Quarterly market commentary

MARCH 2025

True north strong and free

The first quarter of 2025 marked a significant shift from 2024's investing trends. U.S.-centric, growth-focused strategies seem to have given way to more diversified and value-oriented investing. The Canadian economy was well positioned for this rotation and provided the strongest relative and absolute equity returns in our portfolios for the first quarter. As the narrative of U.S. exceptionalism fades, it is being replaced by concerns about slowing economic growth and shifting global dynamics.

For capital allocators, navigating volatility requires conviction in investment decision-making. In turbulent periods, markets often overreact to headlines, creating temporary misalignments between fundamentals and asset prices. Fidelity's rigorous fundamental research and deep understanding of the businesses it covers allow us to identify and capitalize on these moments, enabling us to transform uncertainty into opportunity.

Canadian equities

Canadian equities were a bright spot in an otherwise difficult market to start the year. Canadian equities, as represented by the S&P/TSX Capped Composite Index, edged up to a slightly positive return of 1.5% in Canadian dollar (CAD) terms at the end of the first quarter. The rally was primarily led by materials (up 20.3% in CAD) and energy (up 4.0% in CAD), benefiting from rising commodity prices and natural gas demand. Health care and information technology made the biggest detractions, but a higher weighting in natural resources in the Index aided in the overall positive return.

Inflation rose to 2.6% in February, exceeding the Bank of Canada's 2% target, but this was largely driven by the end of the temporary GST/HST tax break, not a structural inflationary surge. The Bank delivered two more interest rate cuts totalling 0.50%, with the second cut widely considered pre-emptive insurance against tariffs. Meanwhile, the unemployment rate for March ticked up slightly to 6.7%, signalling softness in the labour market. With surprise fourth-quarter GDP growth providing cautious optimism, investors and policy makers are now watching to see if momentum can be sustained, or if tariff repercussions will weigh on Canada's economic outlook.

KEY TAKEAWAYS

- The first quarter marked a shift from growth-focused investing to diversified value strategies.
- Canadian equities outperformed U.S. equity markets, and capital rotated from U.S. to international regions amid tariff news.
- Bonds provided stability and diversification in a volatile trading environment.
- While challenging in the short term, uncertainty paves the way for long-term investors to capitalize on opportunities in mispriced assets.

U.S. equities

U.S. equities, as measured by the S&P 500 Index, fell by 4.3% in U.S. dollar terms and 4.2% in CAD terms for the first quarter. This marked a sharp reversal after an initial rally in the quarter driven by optimism about pro-growth policies expected from the incoming U.S. president. Market sentiment shifted as tariff concerns and AI sector uncertainty triggered a sell-off, particularly in 2024's top-performing growth sectors, information technology and communication services. Capital rotated into defensive sectors such as health care, utilities and consumer staples, while energy was the best performer. The U.S. unemployment rate ticked up to 4.2%, a key figure amid government job cuts and tariff concerns, as well as lower U.S. GDP estimates. The U.S. Federal Reserve held its policy rate steady, but signalled a slower balance sheet runoff, reflecting stagflation concerns from tariff impacts.

International equities

International equities staged a strong comeback, with the MSCI EM Index rising 3.0% and the MSCI EAFE Index increasing 6.9%, in CAD terms, for the first quarter. Chinese equities were among the top global performers, boosted by DeepSeek's breakthrough in low-cost generative AI, stimulative measures by the government and cheap relative equity valuations. European equities (ex U.K.) posted double-digit returns, driven by Germany's fiscal stimulus for defence spending and infrastructure investments. Additionally, interest rate cuts and strong corporate earnings in the U.K. and Europe have encouraged capital flows out of uncertain U.S. markets into eurozone regions.

Fixed income

We have always been proponents of the value that fixed income securities (bonds) provide to a well-diversified portfolio. Over the last quarter, fixed income securities have delivered stability and capital protection in our portfolios. Bloomberg's global aggregate bond index returned 2.7% CAD as investors looked for stability. Year-to-date, bonds have re-established their traditional negative correlation with equities, providing a positive outcome for diversified investors. On the home front, mortgage rates continue to track downwards after the Bank of Canada cut interest rates twice over the quarter.

Outlook

We remain focused on two potential outcomes of tariff implementation: productive trade negotiations, which could restore investor confidence, or prolonged uncertainty. Prolonged uncertainty regarding tariffs may disrupt Canada's economy in the near term, but the tariffs have already prompted a reassessment of our trade policies. Politicians across Canada have committed to removing interprovincial trade barriers, which could unlock long-term growth potential. Canada's upcoming election could also be pivotal in reshaping trade relationships at home and abroad. Given persistent market volatility and changing investor sentiment, we anticipate continued adjustments in risk assets. In this environment, our priority remains a diversified portfolio approach, leveraging strategic asset classes and geographic exposure to mitigate risks while capturing long-term opportunities through our fundamental investing process.

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