RBC Dominion Securities Inc.

Private Investment Management (Discretionary)

Wealth Management
Dominion Securities

Volume 2, February 2018

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Dear client

This financial letter will be devoted to explaining the return of the volatility that has affected your portfolios and what it means.

Here is our actual recommendation:

While the market's swoon was jarring, we believe investors should maintain equity positions, as healthy economic and earnings growth prospects provide solid underpinnings for equities.

Volatility is back: What the selloff means

Volatility has come back with a vengeance with the Dow Jones Industrial Average and S&P 500 each falling more than 4% on Monday (February 5th) after struggling in previous sessions. At its worst level, the Dow briefly dropped 1,597 points late in the session before recovering some of that lost ground to close down "only" 1,175 points.

We think the equity market's weakness is rooted in the uncomfortable, steep increase in Treasury yields that has unfolded since December 2017 and the related potential that U.S. inflation could pick up, pushing beyond the Federal Reserve's target. This heightened concerns that the Fed could increase rates at a faster-than-expected pace in 2018.

The stock market handled this well for a number of weeks, but the meaningful jump in U.S. wage growth seemed to put an exclamation mark on these risks.

Rising rates and normalizing inflation levels do not automatically open the door to an equity bear market, but they may open the door to further market adjustments. Until the stock market has a better grasp on where interest rates are headed, there could be a tug of war between those who think higher yields are going to climb further and those who think the move in yields is overdone.

The following table presents variations of different stock indices since last January.

Stock Markets Corrections

Indices	Region	Symbol	Value as of 12/31/2017	Peak 01/26/2018		Bottom 02/09/2018	Peak correction	Closing 02/12/2018	Growth following bottom
Down Jones	United States	DJIA	24,719	26,617		23,360	12%	24,601	5%
S&P 500	United States	SPX	2,674	2,873		2,533	12%	2,656	5%
S&P/TSX	Canada	TTT	16,209	16,421	(1)	14,786	10%	15,242	3%
Euro STOXX 50	Europe	SX5E-STX	3,504	3,687	(2)	3,307	10%	3,368	2%
Vanguard Emerging markets ETF	Emerging Markets	VWO	46	51		44	13%	46	4%

(1) The peak value for the S&P/TSX index (Canada) was on January 4th, 2018.

(2) The peak value for the EURO STOXX 50 index (Europe) was on January 23rd, 2018.

The recent stock market correction started last Friday (February 9th, 2018) (a stock market correction implies a minimum 10% decline for at least two stock indices). As you can see, the United States had a 12% fall, Canada and Europe, 10% and emerging markets had 13%.

The volatility's current pace is considered to be within normal range for mid to long term investments. You will find below a table showing the number of days with fluctuations above +/- 1%, as well as, the number of days with fluctuations above +/- 2% for the S&P 500 (United States).

You are able to see how 2017 was proven excessively calm (low volatility) with as little as 8 days with a volatility above +/- 1% and no days with fluctuations above +/- 2% for the S&P 500 (United States).

Year	# of days with moves greater than +/- 1%	# of days with moves greater than +/- 2%
50-year avg.	58	13
2018 pace*	41	20
2017	8	0
2016	48	9
2015	72	10
2014	38	6
2013	38	4
2012	50	6
2011	96	35
2010	76	22
2009	117	55
2008	134	72

* Current pace represents the occurrences to date, annualized for the remainder of the year. In 2018, we've experienced 4 days of market moves greater than +/- 1% and 2 days of moves greater than +/- 2%.

Historical context

A 1,175 point drop isn't what it used to be in percentage terms given the Dow is now well above 20,000. Back when the Dow was at 10,000, that same point decline would have represented a 12% plunge.

That being said, a selloff of this magnitude is rare. The last 4% single-session decline in the S&P 500 was in August 2011 when Washington dawdled about raising the federal debt ceiling, which put the U.S. credit rating at risk. There have been only six sessions with 4% or more selloffs since this bull market began in March 2009.

RBC Wealth Management Technical Strategist Bob Dickey wrote, “We suspect that the volatility will likely continue in both directions over the next several months, in a more normal long-term pattern compared to the low volatility of the past two years. This could take some getting used to.”

Solid underpinnings

Most important for equity investors, the market’s three-legged stool remains sturdy:

- **The economy is strong:** Forward-looking economic indicators continue to suggest recession risks remain very low. This is key because it is recessions that kill bull markets, not uncertainties about Treasury yields. Eric Lascelles, chief economist at RBC Global Asset Management, believes the business cycle has further to go. He wrote, “Our latest work argues that it is still in the ‘late’ stage of the cycle, meaning the next downturn would normally occur within the next couple of years, but not obviously tomorrow.”

- **U.S. corporate profit trends remain solid:** S&P 500 Q4 2017 earnings growth is tracking at a healthy 13.6% y/y pace, and the full-year 2018 estimate has increased substantially thanks to the corporate tax cuts. The 2018 consensus forecast stands at almost $156 per share, or 17.9% y/y growth, up from $146 in December. We think this estimate is achievable.

- **Market valuations have improved:** At the end of 2017, the S&P 500 was trading at 18.2x the 2018 consensus earnings forecast. The significant jump in the earnings estimate combined with the market decline has shifted the valuation down to 17.0x, a more reasonable level, and not too far from the 15.7x average of the past 20 years. Similarly, the valuation of the S&P/TSX has declined to 15.0x 2018 consensus earnings from 16.3x at the start of the year.

Patience is a virtue

We remain comfortable that fundamentals continue to support our modest Overweight allocation to equities relative to the long-term strategic allocation level. In addition to the support that the economy, earnings, and valuation provide, we believe monetary policies will remain relatively tame once the dust settles. But episodes like this tend to take time to play out. Pullbacks can morph into corrections and volatility can shift back and forth for a number of months. We think investors have time to be patient and make portfolio decisions thoughtfully, in line with long-term goals.

Now we want to show you why you should stay invested in the market.

The power of staying invested

Trying to time the market may cause an investor to miss out on long-term growth. Let's take a look at the impact of missing the best one percent of days over 30 years while investing $10,000 in the S&P/TSX Composite Price Index ("TSX").

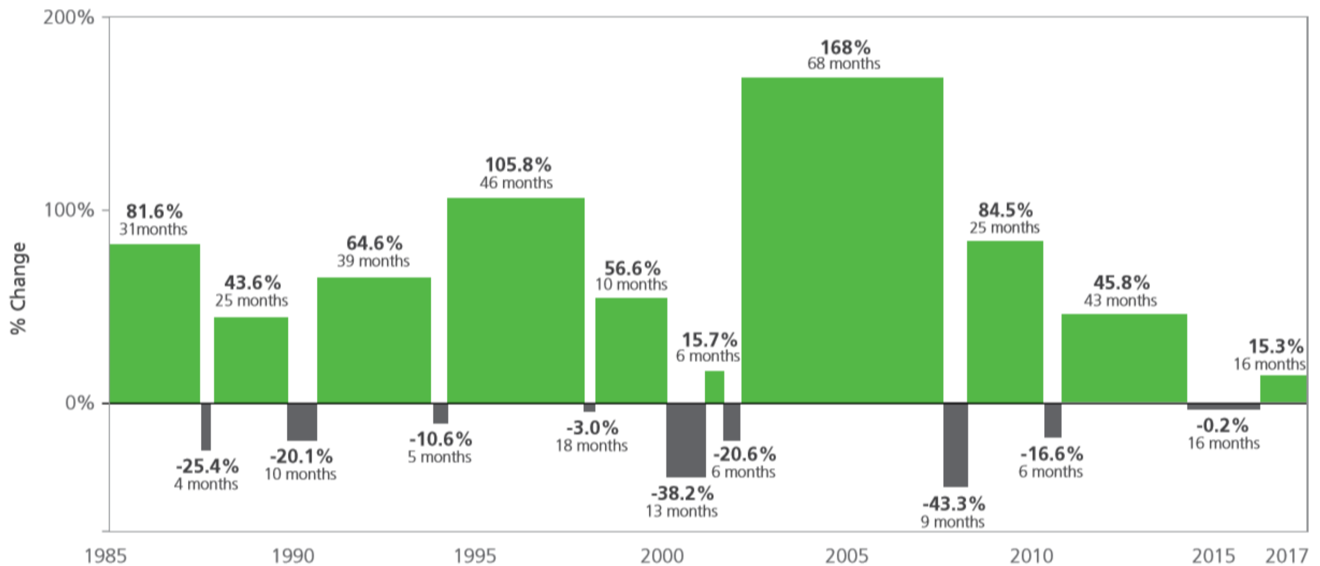
A few days can make a big difference:
A considerable portion of long-term gains can be attributed to a relatively small number of good days. In this example missing the best one percent of days reduced the end value of an investor's portfolio by over $47,000.

The best days typically come after some of the worst:
Many of the best days shown in this example occurred soon after the bad days. An investor who sells their investment on a bad day may miss out on the good days that follow, thus potentially reducing long-term portfolio value.

Source: TD Asset Management Inc. and Bloomberg Finance L.P.

Index returns are here for illustration and comparison purposes. Indices are not managed, and returns do not include acquisitions or sales costs, such fees would reduce returns. An index is not used to indicate the value of a fund's return but is used as a benchmark to illustrate the impact of compound growth rate and therefore cannot be invested in directly.

Canadian bull-bear market cycles: January 1985 – December 2017[1]



Historical data from the graph above shows that Canadian stock market has eventually recovered from its decline and has resumed it upward trend.

That is why keeping a good focus on your long term investment goals and staying invested is important to enable your portfolio to participate to subsequent market increases. As shown in the above table, investors trying to anticipate market movements or selling investments in time of decline might miss oppurtunities of making important returns during upward extended periods or during repossessing.

As always, if you have any questions whatsoever, about your portfolios or anything else, do not hesitate to contact us.

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