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Investment Strategy

2023 Market Outlook

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BMO Capital Markets

Table of Contents

2023 Market Outlook

Days of Liquidity Induced Gains Are Likely Behind Us

For all intents and purposes, 2022 will likely be remembered within the world of investing as the year when reality truly did bite. Long gone are the days following the Great Financial Crisis of monetary slack and mostly easy gains for both stocks and bonds. Instead, the realities of higher inflation (which were frankly in part induced by monetary and fiscal policies) and the resulting effects on markets and the economy induced the first prolonged (longer than three months) bite out of investment returns since 2008. To be clear, zero interest rates and no inflation are not normal. Unfortunately, we have reared an entire generation of investors since late 2007 that believe stocks only go up if interest rates go down. This phenomenon has obviously been skewed even further since the start of the COVID-19 pandemic, but the mantra was already well in place beforehand. To be blunt, the exorbitant liquidity that was flushed into the system in 2020-2021 supercharged these tendencies, and gravity has taken over. It is now time for some moderation. In other words, the great unwind toward normalcy has begun. Regrettably, most investors are having a very difficult time digesting this reality given the playbook of the past 14 years. Add to this the hangover PTSD from the COVID-19 pandemic and what the new normal for society itself looks like, it is no wonder markets, let alone civilization, remain on edge.

But the news is not all dire. In fact, we believe this "great unwind and return to normalcy" is actually very good news – with some bumps and bruises along the way.

Our work shows that secular bull markets can, will, and should have periods of negative or flat returns, even cyclical bear markets – as we clearly endured in 2022. These periods are traditionally considered healthy and much needed times of consolidation that usually generate new leadership within equity markets. While we continue to believe the last several weeks of 2022 will see additional gains in US stocks as the "bearish spring uncoils," much of these short-term reactionary gains will likely be in conjunction with easing inflation, seasonality, and the forced unwind of excessively negative investor sentiment. As such, investors are likely to seek liquidity-driven and opportunistically oversold assets. However, we believe the next three to five years will look very different in terms of leadership as investment conditions normalize.

Normalization Process Will Be Bumpy as Investors Recalibrate Expectations

We believe a path to normalization encompasses a lot of things – including, but not limited to stock market returns, earnings growth, valuation, interest rates, inflation, and economic growth. As such, this "normalization process" is akin to a marathon, not a sprint. This will not be comfortable to most investors who have increasingly employed reactionary and excessively shorter-term investment strategies over the past decade. Therefore, reality and common sense tell us that reactionary and momentum-based strategies centering around macro data points will take a while to unwind. As they do, we believe the reality of a higher-than-zero interest rate scenario, single-digit earnings growth, a moderation of valuation, and historical average stock market performance will spawn more active stock-picking strategies defined by bottoms-up characteristics instead of macro. In addition, it is very likely that US stocks are in the early stages of a multi-year recovery in traditional value investing and small-mid-cap stocks. This is especially evident given the increasingly domestic prowess of US-centric companies within a global landscape that remains several years behind the US, in our view, with respect to balance sheet strength, cash flow generation, and earnings stability. As a result, we believe non-US investors who have been reluctant to own US stocks in the past several years will have no choice but to re-allocate back to the US.

Again, this is a marathon, not a sprint. The sprinters are sure to react to the notion of decelerating earnings and the potential for a mild recession in the beginning months of 2023. From our lens, the cyclical bear market in stocks alongside a prolonged inversion of the yield curve already told investors that a recession would occur. Therefore, to us it is a moot point – and we instead are preparing for what is next. As such, we believe the US stock market will attain mildly higher prices from current levels. However, the path is likely to be far from linear, with the market's near constant focus on headlines, macro, and the Fed surely to generate opportunities within an ebbs-and-flow market for a good part of 2023 as realities of normalcy become clearer and clearer, and momentum strategies begin to fail with more fervor. For our part, we will position accordingly for a "jack be nimble, jack be quick" fundamental backdrop in 2023. As such, we are likely to be more active in our sector and portfolio positioning, let alone overall market forecasts relative to our historical practice of lower turnover and more constant positioning and projections. Buckle up – the road to normalcy is fraught with truth and reality – and that is a very good thing.

S&P 2023 Year End Target Models

S&P 500 Price Target 4,300

For the first time in many years, our enthusiasm for stock market performance potential next year is relatively tempered. We still expect a December S&P 500 rally even if stocks do not hit our 4,300 2022 year-end target. Unfortunately, we believe it will be difficult for stocks to finish 2023 much higher than current and anticipated levels given the ongoing tug of war between Fed messaging and market expectations. While we welcomed the most recent CPI report, one better-than-expected print does not signal the all clear, in our view. From our perspective, the Fed has been crystal clear in their intentions – which means at least a few more FOMC meetings of rate hikes followed by a *prolonged* pause period, something that we do not believe the market has fully discounted. In addition, if any future CPI reports run hotter than anticipated, we think that will likely trigger a stock market overreaction to the downside. Therefore, the market is likely to experience periods of heightened volatility (in both directions) during 1H'23 until overall levels of inflation trend down closer to historical norms throughout the second half of the year. In fact, we believe it is entirely possible for the S&P 500 to retest its current cycle low or even establish a new one – although if that does happen it is not likely to be much lower than the previous one, in our view, and in no way alters our outlook.

So, what does this mean from an investment perspective? We truly believe active investment strategies will be a key pillar for 2023. In other words, investors will need to be nimble throughout the year rotating in and out of areas to take advantage of what we think will be constantly evolving market conditions in order to deliver outperformance. In fact, we suspect we will be doing the same, as 2023 is likely to be a year in which we make more revisions to our outlook and sector opinions than has typically been the case for us historically.

S&P 500 EPS Target $220

We are a bit more cautious on the earnings outlook and expect a mild contraction of roughly 5% in 2023 EPS from our $230 2022 year-end target given the macro circumstances. Stated differently, earnings are likely to be down because we believe that is what needs to happen for inflation expectations to come down (i.e., profit margin deterioration) and for the Fed to finally step aside. Fortunately, we think this is well understood by investors and believe that the market will care more about falling inflation than a slight earnings decline – and maybe even more so than the prospect of a mild recession. In other words, if inflation keeps going down, the market's discounting mechanism is likely going to "cheer" that as opposed to "loathing" a couple of quarters of weak macro or earnings data, in our view. Thus, an expectation for incremental S&P 500 P/E expansion is at the foundation of our 2023 market outlook.

Exhibit 1: 2023 S&P 500 Target Model Scenarios

Scenario	Price	EPS	Rationale
Bull	4,800	$230	US recession is avoided as Fed gets policy spot on, inflation declines throughout whole year, 10yr yield slowly declines throughout the entire year getting close to 3%. This leads to better multiple expansion, earnings are flat and maybe even GROW leading to a double-digit calendar year gain.
Base	4,300	$220	Mild US recession is the foundation; Fed ends its hiking cycle by May the latest; 10yr yield is rangebound just under 4% for the first half, then declines alongside inflation for 2H. Moderate multiple expansion makes up for the slight decline in overall earnings with a flattish calendar year return.
Bear	3,600	$200	Hard landing; Fed overestimated policy. Unemployment starts to accelerate, risk off comes back in full force (investors and companies), so multiples DO NOT expand (probably even compress) and earnings follow a more typical recessionary decline. Good news is interest rates and inflation probably accelerate to the downside. Bad news is this will probably lead to another sizeable calendar year decline

Source: BMO Capital Markets Investment Strategy Group.

Exhibit 2: 2022 & 2023 S&P 500 Targets

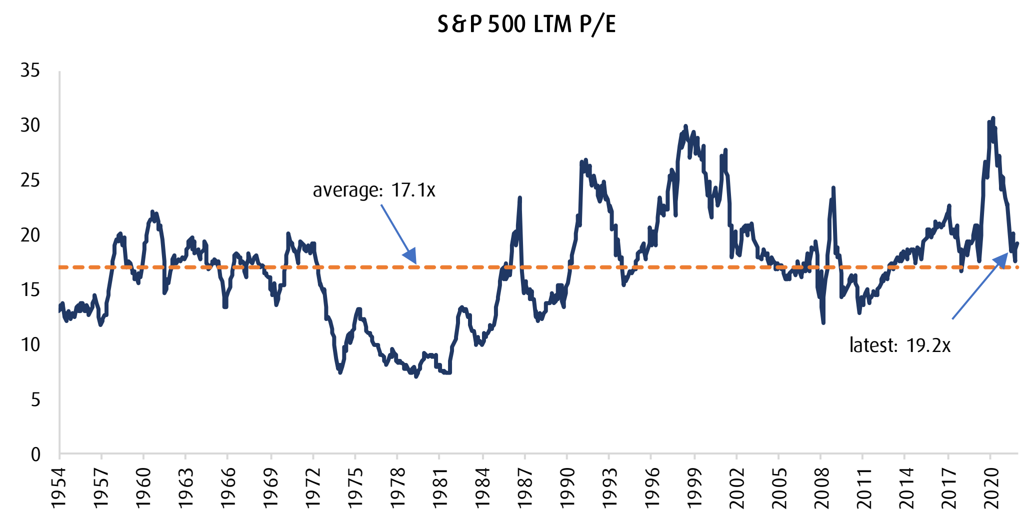
Price Target			
Model	**Category**	**2022E**	**2023E**
Dividend Discount Model	Fundamental	4,300	4,500
Fair Value Price-to-Earnings Model	Valuation	3,900	4,000
Expected Return*		8.5%	8.5%
Latest S&P 500 Close		3,964	3,964
Price Target		4,300	4,300
Earnings Per Share Target			
Model	**Category**		
Macroeconomic Regression Model	Macro	$230	$210
Bottom Up Mean Consensus Expectation	Fundamental	$225	$230
Normalized EPS	Mean Reversion	$192	$197
Expected EPS Growth		10.6%	-4.3%
Prior Year S&P 500 EPS**		$208	$230
EPS Target		$230	$220
Implied P/E		**18.7x**	**19.5x**

*Based on 11/28/2022 closing price.
**Based on our prior-year EPS target if EPS is not fully reported for index.
Source: BMO Investment Strategy Group.

Implied P/E From Both Models Within Historical Context

There is no denying the hyper focus on valuation levels given the interest rate and inflation backdrop. However, we believe some of the fearmongering is being taken out of context. First, the latest values are certainly not as extreme as some are suggesting (Exhibit 3). Second, the current and anticipated level of interest rates – while much higher than the past several years – are not indicative of some sort of P/E collapse by itself (Exhibit 4). Finally, we have found that P/E almost always expands in the months immediately following bear market troughs (Exhibit 5), which we believe is either already in place or will likely be in the very near term. Thus, the 19.5x derived from our price and EPS models implies only a roughly 0.8x expansion between now and 2023 year-end (based on our 2022YE targets), something that is more than reasonable within all this context, in our view.

Exhibit 3: Historical S&P 500 P/E



Source: BMO Capital Markets Investment Strategy Group, Bloomberg.

Exhibit 4: Historical S&P 500 P/E Based On 10-Year US Treasury Yield Range
Monthly data begins Jan. 1954

10Yr Range	Avg	Min	Max	Stdev	19x or Greater Probability
3 - 3.5	15.7	11.8	24.7	3.4	12.9%
3.5 - 4	17.8	11.8	22.0	2.3	34.7%
4 - 4.5	18.6	15.1	22.2	1.4	28.6%

Source: BMO Capital Markets Investment Strategy Group, Bloomberg.

Exhibit 5: Change in S&P 500 P/E Following Bear Market Trough

Bear Market Trough	+3mos	+6mos	+9mos	+12mos	+15mos
10/22/1957	0.0	0.6	2.6	5.2	7.2
6/26/1962	-0.2	1.4	3.2	2.0	2.3
10/7/1966	2.2	3.3	5.4	5.2	4.6
5/26/1970	1.9	2.6	4.2	6.1	6.7
10/3/1974	0.0	2.1	3.2	3.2	4.2
8/12/1982	2.9	3.6	5.5	6.3	6.2
12/4/1987	0.6	-0.4	-0.8	-2.7	-1.8
10/11/1990	0.8	4.2	5.6	7.5	13.4
10/9/2002	3.1	1.5	4.1	3.6	3.8
3/9/2009	5.3	10.5	13.4	8.4	4.9
3/23/2020	7.1	10.5	14.7	17.6	15.1
Average	**2.2**	**3.6**	**5.6**	**5.7**	**6.0**

Source: BMO Capital Markets Investment Strategy Group, Bloomberg.

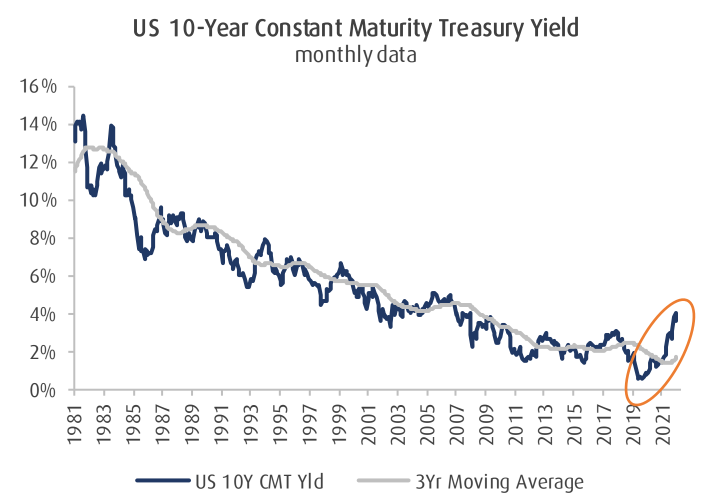
Targets Are More Than Reasonable Despite Main Macro Concerns

As pandemic- and geopolitical-related market issues have started to subside, investor focus has clearly shifted to more traditional macro issues, such as interest rates/inflation, Fed policy, and recession probability, and what each may ultimately mean for market performance. Indeed, many of the trends in each represent a significant departure from the market landscape that was largely intact from 2009-21 (higher rates, more hawkish Fed, and the likelihood of a non-event driven recession), and that fact alone has increased the fear quotient. However, our analysis suggests that these worries may be overblown. In fact, we found that performance trends are quite the opposite of current conventional thinking, and our S&P 500 targets may even be a bit conservative should historical patterns prevail.

Higher Interest Rates Are Not Necessarily a Detriment to Market Performance

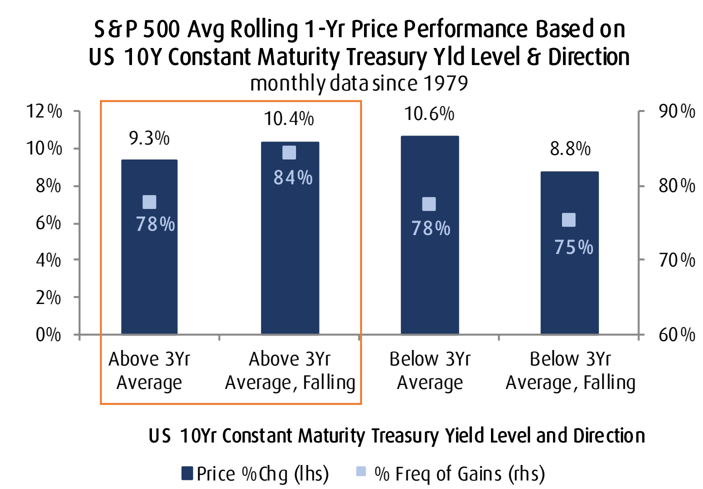
- The US 10-year Constant Maturity Treasury yield has increased more than 200bps this year, carrying a four-handle for the first time since the Great Financial Crisis, and has broken firmly above its three-year moving average after being below this level for nearly three years (Exhibit 6). While the 10-year yield is unlikely to move substantially higher from here with current consensus forecasts calling for a 3.5% yield by 2023 year-end, we still expect the 10-year yield to remain above average for the foreseeable future given the higher-for-longer rate backdrop, a scenario that continues to worry many investors as it relates to stock market performance.
- However, our work shows that US stocks can perform quite well in a higher interest rate environment despite perceptions to the contrary. When examining rolling one-year monthly periods since 1979, we found that when the US 10-year Constant Maturity Treasury yield was above its three-year moving average, the S&P 500 logged a solid 9.3% average one-year gain, not significantly lower than the 10.6% average price return during below-average yield periods.
- In addition, the S&P 500 index performed better when the US 10-year yield was falling from above-average levels, which represents the probable rate environment for 2023, compared to falling from below-average levels. Periods of above-average and falling US 10-year Treasury yields coincided with an average one-year S&P 500 price return of 10.4% with gains occurring 84% of the time, while periods of below-average and falling yields saw an 8.8% average price return with gains occurring 75% of the time (Exhibit 7).
- When the US 10-year Constant Maturity yield was falling year over year from above-average levels, the S&P 500 exhibited double-digit percentage gains about 69% of the time versus just 50% of the time when the yield was falling from below-average levels (Exhibit 8).

Exhibit 6: US 10Y Yield Has Broken Firmly Above Its 3Y Avg This Year



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

Exhibit 7: SPX Logs a 9.3% Avg 1Y Gain When 10Y Yld is Above 3Y Avg



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

Exhibit 8: Higher Freq of >10% SPX Gains When 10Y Yld is Falling From Above-Avg Levels vs. Below Avg

S&P 500 1-Yr Rolling Price % Return Frequency Based on US 10Y Constant Maturity Treasury Yield Level & Direction
(since 1979)

US 10Y Constant Maturity Treasury Yield Level & Direction	S&P 500 Y/Y % Price Return Frequency: 0-10% Gain	0-10% Loss	>10% Gain	>10% Loss
Above 3Yr Average	22.8%	12.3%	55.0%	9.4%
Above 3Yr Average, Falling	15.6%	6.3%	68.8%	9.4%
Below 3Yr Average	23.1%	9.3%	54.5%	13.1%
Below 3Yr Average, Falling	25.4%	8.8%	50.0%	15.8%

Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Conclusions to Fed Tightening Cycles Tend to Be Positives for Market Performance

- While the exact timing of the final interest rate hike by the Fed is up for debate, we believe it is safe to say that the current tightening cycle, which started in mid-March, is likely nearing an end, which should be a tailwind for US stock market performance, based on our work.
- The months leading up to the conclusion of the previous four tightening cycles have been met with muted stock market returns, on average, but the months following the end of such cycles tend to see fairly strong gains.
  - ✓ For instance, the S&P 500 fell 3%, on average, during the three months prior to the end of the last four tightening cycles with the 15.8% decline prior to the Dec '18 cycle-end notably weighing on the average return (Exhibit 9).
  - ✓ That being said, the S&P 500 then logged average gains of 7.4%, 10.9%, and 11.5% in the three-, six-, and nine-month periods following the end of Fed tightening cycles. Additionally, aside from the months after the May '00 interest rate tightening cycle-end, US stocks largely moved higher throughout the nine months post-tightening (Exhibit 10).

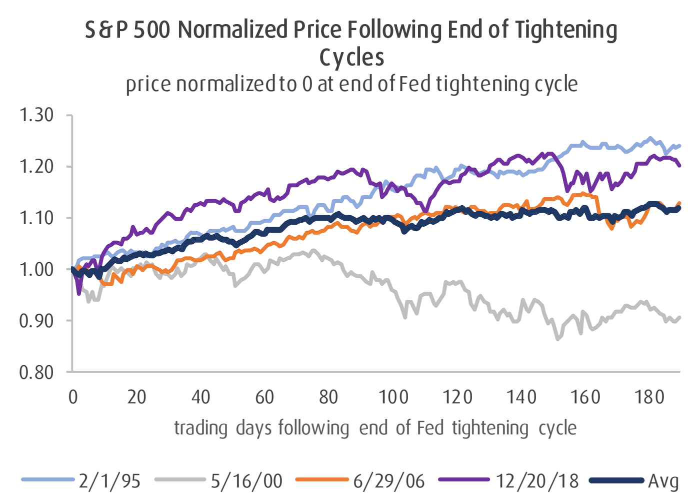
Exhibit 9: On Average, S&P 500 Price Returns Are Muted in Months Prior to End of Fed Tightening, But Pretty Strong Once Cycle Concludes

S&P 500 Price Performance Leading Up to and Following End of Fed Tightening Cycles

End of Tightening Cycle	Months Prior to End of Tightening Cycle: -9M	-6M	-3M	Months Following End of Tightening Cycle: +3M	+6M	+9M
2/1/1995	4.3%	2.0%	0.4%	9.3%	19.0%	24.2%
5/16/2000	10.2%	3.2%	5.6%	0.9%	-6.4%	-11.2%
6/29/2006	3.7%	1.5%	-2.3%	4.9%	11.4%	11.8%
12/20/2018	-9.2%	-10.8%	-15.8%	14.5%	19.7%	21.3%
Average	**2.2%**	**-1.0%**	**-3.0%**	**7.4%**	**10.9%**	**11.5%**

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

Exhibit 10: Aside From 2000, US Stocks Have Largely Moved Higher Once Fed Stopped Raising Rates



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

Implications of a Potential Recession

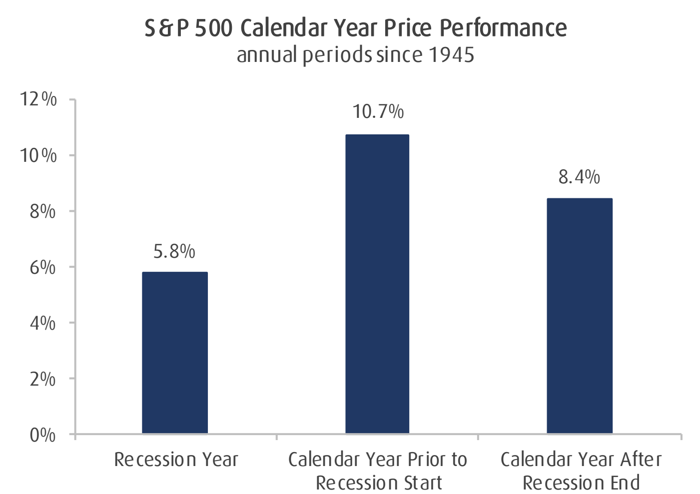
- Given the degree and duration of the yield curve inversion, it is almost inevitable the US will enter a recession at some point during 2023. This is obviously spooking investors given the overall levels of bearish sentiment, particularly since the last three recessions were quite severe by historical standards and sent stocks tumbling as a result.

- However, we think any potential recession this time around will be much tamer. Remember, the Fed has embarked on one of its most aggressive rate hiking campaigns ever, yet employment remains historically strong, while consumer balance sheets have remained intact. Unless those trends change significantly, we cannot envision anything other than a "technical" recession occurring during 2023.

- Nonetheless, investor worries regarding recession years and market implications may be a bit overstated. For instance, the S&P 500 has averaged a 5.8% gain during years coinciding with a recession while EPS averaged only a -2.7% decline (Exhibits 11-12).

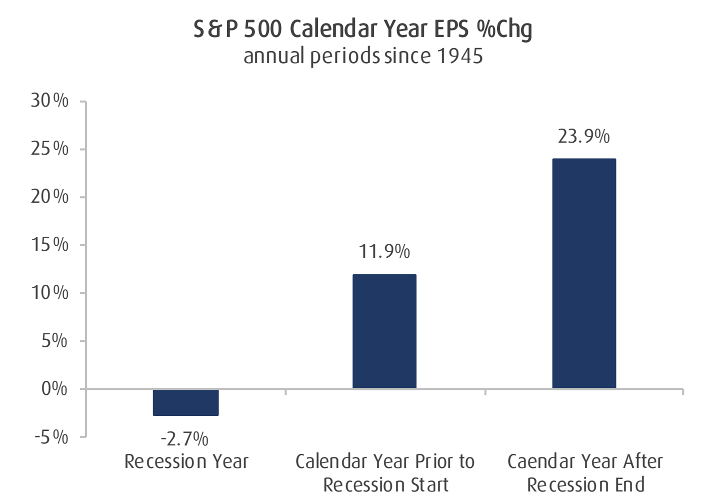
    ✓ For context, calendar years prior to recession years have typically exhibited above-average strength in both performance and earnings growth. Obviously, this has not been the case during 2022, so as we have stated quite frequently lately, the market has probably already discounted much of the recession risk, particularly should it wind up being mild as we expect.

Exhibit 11: During CY of Recession, SPX Averages a 5.8% Gain



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 12: SPX Records a 2.7% Avg Drop in EPS During CY of Recession

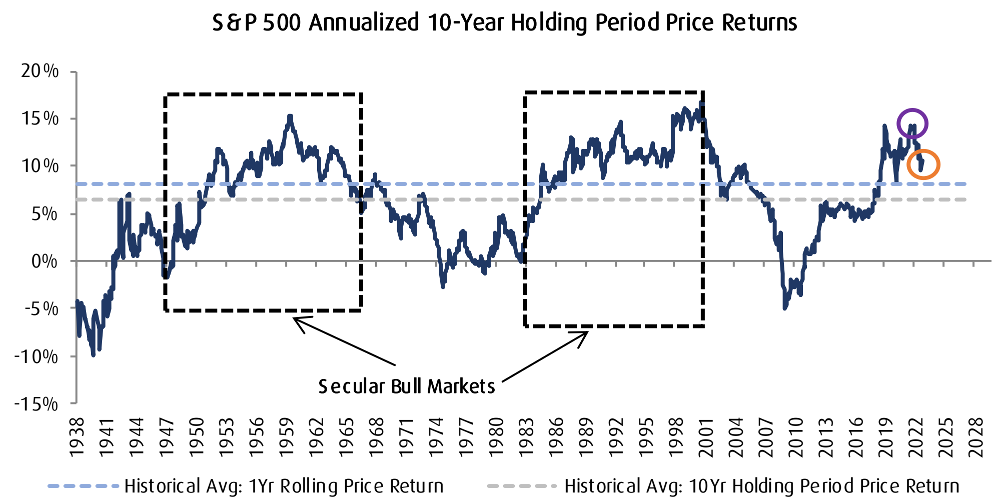


Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver.

Secular Bull Remains Intact

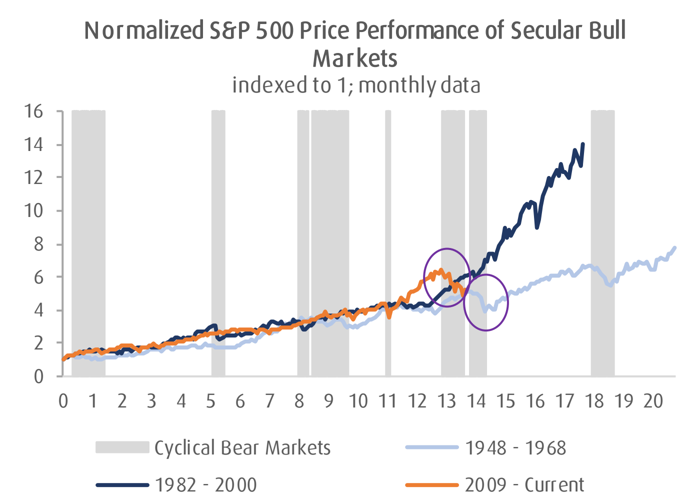
- Despite the 25.4% price drawdown in the S&P 500 this year, we continue to believe that US stocks are in the midst of a secular bull market. It is important to note that cyclical bears are not necessarily secular bull killers. In fact, there have been six cyclical bears during the previous two secular bull markets – four between 1948 and 1968 and two between 1982 and 2000 – and US stocks managed to continue their trek higher after each of these (Exhibit 14).
- In addition, our work shows that secular bull markets have various stages of returns. After the 10-year mark, price returns tend to be more volatile with a higher probability of losses, but the S&P 500 still averages a solid one-year holding period gain of 13.2% in the latter part of secular bulls (Exhibit 15).
- Longer-term performance trends have obviously suffered amid this selloff with the S&P 500 10-year annualized holding period price return notably dropping over the past several months, but still well-above the historical one-year average return level (Exhibit 13). Although the S&P 500 10-year annualized return may have already peaked, it has taken roughly six years during the two prior secular bulls for 10-year returns to make definitive moves below the 6.5% historical average. From our lens, we see normalized and moderate gains in the coming years as more likely than losses.

Exhibit 13: 10Y Annualized Price Return Has Dropped, But Is Still Well-Above One-Year Average Gain



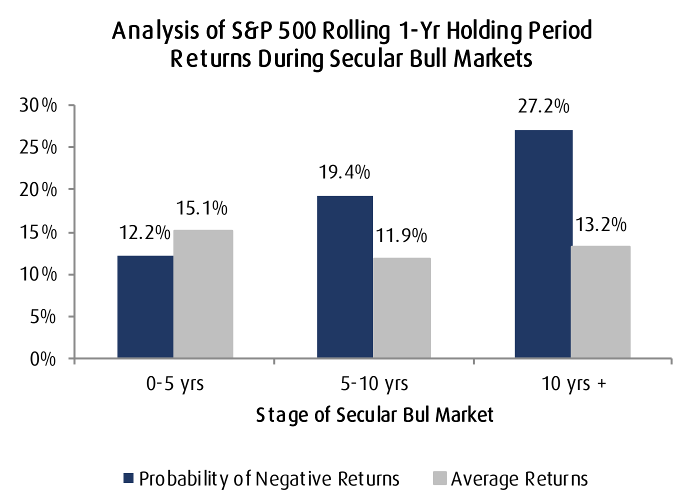
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 14: Cyclical Bears Markets Are Not a Secular Bull Killer



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 15: Returns Are Volatile, But Still Solid, During This Bull Stage



Source: BMO Capital Markets Investment Strategy Group, FactSet.

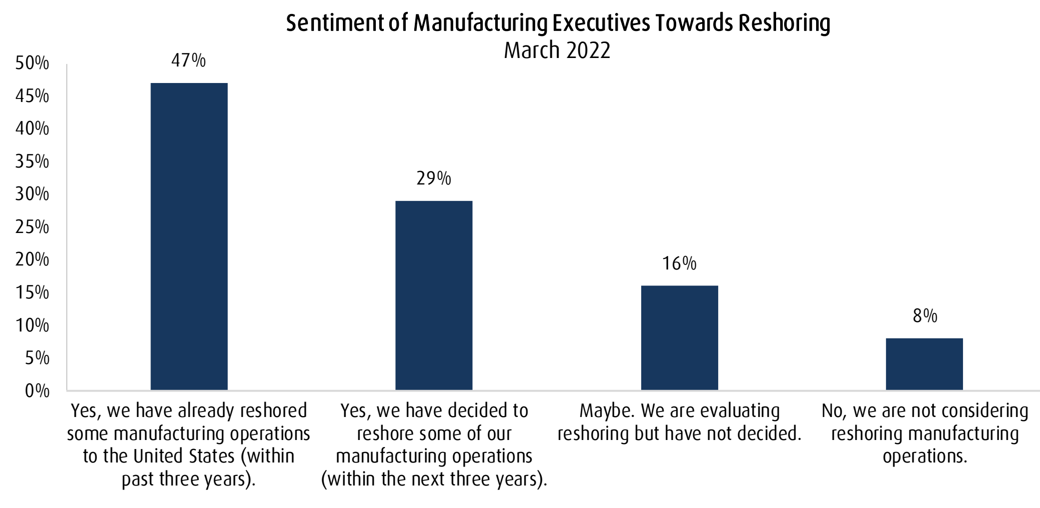
Thematic Focus: Reshoring 2.0

Supply Chains, Redefined

No Longer "One Size Fits All" Solution in the Face of Severe Disruptions

In our 2022 Year Ahead, we wrote about the pandemic-induced global supply chain issues, exacerbated by surging consumer demand and government stimulus driving manufacturers back to the US, or at least, North America, predicting a so-called "onshoring or reshoring" boom. Well, in fact, and not surprisingly, this did not transpire in any form or fashion close to what we expected, although we did see an uptick in overall interest and sentiment from corporate CEOs to eventually reshore (Exhibit 16). What did happen was the unexpected – Russia's invasion of Ukraine in February, which impacted economies near and far, causing massive energy shortfalls in the EU and driving up gas prices to record-high levels. China continued to maintain a zero COVID-19 policy, which slowed down the transition back to normalization, while isolating itself from the global stage, as a means to become increasingly self-sufficient. In the US, record-high inflation and uncertain Fed policies shook stock markets in a volatile year, while consumer spending nonetheless remained strong. Going into 2023, we do not think the current geopolitical climate or sentiment will change drastically, and as such, continue to believe that the US and more generally North America, will provide a safe haven for investors, while companies continue to focus on improving operating efficiencies, reducing costs, preserving cash, and sustaining earnings growth. We think that supply chains will not only move closer to home but evolve, as there is no longer a "one size fits all" solution in the face of severe disruptions, but rather, a "best way forward" as opposed to the accustomed "cheapest way forward." Flexibility, agility, leveragability will all be important factors in determining supply chains and in this regard, in our opinion, reshoring, onshoring, or even friend-shoring will be a practical and viable alternative to manufacturers.

Exhibit 16: Reshoring Interest Rising Among Corporate Executives and CEOs

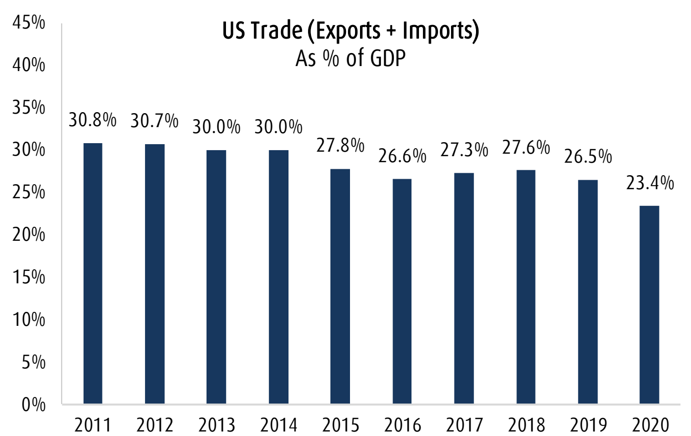


Source: BMO Capital Markets Investment Strategy Group, Kearney.

Global Decoupling Under Way?

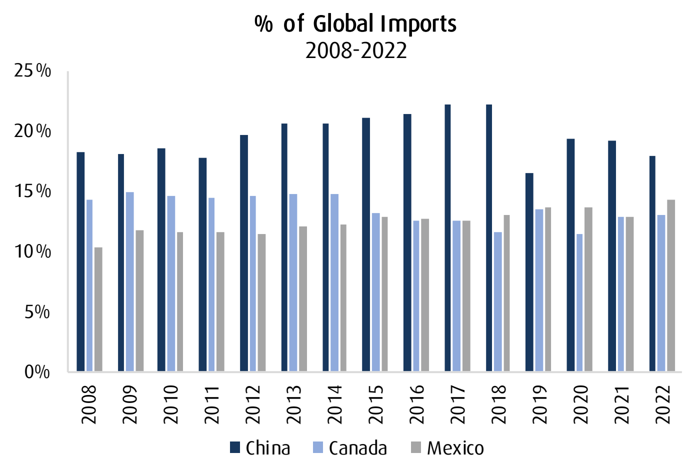
The argument for decoupling of the global economy, or globalization, has surfaced from time to time, particularly during global crises, such as the Tech Bubble Crash of 2000, Financial Crisis of 2008, and more recently the COVID-19 pandemic in 2020. This was because, despite having its origins in the US with respect to sectors (e.g., technology in 2000, housing/subprime mortgages in 2008), the intertwined nature of the global economy caused a downturn that was felt worldwide, rattling financial markets and forcing a structural overhaul in many countries. However, most recently, problems arising from the pandemic seem to have brought on not only a structural shift of sectors including Technology, Consumer Discretionary, and Industrials, but also a form of protectionism in countries, and to some extent, the "end of globalization" (at least for now). Our work shows that indeed, the US reliance on global trade has declined significantly over the past decade. US trade, defined as the sum of exports and imports of goods and services, as a share of GDP, peaked at 31% in 2011 and has steadily declined to 23% in 2020, according to the Bureau of Economic Analysis (Exhibit 17). During this period, personal domestic consumption grew its share to almost 70% of GDP. Imports of goods and services, in line with the growth of globalization, grew steadily in the 80s and 90s to a high of 17% of GDP in 2011, but moved down to just 13% as of 2020, the lowest point since 1999. Trade with China, the leading export partner of the US from 2000 to 2010, and periods between 2010 and 2020, has clearly lagged its North American counterparts (e.g., Canada and Mexico) since 2019 as trade war tensions escalated, a sign that the US-China trade war and geopolitical tensions have reduced trade flows between the two countries (Exhibit 18).

Exhibit 17: US Trade's Share of GDP Has Steadily Declined Since 2011



Source: BMO Capital Markets Investment Strategy Group, BEA.

Exhibit 18: Trade With China Has Been Lagging Since 2019

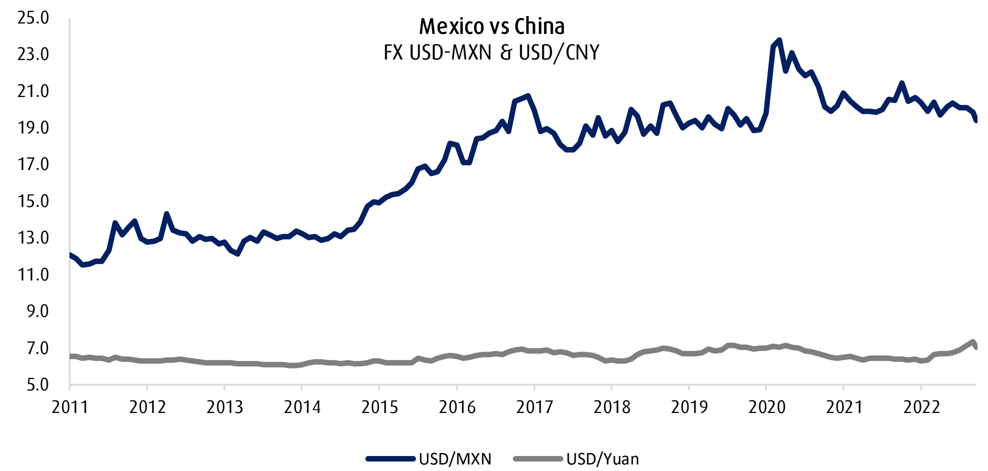


Source: BMO Capital Markets Investment Strategy Group, BEA.

Lower Wages in Mexico and a Strong USD Benefiting Reshoring

While there are several factors companies consider before deciding where to "set up shop" with respect to manufacturing, wages tend to be at the forefront. Low wages in Asia have long attracted US corporations to open plants and factories abroad, and companies benefitted from cheap labor, strong business networks and low compliance standards, particularly in certain countries such as China. We agree, this is a favorable environment to manufacture goods, at least when supply chains were reliable; however, as we have been aware for a while now, this is no longer the case. In addition, wages have been steadily increasing in China. In 2014, the unit labor costs (equivalent to wages adjusted for productivity) in China were equal to those in Mexico. By 2019, manufacturing wages in certain industries were 20% lower in Mexico compared to China, meaning greater efficiency at a lower cost, according to North American Production Sharing, an outsourced and compliance management service specializing in Mexico. On top of that, real wage growth for urban non-private sector workers in China, adjusted for inflation, rose by 8.6% in 2021, according to data from the National Bureau of Statistics. These are considerable increases in labor cost that manufacturers need to consider, and it may just be the start in a fundamental shift, particularly as China looks to move toward its "common prosperity" goal outlined by President Xi Jinping. Another factor to take into consideration when thinking about wages is the USD exchange rates (Exhibit 19). A strong dollar can help offset some costs. The Chinese Yuan, which is pegged to the greenback, does provide some stability, but has not helped offset rising labor costs. Compare this to the Mexican Peso, where wages have also risen, albeit not to the extent seen in China, but with the help of the strong US dollar, labor costs have remained relatively level in US dollar terms. This coupled with the geographical convenience and US/Mexico trade agreements (NAFTA/USMCA, the IMMEX Program), have resulted in companies bringing manufacturing closer to home.

Exhibit 19: Strength in USD Can Help Offset Rise in Wages Across Developing Countries



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Government Incentives Providing a Boost in US Manufacturing

As the pandemic revealed weaknesses of US supply chains, causing unprecedented disruptions in the economy, President Biden, in the early days of his presidency, issued several executive orders with the aim of assessing, supporting, and most importantly, strengthening US manufacturing and supply chains. It became part of a multi-sector, multi-dimensional plan involving setting up new agencies and task forces over his four-year term. Executive orders 14005 and 14017 directed federal agencies to "maximize the use of goods, products, and materials produced in, and services offered in, the US, through financial assistance awards and procurements," and take an "all-of-government approach to assessing vulnerabilities in and strengthening the resilience of critical supply chains." The Supply Chain Disruptions Task Force (SCDTF) has undertaken and completed a number of projects, such as reducing long-dwelling containers at two of the largest US ports by over 70%, committing over $600 million in American Rescue Plan (ARP) resources to produce new supply chain partnerships between the automobile and semiconductor industries, and securing $1 billion in ARP funding to expand US meat processing capacity. In the US, companies are solidifying Biden's commitment to a domestic industrial revitalization by announcing nearly $200 billion in investments in semiconductor, EVs, and battery manufacturing in 2021. The CHIPS & Science Act, which was announced in August 2022, will specifically focus on enhancing and developing the US technology within the semiconductor industry, and companies are making strategic moves to take advantage of government incentives and financial support geared towards advancing US technology to the forefront. Exhibit 20 provides some examples of large US companies', both public and private, investments into domestic manufacturing.

Exhibit 20: Examples of US Companies' Investment Into Domestic Manufacturing

Company	Ticker	Latest Development
General Electric Company	GE – US	Opened a $70 million water heater plant in Camden, South Carolina. GE has increased its spend on US suppliers by two-thirds in the past five years.
General Motors Company	GM - US	Announced it would spend $7 billion on four plants in Michigan. Last year it spent almost $40 billion buying parts from some 5,600 US suppliers.
Intel Corporation	INTC - US	Broke ground on two new semiconductor fabrication facilities, in Arizona. Expected to be fully operational in 2024.
Lockheed Martin Corporation	LMT - US	Investing $16.5 million into a new Missile System Integration Lab facility in Huntsville, Alabama. The defense contractor already has 25 facilities in Alabama and expects to create a further 200 jobs there.
Micron Technology, Inc.	MU -US	Launched a plan to create an enormous manufacturing complex in the town of Clay, N.Y., by investing $31 billion to build four 600,000-sq.-ft. "clean rooms."
Novelis	N/A	A world leader in aluminum rolling and recycling, plans to invest more than $2.5 billion to build a new low-carbon recycling and rolling plant in Bay Minette, Alabama.
Nucor Corporation	NUE - US	Formally started work on a $1.7 billion steel plate manufacturing plant in Brandenburg, Kentucky.
Qualcomm Inc.	QCOM - US	Qualcomm and GlobalFoundries are announcing a new partnership that includes $4.2 billion to manufacture chips in an expansion of GlobalFoundries' upstate New York facility.
Taiwan Semiconductor	TSM - US	Constructing a building that will serve as its second chip factory in Arizona in the United States.
U.S. Steel	X - US	Broke ground on a $3 billion steel-making facility in Arkansas, which will be the largest private project in the history of Arkansas and most advanced steel mill in North America

Source: BMO Capital Markets Investment Strategy Group, Reuters, Business Insider, AZ Governor, Construction Equipment Guide, Cision Ltd., Novelis.

Conclusion

The structural transition and redefining of supply chains will persist throughout 2023, as companies adapt back to normalization, shifting of consumer spending from goods to services, and higher interest rates, softening demand for goods. Whereas supply chains of the past put value on higher cost efficiencies via "just in time" inventory, lean supply chains, and minimal excess capacity, we think flexibility, agility, and leveragability will increasingly play an important part in supply chains going forward. Specifically, this entails added capacity, extra parts on hand, and heftier inventories, even if it is not necessarily the lowest-cost option. In our opinion, supply chains will continue to move closer to home to take advantage of the many factors we have discussed – decoupling of the global economy (again, for now), a strong US dollar, government incentives, and financial support. In the meantime, companies should continuously reposition themselves, and those that are able to secure more domestic/closer supply chains will be beneficiaries of the possible reshoring, onshoring, or friend-shoring boom that we suspect will ultimately happen in the near future.

Sectors, Size, and Style Recommendations

US Sector Opinions

Exhibit 21: US Sector Opinion Summary

Sector	Opinion	Index Weight	Target Weight	BMO Investment Strategy Group Headline
Communication Services	OW	7.3	9.0	Favorite contrarian play; lots of cash, dividend growth is strong, and quintessential barbell sector
Consumer Discretionary	MW	10.3	10.5	Tough to EVER bet against US consumer – especially going into and out of a recession; be very selective
Consumer Staples	UW	7.0	4.5	Defense is expensive and excessively consensus; largest relative valuation expansion in decades
Energy	MW	5.2	5.5	Commodity volatility likely to proceed; longer-term bullish; buy dips and focus on cash flow and dividends
Financials	OW	11.7	13.0	Steady as they go with respect to earnings, cash flow, and dividends – THE value sector
Health Care	OW	15.2	16.5	Becoming more and more consensus, but not expensive defensive area; product companies > services
Industrials	MW	8.5	8.0	Operating metrics improving; focus on domestic companies and avoid internationally concentrated companies
Information Technology	MW	26.3	26.0	Equal parts underweight and overweight – classic neutral as valuations compress, but stable growth leads
Materials	MW	2.7	2.5	Global growth volatility likely to remain elevated; focus on more defensive names with compressed valuations
Real Estate	MW	2.7	2.5	Historically performs better than other classic defensive areas in higher interest rate environments
Utilities	UW	3.0	2.0	Very expensive and extremely over-owned; debt to equity levels are troublesome; own dividend growth

Source: BMO Capital Markets Investment Strategy Group; Key: OW: Overweight, MW: Market Weight, UW: Underweight

Sector Changes

- **Upgrading Industrials to Market Weight from Underweight**
- **Downgrading "Classic Defense" – Consumer Staples & Utilities to Underweight from Market Weight**

Exhibit 22: S&P 500 Annual Sector Performance

Year	COMSV	COND	CONS	ENRS	FINL	HLTH	INDU	INFT	MATR	RELS	UTIL	SPX
1990	-17.7%	-14.9%	12.4%	-1.4%	-42.1%	14.1%	-10.2%	0.3%	-13.9%		-7.3%	-6.6%
1991	7.9%	38.3%	38.4%	2.4%	43.8%	50.2%	26.0%	6.6%	21.5%		16.0%	26.3%
1992	11.0%	17.5%	3.0%	-2.3%	19.8%	-18.1%	6.8%	0.6%	7.2%		0.3%	4.5%
1993	10.8%	12.8%	-6.3%	11.2%	7.8%	-11.0%	15.8%	20.5%	10.5%		7.8%	7.1%
1994	-8.4%	-9.9%	6.8%	-0.4%	-6.4%	10.2%	-4.8%	19.1%	3.3%		-17.2%	-1.5%
1995	37.3%	18.2%	36.2%	26.0%	49.6%	54.5%	35.9%	38.8%	17.3%		25.2%	34.1%
1996	-2.2%	10.5%	23.2%	21.7%	31.9%	18.8%	22.7%	43.3%	13.4%		0.2%	20.3%
1997	37.1%	32.3%	30.5%	22.0%	45.4%	41.7%	25.0%	28.1%	6.3%		18.4%	31.0%
1998	49.3%	39.6%	13.9%	-2.0%	9.6%	42.3%	9.3%	77.6%	-8.0%		10.0%	26.7%
1999	17.4%	24.1%	-16.6%	16.0%	2.3%	-11.6%	19.9%	78.4%	23.0%		-12.8%	19.5%
2000	-39.7%	-20.7%	14.5%	13.2%	23.4%	35.5%	4.5%	-41.0%	-17.7%		51.7%	-10.1%
2001	-13.7%	1.9%	-8.3%	-12.3%	-10.5%	-12.9%	-7.0%	-26.0%	1.0%		-32.5%	-13.0%
2002	-35.9%	-24.4%	-6.3%	-13.3%	-16.4%	-20.0%	-27.6%	-37.6%	-7.7%	-15.1%	-33.0%	-23.4%
2003	3.3%	36.1%	9.2%	22.4%	27.9%	13.3%	29.7%	46.5%	34.8%	20.8%	21.1%	26.4%
2004	16.0%	12.1%	6.0%	28.8%	8.2%	0.2%	16.0%	2.1%	10.8%	21.9%	19.6%	9.0%
2005	-9.0%	-7.4%	1.3%	29.1%	3.7%	4.9%	0.4%	0.4%	2.2%	7.4%	12.8%	3.0%
2006	32.1%	17.2%	11.8%	22.2%	16.2%	5.8%	11.0%	7.7%	15.7%	36.8%	16.9%	13.6%
2007	8.5%	-14.3%	11.6%	32.4%	-20.8%	5.4%	9.8%	15.5%	20.0%	-20.5%	15.8%	3.5%
2008	-33.6%	-34.7%	-17.7%	-35.9%	-56.9%	-24.5%	-41.5%	-43.7%	-47.0%	-45.0%	-31.5%	-38.5%
2009	2.6%	38.8%	11.2%	11.3%	14.8%	17.1%	17.3%	59.9%	45.2%	20.8%	6.8%	23.5%
2010	12.3%	25.7%	10.7%	17.9%	10.8%	0.7%	23.9%	9.1%	19.9%	28.0%	0.9%	12.8%
2011	0.8%	4.4%	10.5%	2.8%	-18.4%	10.2%	-2.9%	1.3%	-11.6%	7.9%	14.8%	0.0%
2012	12.5%	21.9%	7.5%	2.3%	26.3%	15.2%	12.5%	13.1%	12.2%	16.2%	-2.9%	13.4%
2013	6.5%	41.0%	22.7%	22.3%	33.2%	38.7%	37.6%	26.2%	22.7%	-1.5%	8.8%	29.6%
2014	-1.9%	8.0%	12.9%	-10.0%	13.1%	23.3%	7.5%	18.2%	4.7%	26.1%	24.3%	11.4%
2015	-1.7%	8.4%	3.8%	-23.6%	-3.5%	5.2%	-4.7%	4.3%	-10.4%	1.2%	-8.4%	-0.7%
2016	17.8%	4.3%	2.6%	23.7%	20.1%	-4.4%	16.1%	12.0%	14.1%	0.0%	12.2%	9.5%
2017	-6.0%	21.2%	10.5%	-3.8%	20.0%	20.0%	18.5%	36.9%	21.4%	7.2%	8.3%	19.4%
2018	-16.4%	-0.5%	-11.2%	-20.5%	-14.7%	4.7%	-15.0%	-1.6%	-16.4%	-5.6%	0.5%	-6.2%
2019	30.9%	26.2%	24.0%	7.6%	29.2%	18.7%	26.8%	48.0%	21.9%	24.9%	22.2%	28.9%
2020	22.2%	32.1%	7.6%	-37.3%	-4.1%	11.4%	9.0%	42.2%	18.1%	-5.2%	-2.8%	16.3%
2021	20.5%	23.7%	15.6%	47.7%	32.5%	24.2%	19.4%	33.4%	25.0%	42.5%	14.0%	26.9%
2022	-38.2%	-31.7%	-1.5%	61.3%	-9.4%	-3.7%	-6.2%	-25.4%	-11.2%	-27.3%	-2.4%	-16.8%

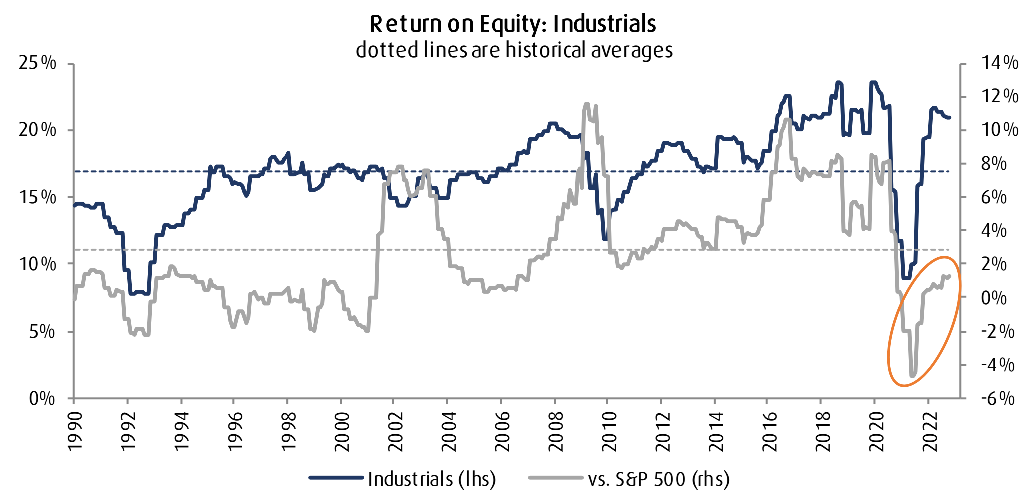
Source: BMO Capital Markets Investment Strategy Group. Performance calculated through 11/28/22. REITs are used as a historical proxy for the Real Estate sector, which was officially established in Sept. 2016.

US Sector Changes

- **Upgrading Industrials to Market Weight from Underweight**
  - ✓ Operating performance is much improved
  - ✓ Own domestically-focused industries and avoid areas that rely on international growth
- **Downgrading "Classic Defense" – Consumer Staples & Utilities to Underweight from Market Weight**
  - ✓ Defensive characteristics no longer apply
  - ✓ Valuations for both sectors are very expensive on relative and absolute basis
  - ✓ There are better defensive areas in the market that offer compressed valuations, stable earnings and steady dividend growth

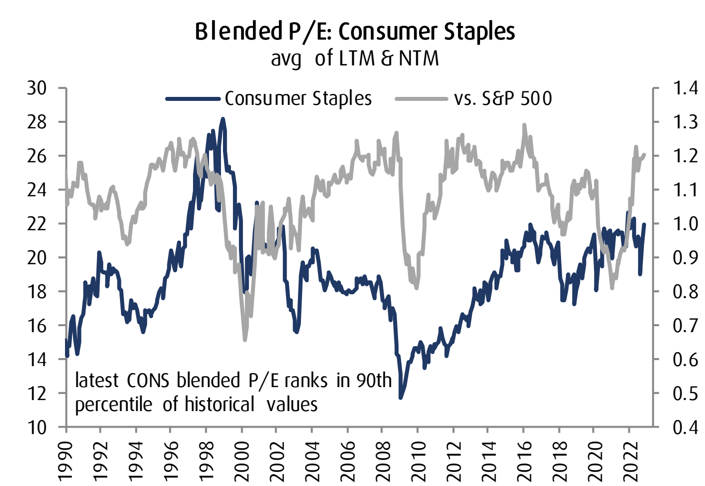
Bottom Line: Outsized overweight and underweight positions *do not* make a lot of sense in our view, especially with macro uncertainties only increasing heading into 2023. As such, remaining being "more neutral" on most sectors provides us an opportunity to be increasingly nimble in *both directions* in 2023 during periods of excess volatility within the overall market.

Exhibit 23: Industrials Return on Equity Improving Relative to Overall Market ROE



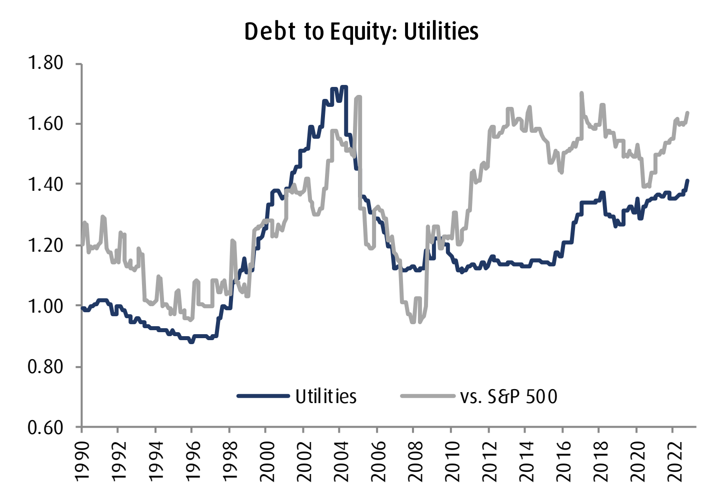
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 24: CONS Blended P/E Has Expanded Sharply Especially vs. SPX



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

Exhibit 25: Utilities D/E Ratio at Highest Level Since Mid-2000s



Source: BMO Capital Markets Investment Strategy Group, FactSet.

US Size and Style

Exhibit 26: US Size and Style Opinions

Sector	Opinion	Comments
Large cap (LC)	MW	Balance higher growth and multiples with value and stability; non-US investors will seek consistency and liquidity of US
Mid cap (MC)	OW	Cash flow, valuation, and operating metrics are much improved; should benefit from domestic focus relative to large caps
Small cap (SC)	OW	Forgotten asset class; depressed valuations and increasingly consistent growth; be careful of value traps; focus on quality
Value	OW	Macro, fundamental and sentiment all favor value for the first time in decades = staying power, but avoid value traps
Growth	MW	Underweight long duration assets by neutralizing overall growth positions with GARP and consistent/quality growth

Source: BMO Capital Markets Investment Strategy Group; Key: OW: Overweight, MW: Market Weight, UW: Underweight

Tilting Toward Value, But Not Completely Discounting Growth

- As we look ahead to 2023, we believe value still holds the advantage over growth amid the higher-for-longer interest rate backdrop, which should support continued outperformance of value stocks, while P/E and earnings growth trends are also tilted in value's favor. In addition, our work shows that the end of Fed tightening cycles and a return to more normalized market gains (0-10%), both of which we expect to occur next year, should be further tailwinds for relative value performance.

  ✓ Value stocks have fared significantly better than growth stocks this year with the Russell 1000 Value outpacing its growth index counterpart by more than 18 percentage points YTD. This bout of outperformance comes after relative price for value vs. growth reached an all-time low on a monthly basis back in November 2021. In fact, Russell 1000 Value relative price still currently sits nearly 40% below its long-term average relative price vs. Russell 1000 Growth since 1978 (Exhibit 27).

  ✓ We believe value's recent outperformance can persist in the months ahead as the higher-for-longer interest rate backdrop should benefit value and continue to hinder long-duration growth names. Indeed, over the past 20 years, the correlation between Russell 1000 Value relative monthly price vs. Russell 1000 Growth and the US 10Y Treasury yield has been 0.81 with the rising yield cycle in place since July 2020 coinciding with roughly nine percentage points of Value outperformance on an annualized basis. (Exhibit 28)

  ✓ It is also important to note that style cycles tend to be long-lasting and US stocks are currently coming out of a 15-year growth outperformance cycle, suggesting to us that the recent value shift could be here to stay (Exhibit 29).

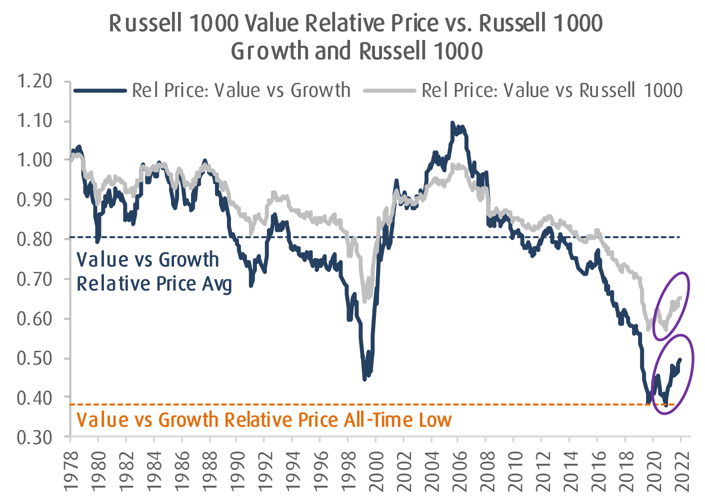
  ✓ On the valuation front, blended P/E for Value and Growth versus the market are roughly in line with historical norms, despite relative P/E for former rising throughout much of the year. Although value stocks have fared much better than growth stocks YTD, S&P 500 Value blended P/E currently stands at a ~25% discount to blended P/E for S&P 500 Growth, a bit steeper than the average multiple discount of 23% (Exhibits 30 & 31).

  ✓ Blended earnings growth has been decelerating for the overall market and across styles, but value stocks have seen their EPS growth rates fall at a slower pace than the broader S&P 500, while growth stocks have exhibited a faster pace of declines as highlighted by the contrasting relative blended growth trends in Exhibit 32. Blended earnings growth for S&P 500 Value has been rising vs. S&P 500 Growth for most of 2022 with value's EPS growth clip currently eclipsing growth's clip by more than five percentage points, representing a notable differential compared to history.

- ✓ Value has largely eclipsed Growth following the conclusion of the past four Fed tightening cycles with the Russell 1000 Value index registering a 20.6% gain, on average, 12 months post tightening, compared to a 15.3% gain for the Russell 1000 Growth (Exhibit 33).

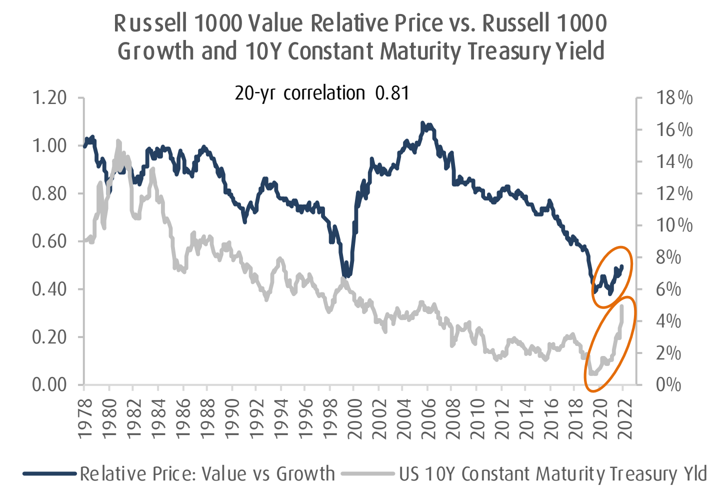
- ✓ As we have already stated, we believe the coming years will bring more normalized returns in the US stock market, somewhere in the 0-10% total return range when measuring the 12-month moving average of y/y monthly S&P 500 returns. We defined this "market regime" in our US Factor Focus report. Our work shows that Value stocks have logged superior average annualized total returns during periods of this 0-10% total return range when compared against Growth stocks and the overall market (Exhibit 34).

Exhibit 27: Value Has Sharply Outpaced Growth YTD After Coming Off All-Time Relative Price Low



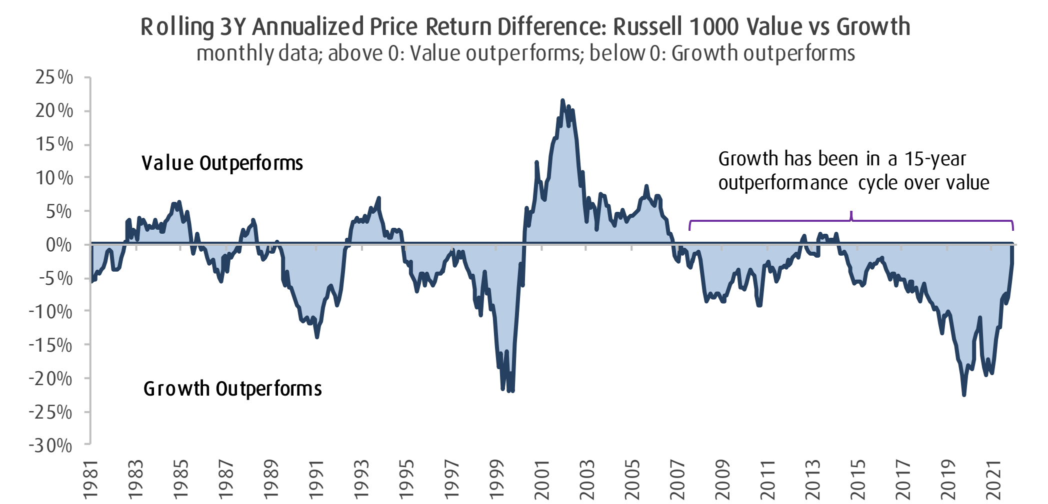
Source: BMO Capital Markets Investment Strategy Group, FactSet, Russell.

Exhibit 28: Higher-for-Longer Interest Rate Backdrop Should Support Continued Outperformance of Value Over Growth



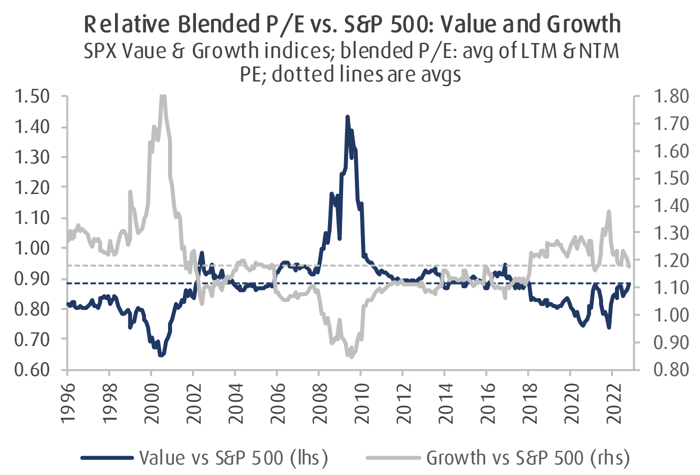
Source: BMO Capital Markets Investment Strategy Group, FactSet, Russell, FRB.

Exhibit 29: Style Cycles Tend to Be Long-Lasting, Indicating That Recent Value Shift May Be Here to Stay



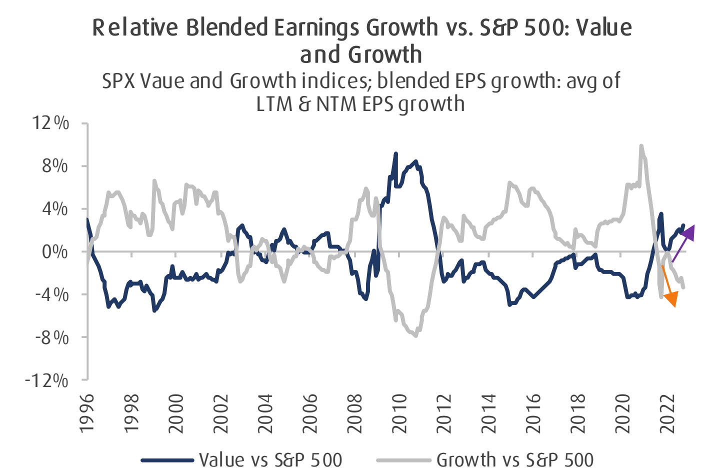
Source: BMO Capital Markets Investment Strategy Group, FactSet, Russell.

Exhibit 30: Blended P/E for Value & Growth in Line With Historical Avg



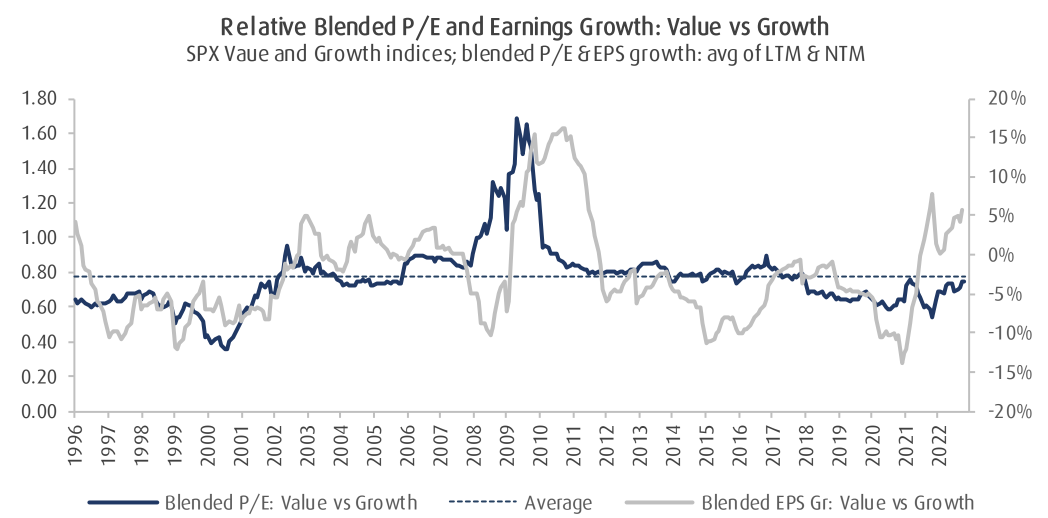
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 31: Blended EPS Growth for Value Has Improved Versus SPX



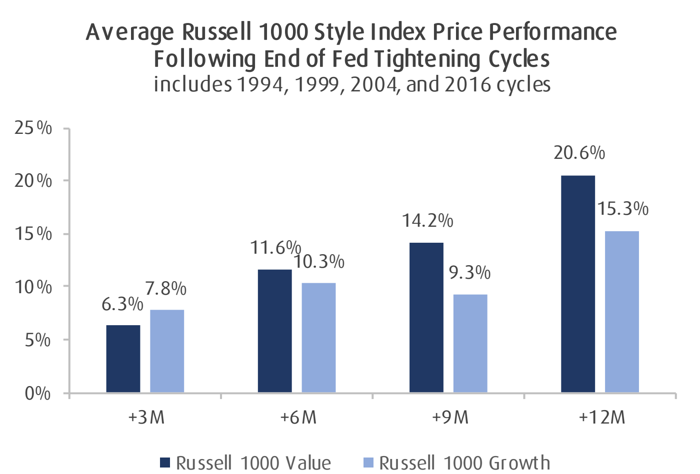
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 32: S&P 500 Value Offering Discounted Relative Blended P/E vs. Growth and Higher EPS Growth



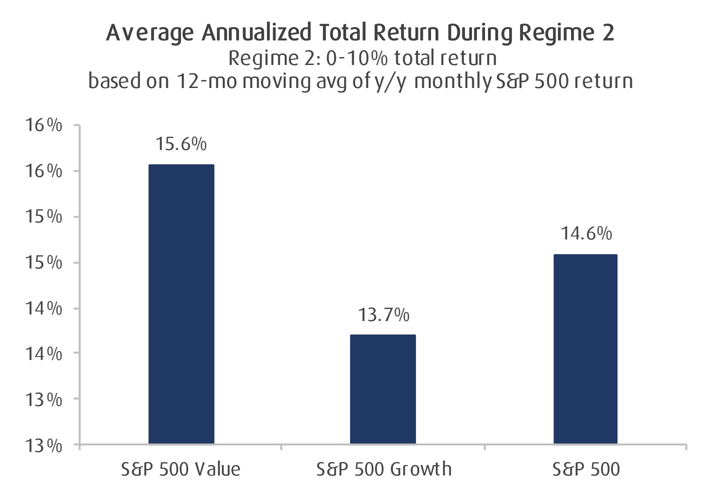
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 33: Value Outpaces Growth 12-Mos After End of Fed Tightening



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

Exhibit 34: Approaching Market Regime Favors Value Over Growth



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Size Dynamics Bringing SMID-Caps to the Forefront

- The surge in the US dollar has put the spotlight back on the more domestic-oriented small- and mid-caps, which have historically outpaced their large-cap peers during periods of sustained dollar strength, and currently trade at significant valuation discounts to large caps. From a performance perspective, SMID-cap stocks have established firm price uptrends vs. large caps in the past several months, which we believe can continue in 2023 given their history of early cycle outperformance.

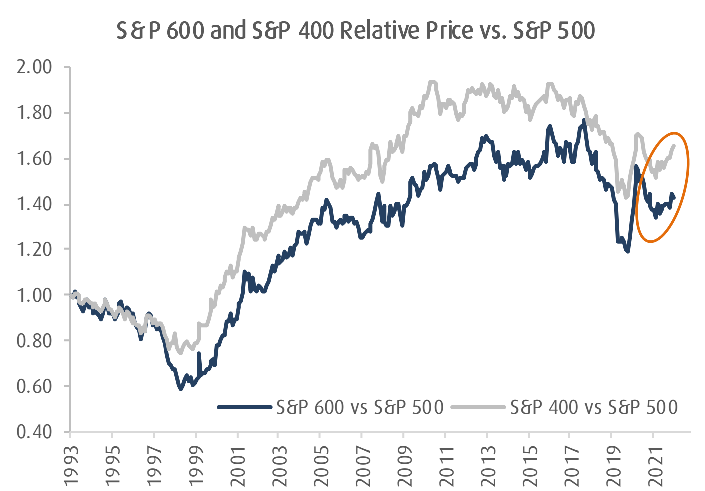
  ✓ Small- and mid-caps have fared better than large caps YTD with the S&P 600 and S&P 400 eclipsing the S&P 500 by more than three and five percentage points, respectively. In addition, relative y/y price %change for small- and mid-caps vs. large caps have each strongly rebounded after falling below the -1 standard deviation level earlier in 2022 (Exhibits 35 & 36).

  ✓ Our work shows that SMID-caps have sharply surpassed large caps during the first 13 months following bear market troughs with the Russell 2000 and Russell Mid-Cap indices outpacing the Russell 1000 by 16.9% and 12.3%, on average (Exhibit 37).

  ✓ S&P 600 and S&P 400 companies derive roughly 80% and 77% of their revenue from the US, respectively, compared to 60% for the S&P 500 (Exhibit 38). This should benefit small-caps and mid-caps if the rise in the value of the US dollar persists, in our view, as their increased leverage to the domestic economy should help protect their overall competitive position and profitability relative to multinational corporations. Indeed, we identified 12 past periods of sustained US dollar strength and found that the Russell 2000 and Russell Mid-Cap averaged annualized gains of 10.2% and 8%, respectively, during these periods, compared to a 4.5% gain for the Russell 1000 (Exhibit 39).

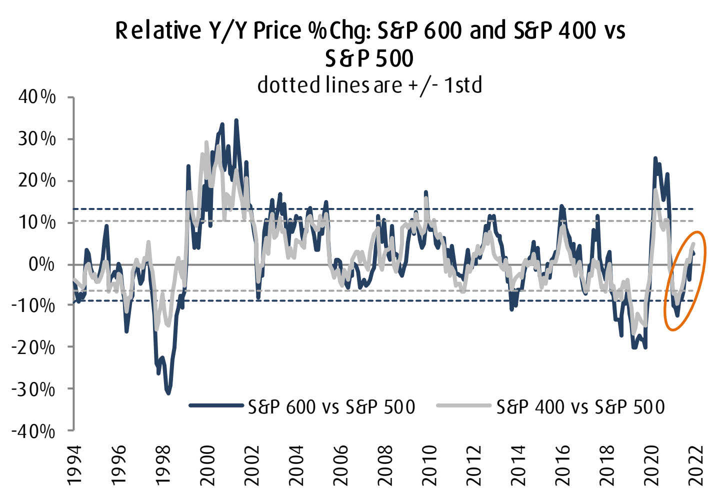
  ✓ On the valuation front, small-cap stocks have historically commanded a 12% premium versus large-caps when it comes to blended P/E, while mid-cap stocks typically trade at a 6% premium. However, SMID-cap relative valuations vs. large caps are currently near record lows with S&P 600 and S&P 400 blended P/E multiples sitting 28% and 25% below their 20-year averages, respectively (Exhibit 40). While small-cap stocks, in particular, may be viewed as a value proposition overall, the group can also offer a longer-term GARP play with a ~15% long-term EPS growth rate (vs. 11% for S&P 500) and PEG ratio of ~0.9x (Exhibit 41).

Exhibit 35: S&P 600 & S&P 400 Relative Price vs. S&P 500 Have Estbalished Firm Uptrends



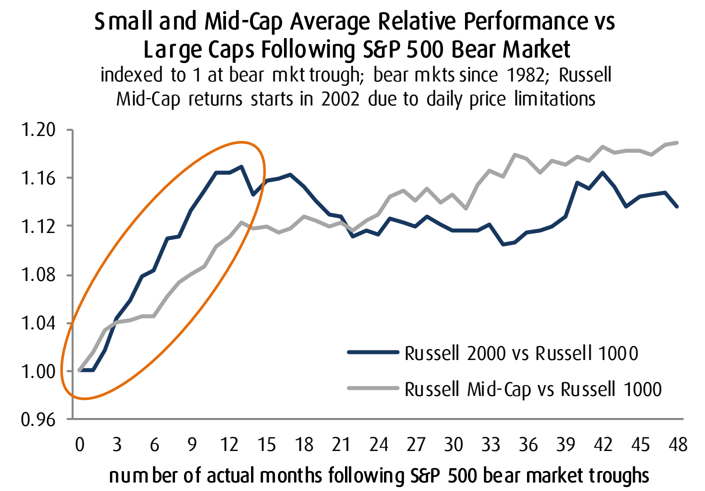
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 36: Relative Y/Y Performance for SMID Caps Has Rebounded After Falling Below -1Std Dev Level



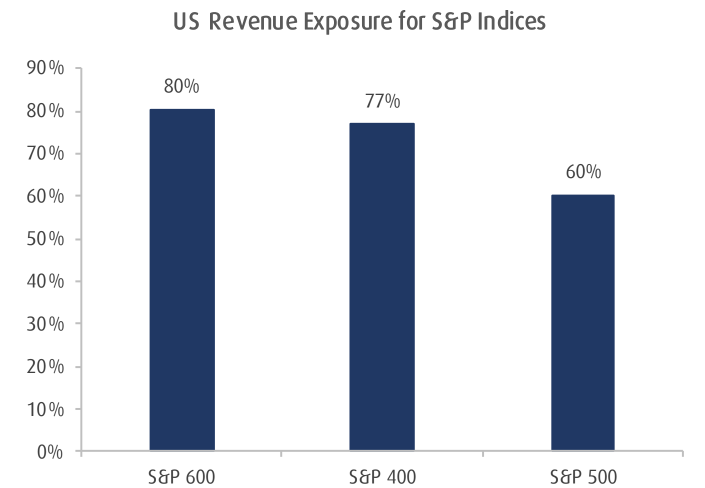
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 37: SMID Caps Tend to Be Early Cycle Outperformers



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

Exhibit 38: SMID Caps More Levered to US Than Their Large Cap Peers



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

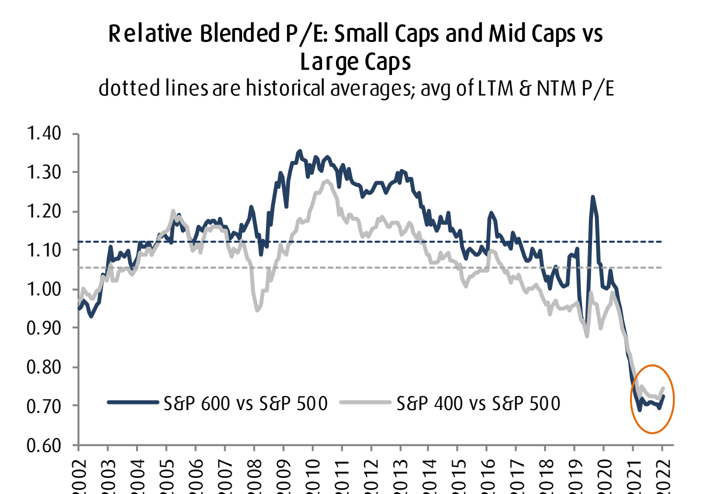
Exhibit 39: Periods of US Dollar Strength Have Historically Favored Small- and Mid-Cap Stocks

Russell Small, Mid, and Large Cap Performance During Periods of US Dollar Index Strength

			Annualized Price %Chg			
Period	Duration (mos)	USD Index %Chg	Russell 2000	Russell Mid-Cap	Russell 2500	Russell 1000
Jun-80 - Feb-85	57	88.3%	16.3%	12.9%	15.8%	9.8%
Dec-87 - May-89	17	19.4%	28.0%	23.3%	26.2%	20.4%
Jan-91 - Jun-91	5	17.2%	44.0%	31.5%	39.9%	21.0%
Aug-92 - Dec-93	16	22.7%	26.3%	18.0%	22.5%	10.5%
Jul-95 - Mar-98	32	24.4%	19.0%	22.7%	20.8%	27.7%
Oct-98 - Jan-02	40	28.3%	7.6%	7.5%	10.1%	1.3%
Dec-04 - Nov-05	11	13.3%	4.3%	10.8%	7.1%	4.7%
Mar-08 - Feb-09	11	22.6%	-46.0%	-49.4%	-46.9%	-47.1%
Nov-09 - May-10	6	15.5%	30.4%	20.1%	27.3%	1.1%
Apr-11 - May-12	13	13.9%	-10.9%	-7.7%	-9.4%	-4.1%
Jun-14 - Dec-16	30	28.1%	5.2%	4.2%	4.2%	5.1%
Jan-18 - Sep-19	20	11.5%	-2.0%	2.2%	0.1%	3.1%
May-21 - Oct-22	*17*	*23.9%*	*-13.3%*	*-9.6%*	*-11.7%*	*-7.0%*
		Avg ex current period	10.2%	8.0%	9.8%	4.5%

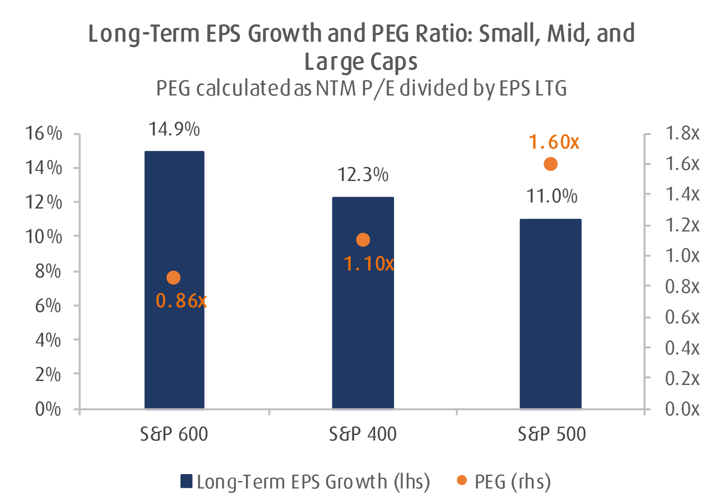
Source: BMO Capital Markets Investment Strategy Group, FactSet, Russell.

Exhibit 40: Small- and Mid-Cap Relative Valuations Sit Near 20Y Lows



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 41: Small Caps Offer Value, But Also a Potential GARP Play



Source: BMO Capital Markets Investment Strategy Group, FactSet.

2023 Market Outlook – Canada

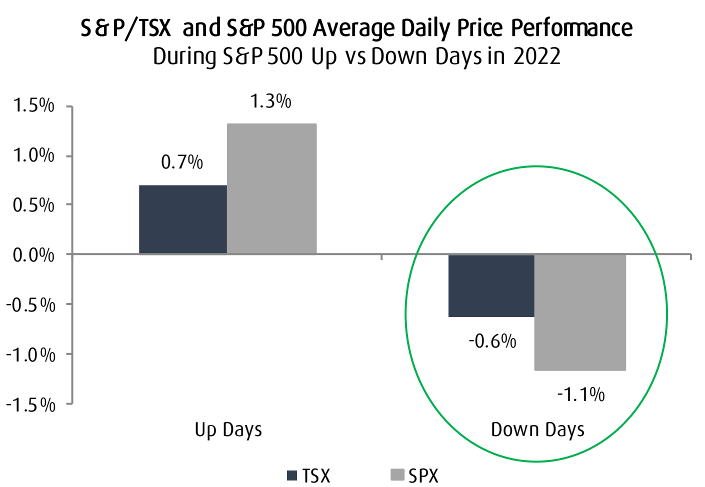
TSX Valuation Reversion Part of the Normalization Process

"As America goes, so goes Canada" has been our long-held adage for the TSX, one which we believe will continue to drive performance over the longer term. In fact, we believe the recent valuation divergence between these two markets presents an opportunity and will likely normalize over the coming years. Yes, this will be a key factor in Canadian relative performance during the broader "normalization process" which we expect over the next several years. No doubt the path to normalization is going to be bumpy for Canada as well; but a return to a more fundamentally-driven, US-centric market as opposed to the liquidity-driven macro-based environment seen over the last few years will see Canadian equity valuations ultimately normalize with the US. From our perspective, as markets transition away from the days of liquidity-induced gains, we believe Canada will benefit from a more value-oriented and fundamentally-driven market. While we think Canada is in a unique position to benefit in 2023, we do not believe we are in a commodity super cycle which would potentially replicate a stretch of Canadian outperformance like in the 2000s. Be that as it may, we do believe the transition back to normalcy will result in more consistent and correlated returns over the coming years, especially given the strong cross-border relationship between Canada and the US.

As we head into 2023, from an equity market perspective, we believe the TSX is further along in repricing the deceleration of earnings growth and the potential for a mild recession in 2023. As such, Canada remains well positioned for near-term outperformance which, in our opinion, will translate into mild outperformance versus the US in 2023 as valuations begin to converge. Indeed, the TSX offered strong downside protection in 2022 (Exhibit 42 for upside and downside relative performance), a trend we believe is set to continue as we head into another volatile year. Overall, we believe the Canadian stock market will attain mildly higher prices from current levels, with a 2023 year-end price target of 22,500 on earnings of just $1500. This represents a 7% annual return based on our 2022 year-end forecast, slightly ahead of our flat expected price return for the S&P 500 during the year.

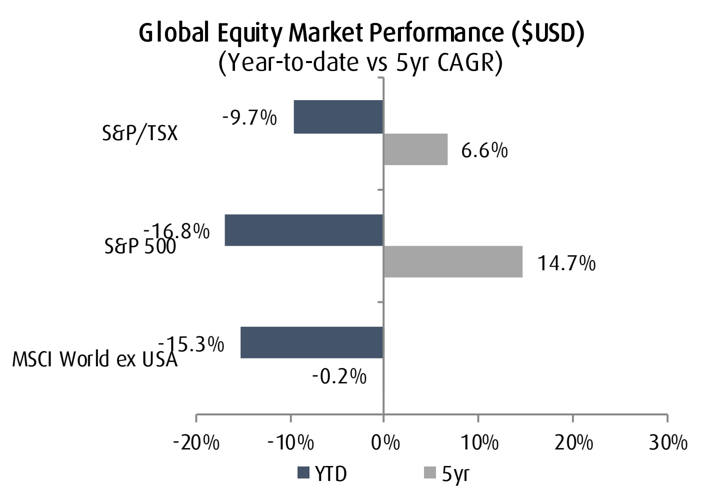
With that said, like the US, 2023 will be a "jack be nimble, jack be quick" environment – an environment that will require more active positioning within Canada and its sectors, particularly as the market reacts to peak interest rates, the end of the tightening cycle, easing inflationary pressures, and the potential for a mild recession in the beginning months of 2023. As such, both our investment strategy and portfolio positioning are likely setting up for "multiple revisions" during 2023, as the market transitions to normalcy and fundamentals react accordingly.

Exhibit 42: TSX in 2022 = Downside Protection



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 43: TSX Outperformed in Difficult Year



Source: BMO Capital Markets Investment Strategy Group, FactSet.

S&P/TSX Price Target 22,500

Although we have tempered our enthusiasm for US equities in 2023, we are a little more constructive on Canadian stocks. No doubt Canadian investors are facing the same macro challenges as US investors; however, the TSX is already trading sub-12x trailing earnings. Therefore, the downside is likely to be more limited, in our opinion. Indeed, the S&P/TSX is outperforming the S&P 500 by over 6% year to date and has managed to avoid entering bear market territory – a trend we expect to continue into the early part of 2023, especially if equity markets retest the current cycle low.

Overall, akin to the US, we believe active investment strategies will be a key pillar for 2023. In other words, investors will need to be nimble throughout the year rotating in and out of areas to take advantage of what we think will be constantly evolving market conditions in order to deliver outperformance. This includes potential shifts in overall TSX weight as Canada outperforms in the early part of the year.

S&P/TSX EPS Target $1,500

Given the macro headwinds, we are more cautious on the earnings outlook and expect a mild contraction of roughly 3% in 2023 from our $1550 2022 year-end target. While we have previously been expecting earnings growth to normalize back to the mid- to low-single-digit range, the more aggressive tightening cycle and risk of a mild recession in 2023 imply earnings are likely to slightly contract next year, particularly as commodity price momentum slows. Fortunately, the S&P/TSX has already been trading at near-record-low earnings multiples, implying this is largely priced in. As such, we expect the twelve-month trailing PE to expand to 15x by the end of 2023 from the current sub-12x LTM PE. Indeed, this remains firmly below the long-run average trailing PE of 17x and our implied S&P 500 2023 LTM PE of 19x.

Exhibit 44: 2023 S&P/TSX Composite Target Scenarios

Scenario	Price	EPS	Rationale
Bull	26,000	$1,600	Recession avoided, Fed gets it spot on, inflation declines throughout the year, 10yr yield averages sub-4% and slowly declines throughout the year. • Leads to sharper multiple expansion and normalization. • Earnings GROW so TSX hits new all-time high.
Base	22,500	$1,500	Yes, Mild recession is the foundation; interest rates (specifically 10yr yield) peaks in the first half, then declines alongside inflation for 2H. • Moderate multiple expansion makes up for the slight decline in overall earnings. • Valuations continue to trend slightly higher closer to long-term historical averages, but the TSX remains at a discount to the US.
Bear	17,000	$1,250	Hard landing; Fed overestimate policy. Unemployment starts to accelerate, risk off comes back in full force. • Multiples DO NOT expand (maybe even compress further) • Earnings follow typical "recession" decline (20-30%). • Good news is interest rates and inflation probably accelerate to the downside. Bad news is this will probably lead to another sizeable calendar year decline.

Source: BMO Capital Markets Investment Strategy Group, Bloomberg.

Exhibit 45: 2022 & 2023 S&P/TSX Targets

Price Target			
Model	**Category**	**2022E**	**2023E**
Dividend Discount Model	Fundamental	21,500	22,225
Fair Value Price-to-Earnings Model	Valuation	21,000	25,144
EPS Revision Model	Mean Reversion		21,125
Macroeconomic Regression Model	Macro		22,674
Expected Return*		3.9%	11.3%
Latest S&P/TSX Close		20,220	20,220
Price Target		21,000	22,500
Earnings Per Share Target			
Model	**Category**		
Macroeconomic Regression Model	Macro	1,200	1,530
Mean Consensus Regression Model	Fundamental	1,590	1,520
Normalized EPS	Mean Reversion	1,350	1,370
Expected EPS Growth		16%	-3.2%
Prior Year S&P/TSX EPS**		$1,340	1,550
EPS Target		$1,550	1,500
Implied P/E		**13.5x**	**15.0x**

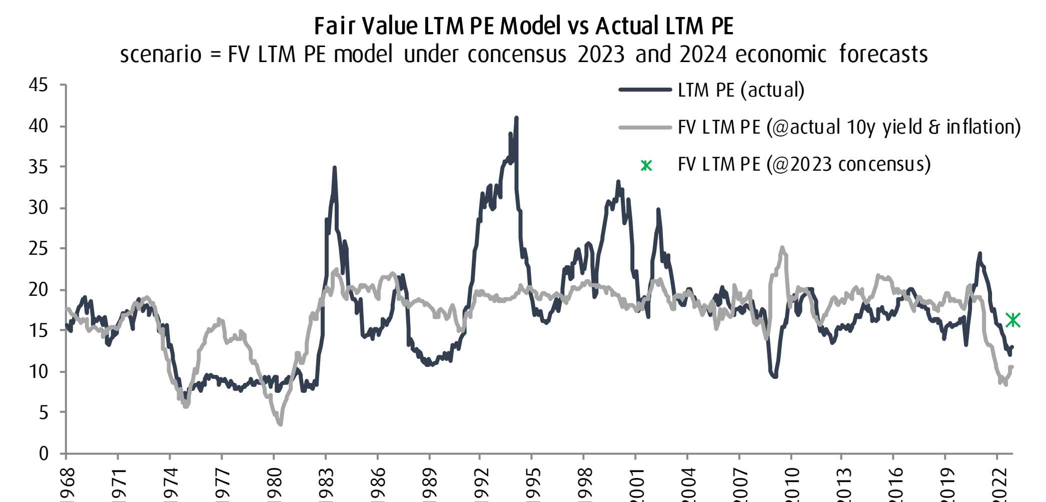
*Based on 11/28/2022 closing price. **Based on our prior year EPS target if EPS is not fully reported for index.
Source: BMO Investment Strategy Group.

Key Notes on Our Models and Underlying Assumptions

Given the persistent inflationary environment and hawkish central banks, we made several adjustments to our underlying model assumptions. Within our dividend discount model, which has been one of our most reliable forecast models, we increased our long-term cost of equity assumption to reflect persistently high interest rates in the 3-5% range. If interest rates do trend lower, this could become a positive tailwind for this model in the coming years.

Our Fair Value PE model shows the upside potential for valuation reversion in 2023 if inflation and interests rates follow the consensus script. This model uses a regression of the relationship between long-term interest rates and inflation to derive a long-term fair value PE. When we apply the 2023 consensus estimates for the US 10-year yield and inflation, and then apply that to our 2023 EPS estimate, the model implies a fair value target of 25,000 for the TSX. Indeed, this model shows valuations reverting to near historical averages during the year if current consensus is achieved.

Exhibit 46: Fair Value P/E Model Shows Sharp Reversion Based on 2023 Consensus Estimates

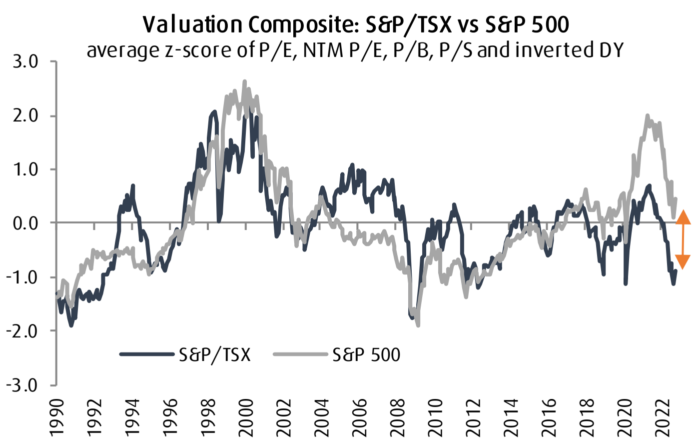


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Canadian Value Proposition Remains a Key Characteristic Heading Into 2023

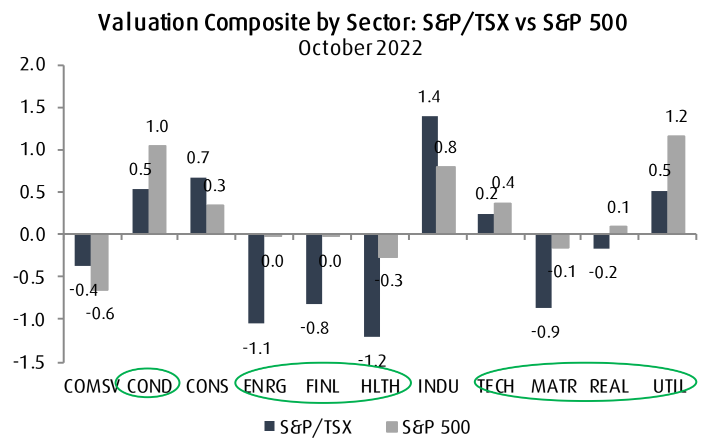
While the consistent value position of Canadian equities relative to the US and other developed markets helped the TSX avoid a bear market in 2022, our S&P/TSX valuation composite was still pushed to the lowest level since 2009 and remains firmly below the S&P 500 valuation composite (Exhibit 47 for a visual on depth of valuation divergence between Canada and the US). Admittedly, although the record valuation divergence against the US narrowed as the TSX outperformed for most of 2022, our work continues to show a strong and broad valuation discount proposition for Canadian equities. As equities transition to an increasingly fundamental-driven market, valuation tends to be at the forefront for investors. As such, the TSX is likely to outperform the S&P 500 for the second year in a row. Overall, while individual sector weight differences remain a key factor in this valuation divergence, our work suggests there remains significant value opportunities broadly in Canada (Exhibit 48). In fact, Energy remains a deep value sector in Canada especially relative to global energy peers. The Canadian Materials sector is an even deeper value sector in Canada given the sharp compression in valuations. Even outside these resource sectors, Canadian Financials, Consumer Discretionary, and Utilities trade at relative discounts to their US counterparts. As such, we believe several value opportunities continue to exist within Canadian equities, especially relative to the US. Therefore, investors should continue to view Canada as an attractive value proposition with a strong income advantage and significant US growth exposure.

Exhibit 47: Gap is Closing, But Valuation Spread Remains



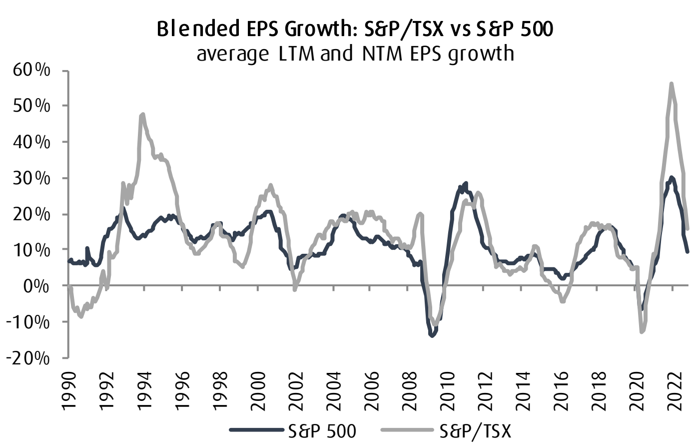
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 48: Most Sectors Are Showing Relative Value vs. the US



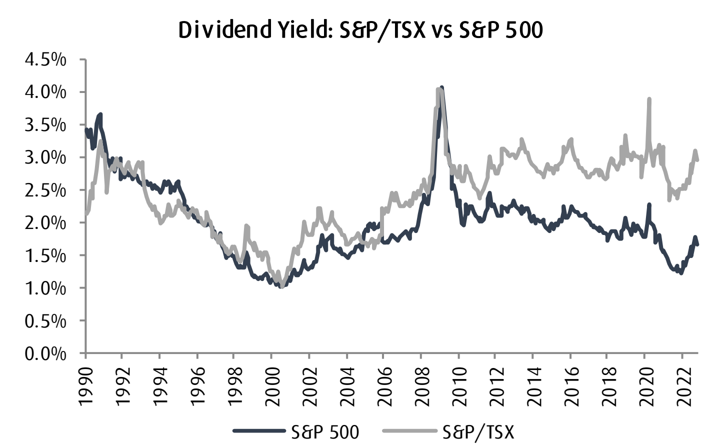
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Exhibit 49: EPS Growth Has Converged and Consistent With US



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

Exhibit 50: TSX Has Strong Yield Advantage



Source: BMO Capital Markets Investment Strategy Group, FactSet.

TSX Can Outperform Through Rising Rate Environments

Clearly rising long-term interest rates and the tightening cycles in the US and Canada are likely to remain key macro issues as we head into 2023, even as inflationary pressures ease. When examining the S&P/TSX absolute and relative price performance during prior interest rate cycles, our work suggests the TSX can still post solid returns and tends to outperform the S&P 500 in these environments (Exhibit 51). As such, we believe the TSX still has plenty of room to continue to outperform within this rising and elevated interest rate backdrop, particularly given the strong relative value position of the TSX. In fact, since 1979 the TSX has outperformed the S&P 500 in seven of the last ten rising interest rate cycles. Furthermore, in the last six rising rate periods the TSX continued to outperform the S&P 500 six months after the peak in interest rates, suggesting this outperformance could have some momentum through 2023. However, our work also suggests this outperformance typically fades, with the TSX ultimately underperforming the S&P 500 on average 12 months after the peak in interest rates and after the last Fed rate hike. Overall, we believe investors should remain overweight Canada heading into 2023, but remain selective and tactically agile given the evolving inflationary and interest rate environment.

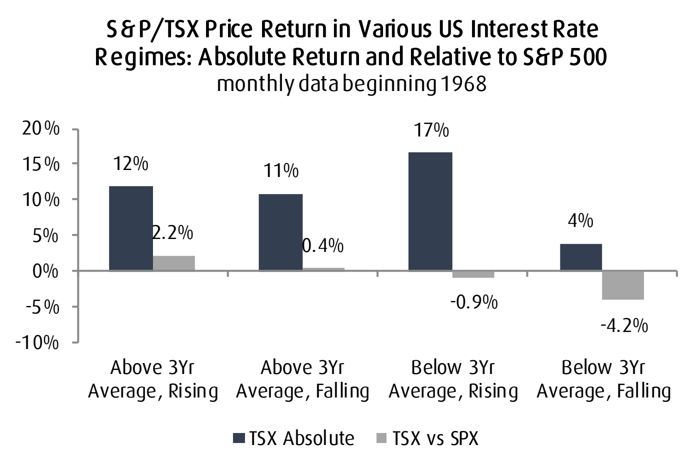
Exhibit 51: TSX Can Outperform During Rising Rate Cycles

S&P/TSX Relative to S&P 500 Average Price Performance During Rising Rate Cycles
Since 1979

Start	End	During Rising Rate Cycle	6m Post Peak	12m Post Peak
6/30/1979	9/30/1981	3.1%	-12.5%	-17.9%
4/30/1983	5/31/1984	4.0%	-2.2%	-2.5%
2/28/1987	2/28/1989	0.4%	-7.7%	-10.2%
9/30/1993	12/31/1994	5.5%	-9.4%	-16.6%
1/31/1996	4/30/1997	-4.5%	0.3%	-7.6%
10/31/1998	1/31/2000	7.6%	19.6%	12.2%
6/30/2003	6/30/2007	29.1%	1.8%	22.2%
12/31/2008	4/30/2010	3.4%	4.1%	-0.6%
7/31/2012	12/31/2013	-12.9%	4.8%	-3.6%
7/31/2016	10/31/2018	-17.4%	1.6%	-2.1%
7/31/2020	10/31/2022	1.5%		
Average All Cycles		1.8%	0.0%	-2.7%

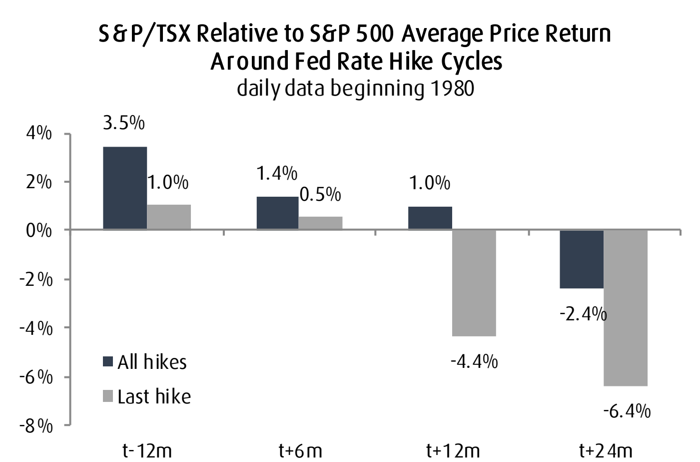
Source: BMO Capital Markets Investment Strategy Group, FactSet, FRB.

Exhibit 52: TSX Often Outperforms When Rates Above 3Y Average



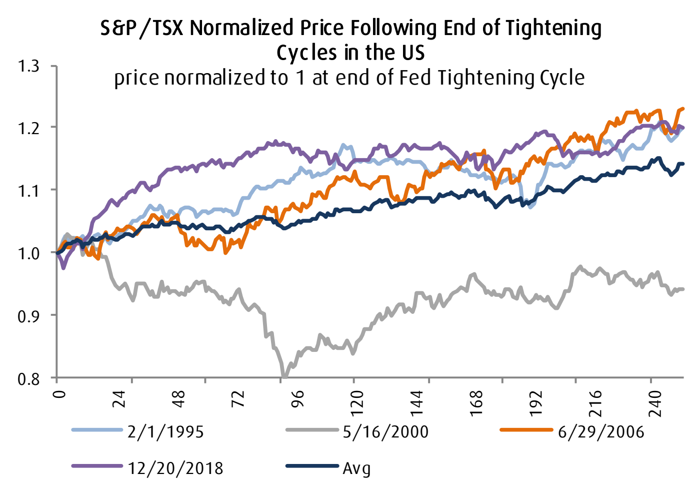
Source: BMO Capital Markets Investment Strategy Group, FactSet, FRB.

Exhibit 53: TSX Can Outperform Through Tightening Cycle, But Outperformance Fades Once Hiking Cycle Ends



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

Exhibit 54: Aside From 2000, Canadian Stocks Have Consistently Moved Higher Once Fed Stopped Raising Rates

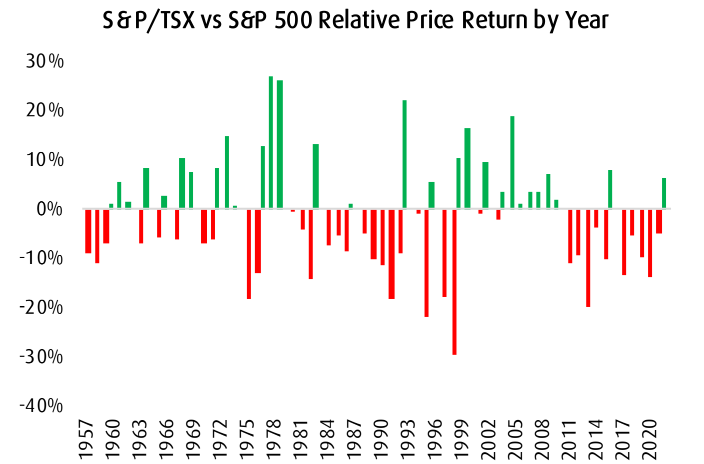


Source: BMO Capital Markets Investment Strategy Group, FactSet, FRB.

TSX Can Outperform for Multiple Years

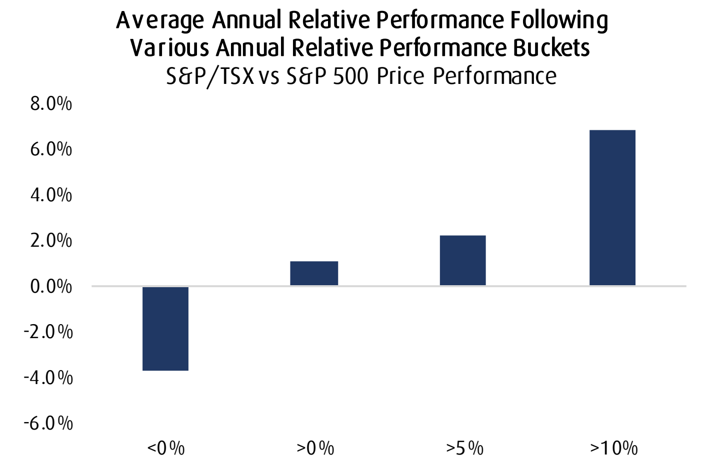
Yes, the S&P/TSX can outperform the S&P 500 two years in a row. Since 1957, the S&P/TSX outperformed the S&P 500 on average following years when the TSX outperformed (back to back outperformances are common). In fact, our work suggests the stronger the relative performance, the stronger the following year's relative performance can be (Exhibit 56). Years when the TSX outperformed by more than 10%, the average performance the following year was nearly 7%. Furthermore, years of outperformance tend to occur in clusters, often lasting multiple years, even outside commodity super cycles.

Exhibit 55: TSX Outperformance Occurs in Clusters



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 56: TSX Can Outperform Following Outperformance Years

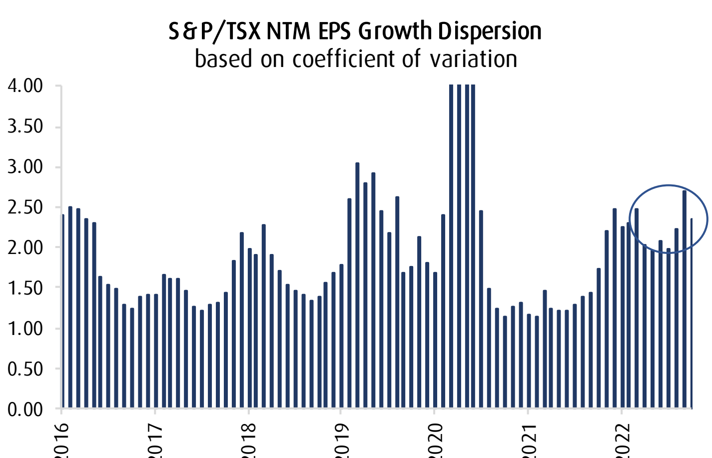


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Canada = Stay Selective = Income + Value + GARP

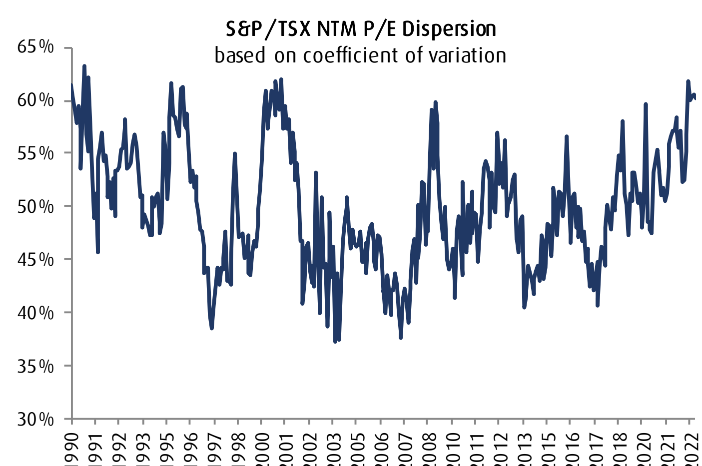
With recession risk and the end of the tightening cycle on the horizon, we believe the market is in a more differentiated fundamental environment that should favour a more selective (increased stock picking) investing approach. Indeed, earnings growth dispersion remains elevated and has continued to rise into year end. Furthermore, valuation dispersion among S&P/TSX companies has significantly increased since mid-2021 and is now consistently hovering near peak levels. As such, we believe investors should become more selective and focus on companies with more reasonable valuations, strong income potential, and sustainable long-term growth profiles.

Exhibit 57: Earnings Dispersion Is Elevated and Rising



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

Exhibit 58: Valuation Dispersion Near Record Levels



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

Post Bear Market and Recessionary Performance

With an inverted US yield curve and an aggressive global tightening cycle, the risk of recession in 2023 for both Canada and the US are elevated. This is a clear risk to equity market performance heading into 2023. In fact, our work shows the TSX posts a mild price contraction on average during recessionary years. As such, we believe 2023 is likely to be another volatile year which will require a more nimble and active investing approach. Our work shows markets tend to trough within the first six months of a recession and the market typically posts significant gains once the bear market lows are set, even as earnings go into contraction over the following 12 months. Of the last 11 US bear markets, the TSX was up almost 30% on average over the next 12 months. When the TSX LTM PE was sub-12x, like it is now, the market was up over 40%, on average, in the following 12 months and up 30%, on average, in the first six months.

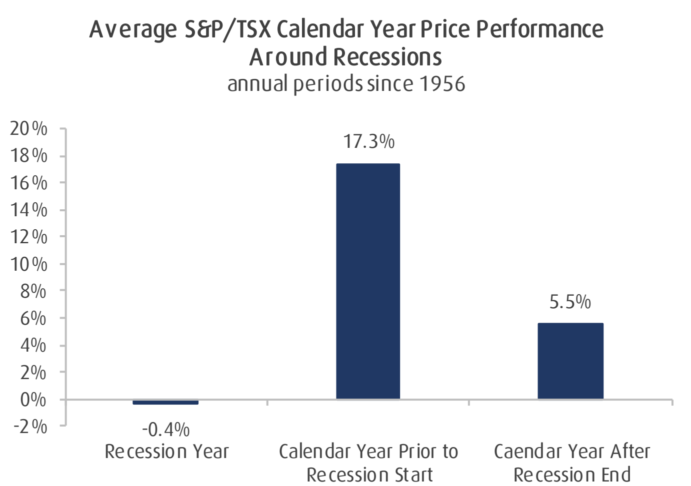
Exhibit 59: TSX Usually Seeing Strong Price Return and Multiple Expansion Post US Bear Markets

S&P/TSX Price Performance, Earnings Growth and LTM P/E Change Following US Bear Markets

	Price		EPS		PE	
Bear Market Trough	6m	12m	6m	12m	6m	12m
10/22/1957	1%	20%	-11%	-12%	1.6	4.3
6/26/1962	10%	18%	0%	10%	1.5	1.2
10/7/1966	16%	12%	5%	5%	1.5	0.9
5/26/1970	11%	18%	2%	-6%	1.3	3.5
10/3/1974	11%	2%	4%	-1%	0.5	0.2
8/12/1982	51%	71%	-46%	-39%	18.6	18.7
12/4/1987	14%	13%	21%	38%	-0.7	-2.3
10/11/1990	15%	9%	-20%	-43%	5.4	11.5
10/9/2002	13%	33%	29%	54%	-2.6	-2.9
3/9/2009	47%	58%	-17%	-22%	6.7	8.9
3/23/2020	42%	68%	-22%	-18%	9.3	11.6
10/12/2022						
Average	21%	29%	-5%	-3%	3.9	5.1
Average (Starting LTM PE < 12x)	30%	44%	-18%	-18%	7.3	8.8

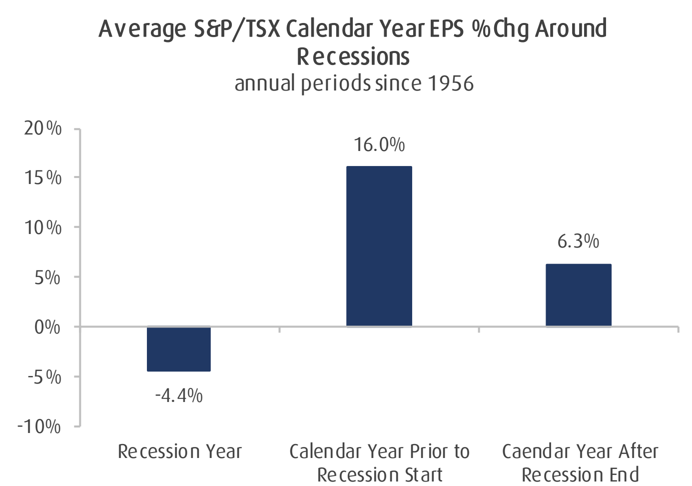
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 60: Recession Years Are Typically Weak



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 61: Earnings Typically Contract in Recession Years



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Focus on Tactical Canadian GARP Opportunities

From a strategy perspective, with Canadian equity markets exhibiting a record valuation divergence against other global markets, we believe Canada can continue to outperform, particularly in the early part of 2023. Furthermore, given the macro headwinds, we believe investors should be very selective with a clear focus on growth at reasonable price, while also focusing on companies with strong income growth profiles. Please see our Canadian All-Cap GARP portfolio, which focuses on companies with below-market valuations that have and are expected to post record earnings over the next few years.

Adding: Enbridge (ENB); Stantec (STN); TELUS (T)

Removing: Air Canada (AC); Bank of Nova Scotia (BNS); Kinaxis (KXS)

Exhibit 62: Canadian Tactical GARP Model Portfolio

Ticker	Company Name	Price	BMO Rating
ALA	AltaGas Ltd.	$22.80	OP
ARX	ARC Resources Ltd.	$18.73	OP
BMO	Bank of Montreal[1]	$132.12	NR; R
BTO	B2Gold Corp.	$4.71	OP
CAE	CAE Inc.	$29.06	OP
CIX	CI Financial Corp.	$14.30	OP
CM	Canadian Imperial Bank of Commerce	$65.10	OP
CNQ	Canadian Natural Resources Limited	$80.52	OP
CNR	Canadian National Railway Company	$169.17	OP
CRT.UN	CT Real Estate Investment Trust	$15.85	NR
CTC.A	Canadian Tire Corporation, Limited Class A	$150.08	Mkt
CVE	Cenovus Energy Inc.	$27.11	OP
CWB	Canadian Western Bank	$25.84	OP
DOO	BRP, Inc.	$94.83	OP
EMA	Emera Incorporated	$52.73	OP
EMP.A	Empire Co. Ltd. Class A	$35.85	Mkt
ENB	Enbridge Inc.	$55.94	OP
EQB	EQB Inc	$57.66	OP
EQX	Equinox Gold Corp.	$4.70	OP
ET	Evertz Technologies Limited	$12.30	OP
FM	First Quantum Minerals Ltd.	$30.97	Mkt
FTT	Finning International Inc.	$32.45	OP
GIB.A	CGI Inc. Class A	$114.45	OP
L	Loblaw Companies Limited	$117.75	Mkt
MFC	Manulife Financial Corporation	$24.03	Mkt
MG	Magna International Inc.	$82.31	NR
NA	National Bank of Canada	$99.13	OP
NGD	New Gold Inc.	$1.50	OP
NTR	Nutrien Ltd.	$110.16	NR
OTEX	Open Text Corporation	$40.05	NR
PXT	Parex Resources Inc.	$19.17	OP
QBR.B	Quebecor Inc. Class B	$28.12	OP
QSR	Restaurant Brands International Inc	$88.81	NR
RCI.B	Rogers Communications Inc. Class B	$60.54	OP
RY	Royal Bank of Canada	$134.81	Mkt
SLF	Sun Life Financial Inc.	$62.47	OP
STN	Stantec Inc	$67.81	OP
SU	Suncor Energy Inc.	$47.38	OP
T	TELUS Corporation	$29.04	OP
TD	Toronto-Dominion Bank	$91.02	Mkt
TECK.B	Teck Resources Limited Class B	$45.29	Mkt
TFII	TFI International Inc.	$140.47	NR
TOU	Tourmaline Oil Corp.	$80.38	OP
TRP	TC Energy Corporation	$65.97	OP

Source: BMO Capital Markets Investment Strategy, FactSet. Prices as of 11/28/2022.
[1]BMO Capital Markets is Restricted on Bank of Montreal (BMO)
*Rating Key, according to BMO Capital Markets Equity Research: OP: Outperform, Mkt: Market Perform, Und: Underperform, NR: Not rated, R: Restricted by BMO Capital Markets Equity Research. **These stocks are covered by BMO Capital Markets, Corp.; all others are covered by BMO Nesbitt Burns, Inc.

Sectors, Size, and Style Recommendations

Canadian Sector Opinions

Exhibit 63: Canadian Sector Opinion Summary

Sector	Opinion	Index Weight	Target Weight	BMO Investment Strategy Group Headline
Communication Services	OW	4.8%	5.0%	Remains our preferred yield play, despite challenges of yield strategies
Consumer Discretionary	MW	3.6%	3.5%	Caution is warranted heading into the early part of 2023, despite greatly improved valuations
Consumer Staples	MW	4.1%	4.0%	Classic defensive sector could benefit in early 2023 but easing inflationary pressures to become a headwind
Energy	MW	18.8%	19.0%	Fundamentally, we want to be overweight = deep value, strong cash generation; however, tends to underperform out of recession and risk of oil prices running its course is high. Continue to favour higher quality large cap Energy stocks with strong cash flow, over high oil price beta names
Financials	OW	31.0%	32.5%	Steadfastly maintaining holdings in broader sector; we prefer companies with diversified balance sheets, strong US platforms, and modest expectations—especially within the banks. Additionally, insurance companies offer strong relative value, even vs. other financials, and could outperform the sector near-term
Health Care	UW	0.4%	0%	Prefer US for diversity
Industrials	MW	13.2%	13.0%	Now the most expensive sector in the TSX; earnings have struggled to meet expectations; Focus on the rails, select manufacturers, and waste companies – especially those leveraged to the US
Information Technology	MW	5.4%	5.5%	No denying fundamental momentum, but performance rate of change is under way; be very selective
Materials	OW	11.7%	12.5%	We remain slightly overweight the Materials sector but shifting our focus to gold, from base metals and companies with strong operating efficiency and cash flow generation
Real Estate	MW	2.5%	2.5%	Stronger-than-expected earnings environment; our work has shown Real Estate to be less interest rate sensitive than other high yielding sectors, particularly since 2002
Utilities	UW	4.4%	2.5%	Rising yields, low organic growth, and high payout ratios are a tough combination

Source: BMO Capital Markets Investment Strategy Group. Key: OW: Overweight, MW: Market Weight, UW: Underweight

Sector Changes

- **Upgrading Communication Services to Overweight from Market Weight**
- **Downgrading Consumer Discretionary to Market Weight on earnings contraction risk**
- **Downgrading Health Care to Underweight from Market Weight**

Exhibit 64: S&P/TSX Annual Sector Performance

Year	COMSV	COND	CONS	ENRS	FINL	HLTH	INDU	INFT	MATR	RELS	UTIL	S&P/TSX
1990	-12.6%	-25.1%	-11.4%	-10.5%	-21.7%	-21.3%	-24.3%	2.8%	-19.3%		-2.4%	-18.0%
1991	21.5%	14.0%	21.4%	-19.0%	21.1%	61.5%	-10.5%	55.9%	-3.6%		1.3%	7.8%
1992	-11.2%	-1.2%	0.9%	3.5%	-11.9%	-14.2%	-11.1%	20.0%	-1.5%		-4.4%	-4.6%
1993	16.4%	21.0%	4.0%	33.1%	27.8%	5.6%	27.6%	18.6%	56.8%		19.1%	29.0%
1994	-1.8%	-11.6%	-1.8%	-7.1%	-6.1%	13.4%	3.0%	-7.2%	4.1%		-9.6%	-2.5%
1995	2.7%	0.6%	19.4%	15.2%	14.1%	62.3%	13.7%	34.0%	7.6%		6.3%	11.9%
1996	30.9%	25.4%	15.2%	36.8%	49.9%	30.1%	30.4%	21.7%	9.7%		22.4%	25.7%
1997	39.2%	28.4%	16.2%	3.1%	49.8%	-11.1%	19.2%	40.1%	-26.2%		38.2%	13.0%
1998	21.1%	6.7%	23.6%	-30.4%	0.6%	-0.3%	-11.2%	7.6%	-12.3%		-4.0%	-3.2%
1999	85.0%	-0.5%	13.3%	26.2%	-13.0%	13.1%	4.1%	188.8%	12.4%		-30.6%	29.7%
2000	22.5%	9.5%	38.1%	46.3%	45.6%	3.8%	28.2%	-31.1%	-8.9%		42.6%	6.2%
2001	-29.6%	1.7%	27.4%	6.1%	1.3%	15.2%	5.5%	-62.1%	8.9%		6.4%	-13.9%
2002	-21.9%	-21.3%	0.9%	12.7%	-5.0%	-42.8%	-31.3%	-64.8%	5.5%		2.1%	-14.0%
2003	12.6%	19.5%	18.9%	23.6%	24.4%	1.3%	21.1%	67.0%	26.0%		19.9%	24.3%
2004	8.2%	8.3%	9.3%	28.7%	16.5%	-17.4%	0.2%	11.5%	5.7%	11.2%	5.0%	12.5%
2005	9.7%	8.6%	-2.2%	61.3%	20.5%	-3.5%	16.5%	-15.8%	13.9%	20.0%	33.1%	21.9%
2006	16.4%	13.2%	3.9%	3.2%	15.9%	-0.7%	12.7%	27.3%	38.0%	23.5%	2.1%	14.5%
2007	16.2%	1.8%	-6.8%	5.0%	-4.6%	-27.1%	8.6%	48.1%	29.1%	-11.6%	6.9%	7.2%
2008	-27.4%	-37.5%	-7.8%	-36.3%	-39.0%	-34.4%	-26.9%	-54.3%	-27.1%	-45.2%	-24.0%	-35.0%
2009	0.7%	11.1%	6.1%	35.0%	38.3%	28.6%	23.7%	44.3%	33.4%	35.0%	12.7%	30.7%
2010	16.2%	21.8%	8.3%	10.0%	6.3%	50.3%	14.4%	-11.6%	35.8%	26.4%	12.6%	14.4%
2011	19.0%	-17.9%	4.8%	-12.3%	-6.6%	49.6%	2.0%	-52.6%	-21.8%	1.1%	1.6%	-11.1%
2012	6.4%	18.7%	20.4%	-3.6%	12.8%	24.1%	12.7%	-3.2%	-6.9%	16.2%	-0.8%	4.0%
2013	8.1%	39.5%	21.4%	9.9%	19.1%	71.7%	34.9%	36.2%	-30.6%	0.5%	-8.6%	9.6%
2014	10.5%	26.4%	46.9%	-7.8%	9.8%	30.2%	20.0%	34.0%	-4.5%	18.0%	11.3%	7.4%
2015	-1.0%	-3.5%	11.0%	-25.7%	-5.5%	-15.8%	-12.5%	14.8%	-22.8%	3.1%	-7.8%	-11.1%
2016	9.9%	8.2%	6.1%	31.2%	19.3%	-78.6%	20.7%	4.4%	39.0%	4.1%	12.7%	17.5%
2017	9.9%	20.4%	6.4%	-10.0%	9.4%	32.7%	17.9%	16.2%	6.3%	5.8%	6.2%	6.0%
2018	-5.3%	-17.7%	0.6%	-21.5%	-12.6%	-16.6%	-3.9%	12.5%	-10.6%	-2.8%	-13.4%	-11.6%
2019	8.2%	13.1%	12.8%	16.2%	16.9%	-11.4%	23.6%	63.5%	22.1%	17.4%	31.6%	19.1%
2020	-8.3%	14.4%	2.8%	-30.8%	-2.9%	-23.6%	15.3%	80.3%	19.5%	-13.0%	10.6%	2.2%
2021	19.1%	16.3%	20.6%	41.8%	31.6%	-20.1%	15.1%	18.3%	2.3%	33.1%	7.5%	21.7%
2022	-3.0%	-4.8%	9.9%	34.9%	-7.0%	-55.5%	5.0%	-51.3%	0.3%	-21.2%	-9.2%	-4.7%

REITs are used as a historical proxy for the Real Estate sector which was officially established in Sept. 2016.
Source: BMO Capital Markets Investment Strategy Group, FactSet. Performance calculated through 11/28/22.

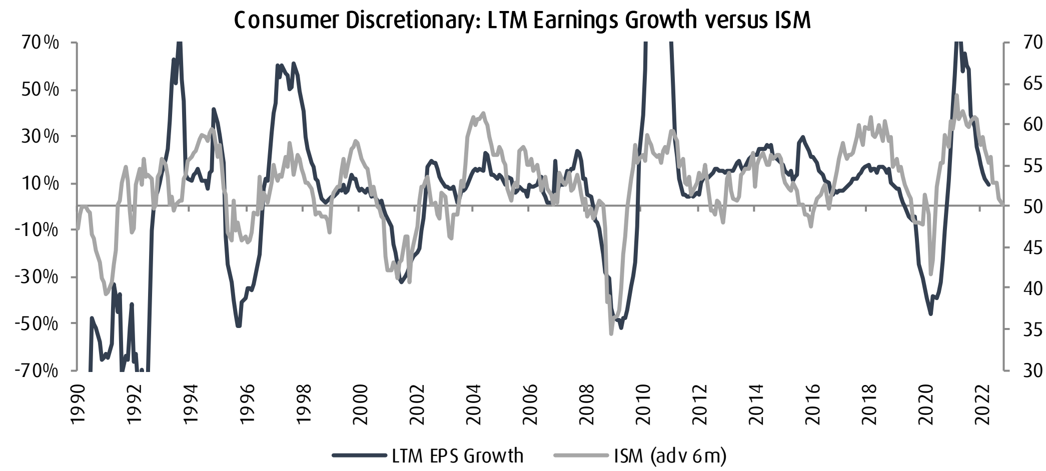
Sectors

Downgrading Consumer Discretionary to Market Weight From Overweight

While we continue to believe the Consumer Discretionary sector offers many key points of stability, including strong dividend growth, buybacks and profitability metrics, we believe 2023 is likely to be a more difficult year for the Canadian and US consumer. Although our base case has been for a normalization in earnings growth to the low single digits within the broad market and sector, given the interest rate pressures and recession risks, we now believe the risk of an earnings contraction in 2023 is elevated. As such, we are downgrading Consumer Discretionary to Market Weight and believe investors should focus on companies with strong cash flow and stable revenue.

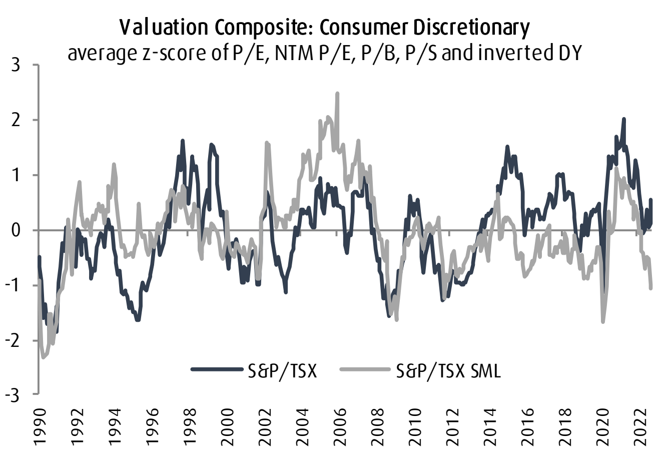
- US purchasing managers index is a strong leading indicator for Consumer Discretionary earnings growth and has decelerated sharply over the last few months. Yes, risk of an earnings contraction in 2023 is elevated and the key risk in 2023.
- Valuations have been stable and near long-term average. However, more volatile smaller cap Consumer Discretionary valuations are pricing in an earnings contraction.
- Forward growth expectations have been stable and will likely need to be revised lower if a recession occurs.

Exhibit 65: 2023 Poses Significant Growth Challenges for the Sector



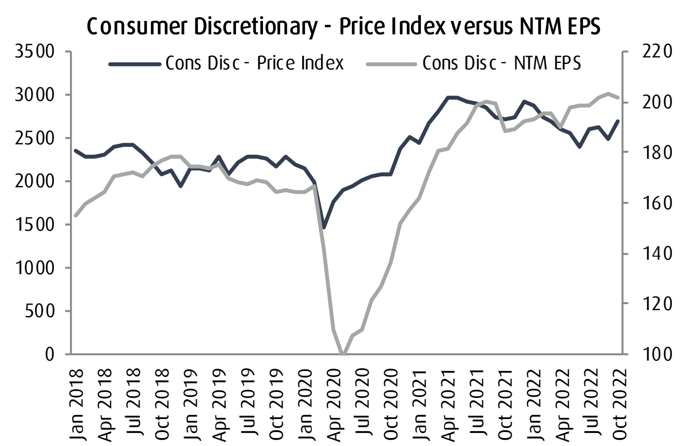
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, ISM.

Exhibit 66: Valuations Are Reasonable, While Small-Cap Consumer Discretionary is Pricing in Earnings Contraction



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

Exhibit 67: NTM EPS Has Been Stable, But Could Be Revised Lower in 2023



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

Canadian Size Opinions

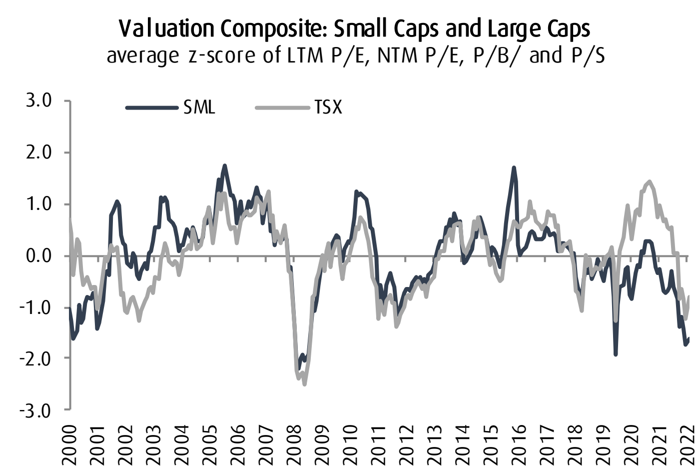
Exhibit 68: Canadian Size Opinions

Sector	Opinion	Comments
Large cap	OW	Large cap is trading at a deep discount to history, while earnings and profitability have been relatively strong and stable. Yes, investors should be selective with a focus on growth-at-a-reasonable price.
Small cap	MW	While small cap is also trading at a deep discount to history and a mild discount to large cap, the small-cap universe has broadly struggled to grow earnings relative to Large Cap.

Key: OW: Overweight, MW: Market Weight, UW: Underweight; Source: BMO Capital Markets Investment Strategy Group.

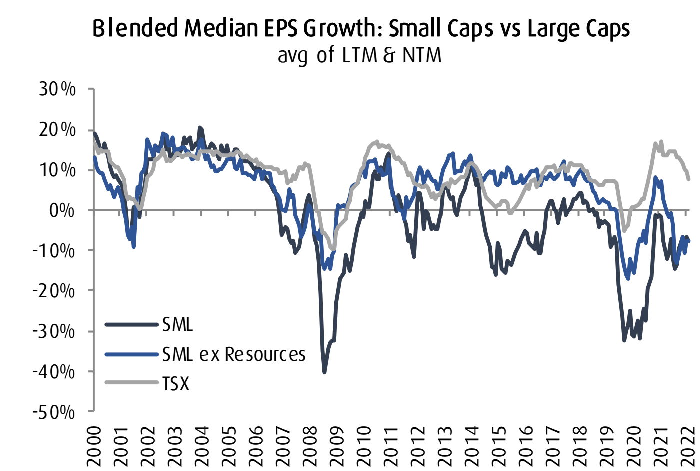
Bottom Line: Although Canadian small-cap is showing a near record valuation discount relative to history, this valuation advantage relative to large cap has narrowed as small-cap stocks have struggled to grow earnings at the same pace as Large Cap. In our opinion, the small-cap universe likely has many more value traps than large cap and, as such, requires greater caution as we head into the more difficult earnings environment of 2023. In fact, unlike the large-cap universe, most sectors in the small-cap universe have struggled to post positive earnings growth over the last 12 months. Overall, we prefer the stability and growth potential of large-caps over small-cap stocks, especially in the early half of 2023. However, opportunities exist in both markets and investors should remain selective with a focus on growth-at-a-reasonable price.

Exhibit 69: Canada is Broadly a Deep Value Market



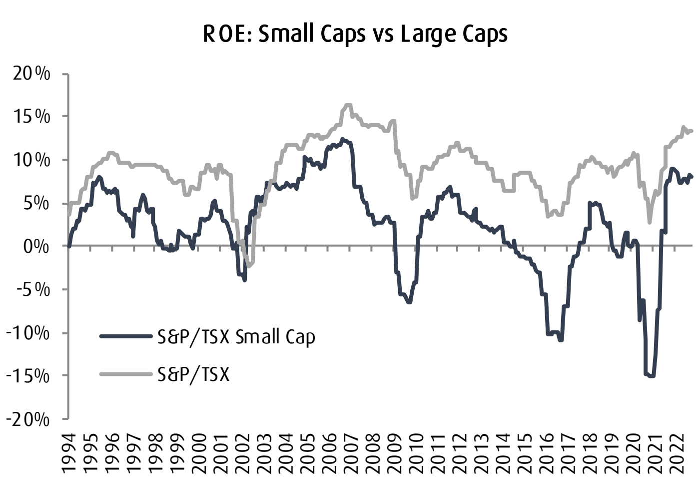
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 70: Small-Cap Has Struggled to Grow Earnings



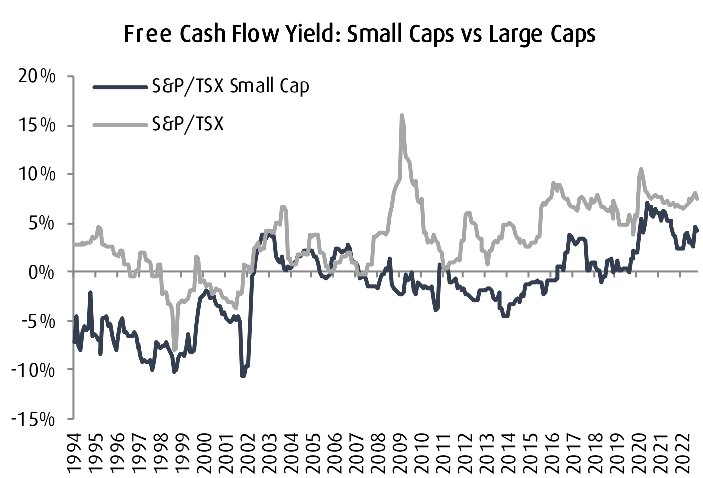
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Exhibit 71: Small-Cap Profitability Has Rebounded, Even as Earnings Growth Struggles = Quality Opportunities Exist



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 72: Cash Generation is Strong = Quality Opportunities Exist



Source: BMO Capital Markets Investment Strategy Group, FactSet.

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Buy	Outperform	52.8 %	17.0 %	51.1 %	56.0 %	57.5 %	57.7%
Hold	Market Perform	45.4 %	18.1 %	46.6 %	42.5 %	40.7 %	37.5%
Sell	Underperform	1.8 %	22.2 %	2.3 %	1.4 %	1.8 %	4.8%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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