RBC Dominion Securities Inc.

The Sandler Quarterly

Wealth Management Dominion Securities

Volume 17 | January 2020

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Defying gravity - markets end the decade on a high note

KEY INSIGHTS

- An impressive S&P500 leads global equity indices higher in 2019
- A friendly Fed and a confident consumer give reason to remain invested
- While optimistic, our return expectations are modest for the coming year
- Stretched valuations, anemic earnings growth and weakening margins temper expectations
- Interest rates show no signs of moving higher any time soon
- Everyone seems to agree with the points above….beware of consensus views!

Investors had plenty to celebrate this New Year's Eve as we bid farewell to 2019 and rang in the new decade. When all is said and done, last year will be remembered as a banner year for the market. US equities fared particularly well, while other major global markets turned in impressive performance (see *Figure 1*).

Despite trade tensions, economic headwinds and talk of recession, markets charted a course to new highs. While these gains were partly due to recovering ground lost in late 2018, both the S&P500 and TSX went on to set new all-time highs.

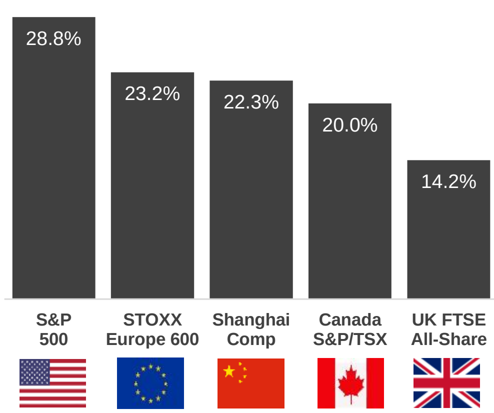

***Figure 1**: 2019 returns by market (Source: Bloomberg)*

As recession and trade war risks were rising, the US Federal Reserve delivered three interest rate cuts. This provided "insurance" to the economy and extended the longest economic expansion on record. The old saying "don't fight the Fed" proved true once again in 2019.

Much of last year's strength can be attributed to the financial health of the US consumer (*Figure 2*). They represent about 70% of activity in what is still by far the biggest and most influential economy in the world. In general, the consumer is confident, employed, and has seen their household balance sheet improve dramatically since the great recession. Unemployment is at a 50 year low, wages are rising, and workers have the flexibility to change jobs. Against this backdrop, the average individual feels comfortable in opening their wallet. The US consumer is undoubtedly a driving force for the global economy and should continue to be for the foreseeable future (see attached Focus Article – *Buying Power*).

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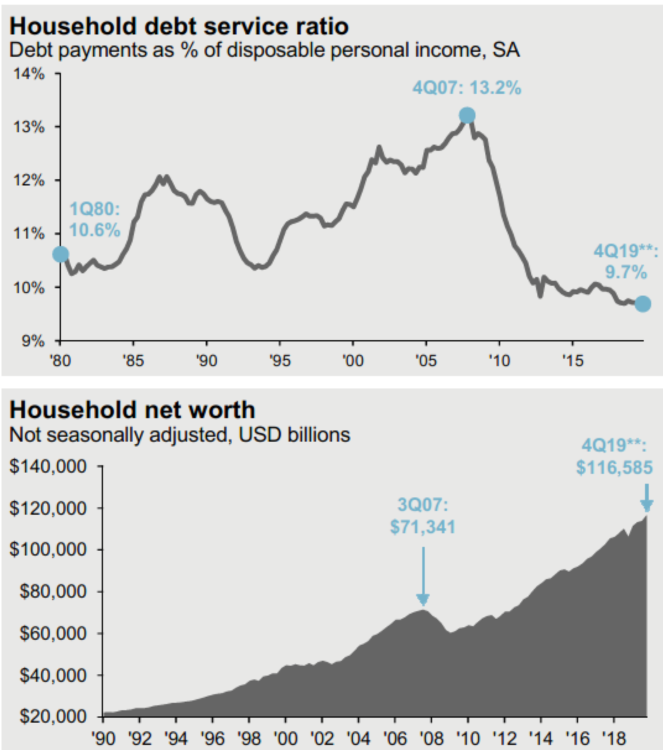

***Figure 2**: US Consumer Data (source: JP Morgan)*

Closer to home, Canadian equity markets also had a remarkably strong year with financials, utilities and real estate all posting gains. Importantly for Canada, energy and materials companies also pulled their weight as the key underlying commodities, oil and gold, showed strength.

Last summer, we made an investment in the gold sector as the price of gold broke out of a five year holding pattern (*Figure 3*). Historically low interest rates are a positive for gold. When making the decision to hold gold, a consideration is the return one must forgo on holding cash. These days, cash pays next to nothing in many parts of the world. In fact, negative interest rates are a strange new reality for trillions of dollars of cash and government bonds. In this environment, gold becomes a relatively attractive asset to hold as a store of value. As of year end the yellow metal was $242 higher than 12 months prior. Gold equities should see meaningful improvement to their bottom lines.

In our Q3 newsletter we reported that long time holding Dream Global REIT was going to be acquired at a very attractive price by New York based Blackstone. The deal closed in December and alas, we are no longer owners of this business. Not seeing the name in our portfolios anymore is bitter-sweet; we made exceptional returns on our investment, but would have been very happy to hold our shares forever.

As the acquisition was initially announced in September, this gave us plenty of time to search for a replacement. We are happy to report that after much due diligence we have used proceeds from Dream Global to purchase another real estate company with a global focus.

NorthWest Healthcare Properties REIT owns a portfolio of high quality healthcare focused real estate located throughout major markets in Canada, Australia, New Zealand, Brazil and Germany. Their properties are made up of medical office buildings, private hospitals and healthcare facilities. In Canada, they are the largest non-government owner and manager of medical office buildings and healthcare facilities from coast to coast. Quality properties, an aging demographic, proven and aligned management, and a 6.75% yield (at the time of purchase) make for a compelling new addition to our portfolios.

Looking forward to the New Year there are, as always, plenty of reasons to be optimistic alongside an equally healthy dose of factors of which to be wary. Investor friendly central banks appear to have little or no appetite for raising interest rates. This will continue to make buying bonds challenging but should support the economy and

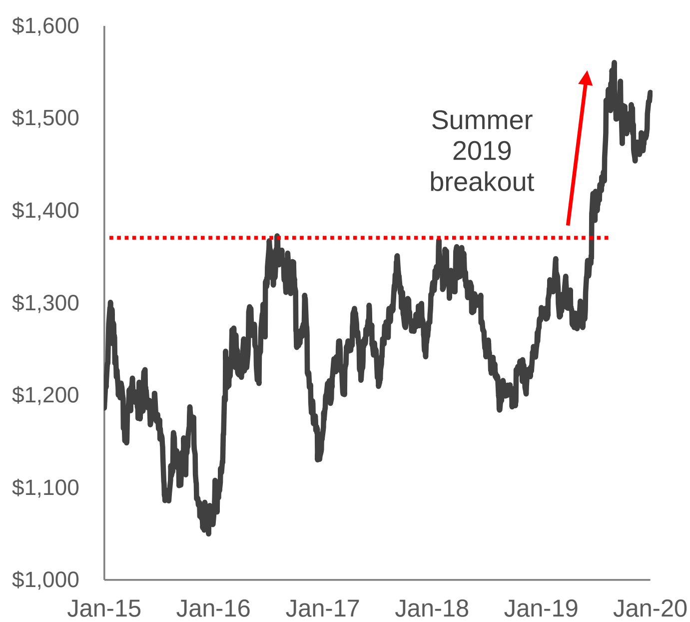

***Figure 3**: 5-years of gold prices in $USD (source: Thomson)*

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keep the stock market on track, albeit at a slower pace than last year. We are cautiously optimistic that a confident consumer can keep most developed economies growing in 2020. That said, we are always monitoring the economic landscape for risks that will eventually bring an end to an admittedly late stage economic cycle.

Slowing earnings growth, narrowing profit margins, and a potentially resurgent trade war all vie to be the first domino to topple; not to mention a concerning escalation of tensions in the Middle East at time of writing. Stock market valuations are far from inexpensive at this point and as such, are vulnerable to a correction - if for no other reason than to hit the reset button. Market corrections are healthy and inevitable. Your portfolio is not only prepared for the next pullback but we are ready to take advantage of it.

Ross Deacon's Retirement

After more than 30 years in the investment industry, our friend and colleague Ross Deacon is retiring this month. Ross' family has a long and rich history on Bay Street and in the brokerage community. From his early days at Deacon Morgan McEwen Easson, through to Dundee and most recently RBC, Ross has provided his clients with thoughtful, fair and common sense advice. His quiet style and unpretentious manner have earned him a reputation as a trusted advisor and a true gentleman.

In turbulent and volatile markets Ross can be relied upon as a steady hand and a voice of reason. We are delighted that he will remain an active member of our investment committee. His ongoing council will guide us in our investment decisions and help us in building better portfolios.

We wish Ross the very best for a well deserved retirement and thank him for many years of friendship.

Making predictions for the year ahead is typically a fool's errand. There is one thing, however, that we are confident in forecasting - the media circus south of the border will continue unabated and increase in absurdity as we approach the election. Our advice? Don't allow the hullabaloo to get in the way of prudent portfolio management. Corporate earnings, economic activity and interest rates matter far more than who is polling favourably at any given time.

As we watch the election unfold from a safe distance our attention will be focused squarely on your portfolio. As ever, we will seek to own profitable, well managed businesses that have been tested through many cycles. We favour companies that can be purchased at a fair price and will pay us a steady, predictable and growing stream of income over time.

After such a strong year, complacency and greed can easily set in. Chasing returns while ignoring the fundamentals of investing is a mistake that we see made time and time again. The late stage of a business cycle often brings challenges for the economy and financial markets when they are least expected. Common sense and pragmatism will win out over complacency and greed every time.

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Supporting Stella's Place

Last quarter, Scott was out fundraising for Stella's Place, Toronto's only health care facility focused on young adult mental health. Stella's Place is an amazing organization that makes a real impact in our community and our team is very proud to support them. In this photo, Scott poses with Stella's Place founder Donna Green in front of the design for the new facility they are building.

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Being stewards of your hard-earned money is a responsibility we take very seriously. In 2020, we will continue to work hard to protect and grow your family's wealth. As ever, we appreciate your business and value the trust you place in our team. Thank you for a great 2019 and we wish you the very best for a happy, healthy, and prosperous year ahead.

Scott Sandler
VP & Portfolio Manager

Ronan Clohissey, CIM
VP & Portfolio Manager

	Q4 2019	1 Year*
Indices		
S&P/TSX	2.43%	19.13%
Dow Jones	6.02%	22.34%
S&P 500	8.53%	28.88%
Nasdaq	12.17%	35.23%
Euro Stoxx	4.92%	24.78%
Japan Nikkei	8.74%	18.20%
India Sensex	6.69%	14.38%
VIX (Volatility)	-19.98%	-45.79%
Commodities		
Gold	3.04%	18.31%
Silver	5.04%	15.21%
Copper	7.97%	3.36%
Oil	12.93%	34.46%
Natural Gas	-11.81%	-34.10%
Currency		
CAD	1.92%	4.99%
EUR	2.88%	-2.22%
JPY	-0.52%	0.90%
AUD	4.01%	-0.40%
GBP	7.88%	3.94%

*As of December 31st, 2019

TFSA & RRSP Contributions

Tax-Free Savings Account (TFSA)

Consider making a contribution to your TFSA early in the 2020 calendar year to maximize the tax-free growth in your plan. The TFSA contribution limit for 2020 is $6,000. If you've been eligible for a TFSA since 2009 and have not yet contributed to one, your contribution limit would be $69,500 as of January 1, 2020.

2019 RRSP Contribution Deadline

The deadline for you to make a contribution to your RRSP that can be claimed as a 2019 tax deduction falls on March 1, 2019.

If you have not done so, please let us know if you would like us to arrange for your TFSA or RSP contribution to be made.

We are often asked whether clients should prioritize contributing to their RSP or TFSA. Please find overleaf a brief description of both account types and the benefits of each.

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Better together: RRSPs and TFSAs

Since their introduction in 2009, Tax-Free Savings Accounts (TFSAs) have rapidly grown in popularity with Canadians, with the most recent figures showing that we own over 13 million TFSAs. And while the total assets in TFSAs ($232 billion) are still dwarfed by those in Registered Retirement Savings Plans (RRSPs) (over $1 trillion)*, they are catching up gradually as Canadians learn more about the benefits of these savings vehicles, and as the lifetime contribution amount – $69,500 as of 2020 – increases every year.

But since their introduction, a debate has raged about which is the better way to save – RRSP or TFSA? The simple answer is both, as the two account types offer excellent benefits for savers, and both can help you reach your goals.

RRSPs and TFSAs: similar, but different

Both RRSPs and TFSAs have unique characteristics, offering Canadians benefits that will help them grow their savings and reach their goals. Both offer account holders important investment and tax benefits, specifically tax-free growth of any investment income produced within either account. This "sheltering" allows account owner's funds to compound and grow at a faster rate.

However, there are a few important differences between them, as captured in the chart below.

The right account for the right goal

Generally speaking, RRSPs work best for long-term savings goals like retirement, with some notable exceptions being for a home purchase or education funding (tax-free withdrawals are allowed under the First-Time Homebuyer's Program and the Lifelong Learning Plan). As withdrawals are fully taxable at the account holder's marginal tax bracket, the general idea with RRSPs is to wait until one has entered their retirement years before withdrawing funds to support their cash flow needs; conversely, contributors benefit from the tax-deductibility of their contributions when their marginal tax bracket is higher.

For many Canadians, RRSPs are seen as a long-term savings vehicle due to their more restrictive rules and the taxability of withdrawals. Given their far greater flexibility, TFSAs are often used for shorter-term goals or simply as a savings account, but can be ideal for longer-term goals like retirement, too.

	RRSP	TFSA
Contributions	Tax deductible	Not tax-deductible
Withdrawals	Fully taxable	Not taxable
Eligibility	You must have earned income	You must be a Canadian citizen and have reached the age of majority of your province of residence
Contribution limits	18% of your earned annual income from the previous year (less any pension adjustment), to a maximum limit as set by CRA (for 2020 it is $27,230)	$6,000 for 2020 and a lifetime limit as of 2020 of $69,500
Carry-forward	Yes, until the year you turn 71	Yes, indefinitely
Ability to contribute after age 71	No, must convert to a RRIF or annuity by the end of the year you turn 71 or close the plan	Yes
Withdrawals affect government benefits?	Yes	No

RRSPs and TFSAs: different, but the same

While different from RRSPs in many ways, TFSAs are the same as RRSPs in one important way: they provide important tax saving and compounding benefits to help investors grow their wealth. Whether you should use a TFSA, an RRSP or both for your savings needs largely depends on your unique goals and circumstances. We can help you make the right choice for you.

*Statistics Canada, 2016.

Focus article

Buying power

Will the U.S. consumer continue to drive growth?

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The consumer is the main engine of the U.S. economy, and with rising wages and a strong employment picture, the consumer appears to be in great shape as the new year begins. Jim Allworth discusses the importance of consumer spending with RBC Capital Markets' Chief U.S. Economist Tom Porcelli.

JA – Tom, you've been adamant for a long time that the pulse of the U.S. consumer is strong and, as long as it remains so, a recession is unlikely to arrive. One would never come to that conclusion reading the daily headlines.

TP – That's for sure. If I was to make a blanket statement it seemed, at least for a time there, no matter how good (or even OK) a data point was, it was interpreted as negative. It was rarely "This is the sign of a strong economy that has staying power."

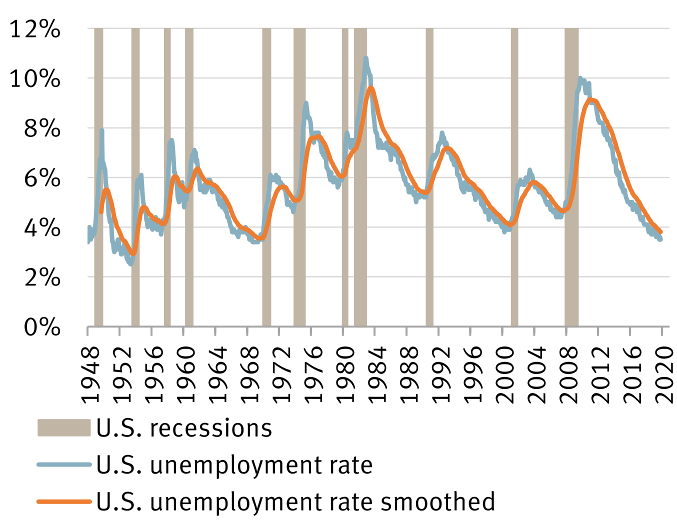
I travelled a lot more than usual in 2019, visiting clients here at home and abroad. Almost every meeting was an uphill struggle when it came to persuading our clients the expansion had further to run because the consumer—the dominant engine of the U.S. economy—was in great shape and showing no signs of running out of steam.

JA – What is the basis for your conviction about the staying power of the U.S. consumer?

TP – Well, the employment picture is definitely the biggest brick in the wall. Tight labor markets suggest wage pressures will continue. The unemployment rate sits

It's been a long time since unemployment was this low

U.S. unemployment rate (U-3 rate %)



Source - RBC Wealth Management, Federal Reserve Bank of St. Louis (FRED); data through 10/31/19

The U.S. labor market is at its tightest in 50 years ...

Tom Porcelli is Managing Director and Chief U.S. Economist at RBC Capital Markets, LLC. He focuses on piecing together the U.S. economic backdrop as part of the global economic effort. Tom travels globally to meet with RBC clients to share his insights on the U.S. economy and markets. He appears regularly on CNBC and Bloomberg and is quoted widely in the global press.

near a 50-year low and is below most estimates of "full employment." Unemployment claims near all-time lows suggest not a whiff of stress in the labor backdrop. And just to drive the point home, at present there are 7.3 million jobs available versus 5.8 million unemployed. Think about that. There are significantly more job openings than the number of unemployed. This is something that has never happened in the history of the data. Furthermore, the National Federation of Independent Business, which surveys its more than 300,000 small and medium sized business members monthly, reports that 26% (1% below the record high) cite the inability to hire qualified workers as their single biggest problem; in the most recent survey (November 2019), 61% of firms reported attempting to hire someone, and 88% of them were unable to find a qualified applicant. In other words, it is not at all heroic to say wage pressures will continue, and thus spending should continue to chug along.

A high percentage of firms surveyed are raising wages or are planning to. One of our highest-conviction calls for 2020 is for a further acceleration in wage growth. Average hourly earnings growth moved convincingly above the 3% mark (y/y) for the first time in a decade a little more than a year ago. We think that pace will be maintained or surpassed in 2020.

Wages are on the rise

Real median weekly wages (1982–84 CPI adjusted dollars)

Source - U.S. Bureau of Labor Statistics; quarterly data through September 2019

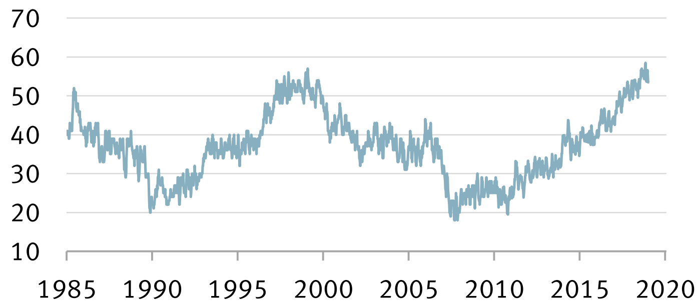
JA – Can the employment picture improve further from this point on?

TP – Yes it can. The average monthly employment gain was 186,000 positions over the past year, but we think that will slow down this year, to something closer to 125,000 per month. Meanwhile, the number of people entering the labor force each month also looks set to slow from about 140,000 down to 100,000. As long as the number of new jobs exceeds the number of new entrants to the labor force (the "break-even" level) then the unemployment rate will continue to decline. On balance, that's what we think will happen over the course of the coming year.

But job creation and the unemployment rate only tell part of the story. The best way to gauge the consumer's ability to drive spending is through wages. Production (non-supervisory) workers comprise more than 80% of the U.S. workforce, and their real aggregate wages—that is, wages after taking out the effect of inflation—are growing at close to a 3% y/y pace, well above the long-term average. Given the tightness of the

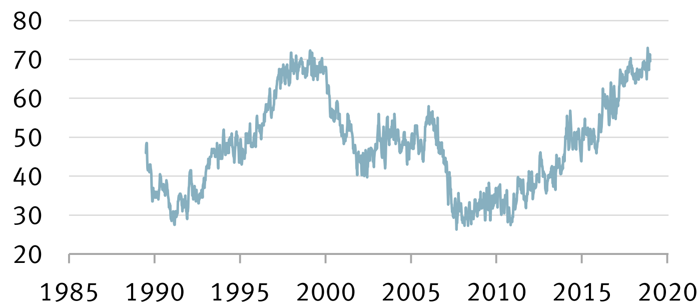
The U.S. consumer is smiling

Bloomberg US Weekly Buying Climate Positive Net Index



... boosting the confidence of the U.S. consumer.

Bloomberg US Weekly Consumer Comfort Index for full-time employed



Source - Bloomberg, RBC Capital Markets U.S. Economics; data through 12/15/19

labor market, there is almost no reasonable argument to be made that casts doubt on the consumer's ability to drive spending in the coming year at a better than 2% pace.

It's no wonder consumer confidence readings are elevated.

JA – Are there any signs that buoyant consumer confidence is inducing reckless spending?

TP – Far from it. In the eleventh year of this longest-ever economic expansion, the consumer's reaction to extreme labor market tightness and the job security it implies, as well as to rising wages, has been to save more. Needless to say, this is an atypical reaction. In fact, our saving model suggests that given this feel-good backdrop the consumer should be drawing down savings. Instead, the saving rate remains elevated in the U.S. at about 8%. And households continue to de-lever despite extraordinarily low interest rates. Credit card delinquencies are running at a rate only slightly above the all-time low reading posted back in 2015.

As we think about 2020, there is almost no getting around the fact that the consumer will again be the engine. On the face of it, calmer waters on the trade front would suggest businesses' capital expenditures (capex) could show some lift in the coming year, but we would caution against placing too much optimism here. Even if trade worries completely vanish, we still have the coming presidential elections that could add a dose of uncertainty to the backdrop. Thus we do not see capex helping propel growth in any material way. Rather, the consumer will again shoulder the burden. Luckily, they can.

JA – Thanks Tom, and all the best for 2020.