iA Global Asset Management

Monthly Macro & Strategy

June 2023

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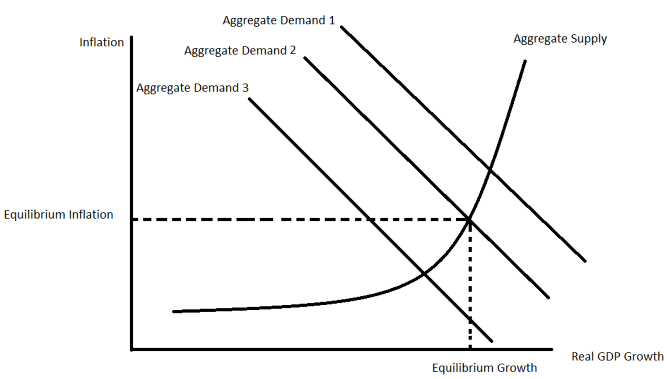
Thinking backward: How likely is a no-recession scenario?

The dynamics of aggregate supply and aggregate demand

Setting the table for this month's exploration of the likelihood of a recession in the next 2 years, we start with a simple economic model to explicate what happened over the past 3 years, and where we stand today.

The AS-AD model is an economic framework that explains how changes in aggregate demand and aggregate supply affect the overall level of economic activity. The model is based on the relationship between the total demand for goods and services (aggregate demand) and the total supply of goods and services (aggregate supply). In the short run, the model shows how changes in aggregate demand can affect the level of real output and the price level. In the long run, the model shows how changes in aggregate supply can affect the level of real output, employment and the price level.



Highlights

- We are taking the opportunity this month to introduce our readers to one of the mental models that underpin our process: thinking backward
- We apply it to our macro financial outlook and use it to evaluate the likelihood of a no-recession scenario in Canada and the U.S. by analyzing the entire chain of events that need to happen for such a scenario to materialize
- Our analysis leads us to believe that such an outcome is unlikely and we therefore kept our positioning unchanged

Global Asset Allocation Views (June 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			■			

The AS-AD model is an important tool for policymakers because it helps them understand the effects of their decisions on the overall economy. For the sake of simplicity and to explicate the role of monetary and fiscal interventions, let's focus on the aggregate demand side of the equation and keep aggregate supply constant.[1]

[1] Even though this model may seem like an oversimplification, we note that most recent data, such as global PMIs and supply chain indexes, show that we are largely back to a "normal" situation on the supply side of the equation; thus, we feel comfortable focusing solely on demand.

Global Asset Management

The chart above represents the AS-AD model in graphic form. The aggregate supply curve is upward sloping because inflation tends to accelerate as real GDP growth increases. In contrast, aggregate demand is downward sloping because as inflation increases demand tends to decrease. The model suggests that there is both an equilibrium level of real GDP growth and an equilibrium level of inflation, which in this example can be found at the intersection of curve 2 and the aggregate supply curve.

Using this framework to think about the impact of the global pandemic and the subsequent monetary and fiscal reactions, we see that the aggregate demand curve initially moved lower (to curve 3), meaning the shock to demand reduced both growth and inflation levels, before swift and massive injections of cash into the system created a situation of excess demand, moving aggregate demand beyond the starting point, to curve 1. At this stage, both equilibrium growth and inflation moved to higher levels.

With the economy sitting in a short-term equilibrium of above-target growth and inflation, central banks intervened by raising rates to shift the aggregate demand curve to the left and to reduce inflation, but also to reduce growth (and risked creating recessions in the process).

Monetary policy is known to act with a lag, and central banks are known to lack perfect foresight, so tightening cycles tend to end in hard landings. The above framework suggests that a soft landing – or, even better, a "no landing" – could be achieved if the central banks were skilled enough to land perfectly back on curve 2; but history suggests we will most likely end up in a situation below the original equilibrium, with inflation tamed but the economy in a recession.

Mental models: thinking backward

The work of economists and strategists is akin to that of intelligence analysts who try to anticipate geopolitical developments. While economists rarely (okay, never) face life-or-death situations, both crafts centre on gathering information, making hypotheses, validating the hypotheses, and formulating an actionable view.

Data collection is crucial to both practices, and we hold a deep conviction that a data-rich process is the key to performing as investors in 2023. Even so, we also recognize that data analysis is where the true value of investors is reaped. In short, gathering and organizing data are the easy part of the job; extracting insights from data is where the added value lies.

The primary cause of intelligence failures is analytical shortcomings rather than limited or inadequate data. Pertinent data tend to be disregarded, misinterpreted, dismissed or overlooked because they deviate from the established mindset or the prevailing mode of thinking. In other words, signals commonly go unnoticed amidst noise because of cognitive biases, such as the herd effect, the anchoring effect or confirmation bias.

One of the ways to work around these very human problems is to use adequate mental models that 1) explicate the hypotheses and 2) facilitate the assignment of probabilities to each hypothesis. This month, we use backward thinking as a mental model to answer a simple yet crucial question: How convinced are we that Canada or the United States will see a recession in the coming 2 years?

Before diving into the analysis, let's take a minute to flesh out backward thinking and its advantages.

Thinking backward to move forward

Thinking backward is a mental model often used in the field of geopolitical analysis and is covered in the seminal book *Psychology of Intelligence Analysis* by Richards J. Heuer.

As a thought experiment, we assume that an unforeseen event has taken place and envision ourselves in the future, looking back to unravel how it could have occurred. We analyze what must have happened 6 months or a year earlier to set up the scenario leading to the result, and which actions were implemented 6 months or a year earlier to lay the groundwork and so forth, until we reach the present.

The practice of thinking backward reorients the focus from the prospect of something occurring to the process of *how* it may occur. Adopting a backward-looking vantage point nurtures an alternative perspective that frees the mind from preconceived notions anchored in the present. Thinking in such a way taps into a different sense of perspective and frequently allows researchers to discover that they can create an entirely plausible scenario for an incident that previously appeared improbable. Thinking backward proves especially useful for scenarios that have low chances of occurrence, but significant consequences should they take place.

So, we ask ourselves a simple question: Let's say we're standing here, in June 2025, and we haven't seen a recession in Canada or the United States. While the no-landing crowd is busy running victory laps, the soft- and hard-landing crowds meet in a room to replay the movie of the past 24 months. What do they see?

The first step is to describe the sequence in a very precise manner. The next step is to assess, using data, the odds that each of these steps happen in precisely this sequence over the period taking us to the summer of 2025. Are we still comfortable with our call for a recession? Or do we realize that we are anchored in our biases? Let's find out!

Transition to 2025

Because it's impossible for us to see directly where aggregate demand and aggregate supply are at any given time and because, just like central bankers, we lack perfect foresight, we must look for clues as to where we are currently on the AD-AS chart, and how likely it is that we'll end up back on curve 2. Our understanding of the propagation of monetary policy leads us to expect the following simplified sequence to unfold by mid-2025:

1- Central banks have tightened monetary policy, borrowing costs have become elevated and both the supply of and the demand for credit are shrinking.
2- Consumer spending slows as households feel less wealthy after a contraction in housing prices and face higher costs for mortgage loans and credit cards. Demand for big-ticket items, such as homes and vehicles, slows even more.
3- Corporate profits decline as reduced investment and slower consumer spending begin to take their toll. Businesses react by cutting costs through workforce reduction and other cost-saving measures.
4- Employment begins to suffer as businesses stop hiring or even lay off employees, causing unemployment to rise.
5- As a result of the economic slowdown, inflation falls back to lower levels.

This general transition usually unfolds over 18 to 24 months.

To achieve a no-recession scenario by mid-2025, many of the above factors, if not most, must happen in moderate fashion or be outright avoided. Let's look at each one individually.

Monetary policy and credit

Some central banks are signaling that monetary policy tightening is complete, for now. Some, like the Bank of Canada, are officially sitting on the sidelines. The U.S. Federal Reserve has hinted that it has moved to a data-dependent stance (our base-case scenario is that the Fed stays on pause for at least the summer, while the economy digests the recent hiking path) whereas it's clear that the European Central Bank is not done yet.

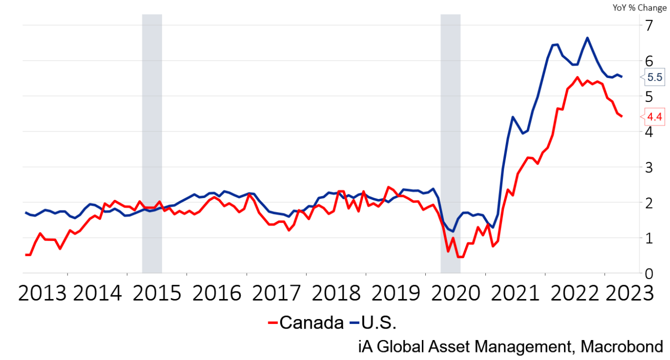
Could we see a swift return to rate cuts in the second half of the year or early in 2024? Of course, but we think it would be an outright reaction to a surprisingly serious economic slowdown over the course of 2023, which defeats the purpose of the argument. For the Fed and other central banks to cut rates, we would need to see a recession first, given the stickiness of services inflation.

This brings us to the credit cycle, which we covered last month here.

For a soft-landing scenario, credit needs to remain somewhat available so that firms continue investing and households continue spending. We showed last month that, overall, credit conditions have already started tightening, much earlier than we usually see in monetary tightening cycles.

Core Inflation: Canada vs U.S.

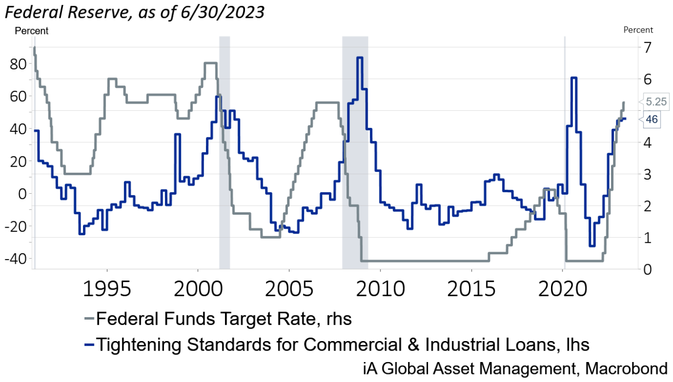
U.S. Bureau of Labor Statistics (BLS), Statistics Canada, % change YoY, as at 4/2023



The recent Senior Loan Officer Opinion Surveys in Canada and the United States show that banks' willingness and ability to lend are diminished, pointing unequivocally toward a lesser supply of credit. The Business Outlook Survey of the Bank of Canada and the National Federation of Independent Business in the United States point similarly to less demand for credit by businesses, suggesting we are late in the credit cycle.

U.S. Tightening Standards vs Fed Funds Rate

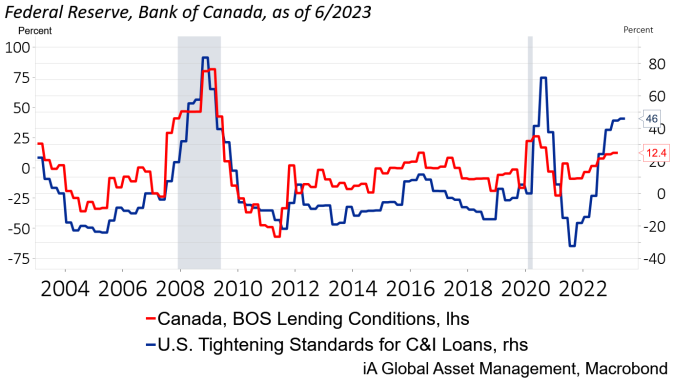
Federal Reserve, as of 6/30/2023



With supply and demand both reduced, we expect credit conditions to hamper future growth.

Lending Conditions: Canada & U.S.

Federal Reserve, Bank of Canada, as of 6/2023



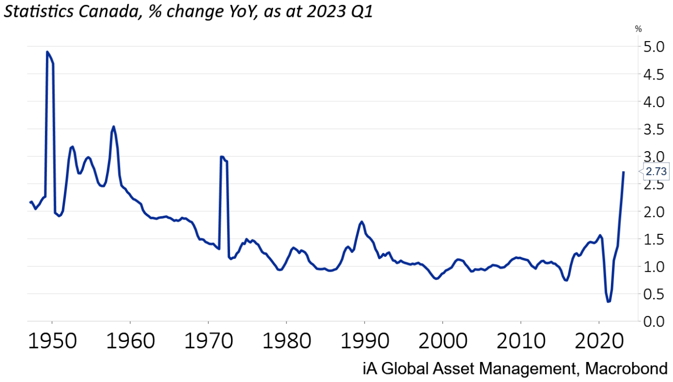
So, the likelihood that monetary policy and/or the credit cycle will turn more favourable in the short run and support a no-landing scenario by mid-2025 is, in our opinion, pretty low.

Housing

Housing has been a bright spot over the past year, with more resilience than we had expected: prices fell by *only* 10-15% in Canada and about 5% the United States. The long-term relationship between mortgage rates and housing prices is still pointing toward more weakness, but there are reasons for optimism, especially in Canada, where massive demographic growth from immigration is most likely putting a floor underneath the demand for housing.

Canada: Population Growth Rate

Statistics Canada, % change YoY, as at 2023 Q1



But maybe the explanation for the limited drawdown in housing prices despite the size and speed of the monetary tightening cycle lies in short-term market dynamics. More precisely, the jump in mortgage rates has been swift: in Canada, the 5-year fixed mortgage rate is 5.75% while in the United States, the 30-year fixed rate is about 7%. Households locked into mortgages with significantly lower rates have virtually no incentive to sell, and prospective buyers are deterred by elevated mortgage rates.

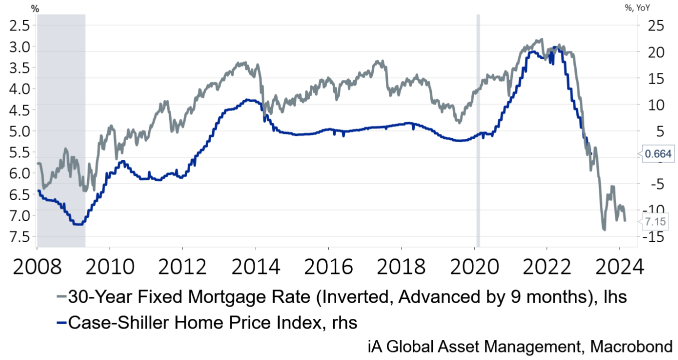
U.S.: 30-Year Fixed Rate Mortgage

Freddie Mac, as of 5/29/2023

Price discovery is happening slowly; therefore, housing, which is a significant store of wealth for most households, has kept its value. Aggregate wealth being an important determinant in consumption patterns, housing has contributed to resilient consumer spending.

U.S.: Headwinds for the Housing Market

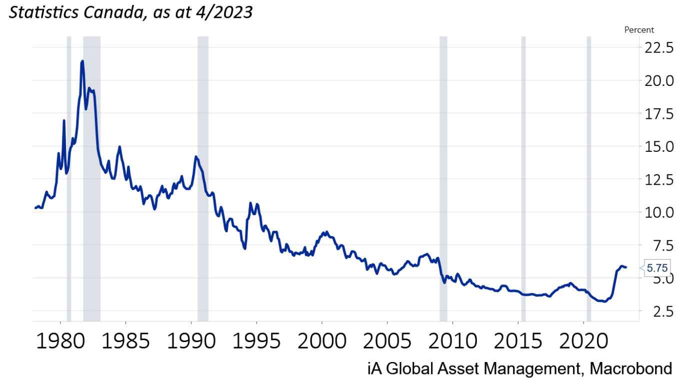
Bankrate, as of March 2023



For the economy to avoid a hard landing, housing must continue to support household wealth. This outcome seems unlikely, however, given the massive interest rate hikes since early in 2022 and the historic rise in mortgage rates on both sides of the border.

Canada: 5-Year Mortgage Rate

Statistics Canada, as at 4/2023



Can housing support consumption over the coming 2 years? Let's say history does not support this hypothesis, but the recent resilience of the North American market leads us to keep an open mind on potential surprises. Leaning toward pessimism, we think the likelihood of housing being supportive is low in the U.S. but medium in Canada.

Consumer confidence

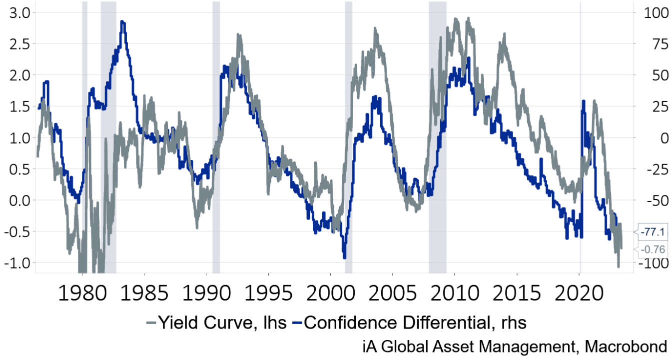
To close the arguments about consumption, we look at consumer confidence as the last piece of the puzzle.

Recent surveys show that the strength of the labour market is making households upbeat about their current situation but less so about the future.

U.S. consumers, in particular, show a widening gap between their views on the current situation and their expectations, which is in fact a pretty efficient leading indicator of recessions (and behaves similarly to the market's take on recession odds, through the slope of the yield curve).

U.S.: Yield Curve vs Consumer Confidence

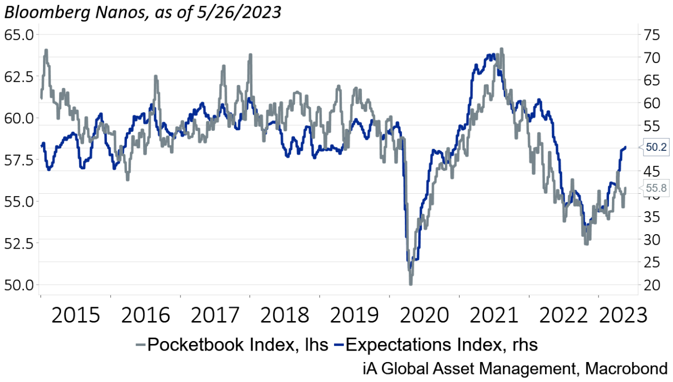
Conference Board Survey, Expectations Less Present Situation vs 10Yr-2Yr



The Canadian situation is in fact more supportive, as the recent opinion of households about their future has been steadily rebounding over the past 6 months, while the Pocketbook index about the current situation has been stable. The net result still indicates households are being careful about the future, but the gap is shrinking.

Canada: Consumer Confidence Index

Bloomberg Nanos, as of 5/26/2023



Overall, we would say that consumer confidence could cause upside surprises in Canada over the coming 2 years, but the U.S. confidence gap is firmly in recession territory now. Absent a quick change of mood, we think the odds of consumer confidence supporting growth are low in the U.S. and medium in Canada.

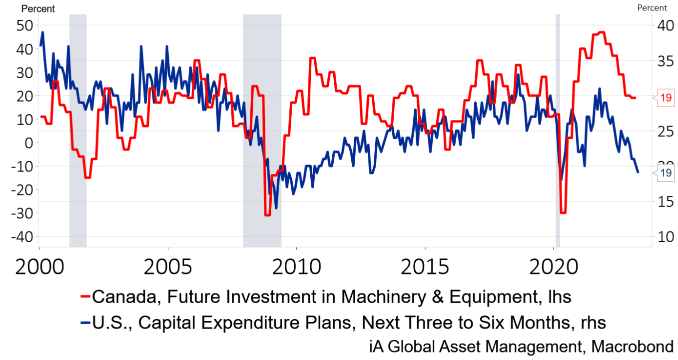
Business investment

We now turn to business investment, the most pro-cyclical and forward-looking component of growth.

As the outlook for business conditions evolves, so does investment. According to the NFIB survey in the U.S. and the Bank of Canada' Business Outlook Survey, the prospects for future investments have been on a downward trajectory since the beginning of 2022, as expectations for future growth and sales have declined.

Investment Expectations

National Federation of Independent Business, Bank of Canada, as of 4/2023



The pronounced declines do not bode well for investment over the next few quarters.

For businesses to turn more optimistic about their investment prospects, we would need to see marked upward revisions in the surveys, combined with upwardly revised forecasts for global growth.

The one wild card is government support for energy-transition investments, namely the Inflation Reduction Act in the U.S. and the equivalent programs announced in the federal and provincial budgets in Canada in recent months. If these programs gain traction and create investment momentum, we could see moderate support from capital spending in the next 24 months.

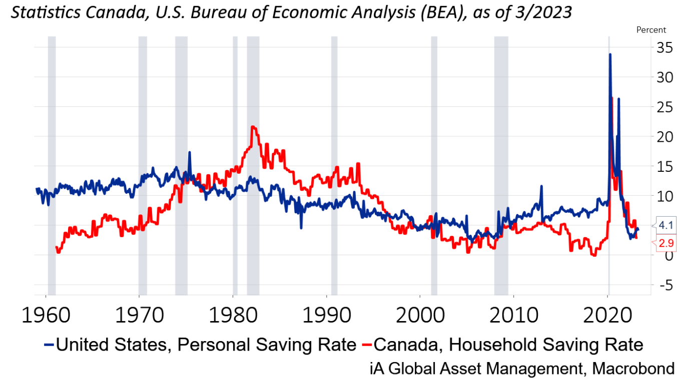
Overall, we would put the odds that business investment spending supports GDP growth over the coming 24 months at medium.

Labour market

The labour market plays a key role in the odds of a no-landing scenario over the next 24 month, and to say that the labour market is tight is an understatement.

Personal Savings Rate

Statistics Canada, U.S. Bureau of Economic Analysis (BEA), as of 3/2023



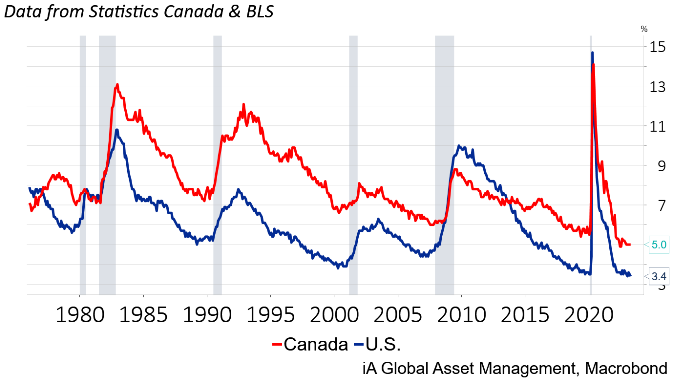
In the United States and Canada alike, the unemployment rates are at record lows. The remarkable tightness of the labour market can be explained from both secular and cyclical standpoints.

The secular explanation is that the population is aging and, therefore, the pool of workers is shrinking, bar immigration.

The cyclical component relates to the resilient consumer, with households still sitting on excess savings. The combination of pent-up demand and some labour hoarding by businesses has maintained a strong labour market so far.

Unemployment Rate: Canada vs U.S.

Data from Statistics Canada & BLS

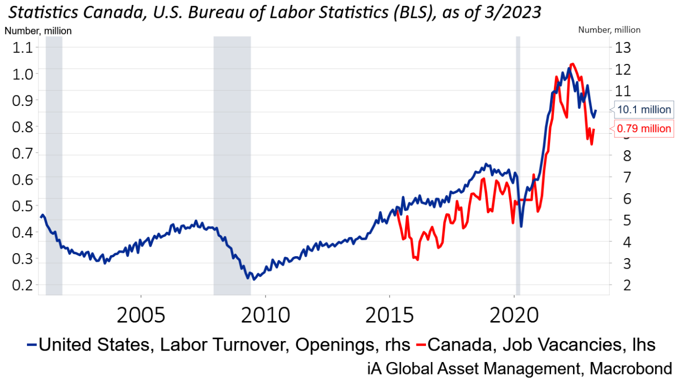


A tight labour market is a prerequisite for a soft landing. The economy can tolerate low growth rates as long as the labour market stays healthy, unemployment remains low and consumers remain mostly unaffected.

Unemployment is still low but other gauges of labour market health seem to be showing signs of weakness. Job openings in the United States and Canada are beginning to decline, suggesting we could be heading toward a softer labour market in the coming quarters.

Jobs openings

Statistics Canada, U.S. Bureau of Labor Statistics (BLS), as of 3/2023



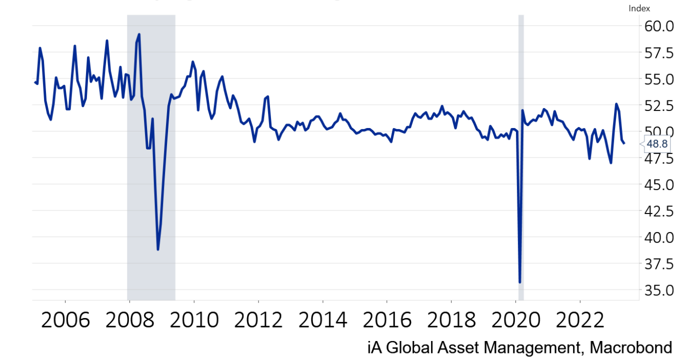
Overall, even though the labour market is a clear source of resilience and could remain strong enough to support growth in the next 24 months, indicators continue to point to a loss of momentum in the coming year. Labour shortages remain a crucial theme, and we estimate as medium the odds that we will be surprised by a still-resilient labour market over the next 2 years.

China

What about China? Its post-COVID reopening has been a disappointment so far. Tighter controls over credit creation coupled with lower-than-expected global demand for manufactured goods have led to underwhelming growth. In April 2023, China's official manufacturing PMI dipped below the no-growth threshold of 50.

China: Official Manufacturing PMI

China Federation of Logistics & Purchasing, as at 5/2023



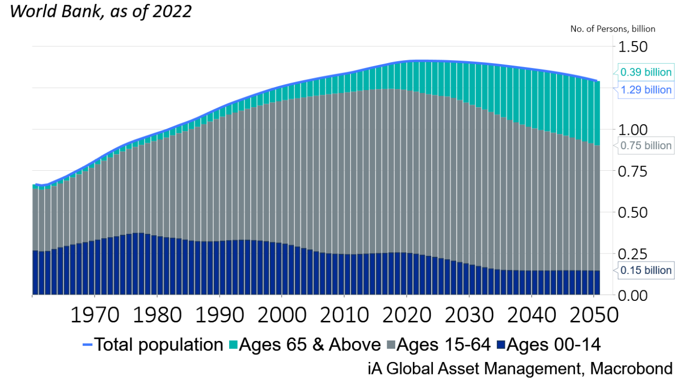
Taking the long view, we see that China has entered a new phase of its demographic transition, as shown by the World Bank forecast below.

China's population is expected to decrease in the coming years amid a combination of factors, including an aging population, a declining birth rate and a shrinking workforce. The country's one-child policy, introduced in the 1970s to control population growth, has had a lasting impact on its demographics. As a result, the proportion of elderly citizens is growing, while the number of working-age adults is declining. This situation could have significant economic and social implications for the country. In fact, it is already acting as a headwind to China's growth, which is forecast to slow in the coming years.

While the global economy has many moving pieces, China is facing its own deleveraging process, which could limit its ability to pick up the pace over the next 2 years. But we never underestimate China and, therefore, place the odds of a positive surprise at medium.

Chinese Population Forecasts

World Bank, as of 2022



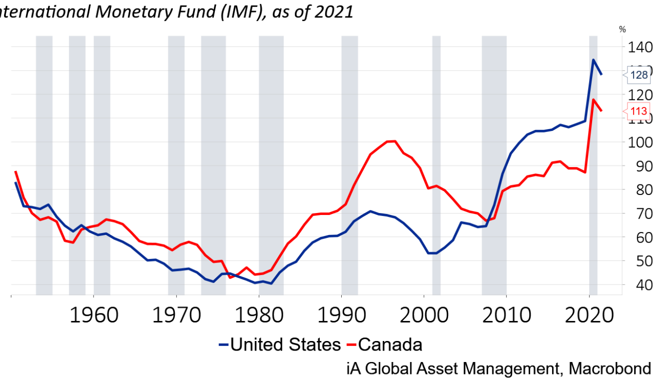
Fiscal stimulus

Finally, could governments provide salvation in the form of renewed fiscal stimulus? We think this outcome is highly unlikely for three reasons.

First, total public debt as a percentage of GDP in the United States, Canada, the United Kingdom and France is already sitting above 100%, limiting their ability to borrow massively in the coming years.

Gross Government Debt as a % of GDP

International Monetary Fund (IMF), as of 2021



The second reason is that it is has become more costly for governments to borrow. Gone are the days when governments could finance their borrowing at almost 0% interest. Any additional debt would cause a significant increase in debt-service costs.

The third reason is that any fiscal stimulus would have an inflationary impact. Even though price stability is not directly the purview of central governments, policymakers will most likely try to avoid stimulating inflation at the same time as central bankers are hard at work fighting it.

With the recent natural experiment that cost Liz Truss her job as U.K. Prime Minister still fresh in our memory, and with the recent debt ceiling negotiations pointing to a reduced spending path in the United States, we think it's quite unlikely that Canada or the U.S. will use the fiscal tool to jump-start growth by mid-2025.

So, about that no-landing scenario by 2025…

Our thought experiment brings us to the following table.

According to the table, the odds that Canada will avoid a recession in the next 24 months are medium, whereas for the U.S. the odds are low to medium at best.

	What should happen to achieve a soft landing?	*Likelihood for the United States*	*Likelihood for Canada*
Monetary policy	Central banks swiftly return to cuts in the absence of a recession.	Low	Low
Credit	Credit conditions ease and demand for loans increases.	Low	Low
Housing	Housing prices remain resilient and continue to create a positive wealth effect for households.	Low	Medium
Consumer confidence	Consumer confidence surprises to the upside, supporting household spending.	Low	Medium
Business investment	Businesses turn more optimistic and increase their investment spending.	Medium	Medium
Labour market	Unemployment remains low, shielding households from a negative wealth effect.	Medium	Medium
China	China's economic growth picks up.	Medium	Medium
Fiscal stimulus	Governments stimulate growth with another round of fiscal stimulus.	Low	Low

Bottom Line

Equities

We haven't changed our overall positioning since last month; we continue to favour fixed income and money market securities over equities.

As in recent months, the valuation gap between the U.S. indexes and the rest of the world remains sizable; given our prudent view on equities, we remain underweight the U.S. stock market exclusively. The debt ceiling crisis did nothing to change our view on U.S. equities.

Looking at current short-term interest rates, we ask ourselves what an investor would need to expect in terms of returns in the coming 12 months to consider holding an overweight position on the S&P/500? This is a crucial question. With the federal funds rate sitting at 5.25% and the potential for further hikes, we assume that one would expect a return of at least 10% on Wall Street to take on equity risk when money markets offer 5%+ returns with absolutely no risk.

Looking at current valuations, we see that the S&P 500 is trading at 18.3 times expected earnings, which is above the 79th-percentile reading on a historical basis. In other words, Wall Street is trading at more expensive multiples than 80% of its historical observations. With this situation happening at the end of one of the most massive tightening cycles in history, there's room for skepticism.

Index	As of May 31, 2023 Current NTM Fwd P/E	Current historical percentile	Available history
NASDAQ	26.0	83	2001-
Russell 2000	20.8	54	1995-
S&P 500	18.3	79	1990-
Nikkei 225	17.2	63	2005-
MSCI ACWI	15.5	65	2001-
S&P/TSX	13.0	16	2001-
S&P/TSX Small Cap	12.9	6	2002-
MSCI EM Ex-China	12.7	67	2020-
MSCI EAFE	12.5	30	2005-
MSCI ACWI Ex-U.S.	12.2	37	2005-
MSCI Europe	12.1	36	2005-
MSCI EM	11.8	31	2005-
MSCI China	9.5	25	2005-

Turning to expected earnings growth, we note that the consensus forecast for 2023 is for earnings per share (EPS) of $222 on the S&P 500, right in line with the 2022 EPS, meaning 0% growth. Consensus EPS expectations for 2024 are $246, meaning 11% growth over the calendar year.

Our leading indicators paint a much dimmer picture, with the ISM pointing to a 5-10% contraction of EPS growth on a year-over-year basis in the coming 6 months, suggesting downside risk to the consensus forecasts.

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S&P 500: Earnings Growth vs ISM Manufacturing

6 month lead on ISM, as at 5/31/2023

Fixed income

We maintained an overweight position in sovereign, long-duration bonds during the month along with an underweight in high-yield corporate credit.

With 10-year sovereign interest rates sitting at their highest levels in more than 10 years, bonds are again a viable alternative to equities. Even though the "there is no alternative" (TINA) concept was omnipresent in the past decade, it now makes ample sense to hold a more balanced portfolio, with the fixed-income portion offering attractive returns, instead of mostly diversification benefits.

Interest rates are obviously a reflection of a few factors: expectations of GDP growth, inflation and the behaviour of central banks. Looking at market expectations for these three components, we can make a case for bonds, specifically long-duration sovereign bonds.

Turning to inflation expectations, even though the fight is far from over, we still see risks that price pressures will continue into 2024. Even so, the consensus forecast is pointing toward a return to target for inflation, which could lead to a central bank pivot at some point in 2024 and, thus, to lower rates along the front end of the yield curve (leading to capital gains).

Commodities and FX

The U.S. dollar has played its role as a safe haven over the past month and has appreciated by 2.7%. This strength could be short-lived, however, if the markets are right and the Federal Reserve lowers its interest rates more than other central banks by 2025, which could lead to a significant decline in the dollar. Meanwhile, emerging market currencies, particularly the high-yielding currencies of Latin America and emerging Europe, are poised for continued strength.

Copper prices have fallen by about 10% over the past month on fears concerning global growth and Chinese demand, wiping out all the gains since the Chinese reopening.

Bloomberg Commodity Spot Index

As at 5/31/2023

iA Global Asset Management, Macrobond

Destocking, in combination with better-than-expected production in Peru, seems to be putting further downward pressure on prices.

Copper Price

London Metal Exchange (LME), USD, as at 5/31/2023

iA Global Asset Management, Macrobond

Turning to gold, which has long been considered a reliable store of value. We tend to rather see gold as an interesting, while opportune choice for investors looking to diversify their portfolios and reduce overall risk.

Gold Price

New York, USD, as at 5/31/2023

iA Global Asset Management, Macrobond

One of the reasons why we're still gun-shy is that the entry point is not favourable given the cyclicality of gold, the recent rise in real rates, as well as the potential resolution of the debt ceiling talks, which could lead to further weakness (prices have already fallen from $2,050 to as low as $1,940 on U.S. debt ceiling progress).

Market Performance

(Total return, in local currency)

As of May 31, 2023	MTD%	QTD%	YTD%	Δ1Y%
Equity				
S&P 500	0.4%	2.0%	9.6%	2.9%
S&P/TSX	-4.9%	-2.2%	2.3%	-2.5%
NASDAQ	7.6%	8.1%	30.3%	12.8%
MSCI World	-0.2%	1.4%	8.9%	3.2%
MSCI EAFE	-1.6%	0.7%	8.2%	6.2%
MSCI EM	-1.0%	-1.6%	2.1%	-4.3%
Commodities				
Gold	-1.4%	-0.3%	7.6%	6.8%
CRB	-1.1%	-1.7%	-2.4%	-14.0%
WTI	-11.3%	-10.0%	-15.2%	-40.6%
Fixed Income				
FTSE Canada Universe Bond	-1.7%	-0.7%	2.5%	0.9%
FTSE Canada Long Term Bor	-2.4%	-0.4%	4.3%	0.2%
FTSE Canada Corporate Bon	-1.4%	0.0%	2.8%	2.4%
Currency				
DXY	2.6%	1.8%	0.8%	2.5%
USDCAD	0.2%	0.4%	0.1%	7.3%
USDEUR	3.1%	1.4%	0.1%	0.4%
USDJPY	2.2%	4.9%	6.3%	8.3%
USDGBP	1.0%	-0.8%	-2.9%	1.3%

As of May 31, 2023	MTD%	QTD%	YTD%	Δ1Y%
S&P/TSX Sectors				
Financials	-5.2%	-2.1%	-0.5%	-7.3%
Energy	-8.0%	-3.8%	-6.0%	-14.5%
Industrials	-3.1%	-2.6%	3.8%	14.8%
Materials	-10.5%	-7.6%	-0.1%	-5.6%
Information Technology	10.1%	11.7%	41.4%	37.9%
Utilities	-1.6%	0.8%	7.6%	-7.7%
Communication Services	-7.0%	-0.3%	2.6%	-7.3%
Consumer Staples	-5.3%	-4.1%	3.5%	8.7%
Consumer Discretionary	-3.8%	-2.5%	2.0%	8.7%
Real Estate	-4.6%	-3.5%	2.1%	-7.8%
Health Care	-3.0%	2.5%	3.4%	-29.4%
S&P 500 Sectors				
Information Technology	9.3%	9.7%	33.3%	18.1%
Health Care	-4.4%	-1.6%	-6.3%	-3.4%
Consumer Discretionary	3.1%	2.1%	18.2%	-1.8%
Financials	-4.5%	-1.6%	-7.6%	-10.5%
Communication Services	6.2%	10.0%	32.2%	4.5%
Industrials	-3.5%	-4.6%	-1.7%	2.3%
Consumer Staples	-6.2%	-3.0%	-2.8%	-2.0%
Energy	-10.6%	-7.8%	-12.9%	-11.0%
Utilities	-6.4%	-4.7%	-8.5%	-12.7%
Real Estate	-4.6%	-3.8%	-2.8%	-18.3%
Materials	-7.1%	-7.3%	-3.8%	-12.6%

12-month market scenarios (as of June 2023)

Baseline (50%)	The North American labour market is more resilient than expected, and the resulting wealth effect may be enough to help the macro landscape avoid a recession in 2023. That being said, the recent turmoil in banks shows that the massive liquidity injections from 2020 to 2022 are creating issues for banks, as deposits flee, causing an interest rate mismatch on their balance sheets. Banks tighten their lending standards, and the credit cycle slows abruptly. This context is raising recession risks for 2023, making the risks more balanced than expected last month. Global inflation remains more persistent than market participants currently expect. Base effects should bring annual inflation to between 3 and 4% by mid-year, before we see a slight reacceleration in the second half. The Fed and the ECB think their work isn't done and continue to tighten in the first half of 2023. The Bank of Canada stays on the sidelines, as the risks to the financial system lead to tighter lending conditions. The first rate cuts by central banks do not come until 2024, when inflation finally gives evidence of being tamed. The housing slowdown caused by the accumulation of higher rates creates a negative wealth effect, keeping the global economy relatively soft. Unemployment rates rise slightly in the second half of 2023, when the full impact of the 2022 rate hikes is felt. China's reopening gives some support to global growth but does not change the overall trajectory. The war in Ukraine, global droughts and high fertilizer prices continue to put upward pressure on food prices. The bear market in equities continues to its resolution in the form of a capitulation event, with a likely bottom in 2023. Sovereign yield curves remain inverted for most of the year. Long rates have risen substantially and present an interesting value proposition, given the growth and monetary policy outlook. **Overweight duration and U.S. dollar, underweight equities.**
Bearish: sticky inflation and banking turmoil (25%)	Sticky inflation remains above central bank targets, and key rates are hiked higher and faster than the market currently expects. Elevated short rates drive money out of bank deposits and into money market funds, pressuring bank balance sheets and causing more turmoil for U.S. banks. Canadian banks remain in good shape and do not face such hurdles. Central banks keep their key rates at the terminal level well into 2024 and use other programs, such as the Bank Term Funding Program (BTFP) and their discount window, to provide liquidity and to avoid bank runs. The economy slows significantly in the second half of the year, leading to a more material deterioration in employment. The recession is deeper in Europe and, with fiscal space being limited, governments have less room to stimulate the economy. The bear market continues, but drawdowns are larger. The absolute low for equities moves to 2024. The bond bear market is prolonged as market participants are forced to reprice bonds in the wake of higher terminal rates. **Underweight equities, duration and fixed income. Overweight cash and U.S. dollar.**
Bullish: falling inflation and pivot (10%)	Inflation returns to target more quickly than expected, allowing central banks to start easing in the second half of 2023. The pressure on banks subsides, and bank failures are limited to specific cases in the United States. Less monetary tightening is necessary over all, and terminal rates are slightly lower than currently expected. Most advanced economies avoid a recession. Energy prices are supported by strong demand. Base metal prices enter a new super cycle, given their role in the energy transition. The stock and bond markets rebound as a recession is avoided. **Overweight equities, base metals and bonds. Underweight cash and U.S. dollar.**
Other (15%)	Banking crisis Escalation or resolution of the conflict in Ukraine. Escalation of tensions between China and the United States. Faster-than-expected global economic slowdown.

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.

Rooted in history, innovating for the future.
