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: Strong fundamentals push markets to new highs heading into year end

- **Strategy:** The fundamental backdrop for global markets remains constructive as we head into the final month of the year. Global economic growth indicators, such as consumer and business confidence and machinery and equipment orders, have remained near 8-year highs across the manufacturing and service sectors in most major economies. This has translated into ongoing economic and earnings forecast upgrades over the past month suggesting the economic expansion could sustain this year's solid pace into 2018. This should help the current growth cycle's duration (now at approximately 8.5 years) approach the longest expansion cycle on record in the post-WWII era (10-years: 1991-2001). As a result, a number of major equity markets in North America, Europe and Asia hit new all-time highs in the month of November. Notwithstanding occasional bouts of profit-taking, we remain bullish on equity markets heading into year-end and the new year. With economic growth set to sustain a healthy pace, commodities holding near recent highs, and interest rates set to gradually rise, we expect cyclical sectors to continue to outperform at the expense of interest-rate defensive segments (see asset allocation tables at the back for more detail). Near-term market drivers and/or event risks to watch for in coming weeks include OPEC's meeting to discuss extending production cuts to year-end 2018 on Nov. 30th, a vote on the U.S. Senate's version of a tax reform bill that could come as soon as Dec. 1st, the U.S. budget expiry on Dec. 8th, and the U.S. Federal Reserve's interest rate-setting meeting on Dec. 13th (25bp rate hike expected).

- **Equities:** The mid-November pullback has come and gone and the market is now trending favorably into year-end as we have been projecting for many months. We expect healthy global corporate earnings growth for 2018, even without proposed U.S tax cuts, on the basis of improved global GDP growth, a benign U.S. dollar in a moderately rising U.S. interest rate environment, fair equity valuations, and a re-acceleration of the corporate merger and acquisition cycle on improving CEO confidence and risk appetite. The rally in equities since 2016 has been fairly broad-based, supported by low interest rates and high liquidity, but in our view the spread between winners and losers could broaden out as liquidity is slowly removed. In such an environment, we believe active management investment strategies could outperform their passive counterparts.

- **Fixed income: Risk-off trade starting to form in market.** Over the past two weeks, Canadian government bond yields have shifted lower and the curve has flattened. This has led to an outperformance of long bonds, but unlike recent trends, this time provincial bonds had the highest returns. Spreads on A and BBB-rated corporate bonds widened out over the last two weeks as risk-off trade in the U.S. market was partially reflected in Canada. It seems this trade has paused, at least for the time being, as U.S. high-yield – the source of the risk-off trade – has stopped underperforming and partially recovered. We have long suggested any correction in the corporate market would be welcomed as an entry point for new money, and we continue to believe this is true. However, we would wait until we see

Scotia Wealth Management™ Enriched Thinking™

spreads in the Canadian corporate bond market begin tightening again.

• **Preferreds**: The preferred share market has been on a slow grind higher over the last two weeks notwithstanding the decline in underlying bond yields. The lack of new issuance since mid-September has driven investors into the secondary marketplace. We anticipate that new issuance will be limited into year-end with issuers looking to take advantage of other sources of funding with larger issue sizes, mostly within the Canadian and U.S. hybrid bond markets. The underwhelming amount of supply should remain supportive of outstanding preferred shares. Investor flows continue to show demand for preferred share exposure yet there has been a transition into actively-managed ETF strategies at the expense of passive-ETFs. We are supportive of this ongoing trend as we remain in favor of active management over passive, especially after such a strong 18-month performance. Our constructive outlook on the market is supported by the expectation of an underwhelming amount of new issuance, higher interest rates, and ongoing positive economic data going forward.

Commodities:* *All eyes on OPEC; Keystone pipeline restarted

• Crude oil market participants will likely be focused on little else this week aside from the semi-annual OPEC meeting scheduled for Thursday, November 30. Media reports suggest OPEC and its partners likely will extend production limits, which currently are set to expire in March 2018, although the duration of the extension remains in question. In the Scotiabank GBM energy strategist's view, the market has largely priced in an extension of the cuts to the end of 2018, and gives this outcome a 45% probability of occurring.

• WTI has had a strong recovery from its YTD lows in June, up 35%, supported by the ongoing supply-demand rebalancing in global crude oil markets. Looking past this week's OPEC meeting, and assuming OPEC and its partners do extend their production cuts, the Scotiabank GBM energy strategist expects the price of WTI crude oil to potentially move into the low-US$60/bbl range in the second half of 2018, following temporary weakness in the first quarter of 2018 tied to seasonally soft demand.

• Elsewhere in the energy sector, the Keystone pipeline resumed operations today, albeit at reduced pressure "to ensure a safe and gradual increase in the volume of crude oil moving through the system". The restart of the pipeline should help alleviate built-up supply in Alberta, which should help narrow the spread between the price of WTI and that of Western Canadian Heavy Crude, benefitting Canadian heavy oil producers, all else equal.

Economics:* *The U.S. economy remains on its expansionary path

• The recent flow of U.S. economic data releases has been supportive, and further confirmed economists' constructive view, of the outlook for the world's largest economy. October readings of industrial production, retail sales, new home sales, and the economic leading index were stronger than expected, while the labour market continued to tighten last month with the unemployment rate falling to a new cycle low of 4.1%. Meanwhile, the U.S. core consumer price index (CPI) also picked up in October with the YoY pace rebounding to 1.8% after dipping to 1.7% in May of this year. The personal consumption expenditures (PCE) deflator, the Fed's preferred measure of inflation, will be released later this week. Consistent with this batch of strong economic data, the U.S. economic surprise index has been picking up and is hovering near multi-year highs. Meanwhile, economists have also been upgrading their economic growth forecasts. The consensus forecast for U.S. 2017 real GDP growth (as compiled by Bloomberg) was revised up to 2.2% from August's 2.1% with more than 35 forecasters upgrading their estimates thus far this month. Meanwhile, the U.S. 2018 median real GDP forecast was revised up to 2.5% on the back of 31 net upgrades from forecast contributors this month. In the near term, markets will remain keenly focused on economic growth indicators including the first revision of U.S. Q3 GDP (est: 3.2% vs prev: 3.0%), along with the ISM manufacturing survey and consumer confidence index.

Geopolitical:* *Political uncertainty has risen in Europe's safe haven. On the evening of November 19th, it became apparent that weeks of coalition negotiations between Angela Merkel's Christian Democratic Party and other German minority parties had broken down. This was followed by meetings between German President Frank-Walter Steinmeier, Chancellor Merkel and heads of the other major German political parties. Chancellor Merkel has indicated she would rather have new elections than run a minority government, while other leaders have varying interest in continuing coalition negotiations. Despite the wishes of the Chancellor and party leaders, the decision on the future path for the German government lies with the President. Whether new elections are held, a minority government is chosen, or a grand coalition is formed, the implications could range from more complicated Brexit negotiations to increased power for populist parties.

• **Contention persists following the NAFTA fifth round negotiations.** This was in spite of hopes that NAFTA negotiations could move past the contentious proposals from the U.S. in round four. Following the conclusion of talks, U.S. Trade Representative Robert Lighthizer released a statement that noted: "I remain concerned about the lack of headway. Thus far, we have seen no evidence that Canada or Mexico are willing to seriously engage on provisions that will lead to a rebalanced agreement. Absent rebalancing, we will not reach a satisfactory result." This comment clearly indicates there still exists a large gap between countries at the negotiating table. In our view, it becomes more likely that negotiations will be prolonged, making it more likely markets will have to endure more uncertainty for months to come. In that scenario, we envision negotiations continuing over the next 12-18 months, punctuated by bouts of volatility, and eventually ending with successful renegotiation.

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	5%	5%
Cash	**0%**	**2%**

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

Disclaimers

Important Disclosures

This material does not include or constitute an investment recommendation, and is not intended to take into account the particular investment objectives, financial conditions, or needs of individual clients. Before acting on this material, you should consider whether it is suitable for your particular circumstances and talk to your investment advisor.

The author(s) of the report own(s) securities of the following companies.
None.

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

Scotia Capital Inc. is what is referred to as an "integrated" investment firm since we provide a broad range of corporate finance, investment banking, institutional trading and retail client services and products. As a result we recognize that we there are inherent conflicts of interest in our business since we often represent both sides to a transaction, namely the buyer and the seller. While we have policies and procedures in place to manage these conflicts, we also disclose certain conflicts to you so that you are aware of them. The following list provides conflict disclosure of certain relationships that we have, or have had within a specified period of time, with the companies that are discussed in this report.

Scotia Capital Inc. is a member of the Investment Industry Regulatory Organization of Canada and the Canadian Investor Protection Fund

General Disclosures

The Global Portfolio Advisory Group prepares this report by analyzing information obtained from various sources as a resource for advisors and their clients. Information may be obtained from the Equity Research and Fixed Income Research departments of the Global Banking and Markets division of Scotiabank. Information may be also obtained from the Foreign Exchange Research and Scotia Economics departments within Scotiabank. In addition to information obtained from members of the Scotiabank group, information may be obtained from the following third party sources: Standard & Poor's, Valueline, Morningstar CPMS, Bank Credit Analyst, Bloomberg, and FactSet. The information and opinions contained in this report have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness.

While the information provided is believed to be accurate and reliable, neither Scotia Capital Inc., which includes the Global Portfolio Advisory Group, nor any of its affiliates makes any representations or warranties, express or implied, as to the accuracy or completeness of such information. Neither Scotia Capital Inc. nor its affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

This report is provided to you for informational purposes only. This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation or particular needs of any specific person. Investors should seek advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized.

Nothing contained in this report is or should be relied upon as a promise or representation as to the future. The pro forma and estimated financial information contained in this report, if any, is based on certain assumptions and management's analysis of information available at the time that this information was prepared, which assumptions and analysis may or may not be correct. There is no representation, warranty or other assurance that any projections contained in this report will be realized.

Opinions, estimates and projections contained herein are those of the Global Portfolio Advisory Group as of the date hereof and are subject to change without notice. For that reason, it cannot be guaranteed by The Bank of Nova Scotia or any of its subsidiaries, including SCI. This report is not, and is not to be construed as (i) an offer to sell or solicitation of an offer to buy securities and/or commodity futures contracts or (ii) an offer to transact business in any jurisdiction or (iii) investment advice to any party. Products and services described herein are only available where they can be lawfully provided. SCI and its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities and/or commodities and/or commodity futures contracts mentioned herein as principal or agent.

Additional Disclosures

This report is distributed by Scotia Capital Inc., a subsidiary of The Bank of Nova Scotia. Scotia Capital Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.

® Registered trademark of The Bank of Nova Scotia, used under licence. ™Trademark of The Bank of Nova Scotia, used under licence. Scotia Wealth Management™ consists of a range of financial services provided by The Bank of Nova Scotia (Scotiabank®); The Bank of Nova Scotia Trust Company (Scotiatrust®); Private Investment Counsel, a service of 1832 Asset Management L.P.; 1832 Asset Management U.S. Inc.; Scotia Wealth Insurance Services Inc.; and ScotiaMcLeod®, a division of Scotia Capital Inc. International private banking services are provided in Canada by The Bank of Nova Scotia.

International investment advisory services are provided in Canada by Scotia Capital Inc. Scotia Capital Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.

Scotia Wealth Management consists of a range of financial services provided, in The Bahamas, by Scotiabank (Bahamas) Limited and The Bank of Nova Scotia Trust Company (Bahamas) Limited. International private banking services are provided in The Bahamas by Scotiabank (Bahamas) Limited, an entity registered with The Central Bank of The Bahamas. International investment advisory services are provided in The Bahamas by Scotiabank (Bahamas) Limited, an entity registered with The Securities Commission of The Bahamas. International wealth structuring solutions are provided in The Bahamas by The Bank of Nova Scotia Trust Company (Bahamas) Limited, an entity registered with The Central Bank of The Bahamas.

Scotia Wealth Management consists of international investment advisory services provided, in Barbados, by The Bank of Nova Scotia, Barbados Branch, an entity licensed by the Barbados Financial Services Commission.

Scotia Wealth Management consists of a range of financial services provided, in the Cayman Islands, by Scotiabank & Trust (Cayman) Ltd. International private banking services, international investment advisory services and international wealth structuring solutions are provided in the Cayman Islands by Scotiabank & Trust (Cayman) Ltd., an entity licensed by the Cayman Islands Monetary Authority.

Scotia Wealth Management consists of international private banking services provided, in Peru, by Scotiabank Peru S.A.A, an entity supervised by the Peru Superintendence of Banking and Insurance.