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TACTICAL ASSET ALLOCATION COMMITTEE

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ASSET ALLOCATION VIEW

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Tactical Asset Allocation Committee

Asset and Market Survey

Economy — Robust recovery in US, but signs of deceleration elsewhere

The United States is now outperforming most other countries in its recovery from recession, and posting positive surprises across a wide range of economic indicators. Strong US retail sales could filter through to robust economic growth reports for the first and, possibly, the second quarters.

That retail strength could combine with high corporate operating leverage to finally stimulate what has remained a weak jobs market. The housing market also remains weak, and inventories recently spiked to nine months' supply despite the extension of a new-buyer support program. These two areas are key to a sustainable recovery and the Federal Reserve is expected to proceed cautiously on any monetary tightening late this year.

Leading economic indicators in other major economies are already suggesting a slowing in the recovery. These data will need close scrutiny for signs of emergent economic weakness in the second half.

Fixed Income — Gov't yields should stay low short term despite recent uptick

Disappointing recent auctions caused US Treasury yields to rise and raised the spectre of higher market rates snuffing out the recovery. However, in the short term*, the Fed is expected to continue anchoring low rates at the short end of the yield curve, while a benign inflation outlook will cap long-term yields.

High yield bonds remain one of the most attractive of any asset class on a risk-adjusted basis. Even a buy and hold strategy is expected to produce attractive returns over the next year, assuming no sharp drop in equity markets. But it has become much more of a trading market, with value to be added by rotating among securities as they move toward fair value.

Equities — Positive short term on strong fundamental backdrop

Positive economic fundamentals are providing a supportive environment for risky assets like stocks in the very short term. But markets and sectors vary widely in their attractiveness, with cyclical sectors and North American markets generally the most highly valued. The window for further gains looks narrow as a slowing recovery and normalization of earnings could combine with poor underlying structural economic factors to weaken sentiment later this year.

Emerging Markets — Slowing recovery

While some, like Brazil and Mexico, continue to surprise on the upside, emerging markets are furthest along the economic recovery path and showing signs of a decelerating recovery. Widespread drops in currency reserves indicate slowing demand for emerging market exports. China's upcoming announcement of its latest reserve numbers will be closely watched for an indication of how quickly this key global growth driver is decelerating.

Currency — Negative on US dollar; positive on euro, commodity currencies

The US dollar is expected to continue weakening – in the short term due to rising risk appetites and longer term due to structural economic problems. The euro

* "Short term" </= 6 months, "Long term" > 6 months

should recover against other majors now that Greece's debt woes have been resolved for the time being. The outlook for cyclical currencies like those in Asia and among commodity producers like Canada and Australia remains strong.

Commodities — Generally negative, except as play on USD weakness

Broadly these markets have been bid up to overvalued levels on speculation about the economic recovery. Only select values remain among some non-oil natural resources, particularly as a play on expected weakness in the US dollar, in which most global commodities are priced.

REITs — Should benefit from rising risk appetites

The rise in global risk appetites should boost REIT valuations as the liquidity premium demanded by investors in risk-averse environments comes off. As a play on real assets, REITs should also benefit from the weakening of the US dollar.

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