



# TACTICAL ASSET ALLOCATION VIEW

**Don Rich**  
**Head of Tactical Asset Allocation**

*Market and economic indicators continue to deteriorate. Despite recent volatility, though, a major correction is not expected until later in the fourth quarter or early in the New Year. In the meantime, we are using rallies to reduce risk in our portfolios.*

## **Asset and Market Survey**

### **Economy – Expected to continue surprising on downside**

Economic surprise statistics, while still positive overall, continue to deteriorate as the rate of negative surprises continues to climb in line with the slowdown in the recovery. The Tactical Asset Allocation team believes risk exposures should be reduced because we expect economic data to continue to disappoint in the short term\*. Global inventory rebuilding has run its course as a source of economic momentum and we see no signs that significant capital expenditures, or employment and consumption growth, will fill the void. We also expect China to surprise on the downside as that economy slows in response to waning global demand and as authorities there attempt to deflate a continued bubble in the property market.

### **Fixed Income – Negative on high yield, neutral on high grade**

While they avoided the sell-offs earlier this year because of their strong correlation to a then recovering U.S. economy, high yield bonds are not expected to be immune to future portfolio de-risking now that the U.S. is slowing.

It looks safer higher up the capital structure. Quality investment grade corporate debt is likely to at least hold onto its value in the short term, while government bonds could see gains, depending on the severity of the economic slowdown.

### **Equities – Negative; move into undervalued and high income securities**

During the volatile, directionless trading that we expect until October, investors could reduce equity portfolio risk by selectively buying stocks that are undervalued or that offer solid attractive dividend yields. Geographically, U.S. equities are expected to benefit from flight-to-quality demand for U.S. dollar denominated assets.

### **Emerging Markets – Negative on sensitivity to slowdown, portfolio de-risking**

The tactical indicators for emerging market equities that were trending positive until late June are now deteriorating. This is consistent with the strong outperformance by these markets last year, and with their sensitivity to weakening global demand and risk appetites.

### **Currency – Positive on U.S. dollar in flight to quality**

The U.S. dollar is expected to rise in the short term. The Canadian dollar may also have seen recent demand as a flight-from-risk haven, although its close link to industrial commodities would hurt in a slowdown.

\* "Short term" <= 6 months, "Long term" > 6 months

**Commodities – Negative on weakening global demand**

We expect prices of industrial commodities to fall further along with demand. Oil markets have remained firm, but may now be weakening. Gold could see strength as a low-risk haven during the downturn, though.

**REITs – Neutral as strong fundamentals balance outperformance**

This market remains the best performer year to date, buoyed in part by nervous bond investors attracted by the high and possibly rising income pay-outs that REITs offer. Sector activity is muted, but balance sheets are healthy.

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