AGF INSIGHTS

OUTLOOK 2021

Almost There

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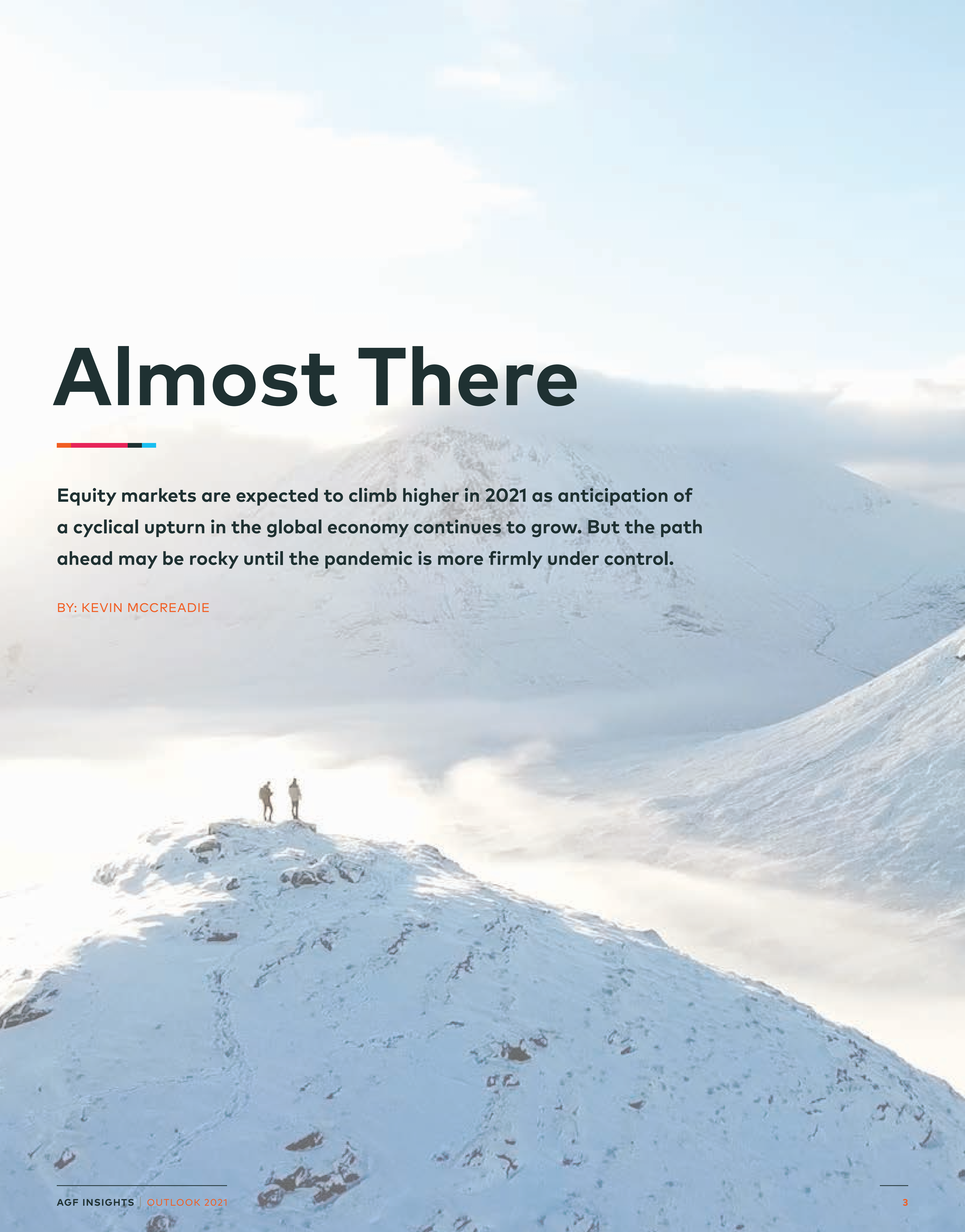


Almost There

Equity markets are expected to climb higher in 2021 as anticipation of a cyclical upturn in the global economy continues to grow. But the path ahead may be rocky until the pandemic is more firmly under control.

BY: KEVIN MCCREADIE

Kevin McCreadie, CFA®, MBA
CEO and Chief Investment Officer
AGF Management Limited

The only way to begin prognosticating about 2021 is to first look back on one of most tumultuous years in modern history. The COVID-19 pandemic has left an indelible mark on all who lived through it and those who lost loved ones will never be the same. It has tested our resolve and demanded our compassion, but it has also exposed our fault lines and laid bare the inequalities that are keeping society from reaching its full potential.

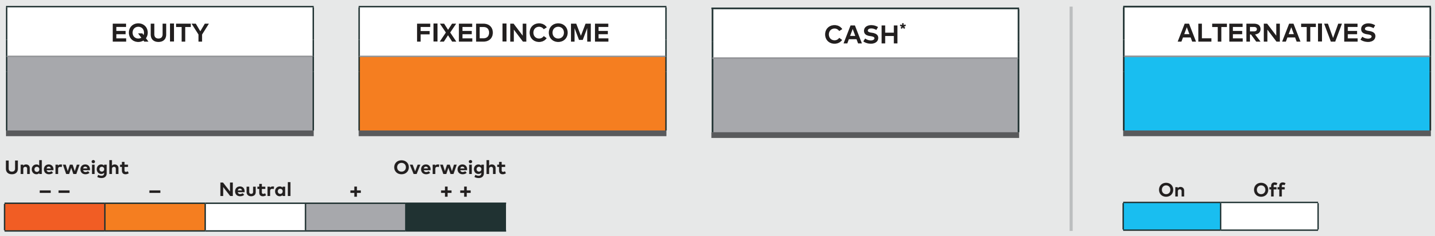
This is true across all facets of life, but the economic lockdowns induced by the pandemic in 2020 have had their own unique impact on investors. In fact, never have stock markets collapsed as quickly as they did this past March, and never has an economy fallen into a recession as abruptly or as deeply before. And yet here we are, more than 10 months since the crisis began, riding one of the most remarkable market rebounds of all time, all the while anticipating a potent economic recovery that could push stocks and other risk assets even higher over the next 12 months.

Still, investors may not want to get too far ahead of themselves. While the beginning of a new economic cycle seems inevitable, the timing of it remains tenuous and in the first few months of 2021, markets may become even more volatile before giving way to a less tumultuous, more favourable trajectory in the second half of the year.

The key in all of this, of course, is the ongoing fight to end the pandemic as it continues to rage and force new temporary lockdowns in several countries around the world including the United States and Canada. Left unchecked, this could result in a double dip recession in at least some regions of the global economy even as optimism about a COVID-19 vaccine continues to grow. In fact, while there are at least two vaccines (and potentially several others) either approved or in process for approval from regulators in Europe and North America, it will be several months before enough doses are manufactured and made available to quell the global spread of the virus. At the same time, regional differences in vaccine availability will also have an impact on the breadth of the economic recovery going forward.

In turn, this only puts more pressure on governments and central bankers to step up their support over the next few months. Fiscal and monetary policy has never been so globally coordinated or so accommodative as it is today,

Asset Allocation: Heading into the New Year



Source: AGF Asset Allocation Committee Fourth Quarter Update (as of October 1, 2020). Based on a 60/40 portfolio mix of equity and fixed income. For more details, please see AGF's Quarterly Outlook and Model Portfolio Allocations.

but the need for more stimulus remains critical to bridge the gap between now and when the pandemic is more firmly under control. Thankfully, the political will to do so remains relatively strong, but time is of the essence and the rollout of new spending in the U.S., in particular, could end up taking longer than would otherwise be desired given the current dynamics of the presidential transition now in progress. A "skinny" stimulus bill before year end with the hope of more later if needed would be received well by an equity market hoping for the recovery to truly begin.

Clearly then, the pandemic – and response to it – will remain one of the big uncertainties facing investors in the early part of the new year. There are, however, several other factors that may come into greater focus as 2021 progresses. For instance, the potential market implications of the new political landscape in Washington, D.C. go beyond the timing and magnitude of the next stimulus package and may still encompass the prospects of higher corporate taxes and stricter industry regulation if run-off elections taking place in January for two seats in the U.S. Senate end up in the favour of the Democrats.

Given this backdrop, it remains crucial to position investment portfolios in a way that protects against downside risks but also takes advantage of the opportunities that will become increasingly evident as the economic recovery picks up more steam.

We believe a bias towards equities over fixed income within the context of a 60/40 portfolio will serve investors well when considering the next year in its entirety. Within equities, a barbell approach that focuses on quality growth companies, but which also tilts towards cyclical stocks, will help navigate the near-term uncertainty around the economy as well as the path to recovery. But then as a vaccine takes hold and economic progress becomes even more certain, a rotation towards those areas of the market that have done well in prior upturns should become more emphasized. Emerging Markets, for example, tend to do particularly well in new economic cycles, as do commodities and those sectors that are most tied to the early stages of an expansion such as financials, consumer discretionary and industrials.

That's not to say investors should completely abandon what benefited them most in 2020. Fixed income will continue to provide important capital preservation despite the threat of rising yields, and while the so-called "work-from-home" equity portfolio may be due for a correction, we believe many of the technology stocks associated with it should continue to resonate long after the pandemic has ended.

Moreover, alternative investments, including long/short hedging strategies and asset classes such as private credit, will continue to offer important diversification to stocks and bonds, and sustainable investment themes may only become more top-of-mind with investors as the need to direct capital more effectively towards environmental and social issues continues to ramp up in the coming years.

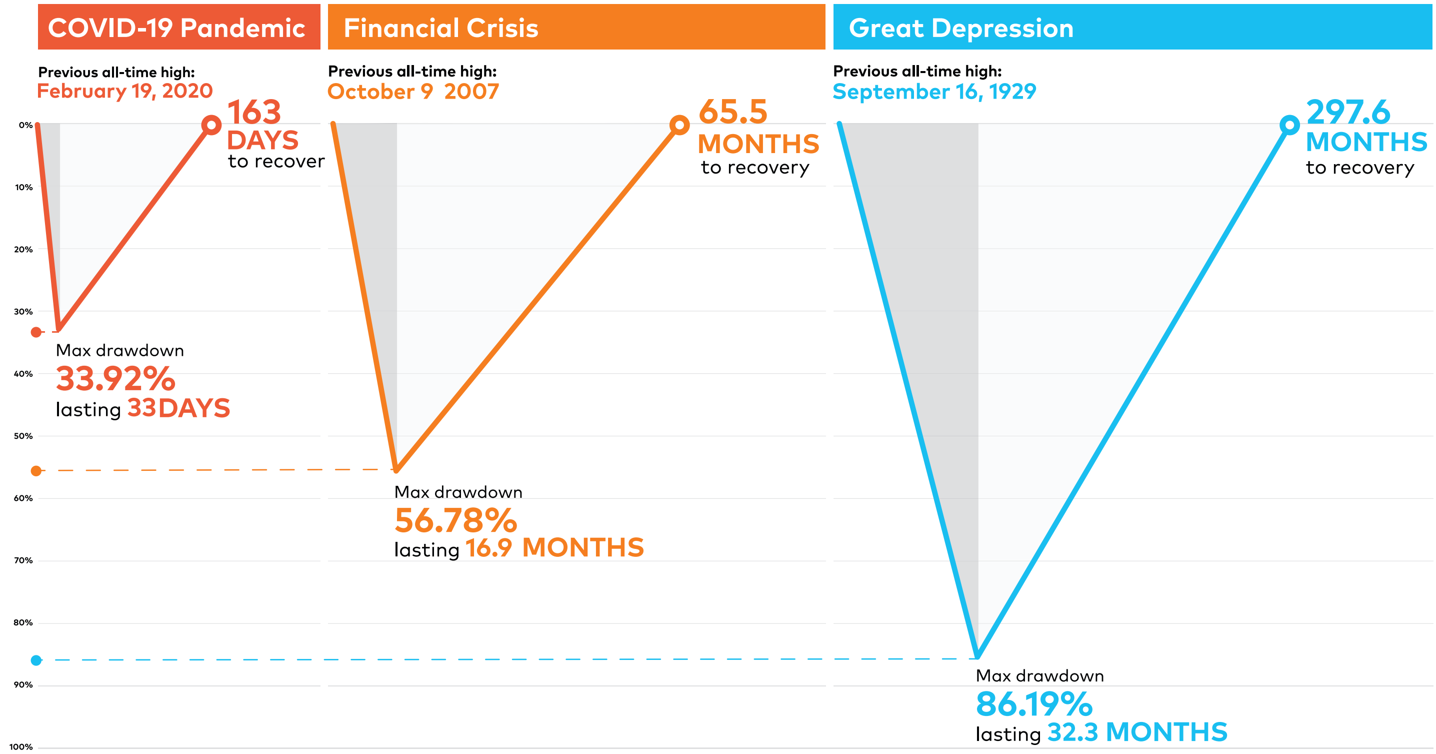
Ultimately, investors can take comfort in knowing the worst of the pandemic will soon be over, but what could end up being a very good year for the global economy and financial markets may not necessarily start out that way. ■

Please see Disclaimer section for full disclosure.

2020 YEAR IN REVIEW

Bear and Back Again

The U.S. equity market has never spiralled into bear market territory as swiftly as it did in 2020. Nor has it ever recovered as quickly to reach new all-time highs.



Source: Bloomberg LP and Cornerstone Research Inc. as of October 31, 2020

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BY: STEVE BONNYMAN, REGINA CHI, RYAN DUNFIELD, ANDY KOCHAR, TOM NAKAMURA, TRISTAN SONES AND DAVID STONEHOUSE

Equity

Emerging Markets Divide (and Conquer?)

As digitalization grows and reforms take root, equity performance in several EM nations could be driven by far more than the post-pandemic recovery in 2021.

By Regina Chi

Given the U.S. equity market's remarkable performance this year – the MSCI USA Index rose by more than 60% between its panic-driven late-March low and the end of November, according to Bloomberg – it might be easy to miss that the rebound has been a global phenomenon. In fact, during the same period, the MSCI Emerging Markets Index rose by more than 60%, too, as several Emerging Markets (EMs), such as China, South Korea and Taiwan, either avoided the worst effects of the pandemic or dealt with them quickly and efficiently.

In 2021, investors should expect a continuation of the late- and post-pandemic recovery in EMs. Even after their 2020 rally, EM equity valuations offer a discount to developed markets. Forward price-to-earnings for the MSCI EM index is about 19x, according to Factset, compared with 26.5x for the MSCI USA index, leaving room for the traditional growth premium relative to the U.S. to reassert itself going forward. As well, the monetary and fiscal policy response to the pandemic in many EMs has exceeded expectations, suggesting a relatively smooth path for recovery, as does the apparently successful development of a vaccine for potential distribution in the first half of 2021.

> **The positive view on emerging markets, however, goes beyond those short-term factors, which coincide with longer-term trends that are shifting the EM landscape.**
>
> **Regina Chi**, Vice-President and Portfolio Manager
> AGF Investments Inc.

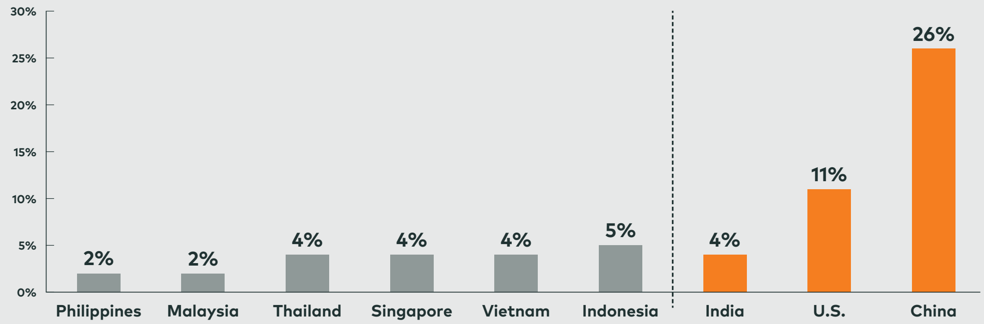
The positive view on Emerging Markets, however, goes beyond those short-term factors, which coincide with longer-term trends that are shifting the EM landscape. One is the rising impact of digitalization, which is transforming and expanding the consumer base and opening new opportunities in technology and retail. E-commerce in China, South Korea, Singapore and Brazil, for example, has been growing for years, but skyrocketed during the COVID environment; we expect that to continue post-pandemic, even if at a slower pace. In other EMs, especially the ASEAN countries

Equity

(except for Singapore) and India, e-commerce adoption has trailed the rest of the world, but the COVID environment might well provide a push toward a more dramatic period of digitalization.

Association of Southeast Asian Nations (ASEAN): Digitization has Only Begun

eCommerce penetration as of 2019



Source: Credit Suisse, December 31, 2019

Meanwhile, a wave of political reforms should enhance several EMs' economic prospects and their risk profile for investors. In Brazil, the Bolsonaro government has managed to negotiate significant pension and tax reform; Indonesia has undertaken an ambitious labour and investment reform program; India has embarked on labour and agricultural policy reform, as well as a "Make in India 2.0" initiative that should spur domestic activity. Finally, China's so-called dual circulation strategy is at the heart of its five-year plan for 2021-2025. While keeping China open to the world, it will reinforce its own market by boosting domestic demand with reforms and self-reliance. This could help insulate China's economy from trade-related shocks, but not mitigate them entirely. Even if at a lower volume, trade and geopolitical tensions between the U.S. and China will continue with Joe Biden as president.

The reality is that the world economy entered a period of deglobalization years ago, and this too will provide opportunities for EM investors. As corporations seek to mitigate trade-tension risk and diversify their supply chains, Asian economies such as Vietnam, the Philippines, Malaysia and India, as well as select Eastern European EMs, are likely to be among the beneficiaries.

Obviously, risks remain. Trade tensions could overheat. U.S. dollar strength or rising rates – neither of which we expect – could undermine vulnerable EM current accounts. Policy commitments to backstop growth could falter. That's why it's important that investors take country-specific factors into careful consideration. If they do, it will be in the context of both short-term and secular factors that support Emerging Markets for 2021 and beyond.

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Fixed Income

Prepare for a Bear

Fixed-income alternatives will be critical for preserving capital and generating bond portfolio returns in 2021.

By Andy Kochar, Tristan Sones and David Stonehouse

Government bond yields may stay range-bound or fall modestly in the near term as the market grapples with rising COVID-19 case counts and the risk of more lockdowns. But a cyclical bond bear market – with government yields rising (and prices falling) – will likely take hold in the new year and reinforce the importance of a well-rounded fixed-income portfolio that includes alternatives to enhance downside protection and provide additional return potential.

The short-term impact of a second COVID-19 wave notwithstanding, the economic cycle appears well on the path to recovery, and historically periods of early cycle expansion are bearish for government bonds in particular. Through 2020, there were several positive signs in measures of real economic activity. Demand appears to have been growing: U.S. inventory levels are low, as is the cost of borrowing, and consumer savings rates are high. These forces should be inflationary, and as inflation expectations rise, so do rates. Perhaps most importantly, the end of the pandemic may be coming into view. The prospect of a COVID vaccine being distributed through the first half of next year augurs well for a U.S. (and Canadian and global) economic expansion. When you add in the likelihood of continuing monetary and fiscal stimulus, the case for a cyclical bond bear sometime in 2021 only strengthens.

How bad might it be? There have been six cyclical bond bear markets over the past three decades, and they have lasted the better part of two years with 10-year Treasury yields rising somewhere in the range of 200 basis points, on average, according to Bloomberg data. More recently, however, these basis point increases have diminished in magnitude, so for the next one investors might reasonably assume that 10-year yields could rise by more than 100 basis points over the course of 18 to 30 months. It is important to note, however, that the pain will not be spread evenly across the yield curve – shorter-duration bonds will feel less of it – and corporate bonds typically perform better than government bonds during periods of recovery.

In turn, while more traditional fixed-income portfolios may be susceptible to modestly negative total returns in 2021, we believe those that invest in alternatives to government bonds are well positioned to preserve capital and maintain a positive return profile. High-yield bonds, for example, have performed well since global equity markets bottomed in March and tend to do well during cyclical bears for government bonds. Convertible bonds, which are corporate debt instruments with upside return

Fixed Income

potential, have also historically outperformed traditional bonds during cyclical bears, and can provide diversification within a fixed-income allocation and downside protection against weak equity markets.

The U.S. 10-Year Treasury Yield (%)

Source: Bloomberg LP. as of November 30, 2020

There should be opportunity in Emerging Markets (EM) bonds as well. The U.S. Federal Reserve's accommodative rate regime is expected to mitigate U.S. dollar appreciation, helping EMs with high U.S.-dollar-denominated debt, and many EMs should benefit generally from rising commodity prices and a global economic recovery. Moreover, the use of derivatives that are designed to provide negatively correlated returns can help protect capital and smooth volatility within a fixed-income portfolio.

Compared with its equity cousin, which can easily take a 30% chunk out of a stock prices, the cyclical bond bear might appear to lack bite. That might lead some investors to simply ride it out and accept the potential for minor declines in their bond portfolios. However, there is little reason to not try and do better than that. In fact, through judicious active management deploying tools such as those mentioned above, positive fixed-income returns are well within reach in 2021. ■

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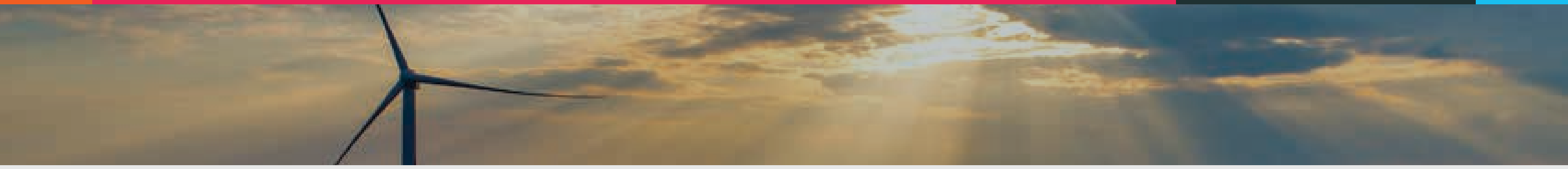


Real Assets

How to Keep It Real

Renewable utilities, office real estate and mobility infrastructure are among the real assets positioned to benefit from an economic recovery in 2021.

By Steve Bonnyman

Whether it's commodities, infrastructure, real estate or utilities, the performance of real assets in 2021 will hinge on an economic recovery driven by the successful approval of a COVID-19 vaccine(s) and related factors such as accommodative monetary policy and the persistence of negative real interest rates. But like every heterogenous asset class, not every option within the real asset universe will fare equally well from this likely, if not instantaneous, outcome.

> **Investors will need to be selective with their allocation to real assets in 2021, but should feel confident that opportunities can offset many of the risks – especially in the oversold categories of the asset class.**
>
> **Steve Bonnyman**, Co-Head Equity Research and Portfolio Manager
> AGF Investments Inc.

Regulated utilities, energy infrastructure stocks and other so-called bond proxies, for instance, will likely underperform their counterparts after providing a "safe haven" of predictable cash flow throughout most of the pandemic uncertainty this past year. This underperformance will be due, in large part, to their lack of expected earnings momentum during the early stages of a new economic cycle which, at least in the short term, could negate still attractive long-term valuations based on continued low rates.

On the other hand, renewable utilities and utility grid-owner developers should benefit from a stronger macro environment and higher levels of capital, while mobility infrastructure assets such as airports, rail, and toll roads seem likely to regain some of their value on the expectation of a resumption in commuting and travel.

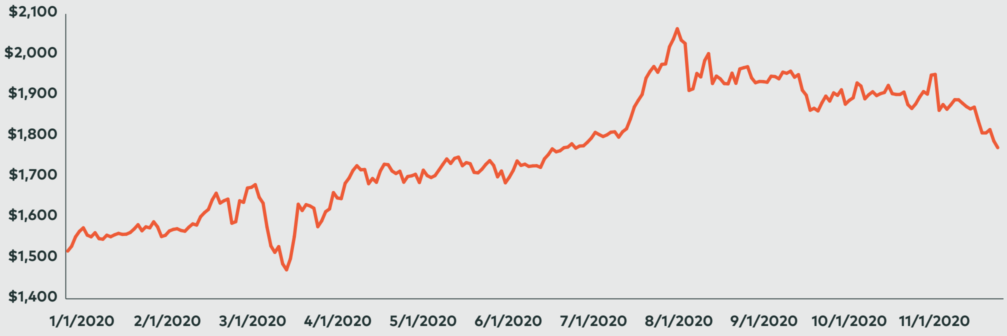
Prospects for real estate assets, moreover, are buoyed by the low-for-longer interest rate environment. This is particularly notable for the heavily discounted office, housing and retail sectors and while the "work from home" theme is unlikely to disappear completely in 2021, performance in these areas seems poised to recover in a more normal economic environment.

Real Assets

Finally, the commodity complex and broader materials industry are both well-positioned to benefit from a rebounding economy and subsequent pickup in industrial activity. This is highlighted by the sharp rise in copper prices in recent months. The base metal has long been an economic bellwether whose long-term demand is supported by its critical role in the electrification of transportation and utility markets.

As for gold and gold equities, fund flows may weigh against them in the early stages of this recovery, but underlying dynamics remain positive. If anything, gold prices may end up moving higher from here given the industry's improved discipline towards profitability and the expectation that both the U.S. dollar and real rates will continue being range-bound, if not weaker, in the near future.

Gold Spot Price (U.S. dollars)



Source: Bloomberg LP. as of November 30, 2020.

Ultimately, investors will need to be selective with their allocation to real assets in 2021, but should feel confident that opportunities can offset many of the risks – especially in the oversold categories of the asset class. Not only do low rates provide a valuation floor for many of these longer-duration investments, the cyclical positioning typically associated with them is relatively low both on a historical basis and regarding the growing potential for a strong economic recovery.

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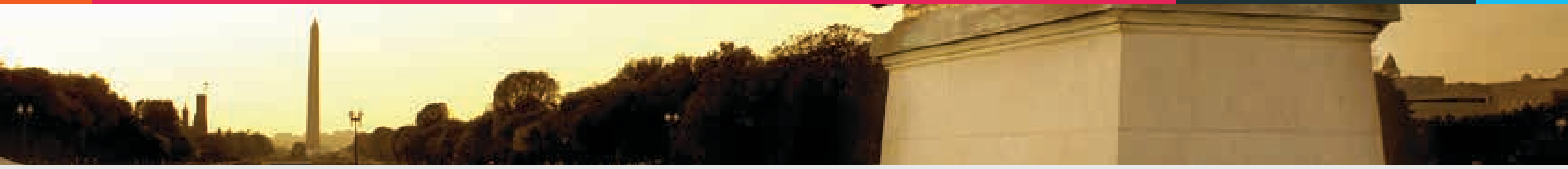


Currency

Fading the U.S. Dollar

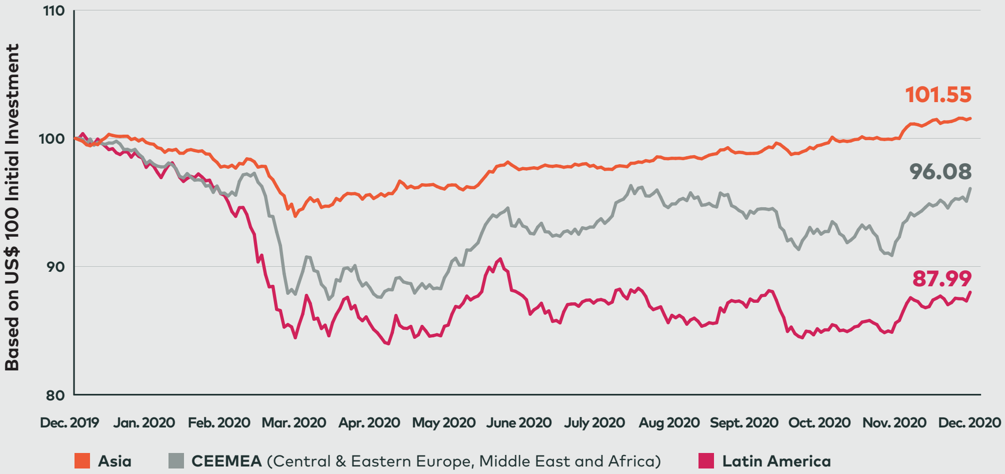
Emerging Market currencies should strengthen in 2021, but traditional FX safe havens may end up suffering.

By Tom Nakamura

The changing face of U.S. politics will play a large role in determining the direction that foreign exchange (FX) markets take in 2021. But current monetary and fiscal policy settings and growing optimism about an eventual end to the pandemic may also help set the tone and bolster Emerging Market (EM) currencies above all others in the process.

In particular, last year's laggards in the developing world are expected to be this year's leaders, led by Latin American currencies and those from Central and Eastern Europe as well as the Middle East and Africa (CEEMEA). Within the more developed markets, meanwhile, the Norwegian krone, the Australian dollar and the Canadian dollar seem poised to outpace traditional safe havens such as the euro, Japanese yen and U.S. dollar, whose strength in recent years has made it more vulnerable as interest rates around the world have become more uniform.

Latin American Currencies Versus EM Counterparts



Source: Bloomberg LP. As of November 26, 2020. Based on equal-weighted indices. An index cannot be invested in directly.

Of course, some of this will depend what on ends up playing out in Washington, D.C. over the next few months. For now, hopes are high that a new White House administration will dampen much of the random event volatility that was a mainstay of President Trump's tenure. This is especially true with respect to U.S. foreign policy and trade. While the U.S. is unlikely to become soft on trade, the Biden

Currency

administration's approach should be more conducive to long-term investing and a return to more traditional diplomacy multilateralism is expected. Unlike in the previous regime, the focus will be on common goals which benefit many countries (and thus many currencies) – not just one country (and thus not just one currency).

At the same time, the pandemic response from monetary and fiscal policy has been impressive but unwinding it will be difficult. Easy monetary policy is likely to be sticky and the U.S. Federal Reserve, European Central Bank and Bank of Japan (G3 central banks) are expected to remain very accommodative and willing to ease even further should economic setbacks occur. Fiscal policy, moreover, is likely to remain loose as well. And with G3 short-term interest rates compressed at very low levels, FX markets will increasingly be driven by growth prospects.

That said, whether there's more or less stimulus hinges on the path of the pandemic. The key determinant is the ongoing development, approval and distribution of a COVID-19 vaccine(s). No doubt, this would benefit all markets, but some may win out more than others. EMs have, for instance, needed to safeguard their populations and economies by spending to support vulnerable health systems, a greater proportion of the population living in poverty, and a workforce that had less scope for remote work. And while investors have been generally accepting of that reality to date, the quicker these economies can return to normal, the sooner EM assets can be re-priced, currencies included, resulting in lowered risk of an adverse credit event. ■

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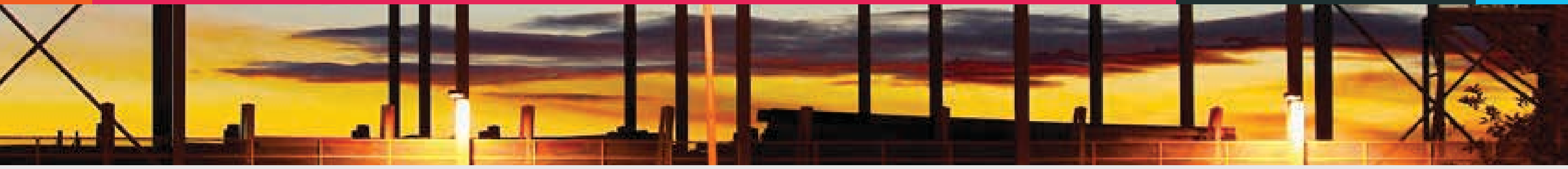


Alternatives

The Three Rs of Private Credit

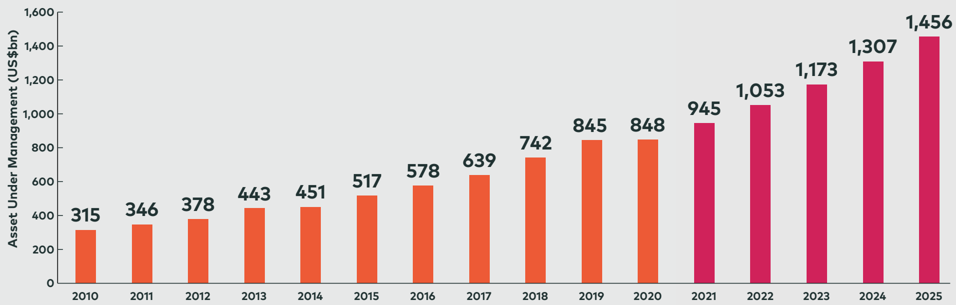
Rates, regulations and restructurings are among the catalysts expected to give the alternative asset class a boost in 2021 and beyond.

By Ryan Dunfield

Private credit has been something of a revelation to investors this past decade. In 2010, there was US$315 billion invested globally in the asset class, according to Preqin, an alternative investment research firm, whereas today that figure stands closer to US$850 billion. And yet, that may not end up being the half of it. In fact, by Preqin's estimates, private credit (or private debt as some call it) is poised over the next five years to become the second fastest growing alternative asset class, trailing only private equity, on its way to US$1.46 trillion in assets under management by 2025.

But even if that prediction falls short, it's hard to deny the attractiveness of private credit—at least for institutional and high-net-worth investors who have access to it going forward. In part, this attraction is a function of the lower-for-longer interest rate environment that has spurred an insatiable investor appetite for high-yielding assets in the wake of the Global Financial Crisis (GFC). And with the U.S. Federal Reserve signaling earlier this year that it has no intention of raising rates in the near term, this demand seems only likely to grow.

Private Debt Assets under Management and Forecast, 2010-2025*



*2020 figure is annualized based on data to October. 2021-2025 are Preqin's forecasted figures.

Likewise, the option to participate in private credit investments is also expected to multiply in the coming years as more traditional banks continue to shy away from higher-risk lending as the result of more stringent government regulation put in place following the GFC. This is a global phenomenon, but one with regional dynamics. For example, it's likely that Canada is only in the early innings of a multi-decade pullback in bank-originated commercial loans and playing catch up to the U.S. and Europe where alternative credit providers already play a meaningful role in the commercial loan market.

Alternatives

In addition, new avenues for non-bank lending are a likely consequence of the economic fallout from the COVID-19 pandemic. Corporate defaults and restructurings are already on the rise, for instance, and by most accounts will continue to climb over the next year—if not longer—and create opportunities, in particular, for restructuring or distressed debt specialists who can help companies find new ways of financing their operations without necessarily upending their capital structure.

Clearly, private credit is an asset class that has a lot going for it. And while it may not be suitable for every investor, there's every chance its role in many diversified portfolios will become more assured over time. ■

Ryan Dunfield, Managing Principal, CEO, SAF Group. AGF and SAF Group have entered into an extended partnership that will focus on new private credit opportunities.

Please see Disclaimer section for full disclosure.

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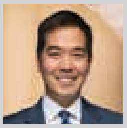

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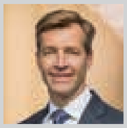

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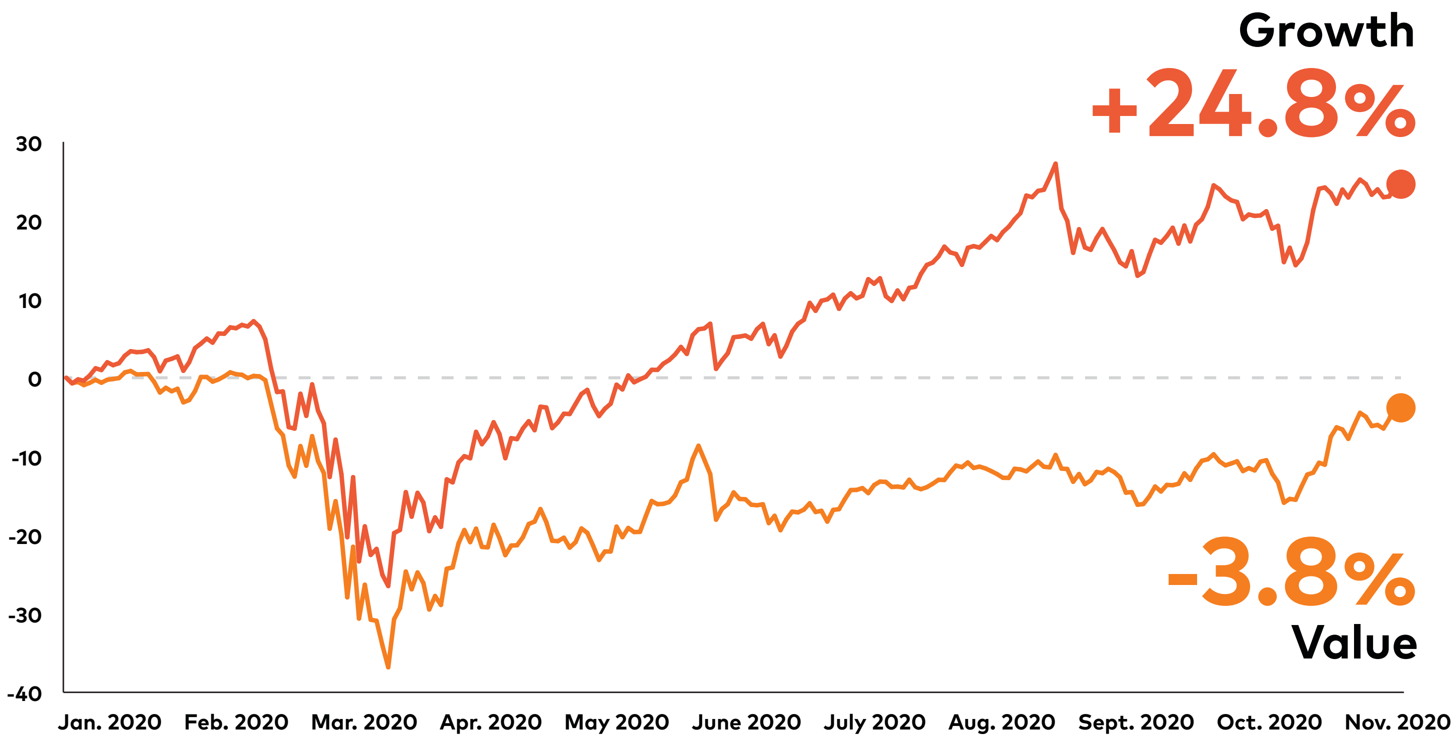
2020 YEAR IN REVIEW

Growth Spurt

Equity returns were driven in large part by the outperformance of growth stocks in 2020, but value stocks have gained ground more recently.



Source: Bloomberg LP, as of November 25, 2020. Growth is represented by the S&P 500 Growth Index. Value is represented by the S&P 500 Value Index. An index cannot be invested in directly.

The Necessary Evolution of 60/40

The idea that 60% of a portfolio should be invested in stocks and the rest in bonds has been a cornerstone of asset allocation for decades, but that doesn't mean practitioners of the concept should always accept it at face value or adhere to the breakdown so strictly – particularly in a dynamic market environment such as today.

BY: TRISTAN SONES, MARK STACEY AND STEPHEN WAY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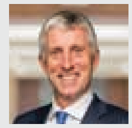
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Members of AGF's Investment Management Team recently sat down (virtually) to discuss the changing attitudes and various adaptations of 60/40 portfolios over the years and give their take on what asset allocators will need to consider in the future.

When did you first learn about the 60/40 concept and what was your first impression of it?

STEPHEN WAY (SW): The first time I heard about it was when I was taking the Canadian Securities Course. And to me, at that point, it didn't make much sense. I thought it was a very rigid and simplistic solution to a problem I didn't fully comprehend at the time. If anything, my knowledge of investing back then was entirely focused on stocks, so much so, that I remember being asked by my father's broker whether I was interested in pursuing an investment career in equities or fixed income and thinking, "what is fixed income?" Of course, that's not the case today. And 60/40 has proven to be a very powerful tool for building long-term wealth.

TRISTAN SONES (TS): For me, it was some time in the mid-1990s. I was working here at AGF, but I was part of the information technology (IT) team at the time, not investment management, and I remember an early client risk assessment questionnaire that mapped you to a series of optimized portfolios that all combined stocks and bonds to varying degrees based on your risk tolerance. It was the first time really learning about both asset classes within an efficient frontier and how a mix of both could improve your overall asset allocation.

MARK STACEY (MS): My first impression is similar. It didn't resonate when I first learned of it, in large part, because I was young and just wanted to grow my money through stocks. This was in the era of rock-star stock pickers and the big goldmine discoveries that made owning Bre-X a must-have before it was exposed as a fraud. So, I wasn't alone in my thinking. The focus for investors back then was squarely on the reward of seeking out big returns. Risk was something you took, not managed, and owning bonds was not part of the mindset.

When did the value of 60/40 start to resonate with you more broadly?

MS: The Tech Wreck in the early 2000s is probably when the idea of managing risk, not just taking it, started to become more top of mind, not just with me, but with investors more generally –and especially those who loaded up on dot.com names and got wiped out by the selloff. But in my opinion, the Global Financial Crisis (GFC) is the event that solidified the importance of asset allocation and made 60/40 the cornerstone it has become today. Of course, institutional investors were already big proponents of asset allocation by that time, but this is when retail investors more widely began to accept the benefits of diversification, not only within their equity holdings, but between stocks and bonds as well.

> **The Global Financial Crisis (GFC) is the event that solidified the importance of asset allocation and made 60/40 the cornerstone it has become today.**
>
> **Mark Stacey**, Senior Vice-President, Co-CIO AGFiQ Quantitative Investing, Head of Portfolio Management, AGF Investments Inc.

SW: Those two experiences shaped a whole generation of investors. And the more familiar people have become with the benefits of diversification in recent years, the more clear it is, I believe, that asset allocation decisions are just as important – if not more – to long-term performance as are the decisions about what individual stocks or bonds to own.

MS: And the most important part of the benefit has been to keep people invested. Most of us would agree that equities will outperform bonds over the longer term, but when you're only invested in stocks and the equity market drops 50% twice in less than ten years, it's hard to maintain your resolve and stay committed. So, the realization that having some allocation to bonds would have helped minimize losses dramatically during these two episodes is a powerful lesson to learn.

While 60/40 is more appreciated by investors today, the makeup of the underlying allocations that define it have continued to grow more complex in recent years. What is driving this evolution?

SW: The Global Financial Crisis has played a big role in that as well. Coming out of it, there was a great deal of concern about inflation, in large part, because of the tremendous amount of stimulus that resulted from it. But that didn't transpire. In fact, the past decade has been mostly deflationary, and as interest rates have continued to come down, there's been a growing willingness among investors to take on more risk in search of yield, not just in fixed income, but also in stocks. As a result, that has led to allocations in a broader range of investments from high-yield credit and Emerging Market debt to mega-cap growth stocks and so-called bond-proxies and more defensive, low-volatility holdings.

TS: The increase in risk tolerance has been a major factor in fixed-income allocations, so much so, that I would argue the biggest change to 60/40 has taken place on the bond side of the equation. For investors who were allocating money to bonds before the GFC, the majority of holdings were likely in domestic government bonds. But as interest rates have continued to drop and yield has become harder to come by, it's forced people to look further afield and consider corporate bonds – both investment grade and high-yield – and more diversification globally, including Emerging Market debt.

MS: Of course, the equity allocation is also much more global now than it's ever been. Part of that, at least here in Canada, is from a change in foreign content regulations some years ago that allowed investors to invest money in their Registered Retirement Savings Plans (RRSPs) more freely in global markets, but it's also an acknowledgement that geographic diversification often provides uncorrelated returns and tends to smooth out volatility over time. Unfortunately, correlations are not set in stone and many of the investments now common in a 60/40 portfolio have become more correlated – not less – in recent years, meaning their diversification benefits are waning. That has a lot to do with how coordinated central banks have become and the fact that interest rates are at near-zero levels almost everywhere in the world.

> **The increase in risk tolerance has been a major factor in fixed-income allocations, so much so, that I would argue the biggest change to 60/40 has taken place on the bond side of the equation.**
>
> **Tristan Sones**, Vice-President and Portfolio Manager,
> Co-Head of Fixed Income,
> AGF Investments Inc.

What does that mean for 60/40 and asset allocation going forward?

MS: It will need to evolve even further and we're already seeing that happen. Alternative asset strategies, including long/short positioning, and alternative asset classes, such as infrastructure and private credit, are growing in popularity for the very reason that they are less correlated to traditional equity and fixed-income markets. Of course, some of these options have different risks attached to them as well. Liquidity, or lack thereof, for instance, is likely to become a more important factor in determining the makeup of 60/40 portfolios in the future.

SW: The biggest risk to asset allocators over the medium- to long-term is inflation. If we see a significant rise in inflation, then bond yields will go up (and bond prices will fall), and a big portion of what's now being invested in equities will likely suffer, including growth stocks and bond proxies. So, that's going to put more emphasis on finding new sources of uncorrelated returns through alternatives and also by re-allocating stock and bond positions towards areas within those asset classes – like value stocks, for instance – that won't be as impacted by rising rates, all else being equal.

TS: If you consider how yields have been falling for so long now, it's easy to understand why many investors have come to expect their fixed-income allocation to always provide some capital appreciation in addition to the standard income we have been accustomed to. In fact, a whole generation of investors has never experienced a rising yield environment and the losses that can accumulate as a result. That probably can't go on forever, though. At some point, all the stimulus being provided by central banks and governments should result in more robust global growth and eventually higher inflation. Maybe not in the near term, and yes, there are several deflationary trends still in play, but it's somewhat surprising that inflation has stayed so low for so long.

SW: There may be no such thing as a risk-free asset going forward. With so much money being printed, investors are likely to grow more sceptical about ballooning government debt loads and the value of fiat currencies. This is one of the reasons why gold is becoming more popular again as a replacement for cash. Then again, look at Japan. It's been in a deflationary cycle for decades despite having a debt-to-GDP ratio above 200%, so maybe other countries like the U.S. have the capacity to duplicate that as well.

Are these strategic adjustments that asset allocators will need to make or are they more tactical in nature?

SW: It's critical to think about this strategically first and foremost and carve out distinct asset classes or pools that will be relied upon over time. Of course, that's going to include equities and fixed income, but also very likely alternatives. In addition, typical weightings in each of these asset classes may require fresh thinking. For instance, instead of 60/40 being the standard for most portfolios, maybe it's more of a 70/30 makeup or a 60/35/5 configuration that takes alternatives into account, which becomes the new starting point. This is akin to how 60/40 portfolios are often adjusted for demographic reasons or based on their own personal risk tolerance, but reflects the growing reality that investors, on average, may need to take more risk to obtain the same return they have in the past.

It's critical to think about this strategically first and foremost and carve out distinct asset classes or pools that will be relied upon over time.

Stephen Way, Senior Vice-President and Head of Global and Emerging Markets Equities, AGF Investments Inc.

MS: Once that strategic allocation is set, that's when tactical decisions come into play. In times of extreme market volatility, the ability to move in and out of positions and rebalance the overall portfolio can help mitigate risk and generate additional alpha, but it needs to be done with a broader strategy in mind. Otherwise, these tactics become undisciplined.

SW: The key is to have an asset allocation plan in place that evolves with the market environment that underpins it. By doing that, investors have a better chance of limiting losses and staying invested.

Please see Disclaimer section for full disclosure.

How to Build the (Nearly) Perfect Hedge

The story behind the AGF anti-beta strategy that has been helping protect investors from market meltdowns for a decade.

BY: BILL DeROCHE

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Chief Investment Officer and Head of
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Some people thought we were crazy.

More than a decade ago, my team and I had an idea to develop a different kind of hedging strategy. Our goal was to find a way to take advantage of certain stock market characteristics that had been demonstrated time and again over the previous hundred years. The first was that low-volatility stocks often outperform high-volatility stocks – a fact that runs contrary to the axiom that higher risk generates higher reward. The second involved market downturns and upturns. Given how stock markets tend to rise over time, you might assume that periods of increasing returns would be more dramatic than periods of declining returns. But that's not really the case. In fact, as a growing body of academic literature pointed out in the aftermath of the Global Financial Crisis, market downturns tend to be more pronounced – bigger – than market upturns, which tend to play out in smaller increments. In short, the market might go up over time, but it usually does so slowly; when it goes down, it usually goes down fast. Or, to put it another way, the market takes the escalator up, but the elevator down.

How, we asked ourselves, could we develop an approach that might help investors take advantage of this anomaly and this asymmetry, while protecting their portfolios from the tail risk of a market meltdown? In its bare bones, our answer was this: an alternative strategy that would be long on low-volatility (low-beta) equities and short on high-volatility (high-beta) equities. Low-beta stocks, we reasoned, would be better insulated against downturns than the broader market but still generate returns, while short positions on high-volatility stocks would reap the benefits when the market fell.

Simple, right? And it worked. We rolled out our strategy in 2011, which seeks to track the Dow Jones U.S. Thematic Market Neutral Anti Beta Index. Since then, the strategy has consistently generated positive returns when the rest of the market was falling. Among the most recent examples, during the February/March COVID-19 crash, the fund returned nearly 11% while the S&P 500 Index fell by more than 33%. That's precisely what a market hedge is supposed to do: protect and perform during so-called long tail events. Yet as simple as our idea was, and as successful as it's been over the past decade, the path to this nearly perfect hedge was far from easy – and we had our doubters.

When we began thinking about the low-volatility hedging strategy, we were interested in developing portfolio tools that would let investors capture pure factors – approaches that would isolate potentially return-generating stock attributes from other more general attributes. Value, momentum and company size (for example, small-cap versus large-cap) are commonly applied factors, and we developed strategies that focused on those as well. But we were particularly excited by the potential of the low-volatility factor. The challenge was that it was also the most complex to develop into an actual strategy.

It took us months, not just because of the technical difficulty, but also because our team went back-and-forth on a central question: beta exposure. With other factors, like value or market capitalization, the difference in beta exposure (that is, the difference between broad market volatility and portfolio volatility) is a relatively minor issue. But with our low-beta strategy, it would be meaningful, to the point where the overall portfolio could have a negative beta, meaning that it would be inversely correlated with the market. The concern – shared with us in no uncertain terms by many of the outside experts we consulted – was that the "insurance" we offered investors would be a huge drag on their portfolios when markets went up, which they do more often than not.

This was a matter of serious internal debate on our team. We could have adjusted for negative beta by fiddling with the strategy's long/short allocation and cash positions. Or we could have added a forecasting element to the strategy – trying to pick winners to boost returns when the market rose. Yet there were problems with both those "fixes." Forecasting would have made our strategy less faithful to the factor we were trying to isolate; achieving beta-neutrality would have undermined our ability to exploit the asymmetry between downturns and upturns. So, in the end, we decided to keep the strategy dollar-neutral – that is, allocate assets equally to long low-volatility positions and short high-volatility positions, even if that meant the resulting portfolio had a negative beta.

> **"But it remains a unique offering, and it has withstood the test of time.**

This was pretty radical, and for some years after rolling out our strategy, it looked like our timing could not have been worse. The ETF industry back then was not nearly as sophisticated as it is now, and in that respect we were probably too early. More importantly, in 2011 equities were only two years into what would become a decade-long rally. For a long time, we debated whether we had made the wrong decision in making the strategy dollar-neutral; the bull seemed to be outrunning our strategy. But we became more comfortable with it as we saw what it could do during downturns – for instance, when fears over trade wars and U.S. government shutdowns sparked market declines and the long/short low-volatility/high-volatility approach paid off. And then, this year, the pandemic hit, and our strategy not only protected against the huge downside, but also produced strong returns during the worst of the correction.

Since we launched the anti-beta strategy, the financial industry's understanding of low volatility and the downturn/upturn anomaly has deepened and grown more nuanced. But it remains a unique offering, and it has withstood the test of time. We have also found that our strategy can – and often does – deliver positive returns even when the broader market is gaining; because of its exposure to low-beta stocks, it is not simply an inverse hedge to the index. Not that the strategy doesn't have bad days: it suffered its worst one-day performance ever on Nov. 9, 2020, caught between a terrible trio of a strong market upswing, a rotation into high-volatility stocks and a wave of short-covering. Yet that's the reality of hedging: it can cut both ways.

A decade ago, we assumed our value strategy would prove to be our most successful, but today the anti-beta approach has more than proven its mettle while value strategies in general have floundered. And we see further applications going forward. For instance, with bond prices high and yields low, a long/short low-volatility portfolio could take on a bigger role for investors as a fixed income adjunct while serving a similar equity hedge function. And the importance of insurance has not gone away. Even though stocks have rebounded from the dark days of late winter, their current high valuations only support the wisdom of protecting against another downturn over the long term. As 2020 has more than amply shown, nobody can really see the next meltdown coming, so it only makes sense to build some defences before it happens.

That's not such a crazy idea, is it? ■

Please see Disclaimer section for full disclosure.

2020 YEAR IN REVIEW

Whatever it Takes

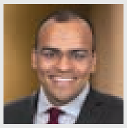
Debt-to-GDP ratios ballooned in 2020 as economic growth collapsed and global governments met the challenge of the pandemic with close to US$12-trillion in new fiscal stimulus measures.

Source: International Monetary Fund Fiscal Monitor, October 2020.

The Consequences of MMT-Lite

It may not be what the purists have in mind, but highly accommodative fiscal and monetary policies sure looks like Modern Monetary Theory (MMT) and the implications could be far reaching for investors.

BY: ANDY KOCHAR AND DAVID STONEHOUSE



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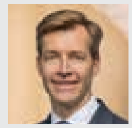

David Stonehouse, MBA, CFA®
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When economic historians look back at COVID-19 – and hopefully they will have that opportunity sooner rather than later – they will undoubtedly point out the remarkable speed and scale with which monetary and fiscal policy converged to combat the pandemic's devastating impact. Central banks, including the U.S. Federal Reserve, have dropped interest rates to near-zero and propagated a host of extraordinary stimulus programs. At the same time, fiscal taps have been opened wide. As of September, according to the International Monetary Fund, governments had spent close to an astonishing US$12 trillion in direct relief and lending – about 8.5% of global GDP. And as coronavirus cases mount resurgences in several developed countries, more spending is on the way.

Zero rates? Rampant government spending? Soaring public deficits? And little apparent concern over adding to an already towering mountain of debt? In the broad strokes, it at least looks a lot like Modern Monetary Theory (MMT) put into action. The formerly heterodox theory posits that governments need not worry about deficit spending since they issue and control money – and more importantly, that they should use deficit spending to achieve full employment and an acceptable degree of inflation. MMT had been gaining traction before the pandemic among some economists and "progressive" politicians, but today every central bank and every government seems to be following at least some of MMT's tenets in trying to cushion the pandemic's effects.

Should investors be concerned? And what might be the consequences? In our view, it is not a question of whether these extraordinary actions are right or wrong – when your house is on fire, you don't worry about the well running dry. And to be clear, the world is not full-on MMT (yet). There has been no explicit endorsement from the Fed or other central banks; there has been no explicit capitulation of central bank independence. So far, we are

The **Canadian fiscal 2020 deficit** is approaching

20%

Bank of Canada ownership of the **Canadian government bond market** could exceed

50% by the end of **2021** at the current pace of purchases.

Source: AGF estimates based on Bloomberg Data.

seeing only the more practicable parts of MMT put into place. In many jurisdictions, governments are distributing so-called "helicopter money" – direct payment or lending to consumers and businesses – and backstopping some level of relief from mortgage and rent costs. Yet although these practices might have been unheard-of only a few years ago, there is no indication the economy is heading for a true secular reset in the form, say, of governments undertaking widespread debt relief for consumers and businesses.

So let's call this "MMT-lite," which is not to minimize its significance. You could argue that the response to the Global Financial Crisis set the precedent, but it is a weak one. Back then, central banks largely had to shoulder the burden of economic recovery; the fiscal response focused on keeping the financial system from failing, as well as infrastructure and other programs that would have an impact only over the span of many years. As well, the monetary response was not uniform globally. The European Central Bank was a laggard in adopting stimulative policies – it was far more concerned about debt than growth – and initially pursued austerity measures, at great cost to the recovery. Even where central banks pulled more levers, for instance in the U.S. and Japan, their efforts led only to a post-crisis decade of mediocre economic growth and continuing fears of deflation.

The dynamics this time are different. Governments are injecting money directly and immediately into the economy. Fiscal and monetary responses are coordinated to a degree not seen since the Second World War, and the scale of the fiscal response dwarfs what occurred a decade ago. And today, central banks and governments around the world are moving in lockstep to provide stimulus.

"Another shock in financial markets could well push policymakers farther along the MMT path, perhaps to embrace such measures as yield curve control.

The impact on public debt and central bank balance sheets is clear. In the U.S., the fiscal 2020 deficit will come in at an estimated 15% of gross domestic product, according to the U.S. Congressional Budget Office (CBO); that is higher than the level at the height of the Global Financial Crisis, and the highest since the Second World War. The M2 money supply (a measure of the money supply that includes cash, chequing deposits and easily convertible near-money) has expanded by more than 24% year-to-date, according to the Federal Reserve Bank of St. Louis – which suggests just how much money is being pumped into the system. On the demand side, the Fed is keeping yields low with quantitative easing; by the end of 2021—based on AGF research using Bloomberg data—it will own an estimated 27% of the U.S. government bond market. Amazingly, the numbers are even higher in Canada, with the fiscal 2020 deficit approaching 20% and Bank of Canada ownership of the Canadian government bond market exceeding 50% by year end 2021 at the current pace of purchases.

For investors, this might sound dire, as it raises the prospect of rampant inflation and of a sharply devalued U.S. dollar. But at least for the short and medium term, these prospects seem dim. For 2021, our base case is that the greenback will remain range-bound, albeit with a weakening bias, as whatever hit it takes from MMT-lite will be countered by stronger economic growth. As for inflation, we expect some cyclical inflation (and a cyclical bond bear) to take hold sometime next year, as the economy and commodity prices rebound from the extreme lows of 2020. Bond yields should creep up and the curve should steepen – developments we imagine the Fed will welcome, as it might finally lay the *bête noire* of disinflation to rest, at least for a time.

Yet there seems little reason to worry about rampant inflation or, for that matter, to anticipate runaway economic growth for years to come. Secular issues – aging demographics, technological trends and massive debt levels among them – seem likely to suppress both, even if a fuller application of Modern Monetary Theory comes to pass. And what we have seen so far of MMT might not be leading to something more extreme; the current dynamics of monetary and fiscal policy might be a kind of perpetual motion machine that simply funds more and more spending. Equity markets, at least, seem to have become quite comfortable with that idea.

And yet, the world is not a static place, as this year has amply demonstrated. Systemic shocks happen, and apparently with increasing frequency. Another shock in financial markets could well push policymakers farther along the MMT path, perhaps to embrace such measures as yield curve control. (Japan has already gone there.) More generally, it is hard to imagine that interest rates will go down forever. Negative nominal rates are not a sustainable construct. At some point, if debt in the economic system continues to soar, markets could force central banks' hand. There are only so many ways to cleanse debt, and two of them (default and austerity) are likely to be either unpalatable or ineffective. That leaves inflating the economy out of debt.

The danger here is twofold. First, when they make big shifts, monetary policymakers tend to overshoot their target. If hyper-inflation occurs, MMT's proponents would argue that the solution is to simply turn off the fiscal taps. But this presents another danger: by that time, more economic power will be in the hands of politicians. Will they be able to steer back to a more frugal course when they hit the guardrails of higher inflation? Their track record is not encouraging.

Thankfully, this is only speculation – a worry for another day. But that day may be coming. If the Global Financial Crisis revealed the path towards Modern Monetary Theory, the COVID environment has cleared it. How far along it will policymakers dare, or need, to go? ■

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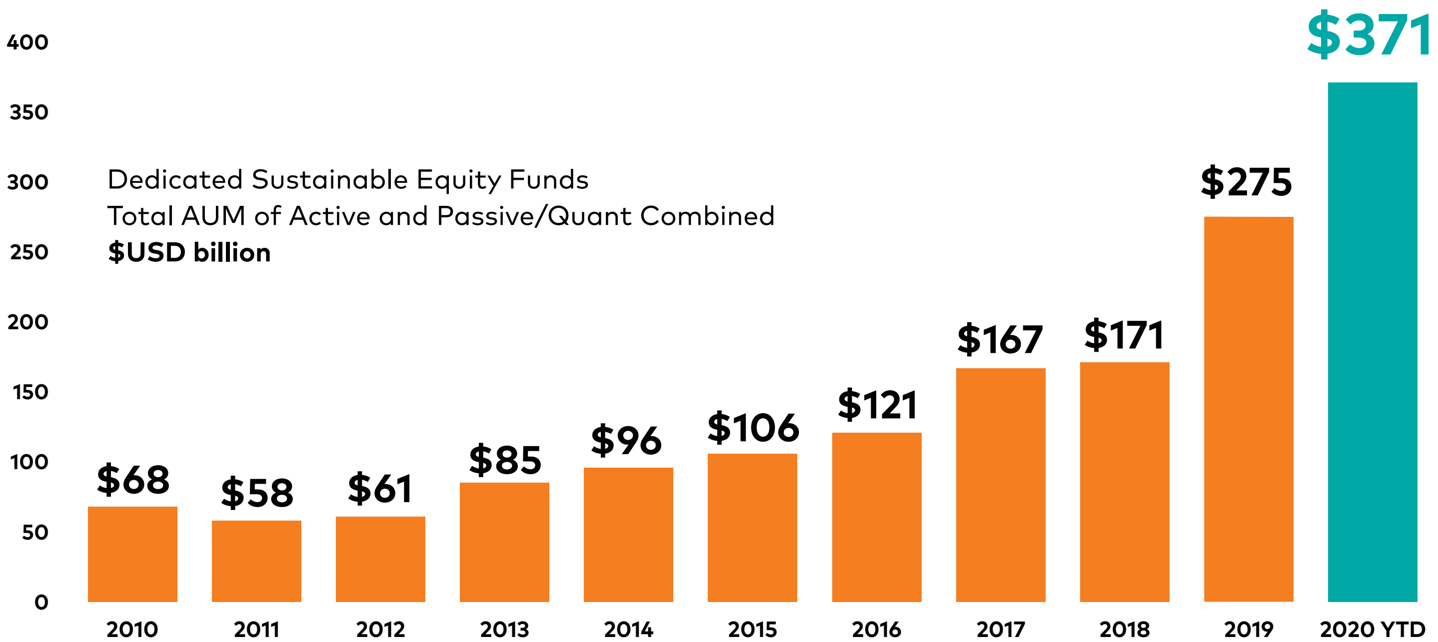
2020 YEAR IN REVIEW

ESG Uninterrupted

Assets under management for sustainable investment strategies continued to grow in 2020.

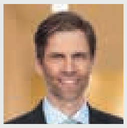


Source: RBC US Equity Strategy. Morningstar. AUM is through 9/30/2020.

The Great Transition

The obligation to build a more sustainable economy has never been greater. Here's what it means for investors.

BY: MARTIN GROSSKOPF



Martin Grosskopf, MBA, MES
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> *Finance is not going to solve climate change, but many of the investments and innovations that will are very capital-intensive. That's why it's so important for the financial system to steer capital to the most promising sustainable investments.*
>
> **Tiff Macklem**, Bank of Canada Governor, November 2020

The economic and social toll wrought by COVID-19 over the past year is without question. Government lockdowns to control its spread have caused one of the deepest and most abrupt global recessions in modern history. But the disease's long-term impact on society and financial markets may end up being even greater as it relates to its influence on how we deal with other systemic problems such as climate change. The pandemic has shone a brighter light on the magnitude and urgency of our environmental and social ills, and has reinforced the need for government, investors and corporate leaders to direct capital more effectively at enterprises that offer solutions to these complex issues.

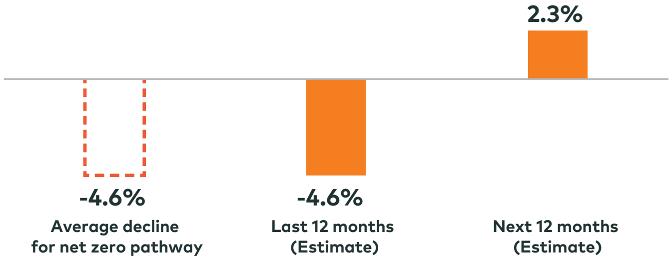
Of course, in doing so, it has become that much harder to envision an investment landscape that does not end up being markedly different than it is today. Accelerating the transition of capital towards activities and business models that embrace sustainability and resilience will likely dictate market returns in the years ahead.

The best starting point for understanding all of this is the Paris Climate Accord of 2015. It was there and then that governments from around the world agreed to limit global warming to at least two degrees Celsius – if not less – and set a goal of zero net emissions (i.e. absorbing the same amount of carbon as emitted) by 2050. At its core, the agreement is grounded in the science of climate change and is designed to avert many of the worst-case scenarios that would otherwise be associated with potential weather disasters in the future.

But the past year has demonstrated that in order to have any reasonable chance of meeting this 2050 objective, the scale of emissions reduction is almost unfathomable.

For example, the COVID-induced lockdowns have resulted in only a 4-5% reduction in global carbon emissions. This level of reduction would be an annual requirement moving forward in order to meet the 2050 zero net emissions long-term objective.

Annual Change in Total Global Emissions



Source: UBS Research, as of September 2020

Although this seems improbable in practice, its daunting magnitude demonstrates the urgent need for increased regulatory action. Led by the European Union's Green Deal, for instance, governments around the world have begun targeting stimulus, first, at 'green' activities such as renewable energy, electric vehicles and building efficiency, but then also increasingly at so-called 'transition' activities. This latter target is much larger than the former and encompasses carbon-intensive industries which may or may not survive in a green economy. These include industries that are so integral to our day-to-day life they cannot simply be shut down and must instead be transitioned towards lower emissions, requiring a re-engineering of entire supply chains and production processes.

As investors, issuers and lenders begin to appreciate the scope of the change required, the opportunities have become just as important as the risks. As we have long proposed (and highlighted by the quote above by Bank of Canada Governor Macklem), capital incentivized by governments will begin to flow towards more sustainable activities and away from those with large environmental footprints. These flows will accelerate due to the fear of unmitigated climate change, but also in a relative race for technology leadership in the fields of renewables, batteries, electric vehicles, building efficiency, hydrogen and biomaterials.

These are areas of transition that one might expect an 'expert' in sustainable finance to highlight. After all, they are specifically environmental in nature and perhaps predictable. However, COVID-19 also lays bare other social arenas in full transition.

The shift in balance of power from shareholder to governments was underway prior to the pandemic, but US$12 trillion of global stimulus – according to the International Monetary Fund – has made obvious the inability of markets to direct capital in a fashion that would provide resiliency in the face of a major natural disaster or similar health crisis. Meanwhile, in a little over a decade since the Global Financial Crisis, increased government intervention in the form of helicopter money and the seeds of a universal basic income (theoretically temporary in nature, but more likely than not to be revisited in the next crisis) now seems to have been inevitable.

Certainly, little of the funding to date addresses the root causes of the pandemic – i.e. a virus that was passed from animal to human (like 60% of the more than 1,400 known infectious diseases can be, according to May 22 article in *Foreign Affairs* magazine) – which in turn provides ample runway for investments that do – as well as those that help build resiliency to deal with the consequences. The interaction between food insecurity, environmental degradation and pandemic spread is a ground well trodden by scientists and addressed directly by the UN Sustainable Development Goals (SDGs) which are providing a longer-term road map for governments and investors. In fact, between 2014 and 2019, the population experiencing some form of food insecurity increased from 22.4% to 25.9% according to the World Health Organization. That's a surprising statistic given the SDGs were launched in 2015, but highlights how the pandemic exposed the fallacy that protectionism can truly isolate citizens from the responsibility of acting and investing with a global mindset.

> **"…the pandemic exposed the fallacy that protectionism can truly isolate citizens from the responsibility of acting and investing with a global mindset.**

Transition in this context might also describe the pension system as it adjusts reluctantly to historically low interest rates and the implication of reduced returns. Systemically higher unemployment coupled with a higher savings rate and lower returns are pressures unlikely to be mitigated by the relentless increases in passive allocations in a period of zero discount rates.

Similarly, post-COVID views of retirement embedded in some interpretations of fiduciary responsibility will surely need to change. Retirees are among the most vulnerable to the globalization of health and environmental risks. A narrow definition of financial health that is based on certainty of income can not compensate for risk to assets (retirement properties, etc.) or health (air quality, pandemic etc).

Clearly then, our transition to a more sustainable economy is no simple task and, in all its forms, will require new thinking, fresh capital, more risk-taking and increased urgency if it's to be successful. Perhaps it took the tragedy of a global pandemic to teach us that and bring truth to the phrase "let no crisis go to waste." ■

Please see Disclaimer section for full disclosure.

The Early Cyclicals

Investors have been focused on the opportunities and risks associated with a late-stage economy over the past few years. But now, in the wake of this year's pandemic-induced recession, attentions have turned to prospects of a new economic expansion and those parts of the market expected to benefit most in this type of an environment. As such, here are four sectors that may end playing a more prominent role in portfolios next year.

BY: RICHARD FISHER, JAMIE MADDOCK, JEAN-SÉBASTIEN NADEAU, ANGELA RHODEN

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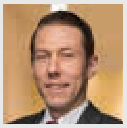

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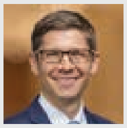

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FINANCIALS

Do Bank on It

By Richard Fisher

The best time to own financials has usually been during the emerging growth phase of an economic cycle and 2021 should prove no exception to the rule. The COVID-19 recession of the past year severely depressed valuations within the sector, however, once a vaccine is approved and widely distributed, several tailwinds should emerge, causing credit-sensitive financials, in particular, to re-rate and climb higher in 2021.

> **Once a vaccine is approved and widely distributed, several tailwinds should emerge, causing credit-sensitive financials, in particular, to re-rate and climb higher in 2021.**
>
> **Richard Fisher**, Co-Head, Equity Research and Equity Analyst
> AGF Investments Inc.

One such tailwind is the return of borrower confidence and improved loan demand as economic conditions normalize. In turn, interest income should outrun margin compression that can also be expected to stabilize from a steepening yield curve in the new year. Credit quality, meanwhile, looks set to emerge as another significant tailwind if various loan deferral programs serve to dampen loan losses and the build-up of loan loss reserves – which accumulated in 2020 – are released into earnings. Finally, the temporary ban on dividend increases and share buybacks that took hold earlier this year for large institutions should be lifted, giving yet another potential boost to the sector.

While re-rating of financial stock valuations could be significant, the governing factor on core earnings growth remains the current zero-bound interest rate policy of central banks. Within the sector, banks and consumer finance companies seem the most attractive heading into 2021. The depressed valuations of life insurance should also re-rate, but the industry responds better to higher absolute levels of interest rates versus a steepening of the yield curve. Asset managers and brokers, moreover, should benefit from better flows and higher asset levels but remain exposed to secular pressures on margins.

Geographically, investors will also need to pick their spots. For example, in North America, the United States may have an advantage over Canada where a more levered consumer could lead to a more sluggish economic rebound.

MATERIALS

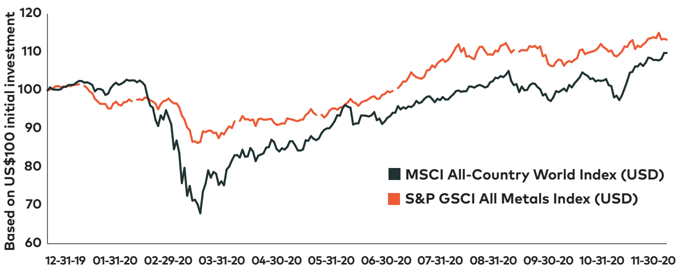
Commodity Super(re)cycle?

By Jamie Maddock

Base and precious metal stocks look attractive heading into 2021, but not just because of the positive impact a cyclical upturn in the economy is expected to have on global commodity demand. Other factors, including massive amounts of government stimulus and corresponding new green policy initiatives, are also at play and when combined with ongoing supply/demand deficits against the backdrop of a vulnerable U.S. dollar, it's possible these catalysts could end up resulting in the next commodity super cycle.

If anything, the cyclical upturn in demand for commodities has already begun following a temporary halt early on in 2020 at the very height of the COVID-19 pandemic. For example, copper, iron ore and palladium prices have netted double-digit returns year-to-date through November and, in each case, have outperformed the MSCI All Country World Index in the process.

Precious and industrial metal commodity performance



Source: Bloomberg LP, as of November 25, 2020. An index can not be invested in directly.

But this upturn in post-COVID demand is also reflective of a broadening global focus towards social and environmental government policies. From China's new five-year growth plan to the European Union's Green Deal and President-Elect Joe Biden's potential new green stimulus package, more emphasis than ever before is being placed on infrastructure modernization and the subsequent shift to a greener energy mix is exceptionally favourable towards certain commodities such as copper and palladium, as well as lithium, cobalt, nickel and zinc. At the same time, many of these commodities are already in short supply, following years of under-investment since the time of the last commodity boom.

Meanwhile, the sheer rise in overall government stimulus, particularly the U.S., could lead to further devaluation in the already vulnerable U.S. dollar. In turn, this may create a positive feedback loop driving commodity prices higher still. And while inflation is an anathema to many, it represents a tail risk that is the highest it has been in decades with metals and oil offering two of the potentially best hedges for investors to protect themselves.

CONSUMER DISCRETIONARY

At Your Leisure

By Jean-Sébastien Nadeau

Like other early cyclicals, the consumer discretionary sector has a long track record of strong returns in the aftermath of recessions. This has been true for both credit and equity markets over the years, and yet, given the unusual nature of the past year's government-mandated economic shutdown, not all the sector's sub-industries should be expected to perform equally well this time around.

For example, homebuilders have already rapidly recovered following the March selloff. In part, that's because house prices have remained relatively resilient throughout the pandemic, while foreclosures have been limited due to multiple government initiatives. Low homeownership rates, enhanced affordability due to lower interest rates and continued home construction – which was not directly impacted by the pandemic – also helped this sub-sector recover more quickly than others. In fact, the U.S. housing market has been so resilient in the face of the crisis that homeownership rates accelerated during the early weeks of the outbreak and haven't waned all that much since then.

While that may bode well for homebuilders going forward, other sub-industries such as leisure, gaming and lodging, which have not recovered as quickly, may end up representing better opportunities in 2021. Of course, earnings in all three areas have been negatively impacted by shelter-in-place and social distancing initiatives adopted across multiple jurisdictions in 2020. More recently, however, each has rallied on the news that three COVID-19 vaccines have shown strong efficacy in trials and may soon be approved by the U.S. Food and Drug Administration. In particular, the performance of cruise lines, movie theatres and gaming companies has been robust of late and they should, on average, continue to benefit once these vaccines are made available to the wider population.

Still, that doesn't mean higher returns are a given. And at least from a credit perspective, investors could be better off waiting for a pullback before choosing to add more exposure to these areas. Ultimately, liquidity and a relatively healthy balance sheet should remain top of mind for investors seeking the best opportunities among these sectors. After all, some companies might not survive the pandemic, but the quality ones that do are most likely to be strong outperformers.

INDUSTRIALS

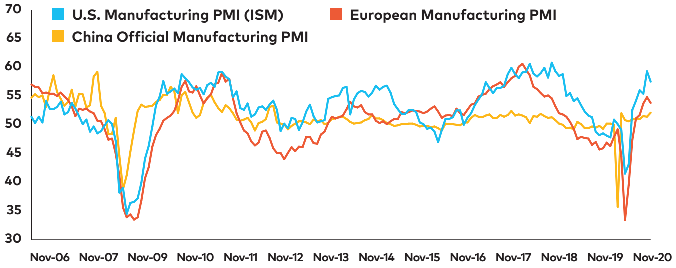
Manufacturing Returns

By Angela Rhoden

While industrials have bounced back from their March lows, the sector remains well-placed to outperform in 2021, given a combination of strong earnings growth, potential for positive estimate revisions and relatively attractive valuations in select sub-sectors.

Global Purchasing Manager Indexes (PMIs) have rebounded strongly and commodities like copper point to a strong recovery in economic activity. This is the point in the business cycle that typically favors Industrials as it signals an acceleration in many of the end markets that the sector serves. A resurgence in economic activity should in turn underpin strong earnings growth for industrials in 2021.

Global PMIs: Strong Rebound



Source: Markit, ISM, Morgan Stanley Research as of November 30, 2020. PMI scores above 50 represent expansion. Scores below 50 represent contraction.

There is also the potential for positive estimate revisions in select industrial companies that have managed the trough particularly well and improved their cost structure. These companies are positioned to deliver better-than-expected margins, which should drive outperformance.

Within the sector, the most significant opportunities are likely to be within cyclical sub-sectors, such as machinery, that are trading at a discount to the market yet offer relatively strong earnings growth. Opportunities also exist within select capital goods companies that have exposure to accelerating end markets and structural areas of growth such as industrial automation.

Admittedly, the onset of fresh lockdowns is a near-term challenge to the pace of economic recovery and could drive volatility in the near-term. However, the growing potential of a vaccine approval could help underpin investor confidence and allow the market to look past any temporary pause in a recovery.

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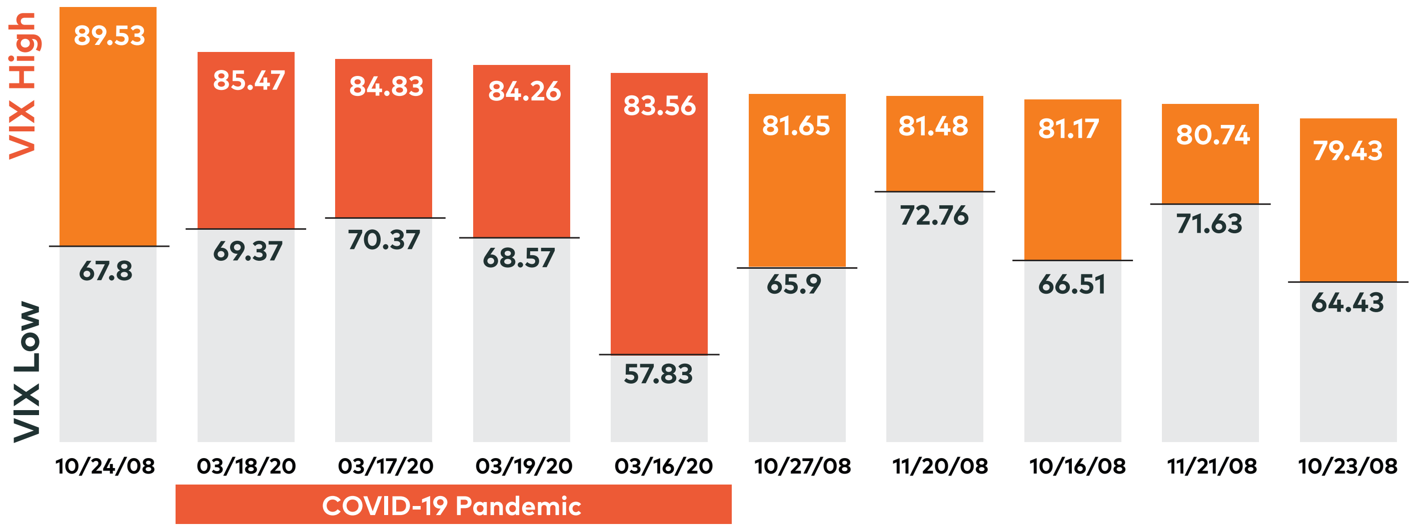
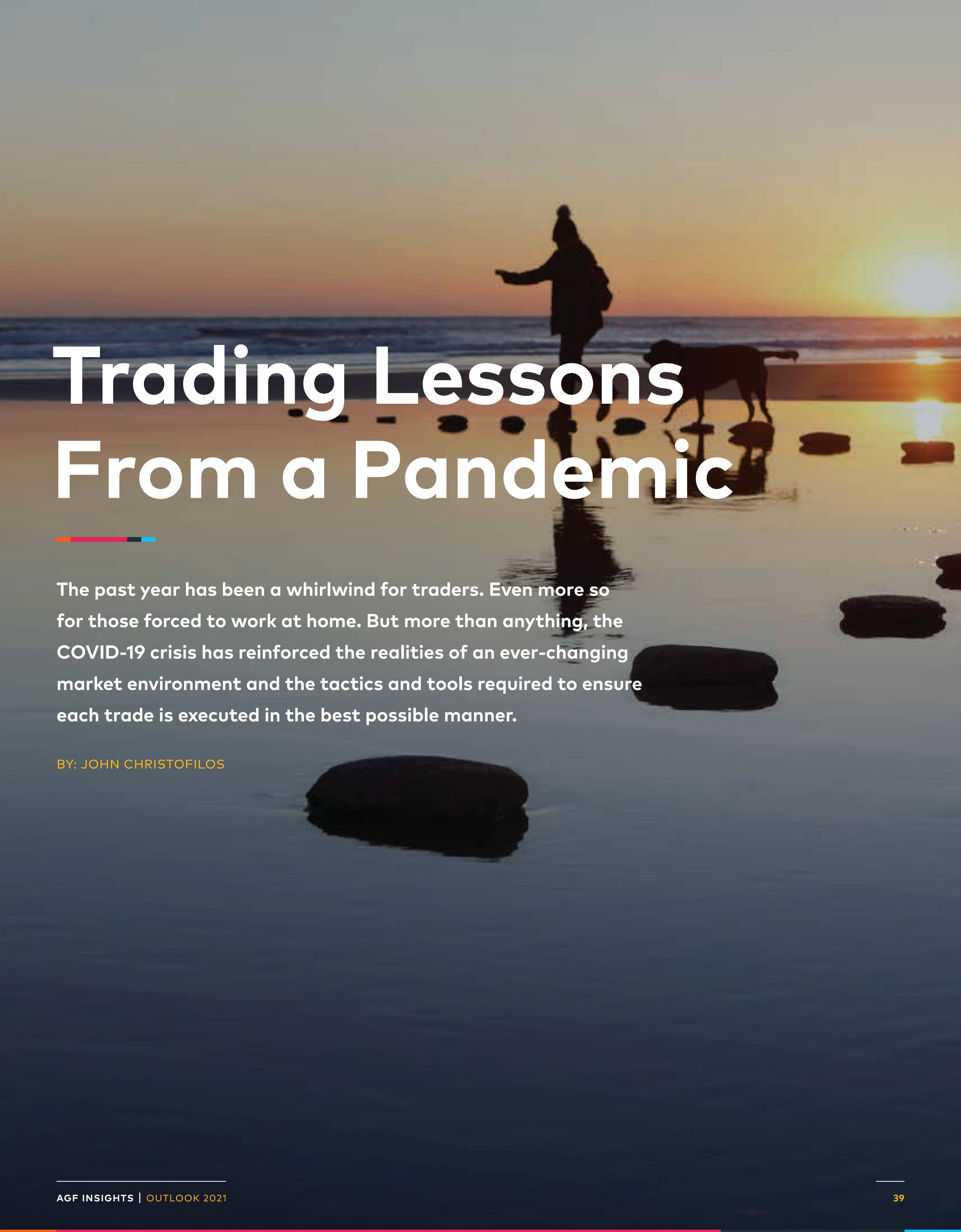
2020 YEAR IN REVIEW

March Madness

The CBOE Volatility Index (VIX) hit levels in early 2020 not experienced since the Global Financial Crisis.



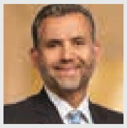
Source: Bloomberg LP as of November 30, 2020. An index cannot be invested in directly.



Trading Lessons From a Pandemic

The past year has been a whirlwind for traders. Even more so for those forced to work at home. But more than anything, the COVID-19 crisis has reinforced the realities of an ever-changing market environment and the tactics and tools required to ensure each trade is executed in the best possible manner.

BY: JOHN CHRISTOFILOS



John Christofilos
Senior Vice-President, Chief Trading Officer and
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Don't take liquidity for granted

Liquidity is vital to markets and traders crave it at the best and worst of times, but it can also be elusive – especially in a crisis – and this past year was no exception. In fact, during the violent market selloff in the early days of the pandemic, liquidity was extremely scarce and bid/ask spreads widened dramatically on even the largest of blue-chip stocks and many of the most popular exchange-traded funds, as well. Trading through this stretch required heightened discipline and, often enough, the best plan of action was to wait for better opportunities to unfold or just do nothing at all. Soon enough, however, liquidity returned to the market and spreads have mostly normalized since the summer, making it more efficient to execute trades in a timely manner. In large part, that's a credit to the U.S. Federal Reserve's large-scale asset purchases and stimulus packages at the height of the crisis. And yet, it can also be attributed to the rise of "Robin Hooders", or day-trading retail investors, who flooded the equity market from the very beginning of the economic lockdown and accounted for as much as 25% of the S&P 500 Index's daily volume in 2020, up from 8% on average the year before, according to Citadel, a U.S. market maker.

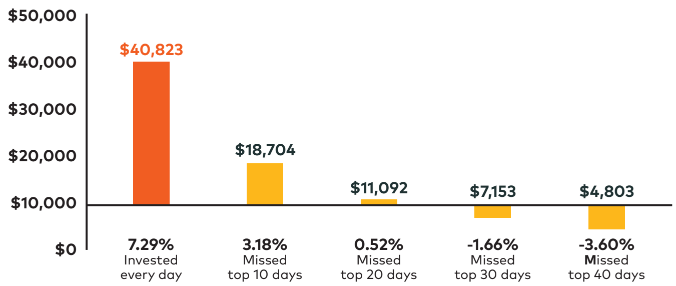
Get technical when fundamentals fail

One of the biggest challenges that investors faced in 2020 was the information breakdown related to company fundamentals. Once the pandemic hit and the economy locked down, it became increasingly difficult to rely on established earnings projections and many businesses stopped offering guidance outright, knowing their future profitability was too up in the air. But technical analysis could still be relied upon during this period and became an even more essential tool for understanding the direction markets were potentially headed. In particular, moving averages, trend lines and stochastics were – and still are – an excellent way to "leg" into trades and pick entry and exit points when executing larger-scale trades. Of course, none of this is to say fundamentals can't be trusted – far from it. But trading decisions that also take technicals into consideration may end up being more worthwhile in the end.

Be wary of market timing

It's an old adage, but one worth repeating in a year highlighted by the fastest bear market recovery in history: *Time in the market is better than trying to time the market*. Granted, that doesn't mean investors are always better off standing pat in a time of crisis, but to quote another old adage, *patience is a virtue* and legging into or out of a position is often the best approach when volatility is heightened.

$10,000 investment in the S&P500 Total Return for the 20 years ended November 30, 2020



Source: AGF Investment Operations as at November 30, 2020. For illustrative purposes only. You cannot invest directly in an index. Past returns are not indicative of future results.

Keep all lines of communication open

Speaking directly with a broker/dealer to get a trade done is far from always necessary these days. In a time when technology rules the roost, the click of a computer mouse is usually all that's needed – and that's a good thing too, given the requirement to work more remotely this year. Still, there are times when picking up the phone and talking through a transaction is the better option. This is certainly true of larger trades, which, when done electronically, often run the risk of being filled with multiple orders at varying prices or not filled at all if limit orders are in place. It also comes into play when trading some ETFs whose bid/ask spreads can widen substantially between the open and close, leading to periodic uncertainty about their value relative to the underlying securities. But perhaps the greatest advantage is related to sentiment. The tone and inflection of a broker/dealer's voice can be invaluable in determining just how motivated the other side of a trade might be, leading to better decision-making and price execution in the end.

Embrace the "Fear Gauge"

Market volatility has a negative connotation for many investors, but it's not something they can shy away from or simply ignore. If anything, it's become more important than ever to pay close attention to the CBOE Volatility Index (VIX), or "fear gauge," as some people call it. As a rule of thumb, a VIX level below 20 has coincided with a risk-on mentality in the past, while a VIX level above 40 has meant the opposite. And this year was no different. The VIX soared above 80 at the height of the selloff in March to hit its highest level since the Global Financial Crisis, but it fell below 40 in April and has stayed there more or less throughout the recovery. By keeping an eye on where it's headed next, investors are in much better position to take advantage of the investing opportunities that may arise. ■

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