TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

JUNE 2019

FIERA CAPITAL

The trade dispute between the US and China intensified in May, with heightened levels of investor angst rippling through the financial marketplace. Negotiations effectively collapsed after President Trump accused China of reneging on a deal that was taking shape and raised the tariffs on $200 billion of Chinese goods, while also going a step further and threatening to impose a 25% levy on an additional $325 billion in goods. Relations between the world's two largest economies soured even further after Trump blacklisted US trade with Huawei, China's second largest technology company. Not surprisingly, China pledged retaliation and said they were "seriously considering" restrictions on the export of rare earth minerals in response. Finally at month-end, Trump doubled-down on his protectionist agenda and vowed to impose tariffs on Mexican goods in a bid to stop immigrants from illegally crossing the border in a move that has jeopardized the ratification of USMCA.

FINANCIAL MARKET DASHBOARD

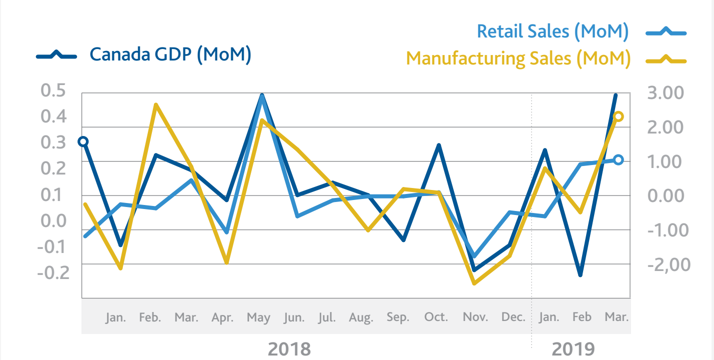
	MAY 31 2019	MAY	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2752	-6.58%	9.78%	1.73%
S&P/TSX	16037	-3.28%	11.97%	-0.15%
MSCI EAFE	1817	-5.42%	5.67%	-8.50%
MSCI EM	998	-7.53%	3.34%	-10.95%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.12	-37.7	-56.0	-73.4
US 2 Year Bond Yield	1.92	-34.4	-56.6	-50.5
CA 10 Year Bond Yield	1.49	-22.4	-47.9	-75.6
CA 2 Year Bond Yield	1.43	-13.4	-43.4	-48.9
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.74	-0.94%	0.90%	-4.13%
EUR/USD	1.12	-0.41%	-2.60%	-4.48%
USD/JPY	108.29	-2.81%	-1.28%	-0.49%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	53.50	-16.29%	17.82%	-20.20%
Copper (USD/pound)	2.64	-9.01%	0.34%	-13.87%
Gold (USD/oz)	1305.80	1.56%	1.91%	0.44%

Global equity markets were whipsawed in May, with the MSCI All Country World capping its first monthly decline since December. The descent was widespread across the world, with no region left unscathed. The S&P 500 collapsed back below the 2800 threshold to a three-month low, while the S&P/TSX also followed suit – though to a lesser extent. Looking abroad, European and Japanese shares were also sideswiped in the turbulent trading environment. Not surprisingly, emerging market bourses took the brunt of the fall and posted their worst monthly drop since August 2015 (when China's surprise devaluation of the yuan spurred a global equity rout) as nervous investors fled indiscriminately from risky assets during the month.

Fixed income markets thrived in the environment of lingering trade hostilities. Yield curves flattened (and in some cases, inverted), with long-term yields falling faster than their shorter-term counterparts. Specifically, the spread between the 10-year treasury yield and the three-month T-bill fell to the most negative since 2007 – which ignited fears of recession and accentuated the downward move even further. The 10 year treasury yield tumbled to a 20-month low as the sharp decline in crude prices and expectations for weaker US growth stymied inflation expectations. And at the short-end, traders ramped-up their wagers for easier monetary policy, with markets discounting nearly three fed fund rate cuts by the end of 2020 even as the Federal Reserve maintained its decidedly neutral stance.

In currency markets, the greenback extended its stretch of monthly gains to a fourth as the tumultuous trade backdrop cast a shadow over the global economy and boosted the allure of the US dollar as a haven. In contrast, the euro declined as investors contemplated the ECB's dovish stance and global trade tensions alike, while the budget debacle between Italy and the European Union also weighed. Finally, the Canadian dollar was pressured lower alongside the precipitous slide in crude prices in May – even after Trump vowed to remove metals tariffs in an important step towards ratifying the USMCA.

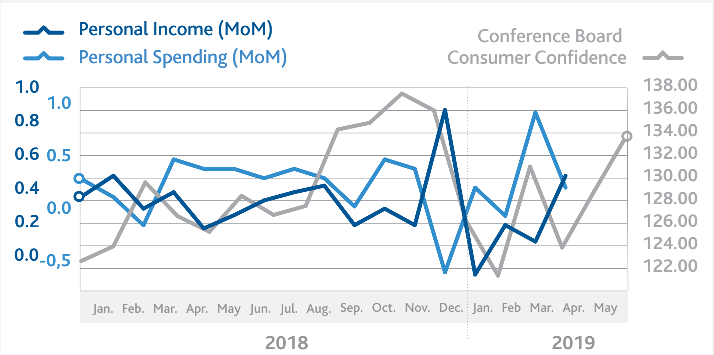
In commodity markets, oil posted its biggest slump of 2019 amid fears that the trade war will stifle global demand, which overshadowed the potential for supply disruptions in the Persian Gulf, US sanctions on Iran and Venezuela, and reduced production from OPEC. Copper retreated to the lowest level this year as the trade dispute between the world's two largest consumers of the red metal weighed on the demand outlook, while in contrast, gold saw some bullish momentum late-month as nervous investors piled into the yellow metal seeking shelter from the storm.



The Canadian economy rebounded convincingly in March and gained 0.5%, making for a strong handoff to the second quarter. Retail sales also accelerated 1.1% in April, thanks to record job creation that has boosted spending prospects, while factory activity also came roaring back during the month, with manufacturing sales rising at their fastest pace since early 2018 (+2.1%).

CANADA

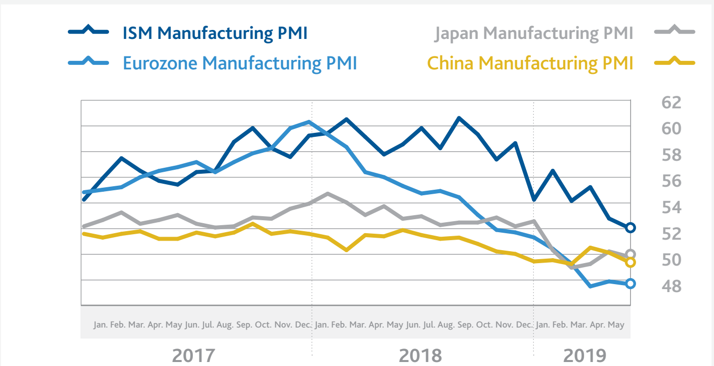
The Canadian economy appears ripe for a recovery after the latest soft patch. While exports detracted at the beginning of the year, domestic demand remained robust, with both consumer and business spending bouncing back forcefully (and more than offsetting a drag from residential investment). Furthermore, the stronger than expected GDP results for March point to improved momentum at the end of the first quarter and a strong handoff to the second quarter. Of note, the consumer has emerged from a spending slump thanks to record job gains, while exporters and the business segment in general should thrive on the combination of strong demand stateside, a competitive loonie, and the lifting of US metal tariffs that increases the likelihood of USMCA ratification – while a resumption of activity in the oil patch should also lend support.



The US consumer continues to thrive on the lucrative combination of low interest rates, healthy job creation, and rising wages that have propelled confidence to its highest level since late-2018. Reasonably healthy personal income (+0.5% m/m) and spending (0.3% m/m) gains in April underscore the strength of the mighty consumer and should bode well for the US economy in 2019.

USA

After a red-hot start to the year, the US economy has shifted gears and is reverting back to more self-sustaining levels. The good news is that the US consumer remains a pivotal source of strength for the US economy, owing mainly to persistently low interest rates and robust labour market conditions that have buoyed confidence and consumer spending habits. In contrast, sentiment in the factory sector has been plagued by the latest escalation in President Trump's protectionist agenda, with the key gauge of US manufacturing activity unexpectedly falling to the lowest level since 2016 in May. The Federal Reserve's preferred gauge of inflation ticked higher in April, consistent with Chair Powell's message that softness was transitory in nature, with the central bank assuming a decidedly neutral stance at its monetary policy meeting in May.



The most observable impact of the intensifying trade debacle has been through the sentiment-channels in the factory space. The global manufacturing Purchasing Manager Index fell to its weakest level since 2012, with softness visible across the globe. Even in the US, the ISM factory gauge fell to its lowest since October 2016, while European, Japanese, and Chinese indices are all sitting below the 50 threshold that divides expansion from contraction.

INTERNATIONAL

The Chinese economy has deteriorated somewhat as trade frictions between the world's two largest economies continues to weigh on sentiment. The manufacturing Purchasing Managers Index (PMI) disappointed and dropped back into contraction territory in May, with a retrenchment in both import and export demand sub-indices suggesting that both internal and external factory conditions remain subdued at this time. That being said, the non-manufacturing, services gauge held steady and suggests that the latest escalation in the trade war has yet to be felt more broadly across the entire economy. The silver lining is that the policy focus in Beijing has shifted back towards cyclical support in order to shield the economy from trade war pressures, with policymakers having ample room to stimulate growth, including infrastructure spending, tax cuts, lower policy rates, and reductions in bank reserves.

MAIN SCENARIO
SUSTAINED GLOBAL EXPANSION

PROBABILITY 65%

The global economy finds its footing and reaccelerates in a synchronous manner, with global growth advancing in-line with its potential rate. The US leads the global charge, though growth moderates to a still above-trend pace as the fiscal and monetary impetus fades in the coming year. Meanwhile, healthy demand stateside and our expectation for receding trade tensions also buoys the Canadian economy and helps to facilitate the much-needed rotation towards exports and business investment (from the consumer and housing sector). Looking abroad, transitory factors that were exacerbated by a tumultuous global trade backdrop recede and both the European and Japanese economies recalibrate, while the Chinese economy stabilizes in response to the plethora of monetary and fiscal stimulus measures that place a floor under the world's second largest economy and by extension, global growth prospects. The environment of moderate, albeit self-sustaining growth keeps inflation stable at levels that do not pose a threat to the economic trajectory and allows major central banks to maintain stimulative policies and remain sidelined throughout 2019 – creating a lucrative, not-too-hot, not-too-cold backdrop for both the economy and investors alike. The accommodative impulse from major central banks ultimately nurtures the economic recovery and extends the visibility of the cycle. This reflationary backdrop bodes well for equities and commodities at the expense of fixed income and the US dollar.

SCENARIO 2
POLITICAL INSTABILITY

PROBABILITY 25%

The trend towards populism and protectionism could ignite a crisis in confidence and destabilize the financial markets. The biggest risk to our base case scenario is a rise in protectionism stemming from the US and the threat of a full-blown trade war that would derail the synchronous global expansion. While the US has proven successful in securing a trade deal with Canada and Mexico and extracting some concessions from China, vulnerabilities remain due to the sizeable trade deficit in the US. Notably, the trade debacle between the world's two largest economies has resurfaced after the latest round of talks ended inconclusively and with higher tariffs for both the US and China – with pressure between these two countries likely to prevail over the near-term as negotiations linger-on unresolved with the added threat of further escalation from here. Meanwhile, Trump's focus may then shift towards other trading partners in Europe and Japan, with the US threatening to use Section 232 (national security grounds) to impose tariffs on auto imports. Taken together, an escalation in the trade debacle would be detrimental for trade flows and hence, the global economy. Finally, the stakes are high for this year's European Parliamentary elections where the populists are likely to continue gaining ground, while lingering tensions and a lack of progress in Brexit negotiations raises the odds of a "hard Brexit" scenario.

SCENARIO 3
STAGFLATION

PROBABILITY 10%

After an extended period of undershooting central bank inflation targets, policymakers tolerate higher inflation (overshoot) and monetize inflation. 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.

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	MAY 31, 2019	SUSTAINED GLOBAL EXPANSION	POLITICAL INSTABILITY	STAGFLATION
PROBABILITY		65%	25%	10%
GDP GROWTH (Y/Y)				
Global	3.70%	3.50%	2.00%	2.75%
Canada	1.40%	2.00%	0.50%	2.75%
U.S.	3.20%	2.50%	1.00%	2.75%
INFLATION (HEADLINE Y/Y)				
Canada	2.00%	2.00%	1.50%	3.00%
U.S.	2.00%	2.00%	2.00%	3.00%
SHORT-TERM RATES				
Bank of Canada	1.75%	1.75%	1.25%	2.00%
Federal Reserve	2.50%	2.50%	2.00%	2.75%
10-YEAR RATES				
Canada Government	1.49%	2.25%	1.40%	3.00%
US Government	2.12%	3.00%	2.25%	4.00%
PROFIT GROWTH (12 MONTHS FORWARD)				
Canada	6.1%	4.2%	-12.8%	6.6%
U.S.	7.1%	4.0%	-8.2%	-2.1%
EAFE	6.9%	1.2%	-6.6%	-6.6%
EM	18.7%	11.8%	-14.5%	1.2%
P/E (FORWARD 12 MONTHS)				
Canada	14.7X	16.0X	14.0X	13.0X
U.S.	15.7X	18.5X	15.0X	16.0X
EAFE	13.2X	15.0X	12.0X	13.5X
EM	11.1X	14.5X	11.0X	11.5X
CURRENCIES				
CAD/USD	0.74	0.79	0.70	0.80
EUR/USD	1.12	1.16	1.10	1.10
USD/JPY	108.29	110.00	100.00	120.00
COMMODITIES				
Oil (WTI, USD/barrel)	53.50	70.00	40.00	80.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SUSTAINED GLOBAL EXPANSION	POLITICAL INSTABILITY	STAGFLATION
PROBABILITY	65%	25%	10%
Money Market	1.8%	1.5%	1.9%
Canadian Bonds	-1.7%	4.0%	-7.1%
Canadian Equity	7.2%	-21.4%	-10.8%
U.S. Equity	7.0%	-13.6%	-14.0%
International Equity	0.5%	-16.3%	-17.6%
Emerging Market Equity	15.6%	-24.3%	-17.9%
Real Assets	7.0%	5.0%	3.0%

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	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.

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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