Kleinburg PRIVATE WEALTH

Carte WEALTH MANAGEMENT INC.

KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 7, ISSUE 7 JULY 2018

“Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves.” - Peter Lynch

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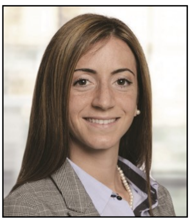
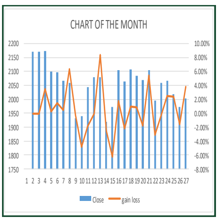
Sergio Simone
EDITORIAL COMMENT



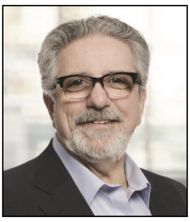
Kristina de Souza
GIVING THE GIFT OF LIFE INSURANCE



US INTEREST RATE CYCLE

Ryan Simone
MITIGATING RISK WITH A MARRIAGE CONTRACT

Editorial Comment



Sergio Simone

Leveraging is the act of using someone else’s money to make money. Most people have leveraged at some time in their lives, like buying a house and taking out a mortgage. Investment leverage is where you borrow money and use that money to invest in stocks, bonds, mutual funds or other types of investments. It has been said that fortunes are often built with other peoples’ money. Most successful businesses have used external funding at some point in their existence.

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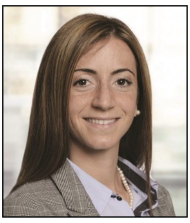
Giving The Gift Of Life Insurance



Kristina de Souza

Many people have given to charities via a life insurance policy. It is very easy to do. The owner of the policy names the charity as a beneficiary. At the death of the insured, the charity receives the death benefit of the policy. Although this method will not generate a taxable event at death, it also generates no charitable income tax deduction. To receive a charitable tax deduction, the donor must make a completed gift during life.

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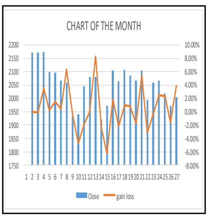
U.S. Interest Rate Cycle



The good news is that for all the stimulus the US has coming down the pipeline this late in the business cycle, there doesn’t seem to be many indications that the economy is excessively overheating. The reason this is good news is that if the US economy is NOT overheating, then we are unlikely to see a typical late-cycle surge in inflation, and the Fed can maintain its gradual path towards policy normalization.

Continue Reading

Ryan Simone

Mitigating Risk With A Marriage Contract

The recent (2016) Canadian census data show that proportionately fewer households are composed of a ‘mom, dad and kids family’ and more people are living alone, as part of a couple without children, or as part of a multigenerational family.

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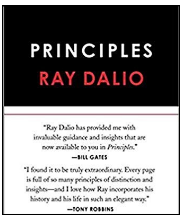


BOOK OF THE MONTH

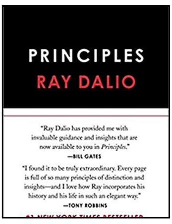
FUND OF THE MONTH SIGNATURE GLOBAL SCIENCE & TECH

INVESTMENT TERMINOLOGY

BLOG OF THE MONTH FINANCIAL DUCKS IN A ROW

Book of the Month

Principles



By Ray Dalio

Ray Dalio, one of the world's most successful investors and entrepreneurs, shares the unconventional principles that helped him create unique results in life and business—and which any person or organization can adopt to better achieve their goals. Dalio's original Principles has been downloaded over three million times, and this expanded and revised edition is the first version available in print.

Fund of the Month—Signature Global Science & Technology Class

This 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 have developed or are developing technological products, processes or services. This includes companies that provide goods and services to these companies and companies that could benefit from advancements and improvements in technology.

Investment Terminology

Active Management

Active management is the use of a human element, such as a single manager, co-managers or a team of managers, to actively manage a fund's portfolio. Active managers rely on analytical research, forecasts, and their own judgement and experience in making investment decisions on what securities to buy, hold and sell. Investors who believe in active management do not follow the "efficient market hypothesis". They believe it is possible to profit from the stock market through any number of strategies that aim to identify mispriced securities.

BLOG OF THE MONTH

The Media Is Great At Blowing Things Out Of Proportion

AR Abnormal Returns a wide-ranging, forecast-free investment blog

The chart below from the Visual Capitalist blog illustrates one reason why the media is held in such disregard of late: hype. The chart shows the many things the media touted over the past 20 years that was going to kill us all. As Jeff Desjardins notes:

"*While having zero deaths is certainly the ideal, and many of the issues above should be taken very seriously especially as stories develop, we should be careful not to blow things out of proportion. Making mountains out of molehills does not help anyone, and it adds to growing distrust of media in general.*"

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

YOUNG HIGH-NET-WORTH CANADIANS INSPIRED AND OPTIMISTIC THEY WILL HAVE A POSITIVE IMPACT ON THE WORLD

TORONTO, June 12, 2018/CNW/ - The definition of legacy in Canada is shifting from value to values, as the next generation of high-net-worth Canadians increasingly prioritize the impact of their money throughout their lives and beyond. 73% of younger high-net-worth Canadians say they will make more of an impact on the world than previous generations while only 48% of older high-net-worth Canadians feel the same way.

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THE FINE ART OF COTTAGE CO-OWNERSHIP

"When people are divided, the only solution is agreement." John Hume

Since we are all human, where there's family, sooner or later there's friction. Unfortunately, all too often the family cottage can become the source of such friction. Everyone has probably heard at least one unfortunate story about family members disagreeing over sharing time, money or energy on the cottage. Where successive generations are to hold the property for a lengthy period, the likelihood of disputes increases, in particular where beneficiaries have different levels of assets, income or interest in the cottage.

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HIGH-NET-WORTH CANADIAN INVESTORS ARE LOOKING ABROAD

Many high-net-worth Canadian investors are increasingly looking for luxury real estate in other countries.

"One main reason they really like it is because foreign real estate is a hard asset that they can touch," said Brad Henderson, CEO of Sotheby's International Realty Canada. It's also an investment where the one percent can enjoy a private and luxurious

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SHOULD HIGH NET WORTH CLIENTS REALLY RISK EXPOSURE TO EMERGING MARKETS?

Developing economies have endured a turbulent few months, but even over the longer term they tend to display more volatility than developed markets. Are high net worth investors better off avoiding them completely?

Emerging markets make up a growing slice of global GDP, and contain some of the fastest growing economies in the world. Indeed the World Bank predicts that emerging economies will grow at a rate of 4.5 per cent in 2018 and at an average of 4.7 per cent in 2019 and 2020.

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FUND MANAGER COMMENTARY

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MYLES ZYBLOCK
DYNAMIC FUNDS

PHILIP PETURSSON
MANULIFE
INVESTMENTS

CLEMENT GIGNAC
IA CLARINGTON

JURRIEN TIMMER
FIDELITY
INVESTMENTS

Myles Zyblock, Chief Investment Strategist

Dynamic Funds

Following are excerpts from Myles Zyblock's recent Investment Junction article.

The historical low levels of financial market volatility recorded in 2017 are unlikely to be revisited for the remainder of this cycle.

Continue Reading

Philip Petursson, CIM, Chief Investment Strategist

Manulife Investments

Escalating tension between the United States and China have unsettled investors worldwide. Global market indices took a tumble in the past month with International equities bearing the brunt of the selling.

Continue Reading

Clement Gignac—Chief Economist and Portfolio Manager

IA Clarington Investments

An Interview with Clement

WHAT IS YOUR BIG PICTURE VIEW?

We do not expect a recession any time soon. It's important to keep in mind that bull markets and business cycles have no expiration date. When inflation is under control, it's a good recipe for a

Continue Reading

Jurrien Timmer, Director of Global Macro

Fidelity Investments

Waiting For The End Game

The U.S. stock market's "benign valuation reset," in which price-to-earnings (P/E) ratios fall while stock prices more or less stay up, is now well into its fifth month. From it's January 2018 peak through late June, the Standard & Poor's 500 index (S&P 500) has been stuck in a trading range of roughly +/- 10%, resulting in a modest 5% drop. That's basically nothing in the grand scheme of things, especially following the massive 50+% gain over the two years that preceded the January peak.

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LINKS

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Investors Look To The U.S. Dollar As Trade War Safe Haven

The U.S. might be the trigger for escalating trade tensions with

Stocks Could Get Rocked In Second Half, Until The Fed Stops Raising Interest Rates

Morgan Stanley said trade

Using Life Insurance Under New Passive Income Rules

In February's 2018 Federal Budget, the Feds clarified the

WTO Urges Nations To Ease Trade Tensions

The World Trade Organization is urging nations to resolve trade tensions, warning that restrictive

Blended Families And Estate Planning

One of the main goals that people have when they are estate planning is making sure their family

Bank of Canada Raises Overnight Rate Target To 1.1/2 Per Cent.

The Bank of Canada today increased its target for the

Parents Missing The Mark On Saving For Kids' Education

By starting a savings plan early, parents can reduce the burden

How The CRA Addresses Non-Compliance In The Real Estate Sector

The Canada Revenue Agency (CRA) uses a combination of

Study Confirms Canadians Are Not Saving Enough For Retirement

Schroders released their annual Global Investor Study, which

Rising Protectionism Threatens Global Trade

Amidst weak global growth, countries around the world are turning inwards, hoisting trade barriers and protectionist

Millennials Face Barriers To Investing, Says OSC Study

The Ontario Securities Commission today released a new study

U.S. Inflation, At 2.9% In June, May Be Tamer Than It Looks

U.S. consumer prices rose in June from a year earlier at the

Report On G20 Trade Measures

WORLD TRADE ORGANIZATION

This report covers new trade and trade-related measures implemented by G20 economies between 16 October 2017 and 15 May 2018. It reveals a number of important trends in global trade policy-making. While G20 economies continue to implement trade-facilitating measures, the more worrying trend during this period is the increase in trade-restrictive measures which has come at a time of increasing trade tensions and associated rhetoric. This should be of real concern to the international community.

Continue Reading

VIDEO LINKS

Outlook For Markets In 2018 Boils Down To Interest Rates

Jeff Weniger, asset allocation strategist at Wisdom Tree Asset

Victims Of Trade Tensions Will Be Emerging Markets

Antoine Lesne, head of SPDR ETF strategy and research at

2018 Global Market Outlook—Q3 Update: Trade-War Tightrope

The two key global market trends of early 2018—U.S.

J.P.Morgan Asset Management

Using The "Guide To The Markets" to Explain The Investment Environment

This economic expansion has been like a healthy tortoise—slow but steady. In fact, as of December, the expansion is in its ninth year, making it the third longest expansion since 1900. Growth accelerated in the third quarter after firming in the second, and rebuilding following a series of natural disasters, alongside tax reform, should add to growth. That said, U.S. growth may be limited moving forward by structural constraints.

EDITORIAL COMMENT-CONTINUED

This concept can also work for individual investors provided they understand the risks and caveats involved. The appeal of leveraging for individual investors is that it can significantly enhance their returns. The downside is that if the investments go south, the losses will also be enhanced.

I am a proponent of leveraged investing but with a big bold **WARNING SIGN** that **leverage is not for everyone**. Unquestionably, leverage can help boost returns, create tax deductions and replace a forced savings plan, and when used properly, leverage can be a very powerful tool to help grow your investment portfolio, which likely accounts for the reason, according to the Investment Industry Regulatory Organization of Canada (IIROC), that $19.4 billion of leverage has been used by institutional and retail investors. As appealing as leverage may seem, it is not for everyone. The strategy comes with an assortment of risks that an investor needs to understand.

Investors should be wary of any advisor who aggressively promotes leverage. When they present you with illustrations, be wary of the assumptions. I have seen many leverage proposals that focus on the good results without equal time spent on the risks of bad outcomes. Before an investor considers investment leveraging they should first take the time to determine what their risk tolerance is. This is a very personal and introspective decision that no risk questionnaire can answer for you. If you have any doubt whatsoever, I suggest that this may not be the right strategy for you.

If you conclude that leverage is the right investment strategy for you, your next steps are to decide on how much to borrow, what to do with the funds and how long to stay invested. For those who have never borrowed money to invest, consider using only a fraction of the funds available to you. Perhaps using 10% - 30% of the available funds for a few years might give you a taste of what to expect and whether you have the character to deal with market volatility.

Once you have determined an amount of borrowed funds to invest, consider investing in a basket of blue-chip dividend paying mutual funds. Leveraging is an aggressive investment strategy so, using a conservative strategy like diversification may help mitigate some of the risk, besides, with today’s low interest rate environment you may have a dividend yield that exceeds your borrowing rate. In fact, there is an arbitrage opportunity here. There is a gain to be made in the spread between the interest payments you make, which are fully tax deductible against income and the dividends you earn, which are taxed at a preferential rate.

One of the best strategies to help mitigate the inherent risks associated with investment leverage is to invest the funds in a well-diversified and disciplined investment strategy rather than following trends or being over-concentrated in your positions.

Since markets are volatile, I suggest you consider a seven to ten-year investment horizon at a minimum. If you are unprepared to stay invested this long, then leveraging may not be appropriate for you. The last thing you would want to do with borrowed money is pull the plug at the wrong time or having someone pull the plug on you. Many leverage loans come with margin calls. This refers to the lender making a demand of payment if the market value falls below a certain level. If you are unable to make this payment, then the loan will be called, and you could realize a significant loss. Several institutions offer Non-Margin Call loans. If leverage is part of your investment strategy, it is important to seek out one of these types of loans.

For all the reasons I have mentioned, the strategy of investment leverage is best suited to more sophisticated and knowledgeable investors who already have a solid foundation of wealth and who consider themselves financially stable. Investors who choose to use investment leverage strategies should have the ability to service the debt from regular cash flow where no part of the existing leveraged assets are required to carry the loan. They must also have predetermined that they would be able to service the loan in a rising interest rate environment, as we have today.

Investment leveraging can be a wonderful tool to help enhance your portfolio growth but the risks involved behoove you to seek professional advice from a Financial Advisor you trust to look after your best interests before diving in.

Feel free to contact me if you have any questions on the practicality of applying this strategy in your portfolio.

Giving The Gift Of Life Insurance—CONTINUED

Giving a policy to charity can be a very substantive gift, especially where the donation combines a death benefit with investment features. These policies can become valuable assets over time. These policies can be extremely beneficial for donors and recipients when the original purpose for the life insurance becomes obsolete. For some it may be the case that beneficiaries are self-sufficient or no longer exist. Some of the typical reactions to such scenarios include cancelling the coverage or opting to take the cash surrender value of the policy, should it exist.

Some argue that there is an even better solution, one that can be mutually beneficial for all parties involved. Should an individual require tax relief while simultaneously feeling philanthropic, one attractive solution may be to gift their life insurance policy to a charity. As appealing as this solution may be, the rules for tax deductions, the policies themselves, and the proper post-gift management of the policies by the charity can be complicated.

When a donor gives a life insurance policy to charity, they are also giving up all rights to and benefits from the policy. They will no longer have the right to change the beneficiary, surrender, assign, or cancel the policy. Attempting to retain any rights to the policy will cause the donor to forfeit the tax deductible benefits of the gift.

There are a few instances where this type of donation makes sense. For example, donation can be a great option for a term policy that is approaching renewal or expiry, while coverage is no longer needed. By nature, term insurance tends to be considered worthless at the end of the term, as it typically has no cash surrender value. This fact in addition to premium increases upon renewal are the main reasons why policyholders are prone to *not* renew a policy. With that said, term policies may be a hidden gem, should their fair market value exceed the cash surrender value.

Another altruistic way to ensure coverage is secured for the future benefit of the charity, is when the insured converts their policy to permanent insurance, such as Universal Life, before it is donated.

Generally, there are a couple of ways this strategy can work. The most simple and commonly used approach is to assign the selected charity as the policy beneficiary, and once the insured passes away the charity receives the death benefit and the estate receives the tax credit. The other method is to change both the beneficiary and the owner of the policy to the name of the charity. Keep in mind that the charity must first approve of the acceptance of the gift. In such cases, the benefit to the donor is immediate, whilst the CRA accepts that policy donations occur at fair market value (FMV). Thus, the donor gets the tax credit for the FMV of the policy, which is usually greater than the cash surrender value.

Life insurance policies that are paid-up can be donated, but so can ones that are not. Thus, it has to be decided who, if anyone, will continue to pay policy premiums. If the insured will continue these payments, they can opt for additional tax credits for the paid premiums. Alternatively, the premiums can be deducted from the policy's cash value, or other charitable donors can opt to continue to pay the premiums. Again, upon the death of the insured, the charity receives the death benefit which in most cases is substantially larger than the policy's premiums and value. As mentioned, upon gifting a life insurance policy, tax credits for the FMV are received by the donor.

Giving The Gift Of Life Insurance—CONTINUED

The credit can be applied to reduce net taxable income in the given year, or carried forward up to five years. The savings can range from $100k-$128k depending on the province and tax brackets.

The key to this overall strategy is to work with an experienced actuary and underwriter. An underwriter will evaluate things like mortality risk and life expectancy of the insured; while the actuary can investigate the key features of the policy such as death benefit, cost of insurance, cash value, mortality risk, policy loans and so on in determining the FMV. As mentioned, the charity must approve of and accept the life insurance policy as a gift. It does not always make sense for them to do so, but good examples of ones worth accepting are those policies where the client is age 70 and up with a serious health issue; and it is these policies that tend to have the highest valuations (FMV).

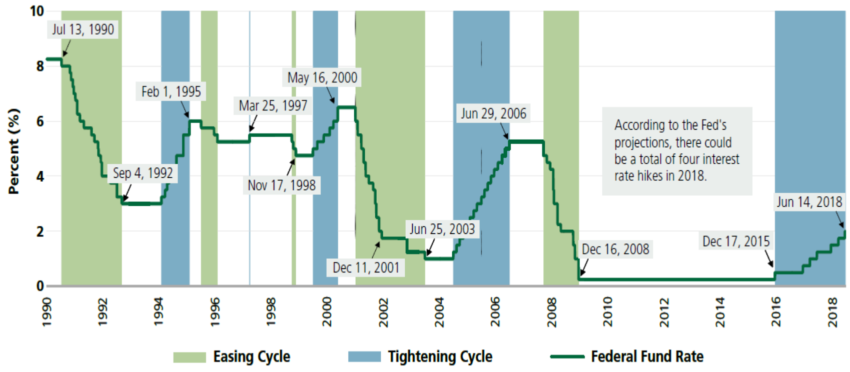
Another great example of policies worth donating are those that are corporately owned. Policies may become trapped within a corporation upon such events as the sale or reorganization of a company; whereby the tax implications of the policy's transfer are excessive. Thus, when tax liabilities impede on mainstream planning strategies, donating a policy can provide a viable solution attached to an attractive tax credit. It's important to keep in mind that you can only deduct up to 75% of net income each year of your life, and can only carry forward this type of credit for 5 years. This information is key to ensure the full donation tax credit can be made use of when the policy is donated at fair market value.

Donating a life insurance policy can be a great way extend and add value beyond the useful period of a policy; providing the insured with a charitable tax credit while supporting a valuable cause.

US Interest Rate Cycle - CONTINUED

Our biggest concern is what will happen after 2020, when much of the fiscal stimulus measures are set to taper off. One option the policymakers have is to extend the stimulus measures. The scenario we want to avoid is the one where the US economy faces a fiscal cliff that provides significant headwinds to growth at a time when the central bank is still in tightening mode.

US Interest Rate Cycle Since 1990



Source: US Federal Reserve, Federal Reserve Bank of St. Louis, as of June 13, 2018.

The pessimists among us might argue that we should be so lucky to get to 2020 before we face these headwinds to growth. We have a polarizing view, where we see the tax and spending bill stimulus measures buoying the US economy enough over the next two years to see growth continue well above potential GDP forecasts. As I have iterated many times in the past, when taking a directional position, always ask "what if I'm wrong"?

Traditionally, at this late stage in the business cycle, there is a surge in inflation and the Fed has to hike rates to get ahead of the situation. This has been the catalyst to propel the US into recession in 10 of the last 13 rate hiking cycles. There are many legitimate inflationary pressures on the economy but there are also disinflationary pressures as well, like low productivity growth, an aging population and continued weak wage growth despite the incredibly low unemployment rate of 3.8 per cent.

I have stated in the past that the Fed should slowly increase interest rates during a good economy, especially when rates have been so low, because it will give them room to cut rates to stimulate the economy during the next downturn.

Our opinion is that the current global growth story will continue over the next few years although there does seem to be some divergence in growth between the US and other developed economies in 2018. The US is poised to play the role of the caboose to power global growth ahead over the next couple of years off the back of fiscal stimulus measures.

It behooves us to keep a close eye on a number of risks to this view, some of which may become more pronounced as we venture into the next decade.

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Mitigating Risk With a Marriage Contract—Continued.

Common-law unions are also increasing although married couples still represent the majority. Currently 21.3% of couples are living in common law – a 15% increase since 1981. As for married couples, just under 50% of marriages end in divorce in Canada.

The traditional family make-up is changing and, part of this demographic change is the breakdown of relationships in which two people living together decide to part ways. I'd wager that more than a few people reading this are close to someone going through a difficult separation/divorce or have experienced one themselves. Fortunately, people can protect themselves from this difficult transition by understanding a few things.

When two people marry, they may or may not maintain separate accounts. Some think that if they have an individual chequing account or investment account, they are keeping their finances separate from their spouse. However, when a couple divorces, a process begins in which net family worth is calculated. A former spouse could access assets in an individual account by proving that the money was used in a way that benefited the family or couple. Believe it or not, this is an incredibly easy thing to prove with a good lawyer. Even if not a single cent was spent out of the account.

When people marry without a marriage contract it should be assumed that nearly all assets are shared, even if it is a second or third marriage. The scary part is that under this assumption, an ex-spouse of your new partner could access your funds, even if they are held in an individual account created prior to the marriage. Fortunately, a marriage contract made prior to or during the marriage can prevent this. Essentially a marriage contract can divide assets so that property remains with the individual in the event of a marital breakdown. The only exception is the matrimonial home. During and after marriage, and regardless of a marriage contract, a home occupied by the couple is equally divided – even if the home is in one spouses name or was purchased prior to the marriage.

Things are a little different for common-law spouses. A misconception that marriage and common-law relationships are treated the same is false. Unlike married couples, individuals in a common-law relationship have no property rights. When a common-law relationship dissolves, the individuals go their separate ways with their own assets and property. Also, the home is not shared between both spouses unless purchased jointly. There are two distinct ways in which one individual can make claims to the other's property after a break-up; however, these claims can only be made under specific circumstances and after 3 years of living together.

If I were to tell you that you had a 50% chance of winning the big lottery this Friday what would you do? With those odds, I suspect most would go out and buy as many lotto tickets as they could. With the odds of divorce being equally as great, perhaps a marriage contract, which can be used to protect both parties from a difficult, lengthy, and costly process, should be seriously considered as part of a complete financial plan. In fact, I would argue that a complete financial plan should always contain a marriage contract amongst its many various components.

Philip Petursson, Commentary continued

So far, the Trump administration has announced tariffs on US$50 billion of Chinese imports, the first US$34 billion of which was implemented on July 6 with the rest possibly coming into force in late August. Most of these tariffs are on intermediate goods, and are therefore likely to increase input costs for US businesses. Anecdotally, many of our portfolio managers have seen this impact the companies that they follow in the form of higher costs. The White House has also threatened tariffs on an additional US$200 billion of imports from China and is constructing a list of goods to be targeted. In response, China also implemented tariffs on US$34 billion of imports from the US on July 6. If this escalates, China could eventually run out of goods to impose tariffs on because it does not import enough items from the US (Chinese imports from the US amount to approximately US$130 billion). China could expand the tariffs to include services and might even take measures such as increasing compliance for US companies operating in China, interfering with licensing, and boycotting US products. They could also potentially allow the Renminbi to depreciate further, and take steps to rebalance the People's Bank of China's balance sheet away from US Treasuries — all measures that could impact markets significantly.

In Canada, the US has already implemented tariffs of 25% and 10% on steel and aluminum respectively. Canada has retaliated with a tariff of 10 - 25% on US$12.8 billion of US goods including maple syrup and whiskey. Steel fabricators and metal importers say the tariffs will jack up prices for everything from rebar used in high-rise condos to structural steel for industrial builds in a market already facing shortages and soaring prices. Job losses and stalled projects could occur.

The impact on the broader Canadian economy is much tougher to quantify as the products impacted represent approximately five percent of Canadian imports from the US. What we will be watching very closely is whether President Trump will follow through on his threat to impose a 25 percent tariff on cars (and potentially auto parts) produced in Canada. High tariffs on cars would increase prices for US consumers which in turn, would cause market demand to drop. Canadian manufacturers would have to cut costs and jobs would begin to evaporate. Around 80 per cent of cars made in Canada are exported, with most of them flowing across the southern border. Canada's vehicle manufacturing industry employs about 125,000 people and about 70 per cent of those jobs are in automotive parts manufacturing.

The question we keep asking ourselves is whether all these threats are a negotiating tactic to lower trade barriers for US exporters or if the measures will be implemented and do real harm to global trade and global economies. In the worst case scenario, trade wars would severely damage global growth and margins while increasing prices – the ultimate worst case scenario of low growth and high inflation. We believe that all parties do not want a full scale trade war and can't stomach implications for the global economy and markets. We also believe that President Trump is unlikely to push tariffs which could negatively impact Republican controlled states and threaten the majority that the GOP holds in both Houses prior to important US mid-term elections in November. Further, we believe given President Trump's taking credit for strong equity market performance (for example, the Dow reaching a new high) that he may be reluctant to implement any policy that would have a long-lasting and negative impact to US stock markets.

When pondering the potential of reducing our equity weight, we remind ourselves of the downgrade of the US's AAA rating, the fear of Greece leaving the Eurozone and Brexit which all resulted in short term sell offs on fears of ***potential*** long term implications. However, markets realized that the risks were overblown and refocused on fundamentals which were strong. Today, based on the tariffs imposed, we believe it is unlikely to result in our worst case scenario of a global recession and bear market.

We expect rising inflation and rising interest rates to compress the price-to-earnings multiple of US stocks. In the international space, the story is the same with global central banks likely to reduce ultra-loose monetary policy adopted since the Financial Crisis as the economies no longer require them. However, we believe that in this environment that we are better compensated for holding equities than fixed income as earnings expectations continue to be strong and historically equities continue to deliver a positive return over a 12 month period in such an environment.

To sum, we expect strong earnings growth to offset any valuation contraction within equities to continue to deliver a positive return over the next 12 months, but perhaps slightly more modest than the historical average.

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Disclaimer

Clement Gignac, Commentary continued

continuation of the business cycle. Our big picture view is positive, but we're mindful of the fact that monetary policy normalization in the U.S. will likely continue.

We expect normalization to begin in Europe and Japan next year and we also expect volatility for the foreseeable future. The absence of volatility last year was unusual.

Source: Bloomberg, as at May 24, 2018.

On a risk/reward basis, we believe Canadian and international equities are likely to out-perform US stocks over a two-to-three year time horizon.

WHAT'S THE BIGGEST RISK?

Beyond the possibility of a trade war between the U.S. and China, the economic indicator I'm focusing on most closely—because we're in the advances stages of the business cycle—is wage growth.

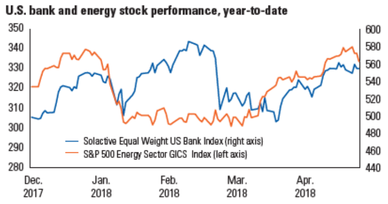
If wages start to accelerate, there are two possible outcomes: Companies absorb the cost, which squeezes profits or companies pass the extra cost along to consumers, which causes inflation and accelerated interest rate increases. Neither outcome would be very good for the stock market.

HOW ARE YOU MANAGING RISK?

We're overweight equities, but we're protecting against downside risk with put options. Even if there is only a 15-20% probability of a bear market, we believe put options are very useful for helping to protect the portfolio. If the market drops by more than 3-4%, the Funds we manage are likely to outperform our peers because of this put option backstop we have in place.

WHY MIGHT THIS BULL MARKET CONTINUE?

We expect equity returns in the single digits. Sector rotation is becoming much more important. We believe very strongly in the value active managers can bring to the table through stock picking and sector rotation. Year-to-date, bank and energy stocks are performing very well.



Source: Bloomberg, as at May 24, 2018.

WHEN WILL RISING YIELDS AFFECT EQUITIES?

We've never seen a recession when real interest rates have been negative. In Canada, we currently have negative real ratees; in the U.S., they're effectively flat. In our view, this means equities still have upside potential. As long as we don't have real short rates of 50-100 basis points, we won't be overly concerned and can expect the bull market to continue.

Real interest rates before recession starts

Recession start	Latest reading before start	6m avg before start
1960	1.9%	1.9%
1970	2.8%	3.0%
1973	5.5%	6.3%
1980	1.8%	2.2%
1981	7.9%	7.1%
1990	3.2%	3.4%
2001	2.6%	3.4%
2007	1.8%	2.6%
	Real interest rate (Fed Funds – Core CPI, %yoy)	
Current	**0.6%**	**0.5%**
Average	3.4%	3.7%
Median	2.7%	3.2%

Source: J.P. Morgan, as at April 30, 2018.

WHAT ARE SOME RECENT TACTICAL MOVES YOU'VE MADE?

Valuations in Japan are very cheap compared to the historical average. Earnings are now positive overall—not as spectacular as in the U.S., but the trend line in Japan is very positive. We have increased our exposure to Japan. We have also increased our exposure to Canada, because we believe Canadian energy stocks are undervalued by 15-20%. We've scaled down our U.S. exposure—but it still remains very high—to make room for these allocations..

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Myles Zyblock, Commentary continued

It is common to see price variability increase as the cycle matures, with the latest bout of turbulence closely linked to rising trade tension.

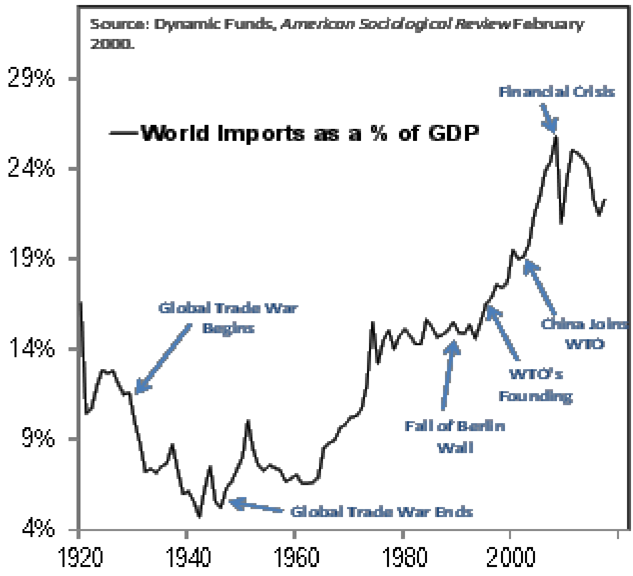
- The friction between China and the U.S. offers one more example whereby the world is stepping back from what has been a relentless march towards globalization (see Chart of the Month). The impending withdrawal of the United Kingdom from the European Union, Donald Trump's presidential victory, and the recent Italian election outcome all argue that there is a deep suspicion about the prevailing establishment; that it is time to try something different.

- At this juncture, the economic costs of the deterioration in trading relationships seem low. They will become larger and harder to quantify upon further escalation. Disruption to supply chains, and business and consumer confidence are all factors that could eventually complicate the calculus and magnify the downside risks.

- A deeper trade war would encourage us to further move up in quality. From a geographic perspective, we would choose to raise exposure to U.S. domestically-focused companies which are profitable, growing and well managed. Key Asian markets which are representative of the global production supply chain, such as Singapore, Malaysia, Taiwan and Korea would be among those areas facing greater performance risks.

- Developed market government bonds, particularly in those jurisdictions perceived to be most vulnerable to a slowdown in global growth, would probably outperform. However these same markets—e.g. Australia, Canada—also have higher-beta currencies so this risk would have to be carefully managed.

Chart of the Month: Globalization Peaked a Decade Ago



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An investor proposing to borrow for the purchase of securities should be aware that a purchase with borrowed monies involves greater risk than a purchase using cash resources only. The extent of that risk is a determination to be made by each purchaser and will vary depending on the circumstances of the purchaser and the securities purchased.

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.

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