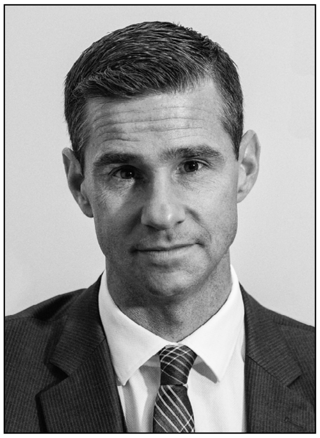
Portfolio Management Commentary

Quarter Ending June 30, 2017



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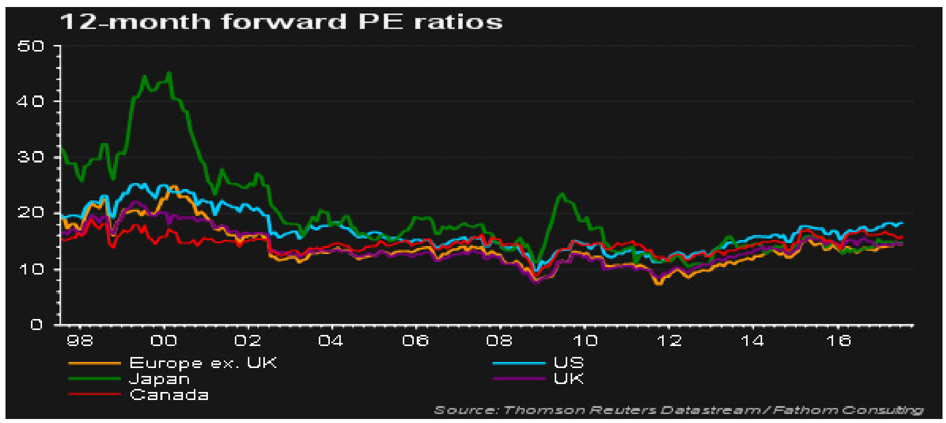
Once again, we start with an analysis of the last quarter. The US is still clearly the most expensive equity universe presented below on a go-forward basis. This is probably why financial soothsayers are projecting market tops on a daily basis. Eventually they will get it right, but human beings are notoriously poor market timers, and we may have to wait a spell longer. Compared to Q1 2017, US earnings growth has seen the most upward revisions versus the eurozone and Canada. This balances out the "too expensive" argument a little. Canadian markets witnessed some softness in the quarter as the S&P TSX Composite retreated 1.73%[1]. However, the underlying fundamentals in Canada, largely supported by the financials, materials, and energy sectors reveal a more attractive entry point based on valuation. As you can see in the second slide, Canada tops the forward growth estimates. Of course, astute observers will notice the tick down in revisions as clearly some of the projections for Canadian energy companies were far too lofty. A stabilization of crude oil and other commodities should lend support for an "invest in Canada thesis" for back half of 2017.



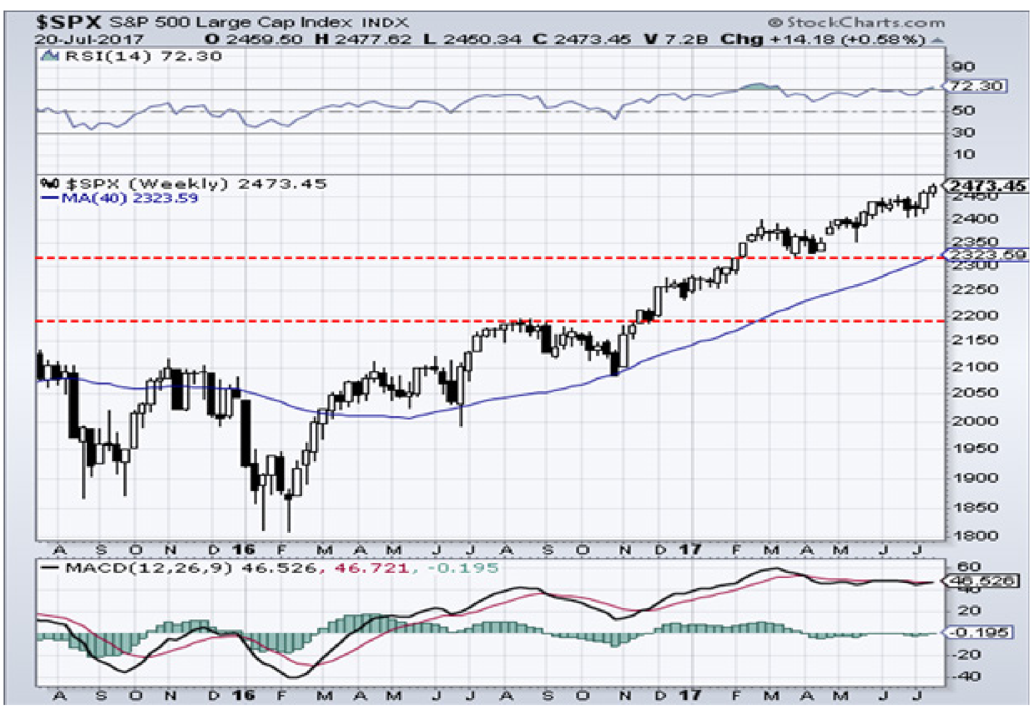
A big question on people's minds is the relationship between the US and Canadian dollar. After much jostling in the 1.30s, the USDCAD cross broke support in late June and is now looking to test the 1.25 level set back in April of 2016. Since the beginning of 2017, the CAD has appreciated 6.28% against the US to become one of the strongest G10 currencies. Only the Swiss franc has fared better.

[1]Based on the total return of the XIC.TO (iShares Core S&P/TSX Capped Composite ETF between March 31, 2017-June 30th, 2017.

Source: Stockcharts.com

Reasons for the strength are manifold: Canada's Q2 GDP growth, oil stabilization, US political uncertainty, and hawkish central bank stances are just a few observations which could rationalize a higher CAD dollar. Given the abrupt weakness in the USD, it looks as the CAD may be overbought at these levels. The weekly RSI(14) of $USDCAD is signalling a possible reversion trade. Our FX department sees the pair trading in the $1.25-$1.30 range for the remainder of the year. How does this impact us? At the top end—in our growth model portfolio, our exposure to the US dollar is roughly 25% of the portfolio. The rest is hedged back to CAD. We may hedge more of our USD exposure if this immediate trend continues.

The US market has continued its ascent in defiance of all of the 'dooms-dayers' and the Trump/Russia debacle. The $SPX spring-boarded off support in the 2300 range, when we last looked, and now sits comfortably above 2470. Another new all-time high has been recorded.



Source: Stockcharts.com

From a technical perspective, the market looks a little overbought, but not in critical condition. I wouldn't be surprised if we enter another consolidate zone around 2400 as participants digest the results of corporate earnings.

Source: Stockcharts.com

The $TSX is a market on a slightly different trajectory. Gains in the first quarter have led to losses in the second as crude oil shed roughly $10 per barrel. Just recently, price found support at 15,000, and now looks to trade at the next zone of resistance around 15,300. Clearly the tick-up in the CAD, and stabilization of oil prices has attracted investor support.

The weekly technical picture has shown some signs of recent improvement, but the RSI needs to close above 50 and the MACD above 0 for me to become more bullish. All-in-all, the $TSX looks to be consolidating at these levels. A close above 15,300 would lend evidence to the bullish camp.

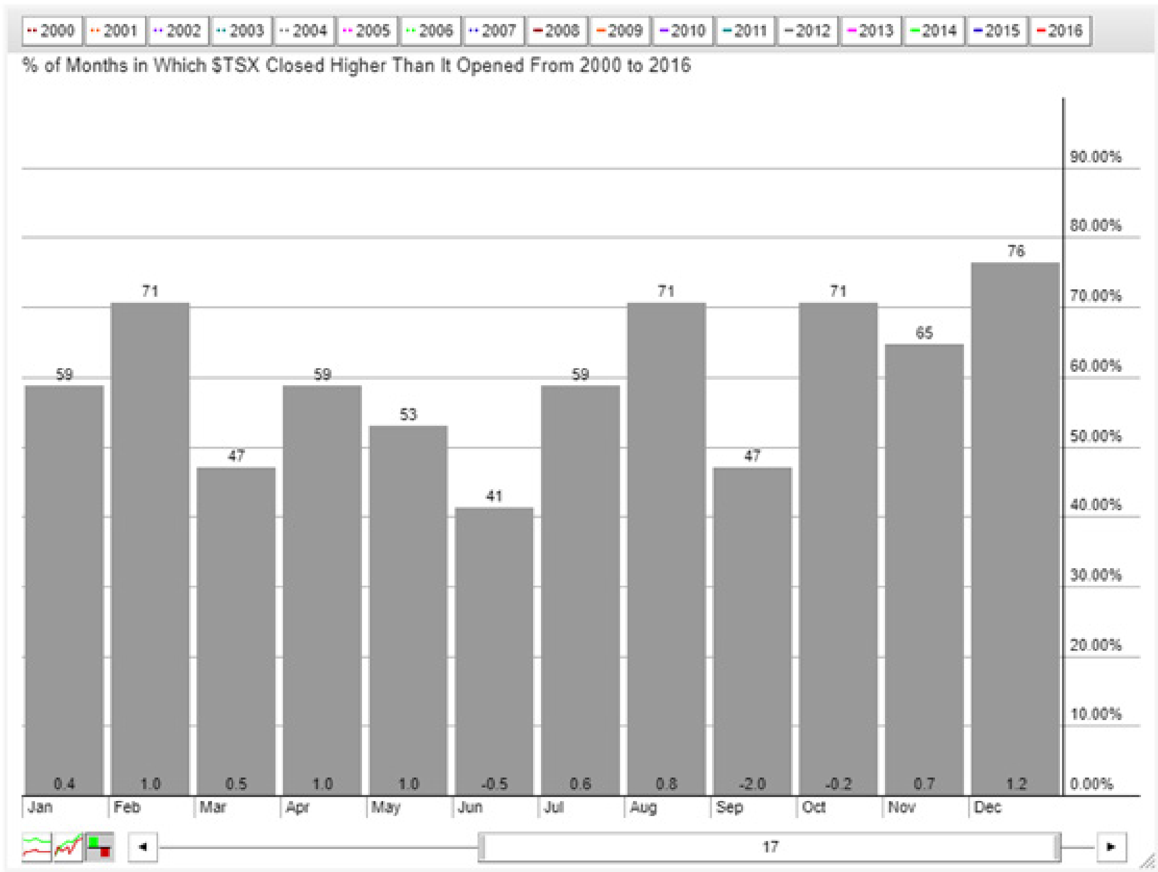
It should come as no surprise that the strongest equity markets of the quarter were international in origin. Perhaps, favourable election results in France, and decent relative valuation multiples, paved the way for capital deployers. Regardless of the reasons, foreign markets were bid up and finished the quarter on a strong note.

Source: Stockcharts.com

Technical signals still look constructive and the price has been tracking the 10-week moving average quite closely. The MACD crossover in the below pane is not worrisome because the stock is still, very much in an uptrend.

I thought it would be interesting to review the seasonal pattern for the $TSX to see how the upcoming months may impact our portfolio. Illustrated below is the past 17 years data, on a calendar basis, up to the end of 2016. What draws my attention is the month of September. Not only is there a high chance of negative return, but its return tends to be the lowest of any month during the year. This pattern also becomes pretty consistent when you adjust for additional rolling periods over the entire dataset.

Seasonality Chart of $TSX



Source: Stockcharts.com

I believe that we can use the September-October corridor to acquire strong positions on short-term pullbacks in price. I will be looking this year to see if seasonality offers us an opportunity to upgrade the portfolios at a reasonable price.

A final word on fixed income in Canada. This July, the Bank of Canada (BoC) increased the overnight lending rate by 25bps marking the first rate increase in seven years. There is speculation that a further increase in rates will occur in October, but arguably, there has to be decent economic follow-through for this to happen. Given the inherent stresses of a hot real estate market and high consumer debt, the BoC must be careful with the velocity of its rate increases. And while the yield curves in both Canada and the US have flattened on the short end, they are still "normal" and upward sloping.

Your Portfolio

As I alluded to earlier, the second quarter was weak for all model portfolios. Weakness in the Canadian markets, the USD, and geopolitical tensions in the Far East had a negative impact on short-term returns. Furthermore, late quarter sell offs in interest rate sensitive instruments dampened a strong April. In my last message, I mentioned that "corrections" are constructive for future long-term gains and I believe that more now than ever. Recognizing that we are entered a period of seasonal weakness for equity investors, I imagine that volatility may increase over the next quarter and present some excellent opportunities for us. I always look for sales in an uptrend.

We made some slight enhancements to the ETF positions in the portfolio models. In broad strokes, I changed our Canadian market holdings to include an emphasis on low volatility (ZLB.TO) and growth (XCG.TO). We removed our weighting in short-term Canadian fixed income (VSB.TO) and allocated capital to higher yielding emerging market debt (ZEF.TO). In the Income Builder model, an allocation was also made to higher yielding long-term Canadian corporate debt (ZLC.TO). And while rates may have increased slightly, this position may produce decent returns if/when a greater equity correction occurs. In the meantime, it pays a higher distribution yield for our income oriented investors.

Final Thoughts

In case I have not mentioned it lately, I want to personally thank you for your business and trust you've placed in me in managing your financial affairs. I take my profession very seriously, and I endeavour every day, to improve my process and your results. Sometimes markets can be irrational. Good quality companies can be mispriced and junk can be priced as gold. But if you are patient, focused, and disciplined then good things will eventually happen. I wish you all the best for the upcoming quarter.