INSTITUTIONAL

MARKET UPDATE

Q1 2017

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OPINIONS AS OF APRIL 3, 2017

HIGHLIGHTS

- With Trump in office, markets continued to move higher
- U.S. Federal Reserve raised interest rates again
- North American bond yields moved slightly lower
- Crude prices declined as drilling activity increased in the U.S.
- Canadian dollar rose to US$0.75

MARKETS EMBRACE TRUMP-LED ECONOMY

U.S. President Donald Trump came to power promising to deliver steep tax cuts and a massive economic stimulus program. Since then not much has happened on that front, but equity markets seem to be embracing Trump and consumer confidence has been improving – at least in the U.S.

While the potential economic benefits of his stimulus plan have likely been priced into the markets, the risk of Trump failing to deliver on them has not. And with Trump's inability to replace the Affordable Care Act, the risk of not delivering on his campaign promises might be going up.

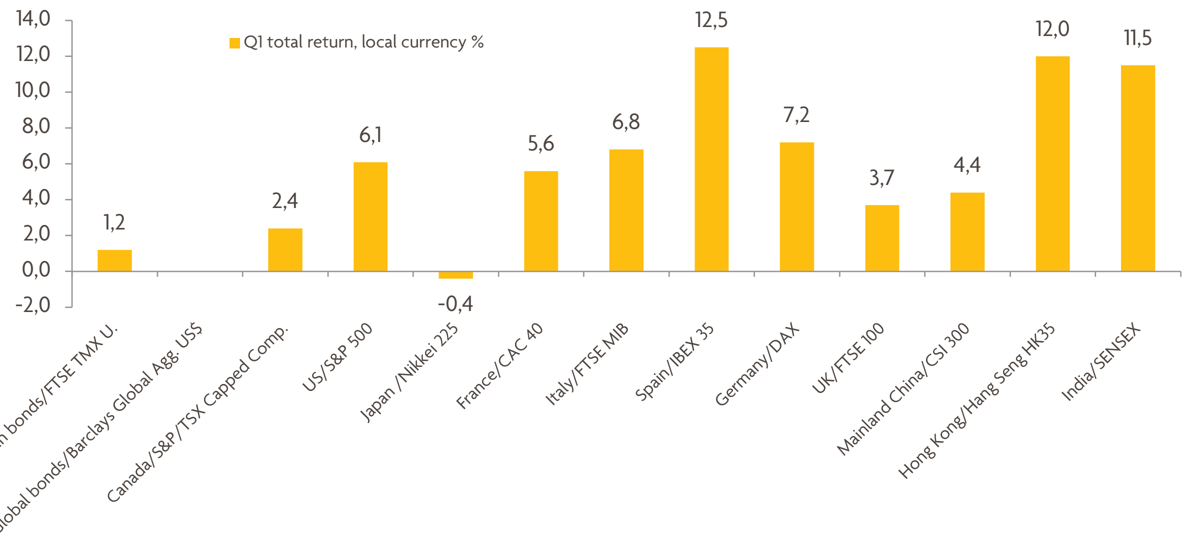
The markets also looked past the U.S. Federal Reserve's decision on March 15 to raise its key lending rate. The Fed has indicated that it may hike it two more times in 2017 – but we think it's more likely that it will increase it just one more time. And despite the controversy swirling around Trump's first months in office and a Fed with a tightening bias, the momentum U.S. markets showed in Q4, 2016 carried over into 2017.

Globally, equity markets generally did well (Chart 1). But emerging-market indexes were the star performers in 2017. This occurred despite all the noise that suggested a Trump presidency would be bad news for them. Perhaps the strength we've seen in emerging markets is partially tied to the fact that nothing yet has happened with negotiations on the trade front between the U.S., Mexico and China, which could ultimately affect their exports to the U.S.

International markets were also higher despite the potential political changes that may occur in Europe this year. To begin with, in March the U.K. officially invoked Article 50 under which the country's withdrawal from the European

Union will be formally negotiated, but it had no major impact on the markets – at least for now. And we are now waiting to see whether the upcoming elections in Germany and France will either benefit or destabilize the EU and move the markets.

CHART 1: POST TRUMP: EQUITIES GENERALLY PERFORM WELL



Source: Bloomberg.

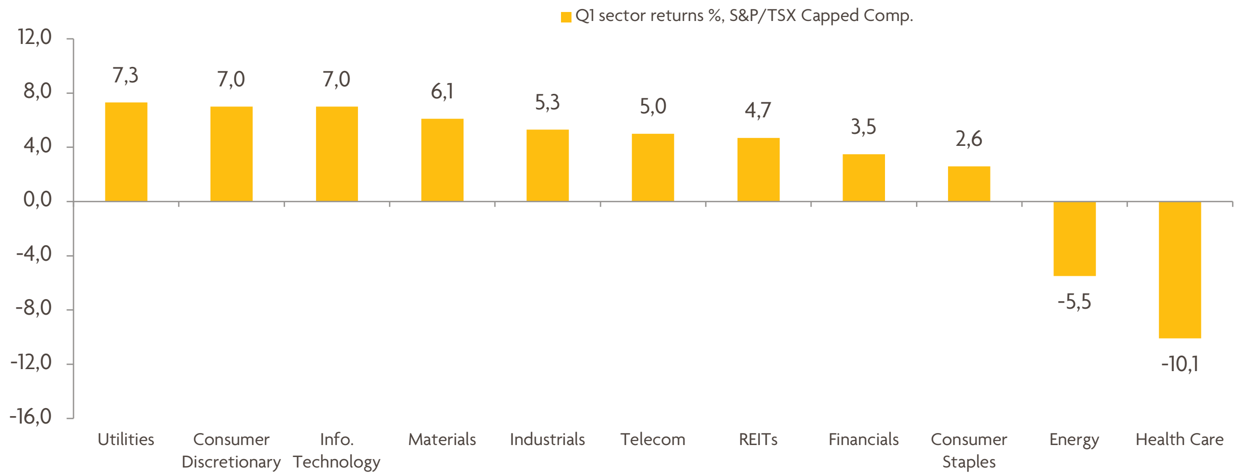
CANADIAN ECONOMY: BETTER, BUT STILL UNCERTAIN

In Canada, the federal government is still rolling out its economic stimulus program. However, economic growth continues to surprise to the upside. And so far in 2017 the performance of the S&P/TSX Composite Index has been more in line with our expectations, finishing the quarter up 2.41% on a total return basis). Utilities, consumer discretionary and technology were the index's top-performing sectors in Q1 (Chart 2).

But there is some uncertainty whether OPEC and some non-OPEC countries will be able to follow through on their agreement to reduce oil production. As a result, oil prices have been volatile. Furthermore, the number of oil rigs deployed in the U.S. has started to rise again, which could strain the supply/demand balance. But it's worth noting that oil prices are starting off from a much higher price point in 2017 than they did in 2016.

Another issue adding to economic uncertainty in Canada is the potential re-negotiation of NAFTA. We believe these negotiations will happen, but we don't anticipate that the outcome could impact growth in 2017. Furthermore, if the economic stimulus Trump has proposed does finally arrive it should help boost U.S. growth, which in turn could be good news for Canadian exporters.

CHART 2: UTILITIES, CONSUMER DISCRETIONARY AND TECH LEAD



Source: Bloomberg.

CANADIAN BOND YIELDS HEAD LOWER

After a surge in Q4, Canadian bond yields fell in Q1 with the yield on Canadian 10-year bonds starting the quarter at 1.87% and ending at 1.63%. Similarly, yields on U S. 10-year Treasuries moved lower from 2.63% to 2.39%. Much of this was tied to the lack of economic stimulus that we've seen so far in 2017 in either Canada or the U.S. We still expect both Canadian and U.S. yields to move higher throughout the year, albeit not significantly.

U.S. ECONOMY: STRONG, BUT CAN TRUMP DELIVER?

Even without Trump's promised economic stimulus program, the U.S. economy has been performing well. But without economic stimulus the question becomes more about U.S. equity valuations, which may then appear slightly rich. We still feel that Trump will deliver on his growth agenda at some point, but it may be closer to the end of 2017. Any market pullback may produce some good investment opportunities, but don't expect the ride to be smooth.

BRITAIN AND EU ENTER DIVORCE COURT

Despite the political uncertainty in Europe economic growth has been decent, jobs have been created and consumer confidence has been growing. And with two elections coming up, we think the next quarter will be very important in determining the future health of the EU, and whether it's time to look for opportunities to invest or to be bearish.

EMERGING MARKETS: ATTRACTIVE BUT RISKS REMAIN

Emerging markets soared in Q1 when the expected economic headwinds from Trump's trade-protectionist policies did not transpire. That doesn't mean the risks aren't still out there, but perhaps the probability of them occurring has been lowered. Certainly there are investment opportunities, with emerging market economies continuing to grow faster than their developed counterparts.

Still, not all emerging market economies are moving in the right direction, and being selective will be critically important in the months ahead. But we view significant market pullbacks as a good buying opportunity.

OUTLOOK: OPPORTUNITIES WITH INCREASED VOLATILITY

Despite the lack of an economic stimulus program, the U.S. equity market continued to move higher on the belief that Trump will yet deliver it. The market may have gotten ahead of itself, and we believe this could trigger pullbacks and higher volatility. However, we think the stimulus package could arrive later in the year and we remain positive on U.S. equities.

At the same time, until we get greater clarity on the European political front we remain cautious on international markets. It's good to see that the eurozone economy is growing and jobs are being created, but we are not being rewarded with the lower equity valuations political uncertainty often brings.

In Canada the roller-coaster ride on oil prices is not helping the economy, but we still feel that markets may improve as the year progresses. We do see an upside in oil prices, and are still slightly bullish on the energy sector even after its poor start to the year. A stronger U.S. economy should boost our exports and there is also a slight chance of a Bank of Canada rate cut, which would at the very least increase economic confidence.

As we predicted in the last quarter, the Canadian dollar still remains range-bound between US$0.74 and US$0.75. Our 2017 forecast has not changed and we expect the Canadian dollar to trade somewhere between US$0.72 and US$0.77 for most of the year.

Canadian and U.S. bond yields should move higher as we head further into 2017, which means bonds will likely produce low to negative total returns. However, we expect the rise in yields to be marginal, unless we get a major economic stimulus boost in the U.S.

Overall, we are slightly bullish on equity markets. But much of this may depend on whether Trump can deliver on his promise to stimulate the U.S. economy.

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