Global Asset Allocation Perspectives & Investment Backdrop

MANAGED ASSET PROGRAMS
First Quarter 2024 Preview

Scotia Global Asset Management.

Market Review

Scotia Global Asset Management, one of Canada's largest asset managers, offers a broad range of investment management solutions to meet the needs of clients in Canada and around the world.

FIXED INCOME

The Canadian bond market rallied an impressive 8.3% in Q4, reversing weak year-to-date performance and finishing the year with a solid annual return. Inflation declined in the fourth quarter, continuing the downward trend seen the recent peak in June 2022. Central banks left rates unchanged throughout the quarter, after most major central banks paused rate hikes in September. As this unfolded, investors shifted expectations for rates, driving yields lower and pricing in a series of interest rate cuts for 2024, a much more optimistic view for fixed income investments. During Q4, the Canadian yield curve shifted downward, flattening, and it remains inverted. The 2-year yield decreased by 98 basis points (bps), while the 10-year and 30-year yields increased by 92 and 78 bps, respectively. Government bonds outperformed Corporate bonds over the quarter.

EQUITY

Equity markets moved higher in the fourth quarter, delivering solid performance for the full year. The TSX gained 8.1%, the S&P 500 climbed 8.9% ($C), MSCI EAFE gained 7.7% ($C), and emerging markets moved up by 5.2% ($C) in the quarter. From a sector perspective, there was broad based strong performance. In Canada, the strongest performers were Information Technology, Financials, and Real Estate, while the only sector with negative performance was Energy. In the U.S., performance was led by Real Estate, Information Technology, and Financials, with Energy the only declining sector. Commodity prices diverged, with gold and copper climbing, but natural gas and WTI crude oil prices falling. Growth outperformed Value in Q4, continuing the trend seen over most of the past year.

To help guide the forward-looking positioning of Scotiabank's managed asset programs, the MultiAsset Management team meets regularly with the Portfolio Managers at 1832 Asset Management L.P. This preview captures the team's current views and portfolio positioning.

Global Themes from the Multi-Asset Management Team

ECONOMIC GROWTH

Growth globally will continue be challenged in 2024 as the lagged impact of the significant tightening in monetary policy slows the global economy. A technical recession can not be ruled out, but we currently do not expect it to be a deep or prolonged one if it occurs as the backdrop for businesses and consumers remains fairly strong.

BUSINESS CYCLE

Global Purchasing Managers' Indices "PMIs" are hovering near contraction with the US being the largest contributor and we expect this trend to continue in 2024. Eurozone PMI is likely bottoming but is expected to stay at a low level. China is likely to disappoint on its reflation goal in 2024 and its role as the engine for the global manufacturing recovery is not likely realized. The reverberations from the Covid-19 pandemic will fade further in 2024 and we expect Services PMIs to trend more meaningfully lower globally. Economic leading indicators point to further headwinds in the coming quarters.

MONETARY POLICY

Central banks have started to acknowledge the impact on economic growth, as well as the progress on inflation from the impact of tight monetary policy. The overall stance has turned dovish but each of them is at a different phase of the policy cycle. In the first half of 2024, the central banks will remain cautious and leave the door open for more rate hikes should inflation reaccelerate. In the second half of 2024, the US Federal Reserve, along with most other central banks, are likely to start cutting rates aggressively.

INFLATION

Headline inflation is meaningfully falling across the global economy as energy, food and goods prices normalize following previous spikes; however, core inflation has continued to remain stubbornly high due to the resilience of economic growth and imbalances in labour markets. The disinflation trend will continue in 2024 but economic growth will likely need to weaken further for inflation to return to more sustainable, lower levels.

RISK

The "higher for longer" regime of rates will continue to create risks in financial markets in 2024 after a prolonged period of ultra-accommodative monetary policy, highlighted by the emergence of a regional bank liquidity crisis in the US. Central banks have considerable tools available to them to offset some of these risks as they materialize, but unintended consequences cannot be ruled out. The recent rally in risky assets has created the opportunity to take a more defensive position to equities in light of the high degree of uncertainty regarding our outlook.

Regional Backdrop

	Fixed Income Environment	Equity Fundamentals
CANADA	The Bank of Canada (BoC) paused its campaign of interest rate increases in September, and this continued through Q4 on the back of declining inflation. There have been a total of 475 bps of rate hikes since the beginning of 2022, but expectations are that rates will move lower throughout 2024. The Canadian yield curve remains inverted, flattening during the quarter as yields shifted significantly downward on the short end and by slightly less on the long end. The 2-year, 10-year, and 30-year yields decreased 98 bps, 92 bps, and 78 bps, respectively. The spread between 2-year and 10-year government yields narrowed from -85 bps in September to -78 bps by the end of December. The yield on the Canada 10-year bond reached 3.11% at the end of December, down from 4.03% in September. Canadian government bonds gained 8.49% in Q4, outperforming corporates, which gained 7.63%. In terms of sectors, performance was broadly strong, but Infrastructure and Communication led, up 11.12% and 9.42%, respectively.	The S&P/TSX Composite index, up 8.1% in the fourth quarter, experienced gains in ten of its 11 sectors. Stocks slipped lower at the beginning of the quarter, before surging higher in November, and building on those gains in December. The continued decline of inflation implied that the world's major central banks would likely reverse the rapid tightening of monetary policy seen over the past two years. Meanwhile concerns over a possible recession abated, which growing consensus that a "soft landing" scenario appears more likely than a hard recession. Interest-rate sensitive sectors gained as bond yields declined. The Energy sector was the one weak area, declining on lower oil and gas prices informed by slowing global economic growth.
UNITED STATES	The treasury yield curve remained inverted and flattened during Q4, shifting substantially lower on both the short end and long end. This follows the Fed pausing rate hikes in the quarter, with growing investor anticipation of by rate cuts in 2024. The yield on the U.S. 10-year bond reached 3.88% at the end of December, down from 4.57% in September. Yields retreated on signs of declining U.S. inflation, moderating economic growth, and indications from central bank officials that policy will ease as inflation comes under control. The curve remains downward sloping between 1- and 10-years, reflecting tighter Fed policy at the short end and softer economic growth expectations on the longer end, similar to what we saw a quarter ago. Spreads between investment grade and government bonds contracted, while high yield bonds underperformed on a relative basis. The Barclays U.S. Aggregate Index gained 6.8% in USD in the fourth quarter.	The S&P 500 surged ahead, up 8.9% in CAD terms. Performance was broadly robust, with ten of 11 sectors up in the quarter. The U.S. economy remains resilient, showing indications that a "Soft Landing" may be achieved. The S&P Manufacturing Purchasing Managers' Index (PMI) was below 50 from May to December, suggesting a softening economy. The number declined from 49.8 at the end of Q3 to 47.9 at the end of the year, which implies that manufacturing is deteriorating. Services PMI has been above 50 since January, and was 52.5 at the end of Q4, suggesting that this part of the economy is improving and still in expansion territory.

Regional Backdrop (cont'd)

	Fixed Income Environment	Equity Fundamentals
INTERNATIONAL	Global government bonds rebounded nicely, surging in Q4 and moving total year returns into solid positive territory. The global bond index climbed 8.1% in USD terms. The Bank of England left rates unchanged in November, then again in December. raised rates another 25 bps in August, following the 175 bps of hikes already implemented earlier in 2023. The U.K. 10-year yield declined materially from 4.44% to 3.54%. The European Central Bank (ECB) also left rates unchanged at its meetings in October and December. The German 10-year yield dropped from 2.84% to 2.02%, while the Italian 10-year yield decreased significantly from 4.78% to 3.70%.	The MSCI EAFE climbed higher in Q4, up 7.7%, up 16.0% for the year. Germany led the way with impressive Q4 gains, while France, Japan, and the United Kingdom also made solid contributions. Hong Kong stocks continued to trade down, and the Hang Seng ended the year in negative territory. Economic data in Europe continued to show a slowing economy. Manufacturing continued to lose momentum, although Services showed some improvement during Q4. Inflation in Europe continues to trend lower, yet remains above desired levels. Japan continues to perform fairly well after a weak 2022.
EMERGING MARKETS	The continuing war in Ukraine and the unfolding situation in the Middle East, along with constrictive monetary policy by the world's major central banks, provides significant uncertainty for global growth. Emerging Market sovereign spreads (vs. U.S.) compressed in Q4 as markets rallied, reversing the recent trend. Inflation continues to trend lower. China's economy has continued to show weakness, but President Xi Jinping has signaled that a sharp slowdown in growth and lingering deflationary risks won't be tolerated. Investors continue to watch for announcements of more material stimulus efforts from the Chinese government. Hard currency (USD) emerging market bonds soared by 9.2% in Q4 as measured by the JP Morgan EMBI Global Diversified Index.	Emerging markets gained in the fourth quarter in Canadian dollar terms, despite a negative translation impact coming from a strong Canadian dollar. Chinese and Hong Kong stocks declined in the quarter, but these losses were more than made up by a strong quarter from India, which was up 10.0%. China, which makes up about 30% of the MSCI Emerging Markets index, is of particular concern. Chinese economic growth is showing signs of easing. It's not clear whether this is a blip, or a signal of a more significant slowdown. Upcoming government stimulus may nudge the economy back towards higher growth. This put some weight on materials and energy stocks and the markets which have a more significant allocations to these sectors.

Asset Allocation Positioning

	Outlook	Comments
FIXED INCOME		
Overall Fixed Income	+	Towards the end of last year, Central Banks signalled a move away from their hawkish stances, helping bring bond yields down and delivering strong returns for fixed income investors. The level of yields is still elevated to recent years and provides a solid base for income and capital appreciation over a long-term horizon. In the short term, moving closer to neutral positioning as the market has quickly priced in rate cuts for this spring or sooner, with possibility of this aggressive timeline not materializing the direction of yields over the quarter is less certain.
Rates		
Canada and U.S.	+	The market sees both the Bank of Canada and Fed cutting interest rates during the second quarter, following recent communications they are confident with the trajectory of inflation. On a tactical basis, we have a more neutral view on duration, instead preferring steepener trades in both Canada and the US, with the expectation that the historical wide spread between front end and long end rates will narrow. This trade can benefit in both periods of rising or falling rates.
Global	+	Despite moderating positions following the recent decline in yields, we continue to see value in bonds outside of North America, with higher recessionary pressures in Europe likely to bring down yields in both Germany and the UK. The Bank of Japan may end yield curve control, exerting upward pressure on yields, yet the uncertainty around timing makes it difficult to take a position.
Credit		
Investment Grade	+	Investment Grade (IG) continues to offer attractive yields relative to government bonds and based on credit spreads are not overly expensive. a potential slowdown in economic activity would be negative, nonetheless balance sheets for IG companies are strong by historical standards and the extra yield pickup along with higher duration should protect on the downside.
High-Yield	–	We remain underweight High Yield issuers, as we believe funding pressure is likely to mount as the world moves further away from the low interest rate environment. Default rates have normalized back to pre-pandemic levels with potential to surge from higher refinancing costs.
EQUITIES		
Overall Equities	––	We have a modestly negative view to equities as we believe the global economy will face challenges over the next 12-18 months. Although global growth has remained surprisingly resilient in the face of the historic tightening in monetary policy, the impact of higher global rates should at some point become an economic headwind. Inflation has made material progress towards targets, but any reacceleration will be viewed negatively by the market. Additionally, low unemployment and elevated housing prices will likely constrain the ability of monetary policymakers to cut rates. Overall, the market rally in the last quarter of 2023 looks stretched, and earnings growth will need to pick up for it to continue. Meanwhile, geopolitical tensions continue to escalate with ongoing conflicts across much of the globe further supporting that a modest defensive positioning is warranted.
Region		
Canada	0	Despite long-term secular tailwinds to the Canadian economy, our view has shifted to neutral in Canadian equities. The Canadian economy is decidedly slowing as the impact of rising rates has had a greater effect on the cost of living in Canada than it has has in the US. The Bank of Canada is currently holding interest rates steady, and any easing of rates continues to await a decline in the economy's stubbornly high rate of inflation. Additionally, coupled with Canada's negative earnings sentiment is the potential for slowing demand in oil markets. Although geopolitical conflicts in the Middle East have the potential to spike oil prices, these spikes are very difficult to predict, further supporting a neutral view to Canadian equities.
U.S.	+	The U.S. market continues to have secular relative strength with strong fundamentals. Despite an inverted yield curve, the manufacturing PMI continues to waffle between contraction and expansion and has most recently moved back into expansion. Although inflation remains sticky, it has declined materially while growth has remained positive, and the unemployment rate has remained low. The U.S. is likely finished raising rates, with an expectation for several cuts this year, and the market appears best positioned to weather a global slowdown relative to other regions. Finally, given the U.S. market contains the largest global tech leaders, those mega-cap names are best positioned to benefit from the ongoing improvements in technology, such as artificial intelligence.
International	–	We remain underweight international markets versus North America. Macro economic indicators remain weak and underperforming those seen in the US. We see limited catalysts for improvement with higher inflation constraining monetary policy and continued risks related to energy insecurity. Key external markets such as China also remain under pressure. In this environment revenue growth is expected to underperform presenting risks to earnings.
Emerging Markets	0	We are neutral emerging markets overall. China remains the dominant market within the emerging markets, both in terms of weight and economic influence. Chinese economic data remains weak, and confidence continues to erode. Structural challenges around the property sector as well as regulatory and geopolitical uncertainty continue to weigh on the Chinese eocnomy. This would point to an underweight, however, discounted valuations and very negative investor sentiment give us caution. China is rolling out stimulus being to counter the weak economy, which is another potential upside risk.

Legend: ++ Very positive + Somewhat positive 0 Neutral – Somewhat negative –– Very negative

Performance – As at December 31, 2023

FIXED INCOME						
Bonds	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
FTSE Canada Universe Bond C$	8.27%	4.08%	6.69%	6.69%	-2.80%	1.30%
Universe Canada All Corporate C$	7.63%	5.24%	8.37%	8.37%	-1.23%	2.51%
Morningstar CAN High-Yield Fixed Inc	5.64%	6.23%	10.07%	10.07%	1.20%	3.73%
BAML U.S. Corporate C$	5.25%	4.63%	5.49%	5.49%	-2.06%	1.91%
BAML U.S. High-Yield Master II C$	4.42%	7.25%	10.41%	10.41%	3.17%	4.47%
Barclays U.S. Agg Bond U$	6.82%	3.37%	5.53%	5.53%	-3.32%	1.10%
Barclays Global Agg U$	8.10%	4.22%	5.72%	5.72%	-5.51%	-0.32%
EQUITIES						
Canadian Equities	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
S&P/TSX Composite C$	8.10%	5.73%	11.73%	11.73%	9.58%	11.29%
U.S. Equities						
S&P 500 C$	8.90%	7.86%	23.27%	23.27%	11.25%	14.97%
Dow Jones Industrial Avg C$	10.27%	10.53%	13.41%	13.41%	10.62%	11.78%
NASDAQ C$	10.95%	9.13%	41.19%	41.19%	7.24%	18.02%
Global Equities						
MSCI World C$	8.75%	7.60%	21.45%	21.45%	9.01%	12.67%
MSCI Asia Pacific ex-Japan C$	5.20%	4.20%	5.12%	5.12%	-3.52%	4.30%
MSCI Japan C$	5.52%	6.47%	17.89%	17.89%	2.18%	6.65%
MSCI Europe C€	8.33%	5.47%	17.78%	17.78%	7.66%	9.07%
MSCI Emerging Markets C$	5.24%	4.74%	7.63%	7.63%	-3.63%	3.43%

Source: Bloomberg, Morningstar

MULTI-ASSET MANAGEMENT TEAM

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Team supported by:
2 Associate Portfolio Managers | 10 Analysts | 1 Trader

As Portfolio Managers for ScotiaFunds and Dynamic Funds managed-asset programs, the Multi-Asset Management Team oversees approximately $121 billion* in multi-asset solutions and strategies. The Team is responsible for portfolio construction, asset allocation policy, and investment strategy research and selection. The Team is also involved in the due diligence and day-to-day management of all portfolio solutions.

*As at December 31, 2023

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