TD Wealth

Capital Markets Overview

Winter 2017

The first 'order-of-business' is surely to wish all of you a very Happy New Year and a prosperous one too!!

An Overview of 2016 and Looking Back for 58 Years

Let us move to the business at hand. First, I will outline a short list of the benchmark returns for 2016. Most of our clients do not have a strong desire for heavy equity participation (i.e. TSX and U.S. S&P 500 returns below) so it will be hard to match the equity returns (unless you put all your investment assets into CDN equities) but we had a successful 2016:

TSX S&P	21.1 %
S&P 500 in the U.S. (CDN $$)	12.0 %
Popular bond index	1.7 %
90 Day Treasury Bills	.5 %

Source: Bloomberg Finance L.P. -2016 annual returns

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Our model portfolios did quite well as we strongly performed above the Canadian TSX (up 44.2%) but fell short of matching the U.S. S&P 500 (down 1.2%); but by diversifying and using both models, we managed on a net-to-net basis to potentially outperform the Canadian index above. We also did well in the fixed income markets as the choice of our preferred shares rebounded nicely from a disappointing 2015. Most of our clients had solid results from a return perspective so we are reasonably pleased. By all means feel free to call us to discuss your individual concerns/results. They will be sent to you soon.

The big decision for most of you – IF you want better returns – is to give us the appropriate Investment Profile (see later in this CMO) and give us the appropriate percent to invest in ‘equities’ or ‘common shares’ or ‘stocks’ (this is dependent of your risk tolerance). While the U.S. Federal Reserve have now started to increase interest rates – they remain extremely low and Fixed Income returns will likely be poor to negative as yields rise. We will do our best to earn you a positive return but it will be very difficult for most bonds and properly diversified Fixed Income portfolios.

Let us move to a quick discussion of the equity markets. It is now Jan 16th as I write this part of our Capital Markets Overview (CMO). The TSX ended Dec 31, 2016 at 15,287 and has now moved up 166 points to 15,453 thus far in 2017 and we have increased our target for this business cycle to 16,000. The S&P 500 in the U.S. ended 2016 at 2,238 and now sits at 2,274 – up 36 points thus far in 2017. We do not establish targets for the S&P 500 index. And we would like to put our use of the Canadian TSX target into perspective.

We believe that stock markets like to ‘double’ (sometimes more than double) over the course of a complete business cycle. A business cycle - in the equity markets - is defined as the low point in a recession to the peak level in a new economic and business cycle.

The latest cycle started in March, 2009 with the TSX at 7,479 although we have used 8,000 as our starting point for our target rather than the exact low point. The peak of the current cycle has yet to be reached and no one knows when or at what level it will do so. All one can do is use reasonable estimates. By doubling the exact low above (i.e. 7,479) we arrive at a target of 14,958 and by using 8,000 as the low we arrive at 16,000. We initially used a target level of 15,000 given the low economic growth rates in this cycle but increased it recently from 15,000 to 16,000 and e-mailed all of you on December 1, 2016 with this change. The previous peak for the last business cycle occurred in June, 2008 at 15,154. On the next page is our proprietary Canadian annual return analysis since 1959 to reflect last year’s (2016) returns and organized by each of the 7 business cycles over this 58 year period had been conducted. The annual 58 Year Rate of Return (ROR) analysis may help you understand the nature of returns in the Canadian capital markets. We strongly urge all of you to review this analysis and the trends of previous business cycles. It definitely helps to put our ongoing discussion of returns into perspective. Since, as previously stated, we believe strongly in business cycles.

Over the past 58 years there have been 7 business cycles; therefore each cycle has an average length of about 8 years. We are now into our 9th year of the current cycle – so this one is getting a little too long. Perhaps Donald Trump should have considered this before he ran for Presidency. Just as an aside – which has failed to be mentioned by most, when Barack Obama took office in January, 2009 the S&P 500 in the U.S. stood at 826. It is now at 2,274 – UP 175% since his election. It went from 826 to 1,498 – up 672 or 81% in his first term and a further 776 points or 94% (since he was first elected) in his second term. While this may offend some – his Presidency has definitely helped equity returns. As you know, Mr. Obama was a Democrat. His predecessor, George Bush, was a Republican and took office in January, 2001. The S&P 500 stood at 1,366 on Jan 31, 2001 and 4 years later was at 1,181 (down 185 points or 13.5%) and then closed at 826 on Jan 31, 2009 (after weathering the 2008 recession). But even if you use the peak of the S&P 500 of 1,576 in October, 2007 – Mr. Bush’s Presidency only brought about a gain of 210 points in 6 years – not a successful Presidency from an equity viewpoint for a Republican.

You will note from the ROR that stocks have 2 attributes: (1) they have the highest return over each business cycle and over the past 58 years; (2) they also have the most number of years when they have ‘negative’ returns. However, most of the ‘larger’ declines have occurred around or near a recession to reflect an outlook for declining corporate earnings during poor economic conditions. For this reason – we, at Arnaud Wealth Management Group (AWMG), do NOT like recessions and tend to be very conservative in our approach ***if we feel future economic prospects are going to deteriorate.*** Given that we are now entering the 9th year of the current cycle, that the stock market has almost doubled, that many individual equities have or will soon reach their full potential (in our opinion), that interest rates may soon start to rise further (which normally occurs towards the end of most business cycles), that real estate markets appear to be fully valued – we are and will remain cautious for the duration of this cycle. We do NOT – unless you are aggressive with your Investment Profile – recommend an ‘overweight’ in equities. This said, it is highly unlikely most portfolio managers will get you or anyone solid returns in any of the other major asset classes. ***<u>You must therefore prepare for a period of lower returns until the next recession</u>***.

58 Years of History

Comparative Rates of Return for the Major Asset Classes
Canadian Capital Markets

			Fixed Income		Equity			
			Cash	Bonds	Stocks			
			Short Term	Long Term				GDP
	Year		T-Bills	Bond Index	TSE Index	Average	Inflation	Growth
1	1959		4.6	-5.1	4.6	1.4	1.3	3.9
2	1960 R		3.3	12.2	1.8	5.8	1.3	2.9
3	1961		2.9	9.2	32.8	15.0	0.6	3.1
4	1962		4.2	5.0	-7.0	0.7	1.3	7.1
5	1963	Cycle	3.6	4.6	15.6	7.9	1.9	5.2
6	1964	1	3.8	6.2	25.4	11.8	1.8	6.7
7	1965		3.9	0.1	6.7	3.6	2.4	6.6
8	1966		5.0	-1.1	-7.1	-1.1	3.5	6.8
9	1967		4.5	-0.5	18.1	7.4	3.7	2.9
10	1968		6.4	2.1	22.5	10.3	4.1	5.4
11	1969 R		7.1	-2.9	-0.8	1.1	4.5	5.4
12	1970	Cycle	6.7	16.4	-3.6	6.5	3.3	2.6
13	1971	2	3.8	14.8	8.0	8.9	2.9	5.8
14	1972		3.6	8.1	27.4	13.0	4.7	5.7
15	1973		5.1	1.9	0.3	2.4	7.7	7.7
16	1974 R		7.9	-4.5	-25.9	-7.5	10.9	4.4
17	1975		7.4	8.0	18.5	11.3	10.8	2.6
18	1976	Cycle	9.3	23.6	11.0	14.6	7.5	6.2
19	1977	3	7.7	9.0	10.7	9.1	8.0	3.6
20	1978		8.3	4.1	29.7	14.0	8.8	4.6
21	1979		11.4	-2.9	44.8	17.8	9.2	3.9
22	1980		15.0	6.6	30.1	17.2	10.2	1.5
	Ave Returns First 22 Years		6.2	5.2	12.0	7.8	5.0	4.8
	No. shaded Yrs		5	5	12			
23	1981 R		18.4	4.2	-10.3	4.1	12.5	3.7
24	1982 R		15.4	35.4	5.5	18.8	10.8	-3.2
25	1983		9.6	11.5	35.5	18.9	5.8	3.2
26	1984	Cycle	11.6	14.7	-2.4	8.0	4.4	6.3
27	1985	4	9.9	21.2	25.1	18.7	4.0	4.8
28	1986		9.3	14.7	9.0	11.0	4.1	3.3
29	1987		8.5	4.0	5.9	6.1	4.4	4.2
30	1988		9.4	9.9	11.1	10.1	4.1	5.0
31	1989		12.4	13.2	21.4	15.7	5.2	2.4
32	1990 R		12.9	7.3	-14.7	1.8	5.0	-0.2
33	1991		8.6	21.6	12.0	14.1	3.8	-1.8
34	1992		7.1	9.8	-1.4	5.2	2.1	0.8
35	1993		5.5	17.5	32.6	18.5	1.7	2.2
36	1994		5.4	-4.3	-0.2	0.3	0.2	4.6
37	1995	Cycle	7.6	20.5	14.5	14.2	1.8	2.3
38	1996	5	4.8	12.2	28.3	15.1	2.2	1.3
39	1997		3.2	9.7	15.0	9.3	0.7	3.0
40	1998		4.7	9.2	-1.6	4.1	1.0	1.5
41	1999		4.7	-1.1	31.7	11.8	2.6	4.5
42	2000		5.3	10.2	7.4	7.6	3.2	4.0
43	2001 R		4.2	8.1	-12.6	-0.1	0.7	1.0
44	2002 R		2.5	8.7	-12.4	-0.4	4.2	3.0
45	2003		3.0	6.6	26.7	12.1	3.0	4.0
46	2004		2.3	7.1	14.5	8.0	2.0	3.0
47	2005	Cycle	2.5	6.5	24.1	11.0	3.0	4.2
48	2006	6	4.0	4.0	17.3	8.4	1.8	3.0
49	2007		4.3	3.8	9.8	6.0	2.2	3.0
50	2008 R		3.1	19.7	-33.0	-3.4	1.6	-1.5
51	2009		0.5	-6.3	35.1	9.8	1.0	-4.0
52	2010		0.4	6.7	17.6	8.2	1.5	2.0
53	2011		1.0	9.7	-8.7	0.7	2.0	1.5
54	2012	Cycle	0.9	3.6	7.2	3.9	1.5	1.8
55	2013	7	1.0	-1.2	13.0	4.3	1.8	2.0
56	2014		0.9	8.8	10.6	6.8	1.5	1.8
57	2015		0.6	3.5	-8.3	-104.0	3.1	1.3
58	2016		0.5	1.7	21.1	7.8	1.5	1.8
	Ave Returns Next 36 Years		5.7	9.2	9.6	5.3	3.1	2.2
	No. shaded Yrs		4	13	19			
	Average Return Over 58 Years		5.9	7.7	10.5	6.3	3.8	3.2
	No. shaded Yrs		9	18	31			
	No. of yrs with Negative Returns		0	10	16			
	Ave Return During Negative Yrs			-2.1	-9.4			

Sources: Bloomberg Finance L.P., Bank of Canada

Our Investment Profiles

We operate with 7 basic Investment Profiles and have updated them since moving to T D Wealth. We ask you to complete a questionnaire – which analyzes your objectives and risk tolerances – and then ask that you choose a basic investment profile with the appropriate and associated asset mix. You are free to redo the questionnaire at any time on a voluntary basis although we may ask that you do it every 7 or 8 years pending our views of the capital markets. Here are the profiles with an upper and lower asset mix constraint AND a 'target' level:

	Cash Reserves (no risk)	*Fixed Income (less risk)*	*Equities (more risk)*
Ultra Conservative	0% to 100% - **target 75%**	0% to 40% - **target 25%**	**0%**
Conservative Income	0% to 100% - **target 30%**	0% to 100% - **target 50%**	0% to 35% - **target 20%**
Balanced Income (Conservative)	0% to 30% - **target 5%**	50% to 90% - **target 60%**	10% to 50% - **target 25%**
Balanced (Conservatively Bal)	0% to 30% - **target 5%**	40% to 70% - **target 45%**	25% to 65% - **target 35%**
Balanced Growth (Aggressively Bal)	0% to 30% - **target 5%**	20% to 60% - **target 30%**	45% to 75% - **target 50%**
Growth (Aggressive)	0% to 50% - **target 5%**	0% to 50% - **target 10%**	50% to 100% - **target 70%**
Aggressive Growth (V Aggressive)	0% to 60% - **target 5%**	0% to 60% - **target 0%**	70% to 100% - **target 80%**

Here are the 7 basic profiles with the corresponding asset mix – noting that we usually combine 'all' (i.e. add all your individual accounts together) your financial assets to establish one investment profile. This can get a little awkward at the regulatory level since they want us to assign a profile and risk tolerance for 'each' account. This makes some sense for selected accounts but we deal with this at each client level. Note that target levels above do not add to 100%. The difference is allocated to Alternatives.

Using and Understanding the Importance of Your Investment Profile

You can change your profile at any time. BUT it will likely require you to re-sign an Investment Policy Statement for each change. I would like to give you an example.

First, however, you should note the 'Target' levels above. This is what we normally strive towards in managing your investments and portfolios with us. If you have any questions – please never hesitate to contact us.

As an example, let us assume you were a client with a 'Balanced (Conservatively Balanced)' profile above. Let us further assume you had this profile for all of 2016 and that we managed your portfolio according to the asset mix outlined above:

5% would have been assigned to Cash Reserves = 5% of 90 day T-Bills of .5% = .025%

45% would have been assigned to Fixed Income = 45% of Popular Bond Index of 1.7% = .765%

35% would have been assigned to Equities as follows:

25% to the CDN equity market of 21.1% = 5.275%

10% to the U.S. equity market of 12.0% = 1.20%

15% would have been assigned to the 'Alternatives' asset class = estimated at 1% return

Total potential return before management fees = 8.265%

Less management fees – using estimate of 1.4% = 6.865%

I might suggest that most of you had returns in excess of 6.865%. But 6.8% is very reasonable for 2016 – all things considered. Again, please call us if you do not agree or wish to change your Investment Profile.

Please, we ask, given the fact that the TSX was up 21.1% last year – immediately jump to the conclusion your return is far too low. If you have asked us to manage your investment assets in a conservative manner and you were assigned one of the first 4 Investment Profiles above – the highest return you would have achieved is 6.865% - NOT 21%. To achieve a return closer to 21% you had to inform us to move you to a more aggressive profile. Even if you had chosen the more aggressive 'Growth' profile – your net return would have only been 13.69% - NOT 21%. You can easily do the math yourself – I have given you all the numbers you need. ***It all depends on how much you want in equities or stocks!!!*** All this said, we caution you that this is NOT the time to get greedy. Please review the 58 year ROR provided with this CMO. Do NOT misunderstand this either. We do NOT think we are heading into a recession in the near term. So we feel comfortable with our target of 16,000 for the TSX in the next year or so. We need you to understand that if you ask us to be 'conservative', then we believe you should accept 'conservative' returns. This is likely to mean returns will be lower than you might otherwise prefer for the next couple of years or so until we have and get through the next recession. Then you may increase your exposure to equities when they have declined due to a future recession. We feel this is the more conservative route and we suggest patience.

Model Portfolios

Canadian Equity Model

After a stellar 2016, so far in 2017 this model is doing very well and we have made no changes going into 2017. You may recall that we revamped this model in March, 2016 and moved away from 2 Canadian models with different objectives (growth versus dividend income) to one model thereby combining these goals.

We have an overdraft of 1.6% - so we will have to make a modest change by reducing our overweight in Encana from 10.4% to 6% by selling 2,000 shares.

In the Interest Sensitive Sector we hold **T D Bank (4.4%), Element Financial (3.0%), and Brookfield Asset Management (3.7%)**. In the Consumer Sector we hold **Parklawn Corporation (4.4%), Maple Leaf Foods (3.8%)** (yes, we bought it back in the last quarter), **Liquor Stores (4.8%), K- Bro Linen (4.8%), Medical Facilities (4.4%)**, and added a position last in the year in **Prometic Life Sciences (4.4%)** (which has increased 36% in less than a month!!). In the Industrial Sector we hold **Air Canada (6.5%), Cargojet (6.5%), Evertz Technologies (4.8%), Aecon (3.6%), and Chorus Aviation (12.2%)**. Finally in the Resource Sector we hold **Parex Resources 7.3%), Western Energy Resources (5.4%), Trans Canada Pipe (3.9%)** (we just added this one), and after selling Crescent Point Energy we added an ETF in **Bank of Montreal Equal Weight Oil and Gas (3.7%)** to go along with our final position in **Encana (10.4%).** I have highlighted the weight for each position in parenthesis – adding them will lead to a negative 1.6% in Cash Reserves.

U.S. Equity Model

After a sub-par 2016, the U.S. model is back on track and strongly performing so far in 2017 and this has been its pattern since we introduced it in 2013. In the Interest Sensitive Sector the model holds **Bank of New York Mellon (7.6%)** and **Visa (7.8%)**. In the Consumer Sector we just switched Bristol Myers into **Merck (4.8%),** to go with **Home Depot (5.4%), Starbucks (5.5%) and Gilead Sciences (4.2%)**. In the Industrial Sector there is **Delta Air (5.5%), Amazon (11.6%), Google (12.2%), Allergen (5.1%), Intel (5.0%) and Unilever (4.9%)**. We have no holdings in the Resource Sector – allowing our Canadian Model to do the work for us in this regard. Our positions above combine for a 79.6% weight and we hold a 20.4% weighting in Cash Reserves to reflect our slightly cautious position.

Some Financial Planning Items

Insurance Needs

As part of the AWMG wealth approach, our team incorporates insurance solutions to help provide protection and manage the risks of our clients. We can connect you with Graeme Gordon, Estate Planning Advisor with TD Wealth Insurance Services who would be happy to meet with you and explore insurance products to help meet your needs. He can offer competitive rates from some of the country's leading insurance companies for term and permanent (Universal and Whole Life) life insurance, disability, critical illness and long-term care insurance products. Should you like to explore insurance solutions options, please contact Tim Arnaud at 416-512-6181 who can connect you with our insurance consultant.

Synthetic Loans

A synthetic loan is another means of obtaining affordable capital. As long as you have non-registered assets that can be used as collateral, we can raise inexpensive forms of debt in the market by borrowing/short selling Government of Canada Bonds. We then provide you the funds with the proceeds raised from borrowing and shorting the bonds. The rate of the loan is based on the bond's yield to maturity. Short selling does involve some risk. It also involves the potential for capital gains if yields rise. Please contact us to learn more about Synthetic Loans so that we can discuss in detail the potential benefits and risk of this strategy to determine if this could be suitable for you.

Summary

For as long as this business cycle lasts, we believe Equities will continue to outperform Fixed Income. Our target for the TSX remains at 16,000 and we will review this target if and when we get there. We do NOT think this is a 'risk-free' target and clients – especially conservative clients – should be forewarned. We are likely to be in the 7th or 8th inning of this 9 inning ball game. We will keep all of you informed if we see any typical recession indicators on the horizon. Should this occur, we will send you all a strongly worded message to reduce equity exposure. But we are NOT there yet. We will see you in March…..our best to all of you.

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