INVESTMENT OUTLOOK Q3 2020

HIGHLIGHTS

Economic Review

- The economic recovery continues to support financial markets, although momentum is being dictated by the government response to the volatile path of the pandemic.
- The yield curve steepened with longer-term bonds underperforming, incorporating some of the improving economic outlook and rising inflation expectations.
- Many market advances in the quarter were substantially influenced by the degree to which the virus has been contained and subsequent progression on the re-opening of economies.

Investment Outlook

- Progress towards a vaccine alongside unprecedented monetary and fiscal stimulus have seemingly overshadowed increasing signs of a second wave of the global pandemic.
- While real (after inflation) yields are in some cases negative, the bond market still provides relatively better downside protection, as has been clearly illustrated this year.
- As ever, discipline around what to buy and how much to pay is critical given significant bifurcations in valuations in equity markets today.

ECONOMIC REVIEW

Financial markets continued their upward climb from their March lows, although the pace of gains slowed significantly during the third quarter. The economic recovery continues to support financial markets, where notable areas of strength were the Chinese economy and the US housing sector. That said, these are extraordinary times, and leading economic indicators that would normally point to continued improvements in the economy are not as relevant during this cycle. The shutting down and re-opening of economies due to a pandemic have little to do with relieving economic excesses, which would normally be a driving force of a recession. Today, economic momentum is being dictated by government response to the volatile path of the pandemic.

On the policy front, there was less to cheer about, as political gridlock seemed to have reduced the possibility of an extension of the US federal government's helping hand. Monetary policy continues to ensure financial conditions are stimulative. In a major shift, the US Federal Reserve essentially prioritized the goal of full employment to now be equal with its inflation goal. In past cycles, the inflation goal reigned supreme, and the full employment goal was the sacrificial lamb in order to achieve the targeted inflation level. Now, there seems to be more flexibility on the inflation front in order to ensure full employment levels. This leaves the Fed more policy room as they will no longer be hindered by tight labour markets in their efforts to stimulate growth. Election uncertainty, while a risk, will be short-lived as, one way or another, it will be resolved by the first quarter of 2021. The fallout, however, may last much longer.

BOND MARKETS

The Canadian universe bond market was up 0.4% in the quarter, bringing the year-to-date return to 8.0%. Interest rates on government bonds stayed in a very narrow trading range while corporate and provincial bond yields declined as investors continued to seek higher yields given the impact of lower policy rates and historical levels of quantitative easing. The yield curve steepened, with longer-term bonds underperforming, incorporating some of the improving economic outlook and rising inflation expectations. The short end of the yield curve remained anchored by the Bank of Canada's stated intention to keep policy rates very low for a number of years.

EQUITY MARKETS

The third quarter continued the positive trends we saw in the previous quarter, albeit at a more moderate pace. US markets generally performed best, with the tech heavy NASDAQ posting a strong 11% gain in USD. In international markets, emerging markets also posted strong returns led by technology-weighted Asian markets such as China and Taiwan. Many market advances in the quarter were substantially influenced by the degree to which the virus has been contained and subsequent progression on the re-opening of economies.

Other developed markets posted more moderate returns than emerging and US markets, with the MSCI EAFE Index rising 4.9% (in USD) in the quarter. The Japanese market was a relatively stronger performer amongst major indexes, despite the orderly replacement of Prime Minister Abe due to illness. Conversely, the U.K. was a laggard in the face of ongoing Brexit uncertainties and a yet uncontained COVID-19 situation. The Canadian market posted positive returns in the quarter (+4.7%), with most sectors showing strong returns with the exception of Energy. Performance of the Energy sector continues to be weak across the globe in the face of anemic demand, high inventories, and ongoing portfolio shifts towards less carbon intensive industries.

From a sector standpoint, leadership came from similar sectors we saw in the second quarter. Technology remains one of the brightest spots, with multiple tailwinds continuing to drive sector returns. These include ongoing work from home trends, increasing ecommerce penetration and resilient cash flows which have driven investors to bid up the stocks to higher than historical valuation levels. Capital markets activity has also followed, with high profile IPO's taking place across many regions. Consumer discretionary businesses also performed relatively well, as economic activity

continued to slowly recover in most markets. We also saw industrial businesses perform relatively well, as the combination of significant stimulus and more limited exposure to consumer trends provide relatively better performance.

Conversely, economically sensitive sectors such as Financials and Energy continue to lag their benchmarks in most major markets. In the case of Financials, both insurance and banks are feeling the multiple effects of the pandemic coupled with ongoing low interest rates and imposed caps on shareholder returns.

Market Returns (as at September 30, 2020)

(%)	3 M	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	4.7	0.0	7.2	5.8	5.6
S&P 500 (C$)	6.8	16.2	14.1	16.8	10.2
S&P 500 (US$)	8.9	15.1	14.1	13.7	9.2
Russell 2000 (US$)	4.9	0.4	7.8	9.8	7.0
DJIA (C$)	5.2	3.8	11.1	12.8	7.6
DJIA (US$)	7.6	3.2	11.3	9.9	6.7
MSCI EAFE Net (C$)	2.8	1.4	5.2	7.4	4.7
MSCI EAFE Net (US$)	4.8	0.5	5.3	4.6	3.7
MSCI Emerging Mkts Net (US$)	9.6	10.5	9.0	2.5	5.8
FTSE Canada Universe Bond	0.4	7.1	4.3	4.4	4.8
FTSE Canada 91 Day T-Bills	0.1	1.3	1.0	1.0	1.5
C$/US$	2.0	-0.9	0.1	-2.6	-0.9

Converted to CAD using London 4pm rates. Returns are annualized for periods greater than one year.

OUTLOOK

The outlook for financial markets is positive as we believe the economic recovery is self-sustaining, and there is significant visibility that the monetary and fiscal policy will remain stimulative. Of course, this is with the current "normal" caveats that the virus does not take a more troubling path and that there will be a vaccine available in the first half of next year. We are optimistic that human ingenuity will prevail.

Valuations are a longer-term hindrance to strong returns, but within markets, there are industry sectors that are attractive as they have lagged the more popular sectors such as technology. Many investors are debating whether they should continue to hold bonds in their investment portfolios given the low level of interest rates. While real (after inflation) yields are in some cases negative, the bond market still provides downside protection, as has been clearly illustrated this year.

The last time the US federal debt was in a similar situation as today, real yields stayed negative for almost 35 years. So, while yields are unattractive relative to recent history, it does not mean they will rise anytime soon, unless you believe central banks have lost control of the interest rate markets. It is also useful to remember that central banks are trying to mitigate the declining inflation trend that occurs in ageing societies. This is not an easy task, particularly when there are historically high levels of debt in economies. The Bank of Japan's efforts in the past two decades highlight the difficulty of achieving targeted inflation goals.

Global equity markets have recovered substantially from their lows earlier in the year, and in many cases are now positive on a year-to-date basis. Progress towards a vaccine alongside unprecedented monetary and fiscal stimulus have seemingly overshadowed increasing signs of a second wave of the global pandemic. The upcoming US presidential election adds an incremental layer of uncertainty, as both candidates have very different perspectives on key issues. This will likely lead to increased volatility as we approach November 3. The key market issues we are monitoring include healthcare policy and regulation around "big technology" as they increasingly form a more dominant part of markets, the economy and our everyday lives.

Given these factors, along with some valuations that leave a limited margin of safety, we proceed cautiously into the final quarter of the year. As ever, discipline around what to buy and how much to pay is critical given significant bifurcations in valuations in markets today. We have seen in previous periods the risk of extrapolating temporary trends on a more permanent basis, both to the positive and negative. In this context, we find now more than ever that the case for an active approach to security selection will be invaluable. Longer term, we remain steadfast in our conviction that a well-selected portfolio of higher quality sustainable businesses will deliver attractive returns for clients with a long-term perspective.

All returns are expressed in Canadian dollars unless otherwise indicated.

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