



## Team Marchand Filiatrault of RBC Dominion Securities

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### Market update

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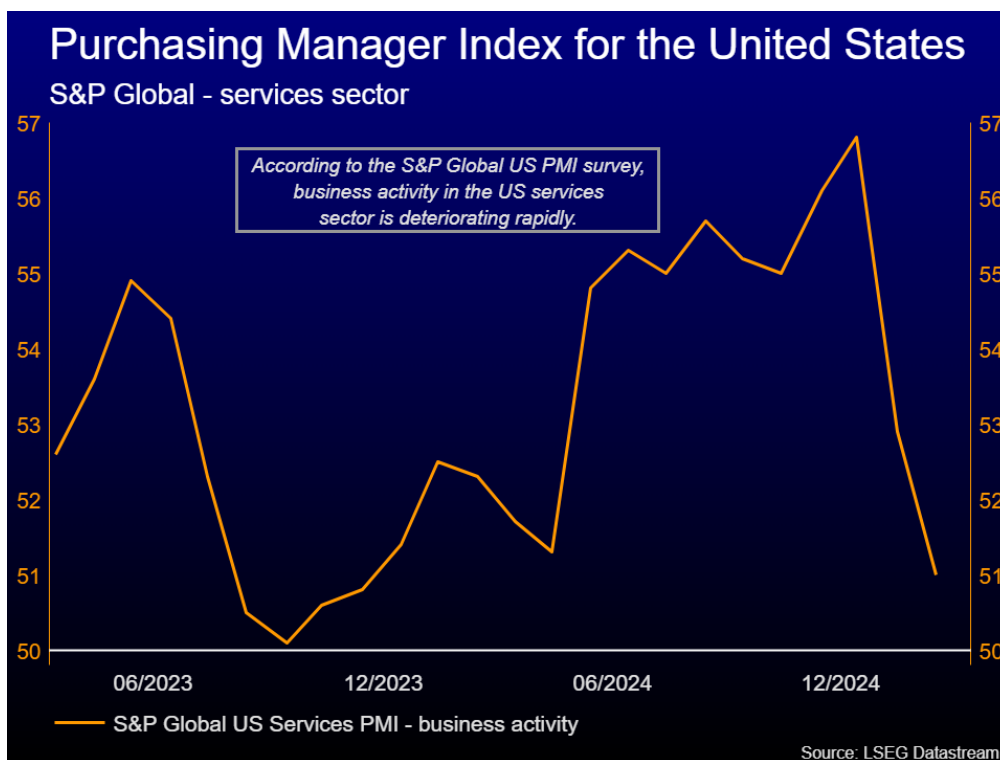
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For the second year in a row since the correction of 2022, the financial markets continued their upward trend in 2024, delivering excellent returns. Like last year, equities led the charge, with returns that far exceeded investor expectations, in particular for the U.S. and Canadian markets. Generally speaking, the stock markets were buoyed by the surprising resilience of the U.S. economy, which stimulated growth in corporate profitability. On top of the economy's solid performance, the markets also benefited from the favourable changes in the Federal Reserve's monetary policy. After first telegraphing the end of its monetary tightening cycle in November 2023, the U.S. central bank then began a series of cuts to its key rate in September 2024, from 5.50% to 4.50%, a move that was very much welcomed by investors. At the same time, enthusiasm for artificial intelligence and the tech sector did not wane in 2024 and it helped push the stock market indices to new heights. Lastly, we cannot ignore the impact of the U.S. election and the Republican Party's return to power as Donald Trump's promises and policies were viewed favourably by the business world initially. It was the promise of lower taxes and the anticipated deregulation of several sectors of the economy that further enticed the financial markets, which saw the potential of these policies quickly reflected in the prices of publicly listed companies. In addition to recapturing the White House, Donald Trump's party also walked away with a majority of the seats in the House of Representatives and the Senate, which will make it easier for him to move forward with his agenda.

As for the other asset classes that are part of portfolios, the returns generated were more than satisfactory in 2024. In fact, fixed income securities, alternative investments and the money market all made a positive contribution to the overall performance of portfolios.

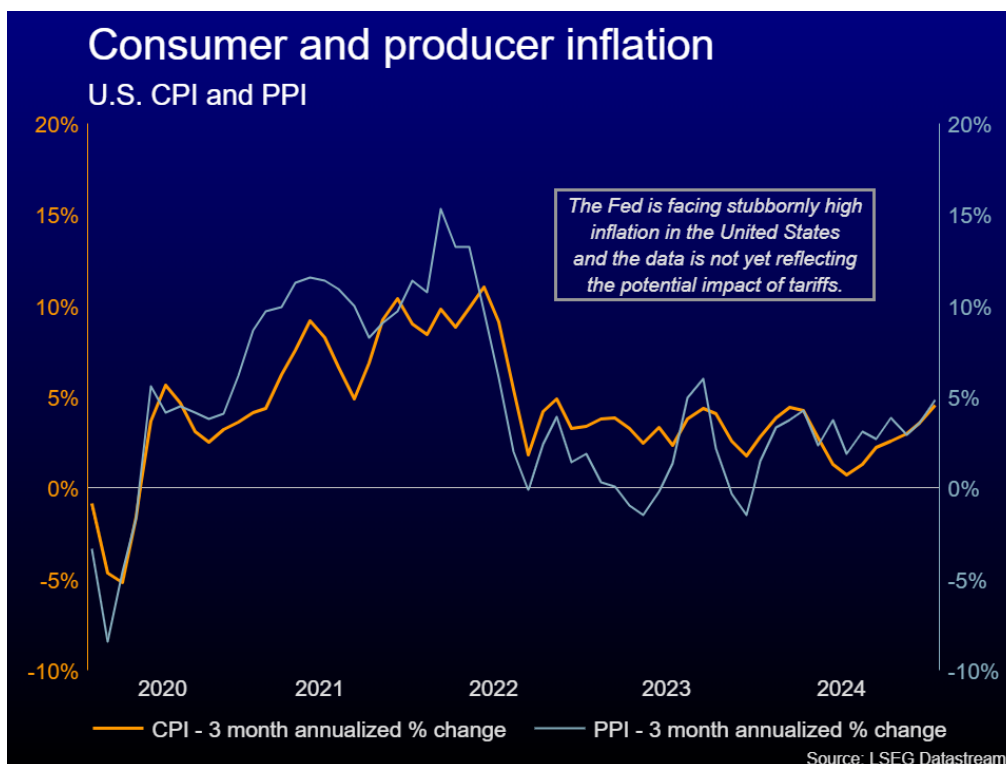
However, since the inauguration of the new U.S. President in January of 2025, economic conditions have become more complicated and uncertainty is growing. First, the government's first major initiatives, particularly the tariff threats, are not looked upon favourably by the financial markets, and we are seeing an erosion of investor and business confidence. This is borne out by a number of recent surveys, such as the one on consumer confidence conducted by the University of Michigan, which saw a significant decline in February. The results of a similar survey conducted by the Conference Board that was released a few days later also shows a recent deterioration in consumer sentiment in the United States. These surveys are obviously very sensitive to any statements made by the new President. They reflect fears of a possible trade war between the United States and the rest of the world, but also the concerns of public sector employees, given how aggressively the Trump administration is going after government spending. This loss of confidence could be reversed if the government's intentions were to be clarified over the next few months but in the meantime the uncertainty is already having an effect on economic activity. Retail sales in the U.S. in January were disappointing and were well below economists' expectations. In addition, the tariff threats seem to also be affecting businesses. According to the most recent S&P Global survey of employees responsible for purchasing, economic conditions are deteriorating and fears are growing on account of the uncertainty generated by the government's policies. It would initially seem logical that the tariff threats would hit the goods-producing sector the hardest, but the survey reveals that this uncertainty is also having major repercussions beyond the manufacturing sector. In fact, as we can see in [Chart 1](#) below, the services sector is being hit particularly hard by the uncertainty. The index has dropped close to the 50 mark (flash report was at 49.7 and final number was revised to 51), a level normally associated with little growth in economic activity. It is important to remember that the services sector represents more than 75% of the U.S.'s GDP. According to the most recent data, the manufacturing sector is faring better. This resilience can be explained quite simply by the short-term increase in bookings in this sector in order to get ahead of any potential tariffs, a phenomenon that could be reversed if the United States goes ahead with its threats.

**Chart 1**



What is making the current situation more delicate is the fact that the U.S. Federal Reserve is again concerned about inflation which is persisting at a higher level than desired, when the customs tariffs have not yet come into effect. Although the inflation rate has dropped significantly since its peak in June 2022, recent trends are less encouraging, and returning to the Federal Reserve's 2% target could be harder to achieve. In [Chart 2](#) below, we see the recent upward trend of the consumer price index and the producer price index. To smooth out monthly volatility, we are illustrating the change (annualized) in prices over a three-month period. As a matter of fact, the Fed Chair Jerome Powell took a firmer stance on price increases since the last decision on December 18, stating that more progress was needed on inflation in order for there to be any new rate cuts and that he would only act if the economic data warranted doing so. Many economists are now predicting that the U.S. central bank will not be able to resume its rate cuts before 2026, a significant change compared to what the financial markets were anticipating just a few short months ago.

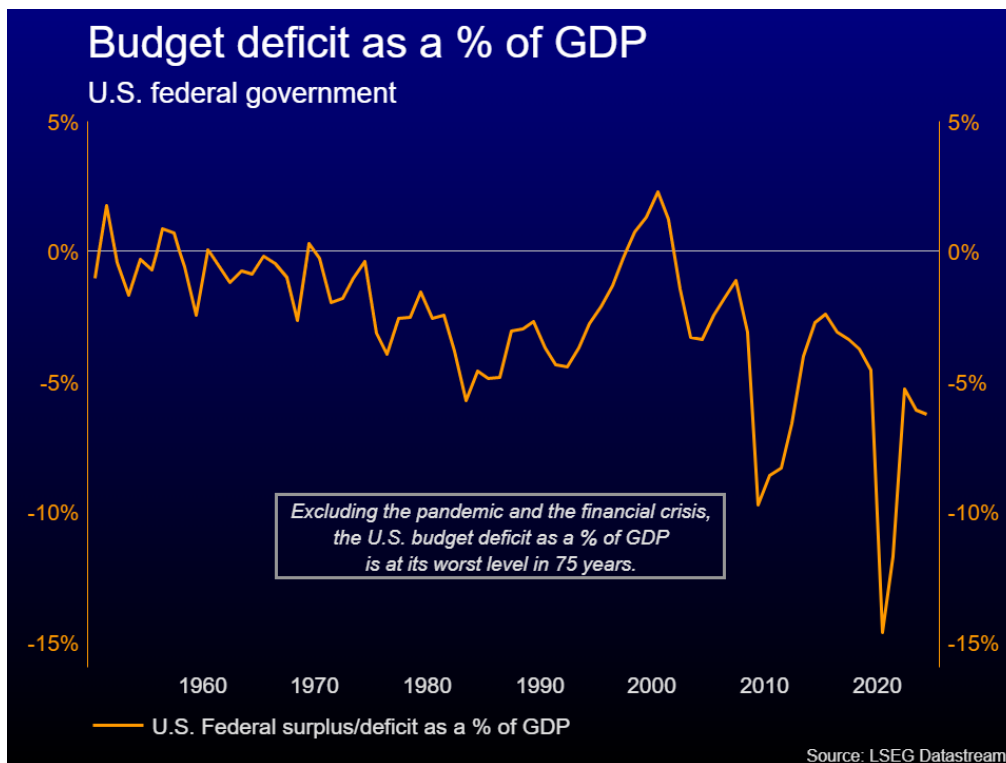
## Chart 2



In addition, in the short term, things are likely to get even more complicated for the economy. In fact, an analysis of the U.S. government's key policies indicates that the most plausible sequence of events in the coming months will be rather unfavourable to the economic climate. While the benefits of certain initiatives might take longer to materialize, the policies with more damaging and worrisome effects could be felt more quickly. Let's first take the tariffs being considered by the new administration that might come into effect in the coming weeks. These protectionist measures are essentially a tax on U.S. imports that will raise the cost of foreign products, especially for products with few alternatives available in the U.S. to replace them. In the shorter term, these measures result in higher prices for the American consumer. Since it is quite likely that the countries targeted by these tariffs will respond with retaliatory measures, a decrease in the demand for American products by foreign markets is anticipated, with obvious unfavourable consequences for the U.S. economy. In short, the vast majority of experts agree that a tariff war between the United States and other countries would be detrimental to global economic activity and would create inflationary pressures likely to persist for some time after the introduction of tariff measures.

Donald Trump has entrusted multimillionaire Elon Musk with the Department of Government Efficiency, commonly called DOGE, whose objective is to aggressively reduce costs in the public sector. While DOGE is facing a number of lawsuits, and some politicians are criticizing the dubious methods of this new entity that reports directly to the President, the layoffs are mounting and are creating a climate of uncertainty for millions of government employees. In the short term, the job losses and the upheavals in the functioning of a number of government departments are unfavourable for economic activity. In the longer term, a reduction in government spending is desirable for the United States, whose budget deficit, as illustrated in [Chart 3](#), reached 6.3% of GDP in 2024, a high level that is not sustainable in the long term.

### Chart 3



While the policy around the deportation of illegal immigrants has received a lot of media attention since the President's inauguration, statistics show that we are far from the mass deportations promised by Donald Trump. However, in light of a resolution that Congress has just passed, things could change. The resolution is a budgetary roadmap for implementing the key measures of the Republicans' program and it contains additional amounts earmarked to combat illegal immigration. If the government does proceed with the promised mass deportations of undocumented immigrants, this would reduce the medium-term growth potential of the U.S. economy. Moreover, and even more damaging in the short term, this decision would further tighten the supply of labour on the job market and could increase labour costs in the United States.

The tax cuts promised for individuals and businesses are also a priority for the government in power. However, these measures will depend on the Republicans' ability to have a budget that includes major reductions in government spending, to finance the tax cuts, passed by Congress. The adoption of such a budget would clearly present a challenge, and it would not be surprising if this part of the Republican program were to be revised downwards or simply delayed, a definite disappointment for the stock markets. It is undeniable that lower taxes in general would

stimulate the U.S. economy, but a sufficient reduction in government spending is needed so that the deficit does not deteriorate any further. Without austerity in government spending, the tax cuts could create inflationary pressures and drive the country's finances to an even more worrisome state in the medium term.

Deregulation of the economy is another theme that is dear to the Trump administration, which has just eliminated hundreds of regulations in a number of sectors of the economy in order to create an environment that is more conducive to conducting business. The Republicans want to make great strides in the energy and financial services sectors. For the energy sector, the Republicans would like to stimulate the production and use of fossil fuels rather than renewable energy sources. Many analysts doubt that companies in the oil and natural gas sector will change their financial discipline of recent years. With the promises made to investors to increase their dividends and buy back their own shares, it is unlikely that players in this sector will significantly increase their investments. At the same time, it is possible that investments in renewable energy production could slow if government grants are reduced or even eliminated. In the financial services sector, the Republicans want to reverse a number of rules that have been in place since the 2008 financial crisis. The objective is to ensure that the banks lend more money, thus stimulating economic activity. Donald Trump's government will undoubtedly succeed in streamlining the regulatory framework governing the financial services sector, but the most dramatic changes will need some time to be adopted and to have a positive effect on economic activity.

It goes without saying that the most disconcerting aspect of the current economic situation is the often inconsistent communications of the new U.S. administration. For investors, it is becoming increasingly difficult to navigate in this din of sweeping pronouncements in which disinformation prevails and statements are riddled with falsehoods. It is also quite difficult to distinguish between the Trump administration's real objectives and what many are considering to be mere negotiating tactics. Meanwhile, the latest developments on the international stage have left us stunned. The United States seems to be wanting to turn its back on its allies and cozy up to certain authoritarian regimes, a 180-degree turn compared with the country's traditional foreign policies. On a more encouraging note, we believe that Donald Trump is very sensitive to the economy's performance and the reaction of the financial markets. Many believe that he will therefore have to exercise restraint in his actions if he wants to avoid being associated with a recession or a drop in the stock markets. The weakness of the stock market over the past few weeks may not be serious enough to make Donald Trump react, but it is sending out a strong warning.

The S&P 500 is the bellwether index followed by all stock market specialists and it is often the benchmark for judging the attractiveness of equities in general. As we can see in [Chart 4](#) at the top of the next page, the S&P 500 is trading at about 22.4x expected earnings over the next 12 months, well above the average valuation of the index over the past 20 years. The high price-earnings ratio of the S&P 500 can partly be explained by the influence of the tech sector, whose weight represents approximately 40% of the total market capitalization of the index. That said, not all S&P 500 securities can be put in the same basket, because the shares of many companies are still trading at very reasonable valuations and are still offering good potential for returns. The Canadian and European markets, which are much less exposed to tech sector securities, are giving us a better read on the average valuation of stocks in general. At much more modest price-earnings ratios of 15.4x and 14.7x, respectively, the Canadian and European markets are trading very close to their historical averages. Lastly, it is interesting to note that S&P 500 securities have been much less correlated for some time now. In fact, this correlation is at a 30-year low; perhaps a sign that investor interest is turning towards companies other than the tech giants.

**Chart 4**

Boosted by the enthusiasm generated by artificial intelligence, tech securities are trading at higher multiples and are thus pulling the valuation of the index upward. As we can see in [Chart 5](#) on the next page, valuations for the tech sector exceed the 20-year average by a significant margin and are reaching levels that we have not seen since the beginning of the 2000s, a period marked by the internet frenzy. While the sector has the wind in its sails and a number of securities remain interesting, we do believe that this sector needs to be approached with caution. With such valuations, the tech sector is inevitably more vulnerable should there be an unexpected shock. The year 2022 is a good reminder that this sector can be very volatile and that it is not immune to sharp corrections. The sector seems to have lost a bit of steam since the beginning of 2025. Investors are starting to question the low returns generated by the enormous investments in the artificial intelligence sector. In addition, competition is heating up, and several new players are emerging, such as the Chinese company DeepSeek with its artificial intelligence model developed in a relatively short time frame and at low cost. The artificial intelligence sector is continually evolving, and the potential for growth is tremendous. But as with the internet in the early 2000s, the winners will not necessarily be those who seem to be comfortably in command today, and many companies will be disappearing. This universe should therefore be navigated with caution.

**Chart 5****Portfolio management**

In 2024 and since the beginning of this year, we have maintained a cautious approach centred on the quality of the investments in the portfolio. We believe that risks are high in the current climate and that stock markets will remain volatile for some time. In terms of asset allocation, we stayed with our slight underweight in equities and kept liquidity at levels higher than the target. Lastly, our exposure to fixed income securities and high-quality alternative investments is close to the overall target for these two asset classes combined. We believe that the expected volatility could create buying opportunities at attractive valuations. We are keeping a close eye on developments and the decisions of the Trump administration and their effects on economic activity and inflation.

**Equities**

For some years now, we have gradually been reducing the risks in our equity portfolio. We have less exposure to sectors that are more sensitive to the pace of economic growth, such as base metals and the oil and natural gas sector, and good exposure to more resilient ones, such as the health sector. Moreover, in keeping with our philosophy, we are focusing on companies that post strong returns on invested capital, that generate significant cash flows and that have low debt levels. In 2024 and since the beginning of this year, we have made a number of changes to our primary portfolio. Rather than a comprehensive description of all transactions, the following is a summary of the key new positions in the portfolio.

### **US Bancorp (USB):**

We decided to initiate a position in this high-quality regional bank while the valuation of its shares seemed attractive compared with the other banks in the sector. In addition, deregulation of the financial services sector in the U.S. could potentially be favourable to bank valuations in the longer term.

### **Zoetis (ZTS):**

A leader in the animal health sector, this company develops a variety of products (medicines, vaccines, diagnostics, etc.) used to care for pets and livestock. Prospects for growth are excellent and the valuation of the stock is below its historic average. The company is in good financial health, posting strong returns on invested capital and generating high cash flows.

### **Thermo Fisher (TMO):**

Thermo Fisher offers a wide range of products and services for the life sciences sector, including analytical instruments, laboratory equipment for research and diagnostics, and prescription drug research and manufacturing services. We added this stock that meets our criteria for quality and whose valuation is well below its historic average while the outlook for the sector is starting to improve.

### **Palo Alto (PANW):**

This company is one of the biggest players in the field of cyber security, a high-growth sector. Threats to corporate and government IT networks and data are becoming increasingly sophisticated, and Palo Alto offers a wide range of solutions to meet these needs. We took advantage of a correction to the price of the stock earlier in the year to initiate a position.

### **Xylem (XYL):**

Xylem's products and services are used to transport, treat, test and monitor water and return it to its natural environment in an efficient and responsible manner for various sectors such as building, industry and agriculture. With aging water infrastructures, a population that continues to grow and rising needs in developing countries, the outlook for growth in this sector is good and Xylem is well positioned to participate and gain market share. In addition, we like the fact that Xylem has a low level of debt and that it generates significant cash flows.

### **Uber Technologies (UBER):**

Many people are seeing the arrival of self-driving cars as a threat to Uber. We believe instead that the company's expertise and its enormous network of users makes it a worthwhile partner. The company is in good financial health and will see its cash flows grow significantly in the coming years. We think that the company could see the valuation of its shares increase as fears around self-driving vehicles dissipate.

**Killam Apartment REIT (KPM.UN):**

Killam is a real estate investment trust that focuses on the multi-residential segment of the real estate industry. With a high occupancy rate of over 97% for its units and an average rent of around 15% less than comparable rents on the market, Killam should be able to grow its revenues at a good pace over the next few years. We believe that the valuation of the stock is attractive and we like the stability of the multi-residential sector in Canada.

**Bombardier (BBD.B):**

We like Bombardier's initiatives to develop its network of service centres to better support its existing fleet of business jets. Not only do maintenance, parts and support services generate profit margins that are higher than those for manufacturing and selling aircrafts, these services also have good growth potential, as Bombardier serves only 50% of the market for its own jets. The company is continuing to pay off its debt, and its valuation remains interesting despite the stock's strong performance since it was added to the portfolio. We nonetheless reduced the position by half recently given the risk of a trade war between Canada and the United States.

**Telus (T):**

Telus has completed the roll-out of its fibre optics network and we are therefore anticipating a significant drop in its capital expenditures, which should enable the company to generate much higher cash flows in the coming years. In addition, competitors in the industry should adopt a more disciplined approach in terms of pricing going forward.

Generally speaking, we sell stocks when the potential for return is limited (fully valued stock), the fundamentals are deteriorating or our quality criteria are no longer being met. Over this past year, we eliminated Crown Castle, KBW Financial Services index fund, CVS, Diageo, Honeywell, Corteva, Home Depot, First Capital and BCE.

**Fixed income securities**

In the fixed income securities portion of the portfolio, we continued to extend the term by buying high-quality bonds with longer maturities and we have again reduced the weight of preferred shares after their excellent performance in 2024. For the bonds added to the portfolios, we are continuing to lean toward those trading at a discount for the tax advantage they offer. We also added an exchange-traded fixed income fund to the portfolio that replicates the universe of bonds in the U.S. and incorporates a strategy that protects against currency fluctuations. This investment in Canadian dollars allows us to take advantage of the current substantial gap between Canadian and U.S. interest rates. This index fund is very low risk given it is primarily made up of government bonds. In a more pessimistic scenario where economic conditions deteriorate more than anticipated, the index is expected to perform well and to help reduce the overall volatility of portfolios.

We hope that this account of our management has been useful to you, and we invite you to contact us for any questions or clarification. We also want to take this opportunity to thank you for your trust in us.



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