RICHARDSON GMP

Global Economic Momentum Continues into 2018

Own equities and reduce fixed income. The current North American economic recovery started in 2016. Evidence suggests financial markets are still comfortably in the middle stages of their cycle, with more growth to come.

- **Earnings growth** is a primary driver of current stock price performance. Companies are making a lot of money. **Tax cuts** should help further.
- **Economic indicators continue to be very strong,** such as the Purchasing Managers' Index, the Leading Indicator Index, Industrial Production, and Consumer Sentiment.
- **Strength in financial markets currently has wide breadth**. Many stocks are participating. Breadth narrows significantly at the end of a bull market.
- **Large capitalization companies have shown the strongest growth** over the last few quarters. This is consistent with early and middle stages of a bull market. Expect rotation towards smaller capitalization companies as the economic cycle moves towards its later stages.
- **Defensive sectors are underperforming** such as telecom, utilities, and staples. They perform best during periods of economic weakness into early recovery. Investment money is not focused on these sectors.
- **Consistent with the middle of an economic cycle**, technology, industrial, financial, and consumer sectors are outperforming.
- **Commodity stocks have yet to show outperformance.** These highly economically sensitive sectors tend to do the best at the end of the cycle.
- **Interest rates are rising,** which is also consistent with economic growth. Economic slowdowns from interest rate increases happen sometime *after* several quarters of rate hikes, not at the beginning. The yield curve is still positively sloped. Yields are so low, they may not be beating inflation. The current cycle has had slower, more persistent growth, and lower and more spread out interest rate hikes.
- **Fixed income returns may struggle** as current low rates rise, reducing performance. Investors pick up very little yield moving to corporate bonds.
- **Equity returns won't be straight upward.** Investors should be conscious of managing risk and the potential for short-term losses with equities.

OUR PARTNERS

Brad A. Hunter

Richardson GMP
Suite 4700, 525 8th Avenue SW
Calgary, Alberta
T2P 1G1

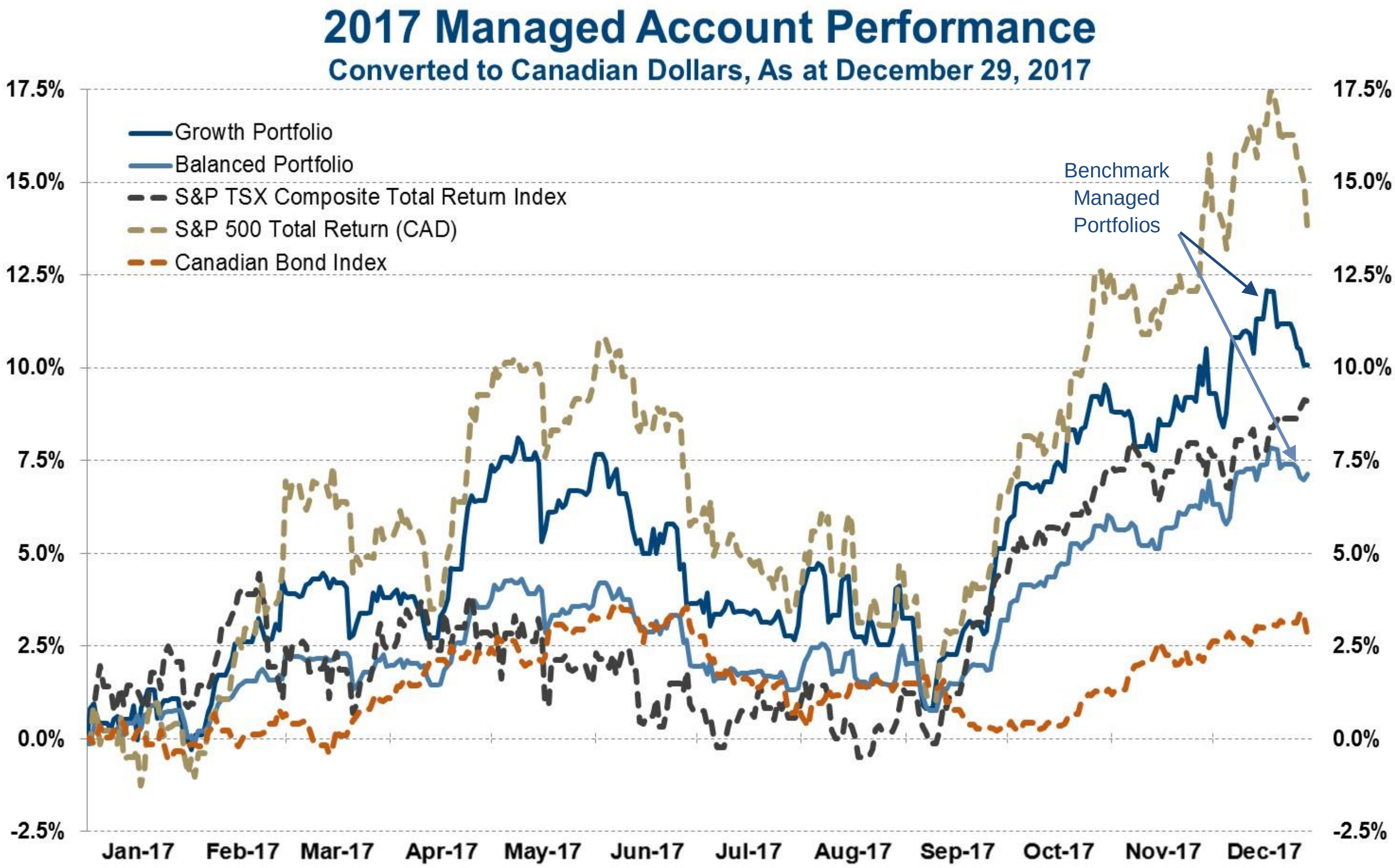
Tel. 1.866.867.7735
Fax 403.355.6109

Brad Hunter, CA, CFP®, CIM®
Director, Wealth Management
Portfolio Manager
Tel. 403.355.6033
www.BradHunter.ca

Connect with me on LinkedIn

Rita Penno
Associate
Tel. 403.355.6034

Chris Mitchell
Associate
Tel. 403.355.6066



Source: Richardson GMP, net of fees, unaudited

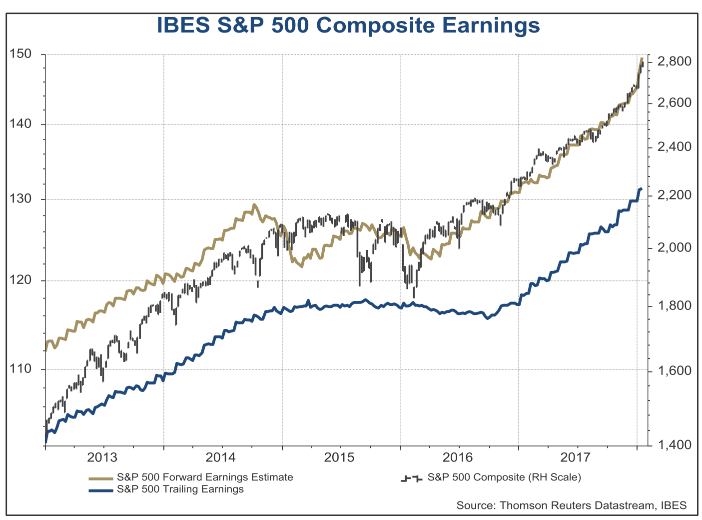
Growth Portfolio is one specific growth-oriented managed account. The asset mix was approximately 80% equity, 5% fixed income and 15% alternative investments.

Balanced Portfolio is one specific balanced managed account. The asset mix was approximately 48% equity, 35% fixed income, 15%alternatives, and 2% cash.

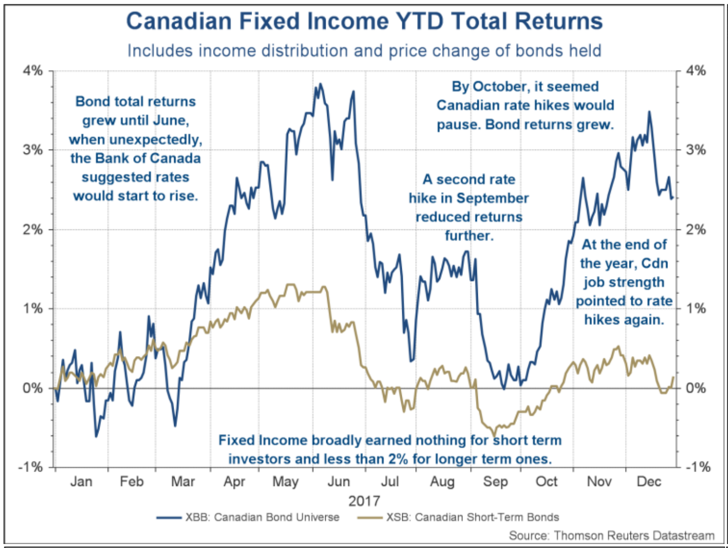
Selected accounts are considered representative of growth and balanced portfolios across most managed client accounts. The level of cash varied throughout the quarter. Individual managed accounts vary in results due to customization. Deposits or withdrawals to portfolios, and the resulting implementation of changes in securities held represents the largest cause for differences in accounts. Client-directed and non-model securities held in managed accounts can also result in a significant performance difference from the average experience.

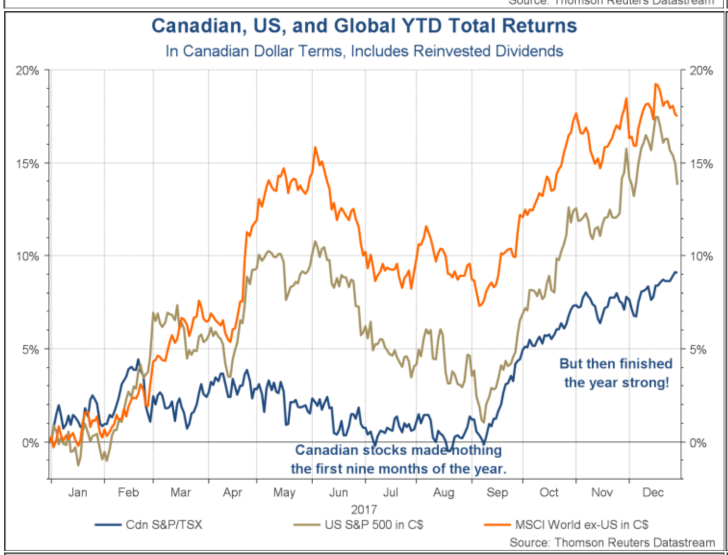
Portfolios had good results last year. Growth-oriented managed portfolios achieved a return between those achieved by American and Canadian stock markets, but with only 80% of funds having equity risk. Balanced portfolios achieved results better than an all-equity Canadian stock portfolio with less than half the funds invested in equities. Diversification in fixed income, alternative investments, and in global markets helped reduce risk. A sizeable allocation to U.S. equities was a significant reason for good performance.

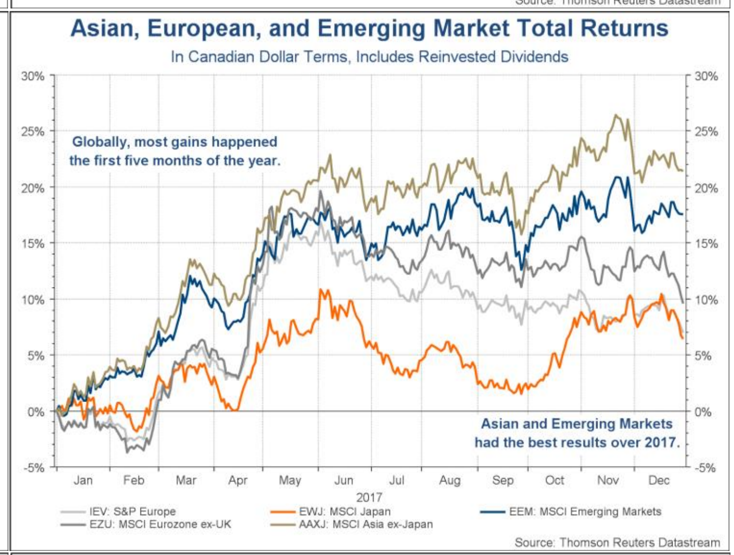
The bull market started somewhere in 2016. Forward earnings estimates for the market turned upward by mid-2016. Actual earnings growth materialized by late 2016 after being flat for two years. Earnings are still rising.

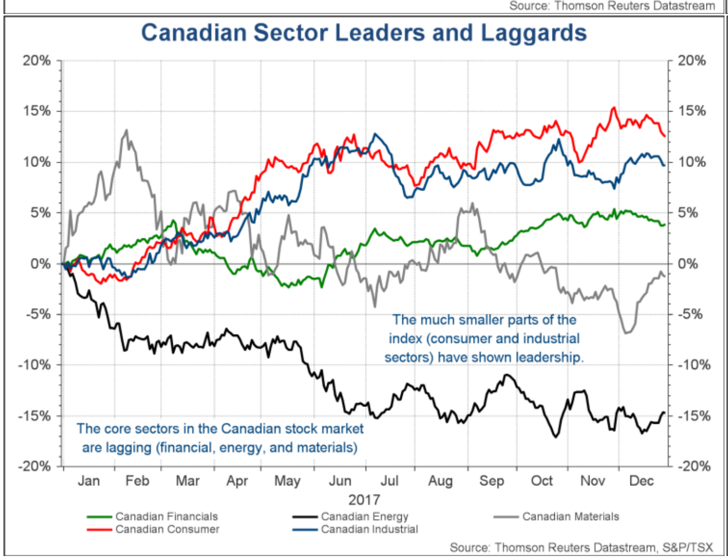


2017 Perfomance of Investment Markets









Positioning in Managed Portfolios

Managed portfolios now hold the lowest amount of fixed income they are permitted to own based on each client's unique personal situation (as documented in their Investment Policy Statement).

The Bank of Canada is expected to raise rates one or two more times in 2018 (after already raising rates mid-January 2018). The U.S. Federal reserve could raise rates two to four times over the year. Inflation expectations, and long-term interest rates continue to rise as well.

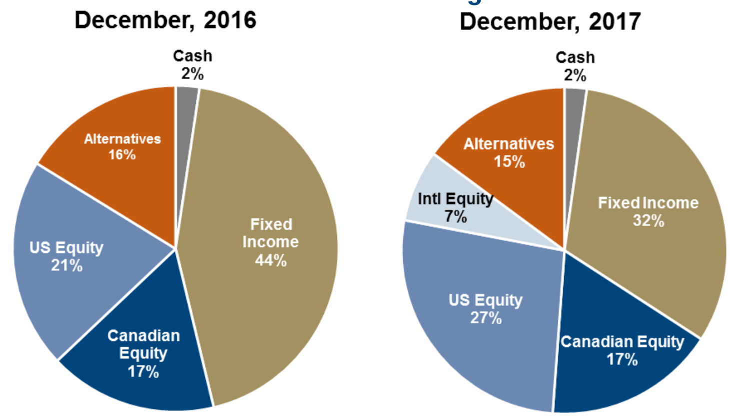
A low interest rate environment where rates are rising produces low and potentially negative returns for fixed income. Owning adjustable rate, rate-reset, and shorter term fixed income are preferred strategies when rates rise.

Balanced investors have double the exposure to global equity positions they have compared to Canadian ones, while most **growth-oriented clients have triple** the amount of U.S. and global equity positions compared to Canadian ones.

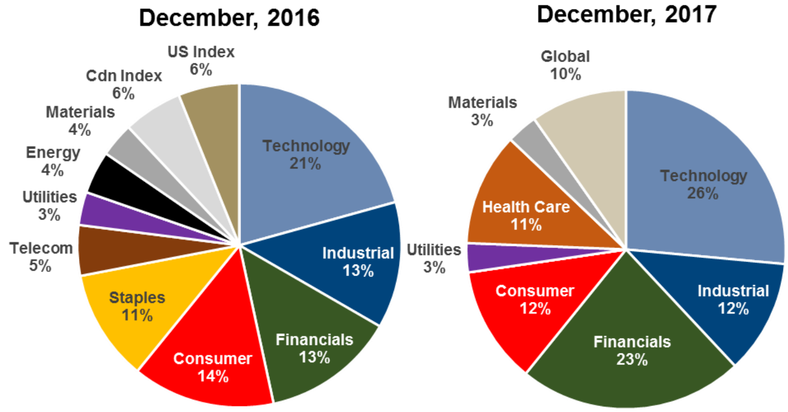
The Canadian stock market simply doesn't have enough representation in the industries that are performing the strongest – technology, industrial, and consumer. Financial stocks helped the Canadian index at the end of the year, and managed portfolios participate by holding several banks and financial companies.

Balanced Account Managed Portfolio

Asset Mix Change



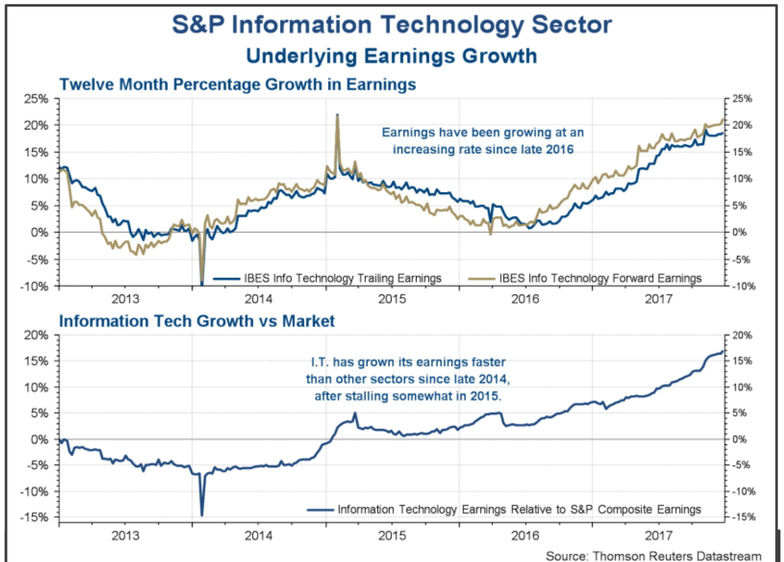
Equity Sector Allocation



Source: Richardson GMP, sample client account, balanced portfolio

Managed accounts had no exposure to equities outside North America a year ago, but now have growing representation in Europe (except the U.K.) and emerging markets. Strong years in U.S. markets subsequently spill over into global markets. Strength in the U.S. dollar allows countries exporting to the U.S. to gain a pricing advantage. Usually *after* periods of several years of U.S. dollar strength, non-North American markets start outperforming. This may still take some time. Global markets outside North America may not outperform until 2019 or later. During 2018, expect a slow increase in exposure to global markets, which currently have attractive valuations.

Technology and financial stocks represent half of the equity portion in managed portfolios. Industrial, consumer and health care form another third. Utilities, staples, telecom, energy, and materials sectors are heavily underweight. Baskets of technology companies are owned in the tactical model through the Dow Jones Internet Index and the S&P Global Technology Index. Among others, these indexes own Alphabet (Google), Amazon, Apple, Paypal, Ebay, Facebook, Intel, Microsoft, Netflix, Samsung, and Salesforce. Individual stock positions in Applied Materials, Genpact, Constellation Software are also held, with larger portfolios also holding Lam Research, Nvidia, and Paychex.



Technology earnings have grown faster than overall market earnings for the past three years. These companies have been growing since 2014 and have experienced faster earnings growth since late 2016.

The Purchasing Managers' Index as well as the Leading Economic Indicator suggest strong current economic growth. The surge in these indicators has typically happened a year after an economic trough. Economic growth seems to persist for a reasonable length thereafter.

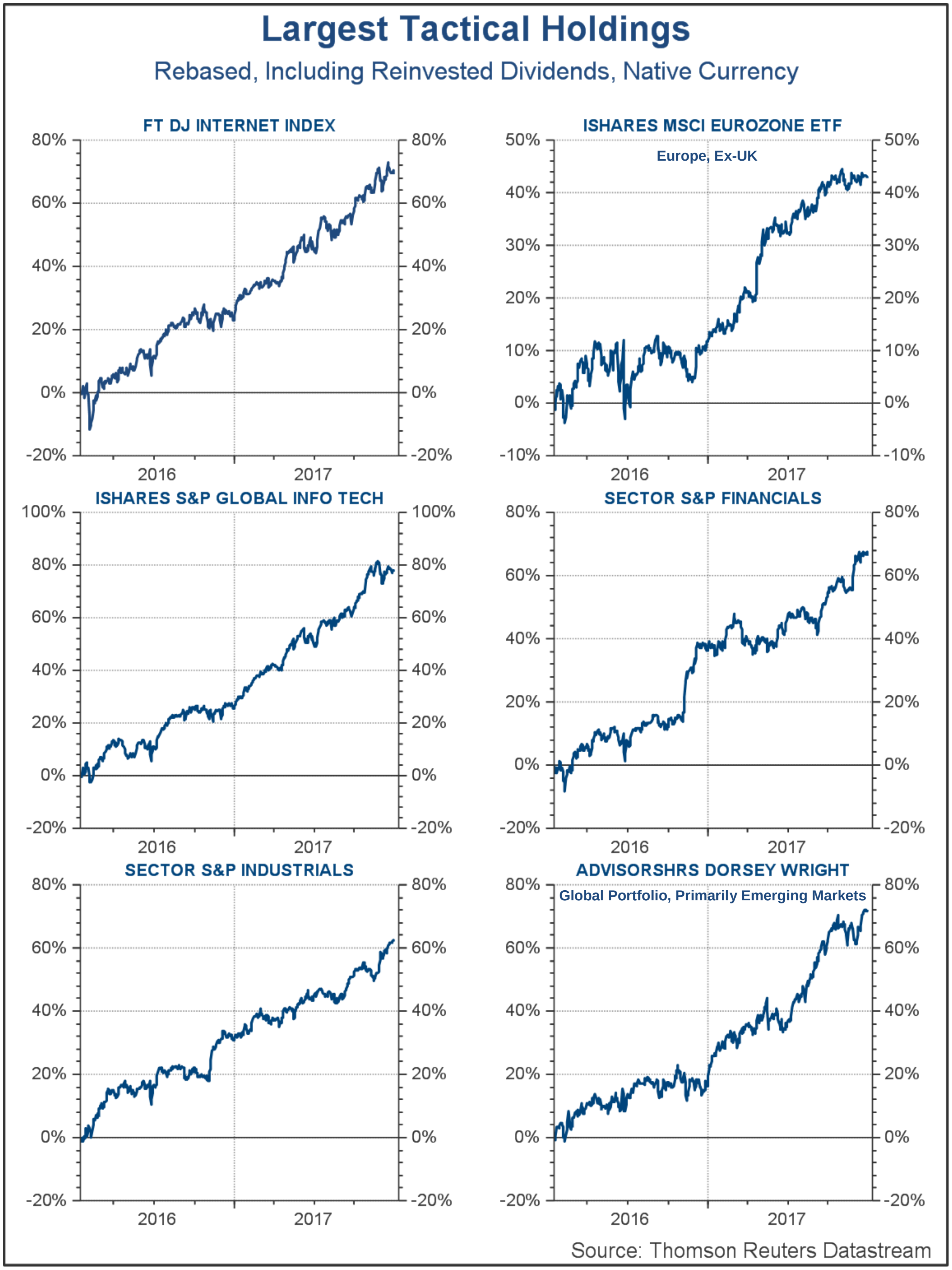
The U.S. Yield curve still is positively sloped, promoting economic growth. If the Federal Reserve proceeds with several more rate hikes over 2018, the yield curve may flatten or invert (and show a reading below zero on the graph to the right). Historically it has been prudent to be more cautious when the yield curve is not stimulative, and actively consider reducing equity exposure. This indicator may start turning negative towards the end of 2018 or well into 2019. Long-term interest rates may also move up substantially as inflation expectations rise and investors sell fixed income. This may defer when the yield curve actually inverts.

I believe NAFTA will be replaced. The current U.S. administration favours *individual* trade agreements with countries and is distancing itself from large, comprehensive, multi-national agreements. Representatives in the U.S. Trade Commission along with Donald Trump have suggested that multi-nation agreements pander to the lowest common denominator and end up with inefficiencies for members.

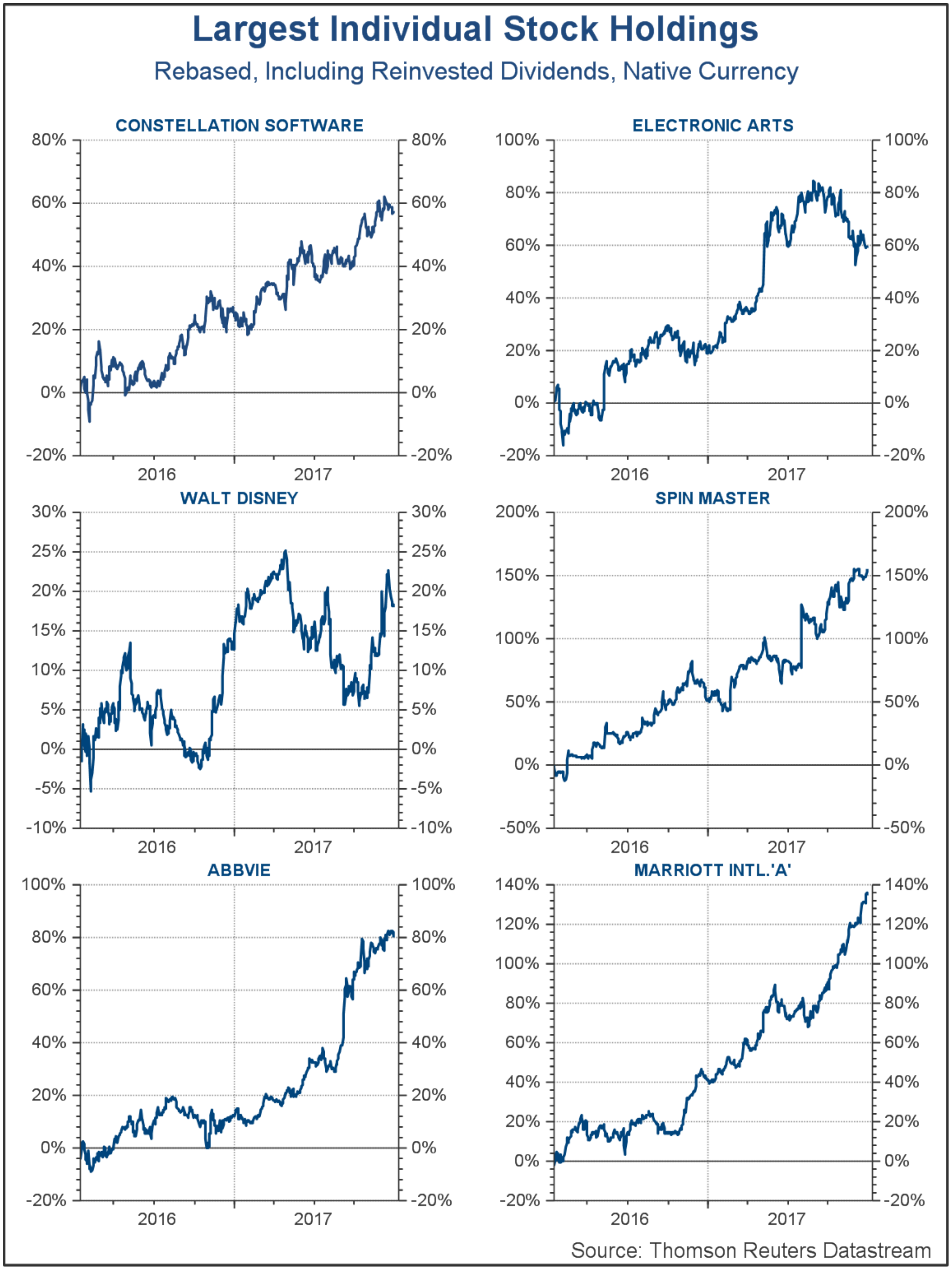
NAFTA *may be* replaced with something nearly identical in the end. Investors shouldn't be concerned if this agreement is changed. Trade contracts around the world are being renegotiated. Replacing NAFTA could lead to a short-term sell off in Canadian companies and the Canadian dollar. Market weakness could be short-lived.

If NAFTA were to be scrapped, I wouldn't expect too much impact on the current stocks held in the Canadian portion of managed portfolios. Renegotiation of terms of trade may be riskier to resource companies. Portfolio holdings in resource stocks is currently very low.

Energy and materials may become a more meaningful part of portfolios as the later stages of the economic cycle play out. American resource stocks may have more potential due to less government regulation (environmental, permitting, and taxation) compared to Canada, and better pricing due to a more robust pipeline system. Small capitalization stocks should also gain more attention as the economic cycle moves to later stages. U.S. tax reform may end up extending or changing the cycle for certain industries this time around. Watching trends and moving according to earnings potential and relative strength should keep investors participating in gains and objectively managing risk.



Represents the six largest tactical positions held in managed accounts. They are all exchange traded funds.



Represents the six largest individual stocks held in managed accounts.

Discretionary Management

Money is fuel. It allows you to either do the things you want to do, or prevents you from doing them when you don't have enough.

The purpose of investing is to match the money you have and will earn to the things you want to do over your lifetime. A financial plan helps you figure out what you want to do, what you have, and what you will earn. The rate of return needed in the plan forms a framework for design of the portfolio. Reporting allows you to compare portfolio results to the plan.

An Investment Policy Statement sets out the parameters in selecting and trading securities. It is designed based on the unique financial plan and personal situation of each family I manage.

I craft various models. Each contains a variety of securities according to an investment goal. Each client uniquely is assigned a portion of these models based on their unique situation on a household basis.

When securities in a model are changed, **the aggregate change across all clients is formed into bulk buy or sell trades.** The bulk trade is managed by our trading group to get the best price, and then allocated to all affected accounts. This allows all clients to be treated equally, fairly, and immediately when changes to a portfolio are desired.

Having the discretionary ability to enact trades proactively without contacting dozens of clients to individually authorize each investment transaction has significant benefits. It frees clients from having to make constant and numerous decisions. Relationships and communications with clients focus on understanding their situation, designing solutions, and finding appropriate securities. The person with authority to make securities decisions is the one responsible for their returns.

A combination of direct ownership of stocks and bonds, **baskets** of securities held in exchange traded funds, and use of **experts** that have access to global markets and unique strategies are all used to form a uniquely crafted portfolio.

I sincerely appreciate your business. I strive to earn your trust. I appreciate introductions you could make for me to any family or friends that might benefit from our services.

Regards,

Brad A. Hunter, CA, CFP®, CIM®
Portfolio Manager, Director, Wealth Management | **Richardson GMP Limited**
Suite 4700 • 525 8th Avenue SW • Calgary, AB • T2P 1G1

Direct 403.355.6033
Email Brad.Hunter@RichardsonGMP.com
Web **www.BradHunter.ca**

Connect with me on LinkedIn