

# Macroeconomic Landscape

## Global Growth

The global economic recovery has lingered on, even in the wake of sporadic virus outbreaks. Inflationary pressures have proven increasingly persistent, which has prompted central banks to accelerate their plans to withdraw emergency-era support.



### Canada

While the latest wave of public health restrictions may inhibit near-term activity, solid fundamental underpinnings should ensure that the Canadian recovery endures, with employment gains, pent-up household savings and healthy corporate balance sheets providing a foundation for both confidence and spending. With considerable uncertainty around the inflation outlook, a torrid housing market and a full recovery in employment, the Bank of Canada has been among the first of developed central banks to warn of tighter monetary policy ahead, presumably after the Omicron clouds have lifted.

### United States

The US economy is on track for another year of strong, above-trend growth. While President Biden's "Build Back Better" bill struggles to navigate Congress, the private sector is now driving growth. Consumer spending power has been enhanced by tighter labour market conditions and elevated savings amassed during the crisis, while businesses are also set to boost investment. Against this backdrop, elevated inflation is likely to prevail, which has sparked a hawkish turn at the Federal Reserve, with officials dialing back on hyper-stimulative policies in response.

### International

The Eurozone is facing its biggest virus wave yet and is under increasing strain, with the implementation of new countermeasures likely to temporarily dampen growth. However, similar to previous waves, an eventual relief on the pandemic front, easing supply-chain bottlenecks and unrelenting central bank support should pave the way for an economic revival next year. Japan's recovery has also been clouded by extended emergency measures that curtailed activity, though the government has unleashed new fiscal support which should help to buttress the economy in 2022.

### Emerging Markets

Emerging market economies face a more daunting outlook. The Chinese slowdown has intensified amid an array of challenges including a regulatory crackdown, property market woes and COVID-19-related disruptions. Fortunately, policymakers have taken note, with both the central bank and government prioritizing stability and growth in 2022. Elsewhere, emerging economies have been plagued by proactive tightening to combat a steep upswing in inflation, while ongoing virus challenges, low vaccination rates and a shrinking growth differential with developed economies underscores the challenges faced by the emerging world.

# Economic Outlook

## A Year of Transition

The macroeconomic landscape has undergone some notable changes heading into 2022. On the health front, risks have resurfaced given the emergence of new virus strains that are circulating globally. While it's still premature to know how severe and impactful these new variants will be, the hope is that advancements on both the vaccine and treatment fronts will reduce the need for draconian, growth-destructive lockdowns.

Meanwhile, the global economy has demonstrated a resilience to subsequent COVID-19 waves thanks to increased spending from consumers, businesses and governments. While COVID-19 dynamics may cast a cloud in the near-term, global growth is expected to remain solid as the virus ebbs, activity continues to normalize and pent-up savings are unleashed.

Both cyclical and structural drivers are set to keep inflation elevated. Pricing pressures intensified in 2021 as the wider economy reopened and as supply-side disruptions boosted the price for goods, resulting in a perfect storm of too much demand chasing too little supply. While lofty prices are expected to revert lower as these pandemic-related imbalances ultimately fade, there are some structural forces taking hold that are likely to prop up inflation,

including a solid labour market recovery and rising commodity prices, while the new Omicron variant could prolong labour shortages and supply chain disruptions, contributing to steeper wage and price increases.

In response, policymakers have begun the transition away from pandemic-era support, while the fiscal impulse is also set to diminish. Both the Federal Reserve and the Bank of Canada have abandoned their narrative that inflationary pressures are “transitory” and have begun the process of scaling back on abundant stimulus.

The key risk to the outlook hinges on how assertively policymakers respond to the inflation backdrop, with the lingering threat that much stickier inflation and unhinged inflation expectations cuts into the spending power for both consumers and businesses and stokes a much more aggressive tightening trajectory, which could amplify the slowdown and choke off the recovery.

Taken together, renewed health risks have added to the wall of worry that investors are already contending with, including runaway inflation, monetary policy normalization and slowing growth. In this environment, investors should be prepared to tolerate higher levels of volatility as we enter the new year.

KEY PILLARS	Q1 2022 THEMES	STRATEGY IMPACT
HEALTH CONSIDERATIONS	COVID-19 variants are running rampant even among populations that boast extremely high vaccination rates, which could spark renewed restrictions, extended social distancing and a reluctance from consumers and businesses to re-engage fully.	=
ECONOMIC FUNDAMENTALS	The global economic recovery remains on solid ground. While cooling from the vigorous initial pace, global growth is expected to remain strong and above-trend as health risks ebb, activity continues to normalize and as pent-up savings are unleashed.	+
CENTRAL BANK POLICY	Policymakers have begun the transition from their extremely stimulative stance and are progressively scaling back emergency-level support. Still, monetary policy remains accommodative overall and far from restrictive terrain.	=
PROFIT GROWTH	Strong earnings recoveries have been discounted, and the bar for positive surprises has been raised given optimistic expectations. Furthermore, profits may be squeezed in the environment of higher input prices and accelerating wage gains.	=
VALUATIONS	Optimistic earnings expectations, intensifying pressure on profit margins, policy normalization and limited scope for further multiple expansion implies a challenging environment for equities, with muted and volatile expected returns in the coming year.	-

# Economic Scenarios

## Main Scenario | Reflation

Probability **50%**

Our base case scenario calls for the global economy to grow at an above-trend pace through 2022, without the fear of an aggressive and destabilizing monetary policy tightening event. The global economic recovery lingers on, even in the wake of sporadic virus outbreaks. While COVID dynamics weigh on activity in the near-term, the recovery ultimately resumes as the latest virus wave subsides, activity continues to normalize, and pent-up savings are unleashed. Meanwhile, both cyclical and secular forces keep inflation elevated, which prompts central banks to dial back on their emergency-era support. However, despite inflation pressures proving more persistent than initially thought, inflation expectations remain generally well-anchored, which allows policymakers to proceed cautiously and pragmatically in normalizing monetary policy. Central bank asset purchases are scaled down through 2022, and both the Federal Reserve and Bank of Canada begin the gradual rate normalization process given that their respective economies will be operating at or near full potential and output gaps will soon be closed. By contrast, central banks in Europe, Japan, and China decouple from this policy trajectory and maintain an extremely stimulative monetary policy stance over the coming year. Still, the North American policy transition from extremely stimulative towards a neutral stance occurs progressively over several years, extending the longevity and visibility of the economic cycle.

## Scenario 2 | Stagflation

Probability **40%**

A growing risk to our base case scenario is that the world economy turns stagflationary in nature, a toxic combination of slowing global growth and accelerating prices. The “Stagflation” scenario assumes that inflationary pressures prove much stickier than previously assumed and de-anchors inflation expectations, with global economic prospects subsiding amid the fallout as a more aggressive tightening trajectory to combat runaway prices ends the cycle prematurely. Specifically, the near-term spike in pricing pressures proves more enduring than expected, and lasts long enough to become embedded in inflation expectations and ultimately triggers a wage-price spiral. Supply-chain dislocations take longer to correct, while shortages and subdued participation in the labour force become more long-lasting given lingering health-related fears of returning to work, the structural shift in demographics (ageing populations), or skills mismatches in the post-pandemic reality. The subsequent rise in input costs and the rapid buildup in wages cuts into the profitability of corporations and consumers struggle to maintain their purchasing power. In response, policymakers abandon their perceived tolerance for higher inflation and act aggressively to stem the inflationary spiral. This assertive and hawkish-leaning policy adjustment sparks a deceleration in global growth to below-potential levels. The stagnation in global growth occurs concurrently with an acceleration in inflation and tighter monetary policy, creating a tumultuous financial market landscape whereby both equities and bonds experience declines amid a marked deterioration in the macroeconomic landscape.

## Scenario 3 | Recession

Probability **10%**

Another wildcard continues to be the emergence of highly-transmissible COVID-19 variants that risk derailing the global economic recovery. In this scenario, the pandemic proves more severe and persistent than anticipated given the predominance of variants in future contagion. The risk is that more variants emerge given that a substantial part of the world population remains unvaccinated and amid uncertainty about the effectiveness of existing vaccines in fighting these new variants. At the same time, vaccine hesitancy in some parts of the world creates a hurdle to reaching herd immunity and fully eradicating COVID-19. As it takes longer to gain control over the propagation of the virus, confinement and mitigation efforts from governments are reinstated and social distancing behaviours linger on, while health fears prompt some reluctance from consumers and businesses to re-engage fully - which ultimately delays the return to normal and fuels a steep contraction in growth.

# Portfolio Strategy

## Matrix of Expected Returns

SCENARIOS	REFLATION	STAGFLATION	RECESSION
PROBABILITY	50%	40%	10%
TRADITIONAL INCOME			
Money Market	0.6%	1.0%	0.3%
Canadian Bonds	-6.8%	-9.0%	7.1%
NON-TRADITIONAL INCOME			
Diversified Credit	8.0%	7.0%	5.0%
Diversified Real Estate	8.0%	7.0%	4.0%
Infrastructure	7.5%	6.5%	5.0%
Agriculture	8.5%	7.5%	6.0%
TRADITIONAL CAPITAL APPRECIATION			
Canadian Equity Large Cap	8.1%	-13.3%	-39.9%
U.S. Equity Large Cap	-16.0%	-21.9%	-38.7%
International Equity	-9.5%	-16.2%	-34.3%
Emerging Market Equity	-0.3%	-11.6%	-34.8%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity	15.0%	12.0%	5.0%
Liquid Alternatives	7.0%	5.0%	0.0%

Discussions regarding potential future events and their impact on the markets are based solely on historical information and Fiera Capital's estimates and/or opinions, and are provided for illustrative purposes only. Expected returns are hypothetical estimates of long-term returns of economic asset classes based on statistical models and do not represent the returns of an actual investment. Actual returns will vary. Models have limitations and may not be relied upon to make predictions of future performance of any account.

# Portfolio Strategy

## Current Strategy<sup>1</sup>

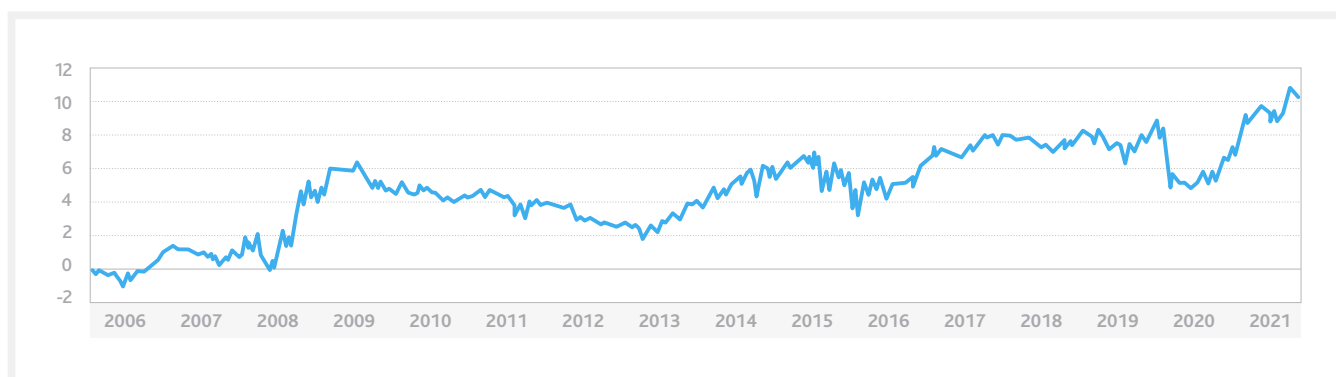
### TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
Money Market	0%	5%	25%	10%	+5%
Canadian Bonds	5%	25%	45%	5%	-20%
Canadian Equity Large Cap	10%	20%	40%	35%	+15%
U.S. Equity Large Cap	0%	10%	20%	0%	-10%
International Equity	0%	10%	20%	5%	-5%
Emerging Market Equity	0%	5%	15%	5%	0%
Non-Traditional Income	5%	25%	45%	40%	+15%

### TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	20%	40%	60%	40%	0%
Money Market	0%	5%	25%	10%	+5%
Canadian Bonds	5%	35%	55%	30%	-5%
TRADITIONAL CAPITAL APPRECIATION	40%	60%	80%	60%	0%
Canadian Equity Large Cap	5%	25%	50%	40%	+15%
U.S. Equity Large Cap	0%	15%	30%	5%	-10%
International Equity	0%	15%	30%	10%	-5%
Emerging Market Equity	0%	5%	15%	5%	0%

## Evolution of Value-Added<sup>1</sup>



<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.

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# Fixed Income Outlook

## Fixed Income Review

Bond markets stabilized somewhat in the fourth quarter. Yield curves flattened, with the short end rising on wagers for an accelerated pace of monetary normalization. However, there was little effect on the long end as inflation expectations remained fairly stable, while some virus-related angst that prompted investors to flock to the safety of government bonds also placed a cap on longer-dated yields.

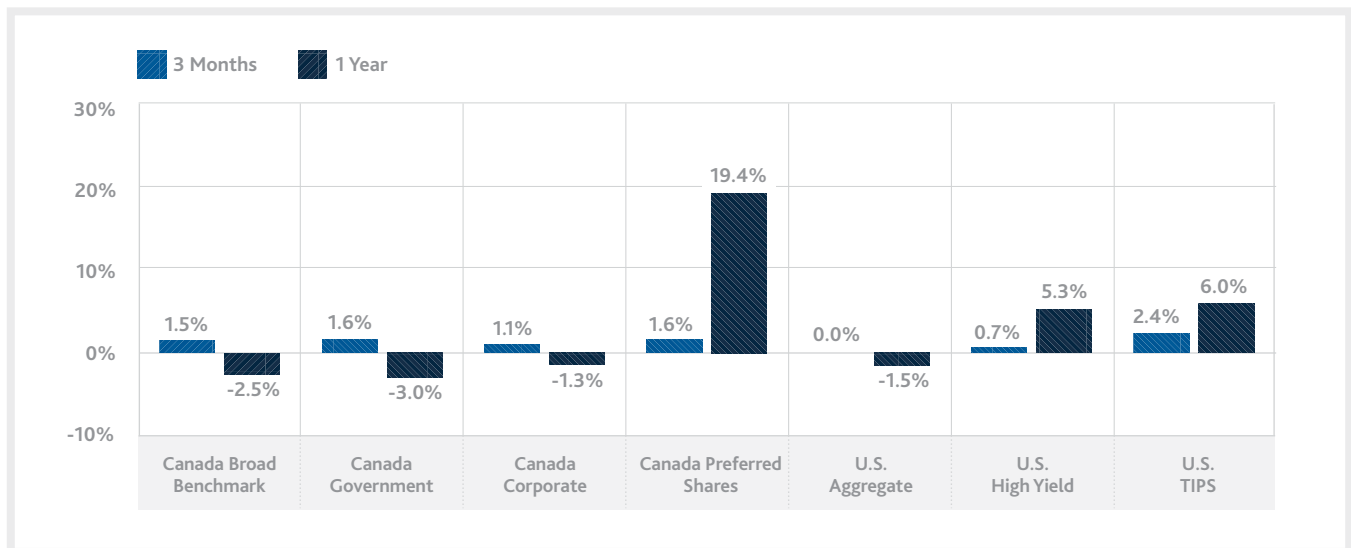
The final quarter saw a profound shift in the stance of global central bank policy amid soaring inflation that has shown little sign of letting up. Consequently, policymakers have opted to look through temporary pandemic-related growth impacts and have forged ahead with their plans to normalize monetary policy.

In response to the strongest inflation in four decades, the Federal Reserve accelerated the pace of its Quantitative Easing (QE) taper program, dropped its reference to inflation being “transitory” and

projected a much steeper forecast for the Fed funds rate. Similarly, the Bank of Canada already tapered its bond buying program and signaled its intention to raise rates when the output gap closes, which the bank judges will be in the “middle quarters” of 2022. The Bank of England unexpectedly raised interest rates in December, setting aside the threat posed by record Coronavirus cases in an effort to tackle surging inflation. The European Central Bank and Bank of Japan are lagging owing to a weaker economic and inflationary impulse in their respective economies.

Meanwhile, there is a growing divergence between China and its developed market peers. While the latter are pivoting towards normalization, the People’s Bank of China is prioritizing growth and stepping up support for an economy that is under strain from a property market crackdown, weak private consumption and sporadic virus outbreaks.

### Fixed Income Market Returns (Local Currency) | As of December 31, 2021



Source: Fiera Capital Corporation

## Investment Strategy

With global growth holding firm, central banks poised to withdraw support and inflation running strong, the path of least resistance for government bond yields should be higher. These factors are already evident at the short-end of the curve but are expected to show up in higher longer-dated yields through 2022.

We expect yield curves to steepen. Long-term government bond yields should rise as markets solidify expectations for policy normalization from major central banks, while persistent pricing pressures will cause investors to demand higher compensation

for inflation risk. While corporate credit remains attractive given the supportive macro backdrop that should mitigate default risks, tight spreads have limited any notable upside potential. This unappealing outlook underpins our maximum underweight allocation to the traditional fixed income asset class. Within fixed income, we advocate for maintaining a short duration and positioning for a steeper yield curve, with a preference for corporate versus government exposures and inflation-linked versus nominal bonds.

# Equity Outlook

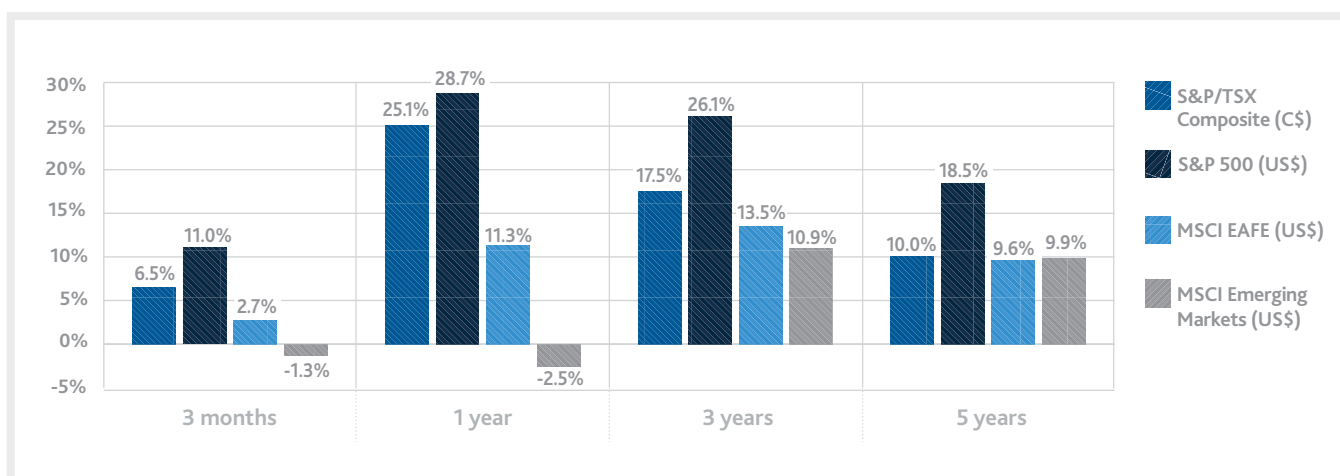
## Equity Review

Global equity markets saw some impressive gains in 2021. Despite facing multiple waves of COVID-19, multi-decade highs on inflation and an abrupt shift in the monetary policy outlook, robust global demand and powerful earnings recoveries saw stock markets push higher.

While volatility gripped the marketplace in the fourth quarter as investors contemplated the economic implications of central

banks' pivot to fighting inflation and the emergence of the highly transmissible Omicron variant, sentiment improved towards year-end as investors took some solace in early indications that the health impacts of Omicron are relatively mild and amid optimism that the global economic recovery will overcome the renewed health threat.

### Equity Market Returns | As of December 31, 2021



Source: Fiera Capital Corporation

## Investment Strategy

Heading into the new year, sentiment remains fragile amid renewed health fears, which may spark some near-term profit-taking. Moreover, monetary policy is set to normalize, and investors will need to recalibrate their expectations accordingly. The uncertainty associated with an incremental withdrawal of policy support is bound to transmit more volatility to financial markets, while multiples are set to contract as the monetary and fiscal impulse progressively fades. And while global growth is set to remain firm, much of the upside for corporate earnings has been realized and strong recoveries have already been discounted. Earnings estimates have become increasingly optimistic, and profits may be squeezed by higher input prices and accelerating wage gains. The combination of buoyant earnings expectations, intensifying pressure on profit margins and limited scope for further multiple expansion implies a challenging environment for equities, with more muted and volatile expected

returns. As a result, we are comfortable with our neutral stance on equities heading into 2022.

We expect Canadian equities to outperform in the environment of rising commodity prices, elevated inflation and higher interest rates that should bode well for TSX earnings momentum. While higher inflation and rising bond yields are a tailwind for cyclical-value sectors that dominate the S&P/TSX, they are likely to weigh disproportionately on the more expensive corners of the market in the defensive-growth space that dominates the S&P 500. Indeed, rising long-term interest rates tend to favour the earnings of value stocks and weigh on the multiples of their growth peers. The S&P/TSX has rarely been this cheap versus the S&P 500, particularly in the context of high energy prices. The energy sector has seen a significant turnaround in its earnings outlook, setting the stage for a re-rating in the coming year.

# Private Alternatives Outlook

## A Challenging Environment for Traditional Asset Classes

Traditional multi-asset portfolios have benefitted from robust returns in both fixed income and equity markets over the last several years. However, the outlook for these asset classes remains somewhat challenged and it may prove difficult to replicate these solid results going forward.






Global equity markets are hovering near record highs. The easy money has clearly been made and we expect more muted (and potentially more volatile) returns after the latest record run.

Meanwhile, questions have surfaced about the inherent safety of fixed income. While offering little in the way of income generation, the low starting point for interest rates has condemned government bonds to future losses, and we expect bond markets to suffer a second consecutive year of losses in 2022. Consequently, traditional fixed income strategies are unlikely to play the same role of providing both stability and income in the portfolio setting.

## The Case for Alternatives

This less favourable risk-reward proposition for traditional asset classes underscores the merits of diversifying a portfolio towards private alternatives. The construction of a well-balanced portfolio will need to integrate higher allocations to private alternatives in order to compensate for sub-par returns in the traditional space. Private alternatives generate relatively stable and consistent

returns with less volatility versus equity markets, while they are less susceptible to significant swings if there is broader market volatility. These features will prove beneficial as the prospect for higher interest rates, reduced monetary policy support, elevated inflation and lingering health risks threaten to ramp-up volatility in the coming year.

	 Agriculture	 Infrastructure	 Real Estate	 Private Debt	 Private Equity
Diversification	✓	✓	✓	✓	✓
Reliable Income Stream	✓	✓	✓	✓	
High Absolute-Return Objective					✓
Inflation Hedge	✓	✓	✓		
Low Correlation to Other Asset Classes	✓	✓	✓	✓	✓

## Investment Opportunities

This macroeconomic outlook requires an expanded set of investment opportunities, and the natural evolution for those seeking stability, higher income and the potential for capital gains is a pivot towards non-traditional asset classes such as private credit, real assets and private equity.

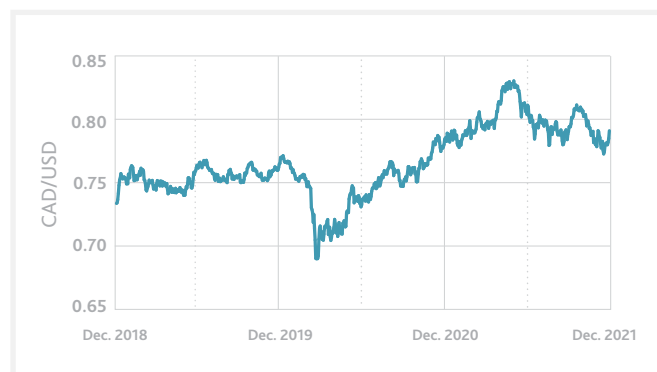
While the next few years promise to be volatile as interest rates rise, private credit is a viable option for those looking for security

and yield. Furthermore, in a world where inflation is higher than it has been for the past three decades and set to remain elevated, real assets such as real estate, infrastructure and agriculture will play a critical role in hedging against inflation. Finally, private equity has demonstrated an ability to outperform public equities, even in market downturns, with less volatility.



# Commodities and Currencies

## CAD / USD



The Canadian dollar rallied into year-end alongside a remarkable turnaround in crude prices and ended 2021 as the only G-10 currency to strengthen versus the US dollar. Still, the loonie struggled to keep pace with 2021's profound gains in oil prices, with persistent US dollar strength ultimately capping any material upside. The greenback thrived as unnerved investors flocked to the safe haven currency and on the rising expectations the Federal Reserve will tighten monetary policy. The path of least resistance for the US dollar remains lower, in our view. We expect the US dollar to revert lower as the rest of the world catches up to the recovery in the US, with the relative rotation in growth dynamics and rate differentials favouring ex-US dollar currencies. The secular downtrend in the US dollar should buttress the Canadian dollar, while our expectation for widespread strength across the commodity spectrum should be a key tailwind for the loonie.

## Oil



After tumbling into a bear market in November, crude oil resumed its powerful rally as fears over the new virus strain receded, while energy consumption has thus far escaped a major blow from the new variant. Oil posted its biggest annual advance since 2009 and a seventh straight quarterly gain. While OPEC and its allies have agreed to their scheduled production increases, the consortium gave itself the flexibility to alter plans given the tremendous uncertainty in the market. Looking forward, we expect crude oil prices to stay firm given our expectation for a strong and above-trend growth trajectory that continues to reinvigorate demand as the reopening progresses and activity normalizes. On the supply side, output growth is being hit by challenges including upstream cost inflation and more expensive financing as the shift to ESG and decarbonization disincentivizes new investment, which implies insufficient supply in the face of strong demand that should bolster prices.

## Gold



Gold prices rose at the end of 2021 as investors sought out a hedge to unrelenting pricing pressures. However, bullion still posted its biggest annual decline since 2015 as central banks geared up to rein in pandemic-era stimulus. We expect gold to trade in a narrow range given some conflicting forces at hand. While bullion's appeal as an inflation hedge should underpin prices, monetary normalization and rising bond yields should limit any notable upside.

## Copper



Copper advanced in the fourth quarter. While China's flagging recovery weighed on demand prospects, copper rebounded after Chinese authorities pledged to counteract growth pressures and stabilize the economy. Considered a barometer for global growth, copper should remain on solid footing as supply struggles to keep up with renewed demand. While infrastructure spending plans should bode well for industrial metals broadly, copper will be a prime beneficiary in the global effort to scale-up in green infrastructure spending.

# Forecasts for the Next 12-18 Months

SCENARIOS	DECEMBER 31, 2021	REFLATION	STAGFLATION	RECESSION
PROBABILITY		50%	40%	10%
GDP GROWTH 2022				
Global	4.40%	5.00%	3.50%	-4.50%
Canada	4.00%	4.50%	1.50%	-5.00%
U.S.	3.90%	4.25%	1.50%	-3.50%
GDP GROWTH 2023				
Global	3.60%	3.50%	2.50%	1.00%
Canada	2.90%	1.50%	1.00%	-1.00%
U.S.	2.50%	2.00%	1.00%	-1.00%
INFLATION (HEADLINE Y/Y)				
Canada	4.70%	3.50%	4.50%	0.50%
U.S.	6.80%	3.50%	4.50%	0.50%
SHORT-TERM RATES				
Bank of Canada	0.25%	1.00%	1.75%	0.25%
Federal Reserve	0.25%	1.00%	1.75%	0.25%
10-YEAR RATES				
Canada Government	1.43%	3.00%	3.50%	0.50%
U.S. Government	1.51%	3.00%	3.50%	0.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
Canada	1348	1350	1150	850
U.S.	226	220	205	150
EAFE	160	155	145	90
EM	105	100	90	55
P/E (FORWARD 12 MONTHS)				
Canada	15.7X	17.0X	16.0X	15.0X
U.S.	21.1X	20.0X	19.5X	16.0X
EAFE	14.6X	15.0X	14.5X	14.0X
EM	11.8X	13.5X	13.0X	12.0X
CURRENCIES				
CAD/USD	0.79	0.87	0.85	0.65
EUR/USD	1.14	1.25	1.15	1.00
USD/JPY	115.08	100.00	105.00	110.00
COMMODITIES				
Oil (WTI, USD/barrel)	75.21	90.00	75.00	35.00
Gold (USD/oz)	1828.60	1800.00	1900.00	2100.00

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# Contact Us

North America			
<b>MONTREAL</b> <b>Fiera Capital Corporation</b> 1981 McGill College Avenue Suite 1500 Montreal, Quebec H3A 0H5 <b>T 1 800 361-3499</b>	<b>TORONTO</b> <b>Fiera Capital Corporation</b> 200 Bay Street, Suite 3800, South Tower Toronto, Ontario M5J 2J1 <b>T 1 800 994-9002</b>	<b>CALGARY</b> <b>Fiera Capital Corporation</b> 607 8th Avenue SW Suite 300 Calgary, Alberta T2P 0A7 <b>T 403 699-9000</b>	<b>info@fieracapital.com</b>  <b>fiera.com</b>
<b>NEW YORK</b> <b>Fiera Capital Inc.</b> 375 Park Avenue 8th Floor New York, New York 10152 <b>T 212 300-1600</b>	<b>BOSTON</b> <b>Fiera Capital Inc.</b> One Lewis Wharf 3rd Floor Boston, Massachusetts 02110 <b>T 857 264-4900</b>	<b>DAYTON</b> <b>Fiera Capital Inc.</b> 10050 Innovation Drive Suite 120 Dayton, Ohio 45342 <b>T 937 847-9100</b>	
Europe		Asia	
<b>LONDON</b> <b>Fiera Capital (UK) Limited</b> Queensberry House, 3 Old Burlington Street, 3rd Floor, London, United Kingdom W1S 3AE <b>T +44 (0) 207 409 5500</b>	<b>FRANKFURT</b> <b>Fiera Capital (Germany) GmbH</b> Walther-von-Cronberg-Platz 13 Frankfurt, Germany 60594 <b>T +49 69 9202 0750</b>	<b>HONG KONG</b> <b>Fiera Capital (Asia) Hong Kong Limited</b> Suite 3205, No. 9 Queen's Road Central, Hong Kong <b>T 852-3713-4800</b>	<b>SINGAPORE</b> <b>Fiera Capital (Asia) Singapore Pte. Ltd.</b> 6 Temasek Boulevard #38-03 Suntec Tower 4 Singapore 038986

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