Asset Allocation

PRIVATE CLIENT SOLUTIONS

Investment Advisory Strategy Group (IASG)

January 30, 2019

Q1/19 Outlook

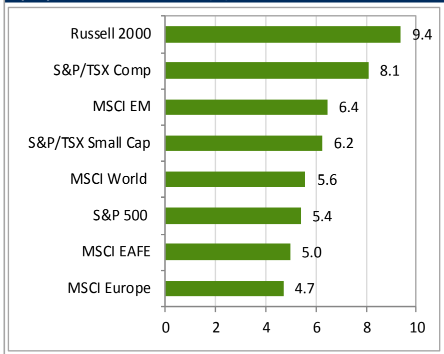
- Global economic activity clearly peaked last year as evident by the contraction in the level of global PMIs that currently sit at 51.5 versus 54.5 twelve-months prior. The world's largest economy, the US, which managed to avoid the slowdown for much of last year, is now also experiencing its own deceleration in economic activity. The most recent US PMI data, while still above 50, has pulled back from elevated levels and hovers just above contraction territory. The slowdown in manufacturing also coincides with a slip in CEO confidence as well as consumer confidence. The ongoing trade dispute between the US and China is the likely culprit impacting CEOs' outlook, while a softening in equity prices and the housing market has negatively impacted the consumer outlook. A further drop in consumer confidence suggests H1/19 consumption expectations may need to be adjusted accordingly. In addition, if CEO confidence continues to slide, this may eventually show up in employment figure, which have been a real bright spot for the US economy. US employment trends have remained healthy through the year, particularly in Q4, providing mixed signals to the market. Over the past 12 months, non-farm payrolls gained 216k on average, the unemployment rate touched a cycle low of 3.8% and average hourly wages continued to trend higher.

- S&P 500 earnings are anticipated to grow 7% year-over-year (yoy) in 2019 as the benefits from the one-time US corporate tax cuts fade and the record number of share buyback activity is unlikely to recur in 2019. A seven percent growth rate marks a significant deceleration from the estimated 22% growth rate in 2018, which is one headwind the market must overcome. We are also seeing analysts lowering their 2019 earnings forecast to incorporate the slower growth outlook resulting in a higher than average rate of negative earnings revisions. While still early in the current quarterly reporting period, we are also seeing an earnings and sales beat rate that is below average.

- Our "US Recession Checklist" in the table on the following page shows seven key economic indicators. The checklist indicates whether the gauges were in expansionary, recessionary or neutral territory at the onset of the past five recessions. Over the past twelve months, five indicators have moved from positive to a neutral level.

- While IASG members believe a US recession is not a near-term concern, we are cognizant of the fact that the probability of recession has been increasing. As such, during the quarterly meeting, members discussed the current economic environment within the context of our recession checklist. The members believe investors should anticipate greater volatility in 2019 and a deceleration in economic output. From this perspective, we believe investors can mitigate these risks by focusing on quality and/or companies with low earnings variability.

Equity Market YTD Returns (%)

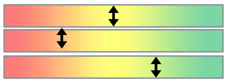


Asset Allocation Summary U/W Neutral O/W

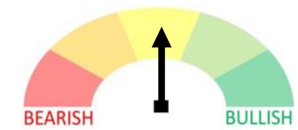
Equities

Fixed Income

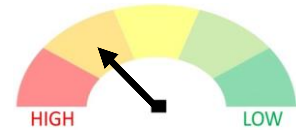
Cash



Market Outlook (6 - 9 months)



Risk Assessment



Price Chart

Source: Bloomberg, Raymond James Ltd.

Note: U/W = underweight, O/W = overweight

Please read domestic and foreign disclosure/risk information beginning on page 7

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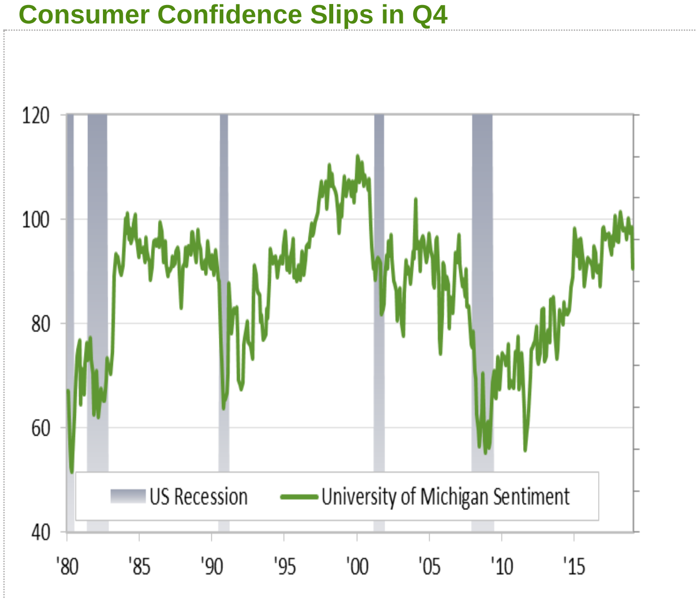
Q4/18 Asset Returns (in CAD) Total Return

Cdn Government Bonds	+1.8%
Cdn Corporate Bonds	+1.1%
Canadian Dollar vs $USD	-5.3%
International Equities (MSCI EAFE)	-7.9%
US Equities (S&P 500)	-9.0%
Canadian Equities (S&P/TSX)	-10.1%

Source: Bloomberg; Returns as of December 31, 2018

Global economic activity clearly peaked last year as evident by the contraction in the level of global PMIs that currently sit at 51.5 versus 54.5 twelve-months prior. The world's largest economy, the US, which managed to avoid the slowdown for much of last year, is now also experiencing its own deceleration in economic activity. The most recent US PMI data, while still above 50, has pulled back from elevated levels and hovers just above contraction territory. The slowdown in manufacturing also coincides with a slip in CEO confidence as well as consumer confidence. The ongoing trade dispute between the US and China is the likely culprit impacting CEOs' outlook, while a softening in equity prices and the housing market has negatively impacted the consumer outlook. A further drop in consumer confidence suggests H1/19 consumption expectations may need to be adjusted accordingly. In addition, if CEO confidence continues to slide, this may eventually show up in employment figure, which have been a real bright spot for the US economy. US employment trends have remained healthy through the year, particularly in Q4, providing mixed signals to the market. Over the past 12 months, non-farm payrolls gained 216k on average, the unemployment rate touched a cycle low of 3.8% and average hourly wages continued to trend higher.

Consumer Confidence Slips in Q4



Source: Bloomberg, Raymond James Ltd.

The Fed

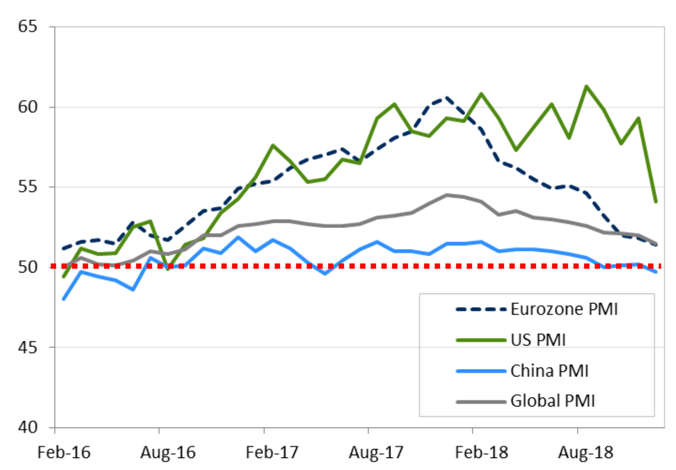
The US Federal Reserve continued on its path to reduce monetary stimulus by raising the fed funds rate 25 bps to 2.50% in December. However, more recently the Fed has become increasingly dovish. Indeed, the FOMC's dot plot indicates members lowered their expectations for rate hikes in 2019, a markedly different outlook just three months prior when Federal Reserve Chairman Jerome Powell commented that "interest rates are still accommodative, but we're gradually moving to a place where they will be neutral…we may go past neutral, but we're a long way from neutral at this point, probably." Clearly, the Fed has walked back from this overly hawkish stance. Members also lowered the neutral range by 25 bps to 2.75%, meaning one more hike and the Fed will achieve a rate where it believes real GDP is growing at its trend rate and inflation is stable. One of the more interesting shifts in stance came from the Fed's most hawkish voting member, Kansas City Fed president Ester George. She said during a speech that "it might be a good time to pause our interest rate normalization, study the incoming evidence and data, and verify our current location."

Fed Dot Plot Calls for 2 in '19

Source: Bloomberg, Raymond James Ltd.

The upward pressure on US interest rates in 2018 forced other central banks around the world to follow the Fed. This tightening cycle occurred at a time when the global economy was losing momentum. The world's second largest economy, China, experienced a noticeable economic slowdown during H2/18. The Chinese government has taken steps to support growth through fiscal and monetary stimulus, but we have yet to see if these actions can reverse the trend.

Global PMIs Moving in the Wrong Direction



Global PMIs	Current	1 Month Ago	3 Months Ago	6 Months Ago	1 Year Ago
Global	***51.5***	***52.0***	***52.2***	***53.0***	***54.5***
U.S.	54.1	59.3	59.8	60.2	59.3
Canada	53.6	54.9	54.8	57.1	54.7
Japan	52.6	52.2	52.5	53.0	54.0
U.K.	54.2	53.6	53.8	54.2	55.7
Euro zone	51.4	51.8	53.2	54.9	60.6
Germany	51.5	51.8	53.7	55.9	63.3
France	49.7	50.8	52.5	52.5	58.8
Italy	49.2	48.6	50.0	53.3	57.4
Brazil	52.6	52.7	50.9	49.8	52.4
China	49.7	50.2	50.0	51.0	51.5

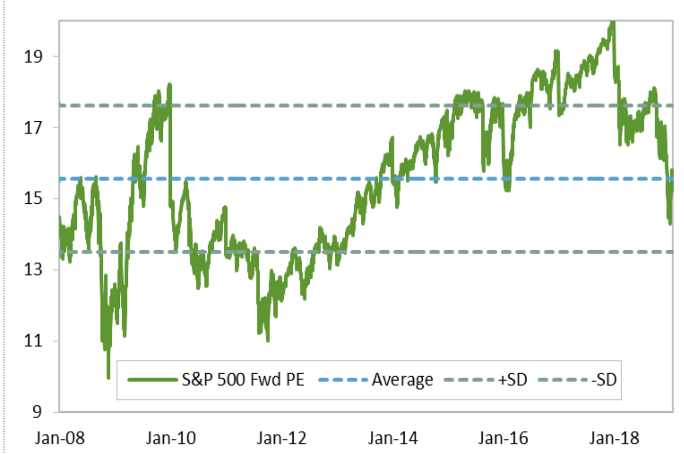
Source: Bloomberg, Raymond James Ltd.

US Earnings

S&P 500 earnings are anticipated to grow 7% year-over-year (yoy) in 2019 as the benefits from the one-time US corporate tax cuts fade and the record number of share buyback activity is unlikely to recur in 2019. A seven percent growth rate marks a significant deceleration from the estimated 22% growth rate in 2018, which is one headwind the market must overcome. We are also seeing analysts lowering their 2019 earnings forecast to incorporate the slower growth outlook resulting in a higher than average rate of negative earnings revisions. While still early in the current quarterly reporting period, we are also seeing an earnings and sales beat rate that is below average.

As earnings expectations are lowered we believe this headwind will make for a difficult first half of 2019. However, upon evidence that the growth outlook has stabilized, markets should be rewarded with higher stock prices particularly as valuation levels have improved over the last 3 months. From a valuation perspective, the S&P 500 is trading at 15.4x this years estimated earnings, in line with its 10-year average.

S&P 500 Price to Earnings Ratio

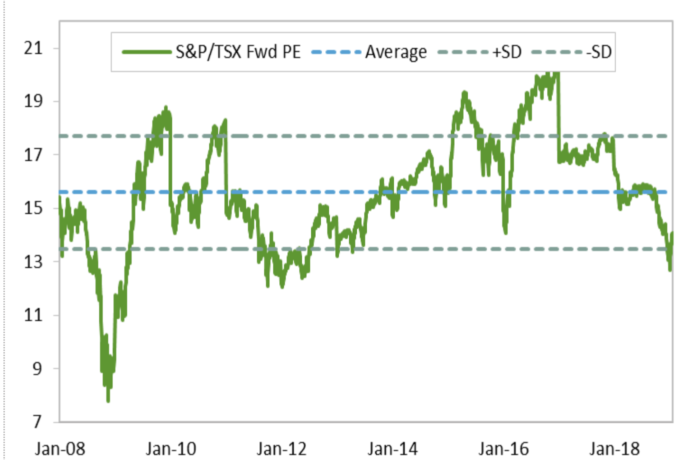


Source: Bloomberg, Raymond James Ltd.

Canada

The valuation disconnect is even wider for the Canadian market, which is trading at steep P/E and P/B discounts from historical levels. Some of this discount is warranted due to consumer debt levels, housing market concerns and a commodity-sensitive economy, but current levels still appear abnormally cheap. Similar to the US, Canadian corporate earnings will also need to be revised lower to reflect weakness in the commodity complex, but there is clearly value here once the global growth picture improves.

S&P/TSX Price to Earnings Ratio



Source: Bloomberg, Raymond James Ltd.

The value of the Canadian equity market is roughly $2.2 tln, so sentiment can mean a lot for a relatively small market like ours. Capital flows have been moving in the opposite direction over the past few years, but perhaps the signing of the US/Canada trade agreement into law, additional export capacity coming online to reduce western Canada's oil supply glut, and a federal election that may place a greater emphasis on economic wealth creation can reverse the trend. A reversal of capital flow would fall within our bull case for Canadian equities, not our base assumption, as we believe it will take time to repair foreign investor confidence in our market.

Commodities will continue to be a big driver for the Canadian market as nearly half the market is closely tied to a variety of commodities. As we look for stabilization in global growth, commodities will also firm. This is particularly true should China offer additional fiscal and/or monetary stimulus. As usual, energy will likely be the biggest swing factor for the S&P/TSX and, amid signs of stabilization in global growth expectations, this sector represents tremendous value. Our US energy team is calling for Brent and WTI to average US$72/bbl and US$62/bbl, respectively in 2019. Key to Canada is whether the WCS/WTI differential will remain narrow as new export capacity comes online (new rail capacity and Enbridge Line 3) in 2019.

S&P/TSX Sector Price Returns

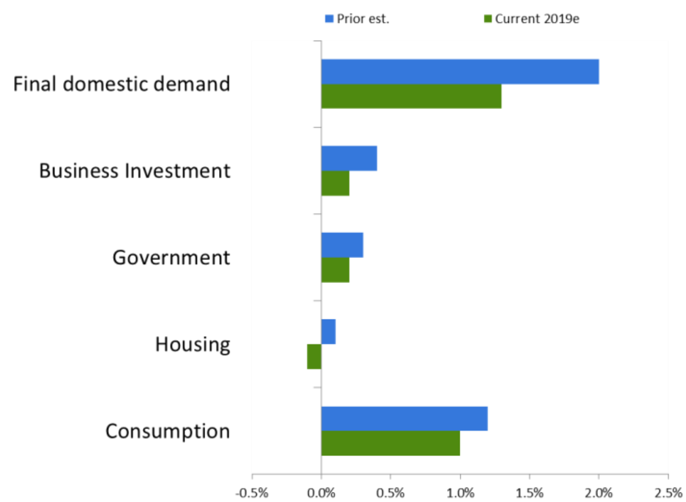
Sector	3-mth Return	1-yr Return	3-mth EPS Change
Consumer Discretionary	-12.3%	-17.7%	4%
Consumer Staples	5.4%	0.6%	7%
Energy	-18.2%	-21.5%	-2%
Financials	-12.3%	-12.6%	10%
Health Care	-35.4%	-16.6%	-17%
Industrials	-13.7%	-3.9%	11%
Information Technology	-10.4%	12.5%	6%
Materials	0.4%	-10.6%	11%
Real Estate	-7.8%	-2.8%	-
Communication Services	0.8%	-5.3%	6%
Utilities	-2.6%	-13.4%	9%
S&P/TSX	-10.9%	-11.6%	6%

Source: Bloomberg; Price returns as of December 31, 2018

Bank of Canada

As for the Bank of Canada (BoC), they estimate the Canadian neutral rate to be between 2.5% and 3.5%, compared to the current level of 1.75%. Three hikes would push the overnight rate to the lower bound, but we do not believe this will occur in 2019. We see the BoC hiking one more time in 2019, thus lagging the Fed. Our more cautious view is predicated on external factors such as weaker global commodity prices, anticipated deceleration in global trade; and internal factors such as a shaky housing market in key areas, negative impact from depressed Canadian oil prices, and signs that higher interest rates are beginning to weigh on consumer spending. In the BoC's October *Monetary Policy Report*, the central bank anticipates business investment to pick up in 2019 to offset some of the negative drags from housing and consumption. However, businesses are unlikely to make major investments at a time when the global growth outlook remains in flux. The latest *Business Outlook Survey* confirms that investment intentions have indeed decreased slightly, but the silver lining is that intentions remain at levels that are consistent with positive business sentiment.

BoC 2019 Economic Projections



Contribution to average GDP

	Current 2019e	Prior est.	Change
Consumption	1.0%	1.2%	-0.2%
Housing	-0.1%	0.1%	-0.2%
Government	0.2%	0.3%	-0.1%
Business Investment	0.2%	0.4%	-0.2%
Final domestic demand	***1.3%***	***2.0%***	***-0.7%***
Exports	1.0%	0.9%	0.1%
Imports	-0.5%	-0.6%	0.1%
Net	***0.5%***	***0.3%***	***0.2%***
Inventories	-0.1%	-0.2%	0.1%
GDP	***1.7%***	***2.1%***	***-0.4%***
CPI	1.7%	2.0%	-0.3%

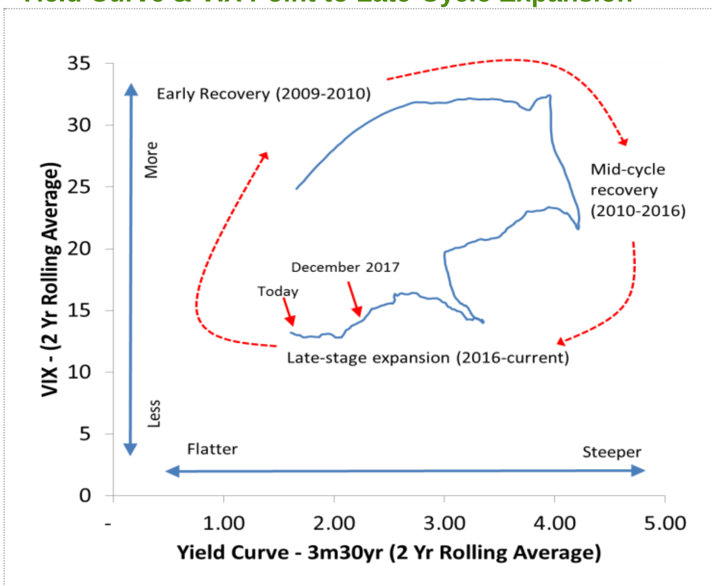
Source: Bank of Canada: Monetary Policy Report January 2019, Raymond James Ltd.

Looking Ahead

Market volatility could continue to be heightened throughout 2019 as headlines on US/China relations, Republicans and Democrats clashing over the debt ceiling and the Mueller findings are released ahead of the US 2020 election campaign. Brexit coming to a head and ongoing budget battles within the EU could also provide plenty of reasons for the markets to swing wildly.

As we outlined in our *2019 Outlook,* we believe we are in the late-stage of the economic cycle. Late-stage is characterized by an increase in volatility and a flattening yield curve, which we illustrate in the chart below. The interplay between these two variables – yield curve on the x-axis and volatility on the y-axis – indicates that as the yield curve flattens investors should anticipate greater volatility.

Yield Curve & VIX Point to Late-Cycle Expansion

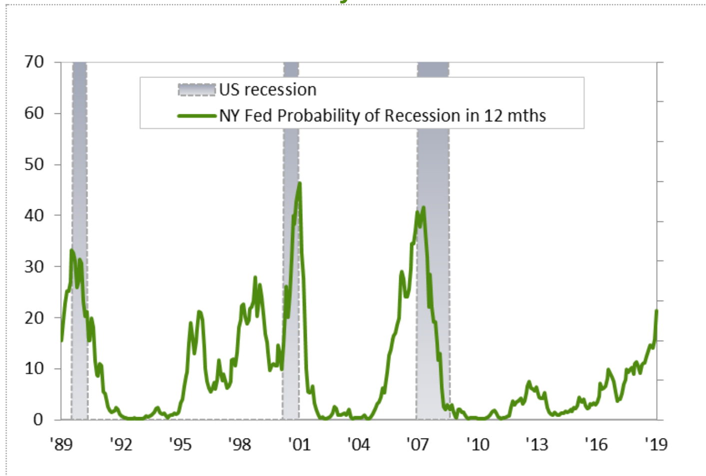


Source: Bloomberg, Raymond James Ltd.

US Recession Check List

Our "US Recession Checklist" in the table on the following page shows seven key economic indicators. The checklist indicates whether the gauges were in expansionary, recessionary or neutral territory at the onset of the past five recessions. Over the past twelve months, five indicators have moved from positive to a neutral level. As we can also see in the adjacent chart, the NY Fed probability of US recession model has been on the rise over the past twelve months. This model's primary input is the yield curve which has received a lot of attention given it has flattened 21 bps over the past 12 months.

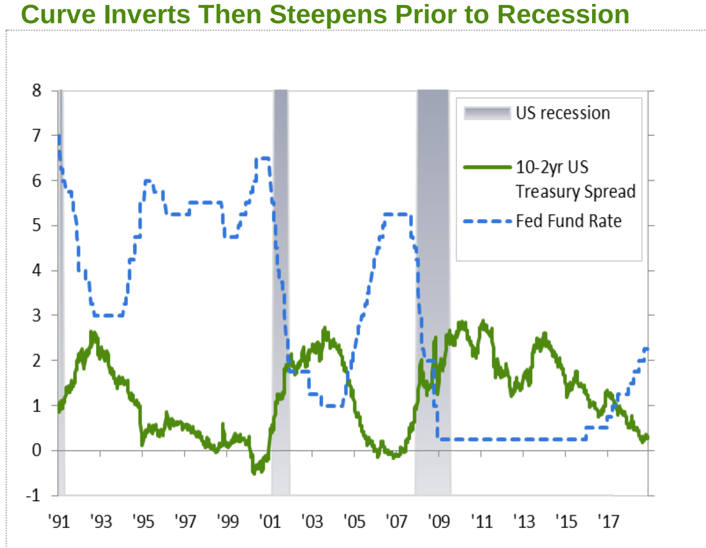
Fed Recession Probability Chart



Source: Bloomberg, Raymond James Ltd.

The yield curve has been one of the more reliable indicators of an impending US recession. In conjunction with other indicators, we believe it would not be wise to ignore the importance of the yield curve. At the current pace, we believe the curve will invert this year, increasing the odds the US will enter recession in 2020. However, the timing between the inversion and the end of an economic cycle vary significantly. Since the 1960's the timing between the initial inversion of the yield curve and a recession is between 6 and 24 months, with an average period of just under a year. But, going back to 1978, the S&P 500 has risen ~16% in the 18 months following an inversion of the curve. To help predict the onset of a US recession, we can see the curve typically inverts followed by a steepening of the curve as the Fed begins to cut short-term rates while the long-end remains stable/declines less.

Curve Inverts Then Steepens Prior to Recession



Source: Bloomberg, Raymond James Ltd.

Survey & Asset Allocation

Prior to our meeting we surveyed IASG members regarding their outlook over the next 6-12 months. Below we summarize the main points of the survey:

- **US GDP growth.** The majority of members believe the US economy will grow 2.5% in 2019, in line with consensus GDP estimates, while the remaining members see growth undershooting consensus.
- **Global GDP growth.** The majority of members believe the global economic will undershoot expectations of 3.5% in 2019.
- **Fed rate outlook.** Members believe the Fed will remain on track to hike two times in 2019, while the remaining members were divided between more or less than two.
- **US 10-year yield.** A slim majority of members believe the US 10-year yield will be higher than current levels.
- **Government versus corporate.** Members prefer government bonds over corporates. This is a notable shift from member's views in 2018, which consistently saw corporate bonds as a better alternative to governments.
- **Duration.** Members continue to believe investors should focus on the short- to medium-end of the curve.
- **Equity market outlook.** Over the next 6-12 months members are neutral to slightly bearish relative to the S&P/TSX consensus target of 18,009. Similarly, the majority of members believe the S&P 500 will fall short of the consensus target of 3,056.
- **Regional exposure.** Over the next 6-12 months members believe the S&P/TSX will outperform the S&P 500.
- **Oil.** Members believe WTI will trade near current levels to slightly higher.
- **Risk factors.** Monetary policy, earnings, geopolitical events and China rank as the top concerns among members.

While IASG members believe a US recession is not a near-term concern, we are cognizant of the fact that the probability of recession has been increasing. As such, during the quarterly meeting, members discussed the current economic environment within the context of our recession checklist. The members believe investors should anticipate greater volatility in 2019 and a deceleration in economic output. From this perspective, we believe investors can mitigate these risks by focusing on quality and/or companies with low earnings variability.

Following the IASG's quarterly asset allocation meeting, we maintained the moderate investor profile as follows:

- Neutral equities at 50%
- Overweight cash at 10%
- Underweight bonds at 40%

US Recession Checklist — **Indicators**

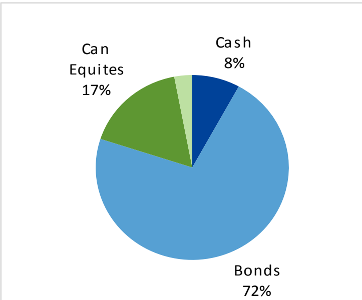
Start of Recession	Manufacturing	Employment	HY Spread	Yield Curve	Housing Starts	Cons. Confidence	Inflation
January 1980	☒	☒	☒	☒	☒	☒	☒
July 1981	☒	☒	☒	☒	☒	☒	☒
July 1990	☒	☒	☒	☒	☒	▤	☒
March 2001	☒	☒	☒	☒	▤	☒	☒
December 2007	☒	☒	☒	☒	☒	☒	☒
Current	☑	☑	▤	▤	▤	▤	▤

☒Recessionary territory; ☑ Expansionary territory; ▤Neutral

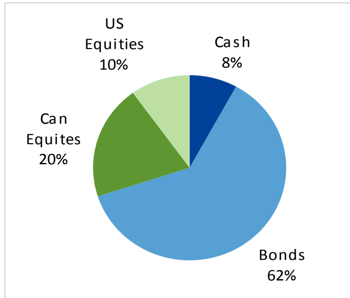
Investor Profiles and Asset Class Weightings

Recommended Asset Allocation

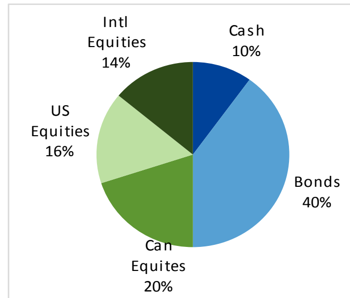
Capital Preservation



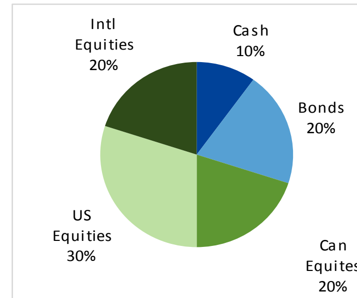
Conservative



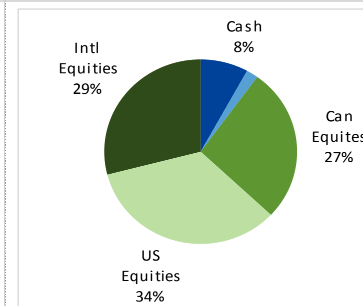
Moderate



Growth



Aggressive Growth



	Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
Cash	8%	8%	10%	10%	8%
Bonds	72%	62%	40%	20%	2%
Can Equities	17%	20%	20%	20%	27%
US Equities	3%	10%	16%	30%	34%
Intl Equities	0%	0%	15%	20%	29%
Tactical Asset Mix (Bonds include cash)					
Bonds | Equities	80 | 20	70 | 30	50 | 50	30 | 70	10 | 90
Strategic Asset Mix (Bonds include cash)					
Bonds | Equities	80 | 20	70 | 30	50 | 50	30 | 70	10 | 90
Asset Ranges					
Cash	0-20	0-20	0-20	0-20	0-20
Bonds	60-100	50-90	20-70	10-50	0-30
Equities	0-30	10-50	30-75	50-90	70-100

Description

Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
May be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which invests primarily in fixed-income securities, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.	May be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of financial markets. The portfolio, which fixed-income securities tend to make up the largest proportion of holdings, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has characteristics that may deliver returns lower than that of the broader market with lower levels of risk and volatility.	May be appropriate for investors seeking a balance between capital preservation and capital growth. This portfolio, which is a split between fixed-income securities and equities, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. With roughly half of the portfolio invested in a diversified mix of Canadian and international equities, investors should be comfortable with moderate fluctuations in the portfolios.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in equities, seeks to keep investors well ahead of the effects of inflation with principal stability as a secondary consideration.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which is primarily invested in equities, seeks to keep investors well ahead of the effects of inflation with little regard for maintaining principal stability. The portfolio may deliver returns comparable to those of the broader equity market with similar levels of risk and volatility.

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