TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

DECEMBER 2018

FIERA CAPITAL

Financial markets gyrated in November as investors contemplated some signs of slowing global growth, a profound slump in crude prices, ongoing trade tensions between the US and China, and a politically-charged environment in Europe. However, a sense of calm came over the marketplace ahead of the highly-anticipated US-China trade discussions, while some dovish-leaning comments from senior Fed officials and speculation for a coordinated supply response from OPEC and its allies also boosted risk appetite. The good news is that the global trade debacle has been temporarily sidelined, with President Trump and Xi agreeing to a 90-day truce as they attempt to negotiate a comprehensive trade deal – though the underlying details are far from clear.

FINANCIAL MARKET DASHBOARD

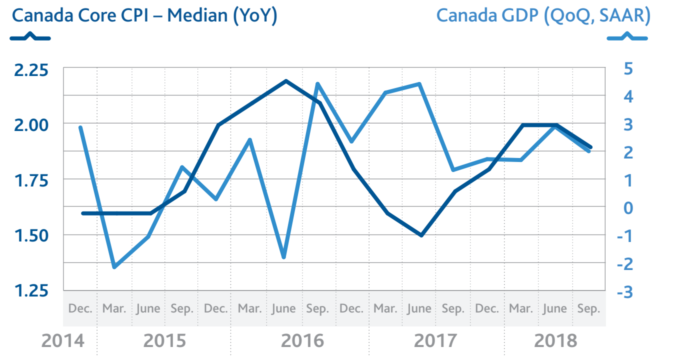
	NOV. 30 2018	NOV.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,760	1.79%	3.24%	4.25%
S&P/TSX	15,198	1.13%	-6.24%	-5.41%
MSCI EAFE	1,810	-0.31%	-11.76%	-10.42%
MSCI EM	995	4.06%	-14.13%	-11.25%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.99	-15.6	58.3	57.8
US 2 Year Bond Yield	2.79	-8.0	90.4	100.5
CA 10 Year Bond Yield	2.27	-22.6	22.3	37.9
CA 2 Year Bond Yield	2.16	-17.8	47.1	72.8
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.75	-1.01%	-5.43%	-2.98%
EUR/USD	1.13	0.04%	-5.73%	-4.93%
USD/JPY	113.57	0.56%	0.78%	0.92%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	50.93	-22.02%	-15.71%	-11.27%
Copper (USD/pound)	2.78	4.46%	-15.85%	-8.54%
Gold (USD/oz)	1,220.20	0.43%	-6.81%	-4.16%

Investor sentiment improved somewhat in November and global equity markets found some solace. The advance was fairly broad based, with emerging market equities significantly outperforming their developed market peers. The S&P 500 ended the month higher on optimism for a US-China trade truce and on speculation that the Federal Reserve will adopt a more cautious approach to policy normalization in 2019. Meanwhile, Canadian stocks posted their best monthly performance since June after the US, Canada, and Mexico signed a new trade deal. Finally, the gauge of emerging market stocks cemented its biggest monthly advance since January after Fed Chair Powell walked back on some of his hawkish rhetoric, while hopes for a trade deal between the US and China also stoked demand for riskier assets.

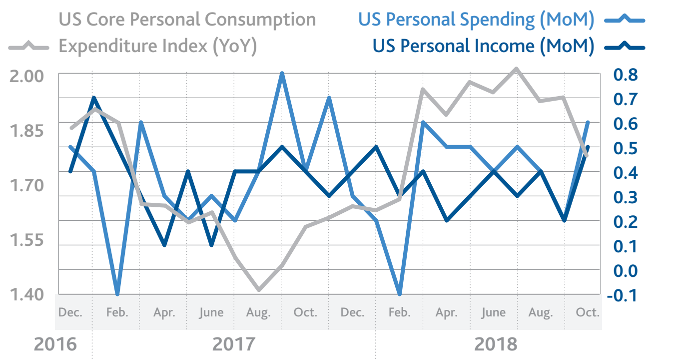
North American fixed income markets also posted positive results in November. Bond yields were broadly lower across the curve and yield curves flattened. The long-end of the curve was pushed lower on the back of a decline in inflation expectations, owing mainly to global growth concerns and the severe drop in crude prices, while the dovish interpretation of Chair Powell's remarks saw investors reign-in their wagers for fed fund rate hikes in 2019.

In currency markets, the greenback swung between gains and losses, but ended the month marginally stronger. The euro eked out a small gain even in light of some signs of softness on the economic front. Instead, the common currency rose after Italy's populist leaders struck a conciliatory tone in the budget showdown with the European Union. Emerging market currencies posted an impressive comeback alongside the broad recovery in risk assets, while the Canadian dollar declined on the back of the precipitous collapse in crude prices, with little in the way of a sizeable bounce following the official signing of the USMCA at month-end.

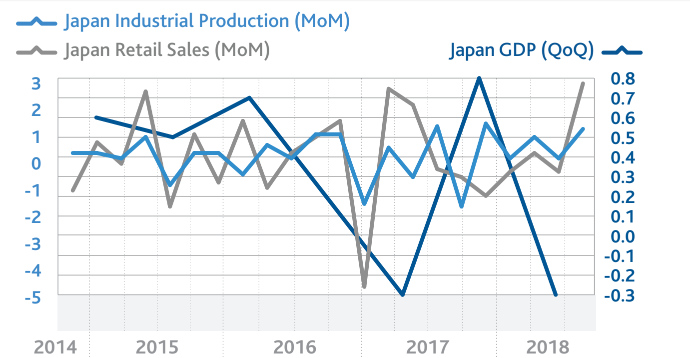
In commodity markets, oil capped its worst monthly return in more than a decade as renewed concerns over a global supply glut were exacerbated by American waivers on Iranian sanctions. However, crude staged an impressive rebound in early December after Saudi Arabia and Russia indicated a willingness to extend production cuts into 2019, while government-mandated production curbs in Alberta lent support to heavy oil prices and saw the discount to US oil narrow substantially. Finally, copper was weighed down by some signs of a deteriorating growth backdrop in China, but managed to recalibrate at month-end on hopes for constructive trade discussions between the US and China.



The Canadian economy has moderated towards levels that are consistent with its long-term potential, while the Bank of Canada's gauges of underlying inflation remain stable and in-line with the central bank's target. That being said, while likely reassuring for the central bank, the environment of softer crude prices could potentially keep the Bank of Canada on the sidelines in January.



The US economy remains in solid shape heading into the final quarter of 2018, thanks to robust consumer spending, healthy income gains, and a decent factory outlook. At the same time, inflation remains well-contained - which has all but reinforced the Federal Reserve's flexible approach to rate normalization in 2019.



The latest string of activity data in Japan suggests that the economy is on the path to recovery following the natural disaster-induced weakness in the third quarter. Retail sales rose by a stronger than expected pace in October, while factory output expanded at its fastest pace in more than 3 years – suggesting that the third quarter contraction was likely a temporary aberration.

CANADA

The Canadian economy moderated to a more self-sustaining and trend-like pace during the third quarter of 2018. While the headline print was largely in-line with expectations, the underlying details were somewhat disappointing. While some modestly positive contributions came from trade and consumer spending, business investment was a drag as uncertainties pertaining to the trade situation weighed on confidence and spending. However, investment could potentially recalibrate in the fourth quarter, with the revised trilateral trade accord now signed by the leadership in Canada, the US, and Mexico and some encouraging signs of easing global trade tensions also lending support. While the growth results were largely in-line with the central bank forecasts and core inflation continues to hover near target, much will depend on commodity price developments going forward and could warrant some caution from the Bank of Canada in early-2019.

USA

The US economy continues to fire on all cylinders. The mighty US consumer got off to a healthy start in the fourth quarter. Spending rose by a stronger than expected 0.6% in October, while incomes rose by a larger than expected 0.5% during the month – with the consumer backdrop well-supported by a healthy labour market, rising wages, and lower taxes that are likely to boost discretionary spending heading into the all-important holiday season. Meanwhile, a gauge of manufacturing activity rebounded in November and suggests that US factories remain healthy and have largely brushed-off trade anxieties between the US and China. Furthermore, the latest ceasefire in the global trade debacle removes a key obstacle and should boost demand for manufactured goods in the final quarter of 2018, providing the Federal Reserve with the scope to raise interest rates in December.

INTERNATIONAL

After some softness during the third quarter, growth prospects in Europe, Japan, and China could be ripe for a reversal. Euro-area growth slowed to its slowest pace since 2014 owing to a quarterly contraction in Germany (thanks to a one-off slump in the auto sector). Similarly, Japanese growth took a severe hit from a string of natural disasters - though stronger than expected retail sales and factory production results for October suggest that the economy is on the path to recovery. Finally in China, while the economy struggles to find a bottom in the wake of slowing domestic growth, ongoing pledges for monetary and fiscal support should lend some support, while receding global trade tensions are expected to remove a key overhang 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 (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.

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	NOVEMBER 30, 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	2.10%	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	2.40%	2.50%	1.50%	3.00%	1.50%
U.S.	2.50%	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	2.27%	3.00%	1.40%	3.80%	1.70%
US Government	2.99%	3.40%	2.25%	4.25%	2.00%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	13.1%	11.3%	-17.7%	6.5%	-12.9%
U.S.	9.6%	9.9%	-10.2%	0.5%	-8.9%
EAFE	2.9%	3.3%	-15.2%	-11.5%	-18.8%
EM	8.5%	19.9%	-22.1%	-10.1%	-22.1%
P/E (FORWARD 12 MONTHS)					
Canada	13.0X	15.0X	15.0X	13.0X	14.0X
U.S.	15.8X	16.5X	16.5X	16.0X	16.0X
EAFE	13.0X	15.0X	13.0X	13.0X	13.5X
EM	11.0X	13.0X	11.0X	11.0X	11.5X
CURRENCIES					
CAD/USD	0.75	0.80	0.70	0.80	0.72
EUR/USD	1.13	1.20	1.10	1.10	1.00
USD/JPY	113.57	110.00	100.00	120.00	100.00
COMMODITIES					
Oil (WTI, USD/barrel)	50.93	75.00	40.00	80.00	45.00

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	-1.6%	8.9%	-7.6%	7.2%
Canadian Equity	13.5%	-16.1%	-5.9%	-17.1%
U.S. Equity	-1.6%	-8.1%	-12.8%	-12.2%
International Equity	9.1%	-11.2%	-18.9%	-14.3%
Emerging Market Equity	22.9%	-22.8%	-22.0%	-21.5%
Real Assets	7.0%	5.0%	5.3%	5.5%

CURRENT STRATEGY [1]

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	ALLOCATION	RELATIVE
Money Market	0.0%	5.0%	25.0%	Neutral	5.0%	0.0%
Canadian Bonds	5.0%	25.0%	45.0%	Underweight	5.0%	-20.0%
Canadian Equity	10.0%	20.0%	30.0%	Overweight	25.0%	+5.0%
U.S. Equity	0.0%	10.0%	20.0%	Underweight	0.0%	-10.0%
International Equity	0.0%	10.0%	20.0%	Underweight	5.0%	-5.0%
Emerging Markets Equity	0.0%	5.0%	15.0%	Overweight	15.0%	+10.0%
Real Assets	5.0%	25.0%	45.0%	Overweight	45.0%	+20.0%

[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.

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EVOLUTION OF STRATEGY [1]

	MONEY MARKET	CANADIAN BONDS	CANADIAN EQUITY	U.S. EQUITY	INTERNATIONAL EQUITY	EMERGING MARKETS EQUITY	REAL ASSETS
October 5, 2011	+7.0%	-15.0%	+8.0%	0.0%	0.0%	0.0%	0.0%
October 12, 2011	+6.0%	-10.0%	+4.0%	0.0%	0.0%	0.0%	0.0%
November 11, 2011	+5.0%	0.0%	0.0%	0.0%	-5.0%	0.0%	0.0%
December 7, 2011	0.0%	0.0%	+5.0%	0.0%	-5.0%	0.0%	0.0%
April 20, 2012	+15.0%	-20.0%	+10.0%	0.0%	-5.0%	0.0%	0.0%
July 31, 2012	+20.0%	-15.0%	0.0%	0.0%	-5.0%	0.0%	0.0%
November 9, 2012	+10.0%	-15.0%	+10.0%	0.0%	-5.0%	0.0%	0.0%
February 19, 2013	+5.0%	-15.0%	+10.0%	0.0%	0.0%	0.0%	0.0%
August 6, 2013	0.0%	-15.0%	+10.0%	+5.0%	0.0%	0.0%	0.0%
December 3, 2013	+10.0%	-15.0%	+5.0%	0.0%	0.0%	0.0%	0.0%
February 5, 2014	0.0%	-15.0%	+10.0%	+10.0%	-5.0%	0.0%	0.0%
October 14, 2014	0.0%	-20.0%	+5.0%	+10.0%	+5.0%	0.0%	0.0%
November 14, 2014	+10.0%	-20.0%	+2.5%	+2.5%	+5.0%	0.0%	0.0%
July 13, 2015	0.0%	-20.0%	+7.0%	+4.0%	+9.0%	0.0%	0.0%
October 19, 2015	0.0%	-20.0%	+11.0%	+0.0%	+9.0%	0.0%	0.0%
June 24, 2016	+9.0%	-20.0%	+11.0%	+0.0%	+0.0%	0.0%	0.0%
July 12, 2016	0.0%	-20.0%	+15.0%	+0.0%	+0.0%	+5.0%	0.0%
July 27, 2016	+5.0%	-20.0%	+12.5%	+0.0%	+0.0%	+2.5%	0.0%
October 31, 2016	0.0%	-20.0%	+12.5%	0.0%	0.0%	+7.5%	0.0%
April 5, 2017	+5.0%	-15.0%	+7.5%	0.0%	-5.0%	+7.5%	0.0%
December 6, 2017	+15.0%	-15.0%	+5.0%	-5.0%	-5.0%	+5.0%	0.0%
October 9, 2018	+15.0%	-15.0%	+5.0%	-10.0%	-5.0%	+10.0%	0.0%
November 9, 2018	0.0%	-20%	+5%	-10%	-5%	+10%	+20%

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

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