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BMO Global Asset Management 2025 Market Outlook

Presented by Sadiq S. Adatia, Chief Investment Officer, BMO GAM

BMO | Global Asset Management

2025: A year of volatility—and opportunity?

We remain bullish on Equity markets for the coming year despite a likely uptick in volatility under the Trump administration.

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As we enter 2025, rising unemployment and sticky inflation have left many investors concerned about the state of the economy. Adding to that uncertainty is the election of incoming U.S. president Donald Trump, whose policies are likely to include new tariffs that could heighten global trade tensions. Based on these factors, we are expecting to see rising volatility in 2025 across Equity, bond, currency, and commodity markets.

One potential source of volatility is inflation, which has arguably been the biggest economic story of the past several years. By the end of 2024, annual inflation rates had settled around the 2-3% range in both the U.S. and Canada—a sign that the interest rate hikes implemented by the U.S. Federal Reserve (Fed) and Bank of Canada (BoC) had done their job. However, we think inflation could remain sticky or even rebound modestly in 2025 based on Trump's trade polices. New tariffs are a virtual certainty—the question is how big they will be and how quickly they'll come into effect. If, for instance, a 10% tariff on Canadian goods is introduced, it could take as long as six months before Canadian consumers start to feel the impact. Oil prices and the housing market will also play a role in inflation's trajectory over the coming year. All together, our expectation is that while inflation could increase, it likely won't be as significant a headwind in 2025 as it has been in recent years.

The inflation picture is also likely to influence the Fed's thinking on interest rate cuts. For much of 2024, the Fed had taken a cautious approach, not wanting to cut rates too fast and perhaps provoke a spike in inflation. After they did finally make a big move—September's supersized 50-basis-point (bps) decrease—the economic data came in strong, meaning a 50-bps cut may not have been necessary. As we enter 2025, we expect the Fed to take a wait-and-see approach, adjusting the timing and magnitude of rate decreases based on the state of the economy and whether inflation picks up. It is important for investors to understand that, for now, the U.S. economy and consumer remain fairly resilient, so there's no need for the Fed to be aggressive. While we expect two-to-three rate cuts from the Fed in 2025 (compared to three-to-four likely cuts from the BoC) and believe the risk is on the side of fewer cuts, we think markets are currently expecting about one rate cut too few. That said, rates being lowered should provide some relief to consumers on both sides of the border—the only questions is whether expectations will match up with reality.

The unpredictability of Donald Trump adds another layer of complexity for the next 12 months and beyond. In addition to tariffs, some of the areas he's said he will focus on include immigration, government efficiency, tax cuts, and deregulation. For markets, the prospect of lower taxes and less red tape is a bullish sign, but the challenge is that the details of some of Trump's plans remain unclear. For instance, he's stated a desire to lower health care costs, but it's unclear how he could accomplish that without government subsidies or lower profit margins for health care companies. Similarly, it's unclear what form billionaire Elon Musk's proposed Department of Government Efficiency (DOGE) will take—whenever Musk is involved, things happen, but it remains to be seen whether his approach will include slashing important services, departments, and jobs like he did when he took control of X (formerly Twitter). On tariffs, the only sure thing is that countries perceived by Trump not to be in America's camp will get hit harder. This is where Canada could win on a relative basis, as we're unlikely to face the same magnitude of tariffs as places like China or Mexico. Tariffs could also help revive U.S. manufacturing and generate some revenue, but that remains to be seen.

INTRODUCTION

Given these uncertainties, we believe that the ability to think tactically and pivot nimbly based on ever-evolving market conditions will be key for the coming year. BMO GAM's Multi-Asset Solutions Team (MAST) continually analyzes economic and market expectations, identifying and implementing opportunities that are incorporated into our monthly House View. We expect this approach to serve us well in 2025, as it will enable us to respond quickly as Trump's policies are rolled out and downstream impacts begin to be understood. For instance, if significant new tariffs are implemented on Chinese goods, we could opt to utilize options against physical positions to create an asymmetric payoff structure, allowing us to minimize our downside while maintaining exposure to capture potential upside. It's these kinds of tools that enable the MAST team to ensure the desired risk-return trade-offs in our portfolios.

Overall, though we're not expecting 2024-type returns, we're still bullish on Equity markets in 2025—we believe they will be higher at the end of year than they are at the beginning, while outperforming cash and bonds. An uptick in volatility is likely, but we don't think waiting out the storm on the sidelines is the right answer, especially given tailwinds in the form of lower interest rates and a strong U.S. economy. Instead, we would advise investors to be patient. In this environment, growth won't necessarily come in a straight line. But as any successful investor will tell you: volatility can create opportunity.

BMO GAM's 5 key investment themes for 2025:

1. **We remain bullish on Equities…**
2. **…with a tilt toward the U.S.**
3. **Rotation throughout the year will be important**
4. **It may be small and mid caps' time to shine**
5. **Hedges may be important and gold can still have a place in portfolios**

Theme #1: Equities

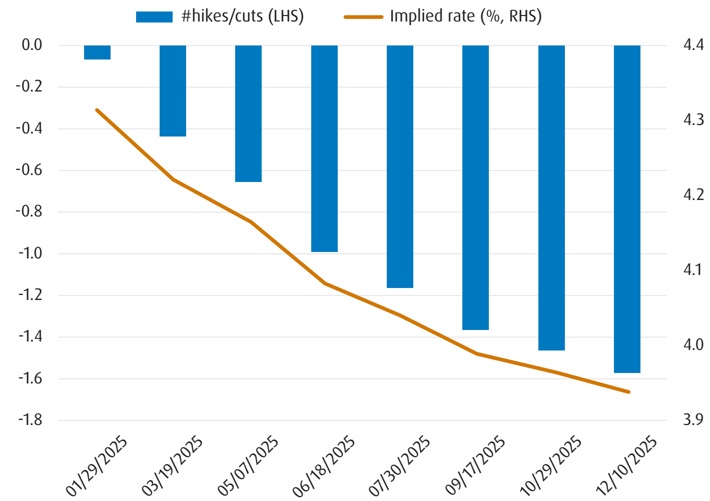
Despite strong performance over the past two years, we remain bullish on Equities for 2025, preferring them to Fixed Income and cash.

In 2024, Equity markets in the U.S., Canada, Europe, Australasia and the Far East (EAFE), and Emerging Markets (EM) all posted double-digit positive returns, with the U.S. leading the way at 33.5%.[1] Given strong underlying fundamentals (driven by the U.S.) and lower interest rates, we think markets can move even higher in 2025.

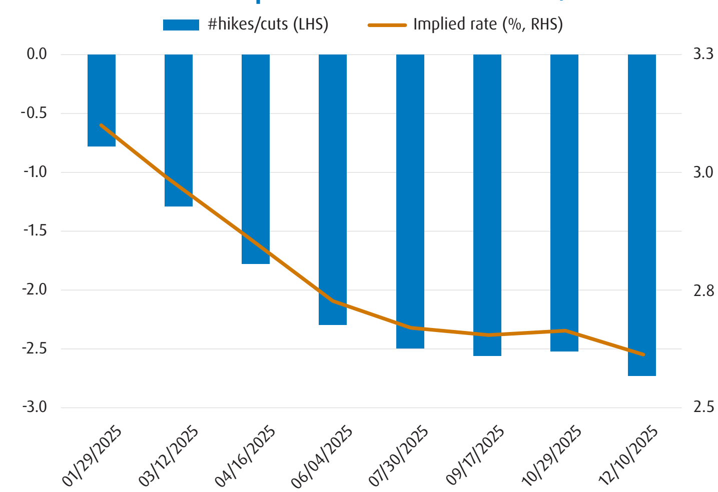
Within equities, we prefer to be overweight U.S. markets. Beyond that, it becomes a question of which geographies are likely to be hit harder by Trump's likely tariffs—and which might escape the worst of the pain. This is where Canada could receive a lift. In November, we upgraded our view on Canada to neutral; while the Canadian economy isn't necessarily strong—unemployment is rising, consumer debt levels remain quite high, and mortgage renewals will impact the strength of the consumer—it should benefit from both a strong U.S. economy (given our standing as one of America's largest trading partners) and a continuation of lower interest rates. We think Trump's proposed 25% tariff on Canadian goods is unlikely, but we do think some kind of tariff is likely, perhaps in the 10% range. China, Europe, and even Mexico can all expect to be hit harder, though given some of the lofty numbers Trump has proposed—a 60% tariff on China, for instance—his bark may not be as big as his bite.

We view cash as the least attractive asset class for the new year—the days of a virtually free 5% return on Guarantees Investment Certificates (GICs) are over. While we don't necessary expect bonds to have a stellar year, we do think they will outperform cash. Ultimately, it comes down to interest rates: if we see more than markets are currently pricing in, bonds could outperform. Given the differing interest rate outlooks in the U.S. and Canada, with more rate cuts expected north of the border, we prefer Canadian Fixed Income to U.S. Fixed Income. With the BoC, the risk is *more* cuts, while for the Fed, it's fewer. Ultimately, we prefer Equities over both bonds and cash.

2025 U.S. implied rate & number of hikes/cuts



2025 Canada implied rate & number of hikes/cuts



Source: BMO Global Asset Management, Bloomberg, as of January 6, 2025.

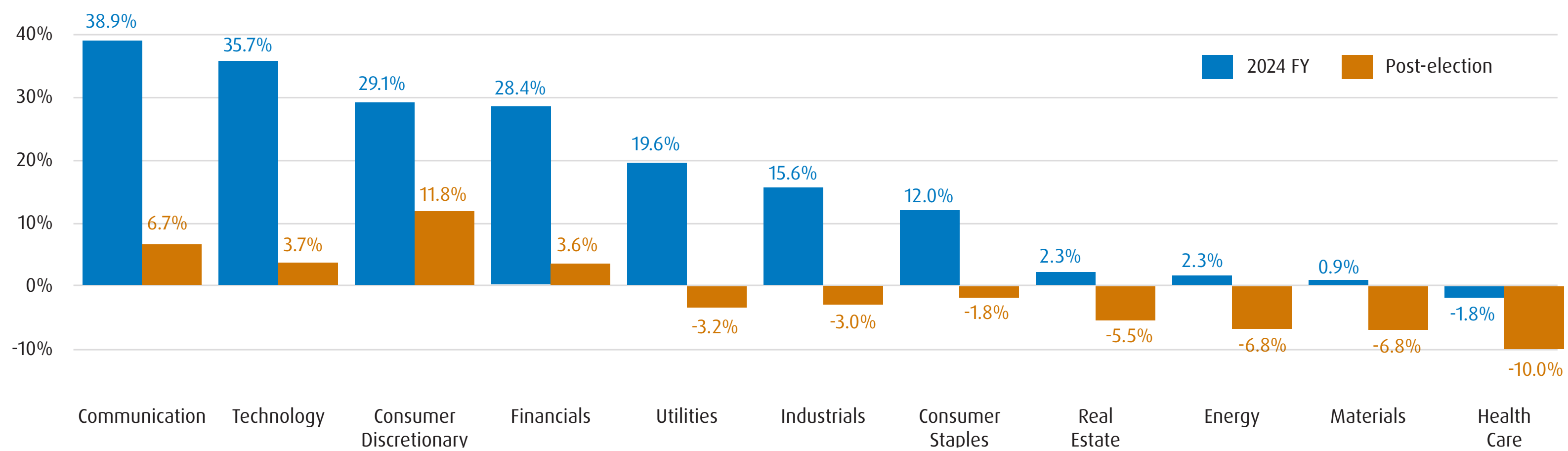
Theme #2: U.S. strength

We think a tilt towards U.S. Equities makes sense in 2025.

Why are we overweight U.S. Equities for 2025? To start: the U.S. economy is the best in the world as we enter the new year. This is not to say that other areas should be expected to struggle, even if certain countries, like China, are in Trump's crosshairs. But over the course of 2024, we've witnessed the resilience of the American consumer, and that has provided support for corporate earnings. Additionally, key investment themes like artificial intelligence (A.I.), cloud computing, and automation are predominantly associated with U.S. companies, and are therefore well-represented in U.S. markets. The simple fact is this: most of the biggest and best companies in the world are American, and generally speaking, we expect them to continue to return good results in 2025.

Trump's victory and America-first policies could also be bullish for the U.S. economy, at least in the near term. For now, given the U.S.' economic might, Trump has the benefit of operating from a position of strength, so it would not be surprising to see some deals work out in America's favour. If some manufacturing does return to U.S. shores and trade patterns reroute to America's benefit, that would be a longer-term boon. But there are also longer-term risks, including potential retaliatory tariffs, mass deportations, and greater political (and geopolitical) uncertainty. While investors should closely monitor these developments, we think any negative economic impacts likely won't arrive at least until the latter part of 2025 or into 2026.

U.S. sectors performance (2024 year-to-date and post-election)



Source: BMO Global Asset Management, Bloomberg, as of December 31, 2024.

Theme #3: Rotation

As markets broaden out and volatility potentially rises, we expect the ability to quickly pivot to be key in 2025.

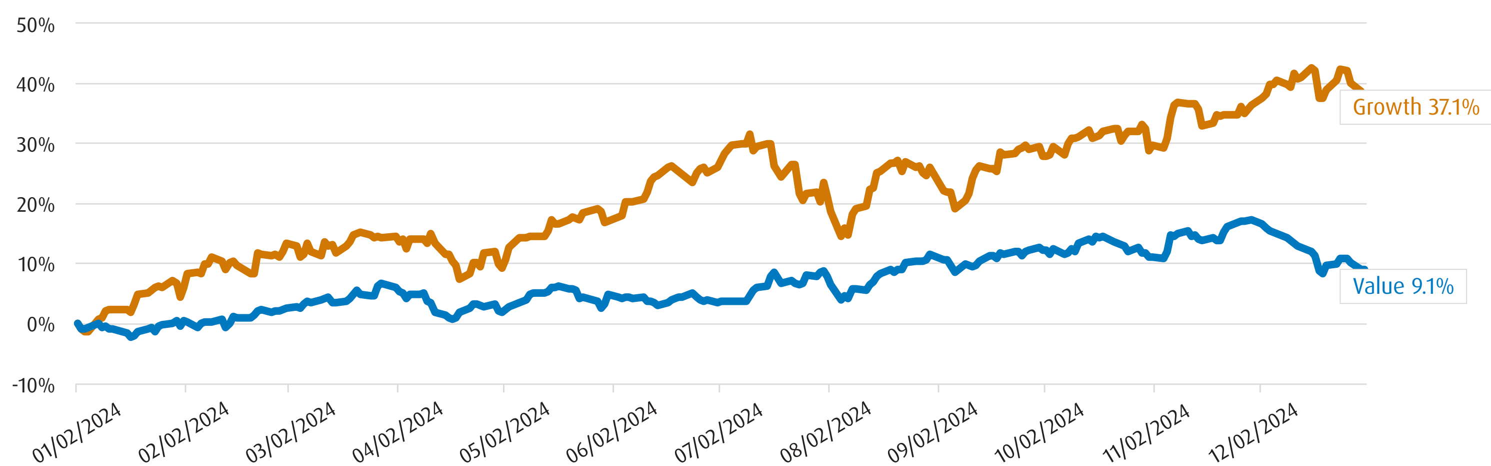
First, it's worth noting that if you are sitting in cash and GICs, you have missed out on two years of better performance in Canadian bonds or conservative portfolios. As rates continue to head lower, the rates of return from GICs and money market instruments are also likely to decline. As such, we think it is time to dip your toes back into the Equity markets, particularly on dips.

Second, the Magnificent 7—Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla—had a historically great run in 2024, and we expect some of them to continue to be dominant players in 2025 and beyond. But we also think there will be opportunities for other stocks to play catch-up.

When we talk about a potential rotation to market segments outside the Magnificent 7 in the coming year, it doesn't mean we advise exiting Growth and going all-in on Value. Rather, we prefer a continuing exposure to selective areas of Growth, including some Mag 7 names, in addition to tilts toward certain sectors and segments that could benefit from the new regime of lower taxes and less regulation. In particular, we prefer both Value and small and mid caps. But this year especially, we don't think it's wise to put all your eggs in one basket—diversification will be key, as will the ability to quickly pivot in response to potentially volatile markets.

Third, at the sector level, we're quite bullish on Financials across nearly all regions. Deregulation in the U.S. should provide some lift, as should a relatively strong American consumer, especially given the likelihood of more rate cuts. Banks also generally offer healthy yields, which could be attractive to investors as interest rates—and, by extension, GIC and bond yields—come down. Beyond Financials, we're also looking at Consumer Discretionary, which is likely to benefit from rate cuts and their expected positive impact on consumer confidence, and even smaller-cap names in Technology. Overall, we want to own companies that have strong fundamentals and great balance sheets, but that perhaps have been held back by headwinds that are now diminishing.

2024 U.S. growth vs. value



Source: BMO Global Asset Management, Bloomberg, as of December 31, 2024. Past performance is not indicative of future results.

Theme #4: Small & mid caps

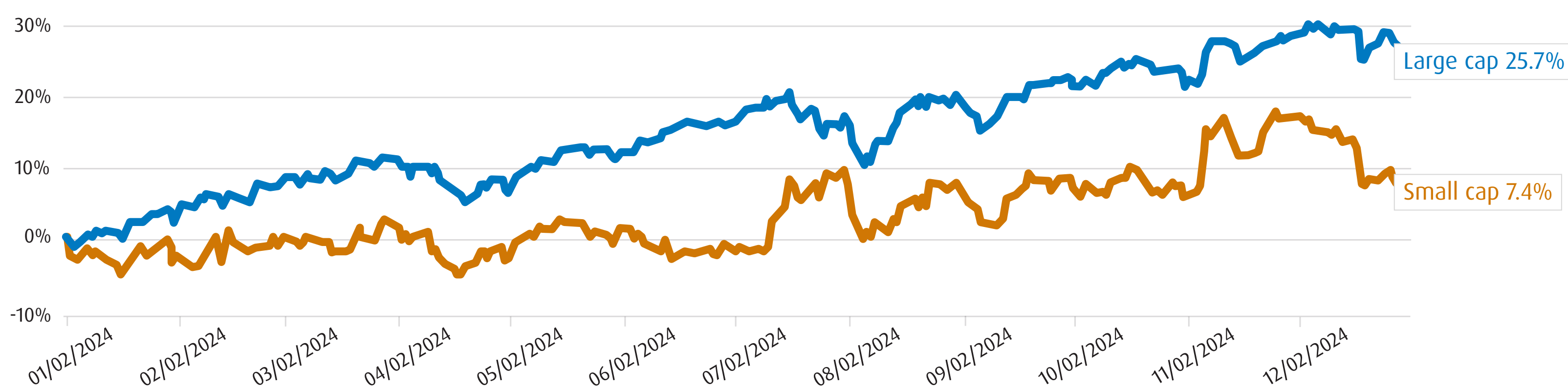
After a year dominated by megacap companies, we believe 2025 may be small and mid caps' time to shine.

With tax cuts and deregulation likely on the horizon, we think the environment is ripe for small- and mid-cap companies to catch up to some of the market leaders.

It boils down to pure fundamentals. Over the past couple of years, small- and mid-cap valuations have been depressed as a result of slower economic growth and higher interest rates; smaller-cap companies' costs are higher on a proportional basis than large-cap companies, meaning that they are more sensitive to interest rates increases. Upward pressure on wages has also impacted their bottom line. But now, it's a different world: interest rates are coming down, inflation is much tamer (at least for now), and wage costs are decreasing. All of those dynamics, as well as Trump's tax cuts and deregulation agenda, are likely to be beneficial to small- and mid-cap names—in fact, we've already seen a bit of a bump in these segments in the wake of the election.

Within small and mid caps, we do have something of a Quality bias. In particular, we're looking for firms that are aligned with some of the market's leading themes, including A.I. These types of companies have all of the recovery potential of other small- and mid-cap names, but with the added potential of becoming takeover candidates if and when the Magnificent 7 and other mega- and large-cap names look to expand. Think of it as something of a venture play in public markets.

2024 U.S. large vs. small cap



Source: BMO Global Asset Management, Bloomberg, as of December 31, 2024. Past performance is not indicative of future results.

Theme #5: Gold & hedges

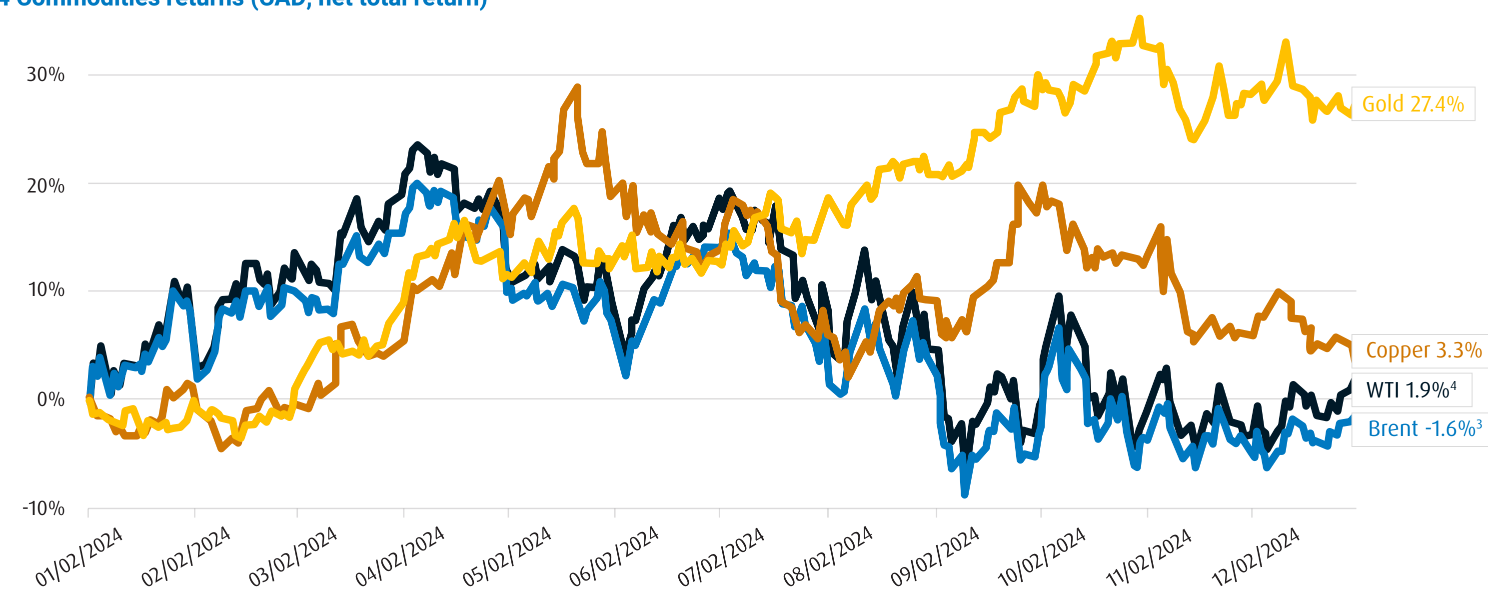
Given the numerous uncertainties facing investors in 2025, we think there's still a place for gold and other hedges in portfolios.

We are bullish on Equity markets in 2025. But given the unpredictable nature of Trump and his incoming administration, we believe there's still a role for gold to play in portfolios as a way to mitigate potential volatility.

It's always important for investors to keep on eye on what could go wrong—to plan for the less desirable scenarios, even if they are unlikely. With Trump, we know some of his policy priorities, but don't know exactly what the risks might be. That's where gold comes in, and fortunately for investors, it's now available at a more attractive price due to the pullback we saw immediately after the election.

It may surprise some investors to know that over the past few years, gold has served as better hedge in portfolios that Fixed Income. We expect it to continue to perform well in that role over the next 12 months. To be clear, we don't primarily view gold as a source of profit unto itself; if gold wins, that prob-ably means volatility has picked up, which would likely be bad news for Equities. Rather, it is gold's lower correlation[2] with Equity markets that is its primary benefit. Gold also benefits from those looking for an alternative to the U.S. dollar. In addition to gold, investors may also consider low-volatility solutions and options as a way to add some protection to portfolios. Fixed Income can also be considered a hedge—if the economy unexpectedly worsens, that could prompt more rate cuts than are currently expected, which would be good news for the bond market.

2024 Commodities returns (CAD, net total return)



Source: BMO Global Asset Management, Bloomberg, as of December 31, 2024. Past performance is not indicative of future results.

BMO Global Asset Management's "Five Lenses" summary for January 2025

These are our "Five Lenses" tactical scores for January 2025—not necessarily for 2025 as a whole. We update our scores each month, so please refer to the *BMO GAM Monthly House View Report* throughout the year for a detailed breakdown of our current positioning.

Lens 1		Lens 2		Lens 3		Lens 4		Lens 5	
Asset mix		**Asset class – Equity**		**Asset class – Fixed Income**		**Style/factor**		**Implementation**	
Tactical score		**Tactical score**		**Tactical score**		**Tactical score**		**Tactical score**	
Equities	+2	Canada	0	IG Credit	0	Value	0	Canadian dollar	0
Fixed Income	0	U.S.A	+2	High Yield	0	Size	-1	Gold	+1
Cash	-2	EAFE	-1	EM Debt	0	Yield	0		
		EM	-1	Duration[5] (Canada)	+1	Quality	+1		

-3	-2	-1	0	+1	+2	+3
Very bearish	**Bearish**	**Slightly bearish**	**Neutral**	**Slightly bullish**	**Bullish**	**Very bullish**
<-5.0%	-5.0 to -2.5%	-2.5 to -1.0%	-1.0 to +1.0%	+1.0 to +2.5%	+2.5 to +5.0%	>+5.0%

Source: BMO Global Asset Management, December 31, 2024.

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BMO GAM's Multi-Asset Solutions

While we remain tactically bullish, strong trailing performance coupled with high equity valuation should motivate longer-term investors to seize this window of opportunity to increase their diversification by utilizing multi-asset strategies like those managed by the BMO GAM Multi-Asset Solutions Team (MAST).

Fund	Theme #1: Equities	Theme #2: U.S. strength	Theme #3: Rotation	Theme #4: Small & mid caps	Theme #5: Gold & hedges	Advisor Series	Series F	ETF Series
BMO Conservative ETF Portfolio	✓	✓	✓	✓	✓	BMO99702	BMO95702	-
BMO Balanced ETF Portfolio	✓	✓	✓	✓	✓	BMO99703	BMO95703	-
BMO Growth ETF Portfolio	✓	✓	✓	✓	✓	BMO99704	BMO95704	-
BMO Equity Growth ETF Portfolio	✓	✓	✓	✓	✓	BMO99705	BMO95705	-
BMO Managed Conservative Portfolio	✓	✓	✓	✓	✓	BMO99332	BMO95332	-
BMO Managed Balanced Portfolio	✓	✓	✓	✓	✓	BMO99476	BMO95746	-
BMO Managed Growth Portfolio	✓	✓	✓	✓	✓	BMO99477	BMO95747	-
BMO Managed Equity Growth Portfolio	✓	✓	✓	✓	✓	BMO99478	BMO95748	-
BMO Global Income & Growth Fund	✓	✓	✓	✓	✓	BMO99165	BMO95165	-
BMO Canadian Income & Growth Fund	✓	✓	✓	✓	✓	BMO99163	BMO95163	-
BMO Monthly Income Fund	✓	✓	✓	✓	✓	-	BMO95148	-
BMO Asset Allocation Fund	✓	✓	✓	✓	✓	BMO99145	BMO95145	-

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Standalone Funds

Fund	Theme #1: Equities	Theme #2: U.S. strength	Theme #3: Rotation	Theme #4: Small & mid caps	Theme #5: Gold & hedges	Advisor Series	Series F	ETF Series
BMO Global Equity Fund	✓	✓	✓	-	✓	BMO99743	BMO95743	BGEQ CN
BMO Global Innovators Fund	✓	✓	✓	✓	✓	BMO99164	BMO95164	BGIN CN
BMO Global Dividend Opportunities Fund	✓	✓	✓	-	✓	BMO99334	BMO95334	BGDV CN
BMO Global Infrastructure Fund	✓	✓	✓	-	✓	BMO99150	BMO95150	BGIF CN
BMO Dividend Fund	✓	✓	✓	-	✓	BMO99146	BMO95146	-
BMO Canadian Small Cap Equity Fund	✓	-	✓	✓	-	BMO99136	BMO99136	-
BMO Core Plus Bond Fund	-	-	✓	-	✓	BMO99159	BMO95159	ZCPB CN
BMO Gold Bullion ETF	-	-	-	-	✓	-	-	ZGLD CN

DISCLAIMERS

[1] BMO Global Asset Management, Bloomberg.

[2] Correlation: A statistical measure of how two securities move in relation to one another. Positive correlation indicates similar movements, up or down together, while negative correlation indicates opposite movements (when one rises, the other falls).

[3] Brent Crude is often considered the global benchmark for oil because roughly two-thirds of the world's oil is priced off Brent Crude futures.

[4] WTI Crude Oil, also known as light sweet crude, is considered the U.S. benchmark for pricing oil.

[5] Duration is a measure of a bond's sensitivity to changes in interest rates. It is expressed in years and helps investors understand how much the price of a bond is likely to change when interest rates move. Essentially, duration estimates the percentage change in a bond's price for a 1% change in interest rates.

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