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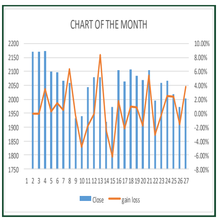
KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 8, ISSUE 1 JANUARY 2019

“The four most dangerous words in investing are: ‘This time it’s different.”
- Sir John Templeton

Sergio Simone
EDITORIAL COMMENT

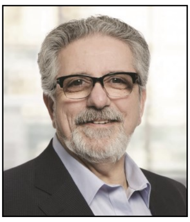
Sergio Simone
EMOTIONAL INVESTING



WHAT’S GOING ON WITH THE STOCK MARKET?

Ryan Simone
PRE-RETIREMENT ASSESSMENT SERIES (III)

Editorial Comment



Sergio Simone

Let me begin by wishing everyone a Happy New Year. I would like to use my first commentary of the year to provide a brief overview of how investment markets have performed over the past year, as well as some perspective for evaluating your portfolio’s results in this context.

Continue Reading

Markets vs Economists

Sergio Simone

After an unusually calm 2017 that produced solid performance for the capital markets, investors experienced a much bumpier ride in 2018. The year began on the same high note as 2017, but before the end of the first quarter ominous signs of volatility were poking through the euphoria. Though volatility was returning back to normal the markets were generally moving higher through the summer months. And then, the fourth quarter hit like a typhoon.

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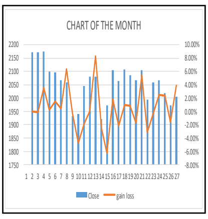
10 Simple Questions About The Stock Market Plunge, Simply Answered



By Andrew Van Dam

(The following article contains many great charts.)

The stock market’s gyrations have dominated headlines for a solid two weeks now, but things can’t be as bad as they sound. Or can they? We looked at the numbers to put this crazy time period in context.

Continue Reading

The Pre-Retirement Assessment Series: Theme Three: Net Cash Theme

Ryan Simone

For pre-retirees, creating a Life Plan typically involves a pre-retirement assessment (PRA). This is where we gather information that is categorized as either a cash source or a cash use.

Continue Reading

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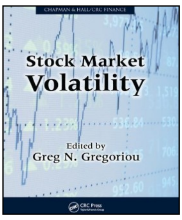


BOOK OF THE MONTH

FUND OF THE MONTH CI GLOBAL HEALTH SCIENCES CORP CL

INVESTMENT TERMINOLOGY

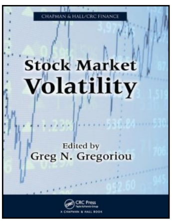
Sure Dividend HIGH QUALITY DIVIDEND STOCKS, LONG-TERM PLAN

BLOG OF THE MONTH SURE DIVIDEND

Book of the Month

STOCK MARKET VOLATILITY

—By Greg N. Gregoriou



The book provides insight to better understand volatility in various stock markets. This timely volume is one of the first to draw on a range of international authorities who offer their expertise on market volatility in developed, emerging and frontier economies.

Fund of the Month—CI GLOBAL HEALTH SCIENCES CORP CL

The Fund's objective is to obtain maximum long-term capital growth. It invests primarily in equity and equity-related securities of companies around the world that specialize in health care or medical industry. This includes companies that provide goods and services to these companies and companies that the portfolio advisor believes would benefit from developments in the health sciences industry.

Investment Terminology

HOSTILE TAKEOVER

A hostile takeover, in mergers and acquisitions (M&A), is the acquisition of a target company by another company (referred to as the acquirer) by going directly to the target company's shareholders, either by making a tender offer or through a proxy vote. The difference between a hostile and a friendly takeover is that, in a hostile takeover, the target company's board of directors do not approve the transaction.

Continue Reading

BLOG OF THE MONTH

Sure Dividend

HIGH QUALITY DIVIDEND STOCKS, LONG-TERM PLAN

THE 8 RULES OF DIVIDEND INVESTING

The 8 Rules of Dividend Investing are guidelines to help you determine what dividend stocks to buy and sell for rising portfolio income over time.

All the 8 Rules are supported by academic research and 'common sense' principles from some of the world's greatest investors.

The 8 Rules of Dividend Investing are more than just ideas, they are applicable to real-world investments.

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

2018 YEAR END TOP TIER REAL ESTATE REPORT

According to a report released today by Sotheby's International Realty Canada. Eastern Canada's major metropolitan areas led the nation in a top-tier real estate performance in 2018, as Western Canadian markets buckled under pressure from local stressors ranging from taxation and regulatory interventions in Vancouver, to strained economic conditions in Calgary. Buoyed by population gains and steady economies, sales over $1 million the Greater Toronto Area (GTA) strengthened over the course of 2018, while Montreal's luxury real estate market posted new records. Vancouver and Calgary's top-tier real estate markets retreated further

Continue Reading

TOP 3 WAYS TO STAY HPER-RELEVANT IN THE ELITE EXPERT ECONOMY FROM THE GLOBAL LUXURY EXPERT NETWORK

Driven by technological innovation and new models that address the human nature of work, the global marketplace for highly skilled professionals in all functions is moving steadily toward a predominantly liquid, on-demand work-force. Increasingly, highly demanded experts can choose to be free agents, and sell their skills to the highest bidders. The 100-year-old Industrial Age mod-els of factory-like fixed work relationships, locations, schedules and processes are melting away; their demise is accelerating..

Continue Reading

GETTING TO KNOW HIGH NET WORTH INVESTORS IN CANADA

The High Net Worth (HNW) population in Canada is a growth story that is becoming increasingly complex in terms of the wealth management needs and expectations of its members. This white paper addresses the opportunity for financial advisors rep-resented by the 790,000 millionaire households in Canada and seeks to identify the key issues that need to be considered by advisors as they seek to attract and retain HNW clients. We analyzed the demand side—HNW clients and their families—then the supply side, including financial advisors and other providers of advice and in-vestment-management services.

Continue Reading

MARKET MOMENTUM: IMPACT INVEST-ING & HIGH NET WORTH CANADIANS

In 2017, SVX began a research and engagement initiative to develop a greater understanding of high net worth individuals' inter-est in and experience with impact investing. To date, Canadian studies and re-search on impact investing has focused on investments made by large institu-tional investors and funds. As such, there is a lack of in-depth insights into indi-vidual investors' views on impact investing. The aim of this report is to provide a comprehensive perspective of high-net worth individuals (HNWIs) in Canada and their investment preferences, interests, barriers and levers.

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FUND MANAGER COMMENTARY

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DAN BASTASIC
IA CLARINGTON

MICHAEL SIMPSON
SENTRY
INVESTMENTS

DINA DE GEER
MACKENZIE
BLUEWATER TEAM

PHILIP PETURSSON
MANULIFE
INVESTMENTS

Dan Bastasic, Senior Vice-President, Investments

I. A. Clarington

Value stocks and credit likely to perform well in 2019. We are expecting stronger returns in the second half of the year. We also expect Rates to keep rising but remain supportive of growth.

WHERE ARE THE OPPORTUNITES

Most asset classes were negative in 2018, Continue Reading

Michael Simpson, Senior V.P. and Executive Portfolio Manager

Sentry Investment Management

Outlook

We have an optimistic view for 2019 that the North American economy will continue to show positive growth with

Continue Reading

Dina DeGeer, Portfolio Manager, Mackenzie Bluewater Team

Market moves continue to be driven by macroeconomic headlines. One of the clear macro themes currently impacting markets is the slowdown in China's industrial sector. The slow down is partially policy driven, as China is attempting to rebalance their growth mix away from commodity intensive construction and towards consumer driven domestic consumption.

Continue Reading

Philip Petursson, Chief Investment Strategist, Manulife Investments

As we close the chapter on 2018 we would describe the markets and our reaction to it with two adjectives—frustratingly disappointing.

Part 1—A Review of 2018

We entered 2018 with muted optimism. Our return expectations were modest and our reasoning sound. US earnings were expected to be strong, boosted by corporate tax cuts, which we felt would be offset by a contracting PE multiple, leaving investors with a mid-single digit return for stocks. Corporate earnings were strong, exceptionally so. And we did see a PE contraction. However, it was far deeper and broader than anticipated as PE multiples fell not only across US equities, but across most major equity markets.

At the beginning of the year we asked ourselves "is it so good, its bad?" That is to ask if the macro-economic environment that supports the equity markets is so

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LINKS

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CPP Increases For 2019

The maximum Canada Pension Plan (CPP) contributory earnings are indexed annually based on inflation. For 2019, indexation will

Canadians Say Paying Down Debt Is Their Top Financial Priority in 2019

Canadians start the year worried about cost of living, low

Trends And Changes For Pension Plan Sponsors Heading Into 2019

The start of a new year is a time to prepare for changes in the

OppenheimerFunds CIO: There Won't Be An Economic Recession For At Least 5 Years

Growing positive sentiment

How Every Asset Class, Currency, And Sector Performed In 2018

We're only a few days into 2019, but it appears markets have

Housing Market Expected To Cool

Canada's housing market is expected to continue cooling off over the next couple of years,

Missing Out—Millennials And The Markets

Millennials are diverse, educated, and tech savvy. They play a vital role in Ontario's economy, and the financial decisions they

What To Expect From Central Banks In 2019

Tightening financial conditions will cause banks to pause, providing investors some relief.

Canadian Advisors Optimistic; Investors Pessimistic About Stocks In Q1 2019

After experiencing some

DARK CLOUDS BRING ROUGHER SEAS

2019 Is expected to be a year of economic transition, both internationally and in Canada. A key theme from the inaugural Delotte economic forecast in October was that the North American economy is in the late stages of a business cycle.

MARKETS VS ECONOMISTS

Global growth has clearly peaked, as long expected, but signs of weaker growth should not be confused with signs that the expansion is in its dying days. Central banks that have been on a tightening path will remain on this path this year.

The decline in equity markets (chart 1) and movements in certain parts of the yield curve over the last few months suggests a clear disconnect between economic prospects as evaluated by markets and those forecast by economists.

VIDEO LINKS

Blackstone's Byron Wien Sees The S&P 500 rallying 15% This Year To New All-Time Highs

Wall Street veteran Byron Wien

The Markets: 2018 Review And 2019 Outlook

After the worst performance in 10 years, the stock market should perform well in 2019.

Monthly Economic Outlook January 2019

Senior economist Tim Quinlan and Economist Charlie Dougherty discuss the government shutdown's effect on the

U.S. FEAR GUAGE SLIDES, BUT MARKET REALITY MAY SPUR RESURGENCE

Wall Street's "fear gauge" is defying the recent market swoon. The CBOE Volatility Index, known as the VIX, has fallen eight of the past 10 trading sessions, closing at 19.98 on Wednesday compared with 36.07 on Dec. 24. That's at odds with large realized swings in U.S. stocks—a potentially unsustainable divergence.

"Market internals imply a VIX of 31 based on trailing realized volatility and five-day SPX returns," UBS Group AG strategist Stuart Kaiser wrote in a note about the gauge's fair value. "60-day realized volatility above 25 percent is the largest driver of that estimate."

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EDITORIAL COMMENT-CONTINUED

HOW DID THE MARKETS DO IN 2018?

We experienced a sharp sell-off in Q4 2018 that was reminiscent of 2008 as most asset classes registered losses for the year. For Kleinburg Private Wealth clients, who held mutual funds in foreign markets, losses were mitigated somewhat by the weakness of the Canadian dollar, which declined about 8% relative to the U.S. dollar for the year.

U.S. equities posted some of the best results among global assets going into the fourth quarter of 2018, with the S&P 500 Index reaching an all-time high and setting a record for the longest bull market on record. This all changed after the fourth quarter sell-off, however, when the Index finished the year with a loss of 4.4%. Fortunately, for those holding U.S. denominated mutual funds, the weak Canadian dollar created small portfolio gains for the year. North of the border, Canada's S&P/TSX Composite Index was weighed down by themes that included plunging energy prices as well as weakness in materials and financial services. The Canadian benchmark finished the year with a loss of 8.9%. KPW clients were extremely underweighted in Canadian equity funds so were not affected by this poor performance. Overseas, the MSCI World Index, a broad measure of developed market equities, fell 8.2% in U.S. dollars, but only –0.2% in Canadian dollars. Although the end result for the year was weak, we fared well in perspective of the Indices' returns.

Central banks in North America continued to gradually raise interest rates throughout 2018. Ten-year U.S. and Canada government bond yields rose and peaked early in the fourth quarter, but fell through November and December to end lower for the year. The FTSE TMX Canada Universe Bond Index, which broadly reflects results for the Canadian government and investment-grade corporate bond market, gained about 1.4% over the 12-month period.

SOME PERSPECTIVE ON VOLATILITY

Trying to pinpoint the reason for the excessively high volatility is difficult at best and 2018 was no exception. It seems a witches brew of geopolitical and economic turmoil all hit at around the same time. These include increasing trade friction between the U.S. and its trading partners, especially China, and the troubled Brexit negotiations between the U.K. and the European Union. While the markets were reacting to these issues, the Federal Reserve, in all their wisdom, decide to raise short-term interest rates leading to tighter financial conditions, while slower economic activity has weighed on commodity prices—particularly oil—and the materials and energy sector.

Regardless of the root cause or causes, there is no doubt that market turbulence can be unsettling for investors, and this year's volatile performance was particularly surprising following last year's steadiness. The reality, however, is that downside market volatility is normal and the extraordinarily low volatility of 2017 was an outlier.

The chart below illustrates this point. It shows that in most years, the S&P 500 will experience several days in which the value of the index drops by 2% or more. Last year, with 15 days registering losses of 2% or more, the level of volatility for the index returned to a more "normal" range.

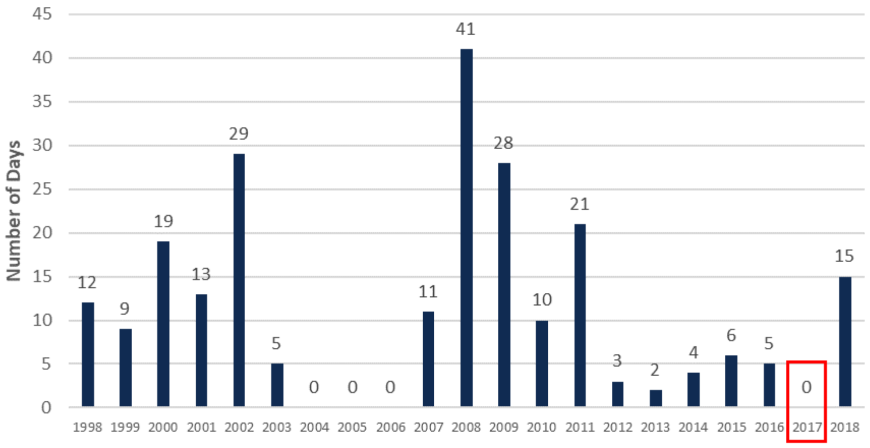
DOWNSIDE VOLATILITY IS NORMAL

The fact is, market volatility is not always a bad thing. Professional money managers often welcome market declines as a necessary ingredient for positive returns over the long-term as it creates opportunities to add to existing positions or buy higher-quality businesses at reduced prices. In 2017, asset prices remained elevated, providing few opportunities to shop for "bargains."

Furthermore, it is nearly impossible to predict when market swings will occur. Studies have shown that investors who attempt to time the market—that is, sell before a downturn and reinvest when markets are poised to rise—often end up missing the best upside days and underperform relative to those who stay invested. Markets do not advance in a straight line but historically, the long-term direction for equities is up.

EDITORIAL COMMENT-CONTINUED

The number of days the S&P 500 fell by –2% or more.



WHAT'S IN STORE FOR 2019?

In contrast to last year's consensus outlook that pointed to a synchronized global economic expansion, many experts now believe we are in the late stages of the economic cycle, with global growth slowing and downside risks increasing. Nevertheless, developed economies are expected to grow throughout the coming year amid moderate inflation expectations. Global interest rates remain low by historical standards, allowing corporations the flexibility to strengthen their balance sheets and invest in the future of their businesses. These conditions suggest a cautiously optimistic outlook for the markets in 2019.

MY ADVICE: STAY DIVERSIFIED, AND INVEST FOR THE LONG-TERM

It can be very difficult to set aside short-term distractions and maintain a long-term perspective when negative headlines dominate as they have in recent weeks. But looking back over the longer term, the most recent market decline may be viewed as a setback in a strong upward run. From its lows reached following the financial crisis in March 2009 to the end of last year, for example, the S&P 500 was still up more than 270%.

I believe the most important action to take as an investor is to create a sound, well-diversified investment strategy that takes your time horizon and tolerance for risk into account, and then to stick to the plan through periods of short-term volatility. As asset classes do not typically perform in a correlated fashion, diversification can help to insulate your portfolio from the extreme highs and lows, and provide a smoother experience over time.

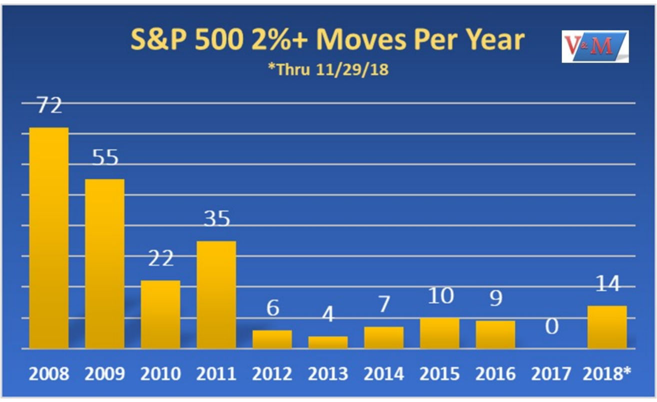
On behalf of the advisors and staff at Kleinburg Private Wealth Management, I would like to thank you for the opportunity to work with you as your financial advisors.

MARKETS VS ECONOMISTS-CONTINUED

Comparing volatility in 2018 and so far, this year to volatility in 2017 is like the difference between sitting on an idyllic beach in Aruba compared to a tsunami in Japan. It can be very frightening when a tidal wave of bearish market activity is eroding your hard-earned investment dollars, but putting all this volatility in perspective, both historically and economically, might help you withstand and endure the wild market gyrations.

The unprecedented lack of market volatility in 2017 is an anomaly and should be relegated to the archives of stock market history. This phenomenon is unlikely to occur again for a long, long time. Since 1982, the S&P 500 has moved more than 1% about one every two trading days. That is more typical of market behavior. In fact, there have been years, in particular, 2002 and 2008, where the index closed up or down by 1% or more in 90% of all trading days.

Putting this in perspective, 2017 had a mere 4% of trading days with comparative volatility while 2018 experienced only 44% of trading days with more than 1% movement. This indicates that the current volatility pales in comparison with the worst times since 1982.



The chart indicates the number of 2%+ daily moves per year on the S&P 500 index. As you can see, the greatest number of annual moves of 2% or more occurred during the years of Quantitative Easing. 2011 was the conclusion of QE2 and the beginning of a reduction in high volatility days. In fact, four of the six high volatility days in 2012 occurred during the first half of the year. It seems the unprecedented added liquidity delivered a stabilizing impact following the financial crisis that began in 2008. The impact is evident from 2012 through 2017. By providing a great deal of low interest investment capital and buy-back opportunities, volatility was severely restrained. In fact, the period from 2016 to 2017 is a stretch of low volatility that we have not seen in 25 years. It is only one of four such periods since 1963.

On page 5 of this newsletter I have added a link to a Scotiabank report titled “MARKETS VS ECONOMISTS”. To summarize, investors may want to put the brakes on overly negative sentiment. The report says that signs of economic weakness should not be confused with signs that the expansion is about to stop. For example, recent movements in the equity markets suggest that investors are expecting a substantial markdown in future growth, including a possible recession. The Scotiabank report says, “There is clearly a disconnect.” The underlying market fundamentals are a testament to the veracity of this statement.

There is a lot of investor concern about government tightening in the U.S. and Canada, but when we dig down a little deeper, we see that real policy rates in the U.S. are barely above zero and those in Canada are actually negative. I believe that the fears of over-tightening are over-exaggerated. The report says that the most significant cause of a dramatic global slowdown is more likely to be triggered by the U.S. – China trade war. Since talks between the two countries seem to be moving forward, this risk to the global outlook is diminishing.

Also, on page 5 there is a link to a 2019 economic outlook report from Deloitte. The firm urges businesses to continue to plan for the future despite expected slower growth, rebalancing of monetary policy by central banks and political uncertainty.

According to Craig Alexander, chief economist at Deloitte Canada, “Businesses shouldn’t let global uncertainty and the shift in growth sway them from planning, making decisions and investing in the future.” He continues to say that “business cycles are a normal part of economic experience. Waiting for risks to play out often means missing key opportunities.”

Pre-Retirement Assessment Series—Continued.

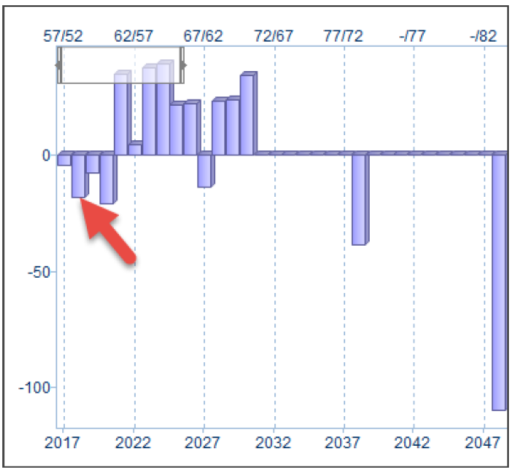
For example, employment income or rental income are cash sources; whereas, contributing to an RRSP, paying into CPP, or paying down debt are cash uses. From this information, one of five themes will inevitably take form.

Every plan, without fail, exhibits characteristics of one of these themes and identifying which theme applies to the plan is the best way to understand a person's core planning issue.

The five themes are: House Rich and Cash Poor, Large Latte Factor, Net Cash, OK to Spend More, and HNW (High Net Worth).

In the previous two months I discussed the House Rich & Cash poor theme and the Large Latte Factor theme. This month I'll address the Net Cash theme.

The Net Cash theme is visible when a person's Net Cash forecast is negative, but only in the short term.



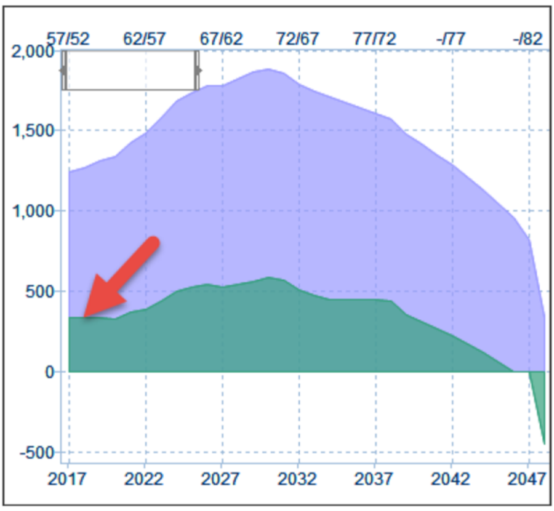
Net Cash

Figure 1: Net cash forecast is below zero in the first four years but rises quickly in year five.

A negative net cash forecast occurs when clients are increasing lines of credit or consuming capital from such things as non-registered savings. I can usually predict a negative net cash theme just by talking to clients prior to starting a plan. This is because these clients are usually the most anxious. They 'know' (or think) they are spending too much and believe the problem is beyond simple budgeting. In other words, spending less on groceries or skipping the daily Tim Hortons drive through will not solve the bigger problem. In a way, these clients are right because there often is no 'real problem'.

Fortunately, in this theme, periods of negative net cash short term and often the result of a temporary life event. For example, younger clients may experience this theme while they fund a child's education expenses. Alternatively, retired clients may experience negative net cash from depleting their portfolios to pay expenses.

On its own the net cash forecast can be disheartening which is why we must also consider an individual's income assets forecast. Often, this forecast will reveal that in the long-term the client is in fact financially sound over the long-term.



Income Assets

Figure 2: Despite the small dip in the green area at the beginning of the graph, income assets are increasing

Since we use income assets to fund lifestyle expenses, an increasing income asset forecast is both possible and favorable despite periods of negative net cash.

Although the previous themes I've discussed may require tactics to address or resolve any issues, no tactics (with the exception of any tax-reduction tactics) apply to a Net Cash theme. Often, the Net Cash theme is resolved by examining the income assets forecast to determine whether there really is an issue.

Pre-Retirement Assessment Series—Continued.

We do know the $50,000 exists because we know the client's exact career income amount as reported to the CRA. We also know to some degree of accuracy the larger regular expense commitments of the client (ie: cars, bills, mortgage, etc).

In other words, $50,000 is somewhere in the 'void'.

In the Large Latte Factor theme, I can surmise that the client is spending more than they realize and this may ultimately hurt them in retirement. Of course, we are in the business of helping clients realize their long-term goals, so there are strategies to help in this theme. For example, a new spending plan could be structured, or a PAC program could be set up (this is particularly useful for younger clients). However, we all have a Latte Factor so it's important that any plan leaves sufficient room for a little Latte Factor spending.

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Dan Bastasic, Commentary continued

while the few that generated positive returns did so with little enthusiasm. It is unusual not to see respectable returns from at least some parts of the investment universe in any given year. The lack of realized opportunities in 2018 will likely produce some winners next year. We believe that interest rates will continue to trend upwards while remaining supportive of economic growth. At the same time, we expect to see the rate of economic growth to moderate somewhat as we move into 2019.

Recent market volatility in North America is likely due to a peak in earnings-per-share growth. While peak earnings have historically been at least partially responsible for weak markets, the record shows that subsequent periods have generally produced positive returns after about a six-month pause. This is particularity true for equities (see table below) and credit-related fixed income. In 2019, we expect to find opportunities in value stocks and credit. We believe the second half of next year will be much better for returns than the first, as markets digest a peak earnings scenario that segues into a more positive environment for earnings and growth. Our view is that financials will outperform the broader equity markets as this scenario unfolds.

Equity markets often pause before accelerating after peaks in EPS growth.

EPS growth peak vs. S&P 500 Index forward returns

WHAT ARE THE CHALLENGES

Peak EPS Growth (date)	Peak EPS Growth	6-month forward return	12-month forward return	24-month forward return	36-month forward return
09/30/93	32.7%	-2.9%	0.8%	27.3%	49.8%
09/30/99	22.4%	16.8%	12.0%	-18.8%	-36.4%
09/31/04	26.3%	-1.0%	4.8%	15.0%	26.2%
09/30/06	19.8%	6.4%	14.3%	-12.7%	-20.9%
09/31/09	198.9%	-7.6%	12.8%	12.8%	27.9%
Average Return		2.3%	8.9%	4.7%	9.3%
Median Return		-1.0%	12.0%	12.8%	26.2%
% Times Up		40%	100%	60%	60%

Source: RBC US Strategy, FACSET, Thomson/IBES, Bloomberg LP, as at May 7, 2018

We are contending with a normalizing economic environment, where growth is strong enough to support stable-to-higher inflation as interest rates continue on their upward path. While this environment will likely produce winners, it will also create weakness in certain parts of the market. Higher-grade fixed income with high sensitivity to rising rates will likely remain under pressure, while the outperformance of growth stocks will likely give way to value. This picture is further complicated by near-term volatility stemming from peak earnings and the potential for prolonged trade tensions.

HOW ARE YOU POSITIONING THE FUNDS?

Our investment approach combines bottom-up, fundamental analysis of individual securities with a macroeconomic overlay that helps identify near-term opportunities and steer us away from emerging risks. Given near-term volatility, all of our mandates are defensively positioned with higher-than-normal cash levels. Our fixed-income exposure has a low relative duration to protect against rising interest rates, while our equity exposure is tilted towards value-oriented securities.

WHY IS THIS THE RIGHT APPROACH FOR 2019?

We expect the bull market to continue through 2019. Near-term concerns will likely dissipate as the year progresses, with strong earnings growth and attractive valuations providing the foundation for improved market conditions. The risk of recession remains low, given the state of developed market growth and generally accommodative fiscal policies, while interest rates are likely to continue trending upward. This environment is favorable for value-oriented equities and credit related fixed income, while high-valued growth stocks and interest-rate-sensitive fixed income are likely to continue facing headwinds as the year unfolds.

Michael Simpson, Commentary continued

Canada not only participating, but also providing sufficient opportunities to invest in attractively valued companies. Our confidence emanates from the ability of the companies we own to generate rising free cash flows and deliver growing dividends:

• BCE stated that cash flows remain strong and reliable heading into 2019, with growth opportunities ahead from business performance, and continued capital and cost efficiency gains.

• Keyera expects cash flow growth in 2019 through projects that can expand volumes irrespective of the gas price, with a capital investment plan to extend its integrated facilities network.

• CGI Group sees demand for consulting accelerating along with outsourcing spending by clients over the next three years, which will help achieve the company's goal of doubling its size over the next five to seven years.

In addition to our micro views, we expect the following macro developments to provide support:

• Fewer than expected interest rate increases by the Bank of Canada as Governor Stephen Poloz attempts to balance inflation with GDP growth

♦ Easing trade hostility between the U.S. and China as both economies realize that a resolution is mutually beneficial.

We also understand that risks to the Canadian economy have been significantly reflected in the stock market despite rising corporate earnings.

While we have an optimistic view for 2019, we have a defensive approach to stock selection that is reflected in our downside protection. Areas where we see opportunities focus on companies with low leverage and the ability to deliver steadily growing cash flows. We also favour companies that have exposure to a faster growing U.S. economy. Focus areas include:

• Industrial firms, particularly in the transportation and waste management sectors that are exhibiting pricing power, which serves to offset inflation

• Consumer staples with less cyclical models that possess the ability to increase returns through the introduction of new products/programs to drive same-store merchandise growth

• Technology companies that realize substantial recurring revenue predicated on established, long-term relationships

• Health care companies in the U.S. that are benefiting from an aging demographic, which is translating into increased use of services.

We have more conviction over the long term rather than the short term. We expect a choppy market in the first few months of 2019 as trade disputes persist, acting as headwind for the global market. Over time, we expect corporate earnings and cash flows to continue to rise and be reflected in stock price appreciation. Additionally, we remain biased to equities over fixed income; the holdings in our Sentry Canadian Income Fund exhibit an average free cash flow yield above 5% and we believe this can grow conservatively at a mid-single digit pace over the next 10 years. Our view is this will significantly outpace a 10-year government bond yielding slightly higher than 2%.

Positioning and opportunities

We maintain a conservative stance in Canadian equities that has served us well in protecting on the downside. We've invested in companies that generate above average returns, rising cash flows and low leverage, which assists in delivering a growing dividend. As such, our exposure consists of businesses that exhibit stability in the fields of telecom, waste management, health care, technology and REITs.

Continue Reading

Michael Simpson, Commentary continued

In 2018 we saw a trade resolution between Canada and the U.S. in the new United States-Mexico-Canada Agreement (USMCA), along with a positive LNG Canada decision. We also believe valuations in Canada have retracted to the point of being overly bearish. Consequently, we are more optimistic heading into 2019, but have reduced our energy weightings given concerns surrounding the global supply/demand balance, which is difficult to predict.

Given recent market volatility, we have seen companies with quality business models tied to competitive advantages, rising cash flows and low leverage, trade at attractive valuations; and we have taken advantage. As discussed, we are finding select opportunities in telecom, industrials, health care, technology and REITs. More specifically, we have added to Telus, which is a leading national incumbent telecommunications company with strong cash flow growth and moderating capex. Also, its fibre to-the-home deployment (past 50%) increases its penetration, generates higher average revenue per user through better services, lowers churn and reduces costs over time. We have also added S&P Global, which has 70%+ recurring revenue, operates in an oligopoly and generates return on invested capital north of 30%. Lastly, where appropriate, we are finding opportunities in IPOs and special situations such as subscription receipts and the use of options to sell premium to generate yield.

Risks

• An escalating global trade war between the U.S. and China that does not come to an end. However, given decades of trade liberalization, we ultimately expect to see a resolution.

• Higher interest rates than expected could lead to a higher discount rate applied to the valuation of company cash flows, translating into lower stock prices. However, with Poloz acknowledging less momentum in the Canadian economy, we see a risk of faster than expected rate hikes as an unlikely scenario.

- The Organization of the Petroleum Exporting Countries and allies have agreed to cut oil production, but risk exists in non-compliance. We are comforted by rising global oil demand and the fact that the contribution of oil and gas to Canada's GDP is half of what it was in 2014 (3.5% from 6%).

- Household indebtedness carried by Canadians has significantly increased in the past decade and we are monitoring the impact that rising household debt service ratios can have on consumer spending.

Dina DeGeer, Commentary continued

Absent any other headwinds, this mix shift would naturally slow the industrial side of the economy. The slowdown, however, is being significantly exacerbated by the US/China trade dispute.

We met with the management team of fund holding Phillips, and they provided a helpful "on the ground" view of how they are managing their supply chain to deal with the tariffs. As a global healthcare and consumer goods company, Phillips sells and manufactures products around the world. Post the enactment of the first round of tariffs, Phillips had begun to plan to shift manufacturing from China to a number of other countries around the world where they already have plants. They also reviewed their supply chain for components in order to find other sources of cost competitive supply.

Although the company welcomed the recent 90-day delay in stepping up the tariffs, Phillips confirmed that they are moving their supply chain regardless. This is partially due to the continued risk of a significant escalation of the tariff war. But equally importantly, labor costs in China have been increasing steadily, and it makes economic sense to reconfigure their sources of supply. This is a story we have heard from a number of companies over the past few years; that for many products, China is no longer the low-cost provider. In our view, in a manner similar to Phillips, the tariff threat may have highlighted this change in cost competitiveness for many companies. As a result, global supply chains may continue to shift even if the US/China trade conflict is resolved favourably. This suggests that underlying economic data from China may continue to be weak. For emerging markets as a whole, this weakness is likely to be at least partially offset by stronger growth from countries that are the beneficiary of the supply chain shift.

Beyond the tariff issue, Phillip's business remains reasonably strong, which is a consistent with public statements of other companies involved in global healthcare. Historically, healthcare has been very resilient to economic slowdowns, as the demand for healthcare continues to grow steadily through economic up and down cycles. We continue to have a substantial component of the foreign content of the fund invested in healthcare businesses, as we increased our holdings in the area substantially over the past 18 months.

Over the past several years we have written and spoken extensively about the importance of the US housing market to the US economic cycle. Because so much of the overall economy is not particularly cyclical (healthcare, general government spending, military spending, consumption of food, utility bills, etc.) the housing cycle tends to have a very large impact on overall economic cyclicality. In fact, the vast majority of post-War US recessions were tied to a downturn in housing activity, with 2008-09 being the most dramatic example.

During the past few months, the US housing market has shown clear signs of slowing on a variety of metrics. Although homebuilders continue to report strong showroom foot traffic, the number of people actually buying houses has fallen noticeably. This slowdown shows up distinctly in overall applications for mortgages, which dropped 15% from the levels seen earlier this year. Unlike the collapse in home buying in the late 2000's which was caused by massive oversupply (and saw mortgage applications drop 65% from peak to trough), the slowdown this cycle appears to be related to affordability, as mortgage rates in the US have gone up substantially over the past few years. This ties in to a concern we have discussed at length; the idea that higher global debt levels may make the economy more sensitive to interest rate increases than in the past.

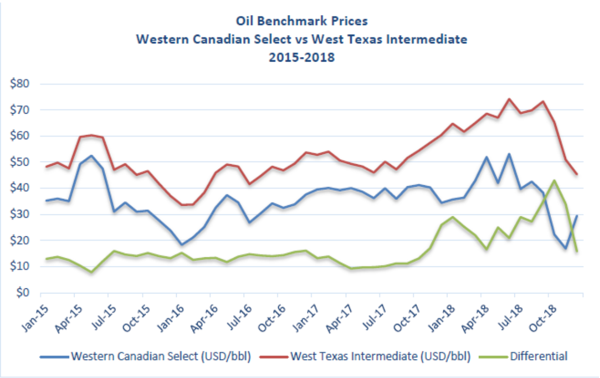
With the recent global equity market turmoil, the US bond market has reversed course, and interest rates have been falling in the US for the past month. Interestingly, in tandem with the resulting drop in mortgage rates, mortgage applications have rapidly recovered back to the levels seen earlier this year. If these levels hold, it seems to imply that US housing data will begin to turn back up heading into the spring of 2019. This is extremely different from the broad consensus view currently in the market of a continued weakening in US housing, and is a large positive for the US economic cycle. We will continue to watch this data closely as it comes in.

good that the only direction for it is down? At the start of the year we didn't think so. We suggested we were close, but not there yet when the direction of the data would lead to a recessionary environment. We still believe this to be the case. The economic data in the United States, Canada, China and Europe have slowed but do not suggest a recessionary environment.

Canada – have we tired of this story yet?

The Canadian equity market returned -8.9% including dividends as measured by the S&P/TSX Composite Index. This included a drop of -10.1% in the fourth quarter. Canada again, was hampered by oil prices that started the year at US$60.42/bbl (West Texas Intermediate Price) rising into the mid-US$70 range before collapsing in the fourth quarter along with stocks to close the year at US$45.41/bbl.

The Canadian benchmark for crude – Western Canadian Select saw even lower prices as the spread between it and WTI widened to $50/bbl in the fourth quarter as Canadian producers suffered from a lack of pipeline and oil-by-rail distribution capacity. A drop of oil prices and widening differential in price compounded the losses suffered by the energy sector.



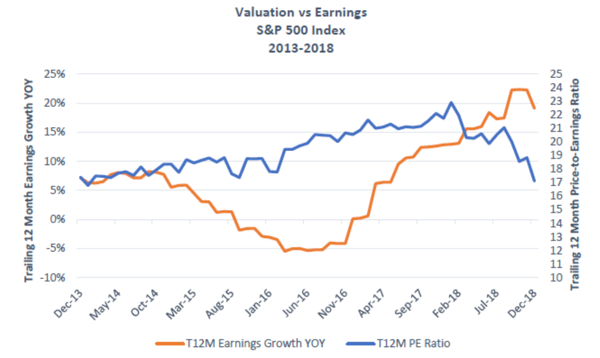
The gains in WTI in 2018 were not fully priced in a widening differential in price. When the differential narrowed it was a result of WTI falling more than WCS.

Source: Bloomberg, Manulife Investments as of December 31, 2018

The decline in stock prices wasn't limited to just the energy sector however, as the correction spared few sectors other than the traditionally defensive consumer staples, telecommunications and utilities.

US Equities – Geopolitical risk trumped all

As mentioned above, heading into 2018 we had expected stocks to benefit from strong earnings growth that would be somewhat offset by a PE contraction. Our valuation models had suggested that the S&P 500 Index at the start of the year was fully valued but not foolishly valued. Our expectations of a PE contraction were met, and in fact by the end of the year were exceeded to the point where we now view US equities undervalued. On the other hand, earnings growth exceeded expectations through 2018 aided by the corporate tax cuts implemented by the Republicans at the start of the year.



Source: Bloomberg, Manulife Investments as of December 31, 2018

2018 was a strong year for earnings growth, accelerating on a rolling 12-month basis to over 20%. The gains were offset by a sharp multiple contraction.

To suggest that geo-politics had a hand in the volatility during the year and the correction through the fourth quarter justified. In fact, 2018 could be a year characterized more by geo-political risk than perhaps anything else. The renegotiation of NAFTA, China/US trade dispute, US midterm elections, US Government shutdown, comments by the President towards the Federal Reserve's interest rate policy, each of these and more have had noted influence on equity market performance, and at times perhaps more so than equity market fundamentals.

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Philip Petursson, Commentary continued

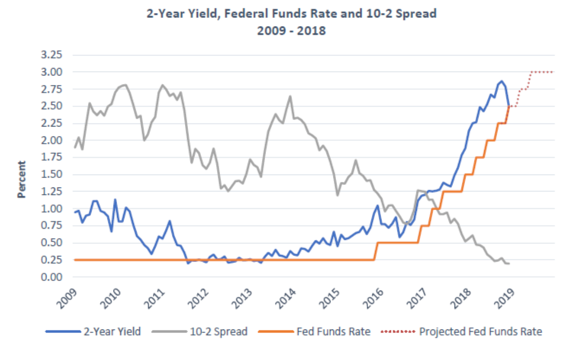
In the end, US equities as measured by the S&P 500 Index fell -4.4% on a total return basis (in US dollar terms). The fourth quarter saw a loss of -13.5% for US stocks that took what had been a surprisingly strong year through the first three quarters to a disappointing finish.

International Equities offered no reprieve

Of our expectations heading into 2018 perhaps international equities were of greatest disappointment to us. As we headed into the year we viewed international equities, which include among others, Asia, Europe and Japan as very attractive. Based on our work, equity valuations in these markets were attractively valued relative to US equities and by a wide margin. Our earnings expectations were more modest yet here we had the potential benefit of a valuation expansion to amplify returns.

We would argue that international equities suffered from the same geo-political influence as their US counterparts. Europe's woes were compounded by Brexit in the United Kingdom, and Italy's budget showdown with the European Commission. As such, international equities as measured by the MSCI EAFE Index (USD) fell by -12.5% in the fourth quarter and -13.4% for the full year.

Fixed Income



Source: Bloomberg, Manulife Investments as of December 31, 2018

The yield curve (10-2 spread) continued to flatten as the 2-year yield rose ahead of the Fed rate increases.

2018 gave us a new Chair of the Federal Reserve in Jerome Powell. Perhaps the only surprise from the Fed was that there were no surprises. The Fed's tightening posture resumed with four rate hikes in 2018 alongside the continued tapering of its balance sheet. As at the end of the year the upper bound of the Federal Funds rate sat at 2.50%. The US 10-year treasury yield ended the year not far off from where it started. However, the path between was much more volatile. The 10-year yield peaked in September at 3.23% before retreating on a risk off rally during the equity correction in the fourth quarter. Throughout the year the yield curve spread, as measured by the difference between the 10 year and 2 year US Treasury yields, flattened to 20 bps by December 31.

The Fed wasn't alone in its tightening bias. The Bank of Canada (BoC) continued to hike as well with three rate hikes of its own to bring its overnight rate to 1.75%. The BoC has been in a more precarious position, trying to normalize rates in Canada while not stifling a consumer over-burdened with debt.

Overall, bond markets disappointed in 2018 as interest rates rose and credit spreads widened. The TMX Overall Bond Index returned 1.4% in Canadian dollar terms while the Barclays Global Aggregate Bond Index fell -1.2% and the Merrill Lynch High Yield Master lost -2.3% (each in USD).

Part 2 – The Outlook for 2019

At any time when we consider the forward outlook for equity markets we bring it back to the fundamentals that have historically been the driver of returns: recession risk, earnings risk and valuation risk. In this regard we continue to struggle to characterize the volatility through the fourth quarter as anything other than a common correction that has been driven by moderating global economic data that has been amplified by headlines and noise.

As we formulate our outlook for 2019 we view the global economic environment as moderating yet favourable. Globally Purchasing Managers' Indices which we use as an indicator for overall global economic growth, are in the majority positive.

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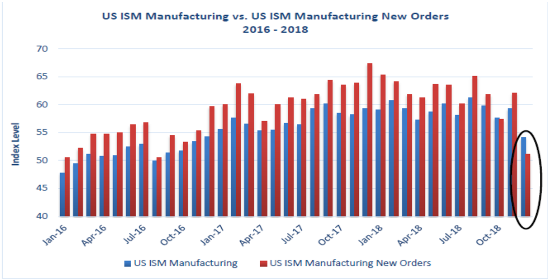
Philip Petursson, Commentary continued

The levels of manufacturing activity are not as strong globally as they were a year ago however, neither are they showing as meaningful slowdown as we saw in 2015. When we look at other manufacturing and trade indicators, they too show a slowing, but not recessionary trend.

	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
JPMorgan Global PMI	52.7	52.7	53.0	53.0	52.7	52.6	52.6	52.7	53.2	53.3	53.5	54.1	54.5	54.4	54.1	53.3	53.5	53.1	53.0	52.8	52.6	52.2	52.0	52.0	51.5
United States	54.3	55.0	54.2	53.3	52.8	52.7	52.0	53.3	52.8	53.1	54.6	53.9	55.1	55.5	55.3	55.6	56.5	56.4	55.4	55.3	54.7	55.6	55.7	55.3	53.8
Canada	51.8	53.5	54.7	55.5	55.9	55.1	54.7	55.5	54.6	55.0	54.3	54.4	54.7	55.9	55.6	55.7	55.5	56.2	57.1	56.9	56.8	54.8	53.9	54.9	53.6
Mexico	50.2	50.8	50.6	51.5	50.7	51.2	52.3	51.2	52.2	52.8	49.2	52.4	51.7	52.6	51.6	52.4	51.6	51.0	52.1	52.1	50.7	51.7	50.7	49.7	49.7
U.K.	56.1	55.7	54.5	54.2	57.3	56.7	54.3	55.3	56.7	55.9	56.6	58.2	56.3	55.3	55.0	54.9	53.9	54.3	54.3	53.8	53.0	53.6	51.1	53.6	54.2
Eurozone	54.9	55.2	55.4	56.2	56.7	57.0	57.4	56.6	57.4	58.1	58.5	60.1	60.6	59.6	58.6	56.6	56.2	55.5	54.9	55.1	54.6	53.2	52.0	51.8	51.4
Germany	55.6	56.4	56.8	58.3	58.2	59.5	59.6	58.1	59.3	60.6	60.6	62.5	63.3	61.1	60.6	58.2	58.1	56.9	55.9	56.9	55.9	53.7	52.2	51.8	51.5
Switzerland	56.2	54.6	57.8	58.6	57.4	55.6	60.1	60.9	61.2	61.7	62.0	65.1	65.6	65.3	65.5	60.3	63.6	62.4	61.6	61.9	64.8	59.7	57.4	57.7	57.8
Holland	57.3	56.5	58.3	57.8	57.8	57.6	58.6	58.9	59.7	60.0	60.4	62.4	62.2	62.5	63.4	61.5	60.7	60.3	60.1	58.0	59.1	59.8	57.1	56.1	57.2
France	53.5	53.6	52.2	53.3	55.1	53.8	54.8	54.9	55.8	56.1	56.1	57.7	58.8	58.4	55.9	53.7	53.8	54.4	52.5	53.3	53.5	52.5	51.2	50.8	49.7
Italy	53.2	53.0	55.0	55.7	56.2	55.1	55.2	55.1	56.3	56.3	57.8	58.3	57.4	59.0	56.8	55.1	53.5	52.7	53.3	51.5	50.1	50.0	49.2	48.6	49.2
Spain	55.3	55.6	54.8	53.9	54.5	55.4	54.7	54.0	52.4	54.3	55.8	56.1	55.8	55.2	56.0	54.8	54.4	53.4	53.4	52.9	53.0	51.4	51.8	52.6	51.1
Ireland	55.7	55.5	53.8	53.6	55.0	55.9	56.0	54.6	56.1	55.4	54.4	58.1	59.1	57.6	56.2	54.1	55.3	55.4	56.6	56.3	57.5	56.3	54.9	55.4	54.5
Czech Republic	53.8	55.7	57.6	57.5	57.5	56.4	56.4	55.3	54.9	56.6	58.5	58.7	59.8	59.8	58.8	57.3	57.2	56.5	56.8	55.4	54.9	53.4	52.5	51.8	49.7
Hungary	52.8	57.0	59.4	55.9	56.2	61.9	56.9	54.2	56.8	59.3	58.3	58.8	60.5	61.1	57.2	56.6	53.3	55.2	52.9	53.3	56.0	54.1	57.1	53.5	54.2
Poland	54.3	54.8	54.2	53.5	54.1	52.7	53.1	52.3	52.5	53.7	53.4	54.2	55.0	54.6	53.7	53.7	53.9	53.3	54.2	52.9	51.4	50.5	50.4	49.5	47.6
Greece	49.3	46.6	47.7	46.7	48.2	49.6	50.5	50.5	52.2	52.8	52.1	52.2	53.1	55.2	56.1	55.0	52.9	54.2	53.5	53.5	53.9	53.6	53.1	54.0	53.8
Australia	55.4	51.2	59.3	57.5	59.2	54.8	55.0	56.0	59.8	54.2	51.1	57.3	56.2	58.7	57.5	63.1	58.3	57.5	57.4	52.0	56.7	59.0	58.3	51.3	49.5
New Zealand	50.0	49.5	47.5	48.6	50.9	50.1	50.5	55.1	56.0	53.4	54.9	58.8	55.1	59.4	57.1	54.3	55.7	57.0	56.4	56.2	56.5	58.4	55.2	52.6	53.3
Japan	52.4	52.7	53.3	52.4	52.7	53.1	52.4	52.1	52.2	52.9	52.8	53.6	54.0	54.8	54.1	53.1	53.8	52.8	53.0	52.3	52.5	52.5	52.9	52.2	52.6
China (caixin)	51.9	51.0	51.7	51.2	50.3	49.6	50.4	51.1	51.6	51.0	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	50.1	50.2	49.7
South Korea	49.4	49.0	49.2	48.4	49.4	49.2	50.1	49.1	49.9	50.6	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	51.3	51.0	48.6	49.8
Taiwan	56.2	55.6	54.5	56.2	54.4	53.1	53.3	53.6	54.3	54.2	53.6	56.3	56.6	56.9	56.0	55.3	54.8	53.4	54.5	53.1	53.0	50.8	48.7	48.4	47.7
Vietnam	52.4	51.9	54.2	54.6	54.1	51.6	52.5	51.7	51.8	53.3	51.6	51.4	52.5	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	51.5	53.9	56.5	53.8
Indonesia	49.0	50.4	49.3	50.5	51.2	50.6	49.5	48.6	50.7	50.4	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	50.7	50.5	50.4	51.2
Malaysia	47.1	48.6	49.4	49.5	50.7	48.7	46.9	48.3	50.4	49.9	48.6	52.0	49.9	50.5	49.9	49.5	48.6	47.6	49.5	49.7	51.2	51.5	49.2	48.2	46.8
Singapore	52.0	51.6	51.4	52.2	52.6	51.4	50.7	51.3	53.2	53.7	54.2	54.4	52.1	53.6	55.3	53.7	55.6	56.8	56.0	53.0	51.1	49.6	52.6	53.8	52.7
India	49.6	50.4	50.7	52.5	52.5	51.6	50.9	47.9	51.2	51.2	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	52.2	53.1	54.0	53.2
Brazil	45.2	44.0	46.9	49.6	50.1	52.0	50.5	50.0	50.9	50.9	51.2	53.5	52.4	51.2	53.2	53.4	52.3	50.7	49.8	50.5	51.1	50.9	51.1	52.7	52.6
Turkey	47.7	48.7	49.7	52.3	51.7	53.5	54.7	53.6	55.3	53.5	52.8	52.9	54.9	55.7	55.6	51.8	48.9	46.4	46.8	49.0	46.4	42.7	44.3	44.7	44.2
South Africa	51.6	51.3	50.5	50.7	50.3	50.2	49.0	50.1	49.8	48.5	49.6	48.8	48.4	49.0	51.4	51.1	50.4	50.0	50.9	49.3	47.2	48.0	46.9	48.2	49.0
Saudi Arabia	55.0	55.5	56.7	57.0	56.4	56.5	55.3	54.3	55.7	55.8	55.5	55.6	57.5	57.3	53.0	53.2	52.8	51.4	53.2	55.0	54.9	55.1	53.4	53.8	55.2
Russia	53.7	54.7	52.5	52.4	50.8	52.4	50.3	52.7	51.6	51.9	51.1	51.5	52.0	52.1	50.2	50.6	51.3	49.8	49.5	48.1	48.9	50.0	51.3	52.6	51.7

Source: Bloomberg, Manulife Investments as of December 31, 2018

However, we do need to recognize that in China and the United States, the two most meaningful economies in the world, manufacturing slowed in December. What is difficult to assess at this time is how much of the slower manufacturing growth can be attributed to uncertainty regarding the trade dispute between China and the United States, and what would be indicative of a broader economic slowdown. In the US the Institute for Supply Management manufacturing PMI slowed from 59.3 to 54.1 in December (while the Markit US PMI fell from 55.3 to 53.8). This marks a significant drop in manufacturing growth that we would attribute to the uncertainty surrounding the proposed additional tariffs on Chinese goods that was put on hold following the Argentina G20 Summit. In China the Caixin/Markit PMI fell to 49.7 from 50.2 the month prior (an index level below 50 is contraction, above 50 is expansion).



Source: Bloomberg, Manulife Investments as of December 31, 2018

The sharp drop in the manufacturing and new orders index in December were uncharacteristic of the prevailing trend. Likely the drop was influenced by trade uncertainty.

Absent other recessionary indicators we believe the current slowing of growth is temporary and may in fact stabilize on positive geo-political outcomes. The consensus among economists is that the next US recession will occur in 2020. While this is an interesting statistic we feel it is far more important to focus on when a recession won't occur. To that end we continue to refer to our table of recessionary indicators. Currently, none of the typical signs of recession are present today. And therefore, we would put the risk of recession in 2019 at 30%.

Sign of Recession	Present today
Inverted Yield Curve	No
ISM Manufacturing PMI Below 45	No
Positive Inflationary Trends	No
Capacity Utilization above 80% and peaking	No
Housing Starts Declining	No
Labor Market Weakening	No
Leading Economic Indicators Negative	No

That may sound higher than some may think, and in fact we did increase our subjective probability higher year-over-year. However, we do need to recognize the signs that would suggest while recession is not imminent, it is not far off in the distance either. These signs would include: a very flat yield curve that may invert in the first quarter of 2019, a US housing market that is showing signs of exhaustion with existing home sales down year-over-year, and a tense political environment that may be prone to a policy mistake.

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Discuss the risks associated with leveraged mutual fund purchased with an investment funds advisor before investing. Purchases are subject to suitability requirements. Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same if the value of the securities purchased declines.

Investors should educate themselves regarding securities, taxation or exchange control legislation, which may affect them personally. This newsletter is for general information only and is not intended to provide specific personalized advice including, without limitation, investment, financial, legal, accounting or tax advice. Please consult an appropriate professional regarding your particular circumstances.

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