AGF ASSET ALLOCATION COMMITTEE

Q1 2022

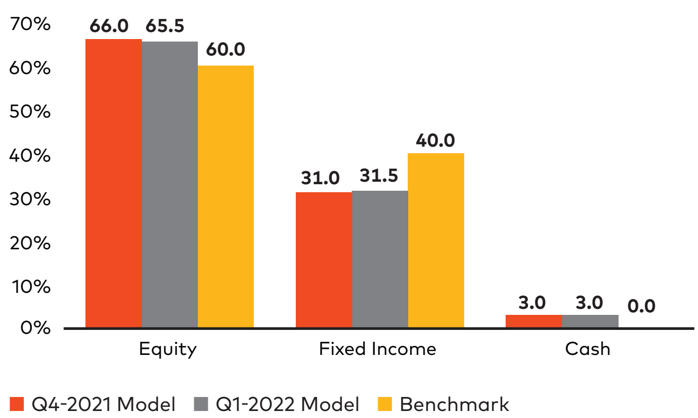
Quarterly outlook and model portfolio allocations

Asset allocation

The AGF Asset Allocation Committee favours equities over fixed income as the economic recovery continues to grind ahead despite near-term hurdles. However, the imminent launch of a new rate hiking cycle may cause heightened volatility and slower growth relative to prior quarters.

The AAC's overweight to equities is slightly reduced to 65.5% with assets directed to fixed income at 31.5%. The underweight to fixed income remains in place, however, as the asset class braces for the impact of rate hikes. The AAC's small allocation to cash is utilized to soften the impact of volatility.

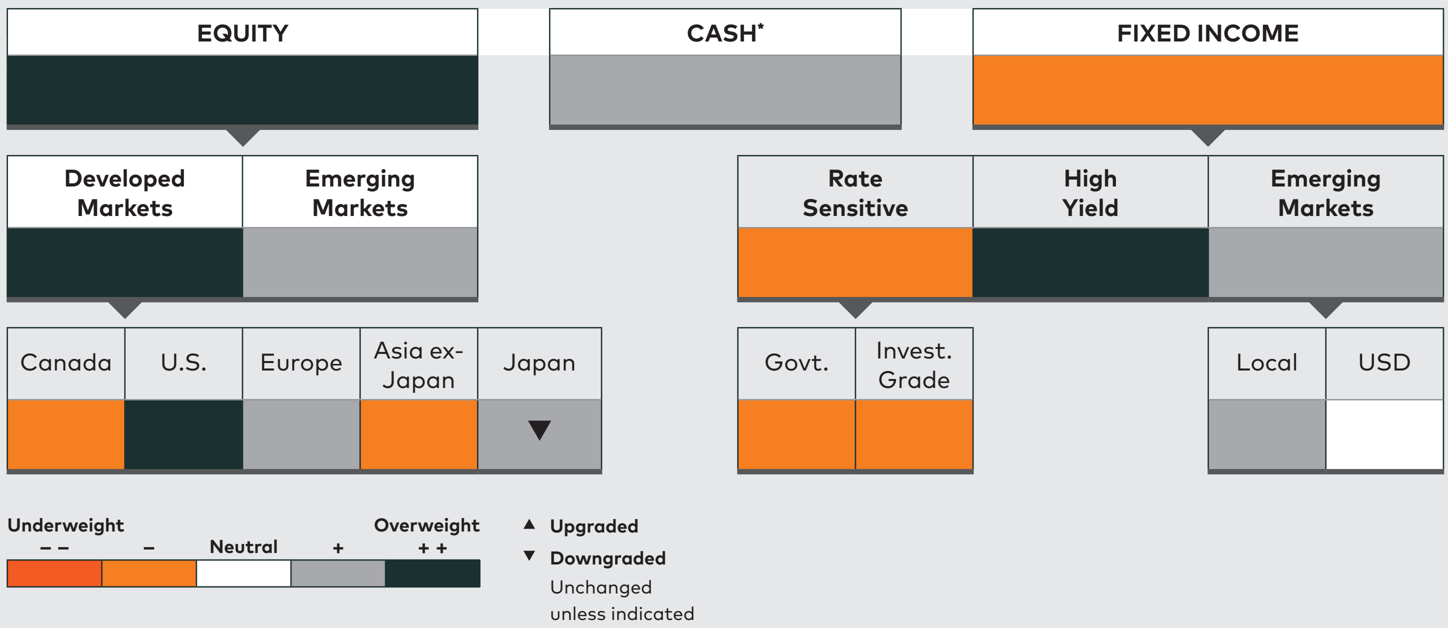
FIGURE 1: Asset allocations



Source: AGF Asset Allocation Committee, January 2022.

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 / 3.5% MSCI Japan / 1.7% MSCI Pacific ex-Japan / 4.8% MSCI Emerging Markets

Q1-2022 market outlook – portfolio applications



* neutral weight at 0%

Equity

- Improvement in supply chain issues and COVID setbacks could support equity growth
- Developed markets are preferred, though prospects for emerging markets are also positive
- Higher commodity prices support Canada, though other markets appear more attractive
- U.S. markets are adjusting for policy measures, but earnings and liquidity remain supportive
- Europe is well positioned with its value-tilted markets and accommodative central bank
- Shipping bottlenecks will continue to impact Asia Pacific Markets (ex-Japan)
- Japan tends to excel during rising rate environments, though government policies could weigh negatively

Fixed Income

- Central bank activity will greatly impact rate-sensitive bonds
- The economic backdrop forms a supportive 'coupon clipping' market for high yield bonds
- Longer duration investment-grade corporate bonds are sensitive to rising yields
- Emerging markets can offer higher yields but are susceptible to a global growth slowdown and persistent inflation

Cash

- A moderate allocation to cash softens the impact of volatility and provides liquidity should tactical opportunities arise

Equity allocation

The Committee's overweight to equities is maintained as a backdrop of slowly easing supply chain issues and COVID-related setbacks could be supportive of market growth. Policy error poses a key risk, however, as equity markets have begun to price in more restrictive measures. The U.S. Federal Reserve's (Fed) projected pace of tightening currently lags market expectations and volatility could remain elevated as this plays out. Equity market strength also hinges on the fight against COVID-19. While early indications show a possible peak in Omicron cases, strict containment measures in China could delay supply chain resolution.

With less dependency on positive COVID progress, developed markets (DM) are preferred over emerging markets (EM) though prospects for both are constructive for the upcoming quarter. Further easing of supply chain issues and broader economic reopening would be supportive of developed markets. However, DM's face the economic impacts of a rate hiking cycle liftoff, which is a hurdle many EM's have already embarked on.

Canada's Energy and Materials sectors benefit from higher commodities prices, and the global reopening trade should be supportive of performance. The Committee has added to Canadian equities, though the country remains underweight relative to other developed markets.

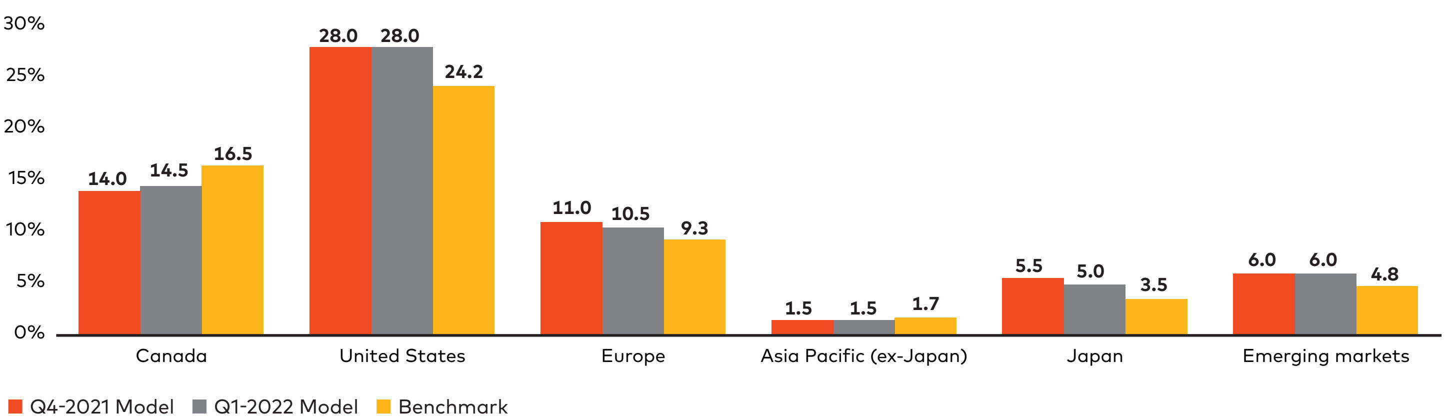
U.S. equity markets are adjusting for policy-restricted growth after several quarters of policy-supported growth. However, the committee expects positive earnings, adequate liquidity and company buybacks could outweigh actions from the Fed and the U.S. continues to be among the most favoured regions.

The current backdrop is supportive of Europe's value-tilted markets and the region's central bank has remained more accommodative among the developed economies. The Committee's overweight is slightly reduced, however, as performance in Europe is somewhat dependent on the health of the global economy.

Shipping bottlenecks will continue to impact Asia Pacific markets (ex-Japan) although the earnings outlook is still reasonable at this point. The region's underweight position is unchanged as greater near-term opportunities are found in other developed markets.

Japanese equities have excelled during rising rate cycles historically and the local economy would benefit from re-acceleration in China. The Committee's favourable view is tempered by the state of Japan's government, however, as the market impact of proposed policies is still unclear.

FIGURE 2: Equity allocations



Source: AGF Asset Allocation Committee, January 2022.

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Fixed income allocation

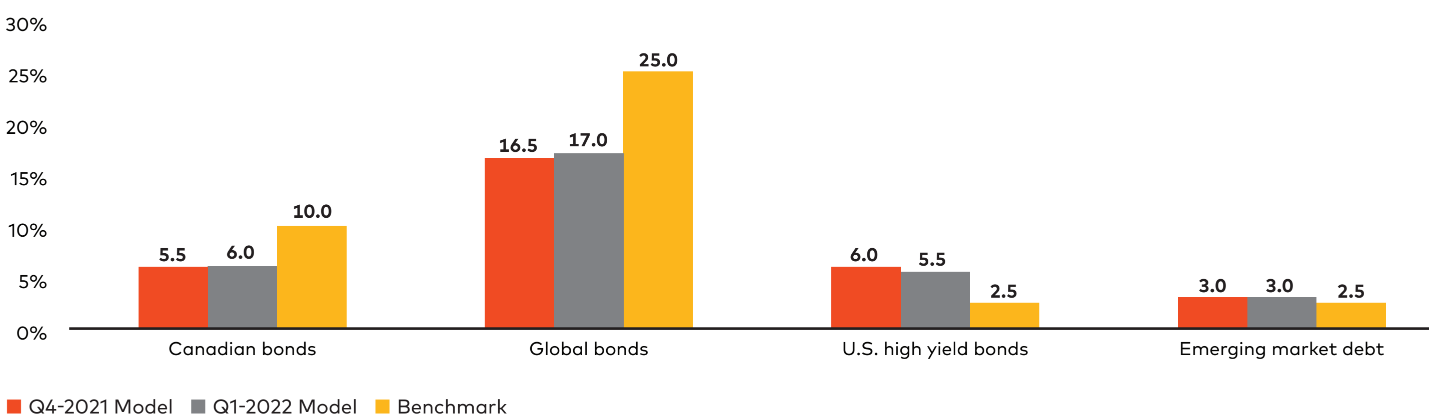
The allocation to fixed income is slightly increased but the Committee's underweight position remains in place. The asset class will likely be defined by central bank activity and the fight to calm inflationary issues in 2022. A well-telegraphed path and reasonable cadence towards interest rate targets could soften damage to government bond markets. However, higher yields in the short end could lead to curve flattening and negligible returns for rate-sensitive debt. If company fundamentals remain constructive and elevated volatility dissipates, credit-sensitive categories such as high yield may offer more upside potential. Emerging market bonds can offer more attractive yields as well, however a slower pace of economic growth combined with more aggressive monetary tightening could pose a challenging backdrop in the upcoming quarter.

The Committee has slightly added to Canadian and global sovereign bonds as aggressive central bank measures have already been priced into the market and equities appear slightly less attractive. However, rate-sensitive categories are meaningfully underweight relative to the benchmark index as persistent inflation could result in further negative price action. With projections from the Fed trailing market expectations, the risk of a policy misstep is heightened.

The allocation to U.S. high yield bonds is modestly reduced, however the category remains most favoured relative to other fixed income assets. Slower economic growth may temper returns, but current levels remain supportive and elevated volatility appears to be dissipating. This backdrop should produce rangebound credit spreads and extend the 'coupon clipping' market for high yield bonds. Investment grade corporate bonds may experience similar constructive conditions; however, the category has a greater sensitivity to the move in rates.

The Committee's view towards emerging market bonds is somewhat positive. These countries offer higher yields relative to developed markets, however the category is more sensitive to a slowdown in global growth. Persistent inflation may also warrant further central bank intervention. Local-denominated EM debt is slightly better positioned than external-denominated EM debt, after recent bouts of weakness.

FIGURE 3: Fixed Income allocations



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Q4 2021 economic recap

The fourth quarter of 2021 was once again marked by COVID-19 fears, this time caused by rapid transmission of the Omicron variant. However, unlike prior periods, renewed uncertainty did not materially alter the course of central banks in their plans to wind down stimulus measures. Supply chain constraints began to ease in the quarter, though remained elevated and at risk of renewed disruptions, which pressured prices and contributed to market volatility.

The U.S. Federal Reserve (Fed) announced it would double its pace of tapering to US$30 billion per month, thus bringing forward the possibility of rate hikes to the spring. The Fed's 'transitory' inflation narrative was also retired during the quarter as the core PCE Index (inflation measure) continued upward to 4.7% in November, a near four-decade high. The job market continued to recover with the unemployment rate improving to 3.9%, though participation rates remained below pre-pandemic levels.

Canada's economic reopening was halted late in the quarter in response to Omicron concerns. Renewed restrictions domestically and abroad, along with depleted oil reserves, triggered a volatile period for Canada's energy-dependent market. Oil prices declined over 20% in November before rebounding quickly in December to end the period roughly unchanged over the course of the fourth quarter. Like the Fed, the Bank of Canada maintained a less accommodative posture and signaled for the start of rate hikes by mid-2022, if not sooner. Economic data was supportive of this, as the unemployment rate improved to 5.9%, just shy of the 5.7% pre-pandemic low. Supply chain constraints and low base year effects also kept inflation levels elevated at 4.7%.

European economies continued their gradual recovery in part with greater accommodative support relative to other developed market central banks. Still, the resurgence of COVID-19 concerns and supply chain issues impacted export-orientated markets, as the Eurozone Manufacturing PMI dipped to a 10-month low of 58.0.

While other advanced economies struggled with price pressures, Japan's inflation rate ended the quarter at 0.6% despite ultra-accommodative policy. Political uncertainty remained, however, with concerns of how newly appointed Prime Minister Kishida's populist-leaning policies may impact financial markets.

Following a far-reaching regulatory crackdown, China began easing measures to kickstart its economy, but strict COVID containment measures, renewed trade uncertainty and ongoing issues in China's property sector led to underperformance. This dragged on emerging markets which were further slowed by higher interest rates in several economies.

The headline macro events of the fourth quarter had contrasting effects on bond yields. The short end of the curve rose as expectations for rate hikes were brought forward, while concerns about potential overtightening causing a future economic slowdown pushed long-term yields lower. Together, this led to curve flattening in the U.S. and Canada.

Credit spreads were active, widening rather meaningfully in November before settling in December, and eventually ended the quarter near decade-lows. Given this backdrop, the outlook for longer-term government bonds relative to high-yield corporate and short-term rate-sensitive bonds is slightly improved.

AGF Asset Allocation Committee

The AGF Asset Allocation Committee is comprised of experienced investment professionals, specializing in various areas of the global bond and equity markets. Members provide insight into risks and opportunities, shaping the outlook of their respective asset class, which leads to an optimized asset allocation view. This top-down view guides the allocations for all funds managed by the Committee.

For more information on the AGF Asset Allocation Committee visit AGF.com.

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