The O'Neill Wealth Management Group

Wealth Management
Dominion Securities

Q3 Executive Summary

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RBC Dominion Securities Inc.

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We hope you enjoyed the summer months, including the bonus of warm weather right to the end of September. For many of us, Fall is defined by a return to regular routines (if not back-to-school), and is dubbed "the new January". As we enter the final quarter of 2017, we are happy to provide your comprehensive quarterly review for the third quarter ended September 30th.

Our summary and view of the previous quarter is really an extension of the themes we discussed in July. Economic growth continues to outweigh political concerns. Over the summer, the global economy's solid momentum shifted some of the focus away from geopolitics. The S&P500 hit a number of new highs, and a weaker US dollar helped emerging markets. Several international risks have lessened, resulting from recent elections in Europe, and Chinese resilience regarding concerns related to growth, debt, the housing market and banks.

Still, protectionism represents a considerable threat to global growth and the risk surrounding international relations is arguably rising. The most acute near-term challenge is the ongoing hostility between the U.S. and North Korea. Longer-term relations between the world's three military superpowers: the U.S., China and Russia potentially present new geopolitical risks.

The weakness in the US dollar continued into Q3. Various branches within RBC – RBC Capital Markets (RBC CM), RBC Economics, and RBC Global Asset Management (RBC GAM) agree that the US dollar should rebound, with the Euro and the Canadian dollar losing ground, though they differ as to the degree and timing. There is no question, currency fluctuations have had an enormous impact on investment portfolios in the short-term.

We welcomed a continuation of the upward trend for interest rates. While this is encouraging for our expectation of future yields on fixed income securities, we anticipate the progression will take several more years.

Stocks have continued to be supported by corporate profit growth around the world. While certainly not cheap, they remain somewhat attractive. That said, our enthusiasm is softened by rising complacency, the overall age of the business cycle, and less compelling valuations.

Over the quarter we maintained our full commitment to equity targets, relative to fixed income, however we continued to trim profits by rebalancing frequently. We are focused on the evolving risk-reward balance as time passes.

The US election last November may have spurred the rise of the S&P500, but is has been corporate fundamentals which have proven to be the driving force for the market. As we look towards the end of the year, the conclusion by RBC GAM's chief Economist Eric Lascelles is that the US economy is in the "late stage of the business cycle", but this does not mean a recession will automatically occur. Arguably, the risk of a shock-based recession is also higher given the geopolitical backdrop, however RBC GAM puts the overall risk of a US recession, of any description, over the next year at about 25%.

Despite, the political uncertainty RBC Economics Deputy Chief Economist Dawn Desjardins remains optimistic about the US economy and forecasts growth of 2.2% in 2017 and 2.4% in 2018. While our base-case is for stocks to rise modestly over the next year, a good investment process also requires careful scrutiny of the risks surrounding that view. In addition to concerns regarding international relations, it remains enormously difficult to anticipate the forward path of U.S. fiscal policy. Very little has been implemented, largely due to President Trump's declining popularity combined with disputes within the Republican Party. Goals have been delayed and diluted, and there remains serious doubt as to whether President Trump will make it through the entirety of his term given a host of potential legal challenges.

Trade remains a key concern, specifically President Trump's insistence that NAFTA be renegotiated. RBC GAM's analysis is summarized by a roughly 1 in 3 chance of a seriously negative set of economic implications from NAFTA renegotiations, and a 2 in 3 chance of a muted effect. This sounds promising, though the uncertainty in the meantime could be a drag, and the negative scenarios are real.

The Canadian economy is celebrating its best period of sustained growth in recent memory. Meanwhile, the catalysts for TSX outperformance that were hoped for by RBC CM's Chief Canadian Equity Strategist Matt Barasch, have not materialized. He contends the Canadian financial market still offers a compelling relative value opportunity to the U.S. market. This view supported our decision to realign our equity position earlier in Q2, by taking profits in the US, and tilting our exposure towards Canadian equity. Despite the interesting dichotomy between the performance of the broader Canadian market and the positive results of the domestic economy, we feel many of our core Canadian stocks trade at a substantial enough discount to global peers, while offering better return on equity, higher and more consistent dividend yields, and growth rates. We are maintaining this overweight position in Canadian equity. The risks to this position must be acknowledged however; namely those surrounding Global Trade, housing remaining a bigger overhang, a domestic weakness like higher consumer debt levels, and oil prices failing to stabilize.

The Canadian dollar's recent strength also poses a risk to the Canadian economy and profitability of Canadian businesses as US-based earnings suffer. The rise of approximately 10% from May to the end of July is only the 4th move of such a magnitude in the past decade, and does not help our competitiveness. While RBC Economics expects the CAD to average under $0.80US, RBC GAM Head of Fixed Income and Currencies, Dagmara Fijalkowski, has a 12 month forecast for the loonie of C$1.37 ($0.73US). While this significant and rapid rise did impact the overall performance on our U.S. assets (when measured in Canadian dollars) in late Q2 and early Q3, the previous tilting of our equity portfolios towards Canadian equity did help mitigate this headwind somewhat.

While not forecasting disaster by any means, RBC GAM's Chief Economist Eric Lascelles does expect the Canadian growth rate to slow in 2018 to approximately 1.5%, citing a combination of Canadian labour laws becoming less business-friendly, tax rates rising in Canada at the same time U.S. rates are set to decline, plans for significantly higher minimum wage in several provinces, and less government stimulus in the form of higher interest rates.

We are delighted to have been wrong so far about a correction in financial markets this year. Periods of lower volatility are welcomed by all investors including us, however we continue to resist the tendency to become complacent. Our commitment to profit-taking, rebalancing, and building some extra flexibility into our portfolios are all in an effort to be somewhat more defensive, while still participating in the overall upward trend. Under a number of the scenarios outlined, stock markets could become more volatile, and the risks of a correction are still very real in our view. However, in the absence of a recession, any pullback is likely to be relatively minor and short-lived, bringing with it opportunities to add to quality positions that meet the criteria for our long-term strategic plans.

The last quarter of the year *may* also bring a significant change to tax planning for our clients who use private corporations, though at the moment there is still a great deal of uncertainty, and to date no draft legislation exists. We will continue to communicate information on this topic in a timely way, and if necessary will review and update personal Financial Plans as needed.

In the meantime, we would like to take this opportunity, in the spirit of Thanksgiving, to express our gratitude for our relationship with you. We truly appreciate the trust and confidence you show in us through your commitment and loyalty. Thank you!

We wish you a beautiful Thanksgiving with family, friends and loved ones.

Sincerely,

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