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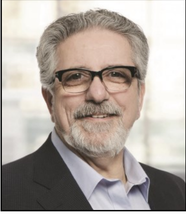
KPW LIFE PLAN—IMAGINE YOUR FUTURE

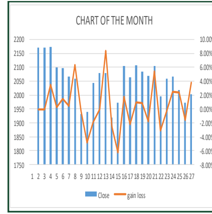
VOL. 7, ISSUE 11 NOVEMBER 2018

"A 10% decline in the market is fairly common—it happens about once a year. Investors who realize this are less likely to sell in a panic, and more likely to remain invested, benefitting from the wealth building power of stocks." - Christopher Davis



Sergio Simone
EDITORIAL COMMENT

Sergio Simone
IS THIS THE END OF THE BULL MARKET?



MARKET VOLATILITY IS NORMAL: STAYING THE COURSE IS CRITICAL

Ryan Simone
THE PRE-RETIREMENT ASSESSMENT

Editorial Comment

Sergio Simone

While it appears the October correction has carried into November, I thought it would be a good opportunity to recap our current investment climate. It has been ten years since the global financial crisis and many investors are under the impression that it has been clear sailing since then, after all we have been in a Bull Market environment. The fact is that there have been several recessions since Lehman failed in 2008.

Continue Reading

What Does History Say About Post Midterm Election Years?

Sergio Simone

The question that is on the minds of many investors, after the U.S. mid-terms is, "How will the outcome influence the economy and financial markets going forward"? By now most people are aware that the Democrats have recaptured a majority in the House of Representatives for the first time since 2010 while the Republicans have increased their hold on the Senate.

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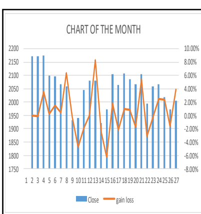
Market Volatility Is Normal: Staying The Course Is Critical



More positive years than negative. Overall, the trend has been positive since 1980. The S&P 500 Index has shown a positive return in 32 out of the 38 full years shown on the chart, which is nearly 84% of the time.

Market declines throughout the year are normal. Despite this positive long-term trend, it is important to highlight that

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The Pre-Retirement Assessment (PRA) Series

Ryan Simone

Theme One: HOUSE RICH & CASH POOR

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.

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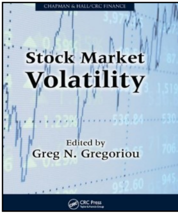
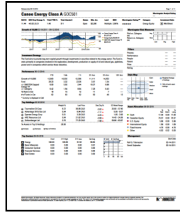
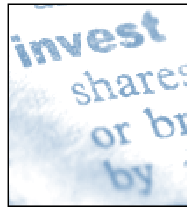




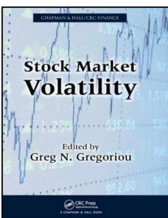


BOOK OF THE MONTH	FUND OF THE MONTH Dynamic Global Dividend Class	INVESTMENT TERMINOLOGY	BLOG OF THE MONTH VALUEWALK

Book of the Month

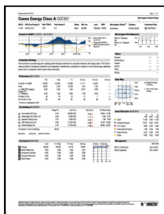
Stock Market Volatility

By Greg N. Gregoriou



Taking into account the ongoing worldwide financial crisis, this 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—Dynamic Global Dividend Class



A core global fund that focuses on undervalued companies that are initiating or increasing their dividends. Focused on large-cap companies and will usually have an overweight to the U.S. in order to decrease volatility. Active hedging strategies are used to mitigate fluctuations in foreign currencies.

Investment Terminology

Efficient Market Hypothesis (EMH)

EMH essentially says that all known information about investment securities is already factored into the prices of those securities. Therefore, no amount of analysis can give an investor an edge over other investors, known as "the market". EMH does not require that investors be rational; it says that individual investors will act randomly, but as a whole, the market is always "right." In simple terms, "efficient" implies "normal". If a crowd suddenly starts running in one direction, it's normal for you to run in that direction as well, even if there isn't a rational reason for doing so.

Continue Reading

BLOG OF THE MONTH

How To Measure The Proximity To A Market Crash: Introducing SRI

A big crash will make investors realize how badly they need better ways to understand and track risk.

In Institutional markets and policymaking inner circles, we still think we know how and have it all figured out. In a show of hubris, despite the Great Financial Crisis of 2007-2008, the models used for the task are more of the same, variations of what used to be there before the crisis. The Efficient Market Hypotheses ('EMH') still holds, and volatility is still the basic ingredient for most risk management models, considered to be the best available measure of risk. This runs counter to ever—recurring empirical evidence: the EMH has been proven to fall short of explaining real world dynamics, while volatility is a bad predictor of impending chaos on systemic—scale (if anything, as warned by Hyman Minsky, it is its bedrock!)

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

Income Splitting Is A Dangerous Tax Game If You Don't Know The Rules—by Jamie Golombek

Our Income Tax Act has a variety of anti-avoidance rules meant to block attempts at income splitting, but there are exceptions to those rules.

With top marginal tax rates over 50 per cent in seven out of ten provinces, the temptation to shift income from a higher-income family member to a lower-income spouse, partner or child has never been greater. Indeed, the spread between the top rate (over 53 per cent in Ontario) and the lowest rate (as low as 20 per cent in

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DEALING WITH VOLATILITY AND DIVERSIFICATION THROUGH THE USE OF ALTERNATIVE INVESTMENTS.

Over the past eight years, new products and investment styles have emerged that enable the retail investor, usually through a professional advisor, to access markets, asset classes and expertise previously only available to institutional investors. Among these emerging products are liquid alternatives which provide the benefits of holding alternative investments while, at the same time, not requiring the investor to sacrifice liquidity.

Continue Reading

HOLDING TITLE TO U.S. PERSONAL-USE PROPERTY AFTER TRUMP'S TAX CHANGES, by David Altro

President Donald Trump's 2017 Tax Cuts and Jobs Act made many changes to the American tax system, some of which are particularly relevant to Canadian snowbirds who own U.S. real estate. One significant change relates to the U.S. capital gains tax rate for corporations. This rate was 35% prior to the act; as such, we never recommended that snowbirds hold title to U.S. personal-use property in either a U.S. or Canadian corporation. (This article pertains only to U.S. personal-use property, not rental property.)

Continue Reading

RETHINKING ASSET ALLOCATION

Low bond yields, a surge in geopolitical tensions, and a shift towards fiscal stimulus are all fueling a fundamental rethinking by the investment management industry of how to generate the best risk-adjusted returns. Against this backdrop, we have tried to articulate actionable solutions to many of the most complex investment questions that we are increasingly fielding from clients who—like us—use a rigorous, top down approach to asset allocation. An important message, we believe, is that—amidst lower expected returns—the traditional relationship between stocks and bonds is now starting to mean revert after a 20-year hiatus. Continue Reading

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FUND MANAGER COMMENTARY

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CLEMENT GIGNAC
IA CLARINGTON

PHILIP PETURSSON
MANULIFE
INVESTMENTS

NOAH BLACKSTEIN
DYNAMIC MUTUAL
FUNDS

DINA DEGEER
MACKENZIE
BLUEWATER TEAM

Clement Gignac, Chief Economist and Portfolio Manager

I A Clarington

Turbulence in the stock markets

October, which just ended, was marked by a high level of volatility on all stock markets with several indices having recorded corrections of more than 10% during the month. The reference

Continue Reading

Philip Petursson, Chief Investment Strategist

Manulife Investments

What a month! The stock market is saying good riddance to October 2018, as we witnessed trillions of dollars wiped out from global equity markets. Whenever the market experiences a correction of this magnitude, our team goes through our reality check of

Continue Reading

Noah Blackstein, CFA, Vice-President & Senior Portfolio Manager

Dynamic Mutual Funds

As of October 24th, the S&P 500 was down in 18 of the past 25 trading days and so far this has been the worst month for the NASDAQ since 2008. I believe that economic conditions are much better now, than in October 2008, and I don't think we are anywhere near a 2008 type of economic crisis. So what has happened to cause recent market

Continue Reading

Dina DeGeer, Sr. V.P., Portfolio Manager, Head of Bluewater Team

The broad-based equity sell-off that began last week continued to pick up steam, with the S&P 500 down over 6% from its peak, the largest drop since February. We have seen a number of proposed explanations for the decline, none of which individually appear particularly compelling.

As always there is a list of "market worries" which have been cited as the cause of the drop. In particular,the continuing trade conflict between the US and China and the steady tightening of monetary policy by the Federal Reserve. In both cases, there were no major or unexpected developments over the past two weeks; the trade conflict continues to simmer, and the Federal Reserve has continued to communicate that they are on a path of gradual tightening.

Another area of general concern is valuations in certain parts of the US market. The initial days of the downturn clearly involved a rotation from more expensive growth stock to cheaper value stocks. The sell-off has since become broader in nature, with far cheaper (on a multiple basis) markets in Europe and Asia falling as much or more than the US market.

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LINKS

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Ten Year-End Tax-Planning Tips For Investors

For some of us, Halloween means trick-or-treating and jack

DI Premiums, How The Taxation Of Disability Insurance Benefits Works

Many advisors would agree that clients should make sure they

Landing Zone For Rising Interest Rates "Sufficiently Uncertain," Poloz Says

The Bank of Canada will decide on the appropriate pace of the

The Stock Market Winners And Losers From The Midterm Election Results

Wall Street thinks the projected

What Is A Low Volatility Investment?

In times of uncertainty, investors who want low risk along with capital preservation may turn to l

Markets Gain On Both Sides Of The Border In Wake Of U.S. Midterms

North American markets closed higher as health-care stocks

Federal Reserve Keeps Interest Rates The Same, but December Hike Likely

The Federal Reserve opted not to change interest rates

Why You Should Stick With 'Buy And Hold'

Wouldn't it be great if you could insure your portfolio against market volatility and drawdowns

Goldman Sachs: The Economy Needs To Slow Down To Avoid A 'Dangerous Overheating'

October's jobs report shows the

MONTHLY ECONOMIC MONITOR

Based on October's global stock market rout, investor concerns are not isolated to just emerging economies anymore. Investors seem to understand that the escalation in the U.S.—China trade war could have ripple effects across

Global Investment Forum: Autumn 2018

The world economy is in good shape and we expect stock markets to reflect this. Unemployment is falling at the global level and should continue to do so as companies with strong profits continue creating jobs.

Importantly, inflation is a benign influence, residing in what could be described as 'Goldilocks' territory, being neither too high which could require damaging rises in interest rates nor too low to morph into the mortal enemy of economic growth: deflation.

VIDEO LINKS

Stocks To Surge 8 Percent To New Records In Final Two Months Of Year

Bill Stone is banking on a significant stock market turnaround this

Investment Strategist Details "The Thing That Worries Me Most Going Into 2019"

With less than two months left in

Volatile Market 'Nothing To Be Afraid of': Investment Strategist

Brian Levitt, senior investment strategist at Oppenheimer

HSBC Monthly View—November 2018—Willem Sels

We have had an overweight to US equities, as you will know, and we maintain them as the biggest overweight in our model portfolio. And this is in spite of a debate raging out there as to whether—because of the strong rally in the US equity market—US equities have become too expensive relative to other markets, and whether its time to shift into another market.

We do not think this is the case. Firstly, it would e odd to make a change to US equities just before the elections: it would mean that we would have a particular insight in the outcome of this election or that we would think that there is a substantial downside case scenario. And we do not think this is actually the case.

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EDITORIAL COMMENT-CONTINUED

2017 spoiled investors who were becoming accustomed to the extremely low volatility. The last global recession bottomed out in early 2016, only two and a half years ago. I recall how that recession caused global central bankers to freefall into panic and opt for significant monetary easing, which we saw as a beckoning to bulk up on risk assets, thus rebalancing portfolios to severely underweight fixed income assets. Today, we feel we are closer to a mid-stage economic cycle that is merely returning to neutral after being in overdrive for some time.

Current volatility swings are causing angst among investors, but in reality, have become more normalized. I have been very vocal about the effects of the substantial amount of stimulus that has been pumped into global economies, particularly the U.S. I have been convinced that this stimulus has been responsible for creating the longest bull market in history and will keep the cycle going for several more years. Take a look around the world and you will see that every aspect of the global economy continues to grow above potential, which is a very healthy sign.

The inevitable conclusion to strong markets is rising interest rates. These rate increases make bonds less valuable. As the bonds lose value, investors should consider owning more because they act as portfolio insurance during periods of market stress. Although bonds may underperform equities in the current market environment, rising rates may eventually take a bite out of economic growth, so, it makes sense to own some investment assets that are negatively correlated to equity markets.

The U.S. has visibly shown the most progress in its recovery since 2008. As it approaches full capacity and inflation targets are exceeded, the U.S. Federal Reserve is tasked with trying to control rising costs. The Fed has become the most aggressive central bank globally when it comes to monetary tightening and removing stimulus. As a result of the rate increases, yields offered in the U.S. have become more compelling when compared with their global counterparts and this has led to a flow of capital into the U.S. market, consequently raising the value of the U.S. dollar.

This has very detrimental repercussions for Emerging countries as many of them fund their debt in U.S. dollars and, as the dollar appreciates, it makes it more difficult for these countries to service their debt. I still vividly recall the “Asian Contagion” in 1997 that was triggered by the devaluation of the Thai Baht after the Thai government was forced to float the baht due to lack of foreign currency to support its currency peg to the U.S. dollar.

Populism seems to be a fad taking over the world. This should be a concern to capital markets. Populists share a number of traits that are not market friendly. They generally have an aversion to globalization, a mistrust of markets and a dislike for institutions that are vital to maintaining the rule of law.

Many investors believe that China’s shrinking economy can be blamed on recent trade disputes with the U.S. I proffer an alternative theory. Though trade issues do not help the problem, I believe it has more to do with the tightening fiscal policies it has had in place over the last couple of years to address excessive leverage issues and avoid creating a debt bubble. I also believe that China has the tools and the capabilities to manage fiscal tightening while avoiding a hard landing.

As geo-politics and the investment cycle drive oil price recovery, Canada may be left in the dust. The energy sector is looking more positive than it has in years as significant geopolitical issues have taken supply offline and OPEC has very little spare capacity to increase production. This has led to higher oil prices. The problem is that stock prices have not been keeping pace, especially in Canada. The problem is that Federal and Provincial governments have been less than friendly to oil companies. Fortunately, government administrations come and go and as changes occur on the political front, investors are keeping an eye on the attractive valuations. There have been several positive announcements recently like Shell’s $40 billion infrastructure investment project.

Although the landscape may not be as negative as some pundits would have us believe, there are issues that need to be watched very carefully.

EDITORIAL COMMENT-CONTINUED

We are maintaining a vigil on any acceleration in the populist movement over the next few years, especially when it impacts policy and likely accelerates the rate of de-globalization. We are especially wary of European parliamentary elections coming in the Spring of 2019 as populist parties are gearing up to become a dominant player in a bid to stymie further European integration.

Although I believe it will be averted, a full-blown trade war between China and the U.S. would be a major concern, especially if President Trump follows through on his threat to raise tariffs to 25% while adding another $200 billion of Chinese imports to the list of goods eligible for tariffs.

There is no doubt that the world is moving to some form of de-globalization – the pace of which will dictate market direction. Navigating portfolio investments at the later stages of the cycle is challenging but can be an amazing opportunity for skilled active fund managers. Our focus will continue to be to isolate these elite fund managers.

Dina DeGeer, Mackenzie Bluewater Team—CONTINUED

From an economic perspective, leading indicators remain solid and the more cyclical areas of the economy continue to expand. In terms of overall market valuations, relative to expected earnings and cashflows, the markets are within normal historical ranges. As always during a downturn we will look to add to positions or initiate new holdings when we feel that valuations are attractive.

Mid cap growth

Clients have been increasingly asking us where we are in the market cycle; they are worried and concerned and perhaps anticipating troubles ahead. Valuations for growth companies have been moving higher making it a very challenging environment for growth investors.

There have been some warning signs that high valuations may eventually be impacted by forward guidance, for example, the growth estimates for the Semiconductor sub-sector were recently revised downwards and ultimately impacted stock prices. The selling we saw this week 'felt' indiscriminate and broad-based; perhaps quantitative and ETF investments are driving some of this selling. The Fed has hiked interest rates 8 times in the US since late 2015 so some of the churn in the market may also be related to a repricing of assets. We have spent the last two and half years reducing the beta and cyclicality of our Fund in anticipation of the eventual end of this

economic cycle. We have also, as always, trimmed or sold positions were shares have become significantly overvalued relative to our models. We own high quality, secular growth businesses and whether the market is currently signalling the end of the bull market or not, we have tried to prepare for the eventual downturn.

Multi asset strategies team

Recent equity volatility appears to start from the bond market. Real yields are rising while inflation expectations have been essentially flat.

This is very significant because it captures two things:

1) the better-than-expected growth of the U.S. economy

2) a re-appraisal of prospects for Fed tightening, with more likely to take place.

A number of asset prices around the world, including equities, were priced off lower for longer rates. This assumption is now being challenged, so it's a bit of a shock for markets. In addition, trade tensions are not helping in terms of market sentiment: markets are spooked by any negative news about the prospects for U.S./China tensions. However, the economy isn't rolling over just yet. Some slowdown is likely in 2019 Q1-Q2 from this year's fiscal stimulus, but things remain robust overall. Recession signs are minimal (if at all present) right now.

Multi-Asset Strategies Team positioning:

We have been neutral on equities since March. The recent market turmoil has moved our position to slightly underweight equities and we are keeping a closer eye on how the markets develop. Should markets continue to collapse, we will be adjusting our positions accordingly.

Our largest view currently is underweight bonds relative to cash. This view is generated by our poor assessment of value across the fixed income markets and our macro views, which suggest growing inflationary pressures, a negative factor for bonds.

Our models of investor sentiment are also negative for the asset class. The gradual flattening of the yield curve in the U.S. and Canada is decreasing the relative appeal of longer term government bonds versus cash.

Within equities, we view the overall dispersion of opportunities at the regional equity level as remaining low, as we see the relative attractiveness of various equity markets (U.S., Canada, Europe and EM) as being similar. However, we do think that U.K. equities appear cheap relative to other global markets. U.K. dividend yields look particularly high relative to other equity markets — as well as relative to the U.K.'s own bond market. Valuations are low in relative and absolute terms, as Brexit risks are embedded in stock prices. The U.K.'s weak currency is also a boon to the earnings of the multinational corporations included in U.K. indices.

We are also overweight Japan, which has seen an improvement in macro conditions. Moreover, our models of investor sentiment point to a positive shift in Japan. The country's easy monetary policy contrasts with other developed central banks, which are removing accommodation. Within currencies, we are currently overweight the U.S. dollar relative to the basket of currencies. The strong comparative performance of the U.S. economy relative to Europe and emerging markets suggests to us that a hawkish Fed will continue to provide support to the U.S. dollar.

Dina DeGeer, Mackenzie Bluewater Team—CONTINUED

At the other end of the spectrum, we are underweight the euro relative to the basket. We think that several issues will prevent the European Central Bank from normalizing interest rates in the near term. The recent budget issues in Italy underscore economic difficulties in the Eurozone periphery, which continue to weigh on the prospect for monetary policy normalization. Our sentiment readings on the euro are also negative.

Fixed income

Market volatility has increased this week due to a number of themes coming together: specifically, a repricing of rates, an uptick in the US– China trade rhetoric and higher global oil prices.

Last week's repricing of rates was key to this week's volatility, especially the move in the US Treasury curve. Although yields have been rising since late August with markets catching up to the Fed's more hawkish narrative the 10-year note never materially held above 3%. Last week, however, 10-year US Treasury yields spiked nearly 20 basis points and traded above 3.25% for the firm time this cycle – thanks in part to Fed Chairman Powell's upbeat comments on the US economy and distance from the so-called "neutral rate" - tightening global credit conditions and breaching significant technical levels in the process.

On trade, the escalation and war-of-words between both the US and China suggest both sides continue to dig in for the long-haul, which we are measuring in quarters, years or more and not months. Beyond the headline trade deficit with the US, there are fundamental differences for how each side wants to resolve the issue that remain incredibly complex, with the US insistence that China dismantle its 2025 industrial and high-tech initiatives a key sticking point which we believe China will never agree to.

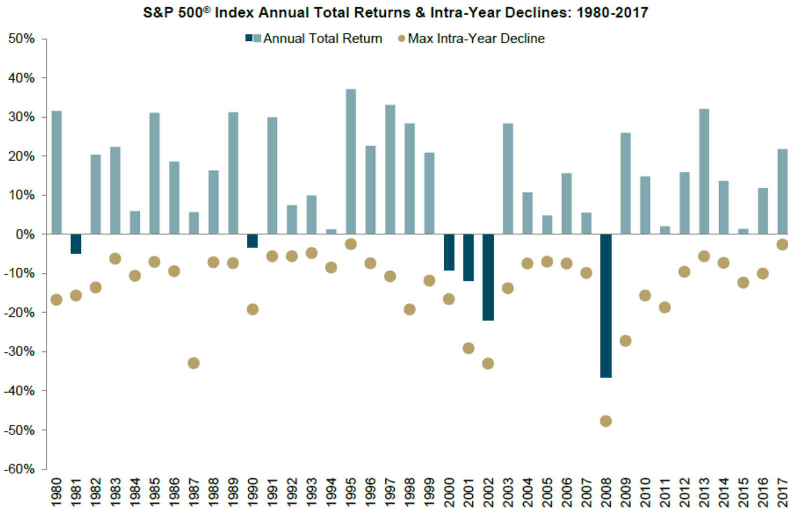
Additionally, the US administration has been more forceful about China's currency in recent weeks.

Higher oil prices, meanwhile, continue to stoke possible global inflationary fears with Brent – the global benchmark – trading above $85/ barrel last week on ongoing supply concerns thanks in part to US sanctions against Iran but also due to Venezuelan and Libyan barrels coming out of the market. Despite US pleas for more OPEC supply, there is very little capacity left in the (OPEC) system to squeeze out more barrels in the near-term and as a result there is now more talk of possibly seeing $100 / barrel in Brent before year-end. Although higher energy prices should be seen by central banks as a transitory inflation factor, the concern is the Fed might need to raise rates slightly more than currently priced by the market thanks to rising oil and higher import prices due to the China tariffs. But the Fed – even though it does not like to say so publicly – is sensitive to larger market corrections and will be aware of any material sell-off in emerging market or riskier assets, adjusting its policy outlook accordingly in order to mitigate any significant tightening in global financial conditions.

Market Volatility is Normal: Staying the Course is Critical - CONTINUED

Over this same period, on average, the largest drop in price from peak to trough for the index in any given year has been 13%. In other words, **intra-year declines of**

Intra-year decline is the difference between the highest and lowest point in the market during that year



more than 10% are quite normal.

Despite declines, markets recover and post gains. While declines of 10% or more are normal, **the average annual calendar year gain has been roughly 13% per year,** including re-invested dividends.

Past performance is no guarantee of future results. It is not possible to invest directly in an index. Returns are based on index price appreciation and dividends. Intra-year declines refer to the largest index drop from a peak to a trough during the year. Not intended to represent the performance of any Fidelity fund or strategy. For illustrative purposes only. Data as of 12/31/2017.Source: Standard & Poor's, Bloomberg.

The Pre-Retirement Assessment (PRA) 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).

Over the next five months I will highlight one of the above themes using real examples from plans I've created. This month I'll examine the more common theme I've come across of House Rich and Cash Poor.

In this theme the Net Worth forecast looks good (see figure 1) but the Income Assets forecast show a shortfall (see figure 2). This means a person is building wealth in the value of their "things" such as a home or cottage but are not building enough into income producing assets such as RRSPs or TFSAs. In other words, maintaining their lifestyle in retirement will not be possible under the current circumstance.

NET WORTH FORECAST

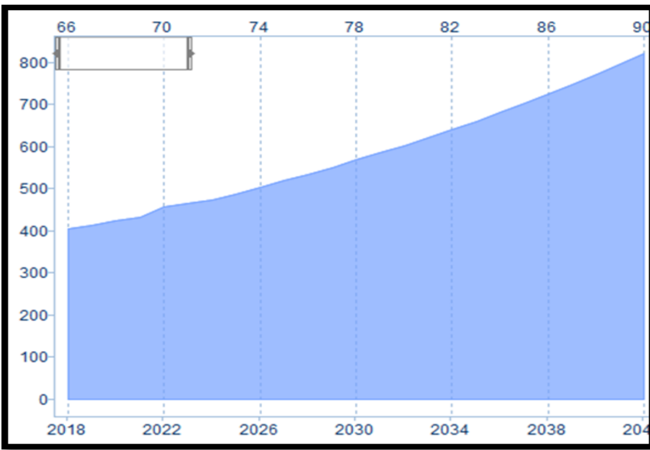


Figure 1: This client's net worth increases over time with the value of the home

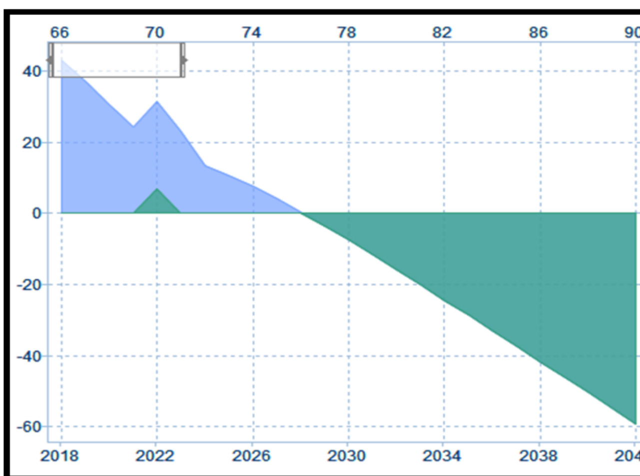


Figure 2: This same client's Income Assets decline over time (blue area of graph) and will not support the current lifestyle beyond age 75

Fortunately, there are solutions to this theme. Besides the tax-reduction tactics, effective tactics depend on the individual. For example, some people will be receptive to converting wealth by downsizing their home. In the case illustrated in figures 1 and 2, this client's home has a projected value of $582,535 at their desired retirement age, making up the majority of their net worth.

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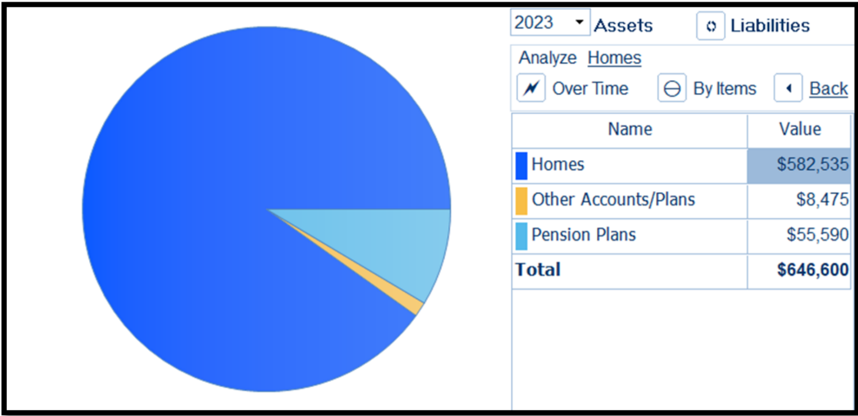
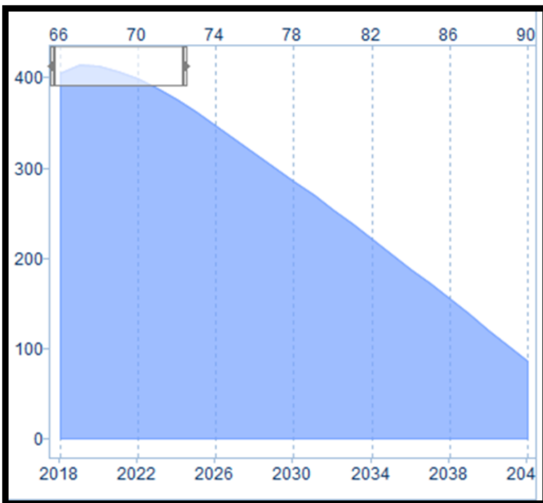
The Pre-Retirement Assessment (PRA) Series—Continued.



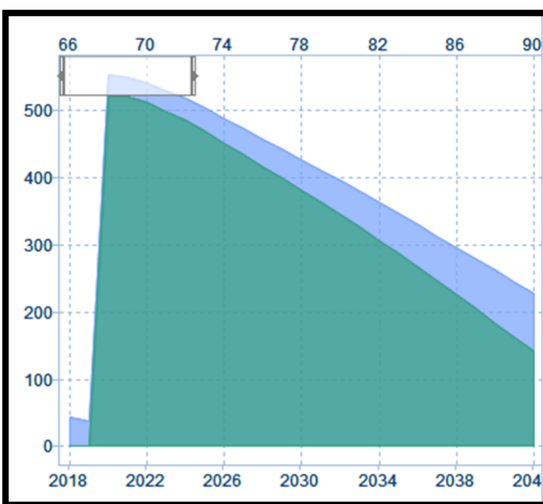
As a recommendation prior to retirement, this person could downsize to a condo or apartment. In which case, their living expenses will be about the same when factoring in rent, condo fees, or utilities but they will have the additional cash from the sale of the home to fund other lifestyle needs.

Since the client has converted the home to an income asset in the form of cash, Net Worth will decline to fund current lifestyle needs.

NET WORTH FORECAST AFTER SELLING HOME



INCOME ASSET FORECAST AFTER SELLING HOME



However, despite the decline in net worth, which is logical given the client is now using that money to fund their lifestyle, this client maintains enough income assets well into their nineties. Ultimately, applying this tactic has a “high-leverage” impact for this client and will solve the entire Income Assets shortfall!

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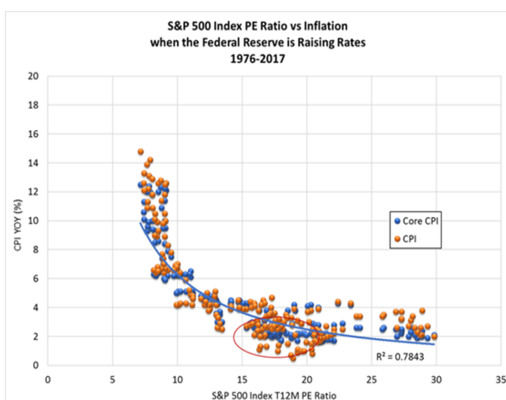
Philip Petursson, Commentary continued

Fundamentals, Earnings and Valuations to determine whether there has been a change to our thesis. After this recent exercise, our view has not changed materially since September as we outlined in our School's Back In Session Investment note. From a fundamental perspective, the risk of recession in the United States has not changed. Although the fundamentals have weakened in Europe and Asia, recession risks remain low. We are early in the earnings season in the US and growth remains strong and if anything, valuations have become more attractive due to the sell-off. So what do we believe are the reasons for the sharp sell-off?

1. **Tighter Financial Conditions:** The market begun to adjust to the backdrop of tighter financial conditions with US Federal Reserve Chairman Jerome Powell's more hawkish comments on October 3rd stating that the Federal Reserve was likely to continue to raise interest rates until the unemployment rate stabilizes. As highlighted by the chart below, there is a very strong relationship between higher inflation (thus higher interest rates) and multiple contractions. Therefore, it didn't surprise us when the markets sold off as the 10-year Treasury yield hit 3.25%. We had been discussing this outcome since the early part of the year (reference: March 2018 Monthly). Markets perhaps were caught off guard by the velocity though.



2. **Peak Global Growth:** This earnings season there is fears of "peak global growth" amidst rising rates + slowing earnings per share (EPS) + falling margins.

3. **Margin Pressure:** Can companies maintain margins in the face of four forces (higher wages + higher interest costs + higher commodity prices + tariffs) which is driving higher input costs?

4. **Slowing Chinese Economy:** While the Chinese economy is slowing, and it is having an impact on international economies, we believe that this will be short lived as China is using multiple levers to protect the economy from further downside. China's fiscal deficit a year and a half ago was 4.3% of GDP, today it is 3.4% with a worsening economic backdrop, the government has expressed a desire to lower taxes and increase spending. For example, China will reduce its personal tax rate for 75% of its population by 50%. It is also looking to reduce its corporate tax rate. We believe these measures will help their economy moving forward similar to the policies enacted in early 2016.

5. **Stronger US Dollar:** An apparent flight to quality to USD, has put pressure on US multinationals, as their earnings are negatively impacted when foreign profits are converted back to USD. In addition it has hurt emerging market equities and debt, as many costs for emerging market companies are priced in USD.

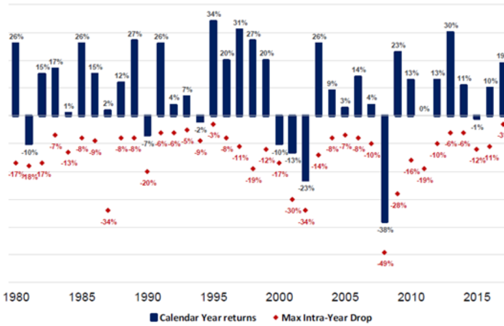
Due to tighter financial conditions, slower global growth, margin pressure, and stronger US dollar the market is adjusting to reflect that both earnings expectations and valuations were too high. We are in a period of transition where we are determining what is the real estimate for 2019 and what multiple do you want to apply in an environment where economic growth is rolling over, interest rates are rising, and earnings growth is slowing.

With recessions risks low and the US Federal Reserve proceeding at a reasonable pace relative to inflation, there is likely limited significant downside risks from here. We believe that markets are going through an exercise of repricing risk in the context of a late stage secular bull and economic cycle. Given all this, we believe that absent exogenous global downside shocks (a sustained trade war between the United States and China), we would put the probability of recession in the next twelve months below 20% . Slowing growth rates are NOT a "recession" but do point to lower returns going forward.. By most metrics, like the percentage of stocks trading above their 50-day moving average and Relative Strength Indicators, the S&P is oversold, along with many international equity markets.

Clement Gignac, Commentary continued

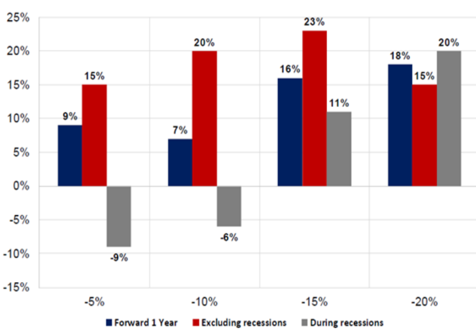
Indices of Bay Street (S&P/TSX) and Wall Street (S&P 500) fell by 6.5% and 6.9% respectively, eliminating in the latter case almost all gains collected since the beginning of the year.

This is the second time this year that the U.S. stock market is in "correction mode", which is defined by a decline of more than 10% since its most recent peak. Although painful for some investors, such volatility is not abnormal on a historical basis. As can be seen in the chart below, we can have a successful year on the stock market in terms of returns, even with intra-year reversals that exceed 20%.



The anomaly was rather the absence of volatility that prevailed on the stock markets from mid-2016 to January 2018. For example, for all of 2017, the worst decline was limited to 3%, a situation last observed more than twenty years ago.

In our opinion, this type of correction may represent a buying opportunity for investors with a medium to long-term horizon, as the likelihood of the North American economy falling into recession is low. Based on historical data, returns recorded during the 12 months following a stock market correction can be very interesting in the context of an extended economic cycle (see chart below).



Investors suddenly worried about interest rate normalization and trade tensions

While we are likely to see a slowdown in economic growth in coming quarters, as the effects of tax reform begin to ease, there is every indication that the world's largest economy will continue to perform well. Leading indicators still do not signal that a recession is upon us.

In fact, one of the pillars of our strategy is the fact that, in the past, the end of all bull markets has generally coincided with the beginning of a recession. For the moment, almost all leading economic indicators signal that the economic cycle should continue for a few more years: business and household confidence is high, the labour market is creating close to 200,000 jobs per month on average, and wage growth is well established, pushing household income up, to name just a few.

Other financial indicators also suggest that the current episode of volatility is limited to a revaluation of stock markets. We note that corporate credit spreads remain narrow, government interest rates have not fallen sharply and the U.S. dollar has not strengthened significantly (three typical symptoms of a concern about the longevity of the business cycle).

The observed return of volatility is probably more related to the tightening cycle of monetary policy in North America.

When the Fed raises its key rate, there are usually two phenomena: 1) volatility in the markets increases and 2) the valuation of the stock markets, as measured by the price-to-earnings ratio, contracts (i.e.: investors are willing to pay less to invest in the markets, despite corporate earnings growth that remains positive).

Another element that has added to prevailing uncertainty is the Trump administration's decision to bring its trade war agenda to the forefront.

Clement Gignac, Commentary continued

Let's keep in mind that the trade relationship between China and the U.S. accounts for only 3% and 1% of their respective economies. According to Oxford Economics, even in the worst case scenario, the impact of massive tariffs between China and the U.S. is expected to be limited to about 1% of the global GDP, an impact certainly significant but not enough to lead the global economy into recession.

How To Navigate The Current Markets

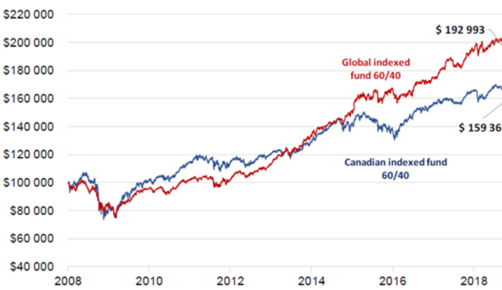
The upward trend in interest rates makes the October market correction more significant than usual for investors with a balanced investment strategy (60% in equities and 40% in bonds). Contrary to their typical behavior, bonds did not come to the rescue this time around thanks to Fed Chair Jerome Powell's early October declaration that he intended to continue the standardization of interest rates. Thus, a Canadian balanced index fund (60% in equities and 40% in bonds) suffered from negative returns in October 2018, which ranks among the four most disappointing months since January 2008.

Worst monthly returns* for a Canadian balanced strategy (60/40) since January 2008	%	Worst monthly returns* for a global balanced strategy (60/40) since January 2008	%
October 2008	-10.34%	September 2008	-8.02%
September 2008	-9.45%	October 2008	-5.90%
September 2011	-4.47%	January 2009	-4.65%
October 2018	**-4.01%**	February 2009	-4.43%
February 2009	-3.51%	June 2008	-3.76%
July 2008	-3.15%	May 2010	-3.65%
June 2008	-3.06%	**October 2018**	**-3.65%**

* Total returns. Source: iAIM.

A second observation is that in the long term, it is always more profitable to remain invested in the markets than to panic during stock market corrections. The performance of such strategies since the beginning of the current economic cycle remains acceptable (see graph below).

Evolution of a balanced portfolio since January 2008
Canadian and global 60/40 portfolios, January 2008 = $ 100 000*



* Portfolios composed of 60% equities and 40% bonds. Canadian funds constructed with S&P/TSX Composite Index and FTSE TMX Canada Universe Bond Index. Global funds constructed with MSCI ACWI Index (CAD) and Barclays Global Aggregate Index (Hedged CAD). Gross total returns.

Sources: iAIM, Bloomberg

We continue to anticipate that the bull market will continue over the next 12 to 18 months but that a volatility more aligned with historical experience would become the norm.

In conclusion, although it is always difficult to anticipate the turning points of economic and stock market cycles, we believe that there is still enough gas in the tank to make this recent decline a buying opportunity for investors with medium and long term investment horizons.

Noah Blackstein, Commentary continued

declines? On October 3rd of this year, Jerome Powell, Chair of the Federal Reserve, gave a speech and said that not only was the Fed going to keep hiking rates for some time, he also said that they would go well above the neutral rate, and that has been re-iterated by several Fed Governors. I don't think the market was expecting that . The factors that would cause me to sell a stock in any situation remain the same today as when I began managing Dynamic Power American Fund: Something has changed with the underlying fundamentals or the long-term growth aspects of a company. Historically 90%+ of the returns of my Funds has been due to stock selection and I continue to focus on bottom-up stock selection and where the best opportunities for secular growth are. Many of the biggest YTD winners have been hit the hardest in October.

Global markets have been significantly detached from the U.S. markets in terms of how they have been hit. For example you can look at where the German or Chinese markets are trading today; to see that Global Markets have been under great pressure this year.

Interest rate increases are not the only reason for what's going on in the markets. Tariffs are coming up in more U.S. CEO conversations. In China, most investors attribute market weakness to the tariff war but significant changes to regulations since the spring have become extremely restrictive. These regulatory changes include approvals of new video games, after-school regulations, and the pharmaceutical industry where the government wants to cut drug prices by 40+%. This has slammed the drug sector in China as the government threatened to import cheaper Indian generic drugs if they have to. There have been a whole host of other regulatory changes besides these. In the U.S. you have had the offset of tax cuts and regulatory easement, but you haven't had the offset in China.

Can these market declines provide an opportunity? From my perspective, for the companies where nothing has fundamentally changed this is an opportunity. If something has fundamentally changed with a company, then it is an opportunity to look elsewhere.

Going through an October 2018—type of market is gut-wrenching. During my 25 year career I have seen many of these types of periods in the markets. They are never easy and never fun. But the lesson learned managing through some of the great bear markets of all time, is to continue to focus on my investment process. Great growth companies always lead us out and up.

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