Sagard

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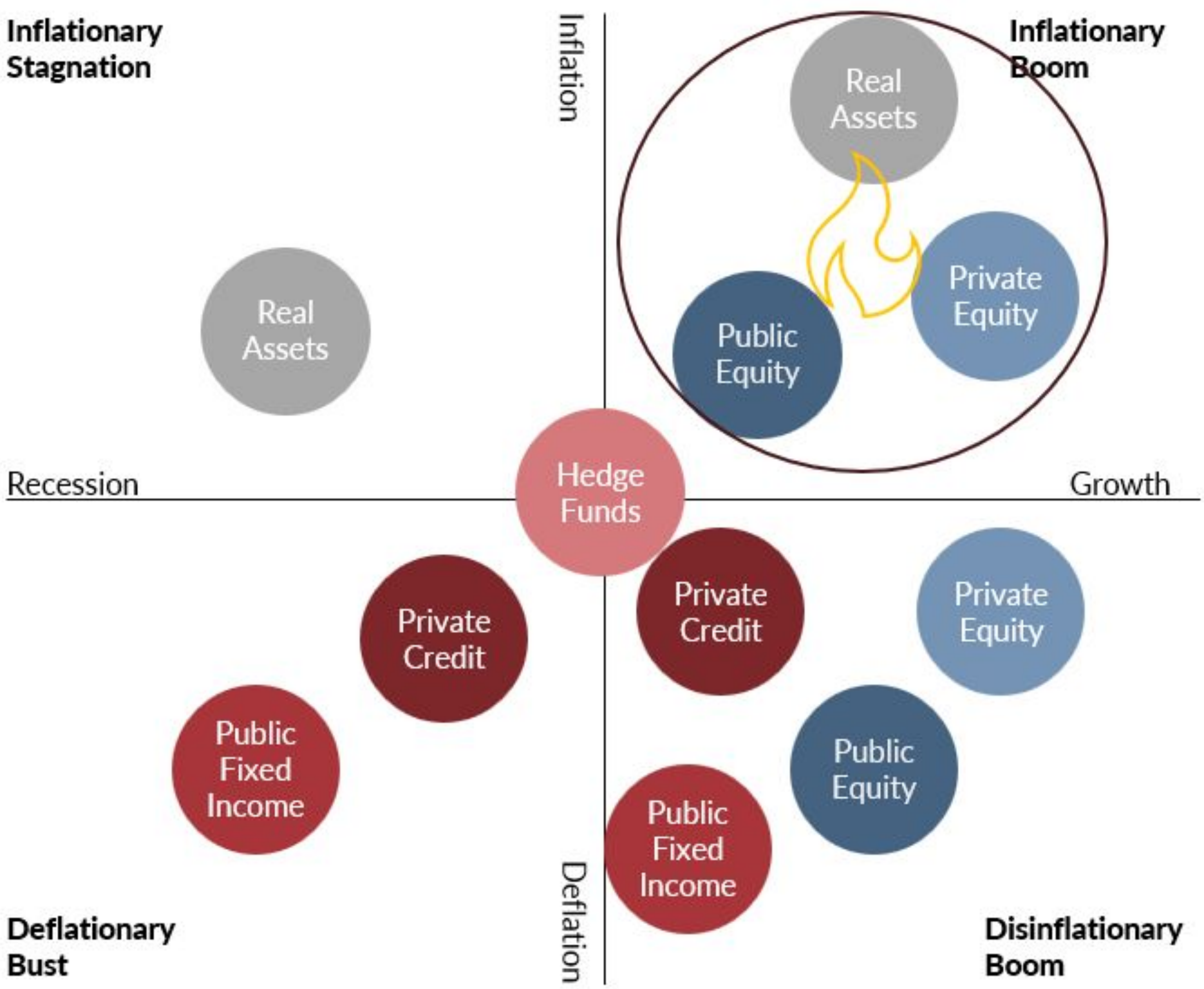
Asset Allocation in Uncertain Times: Looking for Signals

During periods of market stress and heightened geopolitical risk, it can be very challenging to focus on asset allocation. As the noise of the markets escalates, it is much harder to distill the signal.

Current View and Positioning

Our macro lens is driven through a relatively simple framework. Are we in a regime of stronger or weaker economic growth and are we in a period of elevated or low inflation? We believe that the twin stimulating factors of corporate expenditure on AI and the related infrastructure alongside increased government spending (particularly in defence) are both pro-growth while also driving higher than normal inflation.

The chart below shows this and our favored portfolio tilts:



Inflation and Growth Outlook

Has our view changed? We still see the same factors driving both corporate and government spending and therefore still support our view that we remain in an inflationary boom. There are now elevated risks that a prolonged shift higher in energy prices does cause economic contraction, shifting us to the left on the diagram into the inflationary stagnation quadrant. However, we do not think that is the case, for several reasons outlined below:

- **U.S. interest rate policy** – to us it appears that Kevin Warsh, the incoming Chairman of the Federal Reserve, is likely to pursue a rate cutting path, which would strengthen the growth and related inflation picture. As we move closer to May, we expect that the focus pivots away from elevated gasoline prices (inflationary) to the weakening employment picture (deflationary). In fact, it could be argued that higher gasoline will cut into the discretionary spending power of the average American, whereas rate cuts will offer some financing relief.

- **Fiscal stimulus** – we expect fiscal stimulus from many countries to continue, likely with increased financing for defence. We wouldn't be surprised to see tax relief, gasoline subsidies and even lump-sum payments, made to American citizens and others. All of which is stimulative for growth.

- **AI Capital Expenditure** – so far, we haven't seen any change in the advancement of AI and the required infrastructure build. The demand for power, expanding data centers and microchips remain extraordinarily high. This remains supportive to growth and inflation.

What Next?

The market backdrop favours a pragmatic approach to asset allocation with a focus on a few key factors:

The U.S. Dollar	For the past 14 months, the U.S. Dollar had been weakening against most trading peers. Despite this, the trade and fiscal deficit situations have not improved. Over the past 2 weeks we have seen the U.S. Dollar strengthen against almost all currencies as investors seek safety. A continued appreciation in the U.S. Dollar will threaten some of President Trump's trade objectives, putting further pressure on the Federal Reserve to cut rates.
Bond markets	The global sovereign bond market (including U.S. Treasuries) has weakened materially over the last 2 weeks. To quote Luke Gromen, "the first casualty of war is truth, the second is the bond market". Concerns linger over the rising debt loads of developed countries. A reversal in sentiment towards adding bonds for risk-off protection could have larger market implications. If that is the case then U.S Dollar denominated inflation linked bonds could be a great form of portfolio protection.
Oil	While oil price direction remains inherently uncertain, the longer energy prices remain elevated, the harder it will be for some countries and sectors to recover. We've yet to see this follow-through to concerns over the power demand for AI and this is something to watch for. Holding a diversified basket of inflation protection assets such as commodities, gold, real estate and infrastructure, will elevate portfolio pressures from energy driven inflation.

Private Markets and Uncertainty

The key trait that private markets have over public markets is patience. Private markets managers are not under pressure to deploy capital and in most cases are sitting on dry powder ready to deploy. Private equity and private credit opportunities will arise, and new vintages will be best positioned to see through the noise and capture the signal.

We expect the opportunity for private equity and private debt to remain robust for several key reasons:

- Private credit that focuses on tangible assets as part of the underwriting, is likely to see increased values across the assets they lend against, adding to the collateral cushion.

- Private credit will generate higher absolute returns if inflationary forces push the need for higher interest rates.

- Private equity remains the best opportunity to benefit from AI implementation. The private equity model is built on 1) acquiring a business with the use of leverage 2) looking for productivity gains within that business and 3) looking for increased sources of revenue for their portfolio companies. AI will be at the center of productivity gains, with AI equipped equity sponsors most likely to add value to portfolio companies.

The latest vintage in both private equity and private credit will be best positioned to profit from these dislocations and opportunities.

While regional dynamics have introduced a slowdown in investment activity across MENA, global markets continue to move forward. This is precisely the time to reassess strategic asset allocation, ensuring portfolios remain positioned for opportunities beyond the region, where the majority of exposure already lies.

Asset allocation is the most important decision when building portfolios and we believe that a conservative approach with large allocations to alternative investments allows you to navigate storms by looking at the stars for signals rather than focusing on the noise of the waves.

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