

MARKET PERSPECTIVE | 2019-Q1 (Winter)



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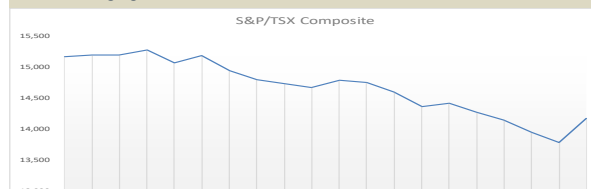
OVERVIEW— Global equity markets pulled back sharply through the fourth quarter of 2018 and particularly through the final month of the year, resulting in markedly negative returns across most regions. After nearly a decade of above average performance lead by strong corporate earnings growth, and increasing multiples supported by low interest rates and low stable inflation, the recent correction has eased valuation concerns and set the trajectory for equities to ride the remainder of the current cycle at a lower but positive pace. In evaluating the performance of markets over the last quarter and indeed for 2018 as a whole, it is important to note that negative pressures affected virtually every asset class and region, with the resulting damage leaving no stone unturned, and it is within this context that individual results should be viewed.

CANADA— Canada has faced a crude reality—energy stocks were the worst performing sector posting a decline of 21%, followed by consumer discretionary, down 18% in Q4 2018. Even cannabis stocks, which were a bastion of optimism for Canadian investors as the country legalized recreational marijuana in 2018, ended the year in negative territory. The S&P/TSX Composite index posted a total return loss of (6.12%) in December and a total return loss of (9.57%) since the start of 2018. Toronto's junior exchange struggled similarly—hard hit by declining resource stocks and the recent rout in cannabis shares, the TSX Venture had its worst day in 3 years on October 30th, and finished the year with a loss of (34.93%) for 2018. Cannabis stocks accounted for more than 1/3 of the 11% decline in the S&P/TSX Venture Composite Index in Q4, with cannabis companies making up ten of the fifteen greatest contributors to the benchmark's downside performance. This has exacerbated a longer-term slump in the commodity-heavy, small-cap S&P/TSX Venture index that has seen the index lose about 80% of its value from its 2007 high, amid long-term weakness in Canadian crude and metals prices. The outsized influence of cannabis stocks is an indication of how the benchmark's composition has changed over time as resource stocks have declined. The S&P/TSX Venture is now comprised of 41% materials stocks, 21% health care (which includes cannabis stocks), and 13% energy. By contrast, in October 2011 the Venture index was comprised of 51% materials stocks and 23% energy, with health care accounting for just under 2% of the index value.

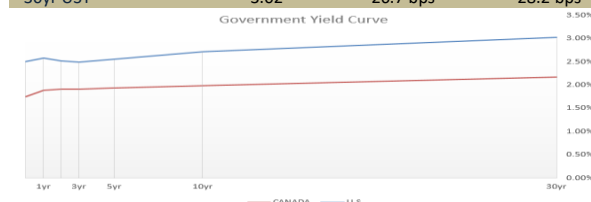
Although Canadian economic momentum has weakened, an economic recession is not the consensus baseline for 2019. Domestic equities have not benefited from the tailwinds of tech stock momentum for the better part of 2018 due to the relatively small tech exposure represented in the S&P/TSX Composite index. However, the downturn in equity markets since September has several contrarian indicators signaling modestly oversold conditions, and sentiment overall is neutral to slightly positive. Moderation of the current historically wide discount between WCS and WTI crude may ease some of the negative tension currently afflicting Canadian equities. According to Bloomberg as of December 31, 2018—trailing and forward price-to-earnings (PE) multiples for the S&P/TSX Composite Index are at 13.5x and 12.0x, both below their respective longer-term averages of 17.7x and 14.5x, and further supported by a healthy dividend yield of 3.4%.

MARKET DIARY -- MONTH AT A GLANCE

Equities (TOTAL returns)	Close Dec 31	MoM TotRet	YTD TotRet
S&P/TSX Composite	14,657.39	-6.12%	-9.57%
S&P/TSX Venture	553.58	-6.31%	-34.93%
Dow Jones	23,588.02	-9.63%	-4.58%
S&P 500	2,534.31	-9.81%	-5.21%
FTSE 100 Index	7,018.95	-3.40%	-8.70%
EURO STOXX 50	3,088.66	-5.71%	-11.85%
Nikkei 225	20,398.98	-10.33%	-10.39%
NASDAQ Composite Index	6,657.35	-10.09%	-3.56%
MSCI EAFE	5,234.52	-5.27%	-14.17%
MSCI Emerging Markets	444.03	-2.97%	-14.85%



Fixed Income	Yield	MoM Chg	YTD Chg
BoC Overnight Rate	1.75	N/C	75.0 bps
3mos Canada T-Bill	1.65	-4.2 bps	60.2 bps
2yr Canada	1.91	-24.9 bps	21.6 bps
10yr Canada	1.99	-27.4 bps	-3.6 bps
30yr Canada	2.17	-22.1 bps	-7.0 bps
Fed Funds Rate	2.50	25 bps	100 bps
90d U.S. T-Bill	2.38	-0.5 bps	9.2 bps
2yr UST	2.52	-27.0 bps	63.3 bps
10yr UST	2.72	-26.9 bps	31.3 bps
30yr UST	3.02	-26.7 bps	28.2 bps



Currencies	Dec 31	MoM Chg	YTD Chg
CAD/USD	0.73	-2.54%	-7.83%
USD/CAD	1.36	2.60%	8.49%
CAD/EUR	0.64	-3.57%	-3.29%
CAD/JPY	80.87	-5.36%	-9.80%
CAD/GBP	0.58	-2.14%	-1.90%

Market Factors	Dec 31	MoM Chg	YTD Chg
Volatility Meter – VIX	28.34	0.57 bps	1.57 bps
Advance/Decline – TSX	3.00	1.79 bps	1.69 bps

Source: Bloomberg

Upside potential remains for Canadian equities but investors need to be careful not to fall into a “value trap”. Above all, what has hindered domestic equity performance is the absence of those constituents that have worked well for most of 2018, notably technology and growth exposures. We do believe that on a relative basis, as sentiment shifts away from the factors that have dominated returns in 2018, there could be some unlocking of “trapped” value—provided that oil prices cooperate. As such, we are modestly positive on Canadian equities, particularly relative to U.S. equities, due to the sizeable valuation and yield advantage.

UNITED STATES— December 2018 was the worst month for the S&P 500 and the Dow Jones Industrial Average since 1931. The S&P 500 lost (9.81%) on a total return basis in December, while the Dow Jones lost (9.63%). For the calendar year, U.S. stocks turned in their worst performance since the financial crisis of 2008 with the broad based S&P 500 posting a total return loss of (5.21%). 2018 has been a departure from 2017 in many ways; the historical calm of 2017, with its maximum peak-to-trough drawdown on the S&P 500 of a mere 2.8%, faded. This was replaced with a return to volatility and as of early December, the S&P 500 had experienced declines of 3% or greater on five individual trading days in 2018. In many ways we have witnessed a return to a more “normal” volatility environment. In other ways however, 2018 was extraordinary in its own right - **2018 is the first year since 1972 that NO SINGLE ASSET CLASS produced a return greater than 5%.**

Poor stock market performance has been largely uncorrelated with the state of the U.S. economy. Real GDP growth through the second and third quarters of 2018 logged in north of 3%—roughly double consensus estimates for the U.S. economy’s long-term potential. Earnings growth for the S&P 500 Index has been 25% or higher in every quarter through 2018—a hair-raising pace usually only seen in the bounce out of recession. And the U.S. Bureau of Labor Statistics shows the unemployment rate stands at a 49-year low and economic fundamentals are unequivocally strong.

The United States is continuing through the second-longest economic expansion since the 1800s, and historically the S&P 500 Index has generally peaked six months prior to the onset of recession. Given the advanced age of this economic cycle, expectations for elevated risk would seem reasonable, a fact however that current economic conditions appear tempted to defy. The Business Cycle Index (BCI) as of December 31st, 2018 forecasts that the probability of recession within the next 12 months is around 25% — a level which signals caution, but not an outright warning. It is however likely that U.S. equity markets have limited upside potential remaining over the near term and our asset mix model suggests a modest underweighting.

GLOBAL EQUITIES— Global equities performed directionally similar to their North American brethren posting their worst performance since 2008, with negative total returns for the FTSE 100, EURO STOXX 50, and MSCI EAFE indices of (8.70%), (11.85%), (14.17%) respectively for the year. Uncertainty surrounding how Brexit will resolve, coupled with the gradual reduction of economic stimulus will present a new financial backdrop in which markets will need to operate in 2019.

Asian equities including China and Japan have seen their worst performance in over a decade. The benchmark Shanghai Composite Index is almost 25% below where it started 2018, making it the worst-performing major stock market in the world. The breakout of a trade war between the U.S. and China has wiped out \$2.4 trillion from Chinese equities values, a deleveraging drive has squeezed margin lending to just one-third of its peak in 2015, and all ten sectors of the Shanghai Composite index have experienced declines of over 8% in 2018. China’s economy is on track for GDP growth of around 6.5% in 2018 (its slowest level since 1990), and China faces headwinds from high indebtedness, slowing property construction, poor demographics, and protectionist trade policies with the United States. In its last two economic downturns in 2009 and 2015, China responded with massive fiscal and credit stimulus. These efforts however came at a price; China’s debt-to-GDP ratio rose from 140% in 2008 to over 250% at present, creating concerns about financial stability. Future Chinese stimulus is unlikely to be as significant and hence effective as before but it should however be sufficient to keep the growth rate near 6% through 2019.

Japan had the largest December drop of all global equity markets with a loss of (10.33%) for the Nikkei 225 index, in large part due to the U.S.-China trade war and recent global political headwinds. Japanese blue chip equities declined across the board, with Toyota Motor Corp falling (5.25%), Sony Corp shedding (5.55%), Nintendo down (4.3%), and Mitsubishi UFJ Financial Group losing (4.0%) in December alone.

Global Headwinds Creating Negative Sentiment

Top 10 Unexpected Events for 2018

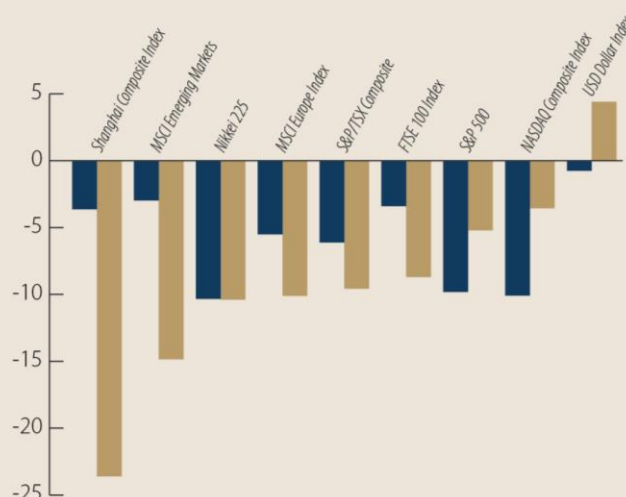


- 75% of unexpected 2018 events had material negative consequences for global markets.

Major World Indices Total Returns in December 2018 compared to 2018

Index	Dec. 2018	2018
<i>Canadian Equities</i>		
S&P/TSX Composite	-6.12%	-9.57%
<i>U.S. Equities</i>		
S&P 500	-9.81%	-5.21%
NASDAQ Composite Index	-10.09%	-3.56%
<i>European Equities</i>		
MSCI Europe Index	-5.50%	-10.11%
FTSE 100 Index	-3.40%	-8.70%
Nikkei 225	-10.33%	-10.39%
Shanghai Composite Index	-3.63%	-23.60%
<i>Emerging Market Equities</i>		
MSCI Emerging Markets	-2.97%	-14.85%

Source: Bloomberg L.P., as of Dec 31, 2018; Returns are total returns



No Place To Hide... A Sea Of Red In 2018

Asset Class Performance

	(%)	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	3Q18	4Q18	2018
Equities	Canadian Equities	2.4	(1.9)	3.7	4.5	9.1	(4.6)	7.8	(0.6)	(11.0)	(8.9)
	Global Equities	6.5	4.2	5.0	5.6	23.1	(1.1)	1.9	5.1	(13.3)	(8.2)
	U.S.	6.1	3.1	4.5	6.6	21.8	(0.8)	3.4	7.7	(13.5)	(4.4)
	Europe	6.3	1.2	2.8	0.6	11.2	(4.0)	4.3	1.3	(11.5)	(10.3)
	Asia	13.4	8.4	6.7	8.3	42.1	0.6	(5.3)	(1.5)	(8.8)	(14.4)
	Japan	(0.3)	6.1	2.4	12.0	21.3	(4.9)	4.1	9.0	(16.9)	(10.4)
	Hong Kong	10.1	8.5	8.6	8.8	41.3	0.9	(2.5)	(2.5)	(6.7)	(10.6)
	China	4.4	7.0	5.8	5.1	24.3	(3.3)	(9.0)	(0.9)	(12.4)	(23.6)
	Emerging Markets	11.5	6.4	8.0	7.6	37.8	1.4	(7.9)	(1.0)	(7.6)	(14.5)
Debt/Credit	Global Investment Grade	0.9	1.8	1.1	1.0	4.9	(1.7)	(0.7)	0.6	(0.2)	(1.9)
	U.S. High Yield	2.4	2.0	1.9	0.5	7.0	(0.7)	1.1	2.4	(4.7)	(2.1)
	Emerging Markets Sovereigns	3.7	2.1	2.5	0.7	9.3	(1.8)	(3.7)	2.1	(0.7)	(4.2)
Commodity	Gold	8.9	(0.6)	3.1	1.8	13.5	1.7	(5.5)	(4.9)	7.7	(1.6)
	Oil (Brent)	(7.0)	(9.3)	20.1	16.2	17.7	5.1	13.0	4.1	(35.0)	(19.5)
Currency	U.S. Dollar Index	(1.8)	(4.7)	(2.7)	(1.0)	(9.9)	5.0	5.0	0.7	1.1	4.4
	CADUSD	0.7	2.9	4.0	(0.5)	6.9	(2.7)	(0.9)	0.0	(6.1)	(8.1)
	EURUSD	1.3	7.3	3.4	1.6	14.1	(5.2)	(5.2)	(0.7)	(1.2)	(4.5)
	GBPUSD	1.7	3.8	2.9	0.9	9.5	(5.8)	(5.8)	(1.3)	(2.1)	(5.6)
	AUDUSD	5.8	0.8	1.9	(0.3)	8.3	(3.6)	(3.6)	(2.4)	(2.4)	(9.7)

Source: Bloomberg L.P., as of Dec 31, 2018; Returns are total returns

- In 2018, all major asset classes experienced negative performance with the exception of the U.S. Dollar.
- The majority of North American and Global Equity markets had their worst quarterly performance in Q4 since the Global Financial Crisis of 2008.
- The worst performing asset class in Q4 2018 was Crude Oil (Brent), down (35%) in Q4 2018.
- The worst performing asset class in FY 2018 was Shanghai Stock Market, down (23.6%) for the year.

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