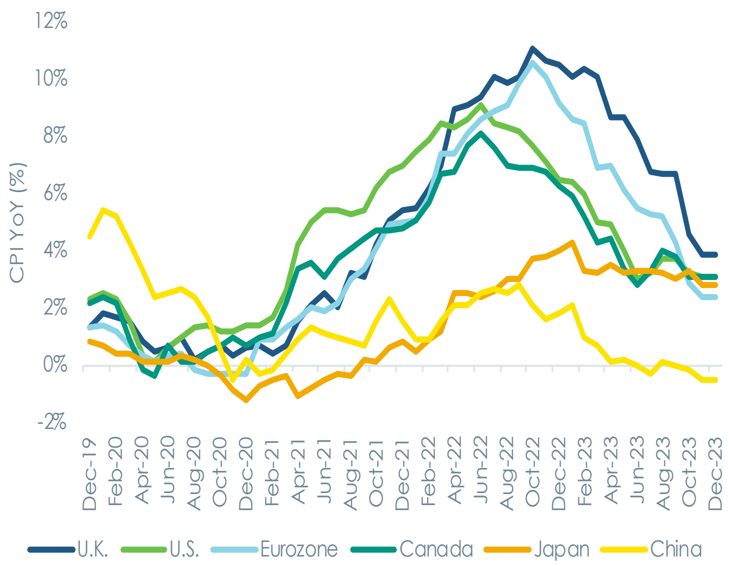
YEAR IN REVIEW

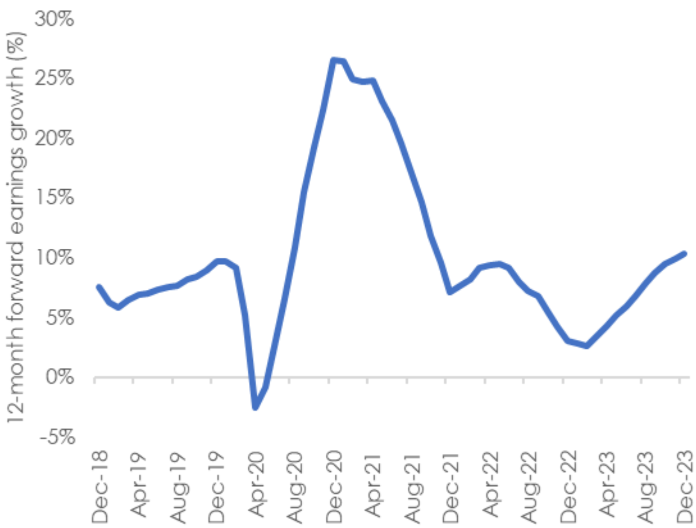
2023

In focus

- The year 2023 was marked by a series of contrasting developments that influenced the global financial markets. On the one hand, signs of peaking interest rates, stabilizing inflation, hopes of an economic soft landing, better-than-expected corporate earnings growth and a surge in large-capitalization technology stocks increased investors' risk appetite. On the other hand, inflationary pressures and the higher costs of borrowing continued to act as headwinds to global economic growth. Despite the headwinds, the U.S. economy showed resilience, growing by an annualized 4.9% in the third quarter, thanks to robust consumer spending, government stimulus and inventory accumulation. China's economy, by contrast, showed signs of weakness, and a slump in the property sector and a fading post-pandemic rebound weighed on growth.
- Continued moderation in inflation and mixed economic indicators also supported bond markets. Treasury bond yields fell toward the end of the year, leading to higher bond prices, with investors increasingly expecting the monetary policy tightening cycle to end and interest rate cuts to happen in 2024. Investment-grade and high-yield corporate bonds also delivered positive returns, benefiting from relatively lower rates of corporate default and the appetite of yield-seeking investors.
- Large-cap businesses in America and Europe contributed to the rise in global equity markets. In the U.S., gains were mostly concentrated in giant technology names, such as Nvidia, which benefited from an optimistic earnings outlook driven by developments in artificial intelligence (AI). European investors favoured companies in the technology, health care and consumer sectors, which demonstrated resilient earnings growth and competitive advantages. While equity market gains were concentrated among a few sectors most of 2023, the rally broadened across other sectors toward the end of the year.
- From a sector perspective, the consumer discretionary and industrials sectors of the MSCI All Country World Index followed the surge in the information technology and communication services sectors. Financials and materials also advanced on expectations of a potential recovery in economic activity. From a style perspective*, growth investing dominated among U.S. equities, but value was the preferred style in Japan, Europe and Asia-Pacific (ex Japan)

As global inflation declined and forward earnings expectations rise, global equities gained.

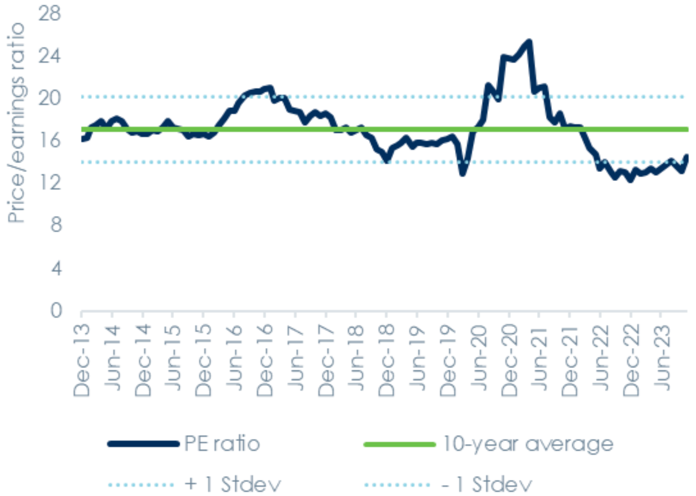




Source: Refinitiv DataStream, as at December 31, 2023. MSCI All Country World Index forward earnings expectations. *Style performance data based on MSCI country and regional indexes.

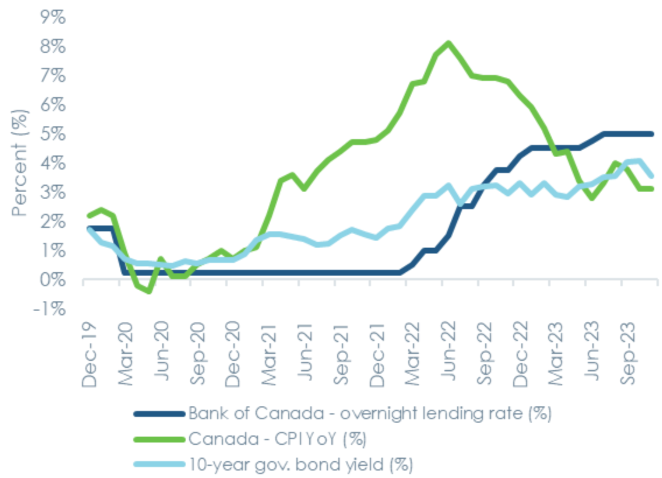
Fidelity INVESTMENTS

Equities are trading at a discount to long-term valuations.



Source: Bloomberg and S&P/TSX Composite Index, as at December 31, 2023.

Monetary policy tightening and moderating inflation



Source: Bloomberg, as at December 31, 2023.

Navigating growth through a volatile year

Canadian equities advanced through a volatile year, owing to robust gains in the information technology, financials and industrials sectors. The S&P/TSX Composite Index traded below its ten-year average price-to-earnings ratio on relatively subdued profit growth expectations. Higher interest rates and a weaker domestic and global economic growth outlook, as well as geopolitical risks, weighed on investor confidence. Nevertheless, there were significant pockets of opportunities across the economy, with several companies beating growth expectations.

A jump in information technology stocks such as Shopify, Constellation Software and CGI, among others, drove the performance of the Canadian equity market. These businesses benefited both from company-specific factors, such as higher-than-anticipated earnings growth, and general enthusiasm about progress in AI technology.

Canadian financials also advanced over the review period, with diversified financials performing better than banks. Most major banks in Canada came under pressure amid concerns about deteriorating credit quality, linked to a challenging housing market and higher capital requirements. In contrast, diversified financials performed relatively better due to company-specific factors, including share buybacks, and favourable growth expectations. Elsewhere, companies in the industrials, consumer staples and consumer discretionary sectors also contributed to overall gains.

Bonds recovered in the final quarter.

Canadian investment-grade bonds rose on solid gains at the end of the year, when expectations of continued moderation in inflation and hopes of potential interest rate cuts lifted investor confidence. The FTSE Canada Universe Bond Index, the benchmark for Canadian investment-grade bonds, rose by 6.7% for the year; yields on the Index declined from 4.3% at the end of 2022 to 3.9% at the end of 2023.

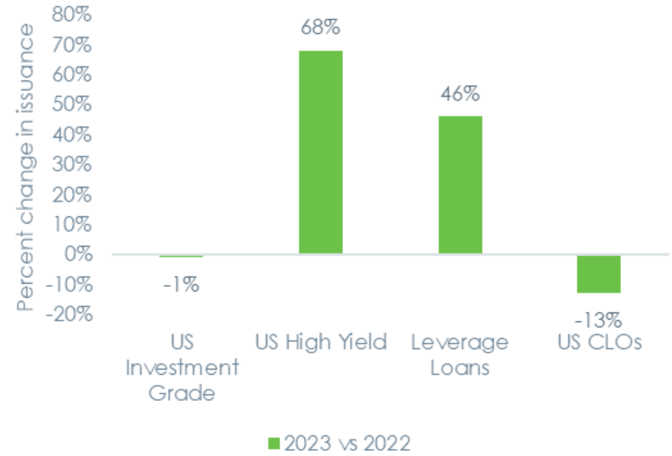
Softer economic growth as rates remain elevated

The Canadian economy shrank unexpectedly by an annualized rate of 1.1% in the third quarter of 2023, but is expected to end the fourth quarter and the year with some modest expansion. In its decision to hold its benchmark rate of interest at 5.0%, leaving it unchanged since the last interest rate hike in July, the Bank of Canada noted that consumer spending had slowed and that price pressures had softened as evidence that tighter monetary policy has been effective in combating inflation thus far.

S&P 500 12-month forward earnings growth

Source: Bloomberg, 12-month forward earnings estimate, as at 31 December 2023.

High yield and leveraged loans issuance increased compared with 2022.



JP Morgan, as at December 21, 2023. CLO= Collateralized loan obligations

U.S. equities advanced.

U.S. equities ended an eventful year with strong gains. Regulators swiftly dealt with the collapse of certain regional banks in the first quarter of the year, supporting investor confidence. Through most of the year, an uncertain outlook for inflation and, as a result, the interest rate trajectory of the U.S. Federal Reserve (the Fed), as well as geopolitical events, contributed to volatility. Monetary tightening made a leading contribution to volatility, with investors worrying about risks to highly indebted businesses and the potential difficulties in refinancing their debt.

Against this backdrop, investors overcame concerns about a likely recession, due to better-than-expected economic data, along with expectations that central banks might be near the end of their interest rate hiking cycle.

An optimistic earnings outlook linked to developments in AI contributed to the surge in large-capitalization technology and related companies across the information technology, communication services and consumer discretionary sectors. Microsoft, Apple, Amazon and Nvidia were among leading beneficiaries of AI-related gains. Elsewhere, cyclically sensitive sectors, such as industrials, materials and financials, advanced, with a strong rally in the final quarter of the year. Energy ended the year posting negative returns, due to falling oil and gas prices. Utilities declined as investors questioned the ability of highly leveraged companies to withstand the higher costs of capital.

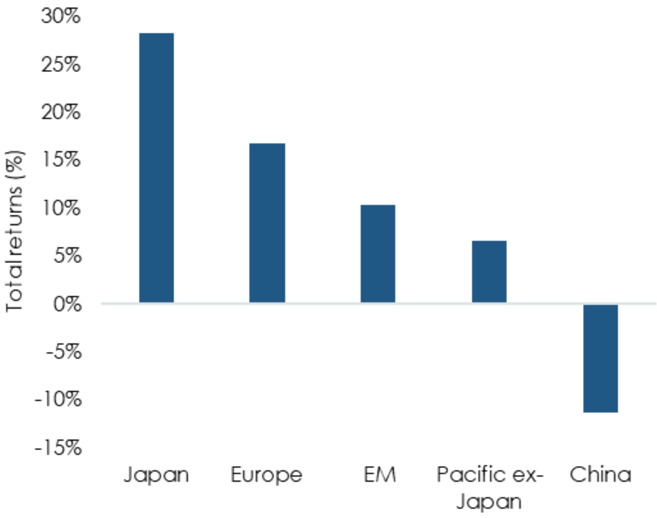
In terms of style, growth outperformed value in the U.S., which stood out among other leading developed markets, where value outperformed growth. Share buybacks by companies were among the factors supporting gains.

Bond investors climb a wall of worries.

In fixed income, U.S. high-yield corporate bonds and U.S. convertibles outperformed U.S. investment-grade and U.S. Treasury bond indexes in 2023. "Fallen angels," bonds that lost their investment-grade credit ratings, were among best-performing bond indexes (ICE BofA U.S. Fallen Angel High Yield Index), as attractive yields, low default rates and demand from income-seeking investors proved supportive. Given demand, high-yield bond and leverage loan issuance increased compared with 2022.

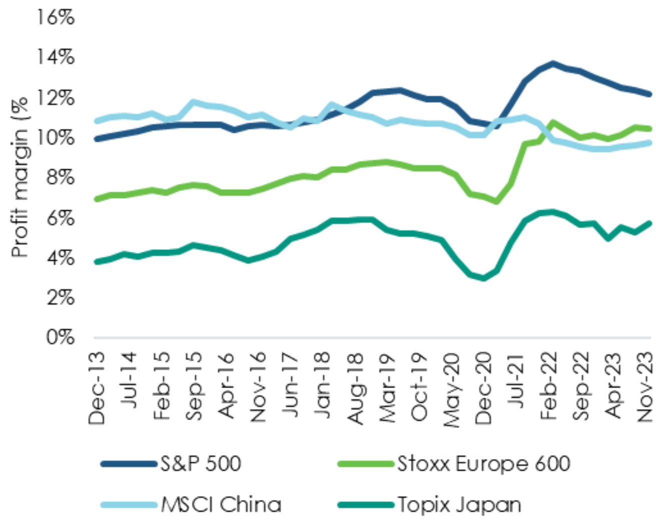
Before ending the year at 3.9%, U.S. ten-year Treasury bond yields (a key instrument in financial markets) had risen to 5.0% on October 19, 2023, when U.S. Fed officials signalled that further rate hikes could be needed, and that the Fed would "move carefully" in its efforts to contain the rise in inflation. A subsequent decline in inflation, both on the CPI Index and the Fed's preferred measure, the Personal Consumption Expenditure Index, supported the view that the Fed might decide to not raise interest rates, and led some analysts to believe that it may actually reduce interest rates in 2024. Recent reports of a broad-based decline in U.S. economic activity also aided gains in bond markets and added pressure on the fall in yields.

Japanese and European equities surged; China lagged.



Source: Refinitiv DataStream, as at December 31, 2023. EM = emerging markets. In U.S. dollar terms. Japan equity market performance in local currency terms.

Profit margins have yet to recover.



Source: Bloomberg. Quarterly data in percentage points, as at December 31, 2023.

Japan and Europe outperformed emerging markets and China.

Lower downside risks due to stabilizing inflation and peaking interest rates in eurozone economies, along with continued optimism about the outlook for corporate earnings, contributed to an equity market rally in the final quarter of the year. Most global markets also traded at a discount to U.S. stock market valuations, which, combined with the prospects of peak interest rates, enhanced stock market performance.

Against barely positive earnings in the rest of the world, annual corporate earnings growth in Japan was substantially above most analysts' forecasts, and larger buybacks announced by some companies further enhanced returns. A series of corporate governance reforms focused on shareholder returns, along with weakness in the yen, were among the factors contributing to gains.

European equities rose due to robust gains in the information technology, industrials, financials and consumer discretionary sectors. Companies such as ASML and SAP in the information technology sector, high-end personal care products company L'Oréal and health care company Novo Nordisk were also among key drivers of performance. In part, investors favoured these companies for their strong pricing power, high profit margin and attractive earning outlook.

Asia-Pacific (ex Japan) and emerging market equities ended the year with relatively modest gains. The relative performance of these markets was somewhat limited due to the decline in Chinese equities, which constitute a large part of both the indexes.

Economic data disappointed in Europe and China.

In economic developments, European consumer sentiment and business climate surveys showed signs of weakness, and manufacturing PMIs indicated contraction (with readings of below 50). Subsequently, annualized inflation declined from a peak 9.2% in December 2022 to 2.4% in November 2023 (latest information available). In China, difficulties in the property sector, declining consumer confidence and regulatory uncertainty contributed to overall economic weakness and slowing GDP growth. Conversely, smaller Asian economies, such as South Korea, Taiwan and India, flourished in 2023.

Appendix

Global markets (returns in Canadian dollar terms)			
Indexes	**2023**	**2022**	**Return (%)**
S&P/TSX Composite	20,958.44	19,384.92	11.83%
S&P 500	4,769.83	3,839.50	23.24%
NASDAQ	15,011.35	10,466.48	41.25%
DJIA	37,689.54	33,147.25	13.41%
Russell 2000	2,027.07	1,761.25	14.09%
FTSE 100	7,733.24	7,451.74	10.89%
Euro Stoxx 50	4,521.65	3,793.62	24.24%
Nikkei 225	33,464.17	26,094.50	18.86%
Hang Seng	17,047.39	19,781.41	-12.70%
Shanghai Comp.	2,974.94	3,089.26	-6.15%
MSCI ACWI	727.00	605.38	19.88%
MSCI EM	1,023.74	956.38	7.49%
Fixed income	**2023**	**2022**	**Return (%)**
FTSE Canada Uni.	1,121.47	1,051.16	6.69%
BBG Global Agg.	471.40	445.92	2.88%
S&P/TSX Preferred Shares	1,690.47	1,596.22	5.90%
Bond yields	**2023**	**2022**	**Change (bps)**
10 yr Canada Govt.	3.11%	3.30%	-0.19
10 yr U.S. Govt.	3.88%	3.87%	0.01
30 yr Canada Govt.	3.03%	3.28%	-0.24
30 yr U.S. Govt.	4.03%	3.96%	0.07
Commodities	**2023**	**2022**	**Return** (%)**
Oil ($/bbl.)	71.65	80.26	-10.73%
Natural gas ($/Mmbtu.)	2.514	4.475	-43.82%
Gold ($/Oz.)	2,062.98	1,824.02	13.10%
Silver ($/Oz.)	23.7953	23.95	-0.66%
Copper ($/lbs.)	3.8905	3.8105	2.10%
Currencies	**2023**	**2022**	**Return* (%)**
CAD/USD	0.7551	0.7378	2.34%
USD/EUR	0.9059	0.9341	-3.02%
CAD/EUR	0.6838	0.6894	-0.81%
USD/JPY	141.0400	131.1200	7.57%
USD/CNY	7.1000	6.8986	2.92%
USD/MXN	16.972	19.4999	-12.96%
GBP/CAD	1.6871	1.6395	2.90%
GBP/USD	1.2731	1.2083	5.36%

Source : Bloomberg and Refinitiv. Total returns. *Price return. **Commodities are quoted in USD.

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