





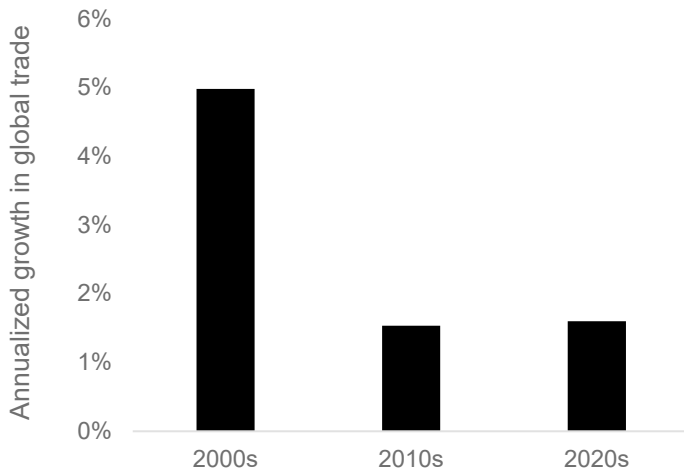






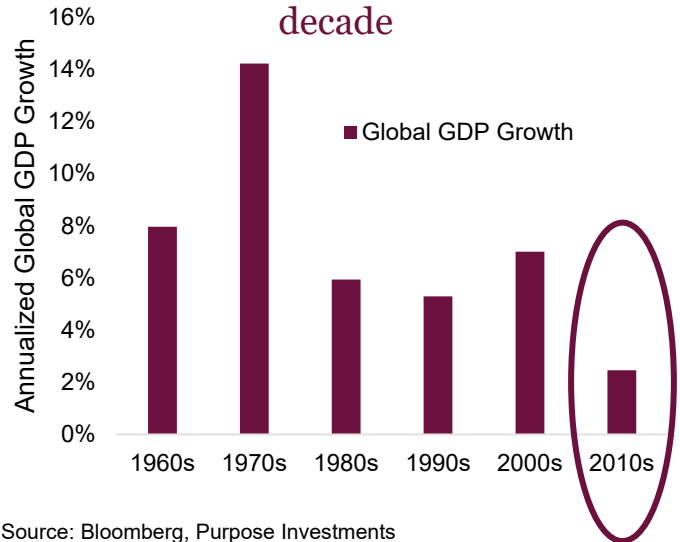


2000s saw rapid rise in global trade -> disinflationary



Source: Bloomberg, CPB Netherlands, Purpose Investments

2010s, due to deleveraging, was a low growth disinflationary decade

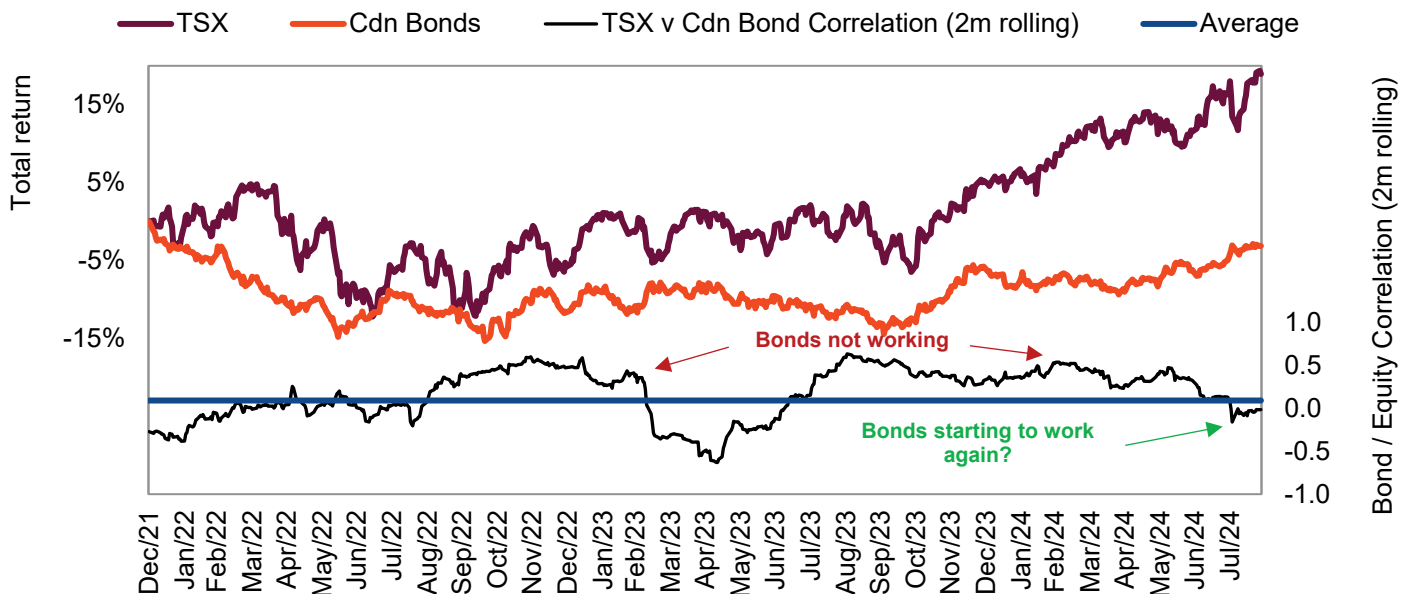


Source: Bloomberg, Purpose Investments

Fast-forward to today, and we should not be surprised to see correlations higher than in recent history. While high, correlations are actually closer to longer historical norms. The real question is, what to do about it, and what happens next?

**Correlations likely to soften** – Inflation is normalizing and coming down. This has central banks dialling down short-term interest rates, which should help soften correlations. And the market is becoming more concerned with the pace of economic growth, or more specifically, the pace of slowing. If you want a simple rule, in a market primarily concerned with inflation, correlations will likely be high. In a market concerned with recession risk, correlations will be lower.

### Bond / Equity correlations, working again



Source: Bloomberg, Purpose Investments

We have seen this over the past couple of months. Unfortunately, we will likely not enter a disinflationary world similar to the 2000s and 2010s anytime soon. A number of longer-term trends will likely keep inflation as a recurring market risk in the coming years. These include:

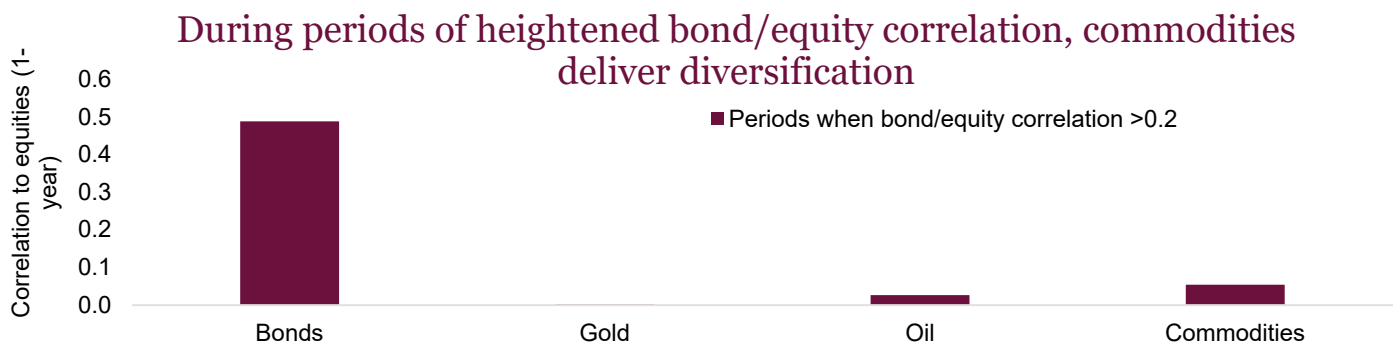
- 1) The disinflationary impact of rising global trade has slowed. Tariffs, protectionism, and a gradual move to a more polarized world are inflationary.
- 2) The energy transition may prove disinflationary as technology advances, but today, it is not. Energy costs are higher, and this translates into higher prices.
- 3) Wages over the past couple of years have been rising as fast or faster than inflation. Given that our economies are tilted more toward service, higher wages drive higher prices. And if you have noticed any recent labour disputes, resolutions are quick and costly.
- 4) Cost of capital used to be much lower. Now not so much. Part of this is due to demographics as the disinflationary force of more savers than borrowers softens. The population is also getting older and moving more towards the decumulation phase.

Countering these inflation factors are the disinflationary forces of technology and higher debt. It is never a straight line, but we would argue inflation will not go quietly into the night. This may lead to correlations remaining higher than in the previous two decades.

**What to do about higher correlations** – Bonds are not broken, and the 60/40 is not dead. However, bond risk mitigation contribution to portfolios will likely be lower than in the 2000s and 2010s. The silver lining is that with yields higher than in recent history, they do now carry a more pronounced return contribution.

That being said, tweaking the traditional 60/40 to find different sources of diversification likely makes more sense today and tomorrow than in years past. Becoming more global helps a little. However, higher correlations are a global phenomenon that limits diversification gains. There are two sources of diversification we believe are worth increased consideration from a portfolio construction perspective:

- 1) **Commodities** – The prices of many commodities and commodity price-sensitive equities offer an added diversification benefit. Gold, oil and broad commodity price indices all carry very low correlations to equities during periods of heightened bond/equity correlations. They also tend to do well when the U.S. dollar weakens, another positive from a portfolio construction perspective. The downside is the volatility in the commodities, and related equities are material, often much higher than bond volatility. Commodity prices often react to short-term supply/demand dynamics, which can oscillate a lot. Many are very sensitive to changes in global economic growth, such as base metals or energy. Some behave based on other factors, like gold. **Commodity exposure offers a good source of diversification but should be used sparingly, given the inherent risk/volatility.**



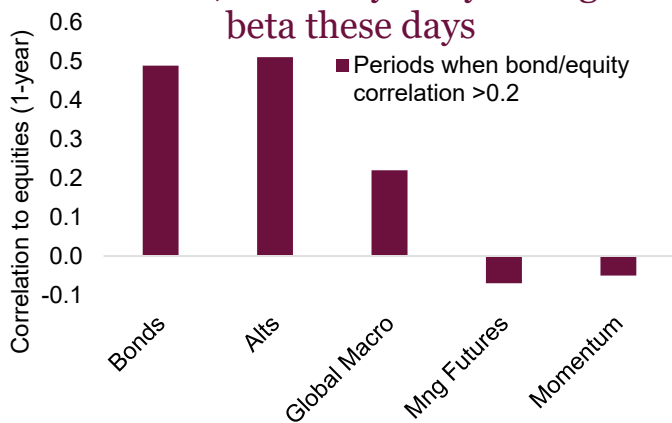
Source: Bloomberg, Purpose Investments, 1970-2024



**2) Alternatives** – This very diverse asset class certainly offers unique strategies that have investment streams, unlike traditional assets, which have diversification benefits from a portfolio construction perspective. The challenge becomes which sub-strategies or managers. Due diligence should not be taken lightly because, over the years, many of these vehicles have become more market beta than one would have thought. This is likely the result of a strong performing equity over the past decade, causing many to take on more market exposure to keep up. Low volatility, low correlation, and low returns are challenges in maintaining or growing assets under management.

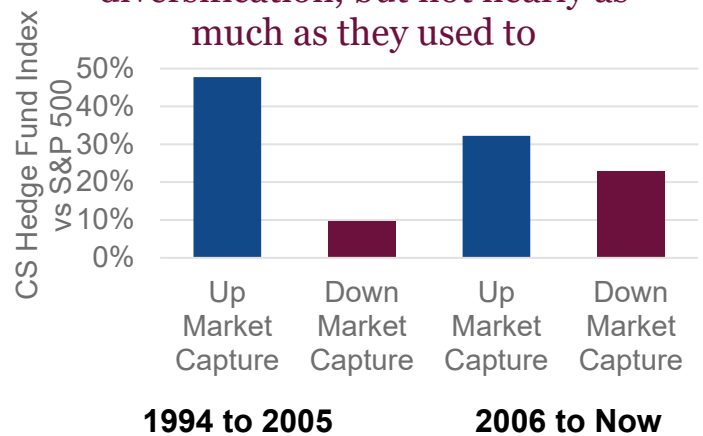
As a result, the broad alternatives index, which is a mashup of many strategies, actually is not as great a diversifier as one might expect. This can also be seen in the up/down market capture from longer ago compared to the past few decades. The good news is more narrowly, there are sub-strategies that continue to be more effective diversifiers. There are truly different strategies throughout, and finding them requires more due diligence. A good initial rule of thumb, if equities are up +10% and your alt is up +10% ... it may be less alt than you think.

**Some alts deliver diversification as well, but many carry strong beta these days**



Source: Bloomberg, Purpose Investments, Alts are CS Hedge Indices, Momentum Barclays Momentum

**Alternatives still offer diversification, but not nearly as much as they used to**



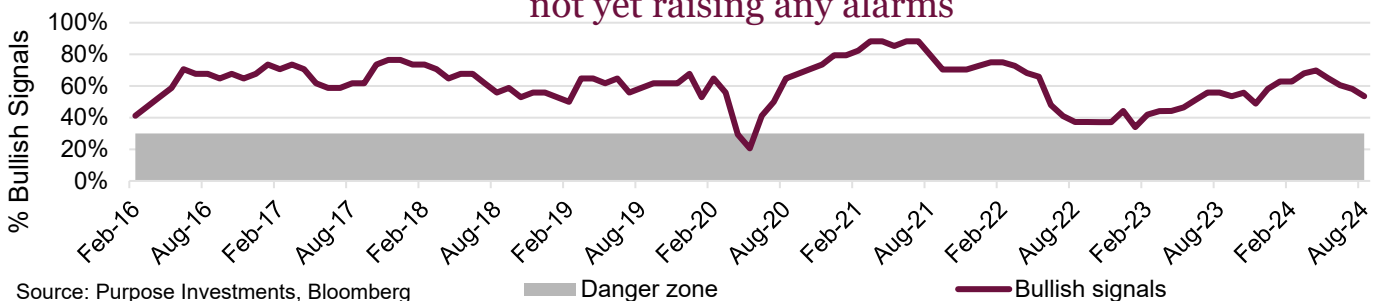
Source: Bloomberg, Purpose Investments, 30 April 2024

If higher equity/bond correlations are now the norm, the efficient frontier for portfolios has been nudged to the right. That means for the same level of return, you should expect greater volatility than before. However, adding in a measured amount of commodity exposure and alternatives can help nudge the curve back to the left.

**Market cycle**

Market cycle indicators have been eroding over the past few months, but they are still reasonable. In April, 70% of signals were bullish, and as of the end of August, this was down to 53%.







































































































**Market cycle indicators - Trend ain't great but not yet raising any alarms**



Source: Purpose Investments, Bloomberg

The U.S. economy flipped two bullish signals to bearish compared to last month. GDP Now, from the Atlanta Fed, an econometric model built around more high-frequency data, dropped from 2.9% mid-August to 2.0% by month end. This measure softened residential investment spending and inventories, the good news being that the consumer remains steadfast. The other signal that flipped was energy demand.

### Market cycle indicators

Grouping	Metric			Better/ Worse	Grouping	Metric			Better/ Worse
<b>Rates</b>				1 / 2	<b>Global Economy</b>				5 / 3
	Net Cuts			+		Global PMI			-
	Yield Curve			-		Copper (6m)			+
	Yield Curve 3m			-		DRAM (3m)			+
<b>US Economy</b>				7 / 12		Oil (3m)			+
	Leading Ind (3m)			-		Commodities (3m)			+
	Leading Ind (6m)			-		Baltic Freight (3m)			-
	Phili Fed Coincident			-		Kospi (2m)			-
	Credit (3m)			+		EM (2m)			+
	Recession Prob (NY Fed)				<b>Fundamentals</b>				5 / 7
	Recession Prob (Clev Fed)			+		US: PE			-
	Citi Eco Surprise			-		US: EPS Growth			+
	GPD Now (Atlanta Fed)			-		US: EPS 2FY v 1FY			+
	US Unemployment			-		US: 3m EPS Revision			-
	Consumer Sentiment (3m)			+		Canada: PE			-
<b>Manufacturing</b>						Canada: EPS Growth			-
	PMI			-		Canada: EPS 2FY v 1FY			+
	PMI New Orders			-		Canada: 3m EPS Revision			-
	Energy Demand (YoY)			-		International: PE			-
	Truck Demand (YoY)			-		Int: EPS Growth			+
	Rail (YoY)			+		Int: EPS 2FY v 1FY			-
<b>Housing</b>						Int: 3m EPS Revision			+
	Starts (6m)			-					
	Months Supply (6m)			+					
	Home Sales			-					
	New Home Sales			+					
	NAHB Mkt Activity			+					

Source: Purpose Investments, Bloomberg

Outside the U.S., the global economy category lost one bullish signal as the KOSPI rolled over. Given the composition of its equity market, the Korean market has long been a proxy for global trade. On the positive side, international earnings growth picked up. Earnings estimates have been steadily improving globally.

### Active Asset Allocation Strategic Guidance

House View		Underweight	Neutral	Overweight
Overall	Equity		--->●	
	Bonds		●<---	
	Cash			●
	Diversifiers		●	
Equities	Canada		●<---	
	U.S.		--->●	
	International			●
	Emerging Markets		●	
	Style Allocation (Value <----> Growth)		●	
	Size (Small <-----> Large cap)			●
Fixed Income	Government			●
	Credit		●	
	Investment Grade			●
	High Yield		●	
	Preferred Shares			●
	Duration			●
Diversifiers	Volatility Reduction Strategies			●
	Growth Strategies		●	
	Structured Product / Yield		●	
	Real Assets			●
		Passive		Active
Act/Pass	Management Approach		●	

Source: Purpose Investments

### Final thoughts

There have been big moves in equities, both down then up thankfully. Big moves in bond yields, moving lower. Big moves in currencies, with USD dropping. Big moves in commodities, economic cyclical ones down, safe haven ones up. This has not been a sleepy summer, so either the seasonal volatility of Sept/Oct came early, or we are just getting warmed up for a wild finish to the year. This is not the time to be chasing in our view, even if Rocky keeps bouncing back up.

**Source:** Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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