

Market Matters

2016 Highlights

- Equities beat out fixed income.
- Within fixed income, high-yield bond funds and shorter duration bonds ended the year ahead of most other fixed income options.
- Within equities, home was a good place to be as domestic equities led right from the start.
 - Value stocks outperformed growth stocks.
 - Small cap stocks beat out the large-cap goliaths.
 - Resources stocks roared while healthcare stocks caught the flu.

This edition of GLC's Market Matters contains excerpts from both [GLC's 2016 Market Review](#), and [GLC's 2017 Capital Market Outlook](#). These special reports from our Chief Investment Strategist, Brent Joyce, CFA, can be found in full on GLC's website and LinkedIn page.

2016: SURPRISE, SURPRISE!

2016 will go down on record as the year of surprises: Brexit, Trump, gold, central banks, oil, yields, and eventually equities all did the unexpected.

A (really) bad start: The first six weeks were marked by unpleasant surprises and risk-off selling. All major global equity markets suffered losses to start 2016. Not only did equity markets stumble, but the 18-month slide in oil prices accelerated as oil prices plummeted to the mid-US\$20. Yields on 10-year Japanese and German bonds turned negative for the first time in history and by mid-July in excess of \$12 trillion dollars of global bonds traded at a negative yield. Volatility extended into other fixed income markets as the 'risk-off' environment drove 10-year Government of Canada yields down to an all-time low in July, below 1%, a level they would re-visit come late September.

A surprisingly happy ending (but not for all): By June the S&P 500 Index recouped its 2016 losses, while Canada bested its neighbour, as the S&P/TSX Composite held near the top of the list of best performing global equity markets all year long. With Brexit fading from the forefront, the summer was one of the lowest volatility and lowest trading volumes on record. Post Labour Day saw attention turn to politics once again with the US election and markets drifted sideways to lower. While it is tempting to point to the US election as the turning-point for markets, that is not the case. Rising yields and the rotation out of defensive, yield-oriented sectors into cyclical, growth-oriented sectors began well

Market returns*	December	Q4 2016	YTD
S&P/TSX Composite	1.4%	3.8%	17.5%
S&P 500	1.8%	3.3%	9.5%
- in Canadian dollars	2.1%	5.9%	6.5%
MSCI EAFE	4.4%	6.7%	2.3%
- in Canadian dollars	3.6%	1.5%	-4.6%
MSCI Emerging Markets	-0.1%	-1.8%	7.1%
FTSE TMX Canada Universe Bond Index**	-0.5%	-3.4%	1.7%
FTSE TMX Canada all corporate bond index **	-0.2%	-1.8%	3.7%

*Local currency (unless specified); price only
 **Total return, Canadian bonds

	Level	December	Q4 2016	YTD
CAD per USD exchange rate	\$0.744	0.0%	-2.3%	3.0%
Oil (West Texas)*	\$53.72	8.7%	11.4%	45.0%
Gold*	\$1,148	-2.2%	12.8%	8.1%
Reuters/Jefferies CRB Index*	\$192.51	1.7%	3.3%	9.3%

*U.S. dollars

S&P/TSX sector returns*	December	Q4 2016	YTD
S&P/TSX Composite	1.4%	3.8%	17.5%
Energy	1.1%	6.2%	31.2%
Materials	-0.8%	-6.5%	39.0%
Industrials	-0.9%	4.9%	20.7%
Consumer discretionary	1.6%	1.0%	8.2%
Consumer staples	-0.4%	-1.8%	6.1%
Health care	-5.2%	-28.8%	-78.6%
Financials	3.2%	10.6%	19.3%
Information technology	-1.2%	-0.7%	4.4%
Telecom services	0.6%	-3.9%	9.9%
Utilities	2.7%	-1.5%	12.7%
Real Estate	3.2%	-1.2%	4.1%

*price only
 Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

before the surprise US election result. The moves were accelerated post-election, as markets chose to embrace a less bombastic President-elect Trump and focus on the potential positive policy moves that the market perceives will spell higher growth, higher inflation, government stimulus, tax and regulatory reform.

Canadian bond markets experienced a wild ride in 2016. Returns rose into the mid-single digits by October, then skidded hard through the fall. A quick snap-back for yields in late December allowed the benchmark to post a slight positive for the year. Government of Canada 10-year bond yields rose 0.33% and 30-year's 0.16% on the year. Of note, the fourth quarter results of 2016 were the worst for the FTSE TMX Canada Universe Bond Index since 1994!

ENTERING A NEW PHASE

For 2017, we see the world entering a period where modest global growth and modest inflation can lead to a normalization of yields and modest results for equity markets. To be clear, the world is not out of the woods entirely and we don't expect things to be spectacular, but the fact that these issues are improving rather than worsening, marks an important inflection.

Our asset mix recommendation favours equities over fixed income. Rising global GDP and inflation favour equities over bonds. We see improving fundamental trends in most global economies, and valuations are manageable. We expect 2017 will see the MSCI World, S&P 500 and S&P/TSX Composite Indices string together back-to-back positive years.

Canada is our favoured market due to its greater sector leverage to global growth and recovering commodity prices. We expect oil to reach an average WTI price of US\$53/bbl over the course of 2017, beginning below that level and ending the year above. Canada's valuations are more justifiable, given the greater cyclical nature of our market. The divergence between sector results is likely to be large, providing greater opportunity for active managers versus a passive management approach.

The outlook for US equities is positive, with a great deal of uncertainty due to potential policy changes. Fortunately, we assess the risk to be skewed to the upside versus the downside on potential policy impacts. Valuations are slightly elevated and the divergence between sector results is likely to be large. Our forecast for the Canadian dollar per US dollar exchange rate is to trade in the low 70¢ range in 2017.

European equities remain near 2½ year lows. Valuations are more attractive than in North America, with similar positive earnings growth expectations. **The degree of uncertainty is high, but so is the potential upside** should we see even small positive surprises.

The recovery for emerging markets has further to go on firmer global growth and commodity prices. The recent pullback sets up an opportunity for a solid positive return, respecting that this asset class by nature is complex and for the risk tolerant investor.

We hold a positive outlook for equities in Europe and the Emerging Markets, but a negative outlook for Japanese equities.

Fixed Income will struggle to manage a positive return in 2017. We expect the total return to be flat. Investors face a sideways market as slowly rising (normalizing) yields grind against the time required for higher coupons to make a positive contribution. Active management to navigate the yield curve and pick-up additional yield through credit instruments (provincials, investment grade and high yield) does provide the opportunity for a slight positive gross return, but likely sub 1%. High quality fixed income securities have the ability to offset bouts of equity market weakness regardless of the underlying trend or the absolute level of yields.

MESSAGE FROM GLC'S PRESIDENT, RUTH ANN MCCONKEY

Amidst a year full of market and geopolitical surprises (some welcomed, others less so), GLC has found the best approach to successfully navigating a volatile environment is to stay focused on advancing our business to serve investors in better and meaningful ways – a theme that will continue in 2017 and beyond. GLC's disciplined investment processes, belief in active management, and commitment to talented investment teams will help us deliver on our primary goal of providing investors with strong long-term investment performance. Thank you for the loyalty and trust you place in us. I wish you all a healthy, successful and fulfilling 2017.

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