NATIONAL BANK

ASSET ALLOCATION STRATEGY

May 1, 2018

Higher rates… volatility… commodities? Smells like late cycle

Highlights

- If you hope volatility will revert back to pre-February levels, think again, as politics continue to take the lion's share of attention in most investors' minds.
- We agree that traffic lights are slowly starting to transition from green to yellow as the U.S. dollar is close to a 2018 high, the Fed Funds rates are increasing, and rising bond yields offer a poor alternative to stocks. Now that the tax-cut boon is behind us, we are also starting to hear some "peak earnings growth" chatter caused by higher wage inflation and increasing corporate costs.
- However, we believe these factors are symptoms related to a late cyclical push, not a risk-off environment. Consequently, we think equities have good quarters ahead of them. The ride may be bumpier than what we were used to in recent years. But, for now, we still don't see any reason to change our bias favouring risk assets.
- For us, this means it is still too early to move back to government bonds. The U.S. 10-year yields have finally crossed the 3% mark for the first time since 2014, and the path of least resistance for bond yields remains upward.
- In that environment, corporate spreads (which remain above historical lows for both investment-grade and high-yield issues), still have room to narrow further. This should help offset losses from rising nominal yields.
- The spread differential between Canadian and U.S. yields has widened once again, but the Loonie resisted fairly well thanks to energy prices' strong overall performance, and should appreciate in the near term as relative growth expectations are near bottom lows.
- U.S. equities started the month with a fresh dip below the 200-day moving average following President Trump's threat to impose another $100 B in tariffs on China. They then rallied all the way back above their 50-day moving average, only to yet again test its lows, unsettled by rising Treasury yields and anxieties that the Q1-2018 earnings may be as good as they get.
- As long as corporations are living up to expectations and leading economic indicators suggest little to no recession risk over the medium term, equities should outperform safer alternatives.
- We also continue to favour Canadian equities over the S&P 500, reflecting our preference for (1) CAD-denominated assets and (2) value-oriented sectors that typically outperform at a later stage in the economic cycle.

Table 1 Global Asset Allocation

Global Classes	− Weights				+
Cash			■		
Fixed Income	■				
Equities					■
Fixed Income					
Federal		■			
Investment Grade			■		
High Yield (USD)			■		
Non-Traditional FI				■	
World Equities					
S&P/TSX				■	
S&P 500 (USD)		■			
MSCI EAFE (USD)			■		
MSCI EM (USD)				■	
Factors and Alternative Investments					
Value vs. Growth			■		
Small vs. Large			■		
Low Vol. vs. High Beta		■			
Canadian Dollar				■	
Commodities				■	
Energy				■	
Base Metals				■	
Gold			■		
Infrastructure			■		

Source: CIO Office

Current Allocation ■
Previous Allocation

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Market Review

Fixed income

- April saw U.S. 10-year yields briefly break above the psychological barrier of 3% for the first time in more than 4 years, before falling back to finish the month at 2.94%, 20 bps higher for the month.
- Rising inflation expectations have also pushed short-term U.S. rates higher, resulting in an almost unchanged yield curve for the period.
- A similar story transpired in Canada, with yields of government securities of all tenors up in April, hence the losses for bond indices.

Canadian equities

- S&P/TSX (C$) gains outpaced U.S. (US$), and EM (US$) equities for a third consecutive month, this time made possible by a strong rebound in the energy sphere.
- Nevertheless, gains were far from a one-sector story. Apart from Healthcare (~1% weight in the S&P/TSX), only interest rate sensitive sectors (Utilities, Real Estate and Staples) finished the period in negative territory.

U.S. equities

- The S&P 500 closed inches higher in April, its first positive month since January's upsurge, although still insufficient to bring the U.S. benchmark back in the green in 2018.
- Behind that flat reading hides quite a lot of volatility, with investors trying to balance among stellar earnings, trade tensions, rising inflation, and monetary policy tightening by the Fed.

Commodities

- Crude oil prices extended their rise, hitting their highest level since December 2014 on the back of increasing geopolitical risks in Syria, Iran and Venezuela, falling inventories, and few signs that OPEC and Russia are looking to end their supply cuts.

Foreign exchange

- The loonie climbed near the 0.80 U.S. cents mark at mid-month, supported by energy prices and rumours of improvements in NAFTA negotiations, but erased all gains in the last weeks with the Bank of Canada resuming its dovish tone.
- The U.S. Dollar index (DXY) delivered its best month since November 2016, i.e. Donald Trump's election, thanks to rising U.S. Treasury yields and inflation combined with a series of disappointing economic figures in the Eurozone.

Table 2 Market Returns

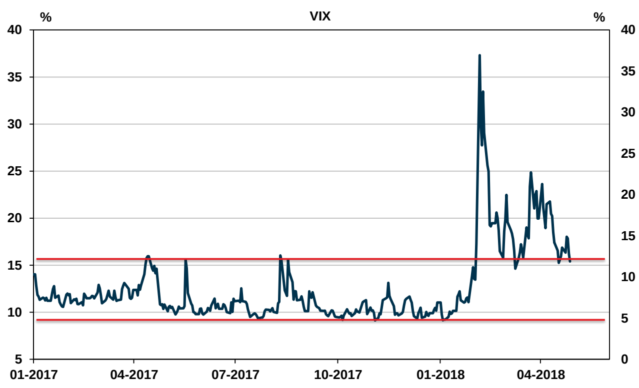
Asset classes	April	YTD	2017
Cash (3-month T-bills)	0.1%	0.4%	0.6%
Bonds (FTSE/TMX Ovr. Univ.)	**-0.9%**	**-0.8%**	**2.5%**
FTSE/TMX Short term	-0.1%	0.2%	0.1%
FTSE/TMX Mid term	-0.8%	-0.8%	1.0%
FTSE/TMX Long term	-2.0%	-2.0%	7.0%
FTSE/TMX Government	-1.0%	-0.9%	2.2%
Federal	-0.7%	-0.4%	0.1%
Provincial	-1.3%	-1.5%	4.3%
Municipal	-1.1%	-1.1%	4.7%
FTSE/TMX Corporate	-0.5%	-0.3%	3.4%
AA+	-0.2%	0.0%	0.7%
A	-0.7%	-0.5%	4.4%
BBB	-0.5%	-0.1%	4.0%
BoAML High-Yield (USD)	0.7%	-0.2%	7.5%
Preferred Shares	-0.4%	-0.6%	13.6%
Canadian Equities (S&P/TSX)	**1.8%**	**-2.8%**	**9.1%**
Energy	6.9%	-3.2%	-7.0%
Industrials	2.9%	0.2%	19.7%
Financials	0.6%	-2.9%	13.3%
Materials	0.4%	-3.9%	7.7%
Utilities	-1.6%	-7.3%	10.8%
Cons. Disc	1.2%	-1.7%	22.8%
Cons. Staples	-1.3%	-7.2%	7.8%
Healthcare	-3.6%	-16.6%	34.2%
IT	2.4%	12.9%	16.8%
Telecom	0.7%	-6.1%	14.8%
REITs	-0.3%	0.2%	11.2%
S&P/TSX Small cap	5.0%	-3.1%	2.8%
US Equities (S&P500 USD)	**0.4%**	**-0.4%**	**21.8%**
Energy	9.4%	2.9%	-1.0%
Industrials	-2.8%	-4.3%	21.0%
Financials	-0.4%	-1.3%	22.2%
Materials	0.2%	-5.4%	23.8%
Utilities	2.1%	-1.3%	12.1%
Cons. Disc	2.4%	5.5%	23.0%
Cons. Staples	-4.3%	-11.1%	13.5%
Healthcare	1.2%	0.0%	22.1%
IT	0.1%	3.6%	38.8%
Telecom	-1.0%	-8.4%	-1.3%
REITs	-0.6%	-5.6%	10.8%
Russell 2000 (USD)	0.8%	0.4%	13.1%
World eq. (MSCI ACWI)	**1.0%**	**0.2%**	**24.6%**
MSCI EAFE (USD)	2.4%	0.9%	25.6%
MSCI EM (USD)	-0.4%	1.0%	37.8%
Commodities (CRB index)	**1.9%**	**2.9%**	**2.2%**
WTI Oil (US$/barrel)	5.7%	13.4%	12.5%
Gold (US$/ounce)	-0.8%	0.7%	12.6%
Copper (US$/tonne)	1.4%	-6.1%	30.5%
Forex (DXY - US Dollar index)	**1.9%**	**-0.3%**	**-9.9%**
USD per EUR	-1.8%	0.6%	13.8%
CAD per USD	-0.4%	2.1%	-6.4%

Source: Datastream 4/30/2018

Volatility: Policy-induced in the short term…

If you hope volatility will revert back to pre-February levels, think again. Politics continue to take the lion's share of attention in most investors' minds, and the new post-correction range formed by the VIX (**chart 1**) has President Trump's fingerprints all over it.

1 VIX: the 2017 highs are now 2018 lows



Source: Datastream

We continue to witness an Art of the Deal inspired "over-threaten-under-sanction" pattern and, looking at the calendar, we should expect more of the same for the rest of 2018 as U.S. midterm elections will take centre-stage. In order to help the GOP maintain control of the house, the President will certainly try to consolidate and energize his base by pushing for protectionist policies which are sure to dominate the headlines.

Despite the assumption that logic eventually prevails over political posturing, investors remain nervous, and such an environment is conducive to outsized market gyrations in response to any signal that the economy has the potential to somewhat weaken.

We agree that traffic lights are slowly starting to transition from green to yellow as the U.S. dollar is close to a 2018 high, the Fed Funds rates are increasing, and rising bond yields offer a poor alternative to stocks. Now that the tax-cut boon is behind us, we are also starting to hear some "peak earnings growth" chatter caused by higher wage inflation and increasing corporate costs. However, we believe these factors are symptoms related to a late cyclical push, not a risk-off environment.

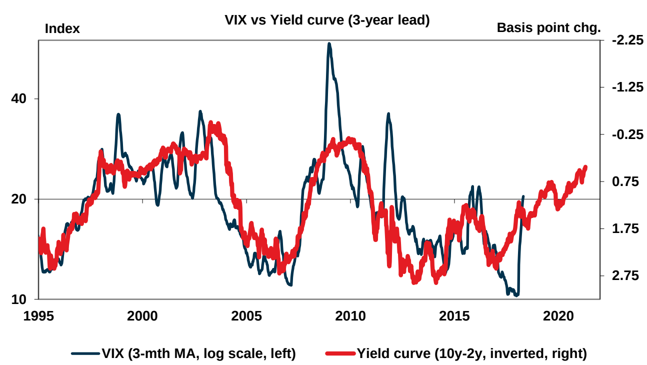
Consequently, we think equities have good quarters ahead of them. The ride may be bumpier than what we were used to in recent years. But, for now, we still don't see any reason to change our bias favouring risk assets.

…and cyclically inevitable in the longer term

A more cyclical aspect of higher-for-longer equity volatility is outlined by the flattening of the yield curve. Since 2010, the interest-rate spread between U.S. 3-month T-bills and 10-year T-notes has narrowed considerably, going from 4% to a low of about 1% recently. While most of the flattening was achieved by the back-end of the curve as weaker growth and inflation expectations pushed longer yields to historical lows, the recent contribution had more to do with the Federal Reserve withdrawing monetary policy accommodation.

As the yield curve is one of the best leading indicators of the economic cycle, the message couldn't be clearer: volatility has reverted to mean for a reason, and it will creep higher the closer we get to the end of the cycle (**chart 2**).

2 Volatility should stay high at this stage of the cycle



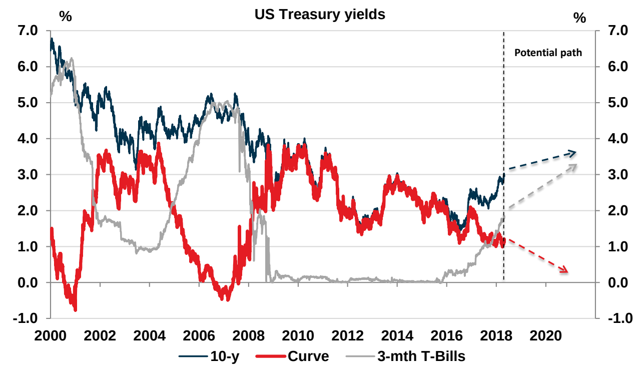
Source: Datastream

However, there is no need to panic, as big jumps in volatility only occur if the economy falls into recession, which tends to happen only when central banks slam on the brakes too hard on economic activity thereby causing an outright inversion of yield curves. In this aspect, we find there is hope.

For one thing, growth and inflation prospects have improved which should lead to higher longer-term yields. For another, while it is true that the Fed will likely pursue the tightening of its monetary policy for the same reasons, we believe it will keep a symmetric approach to inflation and wait for more evidence of overheating before changing its stance. This is to say that the yield curve, which currently stands at a 114 basis-point spread, could remain positive for much longer than perceived by market participants, pushing further away the likelihood of the next slowdown or recession (**chart 3**, next page).

We are not putting our head in the sand here, as we acknowledge that the global economy is most likely past peak growth. But, as shown last month, the ISM Manufacturing Index remains high enough to suggest that: cyclical activity is still buoyant; initial claims fell in April to their lowest level ever recorded, indicating ongoing job momentum; and consumer expectations continue to flirt with historical highs.

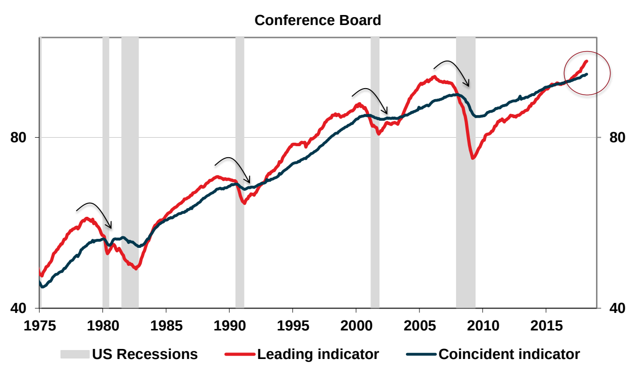
3 The curve should remain positive in the near term



Source: Datastream

Perhaps, the best way to sum it up is by looking at the Conference Board's Leading Economic Indicator (LEI). Not only has its pace of growth accelerated recently, but it continues to pull away from more coincident indicators. This is a good omen as, historically, no U.S. recession has ever happened without the LEI crossing paths with the Coincident Index first (**chart 4**).

4 No leading indication of recession



Source: Datastream

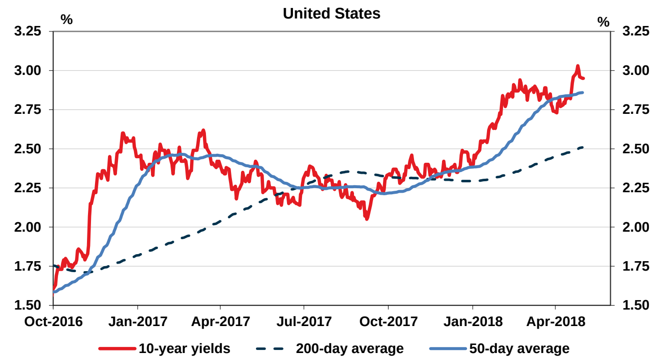
Fixed Income: The path of least resistance is up

For us, this means it is still too early to move back to government bonds. U.S. 10-year yields have finally crossed the 3% mark for the first time since 2014 (**chart 5**) and, although it will likely revolve around that level in the very near term, the path of least resistance for bond yields remains upward.

The main reason is that inflation (a lagging indicator of the cycle) is now in line with, if not a touch above, the Fed's implicit target of 2%, while leading economic indicators are signalling upward pressure is still to be expected (**chart 6**).

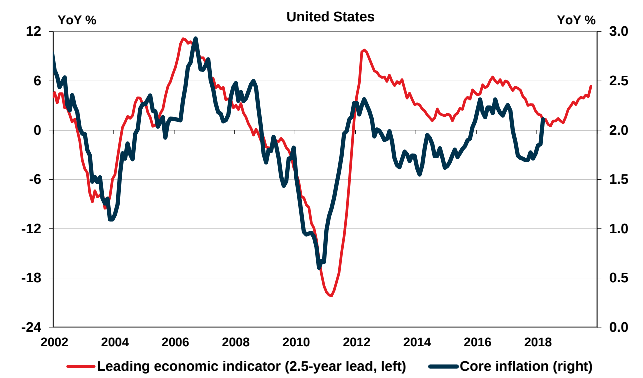
In that environment, corporate spreads which remain above historical lows for both investment grade and high-yield issues, still have room to narrow further (**chart 7**). This should help offset losses from rising nominal yields.

5 Benchmark rates testing the 3% mark



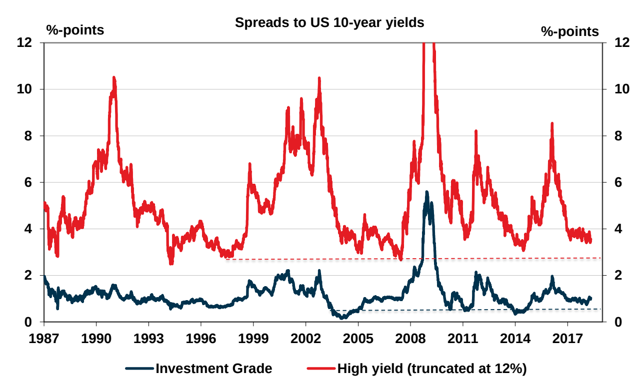
Source: Datastream

6 The path of least resistance is up



Source: Datastream

7 Corporate spreads have room to narrow down



Source: Datastream

Currencies: Talking down the Loonie

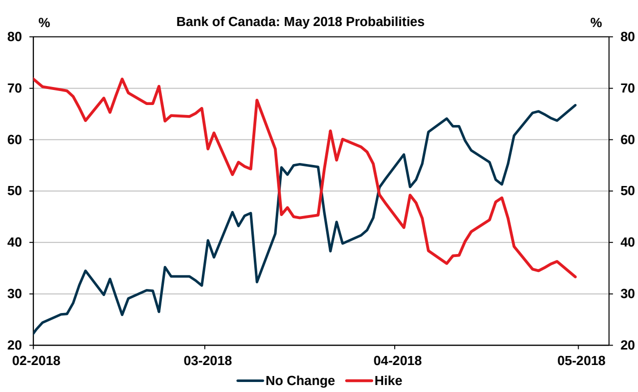
In Canada, the story is different as BoC Governor Poloz threw cold water on the Loonie's strong April start by striking a particularly dovish tone in recent public interventions. The weakness was generated by the Governor's approach regarding rising inflation and the resulting BoC's monetary policy response:

> *"Some people think it's more mechanical and that's fair; if inflation is going to be 2.3[%] you should be raising interest rates to make it 2.0 [%]… I want to go out of my way to help them appreciate that's not the way it works, and that's why I mention the range in context of a forecast that clearly shows the overshoot."*
>
> *- Governor Poloz, April 21, Washington*

Inflation isn't the only subject Mr. Poloz addressed as NAFTA is also on the table, and anyone expecting that a positive resolution on that front would prompt some response from the BoC will also be disappointed. The Governor stressed that such an outcome would not, by itself, constitute a clear signal for a hike, as business investments may take some time to recover from that episode. Uncertainty regarding some of the headwinds the domestic economy is facing, such as the state of the real estate market and household debt, also has an influence on his cautious approach.

Consequently, the chances of monetary policy tightening in May, which was a likely outcome a couple of weeks ago, has become more remote (**chart 8**).

8 Mr. Poloz sets the tone, and it's dovish

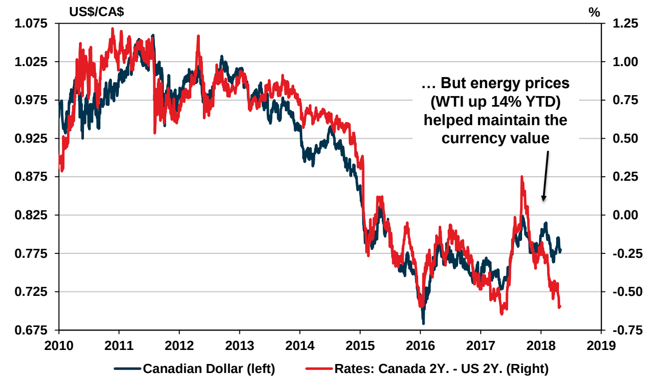


Source: Datastream

Of course, in light of these developments, the spread differential between Canadian and U.S. yields has widened once again. But, the Loonie still resisted fairly well, thanks to energy's strong overall performance (**chart 9**).

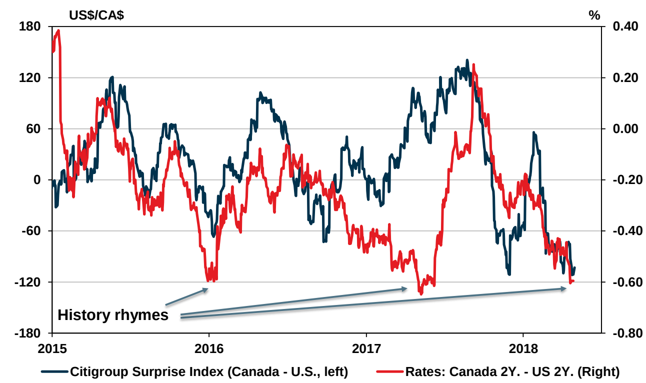
Unless we face worse-than-expected economic growth numbers or a sudden turn for the worse in energy markets, we still believe the Loonie will appreciate going forward. As for the Canada–U.S. yield spread, we doubt it will widen further, especially when expectations are now lower for Canada's future economic performance and we usually witness rebounds after such occurrences (**chart 10**).

9 The loonie is still a rate differential story…



Source: Datastream

10 Due for a rebound favoring Canada?



Source: Datastream

Additionally, our base case scenario still includes an agreement regarding NAFTA and, despite reluctance from Mr. Poloz to tie a hike to a positive development on that front, we think the Canadian dollar will react favorably once the deal is signed.

Commodities: Tailwinds abound

Commodities have been on a roll since the beginning of the year (**chart 11**, next page). Demand for products remains strong and political risks have started impacting prices. The list of tailwinds for commodities has been lengthening lately:

1. The U.S. has ramped up sanctions against Russian oligarchs and Rusal, the world's second largest Aluminium producer with a 6% share of global output, was the main victim. The news sent aluminum prices soaring (**chart 12**, next page). A softening stance from the U.S. on April 23 somewhat eased the initial blow, but uncertainty should support prices in coming quarters.

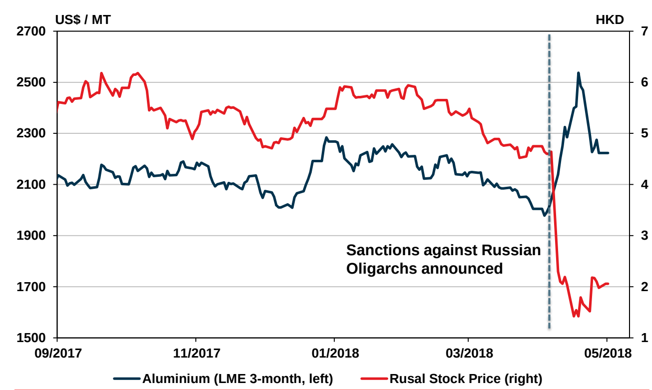
11 Commodities: Late-cycle push and political turmoil are acting as tailwinds

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 YTD
EM 56.3%	EM 26.0%	EM 34.5%	EM 32.6%	EM 39.8%	C$ per USD 25.1%	EM 79.0%	Gold 28.7%	Can Bonds 9.7%	EM 18.6%	US Small 38.8%	S&P 500 13.7%	C$ per USD 19.9%	US Small 21.3%	EM 37.8%	Commo. 7.3%
US Small 47.3%	EAFE 20.7%	Commo. 25.6%	EAFE 26.9%	Commo. 32.7%	Can Bonds 6.4%	US HY 57.5%	US Small 26.9%	Gold 9.6%	EAFE 17.9%	S&P 500 32.4%	S&P/TSX 10.6%	Can Bonds 3.5%	S&P/TSX 21.1%	EAFE 25.6%	C$ per USD 2.3%
EAFE 39.2%	US Small 18.3%	S&P/TSX 24.1%	Gold 21.7%	Gold 29.9%	Gold 3.9%	S&P/TSX 35.1%	EM 19.2%	US HY 4.4%	US Small 16.3%	EAFE 23.3%	C$ per USD 9.0%	S&P 500 1.4%	US HY 17.5%	S&P 500 21.8%	EM 1.0%
S&P 500 28.7%	Commo. 17.3%	Gold 17.5%	US Small 18.4%	EAFE 11.6%	Balanced -16.0%	EAFE 32.5%	S&P/TSX 17.6%	C$ per USD 2.5%	S&P 500 16.0%	S&P/TSX 13.0%	Can Bonds 8.8%	Balanced -0.2%	S&P 500 12.0%	US Small 14.6%	EAFE 0.9%
US HY 28.1%	S&P/TSX 14.5%	EAFE 14.0%	S&P/TSX 17.3%	S&P/TSX 9.8%	US HY -26.4%	US Small 27.2%	US HY 15.2%	S&P 500 2.1%	US HY 15.6%	Balanced 9.6%	Balanced 8.1%	EAFE -0.4%	EM 11.6%	Gold 12.8%	US Small 0.8%
S&P/TSX 26.7%	Balanced 11.4%	Balanced 11.4%	S&P 500 15.8%	Balanced 7.7%	S&P/TSX -33.0%	S&P 500 26.5%	S&P 500 15.1%	Balanced 1.6%	Balanced 8.6%	US HY 7.4%	US Small 4.9%	US Small -4.4%	Commo. 11.4%	Balanced 11.1%	Gold 0.5%
Commo. 20.7%	S&P 500 10.9%	Can Bonds 6.5%	Balanced 12.1%	S&P 500 5.5%	US Small -33.8%	Gold 22.9%	Balanced 10.9%	Commo. -1.2%	S&P/TSX 7.2%	C$ per USD 6.7%	US HY 2.5%	US HY -4.6%	Gold 7.7%	S&P/TSX 9.1%	US HY -0.2%
Balanced 19.8%	US HY 10.9%	S&P 500 4.9%	US HY 11.7%	Can Bonds 3.7%	S&P 500 -37.0%	Balanced 20.7%	Commo. 9.0%	US Small -4.2%	Gold 6.1%	Can Bonds -1.2%	Gold -1.7%	S&P/TSX -8.3%	Balanced 7.3%	US HY 7.5%	S&P 500 -0.4%
Gold 19.0%	Can Bonds 7.1%	US Small 4.6%	Can Bonds 4.1%	US HY 2.2%	EAFE -43.1%	Commo. 13.5%	EAFE 8.2%	S&P/TSX -8.7%	Can Bonds 3.6%	Commo. -1.2%	EM -1.8%	Gold -10.9%	Can Bonds 1.7%	Commo. 5.8%	Can Bonds -0.8%
Can Bonds 6.7%	Gold 4.8%	US HY 2.7%	C$ per USD -0.4%	US Small -1.6%	Commo. -46.5%	Can Bonds 5.4%	Can Bonds 6.7%	EAFE -11.7%	Commo. 0.1%	EM -2.3%	EAFE -4.5%	EM -14.6%	EAFE 1.5%	Can Bonds 2.5%	Balanced -0.8%
C$ per USD -18.2%	C$ per USD -7.3%	C$ per USD -2.5%	Commo. -15.1%	C$ per USD -15.2%	EM -53.2%	C$ per USD -15.1%	C$ per USD -5.2%	EM -18.2%	C$ per USD -2.2%	Gold -28.7%	Commo. -33.1%	Commo. -32.9%	C$ per USD -3.5%	C$ per USD -6.6%	S&P/TSX -2.8%

Source: Datastream

Balanced is composed of 50% Canadian bonds, 17.5% S&P 500, 17.5% S&P/TSX, 10% MSCI EAFE and 5% MSCI EM

12 Tactical missile: sanctions can affect commodity prices



Source: Datastream

2. President Trump's rhetoric about Iran and the nuclear deal, in addition to the appointment of foreign policy hawks such as John Bolton and Mike Pompeo, has ramped up the possibilities of sanctions on the country's oil exports being re-instated, and increases the risk-premium in the energy complex. The President has until May 12 to decide whether to extend the deal for 120 days, or let it lapse.

3. Venezuela's political and economic crises continue as the country's oil production dropped from 2.5 million barrels per day (BPD) in 2016 to 1.5 million BPD.

4. Continued tension between Saudi Arabia and Iran-backed Houthi rebels in Yemen increases the potential of missile strikes on energy production centres, which could disrupt the energy output in an already tight market.

5. Canadian crude continues to be landlocked. So, the benefit of increased production in Western Canada can't fully translate to supply in world markets. The WTI-to-WCS spread has tightened a bit, partly due to rumours of a rail deal which would remove some pressure regarding pipeline demand. But, the overall lack of exporting capacity remains on the short-term horizon, even if Kinder Morgan's Trans Mountain project is finally approved.

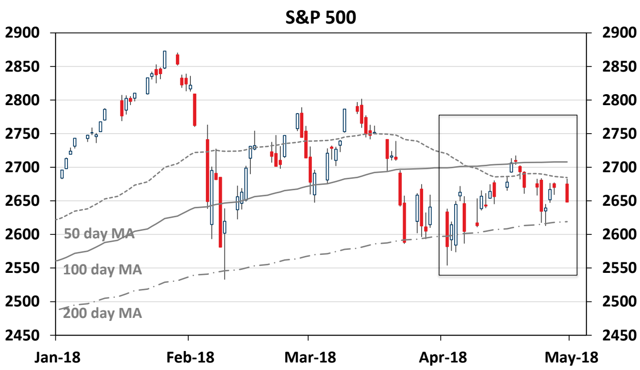
Political risks have more impact on commodity prices than other assets because they are more vulnerable to tariffs and operational roadblocks caused by trade wars. As the current momentum favours protectionism, we think this premium will remain and we expect outperformance from the asset class as the late cycle push continues.

Equities: It's all about earnings

Last month, we stated that "*with (1) the tax reform fully priced-in and, by extension, no longer here to dampen noise, (2) the Fed tightening, and (3) economic indicators already through the roof, investors should buckle up for a roller-coaster year.*" April was no exception.

Indeed, U.S. equities started the month with a fresh dip below the 200-day moving average following President Trump's threat to impose another $100 B in tariffs on China. They then rallied all the way back above their 50-day moving average, only to yet again test its lows, unsettled by rising Treasury yields and anxieties that the Q1-2018 earnings may be as good as they get (**chart 13**).

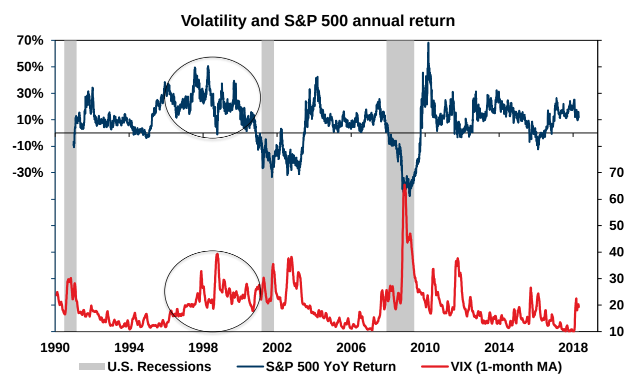
13 **Another month of ups and downs for U.S. equities**



Source: Datastream

Such gyrations surely affect investor sentiment. But it's important to keep in mind that higher volatility doesn't necessarily mean poor equity returns (**chart 14**).

14 **Volatility doesn't necessarily mean poor returns…**



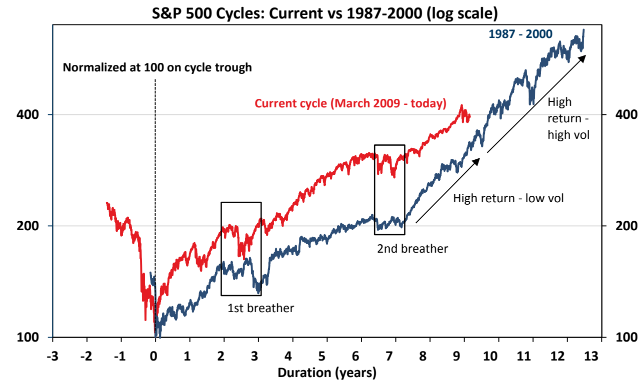
Source: Datastream

As pointed out in previous pieces, the 1987-2000 S&P 500 cycle is a good example of exactly that. As long as corporations are living up to expectations and leading economic indicators suggest little to no recession risk over the medium term, equities should outperform safer alternatives (**chart 15**).

Still, the importance of rising Treasury yields shouldn't be overlooked. As "risk-free" rates creep higher, expected returns on risk assets also need to improve. Otherwise why would you then take that extra risk? The good news is that's exactly what happened, with the S&P 500 earnings yield (the inverse of the P/E ratio) having significantly increased over the last two months (up from 5.3% to 6.1%). That's faster than the U.S. 10-year bond yields rise and, thus, why the earnings-based equity risk premium (ERP) has actually improved lately (**chart 16**).

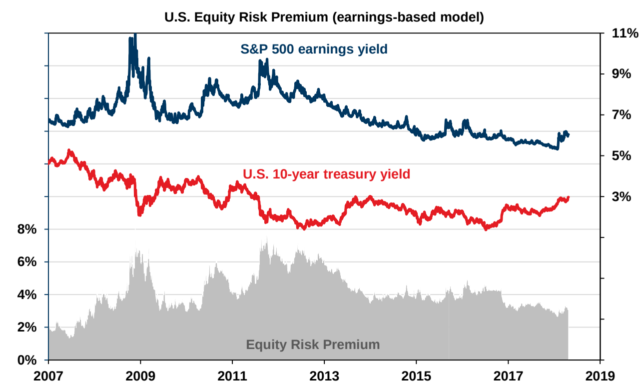
Admittedly, that metric is not suggesting that stocks are a bargain: the ERP remains stuck in the lower end of its last 10-year range. The point we're making is that concerns about money potentially flowing out of equities and into the bond market because Treasury yields have broken above a psychological level appear to be exaggerated. Equities have also become cheaper, and at a faster pace.To put it simply, higher rates imply that investors are less willing to pay high multiples for equities. Hence, the growing importance of corporate earnings as drivers of equity returns.

15 **… as shown by the 1987-2000 S&P 500 cycle**



Source: Datastream

16 **Rates are higher… and so is S&P 500 earnings yield**



Source: Datastream

On that front, solid global growth and tax cuts have pushed the bar quite high. But it appears companies are once again delivering, on track for 24.9% year-over-year earnings growth for Q1-2018 (**chart 17**, next page).

In such context, we stick to our equity over bonds stance, as we expect earnings growth to outweigh potential further ratio compression resulting from rising rates.

We also continue to favour Canadian equities over the S&P 500, reflecting our preference for (1) CAD-denominated assets (see

17 Earnings are once again living up to expectations

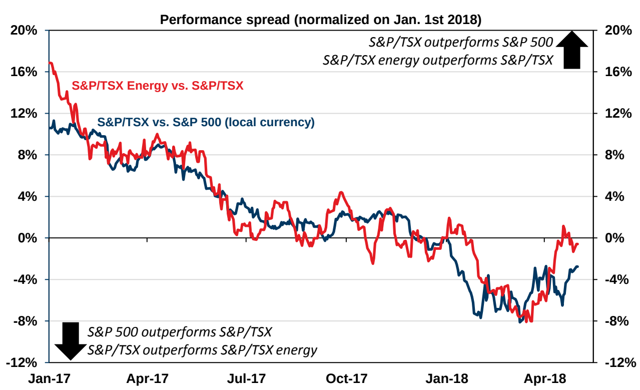
	Earnings Summary - S&P 500				Q1/2018 YoY%
	% Reported	% Beat	% Met	% Missed	Blend*
S&P 500	58%	80%	7%	13%	24.9%
Health Care	54%	97%	0%	3%	15.2%
Technology	48%	94%	6%	0%	33.5%
Staples	47%	88%	0%	13%	12.7%
Financials	77%	83%	9%	8%	29.8%
Industrials	77%	81%	7%	11%	25.5%
Materials	56%	71%	7%	21%	29.1%
Energy	55%	71%	12%	18%	82.8%
Discretionary	49%	70%	8%	23%	16.6%
Real Estate	58%	63%	11%	26%	3.0%
Telecom	67%	50%	0%	50%	14.1%
Utilities	36%	50%	10%	40%	12.1%

Source: Datastream

currencies section), and (2) Value-oriented sectors that typically outperform at a later stage in the economic cycle.

Though still tentative, this has proven to be good positioning of late, with the S&P/TSX posting better monthly performance than U.S. equities for a third consecutive month (in local currency), this time largely on the back of strong rebound in the energy sphere (**chart 18**).

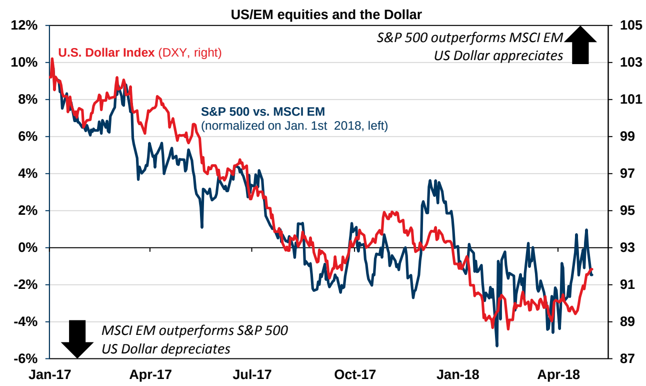
18 Canadian and energy stocks slowly gaining ground…



Source: Datastream

For their part, emerging markets (EM) equities have slightly lagged their counterparts in April, affected by trade tensions, weakness in some of the tech heavyweights, and USD strength (**Chart 19**).

19 …while emerging markets got left behind



Source: Datastream

Short episodes of underperformance were to be expected at some point, as stated in our *Grown-Up Emerging Markets* Strategic Report of March 2018. But, with nothing having significantly changed, fundamentally speaking, we continue to believe EM equities will finish the year as leaders.