Here's What We're Thinking

Global Portfolio Advisory Group

The Investment Committee of the Portfolio Advisory Group meets regularly to formally discuss markets, sector allocation and investment recommendations. Below is a brief synopsis of our current views. For specific investment strategy relating to your investment portfolio, please contact your Scotia Wealth Management advisor.

Investment Strategy: Modest pullback provides opportunity to put cash to work; shifting to overweight international equities

• **Strategy:** Our view from a month ago that a pipeline of volatility-inducing events could trigger a modest pullback (2%-5%) across major indices continues to materialize. Over the month of March, U.S. interest rates were hiked 25bp, President Trump failed to even get a vote on proposed legislation to repeal and replace Obamacare, the U.K. formally triggered negotiations on its exit from the European Union, and the French presidential election race continued to heat up. As a result, global markets have traded with a subtly cautious tone as they absorbed these developments and downgraded lofty expectations of speedy passage of Trump's pro-growth agenda (ie. tax reform, fiscal spending boost, etc.). However, notwithstanding possible short-term market consolidation in coming weeks, we remain constructive on the broad global economic and policy backdrop for global markets as economic activity momentum builds to the upper end of this cycle's range towards a 3% pace. With recession risks over the coming year remaining low, we retain our asset allocation strategy of overweighting equities at the expense of an underweight in fixed income. We continue to recommend that investors should use any material market pullback to put large cash holdings to work.

• **Equities:** Having signaled a bullish view on international equities in recent weeks, we are formally overweighting international equities on the back of a positive medium-term outlook on oil, improving inflationary environment, gradually increasing rates and resilient corporate earnings recovery. Our bullish view is not predicated on the delivery of any portion of President Trump's promised pro-growth agenda including tax cuts, deregulation, cash repatriation or infrastructure stimulus – which, if realized, would provide a further boost to our bullish views.

• At the beginning of March we suggested a small technical pullback in the vicinity of 5% was possible and since the March 1st intraday highs the S&P500 index delivered a 3.4% pullback to the March 27th intraday lows. We believe investors should use this current mild pullback to put "new money" earmarked for risk-assets to work. As stated in a prior HWWT, existing equity positions should remain invested through any upcoming volatility as technical pullbacks will continue to remain shallow given we see healthy global equity returns in 2017.

• **Fixed Income:** Fixed income markets seem to be mixed in their tone over the last two weeks. Since our last update, global yields have moved lower as a risk-off tone has dominated markets. The move has been helped by the failed AHCA vote and softer European inflation data. However this sentiment wasn't shared by the corporate sector who's spreads remained at some of the tightest levels of the past year. In fact, the BBB sector outperformed as participants looked for riskier bonds following some selling earlier in March. This corporate outperformance was as expected, and we continue to believe any future widening of spreads should be taken as a buying opportunity. As for government allocation, we remain underweight but believe any exposure should be sought through provincial bonds.

• **Preferreds:** Although underlying bond yields have slipped lower in the past two weeks, the preferred share market (comprised largely of rate reset preferreds) has remained resilient trading relatively flat to slightly positive. In the last two weeks, Canadian yields in the mid to long-end of the curve (5yr-30yr yields) have fallen between 9-14bps, with 5-year yields down 9bps to 1.12% yet rate resets have remained strong. The lack of new issuance is likely driving demand into secondary issues helping to bolster the market despite yields having fallen. In addition, investors are likely looking beyond near-term retracements in underlying bond yields with the expectation that yields are biased higher alongside U.S. rates in the medium-term. We continue to expect yields in Canada over the next 12-18 months to move higher supporting our preference for rate reset preferred shares. Within rate resets, we see opportunity in both the minimum/floor resets as well as those without this feature trading at a discount to par.

***Currencies and Commodities:* Crude tries to rebound from weak start to the year; CAD holding steady**

• After a tough start to the month of March, WTI has rebounded 5% to $51/barrel since our last report (March 21). We were of the view that the recent weakness in crude oil prices was likely a result of seasonal factors, such as refinery maintenance, that had temporarily led to crude oil inventory builds. Refineries in the U.S. are now returning from seasonal maintenance, resulting in a pickup in U.S. crude oil demand. This has started to ease inventory concerns and has likely supported this rebound in crude oil prices. We expect demand to continue improving as the summer driving season gets underway, helping to offset rising U.S. production and supporting a further recovery in crude oil prices. With respect to upcoming key developments in the crude oil markets, the committee monitoring OPEC's supply agreement reconvenes in late April and could possibly recommend extension of the supply curtailments, while a final decision will be made by the group on May 25.

• The Canadian dollar has done a fair job of weathering the weakness this year in crude oil, with CAD relatively flat versus the USD on a year-to-date basis, compared to a 6% decline in WTI over the same period. The recent rebound in crude above US$50/bbl should help support the CAD in the near-term, with further gains in crude required for more meaningful CAD appreciation. Furthermore, diverging monetary policy between the US and Canada has become less of a concern as talks of a rate cut in Canada has all but diminished, with the expectations for a rate hike over the next 12 months slowly gaining momentum. On the back of these two factors, we have adjusted our expectations and now anticipate the CAD/USD to trade in the $0.73 - $0.77 range over the medium term (previously $0.70-$0.80).

***Geopolitical:* Failed Health Care Act calls future initiatives into question**

• On March 24th the White House withdrew a scheduled vote from the House of Representatives on the American Health Care Act. The Act, Trump's first major initiative as president, was set to repeal and replace a number of aspects of the Affordable Care Act. However members of the very conservative wing of the Republican party in the house, referred to as the Freedom Caucus, argued the new act didn't go far enough to reduce premiums. This lead to an initial postponement of the vote, followed by its eventual withdrawal on the 24th. Focus now turns to President Trump's other initiatives, tax and infrastructure spending. Failure on the health care bill begs the question: how successful can he be with these other initiatives? Additionally, how much have the perceived benefits from these two initiatives already been priced into the market?

Recommended Asset Allocation

Asset Class	Strategic	Tactical
Equities	**60%**	**68%**
Canada	30%	33%
United States	25%	28%
International	5%	7%
Fixed Income	**40%**	**30%**
Government	20%	10%
Provincial	5%	5%
Corporate/Credit	10%	10%
Preferreds - Rate Reset	5%	5%
Preferreds - Fixed Perpetual	0%	0%
Cash	**0%**	**2%**

Sector	Underweight	Neutral	Overweight
Financials			✓
Healthcare		✓	
Consumer Staples	✓		
Consumer Discretionary		✓	
Industrials			✓
Materials			✓
Energy			✓
Utilities	✓		
Telecom	✓		
InfoTech		✓	
Real Estate	✓		

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None.

The supervisors of the Portfolio Advisory Group own securities of the following companies.
None

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