TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

SEPTEMBER 2018

FIERA CAPITAL

Investors had plenty to contemplate in August, including contagion risks stemming from the turmoil in Turkey and Argentina and a highly contentious trade backdrop. While the US and Mexico made some progress in forming NAFTA 2.0, Canada and the US were unable to come to terms for a trilateral agreement. Furthermore, President Trump ramped up his hard-line stance and stated that he wants to move ahead with a plan to impose tariffs on $200 billion of Chinese imports, while also casting doubt on the scope for a trade deal between the US and Europe. In the end, global equity market performance diverged somewhat, with US equity markets taking the fractious backdrop in stride and hitting record highs, while other major bourses moved broadly lower.

FINANCIAL MARKET DASHBOARD

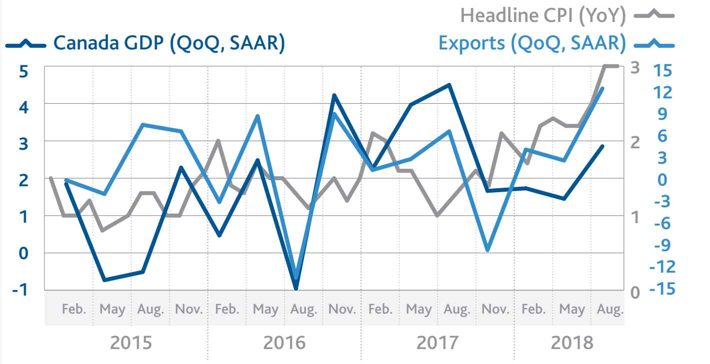
	AUG. 31, 2018	AUGUST	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,902	3.03%	8.52%	17.39%
S&P/TSX	16,263	-1.04%	0.33%	6.91%
MSCI EAFE	1,962	-2.19%	-4.33%	1.62%
MSCI EM	1,056	-2.90%	-8.85%	-2.92%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.86	-9.9	45.5	74.3
US 2 Year Bond Yield	2.63	-4.3	74.4	130.1
CA 10 Year Bond Yield	2.23	-8.2	18.3	37.9
CA 2 Year Bond Yield	2.07	0.1	38.1	79.5
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.77	-0.27%	-3.62%	-4.29%
EUR/USD	1.16	-0.76%	-3.36%	-2.59%
USD/JPY	111.03	-0.74%	-1.47%	0.95%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	69.80	1.51%	15.52%	47.79%
Copper (USD/pound)	2.65	-6.45%	-19.74%	-13.97%
Gold (USD/oz)	1,201.60	-1.81%	-8.23%	-8.87%

Equity performance leadership was extremely narrow in August, with the US proving resilient and leading the global charge. In contrast, most other global bourses declined during the month. Canadian stocks retreated amid ongoing uncertainty regarding the future of NAFTA after failed negotiations in late-August. Meanwhile, European shares traded lower as both emerging market angst and a lack of progress on the Brexit-front weighed – while the trade dispute resurfaced after President Trump unleashed some harsh rhetoric towards the European Union. Finally, emerging market bourses were pummeled as disarray in both Argentina and Turkey sparked fears of global contagion at the same inopportune time that trade tensions have intensified.

In fixed income markets, treasuries advanced, with haven demand spurred by the collapse in emerging market assets and renewed trade tensions that completely overshadowed signs of building pricing pressures. Meanwhile, the failure of the US-Canada trade talks sent Canadian bond yields lower – though the short-end remained well supported by some healthy growth and inflation results that have given the Bank of Canada the green light to raise interest rates this fall. Finally, European peripheral spreads widened on concerns that Italy's populist coalition's plans for aggressive spending policies will collide with European Union fiscal rules.

In currency markets, the greenback strengthened against most of its global peers as the tenuous geopolitical backdrop reverberated through the marketplace and buoyed safe haven currencies. In contrast, lingering questions about the future of NAFTA weighed on the Canadian dollar, while emerging market currencies posted their fifth monthly loss as the rout in the Turkish lira and Argentinian peso fueled fears of contagion across the wider emerging market space. The exception was the yen, which was boosted by safe haven flows and speculation that the Bank of Japan may scale back its asset purchases going forward.

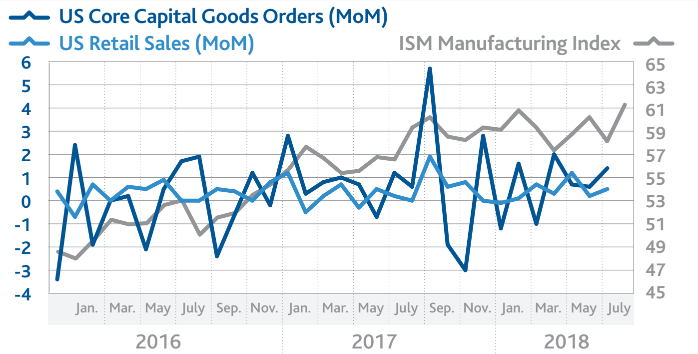
Finally in commodity markets, gold failed to obtain a safe haven bid and declined in August, marking its fifth straight month of losses. Gold was pressured lower owing to recent strength in the US dollar and the Federal Reserve's plans to continue raising interest rates, reducing the appeal of non-interest bearing assets like bullion. In contrast, crude oil staged a comeback as sanctions on Iranian oil stoked concerns for supply constraints at a time when American stockpiles and production are slowing – which helped to allay concerns that the trade war will stifle global demand.



Canadian gross domestic product expanded at a 2.9% annualized pace during the second quarter, thanks to a massive surge in exports. And while headline inflation hit the 3% mark for the first time since 2011, the core gauges of inflation are averaging in-line with the central bank's 2% target, allowing the Bank of Canada to proceed with caution in normalizing policy.

CANADA

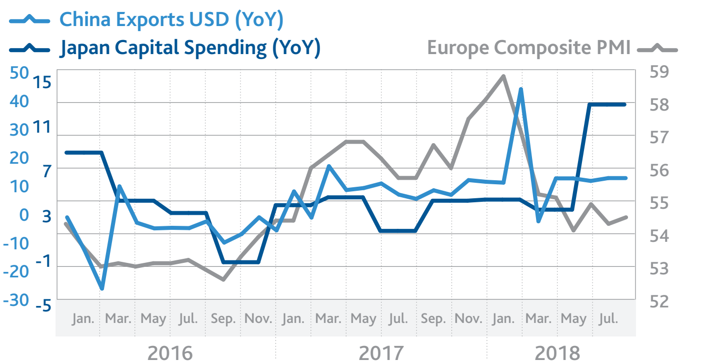
Despite the persistent stalemate in NAFTA negotiations, the Canadian economy continues to impress and grew at the fastest pace in a year during the second quarter. After struggling for years, exports made a fierce comeback and posted their biggest quarterly advance since 2014 – owing mainly to robust US demand. Still, the expansion was fairly broad based, with domestic demand solidifying courtesy of gains in consumer, residential, government, and business spending. With the economy growing near its full potential, excess slack is being absorbed and pricing pressures are building. Notably, headline inflation breached 3% for the first time since 2011, while the Bank of Canada's core gauges are in-line with the 2% target – providing the central bank with the scope to raise interest rates once again in 2018.



The latest string of monthly data suggests that economic momentum has carried over into the third quarter. In July, retail sales advanced by more than expected (0.5%), while capital goods orders (a proxy for business investment) rose 1.4%. Finally, a gauge of US manufacturing activity unexpectedly jumped to a 14-year high in August and sets the stage for further economic strength in the back-half of the year.

USA

The US economy expanded at a faster than initially estimated pace during the second quarter, as expansive fiscal policy continues to fuel an already-buoyant economy. The consumer continues to thrive on the combination of strong job creation, rising wages, and lower personal taxes – while businesses have boosted investment in response to stronger domestic and global demand. Furthermore, high frequency data for July and August suggests that the third quarter will be much the same, thanks to healthy retail sales and factory production results – while the official proxy of US manufacturing activity also jumped higher in August. In response, inflation is slowly coming back to life, with the Federal Reserve's preferred inflation gauge reaching its 2% target for the first time since 2012 – reinforcing the forecast for two more rate hikes this year.



The euro-area PMI print for August remains consistent with an above-trend pace of growth in the third quarter. Meanwhile, strong global demand for Japanese goods (steel exports actually accelerated in July, despite newly-imposed tariffs) and record profits have bolstered capital spending, while Chinese shipments have also been in acceleration-mode, with limited impact from the trade war so far.

INTERNATIONAL

Looking abroad, economic prospects remain reasonably bright, helping to cushion the blow from the escalating global trade dispute. After growing at the fastest pace in a decade in 2017, European growth has reverted back towards more sustainable, albeit still above-trend levels. Meanwhile, the Japanese economy has managed to hold up fairly well in the face of newly-imposed tariffs on steel and aluminum – reflecting strong Asian demand in general. Moreover, strong global demand and record corporate profits has prompted Japanese companies to boost capital investment by the most in over a decade. Finally, the official PMI data for August indicated that the Chinese economy remains broadly stable even despite heightened trade tensions between the world's two largest economies – pointing towards some positive impact from the government's policy shift to support growth.

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.

FIERACAPITAL

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	AUGUST 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	2.40%	3.00%	0.50%	1.00%	3.25%
U.S.	2.90%	3.50%	1.00%	1.00%	4.00%
INFLATION (HEADLINE Y/Y)					
Canada	3.00%	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%	2.25%	1.00%	1.25%	2.50%
Federal Reserve	2.00%	3.00%	2.00%	2.25%	3.25%
10-YEAR RATES					
Canada Government	2.23%	2.85%	1.40%	1.70%	3.80%
US Government	2.86%	3.25%	2.25%	2.00%	4.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	7.9%	8.2%	-29.6%	-19.5%	8.2%
U.S.	13.5%	15.6%	-20.7%	-10.8%	12.3%
EAFE	5.2%	5.2%	-24.9%	-21.1%	12.7%
EM	12.5%	21.4%	-21.1%	-21.1%	27.5%
P/E (FORWARD 12 MONTHS)					
Canada	15.2X	16.5X	16.5X	16.5X	16.0X
U.S.	16.9X	16.5X	16.5X	17.0X	18.0X
EAFE	14.0X	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	1.16	1.20	1.10	1.00	1.10
USD/JPY	111.03	110.00	100.00	100.00	120.00
COMMODITIES					
Oil (WTI, USD/barrel)	69.80	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	1.9%	1.3%	1.4%	2.0%
Canadian Bonds	-1.7%	8.4%	6.7%	-8.2%
Canadian Equity	9.1%	-29.0%	-18.8%	5.8%
U.S. Equity	-8.1%	-19.5%	-13.4%	-4.9%
International Equity	-1.1%	-9.8%	-15.0%	3.4%
Emerging Market Equity	13.7%	-20.1%	-15.7%	12.1%

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.

CONTACT US

NORTH AMERICA

CANADA

Montreal
Fiera Capital Corporation
1501 McGill College Avenue, Suite 800,
Montreal, Quebec H3A 3M8
T 1 800 361-3499

Toronto
Fiera Capital Corporation
1 Adelaide Street East, Suite 600, Toronto,
Ontario M5C 2V9
T 1 800 994-9002

Calgary
Fiera Capital Corporation
607 8th Avenue SW, Suite 300,
Calgary, Alberta T2P 0A7
T 403 699-9000

Vancouver
Fiera Capital Corporation
1040 West Georgia Street, Suite 520,
Vancouver, British Columbia V6E 4H1
T 1 877 737-4433

UNITED STATES

New York
Fiera Capital Inc.[1]
375 Park Avenue, 8th Floor,
New York, New York 10152
T 212 300-1600

Boston
Fiera Capital Inc.[1]
60 State Street, 22nd Floor,
Boston, Massachusetts 02109
T 857 264-4900

Dayton
Fiera Capital Inc.[1]
10050 Innovation Drive, Suite 120,
Dayton, Ohio 45342
T 937 847-9100

Los Angeles
Bel Air Investment Advisors[1]
1999 Avenue of the Stars, Suite 3200,
Los Angeles, California 90067
T 1 877 229-1500

EUROPE

UNITED KINGDOM

London
Fiera Capital (UK) Limited [2]
39 St James's Street, London,
United Kingdom SW1A 1JD
T +44 20 7518 2100

GERMANY

Frankfurt
Fiera Capital (UK) Limited [2]
Walther-von-Cronberg-Platz 13,
Frankfurt, Germany 60594
T +49 69 9202 0750

info@fieracapital.com
fieracapital.com

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