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The Year Ahead 2022
Global Economic Outlook

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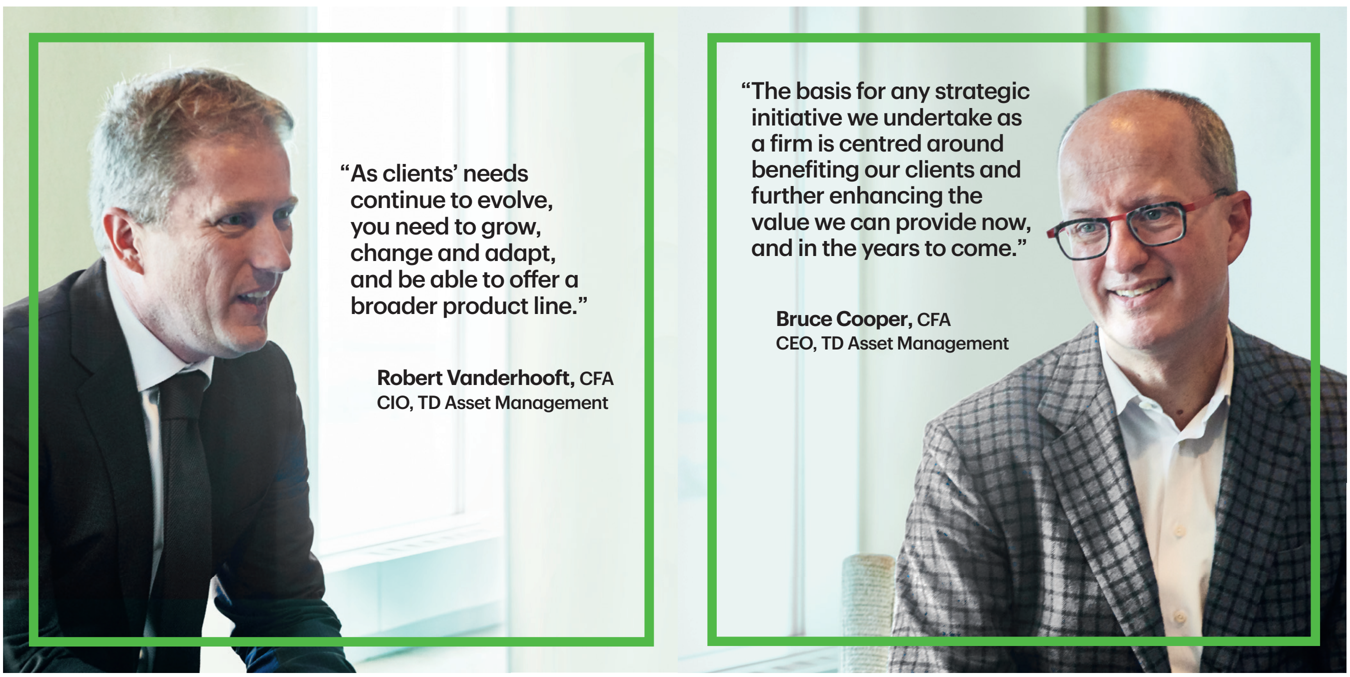

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TD Asset Management

The Year Ahead 2022
Global Economic Outlook

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TD Asset Management Inc.

TD Asset Management

THE YEAR IN REVIEW

2021 has not disappointed investors with an appetite for riskier assets. The performance of North American equity markets has been impressive this year, driven by the strength and resilience of the U.S. and Canadian economies. Markets were buoyed by low interest rates and aggressive government support which benefited individuals and corporations, helping to ease some of the pressures experienced during the ongoing global health crisis. Most international markets have also fared well, surging off of their March 2020 lows, as strong demand for products kept production levels high in many exporting countries. The COVID-19 pandemic continues to impact many regions across the globe; however, the rollout of successful vaccines and therapeutics have certainly helped change the tone of this pandemic from worry to guarded optimism. While central banks and governments came to the rescue throughout the pandemic, their policies have also led to some unintended consequences. Excess liquidity has propelled consumer demand in the face of pandemic related supply chain disruptions, which has led to historically high levels of inflation. This unprecedented liquidity and demand has been very positive for corporate earnings and thus equity prices. The rapid growth in earnings has left markets at the higher end of reasonable value given the prolonged low interest rate environment.

At TD Asset Management Inc. (TDAM), we remained bullish on equities throughout 2021 as record earnings growth, positive earnings surprises and revisions drove share prices higher (Chart 1). Corporate balance sheets remained resilient during the pandemic, save for companies in hard hit sectors like tourism and hospitality. Record low yields and strong demand have led to significant margin expansion, driving the profitability of companies higher in most sectors. In fixed income, it was a different story. Our underweight positioning throughout the past year was reflective of low yields, negative real returns, and the expectation of higher yields. However, we took advantage of opportunities within the high yield and corporate bond space to add incremental income. Alternative assets like real estate, infrastructure, and private debt performed well in 2021, despite the challenges imposed by the pandemic. Industrial real estate for example was a positive contributor to returns, driven by the expansion of e-commerce and the increased need for warehousing and logistics to meet surging demand.

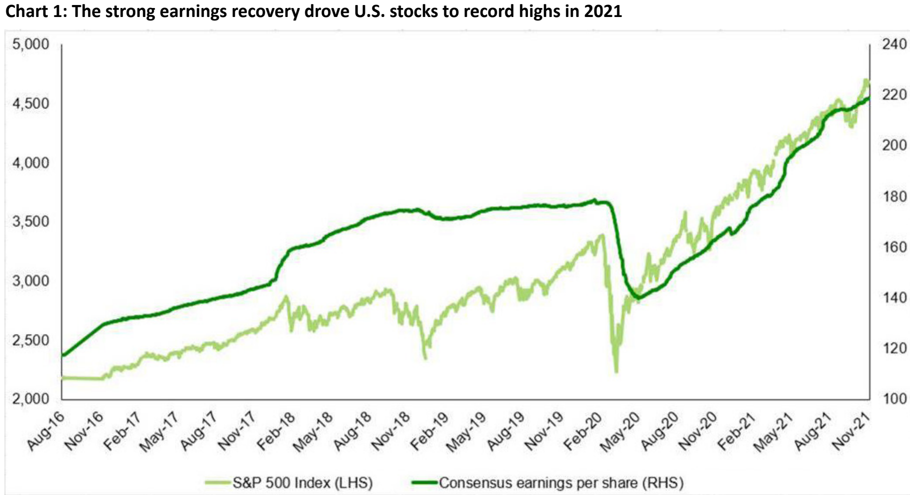
THE YEAR AHEAD

At TDAM, we believe that global economic growth will continue into 2022, but at an unsurprisingly slower and more moderate pace than the remarkable recovery experienced over the previous twelve months. This normalization is typical for an economy in its mid-cycle growth phase. We maintain a modest risk-on perspective as transitional inflationary pressures, pandemic uncertainties, geopolitical instability, and the potential for central bank missteps could all cause disruptions to growth and drive market volatility against a backdrop of lower expected returns.

Equities remain attractive

Overall, we remain bullish on equities going into the new year, however, we have become cautiously optimistic in our outlook. Despite the strong earnings growth of late, we expect conditions to normalize as fiscal and government support is expected to wane in 2022. U.S. stocks should reasonably be expected to deliver mid-to-high single-digit returns in 2022, a decrease from the double-digit returns seen in 2021. U.S. economic data remains robust though some headwinds are starting to emerge. Positive yet decreasing earnings growth, increasing signs of inflation being more structural than transitory, a more hawkish U.S. Federal Reserve (the Fed), and new COVID-19 variants may lead to increased market volatility and lower returns for equities in the coming quarters. In Canada, the story is much of the same. However, sustained and elevated

Chart 1: The strong earnings recovery drove U.S. stocks to record highs in 2021



Note: LHS= Left hand side. RHS= Right hand side.
Source: TDAM. As of November 15, 2021.

commodity prices should drive relative outperformance of Canadian stocks given the country's significant resource based exposure. In addition, Financial stocks, the largest sector of the S&P/TSX Composite Index, should outperform as yields rise and excess capital is returned to shareholders.

Internationally, manufacturing activity in Europe remains broadly expansionary and job growth is improving. We remain optimistic toward European economically sensitive countries (i.e., U.K., Germany, France), which continue to benefit from the broad reopening of businesses. As consumer activity continues to rebound, this should be supportive for corporate fundamentals and drive equity returns higher. However, recent COVID-19 outbreaks in parts of Europe, new variants, surging gas prices and high inflation are a concern. For 2022, we expect mid-to-high single-digit returns for European equities.

China has been in the headlines a great deal recently, for multiple reasons. Chinese equities have been a relative underperformer in 2021, due in part to broad regulatory crackdowns and fears over a widespread meltdown in China's troubled property market. Despite this, fundamentals remain relatively sound and valuations reasonable. Economic growth should stabilize in the coming months as authorities implement supportive policy measures, however, we remain cautious in our outlook. We expect Chinese equities to deliver mid-to-high single-digit returns in 2022 but with relatively more volatility.

Defence with fixed income

We have been, and continue to be, more negative on the outlook for inflation as compared to the Fed and other central bankers, and have expressed serious doubts on the transitory inflation narrative that the Fed has recently backed away from. The U.S. has now registered the fastest rise in consumer prices in nearly four decades, and while we do expect inflation to moderate from these elevated levels, we are concerned that there may be a more persistent element. We expect yields to move modestly higher from current levels in the next 12 months as central banks tighten, which should cause the yield curve to flatten as shorter term rates rise faster than longer term rates. Corporate bonds continue to offer better value over government bonds based on their positive real returns and fundamentals. We continue to see corporate fundamentals steadily improving as companies generate stable and growing free cash flows, which is important for bond investors as it means more cash is available to pay coupons in a timely manner and the principal at maturity. High yield bonds may offer pockets of opportunities, but selection will be key due to the heterogeneity of this space. As we move forward, capital protection will become increasingly vital as the transition from dovish to hawkish central bank policies could incite further volatility in the markets. In addition, many equities will be sensitive to rising yields and investors have exhibited skittishness on any news that could negatively affect future growth prospects. Therefore, we believe fixed income will play a defensive role in portfolios heading into 2022 helping to cushion any pullback in equities while providing opportunities for incremental income.

Alternative assets offer compelling opportunities

Global commercial real estate returns saw a rebound in 2021, demonstrating the importance of portfolio construction through geographic and property type diversification. In the U.S., we saw activity pick up in the multi-unit residential sector of the Sun Belt region due to favourable in-migration patterns that should continue into 2022. In Europe, as the economy rebounds, logistic assets and essential retail should add value through strong capital preservation and income predictability. We expect global commercial real estate to deliver 7-10% returns in 2022 in local currency terms.

Global infrastructure returns in 2021 were also strong given rebounding economies amid loosening quarantine measures. Looking ahead, we see significant opportunity as the need for new infrastructure intensifies. Government commitments to decarbonizing economies has highlighted the opportunity in renewable energy and power infrastructure to meet net zero targets globally.

Within Canadian real estate, transaction activity rebounded significantly in 2021. Investor enthusiasm has been most pronounced for industrial and multi-family assets. Despite a prolonged pandemic, they are exhibiting strong fundamentals and a persistent supply/demand imbalance, leading to sustainable income growth and valuation support. Leasing activity has been picking up, and moreover, Canada's attractive job and population growth bode well for the sector.

Alternative asset returns lagged equity returns in 2021 but we see good income and growth opportunities in 2022. The inflation hedging characteristics of real assets should provide compelling risk-return characteristics for investors.

Loonie to fly high

Despite the gradual tapering of bond purchases by the Fed, it is expected to lag other central banks in its approach to interest rate policy normalization. The potential for interest rate differentials between the U.S. and other developed nations in 2022 could weigh on the U.S. dollar longer term. The Bank of Canada has been more hawkish than the Fed and is projected to raise rates at a faster pace. Coupled with strong commodity prices, this leaves us with a bullish view on the Canadian dollar over the next 12 months.

We know 2021 was a struggle for many, managing work and family life and the concerns around COVID-19. The widespread success of vaccinations and treatments, strong job growth, resilient consumers, and continued government support, have certainly helped lessen the impacts of the health crisis. While we may not be out of the woods yet, we believe we are better prepared to handle material setbacks as we move towards normalcy. At TDAM, our passion and commitment to investment excellence should help us drive long-term returns and deliver on our clients' investment goals.

Have a safe and prosperous 2022.