TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

JUNE 2018

FIERA CAPITAL

Investors remained on edge in May amid political upheaval in Europe and escalating trade tensions, which remained at odds with a constructive global economic backdrop. Following a lack of progress on trade negotiations, the Trump administration announced that it would go ahead with tariffs on $50 billion of Chinese goods and pressed forward with steel and aluminum tariffs for Canada, Mexico, and the European Union. And after several months of gridlock, the anti-establishment Five Star and League coalition managed to scrape together a new Italian government with a "Eurozone committed" finance minister – though political differences are certain to test the future of the euro.

FINANCIAL MARKET DASHBOARD

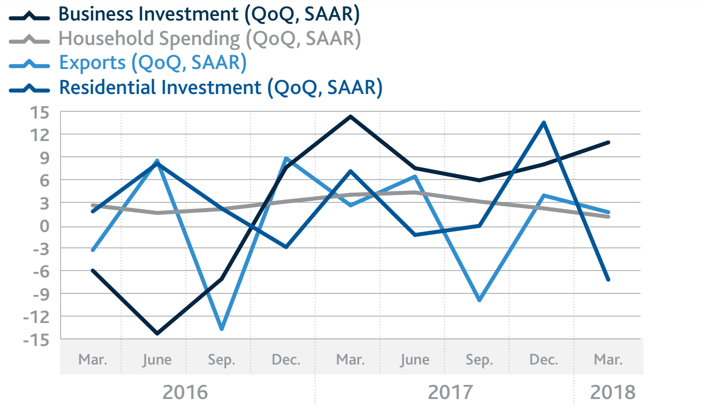
	MAY 31, 2018	MAY	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,705	2.16%	1.18%	12.17%
S&P/TSX	16,061	2.91%	-0.91%	4.64%
MSCI EAFE	1,986	-2.81%	-3.15%	5.09%
MSCI EM	1,120	-3.75%	-3.26%	11.48%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.86	-9.5	45.3	65.6
US 2 Year Bond Yield	2.43	-6.0	54.4	114.6
CA 10 Year Bond Yield	2.24	-6.3	19.9	82.8
CA 2 Year Bond Yield	1.92	2.5	22.9	122.4
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.77	-0.89%	-2.99%	4.19%
EUR/USD	1.17	-3.19%	-2.60%	3.99%
USD/JPY	108.82	-0.48%	-3.43%	-1.77%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	67.04	-2.23%	10.96%	38.74%
Copper (USD/pound)	3.06	0.41%	-7.14%	18.80%
Gold (USD/oz)	1,300.10	-1.45%	-0.70%	2.21%

Global equity markets posted some mixed results in May. North American bourses escaped the politically-charged environment relatively unscathed, with both US and Canadian equity markets ending the month higher. Not surprisingly, European equity markets suffered substantial losses as anti-euro rhetoric in Italy sent European financial stocks tumbling lower. Finally, emerging market equities fell for a fourth consecutive month in May, sending valuations to their cheapest levels sine 2016.

Government bond yields declined as escalating political turmoil and the latest protectionist push from the Trump administration boosted appetite for safe-haven assets. Furthermore, a sharp decline in crude prices also added to downward pressure on inflation expectations and accordingly, bond yields. After breaching a seven-year high of 3.12% mid-month, the US 10 year treasury yield pulled back and ended the month at 2.86%. And at the short-end of the curve, expectations for fed fund rate hikes receded after a dovish interpretation of the Federal Reserve minutes from the May meeting, where participants generally agreed that a "gradual approach" to policy normalization was still appropriate. Canadian results were more mixed, with the long-end of the curve slipping alongside its US counterpart, though the short-end rose modesty as some hawkish comments from the Bank of Canada reinforced that further rate hikes will be forthcoming.

The US dollar advanced in May, owing mainly to a sharp decline in the euro. The common currency tumbled lower as mounting concerns over the leadership situation in Italy and Spain brought into question the viability of the euro. Meanwhile, the Canadian dollar retreated even after the Bank of Canada dropped its cautious stance and laid the groundwork for rate hikes. Instead, the loonie was weighed down by the pullback in crude prices and a lack of progress on the NAFTA-front, while ratcheted-up trade tensions also weighed. Finally, emerging market currencies remained vulnerable in the environment of rising US bond yields and corresponding dollar strength, while heightened risk aversion also pressured emerging market assets in general.

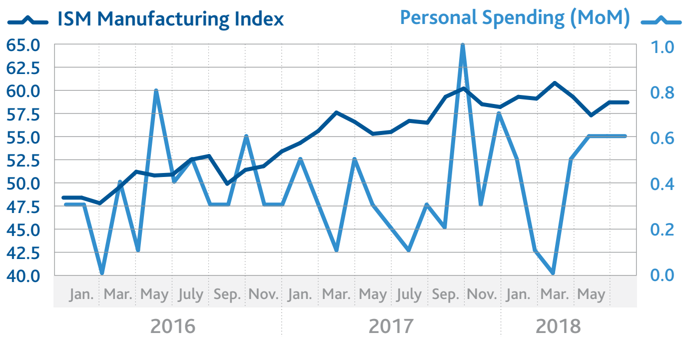
In commodity markets, crude prices sank back below the $70-mark on speculation that OPEC and Russia will restore some production to ease supply disruptions in Venezuela and Iran – while a surge in US production also contributed to the monthly descent. Gold bullion also lost some ground amid dollar gains and rising interest rates that curbed demand for non-interest bearing precious metals during the month.



In the first quarter, the drivers of Canadian growth rotated away from the highly-indebted consumer and a frothy housing market and towards business investment and exports – even despite ramped-up protectionist rhetoric from President Trump and a lack of progress on NAFTA talks.

CANADA

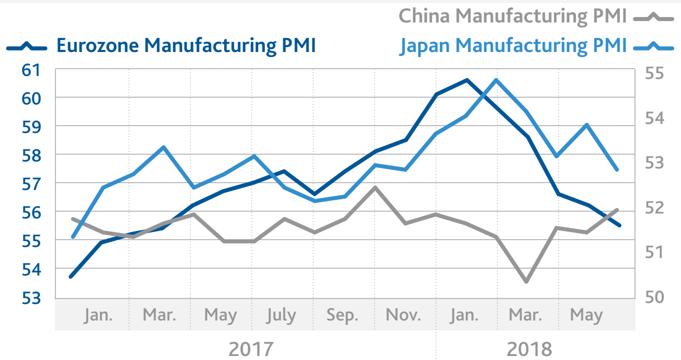
The Canadian economy grew at a 1.3% annualized pace during the first quarter. The underlying trends were largely consistent with a rotation away from an exhausted consumer and housing backdrop towards the externally-oriented and business-related segments of the economy. Specifically, both consumer spending and residential investment softened as households reigned-in their discretionary purchases and as more stringent mortgage rules took effect earlier this year, while business and government outlays accelerated. And while net trade detracted, a surge in imports was to blame (exports contributed positively), suggesting a healthy domestic demand backdrop in general. Meanwhile, core gauges of inflation are hovering around 2%, which has essentially endorsed the constructive tone from the Bank of Canada and set the stage for another rate hike this summer.



After a temporary pullback at the beginning of the year, the US economy made an impressive comeback in the second quarter, with broad based gains across both the consumer and factory sectors. The consumer recalibrated in response to higher disposable incomes and boosted spending in April, while US factory output hit a record high.

USA

Despite the ongoing trade debacle in the US, the world's largest economy is demonstrating some notable signs of momentum in the second quarter. The American consumer was back in full force last month, with the combination of personal tax cuts and a vigorous labour market boosting disposable incomes, confidence, and accordingly, discretionary spending. What's more, the factory sector also remains buoyant according to the latest ISM survey results, with the underlying survey details pointing towards robust demand, solid employment trends, and a revival in pricing pressures. Taken together, these results have all but cemented the case for another rate hike in June, though policymakers remain committed to a gradual pace of normalization thereafter.



Global growth trends have decoupled, though current levels of the manufacturing PMI's remain consistent with a healthy backdrop in general. While both Europe and Japan have lost some momentum, the US and China (the world's two largest economies) have gained some traction and should drive a continuation of the global economic acceleration through 2018.

INTERNATIONAL

According to the global manufacturing purchasing managers' index (a barometer for the health of the global economy), economic softness at the beginning of the year looks to be extending into the second quarter. While growth results were hindered by some temporary effects early-on in 2018, the latest bout of Euroscepticism and anti-establishment rhetoric in Italy appears to be undermining sentiment, while uncertainty on the trade front is likely weighing on investment decisions. While these developments have temporarily depressed activity in the Eurozone, the Chinese economy has defied expectations for a sharp slowdown and proven fairly resilient to escalating trade tensions as well as deleveraging efforts at home, with major economic data suggesting that growth momentum in China remains healthy in the second quarter.

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	MAY 31, 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	2.90%	2.75%	0.50%	1.00%	3.25%
U.S.	2.80%	3.25%	1.00%	1.00%	4.00%
INFLATION (HEADLINE Y/Y)					
Canada	2.20%	2.25%	1.50%	1.50%	3.00%
U.S.	2.50%	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	2.24%	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	8.8%	10.3%	-26.5%	-16.0%	12.9%
U.S.	15.7%	7.6%	-16.7%	-6.2%	18.1%
EAFE	8.2%	2.5%	-24.1%	-20.3%	13.9%
EM	17.3%	26.5%	-17.8%	-17.8%	32.8%
P/E (FORWARD 12 MONTHS)					
Canada	15.5X	16.5X	16.5X	16.5X	16.0X
U.S.	16.2X	18.0X	16.5X	17.0X	18.0X
EAFE	13.9X	15.5X	15.0X	14.5X	15.0X
EM	12.1X	13.5X	11.0X	12.5X	12.5X
CURRENCIES					
CAD/USD	0.77	0.85	0.65	0.70	0.85
EUR/USD	1.17	1.25	1.10	1.00	1.10
USD/JPY	108.82	105.00	100.00	100.00	120.00
COMMODITIES					
Oil (WTI, USD/barrel)	67.04	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	7.9%	-28.1%	-17.8%	7.1%
U.S. Equity	-6.4%	-13.1%	-6.5%	2.7%
International Equity	-4.4%	-10.3%	-15.5%	2.8%
Emerging Market Equity	9.4%	-24.3%	-20.1%	6.3%

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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