TD Wealth

Q4 | Quarterly Market Review

Everything you need to know about the quarter that was

January 16, 2024

Wealth Investment Office

QMR - Q4 23 | Highlights

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Unless otherwise indicated, performance figures are stated on a total-return basis. This document is for distribution to Canadian clients only. Please refer to Appendix A of this report for important disclosure information.

U.S. Equities

- Stocks rebounded in the fourth quarter amid expectations that the Federal Reserve had completed its campaign of interest-rate hikes and was now considering cuts.
- The S&P 500 rose by 11.7%, the Dow Jones Industrial Average rose by 13.1% and the Nasdaq Composite Index rose by 13.8%.
- Ten of the 11 sectors in the S&P 500 performed positively. Real estate and technology outperformed, with returns of 18.8% and 17.2%, respectively. The energy sector was the worst performer, falling 6.9%.
- Small-cap stocks outperformed large-caps; value stocks outperformed growth.

Canadian Equities

- The broad Canadian equities index lagged its American counterpart in Q4, owing in part to a lack of exposure to the “Magnificent Seven” tech mega-caps and perceived central-bank dovishness south of the border, which pulled the U.S. dollar down 2.2% against the loonie.
- The S&P/TSX Composite Index ended Q4 up 8.1%, with 10 of 11 sub-indices posting positive returns.
- West Texas Intermediate finished a volatile quarter at US$71.65, dropping 21.1% from the September 30 close of US$90.79. Financials increased 12.8%, reflecting strength in banks (+11.9%) and financial services (+22.3%). The insurance sector was up 10.2%.
- Large-cap stocks outperformed small-caps; value stocks outperformed growth.

Canadian & U.S. Fixed Income

- Global fixed income markets saw a big rebound in Q4, driven by a sharp decline in developed-market government yields. The FTSE Canada Universe Bond Index posted a return of 8.3%, while the Bloomberg U.S. Aggregate Bond Index posted 6.4%.
- Canadian and U.S. investment-grade corporate bond indices registered returns of 7.6% and 8.0%, respectively.
- The Canadian government bond index rose 8.5% in Q4; the U.S. government bond index fell 5.3%.

International Equities

- International developed markets underperformed their American peers in the fourth quarter, due to the falling U.S. dollar and a lack of exposure to big tech names.
- Emerging markets generally outperformed, as Western investors once again ventured abroad. However, a negatively divergent Chinese performance weighed down the EM index.
- China’s SSE Composite Index fell 4.5% in Q4 due to intense deflationary pressures. Consumer prices fell 0.5% y/y in November.

Market Movers

Equities in Review

October 7

Hamas carries out heinous terrorist attack on Israel, murdering more than 1,100 people. Treasury yields and oil prices initially rise on fears of a wider war, but they quickly recover.

October 10

There's dissention in the ranks, as Atlanta Fed President Raphael Bostic, in a speech, tells the American Bankers Association that he believes the U.S. is on track for a soft landing, and that rates need not rise any higher. Investors rejoice (prematurely).

October 19

Fed Chair Jay Powell pushes back, telling the Economic Club of New York that inflation is too high to discuss an end to rate hikes and that the Fed would be "resolute" in its commitment to the 2% inflation target. Investors rein in their jubilation, pushing yields up over 5% and weakening tech stocks.

October 25

Abysmal Chinese economic data and a looming financial crisis prompt the government to approve a trillion-yuan (US$140-billion) increase to its annual budget. European and Japanese shares rise on the stimulus plan.

October 31

Bank of Japan tweaks its ultra-dovish policy, saying it will now allow long-term bond yields to rise slightly over 1% (previously a hard cap) before intervening.

November 2

Canadian e-commerce powerhouse Shopify jumps 21% after beating top- and bottom-line estimates. The stock was up 54% in November, lifting the S&P/TSX info-tech sector 24% for the quarter — still not enough to compensate for the dearth of tech in Canada.

Early November

Weak job and inflation data spur an "everything rally." Stocks rise on bets that the Fed will refrain from further hikes. Bonds surge as yields plummet from 16-year highs. Tech shares rally.

November 9

Strong results from pharmaceutical giants like AstraZeneca, Sanofi and Novo Nordisk (behind the blockbuster weight-loss drug Ozempic) help lift European indices.

November 13

Moody's downgrades its outlook on the U.S. to "negative" from "stable," citing high debt levels and political polarization. Markets shrug off the news.

November 28

Fed Governor Christopher Waller, in a speech, tells the American Enterprise Institute that the Fed is likely done with rate hikes, echoing Bostic and other Fed officials.

Early December

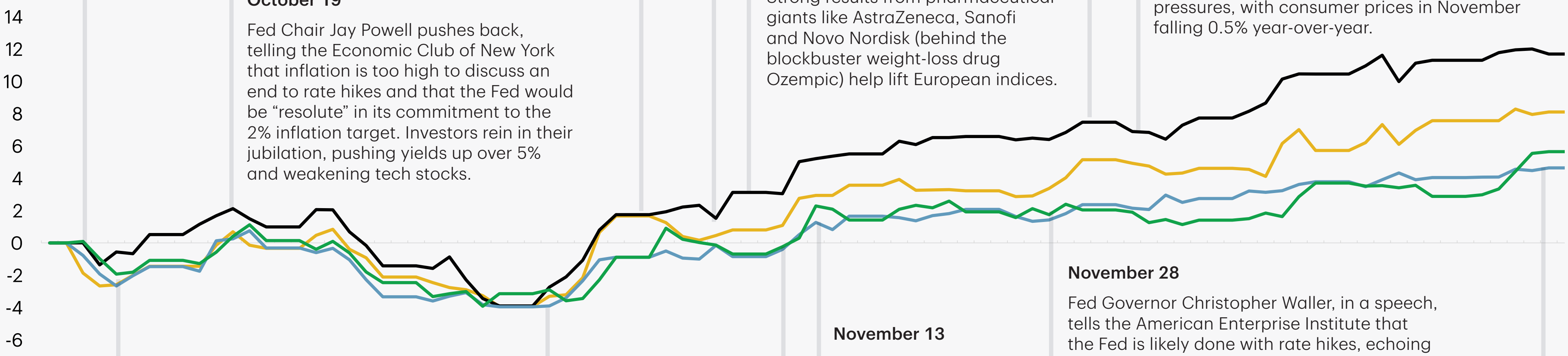
U.S. jobs and inflation data come in stronger than expected, but the Fed's Summary of Economic Projections, released on December 13, reveals a notably dovish tilt, with committee members calling for three rate cuts (instead of one) in 2024. This time, there's no pushback from Powell, sparking a full-fledged Santa rally.

December 10

The Chinese economy succumbs to deflationary pressures, with consumer prices in November falling 0.5% year-over-year.

Late December

Investors are still waiting for the ECB and BoE to show their cards. Both central banks have refused to contemplate rate cuts, but with Germany in recession and the UK wavering in and out of contraction, investors are hoping they will follow the Fed's lead. In emerging markets, meanwhile, investment dollars are flowing in as central banks cut rapidly from double-digit policy rates. China, however, remains the big exception.



S&P 500
MSCI EAFE
S&P/TSX Composite
MSCI Emerging Markets

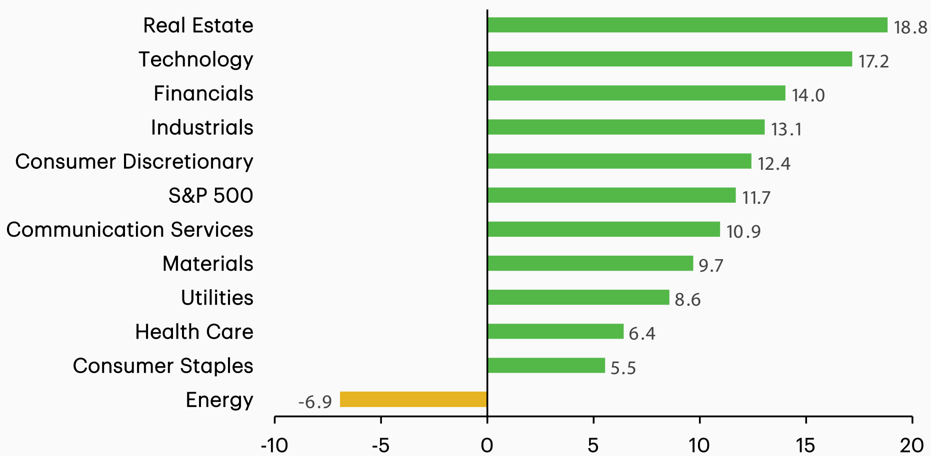
Source: TD Wealth, Reuters, FactSet as of December 31, 2023. **Note:** Indices are tracked in local currencies.

U.S. Equities

Indices	Q4 Return (%)	Q4 Return (%, C$)	Annual Return (%)	Annual Return (%, C$)
Dow Jones Industrial Average	13.09	10.27	16.18	13.41
S&P 500	11.69	8.90	26.29	23.27
S&P 400	11.67	8.88	16.44	13.66
Nasdaq Composite	13.79	10.95	44.64	41.19
Russell 2000	14.03	11.18	16.93	14.14

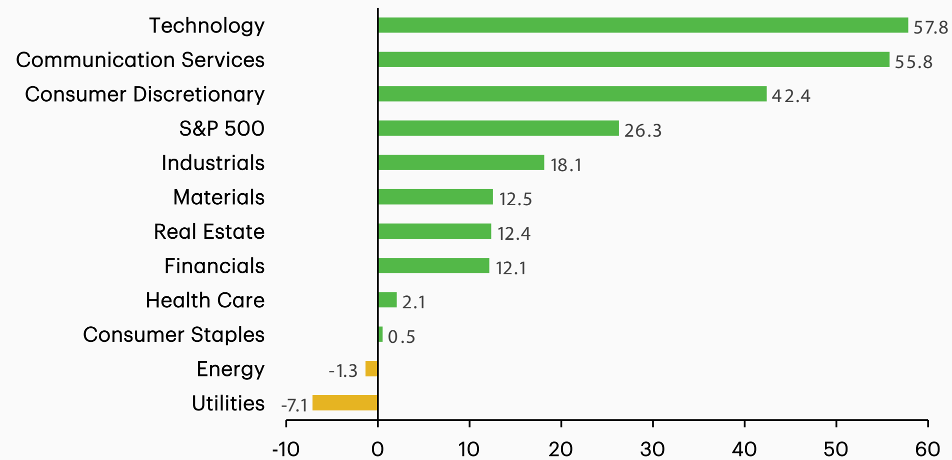
Source: FactSet as of December 31, 2023. Total returns including dividends and distributions. Index returns calculated in U.S. and Canadian dollars.

Q4/23 S&P 500 Sector Returns



Source: FactSet as of December 31, 2023.

Annual S&P 500 Sector Returns



Source: FactSet as of December 31, 2023.

Stocks rebounded in Q4 amid expectations that the Fed had completed its campaign of rate hikes and was now considering cuts. Early in the quarter, however, the messaging was mixed. In October, two Fed officials hinted that the central bank was done hiking, but Chairman Powell pushed back against the narrative, hoping to keep 10-year yields near their 16-year high of 5%. Investors weren't having it, though — after jobs and inflation data came in soft in November, the market was more inclined to believe the doves, spurring a rally in equities and sending long-term yields plunging.

From there on out, it was clear sailing, with little volatility. While the "Magnificent Seven" mega-caps continued to outperform, we began to see a return to riskier segments of the market. Beaten-down mining stocks regained favour, for example, and investing dollars began once again to flow into some emerging markets, leading the U.S. dollar index to fall 5% in Q4. Stronger-than-expected economic data in December might have ended the Fed-driven rally, but then — in what can only be described as a holiday miracle — the central bank's "dot plot" survey of committee members revealed a dovish pivot. This led to an extended Santa Claus rally that carried investors happily into the new year.

For the three months ended December 31, 2023, the S&P 500 rose by 11.7%, the Dow Jones Industrial Average rose by 13.1% and the Nasdaq Composite Index rose by 13.8%. Ten of the 11 sectors in the S&P 500 performed positively. Real estate and technology outperformed, with returns of 18.8% and 17.2%, respectively. The energy sector was the worst performer, falling 6.9%. Small-cap value stocks outperformed in Q4. Large-cap stocks (S&P 500) returned 11.7%, underperforming small-cap stocks (Russell 2000), which returned 14.0% in the fourth quarter. Growth stocks (S&P 500 Growth Index) registered a total return of 10.1%, underperforming value stocks (S&P 500 Value Index), which returned 13.6%.

Investors may have gotten ahead of themselves in their anticipation of rate cuts, however, given the impressive strength of the American economy. In late December, the Bureau of Economic Analysis released its third estimate for the third quarter, reporting real GDP growth of 4.9% (q/q annualized, 2.1% in Q2) — better even than the 3.7% forecast by TD Economics (TDE) last quarter. Resilience was on full display in Q3, with most major categories of spending up for the quarter. Strength in consumer spending was particularly eye-catching. It jumped 4.0% on the back of a tight labour market, which has kept wage growth high, at 4%.

Moving into the fourth quarter, as mentioned, a significant drop in manufacturing orders in October gave investors hope that rate hikes were finally done. However, business confidence hasn't fallen much since then. The Institute of Supply Management's purchasing managers index (PMI) for manufacturers remained contractionary, holding steady at 46.7 in November (47.6 in August). The larger services side of the economy, meanwhile, has remained expansionary, recording a slight monthly rise to 52.7 in November (54.5 in August). The trajectory, however, is downward. TD Economics expects the U.S. economy to slow dramatically in the fourth quarter, with inflation-adjusted GDP forecast to rise just 1.1%. Given the bump in the third quarter, however, the bank has lifted its projection for the year by a notch, from 2.3% to 2.4%.

The labour market, meanwhile, has remained stubbornly tight. The economy generated 262,000 jobs in September, 150,000 jobs in October and 199,000 jobs in November. That represents a three-month average of 204,000 jobs — significantly more than the 169,000 recorded for the previous three months. This tightness was also reflected in the unemployment rate, which ticked down over the past three months, from 3.8% in August to 3.7% in November. Surprisingly, however, these figures still represent a *loosening* from early 2023, when unemployment stood at 3.4% and the economy was pumping out around 300,000 jobs a month. Before pushing ahead with any rate cuts, policymakers will need to see more compelling evidence that the labour market is on a sustained path towards rebalancing. TDE doesn't expect this to happen until the second half of 2024.

The Fed, for its part, has already backpedalled on its "higher-for-longer" convictions. In December, it sparked a secondary rally in equity markets by confirming what many investors had already taken for granted — that the gradual decline in inflation would lead the Fed to cut rates in 2024. The policy rate, at 5.5%, was left unchanged throughout the fourth quarter, but in December the median expectation of committee members shifted 50 bps in favour of the doves. The Fed now expects the policy rate to come down to 4.75% by the end of 2024, implying three rate cuts. TDE expects the Fed to go further, with rate cuts beginning in the third quarter of 2024. It projects four cuts, with a policy rate of 4.5% by the end of 2024.

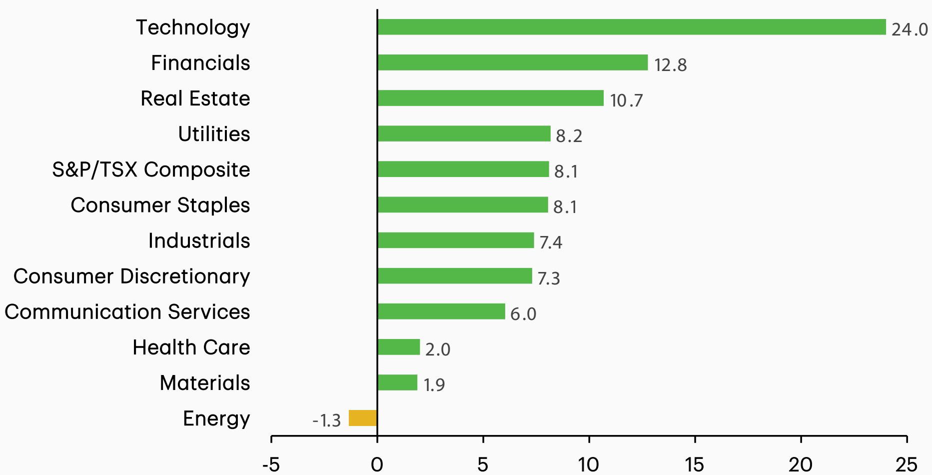
The good news from the Fed's perspective is that inflation has been moving in the right direction. The bad news is that much of the decline over the past few months has been a direct result of falling gasoline prices. Headline CPI inflation fell from 3.7% in August to 3.1% in November — just a tick above the target range (1% to 3%). However, core inflation, which excludes food and energy prices, has hovered around 4.1% for four months now (4% in November). So, while the Federal Reserve has taken rate hikes off the table for the time being, they won't be in any rush to ease financial conditions. A lot, ultimately, will be riding on the state of the jobs market, and whether current conditions are restrictive enough to bring down wage growth.

Canadian Equities

Indices	Q4 Return (%)	Annual Return (%)
S&P/TSX Composite	8.10	11.75
S&P/TSX 60	8.76	12.05
S&P/TSX Completion	5.34	10.44
S&P/TSX SmallCap	5.98	4.79
S&P/TSX Preferred Share	7.28	5.90

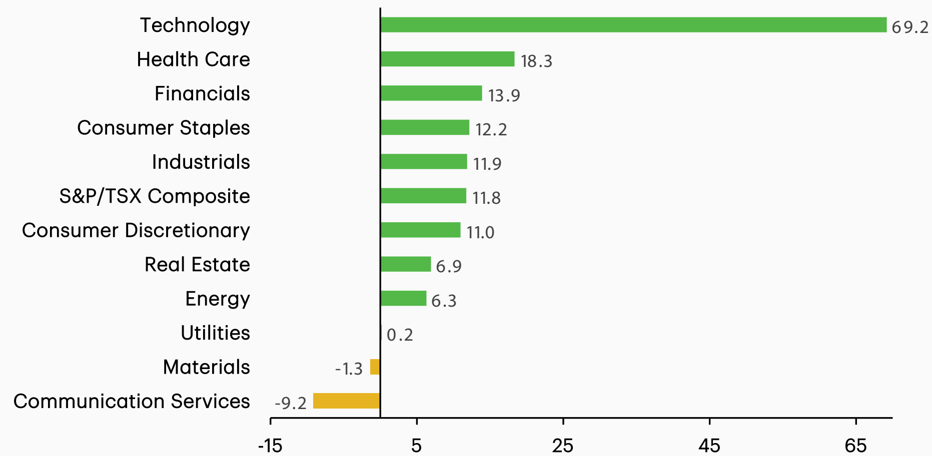
Source: FactSet as of December 31, 2023. Total returns including dividends and distributions.

Q4/23 S&P/TSX Sector Returns



Source: FactSet as of December 31, 2023. Index total returns.

Annual S&P/TSX Sector Returns



Source: FactSet as of December 31, 2023. Index total returns.

The broad Canadian equities index lagged its American counterpart in the fourth quarter, owing in part to a lack of exposure to the "Magnificent Seven" tech mega-caps, which continue to drive returns on the S&P 500. Underperformance in Canada can also be blamed on perceived central-bank dovishness south of the border, which pulled the American dollar down 2.2% against the loonie and 5% against a broader basket of currencies. In single-currency terms, the underperformance in Canada wasn't as pronounced.

Canadian investors in the fourth quarter were fixated on American monetary policy. Weak U.S. inflation and jobs data in early November led to hopes that the Federal Reserve was done with rate hikes. This spurred a broad-based rally, which got a secondary boost in December after the Fed's "dot plot" survey of committee members revealed a dovish pivot, with the median opinion forecasting three rate cuts in 2024. The resulting fall in the American dollar gave the price of gold and industrial metals a lift. One significant exception to the nascent commodities rally was petroleum, which failed to exploit weakness in the U.S. dollar due to continued concerns about the Chinese economy.

The S&P/TSX Composite Index ended Q4 up 8.1%, with 10 of 11 sub-indices posting positive returns. Large-cap value stocks outperformed in the fourth quarter. Large-cap stocks (S&P/TSX 60 Index) rose by 8.8%, outperforming small-caps (S&P/TSX Canadian Small Cap Index), which rose by 6.6%. Growth stocks (MSCI Canada Growth Index) rose by 8.3%, underperforming value stocks (MSCI Canada Value Index), which ended the quarter up 9.0%.

West Texas Intermediate finished a volatile quarter at US$71.65, dropping 21.1% from the September 30 close of US$90.79. Prices initially rose in early October after an attack by Hamas on Israel ignited concerns of a wider conflagration in the Middle East. However, in November, concerns about the economy and the strength of non-OPEC oil production began to dominate. Gold ended the quarter at US$2,071.80, up 11.0% from the September 30 close. The uptrend in the gold price through the quarter effectively mirrored the drop in the U.S. 10-year Treasury yield, reflecting an expectation that real interest rates in the United States have hit a peak and will likely trend down from here.

Financials increased 12.8%, reflecting strength in banks (+11.9%) and financial services (+22.3%). The insurance sector was up 10.2%. EPS for the six largest Canadian banks in fiscal Q4 declined 10% y/y on average, as moderate revenue growth was offset by higher expenses and provisions for credit losses. The group missed consensus estimates by 2%. The Bank of Nova Scotia (-24%), Toronto-Dominion (-4%) and the Bank of Montreal (-1%) surprised negatively, while National Bank (+8%), Royal Bank (+6%) and Canadian Imperial Bank of Commerce (3%) reported better-than-expected results.

Real GDP for the third quarter came in well under expectations, contracting by an annualized 1.1% — significantly below the 1% expansion predicted by TD Economics (TDE) last quarter. However, strong upward revisions to the second quarter (from -0.2% to +1.4%) brought Q2 output back into positive territory, thereby keeping Canada out of a technical recession. The potential for such a scenario was a growing narrative before updated real GDP figures extinguished that possibility.

Although Canada isn't in a recession, technical or otherwise, it is showing weakness, and the risk to growth cannot be dismissed heading into next year. The decline in real GDP growth for the third quarter was primarily driven by external factors, given that net exports and slow inventory accumulation accounted for most of the drag. Final domestic demand — a better measure of domestic economic health — continued to grow at a robust pace. For now, chatter around the possibility of a Canadian recession should ease. TDE expects GDP growth to hum along at a below-trend pace (around 1%) for the better part of 2024.

This economic sluggishness, however, has not yet been seen in the jobs numbers. In September, the economy generated a whopping 63,800 jobs as a surge of immigrants met a horde of prospective employers. Then 17,500 in October. Then, finally, 24,900 in November, for a total three-month gain of 106,200 — 14% more than the previous period. Canada's open immigration policy is, in part, intended to cool the labour market by introducing a large cohort of workers. The strategy has worked to some extent, but a retiring generation of baby boomers has provided a counterweight, leaving the participation rate largely unchanged (65.5% in August, 65.6% in November). The unemployment rate did, however, manage to rise by 30 bps over the past three months, from 5.5% to 5.8%.

This small bump in unemployment, along with the economic contraction in the third quarter, will give the Bank of Canada more confidence that its strategy is working — tighter credit conditions have begun to filter down to the real economy. However, the Bank will want to see the labour market move further into balance before it can start cutting rates. Notably, year-over-year wage gains are still robust (4.8% in November, 5.0% in August), potentially fanning future inflation fears.

Consumers, for their part, have until now shrugged off higher prices, with rising wages bolstering disposable income. But as the impact of higher interest rates begins to be felt, Canadian households will inevitably tighten their belts. In the third quarter, for instance, household net worth fell 1.8%

as investment and real estate valuations fell simultaneously (-2.6% and -1% respectively). Although wages kept pace with rising debt levels, the cost of servicing that debt has risen significantly, cutting into discretionary spending and lifting the debt-service ratio (interest expenses to disposable income) slightly to 15.2%.

The decline in household wealth was amplified, moreover, when adjusted for inflation and population growth: real wealth per capita was 5.0% lower for the third quarter. Although stocks have bounced back mightily since then, this may be countered to some extent by a further pullback in Canadian home prices, which is on track to decline more than 3% in Q4. Rest assured, the Bank of Canada's most aggressive rate-hiking campaign in over 40 years is working. Consumers are reeling in their spending, labour markets are returning to balance, and growth is expected to bring inflation closer to the Bank's 2% target.

That being said, we're not quite there yet. Inflation as measured by the consumer price index (CPI), has come back down after a brief acceleration to 4% in August. It now stands, as of November, at 3.1%. That's still higher than June's 2.8% reading but not far from target. Core inflation (CPI-Median), which excludes energy and food prices, has also come down, from 4.1% in August to 3.4% in November. That may still seem uncomfortably high, but a more recent reading (as opposed to y/y) shows that core inflation has averaged an annualized 2.2% over the past three months — the slowest pace since the beginning of 2021.

These developments support TDE's forecast that the Bank of Canada is done with rate hikes. Progress on inflation should give Governor Macklem the ability to project more confidence that the process is working. This rhetoric will likely continue over the coming months, before the Bank switches gears and starts to signal the beginning of rate cuts, which TDE expects in the spring. Weaker economic conditions in Canada are also expected to prompt the BoC to cut quicker and deeper than the Fed, with TDE projecting six rate cuts in Canada compared to only four in the U.S. If this scenario plays out, the overnight rate would end 2024 at 3.5%, down a sizeable 1.5 percentage points.

Preferred Shares

The S&P/TSX Preferred Share Index strengthened in Q4, ending the quarter 7.3% higher. A confluence of events contributed to this strength, the most important of which was an announcement in the 2023 Fall Economic Update that proposed an exception to a measure introduced in the 2023 federal budget. This measure would deny financial institutions deductions received for dividends in certain circumstances. The exception is for dividends received on "taxable preferred shares" and would apply to dividends received after 2023. This announcement eased previous concerns that financial institutions would stop buying preferred shares, or perhaps even sell their holdings.

Another contributor to the strong performance was a significant decline in interest rates. The five-year yield on Canadian government bonds closed the quarter 108 bps lower q/q and 126 bps below the peak reached in October. A softening labour market and decelerating CPI inflation drove market participants to price in earlier-than-expected rate cuts in 2024, pushing interest-rate-sensitive securities higher.

Finally, there were three announcements to redeem preferred shares, with a total value of $615 million: AltaGas Ltd. (ALA) announced that it will redeem ALA.PR.E, a $200-million fixed rate-reset with a reset spread of 317 bps. ALA intends to use the net proceeds from the $200 million of 8.90% fixed-to-fixed rate subordinated notes, series 3 due November 10, 2083, to redeem the preferred shares; Element Fleet Management Corp. (EFN) also announced its intention to redeem EFN.PR.A, a $115-million issue with a reset spread of 471 bps. EFN stated that it anticipates using a portion of its free cash flow to redeem EFN.PR.C (due June 2024) and EFN.PR.E (due September 2024), with the objective of redeeming all the company's "high-cost legacy preferred shares." The announcement didn't have a material impact on the price of either security, given that the redemption seems to have been priced in; Bank of Nova Scotia (BNS) also announced its intention to redeem BNS.PR.I, a $300-million preferred share with a reset spread of 243 bps. This is BNS's last remaining preferred share.

Canadian & U.S. Fixed Income

Government Bond Yield	Canada			United States		
	Current (%)	Q/Q Change (pp)	Annual Change (pp)	Current (%)	Q/Q Change (pp)	Annual Change (pp)
91-Day Treasury Bill	5.04	-0.08	0.79	5.33	-0.11	0.99
2-Year Government Bonds	3.89	-0.98	-0.17	4.25	-0.79	-0.18
5-Year Government Bonds	3.17	-1.07	-0.24	3.85	-0.76	-0.16
10-Year Government Bonds	3.11	-0.91	-0.19	3.88	-0.69	0.00
30-Year Government Bonds	3.03	-0.78	-0.25	4.03	-0.67	0.07

Source: FactSet as of December 31, 2023. Index returns are reported on a total-return basis; pp (percentage point).

Global fixed income markets saw a big rebound in Q4, driven by a sharp decline in developed-market government yields. A dovish tilt by most developed-market central banks, softer-than-expected inflation and a resilient labour market all strongly favoured the “soft landing” narrative, leading the market to price in more rate cuts and thus lower government yields. As a result, both Canadian and U.S. bond markets performed well. The Canadian fixed income universe, with higher rate sensitivity, saw a deeper repricing in government yields, outperforming the U.S. universe. The FTSE Canada Universe Bond Index posted a return of 8.3%, while the Bloomberg U.S. Aggregate Bond Index (CAD-hedged) posted 6.4%.

In the U.S., the Fed decided to keep the policy rate unchanged in Q4, although the “dot plot” survey of committee members from the December meeting projected a median projection of three rate cuts by the end of 2024, a change of 50 bps. The committee’s guidance listed that inflation has surprised to the downside, which will allow it to consider lifting its foot off the policy brakes earlier than anticipated. The dovish turn from the officials opens the door to easing policy sooner than broadly anticipated in the event inflation continues to evolve benignly.

The Bank of Canada left the policy rate unchanged at 5% at its December meeting. The Bank remains concerned about risks to its inflation outlook, despite more evidence that rate hikes are working. It said that it remains prepared to hike if needed. There were some dovish tweaks in acknowledgement of recent progress on inflation and the larger-than-expected decline in Q3 activity, but the Bank is not ready to declare mission accomplished for a job that remains incomplete. It wants to see more evidence that inflation remains on a path towards 2.0% before it can take rate hikes off the table, and that will be a story for 2024.

Fixed Income Indices	Q4 Return (%)	Annual Return (%)
FTSE Canada Universe Bond Index	8.3	6.7
FTSE Canada Universe All Government Bond Index	8.5	6.1
FTSE Canada All Corporate Bond Index	7.6	8.4
FTSE Canada Real Return Bond Index	10.5	2.0
FTSE Canada Provincial Bond Index	10.4	7.3

Source: FactSet as of December 31, 2023. Total index returns.

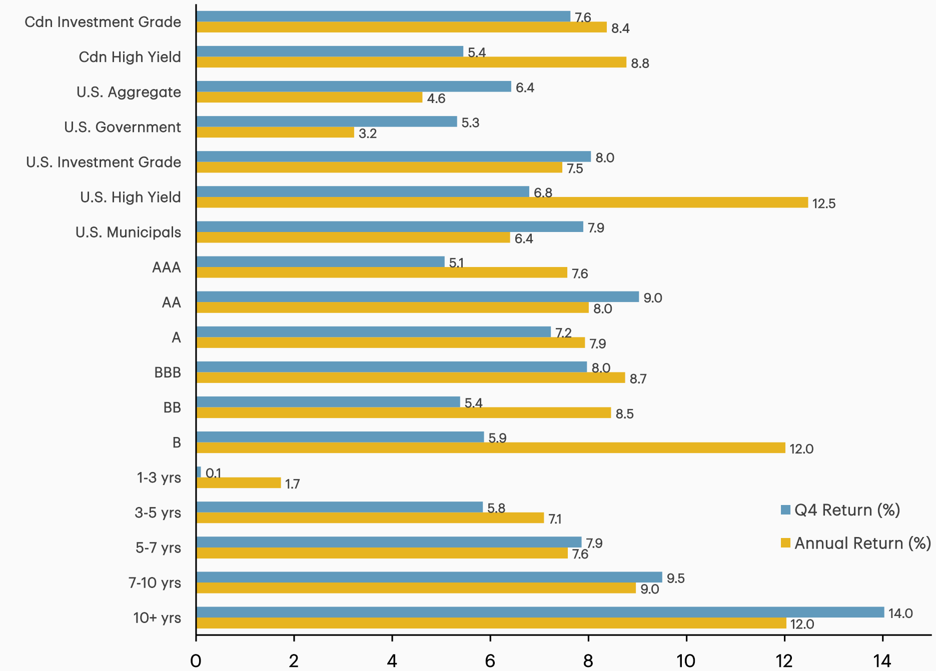
The broad global fixed income universe, represented by the Bloomberg Global Aggregate Index (CAD-hedged), posted a 5.7% return over the fourth quarter. Canadian government bonds outperformed both U.S. Treasuries and the global universe, with the Canadian government bond index returning 8.5% while the U.S. Treasury index (CAD-hedged) returned 5.3% and the global government bond index returned 5.2%. The U.S. 10-year Treasury yield started the quarter at 4.58% and ended at 3.88% (a 69-bp decrease), while the equivalent Canadian government bond yield started at 4.02% and ended at 3.10% (a 91-bp decrease).

Surprisingly resilient economic data, along with the expectation of loosening monetary policy in the U.S., was supportive of spreads. On the Canadian side, the investment-grade (IG) spread performed positively, tightening by 22 bps and ending at an option-adjusted spread of 132 bps, while U.S. IG spreads tightened by the same amount to end at 99 bps. Strong positive performance from Canadian government bonds was the biggest contributor, and tighter spreads added to the positive performance. The corporate sector posted a return of 7.6%, modestly underperforming the aggregate Canadian fixed income index return of 8.3%. Diving deeper, higher-quality credit outperformed the other cohorts, with AA-rated credit posting a return of 9.0%. Lower-rated credit underperformed, with A-rated credit posting 7.2% and BBB-rated credit at 8.0%.

Understandably, long-maturity corporate bonds with less rate sensitivity outperformed both medium- and short-maturity bonds. Over Q4, the longest-maturity cohort of 10-year-plus posted a return of 14%. The medium-maturity cohorts of seven- to 10-year and five- to seven-year returned 9.5% and 7.9%. The shorter-maturity three- to five-year and one- to three-year bonds returned 5.8% and 3.4%. Lower real yields and much higher interest-rate sensitivity led to positive performance for Canadian real-return bonds, which rose 10.5% over the quarter. They outperformed the government bond universe, at 8.5%. Canadian provincial bonds, with longer maturity profiles, also performed strongly and outperformed corporate bonds over the fourth quarter, posting a return of 10.4%.

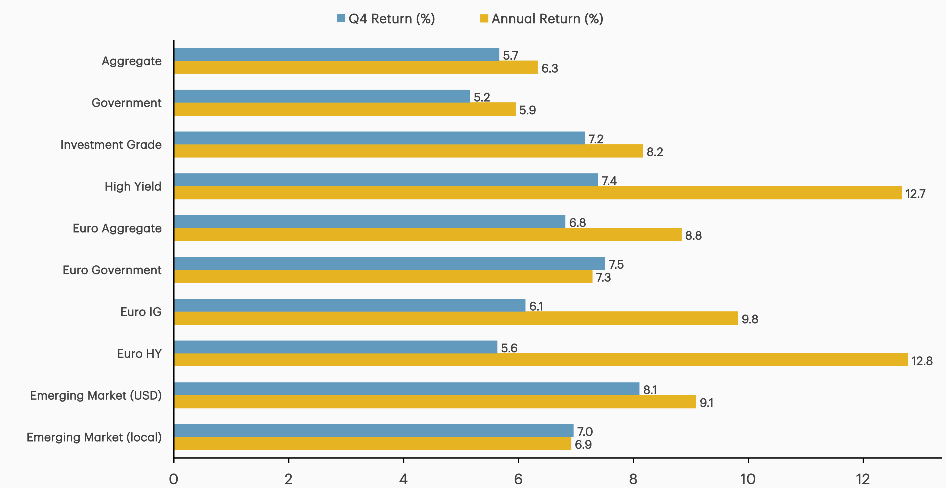
For global corporate bonds, lower government yields and tighter spreads across geographies led to stellar performance. U.S. IG corporate spreads tightened by 22 bps over the quarter, while U.S. high-yield (HY) corporate spreads tightened by 71 bps. The U.S. IG corporate bond universe (CAD-hedged) returned 8.0%, outperforming the global IG corporate universe (CAD-hedged), which returned 7.2%. U.S. HY corporate bonds (CAD-hedged) also performed positively, posting a 6.8% return, marginally underperforming the global HY corporate universe (CAD-hedged) at 7.4%. USD-denominated emerging-market debt also performed well, posting a return of 8.1% over the quarter, while local-currency debt returned 7.0%.

Canadian & U.S. Fixed Income



Source: FactSet as of December 31, 2023.

Global Fixed Income



Source: FactSet as of December 31, 2023.

International Equities

Indices	Q4 Return (%)	Q4 Return (%, C$)	Annual Return (%)	Annual Return (%, C$)
FTSE 100	2.31	4.31	7.93	11.15
DAX	8.87	11.03	20.31	21.31
CAC 40	5.93	8.03	20.14	21.14
MSCI European Monetary Union (local currency)	7.52	9.70	15.97	20.90
Nikkei 225 Stock Average	5.23	8.85	30.96	18.91
MSCI Emerging Markets Free (local currency)	5.65	5.24	10.29	7.63

Source: FactSet as of December 31, 2023. Total returns including dividends and distributions. Index returns calculated in local currencies and Canadian dollars.

International developed markets underperformed their American peers in the fourth quarter, due to the falling U.S. dollar and a lack of exposure to big tech names. The UK's blue-chip FTSE 100 was a faraway straggler, ending the quarter up 2.3%. The strengthening British pound against the U.S. dollar weakened revenues for UK-based exporters, which dominate the index. On the flip side, though, multinational mining giants benefited from rising gold and metal prices. A weak earnings season also held the index back, with misses from heavyweights like Barclays. However, fiscal and monetary stimulus may be on the way. In November, Prime Minister Rishi Sunak vowed to cut taxes as soon as inflation reached target. And despite steadfast hawkishness from the Bank of England, investors are now starting to price in rate cuts for 2024.

Those cuts may come sooner rather than later, if the economy is any indicator. Real GDP shrunk 0.4% in the third quarter (q/q annualized, flat in Q2). This contraction was largely due to strikes in July, with unionized workers in the health, education and transport sectors demanding higher wages to compensate for inflation. The UK consumer confidence index remains weak, at -24 in November (-25 in August). Business confidence, however, has begun to turn the corner, with the composite PMI rising from 48.6 in August to an expansionary reading of 50.1 in November. Inflation, meanwhile, has plummeted from 6.7% in August to 3.9% in November. Against this mixed backdrop, the Bank of England opted to hold the policy rate at 5.25% throughout the quarter. Governor Andrew Bailey has suggested that rates will remain "higher for longer" but that's unlikely to happen if inflation continues to fall dramatically.

Euro zone markets joined in on the Santa Claus rally, with the MSCI European Monetary Union Index rising 7.5% (in euro terms) in Q4. Although economic weakness in China — a top market for European luxury goods — remains a concern for high-end brands, positive earnings from the likes of Hermes, along with more fiscal stimulus from China, seems to have allayed fears of a prolonged downturn. Indeed, European investors were more focused on the possibility of near-term rate cuts, given rapidly falling inflation in Germany (down to 3.2% in November). Strong earnings from big pharma names like Sanofi and Novo Nordisk (of Ozempic fame) also lifted shares. Although the European Central Bank has pushed back hard against the idea that rate cuts are coming any time soon, the Fed's dovish pivot in December was more than enough to lift spirits in Europe.

The euro zone economy, meanwhile, has been wavering between contraction and expansion over the past year. After a slight rise in Q2 (0.8%), the economy shrunk 0.4% in the third quarter (q/q annualized), due to the impact of higher interest rates and weak external demand. Low export numbers have had a particularly acute effect on Europe's largest national economy in Germany, which is in a mild recession. Consumer and business confidence for the monetary bloc have ticked up slightly but remain entrenched in negative territory. The economic sentiment index rose to 93.8 in November from 93.6 in August. And the euro zone composite PMI rose to 47.6 from 47.0 over the same period. If there's one bright spot on the European landscape, it's inflation. Although core inflation remains high, at 3.6% in November, the headline figure has come achingly close to target, falling to 2.4% for the month. The ECB has been careful not to loosen financial conditions prematurely by signalling rate cuts. It made no changes in Q4, keeping the main refinancing rate at 4.5%, but with the European economy teetering on recession, investors are betting on cuts by summertime.

In Japan, the Nikkei 225 Stock Average returned 5.3% in the fourth quarter, a middling performance. Over the year, however, the index came out on top with an extraordinary 31% annual return — its best in a decade. This was due in no small part to a severely weakened yen, which fell 7.1% against the U.S. dollar in 2023. The Bank of Japan has been able to maintain an ultra-loose policy — even as developed economies around the world tighten — thanks to relatively low inflation. In Q4, investors joined in on the Wall Street rally that started in late October after Fed officials hinted at a dovish tilt. Risk sentiment was further buoyed by news, on October 25, that China, its largest trading partner, had approved a trillion-yuan spending plan to stimulate the economy. A strong earnings season, led by flagbearers like Nintendo and Toyota, also helped lighten the mood.

The Q3 reading of the Japanese economy, however, offers a stark contrast. Real GDP plummeted in the third quarter, falling 2.1% (q/q annualized, +4.5% in Q2) due to a cooling in exports growth (2.1%, 16.7% in Q2), which had already been priced into the market. An economic rebound is expected for Q4, but perhaps not enough to convince the Bank of Japan to change course. The BoJ kept its policy unchanged in Q4, aside from the suggestion that it would allow long-term yields to rise slightly above 1% before intervening. (It had been a hard cap.) The BoJ is now the only major central bank with a negative policy rate in the world, at -0.1%, but it's hard to argue with the Bank's reasoning. Inflation has declined in recent months, from 3.1% in August to 2.8% in November. Consumers remain pessimistic, with a reading of 36.1 in November (36.2 in August, 50 being the threshold). And the composite PMI is approaching contraction, at 50.4 in November from 52.6 in August. Against this backdrop of disinflation and weak economic data, hawks need not apply.

Emerging markets generally outperformed in the fourth quarter, as Western investors once again ventured abroad. Among the four largest emerging-market economies, stocks in Brazil, Mexico and India all posted double-digit growth. However, a 34% weighting to Chinese stocks dragged the MSCI Emerging Markets Index down. In local-currency terms, the index rose just 5.7% in Q4, due to a 4.5% decline on the SSE Composite Index. The Chinese economy has suffered from intense deflationary pressures, with consumer prices falling 0.5% y/y in November. Beijing has approved a trillion-yuan (US$140 billion) increase in annual spending to stimulate the economy, but investors remain leery. In India, meanwhile, the Nifty 50 Index tracked Wall Street, rising 10.7% on hopes of a near-term Fed rate cut. A significant decline in oil prices also boosted stocks, given that the Indian economy imports 80% of its crude oil requirements.

Mexico's IPC Index rose 12.7% in Q4, also driven by the Fed's dovish tilt and increased investment in emerging markets. Among major EM nations, however, Brazil was the top performer, with the Bovespa Index rising 15.1% and touching all-time highs. Airlines, in particular, got some relief after price controls from the leftist government turned out to be less onerous than expected, but for the most part the stellar performance in Brazil can be attributed to monetary policy. Emerging-market banks have cut interest rates rapidly in advance of the Fed and ECB. In the fourth quarter, for instance, the Brazilian central bank cut its policy rate a full percentage point, to 11.75%. TD Economics forecasts 2023 growth of 5.5%, 7.1% (fiscal year), 3.4% and 3.1%, respectively, for these nations.

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