Purpose INVESTMENTS

Purpose "WHY" Report

Portfolio construction insights - Why we are tilted the way we are

Purpose Macro Investment Team

Craig Basinger, Greg Taylor, Nawan Butt, Derek Benedet, Brett Gustafson

6 March 2024

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Asset Allocation tilts - Why

Table of Contents

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			●		

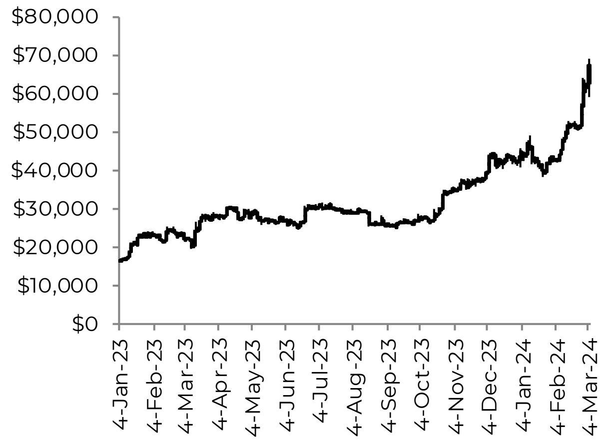
I. Chart(s) of the Month

Chart Referencing:
TL = Top Left, TR = Top Right
BL = Bottom Left, BR = Bottom Right

It took Japan 34 years to reach a new high

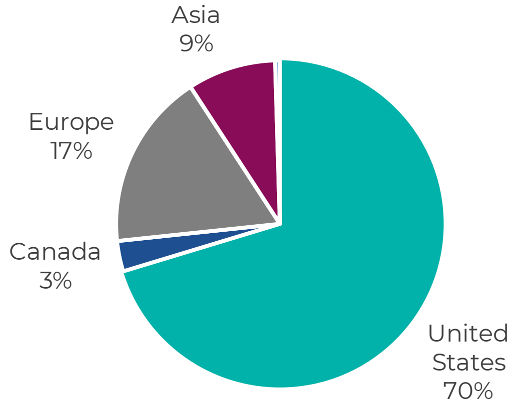
Source: Bloomberg, Purpose Investments

Welcome back Bitcoin



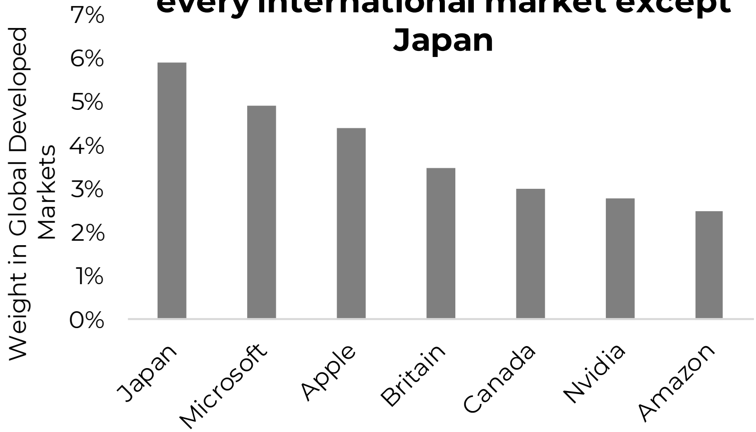
Source: Bloomberg, Purpose

Global Developed Markets - Does this look well diversified to you?



Source: Bloomberg, Purpose Investments

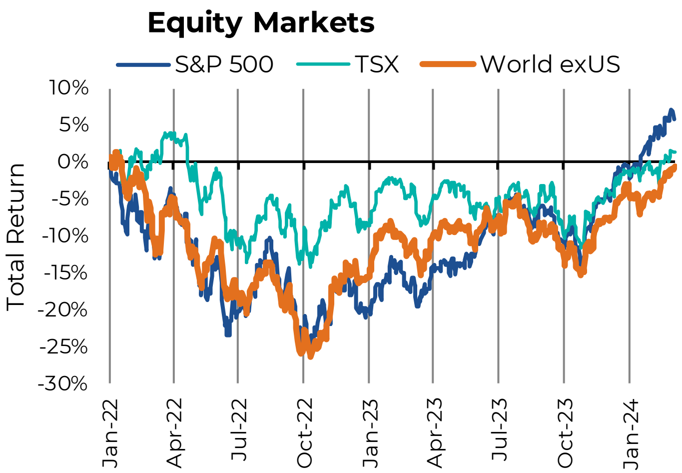
Microsoft & Apple are bigger than every international market except Japan



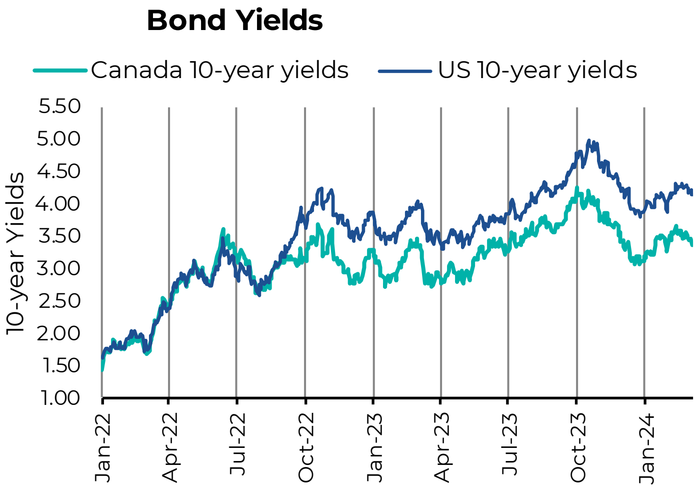
Source: Bloomberg, Purpose Investments

- TL – 'buy the dip' is popular in America, less so in Japan after the Nikkei took 34 years to recover to its previous all-time high
- TR – Bitcoin too reached a new all-time high, a level not seen since late 2021. The new U.S. listed spot ETFs have certainly attracted more buyers.
- BL – Does concentration equal a bubble? Probably not but worth noting the U.S. is now 70% of the global developed market index. It used to be closer to 50-55% years ago. And also peaked around 70% in late 90s.
- BR – Even more notable, Microsoft is bigger than Britain. It is a great company, but these megacaps are getting a tad ridiculous. All good as long as they continue to lead, good luck when they don't.

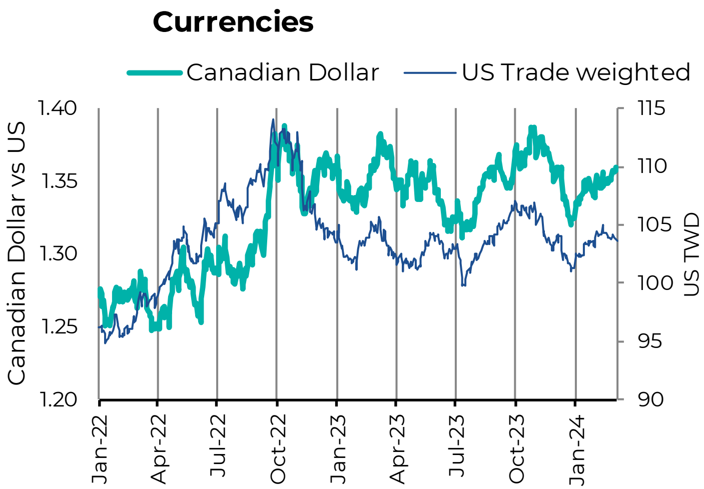
II. Markets



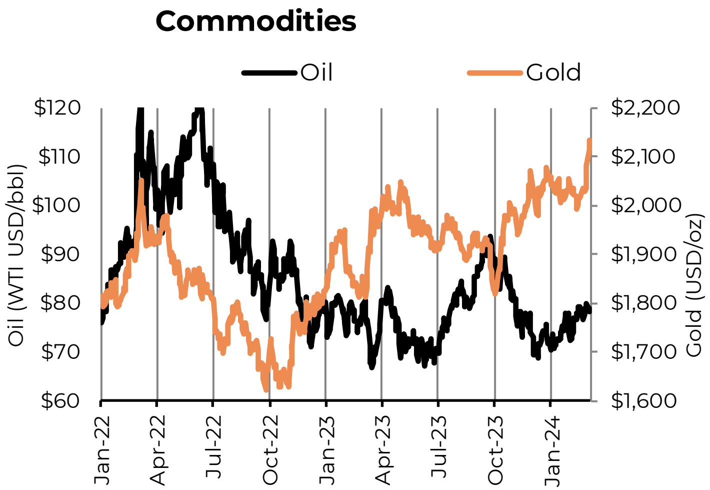
Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments

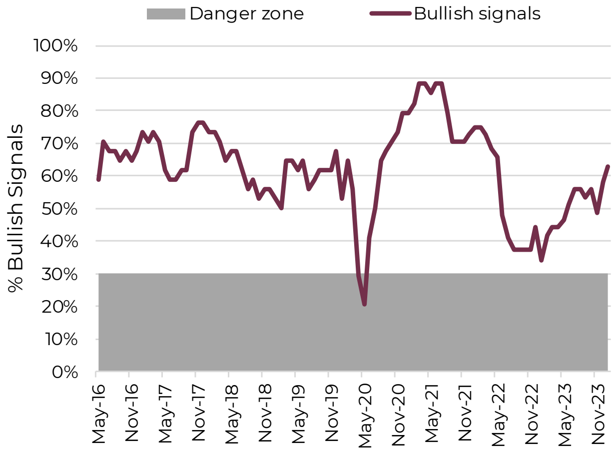


Source: Bloomberg, Purpose Investments

- TL – S&P +20% since October low. Japan +30%, Europe +20%, TSX +14%. Good economic data, many markets reach new highs.
- Rare to have such a strong advance in a 4-month period that wasn't coming out of a deeper bear market.
- TR – US economic data remains strong but global manufacturing data appears to be softening, with yields coming back down.
- BL – USD remains well bid with CAD softening due to lower growth in Canada.
- BR – Gold is flying higher, above $2,100/oz. Still no retail buying based on ETF flows. A rather odd advance given real rates are stable and USD is strong. Oil remains stuck in $70s.

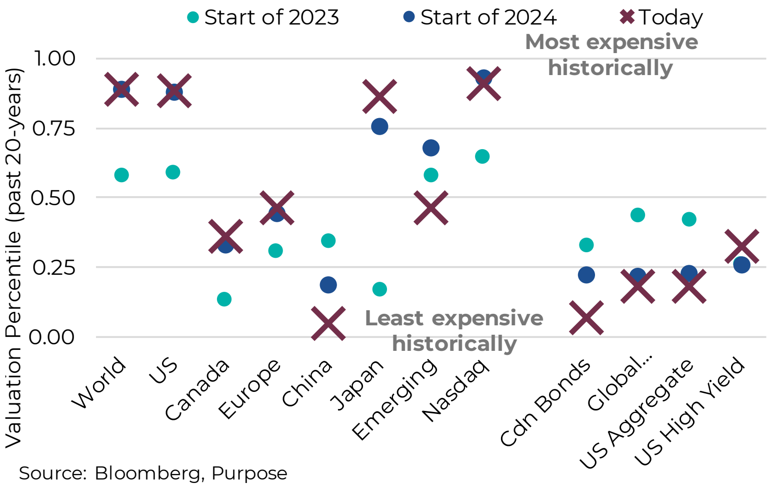
III. Why moderate underweight equity & holding more cash

Market cycle indicators - turning back up



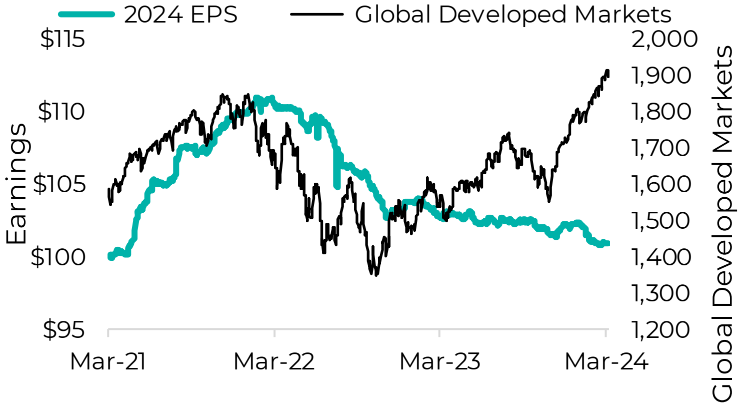
Source: Purpose Investments, Bloomberg

Equity valuations are high'ish, bond valuations are low



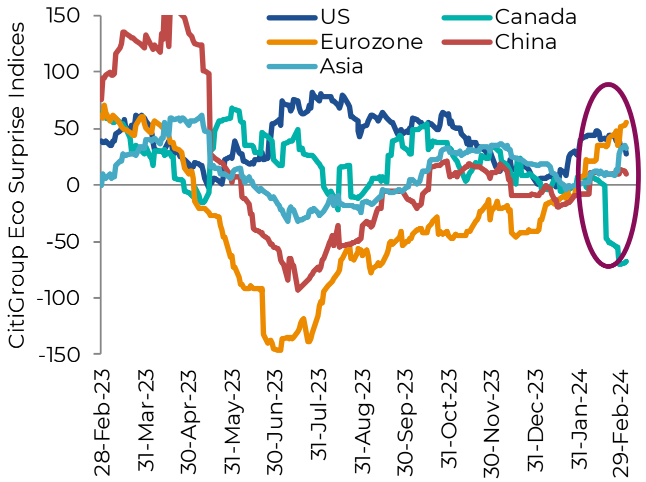
Source: Bloomberg, Purpose

Price up, earnings down is not a sustainable combination



Source: Bloomberg, Purpose Investments

Eco data: Canada poor, US rolling over



Source: Bloomberg, Citigroup, Purpose

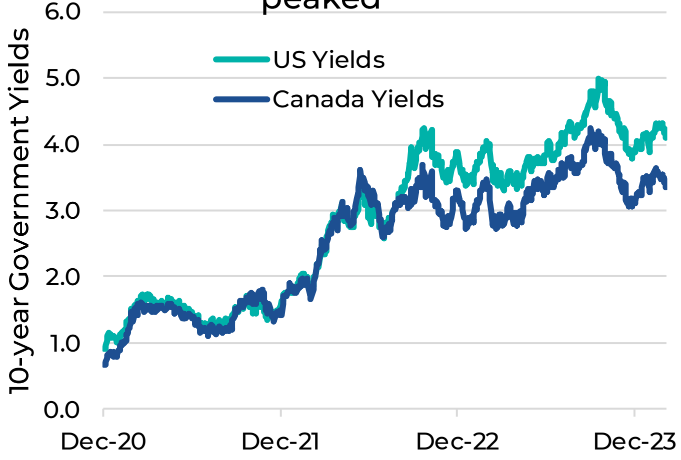
Balanced Equity: 52% vs 57% baseline, Cash 7% vs 2% baseline.

- Still at the party, but feel more comfortable standing closer to the door with a defensive asset allocation tilt
- While we remain impressed with American economic resilience, let's not forget UK, Japan, Germany, Canada all had negative GDP prints lately
- TL - Market cycle has improved, yet given valuations we remain titled cautiously.
- TR – No denying valuations are not appealing. US is skewing global valuations to the high side. More constructive elsewhere.
- BL – Issue is the rally over the past few months has come as earnings estimates have been falling. This is not sustainable.
- BR – while economy appears decent, Canada not so much and the U.S. data has started to soften relative to expectations.

Risks to our view – The U.S. and even global markets are now very concentrated in a few names. If this narrow exceptionalism continues, markets could continue to rise as has been the recent pattern. As this continues, risks are rising.

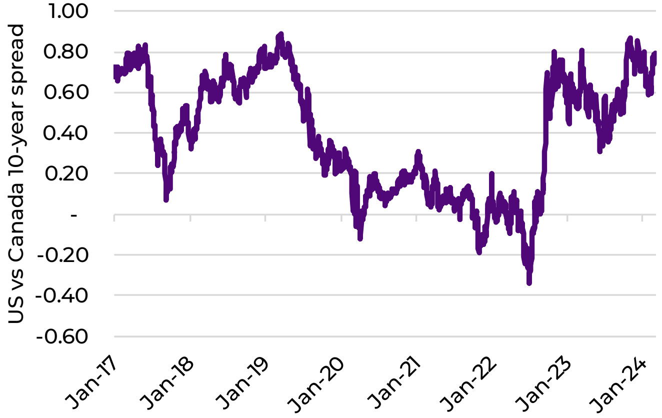
IV. Why overweight bonds

We believe bond yields have peaked



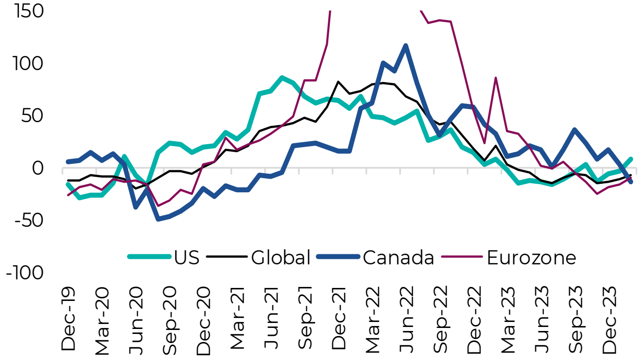
Source: Bloomberg, Purpose Investments

US vs Canadian 10-year yields



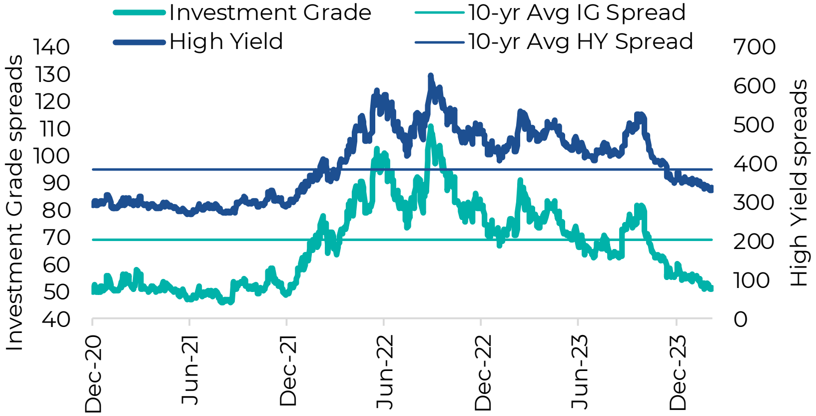
Source: Bloomberg, Purpose Investments

Citi Inflation Surprise Indices - US trend is troubling



Source: Bloomberg, CitiGroup, Purpose Investments

Credit spreads clearly pricing in a very optimistic world



Source: Bloomberg, Purpose Investments

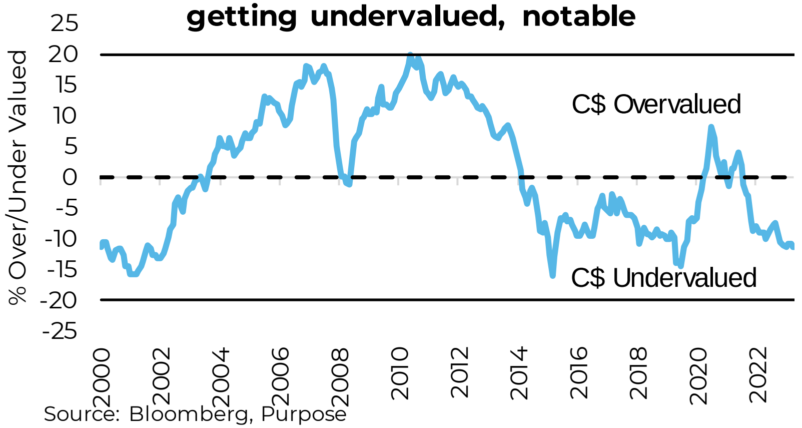
Balanced: Bonds 38% vs 36% baseline

- TL – We expect yields to remain rangebound for now. Inflation is proving stickier, large government issuance, better economic data will keep yields higher. While slowing growth should keep a lid on yields.
- TR – The spread of US vs Canadian yields is back to near term historical highs. Canada pricing in slowing economy, US starting to price in stickier inflation.
- BL – The uptick of U.S. inflation is a risk to bonds. Could be partly due to some reclassification on OER. But no denying stronger U.S. economic data is keeping inflation elevated.
- BL – On the credit side, while the quality is higher historical levels, spreads are still very optimistic. That doesn't leave much room for further improvement. Hence our tilt towards govies, or opportunistic exposure such as prefs.

Risks to our view – global trade has picked up a smidge of late, if this were to accelerate, inflation may arrest its decline.

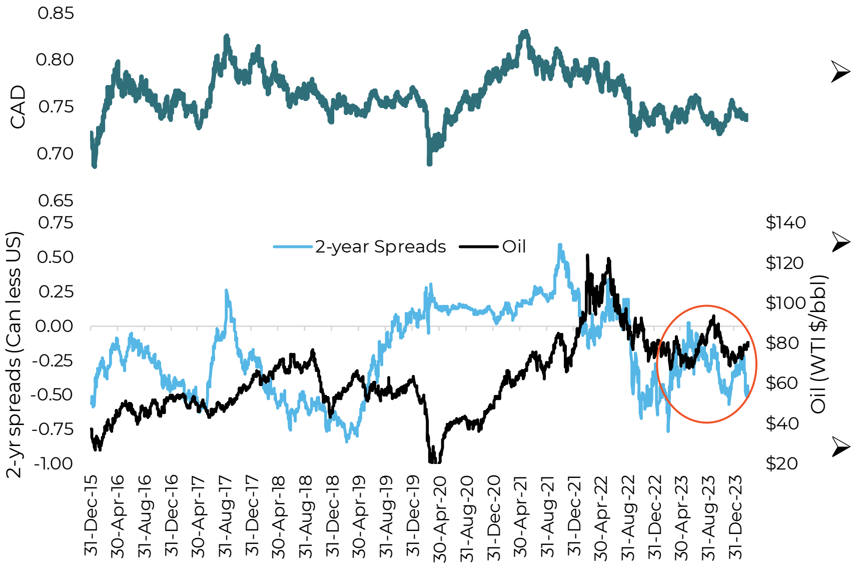
V. Why largely unhedged USD

Purchasing Power Parity has the CAD getting undervalued, notable



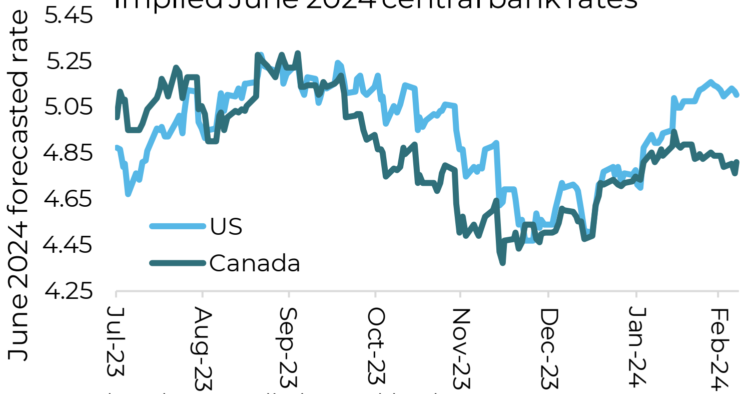
Source: Bloomberg, Purpose

Key CAD drivers remain rangebound



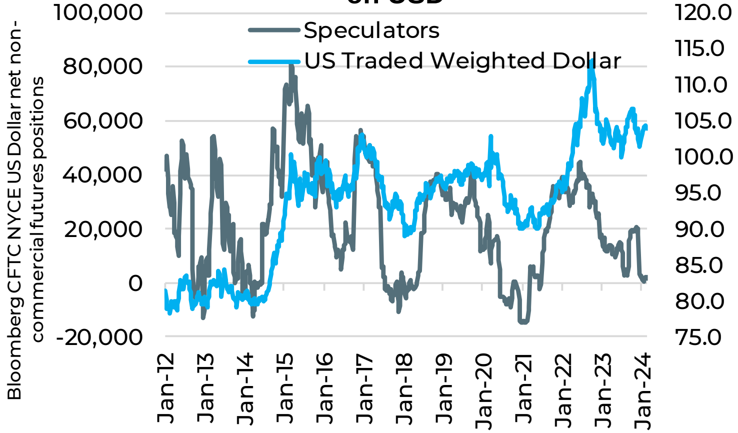
Fed and BoC expectations diverging

Implied June 2024 central bank rates



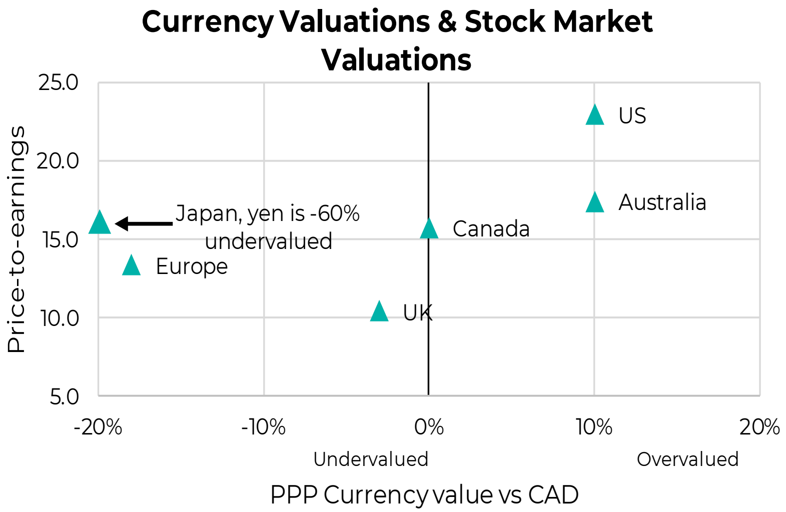
Source: Bloomberg, Implied central bank rates,

Currency speculators remain rather neutral on USD

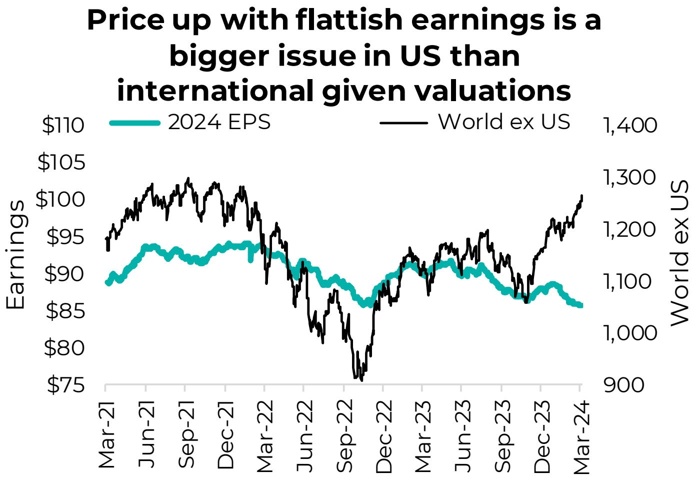


- TL – From a purchasing power parity point of view, the Canadian is undervalued and starting to look interesting. However we remain cautious for a few reasons.
- TR – Loonies remain rangebound versus the U.S. dollar. Key drivers are rate differentials and commodity prices like oil. For now, both remain rather stuck around current levels
- BL – Big moves in the USD are associated with changes in relative inflation rates and expectations of monetary policy rates. These are diverging between Canadian and US, favoring USD over CAD.
- BR- Futures market is largely neutral on the U.S. dollar at the moment. No major bets one way or the other. If it were extreme, we'd be inclined to take a contrarian view
- The U.S. certainly has the growth advantage globally, this should stick for now and the other primary reason why we prefer U.S. dollar exposure is that it is a 'risk off' currency. During period of heightened volatility the U.S. dollar gets stronger, which provided a natural hedge to Canadian investors.

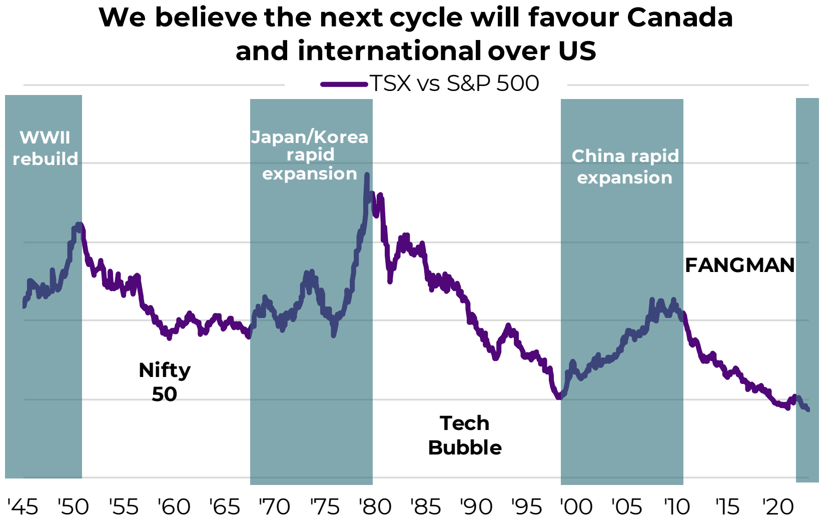
VI. Why overweight international developed, market weight Canada & underweight US equities



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments



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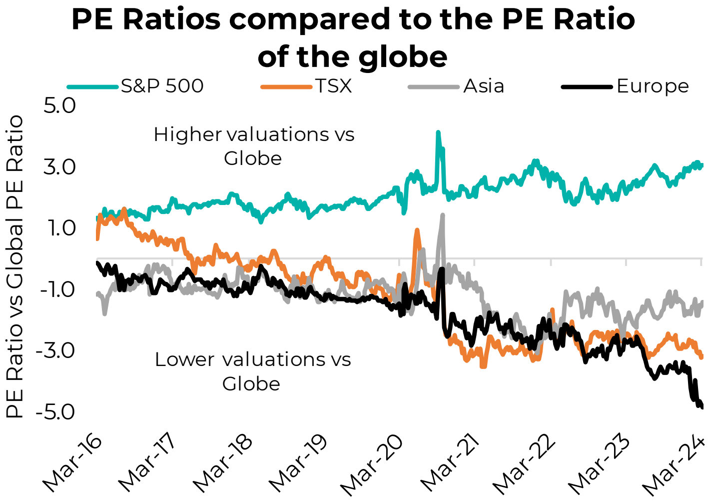


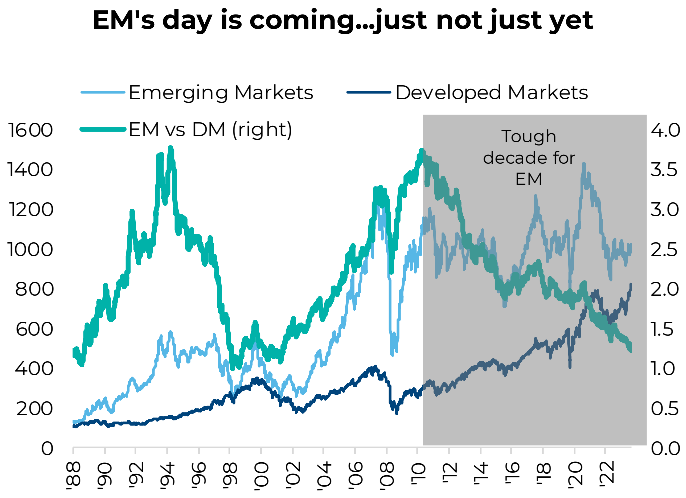
Source: Bloomberg, Purpose Investments

Balanced Equity: TSX 35% vs 35% baseline, International developed 39% vs 35%, US 26% vs 30%

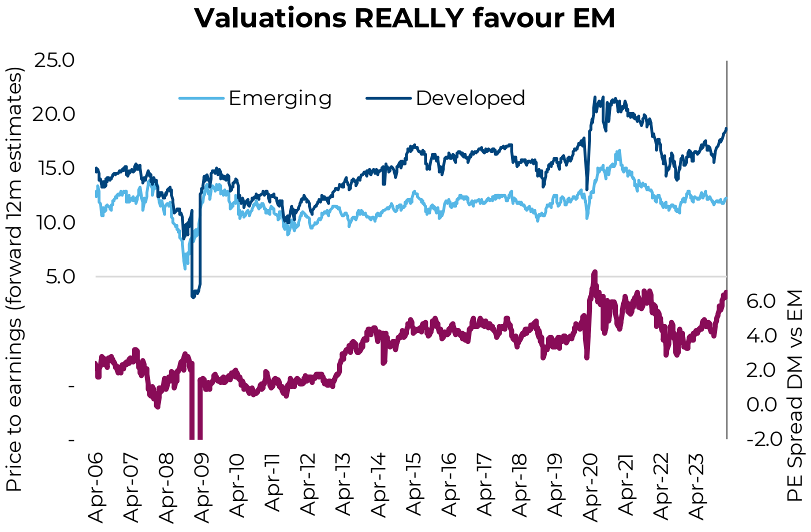
- TL - No question valuations favor international developed markets are cheaper than Canada and way cheaper than US. Add currency to the mix, it is even more compelling.
- BL – After years of US outperformance, table is set for a reversal….at some point
- TR – Rising stock prices and flat earnings is an issue everywhere. At least valuations are still low among international equities, this is a bigger risk for US market.
- BR – on a relative basis, valuations are really stretched.

Risks to our view – the obvious is if megacap tech is going to continue to lead, the US will outperform.

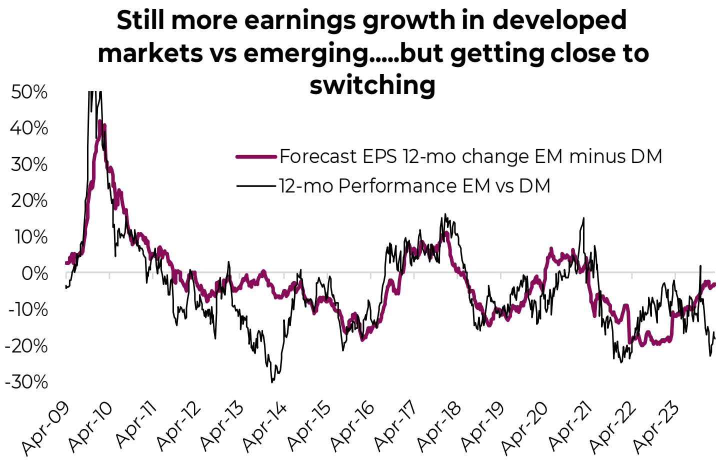
VII. Why almost no emerging markets



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments



Source: Bloomberg, Purpose Investments

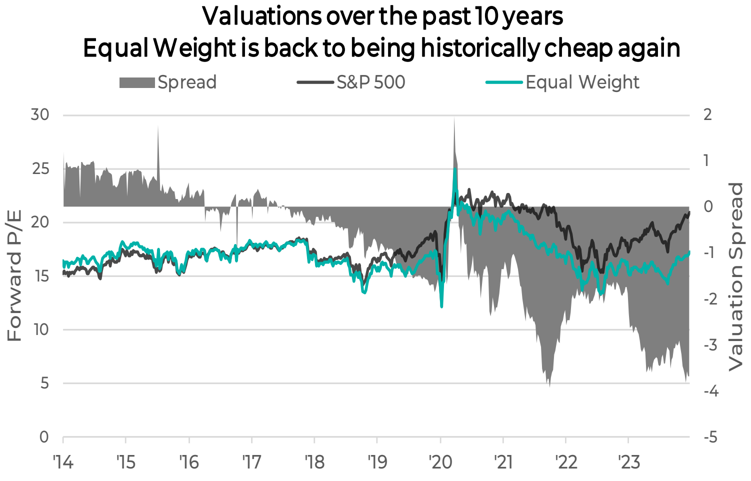
Source: Bloomberg, Purpose Investments

Balanced Equity Allocation: 0% EM with baseline of 5%

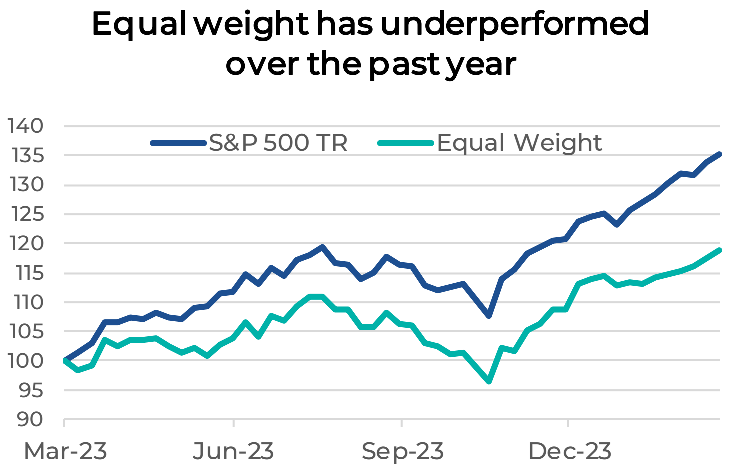
- TL – Past decade has seen EM flat while DM has performed well. Will this reverse someday?
- We are warming to EM
- EM typically does best when liquidity is improving, not tightening. That helps explain recent underperformance. Yet central banks are nearing an inflection point.
- TR – The valuation gap has recently spiked back to a FULL 6 points. That is pretty extreme. Safe to say valuations favor EM.
- BL – EM outperforms when earnings growth is higher then DM earnings growth. This is moving in the right direction, yet not reflected in price performance.
- BR – EM does better when global trade is growing....currently global trade is slowing but is starting to improve.
- Not convinced yet, but warming.

Risks to our view – There has been some uptick in global trade (exports in Korea, Taiwan) but still early to call a trend

VIII. Why equal weight U.S. equity exposure



Source: Bloomberg, Purpose Investments



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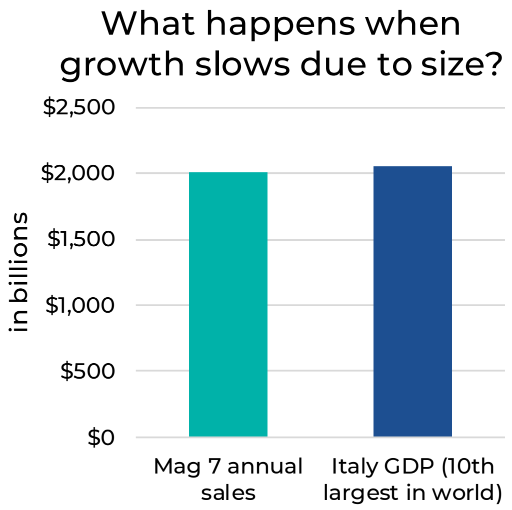
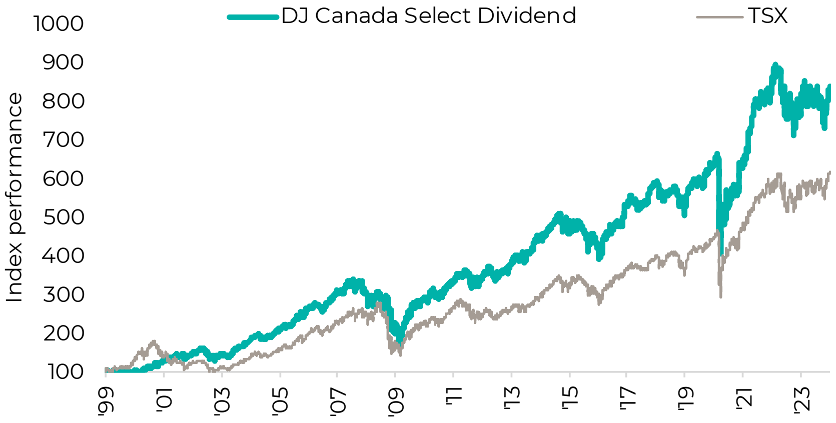


Source: Bloomberg, Purpose Investments

- TL - Equal weight index is attractively valued relative to the market cap weighted index. Spread is back to decade wide level
- TR - Equal weight has underperformed over the past year, after outperforming in 2022. Not surprising given majority of returns this year have been driven by so few stocks. Lots of concentration at the top end of the market. Works well when the big tech names do well. Less so when it doesn't.
- BL – Concentration risk has risen so much. Sales growth next year is the equivalent of Portugal's entire GDP.
- Given elevated recession risk, equal weight reduces sector concentration, increased diversification and avoids making any big capitalization bets.
- **Risks to our view** - While equal weight might be cheap, it is more cyclical. Many investors maintain confidence in the resilience of mega-cap technology stocks during economic downturns, attributing this to their robust fortress like balance sheets

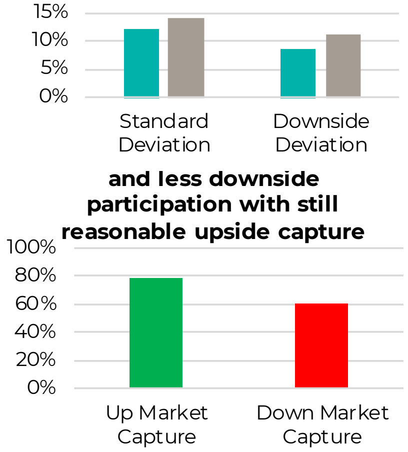
IX. Why dividend factor tilt

Dividend stocks dominance over the TSX



Source: Bloomberg, Purpose Investments

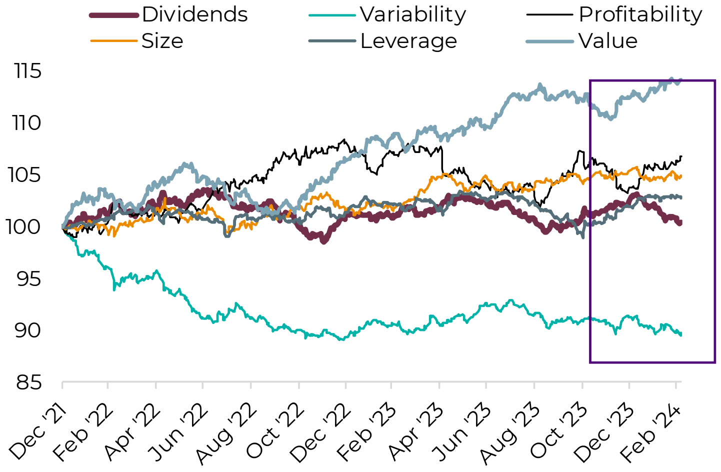
Dividend stocks offer added portfolio stability



1/3 of equity allocation are dividend focused strategies

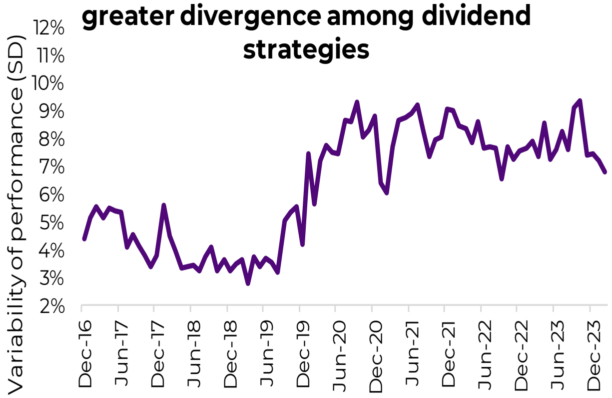
- TL & TR – given our view that a slowdown or recession is a higher probability risk, there is some degree of safety in dividend factor. Historically, less volatile, less downside and its cheap.
- BL – pure dividend factor has been weak, impacted mainly by oscillating bond yields. This will likely continue to be a dominant driver of performance, we do believe yields are unlikely to move materially higher. And valuations have become very compelling in the dividend space.
- BR - Varying factors driving performance has led to greater divergence among dividend strategies. This favors active dividend over static or even factor based.

Dividend & Variability are weakest factors of late



Source: Bloomberg factors for Canada, Purpose Investments

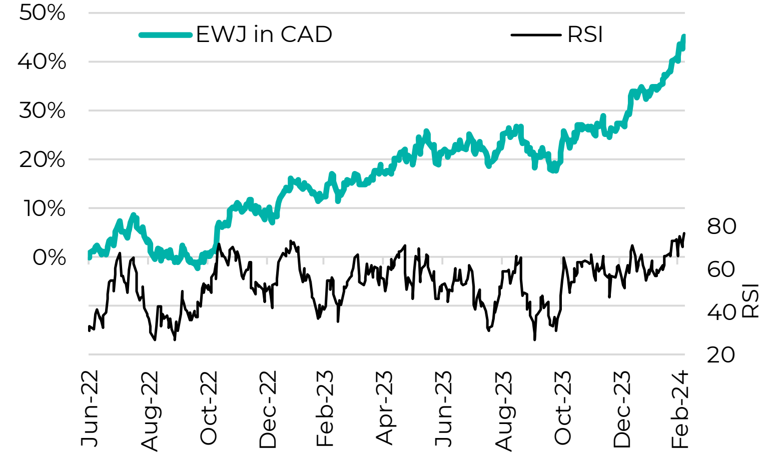
Changing yield world is leading to greater divergence among dividend strategies



Source: Bloomberg, Purpose Investments

X. Why Japan

Do we stay or do we go....we vote stay

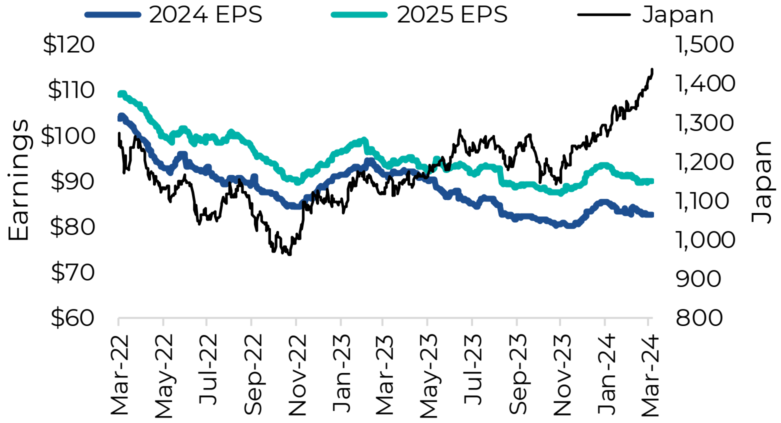


Source: Bloomberg, Purpose Investments

Yen remains very cheap

Source: Bloomberg, Purpose Investments

Earnings have ticked up over past few months. Currently pricing in 8% growth from '24 to '25

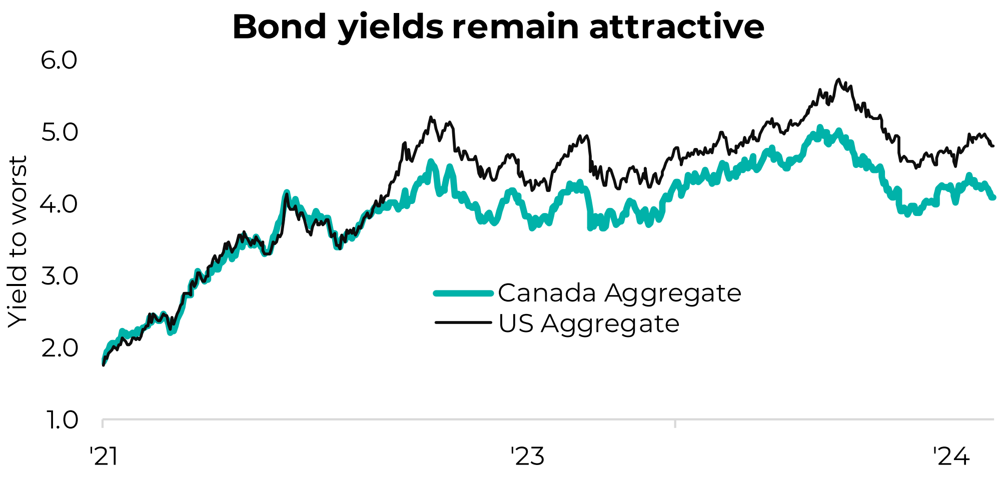


Source: Bloomberg, Purpose Investments

Overweight Asia Developed - Japan

- TL – Tilt has worked out very well, question is whether to reduce or maintain overweight. After strong price gains, valuations are more neutral.
- TR - Currency however remains very attractive, low yen. That is a huge advantage for exporters. And if / when BoJ backs off yield curve controls, we could see a sizeable appreciation in the yen.
- BL – Valuations are not as cheap as they were when we entered this trade, but at 16x ‘24 pretty reasonable. We do believe earnings growth should benefit from weaker yen.
- Corporate governance has been improving. And despite recent attention, Japan remains a chronic underweight among international equity managers and among domestic Japanese investors. In other words, there is lots of potential buying should this trend continue.

XI. Why duration of 5 1/2



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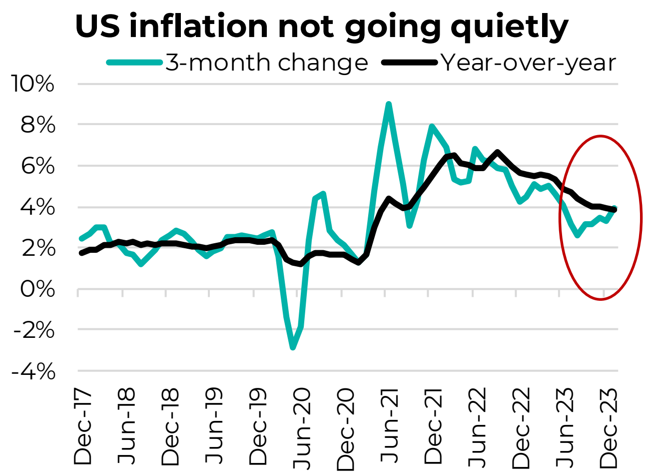
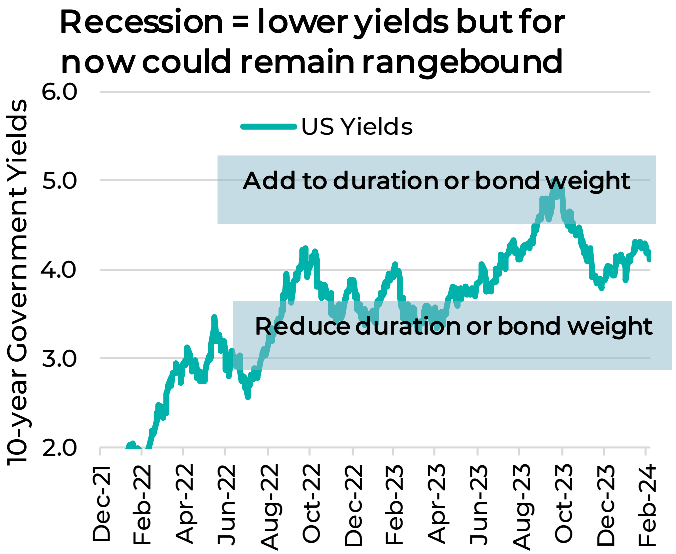


Source: Bloomberg, Purpose Investments



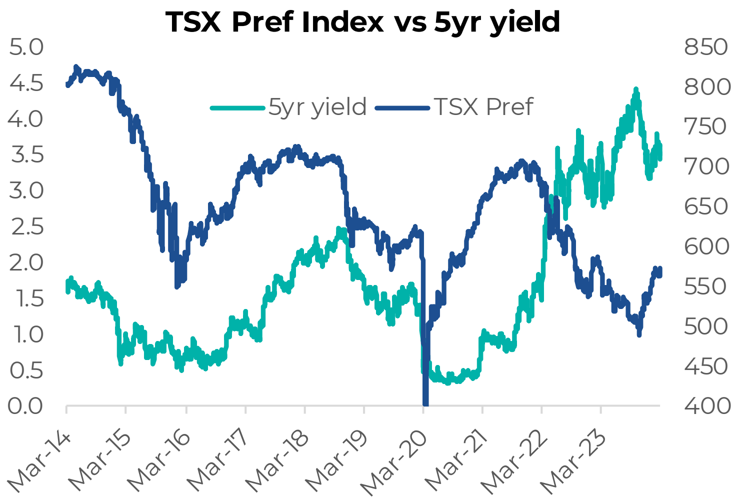
Source: Bloomberg, Purpose Investments

Balanced bond duration is about 5.5

- TL - We are constructive on bonds. With a yield of 4-5%, add some price appreciation given most bonds trading below par and decent single digits. If yields fall due to recession, even better, assuming reasonable credit exposure.
- BL - We do believe inflation will slowly come down further (not in straight line), weaker economic data will help central banks begin cuts. All great for bonds.
- BR - However could remain rangebound in the meantime due to more resilient US economy and issuance. Trade this range but make sure enough of an overweight in case recession does materialize.

Why not – The uptick in inflation is a risk. If instead of global economic weakness infecting the U.S., the U.S. resilience lifts the global economy, inflation will return and yields would move higher.

XII. Why preferred shares



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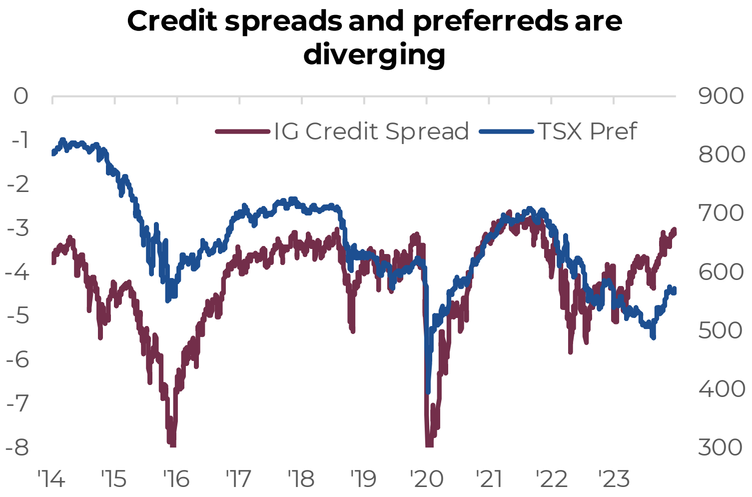

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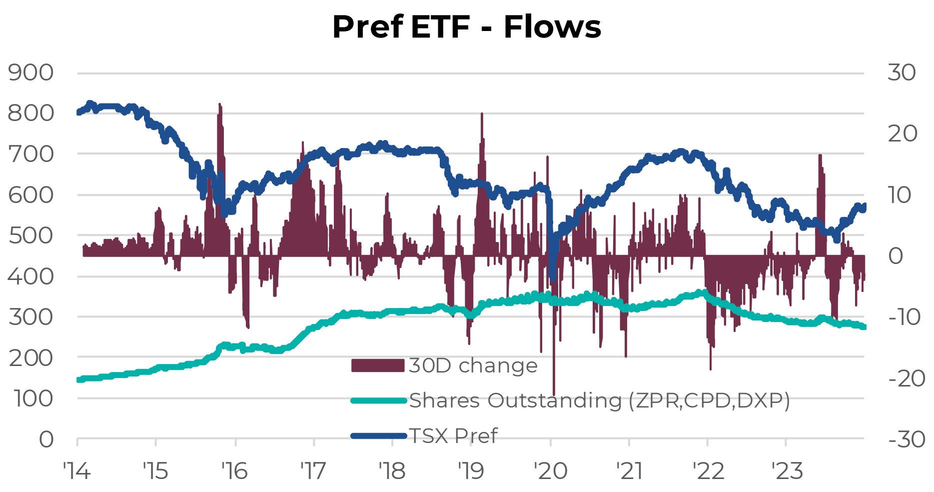
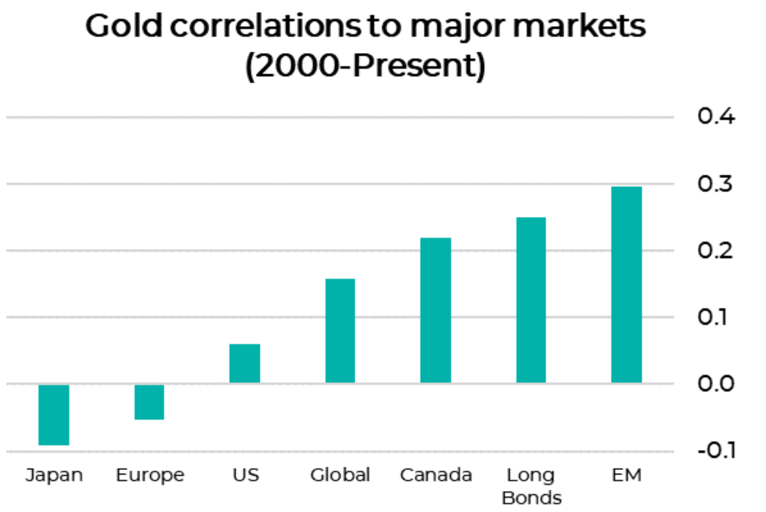


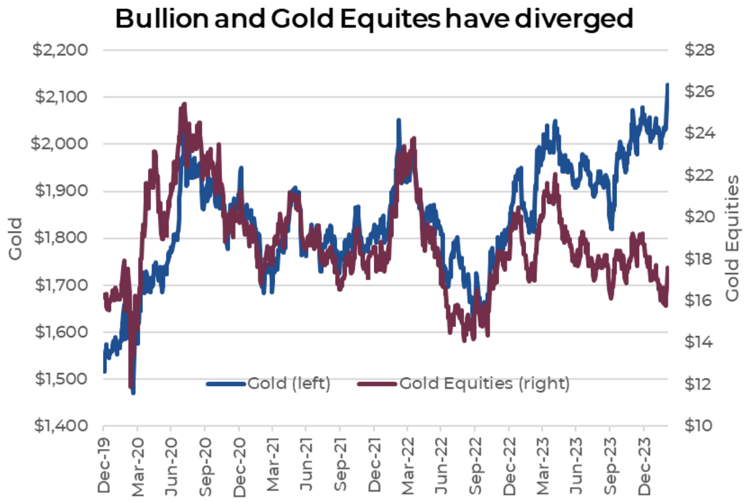
Source: Bloomberg, Purpose Investments

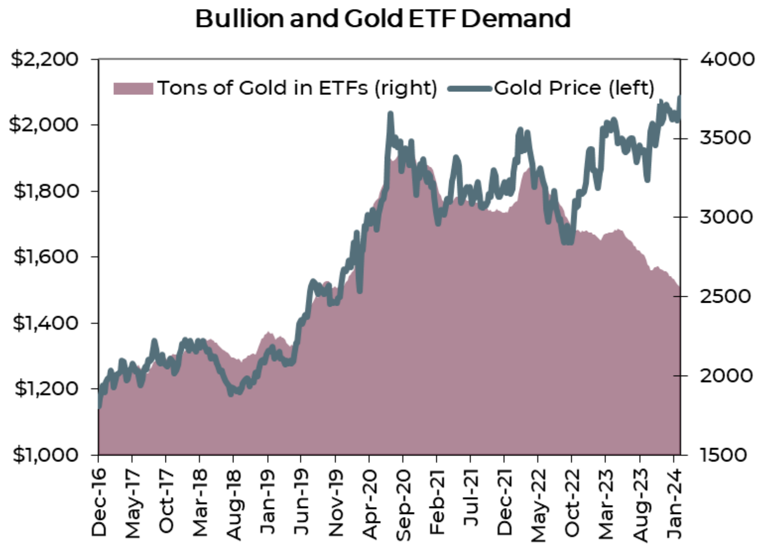
Balanced bond allocation: 7% prefs

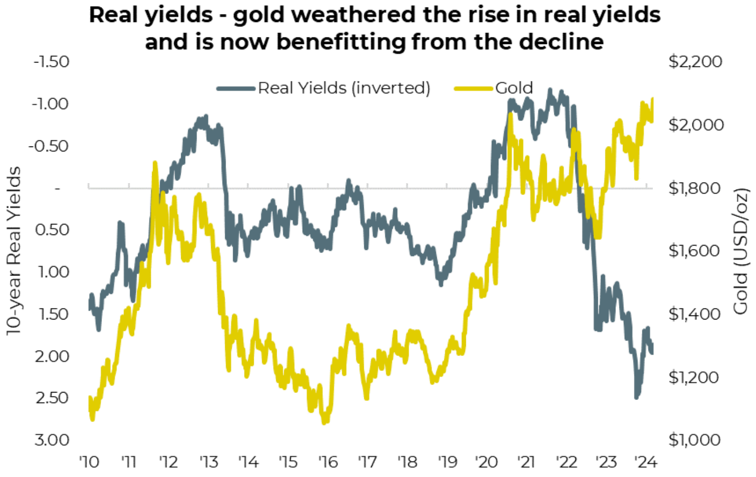
- High after-tax adjusted yields are enticing, especially for rate resets. Present an attractive opportunity for investors seeking income and potentially capital appreciation
- We believe the sweet spot in the pref market are rate resets. Those resetting in the near term are more likely to benefit from the elevated 5-year yields.
- Credit spreads and interest rates are the two primary drivers. Spreads are back near cycle lows contradicting current negative sentiment that still surrounds preferred shares
- Technical factors at play - fund flows turned positive briefly then negative again. We believe sellers will diminish.
- Why Purpose Canadian Preferred Share Fund specifically? First, we see its size as an advantage. Reinvestment risk is a real thing in the pref market given corporations deciding not to call their prefs. For smaller funds, such as RPS this risk is smaller.

XIII. Tilting gold exposure to more equities than bullion









Source: Bloomberg, Purpose Investments

- TL - Low or Negative Correlation: Gold historically exhibits low or negative correlation with other asset classes, making it an effective diversification tool to reduce overall portfolio risk. It plays a long-term strategic role enhancing portfolio efficiency.
- TR: Gold equities have diverged considerably from bullion. We believe there is considerable catchup room for miners given new highs for gold. Miners historically are a higher beta way to play moves in gold prices.
- BL - Central bank buying has supplanted retail ETF demand as a primary driver.
- Inflation Hedge: In addition to its diversification benefits, gold can act as an inflation hedge, protecting the purchasing power of an investment portfolio during periods of rising prices.
- Crisis Alpha: Gold has the ability to earn superior risk-adjusted returns during crises, counterbalancing the return stream of the rest of the portfolio when other assets become highly correlated in times of crisis.