TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

AUGUST 2018

FIERA CAPITAL

The third quarter got off to a decent start, with risky assets thriving in the environment of robust global growth and healthy corporate earnings. Encouragingly, trade tensions subsided somewhat after the US and Europe agreed to a ceasefire on new tariffs, US and Chinese authorities signaled a willingness to re-engage in negotiations, and as NAFTA discussions resumed – all of which reduced the risk of a full-blown trade war. That being said, the US focus has reverted squarely back to China – the target of the protectionist agenda since day one. Indeed, after imposing tariffs on $34 billion of Chinese imports, the next wave ($16 billion) is set to go into effect in August, while President Trump also ramped up the pressure and threatened to impose a 25% tariff on $200 billion of Chinese products, suggesting that the global trade debacle remains far from resolved.

FINANCIAL MARKET DASHBOARD

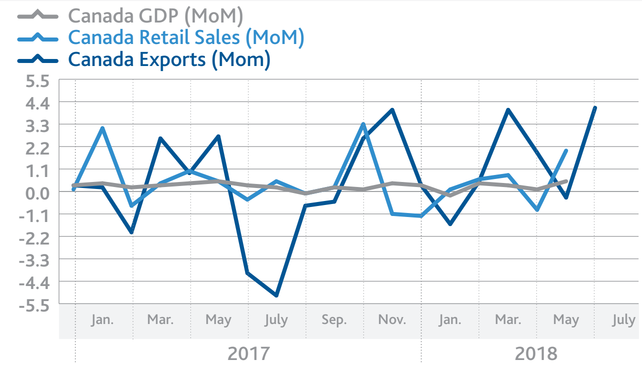
	JULY 31, 2018	JULY	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,816	3.60%	5.34%	14.01%
S&P/TSX	16,434	0.96%	1.39%	8.52%
MSCI EAFE	2,006	2.42%	-2.18%	3.57%
MSCI EM	1,087	1.68%	-6.13%	1.99%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.96	10.0	55.4	66.6
US 2 Year Bond Yield	2.67	14.1	78.6	132.0
CA 10 Year Bond Yield	2.31	14.2	26.5	25.3
CA 2 Year Bond Yield	2.07	15.5	38.0	75.3
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.77	0.97%	-3.36%	-4.07%
EUR/USD	1.17	0.06%	-2.62%	-1.28%
USD/JPY	111.86	0.99%	-0.74%	1.45%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	68.76	-7.27%	13.80%	37.05%
Copper (USD/pound)	2.83	-4.05%	-14.21%	-2.08%
Gold (USD/oz)	1,223.70	-2.46%	-6.54%	-3.39%

Global equity markets were broadly higher in July. The US equity market led the charge owing to the impressive corporate earnings backdrop. Notably, with almost 90% of companies having reported, a strong majority have surpassed expectations on both the earnings and revenue fronts. The Canadian equity market also advanced, though a widespread pullback in commodity prices saw the resource-levered TSX lag its developed market peers. Looking abroad, European stocks staged a comeback after the US and Europe agreed to a temporary truce on tariffs and bolstered the export-sensitive market. Finally, emerging market equities recovered some lost ground and posted their first monthly gain since January as trade tensions defused, while some softer dollar conditions also reignited both stock and bond prices in the developing world.

In fixed income markets, global bond yields backed-up as investors braced for more constructive rhetoric from major central banks in response to the robust global economic and inflation backdrop, with speculation that the Bank of Japan would join the likes of the Federal Reserve, Bank of Canada, European Central Bank, and Bank of England in adopting an increasingly hawkish bias. Meanwhile, signs of easing trade tensions boosted investor appetite for risk and saw credit spreads narrow during the month – with corporate and high yield bonds outperforming their government counterparts.

In currency markets, the greenback ended the month virtually unchanged. The Canadian dollar managed to bounce back after a string of stronger than expected economic results saw investors raise their wagers for Bank of Canada rate hikes, while some encouraging developments on the trade front also bolstered sentiment towards the loonie. In contrast, the yen retreated after the Bank of Japan refrained from making broad changes to its ultra-accommodative policy stance and reaffirmed its commitment to keeping rates "extremely low" for an "extended period" – though reversed course in early August after the central bank allowed for more flexibility around its 10-year yield target.

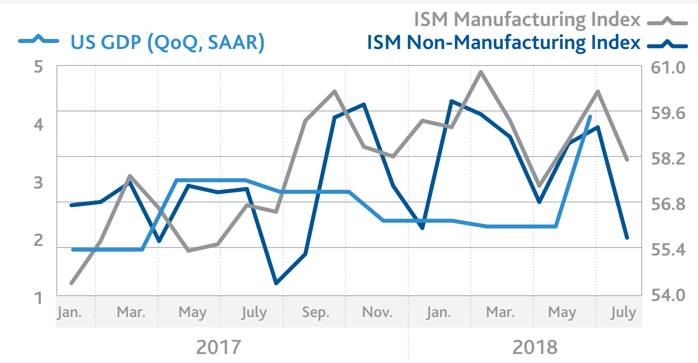
Finally, commodity markets were broadly weaker. Crude prices posted their biggest monthly loss since March 2017 as brewing trade tensions between the world's two largest economies threatened to dampen global demand at the same inopportune time that American shale output surged higher and as some supply disruptions abated. Meanwhile, gold declined for a fourth consecutive month as signs of US economic strength bolstered the case for higher interest rates, while negative sentiment towards China weighed on copper prices.



The Canadian economy was firing on all cylinders during the second quarter and remains on track for a 3% quarterly growth print. Furthermore, inflation is running virtually in-line with the Bank of Canada's 2% target - all but setting the stage for another rate hike in the second half of 2018.

CANADA

The Canadian economy continues to demonstrate some encouraging signs of strength even as trade uncertainties linger on. In May, gross domestic product increased by a stronger-than-expected 0.5% - marking the fastest pace in a year. Economic strength was fairly broad based across both the goods and services sectors, with nineteen out of twenty industries reporting gains. Notably, the consumer was back in May, with retail sales soaring 2.0% thanks to a healthy labour market that's helped the consumer to absorb higher borrowing costs, while the Canadian trade deficit narrowed by much more than forecast on the back of the robust demand backdrop in the US that led exports to a record high.



The US economy expanded at a 4.1% annualized pace during the second quarter – with both consumer spending (+4.0%) and business investment (+7.3%) leading the advance. However, both the manufacturing and non-manufacturing ISM surveys fell back in July, suggesting that US growth is likely to cool somewhat in the second half.

USA

The US economy produced some stellar results during the second quarter, with gross domestic product rising at its fastest pace since 2014. Both the consumer and businesses contributed positively to the quarterly advance, while the trade deficit also declined sharply. While the outlook for US growth remains compelling, forward-looking indicators do suggest that momentum could moderate from these lofty and somewhat unsustainable levels during the second half. Specifically, both the ISM manufacturing and non-manufacturing gauges of business activity pulled back in July – though still-solid readings suggest that the economy will continue to grow at an above-trend pace through 2018, keeping the Federal Reserve on firmly on track to raise interest rates twice more this year.

The Chinese economy moderated somewhat during the second quarter – with gross domestic product increasing 6.7% from a year earlier (down from 6.8%). While the economy is indeed undergoing a slowdown, the good news is that policymakers have ramped up their efforts to stimulate domestic demand and counteract a weakening economy.

INTERNATIONAL

The Chinese economy has proven fairly resilient in the wake of the ongoing trade debacle between the world's two largest economies. Activity data for June was largely supportive of the rebalance story from debt-fuelled investment to more sustainable, consumption-oriented sources of growth, which has helped the economy to maintain some momentum. Notably, while both industrial output and fixed asset investment slowed in June, retail sales surprised to the upside. Taken together, steady growth heading into the second half should help the economy to withstand any potential negative impacts from higher trade barriers with the US, while both fiscal and monetary authorities in Beijing have also expressed a willingness to step-up and support the economy if necessary.

Our current scenarios are for a synchronized global expansion (50%), which is a continuation of the current environment that benefits equities, trade protectionism (30%), which would be negative for equities and positive for bonds, geopolitical 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 50%

The global economy continues to grind higher in a synchronous manner, with all major regions contributing to the advance. The US leads the global charge, thanks to widespread momentum across both the consumer and manufacturing space, while the double-dose of fiscal stimulus boosts an already-buoyant economy. Meanwhile, the Canadian economy moderates towards a more sustainable, albeit above-trend pace – though the fate of NAFTA clouds the outlook. Finally, policymakers in Europe and Japan ultimately prove successful in reflating growth, while 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 30%

The biggest risk to our base case scenario is a rise in protectionism stemming from the US and the threat of a trade war that would derail the synchronous global expansion. Specifically, President Trump's rhetoric on protectionism has translated into action ahead of the midterm elections, with the US imposing tariffs on a variety of imports including solar panels, washing machines, steel, and aluminum – which have been met with retaliatory measures from some of America's closest allies in response. However, Mr. Trump has upped the ante by threatening to slap tariffs on an additional $200 billion of imports from China as well as auto imports – which would be detrimental for trade flows and the global economy alike. In this scenario, anti-trade rhetoric in the US becomes a reality and results in tariffs being imposed on economies such as China, Canada, Europe, Japan and Mexico, with further retaliation igniting a full-blown global trade war.

SCENARIO 3
GEOPOLITICAL INSTABILITY

PROBABILITY 10%

Political upheaval in Europe and vulnerabilities in the emerging world could ignite a crisis in confidence – disrupting the global economy and financial markets alike. Specifically in Italy, the Five Star and League parties have formed a coalition government with Eurosceptic tendencies, with plans to expand fiscal policy that would go against the fiscal rules and threaten the relationship with the European Union – which risks throwing the region into political disarray at the same inopportune time that a lack of progress in Brexit negotiations has raised the odds of a "hard Brexit" scenario. Meanwhile, emerging market economies remain susceptible to a strengthening greenback, particularly those countries with high levels of external debt. An increase in debt-servicing costs raises default risks and capital outflows for the weaker links, with the potential for contagion to spread more broadly across the developing world.

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	JULY 31, 2018	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	GEOPOLITICAL INSTABILITY	STRONGER GROWTH & INFLATION
PROBABILITY		50%	30%	10%	10%
GDP GROWTH (Y/Y)					
Global	3.50%	4.00%	2.00%	3.00%	4.25%
Canada	2.60%	3.00%	0.50%	1.00%	3.25%
U.S.	2.80%	3.50%	1.00%	1.00%	4.00%
INFLATION (HEADLINE Y/Y)					
Canada	2.50%	2.25%	1.50%	1.50%	3.00%
U.S.	2.90%	2.25%	2.00%	1.75%	3.25%
SHORT-TERM RATES					
Bank of Canada	1.50%	2.00%	1.00%	1.25%	2.50%
Federal Reserve	2.00%	3.00%	2.00%	2.25%	3.25%
10-YEAR RATES					
Canada Government	2.31%	2.85%	1.40%	1.70%	3.80%
US Government	2.96%	3.25%	2.25%	2.00%	4.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	10.7%	11.8%	-27.2%	-16.8%	11.8%
U.S.	14.4%	14.2%	-19.4%	-9.3%	14.2%
EAFE	7.6%	6.3%	-24.1%	-20.3%	13.9%
EM	19.9%	25.9%	-18.2%	-18.2%	32.2%
P/E (FORWARD 12 MONTHS)					
Canada	15.4X	16.5X	16.5X	16.5X	16.0X
U.S.	16.5X	16.5X	16.5X	17.0X	18.0X
EAFE	14.2X	15.0X	15.0X	14.5X	15.0X
EM	11.4X	13.0X	11.0X	12.5X	12.5X
CURRENCIES					
CAD/USD	0.77	0.83	0.65	0.70	0.85
EUR/USD	1.17	1.20	1.10	1.00	1.10
USD/JPY	111.86	110.00	100.00	100.00	120.00
COMMODITIES					
Oil (WTI, USD/barrel)	68.76	75.00	50.00	50.00	85.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	GEOPOLITICAL INSTABILITY	STRONGER GROWTH & INFLATION
PROBABILITY	50%	30%	10%	10%
Money Market	1.8%	1.3%	1.4%	2.0%
Canadian Bonds	-1.3%	8.8%	7.1%	-7.8%
Canadian Equity	7.9%	-29.7%	-19.7%	4.7%
U.S. Equity	-7.7%	-16.8%	-10.5%	-1.7%
International Equity	-3.0%	-11.6%	-16.6%	1.4%
Emerging Market Equity	10.7%	-22.2%	-17.9%	9.2%

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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