Monthly Market Insights

Data and opinions as of February 28, 2025

U.S. policy uncertainties, Canada's resilience, & Europe's growth

February 2025 was marked by heightened uncertainty in the U.S., with disruptive and protectionist policies fueling investor concerns of their impact on growth and inflation, amidst strong corporate earnings season. The new U.S. administration also stoked fear in Canada through tariff threats, but Canadian markets remained rather stable. Investors believe Canada can be resilient with the Bank of Canada's (BoC) ability and the federal government's willingness to provide support through policy flexibility, and a strong financial system. Meanwhile, European markets' outperformance stood out, supported by earnings strength, monetary easing prospects, and strategic trade advantages to withstand U.S. tariffs. Investors sought diversification, rotating to European equities that offer growth at more reasonable valuations, and Canadian markets amid global uncertainty. Mega cap companies lost ground and underperformed the rest of the U.S. market, Tesla fell the most, by -27.6% in February.

NEI perspectives

U.S. policy uncertainty: Increasing fiscal and monetary policy uncertainty in the U.S. has led to heightened market volatility, with investors closely watching economic data for clarity. **Bottom line:** Policy uncertainty is likely to keep markets reactive, with potential implications for reduced economic growth and heightened risk sentiment.

Canada's resilience: Despite global headwinds, Canada's economy remains relatively stable, supported by a flexible monetary policy stance, a strong banking sector, and a weaker currency boosting exports. **Bottom line:** Canada's economic fundamentals continue to provide stability, even as external pressures evolve.

Europe's strength: European markets have benefited from strong corporate earnings, improving trade conditions, and expectations of central bank easing, with key sectors like luxury goods and industrials showing resilience. **Bottom line:** Europe's relative economic strength and corporate performance suggest a more constructive outlook compared to other regions.

– NEI Asset Allocation team

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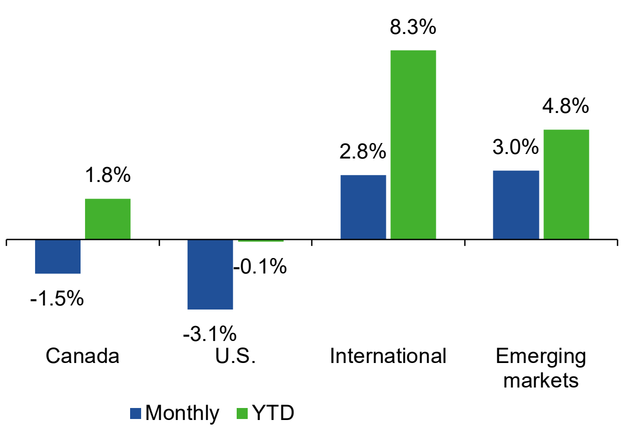
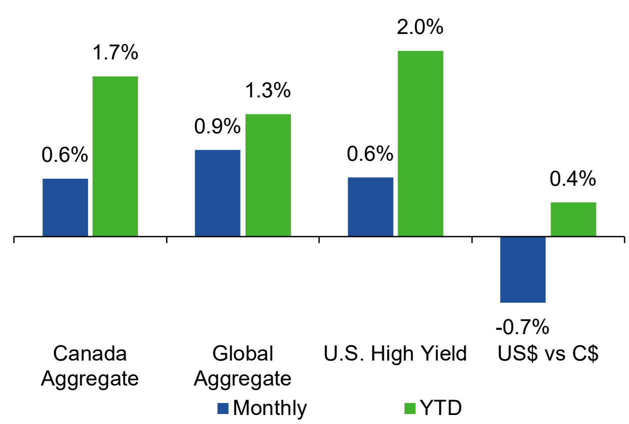
Equity returns (in C$)



Canada: MSCI Canada Index TR; **U.S.:** MSCI USA Index TR **International:** MSCI EAFE Index TR; **Emerging markets**: MSCI Emerging Markets Index TR.

Source: Morningstar Direct.

Fixed income and currency returns (in C$)



Canada Aggregate: Bloomberg Barclays Canada Aggregate Bond Index; **Global Aggregate:** Bloomberg Barclays Global Aggregate Bond Index; **U.S. High Yield:** Bloomberg Barclays U.S. High Yield Index.

Source: Morningstar Direct.

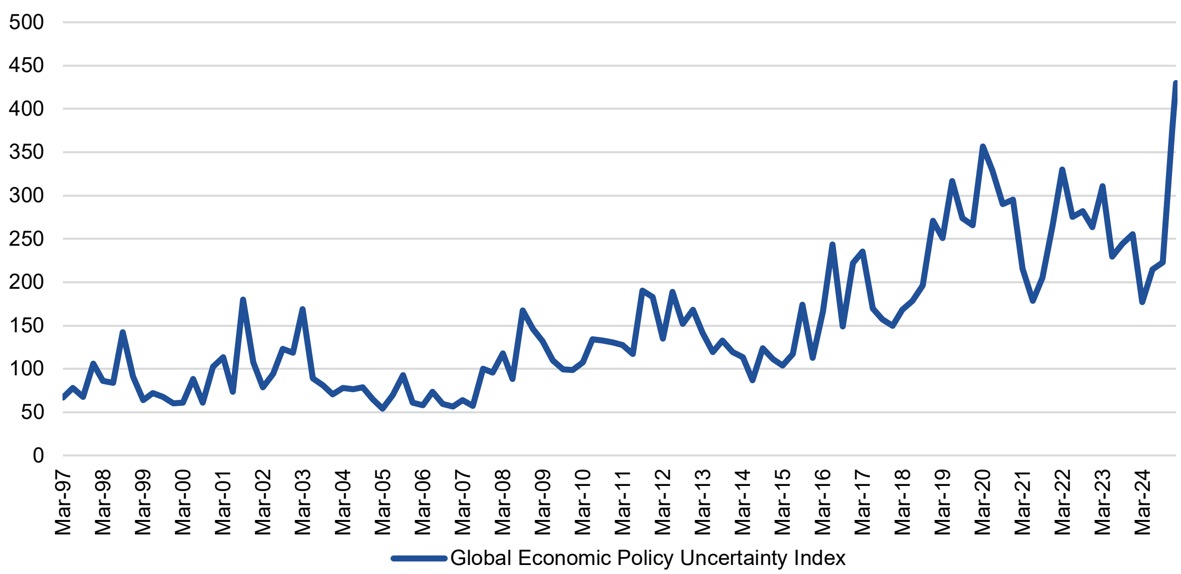
U.S. policy uncertainty weighs on markets

U.S. markets faced increasing volatility in February as investors were concerned about the impact of disruptive policies on growth and inflation. Areas that surged initially upon Trump's election win reversed course, with cryptocurrency, Tesla, and the S&P 500 Index turning negative on year-to-date basis. Weaker-than-expected economic data also weighed on the market, as the Economic Surprise Index plummeted into the negative region, consumer confidence dropped significantly, retail sales disappointed, and business investment stalled. Additionally, the Department of Government Efficiency (DOGE), implemented massive firings of federal employees that added further strain to labour market expectations. The U.S. Policy Uncertainty Index surged, underscoring growing concerns over legislative gridlock and uncertainty around federal spending priorities. The administration issued numerous tariff threats to its closest trade partners, raising concerns on the inflationary risk while hurting growth. The Federal Reserve remained divided, with some officials pushing for rate cuts to counteract slowing growth, while others remain cautious due to persistent inflation risks.

Compounding these concerns were debates over potential deregulations in key industries, including technology and energy. This created additional market anxiety. Investors grappled with mixed signals from policymakers, making it increasingly difficult to assess the near-term economic outlook.

Bottom line: Rising policy uncertainty, weakening economic data, and fiscal austerity measures could prove detrimental to growth and investor sentiment. This is especially worrying at a time when U.S. valuations remain near historical highs. Investors need to remain vigilant in diversifying to more reasonable segments of the market, and to other regions with growth and more reasonable valuations such as Europe and Canada.

Global Policy Uncertainty Index surges to unprecedented all-time highs



Source: Bloomberg.

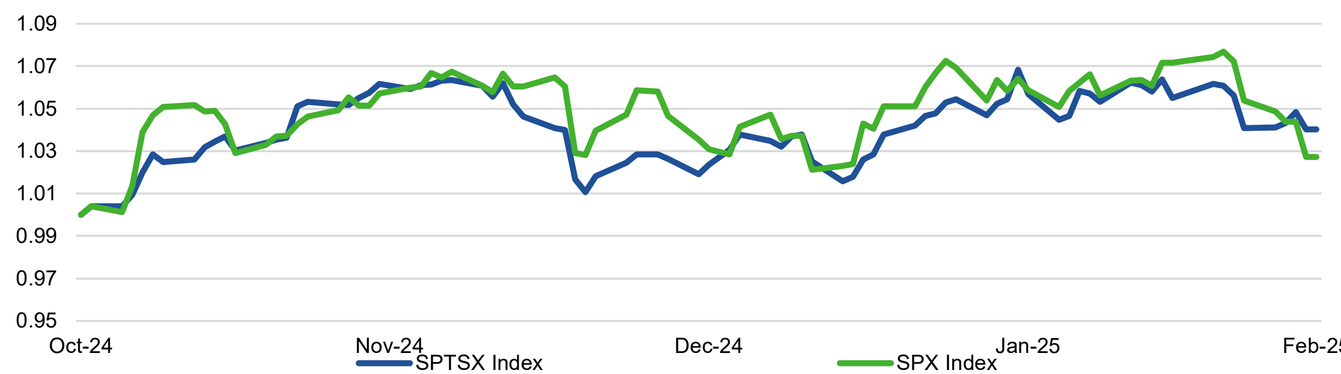
Canada's resilience amid looming tariffs and global uncertainty

Canada reported surprising strong GDP growth for Q4 of 2024 on the back of strong consumption, and residential and business investments. The GDP per capita growth was the strongest in seven quarters, as rate cuts were successful in stimulating the economy thus far. The imposition of 25% tariffs poses a serious threat to the Canadian economy, and may plunge it into a mild recession if the tariffs are not lifted. However, the TSX would likely be more resilient and less impacted by tariffs than the Canadian economy. Earnings growth in Canadian companies are recovering well in the coming quarters. The Canadian market's heavy exposure to energy, materials, and financials also makes it less sensitive to short-term trade disruptions, helpful in weathering the tariff storm. The banking sector is well capitalized and provisioned, and companies with foreign currency revenues would also benefit from a weakening loonie. Additionally, Canada has one of the lowest fiscal deficits in the G7, giving the federal government the ability to provide targeted fiscal support to affected industries, or more directly to consumers. Concerns about mortgage renewals, which had previously been a headwind for Canadian consumers, appear to be overstated. Rising household savings rates and stable employment levels have provided a financial buffer, alleviating fears of widespread financial distress.

The BoC is still expected to cut rates two more times this year, but has room to cut more aggressively to support growth if needed. However, this would further widen the rates gap between the two countries, resulting in further weakening of the loonie.

Bottom line: With ample dry powder in fiscal and monetary policy, and improving export conditions with a weakened currency, Canada's economy has the ability to deal with the tariff threats. The impact on the TSX might even be smaller, since the heavyweights like energy, materials, and financials are less impacted by tariffs. Canadian fixed income and equities remain attractive with prospects of two more rate cuts, strengthening earnings growth and reasonable valuations.

Canadian markets showing resiliency throughout threats of tariffs



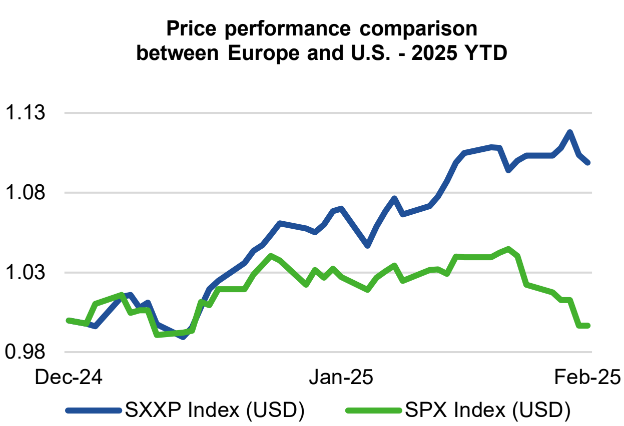
Source: Bloomberg.

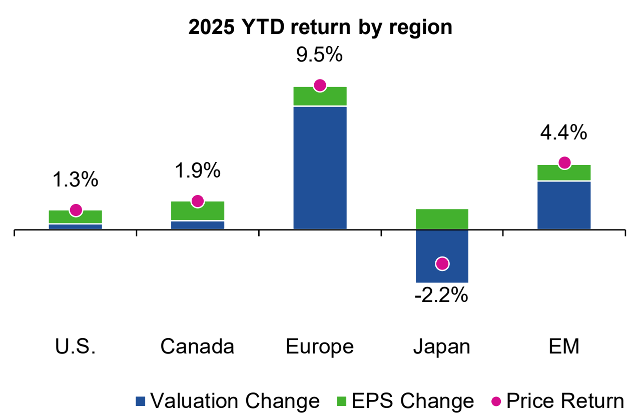
Europe's momentum: supported by strong fundamentals

European markets continued to outperform North American equity markets in February, bolstered by strong corporate earnings, favorable trade agreements, and resilient consumer demand. The U.S.-Ukraine minerals agreement provided a significant boost to industrial and materials stocks, particularly in construction, infrastructure, and semiconductor supply chains. Leading European firms, including luxury and consumer goods companies such as LVMH and Richemont, also posted better-than-expected earnings, reinforcing optimism about the region's economic trajectory.

European Central Bank (ECB) policy expectations also played a key role in driving investor sentiment. With inflation moderating, the ECB is expected to continue to ease rates later in 2025, which could further support rate-sensitive sectors such as real estate and utilities. Additionally, European equity valuations remain attractive relative to U.S. markets, as earnings growth continues in several sectors. This valuation gap has drawn increased interest from global investors seeking opportunities outside the U.S.

European stocks surged in 2025, driven by improved sentiment on growth





Source: Bloomberg.

Beyond Europe, emerging markets are also showing signs of stabilization, particularly in China. Lower-than-expected U.S. tariffs and advancements in artificial intelligence have fueled optimism in China's technology sector, which has been a key driver of recent gains in Asian equities. While geopolitical concerns and secular challenges persist, selective opportunities in China's IT and consumer discretionary sectors are gaining investor attention.

Bottom line: In a highly uncertain regime which will reward diversification, Europe offers a compelling investment destination, supported by strong earnings, central bank easing prospects, and favorable valuations. Selective opportunities are also available in emerging markets with favorable valuations and growth.

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