# Bull Market, Year 2

## Highlights

- With already one quarter completed in 2021, the final picture is clear. Against a backdrop of rising interest rates, stocks have pulled ahead of bonds which are showing losses, while the more cyclical sectors, regions, and factors sit atop the equity podium.
- The ending of Q1/2021 also implies that we have just wrapped up the first year of the ongoing bull market. After such a stellar performance over the period, one can reasonably question what the next year has in store. Historically, second years of bull markets have all featured positive returns (average of 13%)… and corrections (average of 10%). So, what are the key elements that will determine how bumpy the road ahead will be this time?
- On the geopolitical front, there are two major issues that should keep the markets on their toes over the coming quarters – and both revolve around the Biden administration. The first is its infrastructure plan(s) and, more importantly, how this new spending will be funded. The second question concerns the U.S. policy approach toward China, and the April 22 U.S.-hosted climate summit (which Xi Jinping is expected to attend) should provide more information on this front.
- On the macroeconomic front, we see three crucial variables for what's next. First, inflation, as the next few months should reveal significantly higher annual figures. Second, long-term interest rates, which are technically due for a break in the near term, but will likely test the symbolic 2% threshold sooner or later, especially if concerns of economic overheating intensify. And third, the U.S. dollar, which we continue to see weaken over a 12-month horizon but it could remain supported for a few more months given what will likely be a period of spectacular growth south of the border.
- For emerging markets, a rising U.S. dollar usually means underperformance, and the past two months have been no exception. Under these circumstances, we provide an update of the investment thesis that has led us to overweight EMs since last August. In short, our models and analysis show that valuations, fundamentals, and macro conditions continue to point in the direction of EM outperformance relative to U.S. equities. Consequently, we remain positioned in this direction. However, we are slightly reducing their allocation in favour of Canadian equities to account for near-term tail risks and to increase our allocation to cyclical sectors traditionally overrepresented in value indices.

Table 1 Global Asset Allocation Views

| | − ⟵ = ⟶ + | Δ |
|---|---|---|
| **Asset Classes** | | |
| Cash | | |
| Fixed Income | | |
| Equities | | |
| Alternatives | | |
| **Fixed Income** | | |
| Government | | |
| Investment Grade | | |
| High Yield | | |
| Duration | | |
| **Equities** | | |
| Canada | | ↑ |
| United States | | |
| EAFE | | |
| Emerging Markets | | ↓ |
| Value <--> Growth | | ↓ |
| Small <--> Large Cap. | | |
| Cyclicals <--> 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.

*CIO Office*

## Market Review

### Fixed Income

- The U.S. 10-year benchmark yield's relentless appreciation continued as it closed the month at 1.75%, a 121 bps appreciation since the August 2020 lows.
- Naturally, these types of moves have negatively impacted fixed-income products, which all suffered losses year-to-date, with the exception of preferred shares and high yield.

### Canadian Equities

- Canadian Equities followed last month's performances with another impressive showing, closing up 3.9% for March and 8.1% for the first quarter of 2021.
- The breadth of the market was also encouraging, the majority of sectors recorded positive figures for the month, as the only red figures came from IT (-9.3%) and Healthcare (-2.6%).

### U.S. Equities

- Buoyed by President Biden's $1.9T American Rescue Plan, U.S. equities posted solid gains in March (+4.4%).
- This plan together with a successful vaccine rollout ensure the S&P 500 is firing on all cylinders, as all sectors are showing positive performances both in March and the quarter.
- Similar to their northern counterparts, cyclical assets have outperformed their peers since the start of 2021, with energy (+30.9%), financials (+16.0%) and industrials (+11.4%) leading the charge.

### Commodities

- Crude oil took a breather in March, as a rising U.S. dollar and increasing inventories stopped the positive momentum generated since November 2020 lows.
- Gold prices remained under pressure of higher real yields and Greenback strength in March, wobbling around the $1700/oz. threshold.

### Foreign Exchange

- Improving economic fundamentals in the U.S. helped the U.S. dollar appreciate compared to a basket of major currencies last month.
- The Loonie managed to hold on to a positive performance this month, despite pressure from Crude Oil's somewhat muted showing for the period and improved economic prospects from its southern neighbour.

Table 2 Market Total Returns

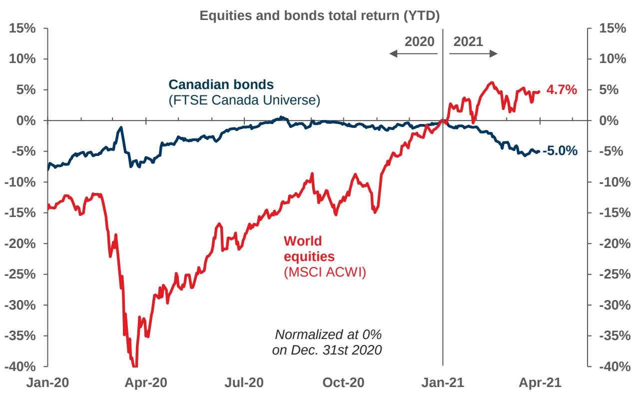
| Asset Classes | March | Q1 | 12 months |
|---|---|---|---|
| Cash (3-month T-bills) | 0.0% | 0.0% | 0.2% |
| Bonds (FTSE CA Ovr. Univ.) | -1.5% | -5.0% | 1.6% |
| FTSE CA Short term | 0.1% | -0.6% | 2.8% |
| FTSE CA Mid term | -1.0% | -4.5% | 1.7% |
| FTSE CA Long term | -3.9% | -10.7% | -0.2% |
| FTSE CA Government | -1.7% | -5.6% | -0.5% |
| Federal | -0.8% | -3.7% | -1.8% |
| Provincial | -2.4% | -7.2% | 0.6% |
| Municipal | -2.0% | -6.0% | 2.3% |
| FTSE CA Corporate | -1.0% | -3.5% | 7.6% |
| AA+ | -0.2% | -1.4% | 4.5% |
| BBB | -1.1% | -3.3% | 10.4% |
| BoAML Inv. Grade ($US) | -1.4% | -4.5% | 9.3% |
| BoAML High-Yield ($US) | 0.2% | 0.9% | 23.3% |
| Preferred Shares | 1.8% | 8.8% | 49.7% |
| Canadian Equities (S&P/TSX) | 3.9% | 8.1% | 44.2% |
| Energy | 7.2% | 20.3% | 40.6% |
| Industrials | 4.6% | 6.6% | 46.9% |
| Financials | 6.7% | 13.9% | 46.7% |
| Materials | 1.0% | -6.9% | 39.0% |
| Utilities | 6.2% | 3.4% | 25.9% |
| Cons. Disc | 6.2% | 12.5% | 96.0% |
| Cons. Staples | 9.4% | 2.5% | 17.9% |
| Healthcare | -2.6% | 38.0% | 69.1% |
| IT | -9.3% | -1.1% | 85.7% |
| Comm. Svc. | 7.5% | 7.1% | 12.2% |
| REITs | 3.2% | 10.0% | 40.3% |
| S&P/TSX Small Cap | -0.2% | 9.7% | 100.2% |
| US Equities (S&P500 USD) | 4.4% | 6.2% | 56.4% |
| Energy | 2.8% | 30.9% | 75.2% |
| Industrials | 8.9% | 11.4% | 69.6% |
| Financials | 5.8% | 16.0% | 67.5% |
| Materials | 7.6% | 9.1% | 78.3% |
| Utilities | 10.5% | 2.8% | 19.4% |
| Cons. Disc | 3.7% | 3.1% | 70.3% |
| Cons. Staples | 8.2% | 1.1% | 28.4% |
| Healthcare | 3.9% | 3.2% | 34.0% |
| IT | 1.7% | 2.0% | 66.6% |
| Comm. Svc. | 3.1% | 8.1% | 60.9% |
| REITs | 6.8% | 9.0% | 32.0% |
| Russell 2000 (USD) | 0.9% | 12.4% | 92.6% |
| World Eq. (MSCI ACWI) | 2.7% | 4.7% | 55.3% |
| MSCI EAFE (USD) | 2.4% | 3.6% | 45.2% |
| MSCI EM (USD) | -1.5% | 2.3% | 58.9% |
| Commodities (CRB index) | -2.9% | 10.2% | 52.0% |
| WTI Oil (US$/barrel) | -6.9% | 22.5% | 188.9% |
| Gold (US$/ounce) | -1.3% | -10.2% | 5.7% |
| Copper (US$/tonne) | -3.8% | 13.4% | 77.9% |
| Forex (DXY - US Dollar index) | 2.6% | 3.7% | -5.9% |
| USD per EUR | -3.2% | -3.9% | 7.1% |
| CAD per USD | -1.4% | -1.4% | -10.7% |

CIO Office (data via Refinitiv) 2021-03-31

## One quarter completed...

Already one quarter completed in 2021, and although it featured few episodes of heightened volatility between asset classes and equity leadership, the final picture is clear. Against a backdrop of rising interest rates, stocks have pulled ahead of bonds which are showing losses (Chart 1), while the more cyclical sectors, regions, and factors (e.g., energy, financials, Canada, small caps, value) sit atop the equity podium (Chart 2).

**1** Q1/2021: Stocks higher, bonds lower ...




CIO Office (data via Refinitiv).

**2** ... and cyclical assets outperformance

Q1/2021 Total Return

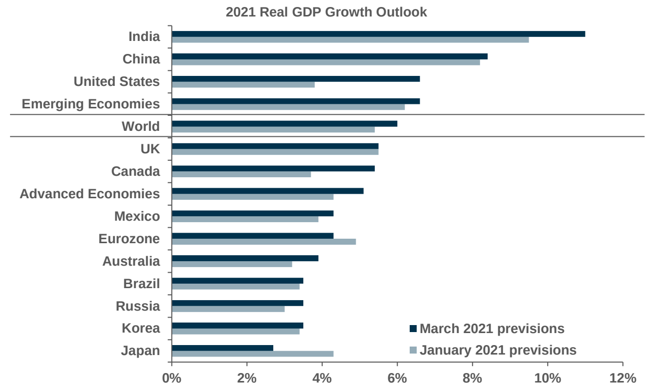
| Cross Assets | Fixed Income | S&P/TSX Sectors | S&P500 Sectors | Equity Regions (in C$) | U.S. Factors | CA Factors |
|---|---|---|---|---|---|---|
| Commo. | Prefs (Can) | Health Care | Energy | Canada | Small | High Div. |
| 13.5% | 8.8% | 38.0% | 30.9% | 8.1% | 12.9% | 14.4% |
| US Small | HY (US) | Energy | Financials | EMEA (EM) | Value | Value |
| 12.7% | 0.9% | 20.3% | 16.0% | 6.7% | 10.4% | 12.8% |
| Can Pref. | Short (Can) | Financials | Industrials | U.S. | High Div. | Large |
| 8.8% | -0.6% | 13.9% | 11.4% | 4.7% | 7.8% | 8.8% |
| S&P/TSX | Corp (Can) | Disc. | Materials | World | MSCI USA | S&P/TSX |
| 8.1% | -3.5% | 12.5% | 10.2% | 3.3% | 5.5% | 8.1% |
| S&P 500 | Fed. (Can) | Real Estate | Real Estate | Europe | Large | Small |
| 6.2% | -3.7% | 10.0% | 9.0% | 2.8% | 5.1% | 7.7% |
| EAFE | IG (US) | Comm. serv. | Comm. serv. | EAFE | Quality | Low Vol. |
| 3.6% | -4.5% | 7.1% | 8.1% | 2.2% | 3.8% | 7.2% |
| EM | Mid (Can) | Industrials | Health Care | Emerg Mrkts | Growth | Quality |
| 2.3% | -4.5% | 6.6% | 3.2% | 1.0% | 0.6% | 5.6% |
| Balanced* | Overall (Can) | Utilities | Disc. | Asia (EM) | Momentum | Growth |
| 1.0% | -5.0% | 3.4% | 3.1% | 0.8% | -0.2% | 0.4% |
| US HY | Muni. (Can) | Staples | Utilities | Japan | Low Vol. | Momentum |
| 0.9% | -6.0% | 2.5% | 2.8% | 0.7% | -1.0% | -1.4% |
| C$ per USD | Prov. (Can) | Techno | Techno | LatAm (EM) | | |
| -1.3% | -7.2% | -1.1% | 2.0% | -6.6% | | |
| Can Bonds | Long (Can) | Materials | Staples | | | |
| -5.0% | -10.7% | -6.9% | 1.1% | | | |

CIO Office (data via Refinitiv).

This outcome is largely a result of the substantial upward revisions to the growth outlook since the beginning of the year (Chart 3) brought on by the fall in new COVID-19 cases and, most importantly, the passage of a $1.9 trillion fiscal stimulus package in the U.S. in early March.

The ending of Q1/2021 also implies that we have just wrapped up the first year of a bull market that began on March 24, 2020. After such a stellar performance since then – the 75% rise in the S&P 500 represents the best first year of a bull market in over 6 decades – one can reasonably question what Year 2 has in store.

**3** Significant upward revisions to the growth outlook




NBF Economics and Strategy (data via NBF, Consensus Economics)

What can history teach us? Since 1957, every second year of bull markets has ended with positive returns for an average gain of 13%. However, a correction of at least 5% and on average 10% has also occurred over these periods (Chart 4). In either case, we would be surprised if the next 12 months turned out to be an exception to the rule. So, what are the key elements that will determine how bumpy the road ahead will be this time?

**4** What can we expect from a bull market in its second year?

S&P 500 Bull Markets Since 1957 (price return)

| Bear Market Bottom | Bull Market Return Year 1 | Bull Market Return Year 2 | Bull Market Max Drawdown Year 2 |
|---|---|---|---|
| 10/22/1957 | 31% | 10% | -9% |
| 10/23/1962 | 36% | 17% | -7% |
| 10/7/1966 | 33% | 7% | -10% |
| 5/26/1970 | 44% | 11% | -11% |
| 10/3/1974 | 38% | 21% | -5% |
| 8/12/1982 | 58% | 2% | -14% |
| 10/19/1987 | 23% | 25% | -7% |
| 7/23/2002 | 24% | 10% | -6% |
| 3/9/2009 | 69% | 16% | -16% |
| 3/23/2020 | 75% | ? | ? |
| **Average** | **43%** | **13%** | **-10%** |

CIO Office (data via Refinitiv, Bloomberg).

## ... with two key questions left to answer...

On the geopolitical front, there are two major issues that should keep the markets on their toes over the coming quarters – and both revolve around the Biden administration. The first is its infrastructure plan(s) and, more importantly, how this new spending will be funded.

According to the details presented on March 31, it seems that Biden's intentions regarding corporate taxes are in line with the plan presented by his team during the election campaign[1]. Specifically, we are looking at an increase in the tax rate from 21% to 28% (it was 35% before Trump's tax cuts), higher taxes on foreign income, and institution of a minimum rate. This would represent a drop of approximately 9%[2] for S&P 500 earnings (Trump's cuts passed in December 2017 had push earnings expectations ~8% higher, Chart 5). However, this only marks the beginning of a long period of negotiation with Congress that could technically stretch all the way to September before a plan is passed.

5 Higher corporate taxes are on the horizon

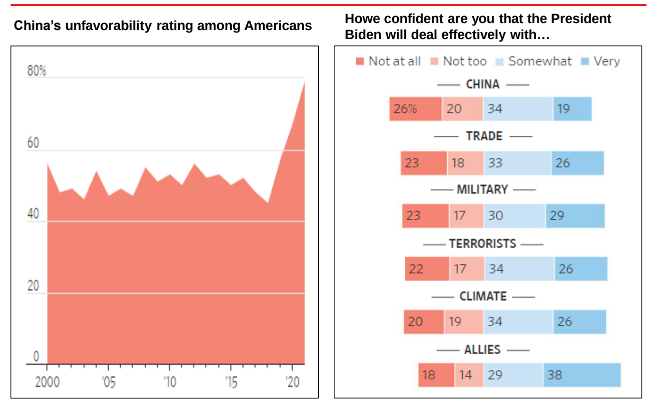

CIO Office (data via Refinitiv).

It is hard to assess to what extent this is already discounted in stock prices. However, the Biden administration has been quite clear in their intentions and, in their case, it always boils down to a policy that, on balance, seeks to boost growth... at a time when economic activity already has good momentum. For this reason, we see this issue more as a volatility factor than a genuine threat to the ongoing bull market.

The second question concerns the U.S. policy approach toward China. In this regard, a first summit between officials of the two countries last month confirmed that their relation will remain tense.[3] No major surprise considering that a tough stance with China is a rare consensus subject in the U.S. and perceived as Biden's weakness, according to recent polls (Chart 6).

But beyond the wars of words, a fundamental issue that could heighten tensions between the two superpowers will be their respective approaches to fighting climate change. Biden's intentions remain vague, and the April 22 U.S.-hosted climate summit (which Xi Jinping is expected to attend) should reveal more. However, one thing is clear: if the U.S. and the European Union were to open the door to a carbon border tax – the cost of which would largely fall on China – it would have a number of geopolitical and economic implications (for more details on

6 Will Biden echo American sentiment toward China?



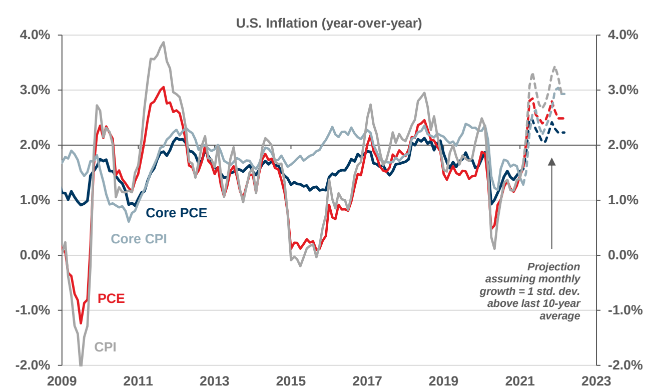

The Wall Street Journal (Source = Gallup, Pew Research Center)
https://www.wsj.com/articles/americans-negative-views-on-china-spike-polls-show-11614870001

the subject, see the latest report by our geopolitical analyst colleague, Angelo Katsoras: *Is a carbon border tax inevitable?*).

## ... and three macro variables to monitor

On the macroeconomic front, we see three crucial variables for what's next. The first is inflation, as the next few months should reveal significantly higher annual figures, if only because of base effects (Chart 7).

**7 The impending rise in inflation...**




CIO Office (data via Refinitiv).

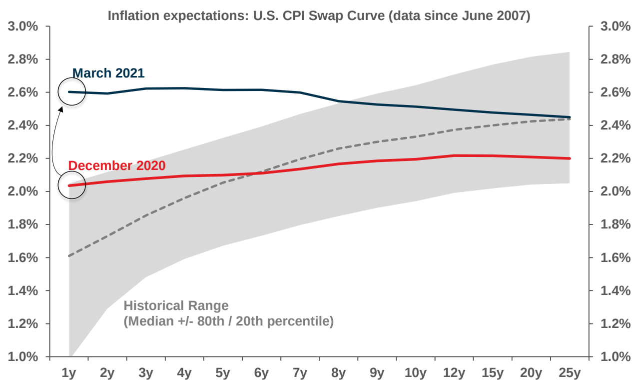
In theory, this bounce should not have an outsized impact on markets since (1) it is widely anticipated (Chart 8, next page), and (2) the Federal Reserve has already said it will essentially ignore any transitory pressure on prices. Nonetheless, significantly higher than expected numbers could certainly cause some turbulence. After all, the Fed's approach represents a regime change from the past forty years, and markets, anxious by nature, will certainly seek to clarify/validate the ambiguous parameters of this new reaction function when the time comes.

[1] *Biden unveils a $2tn infrastructure plan and big corporate tax rise, Financial Times, March 31, 2021.*

[2] Source = Goldman Sachs

[3] *Bitter summit shoes no reset in chilly US-China relations, Financial Times, March 20, 2021*

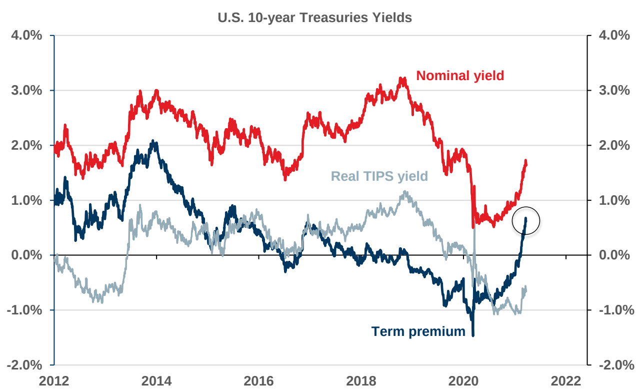
**8** ... appears already priced in by markets...




CIO Office (data via Refinitiv).

Practically speaking, the result of this potential inflation anxiety is the second macroeconomic data point to watch closely: long-term interest rates. Indeed, U.S. 10-year rates have risen sharply since the beginning of the year, occasionally destabilizing the stock markets, and the main reason is the increase in the term premium, i.e. the compensation that investors demand in part for the uncertainty over inflation (Chart 9).

**9** ... but the term premium indicates some nervousness



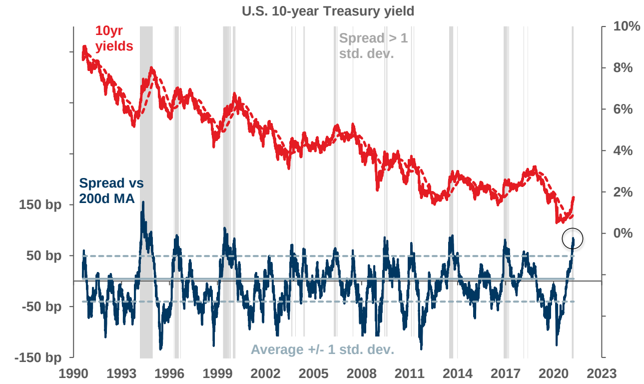

CIO Office (data via Refinitiv).

In the short term and purely on a technical basis, the gap from its 200-day moving average suggests the recent surge in 10-year rates is due for a pause (Chart 10).

That said, as long as economic growth remains strong (as we can reasonably expect), interest rates are unlikely to go much lower (Chart 11). The latest forecast from our colleagues at FBN Economics and Strategy projects 1.90% for U.S. 10-year rates at the end of 2021, but it is quite likely that the market will test the symbolic 2% level by then.

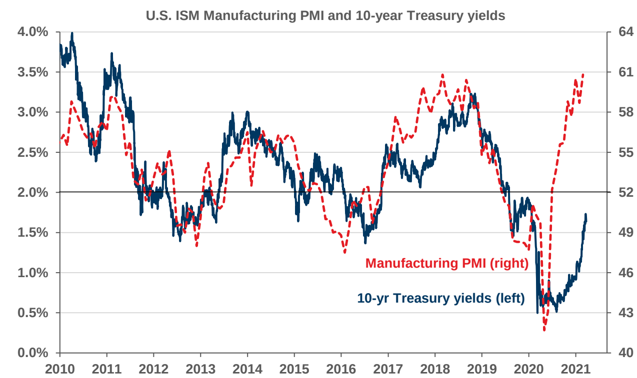
Lastly, the direction of the U.S. dollar – the third important macro variable – also requires special attention. After almost

**10** Treasury yields are technically due for a break...




CIO Office (data via Refinitiv).

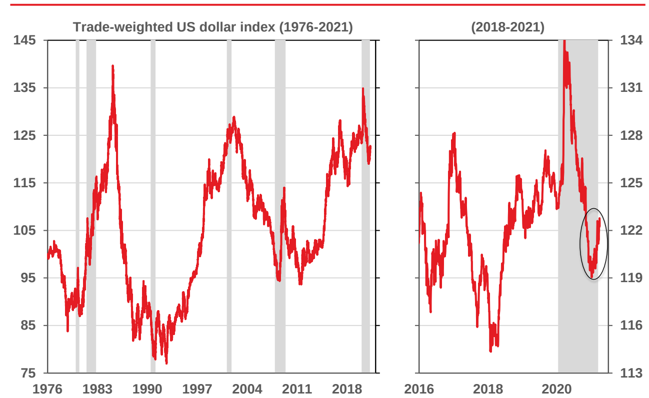
**11** ... but the path of least resistance remains upward




CIO Office (data via Refinitiv).

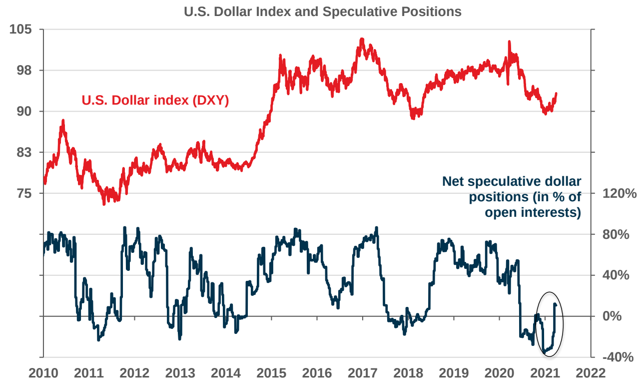
uninterrupted depreciation between April and December 2020, the Greenback has strengthened so far in 2021 (Chart 12), buoyed by sharp improvement in the U.S. growth outlook as well as a reversal of large speculative short positions (Chart 13, next page).

**12** The U.S. dollar bounced back **in Q1...**




CIO Office (data via Refinitiv).

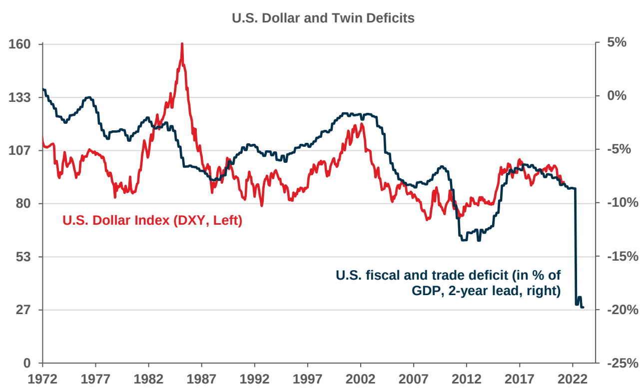
**13** **... as speculators quickly** reversed their short positions




CIO Office (data via Refinitiv).

Over a 12-month horizon, we continue to expect a weaker U.S. dollar environment, as suggested by the size of the budget and trade deficits (Chart 14). However, in the shorter term, the positive momentum from the fiscal stimulus and the effectiveness of the U.S. vaccination operation could result in a series of spectacular economic data south of the border. The Greenback could therefore remain strong for a few more months.

**14** The long-term outlook remains bearish for the USD



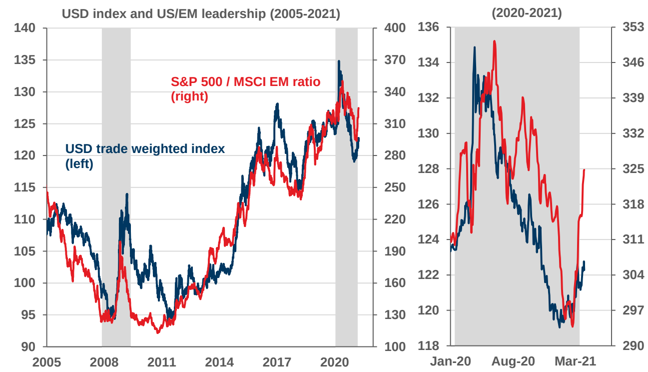

CIO Office (data via Refinitiv).

## Update on emerging markets

A rising U.S. dollar usually means underperformance for emerging markets (EMs), and the past two months have been no exception (Chart 15). After a strong start to the year, the region recently saw its early 2021 outperformance fade as signs of a deceleration came out of China (Chart 16).

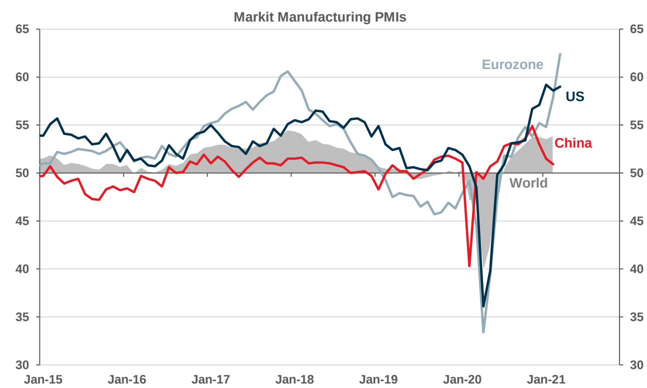
Under these circumstances and considering the risks of continued U.S. dollar strength in the near term, an update of the thesis that has led us to overweight EMs since last August was warranted.

**15** Dollar strength makes life harder for emerging markets...




CIO Office (data via Refinitiv).

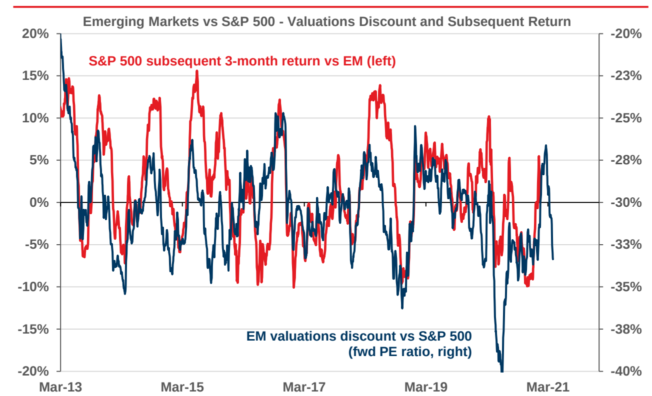
**16** ... as is the moderation in Chinese economic activity




CIO Office (data via Refinitiv).

From a valuation standpoint, the spread between emerging market and U.S. equity price/earnings ratios – a measure that has had some predictive power over a three-month horizon over the past few years (Chart 17) – has shifted back in favour of EMs. This does not mean that the spread cannot continue to widen in the coming months, but it does suggest less downside risk.

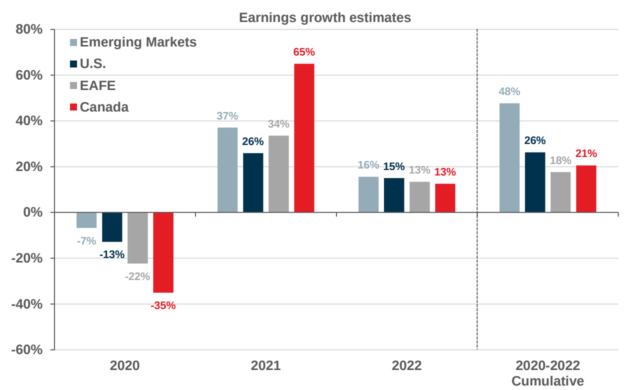
**17** **Relative valuations...**




CIO Office (data via Refinitiv).

From a fundamental standpoint, emerging markets should enjoy strong earnings growth this year and next, in addition to having shown great resilience in 2020. Altogether, this is expected to make it the region with by far the strongest earnings growth over the 2020-2022 period (Chart 18).

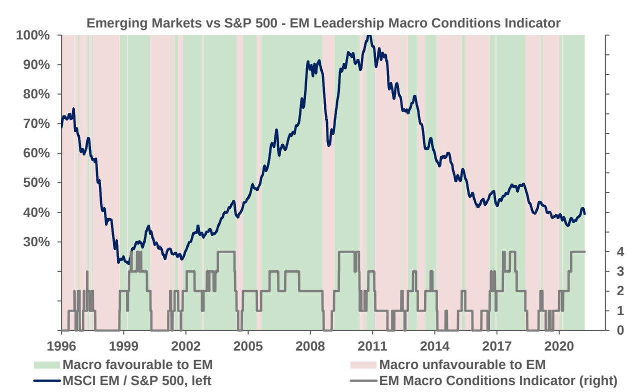
**18 ... expected earnings growth...**




CIO Office (data via Refinitiv).

From a macroeconomic standpoint, our investment thesis relies primarily on three factors, namely: (1) broad-based global growth, (2) accommodative monetary policies, and (3) a weakening U.S. dollar. To take any subjectivity out of the equation, we built a (relatively) simple model that looks at whether these conditions are met, and the result is quite telling. Indeed, a rule overweighting EMs, if a minimum of 2 out of 4 conditions (we added the recommendation of our GRT model as a 4th factor) hold, has rarely been wrong for long. Currently, all 4 conditions argue in favour of emerging markets (Chart 19).

**19** ... and macro conditions argue in favour **of EM...**

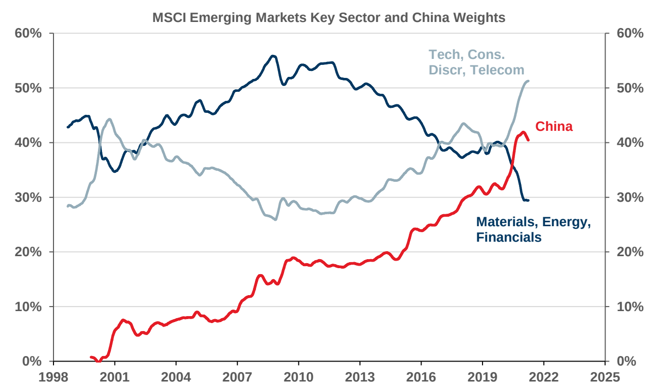



CIO Office (data via Refinitiv). Four conditions are: (1) global OECD Growth Breadth over 75%, (2) % of global central banks in a hiking cycle over 75%, (3) USD 20-day moving average below 200-day moving average, (4) GRT Model overweight EM.

For these reasons, we conclude that an overweight position in emerging markets relative to U.S. equities remains appropriate.

However, an important nuance is in order. The representative index of EMs has evolved significantly over the last decade, essentially following the rise of Chinese technology giants (Chart 20).

**20** ... but their heavyweights are a risk in the near term




CIO Office (data via Refinitiv). Regression-based, 60-day moving average.

While this shift has been a distinct advantage in 2020, it clearly represents a risk to the region's performance in the near term given the potential for escalating Sino-U.S. tensions, regulations in China's technology sector,[4] and the potential for rising inflation to compromise tech stocks' high valuations.

Among the major stock market regions, one alternative that also tends to benefit from a strong global growth environment is our own Canadian stock market index. Indeed, the S&P/TSX sector allocation makes it by far the most cyclical/value of the group (Chart 21) – a disadvantage over the past 10 years that has proven to be an advantage in the first quarter of 2021, and this trend could continue in the coming months.

**21** S&P/TSX: by far the most cyclical index of the group

**Global Equity Sector Allocation (as of March 26, 2021)**

| | Emerging Markets | S&P/TSX | S&P 500 | EAFE |
|---|---|---|---|---|
| Information Technology | 21% | 9% | 27% | 9% |
| Financials | 18% | 32% | 11% | 17% |
| Consumer Discretionary | 18% | 4% | 12% | 13% |
| Communication | 12% | 5% | 11% | 5% |
| Materials | 8% | 12% | 3% | 8% |
| Consumer Staples | 6% | 4% | 6% | 10% |
| Energy | 5% | 13% | 3% | 3% |
| Health Care | 4% | 1% | 13% | 12% |
| Industrials | 4% | 12% | 9% | 15% |
| Real Estate | 2% | 3% | 2% | 3% |
| Utilities | 2% | 5% | 3% | 4% |
| Cyclical/Value* | 55% | 76% | 41% | 60% |
| Defensive/Growth** | 45% | 24% | 59% | 40% |

CIO Office (data via iShares). *Cyclical/Value = Financials, Cons. Discr., Materials, Energy, Industrials, Real Estate.
**Defensive/Growth = Tech, Communication, Staples, Health Care, Utilities.

4 *China's tech giants face a reckoning with the regulators, Financial Times, March 24, 2021*

## Investment Conclusion

The outlook remains pro-risk. The gradual reopening of economies, combined with the impulse from highly accommodative monetary and fiscal policies, should lead to strong economic growth in the coming quarters. As a result, we are keeping our equity overweight unchanged.

Total return expectations should however be tempered, and episodes of increased volatility expected, as we enter the second year of this bull market. Discussions surrounding U.S. corporate tax policy, Sino-U.S. relations, and worries of economic overheating should gradually take over the markets' attention as the pandemic becomes a secondary issue. These risks could turn into opportunities, however, and we maintain some leeway to potentially increase our equity allocation further for this reason.

Within equities, we are slightly adjusting to our geographic mix by reducing emerging markets' allocation (remains overweight) by one notch in favour of Canadian equities (from underweight to neutral). While we remain optimistic on EMs over a one-year horizon, this tactical change seeks to account for near-term risks and to increase our allocation to cyclical sectors ahead of the upcoming strong growth rebound.

Table 3 Base Case Scenario

| Scenario (prob.*) | Key elements and investment implications |
|---|---|
| Base case (70%) | • The coronavirus vaccination campaign accelerates. With the vast majority of the most-at-risk population in developed countries immune, new cases remain relatively low, pressure on the health care system eases, and mortality falls sharply. COVID-19 effectively becomes a secondary issue by early summer in the United States, and by late summer in other developed countries. |
| | • The global cyclical recovery gathers pace. A gradual and permanent reopening of the economy leads to a rise in consumer sentiment and a sharp recovery in the service sector. |
| | • The majority of developed countries policy makers maintain a significant level of fiscal support to businesses and consumers. In the U.S., the Biden administration works for the passage of a major infrastructure plan and moderate tax increases, in line with his campaign pledges. |
| | • Annual inflation rises considerably, driven by a combination of base effects, strong demand and supply bottlenecks. Concerns of economic overheating and potential rate hikes grow occasionally, but central banks stay the course and keep accommodative monetary measures unchanged through the year. |
| | → **Bond yields rise modestly while 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 (20%) | • A multiplication of high-efficacy vaccine alternatives speeds up the immunization process. COVID-19 effectively becomes a secondary issue by late spring in the United States. |
| | • 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 policy rates unchanged. |
| | → **Bond yields rise while the U.S. dollar depreciates. Global equities surge above their long-term trend. Small caps, cyclical, value, emerging markets and EAFE equities significantly outperform.** |
| Bearish (10%) | • Vaccination campaigns fail to outpace the rapid spread of coronarivus variants. Global growth slows down due to an increase in cases, the extension/renewal of containment measures, and weaker consumer sentiment. |
| | • The Biden administration reveals a few surprises. Uncertainty over U.S. fiscal policy, Big Tech regulations and/or Democrats protectionist intentions 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: April 1, 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 rise modestly as inflation expectations normalise, but we expect real yields to remain negative. |
| 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% | 22.4% | 1.4% | 35% | 0.0% | We expect emerging markets to outperform U.S. equities under a backdrop of broad-based global growth and easy monetary policies, with a preference for cyclical and value sectors in EM (RAFI Fundamental, 3%). In the U.S, we favour the high-quality (MSCI Quality, 4% weight) dividend-paying (Div. Aristocrats, 4%) companies and the equal weight index (4%) for their diversified and cyclical properties. |
| 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% | 7.8% | 1.8% | 12% | 2.2% | |
| **Alternatives** | | | | | | | |
| Inflation Protection | 0% | 0% | 2.0% | 2.0% | 40% | 40.0% | The macroeconomic environment remains favourable to gold, with real interest rates likely to remain negative 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% | - | 55.4% | -5.6% | - | - | Our overall portfolio strategy places us overweight in U.S. dollars versus our benchmark, solely 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 risk management 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% | - | 10.7% | 2.0% | - | - | |

*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).*

## CIO Office
CIO-Office@nbc.ca

Martin Lefebvre
CIO and Strategist
martin.lefebvre@nbc.ca

Louis Lajoie
Investment Strategist
louis.lajoie@nbc.ca

Simon-Carl Dunberry
Chief Analyst
simon-carl.dunberry@nbc.ca

Nicolas Charlton
Analyst
nicolas.charlton@nbc.ca

**General**

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