TD Greystone Asset Management

Quarterly Market Update

Spring Overview
(Q1-2019)

CIO *ViewPoint*

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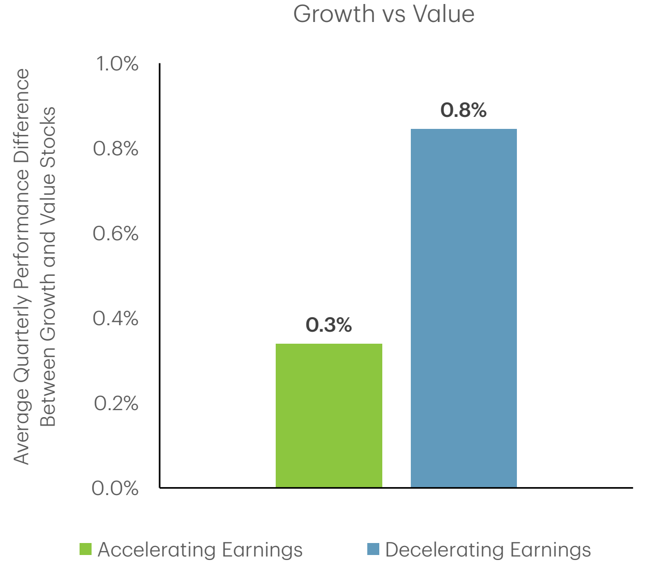
The roller-coaster ride continued for investors with equity markets achieving their highest quarterly returns in 10 years.[1] From its Christmas Eve low, the S&P 500 (U.S. dollars) was up 20%. In China, the mainland CSI 300 Index returned an astounding 29% (Canadian dollars) in the first quarter, responding to stimulus measures. Canadian bond markets also participated with mid-single digit returns for broad bond benchmarks, outperforming global fixed income markets. For balanced investors, despite the returns being a recovery from last quarter, this magnitude of gains has not been witnessed since the initial rebound from the global financial crisis.

While the quarter is a welcome relief from a challenging 2018, the flip side of the coin for investors is that valuations are no longer a tailwind and, consequently, long-term expected returns should be more muted going forward. The stockpile of global bonds with negative yields is approaching $10 trillion[2] and we do not believe that falling yields will provide capital gains until the next recession. In equity markets, the price-to-earnings discount that was available in most markets last quarter has returned to normal levels. Headlines from real asset markets indicate that select managers are experiencing difficulty deploying capital due to an inability to source profitable assets.[3]

Growth Fares Better Late Cycle



Source: Factset. June 1995 - March 2019.

Debate around a looming recession has also intensified despite strong equity returns. Global economic data has slowed significantly, inflation rates remain low, interest rates are falling, and global central banks are signaling that rate hikes will be off the table for the foreseeable future. Inverted bond yield curves (where longer-term bonds yield less than short-term bonds) are also being looked at as an ominous sign, given their presence prior to historical recessions. In our view, the odds of a

[1] As measured by the S&P 500 in local currency. [2] Bloomberg Finance L.P. [3] Wall Street Journal Property Report.

global recession may have increased; however, we do not believe it is on the horizon for the next 12-18 months and the cycle may be prolonged amid lower interest rates. The extended cycle view is anchored in both our fundamental macro-economic outlook and a deeper look at fixed income market indicators.

Looking at fixed income markets, while low yields and the inverted yield curve are gaining notoriety in the press, the reality is that a flat-to-inverted U.S. yield curve provided false recession signals in 1966, 1986, 1995 and 1998.[4] What is key about each of those periods is that the broader yield curve out to 30-year bonds did not invert, which mirrors the case today. Credit markets are also not signaling signs of stress, with high yield spreads (an indicator of corporate bond default risks) returning to lower levels. It is also worth remembering that an inverted yield curve alone is not the only pre-condition for a recession.

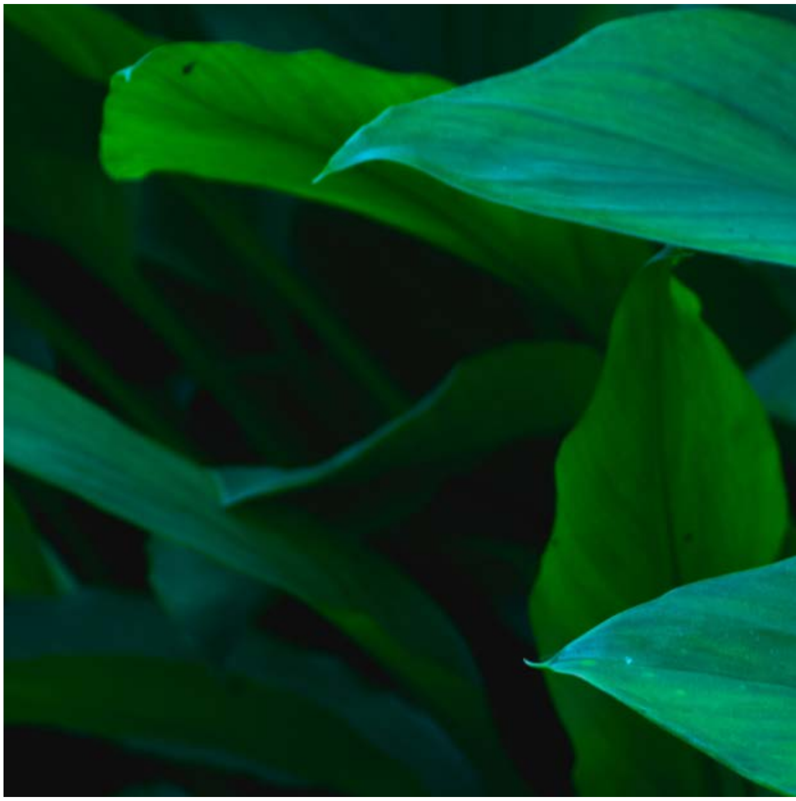
Fundamentally, the global economy is clearly exhibiting late cycle dynamics. Growth is expected to be slower but central bank activity, positive trade developments, loose financial conditions, and a strong U.S. consumer are likely to keep global economic activity from stalling. Sentiment is starting to reflect the slowdown and we believe there is a greater probability that economic growth in 2019 will surprise to the upside versus the downside. We continue to remind ourselves that late-cycle returns can be very strong and there is a risk in becoming overly defensive too early.

Risk reduction will likely occur first in our fixed income portfolios, where a late cycle lens results in a neutral to underweight bias for credit risk. Credit exhibits similar downside risks to equity markets in periods of stress, yet has limited capital gains potential given current spread levels. We are looking for opportunities to increase interest rate exposure but are conscious of pricing in the bond market, which in our view would require a recession to validate current yield levels.

Equities are likely to see softening profitability as higher input costs and slower growth bring margins down from peak levels. Looking through the ups and downs, and focusing on sustainable earnings growth will, in our view, help navigate through late-cycle dynamics. As growth becomes scarce, history has shown that companies able to deliver earnings growth can maintain premium valuations.

Prudent deployment of capital in real assets is increasingly important as allocations increase among investors. Our counsel to the market has been to continue with strategic allocations into real assets due to the potential diversification benefits in the next downturn. In the private debt and mortgage segment, we continue to see attractive lending opportunities in early stages of the real estate development life cycle. In commercial real estate, we view redevelopment of existing assets as an accretive avenue to place capital. Finally, in global infrastructure, we continue to believe that the mid-market segment benefits from the absence of larger global pension players. An ability to access these pockets of low capital availability will help investors reach their target allocations while also achieving suitable expected returns.

From a multi-asset positioning lens, we are not in a defensive posture but have neutralized active risk and hold equity/credit targets at the benchmark. If markets return to the stable dynamics that prevailed prior to 2018, we believe that active management from underlying strategies will provide good potential for added value. If the roller-coaster ride continues, a neutral active risk positon will allow us to harvest asset allocation opportunities as they surface.



[4] Bloomberg Finance L.P.

Asset Class Total Returns

Calendar Year						Q1-2019
2013	2014	2015	2016	2017	2018	3-month
Glo. Eq 35.2	Long Bonds 17.5	Glo. Eq 18.9	Cdn. Eq 21.1	EM Eq 28.3	Real Estate 7.8	Cdn. Eq 13.3
Cdn. Eq 13.0	Glo. Eq 14.4	Infrastructure 11.5	Infrastructure 8.6	Glo. Eq 14.4	Infrastructure 7.8	Glo. Eq 10.0
Infrastructure 12.9	Infrastructure 10.6	Real Estate 7.8	EM Eq 7.3	Infrastructure 10.1	Mortgages 2.4	EM Eq 7.6
Real Estate 10.6	Cdn. Eq 10.6	Mortgages 4.0	Real Estate 6.1	Cdn. Eq 9.1	Bonds 1.4	Long Bonds 6.9
EM Eq 3.9	Bonds 8.8	Long Bonds 3.8	Glo. Eq 3.8	Real Estate 7.2	Cash 1.4	Bonds 3.9
Mortgages 1.3	Real Estate 7.0	Bonds 3.5	Long Bonds 2.5	Long Bonds 7.0	Long Bonds 0.3	Mortgages 2.7
Cash 1.0	EM Eq 6.6	EM Eq 2.0	Mortgages 1.8	Bonds 2.5	Glo. Eq -0.5	Real Estate 1.2
Bonds -1.2	Mortgages 6.0	Cash 0.6	Bonds 1.7	Mortgages 0.9	EM Eq -6.9	Infrastructure 0.6
Long Bonds -6.2	Cash 0.9	Cdn. Eq -8.3	Cash 0.5	Cash 0.6	Cdn. Eq -8.9	Cash 0.4
Market Portfolio[5]						
			4.9	10.4	-0.3	7.3

Asset Class Proxies

- S&P/TSX
- MSCI World (Net)[1]
- MSCI Emerging Markets (Net)[1]
- Infrastructure[2]
- Real Estate[3]
- Custom Mortgage Benchmark[4]
- FTSE Cda 91 day T-bill
- FTSE Cda Universe
- FTSE Cda LT Overall

Source: TD Greystone Asset Management, FactSet, Preqin. As at March 31, 2019. Returns in Canadian dollars, excluding Infrastructure (U.S. dollars). Gross of investment management fees. May be subject to rounding. Past performance is not indicative of future performance.

[1] MSCI, net of foreign dividend withholding taxes.

[2] Infrastructure returns are the Preqin Infrastructure Quarterly Index up to its most recent publication, Q2 2018, and are Greystone Infrastructure Fund (Canada) LP returns thereafter. Infrastructure returns are presented in US$.

[3] Real estate returns are the MSCI/REALpac Canada Annual Property Index - All Assets up to its most recent publication, Q4 2018, and are Greystone Real Estate Fund Inc. returns thereafter.

[4] Custom Mortgage Benchmark: FTSE Cda Short Term Overall 60%, FTSE Cda Mid Term Overall 40% + 0.5% per annum.

[5] The Market Portfolio is the Greystone Balanced Plus fund.

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