

Quarterly Insights



Economic & Investment Outlook

December 31, 2013

The global economy is entering 2014 with positive momentum as growth is now occurring in more geographic regions. Next year may mark the first synchronized rise in growth among major economies since 2010.

Canada's economy surged in the third quarter as GDP increased at a 2.7% annualized rate. This was the fastest pace of growth in over two years with consumer spending, manufacturing and business investment all making increased contributions.

Sustained strength in consumer spending has been one of the key drivers of growth this year. Expenditures have been less debt-financed than in the past as real disposable income has accelerated. Household debt levels are still near record highs in Canada, but appear to have reached a plateau. In recent months the housing market has stabilized at higher price levels, which has helped to maintain consumer confidence.

Employment continued to trend upward for the third consecutive month in November with the creation of 22,000 new jobs. Job growth has been consistent this year with the formation of 148,000 new positions.

Canada's export sector is the only component of the economy that has not returned to its pre-recession level of activity.

However, stronger global growth will begin to have a positive impact on exports and business investment which will make these sectors larger contributors to 2014 growth than they have been up to this point in the recovery.

The U.S. economy grew at a 4.1% annualized rate in the third quarter, as consumer spending and manufacturing activity continued to advance. However, growth-to-date has lagged behind previous recoveries. In the 17 quarters since the recession ended, the economy has expanded at an average annualized rate of 2.3% each quarter. That compares with an average of 3.2% over the same period following the 2001 and 1991 recessions, and 5% following the 1982 recession.

The financial condition of U.S. consumers continues to improve. The Household Debt Service Ratio, which is an estimate of the ratio of debt payments (including mortgages) to disposable personal income, has now declined to its lowest reading in over 33 years.

Economies

Improving,

Markets

Responding

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Economic & Investment Outlook cont'd.

This debt reduction has allowed for increased consumer spending, as retail sales in November climbed by the most in five months.

The American economy also added 203,000 jobs in November, which brings the total of new jobs created this year to 2.3 million. Despite an increasing rate of job creation, there are still 11 million officially unemployed workers in their economy.

The Federal Reserve revealed that beginning in January it will reduce in its bond-buying program from \$85 billion a month to \$75 billion, as an initial move to unwind the monetary stimulus that it is supplying to the economy. At the same time, it also announced that it will extend its commitment to keep interest rates low until 2016.

After two years of contraction, the Eurozone economy has emerged from recession. Growth has been supported by strength in manufacturing and exports. However, high rates of unemployment will continue to be a challenge, as the unemployment rate for the

entire Eurozone remains above 12%. The initial phase of this recovery is likely to be modest, as fiscal austerity measures and structural reforms continue to restrain the expansion of domestic demand.

The European Union has agreed on a structure to close failing banks as part of a broad banking union agreement. Beginning in 2014, a single supervisor based in the European Central Bank will take direct charge of the region's 126 biggest banks, with a single resolution board deciding when a bank needs to be broken up or closed.

The region's banks will be required to pay annually into a resolution fund for the closure of failed lenders, which should reach 55 billion euros in 10 years. However, a failed bank's shareholders, creditors and large depositors will all take losses before the resolution funds are utilized. The goal is to prevent a repeat of the turmoil that occurred in 2008 when failing banks nearly brought their states to the brink of bankruptcy.

Financial Markets

Global financial markets rallied in the fourth quarter as investor optimism about the global economy continued to produce a rotation away from fixed income securities and into equities.

Fourth quarter 2013 returns in local currency terms for world equity markets were:

Country	Index	2013 Q4 Returns
Canada	S&P/TSX	6.53%
United States	S&P 500	9.92%
United States	NASDAQ	10.74%
United Kingdom	FTSE 100	4.44%
Japan	Nikkei	12.70%
France	CAC 40	3.68%
Germany	DAX	11.14%
Hong Kong	Hang Seng	1.95%

Financial Markets cont'd.

The easing of monetary policy that was introduced by global central banks to counter the 2008 financial crisis has reduced bond yields and enabled many companies to refinance a significant portion of their debt at record low interest rates. This has resulted in a sharp reduction in interest expenses for the companies, which together with reductions in corporate tax rates and labour costs, has produced large increases in corporate profit margins. Increasing profit margins rather than increasing revenue have been responsible for the majority of the growth in corporate earnings over the last five years.

This increased operational leverage that is embedded in companies financial statements has been a powerful force, but it cannot be sustained indefinitely.

In the U.S., corporate profits as a percentage of GDP are near record levels, but they are also nearly unchanged from almost two years ago. Therefore, while profit margins don't appear to be falling significantly, they will also not continue to be the primary influence on future earnings growth, now that central bank easing measures are in their final stages. This effect on profit margins is much more advanced for U.S. companies than it is for companies in Canada, Europe and Asia.

Now that interest rates have stopped declining, the profitability of corporations will be much more dependent on increasing sales. As a result, increased economic growth will now become the primary driver of further gains in equity prices.

The Bottom Line

Accelerating world economic growth in 2014 should provide support for the longer term equity markets outlook and continue to place upward pressure on bond yields. We expect volatility and for equities to outperform fixed income securities in this environment.

Equity prices in the U.S. are now trading toward the higher end of historical valuations. Canadian, European and Asian equity prices currently have higher cash yields and lower valuations. Canadian corporate earnings have been increasing throughout the second half of 2013 and we project this trend will continue over the next several years.

The Role of Power of Attorney

Increasing life expectancy and related health issues are resulting in many individuals living to an age when they are no longer able to effectively manage their own finances. Therefore, it is prudent planning to make advance arrangements for potential physical or mental incapacity so that your financial affairs are handled properly.

A power of attorney is the legal authority contained in a written document that allows someone else to manage your legal and financial affairs. Although

this power can be very broad, it does not allow for health care decisions to be made on your behalf.

The person who transfers the power is called the donor and the person receiving the power is called the attorney. The attorney is legally obligated to act on your behalf if they accept the appointment.

The document must be in writing and signed by the donor and a witness. There are specific rules regarding who can act as a witness. It does not have to be signed by the person chosen as attorney.

The Role of Power of Attorney cont'd.

It is also important to note that even when you grant someone power of attorney, you still retain the right to manage your own affairs.

An attorney must always act in accordance with the instructions specified in the power of attorney. The scope and power granted to an attorney must always be used for the donor's benefit.

There are two types of power of attorney:

- ◆ **Specific Power of Attorney**
This is used to grant a power of attorney for a specific task, such as selling an asset. The power granted to the attorney is limited to the specific task. The power ends when the task is completed or if the donor becomes mentally incapacitated.
- ◆ **General Power of Attorney**
A general power of attorney allows the attorney to make decisions concerning all of the donor's financial affairs. This type of power of attorney also ends if the donor becomes mentally incapacitated.

In either of these types, the donor may include a clause in the power of attorney document allowing the attorney to continue acting even if the donor later becomes mentally incapacitated. If this clause is included, the document is referred to as an Enduring Power of Attorney.

Almost anyone can be chosen as an attorney, as long as they have reached the age of majority and are mentally capable. More than one person can be appointed as attorney. They may be appointed to act jointly (make decisions together) or successively (the second-named person only makes decisions if the first-named cannot or will not).

However, when granting any type of power of attorney careful consideration should be given to whom to appoint as attorney. It should be someone whom you can trust completely.

Considerations when granting a power of attorney may include:

- ◆ **Financial skill**
An attorney should have adequate financial experience and expertise to deal with the complexity of your financial situation.
- ◆ **Location or ability to travel**
An attorney needs to be able to communicate decisions on a timely basis.
- ◆ **Age and life circumstances**
Someone who is already at an advanced age today may not have the ability to act over a prolonged future timeframe. Or on the other hand, they may be managing a career and family that do not allow for an adequate dedication of time.
- ◆ **Organizational skills**
An attorney must keep accurate records of their decisions and all transactions concerning the donor's affairs.
- ◆ **Judgement**
An attorney must avoid potential conflicts of interest.

We would suggest consulting a lawyer who has expertise in these matters when drafting a power of attorney, to ensure that the document meets your needs and also satisfies all legal requirements.



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