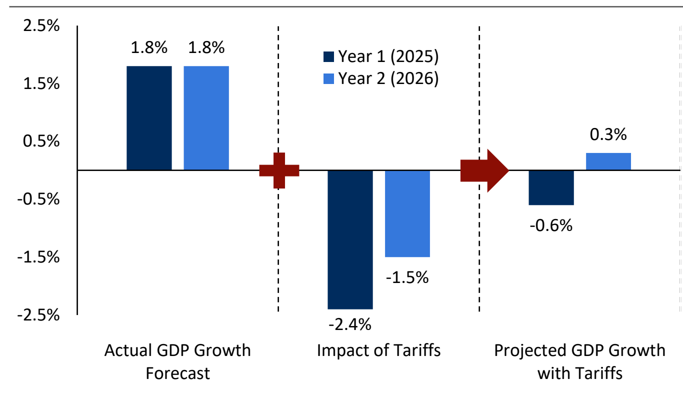
Just to recap here, the United States-Mexico-Canada (USMCA) trade agreement was actually President Trump's deal from his first administration, replacing the North American Free Trade Agreement (NAFTA). USMCA was structured with a review and renegotiation planned for mid-2026. While there can be no assurances that this agreement will survive, it is hard to claim that it is currently being respected under the current barrage of tariff threats, anyway. A complete collapse of USMCA would have further negative consequences for all (3) countries, in part due to the impact on cross-border services. As an example, USMCA currently allows services to be sold in a jurisdiction without requiring a physical presence in that region. Our generally accepted expectation at this point is that the USMCA renegotiation will set a new playing field for trade between the U.S., Mexico, and Canada, and will likely bring a more wholesome treaty that will allow all parties to more forward with more certainty, although likely not without some casualties. We are also inclined to think that timing of these negotiations will be advanced, but that before and through these negotiations, tariff threats will be increasingly used to extract concessions on key areas, which we already expect to include defence spending and critical minerals.

Chart 5 - Canadian Steel and Aluminum Exports to the U.S.



Source: U.S. Census Bureau; Raymond James Ltd.; Data as of December 31, 2024.

Chart 6 - Impact of 25% Tariff Over an Extended Period (6+ months) on Canada



Source: Monetary Policy Report - January 2025, Bank of Canada.

Economics

Canada — Sunny, but with intermittent tariff cloud cover

Notwithstanding the potential short or long-term impacts of tariffs, the Canadian economy has been showing signs of better growth, likely prompted by the faster and more aggressive reduction in the BoC policy rate. We caution that the government's immigration reforms could have a slightly negative impact on economic growth, but that the largest risk to continued improvement in Canada comes from tariff uncertainty. Not only can enacted tariffs have the potential to slow economic growth, but uncertainty can cause businesses to delay investment or expansion plans until the environment is more certain. Potential adjustments to our outlook here can be found in the previous section above, specifically on tariffs.

Strong Q4 GDP growth for Canada, but tariff challenges loom ahead

The Canadian economy was stronger than expected in the fourth quarter of 2024. Annualized q/q growth came in at 2.6%, while the third quarter's growth was also revised to 2.2%, up from the initial estimate of 1.0%. On a monthly basis, GDP growth rebounded in December to 0.2%, after the contraction in November (Chart 7). The preliminary estimate for January showed a strong 0.3% monthly increase as well. One of the key factors in the December increase was businesses accelerating their activities ahead of impending tariffs, resulting in a surge in exports to the U.S. Overall, in 4Q24, Canadian exports to the U.S. grew by 7.4% q/q, while imports also saw an increase, though at a more modest rate of 5.4% q/q.

On an annual basis, real GDP growth is forecasted by the BoC in the January outlook to be 1.8% in both 2025 and 2026 (down from 2.1% and 2.3%, respectively, in the October outlook), but up from 1.3% in 2024. The improvement over 2024 can be partially attributed to the easing of monetary policy (lower interest rates) by the BoC that stimulated both consumer spending and business investment, and increasing export capacity for oil and gas. The reduced outlook however, versus the October report, can be partially attributed to government policies implemented to slow population growth, which leads to both fewer consumers and fewer workers.

As described earlier, across the board tariffs of 25% (excl. Energy at 10%) for an extended period of time would certainly impact Canadian GDP. The BoC has estimated the first year impact at 2.4%, meaning that a 1.8% growth rate before tariffs could become a 0.6% contraction, likely leading to a recession.

One positive side effect of the tariff threats has been the impetus for provinces to reconsider interprovincial trade barriers. A 2019 working paper from the IMF concluded that fully liberalizing internal trade could boost GDP per capita by 4%.

Canadian consumption up in December, but softening into January

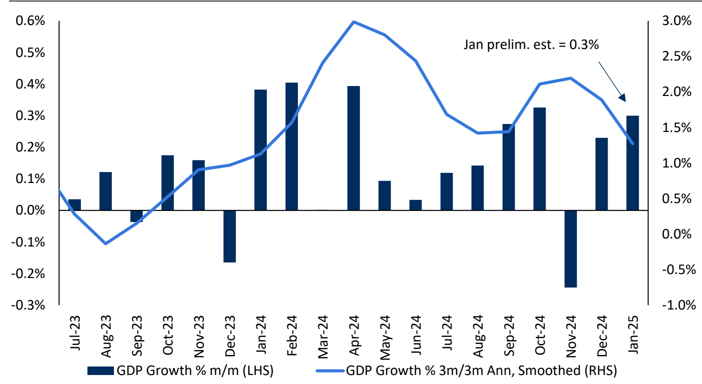
Retail sales in Canada were reportedly up 2.5% to $69.6 billion, which would be the best monthly increase since 2021, and better than the 1.6% consensus forecast. The caveat is that December is typically strong due to holiday spending, and this year was given another boost from the government tax holiday on various items. Regardless, this was a good print in December, but despite the tax holiday continuing through mid-February, preliminary January numbers are pointing to a 0.4% decline.

Headline inflation experienced a modest increase, but remains below the target level

In January 2025, the headline Consumer Price Index (CPI) registered at 1.9%, a slight rise from 1.8% in December, yet still close to the Bank of

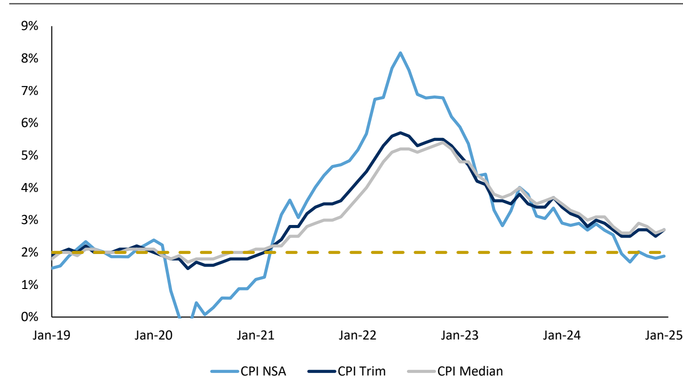
Canada's (BoC) target of 2%. This increase was partly influenced by the temporary GST/HST reduction, which concluded in mid-February. The BoC's preferred core inflation measures, CPI-trim and CPI-median, also saw a slight uptick, both reaching 2.7% in January, up from 2.5% and 2.6% in December, respectively (Chart 8). Despite this increase, these core measures have remained within the BoC's comfort zone of 1-3% since April 2024.

Chart 7 - GDP Growth Rebounded in December, After the Decline in November



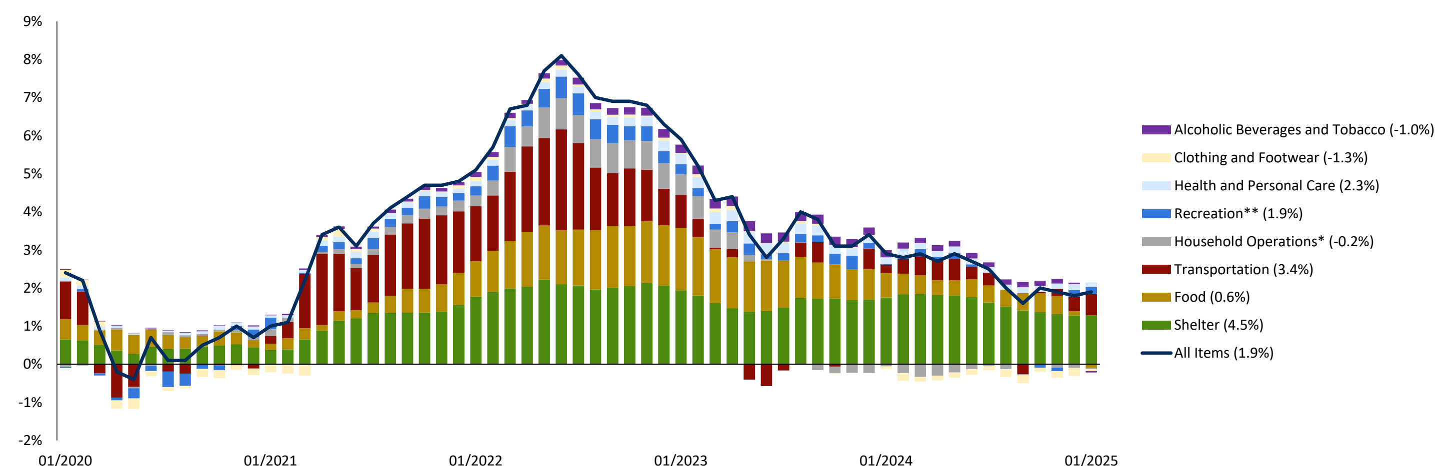
Source: Statistics Canada; Raymond James Ltd.; Data as of December 31, 2024.

Chart 8 - Core Inflation Measures Remain Slightly Elevated



Source: Statistics Canada, Raymond James Ltd.; Data as of January 31, 2025.

Chart 9 - Major Components' Contributions to Canada CPI (Stacked Bars) and Latest Monthly CPI (Bracket Beside the Legend)



Source: Statistics Canada; Raymond James Ltd.; Data as of January 31, 2024. *Household operations, furnishing and equipment; **Recreation, education and reading.

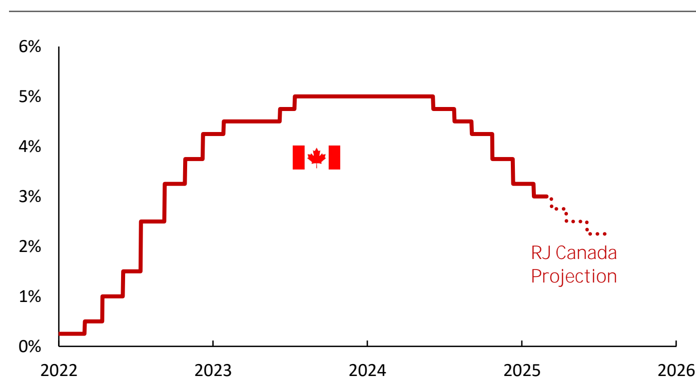
BoC interest rates to continue declining

On January 29, the BoC continued its easing program with another 25bp cut, bringing its policy rate down to 3.00%, marking the sixth consecutive decrease since easing began in June 2024. The Canadian economy continues to be in excess supply and needs a more accommodative environment to boost household spending and business investment to help bring this into balance. Of course the threat of tariffs can create uncertainty that pushes both households and businesses to defer sizeable purchases, so the sooner we have more certainty of these risks, the better. The Bank also plans to end Quantitative Tightening (QT), which was an extra tool to remove liquidity and tame inflation, and to restart asset purchases in March 2025 towards increasing liquidity and lowering longer-term rates.

The BoC started cutting its policy rate earlier and more aggressively than many anticipated in 2024. Despite the widening spread between Canadian and U.S. policy rates, we expect Canada's interest rates to continue declining to 2.25%, the low end of the BoC's nominal neutral interest rate range, by mid-2025. This expectation is based on Canada's below-potential GDP growth, projected flat to negative population growth in 2025 and 2026, and concerning productivity growth. Canada's policy rate may face additional downward pressure if tariffs are seen to be slowing economic growth and more stimulus is needed.

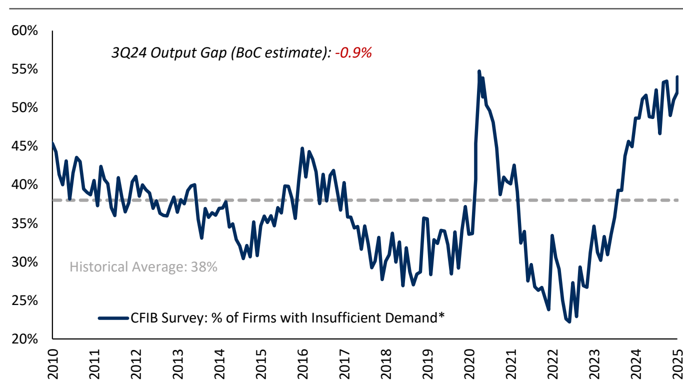
The next BoC meeting is March 12. We expect a 25 bp rate cut to 2.75%. After that, the next meeting will be on April 16, when we are expected another cut to 2.50% and the release of the updated Monetary Policy Report. We have been expecting cuts to continue down to 2.25% (Chart 10), although if we see economic impacts coming from tariffs that are expected to remain longer-term, we would likely be looking for the BoC to lower further into the 1.75-2.00% range.

Chart 10 - Interest Rates to Continue Declining



Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025.

Chart 11 - Excess Supply Continues to Grow in the Canadian Economy



Source: CFIB, Raymond James Ltd.; CFIB survey as of February 28, 2025. *Domestic demand prior to 2024, domestic and foreign demand from January 2024 onward.

Labour market improving

The Canadian economy showed a large gain in employment in January, with a 76k increase, primarily driven by a 57k rise in private sector employment. The country’s population grew by 56k, the smallest increase in two years and the fourth consecutive month of slowing growth. With the population increase, and some people coming back to the labour force (either as becoming employed or actively looking for work), the labour force grew by 61k. With a larger rise in jobs than in labour force growth (Chart 13), the unemployment rate declined to 6.6%, from 6.7% in December and 6.9% in November. Given the still high unemployment rate and fewer job openings, hourly wage growth, on an annual basis, slowed down to 3.5%.

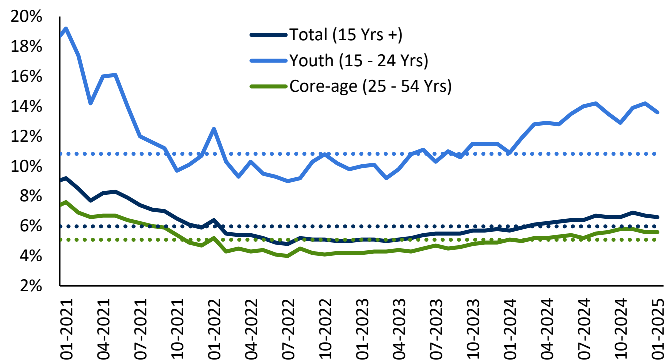
If the immigration reforms continue to slow population growth, and employment growth can continue, we could see a further slight improvement in the unemployment rate throughout this year. Unfortunately the reality, or just the potential, of tariffs can lead to layoffs and deferrals in adding workers, so overall we are not expecting any significant improvements in this metric over the short-term. Employment in manufacturing may be particularly susceptible to changes in tariffs and foreign demand, as the sector has the largest number of jobs dependent on U.S. demand for Canadian exports. An estimated 641k or 39.4% of jobs in manufacturing depend on U.S. demand for Canadian exports, and the sector overall accounts for 8.9% of total employment in Canada.

Housing

House prices rose 0.3% m/m in November and 0.13% in December, suggesting that the BoC’s rate lowering cycle has been breathing new life into the market through the end of 2025. The momentum waned however in January with a 3.3% drop from December in existing home sales, while home prices remained relatively unchanged (-0.07% m/m).

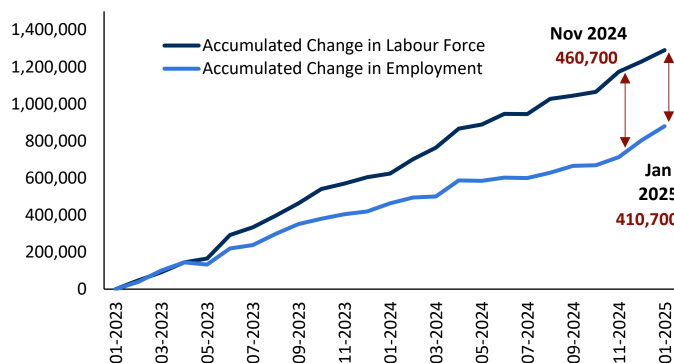
While trade risks and immigration changes add uncertainty to forecasts, the Canada Housing and Mortgage Corporation (CMHC) expects housing starts to slow from 2025 to 2027, but to remain above their 10-year average. Housing sales and prices are expected to pick up as lower mortgage rates and changes to mortgage rules (increasing insured mortgage cap to $1.5M & amortizations to 30 years) unlock pent-up demand in the short term, and as stronger economic fundamentals (barring tariff impacts) will support this over the longer term. Rental markets are expected to see higher vacancy rates and slowing rent growth, slowly helping affordability.

Chart 12 - Youth Unemployment Remains High



Source: Statistics Canada; Raymond James Ltd.; Data as of January 31, 2025.

Chart 13 - Employment Growth Outpaced the Growth in Labour Force for the Second Consecutive Month



Source: Source: Statistics Canada; Raymond James Ltd.; Data as of January 31, 2025.

The U.S. — Mounting Risk to "U.S. Exceptionalism"

President Trump inherited a historically strong U.S. economy for his second presidential term, and the economic growth indicators remain positive so far. However, a few recent leading indicators and sentiment indices have shown the possibility of some weakness on the horizon as tariffs, immigration, DOGE and other policy shifts work into expectations and forecasts. In the coming months, we will closely monitor these leading indicators to see if they materialize and dampen real economic growth. Nonetheless, policy uncertainties are likely to keep the Fed on the sidelines for the March meeting, as it awaits more data on the impacts to economic growth, employment, and inflation.

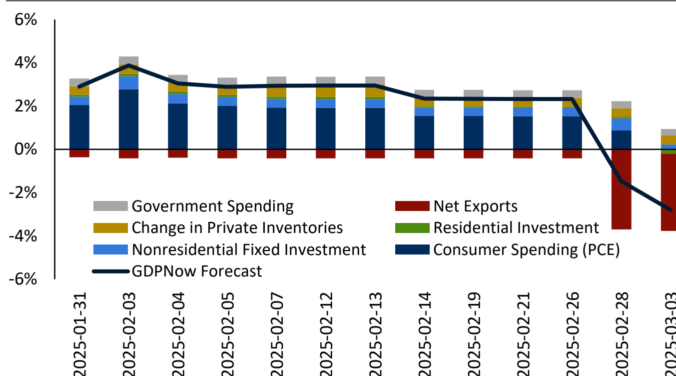
Economic growth indicators remain positive

GDP in 4Q24 came in at 2.3% quarter-over-quarter, annualized, and 2.8% for the full year, down only slightly from 2.9% in 2023. This is a very solid growth rate and continues to be supported by the U.S. consumer. We expect this above-average growth to continue, but at a slightly weaker pace, at 2.4% for 2025, and then 2.2% for 2026. Government investments are expected to further support that growth as the majority of the stimulus money committed under various programs (IRA, IIJA, CHIPS) has still yet to be spent.

However, the Atlanta Fed's GDPNow forecast, which provides a running estimate of real U.S. GDP growth based on current economic data, has sharply declined to -2.8% for 1Q25 due to a surge in imports (Chart 14). Businesses have reacted to tariff threats by front-loading imports and increasing inventory levels. This will lead to noise in the official results, when announced, but should be understood as an exceptional or one-time impact.

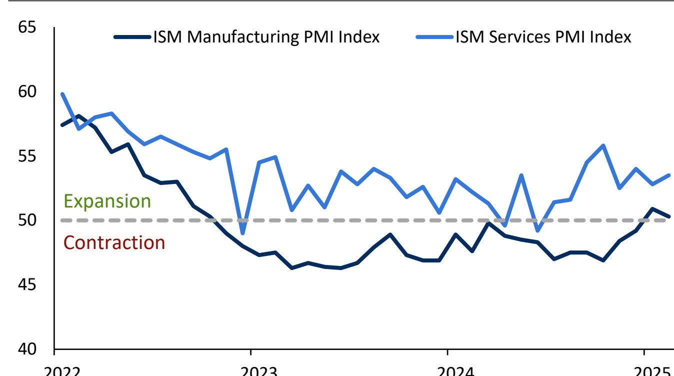
The Institute for Supply Management (ISM) Manufacturing Purchasing Manager's Index (PMI) fell to 50.3 in February from 50.9 in January (Chart 15). While it stayed in expansion territory, it broke the upward trend of the last three months (50.9 in January, up from 46.9 in October). This decline, along with the report's negative tone regarding the tariff impact, may heighten concerns about the economic outlook. On the other hand, the ISM Services PMI held up well despite policy uncertainties, rising to 53.5 in February from 52.8 in January.

Chart 14 - Atlanta Fed GDPNow Estimates for 2025: Q1, Contributions to Growth



Source: Federal Reserve Bank of Atlanta; Data as of March 3, 2025.

Chart 15 - U.S. Manufacturing Expansion Stalls Amid Policy Uncertainties



Source: ISM, data as of February 28, 2025.

U.S. inflation back in the spotlight

In February, we had a bit of a surprise as January data for the Consumer price Index (CPI) showed a 0.47% rise m/m (Chart 16). Even excluding the more volatile food and energy components, CPI was still up 0.45%. January's data can be hot and bounce around, but does this mean that inflation is back in the U.S. and that slow but steady decline to 2.0% is now in question?

We need to keep in mind that it's only one month of data, and the Fed cautions people not to overreact to a few good or bad months. Still, this wasn't a good way to start the year and with continuing tariff uncertainty, we see the risk as to the upside. Last year, we had firm numbers in 1Q turn to soft numbers in 2Q and CPI ended the year at 3.2% after starting at 3.9%.

As far as inflation concerns pushing the Fed to pause interest rate cuts, we should remember that the Fed prefers to focus on PCE inflation, which came in at 0.25% m/m for January, providing a 2.5% y/y increase.

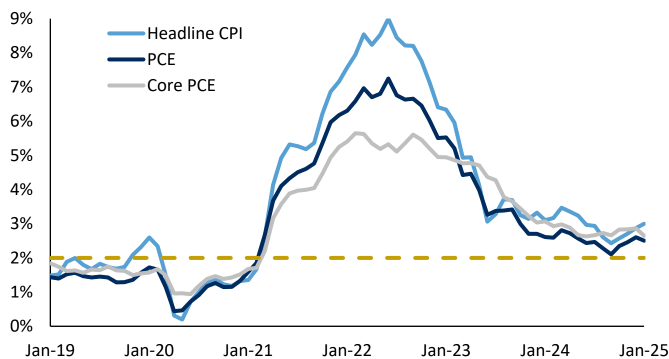
Interest rates coming down, but even more slowly

Our U.S. economics team continues to forecast two rate cuts from the Fed in 2025, as the economy has continued to grow well without needing stimulus from lower rates and unemployment still remains low at 4.0% (Chart 17). Consensus expectations have moved more towards only one cut in 2025, and that would likely be towards the end of the year. The Fed's goal of returning to 2.0% inflation, as measured by the PCE price index was already pushed out to 2027, from 2026, and more pundits seem to be talking about how it might be more reasonable to just accept a 2.5-3.0% rate of inflation going forward. In contrast, the BoC has reaffirmed its commitment to the 2% target with the governor stating "this is not the time" to question that goal. For now, the message from the Fed seems to be that the economy is doing just fine at this interest rate level, which is now significantly less restrictive than previously, and the neutral rate, which maintains the balance between growth and inflation pressures, has risen meaningfully from before the pandemic. We still see an overall desire to move interest rates lower, although there is very little urgency to do so in the short-term.

Labour market remains healthy for now

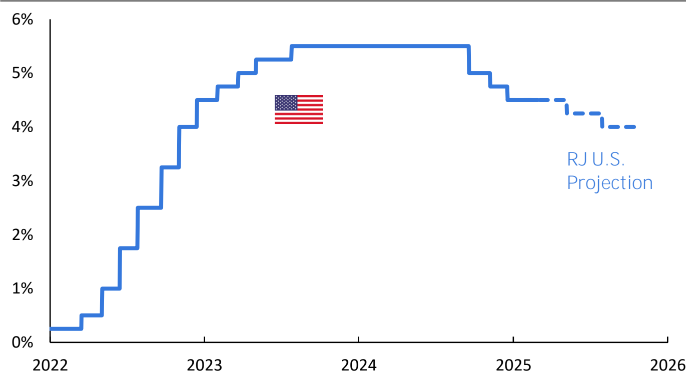
While we are still waiting for the official February non-farm payroll report, economists surveyed by Dow Jones expect job gains of 170,000 and an unemployment rate holding steady at 4%. In contrast, ADP (Automatic Data Processing, Inc.) projects job gains of only 77,000. Despite the wide gap between these estimates, both are within a healthy range. However, we believe the recent negative sentiment around the U.S. economy may dampen hiring intentions, especially for smaller businesses. According to the Intuit QuickBooks Small Business Index, employment for U.S. small businesses with one to nine employees decreased by 124,900 jobs in February compared to January, a 0.99% m/m decline. Nonetheless, two significant factors that could weigh on the labour market, DOGE's restructuring of the federal government and tighter immigration policies, have yet to play out. Although they may partially offset each other, we see more downside risk in the coming months.

Chart 16 - US Inflation (Y/Y Percentage Change)



Source: Factset, Raymond James Ltd.; Data as of January 31, 2025.

Chart 17 - Interest Rates to Come Down, But at a Slower Pace



Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025.

Consumer confidence is getting weaker

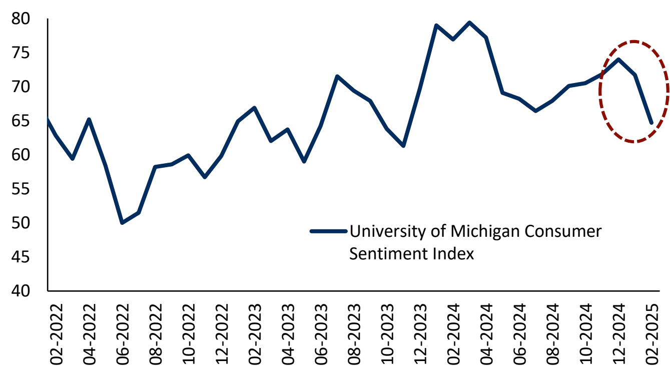
In February, the U.S. Consumer Confidence Index, published by the Conference Board declined sharply for the third month in a row, with the largest monthly decline since August 2021. The index fell to 98.3, from 105.3 in January, with both the Present Situation Index (down 3.4 to 136.5) and the Expectations Index (down 9.3 to 72.9) showing significant decreases. There was a notable drop in assessments of current labour market conditions and business prospects. This decline indicates a softening in consumer confidence and a weakening optimism about future business

conditions and incomes.

The February University of Michigan Consumer Sentiment Index was down 15.9% from a year ago to 64.7, and down from 71.7 in January, the second consecutive monthly decline (Chart 18). Consumer concerns may be exaggerated due to fears of tariffs driving up prices, and could revert if tariffs threats do ultimately get revealed as more bargaining tools, but for now, they could point to a more cautious consumer.

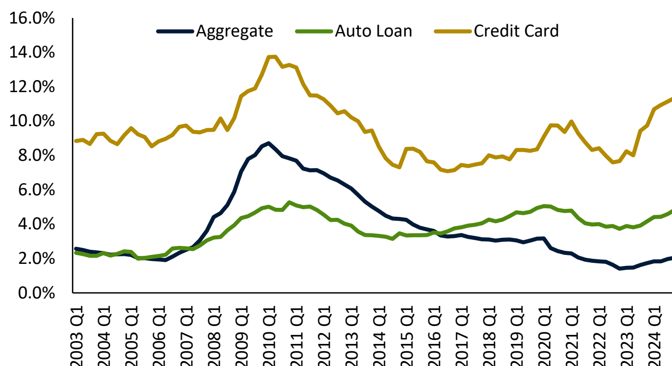
One fact weighing on households might be that total household debt rose US$93 billion in 4Q24, to US$18.04 trillion. The delinquency (90+ days past due) rate also increased from 3.5% to 3.6% to its highest level since 2Q20, driven by auto loans and credit card balances (Chart 19). This could translate into a slowdown in consumer spending.

Chart 18 - Softening Consumer Sentiment



Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025.

Chart 19 - Transition Into Serious Delinquency (90+) by Selective Loan Type

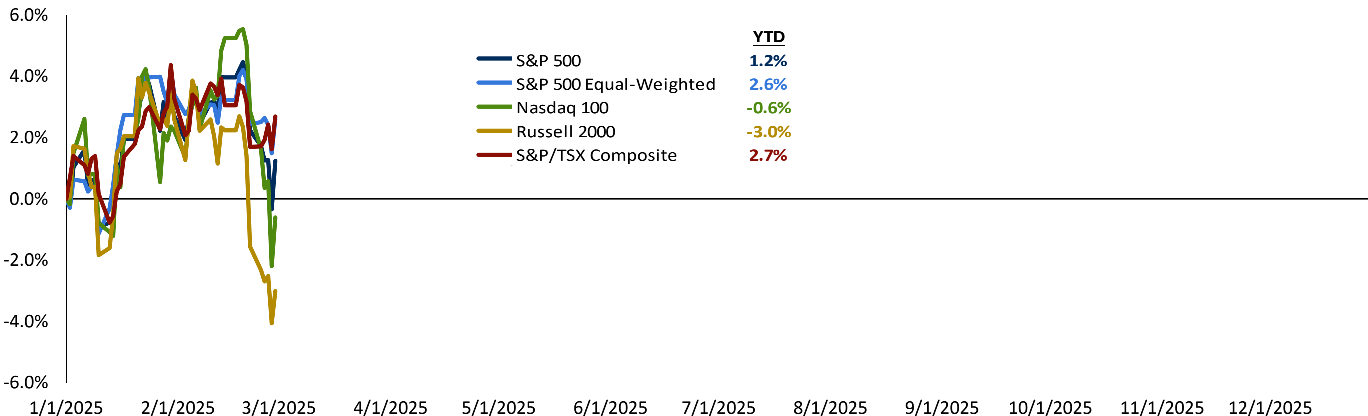


Source: New York Fed Consumer Credit Panel/Equifax. Data as of Q4 2024.

Financial Markets

In February, the TSX Composite, Canada's main stock market index, recorded a -0.5% price return and a -0.4% total return. Meanwhile, the U.S. large-cap benchmark, the S&P 500, saw a larger decline with a -1.4% price return and a -1.3% total return, all in local currency. Within the TSX Composite index, the more service-oriented and defensive sectors generally outperformed amid tariff threats. For the S&P 500, the S&P 493 has been outperforming six of the seven "Magnificent Seven" members year to date. Consequently, non-“Magnificent Seven” sectors outperformed in February, with the industrials sector being an exception. Among other major equity indices, it is not surprising to see the S&P 500 equal-weighted index in a better position than the S&P 500 capital-weighted index, nearly doubling the latter's YTD performance. On the other hand, the U.S. small-cap index, Russell 2000, struggled in February due to negative sentiment surrounding the U.S. economy (Chart 20).

Chart 20 - Selected Indices Price Returns



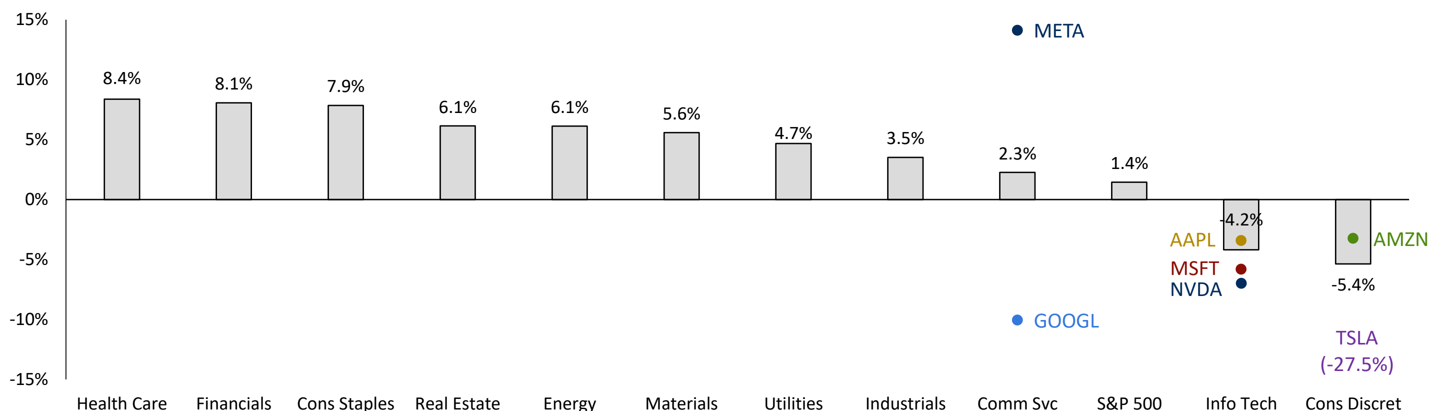
Source: FactSet, Raymond James Ltd; Data as of February 28, 2025. Price return in local currency.

U.S. Equity Markets

As 4Q24 earnings season nears completion, we have seen S&P 500 earnings up 17% from 4Q23 (vs. consensus of 12%). This shows significant strength, but we already see 2025 earnings expectations revising lower by ~1% from the start of the year, to US$271, and down from a peak of US $278, in August. This would still imply a very healthy ~10% EPS growth for the year, but further downward revisions push up valuation multiples, making stocks relatively more expensive. In part, this could be due to companies presenting more conservative guidance given continued uncertainty around tariffs and trade relationships, with U.S. companies with more domestic sales expecting better growth than companies with primarily international sales that might be negatively impacted by a stronger USD and retaliatory tariffs or decreasing appetite for American goods. For the current quarter (1Q25) guidance from S&P 500 companies has resulted in EPS growth expectations for 1Q25 specifically being lowered to +8% from +14% before earnings season began.

Regarding sectors, the high valuations of the "Magnificent Seven" stocks have not only led to lofty expectations but also made investors less comfortable to buy or hold them at current prices. The sectors containing these stocks (information technology, consumer discretionary, and communication services) have lagged behind other sectors year-to-date (Chart 21). This trend aligns with our observation of market broadening, where capital flowing into market segments that are cheaper on a P/E basis, particularly those demonstrating steady earnings growth. In the 4Q24 earning season, the non-"Magnificent Seven" sectors showing the strongest earnings growth were financials, real estate, utilities, and health care (Chart 22). Notably, among the top ten contributors to the S&P 500's year-to-date performance, META is the only one from the "Magnificent Seven", while the majority are from the financials and health care sectors. As we look ahead, we expect decent earnings growth to support further sector rotation. Factoring in potential policies on deregulation and the influence of the enacted and threatened tariffs, which could impact sectors to varying degrees, our preferred segments of U.S. large-cap equities are financials, industrials (including global aerospace & defense), health care, and technology (mostly software).

Chart 21 - S&P 500 Sector and "Magnificant Seven" Year-to-Date Total Returns

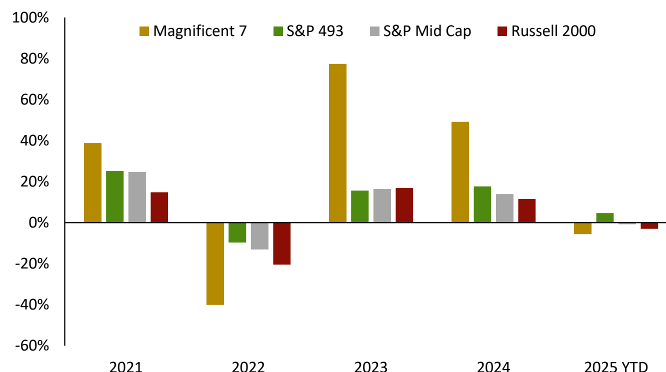


Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025.

Chart 22 - S&P 500 Sector 4Q24 Earnings Growth

Source: Bloomberg, Raymond James Ltd.; S&P 500 4Q24 earnings surprises, data as of March 4, 2025.

Chart 23 - 2025: Time to shine for the "S&P 493" and Mid Cap?



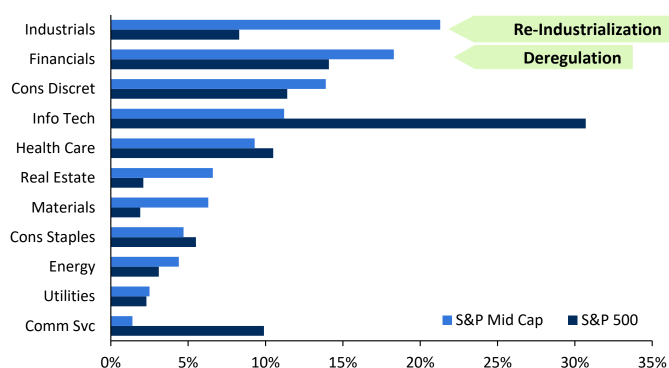
Source: Bloomberg, Raymond James Ltd.; Data as of February 28, 2025.

U.S. mid-cap equities are another market segment that we believe will benefit from the ongoing market broadening trend and the anticipated macroeconomic conditions, while their earnings have demonstrated resilience. Year-to-date, U.S. mid caps, represented by the S&P 400 index, have outperformed both the "Magnificent Seven" and U.S. small caps, represented by the Russell 2000 index (Chart 23). The valuations of U.S. mid-caps are also quite attractive. That group is currently trading at a deep discount compared to its historical long term median, while small cap and large segments are trading at or way above their historical median levels.

Compared to the S&P 500, the sector allocation of the S&P 400, particularly its overweight in industrials and financials, is better aligned with potential economic policies, such as re-industrialization and deregulation (Chart 24). Additionally, the S&P 400 has a greater domestic revenue exposure of 77%, compared to the S&P 500's 59%, making mid-cap earnings less vulnerable to ongoing tariff threats and potential retaliatory tariffs.

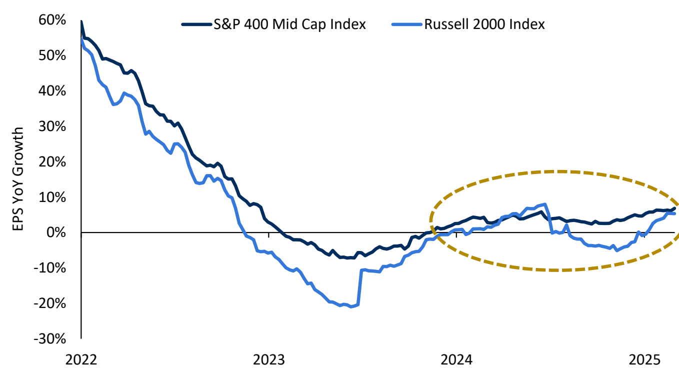
At this stage of the market broadening process, we also prefer mid-caps over small caps. Using a similar framework to our discussion last year on the sustainability of small cap outperformance, we consider two key factors. First, their earnings growth should be stable and improving; second, the macroeconomic backdrop (rate decisions, GDP growth, consumer sentiment, etc.) must align with market expectations. In terms of earnings, unlike small caps, which failed to stabilize their earnings in the second half of 2024, U.S. mid-caps have shown strengthening year-over-year earnings growth, remaining positive since November 2023 (Chart 25). Regarding the macroeconomic backdrop, the increasing uncertainties surrounding the U.S. economy may put mid-caps in a better position than small caps, as mid-caps are more established. Small caps, on the other hand, are more rate-sensitive and heavily influenced by sentiment, which tends to lead to more volatile performance.

Chart 24 - Mid Cap Index Sectors Tailored To Trump's Economic Policies



Source: S&P Global, Raymond James Ltd.; Data as of January 31, 2025.

Chart 25 - Brighter Earnings Outlook for Mid Caps



Source: Bloomberg, Raymond James Ltd.; Data as of February 28, 2025. EPS blended forward 12 months growth year-over-year.

Canadian Equity Markets

The tariff threats caused some disruptions to the TSX Composite's performance in February. As we discussed in the February report, the recent gradual improvement in Canada's economy could be impacted by enacted tariffs or even just the threat of them, affecting market sentiment and narratives. Unlike January, where cyclical sectors outperformed defensive ones, during February, sectors that are more services-oriented or have stronger defensiveness typically did better amid the tariff threats. However, as the markets see more tariff implementations and negotiations, we'll get a better sense of end goals and be accommodated or adjust for these kinds of uncertainties. Until then, market turmoil is likely to continue. Nonetheless, there are some sectors in the TSX Composite that we consider more insulated from the tariff threats and benefiting from stronger sector-specific tailwinds, such as utilities, materials, and information technology.

Top 3 Sectors (February 2025):

- **Utilities**: Several factors contributed to utilities being the top-performing TSX Composite sector in February. First, most companies in this sector are service providers, making them less affected by tariffs and the ongoing tariff threats, which primarily target goods. Market reactions on February 3 and March 4 have also indicated that utilities are more insulated from tariff than most other sectors. Additionally, as a traditional defensive sector, utilities benefit from a potential shift in economic narrative—from an economy turning the corner (favouring cyclical sectors) to one potentially facing recession due to tariff wars (favouring defensive sectors), which was the case in February and may continue for some

time. Furthermore, as the policy rate easing cycle continues, the dividend yields of utility stocks become gradually more attractive compared to government bond yields. Last but not least, although utilities underperformed in January due to market concerns about the future need for data centres given the improved efficiency of A.I. models (e.g., DeepSeek), we believe the market overreacted. Enthusiasm for future power demand could rise again as the market realizes A.I. can be applied more broadly. Therefore, we see several reasons to favour the utilities sector over different investment horizons.

- **Consumer Discretionary:** Although the consumer discretionary sector delivered a relatively decent return in February, we remain cautious. The sector's significant weight in discount stores adds some defensiveness, as consumers are likely to become more value-conscious amid the worsening macroeconomic backdrop due to tariffs. Additionally, its exposure to quick-service international restaurants may mitigate some impact of tariffs, which mainly target goods. However, we are concerned about the automobile components and leisure products industries, as their performance is likely to be hit the hardest by tariffs or ongoing tariff threats. Looking ahead, given the potential for a weakening economic outlook, we anticipate that the consumer discretionary sector as a whole will face more pressure.
- **Materials:** Given that about half of this sector's exposure is in gold, we consider it one of the best-insulated sectors from tariff threats and potential retaliation. In a way, it almost acts as a hedge against tariff policies, which often introduce significant market uncertainties. Therefore, we favour materials in the short term. Recently, traditional factors like the U.S. dollar and real yields haven't been as influential on gold's performance. Instead, gold prices are being driven by tariff uncertainties and central bank purchases. We believe these non-traditional factors will continue to support gold prices in the near term until the market adapts to tariff dynamics and gains a clearer understanding of U.S. policy. While central bank purchases might persist, high prices could make them more cautious. Therefore, in the medium to long term, we expect gold prices to revert to being influenced by traditional factors.

Bottom 3 Sectors (February 2025):

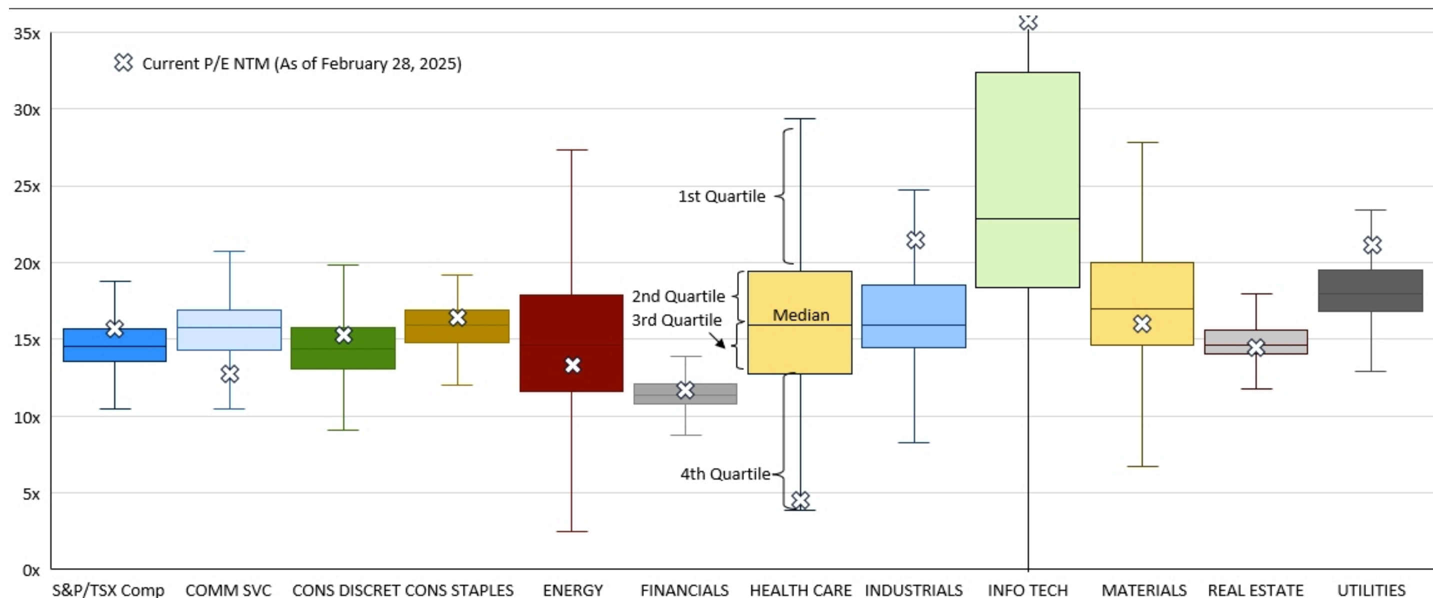
- **Real Estate:** This sector’s performance has been flat since the start of the year. While slower population growth is expected to be a macroeconomic headwind for this sector, the potential for tariffs between the U.S. and Canada could bring additional challenges. One major concern is the rise in building costs if Canada imposes retaliatory tariffs on items imported from the U.S., such as appliances or plumbing fixtures. Some industries, like residential, might be more insulated from the immediate impact of tariffs compared to others, such as industrials and retail. However, since real estate is generally seen as a cyclical sector, we expect its performance to be muted if tariffs are imposed and the economy slows down significantly.
- **Energy:** The energy sector's performance has been quite muted since mid-January, closely tracking the trend in crude oil prices. The newly announced 10% tariffs on energy products from the U.S. add further pressure on future performance, although we expect these tariffs to be short-lived. We anticipate an excess supply of crude oil, as OPEC+ has confirmed their existing plan to increase oil output by 2.2 million barrels per day over the next 18 months, along with a potential ramp-up in U.S. production. Combined with weak demand, this is likely to keep oil prices flat or even declining in 2025. Therefore, we expect the energy sector's performance to remain relatively muted.
- **Information Technology:** Info tech has given back most of its gains from January of this year. While we think info tech stocks might be under pressure, we don't believe the A.I. rally is over yet. When economic sentiment turns negative, capital tends to flow into more defensive sectors. We should also be cautious about the concentration in the TSX Composite info tech sector. However, the quick and strong rebound after the initial DeepSeek shock suggests that the potential for more affordable and efficient A.I. tools is good news for the TSX Composite’s info tech sector, which is mainly made up of software and IT services companies. In fact, the TSX Composite info tech sector has delivered higher returns than the S&P 500 info tech sector over the trailing 6-month, 1-year, and 2-year periods, and very similar returns over the trailing 3-year period, all in CAD terms. Additionally, since the TSX info tech sector is more service-oriented, it should be less affected by U.S. tariffs.

Table 1 - S&P/TSX Composite Sector Performance and Valuations (Ranked by Quarter-to-Date Total Return)

Sector Name	Sector Weight	YTD Total Return	QTD Total Return	1M Total Return	Current P/E NTM	Historical P/E NTM
Materials	12.4%	12.2%	12.2%	1.9%	16.5	17.0
Information Technology	10.2%	6.0%	6.0%	-3.6%	36.8	22.8
Communication Services	2.4%	3.7%	3.7%	1.4%	12.9	15.7
Utilities	3.9%	3.1%	3.1%	3.4%	21.7	18.0
S&P/TSX Composite	--	3.1%	3.1%	-0.4%	15.2	14.5
Industrials	12.6%	2.8%	2.8%	-0.6%	21.9	15.9
Financials	33.0%	2.5%	2.5%	-0.2%	11.9	11.4
Consumer Discretionary	3.3%	2.2%	2.2%	2.1%	15.8	14.4
Real Estate	1.9%	-0.2%	-0.2%	-0.6%	14.1	14.7
Energy	16.1%	-1.5%	-1.5%	-1.7%	13.7	14.6
Consumer Staples	3.8%	-3.0%	-3.0%	-0.3%	16.7	15.9
Health Care	0.3%	-4.7%	-4.7%	-2.1%	4.8	15.9

Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025. The S&P/TSX Healthcare sector has been excluded from the performance commentary due to its minimal representation in the S&P/TSX Composite Index.

Chart 26 - S&P/TSX Composite Sector Current vs. Historical P/E NTM



Source: FactSet; Raymond James Ltd.; Data as of February 28, 2025. Historical P/E: 1/1/2000 – 02/28/2025. Excluding outliners.

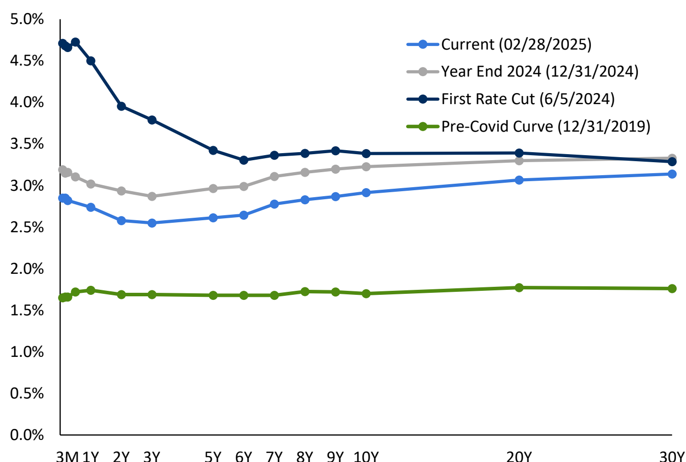
Fixed Income & Treasury Yields

Canada's government yields continued to decline across maturities in February. As of March 4, the day President Trump did not further postpone tariffs on Canada, the front end of the yield curve dropped while the middle and long ends moved up. Fears of a recession in Canada have led markets to price in more rate cuts by the Bank of Canada. However, the magnitude of changes in forward rates shows that the market has been calmer this time compared to February 3. Nonetheless, U.S. tariffs will remain a significant factor affecting the movements of Canada's yield curve. If the situation develops differently than the market expects (i.e., if the tariffs are not short-lived), there could be further declines in the short and mid-term segments of the curve.

Regarding Canada's corporate bonds, we see asymmetric risks due to ongoing tariff challenges. The spread to sovereign bonds could widen if tariffs are implemented for a prolonged period, but there is limited room for improvement if Canada avoids significant tariffs, given that the spread has been gradually narrowing over the past six months. Therefore, at this stage, we may only consider investment-grade corporate bonds, primarily issued by leading companies in sectors like financials, energy, infrastructure, and telecom, which are considered to have high credit quality.

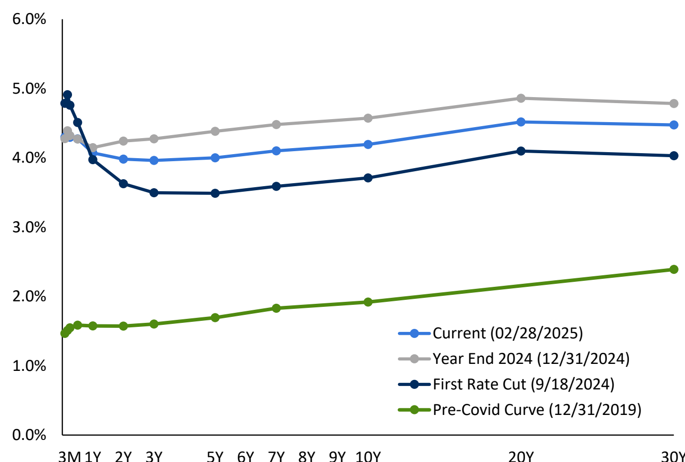
The U.S. yield curve for maturities greater than one year saw a noticeable decline in February, mainly due to some concerning readings from leading indicators and increased negative sentiment about the macroeconomic conditions. However, policy uncertainties might keep the Fed on the sidelines for the March meeting. Despite the ten-year yield dropping more than 20 basis points in just one month, our U.S. Senior Investment Strategist expects it to remain range-bound between 3.75% and 4.75%, ending 2025 around 4.5%. The ten-year yield is still attractive compared to the past decade. With the U.S. stock market priced for perfection and expected to be more volatile this year, it might be beneficial to consider adding some U.S. treasuries to your portfolio to reduce overall risk.

Chart 27 - Canada Government Yield Curves



Source: Factset, Raymond James Ltd.; Data as of February 28, 2025.

Chart 28 - U.S. Treasury Yield Curves



Source: Factset, Raymond James Ltd.; Data as of February 28, 2025.

International Markets

According to the BoC's January forecasts, the global economy is expected to grow close to 3% in 2025, although political and trade tensions do create uncertainty and threaten to reduce that rate.

Mexico is an area of interest as it reported a 0.6% decline in GDP in 4Q24, with 2025 recession fears circulating. An already weak economy may put the country into an even more disadvantageous position in trade negotiations.

Consumer spending in the eurozone was flat to negative in November and December and despite inflation close to the ECB's 2% target, consumers are choosing to save rather than spend, with a savings rate of 15% compared to under 4% in the U.S. and just over 7% in Canada. Economic growth in the euro area is expected to remain modest in 2025, at around 0.8% in 2025, and then strengthen slightly to 1.3% in 2026. We credit an uncertain political and geopolitical environment for this cautious outlook.

In the U.K., inflation picked up to 3.0% in January and is expected to move higher with increases in regulated energy prices.

In China, government initiatives such as debt support for local governments and policies to stabilize the property sector are seen as a short-term boost, while structural challenges, such as an aging population are expected to be a headwind to growth. China is set to release its 2025 GDP target in March, with the IMF forecasting growth of 4.6%, down slightly from 5.0% in 2024.

In Japan, after years of deflation, consumer prices have continued to rise, with inflation hitting 4%, with core measures up 3.2%, giving it the highest inflation rate in the G7, with markets expecting further rate hikes.

International Equities

Tariffs continue to cloud the outlook for many international markets, not only from U.S. tariffs, but if the trade war dampens the economy in China, which would then impact manufacturing focused economies such as Germany and luxury goods sectors from France.

So far, it looks like India, Taiwan, and Vietnam might escape the tariff storm and may even benefit from the growing tension between the U.S. and China, although reciprocal tariff calculations may end up changing this. However, YTD, Indian equities are lagging, with high valuation and disappointing earnings.

European equities have generally done well YTD, as investors have taken advantage of their lower valuations (~40% discount to U.S. stocks) and better than expected earnings despite the economic weakness in those markets. Earnings are also expected to grow 10% in 2025, and we expect that optimism around an end to the Russia/Ukraine war is helping some of this resurgence.

Table 2 - Global Equities Performance

Select Global Equity Indices	Feb (in LCL)	Feb (in USD)	Feb (in CAD)	3 Mo (in LCL)	3 Mo (in USD)	3 Mo (in CAD)	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Major Aggregates												
World (Global)*	-0.5	-0.5	-1.0	0.2	0.2	3.0	3.0	3.0	3.1	19.2	15.9	3.3
EAFE (DM ex U.S. & Canada)*	3.1	3.1	2.5	5.0	5.0	8.1	8.1	8.1	8.3	14.5	13.5	0.9
EM (Emerging Markets)*	0.7	0.7	0.2	1.5	1.5	4.5	2.6	2.6	2.7	12.3	11.8	0.6
Selected Developed Markets												
Nikkei 225 (Japan)	-6.0	-3.5	-4.0	-2.6	-2.9	-0.1	-6.8	-2.8	-2.6	17.2	16.8	0.4
Euro STOXX 50 (Europe)	3.5	3.4	2.8	14.1	12.0	15.2	11.9	12.1	12.3	15.6	13.2	2.4
FTSE 100 (U.K.)	2.0	2.9	2.4	6.9	5.3	8.3	8.3	8.4	8.5	12.2	12.4	-0.2
CAC 40 (France)	2.0	2.1	1.5	12.4	10.7	13.9	10.0	10.5	10.7	15.8	13.4	2.4
DAX (Germany)	3.8	3.8	3.3	14.9	13.1	16.4	13.3	13.5	13.6	14.9	12.6	2.3
Hang Seng (Hong Kong)	13.4	13.6	13.7	18.6	18.6	22.1	14.8	14.7	14.9	10.3	11.9	-1.6
Selected Emerging Markets												
CSI 300 (China)	1.9	1.7	1.1	-0.3	-1.0	1.8	-0.9	-0.7	-0.5	14.9	13.7	1.2
Nifty 50 (India)	-5.8	-6.7	-7.2	-8.1	-11.3	-8.7	-6.2	-8.2	-8.1	18.5	18.5	0.0

Source: FactSet; Raymond James Ltd; Total returns, data as of February 28, 2025. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 2/28/2025. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

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