WEEKLY STRATEGY

Perspectives

BMO Private Wealth

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The Fundamentals are Fine

"The only true wisdom is in knowing you know nothing."
– Socrates

The Through Line: Although the year is still in its infancy, markets have already been confronted with several volatility-inducing macro surprises. Determining if or how the developments will bend the fundamental arc of industry or economic fortunes will take time. Meanwhile, there are things we know, things we are watching, and a framework we can use to evaluate opportunities while awaiting clarity.

"Monday, Monday, so ~~good~~ bad to me"

The last two Mondays have delivered confidence-testing capital market fluctuations, only to see more orderly trading commence during most of the rest of each week.

As we foreshadowed in both our *BMO US Annual Outlook* (2025 Outlook – The name of the game - BMO Wealth Management) and our inaugural *Weekly Strategy Perspectives* – Buckle Up we *expected* volatility to tick higher this year, particularly in the early days as a newly-elected Republican trifecta assumed power in the United States. President Donald Trump's focus (with a long list of campaign trail promises to keep) and his Silicon Valley advisors (with their goal of bringing the Valley's "move fast and break things" motto to Washington, D.C.) were almost guaranteed to keep things spicy.

Markets took a bit of time to wade through the changes spilling from more than 200 executive orders signed or rescinded in the first few days of the presidency before focusing on what for many was a primary concern: tariff policy. But get there markets obviously did. Already on edge from the prior Monday's DeepSeek revelation (and the lofty expectations attached to most AI names), traders opted for a sell-first-analyze-later approach when negative news hit. Safe-haven investments like gold and U.S. Treasury bonds rallied.

Here's the question: what are we to do with Mondays (assuming that skipping them entirely is not an option)? Or more specifically, how much weight do we give the events of the last two and the potential wrinkles they may have introduced?

The fundamentals are still here

Long-term survivability in this business is predicated on an ability to adapt when things don't turn out as expected or when new information is presented. Economies are not static ventures. Rather, a host of things evolve over time – consumer preferences, business trends, regulatory oversight, geopolitics, innovation. The system is fluid, even if many of the models used to predict potential outcomes generate outputs that appear more consistent than is possible in a business cycle filled with hills and potholes (perhaps AI can help change this in the future).

When surprise hits, it's helpful to take a step back and assess what is known, what new information has come to light, and what fresh potential outcomes (if any) have opened up. **Despite the new information that emerged on each of the past two Mondays, for example, the constructive underlying fundamentals that existed before are still here, though their progress will need to be monitored** as the numbers come in and months roll by. We'll want to be sure that the solid trajectory remains largely intact.

What we know

- **Resilient capital markets are to be celebrated** – stocks, bonds, currencies and commodities all adapted rapidly and appropriately when new information came to light without becoming entirely unhinged. When across-the-board tariffs were announced for America's North American trading partners, the greenback strengthened while the loonie and peso fell. Equities in nearly all countries declined. But in adjusting to new realities, they didn't decline markedly. That's notable since most had recently been trading near all-time highs. When the

DeepSeek news hit, shares fell for companies that would be negatively impacted by a slowdown in data center buildout (e.g., energy companies, chip makers). Those that would benefit from increased adoption (e.g., software) rallied.

- **The dynamism and innovation of the business cycle is very much intact –** as evidenced by not only the DeepSeek announcement but also the competitive commentary unleashed by it. As new technologies emerge, early innovators often spend big to establish infrastructure. Then additional iterations, technologies and modifications shift the trajectory as use cases are built. In the early days of computing technology, for example, data storage was exceedingly expensive; only the largest entities could afford mainframe computers and their output. In the late 2000 aughts, however, the price of storage plummeted, and the introduction of smart phones and data accelerated mobile computing technology. The fortunes of mainframes, mid-range computers (and even arguably PCs) were irrevocably changed. When DeepSeek published its methods recently, it was both an exclamation point to a normal evolutionary cycle and a heads-up on the potential for a curve in the trajectory for existing players.
- **Economic trends remain on track** - this week in particular contained a host of data points:
  - Various labor market reports such as the Job Openings and Labor Survey – JOLTS – in the U.S. showed better balance between openings and quits than we saw in the early post-pandemic days, clearing the way for inflation to continue to moderate.
  - Purchasing manager indexes (PMIs) and Institute of Supply Chain Management (ISM) surveys for goods and services in both countries showed progress. In the U.S. in particular, confidence is improving that a lighter regulatory touch, lower administrative burdens and a more amenable M&A environment will get animal spirits at least purring if not downright roaring as the year goes on.
  - **GDP growth trajectories in both countries are stable to improving.**
  - **Accommodative central banks** – the Bank of Canada continues to lead the globe with its rate-cutting campaign (down 200 basis points since it started, to a reference rate of 3%). The U.S. Federal Reserve is on hold but patient after 100 basis points of cuts, creating a stable environment in which businesses can plan.
  - **Notable earnings trends** – nearly 20% of the S&P 500 constituents will report this week, hoping to add to the solid overarching tone of many that have already released results (including the largest banks, four of the Mag 7 and a broad array of consumer goods, transportation and healthcare companies). Reports have been solid, with FactSet noting that 77% of those that had released results as of last Friday had positive EPS surprises.[1] Managements report taking a finely honed scalpel to their operational efficiency – deploying AI, flattening management layers, rearranging supply chains and closely monitoring customer health.
  - **Consumers, particularly in the U.S., remain resilient** - they are employed, with incomes rising above the rate of inflation, and they continue to spend.

What we are watching

Of course, "past performance is no guarantee of future results" and the issues markets have reacted to recently could potentially bend the arc of long-term fundamentals at the macro, micro, industry and individual company level.

Therefore, it will be essential to monitor actions, incoming data, central bank speak, politics and geopolitics. But it is reassuring that we'll be doing so against a starting point of solid fundamentals outlined above. Some of the things on our watch list include:

- **Monitoring how business behaves** relative to tariffs, inventories, capital expenditures, hiring, AI deployment and spending. Great sources of insight here include regular economic data points, the Fed's Beige Book, company commentary from earnings calls and updates, and insights from fundamental analysts.
- **Are animal spirits purring, roaring, or back in hibernation?** Does uncertainty dampen deals and inhibit plant expansions or joint ventures? Or does uncertainty increase them – presuming tariffs and other Made-in-America policies move forward? Do businesses in Canada look to establish broader business activity in the U.S. – or strengthen ties to non-American partners?
- **Can consumer spending continue/ramp up?** In the U.S., if the job market softens further and/or white-collar jobs continue to be rationalized at a higher rate, do the top 20% (which generate close to 40% of GDP) retrench? In Canada, will lower rates revive housing? Will a new government deploy supportive fiscal stimulus?
- **Pre-emptive retaliatory moves** – President Trump's tariff policy and comments about making Canada a 51st state have understandably and deeply wounded the Canadian people. From booing the American national anthem at major sporting events to campaigns to "Buy Canadian" and boycott American-made goods, the angst is real. Could the collective will of individual business moves be enough to inflict noticeable pain? Canada remains the largest consumer of many U.S. goods.

Implications for investors

As mentioned in last week's *Weekly Strategy Perspectives – Navigating Volatility*, equity markets have an historic ability to weather external shocks including wars, terrorist acts, pandemics and other assorted economic calamities. We can expect sharp reactions in the short-term as new information is assimilated into valuations and outlooks. Even so, it is important not to let fear or emotion drive decision-making.

Our advice is to remain calm, remember the fundamentals and understand that change, adaptation and evolution are a normal — and healthy — part of capital markets. As always, maintaining a well-diversified portfolio across asset classes, sectors and individual issuers is the best way to defend against bouts of market volatility.

In focus in North America

Jon Borchardt, Sr. Analyst
George Trapkov, CFA, VP and Portfolio Manager

This week

Canada GDP readings and tariff responses – Canadian real GDP fell 0.2% in November, a tick worse than the flash estimate and consensus call. A sizeable 1.6% pullback in mining/oil/gas drove the downside surprise. Statistics Canada's early estimate for December GDP is +0.2%, with retail activity providing a big helping hand due to the tax holiday. While GDP readings are important, all eyes are on the tariff resolutions. On February 1, U.S. President Trump signed an executive order imposing a 25% tariff on all non-energy imports from Canada and a 10% tariff on energy imports (effective February 4). The tariffs were subsequently delayed until March 4, giving an opportunity for the two neighbours to work out their differences and **paving a pathway to potentially avoid them completely**. BMO Economics now forecasts slightly weaker Canadian growth than the original (1.7% vs. 1.9% for 2025), a slightly weaker loonie (now staying above C$1.40 all year), and meaningfully more downside risk to its BoC call (50 bps worth of rate cuts by this summer). For full details, please read Tariffs Delayed Aren't Tariffs Denied.

U.S. Economy largely in stasis – last week, FOMC Chair Jerome Powell indicated that a resilient economy and labor market allowed the Federal Reserve to take a "wait-and-see" policy approach. Many Fed officials have echoed this message, and subsequent economic data points have done nothing to change the narrative. **U.S. GDP grew by 2.3% in the fourth quarter, while the Institute for Supply Management (ISM) Manufacturing PMI rose into expansion territory for the first time since October 2022. Weekly jobless claims, the Job Openings & Labor Turnover Survey (JOLTS), and the ADP National Employment Report all indicated that the labor market remains solid. Core Personal Consumption Expenditure (PCE), the Fed's preferred inflation measure, came in line with expectations. The report also showed continued strength in consumer spending, which bodes well for economic growth in Q1.** With economic resilience intact and inflation trending as expected, the Fed has room to remain patient in choosing its next policy moves.

U.S. Fed speak illustrates discomfort with heightened uncertainty – From corporate boardrooms to the halls of the Federal Reserve, use of the word "uncertainty" has surged as shifting policy out of the Trump administration has led to elevated economic and geopolitical concerns. Last Friday, the President said there was nothing Canada or Mexico could do to delay 25% tariffs. By Monday afternoon, the announced tariffs had been delayed by 30 days. An additional 10% tariff on goods from China remains in place as of Wednesday morning. Will we see a new trade deal forged with China or an escalating trade war? The answer: uncertain. **Federal Reserve officials are seven-for-seven to start the week, citing policy uncertainty under the Trump administration as a reason to take a more cautious policy approach, despite generally positive views on the economy.** In recent quarterly earnings releases and investor calls, companies, including the likes of Alphabet, Target, Fifth Third Bank, Diageo, Pepsi, and Mondelez, have all cited increased economic uncertainty as a potential headwind for 2025. Gold prices have spiked to an all-time high as this uncertainty drives safe-haven demand. Increased market volatility, delayed business investment, and a higher-for-longer fed rate are among possible outcomes of this uncertainty overhang.

U.S. – DOGE digs in – In just two weeks, we have seen Elon Musk launch a significant attack on the nervous system of the U.S. government bureaucracy as DOGE moved to cut $1T-$2T in government spending. T**he actions taken so far may make it more difficult to advance bipartisan efforts to head off a government shutdown on March 14 when the current continuing resolution runs out.**

Canada earnings updates – The Canadian earnings season is in full swing. CGI's share price reached an all-time high after strong results. Higher wireless prices from a competitor couldn't help Rogers' share price; uninspiring results and stagnant population growth are likely to be a concern for the stock. Railroad results were a bit mixed, with CPKC better than expected while CN Rail's focus was on the guidance of 10-15% EPS growth for 2025. Canadian banks closed their fiscal quarter on January 31 and results are expected later in February.

Next Week

Earnings season continues. A healthy dose of qualitative feedback from Canada with the BoC Market Participants' Survey and deliberation notes from the recent rate setting meeting.

- **Monday 2/10** – Canada BoC Market Participants Survey
- **Tuesday 2/11** – U.S. NFIB Small Business Index | Canada Building Permits
- **Wednesday 2/12** – U.S. CPI and Hourly Earnings | Canada BoC Summary of deliberations
- **Thursday 2/13** – U.S. Initial/Continuing Jobless Claims and PPI
- **Friday 2/14** – U.S. Retail Sales, Industrial Production, Capacity Utilization and Import/Export prices | Canada Manufacturing and Wholesale sales figures

Data scorecard as of February 5, 2025

Equity Market Total Returns						
	2/5/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	6,061	0.4%	3.1%	25.0%	26.3%	-18.1%
NASDAQ	19,692	0.3%	2.0%	29.6%	44.7%	-32.5%
DOW	44,873	0.7%	5.6%	15.0%	16.2%	-6.9%
Russell 2000	2,316	1.3%	3.9%	11.5%	16.9%	-20.5%
S&P/TSX	25,570	0.1%	3.6%	21.7%	11.8%	-5.8%
MSCI EAFE	8,516	0.1%	5.4%	3.8%	18.2%	-14.5%
MSCI EM	585	0.2%	2.0%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Treasury		0.7%	1.2%	0.6%	4.1%	-12.5%
Bloomberg U.S. Aggregate		0.8%	1.3%	1.3%	5.5%	-13.0%
Bloomberg Canada Aggregate		0.9%	2.0%	-4.6%	9.5%	-17.3%
Bloomberg U.S. Corporate		0.8%	1.4%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.2%	1.5%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.4%	1.1%	0.9%	4.5%	-4.7%
Government Bond Yields						
	2/5/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.42%	4.54%	4.57%	4.57%	3.88%	3.88%
Canada 10-Year Government	2.95%	3.06%	3.23%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.44%	4.54%	4.56%	4.56%	3.53%	3.66%
German 10-Year Bund	2.36%	2.46%	2.36%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.28%	1.24%	1.09%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	2/5/2025 Level	WTD	YTD	2024	2023	2022
USD Index	107.58	-0.7%	-0.8%	7.1%	-2.1%	8.2%
CAD:USD	$0.70	1.6%	0.5%	-7.9%	2.3%	-6.7%
Bitcoin	$96,935.73	-5.1%	3.4%	120.5%	157.0%	-64.3%
Gold	$2,867.24	2.5%	9.2%	27.2%	13.1%	-0.3%
Oil (WTI)	$71.03	-2.1%	-1.0%	0.1%	-10.7%	6.7%

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.

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

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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Disclosure

[i] https://insight.factset.com/