RBC Dominion Securities Inc.

Johnston Journal

Wealth Management
Dominion Securities

September 2017

Johnston Wealth Management

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Going nowhere – the TSX in 2017

The TSX hit a record high of 15,943 in late February but since then it has been steadily drifting lower. Why hasn't Canada followed Wall Street's lead?

The Toronto Stock Exchange has been a disappointment for Canadian investors so far this year. While the Dow continues to hit new records and European exchanges post better returns than anyone expected, the TSX has been limping along around the break-even level for most of 2017. As of the time of writing, the TSX index sits at 15,119, down -1.3% for the year and down -5% from the February highs. Canada's stock market has had one of the worst performance records among all the major global stock indexes. It should come as no surprise that some clients are calling complaining about returns.

The TSX index's challenge is over-concentration. Financials account for 33.5 per cent of the index, with energy at 20.7 per cent, and materials at 11.9 per cent. Those three sectors make up almost two-thirds of our stock market. Financials, which comprise one-third of the index by themselves, are -0.7% year-to-date. The energy sector has dropped -15% this year, down -4.3% in August alone.

Canadian GDP has been solid but worldwide investors see Canada as a relatively expensive market. Our country faces tougher trade going forward with its largest partner. Canadian consumers are hooked on debt and have increasingly been binge borrowing against their homes using their properties as ATMs. Oil prices have been falling and the latest Texas storms have not helped as too much oil supply is now sitting around unable to be refined.

What do we need to see our TSX performance pick up? We see a couple of factors which could spur Canadian index returns (1) short market correction – appears to be setting up right now in this historically weak month (2) return of some inflation – this would jump start commodity prices and TSX has lots of commodities (3) better demand for crude oil (4) weakening Canadian loonie – a higher loonie makes our products more expensive in global context and puts a drag on GDP.

We believe the last 2 months of the year should bring a return to an upward trending TSX. Investors should be patient into the fall as we will be looking for opportunities to buy into Canadian stocks and sectors which have pulled back.

The High Flying Loonie

The Canadian dollar (CAD) has appreciated 10% off a low of $0.72 in early May. A 10% CAD move within a three month timeframe is massive and has impacted Canadian investors who hold non-Canadian holdings. Even though US and European stocks are up this year, when the values are converted back to Canadian dollars, returns are negative.

The Bank of Canada (BoC) provided fuel for the move higher with its abrupt turn on June 12 when Deputy Governor Carolyn Wilkins talked about stronger growth ahead for the Canadian economy and the need for a change in monetary policy. That took the market by surprise as the BoC had been hinting about interest rate cuts. At almost the same time, the U.S. Federal Reserve (Fed) started focusing more on the reduction of the balance sheet, implicitly delaying the additional US rate hikes until the end of the year. This caused Canadian bond yields to rise, which causes bond prices to decline. The drop in average bond portfolio has been approximately -2%.

The currency markets took notice, switching attention almost exclusively to this new information and abandoning the previous focus on oil prices. The scenario painted by BoC assumes that the consumer contribution to growth will slow down with exports and corporate investment will take over. The BoC change of direction on interest rates came at a time when short positions on Canadian Dollars were at extremely high levels. Foreign speculative CAD shorts built-up on concerns around Canada's housing market and newsflow surrounding Home Capital Group. These were then reinforced by trades with an eye for a higher USD based on oil weakness. These shorts have now been unwound.

This month, RBC revised our loonie forecast. Our economist are now forecasting the loonie could stay in the $0.81-$0.82 range while the US Federal Reserve Bank is on hold with raising interest rates until December 2017.

Against this backdrop, we recommend taking advantage of the recent CAD strength and tactically adding to foreign stocks, ETFs or mutual funds. While we can't know for sure that this is the end of CAD strength in the short term, we believe it already provides good medium and long term opportunities.

We appreciate this has been a frustrating year for portfolio returns. Once we get past the seasonally weak period of September and first half of Ocotober, our outlook for stock markets is positive for the next 12 months and we hope to once again see a pickup in returns.

Approaching retirement year and/or worrying about the next recession?

If you are seeking equity market type returns with the guarantees provided by fixed income…consider segregated funds.

A Segregated fund combines the growth potential of mutual funds, but have several distinct advantages only available through an insurance company.

10 years ago, segregated funds had high annual management fees, often in the 3-4% range. Over the past years, we have seen fees reduced and now some are comparable to regular mutual fund, with many more benefits. Annual fees on our preferred seg funds are in the range of 1.6-2.3%. The modestly higher fees may be worth your piece of mind. **Give us a call or email us to explore whether seg funds might be a good option for your portfolio.**

Some of the advantages are:

- Death benefits
- Maturity guarantee
- Ability to bypass probate
- Potential for creditor protection
- Ability to lock-in market growth
- Income guarantees
- Further benefit is the speed with which the death benefit is paid because probate is bypassed. A beneficiary can be in receipt of funds in as little as two weeks – this can be very important for someone with final expenses to settle

Thank you to all who attended our 4th Line Theatre Event!

Brace yourself for five years of glacial growth in Canada's housing market, Moody's warns

(Article from September 13th Globe and Mail)

National housing market to see no more than 1.3% annual price gains but Toronto may buck the trend because of strong demand than flies in the face of affordability

Single-family house prices may be overvalued by as much as 60 per cent in Toronto, but cooling measures may take a bigger bite out of markets away from the country's largest metro area, says a new report.

Moody's Analytics maintains the brakes are being put on the housing market across the country and Canadians need to prepare for "several years of retrenchment" with at most as 1.3 per cent annual price growth per year over the next half a decade.

"…the combination of restricted mortgage lending, taxes on foreign purchases in the largest metro areas, and the expectation of higher mortgage rates means that house prices are likely to experience a slowdown in the next few years, especially if speculative home purchases in Toronto and Vancouver are reduced or shut down," writes Andres Carbacho-Burgos, in the eight page report, released Tuesday.

Meanwhile, ratings agency DBRS said in a report Tuesday that booming housing markets in British Columbia and Ontario boosted job growth over the past decade in sectors such as construction, home-related retail and real estate by 28 per cent — faster than other parts of Canada. DBRS said if house prices fall dramatically, other sectors of the economy should be able to absorb those jobs thanks to strong economic growth and steady population gains.

With recent interest rate increases "affordability as measured by the median dwelling price to median family income ratio is also close to a record low, so it is hard to see house prices maintaining the same momentum as before," the Moody's report states.

Consumers with insured loans backed by Ottawa have faced tougher lending restrictions for about the past year but the Office of the Superintendent of Financial Institutions is now looking into cracking down on non-insured mortgage loans, the portion of the market with 20 per cent or more equity in their own home.

Moody's Analytics does say the effects of tougher lending standards, higher mortgage rates and policy interventions from provincial governments will make reactions uneven across the country.

"Greater Toronto is likely to maintain moderate house price growth, while the more policy-restricted market in Vancouver will lead to prices holding steady in coming years," the report says.

Average sale prices in the Greater Toronto Area have dropped almost 25 per cent from April, according to the Toronto Real Estate Board's last set of results for August. That slide coincides with provincial efforts to slow the housing market down, including a province-wide extension of rent control increases that are now tied to inflation and a 15 per cent tax aimed at foreign buyers.

"Although inflows of wealth and real estate speculation get most of the blame for increased overvaluation and reduced housing affordability in Toronto and Vancouver, excess demand is a more permanent culprit," Moody's said.

"Household formations in Toronto and Vancouver, as well as in Toronto's satellite metro areas like Guelph and Oshawa, have exceeded the national rate of household formation for some years now, and residential construction in these two metro areas has failed to keep up."

In the census metro area for Toronto, Moody's said it can see average annualized price growth of 10.7 per cent from the third quarter of 2017 to second quarter of 2018. It sees another 8.5 per cent of annualized growth from third quarter of 2018 to the second quarter of 2019.

The report suggests Toronto has not been left unscathed by regulatory and interest rate changes, but has withstood the moves better than the national market.

"The more restrictive environment means that prices will grow at a much smaller rate: A decline from 27 per cent growth in the second quarter to only 11 per cent in the subsequent year for Toronto is no slight accomplishment, and there will be significant slowdowns in the neighbouring metro areas as well," says Moody's.

"Outside of Ontario with its tight demographic situation and higher average median income, the combination of rising interest rates, more restrictive mortgage regulations, and increasing provincial restrictions such as the Vancouver transfer tax creates a bleak short-term outlook for house prices."

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