Global Asset Allocation Perspectives & Investment Backdrop

MANAGED ASSET PROGRAMS
Third 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

In the second quarter, the divergent paths of the U.S. and Canadian economies were on full display. While the U.S. outperformed in economic growth, spending, and jobs, the global landscape saw easing inflation and start of the interest rate cutting cycle. The Bank of Canada (BoC) led the G7 countries in cutting interest rates by 25 basis points, with the European Central Bank (ECB) following suit. The Federal Reserve continues a wait-and-see approach given that economic fundamentals have been healthy, but inflation remains above target.

The Canadian bond market, represented by the FTSE Canada Universe Bond Index, reversed trends from earlier in the year and finished the quarter positive at 0.9% (C$). High-yield and corporate bonds were the standout performers, continuing the trend seen in the previous quarter. U.S. bonds, on the other hand, finished flat overall due to muted results from the underlying constituents. As in the previous quarter, investment-grade and high-yield spreads continued to narrow, further supporting improving credit market conditions.

EQUITY

Canadian stocks (S&P/TSX) finished mostly flat at -0.5% (C$) for the quarter. Conversely, U.S. stocks (S&P 500) ended at 5.4% (C$), led by the Information Technology, Communication Services, and Utilities sectors. The mega-cap technology and AI-focused stocks continued their dominance this quarter. Global stocks mirrored a similar sector-level story to the U.S. but finished slightly lower at 3.8% (C$) for the MSCI World Index. The Asia Pacific ex-Japan and Emerging Market regions lead with solid performance at 7.4% (C$) and 6.2% (C$), respectively. The outperformance of growth, quality, and momentum investment styles was consistent with the broader leadership seen across equity markets for the period.

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 likely continue to be subdued but positive for the remainder of 2024 as the lagged impact of the significant tightening in monetary policy slows the economy. We currently do not expect a deep or prolonged contraction if a recession occurs as the backdrop for businesses and consumers remains fairly strong.

BUSINESS CYCLE

Global Purchasing Managers' Indices "PMIs" have shown positive signs in the first half of the year, but this may weaken in H2. U.S. PMI has been more resilient than expected backed by the strength of the consumer and low unemployment. Eurozone PMI is likely bottoming but is expected to stay at a low level. China's PMIs have been stable, but the outlook is mixed amidst housing and deflation concerns. Its role as the engine for the global manufacturing recovery is not likely to be realized. Services PMIs remain robust across the board, reducing the risk of an imminent recession in 2H 2024.

MONETARY POLICY

Central banks have started to acknowledge the impact on economic growth and the progress on inflation from the effects of restrictive monetary policy. The overall stance has turned dovish but central banks are constrained by still elevated inflation in many regions. In the first half of 2024, several G10 central banks like BoC and ECB have cut interest rates. Rate cuts are likely to continue at a modest pace, but they will only coincide with further declines in inflation. A sharper economic contraction would be required to see more significant rate cuts.

INFLATION

Headline inflation is meaningfully falling across the global economy as energy, food and goods prices normalize following previous spikes; however, core inflation remains stubbornly high due to resilient economic growth and imbalances in labour markets. The disinflation trend will continue in H2 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. Central banks have various tools to counter emerging risks, but unintended consequences may occur. Growing global geopolitical tension and increasing polarization pose additional risks to markets.

Regional Backdrop

CANADA

Fixed Income Environment

BoC's Bold Cut: Canadian Yield Curve Takes a Dive

Easing cycle initiated: The Bank of Canada (BoC) cut rates in both the June and July meetings by 25 basis points (bps), bringing the rate to 4.50%, becoming the first among G7 central banks to begin their easing cycle and their first cut in over four years.

Yield curve trends: Despite an inverted yield curve, short-mid-end segment yields dropped (3-month: 57 bps, 6-month: 40 bps, 1-year: 33 bps, 2-year: 18 bps), while 10-year and 30-year yields increased 4 bps during the quarter.

Narrowing 2-year 10-year spreads: The spread between 2-year and 10-year government yields narrowed from -71 bps in March to -49 bps by June's end.

Bond yields inch higher: Canada's 10-year bond yield climbed to 3.50% (up from 3.47% in March).

Modest gains: FTSE Canada Universe Bond Index gained 0.86% in Q2, slightly lagging corporates that gained 1.09%.

Real Estate Leads: Real estate sector within fixed income performed well, with a 1.52% increase in the quarter.

Equity Fundamentals

Commodities Shine, Tech Tanks: Canadian Market Rollercoaster

Q2 Performance: The S&P/TSX Composite Index finished Q2 with a slight -0.5% decrease, retreating in nine out of eleven sectors.

Sector Underperformance: Healthcare (-19.07%), Real Estate (-6.69%), and Information Technology (-5.63%) were the worst performers.

Materials Sector Gains: Materials sector posted a 6.89% increase, benefiting from commodities appreciation (silver: 16.74% $USD, gold: 4.34% $ USD).

Market Momentum: Despite failing to maintain previous upward momentum, the market remains close to all-time highs.

Rate Cut Uncertainty: Markets anticipate one more rate cut this year, with uncertainty around BoC's next move, following the CPI's decrease to 2.7% in June.

UNITED STATES

Fixed Income Environment

Fed's Rate Dance: U.S. Yield Curve Keeps Investors on Their Toes

Persistent Inversion: The yield curve remained inverted throughout Q2, marking nearly seven consecutive quarters.

Higher Yields: Yields moved slightly higher compared with Q1 with the long-end increasing more, as market participants adjusted expectations.

Fed's Stance: Federal Reserve maintained interest rates for the seventh consecutive meeting, with Chairman Powell remaining cautious and reiterating the need for more data to prove that inflation has declined, and economic indicators support easing.

Yield Trends: 2-year, 10-year, and 30-year yields increased (13 bps, 20 bps, and 21 bps, respectively) quarter-over-quarter.

Bond Credit Spreads: Investment grade vs. government bonds remained increased slightly, while high yield and corporate bonds outperformed.

Bloomberg Barclays Index: The Bloomberg Barclays U.S .Aggregate Index increased by just 0.07% during Q2.

Equity Fundamentals

Tech Titans Surge: S&P 500 Breaks Records

Upward Momentum: The S&P 500 maintained its momentum, rising 5.35% in CAD terms. The index has made 33 new all-time highs throughout the first half of 2024.

Sector Gains: Information Technology (15.08%) and Telecom (10.59%) led the charge.

Nvidia's Surge: Impressive 36.72% ($USD) growth fueled excitement around AI.

Sector Challenges: Five out of eleven sectors finished in negative territory, indicating technology and semiconductor stocks were the market participants supporting the growth.

Manufacturing Resilience: S&P Manufacturing PMI reached 51.6, the highest in three months.

Services PMI Decline: Concluded the quarter at 48.8, lowest since May 2020, the lowest level since May 2020. This marks the second time this year that the indicator dropped below 50, signaling contraction in the sector.

Regional Backdrop (cont'd)

INTERNATIONAL

Fixed Income Environment

Global Bond Markets React: Rate Cuts and Yield Shifts Define Q2 2024

Global Bond Decline: Global government bonds faced a 1.10% decline in Q2 due to the easing cycle.

Central Bank Actions: The Swiss central bank led with rate cuts in March with Denmark and the European Central Bank following. The Bank of England maintained unchanged rates, but market consensus suggests future cuts.

Yield Shifts:

- U.K. 10-year yield rose from 3.9% to 4.2%.
- German 10-year yield increased from 2.3% to 2.5%.

French Volatility: French 10-year bond climbed from 2.8% to 3.3% amid political uncertainty from President Macron's unexpected election call.

Equity Fundamentals

Global Equities Surge: Growth Stocks Lead the Way in Q2 2024

Global Equities Show Dynamic Performance:

- The MSCI World[1] Index returned 3.79%, driven primarily by strong performance by the U.S. and their robust growth-oriented stocks.

MSCI EAFE Maintains Modest Gains: The MSCI EAFE posted a 0.81% gain in Q2, maintaining decent year-to-date gains at 9.50%.

European Equities Perform Moderately Well: The MSCI Europe Index gained 1.91%, with investors excited about accommodative monetary policies to help fuel economic growth again.

Asia Pacific Ex-Japan Index Soars: The standout performer was the MSCI Asia Pacific ex-Japan Index, soaring by 7.40%, fueled by strong economic data and robust export demand.

EMERGING MARKETS

Fixed Income Environment

Navigating Economic Challenges Amidst Political Shifts in Emerging Markets

South Africa's ANC loses majority: The ANC party in South Africa lost its majority for the first time since the end of apartheid, securing only 40% of the votes.

Mexico's historic election: Claudia Scheinbaum became Mexico's first female president but faces economic challenges due to a struggling economy and financial issues with the national oil and gas company.

India's ruling party declines: India's ruling party led by Modi secured 291 seats, down from 353 in 2019, surprising exit polls that predicted at least 360 seats.

Emerging Markets adapt: Despite political shifts, fixed income and equities rebounded, and central banks in emerging markets proactively eased monetary policy. China aims for sustainable growth by diversifying its economic drivers away from property reliance.

USD Emerging Market Bonds: Hard currency (USD) emerging market bonds increased by only 0.30% in Q2, according to the JP Morgan EMBI Global Diversified Index.

Equity Fundamentals

Emerging Markets Equities Rally in Q2 2024: China and India Lead the Way

MSCI EM Index Rises: The MSCI EM index gained 6.17%, reflecting overall strength in emerging markets equities.

Impressive momentum performance: MSCI EM Momentum Net Total Return surged by 11.69%.

Latin America faces challenges: MSCI EM Latin America declined by 11.22% due to political turmoil in Mexico and Brazil.

Sector Resilience and Declines: The Energy and Industrial sectors showed resilience, while Information Technology soared. Defensive sectors like Health Care and Consumer Staples declined.

Country-specific highlights:

- China's Robust Gain: MSCI China rose by 8.29%, driven by robust economic data and tech sector strength.
- India Bounces Back: MSCI India surged by 11.43% after political uncertainty following the national election.
- Brazil Struggles: MSCI Brazil declined by 11.26%, impacted by political uncertainty and economic reforms.

Asset Allocation Positioning

	Outlook	Comments
FIXED INCOME		
Overall Fixed Income	0	Bond yields have risen to start the year, peaking in the spring as the market pulled back on rate-cut expectations. Over the long-term horizon, yields remain attractive along with likely capital appreciation as global Central Banks lower interest rates. In the short term despite moderating inflation the labor market remains tight increasing chances for fewer cuts, particularly if monetary policy is ultimately not restrictive enough. Due to this balance of risks remain neutrally positioned bonds vs equities for now.
Rates		
Canada and U.S.	0	The Bank of Canada delivered its first rate cut of the cycle in June, yet expectations for a measured approach to further interest rate reductions, with multiple pauses anticipated between hikes. The U.S. Fed sees risk on both sides of the economic outlook but acknowledges the need for higher for longer. Currently positioned for yield curve steepeners in both the U.S. and Canada, which can benefit in multiple environments including the front end coming in significantly if faster and deeper cuts are required or a higher-for-longer scenario pushing up the longer end of the curve.
Global	+	Inflation in the Eurozone and UK has been decreasing, but not as quickly as anticipated. Cuts are still projected due to sluggish growth and policy crimping the economy more than in North America. View inflation returning to target more likely than a sustained upturn in growth and with the ECB already delivering its first cut and BoE expected to move in Q3, long duration should benefit through the end of the year as more cuts are priced in.
Credit		
Investment Grade	+	Demand for Investment Grade credit has remained exceptionally strong with new orders being oversubscribed. Higher coupon rates have led to investors having more money to reinvest and despite historically tight credit spreads, the extra yield pick up over government bonds is supported by strong fundamentals of issuing companies.
High-Yield	–	Despite spreads for the High Yield are near their lowest levels, the riskiest segment has seen their spreads widen out. If signs of stress emerged, they would see their way up the credit spectrum, especially with the maturity wall coming due sooner in High Yield, stemming from a shorter average maturity than Investment Grade peers.
EQUITIES		
Overall Equities	0	We have a neutral view on equities relative to fixed income given an abundance of conflicting economic indicators. From an economic activity standpoint, cracks continue to form in housing activity while unemployment ticks higher. However, from an equity market perspective fast-growing technologies such as cloud, AI and GLP-1's are masking any economic weakness. U.S. fiscal policy continues to be a key counter trend as government transfers to consumers during the pandemic have now shifted to technology businesses and in support of reshoring. Inflation remains sticky, though has fallen considerably, and concentrated markets remain the key risk to monitor while also being the biggest beneficiaries of technological investments. We remain patient and are keeping an open mind toward any emerging opportunities.
Region		
Canada	+	We have a neutral-overweight view on Canadian Equities. The increase in Canadian interest rates has had a more meaningful impact on the Canadian economy than rate hikes have had in the U.S. Given this backdrop, the likelihood that the Bank of Canada continues to cut before the U.S. Fed is high and may create a more positive sentiment for the Canadian stock market. From a valuation perspective, Canadian equities are also priced significantly below that of their U.S. counterparts while longer-term secular tailwinds appear favorable for the country.
U.S.	+	We have an overweight view on U.S. Equities. Inflation has fallen considerably from its peak while the U.S. market continues to see positive momentum as the economy has remained surprisingly resilient. Despite very stretched valuations, from a structural perspective, the U.S. equity market continues to benefit from several growth themes, most notably within advances in artificial intelligence, continued reshoring of manufacturing, and renewed investments in infrastructure.
International	–	We have a neutral-underweight view on International Equities. European equities which represent the largest portion of international markets are less attractive versus other regions. Europe continues to face structural headwinds to global competitiveness and is sensitive to weakness in China. Similarly, cyclical indicators such as PMI's have started to trend lower, and economic surprise has recently turned negative. This together with increasing political risks keeps us cautious on Europe. Outside Europe, we are more positive on Japanese equities (in local currency terms), due to the benefits of their corporate reform push and strong demand for Japanese goods and services due to the weak yen making the country more globally competitive.
Emerging Markets	–	We have a neutral-underweight view on Emerging Market (EM) Equities. The underweight is concentrated in Chinese equities, and we are neutral EM excluding China. China continues to face structural headwinds related to property sector revaluation and deleveraging on the part of consumers. Policy action to date has not been sufficient to offset the structural challenges with the real estate sector and build confidence in the local economy. As China doubles down on manufacturing and tries to move up the value chain, they are facing increasing backlash in their key export markets, particularly the U.S. and Europe presenting further challenges for China to export excess capacity. Taking this together with the potential risks related to U.S. elections leads us to a negative view on China. Outside China, however many emerging markets will benefit from the diversification of supply chains from China to other parts of the world, although political risks have been rising in several key emerging markets, including Mexico, Brazil and South Africa valuations remain compelling.

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

Performance – As at June 30, 2024

FIXED INCOME						
Bonds	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
FTSE Canada Universe Bond C$	0.86%	-0.38%	-0.38%	3.69%	-1.78%	-0.05%
Universe Canada All Corporate C$	1.09%	1.16%	1.16%	6.46%	-0.09%	1.40%
Morningstar CAN High-Yield Fixed Inc	1.45%	3.45%	3.45%	9.91%	1.45%	2.99%
BAML U.S. Corporate C$	1.23%	3.81%	3.81%	8.62%	0.47%	1.71%
BAML U.S. High-Yield Master II C$	2.22%	6.49%	6.49%	14.21%	5.08%	4.69%
Barclays U.S. Agg Bond U$	0.07%	-0.70%	-0.70%	2.64%	-3.03%	-0.23%
Barclays Global Agg U$	-1.10%	-3.16%	-3.16%	0.93%	-5.49%	-2.02%
EQUITIES						
Canadian Equities	**3-Mth**	**6-Mth**	**YTD**	**1-Yr**	**3-Yr CAGR**	**5-Yr CAGR**
S&P/TSX Composite C$	-0.53%	6.05%	6.05%	12.12%	5.97%	9.27%
U.S. Equities						
S&P 500 C$	5.45%	19.64%	19.64%	28.80%	13.74%	16.11%
Dow Jones Industrial Avg C$	-0.26%	8.37%	8.50%	21.72%	11.29%	14.08%
NASDAQ C$	9.15%	21.63%	21.63%	35.18%	15.17%	22.83%
Global Equities						
MSCI World C$	3.79%	16.01%	16.01%	24.82%	10.91%	13.30%
MSCI Asia Pacific ex-Japan C$	7.40%	12.48%	12.48%	17.21%	-0.95%	5.15%
MSCI Japan C$	-3.30%	10.22%	10.22%	17.36%	6.05%	7.94%
MSCI Europe C€	1.91%	10.13%	10.13%	16.15%	7.99%	8.71%
MSCI Emerging Markets C$	6.15%	11.49%	11.49%	16.78%	-1.54%	4.39%

Source: Bloomberg, Morningstar

MULTI-ASSET MANAGEMENT TEAM

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Team supported by:
2 Associate Portfolio Managers | 9 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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