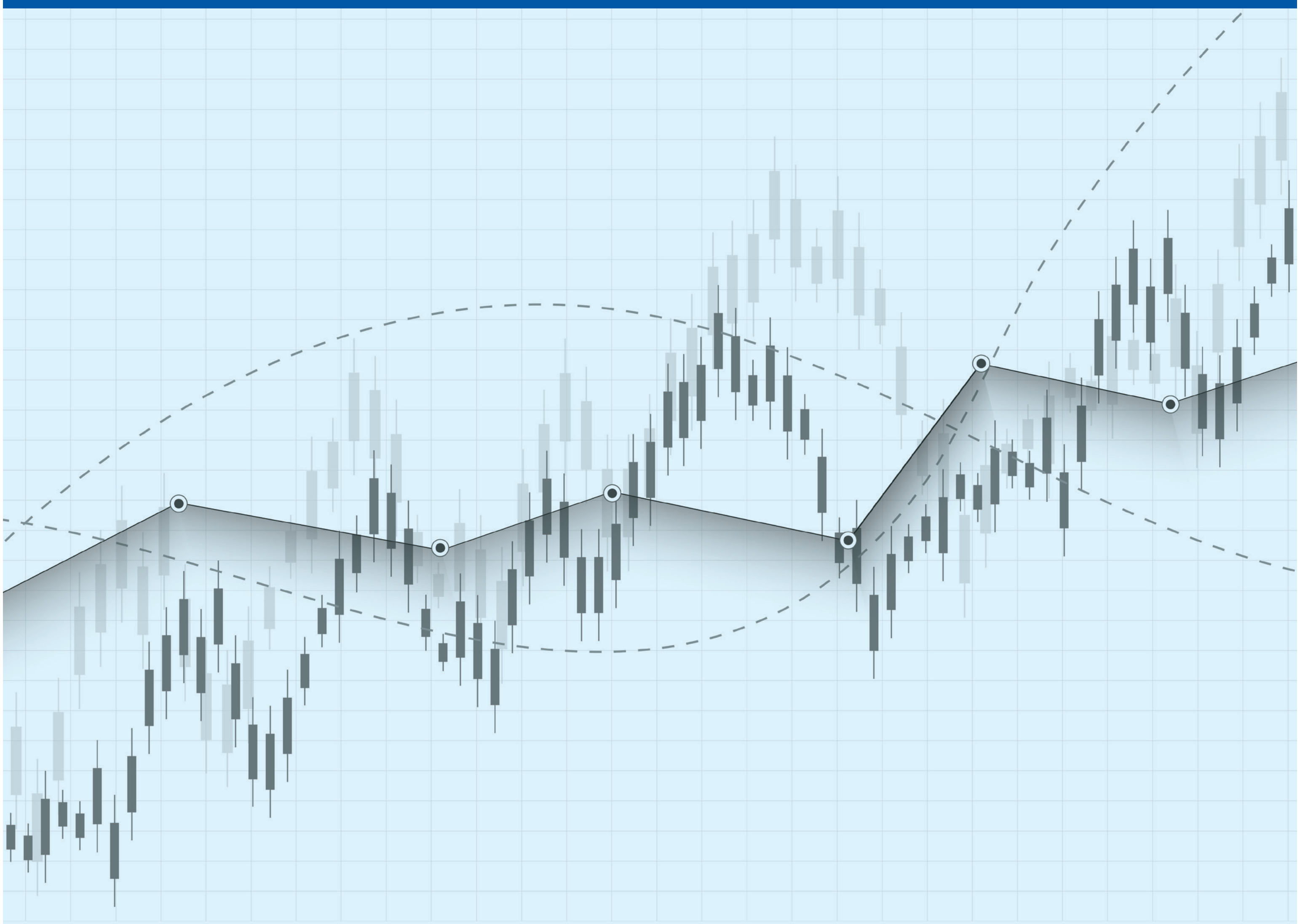
iA Clarington Investments

Perspectives on Market Volatility

August 6, 2024



iA Clarington Investments

Dan Bastasic MBA, CFA

iA Global Asset Management Inc.

IA Clarington Global Balanced Plus Portfolio
IA Clarington Strategic Corporate Bond Fund
IA Clarington Strategic Equity Income Fund
IA Clarington Strategic Equity Income Class
IA Clarington Strategic Equity Income GIF
IA Clarington Strategic Income Fund
IA Clarington Strategic Income GIF
IA Clarington Tactical Income Class

1. What is causing the volatility and how long do you think it will last?

- It is a combination of things that started several months ago with the predicted slowing of many economic variables that were the main catalysts for growth and stock market returns over the past two years.
- From a macro perspective, excess money supply has been steadily declining, while consumer assets, namely excess savings, have fallen below historical average levels.
- We also are in the beginning of a slowing employment picture, with job openings declining to near pre-pandemic levels and unemployment levels increasing.
- Lastly, from a credit perspective, banks have increased loan provisions with the expectation of increasing defaults as auto and mortgage delinquencies have increased.
- So clearly, many of the things that drove consumption in the last few years are moving to trend or below trend, which is calling into question market valuations.
- Market valuations, especially in technology, were at 20-year highs in the first half of the year and in many cases pricing in years of future growth. These assumptions have come into question given economic weakness.
- While the points above are in our opinion the main drivers of the recent market correction, other variables have helped to exacerbate the risks. One key factor is the unwinding of the yen carry trade, which has likely resulted in margin calls and forced selling in recent weeks. Another factor is the risk of a broader conflict in the Middle East. Finally, elevated market sentiment has given market participants a number of reasons to take money off the table.

2. How is this volatility impacting your mandates?

- Our mandates over the past couple of weeks have held up well with much less downside than the markets in general. This has much to do with our overweight to defensive, higher-yielding businesses in utilities, consumer staples and telecommunication services.
- We have reduced our technology weight over the past several weeks in particular, while extending duration in our fixed-income exposure to benefit from declining yields.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- We have not started putting our short-term elevated cash positions to work yet, as our belief is that the above-mentioned variables affecting recent stock market performance will likely not resolve themselves for at least a few months. There will likely be times where the markets rebound, but the underlying catalysts to drive a longer-term general market expansion are just not in place at the moment.
- We will increase our weighting to companies that we believe have not had any material changes to their business outlooks, including those in the utilities sector, select economically sensitive industrials names, and capital goods companies. We will likely wait for better macro data before adding exposure to securities related to energy and materials.

4. Where do you see the opportunities and risks going forward?

- The opportunities are clearly presenting themselves in higher-yielding defensive businesses given their stable cash flows and the likely positive impact on their valuations as interest rates come down. The risks are weighted towards a hard economic landing that would put into question earnings expectations and current valuations beyond the correction we have experienced in the past two weeks.

Matthew Eagan
MBA, CFA

Eileen Riley
MBA, CFA

David Rolley
CFA

Lee Rosenbaum
MBA

Loomis, Sayles & Company, L.P.

IA Clarington Global Balanced Plus Portfolio
IA Clarington Global Equity Plus Portfolio
IA Clarington Loomis Global Allocation Class
IA Clarington Loomis Global Allocation Fund
IA Clarington Loomis Global Equity Opportunities Fund
IA Clarington Loomis Global Equity Opportunities GIF

1. What is causing the volatility and how long do you think it will last?

- A confluence of events has driven market volatility over the past several days, with the VIX reaching levels seen only a handful of times over the last 15 years. Major drivers include:
  - **July jobs report released on August 2.** The payroll report came in weaker than expected and the unemployment rate ticked up to 4.3% (higher than market expectations).
  - **Big tech earnings during the week of July 29.** Expectations were very high, and while the results were not generally concerning, forward guidance was weaker than expected. Additionally, given comments by Alphabet Inc. and others, investors may be coming to the realization that adequate returns on the sizable investments being made in artificial intelligence may be years away, and the current valuations in the technology space are overdone.
  - **Bank of Japan tightening the target rate on July 30.** This exacerbated the yen carry trade unwind: an already appreciating yen was jolted higher by short JPY covering from levered investors that had been taking advantage of low rates in Japan to fund risk asset purchases elsewhere around the globe.
- These events drove many investors to reposition into cash and low-risk assets. Fears that the Federal Reserve (Fed) had kept monetary policy too tight for too long, combined with the carry trade unwind, caused a surge in demand for haven assets like U.S. Treasuries and intense selling of risk assets. Global spreads moved wider, U.S. Treasuries rallied, the yen rallied and the U.S. dollar weakened against the currencies of most investment-grade countries while gaining against popular emerging market and growth-sensitive currencies.
- It is hard to say with conviction how long this volatility will persist, especially with limited hard data releases in the coming weeks. However, we do expect continued near-term volatility until markets gain conviction in either a hard or soft landing.

2. How is this volatility impacting your mandates?

- Despite the August 6 rebound in many risk markets, we lack conviction that the volatility is over. As such, we have not made material changes to our portfolios. While risk markets have repriced a bit, we believe there may be additional volatility and more attractive valuations ahead. We are remaining patient and disciplined within our process and our mandates remain structurally unchanged compared to a week ago.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- At this point, we are waiting for more attractive entry points in risk assets before adding. We will be assessing individual securities as well as broader pockets of opportunity across sectors and asset classes as valuations adjust.

4. Where do you see the opportunities and risks going forward?

- While fears of a hard landing have increased over the past week, there are many data points pointing to a still-resilient economy. In other words, while the risk of a deeper economic downturn may have been highlighted by recent market moves, fundamentals have not meaningfully changed. Therefore, we think there will be opportunities to add risk assets in the future should a sell-off in credit and equities persist. Despite recent market action, most risk assets have still generated positive total returns on a year-to-date basis.
- One dynamic to watch is that global yields remain high, which could entice investors with liquid assets to enter (or add to) global fixed income as overall yield levels remain at the highest levels in more than a decade. Additionally, any intervention to bring calm to the markets ("the Fed put") could limit an opportunity to take advantage of our defensive positioning.

For definitions of technical terms in this piece, please visit iaclarington.com/glossary and speak with your investment advisor.

(24-1631) 08/24

iA Clarington™ Investments

INVESTED IN YOU.