Global Asset Allocation Perspectives & Investment Backdrop

MANAGED ASSET PROGRAMS
Fourth Quarter 2023 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 declined 3.9% in Q3, giving back all of the gains experienced early in the year and slipping into negative territory year-to-date. Stubborn inflation continued to be an issue in Q3, ticking higher after steadily declining over the past year. Central banks continued to raise rates in response, with 25-basis point (bps) interest rate hikes from the Bank of Canada (BoC), U.S. Fed (the Fed), and the Bank of England (BoE). The European Central Bank tightened even more, with two 25 bps hikes in the quarter. Earlier this year markets were pricing in interest rate cuts in mid-2023, then shifted to late 2023, before moving expectations to mid-2024. Investors are now expecting rates to remain "Higher for longer" which has caused yields to continue creeping higher. During Q3, the Canadian yield curve continued to shift upward, steepening, although it remains inverted. The 2-year yield increased by 29 bps, while the 10-year and 30-year yields increased by 76 and 72 bps, respectively. Corporate bonds outperformed government bonds over the quarter.

EQUITY

Equity markets pulled back in the third quarter, after delivering solid performance in the first half of the year. The TSX declined by 2.2%, the S&P 500 dropped 1.2% ($C), MSCI EAFE slipped lower by 1.8% ($C), and emerging markets dipped by 0.5% ($C) in the quarter. From a sector perspective, there was mixed performance. In Canada, the only sectors with positive performance were Health Care and Energy, while the weakest performing were Communication Services, Utilities, and Information Technology. In the U.S., Energy and Communication Services led with the way as the only positive sectors. The weakest performing sectors were Utilities, Real Estate, and Consumer Staples. Commodity prices diverged, as oil prices surged on OPEC+ production cuts, while metals prices slipped lower. Value outperformed Growth in the third quarter, reversing 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

Our 12–18-month investment horizon now looks forward to much of 2024. Growth globally will almost surely be challenged in this period as the lagged impact of the significant tightening in monetary policy impacts the global economy, despite some optimism around China's continued reopening. A technical recession is possible but we currently do not expect it to be a deep or prolonged one if it occurs as the backdrop for businesses and consumers is fairly strong.

BUSINESS CYCLE

Manufacturing Purchasing Managers' Index (PMI) data have continued to trend lower and, absent a brief recovery due to China's reopening, have now turned contractionary. Services PMIs have diverged meaningfully and are continuing to benefit from pent up demand emanating from the prolonged and varied lockdowns during the pandemic. Leading indicators point to further downward momentum in the coming months, primarily as a result of tighter monetary and fiscal policy in developed markets.

MONETARY POLICY

Central banks have been emboldened by the strong recovery in labour markets and very high inflation. The overall stance is still hawkish across the G10 central banks but each of them is on a different phase of the hiking cycle. Stickier than anticipated core inflation in the face of still robust employment markets will lead to continued interest rate hikes, albeit at a slower and less consistent pace.

INFLATION

Headline inflation is meaningfully falling across the global economy as energy, food and goods prices normalize following previous spikes. Core inflation continues to remain stubbornly high as a result of the resilience of economic growth and significant imbalances in labour markets.

RISK

The ongoing tightening cycle is beginning to create risks in financial markets after a prolonged period of ultra-accommodative monetary policy, highlighted by the recent emergence of a regional bank liquidity crisis in the U.S. Central banks have considerable tools available to them to offset some of these risks as they materialize, but unintended consequences cannot be ruled out. Any rallies in risky assets may create the opportunity to take a more defensive position in light of the high degree of uncertainty regarding the outlook.

Regional Backdrop

	Fixed Income Environment	Equity Fundamentals
CANADA	The Bank of Canada (BoC) continued its campaign of interest rate increases early in Q3 in response to stubborn inflation. The BoC hiked rates by 25 bps in July, before holding steady later in the quarter. Rate hikes since the beginning of 2022 now total 475 bps. The Canadian yield curve remains inverted, flattening during the quarter as yields shifted slightly upward on the short end and by a little more on the long end. The 2-year, 10-year, and 30-year yields increased 29 bps, 76 bps, and 72 bps, respectively. The spread between 2-year and 10-year government yields narrowed from -132 bps in June to -85 bps by the end of September. The yield on the Canada 10-year bond reached 4.03% at the end of September, up from 3.27% in June. Canadian corporate bonds declined by 2.2% in Q3, outperforming federal government bonds that dropped 3.1%. In terms of sectors, performance was weak, but Financials and Real Estate led, down 0.18% and 0.78%, respectively.	The S&P/TSX Composite index, down 2.2% in the third quarter, experienced losses in nine of its 11 sectors. Stocks performed well at the beginning of the quarter, before slipping lower in August and then continue to decline through September. While the global economy remained resilient, it became clear that the world's major central banks were going to keep interest rates at relatively elevated levels for the foreseeable future, prompting a sell-off. The Energy sector benefited from rising oil prices, thanks to production cuts from OPEC+. However continued news of tepid growth in China contributed to metals prices slipping lower, contributing to materials weakness. Interest-rate sensitive sectors sold off as bond yields continued to rise.
UNITED STATES	The treasury yield curve remained inverted but steepened during Q3, shifting slightly higher on the short end, and more substantially higher on the long end. This follows the Fed raising rates by 25 bps in July, suggesting more rate hikes will follow if necessary and that relatively high rates will continue until inflation is brought under control. The yield on the U.S. 10-year bond reached 4.57% at the end of September, up from 3.84% in June. Yields climbed higher on signs of U.S. economic strength, sticky inflation, and continued hawkishness. 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, although this difference is less dramatic than it appeared in June. In addition, credit agency Fitch downgraded its U.S. debt rating from the highest AAA level down a notch to AA+. Spreads between investment grade and government bonds contracted, and high yield bonds significantly outperformed on a relative basis. The Barclays U.S. Aggregate Index declined by 3.6% in USD in the third quarter.	The S&P 500 pulled back, down 1.2% in CAD terms. Performance was broadly weak, with nine of 11 sectors down in the quarter. The U.S. economy continues show fairly solid performance, and inflation unexpectedly ticked higher. The S&P Manufacturing Purchasing Managers' Index (PMI) has been below 50 since May, suggesting a softening economy. However, the number has climbed since the end of Q2, rising to 49.8 at the end of Q3, which implies that manufacturing is improving. Services PMI has been above 50 since January, and was 50.1 at the end of Q3, suggesting that part of the economy may be slowing, it is still in expansion territory.

Regional Backdrop (cont'd)

	Fixed Income Environment	Equity Fundamentals
INTERNATIONAL	Global government bonds dipped lower for the second consecutive quarter, slipping into negative territory for the year-to-date. The global bond index dropped 3.6% in USD terms. The Bank of England raised rates another 25 bps in August, following the 150 bps and 325 bps of hikes already implemented in the in the first half of 2023, and 2022, respectively. The U.K. 10-year yield climbed slightly from 4.39% to 4.44%. The European Central Bank (ECB) also continued to raise rates, with a 25 bps hike in July, and another 25 bps hike in September. The German 10-year yield rose slightly from 2.39% to 2.84%, while the Italian 10-year yield increased materially from 4.07% to 4.78%.	The MSCI EAFE slipped lower in Q3, down 1.8%, but remains up year-to-date after strong performance early in the year. The United Kingdom led the way with solid Q3 gains, while Germany, France, and Japan gave up some of the gains from earlier in the year. Hong Kong stocks continued to trade down, and the Hang Seng is now in negative territory for the year. Economic data in Europe has continued to show a slowing economy, with manufacturing and services both losing momentum. Inflation in Europe continues to trend lower, yet remains elevated, leading to continued monetary tightening. 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 continued monetary tightening by the world's major central banks, provides significant uncertainty for global growth. Emerging Market sovereign spreads (vs. U.S.) continued to expand in Q3, continuing the recent trend. Inflation continues to trend lower. China's economy has displayed recent weakness, but President Xi Jinping has signaled that a sharp slowdown in growth and lingering deflationary risks won't be tolerated. Stimulus efforts have been modest to date, but investors continue to watch for announcements of more material stimulus efforts from the Chinese government. Hard currency (USD) emerging market bonds declined 2.6% in Q2 as measured by the JP Morgan EMBI Global Diversified Index.	Emerging markets declined slightly in the quarter in Canadian dollar terms, with a positive translation impact coming from a weak Canadian dollar. China and Hong Kong declined in the quarter, although these losses were partially offset by a solid quarter from India, which was up 2.1%. 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	+	Higher yields keep fixed income attractive over a longer term horizon, with return potential from both income and capital appreciation. Centrals banks are easing off further tightening and shifting towards a higher for longer stance, yet with cyclical growth and inflation to slow next year the balance of risks points to the next material move in yields being to the downside.
Rates		
Canada and U.S.	+	It is possible both the Fed and Bank of Canada raise interest rates once more before the end of the year, however it is expected yields are already near their peak. We favour the intermediate tenors in the U.S., as they should be less sensitive to another hike. Over the quarter, we will likely implement a position targeting a steeper yield curve in either U.S. or Canada to benefit from long end rates converging with the front end.
Global	+	We prefer U.K. bonds, with a sluggish economy and inflation having rolled over, yields should trend lower during the quarter. We expect the Bank of England will be forced to cut rates before the ECB, which is communicating higher for longer rates.
Credit		
Investment Grade	+	Investment Grade continues to offer attractive yields relative to government and with credit spreads at their historical averages are not overly expensive. Strong fundamentals for IG companies should help limit weakness from any potential economic slowdown.
High-Yield	–	We remain underweight high yield issuers, as most borrowers have benefited from terming out their obligations at pandemic low yields. Now with a wall of maturities coming due over the next few years it is likely high yield companies come under pressure from higher financing costs and face rising default rates.
EQUITIES		
Overall Equities	–	We maintain our negative view to equities as we believe the economy will face significant challenges over the next 12-18 months due to the lagged impact of much higher global rates. Although year-to-date sentiment has been very bullish, most of the strength has been concentrated in a handful of mega cap names. Additionally, although headline inflation has eased, core inflation remains stubbornly high, which increases the probability of further hikes and inhibits policy makers from easing. Given this backdrop, the likelihood of a coming recession remains very high. Although the AI theme has propped up U.S. equities, positive economic momentum out of China and Europe remains subdued. Following recent market gains, we feel the risks of recession are not properly reflected in equities.
Region		
Canada	+	The Canadian market will continue to benefit from secular strength in commodity prices and better prospects for relative growth in North America. Energy firms now have a renewed focus on paying out profits to shareholders and deleveraging their businesses, while global oil prices have rebounded as OPEC+ cut production. Additionally, geopolitical risks are also low relative to other regions while the government is supportive of immigration, which should provide a long-term impetus for growth..
U.S.	+	The U.S. market continues to have secular relative strength with strong fundamentals. Despite an inverted yield curve and the manufacturing PMI remaining in contraction, the PMI has recently improved signaling at least a short-term "recovery" in the business cycle. Although inflation remains sticky, the U.S. is nearing the end of its tightening cycle and should weather a global slowdown better than other regions. Additionally, given the U.S. market contains most of the 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. Economic indicators such as Purchasing Manager Indices (PMI) point to weak current conditions. The trend on services activity is weak as we exit the summer, as the impact of pent up demand for travel fades. These economies are seen as generally more fragile due to sensitivity to energy prices and global trade, and are less exposed to some of the super tech trends versus the U.S. Inflation is persistent within Europe and puts pressure on central banks to maintain tight monetary policy in the face of a weakening domestic economy.
Emerging Markets	0	We are neutral emerging markets overall. China is by far most significant country within Emerging markets, both directly via its large allocation, and indirectly due to its central position within the EM supply chain. China remains exposed to structural challenges around the property sector as well as regulatory and geopolitical uncertainty. Chinese structural challenges combined with a generally negative view on equities, biases us negatively towards emerging markets. However, discounted valuations and very negative investor sentiment, together with significant Chinese stimulus being rolled out to counter the weak economy has us concerned about the potential for a near term rebound and therefore remain neutral.

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

Performance – As at September 30, 2023

FIXED INCOME						
Bonds	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
FTSE Canada Universe Bond C$	-3.87%	-4.53%	-1.46%	-1.36%	-5.14%	0.05%
Universe Canada All Corporate C$	-2.22%	-2.04%	0.69%	1.69%	-3.05%	1.19%
Morningstar CAN High-Yield Fixed Inc	0.51%	1.32%	4.15%	7.33%	0.89%	2.05%
BAML U.S. Corporate C$	-0.58%	-3.00%	0.23%	2.32%	-4.29%	1.98%
BAML U.S. High-Yield Master II C$	2.72%	2.07%	5.74%	8.43%	2.22%	3.72%
Barclays U.S. Agg Bond U$	-3.23%	-4.05%	-1.21%	0.64%	-5.21%	0.10%
Barclays Global Agg U$	-3.59%	-5.06%	-2.21%	2.24%	-6.93%	-1.62%
EQUITIES						
Canadian Equities	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
S&P/TSX Composite C$	-2.19%	-1.14%	3.36%	9.52%	9.88%	7.27%
U.S. Equities						
S&P 500 C$	-1.17%	5.08%	12.82%	19.67%	10.60%	10.91%
Dow Jones Industrial Avg C$	0.24%	3.56%	2.85%	17.11%	9.78%	8.08%
NASDAQ C$	-1.64%	8.77%	27.25%	23.91%	7.22%	12.44%
Global Equities						
MSCI World C$	-1.05%	3.57%	11.67%	20.45%	9.23%	8.79%
MSCI Asia Pacific ex-Japan C$	-0.95%	-4.01%	-0.08%	10.01%	-0.81%	2.41%
MSCI Japan C$	0.90%	5.07%	11.72%	24.20%	3.79%	3.38%
MSCI Europe C€	-2.64%	-1.77%	8.72%	27.43%	8.52%	5.55%
MSCI Emerging Markets C$	-0.47%	-1.62%	2.27%	10.21%	-0.77%	1.86%

Source: Bloomberg, Morningstar

MULTI-ASSET MANAGEMENT TEAM

Craig Maddock, CFA
Head, Multi-Asset Management Team and Sr. Portfolio Manager

Yuko Girard, CFA
Portfolio Manager

Mark Fairbairn, CFA
Portfolio Manager

Wesley Blight, CFA
Portfolio Manager

Ian Taylor, CFA
Portfolio Manager

Team supported by:
2 Associate Portfolio Managers | 10 Analysts | 2 Traders

As Portfolio Managers for ScotiaFunds and Dynamic Funds managed-asset programs, the Multi-Asset Management Team oversees approximately $120 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 June 30, 2023

Commissions, trailing commissions, management fees and expenses may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed or insured by the Canada Deposit Insurance Corporation or any other government deposit insurer, their values change frequently and past performance may not be repeated. The information provided in this document is not intended to be investment advice. Investors should consult their own professional advisor for specific investment and/or tax advice tailored to their needs when planning to implement an investment strategy to ensure that individual circumstances are considered properly and action is taken based on the latest available information. Information contained in this document, including information relating to interest rates, market conditions, portfolio positioning and other factors are subject to change without notice. Scotia Global Asset Management is not responsible for updating the information and views expressed. To the extent this document contains information or data obtained from third party sources, it is believed to be accurate and reliable as of the date of publication, but Scotia Global Asset Management does not guarantee its accuracy or reliability. The information provided is not intended to be investment advice.

23SCB024_SGAM_GlobalAssetAlloc_EN 4Q_V1_6

Scotia Global Asset Management.