



Market Review

SEPTEMBER 2024

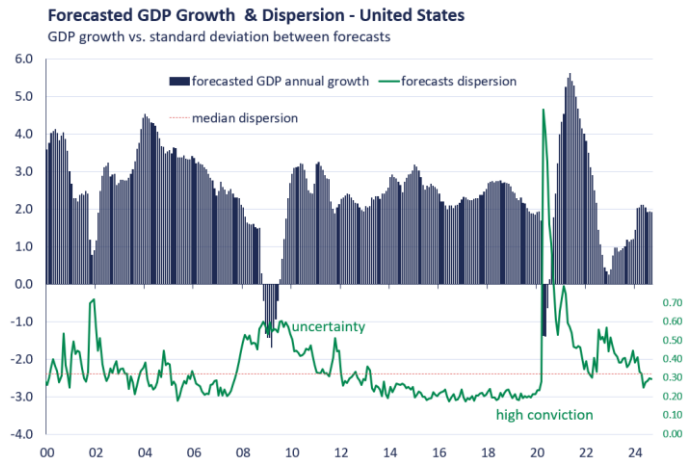
Economic Review

Optimism and confidence: Is the consensus vulnerable to surprises?

According to consensus, economists are not only optimistic about growth, inflation and business earnings over the next 12 months, but also very confident in their forecasts. Indeed, forecasters appear to be largely in agreement, reflecting a high degree of conviction. The prospect of a soft economic landing is also gaining ground. According to data from the Bank of America's Fund Manager Survey, the probability of such a scenario increased to 79% in the third quarter, compared to 64% at the end of the previous quarter.

However, when everyone agrees on the same scenario, the potential for a surprise in the event of bad news is high. Such conviction is astonishing given a macro-financial context that is uncertain due to the employment slowdown, the upcoming US elections and the pace of monetary policy easing, whose adequacy remains uncertain.

In the United States, our current understanding is that there is little excess to be purged from the real economy. Neither consumers nor businesses are overwhelmed by debt. Barring an external shock, our most pessimistic scenario would be that of a short and shallow recession, as in 2001. Consumers at the time proved resilient. Businesses, however, took a pause in the middle of a major tech investment wave when the dot-com bubble burst, which led to a "mini recession." Spiralling government deficits are excesses that will need to be corrected, but neither political party seems to have much of an appetite for budgetary discipline. That said, lower inflation figures in September gave the central bank an opportunity to lower the key rate by 50 basis points (bps), to prevent significant deterioration of the job market in particular.



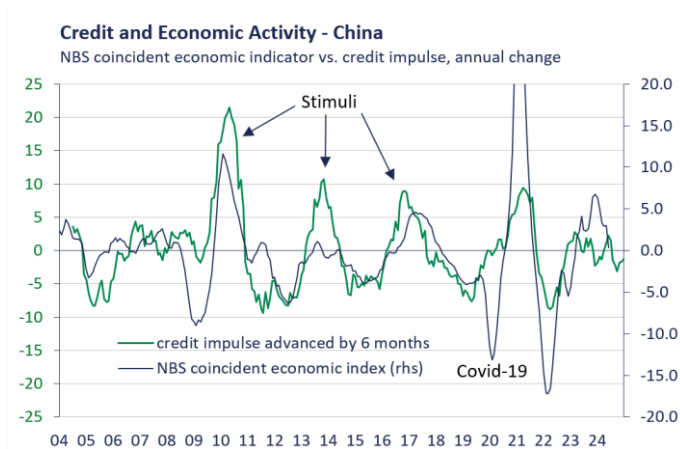
Sources: DGAM, Consensus Economics, Refinitiv, September 2024

In Canada, the economic activity data have almost continuously fallen short of expectations since the start of the year. Inflation has fortunately moderated, and the Bank of Canada has confidently started a monetary easing cycle with 3 consecutive cuts of 25 bps, with further decreases expected in the short term. Mortgage rates have already decreased significantly since their 2023 high—by nearly 2 percentage points for a 5-year mortgage—and signs of improvement appear to be emerging in the real estate sector. However, we have not seen any improvement in the labour market, which is struggling to keep pace with population growth and thereby contributing to the rising unemployment rate. The outlook could improve in a time of rapidly falling interest rates. This would ease the pressure on households, many of which will be renewing their mortgages over the next 12 months. But Canada is not immune to a more pronounced slowdown in the US or to rising trade tensions.

In the eurozone, growth is losing momentum, with household consumption and business investment contracting in the second quarter. By all indications, Q3 will also be disappointing. After the upturn attributable to tourism and the Olympic Games, we have seen little in the way of encouraging news. The job market has slowed, retail sales have deteriorated, consumer confidence is

sluggish and business climate surveys show the same corporate gloom. Europe is very sensitive to the strength of external demand, but its competitiveness and ability to innovate have been losing ground for a number of years. Two recent reports on the future and competitiveness of markets, prepared respectively by Enrico Letta and Mario Draghi, propose solutions to address this decline, although many of the factors holding back economic activity remain beyond EU control. In addition, tax rules and investor tolerance for deficits are more restrictive than in the US. On the other hand, recent news from China is encouraging for European exports, and while the economies of France and Germany are slowing, neighbouring countries such as Spain are faring better. Finally, with inflation now steady, the European Central Bank should be able to announce several cuts in the key rate over the coming quarters. This should help boost household confidence.

In China, whenever external demand has weakened in the past 20 years, the government has boosted domestic demand through infrastructure programs and real estate projects. Such countercyclical measures were implemented during the financial crisis, the European recession in 2012 and the global "manufacturing recession" in 2016. However, we have not seen the government's usual responsiveness this time around, at least not until recently. Past stimulus cycles created significant excesses, especially in the real estate sector, and the government is now prioritizing long-term growth drivers, particularly in technologies. However, it is clear that the economic situation has deteriorated too much in recent months for the government to ignore. In late September, the government announced a new round of monetary and fiscal stimulus measures. New interest rate cuts were added to all those made since 2019 that have failed to boost consumer spending. However, the fact that the government is now adding fiscal stimulus measures and that this time it is targeting the real estate sector—the backbone of household confidence—could make a difference.



Sources: DGAM, National Bureau of Statistics of China, Refinitiv, September 2024

Canadian Fixed Income

In the third quarter, the 10-year yield on Canadian bonds went from 3.50% to 2.96%. Over the same period, the FTSE Canada Universe Bond Index returned 4.66%. Meanwhile, the corporate bonds in this index returned 4.67%, the result of lower interest rates combined with tighter credit spreads.

Provincial Credit

The provincial market saw a much calmer quarter in terms of both domestic and international issuance volume, which did not prevent provincial bonds from underperforming corporate bonds of equal maturity. We are observing a limited tightening of credit spreads for medium-term maturities, with the spreads on 5-year bonds narrowing by 3 bps and closing the quarter at around 27 bps, and those on 10-year bonds tightening by 1 bp to close at 68 bps. The spreads for 30-year bonds widened by 2 bps to 94 bps. For their part, the spreads for Quebec and British Columbia remained stable at 2.5 bps and 3.5 bps compared to those for Ontario. Lower oil prices contributed to a reversal of the gains Alberta saw in the previous quarter, with the result that the spreads for Alberta bonds widened by 3 bps to close at 4 bps compared to those for Ontario.

To date, the provinces have 80% of the required financing, with only half of their fiscal year behind them. However, this does not mean that they are about to put an end to new issues, as it is common practice for the major provinces to prefinance the coming fiscal year. Looking to the future, we still believe that the 30-year bond sector offers the best valuations, especially compared to corporate bonds.

Corporate Credit

Credit spreads on corporate bonds narrowed by 8 bps in the third quarter, with a more modest tightening of only 4 bps for long-term bonds. The CDX index ended the quarter at the same level as in June 2024, but if we exclude the roll effect into the new current index, the spread tightened by 5 bps. The primary market continues to be very active, with issues totalling nearly \$30 billion despite the historically less busy summer season. During the quarter, Moody's and S&P downgraded Bell Canada's credit ratings a notch to BBB (adequate). High debt and little foreseeable short-term improvement explain their decision.

We are maintaining a defensive position with high-quality securities and an underweight in corporate credit. However, an improvement in valuation combined with maintenance of good economic fundamentals could justify an increased weighting in corporate bonds.

Fixed Income Strategy

Our baseline Q3 scenario for the evolution of the Canadian economy and inflation now appears to be increasingly integrated into the valuation of several assets, including interest rates and the shape of the yield curve. With inflation declining rapidly, the Bank of Canada is in a rate reduction cycle intended not to stimulate economic growth, but to avoid a tightening of monetary conditions through an increase in real market rates. We agree with the current market forecast that the key rate should be at the low end of the neutral range of 2.25% to 3.25% over the next year. We have therefore reduced the relative duration of our portfolios.

We remain overweight in corporate securities with maturities of 10 years or less, but are continuing to diversify into non-banking sectors, again with an underweight position in US corporate securities in the shorter portion of the curve via the CDX index. We are maintaining an underweight position in corporate securities with maturities of over 10 years. Overall, the portfolios have an underweight position in corporate and provincial bonds. Some issuer classes are starting to look attractive on the long end of the curve, and we intend to consider them opportunistically. This credit positioning theme has been around for several months, and our analyses suggest that it is the only one that includes very little chance of an economic slowdown.

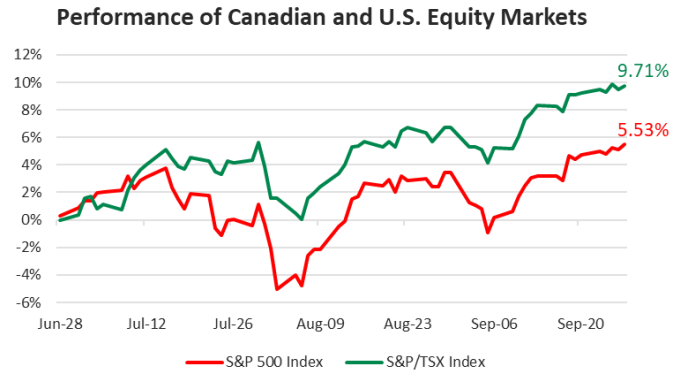
Several recent revisions of US growth and savings rate data suggest that there is no urgent need for a major and rapid rate-cutting cycle. The markets are expecting the rate to converge at just under 3%, in line with the Federal Reserve's long-term forecasts. Markets in both the US and Canada are thus already normalizing rates, while several risky asset classes remain at valuations that are historically relatively high, which is all the more surprising given the scale of the rate hikes and the time it takes for them to filter through to the economy. One may nevertheless wonder if the rise in defaults and late payments on certain types of loans that we are currently seeing will come to an end with the start of the rate-cutting cycle.

Stock Markets

Canadian and US Equities

In the third quarter of 2024, North American stock markets fluctuated significantly on fears of a US recession. The increase in the US unemployment rate to 4.3% in July—its highest level in nearly 3 years—combined with a hiring slowdown, led the Canadian and US markets to drop significantly, by more than 5%. However, they quickly rallied and set new records a few weeks later, when they welcomed the interest rate cuts. Thus, for the quarter as a whole, the S&P/TSX Index posted gains of 9.71%. In

the US, the S&P 500 Index followed a similar course, ending the quarter with a return of 5.53%.



Sources: DGAM, Bloomberg, September 2024

In Canada, it was primarily interest rate cuts that set the overall tone for the quarter. Securities associated with gold continue to benefit from this downward trend due to the decline in real yields it is causing. To this we can add the stimulus measures announced by the Chinese government, which should positively affect global demand for raw materials as well as benefit the Canadian market, given the high concentration of resource sector securities in the stock market index. The underlying demand for resources such as copper continues to benefit from the energy transition and the boom in artificial intelligence applications.

For the first time since the beginning of 2024, all Canadian industry sectors finished Q3 in positive territory. As expected, given the downward trend in interest rates, the materials, utilities and finance sectors outperformed. The real estate sector came in first with a return of 20.77%, a significant turnaround from the second quarter, when the index fell by 7.39%. Companies such as Colliers International Group Inc. and Brookfield Corporation benefited from the prospect of real estate transactions picking up pace due to the interest rates drops. In the materials sector, gold securities posted the best results for the quarter across all sectors, with Osisko Mining posting gains of 70.3%. At the other end of the spectrum, energy sector companies had a more difficult quarter, posting the weakest gains on average due to OPEC's failure to support oil prices, weak demand and slow global economic growth.

International Equity

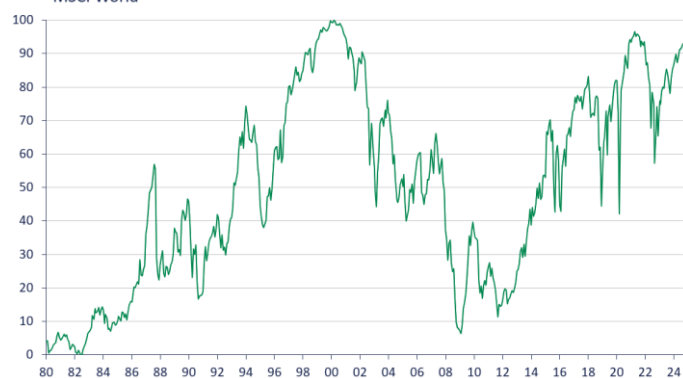
Global equities continued to perform well in the third quarter and again hit record highs, with the MSCI All Country World Index up 4.7% and bringing the year-to-date gain to 18.7%. However, results like this mask a certain volatility, as global equities plummeted by nearly 8% over the course of 3 days in early August. Investors were taken by surprise when the Bank of Japan increased its key rate despite deteriorating macroeconomic

forecasts that followed weaker-than-expected US employment data. The tightening of monetary conditions in Japan led to a strengthening of the yen, culminating in the unwinding of carry trade positions as the currency appreciated by more than 12% in less than a month.

Investor optimism increased at the end of the quarter after the Federal Reserve cut its key rate. The growing consensus that the US economy could avoid a recession has persuaded us to move away from expensive and saturated sectors like technologies and toward segments like small caps and materials, which are sensitive to the economy but whose growth expectations are only weakly integrated into share prices. This trend was reinforced by the Chinese government's announcement of the new stimulus program.

Global equities remain expensive, with the aggregate valuation index hitting its highest level (93rd percentile) since the end of 2021. According to our index, the US stock market remains the most expensive, while Asia-Pacific countries are the most attractive, with a score in the 69th percentile.

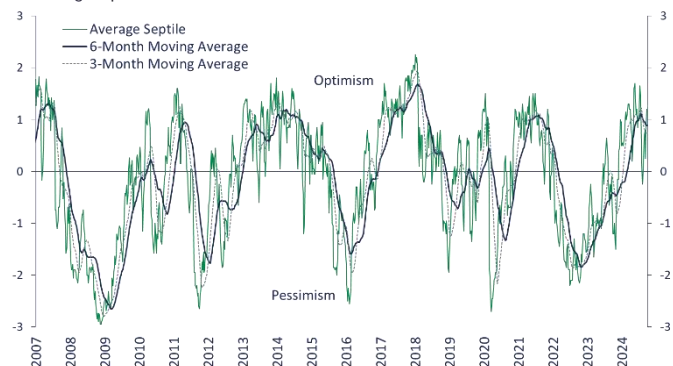
Historical Valuation - Aggregate Percentile
MSCI World



Sources: DGAM, Refinitiv, MSCI, IBES Bloomberg, September 2024

Our internal sentiment index (a composite of 20 indicators) remains high, although the bimonthly readings have recently been more volatile. The moving averages had probably peaked by late September and started a decline, suggesting a change in overall investor optimism that could lead to a reduction in risk exposure.

Investor Sentiment Index
Average septile of 20 indicators



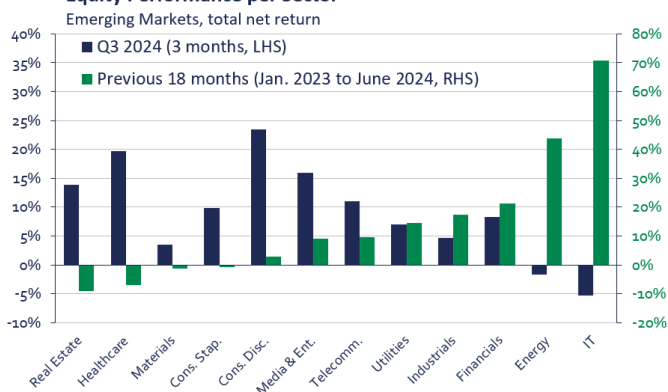
Sources: DGAM, Refinitiv, Bloomberg, State Street Global Markets, September 2024

We are maintaining a defensive position, as investors have remained overly optimistic given the current uncertainty. Indeed, high valuation multiples and excessive investor sentiment point to a disconnect between their expectations and the macroeconomic outlook.

Emerging Markets Equity

Emerging markets saw a significant shift in performance leaders in the third quarter. The tech and energy sectors, which had significantly outperformed since early 2023, were the only 2 that posted a negative return. The shift was also observed among countries. While the Taiwanese and South Korean markets posted declines, the Thai and Chinese exchanges, which investors had previously relinquished, posted gains above 10%.

Equity Performance per Sector



Sources: DGAM, Refinitiv, MSCI, September 2024

As mentioned above, the end of the quarter was characterized by the major measures announced by the Chinese authorities. Given the disappointing implementation of previously announced measures, we will be monitoring their speed of deployment. Further disappointments could quickly reverse sentiment against China.

During the quarter and before the Chinese announcements, our investor sentiment indicator showed a drop into the neutral zone. It remains to be seen whether the new Chinese measures will succeed in reversing this downward trend in the medium term.

As for the valuation of emerging market equities, our normalized model shows a deterioration over the third quarter, from the 77th to the 81st percentile of its historical distribution. We no longer consider these equities to be attractive in absolute terms. However, in relative terms they are still quite attractive compared to US securities and comparable to those of European and the Asia-Pacific region.

Asset Allocation

The most anticipated soft landing in history, for the time being

The likelihood of a recession seems higher than what the financial markets are expecting. The current situation is not comparable to the most often cited soft landing, which happened in 1995. At that time, the Federal Reserve raised its key rate by only 300 bps, compared to 525 bps this time, and the unemployment rate had been falling from mid-1992 until late 1996, whereas it has been increasing in the last year.

In the US, the job market slowdown observed in the regular publication of economic statistics, as well as in the revisions, could trigger economic slowdown feedback loops. The Federal Reserve loudly launched its rate-cutting hikes, which sent stock markets higher and tightened credit spreads. The valuation of the S&P 500 is high in absolute terms and relative to its historical value. The lack of fiscal discipline that persists despite changes in government, particularly since the start of quantitative easing, is expected to continue, regardless of the outcome of the presidential election. Pursuing fiscal and monetary reflation at the same time provides support to economies and investors while potentially encouraging speculative movements, during which downward revisions of EPS forecasts could lead to a market correction. We are maintaining our underweight position in US equities given that their performance has historically deteriorated after a first key rate cut. We prefer securities from other markets, especially emerging ones.

In Canada, the S&P/TSX Index is more sensitive to interest rates due to its industrial composition. The steepening yield curve is favourable to financial institutions, which represent 32% of the index. However, 2 major risks to the economy remain: residential mortgage renewals, which will be more numerous in the spring, and the slowdown in population growth. The new federal target to limit net immigration is expected to generate population growth of less than 1% by the end of 2027, compared to more

recently, when it was over 3%. Businesses that have benefited from this will experience downward pressure on their income when inflation returns to target. Competition for market share is expected to increase, putting pressure on profit margins and earnings per share.

European households are in good health, unlike those in America, as they still have surplus savings. European inflation has fallen below the 2% target for the past 12 months, which should allow the European Central Bank to continue its monetary easing. But for the time being, the European economy, and Germany's in particular, seems to be having trouble finding a floor, especially in terms of manufacturing output and business confidence, possibly due to increased competition from the Chinese economy and the slowdown in the US economy.

In China, which accounts for 27% of the MSCI Emerging Markets Index, the measures announced in late September imply that the central government is trying to create at least a temporary floor for the economic cycle. Still to be resolved is the structural aspect, meaning the surplus of residential real estate assets, whose depreciation is undermining Chinese morale. Moreover, exports that have recently supported Chinese growth are expected to slow due to an oversupply of certain goods, such as electric vehicles, but primarily due to a rise in protectionism.

Historically, the government interest rate curve has rebounded slightly and temporarily following the first key rate cut by the Federal Reserve. The subsequent expected declines are consistent with an economic slowdown scenario and have already been well integrated by financial markets. A change in the expected economic scenario, such as a recession in Canada, would therefore need to happen before we change our positioning.

The table below presents our positioning recommendations as of September 30, 2024. We are lowering our recommendation on Canadian bonds and for equities from other developed markets (MSCI EAFE) whose economic activity appears to have stalled. On the other hand, we're raising our recommendation on Canadian equities.

	POSITIONING				
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CANADIAN EQUITY	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
US EQUITY	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
EMERGING MARKET EQUITY	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
EAFE EQUITY	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
WORLD EQUITY	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
US 10Y BONDS	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
CANADIAN 10Y BONDS	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
CAN. CORPORATE BONDS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
PREFERRED SHARES	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
CASH	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

■ Fixed Income					
Yields to maturity - Canada	Current level	1 month	3 months	6 months	1 year
Bank of Canada overnight rate	4.25%	4.50%	4.75%	5.00%	5.00%
2 years	2.91%	3.33%	4.00%	4.18%	4.87%
10 years	2.96%	3.16%	3.50%	3.47%	4.03%
30 years	3.14%	3.27%	3.39%	3.35%	3.81%
Credit market	Current level	1 month	3 months	6 months	1 year
Mortgage rate (prime rate)	6.5%	6.7%	7.0%	7.2%	7.2%
5-yr Credit spreads (CDX.IG)	53	49	53	51	74
5-yr High yield credit spreads (CDX.HY)	329	322	344	330	481
5-yr Emerging debt credit spreads	323	342	344	287	362

■ Fixed Income indices					
	Current level	1 month	3 months	6 months	5 years (ann.)
FTSE Provincial index	1348	2.1%	5.0%	14.2%	-0.2%
FTSE Municipal index	1460	2.0%	5.0%	13.9%	0.5%
FTSE Corporate index	1425	2.1%	4.7%	14.0%	2.1%
FTSE Overall	1169	1.9%	4.7%	12.9%	0.6%

■ Currencies					
	Current level	1 month	3 months	6 months	5 years (ann.)
CAD/USD	0.74	-0.2%	1.1%	0.4%	-2.1%
CAD/EUR	0.66	-1.0%	-2.7%	-4.7%	-4.2%
CAD/GBP	0.55	-2.1%	-4.4%	-8.4%	-10.0%

■ Fixed Income					
Yields to maturity - United States	Current level	1 month	3 months	6 months	1 year
Fed rate	5.00%	5.50%	5.50%	5.50%	5.50%
2 years	3.64%	3.92%	4.75%	4.62%	5.04%
10 years	3.78%	3.90%	4.40%	4.20%	4.57%
30 years	4.12%	4.20%	4.56%	4.34%	4.70%
Credit Market	Current spread	1 month	3 months	6 months	1 year
Spreads Ontario - 10 years	66	64	64	63	74
Spreads utilities - 10 years	115	122	116	116	135
Spreads communications - 10 years (BBB)	147	159	156	152	185
Spreads banks - 10 years	44	49	50	69	90

■ Equities					
	Current level	1 month	3 months	6 months	5 years (ann.)
S&P/TSX Composite	24000	3.2%	10.5%	26.7%	11.0%
S&P 500	5762	2.2%	4.6%	36.0%	16.4%
MSCI World	3723	1.9%	5.2%	32.7%	14.1%
MSCI Emerging Markets	1171	6.7%	7.5%	26.1%	6.5%
MSCI Global Small Cap.	579	2.0%	8.2%	25.1%	9.9%

■ Misc.					
	Current level	1 month	3 months	6 months	5 years (ann.)
VIX (level)	17%	15%	12%	18%	16%
Bloomberg Commodity Index	100	4.5%	-1.9%	-4.6%	5.6%
Gold	2635	5.2%	13.2%	42.5%	12.3%
WTI crude oil	68	-6.2%	-13.7%	-12.9%	5.7%

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