

# Financial Outlook

April 2018



**OPTIMUM**<sup>®</sup>  
Optimum Asset Management Inc.

## At a Glance

### Summary

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|----------------------|---|--|
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| › Bond Market        | 4 | › The Canadian stock market fell during the quarter. Factors contributing to the decline were slower economic activity, the NAFTA negotiations, the weakness of the Canadian dollar, and increased volatility.                   |
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| › Global Equities    | 6 | › Global equities ended the quarter in positive territory for Canadian investors, thanks to the depreciation of the Canadian dollar.   |
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We would be pleased to send it to you personally.

We are pleased to present you the new edition of our Financial Outlook.  
Please let us know if you have any comments. Happy reading!

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is proud to support the  
Fondation du Dr Julien



425 de Maisonneuve blvd. West, Suite 1620, Montreal, Quebec, Canada H3A 3G5  
Telephone: 514 288-7545

80 Bloor Street West, Suite 1500, Toronto, Ontario, Canada M5S 2V1  
Telephone: 416 922-5000

[www.optimumasset.com](http://www.optimumasset.com)

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 **PR**I Principles for  
Responsible  
Investment

# Point of view

By Pierre-Philippe Ste-Marie, Chief Investment Officer, Fixed Income



## What is volatility?

In finance, volatility is a measure of the deviation in the price of a security over a given period of time. The greater the deviations, the more volatile the security is said to be.

However, certain measures lead to different interpretations of volatility. For example, if we analyze the growth of the Dow Jones Industrial Average (DJIA) between 2006 and 2018 in absolute terms, we note that the index rose from 12,463 points (December 2006) to 24,719 points (December 2017). At first glance, this tells us that the index almost doubled over that time frame, but this measure does not take into account the annual variations within that period.

## A look back at the returns of the DJIA

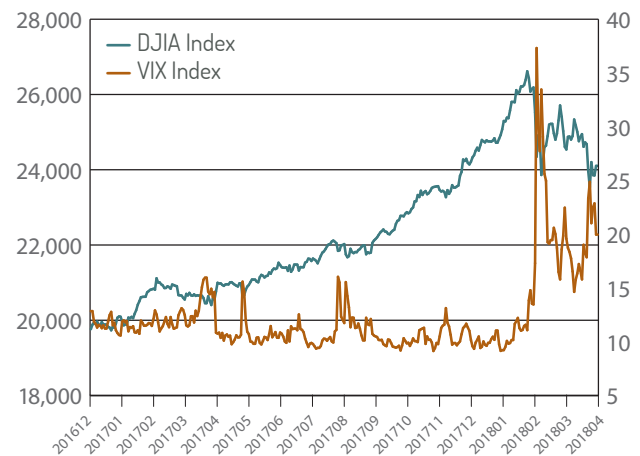
The capital markets (including bonds and stocks) experience both calmer periods and periods of higher volatility. Take, for example, the Dow Jones Industrial Average (DJIA), for which the available data goes back to 1896.

- The DJIA grew strongly with the arrival of railroads between 1896 and 1906, and then experienced a period of stability until 1916.
- The wild years that followed, commonly known as the roaring 20s, fueled another big rise in the index, which was followed by a long slump during the Great Depression of the 1930s.
- The Second World War would bring stability to the DJIA between 1936 and 1946, despite a period of high volatility. After WWII, in the 50s and 60s, the Dow experienced exceptional growth.
- The 1970s saw renewed volatility, especially during the 1974 oil crisis.
- In the 1980s, the DJIA experienced a period of growth, followed by another slowdown. On Monday, October 19, 1987, global stock markets crashed, including the Dow, which lost 22.6% in one day.
- This crash did not stop the market's rise, which continued until the year 2000, when the benchmark indexes were shaken by two crises in the space of 10 years: the dotcom bubble and the 2008 financial crisis, which would wipe out all of the decade's gains.
- Since 2010, the Dow has risen dramatically, more than doubling.

## OAM's positioning

In this context, it is clear that the Canadian bond and stock markets could see continued volatility in the coming weeks and months, considering the different geopolitical events on the horizon. The firm's positioning is therefore defensive, in other words, we are anticipating this volatility and building our clients' balanced portfolios according to market trends.

Figure 1 – DJIA vs VIX



When the market rises in an orderly manner, volatility is low. However, large daily swings result in increased volatility.

Our approach to growing volatility is to be cautious in our investments, with a slightly overweight equity position in the balanced portfolios. This period offers excellent opportunities to buy some attractive stocks. Upon reading this Financial Outlook, you will realize that we do not expect a recession in the near future. Our rather defensive equity management style enables us to add value to the portfolios relative to the market, particularly during these volatile periods. Moreover, we have maintained a cushion that will give us additional leeway to take advantage of opportunities.

# Economy

By **Gérald Gagnon**, Vice President, Investment



Globally, the expansion continues. Developing countries are seeing improved trade balances and are experiencing economic growth. In the euro zone, the momentum of 2016 and 2017 has carried over into 2018, with positive economic growth, spurred particularly by an accommodative monetary policy. In light of these facts, the European Central Bank has tapered its quantitative easing program. However, industrial production was down slightly in the first quarter of the year. The value of the euro remained at around US\$1.22, which is good news for the region.

All things considered, U.S. economic data are generally positive. Employment continues to grow, and the jobless rate, at 3.9%, has fallen to its historical low of the year 2000, when the country was at full employment. Industrial production is solid and shows no signs of slowing, while construction numbers are positive according to observers. Retail sales are disappointing, however, the data available for the last three months showing negative growth. In addition, the U.S. trade balance is quickly deteriorating, which is one of the reasons why President Donald Trump started to impose tariffs on some of its trading partners, including Canada and China, which retaliated at the end of the quarter. Nevertheless, consumer confidence remains high, at rarely seen levels, particularly since the late 1990s, so there is no visible sign of recession for the coming months.

The Bank of Canada hiked its policy rate for the third time in six months, at a time when the country's economy is operating at close to capacity. The BoC once again raised its target overnight rate by one quarter of a point, bringing it to 1.25%. The Canadian economy had an outstanding year in 2017, with gross domestic product (GDP) growth of 3% and robust job market expansion, which prompted the rate hike early this year. Economic growth has eased since the start of the year, however, with the Canadian economy posting two consecutive quarters of 1.7% growth, compared with 4.3% growth at the beginning of the year.

The job picture was negative for the quarter, with not enough new jobs in February (15,000) and March (32,000) to offset the loss of 88,000 jobs in January. This is very different from the situation in

2017, when 427,000 jobs were created over a one-year period. As for housing starts, the news is still good, primarily in the Toronto area, where construction is robust. However, house prices stabilized nationally and even declined in some regions. This may be a sign for investors that the market has peaked. Another factor to consider is the ratio of household debt to disposable income, which has reached record levels. On the other hand, the ratio of Canadian household debt to assets is rather stable, a situation that is sustainable in the coming months. Unemployment hit a new low of 5.8%, and inflation is steady at around 2%. The Bank of Canada is keeping a watchful eye on inflation, but is closely monitoring the NAFTA negotiations and the possible impact on the Canadian dollar and exports to the U.S., our main trading partner.



## OUTLOOK

There is no recession in sight for 2018. However, certain end-of-cycle pressures are starting to appear,

including a slight increase in commodity prices and a flattening of the yield curve with a rise in short-term rates.



# Bond Market



By Myriam Mechouat, Vice President, Quantitative Management

In the United States, 10-year bond yields rose 33 basis points, while in the United Kingdom, they increased by 16 basis points. In fact, most industrialized countries saw a rise in 10-year bond yields. In Italy (-0.23%) and Spain (-0.40%), the economic and political situation contributed to a reduction in the risk premium on their respective bonds. (Table 1).

Yields rose between January and mid-February, particularly for long-term Canadian bonds, on which they reached 2.51%. This reflects investor fears of a potential rise in U.S. inflation and the possibility that the Federal Reserve will adopt a more proactive monetary policy to contain upward price pressures. The yields on these bonds declined in the second half of the quarter, ending the month of March at 2.26%. This resulted in an almost neutral return for all medium- and long-term bonds, as illustrated in the table below. Short-term bonds performed better, with a quarterly return of 0.22%. As for corporate issues, the returns were relatively attractive for the past three months. In fact, volatility was seen in all sectors, because after a first month where credit spreads tightened, the risk premium widened in all sectors for the rest of the quarter.

Federal bonds had the best performance for the quarter, which hadn't been seen for many quarters. The decline in provincial issues was marked by an increase in the risk premium during budget season. Quebec currently has a slight surplus but forecasts strong growth

in its spending. Ontario increased its deficit, which had not been anticipated by the financial markets. It should be noted that 2018 is an election year for both provinces. Also noteworthy is the fact that Quebec has been financing itself at a better rate than the province of Ontario for close to two years now, and the yield spread widened again during the past quarter. This situation had not been seen in the past 40 years (Figure 2). Municipal bonds followed the same path as provincial issues.

Corporate bonds posted a positive return for the quarter. However, corporates at the long end of the yield curve appreciated less than comparable federal issues. This sector was negatively impacted by the stock market turbulence during the quarter. (Table 2).

Figure 2 – Quebec-Ontario 10-Year Yield Spreads

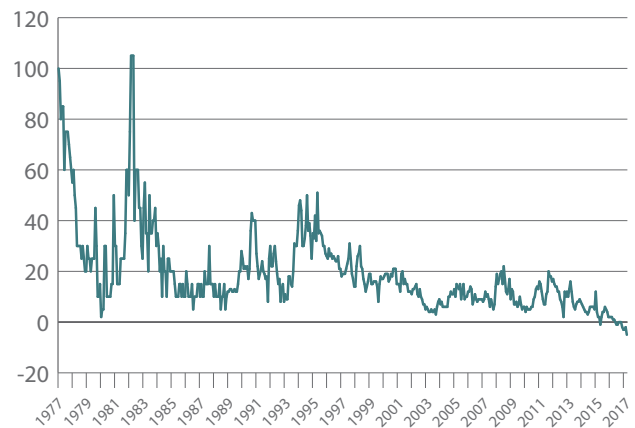


Table 1 – 10-Year Bond Yields

	March 30, 2018	Dec. 29, 2017	Variation
United States	2.74	2.41	+0.33
United Kingdom	1.35	1.19	+0.16
Germany	0.49	0.42	+0.07
Canada	2.09	2.04	+0.05
Japan	0.04	0.04	+0.00
France	0.72	0.78	-0.06
Italy	1.78	2.01	-0.23
Spain	1.16	1.56	-0.40

Source: Bloomberg

Table 2 – Canadian Bond Market Returns  
Performance in the First Quarter of 2018

	Federal	Provincial	Municipal	Corporate	Total Q1
Short	0.23	0.15	0.19	0.25	0.22
Medium	0.02	-0.16	-0.06	0.29	0.01
Long	0.84	-0.53	-0.13	0.39	-0.01
Universe	0.33	-0.27	-0.01	0.28	0.10

Source: FTSE ITRX

We are maintaining a slightly shorter duration than that of the benchmark index in our bond portfolios. We believe

rates could rise between now and year-end. The sector allocation remains unchanged, with a preference

for provincial and municipal issues now that budget season is behind us.

# Canadian Equities



By Martin Delage, Vice President, Equity

The Canadian stock market had a rather difficult first quarter in 2018, with the S&P/TSX posting a return of -4.52% for the first three months of the year. This poor performance is due to a number of factors. Observers were expecting weaker economic growth at the beginning of this year than during the same period in 2017. In addition, the renegotiation of the free trade agreement between Canada, the United States and Mexico (NAFTA) attracted attention and weighed on the Canadian stock market. The uncertainty engendered by these talks could dissipate in the coming weeks, however, since an agreement in principle is likely, which would establish the foundation of a new agreement between the countries concerned.

For the quarter, the only sectors posting positive returns were information technologies (+10.10%) and real estate (+0.53%). The rate increases had little impact on technology companies because of their low debt. CGI Group is among other things planning massive hirings in the next few years to support the growth associated with the contracts it expects to win. Enghouse Systems also had a good quarter, posting strong results with revenues of \$85.1 million versus \$78.8 million for the same period last year. In real estate, Blackstone acquired Pure Industrial Real Estate Trust, which manages a portfolio of industrial properties in Canada and the United States, for \$3.8 billion. In February, another real estate deal saw Choice Properties Real Estate Investment Trust acquire Canadian Real Estate Investment Trust for \$6.0 billion. The real estate arm of Loblaws announced in February that this acquisition will create the largest real estate investment trust in Canada, with 752 rental properties in Canada.

Another major transaction occurred in February when Scotia Bank bought Jarislowsky Fraser for \$950 million. This deal was made in an environment where asset managers are attractive for banks because of the income diversification they are able to generate. Nonetheless, the financial sector had a negative quarter (-3.49%).

Premium Brands Holdings, which owns a portfolio of companies in the food industry, performed well, despite the weak showing of the consumer staples sector (-5.92%). The company did particularly well, announcing a record fourth quarter, an increase in the dividend, and four upcoming acquisitions. The energy sector also ended the quarter in negative territory (-9.44%), with Canadian oil selling at US\$25 less per barrel than its American equivalent, West Texas Intermediate (WTI), early in the year. Canadian producers seem to be having difficulty exporting their extracted oil. The worst performing sector was health care, which underwent a correction from late 2017 levels, as investors rushed to buy marijuana-related stocks.

Table 3 – Canadian Stock Index

Sector Returns in the First Quarter of 2018		
	1 <sup>st</sup> quarter	Year to date
Information technologies	10.18%	-
Real estate	0.53%	-
Industrials	-2.60%	-
Consumer discretionary	-2.87%	-
Financials	-3.49%	-
Materials	-4.28%	-
Utilities	-5.85%	-
Consumer staples	-5.92%	-
Telecommunications	-6.69%	-
Energy	-9.44%	-
Health care	-13.51%	-
S&P TSX	-4.52%	-
S&P TSX 60	-4.61%	-

Source: Bloomberg

# Global Equities

By Martin Delage, Vice President, Equity



The MSCI World Index rose sharply at the beginning of the year, propelled by the S&P 500, which continued its strong performance of 2017 at the start of 2018, breaking through 2,800 points, a new record. However, global equity markets then underwent a correction, marked by negative returns in local currency. This correction was not an unwelcome development for American investors, as the U.S. stock market was relatively expensive. In fact, the pullback brought company valuations more in line with the country's economic growth. So the year started off well, but in late January, a period of high volatility began, with the U.S. equity market losing more than 4% in one day alone.

Market volatility increased considerably in the past few months. Observers seem concerned about wage hikes in the United States, which were higher than expected. This led to fears of a marked rise in inflation, which would put upward pressure on the Federal Reserve's overnight rate.

In addition, stock market indexes were particularly affected in March by news of data privacy breaches, as revealed by the Cambridge Analytical scandal. This communications company with ties to the U.S. Republican Party provided businesses and political movements with strategies and communication tools based on an analysis of data gathered by new technology companies (Facebook and Google, among others). Nevertheless, the information technology sector performed well, considering the rise in U.S. interest rates.

Another threat weighed on foreign investor expectations: the trade war that the United States seems to want to wage with its main trading partners like Canada and Mexico, as well as China. Donald Trump announced a 25% tariff on steel imports and a 10% tariff on imports of aluminum, which came into effect in March.

Euro zone economic indicators are generally positive. Consumer confidence is very high, at levels that haven't been seen in close to 17 years. In addition, unemployment is down in the region. Angela Merkel's new government was officially sworn in for the next four years, which boosted investor confidence in the region. The only cloud on the horizon is the rise of American protectionism, which could affect the euro zone, particularly with respect to motor vehicles, which would be hit with import tariffs.

In France, the reforms proposed by President Emmanuel Macron affect many French citizens, particularly future pensioners, who will see their benefits reduced by these reforms. Nevertheless, for Canadian investors, returns on euro zone investments are attractive when the impact of currency movements on performance is taken into account.

In the United Kingdom, Prime Minister Theresa May proposed a two-year transition phase where relations between the U.K. and the European Union would remain in place. In Japan, the appreciation of the yen negatively impacted the Nikkei stock index and weighed heavily on the companies listed there, most of which are exporters.

The NAFTA negotiations indirectly put significant downward pressure on the value of the Canadian dollar against the U.S. dollar, with the loonie dropping from close to US\$0.80 to US\$0.76, before rising to US\$0.78 at the end of the quarter. It should be mentioned that the countries seem to be close to an agreement, so the Canadian dollar could strengthen in the coming months.

Table 4 – Foreign Equity Markets

	First Quarter 2018 Total Return	
	In local currency	In CAD
<b>MSCI World</b>	-1.2%	1.4%
<b>United States</b>		
S&P 500	-0.8%	1.8%
Nasdaq	3.2%	5.9%
<b>MSCI EAFE</b>	-1.4%	1.2%
<b>MSCI Europe</b>	-1.9%	0.7%
Great Britain	-7.2%	-1.2%
Germany	-6.4%	-1.3%
Spain	-3.9%	1.2%
France	-2.5%	2.7%
Italy	2.8%	8.3%
Switzerland	-5.5%	-1.0%
<b>MSCI Pacifique</b>	-0.6%	2.0%
Japan	-5.1%	3.3%
Hong Kong	0.9%	3.1%
Australia	-3.4%	-2.4%
<b>Emerging markets</b>	1.4%	4.0%

Source: Bloomberg

Foreign equity markets generally posted negative returns in their respective local currencies. However, the weakness

of our dollar lifted these returns into positive territory for Canadian investors. We therefore continue to overweight

the U.S. market and overweight European equities, which offer attractive valuations for investors.

# Portfolio Strategy



As mentioned in our Point of View, the financial markets were characterized by volatility during the quarter. Canadian stocks in particular suffered, posting a return of -4.52%. Global equities also lost ground in their respective currencies, but the depreciation of the Canadian dollar more than offset this decline. For example, the U.S. market expressed in Canadian dollars produced a return of 1.84%.

Between now and year-end, economic growth should continue in North America as well as in Europe and Asia. We will therefore remain overweight equities.

The Canadian stock market performed poorly over the past few years relative to global equity markets. Generally, when we approach the end of a cycle, the Canadian market tends to outperform global markets. That is why our portfolios favour Canadian equities.

Globally, European markets offer better value than the U.S. market. Since monetary policies around the world are more restrictive, we remain underweight bonds. The duration of the portfolios will tend to be rather short.

Figure 3 – Relative Returns on Markets

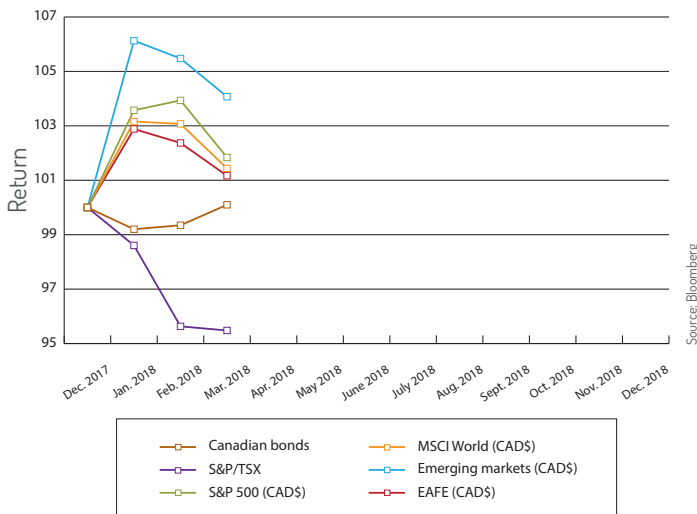


Table 5 – Balanced Portfolio Strategy

Asset Allocation	
Asset Class	Weighting relative to the benchmark
Short Term Securities	-
Bonds	▼
Equities (Total)	▲
Canadian Equities	▲
International Equities	-
United States	▼
Europe	▲
Asia	-
Emerging Markets	▼

Legend: ▲ Overweight  
 - Neutral Position  
 ▼ Underweight



# Market Review

As at March 31, 2018

	Annual			Quarterly	Monthly		
	2015	2016	2017	I	Jan-18	Feb-18	Mar-18
<b>OPTIMUM INDEX (in %)</b>							
Optimum Quebec Bond Index	4.58	2.52	4.71	-0.08	-1.22	-0.01	1.16
<b>FTSE TMX CANADA INDICES (in %)</b>							
Universe	3.52	1.66	2.52	0.10	-0.80	0.15	0.76
Federals	3.66	0.00	0.13	0.33	-0.77	0.36	0.75
Provincials	4.14	1.76	4.33	-0.27	-1.26	0.04	0.96
Municipals	3.18	1.98	4.65	-0.01	-1.07	0.17	0.90
Corporates	2.71	3.72	3.38	0.28	-0.24	0.01	0.51
Short Term	2.61	1.01	0.08	0.22	-0.22	0.28	0.16
Mid Term	4.86	1.61	0.96	0.01	-1.13	0.48	0.67
Long Term	3.80	2.47	7.03	-0.01	-1.37	-0.26	1.65
T-Bill 91 days	0.63	0.51	0.56	0.30	0.08	0.11	0.11
Real Return Bonds	2.79	2.86	0.73	1.38	-0.42	0.31	1.49
<b>STOCK MARKET INDICES (in %)</b>							
<b>Canadian Equities</b>							
S&P/TSX	-8.32	21.08	9.10	-4.52	-1.39	-3.02	-0.16
S&P/TSX 60	-7.76	21.36	9.78	-4.61	-1.39	-3.07	-0.20
S&P/TSX small cap	-13.31	38.48	2.75	-7.73	-2.16	-4.51	-1.24
S&P/TSX mid cap	-10.01	20.50	7.04	-4.24	-1.40	-2.84	-0.03
<b>Foreign Equities (US\$) (in %)</b>							
S&P 500	1.38	11.96	21.83	-0.76	5.73	-3.69	-2.54
S&P 100	0.34	8.78	19.34	-2.18	5.77	-3.96	-3.70
NASDAQ	6.96	8.87	29.64	2.59	7.40	-1.74	-2.79
MSCI World	-0.32	8.15	23.07	-1.15	5.30	-4.10	-2.11
MSCI EAFE	-0.39	1.51	25.62	-1.41	5.02	-4.50	-1.70
MSCI Europe	-2.34	0.22	26.24	-1.86	5.41	-5.86	-1.10
MSCI Asia	3.21	4.46	24.96	-0.57	4.34	-2.08	-2.68
<b>A Foreign Equities CDN\$ (in %)</b>							
S&P 500	20.73	8.74	13.95	1.84	3.57	0.35	-2.02
S&P 100	19.49	5.65	11.61	0.38	3.62	0.06	-3.18
NASDAQ	27.38	5.74	21.25	5.27	5.21	2.38	-2.27
MSCI World	18.70	5.04	15.11	1.44	3.16	-0.08	-1.59
MSCI EAFE	18.62	-1.41	17.49	1.17	2.88	-0.50	-1.18
MSCI Europe	16.30	-2.66	18.06	0.71	3.27	-1.91	-0.57
MSCI Asia	22.91	1.46	16.87	2.03	2.22	2.02	-2.16
<b>CURRENCIES (in %)</b>							
CDN\$/US\$ <sup>1</sup>	19.09	-2.88	-6.47	2.62	-2.04	4.19	0.54
YEN/US\$ <sup>1</sup>	0.37	-2.71	-3.65	-5.69	-3.11	-2.30	-0.37
US\$/EURO <sup>2</sup>	-10.22	-3.18	14.15	2.66	3.41	-1.77	1.07

1. A positive (negative) amount indicates appreciation (depreciation) of the U.S. dollar.

2. A positive (negative) amount indicates appreciation (depreciation) of the Euro.

Source: Bloomberg



# Our team

## INSTITUTIONAL MANAGEMENT



**Brigitte Gascon, MBA, B.Sc.**  
Senior Vice President,  
Development  
Telephone: 514 288-7545, ext. 594  
[bgascon@optimumasset.com](mailto:bgascon@optimumasset.com)



**Gérald Gagnon, CPA, CA, CFA, MBA**  
Vice President,  
Investment  
Telephone: 514 288-7545, ext. 603  
[ggagnon@optimumasset.com](mailto:ggagnon@optimumasset.com)

## PRIVATE WEALTH MANAGEMENT



**Sylvain B. Tremblay, C.Ad., F.PI.**  
Vice President,  
Business Relations  
Telephone: 514 288-7545, ext. 614  
[sbtremblay@optimumasset.com](mailto:sbtremblay@optimumasset.com)



**Éric G. Ouellet, B.A.A., F.PI.**  
Vice President,  
Business Relations  
Telephone: 514 288-7545, ext. 630  
[eouellet@optimumasset.com](mailto:eouellet@optimumasset.com)



**Chantal Matos, F.PI.**  
Manager,  
Business Relations  
Telephone: 514 288-7545, ext. 618  
[cmatos@optimumasset.com](mailto:cmatos@optimumasset.com)



## Optimum Asset Management Inc.

Optimum Asset Management Inc., founded in 1985, has close to \$7.5 billion in assets under management in Canada for institutional and private wealth clients. Optimum Asset Management is a member company of Optimum Group, a private Canadian financial group with international operations in life insurance, property and casualty insurance, life reinsurance, consulting services and asset management. The Head Office of Optimum Group is in Montreal, and more than 500 employees in Canada, the United States and France contribute to its success.

425 de Maisonneuve Blvd. West, Suite 1620, Montreal, Quebec H3A 3G5  
Telephone: 514 288-7545

80 Bloor Street West, Suite 1500, Toronto, Ontario, Canada M5S 2V1  
Telephone: 416 922-5000

OPTIMUM.