Market Perspectives

Q2 2019

TD Wealth Asset Allocation Committee (WAAC)

TD Wealth Asset Allocation Committee (WAAC) Overview

- **Overweight equities** and underweight fixed income as equity valuations now discount global earnings slowdowns
- **Expect lower** for longer interest rate environment to continue with central banks likely paused for the balance of 2019
- **Corporate credit** has attractive incremental yield versus government bonds
- **We anticipate** protracted conflict between China and the U.S. on issues of trade and technology leadership
- **Episodes of volatility** may be driven by trade frictions, potential for central bank missteps and slowing global growth

Market Outlook

Global Equities Surge in Q1 2019

Over the first quarter of 2019, global equities delivered strong performance, posting positive double-digit returns in most major markets. Investor sentiment continues to be buoyed by a combination of perceived constructive U.S.-China trade developments, a more dovish stance from major central banks, and implementation of Chinese stimulus measures.

This year's rally can be seen, in part, as a snap-back from potentially exaggerated worries of a global economic slowdown in the last quarter of 2018. The rally has come despite some evidence of weakening economic and earnings data. In our view, the market's current growth outlook assessment is now at a more reasonable level compared to the end of last year.

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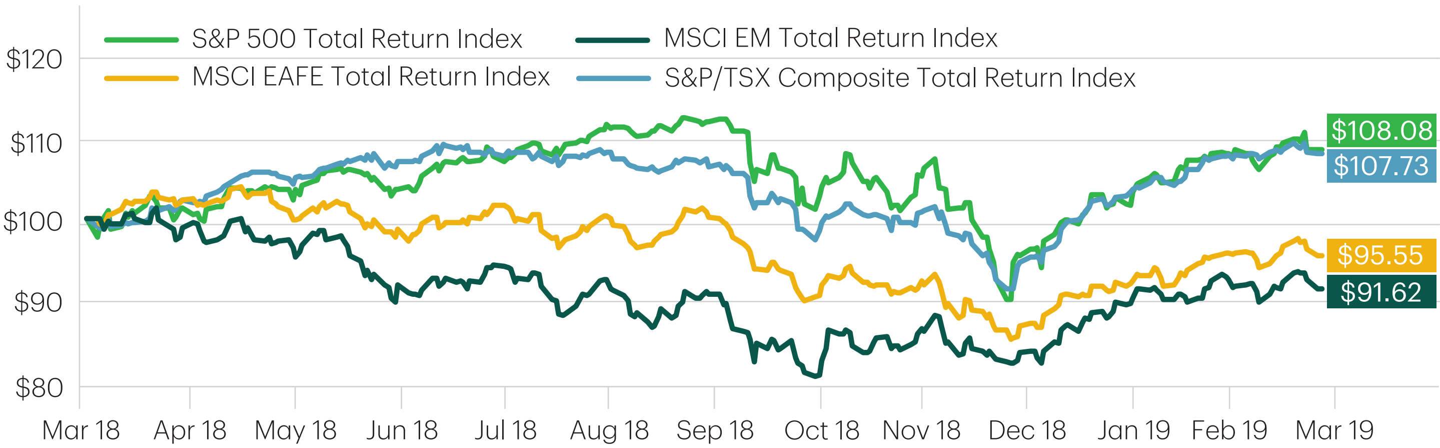
Index returns over the past 12 months — The growth of $100



Source: Bloomberg Finance L.P. As of March 31, 2019.

Deal or No Deal – The World Is Watching

As global markets stormed out of the gate to kick off the year, we believe it's prudent to remain cognizant of potential bumps in the road. These could arrive by way of breakdowns between negotiating international partners, potentially causing regional instability, and collateral damage to peripheral economies.

Regarding U.S.-China trade negotiations, in late 2018 President Trump set a March 1 deadline for completing a deal with China; this deadline was extended to around the end of April. The two sides continue to wrestle with three issues: Narrowing the large U.S. trade deficit with China, intellectual property protection and forced technology transfers. We believe it's unlikely that a resolution will be found for all three issues, in part because of China's desire to become self-sufficient in many technology sectors, including for example, semiconductors. However, it is possible that common ground can be found on narrowing the trade deficit and on some areas of technology. We feel that optimism for a deal has been partly priced into markets, as seen with the strong move this year, and a resolution could act as a further tailwind for markets.

We are also monitoring the Brexit situation, as it continues to weigh on business sentiment in the UK and more broadly, the Eurozone. The UK services Purchasing Managers' Index (PMI) recently fell to around the 50 level (below 50 suggests possible economic contraction), and many businesses cited Brexit as the key reason for weaker demand. Due to party divisions and failed negotiations within the UK Parliament to exit the European Union (EU) on agreeable terms, EU leaders agreed to delay the UK's departure date from April 12 (originally March 29) to October 31, to avoid a no-deal Brexit. The UK can still leave before the new extension deadline – a flextension, if you will - however the U.K. Parliament would need to achieve consensus on a withdrawal arrangement that is acceptable to the EU.

There are still several possible Brexit outcomes that could occur before or by the new deadline, and they include: Leaving the EU with or without a deal, holding a second referendum on the question of leaving, or remaining with the union.

In terms of implications for Canadian investors, regardless of the Brexit outcome, we believe there will be minimal direct impact. We are currently underweight International Equities in our portfolios, due in part to the politics of Brexit, and Europe, but also because growth remains sluggish within the Eurozone. Additionally, most North American companies have relatively limited exposure to the UK.

Benign Monetary Policy Environment Prevails

At its March 2019 meeting, the U.S. Federal Reserve (the Fed), maintained the federal funds rate at a range of 2.25-2.50%, and indicated it does not expect to hike rates for the duration of 2019, a sharp departure from a few months ago when it expected two additional hikes for the year. The Fed also signaled that it is nearing the end of its path towards balance sheet normalization.

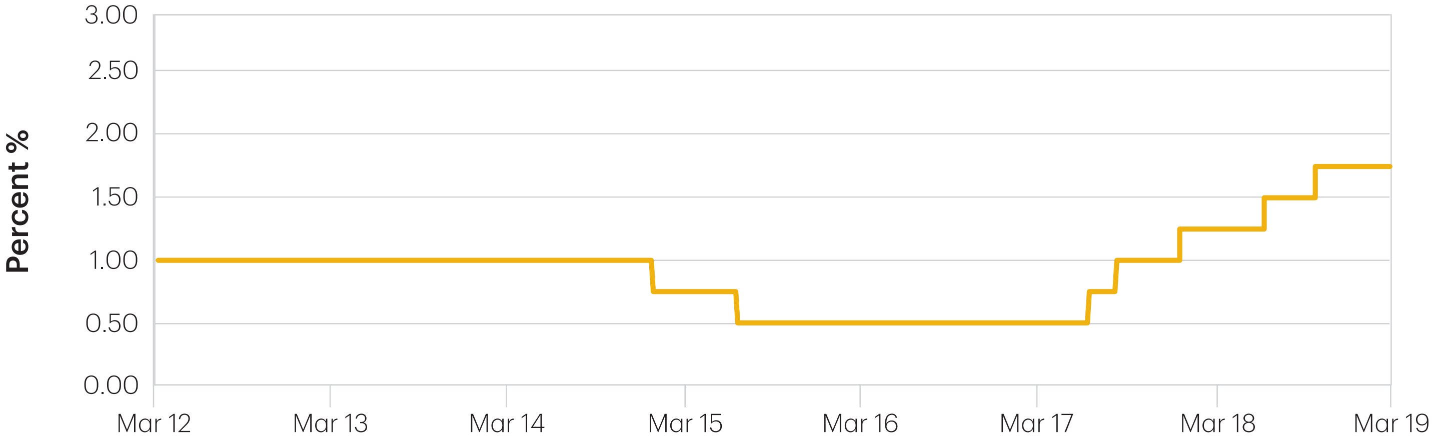
The Fed is projecting the economy to grow at 2.1% in 2019, down from 2.3% previously projected, and sees inflation reaching 1.8%, a 0.1% reduction from an earlier estimate. The Fed also expects a slight bump in the unemployment rate outlook, albeit off historically low levels.

U.S. Federal Funds Rate

Source: Bloomberg Finance L.P. As of March 31, 2019.

In Canada, at its last meeting on March 6, the Bank of Canada (BoC) decided to keep its benchmark interest rate at 1.75% and stated there is "increased uncertainty" about the timing of future hikes. The decision to leave the rate unchanged hinged on the unexpected soft fourth-quarter performance in business and residential investment, exports and household spending, and anticipated slowdown in the energy sector. The BoC suggested that the global economic slowdown has been more pronounced than expected and geopolitical uncertainty is weighing on confidence and economic activity.

Bank of Canada Overnight Rate Target



Source: Bloomberg Finance L.P. As of March 31, 2019.

Perspect

WAAC Positioning and Outlook

Overall, we retain our preference for equities versus fixed income. Global markets have delivered double digit returns year-to-date, and we remain positive on equities for **three primary reasons:**

- **First,** while we expect the economy to slow, we do not foresee a recession in North America;
- **second,** we expect central banks to broadly pause their hiking cycle;
- **and finally,** we believe equities are reasonably valued, despite the strong rally.

Overall, corporate health remains robust with companies generating strong free cash flow. We anticipate the combination of modest earnings growth, 2-3% dividend yields, and stable valuations should deliver mid-to-high single digit returns in the next 12-18 months.

Equities

➡ **NEUTRAL** Canadian equities

➡ **MODEST OVERWEIGHT** U.S equities

➡ **MODEST UNDERWEIGHT** international equities

➡ **MODEST OVERWEIGHT** emerging market equities

You Should Know...

Overall, economic growth in the U.S. appears to be on decent footing.

The release of fourth quarter GDP showed that growth had moderated from 3.4% in the third quarter, to a still above-trend 2.6%, in the final quarter of 2018 (quarter on quarter annualized), however signs of slowing growth continue to crop up.

Looking at recent data, existing home sales fell to a three-year low, durable goods orders were weaker and jobless claims have recently ticked up slightly. Additionally, U.S. manufacturing output fell for a second straight month in February offering further evidence of a slowdown in economic growth early in the first quarter of 2019. As the impact of last year's fiscal stimulus in the U.S. fades, and higher interest rates start to have an impact, we are likely in a lower growth world compared to 2018.

In Canada, there are two particular headwinds that should remain on the radar for Canadian investors. High household debt, remains a concern and will likely weigh on consumption growth in 2019. Second, the paralysis within the Energy (despite the solid rally in 2019) sector, which is preventing pipelines from being built, continues to be an overhang on the whole Canadian market. We view valuations in Canada as attractive, however we continue to prefer both U.S. and Emerging Markets equities for the reasons mentioned.

Outlook

Fixed Income

- **MODEST UNDERWEIGHT** domestic government bonds
- **MODEST OVERWEIGHT** high yield bonds and investment-grade corporate bonds
- **NEUTRAL** cash and inflation-linked bonds
- **MAXIMUM UNDERWEIGHT** global developed market bonds
- **NEUTRAL** global emerging market bonds

You Should Know...

Our overall outlook for bonds hasn't changed since the previous quarter. In our view, the spread of expected returns between equities and fixed income justifies our overweight stance on equities and an underweight fixed income.

We expect coupon-like returns in the low single digits. We are underweight domestic government bonds due to expectations of muted returns in a low inflation and interest rate environment.

We maintain a modest overweight view on investment grade corporate bonds. Slightly wider spreads mean that investment grade corporate bonds now provide real (after inflation) returns. We have a strong preference for the quality end of the spectrum, given signs of stress at companies with weak balance sheets. We also maintain our modest overweight on high yield bonds as we see opportunity to add value through security selection.

Break-even rates - the difference between nominal and inflation-linked bonds - have been gradually rising, but are still reasonable from a historical perspective. Thus, our neutral rating for inflation-linked bonds remains. Within the global developed bond space, we maintain a maximum underweight, as low nominal and real yields in Europe and Japan are not very compelling.

Lastly, we moved to neutral from an underweight position in Emerging Market (EM) bonds. Emerging market bonds have rallied this year, bouncing back from a tough 2018. A U.S.-led slowdown in global growth has prompted central banks to slow their planned pace towards normalization. The Fed's swift pivot from tightening to a policy pause has helped spur demand for EM bonds, as has the subsequent weakening of U.S. dollar (USD) strength. A softer or stable USD supports EM currencies and underpins local currency debt returns.

Canadian/U.S. currency exposure

- **NEUTRAL** the Canadian dollar
- **MODEST UNDERWEIGHT** the U.S. dollar

You Should Know...

We maintain a modest underweight the U.S. dollar.

Potentially slowing U.S. economic growth coupled with the Fed reaching the end of their rate hike cycle for 2019, could put downward pressure on the U.S. dollar versus a trade-weighted basket of currencies.

We are neutral the Canadian dollar vs. the U.S. dollar. Canadian growth and interest rate increases are likely to lag the U.S., which would be a headwind.

Gold

- **NEUTRAL** gold

We believe an allocation to gold can provide insurance in a portfolio against the risk of extreme outcomes. However, we continue to maintain that this insurance is currently not required.

TD Wealth Asset Allocation Committee

The TD Wealth Asset Allocation Committee (WAAC) was established to deliver a consistent asset allocation message and be the source for active asset allocation advice across TD Wealth.

The committee has three prime objectives:

1. Articulate broad market themes
2. Seek to provide macro-level asset allocation direction
3. Help identify the major risks on the horizon.

Committee Members

Chair: Bruce Cooper, CFA
CEO & CIO, TD Asset Management Inc.
and SVP, TD Bank Group

Michael Craig, CFA
Vice President & Director,
TD Asset Management Inc.

Glenn Davis, CFA
Managing Director, TDAM USA

Kevin Hebner, PhD
Managing Director,
Epoch Investment Partners, Inc.

David McCulla, CFA
Vice President & Director,
TD Asset Management Inc.

Robert Pemberton, CFA
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U.S. Wealth Investment Strategist,
TD Wealth

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