



A Merry 2019... and a Happy New Year?

Highlights

- > Many investors were in low spirits at this time last year, a period where nearly all assets offered losses and the U.S. equity market had just undergone its worst December since 1931. Fast forward to today and we are looking at just the opposite picture, with 100% of the main risk assets that we track in positive territory on a year-over-year basis. Now what should we expect for 2020? To answer this question, we'll go through our assessment of the four key pillars of asset allocation, namely, (1) monetary conditions, (2) global growth, (3) valuations, and (4) investors sentiment.
- > The bottom line? With monetary conditions set to remain accommodative and global growth bottoming out, 2020 is shaping up to be a positive year for risk assets. However, investors must temper their return expectations given the already high level of valuation for most financial assets. What's more, high optimism currently reflected in the markets calls for some prudence in the near term. Under these circumstances, we still consider our modest overweight in equities as the right positioning.
- > Within the equity market, we are well aware of a growing consensus in favour of shifting assets away from the U.S. market and into more cyclical indices such as Canada's S&P/TSX and the MSCI Emerging Markets – a legitimate choice assuming that global growth does indeed accelerate. Yet, it is specifically for this reason that we are already holding more of these last two regions than what our GRT model currently recommends. Therefore, we're keeping our geographical asset mix unchanged for now, but could soon bring up changes depending on how trends evolve.
- > In the bond market, the backdrop of rising inflation, better growth and stable overnight policy rates should lead to steeper yield curves through modestly higher long-term interest rates. Against this background, shorter duration spread products should fare relatively well within the fixed-income space, but we don't expect returns much better than their current yield-to-maturity.
- > Turning to the FX market, we expect the U.S. dollar to face some headwinds in the coming months as global growth rebounds and the risk-on mood is reflected as such in the FX space. This should in turn support the Canadian dollar which has so far benefitted only slightly from the USMCA's ratification and a sharp rise in interest rate spreads late last year. That said, the Loonie's upside potential seems limited so long as the Bank of Canada doesn't adopt a more hawkish tone, something we don't foresee for now.
- > In the commodity space, crude oil prices are likely to remain strong this year, benefitting from sustained OPEC+ supply cuts, growing demand, reduced trade uncertainties, and a weaker U.S. dollar. As for gold, while it also tends to benefit from dollar weakness and provides a good hedge against most of the key risks prevailing this year, we don't see the precious metal maintaining its 2019 momentum under our base case scenario.
- > Speaking of risks, we'll have to closely follow various inflation measures through the year. They should tell us whether monetary tightening is coming sooner than expected, or if recent monetary easing fails in its attempt to re-anchor inflation expectations on target. Geopolitics should also keep investors on their toes as tensions between the U.S. and China – albeit not as severe as last year – could take markets by surprise. And, finally, the U.S. Presidential campaign is likely to bring its share of uncertainties, as investors and businesses will have to weigh in the potential for higher taxes and greater regulatory burden against four more years of *Trumpism*. These are the three key risks for 2020.

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					

CIO Office

Current Allocation

Previous Allocation

2019 Market Review

Fixed Income

- > Coming off four rate hikes in 2018, the Federal Reserve changed course last July and subsequently delivered three straight cuts; easing monetary policy was mirrored by a majority of central banks throughout the world.
- > As a result of this falling rate environment, fixed-income products made stellar gains throughout most of the year with the FTSE/TMX Overall Universe posting its best yearly return since 2014.

Canadian Equities

- > In contrast to 2018, last year saw stocks soar on the back of higher valuations, with the S&P/TSX's price earnings ratio finishing near its 30-year average.
- > The top performers were the bond-like Utilities sector as well as IT stocks, the latter's performance driven in large part by gains from Shopify and CGI.
- > Healthcare was the only sector which failed to grow by the end of 2019, its poor performance in large part due to weakness from cannabis companies.

U.S. Equities

- > The top performing major geography, U.S. stocks bounced back from a poor 2018 to post their best year since 2013.
- > Easier monetary policy and a de-escalation of trade tensions between Trump's White House and China late in the year helped the S&P 500 finish the year near record levels.
- > Every sector managed to post double-digit returns, with the Information Technology and Communication Services sectors taking the top two spots, benefitting from a sustained rally in FANG stocks throughout the year.

Commodities

- > Political instability in Venezuela and a drone attack temporarily freezing nearly half of Saudi Arabian's production helped make 2019 a year of heightened volatility in the oil market, with the WTI's trading range growing wider than \$20/bbl from its trough in January to its peak in April.
- > The black gold eventually finished the year as the top-performing major asset class, spurred on by early-December OPEC+ led cuts equivalent to nearly 2% of the world's supply of oil.
- > Meanwhile, gold also impressed, as geopolitical and economic uncertainties helped the lustrous metal climb above the \$1500/ounce mark back in August.

Foreign Exchange

- > Rising Sino-American tariffs in the first half of last year put pressure on the Yuan, as the Chinese currency broke through the 7RMB per USD mark back in August.
- > Amid this tension, the U.S. dollar index rose to a peak of 99.38 before returning to near where it began the year as geopolitical risks became less prominent.
- > Unlike its neighbour to the south, the Loonie appreciated throughout much of this past year on the back of improving rate differentials between the two countries' central banks.

Table 2 Market Total Returns

Asset Classes	December	Q4	2019
Cash (3-month T-bills)	0.1%	0.4%	1.6%
Bonds (FTSE/TMX Ovr. Univ.)	-1.2%	-0.9%	6.9%
FTSE/TMX Short term	-0.2%	0.1%	3.1%
FTSE/TMX Mid term	-1.1%	-1.1%	5.8%
FTSE/TMX Long term	-2.5%	-1.9%	12.7%
FTSE/TMX Government	-1.4%	-1.2%	6.4%
Federal	-1.1%	-1.1%	3.7%
Provincial	-1.8%	-1.3%	9.1%
Municipal	-1.5%	-0.9%	8.8%
FTSE/TMX Corporate	-0.5%	0.1%	8.1%
AA+	-0.2%	0.2%	4.8%
A	-0.9%	-0.2%	9.6%
BBB	-0.4%	0.2%	9.0%
BoAML High-Yield (USD)	2.1%	2.6%	14.4%
Preferred Shares	2.5%	3.9%	3.5%
Canadian Equities (S&P/TSX)	0.5%	3.2%	22.9%
Energy	6.3%	7.1%	21.7%
Industrials	0.5%	5.2%	25.5%
Financials	-2.5%	1.0%	21.4%
Materials	4.9%	7.8%	23.8%
Utilities	-0.1%	2.0%	37.5%
Cons. Disc	-3.4%	-2.3%	15.3%
Cons. Staples	-5.0%	-3.9%	14.4%
Healthcare	1.4%	-5.9%	-10.9%
IT	3.2%	10.8%	64.9%
Comm. Svc.	-1.5%	0.9%	13.0%
REITs	-2.5%	-2.4%	22.6%
S&P/TSX Small Cap	5.4%	6.2%	15.8%
US Equities (S&P500 USD)	3.0%	9.1%	31.5%
Energy	6.0%	5.5%	11.8%
Industrials	-0.1%	5.5%	29.4%
Financials	2.7%	10.5%	32.1%
Materials	3.1%	6.4%	24.6%
Utilities	3.4%	0.8%	26.3%
Cons. Disc	2.8%	4.5%	27.9%
Cons. Staples	2.4%	3.5%	27.6%
Healthcare	3.6%	14.4%	20.8%
IT	4.5%	14.4%	50.3%
Comm. Svc.	2.0%	9.0%	32.7%
REITs	1.3%	-0.5%	29.0%
Russell 2000 (USD)	2.7%	9.5%	23.7%
World Eq. (MSCI ACWI)	3.6%	9.1%	27.3%
MSCI EAFE (USD)	3.3%	8.2%	22.7%
MSCI EM (USD)	7.5%	11.9%	18.9%
Commodities (CRB index)	3.9%	3.6%	-1.9%
WTI Oil (US\$/barrel)	10.7%	13.0%	35.1%
Gold (US\$/ounce)	4.0%	3.2%	18.7%
Copper (US\$/tonne)	5.2%	8.0%	3.4%
Forex (DXY - US Dollar index)	-1.9%	-3.0%	0.2%
USD per EUR	1.8%	3.0%	-1.8%
CAD per USD	-2.2%	-1.9%	-4.8%

CIO Office (data via Refinitiv)

2019-12-31

A Merry 2019...

Many investors were in low spirits at this time last year, a period where nearly all assets offered losses and the U.S. equity market had just undergone its worst December since 1931. Fast forward to today and we are looking at just the opposite picture, with 100% of the main risk assets that we track in positive territory on a year-over-year basis (Chart 1).

1 After a rainy 2018...



Indeed, whatever the asset class, sector, term, credit, region or factor, 2019 has seen solid gains across the board, with U.S. equities standing at the top of the podium (Chart 2).

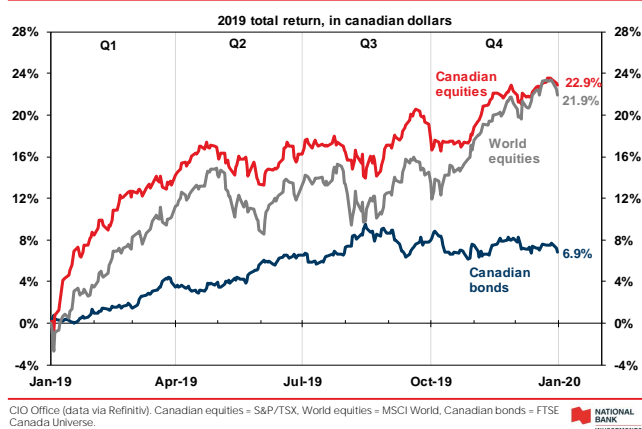
2 ... a merry ...

Market total returns - 2019						
Cross Assets	S&P/TSX Sectors	S&P 500 Sectors	Fixed Income	Equity Regions (in C\$)	U.S. Factors	CA Factors
S&P 500	Techno	Techno	HY (US)	U.S.	Quality	Momentum
31.5%	64.9%	50.3%	14.4%	24.8%	39.1%	29.1%
US Small	Utilities	Materials	IG (US)	Canada	Growth	High Div.
25.5%	37.5%	44.9%	14.2%	22.9%	37.7%	25.8%
S&P/TSX	Industrials	Comm. serv.	Long (Can)	World	Low Vol.	Quality
22.9%	25.5%	32.7%	12.7%	20.9%	35.0%	24.9%
EAFE	Materials	Financials	Prov. (Can)	Europe	Large	Low Vol.
22.7%	23.8%	32.1%	9.1%	18.3%	31.8%	24.1%
EM	S&P/TSX	S&P 500	Muni. (Can)	EAFE	MSCI USA	Small
18.9%	22.9%	31.5%	8.8%	16.5%	31.6%	23.6%
Commo.	Real Estate	Industrials	Corp (Can)	Asia (EM)	Momentum	S&P/TSX
17.6%	22.6%	29.4%	8.1%	13.6%	28.1%	22.9%
Balanced*	Energy	Real Estate	Overall (Can)	Japan	Small	Growth
15.5%	21.7%	29.0%	6.9%	13.2%	27.4%	22.3%
US HY	Financials	Disc.	Mid (Can)	Emerg Mkts	Value	Large
14.4%	21.4%	27.9%	5.8%	12.9%	25.7%	21.9%
Can Bonds	Disc.	Staples	Fed. (Can)	LatAm (EM)	High Div.	Value
6.9%	15.3%	27.6%	3.7%	11.9%	22.5%	19.1%
Can Pref.	Staples	Utilities	Pref. (Can)	EMEA (EM)		
3.5%	14.4%	26.3%	3.5%	10.4%		
C\$ per USD	Comm. serv.	Health Care	Short (Can)			
-5.1%	13.0%	20.8%	3.1%			

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\$).

Of course, these returns did not come in a straight line, with the vagaries of the U.S./Chinese tariffs spat, a first U.S. yield curve inversion since 2007, and persistent slowdown in global manufacturing activity all fueling recession fears and causing great volatility during the second and third quarters. Yet these clouds have dissipated more recently, with the world's two biggest economies reaching a "phase one" trade agreement, economic green shoots accumulating, and global central banks in no rush to withdraw their easy monetary policies. This explains why stocks finished the year so strongly and fixed-income assets stagnated (Chart 3).

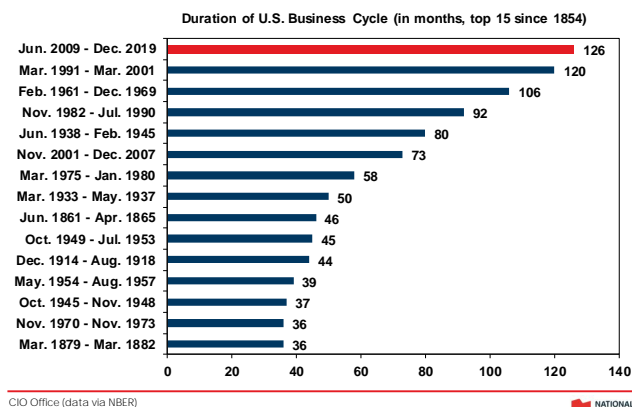
3 ... and busy 2019



... and a Happy New Year?

Now, what should we expect for 2020? Will the current business cycle – now officially the longest in the U.S. history (Chart 4) – carry on? In which case, stocks should continue to outperform. Or, is it time for a more conservative asset mix? To answer these questions, let us go through our assessment of the four key pillars of asset allocation as we enter the new decade, namely, (1) monetary conditions, (2) global growth, (3) valuations, (4) and investors sentiment.

4 Will the current business cycle carry on in 2020?



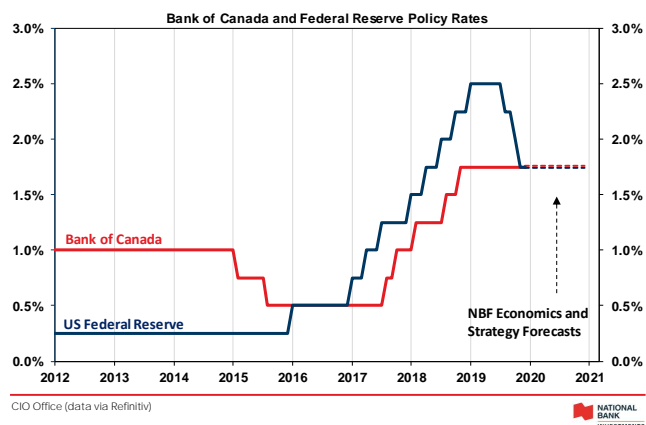
CIO Office (data via NBER)

1. Monetary Conditions

Monetary policies of major central banks should remain accommodative this year, with the Federal Reserve and the Bank of Canada likely to keep their target rates unchanged over the period (Chart 5, next page). This is a completely different backdrop from this time last year and is one of the strongest arguments in favour of risk assets over the next 12 months.

Recall that the main reason behind the equity market correction of December 2018 was the fear of restrictive monetary policies, whereas the Federal Reserve was signalling two potential rate hikes for 2019, after having raised them four times the year before. Yet, faced with a slowing manufacturing sector, a yield curve inversion, a highly unpredictable trade war,

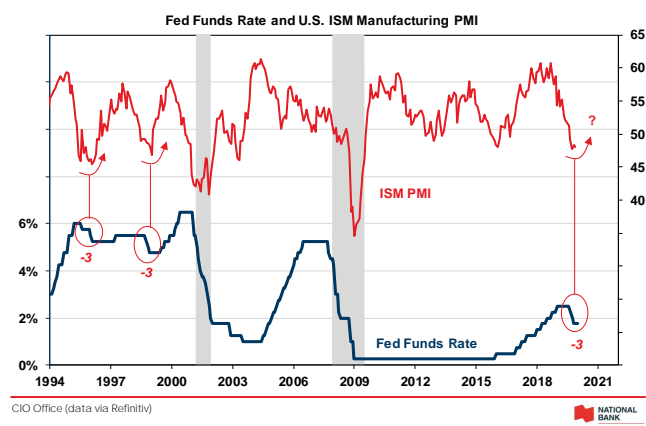
5 Monetary policies should remain accommodative...



and muted inflation, the Fed ultimately delivered three rate cuts instead.

How is that a good omen for this year? Well, first, this is a game plan that has already worked twice back in the 1990s, contributing to a rebound in economic activity in subsequent years (Chart 6).

6 ... with the Fed's recent rate cuts a good omen

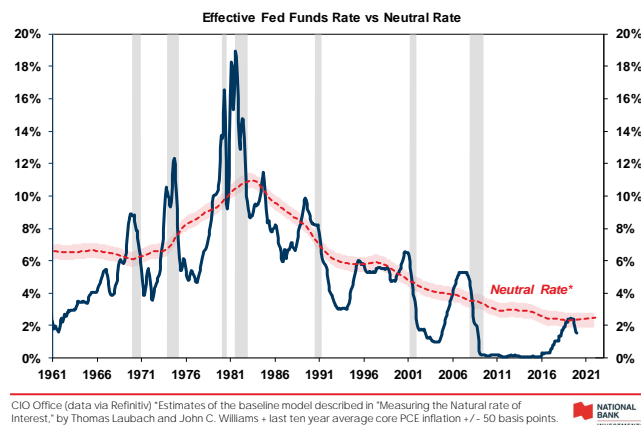


Second – and most importantly – history has shown that business cycles don't die of old age, but of restrictive monetary policies. Each of the last seven recessions since 1960 was preceded by a period of substantially above-neutral policy rates, something we still haven't reached yet (Chart 7).

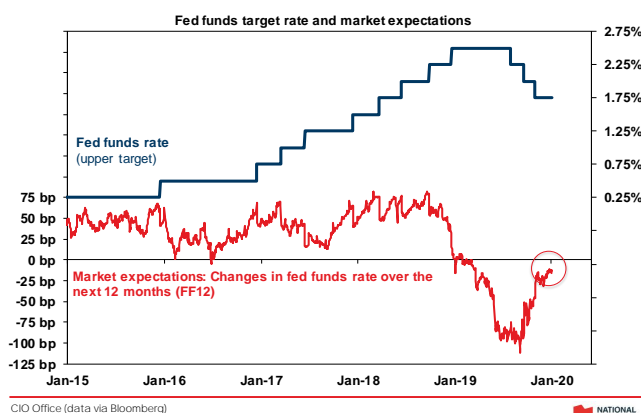
Now, if global growth does indeed accelerate and trade tensions continue to ease, won't the Federal Reserve resume its rate hike agenda? Ultimately, yes, but we don't believe – and neither do markets (Chart 8) – that this will occur in 2020.

The main reason behind this belief is the low inflation environment in which the U.S. has found itself over the last decade, with the Federal Reserve's official price gauge evolving persistently below target over the period (Chart 9).

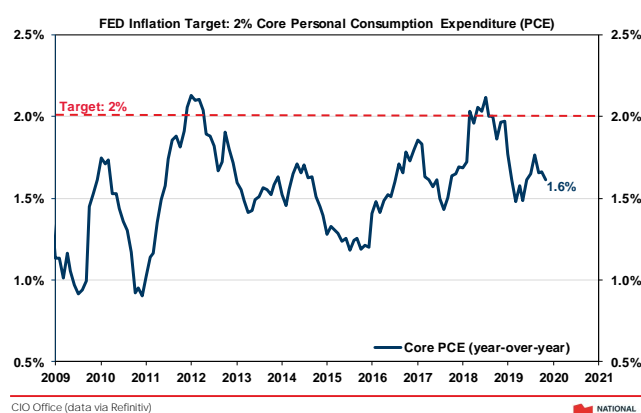
7 Business cycles don't die of old age... ... but of restrictive monetary policies...



8 ... which is unlikely for 2020...

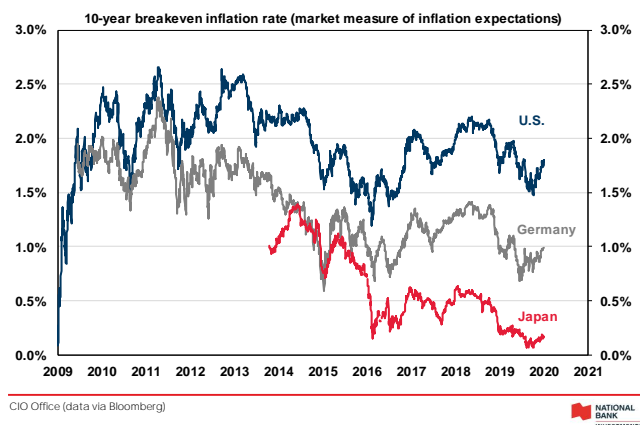


9 ... as the Fed first wants to see higher inflation...



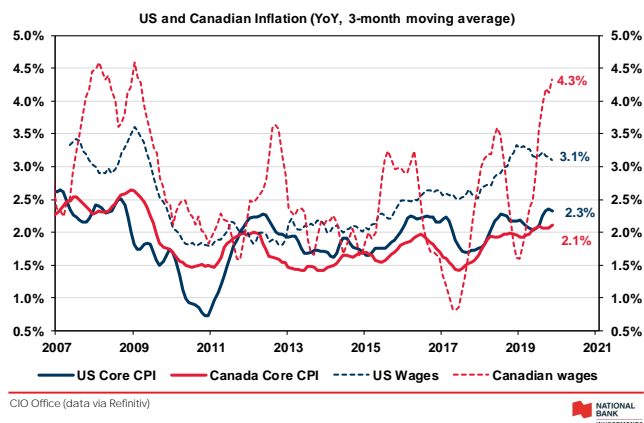
Fed officials fear that consumers and businesses will come to expect permanently weaker inflation, creating a self-fulfilling prophecy which would only undermine monetary policies' effectiveness as we've seen in Japan and, more recently, in Europe (Chart 10, next page).¹

¹ For a more detailed analysis of the importance of inflation for monetary policy and a healthy economy, see our August 2019 Report (*Start With Why*).

10 ... so as to avoid the problems of their peers overseas

Concretely, this implies that the Fed now wants to see inflation “that’s persistent and that’s significant” before even thinking about moving rates higher, as Jerome Powell put it during his December 11 press conference. This leaves the Central Bank in a good position to remain on the sidelines in this Presidential election year.

Could it be that economic agents are all underestimating the potential for higher inflation, in which case rate hikes are closer than we think? Absolutely. In fact, other measures of inflation such as the core CPI and wages have been on the rise lately, especially on our side of the border (Chart 11). That said, the opposite, sustained low inflation, is just as possible judging by the Japanese experience – a scenario bullish for risk assets in the medium-term as it would ensure easy monetary policies and higher stock valuations, but more concerning for the long-term sustainability and stability of the business cycle.

11 Could inflation surprise to the upside? Yes

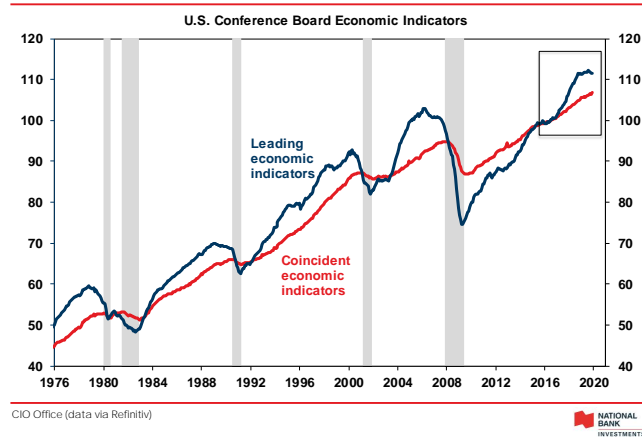
In short, the key takeaway is that monetary conditions are likely to remain accommodative this year, a tailwind to risk assets that should exert modest upward pressure on longer-term Treasury bond yields. The magnitude (or lack thereof) of changes in inflation in this context of an aging business cycle will warrant close monitoring and is our first key risk for 2020.

2. Global Growth

With a large majority of central banks having reduced their reference rates in recent months, global growth should rebound this year (Chart 12).

12 Global growth should rebound this year

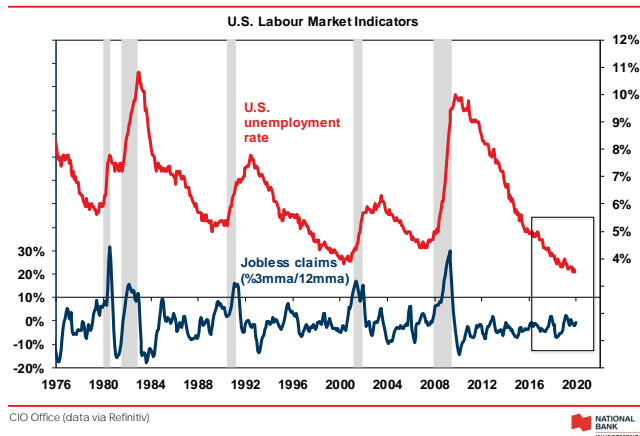
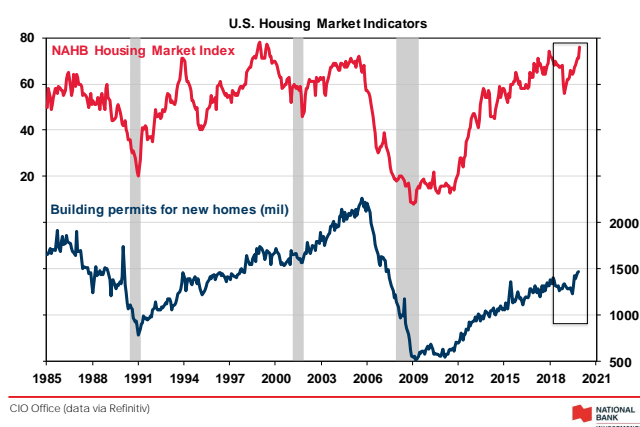
Beyond monetary policy, we are also encouraged by the strength of the U.S. Conference Board Leading Economic Indicator Index (LEI) which unsurprisingly slowed down last year, but nevertheless continues to suggest further growth ahead (Chart 13).

13 U.S. economic fundamentals are still supportive...

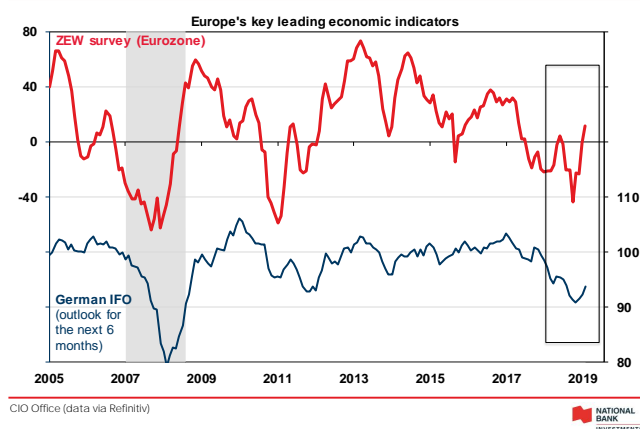
This can partly be explained by a buoyant labour market, with both the weekly jobless claims and the unemployment rate still a long way from recessionary levels (Chart 14, next page).

We should also mention the significant upturn in housing market activity observed lately, with the U.S. Home Builder Confidence Index (NAHB) climbing to a 20-year high and building permits to a 12-year high in December (Chart 15, next page).

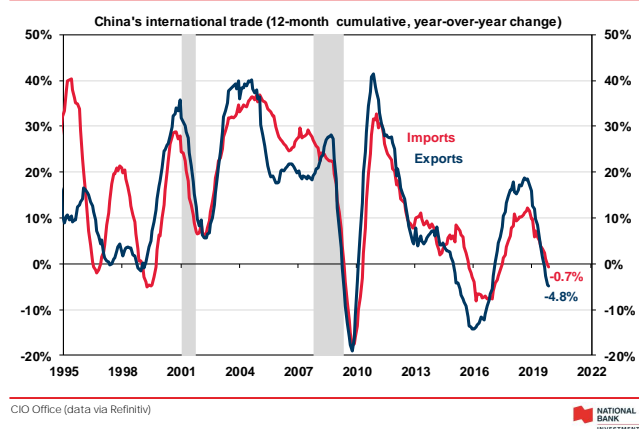
Turning to Europe the context is likely to remain challenging in 2020 with the lack of monetary ammunition on the European Central Bank side, Germany's reluctance to provide fiscal stimulus, and persistent tariff threats from the Trump

14 ... thanks to a buoyant labour market...**15 ... and an upturn in housing market activity**

administration all clouding the region's outlook. On the other hand, we may well be surprised by Europe this year given its pro-cyclical nature and now that Brexit uncertainties have abated. In fact, we are already seeing an upturn in two key European forward-looking measures, a trend we will be watching closely as the year begins (Chart 16).

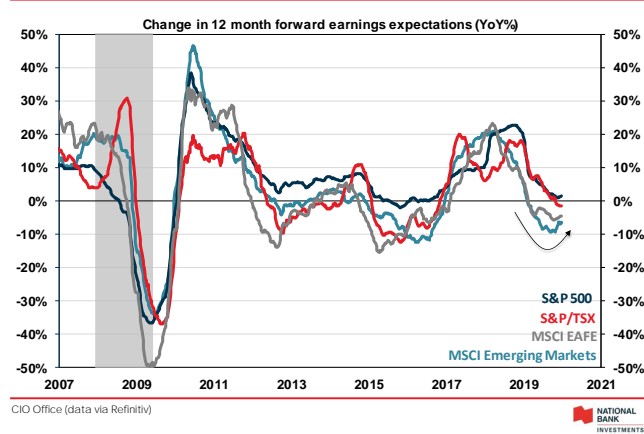
16 Will growth in Europe finally improve?

Finally, let's not forget China, a country that has seen both its exports and imports contract in a year marked by escalating trade tensions with the United States (Chart 17). There is reason for optimism now that the two superpowers have secured an interim deal which includes some tariff rollbacks and suspends new ones. But, let's not harbour any illusions. Many details have yet to be confirmed, as the 86-page agreement (expected to be signed by both parties on January 15) still hasn't been made public. Once signed, will Chinese compliance match President Trump's expectations? Answering a similar question, U.S. trade representative Robert Lighthizer said: "A sceptic would say 'we'll see.' That's probably a wise position to take."

17 Tough year for international trade in China

In any case, we continue to believe that the worst of the tariff spat is behind us as both parties have incentives to reduce trade policy uncertainty, a respite that should pave the way for a resumption of global growth in 2020. But, with fundamental disagreements far from resolved and given President Trump's fiery temper, we still maintain Sino-American tensions as the second key risk for the year – a less prominent but still present source of uncertainty.

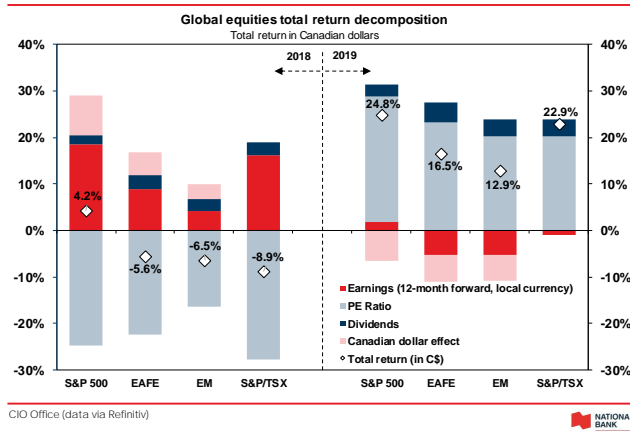
Against this background, we expect the trend in global corporate earnings to turn positive and support risk assets' outperformance in 2020 (Chart 18).

18 The trend in corporate earnings should turn positive

3. Valuations

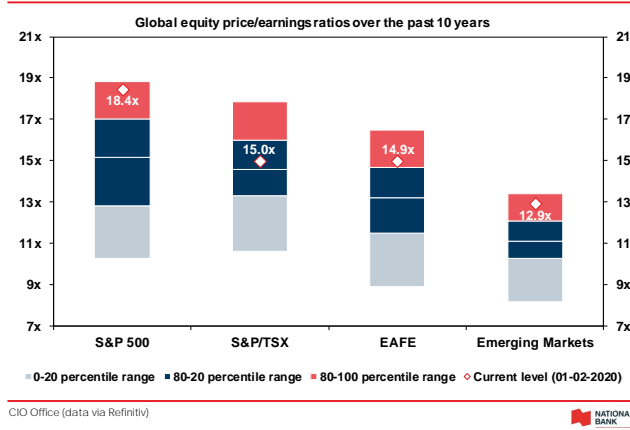
Equity valuations have travelled a long way over the last two years, explaining most of the losses in 2018... and the gains in 2019 (Chart 19).

19 Equity ratios explain most of the last two years...



This run leaves the price/earnings multiples for most equity indices in the upper end of the historical range (Chart 20).

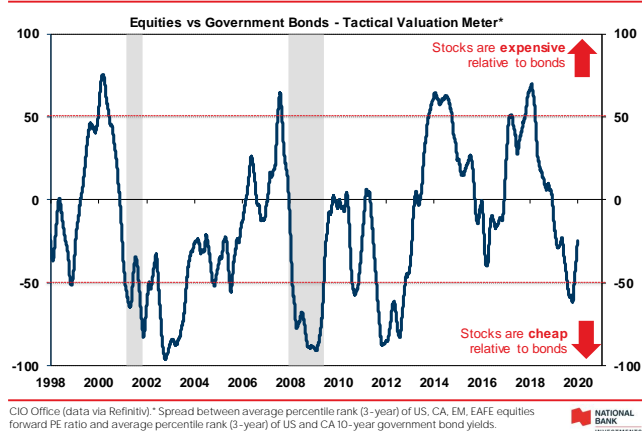
20 ... and are not cheap on an absolute level...



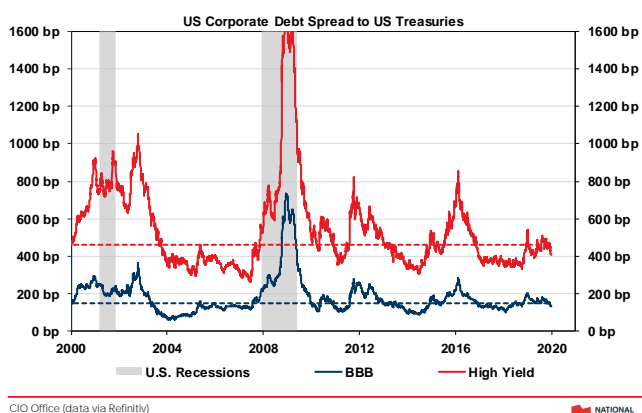
But, when put in the context of the sharp decline in bond yields, stock valuations are far from flashing red. Quite the contrary, our stock/bond valuation meter actually signalled a value opportunity in favour of equities relative to bonds late last summer – a wise call thus far – and remains a distance from worrying levels for stocks (Chart 21). Does that mean that PE ratios will continue to expand and fuel the bulk of equity returns in 2020? No, but their historically high levels should not be a drag on stock market returns as long as interest rates do not start climbing too fast.

Similarly, corporate credit spreads are not cheap. But, they do not exhibit exuberance as they remain closer to their historical average than to their low levels of 2017 (Chart 22). This valuation backdrop – combined with our expectations for easy monetary policies and accelerating global growth – should lead to modest outperformance of credit products over Treasury securities.

21 ... but are so on a relative basis



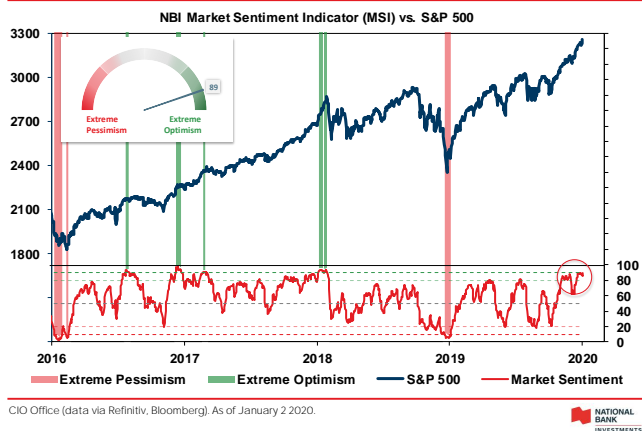
22 Credit spreads: not cheap, not exuberant



4. Sentiment

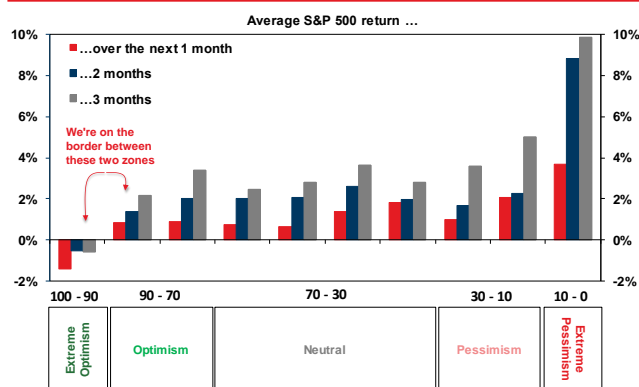
The confluence of positive news over the last few weeks has pushed our market sentiment indicator (MSI) near the threshold of "extreme optimism" in late December and its highest level in two years (Chart 23).

23 Market sentiment is at its most optimistic in two years...



In and of itself, we are not overly concerned by this reading, knowing that the MSI track record is much better at signalling buying than selling opportunities.² However, this does suggest that equities are potentially running ahead of the 2020 agenda and should at least slow their pace in the coming months, as it has generally been the case under such conditions historically (Chart 24).

24 ... which suggests a shift to a lower gear for equities

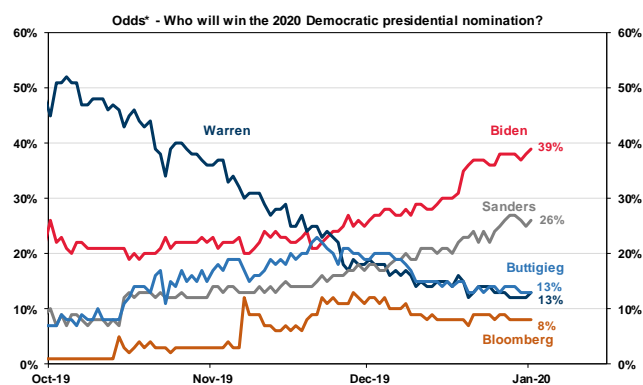


CIO Office (data via Refinitiv, Bloomberg)



One factor that may lead to moderation in investor sentiment is undoubtedly the U.S. elections, the third key risk for 2020. In the near term, the main question remains about who the Democratic candidate will be and, in particular, how far to the left of the political spectrum will he/she be. So far, the betting market sees Joe Biden ahead, followed by Bernie Sanders. But, the picture should become clearer after the first two Democratic Party Presidential primaries in Iowa (February 3) and New Hampshire (February 11) take place next month (Chart 25).

25 Who will win the 2020 Democratic nomination?



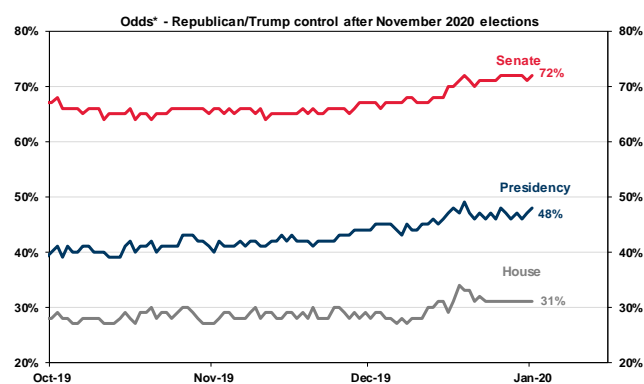
CIO Office (data via *Predictit). As of January 1, 2020.



Once the Democratic race is settled, investors' attention will quickly turn to November 3, the day on which the Presidential election will be held. The Senate (Republican) and the House

(Democrat) are unlikely to switch hands, but the race for the Presidency is shaping up to be extremely close (Chart 26).

26 Which party will win its bid in November 2020?



CIO Office (data via *Predictit). As of January 1, 2020.



If the last four years of Trump's political career are any guide, the election campaign will be colourful, with partisan acrimony deeper than ever. But, in the end, a look back in history would seem to suggest that the outcome of a re-election can be summed up with a simple question: is the economy in expansion or in recession? Case in point, since 1912, U.S. Presidents have never lost a re-election campaign when the economy saw no recession in the second half of their first term (Chart 27). Considering the ongoing strength of the U.S. economy, will Donald Trump be the exception? We shall see.

27 Will Donald Trump be the exception?

Re-election Date	President	Party	Recession two years before election?	Wins Re-Election?
11/5/1912	William Taft	R	Recession	No
11/7/1916	Woodrow Wilson	D	Recession	Yes
11/4/1924	Calvin Coolidge	R	Recession	Yes
11/8/1932	Herbert Hoover	R	Recession	No
11/3/1936	Franklin Roosevelt	D	No Recession	Yes
11/5/1940	Franklin Roosevelt	D	No Recession	Yes
11/7/1944	Franklin Roosevelt	D	No Recession	Yes
11/2/1948	Harry Truman	D	No Recession	Yes
11/6/1956	Dwight D. Eisenhower	R	No Recession	Yes
11/3/1964	Lyndon B. Johnson	D	No Recession	Yes
11/7/1972	Richard Nixon	R	No Recession	Yes
11/2/1976	Gerald Ford	R	Recession	No
11/4/1980	Jimmy Carter	D	Recession	No
11/6/1984	Ronald Reagan	R	No Recession	Yes
11/3/1992	George H.W. Bush	R	Recession	No
11/5/1996	Bill Clinton	D	No Recession	Yes
11/2/2004	George W. Bush	R	No Recession	Yes
11/6/2012	Barack Obama	D	No Recession	Yes
11/3/2020	Donald Trump	R	?	?

CIO Office (data via NBER, Wikipedia)



So, What's the Bottom Line?

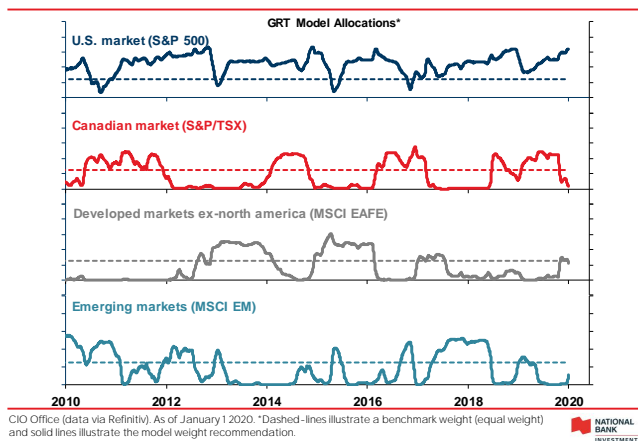
With monetary conditions set to remain accommodative and global growth bottoming out, 2020 is shaping up to be a positive year for risk assets. However, investors must temper their return expectations given the already high levels of valuations for most financial assets. What's more, high optimism currently reflected in the markets (although understandable in view of the recent trade détente) calls for some prudence in the near term. Under these circumstances,

² S&P 500 returns 3 months after an MSI below 10 (extreme pessimism) and above 90 (extreme optimism) have been positive 100% and 57% of the time, respectively. Data since January 1, 2010.

we still consider our modest overweight in equities – initiated last October – as the right positioning.

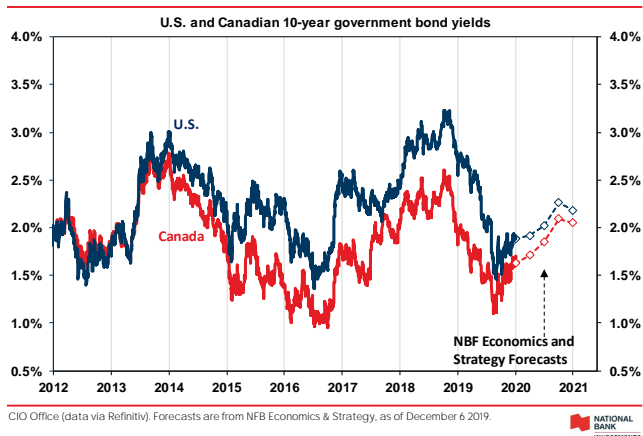
Within the equity market, we are well aware of a growing consensus in favour of shifting assets away from the U.S. market and into more cyclical indices such as Canada's S&P/TSX and the MSCI Emerging Markets – a legitimate choice assuming that global growth does indeed accelerate. Yet, it is specifically for that reason that we are already holding more of these last two regions than what our GRT Model currently recommends (Chart 28, see our December 11 Strategic Report, *Introducing Our Geographical Relative Trend Model*, for further details). Therefore, we're keeping our geographical asset mix unchanged for now (overweight U.S. equities, neutral S&P/TSX, neutral MSCI EM, overweight MSCI EAFE), but could soon bring up changes depending on how relative trends evolve.

28 The GRT is not yet convinced of a change in leadership



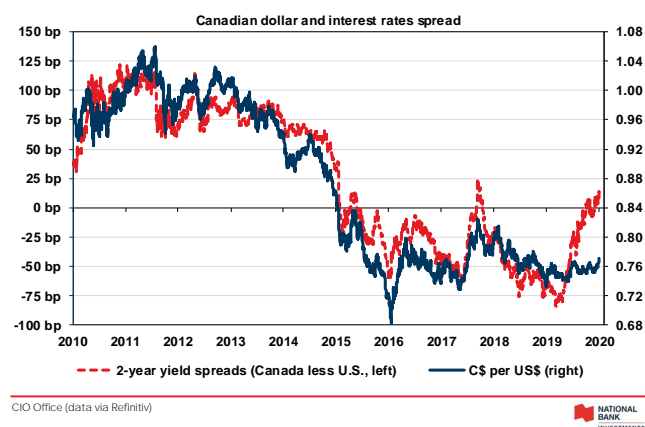
In the bond market, the backdrop of rising inflation, better growth, and stable overnight policy rates should lead to steeper yield curves through higher long-term interest rates. The rise should nevertheless remain relatively contained, with our colleagues from NBF Economics & Strategy expecting 10-year bond yields just slightly above 2% by year-end in Canada and the U.S. (Chart 29). Against this background, shorter duration spread products should fare relatively well within the fixed-income space, but we don't expect returns much better than their current yield-to-maturity.

29 The rise in bond yields should remain relatively contained

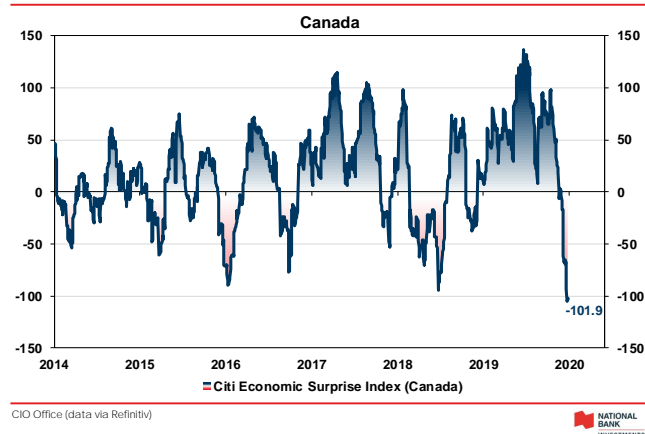


Turning to the foreign exchange market, we expect the U.S. dollar – a counter-cyclical currency – to face some headwinds in the coming months, as global growth rebounds and the risk-on mood is reflected as such in the FX space. This should in turn support the Canadian dollar which has so far benefitted only slightly from the USMCA's ratification and a sharp rise in interest rate spreads late last year (Chart 30). That said, the Loonie's upside potential seems limited so long as the Bank of Canada doesn't adopt a more hawkish tone, something we don't foresee for now in part because of the recent string of weaker-than-expected economic data our side of the border (Chart 31).

30 Rate spreads should support the loonie...



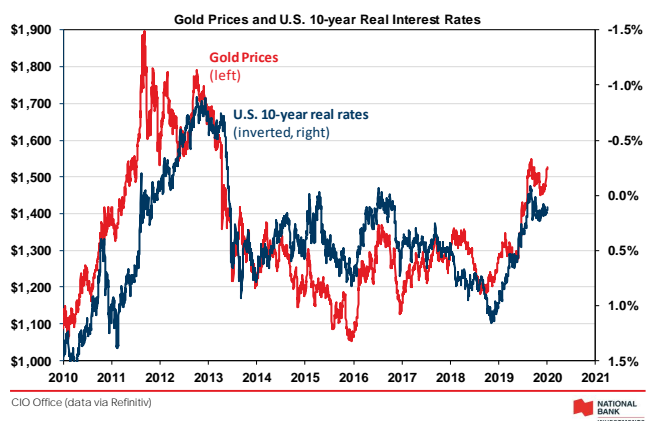
31 ... but the Bank of Canada isn't about to change its tone



In the commodity space, crude oil prices are likely to remain strong this year, benefitting from sustained OPEC+ supply cuts, growing demand, reduced trade uncertainties, and a weaker U.S. dollar. As for gold, while it also tends to benefit from dollar weakness and provides a good hedge against most of the risks to our constructive economic outlook, we don't see the precious metal maintaining its 2019 momentum under our base case scenario (Chart 32, next page).

Speaking of risks, we'll have to closely follow various inflation measures through the year. They should tell us whether

32 Gold: a hedge that has already gone a long way in 2019



monetary tightening is coming sooner than expected, or if recent monetary easing fails its attempt to re-anchor inflation expectations on target. The geopolitical backdrop should also keep investors on their toes as tensions between the U.S. and China – albeit not as severe as last year – could take markets by surprise. And, finally, the U.S. Presidential campaign is likely to bring its share of uncertainties as investors and businesses will have to weigh-in the potential for higher taxes and greater regulatory burdens against four more years of *Trumpism*. These are the three key risks for 2020.

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