TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

FEBRUARY 2017

FIERACAPITAL

In January, investors gauged the recent wave of healthy economic and corporate earnings results, which was at odds with ongoing unease regarding which of Trump's campaign proposals would see the light of day following his inauguration on January 20th. In his first order of business, Trump tackled his "America First" agenda and formally withdrew from the Trans Pacific Partnership, put NAFTA up for renegotiation, and submitted an executive order to place a halt on immigration. However, he also acted on some of his pro-growth proposals as well, approving the Keystone XL pipeline and putting forth some potential infrastructure spending plans. Nonetheless, volatility remained extremely subdued as investors chose to err on the side of optimism, with risky assets soaring higher throughout the month.

FINANCIAL MARKET DASHBOARD

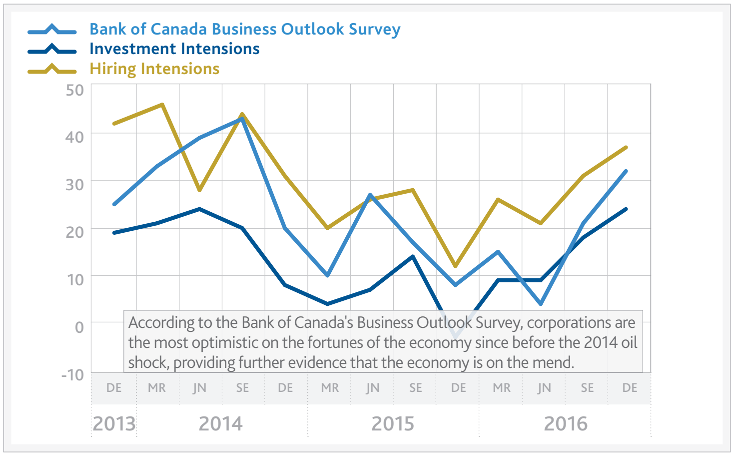
	JAN. 31, 2017	JAN.	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,278	1.79%	1.79%	17.45%
S&P/TSX	15,385	0.64%	0.64%	20.00%
MSCI EAFE	1,732	2.87%	2.87%	8.85%
MSCI EM	909	5.45%	5.45%	22.48%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.45	0.88	0.88	53.20
US 2 Year Bond Yield	1.20	1.61	1.61	43.10
CA 10 Year Bond Yield	1.75	3.80	3.80	53.40
CA 2 Year Bond Yield	0.77	2.40	2.40	34.90
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.77	3.13%	3.13%	7.21%
EUR/USD	1.08	2.67%	2.67%	-0.30%
USD/JPY	112.80	-3.56%	-3.56%	-6.88%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	52.81	-1.69%	-1.69%	57.08%
Copper (USD/pound)	272.75	8.86%	8.86%	31.95%
Gold (USD/oz)	1,208.60	4.94%	4.94%	8.26%

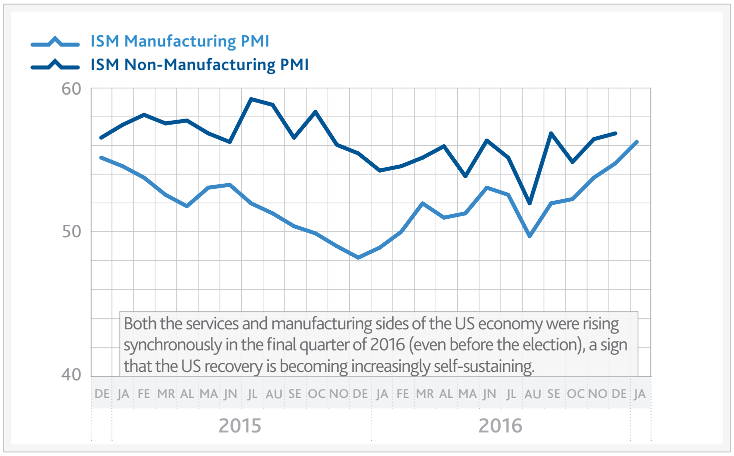
The reflationary trade gained some traction in January, owing to improving global growth prospects, higher commodity prices, and stronger-than-expected corporate earnings results. As a result, investor appetite for risk prevailed and global equity markets climbed higher, with all major regions contributing to the advance. In the US, the S&P 500 hit record highs and posted its third consecutive monthly gain. Similarly, the S&P/TSX came within striking distance of record highs even despite the monthly retreat in energy stocks, thanks to some notable strength in the financials and materials sectors. Finally, international equities also participated in the market upswing, while emerging market bourses led the performance charge and extended their outperformance in 2017.

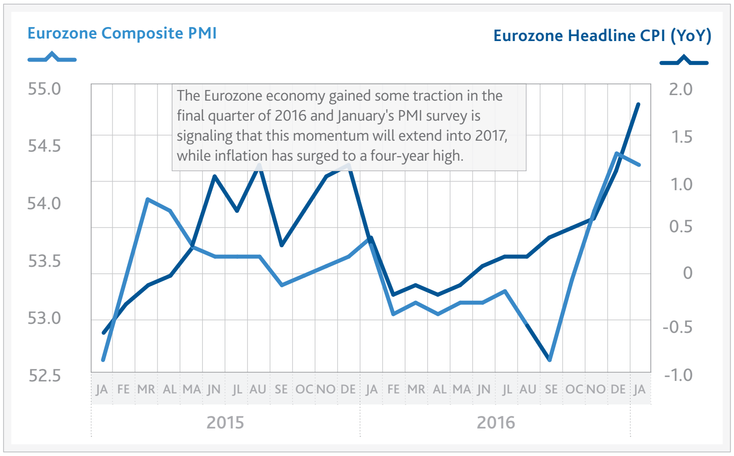
The global ascent in sovereign bond yields continued throughout January, with 10-year government bond yields in both Canada and the US rising following Chair Yellen's constructive outlook on the US economy, reinforcing the FOMC median forecast for three rate hikes in 2017. Similar themes also emerged abroad, with both European and Japanese government bond yields backing-up alongside the ongoing revival in inflation expectations. Finally, credit spreads narrowed to their lowest levels since 2014 in the reflationary, risk-on environment.

After a strong finish to 2016, the US dollar reversed course in January and declined versus its major peers as the Trump administration reiterated its preference for a weaker currency and began its pursuit of some isolationist policies. Meanwhile, despite some dovish rhetoric from the Bank of Canada, the loonie strengthened versus the greenback following the approval of the Keystone XL pipeline, providing Canadian oil companies with better access to the US market.

Finally in commodity markets, the recovery in oil prices stalled-out and crude posted a monthly decline as signs of a strong recovery in US drilling activity offset news that OPEC and non-OPEC producers were on track to meet output reduction goals set in December. In contrast, gold prices soared higher as investors assessed the uncertain political backdrop, while copper prices rallied alongside the weaker US dollar and ongoing signs of global economic momentum, particularly in China (the largest consumer of the red metal).







CANADA

The Canadian economy rebounded nicely in November, with widespread gains reported across both the goods and service-producing sectors. The goods-producing sector is beginning to show some signs of life, with soaring exports providing a healthy lift to the manufacturing sector, while the services sector also contributed positively and posted its ninth straight month of expansion. Meanwhile, despite recent rhetoric around NAFTA and the potential for protectionist policies from Mr. Trump, business sentiment is also on the mend, particularly as the negative impact from the oil price shock continues to fade. Notably, corporations have pointed towards improving domestic sales momentum, the still-competitive level of the loonie, and strengthening demand stateside as reasons to remain optimistic on the fortunes of the Canadian economy through 2017.

USA

While the US economy grew at a slower than expected pace during the final quarter of 2016, the results nonetheless painted a picture of solid domestic demand. The good news is that both consumers and businesses were spending synchronously during the fourth quarter, a sign that the US recovery is becoming increasingly entrenched. While the consumer backdrop continues to impress (owing to a strengthening labour market and a revival in confidence), most encouraging has been the rebound in business investment after four straight quarterly declines, suggesting that corporations may finally be returning to the game after several years in restraint, thanks to the boost in sentiment stemming from Mr. Trump's proposals to ease regulations and revamp corporate tax policy in the US.

INTERNATIONAL

The latest data flow out of Europe remains consistent with an ongoing economic reacceleration, with the currency bloc posting its strongest expansion in three quarters and unemployment declining to its lowest level since 2009, while the January PMI data is suggesting that growth prospects will remain firm in the coming year. Furthermore, Eurozone inflationary pressures accelerated at their fastest pace in four years, propelled by the steady increase in energy prices over the last year. Taken together, while President Draghi continues to err on the side of caution, these constructive macroeconomic developments suggest that the ECB is likely getting closer to the end (versus the beginning) of unconventional stimulus measures and will have to reconsider their positioning later this year.

Our current scenarios are for a synchronized global expansion (65%), which is a continuation of the current environment that benefits equities, political instability (15%), which would be negative for equities and positive for bonds, emerging market instability (10%) led by emerging market disequilibrium that would introduce significant volatility, and finally, global economic stagnation (10%) which would be negative for equities and positive for bonds.

MAIN SCENARIO
SYNCHRONIZED GLOBAL EXPANSION

PROBABILITY 65%

The global economy stages a synchronized acceleration over the next 12 months, with all major regions contributing to the advance. The US economy surges ahead, thanks to an improving consumer backdrop and a manufacturing sector that's finding a floor – compounded further by President-elect Donald Trump's pledges to revitalize the economy through expansive fiscal policy. Meanwhile, the adjustment to low oil prices in Canada remains underway, as the economy thrives on the combination of resurgent US demand, a competitive Canadian dollar, and fiscal support. While policymakers in Europe and Japan ultimately prove successful in reflating growth, emerging market economies prosper in the environment of improving global demand, ample liquidity, and rising commodity prices. Taken together, the immediate focus on growth-enhancing policy initiatives in the US should have positive implications for the global economy in general and bolster inflation expectations across the world, aided further by a revival in commodity prices. This reflationary backdrop bodes well for equities and commodities (ex-gold) at the expense of fixed income and the US dollar.

SCENARIO 2
POLITICAL INSTABILITY

PROBABILITY 15%

The volatile election cycles in both the United States and Europe and the corresponding tilt towards populism and protectionist policies could bring about tremendous political upheaval, disrupting the global economy and financial markets alike. Under this scenario, the surprise victory for Donald Trump in the US elections brings about heightened uncertainty due to his drastic and unconventional policy proposals, including protectionist policies with a profound aversion to trade agreements that would create massive headwinds for global trade. Meanwhile, a rise in euro-skepticism and anti-establishment movements risks throwing Europe into political disarray at the same inopportune time that the economy is struggling to gain momentum, particularly as Italy, France, and Germany hold referendums and elections in the coming year, while the unknown consequences of Brexit negotiations linger on with UK PM May taking a harder line on the UK departure from the EU.

SCENARIO 3
EMERGING MARKET INSTABILITY

PROBABILITY 10%

Emerging market economies are most vulnerable to a faster pace of interest rate increases in the US and a corresponding resurgence in the US dollar. The sharp decline in foreign direct investment, repayment of US-denominated debt, and potential capital outflows could result in major contagion and a corresponding flight to quality trade, further exacerbating USD strength and a broad based tightening of financial market conditions. Furthermore, excessive and rising debt burdens in China leave the economy vulnerable at a time when growth is already slowing, rekindling fears of a hard landing in the world's second largest economy.

SCENARIO 4
GLOBAL ECONOMIC STAGNATION

PROBABILITY 10%

After eight years in recovery-mode, the global economy fails to regain momentum and runs out of steam, as secular forces such as an aging population, weaker labor force growth, and lower productivity temper growth prospects worldwide. Furthermore, the massive amounts of monetary stimulus already in place prove unsuccessful in bolstering growth as a broad-based deterioration in confidence offsets the environment of accommodative policy, leaving policymakers with little ammunition to shelter the economy from the storm.

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FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	JANUARY 31, 2017	SYNCHRONIZED GLOBAL EXPANSION	POLITICAL INSTABILITY	EMERGING MARKET INSTABILITY	GLOBAL ECONOMIC STAGNATION
PROBABILITY		65%	15%	10%	10%
GDP GROWTH (Y/Y)					
Global	3.10%	3.25%	2.25%	2.00%	2.00%
Canada	1.60%	2.75%	1.00%	0.50%	0.50%
U.S.	1.90%	3.00%	1.00%	1.50%	1.00%
INFLATION (HEADLINE Y/Y)					
Canada	1.50%	2.40%	1.75%	1.00%	1.00%
U.S.	2.10%	2.40%	2.00%	1.50%	1.00%
SHORT-TERM RATES					
Bank of Canada	0.50%	0.75%	0.25%	0.25%	0.25%
Federal Reserve	0.75%	1.50%	0.75%	0.50%	0.50%
10-YEAR RATES					
Canada Government	1.76%	2.30%	1.20%	0.95%	1.05%
US Government	2.45%	2.90%	1.40%	1.20%	1.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	25.9%	32.9%	2.2%	-1.2%	2.2%
U.S.	10.8%	15.5%	-8.0%	-12.1%	-9.6%
EAFE	24.0%	17.0%	-8.4%	-18.6%	-13.5%
EM	22.1%	22.7%	-18.2%	-26.4%	-21.5%
P/E (FORWARD 12 MONTHS)					
Canada	16.7X	17.0X	16.0X	16.0X	15.0X
U.S.	17.2X	18.0X	16.0X	15.0X	15.0X
EAFE	14.2X	16.0X	14.0X	14.0X	13.0X
EM	12.2X	13.5X	12.0X	12.0X	12.0X
CURRENCIES					
CAD/USD	0.77	0.80	0.70	0.65	0.70
EUR/USD	1.08	1.05	0.95	1.10	1.15
USD/JPY	112.80	125.00	110.00	100.00	90.00
COMMODITIES					
Oil (WTI, USD/barrel)	52.81	65.00	45.00	40.00	45.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SYNCHRONIZED GLOBAL EXPANSION	POLITICAL INSTABILITY	EMERGING MARKET INSTABILITY	GLOBAL ECONOMIC STAGNATION
PROBABILITY	65%	15%	10%	10%
Money Market	0.6%	0.4%	0.4%	0.4%
Canadian Bonds	-0.8%	5.5%	6.8%	6.7%
Canadian Equity	7.7%	-22.0%	-24.6%	-26.9%
U.S. Equity	4.6%	-15.3%	-18.4%	-22.1%
International Equity	1.9%	-20.3%	-23.7%	-30.1%
Emerging Market Equity	6.8%	-27.7%	-29.9%	-30.5%

CURRENT STRATEGY [1]

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	ALLOCATION	RELATIVE	OCTOBER 31 CHANGES
Money Market	0.0%	5.0%	25.0%	Neutral	5.0%	0.0%	Decreased by 5.0%
Canadian Bonds	20.0%	40.0%	60.0%	Underweight	20.0%	-20.0%	No change
Canadian Equity	20.0%	25.0%	45.0%	Overweight	37.5%	+12.5%	No change
U.S. Equity	3.0%	13.0%	23.0%	Neutral	13.0%	0.0%	No change
International Equity	2.0%	12.0%	22.0%	Neutral	12.0%	0.0%	No change
Emerging Markets Equity	0.0%	5.0%	15.0%	Overweight	12.5%	+7.5%	Increased by 5.0%

[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.

EVOLUTION OF STRATEGY[1]

	MONEY MARKET	CANADIAN BONDS	CANADIAN EQUITY	U.S. EQUITY	INTERNATIONAL EQUITY	EMERGING MARKETS EQUITY
July 4, 2011	+10.0%	-15.0%	+5.0%	0.0%	0.0%	0.0%
August 10, 2011	+5.0%	-15.0%	+5.0%	+5.0%	0.0%	0.0%
October 5, 2011	+7.0%	-15.0%	+8.0%	0.0%	0.0%	0.0%
October 12, 2011	+6.0%	-10.0%	+4.0%	0.0%	0.0%	0.0%
November 11, 2011	+5.0%	0.0%	0.0%	0.0%	-5.0%	0.0%
December 7, 2011	0.0%	0.0%	+5.0%	0.0%	-5.0%	0.0%
April 20, 2012	+15.0%	-20.0%	+10.0%	0.0%	-5.0%	0.0%
July 31, 2012	+20.0%	-15.0%	0.0%	0.0%	-5.0%	0.0%
November 9, 2012	+10.0%	-15.0%	+10.0%	0.0%	-5.0%	0.0%
February 19, 2013	+5.0%	-15.0%	+10.0%	0.0%	0.0%	0.0%
August 6, 2013	0.0%	-15.0%	+10.0%	+5.0%	0.0%	0.0%
December 3, 2013	+10.0%	-15.0%	+5.0%	0.0%	0.0%	0.0%
February 5, 2014	0.0%	-15.0%	+10.0%	+10.0%	-5.0%	0.0%
October 14, 2014	0.0%	-20.0%	+5.0%	+10.0%	+5.0%	0.0%
November 14, 2014	+10.0%	-20.0%	+2.5%	+2.5%	+5.0%	0.0%
July 13, 2015	0.0%	-20.0%	+7.0%	+4.0%	+9.0%	0.0%
October 19, 2015	0.0%	-20.0%	+11.0%	+0.0%	+9.0%	0.0%
June 24, 2016	+9.0%	-20.0%	+11.0%	+0.0%	+0.0%	0.0%
July 12, 2016	0.0%	-20.0%	+15.0%	+0.0%	+0.0%	+5.0%
July 27, 2016	+5.0%	-20.0%	+12.5%	+0.0%	+0.0%	+2.5%
October 31, 2016	0.0%	-20.0%	+12.5%	0.0%	0.0%	+7.5%

[1] Based on a 100 basis point value added objective.

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