The O'Neill Wealth Management Group

Wealth Management
Dominion Securities

Q2 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

Agnieszka Wasiluk
Associate
agnieszka.wasiluk@rbc.com

Edward Lis
Associate
edward.lis@rbc.com

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

It is amazing to think that 2019 is already half over. The rally in equity markets that started at the beginning of this year, after a tough end to 2018, continued right into the start of the second quarter with strong advances during the month of April. In May however markets retreated as the positive expectations of a U.S./China trade deal quickly pivoted and tensions intensified. The U.S. raised tariffs, prompting China to retaliate, and once again shook some investor confidence in the process. The retreat did prove to be short-lived, when negotiations improved. At the time of this writing, most developed equity markets are once again on pace for a strong performance in the month of June.

Our forward-looking view remains much the same as the previous quarter, with perhaps a more mixed macro-economic outlook leading to a *slightly* more positive forecast. The key risks at this stage have become well known: protectionism, the length of the economic expansion and current stage of the business cycle, and slowing growth rates.

Protectionism remains at the top of the list. The breakdown in U.S. – China negotiations in May is an indication of the fragility of the situation. Viewed through a longer-term lens, Eric Lascelle of RBC Global Asset Management (RBC GAM) expects the frictions will regularly arise between the U.S. and China for many years to come, as China's economic ascent challenges the U.S authority that has prevailed for years. Furthermore, RBC GAM does not expect a meaningful deal in the next few quarters. That said, tariffs won't have significant negative impact in the short-term, although they will if they persist over the long-term.

Ongoing analysis done by RBC Economics and RBC GAM point to the same conclusion –we are in a “late-stage” of the economic cycle and it is advancing. U.S. unemployment is the lowest it has been in a decade and the economic expansion is nearing the longest ever. So far credit markets are holding their own, though early signs of weakness are evidenced by an increase in delinquencies on auto loans, and the demand for credit is declining. Last quarter we discussed the “Yield-Curve” (the difference between short and long term interest rates) and how its’ persistent “flatness” and recent “inversion” are early warning signs that a recession is on the horizon in on average twelve months. This long-used metric has been heavily debated over the last several months. While many would suggest “this time is different” there are many examples in history where analysts have dismissed the warnings of the yield curve and a recession ultimately did follow.

RBC GAM has lowered growth expectations for the Canadian economy to 1.25% in 2019 due to some domestic challenges including; the impact of slower U.S. growth on Canada, continued transportation issues of Canadian oil to market, an overall softer housing market evidenced by lower home prices, starts, household credit growth, and slower existing home sales. Finally Canada’s economy continues to be held back by higher income tax rates and a larger regulatory burden on companies than is faced in the U.S.

The U.S. political situation points towards a diminished legislative process and larger battles between parties including the possibility of another government shutdown this fall and possibly another debt-ceiling standoff.

These risks are however offset somewhat by a handful of improved economic indicators including increased global stimulus and lower interest rates. Also, some of the “upside risks”, things that could go better than we presently assume, are the inverse of the downside risks. While protectionism could be worse than we expect, it might also be better. The business cycle could extend for longer in a lower interest rate and inflation environment, and China could defy its downward trend through stabilizing stimulus efforts.

In summary, given the lateness of the cycle and the predictions of the yield curve, the risk of recession is surely higher than usual, though neither imminent nor assured.

So the question remains, how much risk do we want to take in this environment? Financial conditions have improved somewhat with lower interest rates and bond yields. Equities still look compelling, even with heighted risk parameters, as compared to fixed income alternatives.

If we are too fearful and self-protecting by moving to cash and fixed income then we risk missing meaningful upside still offered by equities versus fixed income. While volatility has increased, and in a late-cycle stage it would be normal to expect it to continue, equities still offer decent upside under reasonable assumptions. Even modest earnings gains should be enough to sustain higher prices in an environment of low interest rates and inflation. If we are put off by the once again frustratingly low returns offered by fixed income, and therefore are too aggressive in our commitment to equities, then we remain vulnerable to a turn in markets which can happen quickly.

Over the past several quarters we have been gradually de-risking our portfolios as the business cycle has matured, and we remain on that path now. That said, we believe we should be at or close to the equity targets set in each client’s Investment Policy, while continuing to have liquid positions built into portfolios adding flexibility and the ability use as a source of cash quickly when required.

In addition to remaining committed to profit-taking wherever it is warranted, and to frequent rebalancing in order to manage risk, we have emphasized defensive positions within the equity and fixed income allocations of our portfolios. Quality metrics are our top consideration. Our decision making process includes the question “Are we comfortable owning this position in a recession?”, and by extension “Would we be comfortable adding to this position to create long-term value, if the price were to drop from here?”. Quality guidelines for equity positions include; those who are leaders in their sector, have unstressed balance sheets, higher internal growth rates, and dividend “quality” defined by companies that can pay and grow their dividends without impairing their financial conditions or forgoing growth opportunities.

The positioning of each portfolio must ultimately address the long-term strategic asset allocation, which is the optimal allocation for each individual’s personal circumstances, immediate needs, and future goals, and is linked to each client’s long-term Financial Plan. This is the benchmark that guides rebalancing decisions as it is suitable for the client independent of what is happening in the economy or in capital markets. However, within this long-term plan, shorter-term tactical decisions are made to fine tune portfolios and add value by being agile and responsive to the evolving macro-economic outlook and view for capital markets. Anchoring portfolios around an appropriate and suitable long-term strategic plan and placing boundaries defining the allowable range for tactical positioning, imposes discipline that can limit damage caused by swings in emotions that inevitably accompany both bull and bear markets.

This discipline is something we can control, unlike outside developments in the economy. We also have control over the quality and frequency of our reviews and communication. These comprehensive reviews are part of that commitment to you. We are in the midst of several Financial Plan updates and reviews. We look forward to having these conversations with you.

On behalf of our team, we hope you enjoy summer time with your family and friends. Thank you for the trust and confidence you place in us.

Best regards,

Maureen O’Neill
Vice President and Portfolio Manager

Jennifer Shone
Investment Advisor

Dave Cajka
Wealth Advisor

www.theoneillwealthmanagementgroup.com

Wealth Management
Dominion Securities

This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. Insurance products are offered through RBC Wealth Management Financial Services Inc. (“RBC WMFS”), a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC WMFS. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC WMFS. RBC DS WMFS is licensed as a financial services firm in the province of Quebec. ®Registered trademarks of Royal Bank of Canada. Used under licence. © 2016 RBC Dominion Securities Inc. All rights reserved.