Asset Allocation Strategy

CIO Office | March 2025

Profound changes?

Highlights

- Since President Trump took office just over a month ago, uncertainty over economic policy has literally reached a new high according to some indicators. And yet, the impact on the markets remains relatively limited.
- Overall, the economic backdrop remains fairly constructive, but highly fragile and uncertain, with the Trump administration's policies – and their true consequences for the economy – set to become clearer over the coming months.
- In these circumstances, we believe that now is not the time to opt for any high-concentration strategies, and we encourage investors to think more in terms of diversification rather than trying to take a position based on a highly unpredictable U.S. President.
- Thus, we maintain a neutral allocation across asset classes, with our base case still calling for a volatile year, but ultimately modest and similar returns between equities and bonds – essentially, what has happened since the start of the year.
- Besides, trends in recent weeks have reduced our conviction about the ability of North American equities to outperform in the short term, prompting us to reduce the size of their overweight position.
- Finally, we have exited our exposure to U.S. small caps. Although these stocks still offer attractive upside potential, it has become increasingly clear that for this to happen, we will need greater visibility on the cyclical backdrop, which is currently threatened by U.S. tariffs.

Table 1 Global Asset Allocation Views

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Asset Classes		
Cash		
Fixed Income		
Equities		
*Alternatives**		
Fixed Income		
Government		
Investment Grade		
High Yield		
Duration		
Equities		
Canada		↓
United States		↓
EAFE		↑
Emerging Markets		↑
Value (vs. Growth)		
Small (vs. Large)		↓
Cyclicals (vs. Defensives)		
Alternatives & FX		
Inflation Protection		
Gold		
Non-Traditional FI		
Uncorrelated Strategies		
Canadian Dollar		

This table is for illustration purposes only. Bars represent the degree of preference of an asset relative to the maximum deviation allowed from a reference index. The further to the right (left) they are, the more bullish (bearish) our outlook for the asset is. No bars indicate a neutral view. The column under the delta sign (**Δ**) displays when our outlook has improved (↑) or worsened (↓) from the previous month. Consult **Table 3** to see how they translate into a model balanced portfolio. *For tactical portfolios featuring alternative assets, the position is financed by bonds.

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Market Review

Fixed Income

- The Canadian fixed-income universe continued its strong start to the year in February, as fears related to the imposition of tariffs on Canadian exports contributed to a decline in government bond yields.
- Gains were even larger south of the border, as U.S. Treasuries benefitted from elevated political uncertainty in Washington and the release of disappointing economic data.

Equities

- The trend reversal in favour of the EAFE region continued in February, to the detriment of the S&P/TSX and S&P 500, both of which posted slight monthly losses. Emerging Markets, meanwhile, had a very volatile month, and ended the period relatively unchanged.

  Within U.S. Equities, sectors associated with the tech giants (Consumer Discretionary, Communication Services, Information Technology) underperformed significantly, as did the small caps of the Russell 2000. In contrast, the most Defensive sectors (Consumer Staples, Health Care, Utilities) performed well.

FX & Commodities

- Oil prices fell in February against a backdrop of rising production in non-OPEC countries and relatively weak demand growth. Gold ended the month with modest gains.
- The U.S. dollar depreciated slightly during the month, as early signs of a loss of economic momentum appeared in the United States.

Table 2 Market Total Returns

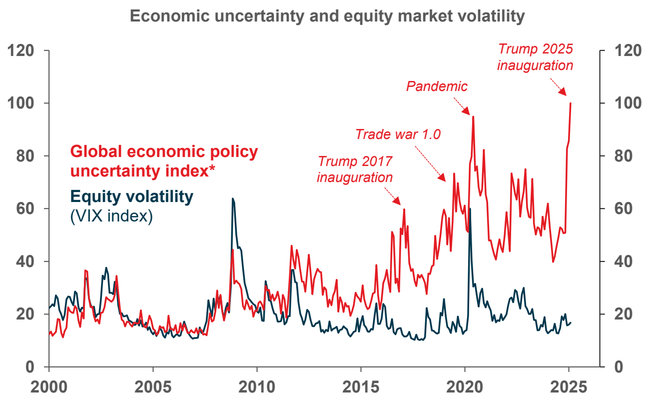
Asset Classes	Feb	YTD	12M
Cash (S&P Canada T-bill)	**0.2%**	**0.6%**	**4.7%**
Bonds (ICE BofA Canada Universe)	**1.1%**	**2.3%**	**8.4%**
Short Term	0.5%	1.4%	7.2%
Mid Term	1.3%	2.6%	9.3%
Long Term	1.8%	3.1%	8.9%
Federal Government	1.1%	2.3%	7.5%
Corporate	0.9%	1.9%	9.6%
U.S. Treasuries (US$)	2.2%	2.8%	4.9%
U.S. Corporate (US$)	2.0%	2.6%	6.8%
U.S. High Yield (US$)	0.7%	2.0%	10.1%
Canadian Equities (S&P/TSX)	**-0.4%**	**3.1%**	**22.5%**
Communication Services	1.4%	3.7%	-16.5%
Consumer Discretionary	2.1%	2.2%	10.5%
Consumer Staples	-0.3%	-3.0%	7.6%
Energy	-1.7%	-1.5%	15.9%
Financials	-0.2%	2.5%	30.6%
Health Care	-2.1%	-4.7%	-1.2%
Industrials	-0.6%	2.8%	4.5%
Information Technology	-3.6%	6.0%	39.1%
Materials	1.9%	12.2%	48.6%
Real Estate	-0.6%	-0.2%	5.9%
Utilities	3.4%	3.1%	21.6%
S&P/TSX Small Caps	-2.3%	-1.6%	16.4%
U.S. Equities (S&P 500 US$)	**-1.3%**	**1.4%**	**18.4%**
Communication Services	-6.3%	2.3%	29.2%
Consumer Discretionary	-9.4%	-5.4%	17.4%
Consumer Staples	5.7%	7.9%	19.2%
Energy	4.0%	6.1%	9.2%
Financials	1.4%	8.1%	31.4%
Health Care	1.5%	8.4%	4.6%
Industrials	-1.4%	3.5%	14.4%
Information Technology	-1.3%	-4.2%	18.4%
Materials	0.0%	5.6%	3.2%
Real Estate	4.2%	6.1%	14.3%
Utilities	1.7%	4.7%	31.7%
Russell 2000 (US$)	-5.3%	-2.9%	6.7%
World Equities (MSCI ACWI US$)	**-0.6%**	**2.8%**	**15.6%**
MSCI EAFE (US$)	2.0%	7.3%	9.3%
MSCI Emerging Markets (US$)	0.5%	2.3%	10.6%
Commodities (GSCI US$)	**-1.3%**	**1.9%**	**5.7%**
WTI Oil (US$/barrel)	-3.9%	-3.4%	-11.7%
Gold (US$/oz)	1.5%	8.6%	39.4%
Copper (US$/tonne)	4.6%	7.9%	11.1%
Forex (US$ Index DXY)	**-0.7%**	**-0.8%**	**3.3%**
USD per EUR	0.0%	0.4%	-3.9%
CAD per USD	-0.4%	0.6%	6.5%

CIO Office (data via Refinitiv, as of 2025-02-28)

Profound changes?

Since President Trump took office just over a month ago, economic policy uncertainty has literally reached a record high according to an indicator based primarily on what is being discussed in the press. And yet, the so-called stock market fear index – the VIX – remains relatively low, potentially a sign that investors have become less prone to panic after a decade that has seen both a first Trump administration and a global pandemic (**Chart 1**).

1 | Plenty of uncertainty, not a lot of panic...



CIO Office (data via Refinitiv, https://www.policyuncertainty.com/index.html). *Last reading normalized at 100.

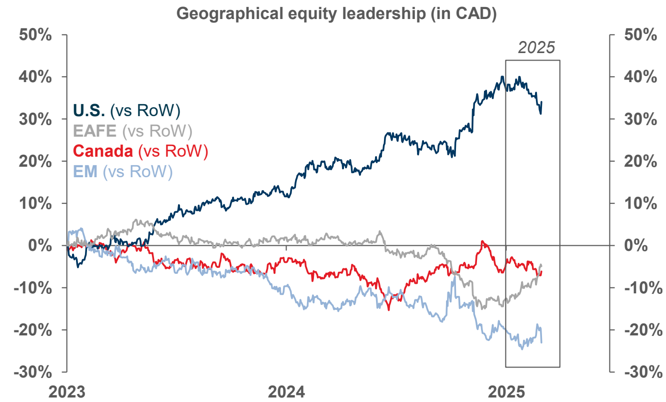
On the surface, equity markets do seem to be still looking for direction, whether in absolute terms or relative to bonds (**Chart 2**).

2 | … with equity markets still looking for direction

CIO Office (data via Refinitiv). *35% S&P/TSX, 35% S&P 500, 20% MSCI EAFE, 10% MSC EM. **Bonds = FTSE Canada Universe.

However, a closer look reveals notable changes in trends beneath the surface, starting with geographical equity leadership which has shifted from North America (Canada, United States) to overseas (Emerging Markets and EAFE, and especially China and Europe) in recent weeks (**Chart 3**).

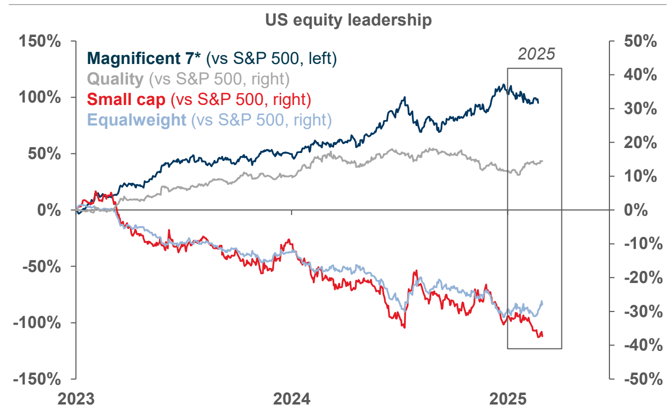
3 | Equity leadership goes overseas…



CIO Office (data via Refinitiv).

Moreover, within U.S. markets, technology giants have suffered a rare underperformance since the beginning of the year, while the "quality" style and the Equally Weighted S&P 500 Index are doing better. For small caps, things remain challenging (**Chart 4**).

4 | … and out of U.S. technology heavyweights



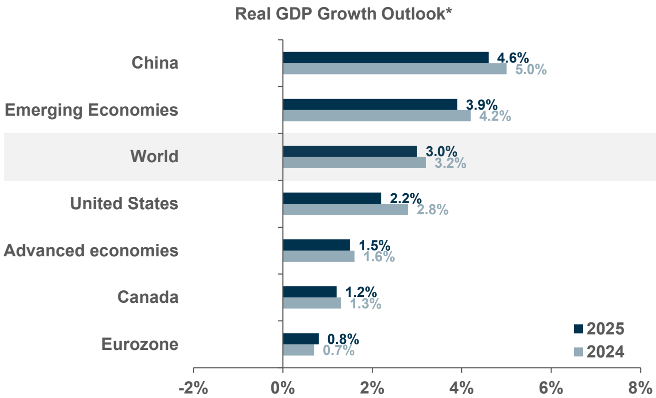
CIO Office (data via Refinitiv). *Microsoft, Facebook, Meta, Alphabet, Amazon, Nvidia, Tesla.

These circumstances have led us to make some adjustments to our investment strategy. But first, let's briefly review the economic background.

Background check

For now, while global economic growth is expected to slow this year, the prognosis remains far from a recession, with the United States still on track to grow just over 2% in 2025 (**Chart 5**, next page).

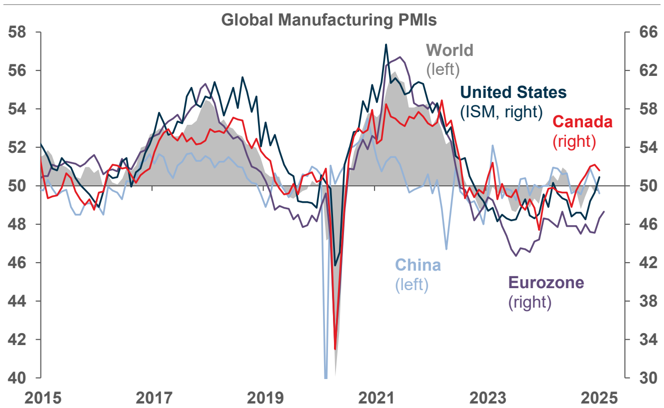
5 | A slowdown in sight, but no recession



CIO Office (data via NBF Economics and Strategy, Consensus Economics). *NBF Economics Monthly Economic Monitor, February 2025.

Moreover, a partial rebound in manufacturing activity has been observed almost everywhere since last year's lows, including in the United States (**Chart 6**).

6 | Global manufacturing activity is picking up…

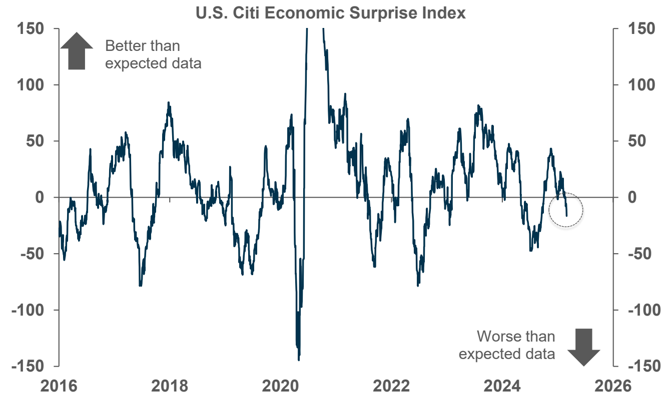


CIO Office (data via Refinitiv).

Even so, expectations for the U.S. economy seem increasingly difficult to meet, as indicated by the Economic Surprise Index, which has just slipped back into negative territory to reach its lowest level since last October (**Chart 7**).

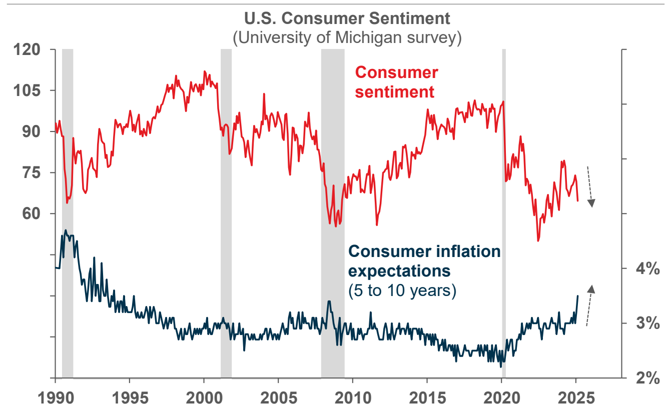
Specifically, this shift can be seen in consumer sentiment, with the optimism that followed Mr. Trump's election having completely reversed since the beginning of this year. And, if their expectations regarding inflation are to be believed – which have just reached their highest level in 20 years (**Chart 8**) – there is no doubt that this partly echoes the concerns surrounding their President's tariff policies.

7 | … but the United States are disappointing…



CIO Office (data via Refinitiv).

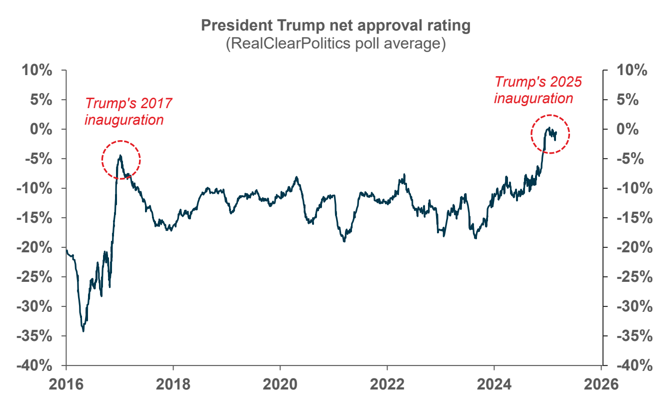
8 | ... with consumers concerned about inflation



CIO Office (data via Refinitiv).

This is only a month or two of data, and more will be needed to draw any conclusions. Nevertheless, it suggests that the honeymoon period with the electorate that has given Mr. Trump leverage at the start of his term in office is unlikely to last forever, somewhat like in 2017 (**Chart 9**).

9 | A honeymoon rarely lasts forever



CIO Office (data via RealClearPolitics).

Tariff tangle

In the space of just a few weeks, 25% tariffs on Canada and Mexico have been announced, postponed, announced again, and we await the next move. In parallel, tariffs of 10% have been imposed on Chinese imports, with a threat to increase them to 20%. Added to this are several mentions of possible reciprocal tariffs on critical goods, on steel and aluminum, global automobiles, the European Union, amon others.

For now, this has mainly resulted in a great deal of confusion, which will hopefully be partly dispelled once Mr. Trump's economic team has completed its holistic review of the country's trade relations in early April. In the meantime, let's try to untangle their potential economic impact in the short term.

At its simplest, the imposition of large tariffs on imports constitutes a stagflationary shock, meaning that it slows down economic growth (stag) through an exogenous increase in prices (flation).

Of course, advocates of such policies will point out that domestic economic growth can benefit from these by promoting local production, while the prices of imported goods can fall if the currency appreciates... and they are right. But we must not lose sight of the negative impact on consumer purchasing power, as well as on business investment amid increased uncertainty (**Chart 10**).

With this in mind, Goldman Sachs' team of economists has attempted the ambitious exercise of modelling the sum of all these interactions according to different scenarios of tariffs and counter-tariffs, for countries concerned. For the United States, their findings show the risk is greater for inflation than for growth, which reflects the country's lower dependence on international trade. But, for the rest of the world and especially, Canada, it is the other way around (**Chart 11**).[1]

10 | Tariffs: weaker growth, higher inflation…

Assessing the potential impact of imports tariffs on U.S. growth and inflation

Growth	**Consumer demand (↓)** Lower real personal income partially offset by tax cuts.	**Net trade (↑)** Shift away from imports toward domestic goods.	**Trade uncertainty and financial conditions (↓)** Lower business investment	=	**Weaker growth**
Inflation	**Tax effect (↑)** Direct increase on consumer and intermediate goods prices.	**Currency effect (↓)** Indirect decrease in import prices from likely currency appreciation.	**Real wages effect (↓)** Lower wage growth resulting from weaker economic growth.	=	**Higher inflation**

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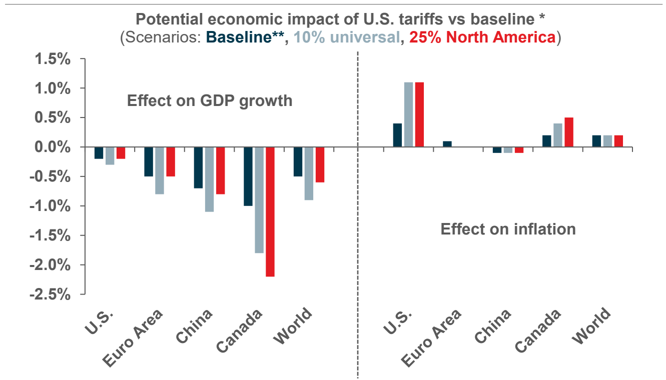
11 | … for all, with some important nuances



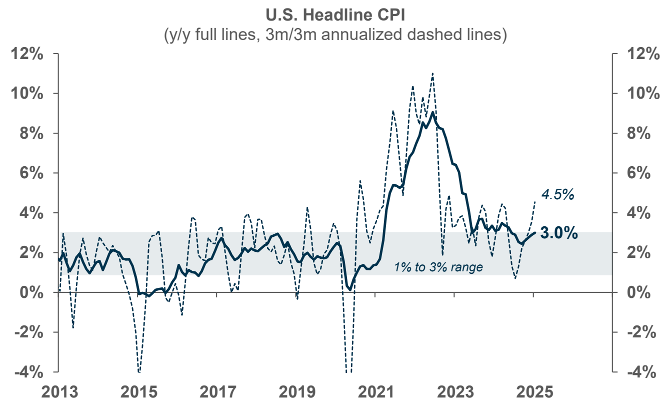
Source: *Quantifying Global Growth and Inflation Risks from Tariffs (Briggs/Dong/Peters), Goldman Sachs Global Investment Research.
**Assumes the already implemented 10pp tariff rate increase on Chinese imports, announced tariffs on aluminum and steel, an incremental 10pp tariff rate increase on China (for a 20pp cumulative increase), a 25pp tariff rate increase on EU autos, and a 10pp tariff rate increase on critical imports (critical minerals, batteries, oil and gas, pharmaceutical products, semiconductors and electronics).

In theory, this suggests that the United States is in a position of strength. Nevertheless, while “timing” is never good for self-inflicting stagflation, it seems particularly bad now that U.S. inflation has shown some rebound over the past three months (**Chart 12**, next page).

Granted, more favourable base effects should help push down the annual CPI growth rate over the next two months. But beyond that, the monthly dynamic will have to resume its slowdown, otherwise the situation could become even more uncomfortable (**Chart 13**, next page).

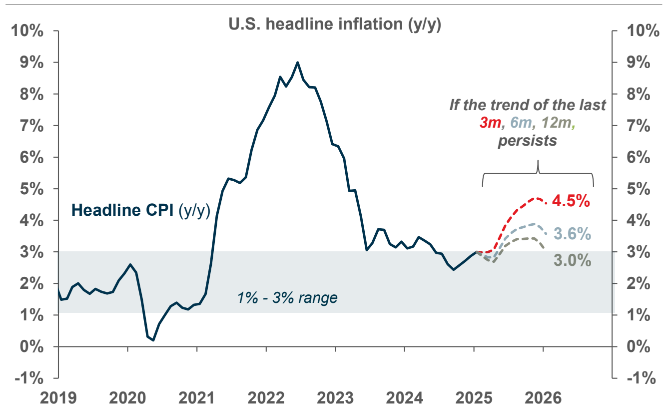
[1] The baseline scenario of Goldman Sachs economists assumes the 10% tariff increase already implemented on Chinese imports, the announced tariffs on aluminum and steel, a further 10% increase on China (for a cumulative increase of 20%), a 25% increase on EU automobiles and a 10% increase on critical imports (critical minerals, batteries, oil and gas, pharmaceuticals, semiconductors and electronics).

12 | A bad time for inflation to rebound



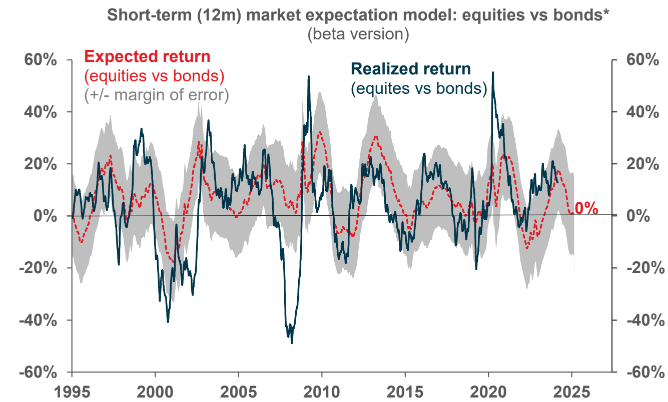
CIO Office (data via Refinitiv).

13 | The next few months will be critical



CIO Office (data via Refinitiv).

14 | Our baseline scenario remains in place

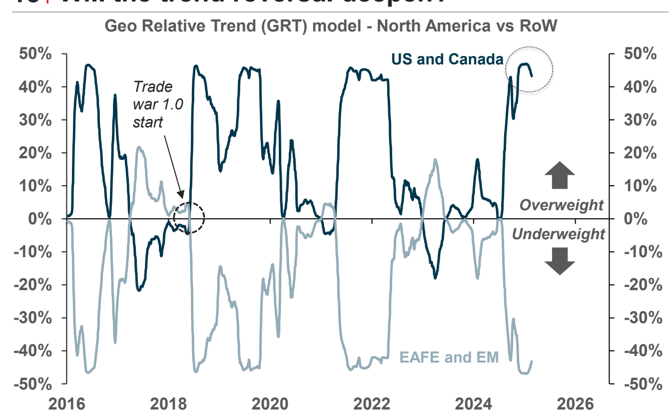


CIO Office (data via Refinitiv). *Equities = *35% S&P/TSX, 35% S&P 500, 20% MSCI EAFE, 10% MSC EM; Bonds = FTSE Canada Universe.

Geographically within equities, trends in recent weeks have reduced our conviction in the ability of North American equities to outperform in the short term, prompting us to reduce the size of their overweighting on February 28.

Specifically, although our relative momentum model still favours Canada and the United States over the EAFE region and Emerging Markets, a period of a few months of more volatile leadership is entirely conceivable, as seen during the previous trade war (**Chart 15**).

15 | Will the trend reversal deepen?



CIO Office (data via Refinitiv).

Strategy update

In terms of **asset class** allocation, we are maintaining a neutral split with our baseline scenario still pointing to a year of high volatility but, ultimately, modest and similar returns for equities and bonds. Overall, this is largely what has happened since the beginning of the year[2] and our model suggests this is still a reasonable prognosis for the next 12 months (**Chart 14**).

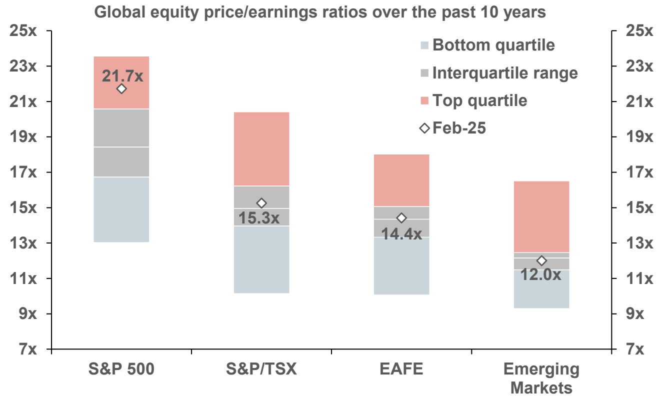
Following this logic, a possible overshooting – upward or downward – of equities relative to bonds could therefore present an opportunity to go against the tide, provided that the macroeconomic backdrop does not change radically.

For Canada, the main risks lie in its sensitivity to commodity prices and the tariff rhetoric of the Trump administration, which remains highly uncertain. But for the S&P 500, it is mainly the

[2] Since the beginning of the year, the MSCI World is up 3.0% in CAD, compared with an increase of 2.3% for Canadian bonds.

much higher valuations that make it an easy target if investor sentiment were to turn sour (**Chart 16**).

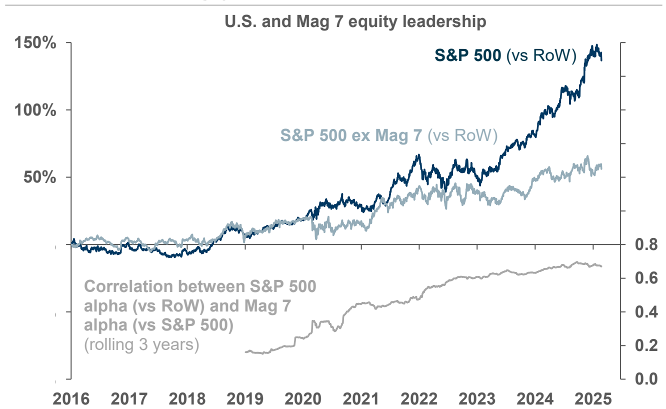
16 | S&P 500 valuations make it an easy target…



CIO Office (data via Refinitiv).

Needless to say, this valuation gap is partly explained by the "Magnificent Seven," without whom the outperformance of the S&P 500 would not even be half of what it has been since 2020. However, while these stocks have been an important driver of returns in recent years, their growing weight has made the S&P 500's performance vis-à-vis the rest of the world much more dependent on them. Case in point: in 2020, the correlation between the outperformance of the S&P 500 (vs. the rest of the world) and that of the "Magnificent Seven" (vs. the S&P 500) was 0.2. Today, it is 0.7 (**Chart 17**).

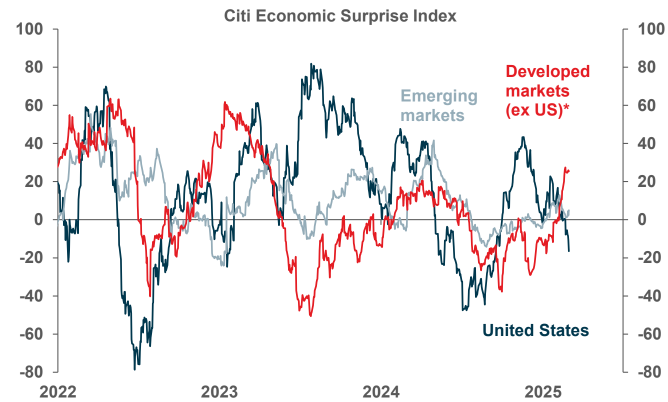
17 | ... increasingly dependent on a few stocks



CIO Office (data via Refinitiv).

However, the EAFE region and Emerging Markets also have a long list of vulnerabilities, whether in terms of their exposure to trade tensions, the strength of the U.S. dollar, or consumers still under pressure in Germany[3] and China.[4]. Nevertheless, this whole context has obviously lowered the bar for positive surprises overseas which could continue to support international rotation in the short term (**Chart 18**).

18 | Negative surprises in the U.S., positive elsewhere

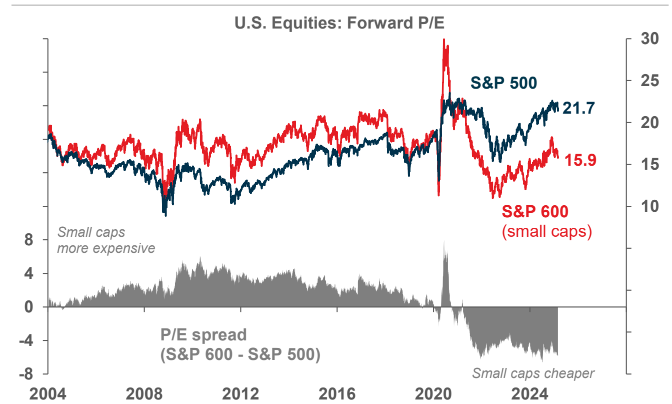


CIO Office (data via Refinitiv). *Europe, Japan, Australia, Canada; weighted by their market capitalization

Within **U.S. Equities,** we have withdrawn from our small cap exposure with the intention of re-evaluating it once the U.S. tariff policy becomes clearer.

Even though this market segment still has a lot of catching up to do in terms of valuation (**Chart 19**), it has become increasingly evident that for this to

19 | Small caps have upside potential…



CIO Office (data via Refinitiv).

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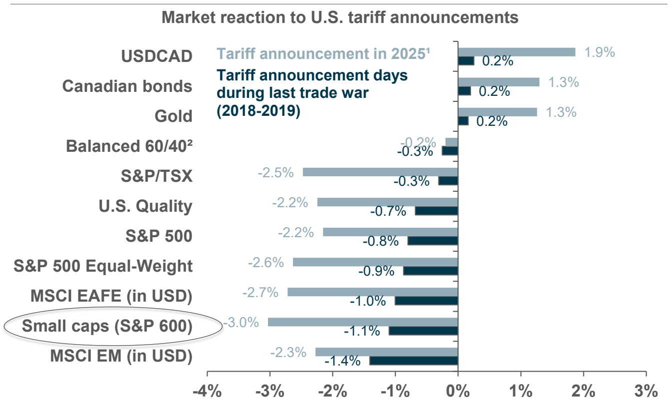
[3] German consumer sentiment unexpectedly worsens in March, GfK finds, Reuters, February 26, 2025.
[4] Will the Chinese Consumer Finally Start Spending?, Bloomberg, January 24, 2025.

happen, we will need better visibility on the cyclical context, which is currently threatened by U.S. tariffs (**Chart 20**).

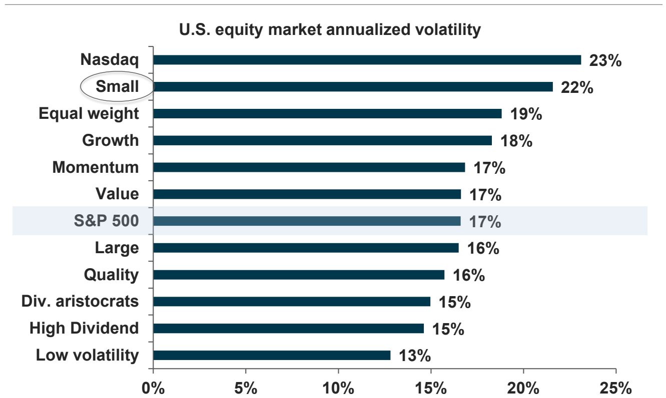
20 | … but are sensitive to tariffs…



CIO Office (data via Refinitiv).1. Price return between market close on Jan 30, 2025 and Feb 3, 2025 at 10:00AM.
2. 21% S&P/TSX, 21% S&P 500, 12% MSCI EAFE, 6% MSCI EM, 40% FTSE Canada Universe, all in CAD.

In return, we continue to favour a slightly more cautious positioning in less volatile and better diversified segments such as the "quality" style and the Equally Weighted S&P 500 Index (**Chart 21**).

21 | … being fundamentally riskier

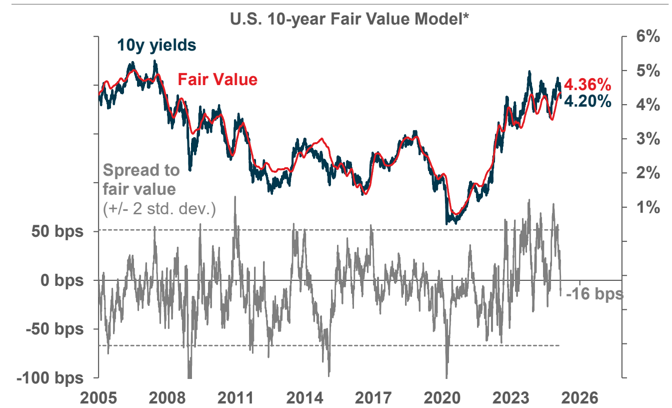


CIO Office (data via Refinitiv).

Within fixed income, our defensive positioning – a little more duration and a little less credit – remains largely unchanged. However, with the recent rally in bonds bringing U.S. 10-year rates back to our fair value model (and even a little below, **Chart 22**), the potential short-term gains are no longer as significant. Consequently, we have marginally reduced the duration of our U.S. Treasuries position.

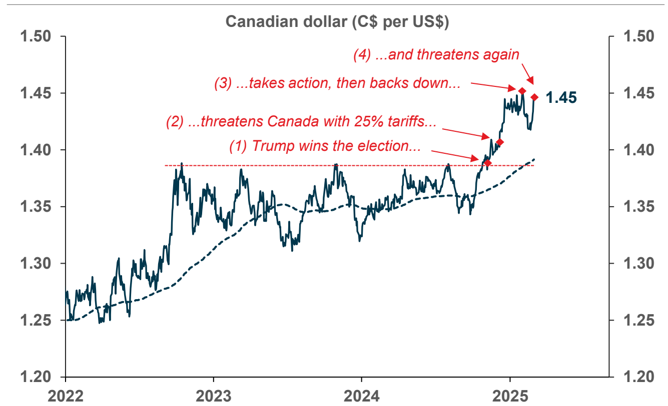
Finally, **in currencies**, we continue to see the U.S. dollar (relative to the Canadian dollar) as an insurance policy against more adverse tariff scenarios, a role it has played well to date, and which still deserves an important place in an adequately diversified portfolio (**Chart 23**).

22 | Treasuries are no longer oversold



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

23 | The Loonie waits, watches and adjusts



CIO Office (data via Refinitiv).

The bottom line

Overall, the economic backdrop remains relatively constructive, but highly fragile and uncertain, with the Trump administration's policies – and their true economic consequences – set to become clearer over the coming months.

In these circumstances, we believe that now is not the time to opt for any high-concentration strategies, and we encourage investors to think more in terms of diversification rather than trying to take a position based on a highly unpredictable U.S. President.

Table 3 Global Asset Allocation - Model Portfolio Weights (in CAD)

	Benchmark		Model Portfolio				Comments
	Total	Asset Class	Total Allocation	Total Active Weight	Asset Class Allocation	Asset Class Active Weight	
Asset Classes							
Cash	0%	-	0.0%	0.0%	-	-	While a soft landing seems the most likely scenario, investors are nonetheless faced with high valuations, a fragilized economy and heightened political uncertainty. Overall, this context argues for a balanced strategy across asset classes. Alternative assets help to control total portfolio risk through their diversification effects.
Fixed Income	40%	-	38.0%	-2.0%	-	-	
Equities	60%	-	60.0%	0.0%	-	-	
Alternatives	0%	-	2.0%	2.0%	-	-	
Fixed Income							
Government	29%	74%	28.5%	-0.9%	75%	1.4%	With central banks moving gradually towards a neutral policy stance, the upside potential for bond yields looks limited, while an economic slowdown would see them fall rapidly. This situation justifies a slightly longer duration as an insurance policy against a surprise recession. In addition, credit spreads near historic lows suggest a negative asymmetry for corporate bonds, justifying a slight underweight in this category.
Investment Grade	11%	26%	9.5%	-1.1%	25%	-1.4%	
High Yield	0%	0%	0.0%	0.0%	0%	0.0%	
Duration	*7.2 yrs*	-	*7.9 yrs*	0.7 yrs	-	-	
Equities							
Canada	21%	35%	23.0%	2.0%	38%	3.3%	In addition to strong momentum, the economic and geopolitical context favours North American equities over the rest of the world. In the U.S., the equally weighted index presents better risk-return prospects in view of a manufacturing recovery, as does the value style in Canada. The strategy nevertheless remains prudent and diversified, with quality companies in the US, European stocks in the EAFE region, and large caps in emerging markets.
United States	21%	35%	23.0%	2.0%	38%	3.3%	
EAFE	12%	20%	9.0%	-3.0%	15%	-5.0%	
Emerging markets	6%	10%	5.0%	-1.0%	8%	-1.7%	
Alternatives							
Inflation Protection	0%	0%	0.0%	0.0%	0%	0.0%	A systematic quantitative strategy that takes advantage of market trends while aiming for maximum decorrelation with equities and tight control of volatility (NALT) plays an important role as a diversifier, especially in relation to the risk of a surprise resurgence in inflation.
Gold	0%	0%	0.0%	0.0%	0%	0.0%	
Non-Traditional FI	0%	0%	0.0%	0.0%	0%	0.0%	
Uncorrelated Strategies	0%	0%	2.0%	2.0%	100%	100.0%	
Foreign Exchange							
Canadian Dollar	61%	-	59.2%	-1.8%	-	-	The overall portfolio strategy involves an overweight in the US dollar and, to a lesser extent, the yen.. This positioning reflects the geographic allocation within equities, as well as a willingness to underweight the Canadian dollar against safe-haven currencies amid global economic uncertainty and heightened geopolitical tensions.
U.S. Dollar	21%	-	26.8%	5.8%	-	-	
Euro	5%	-	4.5%	0.0%	-	-	
Japanese Yen	3%	-	1.5%	-1.5%	-	-	
British Pound	2%	-	1.6%	-0.1%	-	-	
Others	9%	-	6.4%	-2.4%	-	-	

CIO Office. The fixed income benchmark is 100% FTSE Canada Universe. There are no alternative assets in the benchmark as their inclusion is conditional on improving the risk/return properties of traditional assets (60/40). The amplitude of the colour bars under the "Active Weight" columns are proportional to the maximum deviations of the portfolio (+/- 10% for stocks and bonds, +10% in cash, +20% in alternative assets).

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General

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