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INVESTMENT COUNSEL

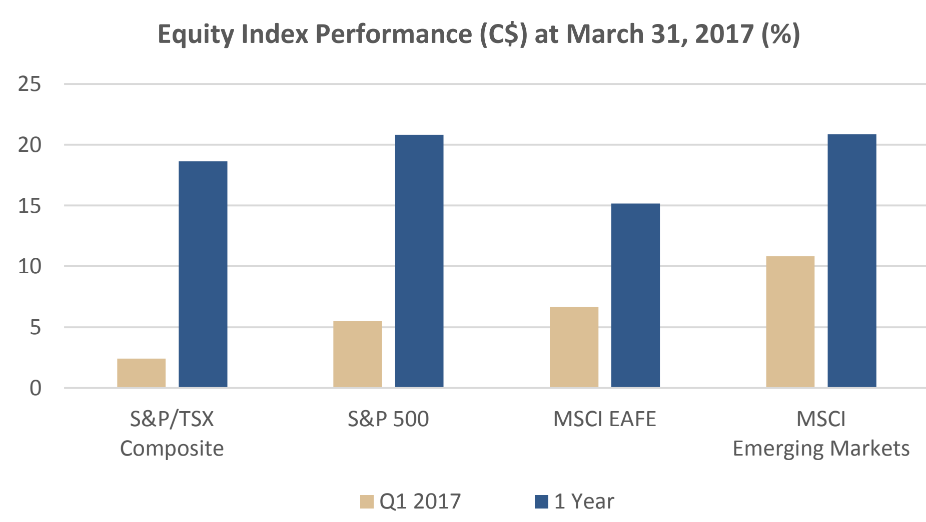
Q1 2017 Global Economics Overview

Economic Overview

Political events continued to exert a dominant influence over the markets during the quarter. Market advances in general, after the previous quarter's Trump bump, began to show some signs of slowing. U.S. President Donald Trump's ability to proceed with his pro-growth initiatives was brought into question with his lack of success in repealing the Affordable Care Act (also known as Obamacare) and continuing political subterfuge accusations. His cabinet shuffles combined with flip flops on foreign and trade policies added to market uncertainty and volatility.

However, despite these headwinds, economic momentum in many economies improved, pointing to a possible solid recovery from years of financial crisis in the 19-member euro currency bloc. There are still trouble spots such as Greece, but there also appears to be an improving political mood (i.e. a pro-EU government win in the Netherlands) ahead of elections in some key European nations.

Many emerging market economies also followed along with the theme of improved economic momentum.



Source: Bloomberg

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Inflation and GDP Growth as of December 31, 2016					
	Canada	U.S.	Euro Area	U.K.	China
CPI (YoY)	1.50%	2.10%	1.10%	2.20%	2.30%
Real GDP (YoY)	1.95%	2.00%	1.80%	1.90%	6.80%

Valuation Multiples as of March 31, 2017				
	S&P/TSX	S&P 500	EAFE	EM
P/B	1.93x	3.10x	1.67x	1.64x
P/E (Fwd)	19.8x	18.2x	15.3x	13.3x

Sources: Bank of Canada, Statistics Canada, U.S. Bureau of Labor Statistics, Bloomberg, BNY Mellon

Canada

Select headline economic numbers suggest that Canada's economy is, on a shorter term basis, the strongest of the G7 economies. Canada is healing from the devastating 2014-2016 oil price decline which, from a reversion to the mean basis, has produced these relatively positive comparisons. The Bank of Canada with its low dollar policy has been attempting to improve export growth. The consumer is spending and home price increases in major centres remain a concern as wage and employment growth have lagged these extreme price advances. Employment levels have improved but the quality of such advances remains up for debate. According to the Bank of Canada's Business Outlook Survey, "companies and their associated capital spending plans remain wary in an environment of elevated uncertainty about potential U.S. policy changes, but most have not yet felt any negative consequences." Stepping back and viewing longer term trends, Canadian economic growth remains in the 2% range as most developed economies deal with ageing demographics and uncertain productivity levels.

The U.S.

Trump, Trump, Trump are the three main quarterly factors affecting the short-term U.S. economic outlook. Forecasting the economic and political environment in the short term is a lesson in futility. Expectations of congressional co-operation, or lack thereof, with Trump's initiatives should be left to a statistical Monte Carlo simulation. Growth will continue in the 2% range longer term, in line with the other G7 economies, but the U.S. is unlikely to be the engine of world growth above these levels. Geopolitical concerns and the Trump administration's reactions fog any intrinsic methodologies. The market is faced with political challenges not seen for decades. Caution remains the operative strategy. It must be remembered that, for the markets, the short term concern is Trump's ability to enact corporate tax cuts after a significant portion of these potential cuts may have already been priced into the market.

Europe

Continued quantitative easing appears to be finally having its intended positive effect on European growth. While high by developed world standards, an overall euro area unemployment rate of 9.5%, down from over 12% after the Great Recession, is a measure of accomplishment. Even Italy, whose economic performance has lagged that of Germany and France, has shown encouraging improvement. Brexit and French and German elections are a risk to the European Union (EU) but the Dutch election result and French opinion polls suggest the pro-EU movement is beginning to re-establish itself in Europe. Compromise on Brexit appears to be at a low point, but this is typical of negotiations before significant compromises are reached. These negotiations will be long and drawn out with many “lines in the sand” being drawn and redrawn by all parties involved. Time lines will increasingly add to market tension, especially when pending French and German elections eat into the two-year Brexit negotiation period, which officially began at the end of March. The risk of “no deal”, however, weighs on the collective market sentiment.

The U.K.

Brexit and the upcoming two years of negotiations remain front and centre in the U.K outlook. Expectations range from a long drawn out negotiation process to a lack of compromise between the parties. Currency fluctuations remain the main force behind short term market movements. Corporate reaction to these political developments also remains unsettled. The April 29, 2017, EU Summit is seen as the start to a very thorny negotiation process fraught with risk and political intrigue. Caution remains the market’s watch word.

Japan

Monetary, structural and fiscal reforms in Japan, known as Abenomics, continue but still fall short of their objectives of increasing growth and inflation. The U.S. withdrawal from the Trans-Pacific Partnership has put a damper on Japan’s goal of further trade liberalization, but as a counterbalance, the country is proceeding with negotiations to conclude an Economic Partnership Agreement with the EU. Restarting nuclear power plants after the 2011 Fukushima nuclear disaster remains an additional priority despite public apathy. Growth in this environment is expected to remain muted, in the 0.5% to 1.0% range. Exchange rate movements will continue to be the major market moving factor.

Emerging Markets

There was a surge in market optimism toward the developing world as fears of Trump’s protectionist rhetoric sparking a global trade war receded. The Mexican currency benefited the most from this short term risk reduction. EM trade grew at its fastest rate in seven years and inflation eased. Government and corporate bond issuance surged in response. This possible sea change in the perception of emerging countries’ economic potential helped shift international flows of investment capital. Unofficially, emerging market GDP continued to improve above the 4% level during the quarter. China remains a wildcard, but its stock market has shown its best start to a year in more than a decade. Reports suggest that this momentum is spreading from China to Latin America and Eastern Europe. Even politically challenged South Korea, which impeached its president, showed impressive returns. Laggards included Greece, which is struggling to meet creditor conditions, and Russia, which has been unsuccessful in lifting U.S.-imposed economic sanctions.

Bonds

Following decent economic performance in Canada at the end of 2016, positive momentum continued into the first quarter of 2017. Job growth, consumption, and confidence levels remain strong. On the other hand, businesses continue to show signs of tentativeness, likely reflecting uncertainties relating to Canada's trade position given the upcoming NAFTA negotiations with the U.S.

Despite the strength of the economic data, and following the large yield increase late last year, the 10-year Government of Canada bond yield fell a few basis points and fluctuated in a relatively narrow band during first quarter. The yield on the equivalent bond in the U.S. was virtually unchanged despite a well-telegraphed interest rate hike by the U.S. Federal Reserve Board (the Fed) in March. Equity and credit markets responded more positively to the economic signals while interest rates reflected a growing concern over the ability of the economy to sustain its momentum. This concern is particularly true in the U.S. as it pertains to President Trump's ability to enact economy-boosting legislation.

Canadian Bond Market Performance		
	First Quarter 2017	**1 Year**
TMX Universe Bond Index	1.2%	1.5%
TMX Short Term Bond Index	0.7%	1.3%
TMX Long Term Bond Index	1.9%	1.7%
Canadas	0.6%	-0.4%
Provincials	1.4%	1.5%
Investment Grade Corporate	1.8%	4.1%
High Yield Corporate	3.2%	19.6%

Source: FTSE TMX

All returns shown in the Global Economic Overview are expressed in Canadian dollars unless otherwise stated.