The O'Neill Wealth Management Group

Q2 Executive Summary

Wealth Management
Dominion Securities

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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
www.maureenoneill.com
1-800-461-1958

Summer has arrived. We hope you will enjoy the longer days, and outdoor activities that accompany the season. We are pleased to enclose your Portfolio Review for the second quarter ended June 30, 2017.

At this mid-point in the year, most major stock markets have posted gains, with the S&P/TSX being a notable exception as Canadian stocks fell over the quarter due to weakness in the financial and energy sectors, leaving the benchmark in slightly negative territory year-to-date. While the S&P500 and the MSCI World Index are up comfortably so far this year, from our domestic vantage, some of those gains have been tempered by a recent and significant rise in the Canadian dollar. Our equity portfolios have held in well. Our underweight position in energy, along with more conservative stock selections within the sector, and broader sector diversification through our access to the U.S. market, has continued to help us. Our investment discipline remains focused on quality, stability and recurring income, in an effort to deliver a more sustainable, lower volatility experience.

There have been a number of reasons why most global financial markets have gone through this period of enhanced growth. Some can be explained as a natural bounce after the economic pull-back of late 2015 to mid-2016. There is also the lagged effect of monetary stimulus, and a positive spillover from an accelerating Chinese economy. Since last November there has been a high degree of optimism in response to the US election, and finally, the negative pull of the financial crisis may finally be fading. Despite strong performance overall, financial markets went into risk-off mode in mid-May amid renewed political controversy surrounding U.S. President Donald Trump's administration, culminating in the appointment of a special counsel to investigate the possible connections between Russia and Trump's campaign during the presidential election.

Meanwhile, in addition to the weakness in oil, Canadian performance was weighed down by worries regarding domestic housing and consumer indebtedness as well as concerns over trade given President Trump's protectionist comments directed specifically at Canada - the US's largest trading partner. There was improvement in Europe as a wave of potentially populist elections managed to avoid trouble in Austria, the Netherlands and France.

Looking forward, while economic fundamentals are still positive, and the US economy remains healthy, there are some signs that growth has peaked. The ISM manufacturing index, while still corresponding with growth, is slightly lower than the high recorded in February, and economic surprises are no longer as consistently positive as before. RBC Global Asset Management (RBC GAM) states in their Global Investment Outlook for Summer 2017 that they suspect the acceleration phase of this mini-cycle has come to an end, and are budgeting for a slight deceleration from the recent robust figures over the remainder of 2017.

Only time will tell if there are any merits to the latest allegations against the Trump Team, however the growing consensus is the implementation of the Trump administrations' pro-growth policies will be delayed to at least 2018, and will come with an expected diluted impact on the economy. That said, even if diminished, there could be a variety of short-term positives in the form of tax cuts, infrastructure spending, and deregulation. However to what degree the longer-term negatives from protectionism, reduced immigration and higher interest rates counteract the positives is unclear. RBC GAM asserts that over the long-run, the net effect will be negative, though less powerfully than previously thought.

According to RBC Capital Market's (RBC CM) Canadian Equity Strategist, Matt Barasch, the outlook for Canadian equities is constructive and he is looking forward to a better second half of 2017. This view is partially predicated on a recovery in the price of oil into the end of the year. RBC CM, and RBC Economics also acknowledge the housing and consumer debt trends are worrisome, more so in concentrated markets, however absent a sharp downturn in Canadian economic growth and a concurrent rise in unemployment, any correction or consolidation in prices is likely to be orderly.

One of the biggest changes of the quarter happened late in June when the Bank of Canada (BoC) Governor made a bold statement regarding the interest rate cuts implemented to combat the oil price shock, when he said "they look as though they have done their job". RBC Economics took this comment, along with a recent run of stronger-than-expected economic data, into consideration when they revised their forecast on interest rates. They now believe the Bank of Canada will raise rates at their next meeting on July 12th, and then again in October, removing the .50% cuts from 2015. In response to this change in forecast, RBC Dominion Securities Portfolio Advisory Group (RBC DS PAG) was quick to point out "the levels of household debt could constrain the Bank of Canada's ability to meaningfully increase interest rates and embark on a traditional (pre-global financial crisis) hiking cycle".

RBC CM agrees the time has come for the BoC to begin raising interest rates in Canada as housing needs an "all hands on deck" mentality. They conclude their Canadian Strategy with the view that the current fundamentals and valuations continue to support the positioning toward Canadian stocks, and furthermore indicates the sharp underperformance of the TSX year-to-date has opened a compelling opportunity.

At the same time, the European outlook has turned more positive. Political risks have declined significantly, valuations are much more attractive, and growth has better momentum. Future risks still exist for the Eurozone as Italy's next election in late 2017 or early 2018 could be dangerous, and negotiations over the latest Greek bailout installment have also been contentious. More generally the continent's bank and sovereign debt loads still possess the potential for trouble and global populism has not run its full course.

Given this backdrop, we have heeded the advice of both RBC DS PAG, and RBC CM and modestly downshifted our view of U.S. equities, as the robust performance over the past year has pushed up stock valuations to levels that are rich relative to historical norms, and therefore cannot be ignored. While this is not a negative call on the U.S. market, some profit taking and a modest repositioning of equities was in order in our view. We have established a small position in Continental Europe, and our equity exposure is now slightly more tilted towards Canadian Equities.

While the expected ramp-up in the economy following the US election has yet to materialize, the economy is still strong, and a global expansion is underway. That said, as we described in our Executive Summary note from Q1, we are concerned about complacency in the market, which is evidenced partially by the relatively low levels of volatility we have experienced over the past year. We continue to be vigilant, and have actively reduced our equity allocation as stocks push through record levels, to ensure we are regularly in line with the Asset Allocation guidelines of each client's Investment Policy Statement. The most notable risks of protectionism, an aging business cycle, and precarious geopolitics make a market correction conceivable. Therefore we continue to believe having some flexibility built into portfolios is prudent, so we can make shorter-term tactical decisions if they are warranted and will add value to our longer-term strategic plan.

At the core, our financial practice is a business built on the relationships with our clients. We are grateful for the opportunity to have that unique connection, defined by your personal needs and goals, and to be in a position to help align them with your own personal Wealth Management plan.

Thank you for the trust and confidence you have placed in our team. We look forward to our discussions with you. In the meantime, we hope that you enjoy the summer!

Sincerely,

M O'Neill

Dave Cajka

Maureen O'Neill
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