CIO insights: The evolving market landscape

Andrew Marchese
Chief Investment Officer and Portfolio Manager

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Can the profit story endure?

The market has reached an important junction in the macro backdrop and valuation

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Four pillars of the equity market

Earnings

Interest rates

Liquidity

Valuation

Source: Fidelity Investments Canada ULC.

Executive summary

Corporate profit backdrop has proven to be no worse than consensus forecasts set out 15 months ago. **Market consensus forecasts point to accelerating growth in 2024**. Market has priced in a meaningful amount of this, with multiple expansion in 2023.

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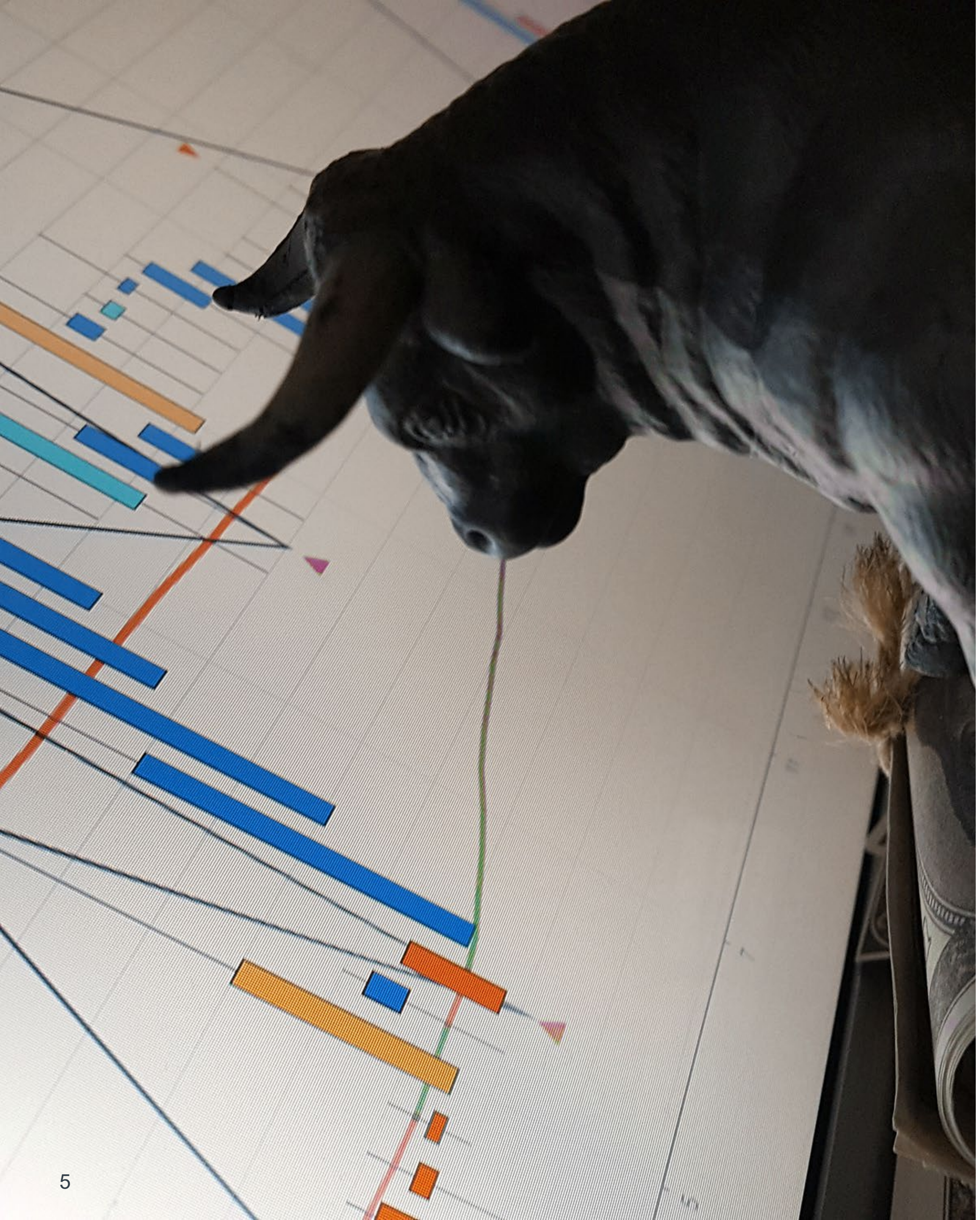

Executive summary

Equity breadth is somewhat narrow, and **leadership is not synonymous with a new bull market.**

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Executive summary

Unemployment may be the single most important macroeconomic metric to observe going forward, and it will determine the fate of the price of various asset classes and interest rate policy.

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Executive summary

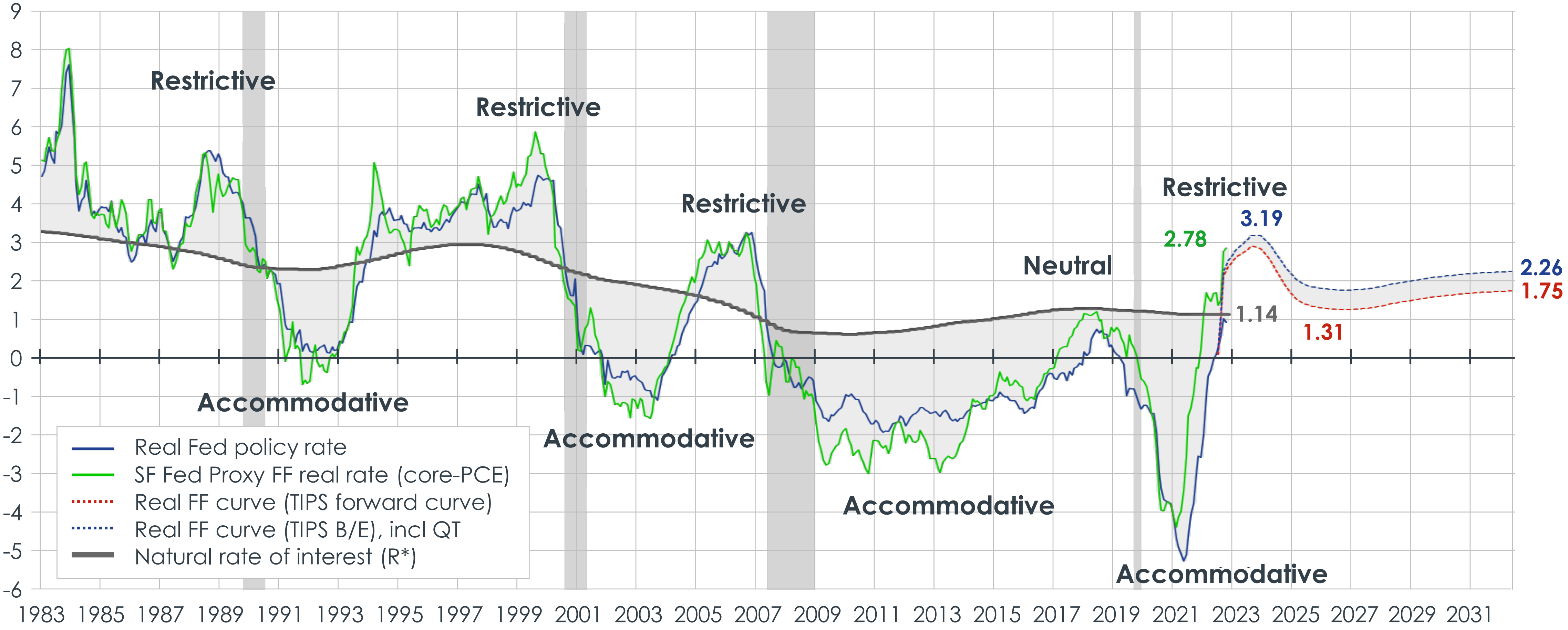
Valuation disparities are becoming large again, setting up opportunity for changes in asset allocation and leadership.

Global economic cycle

The diagram above is a hypothetical illustration of the business cycle, the pattern of cyclical fluctuations in an economy over a few years that can influence asset returns over an intermediate-term horizon. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one.
A growth recession is a significant decline in activity relative to a country's long-term economic potential.
Source: Fidelity Investments (AART), as at June 30, 2023.

How restrictive is monetary policy?

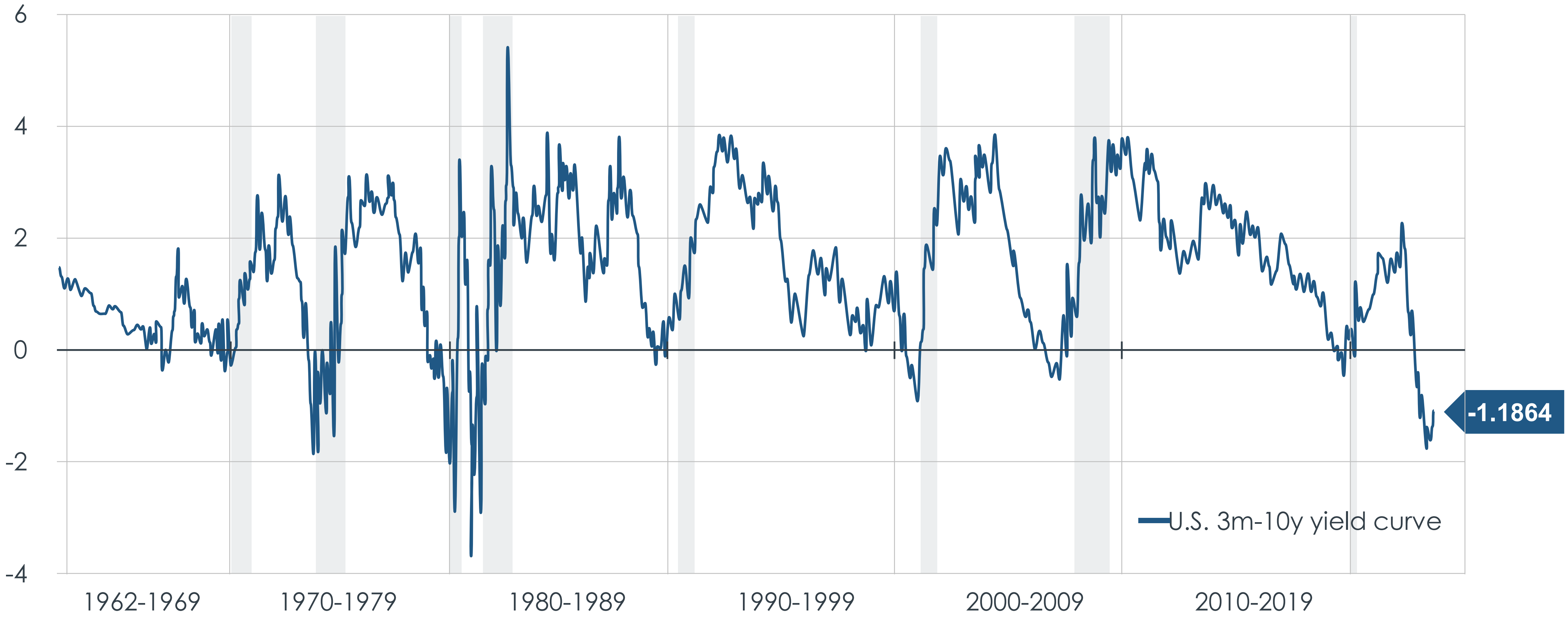
U.S. monetary policy



Source: FMRCo and Haver. Data as at September 15, 2023. Monthly data.

Are we really out of the economic woods?

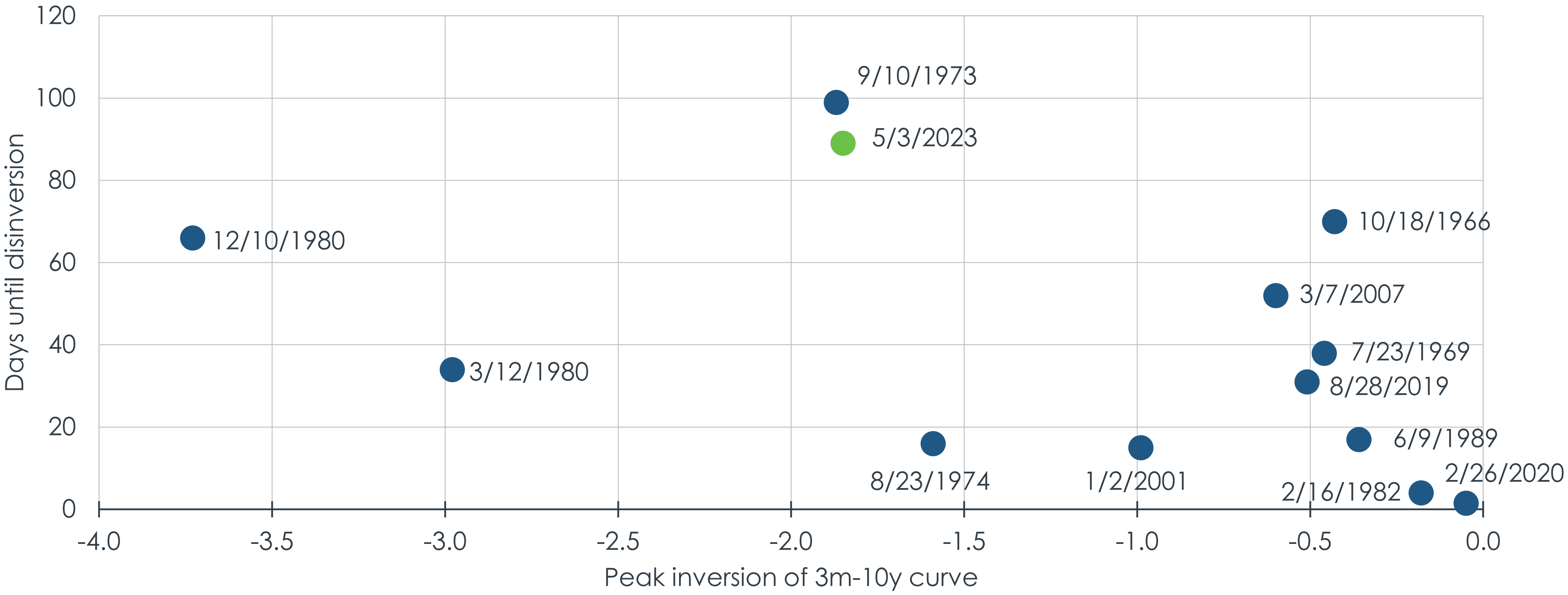
Recession warning – Inversions like this tend to end with economic contraction



Source: Bloomberg. Data as at September 8, 2023. Shaded areas indicate U.S. recessions.

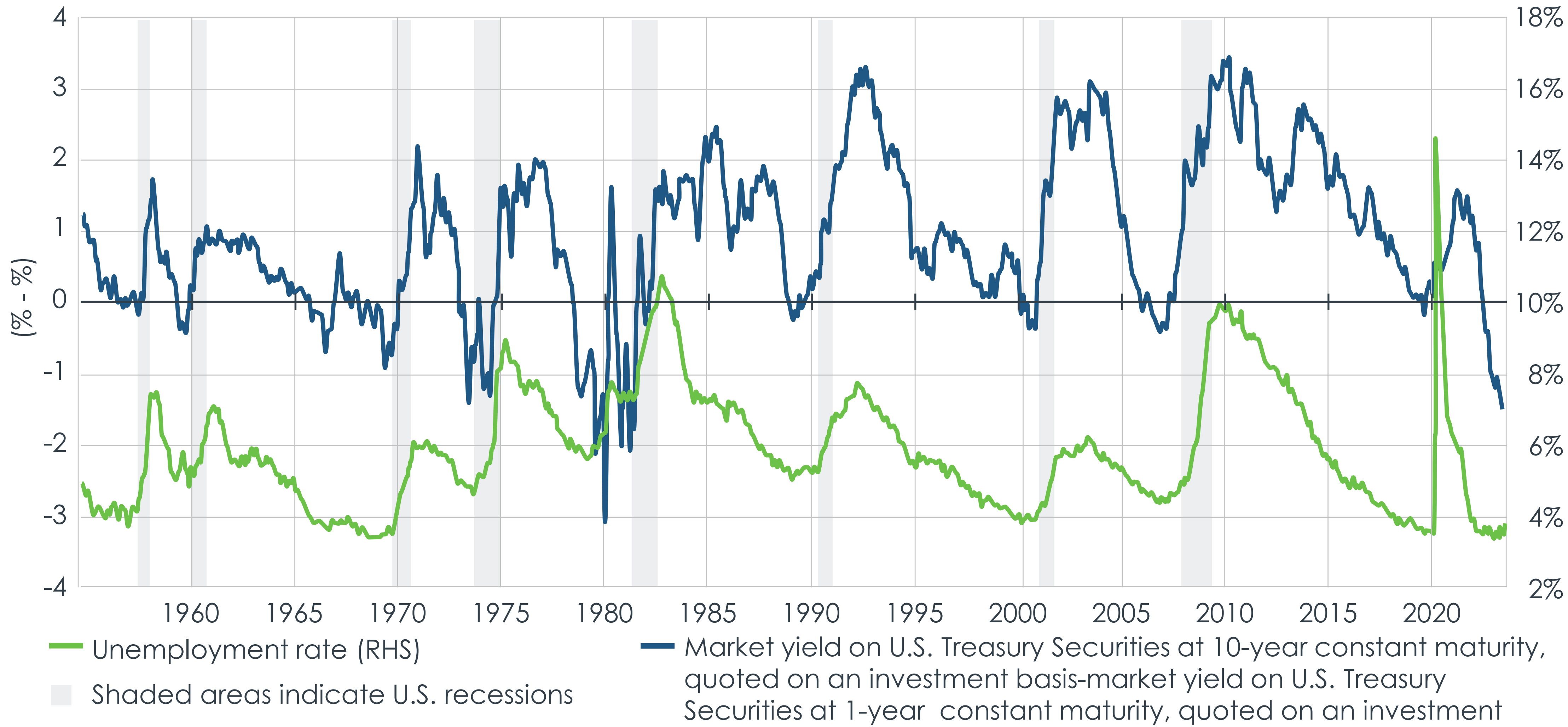
Are we really out of the economic woods? (cont'd)

Peak yield curve inversion and time until disinversion



Source: Bloomberg. Data as at September 8, 2023.

U.S. unemployment



Source: Economic Research, Federal Reserve Bank of St. Louis. Data as at September 8, 2023.

Corporate profit backdrop

Stable forecasts, but where does the risk lie?

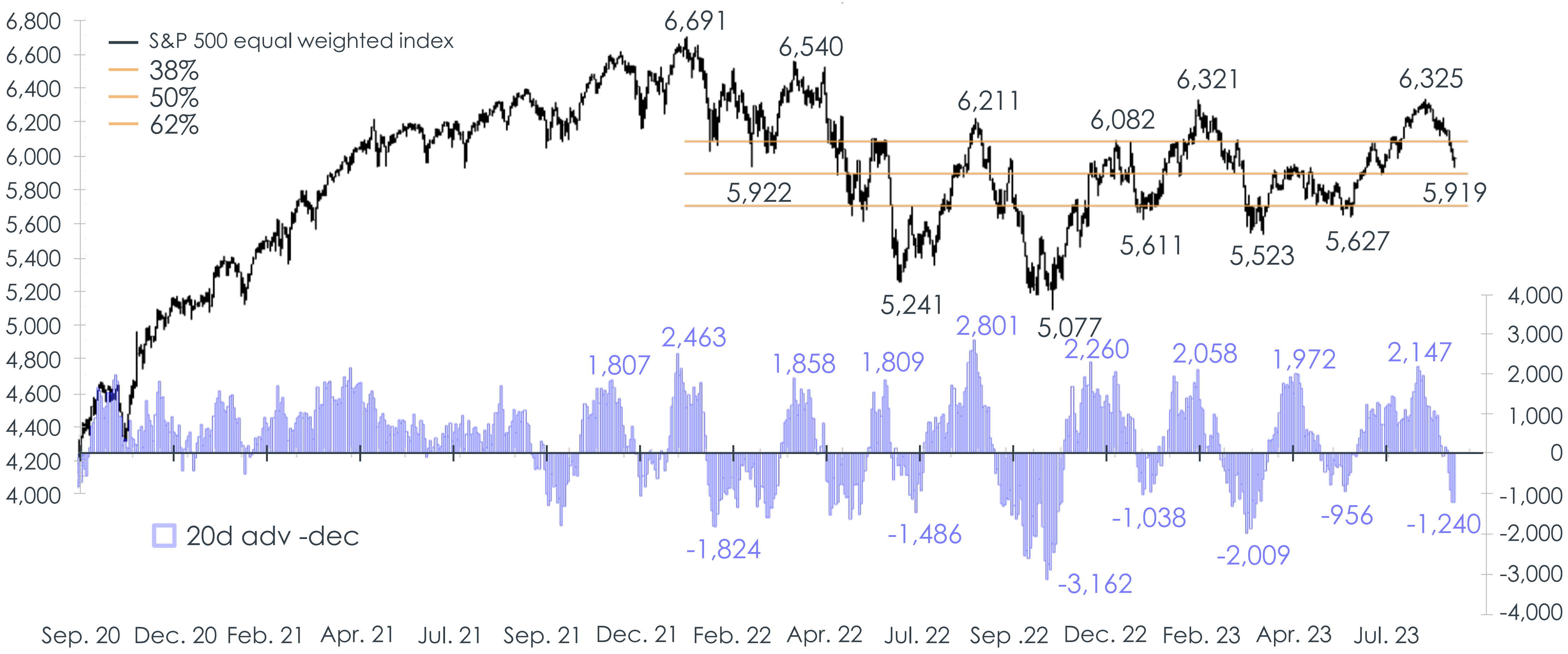
S&P 500 Index	Q2 '23	Q3 '23	Q4 '23	CY2024
EPS estimate (Sep. 8, 2023)	$54.24 (actual)	$56.44	$57.75	$241.52 (+11% YoY growth rate)
EPS estimate (Apr. 18, 2023)	$54.39	$56.66	$57.96	$241.05 (+10% YoY growth rate)

- Historically, GDP and EPS bottom 18–24 months after a peak in ten-year yields
- Current manufacturing ISM data are consistent with 1% real GDP growth historically
- 1% real GDP growth is historically consistent with weakness in capex and EPS
- Consumer spending has been resilient due to a drawdown in household excess savings

Source: Bloomberg consensus earnings per share estimates. As at September 8, 2023.

Market breadth lacking and small caps not participating

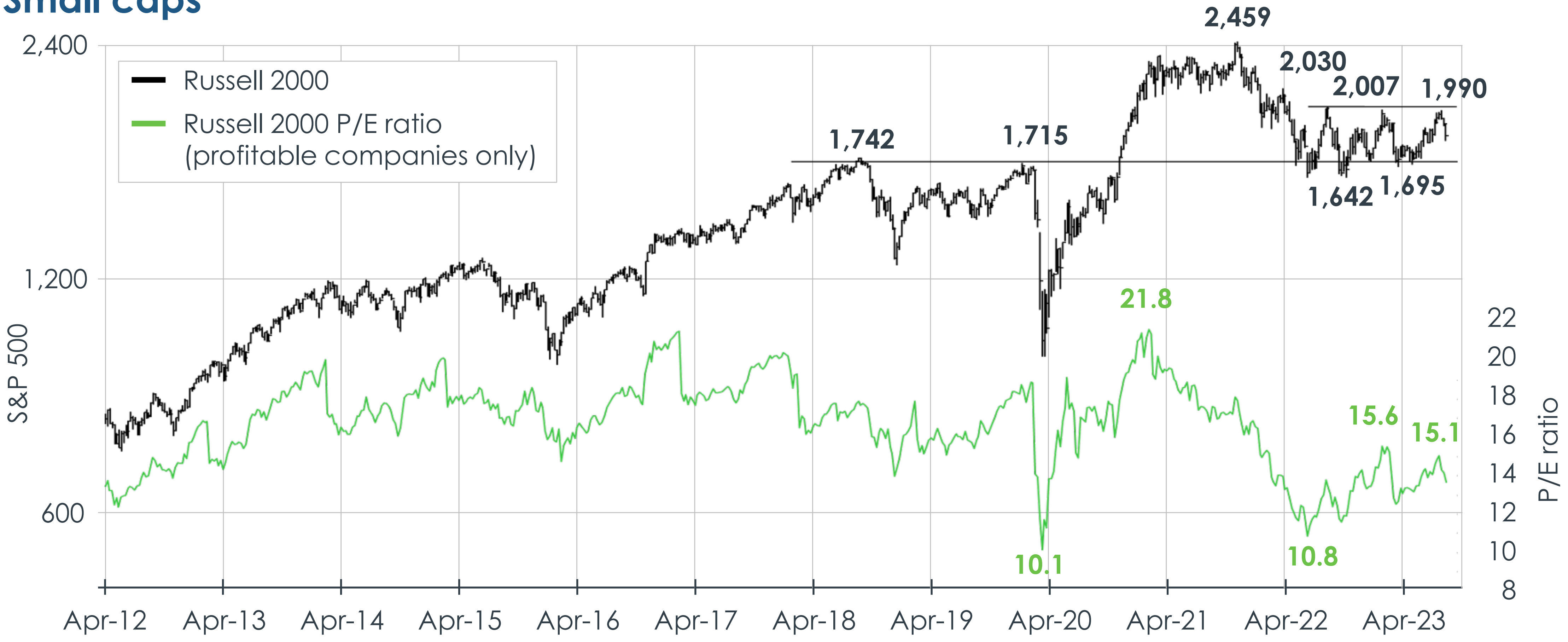
S&P 500 Equal Weighted Index



Source: FMRCo, Bloomberg and Haver. Daily data. As at September 8, 2023.

Market breadth lacking and small caps not participating (cont'd)

Small caps



Source: FMRCo and Bloomberg. Weekly data. As at September 8, 2023.

Profit expectations are high for "risk on," as profit growth estimates argue for reacceleration of business conditions and valuations have expanded in anticipation.

"Risk off" areas of the market have experienced valuation compression, particularly on a relative basis.

Market leadership

Sector: S&P 500 Index	YTD return	12-month EPS growth (est.)	12-month revenue growth (est.)
Info. tech.	21.2%	9.9%	6.2%
Comm. services	16.0%	21.3%	3.4%
Cons disc.	12.0%	10.9%	5.9%
Industrials	10.1%	9.7%	5.9%
Energy	7.1%	-1.2%	-2.3%
Materials	2.1%	4.6%	1.7%
Real estate	1.1%	0.3%	5.7%
Financials	-2.8%	11.5%	5.9%
Consumer staples	-4.9%	7.7%	4.3%
Health care	-5.1%	7.6%	5.4%
Utilities	-8.4%	6.7%	2.7%

Source: Bloomberg, as at September 8, 2023.

Valuation

1

Market P/E multiple has expanded five points to 20x during 2023, which is reasonable on a long-term basis, assuming historical equity risk premium and long-term historical growth, but is expensive based on the current real-yield environment.

2

The market is implicitly betting on lower inflation and interest rates but better long-term growth.

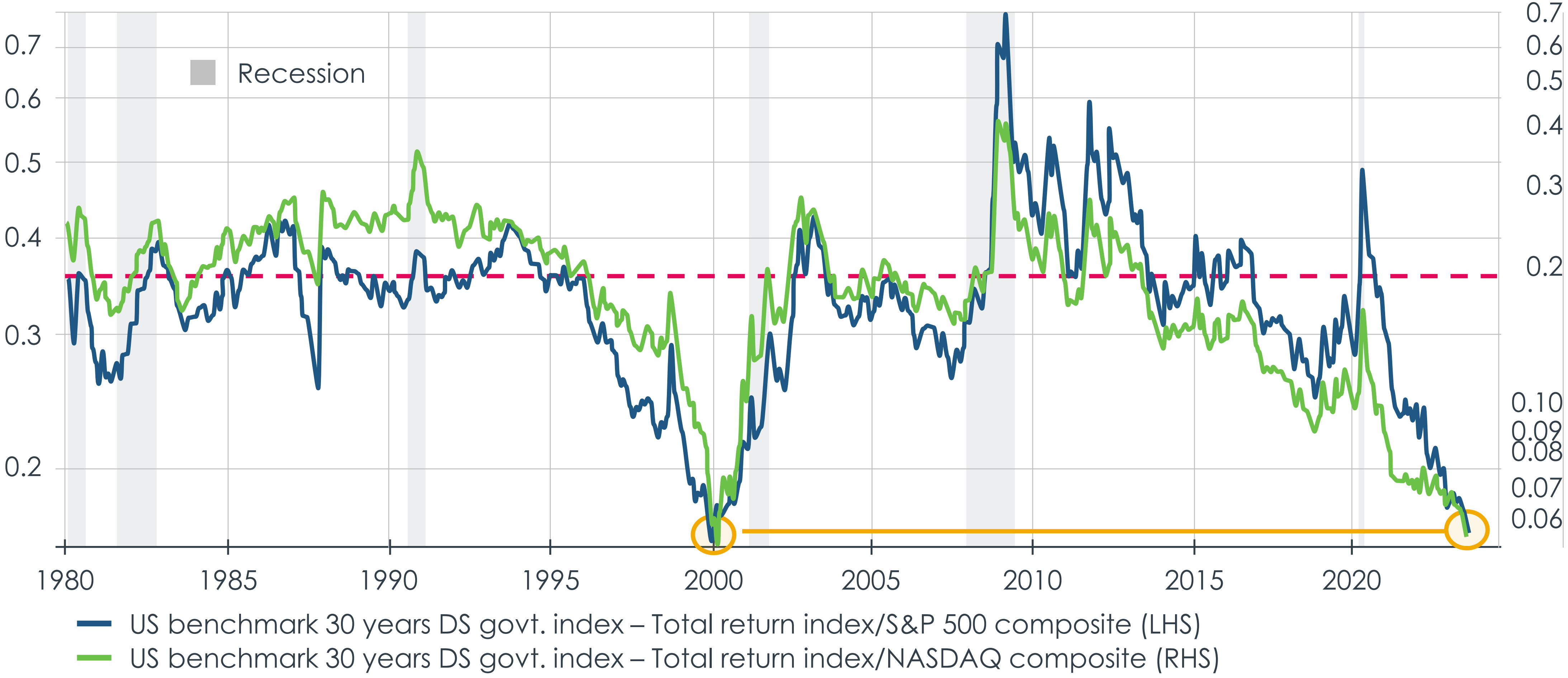
3

Valuation argues for rotation to securities and asset classes where relative valuation is attractive and expectations for growth (and risk) are low.

Source: Bloomberg, as at September 8, 2023.

Valuation (cont'd)

30-year U.S. treasury total return relative to S&P 500 and NASDAQ



Source: Refinitiv DataStream, as at September 8, 2023.

Valuation (cont'd)

S&P 500 earnings yield minus three-month U.S. Treasury yield

Source: Bloomberg, as at August 31, 2023.

Recap

1 Unbalanced markets lead to opportunities: look for opportunities in securities and asset classes that have lagged and valuation has not priced high expectations. **Think contrarian when deploying new capital.**

2 Factor-based leadership should continue to persist until global central banks show signs of change: **look for signs of change in monetary policy to rotate into lagging factor-based product** to alter an overall portfolio.

3 **Pay attention to signals in leading economic indicators, unemployment, and monetary policy** to further alter portfolios.

4 Continue to **add asset classes which are lowly correlated with markets.**

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