WAAC Perspectives

TD Wealth Asset Allocation Committee (WAAC)

SEP 2021

At a glance

1. Over the strategic horizon, the macroeconomic outlook remains favorable for equities. However, the pace of gains for global stocks will likely moderate markedly relative to the previous 12 months. While we remain positive on equities, we are more cautious in our outlook compared to the past year. Defensive positioning with an emphasis on quality may be warranted, as potential headwinds could drive episodic volatility.
2. Inflationary pressures have persisted in segments of the economy due to global supply chain backlogs, high consumer demand, and rapidly tightening labour markets. While we continue to view these pressures as transitory, the impacts could linger longer than initially thought; but prices should begin to normalize from current levels.
3. Aside from inflationary risks, a mix of headwinds could impact global markets over the next 12-18 months. These include, disruptions to the labour market recovery, peaking economic and corporate earnings growth, and the longer-term implications of COVID-19 variants.
4. While we maintain an overall modest underweight to fixed income, we believe fixed income exposure within portfolios remains important. Fixed income can provide quality income, diversification benefits and insulate portfolios during periods of elevated volatility.
5. Where appropriate, portfolio exposure to alternative assets may take on greater importance in diversifying sources of income and achieving 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

No positioning changes for September 2021

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	WAAC is Monitoring	Potential Implications
Equities Modest Overweight	**Despite equity prices at the high end of historical ranges, we do not view valuations as excessive**	Despite equity prices at the high end of historical ranges, we do not view valuations as excessive. As markets have risen, driven by strong earnings growth, forward price-to-earnings multiples have contracted, making equities more reasonably valued. Long-term structural trends remain intact and supportive of equities; however, market pullbacks in more expensive areas could fuel broader volatility. S&P 500 Index companies remain underpinned by strong earnings growth, although the pace of growth may be decelerating. As the economic recovery unfolds, we expect quality secular growth companies to outperform, as they may be less susceptible to near-term disruptions in economic conditions. In Canada, a cooling housing market and ongoing supply chain disruptions, dampened recent market activity. However, high frequency data suggests that the economy remains healthy and will continue to recover. Additionally, regardless of the outcome of the September Federal election, Canadian stocks appear to be discounting any major policy changes that could have material impacts on the market and economy. We see relative value in Chinese equities as market valuations are attractive. Lack of policy transparency remains a risk, but solid structural dynamics remain intact longer term.
Fixed Income Modest Underweight	**Corporate bonds, despite spreads remaining narrow, offer some value over government bonds**	The bond market will likely be subject to volatility from an uneven recovery, the inconsistent pace of vaccinations globally, potential for future virus outbreaks, and the impact of global central bank policy actions. We believe interest rates will remain near historic lows as the U.S. Federal Reserve (the Fed) continues to incorporate highly accommodative polices with respect to interest rates and their balance sheet. The yield curve may become steeper, with intermediate and long-term rates climbing on the back of positive economic prospects. Corporate bonds, despite spreads remaining narrow, offer some value over government bonds which continue to deliver negative real returns; thus, we maintain our preference for high-quality investment grade corporate bonds. Within high yield we believe pockets of opportunities exist, but the market is not homogenous, and due to idiosyncratic risks, we remain highly selective.
Alternatives/ Real Assets Modest Overweight	**Canadian real estate rental payment trends continue to improve**	Within Canadian real estate, rental payment trends continue to improve due to the reopening post third wave. Residential and industrial assets are expected to see continued value appreciation through 2021. The more transmissible Delta variant has tempered an otherwise upbeat reopening outlook. The pandemic has negatively impacted global real estate markets where both transaction volumes and leasing velocity have declined. However, office, industrial and residential sectors have performed relativity well given the circumstances. Within global infrastructure, the latter part of 2021 is expected to be active as investors reposition for a post pandemic world. We continue to increase focus on sustainable investing while embedding ESG compliance processes through the due diligence of new investments and asset management. The discipline demonstrated by commercial mortgage lenders prior to COVID-19 has helped to minimize deterioration in loan fundamentals, and the mortgage market remains relatively healthy with very few reported instances of defaults. We expect commercial mortgages to continue to provide resilient income streams.
Sub-Classes	**USD could see support from higher inflation and tapering prospects**	While the U.S. dollar (USD) has been rangebound, broadening concerns over the Delta variant, and a modest rebound in yields, have provided support and driven the recent positive performance. Additional support could come from higher inflation, tapering prospects and the performance of the U.S. economy versus its counterparts. We maintain our neutral outlook. Gold's underperformance in 2021 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 risk assets have also diminished demand for gold. We remain optimistic over the long-term prospects for the Canadian dollar and economic growth, versus the USD, despite the recent negative Canadian GDP print. The combination of strong progress in vaccinations and labour market recovery bode well for the currency as Canada continues to emerge from pandemic related restrictions.

Strategic Positioning

At a Glance

	Asset Class	Underweight	Neutral	Overweight
Fixed Income Underweight	Domestic Government Bonds	▲		
	Investment Grade Corp. Bonds			▲
	Inflation-Linked Bonds			▲
	High Yield Bonds	▲		
	Global Bonds — Developed Markets	▲		
	Global Bonds — Emerging Markets		▲	
Equities Overweight	Canadian Equities			▲
	U.S. Equities			▲
	International Equities			▲
	Chinese Equities			▲
	Emerging Markets Equities – excl. China		▲	
Alternatives/ Real Assets Overweight	Commercial Mortgages			▲
	Domestic Real Estate		▲	
	Global Real Estate			▲
	Infrastructure			▲
Sub Classes Underweight	Gold		▲	
	Canadian Dollar vs U.S. Dollar			▲
	U.S. Dollar vs basket of currencies		▲	
	Cash	▲		

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.