TURNER INVESTMENTS COMMENTARY

Hon. Garth Turner PC

Senior Vice President,
Private Client Group,
Financial Advisor

416-346-0086

Douglas Rowat

Senior Vice President,
Private Client Group,
Portfolio Manager

416-777-6403

Ryan Lewenza

Senior Vice President,
Private Client Group,
Portfolio Manager

416-777-6416

TOP BUSINESS STORIES OF 2017

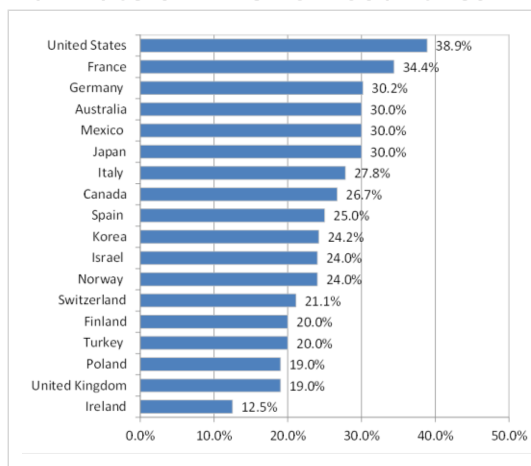
US CORPORATE TAX REFORM FINALLY ARRIVED

For a time, it seemed that the Republican corporate tax reform plan would fail in the same way that its health care reform proposal did earlier in the year because of insufficient support from within its own party (Trump eventually called Senate Republicans "total quitters" for giving up on the replacement of Obamacare). However, after lengthy last minute negotiations with holdout Republican senators, the Senate passed the new tax bill on December 20th by a party-line vote of 51 to 48. The tax overhaul was forecast to increase the federal deficit by hundreds of billions of dollars, but it drastically cut the federal corporate tax rate from 35% to 21% along with lowering personal tax rates and reducing or eliminating estate taxes. Passage of the bill was a much-needed legislative victory for the Trump administration, which up until that point was generally perceived as disorganized and unable to secure loyalty from its own Republican Party.

Our Take for 2018

We believe that the Republican tax reform plan represents one of the most significant tax reforms seen in decades, which could provide a significant boost to the US economy over the next several years. We believe these changes will immediately improve the US economy by enabling US corporations to increase investment spending, add to their workforces and grow wages.

US Had the Highest Corporate Tax Rate of All OECD Countries



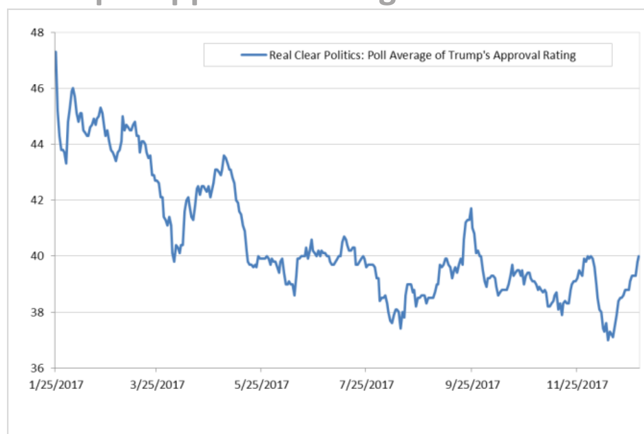
Source: OECD, Turner Investments. For US, includes state and federal tax rate.

Other pro-growth Trump policies that could possibly be enacted this year include increased infrastructure spending and the elimination of government regulations, which Republicans argue have been hampering economic growth for years.

THE NOOSE TIGHTENED AROUND THE TRUMP ADMINISTRATION

While Trump's legislative agenda had its hits and misses in 2017, his own personal and inner-circle difficulties amounted to one big miss. It's hard to pinpoint when Trump's troubles began in earnest because his first year as president was marked by an avalanche of almost continuous controversy. However, certainly a key turning point came with his firing of FBI Director James Comey in May. The FBI had opened an investigation into the billionaire president due to his business interests with Russians and Russia's possible interference in the 2016 presidential election. Comey's firing, which created an uproar due to its apparently blatant conflict of interest, eventually led to the creation of a bi-partisan special-counsel investigation team led by former FBI Director Robert Mueller.

Trump's Approval Rating Plummeted



Source: Bloomberg, Turner Investments

By year-end, Mueller had indicted four of Trump's key advisors including former National Security Adviser Michael Flynn who pled guilty to "willfully and knowingly" making "false, fictitious and fraudulent statements" to the FBI. Flynn's guilty plea started the ball rolling for an almost continuous decline in Trump's approval rating throughout 2017.

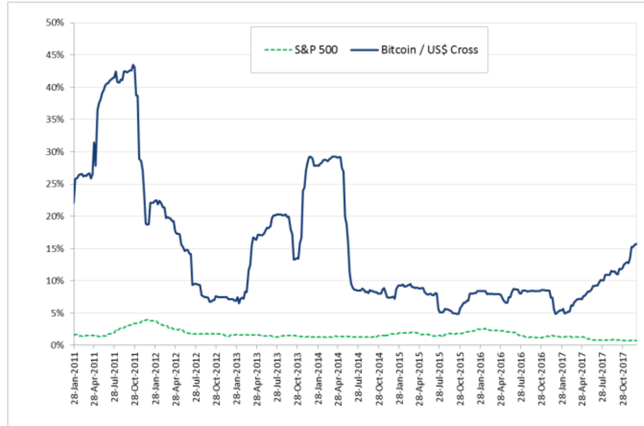
Our Take for 2018

It's a virtual certainty that the Mueller investigation will continue to be a key focus for markets in 2018. If a complete collapse of Trump's presidency appears probable this would very likely be negative for markets because the Republican agenda is seen as stimulative for corporate profit growth. However, it's likely the downside would be short-lived because Trump's successor, Vice President Mike Pence, himself supports the same agenda and is viewed as, needless to say, a more traditional politician. Also, because the most important aspect of the Republican agenda—corporate tax reform (see above)—has already been passed into law and the US economy remains strong, the downside is likely to be limited if Trump were to be impeached or serve only one term.

BITCOIN EXPLODED

Bitcoin, in case you were living under a rock last year, is a digital currency that saw its price reach mind-boggling levels in 2017. Bitcoin was invented by a person (or group) working under the pseudonym Satoshi Nakamoto who was trying to create a transaction system that would prevent counterfeiting. The first bitcoin software was released in early 2009. The central appeal of bitcoin is its use of blockchain technology, which is a publicly visible, anonymous, online ledger that makes every single bitcoin transaction transparent and, ostensibly, secure. Nakamoto also capped the bitcoin market as no more than 21 million bitcoins will ever be issued.

Bitcoin's Unbelievable Volatility



Source: Bloomberg, Turner Investments. Chart measures 6-month rolling standard deviation of the bitcoin/US$ cross price and the S&P 500 Index. Standard deviation measures the amount of variation or dispersion within a particular index or security. In other words, it measures risk.

As bitcoin's price rose throughout the year, the debate raged as whether or not it was a legitimate financial asset. Proponents of bitcoin argued that it was a revolutionary new payment system that will benefit consumers and investors alike by allowing them to bypass big banks, governments and credit-card companies to perform transactions. Detractors argued that bitcoin was simply a software database and that its value wasn't supported by any underlying fundamentals whatsoever. In September, JP Morgan CEO Jamie Dimon even went as far as to call bitcoin a "fraud". But regardless of its legitimacy, the price of bitcoin in US dollars soared a staggering 1,400% in 2017.

Our Take for 2018

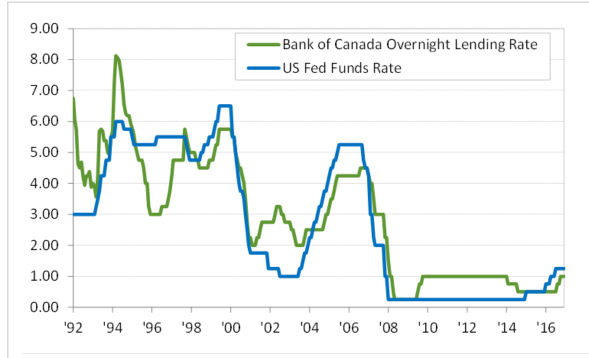
We're undecided regarding bitcoin's long-term potential, but we're certain of two things: 1) we only use ETFs in building client portfolios, and while there are several proposals for bitcoin ETFs, as of this writing, one doesn't yet exist and 2) bitcoin is extraordinarily volatile. To put the volatility in perspective, over the past five years (to year-end 2017) the S&P 500, a relatively volatile equity market, has recorded *zero* trading days with a one-day gain or decline of 5% or more. Bitcoin meanwhile has recorded a staggering 280 such days, including six days where it dropped by 20% or more and two days where it actually fell by 40% or more! As a result, it's highly unlikely that we'll be directly investing our clients in bitcoin in 2018.

THE RATE-HIKE PARADE BEGAN

After years of record-low interest rates, some central banks began the process of normalizing interest rates in 2017. With the Canadian and US economies accelerating last year and inflation slowly picking up, the US Federal Reserve and Bank of Canada responded by hiking interest rates three and two times, respectively. For Canada, 2017 was the complete inverse of 2015 when the Bank of Canada cut interest rates twice as it contended with a recessionary Canadian economy.

Impressive labour-market strength was shown for both countries as the US economy added an additional 2 million jobs, which helped drive the US unemployment rate down to a 15-year low of 4.1%, and in Canada, over 400,000 jobs were created with our unemployment rate falling to 5.7%.

The Fed and BoC Historically Move Rates In Lock-Step



Source: Bloomberg, Turner Investments

Our Take for 2018

With both economies at or close to full employment, it makes sense for the Fed and Bank of Canada to begin tightening their monetary policies. The key question is how fast and how much will they do this?

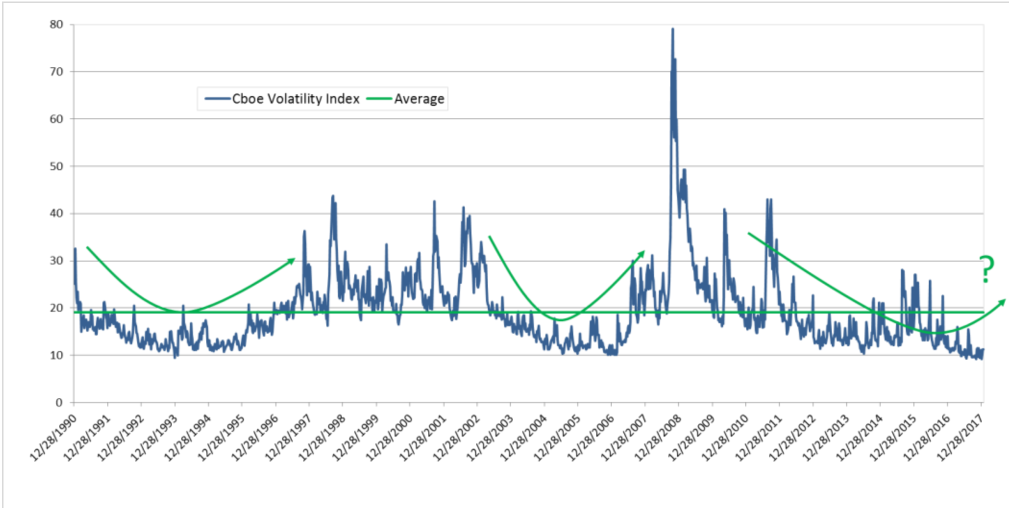
In 2018, we see the US economy growing by more than 3% driven by a strong consumer and the recent US tax reform, which should provide additional stimulus for its economy. For Canada, we see slower growth of roughly 2.5% as higher interest rates weigh on consumer spending and uncertainty over NAFTA weighs on businesses and exports.

Based on this outlook, we see the Fed hiking rates faster than the Bank of Canada with the Fed potentially raising rates three times in 2018 versus the Bank of Canada at two hikes for this year. The key point is that we see central banks continuing to tighten but to remain gradual with their rate increases.

VOLATILITY DISAPPEARED

While bitcoin values kept investors on their toes in 2017, overall market volatility was generally putting them to sleep. The Cboe Volatility Index (VIX), which measures market expectations of near-term volatility based on S&P 500 option prices, hit an all-time-low close of 9.14 in November. Overall volatility was down 21% y-o-y. What makes the VIX readings remarkable is that they occurred in a year when the US president threatened North Korea with nuclear annihilation and was himself under investigation by special counsel Robert Mueller to determine his possible collusion with Russia during the 2016 election campaign. Thus far, as noted above, Mueller has charged four Trump associates with various crimes including former National Security Adviser Michael Flynn. However, despite these political uncertainties, markets remained docile and investors focused on the business positives including rising corporate profitability and the Republican's corporate tax reform (see above).

Volatility Moves In Cycles



Source: Bloomberg, Turner Investments

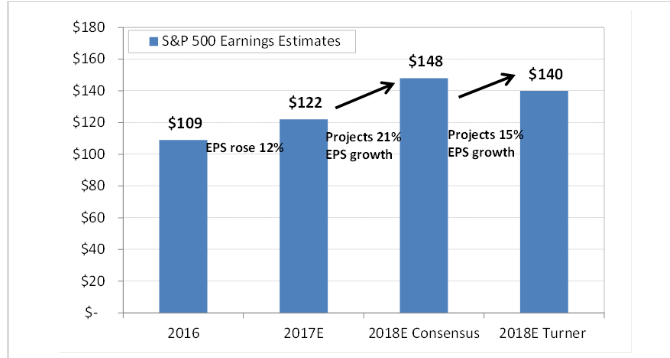
Our Take for 2018

While we recognize that something has to actually occur to cause volatility to rise, we are not blind to volatility's historical cycles. Volatility has now declined for three consecutive years, which is unusual; sits at roughly *half* its long-term average; and, except for a brief period in 2015 and 2016 has been subdued for roughly six years. Historically, 5–7 years is close to the maximum length of time for volatility to remain low (see chart). The pattern suggests to us that volatility is likely to begin rising, perhaps this year. What will cause the rise is uncertain (A Trump indictment? Trump's unpredictable foreign policy? Interest rate increases?), but an emphasis on ETFs that control volatility without significantly limiting upside potential will be a priority throughout the year.

A RECORD NUMBER OF MARKET HIGHS

The Dow Jones Industrial Average (DJIA) hit 70 record highs in 2017 and hit *four* 1,000-point milestones for the first time ever—a record of records, so to speak. On January 25th the DJIA closed above 20,000 for the first time and didn't stop there, overall advancing more than 25% y-o-y. Of course, it wasn't just the DJIA that performed well last year. The other major US equity benchmarks—the S&P 500 and Nasdaq—also had impressive years, advancing more than 19% and 28%, respectively.

US Earnings Outlook Remains Bright



Source: Bloomberg, Turner Investments

Earnings growth, of course, was a major driver of these double-digit returns. Last year S&P 500 earnings rose roughly 13% y-o-y (we're still waiting on final Q4 results) and this earnings growth drove roughly two-thirds of last year's market gains. So last year's gains were driven by improving fundamentals (i.e., earnings) more than anything else.

Our Take for 2018

We're conservatively (versus consensus) forecasting S&P 500 earnings to grow 15% y-o-y this year as the global economy accelerates, commodities trend higher and US companies get a boost from the lower corporate tax rate. We see earnings growth as the single biggest driver for equity markets and this is the central reason why we see this bull market continuing in 2018.

COMMODITIES AND EMERGING MARKETS RALLIED

With the global economy rebounding strongly last year, commodities bounced back in 2017 following recent years of underperformance. For example, WTI oil rose 12% y-o-y in 2017 to US$60.42/barrel while copper prices rallied 32% to US$3.30/lb. Production cuts from major oil exporters and stabilizing US shale oil production also contributed to oil's rise and the supply glut that the oil industry experienced in 2015 had largely evaporated by the end of 2017. Relatively robust economic growth from China and a strong US consumer was also beneficial for raw material demand.

Commodities Are Extremely Cheap Relative to US Equities

Source: Bloomberg, Turner Investments

Our Take for 2018

We believe the outlook for commodities remains bright, which could have positive implications for our clients' emerging market exposure. There are a number of factors that drive our positive view:

1. Global growth is expected to rise to 3.7% this year, which would mark the strongest growth rate since 2011. For the first time in years we are seeing a synchronized expansion with all key countries and regions accelerating. For example, China's economy rebounded from its slowdown in 2016 with its economy growing at 6.9% in 2017. Europe's economy grew at more than 2% last year, while the US economy has averaged 3% GDP growth over the last three quarters. We see this trend continuing in 2018.
2. Many commodities are seeing a return to a more balanced market with high inventories being worked off and supply starting to match demand. Copper, for example, has seen supplies tighten from lower mining activity while demand from China remains strong. Similarly, global oil inventories are down from their peaks with demand expected to outstrip supply in 2018, according to the US Energy Information Administration. A more balanced market for many commodities could lead to further price gains in 2018.
3. Even with the recent bounce in commodities they remain very cheap relative to other assets. We illustrate this above by comparing commodity prices relative to the S&P 500. We note that commodities are trading at nearly a 50-year low relative to US stocks. We believe some mean reversion is due and that commodities will continue to add to last year's gains.

Our positive view of commodities should be supportive of emerging market equities given their high exposure to the resource sector. We added to the emerging markets last year, which turned out to be fortuitous with emerging market equities delivering strong gains in 2017. We see this trend continuing in 2018.

STORMY WEATHER

2017 was a terrible year for weather-related disasters. It seemed like every other day we were hit with another catastrophe from Hurricane Harvey and Irma to droughts and heat waves to wildfires in British Columbia and California. All told, the US National Oceanic and Atmospheric Administration (NOAA) estimated that economic losses from the 16 main weather-climate disasters in 2017 exceeded US$306 billion, a new record.

Here's a good summary quote from a recent NOAA press release: "The biggest newsmakers include the western U.S. wildfires that caused damages tallying $18 billion—triple the previous U.S. record. Losses from Hurricane Harvey exceeded $125 billion, which ranked second only to Hurricane Katrina, the costliest storm in the 38-year period of record. Hurricanes Maria and Irma had total damages of $90 billion and $50 billion, respectively. Hurricane Maria now ranks as third costliest weather and climate disaster on record for the nation, with Irma coming in close behind as fifth costliest."

Our Take for 2018

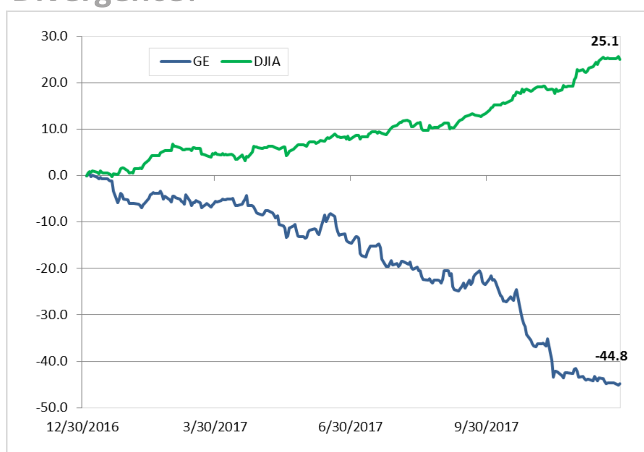
We'll leave the explanations as to why these disasters are occurring to the experts, but we believe 2017 was simply a continuation of a clear long-term worsening weather trend and that we're likely to see more of these weather-related events in 2018 and beyond.

From an economic and investment perspective, we don't see the weather having a material impact on economic growth or equity market returns over the short to medium term, but it's a worrisome trend that could become more impactful over time. For now, while devastating to the people and areas impacted, the broader economic disruption is likely to be minimal. Growth in these areas could also potentially accelerate in subsequent quarters as rebuilding takes place. Overall, the market impact from weather events was minimal in 2017 and will likely continue to be so in 2018.

GENERAL ELECTRIC'S SHARE PRICE COLLAPSED

General Electric (GE) was formed in 1892 and just a few years later, in 1896, the iconic Dow Jones Industrial Average (DJIA) was launched with GE as one of its original members. Over 120 years later, GE remains the only original company still a part of the DJIA. However, in 2017 speculation was rampant that GE might lose this legendary status. There are no strict rules for inclusion in the DJIA and decisions are actually made by the editors of *The Wall Street Journal*, but many felt that GE had lost the respect of investors, was no longer a representative component of the US economy and that it was just a matter of time before it got the boot.

Divergence!



Source: Bloomberg, Turner Investments. Chart measures cumulative price returns as a percentage throughout 2017

Here's why. GE struggled operationally throughout the year with particularly weak results from its power generation business especially within the gas and coal space. Near year-end, the company announced plans to lay off 12,000 workers within power generation in order to bring costs under control. Other factors weighed on performance including high pension costs and ongoing liabilities related to its long-term care insurance business. Ultimately, the headwinds resulted in new CEO John Flannery repeatedly disappointing the market with GE's earnings results and forced a massive 50% cut of the company's dividend. All told, GE's shares plummeted almost 45% in 2017, a remarkable underperformance of the overall DJIA, which advanced more than 25%.

Our Take for 2018

General Electric's troubles served as a reminder of why we don't invest in individual equities in client portfolios. With a surging global economy and an uptrending bull market, who would have guessed that a highly cyclical engineering conglomerate such as GE would underperform so badly? Such are the dangers of individual stock selection. Even apparently safe, well-established companies find ways to self-destruct, which can devastate improperly diversified portfolios. JP Morgan examined the price action for securities in the Russell 3000 Index, a broad-based index of US equities, and showed that, over time, the odds of any one position experiencing a catastrophic loss—a decline of 70% or more from the peak with minimal recovery—were 40% and in some riskier sectors, such as information technology, the odds rose to nearly 60% (see adjacent table). While GE didn't fall into the 'catastrophic loss' category in 2017, its decline still highlights the problem of equity concentration risk. If you had a portfolio of only, say, five or six stocks, imagine how devastating it would have been to have held GE last year? One of the greatest bull-market years in history would have been wasted. Our portfolios will always utilize broad-based, fully diversified ETFs.

Falling From Grace

Sector	Total % of companies experiencing a "catastrophic loss", 1980–2014
Consumer Discretionary	43%
Consumer Staples	26%
Energy	47%
Materials	34%
Industrials	35%
Health Care	42%
Financials	25%
Information Technology	57%
Telecommunication Services	51%
Utilities	13%
All sectors	**40%**

Source: JP Morgan; a catastrophic loss is defined as a 70% decline from peak value with minimal recovery. Data based on Russell 3000 Index constituents.

EUROPEAN MARKETS RALLIED

It's been a tumultuous decade for European equity markets. Like all markets, Europe was pummeled during the 2008–09 financial crisis, but as global markets slowly rebounded, Europe threatened to derail the entire recovery as its own sovereign debt crisis erupted (remember Greece and 'contagion'?). Finally, the surprise Brexit vote in 2016 indicated that the European Union (EU) may be on its last legs. However, investors may have been premature in predicting Europe's demise.

Europe began 2017 engulfed in political uncertainty as it appeared it might follow the US example and elect far-right candidates who were mainly focused on breaking up the EU. However, the election win in May by France's Emmanuel Macron, a more moderate candidate compared to his populist rival Marine Le Pen, signaled that Europe was headed in a more centrist direction. This trend was confirmed in September as Angela Merkel and her Christian Democrats won the German election and by year-end she seemed close to forming a coalition government and proceeding with her fourth term in power.

Our Take for 2018

European political uncertainty will continue to be a market focus in 2018 as Italy goes to the polls in early March. Currently, yet another populist, anti-establishment party, the Five Star Movement, is a contender in this election. The Five Star Movement has suggested that, if elected, it will hold a referendum to determine whether Italy should remain in the EU. Despite this political uncertainty, the many years of European markets underperforming the US have made European equity valuations comparatively quite attractive. We are likely to continue to hold the Vanguard FTSE Europe ETF (VGK) in our client portfolios. VGK tracks the performance of the FTSE Developed Europe Index and holds recognizable blue-chip European companies such as Nestle, Siemens, Royal Dutch Shell and Novartis. VGK performed well in 2017, up more than 23%.

CONCLUSION: THE TRUMP ERA CONTINUES

We noted last year that "many of Trump's policies have the potential to be enormously positive for the US economy and markets". We certainly said this with a certain amount of trepidation, but it turned out to be a correct statement as the S&P 500 rallied more than 19% and global equities overall advanced more than 20%. But now we head into year two.

We maintain a favourable view of markets as the positive momentum from Trump's tax reform has the potential to extend well into 2018. However, we are also cautious on a number of fronts: elevated equity valuations, rising interest rates that will eventually blunt economic growth and corporate profitability, persistent political risks (the Italian elections in March, the US mid-term elections in November and the ongoing Mueller investigation) and simply the unusual length of time that volatility has remained low are all factors that concern us.

Clients should expect us to move quickly to lower portfolio risk if we begin to see deterioration in fundamentals, particularly US corporate earnings. We're enjoying the Trump stock market party, but all parties eventually come to an end.

TURNER INVESTMENTS OF RAYMOND JAMES LTD.

40 King Street West
Suite 5300, Toronto, Ontario M5H 3Y2
Tel: 416-777-7000 | Fax: 416-777-7020

www.turnerinvestments.ca

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