Asset Allocation Strategy

CIO Office | June 2025

Seeking certainty

Highlights

- After falling and then rebounding dramatically in April, equity markets continued their recovery in May, this time supported mainly by easing trade tensions between China and the U.S.
- Summer looks set to be volatile in the financial markets, with the U.S. administration negotiating both trade relations with its main partners and its tax plan with the Senate. However, some parameters are starting to fall into place.
- On the tariff front, although anything can happen, the realignment of the Trump administration brings us closer to levels that are more tolerable for the economy. Besides, in its current form, the budget plan appears to be broadly in line with election promises and is, therefore, not set to significantly alter the trajectory of the budget deficit which remains abnormally high.
- Ultimately, the fate of financial markets remains largely dependent on the measures taken by the Federal Reserve once all these changes settle. With economic data still largely positive, it can afford to wait.
- Overall, aside from the daily noise, the resilience of the economy and markets suggests that equities could remain on their upward trend relative to bonds, confounding widespread investor pessimism as has often been the case in the past.

Global Asset Allocation Views

Asset Classes	-		N		+
Equities				■	
Fixed Income		■			
Cash			■		
Alternatives				■	
Fixed Income					
Government				■	
Credit		■			
Duration				■	
Equities					
Canada				■	
United States		■			
EAFE				■	
Emerging Markets			■		
Alternatives & FX					
Gold			■		
Uncorrelated Strategies				■	
Canadian Dollar			■		

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Bottom line: While the economy is set to slow down, a global recession remains an alternative scenario provided that the Trump administration's immediate priority continues to be securing trade deals and implementing policies conducive to growth. As such, although the risk level of our strategy remains measured, we are now slightly overweight equities, while the outlook for emerging markets appears to be improving.

Market review

Fixed income

- The Canadian fixed-income universe ended the month virtually unchanged, with bond yields staying put across the curve. Corporate bonds outperformed, with credit spreads narrowing slightly as fears of a global recession receded.
- In the United States, the Trump administration's fiscal plan (the One Big, Beautiful Bill) caused some anxiety in bond markets, particularly within the long end of the yield curve. Treasuries posted monthly losses, while riskier High Yield securities strongly outperformed, benefitting from their shorter duration and investors' renewed risk appetite.

Equities

- In equities, May was characterized by the significant rebound in global markets following the Trump administration's pivot toward a more conciliatory tone in regard to tariffs. In contrast to the previous two months, the performance of the four equity regions was relatively similar.
- Within the S&P 500, the three tech sectors (Comm. Services, Consumer Disc., Info. Tech.) and Industrials pulled the Index higher, while Health Care was hit hard by the scandals surrounding United Health.

FX & Commodities

- Gold and currencies ended May with little change. Oil prices rebounded but remain sharply lower than they were at the beginning of the year.

Market Total Returns

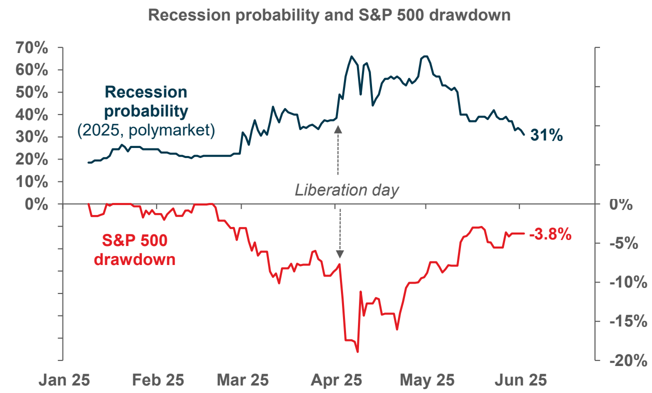
Asset Classes	May	YTD	12M
Cash (S&P Canada T-bill)	**0.2%**	**1.3%**	**4.1%**
Bonds (ICE Canada Universe)	**0.1%**	**1.3%**	**7.0%**
Short Term	0.2%	1.8%	6.7%
Mid Term	-0.2%	2.0%	8.3%
Long Term	0.3%	-0.3%	6.3%
Federal Government	-0.3%	1.3%	6.3%
Corporate	0.7%	1.9%	8.8%
U.S. Treasuries (US$)	-1.1%	2.5%	4.9%
U.S. Corporate (US$)	0.0%	2.3%	5.8%
U.S. High Yield (US$)	1.7%	2.6%	9.3%
Canadian Equities (S&P/TSX)	**5.6%**	**7.0%**	**21.0%**
Communication Services	2.2%	1.9%	-13.2%
Consumer Discretionary	8.1%	9.8%	18.3%
Consumer Staples	1.2%	6.3%	17.4%
Energy	4.5%	0.6%	5.1%
Financials	6.5%	6.9%	30.9%
Health Care	1.1%	-14.2%	-2.1%
Industrials	8.9%	5.7%	9.1%
Information Technology	8.0%	0.8%	50.0%
Materials	2.5%	25.4%	27.9%
Real Estate	4.4%	1.8%	12.7%
Utilities	1.9%	9.7%	22.8%
S&P/TSX Small Caps	7.2%	6.2%	13.7%
U.S. Equities (S&P 500 US$)	**6.3%**	**1.1%**	**13.5%**
Communication Services	9.6%	3.6%	20.2%
Consumer Discretionary	9.4%	-6.0%	21.5%
Consumer Staples	1.8%	8.5%	14.1%
Energy	1.0%	-3.9%	-9.6%
Financials	4.4%	5.9%	24.3%
Health Care	-5.5%	-3.1%	-6.0%
Industrials	8.8%	8.8%	17.5%
Information Technology	10.9%	-1.6%	14.6%
Materials	3.0%	3.6%	-3.5%
Real Estate	1.0%	3.3%	13.7%
Utilities	3.8%	9.1%	16.2%
Russell 2000 (US$)	5.3%	-6.8%	1.2%
World Equities (MSCI ACWI US$)	**5.8%**	**5.5%**	**14.2%**
MSCI EAFE (US$)	4.7%	17.3%	13.9%
MSCI Emerging Markets (US$)	4.3%	8.9%	13.6%
Commodities (GSCI US$)	**1.6%**	**-2.4%**	**-2.7%**
WTI Oil (US$/barrel)	3.2%	-15.2%	-21.2%
Gold (US$/oz)	-0.7%	25.1%	41.0%
Copper (US$/tonne)	4.7%	10.3%	-3.7%
Forex (US$ Index DXY)	**-0.1%**	**-8.4%**	**-5.1%**
USD per EUR	-0.1%	9.6%	4.6%
CAD per USD	-0.4%	-4.5%	0.8%

CIO Office (data via Refinitiv, as of 2025-05-30)

Seeking certainty

After falling and rebounding dramatically in April, equity markets extended their recovery in May, this time mainly supported by easing trade tensions between China and the United States, and the resulting decline in recession risk (**Chart 1**).

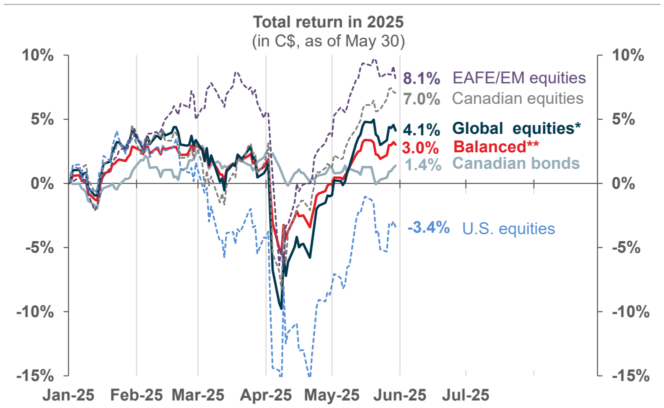
1 | A spectacular round trip...



CIO Office (data via Refinitiv, polymarket).

Overall, this essentially brings the return on a benchmark balanced portfolio back to where it was three months ago, i.e., slightly positive with the gap between equities and bonds remaining relatively narrow, but with a wider spread between the U.S. equities and the rest of the world (**Chart 2**).

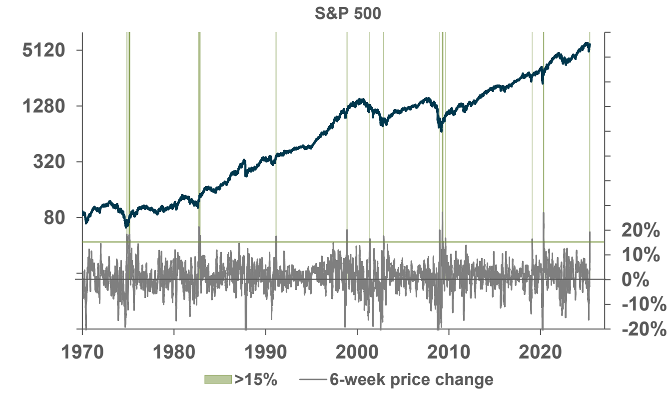
2 | ... bringing markets back to February levels



CIO Office (data via Refinitiv). *35% S&P/TSX, 35% S&P 500, 20% MSCI EAFE, 10% MSCI EM, *60% Global equities, 40% FTSE Canada Universe.

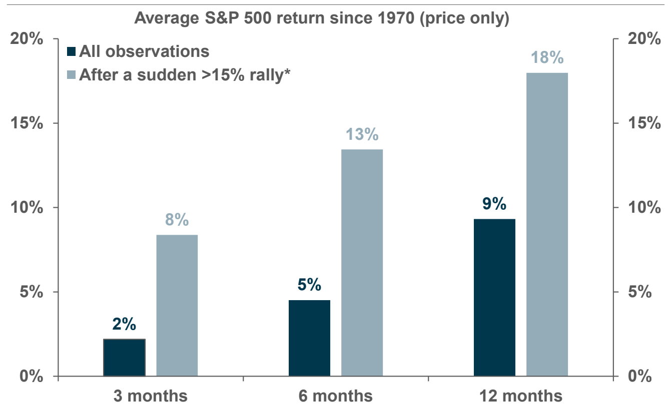
While it is natural to question the sustainability of such a rapid stock market rebound, historically this has often signaled that the worst is behind us (**Chart 3**). Case in point: since 1970, the average annual return of the S&P 500 after a six-week rise of more than 15% is twice the unconditional average (**Chart 4**).

3 | A sharp market rebound...



CIO Office (data via Refinitiv).

4 | ... is typically a good omen



CIO Office (data via Refinitiv). *A six-week rally greater than 15%.

Naturally, historical averages do not preclude a short-term pullback, given the lingering uncertainty surrounding U.S. trade, tax, and monetary policies.

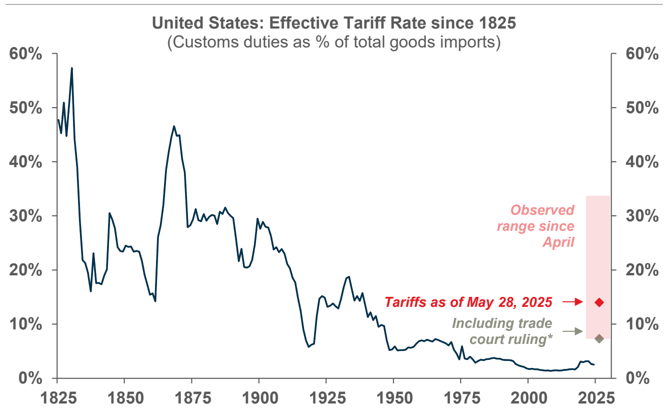
Nevertheless, certain parameters are starting to fall into place. Let's take stock of the situation.

Tariffs…

To keep the economic impact of tariffs manageable, two things are needed. First, tariff rates should not be so high that they suddenly destroy business models. Second, the terms and conditions should be stable so that businesses and consumers can plan accordingly.

In the first case, the Trump administration's realignment since the chaos of April 2 and the standoff with China brings us closer to more tolerable levels for the economy, with effective tariffs around 14%. In theory, tariffs could even fall to 7% if the May 28 ruling of the U.S. International Trade Court were to ultimately stand, although this seems unlikely (**Chart 5**).

5 | Tariff increases: it's all relative



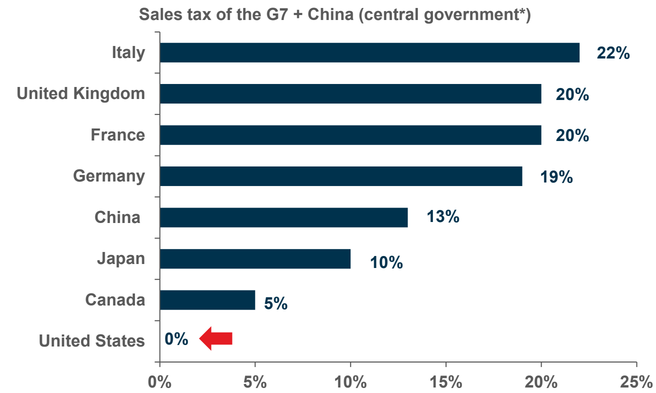
CIO Office (data via Refinitiv, U.S. Census, Bloomberg, Goldman Sachs Economics, NBF Economics & Strategy). *Includes Goldman Sachs' estimated impact of the ruling by the New York-based court of international trade that blocks certain tariffs from being implemented.

To be clear, these tariffs will still slow growth and fuel inflation in the coming months. However, when you consider the U.S. government's overall tax policy, the perspective changes.

For instance, the United States is the only G7 country that does not have a federal sales tax on goods and services (**Chart 6**).

Thus, taxing imported goods at a weighted rate of 14% represents revenue (or the equivalent of a

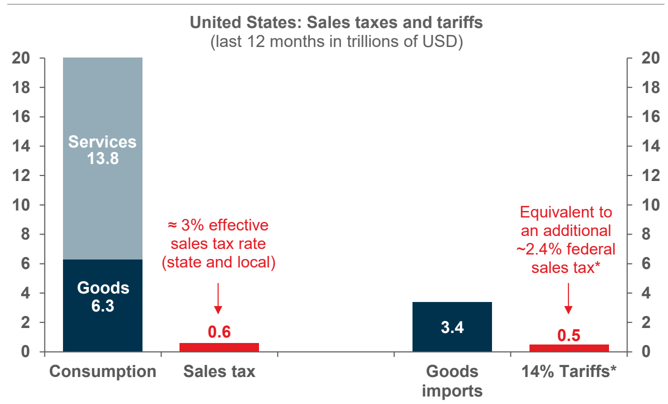
6 | The United States charges relatively little taxes…



CIO Office (data via Trading Economics). *Excludes state, provincial and municipal taxes.

federal sales tax) of 2.4% of all goods and services consumed which adds to state sales tax revenue of around 3% (**Chart 7**). This is far from the ≈20% observed in Europe, for example.

7 | … and that probably won't change (much)



CIO Office (data via Refinitiv, NBC, Bloomberg, U.S. Census, NBF Economics & Strategy). *Estimated effective tariff rate taking into account all tariffs announced to date. This tariff rate is then applied to the volume of goods imports of the last 12 months.

That said, when it comes to stability, we are still a long way from an environment where companies can make informed long-term decisions, and that's problematic.

In theory, the tariffs that sparked panic in the markets in April were only suspended until July 7 for the "reciprocal" part, and until August 14 for China. In addition, the judicialization of U.S. tariff policy adds to the confusion.

In other words, not only is it unclear what President Trump wants to do, but what he can do is also ambiguous. What we do know, however, is that it is not in his interest to cause a recession, and the best way to ensure that is to stay on the path of de-escalation and trade deals.

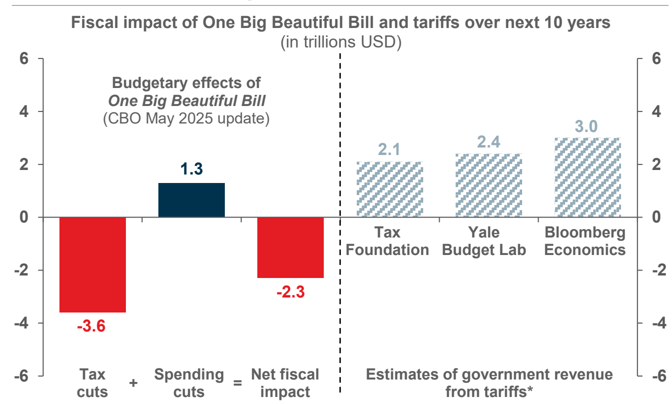
… taxes…

In addition to tariff negotiations, the Trump administration is starting talks on its tax plan — the "One Big, Beautiful Bill" — which should be passed by the Senate by August at the latest, to avoid hitting the debt ceiling.

For now, the plan adopted by the House of Representatives is essentially in line with the U.S. president's campaign promises, with a few nuances.[1]

According to an analysis by the Congressional Budget Office (CBO), the sum of planned tax cuts and spending cuts is expected to add $2.3 trillion to the U.S. debt over a 10-year period. In theory, this spending could be offset by additional revenue from tariffs, which is estimated at between $2.1 trillion and $3.0 trillion over the same period, according to various independent research firms (**Chart 8**).

8 | The U.S. fiscal plan...



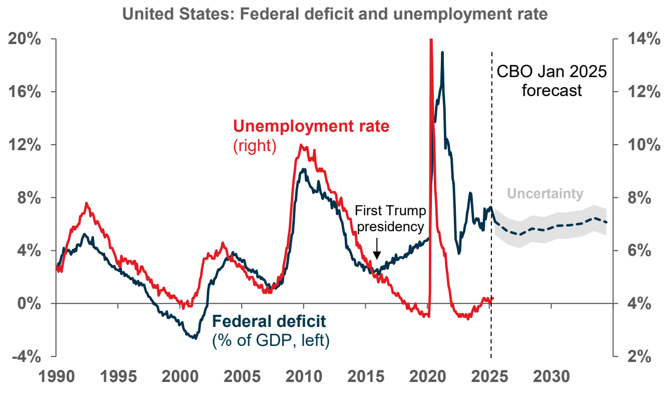
CIO Office (data via Refinitiv, Bloomberg, CBO). *Bloomberg Economics estimates tariffs will generate around $300 billion a year on average. Over the next 10 years, the Tax Foundation estimates $2.1 trillion and the Yale Budget Lab projects $2.4 trillion.

In practice, however, the only dollar that is certain is the one that will be spent, while most budget cuts are planned for later and revenue from tariffs is obviously very uncertain.

[1] For all the details: A Guide to Trump's Tax Cuts: What's in His 'Big, Beautiful' Bill, Bloomberg, May 22, 2025.

In any case, by spending more on one side and potentially seeking more revenue on the other, President Trump is not on track to reverse the trajectory of the budget deficit which has been out of step with economic logic since his first term (**Chart 9**).

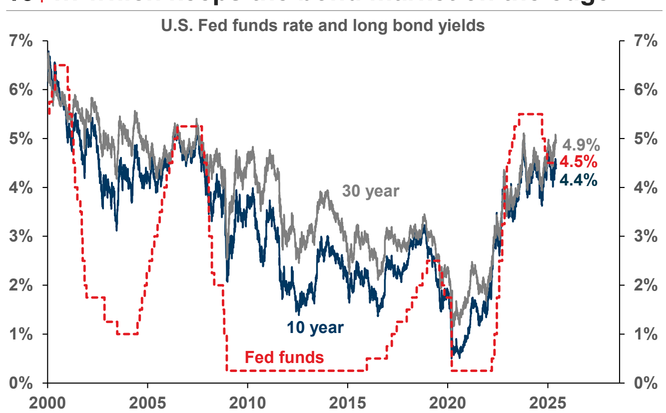
9 | … doesn't look set to reduce the deficit…



CIO Office (data via Refinitiv, CBO).

Unsurprisingly, this environment continued to fuel concerns over longer-term bonds, with U.S. 30-year yields even revisiting their October 2023 highs (**Chart 10**) at a time when the Federal Reserve seems in no hurry to change its tone.

10 | … which keeps the bond market on the edge



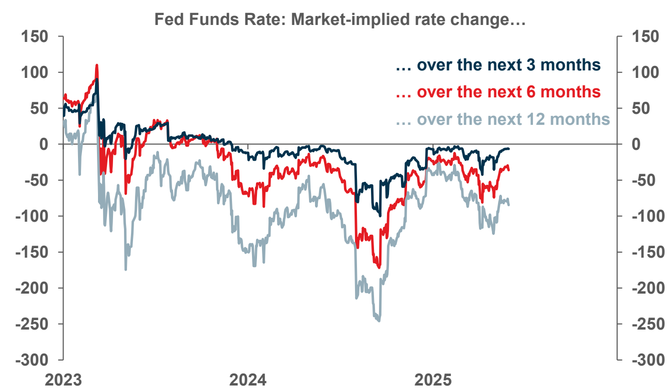
CIO Office (data via Refinitiv).

… interest rates

Beyond U.S. fiscal and trade policies, the fate of financial markets remains largely dependent on the measures taken by the Federal Reserve once all these changes become clearer.

For now, markets expect the Fed to remain patient for a few more months before delivering its first rate cut toward the end of the year, and a total of three cuts over the next 12 months (**Chart 11**).

11 | No rush for the Federal Reserve...



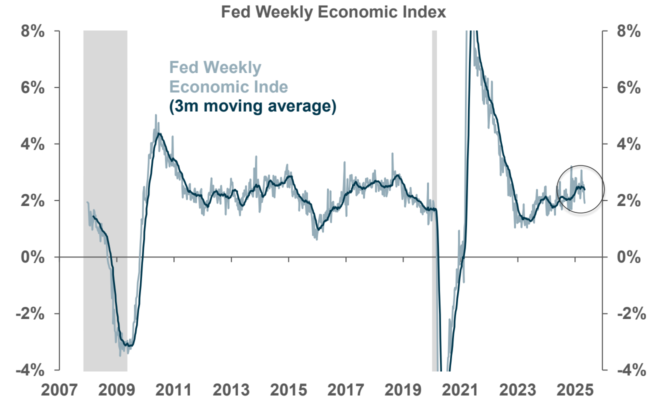
CIO Office (data via Refinitiv).

Indeed, there does not appear to be any urgency. For example, the Dallas Fed's weekly economic indicator — an index that incorporates a range of hard data such as retail sales, jobless claims, gasoline consumption, and rail traffic[2] — still shows no signs of a slowdown in economic activity (**Chart 12**, next page).

However, to avoid a sudden halt, consumer and small business sentiment — which had fallen sharply in the wake of the April tariff scare — will need to recover quickly. In this regard, the rebound in the Conference Board's Consumer Confidence Index at the end of May was encouraging (**Chart 13**, next page).

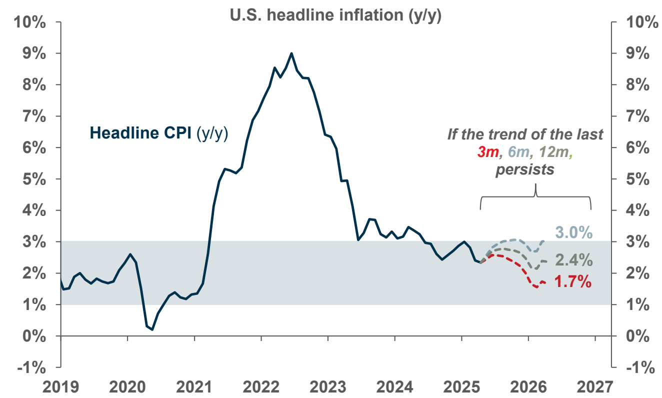
[2] https://www.dallasfed.org/research/wei/series

12 | … with an economy still on track



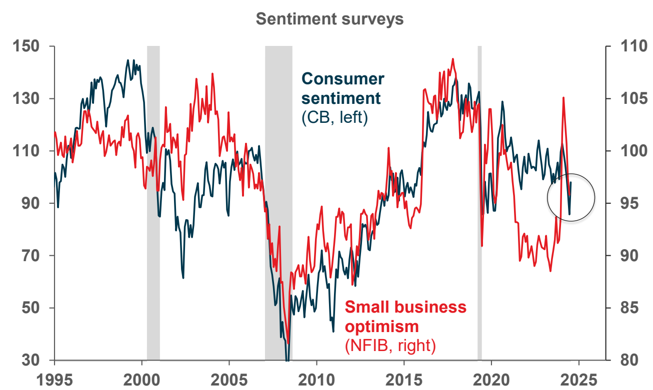
CIO Office (data via Refinitiv).

14 | Inflation seemed headed in the right direction...



CIO Office (data via Refinitiv).

13 | Sentiment surveys must rebound



CIO Office (data via Refinitiv).

15 | … what will be the impact of tariffs?

CIO Office (data via Refinitiv).

Speaking of encouraging trends, without all the concerns about tariffs, markets would probably have cheered the latest U.S. inflation data, which suggest that CPI is on track to converge not far from the 2% target over the next 12 months (**Chart 14**).

Unfortunately, the imposition of tariffs will inevitably change the picture to an extent that will become clearer in the coming months. If we are to believe the inflation derivatives market, this could translate into a premium of just under 1% on annual inflation, which is therefore likely to hover around 3% (**Chart 15**).

Overall, none of this suggests the Fed is about to pivot toward a more neutral monetary policy stance.

However, it could start discussing potential rate cuts next Fall, once the key parameters of the Trump administration's economic agenda have been established, allowing for a better assessment of the cost of its policies for inflation and growth.

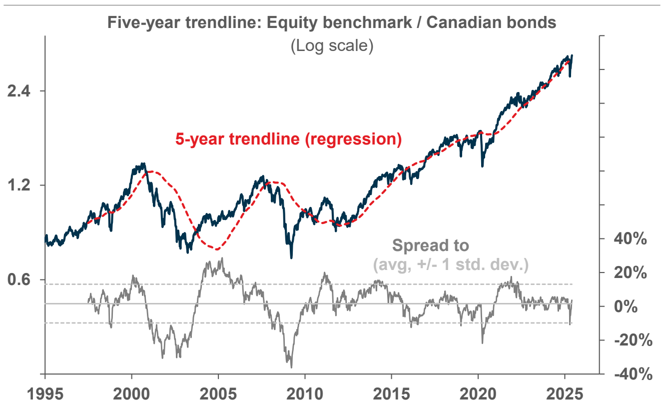
The bottom line: strategy update

Although the risk level of our asset allocation strategy remains measured ahead of what is likely to be a volatile Summer for financial markets, we increased our equity allocation relative to bonds at the end of May.

As time passes and certain aspects of the U.S. political agenda begin to take shape, the economic fog is slowly lifting, revealing the following observation. While the economy is set to slow down, a global recession remains an alternative scenario, provided that the Trump administration's immediate priority continues to be securing trade deals and implementing policies conducive to growth.

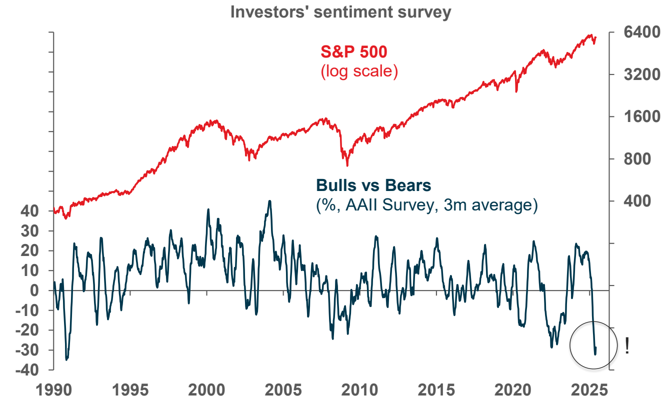
As such, setting aside the daily noise, the resilience of the economy and markets suggests that equities could carry on their uptrend relative to bonds (**Chart 16**), confounding widespread investor pessimism as has often been the case in the past (**Chart 17**).

16 | Stocks vs bonds: an upward trend…



CIO Office (data via Refinitiv).

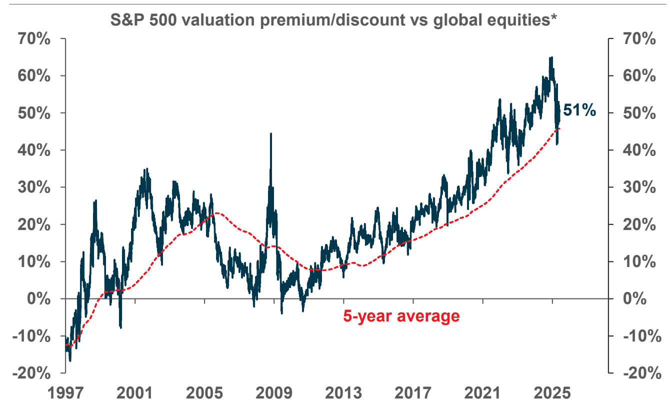
17 | … which could confound more than a few (again)



CIO Office (data via Refinitiv).

Besides, within the stock markets, the upside potential still appears relatively limited for U.S. equities whose valuation premium relative to the rest of the world is likely to continue to be called into question (**Chart 18**).

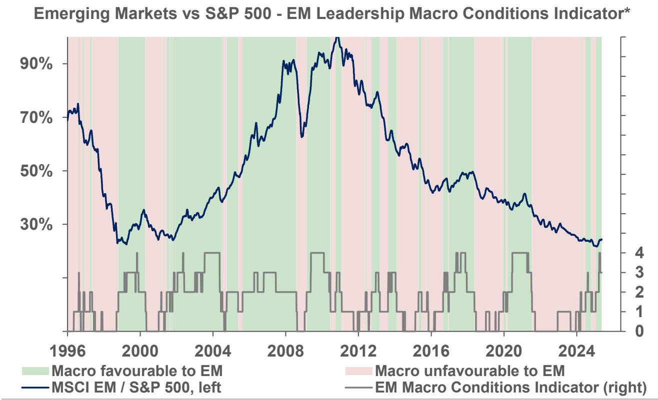
18 | A premium called into question for U.S. equities



CIO Office (data via Refinitiv). *Average of MSCI EAFE, MSCI EM, S&P/TSX

Against this backdrop, we have increased our allocation to emerging markets (EM) from underweight to neutral. Over the past few weeks, a series of factors generally favourable to EMs have appeared on our radar, with a weakening U.S. dollar, a majority of central banks cutting rates, and positive equity market momentum relative to the rest of the world (**Chart 19**, next page). Thus, although geopolitical tensions remain a risk, the

19 | Is the tide turning for Emerging Markets?

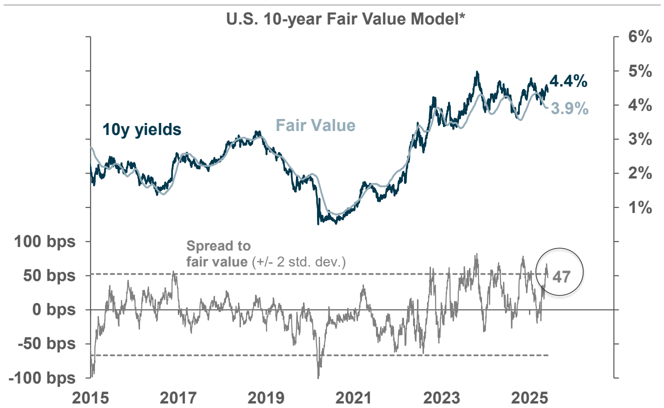


CIO Office (data via Refinitiv). *The indicator measures 4 conditions: (1) USD on a downtrend, (2) broad-based global growth, (3) large majority of central banks accommodative, (4) EM positive relative momentum.

current environment no longer warrants an underweight position in the region.

With regard to bonds, for now, we are inclined to maintain a slightly longer duration profile, with 10-year U.S. yields once again trading two standard deviations above our fair-value model (**Chart 20**).

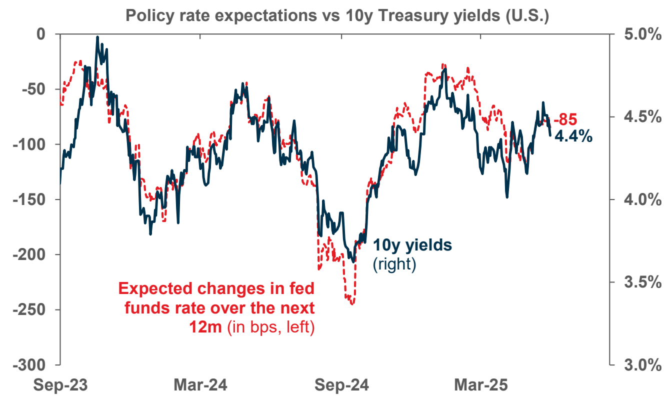
20 | The rise in bond yields seems stretched…



CIO Office (data via Refinitiv). *Based on (1) medium-term policy rate expectations and (2) long-term inflation expectations

However, since their peak in October 2023, U.S. Treasury bond yields have been moving mainly in line with expectations regarding the Fed's decisions over the next 12 months. From this perspective, barring a recession, 10-year yields are likely to fluctuate between 5% (if the consensus is that the Fed will not cut rates in the coming year) and 4% (if the consensus is that the Fed is moving toward its own estimate of the neutral rate, 150 bps lower than current levels) (**Chart 21**).

21 | … but what happens next depends on the Fed



CIO Office (data via Refinitiv).

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