Asset Allocation

PRIVATE CLIENT SOLUTIONS

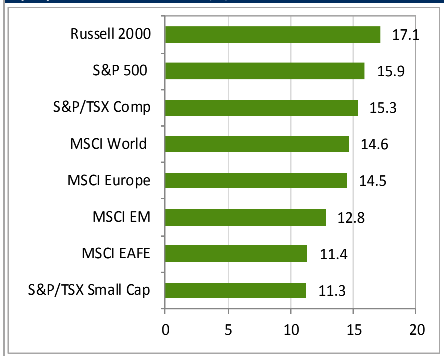
Investment Advisory Strategy Group (IASG)

April 16, 2019

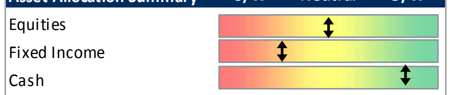
Q2/19 Outlook

- The global economic slowdown showed some early evidence it had run its course during the first quarter, but the level of global PMIs continue to hover marginally above 50 versus 53.2 twelve-months prior. The vast majority of the slowdown occurred outside the US, particularly within China and Europe. In response, the Chinese government stepped up fiscal and monetary stimulus via tax cuts and the People's Bank of China (PBoC) increased efforts to boost credit growth and reduce corporations' borrowing costs. At the same time, Chinese ruling party officials cut the country's economic growth target for a second time within 6 months, now anticipating 6.0-6.5% in 2019, down from last year's target of about 6.5%. This is the first time policy makers have used a band rather than a specific targeted level. If China grows at 6% this year it would be the slowest pace of economic growth in almost three decades, which may provide an additional headwind for overall global GDP growth.
- Bull markets 'climb on a wall of worry' with the top concerns over the past six months being: the Federal Reserve's tightening bias, a global economic slowdown and US/China trade relations. On October 3, 2018, the Fed chairman spooked the market by saying the fed funds rate was "a long way" from the neutral interest rates (see point 1 on chart on next page) and again on December 19 (pt 2) by saying the balance sheet run-off was on autopilot and "I don't see us changing that." The Fed's misread of the market's appetite for continued tightening, particularly in an environment where growth was decelerating, sent the S&P 500 down 20% from its 2018 peak in just a matter of weeks. Clearly, the Fed listened to the market as the central bank quickly pivoted to more accommodative forward guidance as on January 4 (pt 3), the Fed said "we wouldn't hesitate to change it [fed funds rate] and that would include the balance sheet". With those simple words and other central banks also pivoting, one of the market's primary concerns was eliminated.
- Last November we downgraded equities to neutral stating, "cognizant of the increased risk factors in the market, we have also been recommending investors reduce systematic equity risk by rotating from growth to value and focusing on quality and/or companies with low earnings variability." As a result of the downgrade to equities, cash moved to an overweight. During our quarterly meeting, members discussed the appropriate level of cash given the significant pivot the central banks have made over the past few months. Members believe that the deployment of cash will be, as the Fed would say, data dependent. Key to this data dependence will be US earnings season, corporate guidance and a continuation in the trend of supportive economic data. Members anticipate the next leg of market returns to be driven by an improvement in the underlying fundamentals.

Equity Market YTD Returns (%)

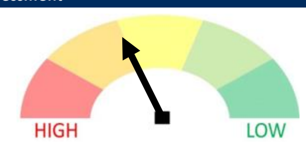


Asset Allocation Summary U/W Neutral O/W



Market Outlook (6 - 9 months)

Risk Assessment



Price Chart

Source: Bloomberg, Raymond James Ltd.

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

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Q1/19 Asset Returns (in CAD) Total Return

Canadian Equities (S&P/TSX)	+13.3%
US Equities (S&P 500)	+11.5%
International Equities (EAFE)	+8.1%
Cdn Corporate Bonds	+4.0%
Cdn Government Bonds	+3.9%
Canadian Dollar vs $USD	+2.2%

Source: Bloomberg; Returns as of March 29, 2019

The global economic slowdown showed some early evidence it had run its course during the first quarter, but the level of global PMIs continue to hover marginally above 50 versus 53.2 twelve-months prior. The vast majority of the slowdown occurred outside the US, particularly within China and Europe. In response, the Chinese government stepped up fiscal and monetary stimulus via tax cuts and the People's Bank of China (PBoC) increased efforts to boost credit growth and reduce corporations' borrowing costs. At the same time, Chinese ruling party officials cut the country's economic growth target for a second time within 6 months, now anticipating 6.0-6.5% in 2019, down from last year's target of about 6.5%. This is the first time policy makers have used a band rather than a specific targeted level. If China grows at 6% this year it would be the slowest pace of economic growth in almost three decades, which may provide an additional headwind for overall global GDP growth.

As for Europe, the European Central Bank (ECB) underscored the rising risks to growth in the euro area and highlighted that it was ready to deploy all policy tools as necessary (Mario Draghi's "Whatever it takes 2.0" moment). The ECB held its key policy rates and announced a change in its rate guidance by pushing back a rate hike to mid-2020.

While the global economic picture remained mixed, there were some positive developments. In response to the central bank's dovish shift, US financial conditions loosened, according to the Chicago Financial Conditions Index. The conference board's Leading Economic Indicator index ticked higher, the first increase in five months. The US economy added 196,000 non-farm jobs in March, which together with some positive revisions in the prior month, provided some reassurance February's sharp drop in payrolls growth was an aberration rather than the start of a new trend. China's services and manufacturing PMI rebounded, Eurozone services PMI pushed up and industrial production data from Europe's manufacturing powerhouse, Germany, came in well above market expectations.

Global PMIs Bottoming Process in the Works

Global PMIs	Current	1 Month Ago	3 Months Ago	6 Months Ago	1 Year Ago
Global	***50.6***	***50.6***	***51.4***	***52.1***	***53.2***
U.S.	55.3	54.2	54.3	59.5	59.3
Canada	50.5	52.6	53.6	54.8	55.7
Japan	49.2	48.9	52.6	52.5	53.1
U.K.	55.1	52.1	54.3	53.7	54.8
Euro zone	47.5	49.3	51.4	53.2	56.6
Germany	44.1	47.6	51.5	53.7	58.2
France	49.7	51.5	49.7	52.5	53.7
Italy	47.4	47.7	49.2	50.0	55.1
Brazil	52.8	53.4	52.6	50.9	53.4
China	50.8	49.9	49.7	50.0	51.0

Source: Bloomberg, Raymond James Ltd.

The Power of the Pivot

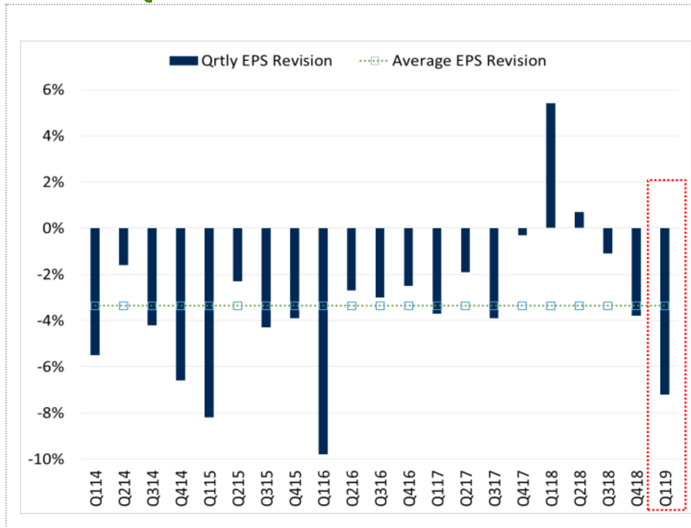
Bull markets 'climb on a wall of worry' with the top concerns over the past six months being: the Federal Reserve's tightening bias, a global economic slowdown and US/China trade relations. On October 3, 2018, the Fed chairman spooked the market by saying the fed funds rate was "a long way" from the neutral interest rates (see point 1 on chart on next page) and again on December 19 (pt 2) by saying the balance sheet run-off was on autopilot and "I don't see us changing that." The Fed's misread of the market's appetite for continued tightening, particularly in an environment where growth was decelerating, sent the S&P 500 down 20% from its 2018 peak in just a matter of weeks. Clearly, the Fed listened to the market as the central bank quickly pivoted to more accommodative forward guidance as on January 4 (pt 3), the Fed said "we wouldn't hesitate to change it [fed funds rate] and that would include the balance sheet". With those simple words and other central banks also pivoting, one of the market's primary concerns was eliminated.

The Fed's indication that it is willing to adjust the balance sheet is the more nuanced and important takeaway for the first quarter. On March 20 the Fed announced it would stop scaling back its portfolio of bonds, which allowed up to $50 bln of treasuries and mortgage-backed securities to roll off its balance sheet each month. By September, the Fed's balance sheet will hold $3.5 tln in bonds, more than four times the amount held prior to the financial crisis. In short, this change to the balance sheet can be viewed as a form of easing.

S&P 500 and the Fed

Source: Bloomberg, Raymond James Ltd.

S&P 500 Q1/19 Revisions



Source: Bloomberg, Raymond James Ltd.

US Earnings

As US earnings season gets underway, we view this quarter as one of the more important reporting periods in recent memory. The stronger US dollar, slower global economic growth and trade tensions have weighed on companies in the S&P 500 with higher international revenue exposure, while domestically focused companies begin to see the fading benefit of the Republican tax cuts. As such, S&P 500 Q1/19 estimated earnings have declined from 2.9% at the end of December to the current -4.2%. If -4.2% is the actual decline for the quarter, it will mark the first year-over-year decline in earnings for the index since Q2/16.

All eleven sectors have experienced a downward revision with the aggregate of the median EPS estimates dropping by 7.5% during the quarter. The decline in the estimate has been well above historical averages with the 5-year revision at -3.2% and 10-year of -3.7%. In fact, the first quarter marked the largest percentage decline in the bottom-up EPS estimate during a quarter since Q1/16 (-9.8%).

Margins for the overall S&P 500 will also be highly scrutinized, as analysts have been aggressively reducing margin expectations amid concern for companies abilities to pass on labour, transportation and raw material costs onto the consumer.

While the potential for a negative earnings quarter gives us pause, based on historical earnings surprise data, the S&P 500 should narrowly avoid this negative outcome. With a 5-year EPS surprise rate of 4.8% above estimates, Q1/19 may show flat y-o-y growth as the quarter unfolds.

Given the current inflation environment, monetary pivot and assumption that Q1/19 earnings will be supportive, we don't see valuation levels as a headwind for the market. The S&P 500 forward 12-month P/E ratio is 16.7x, compared to the 5-year average of 16.4x and 10-year average of 14.7x.

Canada

The S&P/TSX posted a Q1 return well above historical average at 12.4%. In fact, the Q1 return was the strongest start to the year since 2000 and ranks as the 6th best quarter in S&P/TSX history going back to the 1920s. The strong start to the year helped to offset the difficult ending to 2018. The first quarter has historically been good to equity investors helping to prepare investors for the more challenging quarter ahead. The second quarter is often a more difficult period for equities, as the S&P/TSX exhibits the weakest average quarterly return and the fewest positive returns during the time. Following such a strong Q1, we isolated the number of times the S&P/TSX posted a double-digit Q1 returns to see what it might mean for the second quarter. There have been 12 times the market recorded a double-digit Q1 return with the subsequent Q2 return showing an average gain; a historical average of 3.2% versus 0.8% for all Q2s and the probability of a positive return improves dramatically to 75%. In this case, we can conclude strength begets strength.

The commodity space also enjoyed a strong quarter supporting the energy and materials sectors. The S&P/TSX energy and materials sectors gained 14.4% and 8.2%, respectively. WTI advanced over 32% in Q1/19, its best quarter since 2009, as supply constraints supported global oil prices. Gold gained on the central bank pivot, while copper advanced amid the reflation trade and the US and China inching closer to a trade deal.

As with other central banks, the Bank of Canada (BoC) followed the Fed's lead and moved to a more neutral/dovish stance amid several sources of uncertainty, persistently weaker Canadian oil prices, the adjustment of household spending to tighter mortgage finance guidelines and higher interest rates, and global trade policy and geopolitical issues. With the monetary shift and heightened concern the Canadian economy may slip into recession, more defensive pockets of the market have shown good relative strength. In the first table below we illustrate sector performance after the BoC pauses; defensive areas of the market have shown a tendency to outperform with consumer staples, communication services and real estate leading the way, while within the cyclicals industrials have performed well in the past.

S&P/TSX Sector Performance After a BoC Pause

Sector	Average	BoC Pause After: Hiking	BoC Pause After: Cutting
Communication Services	14.9%	22.1%	6.2%
Consumer Discretionary	8.9%	15.5%	0.9%
Consumer Staples	20.6%	29.5%	10.1%
Energy	4.5%	4.9%	4.2%
Financials	11.7%	15.3%	7.6%
Industrials	17.8%	26.1%	7.9%
Information Technology	-2.4%	-9.1%	5.9%
Materials	-1.4%	-10.2%	9.6%
Real Estate	15.0%	20.4%	8.7%
Utilities	7.0%	7.4%	6.8%

Note: Outlier health care excluded

S&P/TSX Q1/19 Sector Price Returns

Sector	3-mth Return	1-yr Return	3-mth EPS Change
Communication Services	8.8%	11.7%	-2%
Consumer Discretionary	9.3%	-7.0%	-2%
Consumer Staples	10.2%	18.2%	2%
Energy	14.4%	0.2%	11%
Financials	9.4%	-0.1%	-3%
Health Care	48.9%	44.0%	7%
Industrials	14.8%	13.7%	-2%
Information Technology	25.2%	28.0%	-3%
Materials	8.2%	1.4%	-9%
Real Estate	16.3%	13.8%	NA
Utilities	14.7%	6.8%	2%
S&P/TSX	12.4%	4.8%	-1%

Source: Bloomberg; Price returns as of March 29, 2019

From a valuation perspective, the S&P/TSX forward PE multiple has expanded 2.2x over the past quarter and now trades at 15.2x, a discount to its 10-year average of 16.1x. We do not see the multiple expanding much above historical levels given country specific risk factors such as consumer debt levels and housing market concerns.

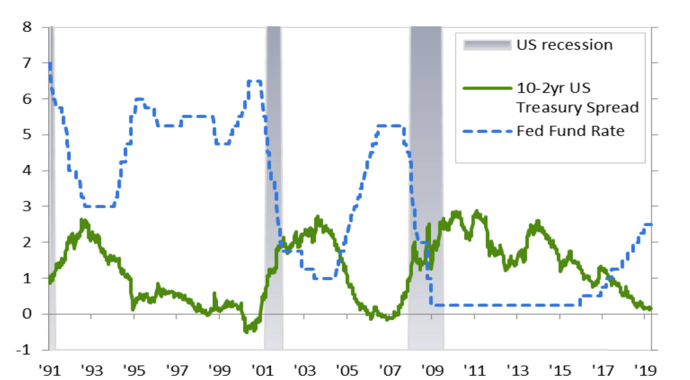
Looking Ahead

We anticipate market volatility to remain heightened throughout 2019 as headlines on US/China relations, risks to global growth, geopolitical events including Republicans and Democrats clashing over the debt ceiling, Brexit and ongoing budget battles within the EU could 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. In fact, Q1/19 saw a significant number of terms across the curve invert. While the bond market is flashing yellow, we note the 2s10s (10-Year Treasury minus the 2-Year Treasury) and 3m30yr (30-Year Treasury minus the 3-Month Treasury) has yet to invert. Even upon an inversion, the timing of a US recession and a peak in equity prices is difficult to pinpoint:

- On the last seven occasions that the US yield curve inverted (excluding a 2 week inversion in 1998), the US economy went into recession every single time within 15 months (on average after 11 months)
- The yield curve tends to remain negative on average for 11 months and a minimum of five months
- Equities peak usually six months after a yield curve inversion
- Over the three months period after inversion the S&P 500 rose 3% on average and was up 75% of the time. After 18 months, the S&P was down on average 8% and up only 38% of the time

Yield Curve 2s10s Near Inversion

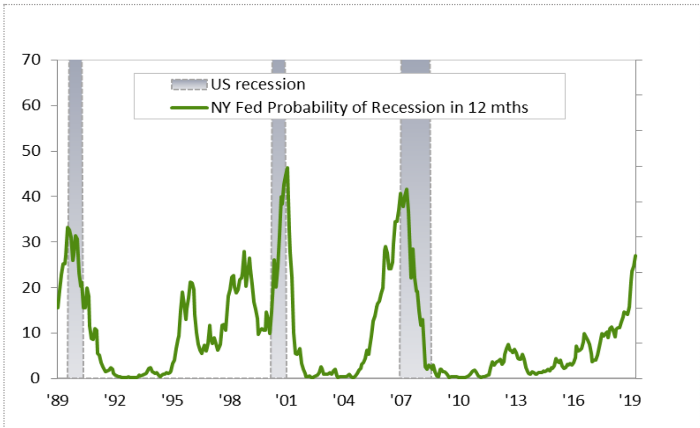


Source: Bloomberg, Raymond James Ltd.

US Recession Check List

Our "US Recession Checklist" in the table below shows seven key economic indicators. The checklist indicates whether the gauges were in expansionary, recessionary or neutral territory at the onset of the past recessions. Over the past twelve months, five indicators have moved from positive to a neutral level. We can also see in the chart below the NY Fed probability of US recession model has been on the rise over the past twelve months.

US Recession Risks on the Rise



Source: Bloomberg, Raymond James Ltd.

Asset Allocation

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IASG members believe a US recession is not a near-term concern and the Fed's recent shift in bias has diminished the near-term risks. However, we are cognizant that risks to the outlook have risen and many uncertainties remain. As such, 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%

On the subsequent page, we include the return profiles for each of the client profiles. To generate the profile statistics we use return data from dating back to 1971 for each of the asset classes. The profiles are rebalanced to their strategic weights on an annual basis.

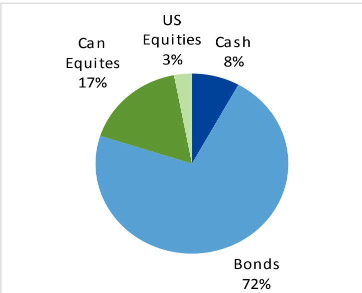
US Recession Checklist	Indicators						
Start of Recession	Manufacturing	Employment	HY Spread	Yield Curve	Housing Starts	Cons. Confidence	Inflation
January 1980	☒	☒	☒	☒	☒	☒	☒
July 1981	☒	☒	☒	☒	☒	☒	☒
July 1990	☒	☒	☒	☒	☒	▤	☒
March 2001	☒	☒	☒	☒	▤	☒	☒
December 2007	☒	☒	☒	☒	☒	☒	☒
Current	☑	☑	▤	▤	▤	▤	▤

☒Recessionary territory; ☑ Expansionary territory; ▤Neutral

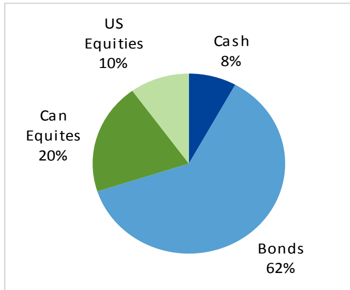
Investor Profiles and Asset Class Weightings

Recommended Asset Allocation

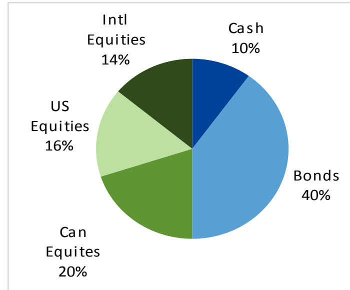
Capital Preservation



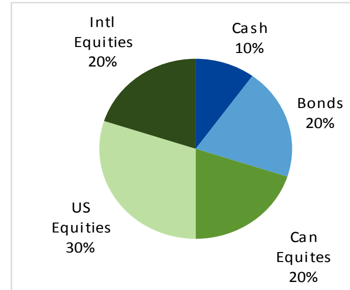
Conservative



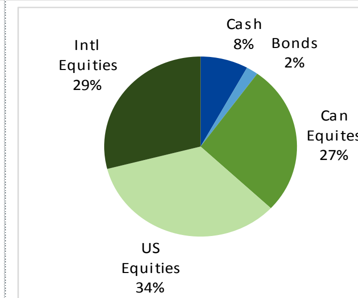
Moderate



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%	14%	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

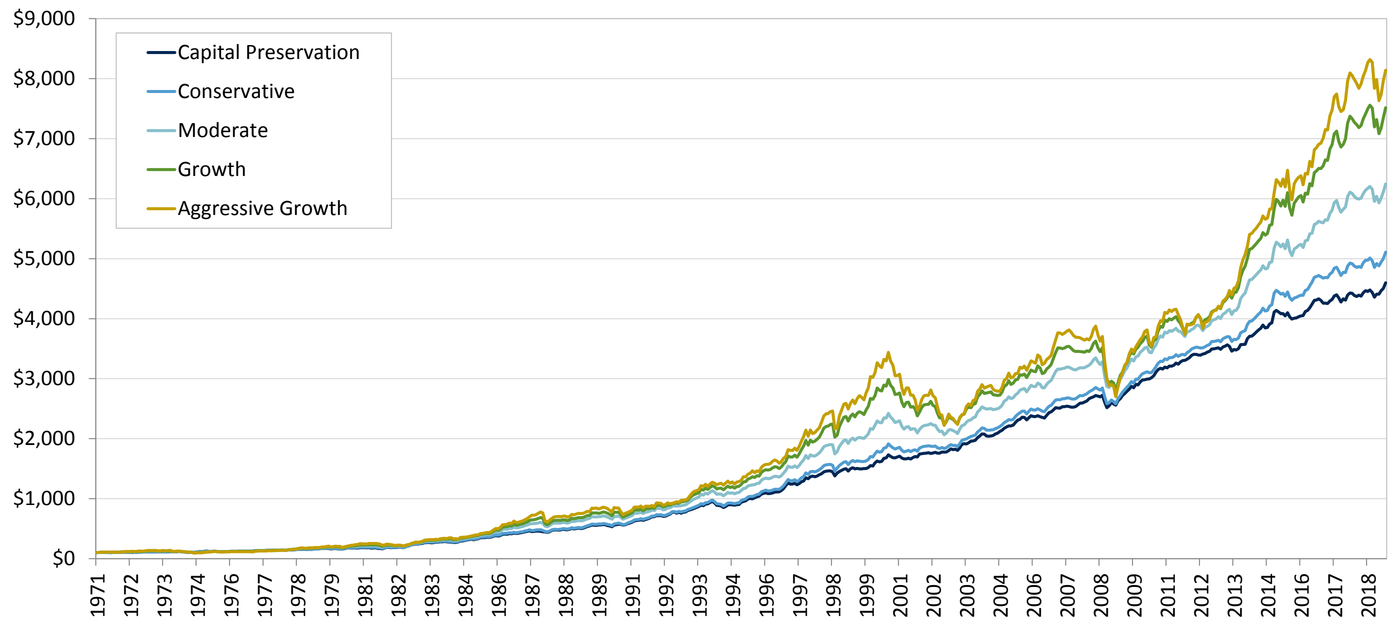
Description

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.

Client Profile Statistics

	Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
Total Return (annualized)	8.3%	8.5%	8.9%	9.4%	9.5%
Avg Monthly Return	0.68%	0.70%	0.74%	0.78%	0.81%
Avg Rolling 12 Month Return	8.5%	8.8%	9.3%	9.9%	10.4%
Annualized Std Dev (36 months)	3.4%	3.7%	4.6%	6.0%	7.3%
Sharpe Ratio	2.4	2.3	1.9	1.5	1.3
Best 12 month Rolling return	46.5%	48.0%	46.1%	46.3%	47.7%
Worst 12 month Rolling Return	-7.7%	-11.3%	-18.9%	-26.1%	-32.6%

Value of $100 Invested



Source: Bloomberg, Raymond James Ltd. As at March 31, 2019, Inception January 1971.

Performance statistics are calcluated using C$ monthly returns that are rebalanced every calendar year using the recommened asset class weightings for each profile (cash weighting has been rolled up into the bond weighting).
Benchmarks: Bonds = FTSE/TMX Canada Universe Bond TR Index; Canadian Equities = S&P/TSX Composite TR Index, US Equities = S&P 500 TR Index; International Equities = MSCI EAFE TR Index.

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