TD Asset Management

Market Perspectives 10 Minutes

From the Desk of the Public Equities Team

That Bear's Watching – From MAGA to MEGA and Other Market Musings

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At TD Asset Management Inc., (TDAM, we, our), we believe our business is about collaboration with you – the investor and long-time unitholder. The better you understand the rationale for our decision-making, the more clarity you have on how our returns follow.

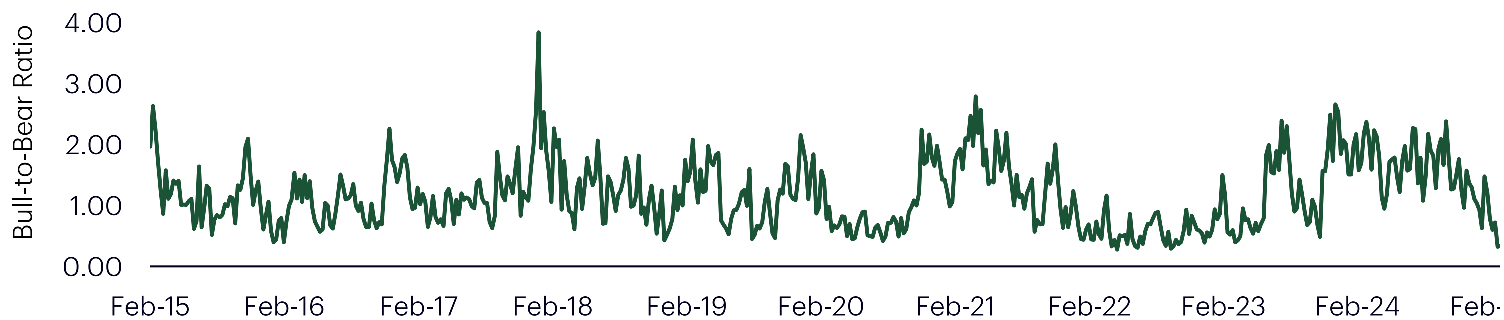
Make Europe Great Again?

It's been just over 2 months into the new year and there's been no shortage of market moving events, be it fundamentals, macroeconomic, or political. Some of the headline grabbing developments include: DeepSeek (Hangzhou DeepSeek Artificial Intelligence Basic Technology Research Co., Ltd.) dethroning U.S. technology dominance in artificial intelligence (AI) and the consequent unraveling of the datacenter trade, the Department of Government Efficiency (DOGE) taking a chainsaw to government spending, President Donald Trump's furious flurry of executive actions, tariff uncertainty both in magnitude and timing, and the rewiring of geopolitical frameworks. On the other hand, the S&P 500 Index had another successful earnings season with sales momentum, margin expansion, and generally positive results that beat expectations. And so amid conflicting data points, it is critical to our decision-making that we remain objective in the face of uncertainty, separate the noise from the narrative, and keep focused on our North Star, namely:

i. Where we are in the economic cycle?
ii. What is the state of monetary policy?
iii. What are the expectations for outsized cash flow compounding from companies?

With these big picture views, we have remained balanced in our view with a focus on cyclicals and long-term secular themes. In fact, investor sentiment is currently reflected in our custom Bull-Bear ratio, which is at 0.3x, as seen in **Chart 1**. Historically, 1 year forward returns from these levels, if we are not heading into a recession, have been above average.

Chart 1: Investor Sentiment is at the Low-End of the 10-Year Range in the U.S.



Source: Bloomberg Finance L. P., TD Asset Management Inc., as of March 6, 2025.

Looking beyond U.S. equities though, there is something else brewing under the surface, and it has a distinct Global flavour. When looking at year-to-date ("YTD") returns across major markets, North America is flat and Japan is negative, but European markets, and Hong Kong, are all up double digits YTD. Consensus remains that President Donald Trump initiating trade wars, tariffs, and threatening reduced NATO involvement could be disastrous for European and Chinese economies. However, there is the possibility that U.S. isolationism may galvanize the European Union (EU) to take substantive positive policy changes, such as loosening of stringent regulations, joint sovereign bond issuance to fund stimulus, market friendly standards, and fiscal integration. As seen in Chart 2, Europe and China have handily beaten their U.S. counterparts in performance this year. In fact, parts of European equities have been outperforming for quite some time – European Banks, which are currently trading at high single digit price-to-earnings ("P/E") multiples, have outpaced the Magnificent 7 over the last three years!

Similarly, Chinese equities could move away from an investment led model to consumption, rebalancing the economy to a more sustainable growth trajectory. These possibilities could significantly improve the long-term equity outlook in those regions. We hold investments that can benefit from these structural changes, notably in the Chinese Technology, European Financials, Luxury, and Industrials sectors.

Chart 2: Returns and Valuations of Key Indices

Name	YTD Return	3 Year Return (Annual)	Forward P/E Full Year 2026
DAX Index	14.4%	18.6%	13.4x
CAC 40 Index	9.4%	12.2%	13.8x
FTSE 100 Index	5.1%	10.2%	11.4x
The Tokyo Stock Price Index ("TOPIX")	-4.1%	16.9%	13.3x
The Hang Seng Index	18.6%	9.2%	10.6x
MSCI EAFE Index	9.1%	10.0%	14.0x
S&P 500 Index	-4.5%	11.8%	18.6x
Nasdaq 100 Index	-7.5%	14.4%	21.2x
MSCI Europe Banks Index	21.5%	33.5%	8.4x
Bloomberg Magnificient 7 Total Return Index	-15.5%	26.4%	22.3x

Source: Bloomberg Finance L.P., TD Asset Management Inc., as of March 10, 2025.

DeepSeek Dislocation

Earlier this year, Chinese startup DeepSeek announced that they had developed an AI model (R1) that is able to replicate cutting edge AI workloads at a fraction of the cost. Our Technology analysts and Empirical Research Teams have reviewed the claims and while some questions remain on veracity, particularly with respect to model training, there is no question that advances with respect to full-stack optimization have reduced cost per query. Consequently, stocks that were *investor darlings*, because of their outsized long-term growth opportunity in building out AI infrastructure such as datacenters, were all significantly impacted by this announcement.

Chart 3: Datacenter *Darlings* Yet to Recover

Name	Sub Industry	DeepSeek Drawdown Jan 27, 2025	Returns Since Then Jan 27 – Feb 28
NVIDIA Corporation	Semiconductor Devices	-17.0%	-12.4%
Arista Networks, Inc.	Communications Equipment	-22.4%	-28.0%
Cadence Deisgn Systems, Inc.	Application Software	-9.6%	-21.87%
Eaton Corporation plc	Electical Power Equipment	-15.6%	-20.5%
Vertiv Holdings Co.,	Electical Power Equipment	-29.9%	-35.0%
Prysmian S.p.A.	Fabricated Metal & Hardware	-8.8%	-20.8%
Constellation Energy Corporation	Power Generation	-20.8%	-27.9%

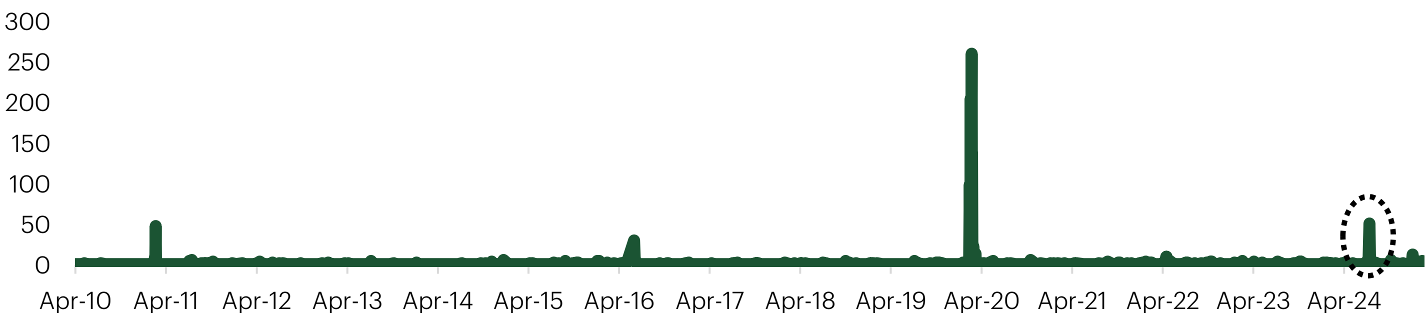
Source: Bloomberg Finance L.P., TD Asset Management Inc., as of February 28, 2025.

We were aware of the risks to these stocks, both on the upside and downside, given the potential for significant profits and free-cash-flow (FCF). We took a cautious approach by moderating our exposures, despite the immense growth opportunity. As a result, while our performance has been impacted, it has not been detrimental, thanks to our offsets and judicious position sizing.

Highlighting our discipline and research capabilities, we have not increased our exposure to any datacenter names, despite the recent pullback, as sentiments remain soft, and the market digests the AI investment cycle. Instead, we have been steadily reducing our datacenter exposure and reallocating into companies that are diversifying their underlying cash-flow drivers in their portfolios, such as high-quality Japanese retailers and European Pharmaceutical companies.

In terms of research, we have relied on our Empirical Research Team for guidance on prior market dislocations. The team analyzed stock performance following significant single drawdowns, and the results were less favourable than expected.

Chart 4: Number of Stocks Declining >15% in a single trading session



Source: FactSet Research Systems. As at April 30, 2024.

Chart 4 shows the number of stocks in developed markets that have corrected -15% in a single day. Outside of the early days of the COVID-19 pandemic, there are very few periods of significant dislocations in the last 15 years. On average, six months after the big drawdown event, these stocks tend not to outperform the benchmark. Effectively, this suggests that the odds are not in favour of buying a stock that has drawn down -15%, in the hope that it will subsequently outperform in the immediate aftermath of the drawdown event.

Based on our Fundamental and Empirical Research Teams, we believe we should not be chasing these stocks at the moment. It is hard to argue with this disciplined investment approach, and we remain on the sidelines, with an eye to potentially reduce exposure further.

Current Trends and Market Musings

1. Q4 Earnings Season Delivers Strong Results: Revenues and earnings continue to grow, margin expansion with inflationary pressures is moderating, and the only sectors with negative earnings growth over the fourth quarter of 2024 were Energy and Industrials. The saying "as goes earnings, so goes the market" holds true, as it is difficult to see a significant market correction for an extended period in a healthy earnings backdrop. While this could change, we have not seen any signs of that yet.

2. Risks are Balanced: The perpetual tariff risk, and their negative externalities, continue to sit heavily on investors' minds, but on the other side of the ledger, there are also accommodative central banks. The European Central Bank has over three 25 basis points (bps) rate cuts penciled in for 2025, taking the target rate to 2%, and the U.S. Federal Reserve (the Fed) is also projected to have three rate cuts and an expected overnight rate of 3.75% for the end of the year.

3. **Continued Breadth in this Bull Market:** A positive outcome from the DeepSeek dislocation is that it shone a light on areas of the market that have been ignored. We can think of Financials sector stocks that continue to rally, defensive sectors such as Pharmaceuticals that look to be bottoming, and if we avoid a consumer recession - our base case - and rates come off the boil, this can be a positive backdrop for capital goods.

Finally, a note about the Canadian equity market, which has faced many challenges recently. The S&P TSX Composite Index has remained resilient despite tariff threats, politics, and inflation continuing to dominate the news cycle. At TDAM, we remain confident in our disciplined approach, which has consistently guided us through shifting economic cycles, technological breakthroughs, and changing consumer behaviours. Our highly experienced teams are motivated and fully committed to identifying high-impact investment opportunities amid growing economic uncertainty.

Remain nimble to seize opportunities. Have balance in portfolio exposures. Keep calm and compound on.

Damian Fernandes, Jose Alancherry, and Team

For further information, please contact your TDAM Representative.