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The World at Large: Too Far, Too Fast?

We’re moving forward. Society and the economy are encouragingly adapting to COVID-19. But is it enough to justify the extent of the April to June equity market rebound? We don’t think so.

“I think we consider too much the good luck of the early bird and not enough the bad luck of the early worm.”
~ Franklin D. Roosevelt, 32nd president of the United States, 1882-1945.

The economy has begun to heal – economic indicators show early positive signs toward a new, different normal – and we are celebrating alongside the many who are anxiously awaiting a professional haircut. BUT, it’s still early days and knowing exactly what the ‘new normal’ will look like is nearly impossible (see our GLC Insights: Crises are Trend Accelerators for more). Even putting aside the unfortunate potential for a second-wave setback, we think the sharp recovery for equity markets up to June 15, 2020 is too far, too fast (see Exhibit 1.1 – Too Far, Too Fast). We anticipate a return of volatility.

Equity markets have been on a one-way, largely uninterrupted tear since breaking out of their brief sideways consolidation pattern in late May. From the lows of March 23, 2020, the S&P/TSX has gained 36.8%, the S&P 500 has increased 37.1%, the MSCI EAFE has rebounded 29.3% and MSCI Emerging Market Index is up 28.3%.
The World at Large

We hail safe reopening efforts and are encouraged by the better-than-feared early progress. But we must separate hope from strategy, and fundamentals from emotions. While the economic fundamentals are better than expected and we’re optimistic about achieving some of the better-case scenarios, stock markets appear to be getting ahead of themselves, declaring victory when it’s barely at half time in what will surely be a long game.

Understand we’re not bearish on society or capitalism prevailing. We see brighter days ahead, and worst-case scenarios need not be the base case (just like best-case scenarios need not be the base case). But, when assets are priced for perfection, we would rather be sellers into strength. As such, we currently stand defensively positioned, poised to seize on shifts in sentiment and the expectation of assets repricing from frothy levels.
This isn’t your parents’, grandparents’ or great-grandparents’ recession

Comparisons are being made between the current environment and the Great Depression of the 1930s and the Great Recession or Global Financial Crisis (GFC) of 2008/2009. And some of the economic data indeed creates a devastating picture, harkening back to those times. We see present conditions as neither a depression, nor a typical recession; rather, we’re calling it the Great Cessation. It is, and will be, different. Capital markets, and society in general, will need to adapt. The current recession is expected to be deep, but short. This doesn’t change the fact that recessions of any kind bring some level of business failures, defaults, restructurings and longer-term damage. The magnitude and extent of these ‘second-order impacts’ are the focus of our attention as to where we see risks and opportunities in capital markets.

Our first rule of COVID-19

Our first rule of COVID-19 states the world (and economy) only returns to normal when both the actual and the perceived threat that caused the disruption is eliminated – period. Everything else is just a bridge to that day.

The ultimate end game is a vaccine. Unprecedented global cooperation and effort to discover a prevention are proceeding rapidly and plans are being laid well in advance for the global dissemination of the vaccine, if, and when it comes. But until then, human behaviour is impacted by the severity, shock and fear associated with the shutdown caused by the pandemic. Being able to do something isn’t the same as being willing to do it. Just because something is allowed, doesn’t mean all consumers will rush to embrace everything they used to do.

It’s all about the fallout and the lasting blow to confidence

As economies re-open and societies adjust, after the euphoria of the initial first steps toward a return to normal fade, we expect lingering damage to consumer, business and investor behaviour and confidence. Observing where post-lockdown rebounds are occurring, the path is tentative.

   Government warnings (and financial incentives) to stay home may eventually turn into government encouragements to return to work and get out and spend.

The likely result is a combination of lower consumption (especially discretionary), increased risk-aversion, higher savings and weaker business investment. These are the types of ‘second-order impacts’ we consider in our capital market outlook and market return forecasts.
Debt – a double-edged sword

Another second-order impact will be managing, coping and moving forward under the massive piles of debt across households, businesses and governments. To varying degrees, debt levels were already stretched before the crisis. Today, some households, businesses and governments have been left in a fragile and precarious position, pinching their ability to grow and recover from the crisis while leaving them less able to handle further economic shocks, should they come. Using debt responsibly can fuel productive expansion, but the word ‘debt’ is often paired with the word ‘burden’ for a reason. These now larger debt burdens will restrain households, businesses and governments – and hence, economic growth.

Emergency support can’t last forever

The current environment features significant differences to the historical record. Globally, equities are being fueled by ample liquidity, including extraordinary government supports. Unique measures include the U.S. Federal Reserve backstopping the high-yield bond market and circumventing the traditional money transmission mechanism by moving to directly purchase individual investment-grade corporate bonds. This latest Fed move is especially puzzling as it comes even though no problems appear to exist in high-quality credit markets. New issuance is robust, and after widening substantially in March, spreads have narrowed meaningfully. These actions may continue to support equity markets (and risk assets more broadly) despite weak fundamentals. However, a choppy sideways move – what we might call a ‘time correction’ – would be healthy for markets to consolidate the sharp, rapid rebound experienced thus far from the March 23rd bottom. Monetary and fiscal authorities are flooding the system with money that’s fueling prices of all assets, both risky and safe, leaving equity markets expensive and sovereign bond yields low. This combination delivers a muted return outlook for the time being. A price correction (and not necessarily a full re-test of the lows) would pique our interest in adding to our risk assets.
1.2 | Markets Won’t Want These Curves to Flatten

Bottom line: Our current stance may require patience since the current momentum in equities is very positive. Likewise, room remains for a rotation trade to play out: plenty of bearish views persist; mountains of cash are sitting on the sidelines; and, many individual stocks remain cheap and well off their highs. All these factors are prime fuel that may lead equity markets to further overshoot in the short term. Our view considers this near-term possibility, but then looks further ahead in the investment horizon for the next six to 12 months. We forecast a low single-digit return for fixed income; and a difficult path through year-end for equity markets.

Our base-case scenario:

- Markets experience an initial euphoric release as lockdowns are lifted; bond yields rise mildly and equities overshoot to the upside – this is underway and may have further to run.
- Eventually, sober realities will set in that medium- to longer-term damage has been inflicted and will result in a reckoning that negative second-order impacts are real and will be a drag on growth.
- Markets will recognize the drag on growth and that the winnowing of, or removal of, government support measures will require the economy to stand more on its own.
- There’s also the bruising reality that all the efforts and emergency measures to bridge the gap come with costs – higher taxes, lower spending and heavier debt burdens.
Equities – The fast and furious

Equity markets are a blend of fundamentals and emotions – sentiment by another name – and on sentiment, they tend to over and undershoot. Equities are being fueled by:

- Ample global liquidity (including extraordinary government support measures, such as the U.S. Federal Reserve backstopping the high-yield bond market);
- Hopes a mitigating therapy or vaccine is found quickly; and
- Expectations that activity will rebound swiftly as economies reopen.

The combination leaves markets fragile. We see the current risk/reward trade-off in equities as asymmetric – the greater risk being one of disappointment versus upside surprise.

We recommend an underweight position in equities. Within equities, we recommend broad, diversified geographic and sector allocations with neutral allocations to Canadian and U.S. equity. Our underweight is accounted for through mild underweights to both International (EAFE) and Emerging Market equities.

When only the very best will do

Current equity market levels can be justified due to select enthusiastically positive scenarios. But a sufficient number of other scenarios exist, with reasonable probabilities, that continue to make us cautious on the outlook for further meaningful upside in equity markets from current levels. Valuations are extremely elevated. At best, higher valuation multiples pull forward future returns; at worst, they represent a high precipice from which they can fall (see Exhibit 2.1 – Global Equity Valuations).

2.1 | Global Equity Valuations

Equity markets are forward-looking by design, pricing in the future is what they do. When corporate earnings are troughing, equity valuation levels are expected to be high – and they are! Markets are correct to price companies on more normalized conditions, and with 2020 being anything but normal, investors have effectively written off earnings as damaged goods. So, it’s all about the recovery and looking on into 2021. With that, we see two problems:

- Line-of-sight to 2021 fundamentals, namely corporate earnings and the yield environment upon which to discount those earnings, is understandably cloudy. Many companies have decided not to issue forward guidance in light of the uncertainty. What fiscal and monetary supports look like a year from now is unclear (in the U.S., this is exacerbated by election-year uncertainty).
- We believe current estimates for 2021 earnings are optimistic; while we hope for best-case scenarios, we must separate hope from strategy and fundamentals from emotions (see Exhibit 2.2 – Global Earnings Growth Expectations).
Our view is that there is currently a large disconnect between fundamental indicators and equity prices, particularly in large cap U.S. equities, which may not be surprising given the deep disruption companies have faced. With activity down 90% in some businesses, a celebration of a 100% or 200% recovery off the low may sound warranted. But if activity a year from now is still only 80% or 90% of pre-COVID levels, then current earnings estimates are too high, and equities are likely pricing in too much good news. We feel markets are currently ignoring these sober realities.

Absent from the ‘bull’ narrative are concerns over increased debt levels, the prospect of increased taxation (via a Biden presidency) or the return to trade wars and tariffs (via a Trump re-election), along with costs associated with any and/or all the following:

- Adoption and necessary retooling to accommodate new safety measures/regulations;
- Deglobalization, onshoring/near-shoring, and disrupted supply chains (‘just in time’ inventories becomes ‘just in case’ stockpiles).

Profits are going to have to make accommodation for flexibility, resiliency and redundancy. Yet many markets are calling for significant bounce backs in earnings. Further justification to the ‘bulls’ is that elevated forward P/E multiples are reasonable due to extraordinarily low bond yields; yet if the situation is “back to normal” in 12 months, shouldn’t government intervention begin to be unwound? Shouldn’t bond yields be at least somewhat higher by that time? All of these questions contribute to our concern that equities have simply run too far, too fast on enthusiasm versus our fundamental outlook. Too boot, speculation around poker players and sports bettors turning to day-trading to get their entertainment – well that only adds fuel to our view that markets have disconnected from more rational thought (see our ‘What should we make of all this “poker/sports gambler cum day trader” talk? Not much.’ article for more).

Wave good-bye to abundant share buybacks and dividend increases

Globally, dividends are seeing cuts, with energy, financials (outside of North America) and consumer discretionary stocks (especially travel and hospitality) bearing the brunt.

- U.K. banks have suspended dividends at the encouragement of the Bank of England.
- In the U.S., Germany and France, recipients of government aid packages are restricted from dividend issuance (and share buybacks in the U.S.).
- In Canada, bank regulator OFSI spelled out in a March memo that, “OSFI has set the expectation for all federally regulated financial institutions that dividend increases and share buybacks should be halted for the time being.” This language is carefully chosen to say, “dividend increases”. (While never a guarantee, we don’t expect dividend reductions from the Canadian banks, either voluntarily or through regulation.)

A sentiment shift appears underway amongst the public, politicians and some regulators against share buybacks and dividend increases.
Beyond these moves to restrain capital disbursements (which have been favourable to shareholders) is the consideration that the decade-long game of swapping debt for equity through issuing cheap debt to buy back shares is coming to a close. Even prior to 2020, government intervention in credit markets to orchestrate historically low interest rates had distorted pricing incentives between debt and equity, leading corporations to take on debt. Corporations have been ‘juicing’ earnings per share (EPS) growth by using the proceeds from debt issuance for share buybacks that reduce the denominator (share count) in EPS. For those corporations whose balance sheets were already brimming with debt and are now tacking on more to bridge through the crisis, the ability to add on even more debt for the purpose of share buybacks and dividend increases will be dampened – not to mention rising costs of doing business and the potential for heavier tax burdens.

Why does this matter? Share buybacks have been an important source of demand for equities (i.e., increasing stock prices) over the past decade. In fact, some studies have suggested that since the Great Financial Crisis (GFC), much of the upside for the S&P 500 Composite Index (both price and EPS growth) has been fueled by trillions of dollars of corporate share repurchases. If this ability is removed, you also remove an important source of support for equity prices.

Regional Equity Market Considerations

Canadian Equities

Canadian equities face the double impact of a global recession and the collapse in energy prices. The sector composition (favouring cyclicals and value) should fare well as oil prices stabilise and the yield curve steepens.

Our base-case scenario envisions 2021 TSX earnings returning to $975, which is below the current $1,002 consensus estimate. Note that TSX earnings that were $1,060 in 2019 are projected to drop to $706 in 2020 (a -33% decline) and then rebound 42% in 2021. The two biggest drivers of the growth in earnings are the financials and energy sectors. We’re comfortable with the contribution from financials, but with the energy sector’s outlook being so highly uncertain, our enthusiasm for Canadian equities is tempered somewhat – making us most comfortable with a neutral weight.
U.S. Equities

U.S. equities continue to trade at a premium valuation. Fiscal and monetary stimulus are most forceful in the U.S., but the S&P 500 derives significant revenue from global operations. Elevated valuations drive muted return prospects and the 1.8% dividend yield is modest relative to other markets. However, while some dividend attrition is to be expected, the sector composition (notably the 26% weight in the information technology sector) suggests dividend erosion should be milder than in other markets. A waning U.S. dollar is another positive for S&P 500 earnings in 2021.

Our base-case scenario envisions 2021 S&P 500 earnings returning to $155, which is also lower than the current $160 consensus estimate for 2021. Note that S&P 500 earnings were $162 in 2019; consensus projects them to drop to $127 in 2020 (a -22% decline) and consensus sees them rebounding 26% in 2021, back to $160.

For our return forecasts, we consider that the sector composition (secular growth typically commands higher multiples) and very low yield environment provide a rationale for assigning an elevated P/E multiple (just not as elevated as at present in our view, or versus bullish forecasts). P/E multiples in the 19 to 20X range are still generous against longer-term averages of 15.7X. Even if one chooses to assign higher multiples and use consensus or above-consensus earnings expectations these scenarios drive only modest returns for the risk. Our base case of a 19 to 20X P/E multiple on below-consensus earnings of $155 (which still allows for earnings to return to 97% of 2019 levels) suggests a market that is currently fully valued. Add back a modest second-half dividend yield of 0.9%, and we arrive at a second-half 2020 total return of flat to slightly negative for the S&P 500 Index (see Exhibit 2.4 – S&P 500 Return Scenario Matrix).

2.4 | S&P 500 Return Scenario Matrix

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<tr>
<th>2021 EPS</th>
<th>Level</th>
<th>% change from current level of 3067</th>
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<tr>
<td>$145</td>
<td>2610</td>
<td>-15%</td>
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<tr>
<td>$150</td>
<td>2700</td>
<td>-12%</td>
</tr>
<tr>
<td>$160</td>
<td>2800</td>
<td>-6%</td>
</tr>
<tr>
<td>$165</td>
<td>2970</td>
<td>-3%</td>
</tr>
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GLC base case $155 2790 -9% 2945 4% 3100 1% 3255 6%
Consensus $160 2880 -6% 3040 -1% 3200 4% 3300 8% 3455 13%

Source: Bloomberg, as of June 15, 2020.

International Equities (EAFE)

Longer-term domestic structural issues and the heavily export-oriented footprint for EAFE corporations leave them less attractive in a global recessionary environment and an impaired global trade and tourism backdrop. The group offers slightly cheaper valuations versus peers and a decent dividend yield of 3%. However, the region faces a punitive interest rate regime and a history of dividend cuts in prior recessions, especially in Europe; where some jurisdictions have moved to curb or limit dividends. Geopolitical concerns linger with Brexit, trade frictions with the U.S. are possible and while Europe is no stranger to crises, each successive one is a test of the euro-experiment – and euro-skeptic voices linger. We recommend a slight underweight, low neutral International equity exposure.
Emerging Markets Equities (EM)

Emerging Markets are behaving better than history would suggest given the extent of the decline in developed markets. China is further along in their experience with COVID-19 and reopening efforts. Chinese authorities are stimulating the economy, but these efforts will not entirely offset lost demand. EM equities are the most sensitive to weak global economic conditions, trade frictions and deglobalization. While China, Taiwan and South Korea comprise the lion’s share of the MSCI EM Index at 63.5%, India and Brazil make up the next 13% (8% and 5% respectively). Both countries are having little success in flattening their individual COVID-19 infection curves and both are experiencing geopolitical and/or political turmoil.

Offsetting these headwinds is abundant global liquidity that can end up seeking the potentially higher returns of emerging markets. Furthermore, softening global financial conditions due to waning U.S. dollar strength is a plus. Evaluating the myriad of risks and rewards and given that benchmark weights are typically modest to begin with given the generally stark risk/reward trade-off, leaves us recommending a slight underweight to low neutral emerging market exposure.
Fixed Income

We recommend an overweight to high-quality fixed income as it continues to offer downside protection in the face of elevated uncertainty. Sovereign bond yields have bounced off historical lows, stabilizing at low levels. Credit spreads have come in off their highs. Central bank responses, lower inflation (through commodity price pass-through) and risk aversion will keep yields lower for longer.

Overall, we forecast 1.5% return for the FTSE Canada Universe Bond Index for the back-half of 2020. Importantly, high-quality fixed income remains capable of delivering a substantially higher return under a risk-off environment.

Government bond yields reflect a greater degree of pessimism than equities – more consistent with a choppy, tougher and longer recovery scenario. However, government bonds, after a small hiccup in March where they didn’t provide as much safety as one might expect, have stabilised and quickly returned to delivering superior risk-mitigation qualities. Sovereign bond yields are being anchored by the Bank of Canada (BoC), which has cut the overnight rate to 0.25% and has repeatedly stated they see this as their effective lower-bound. We don’t see a significant risk that government bond yields rise meaningfully in the near term. We see Government of Canada bond yields in the front half of the curve, ranging between 0.30% and 0.90% (see Exhibit 3.1 – Canadian Yields). Our active fixed income managers are taking advantage of this trading band through duration positioning. We therefore recommend an overweight position to government bonds and cash (where applicable).

We see investment-grade corporate bonds as attractive given their mix of yield pickup and modest safety. In Canada, these assets are being supported by the Bank of Canada, which has initiated quantitative easing across money markets, mortgages and provincial and corporate bonds, backstopping credit spreads in these markets – fostering a ‘buy what the bank buys’ mentality amongst market participants. We see price appreciation happening over time, benefiting from narrowing spreads, along with an attractive relative running yield and risk/reward relationship (see Exhibit 3.2 – Canadian Investment-Grade Yield Spreads). We recommend an overweight position in investment-grade corporate bonds. However, we’re being particularly cautious in our selection of BBB corporate bonds, as we anticipate credit downgrades to accelerate – bond selection will be a key success factor for investors within the BBB tranche.

### 3.1 | Canadian Yields

![Government of Canada Bond Yields](chart)

Source: Bloomberg, as of June 15, 2020.

We see government bond yields as attractive given their mix of yield pickup and modest safety. In Canada, these assets are being supported by the Bank of Canada, which has initiated quantitative easing across money markets, mortgages and provincial and corporate bonds, backstopping credit spreads in these markets – fostering a ‘buy what the bank buys’ mentality amongst market participants. We see price appreciation happening over time, benefiting from narrowing spreads, along with an attractive relative running yield and risk/reward relationship (see Exhibit 3.2 – Canadian Investment-Grade Yield Spreads). We recommend an overweight position in investment-grade corporate bonds. However, we’re being particularly cautious in our selection of BBB corporate bonds, as we anticipate credit downgrades to accelerate – bond selection will be a key success factor for investors within the BBB tranche.
The pandemic has brought spread widening to high-yield bonds, but by less than the downdraft in other risk assets would suggest. Spreads have narrowed somewhat and running yield has some attraction (see Exhibit 3.3 – Canadian High-Yield Credit Spreads). However, current spread levels are priced for a mildly rising default rate to ~ 6%. Defaults in this range represent a better-to-best case scenario as prior recessions featured default rates closer to 9%, with severe recessions seeing 15%. Spreads would need to be several hundreds of basis points wider to compensate for these less-rosy higher default scenarios. Our active fixed-income managers continue to uncover selected unique opportunities through individual security selection where the risk/return trade-offs are appealing. We recommend an underweight position in high-yield bonds.
Currency, Oil and Gold

Currency

The loonie is driven primarily by three factors: oil prices; interest rate differentials; and, U.S. dollar sentiment/momentum.

- **Oil** – The loonie is currently trading higher than oil prices alone would suggest. With oil prices reasonably close to our forecast estimate, we don’t see room for much appreciation of the currency on the back of higher prices for oil. Should substantive developments occur with pipelines in Canada (even absent higher oil prices), the Canadian dollar could see a small boost.

- **Interest rate differentials** – The U.S. Federal Reserve (Fed) and the Bank of Canada (BoC) are both on hold from raising interest rates for the foreseeable future. However, the Fed’s target range is between 0% and 0.25%, whereas the BoC is holding rates firm at 0.25% and reiterating often that they see this as effectively their lower bound. The Fed has stated that negative rates are not something they wish to pursue, but they’ve not been as emphatic as the Canadians. These differences in central bank posturing leaves Canadian 2-year bond yields 0.1% higher than their U.S. counterparts, providing support for the Canadian dollar. We don’t see this dynamic changing anytime soon.

- **U.S. dollar sentiment/momentum** – The U.S. dollar is a safe-haven, countercyclical currency. Currently, momentum and sentiment lean toward a lower dollar and the currency has been weakening since late May. U.S. dollar strength should remain contained as the global recovery progresses. Any set back would reverse this trend and (while not our base case) would likely cause the loonie to test the USD $0.70 range.

4.1 | Canadian Dollar USD 72¢ - 75¢

We see the Canadian dollar trading in a range between USD $0.72 and USD $0.75 (see Exhibit 4.1 – Canadian Dollar USD 72¢ - 75¢).
Oil

After significant weakness and volatility, including a dip into negative territory (see our April podcast: *What’s going on with oil prices*), the price of oil has rebounded and is being buoyed by recovering demand as economies reopen, along with new and renewed supply constraints across the globe.

Due to uneconomical prices, U.S. oil production has fallen by three million barrels per day (mbpd) to 10.5 mbpd, and the number of active oil rigs in the U.S. has fallen by 70%. Similarly, Canadian production has fallen 27% YTD to 3.3 mbpd. OPEC, Russia and other partners (OPEC+) are currently withholding almost 10% of global supplies from the market (9.7 mbpd). OPEC+ has agreed to extend these record production cuts, but only until the end of July. However, the U.S. is exerting pressure on the cartel to help prop up oil prices, fearing lasting damage to the U.S. oil industry, which has grown to be a substantial jobs and economic engine for large parts of the U.S. Midwest. OPEC+ craves higher oil prices to sustain their economies. All this leaves reason to believe production caps will continue for quite some time as demand will take time to fully recover and swollen global inventories will need time to get worked down. The International Energy Agency (IEA) estimates global oil consumption in 2020 will contract by a record 8.1 mbpd. While they see it climbing by 5.7 mbpd in 2021, to average 97.4 mbpd, that would still be 2.4 mbpd below 2019 levels. The IEA suggests demand may not return to 100 mbpd until 2023.

Overall, oil prices sit in a precarious position: there is more fundamental downward pressure on prices (due to excess capacity and supply) than there is support for prices stemming from demand. Artificial production constraints are the only thing keeping oil prices afloat today, but these appear to be holding for now.
Gold

Gold prices have spiked 14% YTD on safe-haven demand, tumbling bond yields and very stimulative monetary policy. An examination of the chart shows a period of consolidating gains is currently underway in the USD $1,725 range (see Exhibit 4.3 – Gold Spot Price – Support at USD $1,700).

The near-term price of gold may need to take a breather to digest this increase as peak risk-off sentiment fades. In the medium term, the price of the yellow metal should continue to receive support for current levels given U.S. dollar weakness, low global bond yields and ample central bank money printing across the world.

For those betting on gold moving substantially higher, that is a wager on higher inflation (barring a setback in the pandemic or a geopolitical crisis sparking a renewed ‘flight to safety’ trade). Those touting the inflation argument will likely have to wait until demand pressures accelerate sufficiently to offset the deflationary impacts of the economic shock – a timeframe we see as beyond our 12-month forecast horizon at a minimum. Having a modicum of exposure to gold makes sense in the current environment because money printing, geopolitical uncertainty and second-wave virus risks are all real. Having said that, Canadian investors with domestic equity exposure are typically well-situated already, with gold-related stock exposure in the S&P/TSX now at a ~10% weight (double the level of just a few years ago).

Our expectation is for the price of gold to continue trading above USD $1,700, but we do not see a substantial breakout in the offing.
# GLC Outlook Summary

**Fixed income**

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Bond yields have bounced off historical lows, stabilising at low levels. Credit spreads have come in off their highs. Central bank responses, lower inflation through commodity price pass-through and risk aversion will keep yields lower for longer. Bond yields reflect a greater degree of pessimism than equities, more consistent with a recession. We recommend an overweight to high-quality fixed income as it continues to offer downside protection in the face of elevated uncertainty.

**Government bonds**

Government bonds are attractive for their superior risk-mitigation qualities. We see sovereign yields in a 0.30% to 0.90% trading range. We will opportunistically take advantage of relative-duration opportunities within this range.

**Investment grade corporate bonds (I.G.)**

We see I.G. corporate bonds as attractive given their mix of yield pickup and modest safety. I.G. spreads widened materially and have retreated somewhat with the aid of expansive policy backstops. There is room for price appreciation through time on narrowing spreads, meanwhile there is attractive relative running yield versus the risk.

**High-yield corporate bonds**

High-yield spreads widened, but by less than moves for other risk assets would suggest. Spreads have narrowed somewhat, running yield is attractive. The U.S. Fed is backstopping U.S. high yield, not so in Canada. Our active fixed-income managers continue to uncover selected unique opportunities through individual security selection where the risk/return trade-offs are appealing.

**Equity**

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A global economic recovery from the COVID-19 containment efforts is unfolding. The magnitude of the rebound is uncertain. Current equity market levels can be justified with select enthusiastically positive scenarios. A sufficient number of other scenarios exist, with reasonable probabilities, that continue to make us cautious. Valuations are elevated. We recommend an underweight position given the uncertainties that may lie ahead.

**Canada**

Canadian equities face the double impact of a global recession and the collapse in energy prices. The sector composition (favouring cycicals and value) is poised to see an outsized rebound on improving sentiment, but the outlook for the energy sector warrants some caution. The hefty 3.3% dividend yield provides some buffer.

**U.S.**

U.S. equities continue to trade at a premium valuation. Fiscal and monetary stimulus are most forceful in the U.S., but the S&P 500 derives significant revenue from global operations. Elevated valuations drive muted return prospects and the 1.8% dividend yield is modest relative to other markets.

**International**

Longer-term domestic structural issues and a heavily export-oriented footprint for EAFE corporations leave them less attractive in a global recession/impaired trade and tourism backdrop. Valuations are elevated (but cheaper than peers). The 3% dividend yield is attractive, dividend cut risks are high (historical precedent, plus government restrictions).

**Emerging markets**

EM equities are sensitive to weak global economic conditions, trade frictions and deglobalization. Offsetting these headwinds are abundant global liquidity and softening global financial conditions on waning U.S. dollar strength. EM equities present a stark risk/reward tradeoff most appropriate for those with higher risk tolerance and longer time horizons.
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