Market Perspectives Q4 2019

TD Wealth Asset Allocation Committee (WAAC) Overview

- Overweight equities and underweight fixed income
- Expect "lower for longer" rate environment to continue with inflation low and central banks accommodative
- Corporate credit has attractive incremental yield versus government bonds
- We anticipate a protracted conflict between China and the U.S. on issues of trade and technology leadership
- Episodes of volatility may be driven by trade frictions and slowing global growth

Market Outlook

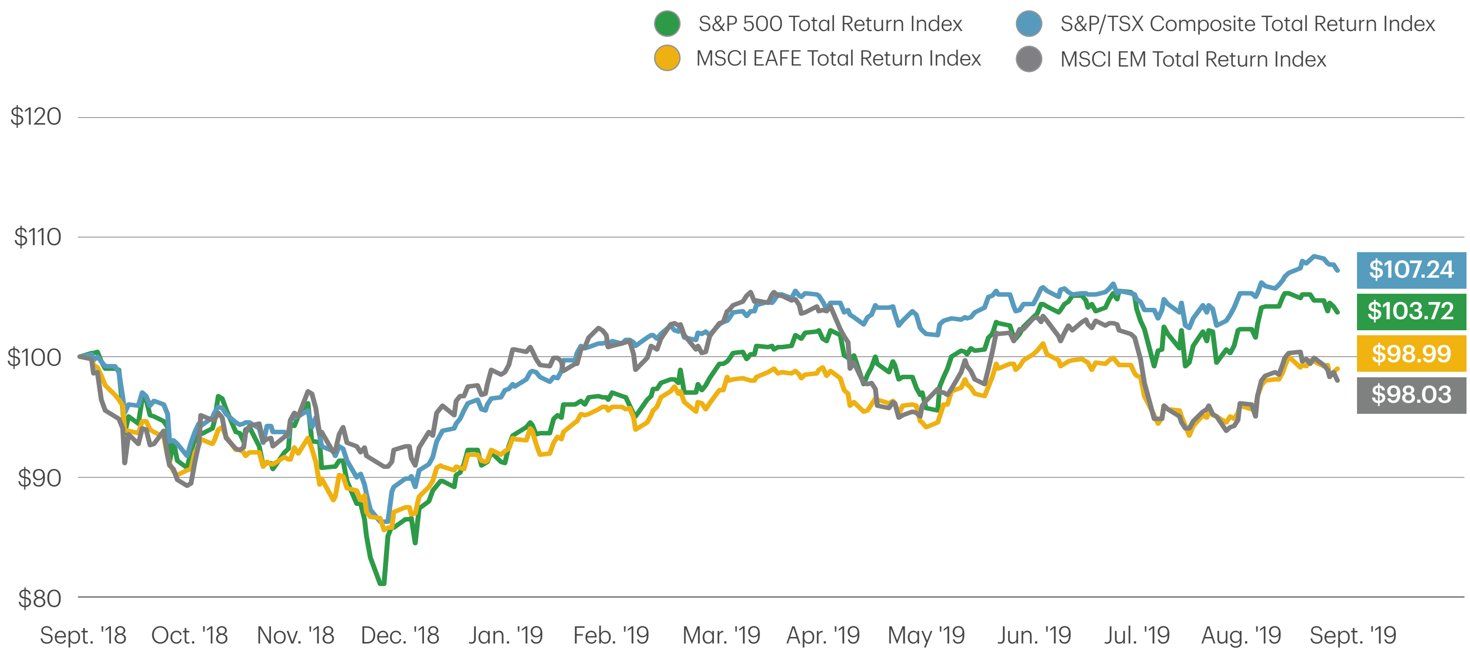
Stocks zig-zag in Q3 but remain within reach of historic highs

So far in 2019 markets have been forced to digest a steady diet of stomach-churning headlines spanning the geopolitical and economic spectrum. These include: increasing recessionary risks, inverted yield curves, negative yielding debt, trade wars, drone strikes on Saudi oil facilities, Hong Kong protests, decelerating global growth, an unresolved Brexit debacle, and of course a U.S. President with a penchant for erratic, market-rattling tweeting—to name just a few.

Despite these myriad events, bonds and equities have delivered impressive year-to-date returns across most major global markets and equities remained within striking distance of all-time highs as of the end of September. These gains can largely be attributed to accommodative central banks universally cutting rates and a commitment to quantitative easing, in an effort to extend the current economic cycle. Additionally, in North America, economic and corporate health remain relatively strong, and resilient labour markets continue to underpin a confident and spending consumer.

As we've stated throughout the year, the WAAC does not see substantial risk of a recession in the near-term— at least not for North America. However, in the longer-term, protracted trade disputes pose a risk of lower growth and higher inflation, which could create a challenging environment for stocks and bonds. While global markets have remained resilient in weathering numerous storms throughout 2019, a period of consolidation should not be unexpected considering the potential risks on the horizon, and the market's strength this year.

Index Returns Over the Past 12 Months — The Growth of $100



Source: Bloomberg Finance L.P. As of September 30, 2019.

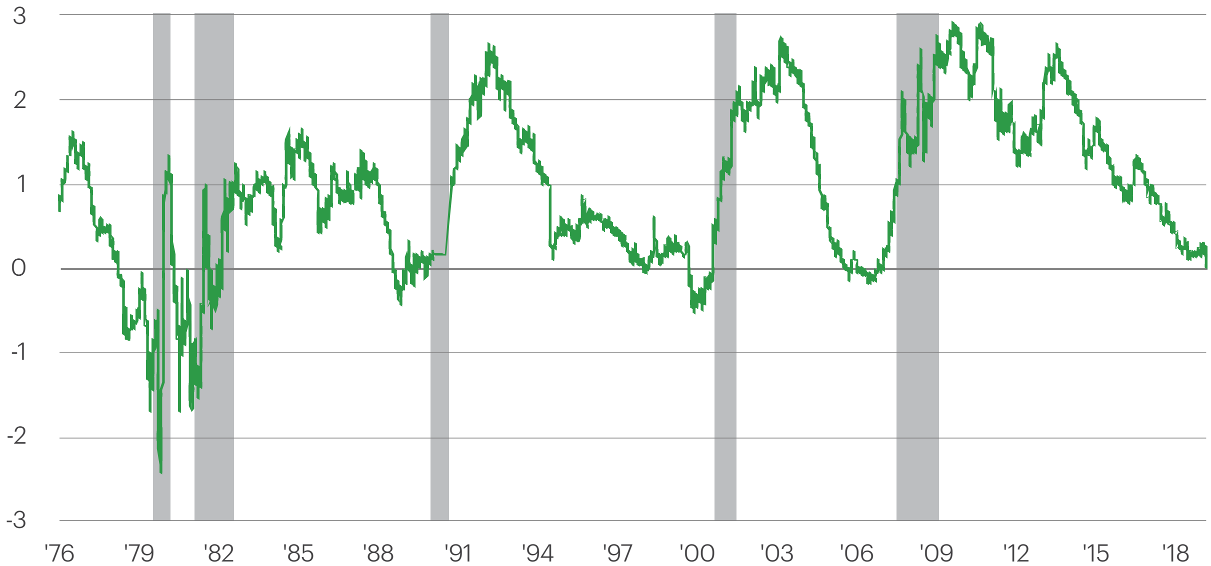
Inverted yield curve tilts market sentiment

Over the course of 2019, several maturities across the yield curve inverted and caused much consternation among market participants. But what is a yield curve inversion? Simply put, it's when short-term interest rates rise above longer-term rates. Alarm bells rang loudest when the U.S. 10-year Treasury yield initially fell below the U.S. two-year Treasury— while an imperfect gauge this phenomenon has typically preceded a recession.

A yield curve inversion can be a warning signal for financial markets, however there is often a significant lag before an economic downturn or major market decline. The markets have rallied more than 15% on average in the months following an inversion, and a recession has occurred about 17 months after.[1]

inversion

10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity



The shaded areas in the chart indicate recessionary periods.

The last five recessions were preceded by the inversion of the 2 and 10-year maturities of U.S Treasuries.

Source: Federal Reserve Economic Data. Economic Research Division, Federal Reserve Bank of St. Louis. As of August 15, 2019.

3 reasons why the WAAC does not expect a near-term recession

Many investors may be concerned that a recession is on the horizon because we are in the longest economic expansion on record. However, economic expansions don't abruptly end without reason – there is usually one or more catalysts. And while moderating global growth and ongoing trade risks could be the catalysts, the North American economy and corporations remain relatively healthy and lower interest rates should continue to support markets. While a recession is not beyond the realm of possibility, we do not expect one to materialize imminently, and the following are the primary reasons the WAAC maintains this stance.

1

Corporate profits remain strong

U.S. companies continue to increase revenues and Earnings Per Share. Margins have been declining but remain at solid levels as companies manage cost structures effectively. Share buy-backs and rising dividends are also adding to growth.

2

Employment is strong

The U.S. and Canadian economies continue to create jobs and wages are rising, which are both supportive of consumer spending and driving economic growth.

3

Interest rates expected to remain low

The U.S. Federal Reserve (the Fed) and global central banks are committed to accommodative monetary policy in an effort to support global economies. Lower interest rates also tend to support stock prices, particularly dividend paying stocks that offer more attractive yields relative to bonds.

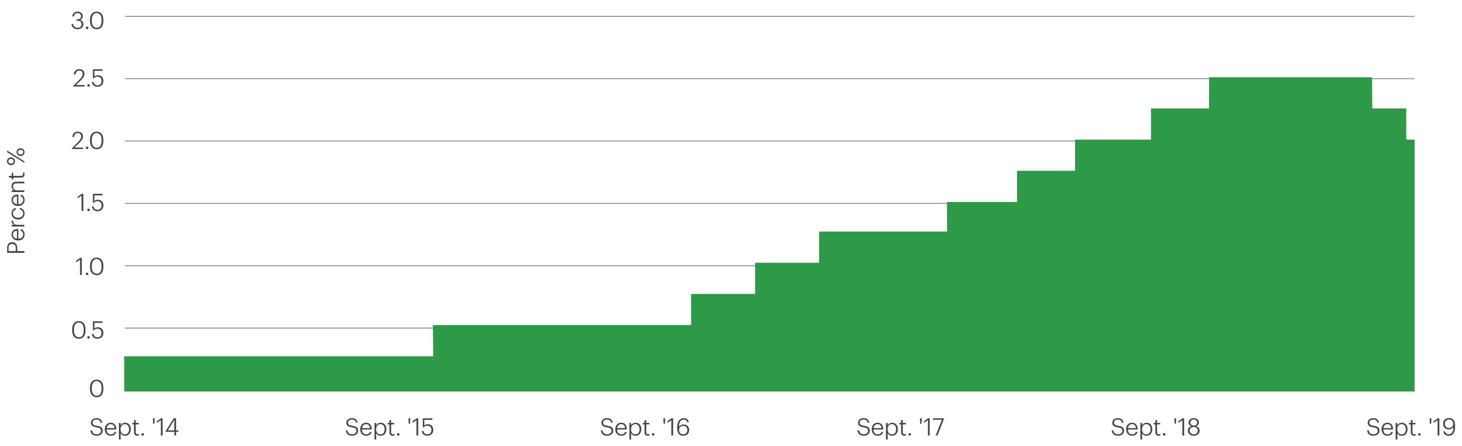
Fed cuts rate for a second time in 2019

The Fed cut its policy rate by 25 basis points to a range of 1.75% to 2% in September, a measure designed to insulate the U.S. economy from decelerating global growth and other geopolitical threats. In its policy statement, the Fed cited “the implications of global developments for the economic outlook as well as muted inflation pressures” as the rationale for the rate cut.

As risks continue to cloud the horizon, overall domestic economic data remains healthy, creating a complicated backdrop for the Fed. Corporations are hiring and consumers are spending, but the ongoing trade war and prospects of an unruly Brexit outcome have kept markets on edge. Meanwhile, inflation has remained below the Fed’s target range, giving officials room to maneuver rates lower if needed.

The Fed also noted that it “will continue to monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion."

U.S Federal Funds Rate



Source: Bloomberg Finance L.P. As of September 30, 2019.

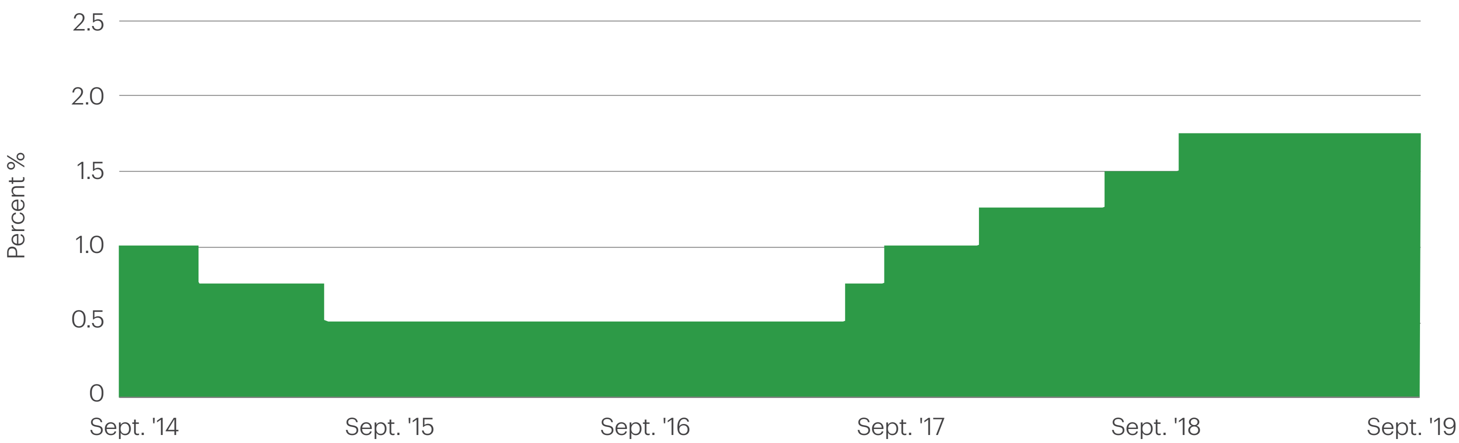
Outlook

The Bank of Canada (BoC) avoids rate cutting party

The BoC was not ready to join the central bank rate cutting party when it met in August. The BoC kept its benchmark rate unchanged at 1.75%, as the Canadian economy continued to expand despite elevated levels of private debt, slowing business investment, and concerns over international trade.

In its policy statement, the BoC cited waning global economic activity and the unpredictability of the China/U.S. trade relationship as potential risks to future growth. The Bank also noted the resiliency of the Canadian economy. Second quarter gross domestic product data exceeded expectations, after some weaker readings earlier in the year, and improvements in the housing sector and job market continue to support the economy. After weighing domestic strength against external global risks, the Bank stated that "the current degree of monetary policy stimulus remains appropriate." The BoC also indicated that it's receptive to remaining accommodative, while "paying particular attention to global developments and their impact on the outlook for Canadian growth and inflation."

Bank of Canada Overnight Rate Target



Source: Bloomberg Finance L.P. As of September 30, 2019.

Growth

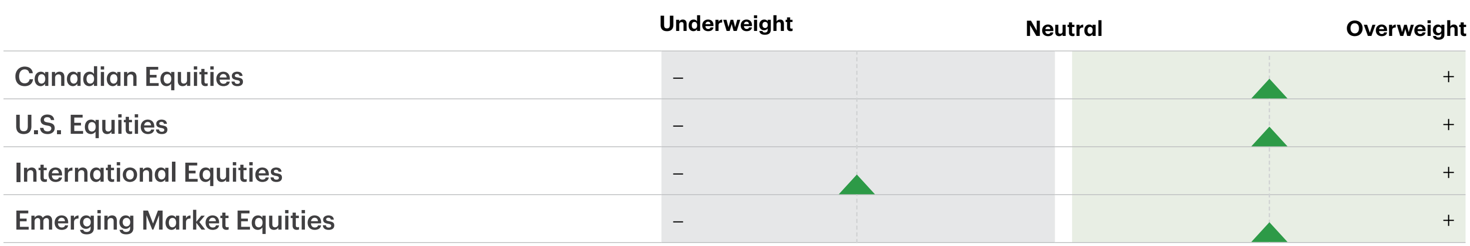
WAAC Positioning and Outlook

Bond and equity markets appear to be sending divergent signals about their outlook for the global economy. On the one hand, bond markets are especially cautious, as yields continue to trend lower, suggesting that an end to the current cycle is near. On the other hand, stock markets are telling us not to worry so much, and continue to hover close to all-time highs, signaling a rosier outlook.

In our view, economic fundamentals and corporate earnings remain positive, but decelerating global growth, uncertainty around geopolitical events and a flat to inverted yield curve, may contribute to bouts of elevated market volatility for the remainder of 2019 and into 2020. However, ongoing policy support, the absence of financial system vulnerabilities and a resilient consumer should help extend the U.S. economic expansion and provide support for financial markets.

Equities

You Should Know... | In **Canada**, we are seeing pockets of strength that are exceeding expectations.



In Canada, the housing market has shown improved fundamentals and household balance sheets strengthened modestly in the second quarter. The labour market also remains strong which should continue to support consumer confidence and spending. We view Canadian stocks as relatively inexpensive compared to other developed markets, and this is partly the impetus for upgrading our view on Canadian equities from neutral to modest overweight during the quarter. We feel that a combination of supportive valuations, solid job creation and robust free cash flow generation from established names in the Energy sector justify this action.

In emerging markets, recent Chinese economic data has been weak in nearly every aspect, with industrial output and retail sales data pointing to lethargic demand and low confidence among businesses and consumers. Despite ongoing political turmoil and a sluggish economy, longer-term we are positive on Chinese equity markets.

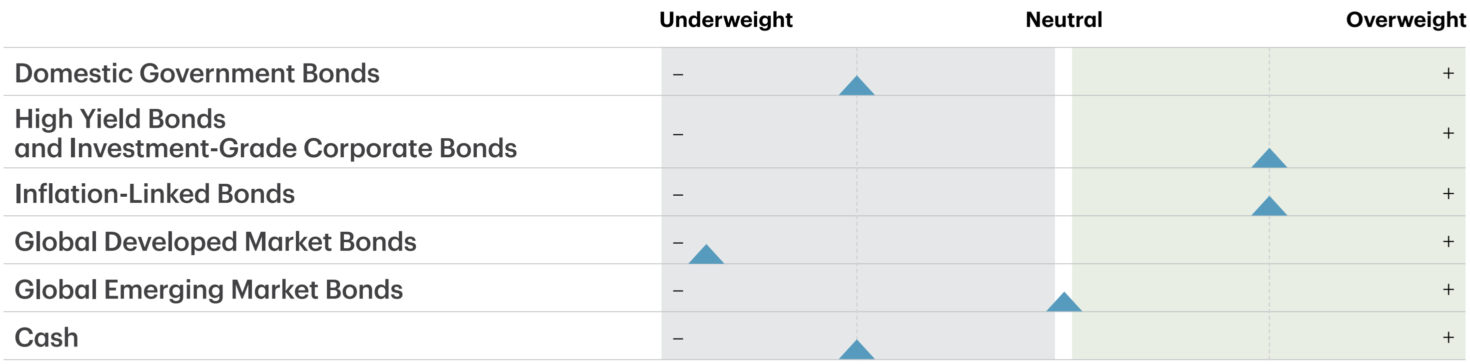
There is considerable opportunity for the Chinese equity market to catch up to the relative size of its economy, and for investors this means an expectation for better future stock market returns, compared to the U.S. This is one factor contributing to our modest overweight emerging markets view. A resolution, or partial resolution to the trade dispute, could also act as a tailwind for China and other global markets.

We maintain a modest underweight view for international equities as Brexit remains a significant overhang. In particular, a no-deal exit would likely be more negative for UK growth than many forecasters expect, and could also create a drag on European and global growth given the massive uncertainty that may result.

Fixed Income

You Should Know...

Our overall outlook for bonds remains unchanged as we view the spread of expected returns between equities and fixed income as justification for our overweight stance on equities versus fixed income.



We expect coupon-like returns in the low single digits for the foreseeable future, particularly in light of central banks remaining highly accommodative on monetary policy.

We are underweight domestic government bonds due to expectations of muted returns in a prolonged low inflation and interest rate environment. We remain constructive and more selective on credit, and are comfortable with our modest overweight stance on high yield and investment grade corporate bonds, as they continue to offer a yield advantage over government bonds. In general, corporate bond markets delivered positive total returns thanks to falling yields. Higher-quality bonds (i.e., investment grade) and high-yield bonds both benefited as spreads narrowed and yields fell.

During the quarter we shifted from neutral to modest overweight inflation-linked bonds. While a significant surge in inflation is not in the Committee's forecast, inflation insurance is inexpensive for investors looking to protect against a rise in interest rates driven by a shift in expectations. We also moved from neutral to modest underweight cash. As overnight interest rates continue to fall around the globe, the real return on cash and the optionality it provides portfolios is diminished.

Within the global developed bond space, we maintain a maximum underweight view, as low or negative nominal and real yields in Europe and Japan are not compelling.

Forecast

Canadian/U.S. currency exposure & Gold

You Should Know...

During the quarter, we adjusted our view on the Canadian dollar vs. the U.S. dollar, from neutral to modest overweight. Growth differentials between the U.S. and rest of the world, including Canada, are narrowing and this is expected to continue.

We retain a modest underweight on the U.S. dollar (USD). The potential for slowing U.S. economic growth, coupled with a highly accommodative Fed, could put downward pressure on the USD versus a trade-weighted basket of currencies.

We believe an allocation to gold can provide insurance in a portfolio against the risk of extreme outcomes. However, we continue to maintain that this insurance is currently not required.

TD Wealth Asset Allocation Committee

The TD Wealth Asset Allocation Committee (WAAC) was established to deliver a consistent asset allocation message and be the source for active asset allocation advice across TD Wealth.

The committee has three prime objectives:

Committee Members

Robert Vanderhooft, CFA
Chief Investment Officer,
TD Asset Management Inc.

Michael Craig, CFA
Managing Director,
TD Asset Management Inc.

David Sykes, CFA
Managing Director,
TD Asset Management Inc.

Robert Pemberton, CFA
Managing Director,
TD Asset Management Inc.

Glenn Davis, CFA
Managing Director, TDAM USA

Kevin Hebner, PhD
Managing Director,
Epoch Investment Partners, Inc.

Brad Simpson, CIM, FCSI
Chief Wealth Strategist,
TD Wealth

Sid Vaidya, CFA, CAIA
U.S. Wealth Investment Strategist,
TD Wealth

Bryan Lee, CFA
Vice President & Director,
TD Asset Management Inc.

[1]Sources: Ben Carlson and Ritholtz Wealth Management - https://awealthofcommonsense.com/2018/02/yield-curve-inversions-arent-great-for-stocks/