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Market Outlook

Investment Strategy Quarterly

Q2 2016

TD Wealth Asset Allocation Committee Overview

- High debt levels and demographic trends imply a persistent low growth environment
- Overall, the TD Wealth Asset Allocation Committee ("we") expect an environment of muted returns; low single digits for fixed income and low to mid-single digits for equities
- We anticipate periods of elevated volatility across asset classes
- A lack of central bank flexibility, high debt levels, decelerating earnings growth, credit market stress, full valuations and geopolitical and emerging market risks are all potential sources of volatility
- Cash, domestic government bonds and gold may all provide insurance against the risk of extreme outcomes

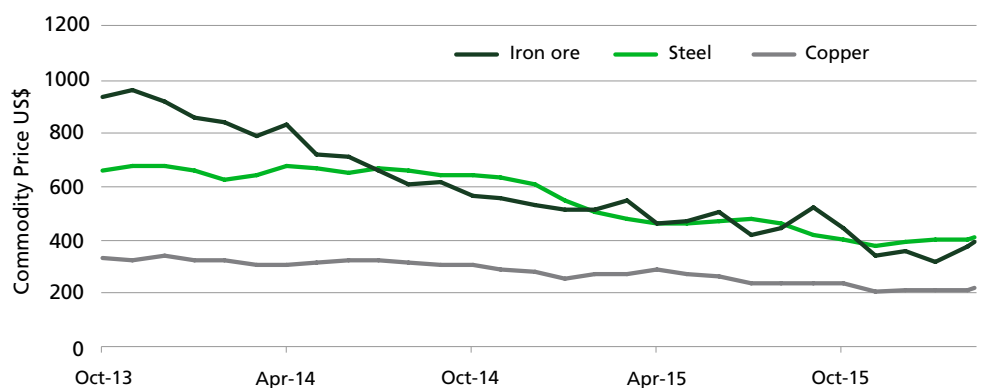
The new year got off to an inauspicious beginning — during the opening week of 2016, the S&P 500 Index and MSCI EAFE Index both dropped 6% and emerging markets fared even worse as global equities recorded their worst-ever start to a year. The downward trend continued in the second week as economic growth showed further signs of slowing and turbulence roiled the Chinese stock market. Amid the sharp declines, many investors adopted a cautious sentiment and turned to perceived safe haven assets such as bonds and gold.

In its January forecast, the International Monetary Fund downgraded its global economic growth forecast for 2016 from 3.6% to 3.4%¹, and early in the quarter, several signs pointed to a continued deterioration in growth. A survey of global purchasing manager indices, a proxy for the health of the manufacturing sector, showed deterioration in the majority of regions, with only 5 of 21 showing improvement.

In the U.S., fourth quarter GDP growth slowed notably from the previous quarter, expanding only 0.7%, and the Institute for Supply Management index showed that non-manufacturing activity contracted in February for the fifth straight month. In China, exports were down, imports were

down and prices were down. In addition, investment is growing at its slowest pace in 15 years, which had a notable impact on commodity prices, particularly industrial commodities such as copper, iron ore and steel as China is the world's largest consumer of these goods.

Chart 1: Industrial Commodities October 2013 - February 2016



Source: Bloomberg Finance L.P., TD Asset Management Inc. as at February 29, 2016.



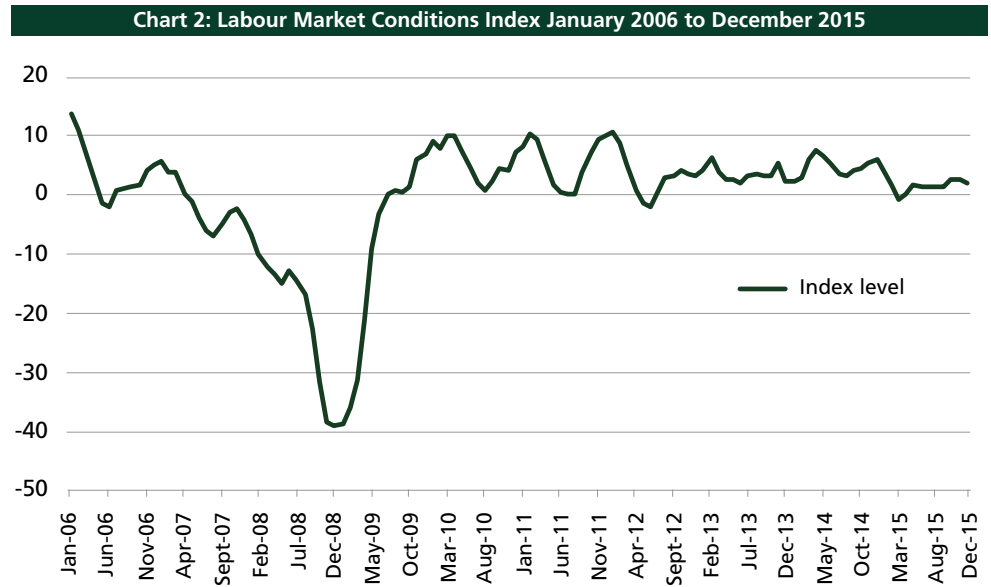
As the quarter progressed, commodity prices stabilized and economic data in the U.S. improved, particularly employment data, which surpassed expectations. The unemployment rate held steady at 4.9%, its lowest level since 2008, and wages continued to grow. This, combined with continued reassurances from global central banks that they would remain supportive, helped to calm investor nerves and, for the most part, equities recovered their early losses.

Investors continued to keep a close eye on global central banks to see how they would respond to decelerating growth. Perhaps the most surprising move was the Bank of Japan's (BoJ) decision to join the European trend and implement negative interest rates. The BoJ's announcement came at the end of January and contributed to market volatility and the risk-off tone early in the quarter as investors digested the news. The Bank of Canada maintained its accommodation. At its March meeting, the European Central Bank (ECB) cut its deposit rate, sending it further into negative territory. It also cut its main refinancing rate and expanded its quantitative easing program from €60 billion euros per month to €80 billion. In the U.S., the Federal Reserve (the Fed), held rates steady and reinforced that rates will remain low for a prolonged period. Early in the year, the Fed appeared quite dovish, and markets were not anticipating it would raise interest rates during 2016. However, as domestic economic data improved later in the quarter, so too did the potential for further rate increases. Nonetheless, we continue to believe this will be the loosest tightening cycle in Fed history.

Market Outlook

We have been forecasting an environment of muted returns with episodes of increased volatility for some time, and that continues to be our view. This translates to an expectation of low single digit returns for bonds and low to mid-single digit returns for equities.

Risks that may fuel bouts of volatility include elevated debt levels, credit market stress and significant capital outflows from



Source: U.S. Federal Reserve, Bloomberg Finance L.P., TD Asset Management Inc. as at December 31, 2015.

China. While most of our investors do not have direct exposure to China, capital outflows may lead to currency weakness and increased concerns about the risk of deflation. We are also watching economic growth closely because further slowing would make it more challenging for companies to grow their earnings - and our return estimates are based on companies being able to grow their earnings at least modestly. Finally, central banks remain accommodative, and investors' belief in the liquidity and support they are providing has sustained asset price growth. However, unorthodox policies, such as quantitative easing, may have reached the point of diminishing returns, and if investors lose confidence in central banks' ability to effect meaningful change, a risk-off sentiment would likely take hold.

In this environment, we remain cautious. During the quarter, we increased our domestic government bond ranking from modest underweight to neutral and our global government bond ranking from maximum underweight to modest underweight. While yields remain very low, government bonds can offer diversification benefits and stability to portfolios. We believe gold can also play a role in providing insurance to a portfolio, and we recently upgraded gold from neutral to overweight.

While we are cautious, we are not negative. We believe it is crucial for investors to keep a long-term perspective. As such, we maintain our preference for a diversified investment portfolio, including high quality domestic and global dividend paying equities, government and investment grade corporate bonds, a modest allocation to cash and some gold where allowed by investment guidelines.

Equity/Fixed Income split

Neutral equities versus bonds

We are neutral equities versus bonds. We believe bonds will provide low single digit returns and equities will provide low to mid-single digit returns. While bond returns may be modest, they offer diversification, some income and can have an important stabilizing effect on portfolios. In terms of equities, many companies reporting fourth quarter results during February showed a continuation of 2015's trend toward decelerating earnings growth. With modest earnings growth and valuations already approaching or at fair value, we anticipate that equity returns will be moderate. Although equities are expected to provide slightly higher returns than bonds, we anticipate episodes of high volatility. We continue to prefer high quality dividend paying equities that offer a stable, gradually rising stream of income.

Geographic split

Prefer developed markets versus emerging markets

We maintain our preference for developed markets over emerging markets. Within the emerging markets, valuations are attractive. However, high debt levels, slowing economic growth and weaker commodity prices pose risks.

Corporate/Government Bond Split

- *Overweight cash*
- *Neutral government versus corporate bonds*
- *Underweight high yield*

We remain overweight cash, which should provide stability in times of increased volatility. During the quarter, we upgraded our domestic government bond holdings from modest underweight to neutral and our global government bond holdings from maximum underweight to modest underweight. Yields remain very low; however, government bonds can offer stability and diversification benefits, which should be helpful amid increasing volatility. We maintain our neutral position in corporate bonds.

We remain underweight high yield bonds. Spreads widened notably over 2015, particularly in the Energy sector, and the trend continued in the first quarter of 2016. However, we remain concerned about select pockets of stress and believe that default rates may rise, particularly in the commodity space.

Canadian/foreign currency exposure

Neutral the Canadian dollar

The Canadian dollar declined significantly versus the U.S. dollar over 2015 as oil prices dropped and central bank policies diverged. The loonie gained back a little of its lost ground in the first quarter of 2016, but broadly we expect it to remain low for an extended period. We believe it will continue to trade in a range around its current level as the Canadian economy shifts away from its reliance on commodity-based exports. If monetary policy in the U.S. continues to diverge from that in Canada, there is potential for further weakening of the Canadian dollar. However, we maintain our neutral weighting, believing the Canadian dollar is close to fair value.

Gold can be viewed as a currency alternative, and we believe an allocation to gold may provide insurance to a portfolio against the risk of extreme outcomes.

TD Wealth Asset Allocation Committee:

The TD Wealth Asset Allocation Committee was established to deliver a consistent asset allocation message and be the originating source for active asset allocation advice across TD Wealth. The committee has three prime objectives: articulate broad market themes, provide macro-level asset allocation and identify the major risks on the horizon.

Committee Members:

Chair: **Bruce Cooper**, CFA
Chief Investment Officer, TD Asset Management Inc. and SVP, TD Bank Group

Anish Chopra, CA, CFA
Managing Director, TD Asset Management Inc.

Glenn Davis, CFA
Managing Director, TDAM USA Inc.

Kenneth Hightower, PHD, CFA
Director, Quantitative Research & Risk Management, Epoch Investment Partners, Inc.

Martha Hill, CFA
Associate Vice President, TD Wealth

Robert Pemberton, CFA
Managing Director, TD Asset Management Inc.

David Sykes, CFA
Managing Director, TD Asset Management Inc.

Sid Vaidya, CFA, CAIA
U.S. Wealth Investment Strategist, TD Wealth

Geoff Wilson, CFA
Managing Director, TD Asset Management Inc.



¹Source: IMF, World Economic Outlook Update, January 2016. Unless indicated, the information contained herein is current as at March 31, 2016. The information contained herein has been provided by TD Wealth and is for information purposes only.

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The TD Wealth Asset Allocation Committee ("WAAC") is comprised of a diverse group of TD investment professionals. The WAAC's mandate is to issue quarterly market outlooks which provide its concise view of the upcoming market situation for the next six to eighteen months. The WAAC's guidance is not a guarantee of future results and actual market events may differ materially from those set out expressly or by implication in the WAAC's quarterly market outlook. The WAAC market outlook is not a substitute for investment advice. TD Wealth represents the products and services offered by TD Waterhouse Canada Inc. (Member – Canadian Investor Protection Fund), TD Waterhouse Private Investment Counsel Inc., TD Wealth Private Banking (offered by The Toronto-Dominion Bank) and TD Wealth Private Trust (offered by The Canada Trust Company).

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