Wealth Management
Dominion Securities

The Sandler Quarterly

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We are excited to write this first quarterly commentary as an expanded team. As you know, our team has recently grown and over the coming months we are sure that the benefit of these changes will become apparent. Our goal is to continually improve the service and advice that you receive as a client. Please find a contact directory showing all the professionals in our group on the left of this page.

2017 has begun on a positive note for our portfolios. We are particularly pleased to consolidate last year's impressive gains and add to them with first quarter returns that have exceeded our expectations. Equity markets started the year in the green; major North American and Global indices all ended the first quarter in the plus column. The TSX Composite returned a total of 2.4% from January 1st, 2017 thru March 31st, 2017 and was one of the weaker markets that we follow. Please refer to the enclosed portfolio report for your personal performance.

The first quarter was once again "noisy" on the political front. Washington continued to dominate the headlines, initially giving the markets hope that President Trump's policies would breathe life into the economy. More recently, doubt has crept in and expectations have been tempered; can he actually affect the change he has proposed or will Washington politics steal the wind from his sails? Turning big ideas into political reality is far easier said than done.

Globally, investors are paying close attention to corporate tax reform and increased infrastructure spending. That said, expectations are muted when it comes to the timing of these changes. Recent RBC research shows that 90% of institutional investors believe tax cuts will most likely be part of the final corporate tax legislation, however only 60% think that the odds favour those changes occurring by the end of 2018. Of note for Canadians, the odds of a border adjustment tax are remarkably low. Please find a summary of this research in the attached RBC report, *The Washington Meat Grinder*.

Our view is that corporate tax reform and infrastructure spending will occur, but the magnitude and timing of these changes remain to be seen. Undoubtedly, there are many months (if not years) of debate ahead of us. In the meantime, life will go on; our capital cannot afford to play wait and see. We will continue to invest in world class companies that will deliver profits and dividends regardless of the outcome of these issues. Companies like TD Bank, Apple and Starbucks have excelled through many business cycles and administrations; this time is no different.

Canadian markets will continue to be heavily influenced by what happens south of the border and by the price of a barrel of oil.

Quarterly Review

Q1 2017

TFSA Reminder

Please don't forget to make your TFSA contribution this year. The limit for 2017 is $5,500. If you have any questions or need assistance, please call us at the office.

We made a decision almost two years ago to exit all energy producers and have yet to regret that decision or change our stance. The oil market seems to have found an equilibrium at around $50 per barrel and we do not anticipate any reason for this to change in the foreseeable future. Higher prices are met quickly with increased shale oil production in North America that, so far, has kept a lid on prices in the mid $50's.

Markets and politics are ever changing. Barely a day goes by without some seemingly sensational breaking news. The attached RBC commentary, *Digital Deluge*, echoes our thoughts. Please pay particular attention to the section under the heading *Erect a firewall*. While we do not believe in reacting to media headlines and hype, we are continuously making adjustments to your portfolio. These changes are in reaction to market movements that cause us to stray from our desired asset allocation.

Following a sharp increase in equity values since the US election we have been actively trimming our holdings to bring them back in line with our equity allocation targets. The result is a higher cash component in many portfolios. This rebalancing has the effect of taking some profits and locking in welcome gains. At the same time, it positions us with a war chest to deploy when fear revisits the market. As we know all too well, the next market downturn is not an *if*, but a *when*.

Despite the fact that interest rates have risen from generational lows, finding fixed income investments continues to be challenging. The preferred shares that we were actively buying last year have been a wonderful investment and have generated healthy returns in an otherwise meager fixed income environment. Over the past 12 months ending March 2017, the widely tracked Solactive Laddered Canadian Preferred Share index (as shown in *Figure 1* below) has risen by over 25% and continues to make new highs. We feel that while the yield from many of these shares is still attractive relative to other income vehicles, the opportunity for gains has diminished and we do not expect a repeat of the last year. Some preferred share issues have risen to unwarranted prices and in these cases we have taken some welcome profits. We are constantly looking for new investments that provide stability of income and capital preservation to satisfy the fixed income component of your portfolio.

Figure 1: *Solactive Laddered Canadian Preferred Share Index*

Quarterly Review
Q1 2017

To recap, 2016 was a great year for portfolios and 2017 has started off very well too. We know from experience that we should not expect this outperformance to continue indefinitely. With that in mind, we feel that your portfolio is well positioned to weather the next market downturn. Our equity holdings are primarily focused in less volatile industries; add to that a healthy cash position, the right amount of fixed income, and the eventual market pullback starts to look like an opportunity rather than something to be feared.

Sincerely,

Stephen Sandler,
Vice President and Portfolio Manager

Ronan Clohissey,
Vice President and Portfolio Manager

Scott Sandler,
Vice President and Portfolio Manager

Indices	2017 Q1	TTM*
S&P/TSX	1.70%	15.22%
Dow	4.56%	16.84%
S&P	5.53%	14.71%
Nasdaq	9.82%	21.39%
Euro Stox	6.39%	16.51%
Nikkei	-1.07%	12.83%
S&P BSE	14.46%	24.02%
VIX	-11.89%	-11.33%

Commodities	2017 Q1	TTM*
Gold	8.86%	1.33%
Silver	14.68%	18.32%
Copper	5.46%	20.44%
Oil	-5.81%	31.98%
Natural Gas	-15.81%	59.84%

Currencies	2017 Q1	TTM*
CAD	0.91%	-2.35%
EUR	1.28%	-6.40%
JPY	5.03%	1.06%
AUD	5.84%	-0.37%
GBP	1.70%	-12.60%

*Trailing Twelve Months

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April 6, 2017

RBC WEALTH MANAGEMENT

Global Insight Weekly

A closer look

The Washington meat grinder

Kelly Bogdanov – San Francisco

The Trump administration is learning an age-old political lesson—turning big ideas and big dreams into political reality is a Herculean task. Investors have come to grips with this and the heady pro-growth expectations have been tempered. But we think this recalibration could end up serving markets well.

Otto von Bismarck, the first chancellor of Germany, explained to his countrymen more than 100 years ago that laws, like sausages, never really garner the respect they deserve because we know how they're made. It can be an ugly sight.

The new U.S. administration's pro-growth policies are entering the sausage-making process. With outrage on the left, divisions on the right, and reported infighting inside the administration, the legislative process in Washington can be tough to watch.

Wall Street is monitoring developments closely, as there are a number of proposals that could impact economic and corporate earnings growth over the near term, at least.

But it turns out institutional investors have muted expectations of Washington. They don't expect there will be a wave of new market-friendly laws passed anytime soon, according to a recent survey by our national research correspondent.

We view this as good news, as expectations are restrained enough that legislative disappointments are unlikely to derail the equity bull market, and passage of pro-growth legislation could provide upside to the major indexes.

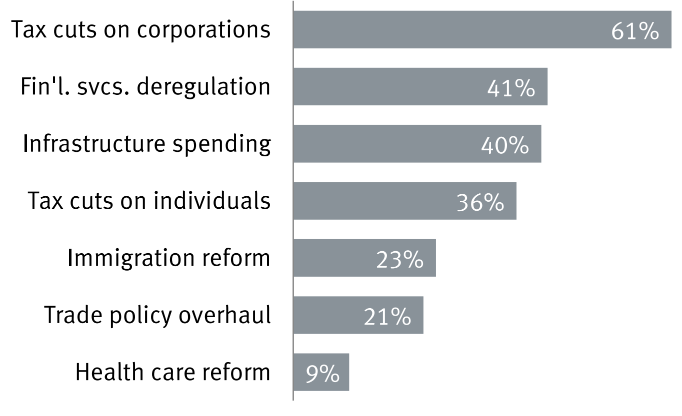
Grounded in reality

Institutional investors as a group—it includes mutual funds, pension funds, and hedge funds—have corporate tax cuts in their sights and not much else. Following are survey highlights:

- **Restrained optimism for corporate tax reform**: 61% of institutional investors surveyed believe there is greater than a 50/50 likelihood that significant corporate tax reform will become law in the next two years. The bulk

Institutional investors most optimistic on corporate tax cuts

Percent of institutional investors surveyed who believe the odds are more than 50% that the following initiatives will be passed into law or be implemented by executive order by December 2018



Source - National research correspondent survey of institutional clients, RBC Wealth Management; data as of 4/3/17

Market pulse

3 Stretched valuations shouldn't lasso the U.S. equity bull

3 Where to find value in the Canadian Energy space

4 The broad-based recovery in Europe

4 China planning a new megacity

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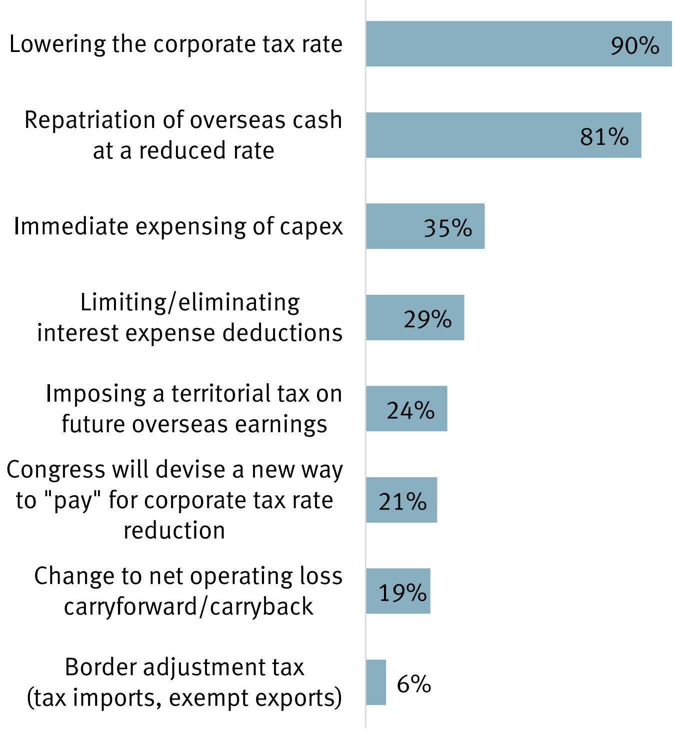
of respondents anticipate it would occur in Q4 2017 or Q1 2018. We think the odds are somewhat better than 61%, but acknowledge corporate tax cuts are by no means a done deal given the various factions among House and Senate Republicans. Also, we expect stumbling blocks along the way, just like when President Reagan was pushing his corporate tax package in 1986. It nearly failed three times before it passed—sausage making at its extreme.

- **A plain-vanilla corporate overhaul expected**: Despite all of the talk about a creative overhaul of the tax code, investors expect a conventional corporate package. 90% believe there is greater than a 50/50 likelihood it will include a corporate tax rate cut, and 81% believe it will allow overseas cash to be repatriated at a lower tax rate. Tech, Pharma, and select Industrials would benefit the most from repatriation, as they have the highest overseas cash hordes. Most interestingly, only 6% anticipate the highly controversial border adjustment tax will be included in the package. The capex expensing and interest deduction provisions also receive low odds (see upper chart).
- **A modest, not "yuge" rate cut anticipated**: Views are also restrained about the magnitude of a corporate tax rate cut and are nowhere near President Trump's desired 15% rate. 44% of institutional investors believe the current 35% federal corporate rate will be cut to 25%–29%, and 46% foresee a shift down to a 20%–24% rate. The precise level matters—the lower the rate, the greater the number of companies that will benefit. The current effective tax rate is roughly 27% for the S&P 500, and 31% and 32% for midcaps and small caps, respectively. Among S&P 500 industry groups, nine have tax rates of 30% or more, including Energy, Transports, and Diversified Financials (see lower chart).
- **Investors are less optimistic other policies will become law**, such as financial services deregulation, infrastructure spending, tax cuts on individuals, immigration reform, a trade overhaul, and health care reform, as illustrated in the chart on page 1. We think the likelihood of financial services deregulation and regulatory relief for other industries is much higher than these investors are giving credit. We also rate the likelihood of tax cuts on individuals as above 50%, especially for middle income Americans.

If the survey results are any indication, the market's bar for public policy achievements is not high. Despite Wall Street's day-to-day focus on political developments, it does not seem like investors are expecting much. We would rather have institutional investors' expectations muted, like they are now, than confident that a series of pro-growth proposals will become law. This could ultimately result in upside to the major U.S. equity indexes if any pro-growth initiatives actually pass.

Investors see very low odds a border adjustment tax will be included in final corporate tax legislation

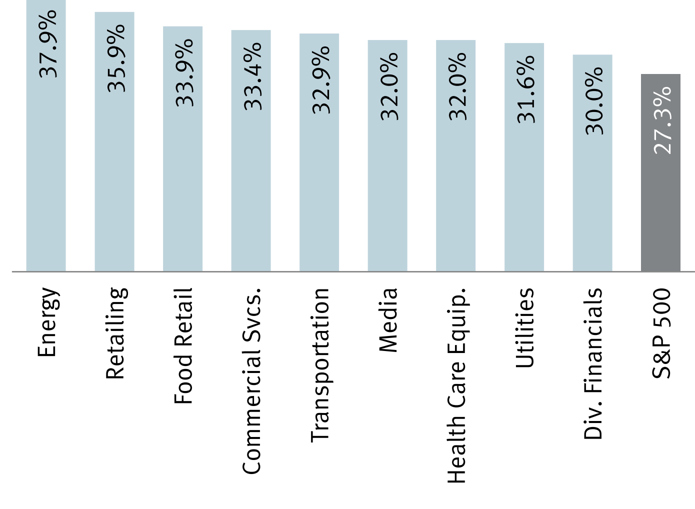
Percent of institutional investors surveyed who believe the odds are more than 50% that the following initiatives will be part of a corporate tax cut package



Source - National research correspondent survey of institutional clients, RBC Wealth Management; data as of 4/3/17

Energy, Transportation, and Diversified Financials, among others, stand to benefit the most from a corporate tax rate cut

S&P 500 industry groups with the highest effective tax rates*



* Data represents the trailing five-year effective tax rate (taxes paid / pre-tax income)
Source - RBC Capital Markets, FactSet, Compustat, S&P

March 30, 2017

RBC WEALTH MANAGEMENT

Global Insight

Weekly

A closer look

Digital deluge

Kelly Bogdanov – San Francisco

The access to information brought by the digital revolution has undoubtedly enhanced the way we live and do business. But information overload can cloud what's really important or manipulate emotions, so investors need to remove the overamplification of digital noise from investment decisions.

Technology, especially digital and social media, is likely playing a heightened role in shaping the way investors think about portfolios. Technology has become a megaphone, amplifying the political noise in Washington and issues surrounding Brexit.

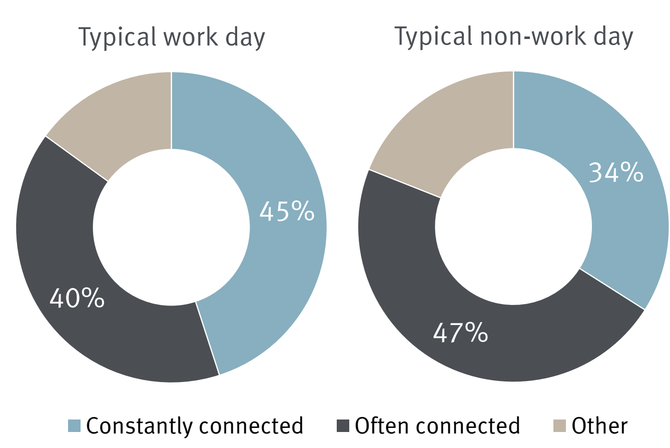
The increased usage of smartphones and digital media has changed the way we consume political and public policy information. Access to information has expanded wildly compared to just 5–10 years ago.

When President Obama was first sworn into office in January 2009, 17 million iPhones had been sold worldwide. It was a relatively new product. By the time President Trump was sworn in eight years later, another 1.1 billion iPhones had been sold. Add to that millions more Samsung and other smartphones. Internet access is now at our fingertips anytime, all the time, 24/7.

On a typical work day, 85% of Americans who are employed are connected to the internet on at least one device—a smartphone, tablet, or desktop—either constantly or often. On non-work days, 81% are connected (see chart). Both are remarkable statistics. While we haven't seen figures for sister countries Canada or the U.K., we imagine they are similar.

Internet anytime, all the time, 24/7

% of employed in U.S. who are constantly or often connected to the internet through at least one device



Source - American Psychological Association, *Stress in America Coping with Change, 2016*; devices include smartphone, tablet, or desktop

How much is too much?

With increased internet access, an overabundance of information has followed. From 2013 to 2016, consumption of digital media on smartphones doubled in the U.S. (see top chart on the next page). That rate could be even higher in Asia based on the region's explosive growth of smartphone penetration.

Market pulse

3 Follow the money moving into and out of U.S. equities

3 Why Canadian fixed income investors should play defense

4 Differing views on Brexit negotiations

4 Beijing's preferred candidate wins Hong Kong election

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The Washington Post, *The New York Times*, and *The Wall Street Journal* publish an average of 1,700 stories and videos collectively per day, according to a study by *The Atlantic*—that's per day, not per week. And there are thousands more articles and videos from other news outlets, both establishment and new media. Not to mention what is published in other countries and what is circulated and recirculated on social media worldwide.

It should be no surprise that many people, especially Millennials and those in Generation X, feel "attached" to their smartphone or tablet (see lower chart).

Is this digital media deluge helping to shape our perceptions about political, public policy, and economic developments, and could it be impacting how we view investment portfolio allocations in light of those factors? We think so.

Erect a firewall

We believe the challenge for investors is to separate the digital noise from investment decisions.

Much of the noise has little to do with what typically impacts financial markets over the long term. While ongoing political dramas can certainly nudge markets here and there over the short term, markets are primarily driven by economic trends, corporate earnings, valuations, and central bank policies over the medium and long term.

Public policy decisions tend to impact markets only when they spur or hamper GDP or earnings growth. For example, a large U.S. corporate tax cut could push S&P 500 earnings growth meaningfully higher, potentially into the mid-double digits this year and next year. This issue could have the biggest positive impact on the market, in our estimation. But without a significant corporate tax cut, earnings still seem set to grow 8% or more this year and 9% next year—not so shabby.

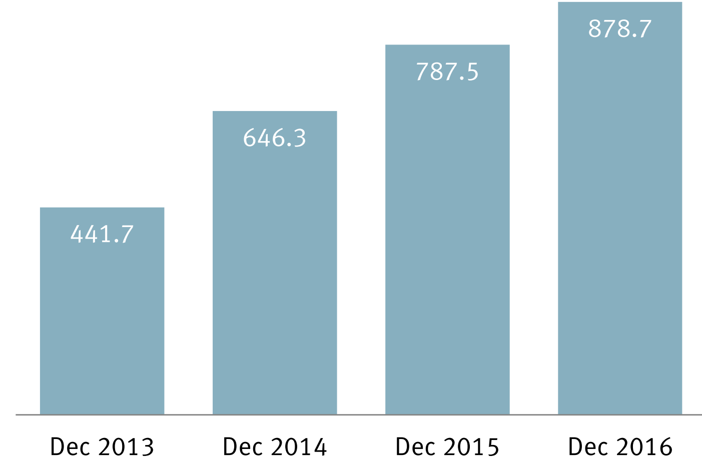
The U.S. economy's sound footing is driving the underlying earnings strength. That is why the direction of economic indicators is so important. Recessions typically cause bear markets for U.S. equities, not back-and-forth political squabbling or the success or failure of key public policy proposals.

Leading economic indicators flash warning signals if a recession is looming. For some time, four of our six main U.S. recession indicators have been in expansion mode. The other two are neutral. None of them are contracting. This and other data keep us constructive on U.S. and global equities based on a 12-month time horizon.

When it comes to asset allocation decisions, we recommend investors focus on good old-fashioned, tried-and-true economic indicators and earnings trends rather than the digital deluge.

Consumption has nearly doubled from 2013 to 2016

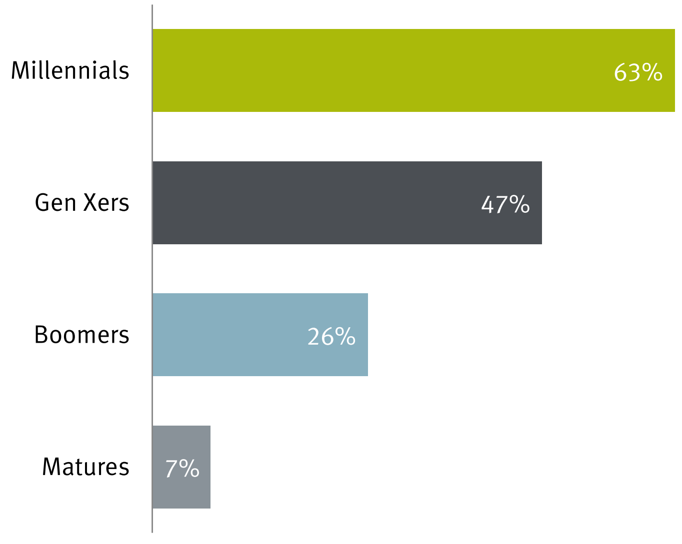
U.S. digital media consumption on smartphones in billions of minutes



Source - comScore Media Metrix Multi-Platform & Mobile Metrix; monthly data

Who are the most connected?

Those who feel like they are "attached" to their phone or tablet



Source - American Psychological Association, *Stress in America Coping with Change, 2016*