

Fiera Capital Global Asset Allocation

MONTHLY UPDATE: FEBRUARY 2023



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The new year got off to a roaring start on rising hopes for a soft landing for developed economies as inflationary pressures showed continued signs of abating, while China's reopening also fueled investor optimism at the beginning of the year. While central banks have downshifted the pace of tightening in response to moderating inflation, the focus now turns to the implications of cumulative rate hikes on both the economy and corporate earnings. Here, early signs are pointing towards some fundamental deterioration, which remains at odds with the latest revival in risky assets.

FINANCIAL MARKET DASHBOARD				
	JAN. 31, 2023	JAN.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	4077	6.18%	6.18%	-9.72%
S&P/TSX	20767	7.13%	7.13%	-1.57%
MSCI EAFE	2100	8.05%	8.05%	-5.49%
MSCI EM	1032	7.85%	7.85%	-14.63%
FIXED INCOME (%)		BASIS POINT CHANGE		
U.S. 10 Year Treasury Yield	3.51	-36.8	-36.8	173.0
U.S. 2 Year Treasury Yield	4.20	-22.5	-22.5	302.2
U.S. Corp BBB Spread	1.70	-16.0	-16.0	35.0
U.S. Corp High Yield Spread	4.63	-46.0	-46.0	113.0
CURRENCIES		% PRICE CHANGE		
EUR/USD	1.09	1.48%	1.48%	-3.31%
CAD/USD	0.75	1.86%	1.86%	-4.50%
USD/JPY	130.09	-0.79%	-0.79%	13.01%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	78.87	-1.73%	-1.73%	-10.53%
Copper (USD/pound)	4.23	10.90%	10.90%	-2.28%
Gold (USD/oz)	1929.50	5.66%	5.66%	7.49%

Global equity markets had a stellar January as expectations for a dovish pivot in the monetary tightening cycle saw price-to-earnings multiples re-rate higher. The MSCI All Country World rebounded 7.1% last month. Regionally speaking, gains were widespread across the globe. The S&P 500 posted a 6.2% monthly return, while the S&P/TSX jumped 7.1%. Looking abroad, European stocks (+8.5%) posted their best January since 2015, while emerging markets (+7.9%) thrived on the back of Beijing's pro-growth policy shift that bolstered Chinese stocks (+11.8%).

Fixed income markets also rallied strongly on widespread anticipation that central banks are nearing the end of the tightening cycle as inflationary pressures subside. Government bond yields slid lower in response. In the US, the 2 year treasury yield fell by 22 basis points to 4.20%, while the 10 year treasury yield declined by 37 basis points to 3.51%. The Barclays US Aggregate Bond Index rose 3.1% for the month. Similarly in Canada, the 2 year Government of Canada bond yield fell by 30 basis points to 3.75%, while the 10 year bond yield declined by 38 basis points to 2.92%. Consequently, the FTSE Canada Universe Bond Index also rose by 3.1%.

In currency markets, the US dollar (DXY) retreated for the fourth straight month as the environment of improved risk appetite and a narrowing of rate differentials between the United States and the rest of the world weighed on the counter-cyclical greenback. By contrast, the pound, euro, yen, and Canadian dollar all strengthened versus the US dollar last month. Specifically, the euro and the pound advanced after fourth quarter GDP results provided a better-than-anticipated assessment of recent economic conditions across the Eurozone and the United Kingdom.

In commodity markets, crude oil fluctuated throughout the month and capped a third monthly loss as concerns about the looming economic slowdown in developed markets overshadowed optimism over a revival in Chinese demand. Turning to metals, gold extended recent gains on investor hopes for a less-hawkish Federal Reserve, which saw both treasury yields and the US dollar edge lower throughout the month and boosted the appeal of the yellow metal. Finally, copper soared higher following China's emergence from Covid lockdowns that has set the stage for a revitalization in demand from the top-consuming nation, which comes at a time when stockpiles remain thin given some supply disruptions from major producers in Latin America.

Economic Overview

UNITED STATES

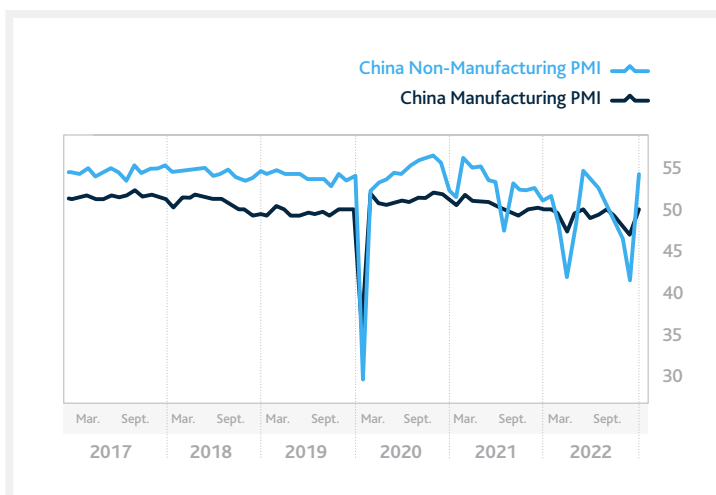
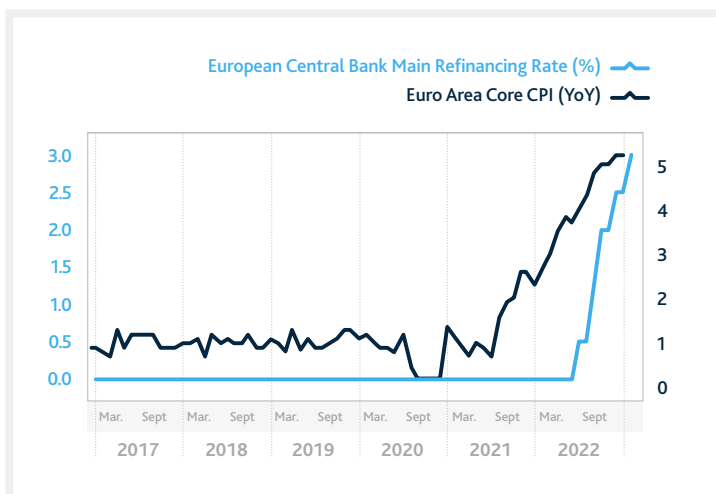
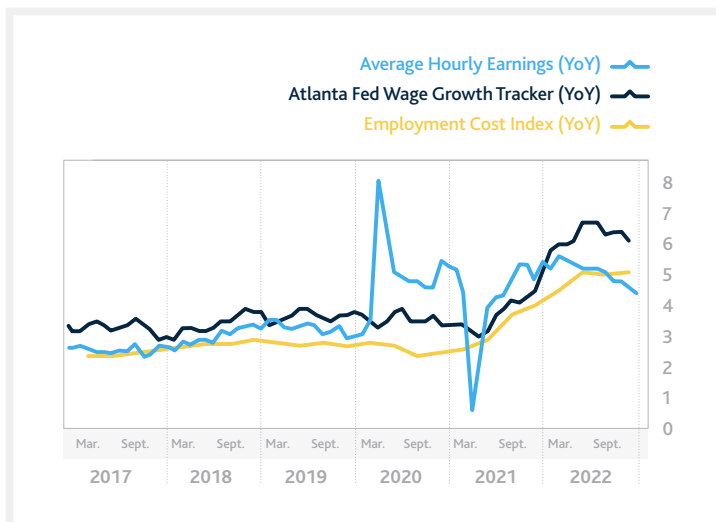
The Federal Reserve further slowed the pace of rate increases at the latest policy gathering, lifting their target for the fed funds rate by 25 basis points to a range of 4.50% to 4.75%. As justification for the downshift, the accompanying statement acknowledged that inflation has eased somewhat. However, the statement also reinforced that inflation still remains elevated, and as a result, strongly hinted that there will likely be “a couple more” rate hikes in coming meetings. In the press conference, Chair Powell attempted to strike a balance between the recent moderation in inflation with the view that more progress will be required from here, particularly given that the core services ex-housing measure (the category officials watch most closely) remains uncomfortably high. Notably, tight labor market conditions and persistent labor market imbalances are threatening to keep wage pressures elevated and feed into higher prices. Indeed, while the Employment Cost Index decelerated by more than expected in the fourth quarter, wages are still rising too swiftly to be consistent with the Federal Reserve’s 2% inflation target and suggests that their work is not yet complete.

INTERNATIONAL

The European economy held up better than expected at the end of 2022, with the fourth quarter GDP estimate showing the economy expanded by 0.1% q/q, above expectations that were calling for a 0.1% q/q contraction. The improving energy situation stemming from milder-than-expected winter conditions contributed to the region’s economic resilience at the end of the year. While encouraging indeed, recent rhetoric from the European Central Bank suggests that policymakers remain concerned that underlying inflationary pressures are too elevated - and the risk is that economic resilience could add to inflationary pressures and set the stage for further monetary policy tightening that would ultimately act as a drag on growth. Of note, core inflation in the Euro Area held firm at a record 5.2% y/y in January, well-above the 2% objective. In early February, the European Central Bank lifted policy rates by 50 basis points. President Lagarde warned that the most aggressive bout of monetary tightening in the central bank’s history isn’t yet complete, and stated that another 50 basis point move is all but certain next month.

EMERGING

In China, the official purchasing manager indices (PMI) came in much stronger than expected in January. Both the manufacturing and the non-manufacturing indices returned to expansion territory for the first time in four months, suggesting that economic activity is gaining momentum following Beijing’s exit from Zero Covid policy. Specifically, the service sector was the main beneficiary of China’s reopening and the Lunar New Year holiday spending, with the services PMI jumping to a seven-month high – while the factory PMI also rose back above the 50-line that divides expansion from contraction. Looking forward, the normalization of economic activity and the release of pent-up demand is expected to support the Chinese economy through 2023. Economists are forecasting gross domestic product growth this year of 5.1%, higher than last year’s 3% expansion. That being said, while China’s strong rebound provides a cushion for softening growth in developed market economies, it risks adding an inflationary impulse at a time when major developed market central banks are trying to rein in consumer prices.



Economic Scenarios



Main Scenario | Deep Recession

Probability **55%**

In our high probability scenario, stubbornly elevated inflation that is proving increasingly entrenched triggers the continuation of aggressive monetary tightening that inevitably sparks a recession. The depth and magnitude of the recession ultimately hinges on how persistent inflation proves to be, and on how much pain policymakers are willing to inflict on the economy in order to bring inflation down to levels deemed acceptable. In this scenario, while goods prices peak and begin to roll over, underlying “core” inflation proves to be more sticky and entrenched, with wages, services inflation, and shelter costs all remaining uncomfortably elevated. Inflation expectations de-anchor and spiral higher, which forces central banks to prioritize tackling inflation in order to restore their inflation-control credibility, regardless of the economic fallout. In response, policymakers tighten monetary policy much more assertively and keep rates in restrictive terrain for longer. Policymakers are unlikely to pause the rate hike cycle until they see convincing evidence that inflation is coming down, which ultimately means that central banks will be hiking interest rates well into economic weakness, making way for a “Deep Recession.”

Scenario 2 | Shallow Recession

Probability **30%**

In this less severe recessionary scenario, central banks continue raising interest rates in order to rein in still-elevated inflation, albeit in smaller increments and to a lesser extent given that long-term inflation expectations remain reasonably anchored. Inflation responds favorably to the demand destruction stemming from cumulative tightening to date and begins to subside more meaningfully in early 2023. Moreover, supply-demand imbalances stemming from both the pandemic and the geopolitical conflict in Europe resolve themselves faster than expected. This allows central banks to temper their hawkishness somewhat and interest rates peak at a lower level versus the “Deep Recession” scenario. Still, interest rates breach restrictive terrain and inadvertently pushes the economy into a recession, albeit a mild one given relatively healthy fundamentals heading into the downturn (stronger balance sheets, excess savings, pent-up demand) that help to limit the damage and the lack of significant financial imbalances that exacerbated past recessions.

Scenario 3 | Stagflation

Probability **15%**

As policymakers are unable to simultaneously achieve their inflation and growth targets, they are forced to choose between the two and opt to prioritize the economy and live with above-target inflation. In this scenario, central banks abandon their tightening campaign prematurely at levels that avoid an outright contraction. Global growth slows to below-potential levels, but global inflation remains elevated and above-target. While markets welcome the less-aggressive policy stance that helps to avert a recession, the risk of a stagflationary episode circa 1970 takes hold in the longer-run. Recall that the recovery in the 1970s eventually required even steeper increases in interest rates down the road, which played a prominent role in triggering a string of financial crises and a prolonged period of economic stagnation. The good news is that unlike the 1970s, central banks now have clear mandates for price stability, and have established a credible track record of achieving their inflation targets.

Forecasts for the Next 12-18 Months



SCENARIOS	JANUARY 31, 2023	DEEP RECESSION	SHALLOW RECESSION	STAGFLATION
PROBABILITY		55%	30%	15%
GDP GROWTH				
Global	2.10%	1.00%	2.00%	2.50%
U.S.	0.30%	-2.00%	0.00%	1.00%
Canada	0.50%	-1.00%	0.50%	1.50%
INFLATION (HEADLINE Y/Y)				
U.S.	6.50%	4.50%	3.50%	5.50%
Canada	6.30%	4.00%	3.25%	4.50%
SHORT-TERM RATES				
Federal Reserve	4.75%	6.00%	5.25%	4.75%
Bank of Canada	4.50%	5.50%	4.75%	4.50%
10-YEAR RATES				
U.S. Government	3.51%	5.00%	4.25%	4.50%
Canada Government	2.92%	5.00%	4.00%	4.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
U.S.	226	200	225	240
Canada	1561	1300	1400	1500
EAFE	162	100	140	155
EM	82	65	75	90
P/E (12 MONTHS FORWARD)				
U.S.	17.8X	15.0X	17.0X	18.5X
Canada	13.3X	12.0X	14.0X	14.5X
EAFE	13.0X	12.0X	14.0X	14.5X
EM	12.5X	11.0X	13.0X	14.0X
CURRENCIES				
EUR/USD	1.09	1.00	1.10	1.15
CAD/USD	0.75	0.75	0.80	0.85
USD/JPY	130.09	135.00	125.00	115.00
COMMODITIES				
Oil (WTI, USD/barrel)	78.87	90.00	110.00	130.00
Gold (USD/oz)	1929.50	2100.00	1900.00	1800.00

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



Matrix of Expected Returns (USD)

SCENARIOS	DEEP RECESSION	SHALLOW RECESSION	STAGFLATION
PROBABILITY	55%	30%	15%
TRADITIONAL INCOME			
Money Market	5.3%	4.9%	4.6%
U.S. Investment Grade Bonds	-8.5%	-3.5%	-5.0%
NON-TRADITIONAL INCOME			
Diversified Credit	6.0%	7.0%	8.0%
Diversified Real Assets	5.0%	6.0%	8.0%
TRADITIONAL CAPITAL APPRECIATION			
U.S. Equity Large Cap	-26.4%	-6.2%	8.9%
International Equity	-42.9%	-6.7%	7.0%
Emerging Market Equity	-30.7%	-5.5%	22.2%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity & Placements	5.0%	7.5%	12.0%
Liquid Alternatives	0.0%	2.5%	5.0%

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Current Strategy¹



TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	0.0%	17.5%	40.0%	27.5%	+10.0%
Money Market	0.0%	0.0%	40.0%	27.5%	+27.5%
U.S. Investment Grade Bonds	0.0%	17.5%	40.0%	0.0%	-17.5%
NON-TRADITIONAL INCOME	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%
TRADITIONAL CAPITAL APPRECIATION	17.5%	37.5%	57.5%	17.5%	-20.0%
U.S. Equity Large Cap	0.0%	20.0%	40.0%	10.0%	-10.0%
International Equity	0.0%	12.5%	20.0%	2.5%	-10.0%
Emerging Market Equity	0.0%	5.0%	20.0%	5.0%	0.0%
NON-TRADITIONAL CAPITAL APPRECIATION	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%

¹ Asset mix 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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Fiera Infrastructure Inc. ("Fiera Infra**")**, a subsidiary of Fiera Capital Corporation is a leading global mid-market direct infrastructure investor operating across all subsectors of the infrastructure asset class.

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