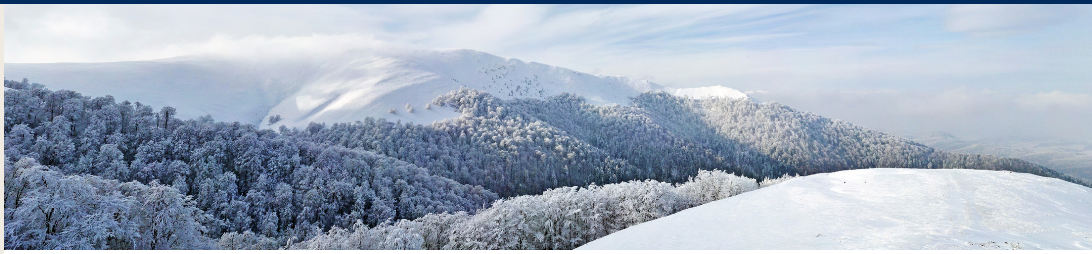
RBC Dominion Securities Inc.

Fickel's Focus

WINTER 2016



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Fourth Quarter Investment Commentary

Economic Overview

Global growth was a mediocre 3.0% for 2015. The World Bank forecasts 2.9% for 2016 as decelerating activity in China and weakness in emerging markets offset relative strength in the U.S., UK, India, and Europe. Monetary policies will diverge as the U.S. begins a cycle of modest rate hikes and Europe presses ahead with Quantitative Easing (QE).

The U.S. consumer accounts for 70% of U.S. activity and is doing well. CIBC estimates that lower energy prices transfer $1 trillion from producing to consuming regions with the U.S., European and Japanese consumers being the main beneficiaries. U.S. household spending will generate three-quarters of the 2.5% estimated GDP growth in 2016, offsetting weakness in the manufacturing sector, which continues to suffer from weak oil and gas, foreign exchange, commodity deflation, low pricing power and slowing China/emerging market demand. Wages are growing, consumer balance sheets are healthy—debt service payments are at 35-year lows—and jobs plentiful. Auto sales will flatten in 2016, housing improve, outlays for food and fuel decline and exports held back by a strong $U.S. As the economy approaches full employment, the tightening labour market will generate upward pressure on wages.

Europe is benefitting from weak energy prices, low rates, currency depreciation and less fiscal drag. Q3 GDP growth of 1.6% was twice the average rate experienced between 2003 and 2014 and supported by both domestic and external demand. Banks are easing credit conditions, consumer confidence is at a four-year high and measures of manufacturing activity are firmly in expansion territory. At 10.4%, unemployment is at its lowest level in four years and companies are hiring at the fastest pace since the financial crisis. The European Central Bank (ECB) continues with its 60 billion euros a month sovereign bond buying program, which should support growth of 2.0% in 2016.

According to the Bank of Canada, the economy is undergoing a major transition in the drivers of economic growth with activity picking up in the non-resource sector. A weak Canadian dollar and a firm U.S. economy should boost export growth in 2016 with trade providing a meaningful 0.5% lift to GDP. In fact, wholesale trade rose 1.8% in November as Canadian exporters not linked to the commodity-supply chain benefitted from a weak loonie. Housing, auto sales and surprisingly, retail sales, remain strong while business capital investment is sluggish. Economic growth will be tepid at 1.5% aided by the newly elected Liberal federal government's platform, which contains $150 billion in new investment over the next four years but held back by softness in the energy patch. Canadian dollar depreciation is keeping core inflation close to 2%, which, along with average annual wage gains of 3%, suggests no further BOC easing.

China's economy grew 6.9% in 2015, its weakest pace in 25 years. The International Monetary Fund forecasts 6.3% in 2016. For years, the Chinese economy had been overstimulated with cheap financing, which led to excessive investment in fixed assets. Not only did this lead to exceptional GDP growth, but also to a large stock of unneeded buildings and infrastructure.

China is now attempting to lesson its dependence on investment and exports, repositioning the economy to a more balanced one by placing more emphasis on consumer spending and services. Recent data confirm that the "real" side of the economy continues slowing with industrial output growing just 5.9% in December. Retail sales grew 11.1%, encouraging news for those who are counting on the consumer to be the new engine of growth. This transition, combined with excess supply and weakness in other emerging markets, is weighing on global commodity consumption and prices.

Emerging Markets (EM) are stuck in a multi-year adjustment phase challenged with weak productivity growth, excess capacity particularly in Asia, high debt levels and aging populations. EM's are having to contend with weak China data, falling commodity prices and the prospect of higher U.S. interest rates.

Investment Outlook and Equity Commentary

When U.S. activity expands as it is now and as we expect in 2016, the S&P 500 has generated a positive return 85% of the time and a return greater than 10% almost 70% of the time. Bear markets are associated with recessions and in view of recent data, a recession does not seem imminent. Every U.S. post-war recession has been preceded by a flattening or inversion of the yield curve, however, the yield curve remains very steep.

The S&P 500 earnings yield of 6.7% (inverse of P/E) compares favorably to long U.S. Government Bond yields of 2.7%, making equities relatively attractive versus bonds. On an absolute basis, U.S. stocks are fairly valued, trading at 15x forward earnings, in line with the long-term historical average. Fairly valued equities, slow global growth and peak U.S. corporate profit margins suggest a mediocre outlook for the S&P 500 with the prospect for mid-to-high single digit reurns. Our overweight in U.S. stocks (approximately 26% versus the benchmark of 20%) is concentrated in defensive consumer and health care equities that are less sensitive to sluggish global activity. Names include Abbott, Costco, Google, Home Depot, Johnson & Johnson, Medtronic, Merck, Proctor & Gamble, Time Warner, and Walgreens Boots.

We are overweight Europe (approximately 6% versus a benchmark of 5%) mainly through the SPDR Euro Stoxx 50 Index Fund. For the first time in five years, Eurozone earnings outperformed U.S. earnings up 11% in 2015 compared to flat earnings for the S&P 500. Europe is in the early stages of a business cycle recovery and we expect depressed corporate profits to grow at high single digit rates for the next several years. European stocks are inexpensive, trading at less than 14X forward earnings, yield over 3.4%, and have typically outperformed U.S. equities in the year following U.S. rate increases. European stocks offer good value relative to government bonds with dividend yields trading at wide spreads versus 10-year bond yields.

We are underweight Canadian equities (about 26% versus the benchmark of 30%) given our concern regarding the preponderance of stocks geared to the resource/commodity sector, which continues to suffer from excess supply and weak demand. That said, the TSX Composite, ex-energy stocks, is trading at a price-to-earnings ratio below its long-term average. We remain vigilant and continue to look for opportunities outside of the commodity sectors. Canadian banks offer good value trading at low p/e multiples (10x) and provide attractive dividend yields (4.7%).

Over the last three months, we have completed the transactions detailed below:

Utilities: + Hydro One (H) was added in view of its attractive low risk 4% rate base growth through 2019 as it replaces aging infrastructure, improves system reliability and builds out its facilities in response to new customers. H's p/e multiple of 17.8x is reasonable and its dividend yield of 3.8% is attractive and expected to grow.

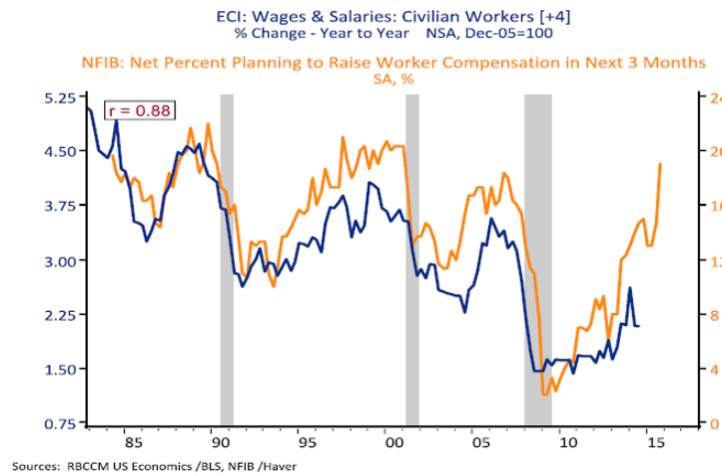
Health care: +Johnson & Johnson (JNJ) is benefitting from strong pharma results and cost containment. A more aggressive use of its balance sheet through acquisitions and stock buybacks offers potential catalysts. JNJ trades at a reasonable p/e multiple of 15x 2016 estimates and yields 3%. -Roche Holdings (RHHBY) was used as a source of funds.

Fixed Income

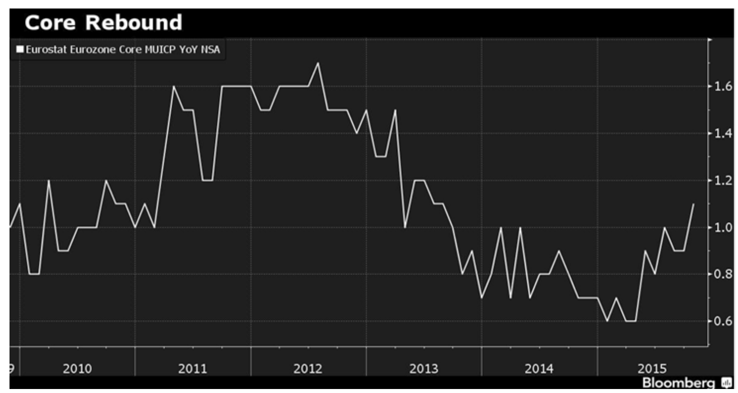
Inflation may be finally showing signs of life in the world's biggest economies. JP Morgan (JPM) economists' estimate the average core rate of inflation—which strips out food and energy costs—in the 33 economies they monitor is running around 2.4% in October, the fastest pace in 15 years.

U.S. core inflation is edging higher (see chart) as Americans pay more for services, including rents and medical care. Shelter costs are increasing at a lofty 3.2% and account for 42% of core CPI. They are headed higher as the rental vacancy rate remains at the lowest level since 1994. Health care costs, which represent about 10% of core CPI, are set to rise by more than 2.5% in 2016 as the impact of the 2015 cuts to Medicare and Medicaid roll off. Excluding the food and energy components, core consumer prices rose at a year-over-year rate of 2.1% in December, the highest since July 2012.

U.S. employment growth is strong. December jobs rose a higher-than-expected 292,000, building on upwardly revised numbers for November and October. The net share of firms planning to increase employment in the next three months ticked up to a new cycle high (see chart). Mentions of labour shortages were widespread in the Federal Reserve Beige Book. Wages will accelerate, putting added pressure on inflation. Fed Vice Chairman Fisher recently noted that some of the forces holding down inflation in 2015—particularly those due to a stronger dollar and lower energy prices—will begin to fade in 2016.



In Europe, ECB President Draghi continues to ring the deflationary alarm bells, yet the core picture looks very different from what the headline level shows. While the headline inflation rate in the 19-nation euro area was 0.1% in October, the core rate climbed to 1.1% - the fastest since August 2013 (see chart).



We are underweight fixed-income, holding about one-half of our targeted exposure in short-term positions (mainly cash) as we await better opportunities. Government bonds are expensive. A 25 basis point rise in 10-year Canada Government yields from current levels (1.1%) would result in a negative total return over the next 12 months. Real rates are negative and global inflation trends look to be headed higher. JP Morgan economists believe we are at a turning point for worldwide consumer prices (and that's not bond-friendly).

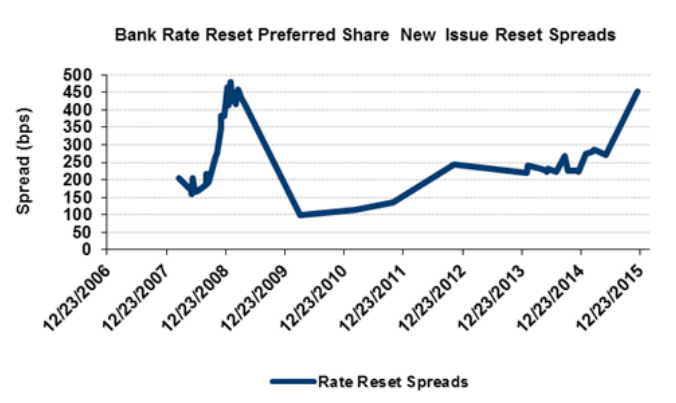
Portfolios hold about 20% in preferred shares through a combination of floating, fixed-reset and perpetual instruments.

During Q4, we added to the BCE monthly pay floating rate preferreds. The dividend is set at 100% of the Canadian Bank Prime Rate and offer protection against rising rates. The current yield of 5.5% is equivalent to a pre-tax bond yield of 7.15% for high income earners.

The Westcoast Energy Inc. 5.25% 5-yr rate re-set preferred new issue was purchased. Investors will receive a dividend of 5.25% for five years and can then choose one of the following two options:

1. For an additional five-year period, receive a fixed quarterly dividend equal to the five-year Government of Canada yield +4.26%, and no less than the initial fixed rate of 5.25%
2. A dividend equal to the 90-day Canadian T-Bill rate +4.26%, resettable quarterly

We added the Royal Bank, Bank of Nova Scotia and TD Bank five-year 5.50% rate reset preferred share new issues, which carry reset spreads of 453,451 and 466 basis point resets spreads over five-year Canada Government bonds respectively. These reset spreads are the largest offered by a major Canadian bank since the financial crisis (see chart). The 5.5% yields are equivalent to pre-tax bond yields of 7.15%.



Shares of the Great West Life Inc 5.4% perpetual preferreds were bought at a discount to their issue price yielding 5.65% for a pre-tax bond equivalent yield of 7.35%.

Performance

Portfolio performance is measured beginning on the first day of the month following the arrival of all assets. This allows performance to be consistent with benchmark returns, which are calculated on a full-month basis.

Our Q4 portfolio returns ranged from 2.9% to 4.6% for Income (Benchmark 1.5%); 4.1% to 6.7% for Balanced (Benchmark 2.6%); and 6.8% to 7.5% for Growth (Benchmark 2.9%). The Benchmark Compositions are set out in the following table. Dispersion of returns will narrow over time as portfolios are migrated towards their respective models.

Portfolio Asset Allocation And Peformance (Q4 2015)

	Benchmark Performance	Asset Allocation					
	Return (Q4 15)	Cash	Fixed Income	Cdn Equities	U.S. Equities	EAFE	Total
Income Portfolio	1.54%	10%	45%	30%	10%	5%	100%
Balanced Portfolio	2.56%	5%	40%	30%	20%	5%	100%
Growth Portfolio	2.93%	5%	30%	35%	25%	5%	100%

Accounts benefitted from being overweight U.S. and international stocks, underweight Canadian stocks and holding U.S. cash. We are significantly underweight cyclicals such as energy and materials and overweight financials, consumer staples and utililies.

Team Update

Our associate, Nindy Singh transferred to another RBC Dominion Securities office on January 18, 2016 to be closer to her newly purchased home in Mississauga. Nindy found the daily commute of 1 ½ hours each way to be exhausting.

We thank Nindy for her tremendous contribution and truly wish her all the best. We welcome Jaana Sauso as Nindy's replacement. Jaana is extremely competent, very knowledgeable and has previously worked with members of the team.