Game Changers?

Highlights

> After a strong start, the first month of 2021 ended with a slight loss for the S&P 500 as an increasingly heated battle between retail investors and short sellers drove volatility higher. Meanwhile, the latest economic data revealed a slowdown in growth, largely expected given the sharp rise in new COVID-19 cases in several countries and subsequent containment measures put in place since October.

> Fortunately, not only does the number of new cases appear to be levelling off in many areas, but the percentage of the population having received at least one dose of COVID-19 vaccine is on the rise. Granted, almost every country has faced a series of logistical, manufacturing, and even geopolitical challenges since the beginning of the vaccination campaign, a key risk for which any prediction remains hazy. Nevertheless, challenges encountered so far do not seem to have materially affected the endpoint of near herd immunity.

> Yet, the first surprise of the year did not come from COVID-19, but from U.S. politics, and as early as January 5, when Democratic candidates won the two Senate seats at stake in Georgia's runoff elections. This places Joe Biden's party in an excellent position to advance further fiscal relief, though its size could be smaller than the $1.9 trillion targeted. This increases the potential for a significant recovery in the second half of the year.

> Under these circumstances, U.S. small-cap stocks performed particularly well. They have reasons to keep outperforming over the cyclical horizon, but we advocate greater caution in the short term. A key reason is the powerful horde-effect of the growing Reddit community which caused a few stocks that many associated with another era to defy the rules of gravity. Time will tell if this relatively new phenomenon is a game changer for financial markets... or just a game set to stop. However, for an index like the S&P 600, the implication is very real since, as of January 29, GameStop was the index's largest position.

> Overall, the economic backdrop continues to evolve in the direction expected. Consequently, we are taking advantage of the slight decline recorded at the end of the month to continue the gradual increase in our equity allocation, in line with our intentions detailed in our 2021 outlook published last December. We are certainly not shielded from a more pronounced decline. But, with our sentiment indicator near neutral, downside potential appears relatively limited. In addition, the bulk of the increase in equities is achieved through a greater allocation to emerging markets, while we are reducing the weight of US equities. The primary objective is to gradually increase the cyclicality of our portfolio strategy. The S&P 500 is more defensive in nature, whereas emerging markets are best positioned to benefit from a pick-up in global economic activity.

Table 1 Global Asset Allocation Views

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Asset Classes		
Cash		
Fixed Income		↓
Equities		↑
Alternatives		
Fixed Income		
Government		
Investment Grade		
High Yield		
Duration		
Equities		
Canada		
United States		↓
EAFE		
Emerging Markets		↑
Value vs. Growth		
Small vs. Large Cap.		
Cyclicals vs. Defensives		
Alternatives & FX		
Inflation Protection		
Gold		
Non-Traditional FI		
Uncorrelated Strategies		
Canadian Dollar		

This table is for illustration purposes only. Bars represent the degree of preference of an asset realtive to the maximum deviations allowed from a reference index. The further to the right (left) they are, the more bullish (bearish) our outlook for the asset is. For equity factors/styles, a bar to the right indicates a preference for the factor to the right (e.g. Growth) and vice versa. 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 for details on the base-case economic scenario underpinning these views and Table 4 to see how they translate into a model balanced portfolio.

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Market Review

Fixed Income

- A steepening yield curves in the U.S. and Canada acted as headwinds for Fixed-Income products in January.
- In particular, the U.S. 10-year benchmark rate climbed above the 1% mark early in the month to levels not seen since March 2020, on the back of rising inflation expectations following a blue sweep for Democrats.
- Meanwhile, credit spreads edged down for a fourth consecutive month, especially helping U.S. High-Yield bonds outperform.

Canadian Equities

- Canadian equities closed out the first month of the new year down overall.
- Early rotations toward the more cyclical Materials and Consumer Stapes sectors were reversed by the end of January as a post-holiday resurgence in COVID cases highlighted risks to the ongoing recovery.
- The ever-volatile Healthcare sector took top spot this month (35.3%) followed far behind by Energy and Utilities stocks (2.8% and 2.7%, respectively.

U.S. Equities

- A Democrat sweep of both houses of congress set the stage for larger deficit spending in Washington, providing a tailwind for risk assets early in the month.
- However, a slower-than-expected vaccine roll-out and an ever increasing COVID-19 case load across the country weighed heavily on U.S. equities, ultimately pushing them further away from record highs by month's end.
- Consumer Staples lagged (-5.2%), while Energy stocks outperformed all other sectors (3.8%).
- Meanwhile, smaller capitalization stocks enjoyed a revival, closing out January having outperformed every S&P 500 sector.

Commodities

- Oil prices rose in January for a third month in a row, buoyed in part by a strong recovery in China as well as news that Saudi Arabia would further reduce its daily output in February and March.
- Gold prices, on the other hand, retreated as investor sentiment remained positive throughout most of the month.
- Rising rates and a stronger U.S. dollar also weighed on the lustrous metal's performance.

Foreign Exchange

- Last month, the Greenback firmed against a basket of developed market currencies, reversing December's slide.
- Meanwhile, the Loonie remained rangebound throughout January.
- To the East, China's tightly controlled Renminbi crossed below the 6.5 per USD mark – a first since June 2018 – and yet another milestone for the currency in the wake of a currently stalled trade war.

Table 2 Market Total Returns

Asset Classes	January	12 months	2020
Cash (3-month T-bills)	0.0%	0.7%	0.9%
Bonds (FTSE CA Ovr. Univ.)	-1.1%	4.4%	8.7%
FTSE CA Short term	0.1%	4.3%	5.3%
FTSE CA Mid term	-0.5%	6.5%	10.1%
FTSE CA Long term	-3.0%	3.1%	11.9%
FTSE CA Government	-1.3%	4.1%	8.7%
Federal	-0.8%	3.9%	7.3%
Provincial	-1.7%	4.2%	9.9%
Municipal	-1.1%	5.5%	10.1%
FTSE CA Corporate	-0.5%	5.3%	8.7%
AA+	-0.1%	4.7%	6.3%
BBB	-0.3%	6.0%	9.4%
BoAML Inv. Grade ($US)	-1.2%	5.9%	9.8%
BoAML High-Yield ($US)	0.4%	6.6%	6.2%
Preferred Shares	2.6%	8.8%	6.2%
Canadian Equities (S&P/TSX)	-0.3%	3.5%	5.6%
Energy	2.8%	-22.7%	-26.6%
Industrials	-2.9%	8.7%	17.0%
Financials	-0.1%	-0.5%	1.6%
Materials	-3.5%	19.9%	21.2%
Utilities	2.7%	9.9%	15.3%
Cons. Disc	-2.6%	16.9%	17.1%
Cons. Staples	-5.3%	-5.4%	4.3%
Healthcare	35.3%	6.9%	-23.0%
IT	-0.7%	63.9%	80.7%
Comm. Svc.	0.5%	-5.9%	-3.7%
REITs	1.6%	-11.4%	-8.7%
S&P/TSX Small Cap	0.5%	16.7%	12.9%
US Equities (S&P500 USD)	-1.0%	17.2%	18.4%
Energy	3.8%	-22.6%	-33.7%
Industrials	-4.3%	6.8%	11.1%
Financials	-1.7%	-0.8%	-1.7%
Materials	-2.4%	25.6%	20.7%
Utilities	-0.9%	-6.6%	0.5%
Cons. Disc	0.4%	33.0%	33.3%
Cons. Staples	-5.2%	4.6%	10.7%
Healthcare	1.4%	18.3%	13.4%
IT	-0.9%	37.1%	43.9%
Comm. Svc.	-1.3%	20.9%	23.6%
REITs	0.5%	-3.0%	-2.2%
Russell 2000 (USD)	5.0%	28.5%	18.4%
World Eq. (MSCI ACWI)	-0.4%	17.6%	16.8%
MSCI EAFE (USD)	-1.1%	9.4%	8.3%
MSCI EM (USD)	3.1%	28.3%	18.7%
Commodities (CRB index)	3.8%	2.6%	-9.3%
WTI Oil (US$/barrel)	8.3%	1.5%	-21.0%
Gold (US$/ounce)	-2.1%	17.1%	24.8%
Copper (US$/tonne)	1.5%	41.6%	26.0%
Forex (DXY - US Dollar index)	0.7%	-7.0%	-6.7%
USD per EUR	-0.7%	9.6%	9.0%
CAD per USD	0.4%	-3.5%	-2.0%

CIO Office (data via Refinitiv) 2021-01-29

Kicking off the new year...

After a strong start, the first month of 2021 ended with a slight loss for the S&P 500 as an increasingly heated battle between retail investors and institutional short sellers drove volatility higher. Despite the turbulence, U.S. small-cap stocks and emerging markets still posted sizeable gains (more on this later), finishing January among the top performing assets, as they did in 4 of the last 5 quarters (Chart 1).

1 A two-tone start to the year...

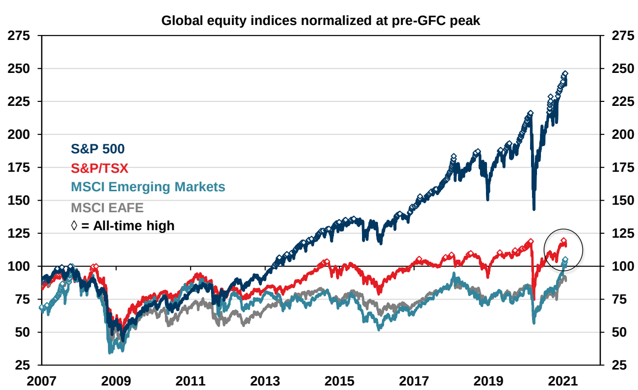
Total return - Cross Assets

Q4-2019	Q1-2020	Q2-2020	Q3-2020	Q4-2020	2021 YTD
EM	C$ per USD	US Small	Can Pref.	US Small	US Small
12.3%	8.5%	24.9%	11.4%	31.4%	5.0%
US Small	Can Bonds	EM	EM	EM	Commo.
9.6%	0.9%	20.5%	9.7%	19.8%	4.9%
Commo.	Balanced*	S&P/TSX	S&P 500	EAFE	EM
9.1%	-9.9%	20.0%	8.9%	16.1%	3.1%
S&P 500	US HY	S&P 500	US Small	Commo.	Can Pref.
8.7%	-13.7%	18.6%	4.9%	14.5%	2.6%
EAFE	S&P 500	Can Pref.	EAFE	S&P 500	US HY
8.2%	-18.1%	17.5%	4.9%	12.1%	0.4%
Can Pref.	EAFE	EAFE	S&P/TSX	S&P/TSX	C$ per USD
3.5%	-22.7%	15.2%	4.7%	9.0%	0.3%
Balanced*	S&P/TSX	Balanced*	US HY	Can Pref.	S&P/TSX
3.5%	-23.1%	11.9%	4.7%	7.3%	-0.3%
S&P/TSX	Can Pref.	Commo.	Commo.	US HY	Balanced*
3.4%	-24.2%	10.9%	4.6%	6.5%	-0.6%
US HY	EM	US HY	Balanced*	Balanced*	S&P 500
2.6%	-25.3%	10.3%	3.4%	5.7%	-1.0%
Can Bonds	US Small	Can Bonds	Can Bonds	Can Bonds	EAFE
-0.5%	-30.1%	6.2%	0.4%	0.6%	-1.1%
C$ per USD	Commo.	C$ per USD	C$ per USD	C$ per USD	Can Bonds
-1.4%	-43.0%	-3.8%	-1.9%	-4.6%	-1.1%

CIO Office (data via Refinitiv). *Balanced = 40% FTSE TMX Universe, 21% S&P/TSX, 21% S&P 500 (C$), 12% MSCI EAFE (C$), 6% MSCI EM (C$)

While this rise allowed the U.S. stock market to momentarily reach a new high, the most noteworthy events were a first return above the pre-COVID level for the S&P/TSX and the first record high for the MSCI Emerging Markets Index since... October 2007 (Chart 2).

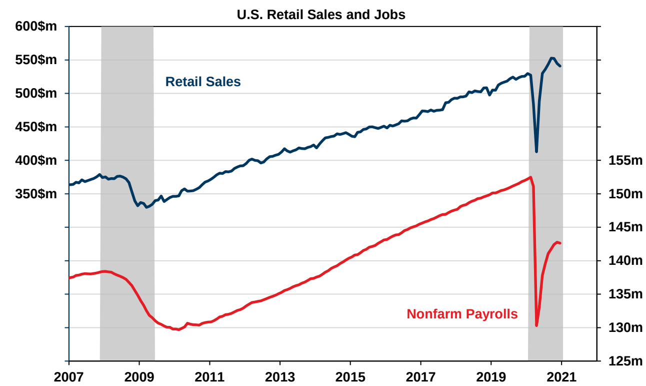
2 **... featuring some** noteworthy **record highs...**



CIO Office (data via Refinitiv). Price index only. Does not include dividends.

Meanwhile, the latest economic data revealed a slowdown in growth. For instance, while retail sales remain above their pre-COVID level, they have recorded a decline for the third consecutive month. As for employment (which is only about halfway through its recovery), December figures showed a loss of 140k, the first decline since their collapse in April 2020 (Chart 3).

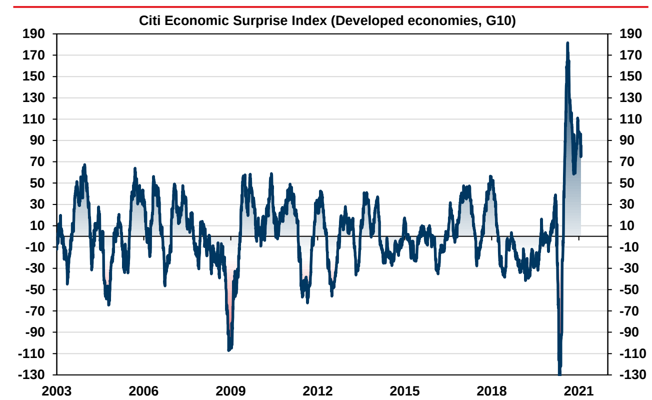
3 **... and an economic slowdown...**



CIO Office (data via Refinitiv).

How can we explain the relative insensitivity of equity markets to apparent economic weakness? Simply by the fact that this slowdown is (1) already in the rear-view mirror, and above all (2) largely anticipated. This last point is well reflected by the Economic Surprise Index of the G10 countries, which is certainly not as strong as it was last August but remains far from indicating genuine negative surprises (Chart 4).

4 **... with few surprises...**



CIO Office (data via Refinitiv). As of Jan. 29, 2021.

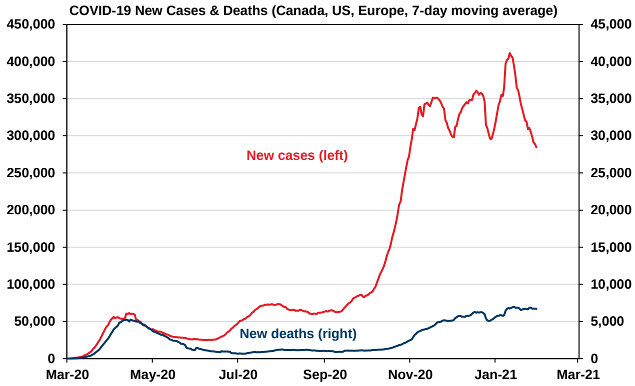
In turn, the predictability of this slowdown can be explained by its cause, which is now well known to everyone: COVID-19. The sharp rise in new cases in several countries since October (Chart 5, next page) combined with the maintenance of several containment measures were bound to result in weaker economic data this winter.

Fortunately, not only does the number of new cases appear to be levelling off (and even declining) in many areas, but the number of COVID-19 vaccine doses administered as a percentage of the population is on the rise (Chart 6, next page).

Granted, almost every country has faced a series of logistical, manufacturing, and even geopolitical[1] challenges since the beginning of the vaccination campaign, a key risk for which any

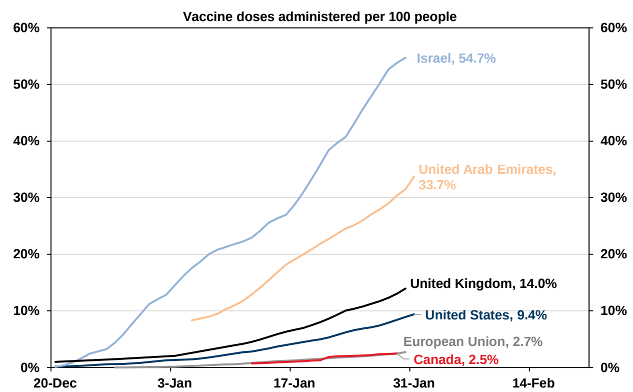
[1] Europe's delays in COVID-19 vaccine delivery are causing tempers to flare. The Economist, January 27, 2021.

5 … given the virus surge



CIO Office (data via Johns Hopkins University).

6 The vaccination campaign is in motion



CIO Office (data via Our World in Data). Data as of Jan. 30, 2021.

prediction remains hazy. Nevertheless, challenges encountered so far do not seem to have materially affected the endpoint of near herd immunity, as summarized by Dr. Fauci, who is certainly not recognized for his complacency:

> *As the months go by, I would expect by the time we get to April, it will be what we call open season on vaccines. Everyone will be able to get a vaccine. So I think by the end of the summer, if we get 70% to 85% of the population vaccinated and get a good herd immunity, I think by the fall we could start to approach some form of normality.*
>
> *Dr. Anthony Fauci, January 7, 2021*

In addition, the newly released data from the Johnson & Johnson vaccine study suggest the vaccination campaign could soon gather pace, assuming the regulatory approval currently expected by the end of February is achieved. The company has pledged to deliver 100 million doses to the U.S. by June, while Canada signed an agreement for 38 million doses last August. It is still too early to know if this one will really be a game changer in the fight against COVID-19. But again, Dr. Fauci's comments reflected a certain optimism:[2]

> *If this were out there and we didn't have the Moderna 94-95% …. We would have said wow, a 72% effective vaccine that's even more effective against severe disease is really terrific. […] A vaccine that's inexpensive, that's a single dose, and that has no cold chain requirements -- that's pretty good.*
>
> *Dr. Anthony Fauci, January 29, 2021*

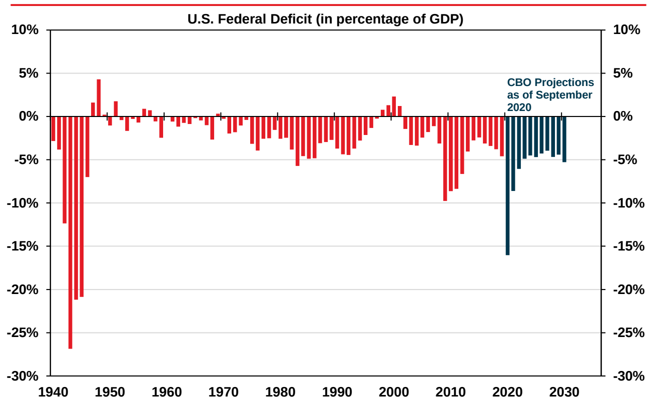
… with a blue sweep

The first surprise of the year did not come from COVID-19, but from U.S. politics, and as early as January 5, when Democratic candidates won the two Senate seats at stake in Georgia's runoff elections. This gives control of the Senate to the Democrats (thanks to the tie-breaking vote of the new Vice-President, Kamala Harris), in addition to that of the House of Representatives and, of course, the Presidency.

Joe Biden's party is therefore in an excellent position to advance its policy agenda, the immediate priority of which is seemingly to approve further fiscal relief. Asked about the budget deficit which is already at a peacetime record high (Chart 7), the new Secretary of the Treasury replied that:

> *Neither the president-elect, nor I, propose this relief package without an appreciation for the country's debt burden. But right now, with interest rates at historic lows, the smartest thing we can do is act big.*
>
> *Janet Yellen, January 19, 2021*

7 Fiscal spending…



CIO Office (data via Refinitiv).

This simple answer illustrates how much the game has changed from the austere mentality that prevailed in Washington in the months following the financial crisis (a mistake with hindsight, according to a majority of economists[3]), and highlighted by the comments of the then newly-elected U.S. President:

[2] Johnson & Johnson COVID-19 vaccine is 66% effective in global trials, but 85% effective against severe disease, company says. CNN, Jan. 29, 2021.

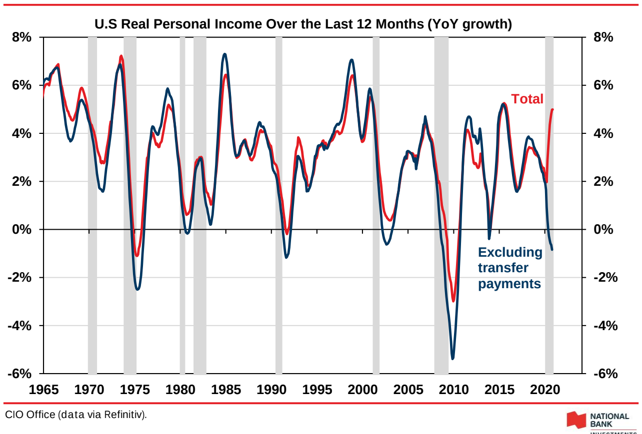
[3] OECD warns governments to rethink constraints on public spending. Financial Times, January 4, 2021.

I think it is important, though, to recognize if we keep on adding to the debt, even in the midst of this recovery, that at some point, people could lose confidence in the U.S. economy in a way that could actually lead to a double-dip recession.

Barack Obama, November 18, 2009

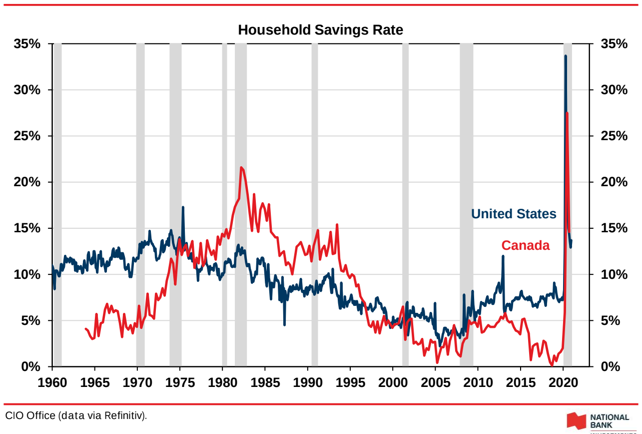
To be clear, this doesn't mean that Democrats will be able to pass the most progressive version of their agenda unchallenged. In fact, our colleague, Angelo Katsoras, geopolitical analyst with NBF's Economics and Strategy team, anticipates that only $1 trillion of the $1.9 proposed by the new administration will be approved soon (see his latest report – What a unified Democrat government could accomplish – for more details). In any case, there is little doubt that total U.S. household income will remain insulated from any sharp decline caused by the pandemic over the next year (Chart 8).

8 ... should continue to support households



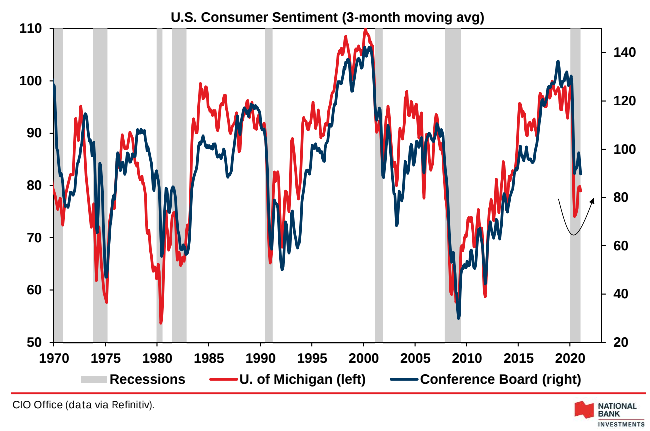
Since several restrictive measures continue to limit the ability to consume, a significant fraction of household income (including the fiscal stimulus) should continue to be saved (Chart 9).

9 Today's high level of **savings...**



This increases the potential for a significant recovery in the second half of the year, providing that consumer sentiment improves (Chart 10).

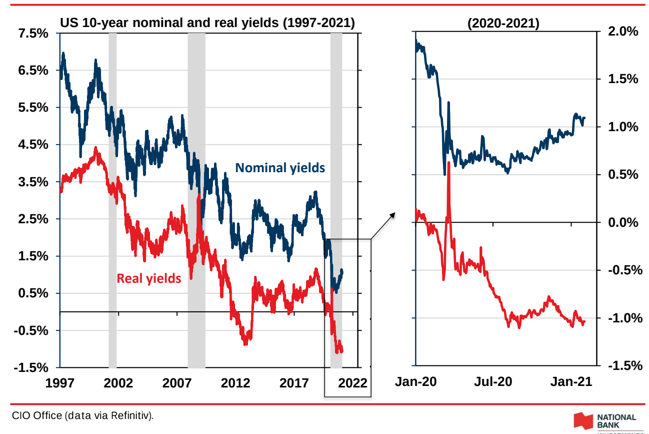
10 **...** increases the potential for a sharp recovery post-COVID



Interesting rates movements

In a different time, one might have expected the prospect of massive deficits to lead to a sharp rise in long-term bond yields. Today, nominal rates did indeed rise noticeably in the aftermath of the Democratic victory on January 5, but the move remained modest and even partially reversed in the following days. Thus, nominal rates ended the month only slightly higher, while real rates remain confined near a historical low (Chart 11).

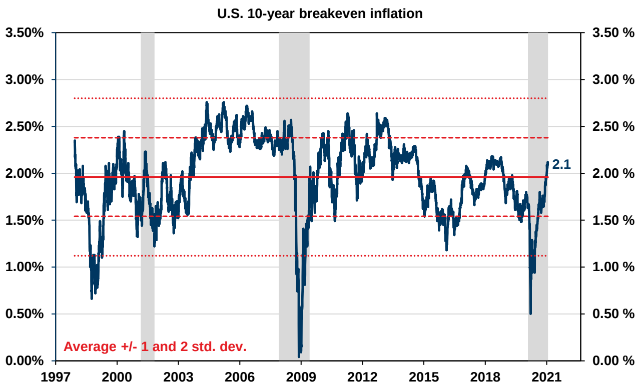
11 Modest rise in nominal interest rates...



In our view, this is a direct reflection of the new approach to monetary policy put forward by the Federal Reserve, which is using the full weight of its balance sheet and forward-looking guidance to achieve its inflation target, on average. As a matter of fact, the 10-year "breakeven" measure of expected inflation (i.e., the difference between real and nominal interest rates) has recently risen above its long-term average for the first time since November 2018 (Chart 12, next page). This confirms that the deflation feared by the Fed since the beginning of the crisis is no longer a dominant risk.

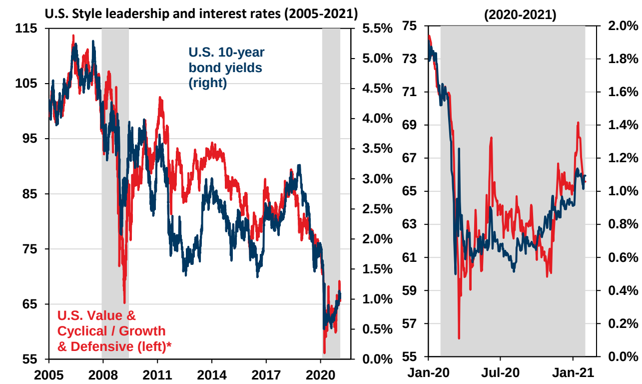
On the other hand, if too little inflation is not a key concern, at what level could too much inflation become a problem for the stock markets? In and of itself, the threat is not so much a rise in inflation, but rather the moment when central banks will fight

12 ... driven by an upturn in inflation expectations



CIO Office (data via Refinitiv).

14 Modest outperformance of cyclical sectors

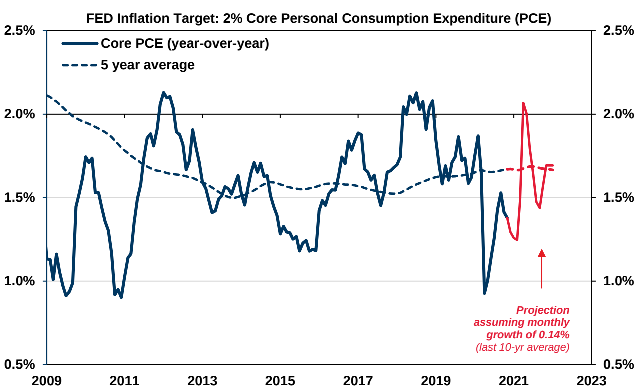


CIO Office (data via Refinitiv). *Ratio between average of S&P 500 Value & Cyclical sectors (Financials, Energy, Materials, Cons. Discr., Industrials, Real Estate) and Growth & Defensive sectors (Tech, Health care, Comm svs, Utilities, Staples)

it. Unfortunately, it is impossible to know exactly when or where that time will come. But, since the Fed's intention is to wait until inflation is above target for an extended period of time before starting to consider raising interest rates, it is not likely to happen in 2021, or even 2022.

In the meantime, markets are not necessarily immune to any jolts caused by inflation. A first test is looming on the horizon, with base effects expected to result in year-on-year figures above the 2% target as early as April 2021 (Chart 13). Nevertheless, any potential volatility associated with this temporary rise in inflation should itself also be temporary, as the Fed is already preparing the ground with this perspective.[4]

13 First reading above target on the horizon



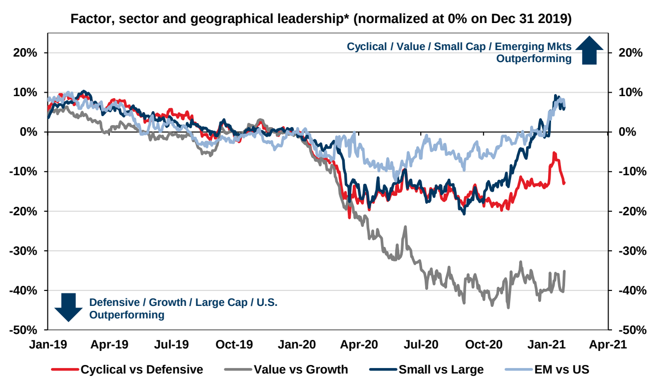
CIO Office (data via Refinitiv).

Sizing equity leadership

Mirroring interest rate movements, leadership between cyclical and defensive sectors began the year with a relatively strong increase in favour of the former which moderated in the following days (Chart 14).

However, a closer look at key relative equity trends shows that the strongest turnaround is not on the cyclical-vs.-defensive end and is even less so on the value-vs.-growth front. It is rather on the side of emerging markets and U.S. small-cap stocks (Chart 15).

15 Emerging markets and small caps take the lead



CIO Office (data via Refinitiv).

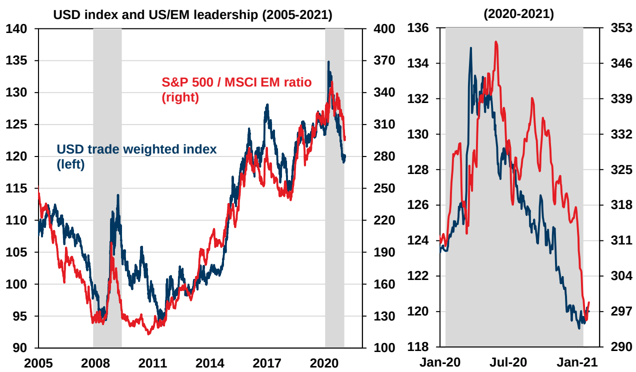
For emerging markets (EM), we expect this trend to continue. As we have mentioned a few times since initiating an overweight in the region in early August, EM are well positioned to outperform in an environment of rising global growth and a weakening U.S. dollar – two elements central to our baseline scenario (Chart 16, next page).

For U.S. small-cap stocks, they have many reasons to keep doing well, which they tend to do coming out of recessions and, especially, when investors' risk appetite is abundant. Accordingly, we observed a certain correlation between their relative performance and high-yield credit spreads (Chart 17, next page).

However, we advocate greater caution in the short term for two reasons. First, U.S. small caps' spectacular rise in recent months has pushed their core index, the S&P 600, to unprecedented heights relative to its 200-day moving average. This suggests at least a slowdown, if not a correction in the near term (Chart 18, next page).

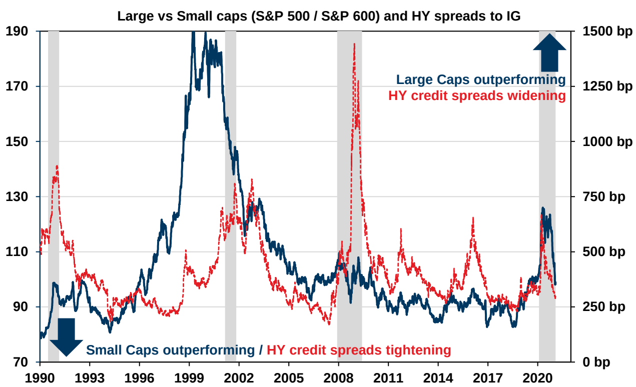
[4] Fed set to look beyond post-pandemic inflation shock. Reuters, January 25, 2021.

16 Weak U.S. Dollar: A tailwind for emerging markets



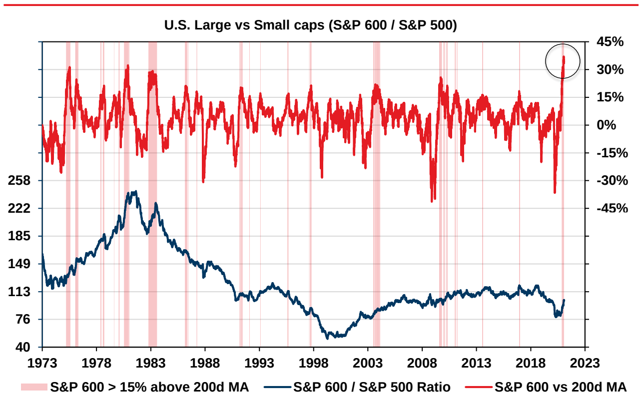
CIO Office (data via Refinitiv).

17 U.S. small caps are in high demand...



CIO Office (data via Refinitiv).

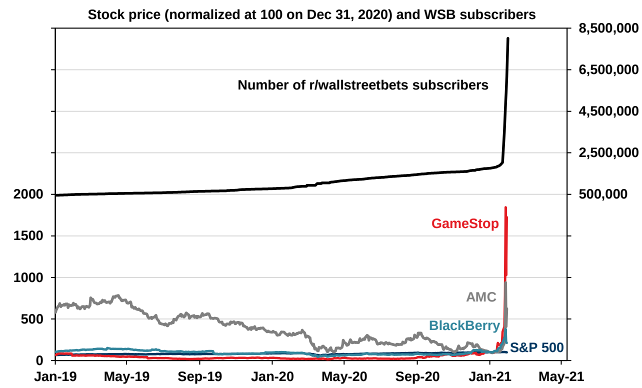
18 **... and** deeply overbought in the short term



CIO Office (data via Refinitiv).

Secondly, we cannot ignore the present 'phenomenon of the hour' on the stock markets: the hunt for stocks with a high short interest led by an army of retail speculators gathered on the popular "WallStreetBets" forum on Reddit. The powerful horde-effect of this growing community – the number of subscribers jumped from around 2 million to over 6 million in the space of a week – caused a few stocks that many associated with another era to defy the rules of gravity (Chart 19). Bets are on to see if this relatively new phenomenon is a game changer for Wall Street… or just a game set to stop once its true price is revealed. However, for an index like the S&P 600, the implication is very real since, as of January 29, GameStop was the Index's largest position.

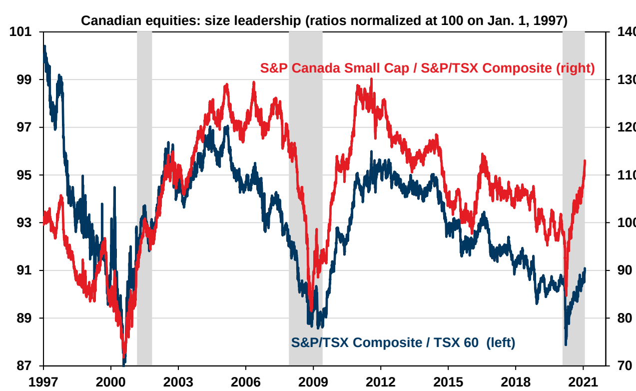
19 To the moon… and back?



CIO Office (data via Refinitiv, subredditstats.com, reddit.com). As of February 1, 2021.

On our side of the border and far from the headlines, Canadian small-cap stocks have also significantly outperformed since last March. While some caution is also warranted in the near term for this highly volatile index, a potential change for those holding positions in the TSX60 Index could be to shift assets into the broader composite index. While the performance gaps are not as large as with the small-cap index, there is still plenty of room for the trend to continue after nearly a decade of outperformance by Canadian large-cap stocks (Chart 20).

20 A size rotation is also underway in Canada



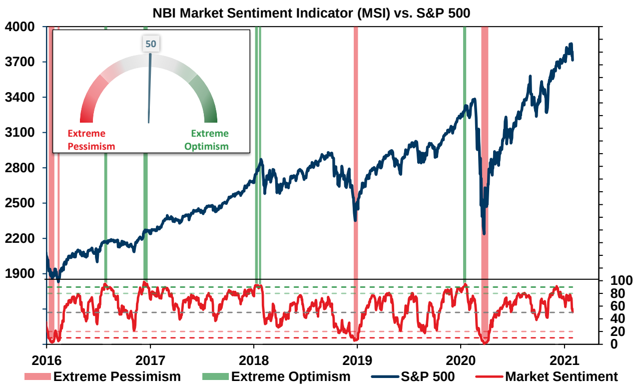
CIO Office (data via Refinitiv).

Investment Conclusion

Overall, the economic backdrop continues to evolve in the direction expected. The onset of a harsher winter has unsurprisingly revealed a slowdown, but this should gradually give way to a stronger recovery as the COVID-19 situation subsides. The speed of the vaccination operation remains a key risk that varies greatly from country to country. Nevertheless, one can reasonably assume the pace should accelerate beyond the immediate logistical challenges, while immunization of the high-risk population already well underway remains the one with the largest positive marginal effect. Besides, the imminence of further fiscal stimulus measures south of the border both reduces the risk of a sharper slowdown in the early part of the year and increases the potential for recovery thereafter.

Consequently, we are taking advantage of the slight decline recorded at the end of the month to continue the gradual increase in our equity allocation, in line with our intentions detailed in our 2021 outlook published last December. True, valuations remain high on a historical basis, and we are certainly not shielded from a more pronounced decline. However, we don't see the heights of equity multiples as a constraint to the bull market, a subject that we covered in a strategic report recently published.[5] Moreover, our sentiment indicator is neutral (Chart 21) which indicates relatively limited downside potential.

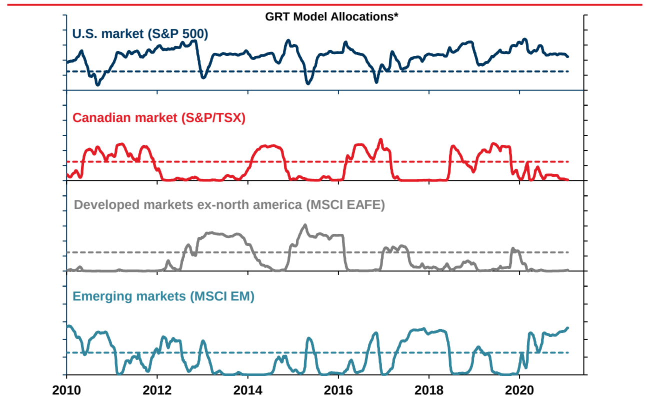
21 Market sentiment: Neither hot nor cold



CIO Office (data via Refinitiv, Bloomberg).

In the same vein, we are stepping up our latest moves in terms of geographic allocation by further reducing our exposure to the U.S. stock market in favour of emerging markets. The primary objective is to gradually increase the cyclicality of our portfolio strategy. The S&P 500 is more defensive in nature, whereas emerging markets are best positioned to benefit from a pick-up in global economic activity. In addition, the signal from our GRT Model toward EM strengthened in recent months, while it reached its lowest level since June 2019 in the U.S. (Chart 22).

22 Emerging markets moving up, U.S. moving down



CIO Office (data via Refinitiv).

[5] Shiller CAPE ratio higher than in 1929 : Are we in a bubble?

Table 3 Base Case Scenario

Scenario (prob.*)	Key elements and investment implications
Base case (70%)	• The coronavirus vaccination campaign provides immunization for the vast majority of the most-at-risk population in developed countries by the end of Q1-2021 and takes us near herd immunity mid-year. COVID-19 gradually becomes a secondary issue as pressure on the health care network subsides.
	• The strong global cyclical recovery continues. After a more challenging start of the year due to containment measures, the pace of growth accelerates in Q2-2021, driven by a gradual and permanent reopening of the economy, a rise in consumer sentiment, and a recovery in the service sector.
	• Central banks ensure highly accommodative monetary conditions as inflationary pressures remain muted. Asset purchases are extended and even increased if need be.
	• The majority of developed countries policy makers maintain a significant level of fiscal support to businesses and consumers.
	→ **Bond yields remain stable while the U.S. dollar depreciates. Global equities continue to rise along their long-term trend. Leadership remains volatile but edge in favor of cyclical and emerging markets equities. Mega-cap stocks lag.**
Bullish (15%)	• A multiplication of high-efficacy vaccine alternatives speeds up the immunization process. Countries remove the bulk of their containment measures earlier than expected.
	• The reopening of economies following a definitive victory against COVID-19 reveals an unsuspected pent-up demand. Consumer sentiment surges; excess savings accumulated during the pandemic translate into consumer spending. Inflation rises, albeit not high enough to cause discomfort among central banks, which keep their rates unchanged.
	→ **Bond yields rise modestly while the U.S. dollar depreciates. Global equities surge above their long-term trend. Small caps, cyclical, emerging markets and EAFE equities significantly outperform.**
Bearish (15%)	• Vaccination campaigns are delayed. The slowdown in economic growth expected in Q1-2021 extends into Q2-2021 due to an increase in COVID-19 cases, the extension of containment measures, and a sharp drop in consumer sentiment.
	• The new Biden administration reveals a few surprises in its first 100 days. Uncertainty over U.S. fiscal policy, Big Tech regulations and/or sino-american relations force markets to recalibrate their expectations.
	→ **Bond yields fall and the U.S. dollar shoots higher. Equities venture in correction territory. Leadership shifts to government and high-grade bonds. Defensive stocks outperform.**

*CIO Office. Last update: January 4, 2021 (updated quarterly unless an event demands a revision). *Subjective probabilities based on current market conditions and subject to change without notice.*

Table 4 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%	-	-	Early in a new economic cycle, the outlook for equities compares favourably to bond markets, which are showing yields close to an all-time low. Alternatives allow for better control of the total risk of the portfolio and offers protection against a potential recovery in inflation. Overall, this positioning is pro-risk.
Fixed Income	40%	-	31.0%	-9.0%	-	-	
Equities	60%	-	64.0%	4.0%	-	-	
Alternatives	0%	-	5.0%	5.0%	-	-	
Fixed Income							
Government	28%	73%	17.5%	-10.5%	55%	-18.3%	Highly accommodative monetary conditions and a gradual recovery in economic activity should lead corporate bonds to outperform government securities. For risk control purposes, we are sticking to investment grade credit. Treasury yields should remain close to current levels, with inflation expectations exerting only modest upward pressure on interest rates over the cyclical horizon.
Investment Grade	12%	27%	14.5%	2.5%	45%	18.3%	
High Yield	0%	0%	0.0%	0.0%	0%	0.0%	
Duration	*8.2 yrs*	-	*7.8 yrs*	-0.4 yrs	-	-	
Equities							
Canada	21%	35%	21.0%	0.0%	33%	-2.2%	Geographical mix broadly in line with the recommendations of our GRT model. We expect emerging markets to be the major beneficiaries of the weakening U.S. dollar environment. To diversify against a potential style rotation and add cyclicality, we favour the high-quality (MSCI Quality, 4% weight) dividend-paying (Div. Aristocrats, 4%) companies and the equal weight index (4%) in the U.S.
United States	21%	35%	21.0%	0.0%	33%	-2.2%	
EAFE	12%	20%	12.8%	0.8%	20%	0.0%	
Emerging markets	6%	10%	9.2%	3.2%	14%	4.4%	
Alternatives							
Inflation Protection	0%	0%	2.0%	2.0%	40%	40.0%	The macroeconomic environment remains very favourable to gold, with real interest rates likely to trend lower and the U.S. dollar to depreciate. Accordingly, TIPS should outperform their nominal counterparts, in addition to providing more direct inflation protection and little volatility. This asset mix offers low correlation with traditional assets.
Gold	0%	0%	3.0%	3.0%	60%	60.0%	
Non-Traditional FI	0%	0%	0.0%	0.0%	0%	0.0%	
Uncorrelated Strategies	0%	0%	0.0%	0.0%	0%	0.0%	
Foreign Exchange							
Canadian Dollar	61%	-	54.0%	-7.0%	-	-	Our overall portfolio strategy places us overweight in U.S. dollars versus our benchmark, mainly through our gold position. Although our base case scenario is consistent with a slight appreciation of the Canadian dollar, we maintain this positioning solely for hedging purposes as gold in CAD offers more attractive historical properties from a portfolio construction standpoint.
U.S. Dollar	21%	-	24.0%	3.0%	-	-	
Euro	5%	-	4.9%	0.3%	-	-	
Japanese Yen	3%	-	3.3%	0.2%	-	-	
British Pound	2%	-	1.8%	0.1%	-	-	
Others	9%	-	12.1%	3.4%	-	-	

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 color 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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General

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