TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

NOVEMBER 2018

FIERA CAPITAL

Volatility reasserted itself in October as the environment of rising interest rates, lingering trade tensions between the world's two largest economies, and tightening financial conditions roiled the marketplace. Notably, nervous investors fled indiscriminately from risky assets amid fears that rising interest rates will erode global growth, corporate profits, and equity valuations - while the trade rift between the US and China, Italy's budget showdown with the European Commission, and ongoing Brexit uncertainties also dampened investor sentiment. In the end, more than $8 trillion was swept from global equity values since September's highs – marking the biggest wipeout since the depths of the global financial crisis.

FINANCIAL MARKET DASHBOARD

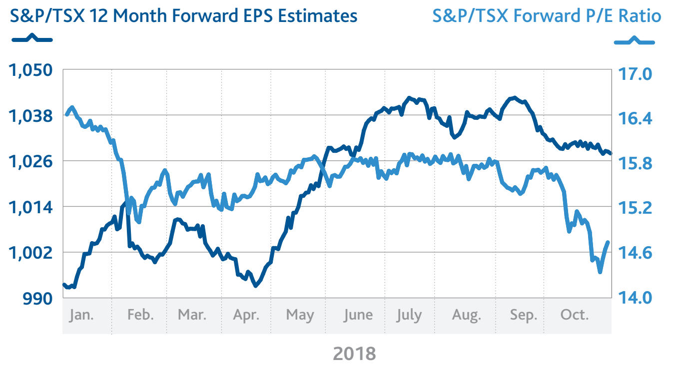
	OCT. 31 2018	OCT.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,712	-6.94%	1.43%	5.30%
S&P/TSX	15,027	-6.51%	-7.29%	-6.23%
MSCI EAFE	1,815	-8.03%	-11.49%	-9.36%
MSCI EM	956	-8.78%	-17.48%	-14.58%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	3.14	8.2	73.8	76.4
US 2 Year Bond Yield	2.87	4.8	98.4	126.7
CA 10 Year Bond Yield	2.49	6.7	44.9	54.3
CA 2 Year Bond Yield	2.34	12.4	64.9	94.4
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.76	-1.88%	-4.46%	-2.04%
EUR/USD	1.13	-2.52%	-5.77%	-2.87%
USD/JPY	112.94	-0.67%	0.22%	-0.62%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	65.31	-10.84%	8.09%	20.10%
Copper (USD/pound)	2.66	-5.20%	-19.44%	-14.25%
Gold (USD/oz)	1,215.00	1.97%	-7.20%	-4.37%

Global equity markets posted their worst monthly performance in six years, with the MSCI All Country World shedding more than 8% in October. The rout in equity markets was fairly broad based in nature, with no region left unscathed. The S&P 500 broke firmly below its 200-day moving average and has all but erased its year-to-date gains, while the Nasdaq bore the brunt of selling pressures and entered official correction terrain as some disappointing earnings reports from US technology bellwethers saw the high-flying sector reverse course. The S&P/TSX was not spared and selling pressures intensified owing to weakness in the energy sector, particularly as pipeline bottlenecks pushed Canada's heavy crude prices towards decade-lows. Looking abroad, European shares posted their worst month since January 2016, while emerging market bourses extended declines as investors contemplated the Federal Reserve's interest rate trajectory, escalating trade tensions, and some signs of economic moderation in China.

Despite the risk-averse tone in the marketplace, North American fixed income markets posted negative results in October. Bond yields were broadly higher in the US and Canada as major central banks reiterated their commitment towards monetary policy normalization. Meanwhile, corporate, high yield, and emerging market bond spreads all widened in the wake of the global equity rout, the latest slump in crude prices, and heightened levels of risk aversion in general.

In currency markets, the greenback touched its strongest level in over a year. Meanwhile, the Canadian dollar retreated even after the central bank raised interest rates and reinforced the need to return borrowing costs back to neutral. Instead, the generally robust US dollar and stumbling crude prices largely overwhelmed the mildly hawkish undertones from the Bank of Canada. The euro was softer after third quarter growth results missed estimates, while the standoff between the Italian populists and the European Commission over the 2019 budget lingered on. The pound was weaker as a lack of progress in Brexit talks rattled sentiment, while the Chinese yuan hovered around a decade-low. In contrast, the yen bucked the global trend and advanced as the dismal mood in the marketplace triggered safe haven buying.

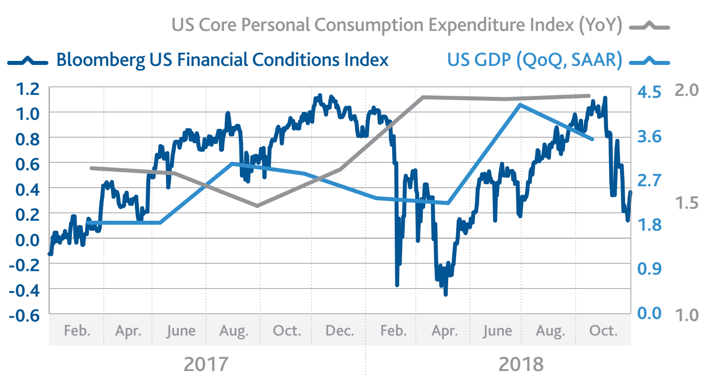
Finally in commodity markets, crude prices tumbled lower as havoc in global equity markets and the trade dispute between the US and China threatened to stifle global oil demand, while a buildup in US stockpiles also weighed. Gold posted its first monthly advance in seven months as the tumultuous trading environment boosted the appeal of the yellow metal as a haven, while copper pulled back alongside some early indications of a slowdown in Chinese growth.



The Canadian stock market has experienced some notable selling pressures in 2018. The steep decline has sent valuations to levels not seen since 2013, even as earnings estimates have remained elevated. The S&P/TSX has lost 1182 points since the beginning of the year, with multiple contraction (-3964 points) fully offsetting an increase in earnings expectations (+2782 points).

CANADA

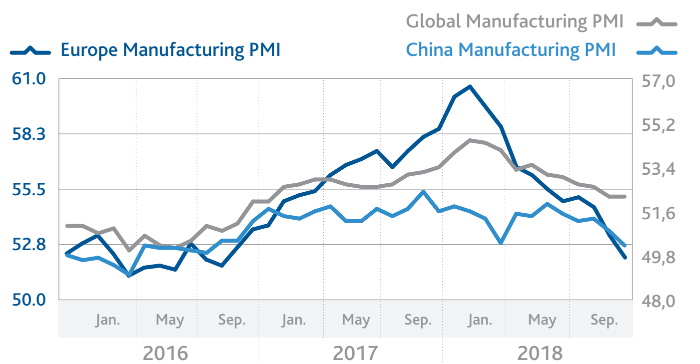
The Canadian economy moderated towards more sustainable levels in the third quarter - though continues to operate in line with the economy's estimated potential. The quarterly Business Outlook Survey painted a picture of widespread optimism. The robust US demand outlook saw expectations for future sales jump higher, while businesses reported persistent capacity pressures and labour shortages – both of which saw investment intentions and inflation expectations accelerate in accordance. Much to no one's surprise, the Bank of Canada raised interest rates in October and adopted an increasingly constructive stance. While trade headwinds have receded substantially following the successful renegotiation of NAFTA in late-September, the economy continues to operate near full capacity, with buoyant economic conditions placing upward pressures on both wages and inflation.



In the US, tightening financial conditions have done little to dissuade the Federal Reserve from pursuing its path to monetary policy normalization in the coming year, thanks to the combination of robust, fiscally-charged growth and core inflation that's held at the central bank's 2% target for five consecutive months.

USA

The US economy continues to impress and is on track to post its strongest annual growth rate in several years. The US economy accelerated at a robust 3.5% annualized pace during the third quarter, with broad based gains across consumer spending, government spending, and business investment. The consumer was exceptionally strong, thanks to a tight labour market that's fuelling wage gains, while government spending also accelerated sharply. Meanwhile, the Federal Reserve's preferred gauge of inflation has been anchored at the 2% target for five consecutive months, which leaves little reason for the Federal Reserve to back down from its plans to continue gradually unwinding monetary policy accommodation, even despite October's rout in global equity markets and the corresponding tightening in financial conditions.



We are witnessing some tentative signs that newly-imposed tariffs are beginning to take a bite out of global growth, with the global manufacturing PMI shifting lower in 2018. The largest contributors to the decline were in China and Europe, where the manufacturing PMI's have sunk towards two-year lows as ramped up protectionist measures weigh on sentiment.

INTERNATIONAL

There are some early indications that the trade dispute is weighing on global growth, with the deterioration most visible in the Chinese and European factory sectors. The Chinese gauge of manufacturing activity dropped to its weakest level in two years in October, while the export sub-index fell deeper into contraction territory. That being said, policymakers have acknowledged the loss of momentum and signaled that further stimulus is forthcoming, helping to facilitate a soft landing for the world's second largest economy. Similarly in Europe, manufacturing surveys have moderated, while the Italian budget crisis and Brexit anxieties have also weighed – though building inflation pressures suggest that the ECB will not be swayed in its plans to cease asset purchases and begin normalizing monetary policy next year.

Our current scenarios are for a synchronized global expansion (60%), which is a continuation of the current environment that benefits equities, trade protectionism (15%), which would be negative for equities and positive for bonds, stagflation (15%) which would be detrimental for both bonds and equities, and finally, geopolitical instability (10%) that would introduce significant financial market volatility.

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 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 still above-trend pace. 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 15%

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. Mr. Trump has since upped the ante by imposing tariffs on a total of $250 billion worth of Chinese goods (of which China has retaliated), while threatening to slap tariffs on an additional $267 billion of imports as well as levies on global 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
STAGFLATION

PROBABILITY 15%

After an extended period of undershooting central bank inflation targets, policymakers tolerate higher inflation (overshoot) and monetize inflation by letting the economy run hot. As a result, inflation expectations start to de-anchor from current subdued levels and surge higher. This would come at the same time that fiscal stimulus is being reigned-in (2020) in the later stages of the economic expansion, causing growth to moderate to well below potential levels in response. In the Stagflation scenario, a stagnation in growth occurs concurrently with an acceleration in inflation as a result of previous excessive monetary stimulation and an exhaustion of productive capacity - creating a tumultuous financial market landscape whereby both equities and bonds experience broad based declines.

SCENARIO 4
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.

FIERACAPITAL

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	OCTOBER 31, 2018	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	STAGFLATION	GEOPOLITICAL INSTABILITY
PROBABILITY		60%	15%	15%	10%
GDP GROWTH (Y/Y)					
Global	3.50%	4.00%	2.00%	2.75%	3.00%
Canada	2.50%	3.00%	0.50%	2.75%	1.00%
U.S.	3.00%	3.50%	1.00%	2.75%	1.00%
INFLATION (HEADLINE Y/Y)					
Canada	2.20%	2.50%	1.50%	3.00%	1.50%
U.S.	2.30%	2.50%	2.00%	3.00%	1.75%
SHORT-TERM RATES					
Bank of Canada	1.75%	2.25%	1.00%	2.00%	1.25%
Federal Reserve	2.25%	3.00%	2.00%	2.75%	2.25%
10-YEAR RATES					
Canada Government	2.49%	3.00%	1.40%	3.80%	1.70%
US Government	3.14%	3.40%	2.25%	4.25%	2.00%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	16.0%	19.7%	-15.2%	9.8%	-10.2%
U.S.	11.4%	11.7%	-8.7%	2.1%	-7.4%
EAFE	6.4%	4.6%	-14.1%	-10.3%	-17.8%
EM	36.3%	21.7%	-20.9%	-8.7%	-20.9%
P/E (FORWARD 12 MONTHS)					
Canada	12.9X	15.5X	15.0X	13.0X	14.0X
U.S.	15.5X	16.5X	16.5X	16.0X	16.0X
EAFE	12.8X	15.0X	13.0X	13.0X	13.5X
EM	8.5X	13.0X	11.0X	11.0X	11.5X
CURRENCIES					
CAD/USD	0.76	0.83	0.70	0.80	0.72
EUR/USD	1.13	1.20	1.10	1.10	1.00
USD/JPY	112.94	110.00	100.00	120.00	100.00
COMMODITIES					
Oil (WTI, USD/barrel)	65.31	80.00	50.00	90.00	55.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	STAGFLATION	GEOPOLITICAL INSTABILITY
PROBABILITY	60%	15%	15%	10%
Money Market	2.0%	1.4%	1.9%	1.5%
Canadian Bonds	-0.3%	10.2%	-6.3%	8.5%
Canadian Equity	23.8%	-15.2%	-4.8%	-16.2%
U.S. Equity	-2.5%	-5.5%	-10.3%	-9.7%
International Equity	5.9%	-10.6%	-18.4%	-13.6%
Emerging Market Equity	24.5%	-18.8%	-18.0%	-17.5%

CURRENT STRATEGY [1]

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	ALLOCATION	RELATIVE	OCTOBER 9, 2018 CHANGE
Money Market	0.0%	5.0%	25.0%	Overweight	20.0%	+15.0%	No change
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%	No change
U.S. Equity	3.0%	13.0%	23.0%	Underweight	3.0%	-10.0%	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	15.0%	+10.0%	Increased by 5.0%

[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
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%
October 9, 2018	+15.0%	-15.0%	+5.0%	-10.0%	-5.0%	+10.0%

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

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