# Asset Allocation Strategy

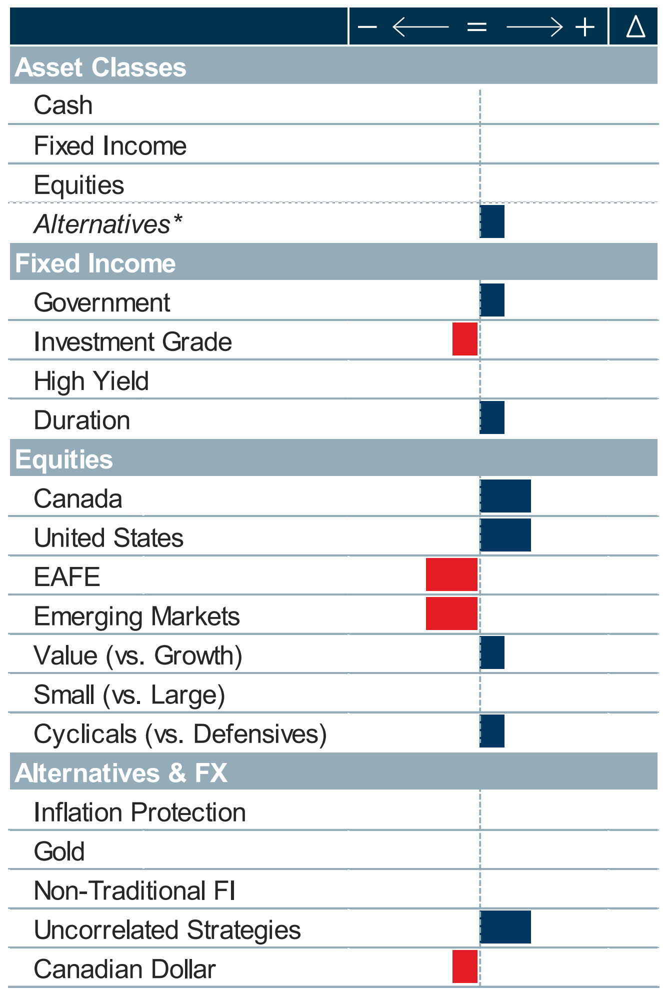
**CIO Office | April 2025**

## Second thoughts

### Highlights

- The record uncertainty into which the Trump administration has plunged the global economy has finally dragged the S&P 500 into correction territory in March. However, what happens next depends largely on the scale of the economic slowdown that is beginning to take shape.
- In this respect, consumer sentiment surveys do not lie: nascent optimism has turned into growing pessimism over the past three months. And while the overall economic data is not as bleak, the U.S. administration runs the risk of triggering a recessionary spiral if allowing this situation to last too long.
- Nonetheless, performances of the main asset classes in Q1-2025 were nothing exceptional, with global equities and bonds posting modest and similar returns, in line with our baseline scenario. What is surprising is the underperformance of the United States relative to the EAFE region over the period: the worst in 23 years.
- The risk of foreign stocks keeping pace with North America seems limited in the short term. However, a sustained downward trend in the US$ could ultimately justify a change in our geographical mix, which will probably have to wait until the tariff cloud clears a little.
- In sum, the economy is going through a rough patch and, although our baseline scenario still foresees slight economic growth, the likelihood of a recession has increased.
- Against this backdrop, we are maintaining a balanced allocation between equities and bonds. However, in the event of an overreaction to the decline in the stock markets, an opportunity to go against the tide could arise. However, the asymmetry of the scenarios is not yet sufficiently bullish for such a stance.

**Table 1 Global Asset Allocation Views**




This table is for illustration purposes only. Bars represent the degree of preference of an asset relative to the maximum deviation allowed from a reference index. The further to the right (left) they are, the more bullish (bearish) our outlook for the asset is. No bars indicate a neutral view. The column under the delta sign (**Δ**) displays when our outlook has improved (↑) or worsened (↓) from the previous month. Consult **Table 3** to see how they translate into a model balanced portfolio. *For tactical portfolios featuring alternative assets, the position is financed by bonds.

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## Market Review

### Fixed Income

- The Canadian fixed-income universe ended the month of March with slight losses, as bond yields were held back by higher-than-expected inflation data. Moreover, despite having cut its policy rate by 25bps at its latest meeting, the Bank of Canada seemed somewhat reluctant to further continue its easing cycle, at least in the short term.
- In the United States, the deterioration in investor sentiment led riskier fixed-income securities (Corporates and High Yield) to underperform Treasuries.

### Equities

- The sharp rotation toward overseas equities continued unabated in March, with the EAFE region and Emerging Markets remaining flat, while the S&P/TSX and the S&P 500 registered losses instead. The U.S. underperformed significantly, ending the first quarter of the year in negative territory, unlike the three other equity regions.
- Within the S&P 500, it was once again the sectors associated with the technology giants (Consumer Disc., Communication Services, Information Technology) that dragged the Index down. In fact, excluding these three sectors, the U.S. stock market is actually slightly positive on a year-to-date basis.

### FX & Commodities

- Gold continued to benefit from the elevated uncertainty with monthly gains of nearly 10%, while oil prices increased somewhat.
- The U.S. dollar depreciated sharply over the month, particularly against the euro, as the economic outlook in the United States darkened, while European economic data surprised to the upside.

Table 2 **Market Total Returns**

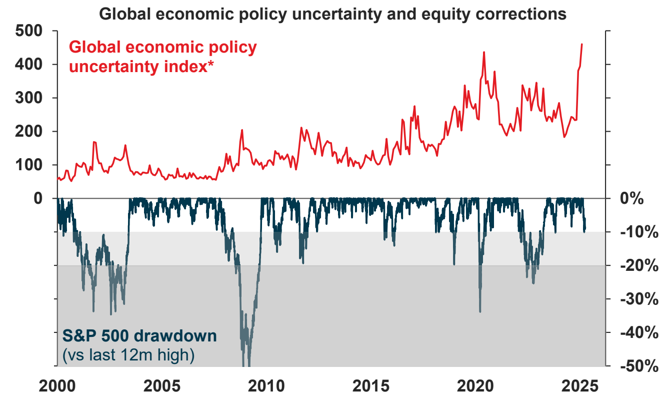
| Asset Classes | March | Q1 | 12M |
|---|---|---|---|
| **Cash (S&P Canada T-bill)** | **0.3%** | **0.9%** | **4.6%** |
| **Bonds (ICE BofA Canada Universe)** | **-0.3%** | **2.0%** | **7.6%** |
| Short Term | 0.3% | 1.7% | 7.0% |
| Mid Term | 0.0% | 2.6% | 8.5% |
| Long Term | -1.3% | 1.8% | 7.2% |
| Federal Government | -0.1% | 2.2% | 6.9% |
| Corporate | -0.1% | 1.8% | 8.9% |
| U.S. Treasuries (US$) | 0.2% | 3.0% | 4.5% |
| U.S. Corporate (US$) | -0.3% | 2.4% | 5.3% |
| U.S. High Yield (US$) | -1.1% | 0.9% | 7.6% |
| **Canadian Equities (S&P/TSX)** | **-1.5%** | **1.5%** | **15.8%** |
| Communication Services | -1.5% | 2.2% | -11.9% |
| Consumer Discretionary | -2.4% | -0.2% | 6.9% |
| Consumer Staples | 2.6% | -0.5% | 13.8% |
| Energy | 4.2% | 2.7% | 12.6% |
| Financials | -3.6% | -1.2% | 21.7% |
| Health Care | -4.4% | -9.0% | -16.8% |
| Industrials | -4.6% | -2.0% | -3.2% |
| Information Technology | -12.7% | -7.5% | 21.8% |
| Materials | 7.2% | 20.3% | 38.1% |
| Real Estate | -1.4% | -1.6% | 2.1% |
| Utilities | 1.8% | 4.9% | 20.6% |
| S&P/TSX Small Caps | 2.6% | 0.9% | 11.1% |
| **U.S. Equities (S&P 500 US$)** | **-5.6%** | **-4.3%** | **8.3%** |
| Communication Services | -8.3% | -6.2% | 13.6% |
| Consumer Discretionary | -8.9% | -13.8% | 6.9% |
| Consumer Staples | -2.4% | 5.2% | 12.4% |
| Energy | 3.9% | 10.2% | 2.5% |
| Financials | -4.2% | 3.5% | 20.2% |
| Health Care | -1.7% | 6.5% | 0.4% |
| Industrials | -3.6% | -0.2% | 5.6% |
| Information Technology | -8.8% | -12.7% | 5.9% |
| Materials | -2.6% | 2.8% | -5.7% |
| Real Estate | -2.4% | 3.6% | 9.6% |
| Utilities | 0.3% | 4.9% | 23.9% |
| Russell 2000 (US$) | -6.8% | -9.5% | -4.0% |
| **World Equities (MSCI ACWI US$)** | **-3.9%** | **-1.2%** | **7.6%** |
| MSCI EAFE (US$) | -0.3% | 7.0% | 5.4% |
| MSCI Emerging Markets (US$) | 0.7% | 3.0% | 8.6% |
| **Commodities (GSCI US$)** | **2.9%** | **4.9%** | **3.8%** |
| WTI Oil (US$/barrel) | 2.7% | -0.8% | -14.4% |
| Gold (US$/oz) | 9.6% | 19.0% | 41.1% |
| Copper (US$/tonne) | 3.4% | 11.6% | 10.2% |
| **Forex (US$ Index DXY)** | **-3.2%** | **-3.9%** | **-0.3%** |
| USD per EUR | 3.9% | 4.3% | 0.0% |
| CAD per USD | -0.5% | 0.0% | 6.3% |

CIO Office (data via Refinitiv, as of 2025-03-31)

## Second thoughts

The record uncertainty into which the Trump administration has plunged the global economy has finally dragged the S&P 500 into correction territory – defined as a decline of at least 10% from a recent peak – in March (**Chart 1**).

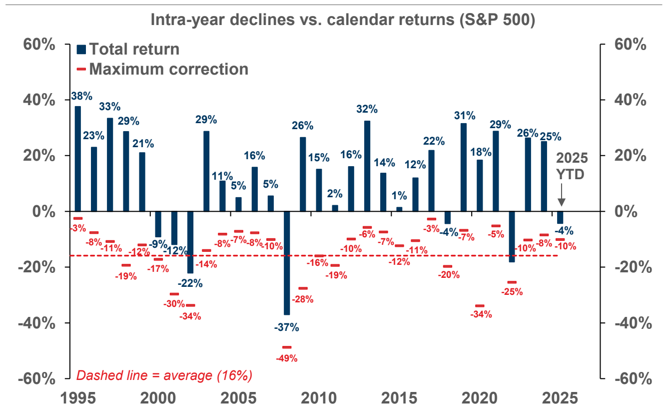
### 1 | Uncertainty hangs over the equity markets




CIO Office (data via Refinitiv). *https://www.policyuncertainty.com/

In and of itself, this is nothing exceptional. Since 1995, the S&P 500 has recorded an average correction of 16% per calendar year (**Chart 2**).

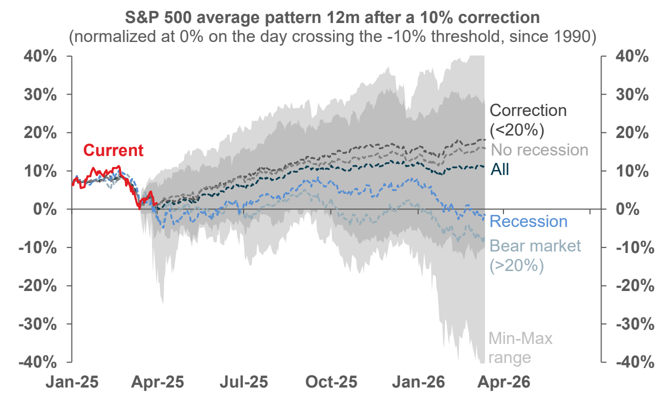
### 2 | Nothing more normal than a correction




CIO Office (data via Refinitiv).

However, if we take a closer look at how stocks generally behave following a 10% decline, two observations stand out. First, in the very short term, it is quite typical to see markets first rebound before revisiting their recent low a second time – not far from what has happened so far. Secondly, whether or not this is an opportunity over a 12-month horizon depends largely on whether or not the U.S. economy will go into recession (**Chart 3**).

### 3 | What happens after a 10% correction?




CIO Office (data via Refinitiv).

For any given year, the risk of recession is generally about one in eight. However, according to the betting market, the probability of a recession in the United States in 2025 is currently slightly above one in three (**Chart 4**), a direct consequence of tariffs, both announced and imminent (**Chart 5**, next page).

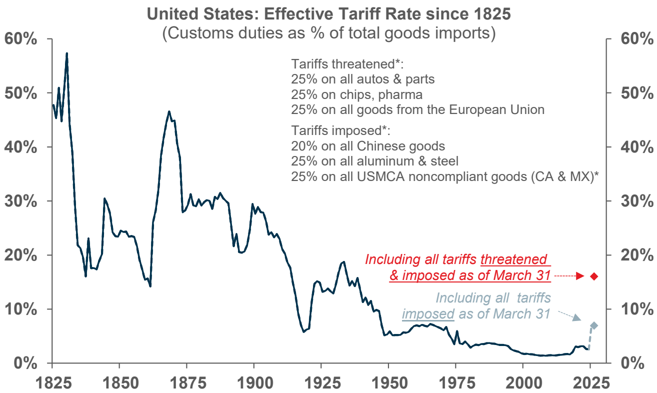
### 4 | Recession risks on the rise…


CIO Office (data via Polymarket).

Nothing to allay fears, President Trump showed little concern about the risk of recession, saying that "we are going to experience disruptions, but we don't mind" when asked about the subject.[1] One thing is certain, American consumers are starting to worry.

[1] Trump says a transition period for the economy is likely: 'You can't really watch the stock market', CNBC, March 10, 2025.

**5 | … in response to a significant tariff shock**

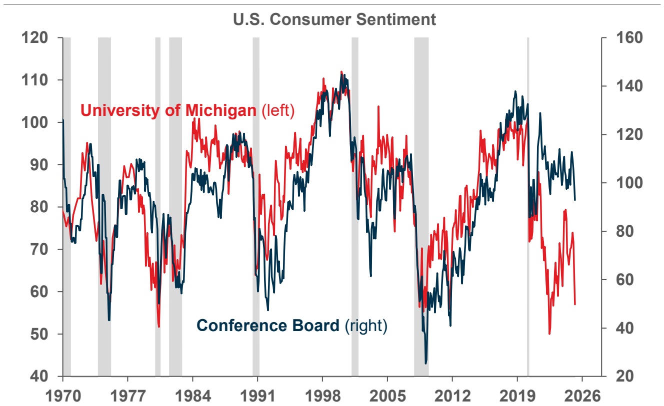



CIO Office (data via Refinitiv, US Census, Bloomberg Economics). *Impact of new tariffs according to Bloomberg Economics. Tariffs on USMCA noncompliant goods are 25%, with the exception of those on Canadian energy and potash, which are 10%.

## Consumers in a bad mood

Consumer sentiment surveys paint a clear picture: nascent optimism has given way to growing pessimism over the past three months (**Chart 6**).

**6 | Consumers are concerned…**

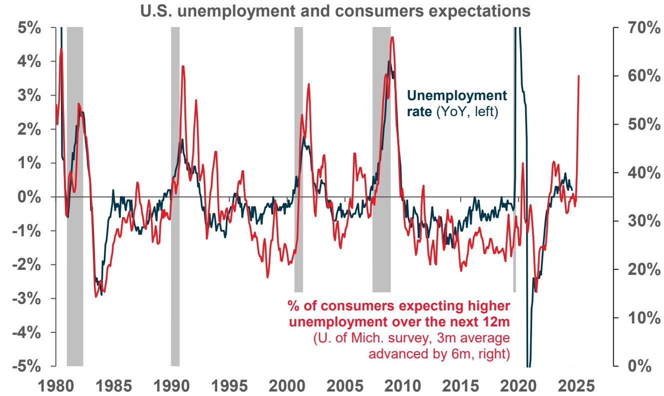



CIO Office (data via Refinitiv).

And beyond concerns about tariffs and inflation, U.S. consumers are clearly increasingly worried about their job prospects, with the share of respondents expecting an increase in the unemployment rate at its highest level since 2009 (**Chart 7**).

That said, one should always be careful with polls, as sentiment can sometimes be exaggerated

**7 | … that unemployment will rise**

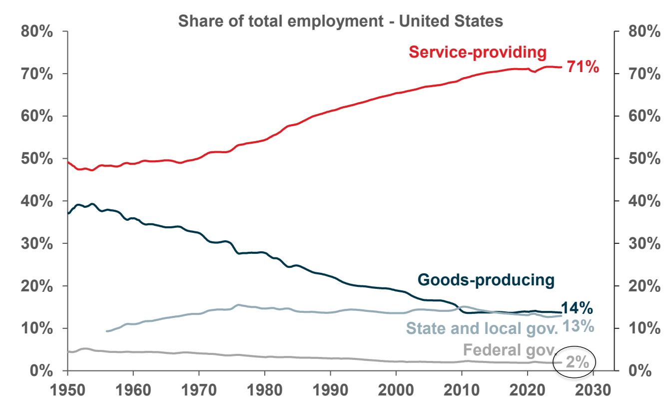



CIO Office (data via Refinitiv).

compared to reality. The omnipresence of the Department of Government Efficiency (DOGE) cuts in the civil service, in the media on a daily basis, is probably an important factor here.

In this regard, it is worth bearing in mind that federal employees represent around 2% of the American workforce, i.e. almost 3 million people (**Chart 8**).[2] This is not insignificant, but it puts into perspective the actual layoffs related to DOGE initiatives which are estimated to have affected around 62,000 people (0.04% of American workers) to date.[3]

**8 | It's all about perspective**



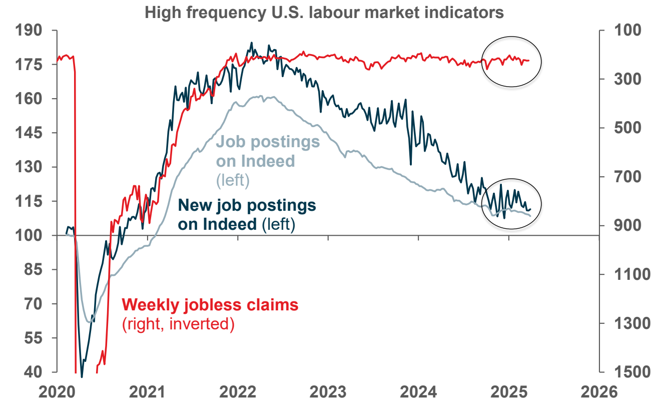

CIO Office (data via Refinitiv).

[2] Department of Veterans Affairs, Department of Homeland Security, Department of the Army, Department of the Navy, Department of the Air Force, Department of Defense. For more information, see What the data says about federal workers, Pew Research, January 7, 2025.

[3] Job Cuts Surge on DOGE Actions, Retail Woes; Highest Monthly Total Since July 2020, The Challenger Report, March 6, 2025.

From a broader point of view, high-frequency labour market indicators continue to send out rather positive signals, with job offers and unemployment insurance claims relatively stable (**Chart 9**).

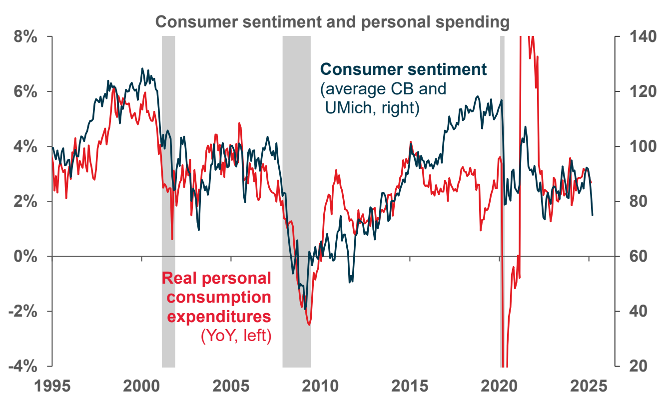
**9 | For now, employment is relatively steady...**




CIO Office (data via Refinitiv, FRED).

Nevertheless, we must remain vigilant. By undermining consumer morale, the U.S. administration runs the risk of triggering a recessionary spiral in which a decline in consumer spending (**Chart 10**) translates into a decline in business revenues, which then forces companies to lay off workers, thus pushing the newly unemployed to reduce their consumer spending... and so on.

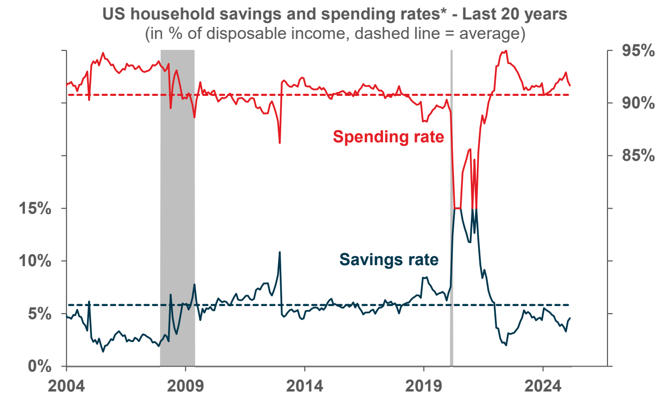
**10 | ... but consumer morale matters**




CIO Office (data via Refinitiv).

According to the latest news, households are still inclined to spend more and save less than average (**Chart 11**). But the coming months will be an important test for this trend, which partly explains the surprising resilience of the U.S. economy over the past three years.

**11 | Keeping an eye on the savings rate**

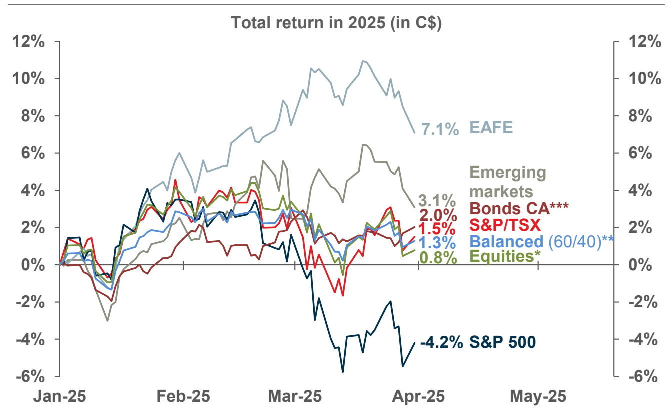



CIO Office (data via Refinitiv). *Savings rate and spending rate truncated at 15% and 80%, respectively.

## Around the world

Despite the uncertainty, the performance of the main asset classes after one quarter in 2025 is by no means exceptional, with global equities and bonds posting modest and similar returns, in line with our base scenario. What is surprising is the spectacular gap between the gains recorded in the EAFE zone – consisting mainly of European shares – and the losses posted by U.S. equities (**Chart 12**).

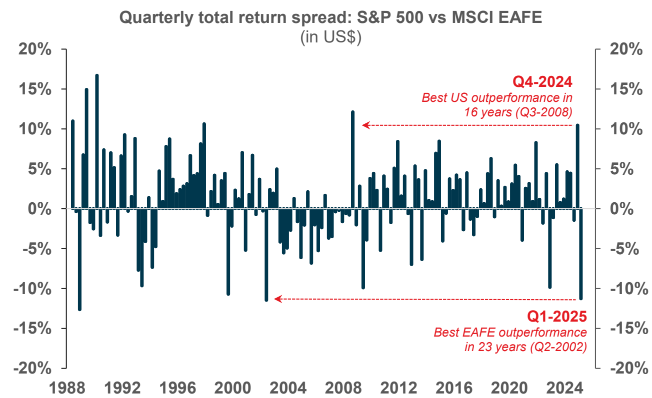
**12 | Modest returns...**




CIO Office (data via Refinitiv). *35% S&P/TSX, 35% S&P 500, 20% MSCI EAFE, 10% MSCI EM. **60% Equities, 40% CA Bonds. ***FTSE Canada Univers.

To put things into perspective, compared to the MSCI EAEO, the S&P 500 has just recorded its worst quarter in 23 years which, let's recall, follows its best quarter in 16 years (**Chart 13**, next page).

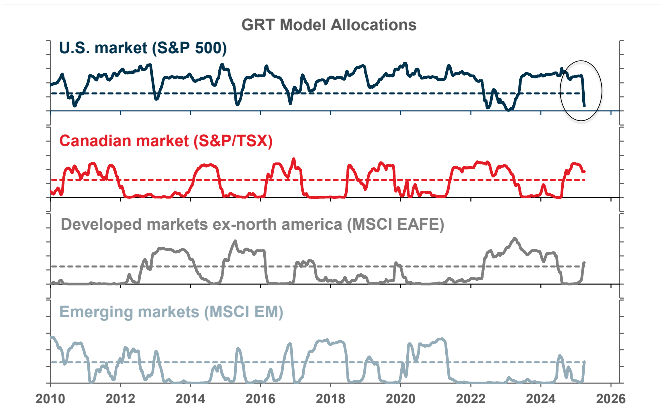
### 13 | … marked by an extreme U.S. - EAFE divergence




CIO Office (data via Refinitiv).

Seeing this trend take shape, last month we reduced our overweighting of U.S. and Canadian equities in favour of the EAFE region and emerging markets. But if it were only up to our relative momentum model, we should now underweight the S&P 500 in favour of the EAFE region and perhaps even Emerging Markets (**Chart 14**). The question is whether this change of leadership can effectively continue: a complete review of the situation is in order.

### 14 | Is U.S. equity leadership gone for good?

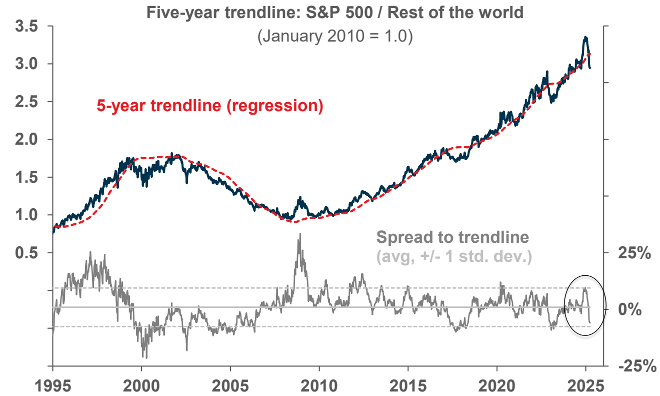



CIO Office (data via Refinitiv).

On a technical basis, if American exceptionalism appeared stretched relative to the trend near the end of 2024, it is now the reversal in favour of the rest of the world that seems somewhat extreme (**Chart 15**). At the very least, this suggests a period of consolidation in the short term.

In terms of valuations, there is substantial room for convergence, with overseas stocks trading at price-

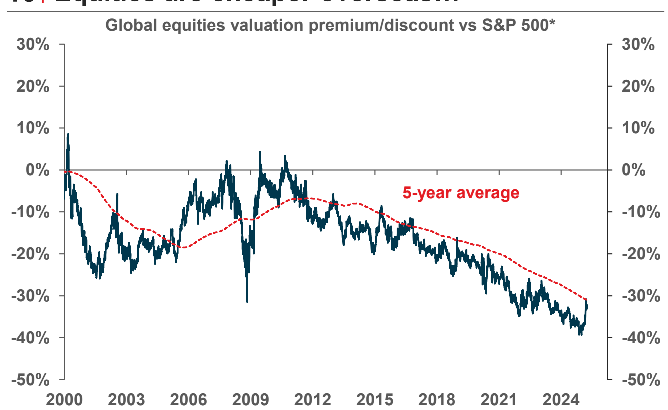
### 15 | Relative trend: from one extreme to the other




CIO Office (data via Refinitiv).

to-earnings ratios around 30% lower than the S&P 500. Nevertheless, this argument has been circulating for at least 15 years, which has not prevented this discount from tripling over the period (**Chart 16**). As such, a profound structural change will probably be necessary for the dynamics of relative valuations to be reversed to a greater extent.

### 16 | Equities are cheaper overseas…

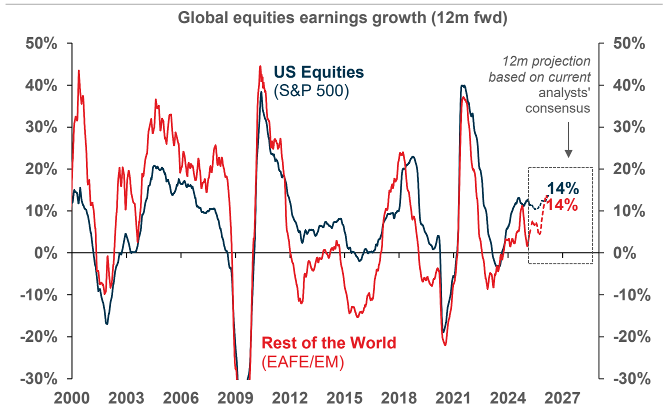



CIO Office (data via Refinitiv). *PE ratio discount. Global equities = average of MSCI EAFE and MSCI EM.

From a fundamental point of view, it is not impossible that such a change is indeed taking shape – driven notably by a move away from fiscal conservatism in Europe and toward isolationism in the U.S. – but it is not a foregone conclusion.

In simple terms, the premium on U.S. equities is mainly attributable to their profits, which have shown more stable and almost systematically higher growth over the past 15 years. Could this change? For now, although expectations have been revised upward internationally and downward in the U.S., the consensus sees comparable profit growth between the two blocs over the next year or two (**Chart 17**).

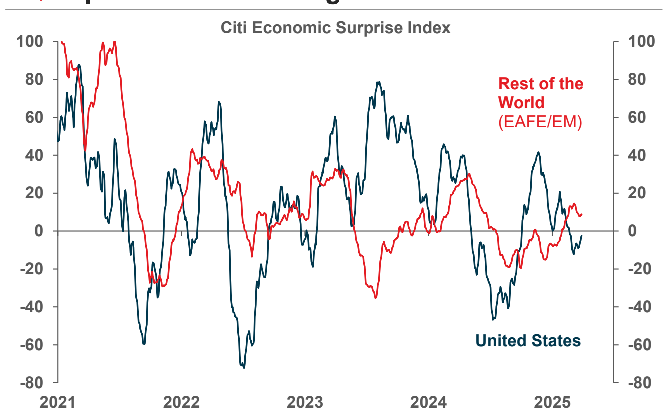
### 17 | ... but their profits are more volatile




CIO Office (data via Refinitiv).

Naturally, these forecasts will continue to be adjusted as the economic context evolves, which remains highly uncertain. But if the CITI Economic Surprise Index is to be believed, the bulk of the recalibration of relative expectations between the United States and the rest of the world may be behind us (**Chart 18**).

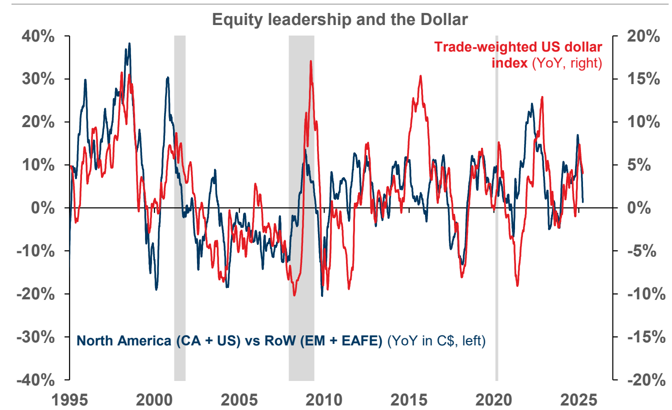
### 18 | Expectations are being recalibrated




CIO Office (data via Refinitiv). *

However, the big question when thinking about geographic leadership is the direction of the U.S. dollar. Given its importance to world finance and trade, a weak dollar eases global financial conditions and signals an improving aggregate economic cycle. In addition to the direct impact on returns, a weakening Greenback therefore tends to favour international equities (**Chart 19**).

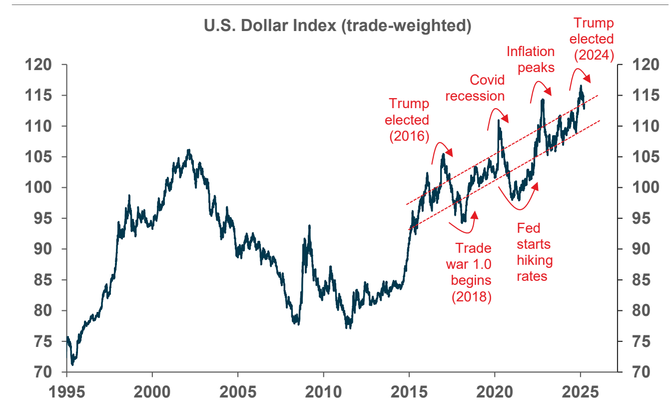
### 19 | The direction of the Greenback is a key factor…




CIO Office (data via Refinitiv).

Over the last ten years, the U.S. dollar has generally followed an upward trend, with a series of highs and lows reflecting significant economic upheavals (**Chart 20**).

### 20 | … to be closely followed



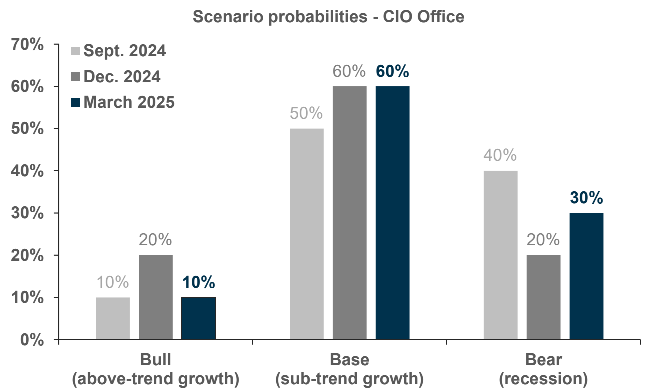

CIO Office (data via Refinitiv).

If history repeats itself, the depreciation seen since the peak around President Trump's inauguration could very well continue this year. But first, the tariff cloud will probably have to clear, given the risk it poses to both global growth and U.S. inflation, limiting the Federal Reserve's ability to quickly lower interest rates, if need be.

## The bottom line

The economy is going through a turbulent period and, although our baseline scenario still foresees slight economic growth, the likelihood of a recession has increased (**Chart 21**).

**21 | The economic backdrop is growing more fragile**




CIO Office (data via Refinitiv).

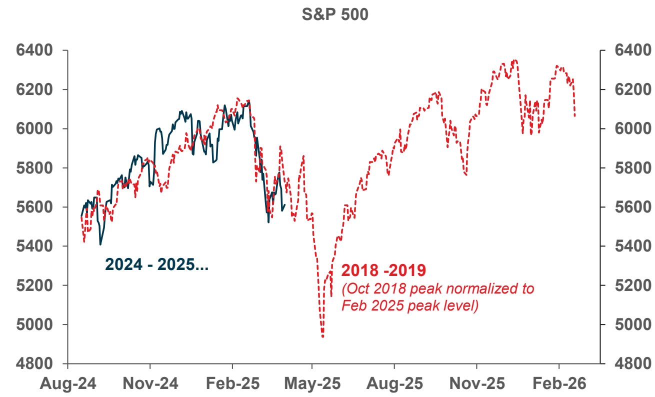
For markets, we must therefore expect volatility to persist over the coming months, until we see where the tariff conundrum lands, and where the gap between "soft" data (such as consumer sentiment surveys) and "hard" data (such as unemployment insurance claims) settles.

In this context, we maintain a balanced allocation between equities and bonds, as we see these two asset classes as offering complementary risk profiles and similar return prospects over a 12-month horizon.

However, should there be an overreaction to the downside by equity markets – somewhat like what happened during the previous Trump administration in late 2018 (**Chart 22**) – an opportunity to go against the trend could present itself. For now, the asymmetry of the scenarios is not yet sufficiently skewed to the upside for such a stance.

Finally, in terms of the geographical allocation within equities, after the spectacular outperformance of international stocks in Q1, the risk of such a divergence recurring seems limited compared to the chances of a recovery of North American equities in the short term. However, we will be keeping a close eye on relative trends, the evolution of the Greenback, valuations, and profit outlooks which could ultimately justify a change to our geographic mix in the near future.

**22 | A look back at the fourth quarter of 2018**




CIO Office (data via Refinitiv).

**Table 3 Global Asset Allocation - Model Portfolio Weights (in CAD)**

| | Benchmark | | Model Portfolio | | | | Comments |
|---|---|---|---|---|---|---|---|
| | | | Total | | Asset Class | | |
| | Total | Asset Class | Allocation | Active Weight | Allocation | Active Weight | |
| **Asset Classes** | | | | | | | |
| Cash | 0% | - | 0.0% | 0.0% | - | - | While a soft landing seems the most likely scenario, investors are nonetheless faced with high valuations, a fragilized economy and heightened political uncertainty. Overall, this context argues for a balanced strategy across asset classes. Alternative assets help to control total portfolio risk through their diversification effects. |
| Fixed Income | 40% | - | 38.0% | -2.0% | - | - | |
| Equities | 60% | - | 60.0% | 0.0% | - | - | |
| Alternatives | 0% | - | 2.0% | 2.0% | - | - | |
| **Fixed Income** | | | | | | | |
| Government | 29% | 74% | 28.5% | -0.9% | 75% | 1.4% | With central banks moving gradually towards a neutral policy stance, the upside potential for bond yields looks limited, while an economic slowdown would see them fall rapidly. This situation justifies a slightly longer duration as an insurance policy against a surprise recession. In addition, credit spreads near historic lows suggest a negative asymmetry for corporate bonds, justifying a slight underweight in this category. |
| Investment Grade | 11% | 26% | 9.5% | -1.1% | 25% | -1.4% | |
| High Yield | 0% | 0% | 0.0% | 0.0% | 0% | 0.0% | |
| Duration | *7.2 yrs* | - | *7.9 yrs* | 0.7 yrs | - | - | |
| **Equities** | | | | | | | |
| Canada | 21% | 35% | 23.0% | 2.0% | 38% | 3.3% | In addition to strong momentum, the economic and geopolitical context favours North American equities over the rest of the world. In the U.S., the equally weighted index presents better risk-return prospects in view of a manufacturing recovery, as does the value style in Canada. The strategy nevertheless remains prudent and diversified, with quality companies in the US, European stocks in the EAFE region, and large caps in emerging markets. |
| United States | 21% | 35% | 23.0% | 2.0% | 38% | 3.3% | |
| EAFE | 12% | 20% | 9.0% | -3.0% | 15% | -5.0% | |
| Emerging markets | 6% | 10% | 5.0% | -1.0% | 8% | -1.7% | |
| **Alternatives** | | | | | | | |
| Inflation Protection | 0% | 0% | 0.0% | 0.0% | 0% | 0.0% | A systematic quantitative strategy that takes advantage of market trends while aiming for maximum decorrelation with equities and tight control of volatility (NALT) plays an important role as a diversifier, especially in relation to the risk of a surprise resurgence in inflation. |
| Gold | 0% | 0% | 0.0% | 0.0% | 0% | 0.0% | |
| Non-Traditional FI | 0% | 0% | 0.0% | 0.0% | 0% | 0.0% | |
| Uncorrelated Strategies | 0% | 0% | 2.0% | 2.0% | 100% | 100.0% | |
| **Foreign Exchange** | | | | | | | |
| Canadian Dollar | 61% | - | 59.2% | -1.8% | - | - | The overall portfolio strategy involves an overweight in the US dollar and, to a lesser extent, the yen.. This positioning reflects the geographic allocation within equities, as well as a willingness to underweight the Canadian dollar against safe-haven currencies amid global economic uncertainty and heightened geopolitical tensions. |
| U.S. Dollar | 21% | - | 26.8% | 5.8% | - | - | |
| Euro | 5% | - | 4.5% | 0.0% | - | - | |
| Japanese Yen | 3% | - | 1.5% | -1.5% | - | - | |
| British Pound | 2% | - | 1.6% | -0.1% | - | - | |
| Others | 9% | - | 6.4% | -2.4% | - | - | |

CIO Office. The fixed income benchmark is 100% FTSE Canada Universe. There are no alternative assets in the benchmark as their inclusion is conditional on improving the risk/return properties of traditional assets (60/40). The amplitude of the colour bars under the "Active Weight" columns are proportional to the maximum deviations of the portfolio (+/- 10% for stocks and bonds, +10% in cash, +20% in alternative assets).

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