Market Perspectives + 10 Minutes = Current Insights

TD Wealth

WAAC Perspectives

TD Wealth Asset Allocation Committee (WAAC) and
TD Wealth Investment Policy Committee (WIPC)

2022
DEC

At a glance

1. Global equity markets may experience headwinds as economic data deteriorates into 2023. We feel that market expectations are still not sufficiently pricing in a recessionary scenario, as leading growth indicators and employment remain neutral to strong. Forward earnings estimates have been reduced broadly, but further deterioration in forecasts is expected. We expect global equities to remain rangebound through to mid-2023.

2. The historically unprecedented pace of central banks' rate hiking cycle, amid the backdrop of high global debt, may have unintended consequences for various asset classes. Additionally, the rapid rise in rates to combat persistently high inflation and wage pressures continues to drive concerns around a global recession. The war in Ukraine, among other ongoing geopolitical turbulence, also remains a risk to the market outlook.

3. For investors looking beyond near-term volatility, yields across fixed income sectors are well above the lows of the past decade and now offer higher potential returns. We believe fixed income may outperform equities over the next 12-month period. Fixed income can also help to provide diversification benefits, reduce overall portfolio volatility and preserve capital over the longer term.

4. Given that high equity volatility is likely to persist for risk assets, investors may benefit from an allocation to alternative assets to help manage portfolio volatility. Assets like mortgages, infrastructure and real estate may also provide some long-term inflation protection and attractive absolute returns. Alternatives could also help portfolios through either transitory or more structural inflation outcomes.

WAAC Positioning Changes

Asset Class	From	To	Rationale
Canadian Equities	Modest Overweight	Neutral	Following a year of relative outperformance for the S&P/TSX Composite Index versus many global counterparts, current headwinds may make continued outperformance more challenging as we enter 2023.
Domestic Government Bonds	Modest Overweight	Maximum Overweight	Yields have stabilized at multi-year highs and government bonds are appealing due to their potential to generate positive nominal returns over the longer term.

Fixed Income

Maximum Overweight Overall

Domestic Government Bonds	**Maximum Overweight**	North American central banks are beginning to slow the pace of policy rate hikes as inflation pressures show signs of easing at the margins. As a result, yields have stabilized at multi-year highs and government bonds remain appealing due to their potential to generate positive nominal returns over the longer term.
Investment Grade Corporate Bonds	**Modest Overweight**	With a slowing global economic outlook, we prefer investing in higher quality corporate bonds. Credit fundamentals are robust and all-in yields are attractive, although there is limited upside from any further spread tightening in the near term. While their respective economies are more vulnerable to a downturn, corporate bond opportunities in Canada and Europe are modestly more compelling than U.S. opportunities due to valuation.
Inflation-Linked Bonds	**Neutral**	With the expectation that high inflation levels may be starting to peak and beginning to normalize, inflation insurance is moderately attractive for investors.
High Yield Bonds	**Modest Underweight**	Higher interest rates and a deteriorating economic backdrop will likely cause default rates for high yield bonds to rise from currently low levels. This could result in further volatility and downside risk for credit spreads despite the high potential return in the sector. Solid credit fundamentals should prevent high yield bonds from experiencing the extreme dislocations seen in some prior recessionary periods.
Global Bonds-Developed Markets	**Modest Underweight**	Investors are increasingly paying attention to the global economic slowdown narrative, so we are starting to see some reversal of the extreme bearish sentiment and positioning in the global bond market. As bond yields have risen considerably year-to-date, some markets now offer attractive incremental yields, net of currency hedges. Non-USD- denominated bonds may also benefit from a potentially weakening U.S. currency.
Global Bonds-Emerging Markets	**Neutral**	The dispersion of returns within emerging markets has presented some opportunities. We are comfortable maintaining a neutral outlook as yields are attractive in some regions where central banks have proactively hiked interest rates, while bond returns will likely decline in other regions where central banks are still early in normalizing monetary policy.

Equities
Neutral Overall

Canadian Equities	**Neutral**	For most of 2022 we were overweight Canadian Equities. This was effective as the S&P/TSX Composite Index outperformed many global counterparts. However, today there are headwinds that may make continued outperformance more challenging as we enter 2023. For the Canadian Financials sector, while net interest margins may still have room to grow, we do not expect the magnitude of this tailwind to persist. Additionally, provisions for credit losses may need to be higher across the banks' balance sheets which could act as a modest earnings headwind. Further, following significant outperformance by the Energy sector in 2022, we expect a more balanced energy market and moderate performance for the sector going forward.
U.S. Equities	**Neutral**	Forward earnings estimates have been lowered in most sectors, but further deterioration in forecasts is expected. However, many blue-chip U.S. equities have seen sharp compression of valuation multiples and are trading close to long-term historical averages. Any further market weakness could be viewed as an opportunity to incrementally add to high quality compounders. We remain focused on quality in the market, specifically on companies with robust fundamentals, access to growth and sustainable free cash flow generation.
International Equities	**Neutral**	While inflationary pressures and geopolitical risks continue to cloud the outlook for global equities, we see some opportunity within international (European) markets as they appear inexpensive on a forward price-to-earnings basis relative to their history and in comparison to U.S. equities. A weakening U.S. dollar (USD) may also provide a tailwind for international stocks over the next 12-18 months.
Chinese Equities	**Neutral**	In our view, China's outlook remains weak, however, we are hopeful that 2023 could see a sentiment reversal in China triggered by the government's possible easing of certain detrimental policies. These include the Zero-COVID-19 policy, the property-market crackdown, anti-trust campaigns over the Technology sector, and geopolitical tensions with the U.S. and Taiwan. Depressed valuations in select sectors may provide long term opportunity.
Emerging Market Equities (excluding China)	**Neutral**	Emerging markets equities, similar to many global counterparts, are being challenged by persistently high inflation, concerns over global central bank monetary tightening, and the prospect of recession in many western economies. Our outlook for emerging markets remains cautious while recognizing that low valuations may provide a good entry point.

Alternatives

Modest Overweight Overall

Commercial Mortgages	**Modest Overweight**	We maintain a modest overweight to commercial mortgages. Commercial mortgages continue to provide accretive income while insulating investor returns from the increased volatility in interest rates. Income collection via scheduled principal and interest payments remains resilient while demonstrating less volatility than observed in other corners of the fixed income markets.
Domestic Real Estate	**Neutral**	We maintain a neutral weight to Canadian Real Estate. Aggressive interest rate hikes over the second half of 2022 are driving upward pressure on capitalization rates across property types. However, property fundamentals remain sound with supply/demand imbalances persisting within industrial and multi-family assets. This results in continued rental rate growth. High quality, transit-linked properties are exhibiting robust leasing activity.
Global Real Estate	**Neutral**	We maintain a neutral weight to Global Real Estate. Rising inflation and interest rates remain the primary risks globally. Markets with strong institutional sponsorship, positive real estate fundamentals (i.e., low vacancy rates, rental rate growth), moderate development activity and conservative leverage ratios are long-term structural elements that may help support the broader real estate sector. We believe that being globally diversified within major cities and high quality assets should help navigate through economic turbulence.
Infrastructure	**Modest Overweight**	We maintain a modest overweight to Infrastructure. We believe infrastructure is well positioned to outperform relative to other asset classes through this interest rate cycle, even though rising interest rates will increase risk-free rates used to price private asset classes. Increases in cash flow from higher than expected inflation is buffering the rising rates and we anticipate core-plus portfolios may be best positioned given the embedded growth in revenue from value-add and opportunistic assets.

Sub classes

Gold	**Modest Overweight**	The precious metal has been hurt by the U.S. Federal Reserve's (the Fed) aggressive rate hikes over the year, although it did rise above the key $1,800 level later in the year amid signs the Fed might be less hawkish in the coming months. We maintain a modest overweight view for gold which typically acts as a defensive measure against extreme events and high inflation.
Canadian vs. U.S. Dollar	**Neutral**	Over 2022, the Canadian dollar (CAD) has been the third-best-performing G-10 currency, buoyed by rising commodity prices and aggressive central bank tightening. Going forward the CAD's performance will be largely dependent on the path of rate hikes by the Bank of Canada, the strength of the Canadian economy and commodity prices.
U.S. Dollar vs. basket of currencies	**Modest Underweight**	A more aggressive U.S Fed, capital flows into U.S. assets and a weak growth outlook across Europe and China have all contributed to USD strength in 2022. We expect this trend to reverse as markets increasingly price in a Fed pivot. Additionally, a narrowing of rate differentials between the U.S. and other central banks should make the U.S. dollar less attractive and foreign currencies more so.
Cash	**Neutral**	Maintaining neutral cash positioning allows for strategic deployment to other asset classes as opportunities arise. Cash can also provide flexibility to navigate the short-term outlook and uncertainties.

Summary of WAAC Strategic Positioning

	Assets Class	Underweight		Neutral		Overweight
Fixed Income ● Maximum Overweight	Domestic Government Bonds					●
	Investment Grade Corp Bonds				●	
	Inflation Linked Bonds			●		
	High Yield Bonds		●			
	Global Bonds - Developed		●			
	Global Bonds - Emerging			●		
Equities ● Neutral	Canadian			●		
	U.S.			●		
	International			●		
	Emerging Markets excluding China			●		
	China			●		
Alternative / Real Assets ● Modest Overweight	Commercial Mortgages				●	
	Domestic Real Estate			●		
	Global Real Estate			●		
	Infrastructure				●	
Sub-Classes	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.

WIPC strategic and dynamic asset-class weights

by investor profile

The Wealth Investment Policy Committee (WIPC) made a few changes to its dynamic asset allocation in accordance with the positioning changes by WAAC in December. WIPC maintained the overall allocation to fixed income at overweight in all profiles, while reducing the allocation to high yield bonds by 1% to 2% underweight and bringing the allocation to domestic government bonds up by 1% to 4% overweight in more conservative profiles. WIPC also maintained the overall allocation to equities at neutral across all profiles. Within equities, WIPC increased the allocation to international equities by 1% to 2% to neutral, while reducing the overweight position in Canadian equities by 1% to 2% to neutral from overweight across all profiles.

Asset Class	Balanced Income		Balanced		Balanced Growth		Growth		Aggressive Growth	
	Strat.	Dyn.	Strat.	Dyn.	Strat.	Dyn.	Strat.	Dyn.	Strat.	Dyn.
Cash	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%
Fixed Income	56.0%	57.0%	41.0%	42.0%	26.0%	27.0%	16.0%	17.0%	0.0%	1.0%
Domestic Gov't Bonds	20.0%	24.0%	14.0%	18.0%	9.0%	12.0%	5.0%	7.0%	0.0%	1.0%
Invest. Grade Corp Bonds	19.0%	20.0%	14.0%	15.0%	9.0%	10.0%	6.0%	6.0%	0.0%	0.0%
Inflation Linked Bonds	4.0%	4.0%	3.0%	3.0%	2.0%	1.0%	1.0%	1.0%	0.0%	0.0%
High Yield Bonds	4.0%	2.0%	3.0%	1.0%	2.0%	1.0%	1.0%	0.0%	0.0%	0.0%
Global Bonds - Developed	6.0%	4.0%	5.0%	3.0%	3.0%	2.0%	2.0%	2.0%	0.0%	0.0%
Global Bonds - Emerging	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	1.0%	1.0%	0.0%	0.0%
Real Assets	10.0%	10.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	13.0%	13.0%
Mortgages/Private Debt	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	0.0%	0.0%
Real Estate/Infrastrucutre	3.0%	3.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	13.0%	13.0%
Equity	32.0%	32.0%	42.0%	42.0%	57.0%	57.0%	67.0%	67.0%	85.0%	85.0%
Canadian	10.0%	10.0%	12.0%	12.0%	17.0%	17.0%	20.0%	20.0%	25.0%	25.0%
U.S.	13.0%	13.0%	17.0%	17.0%	23.0%	23.0%	27.0%	27.0%	35.0%	35.0%
International	6.0%	6.0%	8.0%	8.0%	11.0%	11.0%	13.0%	13.0%	15.0%	15.0%
Emerging Markets	3.0%	3.0%	5.0%	5.0%	6.0%	6.0%	7.0%	7.0%	10.0%	10.0%
Fixed Income	65.0%	65.0%	50.0%	50.0%	35.0%	35.0%	25.0%	25.0%	2.0%	2.0%
Equity	35.0%	35.0%	50.0%	50.0%	65.0%	65.0%	75.0%	75.0%	98.0%	98.0%

Condensed view:

Asset Class	Balanced Income		Balanced		Balanced Growth		Growth		Aggressive Growth	
	Strat	Dyn	Strat	Dyn	Strat	Dyn	Strat	Dyn	Strat	Dyn
Cash	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	1.0%
Fixed Income	63.0%	64.0%	48.0%	49.0%	33.0%	34.0%	23.0%	24.0%	0.0%	1.0%
Government	32.0%	34.0%	24.0%	26.0%	17.0%	18.0%	11.0%	12.0%	0.0%	1.0%
Corporate	31.0%	30.0%	24.0%	23.0%	16.0%	16.0%	12.0%	12.0%	0.0%	0.0%
Equity	35.0%	35.0%	50.0%	50.0%	65.0%	65.0%	75.0%	75.0%	98.0%	98.0%
Canadian	11.0%	11.0%	15.0%	15.0%	20.0%	20.0%	23.0%	23.0%	29.0%	29.0%
U.S.	14.0%	14.0%	20.0%	20.0%	26.0%	26.0%	30.0%	30.0%	40.0%	40.0%
International	7.0%	7.0%	10.0%	10.0%	13.0%	13.0%	15.0%	15.0%	19.0%	19.0%
Emerging Markets	3.0%	3.0%	5.0%	5.0%	6.0%	6.0%	7.0%	7.0%	10.0%	10.0%

Strat: Strategic, Dyn: Dynamic. Source: Wealth Investment Policy Committee, as of December 9, 2022.

WIPC Strategic and dynamic asset-class weights

Assets	Positioning	Fixed Income Factor	Equity Risk Factor	Currency Risk Factor	Illiquidity Risk Factor	Alpha
Factor Positioning		Overweight	Neutral	Underweight	Overweight	Dynamic
Cash	Underweight	●				●
Fixed Income	Overweight					
Domestic Government Bonds	Overweight	●				●
Investment Grade Corp. Bonds	Overweight	●	●	●		●
Inflation Linked Bonds	Neutral	●		●		●
High Yield Bonds	Underweight	●	●	●	●	●
Global Bonds - Developed	Underweight	●		●		●
Global Bonds - Emerging	Neutral	●		●	●	●
Equity	Neutral					
Canadian	Neutral		●			●
U.S.	Neutral		●	●		●
International	Neutral		●	●		●
Emerging Markets ex China	Neutral		●	●		●
China	Neutral		●	●		●
Real Assets	Overweight					
Mortgages/Private Debt	Overweight	●	●	●	●	●
Real Estate/Infrastructure	Neutral	●	●	●	●	●

Source: Wealth Investment Policy Committee, as of December 9, 2022.