Quarterly Market Commentary – Quarter Ended September 30, 2017

Overview

The third quarter of 2017 was another strong quarter across equity markets as ongoing global growth and solid corporate earnings along with low unemployment (particularly in North America) have led to continued consumer confidence. Overall, the markets have experienced very little volatility and both US and International equity markets have moved ahead the past 12 months largely unimpeded despite increasing tensions between the US and North Korea, ongoing political struggles in the US and a significantly damaging hurricane season. As an illustration of the stability of the market over that period, the US equity market (as measured by the S&P500 in USD) has not experienced one decline of greater than 3% over the last year leading to a one year return of 18.6%. The Canadian equity market has participated in much of this upward trend and had a solid return of 3.7% in the third quarter. However, a decline of 1.6% in the second quarter has held the Canadian equity index to a return of 9.2% as compared to the double digit returns in the foreign equity markets over the past year. While the global equity markets have enjoyed this continued forward momentum, returns for Canadian investors have been muted somewhat over the past two quarters by a rapid rebound in the Canadian dollar, particularly against the US dollar (12% swing from May to September), but also against the UK pound sterling and the Japanese yen. In the third quarter, this strong currency effect reduced the MSCI World (global equity) market return from 3.9% in local currencies to 0.8% in Canadian dollars. The primary driver behind the strong gains in the Canadian dollar over the past several months has been the Bank of Canada's decision to increase interest rates twice in the third quarter (first increase since September 2010) in light of the strong data generated by the Canadian economy and the continued bullish outlook for the economy going forward. This, of course, had a negative impact on the Canadian fixed income market resulting in a decline of 1.8% for the last quarter. Canada's monetary policy tightening has not occurred in isolation, as many central bankers around the globe have suggested removal of their monetary policy stimulus currently in place. The US Federal Reserve announced "quantitative tightening" and may raise rates again this year, the European Central Bank is likely to slow down the pace of repurchases in their QE program, and the Bank of England has even hinted at tightening in the coming months.

Global Equity (in local currency terms unless noted otherwise)

The global equity market generated a solid positive return for the sixth consecutive quarter but, as noted above, this strong return was reduced significantly by the strong Canadian dollar. With the exception of the last two quarters of 2016 in which international stocks outperformed, it has been the US equity component that continues to lead the index forward and it repeated again in the third quarter. During this period, economically sensitive (cyclical) stocks and sectors have earned much greater returns than defensive sectors and as a result, growth stocks outperformed value stocks. This outperformance has been by a wide margin thus far in 2017 (20.3% versus 12.0%) led by the US Technology component of the index. All but two of the 23 constituent countries in the MSCI World index were positive in the third quarter. Emerging markets had another strong quarter gaining 7.6% (up 23.5% year to date).

Canadian Equity

Having generated a positive return of at least 2.4% in six of the past eight quarters, the S&P/TSX Composite has earned a return of 11.7% per annum over the past two years. In the third quarter, seven of the eleven sectors that comprise the index were positive with the most significant contributions from Financials, Energy and Materials (as expected given they are the largest sectors in the index with an aggregate weight of 66%). Energy was the strongest performer gaining 6.6% in the quarter as the oil price moved back up over $50 while Financials were up 4.5% and represent the largest sector at 34.5% of the index. The four negative sectors in the index (more defensive sectors like Consumer Staples and Utilities) represent just over 10% of the index and had minimal impact on the overall return for the quarter. The S&P/TSX Small Cap index was up less than the Composite index and is now only up 1.2% over the past 12 months following a 35% return over the same 12 month period ending September 30, 2016, once again highlighting the extreme volatility of the Canadian small cap market.

Fixed Income

The Canadian bond market declined by 1.8% in the third quarter as the Bank of Canada elected to raise the overnight lending rate by 0.25% in both July and September (from 0.5% to 1.0%) in light of recent positive economic data. With negative returns in two of the past four quarters, the broad Canadian bond index has declined by 3% over the past 12 months, marking the largest one year decline for the index since December 1994. The 10-year Government of Canada bond yield jumped by 0.35% over the course of the quarter, finishing the quarter at 2.1% (the yield was 1% one year ago). In a reversal from the second quarter, provincial bonds were the largest decliner (down 2.5%) while federal bonds fell 1.6% and corporate bonds were down 1.3%. From a yield curve perspective, long-term bonds were hit the hardest in the quarter with a drop of 4.1% while mid-term and short-term bonds fell 1.5% and 0.4% respectively. Global bonds were negative in the quarter (-2%) and are now down 7.3% over the past 12 months (in Canadian dollars).

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Capital Market Performance for the Period Ending September 30, 2017

Benchmark Index	Asset Class	Quarter	Year to Date	One Year	Three Year	Five Year	Ten Year
MSCI World (C$)	Global Equity	0.82	7.83	12.43	11.64	16.41	6.60
MSCI ACWI (C$)	Global Equity (incl. Emerging Markets)	1.15	8.98	12.89	11.38	15.58	6.27
S&P500 (C$)	US Equity	0.48	6.19	12.85	14.88	19.80	9.90
MSCI EAFE (C$)	International Equity	1.37	11.50	13.32	8.89	13.67	3.66
MSCI EM (C$)	Emerging Markets	3.76	18.77	16.51	8.75	9.06	3.64
S&P/TSX Composite	Canadian Equity	3.69	4.45	9.18	4.54	8.06	4.06
S&P/TSX Small Cap	Canadian Small Cap	2.36	-1.85	1.21	2.44	3.94	1.41
Citigroup World Government Bond Index (C$)	Global Fixed Income	-1.96	-1.00	-7.30	4.63	4.46	5.33
FTSE TMX Corporate Bond	Canadian Corporate Fixed Income	-1.34	1.49	-0.37	3.26	3.40	5.55
FTSE TMX Universe Bond	Canadian Fixed Income	-1.83	0.49	-2.98	2.78	2.65	4.73
FTSE TMX 91 Day T-bill	Canadian Cash	0.13	0.32	0.47	0.57	0.73	1.09

Source: FTSE TMX Bond, MSCI Barra, S&P Dow Jones Indices