Starlight Capital Diversified Equities 2025 Outlook

January 2025

Starlight™ CAPITAL Focused Investing

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Diversified Equities

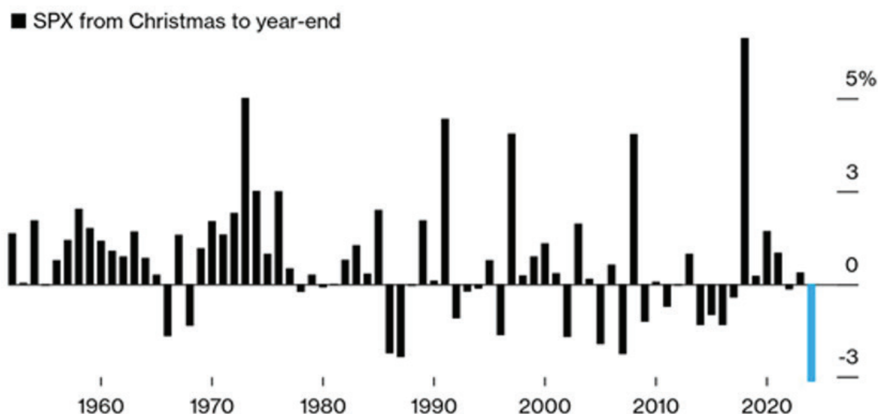
2024 Review

2024 was undeniably eventful, marked by dramatic headlines and significant market developments. The equity markets faced a series of challenges and uncertainties but ultimately delivered impressive performance, making it one of the best back-to-back years in a quarter-century.

Uncertainty regarding the timing and extent of rate cuts dominated much of the narrative. In January, six rate cuts were anticipated in the U.S. for the year. However, by May, expectations had dwindled to fewer than two cuts, triggering a market pullback. By year-end, the Federal Reserve implemented a total of four rate cuts, including a final 25 basis point cut in December that was perceived as hawkish, contributing to the worst year-end (Christmas to Dec.31) decline for the S&P 500 since 1952.

S&P 500 Saw Worst Year-End Fall Since 1952

Index declined over 1% only 12 times during this period



Source: Bespoke Investment Group.

Economic challenges persisted in Canada, with uncertainties around tariffs, trade policies, and diverging monetary policies between the Bank of Canada (BoC) and the Federal Reserve (Fed) weighing on the Canadian dollar and valuations. The BoC began cutting rates in June as inflation comfortably trended toward the 2% target, even dipping to 1.6% by September. To counter a weakening job market, the BoC implemented seven rate cuts throughout the year, including two supersized 50-bps reductions late in the year, bringing the policy rate down from 5% to 3.25%. Although the market initially anticipated three rate cuts by the Bank of Canada for 2025, hawkish signals from the Governor Tiff Macklem and Chairman Jerome Powell tempered these expectations. Following the last BoC and Fed meetings, market sentiment shifted, reducing expectations for rate cuts in Canada to less than two.

Unemployment rose sharply by nearly one percentage point, ending the year at 6.7%, well above pre-pandemic levels.

The late 2024 resignation of Canada's Finance Minister created political turmoil, eroding public and party confidence in the government. This wave of instability ultimately culminated in the resignation of the Prime Minister, marking a significant shift in the nation's leadership.

Geopolitical and economic shocks added to the volatility in 2024. The Bank of Japan's surprise interest rate hike triggered the unwinding of the Japanese "Yen carry trade" (where investors borrow Yen at low rates to invest in higher-yielding assets elsewhere), forcing investors to sell off assets and sparking a sharp correction, particularly in large-cap Technology stocks. This sell-off, however, proved to be short-lived as the market quickly recovered,

with sectors like Energy and Financials gaining momentum while Technology lagged in Q3. The year was further marked by a historic assassination attempt on Donald Trump, who went on to win the U.S. presidential election. This “Trump bump” injected optimism into the markets late in the year, fueling a market rally.

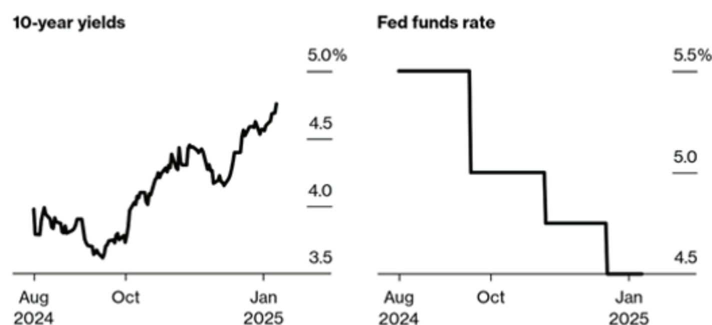
Despite these challenges, recession fears waned, unemployment remained resilient, and inflation continued to cool. The U.S. equity market climbed the wall of worry, delivering a total return of approximately 25% for the S&P 500.

In late 2024, Canadian equities experienced a significant rally, with the TSX reaching record highs and achieving a return of approximately 22%, narrowly trailing the S&P 500. The rebound was largely driven by the rate-easing cycle, with the TSX benefiting from strong performance in resource sectors such as Materials and Energy, while Information Technology emerged as the best-performing sector.

The U.S. 10-year yield, which had been trending lower earlier in the year, started to rise after the Fed’s first rate cut, complicating the outlook for inflation and valuation levels.

Fed Conundrum

Ten-year yields rise more than 100 basis points even as Fed cuts



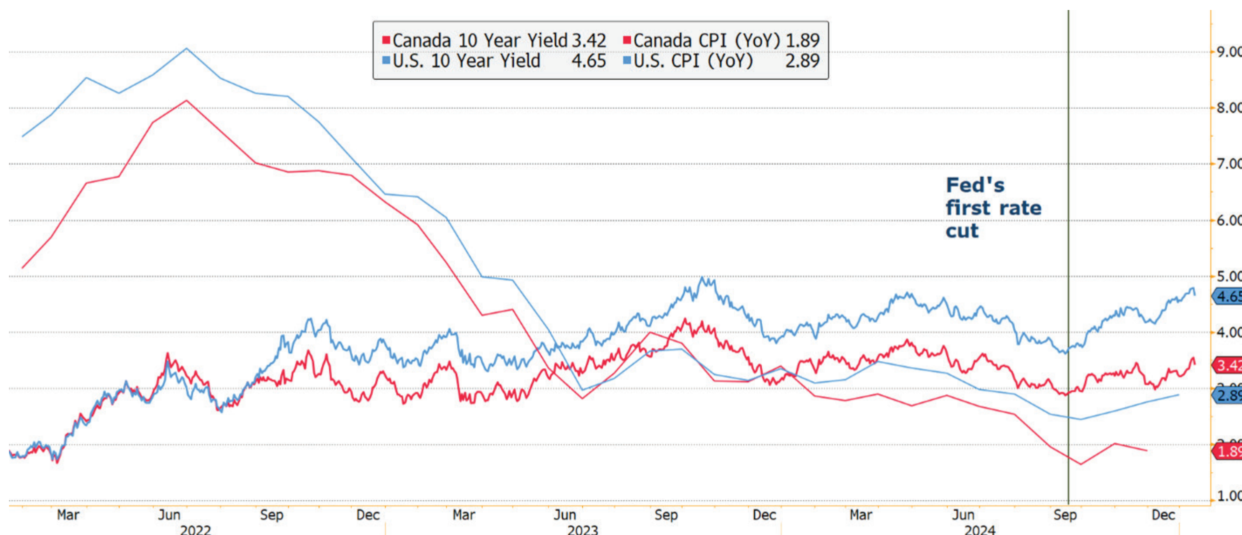
Source: Bloomberg Finance L.P.

2025 Outlook

As we look ahead to 2025, uncertainty remains a prevailing theme, driven by political and economic factors. The implications of these uncertainties are likely to be more pronounced for Canada compared to the U.S., and in the first half more so than the second half.

President Donald Trump is expected to implement significant policy changes, including tax cuts and deregulation. While these measures aim to boost economic growth, they also bring risks such as tariffs, immigration reforms, and potential market volatility, with Canadian businesses potentially bearing more pronounced impacts. The U.S. is Canada’s largest trading partner, representing roughly two-thirds of Canada’s annual of global trade. Tariffs in the range of 10%-25%, as speculated, could have detrimental impacts on the economy (namely Energy, Autos, Financials), unemployment, and the Canadian dollar.

Inflation also remains a persistent concern, presenting challenges to broader market participation. Following the Federal Reserve’s 50-basis-point rate cut on September 18, 2024, the 10-year yield moved higher and has remained elevated, potentially weighing on rate-sensitive sectors and small-cap stocks.



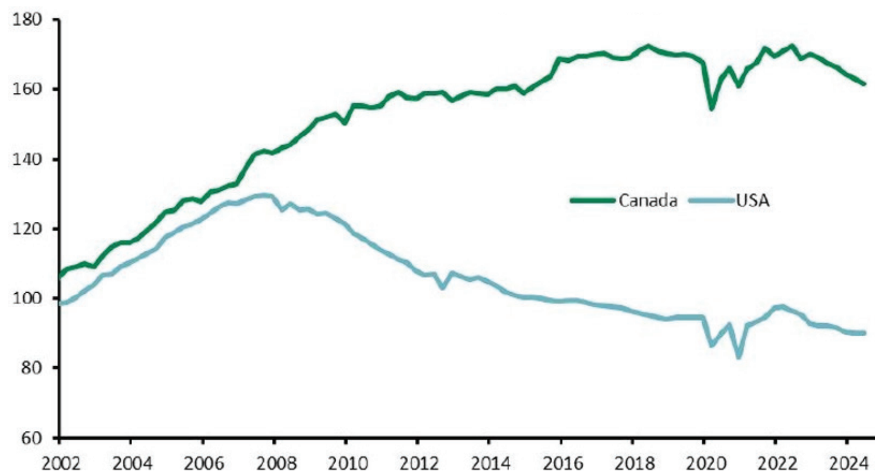
Source: Starlight Capital & Bloomberg Finance L.P.

January's U.S. job's report was the latest sign that the U.S. labour market has recovered from its midyear stumble and that the economy remains strong. The gain in nonfarm payrolls was the largest since March (2024) and well above expectations. Consequently, expectations for a rate cut in the summer have shifted closer to the end of the year, with some even anticipating no cuts at all.

In Canada, unemployment has been gradually increasing, reflecting deeper economic pressures, including the impact of mortgage renewals within the "great renewal" cycle currently underway in the real estate market. The latest jobs number also showed job growth well above expectations, however we believe this could be a temporary bump as risks to the economy remain elevated ahead of tariff announcements. Canadians are also carrying higher levels of household debt relative to disposable income compared to their American counterparts, leaving them more vulnerable to potential economic shocks.

US household balance sheets are in better shape

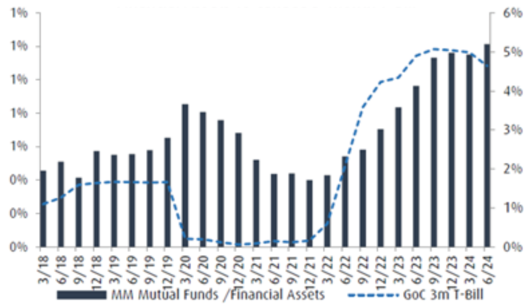
Ratio of Household debt to disposable income (%)



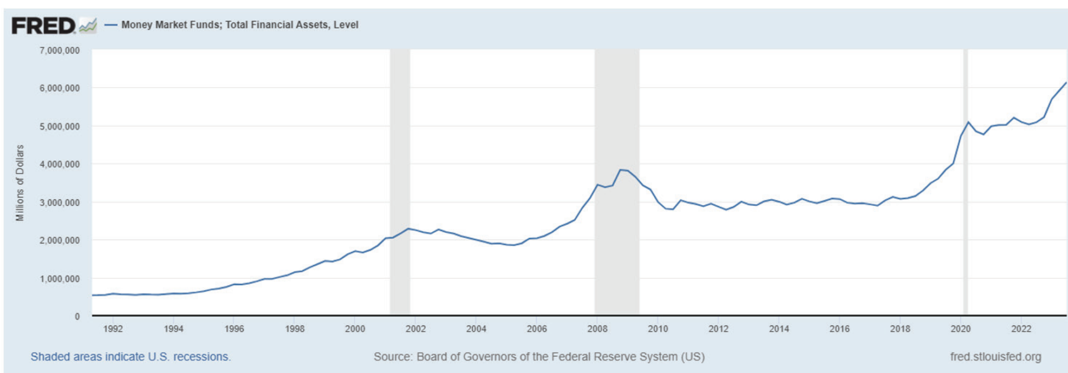
Source: Haver & Desjardins Capital Markets.

Market liquidity is improving as fund flows increase, yet a significant amount of idle cash remains on the sidelines in both geographies.

Domestic Cash Investments Are Elevated
CDN Money Market Funds: as Percentage of Household Financial Assets vs Canada 3-month T-Bill



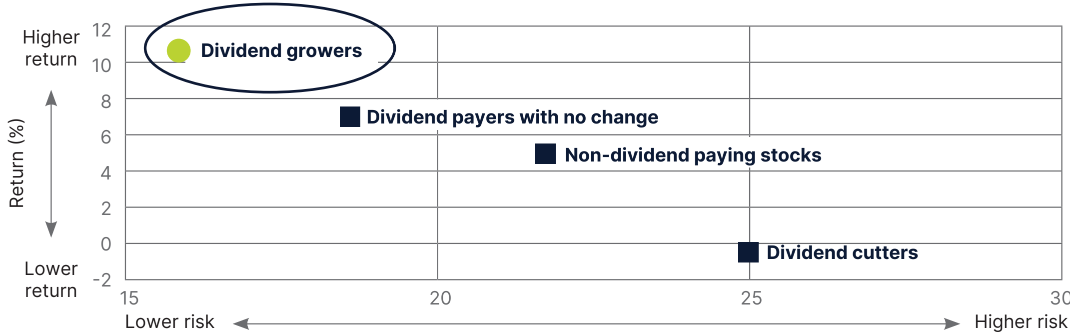
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.



Source: Board of Govenors of the Fed System (US).

This trend suggests that investors who previously sought safety and yield could begin re-entering the market if short term rates are able to normalize lower throughout the year. We recommend dividend growth mandates, as they provide superior risk-adjusted returns over time compared to high-yield alternatives.

Dividend Growth Stocks have Outperformed with Less Risk
Risk vs return, annualized , 1973 - 2022



Source: Ned Davis Research, Inc. and Refinitiv, 31 Jan 1973 – 31 Dec 2022. Past performance is no guarantee of future results. Performance represents the historical risk/return performance of S&P 500 stocks grouped by dividend policies.

Regionally, the U.S. economy is positioned more favorably than Canada. This is due to ongoing risks such as tariffs, elevated housing vulnerabilities, elevated household debt, and rising unemployment. Declining immigration levels could also have an outsized impact on mature businesses in Canada, where they have historically been the driver of incremental growth. However, Canada's rate-sensitive economy, characterized by shorter mortgage terms, is beginning to show early signs of recovery in the housing sector as interest rates decrease. Furthermore, the upcoming Canadian election could lead to the establishment of a cost-conscious, pro-growth government, potentially bolstering economic momentum.

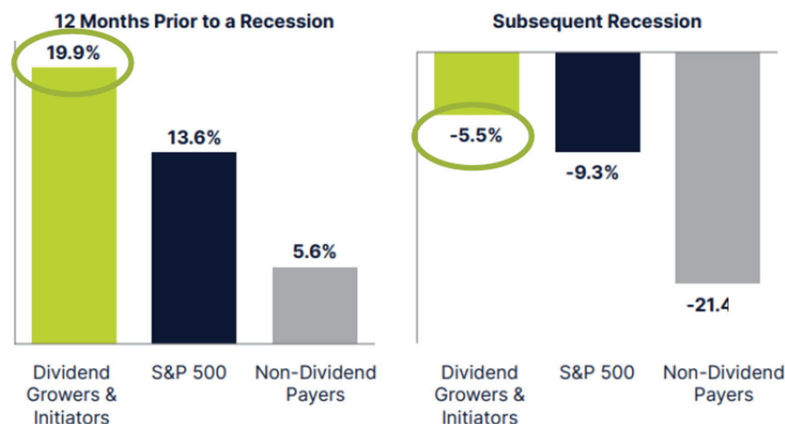
Market conditions appear favorable for continued broadening throughout the year, supported by Trump's business-friendly policy agenda, which prioritizes deregulation in Banking, Energy, and Healthcare, along with tax cuts, although the potential for volatility is elevated. Investors should remain balanced with respect to risk and maintain well-diversified portfolios to weather any volatility that may arise, particularly in the first quarter of the year during Trump's inauguration. Prioritizing companies with strong balance sheets, attractive valuations, and secular growth trends that support earnings growth is expected to yield positive results for the year.

Artificial Intelligence (AI) continues to be a driving force for the Tech sector as well as the U.S. economy. The "Magnificent Seven" technology leaders are projected to invest over $500 billion in capital expenditures and research and development over the next year. This figure excludes adjacent spending categories, such as semiconductor designers and manufacturers, datacenters, utilities, and emerging service providers in sectors like financials and retail. When accounting for system-wide AI spending—including technology hardware, software, and industrial research and development expenses—total expenditures could exceed $1 trillion. This rapid growth, underscores the transformative potential of AI but raises concerns about capital misallocation and overoptimistic growth expectations. By late 2025, investors may increasingly focus on monetization and the practical returns from these substantial investments.

Healthcare remains a promising sector with strong secular growth driven by an aging global population. This demographic shift, often referred to as the "Silver Tsunami," is creating a wave of demand for healthcare products and services as the population ages. By 2030, all baby boomers will be over the age of 65, pushing the U.S. senior population past 70 million, up from the current 62 million, which represents 18% of the population. By 2054, this group is expected to grow to 84 million, accounting for nearly 25% of the population, according to the U.S. Census Bureau. The healthcare industry is characterized by numerous oligopolies with strong competitive moats. These companies are experiencing increased demand, leading to robust cash flows and consistent dividend growth.

Resilience in investment strategies will be critical to providing downside protection during volatile periods. Our active management approach will allow us to capitalize on market dislocations and take advantage of emerging opportunities. Whether the market experiences further broadening or a return to concentration, our fund is well-positioned to deliver strong performance in any environment.

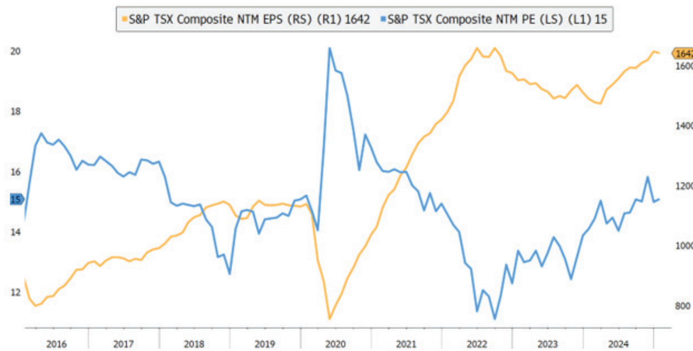
Dividend Growers Prior and During Recessions
Average Cumulative Return Over the Last 5 Recessions (January 1, 1979 - December 31, 2018)



Source: National Bureau of Economic Research and Ned Davis Research, Inc., 1/1/79-12/31/18, based on the five most recent recessions. Past performance is no guarantee of future results. The average total return performance of each group and the S&P 500 are based on equal-weighted geometric average, computed monthly.

While another 20% return year is unlikely given elevated valuations, we expect positive returns in 2025, driven by earnings growth and strategic positioning. Our approach remains focused on delivering superior outcomes while adapting to the evolving market landscape.

P/E and EPS Growth – TSX



Source: Starlight Capital & Bloomberg Finance L.P.

P/E and EPS Growth – S&P500

Valuation Trades ~22x As Consensus EPS Pushes Higher

Source: FactSet, Morgan Stanley Research as of Dec. 31, 2024.

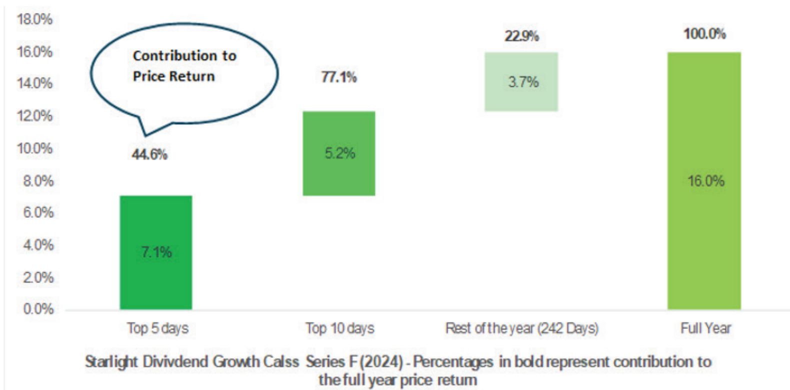
Conclusion

The year 2025 presents a complex yet promising investment landscape. By maintaining a disciplined, diversified approach and emphasizing high-quality businesses, we are confident in our ability to navigate the uncertainties ahead. Dividend growth stocks, in particular, stand out as reliable, all-weather investments that can deliver attractive returns in both stable and volatile conditions.

Staying invested is crucial for achieving long-term financial goals. Historical evidence consistently shows that “time in the market beats timing the market,” as trying to predict market movements often leads to missed opportunities. A disciplined, long-term approach enables investors to benefit from the compounding growth of their investments and income over time. In 2024, the top 10 highest return trading days contributed to over 75% of the fund’s full year total return and the top 5 contributed to almost 50%. Therefore, missing a few important trading days would’ve been detrimental to investment outcomes.

TIME IN the market beats TIMING the market

Price Return (%)



We look forward to partnering with you in 2025 to achieve your financial goals.

Starlight Capital's strategy for diversified equities centers around four core areas of emphasis:

1. Emphasizing high-quality growth at a reasonable price for growth portfolios.
2. Concentrating on high-quality dividend growth stocks for equity income portoflios.
3. Maintaining a balanced approach to risk management and portfolio construction.
4. Paying close attention to companies with strong free cash flow (FCF), ensuring your clients are invested in companies with robust financial health, capable of weathering economic storms and delivering consistent returns over the long term.

The Starlight Dividend Growth Class is a concentrated portfolio of 41 high-quality companies with a track record of increasing dividends by 10%+ annually. The Fund pays a tax-efficient monthly distribution, with the 2025 distribution increased by 20.1% to 4.1%. As at December 31, 2024, the portfolio holdings had a dividend CAGR of 11.7%, 12.9% and 10.1% for the one-year, three-year and five-year periods, respectively.[1]

We invite you to partner with us.

Starlight Capital

[1] Starlight Dividend Growth Class, Series F. As of December 31, 2024. CAGR excludes private investments and cash and cash equivalents. CAGR is Portfolio Annual Growth Rate.

Investment Management Team

Sean Tascatan CFA
Senior Portfolio Manager, Diversified Equities

Sean Tascatan joined Starlight Capital in January 2023 as Senior Portfolio Manager. He has over 10 years of experience in the investment industry.

Mr. Tascatan most recently held a position at Caldwell Investment Management as the lead portfolio manager of numerous dividend funds, including a U.S. Dividend Growth Fund where he specialized in high-quality, dividend paying U.S. equities. Prior to that, he worked at Sentry Investments where he was a key member of an award-winning Equity Income team that garnered multiple Lipper Fund and Morningstar Investment Awards. There, he was the co-manager of a $3B U.S. Growth and Income Fund and a $500MM Diversified Equity Fund.

Mr. Tascatan holds the Chartered Financial Analyst designation and has completed the Options Licensing Course and has an Honours Bachelor of Arts degree in Economics and Financial Management from Wilfrid Laurier University.

About Starlight Capital

Starlight Capital is an independent Canadian asset management firm with over $1 billion in assets under management. We manage Global and North American diversified private and public equity investments across traditional and alternative asset classes, including real estate, infrastructure and private equity. Our goal is to deliver superior risk-adjusted, total returns to investors through a disciplined investment approach: Focused Business Investing. Starlight Capital is a wholly-owned subsidiary of Starlight Investments. Starlight Investments is a leading global real estate investment and asset management firm with over 360 employees and $28B in AUM. A privately held owner, developer and asset manager of over 66,000 multi-residential suites and over 7 million square feet of commercial property space. Learn more at www.starlightcapital.com and connect with us on LinkedIn at www.linkedin.com/company/starlightcapital/

Invest With Us

For more information on our investment solutions, learn more at **starlightcapital.com** or speak to our Sales Team.

Important disclaimer.

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