TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

SEPTEMBER 2019

FIERA CAPITAL

Sentiment remained fragile in August as investors grappled with a flurry of trade headlines, a fraught geopolitical backdrop, and yield curve inversion that stoked recession fears. The US-Sino trade debacle intensified and overshadowed a generally supportive message from global central banks. At the beginning of August, President Trump announced a 10% tariff on the final tranche of Chinese imports effective September 1st – though walked that back on August 13th and delayed the tariff on some of those goods until December. Then on August 23rd, China retaliated and raised tariffs on US imports effective in September and December, while Trump responded with a plan to ratchet up duties on all Chinese imports even further. In the end, the 15% tariff on $110 billion of Chinese goods went into effect on September 1st, as did China's retaliatory tariffs – with little clarity regarding the way forward for the US-China trade dilemma.

FINANCIAL MARKET DASHBOARD

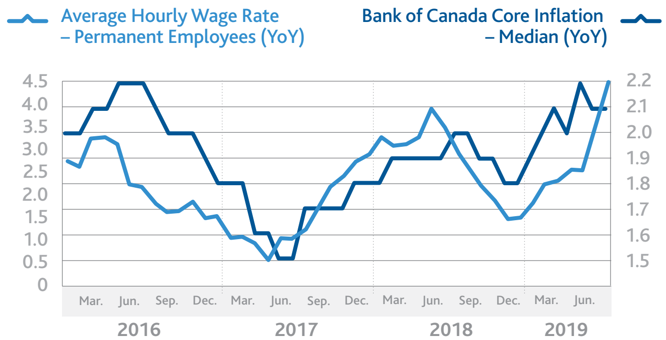
	AUGUST 30 2019	AUGUST	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2926	-1.81%	16.74%	0.86%
S&P/TSX	16442	0.22%	14.80%	1.10%
MSCI EAFE	1843	-2.87%	7.13%	-6.09%
MSCI EM	984	-5.08%	1.92%	-6.78%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	1.50	-51.8	-118.8	-136.4
US 2 Year Bond Yield	1.50	-36.8	-98.4	-112.3
US Corp BBB Spread	1.48	8.0	-38.0	-4.0
US Corp High Yield Spread	4.22	38.0	-105.0	81.0
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.75	-0.88%	2.47%	-2.01%
EUR/USD	1.10	-0.85%	-4.23%	-5.34%
USD/JPY	106.28	-2.30%	-3.11%	-4.28%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	55.10	-5.94%	21.34%	-21.06%
Copper (USD/pound)	2.53	-4.99%	-3.72%	-4.38%
Gold (USD/oz)	1523.00	6.79%	18.86%	26.75%

Global equity markets were on the defensive as ongoing trade deliberations between the world's two largest economies clouded the global backdrop and sapped risk appetite. The MSCI All Country World retreated 2.6% in August. Regionally speaking, the S&P 500 posted its first monthly decline since May (-1.8%), while weakness also spread to overseas markets, with both European and Japanese bourses joining the retreat. Not surprisingly, emerging market bourses took the brunt of the weakness and lost 5.1%, marking the worst August since 1997. In contrast, the S&P/TSX managed to buck the downward trend and posted a modest gain, thanks to soaring gold prices that bolstered the materials sector.

Bond yields were pummelled across the globe as unrelenting demand for the safety of bonds lingered-on. The US treasury market posted its biggest rally since the depths of the global financial crisis. The 30 year treasury yield fell to an all-time low and ended the month at 1.96% (56 basis points lower), while the 10-year treasury yield ended the month at 1.50% (down 52 basis points). Meanwhile, the spread between the 10- and 2-year treasury turned negative (the yield curve inverted), which fueled fears of recession. Interestingly, this profound plunge in bond yields was somewhat self-fulfilling in that nervous investors moved even more aggressively into bonds in response and accentuated the downward move.

The US dollar extended its advance in August, underscoring weakness elsewhere across the globe. The euro collapsed to a two-year low amid worrisome political developments in Italy, while deteriorating Eurozone economic results bolstered bets for increased stimulus from the ECB. The pound slipped as the likelihood of a "hard" Brexit rose following PM Johnson's announcement that he's suspending Parliament this fall (reducing the time for opponents to halt a no-deal Brexit). In contrast, the Japanese yen was the sole winner and thrived as investors flocked to the safe-haven currency in what was a tumultuous month.

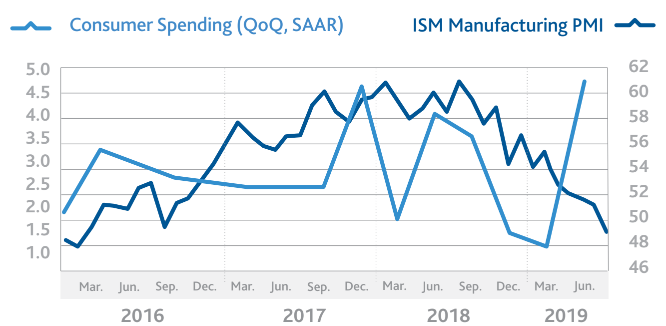
Gold rallied for a fourth month as trade uncertainties and negative real rates drove bullion prices to a six-year high, while copper skidded lower as investors faced fresh evidence that the trade war is taking its toll on the global economy. Finally, oil collapsed amid concerns that US-China trade relations are weighing on the demand outlook, which completely overshadowed signs that OPEC's supply cuts are proving successful in trimming stockpiles.



The Canadian economy grew at a faster than expected 3.7% annualized pace during the second quarter - far-exceeding the Bank of Canada's 2.3% forecast. Meanwhile, the preferred core inflation gauge has been running in-line with the 2% target since April, while wages grew at the fastest pace since 2009 - tempering the case for immediate rate cuts from the Bank of Canada.

CANADA

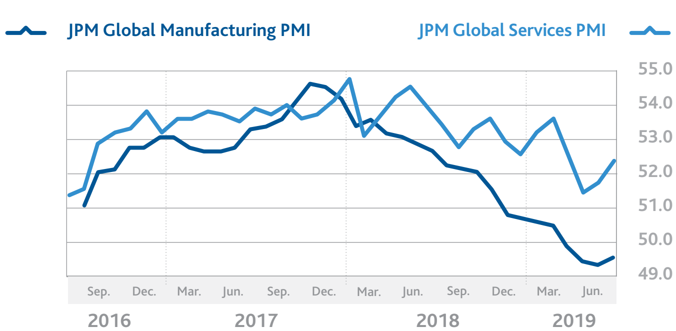
After a difficult start to the year, the Canadian economy recovered meaningfully in the second quarter of 2019. The stronger-than-expected 3.7% (annualized) acceleration in output was primarily a result of a 13.4% surge in exports, which marked the fastest increase in exports since 2014. However, household consumption growth and business investment were broadly weaker and resulted in a decline in domestic demand overall. Encouragingly, inflation results surprised to the upside in July, with the average of the Bank of Canada's three measures of underlying "core" inflation unexpectedly ticking up and is now sitting right at the central bank's target – providing the scope for the Bank of Canada to remain sidelined for now even as other major central banks embark on easier monetary policies.



The US factory sector unexpectedly slipped into contraction terrain in August for the first time since 2016 in response to an intensifying trade backdrop, though regional surveys suggest that factory sentiment may be stabilizing. Meanwhile, household fundamentals remain robust amid tight labour market conditions and should allow the consumer (2/3 of the economy) to remain insulated from factory woes.

USA

The US consumer continues to be fairly immune to trade-related woes, which should prevent weakness in manufacturing from dragging the US into a recession anytime soon. Consumer spending grew at the fastest rate since 2014 during the second quarter, while stronger than expected retail sales and personal spending data for July suggest that the consumer remained a pivotal source of strength early-on in the third quarter. As widely expected, the Federal Reserve followed through with an "insurance" rate cut at the July gathering in response to a number of global "crosscurrents" at hand (notably trade tensions that have clouded the global growth backdrop), which when combined with subdued inflationary pressures has provided the flexibility and optionality to provide further stimulus if warranted.



While deepening woes from the US-China trade debacle have plagued the global factory space, it isn't yet evident that the manufacturing slump will spillover to the services sector. The global services PMI remains firmly in expansion territory (at 52.5), while the global manufacturing PMI ticked higher in August (to 49.5).

INTERNATIONAL

While the global manufacturing sector remains firmly in contraction terrain, the consumer-oriented services sector continues to defy weakness in the factory space and has remained the driving force of global growth. Notably, trade-induced uncertainty in the factory sector has been contained thus far and has yet to spillover to the larger, more prominent services-side of the global economy. Indeed, the consumer has maintained its resilience given solid employment trends that have bolstered confidence and spending and ultimately sheltered the global economy from the storm. Moreover, the good news is that the global manufacturing PMI ticked higher in August, marking the first increase in 16 months – though deteriorating forward-looking sub-indices (new orders/exports) suggest that businesses remain in defensive-mode as the trade war lingers-on unresolved.

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	AUGUST 30, 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	1.50%	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.	1.80%	2.00%	2.00%	3.00%
SHORT-TERM RATES				
Bank of Canada	1.75%	1.75%	1.25%	2.00%
Federal Reserve	2.25%	2.00%	2.00%	2.75%
10-YEAR RATES				
Canada Government	1.16%	1.90%	1.40%	3.00%
US Government	1.50%	2.50%	2.25%	4.00%
PROFIT GROWTH (12 MONTHS FORWARD)				
Canada	4.8%	3.5%	-13.3%	5.9%
U.S.	7.8%	4.1%	-8.1%	-2.0%
EAFE	9.3%	4.7%	-3.3%	-3.3%
EM	7.7%	14.9%	-12.2%	4.1%
P/E (FORWARD 12 MONTHS)				
Canada	15.1X	16.5X	14.0X	13.0X
U.S.	16.6X	19.0X	15.0X	16.0X
EAFE	13.6X	15.5X	12.0X	13.5X
EM	12.3X	15.0X	11.0X	11.5X
CURRENCIES				
CAD/USD	0.75	0.80	0.70	0.80
EUR/USD	1.10	1.16	1.10	1.10
USD/JPY	106.28	105.00	100.00	120.00
COMMODITIES				
Oil (WTI, USD/barrel)	55.10	70.00	40.00	80.00

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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%	2.3%	-8.8%
Canadian Equity	7.9%	-23.4%	-13.0%
U.S. Equity	3.7%	-17.5%	-17.8%
International Equity	2.7%	-16.1%	-17.4%
Emerging Market Equity	21.6%	-22.0%	-15.5%
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.

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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