TD Wealth

High Dough

Portfolio Strategy Quarterly | Q2 2025

April 2025

En Bref

High dough.

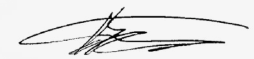
"When you blow at high dough" rings across the Canadian psyche and is probably as recognizable in the Great White North as "we stand on guard for thee." It's a call to avoid acting impulsively or carelessly when you have a lot riding on something, such as your life savings. It suggests a cautionary approach, urging one to be patient and not overstep the bounds of what's appropriate at a given stage, like what to do in the middle of financial-market volatility.

This seems like a great starting point for our Portfolio Strategy Quarterly for Q2/2025. Every hour brings in new tariffs, tweets — and new contradictions. It's like we are all living in a bread mixer and the power switch keeps getting intermittently turned on and off. What an environment we live in.

In a portfolio-management context, "Don't blow at high dough" means that tactical or dynamic shifts should only be made at the margin, in an intentional and risk-controlled manner. Remember, financial-market dynamics are driven by our interactions.

Sometimes it's good, in volatile times, to remind ourselves of how we think. This is evolution at the speed of thought. In times like these, investors need to be able to adapt, and adaptation is what we do.

Be well,



Brad Simpson
Chief Wealth Strategist, TD Wealth

Cracking Complexity

Complexity

What was old ...

The imposition of massive U.S. tariffs, estimated at 26% on average, may seem unprecedented. It's not. Nearly a century ago, President Hoover enacted tariffs, initially to protect farmers — in a move thought to have exacerbated the Great Depression. Now taxes are being raised to support manufacturers.

Selling America

The 90-day pause on U.S. reciprocal tariffs came after a significant move higher in Treasury yields. In the week following "Liberation Day," daily trading volumes averaged $1.6 trillion, up from $671 billion. The 10-year yield rose around 30 bps. The U.S. dollar index fell 3.6%. And the price of gold rose 3.6% to record highs.

45%

Our base-case scenario (i.e., what we believe is most likely, at 45% probability) anticipates a mild U.S. recession this year, with tariffs settling in between 10% and 25%. We think there's a 40% chance it could be better than this, and a 15% chance it could be worse.

$900 Less

Tariffs could increase the cost of living in the U.S. by $3,600 on average, while even the most ambitious tax-cut proposals would lift income by $2,700 — leaving Americans, on average, with $900 less in their pockets.

7.5%

U.S. inflation is expected to rise from 2.8% to anywhere between 3% and 4% by as early as Q2. If inflation were to hit the upper end of that range and remain there for a full year — that is, if the U.S. administration were to dig in on tariffs — it would lift the inflation rate to 7.5% by next year.

+76K > +1K > -33K

That's the trajectory of the Canadian jobs market of late, as hiring comes to a screeching halt. In January, a blockbuster 76,000 jobs were added. Then, a negligible 1,100 jobs in February. Then a decline of 32,500 jobs in March.

50% Defensive

Why has the S&P/TSX Composite Index performed better than the S&P 500 this year? About 50% of its composition is defensive in nature (financials, pipelines, telecoms, consumer staples, utilities) — making Canada the safe haven for once.

The Big "IF"

Economists agree that an ambitious U.S. tariff agenda could severely impact the global economy, but equity analysts don't yet think it will come to that. (Will the end result be less severe than proposed?) Estimates for 2025 and 2026 earnings growth remain in positive territory.

Adaptation

History, Not Headlines

News fed through a firehose of social media posts have led us to fixate on the latest headline, at the expense of deeper understanding. During times of uncertainty, it pays to broaden your perspective by heeding the words of trustworthy advisors.

High-odds Proposition

Over the long term, it's been almost impossible to lose money on the broad market. The probability of making at least some money on the S&P 500 over a five-year period is 85%; over a 20-year period it's 100%.

Process Over Prediction

We manage investments based on a guiding set of principles designed to work in a world that's constantly changing. We focus on investor's goals and true diversification. We build resilient portfolios that aim to perform regardless of the environment.

Remember the 10/10/10 Rule

How are you likely to feel about this in 10 minutes vs. 10 months vs. 10 years? Be patient. There's a reason it's considered a virtue.

Foursquare

There are four basic economic environments: rising growth, falling growth, rising inflation and falling inflation. Markets react as economies shift from one to another, but transitions are unpredictable and can be fraught with challenges. We don't predict the future, we invest in all four areas.

Adaptive Approach

The large majority of assets in any good investment portfolio should be allocated strategically, not tactically. That means adapting to challenges as they emerge, not positioning for challenges before they emerge.

Be Compensated

The goal of factor diversification is to reduce unintended risk exposures and target exposure to compensated factors while minimizing exposure to uncompensated factors.

Reason over Intuition

Propagandists have long used headlines to influence the populace. Now social media is reinforcing that influence a hundred-fold, and it's interfering with investment decisions. Trust the numbers, not the media.

PSQ2.2025 | Executive Summary

House Views

Fixed Income, modest underweight: The outlook for the Canadian economy remains uncertain as U.S. tariffs weigh on consumers and businesses. However, the Bank of Canada has flexibility to respond to a wide array of outcomes, including a reduction of the policy rate to provide support to the economy. As the monetary-easing cycle progresses, we expect bonds to provide diversification benefits, reduce overall portfolio volatility and preserve capital. **Equities, modest overweight:** Global equity markets have been volatile and under pressure over the past month as investors try to gauge the impact of the tariff situation, which remains fluid. We remain overweight equities because we believe some risks have been priced into the market and are constructive over the medium term. **Alternatives, modest overweight:** We believe that an allocation to alternative assets can benefit diversified portfolios, especially when implemented over the long term. Alternative assets can provide inflation protection and attractive absolute returns, while acting as long-term portfolio stabilizers via their diversification benefits and less correlated income streams. Given the nature of private asset classes as well as the present phase of value adjustment in several markets and asset classes, we believe that this may be an attractive time to increase or consider an allocation to alternative assets.

Quarter in Review

As of April 11, 2025, the first quarter was marked by rapid shifts in policy, market sentiment, and economic expectations. Tariff shocks, particularly post-February 1, led to volatility, decoupling between the U.S. and Canada, and fears of stagflation. Markets initially downplayed risks, but volatility surged in April, pushing yields higher and raising concerns about global investor confidence in U.S. assets. **A 'Wait and See' economy.** Leading indicators showed weakening sentiment in both the U.S. and Canada before tariffs hit, prompting cautious behaviour from businesses and consumers. Canadian small businesses reported record-low outlooks while U.S. corporate sentiment declined more modestly. Canada's labour market faces structural challenges tied to immigration and underemployment, though sectoral shifts point to rising productivity. Meanwhile, slowing population growth and proposed housing policies could ease affordability issues and spur investment ahead of elections. **Tariffs invite unprecedented volatility**. Tariffs rattled global markets, reversing optimism about a U.S. productivity boom and pushing the equity risk premium (ERP) sharply higher. U.S. stocks fell 8% YTD, reflecting rising risk aversion. Canada fared better due to higher ERP and dividends. Correlations surged, hurting diversification and active strategies. Defensive equity strategies, like low-volatility factors, offered some protection amid growing uncertainty and shifting asset class relationships.

Economics

The U.S. administration imposed a 90-day pause on reciprocal tariffs, dropping all countries (excluding China) to a flat 10% tariff. This comes in addition to the sectoral tariffs, including steel & aluminum and finished autos & parts. **We estimate the effective tariff rate in the U.S. to be 26%**, the highest level in over a century. However, this is skewed by the outsized 145% tariff on China. **Tariff announcements have been almost a daily occurrence, making it difficult to pin down assumptions** let alone a forecast. In the current state, we estimate the U.S. will expand just 1.2% this year but the bands around the forecast are larger than normal. **High and persistent uncertainty breeds recessions**. While we still feel the U.S. economy can skirt a recession, risks to the outlook are increasingly tilted to the downside the longer it takes for the administration to provide a clear operating policy framework for businesses and households.

Fixed Income

In the first quarter of 2025 the focus shifted away from monetary policy to the risk of slower economic growth and higher inflation. Given the high degree of uncertainty, most forecasts will have an extremely short shelf life. We expect volatility to remain elevated given the unprecedented nature of this environment and uncertainty around potential outcomes and policy responses. **We maintain our modest underweight view on fixed income overall** as we believe returns going forward will largely be in line with average historical levels and mainly composed of the coupon. **We hold a neutral view on domestic government bonds**. Canadian government bonds are attractive at current yields and offer opportunities for income generation and downside protection, but we expect yields to be volatile given the uncertain outlook. Importantly, Canadian government bond yields have remained highly correlated to U.S. government yields. **We remain modest overweight on investment grade (IG) credit**. IG spreads are still tight, and we believe Canadian IG corporate bonds, with their slightly wider spreads, are more attractive than U.S. IG. We expect softening economic conditions to widen spreads (indicating the market is pricing in more risk) but only by a modest amount unless the economic slowdown is more severe than expected. We remain focused on high quality credit—companies with robust balance sheets. **We hold a neutral view on high yield (HY) credit.** HY spreads are still tight post the recent widening, reflecting little premium for increased economic uncertainty. We expect HY spreads to widen further if the growth outlook softens although the improved quality of this universe and lower expected net issuance should keep spreads from returning to previous recessionary levels. We continue to favour the higher quality cohort of the HY credit market and floating rate loans.

Equities

In the wake of Donald Trump's re-election in November 2024, U.S. equity markets surged on expectations of pro-business policies, with the S&P 500 reaching record highs by February 2025. However, optimism quickly faded when Trump announced steep tariffs on Mexico and Canada in March, and broader tariffs in April. The market reacted sharply, with the S&P 500 dropping nearly 15% in three days — an event-driven bear market fueled by uncertainty rather than the tariffs themselves. A temporary reprieve on April 9 sparked a major rally, but volatility persisted, making U.S. markets headline-driven and highly reactive. In contrast, Canadian equities outperformed despite facing similar risks. Exemptions for compliant goods under the CUSMA helped Canada avoid the worst impacts, and the S&P/TSX gained 1.5% in Q1 2025. While Canada faces economic headwinds like weaker consumer demand, higher inflation, and job market shifts, its market remains attractive due to defensive sector exposure, solid dividend yields, and relatively lower volatility. Fiscal stimulus potential and strong institutions support resilience. In this uncertain trade environment, a tactical investment approach — avoiding panic selling and capitalizing on strength — is key for navigating ongoing market swings. **Is it too early to bet on international equities?** International equities outperformed U.S. markets in Q1 2025, driven by Germany's fiscal shift and hopes for broader EU stimulus. However, gains faded in April amid U.S. tariff threats and recession fears. Europe's economic recovery remains fragile, with contracting PMIs and industrial output, and China's slowdown adds pressure. **EM prospects amid the Sino-American tug-of-war.** Emerging-market equities outpaced global peers, led by a tech rally in China after DeepSeek's launch. However, concerns over China's structural slowdown and U.S. tariffs kept emerging markets underweight. April saw escalating tensions, with the U.S. and China imposing steep tariffs. These measures could slash GDP in key EM countries and disrupt global trade. While EM valuations remain near pandemic lows, offering downside protection. Investors are urged to stay selective and patient amid volatility.

Private Markets

Exit activity remains muted amid market uncertainty, favouring secondaries and preferred equity. **Private equity.** Private equity markets face headwinds from rising capital costs, muted exits and stagflation fears, driving demand for liquidity solutions like secondaries. With record-high LP-led sale volumes and rising evergreen retail capital, 2025 secondary transaction volumes may exceed $200 billion. A disciplined focus on middle-market buyouts with value-creation potential, co-investments, and diversified mandates remains key. As portfolio rebalancing pressures mount from market dislocations, preferred equity and innovative liquidity tools are gaining appeal.

Despite short-term challenges, long-term NAV growth, conservative valuations and strong GP performance offer resilience. Investors must align with funds that balance complexity, liquidity, and compounding potential while managing risks linked to illiquidity and market recalibration. **Private Credit.** Private credit stands out for its self-liquidating nature, steady cash flows, and resilience during market dislocations. Direct lenders played a key role in refinancing distressed debt and addressing maturity walls, especially as public lending options dwindled. PIK usage rose but remains manageable when used conservatively. Private credit now supports a growing share of refinancing activity, highlighting its strategic role amid tightening conditions and upcoming debt maturities. **Unlisted Assets.** The $21 trillion U.S. commercial real estate market faces mixed dynamics: office remains weak, industrial has softened, while apartments and retail hold steady. Since June 2022, office and retail prices declined, while industrial and apartments showed modest resilience. Investors favour data centres, industrial, and diverse rental housing over office and retail malls.

Currencies

Liberation Day sparked renewed volatility, threatening U.S. Treasuries, boosting gold and euro appeal, and challenging global risk sentiment and correlations. **The world in a nutshell.** The announcement of reciprocal tariffs unleashed volatility, marking a shift from U.S. exceptionalism. Trust is eroding, correlations are breaking, and global markets are repricing. The U.S. dollar faces downside risk versus G10 currencies amid trade tensions and weakening growth. **The Loonie: BoC saving its powder.** The Bank of Canada's steady stance supports CAD, aided by improving positioning and expectations of a weaker USD.

Commodities

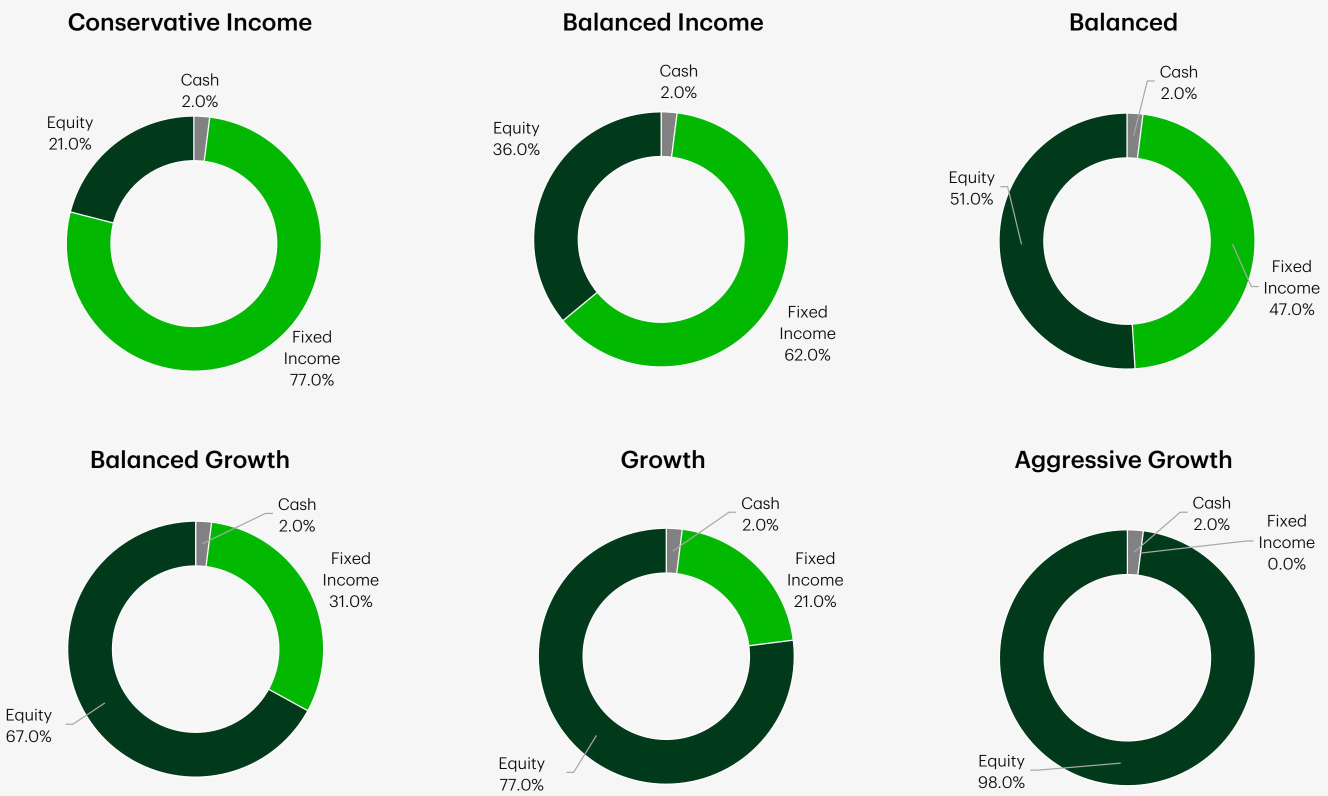
Commodity markets reflect fluctuating expectations around global economic growth, trade tariffs, and inflation, leading to swings in prices. Commodities serve as both barometers of economic health and hedges against inflation, reacting to policy shifts like new tariffs and reshoring efforts that disrupt supply chains. At the same time, fiscal expansions by governments worldwide are bolstering demand for raw materials. In the long run, structural forces—ranging from massive infrastructure projects and AI-driven energy needs to global supply chain reconfiguration—create enduring tailwinds supporting the commodity market outlook.

Figure 1: Direction from WAAC: strategic positioning

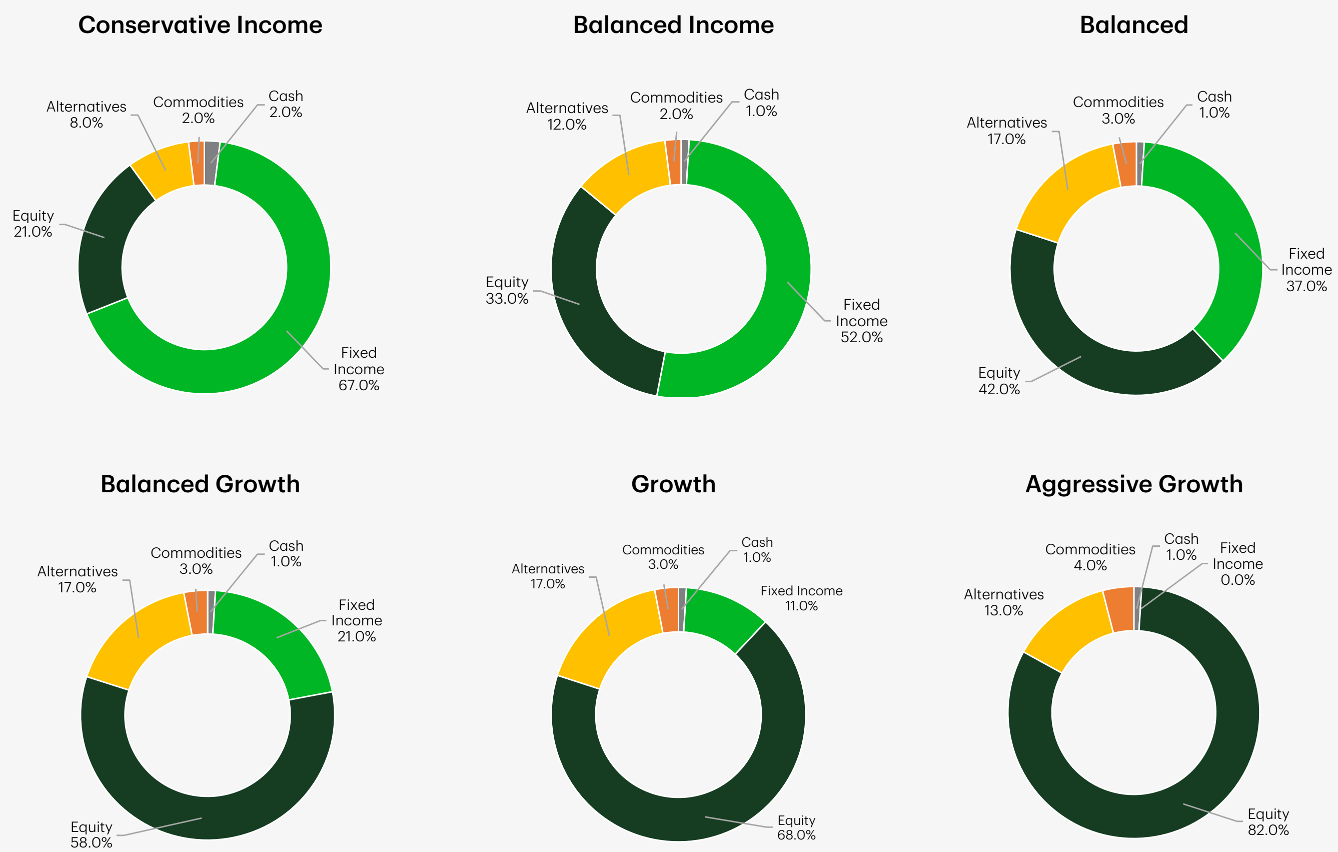
	Asset Class	Underweight		Neutral		Overweight
Cash & Equivalents Modest Underweight			●			
Fixed Income Modest Underweight	Domestic Government Bonds			●		
	Investment Grade Corp. Credit				●	
	High Yield Credit			●		
	Global Bonds - Developed			●		
	Global Bonds - Emerging		●			
Equities Modest Overweight	Canadian				●	
	U.S.				●	
	International		●			
	Emerging Markets		●			
Alternative /Real Assets Modest Overweight	Commercial Mortgages				●	
	Private Debt		●			
	Domestic Real Estate			●		
	Global Real Estate		●			
	Infrastructure				●	
Commodities Modest Overweight	Commodities				●	
Sub-Classes	U.S. Dollar vs Basket of Currencies		●			

Source: Wealth Asset Allocation Committee, as of April 24, 2025.

Dynamic asset-class weights by investor profile (Condensed)



Dynamic asset-class weights by investor profile (Expanded)



Strat: Strategic, Dyn: Dynamic. Source: Wealth Investment Policy Committee, as of April 24, 2025.

Summary | Q2 2025

In a portfolio-management context, "Don't blow at high dough" means that tactical or dynamic shifts should only be made at the margin, in an intentional and risk-controlled manner.

We manage investments based on a guiding set of principles designed to work in a world that is constantly changing. We focus on investors goals and true diversification. We build resilient portfolios that aim to perform regardless of the environment.

- U.S. hard data remains relatively resilient, in contrast to soft survey data. Fiscal stimulus will increase for the rest of world.
- We will continue to see sustained volatility in government yield markets while the shifting world trade scenarios play out.
- The most likely scenarios for tariffs are: (1) 10% to 25% on average – a significant increase in the average U.S. tariff rate, from around 3% previously; (2) They remain in place, and a recession happens; and (3) They remain in place in some volatile form while businesses and households continue to invest and spend, so the economy muddles through.
- We expect that we may continue to see questions about the safe-haven status of U.S. Treasuries, in spite of the diversification benefits that they will undoubtedly continue to provide.
- The fear of a global trade war has led market participants to think with their amygdala instead of their frontal cortex. Remember, over a 10-year period, it is almost impossible to lose money.
- We would classify this is as an event-driven bear market. Don't sell into panic; the market provides repositioning opportunities. An environment well suited for long/short and hedging strategies.
- Diversification into commodities is paying off.
- Things are changing fast, and the volume is high, but over the long run, diversification wins.

Our Positioning

Fixed Income | Modest Underweight. We expect only modest low-to-mid single digit total returns over the next 12 to 18 months. Nevertheless, against a backdrop of continued monetary policy easing, we expect that bonds will continue to provide stable income and preserve capital.

Equities | Modest Overweight. We expect positive earnings growth to continue to drive attractive relative returns over the medium term. We continue to have a bias for U.S. and Canadian equities. We continue to expect considerable volatility.

Alternatives | Modest Overweight. Alternative assets can provide attractive absolute returns at a time when financial markets are volatile.

- **Private Equity**: Environment continues to bode well for secondaries and curated preferred-equity structures that provide an off ramp for LPs and GPs.
- **Private Credit**: Look for healthy leverage, senior secured positions, low non-accruals, and payment in kind (PIK) for the right reasons, such as annual recurring loans to fast growing software companies or opportunistic credit.
- **Real Assets**: This category is very nuanced and based on specific assets and markets. We like portfolios that are focused on assets with structural tailwinds and constructive contracting.

Commodities | Modest Overweight. A changing world order provides an opportune environment for commodities. In addition, growing power demands from AI and the energy transition, and ageing infrastructure across the developed world are all tailwinds for commodities.

Market Performance

Canadian Indices ($CA) Return	Index	(%) 1 Month	(%) 3 Months	(%) YTD	(%) 1 Year	(%) 3 Years	(%) 5 Years	(%) 10 Years	(%) 20 Years
S&P/TSX Composite (TR)	103,771	-1.51	1.51	1.51	15.81	7.77	16.76	8.54	7.97
S&P/TSX Composite (PR)	24,918	-1.87	0.77	0.77	12.41	4.41	13.24	5.27	4.88
S&P/TSX 60 (TR)	5,096	-1.95	1.74	1.74	15.82	7.73	16.49	8.99	8.38
S&P/TSX SmallCap (TR)	1,518	2.56	0.88	0.88	11.08	1.68	20.11	6.13	4.16
S&P/TSX Preferred Share(TR)	2,163	-0.12	2.59	2.59	16.70	4.42	12.74	3.83	3.15
U.S. Indices ($US) Return									
S&P 500 (TR)	12360	-5.63	-4.27	-4.27	8.25	9.06	18.59	12.50	10.23
S&P 500 (PR)	5612	-5.75	-4.59	-4.59	6.80	7.40	16.77	10.50	8.11
Dow Jones Industrial (PR)	42002	-4.20	-1.28	-1.28	5.51	6.59	13.89	8.98	7.18
NASDAQ Composite (PR)	17299	-8.21	-10.42	-10.42	5.62	6.75	17.57	13.44	11.39
Russell 2000 (TR)	10917	-6.81	-9.48	-9.48	-4.01	0.52	13.27	6.30	7.55
U.S. Indices ($CA) Return									
S&P 500 (TR)	17769	-6.05	-4.37	-4.37	14.96	14.32	18.91	13.93	11.19
S&P 500 (PR)	8068	-6.17	-4.68	-4.68	13.42	12.57	17.08	11.90	9.04
Dow Jones Industrial (PR)	60382	-4.62	-1.37	-1.37	12.05	11.73	14.20	10.36	8.10
NASDAQ Composite (PR)	24869	-8.62	-10.50	-10.50	12.16	11.90	17.89	14.88	12.36
Russell 2000 (TR)	15694	-7.22	-9.57	-9.57	1.94	5.37	13.57	7.64	8.48
MSCI Indices ($US) Total Return									
World	17060	-4.40	-1.68	-1.68	7.50	8.10	16.67	10.07	8.51
EAFE (Europe, Australasia, Far East)	11939	-0.29	7.01	7.01	5.41	6.60	12.31	5.91	5.67
EM (Emerging Markets)	2939	0.67	3.01	3.01	8.65	1.91	8.38	4.11	6.44
MSCI Indices ($CA) Total Return									
World	24525	-4.82	-1.78	-1.78	14.13	13.31	16.99	11.46	9.45
EAFE (Europe, Australasia, Far East)	17164	-0.73	6.90	6.90	11.90	11.74	12.61	7.25	6.59
EM (Emerging Markets)	4225	0.22	2.91	2.91	15.34	6.82	8.67	5.43	7.36

Currency									
Canadian Dollar ($US/$CA)	1.44	-0.51	0.02	0.02	6.26	4.78	0.46	1.27	0.87
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	8583	-2.58	5.01	5.01	7.92	4.53	8.64	2.40	2.85
Hang Seng (Hong Kong)	23120	0.78	15.25	15.25	39.77	1.67	-0.41	-0.74	2.72
Nikkei 225 (Japan)	35618	-4.14	-10.72	-10.72	-11.77	8.58	13.49	6.37	5.74

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	2.64	2.61	2.97	3.23
U.S. Treasury Yields	4.30	3.95	4.21	4.57

Bond Indices ($CA Hedged) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada 91-day Treasury Bill Index	476	0.27	0.83	0.83	4.49	4.04	2.51	1.77
FTSE TMX Canada Universe Bond Index	1193	-0.28	2.02	2.02	7.65	2.50	0.88	1.77
FTSE TMX Canada All Government Bond Index	1117	-0.36	2.09	2.09	7.25	1.86	0.07	1.38
FTSE TMX Canada All Corporate Bond Index	1466	-0.05	1.81	1.81	8.84	4.38	3.19	2.86
U.S. Corporate High Yield Bond Index	305	-1.15	0.65	0.65	6.47	4.03	6.59	4.26
Global Aggregate Bond Index	261	-0.54	0.81	0.81	3.37	0.72	-0.10	1.49
JPM EMBI Global Core Bond Index	538	-0.92	1.70	1.70	5.14	1.78	2.53	2.20
S&P/TSX Preferred Total Return Index	2163	-0.12	2.59	2.59	16.70	4.42	12.74	3.83

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of March 31, 2025

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