

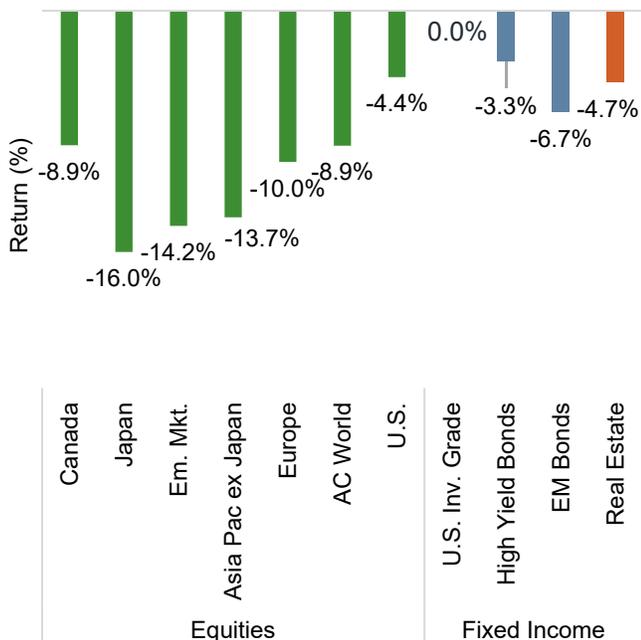
Summary

Canadian equities declined in 2018 and underperformed their global peers in Canadian dollar terms. U.S. equities also corrected as the risk of slowing pace of economic expansion, higher interest rates and weaker corporate earnings growth dampened investor confidence. Global equities were mostly worse off, while fixed income and real estate indices edged lower. The China-U.S. trade dispute and the end of the quantitative easing program in most of the developed market economies were among the most prominent factors driving a change in global investor sentiment.

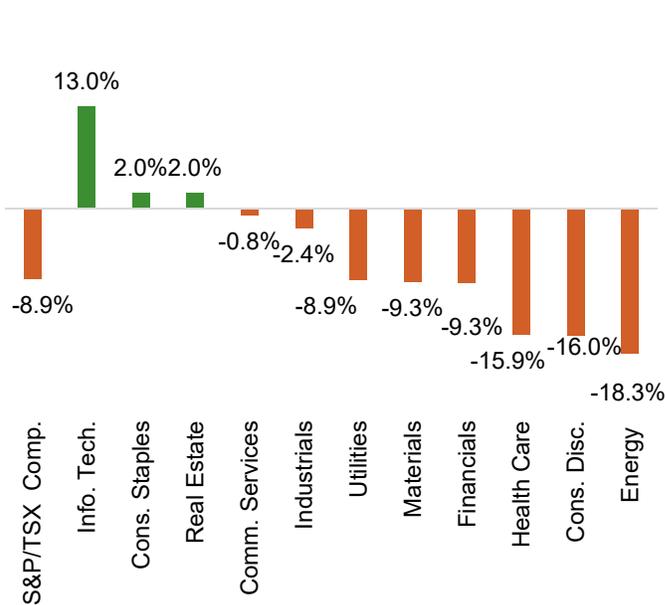
In fixed income markets, the difference in yields between the long- and short-term government bonds narrowed, reflecting concerns about lower economic growth and inflation in the longer-term. Among central banks, the US Federal Reserve (Fed) raised interest rates four times through the year and indicated that it would likely announce two more rate hikes in 2019. The European Central Bank (ECB) announced the end of its asset purchase program, while the Bank of Japan (BoJ) decided to continue its financial support program to support growth and push inflation expectations higher.

Emerging markets and Asian equities fell sharply. The combined effect of rising trade tensions, weaker demand from leading export destinations, the rise and the subsequent fall in oil prices, and tightening global financial conditions contributed to a rapid contraction in many countries. A stronger dollar also added to emerging market woes, making it harder to repay dollar denominated debt. European equity and fixed income markets also ended in negative territory.

Most markets and asset classes declined.

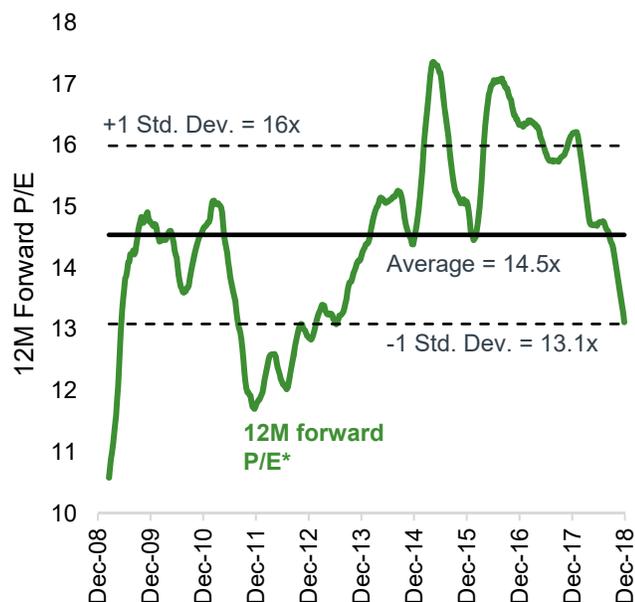


In Canada, energy producers declined sharply.



Source: Thomson Reuters DataStream. MSCI Indexes for all regions and countries, except S&P 500 Index for the U.S. Index and S&P/TSX Composite Index for the Canada Index. Returns are in U.S. dollars, except for Canada, Japan and European Indexes, which are in local currency terms. All returns are total returns.

Canadian equity market valuations fell...



Source: Thomson Reuters DataStream, *12 week moving average, December 26, 2018.

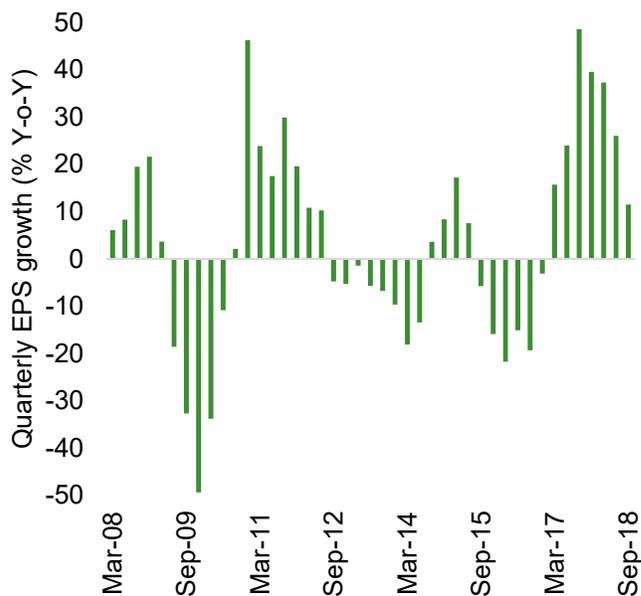
Canadian equities fell behind most of their global peers (in Canadian dollar terms), as earnings expectations eased, while the fall in oil prices and prospects of slowing global growth dampened investor confidence.

Most sectors declined, with energy producers leading the fall. While this was partly due to the fall in global oil prices, the absence of a pipeline infrastructure in Canada also contributed to the loss. The absence of infrastructure raises costs and leads to a build-up of inventory, which in turn contributes to a deep discount to oil produced in the U.S.

Generally, sectors which tend to be most significantly impacted by the business cycle, such as consumer discretionary, materials and financials underperformed the broader index. Companies such as Dollarama, a retailer, declined in view of rising competitive pressure and risk of slowing consumption growth.

Conversely, the information technology (IT) and consumer staples sector ended in positive territory. In the IT sector, e-commerce platform operator Shopify and IT services provider Constellation Software were among prominent gainers.

...as earnings growth rates moderated.

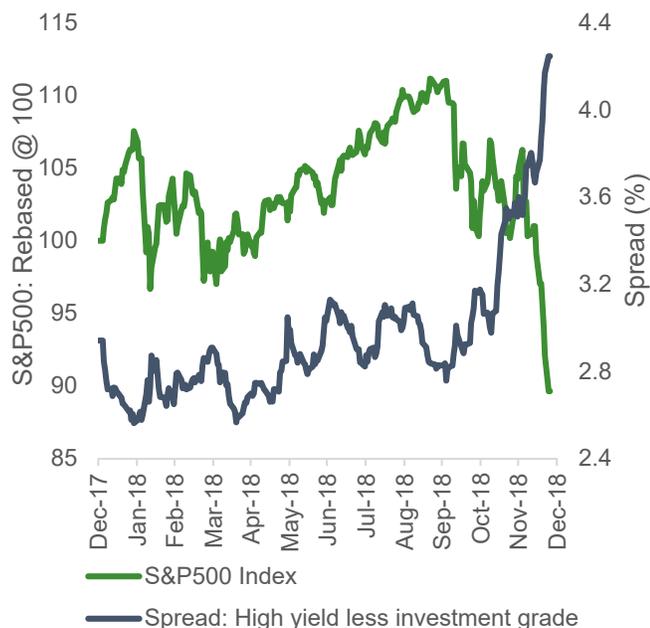


Source: FactSet, December 31, 2018.

Meanwhile, the Canadian economy expanded in line with expectations despite uncertainty due to the end of the North American Free Trade Agreement (NAFTA), which underpinned trade relations with the U.S.. The new U.S.-Mexico-Canada Agreement (USMCA) is expected to reduce trade policy uncertainty in North America.

The Winter Business Outlook Survey (BOS) continued to report strong sales, solid capex intentions, and significant capacity constraints, but also emphasized the weak outlook of firms in the oil-producing Prairie provinces. Thanks to solid employment growth and rising income, the Bank of Canada expects household spending to grow at a steady pace. Nevertheless, higher interest rates and housing market policies is likely to result in moderating credit growth and impact housing activity.

U.S. equities declined; credit spreads widened.



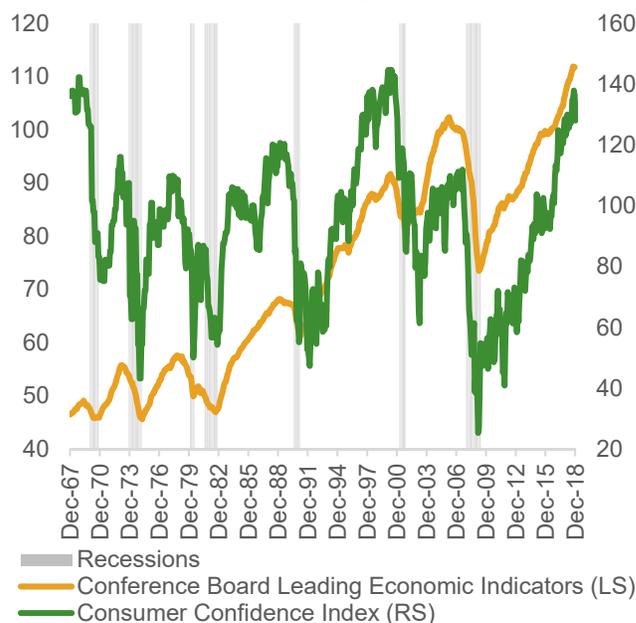
Source: Thomson Reuters DataStream, December 31, 2018.

The announcement of a reduction in corporate tax rates, better-than-expected corporate earnings, and higher fiscal spending which fueled growth in the U.S. economy, buoyed investor confidence. After-tax profits rose a robust 16% at the end of September 2018, thanks to the sharp cut in corporate tax rates.

However, sentiment turned in September, when the trade-war between the U.S. and China escalated, the U.S. dollar strengthened and global growth outlook weakened. Additionally, risk that higher interest rates would add to pressure on corporate and household balance sheet, impacting capital expenditure and consumer spending, also hampered investor confidence.

The U.S. Federal Reserve further reduced its balance sheet – selling assets that it acquired in the course of its quantitative easing program – contributing to a fall in liquidity. After an unprecedented post-crisis period of global monetary easing, the reduction of liquidity challenged demand for less liquid assets, such as high-yield bonds and emerging-market securities, potentially contributing to elevated asset-market volatility.

U.S. economy on solid footing



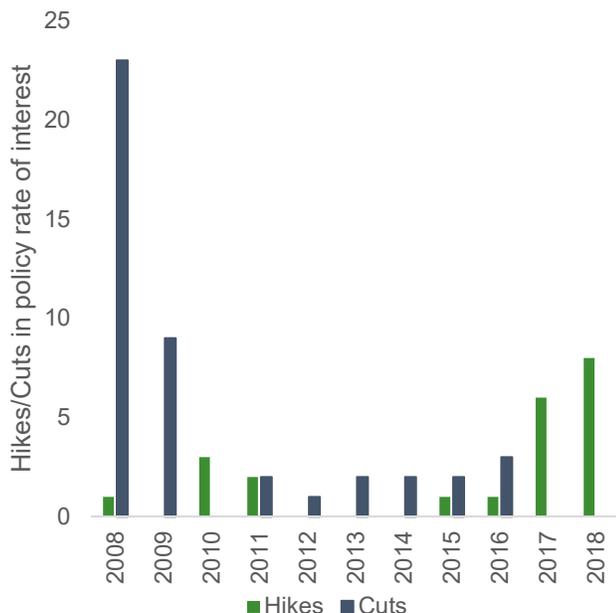
Source: Thomson Reuters DataStream, December 15, 2018.

A flattening yield curve – which refers to the narrowing difference between the interest earned from short and long-term bonds – and falling demand for loans due to higher interest rates contributed to the weakness in the financials sector. Meanwhile, the technology sector came under pressure as the risk of increased regulatory scrutiny and decreased earnings expectations weighed on investor confidence, compressing valuation multiples - as measured by the price-to-earnings ratio.

A rapid expansion of the U.S. economy and falling unemployment prompted fears of a rise in inflation and contributed periodically to a rise in treasury bond yields. However, yield on treasury notes declined in the final months of the year as risks to global growth increased.

Given solid employment growth and rising income levels, U.S. consumer confidence remains strong. Leading economic indicators also continue to support optimism about the U.S. economy.

Global monetary policy tightened in 2018.*



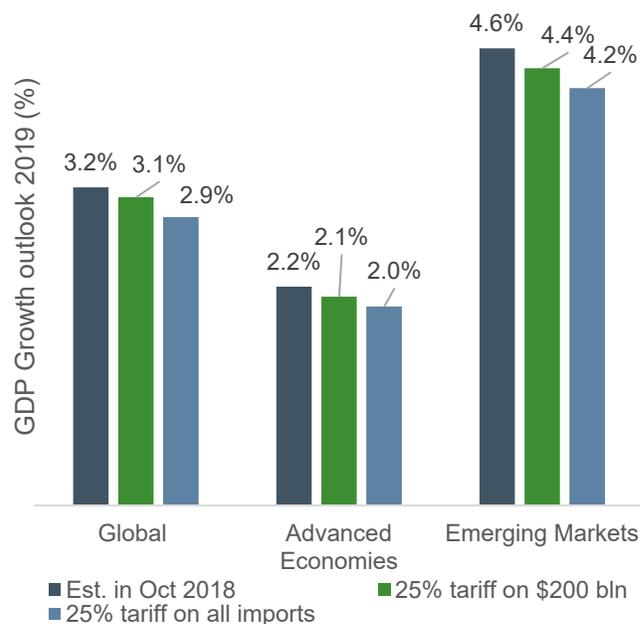
*Central banks include Bank of Japan, European Central Bank, Federal Reserve, Bank of England and the Bank of Canada, December 2018.

Optimism about global growth at the beginning of the year faded as the U.S. administration announced a series of tariffs on imports, triggering retaliatory measures by governments in Europe and from China among others.

Trade tensions escalated in September after the U.S. President directed the office of the U.S. Trade Representative to impose tariffs on roughly \$200bn of Chinese imports. Among countermeasures, Chinese policymakers introduced reflationary policies to mitigate the impact on exports. Later in the year, China and U.S. agreed to a 90-day truce to negotiate a potential resolution to the dispute. Within China, efforts to reduce excess debt in the financial system also played a role in financial market weakness.

A stronger dollar and a banking crisis in Turkey weighed on emerging markets with current account deficits and high levels of foreign currency debt. In Europe, the election of a Eurosceptic government in Italy raised fears about the stability of the eurozone, which was already shaken by Brexit. Italian bond yields spiralled higher as investors grew concerned about the new government's spending plans.

Trade tensions affected global economic outlook.



Source: Citi Research, December 3, 2018.

Oil and commodity prices fell sharply due to expectations of slowing global economic growth and rising supply. While energy importing countries such as India benefited from the fall in oil prices, energy exporters and producers came under selling pressure.

European financials underperformed due to a combination of contagion risks and stock-specific factors, reflecting a broader deterioration in the outlook for growth. Elsewhere, consumer discretionary was the worst performing sector in the Asia Pacific ex Japan region.

Largely as a result of the sharp sell-off in the second half of 2018, Asia Pacific ex Japan and Emerging Market equities are now trading at a steep discount to developed market valuations, in terms of price-to-forward earnings expectations. Meanwhile, economic growth prospects, while relatively moderate, remain elevated thanks to solid economic fundamentals and favourable demographics.

Year in spotlight

Attempting to time the market can be costly

Research studies show that the decisions investors make about when to buy and sell funds cause those investors to perform worse than they would have had the investors simply bought and held the same funds. If you could avoid the bad days and invest during the good ones, it would be great—the problem is, it is impossible to consistently predict when those good and bad days will happen. Since the best days often follow the worst ones, it is advisable for investors to remain fully invested and not react to market up and downs.

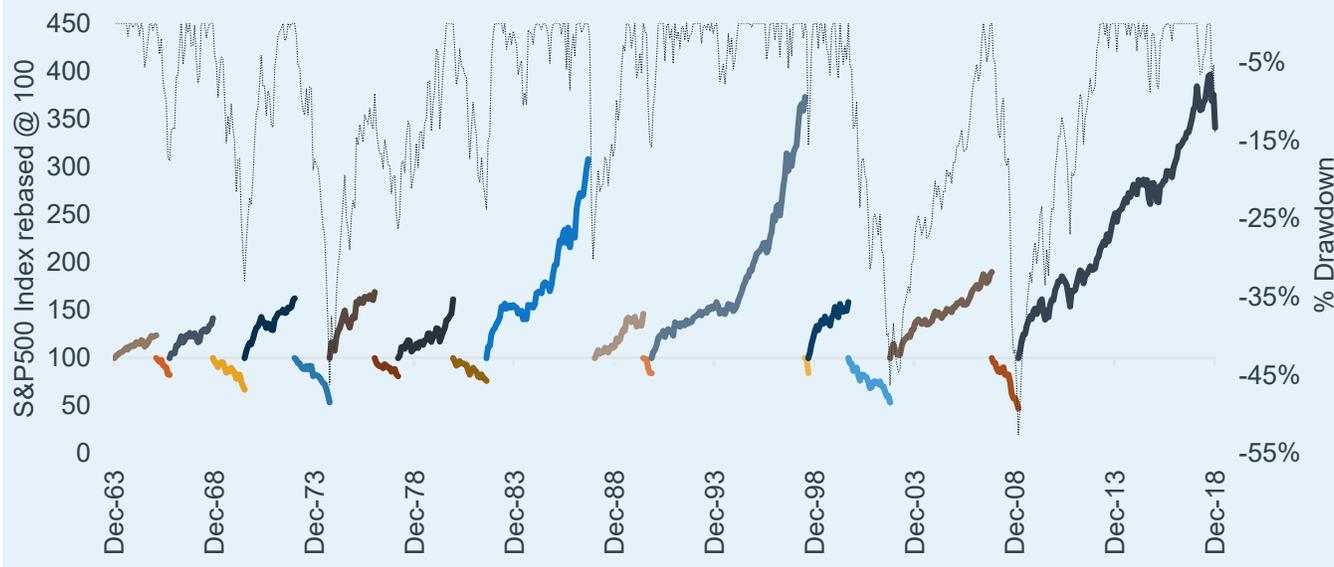
S&P 500 COMPOSITE RETURNS AND THE GROWTH OF \$10,000 FROM 1989 TO 2018



Source: Thomson Reuters DataStream. Total return. Data ranges from December 31 1989 to 31 December 2018. Past performance is no guarantee of future results.

Market drawdowns are often short-lived

The current bull market rally has become the longest one on record, by avoiding a 15% or more decline. Since 1963, bull markets have – on average – lasted for 62 months, delivering an attractive return of 106.8%. Conversely, drawdowns of greater than 15% have lasted for around 14 months, declining by 29% on average. While past performance is no guarantee of future results, history suggests that staying invested may prove to be a far more rewarding strategy than predicting the global economic trajectory or the future of financial markets.



Source: Thomson Reuters DataStream. Price return. Data ranges from December 31, 1963 to December 31, 2018. Past performance is no guarantee of future results.

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