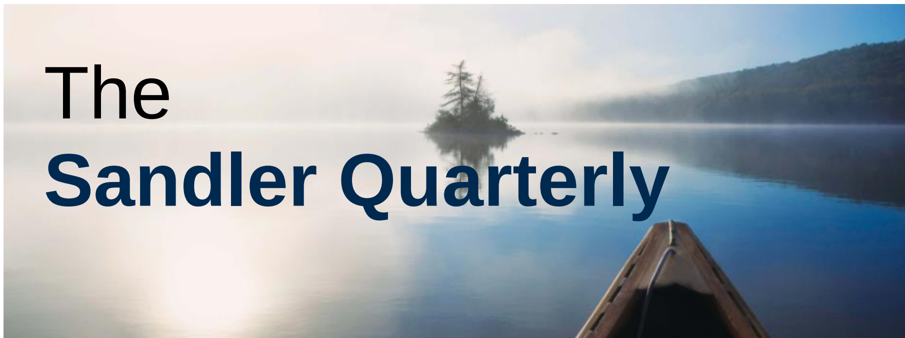
RBC Dominion Securities Inc.

The Sandler Quarterly



RBC Wealth Management Dominion Securities

Volume 7 | July 2017

Stephen Sandler
VP & Portfolio Manager
stephen.sandler@rbc.com
416-842-6685

Ronan Clohissey, CIM
VP & Portfolio Manager
ronan.clohissey@rbc.com
416-842-6683

Scott Sandler
VP & Portfolio Manager
scott.sandler@rbc.com
416-842-6684

Ross Deacon
Portfolio Manager
ross.deacon@rbc.com
416-842-6682

Michelle Noel Smith
Associate
michelle.noelsmith@rbc.com
416-842-8675

Steve James
Associate
steve.james@rbc.com
416-842-8674

Brendan Hollis, CFA
Associate
brendan.hollis@rbc.com
416-842-8673

Gary Tsang, CFA
Associate
gary.h.tsang@rbc.com
416-842-8672

Gina-Lee Gatto
Associate
gl.gatto@rbc.com
416-842-6677

In our 2017 first quarter newsletter we reported on a positive start to the year for your portfolio. At that time we had also discussed trimming exposure to some of our investments and increasing cash in anticipation of market weakness. The markets' honeymoon phase with President Trump was beginning to wane. Now three months later, it is clear that the promised tax reform and infrastructure spending will take far longer to deliver than originally hoped for.

Despite this shift in sentiment, the US market continues to perform well even though volatility has recently increased in the high flying tech sector. Through the end of May, just five tech companies (Apple, Google, Amazon, Facebook & Microsoft) had accounted for 33% of the S&P500's gain year to date. We participated in some of these gains through our investment in Apple. This outperformance of such a small number of companies tends to obscure the return of the broader market. In Canada, our market has now ventured into negative territory for the year; this thanks to a weak outlook for the oil patch due to falling energy prices.

An increased cash position and a lack of commodities exposure has helped us to sidestep much of this weakness and protect the gains made in Q1. In addition, strong performance in April buffered slight weakness in May and June. Please see the attached portfolio report for your personal rate of return year to date as well as month by month.

A recent focus for us has been upgrading the quality of fixed income holdings. Lesser quality bonds and preferred shares have become expensive relative to their lower risk, investment grade cousins. The slightly higher yield offered for holding these instruments is not worth the additional risk. For fixed income, we are moving up the quality ladder while keeping maturities short. The US has now raised rates four times with Canada beginning to indicate that the first rate rise here may be on the horizon. In anticipation, bond yields have moved sharply higher (please see figure 1) and we have been adding to our fixed income holdings at attractive rates. Of note, the increased likelihood of rising rates in Canada has driven the Canadian Dollar to its highest level in nine months (please see figure 2).

Welcoming Gina-Lee Gatto

We are pleased to announce that Gina-Lee (GL) Gatto has joined The Sandler Wealth Management Group. GL's industry experience and excellent client service will be a great benefit to our team. Gina-Lee can be reached at 416-842-6677 or gl.gatto@rbc.com.

Quarterly Review
Q2 2017

***Figure 1**: Government of Canada 5 Year Yields (Source: BoC)*

***Figure 2**: USD/CAD Exchange Rate (Source: BoC)*

Looking forward we are pleased with how our portfolios are positioned. We remain overweight cash by design, although we continue to search for new opportunities. Recently we added Brookfield Properties to client accounts. Brookfield owns some of the best real estate in the world and their management team is beyond compare. Primarily, their properties are class A office complexes in the US, Canada and Britain. They also own some retail properties in the US; this type of property is out of favour with investors as online shopping is justifiably causing concern for traditional retailers.

As a result we have been able to buy Brookfield Properties for a 30% discount to its intrinsic value. World class assets, top quality management, great value and a 5.5% yield makes for an ideal investment in our opinion.

Staying with Real Estate, we have recently returned from a tour of Austria and Germany to view properties owned by Dream Global REIT. This is an investment that we became involved with in 2011. Since then we have witnessed a continual improvement in the quality of portfolio and tenant roster. This trip was no exception; the new buildings in Vienna and Stuttgart are very impressive. Importantly, while we were there, the company announced a successful renegotiation of a key lease with Deutsch Post. As a result of this news, the shares are trading at their highest level in four years and still yield over 7% even at today's price.

Secure Two Way Messaging is Now Available

Please feel free to message anyone on our team via the Two Way Messaging system that is accessible through your DS Online account, using the tab > send a secure message < at the top of your Summary page. The message system is an easy and secure way of instructing our Investment Advisors and Associates without the requirement of your signature to authorize the following tasks:

- Address Changes
- Wire funds out to a third party
- Cheque authorization to a third party
- Transfer securities and cash to a third party account at RBC DS.
- TFSA contributions to a third party/withdrawals
- RSP withdrawals
- RIF withdrawals/change a payment

If you do not have DS Online but wish to be set up, please call Michelle at 416-842-8675 or Steve 416-842-8674.

Quarterly Review
Q2 2017

Our recent client event with Chief Investment Strategist, Jim Allworth, was insightful. His position is that economic indicators in the US point to continued strength in the economy with no signs of recession in the near future. This, coupled with easy and cheap access to credit, makes Jim think that there is room for the market to grind higher. He believes that under current conditions we should give equities *the benefit of the doubt* (see attached commentary).

Summer is typically a slower time in the market. This does not mean that we should pay any less attention to our finances and investment goals. With the exception of some vacation time, we will have a full team in the office. This can be a great time to book a review of your portfolio and investment policy statement (IPS) before things get busy again in the fall. We are always happy to hear from you.

Enjoy the summer,

Stephen Sandler
Vice President & Portfolio Manager

Ronan Clohissey
Vice President & Portfolio Manager

Scott Sandler
Vice President & Portfolio Manager

Indices	**2017 Q2**	**YTD****
S&P/TSX	-2.35%	-0.69%
Dow	3.32%	8.03%
S&P	2.57%	8.24%
Nasdaq	3.87%	14.07%
Euro Stox	-1.69%	4.60%
Nikkei	5.95%	4.81%
S&P BSE	4.39%	16.13%
VIX	-9.62%	-20.37%

Commodities	**2017 Q2**	**YTD****
Gold	-0.61%	8.20%
Silver	-8.94%	4.42%
Coppper	1.91%	7.31%
Oil	-9.01%	-14.30%
Natural Gas	-5.03%	-20.05%

Currencies	**2017 Q2**	**YTD****
CAD	2.73%	3.67%
EUR	7.27%	8.64%
JPY	-0.85%	4.14%
AUD	0.79%	6.67%
GBP	3.78%	5.55%

***YTD ending June 30th, 2017*

Wealth Management
Dominion Securities

RBC Dominion Securities Inc.

Wealth Management
REVIEW

Wealth Management
Dominion Securities

www.rbcwealthmanagement.com | July 2017

In brief

When we invest in youth great things happen

To help celebrate Canada's 150th birthday, we gave thousands of young Canadians $150 and challenged them to make it count. See their stories at: **rbc.com/make150count**

Reduce your paperwork with eDocuments

Securely view your RBC Dominion Securities account statements, trade confirmations and other documents online, instead of receiving them in the mail. Switching is easy – simply contact your advisor to learn more.

Top-ranked services to help meet your financial goals

We're honoured to be ranked Canada's leading bank-owned wealth management firm for the 10th year in a row in the 2017 Brokerage Report Card published by *Investment Executive*.

The benefit of the doubt

By Jim Allworth

As we glide into the summer holidays, we would all like to be able to put our investment and economic concerns to bed for a few weeks or months. As usual, it is far easier to come to terms with the long-term outlook for the economy and equity markets. The short term always seems worrying.

The long term needs the answer to only one question: Is a recession on the horizon, in particular a U.S. recession? The answer, as it has been for almost eight years, is "no." And the changes that would cause us to alter that view are, so far, giving benign readings.

Importantly, credit conditions remain constructive. Central banks everywhere in the developed world continue to run "easy money" policies and banks are looking for creditworthy borrowers. Typically, both the cost and availability of credit become noticeably restrictive before a recession gets underway. In our judgment, getting from here to there will take considerable time.

It has to be noted that the monetary backdrop has begun to change. The Fed is raising rates, albeit very slowly. Most central bankers have stopped talking about further rate cuts.

The Fed has said it will begin slowly shrinking its balance sheet later this year, which should put moderate upward pressure on long-term interest rates. Meanwhile, the European Central Bank is expected to further scale back its bond-buying program from its current pace of 60 billion euros per month. So, one can argue global monetary conditions are gradually normalizing, if not tightening. But it's "early days" and, in our view, outright restrictive conditions are some way off.

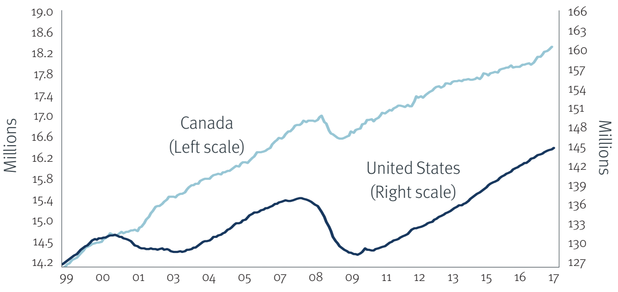
One very reliable indicator of whether a recession is immediately ahead is the unemployment rate. It rarely changes trend: moving steadily higher while the economy is in recession and falling throughout an expansion. Today, the U.S. unemployment rate (see chart) is at 4.3%, close to a 50-year low. Canada's unemployment is trending similarly.

Since WWII, once the trend in unemployment turned higher,

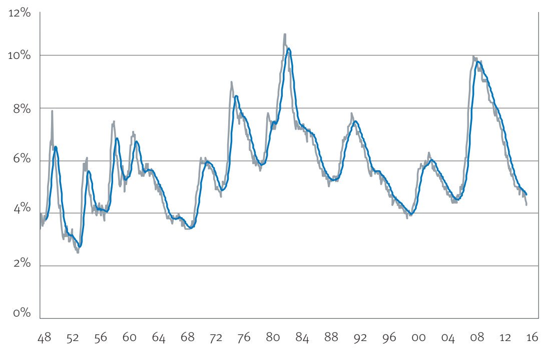
Continued on page 2

The benefit of the doubt – Continued from page 1

Employment



U.S. unemployment rate – 12-month moving average



On average the unemployment rate 12-month moving average turns higher four months before a recession begins. Sources: U.S. Labor Department; Statscan

the start of a recession was only a few months away. Currently it would take significant deterioration in employment data to deliver such a trend change, probably several months of outright job loss. Not impossible but so far unlikely.

Getting the recession call right matters because U.S. recessions have always been associated with bear markets for stocks. Absent compelling indications that an economic downturn is close, we choose to give equities the benefit of any doubt.

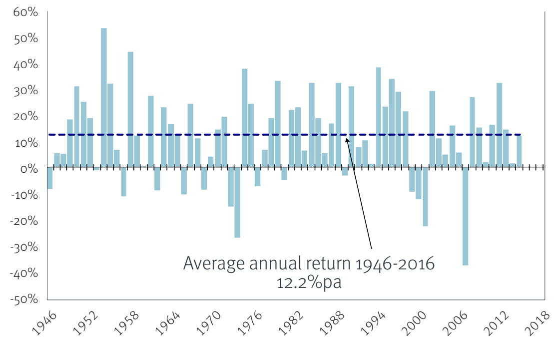
As usual, the short term looks more problematic. Today for U.S. investors, two issues rise above the constant political noise: the U.S. economy's apparent inability to move beyond 2% growth and stock market valuations that appear stretched.

Investors are confounded by a U.S. stock market that keeps on rising – the S&P 500 price/earnings multiple has moved from 15x at a correction low in early 2016 to about 20x today – even as earnings have barely moved higher over three years and the economy has stubbornly refused to shift out of second gear. The index is up 9% year-to-date and 35% over the past 17 months.

Paradoxically, the Canadian economy has developed unexpectedly strong momentum and earnings have improved but the TSX has lost 1% so far in 2017.

P/E multiples tell you almost nothing about where the market is headed next or even over the next year. Low P/Es can go distressingly lower and already high ones stretch dizzyingly higher. There are no reliable "lines in the sand."

S&P 500 Annual returns



Source: RBC Dominion Securities

Last year, the total return delivered by the S&P 500 (dividends plus price appreciation) was, quite unusually, almost dead-on the 12.2% per annum long-term average since the end of WWII. A glance at the chart shows that determining whether this year or next year are likely to be up or down, or above or below average, is not much better than a coin flip.

And inside the annual results shown here there is plenty of intra-year volatility. Corrections are a fact of investing life and while it always looks, after the fact, like they happen for reasons that should have been seen looming in advance, in our experience that is largely an illusion born of hindsight.

We expect there will be at least one correction of note before we get to the next "bear market" for stocks, probably more than one. But it would be less than forthright to suggest that spotting its arrival or extent correctly would be anything more than accidental.

For now, enjoy the summer weather content in the knowledge that the factors which normally make equities the best-performing asset class over reasonable holding periods remain intact.

For more thoughts on the prospects for financial markets, ask for our July issue of *Global Insight*.

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.