Good News Regardless of the Headlines

By Scott Guitard

Despite the many concerning geopolitical headlines of Q1, global equity markets marched upwards, anticipating higher US economic growth driven by the Trump administration's expansionary fiscal policy. Following their swift spike in the closing quarter of 2016, global bond yields took a step back in Q1, as investors reassessed inflation expectations. As geopolitical headlines dominate the news, we believe:

- The US Federal Reserve (the Fed) will likely continue its tightening trend, raising rates a few more times this year. Long-term Canadian bond yields will face upward pressure due to the Fed's actions, while the upside for Canadian short-term bond yields will be limited, as the Bank of Canada is likely to remain inactive.
- There is upside for European equities in 2017 as the cyclical recovery continues. However, we remain wary of the elections underway in the region and the potential ripple effects (i.e., Brexit) of nationalist governments being elected in Germany, France or Italy.
- North American equities will offer less upside in 2017. The "Trump" rally has pushed US equity valuations higher; however, corporate earnings growth must accelerate to drive further sustainable price appreciation. While Canadian equities have impressed over the past 12 months, we do not expect the energy and materials sectors to keep pulling the market along.
- The stronger global growth outlook and relatively low valuations helped emerging markets outperform developed markets in Q1, reversing the previous quarters' trend.

INVESTMENT STRATEGY

In keeping with the themes outlined above, in Q1 we reduced our tactical overweight to fixed income and increased our asset allocation to International equities. We believe valuations and investor sentiment could improve significantly if upcoming European elections come and go without a nationalist government taking office. That said, we focus on positioning portfolios to effectively weather a variety of scenarios, including electoral surprises.

KEY PERFORMANCE DRIVERS

Positive returns remained the theme through the first quarter of 2017. Looking at absolute returns, we saw good news across asset classes with International equities leading the way. Strong security selection by underlying fixed income and US equity managers contributed to modest gains in relative performance.

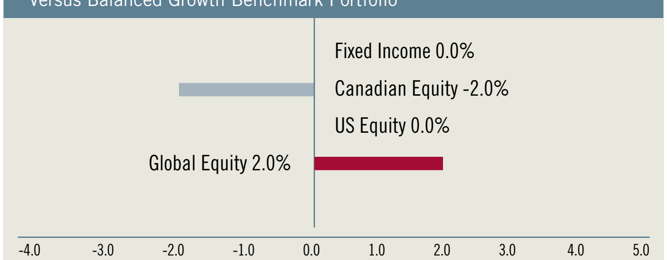
More specifically, across US equity holdings, exposure to growth stocks contributed overwhelmingly to positive returns, as momentum and growth strategies regained favour. Focusing on bonds, security selection was the main driver of outperformance, particularly selection within federal and provincial sectors.

The tactical asset mix—specifically the underweight to Canadian equities and overweight to fixed income over the period—tempered Q1 performance.

ALLOCATION PROCESS

Our investment strategy, including asset allocation decisions, is the result of ongoing discussion within our Private Client Investment Strategy Committee. We begin this process by making strategic investment decisions against an internal benchmark—for example, the Balanced Growth Benchmark Portfolio, which is based on a neutral asset mix, a balanced portfolio and near-perfect market conditions.[1] The difference between our investment strategy and the benchmark portfolio reflects our active commitment to effectively manage risk and generate superior long-term returns. In updating our investment strategy, we review our investment portfolio and benchmark and complete any required trades.

Active Asset Mix Strategy (%)
Versus Balanced Growth Benchmark Portfolio



Market Performance (%)	Q1 2017	1-Year	5-Year
S&P/TSX Composite Index	2.4%	18.6%	7.8%
S&P 500 Index (CDN$)	4.9%	20.1%	20.0%
MSCI EAFE Index (CDN$)	6.2%	15.1%	12.6%
FTSE TMX Canada Universe Bond Index	1.2%	1.5%	3.5%
CDN$ Versus USD	0.9%	-2.4%	-5.6%

The above Index reviews are calculated from external sources and, where applicable, reflect total returns. All figures are in Canadian dollars and are as of March 31, 2017.

1. The Balanced Growth Benchmark Portfolio is comprised of 40% fixed income assets and 60% equity assets.