PICTON
INVESTMENTS

ASSET ALLOCATION OUTLOOK

THE PICTON REPORT
2025 MID-YEAR UPDATE

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NAVIGATING GROWTH, INFLATION, AND POLICY **UNCERTAINTY THROUGH A 40/30/30 LENS**

Big Picture: What We See Ahead

Post-election euphoria has quickly morphed into a “Trump Slump”. Recession expectations are rapidly rising after the Trump administration came out hot out of the gates with many new policy initiatives that have a net stagflationary impact (i.e. push inflation higher, and economic growth lower).

Our outlook is built on three key scenarios (base, bull, and bear) that explore possible outcomes over the next 3 to 12 months and their potential impact on asset classes.

Base Case: Stagflation

Our previous bearish scenario has now become our new base case: Higher inflation has caused the Fed to stop cutting rates and take a more cautious, balanced approach. Trump has quickly implemented his most disruptive policies within the first year of the second term of his presidency (perhaps so that there is time to take credit for the recovery by the fourth year of his second term). Inflationary trade and immigration policies are expected to result in outright stagflation and policy uncertainty is likely killing business confidence. At the same time, the AI bubble seems to have popped, and the resulting reverse wealth-effect can be another headwind to growth.

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ASSET CLASS POSITIONING: WHERE WE STAND

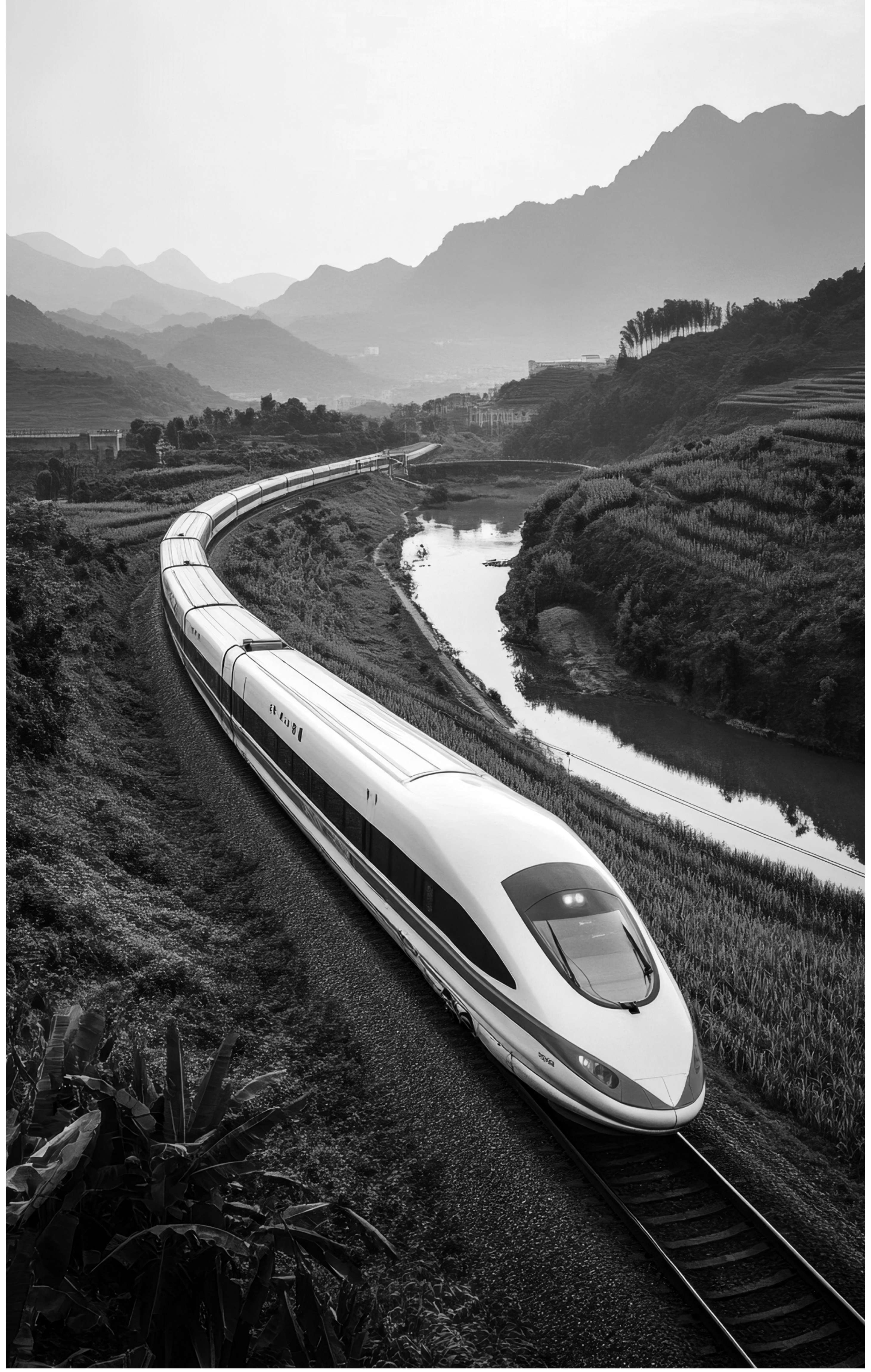
In terms of positioning, weightings are discussed relative to a broad 40/30/30 target allocation of equities/fixed income/alternatives based on our belief that this asset allocation mix is a better way to build portfolios that deliver greater certainty.

> *While large-cap U.S. equities have bounced considerably off the lows,* ***we don't think markets are returning to the U.S. exceptionalism trend*** *of the past decade.*

EQUITIES

Fade American Exceptionalism, Look to the Rest of the World for Better Opportunities

- **We are Neutral Overall.** While large-cap U.S. equities have bounced considerably off the lows, we don't think markets are returning to the U.S. exceptionalism trend of the past decade. As such, we have added a "Developed Markets Ex-U.S." equities category in our allocation table to show our preferences within Developed Markets as the end of U.S. market dominance seems to be upon us.
- **Where We're Focused:** We're looking for opportunities outside the U.S. and in Emerging Markets, where monetary and fiscal policy conditions are better (as are valuations).
- **Inflation Impact:** We're tilting back toward manufacturing sector, where the impact of tariffs and trade wars could lead to rising inflationary pressures.



FIXED INCOME

Neutral with a Hedged Approach

- **We're Neutral.** Government bond yields offer a decent return relative to equities, especially outside of the U.S., where bond vigilantes are becoming increasingly concerned with the lack of fiscal discipline. This could result in some stress events where policy makers will need to respond to sharp spikes in bond yields.
- **Credit View:** We view the credit market broadly as overvalued and expensive, prompting our defensive, hedged stance in this space.

ALTERNATIVES

A Vital Diversifier

- Our base case has become more cautious, and we remain vigilant to tail risks, including unexpected policy shifts from the Fed or geopolitical developments, which could significantly alter the trajectory of markets. These risks are reasonably accounted for in our probability-weighted scenario forecasting.
- With heightened uncertainty around U.S. economic policy, especially with relation to trade policy, alternatives remain a key pillar of our diversified model. Alternatives are comprised of three components: Enhancers which can add to Equity or Fixed Income risk; Diversifiers which provide returns independent of market moves, and Inflation Protection.
- Within Alternatives, we believe maximizing exposure to Diversifiers can reduce the beta of the overall portfolio to traditional Equity or Fixed Income risks. For example, this could mean a shift from long-only equity to long/short strategies, or a shift from long/short exposure to market-neutral strategies.
- We also believe in maintaining exposure to Inflation Protection given we see the risk of inflation surprising to the upside.

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Key Risks We're Watching

While our base case is cautious, we remain vigilant to potential disruptors:

- **U.S. Government Policy Shifts:** Tariff policy was temporarily paused, likely due to unfavorable market reactions (such as the U.S. 30-year bond yield briefly hitting 5% on May 21). However, these postponements may not last, and long-term resolution may require the (re)negotiation of complicated trade details, which can take longer than anticipated.
- **End of Globalization:** Markets will have to eventually deal with the fact that the policy environment has changed, and the era of unconstrained globalization is likely behind us.
- **Geopolitical Events:** Unexpected developments on the world stage could increase market volatility.

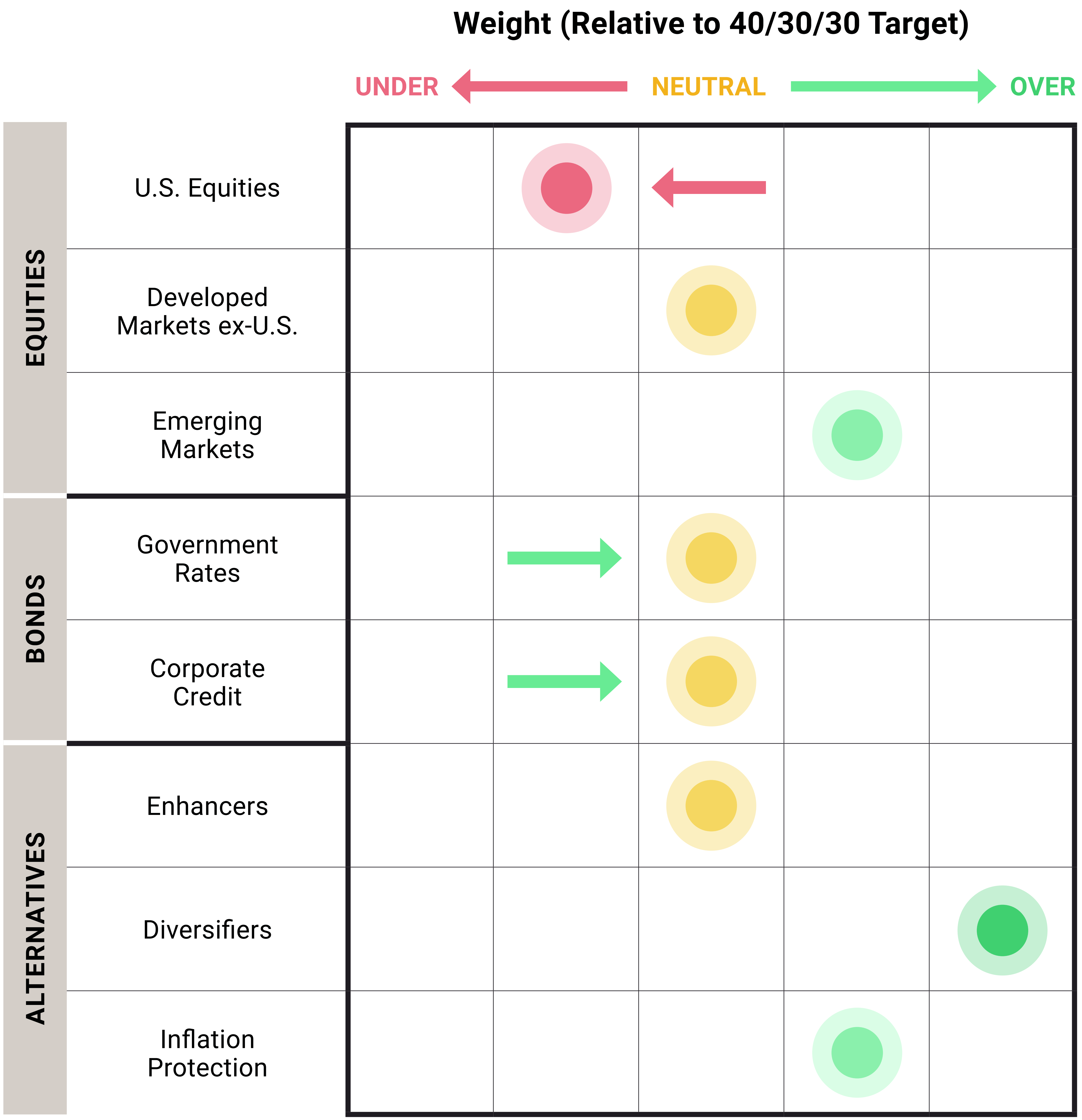
Strategy: Thinking in Terms of Possibilities, Not Certainties

To navigate this landscape, we're staying nimble, leveraging a scenario-based approach that aims to help prepare for a range of possible market conditions. Our allocation decisions are tied to a core 40/30/30 framework, with positioning adjustments made as market dynamics shift.

40% TO EQUITIES

30% TO FIXED INCOME

30% TO ALTERNATIVES



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All figures provided are sourced from Bloomberg L.P. unless otherwise specified, and are based on data as at the dates indicated.

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