

Quarterly Insights



Economic & Investment Outlook

March 31, 2016

2016 had a turbulent beginning, as the Bank of Japan shook investor confidence with a surprising decision to follow the lead of the Eurozone and implement a negative interest rate policy. Concerns increased around the globe about the possibility that central bank policies were now reaching the limits of their effectiveness. This resulted in record setting volatility across many global financial markets as apprehensions grew about a renewed slowdown in world economic growth.

Canadian economic growth for 2015 declined to 1.2%, primarily as a result of large reductions in business investment from the resource sector. However, as the effects of the decline in the price of oil are continuing to work their way through the Canadian economy, positive signs of renewed growth are emerging.

January saw a 0.6% expansion of the Canadian economy. This is the fourth straight month of growth and the largest monthly increase since July 2013. Growth was widespread, driven by both goods and services.

Canadian retail sales surged 2.1% in January, which was the largest monthly sales gain since March 2010.

Real exports grew in January by 2.5%, following a 3.2% gain in the prior month. Exports have increased 10% since May of 2015. As export volumes accelerate, trade is poised to provide a significant boost to economic growth. Manufacturing sales rose 2.3% in January to reach an

all-time high. It was the third straight month of gains.

Despite some regional differences among oil and non-oil-producing provinces, the housing market continues to be a key overall driver of the Canadian economy. Existing home sales rose by 0.8% in January and were up 18.7% from last year. Housing starts for February posted their biggest one-month gain since 1983.

As anticipated, the federal government announced its budget this past month with a projected deficit near \$30 billion for the next fiscal year. New spending initiatives on infrastructure are intended to assist in boosting economic growth over the next several years.

The improvement in the outlook for the Canadian economy has sparked a strong rally in the Canadian/US dollar exchange rate. After reaching a low of 68.21 cents in January, it rose steadily to close the quarter at 77.00 cents.

The US economy grew at an annual rate of 2.4% in 2015, which was unchanged from the prior year.

Despite concerns of a significant slowdown in the US economy to start 2016, growth continued to be stable. Reports on consumer spending, industrial production, construction and durable goods orders all suggest that economic growth increased during the first quarter of the year.

*Renewed
Growth*

-

*Suppresses
Turbulence*

Inside this issue:

<i>Economic & Investment Outlook</i>	1-2
<i>Financial Markets</i>	2
<i>The Bottom Line</i>	3
<i>The Clustering of Volatility</i>	3-4
<i>Index Announcement</i>	4

Economic & Investment Outlook cont'd.

Factory production rose by 0.2% in February, boosted by demand for business equipment. This followed a 0.5% gain in January and appears to show that weakness in the manufacturing sector is subsiding. Over the last 12 months, US manufacturing output has grown 3.3% primarily due to domestic demand.

Consumer purchases climbed in January by the most in eight months, fueled by faster employment earnings growth. This indicates the biggest part of the US economy maintained momentum to start 2016. However, the February income and spending reports show that consumption growth could decline below 2% for the first time in a year, which will result in a drag on first quarter economic growth.

The US labor market continues to improve, with average monthly jobs gains of 209,000 in the first three months of the year. The rise in the labor force participation rate over the past six months has been the strongest in over two decades. This suggests

that the strong employment environment is continuing to encourage an increasing number of individuals to re-enter the workforce.

We expect US economic growth in the first part of this year to be at a pace similar to 2015, before gradually accelerating as this year progresses.

Industrial output in the Eurozone grew by 2.1% in January, which was the biggest monthly increase in six years. Unemployment has also declined to reach a five year low. However, there continue to be substantial differences among countries as unemployment in Germany is 4.3%, compared to Spain at 20.5%.

In an effort to continue to support economic growth, the European Central Bank has announced further reductions in its administered interest rates and expanded its bond-buying stimulus program to now include corporate bonds.

Financial Markets

The selling that was present in equity markets at the end of last year became more aggressive in January and February. February marked a fourth consecutive monthly decline for global stocks and pushed the MSCI World Index down to more than 20% below its 2015 high.

Corporate bond spreads widened in many resource based sectors as weakness in commodity prices raised concerns about potential corporate debt defaults. However, as the quarter drew to a close markets began a partial recovery rally.

First quarter returns in Canadian Dollar terms for world equity markets were:

Country	Index	2016 Q1 Returns
Canada	S&P/TSX	3.72%
United States	S&P 500	-5.44%
United States	NASDAQ	-8.74%
United Kingdom	FTSE 100	-7.18%
Japan	Nikkei	-17.38%
France	CAC 40	-11.26%
Germany	DAX	-12.95%
Hong Kong	Hang Seng	-11.03%

Switzerland, Sweden, Denmark, the Eurozone and now Japan have implemented negative central bank policy rates. According to Bloomberg, more than \$7 trillion of government bonds now yield less than zero, which represents close to 40% of the Eurozone and 75% of the Japanese tradeable bond markets.

There are deepening questions whether lowering policy interest rates further into negative territory is actually beneficial or harmful for an economy, given the adverse consequences for banks and other financial institutions.

In a negative interest rate environment, banks pay a fee (i.e. a negative rate) on excess reserves on deposit with the central bank. As a result, negative rates tend to shrink bank profits by reducing the size of the spread between the rate at which they borrow and the rate they receive from making loans.

If profit potential on loans is reduced too extensively, then banks may either scale back lending or increase rates to borrowers. Either of these actions defeats the reason why central banks have introduced a negative rate policy. Swiss and Danish banks have responded in this way, By increasing borrowing costs for homeowners since negative rates were introduced.

The Bottom Line

The global economy continues to undergo a period of more turbulent cross currents while producing modest economic growth.

Equity, currency, fixed income and commodity markets continue to be volatile as the divergence in global monetary policies, and the unintended conse-

quences of negative interest rates, are having unanticipated effects.

However, we expect that as the normalization of US monetary policy continues, it will remove some of the uncertainty and encourage stability in financial markets as the year progresses.

The Clustering of Financial Volatility

This year began with significant volatility across all global financial markets. Using the US as an example, the S&P 500 stock market index experienced its worst-ever start to a new year, by falling 10.54% in the first 28 days of trading.

The psychological make-up of investors makes these periods of volatility difficult. Market sell-offs attract media headlines, which results in a negative feedback loop being created. When financial market volatility is followed by increasing media attention, these two trends reinforce each other in the minds of investors. The common result is that a heightened level of uncertainty produces an emotional response that encourages some investors to remove themselves from the markets, with the intention of re-entering once the volatility subsides.

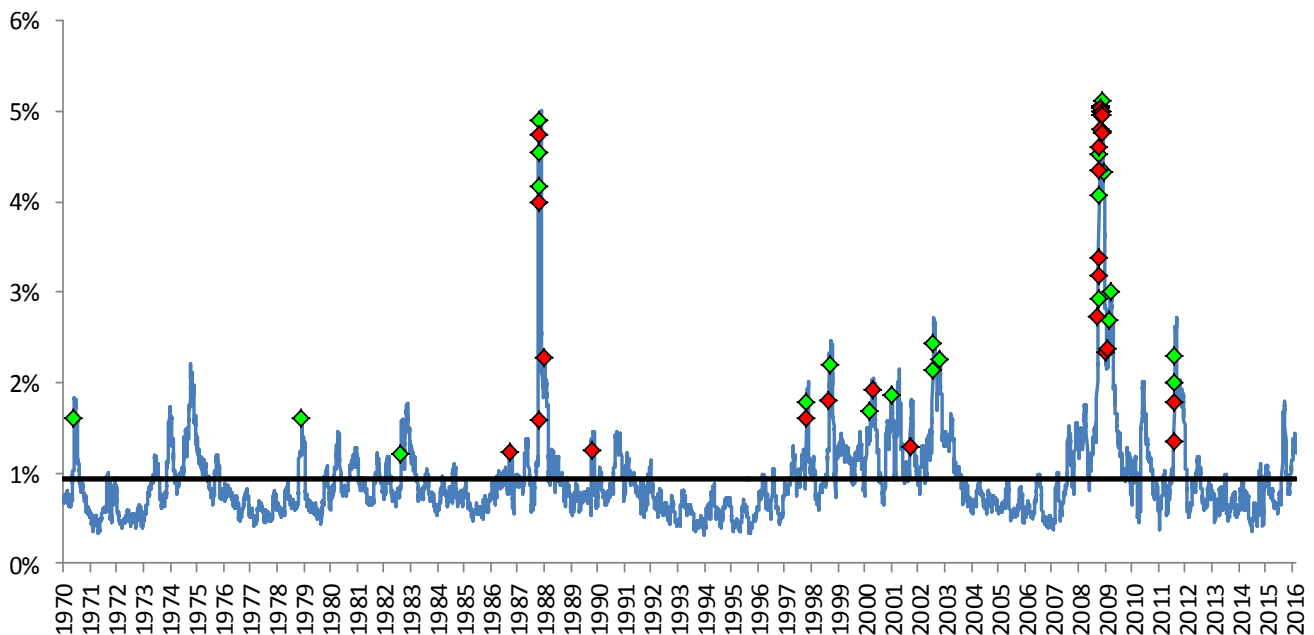
This period of volatility resulted in the same investor behaviour. According to data from Bloomberg, US investors withdrew nearly \$140 billion from equity mutual and exchange-traded funds in the twelve month period ending in February. This outflow was comparable only to the period during the global

financial crisis that began in 2008.

As difficult as these periods of volatility can be, we encourage our clients to make what has historically proven to be the most rational decision, which is to retain their investment holdings and wait for the volatility to run its course.

Markets are dynamic and unpredictable over the short-term. Prices do not always move slowly and steadily. Instead there is price movement discontinuity, with large leaps in either direction. This discontinuity is the main reason why trying to time exit and entry points into financial markets usually results in a less successful outcome than “staying the course” through volatility.

The chart below shows the best and worst days that have occurred in the S&P 500 Index since 1970. The green dots represent the 25 best days and the red dots represent the 25 worst days. All 50 of these days occurred when volatility was above average (the black line).



The Clustering of Financial Volatility cont'd.

These periods of price discontinuity also tend to cluster, meaning that large downward moves are frequently followed by large upward moves. Missing even a few of the large positive days can have a significant negative effect on long-term returns. This is due to the fact that a few very good days account for a large part of the total return produced, even over long-term time horizons.

If an investor missed out on only the 25 best days (out of 11,620) since 1970, the long-term invest-

ment return they would realize would be close to 50% less than if they had simply retained the investment throughout the entire holding period.

Investing over a long-term horizon will always have periods of price volatility that will challenge an investor's fortitude. However, history shows that investment success rewards those investors who can disregard periods of short term volatility.

Index Announcement

Index Wealth Management Inc. is pleased to announce that we have entered into a merger agreement with Bellwether Investment Management Inc. Bellwether is based in Oakville, Ontario and offers a range of investment solutions, which includes a managed exchange traded fund (ETF) portfolio.

Upon completion of the merger, the combined firm will consist of a total of eight portfolio managers and will have five offices located from Vancouver to Montreal. Index Wealth Management will operate as a division of Bellwether upon completion of the merger.

This strategic amalgamation will not change the portfolio manager you currently work with at Index, the custodian of your accounts or your portfolio management fee scale.

Index will now have an expanded national presence, access to additional investment resources and enhanced administration support to further enhance our level of service to you. Our expanded team will continue to devote our best efforts to attaining your investment success.

We would be pleased to answer any questions you may have or please feel free to look at the Bellwether website (www.bellvest.ca) for details regarding our new colleagues.

Suite 300
1055 West Hastings Street
Vancouver, BC
V6E 2E9
T: 604.609.6177

2600 Sun Life Plaza
144-4th Avenue S.W.
Calgary, AB
T2P 3N4
T: 403.269.1375

Suite 1204
220 Portage Avenue
Winnipeg, MB
R3C 0A5
T: 204.989.6200