Quarterly Report
AUTUMN 2024

HEWARD
INVESTMENT MANAGEMENT INC.

"The Time Has Come for Policy to Adjust" - Fed Chairman Jerome Powell - While China Provides an Adrenaline Shot to its Economy!

OVERVIEW

The Fed went for it! Fed Chair Jerome Powell entered a new phase in his campaign to land the U.S. economy, lowering interest rates at their September meeting with an audacious half-point cut. The move raised new questions the central bank couldn't easily answer. But it underscores Powell's desire to prevent the central bank's past rate rises from tipping the economy into recession now that inflation is heading down. Mr. Powell characterized the move as "recalibrating policy lower over time to a more neutral level." And, while he has typically avoided offering specific targets, he volunteered that "the neutral rate is probably significantly higher than it was" before the pandemic. Now, it seems popular, to compare monetary policy with scaling mountains, particularly how to get down. The analogy is uncomfortable, as descending is more hazardous than the ascent. That's when accidents happen!

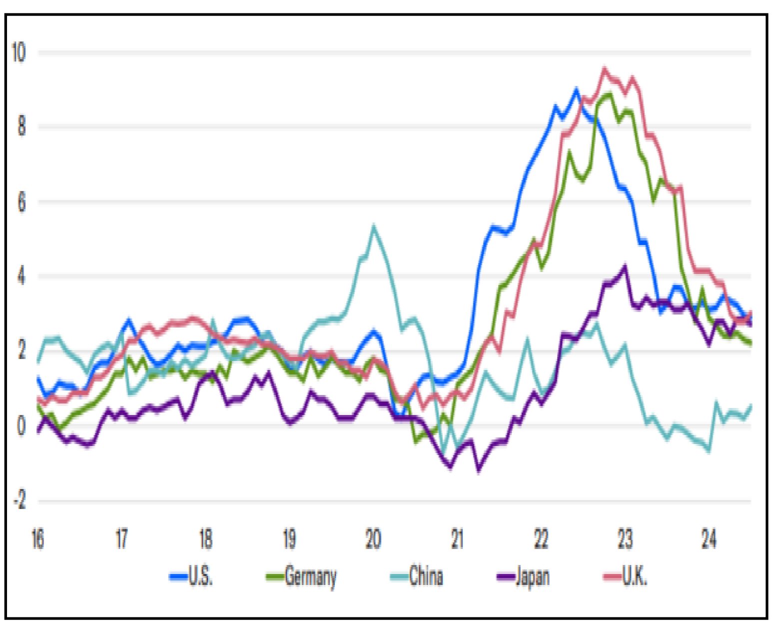
Parts of the U.S. economy have been weak for the past two years, including manufacturing & housing. Yet despite the sluggishness in goods sectors, aggregate U.S. growth has performed notably better vs. other countries abroad. The Fed's pivot suggests this outperformance is ending, meaning that the U.S. is now facing similar issues, as other countries. The key for a U.S. soft landing will be getting previously impaired sectors of the economy to turn up before labor market cracks cause spending on services to slacken too much. The silver lining is that lower rates and a weaker US$ are associated with rising odds that a floor develops in manufacturing.

The world's three dominant economies are entering a new, combative phase as the U.S. increasingly uses trade weapons borrowed from China's playbook. That threatens to deepen international fissures and challenges decades of free-market orthodoxy while leaving Europe with big decisions to make. "Former President Trump let the protectionist genie out of the bottle and no one dared to put it back in" (Simon Evenett). Then Joe Biden ushered America into the new industrial policy age. This has been punctuated by his latest round of duties on Chinese imports. The $31 trillion arena of international commerce has withstood shocks in recent years, including the U.S.-China trade war. Now, the linchpin is the European Union (EU). It's caught between its role as a defender of multilateral rules and fearing the loss of millions of jobs and billions in investment as the U.S. and China wield market-distorting subsidies and tariffs.

The EU's politics were shaken last month after Mario Draghi, former European Central Bank president, published his long-awaited report on economic stagnation, worsened by the competition posed by Chinese exports and the end of cheap Russian energy. Hardly a news item, his demand for more joint debt has already been opposed by Germany. The crucial point of the report is that "the EU should aim to move closer to the U.S. example in terms of productivity growth and innovation." Emphasizing the importance of the technology sector, Draghi pointed out that it is responsible for almost all of the U.S. productivity outperformance over the past 20 years. He argues that "Europe cannot afford to remain stuck" in old industries.

Central Bankers in emerging markets (EM) can be forgiven for feeling relief after the Fed's jumbo cut. Their economies have already reaped the benefits from proactively dealing with the post-pandemic inflation breakout. Subsequent easing has been constrained by high rates elsewhere. It would be imprudent for EM central banks not to be on the same wavelength as developed central banks, given they have to deal with weak and potentially volatile currencies.

DISINFLATION ACROSS THE GLOBE CPI, % CHANGE YR AGO



Source: Multiple Sources, BLS, Moody's Analytics

UNITED STATES

How fast the Fed cuts and by how much at future meetings remains a wild card. Powell has tried to dissuade investors of the view that a half-point cut should be the default path at their next meeting. The recent move was more of a “catch-up” as if they had the July employment data at their last meeting, they likely would have cut back then. For now, a “soft landing” seems intact. Recent surveys have found that the U.S. economy continues to grow, and have indicated little threat of recession despite signs that the labor market has cooled off more rapidly than previously believed. Meanwhile, the service side of the economy employs most Americans, and with that, the U.S. consumer has been the workhorse of the economy. While consumer credit continues to expand, the small cracks in the U.S. labor data imply that the spending trajectory has slowed. But, until the small cracks in the labor market turn into big cracks, there remains fundamental support for spending. Some of the largest banks in the U.S. seem to agree, as their comments show that consumers have continued to spend and borrow, helped by a strong job market and wage gains. But they also said, that higher inflation and interest rates have increasingly pressured budgets, especially for lower-income households. Banks reported that more borrowers have carried credit card balances over from month to month, with particular pressure on consumers, that are already on shaky financial ground. Meanwhile, manufacturing continues to weaken. Fortunately, the sector is a much smaller part of the economy but has been in a prolonged slump due to high interest rates and a shift in consumer spending patterns.

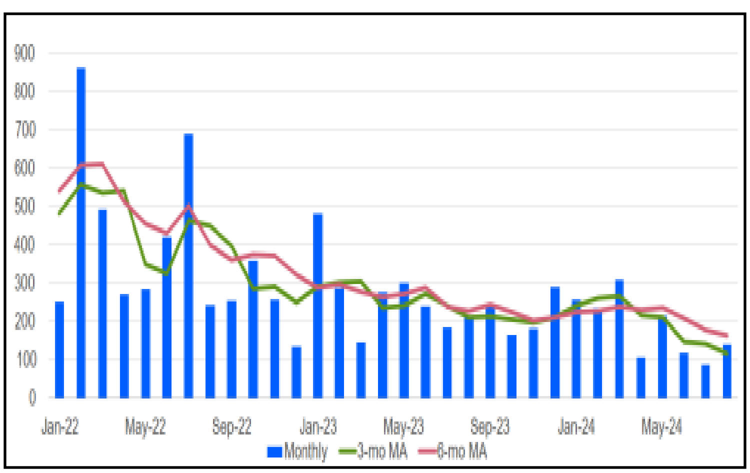
CANADA

Canada’s annual inflation rate cooled to 2% in August, finally hitting the Bank of Canada’s target after a tumultuous battle with skyrocketing price growth. With that, Bank of Canada (BoC) Governor Tiff Macklem has become so confident their policies have crushed inflation that he has tweaked their decision-making process. Now officials are setting policy rates to prevent price pressures from slowing too much, and their current concerns are, slow growth, tapped-out consumers, and rising unemployment. While they point out that a lot of the rise in unemployment is because of the new arrivals, it still counts as a signpost of an economy that might be getting too weak. Pent-up demand for things like new cars and travel is fading, as families are setting aside more of their income for debt payments, leaving less money for discretionary spending. However, Macklem also rejected the idea put forth by some, that the BoC is now on a predetermined path of cutting rates. Canada’s household debt burden is edging lower, indicating that people are hesitant, to take on loans at higher interest rates (Statistics Canada). The household debt to disposable income ratio, continued to decline in the second quarter, marking the fifth consecutive quarterly decline. Meanwhile, the tech sector should continue to be a bright spot, driven by advancements in Artificial Intelligence (AI), clean technology, and digital transformation. In September, Canadian manufacturing activity strengthened for the first time in 17 months as market demand improved and lower borrowing costs bolstered confidence in the economic outlook.

EUROPE

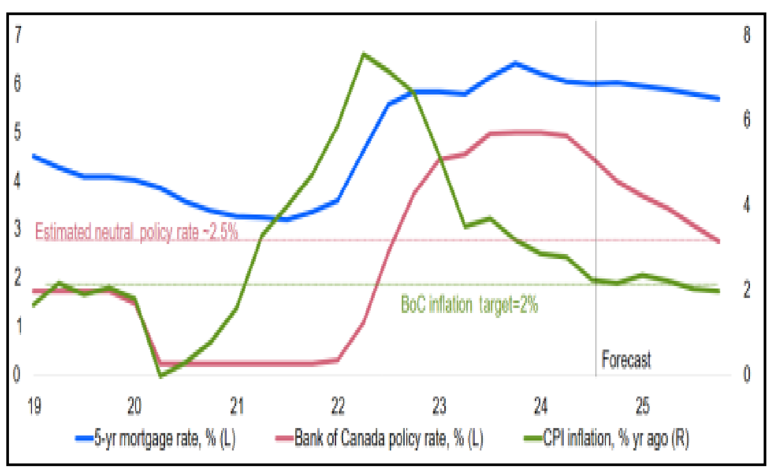
In its attempt to boost a faltering economy, the European Central Bank (ECB) lowered interest rates by a quarter point in September, its second cut in three months. This was in line with major central banks, who have shifted their focus from fighting inflation to supporting growth. ECB President Christine Lagarde said at a news conference that it was “pretty obvious” eurozone interest rates were on a “declining path,” but that the speed and scale of future rate cuts have yet to be determined. However, at the end of September Germany reported that its inflation rate declined further below the ECB’s 2% target. The German data came after inflation cooled more rapidly than expected in France and Spain, potentially increasing the pressure on policymakers to vote for an ECB rate cut, in October as well. In its policy

JOB GAINS ARE CLEARLY COOLING MONTHLY CHANGE IN NONFARM EMPLOYMENT GROWTH



Source: BLS, Moody’s Analytics

BANK OF CANADA PIVOT SLOW TO BRING RELIEF ON CONSUMER RATES



Source: Bank of Canada, Statistics Canada, Moody’s Analytics statement, the bank also trimmed its economic outlook for the eurozone, now, slightly below its June forecast. Private domestic demand in Europe has weakened as households consume less, firms have cut down business investment and housing investment has weakened. A range of factors have had an impact on the economic situation in the UK. But recent data suggests that GDP growth rates are stabilizing, after a period of volatility caused by Brexit, the COVID-19 pandemic, and global uncertainties. In a more cautious approach than the Fed, the Bank of England left its key interest rate unchanged. However, it is likely to follow up on an August cut over the coming months in anticipation of a decline in inflation to its 2% target. It remains concerned by the pace at which services' prices and wages are rising. The pound meanwhile, is at its highest level since 2022.

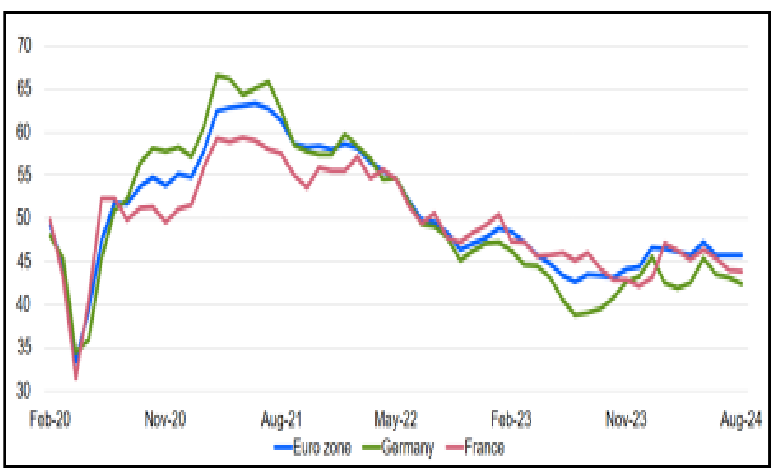
EMERGING & DEVELOPING MARKETS

The Communist Party's Politburo has remained committed to achieving this year's "economic and social development targets", including the GDP goal. On the other hand, President Xi has spent years stressing that the quality of growth matters most. However, after underscoring the mounting alarm within the government, the central bank finally acted. With the economy dogged by a property market crisis, consumer price weakness, rising global trade tensions, and depressed investor confidence, the central bank announced a "blitz" of measures to support the country's weakening economy and energize its moribund stock market. It probably says more about China's lack of policy stimulus to date that the monetary measures announced amounted to the strongest set of steps seen in years. But at the end of the day, it's a "growth boost," not an "economy fix." And, while It's too early to tell if China's stimulus blizzard will reignite flickering growth, its impact is already unmistakable in one corner of the economy: Red-hot stock markets. After a disappointing start to the year, buoyed by strong consumption of automobiles and other durable goods, Japan's economy posted surprising growth numbers, led by an increase in private consumption. In a move motivated by its growing confidence in the nation's economy, the Bank of Japan (BoJ) increased rates (0.25%) in July, and, said it would be tapering its massive buying of government bonds. But, BoJ Governor Kazuo Ueda pushed the likelihood of an October rate hike further to the sidelines. Meanwhile, sentiment among large Japanese manufacturers held steady during the three months to September, as businesses weighed the impact of China's economic slowdown and the yen's appreciation.

COMMODITIES

Global manufacturing activity had been the most immediate issue for base metals. Purchasing Manager Surveys have confirmed the air pockets in the U.S., European, and Chinese manufacturing sectors. Industrial users have continued to run down inventories, exacerbating the headwinds. Despite this, the fundamentals have not been that bad and, now China finally seems truly dedicated to pulling its economy out of its deflationary spiral and steering it toward the government's official growth target. With the country unveiling fresh monetary stimulus (the biggest since the pandemic), commodity prices globally have gotten a boost. Initially, two sectors garnered investors' interest, materials, and energy. The first remains supported by gold prices, which climbed to record highs, and copper and iron ore prices, which surged. However, now energy after initially seeing interest, is reflecting a macro backdrop for demand, that has deteriorated. Updated supply-demand models suggest that OPEC+ will have to delay further, the unwinding of voluntary cuts. Furthermore, Saudi Arabia seems preparing to abandon its unofficial $100 a barrel oil price target, as it gets ready to raise output to win back market share, even if it means lower prices (Financial Times). This should lead to lower oil price assumptions for 2025. Meanwhile, the outlook for natural gas is expected to improve. New Permian pipeline takeaway additions are coming, U.S. natural gas-fired power generation continues to grow, the speed of new LNG project ramps, and the stability of LNG exports are all key factors that will determine the health of the North American natural gas market.

MANUFACTURING PMIS POINT TO FURTHER CONTRACTIONS (MANUFACTURING PURCHASING MANAGER'S INDEX)



Source: S&P Global, Moody's Analytics

LOSING FAITH: CONSUMER CONFIDENCE, 100 = NEUTRAL

Source: China National Bureau of Statistics, Moody's Analytics

STRATEGY

After countless prognostications of when and by how much rates would be cut since last October, the process has finally begun. The Federal Reserve and the BoC are firmly on the monetary easing path, and the prospect of a full-blown recession, hitting the North American economies has substantially subsided. However, while cycles do not always repeat themselves, investors should "curb their enthusiasm" somewhat. Historical records show that markets tend to perform much better (in the period) between the last hike in a Fed tightening cycle and the first cut in rates than they do after the first cut in the Fed Funds rate. Significant progress has been made on the inflation front, but tighter labor markets mean, it will take more time to moderate elevated services inflation. While core goods inflation has already normalized, freight cost increases may offset some of this. More rate cuts will be coming from central banks but with a greater divergence of outcomes. The progress made on the inflation front will allow them more leeway to balance growth and inflation objectives. Despite a constructive growth outlook global equity markets remain fragile, and with the rising geopolitical tensions adding to volatility, this suggests that this is not the time to take an aggressive position. A constructive macro environment is typically associated with strong markets, and would support a tilt towards riskier assets. However, current valuations remain elevated and future earnings may not match current projections. Thus, we maintain our stance (slightly below neutral), taking profits or adding to positions based on market opportunities. We continue to favor those stocks with visible revenue/earnings growth and whose managements are committed to growing their dividends. Slowing economic growth and more muted inflation numbers provided ample ammunition for global central banks to continue or to start easing their interest rate policies. We will see additional rate cuts through the year end, and continuing next year. In anticipation of these easier monetary conditions, bond market yields continued declining, resulting in one of the best quarterly performances on record. Although we expect bond market rates to fall further in the next couple of months and quarters, those declines will likely be modest compared to the moves we have already experienced. During the quarter we increased the duration of the fixed-income pool fund, although we remain well below the benchmark level. The resulting performance gap was more than offset by the performance in other fixed-income vehicles, notably preferred shares. As credit spreads continue to move at historically low levels, we further reduced corporate bond exposure in favor of provincial bonds.

FORECAST 2024	**CURRENT 30-SEPTEMBER-2024**	**2024 RANGE**	**2024 YEAR-END**
INTEREST RATES			
Bank of Canada Overnight	4.25%	3.50% - 5.00%	3.50%
Federal Funds Rate	5.00%	4.50% - 5.50%	4.50%
10-year Canadian Treasury	2.95%	2.60% - 3.85%	2.70%
10-year US Treasury	3.78%	3.40% - 4.65%	3.50%
COMMODITIES			
Gold (US$/oz.)	$2,636	$1,990 – 2,750	$2,675
Copper (US$/bbl)	$4.55	$ 3.65 –5.11	$4.80
Oil WTI (US$/lb)	$68.17	$62.00 –87.00	$62.00
Natural Gas	$2.92	$1.58-$3.35	$3.25
MARKETS			
S&P/TSX Composite Index	24,000	20,585 - 24,300	23,500
S&P 500 Index	5,762	4,689 - 5,850	5,400
MSCI World	3,723	3,114 - 3,850	3,650
CANADA DOLLAR/US DOLLAR	$0.7394	$0.7200 – 0.7550	$0.7400

2115 rue de la Montagne, Montreal, QC H3G 1Z8
Telephone: (514) 985-5757 **Toll Free:** 1-800-567-5257
Email: info@heward.com **www.heward.com**

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