TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

FEBRUARY 2019

FIERA CAPITAL

After a dismal end to 2018, risk appetite resurfaced in January - thanks to an increasingly conciliatory tone from global central banks, solid corporate earnings results, and some tentative signs of progress on the US-China trade front. Notably, financial markets embraced the Federal Reserve's pivot away from its tightening bias, with policymakers signaling a near-term pause in rate hikes – while similarly cautious undertones from the likes of the European Central Bank, Bank of Japan, and People's Bank of China also lent support. Moreover, high-level trade discussions between the US and China ended on an optimistic note - though stopped short of a breakthrough that would end the conflict ahead of the March deadline for avoiding further escalation in the trade war.

FINANCIAL MARKET DASHBOARD

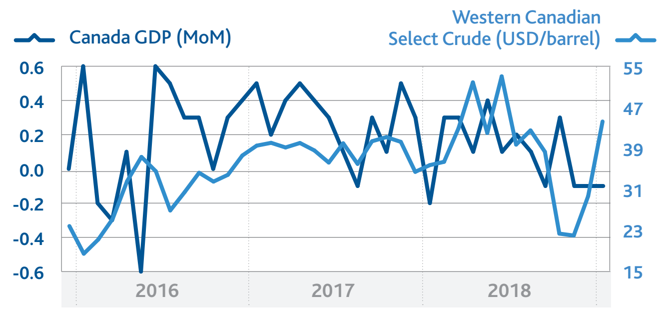
	JAN. 31 2019	JAN.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,704	7.87%	7.87%	-4.24%
S&P/TSX	15,541	8.50%	8.50%	-2.58%
MSCI EAFE	1,831	6.47%	6.47%	-14.95%
MSCI EM	1,050	8.71%	8.71%	-16.31%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.63	-5.5	-5.5	-7.6
US 2 Year Bond Yield	2.46	-3.0	-3.0	31.7
CA 10 Year Bond Yield	1.88	-8.8	-8.8	-41.0
CA 2 Year Bond Yield	1.78	-8.8	-8.8	-6.3
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.76	3.91%	3.91%	-6.18%
EUR/USD	1.14	-0.17%	-0.17%	-7.78%
USD/JPY	108.89	-0.73%	-0.73%	-0.27%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	53.79	18.45%	18.45%	-16.90%
Copper (USD/pound)	2.78	5.83%	5.83%	-12.86%
Gold (USD/oz)	1,319.70	3.00%	3.00%	-1.44%

Global equity markets made an impressive comeback in January after breaching deeply oversold levels late last year. US equities closed at an eight-week high, while Canadian equities also roared higher – with the S&P/TSX ending January at its highest level since October. The more relaxed outlook from global central banks and some robust earnings results also contributed to a bounce back in European shares. Finally, emerging stocks continued to outperform their developed peers as investors cheered the Federal Reserve's flexible approach to monetary normalization, while hopes for diffused trade tensions and softer dollar conditions also added fuel to the emerging market rally that began in late-2018.

North American fixed income markets also posted positive results as the profound shift in global monetary policy sent bond yields lower. Of note, the Federal Reserve walked back on hawkish testimony and signaled that the subdued inflation backdrop will allow for a "patient" approach to the future policy path. Similarly, the European Central Bank acknowledged the vulnerable economic and geopolitical backdrop and downgraded its assessment for risk, while the Bank of Japan lowered its inflation forecasts – essentially signalling no end in sight for ultra-accommodative policies from central banks abroad. Meanwhile, credit spreads narrowed after a violent blow-out in late 2018, with corporate bonds outperforming their government peers in January.

The greenback declined for a second consecutive month amid the Federal Reserve's increasingly dovish stance, while the prolonged government shutdown also weighed. In contrast, the Canadian dollar firmed thanks to the strong comeback in crude prices and broad US dollar weakness in general. The pound also ended the month higher on speculation that a no-deal Brexit will be averted, while emerging market currencies continued their winning streak at the beginning of 2019.

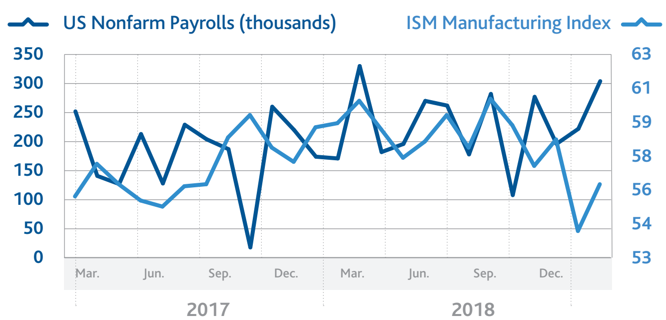
In commodity markets, oil prices soared higher as OPEC and its allies made good on their pledges to curb production at the beginning of the year, while the political crisis in Venezuela also threatened to disrupt supply for a market that's already nearly-balanced. Gold posted its fourth straight monthly gain after the Fed signaled a pause in its rate hike trajectory, while US dollar weakness also reinforced the appeal of the yellow metal. Finally, copper posted robust gains after China's economy stabilized somewhat in January, while signs of simmering trade tensions also helped to alleviate the outlook for global demand.



In Canada, recent softness in interest-sensitive sectors such as consumption and housing have reinforced the necessity for exports and investment to drive growth going forward. And while woes in the energy are also set to temporarily depress growth in the first quarter of 2019, the sharp rebound in Western Canadian Select crude prices should set the stage for a rebound in the second quarter.

CANADA

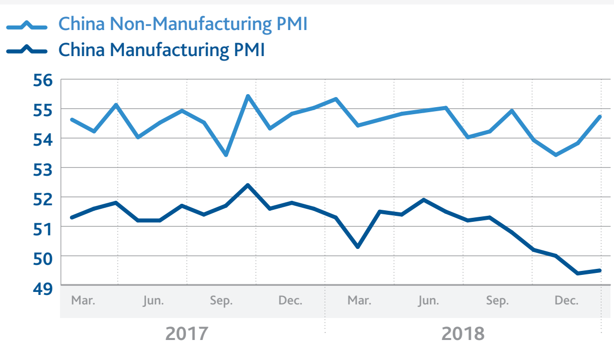
The Canadian economy slowed at the end of 2018, with output contracting modestly in November. Weakness was exacerbated by woes in the energy sector (with discounts on Canadian crude hitting record highs in November), while the retail, autos, and construction-related sectors were also vulnerable in the rising rate environment. These trends have all but reinforced the necessity for Canada's growth drivers to rotate away from the overly-exhausted consumer and housing sectors towards exports and investment, which should be facilitated by a solid demand backdrop stateside and a still-competitive loonie. Looking ahead, the combination of temporary, oil-induced weakness at the beginning of 2019, heightened global economic uncertainty, and a tame inflation backdrop has reinforced a patient approach from the Bank of Canada for 2019.



Signs of underlying resilience in the US economy were largely at odds with the Federal Reserve's dovish-turn at the beginning of 2019. Consumer trends remained supportive thanks to an impressive 304k payroll print and a 3.2% y/y acceleration in wages in January, while the factory sector also surprised to the upside, with the ISM Manufacturing index unexpectedly rebounding early-on in the new year.

USA

While a number of economic data releases have been delayed due to the partial government shutdown, incoming data suggests that the world's largest economy remains in healthy shape. Of note, the US economic backdrop remained buoyant early-on in 2019, owing to robust job creation and stellar wage gains, while the impressive rebound in the factory sector also suggests that fears of a pronounced economic slowdown are generally misplaced. This economic strength came in stark contrast to the Federal Reserve's dovish-turn in January, with the central bank capitulating on its plans for further rate hikes in the near-term in response to a number of "crosscurrents" at hand (such as slower growth in China and Europe, ongoing trade negotiations, financial market volatility, and Brexit).



The official PMI data for January suggests that the Chinese economy may have stabilized after the softness witnessed through 2018. The slowdown in the factory sector has eased off somewhat, while the services sector continues to show signs of resilience in an encouraging sign that the recent string of monetary and fiscal stimulus measures may finally be placing a floor under the world's second largest economy.

INTERNATIONAL

The global economy lost some momentum last year, owing mainly to the contentious trade backdrop and signs of slowing growth in China – a key player on the global scale. However, we are seeing some tentative signs of stabilization in China in an encouraging sign that recent monetary and fiscal measures to reflate the economy are finally beginning to bear some fruit – which should have positive spillover effects for the global economy in general. Namely, high-frequency activity data such as retail sales and industrial production both reaccelerated in December, while the official gauge of China's economy indicated that the factory sector slowdown eased somewhat in January – though further stabilization in the world's second largest economy hinges directly on the outcome of ongoing US-China trade discussions.

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	JANUARY 31, 2019	SYNCHRONIZED GLOBAL EXPANSION	TRADE PROTECTIONISM	STAGFLATION	GEOPOLITICAL INSTABILITY
PROBABILITY		60%	15%	15%	10%
GDP GROWTH (Y/Y)					
Global	3.70%	3.80%	2.00%	2.75%	3.00%
Canada	1.70%	2.50%	0.50%	2.75%	1.00%
U.S.	3.00%	3.00%	1.00%	2.75%	1.00%
INFLATION (HEADLINE Y/Y)					
Canada	2.00%	2.50%	1.50%	3.00%	1.50%
U.S.	1.90%	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	2.50%	3.00%	2.00%	2.75%	2.25%
10-YEAR RATES					
Canada Government	1.88%	2.80%	1.40%	3.80%	1.70%
US Government	2.63%	3.20%	2.25%	4.25%	2.00%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	5.6%	8.2%	-17.8%	6.3%	-13.0%
U.S.	6.2%	8.6%	-11.3%	-0.7%	-10.0%
EAFE	5.1%	4.1%	-14.5%	-10.8%	-18.2%
EM	5.5%	19.9%	-22.1%	-10.1%	-22.1%
P/E (FORWARD 12 MONTHS)					
Canada	14.2X	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	11.9X	13.0X	11.0X	11.0X	11.5X
CURRENCIES					
CAD/USD	0.76	0.80	0.70	0.80	0.72
EUR/USD	1.14	1.20	1.10	1.10	1.00
USD/JPY	108.89	110.00	100.00	120.00	100.00
COMMODITIES					
Oil (WTI, USD/barrel)	53.79	70.00	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	-2.7%	6.6%	-9.9%	4.9%
Canadian Equity	8.1%	-18.0%	-8.0%	-18.9%
U.S. Equity	1.7%	-5.0%	-9.8%	-9.2%
International Equity	9.2%	-11.1%	-18.9%	-14.2%
Emerging Market Equity	17.9%	-25.9%	-25.2%	-24.7%
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%	Underweight	0.0%	-5.0%
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	5.0%	-5.0%
International Equity	0.0%	10.0%	20.0%	Underweight	5.0%	-5.0%
Emerging Markets Equity	5.0%	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%
December 17, 2018	-5.0%	-20%	+5%	-5%	-5%	+10%	+20%

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

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