

Q4 2023

Investment Outlook & Portfolio Strategy



Macroeconomic Landscape

Global

Global growth is expected to stagnate to below-trend levels as the environment of “higher-for-longer” interest rates take their toll on the economy.



United States

The US economy has been a standout in terms of economic resilience. However, economic resiliency has kept inflation stubbornly elevated and prompted the Federal Reserve to raise interest rates by much more than anticipated and keep them there for an extended time. Consequently, we expect momentum to subside as the impacts of the most aggressive tightening campaign in four decades begins to bear fruit and as household finances deteriorate under the weight of cooling job growth and dwindling excess savings.

Canada

The Canadian economy stalled out in the third quarter as the impact of cumulative rate hikes took hold and dampened spending. However, there has been very little downward momentum in underlying inflation. Wages are still running at 4% to 5%, while the Bank of Canada's preferred gauges of underlying inflation have heated back up to 4%. This leaves the Bank of Canada in a difficult position as recent signs of reaccelerating inflationary pressures collide with an economy that is losing steam.

International

The European economy is suffering under the weight of high inflation and interest rates, while the global factory downturn has imposed a more pronounced brake on growth given that the Eurozone (Germany) is heavily reliant on manufacturing versus other advanced economies. While the European Central Bank has lifted the deposit rate to a record high, officials have reiterated that rates will be kept at “sufficiently restrictive levels for as long as necessary” – which is likely to deal another blow to an already languishing economy.

Emerging Markets

The Chinese economy has shown some tentative signs of stabilization following an uninspiring recovery earlier this year. However, the world's second largest economy is facing a number of headwinds, including weak business and consumer confidence, a faltering property market, and slowing global demand for Chinese exports. Linger headwinds have been met with a lackluster policy response given policymakers' desire to avoid driving up debt and exacerbating financial risks, which suggests the stimulative measures are unlikely to boost growth in a meaningful way.

Economic Outlook

Stagflation

Extreme optimism in the first half of 2023 gave way to growing skepticism in the third quarter as investors contemplated the trajectory for inflation, monetary policy, and the economy. Volatility resurfaced and both stock and bond markets ended the quarter in negative terrain as the “higher-for-longer” interest rate narrative took hold following data that showed economic resilience in the United States that has translated into elevated and persistent inflation.

It has become abundantly clear that monetary policy is not yet restrictive enough to bring inflation to heel and that it is virtually impossible to bring inflation back to the 2% objective without pushing interest rates to levels that would ultimately tip the economy into a recession. While questions have surfaced regarding the Federal Reserve’s commitment to the 2% inflation target, our sense is that policymakers do not believe that bringing inflation to 2% justifies the severe economic and social consequences associated with doing so.

Instead, with long-term inflation expectations remaining well-anchored, policymakers appear willing to live with higher inflation for longer and will amortize the decline in inflation over an extended period of time. As such, we expect policymakers to pause their tightening campaigns at interest rate levels that are not restrictive enough to bring inflation back to 2% over the next 3 years. Still, while monetary policy tightening is likely close to peaking, it will nonetheless remain in modestly restrictive terrain for some time. While averting an outright contraction, we expect the economy will slow to below-trend levels and inflation will edge lower in response over the coming years. The Federal Reserve’s own projections for inflation and interest rates support this view in that officials do not see a return to 2% inflation before 2026.

FEDERAL RESERVE SUMMARY OF ECONOMIC PROJECTIONS				
September 2023 Forecasts	2023	2024	2025	2026
Change in real GDP (June projection)	2.1% (1.0%)	1.5% (1.1%)	1.8% (1.8%)	1.8%
Core PCE Inflation (June projection)	3.7% (3.9%)	2.6% (2.6%)	2.3% (2.2%)	2.0%
Federal Funds Rate (June projection)	5.6% (5.6%)	5.1% (4.6%)	3.9% (3.4%)	2.9%

Source: Federal Reserve, September 2023.

Investment Strategy

There has been plenty of debate as to the so-called “landing” for the economy over the coming year. While investors have been anticipating an optimistic outcome that involves a soft landing, this scenario is difficult to achieve without imminent rate cuts – something that appears highly improbable at this time. A sustained rise in energy prices adds to the upside risks to inflation and reduces these odds even further. Meanwhile, the higher-for-longer interest rate mantra has shifted the investor narrative back towards the stagflationary outcome, which is our high probability scenario. While the financial market implications of the “Stagflation” scenario are less dire than recessionary outcomes, they are nonetheless negative for both stock and bond markets given that the environment of higher-for-longer interest rates and still-elevated inflation is likely to come up against a backdrop of stagnating growth. As such, a defensive portfolio positioning continues to be warranted over our cyclical investment horizon.

Economic Scenarios

Main Scenario | Stagflation

Probability **55%**

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 our high probability “Stagflationary” scenario, well-anchored long-term inflation expectations and tentative signs of easing wage and price pressures allow the Federal Reserve to tolerate above-target inflation for longer, with the central bank abandoning its tightening campaign at levels that would avoid an outright contraction in growth. Global growth slows to below-potential levels, but global inflation remains elevated and above-target. So long as the economy is operating below its potential, supply-demand imbalances would subsequently rebalance and allow inflation to subside, albeit over a longer period of time. While less-dire than the hard landing recessionary scenario, the lingering risk of a self-fulfilling wage price spiral where wage and price setters increasingly orient themselves to higher inflation rates could potentially translate into even steeper rate hikes down the road and a prolonged period of economic stagnation.

Scenario 2 | Shallow Recession

Probability **25%**

The US economy defied expectations for a sharp slowdown in 2023 following the most aggressive monetary tightening campaign in decades. Economic resilience was a result of the relatively robust underlying economic fundamentals heading into the downturn. Notably, pent-up demand from the pandemic, excess savings, persistent labor market imbalances (too much demand chasing too little supply), and rising wages all buttressed demand and allowed the economy to hold up reasonably well in the wake of over 500 basis points of rate hikes. However, in this less severe recessionary scenario, these tailwinds that acted as a buffer to the sharp increase in interest rates turn into headwinds in late 2023 that inevitably pushes the economy into a mild recession. Specifically, cumulative central bank tightening begins to weigh more materially on the economy given the long lags in the monetary transmission mechanism, while the drag from fiscal policy that is set to contract in 2024 and a deterioration in household finances weigh more prominently in the data. Still, with interest rates peaking at a lower level versus the “Deep Recession” scenario, the economic fallout is less damaging in the “Shallow Recession” scenario.

Scenario 3 | Deep Recession

Probability **10%**

In the hard landing recession scenario, stubbornly elevated inflation that proves 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. While goods prices subside, underlying “core” inflation proves to be more sticky and entrenched, with continued resilience in the labor market and consumer spending slowing the descent of wage and services inflation. Inflation expectations de-anchor and spiral higher in response, which forces central banks to prioritize tackling inflation in order to restore their inflation-control credibility, regardless of the economic fallout. As a result, central banks 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 more convincing evidence that inflation is subsiding meaningfully, which when combined with the delayed impact of cumulative monetary tightening to date ultimately means that central banks will be hiking interest rates well into economic weakness, making way for a “Deep Recession.”

Scenario 4 | Disinflation

Probability **10%**

In the “Disinflation” scenario, the economy proves to be much weaker than previously thought, which when combined with the disinflationary forces from cumulative monetary policy tightening and tighter credit conditions sends inflation spiraling lower towards 2% without dipping the economy into recession. This disinflationary impulse prompts central bankers to pause their tightening campaign in the back-half of 2023. By 2024, inflation that has subsided meaningfully allows the Federal Reserve to transition from an on-hold monetary policy stance towards interest rate cuts. Consequently, the economy averts a hard landing economic scenario, and a new economic cycle begins in mid-2024.

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Portfolio Strategy

Matrix of Expected Returns (USD)

SCENARIOS	STAGFLATION	SHALLOW RECESSION	DEEP RECESSION	DISINFLATION
PROBABILITY	55%	25%	10%	10%
TRADITIONAL INCOME				
Money Market	5.3%	4.5%	4.3%	4.8%
U.S. Investment Grade Bonds	-3.8%	4.2%	8.1%	4.6%
NON-TRADITIONAL INCOME				
Diversified Credit	8.0%	7.0%	6.0%	7.0%
Diversified Real Assets	8.0%	6.0%	5.0%	7.0%
TRADITIONAL CAPITAL APPRECIATION				
U.S. Equity	-2.1%	-19.8%	-30.0%	18.2%
International Equity	3.4%	-13.6%	-26.2%	30.0%
Emerging Market Equity	9.2%	-11.8%	-25.0%	33.8%
NON-TRADITIONAL CAPITAL APPRECIATION				
Private Equity & Placements	12.0%	8.0%	5.0%	15.0%
Liquid Alternatives	5.0%	2.5%	0.0%	7.5%

Source: Fiera Capital, as of September 29, 2023.

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Portfolio Strategy

Current Strategy¹

TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	0.0%	17.5%	40.0%	17.5%	0.0%
Money Market	0.0%	0.0%	40.0%	17.5%	+17.5%
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%	27.5%	-10.0%
U.S. Equity	0.0%	20.0%	40.0%	15.0%	-5.0%
International Equity	0.0%	12.5%	20.0%	7.5%	-5.0%
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%

Source: Fiera Capital, as of September 29, 2023.

¹ 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

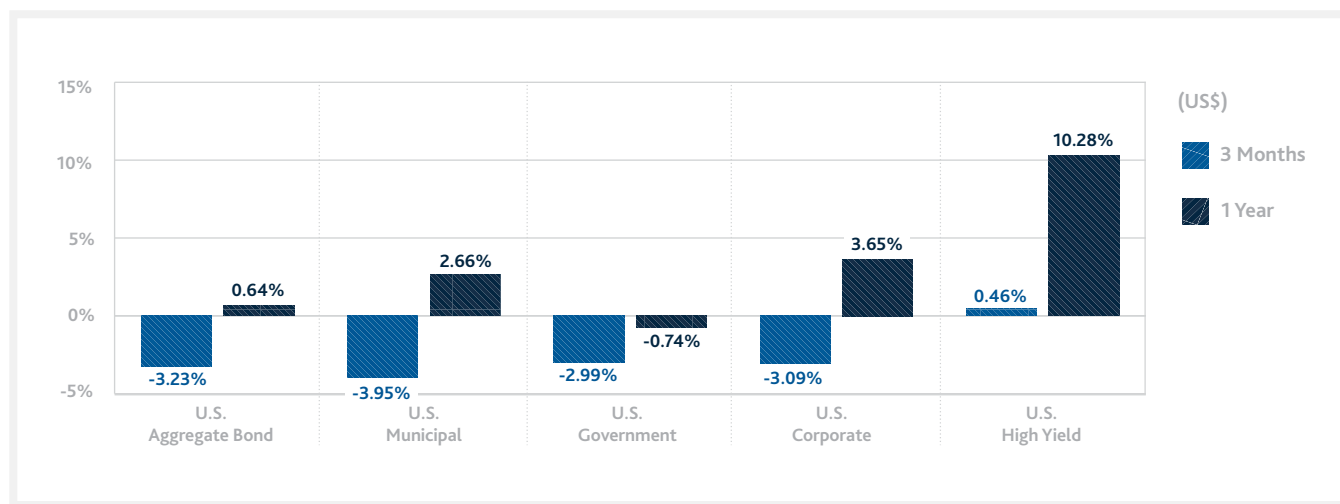
Fixed Income Review

Fixed income markets generated negative results in the third quarter and have erased all of their year-to-date gains. Bond yields pushed significantly higher following signs of economic strength and still-elevated inflation that prompted a recalibration in expectations for interest rates, with investors bracing for an extended period of higher rates. A deteriorating US fiscal position, the move by Fitch Ratings to strip the US of its top credit grade, and soaring crude oil prices also contributed to the upward move in bond yields. The Barclays US Aggregate Bond Index slipped 3.2% in the third quarter, bringing its year-to-date performance down to -1.2%.

The US economy has defied expectations that cumulative rate hikes would bring on a recession. Instead, the world's largest economy has held up reasonably well in the wake of over 500 basis points of rate hikes, thanks to pandemic-related stimulus that bolstered household savings and unrelenting labour market imbalances that have propped up wages and kept unemployment low.

While encouraging, these developments have also made it extremely difficult for central banks to rein in inflation that is proving increasingly entrenched. Recent strength in oil prices has further complicated matters at a time when many central banks hoped to be at or near the end of their tightening campaigns. As such, with inflation still too hot for comfort and decisively above-target, the macroeconomic narrative has shifted towards rates needing to stay higher for a prolonged period of time in order to bring inflation back towards the 2% goal. The Federal Reserve's latest Summary of Economic Projections corroborated this "higher-for-longer" narrative. At the September gathering, officials revised up their forecasts for interest rates. While participants expect that one more 25 basis point rate hike will be necessary before year-end, rates are expected to remain above 5% through 2024 and the 2025 end-point was also raised to 3.9%. Also notable was the fact that the Fed now sees restrictive policy right through to 2026.

U.S. Fixed Income Market Returns



Source: Fiera Capital, as of September 29, 2023.

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Investment Strategy

The path of least resistance for long-term bond yields should be higher from here. We expect yield curves to steepen in a bearish fashion, with the largest upward move at the long end of the curve given our outlook for higher inflation and a sustained rise in crude prices. While investors have recalibrated their expectations to be closer in line with the Federal Reserve's latest forecasts, they are not yet positioned for a prolonged period of higher rates. Amplifying the upside risk to yields, the Treasury is likely to issue a deluge of debt to fund ballooning deficits at a time when the Fed is reducing its balance sheet holdings. This unappealing outlook underpins our underweight allocation to traditional fixed income.

Equity Outlook

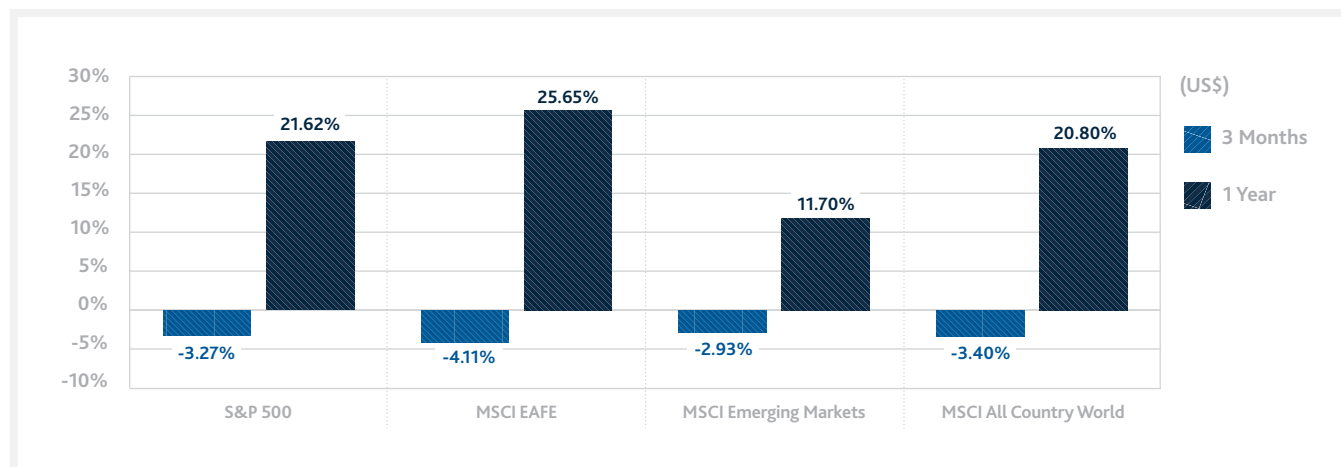
Equity Review

After a strong start to 2023, global equity markets reversed course in the third quarter as the sharp backup in global bond yields sapped risk appetite and weighed on stock market valuations. The MSCI All Country World index ended the quarter nearly 4% below where it started with no major benchmark we track left unscathed.

The outlook for equity markets remains challenging, in our view. We expect that the stagflationary environment will act as an obstacle to any further valuation expansion and/or earnings acceleration as investors align with the prospect for central banks to keep interest rates higher for longer in order to dampen economic growth, while reducing the likelihood of a scenario where central banks pre-emptively cut interest rates ahead of a recession.

On the valuation front, year-to-date equity market gains were predominantly driven by multiple expansion as investor hopes for imminent rate cuts pushed valuations markedly higher. Given that these views are now being reassessed, valuations need to adjust lower to the new reality of higher interest rates for longer. On the earnings front, optimistic expectations leave investors vulnerable to bad news in the form of a deteriorating economic backdrop given that much of the good news on the economy has already been baked into earnings forecasts. A reacceleration in economic growth that would sustain this year's earlier gains is highly unlikely in our view – particularly given our expectation for growth to slow to below-trend levels.

Equity Market Returns



Source: Fiera Capital, as of September 29 2023.

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Investment Strategy

In this environment, we maintain an underweight stance on equities over our tactical 12-18 month horizon. While there's very limited scope for further multiple expansion as interest rates rise by more than markets generally expect, our expectation for stagnating growth and earnings prospects emboldens our defensive stance. Regionally, the stagflationary environment should buttress both commodity prices and the Canadian economy alike, underscoring our preference for the resource-levered S&P/TSX, while relatively attractive valuations versus its global peers also warrants an overweight allocation to the Canadian market. By contrast, we believe that the year-to-date growth-driven S&P 500 rally is running out of steam, with upside potential capped by lofty valuations at a time when expensive growth equities could be vulnerable in a higher-for-longer interest rate environment. Already, the threat of tighter policy has reversed some of the gains in this year's high-flying tech stocks. While these growth companies are renowned for their long-term prospects, they suffer the most when future profits get discounted at higher interest rates.

Private Markets Outlook

The Case for Private Markets

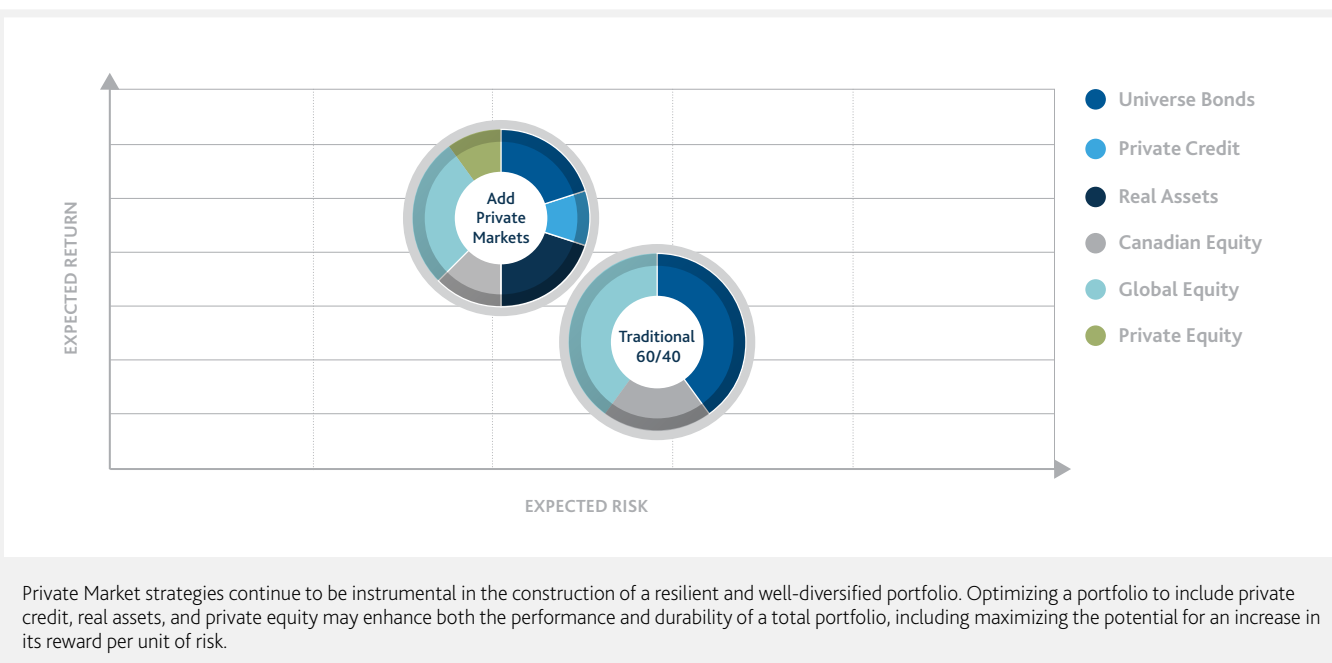
The third quarter brought with it a fresh set of challenges. With stagflationary headwinds looming large, both equity and fixed income markets generated negative results – underscoring the case for private market strategies in a well diversified portfolio. While the merits of allocating to private markets are valid across most macroeconomic environments, they are particularly attractive in an environment of elevated inflation and stagnating growth.

Critically, private markets strategies are less susceptible to significant swings if there is broader market volatility – something we expect will prevail as macroeconomic risks intensify in the coming year. Our expectation for a challenging financial market environment reinforces the need for both stability and yield in the portfolio setting, and non-traditional income strategies can smooth out the potentially volatile returns of public market asset classes in a stagflationary environment where the risk to bond yields is skewed to the upside. Longer term, we expect inflation to settle around 3% over the next 5 years given secular forces including demographic trends (aging populations), deglobalization, rising debts/deficits, and the imbalances associated with the green energy transition. Structurally higher inflation (and accordingly, interest rates) suggests that long-term government bonds 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 a well-balanced portfolio.

Private credit is a viable option for those looking for security and 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 originate loans at attractive risk-adjusted yields (enhanced yield with senior secured risk). 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 generating a stable income stream and hedging against inflation. Specifically, farmland and underlying produced agricultural commodities tend to generate value in real terms, while infrastructure has the potential to yield predictable cash flows with contracts that frequently include built-in protections against inflation. Meanwhile, real estate is often considered a good inflation hedge because it's a tangible asset whose replacement costs rise with inflation, benefiting from the appreciation in value. Additionally, rents usually increase with inflation, ensuring a growing cash flow for property owners.

Taken together, the construction of a properly diversified portfolio should include an allocation to private credit and real assets as an alternative to traditional fixed income. In addition to the attractive investment attributes above, their low correlation to traditional asset classes provides added diversification benefits and a reduction of overall portfolio risk, which is especially critical given our expectation for continued volatility across both stock and bond markets.

Portfolio Resiliency & Private Market Strategies



Source: Fiera Capital, for illustrative purposes only.

Commodities and Currencies

Currency Markets



The US dollar (DXY dollar index) capped its strongest quarterly gain in a year as the prospect for interest rates to remain elevated for a prolonged period sent both treasury yields and the greenback soaring higher. The dollar rose versus all of its Group-of-10 peers given the Federal Reserve's relatively more hawkish stance versus the European Central Bank, Bank of England, and the Bank of Japan. The euro, pound, and yen all retreated during the quarter. Even the Canadian dollar succumbed to a broadly stronger greenback, despite the profound rally in crude oil prices. After an extended period of unrelenting strength, the US dollar is likely to soften in the coming year as the Fed adopts a sidelined approach, which may potentially see rate differentials between the United States and its global peers narrow in response. Moreover, we expect the Canadian dollar to strengthen on the back of our bullish call on crude oil prices that should buttress the loonie in the coming year.

Gold



Gold tumbled to a seven-month low on the back of a firmer US dollar and as treasury yields pushed to multi-year highs, dampening the allure of non-interest-bearing bullion. We expect gold to trade in a narrow range given some conflicting forces at hand. While bullion's appeal as an inflation hedge and a safe haven should underpin prices, the prospect for higher interest rates should limit any notable upside for the yellow metal.

Source: Bloomberg, as of September 29, 2023.

Oil



Crude oil notched its largest quarterly gain since the initial jolt from the war in Ukraine in early 2022, with lingering imbalances in the physical market sending prices soaring over the last three months. Market conditions tightened substantially after OPEC+ heavyweights Saudi Arabia and Russia extended production cuts and as official US data confirmed a collapse in crude stockpiles at the vital hub in Cushing, Oklahoma. Both the International Energy Agency and OPEC warned that the market would be in deficit through year-end. Adding to already tight market conditions, the latest geopolitical developments in the Middle East have created upside risks to oil prices should the Israeli-Hamas conflict escalate from here. We remain bullish on oil prices on the back of favourable supply-demand dynamics. While some demand destruction is inevitable in a stagflationary environment, supply-side restraints including low spare capacity and continued production management by OPEC+ should also place a floor under prices and limit the extent of price declines during the economic slowdown.

Copper



Copper ended the quarter virtually unchanged. While an underwhelming recovery in top-consumer China and lingering woes in the property sector have weighed on demand, authorities' pro-growth policy stance aimed at infrastructure spending and aid to the property sector counteracted some of that weakness in domestic demand. Longer-term, copper stands to benefit in the global effort to scale up in green infrastructure spending and expanding the electric-generation grid.

Forecasts for the Next 12-18 Months

SCENARIOS	SEPT. 29, 2023	STAGFLATION	SHALLOW RECESSION	DEEP RECESSION	DISINFLATION
PROBABILITY		55%	25%	10%	10%
GDP GROWTH					
Global	2.60%	2.50%	2.00%	1.00%	3.50%
U.S.	0.90%	0.75%	-0.75%	-1.50%	2.50%
U.S. Output Gap		0.00%	-1.50%	-3.00%	1.00%
Canada	0.70%	1.00%	-1.00%	-2.00%	2.00%
INFLATION (HEADLINE Y/Y)					
U.S.	3.70%	3.50%	2.50%	2.00%	2.00%
Canada	4.00%	3.50%	2.50%	2.00%	2.00%
SHORT-TERM RATES					
Federal Reserve	5.50%	5.00%	3.50%	3.00%	4.00%
Bank of Canada	5.00%	4.50%	3.00%	2.50%	3.50%
10-YEAR RATES					
U.S. Government	4.57%	5.50%	4.25%	3.50%	4.00%
Canada Government	4.03%	5.00%	3.75%	3.00%	3.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)					
U.S.	240	240	215	200	260
Canada	1565	1500	1400	1300	1600
EAFE	151	150	135	125	165
EM	71	80	70	65	85
P/E (12 MONTHS FORWARD)					
U.S.	17.9X	17.5X	16.0X	15.0X	19.5X
Canada	12.5X	13.5X	13.0X	12.0X	15.5X
EAFE	13.4X	14.0X	13.0X	12.0X	16.0X
EM	13.4X	13.0X	12.0X	11.0X	15.0X
CURRENCIES					
EUR/USD	1.06	1.10	1.05	1.00	1.12
CAD/USD	0.74	0.83	0.75	0.70	0.80
COMMODITIES					
Oil (WTI, USD/barrel)	90.79	110.00	90.00	80.00	100.00
Gold (USD/oz)	1848.10	1900.00	2000.00	2100.00	2000.00

Source: Fiera Capital, as of September 29, 2023.

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