Asset Allocation Strategy

CIO Office ▪ August 2021

Dear All,

Our monthly Asset Allocation Strategy report is taking a break this August. The following pages contain a brief market review and our usual tables.

Have a good Summer and we look forward to connecting with you again in September.

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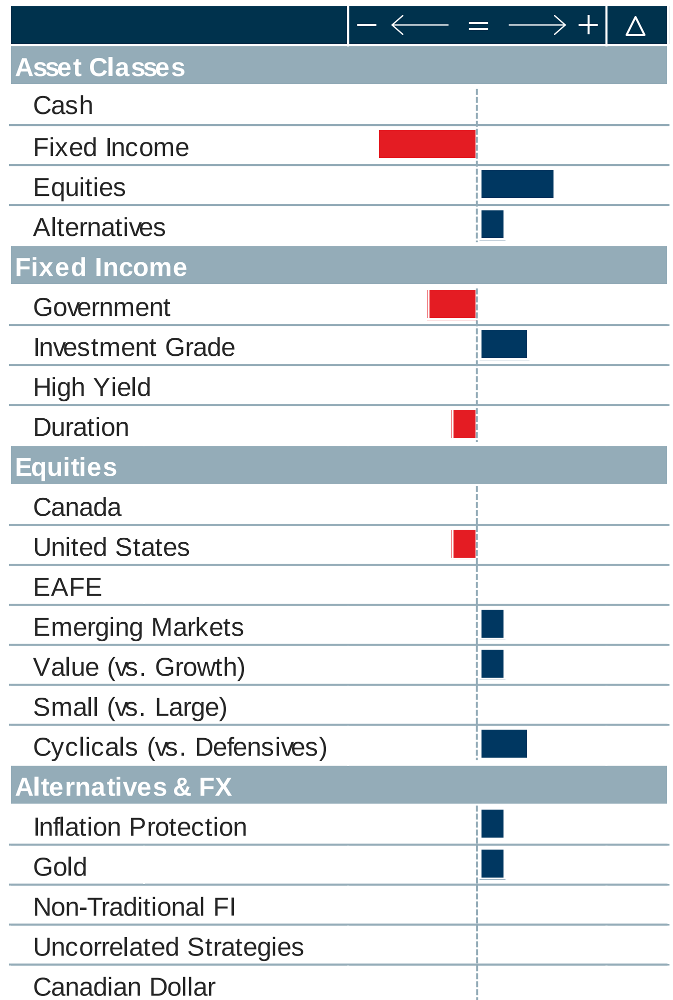
Table 1 Global Asset Allocation Views



This table is for illustration purposes only. Bars represent the degree of preference of an asset relative to the maximum deviation allowed from a reference index. The further to the right (left) they are, the more bullish (bearish) our outlook for the asset is. No bars indicate a neutral view. The column under the delta sign (**Δ**) displays when our outlook has improved (↑) or worsened (↓) from the previous month. Consult **Table 3** for details on the base-case economic scenario underpinning these views and **Table 4** to see how they translate into a model balanced portfolio.

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Market Review

Fixed Income

- FOMC participants opted to keep target rates and asset purchases unchanged following their latest meeting in late July.
- Longer-term yields further retreated at home and in the U.S., with the latter's 10-year benchmark rate sliding 23 bps lower by last month's end.
- As such, longer-duration products outperformed their shorter-duration counterparts.

Equities

- U.S. equities racked up their sixth consecutive month of gains in July, spurred on by strong corporate earnings.
- Indeed, 89% of S&P 500 companies have so far surpassed analyst expectations, for a blended estimate of 90% year-over-year growth in net income across index constituents.
- Canadian equities surpassed both their U.S. counterparts as well as global stocks with our surging Tech sector at home as the driving force behind this positive performance.

FX & Commodities

- Oil prices further strengthened in July, encouraged an increase in demand as developed countries slowly relaxed pandemic-related restrictions.
- This occurred, despite OPEC+ countries having reached a deal to increase supply by an extra 400,000 barrels a day each month, starting in August and set to expire only in December 2022.
- Meanwhile, the price of gold slumped, hindered by a strengthening Greenback.

Table 2 Market Total Returns

Asset Classes	July	YTD	12 MTH
Cash (3-month T-bills)	0.0%	0.1%	0.1%
Bonds (FTSE CA Univ.)	**1.0%**	**-3.5%**	**-2.4%**
FTSE CA Short term	-0.2%	-0.5%	0.7%
FTSE CA Mid term	0.5%	-3.0%	-1.4%
FTSE CA Long term	2.8%	-7.4%	-6.9%
FTSE CA Government	1.0%	-3.9%	-3.6%
FTSE CA Corporate	0.8%	-2.3%	0.8%
BoAML Inv. Grade ($US)	1.7%	-1.1%	3.6%
BoAML High-Yield ($US)	1.4%	3.7%	15.6%
Preferred Shares	-0.2%	14.3%	36.6%
CA Equities (S&P/TSX)	**2.5%**	**17.3%**	**33.9%**
Energy	6.4%	37.0%	44.5%
Industrials	0.3%	6.8%	29.9%
Financials	0.7%	23.4%	49.7%
Materials	-6.2%	-0.4%	4.6%
Utilities	2.3%	4.9%	23.0%
Cons. Disc	0.1%	17.6%	54.3%
Cons. Staples	1.4%	8.5%	11.7%
Healthcare	0.9%	22.0%	36.1%
IT	18.2%	21.7%	35.8%
Comm. Svc.	3.8%	18.2%	25.0%
REITs	4.2%	21.7%	39.0%
S&P/TSX Small Cap	0.5%	19.8%	57.7%
US Equities (S&P500 USD)	**2.3%**	**15.3%**	**40.8%**
Energy	4.6%	45.6%	49.4%
Industrials	-2.2%	16.4%	51.4%
Financials	-3.0%	25.7%	61.8%
Materials	-5.3%	14.5%	48.5%
Utilities	-2.2%	2.4%	15.8%
Cons. Disc	3.8%	10.3%	37.1%
Cons. Staples	-0.2%	5.0%	23.3%
Healthcare	2.3%	11.9%	27.9%
IT	7.0%	13.8%	42.4%
Comm. Svc.	2.7%	19.7%	48.4%
REITs	3.2%	23.3%	31.9%
Russell 2000 (USD)	1.8%	17.0%	60.3%
World Eq. (MSCI ACWI)	**1.4%**	**12.6%**	**39.9%**
MSCI EAFE (USD)	-1.1%	9.2%	32.9%
MSCI EM (USD)	0.2%	7.6%	41.4%
Commodities (CRB index)	**3.7%**	**27.2%**	**54.8%**
WTI Oil (US$/barrel)	11.0%	52.5%	87.5%
Gold (US$/ounce)	-7.4%	-7.0%	-1.0%
Copper (US$/tonne)	-8.8%	20.7%	55.7%
Forex (DXY - USD index)	**2.7%**	**2.8%**	**-5.1%**
USD per EUR	-3.0%	-3.1%	5.6%
CAD per USD	2.8%	-2.7%	-8.7%

Data via Refinitiv 2021-06-30

Table 3 Base Case Scenario

Scenario (prob.*)	Key elements and investment implications
Base case 70%	With the success of vaccination campaigns, COVID-19 essentially becomes a secondary issue in early summer in the United States, and shortly after in other developed countries. The number of new cases remains relatively low, but more importantly, pressure on the health system and mortality rates drop significantly.
	The pace of global growth peaks in early summer. Nevertheless, strong underlying trends such as a substantial accumulation of excess savings, rising consumer sentiment and a strong recovery in the services sector keep growth above its long-term average.
	The majority of developed countries policy makers are initiating a gradual and cautious phase-out of emergency fiscal support. In the U.S., the Biden administration works for the passage of a major infrastructure plan and moderate tax increases, not too distant from 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. The Fed clarifies its intentions regarding the gradual reduction of its asset purchases between August and September 2021.
	→ **Bond yields rise modestly while global equities continue to rise along their long-term trend. Leadership remains volatile but edge in favour of cyclical and emerging markets equities.**
Bullish 20%	The high efficacy of the vaccines allows a definitive victory against COVID-19 and its variants. The reopening of economies reveals an unsuspected pent-up demand. Consumer sentiment surges; excess savings accumulated during the pandemic translate into consumer spending.
	After rising sharply, inflation stabilises to settle slightly above historical averages as supply adjusts. This goldilocks backdrop of strong real growth and moderate inflationary pressures proves highly favourable for risky assets as rate hikes remain distant.
	→ **Bond yields tread water while the U.S. dollar depreciates. Global equities surge above their long-term trend. Leadership remains volatile. Emerging markets equities outperform significantly.**
Bearish 10%	Strong inflationary pressures push long-term inflation expectations into a range that forces central banks to tighten monetary conditions earlier than expected. In parallel, uncertainty over U.S. fiscal policy, Big Tech regulations and/or Democrats protectionist intentions force markets to recalibrate their expectations.
	Vaccination campaigns fail to counter the rapid spread of coronavirus variants in some parts of the world. Fears of another wave of contagion as autumn arrives negatively impact consumer sentiment, global growth slows.
	→ **Bond yields volatility increases and the U.S. dollar shoots higher. Equities venture in correction territory. Leadership is highly volatile but edges in favour of growth (value) stocks in the COVID revival (inflationary pressure) scenario.**

CIO Office. Last update: July 2, 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: Allocation	Total: Active Weight	Asset Class: Allocation	Asset Class: 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%	16.8%	-11.2%	54%	-18.8%	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%	14.2%	2.2%	46%	18.8%	
High Yield	0%	0%	0.0%	0.0%	0%	0.0%	
Duration	*7.8 yrs*	-	*7.5 yrs*	-0.3 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).

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General

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