Investment Strategy

PRIVATE CLIENT SOLUTIONS

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2017 Outlook

Reigniting Growth

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Highlights

Economic growth has been crawling along at a turtle's pace for much of the economic recovery, but we are seeing evidence that growth is set to accelerate in 2017. After eight years, central banks' policy decisions appear to be creating the desired inflationary pressures, which may induce consumers and corporations to spend and invest. This is in stark contrast to the deflationary fears that have been holding the market hostage for much of this recovery. Despite the numerous risks facing the market, we believe market participants will take the "glass is half full" view and support further equity market gains. But the path forward will not be without its challenges as political "unpredictability" will be a source of volatility. However, if the stars align and the US government can move forward on many of the proposed pro-growth policies, there is the potential for US economic activity to rocket ahead, taking global economic activity along for a ride.

- Many positives and just as many negatives may impact the Canadian economy in 2017. On the positive side, and key to Canada, is a recovery in commodities, a modest fiscal infrastructure spending program and childcare benefit that will support economic growth.
- We see the commodities sectors having another good year in 2017. We expect oil to trade in a range of US$50-60/bbl through H1/17, which will be supportive of a further recovery in energy sector earnings. Industrial metals should benefit from rising inflation expectations and increased demand from the world's largest economy.
- We do not anticipate the Bank of Canada (BoC) will raise rates in 2017; however, that wouldn't stop long-term yields from rising. The Canadian and US bond markets have a significantly strong correlation, so an increase in US long-term yields should be accompanied by a similar move in Canadian yields.
- Our S&P/TSX Composite Index 2017 price target is 15,975. If realized, this would equate to a 4.3% price return plus a dividend of 2.8% equalling a total return of 7.1%. We forecast TSX earnings to recover and assume no multiple expansion to arrive at our year-end target. Our US team's 2017 base case for S&P 500 earnings is US$130/sh and applying their 18-19x base case P/E multiple puts S&P 500 fair value in a range of 2,340-2,470, or a 3.3% to 9.1% potential price return (5.3% to 11.1% total return). If we factor currency into the equation, we have a slight preference for the US over Canada from a total return perspective.
- We favour large over small caps despite small caps having a slight edge over large caps in terms of P/B valuation. We are cognizant of the numerous risks in the market, but acknowledge the call should be more dependent on one's risk tolerance. Given our view that growth is accelerating, this bodes well for Canadian equities, particularly for those Canadian companies with US operations; we recommend investors actively seek out such companies. We forecast a continued shift in investment style away from defensives to cyclicals, away from growth and momentum toward value as a style, and, as Canadian long-term yields rise in tandem with our US counterparts, we believe dividend growers will outperform dividend payers.
- The past five years have been very tough for active managers with many headlines pointing out underperformance compared to their passive peers and higher associated costs. However, we are big believers in cycles, and there are times when stock pickers thrive, and times when they add little value compared to lower cost passive products. We believe the current environment is starting to turn in favour of a stock picker's market, which should bode well for active management.
- In 2017, we see many of the same themes affecting USDCAD; namely the movement of crude oil prices and divergent monetary policy in addition to US fiscal spending. We think given the Fed's projection of three hikes next year, coupled with a range bound WTI price, we could see USDCAD trading up to 1.39 in H1/2017 with a likely cooling in H2 back down to 1.36.

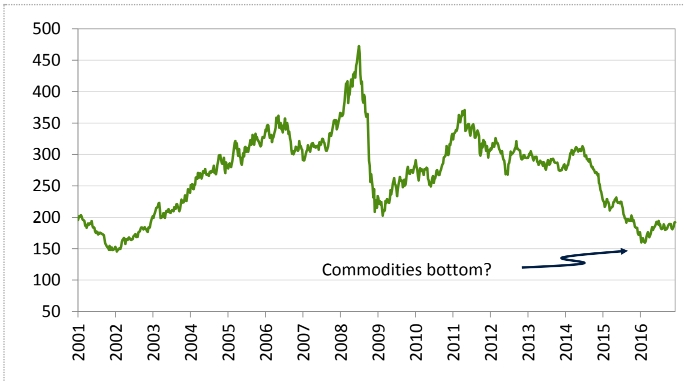
Canadian Outlook

Many positives and just as many negatives may impact the Canadian economy in 2017. On the positive side, and key to Canada, is a recovery in commodities, a modest fiscal infrastructure spending program and childcare benefit that will support economic growth. On the opposing side, a moderation in housing, slowing global trade, an overstretched Canadian consumer and the composition of job gains will act as a drag. However, we believe the biggest contributor to growth in Canada, and globally, will be US government passing and implementing pro-growth policies which will reignite global economic growth and improve overall sentiment.

Tailwinds

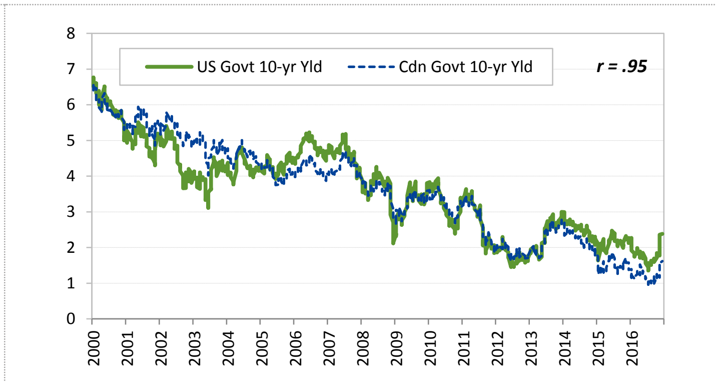
- **Commodities.** We see the commodities sectors having another good year in 2017. We expect oil to trade in a range of US$50-60/bbl through H1/17, which will be supportive of a further recovery in energy sector earnings. Industrial metals should benefit from rising inflation expectations and increased demand from the world's largest economy. We also see gold benefitting from higher inflation, but we caution our readers that inflation is only part of the equation. Real rates (nominal minus inflation) are a more important predictor of bullion prices, thus if long-term yields continue to rise in tandem with inflation, gold will underperform. However, we believe US long-term yields are due to temporarily pull back while inflationary pressures remain in place, setting gold and gold equities to outperform. We do not forecast this trade to remain in place for the entire year, so we suggest investors look to be more active with their gold positioning. With inflationary pressures persisting in 2017, commodity prices will be supported and will act as a tailwind for the entire commodity complex. History is also on the side of commodities in 2017. Looking at historical sector returns, the materials sector shows a tendency to post back-to-back winning years and we're coming off a year in which the materials sector rose 39.3%. A recovery in commodities is a positive for the Canadian economy and will support modest employment gains, as ~1.8 mln jobs are directly and indirectly tied to commodity-related industries.
- **Fiscal stimulus.** The Liberal government's fiscal spending program is modest compared to what is being proposed in the US; the Liberals propose running deficits totalling $120 bln over the next 6 years. The Canadian government is projecting a 2017 deficit of $27.8 bln, or 1.7% of GDP, with one-third directed to stimulus measures. The US is proposing a more aggressive infrastructure spending program, although admittedly details are vague at this point. We also have other US fiscal measures to look forward to including meaningful tax reform that would lower the corporate tax rate from 35% to 15-20%; simplifying of the tax code into three brackets; and the potential repatriation of overseas cash. In the short term, we view these measures and the sentiment towards them as equity-friendly.
- **Monetary policy.** We do not anticipate the Bank of Canada (BoC) will raise rates in 2017; however, that wouldn't stop long-term yields from rising. The Canadian and US bond markets have a significantly strong correlation, so an increase in US long-term yields should be accompanied by a similar move in Canadian yields. With the BoC on hold this year and the prospects for the yield curve to steepen, we anticipate financials, particularly banks, will enjoy strong returns in 2017. We anticipate BoC and Fed policy divergence through 2017, which suggests CAD weakness.

CRY Index – Commodities on the Rise



Source: Bloomberg, Raymond James Ltd.

US Govt. 10 Yr & Cdn Govt. 10 Yr Yield Correlation

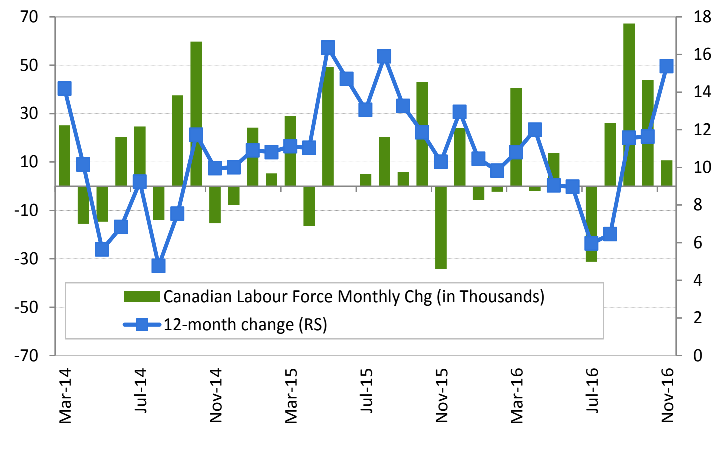


Source: Bloomberg, Raymond James Ltd.

Headwinds

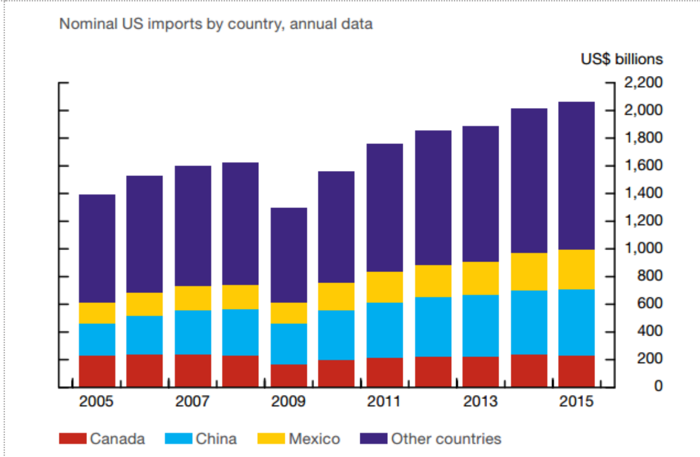
- **Debt-laden consumer.** Canadian consumers' fortunes are clearly tied to the housing market. We expect the Canadian housing market to remain elevated amidst modest economic growth buoyed by a recovery in commodities, and while credit will remain available for many Canadians, there is little room for consumers to take on additional debt. We see this as a constraint on consumption and presenting a challenging year for some retailers.
- **Jobs, Jobs, Jobs.** Canadian job gains have been concentrated in part-time and self-employed, many of which are neither high paying nor provide the security of benefits. The lack of full-time employment gains will serve to constrain spending and again act as an impediment to consumption.
- **Exports.** Improved US growth bodes well for Canadian exports – exports show a correlation of 0.63. However, this correlation includes both energy and non-energy. Excluding energy, a worrying trend has emerged for exporters over the last couple of years as they have been losing US market share to other countries. More troublesome is that in recent quarters the losses have occurred despite a weaker Canadian currency.

Headline Employment Gains, But Mostly Part-Time



Source: Bloomberg, Raymond James Ltd.

Canadian Exports Losing US Market Share



Sources: US Census Bureau, Haver Analytics and Bank of Canada calculations

S&P/TSX - Another Good Year in Store

Our S&P/TSX Composite Index 2017 price target is 15,975. If realized, this would equate to a 4.3% price return plus a dividend of 2.8% equalling a total return of 7.1%. We forecast TSX earnings to recover and assume no multiple expansion to arrive at our year-end target. Our US team's 2017 base case for S&P 500 earnings is US$130/sh and applying their 18-19x base case P/E multiple puts S&P 500 fair value in a range of 2,340-2,470, or a 3.3% to 9.1% potential price return (5.3% to 11.1% total return). If we factor currency into the equation, we have a slight preference for the US over Canada from a total return perspective. Our preference for the US is also predicated on improved economic sentiment amid proposed tax reform, infrastructure spending and other pro-growth policies. As such, we see the US having more positive growth drivers in play compared to Canada. From a relative valuation perspective, the US is trading at a slight discount to Canada further reinforcing our marginal preference for the US.

Scenario	S&P/TSX Projection	Comments
Bullish Case	18,515	Oil prices break above $60/bbl and other commodities are bid. TSX multiple continues to expand amid improving sentiment.
Base Case	**15,975**	**Our base case is a modest recovery in commodities, which will support TSX earnings. We assume no multiple expansions.**
Bearish Case	12,750	Oil prices and other commodities retest previous lows amid political upheaval in the EU and increased uncertainty.

Positioning – Sector & Theme

We favour large over small caps despite small caps having a slight edge over large caps in terms of P/B valuation. We are cognizant of the numerous risks in the market, but acknowledge the call should be more dependent on one's risk tolerance. Given our view that growth is accelerating, this bodes well for Canadian equities, particularly for those Canadian companies with US operations; we recommend investors actively seek out such companies. We forecast a continued shift in investment style away from defensives to cyclicals, away from growth and momentum toward value as a style, and, as Canadian long-term yields rise in tandem with our US counterparts, we believe dividend growers will outperform dividend payers.

S&P/TSX Sector Recommendations For 2017

Sector	Allocation	Relative Trend	Comments
Consumer Discretionary	N	Neutral	We remain Neutral on the sector. We see rising long-term yields, a stretched consumer balance sheet with little room to increase discretionary and the composition of job gains acting as a headwind. We favour **Movie & Entertainment** and **Specialized Consumer Services**.
Consumer Staples	N	Declining	We remain Neutral on the sector. We favour **Food Retail** as inflationary pressures will benefit grocers.
Energy	N	Rising	We remain Neutral on the sector. We believe oil upside will be capped and we'll trade in a range of approximately $50-$60/bbl. We favour **Integrated Oil & Gas** (beta) and **Equipment Servicers** (alpha).
Financials	OW	Rising	We upgrade the sector to Overweight. We forecast a steeper yield curve benefitting the sector as a whole. We favour **Banks** over Insurers and Diversified Financials.
Health Care	UW	Declining	This sector is not meaningful, representing just 0.5% of the S&P/TSX.
Industrials	OW	Rising	We upgrade the sector to Overweight. Modest fiscal spending in Canada and stronger economic growth in the US will be a tailwind for the sector. We favour industrials with exposure in the US, which may participate in the potential infrastructure spending. On an industry level we favour **Construction & Engineering**, **Railroad** and **Trucking**
Information Technology	N	Neutral/Declining	We downgrade IT to Neutral. We favour **IT Consulting & Services** and **Application Software.**
Materials	N	Neutral/Declining	We remain neutral on Materials. We favour **Diversified Metals & Mining** and **Metal & Glass Containers.**
Real Estate	N	Declining	We remain Neutral on Real Estate. We favour **Residential REITs.**
Telecom	UW	Declining	We downgrade Telecom to Underweight. We favour **Integrated Telecom Services**.
Utilities	N	Declining	We remain Neutral. We favour **Independent Power Producers** and **Renewables**.

Source: Raymond James Ltd. N = Neutral, OW = Overweight, UW = Underweight.

Jason Castelli, CFA
VP, Portfolio Manager

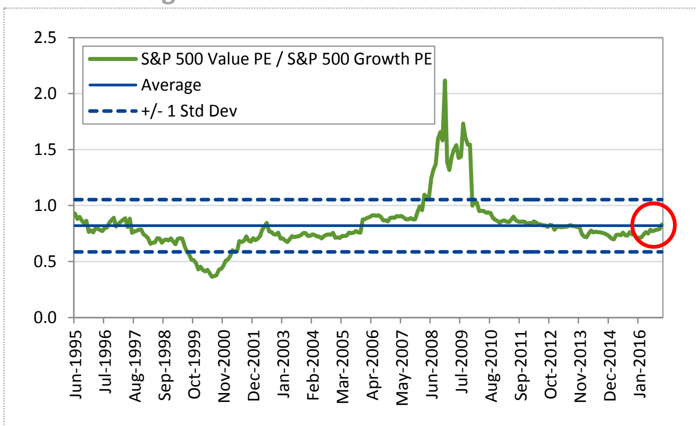
Style Selection Outlook

When it comes to value vs growth, the growth camp has been joyfully boastful for the last eight or so years, as growth has dominated value since the financial crisis. The Canadian market faces such severe sector concentration issues, when it comes to style rotation analysis, our focus remains on the US which is a much more diversified market. We believe the same sectors in Canada will also benefit based on moves in the US, due to the close economic ties between our countries. Below we take a look at the fundamentals, technicals and economic backdrop for each style.

Looking at the price to earnings multiples, we are indifferent between the value and growth styles as they are trading in line with their 20-year average relative to one another on a P/E basis (using the S&P 500 Value Index and S&P 500 Growth Index as proxies). Additionally, we see a similar valuation on a price to cash flow relative basis.

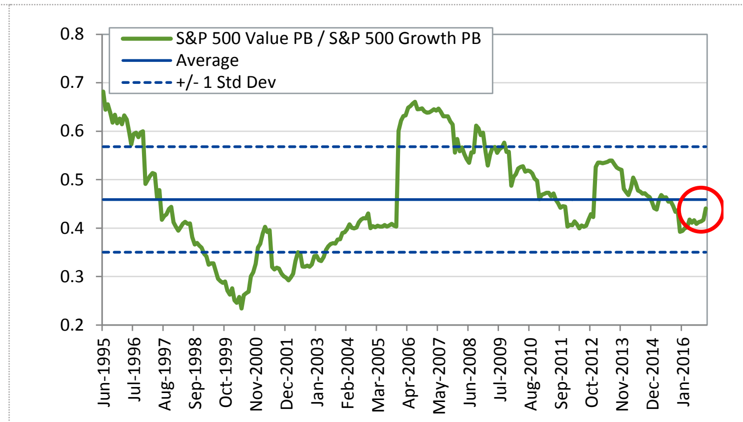
However, using price to book, a key tenet of Benjamin Graham's studies, value is actually trading at a slight discount to growth over the same period, giving a slight edge to value investors going forward.

P/E Ratio: S&P 500 Value Trading in line with Historical Avg Relative to S&P 500 Growth



Source: Bloomberg, Raymond James Ltd.

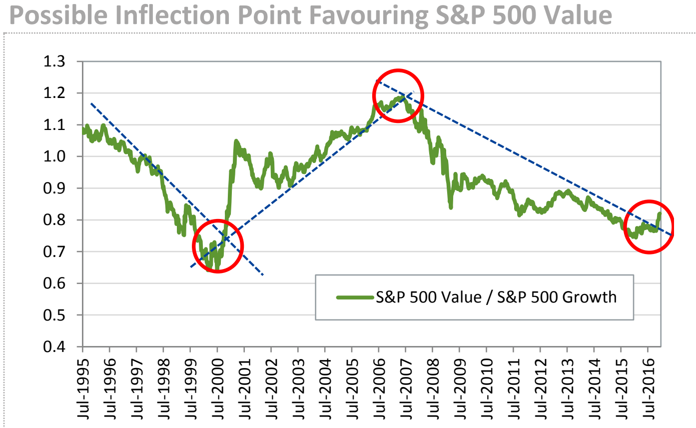
P/B Ratio: Favouring Value



Source: Bloomberg, Raymond James Ltd.

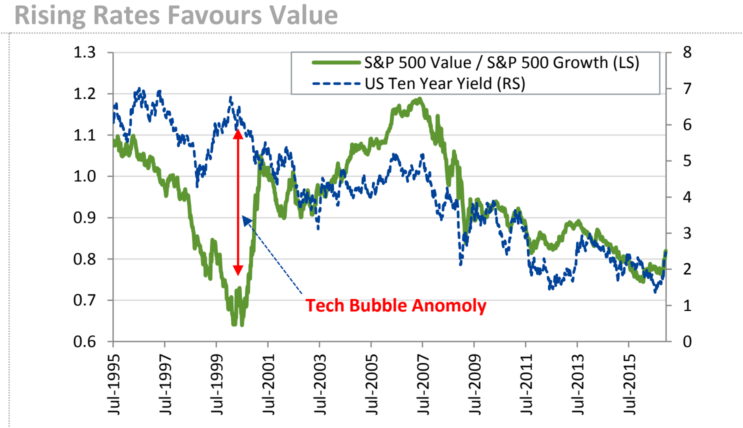
From a technical standpoint, the tide is starting to turn in favour of value. As you can see, the styles go through very long periods of outperformance/underperformance dating back to 1990. In mid-2016, value broke above a very important long-term bearish trend line that began in late 2007 (see left chart below). If this trend holds, we could be entering a period where value regains its dominance for several years.

Possible Inflection Point Favouring S&P 500 Value



Source: Bloomberg, Raymond James Ltd.

Rising Rates Favours Value



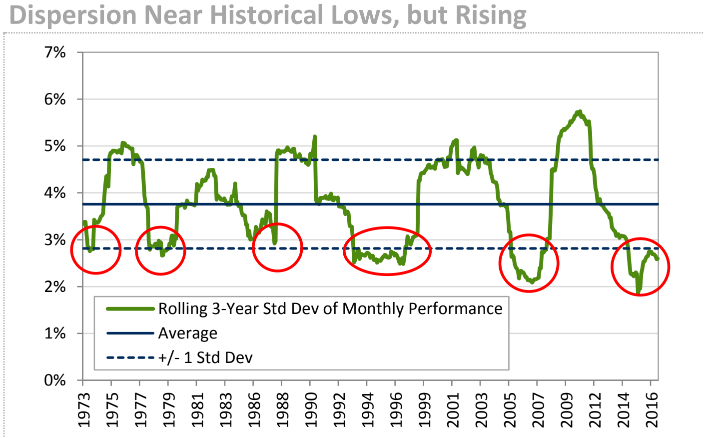
Source: Bloomberg, Raymond James Ltd.

When we look at the economic backdrop, we believe that value is supported on this front. We see US government bonds under pressure moving forward. US treasury yields have moved significantly higher from the July 16th low, where the US ten-year yielded only 1.31% (currently 2.31%) on the back of improved economic data and increasing probability that the Fed will hike faster than expected in 2017. Additionally, many of the policies President-elect Trump has set forward are considered inflationary, which could put further upward pressure on the yield curve. We also note that many major players in the fixed income market are now calling for higher yields (Gundlach, Gross, Canso, to name a few); this should continue to be supportive of value investing as rising rates have historically favoured value over growth with the exception of the 2000 tech bubble (see right chart above).

Active/Passive Outlook

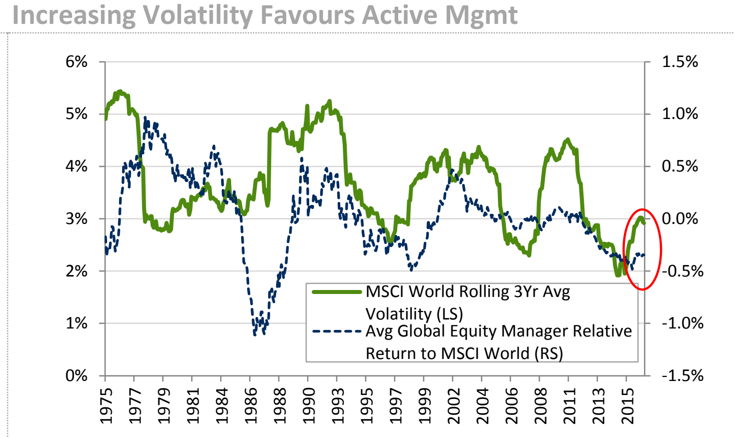
The past five years have been very tough for active managers with many headlines pointing out underperformance compared to their passive peers and higher associated costs. However, we are big believers in cycles, and there are times when stock pickers thrive, and times when they add little value compared to lower cost passive products. One metric we look at to determine whether we are in a stock picker's (opportunistic) market or a passive market is dispersion. Dispersion is a direct measure of how differently individual assets perform compared to the average. When dispersion is increasing, active managers have a wider opportunity set in the sense that some assets go up while others go down, and being selective in what they own can add significant value relative to a benchmark. When dispersion is decreasing, assets behave more similarly and being selective adds little value as a rising tide lifts all boats. Below is the dispersion of the S&P/TSX Composite, S&P 500, and MSCI EAFE indices which currently sits at historical lows, but is rising. Also notice it is very cyclical in nature (average peak to trough length is 8.4 years). This in part helps explain why active managers have had such a tough time over the last five years as dispersion has been decreasing since its peak in mid-2010. When dispersion increases, so does volatility. When we overlay the relative returns of the Canadian-sold average global equity mutual fund manager compared to their benchmark (MSCI World), you can see that active managers have historically outperformed their benchmark when volatility is rising, but with a lag. Granted that we have started to see dispersion start to rise off historic lows, and volatility has already begun increasing, while active manager returns have held steady; we believe the current environment is starting to turn in favour of a stock picker's market, which should bode well for active management. This not necessarily a call for 2017 alone, as these cycles can take time to play out (8.4 years in fact!). But it is our belief that active managers will perform well over the next several years. All that being said, not all active managers are equal. In order to significantly outperform a benchmark, one needs to look different from the benchmark. One quick way to check this is to take a look at active share. Studies have refuted that simply having high active share alone adds value, but it is at least a starting point. Active share measures how differently a manager looks than his benchmark. If the active share is quite low, there is a chance the manager will add little value and is charging a large fee for benchmark-like performance. These "closet-indexers" have negatively impacted the active management space.

Dispersion Near Historical Lows, but Rising



Source: Raymond James Ltd., Bloomberg. *Equal Weighted S&P/TSX, S&P 500, MSCI EAFE Dispersion shown above.

Increasing Volatility Favours Active Mgmt



Source: Raymond James Ltd., Bloomberg

Bottom Line

- On the style selection front, we favour value investing as valuations, technicals and the economic environment looks to be turning in favour of this style for the first time in many years.
- Despite mediocre performance since mid-2010, we believe we are entering a stock picker's market and skilled active managers will be able to add significant value over the next several years.

Andrew Clee, CFA, Portfolio Manager
Mutual Fund & ETF Specialist

Searching For Value in 2017

To expand on our value call, we identify Canadian equities trading at a discount relative to the market (current S&P/TSX Composite Index P/B multiple of 1.9x) and those that trade at a discount to their respective sectors. Below we highlight 10 value-oriented names that we believe could perform well in 2017.

- Following the OPEC deal to cut production by roughly 1.2 mln barrels per day -- the first production cut in eight years -- oil prices along with the broad energy sector soared. We believe E&Ps, which have more leverage to the commodity, will be the greatest benefactors of this long-awaited decision as oil and natural gas prices trend higher. **Birchcliff Energy Ltd. (BIR-T)** and **Kelt Exploration Ltd. (KEL-T)** are well-positioned for higher oil prices and have P/B multiples of 1.5x and 1.4x, well below the market multiple. BIR has solid exposure to natural gas, comprising 83% of total production. In Q3/16 the company outlined its five-year plan to reach production of ~130k boe/d by 2021, funded out of internally generated cash flows. BIR also indicated that it could begin paying a quarterly dividend of $0.025/share in 2017, for a total of $26 mln in 2017. KEL, on the other hand, has a more diversified product mix with 60% exposure to natural gas, 28% to oil and 12% to natural gas liquids. However, the company expects to generate 61% of its operating income from oil and 31% from natural gas. KEL expects a 38% increase in their capex for 2017 to $134 mln and a ramp up in oil production by 28%. Hence as oil prices trend higher, these stocks should benefit. Within the Integrateds, we see **Suncor Energy Inc. (SU-T)**, which generates over 63% of its revenue from refining operations, as a good fit. The company expects refinery utilization of 92-96% in 2017 and roughly 40% of their 2017 capex program to be allocated towards upstream projects, providing more leverage to oil if prices continue higher in the year ahead. Following the sale of its Petro-Canada Lubricants business to HollyFrontier (HFC-US) for C$1.1 bln, the company's financials and free cash flow profile look more attractive going into the New Year. The stock currently trades at a P/B multiple of 1.6x, below the market multiple.
- Within the materials sector, we favour **Intertape Polymer Group Inc. (ITP-T)**, a manufacturer and seller of a variety of tapes. We believe ITP has solid growth prospects in 2017 given their $90 mln capex spend in 2016, the highest in the company's history, which is anticipated to improve profitability in 2017/18. Additionally, the company is focused on making acquisitions and expanding globally: recently ITP closed their Powerband deal, a tape manufacturing company in India for $42 mln, and they expanded into e-commerce through the $16 mln Better Packages acquisition. The stock is trading at 15.3x forward PE, the high-end of its five-year valuation, but trades at a 49% discount relative to peers despite having similar or better growth prospects and much higher return on capital. For investors with a higher risk tolerance, we favour **HudBay Minerals Inc. (HBM-T)**, an integrated mining company with development properties, exploration, processing and refining activities, offering exposure to copper (66% of 2015 revs), zinc (21%) and precious metals (13%). Year-to-date (YTD), zinc has been the best performing base metal, up roughly 68%, followed by copper prices, up roughly 21%. While zinc prices have been propped up by more short-term supply disruptions including production cuts and mine closures by some large miners (Gencore and Century), copper, on the other hand, hasn't seen as many supply disruptions and, as such, its price has been more stable throughout the year. HBM's assets are well diversified with units in Peru (Constancia mine), Manitoba (Lalor mine, 777 mine and Reed mine) and Arizona (Rosemont project). The stock's P/B multiple of 0.9x is currently trading below the market multiple.
- Within financials, banks have screened favorably. **Bank of Nova Scotia (BNS-T)** and **National Bank of Canada (NA-T)** have increased 38% and 36% YTD, better than their peers, given the run up in oil price, to which they are more levered with their loan exposure to the energy sector. While NA is more Canada focused, BNS has more exposure to global markets; the group operates in the Caribbean and Central America, Mexico, Latin America and Asia. The international growth platforms have contributed to Scotiabank increasing its quarterly dividend payout ten times since FY12, from $0.52/sh to $0.74/sh in Q4/16. From a valuation perspective, NA and BNS trade at a P/B multiple of 1.9x and 1.8x, respectively, below the market multiple. Within the real estate sector, **First Capital Realty Inc. (FCR-T)** screened favourably. FCR is an owner, developer and active

manager of retail-focused properties in Canada; 142 of their 159 (89%) properties are anchored by either large supermarkets and/or drugstores. Additionally, FCR has large anchor tenants and has properties that are located in urban markets with high barriers to entry such as the Greater Vancouver Area, Greater Toronto Area and the Greater Montreal area. In terms of growth, the company has a development pipeline of over 14 mln sqft going forward. FCR has also paid a dividend for the past 22 consecutive years and currently yields 4.2%. Their payout ratio is at 55%, proving the dividend is sustainable and may experience growth in the future. The stock's below-average P/B multiple is 1.2x.

- Within industrials, **TransForce Inc. (TFI-T)** is up over 11% since the US presidential election. The stock looks attractive as the transportation and logistics services company generates 38% of its revenue from the US. In terms of other growth opportunities, the company has completed over 100 acquisitions over the past 10 years. Additionally, TFI offers e-commerce services to 80 cities in Canada and the US, and provides same-day delivery in 18 of those cities. The e-commerce segment offers both organic and acquisition growth opportunities within TFI's Package and Courier segment. The stock currently trades at the higher end of its five-year forward PE multiple, but at a 27% discount to the industrials sector, and is supported by the 15% EPS and revenue growth expected in 2017. **New Flyer Industries Inc. (NFI-T)** is a manufacturer of heavy duty transit buses in Canada and the US (90% of revenue). It is the number one transit bus & motor coach manufacturer and parts supplier in North America. The stock has had a solid run up over the past two years up, roughly 83% annually, propped up by the acquisition of Motor Coach Industries (MCI), a leading manufacturer of motor coach and parts/service support, for $455M in cash in November 2015. The acquisition was highly accretive to EPS (even without synergies) and targeted ~$10 mln in annual synergies. Following the acquisition, NFI raised its dividend by 12.9%. Analysts expect EPS to grow by 84% in 2016 and 12% in 2017. At the moment, the stock is trading at the mid-range of its five-year forward PE multiple and a 30% discount to the industrials sector; the stock could have more room to expand as the US economy picks up.

Company	Ticker	Sector	P/B	Forward P/E	P/B Relative to S&P/TSX	Discount Relative to Sector
Birchcliff Energy Ltd	BIR-T	Energy	1.5x	36.5x	-21%	-75%
Kelt Exploration Ltd	KEL-T	Energy	1.4x	-	-29%	NA
Suncor Energy Inc	SU-T	Energy	1.6x	29.3x	-14%	-80%
Intertape Polymer Group Inc	ITP-T	Materials	4.5x	15.3x	132%	-49%
Hudbay Minerals Inc	HBM-T	Materials	0.9x	21.1x	-55%	-29%
Bank Of Nova Scotia	BNS-T	Financials	1.8x	12.1x	-8%	-11%
National Bank Of Canada	NA-T	Financials	1.9x	10.9x	0%	-19%
First Capital Realty Inc	FCR-T	Real Estate	1.2x	-	-38%	NA
Transforce Inc	TFI-T	Industrials	2.2x	14.5x	15%	-27%
New Flyer Industries Inc	NFI-T	Industrials	3.1x	13.9x	61%	-30%

Source: Bloomberg

Larbi Moumni
Equity Specialist

No Bull, Yields are Heading Higher

All signs point to a very uneventful 2017 for Canadian bond yields. Inflation is well contained, as the latest CPI report noted that consumer inflation is well below the Bank of Canada's target rate of 2.0%. Year-over-year, consumer inflation was only 1.5%, while core inflation was a benign 1.70%. Both Canadian retail sales and GDP reports suggest there is still room for growth. In fact, the Bank of Canada's latest business outlook report indicated there was slack in the Canadian economy and statements from the Bank of Canada Governor suggest the benchmark interest rate will not change in the near term.

Consensus Forecast for Canadian Yields

	Current	Q1 17	Q2 17	Q3 17	Q4 17
Cda 30-Year	2.38	2.20	2.27	2.31	2.39
Cda 10-Year	1.74	1.52	1.60	1.71	1.81
Cda 2-Year	0.75	0.68	0.70	0.77	0.88
Cda 3-Mo Bill	0.49	0.50	0.51	0.54	0.61
BOC Overnight Rate	0.50	0.45	0.45	0.50	0.55

Source: Bloomberg. As at December 13, 2016.

As a result, market forecasters are predicting a modest 7 basis point rise on the Canada 10-year benchmark yield from the current level of 1.75% by the end of 2017. However, bond yields could get "Trumpified." Investors should not dismiss incoming US President Donald Trump and the effect his stimulus policies may have on inflation and, more importantly, on inflation expectations. Note that while yields on the front end of the yield curve are influenced by policy makers through interest rate hikes, long bond yields are influenced by inflation expectations. Some market observers have jokingly said Trump will "make inflation great again." If Trump's spending intentions do come to fruition, it will be just a matter of time before Canada sees some trickle up effect and investors shouldn't be surprised to see the yield on the 10 year benchmark breach the psychological 2.0% barrier, a level not seen since October 2014. With the possible threat of rising bond yields, it would be prudent for fixed income investors to protect their portfolio to the downside by keeping portfolio duration shorter than 5 years.

5%...Do it With Preferred Shares

After the first few weeks, 2016 was great for Canadian preferred shares. YTD, the total return on the Canadian Preferred shares Index is 2.5%, but if you exclude those first two weeks, the total return is over 20%. As we go into 2017, we expect the dominant themes that drove the preferred market higher in 2016 will continue into 2017.

Symbol	Annual Dividend	Yield (%)	DBRS Rating	Reset Date or Par Call Date *
Fixed-Resets				
MFC.PR.G	$1.10	5.4%	Pfd-2	Dec-2021
TRP.PR.J	$1.38	5.2%	Pfd-2L	May-2021
BMO.PR.B	$1.21	4.7%	Pfd-2	Feb-2022
FFH.PR.K	$1.25	6.0%	Pfd-3	Mar-2017
Perpetuals				
CU.PR.D	$1.23	5.4%	Pfd-2H	Sep-2021
POW.PR.G	$1.40	5.6%	Pfd-2	Apr-2021

Source: Bloomberg, Raymond James Ltd. As at December 15, 2016.
* Reset Dates for Fixed-Resets, Par Call Date for Perpetuals

- **Yields Remain Flat to Higher:** Consensus is for Canadian yields to remain flat to higher. After the recent rate hike in the US, and with the recent "Trumponomics" inflation trade, yields across the world have pushed higher.
- **Institutional Support**: On average, 2016 deal sizes were upsized by over 60% due to high demand. These increases were due in large part to the higher levels of institutional participation. For bank issues, over 50% were bought by institutional investors.
- **Reset Spreads are Tightening**: Over the latter half of 2016, we saw reset spreads compress. We have also noticed that yields on more recent new issues are lower compared to earlier in the year. We view this as a good sign as buyers of new issues are becoming more supportive. This has also been helped by the increase in institutional buyers.

Getting Paid to Wait

With no rates hikes or cuts being forecasted in Canada for 2017, we suggest a market weight in perpetuals (~30%) and the remainder in fixed-resets for your preferred shares portfolio. Keep in mind that preferred shares should not be used as a substitute for bonds but in an addition to enhance yield in a laddered portfolio. Use a barbell strategy with fixed-resets by having a mix of newly issued fixed-resets (eg., ones with yield minimums, and bank/insurance issues), and those that were issued prior to these features. When looking at the latter (which are trading at a discount), look to ones with fixed-reset dates that are 4+ years out with a higher relative reset versus their peers.

Anderson Lam, Fixed Income & Phil Kwon, Fixed Income Specialist

Loonie to Stay Grounded in 2017

In this article, we provide our 2017 USDCAD forecasts and analyze the main themes we believe will drive the currency pair in the upcoming year. At the time of writing, the Loonie was up 4.41% against the Greenback YTD. Much of this gain can be attributed to WTI being up over 37% YTD. Also contributing to the Loonie's strength over the past year was the difference between how many hikes the Federal Open Market Committee (FOMC) had projected at the beginning of the year and how many actually occurred. At the start of 2016, the FOMC had projected four hikes in 2016, but the committee ultimately only delivered one hike. In 2017, we see many of the same themes affecting USDCAD; namely the movement of crude oil prices and divergent monetary policy in addition to US fiscal spending.

Last year saw crude oil come off of multi-year lows and eventually settle into a USD $40-50/bbl range for most of the year. Recent oil strength has been on the back of an OPEC production cut deal and we await production numbers to see if all members are adhering to the agreed upon cuts. As previously mentioned, we see oil trading in the range of USD $50-$60/bbl, which will be supportive of the Loonie.

On the monetary policy front, the Fed is projecting three hikes in 2017, recently revised up from two at the most recent FOMC meeting. As a result, we've seen yields push up across the treasury curve with some mild flattening as the market had only priced in a couple of hikes for next year. As for interest rate probabilities, we have seen them tick up post-FOMC with at least one hike in 2017 priced in. Currently US Core CPI y/y is trending at 2.1% and US headline CPI is at 1.6%. Given that we see crude oil prices trending mildly higher in 2017, and other factors we will highlight shortly, we foresee headline US CPI reaching its 2% target in 2017. This gives us some conviction that the Fed could make good on three hikes next year. While the Fed is in a tightening mode, the Bank of Canada (BoC) is maintaining a neutral policy stance. Given that oil is well below historical averages and growth has been tepid at best, Governor Poloz will likely keep the policy rate unchanged in 2017.

On the fiscal policy front, US President-elect Trump has indicated that he wants to engage in infrastructure spending, which is an expansionary policy. We don't yet have the details, but we can make some inferences on the effect on both inflation and treasury yields. With regards to inflation, infrastructure spending tends to be inflationary. Concerning yields, if Trump increases the deficit to fund the infrastructure spending, and thus increases borrowing, we could see yields tick up further. In Canada, we should start seeing the effects of the Liberal spending plan as money starts to be put to work.

So what does this all mean for USDCAD? We think given the Fed's projection of three hikes next year, coupled with a range bound WTI price, we could see USDCAD trading up to 1.39 in H1/2017 with a likely cooling in H2 back down to 1.36. Our base case is predicated on the Fed sticking to its projected three hikes and WTI trading within a USD $50-$60/bbl range. Downside risks to the currency pair is if the Fed does not hike three times next year and/or if crude oil breaks out to the topside. The upside risk is if OPEC doesn't stick to their production cuts and oil falls off - we could then see downward pressure on the Loonie. All in all, we see USD strength in 2017 and believe portfolios should be positioned accordingly.

Andrei Bruno, MBA
Foreign Exchange

Risks to Outlook

There are always risks to market forecasting and investing. The only certainty in 2017 is that there will be increased uncertainty amid rising global protectionism, political instability (populism around the globe), interest rate volatility, as well as the potential for many new headwinds to develop. We find the potential risks to our outlook, both to the upside and to the downside, elevated this year. We will outline a few key risks but our base view is that markets, as in the past eight years, will remain resilient thanks to the supportive nature of our global central banks and now the potential for fiscal measures in the US.

Risk to the Upside

- **Trumponomics.** If the US government can successfully pass and implement pro-growth policies while avoiding much of the protectionism measures proposed during the election campaign, we see upside risk to our forecast. Our US team estimates a lower effective tax rate has the potential to boost S&P 500 earnings by an additional 6-7%; a favourable repatriation tax (assuming 10% tax rate) could result in an estimated US$2.4 tln in overseas cash coming back to the US. The cash would be used on capital expenditures, reducing debt, and of course corporate America's favourite use of cash, shareholder-friendly share buybacks and dividend increases, as well as M&A.
- **Helicopter money.** One path to implement large infrastructure spending programs, while not adding to the deficit could be helicopter money. Helicopter money or fiscal quantitative easing could be achieved by the central bank swapping and/or buying domestic bonds into very long dated zero coupon bonds, which would have the effect of increasing government capacity to spend with little fiscal financing impact. By doing this, the central bank injects liquidity into the financial system by allowing governments to fund infrastructure projects, provide tax cuts and/or simply deposit money into its citizens' bank accounts. The short-term impact of this would be positive for equity markets, while the long term implications are less clear.

Risks to the Downside

- **Stagflation.** Inflationary pressures are clearly building, although we do believe there are enough deflationary pressures to keep inflation in check. However, if inflation continues to rise in an environment of anemic economic growth, there is the real potential for stagflation – the painful combination of high inflation and weak economic activity.
- **Fed tightening.** The Fed intends to gradually hike rates in 2017. However, if they tighten too fast, perhaps to contain inflation, this could have a negative impact on an economy that assumed increasing levels of debt to pull consumption forward. Aggressive Fed tightening could have a significant negative impact on consumption and lead to an economic slowdown or, worse, a recession.
- **Protectionism.** Trade protectionism is on the rise globally. The EU recently slapped an anti-dumping 81.1% duty on Chinese steel, the US has raised tariffs on steel from China, India, Italy, South Korea and Taiwan, while other countries have also engaged in protectionism measures. According to the World Trade Organization, among the G 20, the group has implemented an average of 17 trade constraints a month. Adding further disruption, the Trump administration intends to withdraw from the Trans-Pacific Partnership, renegotiate the North American Free Trade Agreement, and penalize Chinese imports. These restrictions come at a time when world trade volumes have grown little more than 3% a year since 2012, less than half the average expansion rate over the prior three decades, according to the International Monetary Fund.
- **Strong US Dollar.** A stronger dollar poses risks to Emerging Markets as a strong dollar may cause capital outflows from EMs, while for US companies, the currency translation lowers the dollar value of earnings outside the US.
- **US-China Relations.** Tensions between the two countries have been on the rise for much of the Obama administration and the relationship is set for more uncertainty under Trump. Tensions between the two nations are a potential source of market volatility.
- **Monetary Stimulus.** Global central banks have flooded the capital markets with liquidity to help spur growth and fight deflation. We are nearing the end of the existing monetary intervention as the marginal benefits are becoming less effective. As we transition to a period of less central bank intervention, there may be an increase in uncertainty for equity and bond markets. At the time of writing, the ECB appears on track to expand its balance sheet in excess of the Fed; however, if QE were to end abruptly due to political pressure, this could put the equity markets at risk.
- **Rising Populism.** Voters have shaken the world in 2016, what with the Brexit outcome, the election of Donald Trump and the Italian referendum. The wave of refugees entering the European Union (EU) along with security threats have led to an increase

in anti-immigrant, anti-EU and anti-Islam sentiment, benefitting far-right populist parties from the National Front in France led by Marine Le Pen, to Germany's Alternative fur Deutschland led by Albrecht Glaser, and Holland's Party for Freedom led by Geert Wilders. While polls can be good indicators of the outcomes, we mustn't forget the surprise results of the UK referendum and the US election. Going into 2017, political uncertainty is set to shadow the markets with important elections happening across the world. In the table below, we highlight a few key dates:

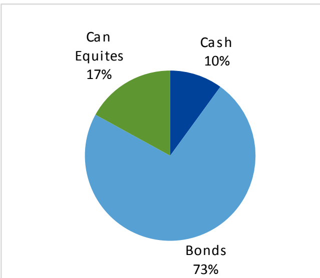
Date	Commentary
March 15	Netherlands: Current Prime Minister Mark Rutte's People's Party for Freedom and Democracy seems to be in a tight race against the far-right Party for Freedom led by Geert Wilders, which has been gaining traction. Geert Wilders' party is promising to ban Muslim immigrants and make a proposition to leave the EU if elected. Despite being convicted for inciting discriminatory comments against Moroccans in the country, support for Geert Wilders increased in polls.
April 23	France: Following the terrorist attacks in Paris and Nice, France has seen a rise in anti-immigrant, anti-EU and anti-Islam sentiment, benefitting the far-right Front National's Marine Le Pen. This, in addition to high unemployment (10%), has also led to current president François Hollande's record-low (15%) approval rating. As he has declined to run for a second term, his Socialist party holds primaries in January 2017. Former Prime Minister Francois Fillon was elected at the centre-right Republican Party's primary, beating moderate Alain Juppe.
May 19	Iran: While anti-establishment sentiment hasn't spread to Iran, this election will be important as the country transitions to its post-sanction era. Depending on who is elected will determine how tough or moderate the country is towards the rest of the world.
October 22	Germany: Angela Merkel's loose refugee policy has attracted criticism against her liberal conservatism Christian Democratic Union and fueled the rise of anti-immigrant and anti-Islam movements in Germany, which has driven support for the right-wing populist Alternative fur Deutschland (AfD) party. AfD has been making progress in Germany's regional elections and rising in opinion polls. Any retreat of German leadership within the European Union (EU) may severely impact EU continuity.
Fall 2017	China: The country's 19th Party Congress is where China's top leaders for the next five years will be selected. This transition happens in Fall 2017 and could shape the country's future over the next 15 years.
2017	Another change that will happen in 2017 is the rotation of voting members at the Federal Reserve, with three regional Fed presidents set to vote for the first time in the New Year. The new members will be Patrick Harker, known to be slightly hawkish, Neel Kashkari, Robert Kaplan, known to be more centrist, and Charles Evans, known to be dovish. Some believe the Fed could turn more dovish in 2017 due to this shift as Loretta Mester (Hawk), Esther George (Hawk) and Eric Rosengren (Dove) lose their voting rights.

Investor Profiles and Asset Class Weightings

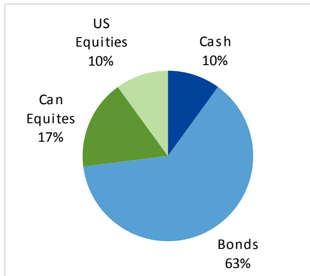
Recommended Asset Allocation

	Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
Cash	10%	10%	10%	10%	10%
Bonds	73%	63%	38%	18%	0%
Can Equities	17%	17%	17%	17%	22%
US Equities	0%	10%	20%	33%	38%
Intl Equities	0%	0%	15%	22%	30%
Tactical Asset Mix (Bonds include cash)					
Bonds | Equities	83/17	73/27	48/52	28/72	10/90
Strategic Asset Mix (Bonds include cash)					
Bonds | Equities	80/20	70/30	50/50	30/70	10/90
Asset Ranges					
Cash	0-20	0-20	0-20	0-20	0-20
Bonds	60-100	50-90	20-70	10-50	0-30
Equities	0-30	10-50	30-75	50-90	70-100

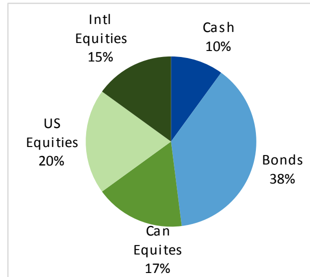
Capital Preservation



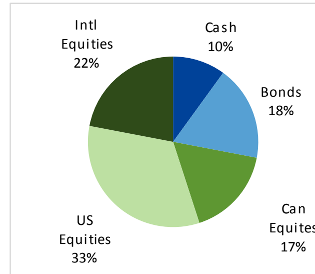
Conservative



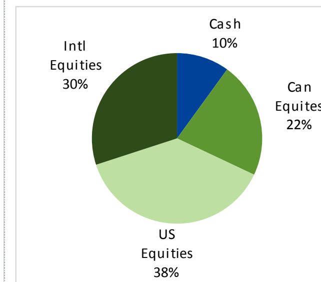
Moderate



Growth



Aggressive Growth



Description

Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
May be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which invests primarily in fixed-income securities, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.	May be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of financial markets. The portfolio, which fixed-income securities tend to make up the largest proportion of holdings, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has characteristics that may deliver returns lower than that of the broader market with lower levels of risk and volatility.	May be appropriate for investors seeking a balance between capital preservation and capital growth. This portfolio, which is a split between fixed-income securities and equities, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. With roughly half of the portfolio invested in a diversified mix of Canadian and international equities, investors should be comfortable with moderate fluctuations in the portfolios.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in equities, seeks to keep investors well ahead of the effects of inflation with principal stability as a secondary consideration.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which is primarily invested in equities, seeks to keep investors well ahead of the effects of inflation with little regard for maintaining principal stability. The portfolio may deliver returns comparable to those of the broader equity market with similar levels of risk and volatility.

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