



Market Perspectives



Geopolitical Destabilization: Managing Through Market Uncertainty



TD Wealth Asset Allocation Committee (WAAC) Overview

- In advance of the conflict in Ukraine, we anticipated a year of heightened volatility due to slowing economic and earnings growth and moderated our return expectations as a result. However, we maintain a preference for equities over fixed income overall.
- We continue to expect Canadian equities to outperform their global counterparts as the Financial and Energy sectors may deliver sustained earnings strength in a rising rate and elevated commodity price environment.
- We are closely monitoring the European geopolitical situation for economic impacts. The unknown duration of the Russia/Ukraine war, combined with higher interest rates, elevated inflation and the likelihood of an economic slowdown has increased recessionary risks, particularly in the Eurozone.
- We maintain an overall underweight to fixed income due to low or negative real returns. However, we believe fixed income exposure within portfolios remains important. Bonds can provide investors with consistent income, diversification benefits and insulate portfolios during periods of elevated volatility.
- With low fixed income yields and the potential moderation of equity returns, an allocation to alternative assets could be beneficial in managing portfolio volatility, providing some long-term inflation protection and attractive absolute returns. We believe alternative assets can help portfolios under either transitory or more structural inflation outcomes.

First Quarter in Review and Market Outlook

At TD Asset Management Inc. ('TDAM', 'we', 'our') our commitment to delivering quality, risk adjusted returns is complemented by our focus on preserving and protecting portfolio assets through active risk mitigation. Like the rest of the world, we are deeply concerned about the situation in Ukraine and hope that the terrible violence will soon end.

Not only has the Russian invasion of Ukraine rapidly evolved into a humanitarian crisis, with so many lives upturned, it has also exacerbated financial market volatility, with its impacts on commodity prices being front and centre.

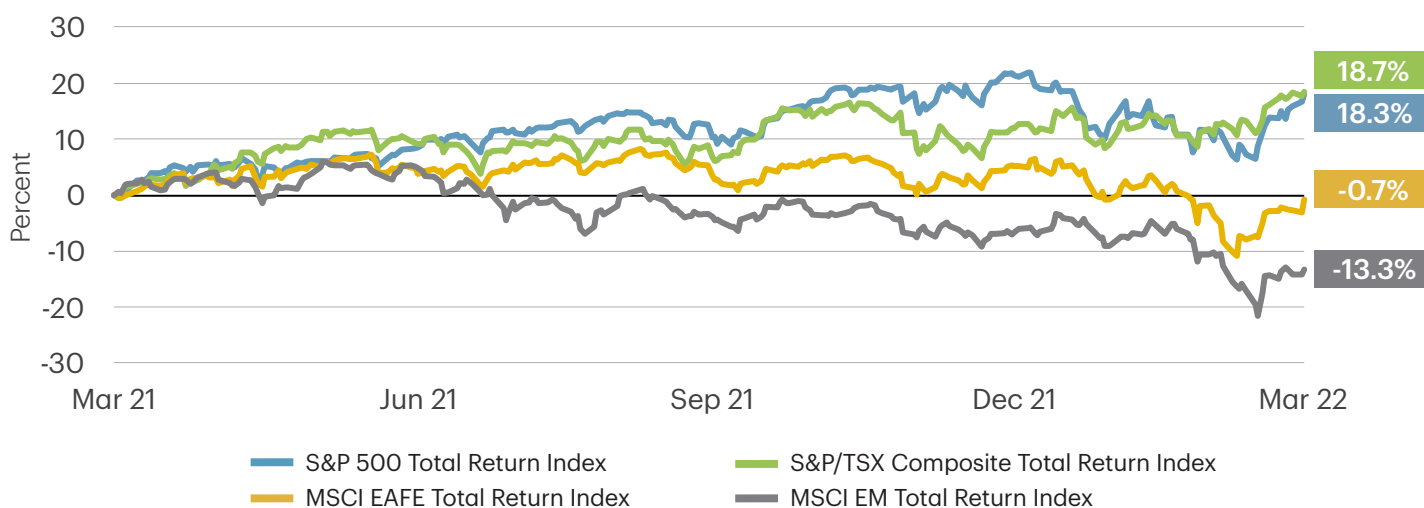
The war has delivered a major blow to globalization: disrupting trade and adding new crimps to recovering supply chains, all while continuing to fuel elevated inflationary pressures. Prior to the invasion, investors were already facing rising bond yields and hotter-than-expected year-on-year inflation readings around the world. Add tight labor markets, decelerating corporate profits and the disruption to financial conditions due to tragic geopolitical events, and the wall of worry now appears very challenging to overcome.

One point to emphasize: TDAM currently has immaterial exposure to Russian securities (stocks or bonds) in our investment portfolios, and we do not have any intention to add exposure to Russian securities in any of our solutions at this time. Across our proprietary asset allocation solutions, less than 5 basis points (0.05%) of assets have direct exposure to Russian securities.

Any decisions to allocate portfolio assets to Russian markets in the future will be carefully weighed against prevailing political and economic circumstances. Additionally, TDAM is committed to complying with all applicable sanctions and regulations.

We will continue to closely monitor the stress in financial markets and the potential impacts of the ongoing geopolitical tensions on the economic outlook. As asset managers, we must consider the many potential outcomes of the conflict, including one in which the war is prolonged and could continue to destabilize financial conditions over a longer term. This analysis will allow us to form an appropriate and measured response from an investment portfolio allocation perspective. In the current environment, we continue to favour equities over fixed income longer term but maintain a very modest risk-on position. Predicting how severe the current market drawdown will be is a difficult task, but we are always mindful that selloffs help to clear market excesses, and any significant weakness could present attractive strategic buying opportunities. In the following section, we provide our insights on the impact of the Russian invasion of Ukraine on oil markets, which have jumped to levels not seen in decades, and what all this could mean for the outlook. For an in-depth perspective on our current views on key asset classes, as well as our strategic positioning views over the next 12-18 months, please review the **WAAC Positioning and Outlook** section of this report.

Chart 1: Index returns over the past 12 months (based in USD)



Source: TDAM. As of March 29, 2022.

Oil – Higher for Longer?

Historically oil demand growth has been stable at just above 1% per year. While COVID-19 lockdowns and lower mobility reduced oil demand in 2020 – 2022 compared to 2019, by 2023 oil demand is expected to surpass 2019 levels and should continue to grow until various energy transition drivers (such as electric vehicles) start to reduce overall demand, which would likely be by the end of this decade or in the early 2030's. Oil supply growth from large-scale greenfield developments (such as oil sands) is unlikely to be sanctioned, leaving supply growth to largely come from short-life projects, such as horizontal drilling. If these short-life oil developments are not able to bridge

the supply/demand gap, then oil prices could remain higher for longer.

With the recent Russian invasion of Ukraine, oil prices have shot up over \$100/barrel and, as a result, consumers have been feeling the pain in their wallets as gasoline prices hit record levels across the globe. **Chart 2** below highlights the steady grind higher, with West Texas Intermediate (WTI) oil prices averaging approximately \$66/barrel in the second quarter of 2021, \$70/barrel in the third quarter, \$77/barrel in the fourth quarter and nearly \$90/barrel so far in 2022.

Chart 2: Oil Continues its Steady Climb



Source: WTI Crude Oil (\$/barrel) from FactSet. As of March 7, 2022.

What is causing these high oil prices? While the Russian invasion of Ukraine has caused the most recent spike in prices, oil prices had already been climbing for well over a year prior to the invasion. In the short term it appears that current high oil prices are a result of actions that Organization of the Petroleum Exporting Countries Plus (OPEC+) took to balance the market after COVID-19 shut down worldwide economies in 2020 and increasing inventory shortages.



Russian invasion of Ukraine

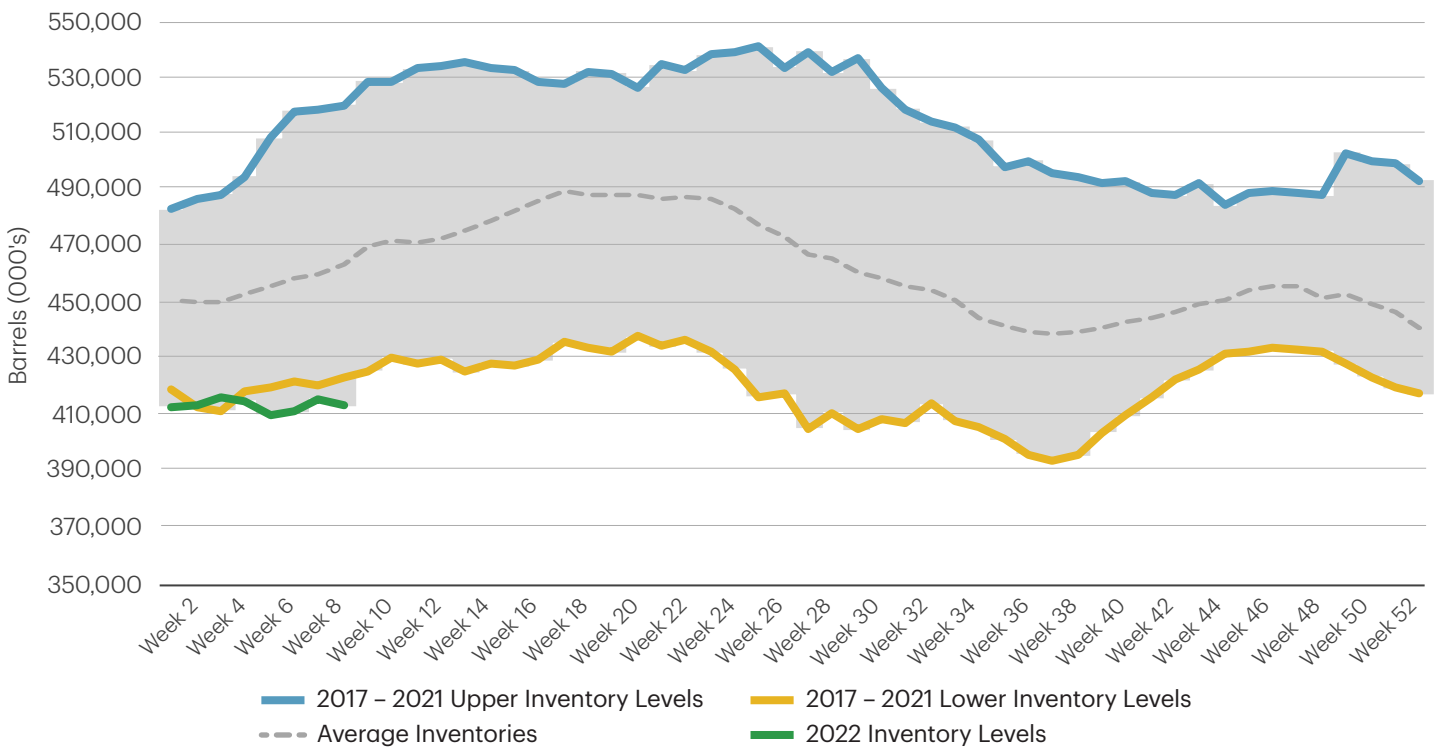
The Russian invasion of Ukraine caused the spike in WTI prices from the \$90 range to over \$130 due to worries that the war could cause supply disruptions and prices have since remained highly volatile. Furthermore, sanctions against Russian banks which make it harder to trade Russian oil, U.S. and U.K. actions to ban imports of Russian oil, as well as Russian counterthreats to reduce oil production are further stoking supply fears and causing elevated oil prices. If there are actual supply disruptions, whether caused by war or due to sanctions, oil could continue to remain elevated.

Inventory Shortages

Global oil inventory levels originally ballooned in early 2020 with the COVID-19 worldwide economic shut-downs; however, OPEC's production cuts have served to gradually reduce global inventory levels. The U.S. Energy Information Administration estimates that global oil and other liquids production in 2021 was 95.5 million bbl/d while global consumption was 97.1 million bbl/d.¹ This means that global oil inventories were reduced by approximately 1.6 million bbl/d or 584 million barrels

over 2021. **Chart 3** below shows estimates of U.S. total oil inventories from 2017 to 2022. The blue line shows the highest inventory levels seen over the past five years while the yellow line shows the lowest levels over the same five years. The dotted grey line shows average inventories. Finally, the green line on the left-hand side of the chart shows that oil inventory levels so far in 2022 are at very low levels compared to the last five years.

Chart 3: Crude Oil Inventories – 5 Year High, Low, and Average



Source: TD Asset Management Inc., US Energy Information Administration. Date range: January 1, 2017 to February 25, 2022.

Historically, when oil inventories are low, oil prices become more sensitive to events or news that indicate possible further supply disruptions. For instance, news that some OPEC+ countries were unable to ramp up their production to meet quotas along with news that cold weather in Texas was interfering with oil production has an outsized impact on current oil prices because existing inventories are low.

¹Short-Term Energy Outlook (Feb 8, 2022) at www.eia.gov/outlooks/steo/marketreview/crude.php

What Could Lead to Lower Prices in the Short Term?

An end to the Russian/Ukrainian conflict would likely see oil prices drop significantly from current levels. Other than this, increasing global oil inventory levels and a new U.S./Iran nuclear deal which could see Iran increasing oil exports by up to 700,000 bbl/d are the most likely near-term events which could lower oil prices. Less likely is OPEC+ abandoning their measured supply cuts and moving to produce at maximum levels.

However, if there are supply disruptions it is possible that OPEC+ could step in to balance the market if these potential disruptions are not too severe; Russia is the world's second largest oil exporter and OPEC+ does not have enough spare capacity to replace Russian production volumes. Finally, a new COVID-19 variant which causes world-wide economies to shut down again would be very negative for oil prices.

Mid-to-Long Term Oil Prices

Forecasting where mid-to-long term oil prices are going to settle is an exercise in futility as there are too many unknowns. However, we should consider the following points:

- While the transition to a low carbon world is occurring, and is necessary, this could take far longer than expected.
- The bulk of oil (65%) is used for transportation, which is why the transition to electric vehicles (EVs) is so important. However, charging infrastructure needs to be built before we see widespread EV adoption. For example, people who live in apartments or condos are unlikely to buy EVs until they can charge their vehicles in their own garages.
- Even when sales of cars with internal combustion engines are banned (likely 2035 or beyond in Canada), it will take about 10 years until the bulk of these cars are off the road.
 - The developing world will take longer to transition away from internal combustion engines because their electrical infrastructure will take longer to build up.
- Oil supply should naturally decline over the coming years as existing oil wells are depleted. Large U.S., European and Canadian oil and gas companies are unlikely to commit to developing large-scale oil deposits due to uncertainty around future oil prices and the speed of the transition to a lower carbon world.
- Even assuming oil and gas companies had a desire to develop large-scale oil deposits, governments, environmental activists and even oil and gas company shareholders are increasingly against new developments.

If we see a gradual decline in oil demand over the next decades, and with a gradual decrease in oil supply, oil markets could remain relatively balanced, which could support robust oil prices into the 2030s and beyond.

Where to invest to benefit from higher oil prices?

The WAAC has been optimistic on Canadian equities due in part to rising yields and commodity prices, which are expected to benefit companies in Canada's Financial and Energy sectors. Canada's equity benchmark, the S&P TSX Composite Index, has a larger overweight than its U.S. and global peers in both the Energy and Financial sectors and as such, should benefit to a greater degree than other countries from higher commodity prices and rising rates.

TDAM offers several diversified and equity focused solutions that can provide increased exposure to Energy (and Financial) holdings to potentially enhance portfolio returns. While no one may be able to avoid the high gas prices at the pump, investors may be able benefit from oil and gas company profits through TDAM's portfolio solutions. Speak to your advisor today or visit [our website](#) to learn more.

WAAC Positioning and Outlook

Primary concerns to real economic growth include elevated and more persistent inflation, tight labor markets, monetary policy missteps, and geopolitical events which could lead to elevated market volatility and tighter financial conditions. Returns are likely to moderate considerably as markets appear to be pricing-in the potential of recessionary risks. Overall, we maintain a moderate risk-on stance for equities; however, we have become increasingly more cautious in our outlook over the past quarter.

Equities

	Maximum Underweight	Modest Underweight	Neutral	Modest Overweight	Maximum Overweight
U.S. Equities			●		
Canadian Equities					●
International Equities		●			
Chinese Equities		●			
Emerging Markets Equities – excluding China			●		

From a global equity perspective, the current investment climate remains uncertain and recessionary risks are rising in certain regions. A broad economic slowdown driven by a combination of higher interest rates, elevated inflationary levels, and commodity prices, could weigh on investor sentiment and lead to muted returns for riskier assets over the next 12-18 months. We believe that companies that continue to deliver quality earnings growth will provide the best opportunity on a longer-term basis; however, we do recognize the risk of near-term underperformance from growth equities, particularly if interest rates rise further.

In the U.S., high inflation readings and strong labour markets are driving expectations for nearly six rate hikes by the end of 2022. They have also led to investor concerns about slowing corporate earnings growth, however U.S. companies continue to deliver strong results. Despite this, the effects of the war in Ukraine and tighter monetary conditions could dampen S&P 500 Index performance, as the growth outlook may be weaker than previously anticipated.

While Chinese policy makers have appeared relatively accommodative in an attempt to boost economic

growth and consumer spending, China's growth rate is still exhibiting signs of weakening. Increased government regulation, slowing consumer spending, continued struggles within the property market sector and geopolitical risks have all weighed on China's recovery. China's zero-COVID-19 policy could also have an impact to its growth outlook.

We have a much more bullish stance on Canadian equities for 2022. With rising yields and commodity prices, companies in Canada's Financial and Energy sectors (the two largest components by weight in the S&P/TSX Composite Index) are expected to outperform other sectors and markets. Investors may also expect dividend increases and share buybacks due to the strong balance sheets of these companies.

The growth outlook for international stocks has materially deteriorated in recent weeks due to the outbreak of the war, and the dramatic rise in commodity prices. We expect growth across the Eurozone to broadly decelerate, due to fears over rising interest rates, soaring inflation and the geopolitical conflict.

Alternatives/Real Assets

	Maximum Underweight	Modest Underweight	Neutral	Modest Overweight	Maximum Overweight
Infrastructure					●
Commercial Mortgages				●	
Domestic Real Estate				●	
Global Real Estate				●	

Broadly, global real estate economic and property fundamentals are moving towards pre-pandemic levels, as many COVID-19 related restrictions are being lifted and cities are getting closer to a sense of pre-pandemic normalcy. As a result, our outlook for real estate is healthy as we expect strict lockdowns to be less frequent. We anticipate that alternative real estate, particularly U.S. life sciences/lab office, will continue to gain prominence given the highly specialized nature of these assets, lower correlation and higher income potential versus traditional real estate (e.g., office, retail) going forward. U.K. multi-unit residential also presents as a growing investment opportunity given the sector's low institutional ownership relative to other countries, in addition to its potential diversification and income stability.

After a slowdown in 2020, annual transaction activity within Canadian real estate hit a new record, surpassing \$57 billion over 2021. Momentum is expected to remain strong in 2022 with demand highest for industrial and multi-family real estate. Notwithstanding, office and retail assets will begin to experience more transaction volume as fundamentals improve, and investors seek out higher yielding sectors. Canada's forecasted GDP and population growth continue to lead its G7 peers, providing an attractive landscape for commercial real estate participants. Despite entering a rising interest rate period over the short term, upward pressure on capitalization rates is not expected. Interest rates have been lingering at historically low levels, and there is a significant income spread between capitalization rates and bond yields that provides a cushion to rising rates.

Commercial mortgages continue to provide accretive income in today's low yield environment. An attractive feature of commercial mortgages is its lower duration and the ability to insulate investor returns from the increased volatility witnessed in interest rates. Income collection has been resilient, with our exposure experiencing zero impairments or defaults throughout the pandemic while collecting 100% of scheduled principal and interest payments. High quality commercial mortgage spreads are now slightly below pre-COVID-19 levels, however the yield advantage offered through commercial mortgages versus corporate and universe bonds remains historically attractive on a duration adjusted basis.

Infrastructure allocations have come into focus for portfolios as a diversifier, a source of excess return and inflation protection during a time of uncertainty. As central banks begin to raise rates, high inflation continues to persist and the outbreak of war in Europe and the subsequent sanctions on Russia have had dramatic impacts on Energy markets. These current socioeconomic and macro trends are driving a significant opportunity in infrastructure investment. We believe there are significant tailwinds for infrastructure portfolios broadly, and specifically those that have exposure to growth in renewable energy. Demand for renewable energy is expected to accelerate significantly from regional climate goals as well as energy security needs.

Fixed Income

	Maximum Underweight	Modest Underweight	Neutral	Modest Overweight	Maximum Overweight
Investment Grade Corporate Bonds				●	
Inflation Linked Notes			●		
High Yield Bonds		●			
Domestic Government Bonds		●			
Developed Markets Bonds	●				
Emerging Markets Bonds			●		

We expect the bond market to be subject to heightened volatility due to North American central banks transitioning their policy framework from accommodation to stabilization, more persistent inflationary pressures, and the current European geopolitical crisis.

Despite the bond rally triggered by the Russia/Ukraine war, yields are expected to trend higher from current levels over the next twelve months. However, real yields on global sovereign debt are likely to remain negative for an extended period and remain unconvincing from an investment standpoint.

While the Bank of Canada and the U.S. Federal Reserve (the Fed) have signaled that interest rates are expected to increase beginning in March, overall financial

conditions should remain relatively supportive to the corporate sector, and hence our continued modest overweight stance to corporate credit. However, the uncertainty around the economic impact caused by the European geopolitical crisis combined with interest rates hikes, increases the likelihood of an economic slowdown.

We maintain a neutral outlook for high yield bonds. Spreads remain at relatively compressed levels, which has limited the attractiveness of relative opportunities. We remain selective in high yield.

We see less opportunity in inflation-linked bonds as real yields rise largely due to the rise in nominal yields.

Fixed Income

Sub-Classes

	Maximum Underweight	Modest Underweight	Neutral	Modest Overweight	Maximum Overweight
Gold			●		
U.S. dollar versus a basket of currencies			●		
Canadian dollar vs. the U.S. dollar				●	
Cash				●	

We continue to expect strong performance from the Canadian Financials and Energy sectors. We also expect rate increases to contribute to the longer-term outperformance of the Canadian dollar versus other major market currencies.

High inflation readings from around the globe, combined with the ongoing concerns surrounding Russia's invasion of Ukraine, has sent gold rallying due to its safety characteristics. Despite prices pulling back slightly from recent highs, gold may remain elevated as investors continue seek a hedge against the threat of inflationary shocks that could be exacerbated by the war.

The U.S. dollar (USD) has demonstrated strength compared to its global counterparts over the quarter. This trend may continue as we expect the Fed to embark on a rate hiking cycle and as investors seek the safe haven appeal of the global reserve currency during this period of instability. However, the exceedingly high levels of the Fed's balance sheet remain a concern.

Due to the prevailing risks of destabilizing financial conditions, increasing cash levels is prudent in order to provide liquidity and greater flexibility for strategic asset allocation, particularly during periods of elevated market volatility.

Outlook

TD Wealth Asset Allocation Committee

The TD Wealth Asset Allocation Committee was established to deliver a consistent asset allocation message and be the source for strategic asset allocation advice across TD Wealth.

The committee has three prime objectives:

1

Articulate
broad market
themes

2

Provide
macro-level
asset
allocation

3

Identify the
major risks on
the horizon

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