Quarterly Market Review

Portfolio Advice & Investment Research

October 2, 2018

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Unless otherwise indicated, performance figures are stated on a total return basis.

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Please refer to Appendix A of this report for important disclosure information.

Q3/18 Quarterly Market Review

Highlights

Canadian & U.S. Fixed Income

- The Canadian government bond index fell 1.15% Q/Q, underperforming the U.S. government bond index, which declined 0.60% Q/Q, as measured by the Bloomberg U.S. Treasury Bond Index.
- Canadian and U.S. corporate bond indices registered returns of -0.46% and +0.94%, Q/Q respectively. Underperformance in Canada was largely due to duration as credit markets continued to hold up well. U.S. investment-grade credit spreads narrowed slightly during the quarter as supply-demand imbalances eased.
- High-yield credit spreads remained narrow compared to historical levels, supporting a return of 2.44% Q/Q for the sector in the United States

Canadian Equities

- The Canadian equity market edged downward in Q3/18 as the S&P/TSX Composite Index fell 0.57%.
- Six of the eleven sectors posted a positive return. Health care was up 31.38% on the strength of cannabis stocks.
- Mid-cap stocks outperformed large- and small-cap stocks, and growth stocks outperformed their value counterparts.

U.S. Equities

- U.S. equity markets powered ahead on strong economic data. The S&P 500 returned 7.71%, the Dow jumped 9.63% and the NASDAQ returned 7.41%.
- All 11 sectors in the S&P 500 delivered a positive return during the third quarter.
- Large-cap U.S. equities significantly outperformed small-cap and mid-cap stocks, and U.S. growth stocks outperformed their value counterparts.

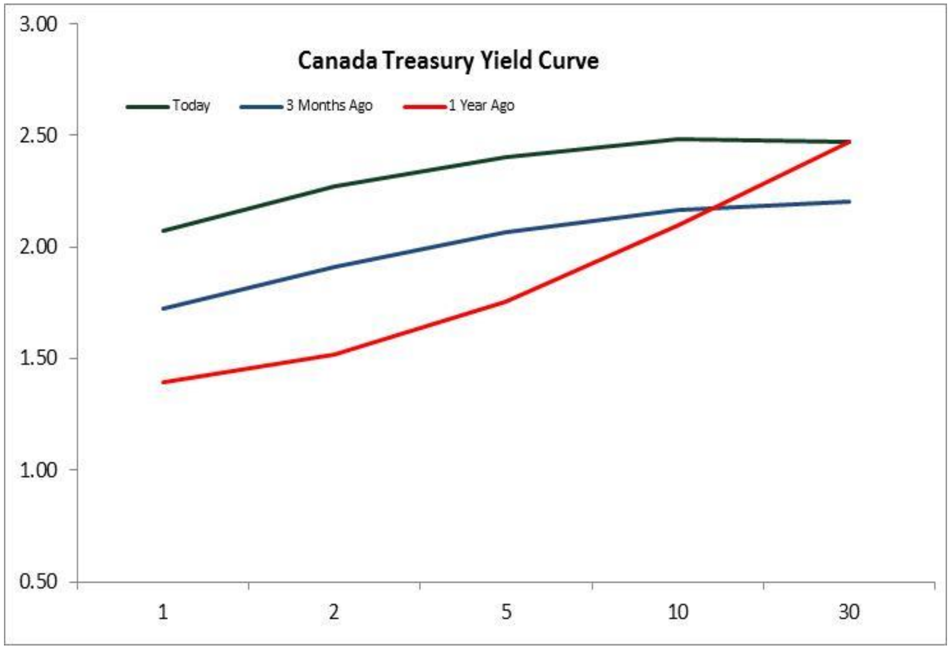
International Equities

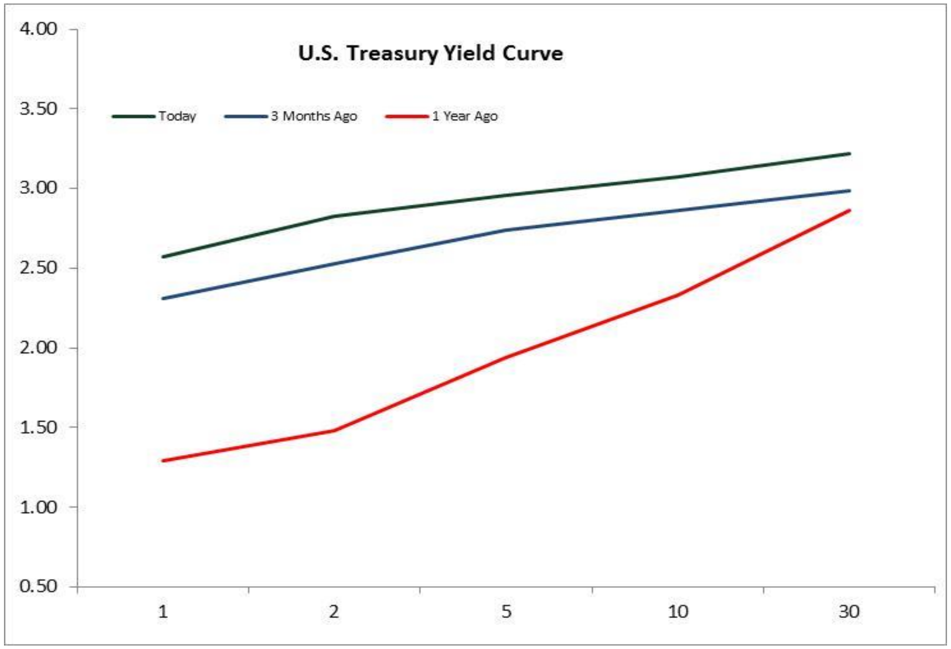
- Major developed markets were mixed in Q3/18, with Japanese equities a strong outperformer on the weakening yen. The MSCI Emerging Markets Index rose 0.42%, slightly underperforming developed markets as instability in Turkey, Russia and Argentina dampened sentiment, in addition to rising tariff pressure on China.

Canadian & U.S. Fixed Income

Money Market/Bond Issues and Indices	Q3/18 Return	YTD Return	Canadian Yields	U.S. Yields
91-Day Treasury Bill	--	--	1.58%	2.20%
2-Year Government Bonds	--	--	2.21%	2.82%
5-Year Government Bonds	--	--	2.34%	2.95%
10-Year Government Bonds	--	--	2.43%	3.06%
30-Year Government Bonds	--	--	2.42%	3.21%
FTSE Russell Canada Universe Bond Index	-0.96%	-0.35%	2.91%	--
FTSE Russell Canada All Government Bond Index	-1.15%	-0.57%	2.69%	--
FTSE Russell Canada All Corporate Bond Index	-0.46%	+0.23%	3.44%	--
FTSE Russell Canada Real Return Bond Index	-2.21%	+1.08%	0.71%	--
ICE BofAML US High Yield Index – US$	+2.44%	+2.52%	--	6.23%
ICE BofAML High Yield Canadian Issuers Index - US$	+2.14%	+1.72%		--

Source: Bloomberg Finance L.P. as at September 30, 2018. Index returns are reported on a total return basis.





Source: Bloomberg Finance L.P. as at September 30, 2018.

The Canadian government bond index fell 1.15% quarter-over-quarter (Q/Q) in Q3/18, underperforming the U.S. government bond index, which declined 0.60% Q/Q. On a year-to-date (YTD) basis, the FTSE Russell Canada All Government Bond Index was down 0.57%, while the Bloomberg U.S. Treasury Bond Index was off 1.64%.

After a relatively calm summer for financial markets in developed economies, G-7 sovereign yields drifted up in September toward their year highs (10-year U.S. Treasury to 3.10% from 2.4% at the end of 2017). The upward movement in yields during the quarter reflected firm risk markets that saw record highs established by U.S. equity indices and solid economic data that firmed central bank rate-hike expectations. The U.S Federal Reserve raised its policy rate in September, with the Bank of Canada expected to hike its policy rate again in October. The European Central Bank reiterated its plan to end its quantitative easing policy by December this year, and begin raising rates in the fall of 2019. Although the Bank of Japan has made no indications to change monetary policy, the gradual rise in global interest rates has effectively reduced the amount of asset purchases needed to maintain its target rate of approximately 0.0% for the 10-year government bond yield.

The U.S. Federal Open Market Committee on September 26, 2018, increased the target federal funds rate by 25 basis points (bps) to a range of 2.00% to 2.25%, with a target effective rate of 2.125%. In updated September forecasts, the median projection of Fed officials remained at four rate hikes for 2018, three for 2019 and one for 2020 (none for the newly added 2021 forecast). The longer-run federal funds rate projection ticked up to 3.00% from 2.875%. Another 25-bps rate hike is currently discounted by the market in December and two or three more are expected in 2019, which brings the Fed Funds rate back to a “neutral” level from “emergency” levels. Notably, the median Fed projection for the federal funds rate is anticipated to remain above the longer-run neutral level through 2021.TD Economics is forecasting a further rate hike in 2018 (December), three in 2019 and expects the funds rate to peak in the vicinity of 3.25% this cycle, slightly above the Fed’s estimate of the longer-run neutral rate.

Bank of Canada (BoC) Governor Stephen Poloz’s September 28 speech reiterated that the path for the central bank is towards higher rates, re-emphasizing its data dependency and “measured pace” approach. He noted that the BoC’s models put the economy at full capacity, which was consistent with core inflation metrics, but cautioned that the forecasts were inexact. He argued that the Bank could not conduct monetary policy mechanically, citing uncertainties relating to high household debt levels, new mortgage lending guidelines, and around international trade policy. The United States and Canada reached a last-minute agreement to salvage the North American trilateral trade pact, with reduced trade uncertainty being less of hindrance for the BoC to conduct monetary policy. Following a 25-bps rate earlier this year on July 11, another BoC rate hike is widely expected on October 24, which still puts it roughly 75 bps below “neutral,” according to TD Economics.

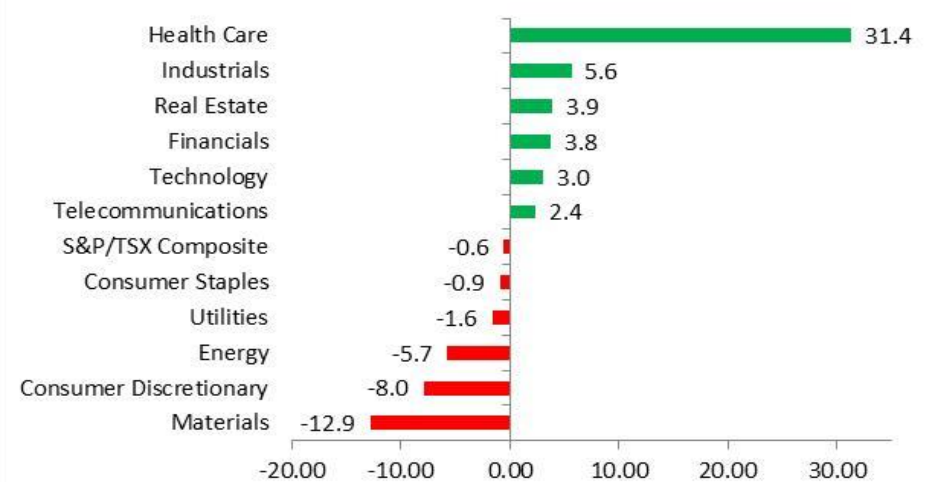
Yield curves in North America continued to flatten in Q3/18. The U.S. Treasury (UST) yield curve bear-flattened with yields of longer-dated securities rising less than those at the front end of the curve. The 2-year UST note yielded 2.82% at the end of September, as yields rose 29 bps during the quarter. The 10-year UST yielded 3.06% at the end of Q3/18, as yields were up 20 bps during the quarter. The Canadian yield curve flattened by 4 bps in Q3/18, reflecting a largely upward parallel shift as Bank of Canada rate-hike expectations were recalibrated higher by resilient economic data. The 2-year Government of Canada bond yielded 2.21% at the end of September, up 30 bps from the end of Q2/18. The 10-year Government of Canada bond yielded 2.43% at the end of Q3/18, as its yield rose 26 bps during the quarter.

Canadian and U.S. corporate bond indices registered returns of -0.46% Q/Q and +0.94% Q/Q, respectively, in Q3/18. The underperformance in Canada was largely due to duration as credit markets continued to hold up well. U.S. investment-grade (IG) credit spreads narrowed slightly during the quarter as supply-demand imbalances caused by U.S. tax changes and primary market issuance eased. High-yield credit spreads remained narrow compared to historical levels, supporting a return of 2.44% Q/Q for the sector in the U.S.

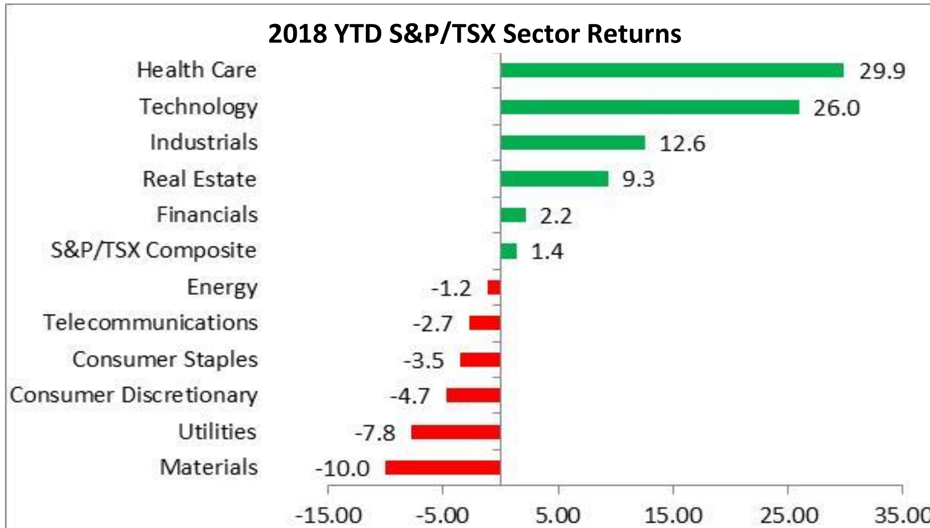
Canadian Equities

Indices	Q3/18 Return	YTD Return
S&P/TSX Composite Index	-0.57%	+1.36%
S&P/TSX 60 Index	-0.65%	+1.48%
S&P/TSX Cdn MidCap Index	-0.34%	+0.96%
S&P/TSX Cdn SmallCap Index	-2.81%	-4.42%
S&P/TSX Preferred Share Index	+0.45%	-1.17%

Source: Bloomberg Finance L.P. as at September 30, 2018. Total index values and returns, except the S&P/TSX Preferred Share Index which is reported on a price return basis.



Source: Bloomberg Finance L.P., as at Sept 30, 2018. Index Total Returns.



Source: Bloomberg Finance L.P., as at Sept 30, 2018. Index Total Returns.

The Canadian economy accelerated as we approached mid-year, with real GDP expanding at an annualized pace of 2.9% (1.4% in Q1/18). Stronger economic growth was attributable to rising energy and consumer goods exports. Household spending, up 2.6%, also played an important role, outpacing a negligible rise in income. Business investment, however, was limited to a 2.2% rise, its slowest pace in six quarters, and muted economic activity set the stage for a slowdown going into the second half of the year. In the third quarter, slowing mortgage growth helped tame the rise in household debt, as servicing costs rose alongside mortgage rates. In September, the Bank of Canada held its key policy rate at 1.5%, but in doing so struck a somewhat more hawkish tone. TD Economics now expects real GDP growth to slow to the low-2% range in the fourth quarter. The announcement of the US-Mexico-Canada (USMCA) trilateral trade agreement, on September 30, could support a stronger outlook for the Canadian economy and signal a faster pace of rate hikes. The BoC's next rate hike is now widely expected in October, as the Bank weighs a slowdown in business investment against a recent uptick in inflation and the impact of the new trade agreement.

Canadian equity markets were slightly negative in Q3/18 as the S&P/TSX Composite Index edged downward 0.57% (+1.36% YTD) and about half of the S&P/TSX capped indices (six of eleven) posted positive returns. Health care was the top-performing sector during the quarter, posting a 31.38% return (29.88% YTD) as cannabis stocks skyrocketed: Aurora Cannabis Inc., Aphria Inc. and Canopy Growth Corp. advanced by 38.50%, 51.64% and 63.33% respectively. Energy stocks, meanwhile, fell 5.73% (-1.17% YTD) alongside a 1.21% quarterly decrease in West Texas Intermediate crude oil prices. Oil prices seesawed in the quarter, as a boost in Lybian supply gave way to broader fears over Iranian sanctions and diminished OPEC supply. Financials, comprising the largest S&P/TSX sector, returned 3.78% during Q3/18 (2.24% YTD), significantly outperforming the broader index thanks to strong earnings reports. The price of gold bullion continued its downward trend, falling 4.84% in Q3 (-8.48% YTD) as traders respond to a U.S. dollar that has risen on the back of tax cuts and rising interest rates.

During the quarter, mid-cap stocks outperformed small-cap and large-cap stocks. The S&P/TSX Canadian Mid Cap Index returned -0.34% in Q3/18 (+0.96% YTD) compared to -0.65% for the large-cap S&P/TSX 60 Index (+1.48% YTD) and -2.81% for the S&P/TSX Canadian Small Cap Index (-4.42% YTD). Canadian growth stocks, as measured by the Morningstar Canada Target Momentum Index, declined 2.62% (+13.27% YTD) and outperformed the comparable value benchmark, the Morningstar Canada Target Value Index, which returned -2.85% (-4.83% YTD). The S&P/TSX significantly underperformed its cousin to the south, as the S&P 500 surged on positive economic data.

Canadian preferred shares rose 45 basis points during Q3/18. The S&P/TSX Preferred Share Index gained 1.10% over the July-August period before it erased most of those gains in September. Price movements over the quarter have been primarily driven by a rise in interest rates. When looking at the aggregate market movement, it would seem at first that credit spreads have had an impact on prices. However, a deeper look at the performance of the individual segments would provide a better understanding of the reason behind the market return. Fixed rate-resets rose 0.91% during the quarter due to a 27-basis-point rise in the five-year Government of Canada bond yield, which closed the quarter at 2.34%. Floating rate-resets were the best performing segment, gaining 3.68%. Perpetuals, on the other hand, declined 0.66% in response to a 22-basis-point rise in the 30-year Government of Canada bond yield, which closed the quarter at 2.42%.

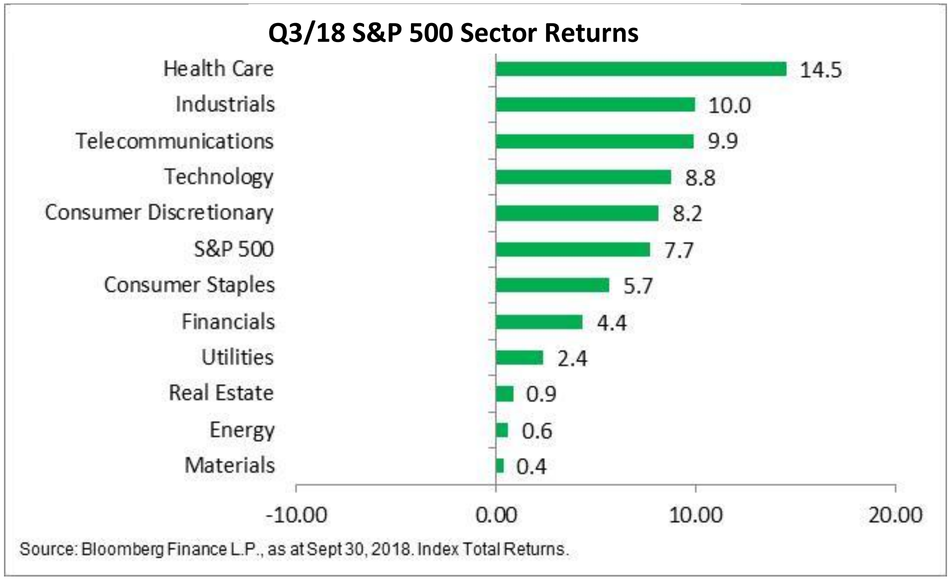
On a year-to-date basis, Canadian preferred shares achieved a return of -1.17% (2.31% on a total-return basis). New issuance amounted to C$950 million during the quarter and was concentrated in one week in September, while redemptions, which were limited to bank issues that do not comply with the non-viability contingent capital (NVCC) treatment, amounted to C$800 million. Total new issuance for the same period in 2017 amounted to C$1.25 billion.

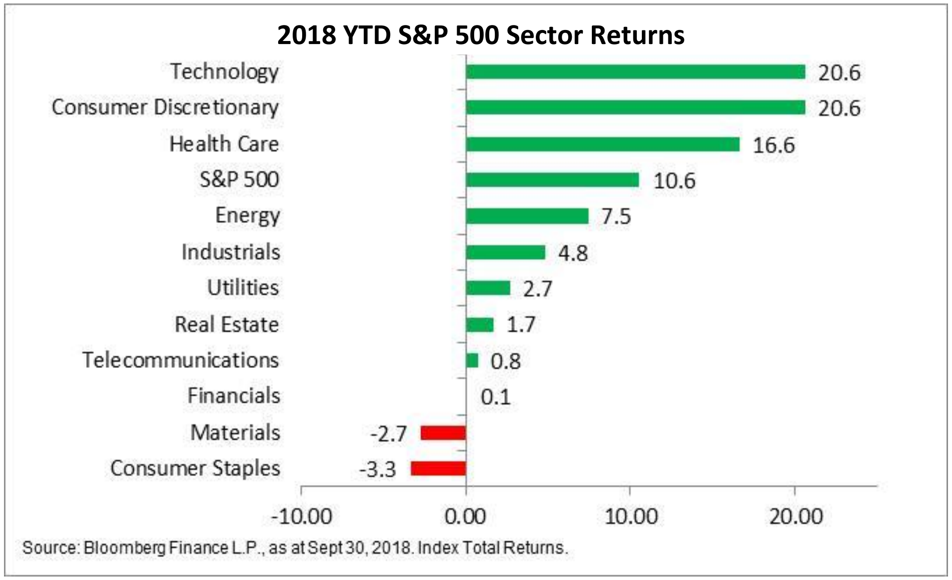
Interest rates are expected to stay as the main driver of returns in the fourth quarter of the year, although those returns might be dampened by increasing new issuance as non-financial companies look to right-size their capital structure.

U.S. Equities

Indices	Q3/18 Return	Q3/18 Return (C$)	YTD Return	YTD Return (C$)
Dow Jones Industrial Average Index	+9.63%	+7.91%	+8.83%	+12.41%
S&P 500 Index	+7.71%	+6.02%	+10.56%	+14.20%
S&P 400 Index	+3.86%	+2.24%	+7.49%	+11.02%
NASDAQ Composite Index	+7.41%	+5.73%	+17.48%	+21.34%
Russell 2000 Index	+3.58%	+1.95%	+11.51%	+15.18%

Source: Bloomberg Finance L.P. as at September 30, 2018. Total index values and returns. Index returns calculated in local currency and C$.





U.S. equity markets were firing on all cylinders throughout the third quarter. The S&P 500 returned 7.71% in Q3/18 (10.56% YTD), the Dow jumped 9.63% (8.83% YTD) and the NASDAQ returned 7.41% (17.48% YTD). All 11 sectors in the S&P 500 delivered a positive return during the quarter, with health care and industrials enjoying the biggest increases, respectively, at 14.53% (16.63% YTD) and 10.00% (4.84% YTD).

U.S. markets shrugged off the implications of an escalating trade war with China. In the second quarter, after-tax corporate profits grew the most Y/Y since 2012, and real GDP grew an impressive 4.2%, the most Y/Y since 2014. Federal Reserve Chair Jerome Powell made clear that concerns over protectionism would not deter the Fed from its program of gradual rate hikes, alongside steadily rising inflation. Investors disregarded weak housing data — both in terms of starts and existing home sales — as well as economic crises in Argentina and Turkey, focusing instead on positive indicators, such as a trade truce with the European Union in July and a bilateral agreement with Mexico in August, which Canada joined in late September. As the U.S. economy continues to boom, tilting the labour market in favour of workers, the Fed has seen little reason to alter course. On September 26, it raised the upper limit of its funds rate 25 basis points, to 2.25%.

The S&P 500, a benchmark for U.S. large-cap equities, increased 7.71% in Q3 (10.56% YTD) and significantly outperformed small-cap U.S. stocks, as measured by the Russell 2000 Index, which returned 3.58% (11.51% YTD). The S&P 500 also outperformed the S&P 400 Index, a measure of U.S. mid-cap stocks, which rose 3.86% (7.49% YTD). U.S. value stocks, as measured by the Morningstar U.S. Value Index, returned 5.66% (3.90% YTD), and underperformed the comparable growth benchmark, the Morningstar U.S. Growth Index, which registered a total return of 7.59% (20.53% YTD) during the quarter.

International Equities

Indices	Q3/18 Return	Q3/18 Return (C$)	YTD Return	YTD Return (C$)
FTSE 100 Index	-0.66%	-3.34%	+1.01%	+0.61%
DAX Index	-0.48%	-2.57%	-5.19%	-5.40%
CAC 40 Index	+3.36%	+1.19%	+6.43%	+6.20%
MSCI Europe (LC) Index	+2.12%	+1.29%	+2.21%	+3.41%
Nikkei 225 Stock Average	+8.91%	+4.63%	+7.79%	+10.44%
MSCI Emerging Markets Free (LC) Index	+0.42%	-1.71%	-2.26%	-3.73%

Source: Bloomberg Finance L.P. as at September 30, 2018. Total index values and returns. Index returns calculated in local currency and C$.

Major developed markets were mixed in Q3/18, with Japanese equities a strong outperformer. In Europe, the U.K.'s FTSE 100 Index seesawed, ending the quarter with a -0.66% return (+1.01% YTD). Britain's blue-chip index rose steadily through July, as consumer stocks selling to U.S. markets benefited from a depressed pound. The British currency continued to fall through August, as Prime Minister Theresa May faced criticism both at home and abroad for her Brexit strategy, raising fears of a "no deal" scenario. Exchange-related gains were short-lived, however, as the Turkish economic crisis precipitated a sell-off across Europe. British stocks continued to decline in September, as sterling firmed and hopes fizzled that a U.S.-China trade war could be averted.

Germany's DAX Index returned -0.48% in Q3/18 (-5.19% YTD) and France's CAC 40 Index returned 3.36% (6.43% YTD). On September 13, in a well telegraphed announcement, the European Central Bank's (ECB) Governing Council reaffirmed that it will not raise rates until the fall of 2019. The ECB, however, will continue its de facto tightening policy of tapering off purchases under its quantitative easing program. The central bank intends to halve its QE asset purchases in October, to 15 billion euros, and wrap up the 2.6-trillion-euro program by the end of December, assuming economic developments play out as expected.

Japan's Nikkei 225 Stock Average returned 8.91% in Q3/18 (7.79% YTD), rising to a 27-year high on a weakening yen and easing trade concerns. On September 19, the Bank of Japan (BoJ) Policy Board voted 7-2 to maintain its ultra-loose policy. The BoJ will keep its short-term rate target at -0.1% and continue to guide 10-year yields to 0.0%, despite a July decision to allow a more flexible framework for the long-term target. In his policy statement, Governor Haruhiko Kuroda noted that Japan's export-reliant economy was set to expand modestly on the back of global demand. Kuroda, however, reaffirmed a pledge to keep rates low as inflation remains far below the BoJ's 2% target.

The MSCI Emerging Markets Index returned 0.42% in Q3/18 (-2.26% YTD), as markets seesawed on souring relations with the world's largest economy. Equity markets in Turkey and Russia plummeted on the threat of U.S. sanctions, while China committed to boost stimulus as it was drawn into an escalating trade war with the United States. Mexico managed to strike a bilateral deal with its northern trading partner, providing a brief respite in August (with Canada joining in after market close on September 30). The Shanghai Composite PR Index returned -0.92% (-14.69% YTD), and the Indian Nifty 50 PR Index returned 2.02% in Q3/18 (3.80% YTD), hitting a two-year high in August, as blue-chips bucked the broader trend on the back of solid financial-sector fundamentals.

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