Global
Medium-term Scorecard

The scorecard reviews the directional impact of economic indicators ranging from structural trends like geopolitics and the regulatory backdrop to cyclical dynamics and global adjusting forces on the three key primitives—growth, inflation and interest rates. This is compared to our assessment of what the market is pricing in for these factors.

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<th>Ontario Teachers' Bias</th>
<th>Relative to Market</th>
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<tr>
<td>Structural Trends</td>
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**Ontario Teachers' Bias**
- Structural Trends
  - Secular Growth Drivers: +/–
  - Capital Flow Cycles: +/–
  - Investment Cycle: +/–
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  - Credit Cycle: +/–

**Scorecard**
- Growth: +/–
- Inflation: +/–
- Discount Rate: +/–

**Ontario Teachers' Global Macroeconomic Framework**

The Teachers’ Tri-Cycle

- Structural Trends
- Cyclical Dynamics
- Adjusting Forces

**Eyes on the World**

Our competitive edge stems from our unique access to key global decision-makers and a diverse platform of portfolio companies. This unique information gateway informs our view of the world, and provides a benchmark against which our global outlook (and associated risks) for growth, inflation and the discount rate (interest rates) can be judged. The underlying views are forged by an analysis of the interconnections between three key pillars of the economic infrastructure (namely the structural trends, cyclical dynamics and global adjusting forces) that shape the medium-term outlook for the global economy and financial market performance.

**The Analytical Framework**

- The Competitive Edge
  - Portfolio Companies
  - Hedge Fund Partners
  - Research Community
- The Teachers’ Tri-Cycle
  - Structural Trends
  - Cyclical Dynamics
  - Global Adjusting Forces
- The Investment Outlook
  - Financial Market Outlook
  - Global Macro Risk Monitor
  - Global Scorecard
- Market Assessment and Outlook

**Ontario Teachers’ Pension Plan**

Waiting for the Lift

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Thank you for your interest in our report. Please note that this information may not be reproduced without the prior express written consent of Ontario Teachers’.
The global economy is at an important inflection point, with positive (though weaker more recently) cyclical growth to re-accelerate. However, we now see the risks to our base-case growth narrative were unjustifiably high in our market’s growth expectations negative data surprises have been more frequent, and investor derived “euphoria” has been sufficiently entrenched to disrupt the self-sustaining growth narrative. The biggest negative data surprises have been concentrated in the Eurozone and Japan where the markers’ growth expectations were arguably high in our view. We expect global GDP growth to re-accelerate.

Financial markets have stabilized since the February panic that resulted in the VIX spiking, even though recent anxiety around rising US-China trade tensions has kept volatility from dropping more aggressively. While the VIX remains well below the February high watermark, we do not expect the index to fall back to the abnormally low levels seen prior to the February spike.

Inflation momentum to drift higher. Although the economic data have been somewhat disappointing so far this year, we do not see this weakness as being sufficiently entrenched to disrupt the self-sustaining growth narrative. The biggest negative data surprises have been concentrated in the Eurozone and Japan where the markers’ growth expectations were arguably high in our view. We expect global GDP growth to re-accelerate.

Global Macroeconomic Outlook

Our constructive medium-term view on EMs is being stress-tested as we move through 2018, perhaps excessively euphoric expectations around the outlook at the turn of the year. The biggest negative development for EMs since Q1 has been the slowdown in China, which has led to a broad re-pricing lower and EM FX volatility picking up. However, we continue to believe that the dynamics behind the back-up in yields will persist. From QE to QT: Central banks make a policy error by tightening too aggressively. The rise in yields this year has been broadly consistent with our expectations. Less expected, however, has been the pace of the adjustment, which has been much sharper than we thought. And while we still believe that the dynamics behind the back-up in yields will persist.

It is difficult to be constructive over the next nine to twelve months, but not derailed. Despite the magnitude of the run-up in global stock markets, we continue to believe that there is significant upside for risk assets and are mildly bearish on global fixed income. The geopolitical climate has improved in some regions and worsened dramatically in others. On the Korean Peninsula, tensions have eased. In contrast, the progress in the Middle East has worsened, and amid rising geopolitical tensions in the Middle East.

GLOBAL ECONOMIC & MARKET UPDATE

RISING TRADE TENSIONS

We have become more concerned about the potential for the US and China to engage in a potentially damaging tit-for-tat trade war, risking a disruption to one of the key pillars of the constructive global growth outlook. Although recent conciliatory moves are encouraging, a quick to these underlying issues is difficult and the risk of miscalculation high.

RISK DIAL

OUTLOOK: Bullish

Central bank policy error: financial conditions are tightening more aggressively than the underlying economic conditions warrant. Unexpectedly, monetary conditions are tightening more aggressively than the underlying economic conditions warrant. Unexpectedly, monetary conditions are tightening and economic activity is weakening.

Financial Market Outlook

EQUITIES

Outlook: Bullish

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Inflation Risk

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OUTLOOK: Bearish

Outlook: Bullish

LOW < 25% MED 25-50% HIGH > 50%

RISK DIAL

Gradually Shifting

NEW LEVEL

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GLOBAL ECONOMIC & MARKET UPDATE

Cyclical Growth Bounced Expected

Underpinning our constructive growth view is a recognition that the global financial system remains on the opening rebound from credit shock and capital activity, with additional help from fiscal policy and still supportive global financial conditions.

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The Teachers’ Tri-Cycle

FRAMEWORK

The Long-term Trends or Secular Drivers are those that evolve over a protracted period and have a significant impact on the economy and financial markets. They are influenced by factors such as demographics, technological change, and resource availability.

Structural Trends

1. Structural Trends

Cyclical Dynamics

2. Cyclical Dynamics

Global Adjusting Forces

3. Global Adjusting Forces

The Tri-Cycle

1. The teachers' competitive advantage stems from our unique access to key global decision-makers and a diverse platform of portfolio companies. This unique information gateway informs our view of the world, and provides a benchmark against which our global outlook (and associated risks) for growth, inflation and the discount rate (interest rates) can be judged. The underlying views are forged by an analysis of the interconnections between three key pillars of the economic infrastructure (namely the structural trends, cyclical dynamics and global adjusting forces) that shape the medium-term outlook for the global economy and financial market performance.

Global Medium-term Scorecard

Q2 2018 | Q3 2018

Global

Growth

Inflation

Discount Rate

Secular Growth Drivers

Credit Cycle

Business Cycle

Investment Cycle

Trade Cycle

Capital Flow Cycle

Ontario Teachers' Bias

Relative to Market

Global Scorecard

Medium-term Scorecard

Ontario Teachers’ Bias

Ontario Teachers’ Bias

The scorecard reviews the directional impact of economic indicators ranging from structural trends like geopolitics and the regulatory backdrop to cyclical dynamics and global adjusting forces on the three key primitives – growth, inflation and interest rates. This is compared to our assessment of what the market is pricing in for these factors.

We believe that our unique insight and access to key global decision-makers and a diverse platform of portfolio companies provide a benchmark against which our global outlook can be judged.

Our unique access to key global decision-makers and a diverse platform of portfolio companies provides a benchmark against which our global outlook can be judged. The underlying views are forged by an analysis of the interconnections between three key pillars of the economic infrastructure (namely the structural trends, cyclical dynamics and global adjusting forces) that shape the medium-term outlook for the global economy and financial market performance.
The global economy is at an important inflection point, with positive (though weaker more recently) cyclical growth momentum contrasting with an unfavorable secular growth backdrop. Addressing these cross-currents entails simultaneously navigating rising inflation pressures to rise as the pace of economic slack absorption accelerates. The spurt in global core inflation momentum should remain gradual, providing considerable latitude for central banks to remain patient. The supportive monetary policy backdrop will be key in sustaining positive global growth momentum.


**Macroeconomic Outlook**

**Inflation Risk**

**Drifting Higher**

We see further scope for underlying global inflation pressures to drift higher as the pace of economic slack absorption accelerates. The spurt in global core inflation momentum should remain gradual, providing considerable latitude for central banks to remain patient. The supportive monetary policy backdrop will be key in sustaining positive global growth momentum.

**Construction Growth**

**Narrative intact:** Although the economic data has been somewhat disappointing so far this year, we do not see this weakness as being sufficiently entrenched to disrupt the self-sustaining growth narrative. The biggest negative data surprises have been concentrated in the Eurozone and Japan, where the market's growth expectations were already painfully low in our view. We expect global GDP growth to re-accelerate.

**Developed Markets**

**Outlook:** Bullish

Financial markets have stabilized since the February panic that resulted in the VIX spiking, even though recent anxiety around rising US-China trade tensions has kept volatility from dropping more aggressively. While the VIX remains well above the February high, it is not clear this index will fall back to the abnormally low levels seen prior to the February spike.

**Cyclical Growth Bounce Expected**

Underpinning our constructive growth view is a recognition that the global business cycle remains on the upswing, buttressed by robust trade and capital activity, with additional help from fiscal policy and still supportive global financial conditions.

**Higher Volatility Regime to Prevail**

Financial markets now believe the inflationary pressures that contributed to the VIX spiking, even though recent anxiety around rising US-China trade tensions has kept volatility from dropping more aggressively. While the VIX remains well above the February high, it is not clear this index will fall back to the abnormally low levels seen prior to the February spike.

**Inflation Momentum to Drift Higher**

Alongside a pick-up in growth momentum, we see further scope for underlying global inflation pressures to rise as the pace of economic slack absorption accelerates. The spurt in global core inflation momentum should remain gradual, providing considerable latitude for central banks to remain patient. The supportive monetary policy backdrop will be key in sustaining positive global growth momentum.

**Emerging Markets**

**Outlook:** Bullish

Our constructive medium-term view on EMs is being stress-tested as we move through 2018, with EM asset prices weakening and EM volatility picking up; however, we continue to believe that the recent weakening of EM asset prices is a transitory correction of perhaps excessively euphoric expectations around the outlook at the turn of the year.

**Balance of Risk Lowered**

On net, the upbeat macro assessment is unchanged relative to our expectations at the turn of the year. However, a number of risks to our view are being fairly balanced (representing a doomsday scenario from an upside basis).

**Financial Market Outlook**

**Outlook:** Bullish

Global equities are mostly flat on the year, after briefly dropping into correction territory in February. We expect risk appetite to enjoy a modest rebound into the second half, buoyed by constructive global economic growth with the continued delivery of earnings growth to (absolutely demanding) expectations.

**Equities:** Bullish to Neutral

**Fixed Income:** Bearish

**Outlook:** Bullish

The rise in yields so far this year has been broadly consistent with our expectations. Less expected, however, has been the pace of the adjustment, which has been much sharper than we expected when the US tax cut initially landed on the US$ in late 2017. While we believe the dynamics behind the back-up in yields will persist, we see some modest upside dollar risks over the next few quarters.

**U.S. Dollar:** Cyclically Bullish

One the medium term we see no clear direction for the dollar, as the tug-of-war between negative structural and inflationary forces plays out. However, with near-term economic growth and interest rate differentials likely to favor the greenback, we see some modest upside dollar risks over the next few quarters.

**Credit:** Spreads widening

With benchmark rates rising at a more forceful pace, the US$ and EM spreads could widen as a result of rising funding costs. Against this backdrop, we expect credit spreads to start gradually widening.

**Commodities:** Bullish to Neutral

The backing for energy is favourable, with the oil market now close to balance. Any supply disruptions arising from the re-imposition of Iran sanctions will boost prices. Even though we expect some of the pricing headwind to be taken up by improved production elsewhere, we see the potential for demand growth to support prices.

**On our Risk Radar**

**Central Bank Policy Risk**

The risk of a higher rate of US central bank policy error is low, but the risk of a higher rate of EM central bank policy error is high. This risk may not be imminent, nor is such an error part of our base-case view. However, with monetary policy tightening across EMs, uncertainty has increased relative to an environment in which zero interest rates policy tends to persist for many years.

**Geopolitical Risks Elevated**

The geopolitical climate has improved in some regards, and warranted dramatically in others. On the Korean Peninsula, tensions have eased. In contrast, the prognosis in the Middle East has worsened, and an unfolding crisis in the region will have implications for crude oil prices and the global outlook more generally.

**Rising Trade Tensions**

We have become more concerned about the potential for the US and China to engage in overtly damaging tit-for-tat trade-war actions, risking a disruption to one of the key pillars of the current growth trajectory. Although recent conciliatory moves are encouraging, a quick fix to these underlying issues is difficult and the risk of escalation high.
The global economy is at an important inflection point, with positive (though weaker more recently) cyclical activity, with additional help from fiscal policy and still supportive global financial conditions.

The backdrop for energy is favourable, with the oil market now closer to balance. Any continued delivery of earnings relative to (admittedly demanding) expectations.

We have no strong conviction on the direction for the USD over the medium term, though we see the risks as being finely balanced (representing a downgrade from an upside bias earlier).

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We see a key prerequisite for underlying global inflation pressures to drift higher as the pace of economic slack absorption accelerates. The backdrop for energy is favourable, with the oil market now closer to balance. Any continued delivery of earnings relative to (admittedly demanding) expectations. We see higher risk of a DM central bank policy error.

We expect risk appetite to enjoy a modest rebound into the second half of the year, driven by expectations of lower global core inflation growth and the continued delivery of earnings relative to (admittedly demanding) expectations. We believe the dynamics behind the stock rally in equities will persist.

We see the risks as being finely balanced (representing a downgrade from an upside bias earlier).

We have become more concerned about the potential for the US and China to engage in a potentially damaging tit-for-tat trade war, risking a disruption for consumers globally. Although the impact appears to have been only mildly negative so far, the calculus would likely change if crude oil prices continue climbing to above US$50/bbl.

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The Teachers’ Tri-Cycle

1. Structural Trends
   The long-term trends or secular trends that define the investment environment, and influence the decision-making process of firms, households and non-market actions at both the individual and aggregate level.

2. Cyclical Dynamics
   Forces related to fluctuations in the economy, policy and credit regimes that are driving forces behind economic and asset market performance.

3. Global Adjusting Forces
   Those forces define the avenues for spillovers across economies and regions. In particular, they form the mechanisms through which developed and emerging economies and financial markets become integrated through trade and capital investment flows.

The scorecard reviews the directional impact of economic indicators ranging from structural trends like geopolitics and the regulatory backdrop to cyclical dynamics and global adjusting forces on the three key primitives – growth, inflation and interest rates. This is compared to our assessment of what the market is pricing in for these factors.

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