TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

SEPTEMBER 2017

Investors had plenty to contemplate in August. Namely, critical deadlines are looming on the US political calendar, including the approval of the 2018 budget to avoid a government shutdown and the debt ceiling showdown this fall. Furthermore, escalating tensions between the US and the Korean peninsula also added to financial market woes, while markets were rattled after Hurricane Harvey swept across the Southern Texas coast. In the end, global equity markets largely took these events in stride, as robust economic results across the world underscored the resilience of the global economy.

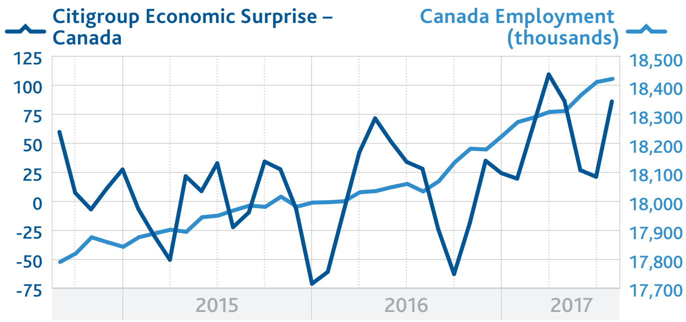
FINANCIAL MARKET DASHBOARD

	AUGUST 31, 2017	AUGUST	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2,472	0.05%	10.40%	13.85%
S&P/TSX	15,212	0.45%	-0.50%	4.21%
MSCI EAFE	1,931	-0.31%	14.66%	14.55%
MSCI EM	1,088	2.01%	26.14%	21.71%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	2.12	-17.7	-32.7	53.7
US 2 Year Bond Yield	1.33	-2.4	13.7	52.0
CA 10 Year Bond Yield	1.85	-20.8	12.8	82.5
CA 2 Year Bond Yield	1.28	-4.1	52.8	69.9
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.80	-0.04%	7.66%	4.99%
EUR/USD	1.19	0.57%	13.25%	6.74%
USD/JPY	109.98	-0.25%	-5.97%	6.33%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	47.23	-5.86%	-12.08%	5.66%
Copper (USD/pound)	3.08	6.48%	22.89%	48.78%
Gold (USD/oz)	1,318.50	4.10%	14.48%	0.81%

US equities ended the month virtually unchanged as investors weighed ongoing political gridlock and the ramifications of Hurricane Harvey against a healthy economic backdrop, while Canadian equities eked out a small gain as the slide in energy stocks was countered by a rebound in the materials sector. Meanwhile, international equities pulled back following recent strength in the euro and yen, which threatened to dampen the earnings revival in Europe and Japan. Finally, emerging market equities proved resilient and continued to lead the performance charge in August. The gauge of developing market equities breached its highest level since 2014 as US dollar weakness and lower treasury yields bolstered the appeal of risky assets, while stronger economic prospects in the emerging world also lent support.

In fixed income markets, bond yields declined as risk aversion spread across the globe and sent investors flocking to the safety of government bonds. Consistent with the cautious tone in the marketplace, credit spreads widened and government bonds outperformed their corporate peers during the month. In the US, investors remain skeptical of the Federal Reserve's ability to raise interest rates again in 2017 amid ongoing political uncertainties in Washington and persistently soft inflation results, both of which have seen investors recalibrate their expectations for fed fund rate hikes this year. Meanwhile, Eurozone bond yields also pulled back after President Draghi failed to provide any insight on next steps towards monetary policy normalization in Jackson hole, which investors interpreted as dovish in general.

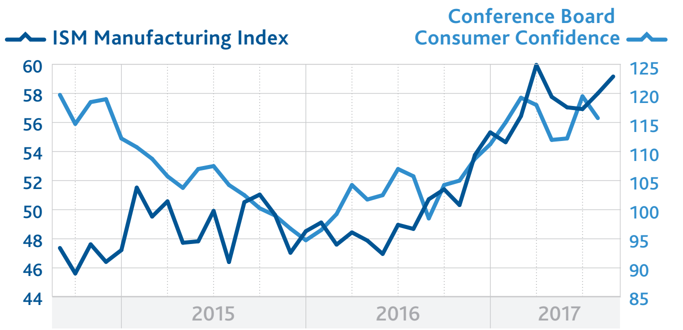
The greenback ended the month modestly lower, owing to the deteriorating political climate in the US and concerns over North Korea's nuclear ambitions, but reversed course after second quarter GDP results were revised higher. Meanwhile, the euro marched higher through August, but lost some of its lustre after ECB officials voiced concerns about the strength of the currency at month-end, while the Canadian dollar remained well-supported after stronger than expected growth results bolstered the case for another rate hike in 2017. Finally in commodity markets, oil prices declined after Hurricane Harvey inundated refineries along the Gulf coastline, while gasoline prices surged to a two-year high. Copper prices rallied to a three-year high on the back of China growth optimism, while the combination of safe haven demand and reduced US rate expectations drove gold to its highest level this year.



The Canadian economy continues to exhibit stellar performance, with the Citigroup Economic Surprise index hovering close to seven-year highs. The consumer remains a dominant force, thanks to robust job creation over the last year.

CANADA

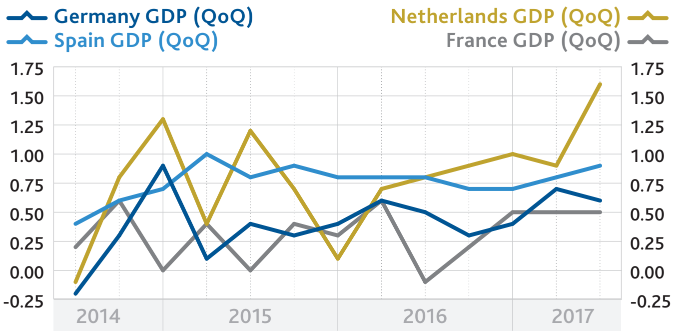
The Canadian economy continues to impress, with second quarter growth soaring to a 4.5% annualized pace, its strongest since 2011. While the expansion has indeed been fairly broad-based, the consumer remains the dominant engine of growth amid the recent string of employment gains, rising home values, and cheap credit – all of which have bolstered discretionary spending. Encouragingly, the solid monthly results in June also suggest that this momentum was maintained heading into the third quarter, with both the goods and services-producing sectors contributing positively. The latest surge in Canadian growth should continue absorbing excess capacity in the economy and allow the Bank of Canada to proceed with another rate hike later this year.



Ongoing political upheaval and geopolitical turmoil have not been enough to derail confidence in the fortunes of the US economy, with both consumers and businesses encouraged by improving economic conditions at home and abroad.

USA

In the US, gross domestic product rose at a 3% annualized rate in the second quarter, its fastest pace in two years. The consumer continues to drive the acceleration, with confidence soaring to its second highest reading this cycle as Americans thrive on the combination of a firming labour market, healthier finances, and low interest rates. Meanwhile, corporations remain largely unphased by the US administration's lack of progress on enacting its pro-growth policy agenda and have instead focussed on the revival in global demand and the weaker greenback – both of which have boosted optimism and investment. Finally, while the fallout from Hurricane Harvey is likely to have a negative impact on growth in the current quarter, reconstruction efforts are expected to instigate a turnaround later this year.



The European economic recovery has become increasingly self-sustaining, with the acceleration spreading more broadly across the 19-nation region.

INTERNATIONAL

The European economy is undergoing a self-reinforcing recovery, even despite recent gains in the euro. While Germany and Spain were the main contributors to growth last quarter, France, Italy, and the Netherlands also posted some respectable results - providing further impetus for the ECB to scale back on its asset purchases in 2018. Meanwhile, the Japanese economy posted its sixth consecutive quarter of expansion, driven entirely by a resurgence in domestic demand. However, the Bank of Japan has pledged to forge on with its unprecedented stimulus, as inflation remains far-below target and as the deflationary mindset in Japan continues to place a cap on prices. Finally in China, the theme of stability has prevailed ahead of the National Party Congress this fall, with the official factory gauge strengthening further in August.

Our current scenarios are for a synchronized global expansion (65%), which is a continuation of the current environment that benefits equities, political instability (15%), which would be negative for equities and positive for bonds, emerging market instability (10%) led by emerging market disequilibrium that would introduce significant volatility, and finally, global economic stagnation (10%) which would be negative for equities and positive for bonds.

MAIN SCENARIO
SYNCHRONIZED GLOBAL EXPANSION

PROBABILITY 65%

The global economy continues to expand in a synchronous manner, with all major regions contributing to the advance. The US expansion lingers on, thanks to widespread improvements across both the consumer and manufacturing sectors of the economy, while political developments have an overall neutral impact. Meanwhile, with the worst of the oil shock behind us, the Canadian economy thrives on the combination of resurgent US demand, a competitive Canadian dollar, and fiscal support. Finally, while policymakers in Europe and Japan ultimately prove successful in reflating growth, emerging market economies prosper in the environment of improving global demand, ample liquidity, and rising commodity prices. Taken together, the lucrative combination of synchronized global growth and a revival in commodity prices should bolster inflation expectations across the world, though not to levels that would threaten the status of the economic recovery. This reflationary backdrop bodes well for equities and commodities (ex-gold) at the expense of fixed income and the US dollar.

SCENARIO 2
POLITICAL INSTABILITY

PROBABILITY 15%

Recent trends towards populism and protectionism could bring about tremendous political upheaval and a corresponding crisis in confidence, disrupting the global economy and financial markets alike. Starting in Europe, while anti-euro parties were unable to gain significant ground in France and the Netherlands, the potential for a rise in euro skeptic movements in Italy (where support for the euro remains low) and possibly Spain risks throwing the region into political disarray at the same inopportune time when the fallout of Brexit remains highly uncertain. In the US, the potential for ongoing gridlock threatens to delay President Trump's pro-growth agenda, while ongoing pressure to make good on his campaign promises ahead of the midterm elections could see the President's rhetoric on protectionism translate into action, particularly due to his ability to act unilaterally on the foreign policy front. Finally in China, the leadership change at the National Party Congress this fall could pose considerable risks to both economic growth and financial stability if policymakers retain power and enact more assertive, wide spread financial sector reforms to crack down on excesses.

SCENARIO 3
EMERGING MARKET INSTABILITY

PROBABILITY 10%

Emerging market economies are most vulnerable to a faster pace of interest rate increases in the US and a corresponding resurgence in the US dollar. The sharp decline in foreign direct investment, repayment of US-denominated debt, and potential capital outflows could result in major contagion and a corresponding flight to quality trade, further exacerbating USD strength and a broad based tightening of financial market conditions. Furthermore, excessive and rising debt burdens in China leave the economy vulnerable at a time when growth is already slowing, rekindling fears of a hard landing in the world's second largest economy. Finally, anti-trade rhetoric in the US becomes a reality, resulting in tariffs being imposed on emerging market economies such as China and Mexico, with retaliatory measures igniting a global trade war.

SCENARIO 4
GLOBAL ECONOMIC STAGNATION

PROBABILITY 10%

After eight years in recovery-mode, the global economy fails to regain momentum and runs out of steam, as secular forces such as an aging population, weaker labor force growth, and lower productivity temper growth prospects worldwide. Furthermore, the massive amounts of monetary stimulus already in place prove unsuccessful in bolstering growth as a broad-based deterioration in confidence offsets the environment of accommodative policy, leaving policymakers with little ammunition to shelter the economy from the storm.

FORECASTS FOR THE NEXT 12 MONTHS

SCENARIOS	AUGUST 31, 2017	SYNCHRONIZED GLOBAL EXPANSION	POLITICAL INSTABILITY	EMERGING MARKET INSTABILITY	GLOBAL ECONOMIC STAGNATION
PROBABILITY		65%	15%	10%	10%
GDP GROWTH (Y/Y)					
Global	3.50%	3.75%	3.00%	2.00%	2.00%
Canada	4.30%	2.75%	1.00%	0.50%	0.50%
U.S.	2.20%	3.00%	1.00%	1.50%	1.00%
INFLATION (HEADLINE Y/Y)					
Canada	1.20%	2.40%	1.75%	1.00%	1.00%
U.S.	1.70%	2.40%	2.00%	1.50%	1.00%
SHORT-TERM RATES					
Bank of Canada	0.75%	1.25%	0.75%	0.50%	0.50%
Federal Reserve	1.25%	2.00%	1.25%	0.75%	0.50%
10-YEAR RATES					
Canada Government	1.85%	2.50%	1.70%	1.40%	1.50%
US Government	2.12%	3.00%	1.40%	1.20%	1.25%
PROFIT GROWTH (12 MONTHS FORWARD)					
Canada	6.8%	16.0%	-13.8%	-16.7%	-13.8%
U.S.	10.7%	12.4%	-13.5%	-13.5%	-5.7%
EAFE	14.8%	13.9%	-16.7%	-16.7%	-8.0%
EM	20.4%	23.3%	-17.3%	-24.5%	-17.3%
P/E (FORWARD 12 MONTHS)					
Canada	16.9X	17.0X	16.0X	16.0X	17.0X
U.S.	17.6X	18.0X	16.0X	16.0X	16.0X
EAFE	14.7X	15.5X	14.0X	14.0X	14.0X
EM	13.1X	13.5X	13.0X	12.0X	13.0X
CURRENCIES					
CAD/USD	0.80	0.80	0.70	0.65	0.70
EUR/USD	1.19	1.20	0.95	1.10	1.15
USD/JPY	109.98	125.00	110.00	100.00	90.00
COMMODITIES					
Oil (WTI, USD/barrel)	47.23	65.00	45.00	40.00	45.00

MATRIX OF EXPECTED RETURNS

SCENARIOS	SYNCHRONIZED GLOBAL EXPANSION	POLITICAL INSTABILITY	EMERGING MARKET INSTABILITY	GLOBAL ECONOMIC STAGNATION
PROBABILITY	65%	15%	10%	10%
Money Market	1.0%	0.8%	0.6%	0.6%
Canadian Bonds	-1.5%	4.1%	5.9%	5.2%
Canadian Equity	9.0%	-23.7%	-26.4%	-19.0%
U.S. Equity	4.3%	-18.5%	-12.2%	-11.1%
International Equity	4.5%	-21.2%	-15.1%	-12.9%
Emerging Market Equity	5.6%	-22.0%	-29.3%	-22.0%

CURRENT STRATEGY [1]

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	ALLOCATION	RELATIVE	APRIL 5 CHANGES
Money Market	0.0%	5.0%	25.0%	Overweight	10.0%	+5.0%	Increased by 5.0 %
Canadian Bonds	20.0%	40.0%	60.0%	Underweight	25.0%	-15.0%	Increased by 5.0 %
Canadian Equity	20.0%	25.0%	45.0%	Overweight	32.5%	+7.5%	Decreased by 5.0%
U.S. Equity	3.0%	13.0%	23.0%	Neutral	13.0%	0.0%	No change
International Equity	2.0%	12.0%	22.0%	Underweight	7.0%	-5.0%	Decreased by 5.0%
Emerging Markets Equity	0.0%	5.0%	15.0%	Overweight	12.5%	+7.5%	No change

[1] Based on a 100 basis point value added objective. The benchmark employed here is based on a model portfolio and for illustrative purposes only. Individual client benchmarks are employed in the management of their respective portfolios.

EVOLUTION OF STRATEGY[1]

	MONEY MARKET	CANADIAN BONDS	CANADIAN EQUITY	U.S. EQUITY	INTERNATIONAL EQUITY	EMERGING MARKETS EQUITY
August 10, 2011	+5.0%	-15.0%	+5.0%	+5.0%	0.0%	0.0%
October 5, 2011	+7.0%	-15.0%	+8.0%	0.0%	0.0%	0.0%
October 12, 2011	+6.0%	-10.0%	+4.0%	0.0%	0.0%	0.0%
November 11, 2011	+5.0%	0.0%	0.0%	0.0%	-5.0%	0.0%
December 7, 2011	0.0%	0.0%	+5.0%	0.0%	-5.0%	0.0%
April 20, 2012	+15.0%	-20.0%	+10.0%	0.0%	-5.0%	0.0%
July 31, 2012	+20.0%	-15.0%	0.0%	0.0%	-5.0%	0.0%
November 9, 2012	+10.0%	-15.0%	+10.0%	0.0%	-5.0%	0.0%
February 19, 2013	+5.0%	-15.0%	+10.0%	0.0%	0.0%	0.0%
August 6, 2013	0.0%	-15.0%	+10.0%	+5.0%	0.0%	0.0%
December 3, 2013	+10.0%	-15.0%	+5.0%	0.0%	0.0%	0.0%
February 5, 2014	0.0%	-15.0%	+10.0%	+10.0%	-5.0%	0.0%
October 14, 2014	0.0%	-20.0%	+5.0%	+10.0%	+5.0%	0.0%
November 14, 2014	+10.0%	-20.0%	+2.5%	+2.5%	+5.0%	0.0%
July 13, 2015	0.0%	-20.0%	+7.0%	+4.0%	+9.0%	0.0%
October 19, 2015	0.0%	-20.0%	+11.0%	+0.0%	+9.0%	0.0%
June 24, 2016	+9.0%	-20.0%	+11.0%	+0.0%	+0.0%	0.0%
July 12, 2016	0.0%	-20.0%	+15.0%	+0.0%	+0.0%	+5.0%
July 27, 2016	+5.0%	-20.0%	+12.5%	+0.0%	+0.0%	+2.5%
October 31, 2016	0.0%	-20.0%	+12.5%	0.0%	0.0%	+7.5%
April 5, 2017	+5.0%	-15.0%	+7.5%	0.0%	-5.0%	+7.5%

[1] Based on a 100 basis point value added objective.

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