NATIONAL BANK INVESTMENTS

ASSET ALLOCATION STRATEGY | March 2021

Stocks and Yields: **It's Complicated**

Highlights

- Despite an increase in volatility at the end of the month, February proved favourable for risky assets with global equities increasing their lead over bond markets. This reflects, in part, a marked improvement in the fight against coronavirus, just in time for its first "anniversary" since the WHO formally categorized it as a global pandemic.
- With the light at the end of the COVID-19 tunnel approaching, it is no surprise that market attention is increasingly turning to what awaits us beyond the health crisis. Factoring in the magnitude of upcoming fiscal spending, the bond market is visibly seeking to test the conviction behind the Federal Reserve's intentions regarding the impending rise in inflation. We do not expect the Central Bank to change its stance in the coming months. As a result, the rise in rates, although it has the potential to continue during the year, should slow down and remain relatively contained.
- To what extent is the stock market threatened by this potential increase in long-term interest rates? To answer this question, we look back at the last 40-years of "complicated" relationship between stocks and yields. The conclusions are likely to surprise some investors.
- In short, although this is probably not our last episode of increased volatility caused by inflationary fears, it is unlikely to halt the ongoing bull run. This will hold true as long as higher bond yields are driven by improving growth prospects, not monetary policy tightening.
- Geographically, emerging markets are certainly more vulnerable to a context of tighter monetary conditions involving higher real yields, as we saw at the end of February. However, we continue to believe that they are best equipped to outperform in a context of a pick-up in global growth. History shows that this is all the more true when compared with U.S. stocks which are more defensive in nature and when expected inflation is on the rise, as should be the case during the year.
- We are keeping our asset allocation unchanged this month as we continue to expect equities to outperform bonds, driven by broad-based recovery in global growth in 2021.

Table 1 Global Asset Allocation Views

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Asset Classes		
Cash		
Fixed Income		
Equities		
Alternatives		
Fixed Income		
Government		
Investment Grade		
High Yield		
Duration		
Equities		
Canada		
United States		
EAFE		
Emerging Markets		
Value <--> 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.

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Market Review

Fixed Income

- U.S. 10-year benchmark yields surged higher throughout February, climbing nearly 40 bps and ending the month near their highest level in a year.
- Prices move inversely with yields and Fixed Income performance suffered for it, with longer-duration lagging their peers.
- Only preferred shares and high yield debt managed to post gains over the period, the latter of which was buoyed by yet another month of tightening credit spreads.

Canadian Equities

- Canadian equities closed out February as the top-performing region (up 4.4%), boosted by a relative overweight in more cyclical sectors such as Energy, Industrials, and Financials.
- While the last week of the month did see technology (up 9.9%) stocks pare back some gains, they remained the top-performing sector in February, along with the Energy and Consumer Discretionary sectors (9.1% and 8.7%, respectively).
- The laggard for the month included the more defensive and interest-sensitive Utilities sector (down 5.1%).

U.S. Equities

- U.S. stocks closed out last month up 2.8%, moving still further away from their pandemic-induced 2020 lows.
- With 10 out of 11 sectors currently positive on a 12-month basis, the current rally could only be categorized as "broad-based."
- A perking up in oil prices helped Energy stocks remain the best performing sector for a second consecutive month as well as outperforming the next best sector by an impressive 11.2%. Other cyclical stocks such as Financials and Industrials (11.5% and 6.9%, respectively) impressed as well.
- In similar fashion to their cousins to the North, laggards for the month included the more defensive and interest-sensitive Utilities sector (down 6.1%).

Commodities

- A reduction in output from Saudi Arabia combined with colder weather in Texas hampering production, helped to support the price of oil last month.
- WTI closed out February near a recent peak of $63.53 per barrel – a level not seen since May, 2019.
- Meanwhile, rising real yields weighed on the value of bullion, with Gold prices dropping 7% in February.

Foreign Exchange

- The value of the U.S. dollar against a basket of major currencies seesawed last month, ultimately finishing a tick higher (up 0.3%) following a volatile trading day on the last day of the month.
- As for the Loonie, a steady appreciation in its value throughout the month was quickly interrupted and reversed over the course of the final two trading days of the month, with the currency closing out February relatively flat.

Table 2 Market Total Returns

Asset Classes	February	YTD	12 months
Cash (3-month T-bills)	0.0%	0.0%	0.6%
Bonds (FTSE CA Ovr. Univ.)	-2.5%	-3.6%	1.1%
FTSE CA Short term	-0.8%	-0.7%	2.8%
FTSE CA Mid term	-3.1%	-3.6%	2.3%
FTSE CA Long term	-4.2%	-7.1%	-1.9%
FTSE CA Government	-2.7%	-4.0%	0.5%
Federal	-2.1%	-3.0%	0.6%
Provincial	-3.2%	-4.9%	0.2%
Municipal	-3.0%	-4.1%	1.7%
FTSE CA Corporate	-2.0%	-2.5%	2.8%
AA+	-1.1%	-1.2%	3.0%
BBB	-2.0%	-2.2%	3.5%
BoAML Inv. Grade ($US)	-2.0%	-3.2%	2.5%
BoAML High-Yield ($US)	0.3%	0.7%	8.6%
Preferred Shares	4.2%	6.9%	17.4%
Canadian Equities (S&P/TSX)	4.4%	4.0%	14.7%
Energy	9.1%	12.2%	-9.3%
Industrials	5.0%	1.9%	21.8%
Financials	6.9%	6.8%	12.3%
Materials	-4.4%	-7.8%	23.9%
Utilities	-5.1%	-2.6%	7.0%
Cons. Disc	8.7%	5.9%	37.1%
Cons. Staples	-1.0%	-6.3%	-0.5%
Healthcare	4.6%	41.6%	34.2%
IT	9.9%	9.1%	85.0%
Comm. Svc.	-0.9%	-0.4%	0.0%
REITs	4.9%	6.5%	-3.9%
S&P/TSX Small Cap	9.5%	10.0%	41.8%
US Equities (S&P500 USD)	2.8%	1.7%	31.3%
Energy	22.7%	27.3%	11.1%
Industrials	6.9%	2.3%	25.9%
Financials	11.5%	9.6%	24.6%
Materials	3.9%	1.4%	42.4%
Utilities	-6.1%	-7.0%	-2.8%
Cons. Disc	-0.9%	-0.5%	42.5%
Cons. Staples	-1.4%	-6.5%	12.3%
Healthcare	-2.1%	-0.7%	24.1%
IT	1.2%	0.3%	49.7%
Comm. Svc.	6.2%	4.8%	37.1%
REITs	1.5%	2.1%	5.1%
Russell 2000 (USD)	6.1%	11.5%	49.1%
World Eq. (MSCI ACWI)	2.3%	1.9%	30.9%
MSCI EAFE (USD)	2.3%	1.2%	23.0%
MSCI EM (USD)	0.8%	3.9%	36.5%
Commodities (CRB index)	9.3%	13.5%	19.6%
WTI Oil (US$/barrel)	21.8%	31.6%	41.9%
Gold (US$/ounce)	-7.0%	-9.0%	8.9%
Copper (US$/tonne)	16.2%	17.9%	62.7%
Forex (DXY - US Dollar index)	0.3%	1.0%	-7.4%
USD per EUR	-0.1%	-0.8%	10.5%
CAD per USD	-0.3%	0.1%	-4.9%

CIO Office (data via Refinitiv) 2021-02-26

COVID-19 down...

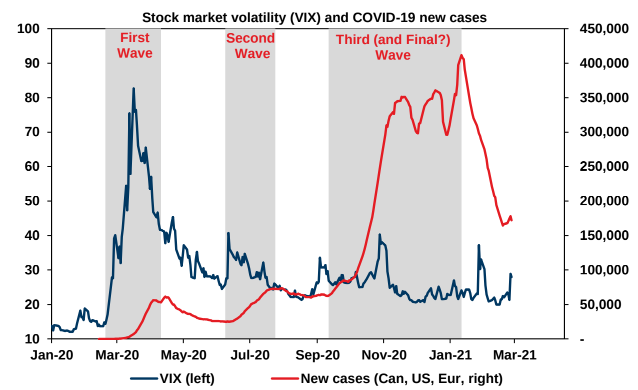
Despite an increase in volatility at the end of the month, February proved favourable for risky assets with global equities increasing their lead over bond markets, which are showing losses year-to-date (Chart 1).

1 Equity markets widened their lead in February...

CIO Office (data via Refinitiv).

This reflects, in part, a marked improvement in the fight against coronavirus, just in time for its first "anniversary" since the WHO formally categorized its spread as a global pandemic.[1] The number of new cases per day in developed countries has fallen sharply since their peak on January 11 (Chart 2), while the vaccination campaign continues to gain momentum globally (Chart 3).

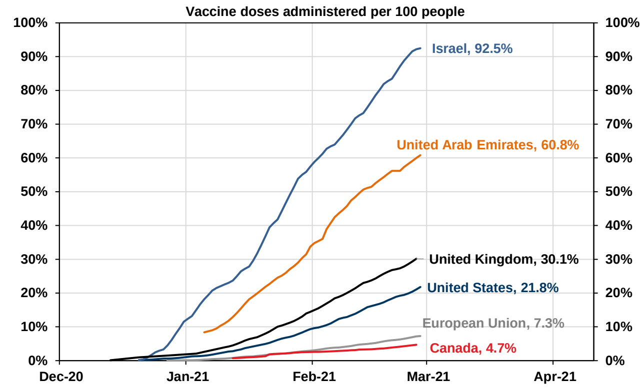
2 ... with new COVID-19 cases falling...



CIO Office (data via Refinitiv, Johns Hopkins University).

As you can see, Israel has a significant lead in the race toward herd immunity. It is still too early to fully measure the economic impact of their progress, which is not expected to have a significant effect beyond its borders in any case, given that the country accounts for only 0.28% of the world's GDP. However, this advance gives us a more complete picture of the effectiveness of mass vaccination, and the news is good.

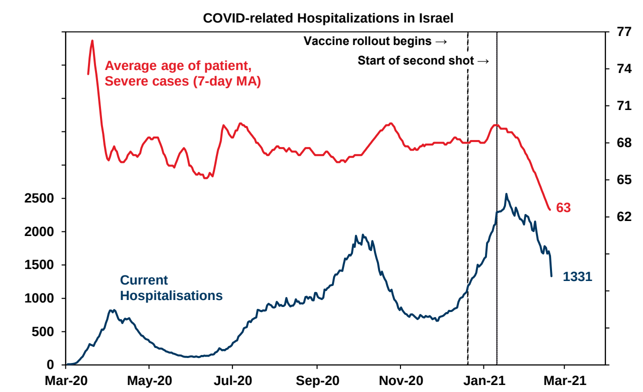
3 ... the vaccination campaign accelerating...



CIO Office (data via Our World in Data).

For instance, Israeli data showed an 85% efficacy rate 15 to 18 days after the first dose of Pfizer's vaccine – a figure that increases to 95% after the second dose.[2] In addition, not only has the number of hospitalizations dropped by about half from its peak, but the average age of patients – relatively stable before the vaccination campaign started – has dropped significantly (Chart 4).

4 ... and working



CIO Office (data via Our World in Data, data.gov.il/dataset/covid).

These numbers strengthen our base-case scenario which assumes that while COVID-19 will remain an issue throughout the year, its scope will diminish as immunization of the most-at-risk population reduces the pressure on health care systems. Uncertainty associated with the variants remains, but there are reasons to believe that a turning point should be reached by summer, if it has not already occurred.

... rates up...

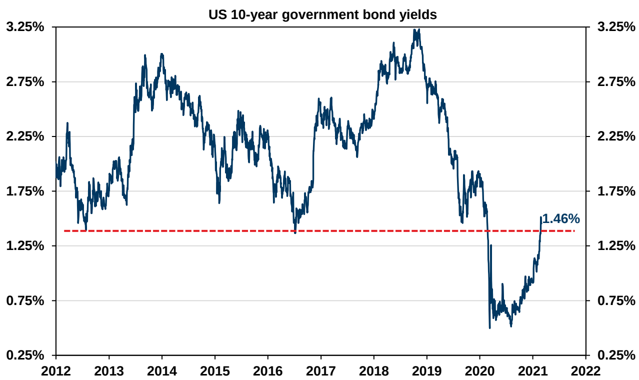
With the light at the end of the COVID-19 tunnel approaching, it is no surprise that market attention is increasingly turning to what awaits us beyond the health crisis. Factoring in the magnitude of upcoming fiscal spending – the U.S. Congress is

[1] WHO declares the coronavirus outbreak a global pandemic, March 11, 2020.

[2] Israeli study finds Pfizer vaccine 85% effective after first shot, Reuters, February 18, 2021.

on track to pass the entire $1.9 trillion Biden plan by mid-March[3] – the bond market concludes that this merits higher interest rates. Accordingly, 10-year U.S. Treasury yields jumped above a key technical threshold last month (Chart 5). This raises a question: what is the upside potential for rates from here on out?

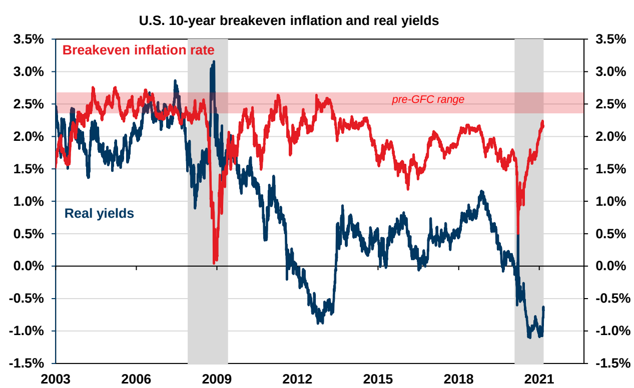
5 Sharp jump in 10-**year Treasury yields…**



CIO Office (data via Refinitiv).

To respond to this, it is essential to analyze rate movements in two components: expected inflation and real rates. Since their lows in August, the rise in expected inflation has been largely responsible for the climb in yields. Breakeven inflation could still increase by about ~30 bps before settling into the pre-financial crisis range recognized as being consistent with a Federal Reserve that meets its inflation target (Chart 6). This is unlikely to happen in a straight line, but a strong economic recovery could certainly bring us there by the end of the year – an optimal scenario for the Fed, which has been trying unsuccessfully to anchor inflation expectations higher for several years.

6 **… but upside appears relatively limited…**

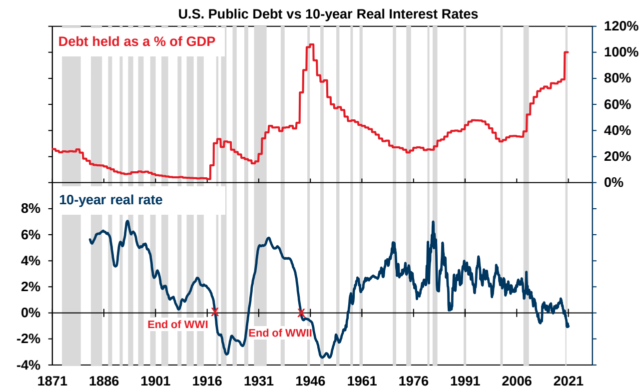


CIO Office (data via Refinitiv).

That said, for interest rates to rise significantly higher, real rates – which rose considerably in February but remain negative – would have to contribute to the trend. These essentially reflect the outlook for the Federal Reserve's policy rate and, on this front, it seems that the market is currently trying to test the Central Bank's tolerance for letting them run higher. However, for three main reasons we should expect Powell to stay the course and thus limit any substantial increase.

First, keeping real interest rates negative in the face of the substantial increase in public debt is an integral part of the U.S. Central Bank's "post-war" strategy (Chart 7). It would be surprising if the Fed were to hastily abandon this key condition.

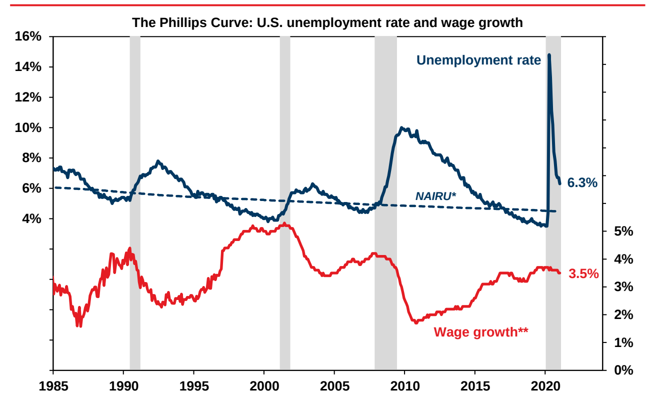
7 **… as real yields should remain negative…**



CIO Office (data via Refinitiv, FRED, CBO).

Second, the Fed's new policy framework formalized last summer places greater emphasis on ensuring "maximum" and "inclusive" employment levels than on the possibility of higher inflation.[4] As such, Powell is unlikely to change his tune at the current level of unemployment. And even when employment fully recovers, it seems his intention is to ignore the Phillips[5] curve and wait until wage increases materialize before considering possible rate hikes (Chart 8).

8 **… given the Fed's focus on employment…**



CIO Office (data via Refinitiv). *Non-Accelerating Inflation Rate of Unemployment, CBO estimates. ** Atlanta Fed wage tracker since 1997, total private nonfarm average hourly earnings before.

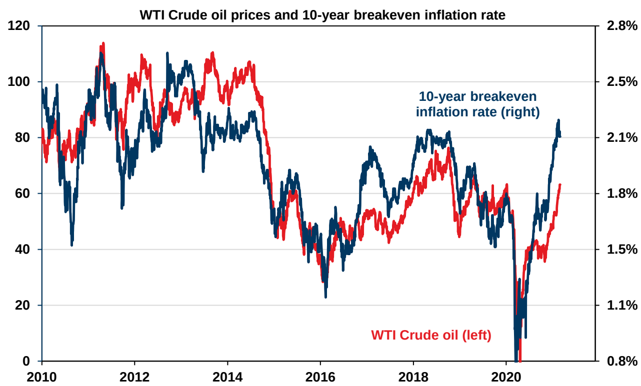
[3] House Puts $1.9 Trillion Stimulus on Fast Track, With No G.O.P. Votes, The New York Times, February 22, 2021.

[4] What is the Fed's new policy framework, and why does it matter? Reuters, August 27, 2020.

[5] With new monetary policy approach, Fed lays Phillips curve to rest, Reuters, August 28, 2020.

Third, while a confluence of circumstantial events is most likely to spur inflation over the next few months, it is equally likely that this will be tolerated by the Fed. These include baseline effects, as discussed in last month's report, but also bottlenecks in certain sectors of the economy affected by the pandemic which are poised to see a rapid increase in demand for their goods and services. On top of this, the recent rise in oil prices – closely linked to the increase in breakeven inflation (Chart 9) – accentuated by the production stoppage following the deep freeze in Texas is also among the volatile elements that, in principle, should not have a persistent impact on core inflation.

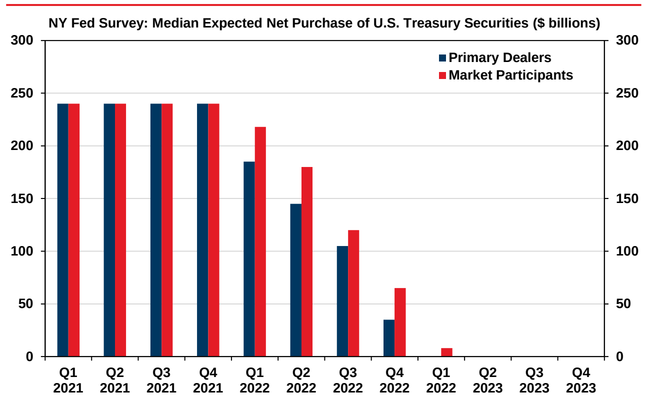
9 … and intention to tolerate the impending rise in inflation



CIO Office (data via Refinitiv).

Could it be the Fed is wrong in believing that the impending rise in inflation will only be transitory, and that the Philips curve no longer applies to today's world? In fact, the reality is probably that the Fed is perfectly aware of the potential for a sustained increase in inflation (which it partly seeks). On the other hand, the Fed is also well aware that the words it uses are themselves a monetary policy tool: the slightest deviation from the current rhetoric of maximum accommodation would risk tightening monetary conditions and jeopardize the economic recovery (à la Taper Tantrum of 2013). For now, the first material change to the Fed's policy stance is expected in late 2021/early 2022 when it may signal a reduction in the pace of asset purchases (Chart 10).

10 Assets purchases should begin to taper early next year



CIO Office (data via New York Fed).

In sum, this suggests long-term bond yields do have upward potential over a 12-month horizon, but this remains relatively limited and should mainly come through an increase in inflation expectations.

… and stocks? Well, it's complicated…

The follow-up question: to what extent is the stock market threatened by this potential increase in long-term interest rates? To answer this question, a look at history is in order and may surprise some investors.

When we look at the average annual return of global equities in parallel to bond yield movements since 1980, we see that stocks have performed almost twice as strong when rates were rising (15.9%) than when they were falling (8.6%). Even more interesting, when we divide this period into two 20-year blocks, we see that since 2000, the bulk of stock market returns have been achieved in a context of rising long-term rates (average return of 18.6%, compared with 0.4% when rates were down). This portrait is, however, different between 1980 and 2000, a period when the stock market did better in a context of declining (18.4%) rather than rising (13.5%) rates (Chart 11).

11 The relationship between stocks and yields…

MSCI World annual total return and changes in interest rates*

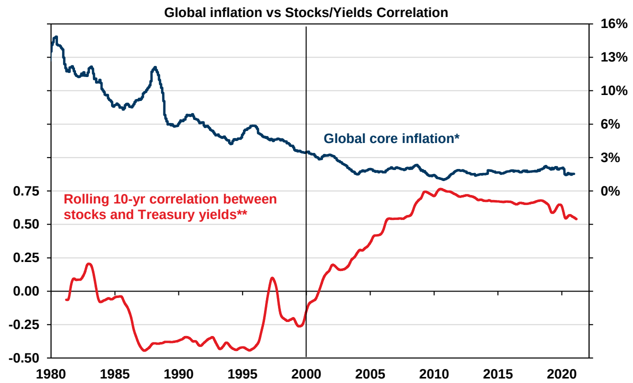
Annual change in 10-yr Treasury yields (in bps)	1980 - 2020 % of obs.	1980 - 2020 Average Equity Return	1980 - 2000 % of obs.	1980 - 2000 Average Equity Return	2000 - 2020 % of obs.	2000 - 2020 Average Equity Return
> 150	8%	16.0%	15%	15.7%	1%	21.7%
100 to 150	6%	18.4%	8%	15.2%	4%	24.7%
50 to 100	12%	16.6%	11%	12.8%	14%	19.4%
0 to 50	14%	14.2%	10%	9.7%	18%	16.5%
0 to -50	19%	8.8%	11%	9.9%	27%	8.4%
-50 to -100	18%	2.1%	16%	13.0%	20%	-6.0%
-100 to -150	13%	3.8%	13%	15.4%	14%	-6.4%
< -150	9%	29.3%	16%	31.9%	1%	-1.7%
Rates up	41%	15.9%	44%	13.5%	37%	18.6%
Rates down	59%	8.6%	56%	18.4%	63%	0.2%

CIO Office (data via Refinitiv). *U.S. 10-yr Treasury yields. *% of obs.* = Percentage of observations.

How can this be explained and, especially, why the divergence between the two sub-periods? A fundamental factor is the evolution of the monetary and inflationary context over the decades. Prior to the 2000s, periods of rising interest rates were mainly driven by central banks seeking to stabilize inflation lower, which they ultimately succeeded in doing by the turn of the millennium. Since then, the main contributor to rising bond yields has generally been improving economic growth prospects. Consequently, the correlation between stock markets and interest rate movements has changed from generally negative before 2000 to positive thereafter (Chart 12, next page).

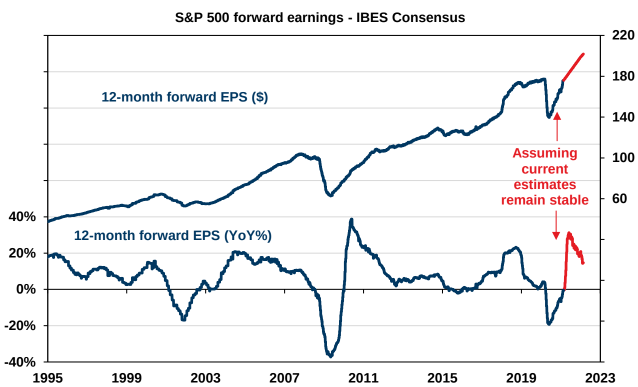
A return to the paradigm of the pre-2000 years at some point in the next decade cannot be ruled out. But for the time being, it goes without saying that central banks are not engaged in a fight against inflation – quite the opposite. On the other hand, a marked rebound in economic growth is on the horizon (Chart 13, next page), suggesting that stock markets, as a whole, may carry on their bull run.

12 ... depends on the relationship of central banks with inflation



CIO Office (data via Refinitiv). *CPI excluding food and energy, OECD total. ** Correlation between MSCI World total annual total return and U.S. 10-yr treasury yields annual change.

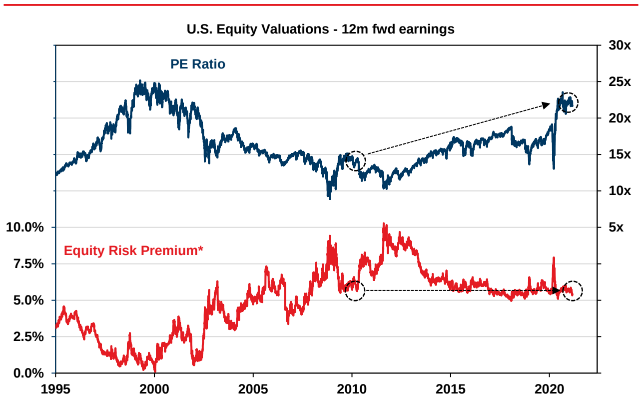
13 A significant increase in earnings is on the horizon



CIO Office (data via Refinitiv).

Of course, this does not preclude episodes of heightened volatility caused by inflationary fears and a possible tightening of monetary conditions, as mentioned in last month's report and, indeed, observed in late February. However, as long as real rates do not rise too high too quickly, the equity risk premium – a valuation measure that seeks precisely to quantify the opportunity cost between stocks and bonds – should remain largely in favour of equities (Chart 14).

14 Risk premium still favours equities



CIO Office (data via Refinitiv). *Inverse of the P/E ratio less (10-year rate less 10-year CPI inflation swap).

... for some more than others

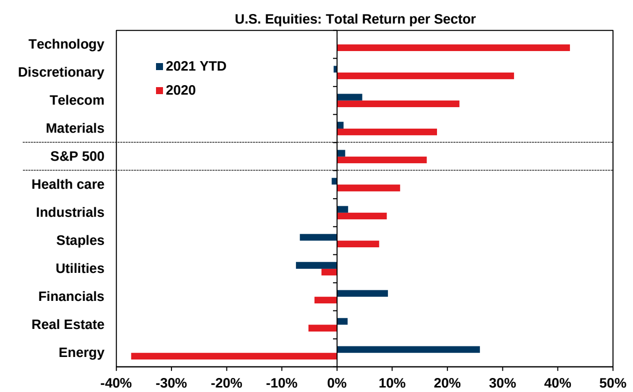
Although overall, we conclude that the stock market can absorb the rise in long-term yields, this is clearly easier (and even beneficial) for cyclical stocks, and less so for defensive stocks (Chart 15).

15 Interest rates: a key factor for equity leadership

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

Case in point: the energy sector recorded an impressive 26% increase year-to-date (first position), a sharp contrast to its 37% decline in 2020 (last position). At the other end of the spectrum, the technology sector – the big winner in 2020 – is lagging behind since the start of the 2021 and unchanged over the period (Chart 16).

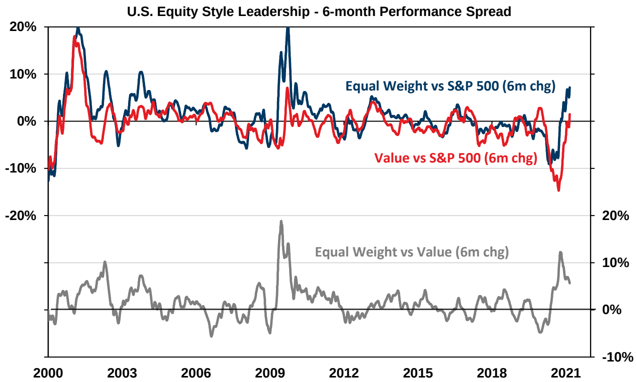
16 Winners of 2020 are passing the baton



CIO Office (data via Refinitiv).

We did not expect to see rates and stock market leadership move this quickly and with such amplitude. However, our preference for cyclicality within equities was positioned in that direction. Concretely, we still like the equally weighted S&P 500 Index. Back in September, we argued that it should benefit from an upcoming widespread improvement in economic activity shifting investors' appetites from the few large technology companies dominating the U.S. stock market. Six months later, this index has not only outperformed the capitalization-weighted S&P 500, but also the value style (Chart 17, next page) – and we see this trend continuing.

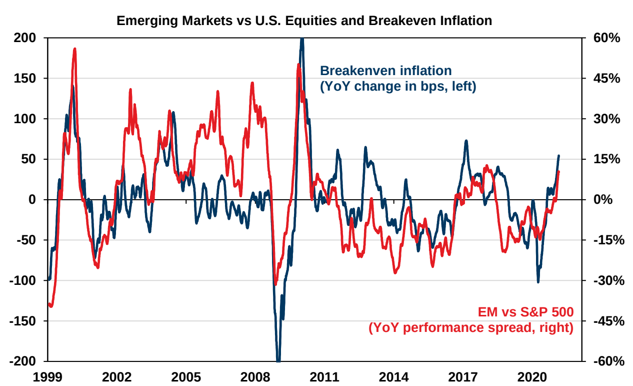
17 Net outperformance for the U.S. equally weighted index



CIO Office (data via Refinitiv).

Geographically, emerging markets (EMs) are certainly more vulnerable to a context of tighter monetary conditions involving higher real yields, as we saw at the end of February. However, we continue to believe that EMs are best equipped to outperform in a context of a pick-up in global growth. This is especially the case when compared with U.S. stocks which are more defensive in nature and when expected inflation is on the rise as it should be during the year (Chart 18). In part, this is why we have been overweighting this region since last August, a position that we recently increased against a reduction in our allocation to U.S. equities.

18 Rising inflation expectations: a tailwind for emerging mkts



CIO Office (data via Refinitiv).

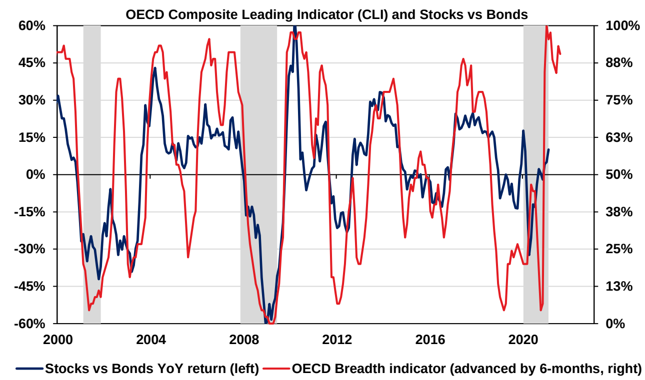
Investment Conclusion

Fundamentally, the economic background continues to evolve in the desired direction. Advances on the vaccination front, the sharp decline in new cases of COVID-19, and the imminence of a major fiscal plan in the United States all point to a strong recovery in economic activity in the near future.

The counterpart to these positive developments was considerable movement in longer-term bond yields, with markets visibly seeking to test the conviction behind the Federal Reserve's intentions regarding an impending rise in inflation. We do not expect the Central Bank to change its stance in the coming months. As a result, the rise in rates, although it has the potential to continue during the year, should slow down and remain relatively contained.

For the stock market, this is probably not our last episode of increased volatility caused by inflationary fears. However, this has more implications for equity leadership than for the sustainability of the equity bull market at this stage. As such, we are keeping our asset allocation unchanged this month, as we continue to expect equities to outperform bonds driven by a broad-based recovery in global growth in 2021 (Chart 19).

19 A broad-based rebound in global growth is in sight



CIO Office (data via Refinitiv). Stocks vs Bonds = MSCI World total return vs U.S. 10-yr Treasuries total return.

Table 3 Base Case Scenario

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

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

Table 4 Global Asset Allocation - Model Portfolio Weights (in CAD)

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

CIO Office. The fixed income benchmark is 100% FTSE Canada Universe. There are no alternative assets in the benchmark as their inclusion is conditional on improving the risk/return properties of traditional assets (60/40). The amplitude of the color bars under the "Active Weight" columns are proportional to the maximum deviations of the portfolio (+/- 10% for stocks and bonds, +10% in cash, +20% in alternative assets).

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General

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