Quarterly Insights

September 30, 2016

Economic & Investment Outlook

Although the Canadian and US economies have been weaker than expected in the first half of this year, economic data suggests that growth in both countries will likely increase during the remainder of 2016.

Economic growth in Canada contracted at a 1.6% annualized pace in the second quarter, primarily as a result of the Alberta wildfires that halted oil production for several weeks. However, the third quarter will receive a boost as oil sands output has resumed and reconstruction is underway of the damaged portions of Fort McMurray and surrounding areas.

June economic growth advanced 0.6% and non-energy export volumes rose by 3.4% in July. The volume of retail sales also rose 0.3% in July, pointing to some renewed momentum in consumer spending which had previously recorded four consecutive months of declines.

Total government spending rose at a 2.7% annualized pace in the second quarter to reach the highest level in six years. The Federal government has committed $11.9 billion towards infrastructure spending over a two year period to assist with economic growth. Recent revisions to the child benefit program are also forecast to help consumer spending.

In late September, OPEC agreed for the first time in over eight years to cut oil production. If the agreement holds and assists in supporting oil prices, it will brighten the prospects for the energy industry and provide a benefit to our oil producing provinces which have seen economic growth retrenching over the last year.

Housing activity continues to remain a regional story reflecting divergent provincial economic fundamentals. Recent data has shown a dampening of Vancouver's housing market since the implementation of a new land transfer tax on foreign buyers. Both existing home sales and average home prices have declined, with the average price now down 21% from the peak reached in April. However, home prices in Toronto continue to advance with the average resale house price having risen nearly 18% in the last year.

Rising home prices continue to fuel increases in consumer debt. In the second quarter, Canadian household debt exceeded the country's gross domestic product for the first time, as liabilities climbed to a fresh record relative to disposable income. Households are accumulating debt at twice the pace of their income.

US economic growth remains uneven, with consumers continuing to spend while business investment lags.

US consumer spending is projected to increase by 3% in the third quar-

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Economic & Investment Outlook cont'd.

ter, with new auto sales continuing at a pace similar to last year's all-time record. Spending will continue to be supported by a rise in consumer confidence, which reached a nine year high in September. Rising housing prices and declining unemployment are fueling consumer optimism.

New orders for US factory goods fell for a second straight month in June on weak demand for transportation equipment and capital goods. Manufacturing has been pressured by a strong dollar and weak global demand, which have undermined exports of factory goods. However, there are tentative signs that the business spending downturn is starting to ease as a large portion of excess business inventories, relative to sales has been eliminated.

Unemployment, which peaked at 10% in 2009, has now fallen below 5%. The pace of job growth has moderated in the past three quarters as businesses are finding job vacancies more difficult to fill. According to the Federal Reserve, the number of job openings hit record highs in July. As a result, wage inflation has risen to near 2.5% from last year's 2% level.

The World Trade Organization predicted that global trade will rise only 1.7% this year, down from its earlier prediction of 2.8%. World trade is weakening to its slowest pace since 2009. Protests against trade agreements are gaining momentum in Europe and elsewhere. Growing anti-globalization sentiment will continue to be an increasing headwind for global economic growth.

Financial Markets

Global equities experienced a broad advance in the third quarter. Returns in local currency terms for world equity markets were:

Country	Index	2016 Q3 Returns
Canada	S&P/TSX	4.70%
United States	S&P 500	3.31%
United States	NASDAQ	9.69%
United Kingdom	FTSE 100	6.07%
Japan	Nikkei	5.61%
France	CAC 40	4.97%
Germany	DAX	8.58%
Hong Kong	Hang Seng	12.04%

Over the past several years, financial markets have benefited from central bank actions. However, the flood of financial liquidity and asset purchases provided by global central banks is reaching the bounds of its effectiveness. Each new round of action is producing less economic stimulus. There is a limit to how much excess liquidity can protect markets from the underlying economic reality.

More than 70% of developed-market government bonds now have yields of 1% or lower, with almost one third of issues yielding less than zero. Central bank bond purchases now total $180 billion US each month. As the supply of eligible government bonds dwindles, the European Central bank has begun to purchase corporate debt. The Bank of Japan has moved further into unprecedented territory by buying equities at an annual rate of 5.7 trillion yen ($56.12 billion US).

Central bank asset purchases are continuing to have a pronounced effect on pricing and liquidity in markets, as these programs mandate a predetermined scale of purchases regardless of price or return. In many markets, these supply-demand dynamics have completely overwhelmed other fundamental aspects of investment selection and are increasing the correlation of investment asset classes. According to Credit Suisse, the price relationships between equities, fixed income securities, currencies and commodities, show that different markets are influencing each other more than at any time since the 2008 financial crisis. This makes investment asset class diversification less effective in reducing portfolio volatility.

As the US Federal Reserve continues on its path of gradually increasing interest rates, and the stimulus programs of other central banks become marginally less effective, we expect financial markets to transition toward trading at levels that reflect underlying fundamentals. As this process occurs, there will likely be an increase in financial market volatility.

Proposed CPP Changes

The federal and provincial governments reached an agreement to expand the Canada Pension Plan (CPP), which will increase payments to retirees and also raise contribution premiums. Key details of the plan are:

- Changes will be phased in starting in 2019 and the full enhancement of benefits will be available after about 40 years of contributions.
- The income replacement rate will be increased to one-third, from the current one-quarter of eligible insured earnings. The new maximum CPP benefit will then become $17,478 compared to the current $13,000.
- The upper limit on insured earnings will be raised to $82,700.
- The contribution rates for employees and employers will increase by 1% each.

The main beneficiaries of these changes will be young workers, who are less likely to have access to defined benefit employer pension plans. To earn the full CPP enhancement, a person needs to contribute for 40 years at the new scale once the program is fully phased in by 2025.

Under the proposed CPP expansion, Canadians born in 1971 or later are projected to receive a rate of return (after inflation) of 2.5% from their CPP contributions. This represents a small increase from the 2.1% rate of return before implementation of the changes.

Canadians who believe the CPP offers a high rate of return often confuse the individual contribution rate of return with the average return earned by the CPP's investment division, the Canada Pension Plan Investment Board (CPPIB), which is frequently announced in the media.

CPPIB returns have no direct effect on benefits received by retirees. CPP retirement benefits are determined by the number of years a person works, their annual contributions and the age they retire, not CPPIB rates of return.

CRM2

The Client Relationship Model - Phase 2 (CRM2) refers to new security industry regulations that are designed to improve how the financial industry reports and discloses information to investors.

The amendments came into effect on July 15, 2013 and were phased-in over a three-year period. These amendments introduce new industry-wide requirements for reporting to clients about the costs and performance of their investments. The requirements apply to dealers and advisers in all categories of Canadian securities registration.

The regulations require that new account statement requirements be implemented. These include requirements to provide position cost information and to determine market values using a prescribed methodology. As a result, beginning in January 2017, our client portfolio management fees will begin to be calculated and collected from accounts on a monthly rather than quarterly basis. Be assured, that this change will not result in any increase in the annual portfolio management fee scale that applies to your portfolio.

Early next year clients will receive a new standardized report on charges and other compensation paid for the products and services provided, together with enhanced performance reporting.

The CRM2 requirements represent a significant step forward in financial industry client communications and we are committed to assisting the regulators with their implementation.

The Bottom Line

Economic and monetary policy divergences will remain an important influence for financial markets.

We believe central banks have reached a tipping point where the negative side effects of extraordinary policy now seem to outweigh its ever-diminishing benefits.

We will continue to use periods of volatility as opportunities to rebalance asset allocations in client portfolios.

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