# TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

OCTOBER 2019

FIERA CAPITAL

Central banks and trade deliberations dominated the headlines in September, with investors thriving on the accommodative message from central banks and some conciliatory undertones from US and Chinese authorities ahead of high-level trade talks in October. The Federal Reserve took out some additional "insurance" and cut rates for a second time this year, while the European Central Bank lowered rates further into negative terrain and restarted asset purchases. And while policy was left unchanged in Canada and Japan, policymakers left the door open to further stimulus if warranted. However, in a stark reminder of the vulnerability of the macro backdrop, political drama resurfaced at month-end on the heels of impeachment inquiries in Washington, while reports that the Trump administration is considering curbing US investment in China also weighed late in the month.

## FINANCIAL MARKET DASHBOARD

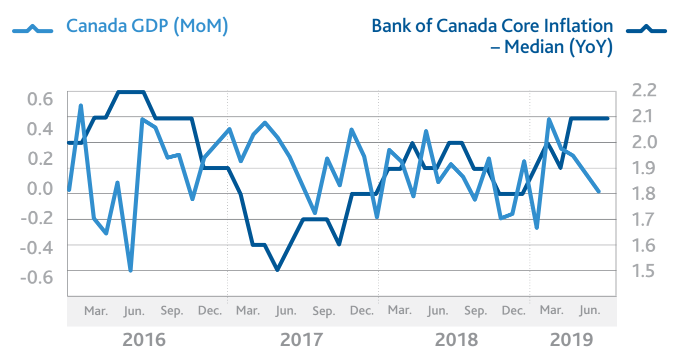
| | SEPTEMBER 30, 2019 | SEPTEMBER | YTD | 1 YEAR |
|---|---|---|---|---|
| EQUITY MARKETS | | % PRICE CHANGE (LC) | | |
| S&P 500 | 2977 | 1.72% | 18.74% | 2.15% |
| S&P/TSX | 16659 | 1.32% | 16.31% | 3.64% |
| MSCI EAFE | 1889 | 2.54% | 9.85% | -4.27% |
| MSCI EM | 1001 | 1.69% | 3.65% | -4.48% |
| FIXED INCOME (%) | | BASIS POINT CHANGE | | |
| US 10 Year Bond Yield | 1.66 | 16.9 | -102.0 | -139.7 |
| US 2 Year Bond Yield | 1.62 | 11.8 | -86.6 | -119.7 |
| US Corp BBB Spread | 1.47 | -1.0 | -39.0 | 0.0 |
| US Corp High Yield Spread | 3.97 | -25.0 | -130.0 | 79.0 |
| CURRENCIES | | % PRICE CHANGE | | |
| CAD/USD | 0.76 | 0.53% | 3.01% | -2.49% |
| EUR/USD | 1.09 | -0.76% | -4.95% | -6.08% |
| USD/JPY | 108.08 | 1.69% | -1.47% | -4.94% |
| COMMODITIES | | % PRICE CHANGE | | |
| WTI Oil (USD/bbl) | 54.07 | -1.87% | 19.07% | -26.18% |
| Copper (USD/pound) | 2.58 | 1.80% | -2.00% | -8.07% |
| Gold (USD/oz) | 1465.70 | -3.76% | 14.39% | 23.01% |

Global equity markets regained some momentum in September. The US equity market managed to retrace almost all of its losses from August and came within striking distance of record levels reached earlier this summer. Meanwhile, the Canadian equity market breached a new all-time high in September amid a revival in the (previously lagging) energy and financials space, which together accounts for close to half of the TSX. Looking abroad, international bourses welcomed the supportive message from central banks, with European stocks closing-in on a one-year high, while Japanese bourses also posted some impressive results during the month. Even emerging market stocks joined the monthly upswing, with the MSCI gauge tracking gains across the rest of the globe.

In contrast, fixed income markets posted negative results in September. Bond yields reverted higher after spending most of the third quarter in a downward spiral in a month that was fueled by stronger than expected economic data in both the US and Canada. Meanwhile, sentiment improved somewhat last month, which saw investors rotate out of the overcrowded bond market and towards riskier assets in the equity space.

The US dollar maintained its positive momentum through September even after the Federal Reserve cut rates for a second time this year. In contrast, the euro slumped to its weakest level since 2017 as economic data in the Eurozone continued to deteriorate at the same time that US economic results surprised to the upside. The yen dropped after the Bank of Japan reduced purchases of bonds in the 3-5 year maturity zone in a bid to steepen the yield curve, while dovish undertones from Governor Kuroda also weighed. Finally, the loonie remained resilient in the wake of dollar strength and declining crude prices. Instead, the Bank of Canada's sidelined approach saw the US-Canada rate differential narrow and lent support to the Canadian dollar.

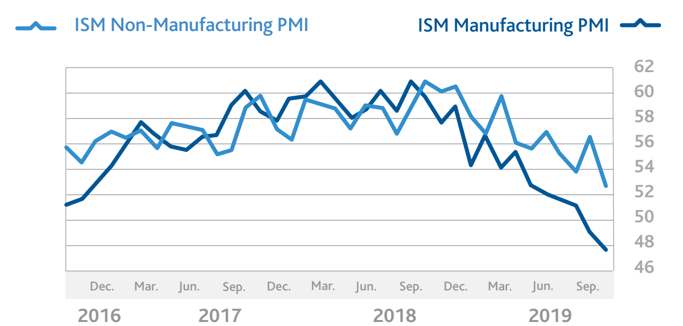
In commodity markets, gold pulled back below its 50-day moving average for the first time in four months amid relentless dollar strength. Finally, after the attack on Saudi Arabia removed 5% of global supply and sent crude prices soaring, oil reversed course as production was restored at a faster than expected pace, while a glimpse of easing tensions between Saudi Arabia and Iran also added to the downward move.




The headline Canadian GDP results were somewhat disappointing in July, though the underlying details revealed that the economy remains in healthy shape. Economic output was virtually unchanged. While goods-producing industries led the decline (-0.7% m/m) on the heels of a sharp (and temporary) pullback in oil and gas activity, the services sector remained reasonably bright and advanced 0.3% m/m during the month.

## CANADA

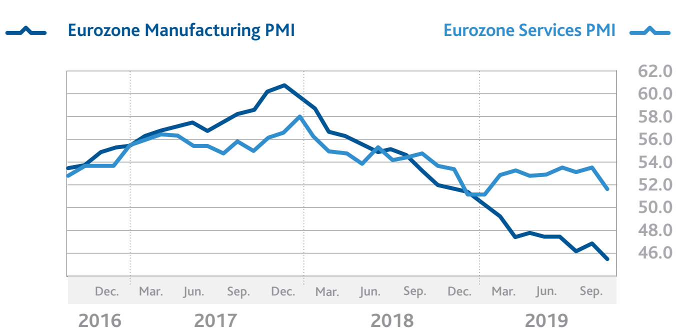
After staging an impressive recovery in the second quarter, the Canadian economy took a breather and reverted back towards a more sustainable pace in July. Industry level GDP was unchanged during the month, with weakness in the goods-producing sector completely offset by strength in the services space. The Bank of Canada is likely to greet this report with a sigh of relief, particularly as the stagnation in July was largely attributable to a temporary maintenance shutdown in Atlantic Canada's offshore oil production facilities. Furthermore, the central bank's preferred gauge of underlying inflation has held firmly in-line with the 2% target for the last several months, providing the Bank of Canada the leeway to remain sidelined for now.




In the US, trade-induced anxieties sent the factory sector tumbling further into contraction terrain in September, with the ISM Manufacturing index falling from 49.1 to 47.8. Meanwhile, the services side of the economy also took a step back, though did remain firmly in expansion territory last month. The ISM Non-Manufacturing Index fell from 56.4 to 52.6 in September and is now sitting just above the cycle low hit in 2016.

## USA

Economic data in the US has largely been surprising to the upside over the last few months, defying market expectations for a pronounced slowdown in the world's largest economy. The Citigroup Economic Surprise Index has bounced profoundly higher, owing to a string of consensus-beating results that include the Philadelphia Fed manufacturing index, retail sales, jobless claims data, existing home sales, and industrial production results. However, the US factory sector has not been immune to trade-induced uncertainty that's inundated global manufacturers' over the last several months. Instead, it would appear that the trade spat may now be spilling over to the US business community, with the closely-watched ISM Manufacturing Index stumbling further into contraction territory in September.




The latest survey data in Europe adds to the narrative of an economy that's being plagued by ongoing trade tensions, slowing foreign growth, and Brexit-related angst. The economy stagnated at the end of the third quarter, with the slump broadly reflected in the factory sector. However, the measure of services has also deteriorated in a troublesome sign that weakness is spreading more broadly across the economy.

## INTERNATIONAL

The export-oriented economy in Europe continues to be one of the main casualties of the US-China trade war. The composite PMI slid to 50.1 in September, marking the weakest pace of expansion in 75 months. Services sector growth moderated from 53.5 to 51.6, while the factory sector deteriorated further, falling from 47.0 to 45.7 (the steepest deterioration in factory conditions since October 2012). The move lower was predominately a result of lower survey data in Germany, with the manufacturing PMI tumbling to a decade low of 41.4 (from 43.5). With early indicators suggesting that the German locomotive is moving decisively towards technical recession, the silver lining is that fiscal stimulus is almost surely to follow.

## 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.

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FORECASTS FOR THE NEXT 12 MONTHS

| SCENARIOS | SEPTEMBER 30, 2019 | SUSTAINED GLOBAL EXPANSION | POLITICAL INSTABILITY | STAGFLATION |
|---|---|---|---|---|
| PROBABILITY | | 60% | 30% | 10% |
| GDP GROWTH (Y/Y) | | | | |
| Global | 3.20% | 3.25% | 2.00% | 2.75% |
| Canada | 1.30% | 2.00% | 0.50% | 2.75% |
| U.S. | 2.30% | 2.25% | 1.00% | 2.75% |
| INFLATION (HEADLINE Y/Y) | | | | |
| Canada | 1.90% | 2.00% | 1.50% | 3.00% |
| U.S. | 1.70% | 2.00% | 2.00% | 3.00% |
| SHORT-TERM RATES | | | | |
| Bank of Canada | 1.75% | 1.75% | 1.25% | 2.25% |
| Federal Reserve | 2.00% | 1.75% | 1.50% | 2.75% |
| 10-YEAR RATES | | | | |
| Canada Government | 1.36% | 1.90% | 1.40% | 3.00% |
| US Government | 1.66% | 2.50% | 2.25% | 4.00% |
| PROFIT GROWTH (12 MONTHS FORWARD) | | | | |
| Canada | 11.9% | 3.7% | -13.1% | 6.2% |
| U.S. | 8.4% | 7.2% | -8.1% | -2.0% |
| EAFE | 9.3% | 4.6% | -3.4% | -3.4% |
| EM | 10.1% | 13.8% | -13.0% | 3.1% |
| P/E (FORWARD 12 MONTHS) | | | | |
| Canada | 14.4X | 17.0X | 14.0X | 13.0X |
| U.S. | 16.8X | 19.0X | 15.0X | 16.0X |
| EAFE | 13.9X | 15.5X | 12.0X | 13.5X |
| EM | 12.2X | 14.0X | 11.0X | 11.5X |
| CURRENCIES | | | | |
| CAD/USD | 0.76 | 0.80 | 0.70 | 0.80 |
| EUR/USD | 1.09 | 1.16 | 1.10 | 1.10 |
| USD/JPY | 108.08 | 105.00 | 100.00 | 120.00 |
| COMMODITIES | | | | |
| Oil (WTI, USD/barrel) | 54.07 | 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% | 2.0% |
| Canadian Bonds | -0.5% | 3.4% | -7.7% |
| Canadian Equity | 9.7% | -24.4% | -14.2% |
| U.S. Equity | 5.5% | -18.4% | -18.8% |
| International Equity | 0.7% | -17.8% | -19.0% |
| Emerging Market Equity | 12.2% | -22.9% | -16.5% |
| 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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