Q2 2024

Investment Outlook & Portfolio Strategy

FIERA CAPITAL

Macroeconomic Landscape

Global

The global economy is running at a healthy and above-trend pace, which has kept inflation stubbornly elevated and prompted central banks to reconsider the timing and magnitude of monetary policy easing in 2024.

Canada

The Canadian economy is running at an anemic pace as the impact of cumulative rate hikes weighs on heavily indebted households that are more sensitive to higher borrowing costs. While the Bank of Canada has managed to steer the economy towards a better balance between supply and demand ("modest excess supply") which should exert disinflationary pressure and allow for rate cuts, still-strong wage gains, firm services prices, and the reality that the central bank's core inflation gauges are holding above 3% underscores the need to proceed with caution.

United States

The US economy continues to defy expectations for a more meaningful slowdown. Indeed, the Atlanta Fed GDPNow forecast is sitting well above 2% for the first quarter of 2024. Excess demand conditions have stymied the disinflationary impulse from last year, with several key inflation metrics surprising to the upside in early 2024. Consequently, a chorus of Federal Reserve officials have pushed back on expectations for early and aggressive rate cuts, with their patient approach validated by recent data showing a resilient economy that is keeping inflation entrenched.

International

The Eurozone economy narrowly skirted a recession last year, though the German locomotive was the exception and contracted in the final two quarters of 2023. While Germany's important manufacturing sector has been its biggest weak spot given soft global demand that has dampened activity, slowing inflation and rising household incomes have raised hopes that consumers will drive a recovery during the rest of the year. Meanwhile, the European Central Bank is expected to ease the burden on companies and consumers by lowering borrowing costs as early as June.

Emerging Markets

The Chinese economy continues to grapple with several headwinds, including a lingering property crisis, deteriorating private sector sentiment, and stubborn deflation. While policymakers ramped up both monetary and fiscal stimulus efforts to juice the ailing economy, depressed consumer and business sentiment has dampened their impact and has failed to boost activity in a meaningful way across the broader economy. Uninspiring activity across the world's second largest economy adds to the urgency for more forceful policy support.

Economic Outlook

Upside Surprises: Growth & Inflation

Investors spent much of the first quarter recalibrating their expectations for interest rates as a resilient economy and sticky inflation brought into question wagers for early and aggressive monetary policy easing. As the summary of Key Policy Variables illustrates, economic data has been surprising to the upside. The economy is running well above its trend level, with excess demand conditions keeping inflation uncomfortably elevated. Meanwhile, the labour market continues to fire on all cylinders. Nonfarm payrolls averaged over 200k in the last three months, while job openings remain well above their historic norms. Tight labour market conditions are keeping wages elevated and above levels consistent with 2% inflation.

Somewhat worrisome is that the disinflationary impulse stalled out at the beginning of 2024. The Federal Reserve's preferred gauge of underlying inflation, the core personal consumption expenditures (PCE) price index, came in hot for a second straight month in February. Is this a sustained inflationary trend? Ultimately, the burden of proof will be on the data. Should inflation fail to make material progress in the next few months, that would tip the scales to a more hawkish policy outlook and risk a further delay on the timing of interest rate cuts.

Key Policy Variables: United States	2024 Federal Reserve Target	Current	Soft Landing	Inflation Revival
Potential (Trend) Gross Domestic Product Growth (%)	2.3%	2.8%		**
Gross Domestic Product Growth (Q/Q, Annualized)	1.6%	2.8%		**
Unemployment Rate (%)	4.1%	3.8%		**
Nonfarm Payrolls (3 Month Average)	200k	275k		**
Average Hourly Earnings (Y/Y)	3.0%	4.1%		**
Atlanta Fed Wage Tracker (Y/Y)	3.0%	4.7%		**
Employment Cost Index (Y/Y)	3.0%	4.2%		**
Job Openings To Unemployed Ratio	1.20	1.36		**
Core Personal Consumption Expenditures Price Index (Y/Y)	2.3%	2.8%		**
Long-Term Inflation Expectations (%)	2.5%	2.8%	**	
FEDERAL RESERVE POLICY RATE		**5.50%**	**LOWER**	**STABLE**

Scenario Overview & Investment Strategy

The balance of risks warrants a neutral stance on equities from a risk-reward perspective over our cyclical 12-18 month time horizon.

- **Soft Landing (50%):** Our high probability scenario assumes that the disinflationary trend reasserts itself in the coming months with little in the way of damage to the economy. This would allow for monetary policy easing to commence this summer, which would ultimately revitalize both growth and earnings. This is the only scenario that bodes favourably for stock markets.
- **Inflation Revival (30%):** Should an economy that remains "too hot" prompt policymakers to reconsider their easing plans and refrain from pursuing the magnitude of rate cuts discounted in the market, investors would need to recalibrate their expectations for interest rates higher. This would act as a powerful headwind for both stock and bond markets.
- **Shallow Recession (20%):** An outright recession stemming from cumulative tightening to date cannot be ruled out. While rates would undoubtedly be aggressively slashed, a recessionary environment and the implications for corporate earnings would outweigh the stimulative impacts from rate cuts and sap both risk appetite and equity markets alike.

Economic Scenarios

Main Scenario | Soft Landing — Probability **50%**

In this optimistic scenario, the world's major central banks prove successful in engineering a so-called soft economic landing, thanks to a persistent downtrend in inflation that comes with very limited deterioration in the economy. The disinflationary impulse prompts central bankers to transition from an on-hold monetary policy stance towards aggressive interest rate cuts in 2024 and inflation is contained without a recession or a significant cost to employment. Central banks achieve the soft landing by cutting rates at early signs of economic weakness, keeping the economy not-too-hot or not-too-cold, but just right. Consequently, the economy averts a hard landing and a new economic cycle begins.

Scenario 2 | Inflation Revival — Probability **30%**

In the "inflation revival" scenario, both growth and inflation surprise to the upside, which brings into question the ability of central banks to pivot towards easing monetary policy in 2024. Should persistent economic resilience, tighter than expected labour market conditions, and the recent easing of financial conditions spark a second wave of inflation, central banks would undoubtedly abandon their plans to cut interest rates and instead prioritize bringing inflation back to 2% by leaving interest rates at current elevated levels for an extended time. Indeed, cutting interest rates while the economy is operating above its potential and at a time when labour market conditions remain relatively tight risks slowing or even reversing the disinflation process. Amplifying the upside risks to inflation would be an unwelcome escalation in the geopolitical conflicts in Ukraine and/or the Middle East that would create an oil shock and add to the inflationary impulse. Taken together, unrelenting economic strength would pose an obstacle to imminent central bank rate cuts and would necessitate an extended period of restrictive monetary policy until inflation is firmly on the path to 2%.

Scenario 3 | Shallow Recession — Probability **20%**

In the "shallow recession" scenario, consumer-led tailwinds that acted as a buffer to the sharp increase in interest rates through 2023 morphs into headwinds that inevitably pushes the economy into a mild recession in 2024. Cumulative central bank tightening begins to weigh more meaningfully on both consumers and businesses given the long lags in the monetary transmission mechanism and weighs more prominently in the data. Specifically, household finances deteriorate under the weight of a cooling jobs market and dwindling excess savings that are set to be drawn down by mid-year. Meanwhile, tight monetary policy and credit conditions exerts more pain on businesses, manifesting itself into a surge in bankruptcies of vulnerable businesses. Inflation slows by much more than expected in response to the loss of economic momentum, with the disinflationary trend expedited by a potential de-escalation in geopolitical conflicts that pushes major commodity (food and energy) prices lower. Central banks begin cutting interest rates imminently and by more than previously thought, but not soon enough to avert a rise in unemployment and a mild recessionary outcome.

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Portfolio Strategy

Matrix of Expected Returns (CAD)

SCENARIOS	SOFT LANDING	INFLATION REVIVAL	SHALLOW RECESSION
PROBABILITY	**50%**	**30%**	**20%**
TRADITIONAL INCOME			
Money Market	4.3%	5.0%	3.8%
Canadian Bonds	-0.3%	-5.8%	3.5%
NON-TRADITIONAL INCOME			
Diversified Credit	7.0%	8.0%	7.0%
Diversified Real Estate	8.0%	9.0%	6.0%
Infrastructure	7.0%	8.0%	6.0%
Agriculture	7.0%	8.0%	6.0%
TRADITIONAL CAPITAL APPRECIATION			
Canadian Equity	11.9%	-5.6%	-17.9%
U.S. Equity	2.8%	-21.3%	-22.3%
International Equity	0.7%	-9.0%	-21.1%
Emerging Market Equity	13.1%	-11.4%	-20.9%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity	15.0%	12.0%	8.0%
Liquid Alternatives	7.5%	5.0%	2.5%
CAD/USD	0.80	0.75	0.70

Source: Fiera Capital, as of March 29, 2024.

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Portfolio Strategy

Current Strategy[1]

TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
Money Market	0%	5%	30%	10%	+5%
Canadian Bonds	5%	25%	45%	5%	-20%
Canadian Equity	10%	20%	40%	30%	+10%
U.S. Equity	0%	10%	20%	5%	-5%
International Equity	0%	10%	20%	0%	-10%
Emerging Market Equity	0%	5%	15%	10%	+5%
Non-Traditional Income	5%	25%	45%	40%	+15%

TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	**20%**	**40%**	**60%**	**40%**	**0%**
Money Market	0%	5%	30%	10%	+5%
Canadian Bonds	5%	35%	55%	30%	-5%
TRADITIONAL CAPITAL APPRECIATION	**40%**	**60%**	**80%**	**60%**	**0%**
Canadian Equity	5%	25%	50%	35%	+10%
U.S. Equity	0%	15%	30%	10%	-5%
International Equity	0%	15%	30%	5%	-10%
Emerging Market Equity	0%	5%	15%	10%	+5%

Evolution of Value-Added[1]

Source: Fiera Capital, as of March 29, 2024.

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. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

Fixed Income Outlook

Fixed Income Review

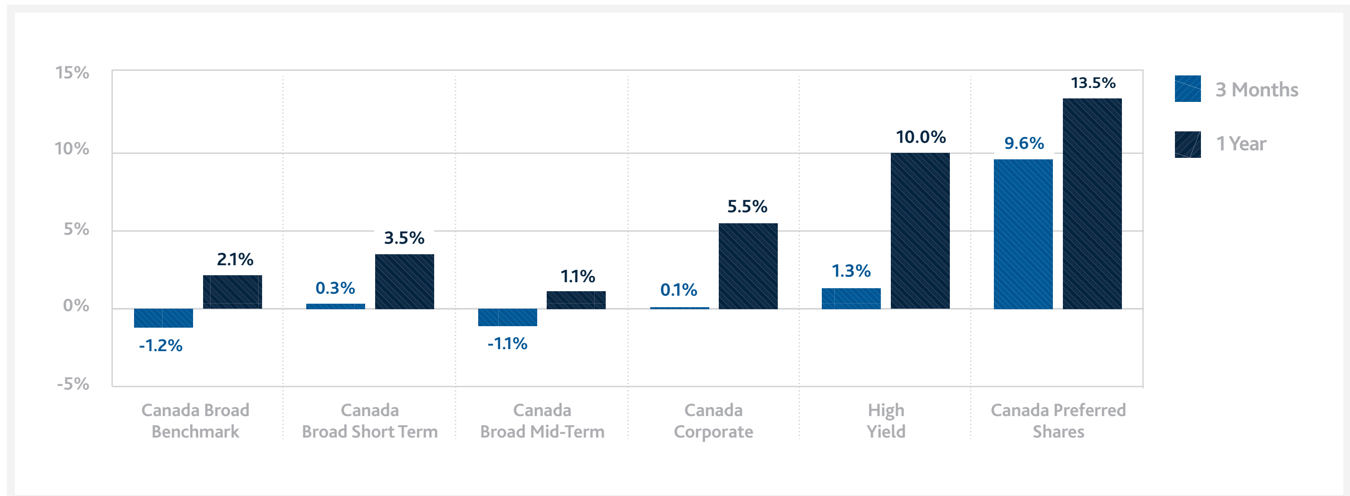
Fixed income markets came under pressure in the first quarter. Government bond yields reverted higher as investors recalibrated their expectations for monetary policy easing in response to resilient growth and sticky inflation. Investors unwound their bets for a flurry of rate cuts in response, dialing back earlier wagers for as much as six rate cuts this year to fewer than three. For the quarter, the FTSE Canada Bond Universe shed -1.2%.

While central banks acknowledged that interest rates have peaked and are setting the stage for monetary policy easing this year, both the timing and magnitude will ultimately hinge on the trajectory for inflation. The Federal Reserve left interest rates unchanged in March. However, the central bank upgraded both its growth and inflation forecasts for 2024 and 2025. Still, officials are forecasting three rate cuts this year – though the margin was slim with 9 out of 19 participants anticipating 50 basis points or less of rate cuts in 2024. Chair Powell acknowledged that the stronger-than-anticipated inflation readings for January and February constituted bumps in the path toward the 2% target and that policymakers need further evidence that inflation will "sustainably" return to the target before pivoting to rate cuts in order to avoid an unwelcome reacceleration in inflation.

The Bank of Canada is in a precarious position as it attempts to balance the environment of slowing growth with still-elevated inflation. Officials indicated they are waiting for enough data to convince them that inflation is on a sustained march to the 2% target before they begin cutting rates. Governor Macklem said that with inflation still close to 3% and inflationary pressures persisting, policymakers needed to "give higher rates more time to do their work" and that it is premature to consider lowering rates given that upside risks to inflation remain. Still, anticipated softness in growth and an economy that is operating "in modest excess supply" are expected to drive inflation lower and open the door to easing later this year.

Elsewhere, officials have softened their stance. European Central Bank President Lagarde gave the clearest signal that officials are converging around June as the most likely starting point for reductions in borrowing costs – while Bank of England Governor Bailey called the market's expectation for two to three rate cuts as "reasonable."

Canadian Fixed Income Market Returns



Source: Fiera Capital, as of March 29, 2024.

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Investment Strategy

Over the last quarter, bond markets have realigned themselves closer to central banks' forecasts, leaving little in the way for further downside in bond yields (and upside in prices). However, the looming risk of a second inflation wave suggests that the risk to bond yields is to the upside (and prices to the downside) – a "hawkish" surprise that would ultimately be negative for bonds. Given these unattractive risk-reward prospects, we maintain an underweight allocation to bonds.

Equity Outlook

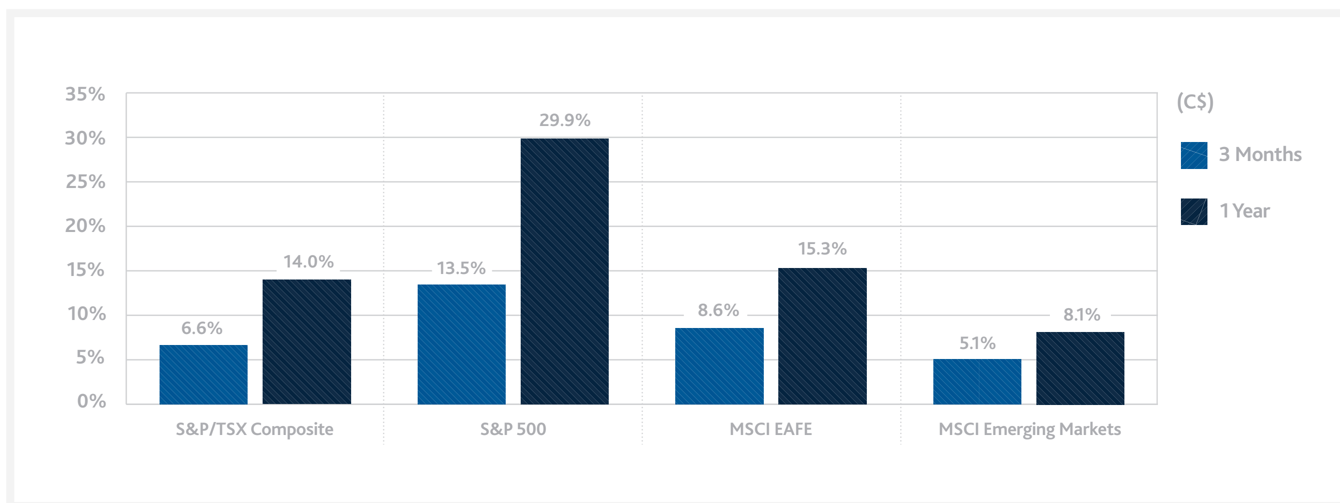
Equity Review

Equity markets had a spectacular start to the year and extended their winning streak to five straight months, with solid economic data, the prospect for rate relief, and rock-solid earnings results buttressing risk appetite. Hopes for a so-called "soft landing" catalyzed a market rally that sent many global indices to new record highs. In Canadian dollar terms, the MSCI All Country World rose 11% in the first quarter. The S&P 500 advanced 13.5%, while the S&P/TSX rose 6.6%. The MSCI EAFE gained 8.6%, while the MSCI gauge of emerging market stocks edged higher (5.1%), with negative performance in China driving underperformance at the beginning of the year.

The trajectory for stock markets ultimately hinges on the outlook for inflation, interest rates, and accordingly, the so-called "landing" for the economy. Our high probability scenario is calling for a goldilocks "soft landing" scenario where inflation decelerates towards the 2% target without a meaningful deterioration in economic activity. This allows central banks to cut interest rates at early signs of economic weakness, keeping the economy not-too-hot or not-too-cold, but just right. An environment of disinflationary growth is unambiguously positive for stocks. In our main scenario, global equities would require both earnings growth (the "E" in P/E) and central bank rate cuts (the "P" in P/E) to validate current valuations and the potential for further upside. We assign a 50% probability to this optimistic scenario.

That being said, there are some notable risks to the outlook and recent stock market gains would undoubtedly be vulnerable should investors move to price-in an alternative scenario that includes either a restrained liquidity backdrop ("Inflation Revival" = 30%) and/or a deteriorating growth and earnings backdrop ("Shallow Recession" = 20%). On the former, the risk of a second wave of inflation would prompt a "hawkish" policy response – namely the need for interest rates to remain higher for longer. In this scenario, upside surprises to both growth and inflation would prompt central banks to abandon plans to cut interest rates. Bond yields would revert higher in response and equity market valuations would contract. On the latter, economic growth deteriorates more meaningfully as the cumulative impact of past rate hikes begins to take its toll. While central banks would certainly step in and slash interest rates, it would not be soon enough to avert a mild recessionary outcome and a bear market in stocks.

Equity Market Returns



Source: Fiera Capital, as of March 29 2024.

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Investment Strategy

With 50% of our scenarios favouring risky assets and 50% advocating for a defensive positioning, we maintain our neutral stance on stocks over our tactical 12-18 month horizon.

Private Markets Outlook

Inflation, Interest Rates & The Case for Non-Traditional Income

Over the last year, inflation has made some remarkable progress in subsiding. While encouraging indeed, there are growing reasons to believe that we are embarking on a period of structurally higher inflation versus the post-2008 era. We expect inflation to settle between 2.5% and 3.0% over the next 5 years given secular forces including demographic trends (aging populations) and labour shortages, deglobalization (onshoring), rising debts/deficits, lingering geopolitical conflicts, and the imbalances associated with the green energy transition.

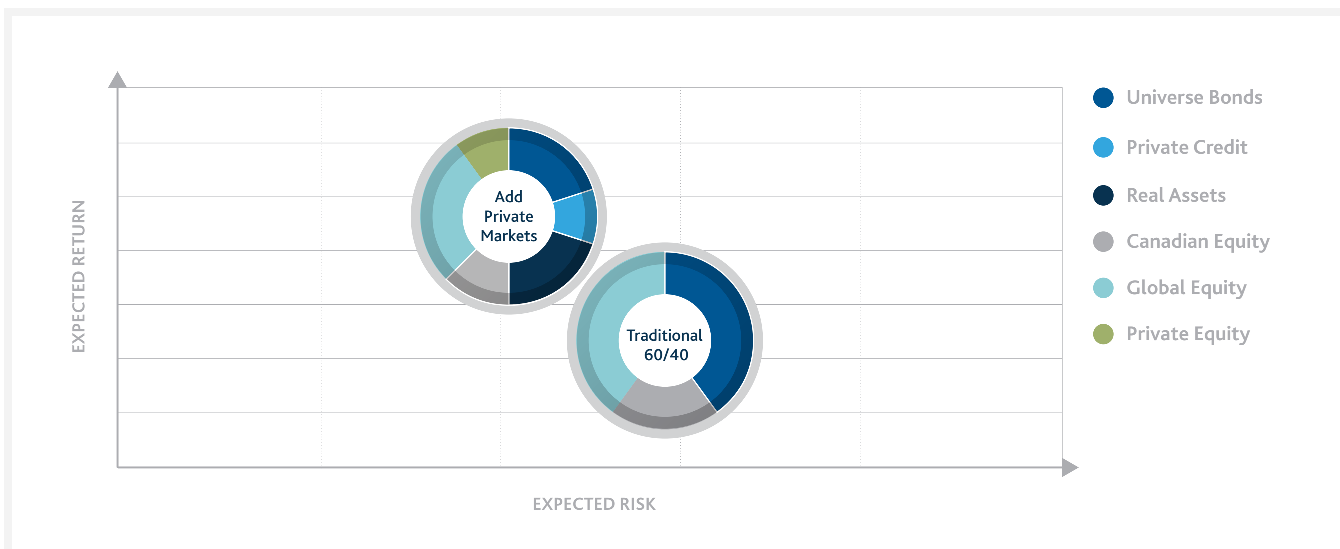
Structurally higher inflation (and accordingly, interest rates) suggests that long-term government bonds may fall short of what investors have grown accustomed to over the last several decades and reinforces the case for non-traditional sources of income to capitalize on these longer-term trends.

Private credit is a viable option for those looking for stability, downside protection, and predictable yield. The opportunity is particularly compelling given that banks are retrenching from lending activities at a time when interest rates are elevated, which has allowed private lenders to fill that financing gap left by traditional banks and originate loans at attractive risk-adjusted yields (enhanced yield with senior secured risk).

Meanwhile, in a world where inflation is higher than it has been for the past four decades and set to remain elevated, real assets should play a critical role in generating a stable income stream and protecting purchasing power in a higher inflation environment. Specifically, farmland and the underlying produced agricultural commodities tend to generate value in real terms as prices rise, while infrastructure has the potential to yield predictable cash flows that are uncorrelated to the economic cycle with contracts that frequently include built-in protections against inflation. Meanwhile, real estate is often considered a good inflation hedge because it is a tangible asset whose replacement costs rise with inflation, benefiting from the appreciation in value. Additionally, rents usually increase with inflation, ensuring a growing cash flow for property owners. From a valuation perspective, the opportunity is particularly compelling given that the monetary tightening cycle has reached a peak and interest rates are set to decline by mid-2024, setting the stage for a recovery in the coming year.

Taken together, the construction of a properly diversified portfolio should include an allocation to private credit and real assets as an alternative to traditional fixed income, which is especially critical given our long-term forecasts for above-average inflation and interest rates. In addition to the attractive investment attributes above, their low correlation to traditional asset classes and their differentiated sensitivities to inflation and the economic cycle provide diversification benefits and a reduction of overall portfolio risk, underscoring the merits of allocating to non-traditional income and enhancing the risk-reward proposition in the portfolio setting.

Portfolio Resiliency & Private Market Strategies



Private Market strategies continue to be instrumental in the construction of a resilient and well-diversified portfolio. Optimizing a portfolio to include private credit, real assets, and private equity may enhance both the performance and durability of a total portfolio, including maximizing the potential for an increase in its reward per unit of risk.

Source: Fiera Capital, for illustrative purposes only.

Commodities and Currencies

Currency Markets

The US dollar posted a healthy (3.1%) quarterly gain as investors dialed back their wagers for aggressive rate cuts in response to robust growth and persistent inflation. Hawkish remarks from Federal Reserve officials added to these wagers and prompted speculation the central bank may lag its peers when it finally comes to pivot. The greenback was higher versus its major trading partners, with the euro (-2.3%), pound (-0.8%), yen (-6.8%), and Canadian dollar (-2.2%) all retreating. The euro and the pound both weakened after the European Central Bank and Bank of England both softened their policy stance and set the stage for rate cuts as early as June. The yen failed to reverse its weakening trend even after the Bank of Japan raised interest rates for the first time since 2007. The Canadian dollar also edged lower, as relatively softer economic growth and recent progress on the inflation front saw traders brace for a more dovish Bank of Canada versus the Federal Reserve.

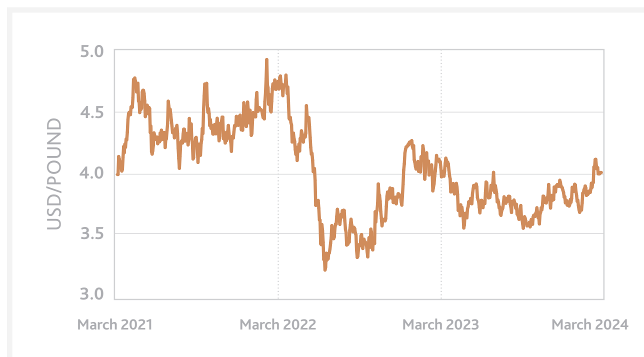
Oil

Crude oil posted a solid quarterly gain on the back of bullish tailwinds stemming from lower output from the Organization of Petroleum Exporting Countries and its allies (OPEC+). The output curbs of 2 million barrels per day have been extended to the end of June, underpinning expectations that global stockpiles will shrink and tighten market conditions. Crude's revival in the first quarter was also aided by escalating geopolitical tensions in the Middle East that have tightened physical market conditions. Meanwhile, inventories at Cushing are at the lowest seasonal level in two years – while consumption trends have held firm across the United States and China - adding to the imbalances between supply and demand in the market. We remain bullish on oil prices on the back of favourable supply-demand dynamics. Particularly on the supply-side, ongoing tensions in the Middle East risks prompting an oil shock, while continued production management by OPEC+ should place a floor under prices in the coming year.

Gold

Gold hit a fresh all-time high in the first quarter, fueled by bets for an eventual pivot to rate cuts in 2024 and amid deepening geopolitical tensions that have boosted demand for the safe haven metal. We expect gold to trade in a narrow range considering some conflicting forces at hand. While bullion's appeal as an inflation hedge and a safe haven given lingering geopolitical risks should underpin prices, the prospect for treasury yields (and the US dollar) to revert higher may limit any notable upside for the yellow metal.

Copper



Copper notched a quarterly gain, thanks to stimulative monetary and fiscal policy aimed at buttressing the Chinese economy – the top consumer of the red metal. Supply-side restraint added to tight market conditions and buttressed prices. Still, an underwhelming recovery and lingering woes in the property sector may weigh on demand, though authorities' efforts to spur infrastructure spending and provide aid to the property sector may counteract some of that weakness. Longer-term, copper stands to benefit in the global effort to scale up in green infrastructure spending and expanding the electric-generation grid.

Source: Bloomberg, as of March 29, 2024.

Forecasts for the Next 12-18 Months

SCENARIOS	MARCH 29, 2024	SOFT LANDING	INFLATION REVIVAL	SHALLOW RECESSION
PROBABILITY		50%	30%	20%
GDP GROWTH				
Global	3.00%	3.50%	4.00%	2.00%
Canada	1.25%	1.00%	2.00%	-1.00%
U.S.	1.75%	1.50%	2.50%	-0.50%
U.S. Output Gap	1.00%	0.50%	1.00%	-1.50%
INFLATION (HEADLINE Y/Y)				
Canada	2.80%	2.50%	3.25%	2.00%
U.S.	3.20%	2.50%	3.25%	2.00%
SHORT-TERM RATES				
Bank of Canada	5.00%	3.50%	5.00%	2.50%
Federal Reserve	5.50%	4.00%	5.50%	3.00%
10-YEAR RATES				
Canada Government	3.47%	3.75%	4.50%	3.00%
U.S. Government	4.20%	4.25%	5.00%	3.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
Canada	1458	1600	1550	1400
U.S.	250	260	240	215
EAFE	156	160	155	135
EM	83	85	72	65
P/E (12 MONTHS FORWARD)				
Canada	15.2X	15.5X	13.5X	13.0X
U.S.	21.0X	22.5X	17.5X	18.0X
EAFE	15.1X	16.0X	14.0X	13.0X
EM	12.5X	15.0X	13.0X	12.0X
CURRENCIES				
CAD/USD	0.74	0.80	0.75	0.70
EUR/USD	1.08	1.08	1.05	1.00
COMMODITIES				
Oil (WTI, USD/barrel)	83.17	85.00	95.00	70.00
Gold (USD/oz)	2217.40	2200.00	1900.00	2300.00

Source: Fiera Capital, as of March 29, 2024.

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