Market Perspectives Q3 2021

Driving Change and Growth Through ESG Investing

TD Wealth Asset Allocation Committee (WAAC) Overview

- We expect to see temporary inflation volatility, driven by accelerating global growth. However, we view this as more of a cyclical phenomenon versus a structural shift (longer term). As the higher year-over-year price comparisons (base effects) roll off, we anticipate that inflation levels will stabilize as economic activity normalizes.
- The combination of strengthening economic conditions, earnings growth momentum, and low rates, continues to reinforce our preference for global equites versus fixed income over the strategic horizon. However, the rate of return for equities is likely to moderate markedly compared to the previous twelve-month period.
- Beyond inflation, primary market headwinds include the uneven pace of vaccinations globally, the emergence of virus variants, the potential for higher personal and corporate taxation rates, and elevated relative equity valuations.
- We maintain an overall underweight bias to fixed income, but with a modest overweight to investment grade corporate bonds. We see value in certain segments of the credit market, despite significant spread tightening. Corporate bonds also provide a yield advantage to government bonds, which remain uncompelling due to their negative real returns.
- In our view, portfolio exposure to real assets has taken on greater importance to achieve higher relative returns at more acceptable volatility levels. Alternative assets, such as mortgages, infrastructure and real estate can also act as a hedge against inflationary risks.

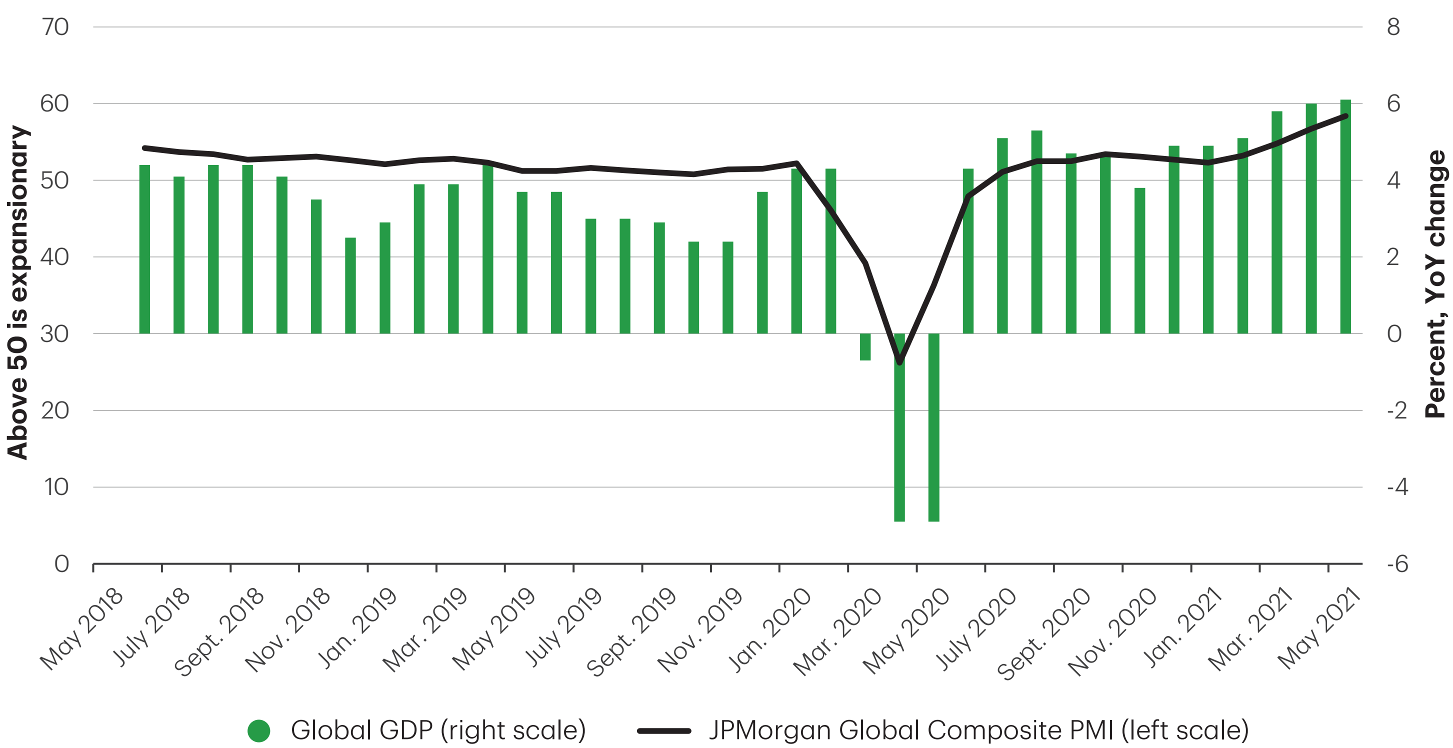
Second Quarter in Review

The TD Wealth Asset Allocation Committee ("we", "our") would be remiss to begin this edition of Market Perspectives without first reflecting on how much societies have progressed since the earliest days of the current health crisis. We know that there is still a great deal of healing to do globally, with some countries having more ground to cover than others. But we have greater confidence today that brighter days are on the horizon than we did twelve months ago.

Global vaccine efficacy remains largely positive. Hospitalizations are declining in many countries and the most vulnerable are now better protected from the virus. However, the dramatic outbreaks experienced in India and other nations in recent months have emphasized the need for improved coordination of vaccine distribution and support from peer nations. Progress continues to be made and we are optimistic that the health crisis will near its end in a matter of months.

On the capital markets front, the easing of lockdown restrictions continues to fuel a healthy investor appetite and sentiment for a broad spectrum of risk assets. Inoculation efforts, combined with extraordinary fiscal and monetary support, have provided significant fodder for economic growth, while also driving an impressive recovery in corporate earnings. Economic data releases have also pointed to strengthening underlying financial conditions. For instance, global composite Purchasing Managers' Index ("PMI") data, a closely watched measure of economic activity, remains broadly in expansionary territory while global Gross Domestic Productivity ("GDP") growth continues to show strong readings (**Chart 1**). Additionally, North American job creation has been strong for most of the year despite some recent signs of tapering. Much of the recent weakness in job creation can be attributed to difficulties in finding people to fill massive vacancies leftover from the pandemic.

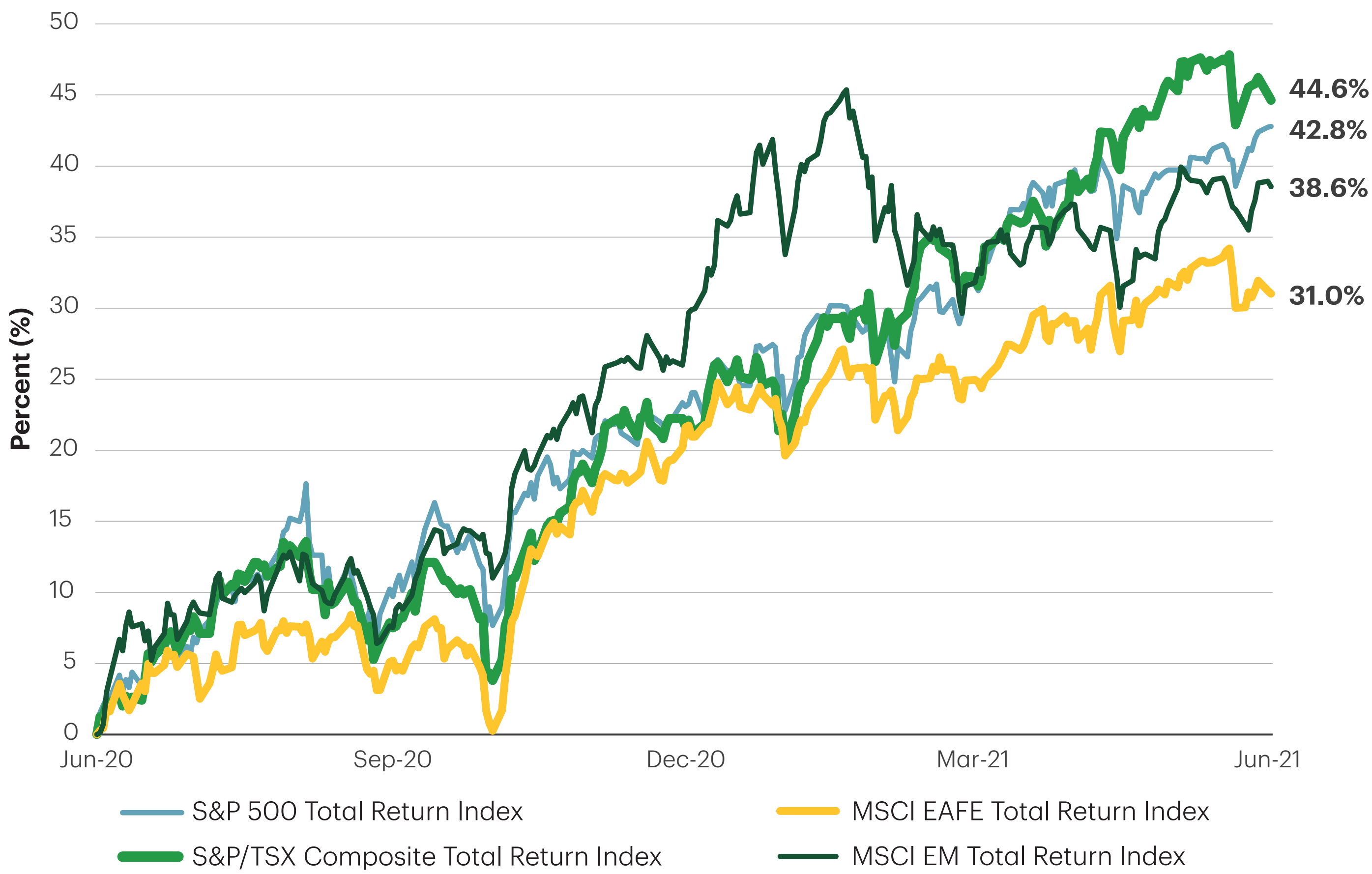
Chart 1: Global PMI and GDP Continue to Expand



Source: Bloomberg Finance L.P. As of May 31, 2021.

Overall, global stock indices advanced over the quarter (**Chart 2**) despite ongoing anxiety over inflation running hotter than expected, and equity valuations remaining near the high end of historical averages. These concerns were largely assuaged by increasing optimism over a surging global economy, combined with a strong corporate fundamental backdrop. As we have commented previously, near-term increases in inflation data should be viewed positively as it reflects healthy signs that markets are expanding. Price growth will likely remain in focus due to supply chain bottlenecks, driven by surging global demand, which has led to spikes in energy, commodities, housing and food costs. We believe the year-over-year price comparisons (base effects) may show high inflationary prints in the interim, as broad reopenings continue. However, in our view, we are nearing the peak of these impacts as the base effects are expected to wear off over the next few months.

Chart 2: Index Returns Over the Past 12 Months (based in USD)



Source: Bloomberg Finance L.P. As of June 29, 2021.

Broadly speaking, the current low rate environment reinforces our strategic preference for global equities, and alternative assets, over fixed income. For an in-depth perspective on our current views on key asset classes, as well as our strategic outlook over the next 12-18 months, please review the *WAAC Positioning and Outlook* section of this report.

Shifting gears, we would like to now shine the spotlight on what TD Asset Management Inc. ("TDAM") is doing as a firm to advance our ongoing commitment to embedding Environmental, Social, and Governance ("ESG") factors into our investment process to drive change and asset growth in a sustainable manner over the long-term.

Integrating ESG: On the Right Side of Change

ESG investing, also known as sustainable investing, takes into consideration both the sustainability and societal impact of a company or business. ESG continues to gain in popularity as people become more attuned to the vast socioeconomic disparities and climate consequences of inaction around the globe. We have all witnessed how a global pandemic can wreak havoc on nations, bringing to the forefront the immense inequalities that continue to exist in areas like health care and socioeconomic policies. Moreover, there has been a renewed focus on climate change as countries look to reduce their carbon footprints to meet stringent international targets amid increasing levels of pollution. ESG's popularity has stemmed from that reality, but also from the perspective of risk and opportunity. From a corporate standpoint, poor ESG performers will increasingly have more difficulty raising money in capital markets, may face higher capital costs, and may be negatively viewed by consumers, impacting their growth. At TDAM, ESG is therefore very much a fundamental part of our risk/ return evaluation of a company.

ESG investing, despite what some have traditionally believed, is not about sacrificing financial returns for personal values. For any investment consideration there are trade-offs, and the same is true for ESG factors; however, research shows that ESG does not detract from financial performance and in some instances may improve risk adjusted returns. A number of companies, often high-quality and stable businesses, are now putting more focus on ESG factors, driven largely by investor demand and increasing regulation. In addition, poor environmental or social stewardship can lead to bad press and legal liability that many companies seek to avoid in this era of social media, where a single misplaced tweet can drastically affect a company's stock price. As they say, the proof is in the pudding. ESG factor-oriented companies have shown similar performance with the market in recent years (**Chart 3**). More importantly, ESG funds may even offer lower market risk when compared to traditional funds[1].

Chart 3: ESG Stocks Can Offer Market Like Returns

Source: Bloomberg Finance L.P. As of May 31, 2021.

[1] Morgan Stanley Institute for Sustainable Investing. (2019). *Sustainable Reality - Analyzing Risk and Returns of Sustainable Funds.* Morgan Stanley. https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf

> **Our approach is** focused on investing in sustainable long-term assets through a risk-managed process. We integrate ESG factors into our investment decision-making across asset classes and engage with companies as active owners on issues that are likely to impact the long-term performance of an investment.
>
> —Priti Shokeen, VP & Director, TDAM

At TDAM, we remain committed to investment excellence and sustainable investing. Our philosophy has been to invest in sustainable long-term assets; accordingly, we have been attentive to ESG aspects of portfolio companies and assets both from a risk and opportunity perspective for a number of years. This journey was formalized as far back as 2008 when TDAM signed onto the UN Principles for Responsible Investing (UNPRI). Most recently, we have received an A+ rating in the last UNPRI reporting cycle.

Our investment teams across asset classes factor in ESG considerations when it comes to managing and selecting assets for portfolios, both from a risk and opportunity perspective. We have grown and will continue to grow our commitment to sustainable investing in order to continue excelling in this fast evolving space. We believe that greater attention to the following areas in ESG will add significant value in seeking long-term sustainable-growing assets:

- **Proxy Voting**
  Proxy voting is an invaluable tool used to solicit change within a company around ESG issues. Support for social and environmental shareholder resolutions can lead to meaningful change within a company or industry. At TDAM, we take our share ownership with a great deal of responsibility as fiduciaries for our clients. As such, we have implemented tools and guidelines that will systematically advance our approach to assessing ESG matters. For instance, the guidelines will generally recommend voting in favour of proposals that enhance ESG reporting, transparency and gender diversity. For the quarter ended March 31, 2021, we participated in 230 meetings and voted on 2,934 proposals. Of those proposals, we voted against management on numerous occasions where we felt there were concerns or areas lacking ESG considerations.

- **Management Engagement**
  We regularly engage with companies we invest in to highlight areas of concern and/or areas of potential improvements. To drive better management of ESG risks in our portfolio companies, in 2020, we engaged with 191 companies across portfolios. Topics included board composition (i.e. tenure, renewal, expertise, and diversity), aligning management compensation with shareholder returns, safety and environmental impact, climate change risk and energy transition strategy, cyber security, and efforts to establish sustainable practices through positive impacts on local communities and other stakeholders. In addition, we aim to apply our approach to all asset classes for consistency and focus on how boards address material and systemic ESG risks as well as ESG expertise.

- ### ESG Research & Analysis
  Measuring sustainability is a tricky business as there are no set standards in place and much of the information used to assess a firm's sustainability is provided by the company itself. In addition, ESG disclosures are currently voluntary, thus reliability remains a concern. Recent developments however should help change this. With growing consensus around sustainability reporting standards, and the emergence of entities such as the Sustainability Accounting Standards Board, the financial materiality of ESG issues is gaining some consistency in the market. At TDAM, we are supportive of these developments and will continue to supplement third-party research and scores around sustainability with our own proprietary methods for greater consistency and accuracy.

- ### Climate Action
  Climate action is expected to accelerate across various jurisdictions as many seek to transition to low-carbon economies. Furthermore, regulatory developments within certain industries and governments will further propel a secular divide between solutions-oriented companies versus the status quo. At TDAM, we aim to push our approach further by looking at macro sectoral effects of climate change and identifying investment risks and opportunities across different actively managed asset classes. We resolutely intend to participate in various initiatives to move the needle forward on climate action, like the Taskforce on Climate Related Financial Disclosures (TCFD). As supporters of the TCFD recommendations and end-users of TCFD reporting, we will be better equipped to evaluate and manage climate related risks and opportunities in our portfolios and ultimately better serve investors.

As data and markets reach new levels of maturity in ESG and sustainable finance, we will continue to advance our commitment to investment excellence by refining our approach on sustainable investing even further, including allocating resources to deeply integrate ESG across all asset classes at TDAM, and by acting as responsible stewards of capital through engagement with companies for better sustainable outcomes.

At TDAM, ESG is fully integrated into our sustainable investing approach and covers all our funds and managed assets. We favour engagement over exclusion; however, we do offer a number of ESG screened investment solutions for those that favour exclusion over engagement. For more information, visit our website at tdassetmanagement.com and access our Sustainable Investing page under the *Resources* tab.

Climate

WAAC Positioning and Outlook

Over the second quarter of 2021, we maintained our modest overweight equities and alternative assets bias, and our underweight to fixed income. We regularly review our positioning and make appropriate strategic adjustments as the environment dictates. We remain active in evaluating long-run return expectations for key asset classes, while relying on input from our network of experienced investment teams to deliver informed strategic views.

Equities

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

The longer-term global macro-outlook remains strong. Continued aggressive monetary and fiscal support from governments and global central banks should help sustain economic growth, and act as a tailwind for stocks. We also expect to see broader market participation across sectors, industries and geographies over the longer-term compared to the narrow leadership of companies that propelled markets higher during the pandemic.

U.S. corporate profits have been robust as S&P 500 Index companies delivered earnings significantly ahead of consensus expectations. We believe that positive earnings revisions and earnings growth momentum will continue into future quarters, but at more moderate levels, as a high bar has been set. Overall trends remain positive, as economic data points to an economy that is healing and expanding. U.S. Federal Reserve ("the Fed") officials, however, have indicated that the economy is still a long way from its target of full employment and has reiterated its commitment to its current dovish policies.

We expect improving fundamentals for the Canadian economy despite the continued stay at home orders for many parts of the country during the past quarter. Business activity is set to broadly accelerate as restrictions are lifted and vaccinations progress, which should unleash a consumer spending surge. We expect outperformance for the S&P/TSX Composite Index relative to the U.S. following an extended period of underperformance. A weaker U.S. dollar has also been positive for several Canadian sectors, including soft based metals, agriculture and both renewable and traditional fossil energy. Leadership within the Canadian equity market should broaden, with cyclically sensitive Financials and Energy potentially outpacing other sectors. Relative to the U.S., Canadian stocks continue to trade at a discount as measured by forward price-to-earnings multiples, creating attractive opportunities.

The global economic recovery, which started in Asia, and then moved to North America, is now taking hold in Europe. We expect Europe to see an acceleration in economic growth. The continent has ramped up vaccination efforts and cases have dropped significantly. As a result, restrictions are being lifted and Europe's higher exposure to more cyclically oriented sectors should act as a catalyst for a strong recovery in economic activity. From a strategic perspective, economically sensitive stocks in sectors like Financials, Materials, Energy, Consumer Discretionary, and Industrials appear attractive over their peers in the U.S. Europe is also showing vast improvement in levels of industrial production and manufacturing.

In China, growth appears to be slowing as monetary policy conditions tighten. However, the Chinese economy remains strong and equity valuations are attractive relative to developed markets. Strong global demand for Chinese exports should continue to provide a supportive backdrop for Chinese equities and its economy longer term.

Alternatives/Real Assets

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

Commercial mortgages continue to provide resilient income streams with the collection of principal and interest payments, while our portfolio exposure experienced zero impairments or defaults through the pandemic. Performance of commercial mortgages, which tend to have more modest interest rate risk compared to other fixed income strategies, have been well insulated from the significant interest rate volatility witnessed year-to-date. Despite volatility in sovereign yields, commercial mortgage spreads have been well behaved, inching down slightly year-to-date and trading near pre-COVID-19 levels. On an absolute and duration adjusted basis, the yield advantage offered through commercial mortgages versus corporate and universe bonds is near an all-time high.

Within commercial real estate, optimism is building in the U.K. and the U.S. as they have made significant strides in their vaccination programs, thus tilting these regions closer to a state of normalcy. Over the last year, grocery-anchored and essential retail has proven to perform well given their defensive nature. As economies reopen, investor sentiment has improved towards other retail assets as foot traffic has gained significant traction, particularly among enclosed shopping centres. As workplaces reopen, cities are witnessing progression towards increasing physical occupancy in offices across the globe, particularly in major Australian cities.

In Canada, transaction activity within the real estate market has rebounded and 2021 is expected to be one of the highest on record in terms of volumes. Canada is also forecast to lead all G7 countries in terms of employment and population growth over the next five years. These economic indicators should support real estate valuations across major markets. Looking at property types, the pandemic is accelerating trends in the real estate market that were already taking place pre-pandemic — namely the rise of remote working/telecommuting, and the growth of e-commerce. While uncertainty looms over the lasting impacts of the pandemic on the demand for office space, the fundamentals for high-quality, centrally located office assets in markets such as Vancouver, Toronto and Montreal remain healthy. Among retail property sub-types, enclosed shopping centres have been most negatively impacted due to government-imposed restrictions and periodic shutdowns; however, they continue to demonstrate their capacity to rebound after recessionary periods. Industrial and multi-family assets are seeing a significant rise from institutional investors. Both property types benefit from robust rental activity and strong fundamentals resulting in demand projections outpacing new supply over time.

Infrastructure continues to offer stable returns, with low correlation to other asset classes, and an imbedded inflation hedge through contracted increases in revenue. Momentum is gathering for new infrastructure projects as economies emerge from the pandemic and governments seek to bridge an enormous gap in required spending. Global initiatives such as the recently announced G7 Build Back Better World, and the recommitment to the Paris Accord, will require significant investments in new infrastructure projects. These initiatives, combined with the world's growing need to refurbish or build new infrastructure, are creating growth opportunities.

Alternatives

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			●		

The yield curve has steepened over the year driven by pro-cyclical trends, optimism over COVID-19 vaccines, and on forecasts for accelerating growth. The short end remains anchored, driven by dovish central bank policy. Longer term, our forecast is for yields to remain range bound near current levels or rise modestly higher; however, some volatility can be expected over the next 12-18 months.

From an absolute return perspective, the fixed income landscape has been challenging in 2021, but the rise in longer term yields should be viewed positively as it reflects expectations for stronger economic growth. Despite evidence of rising inflation, we believe rates will remain historically low as the Fed and other global central banks continue to incorporate accommodative polices with respect to interest rates and their balance sheets. While the Fed has not clearly stated that it will curb its bond purchasing program (quantitative easing) anytime soon, expectations are for tapering to occur over the coming quarters. Quantitative easing, combined with its other accommodative policies, has been credited for providing substantial liquidity and support for markets during the pandemic. The tapering of bond purchases is viewed as a possible precursor to an initial interest rate hike down the road, as it indicates a shift to a more hawkish policy stance. However, most consensus forecasts do not anticipate a rate hike until 2023. The Fed has expressed a willingness to allow inflation to run hotter than normal, in order for the economy to fully recover, before increasing rates.

The prevalence of low rates for the foreseeable future reinforces our strategic maximum underweight view toward global developed market bonds as real returns are likely to remain negative over the longer horizon.

Despite the significant recovery in corporate bond spreads from the dramatic widening during the peak of the pandemic, we see opportunity as corporate credit continues to provide positive real returns. The accelerating rate of the global recovery and vaccinations have provided a positive backdrop for credit markets. Investment grade corporate bonds provide a relative yield advantage, versus domestic government bonds, which remain uncompelling.

We are modest overweight inflation linked bonds, as they can protect against inflation and offer portfolio diversification benefits due to their low correlation to traditional fixed income and equities.

In high yield bonds, steadily improving fundamentals combined with constructive credit conditions means that high yield may offer attractive compensation for risk in specific sectors.

Fixed Income

Sub Classes

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

We remain modestly bullish the Canadian dollar. The outperformance of the Canadian dollar against the U.S. dollar has largely been driven by bond yield differentials due to the Bank of Canada's more hawkish stance and the recent boom in commodity prices. While we expect some of this to continue, we do not foresee the Canadian dollar appreciating significantly versus the U.S. dollar from current levels.

We retain a modest underweight view to the U.S. dollar versus global currencies. While a strengthening economy has provided some support for the currency, the prevalence of low government bond yields and a more dovish Fed will likely counterbalance the dollar's strength longer term.

Gold has trended sideways during the quarter, as surging inflation fears have subsided based on market expectations. As mentioned, our view is that the recent uptick in inflation is transitory, making the inflationary hedge characteristics of gold less appealing over the next 12-18 months. Gold prices are increasingly vulnerable to near-term pullbacks as speculative flows are now slowing alongside physical flows amid India’s battle against COVID-19 and waning Chinese demand.

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

Committee Members

Robert Vanderhooft, CFA
Chief Investment Officer,
TD Asset Management Inc.

Michael Craig, CFA
Managing Director,
TD Asset Management Inc.

David Sykes, CFA
Managing Director,
TD Asset Management Inc.

Robert Pemberton, CFA
Managing Director,
TD Asset Management Inc.

Ted Welter, CFA
Managing Director,
TD Asset Management Inc.

Glenn Davis, CFA
Managing Director,
TDAM USA

Kevin Hebner, PhD
Managing Director,
Epoch Investment Partners, Inc.

Brad Simpson, CIM, FCSI
Chief Wealth Strategist,
TD Wealth

Sid Vaidya, CFA, CAIA
U.S. Wealth Investment Strategist,
TD Wealth

Bryan Lee, CFA
Vice President & Director,
TD Asset Management Inc.

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