iA Global Asset Management

Monthly Macro & Strategy

December 2023

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Highlights

- Despite the recent resilience of the U.S. economy, our internal model continues to point to elevated recession risks ahead.
- Within equities, valuations are getting pricier globally. Canada, U.S. small caps and EAFE seem to offer better value.
- The sharp fall in market rates in November led us to tactically close some of our overweight on sovereign bonds.

Global asset allocation positioning (December 2023)

	--	-	N	+	++	Δ
Asset Classes						
Money Market				■		
Fixed Income			■			↓
Equities		■				
Alternatives			■			
Relative Equity						
Canadian Equities			■			
U.S. Equities		■				
International Equities			■			
EM Equities			■			
Relative Fixed Income						
Government Bonds				■		↓
IG Corporate Bonds			■			↓
HY Bonds		■				↑
Other						
Oil				■		
Gold			■			
USD (trade weighted)			■			↓
CAD/USD			■			

Rockin' around the recession odds

Whether the U.S. economy enters a recession in the next few months remains an important, if not crucial, anchor for any investment strategy. Like many others, we started 2023 with the base-case scenario of a recession in Canada and the United States by year-end. Even though our projections were not too far off for Canada, we were pleasantly surprised by the resilience of the U.S. economy.

A few reasons underlie the recent "American exceptionalism": the country's tight labour market, accumulated excess household savings and impressive fiscal deficits. All are generally cited as reasons for optimism that a recession may be avoided altogether.

As 2024 approaches, we're focusing even more on identifying signs of economic weakness in the U.S. economy. Given the number of moving parts and the potentially conflicting macro signals, it is crucial that we continually reassess and weight the incoming economic indicators, as well as be prepared to adapt our investment strategies to evolving conditions.

Labour market

The Sahm rule, the current flavour of the month, was developed by U.S. economist Claudia Sahm as a simple yet effective tool to guide fiscal policy in real time by trying to predict imminent recessions through unemployment rate trends. The rule, based on historical data, suggests that when the 3-month moving average of the unemployment rate rises by at least 0.50 percentage points above its lowest point of the previous 12 months, there is a high probability that a recession is beginning or impending. Applied to data going back to the 1970s, the Sahm rule has accurately identified U.S. recessions with only one false positive, making it a valuable and accessible tool for policymakers, analysts and others interested in the health of the economy. Its effectiveness is further demonstrated by its successful prediction of the 2007 Great Recession and the 2001 recession.

Even though this rule has a strong track record, the unemployment rate, or any of its transformations, does not fully reflect labour-market tightness; it only accounts for individuals actively seeking employment. This metric overlooks various nuances, such as underemployment, the labour-force participation rate and the number of discouraged workers. Consequently, a low unemployment

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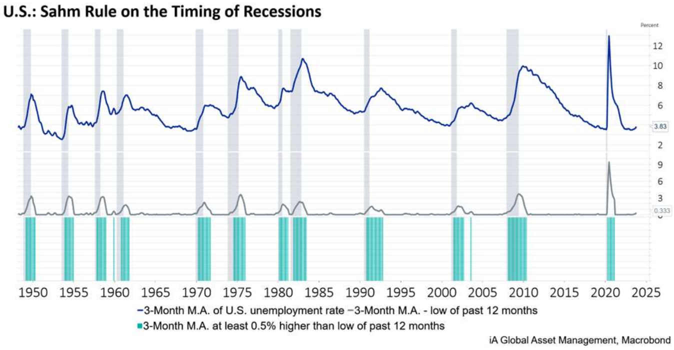
rate might be misleading, because it may not accurately capture the true tightness of the labour market or the challenges faced by potential workers and employers.

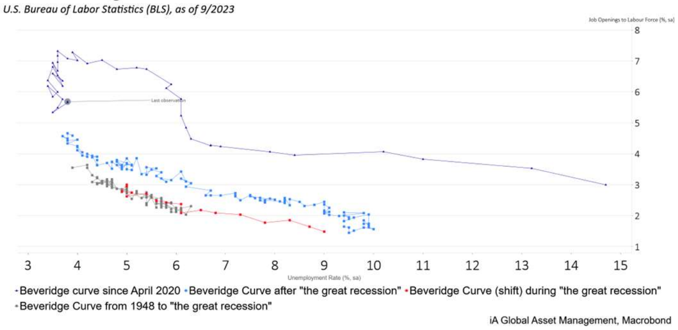
U.S.: Sahm Rule on the Timing of Recessions



The Beveridge curve, in contrast, is useful for understanding labour-market dynamics and identifying mismatches within the job market. For instance, an outward shift of the curve implies a decrease in the efficiency of job matching, possibly because of structural changes or skill mismatches whereby job seekers don't possess the required skills for the available positions. The Beveridge curve currently shows that the ratio of job openings to labour force is in a downtrend, but that the unemployment rate is stable. In other words, the labour market is loosening even if we don't see a material change in the unemployment figures.

The US Beveridge curve

U.S. Bureau of Labor Statistics (BLS), as of 9/2023



According to the most recent long-term population projections from the U.S. Census Bureau, it appears that the U.S. labour market could remain persistently tight for the foreseeable future. With the growth of the working-age population in the current decade being the lowest since the Civil War, businesses and policymakers are likely to face considerable challenges in addressing labour shortages. This reduced labour-force growth is attributed primarily to lower-than-expected immigration rates, which, in turn, affect the overall availability of workers for various industries.

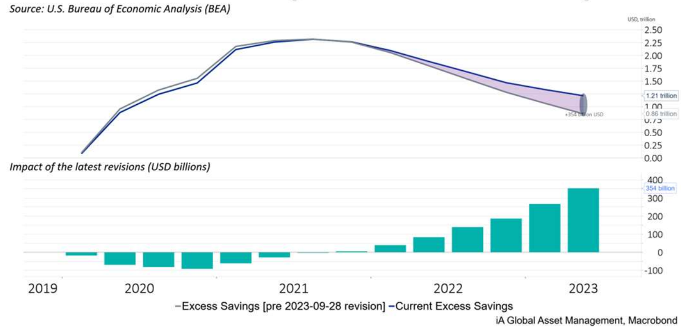
The tight labour market raises several macroeconomic concerns, for it can lead to wage pressures and economic imbalances if not addressed effectively. It also has implications for economic growth and the ability of businesses to expand their operations. Furthermore, the reduced labour-force participation may affect consumption patterns, which play a critical role in driving economic growth. Inflationary pressures may arise in some sectors if the demand for goods and services outpaces the labour supply required to produce them.

Excess savings

Excess savings have been one of the most significant economic stories during and in the aftermath of the pandemic, contributing to the resilience of the U.S. economy. Lockdowns led households to save more than they might have otherwise, and recent data from the Bureau of Economic Analysis suggest that the U.S. excess savings rate may be higher than previously thought.

United States: the latest GDP revisions gave a boost to households' excess savings

Source: U.S. Bureau of Economic Analysis (BEA)



Higher-than-expected excess savings have acted as a financial cushion, enabling consumers to maintain their spending despite concerns over inflation and interest rates. As consumers continue to tap into their excess savings, demand for goods and services continues to be sustained, thereby contributing to the overall economic recovery.

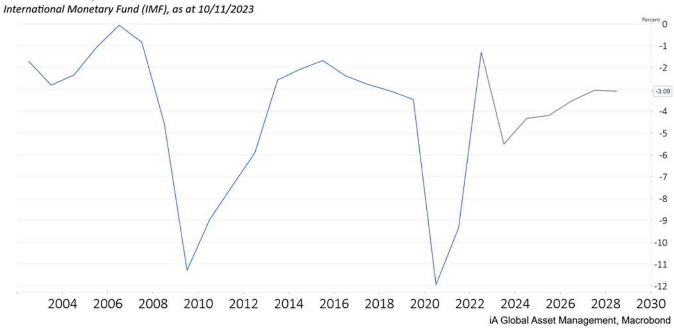
Even so, it is essential to monitor the exact amount of savings and how much remains, as different estimates can affect inflation, growth and the U.S. economy's resilience. The most recent GDP revisions gave a $357-billion boost to excess household savings. As these excess savings are depleted, we should expect a reduction in consumer spending, possibly with ripple effects on various economic sectors and policy decisions.

U.S. deficit

The rise in the U.S. deficit has played a significant role in propping up the economy and contributing to its resilience during the pandemic. Officials resorted to aggressive fiscal stimulus to prevent the health crisis from turning into an economic one. The U.S. implemented its measures at a larger scale than many other regions, resulting in a primary government deficit of 9.4% of GDP in 2021, which came down to 1.3% in 2022 before jumping again to 5.5% in 2023.

This substantial fiscal response has supported the U.S. economy, particularly by driving a recovery in consumer spending. As a result, generous government support has been a prime reason for the robust economic growth that the country has experienced during these challenging times.

U.S.: Primary Deficit as a % of GDP
International Monetary Fund (IMF), as at 10/11/2023



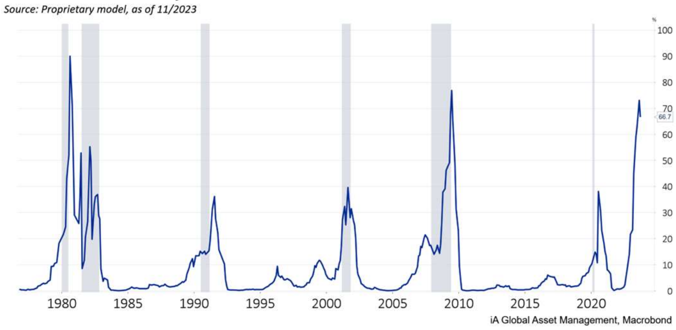
What does our recession model say?

Our in-house recession model attempts to identify economic turning points 3 months before they occur by taking into account a comprehensive set of variables that includes, but is not limited to, unemployment, economic indicators and various characteristics of the yield curve. We use a multivariate logistic regression to forecast the probability of a recession, as defined by the National Bureau of Economic Research (NBER).

Our approach thus quantifies as a probability measure of the risk of a recession according to the current economic climate. It is purely forward-looking because it doesn't rely on a set of economic scenarios.

As can be seen below, our model currently forecasts the probability of a recession over the next 3 months at 66%, one of its highest historical readings.

US Recession Probability
Source: Proprietary model, as of 11/2023



No matter how good any model may be, it is still a stylized version of reality with obvious limitations. We think that, over the next few months, in addition to monitoring our model, we should be paying attention to four key developments that will be crucial in determining whether the United States economy enters a recession:

1- What is the current state of the U.S. job market? Does the unemployment rate continue to rise? Is the ratio of job openings to job seekers tightening?
2- How are excess savings faring? Can the U.S. consumer continue to spend and support the economy?
3- How far is the U.S. government willing to go to continue supporting the economy, especially given the coming electoral cycle? How will the recurrent debt-ceiling negotiations affect its ability to do so?
4- How does monetary policy continue to propagate through the economy? Do we continue to see a tightening in lending standards? Are delinquencies turning into outright defaults?

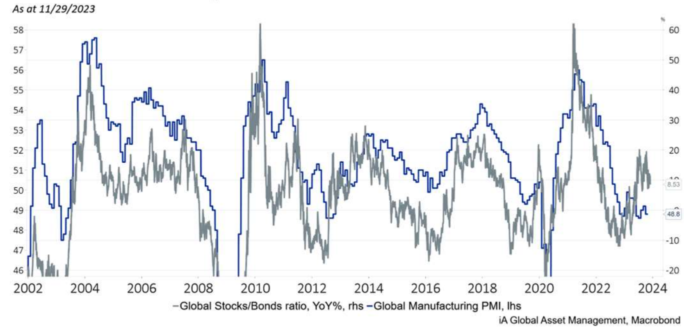
Answering these questions will give us a sense of whether the economy is on track for further weakness.

Bottom line

Equities

There isn't much love for global equities emanating from our **macroeconomic** indicators, that's for sure. Monetary policy continues to make its way toward the heart of the economy, the labour market, as shown by the rise of the unemployment rate since the first quarter of 2023. The long and variable lags have historically played tricks on investor sentiment, with the "this time is different" narrative being a regular feature of the end of most hiking cycles. Given the speed of tightening by the Fed and the Bank of Canada alike in the second half of 2022, it's only natural to expect the first half of 2024 will see a further sharp deterioration of labour markets.

Global PMI vs Global Stocks/Bonds Ratio
As at 11/29/2023

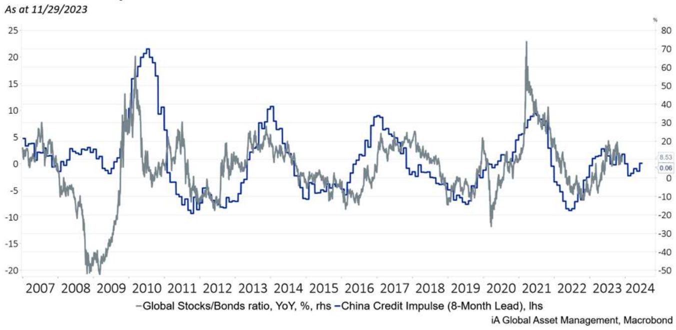


The global manufacturing sector is already in a recession and, despite signs of a recent bottoming, could remain under pressure because the drawdown in the inventory cycle (another regular late-cycle feature) is yet to be completed.

U.S.: Manufacturing & Trade Inventories
U.S. Census Bureau, % YoY, as at 9/2023

The state of the global manufacturing cycle and the credit impulse from China have demonstrated their potency as leading indicators of the performance of the global stocks/bonds ratio. At the end of November 2023, both indicators suggest that bonds should be favoured over equities in the coming months.

China's Credit Cycle as a Driver of Market Returns
As at 11/29/2023



In terms of **momentum,**[1] our framework continues to paint a diverging regional picture.

Starting with the U.S. indexes, we see that the short-term trends have improved to neutral in the past month, while the long-term trends have deteriorated somewhat. The medium-term trend on both NASDAQ and the S&P 500 are in positive territory, painting an overall better picture than last month's.

Outside the United States, we note that momentum signals are generally negative on every window, with the Nikkei being the lone exception. Over all, the picture remains somewhat negative, suggesting that momentum is not on the side of the global ex-U.S. stock market.

Momentum across equity indices

Equities	Fast	Medium	Slow
S&P500	-0.17	0.61	-0.09
NASDAQ	0.01	0.40	0.77
Russel 2000	-0.47	-1.45	-0.83
S&P/TSX 60	-0.21	-1.44	-1.01
MSCI EAFE	-0.18	-1.43	-0.60
NIKKEI 225	0.74	0.47	1.23
MSCI EM	-0.18	-1.43	-0.60

As for **valuation**, November's strong market performance pushed most markets into pricier territory.

While U.S. large-cap equities were still posting the loftiest valuations, we note that emerging markets also saw a rapid rise in their valuation metrics in November, with the median jumping 27 percentiles. Given the weight of the United States in MSCI's World Index and its All Country World Index, the valuation picture has become unfavourable to global equity indexes, but some pockets of value can be identified.

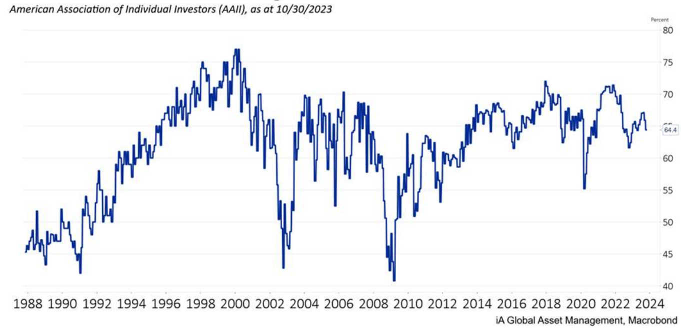
Looking at the table below, we see that the Russell 2000, S&P/TSX, MSCI Japan and MSCI EAFE all continued to offer relatively attractive valuations, with medians below 50%.

Current valuation vs. 10 years historical (percentile)

	EV/Sales	EV/EBITDA	Price/Book	FCF Yield	P/E	Dividend yield*	Median	Change in median vs last month
S&P/TSX	86%	N.A	24%	39%	17%	13%	24%	13%
NASDAQ	77%	79%	75%	20%	79%	80%	78%	1%
S&P 500	82%	80%	87%	6%	80%	89%	81%	10%
MSCI World	84%	74%	88%	12%	65%	85%	79%	32%
MSCI Japan	35%	32%	70%	45%	65%	32%	40%	20%
Russell 2000	13%	24%	5%	94%	6%	84%	18%	10%
MSCI EAFE	40%	22%	70%	82%	17%	38%	39%	32%
MSCI ACWI	83%	76%	86%	21%	68%	83%	80%	25%
MSCI EM	65%	75%	55%	85%	77%	17%	70%	27%

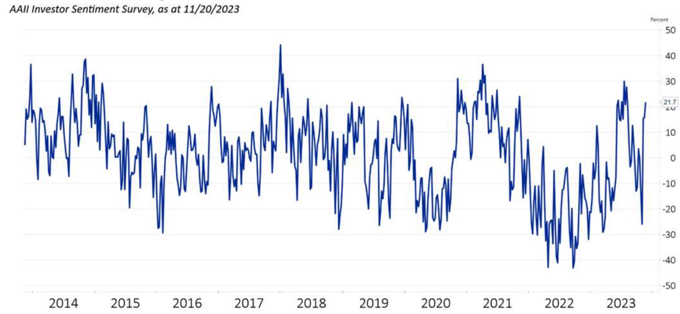
* Inverted

U.S.: AAII Stocks as % of Total Holdings
American Association of Individual Investors (AAII), as at 10/30/2023



Turning to **sentiment**, we note that investor perception has been volatile since 2022, and the recent readings from some of our favoured indicators are again contradictory. The AAII sentiment survey shows a recent fall in the reported average share of stocks as a percentage of total holdings by retail investors, but the well-followed JP Morgan Global Equity Sentiment Indicator and the bull-bear spread from AAII suggest more love for equities.

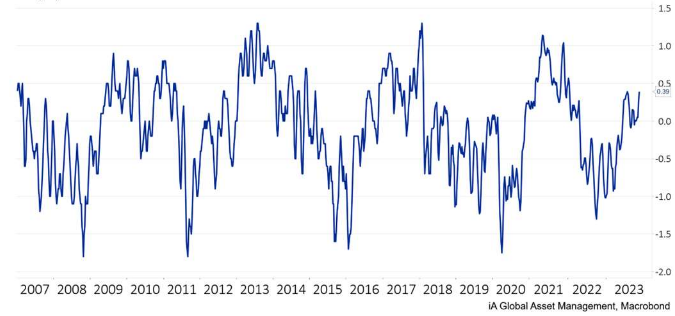
U.S.: AAII Bull-Bear Spread
AAII Investor Sentiment Survey, as at 11/20/2023



Finally, the VIX index suggests that nervousness about a rebound in market volatility has all but disappeared, with the index touching a post-pandemic low below 13.0 toward month-end. All in all, this suggests a more balanced picture on sentiment, with enthusiasm making a comeback of late.

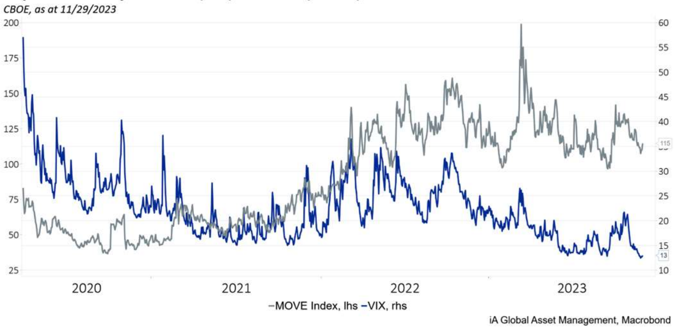
[1] The momentum tables across this publication show the output of our proprietary methodology, with the z-scores of momentum measures across three time windows: fast (fewer than 100 days), medium (100 to 200 days) and slow (more than 200 days).

J.P. Morgan Global Equity Sentiment Indicator
As at 11/24/2023



Wrapping up equities, we note that our macro signals and momentum do not tell a compelling story for risk taking, but valuations and sentiment combine to advocate for a less defensive positioning outside the large U.S. indexes.

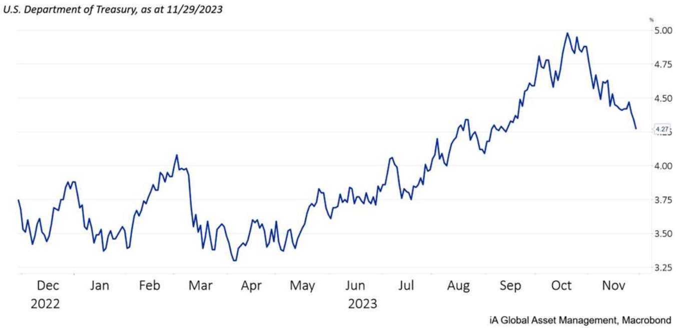
Implied Volatility in Stocks (VIX) vs Bonds (MOVE)
CBOE, as at 11/29/2023



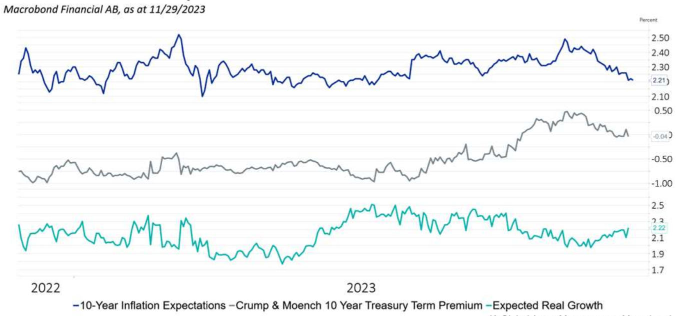
Fixed Income

North American long rates took a dive in November, leading us to tactically change some of our views.

U.S.: 10-Year Rate
U.S. Department of Treasury, as at 11/29/2023



U.S.: 10-Year Rate Decomposition
Macrobond Financial AB, as at 11/29/2023



Our **macro** framework is still sending convincing signals to overweight sovereign bonds and duration, but the speed and amplitude of the recent move lower on rates led us to trim our exposure, for the time being.

The recent slowdown in total inflation brought both the breakeven and the term premium down sharply in November, as the soft-landing and Fed-to-start-cutting-by-mid-2024 theses quickly gained traction. Because our leading indicators suggest that inflation might be more persistent than the market expects, causing the Fed to move more slowly than what is currently priced in, we maintained a smaller overweight in long-duration sovereign bonds, with an eye to adding more when rates retrace some of their recent move.

Momentum across select bond indices

Fixed Income	Fast	Medium	Slow
US 10YR Note	-0.14	-1.28	-1.29
CAN 10YR Bond	0.19	-1.26	-1.29

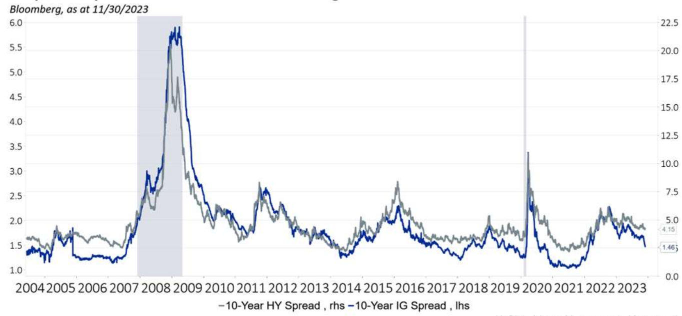
Turning to **momentum**, the most recent trend took a sharp turn higher in November, as incoming data comforted investors that rate cuts were around the corner. The performance of the 10-year bond indexes was strong enough during the month to prompt us to tactically close part of our overweight position, from double positive to single positive. The road ahead could continue to be bumpy, and a tactical approach should benefit our overall stance on fixed income.

From a **valuation** perspective, sovereign bonds continued to offer historically attractive yields.

Looking at corporate bonds, we see that IG and HY spreads tightened some more in November. IG spreads touched a year-to-date low late in the month, reaching a level that makes us confident that the time is right to move from overweight toward neutral in this asset class. As this view was expressed as a relative one, with HY corporates on the other side of the trade, the result is that we moved one notch closer to neutral on HY, from double negative to single negative.

Over all, we still think corporate spreads are relatively tight, given our expectation of more economic pain in 2024, and our net view on corporates, as of late November, was to remain slightly underweight HY bonds.

Corporate Spreads: Investment Grade and High Yield
Bloomberg, as at 11/30/2023



Finally, looking at investor **sentiment**, we note that the MOVE Index (representing the bond market's implied volatility) continues to stick out and to suggest lingering, although slowly declining, nervousness in the market. This index contrasts sharply with the VIX, which is signalling that equity investors expect a smooth road ahead.

Even though this nervousness is not surprising, given how violent the recent repricing of the bond market has been, it does continue to suggest that a contrarian long position on sovereign bonds makes sense. The JP Morgan Client Survey Indicator also sent a positive signal that institutional investors remain net long.

JP Morgan U.S. Treasury Investor Sentiment
All Client Net Long, as at 11/27/2023

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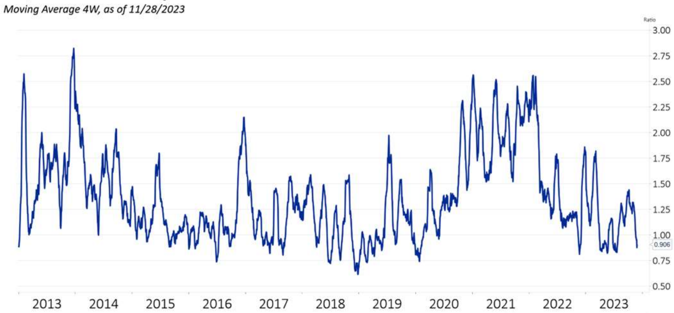
Last, the put/call ratio on 10-year U.S. Treasuries moved below 1 in the past month but seemed to have turned the corner, indicating much less appetite for protection and more positive views on the asset.

Over all, momentum has been strong enough for short-term shifts to some of our positions. We think the convincing signals from our macro, valuation, and sentiment analysis combine to support an overweight position in high-duration sovereign bonds, paired with an underweight position in lower-quality HY bonds.

Put/Call Ratio Treasury Note U.S. 10-Year
Moving Average 4W, as of 11/28/2023



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Commodities and Currencies

The markets seem to have shifted their focus away from the geopolitical tensions in the Middle East, with Brent falling to about $80 a barrel in November.

Crude Oil: Brent
Intercontinental Exchange (ICE), as at 11/29/2023

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Recent talk that OPEC+ may extend its cuts seems to have put a floor under the oil price, although the recent resurgence in U.S. production is a risk factor to our positive view. Again, we note that base metals could be favoured in a scenario where energy prices are much less of a drag on global growth.

Even though our conviction has faded somewhat, we still think commodities could outperform U.S. equities in the coming months and therefore maintained an overweight position in oil.

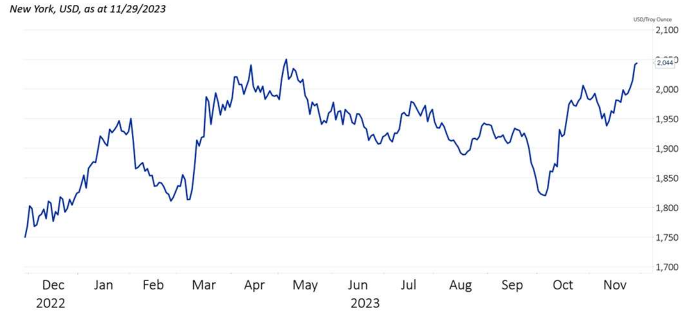
Momentum across select commodities

Commodities	Fast	Medium	Slow
WTI Crude	-0.92	0.05	-0.31
Gold	0.49	-0.12	0.25
Copper	0.08	-0.56	-0.88

Our **momentum** analysis framework suggests that oil's trend may have shifted lower in November, while those of gold and copper recently improved.

Since last month's comments on gold, we haven't seen a convincing signal that would prompt us to move away from our neutral view on the yellow metal.

Gold Price
New York, USD, as at 11/29/2023



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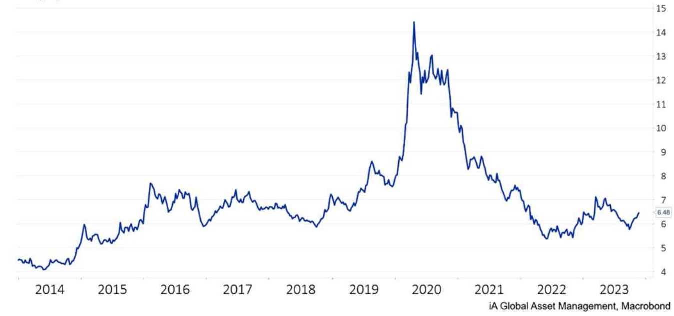
Gold had a volatile month in November, going from $2,000 to $1,950 and back, without a clear macro story to support the swings. We note that gold's outperformance versus the broad CRB Index continued over the past month in a sign of emerging leadership.

We are keeping a keen eye on real rates and the U.S. dollar, with both having moved lower recently, and will stay on the sidelines until a clear entry point manifests itself for gold.

Gold: Relative performance vs CRB Index
As at 11/20/2023



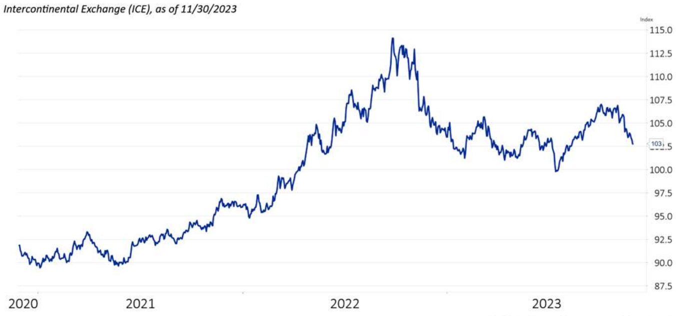
Looking at currencies, we see that the strength of the U.S. dollar has been significant since the summer, but that a reversal seems to be under way. The greenback typically gets stronger when the global economy deteriorates and turns around when the global macro picture finds its footing. While we remain skeptical that the bottom is in for the global economic cycle, given the long and variable lags of monetary policy, we tactically shifted our view to neutral in the short term and took some profits on this trade.

Momentum across select exchange rates

FX	Fast	Medium	Slow
CAD/USD	0.49	0.50	0.27
EUR/USD	-0.49	-0.10	-0.49

As for the Canadian dollar, **momentum** shifted swiftly in November, as with the euro for the fast and medium components. Given this change of trend, we moved from an overweight position in the U.S. dollar back to a neutral stance.

U.S. Dollar: DXY index
Intercontinental Exchange (ICE), as of 11/30/2023



Market Performance

(Total return, in local currency)

As of November 30th, 2023	MTD%	QTD%	YTD%	Δ1Y%
Equity				
S&P 500	9.1%	6.8%	20.8%	13.8%
S&P/TSX	7.5%	4.0%	7.5%	2.3%
NASDAQ	10.7%	8.4%	45.8%	32.6%
MSCI World	8.3%	5.5%	18.2%	12.2%
MSCI EAFE	5.6%	2.1%	12.9%	9.5%
MSCI EM	6.2%	2.4%	6.9%	4.8%
Commodities				
Gold	2.6%	10.2%	11.6%	15.1%
CRB	-1.8%	-3.4%	-4.5%	-6.1%
WTI	-6.2%	-16.3%	-5.4%	-5.7%
Fixed Income				
FTSE Canada Universe Bond	4.3%	4.7%	3.2%	1.4%
FTSE Canada Long Term Bon	8.5%	8.2%	3.2%	-0.5%
FTSE Canada Corporate Bon	3.8%	4.2%	4.9%	3.9%
Currency				
DXY	-3.0%	-2.5%	0.0%	-2.3%
USDCAD	-2.3%	-0.1%	0.1%	1.1%
USDEUR	-2.9%	-2.9%	-1.7%	-4.4%
USDJPY	-2.3%	-0.8%	13.0%	7.3%
USDGBP	-3.7%	-3.4%	-4.3%	-4.5%

As of November 30th, 2023	MTD%	QTD%	YTD%	Δ1Y%
S&P/TSX Sectors				
Financials	10.0%	4.6%	5.6%	-0.3%
Energy	1.5%	1.5%	9.3%	3.1%
Industrials	4.5%	0.9%	5.0%	-1.0%
Materials	4.8%	0.5%	-2.7%	-4.5%
Information Technology	27.4%	19.5%	63.1%	51.3%
Utilities	7.5%	2.7%	-4.9%	-9.2%
Communication Services	7.2%	6.5%	-3.3%	-7.9%
Consumer Staples	1.3%	5.2%	9.2%	7.0%
Consumer Discretionary	6.2%	4.1%	7.7%	3.0%
Real Estate	8.2%	1.7%	-1.7%	-4.4%
Health Care	3.5%	-9.6%	4.9%	-12.7%
S&P 500 Sectors				
Information Technology	12.7%	12.6%	50.7%	38.0%
Health Care	5.2%	1.7%	-3.7%	-5.7%
Consumer Discretionary	10.8%	5.8%	33.0%	17.9%
Financials	10.7%	7.8%	4.4%	-1.2%
Communication Services	7.8%	5.7%	47.3%	35.8%
Industrials	8.5%	5.3%	8.6%	5.2%
Consumer Staples	3.7%	2.3%	-4.5%	-7.5%
Energy	-1.6%	-7.6%	-4.6%	-7.6%
Utilities	4.5%	5.8%	-11.7%	-12.4%
Real Estate	12.3%	9.0%	0.3%	-5.2%
Materials	8.1%	4.6%	5.6%	-0.5%

About iAGAM

A magnet for top investment talent, iA Global Asset Management is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths, and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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