Canadian Equities – The late player

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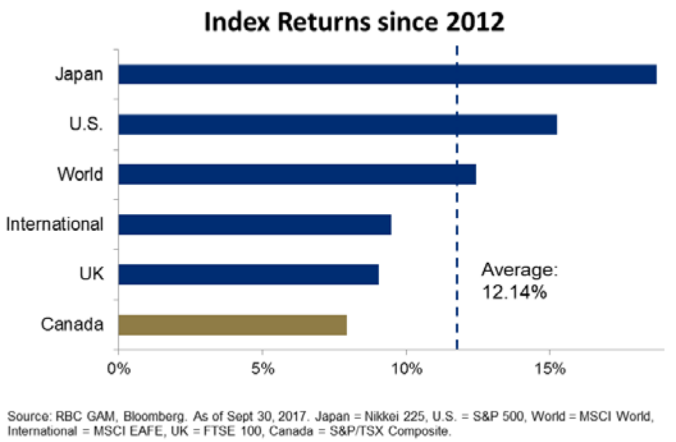
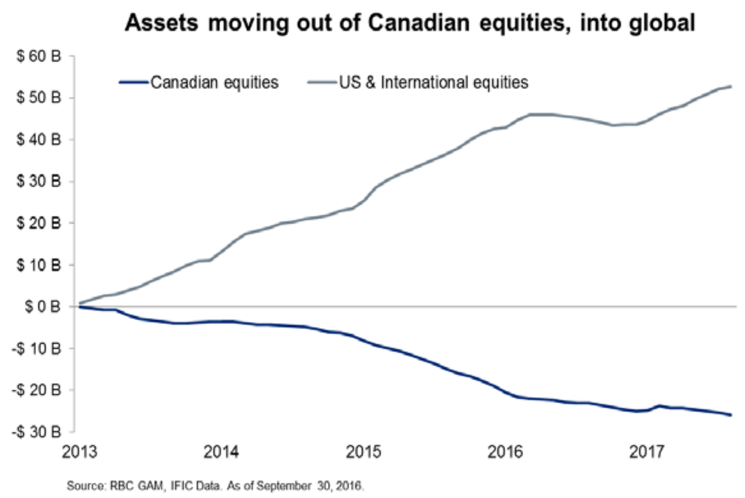
It's likely no surprise to hear that Canadian equity markets have lagged over the last few years. Outside temporary periods of commodity-related strength, Canadian equities have suffered as one of the poorest-performing developed markets in this expansion. In response, we've witnessed investors cutting their losses in Canada and focusing their portfolios around global investing as well as in areas like Technology and Health Care, where Canada lacks bench strength. However, we believe a timely opportunity exists for nimble investors to take advantage of potential late-cycle strength in the Canadian market.

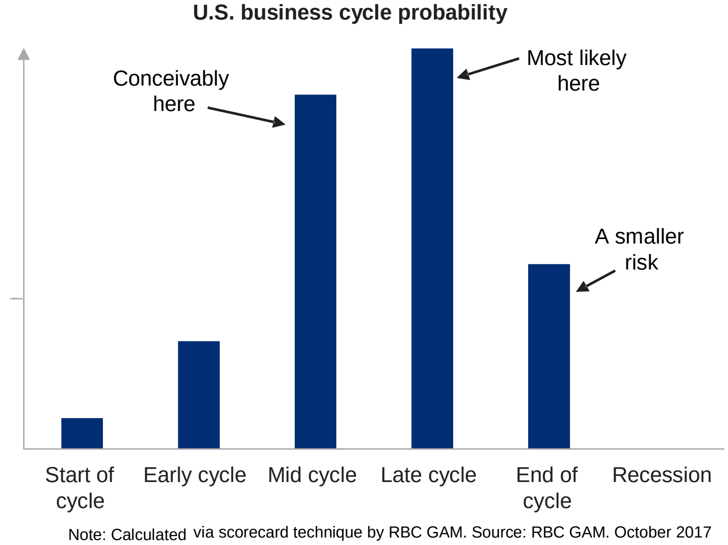


Canadian equities have been one of the poorest-performing developed markets over the last five years.



There has been a clear trend of assets flowing into the U.S. and global strategies at the expense of Canadian equity and dividend-oriented strategies.

Factors such as credit conditions, market sentiment and the current stage of monetary policy indicate we are in the latter stages of the current bull market. Indicators including inventory levels, housing and employment levels also guide us closer to the mid-point of the cycle, which is arguably extended as a result of the previous recession's magnitude. Tightening monetary policy and reflationary policies may lead to a shift in market sentiment, pushing industries and sectors that outperform during the late stages of the business cycle into the spotlight.



Our analysis indicates we're at the last stage of the business cycle, and it's possible we could remain here for months or years.

Indeed, the Canadian market is positioned well as cyclical strength manifests itself due to its naturally heavy exposure to Energy, Materials, Financials and Industrials, sectors in which companies tend to see earnings expansion in the latter innings of the cycle. Understanding Canada's lack of early-cycle exposure – including Consumer, Technology and Health Care – also explains why the Canadian market has fared more poorly over the last five years. Momentum has already begun to favour late-stage cyclicals and we believe this could continue as the cycle matures, setting the Canadian market up for a good period of strong absolute and relative performance.

	Canada	USA	Global	Int'l
Early Cycle	**12.9%**	**57.8%**	**49.7%**	**40.3%**
Consumer	9.0%	20.1%	21.2%	23.4%
Technology	3.3%	23.2%	16.2%	6.3%
Health Care	0.6%	14.5%	12.3%	10.6%

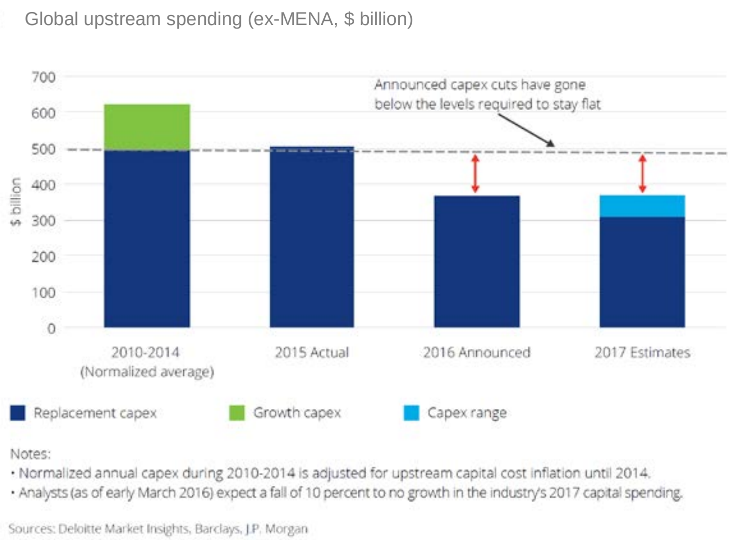
	Canada	USA	Global	Int'l
Late Cycle	**78.5%**	**33.9%**	**41.1%**	**48.8%**
Energy	20.4%	6.1%	6.3%	5.1%
Financials	37.2%	14.6%	18.1%	21.5%
Industrials	9.5%	10.2%	11.5%	14.4%
Materials	11.5%	3.0%	5.1%	7.9%

As of September 30, 2017

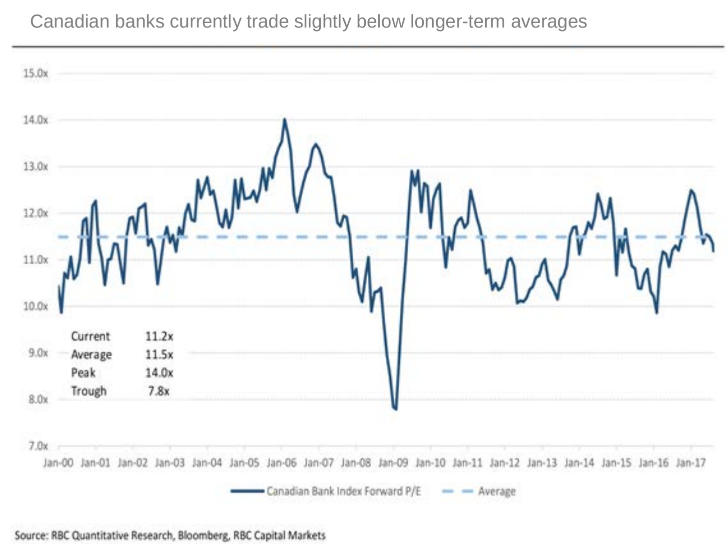
Canada has much higher exposure to late cycle sectors than its global peers.

Interestingly, the market is not priced for this cyclical upturn to occur. In the Energy space, for example, many companies are priced as though oil prices will remain below US$50 per barrel into perpetuity. While current conditions don't point toward significantly stronger prices at this time, the market is seemingly pricing in almost zero likelihood that oil prices will ever recover. Declining capital expenditure and cancellation of projects have created the conditions for tighter supply in the years to come and, as a result, we believe it's possible oil prices could rise from current levels.

In the Financials space, earnings growth has caught up with bank share prices, making bank valuations more reasonable and creating an interesting opportunity. While housing concerns are unlikely to disappear, the pace of concern will likely peak in the coming months as regulatory changes feed through to bank earnings, reducing uncertainty in the space.



Capex in the energy patch has dropped below levels that are required for production to stay flat.



As of September 26, 2017.

Valuations in the banking sector are now more reasonable.

The combination of strong global players and an emphasis on late stage cyclicals puts the Canadian market in a unique position should the cycle play out in typical fashion and this could be beneficial for client portfolios.

The market is also guided by long structural cycles. In the fallout of the technology bubble, we saw Canadian equities come into favour, driven by demand for commodity-related stocks as the globe turned its attention toward growth in emerging markets. A shift occurred after the financial crisis which put the growth of technology, healthcare and consumer-oriented businesses into the spotlight. These cycles tend to last a decade, on average, and we are nearly eight years into one which has benefited the U.S. and international markets. Canadian equities could be in the beginnings of a longer-term uptrend as this structural cycle comes to a natural inflection point.

Canada has been in a long trend of underperformance relative to the U.S. market, and it's possible we could be reaching a natural inflection point as the cycle matures.

We've spent a number of years urging investors to go global with their investments and Canada continues to face headwinds to its economy; however, the stock market and economy do not move in lockstep. Investors who make the decision to sell their Canadian equities after years of disappointing performance could be leaving meaningful opportunity on the table, particularly given indications that we're at a turning point. We would caution investors about the risks of chasing global equity performance and abandoning Canadian equities altogether. Furthermore, we would suggest that investors could benefit from revisiting their exposure to Canadian equities as a potential source of relative and absolute performance at this time.

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