GLOBAL ASSET ALLOCATION PERSPECTIVES & INVESTMENT BACKDROP

FOURTH QUARTER 2024 PREVIEW

Dynamic Funds®
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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 third quarter, the Federal Reserve cut interest rates by 0.50%, the first reduction of this cycle, due to easing inflation and rising unemployment. The Bank of Canada also reduced its policy rate by 50 bps to 4.25% in the quarter. The quarter also saw easing from the European Central Bank, which cut rates to 3.5%, and the Bank of England, which also started its easing cycle after four years.

Despite some volatility, including a brief sell-off in early August, the Canadian and U.S. fixed income markets had strong quarters, while global bonds also benefited from U.S. dollar weakening and the expectation of a potential U.S. soft landing.

The Canadian bond market, represented by the FTSE Canada Universe Bond Index, saw strong returns, nearly recovering from the 2022 drawdown, with the market pricing in more interest rate cuts. Both high-yield and investment-grade corporate bonds posted gains. U.S. bonds also gained, supported by the Fed's easing. The yield curve reversed its inversion after nearly 800 days. In corporate bond market, credit spreads sold off mid-quarter, then rallied to tighter levels by quarter's end, indicating improved credit conditions.

EQUITY

U.S. stocks rose by 4.5% (C$), with gains extending beyond mega-cap tech and AI-focused stocks. The Utilities sector led with a 17% gain (C$), followed by Real Estate at 14.9% (C$). The U.S. outlook remains cautiously optimistic, with markets anticipating a soft landing as easing extends into 2025.

Canadian stocks performed well and outpaced the U.S. this quarter, with the S&P/TSX Composite Index gaining 10.55% (C$), driven by Real Estate (21.9%), Health Care and Financials (15.8%) sectors. Global stocks followed a similar trend, with the MSCI World Index up 5.1% (C$), and value stocks outperforming growth stocks, reflecting a shift in sentiment. Chinese markets rallied towards the end of the quarter, contributing to a more optimistic global outlook.

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

Global growth will be lower than the average of recent years, as higher debt levels and worsening demographics will weigh on growth. We currently do not expect a deep or prolonged contraction, as the backdrop for businesses and consumers remains fairly strong. US economic revisions imply a stronger consumer and lower risk of recession, as confirmed by stronger expected Q3 GDP growth. Chinese stimulus in response to below target growth could lead to upward revisions in growth forecasts for the next 12-18 months.

BUSINESS CYCLE

Global Purchasing Managers' Indices "PMIs" weakened out as expected, but point to a divergence in outcomes and not recession at this stage. U.S. PMI has been more resilient than expected backed by the strength of consumer and still low unemployment. Eurozone PMI is likely bottoming but is expected to stay at a low level due to manufacturing weakness. China's PMIs have been stable, but the outlook is mixed amidst housing and deflation concerns.

MONETARY POLICY

Overall, the stance is dovish, but central banks are constrained by still-elevated inflation in many regions. 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

Easing supply challenges and weakening demand have helped to bring inflation lower. Still tight labor markets, particularly in the US, are keeping wages elevated. It will take either more time or a sharper slowdown in the global economy to bring inflation more confidently to low and sustainable levels.

CURRENCIES

We maintain a balanced stance of both cyclical and safe-haven currencies, with a modest bias towards high carry EM currencies at this stage. Safe-haven currencies will benefit from either an unexpected downturn in global economic growth or normalization of monetary policy. Cyclical currencies could benefit from lower valuation or higher carry supported by strong domestic.

COMMODITIES

Commodity prices have been supported by relatively stable demand globally and tighter supply. Precious metals prices have seen significant gains, partially driven by geopolitical tensions. Anticipated below trend growth in global economy will prevent significantly higher prices the remainder of the year, including oil.

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 Cuts: Impact on Bonds and Yields

Bank of Canada Continues Cutting Cycle : Interest rate cut by additional 25 basis points in July, and September after starting cuts in second quarter.

Yield Curve Adjustment: Yield curve flattened and dis-inverted by the quarter's end.

Short-End Yield Drops: 3-month (-44 bps), 6-month (-81 bps), 1-year (-109 bps), 2-year (-108 bps).

Long-End Yield Decreases: 10-year (-55 bps), 30-year (-25 bps).

Narrowing Yield Spread: 2-year and 10-year spread narrowed from -49 bps to +4.

10-Year Bond Yield: Fell from 3.5% in June to 2.9% in September.

Bond Market Gains: Canadian government bonds had a strong quarter gaining +4.7% in Q3, with corporates posting similar gains across all segments.

Sector Performance: Infrastructure led with a +5.5% increase in the quarter, followed by Energy (+5.3%) and Communication (+5.1%)

Corporate Remains Tight: Credit spreads sold off mid-quarter, then rallied to tighter levels by quarter's end.

EQUITY FUNDAMENTALS

S&P/TSX Composite Index Soars: A Sector-Wide Rally

Impressive Gains: The S&P/TSX Composite Index surged by +10.5% in Q3, with all eleven sectors in the green.

Sector Leaders: Real Estate: +21.9%, Healthcare: +15.8%, Financials: +15.8%, Materials: +11.7%, driven by precious metals like silver and gold.

Modest Returns: Energy and Industrials posted the smallest returns.

Style and Strategy Performance: Value and small caps outperformed growth. Dividend strategies excelled, with the S&P/TSX High Dividend gaining +11.6%.

Economic Outlook: Canada's unemployment rate increased to 6.6% as of August 2024, reflecting slow job growth in the Canadian economy. Market is pricing in expectations for continued interest rate cuts by the BoC to ease pressure on Canadian households.

United States

FIXED INCOME ENVIRONMENT

Federal Reserve Eases, Market Responds Positively

Rate Cut Initiation: Federal Reserve cut rates by 50 bps in September, starting the long-anticipated easing cycle.

Chair Powell's Confidence: Moving away from restrictive policy thanks to inflation moving towards long-term target and now moving focus to the slowing labor market.

Bond Market Performance: Yield curve reverses its inversion after nearly 800 days, longest inversion in history.

Yield Drops: Significant drops in short-mid end yields: 6-months (-92 bps), 2-year (-111 bps), 5-year (-82 bps).

Credit and High Yield Strength: Investment grade credit spreads widened slightly. Following strong performance in previous quarters, high yield slightly outperformed the broad US Aggregate Index, returning +5.3% as measured by the Barclays US Corporate HY.

Aggregate Index Performance: Barclays US Aggregate Index increased by +5.2% during the quarter.

EQUITY FUNDAMENTALS

S&P 500's Spectacular Run

Steady Climb: S&P 500 has risen in seven of the last eight quarters, with four consecutive quarters in the green and the third quarter returning +4.5%.

Broadening Returns: After months of outperformance from growth, U.S. value stocks outperformed small-cap stocks rallied in anticipation of lower interest rates. Healthy rotation into previously underperforming sectors in Q3.

Yearly Achievement: S&P 500 delivered a total return of +36.2% over the past year, a rare feat achieved only twice in the last 20 years.

Historic Gains: Best year-to-date gain through three quarters since 1997 by the end of Q3.

Leading Indices: S&P 500 Equal Weight Index led its capped counterpart, providing another indicator that market breadth is widening beyond just the Magnificent 7 stocks.

REGIONAL BACKDROP (CONT'D)

International

FIXED INCOME ENVIRONMENT

Global Government Bonds on the Rise

Solid Gains: Global government bonds gained +7.0% in Q3, per the Barclays Global Aggregate Index.

ECB Moves: European Central Bank delivered a second rate cut in September, reducing interest rates to 3.5%.

Europe Economic Slowdown: Activity indicators suggested a slowdown in the eurozone economy. PMI Low: HCOB flash eurozone PMI for September hit an eight-month low of 48.9.

European Inflation Trends: Annual inflation softened from 2.6% in July to 1.8% in September.

Bank of England (BoE) Action: BoE cut rates by 25 bps in August, the first reduction in four years.

Governor's Caution: BoE Governor Andrew Bailey committed to cautious further interest rate cuts.

EQUITY FUNDAMENTALS

Global Equity Markets Shine Amid Volatility

Overall Performance: Strong Q3 performance despite short-lived volatility from economic recovery concerns, geopolitical events, and Bank of Japan's moves.

MSCI World Index[1]: Global equities delivered a 5.0% return.

Regional returns: MSCI EAFE Posted a +5.9% increase, maintaining double-digit year-to-date gains while MSCI Europe Index gained +5.2% amid easing monetary policies.

Dividend-Oriented Stocks: Drove positive momentum, the MSCI World High Dividend posted a +8.8% gain in the quarter.

Value and Small-Caps Surge: MSCI World Value Index up +8.2% outpacing the MSCI World Growth Index posting gains of +2.2%, showing investor shift to value and small-caps.

Standout Performer: MSCI Asia Pacific ex-Japan Index soared +by 10.1%, despite early August volatility.

Emerging Markets

FIXED INCOME ENVIRONMENT

Emerging Markets Bonds: Riding the Wave

Standout Regions: South Africa and Latin America excelled. South Africa gains were fueled by falling inflation and a favorable election outcome. Latin America: Benefited from central banks cutting rates.

Asia Currency Performance: EM currencies performed well, helped by a weaker US dollar and favorable interest rate differentials.

Latin America: Currencies struggled due to the unwinding of the Japanese yen carry trade, driven by the Bank of Japan's rate hike.

US Debt Market: Gained from falling US Treasury yields and a global rally in risk assets. The top Performers were in Latin America: El Salvador, Ecuador, and Argentina posted strong returns, with Argentina's economy showing fiscal improvement.

Boost Factors: Rally in sovereign bond yields and increased confidence in a US soft landing.

High-Yield and IG Bonds: Outperformed due to tightening credit spreads and carry. IG bonds gained from lower US Treasury yields.

EQUITY FUNDAMENTALS

Emerging Markets Equities: A Strong Quarter

Overall Performance: MSCI EM index increased by +7.3%, outperforming the world index.

Large-Cap Outperforming: MSCI EM Large Cap rose by +7.3%, outperforming small caps as measured by the MSCI EM Small which gained 4.1%.

Latin America Recovery: MSCI EM Latin America posted gains of +2.4% after Q2 challenges.

Notable Performances: MSCI China: Achieved a remarkable gain of +21.9% as markets reacted to more stimulus, a weakening U.S. dollar and more share buybacks, MSCI India: Increased by +5.9%, recovering from political uncertainties post-election, MSCI Brazil: Posted a +5.8% gain as political uncertainty diminished, and MSCI Argentina: Posted a +14.3% gain as fiscal discipline pays out for Milei government.

Challenges in Other Markets: The Mexican market ended the quarter in negative territory despite an interest rate cut, due to judicial reform concerns, while Turkey was one of the worst-performers indices in EM markets due to local currency depreciation, weaker-than-expected Q2 earnings, and foreign equity outflows.

[1] Source: MSCI. The MSCI information may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com)

ASSET ALLOCATION POSITIONING

	Outlook	Comments
FIXED INCOME		
Overall Fixed Income	0	Bond yields fell as the market priced in additional rate cut expectations in North America. Despite the decline, starting yields remain elevated, offering further opportunities for capital appreciation as central banks continue to lower key lending rates. In the immediate short term, bond yields will be sensitive to signs of a resilient US economy, as much of the Q3 yield decline was in anticipation of aggressive rate reductions from the US Federal Reserve.
Rates		
Canada and U.S.	0	The US Federal Reserve joined other central banks by executing a "jumbo" 50 bps cut for its key lending rate. The Bank of Canada (BoC) also continued to reduce its key lending rate, with both central banks expected to make further cuts over the next 12 months. Future decisions are widely anticipated and, should the North American economy prove more resilient, bond yields may experience a moderate and temporary increase.
Global	+	Inflation in the Eurozone has continued to decline, and the probability of a significant economic slowdown is very high. We expect the ECB to aggressively cut rates, leading to further declines in European bond yields. The Bank of Japan surprised investors with an increase in their key lending rate; however, this has not changed our view that global rates are heading decisively lower.
Credit		
Investment Grade	+	Investment grade credit spreads remain exceptionally tight as investors capitalize on risk assets and the strong health of corporate balance sheets. We continue to extract value from the extra yield compared to government issues. However, this opportunity is approached with an expectation of modest widening if bond yields fall due to an outsized and unexpected weakening of the global economy.
High-Yield	−	Spreads for high-yield borrowers continue to trade near their lowest levels, even with the lowest credit quality issues tightening. While we do not anticipate a significant economic slowdown, the relative value for high-yield versus investment-grade credit is not favorable in our view.
EQUITIES		
Overall Equities	0	We have a neutral view on equities relative to fixed income due to conflicting economic indicators. While US inflation remains slightly above target, the Federal Reserve has seen enough progress to join the global easing cycle, staying ahead of concerns about rising unemployment. Additionally, Q3 saw surprisingly strong upward revisions in US growth data, leading many analysts to reconsider their forecasts for a 2024 recession. Year-to-date, fast-growing technologies such as cloud, AI, and GLP-1s were strong in the first half, masking weaknesses in other industries. Despite some slowdown in these themes in Q3, other less favored industries are now showing strength.
Region		
Canada	+	We have a neutral-overweight view on Canadian equities. The Bank of Canada is earlier in its rate cut cycle than other major central banks, which should help spur underlying economic growth. From a valuation perspective, Canadian equities are also attractively priced, especially compared to US equities. Finally, given the geopolitical backdrop, Canadian equities could benefit from upward price reactions within energy markets.
U.S.	+	We have an overweight view on US equities. The market continues to see positive momentum as the economy remains surprisingly resilient. Inflation has come down considerably from its peak and is now on track to meet the US Fed's target. This enabled the Fed to kick off an easing cycle with a 50-bps rate cut. Easing monetary policy should further support the economy and markets. Despite stretched valuations, the US equity market benefits from several growth themes, especially advances in artificial intelligence. While these themes drove US equities in the first half of the year, Q3 saw strength spread to other underappreciated sectors like Utilities and Real Estate, which have benefited from lower interest rates.
International	−−	We have a neutral-overweight view on US equities. European equities, which represent the largest portion of international markets, remain less attractive compared to other regions due to structural headwinds affecting global competitiveness, particularly energy insecurity and sensitivity to weakness in China. Cyclical indicators like PMI continued to weaken in the quarter, led by Germany, which faces structural challenges as China shifts from being a key customer to a major competitor, especially in the automotive sector. Outside Europe, we have a neutral stance on Japanese equities as the initial excitement over corporate reforms fades, and a recovering yen could weigh on local equity returns in the near term.
Emerging Markets	0	We have a neutral view on Emerging Market Equities. Recently, we adjusted our stance on Chinese equities from underweight to neutral. China still faces structural challenges related to the property sector adjustment, broad deleveraging by consumers and local governments, and geopolitical tensions with the US. However, a significant shift occurred at the end of the quarter when the central bank announced an ambitious monetary easing framework and new fiscal stimulus, including direct payments to low-income individuals. While the details of the fiscal package are vague, this policy shift indicates a new urgency from the government to improve the economy. Given the uncertainty around fiscal details, lower valuation discounts, and ongoing structural risks, we are not aggressively pursuing Chinese equities and remain neutral. Outside China, in other emerging markets, compelling valuations balance rising political risks, keeping us neutral overall.

Legend: ++ Overweight + Neutral-overweight 0 Neutral - Neutral-underweight - - Underweight

PERFORMANCE – AS AT SEPTEMBER 30, 2024

FIXED INCOME						
BONDS	**3-MTH**	**6-MTH**	**YTD**	**1-YR**	**3-YR CAGR**	**5-YR CAGR**
FTSE Canada Universe Bond C$	4.66%	5.56%	4.27%	12.89%	-0.10%	0.63%
Universe Canada All Corporate C$	4.67%	5.81%	5.88%	13.96%	1.49%	2.11%
Morningstar CAN High-Yield Fixed Inc	4.07%	5.58%	7.66%	13.67%	2.56%	3.62%
BAML U.S. Corporate C$	5.72%	5.85%	5.76%	14.13%	-0.98%	1.29%
BAML U.S. High-Yield Master II C$	5.28%	6.42%	8.03%	15.66%	3.08%	4.55%
Barclays U.S. Agg Bond U$	5.28%	5.34%	4.53%	11.65%	-1.36%	0.35%
Barclays Global Agg U$	7.02%	5.83%	3.63%	12.01%	-3.05%	-0.81%
EQUITIES						
CANADIAN EQUITIES	**3-MTH**	**6-MTH**	**YTD**	**1-YR**	**3-YR CAGR**	**5-YR CAGR**
S&P/TSX Composite C$	10.54%	9.96%	17.24%	26.74%	9.52%	10.95%
U.S. EQUITIES	**3-MTH**	**6-MTH**	**YTD**	**1-YR**	**3-YR CAGR**	**5-YR CAGR**
S&P 500 C$	4.54%	10.23%	25.07%	36.25%	14.34%	16.45%
Dow Jones Industrial Avg C$	7.34%	7.16%	16.73%	28.75%	12.35%	12.23%
NASDAQ C$	1.27%	10.86%	24.14%	37.49%	10.31%	18.33%
GLOBAL EQUITIES	**3-MTH**	**6-MTH**	**YTD**	**1-YR**	**3-YR CAGR**	**5-YR CAGR**
MSCI World C$	5.01%	8.98%	21.77%	32.32%	11.44%	13.50%
MSCI Asia Pacific ex-Japan C$	10.10%	17.45%	22.21%	27.71%	2.75%	6.24%
MSCI Japan C$	4.53%	1.22%	15.47%	21.88%	5.28%	7.97%
MSCI Europe C€	5.28%	7.43%	16.19%	25.90%	9.66%	10.00%
MSCI Emerging Markets C$	7.34%	13.96%	19.73%	25.95%	2.58%	6.18%

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 $120 billion* in multi-asset solutions and strategies. The Team is responsible for portfolio construction, asset allocation policy, and investment strategy research and selection. The Team is also involved in the due diligence and day-to-day management of all portfolio solutions.

*As at December 31, 2023

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