The O'Neill Wealth Management Group

Wealth Management
Dominion Securities

Q3 Executive Summary

The O'Neill Wealth Management Group

RBC Dominion Securities Inc.

Maureen O'Neill
Vice-President & Portfolio Manager
maureen.oneill@rbc.com
613-566-7562

Jennifer Shone
Investment Advisor
jennifer.shone@rbc.com

Dave Cajka
Wealth Advisor
dave.cajka@rbc.com

Doug Wilde
Associate Advisor
doug.wilde@rbc.com

Agnieszka Wasiluk
Associate
agnieszka.wasiluk@rbc.com

45 O'Connor St
Suite 900
Ottawa ON K1P 1A4
1-800-461-1958
www.theoneillwealthmanagementgroup.com

Confidence builds through commitment. When we commit to a vision for our future we can more easily clarify the steps needed to get there. Our purpose is centered on helping our clients achieve their vision for the future.

We bring our skills and capabilities in the areas of long-term planning and a defined investment process to the partnership with our clients. We bring discipline and structure to a process that is too often driven by emotions. We help clarify, then focus our decisions on achieving the end results.

In this quarter's commentary we risk sounding a bit like a broken record. While it might be tempting to resist repeating ourselves, we rather hope that you find some comfort in the consistency not only of our message, but in the discipline and continual commitment to our investment strategy.

On the whole our financial results over the summer were strong. Once again, the largest positive contributor to our performance has come from our position in U.S. equity. Fueled by large tax-cuts and increased government spending, the U.S. economy continues to lead the global expansion, and accelerate to its fastest growth rate in four years, at the same time as many other major economies are fading, with their stock market performance flat to negative. Generally the various authorities within RBC (RBC Capital Markets, RBC Economics, RBC Global Asset Management, RBC Wealth Management Investment Strategy Committee) conclude that we continue to be in an environment where we should be rewarded for the risk associated with equities versus fixed income, albeit at a moderating rate, and with the expectation of higher volatility.

That said, there is also growing consensus about the risks surrounding this base-case view. Protectionism, the age of the current business cycle, and slowing Chinese growth are among the primary issues.

Trade is highly levered to global economic growth. Typically when the global economy is strong so is trade growth barring extreme protectionist actions. The damage from recent tariffs is starting to become visible. The U.S. – China tensions are arguably the most consequential threat, and unfortunately there has not been any real progress. Chief Economist for RBC Global Asset Management (RBC GAM) Eric Lascelles now sees a "negative" rather than "slightly negative" outcome as the most likely among his trade scenarios. He estimates about a 0.6% GDP reduction in both the U.S. and China. He also cites a 20% chance of a worst-case scenario in which a full-scale long-lasting trade war erupts, and a 10% chance of a best-case scenario in which trade flows more freely. The first instance could lead to a recession, the second to an era of faster growth.

Thankfully, better progress was achieved closer to home. Hours before the September 30th deadline, a *new* NAFTA agreement was made between the U.S. and Canada, which will now be called the U.S.-Mexico-Canada agreement (USMCA). The largest impact is expected to be on the auto industry, and Canada will be providing access to its dairy industry. Congress must approve the deal before it can take effect, which now appears more likely given the tri-lateral agreement. The early response was positive for both U.S. and Canadian markets. While not a complete win for Canada, the removal of a major threat to cross-border business is a positive development for the Canadian economy. Bank of Canada governor Stephen Poloz has repeatedly mentioned trade uncertainty regarding NAFTA as a significant downside risk. With that risk mostly removed, a rate hike in October is now expected.

The classic definition of a "late cycle" is an economy in the last year or two of its expansion. The evidence is building. There is virtually no economic slack left, leading to higher inflation and tighter monetary policy (higher interest rates). Consumer delinquencies on auto loans and credit cards have begun to rise, if not yet on mortgages. The main message is that the U.S. economy is late in the business cycle, and this leads us to the conclusion that less investment risk is appropriate versus earlier in the cycle.

Rounding out a few other risks include; slower Chinese growth; U.S. mid-term elections that are less than two months away and are expected to produce a democratic majority in the House which could halt the legislative process; and investigations into misdeeds during the 2016 election may also impede the US political system for an extended period. Finally, it is important to note that while we must examine these downside risks, there is also an upside risk that the issues described above are avoided and the status quo of solid economic growth and rising corporate earnings continue.

While Canada's economic growth has been impressive, it has not translated into equity market returns this year. Forecasted growth for 2019 is slower for the now familiar reasons of deteriorated competitiveness relative to the US due to taxation, regulation, labor costs and the environment; combined with lasting concerns about the housing market. Rising interest rates mean many Canadians will be facing more expensive mortgage renewals for the first time in a decade at the same time that new regulations make it harder to obtain a mortgage. The bank of Canada is likely to increase rates a few more times given the current economic strength, however that is likely to change in 2019. RBC GAM expects the Canadian dollar to lose a few cents over the coming year as a result.

As mentioned, this evolving yet familiar backdrop has reinforced our investment strategy. As we benefited from sustained gains in equities this quarter, we have continued to emphasize profit-taking in our portfolios. Once again, one of the ways we have accomplished this is by frequently and pro-actively rebalancing portfolios, and maintaining the long-term strategic Asset Allocation targets defined in each client's Investment Policy Statement. At this point in the cycle we continue to believe this is important, as it actively helps us prepare for the downside while we enjoy the recent gains, and will mean we are ready to take advantage when the market upturn reverses and the opportunity to buy equities returns. Rebalancing adds value particularly during market inflections – from bull to bear, or bear to bull. Our continual rebalancing efforts are critical to portfolio risk management, particularly in the context of a strong run-up in valuations as we have seen with many of our high quality stock positions, and therefore we acknowledge many were ripe for profit taking given valuations are considerably above their respective historical averages and peers.

While we are fully invested up to each client's equity target, we have also continued to add defensive positions to our portfolios, acknowledging the softening of the macro environment. We believe we are positioned well for escalating trade tensions given our lack of exposure to Agricultural, Automotive, and Heavy Machinery sectors. We continue to have lower exposure to cyclical sectors including energy, and have recently increased our exposure to Health Care. We have maintained exposure to Canadian Banks, where despite challenges to loan growth, we still expect reasonable earnings combined with growing dividend yields around 4% to provide worthwhile returns.

We continue to control reduce risk within fixed income. With surplus U.S. dollars available from profit-taking on equities, we have been selectively adding to high quality, short-term bonds in U.S. dollars. This has enhanced overall yield and added diversification. Though we believe it is premature to substantially increase fixed income allocations in our portfolios, we want them to provide a solid foundation in the event of a recession and/or deterioration in the outlook for corporate profits.

Taxes matter! While we feel strongly that our focus on rebalancing and profit taking has been prudent, we remain cognizant of adverse tax consequences in non-registered accounts. We recognize the importance of using tax losses to offset realized capital gains to lessen the tax burden, where it is appropriate to do so, as we look to position portfolios more defensively.

Effective portfolio management involves constant analysis of the macro economic environment as well as perpetual scrutiny of individual positions, so we can adapt accordingly as the situation evolves. However, our true purpose is to align the long-term investment strategy with each client's immediate needs, future goals and vision. This is our commitment to you.

In the spirit of the Thanksgiving season, we would like to take this opportunity to thank you for your partnership and for the trust you place in us. We look forward to seeing you soon.

Sincerely,

Maureen O'Neill
Vice President and Portfolio Manager

Jennifer Shone
Investment Advisor

Dave Cajka
Wealth Advisor

www.theoneillwealthmanagementgroup.com

Wealth Management
Dominion Securities