Economic Update & 2022 Outlook

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Speakers

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Nadeem Kassam, MBA, CFA, Head of Investment Strategy

Nadeem has over 10 years of capital market experience, including a wealth of experience supporting the Advisory channel. He previously worked in the Investment Strategy Group at CIBC Wood Gundy, where he co-managed six North American equity-only and balanced strategies with top-quartile performance, helping to grow AUM in the portfolios to over $3 billion in assets. Prior to joining Raymond James, Nadeem was a Senior Equity Research Associate at RBC Capital Markets where he covered Canadian Consumer Staples, Discretionary and Industrial companies. Nadeem is a CFA charterholder and has earned his MBA from the York University Schulich School of Business.

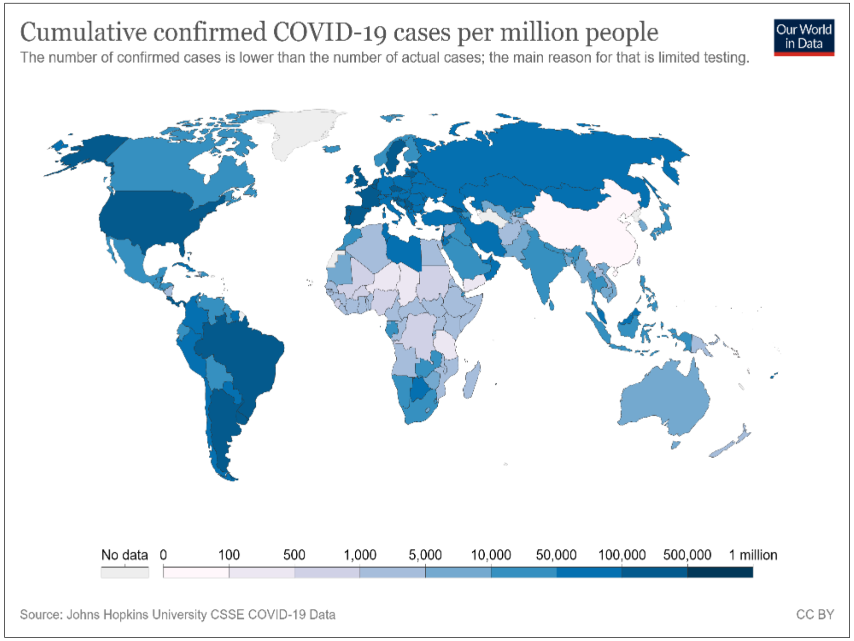
Luiz Furlani, PhD, CFA, Associate Investment Strategist

Luiz has over 10 years of capital market experience working on both the institutional research and buy-side with firms across North and South America. He works closely with the broader Investment Strategy team to deliver industry leading market insights and commentary to assist the firm's clients and advisors with their portfolio solutions. Luiz previously worked with the Canada Pension Plan Investment Board (CPPIB) where he was responsible for generating economic and financial forecasts for several global markets. Prior to joining CPPIB, Luiz worked at Sicredi Asset Management in Brazil as a Portfolio Manager. In this role, Luiz was responsible for the development and management of the firm's fixed income mutual funds (AUM over C$10 billion). In addition to a strong capital markets background, Luiz is a CFA charterholder and has a PhD in Applied Economics.

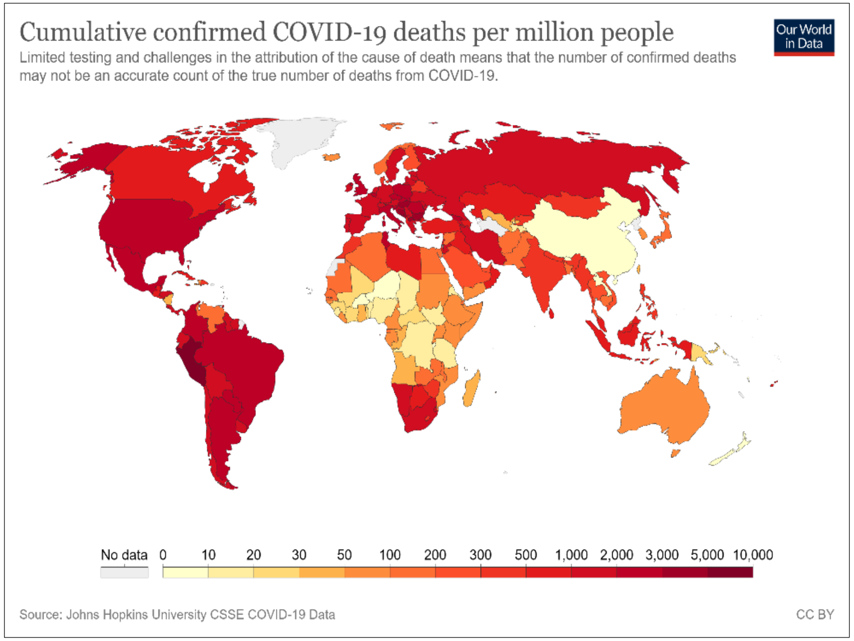
Many firsts over the past year…

A Global Pandemic in 2020

Almost 250 million people were infected by COVID-19 and more than 5 million lives were lost due to the pandemic. Around 40% of confirmed cases and fatalities occurred in the United States, Brazil, and India.



Source: Our World in Data. Data as of November 2021.



Source: Our World in Data. Data as of November 2021.

COVID-19 vs. Past Pandemics

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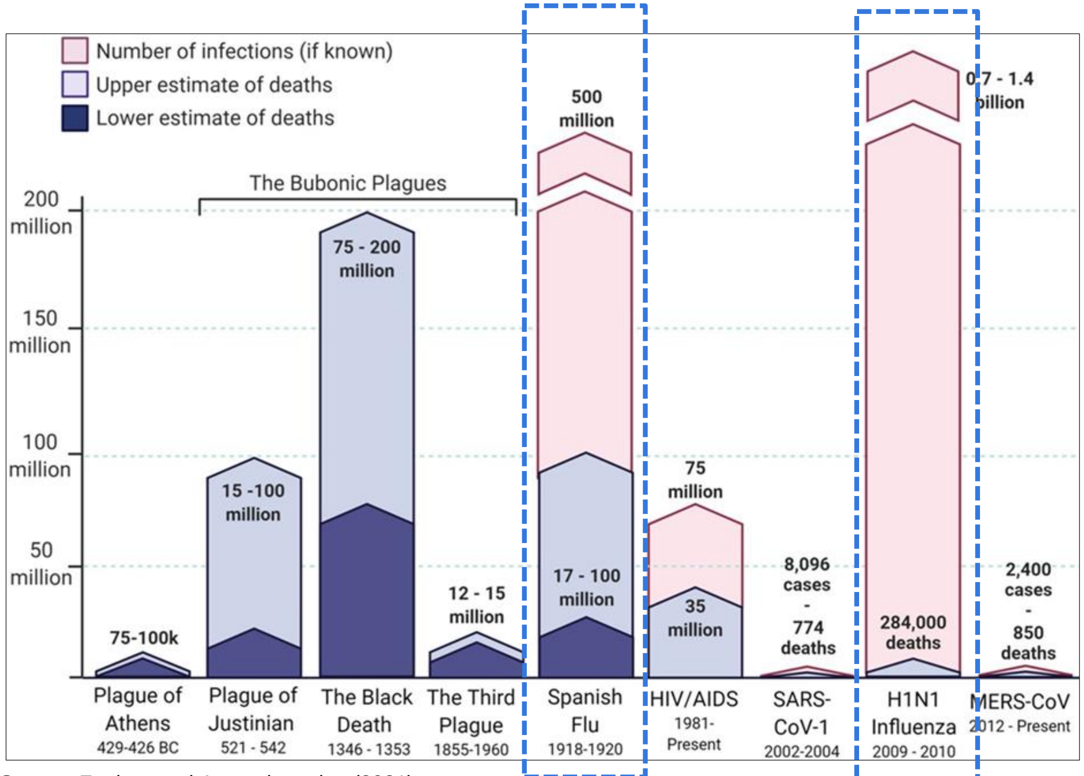
The COVID-19 pandemic was the most severe in recent decades, but not as deadly as other pandemics, e.g. the bubonic plagues or Spanish flu. Possible reasons for that are advances in science, medicine, and substantial investment in the development of vaccines, treatments, and cures.



Source: Feehan and Apostolopoulos (2021)
Available at https://dx.doi.org/10.1016%2Fj.maturitas.2021.02.001

Global Restrictions/Lockdowns

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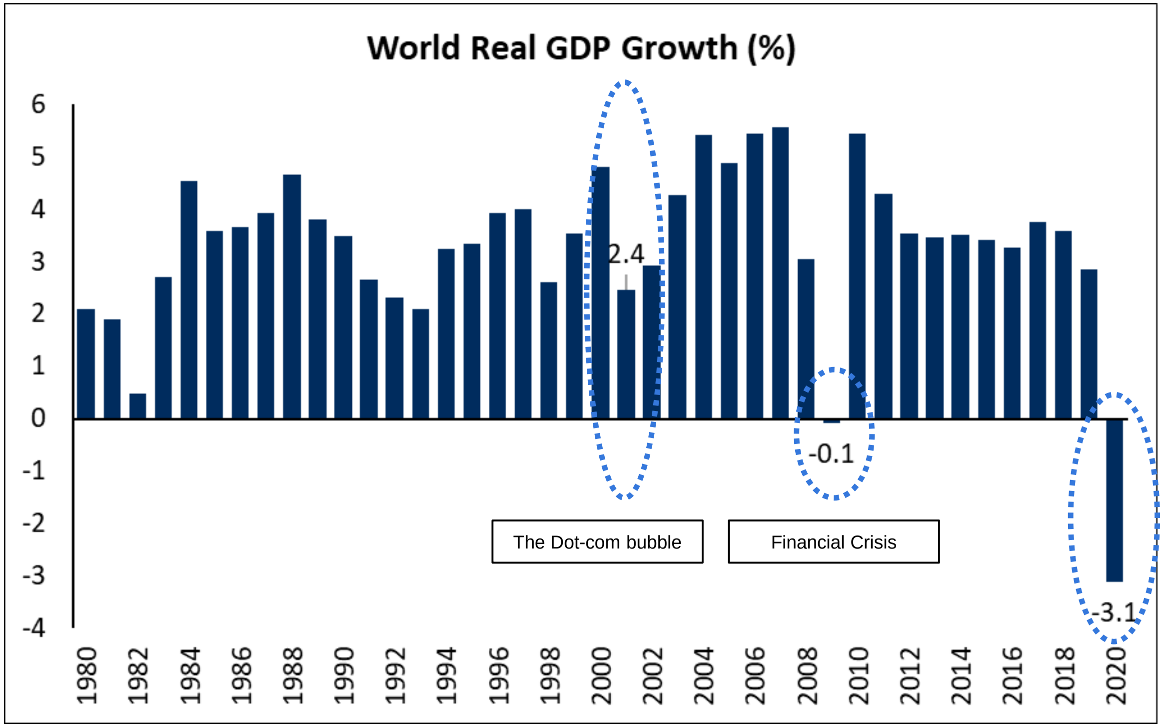
Governments introduced several measures to reduce the spread of the virus, including workplace and school closures, restrictions on public gatherings, travel bans, etc. Lockdowns brought the global economy to a halt.



Source: IMF. Data as of October 2021.

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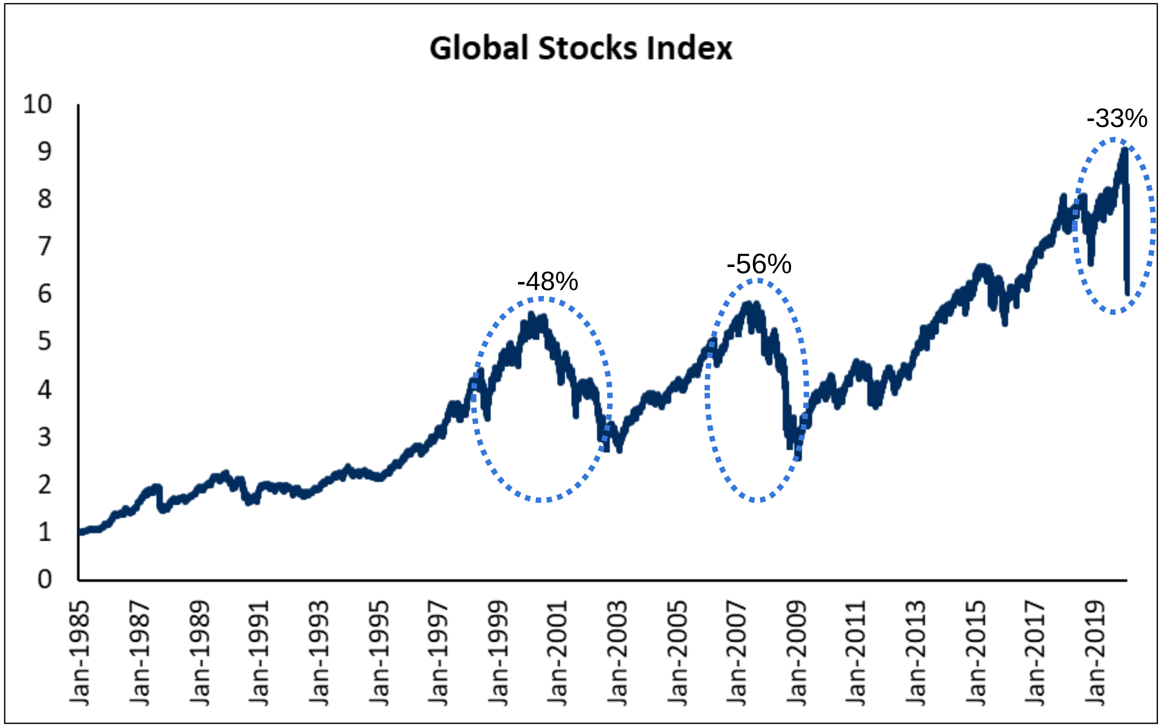
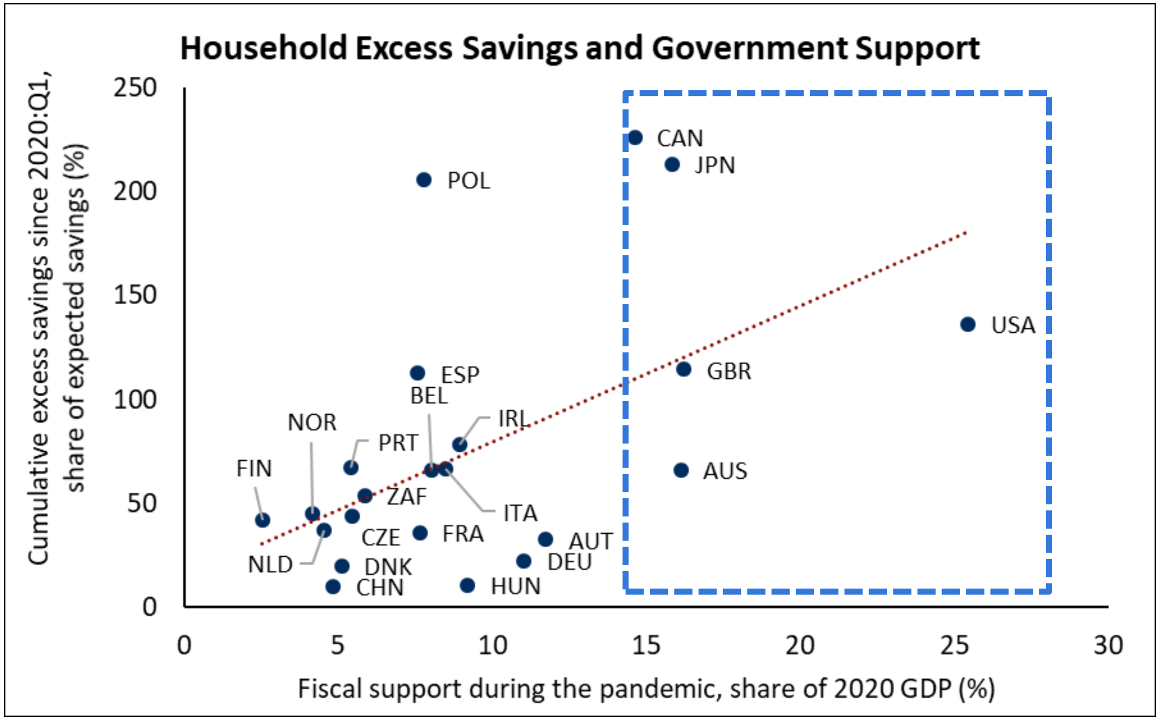
Global Restrictions/Lockdowns



Source: FactSet. Data as of March 2021.

Record Stimulus

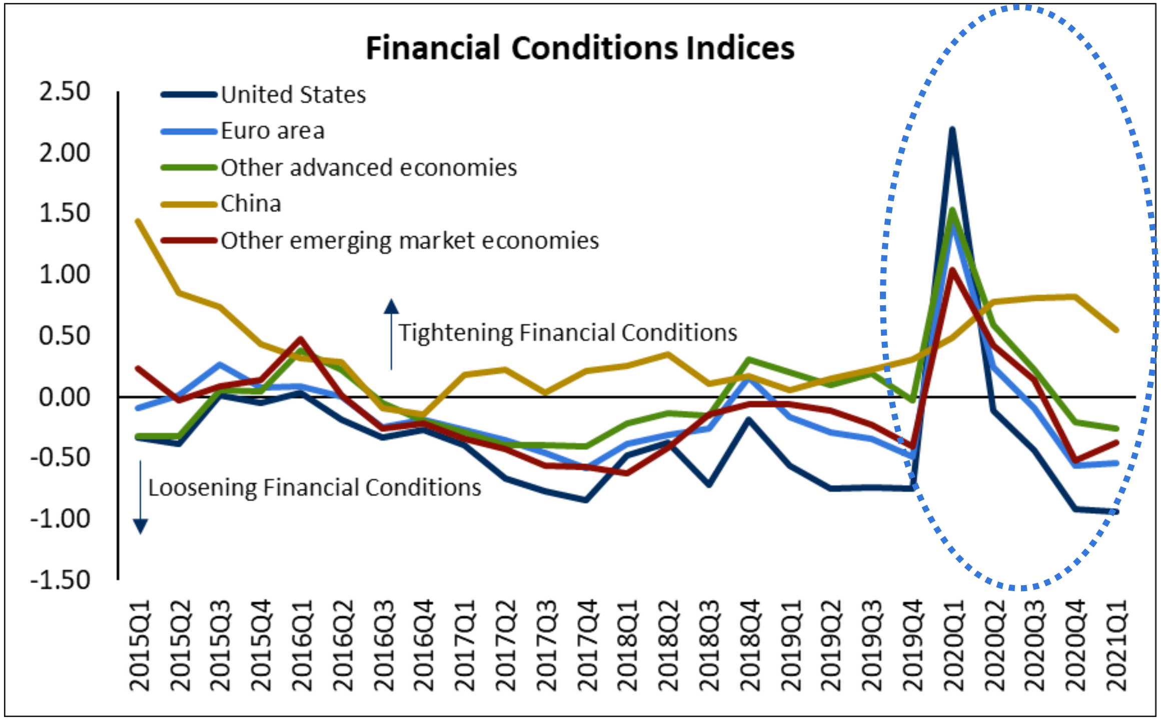
To help offset the worst contraction on record, local authorities added unparalleled level of stimulus, e.g., CARES in the United States, CRB and CEWS in Canada, etc. Due to strict lockdown measures, individuals started to build up excess savings.



Source: IMF. Data as of July 2021.

Record Stimulus

At the same time, central banks reacted strongly by cutting interest rates to record lows, making financial conditions highly accommodative and supportive of global growth.



Source: IMF. Data as of July 2021.

Where are we today…

Wall of Worry…

- COVID-19 – when will it end?
- The Global Economy- reopening/or new lockdowns?
- Market Performance – can this continue?
- Stimulus – is the gravy train over?
- Inflation – are we seeing a repeat of the 70s?

Vaccination Efforts

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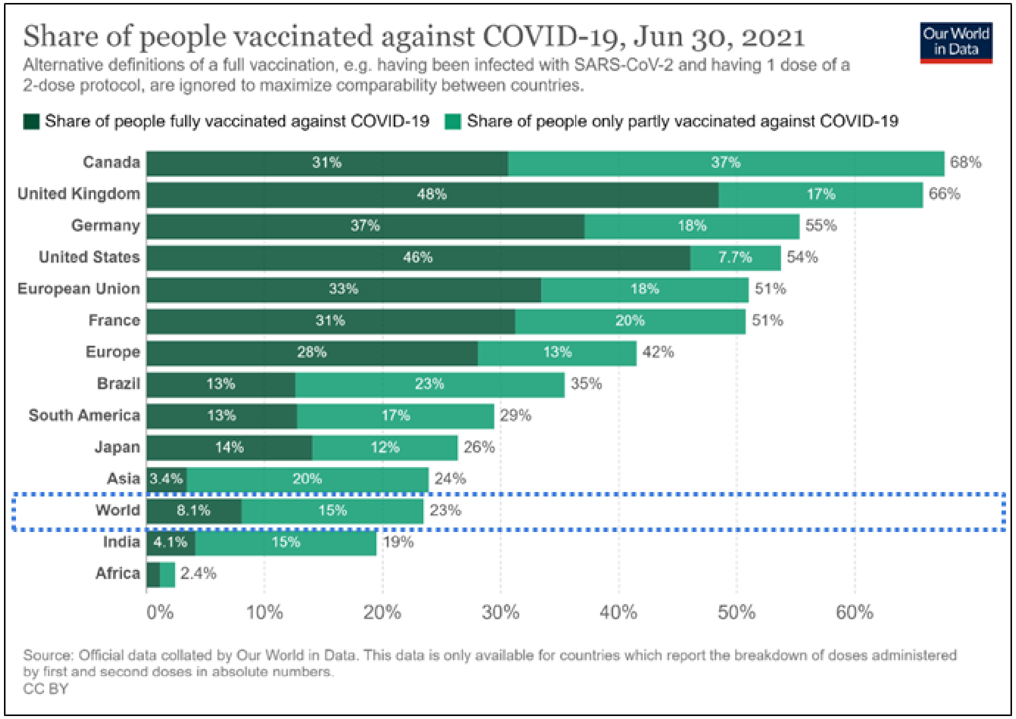
Vaccines were developed and approved in record time, being fundamental for the economic recovery.



Source: Our World in Data. Data as of June 2021.

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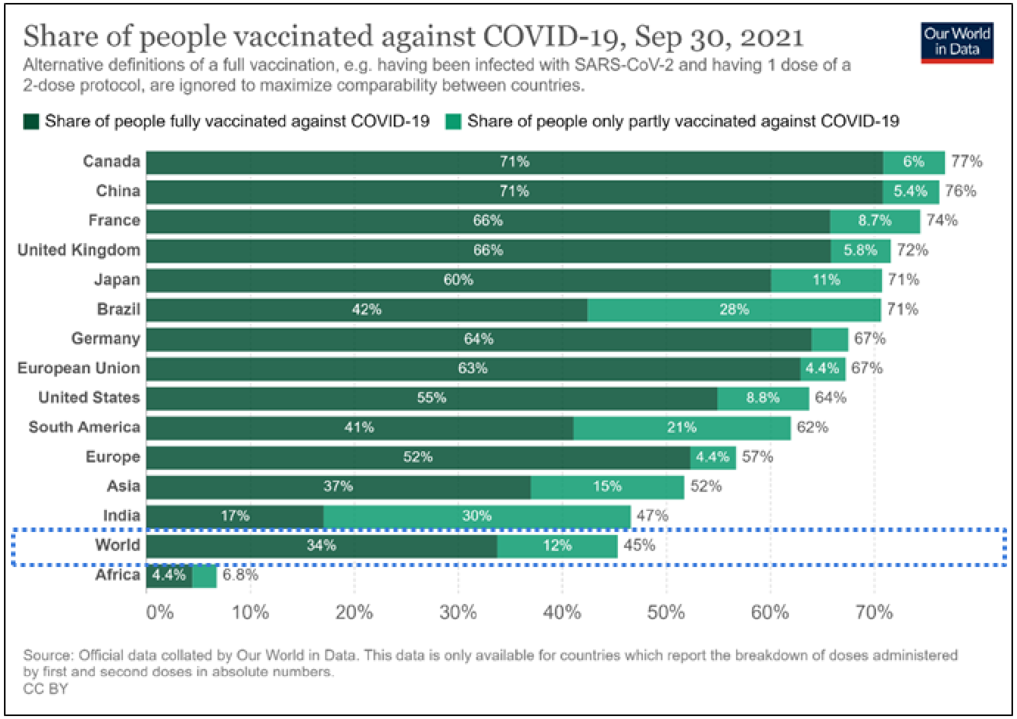
Vaccination Efforts

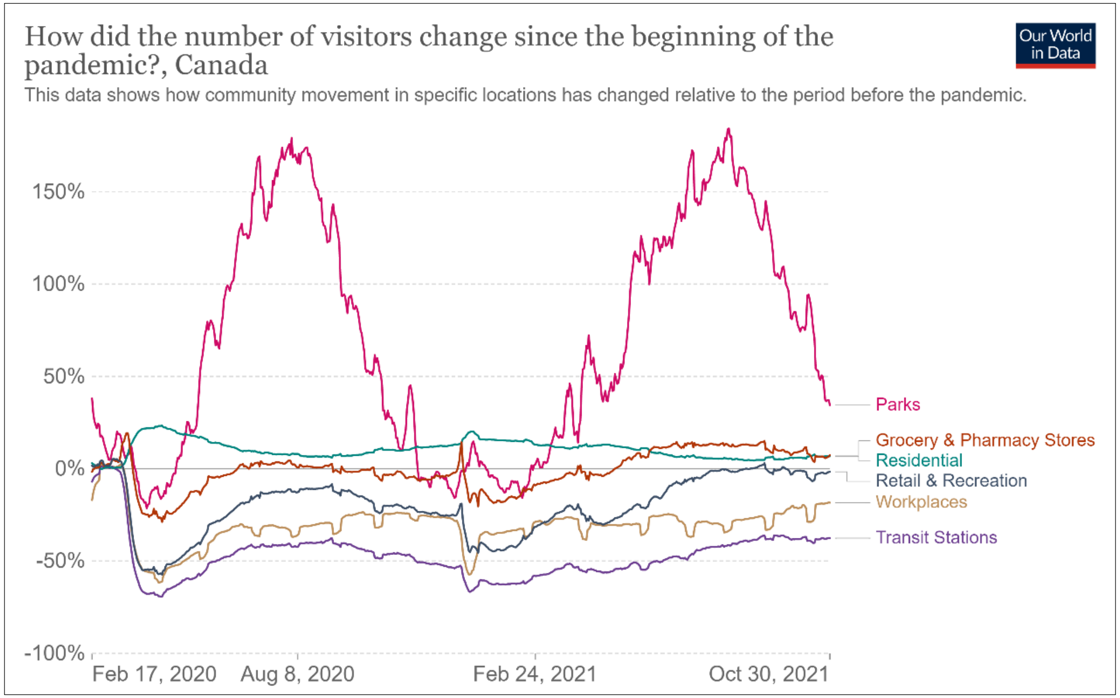
Vaccination efforts continue to progress globally and have increased quite rapidly, particularly over the last quarter.



Source: Our World in Data. Data as of September 2021.

Economies are Loosening Restrictions

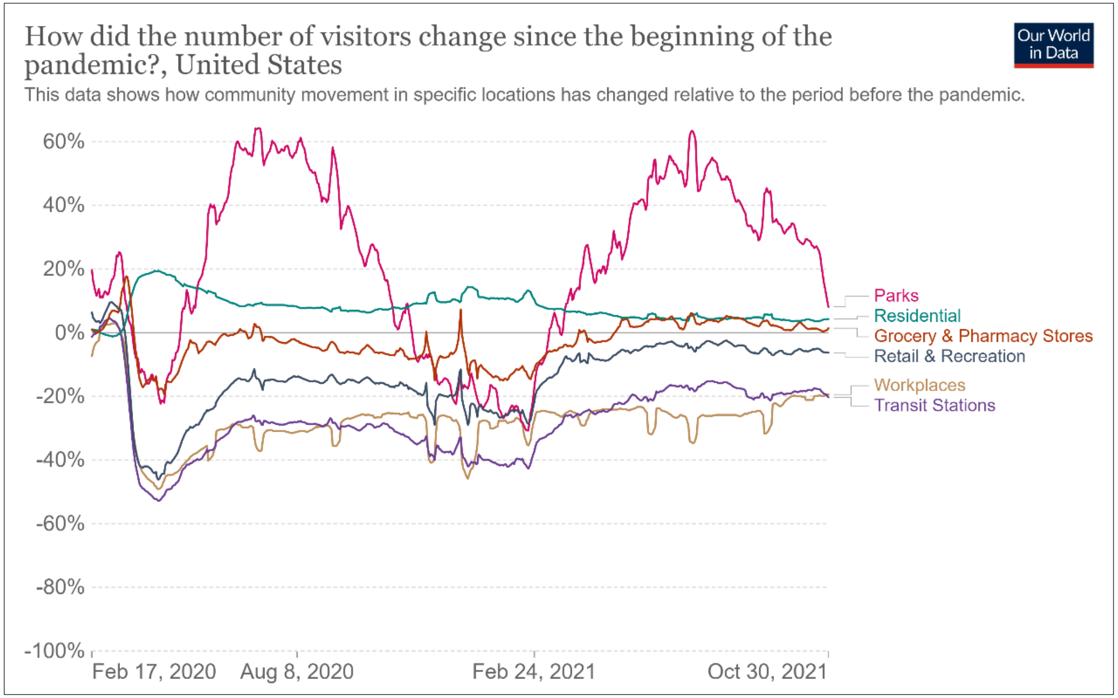
By using data from Google Mobility Trends, we can get insights on how government restrictions and individual behaviours are changing over time. There is a clear trend of normalization for most sectors in Canada, although a few are still far from pre-pandemic levels.



Source: Our World in Data. Data as of October 2021.

Economies are Loosening Restrictions

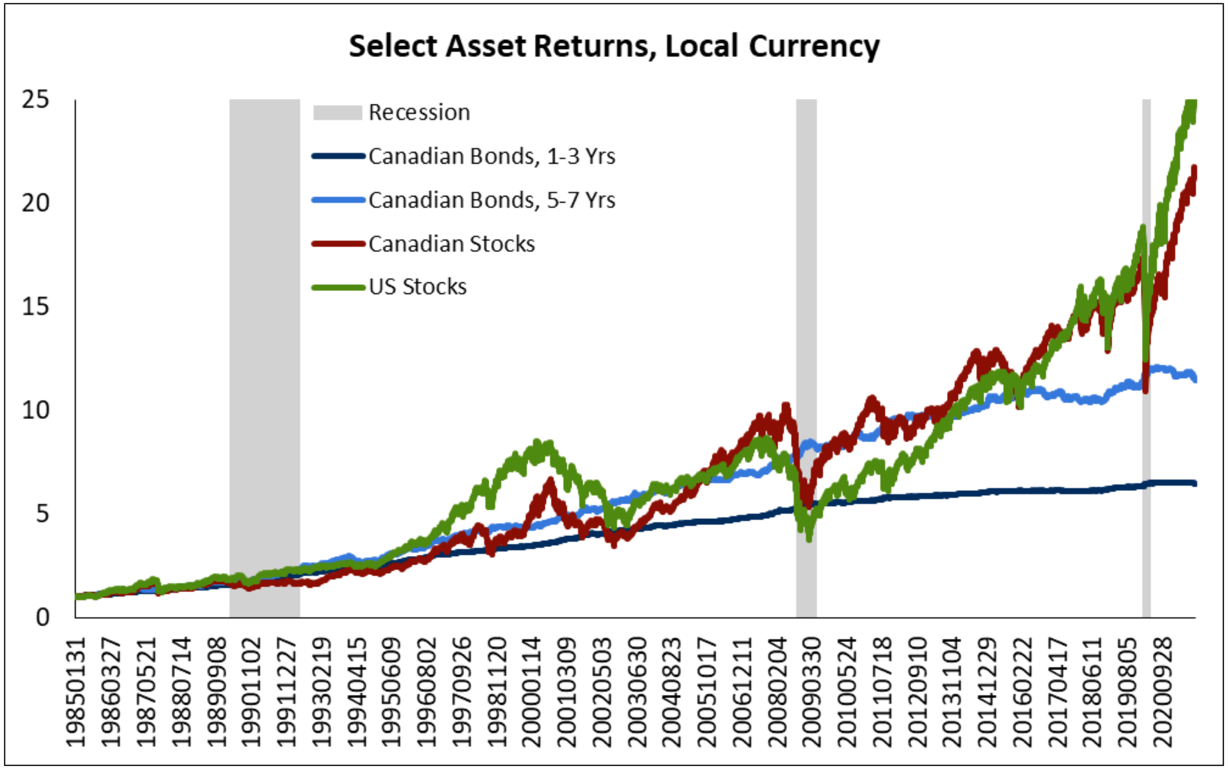
For the United States, the trend of improvement is not as pronounced.



Source: Our World in Data. Data as of October 2021.

Asset Prices have Recovered

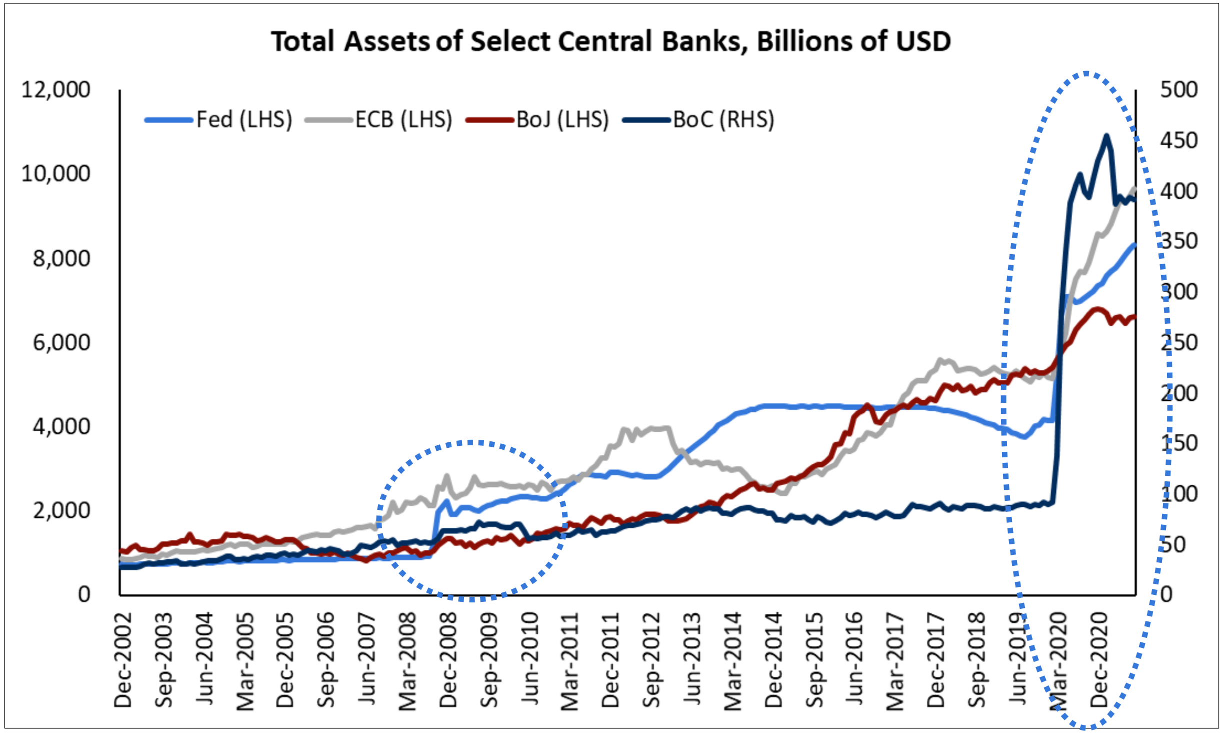
With supportive financial conditions, asset prices have recovered since March 2020.



Source: FactSet. Data as of November 2021.

Monetary Stimulus

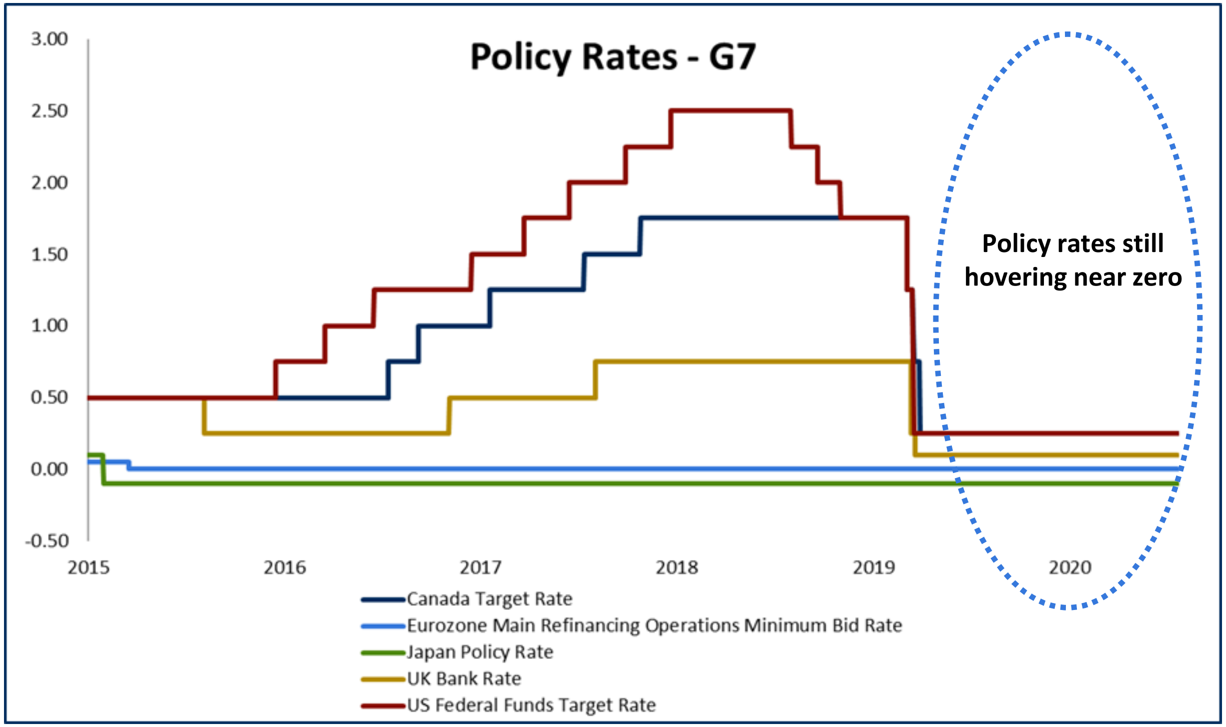
By purchasing government bonds and other securities, central banks were able to reduce other interest rates (e.g., 10y rates), create liquidity, and increase economic activity of businesses and consumers. With interest rates hovering near zero and more stimulus needed, several central banks decided to increase their balance sheets.



Sources: Statistics Canada, FRED, FactSet. Data as of September 2021.

Interest Rates Remain Low

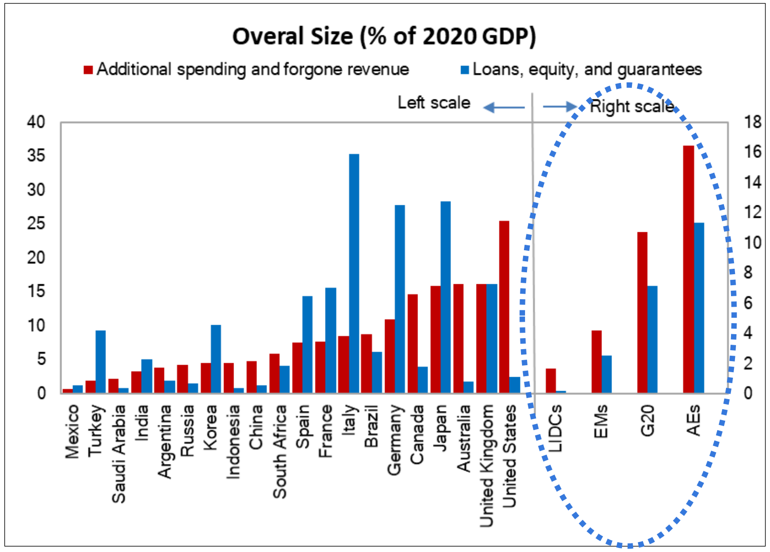
Central banks in advanced economies responded to the pandemic shock by reducing interest rates to their effective lower bounds. Interest rates also hit record lows in several developing economies, although they are going up in a few countries. Overall, monetary policy still can be viewed as highly accommodative.

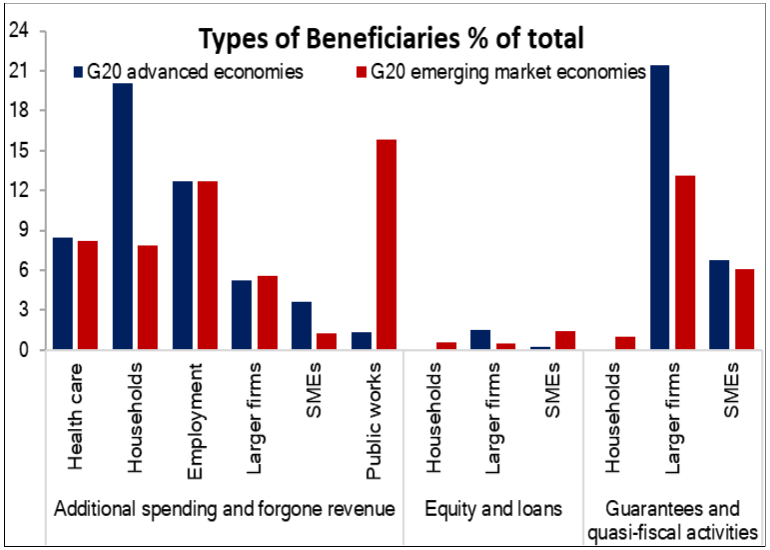


Source: FactSet. Data as of October 2021.

Global Government Fiscal Support

During the pandemic, governments added an unprecedented level of fiscal support.

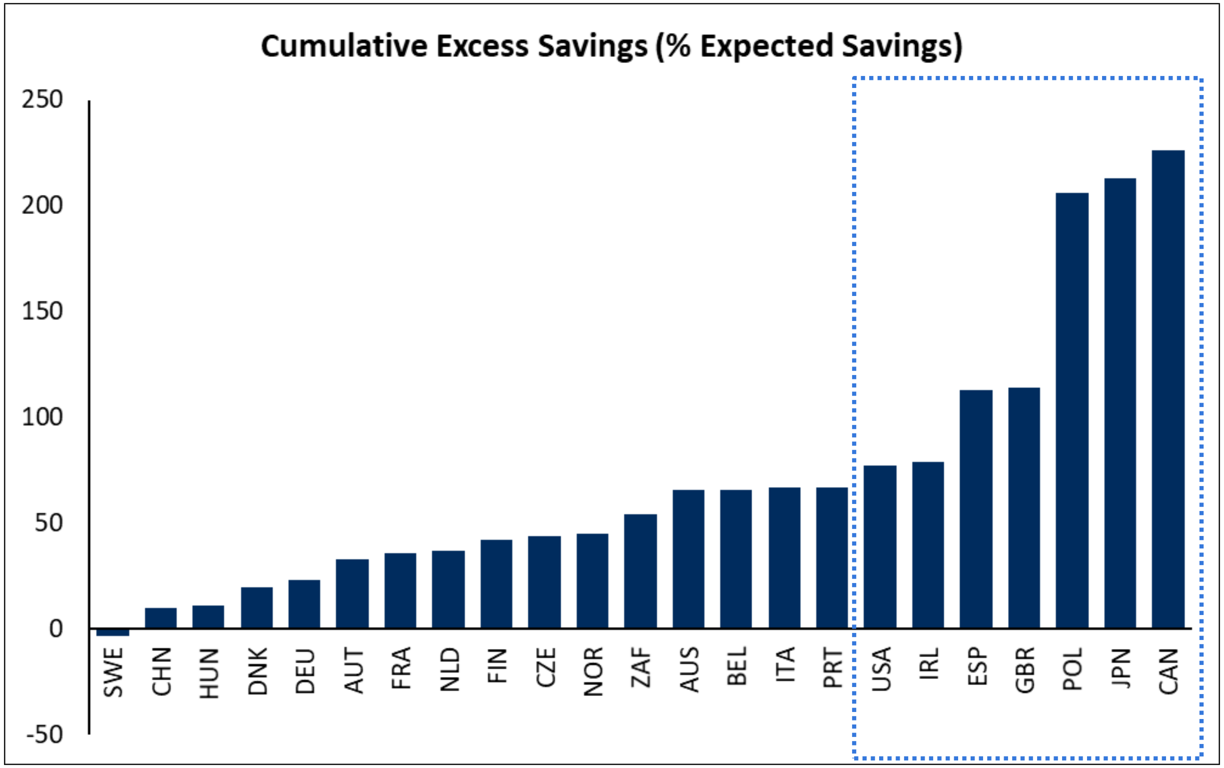




Source: IMF.

Excess Savings

Excess savings increased sharply during the pandemic, fueling stronger growth in consumption and business investment into next year, but also adding to concerns of more persistent high inflation.



Source: IMF

Early-/Mid-Phase of the Business Cycle

Business cycles are fluctuations in an economy's general activity and commonly include four phases with the following characteristics:

- **Early-cycle**: GDP growth moves from negative to positive as the economy recovers from a recession. High growth rates occur in this phase. Monetary policy is easy and inflation is low.
- **Mid-cycle**: GDP growth increases and eventually hits its peak. Inflation rises, and the central bank removes stimulus as it approaches a neutral stance.
- **Late-cycle**: GDP growth slows as the central bank adopts a more restrictive monetary policy to control inflation.
- **Recession**: GDP growth contracts and the central bank loosens its monetary policy stance. Inflation decreases.

Business Cycles		
Monthly Peak	Monthly Trough	Duration (Yrs)
April 1929	February 1933	-
November 1937	June 1938	5.3
August 1947	March 1948	9.8
April 1951	December 1951	3.8
July 1953	July 1954	2.6
March 1957	January 1958	3.5
March 1960	March 1961	3.2
October 1974	March 1975	14.0
June 1981	October 1982	10.6
March 1990	May 1992	6.6
October 2008	May 2009	17.0
February 2020	April 2020	10.9

Source: C.D. Howe Institute Business Cycle Council

Outlook for Global Growth

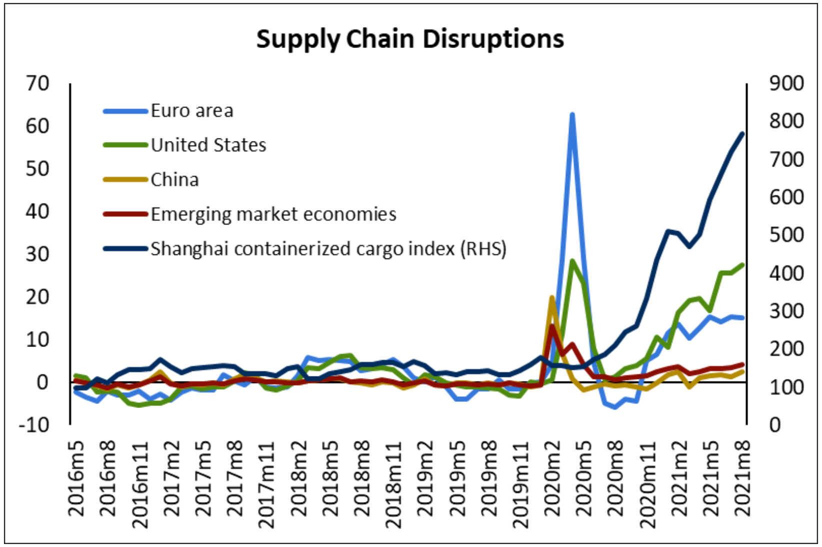
Global growth remains on a very positive trajectory for 2021 and 2022.

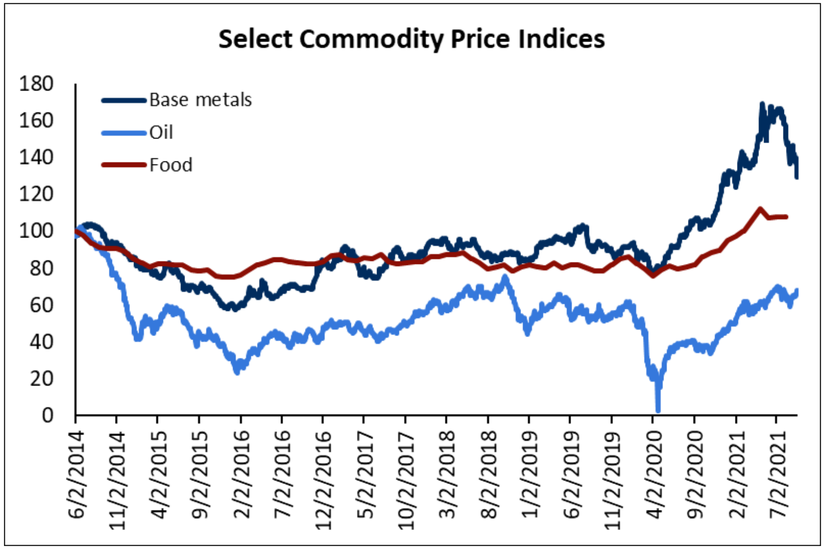
Real GDP Growth (YoY % Chg.)	2020	2021	2022		2020	2021	2022
World	-3.1	5.9	4.9				
Australia	-2.4	3.5	4.1	**Argentina**	-9.9	7.5	2.5
Canada	-5.3	5.7	4.9	**Brazil**	-4.1	5.2	1.5
Euro area	-6.3	5.0	4.3	**China**	2.3	8.0	5.6
Germany	-4.6	3.1	4.6	**India**	-7.3	9.5	8.5
France	-8.0	6.3	3.9	**Indonesia**	-2.1	3.2	5.9
Italy	-8.9	5.8	4.2	**Mexico**	-8.3	6.2	4.0
Spain	-10.8	5.7	6.4	**Russia**	-3.0	4.7	2.9
Japan	-4.6	2.4	3.2	**Saudi Arabia**	-4.1	2.3	4.8
Korea	-0.9	4.3	3.3	**South Africa**	-6.4	5.0	2.2
United Kingdom	-9.8	6.8	4.0	**Turkey**	1.8	9.0	3.3
United States	-3.4	6.0	5.2				

Source: IMF

Outlook for Global Inflation

Although some of the recent factors pushing inflation higher are likely to be transitory (e.g., supply chain bottlenecks), particularly as we move further into the cycle, we still see significant near-term upside for inflation.





Source: IMF

Outlook for Global Inflation

CPI Inflation (YoY % Chg.)							
	2020	2021	2022		2020	2021	2022
World	2.7	4.8	3.4				
Australia	0.9	2.6	2.0	Argentina	36.1	-	-
Canada	0.8	3.8	2.0	Brazil	4.5	7.9	4.0
Euro area	-0.3	2.9	1.4	China	-0.3	2.0	1.8
Germany	-0.7	4.0	1.2	India	4.9	5.5	4.9
France	-0.1	2.9	1.0	Indonesia	1.7	2.0	3.4
Italy	-0.3	1.7	1.8	Mexico	3.2	5.9	3.1
Spain	-0.5	2.5	1.4	Russia	4.9	5.8	4.3
Japan	-0.9	0.7	0.4	Saudi Arabia	5.4	1.6	2.2
Korea	0.5	2.7	1.4	South Africa	3.2	5.0	4.5
United Kingdom	0.5	3.5	2.0	Turkey	14.6	16.7	14.5
United States	1.6	5.1	2.6				

Source: IMF

Canadian Outlook: Some speed bumps along the way to recovery

Canadian Economic Growth Outlook

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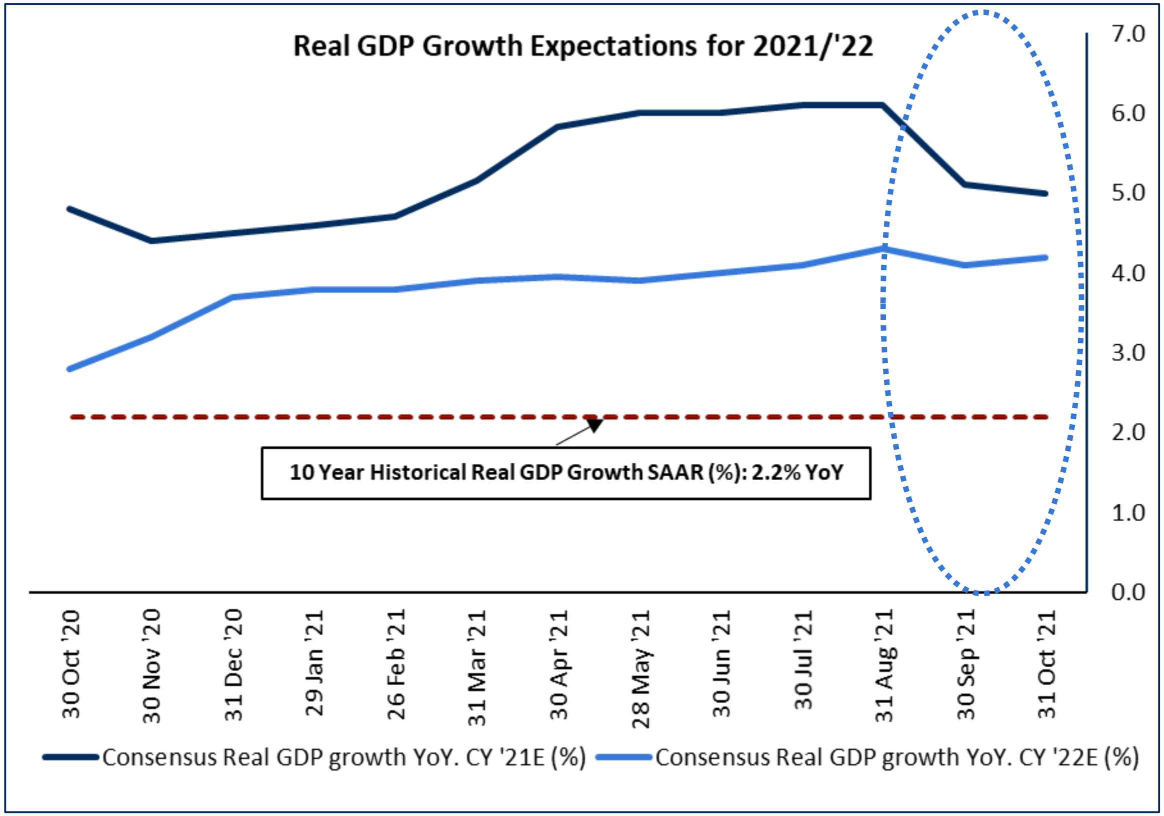
While economic growth has slowed from peak levels in July/August, due to a general softness in housing activity, which cooled from unsustainable levels, and from exports hurt by supply chain disruptions, we still expect economic growth in 2021/2022 to remain above historical levels (the 10-year average of 2.2%).



Source: FactSet

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The Consumer – Looking Good

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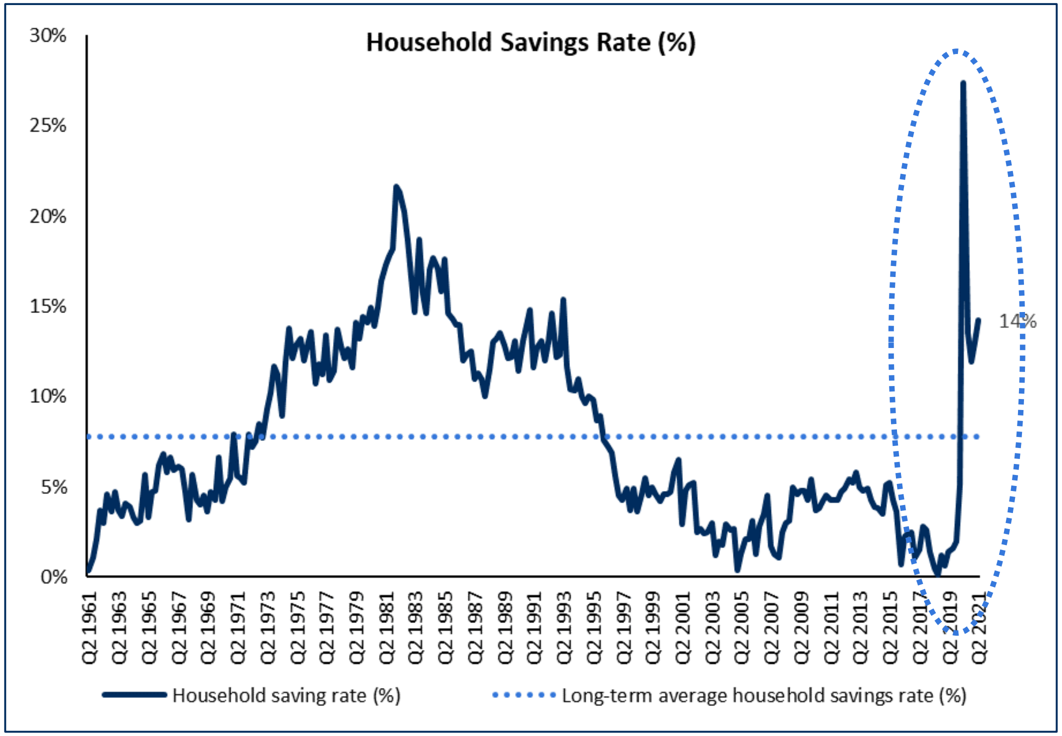

Source: FactSet; As of June 2021

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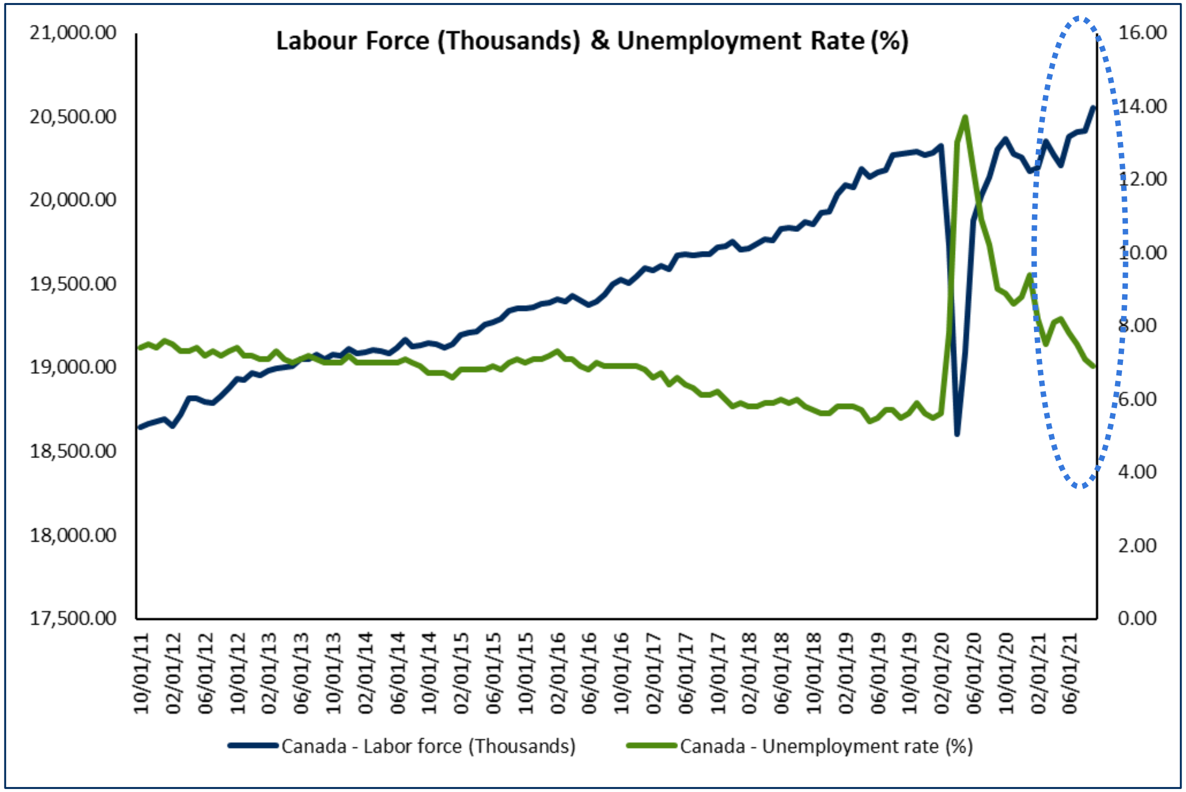
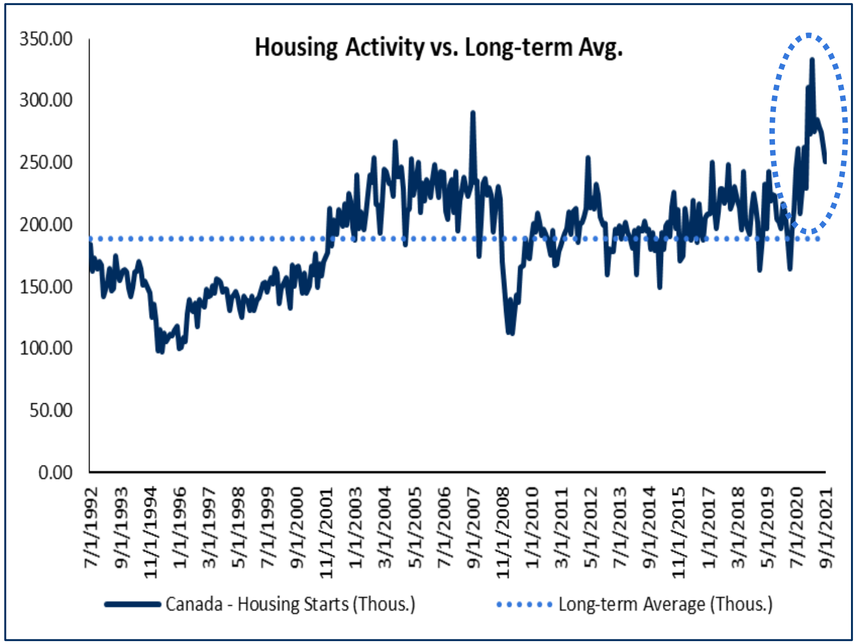
The Consumer– Looking Good



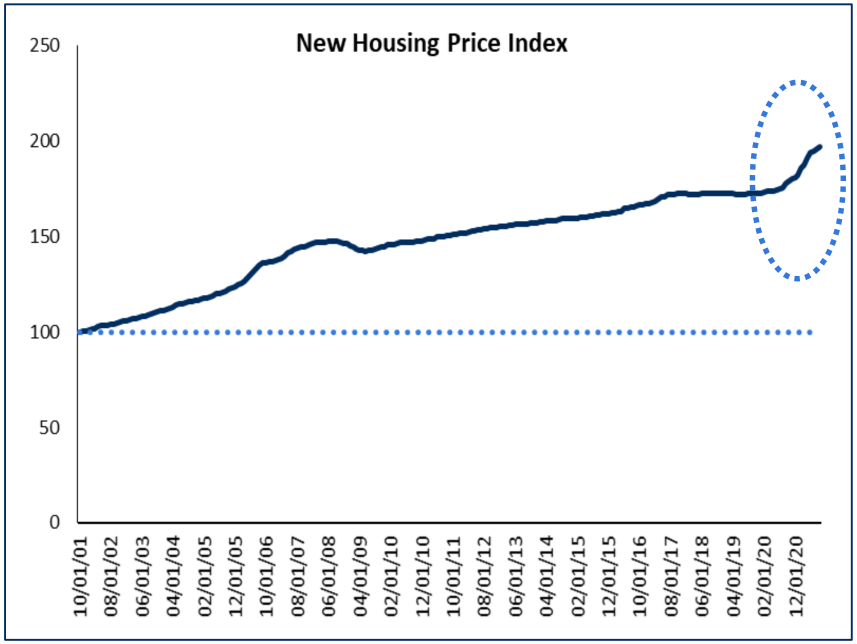
Source: FactSet

Housing Cooling from Peak

Following 5 straight monthly declines, Canadian existing home sales increased by 0.9% m/m in September.



Source: FactSet; As of September 2021

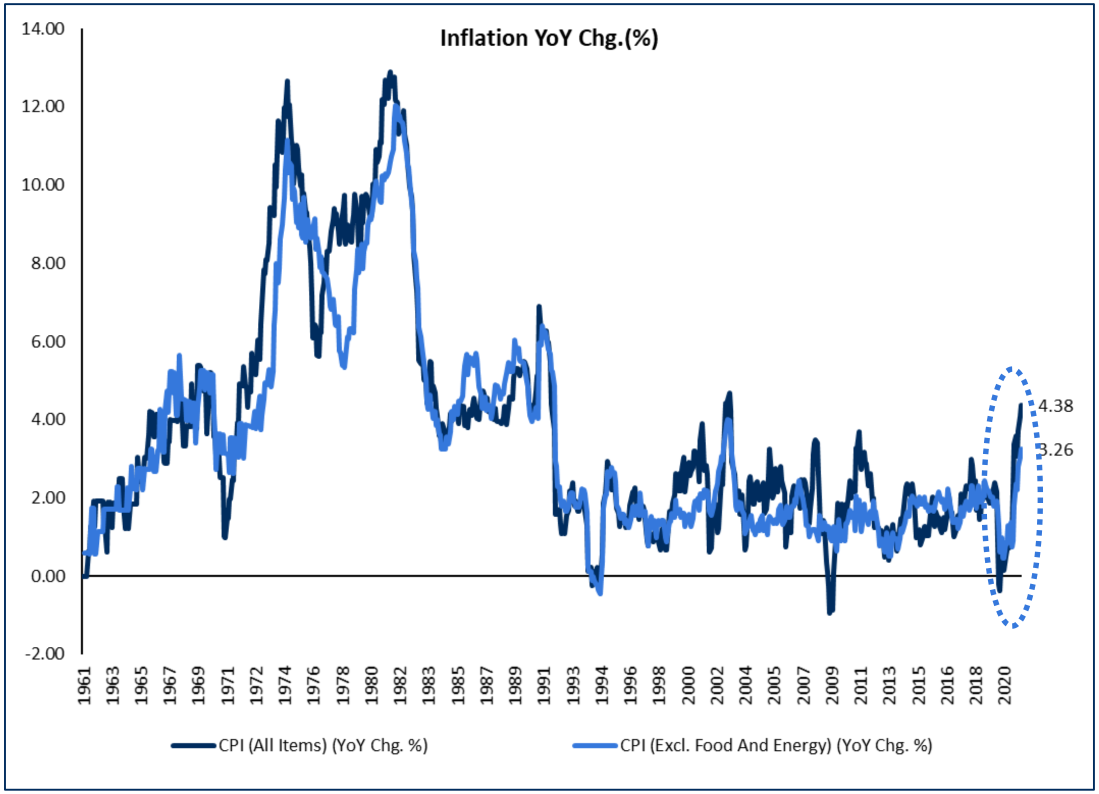


Source: FactSet; Prices Indexed to 100; As of September 2021

Inflation Running Hot!

Private Client Solutions

Inflation has continued to run hot, and has remained above 4%, boosted by base-year effects, gasoline prices, and pandemic-related supply bottlenecks.



Source: FactSet

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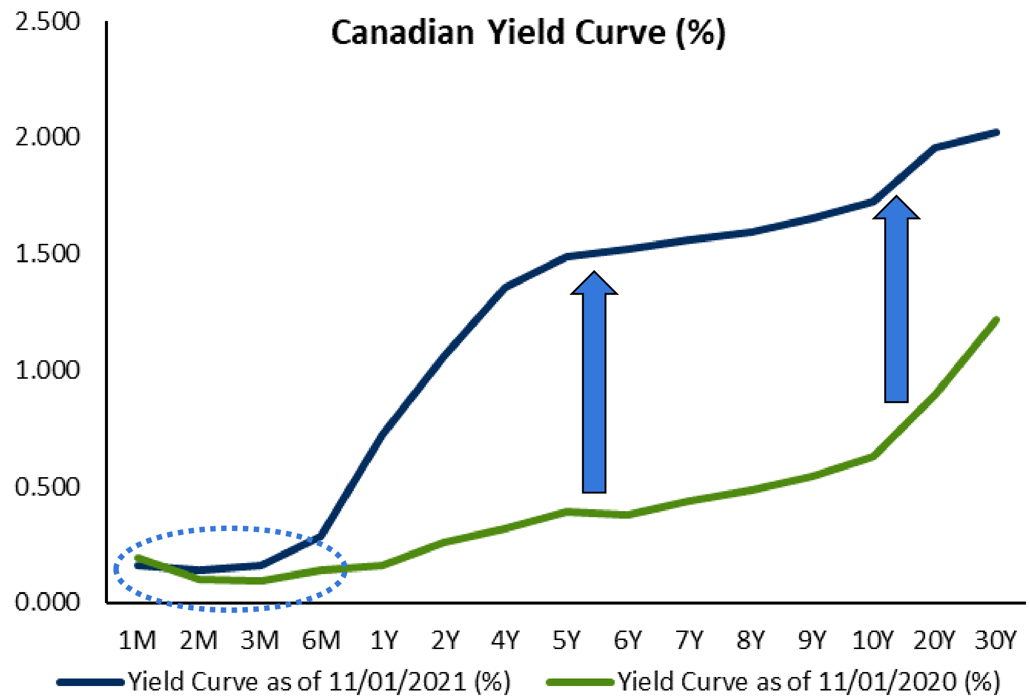
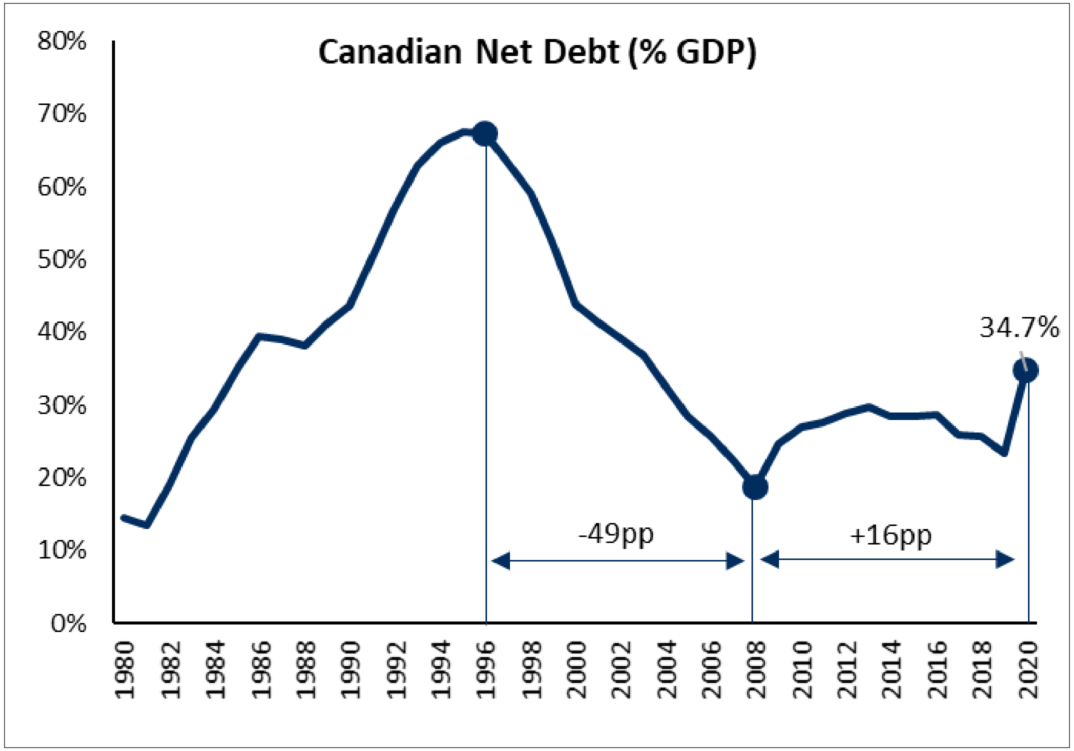
Policy is Accommodative

On the monetary policy front, financial conditions are still very accommodative and positive for equity markets.



Source: FactSet; As of November 2021

Policy is Accommodative



Source: IMF

Final thoughts for investors

Closing remarks

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The outlook for the global economy remains robust and supportive of equity markets. We see firm evidence that the economy is in the early-/mid-phases of the business cycle, which is historically beneficial for the performance of stocks. Uncertainty remains high, but cause for concern remains low. **Leverage periods of weakness in equity markets to add to high-quality positions.**

- **Global growth remains on a positive trajectory for 2021 and 2022.**
- **The Canadian economic outlook remains strong.**
- **Inflation continues to run hot and will likely stick around for longer than expected.**
- **Level of uncertainty is high – but this was also the case in Q1/2020**
- **The risk/reward still favours equities over bonds.**
- **Asset Allocation + diversification = Increase the probability of achieving one's goals.**

Thank you!

Appendix

Appendix

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Source: BMO Global Asset Management

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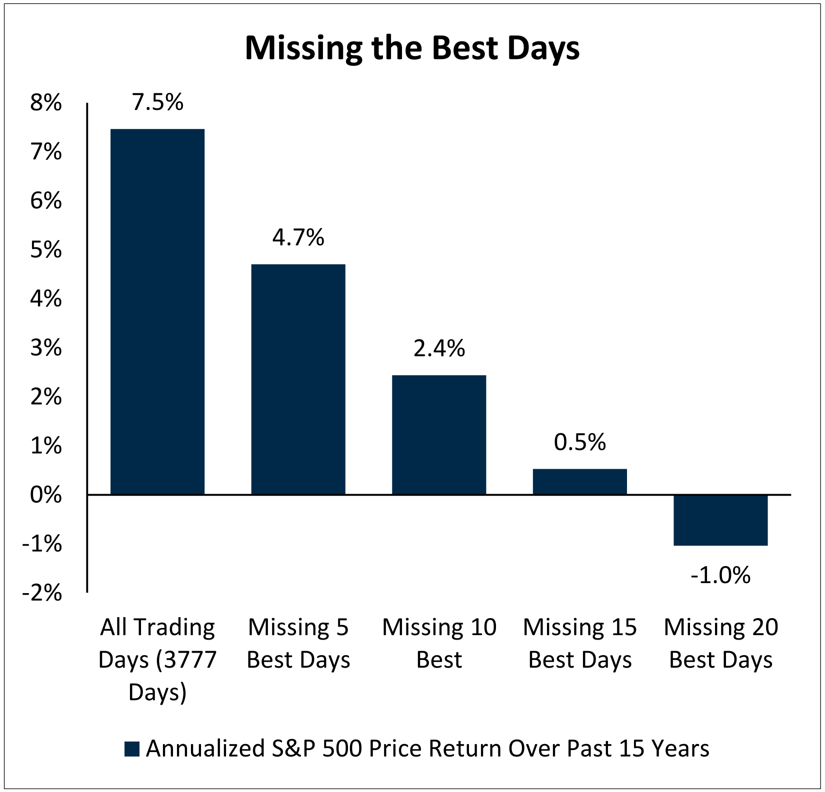
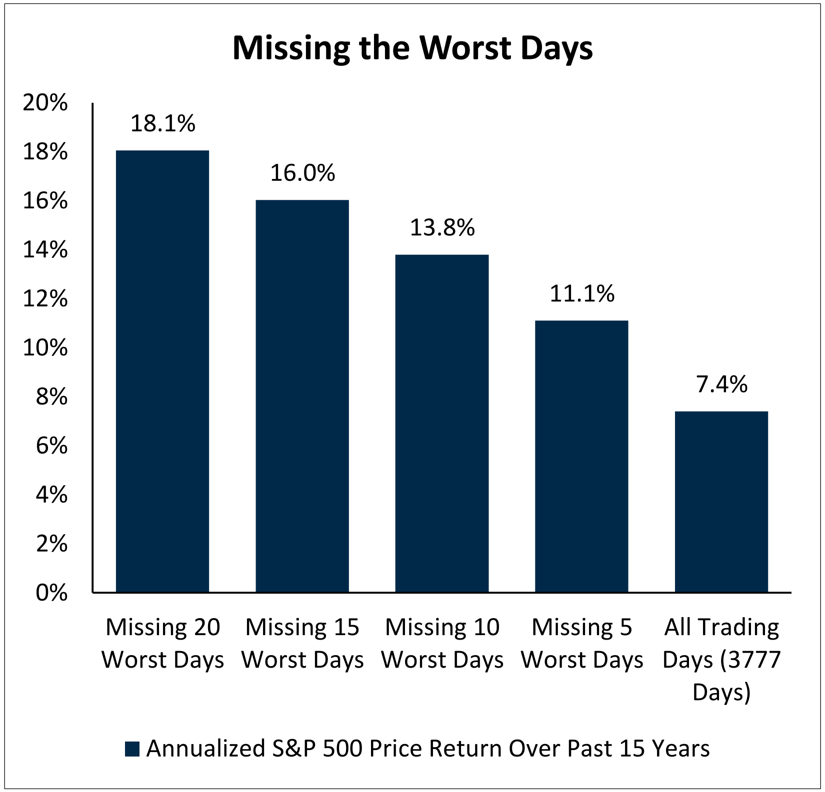
Appendix

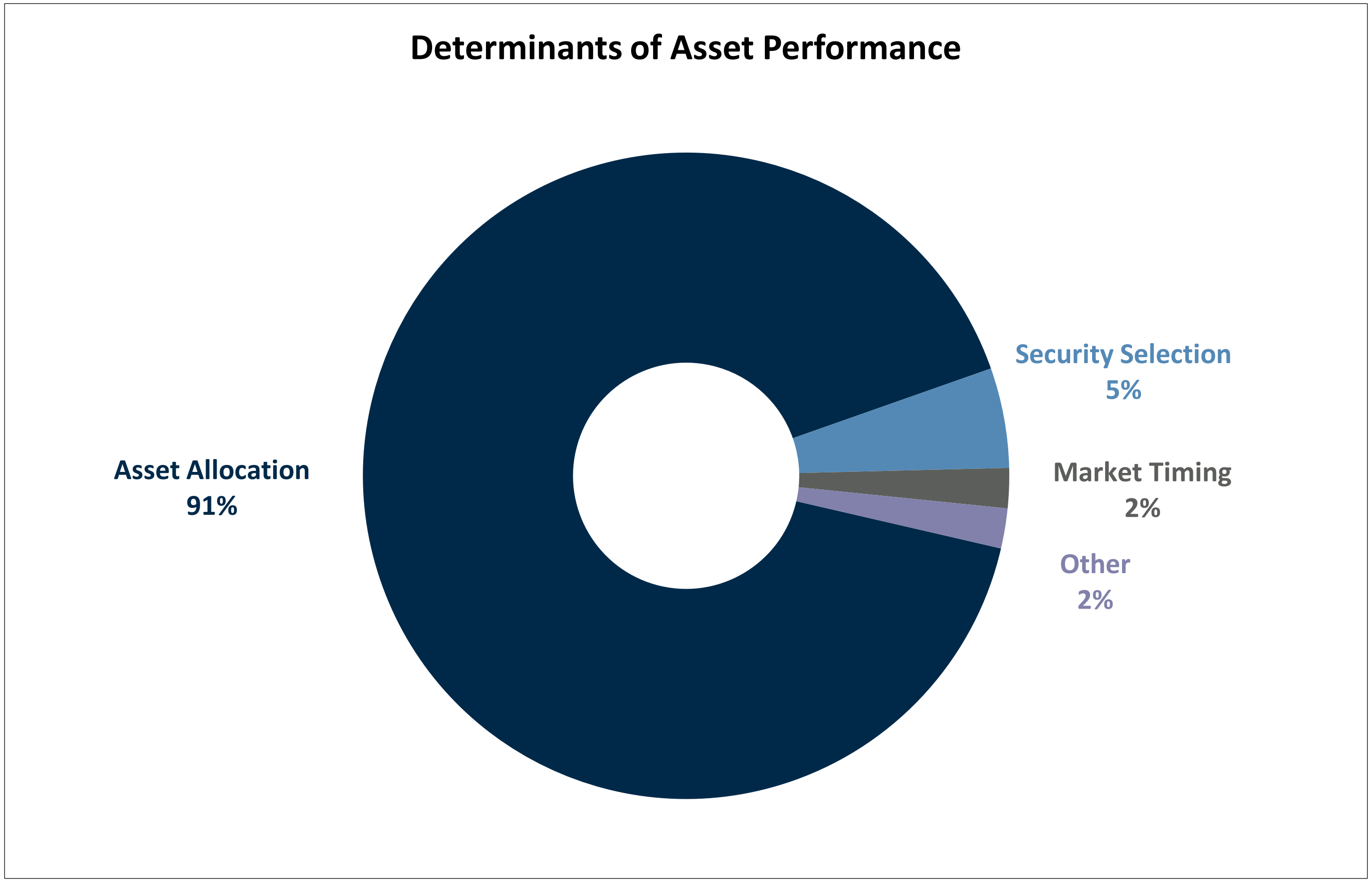


Source: FactSet



Source: FactSet

Appendix



Source: Brinson, Hood and Beebower (1986)

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Goldilocks and the Three Bears

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Our view: As in the 19th-century British fairy tale "Goldilocks and the Three Bears", we have attempted to find the best 'bed' for gold to outperform. While current conditions appear to be 'just right' for gold prices to outperform, there are several variables at play that have resulted in quite the opposite. While timing the market is never an optimal strategy to follow for investors, our research shows firm evidence that long-term oriented investors can benefit from maintaining exposure to gold as an asset class throughout the entire business cycle.

This bed is too soft. Recent performance of the gold commodity has been softer than expected given the surge in inflation and the impact this has had on real yields (currently at ~-3.5%). While historically this level of real yields has been a boon for gold price performance, we caution investors from jumping to conclusions simply based on an analysis of a single variable. In fact, while the real rate remains in deeply negative territory, early phases of the business cycle have been the worst environment across historical business cycles for the yellow metal. However, the performance of gold improves as we move beyond the early phase of the business cycle.

This bed is just right. The most favourable period for gold price performance in the business cycle is during a contraction in economic activity. Looking back at contractionary periods in real GDP since the 1980s shows that gold was up on average by 12% during these periods. This is followed by late-cycle (+10%) and mid-cycle (+8%) periods. In fact, if we look at individual macroeconomic variables to model the most ideal scenario for gold, it would include: **1)** negative real GDP growth (not present in the current environment); **2)** a weak/weakening USD (not present in the current environment, especially with the Fed beginning to taper); and **3)** negative real interest rates (currently present).

Final takeaways for investors. While timing the market is difficult, our analysis shows investors can improve the risk/reward profile of their portfolios by maintaining a strategic allocation to gold throughout the entire business cycle. From our research going back to the 1980s, gold has had a negative correlation to most traditional assets classes (e.g., equities and bonds). For investors looking to add exposure to gold, they can achieve this in several ways, including: **1)** buying physical bars/coins; **2)** gold futures; **3)** physically backed ETFs (**click here**); **4)** gold equities (**Top Picks: FNV, WPM, AEM, GOLD, and NEM**); and, **5)** gold indices and/or gold funds. Each vehicle offers a different risk/return profile and exposure to the changes in the price of gold. At one end of the spectrum, we have physical gold bullion, which offers the lowest risk option for investors and direct exposure to changes in the prices of gold (appreciation and/or depreciation). On the opposite end of the spectrum, we have gold company operators and explorers that expose investors not only to changes in gold prices but also to several other factors, such as operational leverage, exploration optionality, expansion potential, etc.

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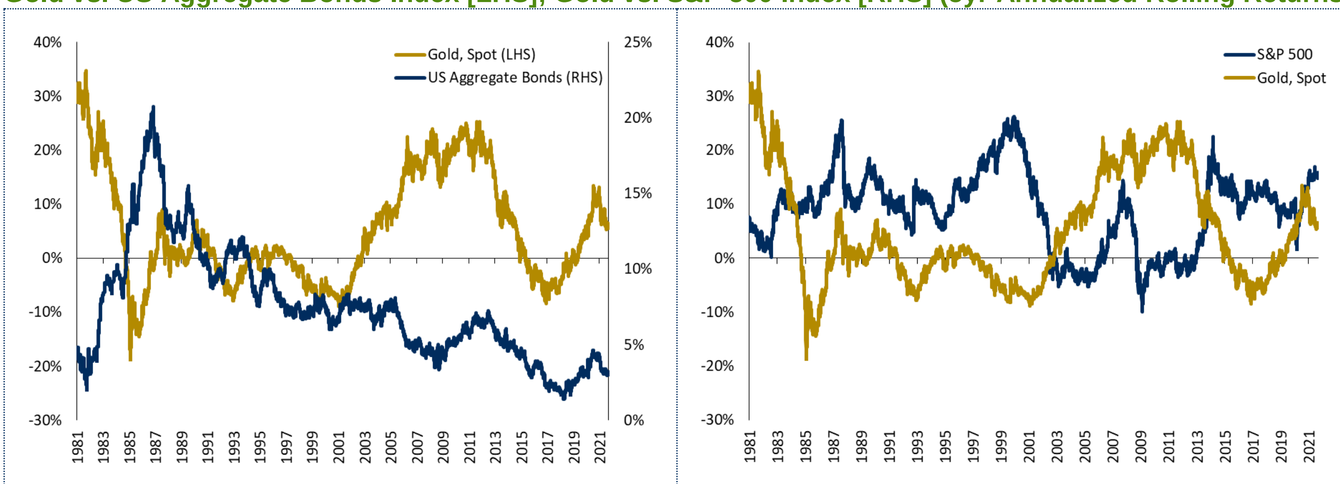
The Role of Gold in a Portfolio

We view gold as a distinct asset class, the performance of which is influenced by several macroeconomic factors, such as **real GDP growth, inflation, interest rates, exchange rates, etc**. However, unlike stocks and bonds, there are idiosyncratic factors that play a role in the performance of gold, including its limited supply. These aspects taken together make gold a unique asset with important diversification benefits in a portfolio, **particularly for long-term oriented investors**.

To showcase these benefits within a portfolio, we compare the returns of gold with select asset classes over the duration of a typical business cycle, which has averaged around 5-years in the United States. The charts below suggest that gold provides protection during periods where traditional assets (e.g., equities and bonds) do not perform well (e.g., during H1 of 2020 in the early days of the COVID-19 crisis).

Gold vs. US Aggregate Bonds Index [LHS]; Gold vs. S&P 500 Index [RHS] (5yr Annualized Rolling Returns)



Source: FactSet, Raymond James Ltd.

Moreover, using correlation analysis, we measure the relationship between US bonds (US Aggregate Bond Index), US equities (S&P 500 Index), and gold prices over a 1-year and 5-year period.

There is a negative correlation between gold and US bonds and equities on both a 1-year and 5-year period, showing that these assets move in opposite directions to one another. The negative correlation of gold with stocks and bonds confirms that adding gold to a portfolio composed of stocks and bonds increases the diversification of the portfolio and therefore mitigates its risk, improving the portfolio's risk-adjusted return.

Gold Correlation with Select US Asset Classes

Correlation	US Aggregate Bonds	S&P 500 Index
1 year	-0.12	-0.21
5 year	-0.35	-0.66

Source: FactSet, Raymond James Ltd.

Correlation shows the strength of a relationship between two variables and is expressed numerically by the correlation coefficient. The correlation coefficient's values range between -1.0 and 1.0. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep, in the same direction. A perfect negative correlation means that two assets move in opposite directions, while a zero correlation implies no linear relationship at all. (Investopedia)

That Bed is too Hard/Soft, but This Bed is Just Right

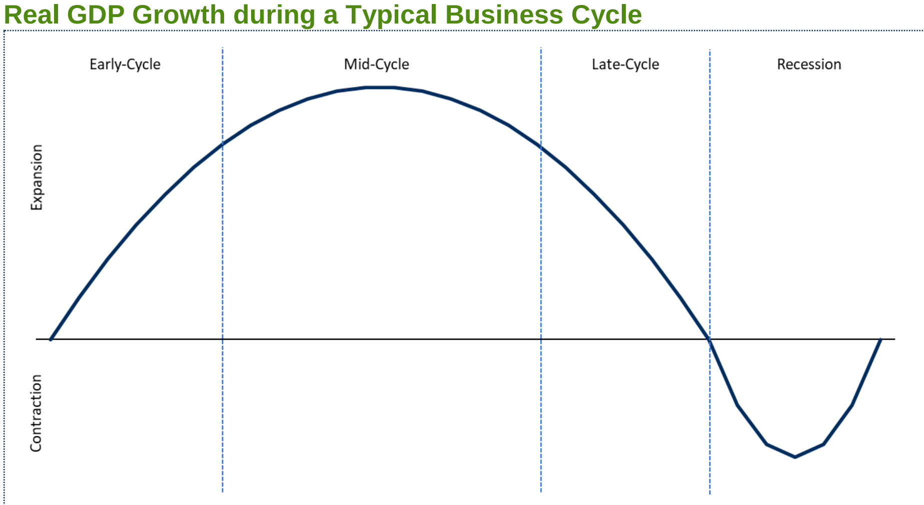
As we have shown above, adding gold to a portfolio with traditional assets is attractive from an asset allocation perspective.

However, for investors interested in making more tactical adjustments to their gold weighting throughout the business cycle (e.g., adding to or reducing their allocation to gold while maintaining a core strategic allocation to it), there are periods of the business cycle when gold performs better than others.

Business cycles are fluctuations in an economy's general activity and commonly include four phases with the following characteristics:

- **Early-cycle:** GDP growth moves from negative to positive as the economy recovers from a recession. High growth rates occur in this phase. Monetary policy is easy and inflation is low.
- **Mid-cycle:** GDP growth increases and eventually hits its peak. Inflation rises, and the central bank removes stimulus as it approaches a neutral stance.
- **Late-cycle:** GDP growth slows as the central bank adopts a more restrictive monetary policy to control inflation.
- **Recession:** GDP growth contracts and the central bank loosens its monetary policy stance. Inflation decreases.

Real GDP Growth during a Typical Business Cycle



Source: Raymond James Ltd.

Using the above definition of business cycles, we determined that the best environment for gold is during periods of contraction in economic activity – gold has traded +12% on average during these periods going back to the 1980s. This is followed by late-cycle (+10%) and mid-cycle (+8%) periods. In fact, if we look at individual macroeconomic variables to create the most ideal scenario for gold, it would include: **1)** negative real GDP growth; **2)** a weak/weakening dollar; and, **3)** negative real interest rate, which is reflective of late cycle/recessionary stages in the business cycle. The worst environment for gold has traditionally been during the early cycle (+0%), when the outlook for the economy is positive, growth is strong, and inflation is low.

Where are we in the cycle? While not an exact science, our data suggests that we are nearing the end of the early-cycle and/or in the early phase of the mid-cycle.

Performance of US Bonds, Equities & Gold during the Full Business Cycle

	US Aggregate Bonds	S&P 500	Gold, Spot
Recession	**12%**	**-7%**	**12%**
1980	11%	26%	20%
1981-82	26%	5%	3%
1990-91	12%	4%	-1%
2001	9%	-12%	5%
2007-09	5%	-26%	12%
2020	12%	-42%	31%
Early-Cycle	**5%**	**14%**	**0%**
1980-81	-7%	10%	-38%
1982-83	10%	20%	-9%
1991-92	12%	9%	-3%
2001-02	7%	-17%	15%
2009-10	10%	11%	32%
2020-21	0%	48%	5%
Mid-Cycle	**7%**	**10%**	**8%**
1976-79	6%	-2%	23%
1983-89	13%	13%	-1%
1992-00	7%	17%	-2%
2002-06	5%	11%	20%
2010-19	3%	12%	1%
Late-Cycle	**10%**	**5%**	**10%**
2000-01	14%	-10%	-9%
2006-07	6%	5%	21%
2019-20	10%	20%	20%

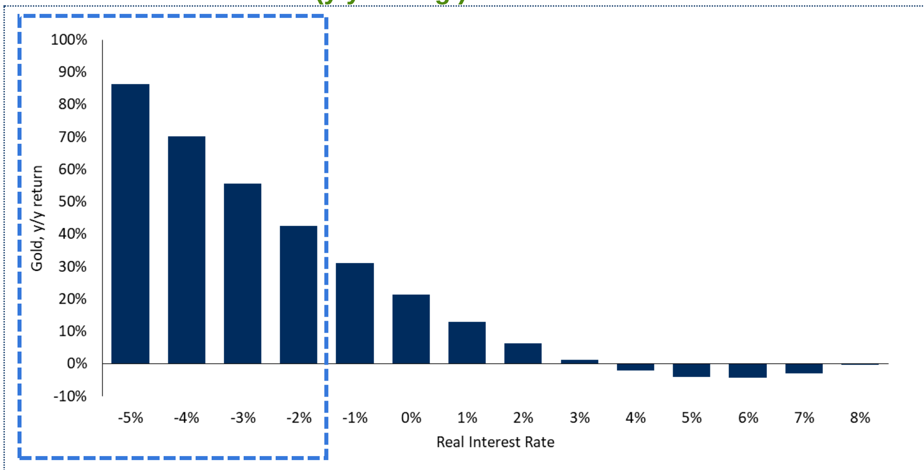
Source: FactSet, Raymond James Ltd.

Given the media's focus on the recent surge in inflation, we took a deeper dive into the relationship between inflation, real yields, and the performance of gold. Our analysis notes that there is a strong relationship between the price performance of gold and real yields, defined as the difference between the 10-year nominal yield and year-over-year (y/y) changes in inflation.

Using data since the 1960s, we estimate the correlation between gold and real yields to be -0.42. This means that **a negative real interest rate is positive for gold**. Moreover, very extreme and extended periods of low real yields have resulted in strong gold price performance.

While we are seeing a very low real yield today (-3.5%), we believe that the recent surge in inflationary pressures that have pushed real yields into negative territory are transitory and not likely to last for an extended period. However, if these transitory pressures prove to be more persistent and or if yields stay lower for longer while inflation runs hot, then this should be a positive environment for gold.

Gold Price Performance (y/y % Chg.) vs. the Real Interest Rate

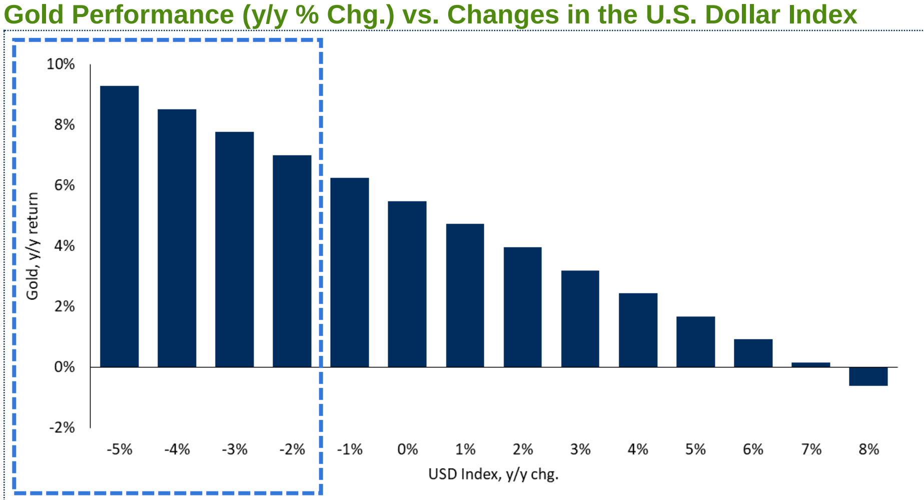


Source: FactSet, Raymond James Ltd.

Since gold is priced in U.S. dollars, changes in the value of the currency are usually associated with changes in the price of gold. We use the DXY index (a trade-weighted benchmark for the international value of the US dollar) to measure the change in the value of the dollar versus the performance of gold. Our data shows that the correlation between gold and the DXY index is -0.44. This means that **a weaker dollar is positive for gold**. This makes sense since investors have historically turned to gold as a store of value during periods of weak USD performance.

There are several factors that influence the USD, the most common being relative real interest rates, which are largely driven by the Federal Reserve (Fed). As discussed above, with real rates in negative territory in the US, changes to the Fed's monetary policy will affect the change in the US currency or DXY Index and the performance of gold. After a period of unprecedented monetary measures (e.g., interest rates slashed to 0%) to combat the impact of the COVID-19 crisis on the economy, there remains high uncertainty concerning the removal of stimulus as we look onward.

Gold Performance (y/y % Chg.) vs. Changes in the U.S. Dollar Index

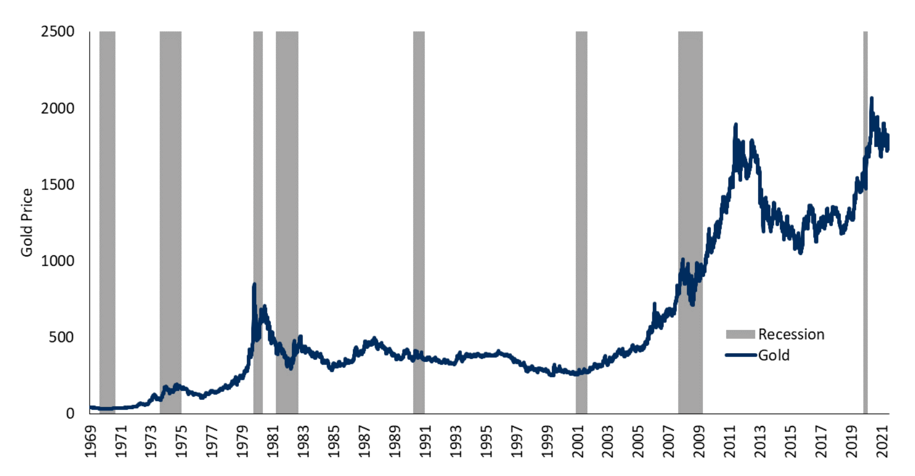


Source: FactSet, Raymond James Ltd.

Finally, **gold performs well when real GDP contracts**. Using NBER's definition of business cycles, the annualized return of gold since the 1960s is 16.2% during recessions.

The current environment is far from contraction territory, with real GDP growing well above historical trend.

Gold Performs well when GDP is Contracting



Source: FactSet, Raymond James Ltd.

Outlook for Gold – Up, Down or Sideways Is our Guess

The current environment has an unusually high level of uncertainty or a "Wall of Worries" as we defined in the October's Insights & Strategies report. The surge in inflation has been dominating the headlines and is conceivably the major risk/catalyst for gold should it remain elevated for longer than expected. While we believe inflation to be transitory, there have been interesting comparisons made to the stagflation environment of the 1970s, a period when gold performed very well (the annualized return on gold was around 30%).

Central banks, particularly in advanced economies, slashed nominal rates to their effective lower bounds to minimize the fallout from the COVID-19 pandemic and the resulting economic shutdowns/restrictions. With high inflation and very low nominal interest rates, the real interest rate is currently negative, around -3.5%, which in isolation should be positive for gold.

However, as mentioned above, real GDP growth is above average and central banks are expected to remove stimulus as the economy moves from the early phase of the business cycle. We believe the U.S. and Canada are between early-/mid-cycle, which historically is not very favourable for gold. The mid-phase, however, is better for gold price performance, while the late and recession phases are the best environments.

Forecasts

	2021	2022	2023	Long-Term
Gold (US$/oz)	$1,788	$1,725	$1,700	$1,600
Silver (US$/oz)	$25.13	$23.00	$23.00	$22.50

Source: Raymond James Ltd.

How to Invest in Gold

Investors can gain exposure to gold in several ways, including buying physical bars, coins, gold futures, physically backed ETFs or gold equities directly or through gold indices and/or gold funds. Each vehicle offers a distinct risk/return profile and exposure to the changes in the price of gold.

In the below table, we have physical gold bullion on one end of the spectrum, which offers the lowest risk option for investors. It gives investors direct exposure to changes in the price of the yellow metal (appreciation and/or depreciation) but no exposure to company or operation risks. On the opposite end of the spectrum, there are gold company operators and explorers, which offer investors not only exposure to changes in the price of gold but also to several other factors such as operational leverage, exploration optionality, expansion potential, etc.

Our recommendation for investors is to focus on the lower risk options in the below table.

How Investors Can Buy Gold–Low Risk to Higher Risk Options

Lower Risk ⟷ Higher Risk

	Bullion	ETF	Gold Royalty/ Streaming Companies	Gold Company Operators	Gold Company Explorers
Exposure to:					
Metal Price Appreciation	Yes	Yes	Yes	Yes	Yes
Production	No	No	Yes	Yes	No
Expansion Potential	No	No	Yes	Yes	No
Discovery Potential	No	No	Yes	Yes	Yes
Acquisition Potential	No	No	Yes	Yes	Yes
Dividend Potential	No	No	Yes	Yes	Yes
Reduced exposure to:					
Capital Costs	Yes	Yes	Yes	No	No
Operating Costs	Yes	Yes	Yes	No	No
Environmental Costs	Yes	Yes	Yes	No	No

Source: Raymond James Ltd

Owning Physical Bullion

Investors have the option of purchasing physical gold bars and coins to gain exposure to bullion. This option provides investors with exposure to changes in its price (appreciation/depreciation). However, owning physical gold bars and coins brings its own set of challenges, including the costs to safely store and transport the physical gold.

Exchange-Traded Options for Bullion Exposure

As an alternative to owning physical bullion, we suggest investors consider Exchange-Traded Receipts (ETRs). The Royal Canadian Mint established the Canadian Gold Reserves Program in order to provide an exchange-traded investment vehicle **that tracks the price of gold and makes investing directly in physical gold available to institutional and retail investors.** Investors can also buy exchange-traded funds (ETFs) to gain exposure to gold. Below we highlight (ETFs) that hold gold as their underlying asset or invest in gold futures contracts. The advantages of ETFs are that they are relatively liquid, low cost, and a convenient option for investing in gold compared to buying physical bullion and storing it.

Gold Bullion ETR/ETF Recommendations

Name	Symbol	Currency	Annual Fee	Domicile
Royal Canadian Mint ETR	MNT MNT.U	$C $U	0.35%	Canada
iShares Gold Bullion ETF	CGL CGL.C	$C (hedged) $C	0.50%	Canada
Purpose Gold Bullion ETF	KILO KILO/B	$C (hedged) $C	0.20%	Canada
SPDR Gold Shares	GLD	$C	0.40%	USA
iShares Gold Trust	IAU	$U	0.25%	USA

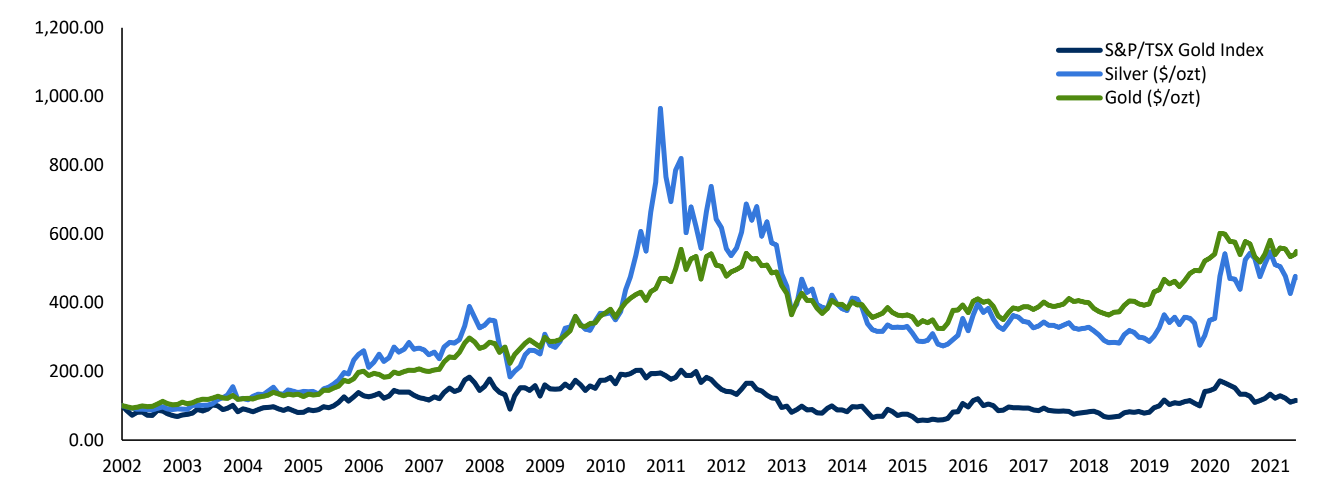
Source: Raymond James Ltd

Equity Recommendations: If you must, stick to quality!

Equities need to show additional returns given their additional risks, aside from providing exposure to price moves in the commodity. That said, this has not entirely been the case for most investors in recent history. In fact, looking back over the past ~20 years, the S&P/TSX Gold Index has significantly underperformed the price performance of gold and even silver.

We attribute this underperformance to: **1)** the ease of access to low-cost alternatives, namely exchange-traded securities; **2)** weak execution by management companies; **3)** poor fiscal discipline at the company level; and, **4)** to a lesser extent, the recent popularity of crypto-assets as a store of value or alternative to gold among the younger demographic.

S&P/TSX Gold Index a Perennial Underperformer vs. Gold and Silver Commodities



Source: FactSet, Statistics Canada

However, there is a "silver lining" during this period. This was the royalty/streaming companies and select senior gold producers, which outperformed, in many cases, the commodity and the broader gold sector.

Royalty/streamers offer a relatively lower risk exposure to the underlying commodity than traditional operating miners, given that they are not exposed to the same extent to operating and capital cost overruns, environmental liabilities, and variable G&A expenses (as the business is scalable). Compared to physical commodities or ETFs, these companies offer more leverage to commodity prices as they have optionality on potential exploration results, expansion potential, acquisition potential, and production increases (growth). Furthermore, they often pay a dividend.

For investors who have a higher risk tolerance and are interested in gaining additional leverage/optionality to gold, our recommendation would be to **proceed with caution, and if you must,** add beta to the gold complex with the addition of senior gold producers.

Three of the top picks from the Raymond James Equity Research team include **Agnico Eagle, Barrick Gold, and Newmont**. Each of these names offers a compelling risk/reward profile; they are trading at a material discount to their royalty and streaming peers, and have an all-in-sustaining cash cost of around US$1000/oz for 2021/2022 – very profitable even if gold prices move lower.

RJL Top Picks: Royalty/Streamers and Senior Gold Producers

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Royalty & Streaming Companies

Company Name	Symbol	Price ($)	Target Price	Stock Rating	Target Return	Mkt Cap ($mln)	Dividend Yield	EV/EBITDA		P/CF		Sales (koz Au-Eq)		AISC		P/NAV (x)
								2021E	2022E	2021E	2022E	2021E	2022E	2021E	2022E	
Franco-Nevada	FNV-NYSE | FNV-TSX	$142.64	$164.00	OP2	15%	$27,257	0.8%	24.9x	24.8x	27.7x	28.0x	629	630	na	na	2.62x
Wheaton Precious Metals	WPM-NYSE | WPM-TSX	$39.86	$55.00	OP2	38%	$17,959	1.3%	19.3x	18.0x	20.0x	18.6x	757	756	na	na	1.70x
Average					**26%**		**1%**	**22.1x**	**21.4x**	**23.8x**	**23.3x**					**2.2x**

Senior Gold Producers

Company Name	Symbol	Price ($)	Target Price	Stock Rating	Target Return	Mkt Cap ($mln)	Dividend Yield	EV/EBITDA		P/CF		Prod. (koz Au)		AISC Cash Cost		P/NAV (x)
								2021E	2022E	2021E	2022E	2021E	2022E	2021E	2022E	
Agnico Eagle	AEM-NYSE | AEM-TSX	$53.18	$74.00	OP2	39%	$12,993	2.6%	7.8x	7.2x	8.4x	8.5x	2,056	2,108	$1,014	$997	1.66x
Barrick Gold	GOLD-NYSE | ABX-TSX	$18.48	$27.50	OP2	49%	$32,901	4.2%	6.3x	6.5x	7.4x	7.5x	4,431	4,780	$1,023	$962	1.07x
Newmont	NEM-NYSE | NGT-TSX	$54.30	$70.00	OP2	29%	$43,301	2.9%			8.9x	9.5x	6,035	6,258	$1,055	$1,036	1.35x
Average					**39%**		**3%**	**7.0x**	**6.9x**	**8.3x**	**8.5x**					**1.4x**

Source: Raymond James Ltd.

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Insights & Strategies

PRIVATE CLIENT SOLUTIONS

November 1, 2021

Contents

Runaway Inflation or is it just Transitory?

The recent surge in inflation has proven to be more persistent than expected and has been dominating the headlines. Consumers have seen the prices of everyday goods (e.g., clothes, housing, food, cars, etc.) increase meaningfully, and are now wondering if we are heading for a repeat of the hyperinflation era of the 1970s or if these pressures are just transitory.

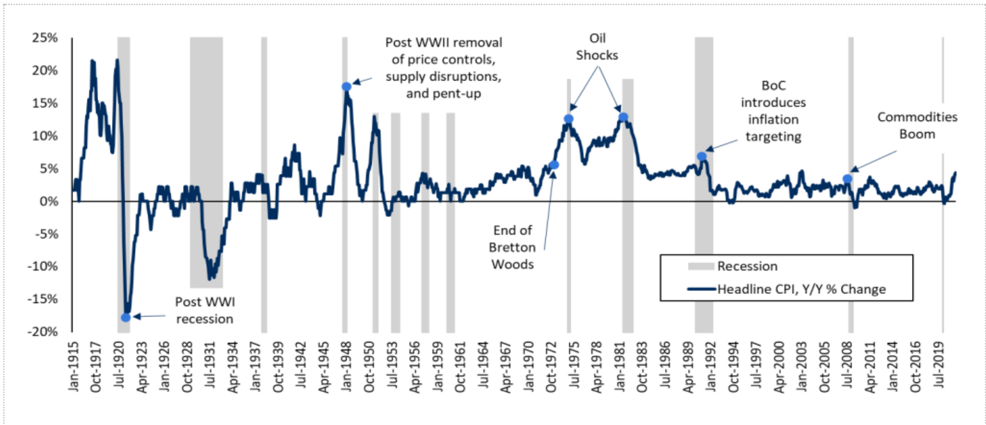
While most experts still believe inflation will be transitory (i.e., expect inflationary pressures to remain elevated over the short-term before normalizing back to the historical trend rate), there have many interesting comparisons to the inflation environment of the 1970s, which was very negative for equity markets and consumers alike, and to the post-World War II (WWII) era, which was positive overall for markets. After combing through over ~100 years of data, we believe the factors present today are more reflective of the post-WWII era than the hyperinflation environment of the 1970s. These factors include supply disruptions, pent-up demand, low interest rates, increasing debt, and labour shortages. While we have yet to see sustainable drivers of inflation (e.g., persistent levels of wage inflation), we expect inflation to remain above trend in 2021 and into 2022, but to normalize thereafter. Against this backdrop, we do not expect the Bank of Canada (BoC) to move interest rates materially higher in the near-term or as aggressively as markets are currently pricing in. In fact, we expect interest rates will move higher starting in mid-2022, with monetary policy remaining highly accommodative.

The key takeaway for investors is that, even in the face of higher inflation and yields, the outlook for equities remains positive. Looking back to periods of rising inflation and yields since the 1990s, Canadian equities performed positively around 70% of the time.

A Walk Down Memory Lane…

The chart below shows consumer price inflation (CPI) for Canada since the mid-1910s. The first thing to note is the **smaller magnitude** of the current rise in inflation compared to previous episodes when inflation reached double digits (e.g., during the 1970s).

Headline CPI, Year-over-Year (Y/Y) % Change



Source: Statistics Canada

Please read domestic and foreign disclosure/risk information beginning on page 6.

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The increases in prices in the 1970s and the early 1980s were triggered mainly by unsustainable increases in oil prices, caused by the embargo implemented by OPEC, along with the decline in production during the Iran-Iraq war (OPEC controlled 56% of the global energy markets in the 1970s vs. about 40% today). That was effectively a supply constraint or supply shock, which is loosely comparable to the supply chain disruptions we are facing today. Back then, unlike the end of 2020, Canada and the US were net-importers of energy. If we look back further to the post-WWII era, the comparison seems more adequate. Aside from price controls, high inflation was caused by supply disruptions and pent-up demand, two important factors behind the current surge in inflation. During the post-war period, the interest rate was kept low, debt increased significantly, and labour shortages surfaced, adding to the similarities described above.

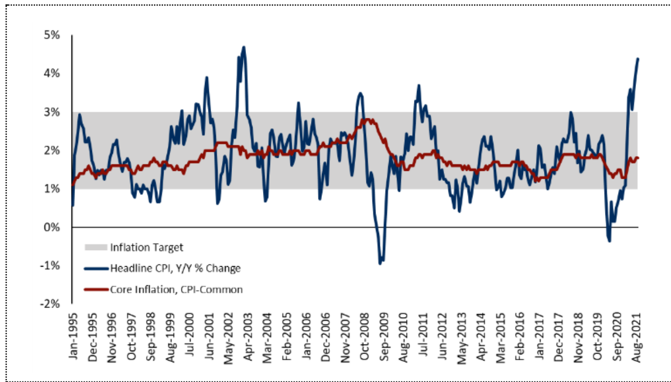
Not Everything is What it Seems

The similarities end there. Arguably, the most important factor that contributed to the rise in inflation during the post-WWII period was the removal of price controls. The economic structure was very different, in particular the monetary system. Canada played an important role as one of the founders of the Bretton Woods system[1], in which countries kept their currencies fixed to the US dollar, which was fixed to gold. In this setting, the primary goal of monetary policy was to control the exchange rate, not inflation. The Bretton Woods system eventually collapsed. In 1973, almost all economies had left the system and their currencies had begun to float.

The Inflation Targeting Regime

Almost two decades after the collapse of the Bretton Woods system, in 1991, the BoC and the federal government created the inflation targeting regime, with a series of targets for reducing inflation. Since 1995, the target for the annual rate of consumer price inflation is 2%, the midpoint of a 1%-3% range. In this framework, the goal of the central bank is clear. The BoC uses interest rates to control inflation, letting the exchange rate float. The following chart shows that inflation has been around this target range for most periods since the adoption of the inflation targeting regime, with much less volatility. Also important to note, the BoC's preferred measure of core inflation is below the mid-point of the target. **<u>Core inflation measures general changes in prices without interference from more volatile prices, which usually are temporary</u>**.

CPI during the Inflation Targeting Regime, Y/Y% chg.

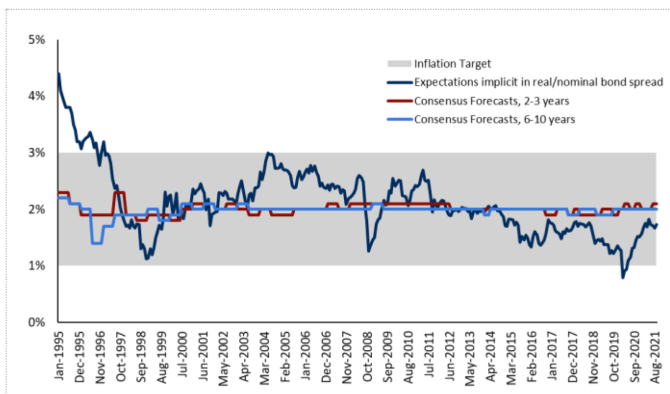


Source: Statistics Canada, Bank of Canada

Enough Looking Backwards – Now Looking Forward

Three major factors are behind the recent surge in inflation: **1)** significant demand ($17 trillion in fiscal stimulus since the start of the pandemic), although there is still excess supply in the economy; **2)** supply chain disruptions; and, **3)** higher commodity prices. We expect each of these factors to normalize by the end of 2022, when inflation should be back within the BoC's target range. This view is further supported by inflation expectations – one of the most important determinants of inflation – being anchored.

Inflation Expectations still Anchored



Source: Bank of Canada

Final Thoughts for Investors

Although uncertainties remain high, we do not expect a runaway period of inflation. The outlook for the economy is still robust and supportive of equity markets.

Nadeem Kassam, MBA, CFA, Head of Investment Strategy
Luiz Furlani, PhD, CFA, Associate Investment Strategist

[1] Canada left the Bretton Woods system in 1950 and adopted a floating exchange rate. The country eventually returned to Bretton Woods in 1962.

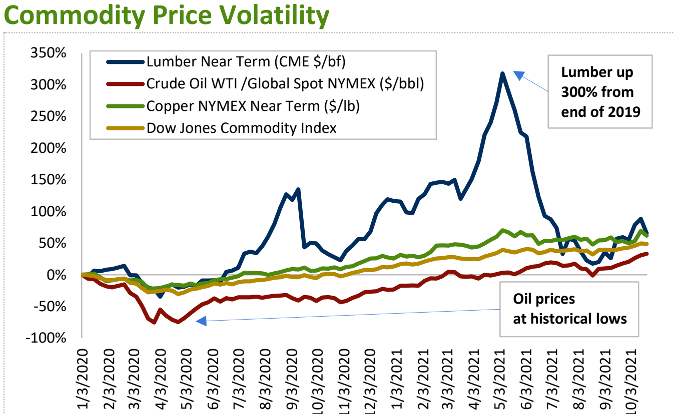
Stock Portfolios versus Inflation

Inflation is a risk that affects all portfolios and one that investors need to watch closely. Inflation risk is the threat that rising prices will erode purchasing power, especially if a portfolio of investments does not keep up with the pace of inflation. One way investors can help protect themselves from inflation risk is by revisiting their asset allocation mix. Undeniably, each investor's optimal asset allocation mix depends primarily on two key factors: one's investment time horizon and their ability/willingness to take on risk. Investors concerned about inflation risk could consider increasing their allocation to stocks; however, not all stocks are created equal in protecting against inflation. Consider investing in companies that can pass on any cost increases directly to their customers or that directly benefit from an inflationary environment.

Commodities for Inflation-protection

Commodity sectors, which include energy and materials companies, directly benefit from inflationary environments since prices for the commodities produced (e.g., oil, gas, copper, or lumber) have a tendency to also perform well. While commodities do well, energy and material companies do even better than the underlying commodities they produce since a lot of these companies have fixed costs; many commodity producers operate the same machines with the same number of employees, no matter the price of the commodity. Thus, when commodity prices rally, these companies have the same level of expenses, with the additional revenue from higher commodity price increases flowing directly to their profits; this is commonly referred to as operating leverage.

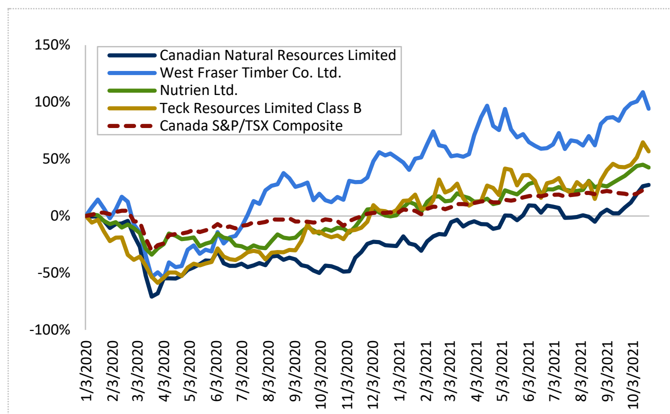
Commodity Price Volatility



Source: FactSet, Raymond James Ltd.

The pandemic's impact on commodity supply and demand profiles has been a major driver of the surges we've seen in commodity prices over the past couple of years. Copper prices benefitted from reduced copper supply as mines shut down due to labour shortages/social distancing measures; lumber prices benefitted from increased demand as work-from-home conditions caused more consumers to renovate and remodel their homes; and oil prices were affected by increasing demand as economies slowly reopened. Since the end of 2019, the price of oil is up 33%, copper +62%, and lumber up 65%. In fact, lumber prices were up over 300% just at the end of April 2021. Commodity prices are volatile, meaning their prices fluctuate considerably; and any impact on supply or demand, whether due to COVID-19, may cause increased volatility in these commodities along with the stock prices of the commodity producers. Considering the present inflationary concerns, we believe investors willing to accept the inherent risk of investing in commodity sectors should focus on buying high-quality companies that have successfully managed the ups and downs of a full business cycle and changes in inflation expectations. Examples of quality names include oil & gas producer **Canadian Natural Resources (CNQ-CA)**, crop nutrient company **Nutrien (NTR-CA)**, steel-coal and copper miner **Teck Resources (TECK.B-CA)**, or lumber producer **West Fraser Timber (WFG-CA)**.

Rallying from Pandemic Lows



Source: FactSet, Raymond James Ltd.

Consider your Risk Tolerance

It is important to remember that stocks are inherently volatile, and commodity stocks even more so. We suggest investors consult with their financial advisors before increasing their allocation to commodity sectors, and to determine whether any of the above mentioned companies match their risk tolerance levels.

Larbi Moumni, CFA
Senior Equity Specialist & Portfolio Manager

Inflated Expectations

Whether inflation is here to stay or is more transitory is key in determining the next step for policy makers and investors alike. As investors, there are ways we can protect ourselves from persistent inflation, including how we build our portfolios and the investments we choose. In this article, we will address the high-level affects inflation can have on an investor's portfolio, and several asset classes that have positive correlation to inflation historically, i.e. as inflation increased, the returns were also positive.

Inflation and Fixed Income

As inflation increases, it decreases your real return. Real return is a measure of your return after accounting for the impacts of inflation. For example, if you own a bond with a current yield of 2% and inflation is at 2%, then your real return is zero (2%-2% = 0%). Inflation consistently eats away at investors' real purchasing power, so it is an important consideration when setting investment return expectations.

Government fixed income: Protecting against inflation in the fixed income segment of your portfolio does not mean taking on more risk. Governments in both Canada and the US issue bonds that provide protection against inflation. In Canada, the federal government issues real return (RR) bonds, with coupon payments adjusted for inflation based on the consumer price index (CPI). The US government issues treasury inflation protected securities (TIPS) where both the principal and interest payments are adjusted for inflation based on CPI. While this sounds like a perfect solution, there are drawbacks. Bonds that provide protection against inflation usually come with lower yields given the added protection**.**

The market for RR bonds in Canada is small relative to the US and heavily weighted to longer maturity bonds. As a result, the RR bond index in Canada only holds about eight bonds and has a duration of over 16 years as measured by one index ETF. Low numbers of issues typically mean lower liquidity, which can lead to unfavourable prices. High duration can lead to short-term negative total returns if interest rates move higher. The reason rates might move higher is that raising interest rates is a primary tool for policy makers to combat inflation. Therefore, while Canadian RR bond ETFs are available, investors should use them cautiously. The US TIPS market is larger by issuance size and offers 5, 10 and 30-year maturities. Varying maturities allow investors to build a diversified portfolio of TIPS with benchmark-like duration; therefore, you do not need to take on excessive duration risk to gain inflation protection. Canadian investors can access these markets by leveraging the following list of ETFs.

Name	Ticker/Fund Code	Active / Passive	Fund or ETF
iShares Canadian Real Return Bond Index	XRB	Passive	ETF
BMO Real Return Bond Index	ZRR	Passive	ETF
Mackenzie US TIPS Index	QTIP	Passive	ETF
CI U.S. Treasury Inflation Linked Bond	CTIP	Passive	ETF

Source: Raymond James Ltd. Data as at June 30, 2021.

Credit exposure: Investors looking for higher yielding (and higher risk) securities amid rising inflation and interest rates can leverage ultra-short duration floating rate loans. While senior loan ETFs do not explicitly control for inflation, their ultra short duration protects your portfolio from rising rates. Given that floating rate loans are typically sub-investment grade, they carry a higher yield, which can also offset at least some affects of inflation. In the **April 2021 Insights and Strategies** we covered how investors could protect against rising rates. In this report we revisited two floating rate loan ETFs: First Trust Senior Loans (FSL-T) and Mackenzie Floating Rate (MFT-T). We believe active management is key in this sector, as both ETFs are given lower levels of liquidity and the higher credit risk.

Inflation and Equities

Inflation is typically seen as a lagging indicator of the market cycle; whereas equity prices are a leading indicator. This does not mean equities cannot provide some inflation protection, but should be a consideration in portfolio selection. Businesses that can more effectively pass through the higher costs are more resilient during periods of high and persistent inflation. Both REITs and commodities are examples and are discussed.

Real estate and REITs: One of the most commonly noted equity 'hedges' against inflation is commercial real estate. The rationale is that inflation-sensitive costs are typically the responsibility of the tenant and, therefore, inflated costs are simply 'passed through' to them. The July 2021 Insights and Strategies, "**REITS–A Buyers Guide**" provides a detailed look at REITs and offers some investment options.

Commodities*:* Commodities are also seen as an effective hedge against inflation. The June 2021 Insights & Strategies titled: "**ETFs & Commodities–A Buyers Guide**" can serve as a resource for those looking for commodity exposure.

Spencer Barnes, MSc., CIM
AVP & Portfolio Manager, Mutual Funds & ETFs Strategy

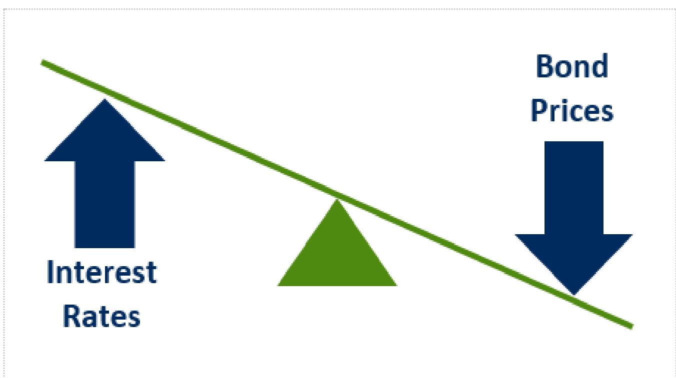
Interested in Inflation

In September, the annual inflation rate rose to its highest level in almost 20 years, rising at a pace of +4.4% year-over-year. While the rate was described as transitory, contributing factors persist. For example, there remains a large disconnect between supply and demand; supply chain issues continue to hinder production and the transport of goods, while demand has grown significantly. If the underlying issues leading to inflation endure, inflation itself could stay above historical levels for longer than previously expected. At the end of October, the Bank of Canada announced it would end their quantitative easing program and communicated that a rate hike could come sooner than previously conveyed. The bank determined that, despite the prolonged effects of the pandemic on the supply chain, commodity prices, etc., the output gap is likely to be narrower than they had predicted.

Rising Expectations

Inflation expectations, and its effect on rates set by the central bank are very important to consider when investing in bonds. As the Bank of Canada raises short-term rates, other yields further out on the curve also increase in response. Since most bonds offer fixed rates, hence, the name fixed income; they expose investors to interest rate risk, whereby they are affected by changes in the overall rate environment. When there are sustained inflationary pressures above the target range, interest rate hikes help combat them. As interest rates rise, consumers tend to save more rather than spend, and this shift in behaviour should work to slow an overheating economy and bring inflation lower. Since fixed-rate instruments pay out a predetermined coupon, the price of a bond falls as current yields rise to compensate for the change in rates.

Inverse Relationship between Rates and Prices



Source: Raymond James Ltd.

However, price fluctuation is not a concern for investors who are looking to hold a bond to maturity. For these individuals, they should find comfort because, as long as the held security does not default (a rare event in investment-grade securities), they will receive par at maturity. Some products like GICs do not experience this fluctuation but, having no liquidity, they also do not provide the option of selling prior to maturity.

What Motivates your Investment Decisions?

Bond purchasers need to consider the motivations behind their investment decisions. For some, preservation of capital is a key factor–perhaps the money has been earmarked for something very specific and the entire amount is required at a particular time in the future. Capital preservation — avoiding a loss of principal — is a very good reason to purchase fixed-income securities, even in lower yielding times. Other investors look to maintain a diversified portfolio, including a sleeve of fixed income along with other investments, such as equities. These individuals may benefit from lower volatility than those who invest solely in one asset class.

Putting Money to Work Today

In today's environment, we recommend investors purchase bonds with shorter terms to maturity. Instruments with maturities less than three years out could provide better compensation to the holder from the risk of rising rates. In addition, shorter maturities allow the holder to see their principal returned sooner, enabling them to reinvest at prevailing rates at maturity. Clients can look at corporate bank bonds with a term to maturity between two and three years, or one to three year GICs (if liquidity is not required). For a more hands-off approach to your fixed income positions, consider laddering bonds, skewed to high-quality corporates, with maturities four to six years out, complemented by a one to four year GIC ladder. This allows investors to stagger maturities across multiple periods, providing a reinvestment opportunity with a portion of their capital over several years.

Clients may also consider products that have payments that can increase over the life of the product, such as real return bonds or step-up notes. Real return bonds see their principal adjusted for inflation and, since coupon payments are based on the adjusted principal, they keep pace with inflation as well. Step-ups also can experience rate changes, but these are based on a predetermined schedule rather than CPI. Usually annually, the coupon of step-up bonds increases, or steps up. To benefit the most from this product type, look for a step up on the secondary market that is trading at a discount to its issue price and carries a healthy step-up rate.

Charlotte Jakubowicz, CMT, CIM
VP, Fixed Income & Currencies

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https://raymondjames.bluematrix.com/sellside/Disclosures.action

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Insights & Strategies

PRIVATE CLIENT SOLUTIONS

October 1, 2021

September Effect Meets Wall of Worry

Contents

After months of summer slumber, market volatility once again reared its ugly head in September. While it caught some off guard, the past 20 years of historical returns show that September has typically resulted in the worst month-over-month showing for the S&P/TSX, with an average return of -1.3% (vs. a range of +1.8% to -0.8% for the remaining months). It is believed that investors *sell in May* or park capital in safer securities while they take off on summer vacation, but return in September ready to lock in gains or tax loss selling before the end of the year. With the markets up ~16% in the first six months of the year, and with COVID-19 restrictions being lifted across the country, we believe many did just that and parked capital in defensive positions - e.g., government bonds, large-cap stocks, large-cap technology, domestic/defensive equities, etc. - while they took off for a much needed vacation.

However, as many investors return to business as usual, they have been met with a heightened level of uncertainty or a *Wall of Worry* including the Canadian elections, quantitative easing (QE) tapering, elevated inflationary pressures, the fourth wave, EPS risk, and a softening in the Canadian economy (Q2 real GDP contracted for the first time since Q1/2020). This is in addition to several global worries, such as uncertainty over the US infrastructure bills/debt ceiling, at least three distinct issues in China, geopolitical risk, etc.

Despite all this, we want to remind investors that **"the time to worry is when no one else is (e.g., Q4/2019) and the time to be buying is when everyone is selling (e.g., Q1/2020)".** The markets rarely go up in a straight line and, despite all the conflicting headlines and volatility in recent economic data prints, the Canadian economic outlook remains positive and we recommend clients **stay invested and buy the dip.**

The economy is in the early-/mid-phase of the business cycle

Business cycles are fluctuations in an economy's general activity and commonly include four phases with the following characteristics:

- **Early-cycle**: GDP growth moves from negative to positive as the economy recovers from a recession. High growth rates occur in this phase. Monetary policy is easy and inflation is low.
- **Mid-cycle**: GDP growth increases and eventually hits its peak. Inflation rises, and the central bank removes stimulus as it approaches a neutral stance.
- **Late-cycle**: GDP growth slows as the central bank adopts a more restrictive monetary policy to control inflation.
- **Recession**: GDP growth contracts and the central bank loosens its monetary policy stance. Inflation decreases.

Most indicators that we monitor suggest the Canadian economy is in the early-/mid-phase of the business cycle, which is historically favourable for equity markets. While real growth is impressive and expected to hover above trend in 2021/2022, GDP is still below potential and conceivably has a long way to go until it is back to normal. This is also the case for the unemployment rate.

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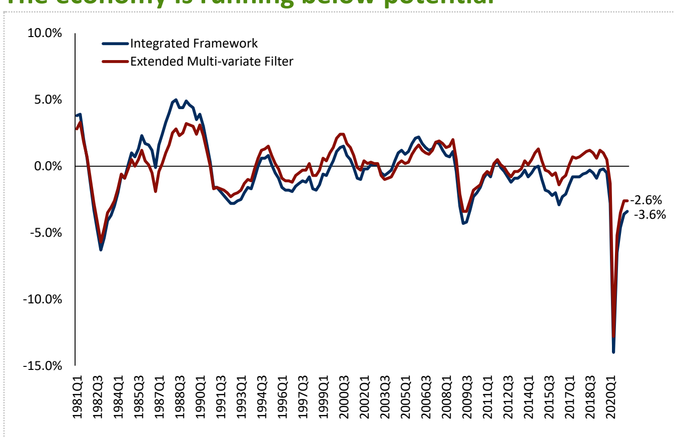
Estimating the potential output and the output gap is important for the Bank of Canada's (BoC) monetary policy, since the output gap – the difference between actual output of the economy and its potential – is a key indicator of inflationary pressures in the economy. When demand is strong, actual output can move above potential, pushing against the economy's capacity to produce and putting upward pressure on inflation. Potential output can thus be defined as the level of output that can be sustained in an economy without adding to inflationary pressures. Potential is determined by structural factors such as demographic developments, education, innovation, and the amount of capital. However, estimating potential output is a difficult task because it is not observable and its determinants can be difficult to measure or estimate.

The two approaches leveraged by the BoC (e.g., the integrated framework and extended multi-variant filter) both suggest slack remains in the economy and thus is supportive of our outlook that we are only in the early-/mid-phase of the cycle.

The economy is running below potential



Source: Bank of Canada

Fiscal & monetary conditions still accommodative

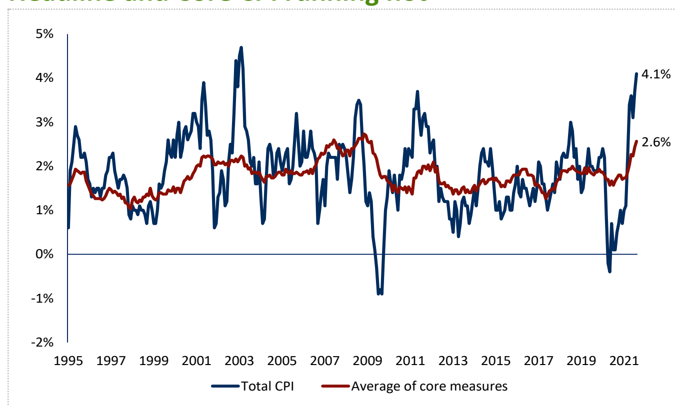
Fiscal and monetary policies are highly accommodative, even after the BoC started tapering (i.e., reducing its weekly bond purchases from $3 billion to $2 billion), and the Federal Reserve hinted it would follow suit. Following its latest policy meeting, the BoC left its target for the overnight rate at the effective lower bound of 0.25% (vs. the ~30-year average at ~2.5%) while maintaining its QE program at a target pace of $2 billion per week. Under all accounts, interest rates remain very low and supportive of economic growth, which we do not expect to change over the near term or until the BoC has completed its tapering efforts.

While the recent Federal election proved to be another non-event for the markets, the returning Liberal government proposed new spending plans of $80 billion (or ~4% of GDP), over the next five years. This supports our positive outlook for the Canadian economy.

Headline/Core Inflation

We expect inflation to remain elevated as we head into 2022. However, we expect most of the pressures that are causing inflation to run above trend will moderate as several transitory elements (e.g., supply chain issues, commodity pressures, elevated demand, etc.) should be reduced over the next year. This should keep inflation within the BoC's target range and result in a continuation of accommodative conditions.

Headline and Core CPI running hot



Source: Statistics Canada

The fourth wave

For Canada, given that 75% of the population has received at least one dose of an approved COVID-19 vaccine, the economic impact from new restrictions/lock-downs has so far been minimal. The evidence points to an increase in infections with no commensurate effect on hospitalizations and fatalities, which reduces the odds of renewed measures that would restrict economic activity.

Investor recommendations

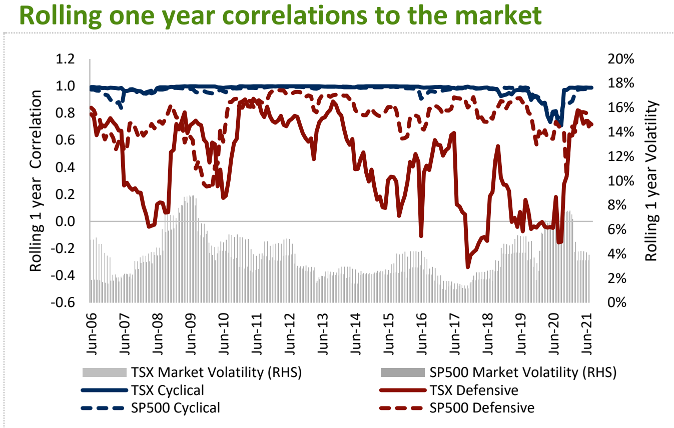
The outlook for the economy is robust and supportive of equity markets. We see firm evidence that the economy is in the early-/mid-phases of the business cycle, which is historically beneficial for the performance of stocks. Uncertainties remain high, but cause for concern remains low. Leverage periods of weakness in equity markets to add to high-quality positions.

Nadeem Kassam, MBA, CFA
Head of Investment Strategy

Balancing Act Amid Shaky Markets

Professional investors will advocate for diversification across asset classes, sectors, investment styles, and more. Warren Buffett said it best, “diversification is a protection against ignorance”, making it an essential part of a disciplined investment process. For equity portfolios, this philosophy holds true, as diversification can yield significant benefits to investors in both the short and long term. In our previous publications, we have discussed how cyclical stocks outperform during the early stages of the business cycle. For an investment manager, this means weighting higher on cyclical sectors that are expected to benefit more from the macroeconomic backdrop. On the flip side, defensive sectors can also yield significant benefits by helping add stability to equity portfolios, especially during periods of high market volatility, when defensives outperform cyclicals. To hold true to the philosophy of diversification and maintaining a balanced strategy, allocating to both is strongly encouraged when investing for the long term. In our analysis below, we look at the risk characteristics of defensive and cyclical sectors against the S&P 500 and S&P/TSX over the last 15 years.

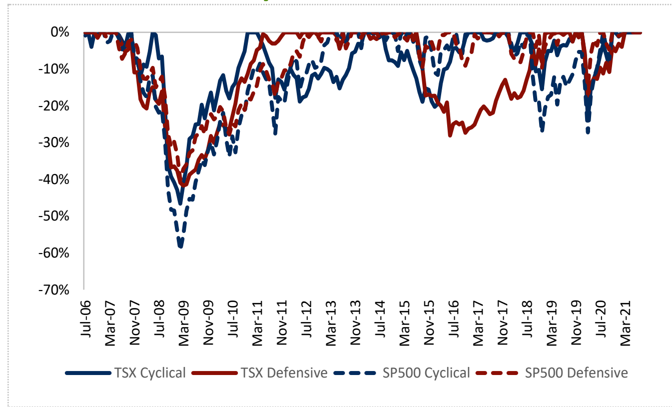
Rolling one year correlations to the market



Source: FactSet, Raymond James Ltd.

When constructing equity portfolios, investment managers will look at their portfolio correlation respective to their benchmark. Correlation is a measure of interdependence between two variables. It measures how much two variables change in the same direction, with a number ranging from -1 to 1, showing an inverse or direct relationship, respectively. In the above graph, we looked at the one year rolling correlations of cyclical and defensive sectors over the past 15 years. The graph clearly highlights that cyclical sectors are more correlated to the broader market. When we look at defensive sectors, the opposite is true, with correlation fluctuating and even turning negative during periods of increasing volatility.

Max drawdown for cyclical and defensive sectors



Source: FactSet, Raymond James Ltd.

Another metric for gauging the riskiness of a particular investment, portfolio, or style is by measuring the max drawdown. This is a measure of an asset’s largest price drop from peak to trough. When analyzing the behaviour of cyclicals and defensive sectors, we see the max drawdown for cyclicals is larger than that of defensives. For the S&P 500, cyclical and defensive sectors had a max drawdown of 59% and 40%, respectively. For the S&P TSX, cyclical and defensive sectors had a max drawdown of 47% and 42%, respectively. The data clearly shows that defensive sectors can help insulate portfolios by declining less than cyclical counterparts or the market.

Final Thoughts

Through this analysis, we show the relative benefits of including defensive sectors like communication services, consumer staples, health care, real estate, and utilities. These sectors are classified as defensive because of their business models and relatively stable cash flows and earnings. For the S&P 500, some examples of defensive names we favour in our guided portfolios are **Alphabet (GOOGL-US)**, **Costco Wholesale (COST-US)**, **Walmart (WMT-US)**, **Bristol-Myers Squibb (BMY-US)**, and **American Tower Corp (AMT-US)**. For the S&P TSX, some defensive names we favour in our guided portfolios are **Alimentation Couche-Tard (ATD.B-CA)**, **Jamieson Wellness (JWEL-CA)**, **Brookfield Infrastructure (BIP.UT-CA)**, **Granite REIT (GRT.UT-CA)**, and **Telus (T-CA)**.

Peter Tewolde
Equity Specialist

Making Sense of Bond Solutions

It's challenging to identify the best way to incorporate fixed income into your portfolio. Fixed income exposure can be gained through many products, including individual bonds, GICs, or managed solutions that hold a basket of securities (mutual funds and ETFs). To help decide which is right for you, the following are some key factors to consider.

Selecting individual bonds

Individual securities are ideal for clients who are looking for a fully customized solution to meet their needs. When you purchase single bonds or GICs, you can tailor:

- **Maturity:** If you have an upcoming payment due, you can match that liability with the maturity of your investment.
- **Credit quality:** Buying securities one by one allows for targeting of specific credit/yield to that particular term.
- **Liquidity:** Investors can choose if they need liquidity, often receiving higher yields for forgoing it.
- **Cash flow:** You can identify the date and amount of future cash flows over the life of the product at the time of purchase.

Using multiple distinct securities allows investors to build a portfolio that is adapted for them. For example, if a family has two children who will attend university, one in 2025 and another beginning in 2027, a ladder can be created where maturities start in 2025, and extend with larger maturities to account for both children's education from 2027 onward.

Buying a basket

Alternatively, some clients may be better served by purchasing mutual funds or ETFs (funds). These investors may prioritize aspects such as:

- **Diversification:** using a basket of securities through funds provides a simpler way to diversify versus individual names.
- **Unique areas of the market:** Clients wishing to gain exposure to more niche investments like high-yield or international bonds may be best served by active management through managed products.
- **Liquidity:** Under times of market stress, these securities may see higher liquidity, allowing the holder to sell out the position.

Funds provide cost effective and diversified exposure to bonds and can be built into many portfolios. However, funds lose the level of customization gained with individual names. One good example is selling a bond before it matures. Most bond funds follow a set of investment rules that dictate when bonds must be bought or sold. These rules typically maintain a specific credit rating, duration, etc. for the portfolio. The timing of a transaction can help you, but it can also generate a loss. When you own individual bonds, you can determine, based on your unique circumstances, if you want to sell that same security, or continue to hold the name.

Please yield

Yield on a portfolio is a common way investors evaluate their potential return and the attractiveness of an investment opportunity. There are many yield metrics, but one important metric to consider is yield to maturity (YTM). YTM measures the total rate of return for a bond that is held to maturity with coupon payments reinvested at the prevailing rate, all else equal. The calculation is complex, but this key metric provides investors with a long-term expected return for their bond or portfolio if markets remain stable over that time period.

Key factors that affect yield to maturity

Factor	Effect on YTM in general
Term to maturity	Higher YTM for a longer term
Credit rating	Higher YTM for lower credit quality
Embedded features (e.g. call features)	Mixed, based on who the feature benefits (issuer or holder)
Perceived safety	Higher YTM for lower perceived safety
Interest rates	Higher YTM for higher interest rates

Source: Raymond James Ltd.

Another common metric for bond portfolios and funds is distribution yield. The distribution yield is calculated as the most recent cash flow annualized, then divided by the net asset value. The distribution yield tells you what you are getting today; whereas the YTM tells you what to expect over the life of the asset. It is important to compare different bond solutions on the same metrics, i.e., apples to apples. The right bond portfolio is one that meets your unique investment needs and long-term objectives. For some, funds might be the best choice, while others might benefit from a customized solution. Raymond James offers both Conservative and Moderate Fixed Income Guided Portfolios of individual bonds that may provide the exposure you are looking for. As always, it is important to consider the reasons you are looking to purchase fixed income, and the factors you weigh more heavily before investing.

Charlotte Jakubowicz, CMT, CIM
VP, Fixed Income & Currencies

Manager Perspectives on Asian Markets

Markets around the globe experienced a volatile September. Many cite the current debt woes of Chinese real estate development company Evergrande as a cause for this disruption. The following is a Q&A style discussion with three active managers in Asian markets to understand the affects on their portfolios, and markets more broadly. Our commentary comes from Benjamin Zhan **(BZ)** who manages **Dynamic Asia Pacific Equity** (focus-list fund), Matthews Asia **(MA)** sub-advisors for **BMO Asian Growth and Income** (focus-list fund), and China AMC **(CA)** sub-advisors for **Mackenzie All China Fund**. Given the rapidly evolving situation, all views and commentary could be subject to revision by the managers.

Just how big is the Evergrande problem?

(BZ) Evergrande does not have a solvency issue, but a liquidity issue. Evergrande is an asset heavy company with 210 million square feet in owned land banks (inventory of land for future development or sale), and many projects under development, which were recorded on the company's balance sheet at a book value of US$192 billion. In addition, the US$300 billion debt figure could be misleading, with only US$110 of that debt being interest-bearing obligations. The remaining liabilities are subject to different terms from what is typically considered "debts" in western societies, because their repayment schedules and priority of claims are very different.

Could there be a contagion effect from Evergrande?

(MA) Evergrande's problems are unlikely to cause systemic problems and the likelihood of this devolving into a global financial problem is miniscule. Our base case is that Evergrande will undergo a restructuring that might cause loss to some stakeholders. The next couple of quarters could also result in additional demand for liquidity by the property ecosystem, from materials suppliers to contractors. This means that China will have to use some tools to ensure that there is sufficient system-wide liquidity.

Is Evergrande China's Lehman Brothers?

The answer to this question across managers was unanimously. No, it is not.

(CA) We believe Evergrande poses idiosyncratic credit risk (company specific risk) instead of systematic (market) risk and would not lead to broader contagion in the financial market. Lehman was brought down by the collapse of U.S. housing markets; whereas Evergrande failed on its own business strategy. The Lehman crisis was precipitated by a meltdown of subprime mortgage market; whereas, loan-to-value ratio (LTV) in China's housing market is much lower.

(BZ) The comparison to Lehman Brothers is widely off base. The now defunct U.S. investment bank was the mastermind and at the centre of multi-layered financial engineering with massive complexity and unmeasurable liabilities. Evergrande is an overly indebted, relatively simple player in a simple and asset-backed industry, real estate development. Yes, Evergrande borrowed immensely and carries chain liabilities as unpaid bills and delayed salaries, but unlike in the U.S., those liabilities were never securitized and multiplied thanks to China's relative underdeveloped financial system. So, those liabilities are identifiable, measurable, and realizable.

Does Evergrande's financial problems represent a risk to China's financial system?

(MA) We believe Evergrande's financial problems are highly unlikely to create a risk to China's financial system. The company has an enormous debt burden, but it is insignificant given the scale of China's financial system. In recent years, two companies with similar magnitude debt burdens, Anbang and HNA, were successfully restructured without creating systemic damage. As in the past, we expect the government to take an active role in managing the restructuring of Evergrande to mitigate the risks, by ensuring that its current liquidity problem does not become an insolvency problem and a bigger crisis of confidence in the Chinese financial system.

What is the current outlook for China today?

(CA) We believe China has set a clear path for economic development, gearing up for innovation-driven and sustainable growth rather than looking to real estate to stimulate growth. The government will pay more attention to home affordability and sustainable urban development. For real estate companies, the era of relying on rapid land appreciation and easy access to credit has gone.

(BZ) For the broader economy, if decisive actions are taken on Evergrande, it should be taken as a very positive sign by investors for two reasons. First, it is a clear sign that the Chinese government considers China as strong enough to absorb the affects, and the government has readied its system to proceed with in order. Second, China is proving that they are living up to their promise to move the country towards a free-market driven and law-based economy.

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FX – A Short Trip Around the World

USD

The broader USD came under some pressure following the latest Federal Reserve (Fed) decision. While a tapering announcement before year-end is essentially locked in, the market had been gradually pricing it in. Fed Chair Powell noted that, while a decision on tapering is not indicative of a liftoff in rates, the tapering process could conclude around mid-2022, implying a much speedier reduction in stimulus than many expect. Global growth expectations appear to be cooling a bit while inflation remains elevated. Many central banks continue to view the inflation shock as transitory due to supply bottlenecks and base effects, while reiterating their goal of supporting the recovery. This should provide an added tailwind for risk assets and weigh on the USD. Global financial conditions also remain well supported for growth, considering a central bank normalization backdrop, with rate hikes still years away for many. Given these global macro drivers, the DXY US Dollar Index has been increasingly tracking broader risk sentiment. We are not ruling out short-term USD strength as factors like the ongoing situation with China's Evergrande and the Fed's tapering on the horizon leading to a spike in US yields continue to affect broader risk sentiment, which may lead to the greenback catching a bid.

Positioning Recommendation: USD/CAD has been finding strong support at its 50-day moving average (MA) for most of September. We expect the pair to eventually fall within the 1.24-1.26 range by year-end as a rebound in oil prices and US/CDN yield spreads in CAD's favour keep USD strength modestly in check.

CAD

With the Bank of Canada ahead of the Fed regarding tapering, this may suggest some room for CAD strength in the months to come. Canada also recorded its first consecutive current account surpluses in Q1 and Q2 of this year, after running continuous deficits dating back to 2008, which should bode well for CAD as a form of a safe-haven currency. On a related note, Canada's net international investment position (NIIP), which is the difference between the value of a country's external assets and liabilities, is also quite robust at CAD$1.5trn or 61% of GDP as of Q2/2021. This puts Canada in net creditor status, which should provide the CAD with some additional armour in moments of broader risk-off market episodes (i.e., limited upside potential in USD/CAD).

Positioning Recommendation: Taken together with its rising correlation to oil prices, the CAD should find itself in a more favourable position against the EUR, GBP, and AUD, etc.

GBP

Already one of the top-performing G10 currencies, YTD, the GBP caught a surprising bid following the latest Bank of England (BoE) rate decision. While its main policy rate and pace of asset purchases were both left unchanged at 0.10% and £875bln, respectively, the decision was far more hawkish than expected. Two members of the Monetary Policy Committee (MPC) voted for a premature end to the BoE's program of government bond purchases, as the case for tightening appears to be gaining momentum. They revised expectations downward for Q3/2021 GDP growth to 2.1% (from 2.9%) and warned that inflation is expected to rise above 4% by year-end and may remain above this level well into Q2/2022. The key takeaway from the BoE was that the case for higher interest rates "appeared to have strengthened". This led to the market bringing forward its rate-hike expectations to February 2022. Despite some of the positive GBP developments stemming from the BoE's seemingly hawkish rhetoric, it will undoubtedly be faced with a tricky balancing act to convince the market that it can rein in inflation expectations while simultaneously dealing with a slower economic growth outlook.

Positioning Recommendation: After failing to clear the 1.76 handle to the upside on many occasions, GBP/CAD has been on a downward trajectory. We expect CAD to outperform the GBP given their respective macro outlooks and are thus looking at 1.70-1.72 as the next key range of support to the downside.

EUR

As far as G10 FX performance goes, the EUR has been mildly disappointing. It is down +4% against the USD YTD at the time of writing and is expected to remain under pressure going forward. The latest German IFO sentiment numbers came in more or less mixed versus market expectations, but the Business Climate index, a leading indicator for economic activity over the next six months, slipped to a five-month low. Shortages of semiconductor chips and other raw materials continue to strain Germany's manufacturing sector with supply bottlenecks. Together with disappointing PMI data, this may suggest further weakness in the EUR.

Positioning Recommendation: EUR/CAD has been pinned within the 1.48-1.50 range for most of Q3 and is currently trading around the 1.48 handle at the time of writing. Expecting CAD to outperform the EUR in the near term, the pair should eventually trade around the 1.46 level by year-end.

Ajay Virk, CFA, CMT
Foreign Exchange

Liquid Alts: Alternative Strategies Aren't Just for High Net Worth Investors Anymore

Until the Canadian mutual fund regulatory framework was changed in late 2018, traditional hedge fund strategies were largely reserved for sophisticated and high net worth (otherwise known as) accredited investors who had to qualify from a minimum annual income or net worth requirement. The result of these changes was the creation of a new class of mutual funds and exchange-traded funds called alternative mutual funds, or more commonly referred to as liquid alts, which now provide mainstream investors with additional choices for portfolio diversification. Investors may wish to include alternative investment strategies in their portfolios because of the characteristics they can exhibit, such as low correlation to stocks and bonds, downside protection features, diversified income streams, or the ability to enhance risk-adjusted returns.

Under the new rules, liquid alt investment fund managers can take advantage of a more flexible investment framework compared to what traditional mutual funds have been able to achieve. While there are still regulatory constraints on the degree of flexibility that can be employed within a mandate, managers can now use tools such as shorting securities, using leverage, and borrowing funds without cash collateralization to generate income, protect against equity market declines, or enhance returns for investors.

Liquid alts offer mainstream investors access to alternative investment strategies that can be used to more fully diversify an investment portfolio. Other key benefits for investors over traditional hedge fund investments include lower minimum investment amounts; increased liquidity (most funds have daily liquidity); additional transparency of underlying investment holdings; and no subscription agreements or paperwork that must be completed to invest.

Many investments managers have taken advantage of this enhanced investment framework since the revised rules went into effect, and the Scotiabank Alternative Mutual Fund Index now includes a total of 60 investment funds (as of August 31, 2021). As seen below, a well-diversified basket of liquid alts has offered downside protection and less volatility versus equity markets with a return that has been better than low-yielding fixed income mandates. In an environment where investors are required to make relative decisions about where to allocate capital for the appropriate investor, alternative investments can be a way to bridge the gap between equities and fixed income. In a low interest rate environment, alternatives can offer additional diversification and the potential to achieve a more favourable rate of return than fixed income, with less volatility than equities.

It's important to remember that despite increased accessibility to these products by everyday investors, not all liquid alts are created equal or serve the same investment purpose. An investor needs to carefully consider the fund's strategy based on their investment objective with an understanding of how the fund is expected to perform under various market conditions.

Emma Querengesser
Senior Alternative Investments Specialist

Return and Risk Metrics	YTD	1-YR	Annualized SI (Jan 1, 2019)	Annualized Volatility (%)	Return/Risk
Scotiabank Alternative Mutual Fund Index (Equal-Weighted)	**7.70%**	**11.68%**	**6.75%**	**6.30%**	**1.07**
S&P TSX Composite Index (Total Return, CAD)	20.16%	28.24%	18.12%	16.96%	1.07
S&P 500 Index (Total Return, USD)	21.58%	31.17%	27.03%	17.61%	1.53
MSCI World Index (Total Return, USD)	18.29%	30.33%	23.86%	17.59%	1.36
FTSE TMX Canada Universe Bond Index (CAD)	-2.59%	-1.66%	4.75%	4.79%	0.99

Historical Monthly Returns (%) – Scotiabank Alternative Mutual Fund Index (Equal-Weighted)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2021	0.76	1.60	0.64	1.78	0.31	0.76	0.80	0.82					**7.70**
2020	0.49	-2.70	-6.61	4.59	1.76	0.70	2.49	0.88	-0.68	-0.61	2.79	2.19	**4.91**
2019	1.60	0.69	0.81	0.82	-1.11	0.72	0.37	0.13	-0.14	-0.14	1.16	0.33	**5.33**
Sub-Index Performance (%) – Alternative Equity Focused (Equal-Weighted)													
2021	1.12	3.54	2.10	2.91	0.30	1.36	1.55	1.43					**15.20**
2020	-	-	-	7.10	2.37	0.52	3.13	1.60	-0.98	-1.07	4.53	2.61	**N/A**
Sub-Index Performance (%) – Alternative Credit Focused (Equal-Weighted)													
2021	0.52	0.15	0.10	0.48	0.28	0.70	0.16	0.23					**2.66**
2020	-	-	-	2.91	1.57	1.80	1.72	0.70	-0.43	-0.09	1.89	0.55	**N/A**

Source: Scotiabank, FactSet, Morningstar (as of August 31, 2021)

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"The Heat Is On"

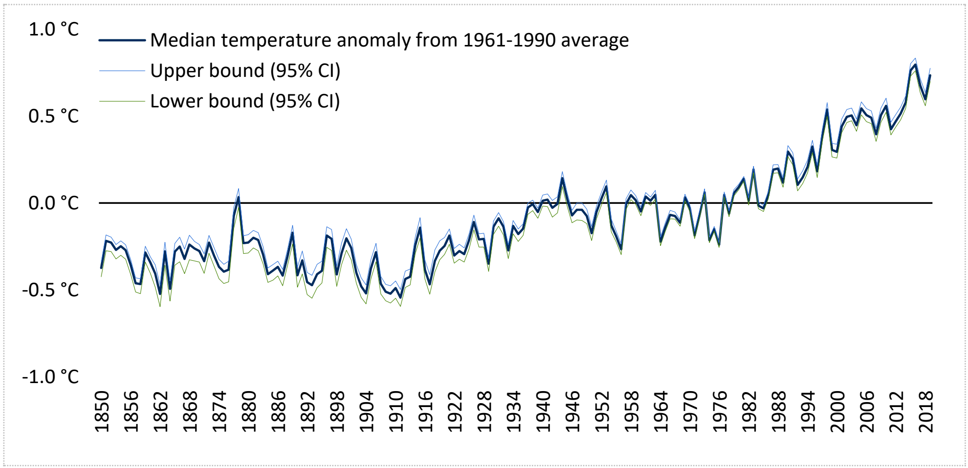
Contents

Growing up in the '80s, I was a huge fan of Eddie Murphy. His laugh was contagious and his acting was always entertaining. Still today, my favourite Eddie Murphy movie is Beverly Hills Cop. One of my favourite songs from the soundtrack was "The Heat is On" by Glenn Frey. This past weekend, as I read through the sixth assessment report (6AR) issued by the Intergovernmental Panel on Climate Change (IPCC), it was clear to me the United Nations was issuing a climate change warning that "The Heat Is On". According to the report, we are heading towards a climate disaster and unless we as a society make strong, rapid, and sustained reductions in CO2, methane, and other greenhouse gas emissions, humanity as we know it will face severe environmental consequences in the years ahead.

The odds of limiting warming to below 1.5°C is falling…

The IPCC report provides **conclusive** evidence that humans have been a major influence on warming the planet at an unprecedented rate. From extreme heat warnings for the first time in the UK, to raging forest fires in Canada and the US, to catastrophic floods in Germany and China, climate change is already causing weather and climate extremes in every corner of the world. According to the report, for humanity to have a 50% chance of limiting warming to 1.5°C it would need to limit carbon emissions to 500 GtCO2. With current CO2 emissions at 40 Gt per year, it is more than likely that the carbon budget will be exhausted in 12.5 years, if not sooner, if we do not make major changes. The 1.5°C mark is widely considered a climate tipping point, but with every additional increment of global warming, the projected changes in extremes will be more frequent and intense. The report projects that global warming of 1.5°C and 2°C will be exceeded during the 21st century unless deep reductions in CO2 and other greenhouse gas emissions occur in the coming decades. This will require the efforts of all stakeholders - corporations, government, investors, and everyday citizens.

Global average land-sea temperature relative to the 1961-1990 average



Source: Our World in Data; Raymond James Research

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Five Shared Socio-economic Pathways

In the report, the IPCC updated their five Shared Socio-economic Pathways (SSPs), which are scenarios based on distinct narratives describing broad socioeconomic trends that could shape future society. They include how societal choices, demographics, ideologies, and economics will affect emissions and climate action, and are used to create inputs for climate modelling. Interestingly, but not too surprising, under each of the IPCC's five core scenarios, there is a strong near-linear relationship between the cumulative CO2 emissions and global warming until year 2050. The following table summarizes the scenarios.

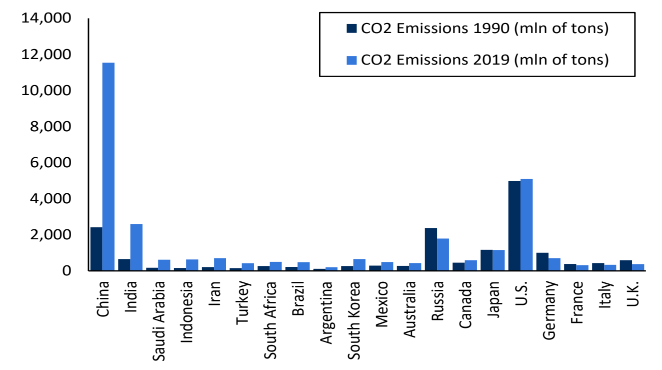
Description of the core five scenarios

Target	Warming Potential in watts per square metre	SSP Scenario		Description
1.5°C	1.9	SSP1	Sustainability - Taking the Green Road	World pivots toward sustainable development.
2°C	2.6			
4°C	4.5	SSP2	Middle of the Road	Social, economic and technological trends continue historic patterns.
4°C	7	SSP3	Regional Rivalry	A resurgent nationalism, concerns about competitiveness, food and energy security.
5°C	8.5	SSP4	Fossil Fuel Development	Development is coupled with the exploitation of abundant fossil fuel resources and the adoption of resource and energy intensive lifestyles.

Source: IPCC; AR6, Credit Suisse, Raymond James Research

A 2020 report published by the Emissions Database for Global Atmospheric Research (EDGAR) notes that despite growing awareness of the correlation between rising CO2 emissions and global warming, the trend has continued to increase since the beginning of the 21st century compared to three decades earlier. This has been mainly due to increasing CO2 emissions from China and other emerging economies. Meanwhile, several developed world economies have reduced their CO2 emissions over the past three decades, in particular the UK and EU. However, despite these encouraging findings, more has to be done for humanity to make significant progress towards the best-case scenario (SSP1) outlined in the IPCC's latest report. Specifically, significant efforts will be required by China, the US, India, EU, UK, Russia and Japan, which as of 2019, were the world's largest CO2 emitters and collectively accounted for 51% of the population, 62.5% of global gross domestic product, 62% of total global fossil fuel consumption and emitted 67% of total global fossil CO2.

Global CO2 emissions trending in the wrong direction



Source: European Commission; Raymond James research.

For investors who have been paying attention to the climate discussion over the past several decades, it should come as no surprise that the power industry is the largest contributor to CO2 emissions globally. Our growing energy demands continue to be met through the extraction and burning of fossil fuels. The growth in emissions from this sector has increased ~50% over the past three decades despite progress on the renewable energy front.

CO2 emissions by global sectors

	CO2 Emissions 1990 (mln/tons)	CO2 Emission by sector % of 1990 total	CO2 Emissions 2019 (mln/tons)	CO2 Emission by sector % of 2019 total	% Chg. 2019 vs 1990
Power Industry	8,882	36%	13,619	36%	53%
Other industrial combustion	4,852	20%	8,248	22%	70%
Transport	5,593	23%	8,199	22%	47%
Other sectors	2,439	10%	4,352	11%	78%
Buildings	3,069	12%	3,598	9%	17%
Total Global Emissions	**24,836**		**38,017**		**53%**

Source: European Commission; Raymond James research.

Investor Recommendations – "You can make a break, you can win or lose"

We expect more emission trading schemes and higher carbon prices to continue to be introduced in the years ahead. This will drive wholesale changes in the demand and cost profiles of industries and economies, with the largest CO2 emitters facing the greatest risk, including companies and sectors that do not heed the IPCC warnings.

Nadeem Kassam, MBA, CFA
Head of Investment Strategy

Investing in Climate Change

There are many potential investment opportunities in climate change, from renewable power to electric vehicles. Companies offering products, technologies and services aimed at helping the environment could play a big role in tackling and mitigating climate change. Below, we highlight a few areas and some select companies that may benefit along the way.

Renewable Power

Renewable energy sources like wind, solar, and hydro are important for the world's transition away from greenhouse gas-emitting fossil fuels, making renewable energy stocks the most obvious beneficiaries for the fight against climate change. Favourable regulatory environments around the world, encouraging policies for low-carbon generating technologies, more end-user demand for green energy, increased vehicle electrification, and declining costs of building new wind or solar plants are only a few of the drivers benefitting companies in this space. The cost to build new wind and solar projects has come close to, or less than, that of conventional combined cycle gas turbines, thus making new renewable energy generation projects more competitive. Select companies related to this space include renewable asset developers/owners such as **Northland Power (NPI-CA)**, **Boralex (BLX-CA)**, and **Brookfield Renewable Partners (BEP.UT-CA)**.

Energy Storage

While oil and gas are stored in natural gas reservoirs or fuel tankers to be used when we need them, renewable sources of energy also require storage solutions. Renewable power from intermittent sources like wind and solar only generate power when the wind blows and sun shines. In order for renewable power usage to grow, energy storage solutions such as lithium-ion batteries are required to store an excess supply of wind and solar power that may be sold during periods of peak demand at higher power prices. During periods of peak electricity demand, utility-scale renewable power coupled with battery solutions can compete with other power sources, such as natural gas-fired plants. Not only do batteries come in handy for utility-scale power generation, but also for powering electric vehicles and storing power to be used by end-customers. In fact, residential, commercial, and industrial customers with renewable power such as solar panels onsite can also store any energy for use at a later time when power prices are higher or during blackout periods. Companies that stand to benefit from energy storage include residential solar developers, utility scale storage developers, and battery manufacturers. Select names in these areas include **SunPower (SPWR-US)**, **NextEra Energy (NEE-US)**, and LG Chem.

Energy Efficiency

Buildings generate roughly 40% of annual global green-house-gas emissions, making energy efficiency a big part of tackling climate change. Improving building insulation/air sealing, heating/cooling technologies, and lighting to reduce energy consumption are key areas for improving energy efficiency within buildings. Besides buildings, industrial factories can also benefit from automation and more energy efficient equipment, which may enhance production efficiency through lower energy costs. As customers and governments look to save on energy usage, policymakers have focused on energy efficiency legislation, helping support the industry. In fact, the US Biden administration aims to upgrade 4 mln buildings to improve energy efficiency and help meet climate targets. Companies that develop technologies to reduce energy use include the likes of **Honeywell International (HON-US)**, **Johnson Controls International (JCI-US)**, **Ingersoll Rand (IR-US)** and **Emerson Electric (EMR-US)**.

Transportation

Electric vehicles (EVs) are becoming increasingly popular and a solid contender in the fight against climate change. While global EV penetration remains sub-3%, supportive regulations, climate change policies, and declining EV costs may provide positive tailwinds for increased EV adoption. While Tesla is the first EV maker that comes to mind, other automakers have also voiced their goals to electrify their car models. In fact, GM plans to transition all of its light vehicles to 100% EVs by 2035, while Ford is targeting 40% of its units sold by 2030 to be fully electric. Companies like **Tesla (TSLA-US)**, **General Motors (GM-US)**, and **Ford Motor (F-US)** may benefit from the EV trend.

Quality Focus

Investors can consider adding exposure to environmentally friendly industries within portfolios to help gain exposure to climate change related themes. In picking names, our focus remains on quality companies with clear competitive advantages, strong management teams, good balance sheets and a solid runway for growth opportunities ahead. While there are many ways to gain exposure to the space, we encourage readers to reach out to their financial/investment advisors and explore the options that match their risk tolerance levels.

Larbi Moumni, CFA
Portfolio Manager

The Environment of Electoral Promises

It's official. After a summer of speculation on a fall federal election, Canadians from coast-to-coast-to-coast are heading to the polls on September 20. In keeping with this month's theme of Environment, Social and Governance (ESG) or Responsible investing (RI), this article will highlight each of the major political party's proposals on the environment, and what affects those policies might have for ESG investors. We will also explore some ways to gain access to ESG and responsible based investments as a Canadian investor.

Each Political Party's Environmental Commitments

The incumbent **Liberal Party of Canada** has not officially released new specific environmental proposals this election. As a result, we looked at the 2021 federal budget for their environmental commitments. The 2021 budget included three major components related to the environment. The first is \$17.6 billion in 'green recovery' to fight climate change, reduce pollution, invest in clean technology and protect the environment. The budget also included \$8 billion in interest-free loans for homeowners to retrofit their houses to reduce their carbon footprint, and \$5 billion over 7 years in a 'Net Zero Accelerator' to help companies invest to reduce pollution.

The **Conservative Party of Canada** has outlined four key commitments to "combat climate change" in their 2021 platform. First is a low carbon savings account funded through taxes each time a person purchases hydrocarbon-based fuel. Funds in the account could finance green home retrofits, purchase transit passes, bikes, or electric vehicles. The second is to become a leader in zero emissions vehicles, including grid enhancements and hydrogen-powered vehicle development. The third and forth commitments include meeting the carbon emission reductions Canada agreed to at the Paris accord, and introducing carbon border tariffs on international polluters such as China. Part of the carbon emissions reductions include \$5 billion in carbon capture, utilization and storage investments by 2030.

The **New Democratic Party of Canada** outlined seven environmental objectives in their 2021 platform, with the key takeaways for investors summarized here. First would be to reduce Canada's emissions by at least 50% from 2005 levels by 2030 and achieve net 0% emissions by 2050. Carbon taxes remain a key driver to accomplish this, which is roughly in line with the other two parties. The next commitment targets net-zero electricity by 2030, and moves to 100% non-emitting electricity by 2040. To deliver on this commitment, the NDP would establish a new Canadian climate bank to boost investment in renewable energy, energy efficient and low carbon technology. Finally, the NDP looks to boost clean tech research and manufacturing with additional incentives.

Energy and Renewable Energy

Strategic policy for Canada's energy sector is also an important election consideration for investors, given energy's weight in our equity indices. With no new election commitments, we place the Liberal Party in a 'stay the course' on the Canadian Energy Sector, both in relation to new renewable energy development and support for hydrocarbon-based fuels. For investors, this could mean a similar, stay the course approach. A Conservative government would look to introduce 'streamlined legislation' that accounts for Canadian Energy companies being leaders in ESG compared to their global peers. This legislation would eliminate Bill C-69 (Impact Assessment Act for Energy Projects), and repeal Bill C-48 (Oil Tanker Moratorium Act). Such policies appear to support Canada's hydrocarbon-based companies while maintaining support for renewables. An NDP government would look to fulfil Canada's G-20 commitment to eliminate fossil fuel subsidies to oil, gas and pipeline companies, redirecting these funds to low carbon initiatives. According to NDP figures, in 2020, the federal government provided \$18 billion to support oil and gas exploration, production, refining, and transportation. A reduction in these subsides could be short term negative for hydrocarbon-based energy producers, but could spur significant new investment in renewable energy.

Investing for Any Outcome

With broad policy support from all parties for renewable energy, this is an obvious choice for those ESG and RI conscious investors to consider. In Canada, two passive offerings in the space include **Harvest Clean Energy ETF (HCLN)** that equal weights the 40 largest clean energy companies in the world and **BMO's Clean Energy ETF (ZCLN)** that replicates the S&P Global Clean Energy Index. Equal weighting is agnostic to company size or market position, and has a tilt towards smaller cap names (HCLN), whereas market cap weighting favours larger more established companies (ZCLN). **Dynamic Energy Revolution Fund** actively looks for established, quality dividend paying companies in the renewable energy sector trading at reasonable valuations.

For investors looking for clean technology more broadly, Desjardin's SocieTerra Cleantech Fund, and NEI's Environmental Leaders Fund are good starting points. Both funds are managed by Impax Asset Management and only invest in companies with a certain percentage of revenue in clean technology. Last but not least, hydrogen. **Horizon's Global Hydrogen Index ETF (HYDR)** provides investors with exposure to the development of hydrogen technology, including fuel cell, storage and transport.

Spencer Barnes, MSc., CIM
AVP & Portfolio Manager, Mutual Funds & ETFs Strategy

Fed & ECB Divergence May Signal a Rough Road Ahead for the Euro

August saw the euro trading at a nine-month low against the US dollar as market consensus rallied behind the notion that the euro zone will maintain its low-interest-rate policy (currently in negative territory) and that its economic recovery would be relatively slower and more challenging than that of the United States. At its last meeting, the European Central Bank (ECB) reiterated that it would keep its aggressive monetary stimulus framework firmly in place as it attempts to underpin the euro zone's economic recovery process, while kicking the "taper-talk" can down the road. While the ECB did in fact provide an increasingly supportive economic growth outlook, it still expects that inflation will remain well below its target at the end of its forecast period in 2023.

This is in stark contrast with the Federal Reserve (Fed), which has increasingly banged on the elusive taper-talk drum as US economic activity and employment levels have strengthened. This signals that they are in fact looking ahead and on track to scale back asset purchases, which currently sit at $120bln per month, by year's end.

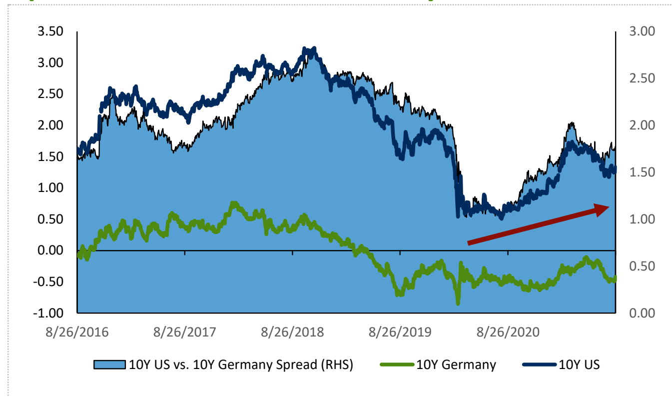
Spread between US Treasury & German Bund yields continue to widen

The hawkish rhetoric emanating from the Fed as of late has helped to lift US rates off their lows. Not to mention, the US House of Representatives have cleared the path toward passing a $3.5tln budget resolution blueprint and set a late-September deadline for a vote on the $1trln infrastructure bill. Thus, expectations of higher growth, inflation and an increased US Treasury supply should support US yields in the near term.

In Europe, the focus is traditionally on German bund yields as it is considered the safe-haven benchmark for the euro zone. Yields have rallied lately as investors seek the safety of sovereign debt in response to a bleak outlook for the region. This growing divergence between a seemingly sluggish European economic recovery and the rest of the world, especially the United States, is expected to widen and keep pressure on bund yields.

We can see this diverging outlook for the US and Europe play out in the spread between US Treasury and equivalent German bund yields, which has been steadily increasing since April of last year and is expected to continue widening. As long as the ECB continues with its asset purchases, this should continue to exert downward pressure on bund yields well into next year.

Spread between US & German yields on the rise

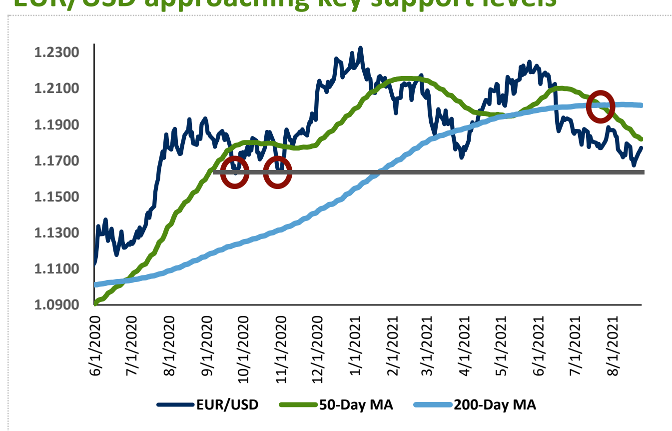


Source: FactSet

EUR/USD woes Deepen

As other global central banks are on the cusp of scaling back some of their pandemic-era stimulus policies, this will inevitably leave the ECB in the rearview as it continues to sit still and lie in wait for the euro zone's economic recovery to make up for lost ground. This growing divergence between the Fed and ECB will continue to weigh on the euro, which, at the time of writing, is already down +3.5% YTD. Not to mention, the Commodity Futures Trading Commission's latest report shows short-EUR positions increasing to levels not seen since the onset of the COVID-19 pandemic. Looking at the charts, we had a "death cross" pattern that formed at the end of July where the 50-day MA crossed below its 200-day MA. That is, of course, a very bearish signal for traders. The 1.16 handle is a level we are monitoring in the short-term, as it curbed some strong selling pressure on two occasions back in 2020.

EUR/USD approaching key support levels



Source: FactSet

Ajay Virk, CFA, CMT
Foreign Exchange

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