2017 year in review

January 2018

2017 A Year for Synchronized Global Growth

45 of the world's largest economies are expected to finish the year with a positive growth rate. That growth has resulted in many equity markets hitting new all-time highs this past year. In all my years in this business, I would have to say that the 2017 equity markets were probably the most anxious bull market I have witnessed. Pundits continuously emphatically warned of the impending "correction" given all the flashing warning signs. I anticipate positive economic growth to continue on a global scale throughout 2018 in spite of many head winds that appear on the radar.

A Look Back

We entered 2017 with many questions, concerns, and unknowns that flashed caution be adhered. Looking back, some of the significant developments that drove uncertainty were:

- A new U.S. President and inexperienced administration that had an early legislative set back in attempts to get Obamacare quashed. Would they be able to get any legislation passed?
- Rising global interest rates usually have a negative effect on equity prices.
- BREXIT was still relatively new and concerns arose around other EU countries commitment to remaining within the union.
- Central banks putting the brakes on the financial liquidity life preserver by ratcheting back Quantitative Easing.
- European Banking system was/is teetering on the precipice with underperforming loans growing at an alarming rate.
- Political uncertainty in recent European elections as the "far right" looked destined to be elected in several countries where stopping immigration and leaving the EU was their primary platform.

Many of the unknowns seem to have been pushed to the sidelines for now (or at least the media is focused on other more captivating stories for the time being). Several of the above issues and concerns were resolved in a "favorable to equity market" fashion; but of course new ones are gaining strength and are now flashing a caution to me as our team navigates 2018 and beyond.

2018 Caution Flags

Some of the below events are a function of positive fundamentals such as economic growth, company earnings, etc. Others remind me of the tech era euphoria which are borderline absurd; and those scare me the most.

- Equity valuations are touching on decade highs.
- Bad global news such as North Korea missile

launches, terror attacks on major cities, and a move to impeach the U.S. President does not rile the markets, or even increase market volatility.

- Many corporations taking advantage of ultra-low interest rates and piling on significant levels of debt to return to shareholders via stock buybacks and increasing dividends. In many cases, leveraging the balance sheet is not being utilized to increase capital expenditures and investment; which is the backbone of a company's future growth and competitiveness.
- If inflation expectations remain subdued, and short term interest rates continue to increase in North America, we could end up with an inverted yield curve. Historically, that signal, if prolonged, has been a strong predictor of recessions.
- The affect increasing interest rates will have on a highly leveraged consumer; whose spending habits are the primary driver of economic growth in North America.
- I worry about taxes increasing in Canada while the U.S. heads in the other direction. What will be the impact on capital flows, both from individuals and corporations?
- Global Central Banks reducing Quantitative Easing (QE) and thereby withdrawing liquidity from the financial markets[1]. One consequence of the European Central Bank's (ECB) QE program is that many short term European Government Bond Yields are negative. Italy for instance, has a two year Government Bond Yield of -.2% and the five year is .72%. Compare that to the U.S. two year treasury yield of 1.9% and the five year at 2.2%. European corporate junk bonds were recently down to 2%. Who would you rather lend your money to? Wasn't the Italian economy recently considered one of the weakest in the EU? Let me understand this; I buy a two year Government of Italy bond and on maturity they actually give me less money back as I am paying them interest.
- Crypto currencies and marijuana stocks – in my view, beyond bordering on the absurd.

A Focus on the Positives

As we move cautiously into 2018, I remain bullish on the equity markets continuing to move in an upward direction; albeit, volatility will most likely increase with more significant pull backs along the journey.

- Recent U.S. tax cuts are probably the biggest equity market story heading into 2018. These tax cuts are complicated and confusing from an investment perspective. Some companies are actively writing off billions of dollars to account for those cuts, but are also guiding better earnings going forward because of those same cuts. Short term pain for long term gain. With stronger earnings, balance sheets can be improved while still rewarding the shareholder. Stock picking of U.S. companies will be that much more complicated and challenging throughout this year and I will be increasingly looking to top quartile money managers to help us navigate this minefield.
- Increased interest rates help our clients achieve a better rate of return within their fixed income allocation of the portfolio. Less risk than equites, and getting a bit better return than you have experienced over the past several years.
- International economies continue to experience growth and that will be supportive of those equity markets. Throughout 2017 I had increased our weighting to the international markets and will continue to do so in 2018.
- In 2017, Canada led the G-7 countries in economic growth with GDP expanding 3% and added an impressive 420,000 net new jobs. This momentum is expected to continue into 2018, albeit at a slightly lower rate of growth.
- OPEC seems to be making a positive difference on oil prices with their continuation of curtailing production. Although the U.S. continues to ramp up production, increased demand seems to be holding inventories in balance.
- Although QE is being unwound, that process appears to be conducted in an orderly fashion with one eye on how asset prices react along the way. Getting interest rates higher and reducing QE are necessary events to generate dry powder for the next recession.

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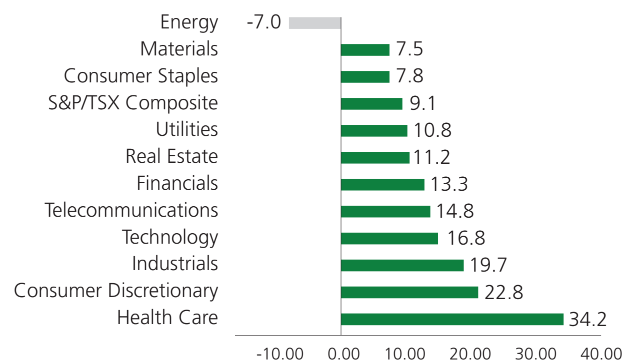
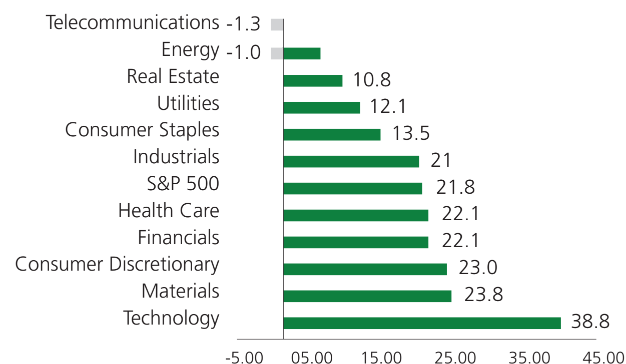
2017 S&P/TSX Composite Sector



Source: Bloomberg Finance LP., as at December 31, 2017. Index Total Returns

2017 YTD S&P 500 Sector Returns



Source: Bloomberg Finance LP., as at December 31, 2017. Index Total Returns

Equity Market Returns

Description	Indices	YTD Return
CAD	S&P/TSX Composite Index	9.10%
US	S&P 500	13.47%
International	MSCI Europe (LC) Index	17.57%
	Nikkei 225 stock Average	17.08%

Sources 1 Q4/17 Quarterly Market Review, Portfolio Advice & Investment Research.

2017 Market Highlights

- Canadian equites had a solid year given their very slow start. The 9.1% return was generated only since September. A strong contributor for the year was health care stocks with marijuana companies and Valeant Pharmaceuticals doing all the heavy lifting within that sector. Energy companies were the major stumbling block with a -7% return over the past year.
- U.S. equities markets kept ratcheting up to new highs, but the returns were more muted in Canadian dollar terms as our dollar strengthened throughout the year. The technology sector was the leader in the U.S. and had a material impact on overall performance as it is the largest sector in the S&P 500 index at over 22%.
- Although interest rates moved up in 2017, which negatively affects bond returns, corporate bonds had a marginal positive year overall which was driven by a tightening of credit spreads.
- International market returns finally showed strength as economies grew and some of the election uncertainties within the EU were abated.

2018 Portfolio Positioning

1. With interest rates forecasted to continue their upward trajectory, I will continue to ladder maturities along the yield curve. I have also been utilizing a few top rated fixed income money managers that undertake some hedging strategies to help increase returns and reduce risk. Risk in fixed income comes in many varieties such as default, credit, duration, and liquidity.
2. I continue to review opportunities to increase our allocation to the U.S. and International markets. At the beginning of last year it was the low Canadian dollar that provided the headwind of converting to USD's and investing. At this point in time, it is market valuations that warrant increased caution.
3. Market volatility can be reduced and returns enhanced with an investment in a market neutral hedge fund that has virtually no correlation to equity markets. TD Wealth recently launched a liquid private equity pool for retail investors managed by Brookfield Asset Management that is focused on global infrastructure investments. I plan on increasing our allocation to these liquid alternative investment vehicles.

TFSA and RSP

The TFSA limit for the 2018 calendar year is $5500, with a lifetime cumulative contribution limit now at $57,500.

For those of you who make your 2017 RSP contribution by March 1st 2018, the 2017 limit is 18% of earned income to a maximum of $26, 010, subject to adjustments. The 2018 RSP limit is $26,230, subject to adjustments.

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Final Thoughts

2018 should be another positive year for global equity markets, although I believe increased volatility will finally begin to appear. Company earnings will be the key driver of individual stock performance given the heightened level of valuations. I believe that these valuations are priced to perfection and I expect investors will have very little tolerance on missed earnings. The challenge for analysts and money managers following U.S. companies is correct forecasting of earnings given the recent changes in tax rates and their effect on specific company's earnings.

Canadian markets should hold up relatively well with the recent strength in energy and base metal prices as global economies continue to grow. Challenges will be stainability of higher energy prices, elevated housing prices, new mortgage rules, and the outcome of NAFTA negotiations.

Jay, Catherine, Maddie and I thank you for your business and wish you and your family a prosperous, healthy, and safe 2018. We look forward to meeting with you in the new year to review your specific needs and navigate your financial journey with experience, knowledge, and commitment on your side.

If you have any questions or issues you would like to discuss, we would be happy to receive your call.

Sincerely,

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Sources: [1] Q4/17 Quarterly Market Review, Portfolio Advice & Investment Research. The information contained herein has been provided by Borger Wealth Advisory Group and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the fund facts and prospectus, which contain detailed investment information, before investing. Mutual funds are not guaranteed or insured, their values change frequently and past performance may not be repeated. Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS. Bloomberg and Bloomberg.com are trademarks and service marks of Bloomberg Finance L.P., a Delaware limited partnership, or its subsidiaries. All rights reserved. Borger Wealth Advisory Group consists of Joshua Borger, Vice President, Portfolio Manager & Investment Advisor; Jay Kolebaba, Investment Advisor and Catherine Edwards, Client Service Associate. Borger Wealth Advisory Group is part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. TD Waterhouse Canada Inc. is a subsidiary of The Toronto-Dominion Bank. TD Waterhouse Canada Inc. – Member of the Canadian Investor Protection Fund. All trademarks are the property of their respective owners. ® The TD logo and other trade-marks are the property of The Toronto-Dominion Bank.
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