Laurentian Bank Securities

ECONOMIC RESEARCH AND STRATEGY

Asset Allocation Model – July Update

We remain comfortable with our decision to adopt a neutral stance on equity vs. fixed income at the end of January as warning signals continued to appear in June. First, the declines in 5yr5yr and 10yr market-based inflation expectations continue to point to a moderation in economic momentum that could make equities highly vulnerable to disappointment. Second, real money supply growth remains on the decline and suggests that a rollover in business sentiment indicators is about to take place, which could mark a cyclical slowdown. Third, weak balance sheet stocks and cyclical sectors are underperforming, which tended to precede softer market returns. Fourth, the recent decline in the global net earnings revisions ratio points to a coming deterioration in the earnings outlook. Another source of concern is the recent pick-up in the CBOE Options Equity Put/Call ratio, which could signal a deteriorating risk sentiment. A topping in the NYSE cumulative advance/decline line, which has not occurred yet, would only reinforce a more defensive stance. However, as earnings are still improving, it would not justify turning underweight equities just yet.

Regional Allocation and Sector Rotation

There is no change to our regional allocation this month with our largest overweight remaining Canadian equities. Even though sentiment about oil prices is currently pretty bleak, we continue to expect the global oil market to tighten in the coming quarters, which should exert a positive influence on oil prices. As for our sector allocation in Canada, we still recommend to overweight the Energy, Materials, Telecommunication Services, Industrials and Information Technology sectors. In the U.S., we still advise clients to overweight the Energy, Materials, Information Technology, Telecommunication Services, Real Estate and Consumer Staples sectors.

Canadian Bond Allocation

Since we turned overweight corporate bonds against Canadian government back in April 2016, credit spreads have significantly tightened. We are reducing our overweight position on the back of the recent decline in the global net earnings revisions ratio and a deteriorating risk sentiment. The recent decline in market-based inflation expectations and consumer confidence also represent significant sources of concern. We still maintain an overweight position as corporate bonds typically continue to outperform government bonds when monetary conditions remain accommodative. With central banks expected to keep their accommodative stance for some time and rates not yet approaching restrictive levels, credit should continue to outperform government bonds. However, the rapidly deteriorating credit metrics should be closely monitored as a tightening in credit conditions that would not coincide with an improving economic backdrop could hurt the profit margin outlook and relative performance of credit.

Model Portfolio as of July 2017				
Asset Classes & Regions	Recommended Weightings (%)	Benchmark Allocation (%)	Over/Underweights (%)	Recommendation
Bonds	50.0	50.0	0.0	=
Government	32.3	34.7	-2.4	-
Corporate	17.7	15.3	2.4	+
Equities	50.0	50.0	0.0	=
Canada	22.5	20.0	2.5	+
United States	15.0	16.0	-1.0	-
Other Developed Markets	9.6	11.6	-2.0	-
Emerging Markets	2.9	2.4	0.5	= / +

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