

Q1 2024

# Investment Outlook & Portfolio Strategy



# Macroeconomic Landscape

## Global

The global economy defied expectations for a more meaningful slowdown in 2023, while inflation plunged lower. In turn, investors are bracing for an unwinding of restrictive monetary policies in 2024.



### United States

The US economy was a surprising standout in terms of economic resilience in 2023. However, the consumer-led tailwinds that drove above-trend growth in 2023 are likely to translate into headwinds heading into 2024. Economic momentum will undoubtedly subside, and the world's largest economy is expected to grow at a below-trend pace as the impact of aggressive policy tightening begins to bear more fruit and as household finances deteriorate under the weight of a cooling job market and dwindling excess savings that are set to be drawn down by mid-year.

### Canada

The Canadian economy is running at an anemic pace as the impact of cumulative rate hikes weigh on heavily indebted households that are more sensitive to higher borrowing costs. Still, somewhat worrisome is that downward momentum in underlying inflation has stalled out. Wages are still running at 5%, while the Bank of Canada's preferred gauges of underlying inflation held firmly above 3% at the end of the year, leaving the central bank in a precarious position as it attempts to balance the environment of slowing growth with still-elevated inflation.

### International

The European economy has been suffering under the weight of high inflation and elevated borrowing costs – while the economy has also battled to shake off its manufacturing malaise since the global factory downturn has imposed a more pronounced brake on growth – particularly given that the Eurozone (Germany) is more heavily reliant on manufacturing versus other advanced economies. With inflation across Europe proving more entrenched than elsewhere, both the European Central Bank and the Bank of England have been more vigilant, and are hesitant in succumbing to the inflation fight.

### Emerging Markets

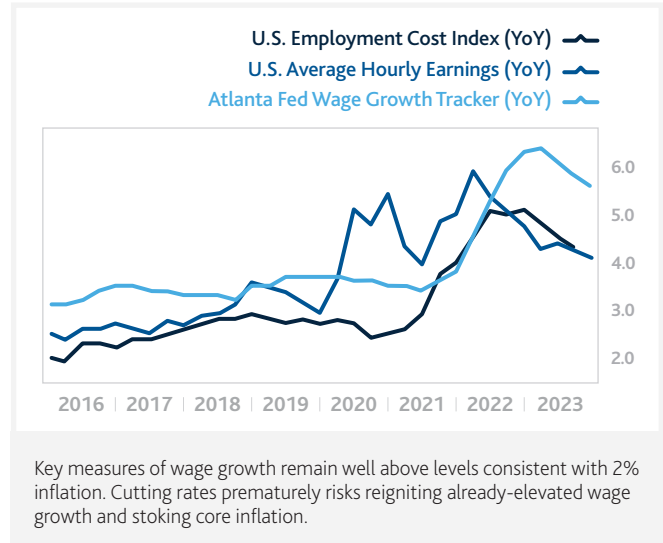
The Chinese economy is unlikely to make a meaningful contribution to global growth in 2024. Recent data reinforced the challenges faced by the world's second largest economy in the wake of weak consumer confidence, waning export demand, and an ongoing property crisis. In turn, this has put pressure on Beijing to roll out supportive policies to juice growth. However, the still-tepid recovery and lingering headwinds have been met with a lackluster policy response given policymakers' desire to avoid driving up debt and exacerbating financial risks.

# Economic Outlook

## A Profound, but Risky Pivot

Financial markets capped 2023 with an impressive fourth quarter, with wagers for a dovish monetary policy pivot and a soft economic landing sparking a profound rally across both stock and bond markets. The Federal Reserve gathering in December marked a pivotal policy shift towards easing, while some tentative signs of cooling inflation saw investors brace for aggressive rate cuts in 2024 and unleashed a bullish pulse across financial markets towards year-end.

The Federal Reserve's latest forecasts are calling for a so-called soft landing whereby inflation subsides without inflicting any major damage on the economy and allows for three rate cuts in 2024. However, this attempt to engineer the "goldilocks" not-too-hot, not-too-cold scenario could come with potentially dire consequences – particularly should premature rate cuts spark a second wave of inflation and a breakout in long-term inflation expectations. Cutting interest rates while the economy is operating above its potential and at a time when labour market conditions remain tight risks slowing or even reversing the disinflation process. Moreover, the subsequent easing in financial conditions may counteract what officials are ultimately trying to accomplish, with an unwelcome reacceleration in economic activity and pricing pressures inconsistent with the Fed's forecasts.



Source: Bloomberg, as of December 29, 2023.

## Scenario Overview & Investment Strategy

The majority (65%) of our economic scenarios have unfavourable implications for equities over our cyclical investment horizon, which argues for a defensive portfolio stance from a risk-reward perspective.

- > **Inflation Revival (45%):** Should an economy that remains "too hot" prompt policymakers to reconsider their easing plans and refrain from pursuing the magnitude of rate cuts discounted in the market, investors would need to recalibrate their expectations for interest rates higher. This would act as a powerful headwind for both stock and bond markets.
- > **Soft Landing (35%):** The biggest risk to our defensive positioning would be a scenario where inflation decelerates even more rapidly than expected with little in the way of damage to the economy. This would allow for substantial monetary policy easing that revitalizes both growth and earnings, which is the only scenario that bodes favourably for stock markets in the coming year.
- > **Shallow Recession (20%):** An outright recession (albeit a mild one) stemming from cumulative tightening to date cannot be ruled out. While rates would undoubtedly be slashed aggressively, a recessionary environment and the implications for corporate earnings would outweigh the stimulative impacts from rate cuts and sap both risk appetite and equity markets alike.

Finally, an erratic geopolitical backdrop remains a wild card. The landscape has become more difficult to navigate under the weight of two active conflicts currently underway. While any escalation risks an oil price shock that would amplify upside inflation risks, a potential ceasefire would act to expedite the disinflationary trend.

# Economic Scenarios

## Main Scenario | Inflation Revival

Probability **45%**

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 in 2024. 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 2 | Soft Landing

Probability **35%**

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 in 2024 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 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 in 2024. 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 exert 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, with the disinflationary trend expedited by a potential de-escalation in geopolitical conflicts that pushes major commodity (food and energy) prices lower. 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	INFLATION REVIVAL	SOFT LANDING	SHALLOW RECESSION
PROBABILITY	45%	35%	20%
TRADITIONAL INCOME			
Money Market	5.5%	4.5%	4.3%
U.S. Investment Grade Bonds	-5.8%	-0.1%	-0.5%
NON-TRADITIONAL INCOME			
Diversified Credit	8.0%	7.0%	7.0%
Diversified Real Assets	8.0%	7.0%	6.0%
TRADITIONAL CAPITAL APPRECIATION			
U.S. Equity	-11.9%	11.7%	-18.9%
International Equity	-3.0%	18.1%	-21.5%
Emerging Market Equity	-8.6%	24.5%	-23.8%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity & Placements	12.0%	15.0%	8.0%
Liquid Alternatives	5.0%	7.5%	2.5%

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

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# Portfolio Strategy

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

### 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 December 29, 2023.

<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

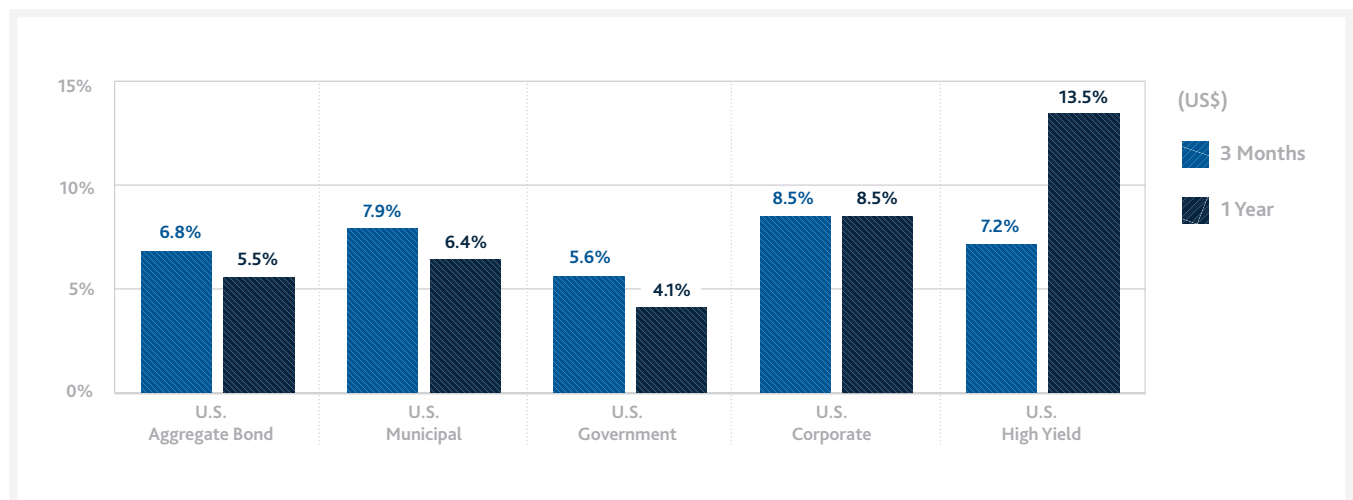
Fixed income markets generated exceptional results in the fourth quarter as traders wagered that central banks will aggressively slash interest rates in 2024. Bond yields tumbled lower and yield curves steepened in a bullish fashion, with the short end of the curve assuming the largest downward move. For the quarter, the Barclays US Aggregate Bond Index gained 6.8%, bringing its 2023 performance to 5.5%.

The Federal Reserve provided its strongest signal yet that the hiking cycle is complete, hinting at a pivot towards easing in 2024. The underlying message was that long policy lags are now making their way more convincingly into the economy and as such, officials will soon begin to consider when it would be appropriate to start cutting rates. The updated forecasts project the Fed's preferred inflation measures falling to 2.4% in 2024, which saw officials pencil in three rate cuts this year. While the Federal Reserve has set the

stage for a pivot, other central banks have been more reluctant to declare victory in the inflation fight.

Bank of Canada officials stated that excess demand is now gone and that growth is expected to remain weak in the coming quarters, which means "more downward pressure on inflation is in the pipeline." However, the Bank reiterated that it is premature to think about rate cuts, and that policymakers still need to see clear evidence inflation is firmly on a path toward the 2% target before they consider pivoting. Elsewhere, officials retained a hawkish-leaning bias and have pushed back on calls for imminent rate cuts given their unrelenting concern about inflation. European Central Bank President Lagarde reiterated that rates will be kept at "sufficiently restrictive levels for as long as necessary" while Bank of England Governor Bailey said "there is still some way to go" in the fight against inflation.

## U.S. Fixed Income Market Returns



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

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## Investment Strategy

Bond markets have moved to price-in major rate relief through 2024, with the Federal Reserve leading the way. However, with the Fed's preferred gauges of inflation still well above the 2% goal, expectations for more than double the rate cuts as projected in the "dot plot" could prove too optimistic. Should the aggressive easing cycle that markets are discounting prove elusive, investors would need to recalibrate their rate expectations higher in response. 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. From a risk-reward perspective, this leaves little room for further downside in bond yields (and upside in prices) and underpins our underweight allocation to traditional fixed income.

# Equity Outlook

## Equity Review

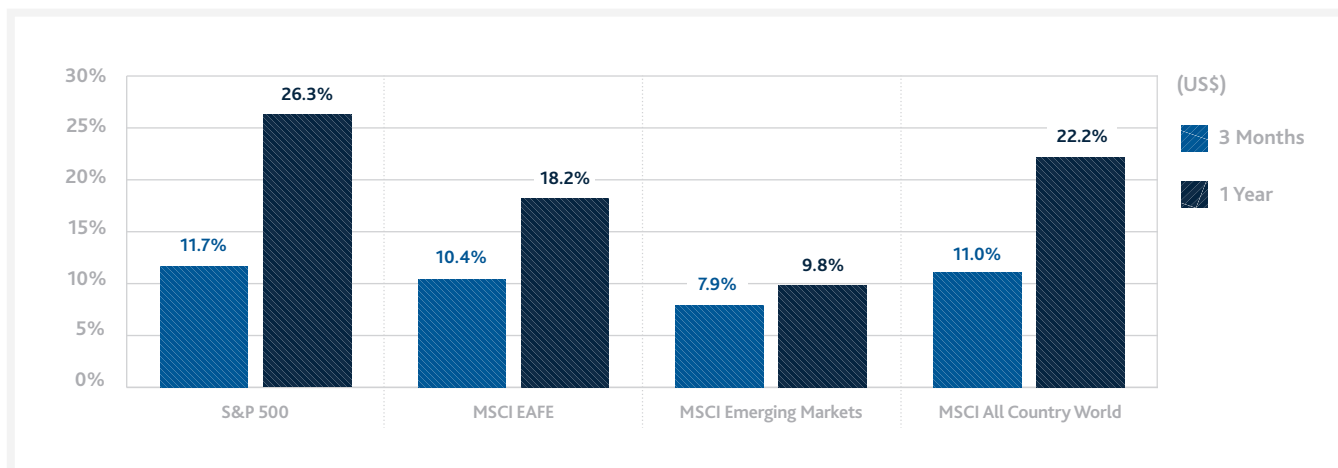
Global equity markets ended 2023 on a high note and soared towards record highs on the back of the sharp retreat in bond yields that propped up valuations and fueled the strong year-end rally across the globe.

The prospect for a soft economic landing and a flurry of rate cuts in 2024 has ignited resounding investor optimism heading into the new year. However, caution is warranted following the profound revival in risk appetite given that this extremely favourable outcome for stock markets has largely been baked into prices, reducing the risk-reward proposition from here. With equity markets currently priced for this not-too-hot, not-too-cold “goldilocks” scenario (soft landing) that would allow for the substantial monetary easing that is currently discounted in the market, investors could be vulnerable to disappointment should the macroeconomic backdrop evolve in a way that ultimately works against these optimistic expectations.

On the valuation front, speculation for aggressive rate cuts in 2024 has pushed price-to-earnings multiples markedly higher. Should these views prove elusive amid firmer growth and/or a reacceleration in inflation, valuations would need to be reassessed and adjusted lower to reflect less monetary policy easing than the market is currently discounting. Somewhat worrisome is that the subsequent easing in financial conditions may ultimately spark a second wave of inflation and counteract what the central banks are attempting to achieve.

On the earnings front, lofty expectations leave investors susceptible to disappointment given that the best potential outcome (a soft landing) has already been built into earnings forecasts. Consensus forecasts are calling for near double-digit earnings growth in 2024 in the United States and globally, something that may prove challenging should macroeconomic risks intensify.

## Equity Market Returns



Source: Fiera Capital, as of December 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. The environment of still-elevated inflation that prompts central banks to keep interest rates higher than most generally expect is likely to provide an obstacle to any further valuation expansion from here. Moreover, overly optimistic earnings forecasts could be ripe for downgrades in the absence of the most favourable soft landing scenario and emboldens our defensive stance. The prospect for a near-term correction has been amplified by stock market conditions that have become overvalued, overbought, and overcrowded after the stellar performance at the end of 2023.



# Private Markets Outlook

## Inflation, Interest Rates & The Case for Non-Traditional Income

After reaching peak levels in 2022, inflation has made some notable progress in subsiding through 2023. Still, while encouraging indeed, there are growing reasons to believe that we are embarking on a period of structurally higher inflation versus the post-2008 era. We expect inflation to settle between 2.5% and 3.0% over the next 5 years given secular forces including demographic trends (aging populations) and labour shortages, deglobalization, rising debts/deficits, lingering geopolitical conflicts, and the imbalances associated with the green energy transition.

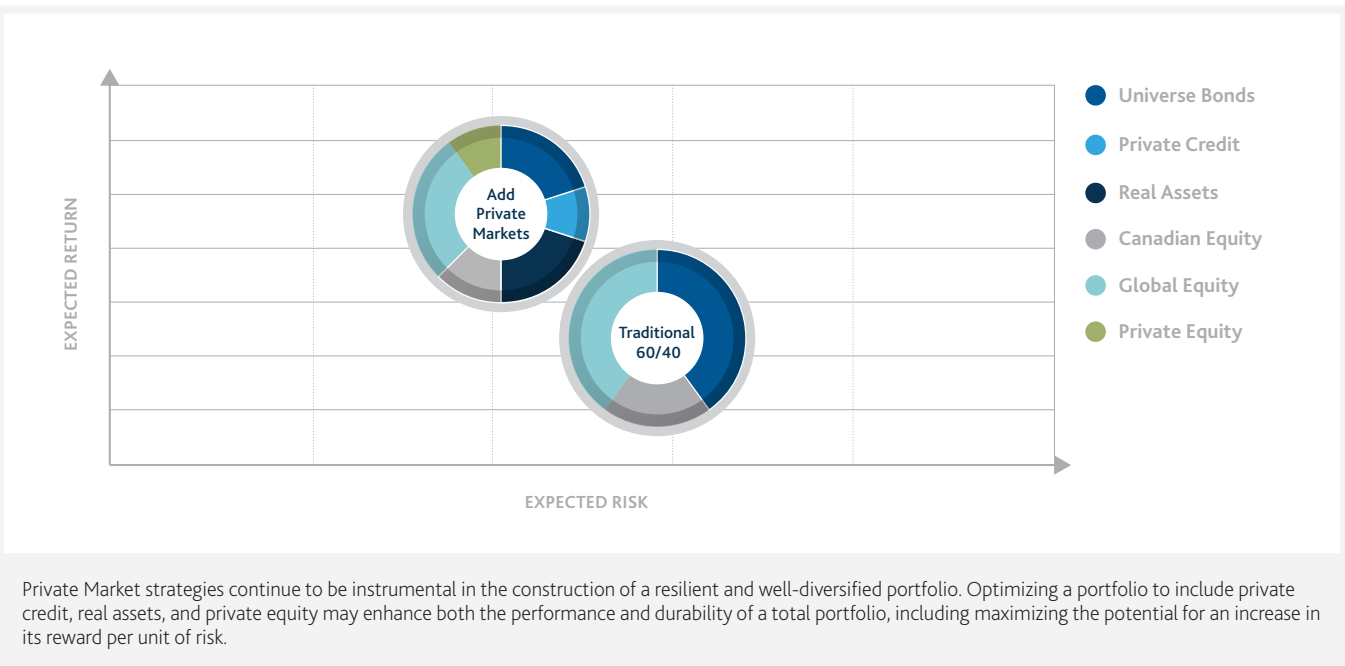
Structurally higher inflation (and accordingly, interest rates) suggests that long-term government bonds may fall short of what investors have grown accustomed to over the last several decades and reinforces the case for non-traditional sources of income in a well-balanced portfolio.

Private credit is a viable option for those looking for 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 the financing gap left by traditional banks and 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 protecting purchasing power in a higher inflation environment. 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 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. 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, which is especially critical given our long-term forecasts for above-average inflation and interest rates. In addition to the attractive investment attributes above, their low correlation to traditional asset classes and their differentiated sensitivities to inflation 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 & Private Market Strategies



Source: Fiera Capital, for illustrative purposes only.

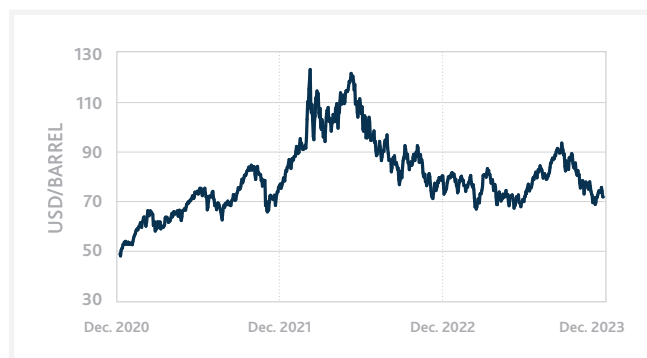
# Commodities and Currencies

## Currency Markets



The US dollar (DXY dollar index) stumbled lower in the fourth quarter to its weakest since July as investors doubled down on wagers the Federal Reserve will start to unwind its restrictive monetary policy stance in the first half of 2024. Currencies around the world jumped to multi-month highs against a broadly weaker greenback, with the euro, pound, yen, and Canadian dollar all strengthening at the end of the year. Both the euro and pound gained after their respective central banks were more reluctant to set the stage for a dovish policy pivot, while the yen got a boost from expectations that the Bank of Japan will raise interest rates for the first time since 2007. The Canadian dollar firmed despite the quarterly rout in crude prices. Should the Fed assume a hawkish-leaning policy stance in response to resilient, globe-leading growth in early 2024, the path of the least resistance for the US dollar should be higher, with a stronger greenback keeping a lid on the currencies of its major trading peers.

## Oil



Crude oil capped what was a tumultuous year and retreated in the fourth quarter as signs of swelling supplies in the US and lingering concerns about ebbing demand growth combined to drive prices lower. Official data showed that crude stockpiles at the key storage hub in Cushing, Oklahoma hit their highest since August, while production has been running at a record clip. These bearish developments counteracted the bullish impulse stemming from an erratic geopolitical backdrop and repeated production cuts from the Organization of Petroleum Exporting Countries and its allies (OPEC+) that failed to propel prices higher through 2023. That said, we remain bullish on oil prices on the back of favourable supply-demand dynamics. Particularly on the supply side, ongoing tensions in the Middle East risks prompting an oil shock, while continued production management by OPEC+ should place a floor under prices and limit the extent of price declines in an economic downturn.

## Gold



Gold advanced to a record high alongside the latest decline in treasury yields, buttressing the allure of the non-interest-bearing metal. 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 given lingering geopolitical risks should underpin prices, the prospect for interest rates to revert higher may limit any notable upside for the yellow metal in the coming year.

Source: Bloomberg, as of December 29, 2023.

## Copper



Copper notched a quarterly gain amid supply pressures and a late-year rally fueled by the prospect for easier global monetary policy that could bolster demand for the red metal. Still, an underwhelming recovery in top consumer China and lingering woes in the property sector may weigh on demand, though authorities' efforts to spur infrastructure spending and provide aid to the property sector may counteract some of that weakness in domestic demand.

# Forecasts for the Next 12-18 Months

SCENARIOS	DECEMBER 29, 2023	INFLATION REVIVAL	SOFT LANDING	SHALLOW RECESSION
PROBABILITY		45%	35%	20%
GDP GROWTH				
Global	2.75%	4.00%	3.50%	2.00%
U.S.	1.50%	2.50%	1.50%	-0.50%
U.S. Output Gap	1.00%	1.00%	0.50%	-1.50%
Canada	1.25%	2.00%	1.00%	-1.00%
INFLATION (HEADLINE Y/Y)				
U.S.	3.10%	3.25%	2.00%	2.00%
Canada	3.10%	3.25%	2.00%	2.00%
SHORT-TERM RATES				
Federal Reserve	5.50%	5.50%	3.50%	3.00%
Bank of Canada	5.00%	5.00%	3.00%	2.50%
10-YEAR RATES				
U.S. Government	3.88%	5.00%	4.00%	3.50%
Canada Government	3.11%	4.50%	3.50%	3.00%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
U.S.	243	240	260	215
Canada	1508	1550	1600	1400
EAFE	156	155	165	135
EM	73	72	85	65
P/E (12 MONTHS FORWARD)				
U.S.	19.6X	17.5X	20.5X	18.0X
Canada	13.9X	13.5X	15.5X	13.0X
EAFE	14.4X	14.0X	16.0X	13.0X
EM	14.1X	13.0X	15.0X	12.0X
CURRENCIES				
EUR/USD	1.10	1.10	1.12	1.05
CAD/USD	0.76	0.75	0.80	0.70
COMMODITIES				
Oil (WTI, USD/barrel)	71.65	95.00	85.00	70.00
Gold (USD/oz)	2071.80	1900.00	1800.00	2000.00

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

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