

Q3 2024

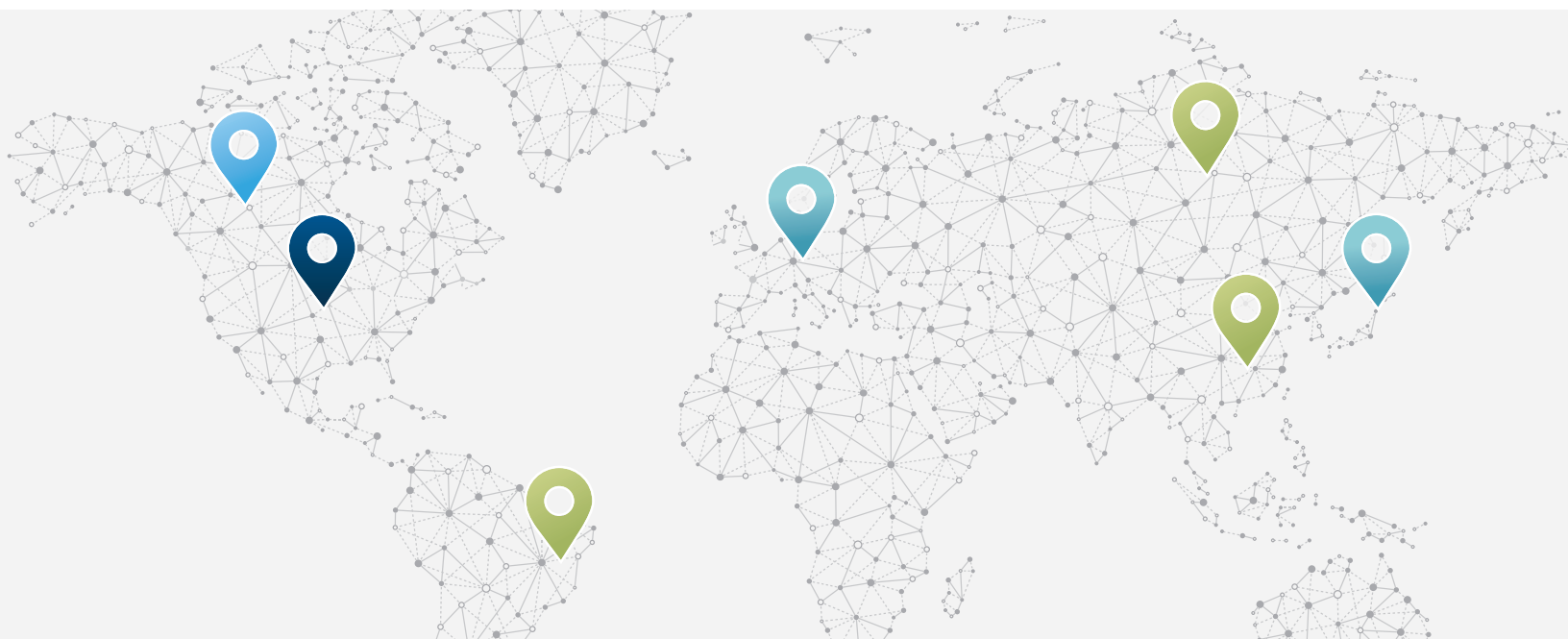
Investment Outlook  
and Portfolio Strategy



# Macroeconomic Landscape

## Global

The global economy has held firm and is growing at an above-trend pace. Encouragingly, inflation is coming to heel across the globe, which has allowed major central banks to pivot towards an easier monetary policy stance.



### United States

The US economy has defied expectations for a more meaningful slowdown, while progress on the inflation front stalled out in early 2024. The good news, however, is that the disinflation process has resumed somewhat, with recent economic and inflation data painting a more promising picture. The Federal Reserve's preferred gauge of underlying inflation has decelerated to a three-year low, while the economy is also cooling down. Still, Chair Powell has reinforced that officials would like to see further concrete evidence of these trends before pivoting.

### Canada

The Canadian economy is running at an anemic pace, with growth slowing to below the economy's potential rate as the impact of cumulative rate hikes weighs on heavily indebted households that are more sensitive to higher borrowing costs. The Bank of Canada has managed to steer the economy into a state of better balance between supply and demand ("modest excess supply"). With inflation melting away more prominently versus its neighbour to the south, the Bank of Canada lowered interest rates at the June gathering.

### International

After an extended period of stagnation, the Eurozone economy rebounded at the beginning of 2024, while unemployment stands at its lowest on record. While the European Central Bank cut interest rates in June, higher inflation forecasts and an unwelcome acceleration in wages are the latest signs that price pressures in the region are proving stubborn and argues for a patient and data dependent approach going forward. Indeed, President Lagarde said "this underpins our determination to be data-dependent and to take policy decisions meeting-by-meeting."

### Emerging Markets

The Chinese economy is facing dual headwinds on both the domestic and external fronts. Property market woes and poor private sector sentiment have limited the scope for domestic-driven growth, while weak external demand conditions and a resumption in trade tensions are constraining export growth. Without quicker and bolder stimulus measures from Beijing, the risk is that growth will undershoot the official 5% target for 2024. However, policy support has underwhelmed. The People's Bank of China has refrained from cutting rates, while fiscal spending has also lagged.

# Economic Outlook

## A Soft Economic Landing

The evolution of both the economic and inflation data has raised the likelihood the Federal Reserve will successfully engineer a soft landing. This may prompt the Federal Reserve to cut interest rates by more than widely anticipated.

Indeed, our closely monitored Key Policy Variables that dictate the path for monetary policy support this narrative. The US economy has cooled to a below-trend pace. After growing by just 1.4% in the first quarter, the Atlanta Fed GDPNow forecast is currently pointing towards 1.5% growth in the second quarter of 2024. There are also some tentative signs that the labour market is coming into a better balance. The ratio of job openings to unemployed persons that measures the balance between demand and supply in the labour market has reverted back toward its pre-pandemic range. Evidence of weakness was also apparent in the latest nonfarm payrolls report. While the economy added a respectable 206k jobs in June,

the prior two months were revised down by a whopping -111k. The unemployment rate has also risen to 4.1% from its cyclical low of 3.4%. As slack continues to build in the labour market, that would undoubtedly help to alleviate upward pressure on wages. On that note, inflation is ebbing. The latest consumer price index (CPI) report came in on the soft side, with both headline and core inflation printing better than expected in June. Finally, long-term inflation expectations remain well-anchored and are stable enough to enable the Federal Reserve to cut interest rates soon.

Meanwhile, Chair Powell provided the clearest acknowledgement yet of the risk of waiting too long to cut interest rates and argued that the risks around inflation and growth are now more two-sided. As inflation shows more concrete signs of slowing, the Federal Reserve's focus is likely to shift towards a deteriorating labour market.

KEY POLICY VARIABLES: UNITED STATES	Federal Reserve Target	Current	Soft Landing	Inflation Revival
Gross Domestic Product Growth (Q/Q, Annualized)	1.6%	1.8%	**	
Unemployment Rate (%)	4.1%	4.1%	**	
Nonfarm Payrolls (3 Month Average)	150k	177k	**	
Average Hourly Earnings (Y/Y)	3.0%	3.9%	**	
Job Openings To Unemployed Ratio	1.20	1.22	**	
Core Personal Consumption Expenditures Price Index (Y/Y)	2.3%	2.6%	**	
Long-Term Inflation Expectations (%)	2.5%	3.0%	**	
FEDERAL RESERVE POLICY RATE		5.50%	LOWER	STABLE

Source: Fiera Capital, as of July 3 2024.

## Outlook & Investment Strategy

It would appear that achieving a "Soft Landing" for the US economy seems much more conceivable. Our high-probability scenario assumes that the disinflationary trend reasserts itself in the coming months with little in the way of damage to the economy. The combination of lower interest rates and positive earnings momentum bodes particularly well for risk assets and warrants a moderate overweight allocation to stocks over our cyclical time horizon.

# Economic Scenarios

## Main Scenario | Soft Landing

Probability 55%

In this optimistic scenario, the world's major central banks prove successful in engineering a so-called soft economic landing, thanks to a persistent downtrend in inflation that comes with very limited deterioration in the economy. The disinflationary impulse prompts central bankers to transition from an on-hold monetary policy stance towards aggressive interest rate cuts and inflation is contained without a recession or a significant cost to employment. Central banks achieve the soft landing by cutting rates at early signs of economic weakness, keeping the economy not-too-hot or not-too-cold, but just right. Consequently, the economy averts a hard landing and a new economic cycle begins.

## Scenario 2 | Inflation Revival

Probability 25%

In the "inflation revival" scenario, both growth and inflation surprise to the upside, which brings into question the ability of central banks to pivot towards easing monetary policy. Should persistent economic resilience, tighter than expected labour market conditions, and the recent easing of financial conditions spark a second wave of inflation, central banks would undoubtedly abandon their plans to cut interest rates and instead prioritize bringing inflation back to 2% by leaving interest rates at current elevated levels for an extended time. Indeed, cutting interest rates while the economy is operating above its potential and at a time when labour market conditions remain relatively tight risks slowing or even reversing the disinflation process. Amplifying the upside risks to inflation would be an unwelcome escalation in the geopolitical conflicts in Ukraine and/or the Middle East that would create an oil shock and add to the inflationary impulse. Taken together, unrelenting economic strength would pose an obstacle to imminent central bank rate cuts and would necessitate an extended period of restrictive monetary policy until inflation is firmly on the path to 2%.

## Scenario 3 | Shallow Recession

Probability 20%

In the "shallow recession" scenario, consumer-led tailwinds that acted as a buffer to the sharp increase in interest rates through 2023 morphs into headwinds that inevitably pushes the economy into a mild recession. Cumulative central bank tightening begins to weigh more meaningfully on both consumers and businesses given the long lags in the monetary transmission mechanism and weighs more prominently in the data. Specifically, household finances deteriorate under the weight of a cooling jobs market and dwindling excess savings that are set to be drawn down by mid-year. Meanwhile, tight monetary policy and credit conditions exerts more pain on businesses, manifesting itself into a surge in bankruptcies of vulnerable businesses. Inflation slows by much more than expected in response to the loss of economic momentum. Central banks begin cutting interest rates imminently and by more than previously thought, but not soon enough to avert a rise in unemployment and a mild recessionary outcome.

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# Portfolio Strategy

## Matrix of Expected Returns (USD)

SCENARIOS	SOFT LANDING	INFLATION REVIVAL	SHALLOW RECESSION
<b>PROBABILITY</b>	<b>55%</b>	<b>25%</b>	<b>20%</b>
<b>TRADITIONAL INCOME</b>			
Money Market	4.5%	5.1%	4.0%
U.S. Investment Grade Bonds	2.6%	-3.4%	6.1%
<b>NON-TRADITIONAL INCOME</b>			
Diversified Credit	7.0%	8.0%	7.0%
Diversified Real Assets	7.0%	8.0%	6.0%
<b>TRADITIONAL CAPITAL APPRECIATION</b>			
U.S. Equity	11.3%	-10.7%	-31.1%
International Equity	10.6%	-9.3%	-24.2%
Emerging Market Equity	17.4%	-13.8%	-28.2%
<b>NON-TRADITIONAL CAPITAL APPRECIATION</b>			
Private Equity and Placements	15.0%	12.0%	8.0%
Liquid Alternatives	7.5%	5.0%	2.5%

Source: Fiera Capital, as of June 28, 2024.

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# Current Strategy<sup>1</sup>

## Traditional and Non-Traditional Portfolios

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
<b>TRADITIONAL INCOME</b>	0.0%	17.5%	40.0%	2.5%	-15.0%
Money Market	0.0%	0.0%	40.0%	2.5%	+2.5%
U.S. Investment Grade Bonds	0.0%	17.5%	40.0%	0.0%	-17.5%
<b>NON-TRADITIONAL INCOME</b>	0.0%	30.0%	50.0%	38.5%	+8.5%
Diversified Credit	0.0%	12.0%	25.0%	15.5%	+3.5%
Diversified Real Assets	0.0%	18.0%	40.0%	23.0%	+5.0%
<b>TRADITIONAL CAPITAL APPRECIATION</b>	17.5%	37.5%	57.5%	42.5%	+5.0%
U.S. Equity	0.0%	20.0%	40.0%	25.0%	+5.0%
International Equity	0.0%	12.5%	20.0%	7.5%	-5.0%
Emerging Market Equity	0.0%	5.0%	20.0%	10.0%	+5.0%
<b>NON-TRADITIONAL CAPITAL APPRECIATION</b>	0.0%	15.0%	40.0%	16.5%	+1.5%
Private Equity	0.0%	10.0%	25.0%	11.0%	+1.0%
Liquid Alternatives	0.0%	5.0%	15.0%	5.5%	+0.5%

Source: Fiera Capital, as of June 28, 2024.

<sup>1</sup> Based on a 100 basis point value added objective. The benchmark employed here is based on a model portfolio and for illustrative purposes only. Individual client benchmarks are employed in the management of their respective portfolios. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

# Fixed Income Outlook

## Fixed Income Review

Fixed income markets generated modestly positive results in the second quarter. While treasury yields pushed higher as investors dialed back their wagers for rate cuts from the Federal Reserve, Canadian bond yields were restrained by softer inflation prints that set the stage for rate cuts from the Bank of Canada. For the quarter, the Barclays US Aggregate Bond Index rose 0.1%.

In the United States, economic resilience and a lack of persistent progress on the inflation front have pushed out the timing for rate cuts from the Federal Reserve. After leaving rates unchanged in June, officials dialed back their forecast for rate cuts in 2024 to one (from three). While recent data has revealed that inflation is resuming its downtrend, Chair Powell reinforced the need for more evidence that the disinflationary trend is intact before pivoting.

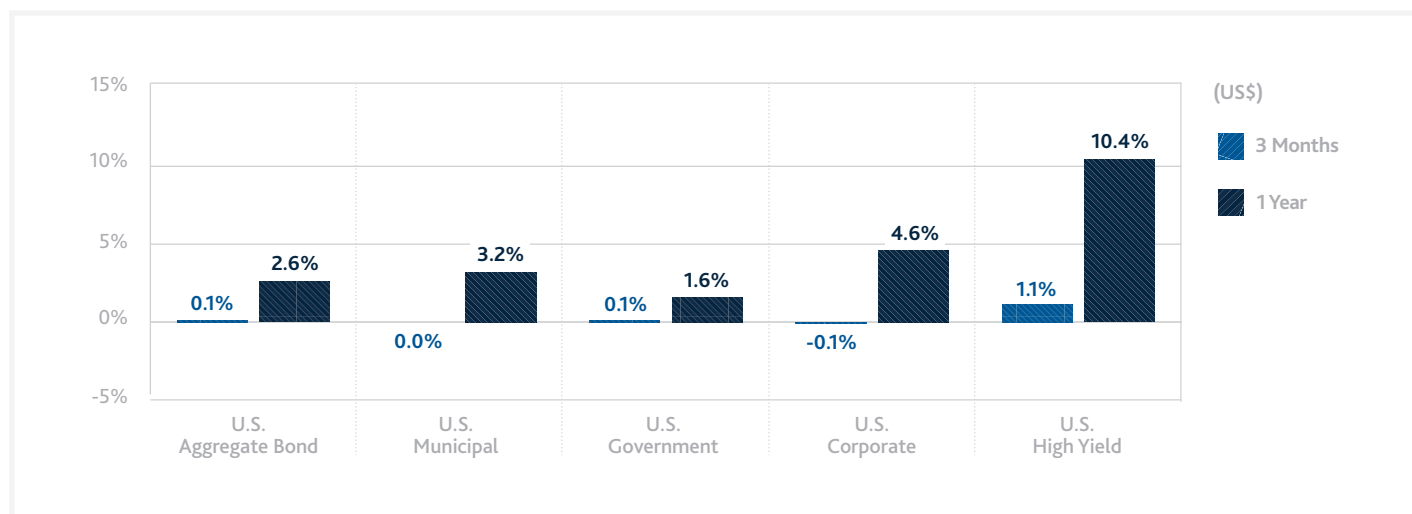
The disinflationary impulse has been more profound in Canada and the Eurozone, allowing their respective central banks to begin easing in June. The Bank of Canada reduced rates by 25 basis points to 4.75%. The Bank framed the decision in response to continued progress on underlying inflation and signaled that this is the first in a series of moves. However, the Bank of Canada's preferred measures of core inflation recently reaccelerated after four months of improvement, casting doubt on the possibility of a second rate cut in July as policymakers wait to confirm whether the latest setback is temporary.

The European Central Bank followed suit and cut the deposit rate by 25 basis points to 3.75% but stopped short of indicating more will follow given elevated wage growth and the fact that inflation is expected to stay above target well into 2025. President Lagarde emphasized that the central bank doesn't yet have sufficient evidence that the threat of inflation has passed. The Bank of England falls somewhere in between. While growth has slowed, the persistence of services inflation (wages) are a lingering concern. The hope is that with employment falling and unemployment climbing, wage growth should soon be on a firm downward path that would allow for the Bank of England to join the easing cycle.

## Investment Strategy

Over the last quarter, bond markets have realigned themselves closer to central banks' forecasts, leaving little in the way for further downside in bond yields (and upside in prices). However, the looming risk of a second inflation wave suggests that the risk to bond yields is to the upside (and prices to the downside) – a “hawkish” surprise that would ultimately be negative for bonds. Lingering geopolitical angst adds to the upside risks for bond yields. Given these unattractive risk-reward prospects, we maintain an underweight allocation to bonds.

## U.S. Fixed Income Market Returns



Source: Fiera Capital, as of June 28, 2024.

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# Equity Outlook

## Equity Review

The “soft landing” narrative extended throughout the second quarter and catalyzed a market rally that saw many global indices breach new highs. In Canadian dollar terms, the MSCI All Country World rose 4.0%. Regionally, the S&P 500 advanced 5.4%. However, the rally has been extremely narrow in breadth, with the “magnificent 7” stocks driving a majority of the quarterly return. Indeed, on an equal-weighted basis, the S&P 500 actually declined in the second quarter. Meanwhile, the S&P/TSX lagged its global peers and edged modestly (-0.5%) lower owing to lackluster performance in the heavyweight energy and financials sectors. Elsewhere, the MSCI EAFE also struggled as political risks intensified following the European Union and French elections. Finally, the MSCI gauge of emerging market stocks outperformed its global peers and jumped 6.1% in the second quarter.

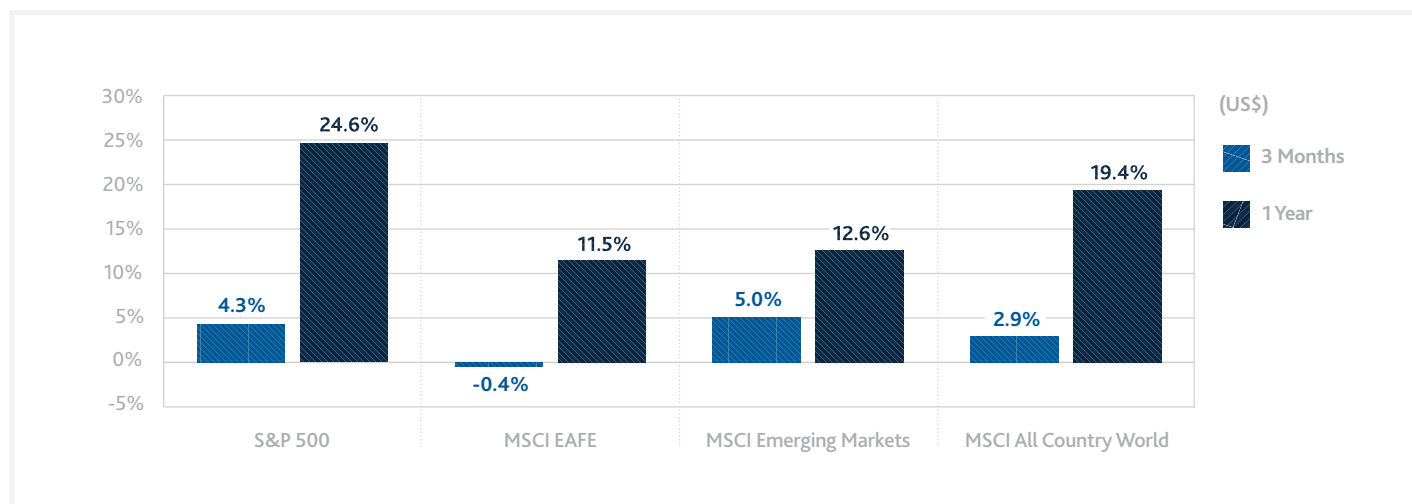
Our high-probability scenario is calling for a goldilocks “soft landing” scenario where inflation decelerates towards the 2% target without a meaningful deterioration in economic activity. This allows central banks to cut interest rates at early signs of economic weakness, keeping the economy not-too-hot or not-too-cold, but just right. An environment of disinflationary growth is unambiguously positive for stocks. Indeed, in our base case scenario, global equities would require both earnings growth (the “E” in P/E) and central bank rate cuts (the “P” in P/E) to validate current valuations and the potential for further upside. We assign a 55% probability to this optimistic scenario.

That being said, there are some notable risks to the outlook and recent stock market gains would undoubtedly be vulnerable should investors move to price-in an alternative scenario that includes either a restrained liquidity backdrop (“Inflation Revival” = 25%) and/or a deteriorating growth and earnings backdrop (“Shallow Recession” = 20%). On the former, the risk of a second wave of inflation would prompt a “hawkish” policy response – namely the need for interest rates to remain higher for longer. In this scenario, upside surprises to both growth and inflation would force central banks to abandon their plans to cut interest rates. Bond yields would revert higher in response and equity market valuations would contract. On the latter, economic growth deteriorates more meaningfully as the cumulative impact of past rate hikes begins to take its toll. While central banks would certainly step in and slash interest rates, it would not be soon enough to avert a mild recessionary outcome and a bear market in stocks.

## Investment Strategy

Our sense is that disinflationary surprises and a soft economic landing are increasingly likely versus an inflation revival and/or a recessionary outcome. In this environment, the combination of rate cuts and positive earnings momentum should make way for a favourable backdrop for stocks over the next 12-18 months and warrants a moderate overweight allocation to equities.

## Equity Market Returns



Source: Fiera Capital, as of June 28, 2024.

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# Private Markets Outlook

## Inflation, Interest Rates and the Case for Non-Traditional Income

While inflation has made some notable progress in subsiding over the last year, there are growing reasons to believe that we are embarking on a period of structurally higher inflation over the next 5 years given secular forces including demographic trends (aging populations) and labour shortages, deglobalization (onshoring), rising debts/deficits, lingering geopolitical conflicts, and the imbalances associated with the green energy transition.

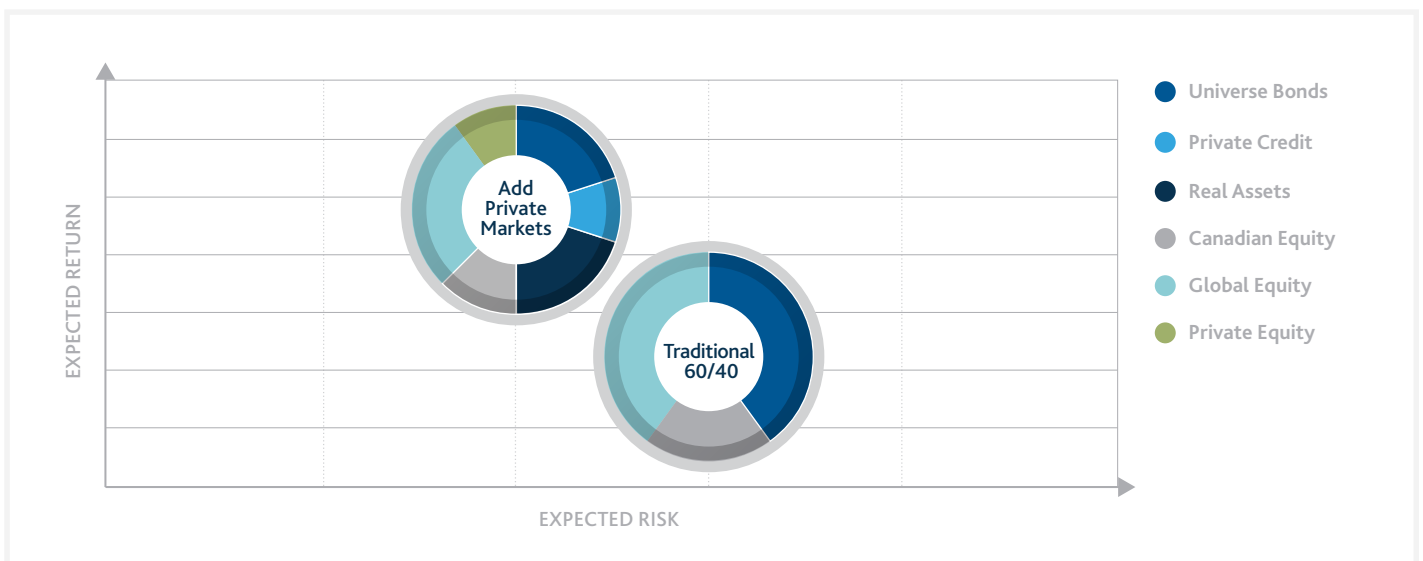
Structurally higher inflation (and accordingly, interest rates) suggests that traditional fixed income may fall short of what investors have grown accustomed to over the last several decades and reinforces the case for non-traditional sources of income in the portfolio setting.

From a portfolio construction perspective, these developments argue for an allocation to private credit and real assets as an alternative to traditional fixed income. Private credit is a viable option for those looking for stability, downside protection, and predictable yield. The opportunity is particularly compelling given that banks are retrenching from lending activities at a time when interest rates are elevated, which has allowed private lenders to fill that financing gap left by traditional banks and originate loans at attractive risk-adjusted yields. Meanwhile, in a world where

inflation is higher than it has been for the past four decades and is set to remain elevated, real assets should play a critical role in protecting purchasing power. Specifically, farmland and the underlying produced agricultural commodities tend to generate value in real terms as prices rise, while infrastructure has the potential to yield predictable cash flows that are uncorrelated to the economic cycle with contracts that frequently include built-in protections against inflation. Meanwhile, real estate is often considered a good inflation hedge because it is a tangible asset whose replacement costs rise with inflation, benefiting from the appreciation in value. From a valuation perspective, the opportunity is particularly compelling given that the monetary tightening cycle has reached a peak and interest rates have begun to decline, setting the stage for a recovery in the coming years.

In addition to the attractive investment attributes above, their low correlation to traditional asset classes and their differentiated sensitivities to the economic cycle provide diversification benefits and a reduction of overall portfolio risk, underscoring the merits of allocating to non-traditional income and enhancing the risk-reward proposition in the portfolio setting.

## Portfolio Resiliency and Private Market Strategies



Private Market strategies continue to be instrumental in the construction of a resilient and well-diversified portfolio. Optimizing a portfolio to include private credit, real assets, and private equity may enhance both the performance and durability of a total portfolio, including maximizing the potential for an increase in its reward per unit of risk.

Source: Fiera Capital, for illustrative purposes only.

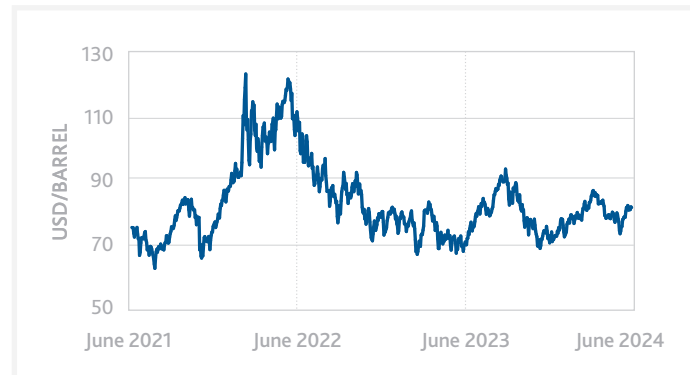
# Commodities and Currencies

## Currency Markets



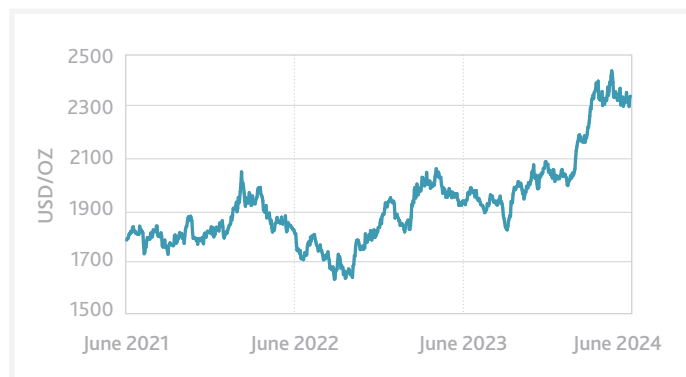
The US dollar (DXY dollar index) posted a quarterly gain after a host of global central banks pivoted to rate cuts ahead of the Federal Reserve. By contrast, both the loonie and the euro came under pressure given the profound disinflationary impulse that saw the Bank of Canada and European Central Bank cut borrowing costs in June. The yen failed to reverse its weakening trend as upside inflation surprises in the United States saw interest rate differentials versus Japan widen and acted as a headwind for the currency. Finally, the pound managed to eke out a small gain as stubborn services inflation prompted investors to dial back their expectations for easing from the Bank of England.

## Oil



Oil fluctuated the second quarter as investors digested a backdrop of lingering geopolitical risks, uncertain supply-side dynamics, and a softer demand outlook for top importer China. While OPEC+ extended output cuts into the third quarter, the coalition set out a plan to restore some production as early as October. Meanwhile, subdued growth prospects in China fueled fears around demand destruction. However, a market gripped by ongoing turmoil in the Middle East helped to revitalize prices towards quarter-end. We remain bullish on oil prices amid favourable supply-side dynamics. While an escalation in geopolitical tensions risks prompting an oil shock, production management by OPEC+ should help place a floor under prices.

## Gold



Gold hit a fresh all-time high on the back of strong demand from central banks to hedge against a tumultuous geopolitical landscape. We expect gold to trade in a narrow range given some conflicting forces at hand. While the prospect for the Federal Reserve to cut interest rates by more than expected could push prices higher from here, lofty valuations may limit any notable upside for the yellow metal.

Source: Bloomberg, as of June 28, 2024.

## Copper



Copper notched a solid quarterly gain as predictions for tighter global supplies and rising consumption associated with the green transition countered signs of weaker demand from top consumer China. Looking forward, copper stands to benefit in the global effort to scale-up in green infrastructure spending. Renewable energy capacity expansion and a growing electric vehicle market underscores that healthy demand is expected to persist and buttress prices for the red metal.

# Forecasts for the Next 12-18 Months

SCENARIOS	JUNE 28, 2024	SOFT LANDING	INFLATION REVIVAL	SHALLOW RECESSION
<b>PROBABILITY</b>		<b>55%</b>	<b>25%</b>	<b>20%</b>
<b>GDP GROWTH</b>				
Global	3.00%	3.50%	4.00%	2.00%
U.S.	2.00%	2.00%	2.50%	-0.50%
U.S. Output Gap	1.00%	0.50%	1.00%	-1.50%
Canada	1.35%	1.50%	2.00%	-1.00%
<b>INFLATION (HEADLINE Y/Y)</b>				
U.S.	3.30%	2.50%	3.25%	2.00%
Canada	2.90%	2.50%	3.25%	2.00%
<b>SHORT-TERM RATES</b>				
Federal Reserve	5.50%	3.50%	4.75%	2.50%
Bank of Canada	4.75%	3.00%	4.25%	2.50%
<b>10-YEAR RATES</b>				
U.S. Government	4.40%	4.00%	5.00%	3.50%
Canada Government	3.50%	3.50%	4.50%	3.00%
<b>PROFIT ESTIMATES (12 MONTHS FORWARD)</b>				
U.S.	260	270	250	215
Canada	1458	1550	1500	1400
EAFE	157	160	150	135
EM	82	85	72	65
<b>P/E (12 MONTHS FORWARD)</b>				
U.S.	21.0X	22.5X	19.5X	17.5X
Canada	15.0X	16.0X	14.0X	13.0X
EAFE	14.8X	16.0X	14.0X	13.0X
EM	13.2X	15.0X	13.0X	12.0X
<b>CURRENCIES</b>				
EUR/USD	1.07	1.08	1.05	1.00
CAD/USD	0.73	0.76	0.78	0.70
<b>COMMODITIES</b>				
Oil (WTI, USD/barrel)	81.54	85.00	95.00	70.00
Gold (USD/oz)	2339.60	2200.00	1900.00	2300.00

Source: Fiera Capital, as of June 28, 2024.

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