TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

MAY 2018

FIERA CAPITAL

After a tumultuous start to the year, a sense of normalcy returned to the marketplace in April. Volatility has consolidated around levels higher than those witnessed through 2017, but remains at levels more consistent with historical norms. With complacency seemingly washed out of the marketplace and less visibility in the economic cycle, investors are striving for direction and appear more sensitive to economic and political developments at hand, including the prospect for higher borrowing costs, lofty earnings expectations, an uncertain geopolitical climate, and brewing trade tensions – essentially underscoring the fragile sentiment in the marketplace at this time.

FINANCIAL MARKET DASHBOARD

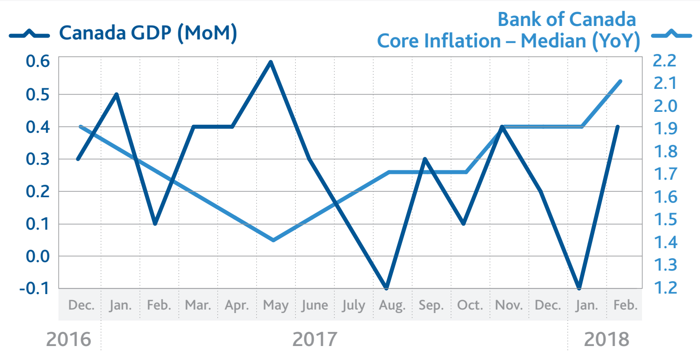
	APRIL 30, 2018	APR.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,648	0.27%	-0.96%	11.07%
S&P/TSX	15,608	1.57%	-3.71%	0.14%
MSCI EAFE	2,044	2.07%	-0.35%	11.45%
MSCI EM	1,164	-0.41%	0.52%	19.07%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.95	21.4	54.8	67.3
US 2 Year Bond Yield	2.49	22.2	60.5	122.6
CA 10 Year Bond Yield	2.31	21.6	26.2	76.0
CA 2 Year Bond Yield	1.89	11.8	20.4	117.2
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.78	0.31%	-2.12%	6.31%
EUR/USD	1.21	-1.80%	0.61%	10.86%
USD/JPY	109.34	2.73%	-2.97%	-1.93%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	68.57	5.59%	13.49%	39.00%
Copper (USD/pound)	3.05	0.89%	-7.51%	17.56%
Gold (USD/oz)	1,319.20	-0.27%	0.76%	4.01%

Global equity markets posted positive results in April. The S&P 500 snapped its two-month losing streak and ended the month modestly higher as investors weighed the rising rate environment against stronger-than-expected corporate earnings. Meanwhile, the S&P/TSX posted some robust results as crude prices staged an impressive comeback and boosted the shares of energy producers, while developed bourses in Europe and Asia regained some ground after a sharp pullback earlier this year. In contrast, emerging market equities retreated as the prospect for an accelerated path of fed fund rate hikes lured investors away from risker assets in the developing world.

Government bond yields backed-up across the curve, with both US and Canadian fixed income markets posting negative results in April. The US 10 year treasury yield broke through the pivotal 3% level for the first time since 2013 as higher commodity prices emboldened inflation expectations – while the short-end rose to a decade-high as confidence in the growth and inflation trajectory boosted expectations for Federal Reserve rate hikes. Meanwhile, corporate spreads remained well-supported by the favourable tone in the credit market, owing to robust earnings prospects, the new US tax regime, higher crude prices, and the gradual approach to monetary normalization.

The greenback closed out its best month since November 2016 after US bond yields rose to multi-year highs. The euro was dragged down by some softer economic results, ongoing uncertainty on the trade front, and as Italy's Five Star leader called for new elections this summer. Meanwhile, the pound retreated as investors reduced their wagers for a May rate hike after some cautious rhetoric from Governor Carney, while softer UK growth results also weighed. In contrast, the Canadian dollar bucked the global trend and eked out a gain versus the US dollar amid lofty crude prices and renewed hopes for an amicable outcome on NAFTA.

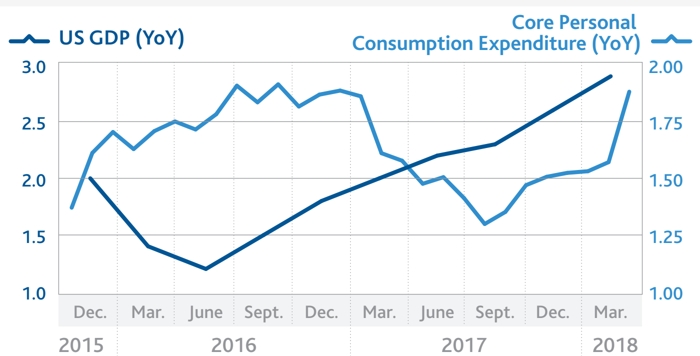
Finally, crude prices jumped to their highest level since late-2014 as the global supply glut continued to vanish, while conflict in the Middle East and speculation for the US to pull out of the Iran nuclear deal and reimpose sanctions against OPEC's third largest producer also boosted prices. Similarly, heavy oil prices also reaccelerated as some restoration of transport capacity and production issues in Venezuela narrowed the differential to WTI. Finally, gold lost some of its lustre in the environment of rising interest rates and corresponding strength in the greenback, while easing geopolitical tensions also reduced the appeal of bullion as a safe haven.



The Canadian economy advanced 0.4% in February, with goods-producing sectors surging 1.2% on the back of stellar gains in manufacturing, oil/gas production, and mining. As a result, underlying pricing pressures are building, with the Bank of Canada's preferred inflation gauge averaging 2.0% y/y in March.

CANADA

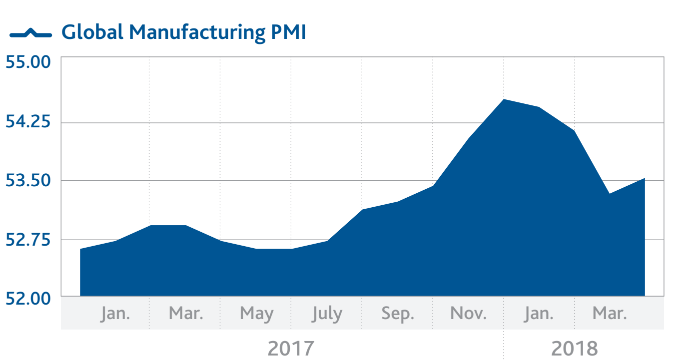
After stumbling into the new year, the Canadian economy bounced back sharply in February, with widespread gains across both the goods and services sectors. The positive surprise came on the heels of an impressive comeback in manufacturing and energy production after some setbacks temporarily depressed results earlier this year. Meanwhile, headline inflation came in at a four-year high of 2.3% y/y, while the average of the Bank of Canada's preferred core gauges remained unchanged at 2.0% y/y. That being said, the Bank of Canada has cited temporary factors in the latest uptick in prices and has assumed a balanced approach in response, weighing the buoyant and above-trend growth trajectory against highly indebted households, increased sensitivity to rising borrowing costs, and ongoing trade tensions - endorsing a pragmatic and gradual approach to further interest rate normalization.



Despite a soft start to the year, the US economy has built some considerable momentum and is running at a 2.9% annual pace - marking its fastest pace since mid-2015. Such performance is helping to absorb excess capacity and placing upward pressure on inflation, with the Fed's key inflation gauge coming in just shy of the 2% target.

USA

While the US economy succumbed to its usual (seasonal) pattern of softness in the first quarter, underlying trends suggest that the world's largest economy remains in decent health. In typical late-stage fashion, businesses have ramped up investment while exports also contributed positively – providing a cushion to the pullback in consumer spending after the outsized spending impulse late last year. Not surprisingly, pricing pressures continue to build in response, with the Fed's preferred inflation gauge breaching the 2% target for the first time in a year - reinforcing the Federal Reserve's plans to continue normalizing monetary policy. The good news is that the US economy can likely tolerate higher borrowing costs, thanks to low levels of consumer and corporate debt, while the temporary boost from tax reform should also act as a buffer.



After hitting a soft patch in the first quarter of 2018 and sparking concerns for a sharp global slowdown, the Global Manufacturing PMI (a barometer for the health of the global economy) ticked up by 0.2 points to 53.5 in April and remains at levels surpassing its long-term average - consistent with a healthy global economy in general.

INTERNATIONAL

Looking abroad, both the European and UK economies took a reprieve during the first quarter, though temporary factors (such as unusual weather patterns) could be partially to blame. However, the European Central Bank and the Bank of England have acknowledged this softness and have exerted some caution in response. Meanwhile, the Chinese economy continues to demonstrate some healthy momentum early-on in the second quarter – spurring confidence that China can tolerate an uncertain trade backdrop. Namely, global demand for Chinese products remains robust, while protectionist threats have been more prevalent in the headlines than the actual economy. Furthermore, Chinese authorities have expressed a willingness to tweak policy if trade tensions and/or the government's deleveraging campaign threaten to derail growth – all but ensuring a soft landing for the world's second largest economy.

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.

FIERACAPITAL

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	APRIL 30, 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	3.00%	2.75%	0.50%	1.00%	3.25%
U.S.	2.90%	3.25%	1.00%	1.00%	4.00%
INFLATION (HEADLINE Y/Y)					
Canada	2.30%	2.25%	1.50%	1.50%	3.00%
U.S.	2.40%	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	1.75%	2.50%	1.50%	1.50%	3.00%
10-YEAR RATES					
Canada Government	2.31%	2.85%	1.40%	1.70%	3.80%
US Government	2.95%	3.25%	2.00%	1.60%	4.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	10.9%	15.3%	-23.1%	-12.2%	18.0%
U.S.	16.3%	9.8%	-15.0%	-4.4%	20.4%
EAFE	10.4%	3.6%	-23.3%	-19.4%	15.1%
EM	22.3%	30.4%	-15.3%	-15.3%	36.9%
P/E (FORWARD 12 MONTHS)					
Canada	15.4X	16.5X	16.5X	16.5X	16.0X
U.S.	16.1X	18.0X	16.5X	17.0X	18.0X
EAFE	14.2X	15.5X	15.0X	14.5X	15.0X
EM	12.4X	13.5X	11.0X	12.5X	12.5X
CURRENCIES					
CAD/USD	0.78	0.85	0.65	0.70	0.85
EUR/USD	1.21	1.25	1.10	1.00	1.10
USD/JPY	109.34	105.00	100.00	100.00	120.00
COMMODITIES					
Oil (WTI, USD/barrel)	68.57	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	-1.5%	8.7%	6.9%	-8.0%
Canadian Equity	11.0%	-26.0%	-15.4%	10.2%
U.S. Equity	-3.5%	-10.4%	-3.6%	5.8%
International Equity	-6.2%	-12.1%	-17.1%	0.8%
Emerging Market Equity	6.2%	-26.4%	-22.4%	3.2%

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.

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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