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What is your outlook for 2019?

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Happy new year! We wish you and your family a joyful and healthy year.

2018 was a turbulent year for stock markets. The year started strong with most equity indexes reaching new highs in the first quarter. The S&P 500 Index had the strongest momentum, peaking at 11.2% at one point but finishing the year at -4.4%. A similar pattern could be found in other equity indexes, as shown in the table below. Compared to 2017, there were also wider daily and intra-day moves. In 2018, there were 32 instances where the S&P 500 Index lost more than 1% on a daily basis. In 2017 there were only four instances.

	January 1 to Peak	Peak to Dec 31	One-year return
S&P/TSX Composite Index	3.8%	-12.2%	-8.9%
S&P 500 Index	11.2%	-14.0%	-4.4%
MSCI EAFE Index	3.7%	-13.7%	-10.5%
MSCI Emerging Markets Index	8.2%	-16.5%	-9.7%
WTI Oil	32.3%	-40.2%	-20.9%

Source: Bloomberg; returns are in local currency

Those who expected bonds to provide better returns were also disappointed. The FTSE Canada Universe Bond Index reported a loss from a price perspective – with the inclusion of income, the index gained 1.4%. Given losses across the board in equity markets and a very mediocre result from bonds to offset, most investors did not earn a positive return in 2018.

“What is your outlook for 2019?”

At the beginning of each year, many investors ask us for our outlook but it is important to remember that many variables can change over the year and affect our assessment. As we begin 2019, we believe the strength of the current 10-year rally is fading with changing monetary policies globally. Money supply is shrinking and the cost of borrowing has either increased or is increasing, depending on geography and the type of borrowers. However, unemployment rates are low, particularly in North America, and this continues to drive consumption and economic activities. We believe an economic slowdown is imminent as economies globally may have reached the peak in money supply and employment. Investor expectations have cooled since October, even on high-flying stocks like Apple. In our opinion, the recent sell-off in the equity markets is accurately pricing the risk of a scenario of slowing economies and earnings growth into the valuations of the stock markets. The markets will probably remain volatile for much of the first part of the year until everyone agrees on a new equilibrium. We expect long-term equity

returns to be positive for all major equity markets and short-term volatility will create opportunities for investors that exercise their convictions.

Markets outside of the U.S. look more attractive to us as they trade at discounts versus U.S. markets. Companies that have strong balance sheets were out-of-favour, in other words, they were underperformers as financing has been readily available in the last several years. This is changing as money supply shrinks and costs increase. U.S.-China trade talk is a wild card as it could change the mood of the markets, taking our expected return of stock markets for 2019 from positive to negative if it ends the wrong way. We are also watching the Brexit negotiations as any outcome could potentially move the currency and capital markets in the U.K.

We are more optimistic compared to the period before the sell-off. Valuations are more attractive and investor expectations are more reasonable. We own quality companies as a recipe for long-term success and we have short-term strategies in place, including the use of derivatives to taper downside volatility. Investment outcomes in 2017 and 2018 were dependent on whether you had money in the markets or not. Investors were able to earn positive returns from almost anywhere in 2017 while the opposite was true in 2018. In our view, 2019 will be more about how and where you invest your capital. This sounds like a happy medium to us.

Combined top 15 equity holdings as of December 31, 2018 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Atco	6. IA Financial Group	11. George Weston
2. SNC-Lavalin	7. Magna International	12. AltaGas
3. Alphabet Class A	8. CSX	13. Bank of Nova Scotia
4. Dollarama	9. Gilead Sciences	14. Microsoft
5. E-L Financial	10. Canadian Utilities	15. Loblaw Companies

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