Asset Allocation Strategy

CIO Office | August 2025

The same story again?

Highlights

- After a brief period of consolidation, equities continued their steady ascent in July, extending their lead over bonds.
- With hindsight, equity markets have essentially been writing variations of the same story for seven years now. First, a certain shock sends markets tumbling in a big way. This decline is followed by a strong rebound often perceived as excessive, but which ultimately proves to be durable once a pivot by policymakers is initiated.
- For the time being, the U.S. economy is holding up well, with the outlook for corporate profits appearing to stabilize, if not improve, while the labour market remains in equilibrium.
- However, the most overlooked positive news of recent months probably concerns the impact of U.S. tariffs on consumer prices. Indeed, the CITI Inflation Surprise Index is at its lowest level in almost 10 years, indicating that forecasters were expecting U.S. inflation to be much more vigorous than is currently the case.
- In this context, a window could indeed open for the Federal Reserve to gradually bring its policy rate closer to neutral over the coming quarters.
- All in all, while a moderate equity pullback is quite conceivable over the next few months, there is every reason to believe that the general uptrend should continue, although elevated valuations mean that we can expect a more modest pace of growth for the remainder of the year.

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: Beyond the political noise, the current environment carries significant tailwinds for the economy which could be amplified by a pre-emptive shift in tone toward a more dovish stance at the Federal Reserve. This context explains why we have gradually adjusted our strategy in favour of risky assets since May, a positioning we still consider appropriate.

NATIONAL BANK INVESTMENTS

Market review

Fixed income

- The Canadian fixed-income universe posted losses in July. Both inflation and net job creation surprised on the upside during the month, putting upward pressure on bond yields.
- In the U.S., Treasuries also ended the month lower, facing, among other things, a more hawkish Federal Reserve than initially hoped.

Equities

- Canadian, U.S. and Emerging Market equities posted fairly similar returns in July, with all three regions ending with modest gains. The EAFE region underperformed, largely due to the depreciation of the euro and Japanese yen.
- Within the S&P 500, Information Technology was supported by the excellent earnings season of the tech giants, while Health Care continued to underperform as it has since the beginning of the year.

FX & Commodities

- Oil prices climbed for the second month in a row in response, among other things, to the resilience of the global economy and the threat of U.S. tariffs against countries importing Russian oil.
- After several months of significant depreciation, the U.S. dollar rebounded in July, with the DXY index gaining more than 3%. The Greenback was supported by good economic data in the United States, as well as by the Federal Reserve which continues to ride alone by keeping its monetary policy in restrictive territory.

Market Total Returns

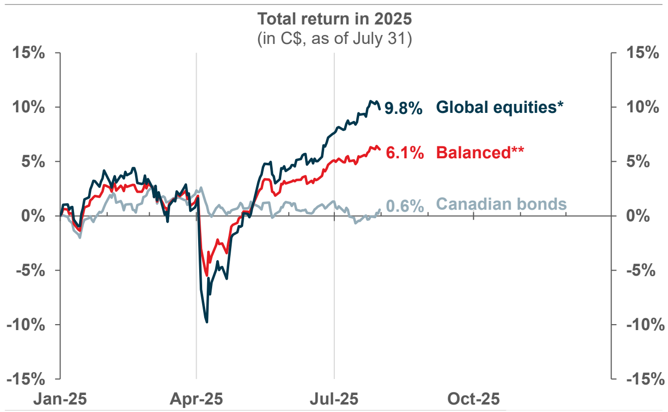
Asset Classes	July	YTD	12M
Cash (S&P Canada T-bill)	**0.2%**	**1.7%**	**3.6%**
Bonds (ICE Canada Universe)	**-0.7%**	**0.6%**	**2.8%**
Short Term	-0.1%	2.1%	4.6%
Mid Term	-0.6%	1.6%	3.8%
Long Term	-1.9%	-2.5%	-0.6%
Federal Government	-0.8%	0.5%	2.1%
Corporate	0.0%	2.2%	6.0%
U.S. Treasuries (US$)	-0.4%	3.4%	2.5%
U.S. Corporate (US$)	0.1%	4.4%	4.7%
U.S. High Yield (US$)	0.4%	5.0%	8.6%
Canadian Equities (S&P/TSX)	**1.7%**	**12.0%**	**21.4%**
Communication Services	5.0%	10.1%	-7.5%
Consumer Discretionary	2.1%	16.3%	20.8%
Consumer Staples	2.1%	6.2%	7.6%
Energy	2.6%	6.7%	12.0%
Financials	1.5%	12.4%	30.4%
Health Care	-6.2%	-12.0%	-5.3%
Industrials	-0.5%	5.4%	5.0%
Information Technology	4.5%	10.4%	50.2%
Materials	0.0%	30.1%	27.3%
Real Estate	4.7%	8.1%	7.3%
Utilities	2.5%	12.7%	20.0%
S&P/TSX Small Caps	1.5%	14.4%	18.1%
U.S. Equities (S&P 500 US$)	**2.2%**	**8.6%**	**16.3%**
Communication Services	2.4%	13.8%	31.3%
Consumer Discretionary	2.6%	-1.3%	19.5%
Consumer Staples	-2.4%	3.9%	7.4%
Energy	2.9%	3.7%	-3.2%
Financials	0.0%	9.2%	21.5%
Health Care	-3.3%	-4.3%	-11.3%
Industrials	3.0%	16.1%	20.7%
Information Technology	5.2%	13.7%	23.7%
Materials	-0.4%	5.6%	-2.9%
Real Estate	-0.1%	3.4%	4.1%
Utilities	4.9%	14.8%	21.3%
Russell 2000 (US$)	1.7%	-0.1%	-0.6%
World Equities (MSCI ACWI US$)	**1.4%**	**11.9%**	**16.4%**
MSCI EAFE (US$)	-1.4%	18.3%	13.3%
MSCI Emerging Markets (US$)	2.0%	17.9%	17.9%
Commodities (GSCI US$)	**3.6%**	**5.6%**	**7.7%**
WTI Oil (US$/barrel)	6.1%	-2.9%	-11.3%
Gold (US$/oz)	0.4%	25.5%	36.1%
Copper (US$/tonne)	-4.9%	10.5%	5.0%
Forex (US$ Index DXY)	**3.2%**	**-7.9%**	**-4.0%**
USD per EUR	-2.5%	10.5%	5.8%
CAD per USD	1.8%	-3.7%	0.3%

CIO Office (data via Refinitiv, as of 2025-07-31)

The same story again?

After a brief period of consolidation, equities continued their steady ascent in July, extending their lead over bonds (**Chart 1**).

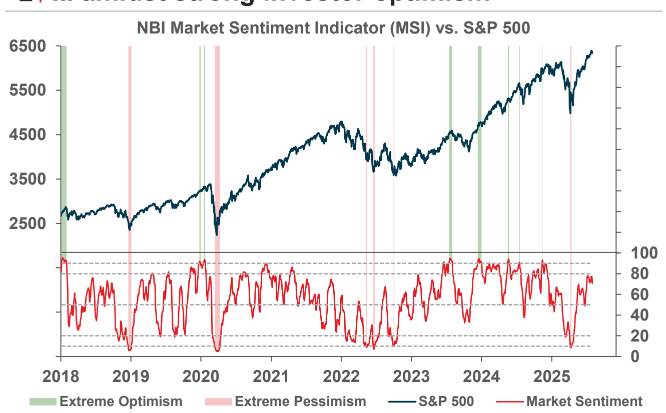
1 | Equities are far ahead of bonds so far this year...



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

At first glance, the optimism prevailing on the stock market – with our sentiment indicator having reached its highest level since December 2024 (**Chart 2**) - may seem exaggerated compared to the sheer magnitude of the economic and geopolitical fog that persists.

2 | ... amidst strong investor optimism



CIO Office (data via Refinitiv, Bloomberg).

Yet, while a moderate pullback is quite conceivable over the next few months, there is every reason to believe that the general uptrend in equities should continue.

Indeed, with hindsight, equity markets have essentially been writing variations of the same story for seven years now. First, a certain shock sends markets tumbling in a big way (Fed too hawkish in 2018, pandemic in 2020, inflationary wave in 2022, tariffs in 2025). This decline is followed by a strong rebound that is often perceived as excessive, but which ultimately proves persistent once a pivot by policymakers (Federal Reserve, U.S. government) is initiated (**Chart 3**).

3 | We've seen this before

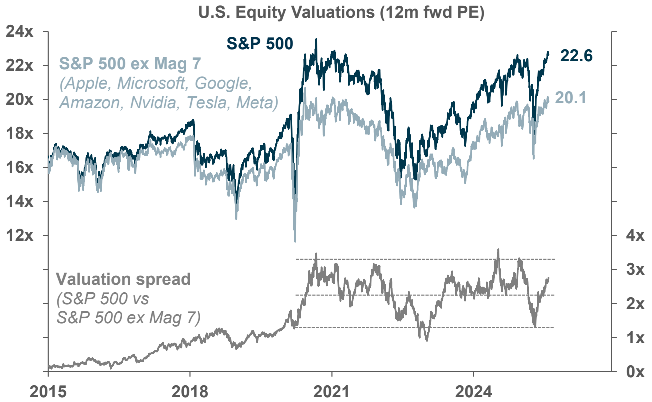
CIO Office (data via Refinitiv).

With this in mind, let's take a brief look at the economic and financial situation in this shortened Summer edition of our monthly newsletter.

The economy is holding up

From a valuation standpoint, it's hard to ask much more of the U.S. stock market from here on in, with price-earnings ratios close to their highs of recent years, regardless of whether we include or exclude the Magnificient Seven (**Chart 4**, next page). So, unless we're heading straight into bubble territory, we can expect a more modest pace of growth for equities over the remainder of the year.

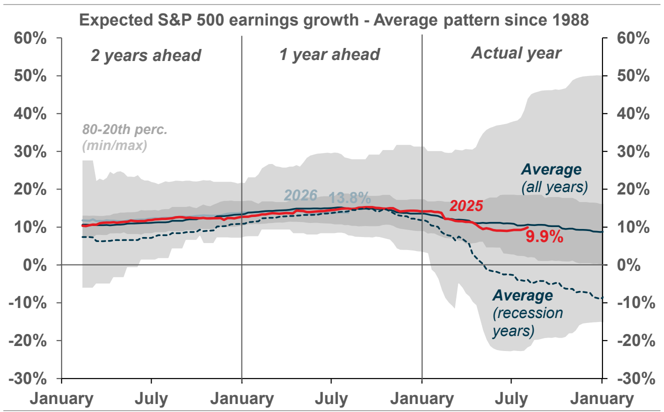
4 | P/E ratios are elevated...



CIO Office (data via Refinitiv).

That said, the outlook for corporate profits appears to be stabilizing, if not improving, since the earnings season kicked off last month (**Chart 5**).

5 | ... but earnings expectations are bottoming...

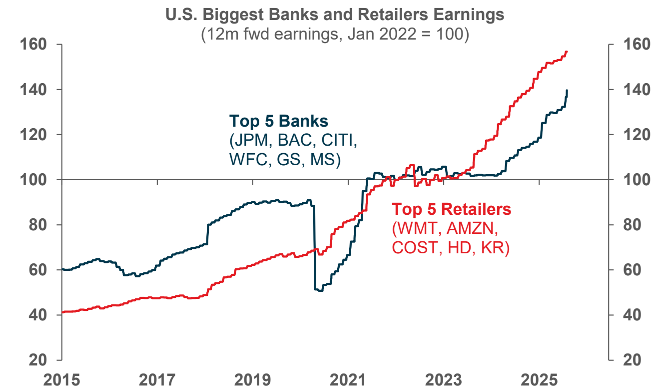


CIO Office (data via Refinitiv).

More specifically, the earnings of major US banks and retailers – important barometers of economic activity in the country – remain firmly secured in an upward trend (**Chart 6**).

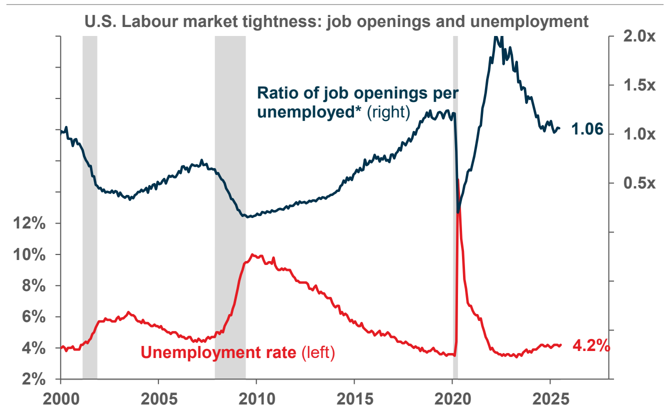
This observation is consistent with what we're seeing on the labour market. Although there are definitely some signs of weakness to watch out for[1], the unemployment rate has stabilized since the end of last year, and the ratio of job openings per unemployed worker is close to 1, suggesting a balanced labour market (**Chart 7**).

6 | ... with strong results from banks and retailers



CIO Office (data via Refinitiv).

7 | The labour market seems broadly in balance...



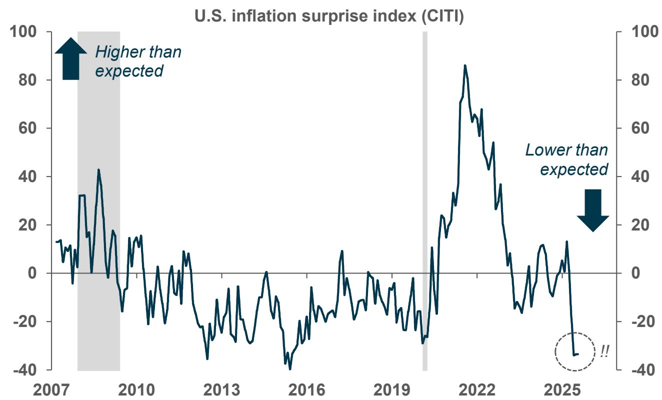
CIO Office (data via Refinitiv).

Finally, the most overlooked piece of information in recent months has probably been the impact of U.S. tariffs on consumer prices. Indeed, CITI's Inflation Surprise Index is at its lowest level in almost 10 years (**Chart 8**, next page), indicating that forecasters were expecting U.S. inflation to be more vigorous than is currently the case.

Let's be clear: inflation is still above target, and seems highly unlikely to return to it in the short term. However, for the time being, the upward pressure on goods prices from tariffs is being spread across economic agents (exporters,

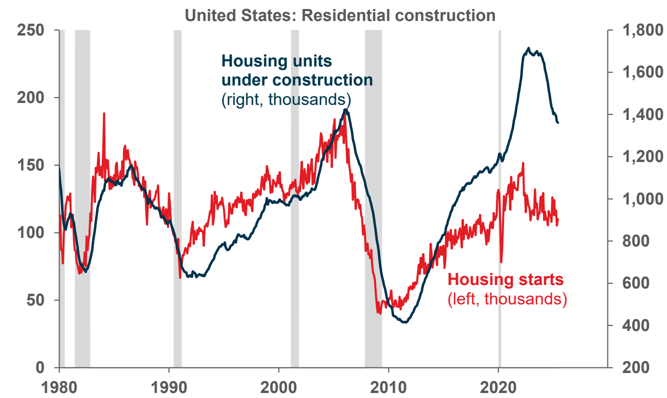
[1]Weakening US jobs market hits center of Fed rate policy debate, Reuters, August 1st 2025.

8 | ... and inflation has surprised to the downside



CIO Office (data via Refinitiv).

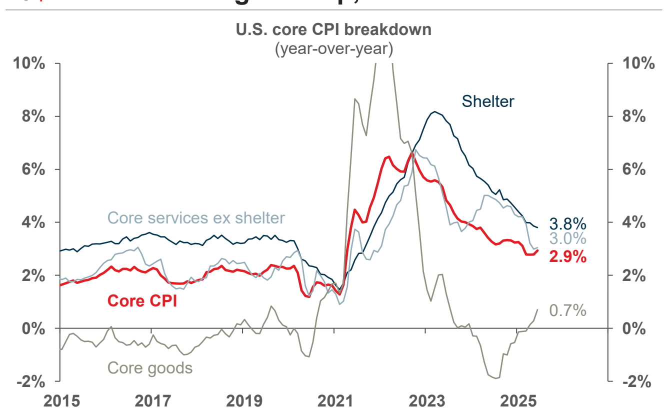
10 | ... as the residential market is losing steam



CIO Office (data via Refinitiv).

importers, consumers) and over time, so that the impact on inflation remains relatively modest. Meanwhile, housing inflation – which weighs almost twice as much as core goods in the CPI and PCE baskets – continues to slow (**Chart 9**), while the real estate sector continues to feel the weight of restrictive interest rates (**Chart 10**).

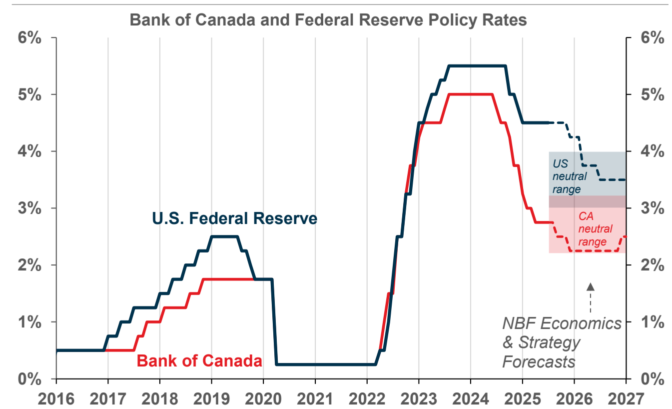
9 | Core inflation: goods up, shelter down...



CIO Office (data via Refinitiv).

Against this backdrop, a window could indeed open for the Federal Reserve to bring its policy rate closer to neutral over the coming quarters. According to the latest projections from our economist colleagues[2], the Bank of Canada should also resume its rate-cutting cycle later this year, in its case stopping at 2.25%, the lower limit of the neutral band (**Chart 11**).

11 | The Fed should start moving toward neutral soon



CIO Office (data via Refinitiv, NBF Economics & Strategy).

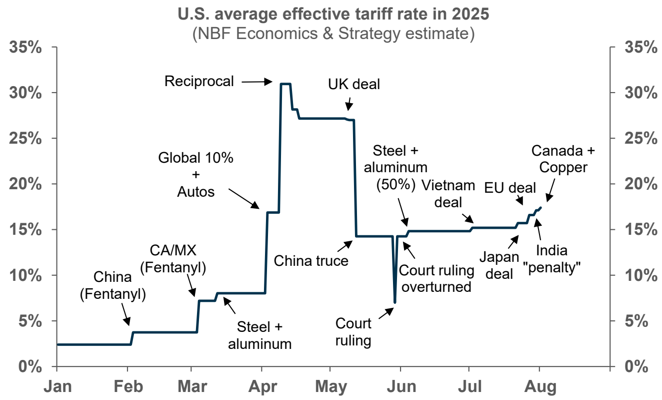
The bottom line

Markets are not immune to negative surprises at any time, as the U.S. President still seems inclined to test the upper limits of tariffs through his protracted negotiations, notably with China and Canada. In this respect, the new agreements reached with Vietnam, Japan, and the European Union, as well as the tariff increase on Canadian exports (which go from 25% to 35%[3]) bring the

[2] Monthly Fixed Income Monitor, July/August 2025.
[3] Trump increases tariff on Canada to 35% from 25%, cites fentanyl, Reuters, August 1st 2025.

effective tariff rate on U.S. imports to around 17%[4] (**Chart 12**), still a considerable level, but well below the peak briefly observed at the beginning of April.

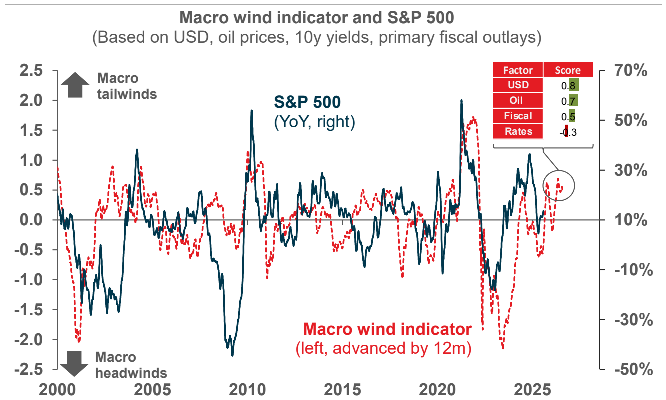
12 | The tariff roller-coaster continues



CIO Office (data via NBF Economics & Strategy, NBC, U.S. Census, Bloomberg).

Nevertheless, beyond the daily political noise, a falling U.S. dollar, oil prices under control, and high fiscal spending all represent important tailwinds for the economy (**Chart 13**) – which could be amplified by a preemptive shift in tone toward a more dovish stance at the Federal Reserve.

13 | Stimulus in the pipeline



CIO Office (data via Refinitiv).

Overall, this context explains why we have gradually adjusted our strategy in favour of risky assets since May, a positioning we still consider appropriate.

[4]According to the latest estimate by our economist colleagues, dated August 1st, 2025.

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