GLOBAL ECONOMY SHIFTING INTO LOWER GEAR

Global trade tensions, Italian fiscal risk and rising interest rates are just some of the issues world equity markets have faced this year. Only a select few countries, including the U.S., have managed to deliver positive returns. Portfolio diversification has not been very helpful—global bond markets have also delivered negative returns year-to-date. The global economic cycle is settling into a weaker path as we move into a late expansion phase, yet growth will remain above potential.

EQUITIES VERSUS FIXED INCOME

Geopolitical risks are receding but not disappearing. With the cyclical outlook more supportive, we see a window of opportunity for equities to perform well, with increased volatility.

TRADE WAR VIEWS (SPECIAL SECTION)

Moving from the old NAFTA to the new USMCA trade agreement is not likely to radically change the North American economic landscape. However, from an investor's perspective, this new trade agreement is an important development, as it substantially alleviates the uncertainty relating to building trade tensions.

For the Bank of Canada, NAFTA uncertainty was one of the reasons that justified its unusually slow pace of policy renormalization. It will likely be delivering rate hikes at a faster pace (or at least signal its intention to do so), providing more support to the Canadian dollar over the short term.

LOONIE

The Canadian dollar remains structurally challenged, limiting its potential to appreciate over the longer term. However, in light of dissipating concern over housing and trade risks and an improving cyclical backdrop, the short-term outlook for the Canadian dollar has improved.

REGIONAL MARKETS

U.S.: Earnings growth is very strong in the U.S. this year, thanks to robust economic activity, tax cuts and share buybacks, but the valuation argument against the U.S. is still very strong. The S&P 500 is the most overvalued developed equity market.

Canada: Earnings should remain relatively strong, but decelerate as the bulk of the boost from higher commodity prices is behind us. In the context of equity market valuation, Canada is relatively attractive, especially when compared to the U.S.

International Developed Markets: On average, EAFE countries trade slightly above our fair value, but are more attractive than the U.S. However, international equities have weaker growth prospects than North American markets.

Emerging Markets: After outstanding returns in 2017, emerging markets (EM) have had a difficult year in 2018. Shorter-term indicators point to EM weakness for the immediate future, although a lot of the bad news seems to be already priced in.

EXPECTED RETURNS

Expected returns for the one-year period beginning October 1, 2018.

	IN CANADIAN DOLLARS			IN LOCAL CURRENCY		
	Global Reflation	Policy Renormalization	Global Recession	Global Reflation	Policy Renormalization	Global Recession
Probabilities	**20.0%**	**50.0%**	**30.0%**	**20.0%**	**50.0%**	**30.0%**
Canada Money Market	2.2%	1.9%	1.3%	2.2%	1.9%	1.3%
Canadian Bond	-0.3%	1.3%	5.8%	-0.3%	1.3%	5.8%
Canadian Federal Govt. Bond	-0.3%	1.4%	7.0%	-0.3%	1.4%	7.0%
Canadian Corp. Bond	2.0%	2.0%	2.6%	2.0%	2.0%	2.6%
Canadian RRB	-0.8%	-0.6%	2.0%	-0.8%	-0.6%	2.0%
Canadian High Yield	4.5%	3.3%	-8.0%	4.5%	3.3%	-8.0%
International Govt. Bond	-4.4%	0.1%	14.6%	-2.6%	-0.8%	6.2%
Canada Equity	15.7%	8.0%	-16.3%	15.7%	8.0%	-16.3%
United States Equity	5.9%	2.8%	-10.7%	10.9%	4.6%	-15.7%
International Equity	15.5%	9.0%	-15.4%	14.1%	6.3%	-20.5%
Emerging Equity	22.9%	9.8%	-24.7%	19.4%	9.4%	-23.9%

ASSET ALLOCATION OUTLOOK

as at October 1, 2018

ASSET CLASS		UNDERWEIGHT		NEUTRAL	OVERWEIGHT	
		SIGNIFICANT	MODERATE		MODERATE	SIGNIFICANT
EQUITY RELATIVE TO FIXED INCOME						
FIXED INCOME	Canadian Money Market					
	Canadian Government Bond					
	Canadian Corporate Bond					
	International Government Bond					
EQUITY	Canadian Equity					
	U.S. Equity					
	International Equity (Developed Markets)					
	Emerging Markets					

CURRENCY (VERSUS U.S. DOLLAR)	UNDERWEIGHT		NEUTRAL	OVERWEIGHT	
	SIGNIFICANT	MODERATE		MODERATE	SIGNIFICANT
Canadian Dollar					
Euro					
Japanese Yen					
British Pound					
Swiss Franc					
Australian Dollar					
Emerging Markets					

For our complete economic views and forecasts, please request the full Perspectives report.