WEEKLY STRATEGY
Perspectives

BMO Private Wealth

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Nauseously Optimistic

"If there's one thing that's certain in business, it's uncertainty."
– Stephen Covey

The Through Line: Companies have navigated a mind-numbing blitz of challenges over the last decade, learning to dodge and weave adeptly. These are helpful skills, given how much the news flow has amped up in just the last few weeks. What strategies are leaders deploying to remain calm amid the uncertainty and keep operations on a steady course to succeed? We explore below.

Rule #1: don't add to the chaos

We had the opportunity to attend the Women in Manufacturing's Winter Leadership Conference this week, hearing first hand from a wide variety of industries about what it takes to survive in the firehose of news that has become the new normal. Change is to be expected when a new president and political party take the reins. Yet the sheer volume of announcements and wider-than-typical range of potential outcomes from various policy shifts seem amplified this time around.

Business leaders have become quite skilled at scenario planning over the past few years as they responded to a seemingly endless series of events: tariffs/trade war that began in 2018; pandemic-induced supply chain disruptions against sharp shifts in consumer spending; West Coast port strikes; rebel attacks on shipping lanes in the Red Sea; East Coast port strikes; extreme weather events; a large spike in inflation; and 525 basis points of Fed hikes – to name but a handful.

Despite the lessons learned about having a "plan B, C and D" at the ready, many businesses are finding it especially difficult to apply this approach to recent announcements, particularly those related to tariffs. The message keeps shifting – will it be 10% or 100%, arrive February 1 or April 1, across the board or with exceptions? Thus, it's challenging to develop viable scenarios for base-case, best-case and worst-case situations. For many leaders, it's helpful to start with some basic pieces of advice about how to view the announcements:

- **don't take them literally** – they are typically designed to establish negotiating stances
- **understand they are highly subject to change**
- **keep calm, don't panic** (thus adding to the sense of chaos); greet each with a steadying breath versus a knee-jerk reaction

Focus on what you can control

Rather than obsessing over the news flow – at least until policy outlines are more firmly established and viable scenario planning can be done – leaders are finding it is **more productive to keep their teams focused on what they *can* control: people; processes; deployment of new technology; and ruthless attention to costs and supplier/customer relationships.**

Several years ago, most companies noted that their primary preoccupation was filling open positions and fighting for talent. That has shifted in recent quarters as the labor market has come into better balance. Core themes are training, retention and upskilling of existing staff; ensuring that management layers are lean; and evaluating potential waves of retirement – especially in skilled manufacturing jobs. Interestingly, there are still mismatches in some areas where schools are turning out highly skilled graduates only to find a lack of domestic jobs in their areas of expertise. This is especially acute in specialized semi-conductor manufacturing operations, for example. Within specific fields such as process engineering, waves of retirements are leading to planning concerns.

Deploying AI and other game changing technologies

One longer-term upshot to the tight labor markets of the early 2020s is the continued integration of labor-saving technologies. From robot-assisted factory floors to autonomous forklifts in most advanced manufacturing facilities, the deployment of technology continues. Processes and data management are migrating entirely to the cloud and software that can seamlessly integrate disparate underlying systems is creating competitive advantages. First-mover companies are finding they can press advantages in lower costs and quicker production times. AI use cases are also being developed to assist rather than replace staff. As one leader put it, **"AI won't take your job, but people who know how to use it will."**

Preserving margins

Companies have shifted attention to updating existing networks and fragmented and/or decentralized processes. While such activities may require investment, it is deemed competitively necessary. As inflation has receded and cost of capital is starting to stabilize with the Fed's steadier hand, many are re-evaluating costs that escalated during COVID but have not normalized. They are seeking ways to streamline and enhance margins wherever possible.

Although many have been engaged in such margin-preserving activities for years, most see there is room to keep doing so without cutting into bone. Targeted strategic investment in technology and renegotiating with suppliers and customers are all on the radar. **Leaders are cognizant of the need to balance a laser focus on cost containment with the need to remain engaged in projects and investments that will build new markets and lead to new pathways for long-term growth.**

Reshoring outlook and tariff planning

While there is a tendency to wait until policy outlines become clearer, **business cannot stand still. Particularly for publicly held companies, growth is a must and competition remains fierce.** Where feasible, companies have been engaged in exploratory discussions aimed at diversifying supply chains away from a primary locus in a single country (e.g., China or Mexico) to multiple countries. However, until tariff policy is more settled many are finding it difficult to model the true expense of setting up in alternate locales. Others are trying hard – with little success – to establish manufacturing beachheads in the U.S., but the plants, capabilities and/or employees willing to do those jobs are not present in sufficient quantities to adequately fulfill needs.

From a tariff perspective, many industries are actively engaging with their lobbying groups. The goal is to help educate (and plead for modifications or exemptions) those who will implement the new policies about the need for a more nuanced approach. Like the proverbial duck frantically paddling under the surface while maintaining composure above the waterline, companies are placing an intense, near-term focus on these topics. It is hoped that policy clarity could come relatively quickly, given several key deadlines in the next few weeks/months:

- **March 4** – Canada and Mexico tariffs readdressed
- **March 12** – tariffs on steel and aluminum to be implemented
- **April 1** – reports due from all agencies outlining existing tariffs, value-added taxes and other assessments applied to U.S. goods, along with suggestions for how to neutralize them
- **April 2** – potential announcement of 25% or more levies on auto, pharmaceutical and semiconductors

For better or worse, business will find it easier to plan once tariff policy is codified. Additionally, **Congress will be debating key tax provisions that could partially offset the harshest impacts of tariffs. These include reinstatement of accelerated depreciation and the outright lowering of the corporate tax rate from the current average of 21%.** A number of business leaders also pragmatically noted that when tariff policy is eventually finalized, it will likely be applied to each company's competition as well.

Pulling it all together

It's worthwhile for investors to take a step back and appreciate how these managements have planned for, and navigated through, such amazingly difficult times. Most stock indexes are close to all-time highs, U.S. GDP has been growing around 3%, earnings for the aggregate S&P 500 are running at low double digit increases in the most recent period (and are expected to continue to grow at a similar rate for the next four to five quarters), with margins in the low double digits, which is significantly higher than they were for much of the last few decades.

Given the attention to margin preservation, even a little bit of extra topline revenue could drop quickly (and in an amplified way) to bottom lines, helping sustain growth in a non-inflationary way. The capabilities that companies have developed through the long list of prior challenges should continue to serve them well in the days ahead.

While leaders are acutely aware of the challenges ahead ahead, they are also justifiably gratified by the job they've done steering their teams and companies so they are positioned to adapt. To say they are outright optimistic is a bit too bold, considering that both the economy and asset markets have been on quite the roller-coaster ride. Rollercoasters can often lead to unsettled stomachs, so "nauseously optimistic" seems an appropriate description to take us all through the next few quarters.

In focus in North America

Jon Borchardt, Sr. Analyst
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This week

U.S. Vice-President J.D. Vance speaks at European Security Conference – On Friday, February 14, Vice-President Vance delivered a speech that shocked many observers at the 61st Munich Security Conference. His focus was not on Russia's war in Ukraine as had been anticipated. Instead, Mr. Vance argued that Europe's greatest enemy is Europe itself and that leftist policies have eroded democracy and suppressed free speech. His remarks drew sharp criticism from European media, which accused Mr. Vance of launching an "ideological war" with "arsonist" rhetoric. For political leaders in Europe, his comments raised concerns about the reliability of the U.S. as a partner. In response, France hosted an emergency meeting with leaders from Europe's seven largest economies to discuss strategies to boost military autonomy and provide continued support to Ukraine.

U.S. earnings season shows solid results – to date, 77% of S&P 500 companies have reported Q4 results, with more than three-quarters posting better-than-expected earnings and 62% beating on the top line, according to the most recent *Earnings Insight* piece from FactSet. These results are roughly in line with the five-year average. The blended earnings growth rate so far in Q4 is 16.9x, **which puts the quarter on track for the highest earnings growth since Q4 2021.** From a company perspective, Boeing (BA) was the top detractor from overall S&P 500 earnings growth, while Nvidia (NVDA) was the largest contributor. Nine of the eleven S&P 500 sectors reported positive year-over-year earnings growth, with energy the biggest drag.

Canada earnings continue to roll in – Canadian insurance companies reported mixed results, with Intact delivering strong earnings while Sunlife missed expectations based on weaker U.S. medical stop-loss experience. Cash flows from the REITS were stable and they continue to be a preferred choice for income-oriented investors. In the retail space, Canadian Tire struggled with sales while Restaurant Brands (owner of Tim Hortons and Burger King) delivered strong operating profits. Bank results will kick off on February 25, with earnings expected to be up mid-single digits. Canadian banks have very strong balance sheets, which should provide them with some cushion against economic uncertainty. On the pipelines front, Enbridge and TC Energy reported good results.

U.S. Manufacturing: trouble under the hood? – Business sentiment had initially improved following November's elections as business owners and executives expressed optimism over the prospect of more business-friendly policies promised by the incoming administration. Included was the potential for a lighter regulatory touch and further reductions in corporate tax rates. At the same time, hopes were high for continued Federal Reserve rate reductions. Since then, the Fed has paused rate cuts due to persistent inflation while uncertainty over federal budget negotiations, tariff policies and immigration reform has increased. **The February Empire State Manufacturing Report observed that "optimism about the outlook dropped significantly," while the National Association of Home Builders (NAHB) reported that "builder sentiment fell sharply in February over concerns on tariffs, elevated mortgage rates, and higher costs."** Additionally, Q4 earnings reports from early-cycle industrial firms, small-to-medium non-residential construction and residential construction companies indicated that recovery timelines are being pushed out. Blue-sky optimism remains, but the clouds that are forming on the horizon are worth watching.

Canadian housing update – Canada's housing market was quiet in January, with soft sales but a seasonally strong increase in new listings. Existing home sales fell 3.3% in seasonally adjusted terms in January but were still up a modest 2.9% from year-ago levels. Balanced overall market conditions leave price trends very stable. The MLS benchmark price was little changed in January and was up just 0.1% from a year ago. Lower interest rates have awakened Canada's housing and mortgage markets, with annual growth in residential mortgages reaching 4% for the first time since mid-2023. That's a boost for Canadian banks' loan growth. Fix or float is the question each time a mortgage comes up for renewal. Sensing the central bank may reduce rates further, more borrowers are opting for a floating-rate loan this time around. But is that the right choice? (Click here for a deeper dive.)

Canada inflation picture well contained – Canadian consumer prices rose 0.1% in January (both on a raw and seasonally adjusted basis), nudging annual inflation up to 1.9%, in line with consensus. The mild headline result is flattered by the GST holiday, which reached peak impact in January and affected 10% of the consumer basket. Gasoline prices, which had been mostly a non-factor recently, perked up 4% month over month. That lifted the annual increase to 8.6%, the fastest pace in more than two years. Rents posted their first monthly decline in more than two years (-0.1%), calming the annual increase to 6.3% (from 7.1% last month and a peak of 9% last spring). Mortgage-interest costs eased to 10.2% year over year from 11.7% in December and the plus-30% pace in 2023. Offsetting those milder trends were big pick-ups in many utility charges. BMO Economics expects inflation to rise for the next two months (GST holiday is over) and continues to lean toward the view that the **BoC will pause at its next decision** (March 12), although developments on the tariff front may yet have a big say in that call. The possible 25% U.S. tariff on Canada and Mexico still looms for March 4.

Next Week

Relatively light data week, though Consumer Confidence is on the docket in both countries and could provide important updates on how Main Street is feeling amid the news flow of the past few weeks. The Fed's preferred inflation measure, PCE, and related cost and spending indexes hits in the U.S. on Friday while Canada will report key business sentiment and GDP information.

- **Tuesday 2/25** – U.S. Consumer Confidence
- **Thursday 2/27** – U.S. Jobless claims, Updated GDP, Durable Goods
- **Friday 2/28** – U.S. PCE, Consumer Confidence | Canada CFIB Business Sentiment, GDP

Data scorecard as of February 19, 2025

Equity Market Total Returns						
	2/19/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	6,144	0.5%	4.6%	25.0%	26.3%	-18.1%
NASDAQ	20,056	0.1%	3.9%	29.6%	44.7%	-32.5%
DOW	44,628	0.2%	5.1%	15.0%	16.2%	-6.9%
Russell 2000	2,282	0.1%	2.5%	11.5%	16.9%	-20.5%
S&P/TSX	25,626	0.6%	3.9%	21.7%	11.8%	-5.8%
MSCI EAFE	8,714	-0.4%	7.8%	3.8%	18.2%	-14.5%
MSCI EM	608	1.1%	5.9%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Treasury		-0.2%	0.8%	0.6%	4.1%	-12.5%
Bloomberg U.S. Aggregate		-0.2%	0.9%	1.3%	5.5%	-13.0%
Bloomberg Canada Aggregate		-0.6%	0.4%	4.0%	6.5%	-11.3%
Bloomberg U.S. Corporate		-0.2%	1.0%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.0%	1.6%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.0%	1.0%	0.9%	4.5%	-4.7%
Government Bond Yields						
	2/19/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.53%	4.54%	4.57%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.18%	3.06%	3.23%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.61%	4.54%	4.56%	4.56%	3.53%	3.66%
German 10-Year Bund	2.56%	2.46%	2.36%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.43%	1.24%	1.09%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	2/19/2025 Level	WTD	YTD	2024	2023	2022
USD Index	107.17	0.4%	-1.2%	7.1%	-2.1%	8.2%
CAD:USD	$0.70	-0.4%	1.1%	-7.9%	2.3%	-6.7%
Bitcoin	$96,315.42	-1.2%	2.8%	120.5%	157.0%	-64.3%
Gold	$2,933.39	1.8%	11.8%	27.2%	13.1%	-0.3%
Oil (WTI)	$72.25	2.1%	0.7%	0.1%	-10.7%	6.7%

**Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.*

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

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Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

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