# TACTICAL ASSET ALLOCATION COMMITTEE MONTHLY COMMENTARY

NOVEMBER 2017

Financial markets were particularly serene in October, with the risk-on trade lingering on unabated amid persistent signs of global economic resilience and robust corporate profits. Encouragingly, global equity markets continued to forge higher even in the wake of ongoing political impasse in the US, escalating tensions in Spain, and as central banks began to remove excess liquidity from the financial system – reinforcing the sustainability and durability of the acceleration.

**FINANCIAL MARKET DASHBOARD**

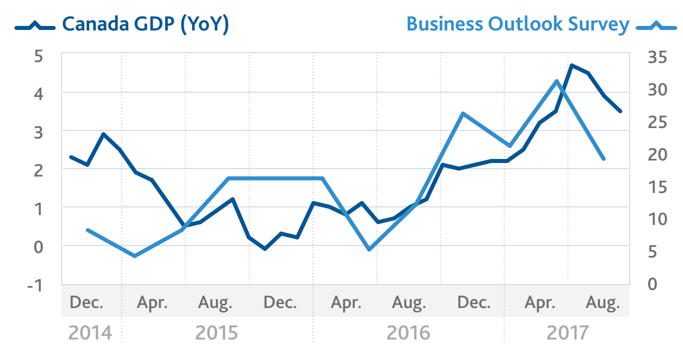
| | OCT. 31, 2017 | OCT. | YTD | 1 YEAR |
|---|---|---|---|---|
| EQUITY MARKETS | | % PRICE CHANGE (LC) | | |
| S&P 500 | 2,575 | 2.22% | 15.03% | 21.12% |
| S&P/TSX | 16,026 | 2.50% | 4.83% | 8.37% |
| MSCI EAFE | 2,003 | 1.46% | 18.92% | 20.22% |
| MSCI EM | 1,119 | 3.45% | 29.78% | 23.64% |
| FIXED INCOME (%) | | BASIS POINT CHANGE | | |
| US 10 Year Bond Yield | 2.38 | 4.6 | -6.5 | 55.4 |
| US 2 Year Bond Yield | 1.60 | 11.7 | 41.1 | 75.9 |
| CA 10 Year Bond Yield | 1.95 | -14.8 | 23.0 | 75.5 |
| CA 2 Year Bond Yield | 1.39 | -12.3 | 64.7 | 84.7 |
| CURRENCIES | | % PRICE CHANGE | | |
| CAD/USD | 0.78 | -3.25% | 4.26% | 4.02% |
| EUR/USD | 1.16 | -1.42% | 10.74% | 6.06% |
| USD/JPY | 113.64 | 1.00% | -2.84% | 8.41% |
| COMMODITIES | | % PRICE CHANGE | | |
| WTI Oil (USD/bbl) | 54.38 | 5.24% | 1.23% | 16.05% |
| Copper (USD/pound) | 3.10 | 4.94% | 23.77% | 40.63% |
| Gold (USD/oz) | 1,270.50 | -0.86% | 10.32% | -0.20% |

Global equity markets were broadly higher in October. The S&P 500 rounded out its strongest month since February on renewed hopes for tax reform, while solid third quarter growth results and healthy corporate earnings also boosted US stocks. After lagging for most of 2017, Canadian equities staged a reversal and have been outperforming their global peers since September, with the S&P/TSX rising to record highs alongside the resurgence in crude prices. Equity gains also extended to overseas markets, with both European and Japanese stocks roaring ahead amid solid earnings reports and some dovish undertones from central banks abroad. Finally, momentum in emerging market equities prevailed, with developing market bourses outperforming their developed counterparts during the month.

North American fixed income markets diverged somewhat in October. In the US, bond yields broke higher across the curve as the economy demonstrated signs of resilience in the aftermath of hurricane activity this fall, while inflation expectations resurfaced owing to the recovery in crude prices and speculation for fiscal expansion in the US – all of which bolstered the case for a rate hike in December. In contrast, Canadian bond yields pulled back as the economy showed signs of moderating after a strong showing in the first half and as the Bank of Canada reigned-in expectations for additional rate hikes. As a result, investors recalibrated and reduced their wagers for another rate hike from the Bank of Canada in 2017.

In currency markets, the greenback strengthened as speculation mounted regarding the Federal Reserve chairmanship and specifics on plans for tax reform. The euro fell after inflation slowed unexpectedly, while the pledge for unprecedented support from the Bank of Japan underscored the divergence from its global peers and weighed on the yen. Finally, the loonie fell to its lowest level since July after the Bank of Canada adopted a cautious approach given signs of moderating growth and downside uncertainties.

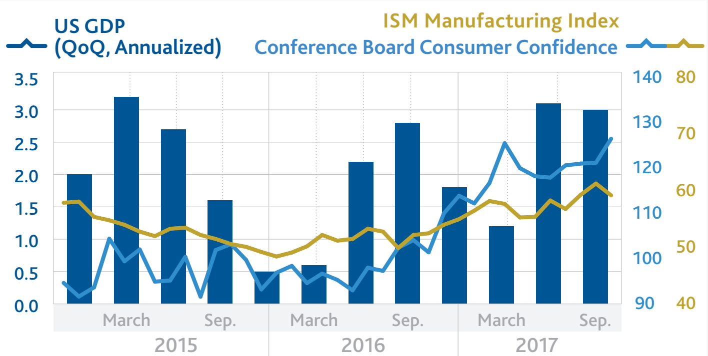
In commodity markets, oil prices staged an impressive rebound after Saudi Arabia and Russia signaled support for an extension of output curbs well into 2018, while US industry data indicated a decline in both crude and gasoline stockpiles. Meanwhile, bullion declined as US dollar strength and fading geopolitical angst weighed on prices, while copper advanced on signs of economic stability in China, the number one producer of the red metal.




The Canadian economy has cooled off after a stellar first half, with both GDP and the Business Outlook Survey rolling over towards more sustainable, albeit still-healthy levels.

## CANADA

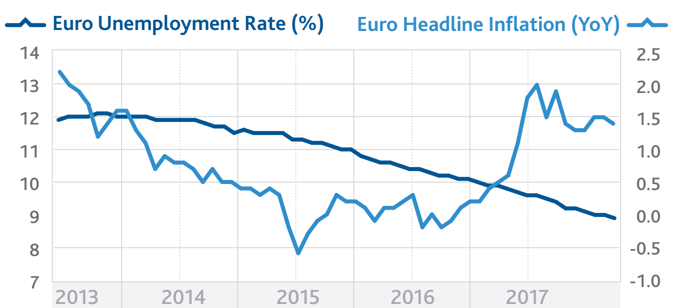
After an exceptionally strong first half of 2017, the Canadian economy moderated towards more sustainable levels in the third quarter, with GDP contracting by 0.1% in August after a flat reading in July. These softer growth results remain consistent with recent rhetoric from the Bank of Canada, which has reigned-in expectations for further rate hikes in the near-term. While the economy is indeed likely to require less stimulus going forward, the bank has adopted a wait-and-see approach in order to monitor how the economy (and specifically the consumer and housing market) adapts to previous rate hikes and new mortgage rules, while downside risks pertaining to NAFTA negotiations and elevated consumer debt levels also warrant some caution at this time.




The US economy has posted two consecutive quarters of impressive growth, while both consumer and business surveys are signaling that the fourth quarter of 2017 will be much the same.

## USA

The US economy proved resilient to hurricane distortions in August and September and rose at an impressive 3.0% annualized rate during the third quarter. The consumer continues to thrive in the environment of strong job creation and higher stock values, with consumer confidence surging to a 17-year high in October. Moreover, the recovery is showing signs of broadening out, with business investment also contributing positively, while robust overseas demand and a softer greenback have bolstered the manufacturing sector. Looking forward, the outlook appears bright amid buoyant business survey results, the prospect for fiscal stimulus from the Trump administration, and as rebuilding efforts provide a boost to growth in the fourth quarter - allowing the Federal Reserve to pursue its plan to raise interest rates once again in December.




While unemployment in the Euro area has fallen to its lowest level since 2009, prices remain anemic - allowing the European Central Bank to assume a slow and gradual approach to monetary normalization.

## INTERNATIONAL

Economic strength has also spread to overseas markets. The European economy expanded by 0.6% in the third quarter and the unemployment rate declined to an 8-year low of 8.9%, while both consumer and business surveys posted their best performance since 2011. However, inflationary pressures remain stubbornly elusive – reinforcing the European Central Bank's cautious approach to monetary normalization. Meanwhile, the Japanese economy is growing at the fastest pace in several years, while PM Abe's election victory all but guarantees the continuation of expansive monetary and fiscal policy for the foreseeable future. Finally, China's economy continues to defy expectations for a sharp slowdown and has been in stabilization-mode, and is well on its way to meet the government's "6.5% or above" growth target this year.

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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 | OCTOBER 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 | 3.50% | 2.75% | 1.00% | 0.50% | 0.50% |
| U.S. | 2.30% | 3.00% | 1.00% | 1.50% | 1.00% |
| INFLATION (HEADLINE Y/Y) | | | | | |
| Canada | 1.60% | 2.40% | 1.75% | 1.00% | 1.00% |
| U.S. | 2.20% | 2.40% | 2.00% | 1.50% | 1.00% |
| SHORT-TERM RATES | | | | | |
| Bank of Canada | 1.00% | 1.50% | 1.00% | 0.50% | 0.50% |
| Federal Reserve | 1.25% | 2.00% | 1.25% | 0.75% | 0.50% |
| 10-YEAR RATES | | | | | |
| Canada Government | 1.95% | 2.65% | 1.70% | 1.40% | 1.50% |
| US Government | 2.38% | 3.25% | 1.40% | 1.20% | 1.25% |
| PROFIT GROWTH (12 MONTHS FORWARD) | | | | | |
| Canada | 15.6% | 19.7% | -14.5% | -17.4% | -14.5% |
| U.S. | 10.9% | 20.1% | -14.8% | -14.8% | -7.0% |
| EAFE | 13.1% | 12.4% | -17.8% | -17.8% | -9.2% |
| EM | 28.1% | 36.4% | -18.1% | -25.3% | -18.1% |
| P/E (FORWARD 12 MONTHS) | | | | | |
| Canada | 16.4X | 17.0X | 16.0X | 16.0X | 17.0X |
| U.S. | 18.0X | 18.0X | 16.0X | 16.0X | 16.0X |
| EAFE | 15.3X | 15.5X | 14.0X | 14.0X | 14.0X |
| EM | 12.5X | 13.5X | 13.0X | 12.0X | 13.0X |
| CURRENCIES | | | | | |
| CAD/USD | 0.78 | 0.85 | 0.70 | 0.65 | 0.70 |
| EUR/USD | 1.16 | 1.20 | 0.95 | 1.10 | 1.15 |
| USD/JPY | 113.64 | 125.00 | 110.00 | 100.00 | 90.00 |
| COMMODITIES | | | | | |
| Oil (WTI, USD/barrel) | 54.38 | 65.00 | 45.00 | 40.00 | 45.00 |

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## MATRIX OF EXPECTED RETURNS

| SCENARIOS | SYNCHRONIZED GLOBAL EXPANSION | POLITICAL INSTABILITY | EMERGING MARKET INSTABILITY | GLOBAL ECONOMIC STAGNATION |
|---|---|---|---|---|
| PROBABILITY | 65% | 15% | 10% | 10% |
| Money Market | 1.3% | 1.0% | 0.8% | 0.8% |
| Canadian Bonds | -2.1% | 4.7% | 6.4% | 5.8% |
| Canadian Equity | 7.7% | -27.6% | -30.1% | -23.1% |
| U.S. Equity | -1.1% | -24.3% | -18.4% | -17.4% |
| International Equity | -8.2% | -26.4% | -20.7% | -18.6% |
| Emerging Market Equity | 4.6% | -26.6% | -33.4% | -26.6% |

## 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.

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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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