Q3 C2024

QUARTERLY MARKET UPDATE

AS AT SEPTEMBER 30, 2024

VESTCOR

The following information is being provided as an overview of Vestcor Inc.'s (Vestcor) investment activities and the general financial market conditions experienced during the noted reporting period.

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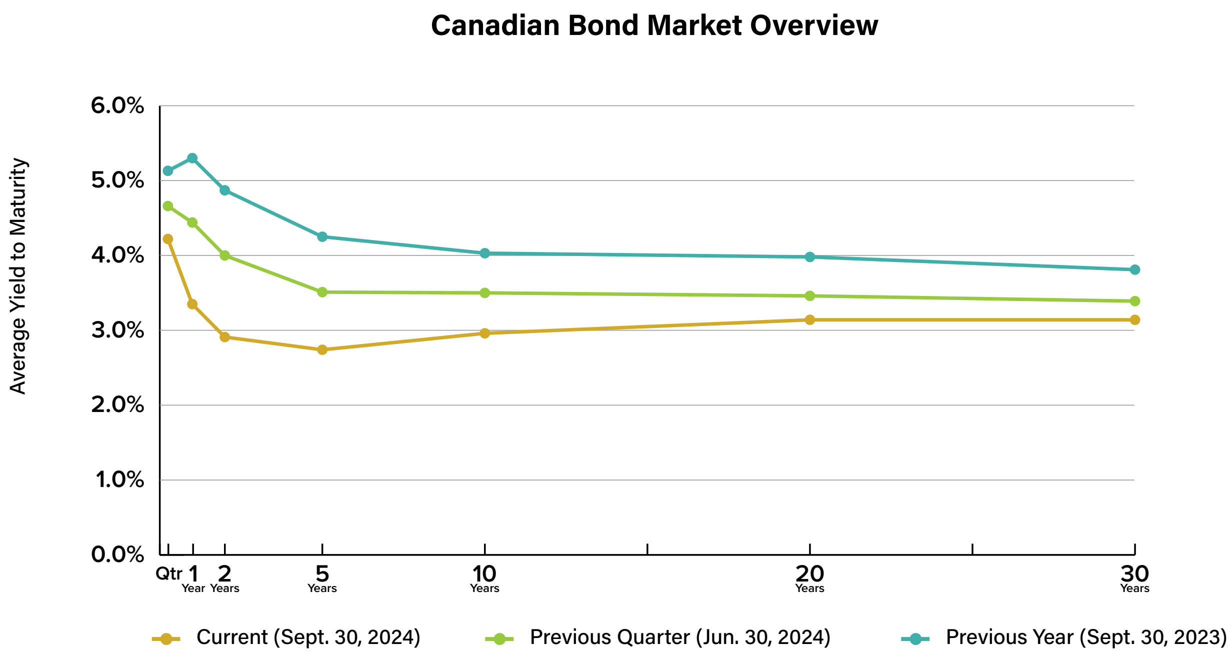
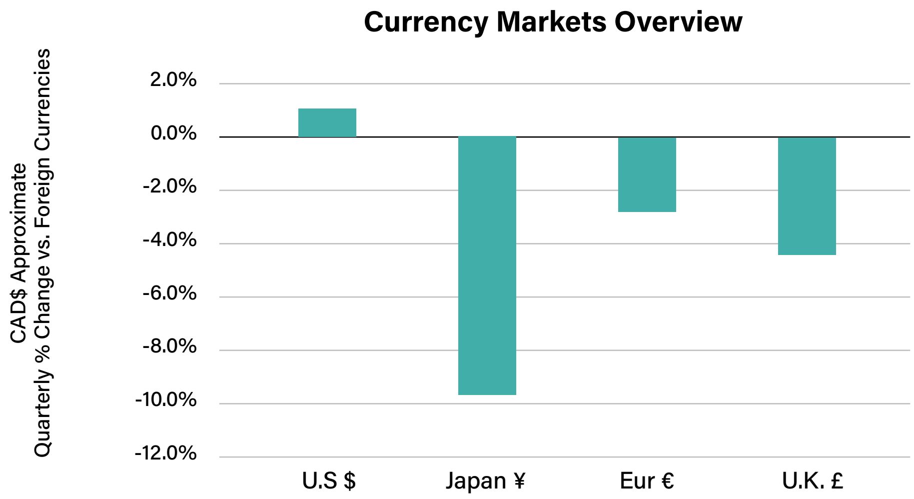
PERFORMANCE OVERVIEW

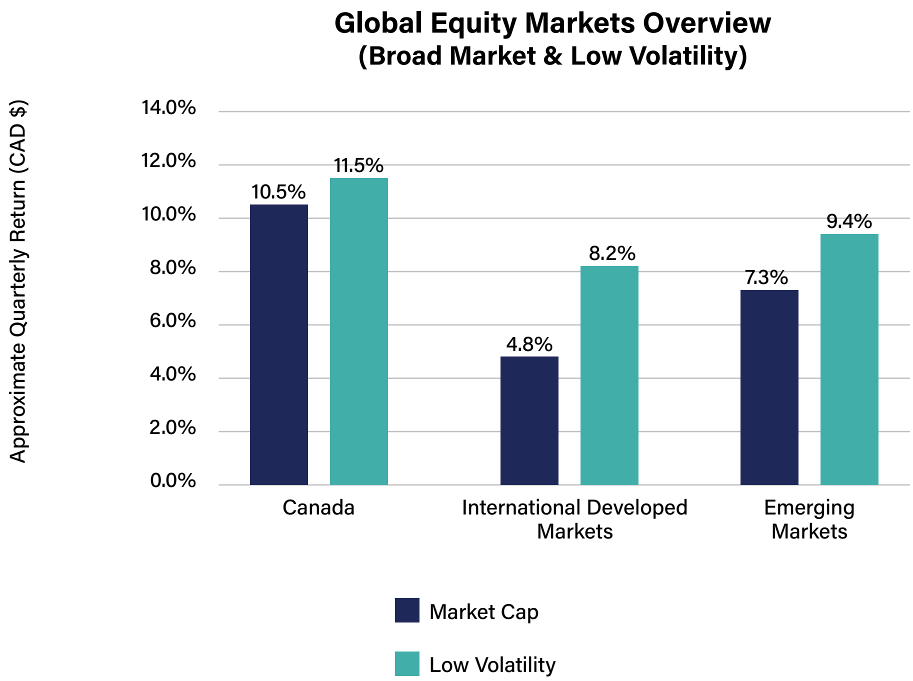
Yields declined across the yield curve over the quarter, with 1-year and 2-year bond yields dropping by over 1%. Shorter-term and longer-term yields fell to a lesser extent. During this period, the Bank of Canada reduced interest rates by 25 basis points in both July and September, bringing the rate down to 4.25% as inflation continues to normalize within the targeted band.



- Given this backdrop, the Canadian All Government Bond index returned 4.66% as yields decreased during the quarter. Although credit spreads tightened, the Canadian Corporate Bond index matched the performance of government bonds, earning 4.67% due to a lower sensitivity to falling yields.
- The Real Return Bond index was strongly positive with a return of 4.23% although still underperforming government bonds.
- In currency markets, the Canadian dollar strengthened against the U.S. dollar but weakened against most other major currencies, with the sharpest decline relative to the Japanese yen.



- Equity markets showed strong performance this quarter, with all regions and strategies delivering positive results. Canadian equities posted double-digit returns, outperforming international counterparts. Notably, Low Volatility outpaced market-capitalization weighted strategies in a period of rising markets.



- Private real estate has generally underperformed their public market counterparts. Retail assets are seeing strong operational results which are positive for valuations. Office markets are still under pressure, but there are signs of improvement in several regions. Multi-family rental continues to perform very well while industrial markets weaken at the margins. Canadian real estate continues to outperform non-Canadian investments.

- Private infrastructure has generally underperformed its public market counterparts. Higher interest rates are weighing on the sector but much of that impact has been offset by revenues tied to inflation.

- Private equity generally underperformed its public market counterparts as valuations in private markets tend to lag public markets. In Q3 2024, the US Federal Reserve lowered interest rates by 0.5%, which is expected to boost M&A activity as the cost of capital decreases, with hopes for further rate cuts. The US IPO market is recovering, with recent successful IPOs signaling potential improvement in 2025, though activity remains below normalized levels. US PE fundraising saw a decline from Q2, while Europe maintained strong fundraising regardless of macroeconomic conditions. Industrial and Technology sectors led PE deal activity in the US, and in Asia-Pacific, large PE firms see significant opportunities in India and Japan for 2025.

MARKET ENVIRONMENT & OUTLOOK

SUMMARY:

- Equities have remained strong thus far in 2024, albeit with some volatility in Q3 over concerns about a potentially slowing economy and uncertainty around a shifting stance for global monetary policy.

- Interest rates have moved higher throughout September and early October, with a broadly flat yield curve indicating minimal extra compensation for taking on more risk in the form of longer dated maturity bonds.

- The monetary policy outlook remains highly fluid, although market prices suggest continued rate cuts in both the U.S. and Canada as the default investor expectation.

- Relatively high valuations resulting from very strong recent returns imply somewhat modest expected returns for U.S. equities over the medium to long term, at least relative to historical averages.

Equities have continued to produce strong returns for investors in 2024, with the S&P 500 up over 20% year-to-date as of the end of Q3. Despite this, the third quarter did feature some higher-than-normal volatility at times, with investors digesting sometimes conflicting economic data and a highly uncertain path forward for monetary policy. Overall, however, economic fundamentals – at least in the U.S. – have remained mostly strong while inflation appears to be under control for the most part, and the base assumption for the average investor has defaulted to either a “soft landing” or “no landing” scenario.

The economic outlook as it stands today has central banks in both the U.S. and Canada on an apparent rate lowering path (the Bank of Canada cut rates by 0.5% on October 23rd to set the overnight rate at a target of 3.75%), and rate expectations among investors have once again coalesced around multiple cuts in both the U.S. and Canada over the next year. As of this writing, markets expect the U.S. short term rate to be cut from its current target level of 5% to less than 4% by the end of 2025, while in Canada bond prices imply an overnight rate below 3% by mid-year next year. Whether or not those forecasts are achieved depends highly on the economic environment at the time, as both central banks remain highly data dependent – a rapidly weaking employment situation could prompt significantly more cuts than are currently expected, while a moderate rebound of inflation could stop the rate cutting cycle altogether.

Reflecting this uncertainty, longer term interest rates have reacted quite strongly to Fed and Bank of Canada policy moves. While extremely short (e.g. overnight) lending rates have come down, longer term interest rates actually began moving higher at the end of Q3. In the U.S., the benchmark 10-year yield bounced off a year-to-date low of about 3.6% in mid-September to reach nearly 4.3% in October, with Canadian yields roughly moving in lockstep. More medium-term yields such as the 2-year also began moving higher in September, and as of early Q4, the U.S. yield curve showed that bonds of all maturities from as short as 3 months to as long as 30 yields all featured yields of between 4% and 4.7%, indicating essentially no compensation for investors for taking on the added risk of longer maturity bonds.

Equity markets, particularly in the U.S., are very highly priced relative to historical averages, with the forward Price/Earnings ratio for the S&P 500 reaching the mid-20s in Q3. In general, while valuations are highly imprecise tools to use for timing market allocations, extremely high valuations are often indicative of relatively below average returns over the long term (e.g. the following 10-12 years). Similarly, markets that are "priced to perfection", with investors paying a high price for anticipated future earnings growth, often leaves markets somewhat more susceptible to short term drawdown as a result of unanticipated economic or geopolitical events (such as was the case in Japan with the unwind of the carry trade in August of this year). Overall, while economic fundamentals remain solid, higher market values are indicative that investors remain more optimistic – and less risk averse – than normal.

Overall, given the geopolitical situation with ongoing volatility globally as well as an upcoming federal election in the U.S., and combined with the somewhat uncertain policy outlook over the next year, investors should continue to expect future displays of the above normal market volatility observed in Q3, providing both pain for investors that got too extended during the bull market run as well as opportunities for investors with the liquidity and decision making framework to take advantage.

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