

AGF ASSET ALLOCATION COMMITTEE

Q1 2025

Quarterly Outlook and Model Portfolio Allocations

Asset Allocation

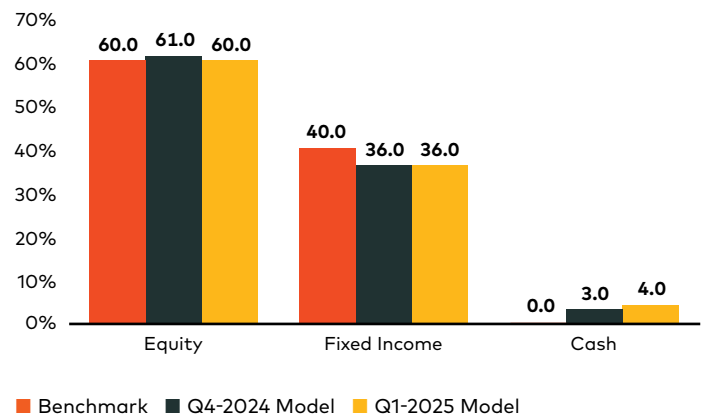
The AGF Asset Allocation Committee (AAC) continues to favour equities over fixed income as the global economy benefits from disinflation and economic growth remains relatively resilient.

While inflation trended down during the year, the fourth quarter witnessed an acceleration in headline inflation amid continued economic growth, as the momentum from the previous quarter carried through. Developed market central banks continued to monitor inflation levels and selectively implement rate-cuts as economic growth varied by geographic region. U.S. equity volatility spiked during the quarter as the incoming U.S. Administration's focus on tariffs began to weigh more heavily on the forward path of interest rates and economic growth.

The AAC's overweight to equities was lowered to 60%, representing a neutral position relative to the benchmark, with assets redirected towards cash. Meanwhile, the AAC maintained an underweight to fixed income, but increased the allocation to Canadian and global investment grade bonds as the outlook for emerging market (EM) bonds was reduced to neutral. The AAC's allocation to cash was

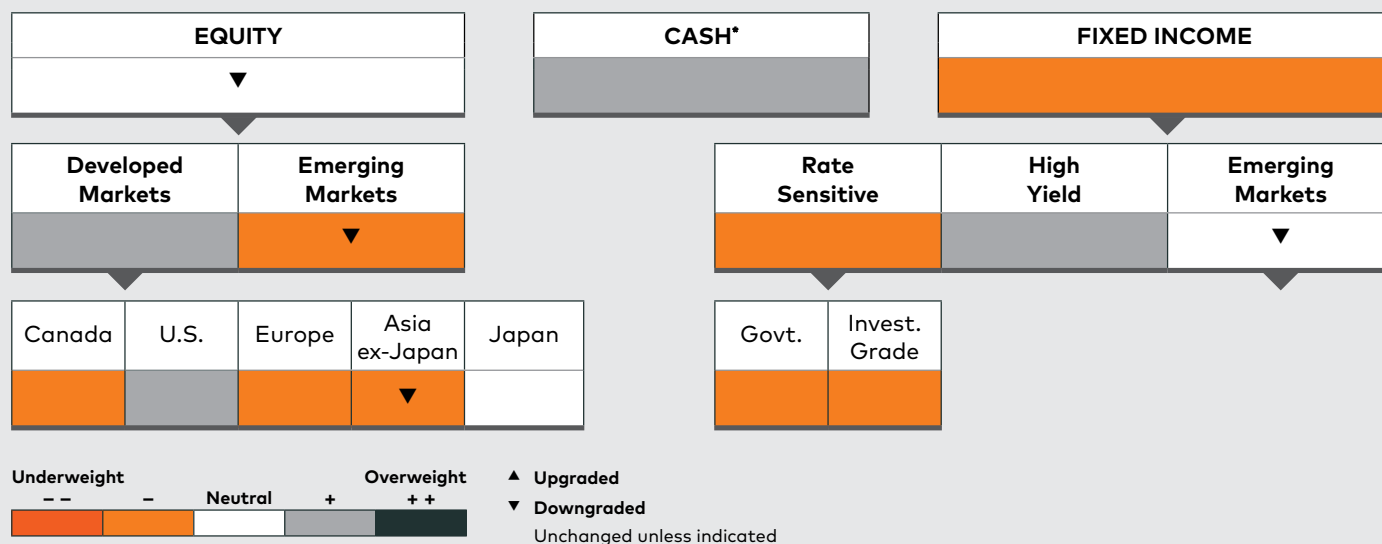
increased to 4% and acts as a hedge against volatility and a funding source for future opportunities. The AAC remains open to the use of alternatives in portfolios. Alternatives can enhance diversification and improve risk-return profiles.

FIGURE 1: Asset Allocations



Source: AGF Asset Allocation Committee December 31, 2024. One cannot invest directly in an index.
 Benchmark: 10% Bloomberg Canada Aggregate Bond Index / 25% Bloomberg Global Aggregate Bond Index / 2.5% Bank of America/Merrill Lynch U.S. High Yield Master II Total Return Index / 2.5% JPMorgan EMBI Global Total Return Index / 16.5% S&P/TSX Capped Composite Total Return Index / 24.2% S&P 500 Total Return Index / 9.3% MSCI Europe Index / 3.5% MSCI Japan Index / 1.7% MSCI Pacific ex-Japan Index / 4.8% MSCI Emerging Markets Index.

Q1-2025 Market Outlook – Portfolio Applications



* neutral weight at 0%

Source: AGF Asset Allocation Committee, December 31, 2024.

Equity

- Equities were reduced to neutral as new U.S. policies could initially slow economic growth and pressure inflation. Moreover, monetary policy is expected to be less accommodative than the market previously projected and sentiment remains elevated
- Developed markets (DM) remain overweight and Emerging markets (EM) were cut to underweight
- U.S. equity markets remain resilient and are supported by a solid, albeit weakening, consumer and the potential for less regulation. U.S. equity markets have moved significantly higher and may need to digest optimistic sentiment and government policy uncertainty
- Canada remains vulnerable to poor housing affordability, an indebted consumer and U.S. policy changes. This is somewhat countered by more accommodative shifts in monetary policies relative to other developed countries
- Europe continues to be impacted by geopolitical tensions with the war in Ukraine and threats to the energy sector. Further challenging Europe's economic outlook is a weak manufacturing sector, upcoming elections in Germany, political uncertainty in France and rising bond yields
- Lackluster global economic growth may continue to impact Asia Pacific (ex-Japan) markets, which is partially offset by the potential for additional stimulus from China

- Japan's inflation rate remains elevated versus history and economic growth forecasts point to a pickup, supporting Japan's divergent monetary policy. While the low yen is supporting export growth, should the currency appreciate, global growth slow or tariffs arise, Japan's export heavy economy would be challenged

Fixed Income

- Moderating inflation and resilient economic growth support the outlook for high-yield bonds, as all in yields remain attractive provided the economy avoids a recession and cash flows hold. However, spreads remain below historical levels moderating the outlook
- The yield curve further normalized significantly over the quarter as long-term yields increased and the U.S. Federal Reserve (Fed) cut rates in November and December. Over the quarter, the 10-year yield rose by roughly 78 basis points to 4.03%
- Emerging market bonds offer higher yields and diversification yet are susceptible to growth slowdowns, currency fluctuations and U.S. trade policy changes

Cash

- Cash remains overweight as it continues to provide a cushion to soften the impact of volatility. Cash yields are lower as policy rates have moved lower, but still provide a reasonable return with low risk, as well as optionality for future investment opportunities

Equity Allocation

The AAC lowered its equity outlook to neutral. EM equities were downgraded to underweight on tariff and growth concerns, as well as disinflationary pressures in China which recent stimulus has yet to improve.

With inflation pressures easing and softness in some economic indicators, the U.S. Federal Reserve (Fed) cut interest rates by 25 basis points in both October and December. Similarly, concerns around the U.S. election results moderated in November, with the prospect of pro-growth policies being enacted by the incoming Administration later in 2025. While Fed officials continue to show support for interest rate cuts this year, the threat of tariffs and resilient economic growth will keep the Fed data dependent.

Equity indices were volatile in December after hawkish Fed meeting notes were released, showing dissent among some voting members. The AAC maintained its overweight position to U.S. equities as economic growth will support earnings. At the same time, rich valuations and the potential for market negative policies moderate the outlook.

Japan's core inflation trended up during the quarter, while the consensus 2025 GDP growth forecast was revised up in mid-November, increasing the odds of an interest rate hike from the Bank of Japan (BoJ) in January. However, the risk of tariffs and weak domestic consumption may weigh on equities, while the Japanese yen is expected to remain volatile. As a result of the above factors and relative opportunities, the AAC lowered its exposure to Japanese equities by 50 basis points and maintained a neutral outlook.

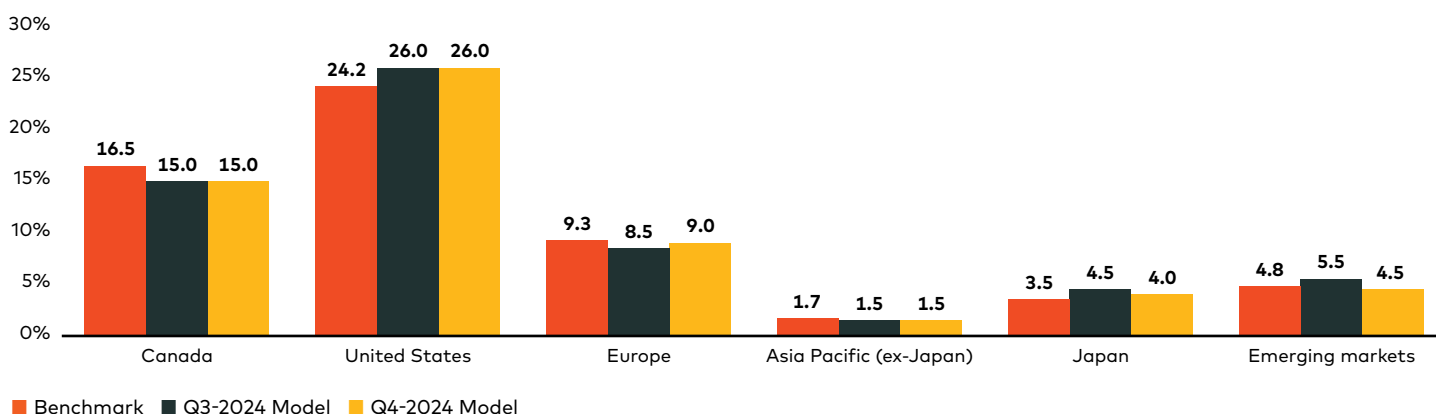
Canadian Gross Domestic Product (GDP) continued to track below the Bank of Canada's (BoC) projections throughout the fourth quarter, along with inflation which remained under the Bank's 2% target in November. The BoC delivered two additional rate cuts during the quarter, aiding rate-sensitive sectors such as Financial, Real Estate, and Utilities. Still, the S&P/TSX Composite Index underperformed the MSCI World Index over the quarter. The AAC maintained its underweight position in Canadian equities.

The AAC's outlook for European equities remains underweight, albeit less so. After a robust start to 2024, European markets traded lower during the fourth quarter on weak earnings growth, stagnant economic conditions and persistent inflation risks. On a positive note, the European Central Bank (ECB) continued lowering interest rates, with two cuts in the fourth quarter and more expected by the market 2025. European valuations remain reasonable, with forward price-to-earnings ratios below 14, suggesting that some stocks are not overly expensive relative to history. Nonetheless, sentiment is heavily influenced by external factors, including the incoming U.S. Administration, as well as internal political turmoil within the European Union. The AAC slightly increased its position to Europe by 50 basis points while remaining slightly underweight to the benchmark as sentiment remains cautious.

The AAC also maintains its underweight position in Asia Pacific markets (ex-Japan). Overall, the Asia Pacific equity market presents a mixed outlook. Hong Kong and Singapore remain attractive jurisdictions on valuation, although rising U.S. trade tensions pose a risk. Conversely, Australian equities are relatively more expensive while offering upside to commodity prices.

The outlook for EM equities was reduced to underweight and the allocation was decreased by 50 basis points. Relative valuations and supportive monetary policy present opportunities that are weighed against risks, including a strong U.S. dollar. India stands to potentially benefit from deglobalization, and fund flows redirected from China, but there are concerns about the political coalition's strategy. South Korea was recently roiled by an unlawful martial law and now an ongoing impeachment process.

FIGURE 2: Equity Allocations



Source: AGF Asset Allocation Committee, December 31, 2024. One cannot invest directly in an index.

Benchmark: 16.5% S&P/TSX Capped Composite Total Return Index / 24.2% S&P 500 Total Return Index / 9.3% MSCI Europe Index / 3.5% MSCI Japan Index / 1.7% MSCI Pacific ex-Japan Index / 4.8% MSCI Emerging Markets Index

Fixed Income Allocation

The AAC maintained an underweight position in fixed income as global economic growth continued, with the services sector making up for broad weakness in manufacturing. Developed market central banks elected to cut interest rates during the fourth quarter. However, U.S. treasury yields continued to move higher on strong economic data and the potential for more inflationary policies from the incoming U.S. Administration. While the risk of a recession has not gone away, particularly in Canada and Europe, the AAC believes that the relatively robust growth in the U.S. has continued to defer this scenario for the time being and could result in relatively modest interest rate cuts.

With this view in mind, the AAC's allocation to U.S. high-yield bonds has remained above neutral, while rate-sensitive categories continue to remain underweight in expectation of resilient growth along with still flatter than normal yield curves, which in our view limit the extent to which long bonds can rally. The AAC anticipates U.S. bond yields could remain broadly within the range of the last two and a quarter years, which is conducive for coupon clipping in high-yield bonds. Credit spreads remained tight during the quarter, reflecting relatively robust economic growth and solid corporate cash flow generation, while at the same time limiting the relative opportunity.

Global bond markets posted negative returns in the fourth quarter, as U.S. Treasury yields moved up over the quarter on stronger-than-expected economic data and reduced rate cut expectations in the U.S. Further, politics

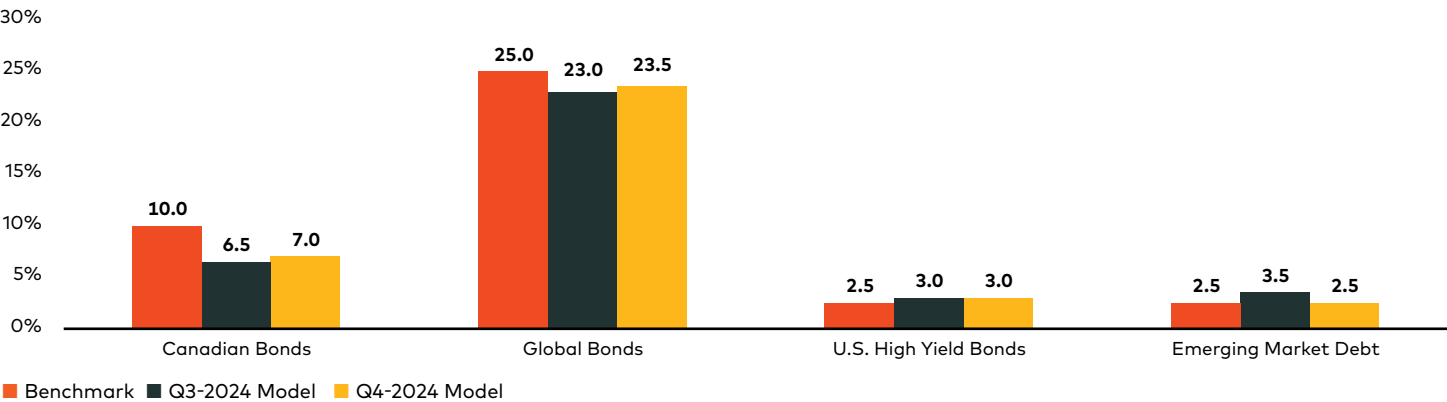
in Europe and the U.S. created volatility in local yields and currencies, as markets grappled with the potential for more uncertainty around government policies. The AAC increased its allocation to global bonds by 50 basis points as a result, while still maintaining its underweight position.

The AAC remains underweight Canadian government bonds owing to unfavourable yield curve characteristics, elevated pessimism regarding economic growth prospects, and the availability of higher yields in other jurisdictions. At the same time, rate cuts from the BoC may outpace other central banks this year, tempering the underweight view.

EM bond spreads also tightened over the fourth quarter assisting performance. However, this tightening was offset by a rise in treasury yields, resulting in the relative underperformance of hard currency sovereign bonds and EM corporate bonds. The AAC expects a modest decline in yields in 2025, aided by improvements in global inflation and the prospect of further rate cuts in developed markets. The outlook for EM bonds was reduced to underweight, as global central banks will be less inclined to cut rates while the U.S. dollar remains strong. The AAC decreased its allocation to EM bonds by 100 basis points.

The AAC increased its cash position to 4%, maintaining its overweight outlook, as cash continues to provide a cushion in the portfolio and lowers volatility. Cash rates remain attractive, particularly in the U.S. where the Fed has cut rates less than other central banks, although the AAC expects the relative attractiveness to decrease in tandem with incoming rate cuts.

FIGURE 3: Fixed Income Allocations



Source: AGF Asset Allocation Committee, December 31, 2024. One cannot invest directly in an index.
Benchmark: 10% Bloomberg Canada Aggregate Bond Index / 25% Bloomberg Global Aggregate Bond Index / 2.5% Bank of America/Merrill Lynch U.S. High Yield Master II Total Return Index / 2.5% JPMorgan EMBI Global Total Return Index

Q4 2024 Economic Recap

The fourth quarter of 2024 delivered continued political turmoil in both developed and emerging markets. U.S. economic growth continued to show resilience in the third quarter, as real gross domestic product (GDP) increased by 3.1% annualized compared to 3.0% in the second quarter. Furthermore, the 3.1% growth represents an increase from the 2.8% estimate projected earlier in the quarter, further highlighting the strength of the U.S. economy. This growth reflected increases in consumer spending for both goods and services, business investment and government spending.

Financial conditions remained favourable over the fourth quarter, despite U.S. Treasury yields moving higher, aided by an improvement in credit conditions. The U.S. 10-year Treasury yield started the quarter at 3.7% and rose to a high of 4.6% in December, ultimately ending the quarter at 4.57%. U.S. real GDP, which measures gross domestic product less inflation, is expected to grow at an annualized rate of 2.6% in the fourth quarter of the year, signalling a deceleration in growth from Q3 and driven lower by private domestic investment. Overall, GDP is projected to grow approximately 2.7% in 2024. The unemployment rate remained relatively stable during the last two quarters of the year, hovering between 4.1% and 4.2% in October and November, which represents virtually no change since June.

The U.S. Federal Reserve (Fed) lowered interest rates by a collective 50 basis points over the quarter, citing a

moderating outlook to inflation pressures and the need for less restrictive monetary policy. However, despite remaining under 3%, there was a marked deceleration in the progress on lowering inflation, as monthly Consumer Price Index (CPI) reports have begun to trend upward since the end of the third quarter, reaching 2.7% year-over-year (YoY) in November from a low of 2.4% in September. The combination of resilient economic growth, stagnating progress on inflation, and the potential for inflationary trade policies proposed by the incoming Administration have caused markets to lower their rate cut expectations to just two 25 basis points cuts by the end of 2025.

The Canadian economy grew at a 1.0% annualized rate in the third quarter of the year, lower than the Bank of Canada's (BoC) expectation of 1.5% growth. Household consumption grew faster than expected, while government expenditures saw their third consecutive quarter of growth across all government areas. However, business investment was weaker than anticipated contracting 7.5% annually. The fourth quarter started stronger, with GDP growing at 0.3% month-over-month in October, representing an acceleration from the previous month. However, preliminary numbers for November suggest softness, in line with softer manufacturing and wholesale advanced readings for the month.

The Canadian Dollar (CAD) witnessed significant weakness

against the U.S. Dollar over the quarter, as risks of a more hawkish Fed and the possibility of tariffs both worked against CAD. However, CAD's performance against other major currencies, including the Euro, Japanese Yen, and Australian Dollar was positive, as the respective economies struggled with their own growth.

During the fourth quarter, Canada's headline inflation remained under the BoC's 2% target, dropping to 1.9% in November on the back of a broad-based slowdown in prices, particularly in mortgage interest costs and travel tours. Along with the weaker GDP growth, the unemployment rate continued to increase, reaching 6.8% in November, highlighting continued pressure on the labour market. Consequently, the BoC lowered interest rates by a collective 75 basis points, to 3.25% and indicated that the balance of economic risks had shifted to the downside. Further decisions will be made on a meeting-by-meeting basis, as the BoC will be looking for evidence of past rate cuts working their way through the economy.

Japan's core inflation accelerated in December, keeping CPI above the Bank of Japan's (BoJ) 2% target for over two years, and raising the expectations of a near-term rate hike in 2025. The policy rate was set at 0.25%, and the BoJ also abandoned yield curve control earlier in the year but stated that accommodative financial conditions will be maintained for the time being. After a temporary rebound at the end of the third quarter, the Japanese Yen resumed its selloff against the U.S. dollar in October as hopes of a BoJ hike in December began to fade.

Meanwhile, the European Central Bank (ECB) reduced its key interest rate by 25 basis points in October and December, bringing the policy rate to 3.15%. Inflation rates in the Euro Area moved up over the quarter, reaching 2.2% in November from a low of 1.7% in September, which was primarily driven by service inflation. Core inflation has stabilized around 2.7% since August, but still above the ECB's 2% target. Moreover, Germany and Spain reported CPI rates 2.9% and 2.8%, respectively, for December. This was ahead of all estimates and driven by food and energy costs. Still, the ECB's policy rate of 3.15% remains restrictive, even considering the recent increase in inflation, potentially giving policymakers room to reduce rates further in 2025.

China reported economic growth of 4.6% for the third quarter, ahead of the market's 4.5% estimate, but below second quarter growth of 4.7%. Industrial production rose 5.3% and 5.4% YoY in October and November respectively, a sign that government measures might have started to have an impact on the economy. Retail sales were mixed throughout the quarter, with October exhibiting the fastest growth since February helped by the annual Singles Day. However, November's numbers disappointed as the real estate slump continued.

EM returns were negative across asset classes over the quarter, impacted by the possibility of tariffs in the new year and political upheaval in South Korea. Within fixed income, EM bond indices were negative, with corporate bonds outperforming local and external bonds. EM currencies were mixed over the quarter, with notable underperformance coming from Brazil and South Africa, while the Indian Rupee and Peruvian Sol were among the best-performing EM currencies.

Broadly speaking, the disinflationary trends from Q3 continued, with some divergence occurring between developed market economies. Inflation continued to moderate in Canada, while the U.S. economy's growth has made reaching the Fed's inflation target more challenging. Similarly, recent data coming out of Europe suggest a slowdown in the progress on inflation. The AAC remains vigilant about the risk of a resurgence in inflation, as the threat of tariffs from the new U.S. administration could disrupt the progress made thus far. In addition, the significant market rally in 2024 may lead to more muted returns in the year ahead, as the market grapples with a political shift in Washington and more protectionist policies. Recent inflation data in the U.S. were encouraging, prompting the Fed to cut interest rates twice throughout the quarter; however, the resilient economic growth and potential for tariff-driven inflation in 2025 has a dampening effect on the future path of rate cuts. With the rate-cutting cycle well underway in most developed nations, and the progress on inflation beginning to plateau, some EM central banks have taken the opposite stance and raised interest rates, as evidence of a resurgence in inflation is starting to build in their respective economies.

AGF Asset Allocation Committee

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For more information on the AGF Asset Allocation Committee visit [AGF.com](https://www.agf.com).

All data sourced from Bloomberg or AGF Investments as of December 31, 2024 unless otherwise stated.

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Publication date: February 7, 2024