TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

AUGUST 2019

FIERA CAPITAL

While investors digested generally upbeat corporate earnings results, mixed signals on the health of the global economy, and the resumption of US-China trade talks, central banks were front and centre in July. As widely expected, the Federal Reserve took out some "insurance" in order to sustain the expansion and cut interest rates at month-end, while the European Central Bank laid the groundwork for further stimulative measures in the fall. Meanwhile, the Bank of England stepped-back from its hiking bias as newly-minted PM Boris Johnson began preparations for a no-deal Brexit. And on the trade front, tensions receded somewhat as US and Chinese policymakers headed back to the negotiating tables after a two-month hiatus.

FINANCIAL MARKET DASHBOARD

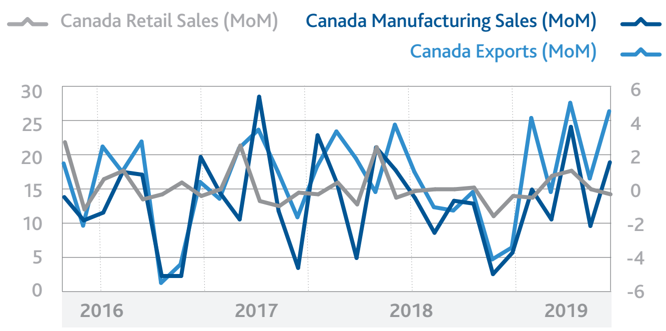
	JULY 31 2019	JULY	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2980	1.31%	18.89%	5.83%
S&P/TSX	16407	0.15%	14.55%	-0.17%
MSCI EAFE	1897	-1.31%	10.31%	-5.43%
MSCI EM	1037	-1.69%	7.38%	-4.64%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.01	0.9	-66.98	-94.5
US 2 Year Bond Yield	1.87	11.7	-61.57	-79.7
US Corp BBB Spread	1.40	-7.0	-46.00	-8.0
US Corp High Yield Spread	3.84	-2.0	-143.00	50.0
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.758	-0.75%	3.38%	-1.40%
EUR/USD	1.1076	-2.61%	-3.41%	-5.26%
USD/JPY	108.78	0.86%	-0.83%	-2.75%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	58.58	0.19%	29.00%	-14.81%
Copper (USD/pound)	2.666	-1.46%	1.33%	-5.84%
Gold (USD/oz)	1426.1	0.88%	11.30%	16.54%

Global equity markets remained well-supported in the environment of accommodative monetary policy, while hopes for progress on the trade front also buoyed sentiment. The US equity market led the charge and breached new highs in July, while the Canadian market also eked out a marginal gain. Looking abroad, European and Japanese bourses welcomed pledges for support from their respective central banks, though a gloomy growth and earnings backdrop weighed somewhat. Finally, emerging market stocks traded in a tight range as investors contemplated the murky global growth landscape, which wasn't enough to counter optimism on the trajectory for Federal Reserve policy and the resumption of US-Sino trade talks.

While the prospect for a synchronous central bank easing cycle reinvigorated the bond rally in early-July, bond yields edged higher throughout most of the month as signs of economic resilience in the US brought into question just how much stimulus is required going forward. As such, investors reigned-in their expectations for the magnitude of rate cuts at the July FOMC gathering. Heading into the meeting, the market was fully-discounting a 25 basis point rate cut and only a 20% chance of a 50 basis point rate cut. The yield curve bear-flattened, with the biggest upward move taking place in the shorter end of the curve, while the 10-year treasury yield also backed-up, though by a lesser extent.

The US dollar advanced thanks to the string of robust economic results that saw investors reconsider their expectations for an overly-aggressive easing path. In contrast, the euro declined as the ECB set the stage for rate cuts and a resumption of asset purchases this fall, while the pound pierced multi-year lows on speculation that UK Prime Minister (and Brexit hardliner) Boris Johnson will opt for a no-deal exit from the EU.

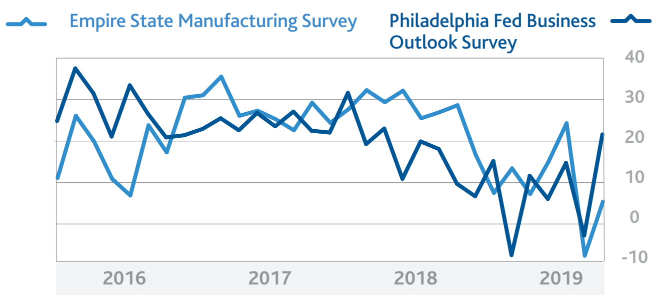
Gold held above $1400/oz owing to dovish-leaning rhetoric from major central banks and the corresponding decline in real rates, while upward momentum was amplified further by mounting geopolitical angst. Oil prices slumped amid renewed concerns about global demand prospects, which largely overshadowed the potential for supply disruption stemming from simmering tensions in the Middle East. Finally, copper prices ended the month virtually unchanged as traders weighed a cooling global demand backdrop against the prospect for an amicable trade accord between the world's two largest consumers of the red metal.



The Canadian economy maintained its positive momentum in May. While the consumer took a breather after a four-month stretch of spending gains, both exports and factory output rebounded. Meanwhile, the core gauge of underlying inflation remains at the 2% goal and will allow the Bank of Canada to remain sidelined even as other central banks pursue easier monetary policies.

CANADA

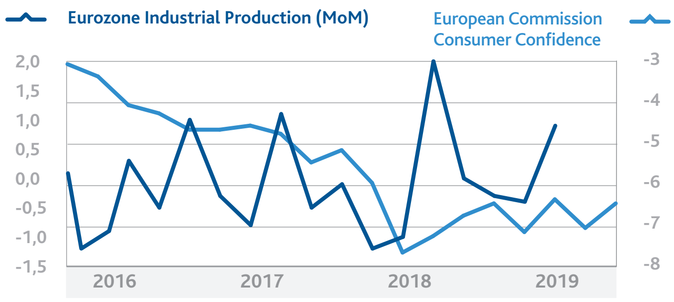
The narrative for a Canadian growth reacceleration remained intact late in the second quarter. Specifically, the trade balance swung back into surplus position in May for the first time since July 2018 on the heels of a 4.6% spike in exports. Meanwhile, factories were back in May, with manufacturing shipments surging at a healthy clip (1.6%). On the softer side, retail sales dropped 0.1% as the consumer took a breather after four straight months of gains. Core inflation held steady around the Bank of Canada's 2% target in June, with the average of the three measures ticking down slightly to 2% (from 2.1% in May), allowing the Bank of Canada to sit out the aggressive easing path from other major central bank peers.



Regional manufacturing surveys bounced higher in an encouraging sign that US factory sentiment may be taking a turn for the better. The New York Fed reported that its Empire Survey of manufacturers rose by 12.9 points in July, while the Philly Fed index surged by 21.5 points – both of which have set the stage for a near-term bounce in the closely-watched ISM manufacturing index.

USA

The latest string of economic results in the US were reasonably upbeat, though proved insufficient in reshaping the market's dovish bias. The improved tone to the data was widespread, with stronger than expected job creation bolstering retail sales and keeping the expansion intact, while the factory sector even found some solace as domestic strength boosted consumer demand for manufactured goods and helped to cushion the blow from weakness in the trade-related space. Of note, manufacturing output climbed 0.4% in June (the most this year), which came on the heels of a consensus-beating 0.4% jump in retail sales and an impressive 224k gain in US job creation. In the end, economic resilience in the US failed to dissuade the Federal Reserve from easing monetary policy at the gathering in late-July.



Is the European economy turning around? Industrial production jumped higher in May, with notable strength across Germany, France, Italy, and Spain. Meanwhile, tight labour markets and accelerating wages have supported household confidence even as uncertainty on the trade front lingers-on, with the European Commission's Consumer Sentiment measure leveling off in July.

INTERNATIONAL

Europe and Japan continue to be a casualty of lingering uncertainty on the trade front. In Europe, the PMI survey data for July disappointed once again in a sign that the economy has been unable to escape from trade-related woes. Of note, the factory sector deteriorated further, with the manufacturing PMI dropping to its lowest level in six years. Meanwhile, the domestically-focused sector remained the main driver of growth, with the services PMI remaining in expansion terrain. Taken together, the struggles in the Eurozone have added impetus to recent calls for more stimulus from the European Central Bank. Meanwhile, Japan PMI data offered a silver lining for the global outlook and improved modestly – though the trajectory for the export-oriented economy remains fragile ahead of the planned consumption tax hike later this year.

MAIN SCENARIO
SUSTAINED GLOBAL EXPANSION

PROBABILITY 60%

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 as the consumer remains a pivotal source of strength, though growth moderates to a still above-trend pace due to limited spare capacity in these later stages of the cycle. Meanwhile, healthy demand stateside and receding North American (USMCA) trade tensions 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 dissipate and both the European and Japanese economies recalibrate somewhat, 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. Notably, central bankers assume an increased tolerance for an overshoot on their inflation targets and a willingness to let the economy run hot (emphasis on "symmetry"), 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 30%

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, trade tribulations between the world's two largest economies have intensified with higher tariffs for both the US and China, while pressure between these two countries likely to prevail over the near-term as negotiations linger-on unresolved with no concrete deal and 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, a period of heightened uncertainty has recommenced in the UK as newly-elected Prime Minister Boris Johnson takes a hardline approach, increasing 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	JULY 31, 2019	SUSTAINED GLOBAL EXPANSION	POLITICAL INSTABILITY	STAGFLATION
PROBABILITY		60%	30%	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.	2.30%	2.75%	1.00%	2.75%
INFLATION (HEADLINE Y/Y)				
Canada	2.00%	2.00%	1.50%	3.00%
U.S.	1.60%	2.00%	2.00%	3.00%
SHORT-TERM RATES				
Bank of Canada	1.75%	1.75%	1.25%	2.00%
Federal Reserve	2.25%	2.25%	2.00%	2.75%
10-YEAR RATES				
Canada Government	1.48%	2.25%	1.40%	3.00%
US Government	2.01%	2.75%	2.25%	4.00%
PROFIT GROWTH (12 MONTHS FORWARD)				
Canada	5.3%	4.4%	-12.6%	6.8%
U.S.	7.3%	3.9%	-8.4%	-2.3%
EAFE	9.0%	2.3%	-5.6%	-5.6%
EM	12.9%	14.1%	-12.7%	3.4%
P/E (FORWARD 12 MONTHS)				
Canada	15.1X	16.5X	14.0X	13.0X
U.S.	17.0X	19.0X	15.0X	16.0X
EAFE	13.7X	15.5X	12.0X	13.5X
EM	12.3X	15.0X	11.0X	11.5X
CURRENCIES				
CAD/USD	0.76	0.79	0.70	0.80
EUR/USD	1.11	1.16	1.10	1.10
USD/JPY	108.78	110.00	100.00	120.00
COMMODITIES				
Oil (WTI, USD/barrel)	58.58	70.00	40.00	80.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SUSTAINED GLOBAL EXPANSION	POLITICAL INSTABILITY	STAGFLATION
PROBABILITY	60%	30%	10%
Money Market	1.8%	1.5%	1.9%
Canadian Bonds	-1.6%	4.1%	-7.0%
Canadian Equity	8.1%	-23.2%	-12.8%
U.S. Equity	4.0%	-18.3%	-18.6%
International Equity	1.9%	-17.8%	-19.1%
Emerging Market Equity	18.0%	-25.3%	-19.1%
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%	Neutral	10.0%	0.0%
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	40.0%	+15.0%

[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%
July 12, 2019	-5.0%	-20.0%	+5.0%	0.0%	-5.0%	+10.0%	+15.0%

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

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