TD Greystone Asset Management

Public Equities Monthly Macro-to-Micro

March 2019

Feature:
China Exports Slowing Down

Macro Highlights:

- **China Exports Slowing Down** – Adding Some Color
- **Global Central Bank Update** – Could Be Good for Growth and Dividend Stocks
- **Show Me The Money** – Why We Are Focused On Earnings Growth
- **Around The Bend** – Brexit

Investment Team Take-Aways:

- **Japan Conference Feedback** – Jeff Tiefenbach and Solo Zhang

March Performance Wrap

Reflections on the sell-off and rally => We've seen an impressive S&P 500 year-to-date rally (Sharpe ratio of over 4) and the S&P has recovered all losses since the Q4-2018 selloff. Earlier this year, it was virtually a consensus that the rally was not sustainable and that a 'retest' of the Q4 lows was imminent. Investors were hesitant to buy and are still largely underinvested. Since the start of the year, the U.S. Federal Reserve (the "Fed") has turned decisively dovish, acknowledging the economic slowdown, various 'crosscurrents,' the negative impact of quantitative tightening, and the large risk financial markets can pose to economic and social stability. The Fed was joined by other dovish central banks to push global equities higher in recent weeks in spite of the weaker global backdrop.

Fund Performance Highlights:

Performance (%)

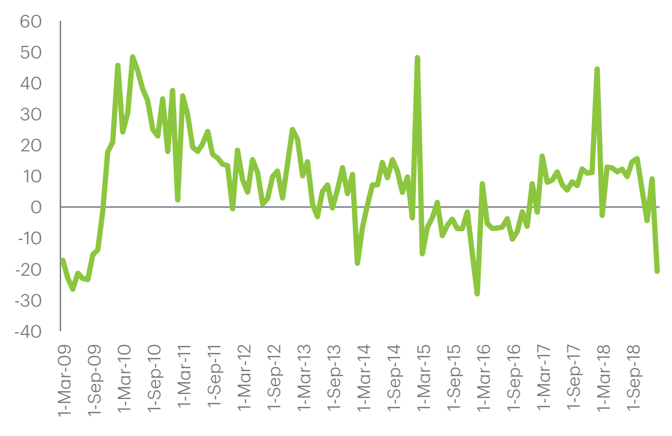
As at March 31, 2019	3-Month	1 Yr	3 Yrs	5 Yrs
Global Equity	**10.6**	**6.0**	**13.2**	**13.7**
MSCI World-ND	10.0	7.8	11.9	10.9
Difference	**0.6**	-1.8	**1.3**	**2.8**
U.S. Equity	**12.4**	**16.6**	**17.8**	**17.5**
S&P 500	11.2	13.5	14.7	15.2
Difference	**1.2**	**3.1**	**3.1**	**2.3**
U.S. Income & Growth	**10.3**	**19.3**	**17.0**	**17.6**
S&P 500	11.2	13.5	14.7	15.2
Difference	-0.9	**5.8**	**2.3**	**2.4**
International Equity*	**10.8**	**-1.7**	**11.2**	**9.7**
MSCI EAFE-ND	7.6	-0.2	8.4	6.3
Difference	**3.2**	-1.5	**2.8**	**3.4**
China Income & Growth	**27.2**	**3.4**	**24.9**	**n/a**
CSI 300 (Net)	28.3	-1.9	8.2	n/a
Difference	-1.1	**5.3**	**16.7**	**n/a**
Canadian Equity	**11.9**	**4.8**	**7.1**	**4.4**
S&P/TSX Composite	13.3	8.1	9.3	5.4
Difference	-1.4	-3.3	-2.2	-1.0

* International funds and MSCI EAFE performance is net of foreign dividend withholding taxes. This figure shows the performance in Canadian dollars, including cash; net of custodial fees, audit fees, transfer agent fees and administrative expenses; gross of investment management fees.

China Exports Slowing Down – Adding Some Color

China's February exports were, down 20.7% year-over-year and with it dragging down the CSI index some 4% on the news (see Figure 1). This followed a weaker growth outlook for European GDP published by the Organisation for Economic Co-operation and Development Organisation for Economic Co-operation and Development (OECD) and the European Central Bank (ECB) in the preceding days. Forward earnings estimates have stabilized recently, but they run the risk of turning sharply lower if the U.S. dollar continues to increase and global growth remains muted.

Figure 1: China Exports (USD) Y/Y%

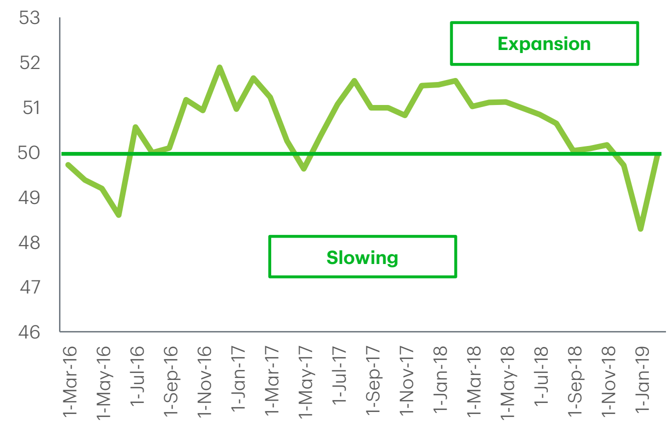


Source: FactSet. National Bureau of Statistics China.

Potential noise due to holiday period:, To be fair, the shifting weeklong Lunar New Year holiday makes year-over-year comparisons of economic data in January, February and sometimes even March, tricky. This year, the holiday came on Feb. 5, 2019, meaning most of the impact was in January and February. The huge base effect from last February largely explains the stomach-wrenching drop this year.

Manufacturing PMI and aggregate financing were small positives: On the positive side, China recorded two notably positive data points recently. One positive figure was the Caixin Manufacturing PMI (Figure 2), which staged an unexpected and substantial rebound, albeit just to neutral territory. The second positive reading was China's aggregate financing figure, which raced to a record ¥4.6 trillion in January. Based on the lagged impact of Beijing's stimulus, which started eight months ago and is continuing today, China's economy is likely just starting to stabilize. We are now over 70 easing moves announced since last summer. And looking ahead, Beijing is already hinting at another cut to the bank required reserve ratio (RRR) next month, a likely further boost for new bank loan growth, which has already improved.

Figure 2: Markit Caixin Manufacturing PMI (Seasonally Adjusted, SA)



Source: FactSet.

The Bottom Line:

Disruptions due to trade disputes and tariffs are now having an impact, as is the delayed impact from China's tightening that took place earlier in 2017. It may take the rest of this year to get signs of further stabilization in the data, following over 70 stimulus measures applied to the economy since June 2018, according to Cornerstone Macro LLC.

Year-to-date, the China Income & Growth Fund has given back some of the outstanding performance reported last year as strong year-to-date price performance was led by more speculative areas of the market. We are focused on higher quality, dividend growth companies that have positive business momentum and have reasonable valuations. Our quantitative screening process leads us more toward opportunities in the consumer sectors, health care and real estate.

Global Central Bank Update – Could Be Good for Growth and Dividend Stocks

Global easing cycle: Since the beginning of 2019, there has been a new round of easing in global monetary policy. The **FED** has u-turned its policy and is now leaning dovish and supportive of equities. There are now market bets being placed on rate cuts by the summer. The **ECB** restarted targeted longer-term refinancing operations (i.e. cheap financing for banks) in early March, and the interest rate hike guidance was postponed again. **Japan** has continued its negative interest rate and quantitative easing policies. In addition, **India** and **Egypt** announced interest rate cuts at the beginning of this year, while the Australian central bank hinted at a possible rate cut. The market also expects countries such as **Turkey**, **Poland** and the **Philippines** to start rate cuts in 2019. As the U.S. rate hike cycle comes to an end, the global monetary tightening cycle may have ended, and may enter a new round of easing in the future.

An Inverted U.S. Yield Curve – Recession Risk? In March, the most frequently watched portion of the yield curve completely flattened and it even temporarily inverted for the first time since 2007. Economic data such as initial jobless claims, auto sales, industrial production and average hours worked aren't signalling recession risks. Neither are financial conditions, which remain supportive. Although every recession since 1960 was preceded by a curve inversion, not every curve inversion preceded a recession. Historically, a recession typically comes along with a build-up of excesses in the economy or financial system, none of which seem to be apparent today.

Did you know? After the "first" yield curve inversions (1989, 1998, 2006) the S&P rallied +39% on average – recessions followed in year 1, 3 years, and 3 years, respectively. Putting the recent yield curve inversion into perspective - the degree of yield curve inversion at present is insignificant relative to previous cycles; the curve would probably need to invert significantly and remain inverted for weeks, if not months, before it would be a reliable recession signal.

The Bottom Line:

Though earnings revisions continue to come down, Powell's dovish tone should (theoretically) support dividend-growth stocks. Also, a more dovish interest rate outlook has positive implications for dividend stocks. In a low rate environment, dividend stocks would be attractive alternatives to bonds. Income investors will increase demand for dividend stocks in their portfolios as bond yields aren't high enough to meet income demands. The total amount of global debt trading with nominal yields below zero is US$10 trillion, according to Bloomberg data, up from a low of US$6 trillion in early 2018.

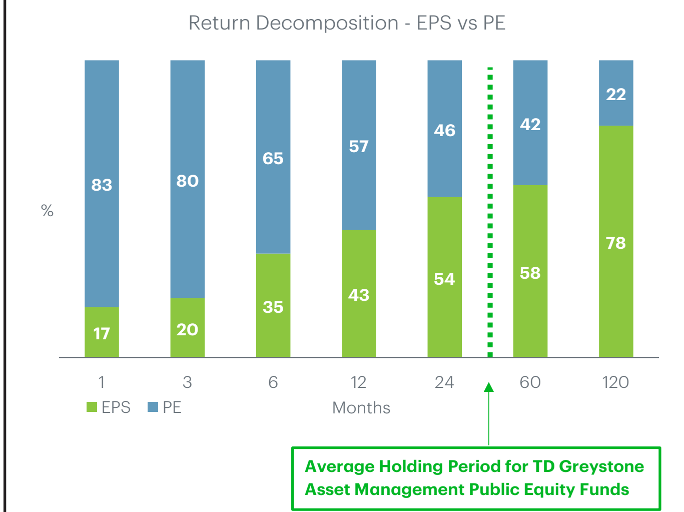
As at February 28th, approximately 30% of S&P 500 stocks had dividend yields greater than the 10-year U.S. Treasury yield. Cornerstone Macro noted that with respect to the inflation outlook, and therefore the outlook for interest rates, the shifts up in labor supply growth and productivity will help keep inflation lower for longer and, in turn, interest rates lower for longer as well.

This is good news for our Income & Growth funds that emphasize a dividend yield and growth approach.

Show Me The Money - Why We are Focused on Earnings Growth:

There are two broad ways to think about what determines asset prices on any given day. Prices are driven either by sentiment or by fundamentals, or some combination of both. But how much of each, and when are returns dependent on either factor?

Figure 3: NTM P/E and NTM EPS, Median contribution to return since 1964



Source: TD Greystone Asset Management, Credit Suisse, S&P 500 data since 1964, Thomson Financial, FactSet.

In Figure 3, we disaggregate the earnings (fundamentals represented by earnings per share (EPS) and the valuation (sentiment, represented by the price-to-earnings (P/E) ratio) contribution to equity returns over different holding periods (1 month through 10 years). As the chart shows, sentiment dominates the majority of equity returns in the short term (i.e. P/E is the important factor within 1-12 month time horizon). Beyond the one-year holding period, equity returns are increasingly dependent on the EPS growth, or said another way: the fundamental story. **While valuation continues to be an important factor in equity returns, a solid understanding of the fundamentals is increasingly important as your holding period extends.**

Fundamental research is a vital part of our disciplined, bottom-up investment process. Our quantitative screening models pick up on positive market sentiment for a company and the job of the fundamental research team is to unravel what is driving that sentiment. **We believe it is the fundamental research that truly sets our concentrated active strategies apart from pure factor investing, due to the added insights uncovered by our dedicated group of global sector analysts.** Our deep understanding of the fundamental drivers of a company's business momentum also allows us to minimize portfolio turnover, which reduces trading related costs that contribute to excess returns over time.

Around The Bend – Brexit

Upcoming Events

Date	Event	Comment
Mid April- End May 2019	Corporate Earnings	Q1-2019 kicks off with U.S. earnings, followed by Europe, Canada
Mid-April 2019	USMCA review	U.S. Intenational Trade Commission assessment due
Up to April 11, 2019	U.K. to "indicate a way forward" to EU	If the Withdrawal Agreement is not approved by Mar 29th
April 12, 2019	Potential Brexit Day I	U.K. could leave the EU without a deal (i.e. Hard-Brexit)
May 1, 2019	FOMC decision	Likely to hold rates, "patience"
May 22, 2019	Potential Brexit Day II	Second extension date of EU Article 50
2H-2019?	USMCA vote	Likely congress to vote yes but debated

Source: FactSet. TD Greystone Asset Management.

It seems as though the half-life of a Brexit analysis is about two hours! For what it's worth, here is the latest episode recap. On the last day the U.K. was to leave the European Union (EU) (i.e. March 29, 2019), Parliament rejected Theresa May's Brexit deal for a third time. This leaves the U.K. no closer to an exit plan after more than two years of negotiations. As things stand, the U.K. could leave the EU on April 12th without an agreement. Most likely however, the EU will agree to a longer postponement period to avoid a widespread economic disruption. General election risk remains a possibility in the U.K. the further Brexit gets pushed out.

The Bottom Line:

The equity market, in general, seems to be taking the drama in stride. Our exposure in the U.K is tilted to companies with a strong global footprint, with the majority of revenues coming from outside of the U.K. **We believe our direct exposure to the U.K. has been minimized and our exposure through U.K. listings is not material.** There are many moving parts to the U.K./EU negotiations and, as such, we do not believe that adding exposure at this time is favorable on a risk/reward basis.

Each month we look to feature some of the great work coming from our Public Equities team. This month, we highlight takeaways from Jeff Tiefenbach, Managing Director & CIO, Public Equities and Solo Zhang, Associate, Fundamental Research, who attended a conference in Japan.

Some things never change: Jeff highlighted that Japan continues to face the same macro issues it has for decades. These include a tight labour market owing to an aging population and lack of immigration, mostly in service areas such as restaurants and in retail. Efforts to try and alleviate these issues include the lowering of the cost of raising children, and easing of foreign worker restrictions. However, despite labour tightness, wages are still quite sticky. Prices are also very sticky – seems like a zero inflation mindset remains firmly ingrained in the consumer mindset.

But some things may be changing slowly: Corporate investment for growth is focused outward –in particular, Southeast Asia and the United States. Jeff provided some examples of this type of intended growth in his notes from meetings with Japanese banks. Finally, Jeff noted that the sales tax increase set for October 1, 2019 (from 8% up to 10%) is pretty much a done deal. The government has a large fiscal package in order to cushion the impact – learning from last time!

Cash Money – Japan's use of electronic payments remains surprisingly low: Solo highlighted some interesting charts and data on how far behind Japanese businesses and consumers are in adapting to electronic payments. Cash continues to be the most popular form of payment, likely owing to the aging population. Coming back to the opportunity for banks, the trend to move Japanese society to cashless will be a slow one. Cost savings to financial intermediaries could be something in the intermediate term but it seems like adoption rates will rise slowly.

Checking in with management – Jeff and Solo had a chance to meet with several companies that we hold in the International and Global funds. For one of our existing holdings, they came away with additional information on the pipeline of business activity underlying a recent acquisition, and more visibility on margin improvement. This will likely mean a potential pick up in earnings revision, which we do not believe is reflected in the current share price. The conference also allowed Jeff and Solo to meet with some other companies of interest that we do not currently hold in the fund, as well as some Japanese industry analysts.

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