TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

MARCH 2018

FIERA CAPITAL

After an exuberant start to the new year and an extended period of market calm, volatility reasserted itself in February. Financial markets were jilted after newly-instated Federal Reserve Chair Jerome Powell embraced a constructive outlook on the US economy and rekindled fears of an accelerated pace of rate hikes, with investors growing concerned that higher interest rates will erode both global growth and corporate profitability. Meanwhile, after a steady stream of growth-friendly policy announcements from the Trump administration, the President roiled the marketplace and took his first big step towards fulfilling his protectionist agenda after announcing his intension to impose tariffs on steel and aluminum imports, sparking fears of a global trade war.

FINANCIAL MARKET DASHBOARD

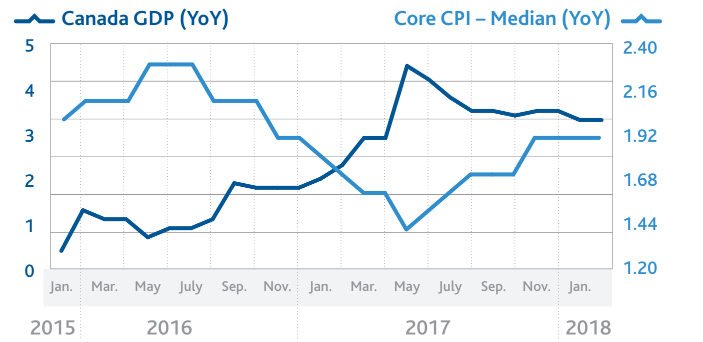
	FEB. 28, 2018	FEB.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,714	-3.89%	1.50%	14.82%
S&P/TSX	15,443	-3.19%	-4.73%	0.28%
MSCI EAFE	2,052	-4.71%	0.05%	17.04%
MSCI EM	1,195	-4.73%	3.17%	27.64%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.86	15.6	45.5	47.1
US 2 Year Bond Yield	2.25	10.9	36.7	99.0
CA 10 Year Bond Yield	2.24	-5.4	19.0	60.0
CA 2 Year Bond Yield	1.79	-5.1	9.8	102.9
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.78	-4.04%	-2.04%	3.66%
EUR/USD	1.22	-1.77%	1.57%	15.30%
USD/JPY	106.68	-2.30%	-5.33%	-5.40%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	61.64	-4.77%	2.02%	14.13%
Copper (USD/pound)	3.11	-2.75%	-5.85%	14.92%
Gold (USD/oz)	1,317.9	-1.58%	0.66%	5.10%

The 15-month winning streak in global equity markets came to a halt in February, with the MSCI All Country World index posting its first monthly decline since October 2016 – even despite ongoing global economic strength and accelerating corporate profits. The monthly rout in equity prices spread broadly across the world, with no region left unscathed. The S&P 500 tumbled lower and posted its worst monthly return in over two years, while the negative undertone in the marketplace also spread more broadly, with notable declines across Canadian, European, and Emerging Market bourses.

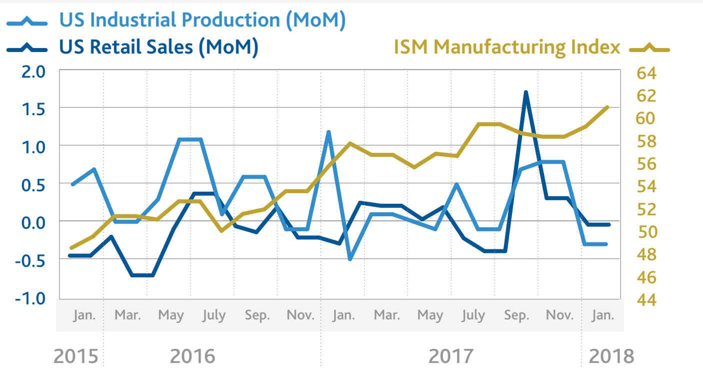
Meanwhile, US fixed income markets sold off aggressively during the month. Bond yields pushed higher across the curve as investors digested the prospect for higher borrowing costs following Chair Powell's hawkish economic assessment, which was compounded further by a revival in inflation expectations. Notably, investors are now fully-pricing three rate hikes from the Federal Reserve in 2018, though have even begun to ponder a fourth rate hike this year. In contrast, Canadian bond yields inched lower during the month as some weak domestic data provided a soft handoff to 2018.

The US dollar was mainly stronger versus its global peers in February, with higher bond yields increasing the attractiveness of the greenback. In contrast, the Canadian dollar declined to a 2018 low amid widening US-Canada interest rate differentials, while lingering NAFTA uncertainties also added to the defensive tone. The euro retreated as some benign inflation results fuelled expectations for ongoing accommodation from the European Central Bank, while the pound was hindered by increasingly contentious Brexit negotiations. Finally, the yen bucked the global trend and strengthened after the Bank of Japan curtailed its purchases of longer-term bonds and hinted at a timeframe for a potential exit strategy from its extraordinary stimulus program.

In commodity markets, crude oil posted its first monthly drop since August amid growing concerns that rising shale production will add to the supply glut in the US - particularly after government reports indicated that stockpiles rose more than expected in late-February. Copper prices also joined the broad based flight from risk assets, while even gold retreated on the prospect for an accelerated pace of rate hikes in the US, though reversed course somewhat at month-end after fears of a global trade war prompted investors to seek out safe haven assets such as bullion.



In response to a stellar economic performance in 2017, underlying pricing pressures in Canada are finally resurfacing, with the average of the Bank of Canada's three core inflation gauges rising to 1.83% (versus the 2% target).



While both retail sales and factory production came in shy of expectations at the beginning of 2018, leading economic indicators suggest that growth should remain buoyant for the coming year.

After years of unprecedented monetary and fiscal support, Japan finally appears to be escaping its deflationary spiral – allowing the Bank of Japan to consider exiting its ultra-accommodative stance if it achieves its inflation target in 2019.

CANADA

The Canadian economy rounded out an impressive year and grew at a 1.7% annualized pace during the fourth quarter of 2017, taking annual GDP to a 3.0% pace for the year as a whole. While the consumer indeed pulled-back to more sustainable levels, both business and residential spending accelerated, while government spending also provided a boost. In contrast, trade detracted as export growth came in shy of imports. Meanwhile, we are finally seeing some convincing signs of underlying pricing pressures in response, with the core gauges followed by the Bank of Canada indicating some firming trends. That being said, newly-announced protectionist measures from President Trump (which have also arguably complicated NAFTA negotiations) are likely to afford the central bank to adopt a patient approach to monetary policy normalization this year.

USA

The outlook for the US economy remains reasonably bright for 2018, notwithstanding any negative ramifications stemming from President Trump's protectionist agenda. While the combination of a tighter labour market, rising wages, and newly-implemented tax cuts are expected to prop up consumer spending, the weaker dollar and strong global demand should bolster exports. Encouragingly, inflationary pressures appear to be building, which has been the missing piece of the puzzle at the Federal Reserve. As such, Fed Chair Powell argued that the economic outlook remains robust and even went so far as to open the door to a possible fourth rate hike this year if the economy gains momentum and inflationary pressures rise, while stating that recent headwinds have now translated into tailwinds for the US economy (fiscal expansion).

INTERNATIONAL

Looking abroad, economic growth remains both durable and increasingly self-sustaining, allowing central bankers to slowly reign-in their stimulative monetary policies after years of unprecedented support. The European economy continues to fire on all cylinders and grew at a stronger than expected pace in the final quarter of 2017, with broad based gains across both sectors and regions. Similarly, the Japanese economy reported its eighth consecutive quarterly advance during the fourth quarter, while headline consumer prices jumped to a three-year high. In response, the Bank of Japan has joined its central bank peers in acknowledging that a plan to begin unwinding its massive stimulus program is forthcoming, hinting that the central bank will begin thinking about how to proceed around the next fiscal year starting April 2019.

Our current scenarios are for a synchronized global expansion (60%), which is a continuation of the current environment that benefits equities, trade protectionism (20%), which would be negative for equities and positive for bonds, political instability (10%) that would introduce significant financial market volatility, and finally, stronger than expected growth & inflation (10%) which would be negative for bonds and positive for equities.

MAIN SCENARIO
SYNCHRONIZED GLOBAL EXPANSION

PROBABILITY 60%

The global economy continues to grind higher in a synchronous manner, with all major regions contributing to the advance. The US expansion lingers on, thanks to widespread improvements across both the consumer and manufacturing sectors of the economy, while stimulative fiscal policy also provides a boost. Meanwhile, the Canadian economy moderates towards a more sustainable, albeit above-trend pace – though the fate of NAFTA clouds the outlook. Finally, while policymakers in Europe and Japan ultimately prove successful in reflating growth, emerging market economies prosper in the environment of improving global demand, ample liquidity, and rising commodity prices. Taken together, the lucrative combination of synchronized global growth and a revival in commodity prices should bolster inflation expectations across the world, though not to levels that would threaten the status of the economic recovery. This reflationary backdrop bodes well for equities and commodities (ex-gold) at the expense of fixed income and the US dollar.

SCENARIO 2
TRADE PROTECTIONISM

PROBABILITY 20%

The biggest risk to our base case scenario is a rise in trade protectionism stemming from restrictive policies in the US. Specifically, renewed pressure to make good on his campaign promises ahead of the midterm elections could see President Trump's rhetoric on protectionism translate into action, particularly due to his ability to act unilaterally on the foreign policy front. The risk of a sudden breakdown of NAFTA negotiations or US-China relations remain front and center from a risk perspective. If anti-trade rhetoric in the US becomes a reality and results in tariffs being imposed on economies such as China, Canada, and Mexico, retaliatory measures could ignite a global trade war – which would all but derail the status of the global economic expansion and fuel a rout in financial markets alike.

SCENARIO 3
POLITICAL INSTABILITY

PROBABILITY 10%

Recent trends towards populism in Europe could bring about renewed political upheaval and a corresponding crisis in confidence – disrupting the global economy and financial markets alike. While anti-euro parties were unable to gain significant ground in 2017, the potential for a rise in euro skeptic movements prevails in Italy (where support for the euro remains low), while political angst in Spain (the Euro Area's fourth largest economy) looms after the Catalonian election indicated strong support for independence – all of which risks throwing the region into political disarray at the same inopportune time when a lack of progress in Brexit negotiations has raised the odds of a "hard Brexit" scenario. And in China, with the twice-a-decade National Party Congress now behind us, we will be watchful on how aggressively President Xi pursues economic reforms and at what expense to the growth outlook. After consolidating his power, an increasingly assertive and wide spread stance towards financial sector reforms to crack down on excesses could pose considerable risks to both economic growth and financial stability.

SCENARIO 4
STRONGER GROWTH & INFLATION

PROBABILITY 10%

Inflation expectations de-anchor from current subdued levels and surge higher on the back of the stronger-than-expected global growth backdrop. Specifically, the global expansion has become increasingly self-sustaining and excess capacity has been absorbed, with all major OECD economies operating at/near full potential. When combined with central bank's tolerance for higher inflation and the overly-stimulative monetary policy backdrop in general, the global economy could potentially overheat and trigger a faster tightening schedule as central bank doves morph into hawks - increasing the risk of a policy error, shortening the cycle, and stifling the economic recovery. With asset valuations at extreme levels, this leaves little room for error from a financial market perspective.

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	FEBRUARY 28, 2018	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	POLITICAL INSTABILITY	STRONGER GROWTH & INFLATION
PROBABILITY		60%	20%	10%	10%
GDP GROWTH (Y/Y)					
Global	3.50%	3.75%	2.00%	3.00%	4.25%
Canada	3.30%	2.75%	0.50%	1.00%	3.25%
U.S.	2.50%	3.25%	1.00%	1.00%	4.00%
INFLATION (HEADLINE Y/Y)					
Canada	1.70%	2.25%	1.50%	1.50%	3.00%
U.S.	2.10%	2.25%	2.00%	1.75%	3.25%
SHORT-TERM RATES					
Bank of Canada	1.25%	1.75%	0.50%	1.00%	2.25%
Federal Reserve	1.50%	2.50%	1.50%	1.50%	3.00%
10-YEAR RATES					
Canada Government	2.24%	2.85%	1.40%	1.70%	3.80%
US Government	2.86%	3.25%	2.00%	1.60%	4.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	11.4%	16.0%	-22.7%	-11.6%	18.8%
U.S.	17.0%	13.4%	-12.2%	-1.2%	24.4%
EAFE	16.7%	8.6%	-19.6%	-15.6%	20.6%
EM	27.9%	34.7%	-12.5%	-12.5%	41.4%
P/E (FORWARD 12 MONTHS)					
Canada	15.3X	16.5X	16.5X	16.5X	16.0X
U.S.	17.0X	18.0X	16.5X	17.0X	18.0X
EAFE	14.1X	15.5X	15.0X	14.5X	15.0X
EM	12.6X	13.5X	11.0X	12.5X	12.5X
CURRENCIES					
CAD/USD	0.78	0.85	0.65	0.70	0.85
EUR/USD	1.22	1.25	1.10	1.00	1.10
USD/JPY	106.68	105.00	100.00	100.00	120.00
COMMODITIES					
Oil (WTI, USD/barrel)	61.64	72.00	40.00	45.00	75.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	POLITICAL INSTABILITY	STRONGER GROWTH & INFLATION
PROBABILITY	60%	20%	10%	10%
Money Market	1.5%	0.9%	1.1%	1.8%
Canadian Bonds	-1.9%	8.3%	6.5%	-8.4%
Canadian Equity	12.2%	-25.2%	-14.5%	11.4%
U.S. Equity	-5.7%	-12.5%	-5.9%	3.4%
International Equity	-6.5%	-12.3%	-17.4%	0.5%
Emerging Market Equity	3.6%	-28.3%	-24.3%	0.7%

CURRENT STRATEGY [1]

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	ALLOCATION	RELATIVE	DEC. 6 CHANGES
Money Market	0.0%	5.0%	25.0%	Overweight	20.0%	+15.0%	Increased by 10.0 %
Canadian Bonds	20.0%	40.0%	60.0%	Underweight	25.0%	-15.0%	No change
Canadian Equity	20.0%	25.0%	45.0%	Overweight	30.0%	+5.0%	Decreased by 2.5%
U.S. Equity	3.0%	13.0%	23.0%	Underweight	8.0%	-5.0%	Decreased by 5.0%
International Equity	2.0%	12.0%	22.0%	Underweight	7.0%	-5.0%	No change
Emerging Markets Equity	0.0%	5.0%	15.0%	Overweight	10.0%	+5.0%	Decreased by 2.5%

[1] Based on a 100 basis point value added objective. The benchmark employed here is based on a model portfolio and for illustrative purposes only. Individual client benchmarks are employed in the management of their respective portfolios.

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EVOLUTION OF STRATEGY [1]

	MONEY MARKET	CANADIAN BONDS	CANADIAN EQUITY	U.S. EQUITY	INTERNATIONAL EQUITY	EMERGING MARKETS EQUITY
August 10, 2011	+5.0%	-15.0%	+5.0%	+5.0%	0.0%	0.0%
October 5, 2011	+7.0%	-15.0%	+8.0%	0.0%	0.0%	0.0%
October 12, 2011	+6.0%	-10.0%	+4.0%	0.0%	0.0%	0.0%
November 11, 2011	+5.0%	0.0%	0.0%	0.0%	-5.0%	0.0%
December 7, 2011	0.0%	0.0%	+5.0%	0.0%	-5.0%	0.0%
April 20, 2012	+15.0%	-20.0%	+10.0%	0.0%	-5.0%	0.0%
July 31, 2012	+20.0%	-15.0%	0.0%	0.0%	-5.0%	0.0%
November 9, 2012	+10.0%	-15.0%	+10.0%	0.0%	-5.0%	0.0%
February 19, 2013	+5.0%	-15.0%	+10.0%	0.0%	0.0%	0.0%
August 6, 2013	0.0%	-15.0%	+10.0%	+5.0%	0.0%	0.0%
December 3, 2013	+10.0%	-15.0%	+5.0%	0.0%	0.0%	0.0%
February 5, 2014	0.0%	-15.0%	+10.0%	+10.0%	-5.0%	0.0%
October 14, 2014	0.0%	-20.0%	+5.0%	+10.0%	+5.0%	0.0%
November 14, 2014	+10.0%	-20.0%	+2.5%	+2.5%	+5.0%	0.0%
July 13, 2015	0.0%	-20.0%	+7.0%	+4.0%	+9.0%	0.0%
October 19, 2015	0.0%	-20.0%	+11.0%	+0.0%	+9.0%	0.0%
June 24, 2016	+9.0%	-20.0%	+11.0%	+0.0%	+0.0%	0.0%
July 12, 2016	0.0%	-20.0%	+15.0%	+0.0%	+0.0%	+5.0%
July 27, 2016	+5.0%	-20.0%	+12.5%	+0.0%	+0.0%	+2.5%
October 31, 2016	0.0%	-20.0%	+12.5%	0.0%	0.0%	+7.5%
April 5, 2017	+5.0%	-15.0%	+7.5%	0.0%	-5.0%	+7.5%
December 6, 2017	+15.0%	-15.0%	+5.0%	-5.0%	-5.0%	+5.0%

[1] Based on a 100 basis point value added objective.

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