TD Wealth

Capital Markets Overview

Summer 2017

Compliments of:

Arnaud Wealth Management Group
TD Wealth Private Investment Advice
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Review – 2nd Quarter of 2017

Here are the year-to-date returns for the popular indexes for 2017 as at June 30th:

TSX Composite Index (TSX)	.74 %
Canada universe bond index	2.36 %
S&P 500 Index (CDN $)	5.6 %
Preferred share index	6.15 % (approximately)
90 day Treasury Bills	.2 %

Source: TD Quarterly Market Review – July 5, 2017

While returns are low, we are pleased with the performance of our Canadian and U.S. equity model portfolios and have definitely added value with our fixed income asset class individual selections. However we are more concerned about the future. Let's take a look at our views of the future.

Our Overall Investment Thesis

Please understand our overall investment thesis primarily revolves around a healthy outlook for the economy because the stock market does NOT like economic slowdowns and dislikes even more economic recessions. It would normally decline at least 20/25% (or more) shortly before or during the onset of a recession – less if we had an economic slump. But we, at Arnaud Wealth Management Group (AWMG), like to avoid the impact of a recession – if we can do it. Furthermore, there is no one alive that can tell you the extent of a market decline if we do have a recession; or when we are going to have one. It is purely a judgment call. For example, you may recall the market declined 50% in the last recession in 2008 and into early 2009. Our advice back then was a 'matter of record' – just like it will be in these CMO's. The TSX topped out in June, 2008 at 15,154 and in just 9 months it declined by 7,675 points (down 50.1%) to a low in March, 2009 of 7,479. Today, (June 29th) the TSX stands at 15,213 – a net gain of just 59 points over the past 9 years from the peak of the last business cycle to today's value ***if you did NOT do any selling in 2008***. We did NOT have our 'discretionary' license back then so we could not do any arbitrary selling but we did give our advice as we do in these CMO's; some followed it, others did not. We prefer to do some selling and avoid some/much of the pain in equities if one is forecasting a recession. That is our philosophy!!! This being said, ***we are NOT forecasting a recession – at least not just yet***. Normally, from the low of a recession (i.e. March, 2009 with the TSX at 7,479) – during the course of the following business cycle – the TSX would then double in value (to 14,958). As indicated above it is currently at 15,213. Most business cycles last between 5 and 7 years (the current one is now 8+ years) and each is different from the preceding cycle. Therefore, from a time perspective this cycle is getting a little 'long-in-the-tooth' and even though our target for the TSX stands at 16,000 (and we will likely increase it to 17,000 if, as, and when it gets to 16,000), we do not like being heroes with your investment capital and we will remain cautious with our advice and portfolio management unless ***you*** wish us to be more aggressive. Please discuss this with us – should you desire.

This cycle – however – has an anomaly. And that would be the near historic level of interest rates. In previous recent cycles one could always rotate portfolios into a reasonable or overweight in the Fixed Income asset class in order to make investor returns. Bonds and preferred shares do quite well if interest rates decline – which, of course, they would do if we entered a recession. But there is very little room for them to decline in the current environment.

In fact, there is considerable 'risk' today with the Fixed Income asset class because most forecasts are for interest rates to 'rise' – not decline - and rising rates will lead to disappointing returns – perhaps negative returns for bonds, bond portfolios, and bond mutual funds.

The yield on a 10 year Canada bond is less than 1.5%. Let us understand something about bonds. With a yield of 1.5% – what it means – is that the ***average*** yield-to-maturity will be 1.5% over 10 years. What I am NOT saying is that your 'return' every year for the next 10 years will be 1.5%. Your return will vary each and every year (or period of time) depending on what happens to this yield. As a general rule of thumb – a 1% increase/decrease in bond yields will cause the 'return' to go down or up by about 10%. **It is imperative that every client understand this issue.** I know I sound like a broken record. So let us just understand what all this really means. If you owned a 10 year Canada bond and its yield went UP from 1.5% to 2.5% - it's market price and value (and hence return) would decline by almost 10%. In this case the return would be negative.

Just so you understand with the example given on the 10 year bond – if the yield rises from 1.5% to 2.5% - say over the period of a year- the return in year 1 will be about a negative 9% and returns in years 2 through 10 will then be 2.5%. This still works out – today – to be an *average* return of 1.5%. Got it?. I sure hope so.

Our Current Forecast

Our forecast is for a reasonable economy for the next year or two, allowing interest rates to gradually rise (as I said above, this is not good for the Fixed Income asset class) and earnings to stabilize at slightly elevated levels (good for equities). Hence our target for the TSX is 16,000 and perhaps even 17,000 in the next year or two (not the next week or month or two – but rather the next year or two).

Hold it Tim, what are we to do if we do not like or trust the stock market?

You must be 'very patient' and 'accept lower returns'. Period. End of this discussion. We will come back to this issue later in this CMO. Let us look at our models. First a note about the branch's upcoming move.

The Branch in Moving

To better serve you the branch has outgrown its current space and is moving up the street to:

5140 Yonge Street, Suite 1600
North York, Ontario M2N 6X7

Our telephone numbers remain the same and will NOT change. They remain under our pictures at the end of this CMO.

Model Portfolios

Canadian Equity model

After a strong 2016, so far in 2017, this model is doing reasonably well and is slightly ahead of the TSX Index benchmark. Unfortunately the return is low. You may recall that we revamped this model a year ago in March, 2016 and moved away from 2 Canadian models with different objectives (growth versus dividend income) to one model thereby combining these objectives into one overall model portfolio.

We sold Prometic Life and some of our position in Western Energy Resources. We also sold Liquor Stores and are looking at our positions in Cargojet and Evertz if they continue moving higher. The objective of these moves is to increase the Cash Reserves in the model portfolio to about 15 or 20%. Our current holding of cash is 10%.

With the weighting in parenthesis, in the Interest-sensitive Sector, as at June 30, 2017 we hold **T D Bank (4.3%) and Brookfield Asset Management (4.2%)**. In the Consumer Sector we hold **Parklawn Corporation (5.3%), Maple Leaf Foods (4.5%)**, **K- Bro Linen (4.6%),** and a new holding in the medical marijuana space in **Medreleaf (1.2%).** In the Industrials Sector, we hold **Air Canada (8.1%), Cargojet (6.5%), Evertz Technologies (5.0%), MacDonald Detwiller (4.2%), Aecon (3.9%), Martinrea (4.6%), and Chorus Aviation (12.6%)**. Finally, in the Resource sector, we hold **Parex Resources (7.0%), Western Energy Resources (2.3% - note we sold some of this position and may sell the balance), Trans Canada Pipe (4.0%)**, and **Altagas Receipts (3.4%)** to go along with our final position in **Encana (4.3%).**

U.S. Equity Model

We have been quite active in the first half of 2017. The portfolio holds 14 selections – enough for what we believe to be proper diversification but not too many that would dilute returns. In the Interest-sensitive Sector, as at June 30, 2017, we hold **Bank of New York Mellon (7.8%)** and **AIG Warrants (4.4%)**. In the Consumer Sector, we have **Merck (4.7%), Starbucks (5.3%), Gilead Sciences (5.9%)**, **Newall Brands (6.6%), Time Warner (5.7%), Proctor and Gamble (5.2%) and recently added (and have traded) a position in Fairmount Santrol (5.7%).** In the Industrials Sector, there is **Google (13.1%), General Electric (4.8%), Microsemi Corp (4.0%), Western Digital (9.1%), and Monsanto (5.8%)**. 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 an 88.0% weight and we hold a 12.0% weighting in Cash Reserves to reflect our semi-cautious position.

Tim, what might you do with the model portfolios if we did have a recession and your forecasts was for lower returns? What would your target for the TSX be if we had a recession?

First, the recessionary target would be a decline of 30% to 50% of the cycle's previous advance. We know the starting point is 7,479 in March, 2009. We do not know the peak. Let's use 16,500. That would be an advance of 9,021 points – so 30% of this = 2,706 and 50% = 4,510. The target for the TSX would therefore be somewhere between 13,794 and 11,990 and this depends on how severe the recession would be. Sorry, that is the best 'guess' I can make at this stage.

The idea is to lose 'less money' than the indexes. This could be done in 4 different ways: (1) rotate part of the portfolio into the asset class called cash reserves (noting that cash cannot decline in value); (2) rotate a few positions into the defensive sector of the equity market such as pipelines and utilities; (3) use derivative products such as index PUTS that should go up in value as the market declines; and finally (4) we might buy some individual market CALLS on selected positions to help generate additional income during a declining or disappointing market environment. There ***ARE*** things a portfolio manager can do to help and we intend doing them. But you should note that in order to do points 3 and 4 you need to have some of your accounts 'approved' for 'options trading'. We cannot and will not enact those portfolio measures without getting these approvals from you.

You should also note we do ***NOT*** plan on vacating the market totally. Good portfolio professionals rarely would use this strategy. We ***will*** ask our clients to review their 'investment profile' and ask them to consider choosing a more conservative one. This would likely encompass asking you to do a new, updated Investment Profile Questionnaire. The last time we asked our clients to consider changing their investment profiles was in 2007 (before the meltdown in 2008 and into 2009). So if we choose this method in the future – please be aware we are not doing it for fun – there is a reason and method to our overall plan.

Fixed Income Overview

The theme in most fixed income markets of late has been one of hawkish global central banks, where the vast majority of them have taken a united stance that inflationary pressures have been growing of late. With more labour markets closer to full employment and the downward draft in commodity prices more squarely behind us, more central bankers believe inflationary pressures are finally starting to build and will continue to do so over the next 12-24 months. Normally we see these kinds of inflationary pressures build well before 8 years have passed in a business cycle. However, the financial crisis in 2008 was very deep and global in nature and has led to a historically subdued global economic recovery. One of the primary reasons for this has been the unsynchronized recovery in different economies around the world which has made it difficult for any one region to lift global GDP. Not until recently have we seen a majority of G7 countries more effectively address their individual policy needs to become more poised for simultaneous economic growth. This trend is behind the hawkish rhetoric (talk of rising interest rates) from the world's central banks of late.

We remain a little more skeptical that such growth projections will come to pass. Many market pundits have been calling for higher interest rates and higher growth rates throughout the current business cycle but growth has remained tepid and inflation has been nowhere to be seen. Deflationary trends resulting from global trade and technology remain firmly in place and the prevailing low interest rates seem to be confirming this to some extent. That said, the U.S. unemployment rate sits at ~4.6% which is near full employment levels. This may in turn lead to an uptick in wages which has been historically linked to higher inflation levels. If labour markets around the world continue to improve, it's possible the rhetoric is on point and inflation may begin to finally creep higher. From

Canada's perspective, we are still grappling with the reality of low oil prices, a lower contribution from the energy sector to overall GDP, and a higher unemployment rate near 6.7%. Despite these potential economic headwinds, the Bank of Canada has jumped on the hawkish bandwagon of late and is also signaling higher interest rates lie ahead. Let's explore the interest rate backdrop in greater detail to better predict where interest rates may be heading.

After first raising interest rates in December of 2015, the U.S. Federal Reserve (the Fed) has raised interest rates 3 more times, most recently in June to a level of 1.25%. By contrast, the Bank of Canada has not raised interest rates in 7 years with our Bank of Canada Governor Stephen Poloz being characterized as more dovish (favouring lower interest rates) over that time frame. However, with the oil price shock of 2015 squarely behind us, and less damage resulting from it than most feared, many now believe it's time for Canada to start normalizing interest rates. With a lower overnight rate in Canada at 0.50%, many now argue that we have room to catch up to the U.S. before even contemplating a possible disruption to economic growth that higher rates might bring. Even with a few rate hikes in Canada, interest rates will likely remain in stimulative territory. Some however worry about what this could do to the frothy housing market in Canada, which already appears to be slowing somewhat in the larger urban areas. Add to this the implied economic slack that still exists in our economy due to our higher unemployment rate, and the prospect for muted energy prices, some argue prospects for inflationary pressures in the Canadian economy are much weaker than in other G7 countries. Export sector growth, which typically requires a weaker Canadian dollar, would also be weaker should higher interest rates push the Loonie to higher levels; just when the contribution of the sector to economic growth may be needed the most. All of this suggests to us the rise in rates in Canada is likely to remain less aggressive than in the U.S.. In the short term though, it would appear the Bank of Canada looks poised to raise interest rates once again after recently signaling that the interest rate cuts that took the overnight rate down to 0.50% from 1% in response to the oil shock of 2015 have largely done their job. It is this recent rhetoric that has led to the steep selloff in Canadian fixed income markets over the past month.

From a portfolio perspective, we have remained short in our maturities among the bonds that we own because we continue to feel like investors are not getting properly compensated to own longer dated securities (> 5-7yrs). As such, we have utilized a barbell approach by owning shorter term government and corporate bonds as well as attractively priced GIC's in combination with a healthy exposure to preferred shares to help generate our fixed income returns. This has worked out in our favour, especially of late as the move higher in Canadian interest rates over the past 3 weeks has significantly hurt the performance of longer dated bonds. In contrast, most preferred shares have embraced the move higher in rates and outperformed other fixed income securities over this period. Specifically, our rate reset and floating rate preferred shares have responded positively to the potential of higher future coupons that accompany higher government bond yields. We feel that we are well positioned in preferred shares, which have earned a very healthy dividend yield of between 4.50% - 5.50% on average. We will remain overweight preferred shares until such a time when we feel interest rates could move materially lower and/or credit spreads could move materially wider.

Lastly, and as a result of all of this action in fixed income markets of late, cash levels are a little higher than usual right now as we are waiting for the sell-off in the fixed income markets to subside before putting fixed income funds to work at higher interest rate levels. Please be patient with us through this period – it shouldn't last long and this is the kind of patience that should pay off over the next few years.

Some Tax and Investment Planning Items (these could save you thousands of dollars)

Insurance Needs

As part of the AWMG wealth approach, our team engages TD Specialists who can help clients incorporate insurance solutions to help provide protection and manage the risks for 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 complement 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 this TD Specialist.

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/selling short Government of Canada Bonds. This strategy sounds complicated but it isn’t at all. We then provide you (or other family members) any funds along with the proceeds potentially raised from borrowing and selling the bonds. The rate of the loan is based on the bond's yield to maturity. For example, the yield on a 5 year Canada bond is 1.1%. That would be the interest expense to you if you choose to use this strategy. As you can see, these yields are substantially lower than conventional bank lending rates. This interest is also tax deductible. Short selling does involve some risk and it's important that you understand these. It also involves the potential for capital gains if yields rise (which we believe they will do). Please contact us to learn more about Synthetic Loans so that we can discuss in detail the potential benefits (and risks) of this strategy to determine if this could be suitable for you or a family member. We think that it may be a good idea to explore this option should you wish to borrow funds. Please think about this issue 'very carefully' and contact us to have a good discussion.

RSP and TFSA Contribution Limits

The 2017 contribution limit for TFSA's is $5,500 bringing the maximum total limit to $52,000. If you are uncertain whether you have made all your contributions you may call Revenue Canada (Rev Cda) at 1-800-959-8281 and press * to speak to an agent. Unfortunately we cannot do this for you since Rev Cda will only speak to you.

The 2016 limit for RSP's was $25,370 (this has passed). The limit for 2017 is $26,010 and you can do this at any time this year up until March 1, 2018 and the limit for 2018 is $26,230.

Investment Policy Statements

TD Wealth have made changes to their IPS's (Investment Policy Statements) so we will be sending you revised copies for you to sign. Now would be a good time to review your Investment Profile.

Spousal Loans

If one spouse pays more in taxes than the other spouse, it may be possible for you to set up a spousal loan to help reduce total family taxes. Call us to discuss this tax strategy. This should be done and we can help with the paperwork and it costs nothing to do. It is very legal and could save clients thousands in taxes.

CRM 2 – New Client Statements, Return calculations, and fee disclosure

The regulatory body for the investment industry (IIROC) have told everyone that we must disclose fees being charged and calculate returns for all clients. While it has taken far too long for this to develop, we are thrilled and endorse all that will occur. In July, you will be receiving revamped client statements outlining your returns on a 'money-weighted' ROR basis. We currently provide you with returns on a 'time-weighted' basis and will inform you of the difference in our next CMO. Fees will be disclosed as well.

Back to the Choice between the Equity or Fixed Income Asset Classes

This is **not** an easy decision by any means. The simple truth is that both asset classes have elevated risks – the Fixed Income asset class because of the potential likelihood for rising interest rates and yields and the Equity asset class because equity valuations are fairly valued (in our opinion) after 8+ years since the last recession. We do believe equities will go higher. BUT if you want 'conservative' investment opinion we suggest that you consider, based on your investment objectives and risk tolerance, maintaining slightly elevated levels of 'cash reserves' despite the fact this could lead to lower returns. That said, we strongly suggest you NOT abandon either asset class (Equity or Fixed Income) – just consider, based on your investment objective and risk tolerance, having slightly lower levels of exposure than you might otherwise have. Our target for the TSX remains 16,000 in the near term and it could easily get to 17,000 before this

cycle matures. The foregoing comments assume you want higher 'returns' on an ongoing basis – year in; year out. For some of you that may not be true and you simply want higher levels of 'income'. There is a huge difference between investing for 'income' as opposed to 'returns'. If the former is your primary investment objective you simply ignore capital gains and/or losses. Most have sincere difficulty with this but I mention it anyway. You can buy a bond or preferred share for it's 'income only' but must ignore any market price adjustments as yields rise and fall. If you can truly do this – no problem….but PLEASE let us know.

Discretionary portfolio management does *NOT* include asset mix decisions

To reiterate, it is you – the client – that MUST make your decision as to your desired 'Investment Profile'. We have developed a questionnaire that can help you or anyone make this decision. We use the following 7 profiles (created by AWMG) and highlight the upper and lower equity range and our desired mid-point target:

Investment Profile	Upper Equity Limit	Lower Equity Limit	Mid-Point Target
Very safe	0%	0%	0%
Conservative Income	35%	0%	20%
Balanced Income	50%	10%	25%
Balanced	65%	25%	35%
Balanced Growth	75%	45%	50%
Growth	100%	50%	70%
Aggressive Growth	100%	70%	80%

You might note we consider these profiles and our use of the equity ranges to be 'conservative' by industry standards. As a result the returns we strive to generate at AWMG can be lower than other investment programs especially if stock markets generate high returns in any given year. We try to 'add value' with the stocks, bonds, or preferred shares we choose for your portfolio. We believe in a reasonable degree of 'timing' at the asset class level, the sector level, and at the individual equity/fixed income position level. We work hard and do our best.

And most of all we 'communicate' our views to you through these Capital Markets Overviews. We put our views and advice 'in writing' for you to review every 3 months and we have not missed a quarterly publication in over 27 years. They are 'our' views and advice. If we believe you should BUY ***or*** SELL Equities and/or Fixed Income selections – we will make every effort to inform you OR manage your portfolios in a discretionary manner after you have given us guidance with your desired Investment Profile. And we encourage you to change your profile as each business cycle progresses as per the above matrix.

We depend on Client Referrals for future business

So please mention our services to your family and friends. Our fees are lower than most and we think very fair by industry standards (much lower than mutual funds) and in many cases tax deductible.

We would really appreciate this. We do not advertise and depend on referrals from clients. Thank you very much in advance.

Summary Outlook

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 if one wants to think of this business cycle as an analogy to a ball game. We will keep you informed if we see any typical recession indicators on the horizon. Some have already started to occur such as high real estate values and rising interest rates. Rising oil and other commodity prices would be another. Should this occur, we will send you a strongly worded message to recommend that you consider reducing equity exposure further than some of you have already done, keeping in mind your investment objectives and risk tolerance. But we are NOT there yet. We believe that we could easily get a 10% 'correction' but NOT a recessionary 'bear' market decline of 20/25%++. We will see you in October…..our best to all of you.

We are moving offices to better serve you.

We would like to inform you
that effective September 8, 2017
we will be relocating to:

5140 Yonge Street, Suite 1600
North York, ON M2N 6X7

This change in our Office will not effect our services.
We will continue to provide the same high level of service
that you have come to expect from our team.

We can be reached at the same telephone number (see below)
and will be happy to answer any questions you may have.

Thank you for your continued support.

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