Macroeconomic Landscape

Global Growth

Macroeconomic risks have intensified and reverberated across the global economy amid persistently elevated inflation that has been exacerbated by the lingering Russia-Ukraine conflict, China's draconian efforts to suppress COVID-19, and a looming (and potentially destabilizing) monetary tightening cycle.

Canada

The Canadian economy held up reasonably well at the beginning of 2022, underscoring the Bank of Canada's urgency in normalizing monetary policy. While consumer spending is expected to remain firm this summer amid pent-up demand for services, accumulated savings, and a tight labour market, outlays are likely to decelerate as the impact of runaway inflation and sharply higher interest rates take their toll on household budgets and domestic demand. Fortunately, Canada's dominance in resource production will create a layer of economic buffer as the wider economy slows.

United States

The odds of a US recession have risen as the monetary policy pendulum swings assertively from ultra-accommodative towards outright restrictive terrain in response to inflation that has proven to be more enduring than previously expected. The combination of sky-high inflation and an aggressive interest rate trajectory will act as a de-facto tax and are bound to curtail purchasing power for both households and businesses. The resilience of the mighty U.S. consumer will be tested as the rapid rise in living costs erodes real incomes.

International

The European economy is facing a crippling combination of spiraling consumer prices and weakening economic activity. The Russia-Ukraine conflict has sent energy prices soaring and threatens to restrain consumer spending, while factories are facing supply chain interruptions, rising input costs, and ebbing demand from China. The European Central Bank is gearing up to raise rates for the first time in more than a decade, adding another headwind to an already brittle economy.

Emerging Markets

The Chinese recovery remains under the shadow of the "dynamic-zero-COVID" policy, which implies that rolling restrictions and sporadic confidence shocks will weigh on domestic activity. At the same time, global demand for Chinese goods is expected to cool and diminish trade's ability to act as a growth driver. In stark contrast to developed world policy, both the central bank and government have vowed to support the economy through a variety of measures – particularly as the official growth target of "around 5.5%" appears increasingly out of reach.

Economic Outlook

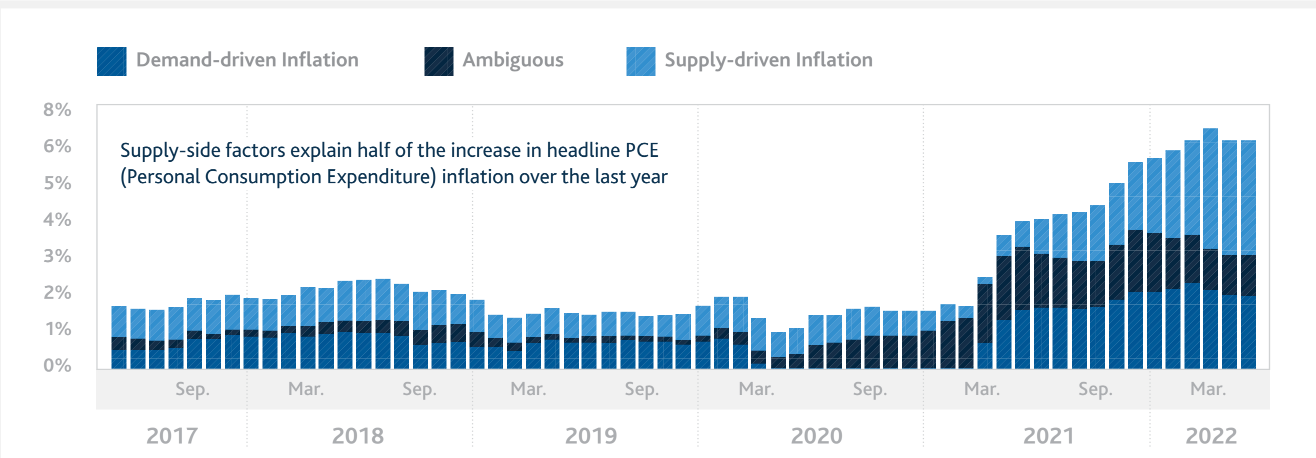
Recession Risks are Mounting

Inflationary forces have intensified and prompted a profound pivot in the monetary policy trajectory, which has brought into question the outlook for the global economy. While the tightening cycle is certain to curb economic output, the depth of the looming slowdown hinges on how far central banks need to take interest rates in order to restore price stability. The path for interest rates (and hence, the economy) will be dictated by inflationary dynamics that are showing little sign of letting up.

We are seeing some notable supply-demand imbalances in goods, services, and labour, with strong global demand at odds with a supply-constrained world that has created a perfect storm for raging inflation. Pricing pressures were already building in early 2022, with excess demand fueled by the unprecedented monetary and fiscal stimulus measures implemented in 2020-2021. However, demand-side strength has been met with supply-side deficits stemming from the dual shock of the war in Ukraine and rolling lockdowns in China that have driven price increases for a wide variety of resources and other inputs. At the same time, tight labour market conditions and significant labour shortages have buttressed wages and added to the inflationary narrative.

In this environment, policymakers are facing a daunting task and need to strike a delicate balance between slowing the economy to reduce excess demand for goods, services, and labour without inadvertently sparking a recession. As such, the risk of a policy error that could manifest into a recession is the single biggest threat. Having erred on the side of caution as inflationary pressures took hold earlier this year, policymakers may be forced to act more aggressively than expected to tackle both supply-push and demand-pull inflation.

Contributions to Year-over-Year PCE Inflation



Monetary policy is more impactful on the demand side, with higher interest rates cooling the economy and reducing demand for labour. However, central banks have little control over supply-driven factors such as skyrocketing food and energy prices and/or disruptions to supply chains. As the Federal Reserve has prioritized tackling inflation at all costs, policymakers will be challenged in bringing inflation back in line without doing undue damage to the economy.

Source: Federal Reserve Bank of San Francisco

Investment Strategy

The growing risk of a “hard landing” scenario warrants a defensive stance from an asset allocation perspective. While this outlook bodes unfavourably for both stocks and bonds, the natural evolution for those seeking stability, higher income, and the potential for capital gains is a pivot towards private markets asset classes including private credit, real assets, and private equity - which offer an attractive risk-reward proposition over our tactical time horizon.

Economic Scenarios

Main Scenario | Deep Recession

Probability **50%**

In our high probability scenario, stubbornly elevated inflation that shows little sign of abating triggers an overly-aggressive monetary tightening event that sparks a recession. The depth and duration of the recession hinges on how persistent inflation proves to be, and on how much pain policymakers are willing to inflict on the economy in order to bring inflation down to levels deemed acceptable. In this calamitous scenario, central banks look to restore their inflation-control credibility after waiting too long to address mounting price pressures and tighten monetary policy too far, too fast – regardless of the economic fallout. The Federal Reserve has prioritized tackling inflation at all costs, and will not come to the rescue of the economy should inflation expectations spiral higher. As such, policymakers are unlikely to pause the rate hike cycle until they see convincing evidence that inflation is coming down, which ultimately means that the Federal Reserve will be hiking interest rates well into economic weakness, making way for a "Deep Recession."

Scenario 2 | Shallow Recession

Probability **30%**

In this less severe recessionary scenario, inflation expectations de-anchor to the upside and force central banks to raise rates at an expeditious pace, which inadvertently pushes the economy into a recession as policymakers act in order to dampen demand for goods, services, and labor. However, interest rates peak at a lower rate versus the "Deep Recession" scenario – while the economic fallout is less damaging in the "Shallow Recession" scenario given the relatively robust underlying economic fundamentals heading into the downturn. Critically, financial imbalances that exacerbated past recessions are now absent, while consumers, banks, and the housing market are all better positioned to weather economic turbulence than they were ahead of the Global Financial Crisis of 2007-2009.

Scenario 3 | Stagflation

Probability **20%**

While central banks ramp up their plans to normalize monetary policy in response to decades-high inflation, interest rates fail to breach "restrictive" terrain that would typically spark an outright contraction. Still, the global economy slows to below potential levels. The speed at which inflation moderates will determine whether the Federal Reserve can temper its hawkishness and in turn avert recession. This scenario assumes that supply-demand imbalances resolve themselves faster than expected and inflation peaks in the near-term as the rotation in demand from goods towards services curtails pricing pressures, while a recovery in labour force participation and an influx of low-skilled labour constrains wage gains. This paves the way for the Federal Reserve to pause its tightening campaign and ultimately allows the U.S. economy to escape recession.

Portfolio Strategy

Matrix of Expected Returns (CAD)

SCENARIOS	DEEP RECESSION	SHALLOW RECESSION	STAGFLATION
PROBABILITY	**50%**	**30%**	**20%**
TRADITIONAL INCOME			
Money Market	3.8%	2.9%	2.4%
Canadian Bonds	-10.3%	-3.7%	0.0%
NON-TRADITIONAL INCOME			
Diversified Credit	5.0%	6.0%	7.0%
Diversified Real Estate	5.0%	6.0%	7.0%
Infrastructure	5.0%	6.0%	7.0%
Agriculture	5.0%	6.0%	7.0%
TRADITIONAL CAPITAL APPRECIATION			
Canadian Equity Large Cap	-17.3%	3.9%	21.1%
U.S. Equity	-21.0%	1.0%	7.2%
International Equity	-32.7%	-4.3%	11.2%
Emerging Market Equity	-26.0%	-5.4%	15.1%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity	5.0%	7.5%	12.0%
Liquid Alternatives	0.0%	2.5%	5.0%
CAD/USD	0.75	0.80	0.85

Portfolio Strategy

Current Strategy[1]

TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
Money Market	0%	5%	25%	20%	+15%
Canadian Bonds	5%	25%	45%	5%	-20%
Canadian Equity Large Cap	10%	20%	40%	27%	+7%
U.S. Equity	0%	10%	20%	0%	-10%
International Equity	0%	10%	20%	3%	-7%
Emerging Market Equity	0%	5%	15%	5%	0%
Non-Traditional Income	5%	25%	45%	40%	+15%

TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	**20%**	**40%**	**60%**	**50%**	**+10%**
Money Market	0%	5%	25%	20%	+15%
Canadian Bonds	5%	35%	55%	30%	-5%
TRADITIONAL CAPITAL APPRECIATION	**40%**	**60%**	**80%**	**50%**	**-10%**
Canadian Equity Large Cap	5%	25%	50%	32%	+7%
U.S. Equity	0%	15%	30%	5%	-10%
International Equity	0%	15%	30%	8%	-7%
Emerging Market Equity	0%	5%	15%	5%	0%

Evolution of Value-Added[1]

1 Based on a 100 basis point value added objective. The benchmark employed here is based on a model portfolio and for illustrative purposes only. Individual client benchmarks are employed in the management of their respective portfolios.

Fixed Income Outlook

Fixed Income Review

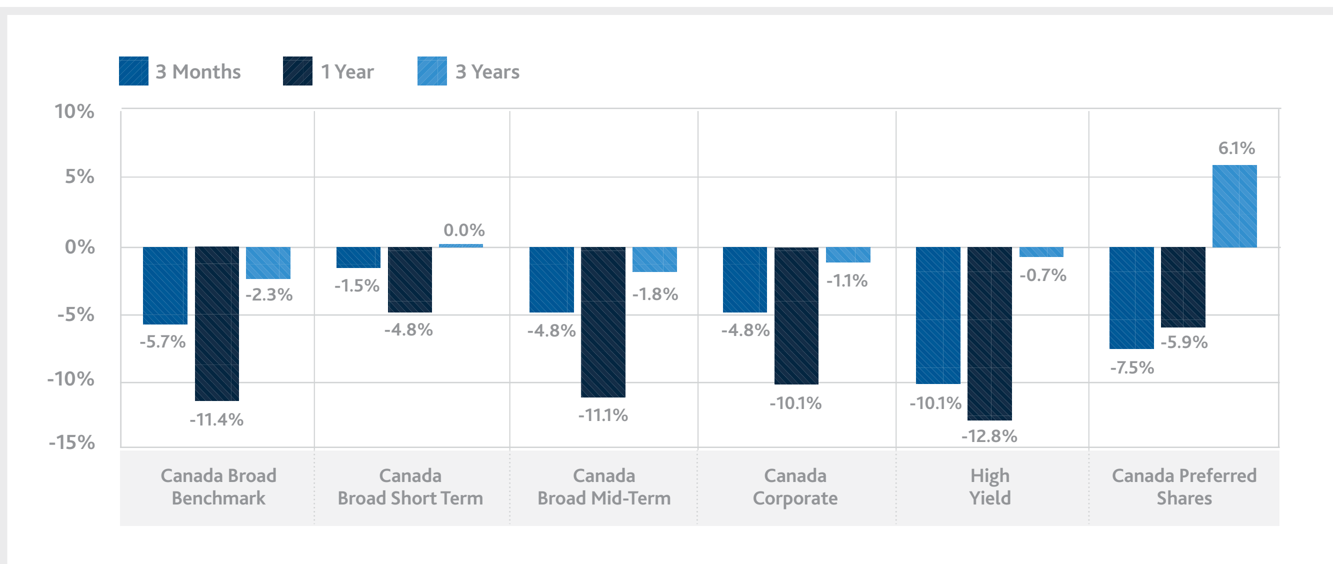
The profound rout in fixed income markets extended throughout the second quarter as central banks deepened their hawkish tilt in response to decades-high inflation. Government bond yields soared higher across the curve as investors braced for an aggressive monetary policy tightening cycle, while credit spreads widened as central banks' efforts to tame inflation at any cost fueled fears of imminent recession.

Global inflation has accelerated and is showing little sign of abating. While transitory factors have driven some of the recent price gains, there are some structural forces taking hold that are set to keep inflation well above central banks' comfort zone for an extended time. Moreover, there is a looming risk that longer-term inflation expectations become unhinged and jeopardize the return to price stability. The Federal Reserve needs to manage these expectations to avoid a self-fulfilling prophecy. Consequently, policymakers have pivoted their focus and have vowed to fight inflation at all costs and appear willing to sacrifice growth in order to do so.

The Federal Reserve is moving "expeditiously" to combat the hottest inflation in 40 years. In June, the Fed raised interest rates by 75 basis points in its biggest move since 1994, while Chair Powell openly endorsed raising rates well into restrictive terrain - a strategy that has often resulted in an economic downturn. He also issued warnings that inflation is going to be longer-lasting than originally thought and acknowledged that bringing down inflation may cause some pain, but stated that the bigger risk is not taking enough action.

Similarly, the Bank of Canada continues to push forward on its expedited path to higher rates to prevent high inflation from becoming embedded in expectations. With the economy moving into excess demand and inflation running at multi-decade highs, the central bank has promised to deliver "forceful" action to wrestle inflation back down – including the possibility of a 75 basis point move in July following the latest inflation results that surprised to the upside in both magnitude and breadth.

Canadian Fixed Income Market Returns | As of June 30, 2022



Source: Fiera Capital Corporation

Investment Strategy

With inflation running hot and central banks swiftly withdrawing support, the path of least resistance for government bond yields should be higher, condemning government bonds to future losses. We expect short-term rates to rise by much more than the consensus view in response to inflationary dynamics that prove extremely difficult to bring back in-line. Meanwhile, rising recession risks warrant some caution in the corporate space. This unappealing outlook underpins our underweight allocation to traditional fixed income at this time.

Equity Outlook

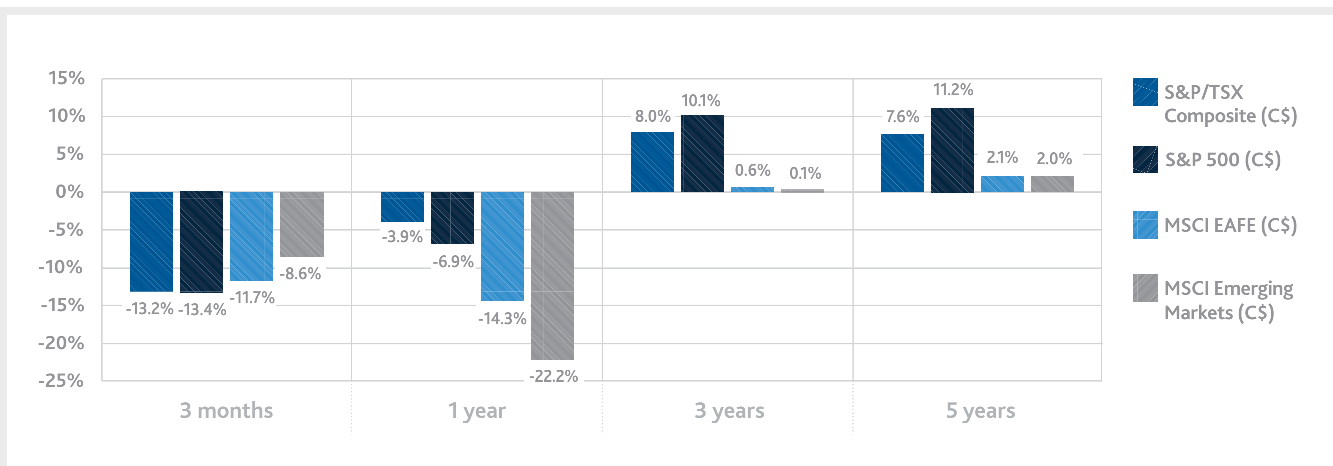
Equity Review

Global equity markets resumed their downward trend in the second quarter and posted their worst quarterly slump since the onset of the pandemic at the beginning of 2020. Volatility gripped the marketplace and sent equity markets into a tailspin, with the rapid pivot to tighter monetary policy in the face of stubbornly high inflation fueling fears of a global recession. The retreat was widespread across the equity market landscape, with no sector or region left unscathed in the quarterly selloff.

While equity market losses this year have been driven by inflation risks and higher interest rates that have pushed P/E multiples lower (the "P" in P/E), focus is likely to shift to the earnings outlook (the "E" in P/E) as the next major catalyst for equities. Our expectation is that the next leg of the equity turmoil will be all about growth, and accordingly, corporate earnings.

Mounting recession risks have called into question the resilience of earnings, which have held up well so far. Indeed, a widening gap has emerged on the views that economists and analysts have on growth. While anxiety that the Federal Reserve's monetary tightening will trigger a recession has pushed economists to slash their economic growth forecasts, analysts' earnings estimates have stayed firm even amidst rising costs and a looming economic slowdown that are bound to squeeze profits. Somewhat surprising is that bottom-up earnings growth expectations have not been revised down to reflect the deterioration in the economic outlook, which has raised questions about whether stock prices are fully reflecting the risks facing the global economy. With bottom-up earnings expectations still quite lofty, disappointment and downward revisions are likely. As such, the next leg down for equities will likely be driven by the earnings side of the equation.

Equity Market Returns | As of June 30, 2022



Source: Fiera Capital Corporation

Investment Strategy

The outlook for equities has deteriorated substantially given that recession risks are looming large. Central banks have abruptly stepped up their fight against inflation, with both the economy and corporate earnings set to assume the collateral damage stemming from their actions. In this environment, we remain defensive and will be assuming an underweight stance on equities over our tactical 12-18 month horizon. Regionally speaking, we continue to expect Canadian equities to outperform their global peers in the environment of buoyant commodity prices that should bode relatively well for TSX earnings momentum. The S&P/TSX has approximately 30% exposure to the resource sector.

Private Markets Outlook

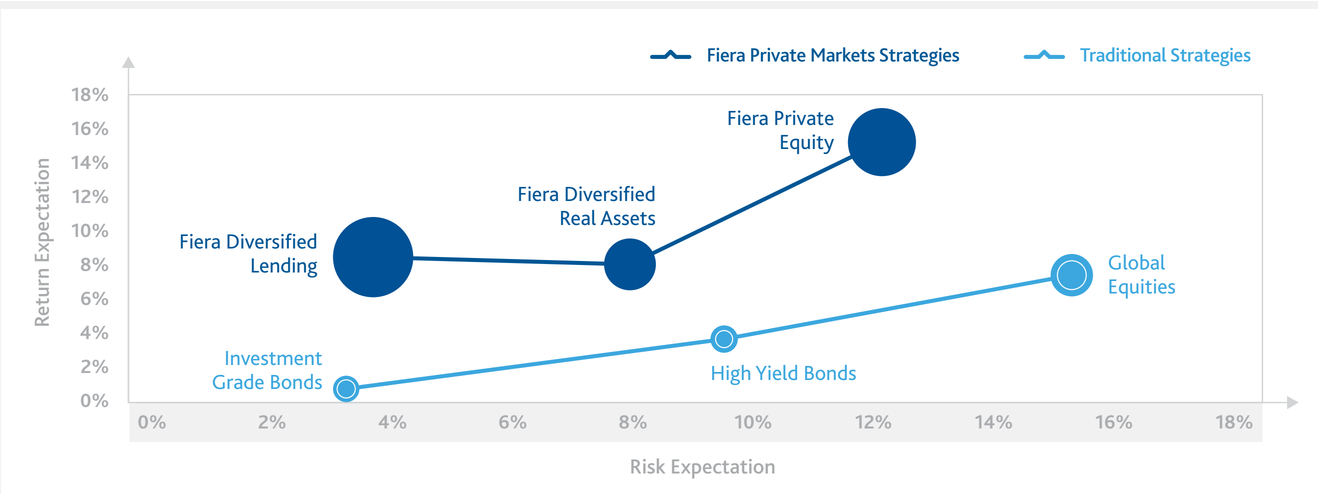
The Case for Private Markets

The outlook for public market asset classes such as stocks and bonds is challenged in the environment of heightened macroeconomic and geopolitical angst, with rising interest rates and dangerously elevated inflation coming up against a backdrop of decelerating economic growth. Consequently, a traditional 60/40 portfolio is unlikely to meet investor objectives given lower expected returns for public equities, while traditional universe bonds may no longer serve as a shock absorber or a diversifier in a tumultuous trading environment.

As such, a well-balanced portfolio will need to include higher allocations to private markets asset classes such as private credit, real assets, and private equity in order to make up for these shortfalls in the public markets space. While the merits of adding private markets strategies to a properly diversified portfolio are valid across most macroeconomic environments, they are particularly attractive in an environment of elevated inflation and stagnating growth. Moreover, private markets are less susceptible to significant swings if there is broader market volatility – something we expect will prevail in the coming year as macroeconomic risks intensify.

Specifically, private credit is a viable option for those looking for security and yield – two very important considerations in the portfolio construction process. Private credit enhances the portfolio yield and provides a stable income stream, with added diversification benefits given its low correlation to public bonds and equities. Much of the private credit space utilizes floating-rate structures that generate higher income as short-term interest rates rise in response to high inflation, while the illiquidity and complexity premium (approximately 2-3%) could act as a shock absorber given the potential for credit losses in an economic downturn scenario. Meanwhile, in a world where inflation is higher than it has been for the past four decades and set to remain elevated, real assets such as real estate, infrastructure, and agriculture will play a critical role in hedging against inflation. Real assets have attributes related to both fixed income and equities, and typically generate stable and predictable cash flows while also providing some capital appreciation potential. Finally, private equity has demonstrated an ability to outperform public equities, even in market downturns, with less volatility.

Given these attractive characteristics, private markets strategies can prove instrumental in enhancing the risk-reward proposition in the portfolio setting. Optimizing a portfolio to include these asset classes may bolster both the performance and durability of a total portfolio, including maximizing the potential for an increase in the reward per unit of risk.



Private Markets strategies offer a relatively attractive risk-reward proposition versus Public Markets. The inclusion of private credit, real assets, and private equity can prove instrumental in enhancing a portfolio's risk-adjusted performance.

Source: Fiera Capital Corporation

Commodities and Currencies

CAD / USD

The Canadian dollar ended the first half of 2022 on a softer note, with unrelenting strength in the greenback limiting any material gains stemming from higher oil prices. The US dollar saw some notable strength against all its major peers given the assertive headstart to the Federal Reserve's tightening campaign, while heightened geopolitical tensions and a deteriorating macroeconomic landscape saw investors flock to the safe haven currency. While the dollar will be supported by these factors in the near-term, the outlook becomes more challenging in the longer run – particularly as other central banks ramp up their plans to tighten policy and play catch-up to the Fed. The downtrend in the U.S. dollar should help to buttress the Canadian dollar, while widespread strength across the commodity spectrum and stronger economic momentum in Canada versus the United States that has prompted a more hawkish-leaning Bank of Canada should be key tailwinds for the loonie in the coming year.

Oil

Crude oil extended its upward climb in the second quarter as resurgent global demand and upended trade flows following Russia's invasion of Ukraine squeezed an already-tight market. While some demand destruction is likely amid a protracted slowdown in global growth, energy will not see the pullback typically expected in a global recession scenario. Supply-side restraints including low spare capacity and continued production management by OPEC+ and U.S. shale producers will ultimately place a floor under crude and energy product prices, while the lingering geopolitical conflict between Russia and the West has yet to be resolved and remains a threat to global energy supplies. Moreover, while the OPEC+ consortium has completed the return of output that it halted during the pandemic, the alliance has struggled to meet its targets – while prolonged underinvestment and regulatory restraint in the energy space has also contributed to supply deficits.

Gold

Gold declined in the second quarter as U.S. dollar strength and rising treasury yields exerted downward pressure on the precious metal. We expect gold to trade in a narrow range given some conflicting forces at hand. While bullion's appeal as an inflation hedge and a safe haven given lingering recession risks should underpin prices, the prospect for an aggressive path of interest rate hikes should limit any notable upside for the non-interest-bearing metal.

Copper

Copper posted its worst quarter since 2008 as recession fears dampened the outlook for demand. Subdued demand from top consumer China also weighed amid rolling lockdowns that restrained construction and factory activity. Often viewed as a barometer for the global economy, copper is at risk of demand destruction in a recessionary scenario. Longer term, however, copper stands to benefit in the global effort to scale up in green infrastructure spending and expanding the electric-generation grid.

Source: Bloomberg

Forecasts for the Next 12-18 Months

SCENARIOS	JUNE 30, 2022	DEEP RECESSION	SHALLOW RECESSION	STAGFLATION
PROBABILITY		**50%**	**30%**	**20%**
GDP GROWTH				
Global	3.20%	1.50%	2.00%	2.50%
Canada	2.40%	-1.00%	-0.50%	1.50%
U.S.	1.90%	-2.00%	-1.00%	1.00%
INFLATION (HEADLINE Y/Y)				
Canada	7.70%	8.00%	6.00%	4.00%
U.S.	8.60%	9.00%	7.00%	5.00%
SHORT-TERM RATES				
Bank of Canada	1.50%	6.00%	4.25%	3.25%
Federal Reserve	1.75%	6.00%	4.25%	3.25%
10-YEAR RATES				
Canada Government	3.22%	5.00%	4.00%	3.50%
U.S. Government	3.01%	5.00%	4.00%	3.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
Canada	1586	1300	1400	1575
U.S.	238	175	225	240
EAFE	154	100	130	155
EM	88	65	75	90
P/E (12 MONTHS FORWARD)				
Canada	11.9X	12.0X	14.0X	14.5X
U.S.	15.9X	16.5X	17.5X	18.5X
EAFE	12.0X	12.0X	14.0X	14.5X
EM	11.3X	11.0X	13.0X	14.0X
CURRENCIES				
CAD/USD	0.78	0.75	0.80	0.85
EUR/USD	1.05	1.00	1.10	1.15
USD/JPY	135.72	135.00	125.00	115.00
COMMODITIES				
Oil (WTI, USD/barrel)	105.76	90.00	110.00	130.00
Gold (USD/oz)	1807.30	2100.00	1900.00	1800.00

Discussions regarding potential future events and their impact on the markets are based solely on historical information and Fiera Capital's estimates and/or opinions, and are provided for illustrative purposes only. Expected returns are hypothetical estimates of long-term returns of economic asset classes based on statistical models and do not represent the returns of an actual investment. Actual returns will vary. Models have limitations and may not be relied upon to make predictions of future performance of any account.

Contact Us

North America

MONTREAL
Fiera Capital Corporation
1981 McGill College Avenue
Suite 1500
Montreal, Quebec H3A 0H5
T 1 800 361-3499

TORONTO
Fiera Capital Corporation
200 Bay Street,
Suite 3800, South Tower
Toronto, Ontario, Canada M5J 2J1
T 1 800 994-9002

CALGARY
Fiera Capital Corporation
607 8th Avenue SW
Suite 300
Calgary, Alberta T2P 0A7
T 403 699-9000

NEW YORK
Fiera Capital Inc.
375 Park Avenue
8th Floor
New York, New York 10152
T 212 300-1600

BOSTON
Fiera Capital Inc.
One Lewis Wharf
3rd Floor
Boston, Massachusetts 02110
T 857 264-4900

DAYTON
Fiera Capital Inc.
10050 Innovation Drive
Suite 120
Dayton, Ohio 45342
T 937 847-9100

privatewealth
@fieracapital.com

pw.fiera.com

Europe

LONDON
Fiera Capital (UK) Limited
Queensberry House, 3 Old
Burlington Street, 3rd Floor,
London, United Kingdom W1S 3AE
T +44 (0) 207 409 5500

FRANKFURT
Fiera Capital (Germany) GmbH
Walther-von-Cronberg-Platz 13
Frankfurt, Germany
60594
T +49 69 9202 0750

Asia

HONG KONG
Fiera Capital (Asia) Hong Kong Limited
Suite 3205, No. 9 Queen's
Road Central, Hong Kong
T 852-3713-4800

SINGAPORE
Fiera Capital (Asia) Singapore Pte. Ltd.
6 Temasek Boulevard #38-03
Suntec Tower 4
Singapore 038986

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