YEAR IN REVIEW

2019

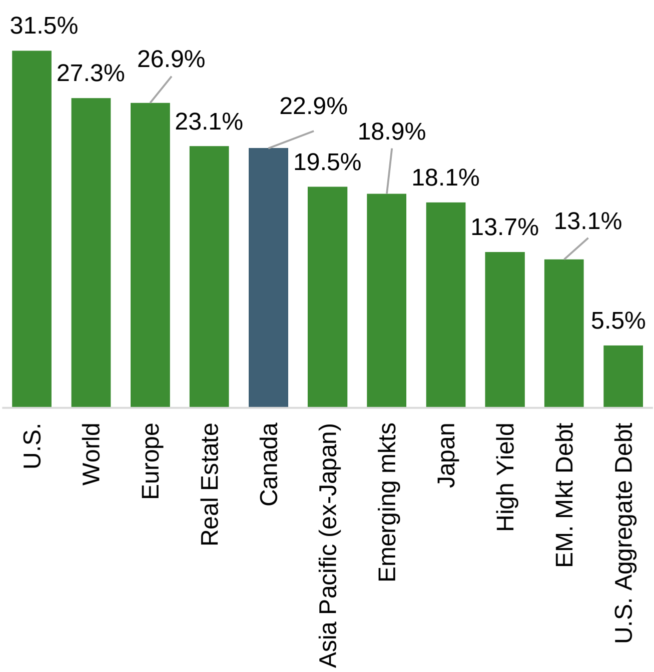
In Focus

Monetary policy easing and sustained growth, particularly in the U.S., supported global equity markets. Meanwhile, fears that escalating trade tensions could dampen global growth, modest corporate earnings and concerns that U.S. economic growth could be peaking after a ten-year-long expansion cycle contributed to risk aversion and resulted in a broad preference for high-quality companies.

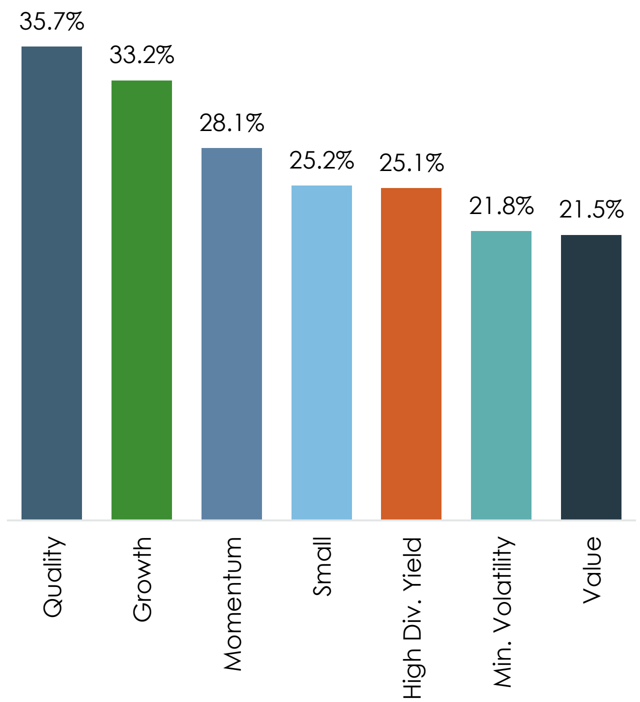
Canadian equities advanced along with their global peers. U.S. equities surged over the year, thanks to strong employment and consumption growth, coupled with sustained corporate earnings growth and signs of easing trade tensions toward the end of the year. Emerging markets, Japan and Asia-Pacific (ex Japan) equities advanced, but lagged their global peers.

Global bonds rose in 2019, even as the amount of outstanding bonds that offer negative yields continued to be meaningful. The decline in government and investment-grade bond yields in developed markets prompted some investors to broaden their search for income by investing in higher-yielding bonds with relatively lower credit ratings. Over the year, the U.S. Federal Reserve (the Fed), along with other central banks across developed and emerging economies, acknowledged risks to economic growth due to the potential impact of weakening global trade, and reduced its benchmark interest rates.

Markets and asset classes advanced



Investors favoured quality and growth stocks



Source: Refinitiv DataStream, as at December 31, 2019, MSCI Indices for all equity markets, except U.S. (S&P500 Composite and Canada (S&P/TSX Comp.). Returns in U.S. dollars, except Canada, Japan and Europe. All returns (except U.S. Agg. Debt) are total returns.

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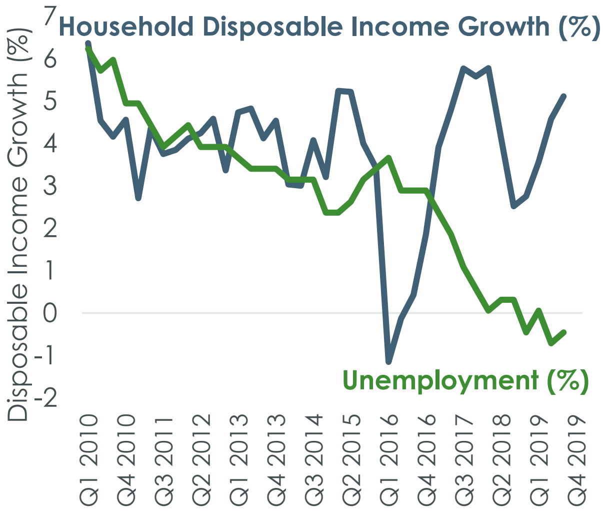
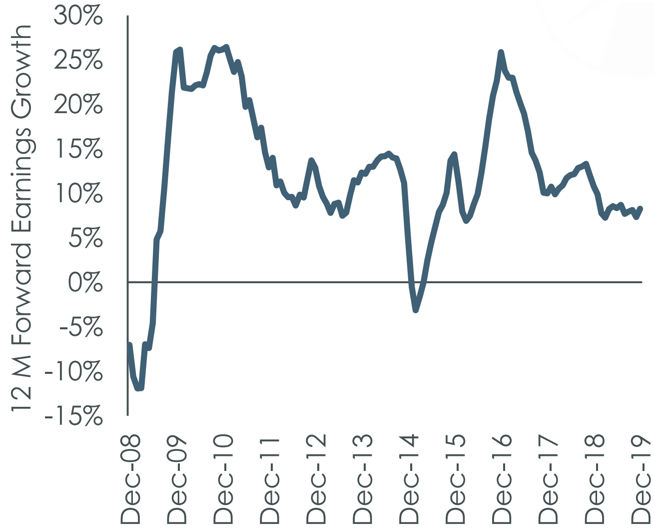
Higher disposable income and falling unemployment



Source: Refinitiv DataStream, December 2019

Canadian forward earnings expectations stabilizing



Source: Refinitiv DataStream, I/B/E/S, S&P/TSX Composite

Canadian equities advanced

A relatively moderate pace of economic expansion and risks stemming from global trade conflicts faded toward the end of the year. A healthy labour market and a late turnaround in the housing sector, as well as expectations of a gradual pickup in economic activity, lifted investor sentiment.

All sectors except health care advanced over the year. Information technology led the gains among sectors, due to better-than-expected earnings for some of its constituents. Sectors that tend to be most significantly affected by the business cycle, such as consumer discretionary, materials and financials, outperformed the broader index.

Conversely, the health care sector declined due to weakness among cannabis-linked stocks. Regulatory changes in the U.S. and company-specific factors contributed to the decline.

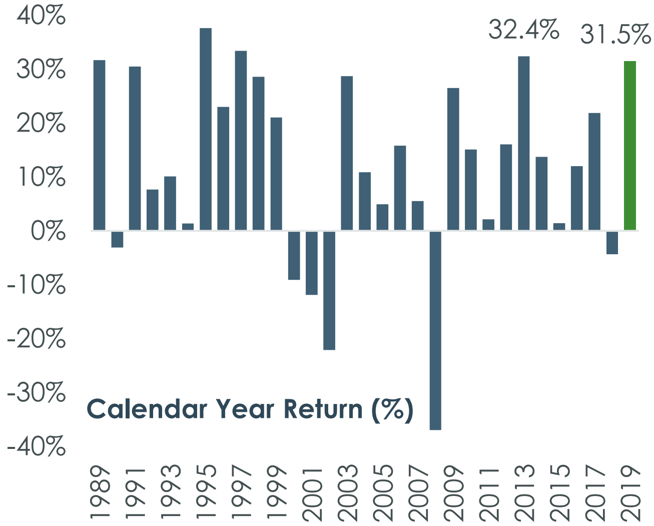
Risk aversion supported bonds

Canadian fixed income markets registered positive returns in 2019, with the FTSE Canada Universe Bond Index rising by 6.9%. U.S.-China trade tensions and global growth concerns supported demand for Canadian government and investment-grade bonds. At its latest policy meeting, the Bank of Canada (BoC) kept its key interest rate unchanged, at 1.75%, but noted that the escalating U.S.-China trade conflict is taking a toll on the Canadian and global economies.

Canadian economy continued to grow

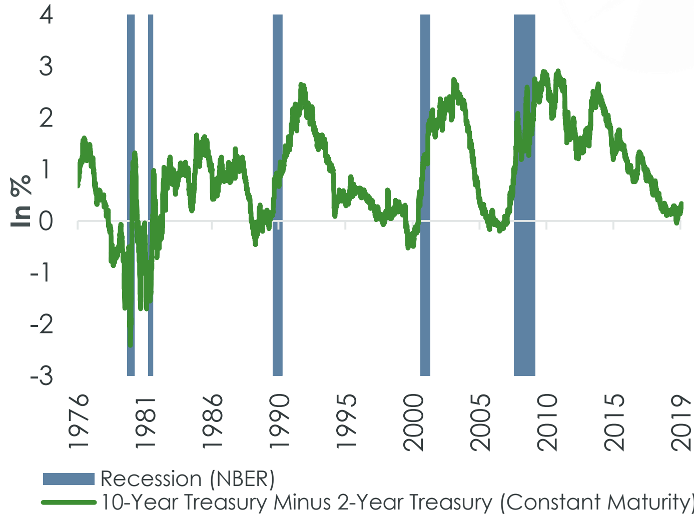
The BoC's decision to hold its policy rate throughout 2019 reflected the fact that Canada's rate of inflation remained close to the central bank's target range. Economic growth in Canada in the third quarter of 2019 came in at a relatively weak rate of 1.3%. Stronger wage growth supported a modest expansion in consumption, while housing investment also supported the economy.

U.S. equities surged, climbing a wall of worries



Source: Refinitiv DataStream, S&P 500 (total return)Dec 2019

Ten-year treasury yield fell below two-year yields, before recovering



Source: Federal Reserve Economic Data, December 2019

U.S. investors overcame growth worries

U.S. equities ended a decade-long economic cycle, and closed 2019 ahead of even the more optimistic expectations.

In the absence of strong earnings growth, a rise in share buybacks and mergers and acquisitions was among the leading drivers of stock market gains. Forward earnings expectations started to improve toward the end of the year, while rising employment and wage growth supported consumer spending and confidence in the outlook for the U.S. economy.

Recognizing risks to financial market liquidity and tightening borrowing conditions, the Fed halted its balance sheet reduction program (selling assets that it acquired in the course of its quantitative easing program) and announced three interest rate cuts over the year. With investors fearing the spillover effects of rising trade tensions and slowing global growth, a more accommodative monetary policy proved encouraging.

The information technology sector remained the biggest driver of market gains, followed by the communication services sector. The financials sector outperformed the broader S&P 500 Index over the year. This contrasted with relative weakness in the energy and materials sectors, where sustained pressure on oil and commodity prices weighed on earnings expectations.

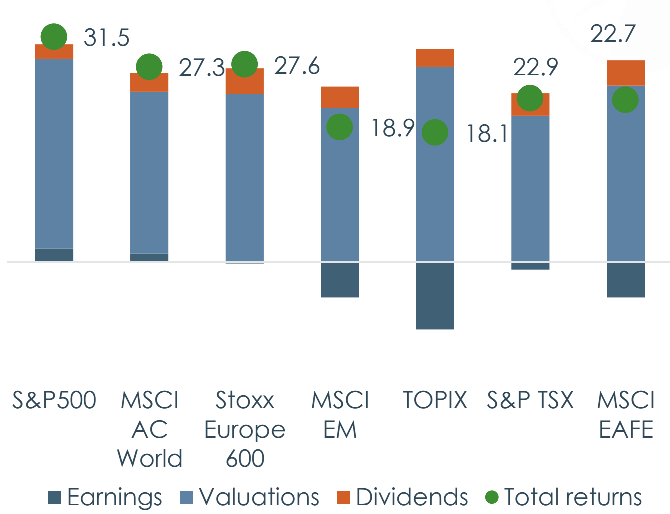
In fixed income, the U.S. ten-year Treasury bond yield rose after the yield curve "inverted" in August 2019 – when the yield on two-year Treasury notes was greater than the yield on ten-year Treasury notes – and long-term bond yields rose toward the end of the year.

The likely completion of a "phase one" trade deal with China is expected to include provisions for better protection of intellectual property rights and higher agricultural imports from the U.S. Meanwhile, consumer confidence and leading indicators continue to point toward sustained growth in the U.S. economy.

Investors increased risk taking as yields declined

Source: IMF, Global Financial Stability Report, October 2019

Scarce earnings growth and low cost of capital supported valuation expansion



Source: Refinitiv DataStream, I/B/E/S, December 31, 2019

Common global themes

The U.S.-China trade dispute and its potentially adverse fallout on global growth, and particularly on emerging markets, set the backdrop for global financial markets. Despite an increasingly risk-averse environment, scarce earnings and low bonds yields prompted many investors to selectively introduce assets such as emerging market debt for relatively more attractive risk-adjusted returns.

Valuation expansion drove gains

Globally, valuation expansion accounted for most of the rise in equity markets in 2019. Structurally lower interest rates and the falling cost of capital, rather than changes to growth assumptions, explain why stock markets continued to reach fresh highs despite weak economic conditions and low earnings growth.

Valuations typically chase earnings higher. This is because when interest rates (and cost of capital) are high, corporate earnings need to be high enough to justify the price being paid for future earnings. With low interest rates being increasingly viewed as a long-term phenomenon, markets are now willing to pay a much higher price for relatively low earnings.

Optimism about emerging markets and Asia

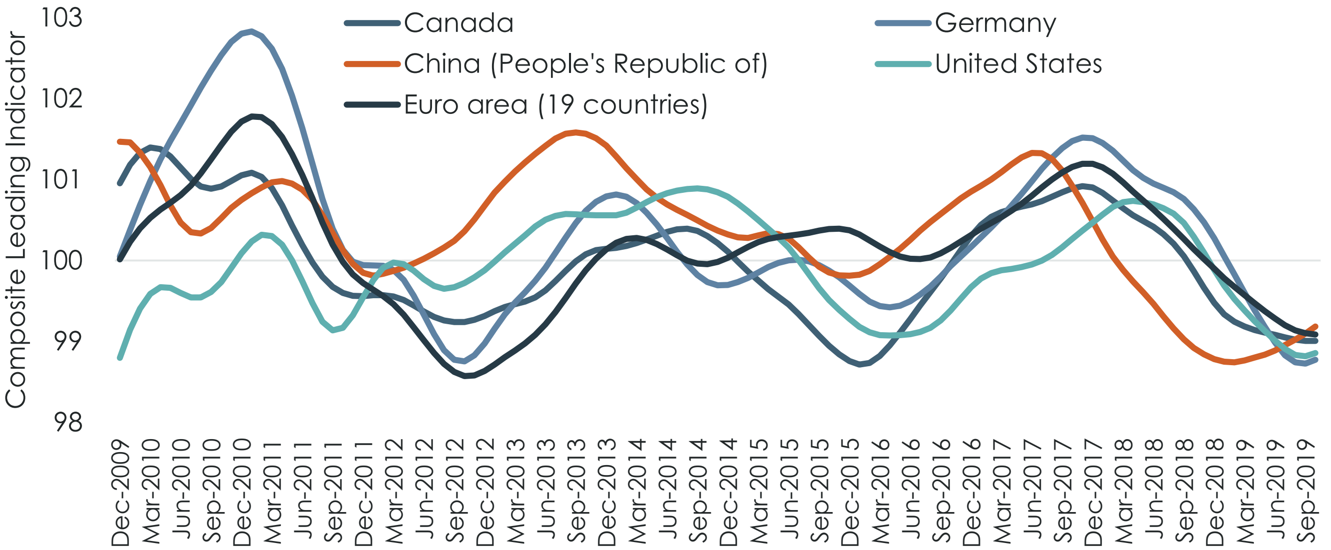
Investors also appeared more optimistic about a recovery in economic growth in Europe, as well as in Asia, and more sanguine regarding political risks in the near term. Emerging markets continue to grow at a faster pace than most of the developed world. Despite strong gains in 2019, Asia-Pacific (ex Japan) and emerging market equities continue to trade at a discount to developed market valuations, in terms of price-to-forward earnings expectations.

Among natural resources, the rise in U.S. shale production acted as a headwind to crude oil prices, where gains for energy companies were limited despite some supply disruption and geopolitical risks. Elsewhere, the price of gold increased sharply during the second half of the year.

Spotlight

There are challenges, but some parts of the global economy could be recovering.

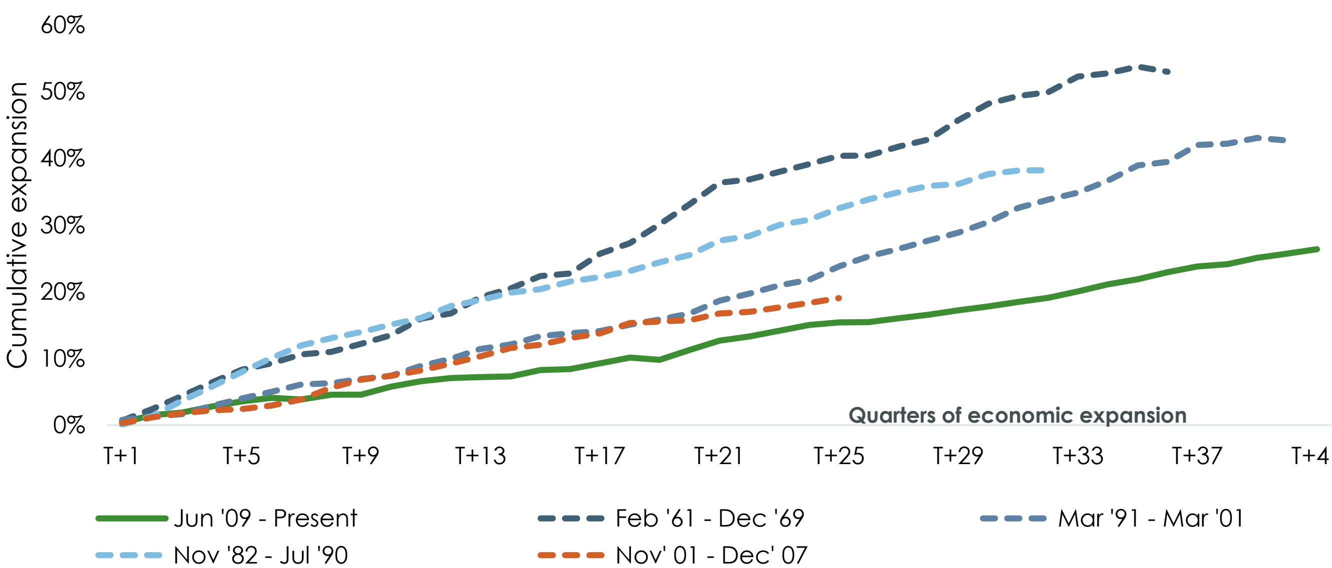
Despite strong gains in equity and fixed income, global economic momentum continued to slow for most of 2019. The composite leading indicator from OECD, which is designed to anticipate turning points in economic activity, appears to suggest that 2020 could see a recovery in global growth. Among prominent economies, momentum in the U.S., Germany and China appears to be stabilizing.



Source: OECD Composite Lead Indicators. Data up to October 2019.

Putting volatility into perspective

The U.S. is currently in the longest economic expansion cycle in the history. While the broader market's worry about the sustainability of this expansionary cycle is understandable, it may not be justified. GDP growth in this cycle has averaged 2.3% since its inception, lower than other periods of major economic expansion post-recession. This modest rate of growth may have prevented the economy from overheating and kept a check on inflation.



Source: Refinitiv DataStream. Data up to September 2019

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Appendix

Global markets (Returns in Canadian Dollar terms)			
Indexes	**2019**	**2018**	**Return (%)**
S&P/TSX	17,063.43	14,322.86	22.9%
S&P500	3,230.78	2,506.85	24.8%
NASDAQ	8,972.60	6,635.28	29.8%
DJIA	28,538.44	23,327.46	19.0%
Russell 2000	1,668.47	1,348.56	19.5%
FTSE 100	7,542.44	6,728.13	15.9%
Euro Stoxx 50	3,745.15	3,001.42	20.5%
Nikkei 225	23,656.62	20,014.77	15.7%
Hang Seng	28,189.75	25,845.70	7.8%
Shanghai Comp.	3,050.12	2,493.90	17.8%
MSCI ACWI	565.24	455.66	20.9%
MSCI EM	1,114.66	965.78	12.9%
Fixed income	**2019**	**2018**	**Return (%)**
FTSE Canada Uni.	1,123.68	1,051.44	6.9%
BBG Global Agg.	511.67	478.92	1.8%
TSX Pref	1,537.91	1,486.16	3.5%
Bond yields	**2019**	**2018**	**Change (bps)**
10 yr Canada Govt.	1.70%	1.97%	-26.5
10 yr U.S. Govt.	1.92%	2.68%	-76.7
30 yr Canada Govt.	1.76%	2.18%	-42.1
30 yr U.S. Govt.	2.39%	3.01%	-62.5
Commodities	**2019**	**2018**	**Return (%)**
Oil	61.06	48.62	19.6%
Natural gas	2.19	3.00	-30.5%
Gold	1,517.27	1,282.49	12.7%
Silver	17.85	15.50	9.9%
Copper	279.70	265.15	0.5%
Currencies	**2019**	**2018**	**Return (%)**
CAD/USD	0.77	0.73	5.0%
USD/EUR	0.89	0.89	2.3%
CAD/EUR	0.69	0.69	7.4%
USD/JPY	108.61	109.69	-1.0%
USD/CNY	6.96	6.88	1.2%
USD/MXN	18.93	19.65	-3.7%
GBP/CAD	1.72	1.74	-1.0%
GBP/USD	1.33	1.28	3.9%

Source : Bloomberg, Refinitiv. Total returns. **Important:** All index values refer to the price index in local currency terms. Return provided in total return in Canadian dollar terms. Commodity prices are in U.S. dollar terms. Returns are in C$ terms.

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