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GLOBAL

STRATEGY DASHBOARD: REBALANCE SUMMARY Q4 2023

David Foster Wallace once told a joke about two young fish who meet an older fish swimming the other way. The older fish says, “Morning boys, how’s the water?” The two young fish swim on for a while before one turns to the other and asks, “What the hell is water?”

For the last decade, our water has been ultra-low interest rates. Investors became conditioned to low and declining rates. Debt, demographics and digitization themes drove a narrative that any other environment wasn’t even possible. Everyone became convinced that prices could never rise materially again. We became Wallace’s fish, unaware that rates were abnormally low.

The point is that today’s investment environment is unfamiliar territory. Many have no experience with inflation. Many have no experience with rising interest rates. And, nearly everyone seems to be flailing around, struggling for oxygen — for a clear worldview that will tell them what to do with their capital.

To be fair, there aren’t many historical frameworks for the current environment — cyclical or secular — to rely upon. Pandemics and war have not been regular features since WWII. It’s no surprise, then, that the forecasting business has been abysmal. The key miss this year has been recession. In fact, global growth is still humming along nicely, labour markets remain robust and the much-feared deep downturn in corporate earnings has yet to materialize. Resilience, rather than recession, has suddenly become today’s watchword.

Most investors, positioned ultra-conservatively earlier this year, are now sweating through one of the most painful U-turns in the forecasting business ever. Only a few months ago, those who dared to dream of soft landings were viewed on the same level as fairytale believers. Now? To put it lightly, things have changed.

Just because recession has been postponed, does it automatically follow that a soft landing is now the most likely scenario? Investors are ditching their recession forecasts in droves and assuming a return to a world of benign inflation and continuing growth — in other words, the same environment that dominated the 2010s. Yet the scenario that should be upgraded is the structurally higher inflation and growth one. Why? Because receding recession risks and reaccelerating growth are likely to feed into higher prices and create stickier inflation.

Meanwhile, at Jackson Hole, the annual jamboree for global central bankers, US Federal Reserve Chairman Powell had a snoozer speech. But ECB President Christine Lagarde’s took on a far different tone. She didn’t discuss near-term policy choices facing the ECB at all. Instead, she gave an expansive talk about the big, macro factors that will keep monetary policymakers on their front foot for years: persistent fiscal deficits, the changing structure of the labour market, climate change, state-led investment in the green transition, and new patterns developing in global trade. Lagarde’s main point was that the job of the central banker is now far different than the 2010s.

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Back then, the main challenge was to generate higher employment and aggregate demand. Now managing inflation has once again entered the mandate.

Looking ahead, investors should conclude that the macro environment is much different. We aren't swimming in water anymore. The problem is the same as it always is during transition periods: people don't give up their paradigms easily, anchoring themselves to the prior regime. Our job as portfolio managers, then, is to assess and anticipate this new environment, and which asset classes will outperform.

CASH AND CURRENCIES

Cash levels moved to neutral

- As near-term recession concerns ebb, money that was sitting on the sidelines should work its way back into risk asset markets.
- Professional investor surveys show this trend is well underway, with cash positions declining from near-historically high levels.
- We expect continued flow into global stock and bond markets and have reduced cash and equivalents exposure to neutral this quarter.

GLOBAL EQUITIES

Maintaining equity overweightt

- Investors have a lot to digest these days, as tightening monetary policy and rising energy costs are offset by resilient corporate profits and fiscal expansion.
- On balance, the outlook for equities remains favourable as fiscal stimulus has a more potent "real economy" impact and corporations opportunistically extended liabilities when interest rates were low.
- We remain overweight equity exposure in client portfolios.

Shifting to dividend-weighted EM equities

- Market capitalization-weighted emerging market indices are light on "real economy" sectors that should thrive in an inflationary growth environment.
- Conversely, dividend-weighted indices overweight commodity-centric sectors such as materials and energy, in addition to bolstering portfolio yield.
- We have pivoted EM equity exposure to a high dividend orientation this quarter.

GLOBAL FIXED INCOME

Narrowing fixed income underweight

- With nominal yields grinding higher in numerous markets during the past quarter, some prominent bond investors have declared an attractive buying opportunity.
- We disagree that bond yields will quickly revert back to pre-pandemic lows. However, the higher yields are becoming more attractive from an income generation standpoint.
- Fixed income exposure has been increased in client portfolios, but remains underweight versus benchmark.

Staying overweight EM bonds

- Emerging market central banks, particularly in Latin America, have won some tough-earned credibility by not dismissing burgeoning inflationary pressure as transitory and proactively hiking interest rates well before their developed market peers.
- Now, with inflationary pressure decisively rolling over in most major EM nations, emerging market bond yields have significant room to decline as central banks embark upon rate cutting cycles.
- Emerging market bonds remain overweight this quarter.

OPPORTUNITY INVESTMENT HIGHLIGHTS

Initiating natural gas equities exposure

- The transition away from fossil fuel-derived energy sources will intensify the reliance on “bridge” fuels such as natural gas and nuclear (uranium), as renewable sources including solar and wind will take time to scale up.
- Natural gas looks particularly attractive at present as Europe remains vulnerable to a harsh winter, global supply/demand conditions are tight and the Henry Hub price appears to be bottoming.
- A position in natural gas equities has been initiated in balanced and growth-oriented strategies this quarter.

Pivoting back to the Chinese internet sector

- Offshore Chinese “H-share” indices are dominated by major Chinese banks (most of which are state-owned) and internet companies.
- Of these two main components, we currently favour the internet sector, which has been dragged down by general risk-off sentiment towards Chinese assets, despite impressive revenues and a sharp reduction in regulatory hostilities.
- Broad Chinese H-share exposure has been shifted towards internet companies in balanced and growth-oriented strategies this quarter.

INVESTMENT STANCE	Versus Benchmark			Changes from previous quarter
	Under	Neutral	Over	
NET GLOBAL ASSET MIX				
Cash		✓		Decreased
Total Equity			✓	Increased
Total Fixed Income	✓			Increased
Opportunity		✓		Unchanged
CANADA INVESTMENTS				
Bonds		✓		Increased
Stocks			✓	Increased
U.S. INVESTMENTS				
Bonds		✓		Unchanged
Stocks	✓			Increased
INTERNATIONAL INVESTMENTS				
Bonds		✓		Increased
Stocks			✓	Decreased

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