WAAC Perspectives

AUG 2021

TD Wealth Asset Allocation Committee (WAAC)

At a glance

1. **We maintain a modest pro-risk stance on global equities; however, we are more cautious in our outlook than in previous months. Returns are likely to moderate considerably as markets appear to be pricing-in full earnings and economic growth potential. Defensive posturing with a greater emphasis on quality may be warranted.**
2. **Inflationary risks may persist in segments of the economy as the global recovery unfolds. We continue to view these pressures as cyclical in nature, versus a longer-term structural shift. This view largely aligns with global central banks and has been reflected in the decline in long-term bond yields.**
3. **Aside from equities at the high end of fair value ranges, a mix of headwinds could impact markets going forward. These include, decelerating earnings and economic growth, more permanent inflationary pressures, unknown impacts of COVID-19 variants, and uneven vaccination rates globally.**
4. **While we maintain an overall modest underweight outlook for fixed income, we believe fixed income exposure within portfolios remains an important consideration due to quality income potential and the downside protection bonds can provide during high volatility periods.**
5. **Where appropriate, portfolio exposure to alternative assets may take on greater importance to achieve higher relative returns at more acceptable volatility levels. Alternative assets, such as mortgages, infrastructure and real estate can also act as a hedge against inflationary risks.**

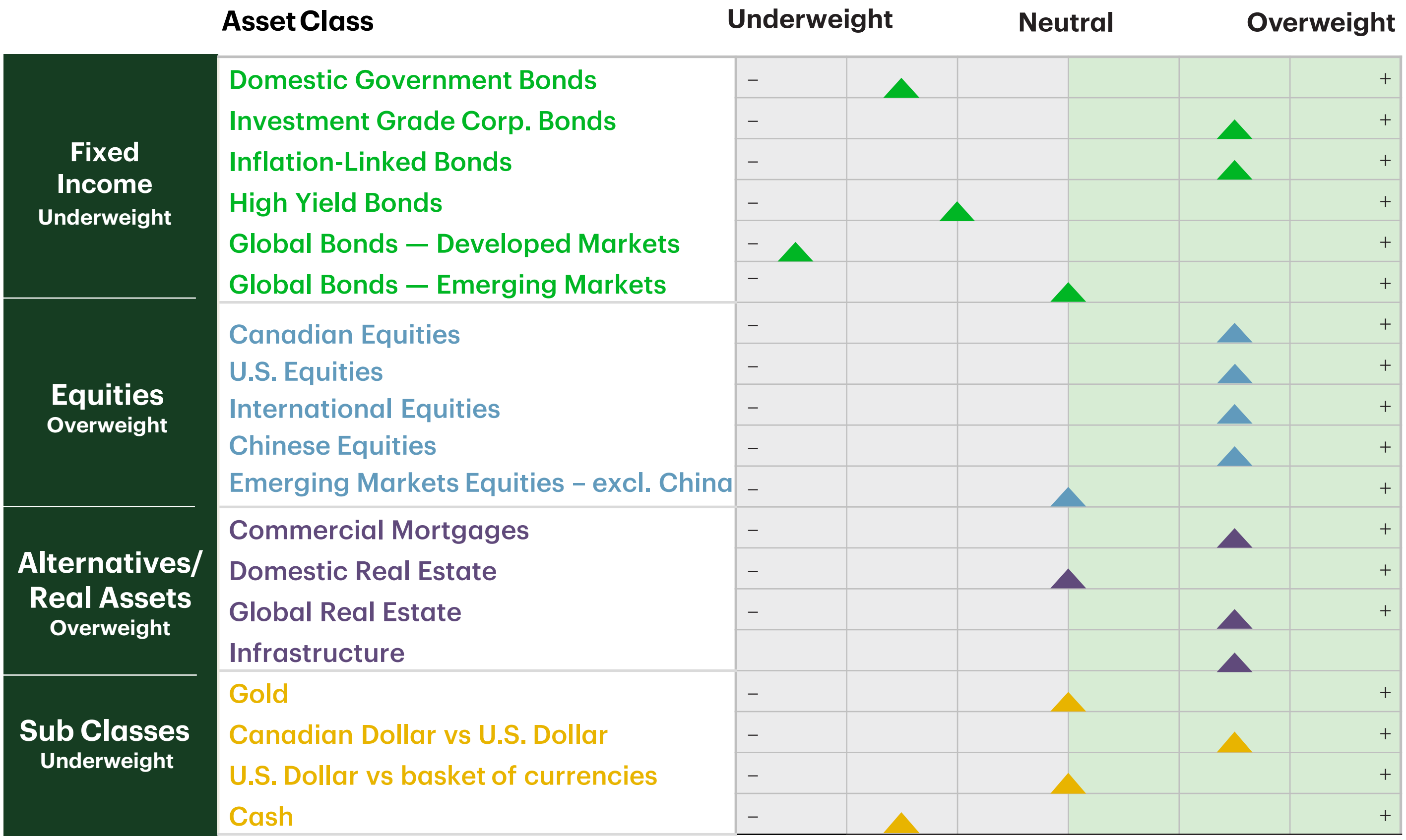
Positioning Changes

Asset Class	From	To	Rationale
Canadian Equities	Maximum Overweight	Modest Overweight	The strategic outlook remains constructive for Canadian equities, however potential weakness within economically sensitive sectors (i.e. Materials & Energy) could weigh on broader market returns as a result of slowing recovery demand.
Emerging Markets Equities (excluding China)	Modest Overweight	Neutral	Our outlook for emerging markets (EM) has shifted to neutral. Continued fiscal stimulus and the recovery in commodities has been positive for EM, but virus outbreaks, vaccine distribution that is lagging developed markets, and rising inflationary pressures in some countries, could act as headwinds.
Domestic Government Bonds	Maximum Underweight	Modest Underweight	We are slightly more positive on domestic government bonds as significant selling pressure is unexpected going forward. Though we maintain a modest underweight view due to the persistence of negative real yields.
U.S. Dollar (USD)	Modest Underweight	Neutral	Strong U.S. labour markets, an improving economic backdrop and the prospect for higher rates over the longer-term, are helping to underpin modest USD strength.
Cash	Maximum Underweight	Modest Underweight	Increased cash levels can provide greater optionality for strategic capital allocation, particularly during periods of elevated volatility.

	WAAC is Monitoring	Potential Implications
Equities Modest Overweight	**U.S. equities continue be driven by high investor risk appetite, and strong economic performance**	Abundant liquidity, strong investor risk appetite, and resilient labour markets, continue to be key drivers of U.S. growth. The business environment is healthy as Purchasing Manager's Index data remains expansionary, and broader financial conditions are strong. Alongside quality earnings growth, these factors should be supportive of U.S. equity gains, although the pace of returns will likely moderate markedly relative to the previous 12 months. The strategic outlook remains constructive for Canadian equities. Solid structural dynamics within Financials should contribute to Canadian market growth, however headwinds within other economically sensitive sectors may impede gains as the economy emerges from the restart. Canadian equity valuations remain attractive due to their relative discount to U.S. equities. Chinese equities have been a relative underperformer this year, due in part to broad regulatory crackdowns, but fundamentals remain sound and valuations reasonable. Economic growth should stabilize in the second half of the year, with authorities suggesting supportive policy intervention if needed. Business confidence in Europe remains high, and economic activity accelerating. We maintain a modest overweight outlook as we believe equity valuations do not adequately reflect Eurozone growth potential, particularly within cyclical sectors.
Fixed Income Modest Underweight	**Central banks committed to providing accommodative monetary measures until economic recovery is achieved**	Despite the less dovish tone in the second quarter, global central banks appear committed to providing accommodative monetary measures until a full economic recovery is achieved. Coupled with supportive fiscal programs from governments, this should provide a reasonably supportive backdrop for fixed income markets. We anticipate that nominal yields will be less responsive to inflation than during similar episodes in the past, yet the longer-term direction of yields should be higher. Given steadily improving fundamentals, we maintain a quality bias within investment grade corporate credit, as adequate compensation for risk can still be found in specific sectors. While we see some value in high yield corporate bonds, and the potential for yield pick-up, narrow spreads mean that extra caution in this space is warranted. As such, we maintain a tactical modest overweight to investment grade corporate credit and modest underweight to high yield bonds.
Alternatives/ Real Assets Modest Overweight	**Commercial mortgages continue to provide resilient income streams**	Commercial mortgages continue to generate steady income and returns with originally scheduled principal and interest payments fully collected. Capital returns have also helped performance with high-quality commercial mortgage spreads tightening versus falling government bond yields. Within Canadian real estate, as more government-imposed restrictions are lifted, the income return remains stable across property type and geography, with rent collection trending towards pre-pandemic levels. We see significant opportunity for growth in infrastructure with strong development pipelines in renewable energy and power infrastructure, supported by a base of core income-producing assets. In global real estate, logistics real estate, multi-unit residential and life sciences assets have contributed resilient income and continue to provide capital preservation and growth.
Sub-Classes	**Previous tailwinds for gold appear to be waning**	Previous tailwinds for gold appear to be waning. Gold's weakness has been driven by investor concern that an improving U.S. economy and higher inflation will motivate the Fed to ease its unprecedented economic support. Low rates have historically helped Gold's appeal versus assets that offer yields. The stronger USD and the relative outperformance of equity markets have also diminished demand for the safe haven metal. Strong U.S. labour markets, an improving economic backdrop, and the prospect for higher rates over the longer-term have contributed to USD strength. The USD continues to maintain a premium over many other G10 currencies, however a disruption in growth could shift sentiment away from the currency. We maintain a neutral outlook. We are optimistic over the long-term prospects for the Canadian Dollar versus the USD. The combination of strong progress in vaccinations, and economic growth momentum, bode well for the currency as Canada exits from pandemic related restrictions.

Strategic Positioning

At a Glance



We continue to monitor the above economic and market themes and believe that maintaining a portfolio of high-quality assets is critical to long-term investment success. While there is always potential for market volatility, we encourage investors to remain focused on the long-term. We consider periods of higher volatility to be normal market behaviour that can help clear excesses and create investment opportunities.