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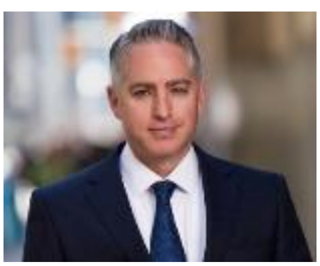

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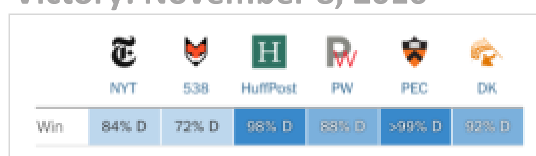
## TOP BUSINESS STORIES OF 2016

### TRUMP WON THE US PRESIDENTIAL ELECTION

It was the most improbable of US presidential election victories, but it got its start back in June 2015 when Donald Trump announced his candidacy with a speech that set the controversial—and sometimes shocking—tone for his entire campaign. In reference to immigration policy, Trump called illegal immigrant Mexicans "rapists" and promised to build a wall across the entire US-Mexican border. He also introduced his now iconic slogan "Make America Great Again". It only got more interesting from here as Trump went on to attack Muslims, a Gold Star family, a Latina Miss Universe contestant, the media (endlessly), actor Alec Baldwin and, most notably, prominent members of his own Republican Party. He also raised eyebrows by citing foreign leaders that he professed to admire including Russian President Vladimir Putin. However, perhaps the most jaw-dropping moment came when a 2005 *Access Hollywood*–bus video surfaced late in the campaign featuring Trump using foul language and stating that he had groped women. Come election time, pollsters had Trump as a very distant long-shot with virtually no chance of winning versus Hillary Clinton. Yet, he won.

**Projected Odds of Clinton Victory: November 8, 2016**




Source: *New York Times*

Despite losing the overall popular vote, Trump won the Electoral College vote 306-232 on an uprising of mostly white, less educated, male voters.

#### Our Take for 2017

We'll certainly never trust another poll as long as we live, but Trump's victory was a reminder that the unexpected is a constant feature of capital market investing and also a reminder of the importance of maintaining a balanced portfolio, which permits upside even when it's not forecast. Remarkably, the S&P 500 traded lower for nine consecutive days just prior to the election as

Trump rose in the polls and concerns over Hillary Clinton's email scandal grew. Indeed, even on election night, as it became certain that Trump would win, Dow futures were lower by more than 800 points. Clearly, a Trump victory was going to be a market disaster. However, by the end of trading the next day, the S&P 500 was actually *higher* by more than 1% and the 'Trump rally' continued throughout the rest of the year. The S&P 500 gained 5% from election day to year-end including dividends and finished the year up 12% overall. This is why we build balanced portfolios: because we know what we don't know. As well as we forecast, the unexpected will always occur.

## BREXIT

Brexit, the British referendum where voters were to decide, in broad strokes, whether they wanted to leave the European Union, was barely on anyone's radar at the start of 2016. However, by June it was all most market analysts could talk about. In an upset, the 'Leave' side won by a 52% to 48% margin, with voters, similar to the US presidential election, divided sharply by demographics. For example, voters with less formal education were far more likely to side with the Leave campaign. The outcome initially resulted in global market volatility, but this quickly stabilized after it was assumed that the Bank of England would take measures to stimulate the UK economy. Politically, the ramifications were severe. The result forced the resignation of Prime Minister David Cameron, who supported the UK remaining in the European Union, and Theresa May, leader of the Conservative Party, took over as prime minister. The British pound was hammered immediately after the vote and never recovered (see chart).

**GBPUSD FX Rate: Can You Spot Brexit?**


Source: Bloomberg, Turner Investments

### Our Take for 2017

All pundits, including us, should have paid more attention to the outcome of the Brexit vote when it came to forecasting Trump's victory a few months later. As with Trump and the US presidential election, many pollsters and betting lines had the Leave side as a long-shot. The Brexit result was an early indicator of the populist uprising not only in the UK and Europe but now globally. Whether the Trump win and Brexit signal a definitive shift for global politics towards the far right remains to be seen. We highlight, for instance, that Hillary Clinton actually won the popular vote in the US presidential election and there was a huge upswell of support for left-leaning Democratic candidate Bernie Sanders. However, the uncertainty that this disruptive right-wing political movement has caused has not necessarily been bad for markets. As an example, the Brexit outcome forced a reaction from the Bank of England as it cut its key bank rate to a record-low 0.25% and announced an increase in its bond-buying program. From the June 23 Brexit vote to year-end, the benchmark UK FTSE 100 Index actually rallied almost 15% on a total-return basis. There are many other key European elections upcoming in 2017 that may result in shifts to the right, including the French presidential election in the April/May. While our clients may not agree with these political outcomes, it's important to remember that the results aren't always bad news for their portfolios.

## PREFERRED SHARES: A COMEBACK!

2015 was ugly for the Canadian preferred share market, as the Bank of Canada cut interest rates twice, the oil price plunged 30% (many preferred share issuers are from the oil & gas infrastructure space) and retail investors, who are notoriously skittish, bailed out. Preferred shares, even with their attractive dividends, fell 15% in 2015.

**Institutional Interest in Preferreds**


Source: BMO Capital Markets, May 2016

It appeared that 2016 was going to follow the same trend, as preferred share prices continued their freefall at the start of the year driven by uncertainty over the Canadian economy and interest rate direction. Cue the comeback. After bottoming in January, preferreds advanced rapidly fueled by a recovering oil price, stimulus spending announced by the Liberal government (therefore less likelihood of another Bank of Canada rate cut), very compelling dividend yields and renewed interest from institutional investors (see chart). Including dividends, preferred shares advanced 7% in 2016, but were up a remarkable 27% from their January lows.

### Our Take for 2017

We stated flatly in our July 2015 newsletter: "we believe that the preferred share market is oversold and that it would be a mistake to sell into current weakness". We were a bit early with our timing, but our investment rationale was correct. Firstly, as we anticipated, bond yields did move higher. Recall that most Canadian preferred shares are structured as rate-resets, which have their dividends pegged to the Government of Canada (GoC) 5-year bond yield. As government bond yields rise, typically so do rate-reset preferred share prices. The GoC 5-year bond yield rose from 0.73% at the start of the year to finish at 1.12%—a very significant yield move. We also noted that preferred share dividend yields had become compelling and would soon start attracting institutional interest ("professional investors are licking their lips" was exactly how we put it). Again, as the chart above indicates, this is also precisely what occurred. We continue to believe that the preferred share market will sustain its momentum in 2017 and we maintain our 18% weighting in most client portfolios. The year-end yield for the sector of 4.9% also remains compelling.

## US EQUITIES HIT RECORD HIGHS

Despite a China scare in January, oil prices falling to new lows, Brexit and the surprise Trump election win, equity markets did very well in 2016, with US equity markets hitting new all-time highs. However, after five consecutive years of underperformance, the S&P/TSX Composite was the standout winner in 2016, with the S&P/TSX posting a total return of 21% versus the S&P 500 at 12%. Despite the strong year, the S&P/TSX was unable to break above its 2014 highs of 15,685. In contrast, the S&P 500 and Dow Jones Industrials both broke out to new highs in 2016, with the S&P 500 and Dow closing the year at 2,238.83 and 19,762.60, respectively. The Dow, in particular, stood out as it got within a hair of the milestone 20,000 level. Is 2017 the year of Dow 20,000+?

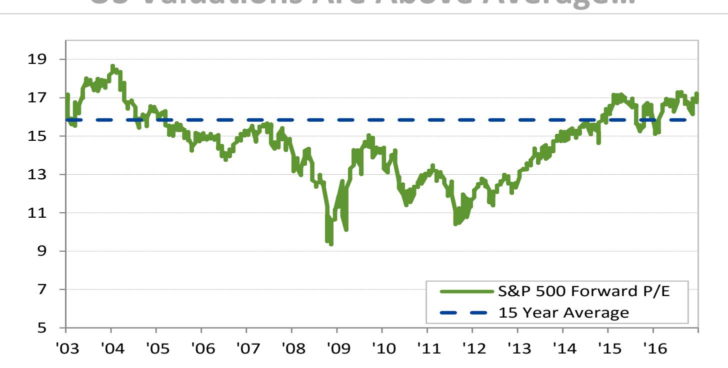
### Our Take for 2017

With US equity markets hitting new all-time highs in 2016 and the Dow within earshot of 20,000, some are pointing to this as an indication that the end is near. We disagree with this simplistic conclusion and see the bull market continuing in 2017. With the strong equity gains seen since 2009 (and in 2016), valuations are definitely becoming elevated, which requires close monitoring; however, we believe the main story in 2017 will be stronger corporate earnings.

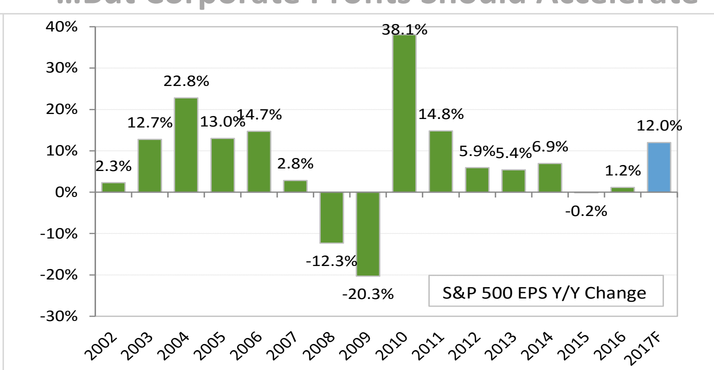
We believe corporate earnings will rebound in 2017, following a disappointing 2016. Currently, analysts expect S&P 500 earnings to rise by 12% in 2017, following 2016's subdued 1% rise. While that estimate appears a bit high to us, we believe the stronger US and global economy should help to drive earnings higher this year and are estimating earnings to rise in the high single-digits. If correct, this should help to drive the S&P 500 higher and we project the S&P 500 reaching 2,400 by year-end.

Valuations are a risk to this forecast, however. Currently, the S&P 500 is trading at 17x forward earnings, which is a 10% premium to the long-term average of 15.5x. So, stocks are a bit expensive, but not at nosebleed levels.

US Valuations Are Above Average…




…But Corporate Profits Should Accelerate




Source: Bloomberg, Turner Investments

## OIL RALLIED

Global oil markets have been in oversupply since the beginning of 2014. This is largely a result of new drilling techniques pioneered by US oil producers, which helped the US to double its oil production in less than 10 years, and OPEC continuing to pump out a record amount of oil. However, this looks set to possibly reverse, with some forecasting global oil markets to balance sometime this year.

Looking back over 2016, it was the start of the year that proved toughest with West Texas Intermediate (WTI) plummeting to US$26/bbl in mid-February—the lowest level since 2003! It then doubled over the next few months hitting US$50/bbl in June before trading sideways for the remainder of the year.

### Our Take for 2017

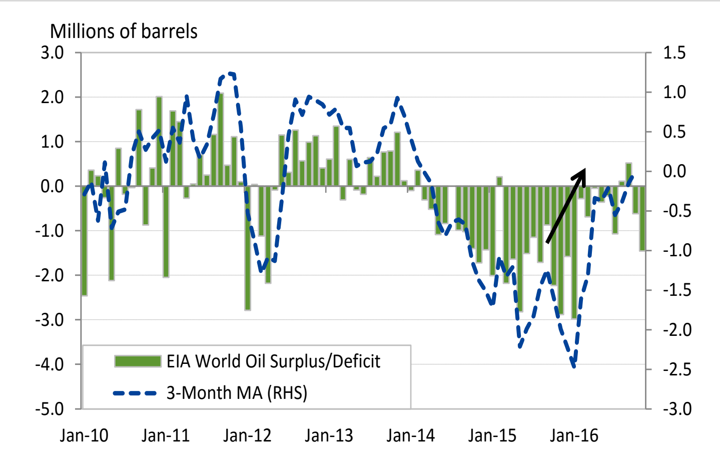
We see oil prices continuing to recover in 2017, but believe upside could be limited due to the potential for US frackers to bring production back online quickly as prices move higher and environmental constraints are removed by Trump.

The key to our more constructive outlook for oil prices is the potential for global oil markets to go from oversupply to a more balanced market in 2017. For example, the US Energy Information Administration (EIA) now believes that global oil markets could balance in Q2/17 versus an earlier forecast for the second half of 2017. We tend to agree with this view and cite the following factors:

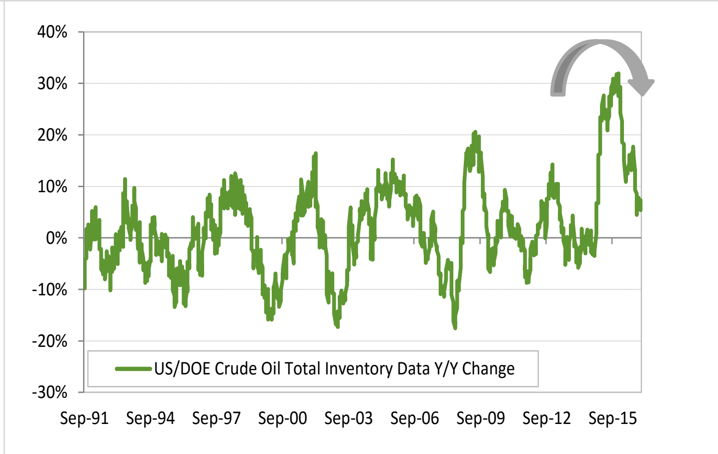
- Global oil demand is expected to rise to a new record high with the EIA forecasting global oil demand to rise to 97.2 mln b/d, from 95.5 mln in 2016.
- Meanwhile, oil supply is expected to rise just modestly. Contributing to reduced supply was OPEC's decision in December to cut their production by 1.2 mln b/d beginning in January. OPEC has a questionable record of adhering to its stated production limits, which we recognize as a risk to our outlook; however, from our perspective OPEC looks to have changed its position from fighting for market share to now supporting higher prices (maybe Saudi Arabia's US$80 bln dollar deficit in 2016 is contributing to this?)
- US oil inventories look to have peaked and are starting to decline on a y-o-y basis. Looking at the chart below, US oil inventories peaked at 30% y-o-y in 2015 and have continued to decline since. Declining inventories are a necessary pre-condition for oil prices to form a sustainable bottom
- Lastly, from a technical perspective, WTI oil prices are looking better having broken above important resistance levels

So, putting it all together, we believe oil prices could firm up a bit in 2017 and are targeting US$60/bbl by year-end. However, we stress that we don't see prices rising appreciably since: 1) inventories, while improving, remain high; and 2) the US frackers could easily ramp up production helping to put a ceiling on oil prices. In short, we remain *cautiously* optimistic for oil prices over the next year.

## EIA Forecasting Balanced Oil Market In 2017




## Inventories Beginning to Improve




Source: Bloomberg, EIA, Turner Investments

## THE FED RAISED RATES

In 2015, the US Federal Reserve dominated newsflow as the market hung on every word from Fed Chairwoman Janet Yellen. And the market finally breathed a massive sigh of relief when the Fed finally raised rates at year-end for the first time in more than nine years. However, the market's focus changed entirely in 2016 as it became much more interested in tweets from Donald Trump than statements from Janet Yellen. This is not to say that the Fed didn't matter in 2016, but it definitely lost some of its relevancy as closer attention, particularly near the election, was paid to Trump's standing in the polls and ultimately, after his victory, to his economic policies.

When the Fed finally did raise its key overnight rate in 2016 another quarter point also near year-end, the market reacted, in sharp contrast to 2015, with more of a shrug of the shoulders. In its final meeting of the year, the Fed indicated that it's now targeting three more rate increases in 2017.

### Our Take for 2017

A second rate hike in two years combined with Trump's potentially inflationary economic policies and the Fed forecast mentioned above, now clearly indicate that a tightening cycle is in motion. We also noted in a recent newsletter that rate increases are virtually never made in

### Tightening Cycles: Rarely Bad For Markets

| Cycle Start | Cycle End | Number of Days | Number of Hikes | Cumulative S&P 500 Total Return (%) |
|---|---|---|---|---|
| 3/29/1988 | 6/5/1989 | 433 | 11 | 29.4 |
| 2/1/1994 | 7/6/1995 | 520 | 7 | 20.3 |
| 6/30/1999 | 1/3/2001 | 553 | 6 | -0.6 |
| 6/30/2004 | 9/18/2007 | 1,175 | 17 | 41.4 |
| 12/15/2015 | ? | 380 so far | 2 so far | 12.1 so far |
| **Average (ex current cycle)** | | **670** | **10** | **22.6** |

Source: Bloomberg. A rate-hike cycle is defined as a period of multiple increases in the Federal funds benchmark overnight rate. Any rate cut ends the cycle.

isolation—they come in bunches. The past four tightening cycles averaged 10 hikes, ranging from a low of six from 1999–2001 to a high of 17 during the most recent cycle (see table above). So what will be the pace of this cycle? And what is a normalized Fed funds rate? Naturally, what "normal" means is subject to much debate, but it certainly isn't the current 0.50%, which is massively below the long-term, 30-year average of almost 4%. This cycle will likely take longer than usual to play out due to a more delicate global economy and the still lingering effects of the credit crisis, but if it were ultimately to result in six to seven increases, the low end of the historical range, and we were to get the occasional half-point increase, we could still eventually end up with an overnight rate near 3%—a dramatic shift from where we are now. As the table also highlights, the early part of a Fed tightening cycle is not necessarily bad for equity markets.

## US AND CANADIAN ECONOMIC GROWTH REMAINED MODEST

The US economy grew at a slower pace in 2016, with US GDP growth expected to be 1.6% y-o-y, versus 2.6% in 2015. Weak investment spending impacted by lower oil prices and lower exports due to a stronger US dollar weighed on growth throughout the year. In Canada, our economy picked up a bit from 2015, when we endured a mild recession in the first half of 2015. The Canadian economy is expected to grow 1.3% y-o-y this year, up modestly from 0.9% in 2015. Lower oil prices significantly weighed on our economy in 2016, with large cuts to capital spending in the energy patch being the main detractor to growth. Fixed investment in Canada has now declined two years in row, down 4.6% in 2015 and 2.6% in 2016.

### Our Take for 2017

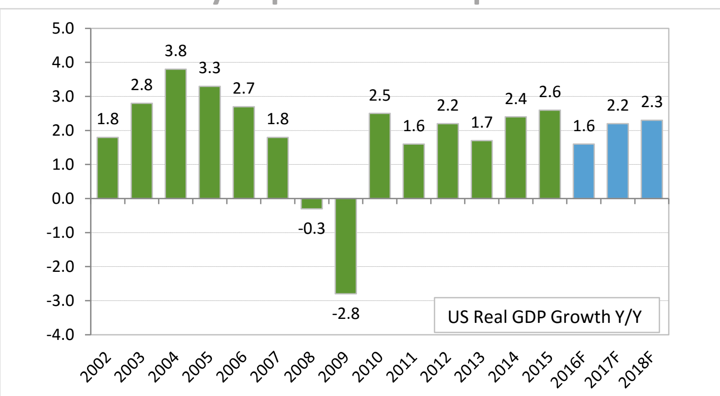
The US economy is coming off its strongest quarter since 2014 with Q3/16 GDP growth of 3.5%. We think this positive momentum can continue and see the US economy picking up in 2017. Economists are projecting the US economy to improve this year, growing by 2.2% y-o-y, up from 1.6% in 2016. The 2.2% forecast is in-line with our expectations of 2% to 2.5% growth. In Canada, we do see a small pick-up in growth aided by higher oil prices and exports; however, our high debt levels, overheated housing market and the potential for negative impacts from Trump's trade policies should act to constrain growth in 2017.

In the US, we continue to see the consumer being the main driver of the US economy as it has been over the last few years. However, President-elect Trump's policies, should they be passed by Congress, have the potential to provide a boost to the economy. So it's possible, if his policies are enacted, that we could start to see quarterly growth more consistently in the 3% range. Specifically, Trump's pro-growth economic policies of lower taxes, less regulation and massive increases in infrastructure spending have the potential to provide a real boost to the US economy. So while our base-case is for GDP growth of 2% of 2.5% in 2017, growth could surprise to the upside if Trump is more successful than expected with Congress.

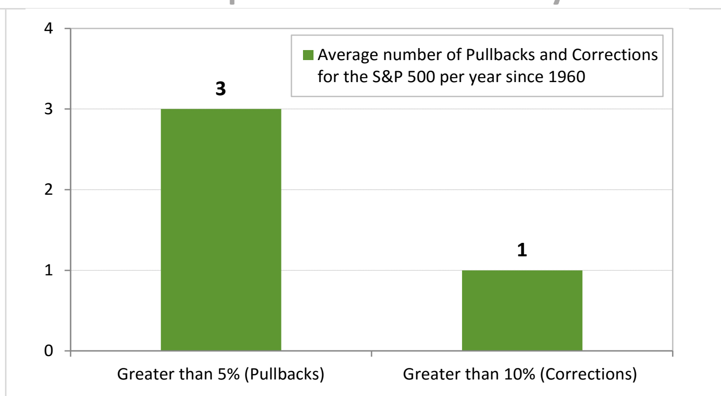
While this would be great for the US economy, which has struggled to accelerate into a higher gear, it could lead to inflation, and in turn, the US Federal Reserve more aggressively hiking interest rates. This is one important risk we will be monitoring closely over the year. Finally, the other risk Trump brings is his often impulsive and bombastic behaviour. If he goes overboard (e.g., follows through with a trade war with China or Mexico), or tweets himself into a disastrous corner, this could destabilize the global economy and financial markets.

We welcome stronger economic growth from Trump's policies, but we'll take a pass on his rash behaviour, which could lead to uncertainty and bouts of market volatility. On average, the S&P 500 encounters three pullbacks (5% or greater) and one correction (10% or greater) each year. It's a fact of life that equity markets encounter bouts of volatility from time to time (hence the importance of a balanced portfolio), and we see this year being no different, especially with Trump at the helm.

US Economy Expected To Improve in 2017




Expect Market Volatility




Source: Bloomberg, Turner Investments

## EUROPEAN BANKING SECTOR RISKS EMERGED

Europe continues to grow slowly with rolling mini crises being the norm. Whether it's a potential Greece default and exit from the European Union, low inflation and negative interest rates, potential bank bailouts or Brexit, each quarter seems to bring a new issue. Given this backdrop, the European Central Bank (ECB) continues to provide massive stimulus through its asset purchases plan. In December, the ECB announced that it was lowering its monthly asset purchases from €80 bln to €60 bln, but decided to extend the program until December 2017.

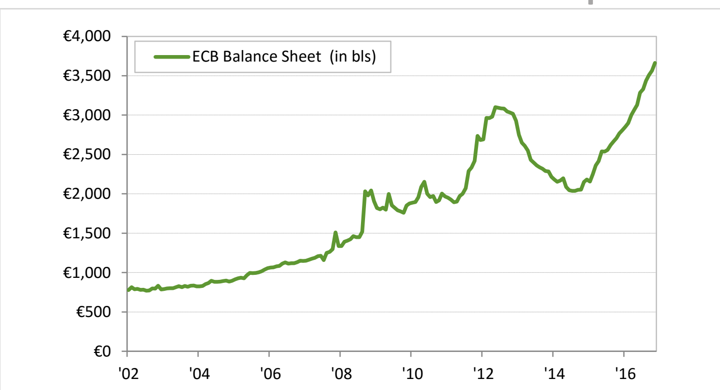
The focus in 2016 was on the Italian banks where it is estimated that €360 bln of loans in the system are impaired and that the banking sector may require a bailout of over €50 bln. We believe this issue will continue to be front and centre in 2017 and may possibly result in banks from other countries also needing some form of government assistance.

### Our Take for 2017

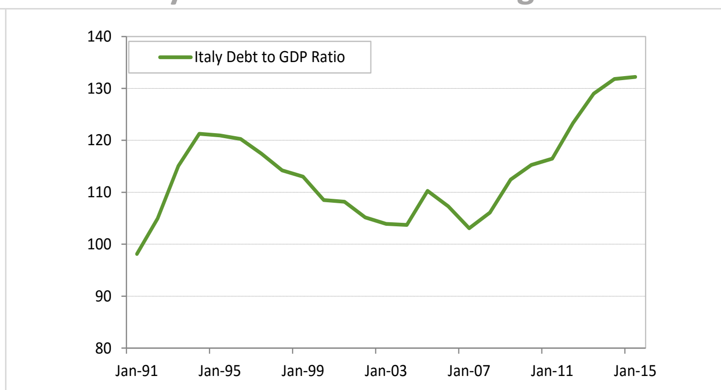
We expect much of the same in 2017. That is, low inflation, slow economic growth, continued asset purchases, occasional banking flare ups and dithering from policy setters. Basically, the status quo. On the positive side, the ECB continues to add stimulus through low interest rates and asset purchases, the euro should continue to weaken supporting exports and equity valuations are attractive for European stocks. On the negative side, debt continues to mount in the region putting it at risk longer term and European populism/anti-globalization continues to spread across many countries. Elections in France, Germany and the Netherlands could see a propagation of this sentiment, which we believe could have negative consequences to trade and growth throughout Europe.

From our perspective, the two central issues that Europe needs to address are 1) the need for structural reforms to make its economy more competitive in a globalized world and 2) to fix its overleveraged banking sector. Overall, we see only decent to subpar equity market performance from the region in 2017 as the markets work though these issues, and therefore, are maintaining our lower exposure to EAFE (Europe, Australasia and Far East) relative to the US and Canada.

**ECB Balance Sheet Continues to Expand**




**Italy's Debt to GDP at a High Level**




Source: Bloomberg, Turner Investments

## CHINA FEARS DIMINISHED

China provided a "growth scare" to the markets in early January after manufacturing data showed that the world's second largest economy was slowing at a faster pace. This, combined with Chinese officials allowing the yuan to devalue in early January, led to a significant sell-off in global equity markets with some predicting that China would face a "hard landing".

This led to kneejerk reactions by some. Economists at the Royal Bank of Scotland, for example, warned of a "cataclysmic year" where stock markets could fall by up to 20% and oil slump to US$16/bbl. RBS recommended investors "sell everything except high quality bonds". Yikes! Well, just like so many before them, the doomsayers got it wrong with the markets bottoming in February and then moving appreciably higher over the next 10 months.

### Our Take for 2017

China's economy looks to have stabilized. While we recognize that China's "official" government statistics are suspect, we do note that GDP growth averaged 6.7% y-o-y in the first three quarters of 2016. More importantly, the HSBC Purchasing Manager Index (PMI), which tracks manufacturing in the country, bottomed in February 2016 at 48 and has risen steadily since. It currently stands at 51.4, which is above the key 50 level (above 50 indicates expansion in the manufacturing sector), and is near its highest level since mid-2014. Imports, which capture domestic demand, have started to improve following two years of negative import growth. Additionally, other measures such as electricity usage, freight traffic and housing activity (measures which are hard to manipulate) are confirming the rebound in China's economy.

We believe China has stabilized and should continue to grow in the 6% to 7% range over the next year. The key risks to our outlook are a potential trade war with the US and the country's rising corporate debt levels. As a result of China's phenomenal growth over the last decade, and some dubious infrastructure projects (e.g., China's "ghost cities"), corporate debt has risen considerably and we believe some of this debt may need to be written off. The question then is how much and when? We'll be monitoring this closely over the next few years.

**China Manufacturing Rebounding**


Source: Bloomberg, Turner Investments

## BRAZIL'S WOES CONTINUED

Ryan Lochte wasn't the worst thing to happen to Brazil in 2016. The country remains mired in a massive recession that has now been ongoing for roughly two years, apparently its worst economic downturn since the 1930s. Data is likely to show that the country's economy shrank 3.5% in 2016 while its unemployment rate remains near 11% (youth unemployment around 20%). Corruption is also an ongoing issue as President Dilma Rousseff was forced to step down in August, impeached for altering budget numbers prior to the 2014 election. Another scandal is engulfing Petrobras, Brazil's massive national oil company, as directors are accused of using company funds to line their own pockets. The Petrobras scandal grows almost daily as more and more individuals become involved including Rousseff and political figures from other administrations. In short, the country is a mess. However, despite all the political upheaval and a seemingly hopeless economy, the Brazilian equity market did manage to record an impressive 40% gain in 2016.

### Our Take for 2017

Our clients did benefit from the Brazilian market recovery as Brazil forms a small part of our overall emerging market ETF exposure. However, due to the risk of emerging markets in general, we keep our exposure here modest. The Brazilian market, as a reminder of the volatility, declined 13% in 2015.

## CONCLUSION: THE TRUMP ERA BEGINS

As a news article on Trump that we read recently noted: down the rabbit hole we go. While many of Trump's policies have the potential to be enormously positive for the US economy and markets—fiscal stimulus measures (including massive infrastructure spending), lower corporate taxes, repatriating offshore profits and decreased government regulation—there is still considerable risk having an inexperienced and reactionary president in charge of the world's largest economy. In last year's market outlook newsletter, we were quite optimistic ("we expect and look forward to a better year for global and Canadian markets in 2016"). While our view remains positive for 2017, we acknowledge that Trump's unpredictability, particularly with regard to foreign policy, creates uncertainty. Obviously, we will watch his presidency closely and make portfolio changes as we think are necessary, but our clients should expect more volatility in 2017. Remarkably, even with all of Trump's antics in 2016, volatility was 23% lower y-o-y. A similar state of calm will be tough to achieve in 2017, particularly now that Trump is actually in charge. However, fortunately for investors, Trump doesn't need to "Make America Great Again". In our view, it's already doing pretty good.



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