

GLOBAL INVESTMENT OUTLOOK 2019

FROM THE GLOBAL CIO OFFICE

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FIERACAPITAL

— CAUTIOUSLY OPTIMISTIC HEADING INTO 2019

Despite the latest escalation in trade tensions and political vulnerabilities in Europe, the narrative of a synchronized global expansion remains firmly intact, while the accommodative monetary and fiscal impulse should allow the expansion to continue uninterrupted in the coming year.

After a tumultuous 2018, 2019 looks set to be another interesting year. We expect the global economy to continue thriving in the coming year, even in the wake of lingering trade hostilities and the politically-charged environment in Europe. Encouragingly, economic momentum remains fairly robust in general, while fiscal stimulus from both the U.S. and China is set to extend the economic upturn well into 2019 and provide a buffer as major central banks take coordinated steps towards monetary policy normalization. Taken together, our base case remains that the environment of synchronous global growth will outweigh the uncertain geopolitical backdrop at hand.

That being said, the potential for periodic bouts of volatility prevails heading into 2019 as visibility of the economic cycle shrinks in time and as monetary policy transitions from accommodative to neutral, which warrants a cautious approach at this time.

In spite of this, we expect the most likely outcome to be that the global economy continues to grind higher in a synchronous manner, with all major regions contributing to the advance. The U.S. should lead the global charge, thanks to widespread momentum across both the consumer and manufacturing space, while the double-dose of fiscal stimulus boosts an already-buoyant economy. Meanwhile, the Canadian economy should moderate towards a more sustainable, albeit still above-trend pace. Finally, we expect policymakers in Europe and Japan ultimately to prove successful in reflation growth, while emerging market economies prosper in the environment of improving global demand, ample liquidity, and rising commodity prices. Taken together, the lucrative combination of synchronized global growth and a revival in commodity prices should bolster inflation expectations across the world, though not to levels that would threaten the status of the economic recovery. This reflationary backdrop bodes well for equities and commodities (ex-gold) at the expense of fixed income and the U.S. dollar.

We are however mindful that there are a number of factors that could derail this picture:

A Rise in Trade Protectionism

In this scenario, a rise in protectionism stemming from the U.S. and the threat of a full-blown trade war would have the potential to derail the synchronous global expansion. President Trump's rhetoric on protectionism has already translated into action, with the U.S. imposing tariffs on a variety of imports including solar panels, washing machines, steel and aluminium – which have been met with retaliatory measures from some of America's closest allies in response.

Mr. Trump has since upped the ante by imposing tariffs on a total of \$250 billion worth of Chinese goods (to which China has retaliated), while threatening to slap tariffs on an additional \$267 billion of imports as well as levies on global auto imports – which would be detrimental for trade flows and the global economy alike. In this scenario, anti-trade rhetoric in the U.S. becomes a reality and results in tariffs being imposed on economies such as China, Canada, Europe, Japan and Mexico, with further retaliation igniting a full-blown global trade war.

Stagflation

After an extended period of undershooting central bank inflation targets, we could see policymakers tolerate higher inflation (overshoot) and monetize inflation by letting the economy "run hot". As a result, inflation expectations could start to de-anchor from current subdued levels and surge higher. This would come at the same time that fiscal stimulus is being reigned-in (2020) in the later stages of the economic expansion, causing growth to moderate to well below potential levels in response.

In the stagflation scenario, a stagnation in growth occurs concurrently with an acceleration in inflation as a result of previous excessive monetary stimulation and an exhaustion of productive capacity - creating a tumultuous financial market landscape whereby both equities and bonds experience broad based declines.

Geopolitical Instability

Political upheaval in Europe and the United Kingdom could ignite a crisis in confidence – disrupting the global economy and financial markets alike. Specifically in Italy, the Five Star and League parties have formed a coalition government with Eurosceptic tendencies, with plans to expand fiscal policy that would go against the fiscal rules and threaten the relationship with the European Union. This would risk a repeat of the euro-area sovereign debt crisis, particularly as Italy remains especially vulnerable to higher interest rates due to its elevated debt levels and low potential growth in the region. This worst-case scenario would risk throwing the region into political and economic disarray at the same inopportune time that a lack of progress in Brexit negotiations has raised the odds of a "hard Brexit" scenario.

— ASSET CLASS REVIEW

Fixed Income

We expect yield curves to steepen in the coming year. While we expect only modest re-pricing at the short end of the curve, a revival in inflation expectations is expected to place upward pressure on the long end of the curve – owing to buoyant global growth prospects and tighter labour markets. Furthermore, treasury supplies are set to increase as the U.S. government ramps up borrowing to fund swelling deficits (at a time when the Fed is unwinding its balance sheet), prompting investors to demand higher treasury yields.

Taken together, we believe that the path of least resistance for global government bond yields remains higher (and prices lower) in the environment of robust and above-trend global growth, rebuilding inflationary pressures and coordinated monetary policy normalization.

In this environment, we maintain our underweight allocation to fixed income. Within the asset class, we maintain a short duration positioning, while also looking further up the risk spectrum towards spread product and inflation protection – both of which should thrive in the pro-cyclical environment of negligible recession (default) risks and a revival in inflation expectations.

Equities

While market sentiment indeed remains fragile, the good news is that the conditions for a recession remain elusive at this time. Looking ahead, global equity markets should remain well supported by the vigorous economic backdrop, healthy corporate earnings prospects and reasonable valuations, while the pragmatic approach to central bank normalization should allow the economic upswing to continue uninterrupted in the coming year, helping to counter any geopolitical uncertainties at hand.

However, the investment landscape has admittedly turned more volatile, which warrants some caution in the near-term. That being said, with volatility comes opportunity. While volatility is surely set to prevail as investors adjust to the environment of rising rates, lingering global trade uncertainties, and political upheaval in Europe – the fundamental underpinnings for risk assets remain largely intact over the coming year, in our view. As such, we will be closely monitoring market levels and (barring any new developments on the macro front) would look to re-establish an overweight allocation to global equities at more attractive levels.

UNITED STATES STRATEGY: UNDERWEIGHT



While U.S. equities should thrive on the buoyant domestic growth backdrop, we believe relative upside is limited and caution is warranted given already-stretched valuations at a time when the Fed is embarking on interest rate normalization – while the potential for political gridlock following the midterm elections could also weigh.

EUROPE AND JAPAN STRATEGY: UNDERWEIGHT



While the European economy is demonstrating signs of health, political susceptibilities in Italy and a vulnerable banking sector could hinder equity performance. Meanwhile, uncertainty regarding the future of the UK will place undue pressure on UK equities as Brexit negotiations linger on, while yen strength could rattle Japanese markets.

EMERGING MARKETS STRATEGY: OVERWEIGHT



We expect developing markets to benefit from the reflationary thrust in the marketplace and should ultimately prove resilient to a tighter Fed in the context of undemanding valuations, thanks to the healthy global growth backdrop, robust earnings growth and favourable dollar conditions – while financial positions have also improved drastically since the depths of the financial crisis.

CANADA STRATEGY: OVERWEIGHT



We believe Canadian equities should thrive in the environment of stronger global growth, accelerating earnings expectations, rising commodity prices and steeper yield curves. Headline risks pertaining to trade and severe discounts on heavy oil have clouded the healthiest fundamental backdrop in years and created a significant valuation discount, setting the stage for a re-rating as these lingering headwinds fade.

Currencies

DXY

We believe that the path of least resistance for the greenback in the coming year remains structurally weaker, owing to the deteriorating U.S. fiscal position and as markets recalibrate their expectations for ex-Federal Reserve central banks (such as the European Central Bank and Bank of Japan) to normalize policy.

CAD/ USD

With NAFTA overhang receding in the aftermath of the trilateral accord, the economy operating at capacity and inflationary pressures on the rise, expectations for a faster pace of rate hikes from the Bank of Canada should help to narrow interest rate differentials between Canada and the U.S. and boost the Canadian dollar going forward. The environment of higher crude prices should also lend support.

EUR/ USD

The euro has been pressured lower in the environment of battered risk appetite, while the showdown between the European Commission and the populist government in Italy regarding the 2019 budget has also weighed on the common currency. In this environment, investors have pared back their wagers for policy normalization from the European Central Bank – though we continue to expect the Central Bank to proceed as planned and cease asset purchases by year-end and raise interest rates in mid-2019. As such, we believe that investors are largely underestimating the path forward for the European Central Bank. Furthermore, the environment of above-trend GDP growth and corresponding revival in inflationary pressures could see this path brought forward in our view, which should see the divergence between the Federal Reserve (largely priced-in) and the European Central Bank (underpriced) narrow somewhat – lending some support to the euro in the coming year.

Commodities

OIL

The outlook for crude oil remains constructive in our view, owing mainly to the lucrative fundamental backdrop at hand. Namely, we expect crude markets to find a better balance in the coming year, with OPEC/Russia maintaining production discipline amid tighter spare capacity overall, while the synchronized global growth backdrop should remain supportive of demand and place a sturdy floor under prices in the coming year.

GOLD

Looking forward, we remain neutral on gold due to some opposing forces in play. While prices remain vulnerable as the stronger growth and inflation trajectory in the U.S. accelerates the pace of monetary policy normalization, the environment of lingering geopolitical angst should help to place a floor under prices.

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