GUARDIAN CAPITAL

Economic Outlook

WINTER
2019

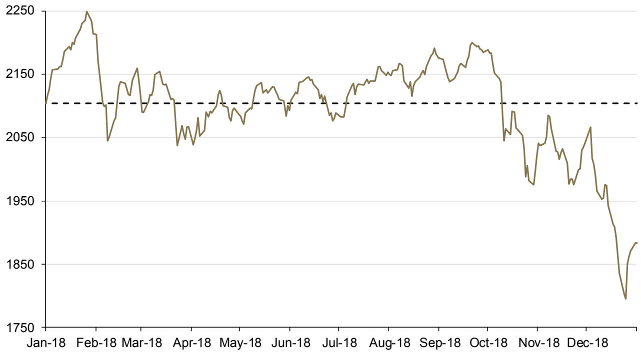
Full of Sound and Fury…

While global equity market could be characterized as calm and one-directional in 2017 — with measures of volatility historically benign and new record highs set on almost a daily basis — 2018 will be remembered as being anything but.

The sprint out of the starting gate quickly gave way to a stumble and markets struggled through the spring and summer to regain their footing, only to rollover as investor sentiment turned notably sour through the end of the year which was punctuated by the worst December performance since the Great Depression.

Chart 1: Fade from black

MSCI World Index
(index)

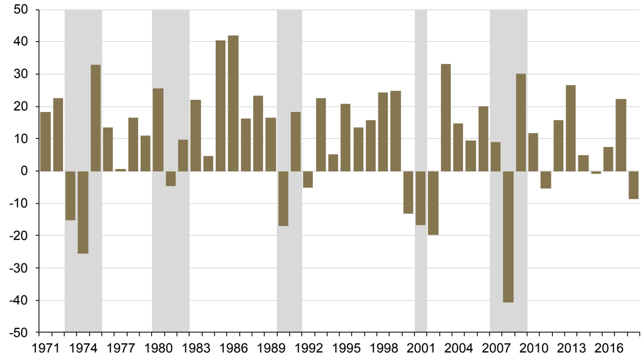


Dashed line represents the closing value from December 29, 2017
Source: Bloomberg, Guardian Capital

The end results for market performance ended up being something pretty unique from a historical context. Not only did the 10% drop in global stock prices for the year represent the worst outturn in a decade, but 2018 will go down as the one of the poorest years for equities outside of a recession since at least 1970 — the only worse years were on either side of the 2001 recession against the backdrop of the bursting of the Tech Bubble and its residual aftermath.

Chart 2: A unique year for performance

MSCI World Total Return Index
(year-over-year percent change)



Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

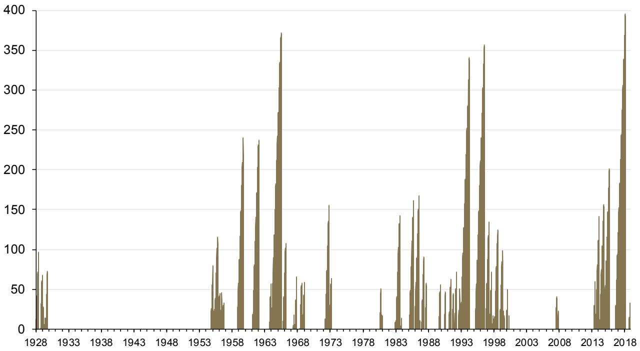
But as tumultuous as it may have seemed and though the end-result may have been unique, what played out in the markets over the past calendar year was not abnormal. It actually represented a return to "normal" market conditions after what was an extremely anomalous period of market stability.

First of all, the performance for the year was obviously marred by the fact that a correction occurred over the final months. While painful for investors, corrections (in which equities drop between 5% and 20%) are part and parcel of bull markets, offering opportunities to clear the froth to help reset for the next leg higher — and these typically happen every four months, or roughly three times per year.

There were, however, no market corrections at all in 2017 — there was actually a record set for the time between market declines of at least 5%, and for the first time on record the S&P 500 generated a positive return in each and every month of year — which makes the fact that there were two notable ones in 2018 feel more significant.

Chart 3: An exception for corrections

Number of Days Before the Start of a 5% Correction in S&P 500
(number)

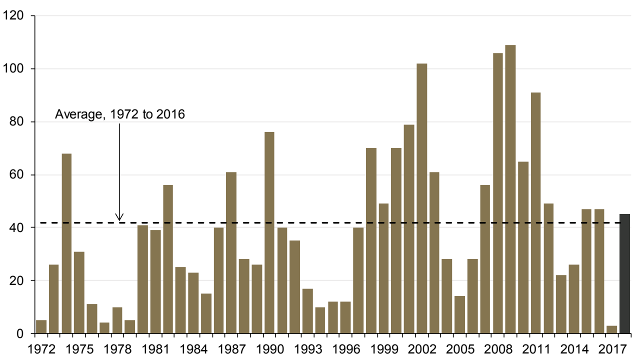


Source: Bloomberg, Guardian Capital

In actual fact, though, the market volatility was not anything out of the ordinary. For example, the MSCI World Index saw 45 trading days in which it either rose or fell by more than 1%. While that tally is 15-times what was recorded in 2017, it actually is in line with the average for the four-and-a-half decades from 1972 to 2016.

Chart 4: Back to normal, actually

Trading Days With Absolute Changes in the MSCI World in Excess of 1%
(number)

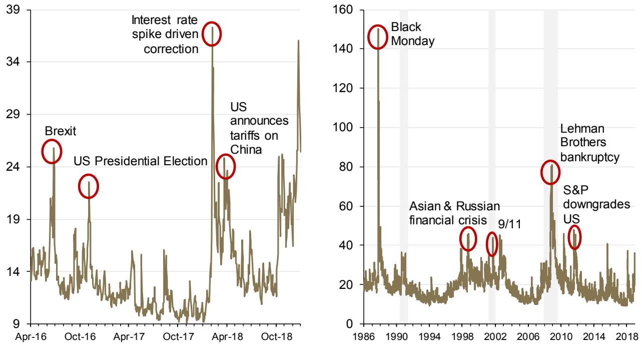


Source: Bloomberg, Guardian Capital

Moreover, the Chicago Board Options Exchange's gauge of US equity market volatility (commonly known by its ticker VIX) may have spiked relative to its historic lows recorded in 2017 and remained elevated through the end of the year, but 2018 was far from being abnormal from a longer-term perspective — and the coming year is likely to be more of the same.

Chart 5: Looking at the forest, not the trees

CBOE Equity Market Volatility Index
(annualized percent)



Prior to 1990, VXO used in place of VIX
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

…Signifying Nothing?

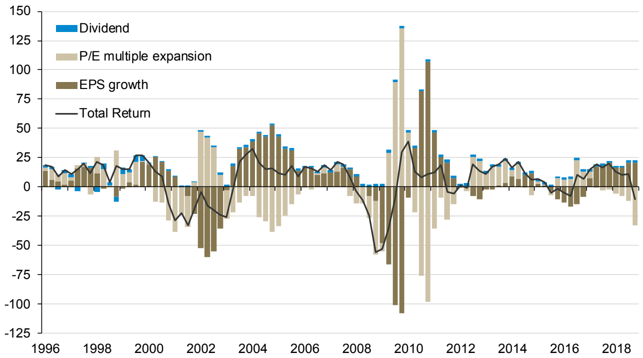
The big question is whether this volatility and weakness in risk assets was actually justified by a marked deterioration in the underlying macroeconomic fundamentals — suggesting that the correction will morph into a bear market — or whether this was the product of something far less nefarious. After all, equities are far from being accurate forecasters of downturns as Nobel-winning economist Paul Samuelson noted in 1966, "the stock market has forecast nine of the last five recessions."

Indeed, taking a deeper look at the underlying dynamics of the market performance appears to suggest that the primary driver has been sentiment rather than any material deterioration in underlying corporate fundamentals or broader economics.

Breaking down the 12-month total return into its components of earnings per share growth (fundamentals), price-to-earnings (P/E) multiple expansion/compression (as a proxy for sentiment), and dividends, shows that we are still seeing solid double-digit earnings per share (EPS) growth and normal dividend income, but the performance impact of these has been completely offset by the compression in the P/E ratio (the MSCI World Index's forward P/E ratio began the year around 18x and currently sits at 14x; for trailing it has moved from 21x to 15x).

Chart 6: A deconstructionist's lens

MSCI World Index Total Return Decomposition
(year-over-year percent change)

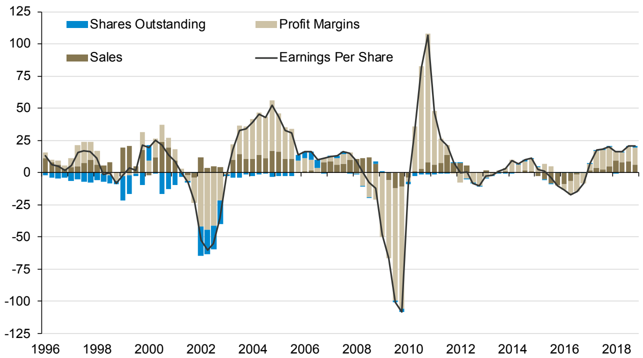


Source: Bloomberg, Guardian Capital

Drilling into the EPS growth components, while the US corporate tax cut has had the impact of raising global profit margins (since the US accounts for nearly two-thirds of the index) and share buybacks have reduced the denominator in the earnings-per-share calculation (in this case, the MSCI World Index's divisor is used as a proxy for share counts) to also boost the figure, earnings have still been supported by healthy growth in sales — and the consensus still has global sales per share growing by 5% over the next 12 months, which should continue to underpin profit growth (which is still expected to be in double digits over the next year).

Chart 7: Breaking down into component parts

MSCI World Index Earnings Per Share Decomposition
(year-over-year percent change)



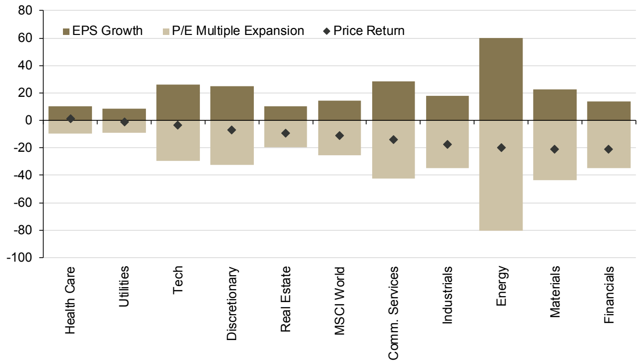
Source: Bloomberg, Guardian Capital

As well, the earnings growth is broad-based across global equity sectors, which is much more positive than if it was concentrated in just a couple that were punching well above their weight (something with a broad base is harder to knock over).

Doing a similar decomposition of this year's performance of the MSCI World index's sectors (looking at just price return, so excluding dividends) shows all 11 have actually notched increases in EPS, and pretty solid ones to boot — however, multiples have compressed across the board, leaving just one of the global sectors in the green for the year (Health Care).

Chart 8: Sectoral similarities

MSCI World Sector Index Price Return Decomposition, 2018
(percent change)

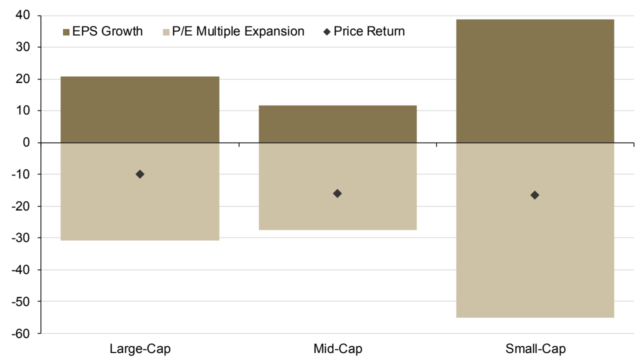


Source: Bloomberg, Guardian Capital

Finally, the poor performance despite good fundamentals was not limited just to the stocks with large market capitalizations — the MSCI World's Mid- and Small-Cap indexes also saw strong EPS growth (for the latter, it was nearly 40%), but experienced significant multiple compression that drove negative performance that lagged their larger-sized peers.

Chart 9: Size did not matter

MSCI World Capitalization Index Price Return Decomposition, 2018
(percent change)



Source: Bloomberg, Guardian Capital

In other words, the poor performance of the stocks appears to be more a function of a broad-based deterioration of market sentiment rather than anything explicitly related to market fundamentals, which suggests that this market weakness too shall pass.

The reports of my death are greatly exaggerated

Here is the very important part of this discussion: while it may be the case that the narrative surrounding the macroeconomic outlook has turned more downbeat, the actual backdrop still remains broadly positive — and without a recession, it will be highly unlikely to see a full on fundamental bear market like the ones that occurred in 2000/01 and 2008/09 in the near-term.

Markets entered 2018 with excessive optimism, supported by a strong end to 2017 and hopes that new tax plan out of the US would underpin a reacceleration of the American economy (and the rest of the world with it).

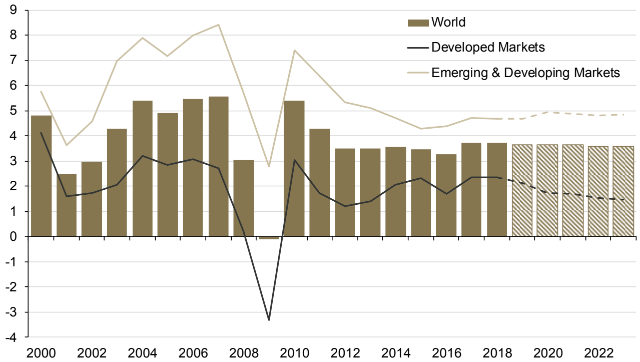
But against lofty expectations (and stretched valuations), there is more scope for disappointment since "good" may not be considered "good enough". When the dataflow failed to fully maintain the robust momentum seen through the second half of the previous year and the White House began firing the opening volleys of a trade war, sentiment turned aggressively and forecasts were scaled back.

In this space early last year, it was cautioned against reading too much into extremes in either direction since the true story is more likely than not somewhere in between — and that is a general tenet of economic forecasting that still holds.

Despite the increased pessimism over the durability of the economic expansion — now closing in on its 10th birthday and within less than six months of matching the period that ended with the Tech Wreck in 2001 as the longest expansion since 1900 — the fact of the matter is when all is said and done, 2018 actually ended up being one of the best years growth-wise of this cycle.

Chart 10: Better than you think

Real GDP Growth
(year-over-year percent change)

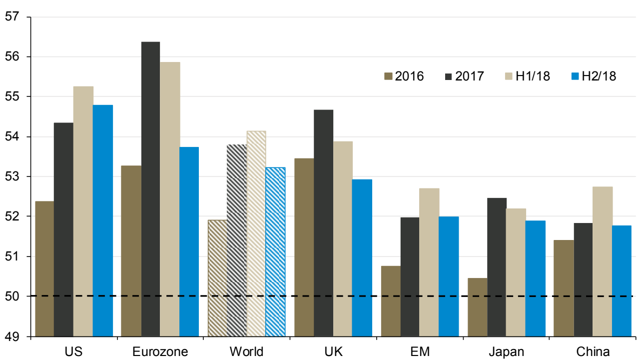


Forecasts are those produced by the International Monetary Fund
Source: International Monetary Fund, Guardian Capital

Economic momentum did slow through the second half of 2018, though this moderation came from very high levels — in many cases, forward-looking indicators of growth were sitting at cycle-peaks and even with the deceleration, these data point continued growth over the coming months and at above-trend, albeit more moderate, rates.

Chart 11: More moderate, but momentum maintained

Markit Composite* Purchasing Managers' Index
(index; >50 denotes economic expansion)



*Composite of manufacturing and non-manufacturing sectors
Source: Bloomberg, Guardian Capital

As an aside, the contractions recorded in Q3 in Germany and Japan need to be taken with a grain of salt since they reflected transitory factors more than underlying weakness. In Germany, large-scale auto production shutdowns (due to the shift to Worldwide Light Vehicle Test procedure at factories) pushed vehicle output down 20% year-over-year and to its lowest levels since Q1 2009. Japan's pullback was the result of the country being ravaged by natural disasters over the summer (Japan experienced significant earthquakes, a severe typhoon, flooding and a major heatwave). The impact of these events will be reversed in Q4 as "normal" activity resumes, with the average of the two more indicative of actual underlying performance.

Scaling Peaks

It is worth emphasizing the difference between peak growth and peak output — the former refers to the highest rate of increase in the level of output, while the latter is the highest level of output. When the peak for output is turned in, it means that the economy is subsequently declining (and falling in recession); when peak growth is turned in, it just means more modest growth but the expansion itself continues (the economy is continuing to expand).

It is very likely that 2018 marked the peak in growth for the cycle, but there is no true sign that the global economy is on the verge of hitting its peak in terms of output — the baseline remains that 2019 will see continued expansion at above-trend rates.

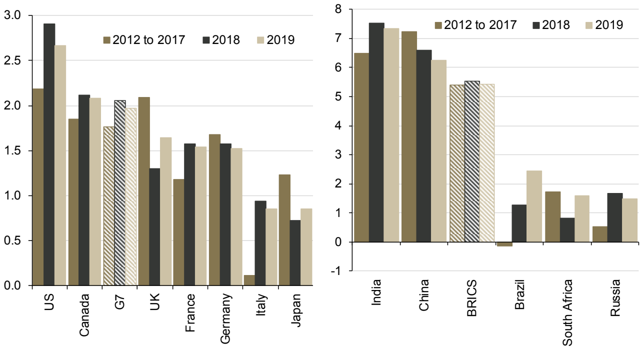
And again, the expansion remains broad-based — it is not a case of a small few leading the charge and dividing the world into the "haves" and "have nots". This is a positive for the sustainability of the expansion since the broader it is, the better able it is to endure.

Of course, the rate of growth is not expected to be uniform across countries. In Developed Markets (DM), the US is again slated to hold on to the top spot as the benefits of the expansionary fiscal policy continue to filter through the economy, while Europe lags as continued political uncertainty weighs on sentiment.

In the Emerging Markets (EM), aggregate momentum looks to largely hold steady as the controlled (and expected) moderation in China's pace of expansion is offset by continued recoveries in the likes of Russia and Brazil, and India once again acts as the pace-setter for the rest of the globe.

Chart 12: Slowing but not slow

Real GDP Growth
(annualized percent change)



Estimates for 2018 and 2019 are based on Bloomberg consensus forecasts
Source: Bloomberg, Guardian Capital

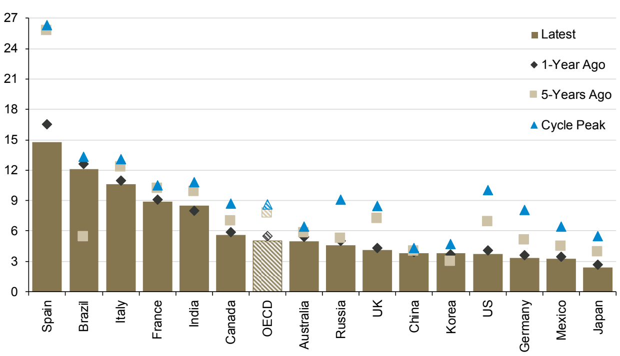
Demanding Jobs

One of the best pieces of evidence supporting a fairly sanguine view on the general health of the economic cycle is the strength of labour markets around the globe. If there were in fact signs that demand for goods and services globally was stagnating, businesses would be scaling back their demand for labour since diminished sales would mean fewer inputs to production are needed, and reducing hours is typically the first measure taken (either by cutting shifts or reducing headcounts).

The data, however, continue to show that demand for workers is extremely robust with unemployment rates plumbing depths not just of this cycle but of generations in many countries and in several cases (such as Canada and post-reunification Germany), setting record lows.

Chart 13: Love of labour not lost

Unemployment Rate
(percent)

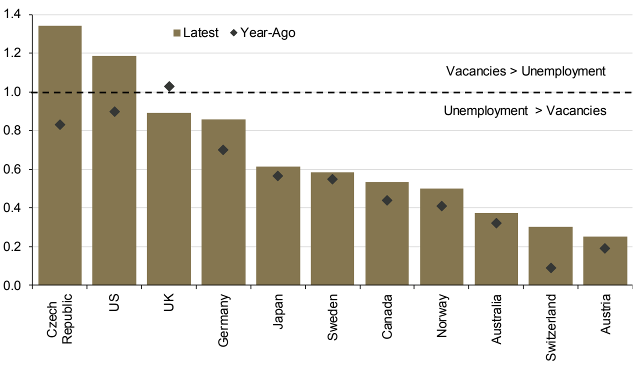


Source: Bloomberg, Organisation for Economic Co-operation and Development, Guardian Capital

Moreover, business surveys are continuing to show that firms are planning to further increase their payrolls, which is turning an already positive environment for those seeking employment even more upbeat as the market tilts in favour of those supplying labour — for example, in the US there are currently more job openings than there are unemployed Americans, while the ratio sits at record highs for other countries for which the data is available.

Chart 14: Help wanted

Job Vacancies to Unemployment
(ratio; latest available)

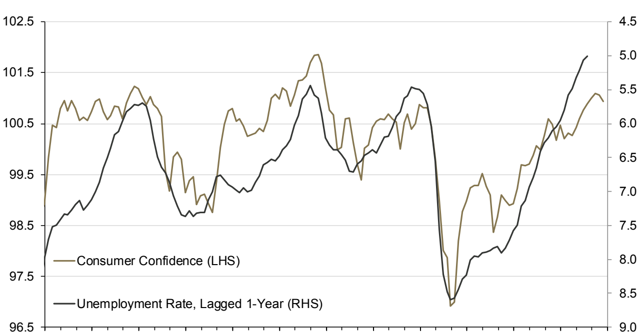


Source: Bloomberg, OECD, Eurostat, Statistics Canada, Guardian Capital

Given that consumer sentiment is most tied to individuals' economic situation and the job market is such that seemingly anybody that wants to work can readily find a source of income, this favourable employment backdrop is being met with cycle-high levels of consumer confidence — though, sentiment is off its peaks against the ongoing political uncertainty and increase in volatility in financial markets.

Chart 15: The joy of working

OECD Consumer Confidence & Unemployment
(index) (percent; inverted scale

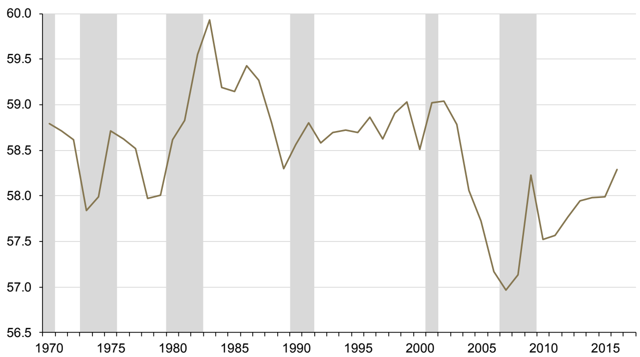


Source: Bloomberg, Organisation for Economic Co-operation and Development, Guardian Capital

Consumers that are happy and optimistic about their abilities to meet current and future financial obligations are consumers that are more willing to spend. This is important with respect to the continued expansion of the global economy since household spending is the biggest contributor to global growth, representing more than half of the world's output — and this is increasingly the case worldwide with the rise of the middle class within the EM.

Chart 16: Consumers still behind the wheel

World Household Expenditure as a Share of GDP
(percent)



Shaded regions represent periods of US recession
Source: World Bank, Guardian Capital

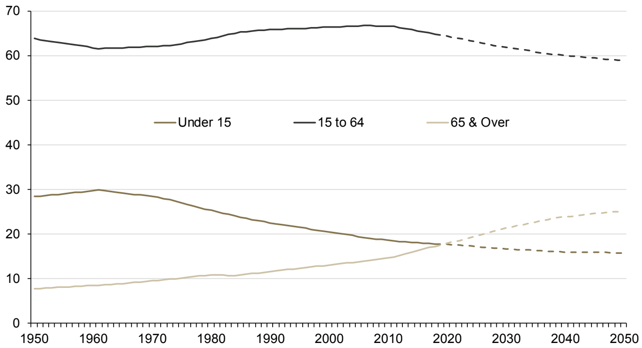
As long as households remain confident enough to continue spending, the economy will continue to be in good shape.

Feeling Constrained

While the robust labour demand is a positive for workers, it is increasingly becoming more of an issue for businesses worldwide. The significant slack in the labour market that was created in the aftermath of the last recession has been effectively absorbed over the last decade which means that the new supply of available labour is being constrained by growth in working-aged population, something that is facing downward pressures as the baby boom generation increasingly reaches retirement age and falls out of the workforce.

Chart 17: Demographic shift

Share of Developed Market Population by Age Cohort
(percent)



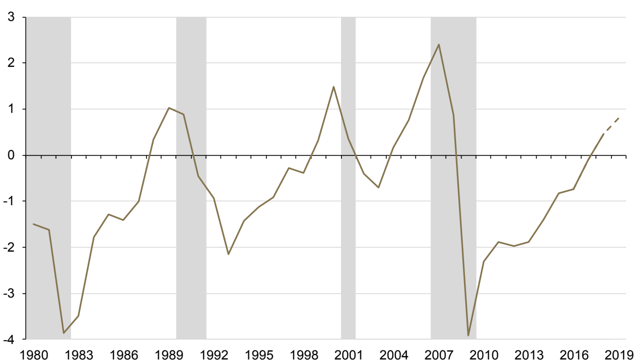
Projections are those produced by the OECD
Source: Organisation for Economic Co-operation and Development, Guardian Capital

Economies are running against capacity constraints; there is a growing scarcity of inputs that would be needed to generate enough output to maintain above-trend growth rates. The lack of adequate available resources is the reason why growth is expected to slow and eventually converge with potential (the rate of growth attainable given the constraints of population growth and technology).

This is mirrored by the estimates that show the output gap (the difference between real gross domestic product and potential) of DM economies finally closed in 2018 and is expected to move into deeper into "overheating" territory.

Chart 18: No more gap to mind

Developed Market Economies' Output Gap
(percent of potential GDP)

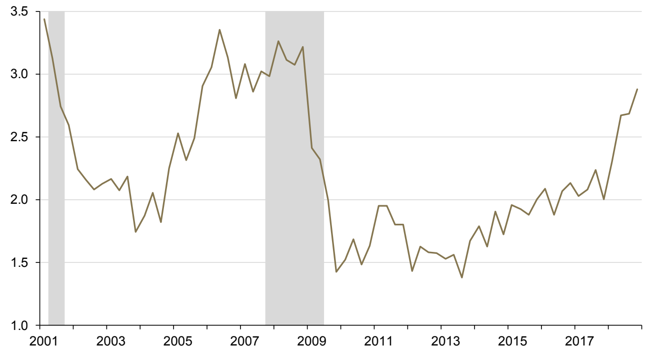


Forecasts are those produced by the International Monetary Fund
Shaded regions represent periods of US recession
Source: International Monetary Fund, Guardian Capital

Against the growing capacity pressures, price pressures are becoming more apparent. On the input side, wage growth has finally perked up in DM, with the average increase in employee compensation among the G7 economies (Canada, France, Germany, Italy, Japan, the UK and US, which collectively account for a third of global output) accelerating notably in the second half of 2018 to a cycle-high rate.

Chart 19: Winning a waged war

G7 Economies' Wage Inflation
(year-over-year percent change)

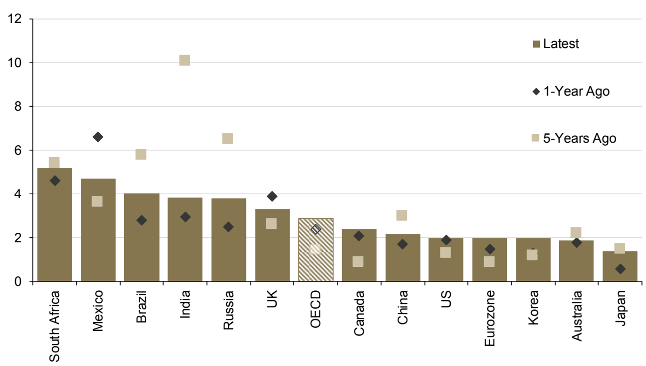


Source: Bloomberg, Organisation for Economic Co-operation and Development, Guardian Capital

With respect to output, thanks to the fact that growth in demand for goods & services is outpacing that of supply as the global economy continues to expand at an above-trend rate, firms are able to pass these costs increases to consumers via higher prices. Increasing upward pressures on prices are also becoming more evident (particularly among the DM, where the economic cycles are comparatively mature).

Chart 20: Inflation inflating

Consumer Price Inflation
(year-over-year percent change)

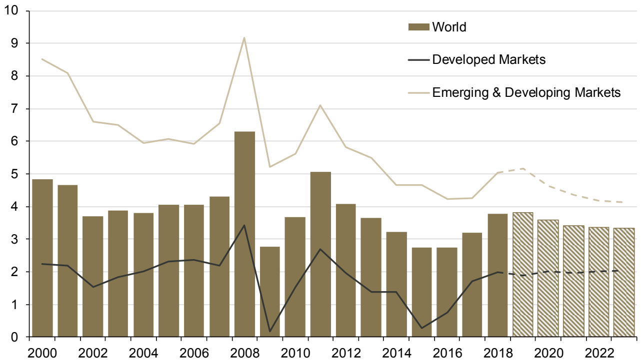


Source: Bloomberg, Organisation for Economic Co-operation and Development, Guardian Capital

The uptick in inflation is not anticipated to quickly subside, with the firming in price pressures projected to persist through the forecast horizon — though, expectations among the DM remain well-anchored near their current levels thanks to the hard-earned credibility of central banks' inflation targeting.

Chart 21: Price pressures to persist

Consumer Price Inflation
(year-over-year percent change)



Forecasts are those produced by the International Monetary Fund
Source: International Monetary Fund, Guardian Capital

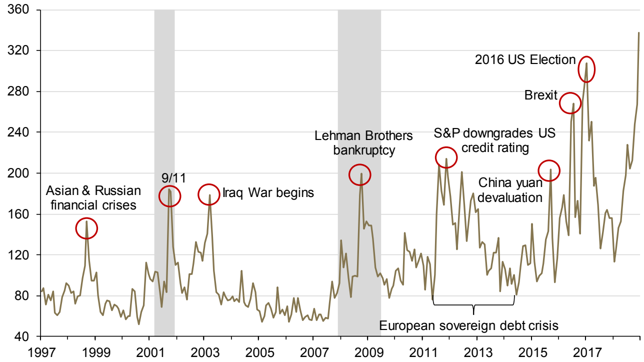
The Only Certainty is Uncertainty

Taken together, this baseline macroeconomic outlook is constructive for risk assets while also supporting the view that central banks should be moving to tighten up their policy settings.

That said, the forecast horizon is anything but clear at the moment (indeed, judging by measures designed to quantify the intangible concept of "uncertainty", there are few periods in recent history that were as unclear as now) meaning that policymakers find themselves having to balance the upside risks to inflation from the baseline projections with the material potential downside risks that stem from the ample uncertainties lingering over the outlook.

Chart 22: A world of uncertainties

Global Policy Uncertainty Index
(index)



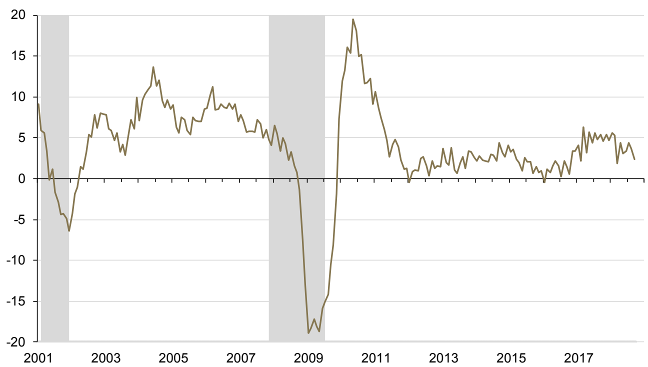
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

As is often the case, the bulk of this uncertainty is political in nature. And in keeping with the trends from the last two-plus years, the primary source of this angst is the White House.

The trade war initiated by the US in early 2018 persists and the negative impacts are becoming more evident with global trade growth slowing through the year.

Chart 23: Trade growth downshift

CPB World Trade Volume Index
(year-over-year percent change)

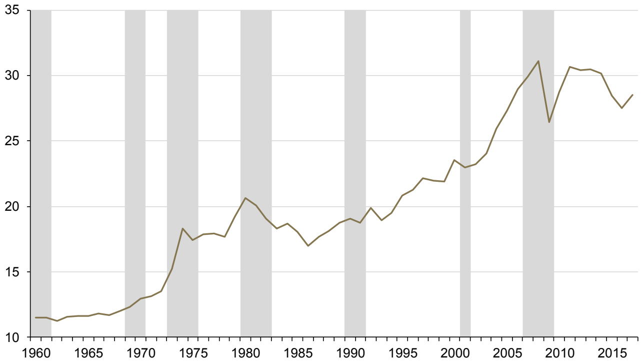


Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

The slowing trade growth may not be the biggest deal for the US since it is effectively a large, closed economy (exports account for just 10% of US output), but trade is an increasingly important cog in the global economic machine thanks to decades of removing barriers to trade in an effort to open up markets — exports account for nearly 30% of global output, nearly double what it was a generation ago.

Chart 24: Increasing importance of trade

World Exports as a Share of GDP
(percent)



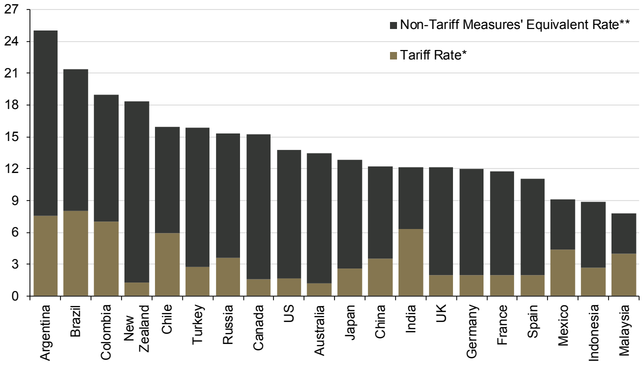
Shaded regions represent periods of US recession
Source: World Bank, Guardian Capital

The implementation of tariffs by the US in the name of protecting domestic interests risks impeding this important part of the virtuous cycle of growth that is trade — in contrast to the views of some policymakers trade is not a zero-sum game with winners and losers, but mutually beneficial for all parties involved and how wealth is spread among countries.

Moreover, the argument that the US needs to adopt these more protectionist policies to level the playing field does not actually appear to be supported by data. Combining the impact of tariffs and non-tariff barriers (policies such as sanitary and technical requirements, licensing and quotas), the US was already less open to trade than Europe, Japan and even China before the new tariff campaign.

Chart 25: US not exactly a bastion of free trade

Tariff & Non-Tariff Barriers to Trade
(percent)



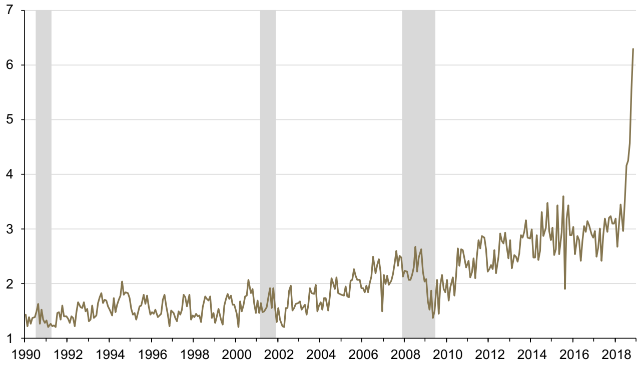
*Weighted-mean applied tariff rate for all products; data for 2016;
**Non-Tariff Measures include sanitary and phytosanitary, technical barriers to trade, border control measures, and quantitative restrictions
Source: World Bank, Organisation for Economic Co-operation and Development, Guardian Capital

Furthermore, while tariffs are intended to cause economic harm to the trading partner by reducing demand for their goods, domestic US companies are subject to negatives as well.

First of all, import duties are not paid by the exporters but by the importers — American companies are the ones footing the bill at customs which, all else the same, means that the cost of production for something that uses foreign-produced inputs rises. The US government has seen monthly customs duty revenues more than double from year-ago levels, to more than USD$6 billion per month.

Chart 26: Importers pay tariffs, not exporters

US Federal Government Customs Duties Revenue
(billions of US dollars)



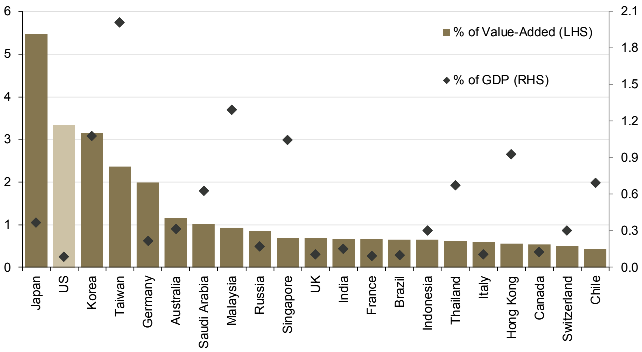
Shaded regions represent periods of US recession
Source: US Treasury Department, Guardian Capital

Second, China's place at the centre of the global supply chain means that the tariffs on its exports do not fully impact its own producers — nearly a third of the value-added of China's exports comes from a foreign market.

The US is actually the second largest contributor (behind Japan) to the value-added in China's exports stateside, meaning that American firms are indirectly impacted by the tariffs even barring retaliatory actions. Of course, as share of GDP, the hit to the US from this channel is marginal, but there would be reverberations felt through Southeast Asia and commodity producers such as Saudi Arabia (crude oil) and Chile (copper).

Chart 27: Kinks in the supply chain

Value Added to Chinese Exports to US
(percent) (percent)

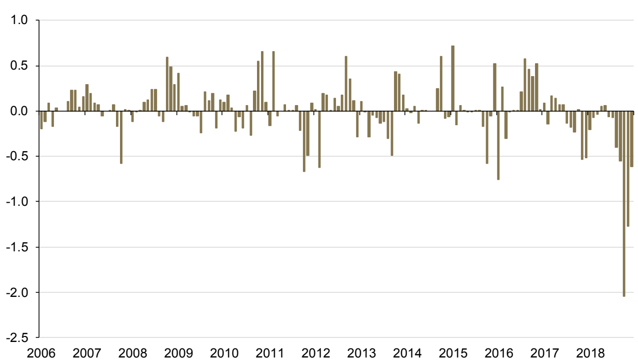


Source: OECD, IMF, Guardian Capital

The retaliatory actions, of course, cannot be ignored since they also have a notable impact on American producers. China has imposed duties on American-made imports and while US exports to China are fairly small in the scheme of the broad economy (they account for less than 1% of GDP), the USD$150 billion tab still means that the world's second largest economy is an important client. As such, the direct hit as well as any US tariff-induced decline in Chinese demand, could cause a big impact to certain segments of the economy — and look no further than US soybean producers, who have seen exports to China fall to zero and left harvests worthless, prompting the government to offer farmers support.

Chart 28: Worth a hill of beans

US Soybean Exports to China
(year-over-year change; thousands of metric tonnes)



Source: US Department of Agriculture, Guardian Capital

Importantly, there have finally been some signs of progress on the trade front. China has offered up some concessions by way of reducing auto import tariffs and opening up market access while the US has agreed not to follow through on the planned tariff increases as part of the 90-day ceasefire agreed to in December — and both parties are scheduled to resume talks in the New Year.

So, while the shadow of an escalating trade war loomed heavily throughout 2018, 2019 brings hope that an end to this skirmish could be on the horizon — though this is far from an absolute certainty.

Any improvement on an external front is positive, especially when it appears as though domestic US politics are set to become somewhat more contentious. So far through the American president's tenure, he has faced only mild pushback to his policies thanks to the Republican dominated Congress. The new year, however, sees the Democrats assume control of the House of Representatives thanks to their victory in the November midterm elections.

While not the most ideal outcome, political gridlock has not been bad for the economy and markets in the past — and the increased difficulties in passing legislation likely means that the market-friendly initiatives such as tax reform measures will not be rolled back nor will key parts of Dodd-Frank regulations be reinstated.

That said, the need for co-operation from both sides of the aisles to avoid difficulties around the raising the debt ceiling (the suspension of which expires on March 2) and getting a funding bill passed to keep government running could result in some headline shocks in the coming months — and that's not to mention the turmoil related to the turnover in the President's Cabinet or the litany of ongoing investigations and lawsuits.

The political backdrop remains highly complicated in Europe as well.

For starters, the UK and the European Union (EU) divorce proceedings have reached an impasse. The deal formally reached between the two at the end of November — which sees a transition period until the end of 2020, maintains citizens' rights within the EU, seeks a "comprehensive" economic relationship including a free-trade area, and commits to a customs-free border between Northern Ireland and Ireland among other -- was soundly rejected by British Parliament, with both the "Brexiteers" (who would prefer to have a clean break from the EU) and the "Remainers" (who prefer the status quo and effectively view any deal as unacceptable) voting against it.

Officials from the EU have stated that the agreement they have reached — is final and will not be involved in any further negotiations — a position that was reaffirmed after the deal's defeat by UK policymakers, with the European Commission stating that the existing agreement is "the best possible deal" and it is "the only way". That said, the magnitude of the rejection by the House of Commons could push European leaders to return to the table — Germany's Angela Merkel commented that "we still have time to talk, but we're waiting to see what the British Prime Minister proposes".

That puts the pressure on the UK and with its 46-year membership in the EU officially set to end on March 29, 2019, at 11:00 p.m. GMT, the clock is ticking. There appear to be three main outcomes currently on the table:

1. A deal of some sort is forced through Parliament as "better than nothing";
2. No deal is reached (the so-called "hard Brexit");
3. A renewed mandate comes from either a new general election or a second referendum.

Prime Minister Theresa May appears set on continuing to push for a deal — even if it requires amendments to the current agreement, particularly related to the customs arrangements, to shift the balance, or an extension of the deadline in order to hold multiple votes à la the passing of the Troubled Asset Relief Program (TARP) in the US in 2008 — but its success is far from a sure thing.

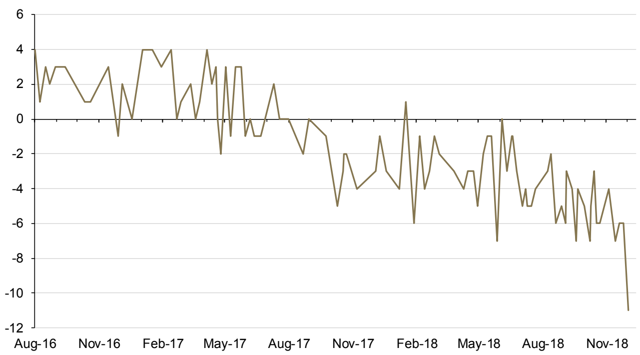
The "no deal" option would be by far the worst outcome for the UK since it would see Britain left naked in the wind and push it into a period of economic and political chaos. But given that it is effectively the default option should a deal not be reached, it can in no way be ruled out as the end result.

The third choice, while a risky proposition since there is no such thing as a sure thing when it comes to a vote such as this, is becoming an increasingly realistic prospect. While it may be the case that there are likely few willing to accept a leadership role in this environment — with a preference seemingly for May to see this through before stepping in to pick up the pieces, given that the Prime Minister has now narrowly survived two non-confidence votes — the prospect of holding another referendum on EU membership is indeed an option on the table (though would likely require the EU agreeing to give the UK a deadline extension).

Opinion polls are showing that in hindsight, Brits are having some buyers' remorse, with results from a proposed second referendum tilting in favour of "remaining" in the EU, while the share of people thinking they made the wrong decision has gapped notably higher.

Chart 29: Bre-gret

Net Balance of Respondents Thinking Britain was Right to Leave EU
(percent; <0 denotes balance in favour of "wrong")



Source: YouGov/The Times Westminster Voting Intentions Survey, Guardian Capital

The hope for a second vote was also given a boost recently when the European Court of Justice ruled that the UK could unilaterally withdraw its Article 50 notice which put the Brexit into motion — and this has served to harden the resolve of "Remainers" in Parliament.

Until this issue is resolved one way or the other, it provides a lingering cloud of uncertainty over the outlook on the other side of the Atlantic.

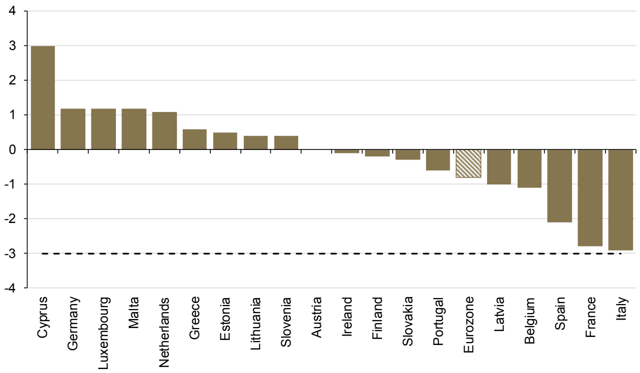
In Continental Europe, Italy's coalition government finally appeased the EU over its fiscal plans in a move to calm markets by "demonstrating determination in the economic politics of government" — Italy agreed to lower its planned deficit to 2.0% for the coming year instead of the initially projected 2.4% by making spending concessions for the year totalling roughly €10 billion.

In France, President Emmanuel Macron has seen his star fall in the second year of his term. His approval ratings have plummeted amidst protests and political rivals even tabled a vote of no confidence (though it was quickly quashed since Macron's party holds a strong majority in the National Assembly).

The civil unrest persists, however, and the promises made by the French President in an attempt to quell the rising wave of protests in the Eurozone's second largest economy — including an increase in the minimum wage, cancelling a tax on low-income pensioners and delaying imposing a fuel tax — create the risk of an impending clash with officials in Brussels given the country's deficit is already expected to come perilously close to the 3% threshold imposed by the Stability and Growth Pact (SGP).

Chart 30: Breaching the threshold

European Commission Projected Deficit to GDP Ratio, 2019
(percent)



Dashed line represents maximum threshold under Stability and Growth Pact
Source: European Commission, Guardian Capital

Elsewhere, Germany faces a degree of political uncertainty for the first time since 2005 after Chancellor Angela Merkel stepped down as leader of the Christian Democratic Union (a party she has headed since April 2000). Her replacement, Annegret Kramp-Karrenbauer, is viewed as Merkel's heir-apparent which means that little is expected in terms of change with respect to basic politics, providing a salve for markets. She does, however, face a tough task in subduing the rising influence of formerly fringe political parties while affirming that a steady hand remains at the till of Europe's growth engine.

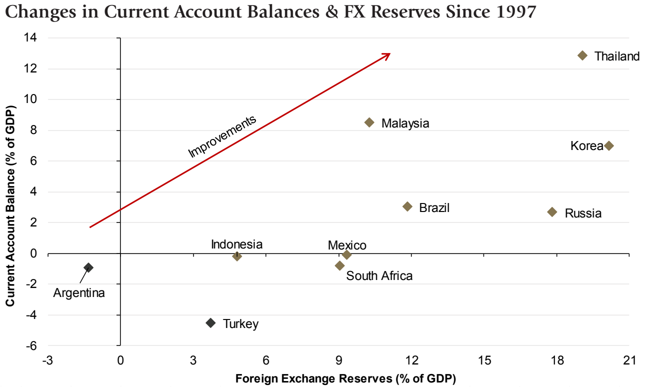
For Europe more broadly, the rise of populism could become a key narrative of the upcoming European Parliamentary election in May with it looking as though the governing body could see a material rise in membership from alternative (and Eurosceptic) parties — though, the broad divergence of views on policy among these groups is likely to prevent them from joining forces and exerting significant influence over the overall policy agenda.

Finally, one area where the risks have diminished relative to a year-ago are in EM, if only because some of those risks actually materialized in 2018.

The extreme vulnerabilities in a couple of EM economies (namely Argentina and Turkey) were exposed early in 2018 prompting a sharp re-pricing of assets in the complex as a whole as concerns rose over contagion. Those concerns have so far proven to be unwarranted — most EM economies took steps over the last two decades to increase currency reserves, decrease current account deficits and reduce dependence on foreign funding, which reduced the risk of a small crisis spiraling into a much larger one such as was seen in 1997.

Chart 31: A different backdrop from the last crisis

Changes in Current Account Balances & FX Reserves Since 1997



Source: International Monetary Fund, World Bank, Bloomberg, Guardian Capital

Entering 2019, the likelihood of these issues flaring up again looks to be relatively low since much needed rebalancing was already forced through and punishment doled out.

The region also faces somewhat diminished political risk relative to a year ago thanks to a smaller slate of elections on the docket. The potential for a change-over in governments in India, Argentina, South Africa and Indonesia (low as it may be), as well as the risks surrounding the new governments in Brazil and Mexico, however, means that political uncertainty remains on the radar.

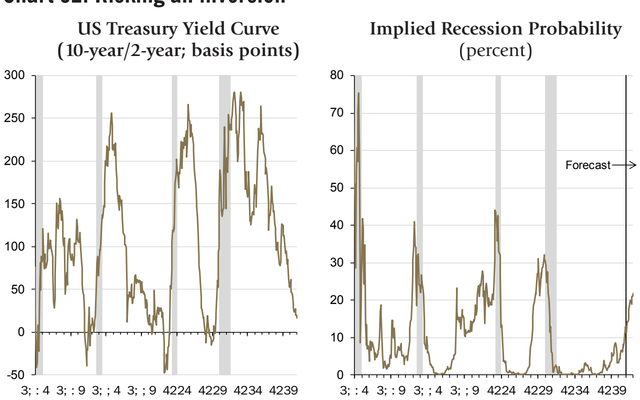
Unrated Cut

One of the more prominent risks on the horizon stems from the message being sent by the bond market.

The yield curve has become extremely flat — the spread between yields on short-term and long-term bonds is just a handful of basis points. Why this matters is because banks finance longer-term loans to consumers and businesses using short-term sources of funds (such as deposits). A flattening yield curve means that lenders' interest rate margins are compressing which reduces incentive to extend credit and can mean that economic activity gets constricted and growth can slow.

The connection between the yield curve and economic downturns has a good track record. In the past when the spread between 2-year and 10-year yields has turned negative (the curve inverts as short-term interest rates are higher than longer-term), a recession has followed in the next year (or two). Using this historic relationship as a guide, the yield curve implies that the probability of an impending recession now is at it highest point of this cycle.

Chart 32: Risking an inversion



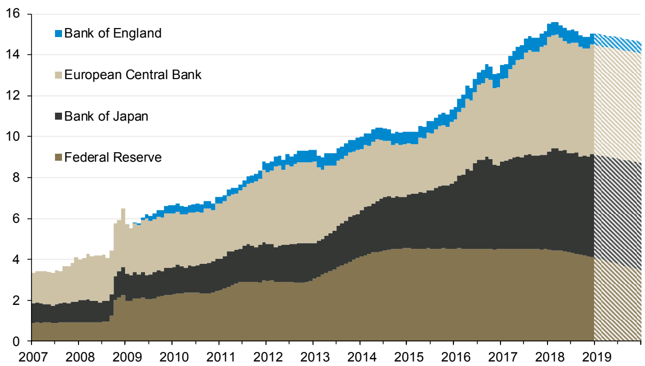
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Importantly, though, the yield curve has not yet inverted — and there is reason to believe the flattening trend could stall.

Central bank bond buying has certainly had an impact on longer-term rates in the market, keeping them at lower levels (and the curve flatter) than would otherwise prevail. But after years of balance sheet expansion, the tide is turning — the European Central Bank (ECB) ended its asset purchases as of December (though it is still reinvesting the proceeds of maturing bonds) and the US Federal Reserve (Fed) is slowly letting its holdings runoff its balance sheet. While the Bank of Japan (BOJ) is adding to its tally for the foreseeable future, the net impact is that the cumulative assets held by the Fed, ECB, BOJ and Bank of England (BOE) are projected to decline over the coming year.

Chart 33: Remaining unbalanced

Central Bank Assets on Balance Sheet
(trillions of US dollars)



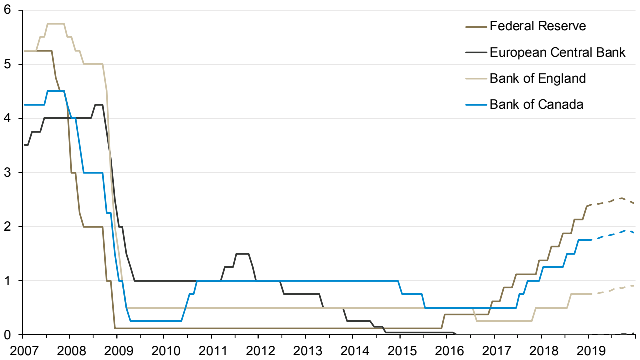
Forecasts assumed Fed balance sheet runoff of $50 billion per month (terminal cap), BOE and ECB maintain assets at December 2018 levels, and BOJ buys average at a pace consistent with the average of the last 12 months; FX rates held at December 2018 levels through forecast horizon
Source: Bloomberg, Guardian Capital

This loosening anchor for the longer-end of the bond market comes at time when the US government is expected to bring a huge volume of bond supply to the market in order to finance its gaping deficit. The shifts among supply and demand could serve to put upward pressure on market rates further out on the yield curve.

At the same point, the flattening of the yield curve reflects that investors are increasingly pricing in a negative environment that will require policymakers to ease policy — the market-implied odds of central banks cutting rates by year-end have been on the rise.

Chart 34: Take a hike (out of the forecast)

Central Bank Policy Interest Rates
(percent)



Dashed lines are Overnight Index Swap forward rates
Source: Bloomberg, Guardian Capital

Again, the baseline outlook remains for continued growth and persistent inflationary pressures which would be consistent with continued policy tightening from central banks — this is something policymakers themselves continue to anticipate, with the last iteration of the US Federal Reserve's "dot plot" showing that the median member of the Federal Open Market Committee (FOMC) still projects two more 25 basis point rate hikes by the end of 2019, while the Bank of Canada (BOC)'s latest statement reiterated that the "Governing Council continues to judge that the policy interest rate will need to rise" into a neutral range to achieve its inflation target.

The bond market's expectations, in contrast, are for a more dire outcome in which not only is the rate hike cycle as good as over, but that lower rates may be warranted to prop up the economy before the year is done. Just as the equity market was priced for perfection at the outset of last year, this appears to be a case of the market expecting something akin to a "worst case" scenario.

Ultimately, something has to give and close the gap between central banks and market expectations and the baseline outlook suggests that it will be markets that are forced to make the adjustment with a repricing across the curve — after all, there is a reason why an old adage in investing is "don't fight the Fed".

Credit Check

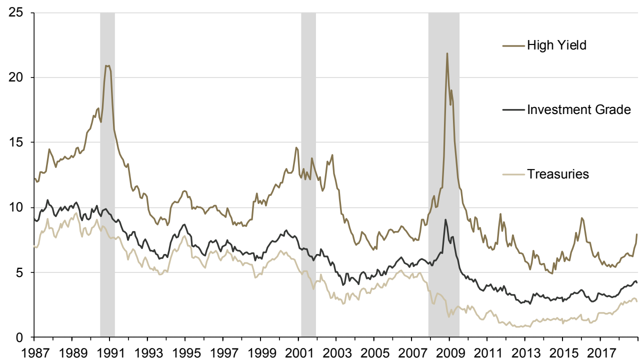
Government bond yields have reversed lower after hitting multi-year highs earlier in the autumn, but the yields offered on corporate bonds have been moving in the opposite direction as credit as an asset class has seen outflows amid the selling of risk assets.

But one of the more interesting developments is that credit markets, which historically have provided indications of a deterioration of the economic outlook, are not flashing the same signals as the government bonds or equities.

Yes, yields on Investment Grade and High Yield corporate debt have moved higher, but they have done so in a pretty orderly fashion and still remain at fairly benign levels.

Chart 35: Higher, but not high, yields

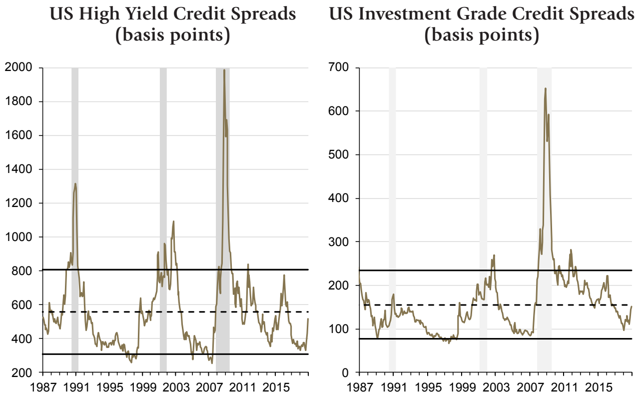
US Bond Index Yields
(percent)



Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Moreover, the spread over government bond yields — a gauge of credit risk — has edged up only marginally all told, and remains on the lower-side of historical averages. There is no strong indication that there are significant worries about corporations across the credit quality spectrum being able to meet their financial obligations — and this at a time when concerns over high corporate debt loads are prevalent.

Chart 36: Low corroboration from credit

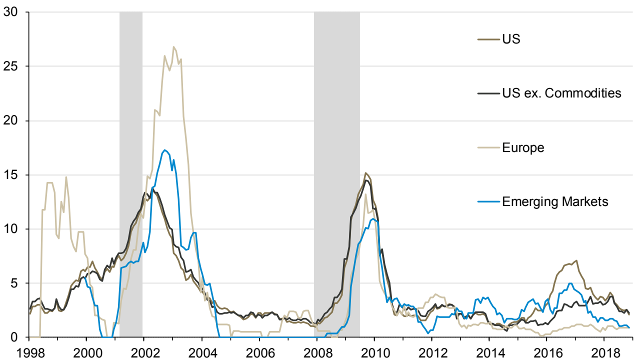


Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

And really, this should not be too surprising. The economy remains in decent shape and corporations are profitable and have strong balance sheets (nonfinancial corporations' debt-to-equity ratios are near cycle lows while liquidity measures are elevated and interest coverage are solid). Against this, corporate default rates remain extremely benign globally and are projected to continue to trend lower over the coming year (Moody's Investors Service and S&P Global forecast that speculative-grade corporate bond default rates will decline further to near cycle-lows over the coming six months).

Chart 37: Credit still quality

High Yield Corporate Bond Default Rate
(percent)



Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Fixed income securities' valuations are ultimately anchored by their promised cash flows and the recent increase in corporate credit yields against the baseline expectations for a continued economic growth would suggest that these valuations have become more attractive.

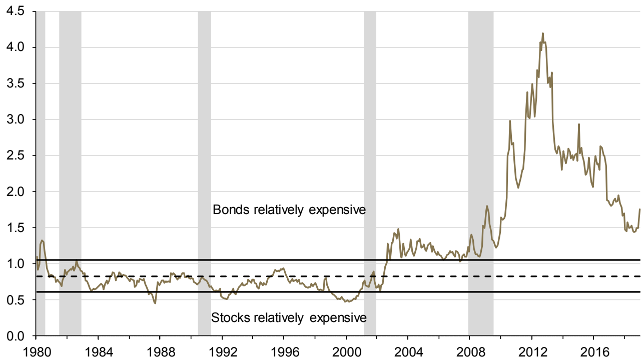
Add the fact that corporate credit provides exposure to positive economic surprises (which benefit the underlying companies) and that the asset class generally offers lower duration — meaning that they are less sensitive to interest rate increases — with a higher yield cushion than their government counterparts, and it would seem that there is a relative value proposition to be made with respect to increasing credit within fixed income allocations.

Taking Stock

On the topic of relative value and asset allocation, the combination of the selloff in equities and the rally in government bonds has pushed the comparative attractiveness even more in favour of equities over bonds in a balanced portfolio context.

Chart 38: It's all relative

Ratio of S&P 500 Earnings Yield to US Bond Universe Index Yield
(ratio)

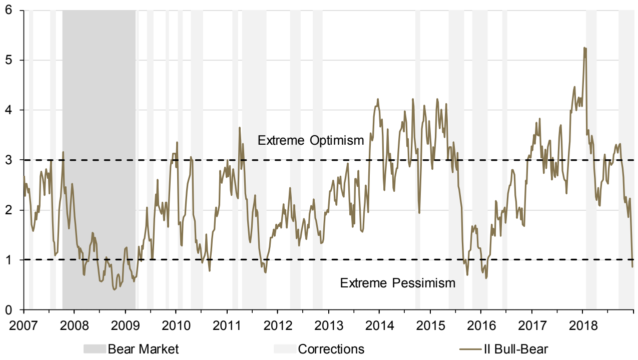


Dashed line represents average from 1980 to 2007; solid black lines +/-1 standard deviation from average
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Again, equities entered 2018 priced for the best possible outcomes and investor sentiment was excessively exuberant. When something hits that magnitude of an extreme, there is only one direction to go — and it certainly moved in that direction. As it currently stands, the last time investors were this pessimistic on the market outlook was early 2016 (and markets subsequently experienced a prolonged rally).

Chart 39: Sentiment swing

Investors Intelligence Bull-Bear Ratio
(ratio of "bullish" survey respondents to "bears")

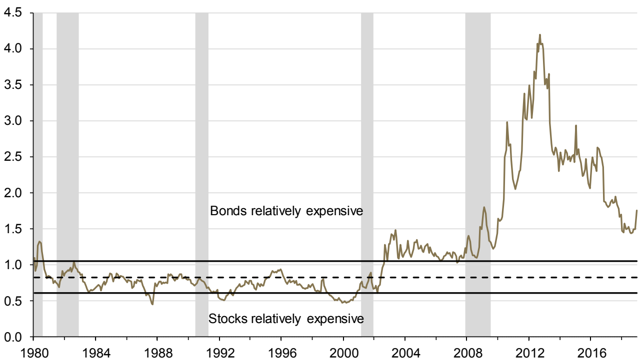


Source: Investors Intelligence, Wall Street Journal, Bloomberg, Guardian Capital

But as was discussed at the outset, while sentiment swung sharply, the underlying fundamentals remained in place and expectations remain for earnings growth to continue at a healthy pace. The result is a significant reversion in equity market multiples which has left them looking not only attractive relative to bond valuations but also on an absolute basis.

Chart 40: Valuation reversion

S&P 500 Forward Price-to-Earnings Ratio
(ratio)



Dashed line represents historical average; solid black lines +/-1 standard deviation from average
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

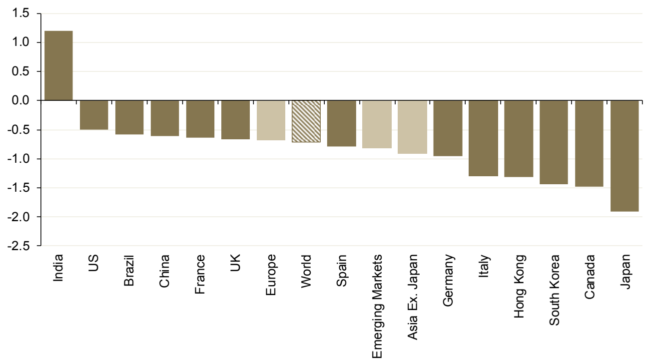
The P/E multiple compression has turned valuations from a headwind to a potential tailwind for the market — for example, back in the 2010/11 period, where there was multiple compression against sustained earnings growth, it saw notable rebounds in P/E ratios and market performance thereafter.

But even more than that, sustained earnings growth means that even if multiples hold at their current levels, markets have the scope to move higher as the "P" keeps pace with the "E".

The potential opportunities provided by the lower valuations extends across almost the entire world with virtually every market now trading at a discount to their 10-year averages — with stocks in EM looking increasingly compelling on an absolute basis and relative to their DM peers.

Chart 41: Bargain hunting abroad

MSCI Country Index Forward Price-to-Earnings Ratio Relative to 10-Year Average
(standard deviations from the average)



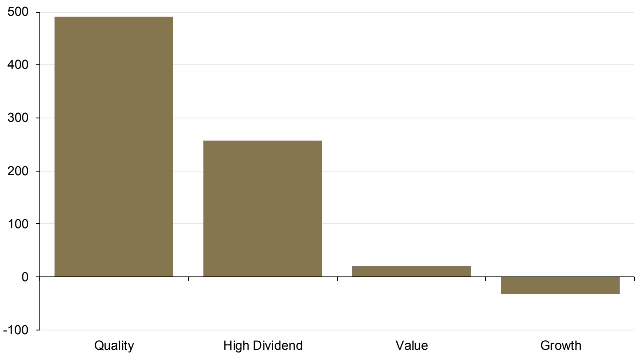
Source: Bloomberg, Guardian Capital

Adding exposure to international equity markets is appealing from a risk management standpoint since it increases geographic diversification, but also provides opportunity to add yield carry that can help to mitigate the volatility in the market — and some of the best yield offerings can be found outside of North America.

Dividend stocks typically outperform the market in periods of heightened volatility in part due to their cash flow cushion muting the downside — when volatility has been above-average over the last two decades, global equities with high dividend yields have beat the broad index. Similarly, "quality" stocks (as per the MSCI classifications, these are stocks that achieve high quality scores based on high return on equity, stable year-to-year earnings growth, and low financial leverage), also provide a haven against volatility, supporting a preference for tilting exposure to these typically stronger and more stable companies with better earnings visibility.

Chart 42: Shelter in the storm

MSCI World Strategy Total Return Versus Overall Index When Volatility is Elevated*
(basis point difference in average annualized rate)



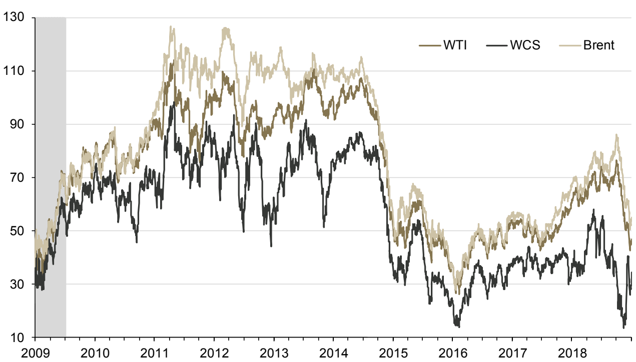
Based on monthly data since January 1995 when VIX is above average level
Source: Bloomberg, Guardian Capital

Oil Slick

One final area to touch on with respect to indicators of a downturn is the slump in commodity prices, particularly oil. After a difficult few years, oil prices finally gained traction in the first half of 2018 as production curtailments helped bring crude inventories down and markets were optimistic on the outlook. Of course, this gave way to a 40% plunge in benchmark prices in just the last three months.

Chart 43: Prices slip on oil slick

Benchmark Crude Oil Prices
(US dollars per barrel)



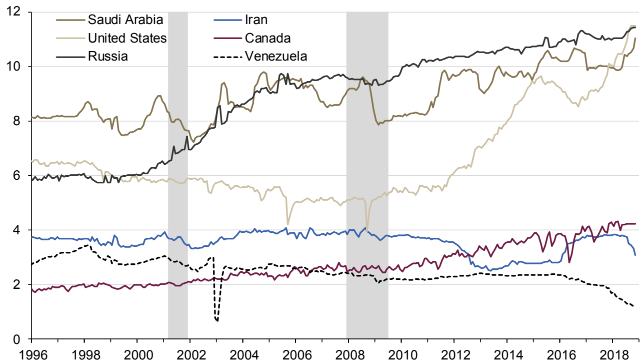
Shaded region represents period of US recession
Source: Bloomberg, Guardian Capital

In contrast to other periods where slumps in oil prices were a function of weaker economic growth (and thus softer demand for oil), what has played out recently is more of an "excess supply" story than being driven by softening demand.

Russia, Saudi Arabia and the US are all pumping out record-high amounts of crude oil — these three countries have cumulatively increased output by 2.5 million barrels per day so far this year.

Chart 44: Drill, baby, drill

Crude Oil Production
(millions of barrels per day)



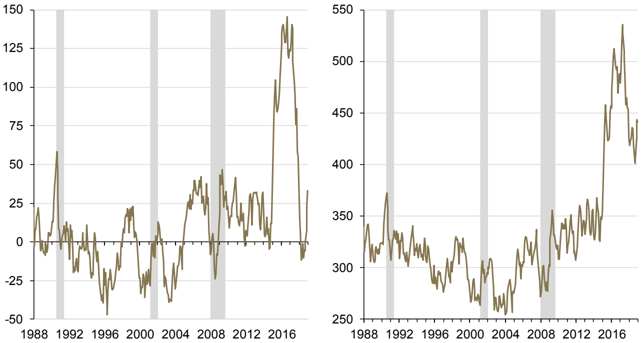
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Part of this increase was designed to cushion the impact of a significant chunk of Iran's nearly-4 million barrels per day being removed from the market — due to the sanctions being re-imposed on Iran by the US as part of its decision to abandon the Joint Comprehensive Plan of Action on May 8, 2018 (with sanctions coming into effect in 180 days' time, or November 4) with the explicitly stated goal of driving Iranian oil exports to zero — as well as to offset the continued decline from Venezuela, where production is in a downward spiral due to country-specific issues (output is down 50% from 2016 levels).

On November 4, however, the US announced that it was granting waivers from the sanctions for eight countries (Iran's largest customers in China and India, as well as South Korea, Turkey, Italy, Greece, Japan and Taiwan) for another 180 days. That meant that there was less production coming off the market at a time when production in general was rising sharply. And given growth in consumption has largely maintained its trajectory that pointed to an excess supply in the market that has pushed already elevated inventories higher.

Chart 45: Supply overhang still hanging over

Excess* US Crude Inventories (millions of barrels) | **US Crude Oil Inventories (millions of barrels)**



*Inventory levels relative to five-year average for a given month
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

When growth in supply outpaces growth in demand, prices decline, which is exactly what we have seen play out.

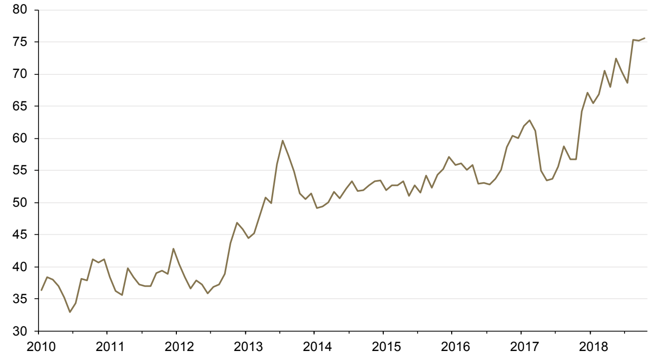
In December, the members of the Organization of the Petroleum Exporting Countries (OPEC) plus Russia and other allied producers agreed to cut output by 1.2 million barrels per day for six months starting January. The move helps to put something of a floor under oil prices, though downside risk still prevails on concerns that US production will continue to ramp up and outpace demand growth.

Prices have, however, recovered sharply for the Canadian heavy oil benchmark price, Western Canadian Select (WCS). WCS faced significant pressure when a court decision quashed much-needed pipeline expansion at a time when existing pipelines were facing severe capacity constraints.

The net result was that the rising amount of crude oil being produced in Canada was unable to readily get to market, leaving stockpiles in the Great White North rising to record high levels and driving differentials relative to other benchmark prices to blow out to previously unseen levels.

Chart 46: Albertan oil glut

Alberta Inventories of Crude Oil & Equivalent
(millions of barrels)



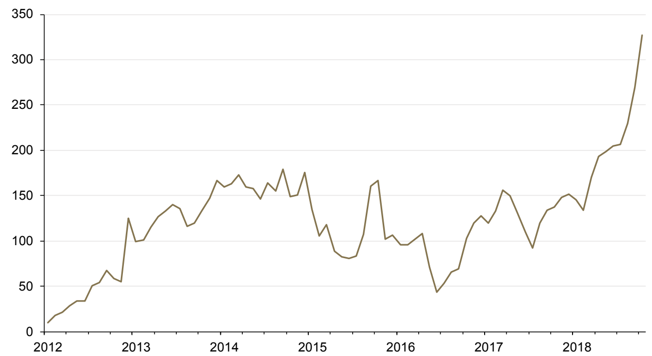
Source: Alberta Energy Regulator, Guardian Capital

There have been two main developments that have helped stabilize the markets and bring price differentials back in line with historical norms.

First, crude by rail shipments have gained significant momentum, more than doubling from year-ago levels and setting all-time highs.

Chart 47: Riding the rails

Source: Alberta Energy Regulator, Guardian Capital
(thousands of barrels per day)



Source: National Energy Board, Guardian Capital

Secondly, on December 3, 2018, the Alberta government ordered oil producers operating in the province to cut production by 325,000 barrels per day (almost 9%) starting January 2019. This move is expected to help clear out excess inventories by the Spring, at which point the cuts are expected to be rolled back to about a third (to 95,000 barrels per day).

That the cuts are not expected to be permanent means they will have only a transitory impact on Canadian growth and should result in negligible spillovers into other areas of the domestic economy.

But the moves are welcome from a broader market standpoint since they could help underpin the beleaguered commodity sectors that comprise a disproportionate weight of the Canadian equity market.

It Is Always Darkest Before the Dawn

In stark contrast to 12 months ago, sentiment in financial markets is quite downbeat heading into the New Year as investors seemingly are gearing up for the worst. But lowered expectations mean that there is scope for the balance of risks to be skewed to the upside.

Despite a growing magnitude of concerns, the underlying macro backdrop remains constructive and the coming year is looking as though it will again record broad-based and above-trend growth.

Against this, corporate earnings are likely to continue to expand which should underpin risk asset performance — and that there is potential for valuations to provide a tailwind also bodes well for the return prospects over the coming months.

The economic outlook, however, also remains supportive of central banks defying market expectations and continuing on with the gradual process of moving monetary policy closer to neutral.

The associated upside risks to interest rates versus what is being priced in and the prevailing low yield cushion makes bonds relatively less attractive and continue to support a tilt toward equities in a balanced fund asset mix.

The heightened uncertainty in the market environment and the high probability that volatility persists, however, suggest that it may still be prudent to manage risk by maintaining a focus on quality and adding exposures to cash flow generating assets.

Balance Fund Summary Views

EQUITIES	+	FIXED INCOME	–
Canadian Equity	Neutral	Government Bonds	–
US Equity	+	Investment-Grade Credit	+
EAFE Equity	Neutral	High-Yield Credit	+
Emerging Markets Equity	+		

Market Returns at December 31, 2018 All Returns in Cdn $

CANADIAN EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P / TSX Composite	-5.4	-10.1	-8.9	-8.9	4.1	7.9
S&P / TSX 60	-5.5	-8.9	-7.6	-7.6	5.0	7.9
S&P / TSX Completion	-4.9	-13.7	-12.9	-12.9	1.4	8.3
S&P / TSX Small Cap	-3.5	-14.4	-18.2	-18.2	-0.3	6.6
BMO Small Cap Blended (Weighted)	-3.8	-15.2	-18.2	-18.2	0.3	8.8
S&P/TSX Composite High Dividend Index	-5.7	-8.9	-10.8	-10.8	2.1	9.5
S&P / TSX Composite Dividend	-5.4	-9.3	-8.6	-8.6	4.9	N/A

S&P/TSX SECTOR RETURNS (%)

Energy	-6.8	-17.3	-18.3	-18.3	-5.5	2.0
Materials	5.7	0.9	-9.3	-9.3	1.2	0.2
Industrials	-9.3	-13.4	-2.4	-2.4	9.2	14.3
Consumer Discretionary	-8.5	-11.9	-16.0	-16.0	7.7	11.9
Consumer Staples	-1.0	5.7	2.0	2.0	14.6	14.3
Health Care	-16.6	-35.3	-15.9	-15.9	-23.2	6.2
Financials	-7.1	-11.3	-9.3	-9.3	7.4	12.5
Information Technology	-5.2	-10.3	13.0	13.0	16.7	5.8
Communication Services	-2.7	2.0	-0.8	-0.8	9.3	12.4
Utilities	-3.1	-1.3	-8.9	-8.9	5.9	7.1
Real Estate	-4.4	-6.7	2.0	2.0	10.2	15.2

US EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P 500	-6.5	-8.6	4.3	4.3	14.1	14.4
Dow Jones Industrial Average	-6.0	-6.3	5.3	5.3	15.3	14.4
NASDAQ	-7.0	-12.9	4.9	4.9	15.3	16.7
Russell 1000	-6.6	-8.9	3.9	3.9	13.8	14.5
Russell 2000	-9.4	-15.7	-2.9	-2.9	9.8	13.2
Russell 3000	-6.8	-9.5	3.4	3.4	13.4	14.4
Russell 1000 Growth	-6.0	-11.1	7.5	7.5	16.1	16.6
Russell 1000 Value	-7.1	-6.7	0.1	0.1	11.4	12.4

S&P 500 SECTOR RETURNS (%)

Energy	-10.4	-19.7	-10.9	-10.9	-0.7	4.6
Materials	-4.5	-7.6	-7.2	-7.2	9.1	12.3
Industrials	-8.4	-12.8	-5.7	-5.7	11.4	13.9
Consumer Discretionary	-6.0	-11.9	9.6	9.6	15.3	19.6
Consumer Staples	-6.8	-0.1	-0.4	-0.4	11.7	12.2
Health Care	-6.3	-3.8	15.8	15.8	16.8	15.9
Financials	-9.0	-8.4	-5.4	-5.4	13.7	12.1
Information Technology	-6.1	-12.9	8.4	8.4	20.8	19.6
Communication Services	-4.9	-8.5	-4.9	-4.9	7.8	8.7
Utilities	-1.6	6.8	13.2	13.2	16.4	11.7
Real Estate	1.0	4.0	10.9	10.9	11.8	10.7

INTERNATIONAL EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
MSCI World Index (Net)	-5.0	-8.5	-0.4	-0.4	9.9	10.9
MSCI EAFE Index (Net)	-2.2	-7.6	-5.9	-5.9	5.7	7.5
MSCI ACWI	-4.4	-7.8	-1.2	-1.2	9.6	10.7
MSCI France	-1.9	-10.2	-4.8	-4.8	6.4	6.6
MSCI Germany	-3.1	-10.7	-15.1	-15.1	2.9	6.7
MSCI Japan	-4.1	-9.4	-4.9	-4.9	8.4	6.5
MSCI UK	-1.1	-6.8	-6.3	-6.3	3.3	8.0
S&P/IFC Investable (Emerging Markets)	0.2	-1.7	-6.4	-6.4	7.8	10.2
MSCI EAFE Growth (Gross)	-2.1	-8.4	-4.5	-4.5	7.2	8.6
MSCI EAFE Value (Gross)	-2.2	-6.7	-6.4	-6.4	5.1	7.3

Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

INTERNATIONAL EQUITIES

MSCI EAFE SECTOR RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Energy	-1.9	-12.9	1.3	1.3	4.0	4.8
Materials	0.2	-10.4	-10.0	-10.0	5.5	7.4
Industrials	-2.9	-9.8	-8.0	-8.0	6.8	9.0
Consumer Discretionary	-1.6	-9.3	-8.5	-8.5	5.2	10.3
Consumer Staples	-1.3	-3.2	-2.7	-2.7	7.9	10.4
Health Care	-3.8	-5.2	4.4	4.4	7.6	9.0
Financials	-3.5	-8.8	-12.8	-12.8	3.4	6.2
Information Technology	-3.3	-12.0	-8.0	-8.0	10.1	8.3
Communication Services	-3.3	-2.5	-4.1	-4.1	3.1	5.8
Utilities	3.7	5.6	10.3	10.3	7.5	1.7
Real Estate	0.5	0.0	-1.7	-1.7	1.1	0.5

Market Returns at December 31, 2018 All Returns in Cdn $

CANADIAN FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada 91 Day TBill	0.2	0.5	1.4	1.4	0.8	0.8
FTSE Canada Short Term Bond Index	0.9	1.4	1.9	1.9	1.7	2.5
FTSE Canada Mid Term Bond Index	1.6	2.4	1.9	1.9	3.7	4.8
FTSE Canada Long Term Bond Index	1.9	1.9	0.3	0.3	6.1	6.4
FTSE Canada Universe Bond Index	1.4	1.8	1.4	1.4	3.5	4.2
FTSE Canada High Yield Overall	-0.2	-1.7	2.1	2.1	5.3	7.0
FTSE Canada Real Return Bond	1.5	-1.1	0.0	0.0	3.8	5.0
SECTOR RETURNS (%)						
FTSE Canada Federal Bond	1.7	2.5	2.4	2.4	2.6	2.7
FTSE Canada Provincial Bond	1.3	1.7	0.7	0.7	4.5	4.9
FTSE Canada All Corporate Bond	1.1	0.9	1.1	1.1	3.7	5.7

GLOBAL FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE World Government Bond	5.2	7.5	8.2	8.2	5.9	2.6

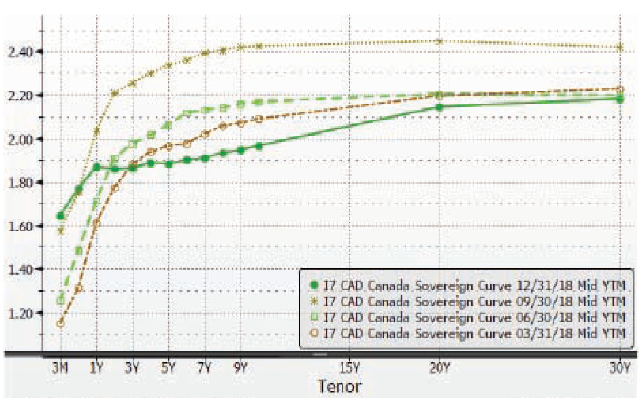
COMMODITY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Bloomberg WTI Cushing Crude Oil Spot Price	-8.4	-34.5	-18.0	-18.0	-9.9	1.3
Bloomberg European Dated Brent BFOE Price	-6.5	-32.3	-13.2	-13.2	-9.2	3.6
Edmonton Crude Oil Syncrude Sweet Blend FOB Spot	31.3	-24.9	-20.6	-20.6	-11.2	-0.5
S&P GSCI Nat Gas Index Spot	-34.5	3.3	8.6	8.6	-2.2	-5.2
S&P GSCI Copper Index Spot	-1.3	0.7	-10.0	-10.0	0.8	8.1
S&P GSCI Gold Index Spot	7.4	13.2	6.8	6.8	6.5	4.9

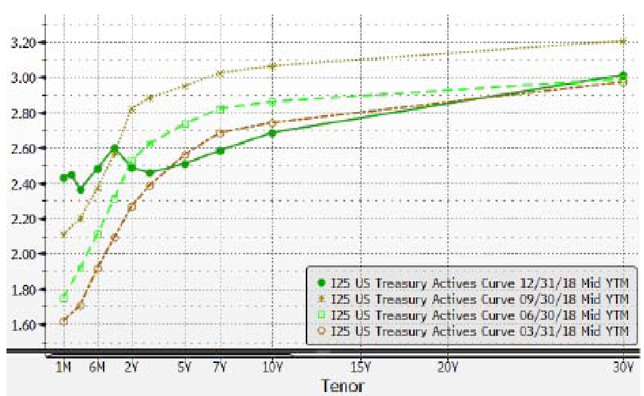
CURRENCY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Canadian $/US $ (% chg)	2.8	5.7	9.1	9.1	5.1	1.1
Canadian $/Yen (% chg)	6.4	9.3	12.1	12.1	4.3	-0.8
Canadian $/GBP (% chg)	1.9	2.4	2.7	2.7	-0.3	-0.3
Canadian $/Euro (% chg)	3.2	3.3	3.7	3.7	1.3	-0.9

GOVERNMENT OF CANADA YIELD CURVE



US TREASURY YIELD CURVE



Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial